THE ROLE OF SMES IN EMPLOYMENT CREATION AND ECONOMIC GROWTH: LESSONS FROM OTHER COUNTRIES

A Response to Neil Ramsden

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1. INTRODUCTION

Mr Ramsden’s paper contains several interesting observations to which I will respond selectively. The focus will be on those aspects that seem most relevant to Namibian SMEs based on the available literature on the subject. I will make particular reference to Namibian studies carried out a few years ago by the Labour Resource and Research Institute (LaRRI), the Namibia Economic Policy Research Unit (NEPRU) and the Institute for Public Policy Research (IPPR) in collaboration with the Joint Consultative Council (JCC).

Mr Ramsden’s paper focuses on the importance of the “business environment” and the support structures that may be needed for SME’s to thrive, drawing on international experiences in both industrialised and developing countries. My paper will attempt to point to some interventions that might be particularly relevant to Namibia. I will also allude to possible limitations for SME development arising from free trade arrangements and liberal economic policies.

My paper will pay particular attention to the potential for job creation and the quality of jobs in the SME sector. Due to colonial economic policies that were biased towards larger businesses, Namibia’s SME sector (both formal and informal) was very small at independence but has grown substantially since then. This occurred not as a result of deliberate interventions but rather as a result of the inability of the formal sector of the economy to absorb the mostly young, new job seekers who enter the Namibian labour market every year.

Namibia has committed itself to the decent work agenda of the International Labour Organisation (ILO) and many Namibian households rely on a single wage earner for their survival. The quality of jobs is thus a crucial determinant in the struggle to overcome poverty and needs to be included in an analysis of the SME sector in Namibia.

2. DEFINING SMEs IN NAMIBIA

Mr Ramsden points to a broad spectrum of definitions across countries and regions. He cites the example of the European Union (EU) which distinguishes between micro-firms, small- and medium size enterprises. In Namibia, there are several names and definitions given to the SME sector which overlaps to a significant extend with the informal sector. The multitude of definitions should not be regarded as a problem in itself but an indication of the challenges regarding the lack of clarity and consistency faced by all those dealing with the sector. A widely used definition of the SME sector in Namibia is the one of the Ministry of Trade and Industry (MTI) (See table 1 below).

<table>
<thead>
<tr>
<th>Sector</th>
<th>Employment</th>
<th>Turnover (N$)</th>
<th>Capital Employed (N$)</th>
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<tbody>
<tr>
<td>Manufacturing</td>
<td>Fewer than 10 persons</td>
<td>1,000,000</td>
<td>500,000</td>
</tr>
<tr>
<td>Service</td>
<td>Fewer than 5 persons</td>
<td>250,000</td>
<td>100,000</td>
</tr>
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</table>

Source: LaRRI and NEPRU 2002

This definition of the SME sector has some limitations. Measuring capital investment, as suggested by the above definition is problematic because of the difficulty of achieving accurate measurement and also because of the impact of inflation. The employee characteristic is simple
to verify and remains a valid criteria. The LaRRI/NEPRU study of 2002 found that about 68% of the SME businesses were small and employed less than three persons. Fifty-eight (58) percent of these businesses were realising a turnover of less than N$ 35,000 per annum whilst only 6% of the businesses had a turnover of over N$ 250,000 (LaRRI 2002:13-14).

A SME baseline study conducted by the MTI in the Erongo and Otjozondjupa regions suggested that the definition be reviewed in light of the findings that the average size of employees in the SMEs was only 2.2 employees (MTI, 1998b: 54). In Northern Namibia, 58% of the enterprises had monthly turnovers below N$ 1000, and 84% had turnovers below N$ 5000. The data collected also showed that 78% of businesses were very small and employed less than three persons (MTI, 1998a, quoted in LaRRI 2002: 14-15).

The MTI study suggested that the current definition be reviewed in light of international definitions on the SME sector in order to allow comparisons. It concluded that the majority of the enterprises will remain micro-enterprises with the exception of a few that might transform themselves into small or ultimately large businesses (ibid: 15).

Earlier studies found that Namibia’s SME sector was engaged in a whole range of activities ranging from:
- subsistence farming;
- crafts (including: woodwork, pottery, handicraft, basketry, jewellery-making, leatherworking, weaving, sewing, and furniture-making);
- small scale manufacturing (including: bread making, tailoring, food catering, candle making, and confectionery);
- small-scale mining;
- small-scale construction (including: building, brick-making, plumbing, welding, carpentry, and electricity);
- informal services (including: transport, repairs of cars, shoes, electric household appliances, gardening, domestic work, and hoe polishing); and
- informal trade (including: rural information markets (Cuca shops), urban information markets (e.g. Katutura “single quarters”), informal cross-border trade (e.g. along the Namibian-Angolan border), informal meat markets (“bushmarkets” in rural and urban areas), informal mahangu marketing, and informal/illegal diamond smuggling. (van der Linden, 1993: 4).

3. FORMAL OR INFORMAL?

The difficulties in defining SMEs are further compounded by the blurred line that exists between the formal and informal economy. Arnold et al (2005: i-ii) found that only the larger SMEs tended to be formal while the jobs created in SMEs were largely informal. A LaRRI study into Namibia’s informal economy pointed to the difficulties in defining it:

“Defining or describing the informal economy is considered one of the toughest jobs and distinguishing it from the formal sector is even harder (Van der Linden, 1993). What might be considered informal in one country might not apply in another. Some have defined it by using the poverty approach, while others use the size of the business and the number of employees. Some use unregistered status and inability to pay tax as guidelines to define the informal economy.

The ILO defines the informal sector as:
Very small scale units producing and distributing goods and services, and consisting largely of independent, self-employed producers in urban areas of developing countries, some of whom also employ family labour and/or a few hired workers or apprentices;
which operate with very little capital, or none at all; which utilise a low level of technology and skills; and which generally provide very low irregular incomes and highly unstable employment to those who work in it (ILO 1991).

Due to the many facets of the informal economy, the best approach is to have country specific definitions. The Namibia Informal Economy Survey (2001) defines the informal economy using the 1993 ILO International Conference of Labour Statistician (ICLS-93):

The informal economy units/enterprises typically operates at low level organisation, with little or no division between labour and capital as factors of production, expenditure for production is often indistinguishable from household expenditure. Similarly, capital goods such as buildings or vehicles may be used indistinguishably for business and household purposes. Labour relations where they exist are based mostly on casual employment, kinship or personal and social relations rather than contractual arrangements with formal guarantees. Furthermore, these units are not registered under specific forms of national legislation. There is no complete set of accounts maintained (MOL 2001: 5).” (Mwilima 2006: 2-3)

4. EMPLOYMENT CREATION

Mr Ramsden pointed out that SMEs account for around 45% of formal sector workers in developing countries and contribute about 24% of GDP. In Namibia, the SME contribution seems to be lower but the lack of up-to-date statistics makes an accurate assessment difficult. Arnold et al (2005) put the SME contribution at 20% of employment and 12% of GDP.

An analysis of the official employment and unemployment figures between 1997 and 2008 reveals Namibia’s huge crisis of mass unemployment as reflected in tables 2 and 3 below. In 2000, the overall unemployment rate (according to the broad definition) stood at 33.8% and increased to 36.7% in 2004 and further to a record 51.2% in 2008. The situation for women and young Namibians was far worse with youth unemployment reaching around 75% in 2008.
Table 2: Employment by sector (1997-2008)

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<tbody>
<tr>
<td></td>
<td>No.</td>
<td>%</td>
<td>No.</td>
</tr>
<tr>
<td>Agriculture (commercial &amp; communal)</td>
<td>146 899</td>
<td>36.6</td>
<td>102 636</td>
</tr>
<tr>
<td>Fishing</td>
<td>6 771</td>
<td>1.7</td>
<td>12 720</td>
</tr>
<tr>
<td>Mining &amp; quarrying</td>
<td>6 592</td>
<td>1.6</td>
<td>7 563</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>25 983</td>
<td>6.5</td>
<td>25 755</td>
</tr>
<tr>
<td>Electricity, gas &amp; water supply</td>
<td>4 576</td>
<td>1.1</td>
<td>6 151</td>
</tr>
<tr>
<td>Construction</td>
<td>19 801</td>
<td>4.9</td>
<td>19 605</td>
</tr>
<tr>
<td>Wholesale &amp; retail trade, repair of motor</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>vehicles, hotels and restaurants</td>
<td>36 803</td>
<td>9.1</td>
<td>67 027</td>
</tr>
<tr>
<td>Transport, storage &amp; communication</td>
<td>13 480</td>
<td>3.4</td>
<td>15 861</td>
</tr>
<tr>
<td>Finance, real estate and business services</td>
<td>28 061</td>
<td>6.8</td>
<td>16 956</td>
</tr>
<tr>
<td>Government service including</td>
<td>56 974</td>
<td>14.2</td>
<td>75 863</td>
</tr>
<tr>
<td>administration, defence, education, health,</td>
<td></td>
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<tr>
<td>social work and social security</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other community, social &amp; personal services</td>
<td>53 065</td>
<td>13.1</td>
<td>36 713</td>
</tr>
<tr>
<td>(including domestic work)</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Other</td>
<td>2 135</td>
<td>0.6</td>
<td>479</td>
</tr>
<tr>
<td>TOTAL</td>
<td>401 203</td>
<td>100</td>
<td>385 329</td>
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</tbody>
</table>

Sources: Ministry of Labour 2001, 2006 and 2009 (unpublished)

Table 3: Unemployment trends (1997-2008)

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</thead>
<tbody>
<tr>
<td>Overall Unemployment</td>
<td>34.5%</td>
<td>33.8%</td>
<td>36.7%</td>
<td>51.2%</td>
</tr>
<tr>
<td>Unemployment amongst women</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>40.4%</td>
<td>39%</td>
<td>43.4%</td>
<td>58.4%</td>
</tr>
<tr>
<td>Unemployment amongst youth (15-24 years)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>58%</td>
<td>67%</td>
<td>61%</td>
<td>75%</td>
</tr>
</tbody>
</table>

Sources: Ministry of Labour 2001, 2006 and 2009 (unpublished)

These figures reveal that Namibia’s jobs are shrinking with the overall number of formal sector jobs being reduced by almost 20% from 401 203 in 1997 to 331 444 in 2008. During that period an estimated 20 000 to 25 000 new, young job seekers entered the labour market every year. This scenario is made worse by the fact that many Namibian households (close to 50%) depend on one main wage earner and thus unemployment has an immediate effect on household survival.

As a result, many people are forced to make ends meet in the informal economy. Although informal employment in Namibia might not be as high as in other African countries, the
informal economy is growing fast – not by choice but as a result of the formal economy’s inability to create sufficient employment opportunities. Thus the task of creating a substantial number of jobs and over time turning them into decent, formal employment opportunities is one of the most critical in Namibia today.

5. QUALITY OF JOBS

A LaRRI study (2002: 6) found that most SME workers did not join the sector by choice but rather because there were no other employment options available. The duration of employment varied greatly between a few months and ten years or more. The average duration of employment was 1 - 2 years and the vast majority of SME workers earned less than N$ 1 000,- per month. Women were concentrated in the lowest salary scales with over half earning less than N$ 500,- per month. SME workers received their payment regularly but enjoyed only few benefits and even the compulsory benefits such as annual leave and membership with the Social Security Commission were only enjoyed by a minority. Almost 90% of SME workers were also not covered by any pension, scheme, medical aid or any other form of insurance.

Few SME workers had other sources of income and most had to rely on their salary as the sole means of survival. Most had to support 1 - 6 people, which means that the SME salaries were a basic means of household survival.

Most SME workers considered their workplaces as safe although there was a difference between the different SME clusters. Most concerns about workplace safety were raised in the construction industry.

Despite the relatively low salaries and the absence of fringe benefits, most SME workers were generally satisfied with their current job. Likewise, the relationship with the business owner was rated positively but because of the low salaries and the lack of benefits, most SME workers would prefer to work in the public sector or in a large private firm. In other words, Namibian SME workers were in the sector because of a lack of alternative employment (loc. cit.).

A subsequent LaRRI study into the informal economy confirmed many of these trends. In 2006, business operators earned monthly average incomes of about N$ 1450 while informal economy workers earned monthly average incomes of N$ 375 with the majority of the workers earning below the average incomes. A gender analysis of incomes revealed that female workers earned lower wages than men although they had higher educational qualifications (Mwilima 2006: vii).

The working conditions in the informal economy were characterised by long working hours, low salaries, lack of employment contracts, lack of benefits such as medical aid and paid maternity leave. Overtime payments as prescribed in the Namibian Labour Act hardly occurred. Few workers were registered with the social security commission, thus making them more vulnerable during times of sickness and pregnancy. However, more than half of the operators provided benefits to their workers in the form of food, accommodation, transport, annual leave and assistance during times of difficulty (loc.cit).

Generally workers in the SME sector seem to have relatively few concerns about their workplace safety. However, the provision of safety equipment at the workplace was found to be inadequate and there are far too few labour inspectors to ensure adherence to basic health and safety standards as well as the basic provisions of the Labour Act and the Social Security Act (LaRRI and NEPRU 2002).
These findings show that most employees in Namibia’s SMEs fall into the category of the “working poor” who struggle to meet even their basic needs despite being in full-time employment. The legally binding minimum conditions of employment as set out in the Labour Act tend to be ignored in SMEs. This was also found to be the case in the construction industry where a survey commissioned by the Construction Industries Federation (CIF) revealed that 60% of SMEs paid their staff below the legally required minimum wage (Consult Buro 2007).

6. SME CHALLENGES

Mr Ramsden outlined several challenges experienced by SMEs in developing countries, including cumbersome business regulations, insufficient infrastructure, corruption, access to finance and management capacity (i.e. the need for skills across a wide range of disciplines, many of which are specialised/technical). He also pointed out that the smallest firms are most severely affected by these constraints. Although SMEs often start with internal sources of funding (such as savings) they tend to require external funding as they grow. Access to such funding was mentioned as a major obstacle to SME growth and development. How does this compare to the empirical evidence from Namibia?

The LaRRI-NEPRU study of 2002 found that the majority of SMEs had a fixed telephone and/or a cellular phone. Even amongst SMEs with turnovers below N$1,300 per month, the prevalence of fixed telephones was higher than 50%. About three in four SMEs were registered with a ministry or a local municipality but there was a strong relationship between registration of the businesses and turnover. The average monthly turnover for registered SMEs was N$ 13 900 compared to N$2,100 in the case of unregistered ones. The larger SMEs were also those operating a bank account.

Only one out of 10 SMEs enjoyed any credit facilities provided for by their suppliers and less than 15% of businesses had taken up loans during the past 12 months. On the other hand, 44% of the SMEs surveyed had invested during the last 12 months with an average amount of N$9,700.

The LaRRI-NEPRU study found that financial support was by far the most needed support by SMEs but a subsequent study by Arnold et al in 2005 found that SMEs not only rely on their own financial resources but also “don’t even want credit as they perceive it as negative”. Perhaps even more surprising, the latter study found that the majority of Namibian SMEs did not want to use the existing business support services in future (Arnold et al 2005: ii).

Skills development for SMEs seems to be a widespread phenomenon in Namibia. LaRRI and NEPRU found that over 80% of all SME owners had attended both a management and a technical training course during the past 12 months. For the businesses with a monthly turnover below N$1,300 the figure was over 90%.

These empirical findings suggest that the challenges facing SMEs in Namibia only partly conform with those in other developing countries. Challenges like unreliable electricity supply and widespread corruption seem to be less of a problem in Namibia than elsewhere. However, many of the existing business support services in Namibia seem to be of little relevance to SMEs. This however, may have changed in recent years as the studies referred to in this paper were already carried out in 2002 and 2004 respectively.
7. SME SUPPORT

Mr Ramsden’s paper alludes to various support strategies needed to effect SME growth and development. These include financial services that will meet SME needs, effective collateral regimes that will contribute to banks lending to and supporting SMEs more willingly and a supportive legal framework for SMEs. An interesting example cited is China which works on the use of movable collateral registries to overcome the challenge of collateral experienced by SMEs.

Some of these suggestions are echoed in the Namibian studies. Arnold et al (2005: iii) suggest the introduction of special financial services for small businesses and the systematic promotion of linkages between larger private firms of the SMEs as such linkages hardly exist. The authors but also allude to the need to undertake regular SME development and impact assessments to continuously assess the effectiveness of the support measures taken. This is certainly a key challenge in Namibia where comprehensive and reliable data are hard to come by and often already outdated by the time the reports are released.

8. CREATING AN ENABLING ENVIRONMENT

Mr Ramsden’s proposal for the creation of an enabling environment for SMEs are based on market-friendly, supply-side interventions. His paper does not provide an analysis of how liberalised economies and fierce competition may undermine the development and growth of SMEs. The “South-East Asian Tigers”, for example, advanced their economic growth on the basis of state interventions in the economy, coupled with systematic support and protection for local companies. This only changed gradually once local companies (many of which started out as SMEs) had grown and were firmly established, able to survive international competition.

Such an approach may hold relevant lessons for Namibia since our markets are dominated by imports in virtually all sectors. Retail, banking, mining and fishing, for example, are almost completely dominated by transnational corporations (TNCs). Namibia’s manufacturing sector remained very small despite the various attempts to kick-start local processing through Export Processing Zones (EPZs) and other incentives for (mostly foreign) investors.

The potentially damaging impact of free trade arrangements and foreign competition in Namibia was highlighted by two specific cases in recent years. One was the proposed free trade agreement between the EU and the ACP countries and the other one was the impact of Chinese retailers, particularly in Northern Namibia. African trade analysts such as Wallie Roux, Yash Tandon and Dot Keet as well as our Minister of Trade and Industry, Dr Hage Geingob, have repeatedly alluded to the dangers of the proposed Economic Partnership Agreements (EPAs) for development prospects in general and Africa’s emerging industries in particular. In his address to the National Assembly on 19 May 2010, Dr Geingob pointed out that the EPAs in their current form would make it impossible for Namibia to use export taxes on raw materials as an incentive for value addition inside the country. Likewise Namibia would have to abandon its current system of infant industry protection and thus the proposed EPAs would undermine Namibia’s industrialisation efforts (Windhoek Observer, 22-28 May 2010). This would certainly affect the prospects of SME growth and development and thus the Namibian government’s resistance against the interim EPAs was an important step towards negotiating a more conducive trade agreement that will be more conducive to the developmental needs of African countries.

Liberal access for imported goods and services to Namibian markets is likely to undermine SME chances of success. A recent study into Chinese investments in Namibia, for
example, found that the welcoming attitude towards Chinese investments that seemed prevalent amongst Namibian politicians and government officials was not shared by Namibia’s small traders. They pointed out that Chinese businesses were now even threatening the small subsistence home industries trading in “kapana” (roasted meat) and “fat cakes”. A local businessman, John Endjala, was not happy that government failed to protect local people from unfair competition: “Threats from the Chinese are harming our businesses – they are also going into the kapana business and competing with our people because they know how to do it. We cannot go against the Chinese because they have been welcomed here by our government... Most of them employ locals to do the meat roasting and selling. Chinese traders in Windhoek, particularly at the popular Chinatown, have been accused of paying their employees paltry salaries of as low as N$ 300 ... After having overtaken the construction and other established businesses they are now competing against our mothers who are selling kapana and they are even speculating in bread making” (Informante, 7 June 2007, quoted in Jauch and Sakaria 2009: 19).

A LaRRI study pointed out that in 2008, a group of indigenous business people in Northern Namibia had publicly voiced their outrage over what they termed unfair competition from Chinese traders. An “Anti-Chinese Group” was formed and called on government to protect local businesses. They pointed out that the Chinese merchants have an advantage because they source their goods directly from China. The group demanded that Chinese merchants should be restricted to operating warehouses from where local businesses could buy. The group’s chairman Epafras Mukwilongo stated that: “Some of these people (Chinese) get subsidies from their government, they can afford to sell their products at a very low price and we don’t have any type of protection. Chinese investors are taking all the business opportunities from the local people. We understand that we have a free market economy, that we have to compete, but what is happening is robbery, it is not free and fair competition... The government is telling the youth that they should go and establish SMEs, but how does government expect this people to compete against already skilled and experience business people if they are not given any type of protection?” (quoted in Jauch and Sakaria 2009: 19-20)

On a more positive note, the introduction of quotas for retailers (as happened in recent years) to source a certain percentage of their goods locally may hold great benefits for Namibian producers and could be targeted at the SME sector. Linkages between local producers to retailers through the creation of local supply chains could well be achieved through such interventions which target the supply and demand side at the same time. Likewise, government procurement like army and school uniforms, school furniture etc. could be deliberately sourced from local SMEs as a deliberate developmental intervention.

Finally, the introduction of a national Basic Income Grant (BIG) is likely to have a positive effect on the development of small businesses that target local markets. The BIG pilot project in Otjivero has shown how the small cash injection into a local economy created a local market and consequently resulted in the emergence of a variety of new, small businesses such as bakeries, dress-makers, shoe repairs, barber shops, brick makers etc.

9. CONCLUSION

There is no doubt that the SME sector has a large potential for employment creation which is desperately needed in Namibia. The Namibian government’s ambitious target of transforming the SME sector into the lead sector of the economy may not have been achieved yet but its potential for employment creation seems significantly larger than that of Namibia’s large
business sector due to SMEs’ labour-intensive nature and their use of local resources. The SME sector was estimated to grow by about 16 500 jobs per year compared to only 3 000 - 4 000 jobs in the larger business sector (LaRRI and NEPRU 2002). However, these figures are dated and there is an urgent need for accurate data as well as a continuous assessment and evaluation of the sector. This should include an analysis of the effectiveness of support services available to SMEs.

Incentives to entice small businesses to register with a local, regional or national authority should be considered as a possible strategy to obtain a fairly good picture of the size of the SME sector. SMEs are likely to be willing to register if there are benefits to be gained. Incentives for voluntary SME registration could include inter alia, access to free management and technical courses.

Provided that the SME sector receives adequate support and protection, its impact on unemployment could be far more significant than that derived of foreign investment in Namibia. The mining sector, for example, which accounted for the bulk of Namibia’s foreign direct investment (FDI) over the years, created less than 10 000 jobs. Although employment in the SME sector seems to usually be of a short to medium term duration, there are a number of positive trends such as the friendly and conducive employer–employee relationship that prevails in the sector. However, key labour challenges such as low salaries and lack of benefits as well as gender discrimination urgently need to be addressed to avoid the SME sector becoming a gathering of the working poor.

The dilemma posed by low earnings is exacerbated by the fact that the majority of workers in the sector do not have any other source of secondary income. Improved conditions of employment should be seen as being in the interests of not only SME workers but also SME owners, service providers and government because improved conditions will help to raise living standards, productivity, and demand for local goods. This should thus be a central element of an SME development strategy.

The positive employee-employer relationship could become an incentive for workers to stay in the SME sector if this is coupled with improved conditions of employment and ongoing training. It might be worthwhile exploring the link between more systematic training for SME workers, increased output and better working conditions which in turn would encourage workers to stay.

There are several Namibian organisations that provide technical, managerial and other forms of assistance to SMEs such as the Joint Consultative Council (JCC) and SME Compete. They are well-placed to work with government and SMEs to deal with the operational challenges facing small businesses, several of which were mentioned in Mr Ramsden’s paper. Government, however, still has a larger responsibility and role to play in regulating the macro-economic environment. The issues of local value-addition and unfair competition faced by SMEs require particular attention. The policy space must be kept open for developmental interventions by the state, including measures to encourage and protect local processing, establishing linkages between state institutions and SME suppliers as well as SME linkages with larger private firms.

During the colonial regime, the growth and development of the SME sector was deliberately hampered and competition from South African companies (such as retail chains) posed a major threat for Namibian SMEs. Today, Chinese, European and other imports have added pressure on SMEs. As a policy recommendation, government should guard against the creation of an environment in which small operators are pushed out of business by transnational
corporations who tend to repatriate their profits. Nurturing small operators is desirable in that they are labour-intensive and thus may create and sustain more jobs than larger business sector.

10. REFERENCES


Van der Linden, E (1993). The role of the informal sector. Windhoek: NEPRU.