Small Business Development, Entrepreneurship And Expanding The Business Sector In A Developing Economy: The Case Of South Africa

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Abstract

A dynamic small business sector can make an important contribution, not only in employment creation, but also in lessening concentration in South Africa's generally oligopolistic industrial structure. However, for the small business sector to make a meaningful contribution to the economy it needs to be integrated into the mainstream. This is going to require a concerted effort both from government and the formal private sector. The paper investigates how the South African private sector views small business and whether it is making a concerted effort at integrating this sector into the framework of the economy as a whole.

1. Introduction

The 1990s saw a remarkable shift in emphasis on the role of small business development within overall economic development strategies. In the past small-scale enterprises were defended on the basis of social reasons as a panacea for the unskilled, surplus labour in existence in developing countries. It provided income-earning opportunities for the informal sector. As such it was perceived as a marginal sector and integrating this sector into mainstream economic activity was considered unimportant. However, more recently it has been demonstrated that small-scale enterprises have a valid claim to greater importance and strategies have been developed world-wide to expand and integrate this sector (Steel, 1993).

This paper investigates how the South African private sector views small, medium and micro-enterprises (SMMEs) and whether it is making a serious effort at promoting this sector and integrating it into the framework of the mainstream economy. It is a qualitative study which combines a series of in-depth interviews with business organisations and chambers, and provides concrete case studies highlighting current business practices. Apartheid in South Africa created extreme distortions in the business world - big business isolating itself from SMMEs and white business isolating itself from black business. This study attempts to illustrate that destroying these mindsets not only makes for positive social development but also for good business practice.

2. Small business development: A theoretical and comparative perspective

The policy environment faced by SMMEs determines their capacity to contribute to the process of development. It is important therefore to identify possible policies that retard the growth of this sector, such as import licences that small firms find difficult to obtain. Market imperfections may constrain small firms' access to resources by failing in the area of financial intermediation, for instance (Steel, 1993: 39). To develop a conducive framework for SMMEs to thrive in, the government may have to correct such distortions and 'level the playing field'.

Readers with comments or questions are encouraged to contact the authors via email.

Governments worldwide have assisted SMMEs for various reasons. Rwigema and Karungu (1999: 111-112) and Harper (1984) maintain that these include propositions that:

- Small enterprises, broadly defined, have shown a remarkable capacity to absorb labour.
- Assistance to small enterprises displays sensitivity to poverty mitigation. Small enterprise promotion then becomes a political necessity.
- SMMEs are usually locally owned and controlled, and can strengthen the extended family and other social systems and cultural traditions.
- Indigenous people in South Africa have been prevented from playing their due role in the economy, and their first attempts are likely to be in SMMEs. Indigenous businesses are usually small, requiring various forms of assistance.
- The products of SMMEs tend to originate from indigenous craft traditions, and they are also more likely to satisfy the needs of poor people than are the products of large enterprises and foreign technology.
- Because the profits of small enterprises are not dependent on long production runs, small firms can manufacture smaller quantities of products which have a regional or even a local market. In poor communities, with less efficient communications, local differences in taste are far more pronounced, and only small enterprises can economically cater for them.
- SMMEs satisfy local needs not only by making differentiated products, but by also being scattered throughout the country. This ensures a more equitable distribution of employment opportunities.
- Local technology is more likely to use locally produced raw material and equipment, saving foreign exchange. When transport is expensive and internal communications are inefficient, there is merit in promoting local small units using local materials to satisfy local needs.
- Research in industrialised countries suggests that people working in small enterprises are happier in their work than those who work in large firms, despite generally lower wages and poorer working conditions (see Harper, 1984: 13).
- SMMEs provide a nursery and proving ground for entrepreneurship and innovation. They also provide a valuable outlet and proving ground for the entrepreneurial ambitions of government employees wishing to switch careers.
- SMMEs provide employment to, and sometimes exploit the entrepreneurial talents of, women. Particularly in rural areas, cottage industries or informal firms (sewing, knitting, food preparation etc) serve as a valuable source of income and personal development, as well as outside contacts, for the otherwise unemployed.
- SMMEs tend to use less capital, a scarce resource, than large firms. They also use less management, which is even scarcer.
- For the economy as a whole, Harper (1984: 16) argues that:
  'small businesses are likely to be more resilient to depression, and to offer a steadier level of employment than large ones; their activities and locations are diverse, they depend on a wide variety of sources and types of raw material, and their owners, if only for the want of any alternative, are likely to stay in business and maintain at least some activity and employment in conditions where foreign investors... would have closed their factories...'
- Comparative studies of large and small businesses, carried out in countries at all stages of development, confirm that small firms generally employ more labour per unit of capital, and require less capital per unit of output, than do large ones (Harper, 1984: 16).

Small businesses typically complain that shortage of capital is their major problem and that this impacts their ability to invest in a particular asset, whether it be raw material, equipment, customer credit or finished products. Another issue often raised is deficient demand (Harper, 1984: 26). In South Africa, government has attempted to attend to the first issue of finance through organisations such as Khula Enterprise Finance Ltd. The latter issue of ineffective demand is perhaps a more serious problem which the government has attempted to address through its procurement strategy. Inadequate demand arises from inadequate access, disadvantages of scale, and lack of skill and initiative in marketing; and here assistance programmes can try to fill these gaps. Hence, the establishment of Ntsika Enterprise Promotion Agency by government, which seeks to address access to markets, training, technology, information, counselling and infrastructure. The private sector has a more important role to play in addressing SMMEs' inadequate demand problems by promoting complementarity between small and large firms. Steel (1993: 41) points out that in some Asian countries (e.g. Taiwan) with well-developed urban industrial and financial systems, small enterprises have benefited from subcontracting arrangements with larger firms and as a result have gained easier access to finance. To ensure that such arrangements are mutually beneficial it is vital to avoid policies that favour imported inputs and in ensuring that the tax system does not penalise inter-firm transactions. Direct interventions, such as India's policy of reserving certain products for small enterprises, may be counterproductive if they protect expensive, low quality goods.

In South Africa, years of capital controls made it difficult for South African companies to invest abroad and the result was that it generated vertical and horizontal integration by South African firms. Hence the oligopolistic nature of the economy. Large firms faced no incentive to subcontract to small firms because surplus funds could be used to produce non-core activities in-house. With the lifting of capital controls it is likely that large firms will increasingly shed non-core activities through subcontracting and outsourcing and that this will stimulate small business development. Likewise, recent labour legislation aimed at the larger firms may result in raising the costs of size and may foster subcontracting.

3. SMMEs in South Africa

The National Small Business Act of 1996 classifies small businesses into four categories: micro, which includes survivalist enterprises; very small; small; and medium. Ntsika (1997) estimates that in 1995 the overall contribution to the total GDP was 20.8% for small enterprises, 11.9% for medium enterprises, and 67.3% for large enterprises. As regards contribution to formal employment it was estimated at 29.5% for small enterprises, 15.3% for medium enterprises, and 55.2% for large enterprises. In 1995, there were an estimated 591,000 self-employed and employers with a turnover less than the VAT limit of R150,000.[i] Approximately 200,000 of these enterprises should be considered as survivalist, since their turnover is less than R1000 per month. These enterprises have largely been created as a basic source of income by the unemployed. An additional 400,000 enterprises are micro-enterprises, of which approximately 137,000 employ at least one employee. Of the total estimated private sector enterprises in 1995, 23.3% were survivalist, 31% micro (with no employees), 16.4% micro (1-4 employees), 19.7% very small, 7.6% small, 1.4% medium, and 0.7% large. However, the distribution of private sector employment reveals an entirely different picture: large enterprises employ 39.3%, medium 13.8%, small 19.9%, very small 13.3%, micro (1-4 employees) 6.8%, micro (no employees) 3.9%, and survivalist 3% of the workforce.

The small business sector in South Africa has the potential to contribute to job creation and economic growth, whilst at the same time redressing historical imbalances and increasing black economic participation. Ntsika (1997: 28) warns that 'the current state of economic participation of black entrepreneurs is of great concern'. It estimates that only about 1.4% of the African population are entrepreneurs compared with 7.5% among whites. The highest percentage of involvement by the black population is in the survivalist class where returns are very low and limited value is added to the economy. As the size of the enterprise increases, the percentage of black entrepreneurship decreases substantially. Blacks make up 86% of survivalist enterprises, 64% of micro-enterprises (no employees), 40% of micro-enterprises (1-4 employees), and only 29% of very small enterprises. Ntsika (1997: 28) states that there 'does not appear to be any meaningful "weaning" of successful black entrepreneurs from low to high enterprise levels'.

A major World Bank survey (2000) of SMMEs in Johannesburg reveals several interesting facts with national relevance which informs this study:

- The most important constraints faced by SMMEs are insufficient demand (primary constraint), cost of capital, crime, and infrastructure.
- Of concern is the fact that almost 60% of SMMEs reduced their employment between 1997 and 1999. When asked what the necessary conditions for the addition of 10 employees was, SMMEs responded as follows in order of importance: increase in demand, increased business visibility, fall in the interest rates, government promotion of SMMEs, more contracts from government and large businesses, fall in real wage, increased exports, cheaper imports, and a decline in foreign competition. Insufficient demand was again the primary reason given for their lack of expansion, followed by a lack of access to capital.
- Policy stability, lower interest rates, education and training, promotion of SMMEs in public services, flexible wages, and business information were cited, in that order, as the main ways in which the central au-

thorities can help SMME growth. In the case of local government, the main methods of assistance were safety and security, infrastructure, ethical local officials, public transport, the improved attitude of local officials, and investment support.
- SMMEs made extensive use of temporary workers with 90% citing flexibility to expand or contract as their primary motivation for this.
- SMMEs engaged in manufacturing, IT and tourism complained about the difficulty of finding skilled or semi-skilled labour .
- Government procurement seemed to have a very limited impact with just over 10% of the firms surveyed having been awarded a government contract. The average time taken in preparing a submission for a government contract was 3.1 months and the ratio of successes versus failures in terms of contracts submitted was just over 3:1.
- SMMEs had very little knowledge of DTI (Department of Trade and Industry) promotion programmes whilst other local and national government promotion programmes had a higher awareness. Start-up capital was primarily sourced from individual and family savings with bank loans playing a very subordinate role. More than 50% of SMMEs surveyed had not used formal bank loans in the past five years.

The issue which came out time and again in the World Bank study is the lack of linkages that exist between large and small businesses and hence this paper's focus.

4. The role of business in the development of SMMEs in South Africa

Big business can act as a powerful stimulus for the SMME sector by providing a real and steady source of demand. However, companies may have to work closely with the SMMEs to ensure that the product they produce is of the necessary quality and that delivery targets are met. The advantage of this approach is that it also creates a positive externality in that the SMMEs benefit through skills transfers. Tendler (1994) argues that limitations currently exist as regards this approach in South Africa:

- The corporate sector is not really interested in outsourcing notwithstanding knowledge of international experience;
- Links that do exist are merely 'cosmetic' to look politically correct;
- The subcontracting relationships which exist have a monopsonistic element to them leading to dependence.

This study finds that these limitations have been exaggerated. Almost all of the companies examined saw real commercial opportunities in outsourcing and nothing cosmetic was apparent. Likewise, no real evidence of monopsonistic relationships was evident (with the possible exception of the state, which through its late payment was holding companies financially hostage). However, outsourcing in South Africa is still very much in its infancy and many opportunities still exist for outsourcing. South African companies appear to be slow in adapting their practices to reap the benefits of links with SMMEs. Section 4.1 outlines the linkage programmes of a number of companies and business chambers.

4.1 Linkage programmes

Anglo/De Beers[ii] Small Business Initiative

In 1989 Anglo and De Beers established their Small and Medium Enterprise Initiative (SMEI) to formalise and dramatically expand their links with SMMEs. This represents one of the first such initiatives in South Africa. In its first 10 years, the cumulative value of business placed through the SMEI amounted to roughly R1 billion. In the 1995/96 financial year, the SMEI facilitated business transactions with a value of R200 million for 185 emerging businesses employing 3298 people (Sikhakane, 1997: 8). The SMEI consists of about a half dozen consultants who scour Anglo/De Beers's centralised purchasing function to identify possible areas of business which can potentially be better performed by SMMEs. In July 1998 the Anglo/De Beers SMEI was split up with Anglo, De Beers and Anglogold each setting up their own initiatives along similar lines.

The establishment of the SMEI was aimed at the formalisation and drastic expansion of Anglo and De Beers links with SMMEs. Their interest in this area was based on the Pacific Rim phenomenon of the dual economy, wherein business is characterised by complex, yet efficient strings of suppliers of goods and services competing fiercely for the custom of large corporations, which in turn are kept lean and efficient (Sikhakane, 1997: 8). The SMEI is not a non-profit organisation and the economic empowerment of the previously disadvantaged is not its primary focus. However, it is expected that the previously disadvantaged hold either a majority or equal stake in the business before the SMEI will become involved.

It works as follows: The SMEI takes an equity stake of not more than 20%, expecting to be bought out by the entrepreneur within two to three years based on an independent auditor's commercial evaluation of their stake. Although the SMEI only holds a minority stake, consensus must be reached on all agreements. The SMEI makes its income in three ways, namely through dividends, through the sale of their shares on a commercial basis, as well as charging a small management fee. The SMEI will only get involved with an entrepreneur if he/she takes a stake in the business venture from the outset. The entrepreneur must have something to lose. The amount invested by the entrepreneur may be matched by the SMEI even though its equity stake will not exceed 20%. The SMEI will also provide loan financing of up to R250,000 at commercial interest rates. The collateral requirements are fairly flexible and not as strict as that of commercial banks.

The SMEI receive a large number of requests for assistance by mail but these by and large are not viable or do not interest the SMEI. Generally the SMEI will identify opportunities first and will then attempt to find suitable entrepreneurs. Often if Anglo/De Beers wish to outsource or privatise a function they will first approach those currently employed as potential entrepreneurs before looking elsewhere. Interestingly the SMEI have invested in entrepreneurs whose activities are not directly linked to those of Anglo/De Beers. As such, the SMEI moves beyond the realm of outsourcing to becoming a minor Small Business Development Corporation. Their aim is to be a profit-making centre.

The SMEI has three foci: the investment arm in new business, facilitation in businesses in which it will not become directly involved via investment but will provide assistance and advice, and contracting and purchasing where they make use of existing businesses and introduce them to Anglo/De Beers for possible outsourcing. The SMEI are aware of the dangers of monopsonistic-type relationships with the SMMEs they create and thus discourage entrepreneurs to be solely dependent upon Anglo/De Beers as clients. As such, they do not require these entrepreneurs to work exclusively for Anglo/De Beers.

The SMEI has involved itself in a range of activities with tremendous results. Examples include, Simunye Engineering Services which cleans and refurbishes a wide range of opencast mining equipment. This company was formed in 1991 by an unemployed dragline cleaner and a retired foreman with the help of the SMEI and a start-up capital of R54,000 and which is now a multi-million rand enterprise. Stimela Rail, which maintains 120 kilometres of railway lines for Amcoal; Eland Bricks, which produces 200,000 bricks per month for housing construction and 30,000 to 40,000 specialised underground support bricks; Ceza Conveyor Services, which maintains and repairs the kilometres of conveyor belts connecting Amcoal's five collieries near Witbank to its Rapid Loading Terminal in Richard's Bay; Duswan Services, which recovers lifting tackle from mine scrap heaps, refurbish and restore the equipment and sell it back to the mines - a turnover well in excess of R1 million annually and with significant savings to the mine; and Reef Food Services, formed with a capital of R89,000 in 1990 and with a return of in excess of R80 million for the year ending March 1997 (Sikhakane, 1997: 9-18).

Evaluation: The Anglo/De Beers SMEI is generally a success story which shows the potential for establishing links between big and small business, although they had their share of failures too. Their decade-long involvement with SMMEs, with investments totalling R1 billion, has resulted in Anglo/De Beers shedding a number of their non-core activities (thereby improving efficiency) in the process of creating SMMEs and has turned this unit into a profit-generating centre. It shows that such links can be profitable for both partners. The experiences of this initiative should, however, be more widely shared as it has the potential to stimulate similar endeavours by other large corporations. The SMEI have no fixed formula for identifying successful entrepreneurs. Whilst a basic level of literacy is obviously a necessity, a higher level of education is not a requirement. Rather the SMEI consultants watch out for four warning signs: a) a reluctance to contribute start-up cash (not necessarily very much in absolute terms but an amount the entrepreneur would be loath to lose); b) an unproven ability and aptitude for hard work; c) a record of dishonesty; and; d) unrealistic expectations of quick wealth (Sikhakane, 1997: 12).

Xerox

Xerox South Africa forms part of Fintech Limited which in turn falls under the Altron umbrella. Fintech holds a 50% stake in Xerox SA with the other 50% equity being held by Xerox Ltd (UK). In 1991 Xerox, in an attempt to increase its market share, adopted a strategy that seeked to incorporate the best elements of franchising and agencies into its concessionaires programme. The concept has proven successful elsewhere, with Xerox doubling its market share in the United Kingdom in five years.

The concessionaire programme works as follows: In June 1998 Xerox advertised nationally for potential entrepreneurs. Over 170 responses were received with 65 candidates being interviewed. An induction day was held to explain the programme and the candidates were asked to draw up a business plan. As a result, 11 concessionaires were signed up, 3 from historically disadvantaged backgrounds. The condition was that these entrepreneurs had to possess some previous business experience. In addition, Xerox was looking for entrepreneurs with vision, an appropriate strategy, and a viable business plan. These concessionaires are granted an exclusive area, a vast product range, Xerox back-up, and Xerox training. Xerox regards the concessionaire programme as a joint-venture with potential entrepreneurs. The advantage for Xerox is that they get to expand their sales force and thereby market share whilst not carrying the entire overhead. The concessionaires are required to be made up of at least 3 sales representatives. The experience in the United Kingdom is that many will grow to a sales force of between 35 to 45 people. The concessionaires themselves are aimed at targeting smaller businesses (with less than 100 employees).

The concessionaires operate as sales organisations. They secure orders and place them with Xerox, which will then process the orders and ensure their delivery. The concessionaires do not therefore have to purchase the equipment themselves. They are awarded dealer prices and are free to work out there own margins as long as these do not exceed the recommended prices. A service agreement must be sold with every machine sold, but Xerox will pay an annuity for every such contract they bring in. Various incentive schemes are in place to reward sales, such as rebates based on their level of purchases. Xerox will loan up to 50% of initial funding (total start-up cost is anticipated at R100,000 - significantly lower than franchise agreements). Xerox also provides a comprehensive and continuous training programme on various facets of the business: Xerox processes, product training, human resource and sales training. For each concessionaire, a Xerox director will be appointed to their board purely on an advisory basis. These Xerox people will be appointed to compensate for areas in which the entrepreneur may be lacking in skill.

Xerox Facilities Management (XFM): Xerox is a major player in the area of outsourcing through its facilities management. Printing is a non-core activity for most companies but it is the core activity for Xerox. As such it is involved in the area of taking over print-rooms of large corporations. Employees in these corporate print rooms have no scope for career advancement given that it is a non-core activity. But once Xerox takes over these print-rooms it will identify, train and develop employees since this is a Xerox core area. It will also remunerate employees on a profit share scheme which in turn encourages productivity. Examples were cited of operators at copy centres becoming site managers at some XFM centres. Xerox is thus in a better position to stimulate affirmative action on the output side of the IT industry as it is better able to identify black entrepreneurs in this sector. Xerox will also consider potential joint-venture companies with existing staff (with a distinct black focus), although this does carry a normal business risk for the staff.

Evaluation: The concessionaire programme is innovative and holds much potential for other South African businesses. It has the advantage that it requires no royalty or franchise fees to be paid by entrepreneurs and thus makes it more accessible to small businesses. These entrepreneurs gain access to Xerox international technology and investment in R&D (which exceeded R10 billion for 1997). They indirectly become part of a multinational corporation whose revenue exceeded R110 billion for 1997. They gain access to Xerox training and sales skills and are able to free ride on its marketing strategy. A drawback is that real equity is not acquired by the entrepreneur. The XFM programme brings outsourcing to the fore and has potential spin-offs in the realm of black economic empowerment through joint-venture companies.

Company X: Construction and procurement

Company X chose to remain anonymous as it relies on government for 90% of its business. It is a medium-sized construction company, currently employing up to 250 people, and operates in the central regions of South Africa. It was established in the mid 1960s by the current Managing Director as a one-man operation. At that stage, most of its work came from subcontracting from larger companies, and its success thus illustrates the potential of the SMME sector. The irony is that it is now outsourcing a large part of its business to newer SMMEs.

Company X, however, illustrates the dangers of government procurement strategies. This historically white company relies very heavily on government procurement. However, as a result of government procurement policy it has had to find ‘innovative’ ways of circumventing these regulations. As a result its board of directors was recently expanded from one to eight. Besides the existing director (who maintains 60% control), he has added three female family members, as well as four black directors. But these four black directors (who were and are his employees) have no real say in the running of the business, earn no profits and are barely aware of their position. He did this so as to maintain his relationship with government which requires joint-ventures with the historically disadvantaged. As a result Company X has secured a steady stream of government business. Not once has this company provided the lowest bid on tenders and yet it has won the tenders because of its ‘favourable’ composition. The Managing Director pointed out that almost all his competitors have done likewise. He complained that the tender process was rife with nepotism and corruption.

On a recently won R6 million tender (on which this company was not the lowest bidder), the bid required that they subcontract 30-35% of the contract. They have thus subcontracted R2.1 million worth of business. The Managing Director maintained that he was not overly unhappy about being forced to subcontract but pointed out that he had had some problems in the past. A small company that he subcontracted to did not pay the necessary tax and as a result Inland Revenue demanded payment from Company X. The law does not permit Company X to deduct tax from the subcontractors. Also he has taken on subcontractors in the past who proved to be incompetent and now he ensures that they are first put on a probation period. He states that subcontracting has its benefits as they are often cheaper because they do not comply with government regulations such as labour legislation. This company has subcontracted various parts of its business, including brick-laying, plastering, carpentry, plumbing, painting, glazing and metal-work. Unions have not been happy with the subcontracting arrangements because it excludes their members.

As regards government policies, the company maintains that it has always subcontracted and would do so even if the government regulations were not in place. However, the Managing Director pointed out that government policies aimed at promoting SMMEs were futile and contradictory. For example, government has been slow in paying for work done (often taking up until five months to pay). This medium-sized company can only barely manage this delay but it would certainly bankrupt a small enterprise.

Evaluation: Government procurement strategy has often resulted in companies finding a quick-fix solution to ensure access to government work. This is not a healthy state of affairs. This company has created a dummy board to circumvent government regulations. As a result its business is booming and yet its previous practice was not a detrimental one, in that workers have enjoyed profit-related bonuses, labour relations have been good, and it has always subcontracted voluntarily. Also, it was apparent that it did have good historical links with SMMEs.

South African Breweries

The South African Breweries Beer Division's (SAB) commercial equity programme seeks to engage or create enterprises that are owned and/or controlled and operated by people from historically disadvantaged backgrounds in sustainable and mutually beneficial relationships. The objective was to transform SAB’s supplier base so as to better reflect the realities of South African demographics and thereby to spread the benefits of dealing with SAB more equitably. Until recently, 90% of SAB’s suppliers were white whilst 85% of its customers were black. This situation was clearly untenable in the new political dispensation and SAB has thus tried to reposition itself to exploit the opportunities that are currently available.

SAB believes that there are two areas that are important in the arena of black economic empowerment, namely equity access (ownership of the means of production), and operational management (skills transfer). SAB's commitment to black economic empowerment is based upon the following premises:

- it must make commercial sense;
- it needs to show that large companies can be good for socio-economic upliftment;
- it will expand the supplier base;
- it has social and moral ramifications.

SAB has examined its value chain looking for every conceivable opportunity to promote affirmative outsourcing. It has tried to ensure that black firms are made part of every aspect of the SAB value chain without compromising quality, service or cost effectiveness. The intention is to move beyond SAB's traditional small business ventures in shebeens and taverns, which dates back to the 1960s where it was involved with efforts to bring about deregulation of the black liquor industry. In the 1980s its Customer Development Programmes assisted shebeens and taverns in obtaining licences and provided them with business management skills. SAB now wants to engage in real value-added activities and the economic mainstream. SAB encourages joint-ventures to make use of white skills and black potential. It has redirected business opportunities to such firms. Likewise, SAB expects its suppliers to do the same and thus stimulate a second tier of affirmative outsourcing. However, SAB does not undertake any evaluation of their suppliers and does not place them under any legal compulsion. It simply encourages them. SAB does not take an equity stake in any of these SMMEs but makes the business opportunities available to them. It identifies these opportunities and then looks for suitable suppliers. SAB prefers the previously disadvantaged to have at least a 50% share although a smaller equity may be acceptable if the deal is really large. This it terms 'affirmative procurement'. Examples include:

- Thuthuka Packaging (Pty) Ltd, which was formed in August 1997, and is 51% owned by three black consortia, which prints the labels for beer bottles. The white partners are able to provide indispensable technical expertise because they have been in this business for many years. Thuthuka has won a contract for the printing of one billion labels during the 1999 financial year. This substantial order has enabled it to borrow from a large commercial bank to purchase its own R6 million printing machinery.
- Seekers-Lesedi travel agency was established in April 1998 through a 50:50 partnership between Seekers (a pre-existing, reputable travel agency) and David Malakalaka. SAB had put out a tender for its travel business but made it known that it would only consider doing business with a company with a minimum 50% owned by the previously disadvantaged and who will actively be involved with the day-to-day business. Malakalaka, who has a background in the travel business, was approached by Seekers for this joint-venture. It now operates in-house from Beer Division's offices with 7 consultants.
- Uptrend Business Solutions have established an in-house stationery shop at SAB but have retained their profitable retail store in the Johannesburg CBD. The company now intends to replicate this recipe with other blue-chip companies and establish in-house stationery stores. Uptrend now caters for both office automation (fax machines, copiers, PCs etc) and stationery supplies.
- SAB has put in place various support systems to assist black farmers in the growing of barley, essential for beer production. 56 black farmers have already planted barley on a commercial basis this season. Most black farmers have plots of around 10 hectares and should be able to produce 5.5 tons of barley per hectare. SAB provided expert technical advice and worked with the local agricultural bank to extend credit facilities to black farmers (Enterprise, 1998: 111).

SAB's commercial equity programme has its roots in the owner-driver scheme which was launched in 1987. SAB believed that the delivery side had outsourcing potential, but instead of looking outside the company, it realised that it already possessed a fleet of trucks and had existing drivers who had the necessary skills and understood SAB's customer service ethos. However, they did not possess the necessary entrepreneurial skills. SAB thus undertook to support and train them in the area of business management including book-keeping, income tax and legal requirements, cash flow arrangements, and industrial relations. Phase 1 entailed the loaning of the trucks to the participating drivers who became responsible for the operating costs of the trucks. SAB agreed to pay them a delivery rate per kilometre travelled and cases delivered. Those drivers who were successful moved to phase 2 where SAB took back the trucks, entering into long term five year contracts. This enabled the drivers to enter negotiations with finance houses to raise over R500,000 necessary to buy the trucks from SAB. It assisted the drivers in arranging finance with finance houses.

Finance houses proved to be willing to assist given the long term nature of the drivers' contracts which would allow them to service the debt. Presently more than 60% of delivery occurs through the owner-driver scheme.

SAB assists previously disadvantaged entrepreneurs by helping them with the government tendering process, arranging up-front payment where working capital is proving problematic, facilitating finance from third party institutions for capital expenditure, offering technical assistance, and helping with the acquisition of raw materials at better prices. The SAB programme does not use a complicated tender document system, but rather calls for basic quotes, which are thus accessible to SMMEs. SAB's experiences with SMMEs has been mixed. However, they have gone into this arrangement expecting as much. Some SMMEs have delivered wonderful service and others less than satisfactory. But SAB has adapted its way of doing business to try and accommodate them - it is 'not business as usual' when dealing with SMMEs and it may require a more hands-on approach. Traditional business practices do not necessarily work. Payment terms have to be reviewed. SMMEs cannot afford payment over protracted periods and SAB has accommodated them through a cash on delivery payment system. SMMEs do not have warehouses and as such business has to change the way it makes orders. Instead of making huge orders infrequently, it may require smaller orders more regularly. The lack of black suppliers in many areas was cited as a problem that SAB has encountered. SAB is presently building corporate linkages with other big businesses so as to share experiences and build up a common database of potential black suppliers. Through the Corporate Sector Development Forum (comprised of about 20 large companies) they share information and are building up a common database which will be made available over the Internet.

In the financial year ending March 1998, Beer Division's spending on commercial equity arrangements totalled R264 million, up 29% on the previous year. The company spent R147 million on sales and distribution (167 owner-drivers), R15 million on office and site services (security, cleaning, gardening), R11 million on catering, R11 million on packaging materials, R10 million on the creative disposal of by-products, R8 million on printing, R7 million on travel, and R12 million on maintenance of equipment (Enterprise, 1998: 110).

Evaluation: SAB's commercial equity programme has stimulated SMME development in innovative ways. It has cost SAB relatively little as they have insisted that they will not pay a premium or accept lower quality. SAB's programme really only makes the opportunities available and then searches for potential entrepreneurs. In the process SAB has shed its non-core activities which is in line with current international business practice. The SAB programme is one which other South African firms could quite easily adopt as it requires little investment from the company.

Barlows Limited[iii]

Barlows has a number of programmes in place to assist the development of the entrepreneurial class. However, as far as affirmative procurement is involved, this is rather limited given the specialised and highly technical nature of Barlow's business. In addition, Barlow's decentralised system makes it difficult to implement and enforce an affirmative procurement strategy. As such, outsourcing is minimal.

A rather interesting programme called the 'Emerging Contractor Programme' has been in operation since 1995 and is organised by the Barlow Equipment Company. Barlows has approached some of its traditional customers and advised them on the advantages of encouraging their employees to work independently as contractors. These entrepreneurs then receive assistance from Barlows to get their business started. Barlows provides them with financing through a repayment package to purchase the equipment (earthmoving equipment costs around R750,000). Unlike commercial banks, Barlows is willing to look beyond collateral and be more innovative. They are provided with administrative support, 24 hour maintenance facilities, tendering advice, and training. More importantly, the Emerging Contractor Programme identifies and establishes businesses with which these entrepreneurs can do business with and negotiates long term contracts for them (18 -36 months). Thus far, 36 entrepreneurs have been assisted in this way. Barlows has an almost perfect record with no repossessions and most of them are now buying their third or fourth machine. Whilst certain companies were initially reluctant to do work with outside contractors, the Barlows backing and the successful existing cases, have encouraged firms to give the programme a try. The advantages to companies include writing equipment off their books, improved delivery times and increased productivity. Barlows gains by widening its client base. Another programme has just been started which is aimed at entrepreneurs in the construction industry and is directed at public sector contracts through the Public Works Department. These programmes are all built around

Barlow's core businesses and rely on sustainable practice. Barlows insists that these entrepreneurs must be able to support themselves independently of Barlows after the initial paternalistic relationship is concluded.

Evaluation: The only major Barlows programme (the Emerging Contractor Programme) is innovative and allows blacks to penetrate areas they would traditionally not have access to. Barlows provides them with comprehensive back-up. An area that needs to be pursued, however, is the still underdeveloped domain of procurement where unexplored opportunities exist.

NAFCOC[iv] Initiative: Business Linkages for Under-utilised Enterprises (BLUE)

BLUE is a USAID funded project established in 1995 in a co-operative agreement with the National Industrial Council, an affiliate of NAFCOC. The BLUE project aims to increase, significantly and sustainably, the business done between large buyers and small suppliers, as its contribution towards normalising South Africa's economic structures. The project's purpose is to assist in structuring commercially viable long-term relationships between big business and the government, and supply firms owned or run by historically disadvantaged entrepreneurs. Up until February 1998 contracts worth R105.8 million had been secured.

The Blue project has two components:

- Business and technical advisory services which includes training;
- Subgrants Contracts and Assistance Fund which fund the Business Information and Advisory Centres (BIACs)

The BLUE project is committed to business education and training which forms the cornerstone of sustainable business success and provides such training in the following areas:

- Obtaining government tender business
- Labour relations
- The General Law of Contract and Public Tender Contracts
- Statutory Obligations
- Cost estimating and product pricing
- Purchasing and inventory control
- Improved productivity
- Production planning and control

Obtaining tender business represents a significant opportunity for SMMEs and this course has proven to be exceptionally popular. By December 1997, entrepreneurs who attended the Tender workshops had secured contracts worth over R9 million. BLUE has also assisted in funding certain clients to achieve ISO 9000 accreditation, resulting in contracts worth R1 million being awarded to them.

The BIACs provide crucial connectivity and back-up, with readily available support, to encourage and develop business linkages between previously disadvantaged SMMEs and large companies, parastatals and government departments. The activities of BLUE are decentralised, as entrepreneurs and affirmative procurement opportunities exist throughout the country.

The BLUE project has more than met the initial targets it set, as is outlined in the table on the next page based upon its published documentation.

As is illustrated in Table 1, BLUE by February 1998 had exceeded the targets set for the project up until September 1998 in every category.

BLUE does not involve itself in business start-ups but instead focuses on the development of existing SMMEs with a minimum monthly turnover of R7500 per month. The aim of BLUE is not to encourage handouts from big business but rather to create a situation in which everyone wins. It will only act as a go-between big business and emerging black business if it feels it can guarantee quality and service. In order to be placed on BLUE's database, the applicant must first fill out a form detailing the nature of business, background, turnover, and list its major clients for reference purpose.

Table 1 – BLUE's targets versus its achievements, 1995-1998

	Achieved to Feb '98	Target to Sept '98
Value of contracts secured by historically disadvantaged suppliers	105 886 912	15 000 000
Number of contracts secured	698	200
Number of suppliers participating	231	50
Number of large buyers purchasing	222	20
Number of training modules developed and tested	10	6
Number of training sessions and workshops	164	30
Number of entrepreneurs reached	4 126	1 000

Evaluation: The BLUE project is to be commended. It exceeded its mandate and forged necessary links between big and small businesses on a commercial basis. Unfortunately, due to lack of funding it was shut down at the end of September 1998. Attempts to secure funding from government agencies failed and one must question government thinking in this regard. BLUE had an established track record and instead government seeks to duplicate its efforts in a terrain better served by the private sector itself.

Get Ahead Foundation

The Foundation was formed in 1984 as a development agency involved with schooling, community health and the like. In 1987 it decided to become involved in micro-lending. It relies on overseas donors (particularly the Kellogg and Ford Foundations and USAID) for most of its funding. It has two foci: the first being as a financier of small and micro-enterprises (Get Ahead Financial Systems) and the second related to development and training (Get Ahead Development). However, it encompasses a much more multi-faceted approach including an incremental housing loan scheme, technical training in welding and panel beating, the formation of business associations, marketing for small-scale industry products, winter school programmes, job creation projects including a car wash and aluminum can collection, a primary health care project, capacity building with community-based organizations, and a commercial partnership programme that offers informal retailers a short-term line of credit through private sector wholesalers (see Churchill, 1995).

Its lending arm is focused on the micro/survivalist enterprises and is based on the Stokvel concept of group lending. Eligibility for Get Ahead Foundation assistance is based on the following criteria:

- They finance income generating business activities;
- Borrowers must be permanent residents with valid identity documents;
- Stokvel members cannot be from the same family;
- Borrowers must be in business for at least six months before they can borrow from Get Ahead;
- Borrowers must have the capacity to enter into legal contracts.

As already mentioned, the Foundation provides financing on the basis of group lending. As such it does not require any collateral but holds all the members responsible for the debt and works on the principle of peer pressure to recover its loans. Loans are issued to micro-entrepreneurs in self-selected groups of five to ten members who are responsible for guaranteeing each other's portion of the loan. Its recovery rate stands at over 90%. Its recovery rates are this high because its geographical spread is so thin (only Soweto residents in this case) and because of its reliance on joint and several liability. Financing starts from as little as R100 to as high as R30,000 although one has to graduate through the repayment of smaller loans to qualify. Get Ahead keeps in close contact with its entrepreneurs providing advice and monitoring their activities. It provides training internally on various aspects of business including general administration and book-keeping. They undertake no credit checks but merely verify the relationships of the applicants to one another, ensuring they know and trust each other. Loans are made to enterprises that have been in business for at least six months and are charged a simple interest rate of 15% over four months. Presently, 11% of its lending is in manufacturing, 3% in services, and the remainder in retail.

Whilst most of their customers remain at survivalist level, the Foundation has had some phenomenal success stories. A sewing enterprise, which was started in 1964, approached the Foundation for finance in 1987 because he was unable to access loans anywhere else. Through a series of loans the enterprise expanded and has now outgrown Get Ahead. He currently has assets exceeding R500,000 and now trains over 300 students annually in sewing and dress-making. Another such case is a bumper manufacturer started in 1990 by a young unemployed man. His first loan from the Foundation was granted in 1991 and has also outgrown Get Ahead. He now has some contracts to refurbish bumpers for big business.

The Foundation maintains the main impediments to SMME growth lies not on the supply side (although training and finance remain problematic) but rather on the demand side (secure customer base, access to markets and tenders). This is where business has an important role to feed into the system. They opined that big business was not interested in establishing links with SMMEs. They had attempted to contact large companies (including clothing stores and car-part manufacturers) but to no avail. Big business was concerned that SMMEs could not guarantee quality not meet delivery targets. However, Get Ahead has some innovative SMMEs on its books that would be in a position to link into business systems.

A study by Churchill (1995) found that between 1988 and 1994, Get Ahead's Stokvel Programme issued R13 million in loans to nearly 24,000 micro-entrepreneurs. The study compared Get Ahead borrowers to a control group of prospective borrowers. It found that Get Ahead loans make a significant contribution. Profit growth with borrowers is almost twice that of the control group, and employment growth 86% higher. Likewise, it found that the loans have a direct bearing on quality of life.

Evaluation: The Get Ahead Foundation focuses only on small and micro-enterprises. It is innovative and it works. Its recovery rate is excellent and it has made a meaningful contribution to its community. Its efforts could be put to better use if business found a way of tapping into this resource. A way should be found to accredit these small and micro-enterprises to deal with the problems of adverse selection and asymmetric information problems encountered by big business when dealing with this sector.

5. Thematic synthesis

The South African economy is currently undergoing a period of structural adjustment as a result of South Africa re-entering the global economy after the sanctions era. This period of liberalization may have profound effects on the nature of the economy. The relaxation of capital controls, for example, should result in the corporate sector shedding its non-core activities because foreign avenues will be available for surplus capital. This should affect the SMME sector in a positive manner as they stand to gain from outsourcing arrangements. The labour legislation, which is particularly unfriendly towards big business, may also result in further outsourcing. But South African firms are behind their international counterparts in this respect[v]. Everyone interviewed in this study agreed that outsourcing is still in its infancy in South Africa and that many opportunities exist for South African firms to take advantage of. South African firms are riddled with non-core activities as a result of past practices.

This study, however, highlighted some innovative practices undertaken by big business in South Africa so as to foster SMME development and black economic empowerment. Almost all of these programmes were commercially based although socio-political reasons seemed to underlie many of them. Interestingly, the firms that had adopted links for social responsibility reasons have learned that it is in fact cost effective and efficient to do so. Programmes ranged from SAB's procurement outsourcing, Xerox's concessionaire programme as an alternative to franchising, and Anglo/De Beers's highly profitable small business initiative which has moved beyond procurement and created joint-ventures. Almost all these programmes rely on financial statements as their primary means of evaluation. Xerox will evaluate the success of the programme by gains in market share, Company X is primarily concerned with fulfilling government tender requirements, Anglo/De Beers measures its success through returns on investments, and Barlows through increased sales.

The length of the contracts awarded to SMMEs varied widely. Company X outsourced only particular functions to SMMEs (be it painting, plumbing etc.) and as such the contracts were of a very temporary nature although they were used frequently. Barlow's Emerging Contractor Programme has a contract length of 18-36 months which is intended to provide the SMMEs with a more stable revenue and thus facilitate repayment of loans. The SMEI expects to be bought out within two to three years. SAB makes use of a number of contract lengths. The owner-driver scheme makes use of five year contracts, Lesedi was awarded a three year contract, whilst Uptrend has an open-ended contract. It would appear that longer contracts are more successful in assisting SMMEs for two main reasons: firstly, SMMEs find it easier to negotiate with finance houses once they have been awarded long contracts as these provide a guarantee of repayment, and secondly, SMMEs face steep learning curves and are unlikely to prove successful immediately. They require more nurture and assistance in the short run and longer contracts facilitate this.

Almost all the interviewees felt that although government was attempting to address the development of the SMME sector through bodies such as Khula and Ntsika that its efforts were often misguided and that government was suffering from real capacity constraints. Khula was criticized for relying too heavily on commercial banks as intermediaries, whilst Ntsika's system of accrediting training institutes was also criticized. Many argued that government was part of the problem. Its tendering system is complicated and often inaccessible to SMMEs. Additionally, government has become infamous as a late payer which places huge burdens on companies; SMMEs in particular cannot cope with such a situation. The irony is that whilst government is spending vast quantities of money in trying to stimulate the SMME sector, it may also responsible for their demise through its payment record. Government labour legislation was seen as an additional impediment because it has raised the cost of employment, by expanding the Basic Conditions of Services for example.

The SMME sector was seen to be facing major obstacles and challenges. These can be classified under seven headings:

- Finance - It was generally felt that this is an area which has been significantly addressed and that it has become less of a problem. However, it remains an obstacle and commercial banks were singled out as being far too conservative and risk averse in their lending which, in turn, negated Khula's efforts.
- Labour - Labour legislation was criticised repeatedly for raising the costs associated with employment. Complying with tougher labour laws was a costly exercise. Small and micro-enterprises rely heavily on informal labour contracts so as to keep costs down and this was being challenged by new laws. The SMME sector find it difficult to attract skilled labour and the cost of unskilled labour was seen as too high.
- Trade - Although South Africa has seen significant deregulation in the past decade, some felt that overregulation was still an issue and that licensing, health and safety laws and the like needed to be relaxed.
- Tax - The complexity of the tax system raised the cost of doing business because SMMEs do not have the capacity to administer this area and found it difficult to afford accountants.
- Procurement - The public sector tendering system was regarded as inaccessible to SMMEs. It was too complicated and tenders were too large for SMMEs.
- Infrastructure - This is a particular problem in the townships where inadequate roads as well as electricity and telephone networks hampered SMME development.
- Demand - This came up repeatedly as the primary challenge facing SMMEs. The growth of this sector was being stunted by the lack of a steady demand for their products.

It is in this area that links with big business have a critical role to play but these are as yet underdeveloped. The reasons given by business revolved around problems of asymmetric information in that there were enormous risks in awarding contracts to SMMEs with limited track records. A further set of complications is linked to the way in which management appraises results. Managers are very much performance driven requiring immediate results and hence tend to be impatient about dealing with SMMEs which have high learning costs. This puts huge strain on middle management (who generally are responsible for day-to-day operations and who would make the decision regarding doing business with SMMEs) which is rewarded on the basis of short term delivery and as such face enormous risk in engaging with SMMEs.

Important lessons have emerged from all the interviewees' experiences and some of these are discussed below. Anglo/De Beers small business initiative has been operation since 1989 and whilst they insist that they have no fixed formula for identifying successful entrepreneurs, they do watch out for four warning signs: a) a reluctance to contribute start-up cash (not necessarily very much in absolute terms but an amount the entrepreneur would be loath to lose); b) an unproven ability and aptitude for hard work; c) a record of dishonesty; and; d) unrealistic expectations of quick wealth. Other lessons were on a more practical level. Dealing with SMMEs cannot occur along the lines of 'business as usual' and big business needs to appreciate this. Payment terms may have to be changed from 120 days to cash on delivery, as they do not have extensive overdraft facilities. SMMEs often do not have storage or warehouse facilities. To overcome this big business can either assist with storage or alternatively specify smaller, more regular contracts instead of infrequent bulk orders. This requires less storage capacity. Big business can also help by buying in bulk, thereby gaining discounts, and then selling to SMMEs at a reduced rate. Tenders proved to be a particular problem. Tender documents were often too complicated and as such not accessible to SMMEs. Likewise tenders were often too large for SMMEs to deal with as they do not possess the necessary capacity and financial backing required. This situation can be dealt with through the simplification of tender documents and ensuring that tenders are put out in smaller tranche. The problems with tenders are true both for the public and private sectors. Contracts awarded to SMMEs need to be of a sufficient time period to ensure their sustainability. Lastly, I would argue that the appropriate level to 'intervene' and attempt to modify attitudes regarding the development of linkages between big and small business is at the branch level rather than at head office. Whilst it is important to influence a company's overall strategy, actual implementation of linkages occurs at branch level. Non government organizations (NGOs), such as BLUE and the Small Business Project, have a critical role to play here in educating regional managers as to the benefits of dealing with SMMEs.

The World Bank (1993: 58) states that SMMEs in South Africa would be stimulated through the establishment of links with the large corporate sector and government. These links would foster job creation whilst beginning to align quality and productivity. It sees subcontracting as essential for the establishment of these links but maintains that the preconditions for this are not yet present in South Africa. These preconditions include incentives for big business to subcontract work, the ability of supplier firms to meet the standards and needs of other sectors, and the existence of practical opportunities for small enterprises to become subcontractors. The World Bank (1993: 59) argues that the first step in implementing a successful linkage programme would be for NGOs and development agencies to intensify networking between their clients and big business or government. Existing mechanisms, such as business opportunity centres, industry hives, matchmaker fairs, and small business directories, should be encouraged, but additional projects, such as the compilation of a national database, must be undertaken as well. Ensuring access to programmes that train entrepreneurs and upgrade the capacity of small enterprises is an important function for NGOs. Gaining union support for linkage programmes and providing incentives that encourage big business to subcontract to SMMEs are also important. Lastly, an effective lobby would improve the chances that such initiatives would succeed. The World Bank (1993: 59) outlines various methods which have been used internationally to link small and large businesses. Korea introduced mandatory links, by requiring that 1,200 items in 40 industrial sectors be supplied by 2,200 contractors. In Korea today, 98% of all business falls within the SMME sector and account for 66% of all jobs and 40% of all exports. The mandatory links have been effective because they have been integrated with other programmes. By contrast, product reservation in India have not worked because the choice of products is arbitrary, policy criteria are lacking, and product reservation is not linked with other policy objectives. In Ireland, linkage programmes are coordinated by a 20-person team that focuses on building relationships between SMMEs and big business. On the demand side , it undertakes research to discover what, when and how much the company buys, at what cost and the technical requirements for products. On the supply side, it aims to analyze which enterprises have the capacity to supply the product and what upgrading is needed. As such, it seeks to match the capabilities of the purchaser and supplier.

6. Conclusion

The SMME sector is already large in South Africa but it is not yet fully integrated into the economic mainstream. It exists often on the periphery and often without links to the broader economy. For the SMME sector to realise its potential as a dynamic, innovative centre it must develop links with the rest of the business sector because only in this way will its business become fully sustainable. These links need to be mutually beneficial or otherwise it will only be a temporary phenomenon. Coercive legislation from government will result in businesses investing resources in finding ways to circumvent such legislation if it is not going to be in their best interests to comply. Big business in South Africa is already feeling persecuted on all fronts and more legislation will prove detrimental in the long run. Real profitable opportunities exist in outsourcing and big business needs to be proactive in exploiting these, otherwise the legislation will come. The compilation of a national database must be undertaken so that big firms are aware of SMMEs capable of undertaking that business. A form of accreditation by some institution could do much to alleviate the problems of asymmetrical information hampering the development of links between small and big business. South African business will be making progress when it realises that doing business with SMMEs makes for good business. Promoting links between big and small business should be mutually advantageous – the social responsibility should be a secondary consideration.

7. Suggestions for Future Research

SMMEs in developing countries face challenges which are unique and immense and thus present many challenges for future research. Five important areas for research in this regard emanate from this study. First, research must be undertaken on the mobility of SMMEs from the periphery and informal sector into the formal sector and economic mainstream. There is much to be learnt from the rather limited success stories in developing countries. Second, the phenomenal increase in outsourcing over the past decade presented many opportunities for small businesses and these need to be documented. Third, the impact of government procurement on SMMEs must be understood. Fourth, the recent emphasis on the flexible economy and industrial districts has focused on the developed world and we need to understand their impact in a developing country context. Last, more research on the links between big and small businesses must be conducted to understand the resistance of big companies to doing business with SMMEs. Only then can we really begin to understand the obstacles facing SMMEs and their integration into the economic mainstream. 🕮

End notes

i. The exchange rate in April 2001 being around R8 to the US dollar.
ii. Anglo American is South Africa's largest industrial conglomerate with major interests in most sectors. It is also the world's fourth largest mining company. It recently put in a bid to buy the diamond cartel De Beers in which it has always had a substantial shareholding.
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iv. NAFCOC is a black business umbrella/chamber association.
v. In 1996, $100 billion was spent in the USA on outsourcing. Some form of outsourcing is also used by up to 85% of British firms (Fortune, October 14, 1997). IBM and EDS, leaders in outsourcing, both see great potential in the South African market but argue that more education is needed to show firms the benefits of outsourcing (Business Times, 10 November 1996).

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Notes

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