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Factors contributing to the demise of informal enterprises: evidence from a Cape township

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The reasons for the closure of fairly well-established informal enterprises are varied. Between 2010 and 2015, in the Cape Flats township of Delft South, a key factor was the failure to respond adequately to the more entrepreneurial business model of foreign traders and the strict enforcement of unfavourable liquor trading policies. Still, household misfortunes and broader socio-cultural dynamics also played crucial roles. A richer understanding of why enterprises shut down should inform policy to foster the sustainability of informal enterprises.

Introduction

Little in-depth research has been conducted on the reasons why informal micro-enterprises in townships fail. Moreover, the existing literature on enterprise closure tends to focus solely on internal and external business factors such as deficiencies in the education and business skills of the owners of these initiatives; unsustainable business models; limited market research and understanding; inadequate capital; and an inability to cope with competition (see Hutchinson & De Beer 2013; Ligthelm 2010; Maas & Herrington 2006; Rolfe *et al.* 2010). What has often been ignored is a more holistic examination of how the household and broader socio-economic contexts of the owners of enterprises in townships intersect with these business factors and thus contribute to the failure of their enterprises (Neves & Du Toit 2012: 132).

Without a nuanced understanding of the full range of factors contributing to the closure of informal enterprises, government policies will not be able to respond appropriately to ensure the survival and sustainability of informal enterprises. This article seeks to contribute to a fuller understanding of the various factors leading to the closure of informal enterprises.

The research: business closures in Delft South 2010-2015

The findings derive from fieldwork conducted in the Cape Flats township of Delft South in mid-2015 (for more detail, see Hartnack and Liedeman 2016). This research was part of a re-survey of the activities of informal enterprises in the site, which was first comprehensively surveyed in 2010/11 (see Charman & Petersen, *Econ3x3*, 2015). The re-survey found that, overall, the informal economy in the area had doubled from 879 enterprises in 2010/11 to 1789 by 2015 (Charman & Petersen, *Econ3x3,* 2016).

However, enterprise exit was significant in some sectors. During the re-survey, all enterprises that were open in 2010/11 but which had subsequently closed were identified and efforts made to interview their former owners. While this proved to be difficult (many former owners could not be located, had died, moved away or were now working elsewhere), a total of 13 individuals who had run 19 enterprises agreed to participate in in-depth interviews.

Because most were former owners of more established and longer-running enterprises, the research makes less of a contribution on why short-duration survivalists close shop; rather it examines why businesses that were sustainable over a longer period subsequently closed.

Nine of the 19 closed enterprises were grocery retail (spaza) shops while three were liquor retailers (shebeens). There were two educare centres, two food takeaway shops, a greengrocer, a games shop and a transport business. Although they ultimately failed, these enterprises had operated for 5.5 years on average, enjoyed a decent turnover, employed 34 individuals in total and provided decent livelihoods for their owners. These were thus not ephemeral survivalist enterprises (with owners simply biding their time until a better, formal job offer materialised), but substantial concerns run by willing individuals with long-term entrepreneurial ambitions.

Enterprise exit in most sectors was complex, with a dynamic combination of factors being to blame for their closure. Most often, a number of small and great challenges (business, household and wider social environment) combined over time to contribute to the failure of the enterprise. The following main factors played a role in the closure of these previously sustainable enterprises.

Business factors contributing to the failure of informal businesses

An inability to cope with competition

All of the businesses that had closed down had been affected by competition with other enterprises. In seven cases – all in the grocery retail or green grocer trade – business competition was the primary challenge contributing to the closure of the enterprise. While smaller enterprises faced growing competition and the dilution of their market due to the increasing entry of similar family-run South African enterprises in their neighbourhoods, larger spaza shops faced stiff competition from the relatively recent entrance of foreign traders who employ a much more entrepreneurial business model (see Liedeman *et al.*, *Econ3x3,* 2013). This is the story 'of the relatively rapid capture of the spaza retail market by larger-scale, collective businesses run by Somalis [who] employ entrepreneurial business practices, especially price competition, to outcompete and in many cases, take over, South African shops typically run on more individual and "survivalist" lines' (Charman *et al.* 2012: 49).[1]

Significantly, almost all the respondents felt that they had been able to manage their enterprises well until they experienced what they termed as 'unfair' forms of local competition. Despite the narratives of the owners, the fact that these enterprises closed in the face of competition could be a sign that the traders lacked commercial skills and entrepreneurial acumen and were unable to adapt. Indeed, even though these enterprises had survived longer and performed better than average, their business approach clearly could not compete with a sudden takeover of the grocery retail sector by newcomers employing a different and perhaps more dynamic entrepreneurial model.

Were these failing enterprises simply not growth oriented and/or entrepreneurial? The examples in this study complicate any binary understanding which sees informal enterprises as falling rigidly into either a 'survivalist' or a 'growth-oriented' entrepreneurial category. While they may not have been the epitome of highly competitive and nimble entrepreneurial or growth-oriented firms, most of the spaza shops in this study appear to represent a middle ground between survivalist and determined growth-oriented enterprises. (It may actually be more useful to understand informal enterprises by seeing them on a continuum between being survivalist and growth-oriented.) Despite stiff competition, the best-run spaza shops in the case studies were often undermined by other, non-business-related factors which tipped the balance between success and failure (see below), rather than a lack of competitive drive.

[1] See also Liedeman (2013) and Liedeman *et al.* (2014) on the dynamics of this change in the spaza sector.

Regulatory barriers and law enforcement

In the liquor retail sector, the tough regulatory environment, coupled with the strict enforcement of liquor trading laws, was the most significant challenge contributing to the closure of enterprises (Charman *et al.* 2013). In this study, former retail traders had been able to compete and make good money despite the high number of shebeens and the continual entry of new traders into the sector. However, because they faced significant hurdles in order to register and become properly licenced (i.e. as taverns), all three shebeens faced frequent fines and police harassment. Such attention and the costs involved in applying for formalisation and paying almost weekly fines contributed most to the decision to discontinue trading.

The two educare centres also struggled to register properly due to an unreasonably onerous bureaucratic process, coupled with the very high standards required to register a formal educare centre. Failure to register prevented them from receiving government support for establishing their infrastructures and teaching materials as well as the government subsidy offered per child.

Household and socio-economic factors

Household factors and 'shocks'

Significantly, while owners of enterprises often felt that they could deal with tough competition or unreasonable regulations, what often precipitated the demise of their enterprises was an unexpected blow at household level. Family obligations such as funerals sometimes played such a role; another hindrance was competing household investment priorities or the loss of an important source of household income. Although household-level calamities such as death, illness, fire or residential eviction were not found to play as major a role as expected in the closure of enterprises , in five cases they did worsen the impact of business-related challenges. For example, one of the most successful spaza owners suffered a stroke, forcing the family to spend their time and resources on caring for him rather than attending to the shop. In contrast to the business model of spazas owned by foreigners, where a partner often steps in if there is an illness or death, the family-run nature of the locally-owned spaza meant nobody else was available to step in and run the business in an emergency.

Broader socio-cultural challenges

A more widely faced set of challenges, if not always as significant, had to do with the broader social and communal contexts in which the enterprises operated. Eight individuals said that conflict with their neighbours in residential areas had proved a problem — in some cases contributing to the closure of their enterprises. Such conflict often took the form of disputes over the right to trade in specific residential streets or areas. Surprisingly, only one respondent noted major crime and violence as a direct cause of the closure of the business.

Another struggle faced particularly by those running educare centres was the culture of non-payment of fees. One of the two educare centres in the study closed specifically because the parents had not paid their fees over several years. Parents often changed educare centres when pressure was put on them to pay outstanding fees, with competing educare centres happily taking the children in until they too experienced non-payment. Thus, the combination of an inability to register and qualify for government support, and poor support from (mostly poor) clients in the community puts this important service at risk.

Conclusion and reflections on policy

Accepting that informal enterprises present as a continuum between survivalist and growth-oriented firms has important policy implications. Survivalist enterprises often have short lifespans or are seldom able (or willing) to graduate into larger, more sustainable businesses. Most informal enterprises in Delft South fall into the former category (e.g. street traders; house shops; small shebeens; food take-ways) — nevertheless they provide many residents with a major source of livelihood. Therefore, despite their lack of growth or employment potential, government policy should support (and empathise with) such traders. This support should include providing a regulatory framework which looks after the health and safety of the owners as well as their customers.

However, policy should not look to such survivalist enterprises for the growth, development and eventual formalisation of informal enterprises in townships. A better focus would be to support the cohort of enterprises in the middle of the continuum which have been operating over a longer period and have demonstrated that they can be moderately successful over time. The owners of such enterprises aspire to be entrepreneurial and to run successful growth-oriented enterprises, including taking on employees. Many have learnt much from the experience of running an enterprise and would remain in, or re-enter, the sector *if* they had the right support and regulatory environment.

The first national policy on the informal sector – the National Informal Business Upliftment Strategy (NIBUS) – is a step in the right direction in terms of its goals to reduce regulatory barriers and provide support to informal enterprises. However, it must avoid an excessive focus on regulatory compliance or fruitlessly trying to 'graduate' survivalist businesses which clearly have no potential or inclination to operate at more than a survivalist level. Instead, there are numerous middle-range enterprises that are struggling, or have recently closed. These would eagerly respond to the kind of support mechanisms contemplated by NIBUS. While the mooted Business Licensing Bill (2013) would be ill-advised with regards to survivalists (who would resist such a policy), the middle-range enterprises have more potential to respond positively to registration if they have sufficient support, experience an improvement in the trading environment and can see the benefits clearly.

NIBUS and other policies – at all levels of government – should focus their support on middle-range informal enterprises' needs and barriers to growth. In the grocery retail sector there is a need for a more robust regulatory framework which levels the playing fields and allows South African family-run spaza shops to compete with foreigners' spaza shops and the large retail chains which are increasingly setting up in townships. Since some of the more aggressively entrepreneurial spaza shops use various contraband goods (e.g. cigarettes) to subsidise their everyday products, law enforcement agencies and the South African Revenue Service must ensure better regulation and taxation of products such as grey-market cigarettes (see Liedeman and Mackay 2015).

It is also advisable to support other areas of the informal sector where South African entrepreneurs still have an edge (e.g. food takeaways, liquor retailing, car washing and repairs, educare services). For example:

- The relaxation of urban by-laws or the provision of legal sites (to allow, for example, motor mechanics space to operate properly) would help to keep such enterprises in business.
- While shebeens doubtless need to be regulated to some degree, those with the potential to formalise should be assisted to do so, rather than simply shutting them down, since they provide many with their livelihoods and foster the existence of many related enterprises.
- The government should also make it much easier for educare centres in townships to register and to receive subsidies and support for their work. This is not only an important way to make a living, but it also provides an important service to local communities.

Finally, it is clear that non-business factors also play a crucial role in the struggles and demise of informal enterprises in townships. Government assistance facilities such as loans, subsidies and emergency relief packages should be made available to entrepreneurs who have demonstrated a commitment to regularising their activities, employing people and growing. Government cannot apply the stick of regulation to township entrepreneurs without also offering them a carrot in the form of tangible support.

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