

# POLICY BRIEF

DR CHARLENE MUSIZA | JUNE 2025



## Transforming small businesses via clusters and collective intellectual property rights

### Executive Summary

Small and medium enterprises (SMEs) are significant contributors to the South African economy. They promote growth, create employment, and support poverty alleviation. It is estimated that they account for about 40 per cent of the country's GDP. However, they encounter challenges that hinder their growth – a complex legal and regulatory environment, limited access to financing, markets and effective marketing strategies. Some of these challenges can be overcome through industrial clusters and the use of collective intellectual property rights. Such a strategy can be implemented by the Department of Small Business Development (DSBD) through streamlining activities to grow small businesses by promoting the growth of industrial clusters, as well as supporting and facilitating the utilisation of collective intellectual property rights (certification and collective marks). This can be effectively done through a comprehensive revision of Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprises (ISPESE) by the DSBD.

### Introduction

The role of SMEs in advancing economic development in South Africa cannot be overstated. However, they face

several constraints that limit the growth of their businesses and struggle to maintain markets. Some of these factors arise from the actual small size of their businesses and from their isolation<sup>1</sup>, including a lack of market access and proper marketing<sup>2</sup>. Small businesses face stiff competition from established businesses and with limited marketing experience, poor quality control and production standardisation it becomes challenging to compete.

Ineffective coordination of policies relating to SMEs limits their growth. Challenges of coherence and coordination of policies and departments and agencies that support SMEs, hinder the efforts for SMEs to scale and grow. The activities of the Department of Small Business Development (DSBD), through the Small Enterprise Development Agency (SEDA) and the Small Enterprise Finance Agency (SEFA), are not aligned with the activities engaged in by the Department of Trade and Industry (DTI), which also offers SMEs support. This then leads to the duplication of activities and fragmentation of SME support activities.

Government regulations add another layer of complexity to the challenges these SMEs face, such as isolation, size

constraints and market issues. One of the ways to address these challenges is by developing policies that support SME clusters. This approach can help businesses overcome isolation, ensure better coordination of government support and promote the use of collective intellectual property rights.

Clusters are groups of entrepreneurs engaged in inter-related activities within a specific location or industrial sector. The United Nations Industrial Development Organization (UNIDO) defines them as 'geographical concentrations of interconnected enterprises and associated institutions that face common challenges and opportunities.'<sup>3</sup> This definition incorporates two key elements: the geographical aspect, referring to the location of enterprises within a specific area, and the sectoral aspect, which includes enterprises involved in similar or related activities. Clusters and the use of collective intellectual property rights can enable small businesses to overcome the constraints exacerbated by their size, and, at the same time, overcome some of the marketing challenges.

Clusters support the development of external economies – where the actions of one actor generate benefits for others, ultimately lowering transaction costs for all enterprises involved. External economies, such as improved market access, a specialised labour pool, easier access to suppliers of specialised inputs and services, and the spread of new knowledge through technological spillovers – can be beneficial to SMEs. Besides external economies, clusters create a foundation for cooperation among small-scale producers, helping them build the capacity to use collective intellectual property rights. Research highlights that collective ownership under collective marks fosters collaboration, syndication of economic activities, and teamwork<sup>4</sup>, which is especially beneficial for entities facing size constraints

### ***Analysis of the legal and policy framework on SME***

When it comes to SME policies, the presence of various departments and policies makes coordination challenging. The DSBD is mandated with the responsibility to guide and coordinate the development of SMEs and cooperatives, and two units are integral: the Small Enterprise Development Agency (SEDA) and the Small Enterprise Finance Agency (SEFA). SEDA designs and implements development support programmes, while SEFA assists SMEs with financing and offering loans of up to R15 million<sup>5</sup>. Besides SEFA, the DTI also administers a fund for SMEs, which provides financing to black owned and managed businesses and provides non-financial support to SMEs.

Different sectoral policies also address SMEs as the activities of SMEs cut across different sectors. The Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprises (ISPESE) informs policy on SME development, highlighting increasing financial and non-financial support, reducing regulatory constraints, improving the demand for

SME products and services. It also provides the framework of cooperation and integration of activities of institutions involved in SME development. In addition to ISPESE, the Broad-Based Black Economic Empowerment Act 53 of 2003 (B-BBEE) aims to improve the participation of black owned local enterprises in economic activities. Notably, section 2(e) of the Competition Act 89 of 1998 provides an objective to ensure that SMEs have an equitable opportunity to participate in the economy. The National Treasury also revised preferential procurement so that a percentage of state procurement be reserved for SMEs and cooperatives and SEDA supports SME participation in public procurement, for instance via the Black Business Supplier Development Programme and the National Informal Business Upliftment Strategy.

It is clear that SME development has been championed by different interventions, from access to finance, skills development, and infrastructure. However, the multiplicity of departments and sectoral policies has resulted in incoherence and ineffective coordination of departments and agencies. This was also highlighted in the Annual Review of Small Business and Cooperatives, which identified at least eight departments with activities that relate to SMEs<sup>6</sup>. The result is fragmentation and duplication of activities. Furthermore, implementation and follow up of the programmes are unsatisfactory, as most support services never reach the intended beneficiaries, and the agencies are sometimes under resourced.

Despite the support received from government, many SMEs fail as they lack knowledge about the market. Non-financial factors, such as an inability to conduct market research, low quality products and services and insufficient advertising, militate against them. This has a negative impact on the ability of SMEs to succeed. Among the identified marketing factors include poor product variety and branding. They are unable to adequately employ product branding, which can attract customers. In a study by Cant et al (2013), it was found that some SMEs were aware of the importance of branding, even though they lacked the resources to employ branding strategies<sup>7</sup>. They struggle to build a recognised brand name and establish a reputation among customers.

A brand name would be useful not only in creating an association of the products or services of SMEs, but also in distinguishing the products and services from others. In this context, using certification and collective marks for groups or associations of SMEs could help them overcome some of these market-related challenges. Clusters provide an ideal framework to use collective rights as they serve as catalysts for cooperation and collaboration and can support the standardisation of product quality. They foster opportunities for joint action and support effective use of limited financial resources, and SMEs benefit from specialised skills within the cluster,<sup>8</sup> thereby enhancing competitiveness.

## Recommendations

Given the market-related challenges that SMEs face and the fragmentation of SME support, several recommendations can be made to address these challenges<sup>9</sup>. It is crucial to approach this issue in a two-pronged manner – promote cluster development and facilitate the use of collective intellectual property rights – and both can be achieved through a revision of the SME policy. The DSBD ought to therefore revise the Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprises (ISPESE), firstly, to address both financial and non-financial support for SMEs and, secondly, to outline activities to foster industrial cluster growth and promote the use of certification and collective marks. The DSBD must implement a cluster development action plan, which identifies strategic industrial sectors and practical steps to using certification and collective marks. The DSBD must involve the other departments and agencies, such as the DTI, to develop a comprehensive SME policy. This will transform SMEs and enable them to effectively contribute to the growth of South Africa's economy.

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