Draft Report

The Legal Empowerment of the Poor: Informal Business

Prepared for the Commission for the Legal Empowerment of the Poor

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Executive Summary

1. Introduction

Legal empowerment describes an approach that has as its objective to increase marginalised people's control over their lives, by making human rights a reality for the poor (Golub 2003:5). Legal empowerment is part of an integrated strategy that includes both rights-based activities and other development activities, such as building social capital or literacy projects (Golub 2003). Such activities ostensibly have nothing to do with law; yet may be critical interventions that enable marginalized people to exercise their human rights.

The Commission for the Legal Empowerment of the Poor recognizes that the reality for the poor is that they live outside of the law in the 'informal or extra-legal sector'. The objective of 'formalisation' is to enable people to participate in the 'formal sector' by giving people access to 'jobs, markets, incomes, social protection and security'. The Commission recognizes that in order for formalization to have any substance, it is important to understand what creates and sustains informality in the particular context.

In South Africa, the systematic exclusion of black people from participating in the formal economy has resulted in an inextricable link between informality and race. Legislation controlled the influx of black people from rural 'homelands' (poorly resourced rural area assigned to black nations) to so-called 'white' urban areas. Disenfranchised people were granted temporary licenses to live in urban centers in order to provide labour. These 'temporary' residents had to live in 'townships', dormitory suburbs which were, and still are, outside cities. Different population groups had access to differential education. Black Africans were educated to provide unskilled labour to white-owned business. In addition, black Africans were prevented from owning a business or holding title to land. Other populations groups were subjected to forced removals.

From the perspective of informal business, the legacy of these apartheid laws is that:

- Black Africans were excluded from the formal economy, except as unskilled labour. For the majority, the education and skill levels are therefore vastly inferior to their white counterparts. This inequality in education persists today (van den Berg 2005), which has enormous implications in terms of the ability of the poor to enter sophisticated formal markets, either as employees or as business owners.
- All 'black' population groups were spatially separated from towns and cities, which for the poor, who cannot re-locate to previously 'white' suburbs, is still the case. This means

that these businesses service their local community, which is poor. In addition, spatial separation impacts on the transaction costs of accessing inputs for businesses.

The democratic government has promulgated an array of Acts to address the inequality brought about by apartheid. The legal empowerment challenge is therefore not to advocate for broad based legislative reform. Rather, the challenge is to ensure *effective pro-poor implementation*. In this paper I will argue that from a legal empowerment perspective, the critical distinction we need to make is between those informal businesses that have the potential to access markets other than their own community ("external markets") and those that are only able to sell their goods or services to their own community.

I will argue that only a small percentage of informal businesses can access formal markets. For the vast majority, the legal empowerment strategy should focus on:

a) Increasing the participation of the poor in the formal economy as people, rather than as business owners. I argue that access to quality education, housing, infrastructure, healthcare etc are more strategic interventions and will impact livelihood strategies more significantly than interventions such as reducing barriers to formalisation or improving access to credit.
b) Reducing the transaction costs of small businesses in their backward linkages with formal business.

2. Understanding the Informal Sector

It is estimated that there are between 1 and 2.3 million informal businesses in South Africa, which contribute between 7 and 12 percent to South Africa's GDP. An estimated 45,5% of informal enterprises are owned and managed by women and approximately 54,5% by men. An estimated 91, 3% are owned and managed by Africans (Stats SA 2005). Given the Commission's focus on poverty, and that black Africans, and particular black women, are the poorest of the poor, this paper will focus on the 91.3% black owned informal businesses.

More than half of all informal businesses are involved in retail. In this paper, I concentrate on the retail and manufacturing sectors, which constitute approximately 64% of all informal businesses. I discuss broad legal interventions that would empower these categories of businesses. I discuss a third category, which can broadly be defined as service industries. Skinner (2007) estimates that the services sector comprises 9% of informal businesses. I shall refer to these sectors in the context of the following three categories of small business: (a) home-based enterprises; (b) street traders and (c) micro-enterprises that have the potential to access formal markets. This third category is limited to a small percentage in the manufacturing, service and agricultural industries.

3. Home-based Businesses

The majority of businesses (60%) are home-based and operate in dormitory suburbs or 'townships' that are spatially separated from towns and cities. More than half of these informal businesses operate in the retail sector, which means that they only sell to their own local market. Typically such business operate from a room in a home, a corrugated iron structure built onto a home, a semi-permanent structure that lines particular streets in townships, or a table near a transport node or school. Businesses in the retail sector s typically sell groceries, raw or cooked meat (the latter is roasted over an open fire), alcohol, second-hand furniture etc. These businesses require a license and a 'certificate of acceptability' if they sell perishable food. If they fail to comply, their goods may be confiscated and they may be fined or imprisoned for three months. In reality few comply, given that these regulations are not often implemented in townships.

The profile of the typical informal business owner is of a person with little skill or education, no informal employment experience, few links with the formal sector other than as a consumer and few assets. The effects of HIV- Aids on informal business is significant, if undocumented. The ability of such a person to be able to manage her business to graduate to the formal sector is very unlikely. Improving the rights of the person, rather than supporting supply-side interventions for the business, is more likely to improve livelihood strategies of the poor. For women this means support with childcare (such as pre-schools) and for men and women, access to healthcare, housing, sanitation, crime prevention, banking and education.

Empowerment strategies for home-based businesses

Napier and Liebermann (2006) argue that in other developing countries the ability of informal business to form forward linkages – the ability to sell their goods or services to formal business - impacts on their scale and diversity. The absence then of forward linkages in South Africa means that businesses remain very small and that there is very little diversity. Most serve their neighbourhood market only. This means that formalization of the business is irrelevant to the vast majority of informal businesses. Unless businesses operate in the formal sector, there is no real or perceived need to formalize and no sanction to remaining informal.

How then does one facilitate the engagement of informal businesses with the formal economy?

From a policy perspective one should not differentiate the owner from the business. Business owners themselves do not differentiate between home and business consumption and

expenditure. Many international and South African studies show that improved housing, access to consumer credit and even social security in the form of cash transfers impact on the income generation ability of the poor.

I would argue that there are two strategic areas for the Commission to focus its efforts in South Africa. The first is to reduce the transaction costs of informal businesses in the context of their backward linkages with the formal sector. I shall discuss this aspect with reference to an example of BEST Practice in South Africa. The second is for the Commission to work with stakeholders to lobby and litigate for improved education in South Africa, given the correlation between education and entrepreneurship. As education is one of the socio-economic rights contained in the Constitution, this could be an important area to advance the jurisprudence of socio-economic rights.

Reducing transaction costs of informal business

Few home-based businesses are able to access formal markets and do not therefore have forward linkages with formal businesses. However they do have backward linkages, in that they purchase inputs from formal wholesalers. An example of best practice, The Triple Trust Organisation (TTO), shows that by intervening in the backward linkage with big business, transaction costs are reduced, which improves the livelihood of small businesses.

TTO is a proponent of Making Markets Work for the Poor (MMW4P). In this context, MMW4P uses 'value-chain analysis' as a starting point. Value Change Management entails an analysis of a sector that 'outlines the process from product inception to final consumption and identifies the role of informal economy workers. In the process key interventions are identified to enhance the incomes of those working within it' (Naidoo 2006). The importance of building social capital in the context of value-chain management is illustrated by reference to the TTO case study. By forming an association that negotiates with wholesalers, spaza or tuckshops get discounts, goods are transported to premises by a distributor, which offers revolving credit; and manufacturers are persuaded to change packaging and sizes for their client (the Association).

Education

One of the key structural constraints for people in the informal sector to participate in the formal market, is the inferior education that the past and the current generations of disadvantaged children have and are receiving. Given the strong correlation between education and the ability to start a sustainable business that is more than a survival strategy (Von Broembsen and Wood 2005), the development of jurisprudence around a right to quality education is a key empowerment strategy.

4. Street traders

The one component of informal business in the retail sector that is able to access formal markets, is street traders, who sell their goods from pavements or stalls in inner cities or town centres to middle class clientele. Local government can prohibit street traders from trading in certain areas. Certain local authorities apply a blanket prohibition in city and town centres. The role of local government, particularly the extent to which local government applies by-laws in a developmental way is critical for this category. Detailed recommendations are contained in the main body of the text. The two key recommendations are that we develop a national framework, with national and provincial governments assuming a more constructive oversight role (over local government); and that we progress from a criminal to an administrative framework.

5. Forward Linkages: manufacturing, craft, agricultural

The third category is micro-enterprises in the manufacturing, agricultural and craft (a sub-sector of manufacturing) that are able to access formal markets. Few of these businesses are able access markets without the assistance of an intermediary.

A best practice example of value chain management illustrates that an intermediary (which could be for- or non-profit) lowers the barrier to entry for informal businesses in the craft sector by providing the following services:

- Information about the market and design input;
- Consolidation of volumes from small producers;
- The ability to secure large export orders and divide them between small producers; and
- The organization assumes the financial risk.

The critical pay-off for informal business is that it reduces the complexity of producing for external markets, which lowers the barriers to entry. An intermediary can lower the barriers of entry *and* if the intermediary plays a developmental role, can assist the producer to move his or her business to the next level in terms of sophistication. Of course if the intermediary is a market player rather than a non-profit organization, unequal power introduces the potential for the intermediary to exploit the producer. The challenge would be to explore whether one could regulate fair trade.

One suggestion is that sector-based industry associations are established, that regulate the behavior of intermediaries. Government funding for export, attending trade shows, etc. could be coupled to membership of the association, which could require developmental interventions, such

as transferring the following skills to producers: contracting with subcontractors, design, compliance with formality requirements etc. In addition, an administrative tribunal run by the association could address complaints by producers.

Summary of Recommendations

In summary, I would suggest the following strategic areas of focus for the Commission:

- To lobby and litigate for a right to education that has content
- To support a strategy to undertake value-chain analysis in key industries and to develop a strategy to build social capital at a local and sectoral level
- To work towards a National Framework for street traders
- To move from criminal to administrative legal framework for street traders and home-based business in ‘formal’ homes
- To create an enabling environment for fair trade intermediaries

1. Introduction

Legal empowerment describes an approach that has as its objective to increase marginalised people's control over their lives, by making human rights a reality for the poor (Golub 2003:5). It is a 'bottom-up' approach, in that unlike a 'top-down, state-centered approach' that focuses on legislation and legal institutions, its point of departure are poor people themselves – their experiences, their reality.

> It is grounded in grassroots needs and activities but can translate that community-level work into impact on national laws and institutions. It generally strengthens civil society and the legal capacities and power of the poor in order to address their priorities, but wherever possible involves cooperation with government (Golub 2003:5).

Legal empowerment is part of an integrated strategy that includes both rights-based activities and other development activities, such as building social capital or literacy projects (Golub 2003). Such activities ostensibly have nothing to do with law; yet may be critical interventions that enable marginalized people to exercise their human rights.

The Commission for the Legal Empowerment of the Poor recognizes that the reality for the poor is that they live outside of the law, in the 'informal or extra-legal sector', in that they do not have legal title to land, access to banks or formal credit and they generate income in 'underground businesses'. The objective of 'formalisation' is to enable people to participate in the 'formal sector' by giving people access to 'jobs, markets, incomes, social protection and security'. The Commission recognizes that in order for formalization to have any substance, it is important to understand what creates and sustains informality in the particular context (Overview Paper 2006).

This paper is concerned with one aspect of the poor's lives: their income generation strategies, or informal business. First I explore the factors that led to the creation of the 'informalisation' in South Africa and that contribute to its perpetuation. Thereafter I discuss the informal business sector in as much depth as a paper of this nature allows. I focus on three categories of small business, discuss their problems, the legislative framework in which they operate and frame recommendations for each.

I will argue that from a legal empowerment perspective, it's critical to distinguish between those informal businesses that have the potential to access external or formal markets and those that are only able to sell their goods or services to their own community.

I will show that only a small percentage of informal businesses can access formal markets. For the vast majority, the legal empowerment strategy should focus on:

a) Increasing the participation of the poor in the formal economy as people, rather than as business owners. I will argue that access to quality education, housing, infrastructure,

healthcare etc are more strategic interventions and will impact livelihood strategies more significantly than supply-side interventions, which have largely failed to transform the sector[i].

b) Reducing the transaction costs of small businesses.

2. Contextual background

As a result of our history of systematic exclusion of black people from participating in the formal economy, informality and race are inextricably linked in South Africa. A number of racist laws were enacted to give effect to the extraordinary notion that black people were simply there to provide unskilled labour to white business. Black Africans who constitute approximately 79, 6 % of the total population, were targeted specifically.

Briefly, legislation controlled the influx of black Africans from rural ‘homelands’ (poorly resourced rural areas assigned to black nations) to so-called ‘white’ urban areas. Disenfranchised people were granted temporary licenses to live in urban centers in order to provide labor. These ‘temporary’ residents had to live in ‘townships’, dormitory suburbs which were, and still are, outside cities and towns. One of the cornerstones of apartheid was differentiated education for different population groups. An education curriculum was designed to limit black Africans to manual laborers. In addition, they were not permitted individual title to land or to own a business.

From the perspective of informal business, the legacy of these apartheid laws is that:

- Black Africans were excluded from the formal economy, except as unskilled labour. For the majority, the education and skill levels are therefore vastly inferior to their white counterparts. This inequality in education persists today (van den Berg 2005), which has enormous implications in terms of the ability of the poor to enter sophisticated formal markets, either as employees or as business owners. In addition, as black Africans were not allowed to own businesses, skills were not passed from generation to generation, as they were amongst artisans in sections of the ‘Coloured’ community or as is the case in other developing countries. Skill levels are therefore very low, which also impacts on the kinds of businesses people establish and their ability to access formal markets.

- All ‘black[ii]’ population groups were spatially separated from towns and cities, which for the poor, who cannot re-locate to previously ‘white’ suburbs, is still the case. As a result, most informal businesses operate from homes or informal structures at transport nodes and informal markets in the townships, sometimes far away from town or city centres. This means that these businesses service their local community, which is poor and often

buys on credit. In addition, spatial separation impacts on the transaction costs of accessing inputs for businesses.

Our democratically elected government has promulgated numerous laws to remedy the legacy of inequality. Briefly, these include, but are not limited to:

- The Constitution of 1996, which is one of the most progressive constitutions in the world. Not only does it contain civil and political rights, but also socio-economic rights, including the right to food and water, healthcare, housing, social security and education.
- Legislation to restore rights to land use and tenure
- The Schools Act, which provides for differentiated funding, that is biased towards poor schools.
- The Preferential Procurement Policy Framework Act of 2000 that committed government to preferentially procure goods from black- owned business and to break down tenders into smaller units, to enable smaller businesses to tender for contracts.
- The Competition Act of 1998, which aims to address anti-competitive behaviour of white –owned corporations that have a monopoly on local markets
- The Broad-Based Black Business Empowerment Act of 2003, in terms of which any business that wants to tender for government work or applies for government assistance or licences, must comply with 5 areas of black empowerment. These include transferring skills to black staff members, procuring from black-owned businesses and spending 1% of their after-tax profits on enterprise development.
- The National Small Business Act of 1996, which established institutional structures to give effect the government's National Small Business Strategy.

The legal empowerment challenge is therefore not to advocate for broad based legislative reform. Rather, the challenge is to ensure *effective pro-poor implementation*, which is lacking. Even if such pro-poor implementation is effected, the effects of apartheid are such that it will still take decades to undo its legacy.

3. Understanding the informal sector

South Africa is characterized by a dual economy – a modern, industrialized economy that lives side-by-side with an informal economy. The term 'informal economy' generally refers to all activities that are not recorded by formal labour market data, which would include street traders, home-based businesses, casual and contract workers, domestic workers and farm workers.

Black Africans represent approximately 83% of the informal economy (Valodia 2000)[iii]. Women constitute approximately 57% of the informal economy, of which approximately 49% are black African women. Valodia disaggregates the data according to gender and the type of activity undertaken and reports that:

- Most women (55%) are domestic workers. Less than a third, (26%) own and manage their own informal business. Of these, the vast majority are in the retail sector.
- Men's work in the informal economy is also of the unskilled or low-skilled variety. Just under half (49%) of men are casual or contract employees, while approximately 36% own and manage an informal business.

In other words, just over a third of all people in the informal economy own and manage a business. A small percentage of the remaining two thirds are paid or unpaid employees of these businesses[iv]. This study focuses on one component of the informal economy, namely informal businesses. For the purposes of this paper, informal businesses are defined as unregistered, unregulated economic activities that contribute to the gross domestic product.

Informal business forms part of the government's strategy for the SMME – the Small Medium and Micro-enterprise – sector. A schedule to the National Small Business Act defines these categories for each industry.

Size and contribution of informal business to GDP

Estimates of the size and contribution of informal businesses vary considerably. It is estimated that there are between 1 and 2.3 million informal businesses in South Africa, which contribute between 7 and 12 percent to South Africa's GDP (Dewar 2005). Micro-level studies – seven in total – suggest that between 3 and 7 out of every ten household in informal settlements are involved in some kind of informal income generation activity (Valodia 2000; Napier et al 2002).

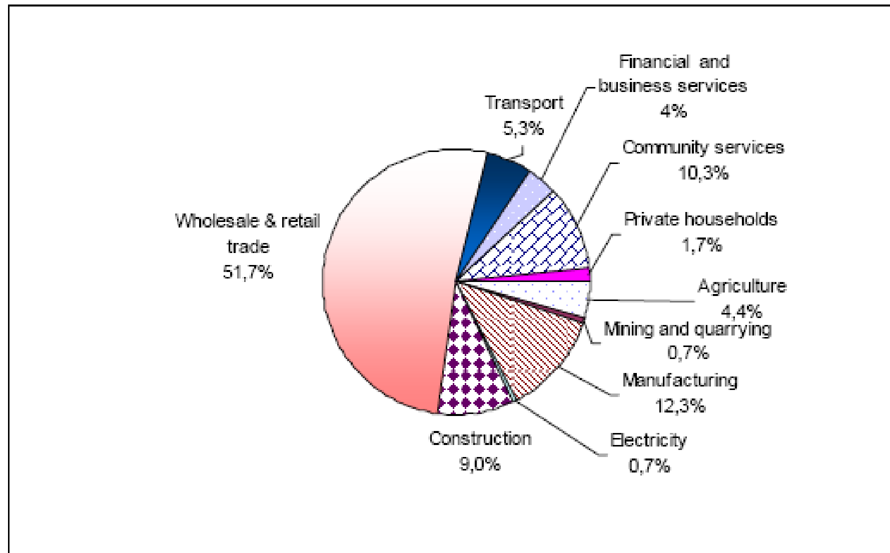
Race and Gender component of informal business

An estimated 45,5% of informal enterprises are owned and managed by women and approximately 54,5% by men. An estimated 91, 3% are owned and managed by Africans (Statistics SA 2005)[v]. Given the Commission's focus on poverty, and that black Africans, in particular black women, are the poorest of the poor, this paper will focus on the 91.3% black owned informal businesses.

Distribution of informal business by sector

The diversity of the informal businesses is evident from Figure 1. It is important to note that more than half of all informal businesses are involved in retail.

Figure 1: Sectors in which Informal Business operate



Unspecified industry not included in the total percentage

Source: Stats SA (2005) p xv.

Each sector incorporates several sub-sectors. Businesses in the building sector are constrained by different factors to those in the retail, hospitality or craft industries. Sector-specific studies are therefore important to design optimal strategies. This paper seeks to address generic legal empowerment. The kind of intervention required is in broad terms determined by whether or not businesses can access the formal market, which is partly determined by the sector in which they operate.

In this paper, I concentrate on the retail and manufacturing sectors, which constitute approximately 64% of informal businesses. I include a third broadly defined category - service industries. The services sector comprises an estimated 9% of informal businesses (Skinner 2007). I refer to these sectors in the context of the following three categories of small business: (a) home-based enterprises; (b) street traders and (c) micro-enterprises that have the potential to access formal markets. This third category is limited to a small percentage of businesses in the manufacturing, service and agricultural industries.

4. Home-based businesses

Approximately 60% of all informal businesses are home-based (Stats SA 2005). This implies that that these business are located in 'townships', dormitory suburbs outside towns and cities. Some

of these townships have formal housing, others are informal settlements characterized by 'shacks' (homes built from corrugated iron) with an outside tap and toilet ('site and service') and still others are totally informal – shacks often not built on designated erven, no sanitation (people relieve themselves in bushes) and communal taps provide the only water. Many people live in a structure built onto the back of a 'site and service' shack, which they rent from the owner of the shack.

Home-based businesses may be 'survivalist' or more sophisticated micro-enterprises. Studies show that businesses in townships that have more formal housing and access to electricity and running water (as opposed to a communal tap) are more sophisticated and sustainable than those where homes are 'shacks' and have access to few amenities (Napier and Liebermann 2005).

Below I take a closer look at what we mean when we refer to survivalist or micro-enterprises. Thereafter I discuss the legislation applicable to home-based businesses.

Survivalist enterprises

One of the most comprehensive studies on home–based businesses in South Africa states that 'HBE's [in South Africa] are predominantly informal in nature and survivalist in scale' (Napier and Liebermann 2006).

The primary reason for starting a survivalist enterprise is literally to put bread on the table. It is unrelated either to a business opportunity or to the entrepreneur choosing to start a business rather than being employed. *Survivalist enterprises tend to operate in limited sectors, either in retail or in the service industry, into a poor, local, overtraded market.* They trade in low value-added activities, profit margins are very small and competition is fierce (von Broembsen 2002). The Department of Trade and Industry's White Paper on Small Business describes survivalist enterprises as follows:

> Survivalist enterprises are activities by people unable to find a paid job or get into an economic sector of their choice. Income generated from these activities usually falls far short of an even minimum income standard, with little capital invested, virtually no skills training in the particular field and only limited opportunities for growth into a viable business. Poverty and the attempt to survive are the main characteristics of this category of enterprise (1995:10).

From a policy perspective one should not differentiate the owner from the business. Business owners themselves do not differentiate between home and business consumption and expenditure. A typical owner of a survivalist business - of which 6 out of 10 are female - has the following characteristics:

1. She more than likely operates in the retail industry, selling fruit, meat, groceries (called a spaza shop), sweets, liquor, second-hand furniture etc. If she operates in the service industry, she may a hairdresser, a panel beater (if a man) or operate a mobile phone booth.
2. She is poorly educated. She may be illiterate and may not speak English, which is the language necessary to access markets outside of her community.
3. She has no formal sector employment history and is unskilled.
4. She lives in a shack or a 23-30m2 house. If she lives in a shack, she has no title to her home. If she lives in a brick house, she has title, but as the quality of government housing and crime in the neighbourhood are such that there is no established second-hand market, banks are reluctant to accept these homes as collateral for loans.
5. She operates her business either from an outhouse or backyard shack made from old corrugated iron and wooden planks; from a room in the house dedicated to retail activity (Rogerson in Shisaka 2006) or from a table near transport nodes or schools.
6. She may not have access to banking facilities at all. If she does, she would only have a bank account. Typically she relies on informal savings mechanisms such as belonging to a burial society, an informal rotating credit fund based on reciprocity or a church group.
7. Women are at home and care for children, but the opportunity costs of child-care and household responsibilities impact heavily on income generation. A qualitative study by Nqelo and Malan captures this well:

> Women at home do household chores first before they switched [sic] to working on their businesses. These chores could take up half of their day. Being at home in African areas, especially in areas where most people are unemployed, often means attending to visitors or passers-by as it is rude to chase people away. Sadly therefore the business suffers (1998:36).

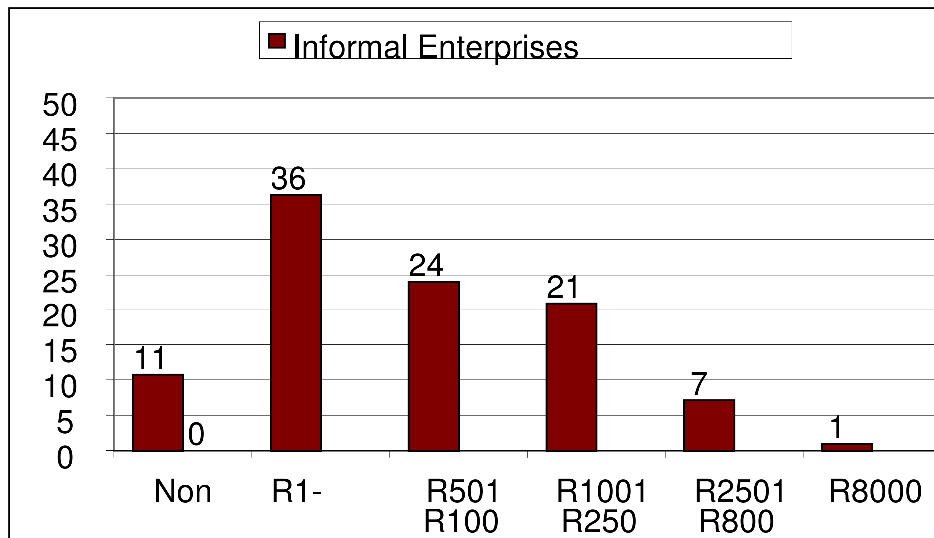
It should be clear that so little has been invested in the human capital of survivalist 'entrepreneurs', that the possibility of these businesses accessing any markets other than their local community is very remote.

Micro-enterprises

Much has been made in recent years by the Department of Trade and Industry of the potential of micro-enterprises to grow into small formal sector businesses. How do micro-enterprises differ from survivalist activities? Officially a micro-enterprise is defined as a business that operates informally, is unregistered, employs fewer than 5 people and has a turnover of less than R 200 000 (see Schedule to National Small Business Act 1996). In reality, micro-enterprises differ little from survivalists. Most operate in the retail sector, a sector that is limited to local markets; earnings are minimal and employment conditions are poor. I enlarge below.

Figure 2 shows the monthly earnings of both owners and employees of informal sector businesses, which include micro-enterprises. It is evident that only 8% of informal businesses earn above the minimum tax threshold, which is R 40 000 per annum[vi]. In other words 92% of informal businesses earn below R 2500 a month. A significant 71% earn below R 1000 per month. The 11% that do not earn anything probably refers to family members who work in micro-enterprises as unpaid employees. It is estimated that only 3% of employees of micro-enterprises are paid (May and Stavrou in Napier et al 2006).

Figure 2: Monthly earnings of survivalist and micro-enterprises



Source: Skinner 2007, calculations based on Labour Force Survey

I shall now discuss the legislation applicable to home-based businesses and then discuss recommendations for legal empowerment.

Legislation applicable to Home- based businesses

Unlike many other countries, home-based businesses in South Africa do not need a licence to operate legally. The only exceptions are if they trade in perishable food, medicines or liquor (or adult entertainment). Since the majority of home based businesses sell perishable food (such as bread and milk), this merits some discussion. In terms of the Business Act of 1991, the owner of a business trading in perishable food is required to have a licence. In addition, health regulations require the business to apply for a ‘certificate of acceptability’ in order to trade legally. This licence is obtained from a local authority, which sends 5 different departments - Environmental Health; Noise and Air Pollution Control; Metropolitan Public safety and Emergency Services, Fire

Safety; Urban Planning; and Building Control - to assess compliance, before granting the licence. Should the business trade without a licence, the trader may be taken to court and fined or imprisoned for 3 months. The regulation thus relies on criminal rather than administrative law sanctions. In reality however, the regulations are rarely enforced in townships. Nevertheless, they are enforced against street traders who trade in inner cities. Suggested strategies are therefore discussed in the section on street traders.

In terms of Schedule 4B of the Constitution, trading and building regulations are local government responsibilities. Home-based businesses in communities that are characterised by formal housing are subject to zoning regulations in terms of Land Use Planning Ordinances, local authority by-laws as well as building regulations. As this is a local authority responsibility, there is little uniformity across the country in terms of whether the by-laws are enforced and how they are implemented. Few local authorities have the capacity and the commitment to implement by-laws at all in townships and if they do, only one or two do so in a pro-poor way. Durban local authority has experimented with educating people on why particular by-laws are there and helping them to comply.

During the apartheid regime, there were different planning practices for different parts of cities and towns. 'White' suburbs were subject to particular zoning regulations and black townships to others. While many local authorities are drafting new regulations that give more consistent rights to all urban residents, the reality is that we still live with this legacy (Napier and Liebermann 2006). Space constraints preclude a comprehensive discussion of town planning and the implications for home-based businesses. It is a complex and important area that merits a special focus, but which falls outside the ambit of this paper.

I will now explore how home-based businesses can be assisted to engage with the formal economy. In this section I discuss an example of best practice and I argue that the single most critical intervention for the next generation of informal business owners is to give effect to the constitutional right to education.

Home- based businesses: the means to engage with the formal economy

A range of government interventions, including legislation such as the Preferential Procurement Act and the Broad Based Black Empowerment Act envisage that micro-enterprises should be able to establish forward linkages with the formal sector, by selling their products or services into the formal sector. In reality, such forward linkages are 'almost non-existent' in South Africa (Napier and Mothwa 2001; Smith et al 2005; Tladi and Pedro 2007; John James 2007)[vii].

A small percentage of informal businesses are able to establish forward linkages, which I discuss in sections 5 and 6 below. But for the vast majority, forward linkages are impossible, predominantly because the lack of investment in human capital is such that people do not have the education, skills (technical, language or business management) or exposure that would qualify them to know how to start a business that could meet the demands of the formal sector.

Napier and Liebermann (2006) argue that in other developing countries the ability of informal business to form forward linkages impacts on their scale and diversity. The absence then of forward linkages in South Africa means that businesses remain very small and that there is very little diversity. Most serve their neighbourhood market only. This means that formalization of the business is irrelevant to the vast majority of informal businesses. Unless businesses operate in the formal sector, there is no real or perceived need to formalize and no sanction to remaining informal.

How then does one facilitate the engagement of informal businesses with the formal economy?

I started this section by arguing that from a policy perspective we should not distinguish between the person and the business. Many international and South African studies show that improved housing, access to consumer credit and even social security in the form of cash transfers impact on the income generation ability of the poor. In South Africa, civil society is very active in the areas of housing and credit. The debates are sophisticated and well documented. I would argue that with respect to access to credit, which is key for informal business, civil society is influential and is working collaboratively with government. Space constrains a detailed discussion in an area in which I do not think it most necessary for the Commission to concentrate its efforts.

I would argue that there are two strategic areas for the Commission to focus its efforts. The first is to reduce the transaction costs of the informal businesses in the context of their backward linkages with the formal sector. I shall discuss this aspect with reference to an example of BEST Practice in South Africa. The second is for the Commission to work with stakeholders to lobby and litigate for improved education in South Africa, given the correlation between education and entrepreneurship, which will be discussed below. As education is one of the socio-economic rights contained in the Constitution, this could be an important area to advance the jurisprudence of socio-economic rights. I discuss each area in turn.

Backward linkages: reducing the transaction costs

The best example in South Africa of a model that seeks to address the problems faced by small businesses is the Making Markets Work for the Poor (MMW4P) conceptual framework, of which The Triple Trust Organization (TTO) is a one of a number of proponents[viii]. The work of this organization amongst spaza or tuckshop owners was highlighted as a 'success story' in the Department of Trade and Industry's latest annual survey of small business.

The principal of MMW4P can be described as follows: The starting point is the market, not the business (or the poor themselves). Initially called 'sub-sector' analysis and now 'value-chain analysis', the particular value chain is analysed to ascertain who supplies who and what value is added in each stage of the process[ix]. The analysis examines (i) how informal business participates in the particular market, (ii) where there is market failure (barriers to the poor participating) and (iii) strategies to overcome such constraints. The objective is to facilitate a more effective participation of informal businesses in the market. Importantly therefore, the intervention is supply- rather than demand- led. Gibbs, a proponent of MMW4P in the UK articulates the role of the intervening organisation as follows:

> As a general rule, the risks of distortion (of the market) are reduced if organisations are not subsidised directly in the delivery of a service or a product, but are supported through assistance, for example, to develop capacity, new products, new business linkages or collaborative working arrangements. Direct transaction subsidies – "invading" the heart of market processes – run the risk of distorting prices and incentives more than less direct routes. Ideally also, actions should work with a number of players so that unfair competitive advantage does not accrue to one player at the expense of the market system as a whole. (Gibbs et al p 21)

Business Development Services (BDS) refers to non-financial interventions that, based on the above analysis, are developed in order to facilitate more effective participation of informal business in the particular value chain. Such interventions should ultimately become a sustainable business that services informal businesses. In practice BDS works as follows:

One of The Triple Trust Organisation[x] (TTO)'s foci has been home-based businesses in the retail sector i.e. spazas or tuckshops. Analysis of the market (or specific value chain) showed that these businesses are not able to sell into 'external markets' i.e. do not have forward linkages to big business. But they do have backward linkages, in that they buy their supplies from wholesalers. The businesses' margins of profit were very small for a number of reasons, of which two were (a) the fact that they were not getting discounts from wholesalers and (b) as they had

use public transport and therefore had to accommodate all their purchases on their laps, they could not buy in bulk. TTO's major strategy was twofold:

- **Horizontal**: to move away from interventions with individual businesses and build social capital amongst owners of spazas and 'home shops'. This was achieved by organising the owners into a network, called SHOPNET. Business owners (approximately 800) were mobilised around a common cause – their supply chain.
- **Vertical** i.e. an intervention in the supply chain. At present TTO manages SHOPNET, which places bulk orders with wholesalers. As a result, wholesalers now provide discounts and distributors deliver goods to shops.

The result has been astounding. On a 'horizontal' level, members see real benefit: they no longer have to travel to buy goods; their profit margins have increased, as their input costs have been lowered and as they benefit from economies of scale. In addition, once a business reaches a certain size, distributors offer revolving credit. TTO sees growth in terms of a diversification of products and a bigger turn-over.

On a vertical level, wholesalers compete for SHOPNET"s business. SHopnet has been able to or plans to:

- negotiate with manufacturers to produce products for the home shop market e.g. half loaves of bread, smaller quantities, specific packaging
- assist people in the community who own small trucks to start a business transporting goods for home owners
- Work on a business plan with a local book-keeper to keep the books for businesses, on a paid basis
- Offer businesses basic business skills, such as understanding an invoice or a statement

There is an intended progression – members of Shopnet start as voluntary buying group member. As members experience the benefit of the network, TTO intends for the SHopnet to become a franchise and for members to pay a monthly fee to belong to it and use its services. In other words, SHOPNET will become a sustainable business.

The Correlation between Education and Business

The Global Entrepreneurship Monitor is an annual population survey that focuses on entrepreneurship in approximately 45 countries around the globe. It has shown that globally there is a strong correlation between levels of education and starting a business that is a response to

an opportunity, rather than one started for reasons of necessity i.e. the latter being the motivation for many informal businesses in South Africa. The more educated a person is, the more likely they are to start a sustainable, opportunity-motivated business. The less educated a person, the more likely they are to start a business that is motivated by necessity.

In this section I shall argue that the school education that most South Africans receive is of a poorer quality to that of other developing countries, and most definitely to that of its poorer neighbours. The poor quality education impacts on the kinds of businesses that poor people in South Africa are able to establish. I have shown in the previous sections that the education and skill levels of the poor are such that they are unable to access formal markets. Unless the education system in South Africa is addressed, one of the primary structural reasons for the inability of the informal sector to formalize will remain in place for future generations. I now turn to these arguments, which will be followed by recommendations for the Commission to consider.

Comparing entrepreneurship in South Africa with five other developing countries[xi], von Broembsen and Wood (2005) consider three categories of people: (a) those that have tertiary education, (b) those that have completed secondary education and (c) those that have not completed secondary education. The study shows that in the first category - 'those that have tertiary education' - South Africans are as likely to start a sustainable 'opportunity–motivated' business as in any other developing country in the comparison. However, the picture is very different for the other two categories. Where students have completed secondary schooling, students in all five other developing countries are three times more likely to start a sustainable (opportunity-motivated) business than they are in South Africa. In the case of students that have not completed secondary schooling, they are 23 times less likely to start such a business than is the case in Argentina, the country with the next lowest figure.

In several other developing countries, the probability of secondary school leavers owning and managing a sustainable business is almost as high as for those with tertiary education. In South Africa, the proportion is 77% lower for secondary school leavers compared to those with tertiary education. In other words, while completing secondary schooling is almost as good a preparation as tertiary education for new business creation in the other developing countries, secondary schooling in South Africa provides a far less satisfactory preparation for starting a business than does tertiary education. Only those young South African adults with tertiary education are likely to be prepared to an equivalent extent as their peers in other developing countries.

The correlation between the level of formal education and the probability of starting a sustainable opportunity-motivated business would suggest that the distribution of educational attainment

would logically have major implications for the overall rate of entrepreneurial activity. The greater the proportion of the population that has attained post-secondary education and, correspondingly, the smaller the proportion that has not completed secondary education, the better for the overall rate of entrepreneurial activity.

Yet, very importantly, a comparison of the distribution of educational attainment in the six countries shows that the correlation between educational attainment and entrepreneurial activity in South Africa is not mirrored in the other developing countries. The distribution in South Africa is one of the three worst in the sample, with 55% of young adults not having completed secondary education and only 9.5% having tertiary education. Brazil, Uganda and South Africa are the three countries where the percentage of youth that have not completed secondary education not only outweighs any of the other education categories, but constitutes more than half of the population of young adults.

But, despite the fact that in Uganda and Brazil the proportion of adults that have not completed secondary schooling is higher than in South Africa, this does not translate into low levels of entrepreneurial activity, as is the case for South Africa. It is clear, therefore, that while the distribution of educational attainment is an enormous challenge in South Africa, the country is not unique. What does seem to differentiate South Africa from other developing countries is that the quality of education provided by schools is inferior.

SACMEQ II (Southern African Consortium for Monitoring Educational Quality) surveys show that South African schools perform poorly compared to schools in thirteen other African countries. Grade 6 learners, teachers and principals were surveyed in fourteen countries in southern and eastern Africa to assess reading and mathematical skills. South Africa's scores for both reading and mathematics locate it in the bottom half of the countries (van den Berg 2005).

SACMEQ categorises learners in terms of their socio-economic status (SES) – the poor having a low SES and the wealthy having a high SES. The poor in South Africa are ranked eleventh in respect of both their reading and mathematics skills. In other words, of the 14 African countries surveyed, only three are worse off educationally than South Africa in terms of the quality of education provided to the poor. And of course we are referring to countries with a significantly lower GDP per capita than South Africa.

Fewer than 10% of young adults in South Africa will be able to access tertiary education and this is unlikely to change. The remaining 90% of young adults, who cannot access tertiary education, will remain dependent on the quality of education available in schools. All the evidence suggests

that the overwhelming majority of young adults do not and historically have not received education of an adequate quality, even by the standards of developing countries that are far poorer than South Africa (von Broembsen and Wood 2005).

Several studies show that poor education in South Africa can be ascribed to poorly qualified teachers, large pupil to teacher ratios; teachers unable to teach new curriculums and poor management of schools (Orford et al 2004; Kingdon 2002, van den Berg 2005; Weekend Argus 2007). In the section that follows, I shall make suggestions on how this problem of a lack of access to quality education could be addressed from a legal empowerment perspective.

Home Based Businesses: Suggested Legal Empowerment Foci

i) Reducing the transaction costs of informal businesses

The BEST Practice example of The Triple Trust Organisation's interventions with spazas or home-shops illustrates the value of the 'making markets work for the poor' approach – and in this context, the value chain analysis coupled with Business Development Services (BDS) interventions illustrate that effective institutions (that ultimately become businesses) offer economies of scale that reduce the costs of transacting in markets. The form of these institutions may differ from context to context. For example, it may be that in a particular agricultural sub-sector a supply input that is cheaper or more reliable would reduce the businesses' transaction costs. Further illustrations of value chain management are discussed in section 6.

From the Commission's perspective, working with local stakeholders to undertake value-chain analysis in key sub-sectors of the informal economy and designing appropriate BDS strategies would be a very important contribution. Perhaps a generic empowerment strategy would be to work with local stakeholders to develop a strategy or a model to build social capital or associations. Forming local industry associations is not only important to reduce the transaction costs of individual businesses in backward linkages with the formal sector, but also facilitates forward linkages with Big Business. John James, who heads up the USAID Southern African Linkage Programme and SABLE (The South African Business Linkage Programme) argues that unless big business can contract with an Association, the transaction costs for big business in transacting with a number of very small contractors is too high to be feasible.

Communities are very wary of committing to associations that collect fees, but are ineffective[xii]. Literature on Public–private partnerships (or partnerships between communities and business in the USA) outline BEST Practice for building social capital with local economic development as an

objective. One of the key factors for success is the presence of a ‘champion’ who will drive the process, either a community person or a strong organisation (or in the case of the UK, strong local government). I mention this, as many local level public-private partnerships in South Africa have been ineffective, as there has been no strong, accountable lead organisation[xiii].

i) Securing quality education for the poor

Sections 26, 27and 29 of the Constitution state that everyone has the right to the following socio-economic rights: the right to housing, health care, food and water, social security (if unable to support themselves) and basic education. The first four rights are known as ‘qualified rights’ in that rights are qualified in the following way: “The state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realization of this right”. This means that provided that the state can show that it has taken reasonable measures that progressively will allow for access to the right in question, it has met its constitutional duty. A further qualifier is that the state must have ‘available resources’. Despite compelling arguments before the Constitutional Court that there should a ‘minimum core’ to a right, in effect the Court has held that an individual does not have a right to health care or to a house, but only a right to reasonable health or housing policy[xiv].

The right to education however, is an unqualified right. Section 29(1) states that ‘Everyone has the right to a basic education, including basic adult education’. This right is not qualified in that it allows for progressive realization or that it can only be achieved within ‘available resources’[xv]. It would seem therefore that if an individual learner lives in an area where there is no primary school, his or her constitutional right to a basic education would be breached.

Veriava and Fons (2007) argue that the right to education is an ‘empowerment right’ in that without literacy for example, enjoyment of civil and political rights that allow for full participation in a democracy, such as the right to free speech, is curtailed. In addition, they argue that ‘economic, social and cultural rights can only be exercised once a minimum level of education has been achieved’. Several writers point out that the right is one to education, i.e. It suggests educational outcomes need to be met, rather than simply a right to schooling. The state’s obligation is therefore not met simply by allowing access to schooling. The quality of that schooling is paramount.

There is almost no jurisprudence in South Africa on the right to education[xvi]. Geoff Budlender, a prominent public interest litigation lawyer has analysed the evidential requirements needed to bring a case before the Constitutional court in terms of section 29. A high profile activist group,

the TAC, which has been instrumental in procuring HIV-Aids drugs for sectors of the population by litigating against the state, is exploring how to litigate for equal education with reference to the equality clause.

Budlender (2005) argues that there is mounting evidence that the quality of education in this country is unequal, despite more state funding being allocated to poorer schools. He argues that we should analyse what the causes for differential education are (other than funding) and then

> attempt to identify how the courts could be used to compel government to address those causes effectively and in a systematic manner. Once-off litigation is unlikely to succeed. The experience in the USA suggests that systematic litigation involving the use of continued court oversight through structural interdicts is more likely to be effective.

It is here that the Commission has a valuable contribution to make. Research aimed at mounting this kind of strategic litigation with stakeholders (see Conclusion for details) would make a significant contribution to alleviating poverty and inequality. As I have argued above, education is key to enabling informal business to access formal markets. It is a lack of education that places a structural restraint on people 'formalising'. Education (as opposed to schooling) is a significant determinant of the ability of the current generation of school learners to participate meaningfully in all aspects of the formal sector[xvii].

5. Street Traders[xviii]

Street trading is a component of the informal economy that occupies the most attention of local government officials. Since street traders occupy public space over which there is often contest, they are a particularly controversial group. The legislative environment that street traders operate in is thus a good case study to explore the legal environment for the informal economy. This section will detail this in a South African context, with a view to identifying critical areas of intervention that may strengthen these livelihoods.

Street traders are a particularly difficult group to enumerate[xix]. Although numbers fluctuate, there has been a dramatic increase in the number of informal traders operating in public spaces in urban centres throughout South Africa.

The 1991 Businesses Act – Deregulation and re-regulation of trading activities

Under apartheid black business was strictly regulated and often repressed. This was particularly the case with street traders. Rogerson and Hart (1989:32), writing in the late 1980's, state South

African urban authorities ‘fashioned and refined some of the most sophisticated sets of anti street trader measures anywhere in the developing world’.

The 1991 Businesses Act was a key measure for de-regulation of business activities, removing barriers to the operation of informal activities. The Act specified that local authorities, with a few exceptions, have to allow immobile informal trading and cannot restrict traders to specified hours, places, goods or services. The Act thus stopped conservative municipalities from disallowing trading, thereby fundamentally changing the environment in which street traders operated.

The Act was amended in 1993 due to appeals from local authorities faced with increasing congestion of public spaces. The amendment allows local authorities to formulate street trading by-laws and outlines what local authorities can and cannot include. The amendment also allows local authorities to declare restricted and prohibited trade zones. The Act details what the process should be in doing so, ensuring that interested and effected parties are consulted and states that every objection should be considered. Informed by the Businesses Act and its amendments, by the late 1990’s most urban local authorities in South Africa had gazetted street trading bylaws, including the declaration of prohibited and restricted trade zones. Prior to detailing these, the role of different levels of government in street trader regulation needs to be clarified.

National, provincial and local competencies and contestation

In March 1995, the Businesses Act was devolved to a provincial level. Provinces thus oversee the implementation of this Act, particularly with respect to local governments’ promulgating street trader bylaws and declaring prohibited and restricted trading areas. The devolution also allows provinces to amend the Businesses Act. Only one of the nine South African provinces – KwaZulu-Natal – has acted on this. In Schedule 5 (Part B) of the 1996 Constitution, street trading is identified as a matter over which municipalities have executive authority, with the province providing monitoring and support. Section 156 (7) however states that national and provincial government ‘have legislative and executive authority to see the effective performance by municipalities of their functions in respect of matters listed in the Schedules 4 and 5’. Although many local authorities argue that managing street trading is an issue over which they have executive authority, the Constitution gives province and national government oversight roles. As will be detailed in the next section the legislation currently governing street trading is fragmented. A core recommendation to empower street traders is that both provincial and national government use their oversight role more proactively.

Street trading bylaws

The street trading by-laws of different local authorities are similar because they all use the Amended Businesses Act (RSA, 1993) as a guide. They typically contain clauses which prevent traders from, for example, obstructing the movement of traffic or pedestrians, prevent unsafe stacking of goods, limit the attaching of equipment to buildings, road signs etc. and ensure that traders keep their sites clean. Further most bylaws contain the same sanctions for contravention. The Businesses Act specifies the penalties if a trader is operating illegally - traders' goods may be confiscated and a fine of R1000 or imprisonment for a period not exceeding three months can be imposed.

In working towards a more enabling legislative environment for street trader four critical areas are identified.

(i) The size of prohibited and restricted trade zones

The extent and viability of informal trading in any given local authority is determined by the size of prohibited trade zones and the extent to which traders are accommodated in restricted trade zones. The economics of street trading is about passing feet, particularly middle class clients who have more purchasing power. Transport nodes and inner city areas are thus often particularly attractive to street traders. Horn (2000: 4) however does point out that few street traders would advocate free and unbridled trading with no regulation. Over trading is not good for traders as there is a direct trade- off between numbers of traders and incomes individual traders earn.

Different South African cities have opted for different approaches. The Johannesburg City Council for example, in the late 1990's declared the whole inner city a no-trading zone with markets being built to accommodate less than a tenth of the 10 000 traders who were previously operating[xx]. Cape Town, although declaring large areas of the city prohibited trade zones, did demarcate sites in a restricted trade zone in the inner city. Durban has accommodated more street traders than the other two cities. Smaller towns throughout the country have very different approaches. Many towns in the Western Cape and Northern KwaZulu-Natal, for example, have declared their whole town centres prohibited trade zones, while in the Eastern Cape and central KwaZulu-Natal trading is often allowed. An appropriate response is detailed in the recommendations section.

(ii) Fees charged

Traders operating in restricted trading areas in South Africa pay monthly fees. At issue are the amounts charged and the lack of transparency about what these monies are used for. Fees

charged in South African cities vary from a low R10 in Durban for a site without shelter and R35[xxi] for a site with shelter, to Cape Town's R125 flat rate for anyone in the inner city, to Johannesburg where the amount could be as high as R600 depending on the level of services provided. Calculated as a proportion of traders' reported monthly income, this is a lot of money.
The tendency in South Africa, and internationally, is that informal workers pay blanket levies which are too high for the very poor, and too low for the better off. Flat rate charging is regressive: a trader who earns R500 month and pays R75 for her site is paying 15 percent of her income, compared to a trader earning R1500 a month, where the R75 comprises only 5 percent of her income. In many cases the introduction of permits has not been accompanied by an improvement in the infrastructure provided for traders - shelter, tables, storage or toilet facilities.

(iii) Sanctions applied

The sanctions for transgression is that traders can have their goods removed and impounded and are liable to pay a fine or be imprisoned. This in effect criminalises transgressors. Few bylaws require that traders be issued warnings prior to their goods being confiscated or contain appeal processes once this has happened. There is precedent however in that a number of towns in the Eastern Cape have established an appeal mechanism. A trader who feels wronged by any municipal decision is able to go to an appeal committee, which consists of a maximum of five members, at least one of whom has to be from the street trading sector. There is thus a user-friendly system for resolving conflict.

The right to confiscate street traders' goods is going to face a Constitutional challenge. In November 2005 the Legal Resources Centre (LRC) launched a case on behalf of the Phoenix Plaza Street Traders Association, a group of traders whose goods had been subject to ongoing police harassment. The case asked for an order setting aside certain unfair provisions of Durban's Street Trade Bylaws and the Businesses Act of 1991, which are deemed to be irregular and unconstitutional. This is a direct constitutional challenge drawing on the property rights clause in the Bill of Rights. If successful this would have implications for the legality of confiscating street traders' goods throughout the country[xxii].

National health regulations

A final piece of legislation that impacts on informal food traders is the National Department of Health legislation regulating hygiene requirements for food premises. This was promulgated in July 1999 and requires that all those handling food in the formal and informal economies had to have a certificate of acceptability (what has become known as the R918 regulation). This is with a view to protecting the health of consumers.

BEST Practice from the perspective of pro-poor implementation: Since 1994 Durban's City Health Department has held health training programmes for food traders. The City Health Department, drawing on minimum health standards for formal food businesses, has devised a set of minimum health standards for informal traders selling perishable and non-perishable food items. A code of good trading practice was also developed. Health officials provide interactive training sessions where issues of personal, food and environmental health are discussed and the code of good trading practice disseminated. Once traders have been through the training, environmental health officers visit them at their site to assist them in applying the principles that they have learned. If traders have applied the minimum standards, they are awarded a certificate endorsed by the Chief Health Inspector. It is these kinds of better practises that could be documented and disseminated to other local authorities.

Recommendations for Street Traders

The following policy recommendations are premised on a particular understanding of the role of policy in the context of informal traders: 'Regulation should not be seen as the only, or even the primary, purpose of policy. The central issue is creating better chances for capital accumulation and increasing the number of traders (Dewar 2005:10)'.

i) Extend the Role of National and Provincial Government

National government, in consultation with stakeholders, should produce model bylaws and document and disseminate better. The capacity of both national and provincial government need to be strengthened to engage effectively with the informal economy generally[xxiii].

Suggested clauses in by-laws:

- A system of differentiated rentals should be considered. Differentiations should be locally negotiated but could vary for different site size, desirability of location, and the level of services provided.
- The revenues raised should be ring fenced with a significant proportion allocated to street trader infrastructure and servicing of trader sites. This transparency would secure greater co-operation from traders[xxiv]. In Durban, the local authority has provided bathroom and child care facilities for street traders. This is an example of BEST practice that is particularly gender sensitive (SEDA 2004)
- Bylaws should contain a clause whereby traders are warned prior to their goods being confiscated.
- Based on the Eastern Cape experience, appeal procedures should be included in all by-laws

ii) Move from a criminal to an administrative framework

Most importantly, a more progressive approach, in line with viewing these activities as economic activities, would be a move away from a criminal to an administrative legal framework. Traders would be encouraged to comply through a range of incentives but the ultimate sanction would be the removal of the right to trade rather than fines and imprisonment.

6. Forward Linkages: manufacturing, craft, agricultural

As discussed in section one, very few micro-enterprises are able to access formal markets. This section will focus on those that are, by virtue of the fact that they operate in sectors that can meet the demands of the formal sector. Specifically, some informal survival and micro-enterprises in the manufacturing, craft and agricultural sectors have the potential to create forward linkages with the formal sector. I shall focus on one organization that is an example of BEST practice in lowering the barriers to entry for informal businesses in the craft sector.

The Cape Craft and Design Institute

The Cape Craft and Design Institute (CCDI), an organization funded by provincial government, is active in the craft sector in the Western Cape Province, one of 9 provinces in South Africa. Its focus is to facilitate the access of formal markets by informal micro-enterprises in the craft sector.

The CCDI recognizes the myriad of problems that informal businesses face: local markets are poor, mark-ups are therefore small and selling on credit is norm. In addition, producers lack technical skills, information, finance, storage space, transport and their businesses suffer from the effects of crime. Yet, they argue even if one were to solve all of these problems, producers would still not be able to access what are sophisticated external markets, where ‘design is key, quality and consistency is vital and trends shift rapidly’[xxv]. CCDI’s response therefore is demand- rather than supply-led. It starts with an analysis of the market demand, not the problems of the producer. As was the case with The Triple Trust Organisation, the conceptual model that the CCDI bases its approach on is Value Chain Management.

Value Change Management entails an analysis of a sector that ‘outlines the process from product inception to final consumption and identifies the role of informal economy workers. In the process key interventions are identified to enhance the incomes of those working within it’ (Naidoo 2006).

An analysis of the craft supply chain shows that ‘the expectation that the crafter must be the designer, the product developer, the producer, the marketer, the agent and the exporter is not realistic.’ (CCDI 2006). The producer becomes part of a supply chain and other parties fulfill the different specialist roles in the supply chain. The producer therefore does not interact directly with the market, but does so through an intermediary. This intermediary (in this case a non-profit organisation) lowers the barriers to entry by providing the following services to micro-enterprises:

- Information about the market and design input;
- Consolidation of volumes from small producers;
- The ability to secure large export orders and divide them between small producers; and
- The organization assumes the financial risk.

The critical pay-off for informal business is that it reduces the complexity of producing for external markets, which lowers the barriers to entry. The reality of producing for external markets is captured by this comment from Woolworths, a large retailer – ‘by all means cut red tape, but our buyers need compliance with business protocols and practices that mitigate their risks’. Value chain management means that these business protocols and practices are mediated for the small producer by other market players, which otherwise would disqualify such producers from participating in the market.

The CCDI functions as an intermediary for approximately 800 businesses in the craft sector, of which 22% are from outside the metropolitan area. This means that a holistic approach that assesses the level of business and designs appropriate interventions with partner organizations to move the business to the next level is possible. In the process, micro-enterprises are required to register as formal businesses, in order to access state subsidies to attend trade shows etc. There are many organizations that assist with formalizing – which includes acquiring a tax compliance certificate and possibly registering as a Close Corporation with the Registrar of Companies. What is more difficult is that the newly formalized micro-enterprises don’t always understand what is required from them and struggle to comply[xxvi]. Any formal entity has to satisfy a host of legal requirements – audited financial statements, labour requirements and most critically to pay tax, to mention but three. In addition, micro-enterprises subcontract their orders and have little understanding of contractual arrangements with their subcontractors. Frequently there has been no prior agreement regarding price or quality and conflict ensues.

This value chain model is being applied in several other contexts: for example in the traditional medicines sector in the Kwazulu-Natal Province, which is supported by Provincial government and by an Organisation in the Eastern Cape Province, COMMARK, that facilitates rural subsistence farmers selling their cotton and cattle to formal markets.

The role of intermediaries is controversial in South Africa. Other models such as government funded craft hubs, aimed at eliminating the need to for intermediaries to allow producers to sell directly to the end user are also pursued. This debate on the merits of each model falls outside the ambit of this paper. But what cannot be gainsaid is that an effective institution offers economies of scale that reduces the costs for producers to transact in markets.

Recommendations

I have chosen to highlight this model (value chain management) for two reasons. The first is that on the face of it, it is sustainable, as market-based intermediaries address market failure. The second is something I tried to illustrate above – that an intermediary can lower the barriers of entry *and* if the intermediary plays a developmental role, can assist the producer to move his or her business to the next level.

Of course if the intermediary is a market player rather than a non-profit organization, unequal power introduces the potential for the intermediary to exploit the producer. The challenge would be to explore whether one could regulate fair trade.

One suggestion is that sector-based industry associations (as is the case for builders, travel agents, estate agents etc) are established, that regulate the behavior of intermediaries. Government funding for export, attending trade shows, etc could be linked to membership of the association, which could require developmental interventions, such as transferring skills to producers - on contracting with subcontractors, design, compliance with formality requirements etc. In addition, an administrative tribunal run by the association could address complaints by producers.

Stakeholders would include Business Chambers (two of which have programmes to assist informal business). A source of funding for developmental input into these traders could include leveraging the 1% after tax profit that big business is required to spend on small enterprise programmes to secure Black Economic Empowerment (BEE) compliance in terms of the Broad-based BEE Act.

7. Conclusion and a Summary of Recommendations

I have shown that the majority of businesses are home-based and operate in dormitory suburbs or 'townships' that are spatially separated from towns and cities. More than half of these informal

businesses, whether they are survivalist or micro-enterprises, operate in the retail sector, which means that they only sell to their own local market. Typically such business operate from a room in a home, a corrugated iron structure built onto a home, a semi-permanent structure that lines particular streets in townships, or a table near a transport node or school. Businesses in the retail typically sector sell groceries, raw or cooked meat (the latter is roasted over an open fire), alcohol, second-hand furniture etc. These businesses require a license and a 'certificate of acceptability' if they sell perishable food. If they fail to comply, their goods may be confiscated and they may be fined or imprisoned for three months. I was unable to find any literature (or feedback in interviews) on whether compliance poses a barrier, as the reality is that few comply, given that these regulations are not often implemented in townships. Unhygienic practices do abound, such as putting paraffin next to bread. In the interests of consumers, compliance is something that should be pursued, but in a developmental way, such as is epitomized by on KZN Provincial Government, which has developed codes of good practice for informal business, and uses workshops to educate and inform, as well as sends staff to visit business and assist with the practicalities of compliance.

A best practice example shows that by intervening in the backward linkage with big business, transaction costs are reduced, which improves the livelihood of small businesses. The importance of building social capital in the context of value-chain management was illustrated.

The profile of the typical informal business owner is of a person with little skill or education, no informal employment experience, few links with the formal sector other than as a consumer and few assets. The effects of HIV- Aids on informal business are significant, if undocumented. The ability of such a person to be able to manage her business to graduate to the formal sector is very unlikely. Improving the rights of the person, rather than supporting supply-side interventions for the business – is more likely to improve livelihood strategies of the poor. For women this means support with childcare (such as pre-schools) and for men and women, access to healthcare, housing, sanitation, crime prevention, banking and education. One of the key structural reasons for the sustained existence of the informal sector is the inferior education that the past and current generations of disadvantaged children did and still are receiving. The development of jurisprudence around a right to quality education is key to addressing one of the underlying reasons for the perpetuation of informality.

The one component of informal business in the retail sector that is able to access formal markets, is street traders, who sell their goods from pavements or stalls in inner cities or town centres to middle class clientele. Local government can prohibit street traders from trading in certain areas. Certain local authorities apply a blanket prohibition in city and town centres. The role of local

government, particularly the extent to which local government applies by-laws in a developmental way is critical for this category. Various detailed recommendations are contained in the main body of the text.

The third category which was discussed were micro-enterprises in the manufacturing, agricultural and craft (a sub-sector of manufacturing) that are able to access formal markets. A best practice example of value chain management whereby an intermediary (which could be for- or non-profit) lowers the barriers to entry for informal businesses, was explored.

In summary, I would suggest the following strategic areas of focus for the Commission:

1. To lobby and litigate for a right to education that has content
2. To support a strategy to undertake value-chain analysis in key industries and to develop a strategy to build social capital at a local and sectoral level
3. To work towards a National Framework for street traders
4. To move from criminal to administrative legal framework for street traders and home-based business in 'formal' homes
5. To create an enabling environment for fair trade intermediaries

Finally, a word of realism from the Development Bank in its 2005 Development Report:

> Arguably the most important constraint on transforming the second economy is that the vast majority of those who inhabit this economy are manifestly unprepared to make the transition to the first economy or to link to it somehow. This, after all, is why a number of government's second-economy interventions have not had more impact – explicitly or otherwise, they targeted those in the second economy who are relatively entrepreneurial, or bankable, or experienced in commercial agriculture, and sought to help them grow. While these individuals are certainly deserving of support, they are few in number compared to all the other micro-entrepreneurs and small-scale farmers whose prospects of growing are slim. … to the extent that the state can make an impact on the second economy in the short and medium term, it is not in terms of *transforming* the second economy, that is, making it disappear, but in making it somewhat more vibrant and broad-based. The immediate task is to intervene broadly in the second economy in order to help as many people as possible to further realise, incrementally, their economic potential. This will not result in a quick, dramatic alleviation of underdevelopment and poverty. However, it will make an important difference, and it will lay the basis for the longer-term project of eliminating the second economy altogether (2005:).

The proposed interventions are aimed at 'interven(ing) broadly in the informal business sector to help as many people as possible to realize, incrementally, their economic potential'. Securing quality education for the majority of the poor through the socio-economic rights will however undermine a key structural constraint to transforming the informal sector.

Notes

[i] See Rogerson et al 1997; von Broembsen 2002; Development Bank of South Africa 2005 for critique of the government's supply driven strategy
[ii] 'Black' in the broad sense refers to all population groups that were not classified as white i.e Black Africans, mixed race or 'Coloured', Indian and Chinese.
[iii] Valodia relies on the October Household Survey of 1998.
[iv] Skinner (2007) analyses 5 years 2000-5 of Labour Force Statistics to show that two thirds of the labour force are employed in the formal non-agricultural sector

[v] [v] I use the most recent 'official' statistics reported by Statistics South Africa in its annual survey, A Survey of Employers and the Self-Employed (SESE). The reason for this choice is that SESE surveys informal businesses, whereas the Labour Force Survey is a population survey, from which informal business statistics can be extrapolated, as is the Global Entrepreneurship Monitor (GEM). The latest SESE survey is the 2005 survey, which was conducted in September 2005. The report was released in November 2006. SESE defines informal businesses as those not registered for Value-added-tax (VAT)[v].

[vi] The tax threshold is R 40 000 for the 2007 tax year and R43 000 for the 2008 tax year for under 65 yr olds. For over 65 these amounts are R 65 000 and 69 000 respectively.

[vii] I interviewed Tladi and Pedro, directors of a non-profit organisation, The Triple Trust Organisation, that has done extensive research across sectors they work in to determine the extent to which informal businesses participate in the formal market. I also interviewed John James of ECI Africa, who heads up the USAID Southern African Linkages Programme , as well as the Business Opportunities Network, that was established to facilitate linkages between big and small informal business and has abandoned that area of their work.

[viii] This model is also used in the microfinance sector. FinMark is a proponent of this approach in that sector. Funders DFID and GTZ support this model in South Africa.
[ix] Interview with Kirsten Kennedy, Senior Specialist ECI Africa, who have worked extensively inb this area.
[x] Interview with Seth Tladi and Donovan Pedro from The Triple Trust Organisation August 2007
[xi] Countries included in the comparison :Uganda, Brazil, Argentina, China and Chile.

[xii] In my interviews with Seth Tladi and Donovan Pedro, they underlined this point. People are very suspicious of a request to belong to associations, as they have had negative experiences.

[xiii] We do not have the strong local government that the UK has. Thus civil Society or business is most likely to provide the strongest leadership.

[xiv] Government of the RSA v Grootboom 2000 (11) BCLR 1169; Minister of Health and others vs TAC and others (1) 2002 (10) BCLR 1033(CC)

[xv] However see section 36 which is a general 'limitation of rights' clause.

[xvi] I interviewed Prof Sandra Liebenberg, who holds the Human Rights Chair at the University of Stellenbosch and Ferenaaz Veriava of the Centre for Applied Legal Studies.

[xvii] I acknowledge the studies that argue that supply-side interventions such as upgrading human capital have only limited potential to deal with unemployment (Kingdon & Knight, 2000; Lewis, 2001: 25 in DBSA 2005), but empirical studies such as the World Bank's paper "Constraints to Growth and Employment in South Africa' (Chandra et al 2001) show that the growth of formal sector small business is hampered by the dearth of semi-skilled labour.

[xviii] I gratefully acknowledge Caroline Skinner, lecturer in the School of development Studies, university of Kwazulu-Natal, who wrote an input paper for me on street traders. Most of the information and recommendations on street traders are drawn verbatim from her paper.

[xix] The number of vendors can fluctuate from one season to the next, one day to the next, and even during a single day. See the ILO, 2002:51 for further details of statistical challenges for national estimates on street traders.

[xx] Given high unemployment levels traders have persisted to trade and the council has spent a lot of money on enforcement, in parts of the city they have given up and there is unmanaged trading.

[xxi] These fees are currently in the process of being renegotiated.
[xxii] The case has suffered a set back due to the untimely death of the chair of the Pheonix Traders, under whose name the case was being pursued. The LRC is planning to resubmit the case under another trader's name.
[xxiii] See Devey, Skinner and Valodia, 2006 and Rogerson, 2004 for an overview and critique of the broader policy and support environment for those working informally in South Africa.
[xxiv] This suggestion comes from traders themselves (Skinner 2007).

[xxv] This extract from a power-point presentation by someone from CCDI does not cite an author or a year. In interviews with the Cape Craft and Design Institute the views of the presentation were echoed.

[xxvi] Interview with Anne from CCDI

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