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Southern Africa – Towards Inclusive Economic Development

Firms with high-growth episodes in South Africa

Are they persistently high-growth firms?

The analysis of firm growth has been a topic of consistent economic interest as a growing body of literature has lent support to the possibility that the majority of growth and new employment creation is the result of a small sub-sector of high-growth firms (HGFs). While this has been demonstrated to be true in some periods in some countries, it had not been empirically tested in South Africa. Of particular relevance to this literature is the distribution of growth across firms of different sizes and the persistence of individual firm-level growth over time.

As the literature on HGFs has expanded, the interest in the persistence of firm-level growth has become even more relevant as policy makers embrace microeconomic policy interventions that specifically target and support HGFs. A relevant policy question is, therefore, whether empirical evidence on HGFs supports such interventions.

Firm growth in South Africa

The distribution of growth across firms in South Africa during 2010–15 is shown in Figure 1. As is the case in many economies, most South African firms exhibit little to no growth and are bunched in the center of the graph. A relatively small number of firms demonstrate high levels of positive or negative growth (the tails of the distribution).

In South Africa, the firms that experience high-growth episodes exhibit a strong, negative serial correlation in growth, such that the best-performing firms this year are highly likely to perform poorly in other years. In some cases, the growth in one year may even be reversed in subsequent years.

When disaggregated by firm size, these results suggest that the fluctuation in growth is more pronounced the smaller the firm is, such that larger firms are more likely to maintain the gains of a growth period though they are still not likely to continue to have high-growth years. This supports the notion that public policy aimed at HGFs should not identify these firms based on current growth, as this is not a reliable indicator of high-growth firms. A more nuanced approach to identifying whether there are

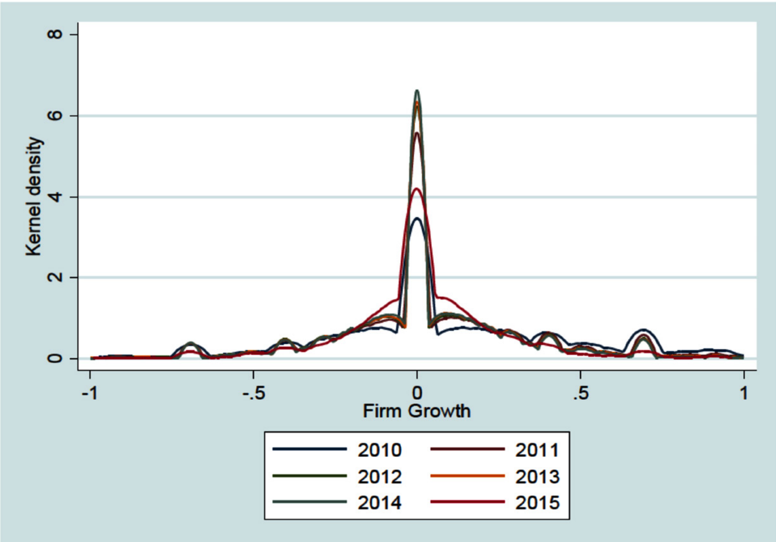
FINDINGS

Firm-level data indicate a strong negative correlation between the scale of growth in one year compared to previous and subsequent years, indicating that firms experiencing large growth episodes are unlikely to replicate the experience in subsequent years

The fluctuation in growth is more pronounced for small firms than for large firms, such that large high-growth firms are more likely to exhibit sustained year-over-year growth

While high-growth firms tend to be more likely than the average firm to sustain year-over-year growth, the negative serial correlation remains

Figure 1: The distribution of firms in South Africa by annual growth



Source: SARS/NT panel data

consistent winners among firms, incorporating broader metrics than simply present growth rates, is warranted.

Among HGFs, we also find that while their growth tends to be more persistent than the average firm, their negative serial correlation remains notably higher than those of the more stagnant firms in the middle of the growth distribution.

Policy implications

Consequently, focusing on high-growth firms may be a poor policy choice in South Africa, given the likelihood that their current growth status will not be reflected in the future. Instead, public policy measures that improve the operating environment of both small and large firms in the economy should be pursued. These include measures to address human capital constraints through skills development. Other measures can address the regulatory burden on enterprises, as South Africa has been noted for its declining ease of doing business in recent years.

The establishment of the InvestSA initiative — which provides a one-stop-shop destination for investors in South Africa — is well-placed to tackle regulatory issues that frustrate both new entrants and incumbents. These measures are sufficiently broad in nature to create an enabling environment for all firms, including the fastest-growing firms in the economy.

Private sector provision of strategic and other business support through incubators, accelerators, and other programmes should be encouraged to facilitate the skills development of growth-focused entrepreneurs, while the work of the Small Enterprise Development Agency (SEDA) should be further publicized to increase access to its services among small and medium-sized enterprises (SMEs).

These measures address different constraints experienced by firms in the South African economy, which particularly frustrate the ambitions of growth-focused firms. By tackling these constraints the long-term prospects of HGFs are improved, while the business environment of all firms in general is also enhanced. Furthermore, these different measures address the enhanced support required by growing SMEs which are more prone than all other firms in the economy to fluctuating performance.

Photo: Qing Hill

By providing the assistance that allows such firms to take advantage of growth opportunities while also offering broad-based support for other firms, the benefits of firm growth can be realized by the South African economy as a whole.

This brief is based on WIDER Working Paper 2018/74 '**On the persistence of growth for South African firms**', by Mulalo Mamburu.

IMPLICATIONS

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Instead, public policy measures that improve the operating environment of both small and large firms in the economy should be pursued

These measures include reducing the regulatory burden, providing extra support to SMEs, enhancing the skills of employees, and reducing constraints on business financing

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