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SOUTH AFRICAN SMALL BUSINESS GROWTH THROUGH INTERFIRM LINKAGES

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ABSTRACT

Economic stagnation in sub-Saharan Africa since 1970 is well documented. While the causes are varied, the paradigm of nationalistic state-led economic development has changed. Economic development occurs in a global marketplace. Manufacturing has shifted from developed to less developed countries, an opportunity that was seized in Asia and Latin America. South Africa's labour, unskilled and costly by world standards, is at a disadvantage as an agile and competitive world market seeks skilled labour at the lowest cost.

South Africa's Gear economic policy suggests that 300 000 new jobs need to be created annually until 2004 in order to reduce unemployment. Small, medium and microenterprise growth is central to meeting this target. Numerous government structures to assist small enterprises have been created. Few, however, assist small business with the demands of the marketplace. Most focus on generic skills training and questionable small business finance. This thesis suggests that interfirm linkages between large and small enterprises is one strategy that can assist the growth of small business, create employment and, increase labour skills.

International experience shows that generic training is less effective in promoting small business than linking business training to actual market-demands. Interfirm linkages, most often through subcontracting, is a strategy used successfully in Taiwan, Indonesia, Malaysia and Brazil. Such linkages are usually government supported and provide incentives for both large and small businesses to work together productively. Three South African interfirm linkage case studies are critiqued. Case study findings indicate that interfirm linkages expose emerging businesses to market conditions, and can provide access to process technology training, low cost raw materials, creative finance, and new markets. Small business 'learns by doing' and also 'learns while earning'.

The state has a role in the development of a vibrant small, medium and microenterprise sector in South Africa. Current support strategies are largely unrelated to market

conditions. Interfirm linkages are an approach that applies market forces in the development of small business. Government policy would be wisely directed to support such business interactions.

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ABBREVIATIONS

ANC	African National Congress
ASEAN	Association of South East Asian Nations
BIPIK	*Program Pembinaan dan Pengembangan Industri Kecil*
BOC	Business Opportunity Centre
BuDS	Business Development Services
CBO	community based organisation
Cosatu	Congress of South African Trade Unions
CSS	Central Statistical Service
DTI	Department of Trade and Industry
CMT	Cut-Make-Trim
FDI	Foreign Direct Investment
FTZ	Free Trade Zone
GATT	General Agreement on Trade and Tariffs
GDP	Gross Domestic Product
Gear	Growth, Employment and Redistribution
GNP	Gross National Product
HDI	Human Development Index
HPAE	High Performing Asian Economy
IFIs	International Financial Institutions
ILO	International Labour Organisation
IMF	International Monetary Fund
KIK	Credit for Small Investment (Indonesia)
KMKP	Permanent Working Capital Scheme (Indonesia)
LBSC	Local Business Service Centre
LDC	Less Developed Country
LE	Large Enterprise
M-CDC	Mabopane-Centurian Development Corridor
MIDA	Malaysian Industrial Development Authority
MITI	Malaysian Ministry of International Trade and Industry
MNE	Multinational Enterprise
MTC	Manufacturing Technology Centre
NAFCOC	National African Federated Chamber of Commerce
NEC	National Empowerment Consortium
NEP	New Economic Policy
NEPA	Ntsika Enterprise Promotion Agency
NGO	Non-Governmental Organisation
NIC	Newly Industrialising Countries

NIDL	New International Division of Labour
Norad	Norwegian Aid Agency
NP	National Party
NPI	National Productivity Institute
NSBC	National Small Business Council
OECD	Organisation for Economic Co-operation and Development
PAYE	Pay As You Earn
PDI	Previously Disadvantaged Individual
PPP	Purchasing Power Parities
PPQM	Profile, Price, Quality, Market
PQLI	Physical Quality of Life Indicator
PSP	Private Sector Participation
RDP	Reconstruction and Development Programme
RFI	Retail Financial Intermediaries
SABS	South African Bureau of Standards
SAP	Structural Adjustment Program
SAW	South African Weatherwear, Ltd.
SMME	Small, medium and micro enterprises
Somema	Soweto Memorabilia Manufacturers
TAC	Tender Advice Centre
TTT	Transkei Training Trust
UIF	Unemployment Insurance Fund
UNDP	United Nations Development Program
VAT	Value Added Tax
WTO	World Trade Organisation

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PREFACE

Primary to both the theory and practice of strategies for economic development has been the benefit thought to derive from trade and the fundamental market forces that determine a country's relative comparative advantage (Thomas and Nash, 1992). More recent thought has considered the potential for developing economies to actively seek to create a competitive advantage, usually by targeting certain industries or sectors for protection, subsidy or preferential access to markets (Porter, 1990). This study targets a particular strategy for developing a long term manufacturing comparative advantage for small, medium and micro enterprises (SMMEs) by entering into innovative interfirm linkages between large, well established enterprises and emergent SMMEs. In the South African context, this study is especially concerned with the effect of such linkages on the development of black owned and operated SMMEs and the contributions that accrue to small businesses from ongoing business interactions with larger enterprises. Most SMMEs enter interfirm linkage arrangements as subcontractors and suppliers of goods and services to larger enterprises, though there is increasing empirical evidence of interfirm private sector joint ventures that serve to strengthen both emergent SMMEs and existing enterprises. This study particularly reviews the experience, benefits and restrictions of three subsistence-level manufacturing SMMEs that linked with the South African private sector and parastatal structures to supply goods and services. The role of government SMME support structures is critically reviewed with reference to world-wide best-practice SMME support. Conclusions and policy recommendations are made based on the benefits accruing from interfirm linkages and the potential of such linkages to complement and expand existing strategies of SMME promotion in South Africa.

SMMEs, established business and government have vested interests in successful interfirm linkages. Linkages and subcontracting arrangements can result in new income streams for small and often informal businesses that lie outside the primary areas of

economic activity while also making a significant contribution to the acquisition and diffusion of skills, knowledge and technology which adds value to local economic activity (Coe, Helpman and Hoffmaister, 1997). Government reaps the benefit of market-driven production in areas of subcontracting which have the potential to help develop a 'culture of productivity' without making an assault on politically sensitive union alliances. Business gains needed political credibility through such arrangements as a participant in national reconstruction and development in this period of continuing suspicion regarding the past and present role of business in South African society (Boraine, 1997).

The extensive market failures associated with apartheid (closed markets, central state control over primary exports, vast parastatal enterprises which crowded out private sector competition, and restrictions on opportunities for employment and education) created South African economic structures unable to integrate successfully with the world economy. The resultant domestic economic activity was highly protected, often organised by the state as semi-autonomous parastatal industries or regulated by government trade commissions. Most business exploited the limited markets dominated by whites leaving small and largely informal businesses to serve the non-white South African market. The development of SMMEs to serve the requirements of an economically diverse populace was stunted by political policies that artificially channelled both supply and demand to the needs of a minority of the population (Wray, 1998).

The National Strategy for the Development and Promotion of Small Business in South Africa (Department of Trade and Industry, 1995a) alludes to the enormous task of redressing past market failures, giving particular attention to the job creation potential of SMMEs. The political collapse of apartheid ushered in a new era of democratic reform, and opened an avenue for new models of economic activity. This could play out in different ways. On the one hand, the desire to resist a new colonialism could lead to economic isolation and protectionism in the hope of creating a unique South African road to economic development. Experience in other parts of sub-Saharan

Africa would seem to render this a risky alternative (Abernathy, 1984). On the other hand, the fervent desire of all political parties to welcome new foreign direct investment (FDI) could well result in South Africa being swallowed whole by a globalised economy leaving a popularly elected government little leverage over an economy that must, at some level, both prosper and contribute to greater income equality in the medium to long term (Padyachee, 1992, 1995).

The challenge of development in South Africa is to increase employment, broaden distribution of wages and enhance skills of all workers, but particularly those workers disadvantaged by apartheid (Lunsche, 1997; *Eastern Province Herald*, 4 March, 1998). As elsewhere in sub-Saharan Africa, this could be accomplished through increasing state employment, redistributing land extensively and rapidly, and by putting vast resources into training and human resource development. Experience indicates that such a strategy, if implemented, would lead to short term gains, increased inefficiencies of state enterprises, rent seeking behaviour, emigration of skilled workers and medium to long term economic stagnation and/or decline.

Rejecting this form of state-led development, the government economic development policy, expressed in the macro-economic strategy for Growth, Employment and Redistribution (Gear) (Government of South Africa, 1996a) clearly anticipates full economic integration of South Africa within an increasingly globalised world economy[1] Among the implications of this is that the freer market assumptions of the international financial institutions (IFIs), the United States and Britain, and the open market initiatives of General Agreement of Tariffs and Trade (GATT) and the World Trade Organisation (WTO), will substantially affect whatever economic policy is undertaken by South Africa. In view of these international trade factors, and the linkage of structural adjustment programs (SAPs) to World Bank financing, the creation of any

[1]The effect of the government's Gear policy framework is discussed in Chapter Five in relation to the requirement for SMME development. At this point it is sufficient to note that Gear policies include a tight short term fiscal stance, state cost containment, lowering of tariffs, relaxation of exchange controls, privatisation of some assets and services, and a social agreement to moderate wage demands of labour. Taken together, these Gear policies anticipate greater economic integration with the world economy and moves toward increased world competitiveness.

so-called independent or unique South African path for economic development is unlikely. Similarly, the utilisation of a particular raw material or resource to take advantage of an inherent comparative advantage will be substantially undermined by global economic pressures that reduce the benefit of such natural advantages.

Over time, as a country develops, it tends to move up the ladder of comparative advantage. Economies that initially exported commodities that are resource intensive move toward exports that are unskilled labour intensive (textiles) to semi-skilled and skilled labour intensive (electronics) to capital intensive machinery) to technological intensive (computers and robotics). As a country's endowments change (natural resources, labour skill or technological prowess), a country's comparative advantage develops (Lewis, 1966). In the last decade considerable debate has focused on the potential for nations to 'create' a comparative advantage (Porter, 1990; Krugman, 1980) by moving up the export 'ladder' from resource and unskilled labour intensive to skilled labour, capital and knowledge intensive economic activity.

Still, South Africa offers an unusual context for economic development in a number of ways. It boasts a highly developed infrastructure, a first-world market population, a skilled labour force, significant technological and heavy industry capacity and relatively low debt levels. South Africa, because of apartheid, also boasts the world's greatest income disparity between the richest quintile and the poorest two quintiles (World Bank, 1996). Its skill disparity is nearly as striking, with more than 50 per cent of the total population functionally illiterate. Apartheid policies created two economic and social worlds within one country. Any long term development strategy for South Africa must increase productivity, increase employment opportunities and increase skill capacity (Economist Intelligence Unit, 1997).

This essay suggests that one strategy to increase employment and income equality while also addressing the skill deficit is through active support for linkages between larger and smaller private sector manufacturing enterprises. Chapter One begins with the assumption that South African development must first be viewed in the context of

economic development within sub-Saharan Africa in the last three decades and the competing ideologies and nationalist fervour that accompanied such post-independence efforts. Chapter Two reviews the policy pressures and inhibitions imposed on developing economies as a result of the resurgence of orthodox economic theory, enforced fiscal restraint and, particularly, the policies associated with the structural adjustment programs (SAPs) of the World Bank. Chapter Three re-examines the role of the state as the primary agent of economic development and suggests that the state has an essential role as the prime manager and facilitator of economic development, without controlling the process. The 'facilitating' state is introduced which postulates the emergence of government structures that create an intentional comparative advantage based on investment in human capital and the development of a significant emergent SMME sector that responds to the demands of a globalised market. Chapter Four reviews Taiwanese state strategies to promote high quality bicycle production through interfirm linkages and highlights the benefits that accrued to an emergent industry. The Taiwanese example is reviewed with reference to the factors that would promote and inhibit similar approaches in South Africa. Chapter Five extensively reviews and critiques current South African state strategies for SMME support. The successful application of state-led SMME support through interfirm linkages in Malaysia and Indonesia is reviewed in Chapter Six. Chapter Seven explores the current state of interfirm linkage in South Africa and examines the potential for more extensive linkages through three case studies of SMMEs in the manufacturing sector. Interfirm linkage case studies comprise Chapter Eight and assessments are made regarding the contributions that interfirm linkages bring to the challenge of economic development. Chapter Nine indicates potential benefits that accrue to the process of SMME development through interfirm linkages. Finally, conclusions are drawn regarding the challenges facing the government of South Africa in its task of supporting small business development. Areas in which further research is warranted are indicated, as the potential for SMMEs to create new jobs and contribute to the skill development of workers in sub-Saharan Africa is increasingly studied.

CHAPTER ONE

ISSUES REGARDING THE ECONOMIC DEVELOPMENT OF NATIONS

> Poor countries are supposed to take advantage of foreign trade by specialising in standardised, labour intensive commodities which make good use of their economies' abundant resource: unskilled labour. Rich countries that are well endowed with physical and human capital, on the other hand, naturally specialise in skill intensive, high tech goods (Rodrik, 1996:1).

Emergence of Development Economics

Rodrik's somewhat cynical comment on economic development crystallises two centuries of debate over economic development: what role do knowledge, human capital, abundant natural resources, and colonialism play in the pattern of uneven development of the nations of the world? These questions underpin the central thesis of this study: that interfirm linkages between large and small enterprises have the potential to create jobs, increase wealth and equity, expand the capacity of unskilled workers through 'learning by doing' and assist in the diffusion of a culture of work throughout society in South Africa. The state assists such linkages through targeted incentives, market-driven training subsidies and other market-related inducements. Presently, vibrant and trusting working relationships between state and the private sector are rare world-wide. In order for South Africa to compete effectively in a global economy it will be necessary to create new businesses that can rapidly generate sustainable employment and offer potential employment to previously disadvantaged with the potential for employee advancement alone with significant capital accumulation. This thesis explores the potential of interfirm linkages to promote black employment and business development within a broader context of development in sub-Saharan Africa.

Job creation, increased economic equity and long-term sustainable economic growth were clearly stated as the primary policy goals of the post-1994 government of South

Africa (DTI 1995a: 3-23). These goals were part of the larger social objectives of government, namely, to increase wealth distribution, broaden education and training, and to meet human needs across a wide spectrum of historic disadvantage (ANC, 1997). The policy was succinctly expressed in the principles of the Reconstruction and Development Programme (RDP)[2] which stated:

> Growth - the measurable increase in the output of the modern industrial economy - is commonly seen as the priority that must precede development. Development is portrayed as a marginal effort of redistribution to areas of urban and rural poverty. In this view, development is a deduction from growth. The RDP breaks decisively with this approach. If growth is defined as an increase in output, then it is, of course, a basic goal. However, where that growth occurs, how sustainable it is, how it is distributed, the degree to which it contributes to …human resource development…are crucial questions when considering reconstruction and development. The RDP integrates growth, development, equity, reconstruction and redistribution into a unified programme (ANC, 1997:3).

Economic growth must be linked to social development; 'qualitative improvement in people's lives' (ANC, 1997:3). Thus, economic growth merely measured by increases in per capita GDP do not sufficiently demonstrate equitable economic growth (the question of 'where' growth occurs and how it is distributed). In South Africa, the historic political context of economic growth cannot be ignored in the development strategy of the post-1994 government. To this end, a central element of the post-1994 government's economic development strategy is the development of a vibrant SMME manufacturing sector in South Africa (DTI, 1995a) with the expectation that SMMEs create employment among the poorest sectors of the population (DTI, 1995a; 1997c).

This opening Chapter provides background to the policy objectives of the post-1994 South African government, and places that background within the context of current global trends in the theory and practice of economic development. This brief discussion of development economics, measurement of human welfare, and income inequality leads to a conclusion that there is a potential conflict between the desire of the state to intervene in economic activity to ensure wealth equity, and a growing global sentiment

[2] The RDP remains a policy of the South African government even though its status as a discrete government department ended in 1996.

that the role of the state economic intervention should be lessened. By examining the effect of structural adjustment policies on the capacity of the state in developing countries, reviewing some examples of successful state intervention, we conclude that there is an important role for the state to assume in economic development. While the degree and focus of state intervention in development is a matter of considerable debate (discussed in Chapters Three and Four), it is suggested that the extent to which state policy contributes to human capital accumulation the state will contribute significantly to long-term economic development.

In this regard, one under-utilised strategy to develop human capital that may address the significant learning deficit among disadvantaged South Africans is to promote interfirm linkages in the private and public sectors between large and small enterprises. Practice elsewhere indicates that interfirm linkages can have a positive impact upon human capital development and economic growth. Even more clearly, practice in Brazil (Tendler and Amorim, 1996) and sub-Saharan Africa (Mead, 1994; Mead and Liedholm, 1998) demonstrates that interfirm linkages can assist SMME development and contribute to reduced Gini coefficients and skill accumulation among unskilled and semi-skilled labour. In such linkages there is the potential for significant positive income migration, acquisition of skills and new market access. These aspects of economic growth, if clearly shown to benefit formerly disadvantaged South Africans, may meet the necessity for tangible social development in South Africa, which is a criteria for successful the kind of economic growth envisioned by the RDP.

This context of economic development follows briefly.

Setting the Context

Development economics emerged as a growing endeavour of study after the close of World War II in reaction to the seeming failure of market forces to achieve equity along with economic growth in less developed countries (LDCs). Economic development theory and implementation strategies grew initially in response to a widely held view that the developing world was a homogenous unit that could be

addressed with a single, simple, right development strategy (Bauer and Wilson, 1962; Sen, 1983b; Lewis, 1984). Further, the willingness of the major industrial powers to tie economic aid for development to particular political loyalties[3] also frequently had an impact upon development strategies in LDCs. Given the breadth of influential factors, there is little uniformity of approach or consistency in a review of economic development in LDCs. Thus, Lal (1985) cogently argued that a post-war effort at creating a unique strategy of 'development economics' was unsuccessful.

Development economics questions Smith's (1776/1937) classical assertion that economic growth will take care of itself: if left alone people will do what they are best able to do, they will adjust to the market conditions, make appropriate choices and, as a result, maximise returns.[4] The state, in the classical paradigm, has a limited and clearly circumscribed role in economic development: to create an enabling environment without undue restriction of the private exercise of contracts and obligations and the free operations of markets. It was assumed that state intervention in economic markets was most frequently a hindrance to the free development of market impulses. We shall return to explore the role of the state in economic development in Chapter Four.

According to Smith, some nations enjoyed greater material abundance than others, regardless of state activity. This he depicts as "the natural order of things". Of the three dominant factors of production - land, capital and labour - land makes all the difference. Land and its natural resources are unequally divided; those nations more bounteously provided for are bound to be richer. The other factors of production are considered equal in the end. Labour, capital and knowledge were assumed to be elastic and transferable, either at a price or as market conditions required. Only land is

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[3]For example, note the willingness of the United States and the former Soviet Union to support Egyptian national development at various times depending upon the state of African relations with the superpowers.

[4]The market rewarded the skilful and adept while punishing the opposite. Smith went on to claim that *laissez-faire* economic activity would work to the optimal good of the majority of the populace, enhancing the wealth of the nations that would lead through a natural period of development from agriculture to commerce and industry.

inelastic and immobile (Landes, 1990). Thus, as each developing country made the best use possible of its natural endowments that were unequally apportioned, those nations endowed with natural advantages accrued unequally greater benefits because of the natural advantages.

Smith's 'natural growth' model of development served as the dominant paradigm of economic development for nearly one hundred and fifty years though it was, in truth, more an explanation of the growth of a few nations than a prescription for world development. In as much as nations had difficulty fulfilling Smith's path to development, that is, doing what comes naturally, Smith asserted that man and politics got in the way and crippled natural initiative and growth (Chenery, Srinivisan and Syraquin, 1986). By the opening of the twentieth century, the Industrial Revolution had spread throughout Europe and North America. Some nations industrialised and emerged as users and processors of raw materials obtained from other nations. Countries in Latin America, sub-Saharan Africa and Asia became major suppliers of primary goods for use and profit maximisation by the industrialised world. The demand for finished goods and opening of world-wide trading of the same throughout the industrialised world led to development of trading and production tiers. The majority of nations supplied unfinished products to the few industrialised nations (Meier, 1984).

The political corollary of industrialisation was colonisation, which became the dominant paradigm of North-South inter-state economic relationships in the nineteenth and early twentieth centuries.[5] By the mid-eighteenth century, European economies were increasingly powered by trade agreements that were largely unfavourable to the colonies. The 'dependency' school of economists relies heavily upon this line of

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[5]Colonies were initially seen as captive markets for new European products and not until the mid-nineteenth century were the raw materials of colonies exploited to fuel expanded production in Europe. "Until well into the nineteenth century all expansionist activity of the British Empire from 1763 had been based on the merchant's interest in the distribution of goods rather than the manufacturer's interest in the production of more of them..." (Hyam, 1993).

reasoning as an explanation for pervasive and persistent underdevelopment (Sunkel, 1989; Cardoso, 1972; Amin, 1976).[6]

While the reasons for the widening gap between developed and less developed countries in the post-colonial, industrial era are varied, it is sufficient to note here that the free markets, enforced by military might failed to provide the avenues for equal, parallel development of nations, as classical theory would predict. Instead, a cycle of dependence was born, creating a lack of access to markets for poorer nations, exacerbating raw material exploitation, and increasing unskilled labour surpluses, with the consequent development of increasingly unfavourable terms of trade between colonies and coloniser.

Reviewing the current disparity between the North and South, classical growth economists (Thrift, 1988) would argue that unequal development was nothing other than utilisation of natural competitive advantage by certain states. Marx's (1894/1962) analysis of the dictates of comparative advantage, especially when reinforced by either military or accumulated economic power, cast an alternative development paradigm. Power, industry and political and historical imbalances between nations became additional factors to consider in the ability of nations to develop. The result of Marxist historical analysis, along with empirical observation that the economic success of some nations seemed to be detrimental to the development of other nations, gave rise to the new field of Development Economics.[7] While not truly a paradigmatic shift, because

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[6]Hill (1970) provides an interesting nuance in the colonised and coloniser relationship by illustrating the capital acquisitive and business expansion practices of indigenous Ghanaian cocoa farmers in Southern Ghana in two periods from 1897 to 1960. Hill posits that indigenous market oriented economic forces mobilised rapid expansion of cocoa production, heavy peasant investment in land and establishment of sound business practices. While amply demonstrated by Hill, cocoa-based indigenous capitalism also had serious limitations in Ghana. As the local economy became increasingly dependent upon cocoa as a sole raw material for export, and with production concentrated in the relatives and heirs of a few extended families, the growth of local economic opportunity was highly restricted to a relative few and served an international economy with the provision of a single commodity without developing a sustainable local economic infrastructure.

[7]While the influence of Marxist historical analysis is prominent, the Marshall Plan and the post-war redevelopment of Europe gave rise to the practical notion that similar economic redevelopment of LDCs could be achieved with corresponding economic development strategies, thus fuelling the discipline of Development Economics (Streak, 1996).

Smith's theory of capital accumulation and growth remained the centre against which others debate, Marxist thought added a lasting dimension to discussion about successful strategies for development in LDCs world-wide[8]. Marxist economic and historical analysis, often mixed with nationalistic fervour and a distrust of international economic integration, remain a primary methodology for economic development in much of the developing world. Central to development economics was the notion that the state must assume an enhanced role in the economic planning of LDCs, especially those newly independent of colonial ties (Landes, 1990). As the state role grew, economic intervention was justified as necessary action to 'protect' the emerging economies from international capitalist exploitation. As Williams (1994) further notes, it proved to be a short step from socialist-led state direction of the economy to the failed nationalistic policies of Guinea, Guinea-Bissau, Mozambique and Ethiopia. More recent experience in the high-performing Asian economies (HPAEs)[9] gives some indication that the role of the state in economic development is more nuanced; targeted interventions in the HPAEs have resulted in significant gains in production, labour force skill and technological absorption (Amsden, 1989, 1994). The role of the state in economic development will be taken up further in Chapter Four.

Understanding Underdevelopment

Theories regarding historical underdevelopment have contributed little to actual improvement in the lives of those who live, day to day, in the poor nations of the world where the average per capita Gross National Product (GNP) is only US $800 compared with the industrialised nations' average per capita GNP of nearly US $19 000 (United Nations Development Program, 1993). Of the world's population, 80 per cent live in LDCs. Together they earn less than 20 per cent of the world's income.

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[8]Some Marxist strategies for development have concentrated on the necessity of improving the industrial capacity of LDCs, the superiority of central governments as the owner of the means of production and the centrality of government in most aspects of economic planning. Other post-Marxists such as Roemer (1982) have focused on the dimensions of power in underdevelopment. Because the world's wealth is concentrated in a few nations, Roemer contends that the central role of government in economic development is necessary to assert nationalistic desires in the face of global capitalism and to bring often unbridled market forces under state control.

Former President of the World Bank, Robert McNamara (1972:8), described the poorest 30 per cent of all people living in LDCs as in a condition of "absolute poverty".

In many instances, low per capita income goes hand in hand with other aspects of deprivation. For instance, life expectancy in Chad, Ethiopia and Sierra Leone is just 55 to 60 per cent of all but one of the 25 so-called top income economies identified by the World Bank Development Report (1990). The daily caloric intake per capita in Italy, Germany, the United States and the United Kingdom and other developed economies is more than twice the intake of those living in Ghana, Guinea, or Angola. Percentages of school-aged children enrolled in education, infant mortality, and other essential indicators reveal similar interconnected burdens of poverty (World Bank, 1990). The Bank describes this as a "condition of life so degraded by disease, illiteracy, malnutrition and squalor as to deny its victims basic human necessities" (World Bank, 1992). The development tables presented below illustrate the dimensions of world-wide underdevelopment, while at the same time illuminating another challenge facing development practitioners: the measurement and interpretation of important economic indicators.

[9] The HPAEs are Taiwan, Korea, Singapore, Japan, Malaysia, Thailand, Indonesia and Hong Kong.

Table 1: Selected Basic Indicators of Development

Select Low-Income-Economies*	Population (millions)	GNP per capita 1993 $	GNP % annual growth 1980-93	Life expect. at birth (years)
All low income economies	***3 092***	***380***	***3.7%***	***62***
Avg., excluding China and India	***1 016***	***300***	***0.1***	***56***
Chad	6.0	210	3.2	48
Mali	10.1	270	-1.0	46
Niger	8.6	270	-4.1	47
Burkina Faso	9.8	300	0.8	47
India	898.2	300	3.0	61
China	1 178.4	490	8.2	69
Zimbabwe	10.7	520	-0.3	53
Sri Lanka	17.9	600	2.7	72
Cote D'Ivoire	13.3	630	-4.6	51
Armenia	3.7	660	-4.2	73
Select Upper-Middle-Income Economies	**population (millions)**	**GNP per capita 1993 $**	**GNP % annual growth 1980-93**	**Life expect. at birth (years)**
All Upper Middle Income Economies	***500.5***	***4,370***	***0.9***	***69***
Venezuela	20.0	2,840	0.7	72
South Africa	39.7	2,980	0.2	63
Malaysia	19.0	3,140	7.3	71
South Korea	44.1	7,660	8.2	71

*Economies classified by the United Nations.
Source: World Bank, *World Development Report, 1995.*

There is more to development than merely increasing per capita GNP. Per capita GNP measurements tend to view countries as homogenous entities, ignoring the enormous variability between the colossally wealthy and desperately poor in many LDCs (Stern, 1991).[10] It does not necessarily follow that a nation's standard of living correlates with

[10] India, Guatemala and Brazil represent such disparity on a world scale; income statistics for the Eastern Cape of South Africa, though egregiously incomplete and erroneous, illuminate the same point in a local context (Eastern Cape Provincial Government, 1996).

per capita GNP, the most commonly used poverty indicator.[11] How does one explain the high life expectancies in countries such as China and Sri Lanka (69 and 72 years respectively) despite a per capita income of less than US $600? Correspondingly, the average life span in those economies judged as upper-middle income (per capita GNP between US $2 200 and $6 000) is no greater than that of China and Sri Lanka, despite per capita income between five and ten times greater. The measurement of key economic indicators for development is complex[12] and economic indicators alone do not perfectly correlate with the reality on the ground nor sufficiently measure the total quality of life index (Chenery, Robinson and Syraquin, 1986).[13]

"Why Isn't the Whole World Developed?"

Whether one accepts the classical growth model of Adam Smith, the Marxist critique of world capitalism, or the call for independent nationalistic development from Africa, it is indisputable that the wealth and development gap between North and South has become a pivotal feature of the late twentieth century global economy. While the North seems to have successfully emerged from the world-wide crises of the 1970s, the South has not. The global crises of the 1970s coupled with the debt and governance crises of the 1980s (Frischtak, 1992) led to a long period of stagnant or negative economic growth (Ravenhill, 1986; Simon, 1990). Development theorists

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[11] Since economic growth (as measured by GNP growth) does not ensure that the condition of the poor will improve, GNP growth, in itself does not constitute or measure human welfare or success in development. GNP growth does not distinguish between the aims and the ultimate use of a given product, nor does it say whether a country's higher GNP merely offsets another natural obstacle. Thus, measurement of GNP growth alone is an imprecise mechanism to determine development.

[12] A further hazard in using cross-country data to compare relative economic development is the common practice of converting country per capita GNP into a universal currency - usually the US dollar - at official international exchange rates. Such a practice often does not reflect the relative purchasing power of different currencies and can result in erroneous comparisons. Kravis, Heston and Summers (1978) introduced the concept of purchasing power parities (PPPs) as a corrective for accurate conversion of per capita income to per capita purchasing power as a measure of development. Since PPPs reflect local purchasing power, in countries with low domestic prices, the per capita GDP (using PPP correctives) will be correspondingly higher than the official converted currency rates of per capita GDP.

[13]The Human Development Index (HDI), a measure of factors contributing to life quality, reflects this disparity in the Eastern Cape. While the HDI for white South Africans is consistently above 0.9 (on a 1.0 scale) the HDI for black South Africans ranges between 0.13 and 0.31.

must now address three related questions. First, why do some nations persistently lag behind others in the process of development? Second, is it possible for LDCs to 'catch up' with developed economies? Third, what is the most effective avenue to economic development?

Myrdal (1957) and others explained underdevelopment in the pre World War II period quite simplistically. As articulated by Myrdal (1957), underdevelopment was a function of poor climate, overpopulation, and capital migration mixed with racial barriers erected by white nations to the detriment of 'coloured nations'. Despite the popularisation of such theories by some, the achievements of Singapore, Hong Kong, South Korea and Ghana, along with the tendency of capital to flow wherever profit can be made quickly, raises problems for such simplistic theories.[14]

Still others regard the unique aspects of colonialism as determinant in underdevelopment. Such dependency theorists including Amin (1972; 1974; 1976), Cardoso (1972), Sunkel (1969, 1989), (Sunkel and Leal, 1986), Baran (1957) and Wallerstein (1979), assert that the developed world intentionally underdeveloped poorer nations through unequal trade and political agreements and, increasingly, through trade alliances and groupings among developed nations (G7, the Paris Group, WTO and GATT agreements). Dependency theorists, combining Marxist analysis and nationalistic pride, affirm Roemer's (1982) emphasis on the power dynamics between developed countries and LDCs as an instrument of understanding. Dependency theory explains the persistent underdevelopment of certain poor countries as a result of

[14]Any mention of the economic success of Asian nations such as Singapore and South Korea raises immediate questions regarding the applicability of such success in the context of African or other developing nations with less physical infrastructure and human capital upon which to base economic growth. While this question will be considered more fully in a later chapter, it is necessary to make a brief comment on the successful Asian route to development. Meier (1995) states that the general view is that Asian success, in particular South Korea, may be attributed to appropriate polices undertaken by their governments. However, the degree to which governments intervened is contested. Some critics (Hughes, 1992; Riedel, 1988; Berger, 1979) take the view, with minor variations, that unfettered markets and a benign state were the significant factors that contributed to the East Asian miracle. Wade (1990), Rodrik (1994) and others make the contrary claim that state intervention in South Korea was far more extensive than commonly recognised, arguing that government strategies for economic expansion were centrally devised and implemented.

unbalanced economic relationships between countries at the periphery of the world capitalist economy and those at the centre or core of the world capitalist system (Amin 1976, 1975, 1972; Schiffer, 1981).

Dependency theorists argue that even if an LDC is in the process of industrialising, the advanced capitalist nation remains the greater beneficiary of trade with the LDC. The developed economy holds the dominant technology, is the home of the multinational corporate structures, and possesses a monopoly on research and development. With such power, even an industrialising LDC remains dependent upon the central economies and the peripheral economy remains exploited by the centre. Technology transfer (the better means of doing a job noted earlier by Easterlin (1981) as a key determinant of development) is still within the control of developed nations which may withhold or transfer such technology as a condition of political co-operation with underdeveloped economies (Niosi, Hanl and Fiset, 1995).

In assessing the particular problems and challenges facing South Africa in the years after 1994, and the Eastern Cape in particular, the legacy of colonial dependence looms large. Wells (interview, 1997) contends that the accumulated capacity deficit created through the imposition of apartheid policies[15] combined with the residue of colonial dependency has created an 'enormous attitude problem' for productive work in the Eastern Cape. Wells posits that the burden of dependency and colonial domination has been felt more harshly in the Eastern Cape than in most other parts of South Africa, possibly the result of a longer and harsher period of domination.

In general, dependency theorists suggest that underdevelopment remains a function of the periphery's dependence upon the operations of international capitalism. Frank (1967:11) sums up the point stating, "It is capitalism, world and national, which produced underdevelopment in the past and still produces underdevelopment in the

[15]Legislation including the Bantu Education Act of 1954 and the Job Reservation Act restricted access to education, business ownership and employment in certain sectors, thus effectively eliminating a culture in which entrepreneurship and long term investment strategies could develop.

present." Sunkel (1969:31) makes a similar point, though specifically related to the accessibility of foreign finance for developing nations: "It is this aspect, the overbearing and implacable necessity to obtain foreign financing - which finally sums up the situation of dependence: this is the crucial point in the mechanisms of dependence." Related to South Africa, Wells (interview, 1997) suggests that dependence upon globalised capitalist structures, combined with the deficits imposed by apartheid, creates a combination of burdens that render hopes for development in South Africa "more difficult here than in any other colonised nation of Africa".

Potential for Unequal Growth: The Kuznets Curve

Even when policies succeed in spurring economic growth, the gains do not always reach the poorest segments of society, and the gains from growth may not be immediately evident. The pattern of growth often affects poverty reduction. If growth is urban biased, displaces rural or unskilled labour, creates a gender gap, alters relative commodity prices, or favours one segment of society over others (for example, the army, farmers, trade unions) then poverty can and does increase (Krueger, 1993; Lipton, 1976). Other patterns of growth also affect poverty. If growth is technologically based, the use of labour-saving technology may increase inequality. Narrow sector-based growth is often partner to continuation of the cycles of poverty among those negatively affected by growth (Sen, 1983a; Meier, 1995). Slow growth often engenders efforts by special interests to secure particular short term favour or protection for non-competitive enterprises which, in the long term, undermine the larger policies that may lead to broad economic growth (Krueger, 1993).

Analysis of development also needs to account for the time value of economic data. Figures for GDP and other economic benchmarks can be deceptive during the process of development, especially for a rapidly modernising economy. Kuznets (1955, 1966) introduced, in a series of articles published between 1955 and 1967, the theory that relative income within developing economies increases, then stabilises and finally, in the medium to long term, begins to decrease. The income-equity trade-off is represented by an inverted U curve where the income share of the top 20 per cent of

the population is plotted against the level of per capita income on the horizontal axis. This is Kuznets' 'inverted U hypothesis' of income distribution. The implication for LDCs is that on the growth path from a low per capita GNP, a period of increasing wealth inequality is most likely to be incurred. Kuznets (1971) went further, indicating that there is likely to be a quite long period of income inequality in developing economies that will not quickly lessen. While Kuznets has been much criticised, a detailed study by Ahluwalia (1976) and later work by Saith (1983) and Williamson (1991) found substantial reason to reaffirm Kuznets.[16] Despite research by Ahluwalia and others that tends to support the Kuznets' theorem, Anand and Kanbur (1993) seriously challenge the inverted-U result hypothesis. They argue that the selection of data in cross-country comparisons is prejudicial to the results and that by varying data sets, one can get markedly different results that either support, contradict or show no relationship at all between stages of development and income inequality.

A recent study published by World Bank economists Deininger and Squire (1996) provides contradictory evidence as to the validity of Kuznets' hypothesis. While growth rates from 1960 to 1990 have varied greatly world-wide (East Asia has boomed while Africa stagnated), the stability of the Gini coefficients suggests that growth, of itself, does not necessarily increase or decrease inequality. The World Bank study concludes that in 88 cases where a country's GDP grew for a decade, income inequality decreased in 45 and increased in 43. However, detailed research by Jha (1996) utilises an

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[16]Ahluwalia proposes the following conclusions that lend support to Kuznets:

- there is strong empirical evidence to support the proposition that relative income inequality increases substantially in the early stages of economic development, with a reversal of this trend in later stages

- a number of developmental processes accompany growing income inequality that can be considered as causal. Among them are inter-sectoral shifts in the structure of production, expansion of the educational level and skill of the work-force, and reduction in the rate of population growth. These processes help explain the improvement in income equity in later stages of development, but not the deterioration in early stages.

- the cross sectional analysis of GDP does not support the view of some that development necessarily brings about an absolute impoverishment of large sections of the population. Rather, cross-country studies have shown that the absolute income of the lower percentile groups rises as the per capita GDP rises - just not as fast as the upper income percentile.

extensive data set of the most recent estimates of income distribution to test the Kuznets hypothesis. Briefly put, the evidence is considerable and persuasive that the Kuznets hypothesis holds; that there is an 'inverted U shaped curve' relationship between economic growth and income distribution which persists.

While Kuznets' theory and recent studies by Deininger and Squire (1996), and Perotti (1993) require further research, the consensus of development practitioners and developing countries remains that the Kuznets inverted U-hypothesis is operative in most developing economies. Kuznets seems to accurately reflect a common dynamic regarding income distribution in the early and mid stages of growth in developing economies. What is less clear is the policy remedy for inequality. Policies such as the compulsory redistribution of land have often proved disastrous for growth (Kingwill, interview, 1996). Foreign donor assistance has had limited impact and success (*Business Day*, 14 April, 1997; Gupta, 1988) in the years since 1970. Rather, it is policies that improve access to education, expand credit facilities for the informal sector and allow for greater integration into the world economy that may best serve to boost growth as well gradually reduce inequality.

Even so, great income inequality might itself hurt prospects of economic growth. The World Bank study (Jha, 1996) finds some evidence that economies with very unequal income distributions have, indeed, grown more slowly than those where income is more evenly spread. The study further suggests that the link between high inequality and low growth lie in the inability of many poor people to obtain access to credit.

Without borrowing power to finance either education or new enterprises, the economy will grow more slowly.[17] Research on the seemingly inverse inequality/growth relationship is limited. It does appear, however, that joint ventures and creative

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[17]Perotti (1993), like the World Bank, suggests that reducing inequality can raise growth and that high inequality retards growth. Perotti cites three possible reasons for the high inequality/low growth link. First, severe inequality reduces access to education for all. Second, inequality may make for political instability that diminishes an attractive climate for investment. Third, income equality lowers fertility rates, thus boosting growth per person, as argued by Ahluwalia (1976).

linkages between larger and smaller firms can assist the development of SMMEs if entrance to the small business sector of the poorest quintiles of a developing economy is hindered by lack of access to finance and/or education. The development of a vibrant SMME sector is widely understood to be a significant factor affecting job creation, skill acquisition and income distribution in developing economies (World Bank, 1995).

The reality remains that the early stages of economic development in LDCs could be described as, 'the rich get richer and the poor get richer, but not as quickly'. However, genuine economic development is a process by which the per capita income increases over a long period during which time the degree of income inequality decreases. More than increasing per capita GDP and decreasing income inequality, economic development also involves cultural change: change of values, attitudes and a change in the capacity of social structures to act in the best interests of the population (Bardhan, 1996). Myrdal (1968) described this process as the "upward movement of the entire social system"'. While one might argue with Myrdal's implied superiority of developed nations, his essential point that economic development is more than mere growth remains instructive.

In summary, the available data tells a story of declining GNP and declining labour productivity in sub-Saharan Africa from 1965 to 1993 (ILO and ILO Updates in World Bank, 1995; Bhat, 1989). Second, increased national GNP does not necessarily correlate with increased standards of living.[18] Increased GNP may be concentrated in a small proportion of the population (as in South Africa), may be dissipated through corruption or may not reach the poorest sectors, as illustrated by the data on the Kuznets hypothesis. In general, available data tells us the magnitude of the problem of equitable economic development, gives us clues as to the value of investment in human capital for long term economic growth, and provides little insight into which policies actually promote growth in LDCs.

[18]The Human Development Index (HDI) is one measure of living standards and includes access to electricity, water, health services and education (Eastern Cape Provincial Government, 1996).

Recently Summers and Heston (1991) of the World Bank group have intensified interest in growth theory, measurement of developmental data and the applicability of such data to theoretical developmental economics. Barro (1989) particularly indicates that, together with an allowance for simultaneity, there are some general cross-table analytical results from the data that can be suggestive. He asserts that:

- economic growth is positively related to human capital;
- growth is positively related to capital investment;
- whether the investment is from the private or public sector seems unimportant in the short term for growth;[19] and,
- low initial per capita GDP coupled with high government consumption appears to be negatively associated with growth.

Learning by Doing

It is in response to this scenario that this thesis targets joint ventures, interfirm linkages and co-operation agreements between larger and smaller enterprises as a vehicle for job creation, new market development and much needed skills training. Given that the democratic government of South Africa prizes these goals, and the apartheid-generated capacity deficits among potential entrepreneurs are so marked, interfirm linkages between existing and emergent business appears to be an under-utilised vehicle for developing the capabilities of SMMEs in a competitive market environment.

Nobel laureate Kenneth Arrow (1962) suggested that productivity would increase with an emphasis upon the learning accompanying doing. Citing Arrow in his historic address to the Economic History Association, Easterlin (1989) asked, "Why isn't the whole world developed?" He noted that development had spread from northern and western Europe, then to North America and some Asian states, but that development did not become commonly diffused throughout most of the world. The nations of the Southern Hemisphere (except the newly industrialising countries (NICs) of Asia)

[19] Though, as Krueger (1993) and others have amply shown, large scale government investment often leads to rent seeking behaviour, protection from world market competition, and consequent inefficiency and lower productivity. The value of government investment can be diminished if spent on inefficient enterprises.

lagged significantly. Positing a possible explanation, Easterlin suggested that development is a function of the rate of technology transfer - the introduction of new techniques. In his view, the spread of development depends upon the growth of science, the spread of education through the populace and political and social liberalisation that enhance the capacity for such technology transfer. Solow (1956,1997), Meier (1984) and Paul Romer (1986) further emphasise investment in human capital. New growth theorists place more emphasis on human capital investment than on natural endowments, with the implication that the benefits that arise from the exchange of ideas in an open economy will power economic development.

Investment in human capital to undergird economic growth was not prominently featured in the developmental strategies of newly independent states in Africa from 1965 to the mid 1980s. As we have indicated, in an attempt to posit the reasons for chronic underdevelopment and to plot strategies for development in the first years of independence, Marxist historical analysis of the relations between the developed world and LDCs was the dominant paradigm, and often led to centralised national economic policies (Lancaster, 1988). Some scholars such as Hyden (1983,1996) and Rosberg and Jackson (1982:14) have argued that, especially in Africa, “economies of affection” and communal and personal loyalties were additional factors in the deep seated centrality of the state in development planning in many newly independent nations.[20]

In response to the well documented failures of centralised economic planning as a strategy for development, the last decade has witnessed a renewed interest in the acquisition of the skills needed to engage effectively in a competitive, globalised world economy (World Bank, 1995). This interest in development of human capital as an appropriate focus for state engendered economic development takes a long term view. It seeks to address the systemic needs of a society for economic growth, rather than

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[20]A good example of the intermingling of Marxist historical analysis and the power of personal and communal ties is well demonstrated by Tanzania’s initial strategy of 'socialism and self reliance’, which combined nationalism and central planning. Similar to many other African states in the first years of governance after independence, Tanzania’s policies brought about bureaucracy, dependence, poor productivity and isolation from world economic development (Williams, 1994).

simply manage existing industries better or redistribute existing resources through policies rather than production (Schultz, 1961, 1962).

Sustained economic growth requires an increasing rate of growth in some of the inputs in national production (Solow, 1956, 1997; Daniels, 1996) at least in the early stages of development. It is not easy to achieve and sustain growth in the various inputs to production, and at some point the law of diminishing returns applies when the profitability derived from each successive input decreases. It is here that Solow (1997:82), following Arrow (1962), suggests that increased accumulation of human capital (knowledge, skill, technology application) may "obey rather different laws from those governing physical capital, in terms of its own production and perhaps in terms of its use in the production of goods. It is possible, then, that sustaining faster economic growth through accelerated accumulation of human capital is a feasible proposition." Investments in human capital can include a broad range of initiatives from the social to the technological including health care, nutrition and sanitation, formal and technical education, and the efficiency that derives from doing a simple job repeatedly, to on-the-job training and application and use of new technologies.

This study targets an under-utilised opportunity for increasing the accumulation of human capital through 'learning-by-doing' through the strategic establishment of interfirm linkages between large enterprises (LEs) and emergent small, medium and micro enterprises (SMMEs) for outsourcing and subcontracting. Given the recent history of economic development in sub-Saharan Africa it is certain that a new role for state participation in economic development[21] is required and that the building of human capacity is an essential foundation for long term economic growth in any society. In large part, this new role of the state has been redefined and narrowed by the ascendancy of structural adjustment reforms as a free market policy prescription for

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[21]The role of the state in economic development is particularly well stated in *The East Asian Miracle*, (World Bank,1993:23). Commenting on state intervention in high performing East Asian states, the author contends that the states in question, "used multiple, shifting policy instruments in pursuit of more immediate economic objectives. State led, pragmatic flexibility-the capacity and willingness to change policies-is as much a hallmark of HPAEs as any single policy instrument."

developing economies. Before examining interfirm linkages as a South African vehicle for SMME development, we review the development and criticism of Structural Adjustment Programs (SAPs), with particular reference to sub-Saharan Africa.

CHAPTER TWO

A RATIONALE AND CRITIQUE OF STRUCTURAL ADJUSTMENT

> The position of the poor in developing countries is extraordinarily bad on a range of quantitative measures, especially when compared with achievements in developed countries...by and large, during the 1960s and 1970s, the poor improved their position as regards both consumption and the social indicators. In the 1980s, however, the picture is mixed, depending upon the aspect and, more importantly, the country being considered (Kanbur, 1994, 88-89).

The Case for Adjustment

Investments in human capital to spur and sustain economic growth and job creation will only succeed if the policy environment is conducive, or at least relatively neutral, to private sector growth. SAPs are policy packages designed by the World Bank and its partners to enforce free market oriented solutions to the problems of underdevelopment in LDCs. The resounding failure, particularly in Africa, of most LDCs to develop since 1970 presents a stark picture to which SAPs seek to respond. On average, real per capita GDP did not grow in Africa over the period 1965-1990, while in East Asia and the Pacific, per capita GDP growth averaged over 5 per cent and in Latin America growth averaged almost 2 per cent annually in the same period. Much of Africa has suffered negative growth (Easterly and Levine, 1997) with this growth tragedy drawing increasing attention. Ample blame has been apportioned to a diverse set of potential causes ranging from poor policies to inadequate education, political instability and inadequate infrastructure for development. The failure of economic growth in LDCs in Africa particularly has led to increasing pressures exerted by international financial institutions (IFIs) to force fundamental structural changes in the economic policies of LDCs. Collectively, these policies are referred to as Structural Adjustment Programmes (SAPs). Designed and implemented differently according to place, political incentives and national divergences, the policies generally seek to

reduce government intervention in economic affairs, reduce artificial trade barriers, increase the power of market forces and decentralise economic decision-making (Rapley, 1994). Their value is contested. Despite the debate on the value of SAPs, the role of such programmes is not likely to diminish in the near future. Whatever strategy is adopted by any developing nation, including South Africa, the policies common to structural adjustment will surely play a part.

The Relevance of Structural Adjustment to South African SMME Policy

The adjustment approach being applied in developing economies world-wide is contested; critics in South Africa opine that adjustment policies will create "further social instability and a contraction of the economy" (Pillay, 1997:17). To the extent that monetary policies in line with structural adjustment are being implemented by South Africa's post 1994 government, it is helpful to review the fundamentals of structural adjustment and assess three strands of criticism.

The general framework of adjustment policies are especially important to this thesis in which it is suggested that effective interfirm linkages between large and smaller enterprises for small business are a neglected strategy for SMME development that ought to be more widely implemented in South Africa. Interfirm linkages for SMME development makes two suppositions that are directly related to the theoretical underpinning of structural adjustment.

First, interfirm linkages presuppose that the integration of a developing economy with global markets will create new global market opportunities and foreign direct investment (FDI) that will have positive spillover effects for the developing economy and to SMMEs. Our thesis follows that SMMEs that are linked in long term relationships with larger enterprises will be in an advantageous position to benefit from new business that might be generated by economic integration.

This is contested ground, with Padayachee (1995:163-5) arguing that the value of foreign investment in developing countries is overstated, is usually tied to political

objectives of 'donor' countries and, in the long run, weakens the capacity of developing countries to compete equally in global markets. A countering view held by Blomstrom, Lipsey and Zejan (1992) suggests that FDI encourages increases in technical know-how, management expertise, efficiency and access to new markets that might otherwise be less readily available to developing economies. Even long-time critics of the benefits of FDI such as Gordon (1994: 43) concede that,

> The…firm's orientation to collaboration as the cement of long-term…relations includes substantive transfers of expertise, financing and managerial assistance to local firms and support for the upgrading and consolidation of local technological and human resource capabilities.

The second assumption related to SAPs is that the state will not necessarily direct, maintain and control interfirm linkages and that market forces will contribute more significantly to the success or failure of interfirm linkages. Since the diminution of the state as a mechanism to direct economic development is a significant aspect of structural adjustment, what is the role of the state, if any, in the formulation and support of interfirm linkages? It will be suggested that the state will assume a significant co-ordinating and monitoring function if interfirm linkages are to work to maximum benefit. This approach eschews both the minimalist state approach advocated by some early proponents of the Asian miracle, or the heavily interventionist approach that marked state-led development in much of sub-Saharan Africa in the 1970s. Rather, as the principles of structural adjustment contribute to increasingly open developing economies, the attention of the state can be refocused from the production of goods and services to a facilitation and regulation of business relationships between enterprises that can create and redistribute wealth, in line with government objectives, with limited intervention. The state as a facilitator of development will be examined further in Chapters Three and Four.

The challenge facing developing economies is enormous, namely to:

- adequately identify the root causes of chronic underdevelopment;
- determine those causes that are internal and which can be remedied with sufficient political will and technical expertise;

- determine those external factors that contribute to poverty in LDCs which must be adapted to;
- analyse and adopt, with country- specific variants, those strategies proposed by various IFIs, most notably the World Bank and the International Monetary Fund (IMF).

This latter point, adoption in some form of economic restructuring suggested or dictated (depending upon one's perspective) by the World Bank and IMF, is the centre of controversy. In part, the economic restructuring suggested by IFIs is contested because it presupposes that most problems of economic development, especially in Africa, are internal, often created by the state itself. Consequently, SAPs tend to diminish the importance and weight of historical causes for underdevelopment and, in the view of some (Loxley and Seddon, 1994; Elson, 1994), tend to blame the victim for the cause. Thus, before proposing any new models for economic development in South Africa we must first review both the intent of structural adjustment policies and the criticism they have attracted.

The theoretical grounding of structural adjustment is that free market forces ought to be the primary paradigm for African development (World Bank, 1983). In a World Bank report nearly a decade later (1991) belief in the development potential of free market forces remained equally firm, albeit with acknowledgement that the state will continue to have a significant, if modified, role:

> The agenda for reform that has emerged from this report calls for governments to intervene less in certain areas and more in others [-] for the state to let markets work where they can, and to step in promptly and efficiently where they cannot. History suggests that this is the surest path to faster growth in productivity, rising incomes and sustained economic development (World Bank 1991:128).

Underpinning the application of structural adjustment policies is bedrock belief in the free market and the broad assertion that governments in developing countries have repeatedly intervened to a greater degree than is helpful to the efficient operations of a free market economy. Political desires to protect local industrial bases, improve income

distribution in the population, or increase employment though large scale public works projects led to further market-distorting state intervention: import quotas, prohibitive tariffs, bloated public employment sectors or confiscatory taxation of productive sectors of the economy. Often, state intervention in economic affairs has involved entering into the production of common consumer goods for short term political or social gain without acknowledgement of the longer term economic implications. Although such interventions sometimes succeed in the short term there are few examples of long term market control by government[22] that has enlivened economic growth in developing countries. Related to this is the increasing weight of evidence that state-owned enterprises are seldom as efficient producers in the long term as are partly or fully private sector producers (Edmunds, *Weekly Mail and Guardian*, 27 June-3 July, 1997; World Bank, 1993b). Structural adjustment policies seek to lessen state intervention in developing economies.

With more than a decade of experience in the implementation of SAPs, the public discussion concerning the rightful role of the state in developing economies has softened. In the early days of the so-called Washington consensus (a response to Latin America's structural crisis if the 1980s) much discussion centred around getting the state out of as much of the ongoing economic activity as possible. Poland's former First Deputy Premier and former Minister of Finance described this approach as 'liberalize as much a you can, privatize as fast as you can and be tough in fiscal and monetary matters (Kolodko, 1998).

Structural Adjustment Policies

Adjustment is comprised of a set of different components that implement economic reform aimed at changing the structure of production and consumption, and increasing

[22]Naya (1989) elaborates on this point related to the policies of East Asian NICs (except Hong Kong) which are highly interventionist. He suggests that intervention in HPAEs differs significantly from state-dominated economic development in Latin American and Africa. Naya proposes that Asian government intervention is limited to those actions that will facilitate market forces in the long term, or which correct market distortions, in marked contrast to Amsden (1989,1991,1994).

the flexibility and efficiency of the economy (Gulhati, 1988). The set of economic prescriptions encompassed by the general term Structural Adjustment Programmes are well known. Measures, variously implemented in different settings, include some or all of the following:

Stabilisation policies: macro-economic adjustments and correction of imbalances in the money supply, foreign payments, and government budgets intended to control inflation. Stabilisation policies are often the first prescriptive measures of adjustment, and have immediate effect on the quality of life in adjusting economies (reduced social spending, increase in prices of previously subsidised goods, and so on.)

Export oriented strategy: a network of policies designed to increase competitiveness of exports based on the theory that export expansion is an invaluable engine of growth classically expounded by Adam Smith (1937, 1994) and revised by Caves (1971), Lewis (1980), Krugman (1980) and others.

Changed structure of production: emphasising production of tradeable goods and consumption of non-tradeable goods. Policies to achieve this may include market-enforced devaluation of currencies and other incentives for consumption of non-tradeable goods.

Deregulation or liberalisation: removal of government interventions and freeing of economic functions, aimed at removal or limitation of price controls, subsidies, quantity restrictions, protectionist tariff structures and other barriers to entry.

Privatisation: based on the assumption that private, competitive business ventures can and will operate with greater efficiency and flexibility, and with greater attention to consumer demand. Privatisation may result in the sale of government-owned assets to private investors and/or contracting formerly governmental functions to private for-profit agents.[23]

Institutional reform: changes in government institutions making it possible for the above economic reforms to be implemented-largely involving removal of administrative controls on enterprise toward those policies supporting private economic activity (Roemer and Radelet, 1991).

The case for reform generally, and for the above elements of structural adjustment, is rooted in the classical paradigm of free and competitive markets. Under ideal

[23]Privatisation refers to a spectrum of policies ranging from commercialisation of public enterprise activity, to privatisation of non-core assets and activities, to outright sale of a minority or majority position in an enterprise. A detailed description is available in "Does Privatisation Deliver?", Economic Development Institute, Washington, DC 1995 by A. Galal and M. Shirley.

conditions, independent economic agents, without government intervention act equally with consumers to value the output of production jointly. Higher demand leads to higher prices that, in turn, leads to greater return on investment for the producer, which leads to increased factors of production, including future workers, which therefore moves economic activity to those activities that create the greatest value. Competition among producers forces the efficient use of all the factors of production and static economic efficiency is achieved (Meier, 1995).

The case for the necessity of structural adjustment is made strongly by the following factors:

- the reality of lagging economies in LDCs which have pursued central statist economic policies;
- the theoretical assumption that integration of LDCs into the world economy will promote foreign investment keen to utilise labour and other resources (Stoneman, 1993);
- devaluation of currency to encourage exports and production of local alternatives while discouraging import consumption (Williams, 1994); and,
- privatisation of government-owned enterprises on the assumption that, in concurrence with other economic reforms, private ownership of former state enterprises will lead to greater efficiency and long term productivity (Summers, 1994).

In summary, structural adjustment seeks policy reforms that limit or target state activity in the free operation of international market forces. The adjustment programmes of the IMF and World Bank are theoretically designed to free markets as completely as possible to equate supply and demand while allowing prices to reflect opportunity cost. Transactions made under these conditions move goods and production factors toward maximum output, thus enhancing growth. The rationale for freeing such markets, adequately restated by Fischer (1986), is a throwback to the classical economic thought of Smith and the development economics of Lewis (1980) and others. Others have commented that structural adjustment is less an embrace of free market forces than a realisation that the governments of most LDCs are so incapable of managing development that, whatever the downside of free market policies, they are still better than ineffective government intervention (Lancaster, 1988). It is probable that the proponents of structural adjustment are not monolithic in

their views and range from free market advocates (Berger, 1991) to the World Bank's chief economist who, in explaining the current Asian crisis, opined that some Asian governments left entirely too much to the free market.

> Many of the problems these countries face today arise not because governments did too much, but because they did too little - and because they themselves had deviated from the policies that had proved so successful over preceding decades. In several countries, for instance, poorly managed financial liberalisation lifted some restrictions, including restrictions on bank lending to real estate, before putting in place a sound regulatory framework (Stiglitz, 1998: 1).

Criticism of Adjustment

Structural Adjustment Programmes have been the subject of three significant schools of criticism. First, an 'impact based criticism' of adjustment argues that whatever the failings of economic policies of LDCs, the cure of SAPs is worse than the illness (Elson, 1994 and Lugalla, 1995). Related to this critique is the view offered by a broad range of Marxist political economists who analyse structural adjustment as the latest in a series of colonial and/or capitalist interventions in the economies of dependent countries with the intent of forcing weak national economies into the United States and European dominated global economy under conditions that will ensure continued economic subservience of developing nations (Arrighi, 1994; Loxley, 1990; and Leys, 1994). A second strand of criticism is 'performance based'. Proponents of this view (Parfitt, 1990; Hutchful, 1994; Stoneman, 1993; Williams, 1994; and Bush, 1994) argue that, whatever its intent, adjustment has not worked, it has not delivered the promised goods. Ponte's (1994) recent critique of the World Bank's (1994) defence of structural adjustment is exemplary in this regard. The third critical view of structural adjustment is that the role of the state is significantly reduced through adoption of SAPs and, consequently, the national sovereignty of LDCs is diminished. It is this 'diminished state' critique of structural adjustment that may be most profound and underlies most other 'performance based' or 'impact centred' criticisms.

Impact-based Criticism

Impact-based criticism ranges from simplistic arguments to the morally persuasive and technically significant. Elson (1994:522) argues that the solution to the problems of underdevelopment in Africa can be found "in seeking to slow down the high speed global economy" and "to adapt the rhythms of the financial markets to the pace of human life". Similarly, Watkins (1994:606), citing external African debt as the primary obstacle to human development in sub-Saharan Africa, states that "the IMF should use its own resources to write off a substantial proportion of the debt owed to it by African governments...which is a consequence of mismanagement by the IMF itself..." While it is likely that the IMF will write off a substantial portion of prior debts incurred by LDCs and will renegotiate payment structures on others, it is also probable that such write-offs will be adjudicated on a case-by-case basis and will require the adoption of policies that embody some of the major initiatives collectively known as SAPs (Evans, 1995). Appealing as the arguments may be to purely humanitarian considerations, Elson's suggested solution borders on wishful thinking while Watkins' envisions a most unlikely revision of conditions for lending based on highly dubious analysis of why countries in sub-Saharan Africa face a debt crisis.

Another criticism from this perspective is offered by those who maintain that the human impact of adjustment is excessively harsh. Kanji and Jazdowska (1993) document in anecdotal form the spiralling prices of food staples, a consequent change in household diets, and a relative increase in the cost of basic medical care in Zimbabwe since the introduction of structural adjustment policies. However, they indicate that the evidence of the deleterious effect of structural adjustment is individual and short term, and that scant longer term data exists to corroborate or contest their assumptions. In this regard, they adopt the position of Beneria (1992:1549) stating that, "the depth of the crisis was felt in a way that escapes statistical and analytic quantification". While such a passionate declaration is difficult to ignore, it is equally difficult to formulate economic policy based on slender evidence.

The World Bank (1995) itself concurs that the effects of structural adjustment sometimes require mediation to protect the weakest segments of society. Because labour is a less mobile factor of production than capital,

> [a]djusting economies will create temporary dislocation in the labour force, increased unemployment in some sectors and the need for social intervention to ameliorate the effects of adjustment on the very poor. Transformation follows diverse patterns in different countries, but it always involves a marked destruction of non-viable jobs and the creation of new ones (Yahie, 1993:23 -24).

Impact-based criticism of structural adjustment occupies a valuable place in the debate on economic restructuring in LDCs and has motivated the development of a poverty-alleviation social-safety-net element into SAP planning. Nonetheless, it can be reasonably argued that structural adjustment is only speeding up a process of inevitable market-forced reforms, and that some social dislocation would happen with or without adjustment.

Performance-based Criticism

Performance-based criticism of Adjustment is succinctly articulated by Loxley and Seddon (1994: 485):

> The World Bank has argued that a significant recovery took place in the second half of the 1980s, as a result of IFI interventions. We disagree.

At first glance, it is tempting to affirm Loxley and Seddon: African economies are still in a poor state and Leys (1994) and others see improvement as a long road ahead. Upon what empirical data, then, does the World Bank base its optimism, and what of its critics? The first level of response is the World Bank contention that policies that have succeeded elsewhere will succeed in Africa. This optimism in cross-country transferability of adjustment rises from a firm conviction in the flexibility and adaptability of relatively free markets structures, and the fact that adjustment policies have been adapted successfully across the globe notably in Ghana, Indonesia and Malaysia and in Poland.

Thus, the Bank argues that:

> Adjustment has contributed to faster GDP per capita growth in half the countries examined in this report, and there is every reason to think that it helped the poor, based on the strong linkage between growth and poverty reduction elsewhere in the world (World Bank, 1994:163).

The claim that structural adjustment policies boost growth relies on data that the Bank claims is already evident in Africa. In the 1994 Bank analysis of 29 sub-Saharan countries which undertook policy reform between 1981 and 1991, countries with greatly liberalised macro-economic policies (Burkina Faso, Gambia, Ghana, Nigeria, Tanzania) vastly outperformed the countries with a deteriorating or unchanged macro-economic policy (Benin, Cameroon, Central African Republic, Congo, Cote D'Ivoire, Gabon, Mozambique, Rwanda, Sierra Leone, Togo and Zambia). Even if one removes Nigeria[24] with the highest rate of GDP growth and Mozambique with the lowest rate of GDP growth, the comparative data remains significant. Those countries attempting aggressive policy adjustment have demonstrated the most significant GDP improvement during the study time-frame which is contrasted by the generally worsening economic performance of non-adjusting countries (World Bank, 1994).

Ponte (1994) does not so much argue that adjustment has been unsuccessful, as point out that adjustment has not met its own expectations and that by measuring the effect of adjustment by using GDP data, the Bank ignores others aspects of development such as income distribution, access to education, and the environment.[25] The Bank's defence of adjustment relies heavily upon GDP data from adjusting and non-adjusting countries. Ponte goes on to argue that by using GDP growth as an indicator, the Bank actually demonstrates the failure of Adjustment by highlighting that the mean GDP increase in seven Bank-identified 'strong adjusters' in the period 1987-1991 was only 2.0 per cent.

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[24]Nigeria's rate of GDP growth is certainly partly due to the 'windfall' that accrued as a result of the world-wide rise in oil prices during the late 1970s and 1980s.

[25]This speaks to the difficulty of using GDP data to ascertain economic development and its social impact.

Ponte's argument is questionable in that he fails to indicate that the mean GDP change in the eleven sub-Saharan countries that were 'non adjusters' was negative 1.6 per cent growth annually (World Bank, 1994). While it is true that proponents of SAPs have touted significantly higher figures of GDP growth while undertaking adjustment, the statistical difference between strong adjusters and non-adjusters is noteworthy.[26] Those who criticise structural adjustment based on performance criteria seem to ignore the increasingly undeniable fact that elements of adjustment, when implemented and sequenced, do lead to significant medium term gains in GDP. While tending to a sense of self-aggrandisement, the following contention by the World Bank (1994:27) needs to be seriously considered:

> One valuable and hopeful lesson for Africa is that spectacular increases in growth are indeed possible - if the right policies are in place.

The World Bank's programmes of structural adjustment have, in the main, sought to limit the degree of government intervention while encouraging market-based incentives to guide economic development. It is unlikely, however, that the Bank's favoured freer market approach of 'getting the prices right' will, by itself, lead to the kind of dynamic growth seen in the HPAEs that most developing economies wish to emulate (Daly, 1997). As amply shown (Wade, 1990, 1991) the HPAEs have intervened to a significant degree in order to target incentives and mould market forces to the benefit of certain industries and technologies. This is particularly important because incentive-based approaches have dominated SAPs while tending to ignore the more difficult and slow-gestating efforts to build up human capital and institutional structures for technology and knowledge transfer. The disappointing results of Structural Adjustment in some areas may arise from the unfounded assumption that market incentives, by

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[26] Particularly when compared with Summers' (1992) contention that even as small an improvement in the GDP as 0.2 per cent annually of the 35 least developed countries would result in an additional $100 billion of capital for reinvestment annually. Structural adjustment does, indeed, seem to deliver at least some of the promised goods.

themselves, will summon forth the capabilities needed to effectively and profitably participate in the marketplace.[27]

The Diminished-state Critique

The final and perhaps most telling criticism of structural adjustment has been previously referred to as the 'diminished-state' critique. Structural adjustment policy is, per se, intervention by IFIs and globalised monetary agents in the economies and trading policies of states in order to encourage (or impose) the adoption of certain free market policies. Adjustment does, in fact, diminish the role of the state in economic planning. The quest for industrialisation in the post-war period of reconstruction in Europe and Asia and later in the period of African decolonisation and independence gave political impetus to the state as the dominant engine of growth in LDCs (Shapiro and Taylor, 1990). In the early days of independence, the state in many African nations assumed the role of economic planning agent. In order to direct social policy, the state often enforced a series of ever-increasing regulatory controls, tariffs and policies that used industrial resources as an instrument for employment creation, staple food subsidies and protection for new industries. For many industrialising countries this view of the state as the spearhead of economic development has become dated, particularly in light of abuse and inefficiencies which appear to be inherent in state driven economic planning (Krueger, 1993). The state as a development agent cannot respond to market variables with the speed or resilience of less regulated entrepreneurs. Further, any state that wished to chart its own course for development has found itself swamped by an avalanche of information and technology that has defined development in the last decade (Frischtak, 1992). As the world's economy has become more integrated, the plans of any individual state for economic development have also become more globalised.

Thus, the diminished-state critique of structural adjustment assumes that the state apparatus in LDCs should remain dominant in developing African economies in order

[27]The argument that more free markets are needed for economic development relates to the corollary need for effective strategies for human capital development, technology transfer in developing economies, and 'learning by doing'. This finds fuller expression in Chapters Seven and Eight.

to resist the global pressures that diminish national sovereignty especially among peripheral economies. Since the goal of structural adjustment is economic development with reduced reliance upon state intervention, considerable concern has been voiced regarding the diminution of the role of the state through the imposition of adjustment (Ninsin, 1988; Loxley, 1990). Despite the so-called 'rolling back of the frontiers of the state' in many countries of the world (Roberts, 1993) that characterised the period 1985-1995, many African countries retained a good measure of sovereignty and bargaining power regarding internal economic policies. However, the waning of the Cold War, the rapid imposition of a new world economic order, the globalisation of markets and capital, and direct intervention in the policies of developing states by donor conditionalities (Melrose, 1985; Corobridge, 1993; *SA Development Monitor*, 1997) have all contributed to a substantial lessening of the role of the African state in development.

Ninsin (1988) attributes the economic difficulties of African states to the 'neo-colonialism' of nominally independent African states subservient to international banking forces. He suggests that further domination by IFI-dictated policies will increase the debt trap and economic marginalisation of African LDCs. Clapham (1985), Young (1988) and Peet (1991) advance the position that international geopolitical imperial control over developing African states, which was once maintained by military apparatus, is now maintained through mechanisms of global economic integration including structural adjustment. Adjustment entrenches the trend toward global capitalist integration with the consequent diminution of the importance of individual states. Without contending that the path of African development has been successful since 1965, these critics of structural adjustment argue that SAPs should be resisted as yet another form of disempowerment of sovereign states and economic neo-colonialism.

Slater (1993, 1994) challenges free market forces as unable to deliver the political goal of economic equity and unlikely to protect the interests of peripheral economies in an integrating world economy, unleashing forces of individualism and accumulative greed.

For developmental statists, the reasoning follows, strong intervention will be required to bring about some level of social equalisation. Consequently, SAPs diminish the role and influence of the state just when the need for the state to participate in economic planning grows in order to regulate wealth accumulation, employment, labour dislocation and trading terms.

The Asian Crisis and Renewed Criticism of World Bank Planning

The financial crisis that began to erupt in Asia in mid-1997 has resulted in turbulence and sharp declines in the currencies, stock markets and other asset prices in a number of Asian economies. Emerging against a backdrop of several decades of outstanding economic performance in Asia, the crisis has put pressure on emerging economies outside Asia (investor fear of emerging market stability is widely held as one factor in the fluidity of Rand value against benchmark currencies). Predictions of a 1 per cent decline in the 1998 rate of world-wide economic growth are widespread (World Bank, 1998).

Without making a detailed analysis of the Asian economic crisis (which is beyond the scope of this thesis), some comment is required in order to assess the role of the IMF and World Bank, related to the above critique. There are four primary causes of the Asian downturn.

First, several Asian currencies appreciated substantially during the early part of this decade, because of artificially pegged exchange rates[28] that encouraged massive short term external borrowing by the private sector, and the risk associated with such borrowing. Currency appreciation (and in some cases overvaluation) contributed to large and growing national current account deficits and worsening terms of trade (exports were more costly leading to a demand slowdown).

[28] Asian currency appreciation was caused by exchange rates that were pegged to the US Dollar. When the Dollar appreciated from a low of 80 Yen to the Dollar in 1995 to a high of 125 Yen in 1997 (a 56 per cent appreciation). This real exchange rate appreciation worsened the terms of trade by making Asian export more expensive, thus making the current account deficits less sustainable through trade.

The need to depreciate currencies in real terms to boost trade led to speculative attacks on Asian currencies, which were then unable to be supported by central banks due to current account deficits.

Second, because the economic growth of Asia seemed limitless, foreign banks were eager to extend loans to the Asian private sector with abandon.

> 'There was a huge euphoria about Asia and Southeast Asia,' said Dennis Phillips, a spokesman for Commerzbank, a big German bank. 'It was the place to be.' (*New York Times*, 27 January, 1998: 1)

Until the current crisis, Asia attracted almost half of total capital inflows to developing countries - nearly $100 billion in 1996. In the last decade, the share of developing and emerging market economies of Asia in world exports has nearly doubled to almost one fifth of the total (IMF, 1998). These massive capital inflows, on a short term basis, often encouraged imprudent bank lending which created long term debt, especially in the real estate sector. When currencies depreciated, short term bank loans, requiring repayment in Dollars and Deutchemarks, became unsustainable.

Third, extensive short term borrowing to finance long term, low quality investment, coupled with lax regulation of the banking industry in many Asian economies, allowed the instability to assume enormous proportions (IMF, 1998; Krugman, 1998). Finally, as the crisis unfolded, significant uncertainty emerged about the authorities'(especially in Thailand and Indonesia) willingness or ability to undertake the necessary reforms to stabilise financial markets. (Necessary measures included the tightening of monetary conditions, closure or strong regulation of ailing financial institutions, and the floating of currencies (particularly the Thai Bhat) long before the crisis broke in July, 1997. The inherent political instability (Indonesia) and isolation (Thailand) of some Asian political leaders rendered financial markets unable to respond quickly to the growing crisis. As lenders withdrew from the most affected economies, markets examined the conditions in other Asian economies and found some of the same weakness in South Korea and neighbouring countries. Investor insecurity spread contagiously, with

repeating cycles of currency depreciation, short term loan demands, and losses on speculative investments along with declining terms of trade and export demand.

The World Bank and IMF responded, engendering widespread criticism. The policy prescriptions are summarised as follows:

- introduction of flexible exchange rates, where they did not exist;
- tightening of monetary policy to ease balance of payment pressure;
- banking regulation reform;
- structural reforms to remove trade barriers and non-transparent corporate and banking practices;
- closure of non-viable banks;
- international supervision of weak banks; and
- increased opportunity for foreign participation in domestic financial systems (World Bank, 1998).

The Asian crisis has spurred renewed criticism of IFIs, and the IMF and World Bank Group in particular. Most of the criticism concerns the rightful role of IFIs, such as the World Bank, in relation to sovereign nations' ability and right to sort out internal economic and political problems. In this regard the Asian crisis adds weight to the 'diminished state' critique of structural adjustment. The IMF's interventions in Asia, which led to government changes in Indonesia and South Korea, are viewed by some as meddling in the affairs of Asian states for the economic benefit of international banks with dim regard for national sovereignty.

> Almost every night in Thailand, a stream of television commentators chafe at the humiliation of witnessing their country's leaders negotiate every element of national economic policy -- from interest rates to budget deficits -- with economists who work largely in secrecy out of the IMF's offices off Pennsylvania Avenue here (*New York Times*, 30 January, 1998:1).

Not only is national sovereignty sacrificed to global institutions beyond the reach of affected economies, few see any positive benefits of the World Bank's and the IMF's policy prescriptions.

> All over Southeast Asia, people are complaining that a cabal of heartless bureaucrats at an institution many have come to loathe -- the International Monetary Fund -- is worsening their economic misery (*New York Times*, 30 January, 1998:1).

Even a cursory review of the policy remedies to be applied in Asia show abundantly that the 'global reach' of the World Bank does, indeed, significantly undermine national sovereignty as seen in the previous 'diminished state' critique of structural adjustment. What is less clear is whether the interventions have improved the economic climate or exacerbated the crisis.

Sachs (1998:19 January) made the following observation regarding the Asian intervention:

> I think it needs a little bit of subtlety. To arrive on the scene and within four or five days say that 16 banks in Indonesia should close down and then to incite a panic, which the IMF internally has now recognised, in which 2/3 of the banking sector within four weeks is subject to a panic run of depositors is just not good performance. To do the same thing in Thailand and Korea is simply not good performance. What we have now is a colossal banking crisis, far beyond the proportions that had to have occurred if the policies had been more subtle. I think the long-term direction of reform is good, but it also is no license to use a sledge hammer when a much more subtle instrument is needed. And I believe that the IMF has a tendency to do this.

While Sachs criticises the IMF intervention for its heavy-handed ineffectiveness, Krugman (1998: 12 January) takes a measured view that the crisis was generated by dynamics that are new to developing economies:

> … the Asians did invent a new kind of crisis, I think. This is really something - we didn't know - there are usual things that you look at for a crisis. You look at government budgets; you look at things that are basically on the books. And this turns out to be an off-the-books crisis. It's all the hidden liabilities of institutions that weren't exactly publicly guaranteed, that weren't exactly not publicly guaranteed.

In Krugman's scenario of poorly regulated financial institutions and government authorities with minimal enthusiasm for politically unpalatable policy remedies, global economic stability may require a diminution of total national self-determination. In this

regard, the IMF and World Bank intervention in the Asian crisis follows a pattern similar to the implementation of structural adjustment: national economies in undeniable turmoil, numerous national obstacles to the market-based policies of the World Bank, financial assistance from IFIs with significant policy and governance 'strings' attached which diminish national sovereignty, and a mixed record of achievement. The Asian crisis demonstrates once again that the role of the state as the sole agent for national economic policy development and implementation has been significantly eroded in the last two decades. What is the new role for government in economic planning?

Beyond the Minimalist State

Economic problems arise when the immediate political and social needs of government disrupt fragile economic growth.[29] Widespread state intervention in markets has led to the World Bank and IMF contention of an inverse relationship between the degree of government intervention and the rate of growth in LDCs. In diminishing the role of the state, SAPs echo earlier work by Wellisz (1971) and Myint (1954) who generalised that state planning most often resulted in mediocre economic performance and that centrally planned economic development has led to less robust growth than free market development. Diminution of the state's role is lauded in a recent World Bank publication:

> Sustained growth with growing labour demand has been achieved by countries that have relied on markets -- domestic and international -- to guide the process of development, whereas inward-looking and centrally planned strategies have generally failed to bring sustainable gains to all workers (World Bank, 1995:41).

The failure of the state-led rush toward import-substitution industrialisation, parastatal control of strategic industries, and mixed political and social agenda in economic policy planning that characterised much of sub-Saharan-Africa from liberation to the mid 1980s is widely recognised (Iskander, 1996). Recent policy reforms have further

[29] For example, in Zimbabwe in 1997 the political need to make large payments to former freedom fighters resulted in massive tax increases for certain sectors, heavy borrowing from reserves, and a resultant currency crisis - taken together, a significant disincentive for further business investment.

diminished state centrality: price deregulation, currency integration into world markets (often leading to market-motivated devaluation) and reduction or removal of tariffs, licensing and quotas have been common elements of liberalisation in developing economies.

If the development state is obsolete, what then is the new role of the state in developing countries? Frischtak (1992) and Serven and Solimano (1994) suggest independently that at the most basic level the state's role is to establish a set of guidelines and market supportive institutions to assign property rights, enforce contracts and establish a stable environment so that productive activity can flourish. Stability, predictability and transparency are the principles toward which the state should strive. In the macro-economic environment, policies should be directed toward long term monetary stability, maintaining public trust in financial institutions and avoiding sudden shifts in economic policy for stability at home and confidence abroad (Frischtak, 1992). That these principles are now widely accepted by advocates of both the developmental state approach and state minimalists indicates just how far concepts of planning have moved from the centrality of the state.

Advocates of the new developmental role of the state now seek a middle ground between the stagnant centrally planned economies of the past and the free market orthodoxy of the 1980s. However, Frischtak's minimalist role for the state in development planning is neither a realistic nor a wise course for developing African economies. Although many countries in Africa are moving toward macro-economic stability by increasing their competitiveness in world markets by providing greater incentives for the agricultural sector, reducing import barriers and allowing currency to float, significant economic reform problems remain. Low-income countries that are reforming may be less able to move quickly to reduce the dominance of the public sector in the economy, especially state dominance in the provision of capital goods (cement, steel, and energy production) (Galal and Shirley, 1994). State dominance in the provision of capital goods is often justified in political terms (avoiding mass employment dislocation). While privatisation and reform of such public enterprises

appears to be the next step in the sequencing of structural adjustment reforms in Africa, these moves will be implemented only gradually. Further, the training and capacity building needs of labour in sub-Saharan Africa (particularly relevant to South Africa) are such that parastatal enterprises may increasingly provide a valuable long term training and business 'mentoring' function.

In addressing the capacity building needs of labour in South Africa, the Overseas Development Institute (1995) suggests that the state in developing countries has an important role in economic development. Along with the need to substantially free market forces is the parallel need to engage in the process of building up indigenous industries (Daly 1997).

> Capabilities should be developed through education, training, technological effort and diffusion in which governments have a role to play due to the fact that many skill and information markets suffer from “failure”. Success experiences suggest that it is important that institutions develop to enable markets to function effectively and to promote capability development. Since markets by themselves may not generate the right institutions, governments again may have to intervene in establishing them (Overseas Development Institute, 1995:3).

In this regard, the next chapter will review the role of the state in economic development, followed by a case study of Taiwanese state intervention in bicycle production in the 1970s . This case study aptly illustrates that targeted and limited state intervention can result in significant economic growth and job creation though SMME support. From this example and its policy implications we will see that the passing of the centrally planned 'developmental state' has opened the way for the emergence of a new enabling role for government that is termed the 'facilitating state'. We then draw certain implications as to the rightful role of the state in SMME support in South Africa.

CHAPTER THREE

STATE POLICY :
FROM LEADING TO FACILITATING DEVELOPMENT

> …with the exhaustion of the Schumpterian state, which spearheaded industrialisation in developing countries in the last forty or so years, a novel mode of state action is required (Frischtak, 1992:14).

The world of development economics is divided into those who put their faith in government intervention and those who trust the marketplace. As the 1997 World Development Report indicated, there has been re-thinking regarding the rightful role of the state in development. The World Bank's call for the 'capable state' echoes Wade's (1992) suggestion that any 'new interventionism' by the state needs to guide rather than replace the markets. To do so requires a substantially strong and agile apparatus of information and enforcement: to enforce policies across sectors uniformly and to have access to market information quickly enough to respond to market changes. Wade (1992:77) goes further to suggest that in some conditions, "the risks of selective intervention are likely to outweigh the benefits. This is true where state authority is rudimentary (as in much of Africa) and where the state elite is fused with the business and landed elite. Here neo-liberal prescriptions are the least bad starting-point for policy".

Deane (1989), suggests that as industrialisation progresses, the state's need for increasing political control over the developing the developing economy gives rise to increasing intervention in policy-making to accompany the growth of new markets and market opportunities, new trading structures and terms of trade. While economists have remained cautious about the rightful role of state in the marketplace, that the state will be active in economic development is now a shared assumption.

Free market operations, based purely on the maximisation of individual behaviour, seldom achieve the optimal resource allocation required by civil society (Slater, 1993). There are circumstances in which the state may need to intervene in economic activity to achieve or direct resource allocation that concurs with the long term political and social vision of national economic development or to achieve an equitable distribution of resources after years of legislated benefits directed to a segment of society (as in South Africa and much of Latin America, for example). Thus, the state is provided with a renewed justification for the manipulation of prices and markets for political ends (which has historically produced both good and bad results) (Chang and Rowthorn, 1995). As a consequence, the state has become firmly entrenched as an important and often leading player in the operations of most economies (Armstrong, Glyn and Harrison, 1991).

Given the commonplace practice of state intervention in the world's industrialised nations (Chang and Rowthorn, 1995), and the desire to assert national pride and self-determination among newly independent colonies in the mid 1960s, the years following independence provided fertile ground in which a widespread culture of state economic planning grew in sub-Saharan LDCs. Rapid economic development was at the top of the political agenda of newly independent countries. The state assumed primacy in economic planning to achieve nationalistic economic independence from former colonial masters (Toye, 1987). As many newly independent states decried the traditional reliance of LDCs upon primary products as an economic dead end which lacked any obvious self-reinforcing growth potential, state intervention and planning followed the 'big push' model of industrial development of Rosenstein-Rodan (1943) which called for an initial capital investment and ongoing co-ordination by the state. Gerschenkron (1962) later suggested what became commonplace in African LDCs: that the state's role in economic development might well grow from managing some aspects of development to large scale institutional financing for rapid industrialisation.

These and similar theoretical constructs found avid practitioners among newly independent states in sub-Saharan Africa. Officials expressed strong feelings against

capitalism, free markets and the exploitation of primary products that accompanied the trade practices of capitalist colonial powers. Especially in Latin America and sub-Saharan Africa, central state economic planning and state ownership of a significant portion of the industrial sector was promoted as an effective counterpoint to an unprotected entrance into world capitalist markets.[30] It was popular to point out that central economic planning could redistribute income and artificially set commodity prices in a way that would produce a socially desired outcome, correct market distortions. Many developing states entered directly into production, establishing firms that were insulated from the rigours of market competition (Roemer and Radelet, (1991).

Such interventions went well beyond the traditional role of government intervention designed to overcome market failures and achieve optimal investment outcomes. Any degree of government regulation of markets creates incentives for rent seeking and corruption as individuals try to circumvent the rules and civil servants can gain income from selective application of regulations.

> When government actions become more important than market forces in determining incomes, economic agents have less incentive to produce efficiently and instead concentrate on seeking governmental favour. Interventions of this magnitude almost always work against productivity and economic growth (Roemer and Radelet, 1991:59).

Thus Sen (1983b: 750) could rightly state by the mid-1980s that the government involves itself in the economy and "is powerful in nearly every developing country" but, he added, often with poor results. It was this factor, the frequency of negative results associated with government intervention, that by the late 1970s gave rise to a

[30]The predilection for central economic planning as a counterpoint to the legacy of colonialism was further supported by the successful and rapid industrialisation of the Soviet Union. The rise of the USSR from one of the most backward nations in Europe in 1920 to a world economic power by 1955 convinced many in the developing world that central planning was at least as viable an approach as was the market mechanism for running the economy. Taken together with a historic distrust of colonial capitalism, it is not surprising that many developing countries opted for strict central planning and management of the economy.

development economics literature that had at its core, the rejection of interventionism. Government became the problem rather than the solution (Huff, 1995).

The Limitations of State Intervention in Economic Planning

The role of the state in African economies grew immensely after independence (Abernathy, 1984). As the economic crisis facing Africa deepened during the 1970s and 80s and as the Asian miracle achieved heightened emphasis, the role of government in economic development became a subject of renewed inquiry. Several African case studies approached the question of state-society relations differently, but come to broadly similar conclusions (see Callaghy, 1984; and Young and Turner, 1985). The findings are concisely summarised by Rosberg and Jackson (1982:18) who made the harsh judgement: "In African countries, governance is more a matter of seamanship than navigation, that is, staying afloat rather than going somewhere."

Not only was state intervention in economic affairs generally unsuccessful in sub-Saharan Africa; even good attempts were often sabotaged by the weakness of policy enforcement. Numerous African states sought to control political activity in the 1970s and 80s through the creation of effective one-party states, the banning of political opposition, the suppression of press freedom and the elimination of an independent judiciary. Despite this, Frischtak (1988) cites a number of observers who conclude that the African state is generally 'soft'[31], that is, unable to effectively implement its own policies. The implication is that state-dominated economic planning might well result in national economic resources being distributed as rewards or bribes to cement the loyalty of political supporters, as Krueger (1974) and others have noted. In roughly the same period as the most dismal economic failure of African states in the 1970s and 1980s, many African states became increasingly bloated, made commitments both locally and internationally that were not fulfilled, and were increasingly unable to enforce internal government policies. It is not surprising, then, that the rise of Thatcher-Reagan freer market and diminished state doctrines of the mid 1980s were

[31] The phrase is originally Myrdal's (1957).

quickly seized upon as both the single correct critique of the failings of African economies and as the one-stop solution.

It is too simple, however, to ascribe economic success or failure merely to greater or lesser state intervention in the economy.[32] Significant government intervention is a hallmark of the enviable success of the HPAEs (Wade, 1990; Huff, 1995). The success or failure of government intervention seems to rest with the kind of intervention and its popular acceptance. Key features of successful intervention in East Asia were: the broad acceptance of government policies by the mass of the population, continuity of policy intervention with the concomitant increase in the perceived credibility of that policy which furthered macro-economic stability, and the ability to effectively implement the policies desired by the government (Huff, 1995). In short, a recipe for successful intervention might be: popular acceptance, policy continuity, and the ability to do what government proposes.

In an increasingly complex world economy in which the starting points for economic participation are tremendously varied, and which increasingly calls for some form of intervention to adjust for market failures, the suggestion that LDCs adopt totally free market policies is probably not realistic.[33] Virtually all governments intervene in the economy to direct, manipulate and adjust market forces for political, social and economic aims. While it is commonly argued across disciplines that the role of the state as an economic planning agent must decline in order for economic growth in LDCs to be strengthened and sustained, that does not equate with no economic role for the state. Wilson (1993:13), arguing for a more effective public/private sector

[32] Nor does the type of government seem to be particularly crucial to the success or failure of intervention. Huff (1995) notes that there is no clear link between economic development and either authoritarianism or democracy.

[33]Neither is it suggested that the industrialised nations were willing to practise during their own development. In this regard, see the history of wool protectionism in England during the 18th and 19th centuries (Hyam, 1993), the artificial support for US cotton and soybean prices in the 1970s or the current US government requirement that all computer printers sold in the US be capable of using only 110 amp power supply, thus restricting and defining a market and making it less open to 'foreign' competitors.

dialogue in Africa, suggests that a prerequisite for economic growth is for states "to shift from a control mode of government-enterprise relations to a regulatory mode". If such a new role for the state is to emerge, certain criticisms of statist central planning[34] must be acknowledged.

The World Bank (1983, 1994) has been especially harsh in its critiques of state economic planning, especially in reference to state ownership of public enterprises, regarding such state monopolies as sources of gross inefficiencies resulting from the lack of profit incentives, competition and financial discipline imposed by capital markets (Chang and Rowthorn, 1995). Related to the critique of public enterprises is Krueger's (1974) 'rent seeking' assertion that the creation of barriers to entry by the state leads to high transaction costs for normal economic activity and waste in the form of cost for political activity aimed at influencing state policy. This has fuelled the drive for public enterprise privatisation and a more *laissez-faire* role for the state in economic development.

Given the lacklustre performance of most economies in sub-Saharan African in the first two decades after independence, the decline of world-wide socialist central economic planning, the global dominance freer market theory and policy, and the withering attack on state planning in Africa, has the state role in economic planning in Africa come to an end? Can we now envision anything more than a minimalist role for the state? While not adopting the notion that individual entrepreneurship and private initiative are the only avenues to economic advancement, it is suggested that there is, within the private entrepreneurial mode, a clue to understanding the success of several HPAEs. By understanding the role of entrepreneurship in the HPAEs and the role of

[34] Perhaps the most cogent and far-reaching theoretical critique of central planning began with the so-called Austrian debate (for a survey of the debate see Lavoie, 1985). Beginning with the assumption that the modern economy is a complex and constantly changing environment which requires a vast effort in compilation and analysis of information on a scale far beyond the capacity of any state apparatus, the Austrian critique concludes that central planning is practically unmanageable, even if desired. While this school of thought has been taken to extremes - that all forms of state intervention are bound to fail - the argument is significant in weakening the case for widespread and long term state intervention.

government regarding such entrepreneurship, we may conclude that the new role of a 'facilitating' developmental state is indeed possible. The consequent step in research and practice is to test which strategies of government intervention are potentially most effectively transferable to South Africa.

The State as Entrepreneur

Perhaps the primary foundation for the belief in individual entrepreneurship as a key to economic growth emerges from the Austrian school belief that that the economic order is uncertain, fast changing, and responsive to the agile competitor (Rosen, 1997; Yeager, 1997). Chang and Rowthorn (1995), in examining the success of some HPAEs, suggest that the state can assist private enterprise in responding to the fast-changing economic environment. In this scenario, the state acts as the entrepreneurial agent, encouraging certain market related behaviours through incentives and penalties, all the while providing up-to-date information about market conditions and opportunities to private entrepreneurs. This state activity is far greater than state minimalists would argue, yet remains constrained from the pervasive historical elements of state ownership of large sectors of the economy. The state as entrepreneur may act as protector, financier, institution builder, marketing agent and strategist, but seldom as owner and as a producer only as a last resort and in isolated circumstances.

Hirschman (1958:112) argued that major economic change or development:

> …depends not so much on finding optimal combinations for given resources and factors of production as on calling forth and enlisting for development purposes resources and abilities that are hidden, scattered or badly utilised .

If Hirschman is right, economic development is much more than merely freeing markets for individual entrepreneurship. Rather, development requires setting a national agenda for economic change and providing a vision for the future, a function that can only be served by the state. The agenda for development might be related to a particular industry or sector of economic activity, but more often would relate to a vision for the

economy or society as a whole, within a global market context.[35] Similarly, Renshaw (1995:36) commenting on Japan's enviable economic development, indicated:

> …a sense of overall direction to the overall evolution of the economy has been provided by the annual economic white papers of the Economic Planning Agency with their thematic titles and by the forward looks or "visions" published every two or three years.... In practical terms, these documents provide criteria or orientation against which countless individual decisions by private and public officials can be tested and hence given **order and coherence which could otherwise only be achieved by a much higher degree of centralisation** (*emphasis added*).

The case for state entrepreneurship is rooted in the state's strategic position as the only organ of society that by its nature is intended to represent, articulate and convey the interests of the whole of society (that the state often does not take the national interest to heart is another matter). At its most potent, the coherent vision of a future economy by the state at an early stage can drive private sector investment into concerted action without coercing such investment (usually ineffective and leading to rent seeking) or making the private sector spend excessive resources on information gathering, political activity, and so on. This account from Taiwan illustrates the point:

> The government... decided to oversee the creation of a rayon-making plant as part of a plan to diversify the textile industry away from cotton fibre. With much help from US advisors it brought together an American synthetic fibre company with several local textile manufacturers from both public and private firms, and oversaw negotiations on the terms of a joint venture.… The resulting corporation was the largest 'private' firm on the island at the time [1957].… In 1962, this same state sponsored rayon company, together with a state financing agency, created another company to make nylon. It started production in 1964 (Wade, 1990: 80-81).

Two aspects of state entrepreneurship are worthy of note. First is the notion that state entrepreneurship assists the implementation of the state vision through creation of an institutional environment that is conducive to the vision's success.

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[35]For example, Bismarck's vision of a unified Germany as a military power provided a focal point for a concerted effort to build German heavy industry in the late 19th century. The national vision consequently inspired both state-sponsored and private industrial development. Resources followed the vision of new and emerging markets in ways that would certainly have been less concentrated, and might not have happened at all, in the absence of an overarching state vision.

In making this argument, Chang and Rowthorn (1995) assume that the process of economic development inherently destroys old alliances and interdependencies while new interdependencies, needs and alliances are emerging. Under these conditions, it is necessary to establish new co-ordination structures that reasonably correspond to or can enable the new pattern of interdependencies. Such new structures will reduce the information costs for all agents operating in an environment of greater economic uncertainty (with the potential for greater economic gain which is the policy objective).

National co-ordination of economic alliances naturally requires, in the first place, that strategies be localised and made suitable and relevant to local and national realities. Second, the development of local strategies for economic development must be tested, adapted and integrated with the requirement of globalised industry. This reality is endorsed in South Africa by the precepts of the Reconstruction and Development Programme (RDP) (African National Congress, 1994), its associated White Paper (Government of South Africa, 1994) and the Development Facilitation Act (Government of South Africa, 1995a). The establishment of new co-ordination structures with global awareness and local implementation planning necessarily requires state involvement.

Second, the entrepreneurial state assumes a new role as the manager of the inevitable cross-institutional conflicts that emerge in the early stages of economic development (Pillay, 1996). Economic development is concurrently both a creative and destructive process. Technological innovations during the process of development inevitably change the ways in which different productive assets are combined with each other. Just as automation changes the use and skill level of labour, often accompanied by increased labour dislocation, the large scale movement of factors of production from one sector to another can cause massive dislocation and the potential for social and economic conflict. This is particularly the case when economic development requires higher skill levels than can be supplied by the resident supply of labour. In such circumstance, owners may be led to bypass or substitute for existing labour, resulting in political activity (strikes, petitions, bribery, etc.) provoking counteraction by others

in society (Chang and Rowthorn, 1995). The particular relevance to economic development in all of sub-Saharan Africa and in South Africa particularly is immediately evident when considering the South African government's Gear economic development plan and the ongoing negative reaction to the plan by Cosatu and the ANC's other political partners (ka'Nkosi, 1998; Paton, 1998).

The entrepreneurial state also plays a role in economic development as manager of conflicts (Pillay, 1996). Left unchecked, market forces exacerbate cross-market tensions creating winners and losers. Unless the state apparatus is particularly strong and well developed, considerable pressure is often exerted on the state to intervene on behalf of one industry or another that is 'losing' in the marketplace. As noted previously, most LDCs are undergirded by developing political structures that are less likely to be able to resist the political pressures and conflicts that inevitably accompany the conflicts inherent in economic growth.

Assuming that almost all states will intervene to manage market conflicts and promote national interests, there are numerous options. On a scale from less to more interventionist, options include: employing monetary and fiscal policies which permit the state to compensate the losers of free market forces without totally subverting the logic of the market: targeting the specific sector or enterprise beneficiaries of state intervention; or explicitly endorsing certain interests, industries or groups within a larger strategy of overall economic development (Amsden, 1994; Chu, 1997; Ntsika, 1997a). Direct intervention by the state permits targeted response to the needs of particular sectors but leaves the process of development open to an often-unmanageable politicisation of the economy.

Constraints on Effective SMME Policy in South Africa

As South Africa makes the transition to post apartheid democracy, a welter of problems must be addressed. Primary among them is the need to rapidly increase productive employment, and to do so within a context of increasing integration into the global economy. Global economic integration assumes tacit adoption of the

fundamentals of structural adjustment, as well as compliance with the post-Washington consensus framework. Essentially, the current dominant paradigm of monetary orthodoxy will continue to constrain the activity of the state in its efforts to address the social and economic problems that face post-1994 South Africa. This is despite the argument by Singh (1994: 52-58) that global integration brings serious dangers to emerging economies if "the wrong kind of openness is attempted or the timing and sequence are incorrect".[36]

Despite a simmering debate on macroeconomic fundamentals, South Africa's post-1994 economic growth strategy has largely adhered to the dominant global paradigm of freer markets and targeted state intervention. It is, then, informative to review the policy options available to South Africa and some of the constraints that will affect policy-making for SMME development. As such, this discussion provides a framework for believing that the South African state can make a policy contribution to the development of SMMEs, and do so as a facilitating agent of business growth, rather than as an enterprise owners and employer.

The post-1994 period in South Africa should be regarded as a time of continuing economic transition. Inconsistent trade policy (Zarenda, 1997), political turmoil amongst the government's supporters in organised labour and mass movements (Lunsche, 1997; Grawitzky, 1997a, 1997b), policy that does not accord with the ANC's base documents on economic restructuring (Padaychee, 1997) and a two-decade-long decline in manufacturing productivity (Kaplinksy, 1995) contribute to a growing sentiment that although current economic policy is consistently within a broad orthodoxy, such policy is still being formulated in response to various pressures, both domestic and international. There are at least four factors that will constrain SMME policy in South Africa in the coming decade, namely: South Africa's two-world

[36] Debate abounds concerning the appropriateness and impact of globalisation on South Africa's economy Michie and Padayachee (1997: 9-26), Fine and Stoneman, (1996) and others argue that a failure to reverse the government's macroeconomic strategy (in line with the post-Washington consensus) will be catastrophic.

paradigm, a predominant retail bias, persistent income inequity and limited improvement in the stock of human capital.

The Two-world Paradigm

It is a commonly held viewpoint that South Africa is a microcosm of the first and third worlds within one national boundary (McCarthy, 1982; 1990). This assessment of South Africa as a bi-polar economic system led, in the apartheid past, to policies of 'separate development' and so-called homeland structures. While the obvious manifestations of 'separate development' were abolished legally with the 1994 elections, underpinning this thesis is the suggestion that the current government's approach to job creation through SMME development remains rooted in an outdated view that the growth of black owned SMMEs will require a necessarily different strategy than that which would promote non-black owned SMMEs.

To elaborate, it is understandably difficult for post-1994 policy makers to analyse the need for job creation strategies in South Africa without examining the causes behind massive unemployment among black South Africans. It is equally understandable and difficult for those same policy makers to enact policy that does not take into account years of apartheid-driven deprivation. The policy danger of this approach lies in the potential for the historical reasons for disadvantage to become justification for SMME initiatives that are more akin to social welfare than to business development. The current failure of the state-sponsored Khula Finance Corporation to compel repayment of even small loans made to emergent entrepreneurs and the R400 million owed by entrepreneurs to the East Cape Development Agency (Daily Dispatch, 23 September, 1997:7; 26 January 1999:3) creates an impression that loans to emergent entrepreneurs under these schemes were made without the policy intention (backed up by appropriate mechanisms) that loans would be repaid.

As shall be demonstrated in Chapter Six, it was the precise failure of loan programs for emergent SMMEs in Indonesia (especially) and Malaysia that led policy makers to seek other forms of SMME support beyond loans. South African SMME policy continues

to rely heavily upon loan-making as a strategy for business growth, despite considerable anecdotal and academic evidence indicating that SMME finance is probably not the single most effective nor needed intervention in support of SMMEs (Buckley, 1997).

Interfirm linkages between large and emergent enterprises force SMMEs to interact on business and market-terms with other enterprises and institutions. However, as is shown in the case studies in Chapter Eight, interfirm linkages can 'soften' the harshness of the marketplace by providing interfirm credit, advances on payments, provision of raw materials at preferential costs and access to markets previously unavailable to the emergent SMME.

Prior studies of the potential of the SMME sector to create jobs in South Africa suggest that black-owned SMMEs cannot compete with larger white-owned enterprises (Nattrass, 1984). Krige (1985) argues that small scale manufacturing in South Africa is stunted because the manufacturing sector is so dominated by large enterprises there is little 'room' for SMMEs to compete. Neither of these conclusions is surprising. It is probably inaccurate, however, to assert that the failure of SMMEs to develop due to competition and 'crowding out' is a particularly South African phenomenon. Indeed, similar comments have been made about the early stages of SMME development in Malaysia (Meyanathan, 1994: 13, 23) and Indonesia (Wie, 1994: 95-99)

In contrast to the two-world paradigm of development, this thesis suggests that emergent SMMEs in South Africa face obstacles similar to SMMEs in Indonesia, Malaysia and Brazil, at least. Access to some form of credit, new markets, skill acquisition, and production technology are common needs identified by growing SMMEs world-wide. The particularity of apartheid in South Africa has created a two-world paradigm that tends to cast government policy regarding small business as a particular antidote to apartheid. While too early to assess accurately, the context out of which current SMME support strategy is moulded could contribute to policy

interventions that artificially protect emergent SMMEs from market forces. Some form of support and protection is probably needed for small business in South Africa. Interfirm linkages are a vehicle that permits short-term SMME protection while gradually introducing market competition in a controlled environment in which the large firm has an interest in the success of its linked SMME partner. State guided interfirm linkage policy can act as an intermediate step between dependence upon state subsidies and complete independence in the marketplace. South African SMMEs require policy interventions that encourage integration into the world economy rather than retreat into the two world paradigm of South African particularity, especially when the issues facing SMMEs in South Africa are remarkably similar to other developing economies.

The Retail Bias

A second constraint on South African policy regarding SMMEs is a *de-facto* policy bias toward retail vs. manufacturing sectors. While the policy framework for the development of SMMEs in South Africa (DTI 1995) acknowledges the need for creation of a vibrant SMMEs within the manufacturing sector, the predominance of SMME support structures that were operative by October, 1998 were those that serviced the retail sector, predominantly in the survivalist category (see page 68ff for SMME categorisation). There is ample evidence of the bias toward retail. A random sampling of existing Local Business Service Centres (LBSCs) in the Eastern Cape Province and KwaZulu Natal indicated that upwards of 75% of all business seeking assistance are owner-operated retail operations that fall into the survivalist category (Delany, interview, 1997). Similarly the small business training materials produced by the International Labour Organisation and endorsed by the Department of Trade and Industry for SMME training in South Africa focus almost exclusively on retail operations. The Competitive Edge plan of the national Small Business Council (1997) suggested that communities will gain an ‘edge’ by demarcating designated areas for hawkers and traders in order to maximise the dynamic between urban consumers and rural producers, while offering little specific advice regarding local manufacturing.

The retail bias is understandable. South Africa's high unemployment, although difficult to measure, is seldom reported as less than 45% of the potential labour force, with youth, women and the Eastern Cape Province cited as sectors with extraordinarily high unemployment (defined as those without wage employment in the formal sector) (South African Reserve Bank, 1992). The informal sector and crime are important income sources for the formally unemployed (Kaplinsky, 1995). Faced with intransigent unemployment and its effects, even survivalist enterprises are welcome. A recent policy document published by Ntsika Enterprise Promotion Agency (NEPA) (1998:9) emphasised the importance of the informal sector by establishing "an Informal Business Training Board to give particular attention to training issues related to micro and survivalist enterprises."

Given the background of exclusion of most South Africans from the basic elements of economic productivity (land, education, job reservation, business ownership), informal trading could be seen as a reasonable step toward economic productivity. The drawbacks of the retail sector are significant, however.

In data studies by Winter (1995) developing country SMMEs in the retail sector failed at a rate 20% higher than the manufacturing sector, the mean employment size of surviving manufacturing enterprises was 270% greater than the employment created in surviving retail enterprises. When all retail and manufacturing firms were evaluated, including those firms that survived more than six years and those that failed, the retail sector contributed to a net job loss while the manufacturing sector - despite business failure - contributed to a net rate of job gain of 3,5% annually.

While it is premature to assume that SMMEs in the manufacturing sector will actually be net creators of jobs (see Behrman and Deolalikar, 1989), the evidence that SMMEs were systematically out-competed and crowded out in Indonesia and Malaysia before policies were adopted to support SMMEs, should give South African policy makers some hope. The right policies can (and did in Malaysia and Indonesia) create a climate in which SMMEs and LEs co-operate for mutual benefit. There is growing evidence

that the manufacturing rather than retail sectors hold promise for long-term job creation (Cardozo, 1997; Stone, 1997b) and that interfirm linkages are a viable means to encourage SMME growth beyond the retail sector

Income inequity

The high Gini coefficients operative in South Africa pose a threat to social and political stability that threatens the post-1994 democracy and may constrain SMME policy. Economic redistribution continues to be a central element in the policy debate both within government and academic circles. How the debate is resolved will have significant bearing on the development of a coherent policy to foster SMME development.

The ANC policy regarding redistribution has evolved over time from its 1990 discussion documents postulating that economic growth would occur through redistribution to the government's later view that investor friendly policies would keep capital 'at home' while attracting confident FDI. The academic debate behind the evolution of government policy included Moll's (1991) critique of ANC proposals on redistribution as 'macroeconomic populism' and Nattrass's arguments (1994a,b) that international business confidence and ultimately incoming FDI would be seriously compromised by redistribution of the order proposed in early ANC documents. Fine(1994) and Kaplinsky (1994) criticised Nattrass's position arguing that the legacy of apartheid generated inequity was impossible to ignore and that it was politically and socially impossible for the government to fail to intervene for dramatic redistribution.

The debate on redistribution continues (Shilowa, 1997; Tati, 1997; Bishop, 1997; Business Day, 1997a,b,c) while government policy has evolved away from short-term redistributive polices, rather favouring business-friendly long-term growth policies. Limited redistribution is accomplished through targeted infrastructure development projects that promise finite immediate job creation and service provision. Such policies and project are often accompanied by exaggerated rhetoric stating that "this programme [housing development] will lead to an increased output in all sectors of the

economy and by modernising our infrastructure and human resource development, we will also develop our export capacity" (ANC, 1994:6).

Against this background, the issue of income inequality remains unresolved. Further, if the Kuznets hypothesis is active in South Africa's economic transition we might expect to see a further widening of income inequality, while globalisation and lessening of tariffs might be accompanied by job displacement and business closures (World Bank, 1995b; Wood, 1990; Redding, 1990)

The development of South African SMMEs is often addressed as a policy complement to immediate labour-intensive public works projects that contribute to immediate employment and trickle-down redistribution, rather than a venture requiring a specific, unique policy prescription. Research by Mead and Liedholm (1998) suggests that SMMEs that develop a close working relationship with larger enterprise business partners have a significant potential to create long-term employment while also developing human capacity at skills that are transferable between industries. This would be in contrast to the highly touted Working for Water project of the Department of Water Affairs which creates low-skill, non-transferrable, temporary jobs eradicating alien vegetation.

Human Capital and the South African Economy

A further issue related to effective policy making for South African SMMEs concerns education and training. The unemployed in South Africa are largely semi-skilled or unskilled. New growth theory suggests that a reduction in income inequality (a government policy objective) will be achieved when the growth rate of output per person increases, and that such an increase is dependent upon investment in human capital and a residual that is described as technical progress (Solow, 1997; Romer, 1986). Thus, government policy that seeks to redress income inequality through systemic improvement in the capacity of the poor to increase productivity must tackle the education question.

While it is beyond the scope of this thesis to comment upon the state of formal education in South Africa, there is room for discussion about education in the form of 'learning by doing' within SMMEs. Accrual of education and technical know-how is reviewed in Chapters Seven, Eight and Nine. From a policy perspective, investment in education is both direct and indirect. SMMEs, especially when linked with larger enterprises, can be important vehicles for on-the-job learning that is both productive and transferable. The case studies in Chapter Eight demonstrate the potential of such learning by doing.

SMME policy in South Africa tends to focus on the redistributive capacity of survivalist entrepreneurship and thus misses the potential for deepening the learning base of labour that exists in linked SMMEs. Since there is significant indirect political pressure for the private sector to demonstrate its commitment to the post-1994 government, it would appear to advantageous to encourage and support interfirm linkages as an approach to development that broadens both the income and skill base of the mass of the population.

In the context of developing a facilitating state model, one of the most interesting approaches is for state action to resolve the inherent conflicts that emerge during development by resetting the public agenda, and thus changing the boundary between the perceived separate realms of the economic and the political. A change in public perception, accompanied by overt or subtle manipulation of economic incentives and barriers, will gradually but definitively change a nation's development agenda (Chu, 1997). A local example of this would be the gradual change in South Africa since 1994 regarding jobs. During the pre-election campaign and after the national elections, much was made of upgrading the national infrastructure through labour intensive construction. The implication was that the government would be a massive catalyst in reduction of unemployment. Since 1995 , however, the emphasis has been increasingly upon creating an environment in which all persons can become entrepreneurs (Prodder, 1996). The political agenda of job creation through public works projects has receded.

Entrepreneurship and self-employment have become the buzzwords of South African development.

The transformation of LDCs into powers that can effectively occupy a role in the globalised economy requires a state that can effectively perform the role of conflict manager. If conflict and constraints can be managed within the process of economic transformation, the state can also assume the role of facilitator of development. The facilitating state seeks new market opportunities for local industry within a global environment, acquires and disseminates information to business, assists with raw material procurement, and identifies and serves training needs of emergent industries. The facilitating state enables business to grow; it seldom operates business itself. We now turn to an Asian example of the facilitating state.

CHAPTER FOUR

A TAIWANESE EXAMPLE OF A FACILITATING STATE

> Taiwanese officials will occasionally say that their economic policy is to let market forces take their course. That, however, is a highly oversimplified and exaggerated statement….Yet the Taiwanese also know how to press market forces into the service of their economic policies (Scitovsky, 1985: 219).

It has become commonplace to look to East Asia for successful models of sustained economic development in the hope that there might be transferable lessons for other LDCs, particularly in sub-Saharan Africa. Both Korea and Taiwan, for instance, demonstrate rapid and sustained enviable economic growth.

Table 2: Comparative Development Indicators

Country	Income 1970-1975[1]	Income 1988-93[1]	Avg. Region[1]	PQLI [2]	Gini [3] Coefficient
Korea	640	7 660	820	88	0.357
Taiwan	650	7 825	820	94	0.317

[1]Per capita GNP for selected state vs. regional average (1988-1993). US dollar equivalents

[2]Physical Quality of Life Indicators compile life expectancy, rates of literacy and rates of infant mortality; 1-100 scale, ascending with quality.

[3]Income distribution: Korea 1982, Taiwan , 1985; 0-1 scale, ascending with inequality.

Source: World Bank (1995), *Social Indicators of Development*

Table 2 shows average per capita GNP for Korea and Taiwan in the 'starting period' of 1970-75 and again in 1988-93. Both Taiwan and Korea show rapid growth in income compared to other economies in the region despite beginning from similar starting points. **Table 2** then shows the average per capita GNP of economies in the region (excluding the HPAEs). The PQLI (Physical Quality of Life Index) gives some

indication of substantial improvement in quality of life indices while the Gini coefficients indicate relatively low-income inequality.

Table 3 compares growth rates between the above examples and South Africa from 1975-1993 while also showing regional comparisons between East Asia and sub-Saharan Africa.

Table 3: Comparative Growth Rates: Average Annual Percentage Change, 1975-1993

Country and Region	Population growth rate	GNP growth per capita	Per capita private consumption
South Korea	1.2	10.2	6.5
Taiwan	1.5	12.0	8.1
East Asia	1.6	6.4	5.3
South Africa	2.4	0.2	-0.2
s-Saharan Africa	2.9	-0.7	-1.5

Source: World Bank (1995), *Social Indicators of Development*.

As seen in **Table 3**, population growth per annum far outstripped per capita GNP growth in South Africa and sub-Saharan Africa with consequent drops in per capita private consumption. The chart indicates that South Africa has suffered much the same fate as the remainder of sub-Saharan Africa during the two decades 1975-1993. It may be misleading, however, to lump the South African demise (at least partly attributable to the increasing effect of sanctions in the 1980s) with the malaise of the rest of sub-Saharan Africa. Indeed, the structure of employment is fundamentally different from that elsewhere in sub-Saharan Africa (World Bank, 1995). Unlike the rest of sub-Saharan Africa, only a small percentage of the population in engaged in agriculture, while an extraordinary percentage of the population is classified as out of the labour force (see **Table 5,** page 71). At the same time policies including land appropriation from the black majority for use by the white minority created a dualistic economy that is without parallel anywhere.

Latimer (1996:14) argues that the impressive growth in Asia is "directly related to the corporatist states' policies of development". Primary policies, according to Latimer,

were job creation through active recruitment of MNEs (multinational enterprises) to relocate to Korea and Taiwan, predicated on a pliable and productive labour force and heavy investment in infrastructure development and education. Latimer may be correct in his assessment of the elements contributing to the success of Taiwan and Korea. If so, it is unlikely that such successes can be quickly duplicated in the developing countries of sub-Saharan Africa. Neither the educational nor financial infrastructure exists currently to provide the support for relocating MNEs, as was the case in Taiwan and Korea, and the workforce is both highly politicised and more costly per production unit than labour in other low-wage countries.

Latimer (1996) also contends that South Africa has a long way to go before it can claim any particularly successful leadership in developing an African road to development. One indication over three decades is a cross-regional comparison of capital investment per worker compared with the growth of GDP per worker as a measure of productivity growth. **Table 4** shows that despite relatively high capital investment in sub-Saharan Africa, productivity per worker is quite low.

Table 4: Growth rates of capital investment and GDP per worker as a measure of productivity, 1960-1990

Region	Capital per worker (%)	GDP per worker (%)
East Asia & Pacific	4.5	3.7
Latin Am. & Caribbean	2.8	1.6
Middle East and N. Africa	4.8	2.4
South Asia	3.2	2.4
sub-Saharan Africa	3.0	0.4

Sources: World Bank, *World Development Report, 1995*; ILO 1986 with ILO updates.

Further, Wade (1990, 1991) terms Taiwan and Korea, among other HPAEs, as 'hard' states, with a strong central government capable and willing to both enforce its policies, for the most part by exacting compliance from the workforce, and negotiate effectively to control many of the factors of industrial production. As previously noted in Chapter Three, growth in developing economies often engenders rapid dislocation, and competing interests seeking government protection. In an environment of

competition and a high degree of politicisation, consistent economic policies require a relatively 'hard' state.

Weakening of the South African State

While the ability of the South African state to enforce its policies is not at the heart of this essay, some comment is required if we are to envisage that the South African government is to play a facilitating role in development. It is commonplace to assume that the South African state has withered dramatically in its effectiveness since the 1994 democratic elections. The reality of the decline in state effectiveness is something greater than the trials of a newly elected government. In fact the South African state has experienced a gradual lessening of its enforcement capacity since 1970. While remaining militarily strong, the Nationalist government between 1970 and 1990 was populated by technocrats drawn from business and the professional sectors. In this, they differed from the past where party leadership rose out of the bureaucracy, the party apparatus or parastatals. The new NP leadership had an economic base outside the state. To protect this, they were willing to sacrifice state dominance (Saff, 1993).

What kind of role can we expect the South African state to assume in the necessary tasks of economic restructuring , job creation and redistribution? This chapter briefly reviews some factors affecting the state's capacity to lead and enforce economic policy in South African, and then turns to an Asian example of moderated state intervention, termed 'the facilitating state'.

Terreblanche and Nattrass (1990:8-22), Wilson (1990) and Louw (1989:27-32) indicate in historical perspective that the South African state has been too big, too corrupt, and too inefficient to encourage sustained productive activity. Not surprisingly, Terreblanche and Nattrass (1990) argue that much of the inherent inefficiency of state economic polices is the result of political policies that served racial and cultural preferences at the expense of balanced growth. The growth of state-owned and subsidised enterprises in basic services and heavy industry, combined with overt political will to provide 'sheltered employment' for Nationalist Party supporters

after 1948, created a hostile environment for new small and medium enterprises. Large enterprises were often state subsidised (and politically corrupt) and the room for small and medium enterprises was constrained by regulation and limited access to raw materials. Political and economic changes between 1973 and 1976 shook the foundations of the apartheid state, leading both government and employers to move toward paying negotiated wage rates for black employment, scrapping of job reservation by racial group and the acceptance of independent trade unions. While this policy was initially intended to divide black 'insiders' (those with approved employment) from outsiders (those without), organised resistance began the demise of the National Party state.

With the advent of organised labour, negotiated employment wages and the ineffectiveness and eventual scrapping of influx control, formal employment opportunities decreased. Between 1976 and 1985 formal employment could only accommodate 20% of all new entrants into the labour pool (Van der Berg, 1985). Formal employment opportunities have continued to deteriorate with some contending (Ensor, 1997) that informal employment occupied at least 20% of the population from the mid-1980s. As political resistance and economic stagnation intensified in the 1980s, the bureaucratic state attempted to consolidate power, at least for the distribution of benefits to a favoured few, and business sought ways to liberalize but not fundamentally change the alliance of mutual protection it enjoyed with the state (Terreblanche and Nattrass, 1990).

Given the history of South African state domination of the economy, and the withering of state capacity in the face of political resistance and poor economic growth, what are the prospects for effective state intervention in the economy by the post-1994 government? Noting that government transformation in South Africa is still ongoing, it would be premature to make anything more than suggestions based on initial trends regarding state development policies. Still , some indicative comments can be made. First, fiscal and monetary orthodoxy combined with a diminishment of the state's role in developing countries has been the dominant world-wide political economic paradigm

since the mid 1980's (Michie and Padayachee (1997). Growth in manufacturing and openness to trade have been dominant themes, especially in the developing Asian economies. As noted previously, South Africa's manufacturing sector, while large, has declined in real terms since 1985. In addition, South Africa's strength in some sectors (mining, chemical, metallurgy), which had the benefit of high protective barriers (Lall, 1993) are endangered as South Africa liberalises trade.

During the 1990-1996 period, ANC economic policy moved significantly from advocacy of state-led redistribution policies before 1994 to market-oriented enterprise policies since assuming political power in 1994. Evidence of this is in the 1995 ANC national conference in which new economic policies were formally endorsed and of which critics suggested that 'economic liberals and pragmatists' were dominating ANC economic policy (Michie and Padayachee, 1997). To wit, monetary and fiscal conservatism targeted inflation rather than redistribution, rapid trade liberalisation and privatisation (EIU, 1995). Criticism of post-1994 centrist economic policy has been widespread and vociferous. The South African Communist Party (SACP) and Cosatu have directly criticised economic policies of the government and Cosatu slammed the government for yielding to World Bank pressure on privatisation and the reduction of trade tariffs while the SACP criticised the failure of government to bring the South African Reserve Bank under the political control of government (Michie and Padayachee, 1997) ostensibly to increase state control over monetary policy for socio-political ends.

It seems unlikely, in the face of global trends that have narrowed state intervention in developing economies and the continuing predominance within government of economic pragmatists, that South African policy will radically depart from a model of limited and targeted state intervention in markets. An interesting question that remains unresolved, and on which further research is justified, is whether the current state is capable of intervening consistently in limited fashion. To advance the proposal that South Africa adopt a 'facilitating state model', we now review how the Taiwanese

state facilitated manufacturing development in one sector, and then examine the relevance to South Africa of some factors underpinning HPAE growth.

If there remain questions as to whether the South African state is 'hard' enough to enforce developmental policies, or lacks the capacity to invest in long term infrastructure development, and is suspicious of the free market impulse, while also wanting economic development with equality, what is a potential route to development? Are there lessons from Asia to be gleaned for application in modified form in the LDCs of Africa, and particularly South Africa. Data for sub-Saharan Africa[37], excluding South Africa, suggests that agriculture will continue to absorb and support a majority of workers, albeit often at subsistence level. Given the historical aberration in the allocation of land and a generally advanced infrastructure, development in South Africa will take a different course. For that reason the success of HPAEs may be of greater relevance to South Africa than elsewhere on the continent.

State Intervention for Development in the HPAEs

What accounts for the outstanding success of the eight high performing Asian economies (HPAEs)? There seem to be three views. The neo-classical assertion is that HPAE success is the result of generally *laissez-faire* economic policies and limited or no state intervention, near-free trade, free labour markets, and undistorted exchange rates. Thus, the World Bank's Frederick Berger could state:

> I believe that the crux of the Korean example is that the active interventionist attitude of the State has been aimed at applying moderate incentives that are very close to the relative prices of products and factors that would prevail in a situation of free trade (Berger, 1991:60).

Nevertheless, over the last decade considerable evidence has accumulated which challenges this view (Wade, 1995; Lall, 1994; Perkins, 1994; Kwon, 1994). It is suggested that, Taiwan and Korea did not, in fact, operate in a free trade environment. In both countries the public sectors were quite large, banking systems were tightly

[37] Data detailed in *African Development Indicators 1996,* The World Bank.

controlled by the state, and the state actively pursued policies to promote specific industries by using targeted subsidies, providing significant protection to alter profit, and exercising considerable economic coercion in order to alter the marketplace.

The reasons to argue against state intervention are legion and well documented in the failures of state-led development in Africa and Latin America. Yet, state intervention in East Asia has been an ongoing part of spectacular economic success, the envy of the developing world. Why is state intervention successful in East Asia and yet is excoriated as inefficient, corrupt and distorting of market influences in LDCs? What has led to East Asian states' more disciplined use of intervention which has enabled economic growth? What has disciplined the state in East Asia not to subvert markets, thus impeding growth?

A closer look at Taiwan as one example of state intervention in an HPAE illustrates a possible response. Wade (1995) contends that Taiwan's economic growth was forged in a governed market; a system in which mostly private enterprises competed under state supervision in the context of a heavy investment in education. Within a framework of domestic market protection and export market competition, state intervention targeted and picked certain industries for particular concession and support. In addition to providing subsidies for selected industries, the Taiwanese government played a direct role in organising private entrepreneurs into investments they might not otherwise have made. In Taiwan it was the government that took initial steps in establishing plastics, textile, steel and electronic industries (Rodrik 1996). Intervention was specific and targeted, and encouraged resources to be allocated in ways that were beyond the scope of market-induced risk assumption. In some instances the state assumed the role of visionary armtwister, having made the determination that certain industries and capacities were too important to the long term economic growth of the state to be left to market forces. Thus, the World Bank (1993a:132-133) argued that:

> …the government moved to restructure the economy. After extensive consultation with domestic an foreign advisors, the government decided to focus on high technology industries: information, biotechnology, electro-optics, machinery and precision instruments and environmental technology industries. The shift to a high technology economy has necessitated the close co-ordination of industrial, financial, science and technology and human resource policies.

Targeted state intervention in Taiwan, as above, contrasts with the neo-classical view on Taiwan's economic development (along with that of other NICs) asserts that the active promotion of an export-oriented strategy in place of import substitution engendered freer market forces that, in turn, fostered economic growth. The following case study by Chu (1997) of the growth of Taiwan's bicycle industry is informative in that the evidence suggests that something more was at work than merely free market forces or a successful export-oriented push. The state acted to facilitate targeted entrepreneurship within a larger framework of national economic planning.

From 1949 (when trade with Japan was permitted and began to interrupt local Taiwanese production of bicycles) to 1962, Taiwan banned the import of bicycles and allowed the importation of only twelve key bicycle parts that Taiwanese industry was not able to produce locally. Four major bicycle producers emerged. The average income level at the time in Taiwan was relatively low, causing consumers to look for price rather than quality, creating a niche for low price informal producers. Unable to meet the low price of the informal competition and coupled with an emergent motorcycle industry, demand for high quality, higher price bicycle sales became seriously depressed by the mid-1960s. The demand for higher quality products could not be met by the existing four producers who grew in response to the local demand for low cost products of correspondingly low quality. By 1968 all four low quality bicycle producer closed, and an initially small high quality bicycle sector emerged.

The export drive beginning in 1969 led to more than 107 000 bicycle units being exported from Taiwan to the US in 1970, increasing to more than one million in 1972. Such phenomenal export growth provoked a retaliatory response from the Canadian and US governments, taking legal action against perceived dumping of Taiwanese

bicycles. The Canadian government succeeded in closing their market to the Taiwanese, while the US case failed. Despite the failure of the US case against Taiwan, it was a public relations disaster and, for a period, US bicycle repair shops almost universally refused to sell or repair Taiwanese products, claiming inferior workmanship. The fact that, indeed, many of the Taiwanese bicycles were of inferior quality did not help matters. In 1974, the US government promulgated a new set of bicycle safety regulations directly targeted to limiting imports of Taiwanese bicycles for the US market. This might well have been the end of the Taiwanese export bicycle industry, were it not for several steps taken by a government/industry coalition in Taiwan.

The government, along with industrial producers of bicycles in Taiwan, introduced and established a new set of product standards in 1974 for the industry to follow. The government also undertook to inspect exports to prevent substandard products from being exported. These two simple measures regularised the industry, upgraded standards, required quality control and rid the market of low-cost substandard producers who undercut major producers for short term gain, while consequently destroying a hoped for international export market for Taiwanese bicycles. Since the introduction of product standards and limited government intervention to secure quality control, Taiwanese bicycle exports steadily grew from 1978 through 1986.

Government intervention did not propel the bicycle industry alone. The market experienced a sudden demand surge in the early 1970s, due in part to the oil crisis. This demand was partly filled by American and other producers, causing some American producers to seek more product or product parts from Taiwan. Thus, the initial push to export came when several American bicycle importers came to Taiwan and placed orders totalling nearly one million units, thus increasing production ten times in two years. With the surge in orders came unexpected help for the Taiwanese industry. Besides placing the order, the American importer often supplied the product specifications, blueprints and technology to produce certain parts. The article produced for export differed in quality, style and price from the domestic Taiwanese product.

Through a close relationship between local producers and foreign demand, technological capacity and know-how was imported to a fledgling industry and successfully transferred. Mowery and Oxley (1995) note that technology is transferred with either one of two characteristics: one is the role of foreigners in the transfer of technology; the other is the market forces mediating the transfer of technology. The case here is one in which the role of the foreigner is active and central.

Foreign bicycle buyers invested relatively little capital, preferring to utilise and upgrade existing local capacity, especially upgrading human capital by upskilling the existing labour force. What is significant is the role of government and industry in creating an environment in which the transfer of technology via 'learning by exporting' could develop - an empirical example of ‘learning by doing’ (Arrow, 1962; Solow, 1956, 1997). Both the potential buyer of bicycles and the government initiated the process for joint, if differing, long term goals (the government to improve an industry's capacity, the buyer for an inexpensive mass product). In various ways the government, bicycle manufacturing industry and the buyer engaged in co-operative efforts to set up and improve production, monitor progress, incorporate technical improvements in production processes and product, provide access to credit, and market the products in developed countries. In the initial stage of bicycle industry expansion, the manufacturers were responsible only for the production phase of a larger joint venture which attracted the active participation of the state, the producer and the buyer in a market driven venture.

The government's role was significant and formative, in a way that assisted and directed market forces toward a long term goal of developing a profitable export-oriented industry of international quality. Between 1949 and 1962 the industry was protected as part of an import substitution strategy with resultant poor quality, low production and lagging demand. Following a government directed change to an export-oriented strategy of development, a surge in demand led to a huge expansion of the producer networks, uncertain quality, and international trade pressures. Government responded to assure quality and eliminate 'fly by night' short term

competitors. The state assisted producers to develop high quality and volume operations. This effort was enabled by the existence of widespread entrepreneurship and commercial expertise across the overall economy, which probably contributed to the agility of the bicycle enterprise to respond to rapid changes in the marketplace. The government further intervened to assist the industry to solve mass production problems and to produce intricate bicycle parts that still had to be imported to Taiwan from other producers. Finally, and perhaps as significant as government intervention in this early stage of the development of the bicycle industry, is the organising and co-ordinating role of the foreign industrial presence. Motivated solely by the desire to produce a high quality bicycle quickly and at low cost, the demand-led foreign purchaser had the effect of co-ordinating widespread and often disparate SMMEs that previously competed against each other in production of bicycle parts. Export-led growth utilised and substantially developed an existing capacity, in part by government intervention in production and in part through the demand-led presence of a foreign market (Yanagihara, 1994).

The role of government was formative in the bicycle industry. While not intervening directly by way of investment, as it did in heavy industry (Wade, 1990), the state was active at two critical points. First, in the 1970s, the government intervened to rid the market of poor quality and to brace the industry against the retaliatory practices of North American markets. Second, the government assisted the industry in solving production problems, enabled acquisition of raw materials at low prices, and established standards for unit production. This maintained the industry's share of the export market.

More recently the government has assisted the industry to upgrade itself and to become self-sufficient in parts production and supply. To this end the government established and funded, along with the industry, the Taiwan Bicycle Industry Research and Development Center in 1991. The short term objective was to assist the industry to replace imported Japanese parts with locally produced parts. Its long term objective

is to raise the technological capability of the industry through joint ventures between industry and government for research and development.

Taiwan s Contribution to SMME Development

Chu's (1997) study of the bicycle industry in Taiwan illustrates the hypothesis that comparative advantage can be created in an LDC through judicious use of government, industry and SMMEs within a globalised economy. A distinctive pattern of development is suggested by Taiwan. At the beginning, local capital is focused solely on learning how to produce. It is here that limited protection for an infant industry may be required. Next, production is targeted for an international, rather than solely domestic market (the superior quality demanded by an international market may be a necessary incentive to increase productivity of local producers in a protected environment). Third, foreign buyers of locally produced products should be looked to more for technology transfer than for foreign direct investment of capital (Walz, 1997). Fourth, as local production is mastered, the government's role should diminish, reducing protection and reverting to regulating quality and research and development. Finally, local producers begin to take over aspects of the enterprise previously done by foreign buyers including: management, marketing, finance and design (Katrak, 1995).

Taiwan out-competed other low wage producers for bicycle production in the market push for bicycles in 1971-74. They may have succeeded in this by permitting short term exploitation (low prices, low wages) in exchange for long term gains resultant from indirect technology transfer which have permitted the industry to advance long after the short term market surge for bicycles in the early 1970s. Long after the demand has levelled in the world market, Taiwan remains the world's top exporter of bicycles. A competitive advantage was created and has been sustained.

Taiwanese government policy interventions in the bicycle industry can be instructive as to the types of interventions that might assist emergent SMMEs in an LDC. Some principles begin to emerge: learning efficient quality production is essential, as is a link to larger enterprises for access to knowledge, markets and training. Protection from

competition probably retards local development. Labour intensive manufacturers took off in East Asian economies as shown in the above-mentioned Taiwanese example for several related reasons. First, it was assumed that participation with the global economy would mean changes and dislocations of existing enterprises. The state intervened to assess which enterprises and sectors should be given some protection. Second, the state enforced higher quality standards than were needed for the domestic market. Third, the state assisted targeted enterprises with access to low cost raw materials and with credit extension. Fourth, links between producers and markets were actively encouraged for training and quality improvement. Fifth, “learning by doing” (Arrow, 1962) was a central element of industrial development. Sixth, industrial development was viewed in the long term with the introduction of industry specific research and development components partially funded by government. Finally, and perhaps most important, the government of Taiwan changed the public perception both domestically and internationally of the quality of Taiwanese products. This change in perception, backed by quality improvement, may be one of the most significant roles of the Asian facilitating state (Chu, 1997; World Bank, 1995).

Factors Affecting HPAE Success Transferability

Education

In considering the success of HPAEs while seeking lessons that might be transferable to South Africa, one of the most striking aspects about most of the HPAEs and especially Japan, Korea and Taiwan, is the dramatic increase in levels of education and skill attained by the workforce in the last 40 years. Myint (1954: 134) was prescient in stating before the Asian miracle that it was obvious that: “[a]n improvement in the quality of the 'human factor' is, then, as essential as investment in physical capital.”

Not only is this reflected in the education level attained by the population generally, but the degree of emphasis in the society upon technical skills and training. Even in 1960, despite per capita incomes that ranked in the lower quartile of all countries, Korea and Taiwan showed much higher than expected rates of school enrolment and literacy than

would have been predicted, in comparison with other countries of similar per capita income. Since 1980, Taiwan's junior colleges and universities have produced twice as many qualified engineers as the United States, relative to population. Since 1960, 25 per cent of all graduates have been engineers (law graduates, 1.2 per cent) and combined science and engineering graduates are nearly half of all graduates in Taiwan in the 1980s. This societal emphasis upon technical training (which may certainly also be 'steered' by state intervention in the granting of study subsidies, university research and development grants, and other technical supports) is fundamental to the success of HPAEs. Recent research by Wood (1990) concludes that trade between Northern and Southern hemispheres is based almost entirely on differences in the availability of human skills and not on differences in the availability of capital. This is to say that the particular comparative advantage in the context of North-South trade in manufacturing depends largely on the skill of the labour force. It might also be concluded that shifts or growth in a nation's comparative advantage will be related to gains in the ratio of skilled to unskilled persons in the labour force. Therefore, targeted investments in education, reinforced by cultural and societal approval and state subsidies provide a first step in government management of the marketplace for long term economic development.

Educational levels in South Africa are markedly less developed than in Korea and Taiwan, even at the beginning of their economic expansion in the late 1950s. Any transferability strategy will have to take into account the skills deficit faced in South Africa before widespread economic development can be sustained (National Productivity Institute, 1997). However, formal education alone is not sufficient. Human capital investments, including commitments to accessible nutrition and health care as well as primary and secondary education and work training, are undeniable components in increasing worker productivity (World Bank, 1995). Further, such investments in human capital must be properly used.

The misdirected, intermittent or non-market related investments[38] in human capital throughout the developing world contribute to the persistence of slow economic growth in LDCs despite generally rising levels of schooling and investments in human capital.

There is not an automatic relationship between increased inputs in human capital and correspondingly increased productivity[39]. Increased education alone will not lead to automatic growth. Rather, the fast growing economies of Asia invested in human capital in ways that combined education and training with increased physical capital (Gittleman and Wolf, 1995; World Bank, 1995) . This finding points to the critical role of government policy in creating an environment that encourages productive investment.

Social Equilibrium

In 1960, Korea and Taiwan were noteworthy for their exceptionally equal distribution of income and land distribution. This was due in part to serious land reform measures undertaken by both regimes in the 1950s (Rodrik, 1996). Even more than relative wealth equality measured by land ownership, Taiwan and Korea display remarkable socio-economic equilibrium[40] despite per capita incomes in 1960 considerably below average (Rodrik, 1996).

Similar social equilibrium indicators, if they were available for South Africa, would present a markedly different scenario. While perfectly correlative figures are not available, in part because of the subjective nature of Adelman and Morris's (1989)

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[38] Caution needs to be exercised in defining non-market-related expenditures. For instance, expenditures for nutrition and health care contribute to the long term development of the labour force in ways not immediately quantifiable by the market. Such expenditures are, however, essential.

[39]Some countries (China, Sri Lanka and Tanzania) have regularly invested more than 20 per cent of GDP into education and training but did not grow rapidly (World Bank, 1995).

[40]Adelman and Morris include such factors (many subjective) as urbanisation, importance of an indigenous middle class, social mobility, literacy, cultural and ethnic homogeneity, fertility, sense of national unity, and modernisation of outlook.

evaluation, some data is suggestive. Literacy appears to be below 35 per cent. Land distribution still concentrates wealth among the top two quintiles of the population. The majority of the population benefits from less than six years' formal education. The decline of agricultural work has led to marked increase in urbanisation between 1985 and 1995 (World Bank, 1996).

The Labour Environment

The labour environment in which development will occur is also significantly different. In Korea, for instance, workers' unions were largely 'captives' of management until the political liberalisation that began in 1987 (World Bank, 1995; Latimer, 1996) at which time Korea's labour unions nearly tripled in number and collective bargaining became institutionalised. Economic growth became entrenched without significant influence (either positive or negative) from organised labour.

South Africa's macroeconomic strategy for growth is rooted in the principles of the Gear strategy, which is increasingly unpalatable to the ANC's allies and political partners (Gindin, 1995; Hart, 1995; Pillay, 1996; Shilowa, 1997; Pira, 1998), who call for tangible evidence of the government's ability to deliver "a better life for all", the ANC's 1994 national election campaign slogan. New jobs would be such evidence and would silence most of the government's critics.

The first strategy for increasing employment was through labour intensive infrastructure development, much of which required labour intensive construction (RDP, 1995). Indeed, one public official in the Eastern Cape, when asked about the RDP, commented:

> It is time to put the machinery in storage yards. The re-building of the new South Africa will be with labourers wielding picks and spades and earning a weekly wage (Mpahlwa, 1995).[41]

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[41] World Bank analysts have supported labour intensive public expenditure as one useful strategy for kick-starting stagnating economies, stating ".... kick-starting the economy through public expenditure could play an important role: well-targeted public investment will help re-distribution while assisting economic recovery" (Fallon and de Silva, 1994: 16).

Public investment for job creation and redistribution is a short term approach. Development of the SMME sector as an engine of economic growth occupies a central place in the government's long term macroeconomic strategy (Department of Trade and Industry (DTI), 1995)[42]. South Africa's labour is highly politicised, is disenchanted with the government's Gear initiative (Pillay, 1996) and tends to oppose economic reforms that open South African industry to world competition as well as open access to new markets. Even if the percentage of unionised labour is not high in actual terms (Von Holdt, 1997) organised labour has a primary role in moulding public opinion about labour issues, as a strong political partner to an emerging government, it exerts a firm influence on state policy.

Linking Global Demand, Government Policy and Learning by Doing

The remarkable success of HPAEs has inevitably led to a search for the 'holy grail' of economic development: the one simple and quick strategy that will unlock the key to future growth in all LDCs. HPAE growth is highly unusual in at least two respects. First, rapid growth has been sustained over three decades, without parallel in any LDC, and rapid growth has been achieved with highly equitable income distribution, with the four fastest growing HPAEs being the most equal (Page, 1994). What factors in East Asia have contributed to this era of economic growth? What factors are transferable to sub-Saharan Africa?

The HPAEs differ from other LDCs in three ways traditionally associated with economic growth: the rate of investment, the rate of gross domestic savings, and the endowment of human capital primarily related to educational attainment.

[42] Several commentators indicate that economic policy transparency, stability and credibility matter as much to foreign investors in developing countries as do specific economic plans. The single most important element for economic growth is investor confidence. This will only materialise if policy making is transparent, with few if any sudden policy shifts, and if policies are seen to be sufficiently insulated from the most extreme demands of various interest groups. Sustainable, consistent and credible economic policies will encourage political stability, investor confidence and consequent economic growth. These prerequisites create an environment in which SMMEs can grow.

Gross domestic investment among HPAEs has exceeded 20 per cent since 1965 and is growing. The rate of gross domestic savings in the HPAEs has nearly doubled since 1965 while dropping in sub-Saharan Africa during the same period. Page (1994: 618), among others, suggests that there is no 'Asian miracle' insofar as "differences in growth rates between the HPAEs and other developing economies largely reflect differences in accumulation." While certainly a significant factor, it is also evident that the HPAE growth was enabled by more than merely factors of accumulation. Page himself notes that total factor productivity in HPAEs exceeds that of most developing economies.

It is commonplace (Lall, 1994; Chu, 1997; Perkins, 1994; Amsden, 1989) to speculate that total factor productivity growth in the HPAEs is a direct result of the investments in universal primary and secondary education made in the HPAEs, and that investments in education are consequently essential for long term economic growth. The World Bank's study, *The East Asian Miracle: Economic Growth and Public Policy*, posits that high investments in primary and secondary education by the HPAEs (especially the 'four Tigers') is foremost among reasons for sustained economic growth in the region.[43] The correlative factor behind the sub-Saharan economic lag, also according to World Bank (1995) in the study *Labour in Sub-Saharan Africa*, is the underdevelopment of, and underinvestment in, the abundant stock of human capital. In other words, masses of the labour force are inadequately educated to meet the competitive world marketplace.

[43] The recent Asian currency crisis has focused further attention on the economic performance of the HPAEs. While the multiple causes of the crisis are beyond the scope of this thesis, and do not materially diminish the economic benefits of investment in human capital that have been clearly demonstrated in the HPAEs, some comment is still necessary.

The East Asian Miracle[44]… lauds investments in formal education as a keystone for economic growth, yet pays scant attention to 'learning by doing', the kind of technology and know-how and education spill-over that accompanies foreign direct investment (FDI), multinational subcontracting and outsourcing. Chu's (1997) study of the Taiwan bicycle industry development makes the point that foreign demand for a quality product drove this sector of industrial development, inspired government regulation, increased domestic market competition, and encouraged industrial research and development strategies to solidify and improve upon technologies accumulated during the first phase of outsourcing and subcontracting on behalf of foreign suppliers. In short, the demand for bicycles increased the revenue, labour skill, technology and government support available to the small enterprises engaged in Taiwan's bicycle industry. From that demand arose benefits that have accrued to make it the world's leading producer of bicycles for export.

The Taiwanese bicycle experience led to enormous growth of a previously small industry (less than 40 000 units in 1965 to 107 000 in 19760 to more than 1 000 000 units in 1972). With growth in production (increased demand) came increased quality (policy intervention), improved production techniques (foreign demand, government support and on-the-job training of under-skilled workers), new SMME development generating employment (sub-contractors) and a research and development component for continuous quality improvement (government and industry co-operation). In a microcosm, the factors contributing to the growth of the Taiwanese bicycle industry could be one model for successful economic growth in LDCs.

The starting conditions present in the HPAEs (especially Taiwan and Korea) and in South Africa differ significantly. Thus, it follows that neither all of the strategies

[44] Four years ago, Paul Krugman (1994) presented the controversial view that the Asian economic 'miracle' was not due to total factor productivity (TFP) growth but rather to an intensive use of inputs, i.e., high rates of investment in Asia and a high rate of growth of labour inputs given the increased labour participation rates in the region. This view was very controversial since it implied that very little TFP growth had occurred in Asia. If true, it also suggested that the very high rates of Asian growth were not sustainable in the long run, given the expected fall in the rate of growth of employment and an expected reduction of investment rates.

employed by the HPAEs will be adaptable to the South African context, nor will the meteoric rise in per capita GDP shown in the HPAEs necessarily be the expected result in South Africa. Having said that, there are significant lessons specifically with regard to developing and exploiting free market comparative advantage which is notable in the HPAEs and which bears significant promise in South Africa.

CHAPTER FIVE

CURRENT SOUTH AFRICAN GOVERNMENT SMALL BUSINESS SUPPORT STRATEGIES

It is not bad to be small, but it is bad to be lonely.

Trevor Manuel, South African Minister of Finance,
at the opening of the President's Second National
Conference on Small Business, Durban, 1998.

Job Creation and SMMEs

South Africa's primary economic issues include the need to reduce income inequity, to develop the structure of manufacturing, to diversify the skill base of labour and to create and sustain new employment. In this regard, the rapid economic growth of the HPAEs, the growth of manufacturing, the development of national labour pools (particularly those that began with large reservoirs of unskilled labour) and falling Gini coefficients are of interest to South African policy-makers. The notable success of SMME development in Taiwan, Malaysia and Indonesia has led to renewed interest in the development of a vibrant SMME sector in South Africa as part of a comprehensive job creation and wealth redistribution strategy of economic development.[45]

The Department of Trade and Industry, in its White Paper for the Development and Promotion of Small Business in South Africa, states that

[45] Training and job creation issues are not unique. In Europe, Rosenstein-Rodan (1943) argued for a state-led 'big push' in order to rapidly industrialize Eastern Europe and train unskilled peasants to become efficient industrial workers. Criticism of the 'big push' has focussed on the effectiveness of rapid industrialization, particularly when linked to import substitution and protectionist policies (Balassa, 1980)..

> Small, medium and micro enterprises (SMMEs) represent an important vehicle to address the challenges of job creation, economic growth and equity in our country. Throughout the world one finds that SMMEs are playing a critical role in absorbing labour, penetrating new markets and generally expanding economies in creative and innovative ways (Parliament of the Republic of South Africa, 1995: 3-4).

While small enterprise development is only one part of an overall plan for development in an LDC, small enterprise development is something of a current rage in LDCs because of the potential to create employment (*Eastern Cape News*, 30 October, 1997; *Eastern Province Herald*, 4 March, 1998b).

Characteristics and Definitions of the SMME Sector

Small, Medium and Micro enterprises (SMMEs) is a business categorisation based on the size of an enterprise measured primarily in terms of employee numbers and, to a lesser extent, on annual revenues. The National Small Business Act (Government of South Africa, 1996b) formalised the definition of small business in South Africa. In somewhat convoluted language, an SMME is described as a separate and distinct entity without subsidiaries or branches, which is managed by its owner(s) and does not include those forms of self-employment where there is no evidence of individual ownership involved in the actual practice of the business. This definition defines SMMEs as those businesses in which the operator has actual financial investment in the business, in contrast to many 'hawking' operations in which the operator appears to be the owner but in fact has no financial interest other than as an employee.

The Act classifies SMMEs into five categories:

Survivalist Enterprises are those where the income generated is generally less that the minimum income standard or poverty line. There are no paid employees and the business asset value is minimal. The economic activity of the business is mainly directed at providing the minimal means to keep the business owner alive. This group might be identified as pre-entrepreneurial and comprises hawkers, vendors, subsistence farmers, and others.

Microenterprises generate an annual turnover that is less than the VAT (Value Added Tax) registration limit of R150 000 per annum. Microenterprises usually lack formal tax registration, may not adhere to labour legislation and standard accounting procedures, and usually have less than five employees. Microenterprises include *spaza* shops, cafés, home-based businesses, mini-taxis and small-scale construction and textile manufacturing. The defining line between the smallest microenterprises and survivalist enterprises is often blurred.

Very Small Enterprises is a category unique to South Africa and refers to businesses employing less than 10 persons, except for mining, electricity, manufacturing and construction sectors where the Very Small Enterprise limit is 20. These enterprises operate in the formal economy, are VAT-registered and have access to limited technology in business operations.

Small Enterprises are distinguished from Very Small Enterprises by the upper limit on employee size of 50 and, in general, such enterprises use more established business practices and supervision and management structures are increasingly complex. Small enterprises have usually passed the stage of direct supervision by the entrepreneur and have developed secondary management systems. Growth into a Small Enterprise usually requires an accumulation of resources over time and access to credit.

Medium Enterprises are formal entities with more complex divisions of labour and management structures employing up to 100 persons (200 in the mining, electricity manufacturing and construction sectors) (Government of South Africa, 1996b).

Before commenting upon the quality and appropriateness of planned support for the SMME sector in South Africa, some general comments about the South African SMME is apt. Emergent entrepreneurs and SMMEs in South Africa share certain characteristics. Half of all SMMEs are less than three years old. Employment growth is inversely related to the age of the firm.[46] The vast majority of newly established SMMEs were begun as strategies to cope with unemployment. Women operate 62 per cent of all micro enterprises and their businesses tend to be in sectors with the lowest levels of profitability and growth in employment. Net monthly income from such micro enterprises is on average below the established subsistence level of R650 monthly.

[46]The average employment growth rate for SMMEs established within the last 12 months is 46 per cent while for those in existence 24-36 months, the employment growth rate averages at 26 per cent. This may be attributable to increased productivity gained from accumulated learning (Macun, 1995) or it may indicate a gradual slowdown in business development. Given the lack of data to support increased business efficiency and productivity, this author assumes that employment growth slows dramatically as SMMEs age.

SMME owners tend to be young (35 per cent of SMME owners are 30 years old or younger) and have six years or less of formal education. Thirty per cent lack even the most rudimentary literacy skills. Few SMME owners have ever experienced work in the formal sector, most are unskilled and have little or no managerial, supervisory or planning experience (Riley, 1997).

Bleak though this picture of emergent entrepreneurs is, there are signs of hope that should be nurtured in the government's SMME strategy. Two mini-sectoral studies of the SMME sector conducted by the World Bank in 1992 and a 1990 Gemini (Growth and Equity through Micro-enterprise Investments and Institutions) study indicated that about 20 per cent of the more established black SMMEs could be classified as dynamic and with good growth potential [47] and another 20 per cent had potential for growth if given assistance with certain common constraints[48] (Riley, 1997).

The definition of categories of business within the SMME sector is not consistent world-wide, so specific comparison by business size is difficult. The availability of economic data by size class of enterprises is also very poor in South Africa. Ntsika Enterprise Promotion Agency (NEPA) has compiled the most recent data sets on the nature of South African SMMEs. Even these data should be regarded with caution as Ntsika points out that in some instances the Central Statistical Service (CSS, 1993, 1994, 1995) "refused to provide aggregated data by size class" with the result that "some crude assumptions had to be made..." (Ntsika, 1997:12).

In the following **Table 5**, private sector enterprises are classified by size and type according to the above categories in 1995. The actual number of differentiated enterprises in each sector is indicated along with the percentage of all enterprises in each sector which gives an indication of the dynamism of new entrants into the sector.

[47]Defined from survey results in terms of annual growth of turnover and revenues, profitability, employment growth rates, and replacement value of fixed business assets.

[48]The most common constraints being access to markets, quality control, and access to finance.

Also indicated is the percentage of total employment in each sector represented by different-sized enterprises, giving an indication of the potential impact on total sectoral employment.

Table 5: Estimated Distribution of Private Sector Enterprises and Employment in South Africa by Sector and Size-Class, 1995

Sector	Survivalist	Micro 0 employees	Micro 1-4 employee	Very Small	Small	Medium	Large	Total
Agriculture	16 000	9 500	12 400	21 000	28 300	3 600	1 400	92 300[1]
% enterprises	17.3%	10.3%	13.4%	22.9%	30.7%	3.9%	1.5%	100%
% employment	1.2%	0.7%	2.2%	7.9%	45.6%	18.6%	23.8%	100%
Mining	650	250	2 000	500	100	100	131	3 731
% enterprises	17.4%	6.7%	53.6%	13.4%	2.7%	2.7%	3.5%	100%
% employment	0.1%	0.0%	0.8%	0.8%	0.9%	2.9%	94.4%	100%
Manufacturing	28 000	24 300	16 600	34 000	5 200	3 850	1 605	113 555
% enterprises	24.7%	21.4%	14.6%	29.9%	4.6%	3.4%	1.4%	100%
% employment	1.8%	1.6%	2.1%	9.2%	9.0%	22.3%	54.1%	100%
Construction	20 000	26 500	16 000	14 000	2 300	930	244	79 974
% enterprises	25.0%	33.1%	20.0%	17.5%	2.9%	1.2%	0.3%	100%
% employment	3.9%	5.2%	11.4%	20.7%	15.1%	16.9%	26.8%	100%
Retail trade	102 000	115000	50 800	36 900	12 500	950	733	318 883
% enterprises	32.0%	36.1%	15.9%	11.6%	3.9%	0.3%	0.2%	100%
% employment	9.1%	10.3%	17.7%	16.5%	17.4%	5,7%	23.3%	100%
Wholesale	800	2 700	1 200	7 100	2 700	750	600	15 850
% enterprises	5.0%	17.0%	7.6%	44.8%	17.0%	4.7%	3.8%	100%
% employment	0.3%	1.1%	2.2%	18.1%	21.5%	20.9%	35.9%	100%
Catering/ Accommodation	2 000	4 800	3 500	3 000	2 700	350	100	16 450
% enterprises	12.2%	29.2%	21.3%	18.2%	16.4%	2.1%	0.6%	100%
% employment	1.4%	3.5%	8.1%	12.5%	38.9%	17.6%	18.0%	100%
Transport	4 000	26 000	12 000	5 800	1 700	280	227	50 007
% enterprises	8.0%	52.0%	24.0%	11.6%	3.4%	0.6%	0.5%	100%
% employment	1.7%	11.2%	16.6%	16.3%	16.6%	9.1%	28.5%	100%
Finance	3 400	27 000	12 400	17 600	4 600	350	350	65 700
% enterprises	5.2%	41.1%	18.9%	26.8%	7.0%	0.5%	0.5%	100%
% employment	0.6%	5.1%	7.0%	16.7%	18.1%	4.9%	47.6%	100%
Community & Personal Services	18 100	23 200	10 300	24 600	3 500	400	300	80 400
% enterprises	22.5%	28.9%	12.8%	30.6%	4.4%	0.5%	0.4%	100%
% employment	4.6%	5.9%	8.4%	38.8%	16.3%	7.4%	18.7%	100%
TOTAL	194 950	259 250	137 200	164 600	63 600	11 560	5 690	836 850
% enterprises	23.3%	31.0%	16.4%	19.7%	7.6%	1.4%	0.7%	100%
% employment	3.0%	3.9%	6.8%	13.3%	19.9%	13.8%	39.3	100%

[1] This horizontal row actually totals 92 200. The documents provided by Ntsika Enterprise Promotion Agency are incorrect, and are reproduced as provided. Percentage totals are rounded to the nearest percent.

The business categories Small, Medium and Large were not defined by size in the survey compiled for this table by Ntsika Enterprise Promotion Agency. A rough definition of enterprise size can be obtained by referring to the business categories defined in the National Small Business Act, 1996 and summarised on pages 68-69.

Sources: Data compiled by Ntsika Enterprise Promotion Agency from various sources including The Companies and CCs Registration Office, 1995; The CSS sectoral census, 1995; Viljoen and Rouckens de Lange standard employment series, 1995 and, the October Household Survey (OHS) 1993, 1994 and 1995.

Among the conclusions regarding SMME development that can be drawn from **Table 5** are the following:

1. South Africa is dominated by the presence of large scale industry which accounts for nearly 40 per cent of all employment;

2. As in other developing countries, manufacturing, retail trade and construction appear to be the sectors in which there is the most opportunity for emergent entrepreneurs, evidenced by the high percentage of small enterprises in those sectors, probably the result of fewer barriers to entry;

3. One quarter of all enterprises in the nation fall into the category of survivalist and nearly 55 per cent of all enterprises employ only family members;

4. South Africa's SMME manufacturing sector is underdeveloped in comparison with other developing economies. South African manufacturing continues to be dominated by a few large enterprises of which 1.4 per cent of all enterprises contribute nearly 55% of all manufacturing employment;

5. As noted in comparative country data, reliance upon subsistence agriculture as a stepping stone for wealth accumulation and eventual entry into other SMME sectors seems possible for less than 5 per cent of the population(The World Bank, 1996)

6. It appears from the initial data that the SMME sector is smaller than previously estimated, comprising about 800 000 enterprises with less than 50 employees each.

South African Policy Prescriptions for SMME Development

The Department of Trade and Industry (DTI) suggests that a developed SMME sector in South Africa can address the two issues of job creation and increasing wealth equity.

It is thought by the DTI that the essential missing elements needed to empower the SMME sector can be developed through the provision of generic business services and training, along with greater access to credit. According to the DTI, the need for such training and access to credit arises from the legacy of apartheid which hindered natural small enterprise development (DTI, 1997). As mentioned previously, massive and rapid job creation (300 000-500 000 new jobs per annum until 1999) was the intended goal of support for the SMME sector (DTI, 1995). Thus, the DTI White Paper stated:

> All over the world it has been recognised that the small business sector plays an important if not critical role in the economic and social development of a country. This also applies to South Africa, where the small business sector has been neglected during much of the century following the discovery of diamonds and gold and the establishment of a modem [*sic*], capitalist economy with almost exclusive white control. While the importance of large industrial, mining and other enterprises for the growth of the economy cannot be denied, there is ample evidence that the labour absorptive capacity of the small business sector is high, the average cost per job created is usually lower than in big business and its role in technical and other innovation is vital for may of the challenges facing South Africa's economy (DTI White Paper, 1995:10).

The DTI estimates that more than 4.3 million persons are engaged in some kind of SMME activity, including those involved in survivalist businesses, fully one quarter of the labour force of 15 million people (DTI, 1995). In addition to its job creation potential, entrance into the SMME sector is viewed as a significant vehicle for black empowerment:

> Experience has shown that in the past black people have been able to make far greater progress in the micro- and small-enterprise segments of the economy than in medium-sized and larger enterprises. Thus, the SMME sector has - all its impediments notwithstanding - proven to be a highly significant vehicle for black economic empowerment (DTI, 1995: 12).

The DTI's objectives and principles for SMME development encompassed a range of broad, general and rather all inclusive 'desirable goods' that were variously described as 'creating and enabling environment for small enterprises' and 'creating a national framework for small business that was to be developed and implemented at the local level' (DTI, 1995, 13). These broad desires were undergirded by five objectives for small business development that serve to define the government's goals. The following

five goals and notes reflect in a shortened form the contents of the strategy outlined in the DTI White Paper of 1995:

Facilitating greater equalisation of income, wealth and economic opportunities

> This relates to the government's belief in the labour absorptive capacity of the SMME sector and increasing access of blacks and women to economic opportunity.

Creating long term jobs

> Because SMMEs are not always able to create long term well remunerated jobs, support for SMMEs needs to include steps to upgrade the skill level of SMME operators and to strengthen the use of appropriate modern technologies to boost capacity to create long term jobs.

Stimulating economic growth

> A differentiated, sector-focused and growth-oriented small business strategy is required to address the obstacles that prevent small businesses from contributing to overall growth.

Strengthening the cohesion between small enterprises.

> Individually SMMEs often lack the resources and skills to improve their own capabilities. Consequently, presently fragmented small producers within sectors need to be helped to network and link more effectively with other SMMEs facing similar constraints in order to overcome these obstacles jointly.

Level the playing field between bigger and small business

> By promoting co-operation between these sectors, it is the intent of this support strategy for small business to rectify this imbalance toward small business.

The national White Paper then delineated a seven-step process leading up to implementation of a SMME support strategy as follows:

1. Awareness building
2. Needs identification and implementation planning
3. Resource identification
4. Strengthening the business and entrepreneurial culture
5. Training of support agency staff
6. Setting goals for the national strategy
7. Stating fundamental principles of SMME development and support.

In summary, without enumerating details of the process, the White Paper assumes that there is a significant capacity deficit regarding establishment and management of the SMME sector. This capacity deficit is attributed to general market failures associated with apartheid and identified in the White Paper itself.[49] In response, the White Paper proposes a process of consultation, study, training of staff and establishment of a mostly newly created SMME support structure to redress the SMME capacity deficit.

Linked to the provision of services by government to the emerging SMME sector is the matter of small enterprise compliance with generally accepted standards of business behaviour. As previously noted, most of the SMME sector in South Africa is not registered. Common reasons for non-registration include the lack of desire or capacity to keep detailed records and the erroneous belief that lack of registration evades VAT (whereas input VAT remains payable even if output VAT is not remitted). Thus, the burden of paperwork for often non-literate SMME operators, the survivalist nature of many SMME activities and the short term nature of many such enterprises are all reasons that mitigate against business registration. The government hopes to regularise such businesses as a side-benefit of providing support services to SMMEs. The government's National Strategy for the Development and Promotion of Small Business in South Africa anticipates that the promotion of small, medium and microenterprises will be a major source of newly generated employment. It is stated in this manner:

> The Government of National Unity is committed towards a strategy of high and sustainable economic development. to achieve this, the economy needs to move on a path of increased investment, enhanced productivity and expanding employment opportunities - and all of this within a mould of increasing general competitiveness...
>
> While the better organised large enterprise sector should be able to move towards the envisaged growth path with relatively limited support and prodding from government, the transformation of the small-enterprise sector

[49]Detailed information is available on pages 14-15 of the White Paper. Briefly stated, the market failures contributing to perceived capacity deficit in the SMME sector derive from Bantu Education, homeland policies, job restrictions, inaccessibility of apprenticeship programmes for blacks, the physical distance separating black housing from commercial areas, the curtailment of property ownership rights for blacks, marriage laws that legally disempowered women, and the huge capital losses incurred by black businesses in the adoption of the Group Areas Acts.

> requires and justifies concerted policies of wider scope as well as the deliberate creation of an enabling environment....
>
> In this transformation process government is a facilitator and not an implementing agent. In fact, small business support programmes are best implemented by institutions that most closely reflect the entrepreneurship and risk characteristics of small businesses themselves. Such institutions are typically small localised non-governmental organisations, private consultancies, partnership and companies.
>
> Finally, while the government's role at the outset of this process is interventionist, it will be scaled down systematically after the first five to ten years (Department of Trade and Industry, 1995:5-6).

It is against this background of stagnant job creation and a new government facing the political reality of the need for rapid job creation, that SMMEs were seen as one significant part of broader economic growth. The broad strategy of economic growth is outlined in the Gear document and includes engagement with global competition and the reduction of protective trade barriers, curbing labour wage demands, identifying potential economic clusters, reduction in state subsidies for industry, and macroeconomic balance (Erwin, 1996).

Interest in the job and wealth-creating capacity of the SMME sector arises from the context of extreme income inequality, stagnant job creation capacity in the formal sector, and the need for an engine of growth other than the public sector for long term growth (Lindauer, 1995). Trevor Manuel (1995) articulates this same point in the context of the Gear policy:

> Small, medium and micro-enterprises (SMMEs) represent an important vehicle to address the challenges of job creation, economic growth and equity in our country. Throughout the world one finds that SMMEs are playing a critical role in absorbing labour, penetrating new markets and generally expanding economies in creative and innovative ways. We are of the view that - with the appropriate enabling environment - SMMEs in this country can follow these examples and make an indelible mark on this economy (Government of South Africa, 1996a:12).

Extensive literature assumes that SMMEs are an effective vehicle for economic development in sub-Saharan Africa, because of their postulated labour absorptive

capacity (Advani, 1997; Bowman, 198; Chandra and Kahn, 1993). As mentioned in Chapters three and four, the job creating potential of SMMEs cannot be uncritically assumed. Prior studies of the potential of the SMME sector to create jobs in South Africa suggest that black-owned SMMEs cannot compete with larger white-owned enterprises (Nattrass, 1984). Krige (1985) argues that small-scale manufacturing is stunted because the manufacturing sector is so dominated by large enterprises there is little 'room' for SMMEs to compete. Debate continues regarding the net job creating potential of the SMME sector, as the 'quick entry-quick exit' dynamism of the SMME sector may, in some sectors, cause net job destruction (Winter, 1995). In this regard, two points should be emphasised. First, Winter concedes that virtually all negative data on SMME job creation potential comes from developed countries (1995:25). Second, while it is premature to *assume* that SMMEs in the manufacturing sector will actually be net creators of jobs (see Behrman and Deolalikar, 1989), the evidence that SMMEs were systematically out-competed and crowded out in Indonesia and Malaysia before policies were adopted to support SMMEs, should give South African policy-makers some hope. The right policies can (and did in Malaysia and Indonesia) create a climate in which SMMEs and LEs co-operate for mutual benefit. There is growing evidence that the manufacturing rather than retail sectors hold promise for long-term job creation (Cardozo, 1997; Stone, 1997b).

This untested assumption is probably attributable to three facts in varying proportions: a large amount of desire, significant extrapolation from existing data, and a lesser amount of empirical evidence. It is desirable politically, economically and socially to create the 300 000 to 500 000 new jobs annually envisioned by Gear. The inability of the formal sector to absorb any but 6 per cent of new entrants to the labour market, and the flourishing of hawkers and traders on streets of nearly every community, has led to the quick extrapolation that small scale business will be the path of economic advancement for many in the new South Africa. There is some empirical data that SMMEs do, indeed, create new jobs (Segal, 1997b; Fallon and de Silva, 1994; Riley, 1997; Parker, Riopelle and Steel, 1995). While there is some debate as to the job

creation potential of SMMEs,[50] the overwhelming sense is that an innovative and vibrant SMME sector is one important element in economic development. However, most of the data on SMME job creation is not from developing countries and the available evidence is mixed (Stone, 1997).

Assumptions Favouring SMME Development

Favouring the development and public sector support of SMMEs, the Department of Trade and Industry (1995a) makes four assumptions:

- SMMEs are more efficient than large enterprises.
- SMMEs can create more employment more quickly than large enterprises, hence do more to alleviate poverty in the short term.
- SMME problems are often symptomatic of market failures.
- SMME support plays an important role in the political stabilisation in developing economies.

In response, the following comments pertain. SMME efficiency cannot be proven in all enterprises, though in highly labour intensive production (such as textile cut, make and trim operations), it is often profitable and efficient to utilise SMME producers as subcontractors to large enterprises (Christerson and Applebaum, 1995)[51]. The reverse is equally true: that SMME development will be minimal in capital intensive sectors.

SMMEs create more employment more quickly than established large enterprises (Daly, 1997) due to the initial relatively low entry costs of new labour intensive SMMEs. In South Africa, this is particularly so at present with the predominant

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[50]Some studies tentatively indicate that while SMMEs create jobs, they also are disproportionate destroyers of jobs. See Davis, Haltwanger and Schuh (1993) and Nasar (1994) for current debate on the issue of SMME job creation.

[51]One caveat should be noted: for products that are highly standardised (jeans and T-shirts) and which change little over time, it is often more efficient to produce such goods using automated production with the implication that SMME producers of such goods will necessarily face eventual technology upgrading and increased manufacturing capacity or market-driven rationalisation.

development of survivalist SMMEs in greater numbers than those enterprises that employ more than immediate family members (Ntsika Enterprise Promotion Agency, 1997). Such enterprises experience very high rates of failure as minor market fluctuations or family illness can rapidly push survivalist enterprises into bankruptcy. Yet, because of the relative ease of entering the survivalist SMME sector, such enterprises are often the first entry into employment. Thus, most developing countries seek to provide some form of support to this informal sector, hoping to encourage both business growth and formalisation.

Support of SMMEs in the survivalist, micro and small business sector usually targets the need for basic business skills training for emergent entrepreneurs and the need for better access to capital. Particularly in South Africa, these two issues reign paramount in the government's strategy for SMME promotion and development (Ruiters, interview, 1997; Tati, interview, 1997). The assumption on which such services rests is that past market failures (restrictions on black business ownership and access to finance) must be addressed in order to create an enabling environment for SMME development (Ebersohn, 1997).

Finally, a primary motivation for South African government support of the SMME sector is the increase in political stability that is coincident with greater access to small business employment, even if on a survivalist scale. Indeed, Rogerson (1997) noted that informal street vendors and other labourers were instrumental in the political protests organised by Mahatma Gandhi in 1908 when they were denied trading licences. Further protest followed the 1913 government decision "that hawkers licences no longer be issued to women' and in 1922, Proclamation No. 111 specified that no trading station could operate within five miles of an existing trading site, which effectively eliminated blacks from the informal trading sector (Ebersohn, 1997). The political power of informal traders and small businesses has not been lost on the new government of South Africa in developing SMME support structures.

Summarising South African SMME Policy Interventions

Interest in promotion of SMMEs stems from the widespread assertion that the SMME sector will generate a majority of new jobs in the country and these new jobs will directly benefit previously disadvantaged persons, thus contributing to equity in development. As with SMMEs in much of the rest of the world, South African SMMEs need assistance in aspects of business such as business management, acquiring access to venture capital, developing human resources and skills training, gaining access to and capturing new and emerging markets, and making appropriate use of applicable technological advances and acquisition of raw materials at competitive prices.

In March 1995, President Mandela convened the first President's Conference on Small Business in Durban, at which time the government committed itself to creating an environment in which small businesses could flourish and prosper and which would encourage the development of an entrepreneurial culture. To implement this commitment, the government established a number of initiatives to stimulate the SMME sector. The National Small Business Enabling Act was gazetted in December 1995, creating a national framework for the delivery of SMME support. Key provisions of the Act included: the creation of Ntsika Enterprise Promotion Agency (NEPA) to wholesale support services to SMMEs; the creation of a National Small Business Council (NSBC) to act as the collective voice of SMMEs to government, and a provision for the government to review the impact of all current laws on SMMEs. Spurred on by the President's Conference, the Small Business Development Corporation (SBDC) has been redefined to focus less directly on services to microenterprises and rather more on a private sector partnership between the corporate sector and government to concentrate on the expansion of viable small and medium sized enterprises through access to share and or loan capital. Alongside these structures is the Industrial Development and Investment Centre that provides an advisory and information service to prospective industrialists and investors wishing to do business in South Africa.

The above small business policy initiatives were promulgated by the government as part of a strategy of the DTI to create an environment in which 300 000 to 500 000 new non-agricultural jobs were to be produced per annum (DTI, 1995). This environment envisions a significant increase in exports of manufactured goods to maintain macroeconomic balances and substantial increases of net domestic and foreign investment in the manufacturing sector. The following agencies have particular portfolios related to the promotion of SMMEs.

Ntsika Enterprise Promotion Agency (NEPA) is a newly formed agency intended to implement SMME support strategies in South Africa. NEPA proposes to work as an intermediary between government, the private sector and NGOs to support SMMEs (NEPA, 1996). NEPA is charged with the following tasks:

- co-ordinating national programmes of research and analysis of issues affecting SMMEs, to assist the task of policy-making;
- implementing policy formulated at the national level and affecting SMMEs;
- promotion of capacity building among SMME support institutions and NGOs to service SMMEs;
- facilitating increased demand-side interventions based on the identified needs of the target groups; and
- being a channel of funding to SMME service providers who carry out contract services to SMMEs on behalf of NEPA.

NEPA's intended function is to self-identify existing and aspiring micro, small and medium sized entrepreneurs, especially women, the rural poor, youth and the less able (Prodder, 1996).

Business Development Services (BuDS) is a unit of NEPA given the task of developing and implementing support services to SMMEs. Such services may include business training, including financial management, stock and inventory control and access to credit for business expansion. The goal is to provide SMME with access to high quality generic business support services. To fulfil this goal BuDS has launched three programmes:

Local Business Service Centres (LBSCs) are intended to provide the first tier of generic business services to SMMEs including business services and training, assistance with business management and aftercare, and networking with other available business services. LBSCs are intended to be accredited by BuDS through an application and evaluation procedure against 10 specific quality guidelines. Any existing NGO may apply for such accreditation, then becoming part of an envisioned network of generic service providers for SMMEs.

Manufacturing Technology Centres (MTCs) render sector-specific, targeted assistance to small manufacturing firms from disadvantaged communities. Four pilot MTCs will be established to assist small and medium sized manufacturing enterprises develop the sort of production flexibility that derives from access to 'best practice' technology and management expertise. MTCs will be designed to focus on a particular industry or sectors in collaboration and co-operation with industry. BuDS will assist with providing funding for such MTCs.

Tender Advice Centres (TACs) are a new creation (1997) of the DTI to specifically assist SMMEs in completing the requirements for tendering for government and parastatal procurement. Until September 1998, only two TACs existed in all of South Africa, an inoperative centre in Gauteng and a functional office associated with Comsec in Port Elizabeth.

Additional SMME support services include the **BuDS Information and Networking Programme** that seeks to provide greater access to information so that the different needs of clients of LBSCs and MTCs can be met within an environment of support and joint venture activity. Thus, the programme seeks to directly facilitate information networking among clients of LBSCs and MTCs, along with other business support institutions, NGOs, academics and provincial business support structures.

Providing policy support and a voice for SMMEs within government is the new statutory body, the **National Small Business Council** (NSBC) which will represent

the interests of SMMEs at both the provincial and national levels. The NSBC will participate with government in the development of SMME policies, and is intended to play a pro-active role in the development of policies that enable a vibrant SMME sector.

Since access to sources of capital and credit are essential for the development and expansion of SMMEs, two government supported financial institutions will provide financial support for SMME: the **Small Business Development Corporation** (SBDC) and **Khula Enterprise Finance Limited**.

The SBDC has repositioned itself to become the nation's leading government provider of for-profit equity and loan capital for small and medium enterprises (over R50 000 turnover). The SBDC focuses on three primary products: loans, risk partnerships and equity partnerships. Loans to SMMEs would be most probably be secured by existing tangible assets, thus making this vehicle most appropriate for existing businesses. Risk partnerships, while not clearly defined by the SBDC, are intended for clients without tangible assets for a collateral loan and without significant business experience. The risk partnership provides both business advice and access to capital. Equity partnerships are possible where the business proposition has growth potential and the client has entrepreneurial qualities and experience. The SBDC also identifies equity partnerships as a vehicle for transformation when business may wish to sell a division of a larger company. "The SBDC has identified this as an ideal empowerment tool" (Prodder, 1996:8).

The SBDC will no longer finance the needs of the informal and micro business sector, that role having been assumed by a new government agency, **Khula Enterprise Finance Ltd.** Khula will not directly interact with SMMEs but will render its loan services through the development of retail financial intermediaries (RFIs) that are financially sound and are committed to serve the SMME sector. RFIs will include

provincial development corporations such as the East Cape Development Agency[52] (ECDA), banks, and NGOs. Khula will make loans to selected RFIs which will, in turn, make loans to applicant borrowers from SMMEs. Two types of loans are offered by Khula to selected RFIs: development and business loans. Development loans are offered to RFIs with little or no experience of lending in the SMME sector, with a minimum of R1 million and a maximum of R10 million, and business loans with a maximum of R20 million will be made to RFIs with experience in the SMME sector. RFIs then make project loans to SMMEs for working capital with a maximum repayment period of 180 days or loans for purchase of equipment with a maximum repayment period of 720 days. Both types of loans are guaranteed up to 70 per cent of the RFI's irrecoverable loss by the government through Khula Ltd.

The Perceived Needs of the SMME Sector in South Africa

The perceived needs of an emerging SMME sector in South Africa have been repeatedly detailed by the Department of Trade and Industry, first in the SMME White Paper (1995) and more recently by Ebersohn (1997) in numerous DTI pamphlets. The perceived needs include:

- redress of the business-management capacity deficit resultant from apartheid policies that restricted business ownership and thus contributed to an undeveloped SMME sector;
- upgrading of the skills of SMME operators to enhance potential for business success;
- employment of appropriate new technologies in SMMEs;
- a broader vision of SMME support than merely improved access to finance;
- policies that 'level the playing field' between SMMEs and large enterprises (LEs) in South Africa; and
- targeted support for SMMEs in certain sectors:
  - -agro-business and small scale farming
  - -small manufacturers of clothing, furniture and metal working
  - -small scale tourism
  - -small scale construction
  - -small scale mining and transport sector operators

with particular attention to those enterprises operated by women with children, youth, those in resettlement areas, and the physically disabled (Ntsika, 1997).

[52] ECDA is currently being reorganised following revelations of suspect business practices among its management staff. At the time of writing, ECDA was effectively inoperative.

Potential Flaws in Current South African SMME Support: Responding to What Demand?

An inadequate analysis of the current SMME environment in South Africa and the potential of certain sectors to support SMMEs may endanger the ultimate goal of developing a thriving SMME sector that will generate jobs, assist income distribution and empower historically disadvantaged sectors of society. Analysis is lacking in five areas:

First, as mentioned in Chapter Four, the premise that SMMEs are net job creators is contested. Winter (1995:26-27) has challenged the SMME job creation thesis on three grounds: that SMMEs are disproportionate job destroyers because the businesses have high failure rates, that there is a tendency for firms to grow and shrink over annual cycles which may appear to illustrate aggregate SMME job creation and, third, that routine migration between employment size categories might seem to show SMME growth when, in fact, existing enterprises may be simply going through normal job-hiring, job-firing cycles. Winter does, however, concede that most SMME job creation data is from developed economies, in which there may be greater opportunity for alternative employment than in developing economies. This fact may lead to workers staying in struggling SMMEs for long periods because there are few alternatives. In sum, the job creating potential of SMMEs in developing economies remains contested.

Second, given the extremely limited resources that the DTI is able to direct for SMME support (Government of South Africa, 1996a; DTI, 1997) it is questionable policy to target agriculture as a primary recipient of SMME support resources. Micro enterprises in the agricultural sector employ 4.1 per cent of all employees in that sector, in contrast to similar enterprises in construction (20.4 per cent) manufacturing (15.7 per cent) or retail trade (37.1 per cent). The impact on job creation in the agricultural sector will be minimal in current terms and will probably decrease[53] despite any SMME inputs, as the terms of trade in agriculture have declined since 1900 and

[53]Agricultural employment has rapidly declined in South Africa from 18 per cent of the total workforce in 1960 to less than 4 per cent in 1993, as a direct result of unfavourable agricultural terms of trade (Lindauer, 1994).

show no indication of reversing (Antrobus, 1997; Lindauer, 1995). Targeted support in the form of incentives, land redistribution and/or extension services may have a political benefit but probably cannot be justified in terms of cost/benefit analysis or job creation potential.

Third, similar comments pertain to the small-scale mining sector. While the vast percentage of mining enterprises are very small (91.1 per cent) those same enterprises employ less than 1.8 per cent of the total mining sector employment (DTI, 1997). Obviously, due to the initial capital investment, the need for sophisticated scientific knowledge and access to international markets, intensive mining is a questionable sector for substantial support (though its very capital-intensive nature could quickly exhaust available support resources). The recent agreements by Anglo-American to sell off nine of its less productive mines to a consortium of small black-owned mining concerns seems little more than a public relations event for Anglo and is one that could drain SMME support with little return in terms of job creation. The small job potential in the small scale mining sector, the cost of SMME support and the already shrinking employment in large scale mining renders this sector unsuitable for significant targeted SMME assistance.

Fourth, a further caution related to SMME assistance concerns the predilection for SMME support services such as Local Business Service Centres (LBSCs), to focus on retail firms and hawkers at the expense of the service and manufacturing sectors. SMMEs support services target retail operations because (i) they are easily identified (openness is a requisite condition of selling a product whereas SMME manufacturing may wish to remain hidden to avoid VAT registration and other regulations) and (ii) a wide variety of retail operations can benefit more immediately from generic training in management and marketing than can small manufacturers who require more targeted, sector or product-specific training in aspects of production efficiency and product quality. Retail firms are more prevalent in South Africa currently because (a) they have easier access to micro-credit due to the collateral value of existing inventory, (b) retail activity and stock turnover allows for repayment of credit much more quickly than

manufacturing which involves greater capital outlay and time delays between capital outlay and payment by suppliers, and (c) due to past market distortions restricting business ownership by black Africans, the retail sector is more developed than the small manufacturing sector.

Unfortunately, the retail sector does not hold great potential for value added growth or for increasing employment beyond the survivalist stage of development. Fully 32 per cent of all retail enterprises which are targeted for SMME support by the government of South Africa are classed as survivalist, have been in business less than two years, and enjoy a business closure rate of 80-90 per cent (Ntsika, 1997). Kuroda and Kasajima (1987) observed that SMME owners' progress along a predictable developmental line. SMMEs commonly begin as traders and hawkers in the retail sector, selling high volume, fast turnover products. Gradually, as capital is accumulated, the products sold migrate to higher price/higher profit items with lower turnover. Retail vendors then vertically integrate in large numbers by assuming production or manufacturing responsibility for some of the products sold, thus seeking to increase profits and increasing market agility. This migration from retail into manufacturing increases business stability, leads to expansion, greater employment, and consequent more targeted and specific training needs.

In the context of massive unemployment among black Africans and the inability of the formal sector to absorb more than a very small percentage of new labour market entrants each year, a coherent SMME support strategy should aim at long term net job creation. However, the retail sector is a weak long term job producer world-wide and there is little reason to think South Africa will be different (Meyanathan, 1994). Thus, there is ample reason to conclude than a South African SMME support policy should look beyond the retail sector as an engine of economic growth and job creation.

It is reasonable to speculate that the motivation for targeting support for the agricultural and mining SMME sectors is more closely related to political objectives than to actual job creation potential. The need to incorporate the former so-called

‘homelands’ and those employed in ‘homeland’ parastatal agricultural industries may be one factor behind SMME agricultural support (Kingwill, interview, 1996). Similarly, with the retrenchment of organised mineworkers and the close alliance between the ANC and its labour partners, targeted support for small scale mining may be politically motivated without adequate consideration for the viability and job creation potential of such enterprises. Extensive literature documents the tendency in most developing economies to have rather fluid boundaries between political, social and economic policies (Frischtak, 1992; Easterly and Levine, 1997; World Bank, 1990). Seldom is effective economic policy formulated in such circumstances.

Finally, a broader critique of the DTI’s strategy for SMME support concerns the dichotomy between supply-side and demand-side support measures. Tendler and Amorim (1996) indicate that most assistance to SMMEs world-wide is supply driven. That is, assistance takes the form of providing one or more ongoing services to emergent business, often including access to credit, business management training or technical assistance. Supply-sided assistance is generic in nature and is applied across sectors in an attempt by the provider to service a maximum number of client enterprises. This is the model of assistance envisioned and now being implemented by the DTI for SMME support. Among the plethora of SMME agencies and services related to the DTI,[54] most provide generic services and none of the targeted services or incentives distinguish between those sectors capable of greatly increasing employment through support and those unlikely to produce long lasting employment gains as noted above.

World-wide best practices and the striking stories of SMME growth have tended to be demand-driven rather than supply-driven (Tendler and Amorim, 1996), have focused on manufacturing sectors, and assist vendors to move from the retail to the

[54]Including NEPA (Ntsika Enterprise Promotion Agency, BuDS (Business Development Services), LBSCs (Local Business Service Centres), MTCs (Manufacturing Technology Centres), NSBC (National Small Business Council, SBDC (Small Business Development Council), Khula (Khula Enterprise Finance Limited), Competitive Edge, Nedlac and no less than 34 different business incentive programmes administered by the DTI.

manufacturing sector (Wie, 1994). Typically, large customers of small enterprise suppliers place increased demand on the SMME supplier at some stage of business development. The increased demand can arise from purely market forces - securing a lower priced supplier for a particular component - or from international market expansion as in the case of rapidly increasing demand for Taiwanese bicycles noted previously. Demand can also be redirected to SMME through political coercion as in the case of state and parastatal procurement. Related to increased SMME demand resulting from coerced redirected procurement policies are local component/local employment policies that are often linked to foreign direct investment (Itoh and Urata, 1994; Rahman, 1997; Wie, 1994).

In attempting to explain the high performance of some national and regional economies, especially the performance of the less developed HPAEs, an extensive body of literature indicates that five broad factors are common to successful SMME support interventions. They are: (i) the development of a context of trust and mutual respect between larger enterprises (LEs) and SMMEs as in Japan (Itoh and Urata, 1994), (ii) interventions that lower the cost of transactions with SMMEs (Stone, 1997a), (iii) the availability of and support for targeted training to assist SMMEs to meet the subcontracting demands of LEs in less developed Asian countries such as Malaysia, Thailand and Indonesia (Meyanathan, 1994; Cardoza, 1997), (iv) government intervention in the marketplace to encourage demand-driven access to training and technology through outsourcing and subcontracting to SMMEs as in Indonesia (Wie, 1994), and (v) policies that encourage and strengthen SMME networks or clusters.

The above-named factors common to successful SMMEs support world-wide relate to support for the manufacturing sector, and to policies that encourage the movement from retail to manufacturing. Among the most effective specific policy applications related to the broad principles are targeted government procurement policies, clustering SMMEs in close proximity to larger enterprises, policies to encourage business linkages, and access to short term credit.

In contrast to known best practices regarding SMME support, the DTI plans to provide services characterised as providing “the first tier of generic services to SMMEs” (Prodder, 1996:1), providing (undefined) support services to manufacturing SMMEs to increase productivity, and to provide easy access to finance for SMMEs (Ntsika, 1997). Most services that the DTI intends to employ in support of SMME development are supply-sided provision of generic training and capacity development. The generic approach is largely related to two factors: the high cost of customised SMME assistance (Wie, 1994; Gittleman and Wolf, 1995; Berry and Escandon, 1994) and the wide variety of assistance needed by small businesses from the most basic managerial skills to different levels of technical assistance and advice. Government will rely upon existing NGOs and community-based organisations (CBOs) to provide services to small businesses in communities they already service for other needs. Thus, agencies that previously provided services to individuals, particularly youth and women, are now being asked to provide business support services. The weakness remains that many agencies with little experience in the business sector agree to provide services in order to gain access to substantial government funding for such service provision. Because the organisations typically have little business experience and may have particular antipathy toward big business for its complicity during the apartheid regime, generic services to micro businesses, *spaza* shops and hawkers tend to be the most prevalent service provided. Illustrative is the Umtata Business Service Centre (1997) which provides, “training for new entrepreneurs in basic business skills, rendering business information and advice, networking for access to finance, business opportunity identification, experience exchange and sign-posting and referrals” (Umtata Business Service Centre, 1997:1).

Initiatives and organisations assisting the SMME sector that tend to be generic in approach rather than sector or firm-specific have significantly less impact than targeted government support (Wie, 1994; Tendler and Amorim, 1995). Generic business support services are often provided to increase the supply of generic business skills and aptitude among potential entrepreneurs. Such services assume that increased skills will

naturally find a niche in the marketplace in the form of new SMMEs. Tendler (interview, 1996) and Amorim (1995) along with Mead (1994) indicate that SMME development usually progresses most quickly and successfully when enterprises are formed in response to an existing market demand, rather than in response to newly acquired business skills.

In many instances when generic skills are provided by NGOs as vendors of services for government, the NGO itself is most often developing its own competency just one step ahead of those to whom it is providing services.[55] This is likely to be the case in South Africa as the organisations most trusted by government to provide services are those that have a history of political opposition to apartheid. Among other noted deficiencies of this supply-sided approach to the provision of business skills is that business training is not grounded in the harsh environment of the marketplace where business training must eventually be put in practice.

Thus, the particular problems and market distortions that gave rise to the need for an SMME training initiative in the first place are not being addressed in the market, but rather as a training component that, once learned, can be transferred to the marketplace (Tendler and Amorim, 1996). There is substantial contrary evidence to indicate that business learning is quickest, most efficient and relevant when it is directly related to the marketplace (Kuroda and Kasajima, 1987).

In general, the elements of the SMME support framework envisioned by the DTI (1995) relate most directly to the capacity of the government to effectively intersect with the SMME sector. The provision of specific services to SMMEs comes off as secondary to developing the capacity of government to understand and have an impact upon the activities of the SMME sector. For example, out of 21 suggestions for government action to create more effective support of SMMEs (DTI, 1995), fully 13

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[55]Biggs, Brimble and Snodgrass (1990) contend that co-ordination among Thai SMME support organisations was weak, that services were seldom tailored to the needs of specific industries or regions, and that some so-called experts have had insufficient knowledge of specific industries to be of much assistance.

were related primarily to the inner workings of government,[56] three were related to improved access to finance, two to training needs of SMMEs, one to information collection and dissemination, and one to the promotion of joint ventures between bigger and smaller enterprises (DTI, 1995).

Four issues emerge as paramount. First, in developing support for SMME in South Africa, an area of gross neglect under previous governments, the present government views the passage of new legislation to define its own role as a fundamental task for support of SMMEs. Second, SMME support will focus on the formation of new quasi-governmental institutions to improve access to finance (commonly believed, but not always proven, to be the major obstacle facing emergent entrepreneurs) (Meyanathan, 1993, 1994). Generic business skills, financial management and general entrepreneurial skills are the third focus of the DTI's national strategy for SMME support. Joint ventures between larger and small businesses are mentioned almost as an afterthought:

> This interest and the active involvement of foreign donor agencies and larger investment groups in such ventures, suggests that there may be no specific need for public funds for that purpose.... Since there still exists considerable suspicion and fear about the risks and possible disadvantages of joint ventures...the government will explore the need and scope for a co-ordinating mechanism to ensure that foreign joint venture initiatives give due attention to black partners.... (DTI, 1995, 10).

This final comment by the Department of Trade and Industry is instructive, if not encouraging, about the potential role envisioned for interfirm linkages for economic development. This is particularly discouraging in light of the effective use of linkages and joint ventures in other developing economies, particularly in East Asia. In the next chapter we review two examples of government interventions in Asia (Malaysia and

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[56]These are enumerated in Section 4.1-4.10 of the National Strategy for the Development and Promotion of Small Business in South Africa (DTI, 1995). The suggested changes include such things as: new legislation defining SMME activity, easing the regulatory environment, monitoring the regulatory reform process, compiling statistical information on SMMEs, regularising SMMEs within a legal framework for tax capture, and standardising all government forms for procurement.

Indonesia) that assisted linkages between smaller and larger enterprises, and the benefits that accrued to the SMME sector. Both the Malaysian and Indonesian experiences are of particular relevance to South African SMME planners. Both Malaysian and Indonesian SMME development have been hindered for three decades under constraints, both social and political, that bear similarity to South Africa (Southall, 1997; Meyanathan and Munter, 1994).

CHAPTER SIX

MALAYSIAN AND INDONESIAN SMME EXPERIENCE

> The challenge for many developing countries is to turn subcontracting relationships into opportunities for skill upgrade.
> (Meyanathan and Munter, 1994:7).

The Indonesian Experience

Having reviewed current South African strategy for SMME development in Chapter Five we now turn to examine different SMME support strategies that have been pursued by the government's of Indonesia and Malaysia. Indonesia's rapid growth between 1965-90 (average of 7 per cent per annum) has been accomplished despite a rapid structural change which has seen Indonesia change from oil and gas dependency to an economy in which non-oil manufactured exports became predominant. Indonesian industrial structure has been characterised as 'upstream socialism and downstream capitalism' indicating state ownership of the means of production of most basic and intermediate products (metals, minerals, chemicals, oil and gas processing, iron and steel aircraft, cement and so on) (Wie, 1994) while seeking to open markets for expanded trade opportunity. The South African parastatal apparatus (Denel, Armscor, Eskom, Iscor, Transnet, Portnet, Spoornet, and so on), developed for political reasons dissimilar to Indonesia, nonetheless has created a climate for SMME development that bears comparison to Indonesia. The similarity is striking in that manufacturing production in both Indonesia in the early 1980s and current day South Africa is marked by a few large enterprises providing most employment and large numbers of small enterprises that provide survivalist employment and a small percentage of total value added to GDP. Both South Africa and Indonesia suffer from the 'hollow middle' syndrome of SMMEs.

Indonesia has pursued an active policy of SMME support, including innovative foster-father business development programmes, generic and sector specific training, and other finance and technical support. The result has been a vital and growing SMME sector with consequent job creation, skills upgrading, and wealth creation and redistribution (*Menteri Perindustrian*, 1991).

The contrast in enterprise size between Indonesia and South Africa is dramatic and confirms the large enterprise domination of South African production. Ninety-nine per cent of all Indonesian enterprises employ less than 50 persons while less than 48 per cent of South African enterprises do so. 52.4 per cent of all Indonesian employees work in firms with less than five employees compared with 18.9 per cent of South African employees in similarly small businesses. The Indonesian case is particularly interesting for South Africa in that the labour force is less educated than other HPAEs, income inequality is greater than any other HPAEs (Wie, 1994), and income redistribution was a primary motivation for the SMME support strategies implemented by the Indonesian government. In other words, from both a policy and starting point perspective, the Indonesian experience brings useful similarities to the South African context.

Table 6: The Relative Importance of Small Enterprises in the Indonesian Manufacturing Sector, 1986[57]

Number of Employees[1]	Number of enterprises	Per cent of total	Total employed	Per cent of total	Per cent of total value added
50 or more	12 765	0.8	1 691 435	32.7	82.2
5-49	94 534	6.2	770 144	14.9	6.8
5 or less	1 416 935	93.0	2 714 264	52.4	11.0
Total	1 524 234	100.0	5 175 843	100.0	100.0

Source: *Biro Pusat Statistik* (1991)
[1] Biro Pusat Statistik compiles data regarding Indonesian SMMEs using different size categories than are used in Malaysia or South Africa, making direct comparisons difficult.

The manufacturing sector can be a powerful growth engine in developing economies, as it was in Indonesia.[58] Small manufacturing offers greater employment potential at the entrance level of business than most other sectors, often beginning as labour intensive operations and offering potential employment at low wage levels for unskilled workers. In South Africa in 1995, the number of enterprises in the manufacturing sector was 74 per cent greater than in the agricultural sector, reinforcing the employment creation potential of manufacturing over agriculture (agriculture 58 900; manufacturing 102, 900) (Ntsika, 1997). The total number of persons employed was 48 per cent greater in manufacturing (228 450) than agriculture (156 000). The rapid growth within the Indonesian manufacturing sector may hold promise for applicable strategies for similar sectoral growth in South Africa.

Rapid growth characterised the Indonesian manufacturing sector from 1965 to 1990, averaging 12.0 per cent annual growth from 1965 to 1980 and 12.7 per cent annual

[57]1986 data on SMMEs in Indonesia were compiled for the 1991 report of Biro Pusat Statistik. No further data have been released to date.

[58] This is not to dispute the conclusions of Julius (1991) that manufacturing production has rapidly migrated from developed to developing economies. The point is, rather, that the structure of world-wide manufacturing has shifted to developing countries with cheaper labour available for the repetitive tasks required by mass production manufacturing.

growth from 1980 to 1989 (World Bank, 1991). By 1993, the Indonesian manufacturing sector contributed nearly 27 per cent to total GDP having grown from 12 per cent in 1970. The manufacturing sector contribution to GDP in South Africa decreased over a similar period (averaging 24 per cent from 1975-1984 and 21.4% from 1985-1989 (World Bank, 1996; Millward, 1995). Between 1960 and 1975, the oil and gas processing industries accounted for the greatest percentage of manufacturing value added in Indonesia (World Bank, 1995). In response to an over-dependence upon one sector, in the mid-1970s the Indonesian government encouraged manufacturing diversification by a directed import substitution strategy that gave rise to numerous small and cottage industries. These were characterised by labour intensive production, low technology and inferior quality. When however, government policy began to emphasise manufactured exports, international demand for quality gave impetus to government-imposed quality control requirements for all exports. The SMME sector, dominated by small and cottage industries, responded quickly and efficiently to the market demand, assisted in part by targeted government SMME initiatives. The textile and basic metal working sectors saw the greatest concentration and increase in relatively low skill employment, while higher technology electronics production has been concentrated in larger firms in the manufacturing sector (*Biro Pusat Statistik*, 1991). The magnitude of manufacturing growth was impressive. In 1983-1990 the total value of manufactured exports increased 370 per cent, while the total value of exports of SMMEs increased 950 per cent (Wie, 1994). Four government interventions were instrumental to the growth of Indonesian SMMEs in the manufacturing sector: the implementation of two different subsidised credit programmes for SMMEs and two related technical assistance programmes. The most successful Indonesian government interventions were those that enabled SMMEs to respond successfully to market-driven demands.

SMME Assistance: From Credit to Interfirm Linkage

Launched in 1973, but significantly expanded in the early 1980s, the Small Industries Development Programme (KIK/KMKP) was the major national credit assistance effort targeting small enterprises particularly in the manufacturing sector. Credit from traditional sources was made available to SMMEs through two forms of government support. The state subsidised the interest rates for loans in the KIK programmes and acted as guarantor of last resort should the loans default. Actual screening for loans and implementation of loan agreements was left in the hands of local loan agents, often commercial bank branches. Thus, by leveraging the state role as guarantor of defaulted loans, credit worth 40 times the government investment was made available to SMMEs (Wie, 1994). The customary and problematic need for loan collateral was greatly reduced by the government loan guarantees.

Particularly targeted to serve the 113 000 SMME manufacturers and the estimated 280 000 cottage industries in 1979, a study by the Netherlands Economic Institute on the effectiveness of the KIK/KMKP credit programme estimated that a total of 23-30 per cent of all target firms actually received assistance by 1983. The largest percentage of KIK/KMKP loans were made to the food processing sector, followed by metal, textile, and wood processing and manufacturing industries (Poot, Kuyvenhoven and Jansen, 1990). In the early years of KIK/KMKP SMME loan support, the programme was adjusted several times to re-focus and target assistance to the sectors of manufacturing that could create the most employment, contribute to skills upgrading (as opposed to investments in low-skill labour-intensive efforts) and to benefit those cottage industries that had shown the ability to move from survivalist to small employers.

Findings of the Netherlands Economic Institute (1986) indicate that the KIK/KMKP subsidised credit yielded generally positive results, and did encourage small enterprises to diversify, enter the manufacturing sector from the retail sector, expand and gradually increase employment. The study further indicated that the KIK/KMKP programme had the most impact on SMMEs in the manufacturing sector in terms of capital investment,

value added and employment. It appears, though was not conclusively shown, that firms taking advantage of KIK/KMKP increased use of technology, increased productivity per employee, and increased employment. Despite these successes, Grizzell (1988) makes a cautious assessment, suggesting that the larger goal of the credit subsidy scheme, which was to create a sustainable alternative source for SMME finance, was jeopardised by high default rates (up to 27 per cent in some years).

By 1984, the default rate of KIK/KMKP loans to SMMEs coupled with banking de-regulation in Indonesia in 1983 gave rise to a short term working capital loan programme (Kupedes) also targeted at SMMEs, albeit with a great emphasis upon loan collection. Kupedes loans were granted at high interest rates[59] but were granted to any potential SMME borrower who only had to show an ability to repay the loan. Responsibility for loan approval and for repayment was devolved to local lending officials. Despite the high interest rates,[60] the loans proved very popular and within one year of Kupedes introduction, 639 000 loans totalling US $166 million were made. Because loan applications and assessment of the viability of payback were made by officials at the sub-district level, with responsibility for repayment vested in the same local officials, community responsibility and peer pressure played a role in repayment. Further aiding loan repayment was the 10 per cent bonus on profits paid by Kupedes to sub-district-level loan officials who induced staff to make viable loans and to closely monitor loan performance[61]. Kupedes loans were granted for shorter duration and in smaller amounts than the KIK/KMKP credit assistance programme. It appears that Kupedes loans were most useful to small enterprises in the retail sector as they grew and expanded into the first tier of manufacturing. Manufacturing enterprises, however,

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[59]The equivalent of 31.2 per cent per year.

[60]Some analysts have noted that the high interest rates on Kupedes loans eliminated wealthier borrowers who could obtain cheaper credit elsewhere, thus opening the market to less wealthy emergent entrepreneurs (Robinson, 1992).

[61] The payment of financial bonuses to loan officials who produced high levels of loan repayment is highly contested policy. While the policy intended to encourage lenders to make only the most viable loans, the lure of financial gain could induce loan officials to intimidate borrowers into forced repayment. In some instances such forced repayment drove borrowers to independent lenders charging exorbitant interest rates, thus endangering small enterprise viability.

made much wider use of the KIK/KMKP loan, probably because of lower interest rates and the ability to secure loans with existing capital investment (Wie, 1994). Taken together, the Kupedes loans serviced the emergent retail sector as it developed and moved into initial manufacturing, while the KIK/KMKP credit subsidy serviced the SMME manufacturing sector, though with higher rates of default.

Credit assistance was soon seen to be insufficient to generate rapid SMME development. In response, two broadly applied technical assistance support programmes complemented Indonesian financial mechanisms in developing manufacturing sector SMMEs. BIPIK (*Program Pembinaan dan Pengembangan Industri Kecil*) co-ordinated technical and training input provision for SMMEs that was implemented by the Ministry of Industry through generic service providers, often local NGOs. It followed the pattern of generic business skill training programmes (Tendler and Amorim, 1996) in providing services that were often not directly applicable to the demand-driven market environment in which most manufacturing SMMEs found themselves. The Indonesian experience, now 15 years old, should be instructive regarding the potential for the extensive generic skills training for SMMEs planned by the South African DTI.

Grizzell (1988) notes that the BIPIK programmes failed in its early stages. Few entrepreneurs took advantage of BIPIK services due to problems applying learnings to the market context (Grizzell, 1988). After some years, BIPIK was redesigned to encourage clusters of similar SMMEs to join in shared space within close proximity to larger enterprises. This effort at clustering resulted in informal linkages being formed between larger and smaller enterprises for subcontracting. This effort signalled a positive shift in BIPIK programmes away from generic service provision to targeted support for SMME clusters responding to market demand.

The positive response of the SMME clusters that were developed under BIPIK gave rise to an innovative "Foster-Father Business Partner" linkage programme that joins larger and smaller enterprises in Indonesia. The foster-father business is a large enterprise, which, because of its access to domestic and/or international markets, is in a

good position to assist an emergent SMME in marketing its own products. In Indonesia, few of the foster-father interfirm linkages stopped at the marketing level; most developed into fully operational SMME subcontracting arrangements. In such arrangements, Foster-Father businesses guided SMMEs by raising their management capability, developed manufacturing processes and technology, assisted with purchase of raw materials, and often acted as a guarantor or conduit for new financing made available to the partner SMME (Suhardi, 1992a). This linkage effort, co-ordinated by government but operating within market constraints, may hold particular promise for South African SMME development. Initially conceived to give SMMEs assistance with access to large enterprise markets, many partnerships have evolved into SMMEs receiving significant assistance with most aspects of business and production from larger enterprises. In return, larger enterprises often succeeded in developing SMMEs into efficient, consistent and loyal low-cost subcontractors for components of final products (Suhardi, 1992b). By 1991, co-operation agreements had been signed by 4 698 large foster-father firms with 21 983 SMME business partners.

The “Foster-Father Business Partner” programme began informally with BIPIK support out of the lacklustre success of the KIK/KMKP and Kupedes loan schemes for SMMEs. The foster-father business programme was formalised in 1989. The government of Indonesia issued a decree through the Ministry of Finance that all state-owned enterprises should allocate 1-5 per cent of net profits to SMME assistance (Wie, 1994). Such government decrees, while not binding, had the pronounced effect of declaring official support for SMME assistance, thus creating a modestly coercive environment for private sector enterprises to join the programme.

It is too early to assess Indonesia’s linkage efforts for SMMEs. While there have been numerous successful linkages, especially in which the foster-father has been able to open markets for SMMEs, there is also some doubt expressed by the private sector as to the long term viability of linkages that arose from government induced ‘forced adoption linkages in which the parent firm receives little or no benefit (Wie, 1994).

Increased transaction costs for large enterprises engaged in foster-father linkages is another aspect of concern for long term viability. Due to the inevitable inefficiencies arising from information gaps, misapplication of technology, poor quality control and the time required for skills acquisition by SMMEs, new foster-father linkages will cost large enterprises more than if production and subcontracting were done without such links (Suhardi, 1992b). It appears that long term linkages could only be attractive for large enterprises if there were a governmental subsidy to assist with a portion of the assumed higher transaction costs. Such a partial state subsidy for linkages may enact the envisioned facilitating role of the state in SMME promotion.

The "Foster-Father Business Partner" programme does not guarantee smooth sailing for linked SMMEs. The market demand (from the large enterprise) for product quality, timeliness, efficiency and consistency are aspects of manufacturing that SMMEs traditionally struggle to maintain. Demands to produce quantity and quality often lead the SMME to rely totally and become dependent upon the large enterprise partner. New market opportunities are lost for lack of market exploration and the SMME can become a de facto wholly controlled subsidiary (or sheltered workshop) of the large enterprise. There may be no immediate solution to the tendency of SMME dependence; it is a concern, though, if the goal is to create independent and market related SMMEs within the broader economy.

Unlike other countries, Indonesia's promotional policies for SMMEs concentrated on cottage industries with several notable points. Emphasis was focused on manufacturing rather than retail, business managerial training was targeted for cottage industries and large enterprises were required to contribute skills worth at least 5 per cent of net annual profits to assist manufacturing SMMEs. These policies were notably ineffective until fostering interfirm linkages between large and small enterprises became state policy and was enforced (Wie, 1994; Meyanathan, 1994; Suhardi, 1992b). This may indicate that SMME policies that are not demand-driven (as they would be if linked to existent larger enterprises) are inherently limited. Further study is indicated.

Since the introduction of Indonesia's Foster-Father Business Partnership plan in 1987 and its formalisation in 1989, SMME manufacturing (excluding oil and gas industries) grew 59 per cent in the food sector, 50 per cent in textiles and leather industries and 74 per cent in hand craft and general semi-skilled manufacturing (Biro Pusat Statistik, 1991). Caution should be taken in reading too much into these statistics since other data indicate that SMME manufacturing contribution to total value added in GDP has not grown comparably (Wie,1994) . Thus we may have policies that encourage more SMMEs to develop, but they do so at survivalist levels. Further research on Indonesian SMME support policy is required. Notwithstanding the critique, at the very least Indonesian SMME support policies that create interfirm linkages have resulted in the proliferation of emergent entrepreneurs at the entry level.

Conclusions: The Indonesian Experience

The Government of Indonesia did several things right. First, reliance upon past sources of wealth (oil and natural gas) was discouraged while an analysis of the structure of the economy indicated that the manufacturing sector, rather than retail or agriculture, would be the most effective engine of new job growth. Education and skill levels indicated that initial stages of new growth would require significant investment in education and training. SMMEs were targeted for development within a larger context of focusing on the manufacturing sector in particular. Generic business training was offered and, when unsuccessful, the government moved swiftly to assess the problems. Through interviews with existing SMMEs and larger enterprises, clustering developed to lend practical SMME support. Access to finance was targeted for certain sectors. Finally, recognising that markets and production skills were, perhaps, more important than finance to emergent SMMEs, the government promulgated and supported the foster-father linkage programme. In summary, Indonesia's manufacturing SMME sector has grown, created employment, developed skills and opened new markets. A significant aspect has been the development of business linkages between large enterprises and SMMEs, with active and tangible public sector support.

Unfortunately, the lesson from Indonesia seems not to have been appropriated and applied in South Africa, given the plethora of credit and generic training interventions planned by the DTI. Nonetheless, failed Indonesian SMME policy gave birth to new strategies for linkages between LEs and SMMEs that have proved remarkably successful.

The Malaysian Experience

Substantial data exists with which to review the structure of the Malaysian economy and the promotion of SMME growth. The development of SMMEs in Malaysia, as part of a larger strategy of economic development, also has some relevance to South Africa in that Malaysian economic development after independence was confronted with some broadly similar structural conditions. Since Malaysian independence in 1957, the government promoted development of large industrial enterprises, (often with strong state ties) through a package of fiscal incentives, free trade zones and tariff protection. Local capital was largely concentrated in finance, real property and commodity production and processing. Industrial expansion was left to multinational enterprises. Concern for the development of SMMEs was limited to quasi-governmental structures designed to assist with provision of small loans, advisory services and infrastructure support (Salleh and Meyanathan, 1994).

Similarly, South African economic development since 1913, and particularly since the early 1950s, has been marked by increasing large enterprise domination of most sectors of the economy, state monopolisation of heavy industries and infrastructure development and heavy dependence upon mining and primary products. State monopolies were further protected by high tariffs and subsidies for ‘favoured’ enterprises (DTI, 1995a). Foreign and multinational investment powered the industrial expansion of South Africa until the retreat of foreign investment rose dramatically in the mid-1980s. The flight of foreign investment heightened protective measures thus increasing the long term competitive disadvantage of subsidised industries.

The political pressures that inhibited international investment in South Africa from the mid-1980s, along with increasing civil turmoil and labour unrest, created a hazardous environment growth in the formal sectors. This is readily evident in the following comparison of the growth of production in the industrial and manufacturing sectors in Malaysia and South Africa. What is also evident in comparison below, is that Malaysian growth boomed in a similar period. The manufacturing sector contributed 24 per cent of the South African GDP in 1970 but declined to 23 per cent of GDP in 1993. During the same period in Malaysia, the contribution of the manufacturing sector rose from 12 per cent in 1970 to 27 per cent in 1993 (World Bank, 1995; Meyanathan and Salleh, 1994).

Table 7: Growth of Production, 1970-80 and 1980-93 in Industrial and Manufacturing Sectors

	Manufacturing growth rate (%)		**Industrial growth rate (%)**	
Country	1970-80	1980-93	1970-80	1980-93
South Africa	4.7	-0.4	2.7	-0.2
Malaysia	11.7	10.3	8.7	8.2

Source: Government of Malaysia, 1988, 1993. Ntsika, 1997.

An essential component to the growth of the Malaysian manufacturing sector, and thus to Malaysia's overall economic growth has been the intentional development of the SMME sector. While the Malaysian economy continued to be dominated by large industries during the period from 1980-1993, growth specifically in the small and medium-sized industrial sectors was substantial. Lack of data constrains adequate analysis of the trends and patterns of manufacturing development in Malaysia. However, some general comments can be made related to the following charts comparing the structure of Malaysian manufacturing in 1981 and 1988.

Table 8: Structure of Malaysian Manufacturing-1981

Number of employees	Total enterprises	% of total	% of total value added	% of employment
Micro <5	8 817	43.1	1.0	1.8
Small 5-49	9 469	46.3	13.4	23.7
Medium 50-199	1 680	8.2	36.1	28.7
Large >200	464	2.4	49.5	45.8
Total (rounded)	20 430	100	100	100

Source: Government of Malaysia, 1981.

Table 9: Structure of Malaysian Manufacturing-1988

Number of employees	Total enterprises	% of total	% of total value added	% of employment
Micro & Small <49	N/A	58.8	7.07	11.66
Medium 50-199	N/A	30.75	28.07	29.77
Large >200	N/A	10.45	64.86	58.56
Total (rounded)	N/A	100	100	100

Source: Government of Malaysia, 1988 : changes in data retrieval eliminated certain indicators used in 1981 from the indicators used in 1988 while combining data on small and micro enterprises.[62]

As **Table 8** and **Table 9** indicate, collectively SMMEs accounted for 54.2 per cent of the total employment (and 50.5 per cent of all value added) in all 20 430 manufacturing establishments surveyed in 1981. Small enterprises absorbed 23.7 per cent of the labour force while medium-sized enterprises absorbed 28.7 per cent. While the available manufacturing census data for 1988 does not correspond directly with 1981 due to methodological differences, some comparison can be made with available data for 1988. As **Table 9** shows, there is evidence of Malaysian industry growing at all levels of size. Of particular interest, however, is the seeming 'migration' of smaller industry to larger scale and to a higher level of value added. This is evident in the decrease in the percentage of micro and small industries in Malaysian from 89.4 per

[62]Meyanathan and Salleh comment that the methodology used by the Department of Statistics in Malaysia tends to underestimate the role of SMMEs in industrial development.

cent in 1981 to 58.8 per cent in 1988 and the corresponding growth of medium-sized enterprises from 8.2 per cent in 1981 to more than 30 per cent in 1988.

In the absence of quantified empirical data, we can presume that the seeming 'migration' of smaller enterprises to larger ones in Malaysia is either the result of genuine growth of the micro and small business sector or the 'crowding out' of new and smaller industries by policies that favour large industrial and manufacturing concerns. There is some truth in both presumptions. What policies have contributed to SMME growth in Malaysia and which successes might be transferable to the South African context?

SMME Support in Malaysia

While Malaysia still does not boast a vibrant SMME sector due to a continuing bias toward large industry, since the early 1990s the migration of smaller industries to larger sized enterprises is increasingly evident, an indication that the SMME sector is self-generating, expansive and reflects the second level development of SMMEs from retail to vertically integrated small manufacturing (**Table 10**).

The package of SMME supports in Malaysia follows a (by now) familiar pattern: eased access to small finance for SMMEs, credit guarantees supported by government subsidies, numerous credit schemes for targeted sectors, and a concerted attempt to increase manufactured exports (Rhyne and Rotblatt, 1994). Similarly, since the mid-1970s, Malaysia has introduced numerous entrepreneurial and business management training programmes. Most are generic in scope and focus. Some (such as the Malaysian Entrepreneurial Development Centre) are residential, others provide skills training on an outreach basis. Meyanathan and Salleh (1994) summarise the effectiveness of Malaysian business training in the following negative terms: (a) limited impact of training; (b) limited practical or hands-on training; (c) outdated technology for training; (d) little ability of the trainers to address the market demands of individual enterprises in the training; (e) lack of knowledgeable trainers; (f) outdated training material; (g) lack of training in rural areas; and (h) too many agencies providing similar

services without co-ordination. In other words, the Malaysian experience again shows the significant limits of generic business skills training which is of particular relevance to South African plans for SMME development.

Table 10: Applications* for establishment of new manufacturing projects by employment size - Malaysia, 1992 and 1996.

Industry	1992		1996		% change in size
Food processing	4 291	*75*[a]	2 362	*63*[a]	-14
Beverages and tobacco	453	*75*	132	*33*	-56
Textiles and textile products	11 983	*146*	2 998	*93*	-37
Leather and leather products	1 521	*190*	131	*65*	-66
Basic metal products	4 209	*131*	4 823	*77*	-42
Fabricated metal products	3 894	*182*	5 223	*81*	-56
Wood and wood products	12 113	*237*	11 053	*172*	-28
Furniture and fixtures	3 657	*135*	5 815	*157*	+16
Paper, printing publishing	2 588	*70*	9 881	*299*	+427[b]
Electrical and electronics	37 912	*164*	42 672	*170*	+3.6

Source: Malaysian Industrial Development Authority, 1997; Center for Policy Implementation Studies, 1993.
* Not all applications were approved. In the years from 1992 through 1996, over 90 per cent of all applications for new manufacturing enterprises resulted in actual business establishment.
a Average. number of employees in new businesses indicated by Italics.
b The remarkable increase in average number of employees per new business in the paper, printing and publishing sector is a statistical aberration in 1996. New business size in this sector has remained relatively constant (70-90) between 1992 and 1995.

In one aspect of SMME development, Malaysia seems to have repeated the initial successes of Indonesia's linkages between SMMEs and larger enterprises. The following case study and conclusions are drawn from interviews with the management of Proton Motors (a subsidiary of Mitsubishi Motors Corporation,) and several auto parts suppliers in Malaysia. The interviews were conducted in 1997 and 1998 by electronic mail and through the Malaysian Ministry of International Trade and Industry (MITI) (1997-1998).

The Proton Umbrella

To increase the local content of the Malaysian automotive assembly industry, the government introduced mandatory deletion programmes for all vehicles assembled in Malaysia. More than 30 components were localised (required to be produced in Malaysia) under this programme. For a variety of reasons including the appreciation of

the Yen (making the cost of Japanese parts exorbitant) Proton Motors led a concerted effort beginning in 1988 to develop local parts manufacturers and vendors for non-critical car parts. By 1992 more than 115 vendors were supplying components to Proton, 52 of which were SMMEs. Most parts produced were small plastic extruded components and metal stamped parts. The local content of Proton cars increased from 18 per cent in 1985 to 40 per cent in 1987 to 70 per cent in 1992. Proton selected vendors within 175 kilometres of the Proton plant to meet its JIT (Just in Time) production requirements, Consequently, the development of SMMEs under Proton was not generally diffused, but developed in close proximity to the vendor's market.

Proton 'adopted' its vendors, many of whom were competing in the formal sector for the first time. When production problems were encountered by SMME suppliers, Proton assumed responsibility for mutual problem-solving with its vendors. Contracts were not terminated where supplier performance was substandard. Rather, Proton adopted an intensive problem-solving approach with its new SMME vendors. Thus, Proton assumed increased transaction costs, without subsidy, for the development of supplier SMMEs. Among the problems encountered and the solutions, are the following:

- Low level of technology in Malaysia generally, contrasted with the demands of motor vehicle production. Proton's own research and development department assisted SMME vendors with production problems, technology application and training. In some cases, high level technical training for SMME vendors was arranged by Proton in Japan.

- Low product quality and a poor appreciation of the need for quality improvement was noted by Proton among many of its SMME vendors. In response Proton linked its vendors with a national testing laboratory for batch sample testing. During the process of SMME quality improvement, Proton has assigned its own quality control staff to work with vendors experiencing problems with quality. Proton's commitment to supplier development is expressed through its problem-solving approach and work with vendors encountering production problems, rather than terminate contracts.

From the programme's inception in 1988 to 1997, no vendor contracts with Proton have been cancelled due to poor production performance.

- SMME failure or inability to read specifications or production drawings and a tendency to produce components 'by feel'. Proton addressed this problem by linking its own research staff with individual vendors for project-specific on-the-job training in tender specifications.

- Undercapitalisation of SMME suppliers. MITI established a fund to assist Proton suppliers by which operational loans were granted to SMMEs with signed orders from Proton in which first-party payments would be made to the lending agency directly by Proton upon contract payment.

- Proton discovered that most SMMEs were unable to acquire raw materials in the quantity needed and at competitive price. Proton assumed the ordering of raw materials for many vendors, thus assuring low price and consistent quality.

- Many suppliers to Proton had little idea how to price their products in order to be competitive while still making a profit. Proton undertakes its own cost analysis for each component and shares that information with each vendor as a starting point in price negotiations. Vendors are assisted in making their own costing estimates and are encouraged to bring that analysis to contract negotiations.

Conclusions: The Malaysian Experience

The experience of Proton and other interfirm linkages in Malaysia is documented in numerous sources (Meyanathan and Salleh, 1994; Toomey, 1998) which draw the general conclusion that SMME development is assisted significantly through business linkages between large and smaller enterprises. The assistance ranges from access to new markets, raw material at competitive prices, and technology, to skills development and informal business advice provided by the more experienced LEs to emergent SMMEs. Government has a role to play in providing some form of access to credit at

later stages of SMME development, in promulgating the advantages of interfirm linkages, and, perhaps, creative a conducive environment for linkages by offering tax incentives or transaction cost subsidies. It is further evident that the current strategy employed in South Africa by the Department of Trade and Industry of teaching generic business skills or business management in the expectation that this will lead to the flourishing of SMMEs is probably not realistic. It is with these assumptions, grounded in both Malaysian and Indonesian experience, and reinforced by the studies of Tendler and Amorim (1996) in Brazil that we now approach the question of linkages for SMME development in South Africa.

CHAPTER SEVEN

INTERFIRM LINKAGES: DIVERSE STRATEGIES IN SOUTH AFRICA

> South Africa has a market of nearly forty-two million customers. Its economy constitutes close on half the Gross Domestic Product of sub-Saharan Africa (Deloitte & Touche, 1997:17).
>
> Most African manufacturers are substantially below the productivity frontier for their industry, in large part due to an 'information poor' environment characterised by few vertical and horizontal linkages between firms… (Stone, 1997a:4)

While the potential market for manufactured goods is huge in Africa, the capacity of South African SMMEs to capture a significant portion of that market has been hindered by substantial capacity deficits related to adequate market knowledge, production process training, technology acquisition, and access to competitively priced raw materials. Though government policy documents frequently cite South Africa's black enterprise sector as a residual employer with a potentially important role to play in alleviating poverty, addressing wealth equity and improving the general welfare, to do so will require successful interventions that address the SMME capacity deficiency. Only then will SMMEs contribute to job creation, skills upgrading, 'learning by doing' and the development of a culture of entrepreneurial work (Park and Johnston, 1995). This is particularly challenging politically as the vested interests of protected industries and organised labour tend to mitigate against widespread entrepreneurship (Nattrass, 1994). Private sector and parastatal interfirm linkages are one vehicle that can assist in developing the capacity of emergent SMMEs. The challenge addressed by Gear is to design a framework of institutions, information, policies and structures to provide emergent black enterprises with broader access to the technical assistance, finance and training that is required to promote SMME growth (Government of South Africa, 1996a). SMME support policies, including the potential role of interfirm linkages, are one part of a comprehensive economic strategy.

Until recently, South Africa enjoyed a relatively high investment-to-GDP ratio compared to other developing counties[63]. However, South Africa did not receive the expected benefits of elevated job creation from the high investment rate. The reasons for stagnant job creation are social and political. During the decade of the 1980s, world-wide political pressure and economic sanctions led to a fall in the value of foreign direct investment and capital stock. This generated an increasing capital intensity within private sector enterprises that hampered new job creation. As international political and economic pressure increased, existing investment in South Africa was channelled to politically 'trustworthy' enterprises with historically lower-than-average productivity. Further, productivity of existing enterprises failed to keep pace with even these reduced levels of investment due to increasing labour activism, rising wages and, significantly, the inadequate acquisition of marketable skills within the workplace (Riley, 1997).[64] Thus, the labour absorptive capacity of the South African economy was reduced by decreasing international trade and markets, higher labour costs, lower per unit productivity, and reliance upon capital intensive production to counterbalance a largely unskilled available labour pool.

World-wide political pressure and economic sanctions during the 1980s caused the state to enforce draconian exchange controls that restricted repatriation of FDI. The 1980s drop in FDI was partially offset by increased state investment in capital intensive projects and industries (MOSSGAS, Armscor) that had limited effect on increasing

[63] Gross domestic investment from all sources has gradually declined from a high of 28.3 per cent of GDP in 1980 to 14.7 per cent in 1992. Data available for 1993 and 1994 show a gradual reversal of the decade-long decline (World Bank, 1996: 25).

[64]

Manufacturing output as a measure of productivity
Gross output per employee (1980=100)

	1970	1990	1991	1992
Korea, Rep.	55	113	114	110
South Africa	64	81	78	75
Singapore	72	130	128	132

Source: World Bank, 1995b.

employment (Fine, 1997). While the exact links between FDI and employment are not straightforward (Lall 1995:522) the increasing capital intensity which has been a characteristic of South African manufacturing since the early 1980s has been a contributing factor to the decline in labour absorptive capacity of the SA economy.

The profound economic inequity that has characterised South Africa for more than a century remains stark. In the formal sector, unemployment among black South Africans is at least 40 per cent, compared with less than 20 per cent among whites, Asians and coloureds taken together, and far less among whites alone (World Bank, 1997). Despite the unreliability of unemployment data in the Eastern Cape, existing data indicate unemployment among blacks to be at least 45 per cent (Godongwana, interview, 1997; Eastern Cape Provincial Government, 1996). Anecdotal evidence drawn from interviews (Gidi, interviews, 1995-98; Mpunzi, interview, 1994; Mkhotyana, interview, 1997) indicates that unemployment in certain rural communities may be significantly higher. Between 1980 and 1994, the South African economy was largely stagnant. Total employment fell, and the ability of the economy to absorb new entrants to the labour force was minimal. By 1992, the formal sector could only absorb 8 per cent of the new labour force entrants, a monumental drop from absorbing over 80 per cent of new entrants in 1960. As a result of the decline in the capacity of the formal sector to provide employment, it is perceived that the informal sector is growing dramatically. All told, it is estimated that the informal sector contributes between 8-13 per cent of the national GDP (Government of South Africa, 1995b). Much current SMME support policy has, as one of its aims, the integration of informal enterprises into the formal economy, including tax registration and employment equity.

South African support for SMME development had been limited until 1995 to access to finance through the troubled Small Business Development Corporation (SBDC) and the provision of technical business advisory services. The past limitations derived from political concerns that directed SMME support services to a small portion of the population, coupled with desires to protect favoured industries from both internal and

international competition. Since 1995, the DTI has made several fitful and not altogether coherent attempts to support SMME development, as we saw in Chapter Five.

Chapter Six illustrated the benefits of interfirm linkages between large enterprises and SMMEs in Asia, particularly Indonesia and Malaysia. While the socio-economic conditions prevalent in South Africa, Indonesia and Malaysia are not directly comparable, the conditions that preceded intensive support for SMME development in both Asian countries are similar enough to compare and contrast the effectiveness of certain policy initiatives for SMME development. Interfirm linkages between LEs and SMMEs have been a successful vehicle in some Asian countries to rapidly increase the vitality and size of an emergent SMME manufacturing sector. Such linkages if actively pursued by policy makers in South African can provide a similar benefit.

What is the experience of interfirm linkages in South Africa and what innovative approaches might now be suggested? Since the thrust of this essay concerns the potential contribution that private-public linkages can make in SMME development, reference to learning from the Malaysian and Indonesian experience will be incorporated in the following review of interfirm linkages and case studies.

Current Models of Corporate Linkage in South Africa

The whole subject of business linkages and partnerships is receiving greater interest on the part of development agencies as well as the private sector itself, in large part due to the evolution of positive attitudes toward the private sector in developing countries and the potential for sustainable job creation. Thus, there is potential for ambitious thinking about partnerships between government, the private sector and the community-based sector for small business development (Synergos, 1995). The very enthusiasm for such economic partnerships for development has led to a profusion of models, requiring some definition and guidelines regarding our particular focus of attention.

Corporate Social Responsibility

Currently, in South Africa, the most common form of private sector 'linkage' between business and the employment and training needs of black South Africans involves some form of supply-driven corporate charitable giving. Charitable giving by the business sector is usually mediated by semi-autonomous corporate foundations or education trust funds, established and funded by a small percentage of net business profits. Corporate charitable giving (or corporate social responsibility) takes several different forms:

- The **donor/recipient** model of corporate foundation. The Liberty Life Foundation (1996) and the Anglo-American Chairman's Fund[65] are such entities that have evolved over the years into funding and capacity-building agencies, using their own funds and acting as channels for other corporate funds, whose main thrust is providing material resources, rather than being involved in day-to-day operations of their chosen projects. The Liberty Life Foundation and the Anglo-American Chairman's Fund typify donor/recipient partnerships with close attention to capacity building.

- The **corporate social development operations** model of corporate partnership is represented in the Palabora Mining Foundation which employs a hands on, operational approach to funding, staffing and organising its own projects for social development. The foundation's stated purpose is oriented toward "the holistic development and empowerment of disadvantaged communities" through the programmes of the Reef Training Centre (RTC) (Synergos, 1995:56) . The RTC acts, on behalf of Palabora Mining, much as any other training NGO acts: identifying training needs, organising students, contracting with the Department of Manpower for potential students, and providing skills based training at a student-set pace.

[65] The Chairman's Fund was the prototype of the donor-recipient model of corporate foundation until it was privatised on 1 July 1998. The fund will now be administered by an independent consulting firm who will be given a budget and guidelines to implement on behalf of Anglo-American.

- The **channel through donor-funding** model is represented in the Rossing Foundation, established by the Rossing Uranium Ltd. (a multinational subsidiary). The foundation began as a self-funded corporate social investment vehicle and has evolved into a channel for significant corporate and foreign funds including the Norwegian Aid Agency (Norad) and the New Zealand High Commission. Its projects encompass a wide range from agriculture to appliqué art to vocational training courses and small business management (Synergos, 1995).

While each of these foundations embodies noble aims and is well organised and effectively run, none of the corporate foundations actually endeavour to transfer the operational skills and assets of the corporate entity to 'disadvantaged persons' within a demand-driven market context. Despite some very intense personal and institutional interaction between the sponsoring business and its social action foundations, such foundations are, in the final analysis, non-productive secondary additions to the primary objective of corporate maximisation of market access and profit. The product of the business is often something quite unrelated to the goals of corporate social responsibility. The lack of any market-related motivation for corporate social responsibility may render such efforts as little more than charitable donations that have benefits but which do not significantly contribute to the incorporation of previously disadvantaged blacks into the formal economy. The three partnership models above represent common types of corporate/community partnerships for social development in South Africa. These different models, nonetheless, raise common questions of motivation, control, ultimate goals and risk sharing.

Limitations of Corporate Social Responsibility

Motivation and Dependence

The motivation for many corporate foundations is the achievement of integrated social and economic development wherein long term community stability and wealth will benefit long term corporate health and wealth (Synergos, 1995). Social investment has the corollary benefit of creating pockets of social good will that may assist in the

achievement of corporate goals (increasing market share and access) by ameliorating any adversarial relationship between company and community. In the long term, however, independent social development in the community may be hindered by these relationships with large corporate donors that have the potential to create increased dependence upon outside funding entities without community ties.

Control

In any kind of partnership, the issue of control and participation is critical. Each example cited above is managed to some degree by a steering committee that consists of corporate employees and representatives of community NGOs and/or beneficiaries of the largesse of the foundations. In some instances the dominance of corporate employees on the foundations' governing body has helped focus the foundations' work on the product to be delivered (literacy training in the case of Liberty Life Foundation). In other contexts such corporate dominance has led to the perception that corporate foundations are really for the benefit of the community elite rather than for the whole community.[66] This criticism aptly describes a frequent complaint about the role and presence of corporate foundations for training in disadvantaged communities.

Privatisation

The growing trend in major South African corporations is to privatize their social responsibility activity by subcontracting the interface between corporate structures and community and government agencies to an independent third party agent. The Anglo-American Chairman's Fund, prominent throughout South Africa for its commitment to uplift education, is one example (Keeton, interview, 1998). While the strategy to privatize corporate outreach is new, the trend, if developed, may lead to the private sector becoming further disengaged from the economic and social issues that are central to government policy, and to whose resolution it may have an important

[66]The Synergos Institute study of the John Deere Corporation and the establishment of the Duduza Training Centre are illustrative of this point. While its objectives state that the centre "should be economically, socially and educationally accessible to the residents of Duduza", the centre is increasingly seen as alienated from the community and elitist (Synergos, 1995: 67-71).

contribution to make, while relying upon monetary contributions through a third party to satisfy corporate social obligations.

Risk

The risks of entering partnerships between NGOs, community and the corporate sector arise from the inherent inequities of scale and resources. Most CBOs and NGOs have limited resources and a narrow scope, in contrast to much greater resource and scope available to the corporate partner. The consequent risk is that the NGO/CBO partner becomes overly dependent upon the corporate partner and loses its independent voice and creative edge, or that its own staff is overwhelmed by the expertise of the corporate partner's staff resource base. Acknowledgement and awareness of such risks would lead prudent NGO partners to seek outside technical assistance in the design of such partnerships (Synergos, 1995).

Ultimate Goal

The ultimate goal(s) of corporate foundations is open to rife cynicism. As stated above, the ultimate goal of corporate social involvement may be quite unrelated or only indirectly related to the particular product of the company. The goal of social philanthropy, or corporate social investment, is, at some level, usually self-serving. It may be a way to open new markets[67] or to gain political credibility. Corporate social investment may serve to dull criticism of certain present or past labour practices. The common theme of such social investment remains that it is what a company does after it fulfils its corporate obligations of production, marketing and sales. In this regard, social investment will always lag behind the advances of business, in good times, and may well be curtailed or eliminated in bad times. Thus, it is a limited device for widespread social and economic development.

[67]This does not need to be seen cynically. For example, ESKOM is rapidly bringing electric power to rural, unserved communities. ESKOM absorbs the enormous up-front costs of providing service in the full expectation that increased usage of existing electric capacity will ensure greater future profits, while providing a service that is seen as a social good.

Doubts about the sincerity of private sector investment in previously disadvantaged communities have led critics to view most forms of corporate partnership as little more than revamped versions of time-worn corporate social investment policies in which very small percentages of corporate profits are directed to social welfare or training projects. While corporate social investment will continue and possibly expand in coming years due to increased political and social pressure, by itself, such social investment will remain a relatively small part of the needed resources for economic development in South Africa. Corporate social responsibility will have little direct effect in the development of the employment-creating capacity in a renewed and vibrant South African economy as envisioned in Gear. Different approaches to private sector involvement in economic development are required.

Strategies for New Forms of Corporate Investment

Interfirm Linkages

Interfirm linkage refers generally to all possible forms of structured economic relationship and transaction between independent firms in the marketplace. In the context of SMME growth in developing economies, interfirm linkage refers to a continual relationship with repeated transactions between the linked parties, as opposed to individual contracts. Interfirm linkages can be divided into different forms of contractual arrangements according to the degree of control one party has over the other. Classifications of interfirm linkages runs from complete control of the linkage by one party to complete reliance upon the market to determine the nature and duration of the linkage (Wong, 1991). Linkages might be classified as follows:

- outright equity control in which the parent company owns 100 per cent of the linked partner;
- joint venture, in which the larger enterprise owns a percentage less than total of the smaller enterprise (majority ownership, 50-50, or minority ownership);
- industrial co-operation agreement;
- licensing and franchising; and
- arms-length market relationships characterised by:
  -infrequent market transactions
  -longer term recurrent contractual supplier-buyer relationships controlled by market forces.

Business relationships between larger and smaller enterprises and tested in the marketplace can assist the development of SMME production capacity. Indications of improved SMME production capacity include results such as increased productivity per investment unit, improved quality performance, increased technology absorption by SMMEs and increased labour skill (Asian Productivity Organisation, 1998; Romjin, 1997; Solow, 1997).

Prior to 1994, the private sector was scarcely involved in assisting the development of black emergent entrepreneurs, though private industry was, arguably, the most experienced and in the best position to promote black entrepreneurs. The national strategy to develop and promote small business in South Africa might well have relied heavily upon a strategy to transfer the skills already imbedded existing business. Instead, the DTI (1995) assumed that the business sector would continue to provide funding for social services rather than utilise its core skill base for the development of new black entrepreneurs and black business ventures.

The examples from Malaysia and Indonesia show that interfirm linkages between LEs and SMMEs, often through government inspired procurement arrangements, have been effective means of private sector participation in SMME development outside South Africa.

Joint Business Ventures

In the last two decades, spurred by the debate on the role of multinationals, many LDCs introduced some form of manufacturing indigenisation or local content restrictions. Within this context, almost all multinational corporations have entered into joint ventures with local partners. While some saw drawbacks early on, most echoed Hammer's comments regarding Occidental Petroleum that after selling the required 51 per cent of its Mexican subsidiary, the profit on the remaining 49 per cent was higher than previous profit with full ownership (*New York Times*, 5 January, 1981).

The debate regarding the impact of multinational corporations on the economies of less developed countries has tended to focus on the negative aspects of dependency: inappropriate capital intensive technologies and creating inappropriate patterns of local consumption (Amin, 1976c; Barnet and Muller, 1974; Hymer, 1970; Biersteker, 1978). An alternative, albeit minority, view has been expressed which stresses the favourable role played by multinationals in technology transfer, employment creation, export market access, local skill development, and general economic growth through interfirm alliances (Vernon, 1971, 1975, 1977).

In the South African context, joint business ventures are one primary vehicle for encouraging and developing black ownership of (primarily) existing businesses. Joint ventures are attractive approaches to redress the past market distortions caused by apartheid polices which proscribed business ownership by various population groups. Among many similar but smaller joint ventures, the recent business alliance between Anglo-American and De Beers and the National Empowerment Consortium (NEC), headed by Cyril Ramaphosa, received significant attention. In this arrangement, the NEC (a grouping of black business leaders, community groups and trade unions) received options to purchase up to 47 per cent equity in Johnnic, a financial and media holding company with holdings valued at more than R10 billion (*Mail and Guardian*, 30 August-5 September, 1996).

Joint ventures offer the potential for teaming capital investments with labour in a structured approach to increasing black shareholding over a defined period of time. In the South African context, joint ventures mean teaming predominantly white capital investment (either foreign or domestic) with black labour and aspirations for ownership. The potential benefit that derives from joint ventures includes capacity building, introduction of new technologies to SMMEs, access to larger markets, and full black participation in the industrial and manufacturing sectors of the economy. Potential shortcomings include questions about the genuine opportunities afforded blacks through joint ventures that leave most control in the hands of white and/or foreign capital.

A recent joint venture in the wine industry is representative of both the potential and shortcomings of joint ventures. Papkuilsfontein Vineyards, with Maluti Foods and Beverages and Stellenbosch Farmer's Winery (SFW) (the largest wine producing co-operative in South Africa), is entering into a joint venture with vineyard workers and local community groups in the western Cape. In terms of the agreement, SFW will receive 50 per cent share capital of the new company, Maluti foods will receive 35 per cent share capital, and 15 per cent ownership will be held by a community trust comprising Papkuilsfontein workers and other disadvantaged persons in the Western Cape. SFW has contracted out the technical aspects of vineyard management and winemaking to Nederburg Wine Farms to develop and manage the viticulture side of the project (*Daily Dispatch*, 4 March, 1998).

The project is heralded as one of but two breakthroughs for community and worker 'ownership' in the Western Cape vineyards. A closer look, however, shows that 'ownership' by previously disadvantaged persons and workers is limited to a paltry 15 per cent, obtainable through workers' labour, without plans for gradual shareholding appreciation (Daily Dispatch, 4 March, 1998). A further benefit noted by nearly every proponent of joint ventures is gradual and accumulative skill acquisition by joint venture partners (Sargent and Matthews, 1997; Romijn, 1997; Mead and Liedholm, 1998; Galal and Shirley, 1994; Wong, 1991,1994). Unfortunately, the viticulture functions, other than manual unskilled and semi-skilled labour, have been subcontracted to the experienced and advantaged Nederberg Wine Estate. In summary, it appears unlikely that either significant black ownership or technological acquisition or skills upgrading will devolve to historically disadvantaged workers or communities through this much promoted wine estate joint venture 'breakthrough'.

As the focus of economic development increasingly emphasises black business ownership, it is reasonable to assume that various forms of joint ventures between the private sector and black South African investment groupings will play a significant role in the future economic development of the country. Will the private sector, on its own,

be able and willing to promote more than token black ownership for disadvantaged persons along with fuller integration into the market of an emerging though small black elite? A few blacks may benefit greatly from joint ventures, and others may be used to put a black face on existing business, but the potentially greater benefits of joint business ventures (skills enhancement, participatory ownership, new market access) may still prove elusive, to the detriment of an already disadvantaged populace.

The benefits and problems of engaging in business joint ventures have been well documented (Vernon, 1971, 1975, 1977; Amsden, 1991; Hart, 1989; Shirley, 1996; Batley, 1996). Among issues that constrain joint ventures in South Africa, most relate to control and power. Business joint ventures invite new participation of blacks in corporate structures, but often with limited roles. Minority shareholding, even among the more creative joint ventures,[68] leaves corporate control essentially unchanged. More common are the kinds of joint ventures represented in the Papkuilsfontein vineyards, in which much is made of limited black participation (in this case no more than 15 per cent) and in which the spin-off benefits of knowledge and technology diffusion is minimal. A parallel thread of joint venture criticism relates to the ultimate business goals. As in corporate social investment noted above, one must ask if and how the commercial goals of joint business ventures can sustain and encourage the socially desirable benefits of skills diffusion, technological acquisition and business education needed for the development of small business in South Africa.

At a conference of business and labour held in April 1998, essential elements of successful joint ventures between larger white owned business and emerging black entrepreneurs in South Africa[69] were defined. A particular focus was to structure joint ventures in ways that will respond both to market demands and also to the

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[68]Such as the Anglo-De Beers /Johnnic agreement mentioned previously.

[69]Held on 3 April, 1998 and attended by executive staff from ESKOM AND TRANSNET parastatals, representatives of traditional white suppliers to parastatals, the National African Federated Chamber of Commerce (NAFCOC), Makana Trust (representing business interests of ex-Robben Island prisoners, Thebe Investments and the DTI. At this conference, the author presented a paper ‘South African parallels to and divergences from the Malaysian experience of generating indigenous small business in the manufacturing sector’.

developmental needs of emergent SMMEs. The following issues were resolved to be non-negotiable foundations of future joint ventures:

- the joint venture must include mechanisms to increase the percentage of black ownership of the new firm to not less than 50 per cent;
- the joint venture should embody skills transfer in an ongoing and measurable manner;
- the joint venture must be self-funding and sustainable as a business proposition;
- mechanisms in the joint venture should be structured to assist entry of individuals with limited access to traditional sources of finance;
- strategic business growth for all joint ventures parties is essential (Toomey, 1998; NAFCOC, 1998)

Joint ventures such as the Papkuilsfontein Vineyard project are limited vehicles for black economic empowerment and transfer of skills, and would not meet the above requirements. These newly promoted guidelines provide a rough framework for future joint venture negotiations.

The following is a case study of a textile manufacturing joint venture between an established, white-owned textile producer (South African Weatherwear or SAW) and a new company to be owned and operated, with technical assistance, by retrenched workers from a former competitor of SAW. This joint venture is newly proposed and will be formally established only in November 1998. The proposed business structure and comments are included here as another working model of LE/SMME linkage that can assist emergent black SMMEs.

Joint Venture Case Study: South African Weatherwear

SAW is a textile and clothing manufacturer located in Gauteng. The company generates R24 million in revenues annually, creates employment for 60 full time employees, and services contracts for both domestic and export within the Southern African Development Community (SADC) countries. Since 1994 SAW has considered some kind of business partnership with emergent black industries, motivated primarily by the desire to enhance the company profile as being responsive to black economic demands, and in order to capture contracts that might be dependent upon SAW having

some role in black economic empowerment (Goldsmith, interview, 1998). The owners have repeatedly stated that they are businessmen concerned with business profitability. Within that business context “we are prepared to investigate any contractual arrangement that will enhance our competitiveness and market share, including arrangements that will enhance the capability of black entrepreneurs who might, one day, be our competitors” (Goldsmith, interview, 1998).

This latest effort at a joint venture between SAW and a smaller supplier was the third such attempt. Similar approaches and mechanisms to establish a joint venture between SAW and a new emergent entrepreneur had failed twice before. Both prior attempts were initiated by SAW, who approached local SMMEs already in the textile industry. According to SAW Executive Officer Goldsmith, neither attempt was successful because of a ‘lack of credibility’ on the part of the proposed SMME partner. It was not possible to find either of the first two partners to interview for this study as both businesses had moved, were not registered or had collapsed. Goldsmith described as 'lack of credibility' as the UN-businesslike characteristics such as not meeting tendering deadlines, borrowing from business capital to pay unrelated expenses of the business proprietor, and a lack of willingness to discipline workers who were not performing adequately. This latest attempt at a joint venture successfully progressed further, in large part due to the active presence of a third party business that is a major buyer from SAW. The third party buyer strongly encouraged SAW to establish a successful joint venture with black SMMEs “if further contracts are desired by SAW” (Goldsmith, interview, 1998). Ongoing large enterprise corporate purchasing pressure and coercion has generated this latest joint venture arrangement in which SAW actively sought out the majority of the former employees of a failed textile enterprise in the area to establish interest in establishing a new company. SAW will continue in its own right as an independent company. SAW will seek to develop a new company with former employees of SAW who have been previously retrenched.

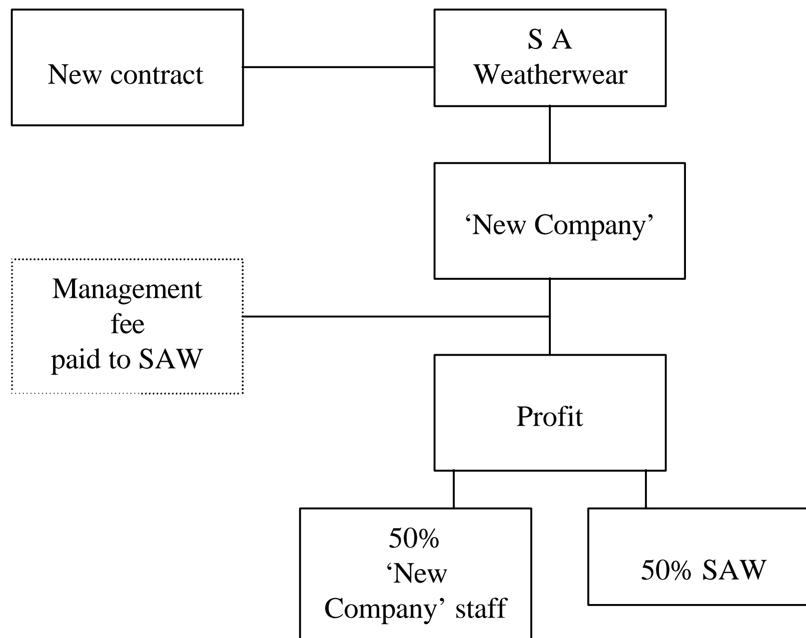
The structure of the joint venture is as follows, with the emergent black owned business temporarily called ‘New Company’. In order to fund the initial stages of ‘New

Company' development, SAW requires a guaranteed contract from the large buyer who traditionally has purchased directly from SAW. This new contract will be divided between SAW and 'New Company'. Each partner brings its own skills and investment to the partnership. The workers of 'New Company' bring their operative skills and PDI[70] (Previously Disadvantaged Individual) status to the company. In return, the employee-owners of 'New Company' receive shares in 'New Company' at a rate assigned by company position. SAW brings its extensive management, technical and financial services to 'New Company' for which a monthly fee is charged. The running of 'New Company' will be by a shareholders' agreement negotiated between the parties. In order for the venture to be successful, it will need the support and assistance of the large buyer whose initial impetus forged the desire for a joint venture. The specific assistance is the awarding of a five-year contract for the provision of clothing. The intended contract has the volume required to establish the 'New Company' joint venture, but it will leave room for additional business to be garnered by 'New Company'.

[70] PDI, or Previously Disadvantaged Individual status, is one basis upon which certain incentives and government contracts are granted to emergent SMMEs. PDI status conveys preferences to those persons whose access to employment, education, social welfare structures and land ownership was legally restricted in any way by the pre-1994 government (DTI, 1995a).

PDI status enables access to certain business preferences and incentives. In some instances preferences are specifically targeted only to benefit PDIs (Heher, interview, 1997; DTI 1997d) while others are theoretically open to all but, in practice, are largely made available to PDIs (Heher, 1997). Incentives that may be made available in the above instance through the PDI joint venture partner and include an array of potential benefits including: the Export Marketing and Assistance Scheme, the Job Scheme, the Import Finance Scheme, the Economic Empowerment Scheme, Workplace Challenge Grants from the Small/Medium Manufacturing Development Programme, and guaranteed credit from the Emerging Entrepreneur Scheme. The details of business preferences to PDIs vary in specifics, but can be generalized in three categories; those that improve access to finance, those providing access to subsidised generic training for new entrepreneurs and those providing financial incentives for job creation and export promotion. (DIT,1995b; 1997a,b,d,e)

Table 11: South African Weatherwear (SAW) / New Company Joint Venture



The new contract needed to facilitate the formation of the joint venture is for provision of jackets, trousers and workshirts with a total value of R8 844 000 and an annual profit of R 2653 200 as follows:

Table 12: Gross Annual Revenue Distribution

Item	Daily quantity	CMT* price per unit	Annual turnover 240 days	Gross annual profit
Jackets	150	164.00	5 900 000	1 770 000
Trousers	200	28.50	1 360 000	408 000
Shirts	400	16.50	1 584 000	475 200
Total				**2 653 200**

*CMT refers to a cut, make and trim textile operation.
Source: SAW internal documents (Goldsmith, 1998).

The proposed profit generated by the joint venture will be distributed, after management expenses paid to SAW, as follows:

Table 13: Gross Profit Distribution

Gross profit (ZA Rand)	SAW monthly fee (12)	Net profit after fees	50% each JV partner	Shareholder earnings per share (1 000 shares) (ZA Rand)
2 653 200	480 000	2 173 200	1 086 600	1086.00

Source: SA Weatherwear internal documents (Goldsmith, 1998).

Each employee of New Company will be a stockholder according to skill and responsibility level, and 50 per cent of the total profit generated by the output of New Company will be distributed to employees as follows:

Table 15: New Company Share Allocation

General workers, table hands, cleaners, cut room, kitchen	1 share
Machinists, pressers, workshop	2 shares
Utility workers, floaters, skilled operators, office staff	3 shares
Assistant supervisors	4 shares
Supervisors	5 shares
Assistant line managers	6 shares
Line managers	7 shares
Production and quality manager	8 shares
Assistant factory manager	9 shares
Manager	10 shares

Source: SAW internal documents (Goldsmith, 1998).

In the proposed joint venture, the factors of incentives, access to capital, and on the job training are pertinent to this study.

Incentives for Joint Venturing

For the retrenched workers who will make up New Company, the incentives are easily understood. There will be employment. No worker in 'New Company' will be paid a wage: payment will be on a piecework basis, creating an immediate incentive for efficient work. All workers are employee-owners of New Company and hold shares that determine end-of-year profit distributions according to **Table 15**. The incentives for employee-owners are direct financial rewards from efficient and profitable work, and steady employment that remunerates for actual production levels.

The incentives for SAW to enter as a 50 per cent partner in New Company are interesting. Until 1994 SAW was content to operate within the prior political and social environment and did so profitably. As political change swept South Africa, SAW management understood two realities: an opportunity and a pressure. The opportunity existed in the potential opening of new markets in the black community and internationally (markets that had been restricted during apartheid). The pressure was the need for an enhanced corporate profile.[71] The matter of corporate profile and community reputation was a powerful motive for SAW to seek joint venture partners for production. Beginning in 1994, SAW understood that the new political environment would probably bring new market conditions that would particularly favour emergent black enterprises and those larger enterprises (white-owned largely) that developed strong linkages with black business. An enhanced business profile, that is, becoming known as an enterprise with active black enterprise linkages, would be likely to open new markets, particularly with government tenders. SAW understood market realities well and sought to establish such interfirm linkages, beginning in 1994. Ultimately, the pressure to establish a viable joint venture between SAW and a black-owned SMME came from one of SAW's large buyers which had instituted a policy encouraging procurement from enterprises that were black owned or which supported black enterprise development through joint ventures and other forms of interfirm

[71] Price, profile, quality and markets (PPQM) are incentives common to successful voluntary interfirm linkages including joint ventures.

linkage.[72] Known as 'second-tier affirmative procurement', such policies are increasingly enforced as tendering requirements by larger enterprise purchasers.

Access to Capital

SAW was able to establish 'New Company' by using under-utilised production capacity in its own plant, by purchasing necessary machinery with advance payments made by Company A for ordered goods, and through direct investment in 'New Company'. SAW's investment in New Company was reduced by the availability of advance payments, which was a direct result of the long term satisfactory business relationship between SAW and Company A. SAW's direct investment was further guaranteed by 50 per cent ownership and profit sharing in 'New Company' and by a monthly management fee payable by 'New Company' to SAW.

The advantages of the joint venture to 'New Company' are enormous: equipment, useable workshop space, close proximity to highly skilled and experienced SAW staff, financial and other management services provided (for a fee) by SAW which has a proprietary interest in the success of New Company. All of this is provided to New Company at no capital outlay, thus addressing one of the pressing needs of emergent SMMEs: access to capital for expansion (Mead and Liedholm, 1987,1998).

On-the-Job Training

One of the primary incentives for policy makers to encourage interfirm linkages is the potential for knowledge and skill acquisition to accrue in the emergent SMME because of business association with the LE. In the case of SAW and 'New Company', the potential exists for significant technical and production skill transfer to employees of 'New Company'. It is less evident in this proposed joint venture that the business management skills transfer is clearly planned as an active part of the joint business venture. The payment of fees for business management by 'New Company' to SAW has the potential to lull senior employees of 'New Company' into the expectation that the financial management of 'New Company' is best outsourced rather than learned

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and applied internally (Tarr, interview, 1998). There is probably little in terms of policy that could be implemented to prevent this dependence upon the larger enterprise in an interfirm linkage other than ensuring that joint venture agreements contain provisions and schedules for active financial management by emergent businesses.

There is considerable evidence that one of the strongest aspects of on-the-job technical learning from interfirm linkages is found in the upward diversification of manufacturing; that is, the gradual rise in technical skills of SMMEs by accessing, copying and reproducing products that are increasingly complex to produce (Romijn, 1997). Not infrequently SMMEs begin by producing very simple products which evolve into manufacturing enterprises only after years of low scale, low wage production of low quality goods. Potential for a more rapid rise from the 'low skill-low quality' trap of many SMMEs is offered by interfirm linkages between SMMEs and LEs in the manufacturing sector (Sargent and Matthews, 1997).

Disincentives for Joint Venturing

The primary disincentive for entering a joint venture encountered by the larger enterprise is increased per unit transaction costs. Transaction costs are increased when doing business with SMMEs, for well-documented reasons having to do with production quality, production efficiency and production waste (Thongpakde, Puppahavesa and Pussarangsri, 1994; Wong, 1991). Stone (1997b) suggests that one of the strongest policy affirmations to encourage interfirm linkages would be to increase the investment made in demand-driven training and technology application. While some findings indicate that SMMEs are reluctant to take advantage of training tax incentives (because some SMMEs are not tax compliant and others are not profitable, thus eliminating the usefulness of tax deductions), Stone also finds that larger firms do tend to make use of tax incentives to reduce the transaction cost of training. Similar tax policy could be applied to interfirm linkages, providing tax incentives to offset the transaction cost disincentive to develop interfirm linkages.

[72] The particular buyer involved with SAW wishes to remain anonymous in this thesis.

Policy for SMME development will need to take into account the considerable transaction costs incurred by LEs when linking with SMMEs.

Until recently, most South African experience with interfirm linkage consisted predominantly of efforts that are best described as corporate social responsibility; actions of social goodwill that were generated by the non-core activity of the enterprise. In the waning years of apartheid policies, corporate largesse was significant in developing and supporting alternative educational and training centres, higher education bursaries, community development structures and social service facilities. Following the political freedom arising from the 1994 elections comes the need to revitalise the economy, deepen the structure of production, and begin the processes of wealth redistribution through the full economic participation of all sectors of society. Donations and social goodwill alone are not sufficient to build a vibrant economy - to create jobs, develop labour skills, and expand the labour absorptive capacity of the economy while expanding existing and developing new markets. These challenges have been addressed in other developing economies by engaging in creative partnerships and interfirm linkages between large and small enterprises, often involving state-supported incentives and other measures to encourage skills transfer, mutual problem-solving and market access for SMMEs. In Chapter Eight we review three case studies of interfirm linkages between LEs and SMMEs and draw initial conclusions.

CHAPTER EIGHT

PROCUREMENT FROM SMMEs: THREE CASE STUDIES IN BUSINESS DEVELOPMENT

> If we don't succeed in ensuring the growth of small, medium and micro enterprises then we will probably have failed in ensuring that this economy is stable, viable and creating employment for years to come.
>
> (Business Day, 7 November, 1997: 6)

Large Enterprise Procurement from Emergent SMMEs

In the past, developing economies emphasised rapid industrialisation while relegating SMME and the informal sector to the periphery of a national development strategy (Tendler and Amorim, 1996). Now, with the failure of national industrialisation strategies in Africa well documented (see Chapter 3) and the job creation potential of SMMEs of interest, new support strategies are being implemented. Targeting government procurement to SMMEs is one such approach. In most developing countries government and parastatal procurement accounts for a large share of all manufacturing and service output, and is thus a primary target for attempts to redirect outsourcing to SMMEs. In India, for instance, government procurement accounts for more than 35 per cent of all non-agricultural GDP (Porter, Ghemawat and Rangan, 1995). While South African data is contradictory, the DTI (1995) White Paper on Small Business Development stated that government procurement is nearly 30 per cent of GDP. The potential benefit that rests in the interaction between government and SMME suppliers is significant.

The primary benefit now envisioned by DTI is the immediate job creation that will be generated by addressing the infrastructure needs of the majority population. However, much more significant long term benefits can be achieved if the government links procurement with training, skills and technology transfer. Numerous public officials (Mpahlwa, interview, 1995; Ngonyama, interviews, 1995-1996) favour labour

intensive, technology aversive public procurement in the expectation of creating more jobs for the procurement expenditure. In contrast, international procurement experience shows that procurement subcontracting can be a vehicle for long term job creation, skills upgrading and technology transfer. Subcontracting in Bangladesh has proven to be "one of the most effective tools for promoting industrialisation...as it brings together skill, technology and business" (Rahman, 1997). Bangladesh employs a policy of active technical skills and production upgrading in targeted industries as part of public sector SMME procurement. Thus, after the capacity of potential SMME suppliers is quantified, targeted assistance is provided to those suppliers who may be able to meet quality and production goals after training inputs. When public procurement invests not only in the item that is being procured but also in upgrading the skills of the worker, the benefit of subcontracting becomes long term, well beyond the contract end. In another context, Redding (1996) argues convincingly that investment in skills and workforce training in the long term can create an environment of innovation and can propel a country out of a 'low skill-low quality' trap. Government procurement can, by its size, play a leading role in the development of a vibrant SMME sector. To do so, procurement should be linked with skills upgrading and training initiatives that seek to increase productivity per worker, lower unit costs, and reduce the transaction costs of subcontracting to emerging SMMEs. This sort of demand-driven SMME procurement and training brings SMME into the marketplace with the potential to successfully compete with other SMME providers while incorporating gradual skills upgrading.

Subcontracting Relationships: Affirmative Procurement

Subcontracting is one form of interfirm linkage that traditionally has involved an 'arms length' relationship between the larger enterprise (buyer) and the smaller enterprise (producer). In the following case study, a South African parastatal develops a procurement relationship that is more dynamic than the traditional 'arms length' interfirm association, and, as such, it proves powerful.

Transnet is South Africa's parastatal transportation holding company, including in its holdings South African Airways, Spoornet (passenger and freight railroads), Portnet (providing a range of seaport and shipping services), PROMAT (materials procurement) and numerous subsidiary enterprises.[73] Transnet prepared for South Africa's political transition with a number of market related strategies for business development and partial privatisation. Chief among these strategies was the decision to make each enterprise within Transnet responsible for its own profitability, or face the possibility of closure or outright sale to the private sectors (Erasmus, interviews, 1994-1996).

PROMAT, responsible for material acquisition for all Transnet operations, transacts annual procurement contracts worth R2.6 billion annually (van Wyk, interview, 1997). Given the range of Transnet operations, purchases by PROMAT range from office supplies to cleaning materials, to workman's clothing, public transport amenities and food, jet engines, and locomotive spare parts. Before 1993, all materials procurement was tendered (either publicly or privately) and contracts were let without concern for the small enterprise development potential of such contracts.[74] Given the new emerging political reality that was evident in the early 1990s, in October 1992, PROMAT began exploring the potential of contracting with black owned SMMEs for a portion of the low and medium technology products routinely used in Transnet operations. When the move toward subcontracting to black owned SMMEs began in 1992, there was no established policy within PROMAT to do so. In the absence of policy directing affirmative procurement, the then chief executive of PROMAT, Daan Erasmus, undertook to formulate an in-house, ad hoc policy of selective procurement from black SMME subcontractors (Erasmus, interviews, 1994-1996; Potgieter, interviews, 1994-1998).[75] When asked why he undertook this policy, Erasmus was direct:

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[73]Other TRANSNET wholly owned subsidiaries include Autonet, Datavia and Propnet.

[74]Though market forces were frequently manipulated by PROMAT in order to let contracts to political allies serving prior governments (Erasmus, interviews, 1994-1996).

[75]Tendler (1996) indicates the seeming importance of the inside 'champion' as a decisive factor in the decision of larger enterprises to enter into new subcontracting arrangements with SMMEs with whom they have had little or no experience.

> It is good business for PROMAT economically, socially, and politically. Economically PROMAT can save in the long term on procurement of low technology items if we develop a network of local suppliers of goods that have traditionally been procured either overseas or from large, unionised, higher cost producers. Socially, the more black communities develop economically, the larger the market for Transnet services. This is a medium to long term approach. Politically, I want to lead my division of Transnet in the political transformation that is coming. Let's be honest, most of my staff will not take initiative if I do not demonstrate commitment to change. I am not only going to show that commitment, I am going to evaluate my staff on their commitment and follow through on principles I set forth.

Maturation of Transnet s Small Business Development Initiative

PROMAT's policy of affirmative procurement was officially promulgated on 5 June, 1996 and 1 July, 1996 by the new Transnet Chairperson. After several years of informal procedures that began the processes of affirmative procurement linkages between PROMAT and a relatively few SMME subcontractees, the Transnet board of directors established a new affirmative procurement framework (Transnet, 1996; Tager, 1996, interview, 1997).

The document stated that:

> Transnet needs to transform its existing procurement practices to be more aligned with its commitment to its corrective action policy of benefiting the previously disadvantaged communities and potential suppliers.... The primary objective must be the development, promotion and support of the national and social interest of South Africa. This objective has three targets, prioritised as:...The promotion development and support of businesses from the previously disadvantaged communities...and the promotion of the national and indigenous suppliers before considering foreign suppliers (1996:3).

Case Study: Inkqubela[76] and PROMAT, Kei Road, Eastern Cape

Pre-linkage conditions

Inkqubela sewing group began with the rudimentary sewing of three women in 1993 who were resident in the rural township at Kei Road[77] in the Eastern Cape. All three were former farmworkers who had been evicted from the farms on which they were born and had laboured since their early teens. Among the three, completion of Standard Four was the highest level achieved, written and spoken English fluency was limited to one member of the group, and none of the women had ever held permanent non-farm employment. Before the formation of Inkqubela, their per capita monthly income from all sources[78] was less than R200. In terms of literacy, prior exposure to formal employment, and education attained, the members of Inkqubela were typical of South Africa's rural poor (World Bank, 1996). One of the three members had some seamstress experience, having learned manual sewing skills while working for the farmer's wife. The other two members had no formal or informal sewing training before Inkqubela.

Inkqubela was formed in the Kei Road Emthonjeni Township through the presence of rural development officers affiliated with the Eyethu Rural Development Mission Centre (Eyethu RDMC). Eyethu RDMC organised rudimentary sewing training to be offered in Xhosa by the staff of All Saint's College. Together with the Kei Road ANC Women's League, Eyethu RDMC organised donations of two pedal-operated sewing machines. Thus, in 1993, Inkqubela was established. Initially, Inkqubela produced simple apparel for the local market, particularly uniforms for local schoolchildren and dresses. Sewing was done on a prepaid order basis.

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[76]Meaning progress in Xhosa.

[77]The author worked for the Anglican Church Department of Social Responsibility which was instrumental in the development of Kei Road and in the establishment of the Eyethu Rural Development Mission Centre which, in turn, played a role in the establishment of Inkqubela.

[78]Excluding any government welfare grants that may have been available at the time.

For the first twelve months of operations in 1993, Inkqubela was housed in the converted garage of Eyethu RDMC in Kei Road, without electricity. Manufacturing was low technology, entirely manual, there was little division of labour (though one of the members was much more efficient in sewing than the other two) and there was low capital investment. Revenues generated totalled slightly less than R 2 000 per month and profit after expenses probably less than R200 per worker monthly (Ngemela, interviews, 1995-1998; Mhlope, interviews, 1993-1994).

Inkqubela sales and marketing were limited almost exclusively to making dresses and school uniforms in response to specific orders taken from friends and acquaintances in Emthonjeni Township at Kei Road, or from orders taken at the monthly market at neighbouring Mgwali. At this point, the individuals working in Inkqubela were loosely associated. If the orders generated were sufficient, they would work together for the month. If orders were limited, the workers readily competed with each other for available business.

Several other factors of an anecdotal nature stand out. The workers did not keep detailed or accurate financial records, did not engage in any systematic method of stock control, and seemed to 'adjust' prices for similar products depending upon family needs or friendships with customers rather than on any assessment of market conditions or producer costs (Mpunzi, interview, 1994; Xokozela, interviews, 1993-1997). The lack of standardised basic business practices rendered the profitability of Inkqubela difficult to assess and made it virtually impossible to set prices for individual items in relation to the cost of producing that same item.

Post Linkage Conditions

In 1994 the chief executive of PROMAT approached a non-governmental organisation[79] working in the rural areas of the Eastern Cape with a request to identify small enterprises that might be able to produce simple textiles for PROMAT. Inkqubela was identified, and PROMAT executives from East London visited the site to

undertake a cursory needs analysis. This needs analysis was aided by staff from Eyethu RDMC, particularly the Centre's Women's Development Officer, Ms N. Xokozela. The idea was to evaluate and assess Inkqubela operations and to spur identification of obstacles that hindered potential business growth. PROMAT's participation in the needs assessment was to determine if there was any business potential in Inkqubela and, if so, how small business capacity could be developed.

The following were identified as Inkqubela needs:

- access to capital loans to finance business expansion;
- access to operating capital loans;
- further sewing skills training;
- assistance with banking and financial management;
- provision of textiles and supplies at discounted (wholesale) cost;
- assistance with skills upgrading such as literacy training;
- employment as soon as possible; and
- payment in advance for work promised (Ngemela, interviews, 1995-1998; Xokozela, interviews, 1993-1997).

PROMAT executives state that they began with a needs assessment in order to ascertain the perceived needs of a potential SMME supplier while, at the same time, conducting their own private potential assessment. In the case of Inkqubela, the potential assessment included the following:

- technical skills need substantial upgrading;
- current work discipline is adequate, but productivity can be improved;
- industrial sewing machines are required;
- short term cost of procured items may be higher than from large volume suppliers;
- long term cost of procuring items from rural producers may be lower (lack of unionised labour);
- expedited payment system should be implemented with this supplier;
- cloth for textiles should be purchased by PROMAT in bulk and supplied on an as needed basis to Inkqubela; and
- one-off contracts should be used to begin the working agreements, with the goal of tendering for long-term contracts to follow acceptable performance in the initial contracts.

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[79]The Department of Social Responsibility of the Anglican Diocese of Grahamstown.

Response to Needs Assessment

The overlap between Inkqubela's needs assessment and PROMAT's private evaluation of the potential of Inkqubela was noted in the following areas: improvement in technical skills, access to low cost materials, preferred payment structures, and access to new machinery for business expansion. Other needs identified by Inkqubela did not relate to any potential business relationship between PROMAT and Inkqubela and were more personal. These more personal needs included: assistance with banking and financial management, assistance with literacy and other skills training and the need for immediate employment.

PROMAT identified a potential for future cost savings in procurement if working relationships could be established now with rural and other emergent enterprises. Subsequent documents and interviews established that PROMAT also identified potent political reasons to link with emergent black entrepreneurs (Erasmus, interviews, 1994-1996; Botha, interview, 1995; Tager, 1996). South African transformation had a particular impact upon parastatal operations, with government mandates bearing significant weight on operations. In 1993 PROMAT issued general policies to seek out potential black subcontractees (Erasmus, interviews, 1994-1996) which were translated into written policy in a series of documents culminating in the Transnet Procurement Framework of 1996 (Transnet, 1996).

In response to the dual needs assessments PROMAT invited the women of Inkqubela to consider the following offer. PROMAT would not provide access to capital but would purchase three industrial sewing machines and related small equipment for exclusive use by Inkqubela. Inkqubela would be responsible for insurance and machine maintenance only and would sign an agreement to that effect. Further, PROMAT would provide two weeks of SABS (South African Bureau of Standards) sewing training on site in Kei Road provided every member of Inkqubela attended the entire training period. Upon completion of the training Inkqubela would set up a production workshop in the unused garage of Eyethu RDMC. PROMAT then awarded several small one-time orders to Inkqubela that were completed successfully. Income at this

stage of development was less than R1 000 monthly. Upon successful completion of the one time orders, PROMAT asked Inkqubela to tender for a three-year contract for production of yellow cloth dusters - a contract generating after-expenses profit of about R4 500 monthly to Inkqubela in 1996, R6 000 to R7 000 in 1997 and slightly less in 1998. Since Inkqubela operates as a co-operative enterprise, all six employees share the proceeds and the per capita income generated by Inkqubela is indicated in **Table 16**. The figures in **Table 16** for the years 1991 and 1992 serve to compare Inkqubela per capita income from manufacturing to the average wages paid on farms in those same years. The figures for farm wages include the total value of farm wages and in-kind payments.

Table 16: Financial Migration of Inkqubela Before and After Interfirm Linkage

Year	**1991***	**1992***	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**[a]
Monthly per capita Income (R)	35-45	35-50	150	250-80	600-700	750	1200-50	1000
Number employed			3	3	4	6	6	6

Source: Mali, interview, 1998; Ngemela, interviews, 1995-1998; Walton, interview, 1998.
*Figures are for farm labour employment before formation of Inkqubela. Included for employment comparison.
[a] The decline in the purchasing power of the Rand renders the 1998 monthly income equivalent to about R600 in 1991.

PROMAT's linkage with Inkqubela for bulk provision of low skill textile products (cleaning cloths, dish towels) had a profound initial impact on the income levels of the original Inkqubela workers whose employment up to 1991 was as unskilled farm workers. The averaged monthly farm wage for the workers up to 1991 was less than R50. As indicated in **Table 16**, by 1993 monthly income for each of the women increased to R200, mainly as a result of spot sewing orders for dresses, curtains and work clothes sold to the local township rural market. There was little income development from 1991 until the late 1994 linkage with PROMAT that showed income benefits in 1995. Income from 1996, 1997 and 1998 varied annually but averaged about R850 monthly.

Inkqubela: Employee Skill Levels

The initial three members of Inkqubela spent their formative years as farm labourers in the rural Eastern Cape of South Africa at a time when access to formal education was routinely denied to rural women both by policy and the long distances between farm worker dwellings and the occasional farm school. As previously noted, written and spoken English or Afrikaans language fluency was limited, and completion of Standard Four was the highest education level attained by Inkqubela members. In general, Inkqubela members had little training and were not highly probable candidates for skills upgrading (George, 1996).

Despite the willingness of PROMAT and SABS to provide training to Inkqubela members, significant obstacles were encountered. During the intensive on-site industrial sewing training course by SABS, neither the instructor[80] nor the training course curriculum were initially prepared to provide training at the basic level required by Inkqubela. To the credit of the SABS and PROMAT, after the first day of training a series of telephonic conversations took place in which the instructor decided to shift the focus of his training to the levels required, a Xhosa interpreter with some sewing experience was hired (at PROMAT cost), and the training was extended by three days (at PROMAT cost).

The training resulted in significantly increased technical sewing skills evidenced by Inkqubela members (use of straight, five-spool overlocker, and industrial buttonhole machines). One member acquired sufficient skills to read and follow written tender specifications, though she required community assistance to actually complete tender applications. Sufficient skills in machinery use and maintenance were attained for members to train new Inkqubela members in machine use without outside training.

Still, the skill levels achieved by Inkqubela were only sufficient to fulfil the most basic tenders by PROMAT (dishcloths and cleaning cloths.) Additional skills were needed compete for workshirt and trouser tenders. To this end, Inkqubela contacted Transkei

Training Trust (TTT) to provide further training. A one-month course was provided by TTT on site at Kei Road. The training was general in nature and covered topics from machine maintenance to shirt and choir uniform sewing. When questioned, it seems that the training, while lengthy, did not result in a significant increase in skill levels. When questioned one member replied, "We know more than the teacher and we got trained for choir robes when we need training to do shirt collars. Collars are the most difficult" (Ngemela, interviews, 1995-1998).

Findings

There appears to be little movement from current income levels. When questioned one employee stated, "We are waiting for PROMAT to give us more work" (Witbooi, interview, 1997). When PROMAT procurement staff were questioned about Inkqubela, Potgieter (1997) stated, "We want to work with Inkqubela, but they do not seem to have the drive, the motivation to run a business. They wait for something to be given to them." In the case of Inkqubela the linkage with PROMAT rapidly increased income levels from below survival levels to that of a survivalist enterprise.

Employee skill levels were developed through the SABS training provided to Inkqubela. The obstacles presented by the deprivation of rural life, limited education and no exposure to the business culture have made effective skills training very difficult to assess and provide (Taylor and McKenzie, 1992). While the SABS training was of high quality, it had to be severely adjusted to approach the needs of workers in a rural environment. The SABS has limited capacity to provide such training. Training provided by TTT was of limited value in that the skill levels of the trainers were deficient. Most interesting is that Inkqubela staff had identified a specific demand-driven training need (shirt collars) in order to tender for industrial workshirts. They have not been able to access such training. When questioned about this, PROMAT (Potgieter, 1998) indicated that they had no idea Inkqubela wanted further training, as no approach had been made by Inkqubela. PROMAT indicated that they would respond positively to a request for further training at Inkqubela if the training was for a

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[80] Daniel Meiring from SABS.

specific product required by PROMAT and if the request came directly from Inkqubela.

The local Eyethu RDMC NGO served as an intermediary to articulate local needs to PROMAT. The role of a 'hero' or 'champion' of an interfirm linkages seems to be important in certain instances where the free flow of information between procuring businesses and potential suppliers is severely restricted. It appears that the role of the intermediary will diminish as SMME services provided by the DTI expand, particularly if the services provided are linked to specific procurement demands. If DTI supports for SMMEs remain largely generic, the role of intermediaries between LEs and SMMEs will continue.

Despite the financial migration and skills development evident in Inkqubela, a fully competitive business culture has not developed among the employees of Inkqubela. The sense of passive 'waiting' for business to be given by PROMAT belies an ongoing disinclination in Inkqubela to seek additional work from firms outside PROMAT. Inkqubela has not been able to leverage its successful contracts with PROMAT to new contracts with other East Cape industry, primarily due to the lack of enthusiastic marketing (Reddy, interview, 1995-1998). The Inkqubela case study may indicate that a potentially useful role for government SMME support would be in marketing the production capacity of SMMEs to existing private sector procurers.

Case Study: MNH Clothing Manufacturers

The Context

MNH Clothing Manufacturers is wholly owned by Michael and Thula Mkhize. MNH is located in a $200m^2$ wooden partitioned section of an abandoned commercial enterprise that was converted into a manufacturing hive by the Business Opportunity Centre (BOC) of Gauteng, an LBSC initiative.[81] Due to conflicts within the BOC, most of the original occupants of the business hive either closed or left the premises.

[81] See Chapter Five for an explanation of the LBSC support strategy for SMMEs.

By mid-1998 only two manufacturers remained, both in textile manufacture, and both were planning to move to larger premises owned by the PROMAT section of Transnet during 1998. MNH equipment appears to consist of six industrial sewing machines (three straight, two overlocker and one small buttonhole) , electric scissors, two large cutting tables and miscellaneous furniture. There is no telephone or fax available.

Pre-linkage Business Development

From 1981 to 1984, Michael Mkhize was employed as a production worker at a chemical firm in Soweto. His wife completed a course in basic seamstress skills in 1984 during her final year of schooling. After completing this training, Thula purchased a used domestic sewing machine and undertook one-off fashion dress sewing from her home. Typically, Thula would visit the pension payout points or the central Johannesburg train station on pay days with a dress sample. There she would take orders for dresses along with a minimum 50 per cent deposit. Characteristically she would make one to four dresses per month, generating a monthly profit of R40 to R150.

In early 1986, Michael Mkhize was promoted to production supervisor in the Forseco chemical factory. A few months after his promotion, Michael approached his employer asking that his wife be given a contract to supply the work overalls used by the chemical workers. His wife was given a spot order[82] for 70 pairs of overalls. While the order was small, Michael reported, “I saw potential and was determined to penetrate the market. There was much more potential than making a few dresses” (Mkhize, interviews, 1997-1998).

Between 1986 and 1988, Thula Mkhize continued to produce fashion dresses for the pension and pay day market, while also servicing several small spot orders from Forseco for work overalls and shirts. During this period, monthly income averaged less

[82]The distinction is made between ‘spot orders’ and contracts. The former is usually small scale, one time only, and does not involve any commitment beyond the spot order from either subcontractor or subcontractee. Contracts are longer term arrangements in which both partners typically are more interested in each other’s wellbeing, for the sake of efficient production and supply.

than R400. In 1988, Forseco began to reject shipments due to poor quality. At first, the work was simply redone without any dialogue between supplier and subcontractor. Eventually, after repeated quality-related rejections, Michael Mkhize questioned the procurement officer at Forseco and discovered that the garment rejections had to do with the type of machinery his wife was using to produce overalls and workshirts. The single domestic sewing machine used for spot orders was inadequate to make industrial work garments, primarily because the domestic machine was not capable of accommodating the heavy thread used to stitch double seams at garment stretch points. Equipment needed upgrading to industrial standards.

For about one year from mid 1989 to mid 1990, Thula and Michael sought whatever business could be completed on the single domestic machine, while seeking ways to upgrade equipment. Michael continued to work for Forseco during this period. After exhausting other avenues, including family and approaches to several community donors, Michael Mkhize secured a loan of R21 000 at 29 per cent interest from the SBDC. With this they purchased two industrial sewing machines and an industrial steam iron and, MNH Clothing was established.

MNH operated in the informal sector. MNH was not VAT registered, did not pay taxes, was not bound by any relevant labour legislation, and was operated from home. A significant part of MNH's telephone marketing and business contact was conducted informally through the telephones of Forseco Chemical, Michael's formal employer. This was viable until mid-1993 when Michael's employer stated that his "divided loyalties between his job and his business were no longer acceptable" (Forseco Chemical Company, 1997). As Michael summarises now in retrospect, "I had to make a choice."

In August 1993, MNH Clothing was founded with one domestic and two industrial sewing machines, an industrial steamer and two employees, Michael and Thula Mkhize. Within two months of founding MNH, PROMAT's small business development division identified MNH as a potential subcontractee through a chance

meeting at a trade fair in Durban which MNH owner Michael Mkhize attended while visiting his sister nearby for a family funeral.

Post Linkage Business Development

When actual business-to-business linkages begin is not always clear. For our purposes it is assumed that linkages begin at the time of first contact between businesses.[83] In October 1993, immediately after the Durban conference, MNH approached PROMAT and requested a production contract for industrial clothing. PROMAT requested that MNH produce and submit five pre-production samples for PROMAT evaluation. At this stage none of the samples passed. PROMAT did, however, invite MNH to move from in-home business premises to space that had been set aside in an unused warehouse at minimal rent.

From the founding of MNH Clothing Manufacturers in August 1993 to October 1994, MNH recorded less than R400 per month profit. All income derived was from one-time spot orders and on-deposit dressmaking. The relationship with PROMAT provided workshop space and little else. In this period MNH submitted further clothing samples to PROMAT that showed improvement but were still rejected. In an effort to upgrade quality, PROMAT then linked the SABS textile testing division with MNH for an intensive two-week training workshop on the MNH premises. The training was job and market specific[84] and taught specific skills, especially skills related to increasing textile manufacturing productivity. In response to training, MNH submitted a further five pre-production samples to PROMAT, all of which were accepted (du Plooy, interviews, 1997-1998).

In early 1994, Michael Mkhize then marketed MNH production of work garments and other textiles to ESKOM and Denel, two South African parastatals. Both procurement

[83]Referring to the period after initial business-to-business contact as the 'post linkage' phase allows us to examine the different routes to successful linkage taken by each firm reviewed in relation to the larger enterprise.

[84]See Tendler and Amorim (1996) for a fuller discussion of the benefits of targeted market specific training.

offices accepted the quality of production as acceptable, but declined to do business with MNH because no certificate of VAT registration could be produced. MNH was, at that time, a non-registered, non-tax paying, informal manufacturing entity. At this point, Mkhize the MNH proprietor approached the Business Opportunity Centre, a government funded LBSC[85] initiative. Staff at the BOC referred MNH to a small business accountant who assisted MNH with the paperwork to secure VAT registration, and thus formalise. In September 1994, the business was officially registered at a total cost of R450. Shortly thereafter MNH received its first small contract worth less than R7 000 from Cromwell Cleaning Concepts to produce cleaning cloths and overalls.

Financial Migration of MNH Clothing

Although MNH Clothing Manufacturers was not formally established until September 1994, the business in the persons of Thula and Michael Mkhize did exist as early as 1985. Income at that stage was limited and certainly averaged less than R400 per month. In the first five years of MNH existence, the business was conducted from the Mkhize home, orders were taken over the telephone at Michael's place of employ (which later became a factor in his employer's dissatisfaction with Mkhize's performance), equipment was limited to manual scissors and domestic sewing machinery and irons. In every sense, MNH was an informal survivalist enterprise from 1985-94. The first business crisis occurred in late 1988 when Forseco Chemical Company who purchased recurring small spot orders for worker overalls from MNH began to complain of poor quality workmanship resulting from the use of domestic equipment when industrial equipment was needed.

In response to the need for improved equipment, MNH incurred R 21 000 debt in 1990 from the SBDC to purchase industrial equipment for textile manufacture. It was unclear after repeated interviews whether MNH successfully repaid the SBDC loan. However, access to capital was needed to move a domestic sideline that began in one-

[85]The LBSC and other SMME support initiatives taken by the DTI are examined in Chapter Five.

off dressmaking into competition for the production of low-end commercial textiles. Still, monthly income remained low until September 1994, the initial contract with Cromwell Cleaning Concepts. In this period, MNH continued to receive a number of small production contracts, primarily from Forseco Chemicals. [86]

One of the obstacles MNH encountered, a very familiar one, is that large volume procurers for industry are reluctant to take a risk with new and unknown suppliers. MNH reported that numerous potential procurers seemed to lose interest in MNH - despite seeing high quality pre-production samples - when MNH could not produce contacts with several industrial clients who had been satisfied with MNH quality and timeliness.

In November 1994, after being identified and referred by PROMAT, Anglo-American approached MNH Clothing with a one-off order for dishcloths, a low technology item. This initial order, worth just over R5 000, was followed by a further invitation from Anglo-American to tender to supply short-sleeved workshirts worth R65 000. MNH won that tender, though it was revealed in subsequent interviews (Mkhize, interviews, 1997-1998) that MNH was not either the lowest tender nor the highest quality producer. Anglo-American made the tender conditional on MNH accepting additional quality and manufacturing training from the SABS, which Anglo arranged at no cost to MNH. The training was supplied and paid for by the SABS as part of its government directed policy of support to emergent entrepreneurs.

[86] The SBDC loan was not repaid in full, and no efforts at collection were taken against MNH. The loan was treated by the MNH proprietor as something less than a legal obligation (Mkhize, interviews, 1997-1998) though the need for access to capital was repeatedly emphasised by nearly all SMME proprietors interviewed. This instance, along with Malaysian and Indonesian experience indicates that access to capital may be best accomplished in ways that secure the loan obligation against future contracts or through interfirm linkages.

Table17: Financial Migration of MNH Clothing

Year	1981-85	1986-88	1988-93	1994	1995	1996	1997	1998
Monthly income	<150	<400	<500	400- 700	4 700- 5 500	12 000 14 000	22000	55000 (estimated)
Number employed	1	1	1	1	3	5	6	10

Source: Michael Mkhize, MNH proprietor; (1998); Johan Potgieter, Manager, Small Business Development Unit, PROMAT, (1997)

In **Table 17** significant manufacturing income growth and development can be observed when MNH began to fulfil contracts for Anglo-American from 1995 to the present. Most obvious is the growth of income generated as evidenced in the table above. The growth in income is further reflected in growth in employment during the same Anglo- associated period. The business migrated from being owner-operated to employing six full time workers with additional workers (up to 13) employed at periods of high demand. Business income remained essentially at subsistence level from the establishment of MNH to the involvement of Anglo in 1995.

Recently PROMAT has entered a two-year contractual arrangement with MNH for provision of all workshirts used in the Transnet operations. The contract is worth over R850 000 for a CMT operation in which PROMAT supplies the necessary cloth. MNH supplies the labour, thread and buttons. MNH will employ 11 workers for the contract period , including the two co-owners. From the early involvement of the parastatal PROMAT to the direct subcontracting with Anglo-American and, subsequently again with PROMAT, a conducive environment has been created for both parastatal and private sector to subcontract with MNH.

Employee Skill Levels

Michael Mkhize began MNH Clothing Manufacturers with several years' experience managing the production of chemical solvents at his former employer, Forseco Chemicals. His wife acquired basic sewing skills through a training course she completed in 1984 and by completing the ongoing sewing orders she took from 1984 to the establishment of MNH in 1993. Consequently, MNH began with somewhat

developed textile sewing skills in one employee and production management skills in the owner that were highly enough developed to have been recognised by his employer.

Until the first significant orders from PROMAT in 1994, MNH operated as a family business with one employee in addition to Michael Mkhize and his wife. The sole employee was personally known to Michael, had some sewing skills and was employed on an as-needed piecework basis. The first orders from PROMAT for dishcloths in 1994, followed by the contract to supply workshirts, pushed MNH to confront several production issues. Additional employees needed to be added to staff, larger production space acquired and additional training to meet industrial specifications was needed. Access to working capital to purchase materials needed for higher quantity production was also required.

PROMAT undertook an active mentoring role with MNH, not unlike the most successful examples of Foster-Father business partnerships in Malaysia (Hussain, 1992; Meyanathan and Salleh, 1994). PROMAT did not advise in any way on the internal operations of MNH (employee levels, wages, working conditions) but did actively pursue those links that would assist the capacity development of MNH. PROMAT assisted with access to materials (eliminating the need for up-front working capital). Specifically, PROMAT took upon itself the ordering and provision of all cloth needed to make workshirts. PROMAT also assigned one quality assurance staff member to regularly (even daily in the early stages) visit the MNH factory and develop an ongoing dialogue with MNH regarding quality. Industrial-level sewing training was by provided by SABS in a co-operative agreement between PROMAT, SABS and MNH at government cost.

Consequently, the skill level of five MNH employees rose from a level that was not acceptable to South African industry to fully meeting all SABS and PROMAT standards for the items to be produced (Muller, interview, 1997; du Plooy, interview, 1997-98). Mkhize (interviews, 1997-98) indicates that he was able to expand his

business very quickly as a result of PROMAT supplying all material needed for the large workshirt order.

Working Conditions

MNH's one-room manufacturing site is well lighted, well ventilated with exterior windows on two sides. The building itself is dilapidated without any obvious sign that ongoing maintenance is being provided by the owner. However, the building is functional, toilets are ample and in working order and no electric or water failures were evident during repeated visits. None of the workers live on premises. There is no telephone.

At present six women are employed working either six or seven days per week, 8.5 hour per day. For this they are paid an average of R900 per month or R 4 per hour , equivalent to cashier wages at major national food chains in South Africa (Shelton, interview, 1998). There is no medical or pension plan. UIF is withheld as is Pay as You Earn (PAYE). VAT payments are made on all sales. Employees are permitted to use MNH facilities on Sundays to sew additional garments for personal use or resale without charge.

Findings

MNH Clothing Manufacturers clearly benefited from an interfirm linkage with PROMAT in terms of business development, employee skill levels, income growth and business expansion. The first spurt of significant and sustained business growth occurred when MNH was subcontracted to provide work overalls to a small chemical concern. In mid 1993, when MNH received the first PROMAT spot order for work clothing, a longer-term interfirm linkage was established. The linkage with PROMAT provided access to new workspace (through a PROMAT business contact), higher technology production training (through SABS) and market demand-driven 'learning by doing'. MNH gained access to new markets as PROMAT recommended MNH to other large enterprises. The linkage with PROMAT introduced innovative partial pre-payment policies for PROMAT contracts and reduced the need for MNH to seek

commercial loans. In sum, MNH's linkages with PROMAT and later with other large enterprise procurers led to increased business income, increased employment, access to new markets, access to capital for business investment, and dramatically increased skills levels and production process technology upgrading.

Case Study: Somema Co-operative (Soweto Memorabilia Manufacturers)

The Context

Somema is the creation of one person, Phyllis Ntini, who began sewing on her own in 1985, taking individual orders along with 50 per cent deposits primarily for dresses and domestic worker uniforms. Shortly after beginning operations, Ms Ntini attracted orders from several schools for limited numbers of school uniforms, which she sub-contracted out to local women in Soweto, often members of her church. Ms Ntini managed all financial interactions with the schools and acted as the agent between the schools and uniform producers. At the height of her independent business, Ms Ntini subcontracted work to up to 10 workers who were paid for piecework produced an average of R200 per month (Ntini, interviews, 1997-1998). By 1989 the school uniform business diminished, in part due to competition from larger scale producers who undercut prices, and also resulting from less demand due to school unrest.

In July of 1990, Somema was started as a community co-operative with eight members, each owning equal shares. Initial investment was R50 from each shareholder. Thirteen members now sew for Somema in 1997 and each new member has made a similar initial investment. All members own equal shares of SOMEMA.

Pre-Linkage Business Development

For the first five years of operation (1985-1990) Phyllis Ntini operated her sewing business as the sole proprietor with up to 10 workers to whom she subcontracted work depending upon demand. In 1989 the business faltered due to decreased demand for school uniforms. In 1990 Somema was re-started as a community co-operative business, with Phyllis Ntini sewing and co-ordinating the business, and all members

sharing profit equally. According to interviews, all members made a small initial investment (R50) upon entry into the business. Most members work from 8 am to 5 p.m. five days per week. In 1990, the first commercial order received by Somema was from Nestle' (South Africa) (Pty) Ltd. for work clothes worth R35 000. The order required Somema to provide all materials and cloth for the garments. Somema accepted the order and promised timely delivery. Interviews now reveal that Ms Ntini did not have, at the time, the financial or skill capacity to purchase the needed materials or to produce the required garments on time (Ntini, interviews, 1997-1998)

Somema defaulted on the first Nestle' order. Shortly before delivery date, Ms Ntini met with Nestle' officials to plead for extended delivery time and 50 per cent prepayment of the total order value with which to purchase material. Nestle' agreed. Cloth was purchased with the advance payment from Nestle' and work shirts were produced to fill the order, and full payment was made.

After this first order Somema re-approached Nestle' with hopes of larger orders or long term contracts. Several interviews with Ms Ntini and others at Somema indicate that Nestle' never responded either positively or negatively to Somema's approaches, and that no further contracts or orders have been forthcoming to this day. Ms Ntini reluctantly suggests that perhaps the quality of the shirts Somema provided to Nestle' was not consistent or satisfactory. No one at Nestle' knew of the order, had available records or recalled Somema or Ms Ntini.

With the disappointing results of the Somema/Nestle' contract, Somema retreated into servicing the small order needs of local schools, community groups, choirs and one time sewing for Soweto customers. The income for Somema is not documented by any records for this period, though Ms Ntini estimates the income as stable and generating no more than R200 per month for each of seven workers (several workers dropped out or worked sporadically).

Post-Linkage Business Development

In 1996 Somema tendered for a multi-million-Rand contract with PROMAT for the provision of work uniforms, overalls and men's pants. The tender was denied after it was determined that Somema did not possess the capacity to fulfil the tender. However, a member of the tender board within Transnet passed on the contact information about Somema to the Manager of the Small Business Development Unit at PROMAT. PROMAT initiated contact with Somema and eventually awarded a contract for workshirts worth R78 000. Somema met the contract late, but with satisfactory quality.

By 1997, Somema was part of the regular database of suppliers for PROMAT and was, accordingly, sent pre-notification of upcoming tender opportunities. Special interest was taken by PROMAT in sending send Somema information regarding a potential large tender that might generate income of R900 000 in 1997. It was a contract for a large quantity of simple work garments. The tender appeared to be both simple enough to complete and of a volume that could be handled by Somema. The PROMAT Manager of the Small Business Development Unit personally visited Phyllis Ntini and the Somema workers, went through the tender procedures and left with the full expectation that Somema would submit the necessary tender. On the day the tender was due, this same Manager telephoned Somema to make sure the tender documents would be submitted by the deadline. During the telephonic conversation, Ms Ntini informed him that she had "forgotten" to complete the tender and had nothing to submit. Since 1997, Somema has had several one-time orders, but has not yet developed any ongoing contracts to supply products on a regular basis to PROMAT.

Financial Migration of Somema

After the SBDC order in 1994, the primary markets for Somema products were African Momentos of Johannesburg, the Soweto Construction Guild (for work uniforms) and PROMAT (with small spot orders). Between 1991 and 1994 Somema income was less than R20 000 annually. In 1994 the total revenues generated by Somema were approximately R35 000; in 1995 revenues were R74 000; in 1996

revenues were R105 455, and in 1997 revenues totalled R118 480. Expected income for 1998 dropped to R6 500 or less per month due to non-renewal of contracts by PROMAT (resulting from unsatisfactory variations in quality) and the inability of Somema to develop additional markets.

Table 18: Financial Migration of Somema

Year	1985-1993	1993	1994	1995	1996	1997	1998
Monthly Revenues	100-600	<1000	<3000	<6000	8750	10500	6500
Number of Employees	1-3	3	5-7	6	8	8-10	10

Sources: Interviews with Somema co-ordinator Phyllis Ntini and from Somema ledgers for 1996 and 1997.

Somema income, while showing a 500 per cent increase since 1991, appears to have stagnated at about R100 000 annually. Most significant is that Somema's client list has not expanded since 1994. With a long history of effective production, good community support and skilled labour, why has Somema not expanded further? There are several factors to consider.

First, interviews with Phyllis Ntini reveal that she and other Somema staff expend considerable effort to cultivate and develop the business relationship with African Momentos and with the Soweto Construction Guild. She stated as much saying, "The contract with African Momentos is our life. We support them, they support us." Behind this sentiment may be an unwillingness to substantially engage with the demands of industrial manufacturing and subcontracting. It may be that Somema's disappointment with the early Nestle' contract led to a sentiment that it was more productive, in the long run, to cultivate a few relationships with those who would purchase low quality trinkets (African Momentos) or those who would not refuse items of varying quality (Soweto Construction Guild).[87] It may be that Somema has not been able to migrate beyond its initial market as a supplier of low quality textile products in Soweto. A second factor concerns the co-operative nature of Somema. As noted

[87]An interview with Thabo Mzi (1998) of the Soweto Construction Guild indicated that Somema's garments have never been returned because of poor quality, while admitting that not all garments produced were of high standards.

previously, employees are paid equal shares of whatever profits accrue from contracts and spot orders. No salaries are paid, nor is payment related to individual productivity.

The current level of income (about R100 000 per year) generates between R350 to R450 per month per worker. Given the opportunity to take extra work home or to work Sundays for individual profit, workers may have reached a wage 'comfort zone' in which their subsistence wage is deemed satisfactory.

Employee Skill Levels Before and After Linkage

In this instance of linkage, there has been no involvement of larger firms assisting with skills training, production development or quality improvement (Ntini, interviews, 1997-1998); Potgieter, interview, 1998). By January of 1998, Ms Ntini indicated that she requested additional training to be facilitated by PROMAT to assist the development and growth of Somema. The management of PROMAT's small business development division replied that such assistance was never requested and, when approached about advice on the tender process, Ms Ntini stated that she "understood all that was needed" (Potgieter, 1998). However, assistance and training to improve financial record keeping was provided by the BOC of Johannesburg (Makgato, interview, 1998).

In sum, a suitable working relationship was not developed between Somema and PROMAT and, consequently, little large firm assistance with production training or skills enhancement was forthcoming. This may be an additional contributing factor to the lack of production growth that has characterised this stage of Somema's commercial development.

Working Conditions

In 1994, the SBC approached Somema with a spot order for sewn textiles worth less than R10 000. At the same time the SBDC invited Somema to take residence in the SBC-sponsored business hive in Nancefield at a nominal rent. The facility is poorly lighted, but is of ample size for 16 sewing work-stations. This initial contract from the

SBDC, coupled with available business space at low rent, provided the initial infrastructure and support necessary to launch Somema. There is water and electricity in the building, paid as a business expense of Somema. Rent is minimal and is paid to the SBDC.

Findings

The linkage between PROMAT and Somema is defined by three characteristics of note: the co-operative nature of Somema, the reluctance of Somema to evaluate and ask for targeted assistance, and the reluctance of larger enterprises to assist in evaluating Somema's business needs. Regarding the co-operative nature of Somema, payment to the members worked as a disincentive for individual high performance since all workers were paid equally at month's end for the total amount of work produced and income generated. That individual incentive might increase productivity seems clearly evident, given the willingness of many Somema members to take work home at night and to work in the workshop on their own retail sewing on weekends (Ntini, interviews, 1997-1998). Second, Somema's initial interfirm experience with Nestle left Ntini and other co-operative members cautious about entering into work agreements that Somema wanted but did not have capacity to complete. At no point, it seems, did Somema seek the assistance of a large enterprise for skills upgrading , nor was SOMEMA able to identify its own needs other than to state, "Our business would grow if we could have a loan" (Ntini, interview, 1997). Neither Nestle' nor PROMAT engaged sufficiently with Somema to facilitate SABS training for Somema workers, who might have benefited significantly. Third, no interfirm linkage with Somema resulted in a larger firm taking an interest in the development of Somema capacity, as was the case with Inkqubela. Lacking such an interest in the gradual development of an SMME's capacity, an interfirm linkage and the large subcontracting orders that can result often has the effect of overpowering an SMME such as Somema. In this instance, Somema seems satisfied to service small contracts and generate subsistence income for its members.

Case-study-derived Conclusions

Political Considerations

The three case studies show various motivations for private sector support for small business. Political considerations were certainly paramount. PROMAT's chief executive, Daan Erasmus (interviews, 1994-1996) states that: "We saw the writing on the wall. We knew by the late 1980s that there would be a new government and the government's greatest need would be to make jobs. So, we wanted to get a head start politically, but, and this should be emphasised, we wanted to do it successfully for both Transnet and for the small business".

Political motivation for parastatal support for the black SMME sector is confirmed by interviews with ESKOM officials (Mamorare, interviews, 1996-1998; Lamola, interview, 1998; unpublished internal documents (DTI, 1997). It was evident as early as 1994 that parastatal procurement was likely to be an early target through which to implement government policies to support black-owned small enterprises. What is surprising is the degree to which Transnet and ESKOM have implemented affirmative procurement.

The proactive willingness of parastatal enterprises to engage in affirmative procurement and related interfirm linkage support is explained by critics as a reflection of the new political agenda of government-owned enterprises rather than reflecting market imperatives. Indeed, South African parastatals made early moves to link with black-owned SMMEs for political not altruistic reasons, and probably for reasons of individual job security and promotion, as illustrated by PROMAT Executive Erasmus' comment above. What emerged from the initial linkages with SMMEs is that PROMAT carefully documented that affirmative procurement, perhaps undertaken for political acceptability, yielded good quality local products at a fair price. South African parastatals were in a favoured position to experiment with interfirm linkages with SMME suppliers because the implied increased transaction costs of affirmative procurement were readily absorbed within the political environment of the parastatal and expected policy initiatives. The initial sheltering of increased transaction costs

within Transnet provided some years of freedom from strict market pressures in which to prove the viability of SMME affirmative procurement, as well as build a base of quality SMME suppliers.

Table 19: Affirmative Procurement Within PROMAT

Year	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**
Total SMME procurement (R1000 s)	100	150	2500	7500	35 000	54 000	77 000
% of total	<0.5	<0.5	<0.5	<0.5	1.67	2.01	2.96

Source: Potgieter, PROMAT, 1998

Table 19 indicates that there has been a significant growth of procurement from SMMEs within PROMAT since 1991. It is equally evident that procurement from SMMEs remains a small part of total procurement requirements. The case studies demonstrate that interfirm linkages can be an effective vehicle for SMME growth, but the constraints on such linkages can be significant. Until government policy actively assists such interfirm linkages, growth of procurement from SMMEs by parastatals and the private sector will be inhibited.

While an increasingly favourable climate for interfirm linkages with SMME suppliers has been created, often in the absence of clear policy directives, the increased transaction costs that are an inevitable part of interfirm linkages for affirmative procurement with SMMEs will be a disincentive for the private sector without some form of state subsidy or tax incentive to mitigate increased transaction costs. The need to ameliorate the increased costs of doing business with SMMEs requires an active policy to create a financial incentive for LEs to engage in new forms of interfirm linkage; an understanding that is well demonstrated in the National Small Business Strategy of Croatia (Zanic, 1997) and in the Emiglia-Romagna region of Northern Italy (Bonareti, 1997) as well as in Malaysia (Meyanathan and Salleh, 1993).

Currently no single defined incentive scheme is available in South Africa to absorb increased costs arising from interfirm linkages for procurement. Despite the evidence that linkages between LEs and SMMEs do increase labour skill, promote job growth and increase access of SMMEs to markets and finance (Toomey, 1996; Meyanathan, 1994) not one of the 20 DTI (1997) incentive schemes promulgated recently support interfirm linkages.

PPQM Incentives for Interfirm Linkages

The political considerations affecting the climate in which interfirm linkages occur can contribute to short term opportunities for a large enterprise to boost its public relations profile by engaging in business with SMMEs. When the official proclamation making interfirm linkages a national movement in Indonesia was announced, more than 21 000 SMME business partners were 'found' by LEs within nine months. While there was no 'hard' coercion to make linkages, the need to do business with large state-owned natural resource processing industries was incentive enough to encourage an enhanced public relations profile in accordance with the national movement (Wie, 1994).

Larger South African enterprises have substantial reason to seek an enhanced business profile in the new political climate. The DTI White Paper on Small Business Development (1995:56-57) strongly encourages "business mentorship and traineeship programmes…to be expanded rapidly, with particular focus on black and women entrepreneurs" further stating that in SMME development training "the main thrust must come from the private sector". Also, the "private sector has to play the most important role through the supply of commercial services for small enterprises…as well as social responsibility commitments of the corporate sector related to small business development."

While the effectiveness of the thrust of the White Paper's SMME support strategies is critiqued elsewhere in this study, it is evident that LEs in South Africa have substantial incentive to raise their profile regarding efforts to support SMMEs. Profile, however,

is a short term incentive for business that needs to be combined with financial incentives or offsets to mitigate interfirm linkage transaction costs, as has been done in Malaysia (Meyanathan, 1994). Toomey (1998) and Goldsmith and Goldsmith, (1998) indicated as much when discussing proposed joint ventures in the South African textile industry, claiming that 'profile' was a legitimate factor to consider in assessing costs and benefits of interfirm linkages, while also indicating that successful linkages will ultimately depend upon the compatibility of linkage partners and their joint commitment to increased profit and market share.

Linkages between LEs and SMMEs can be overtly coerced, as in Indonesia where the Minister of Finance decreed that state-owned enterprises were required to set aside not less than 5 per cent of net profits to assist SMMEs. Overt coercion of state-owned enterprises in Indonesia, along with various official proclamations that interfirm linkages were regarded as a national movement (Suhardi, 1992b), resulted in a significant increase in the number of interfirm agreements operative between 1989 and 1992. Coerced partnerships, however, seldom enjoy the full and enthusiastic support of LE management, with the result that partnership may be tokenistic and minimalist.

A more successful policy approach would be to create incentives to drive LEs into partnerships with SMMEs. Given the socio-political environment, incentives for voluntary partnerships in South Africa have to do with PPQM: profile, price, quality and markets.

Profile is the public regard in which a company is held. Every larger enterprise that wishes to do business in the long term in South Africa must consider its profile in the new South Africa as a priority. Successful linkages between predominantly white-owned enterprises and emergent black-owned SMMEs contribute to enhanced market profile and potentially enhanced market share in the long term.

In a globalised market structure, compromise on **price** is difficult to sustain in interfirm linkages without direct financial incentives. Any drive to increase the number of

SMME suppliers a large enterprise conducts business with must address the international fact that reducing rather than increasing the number of suppliers is a generally accepted protocol within corporate procurement circles (Ward, interview, 1998; van Wyk, interview, 1997). The economic costs of linkage creation between large and smaller firms can be quite high because of initial inefficiencies arising from the skills and capacity deficit inherent in many SMMEs. As long as the bulk of these costs are absorbed by the SMMEs (through low wages paid to workers), large enterprises may not have to face higher unit prices. Increasingly, however, SMME wage demands along with competitive price requirement by LEs will require carefully crafted government financial incentives to sustain linkages. The key to such incentives is that they be time and performance-based, so that there is a built in and visible incentive to increase efficiency among the SMMEs and to transfer know-how and skills from the LE to the SMME.

Quality is perhaps the most consistent negative factor that recurs in interfirm linkages and is directly related to the skills deficit faced by most South African manufacturing SMMEs (van Wyk, interview, 1997; du Plooy, interviews, 1997-1998). Quality shortcomings in SMME subcontractors is not confined to South Africa. Fong's (1990) study of Malaysian subcontracting in the 1970s and early 1980s showed that lack of quality was the most frequently cited reason (18.5 per cent) for LEs not offering subcontracting to SMMEs. At the same time, MITI (Wong, 1991) shows that subcontracting linkages have a profoundly positive effect on enhanced technical and production skills in SMMEs. Thus, while quality deficits may be a hindering factor in interfirm linkages, quality improvement may be just the reason government policy should support such linkages. It is at this point that targeted funding for demand-driven skills training is likely to be a most useful and cost-effective policy intervention (Tendler and Amorim, 1996).

Market development and expansion is potentially the most compelling economic factor to motivate self-induced interfirm linkages, and requires little policy intervention. In the apartheid era, market opportunities were distorted by political

objectives, rendering large segments of the population essentially unimportant to the market interest of most South African industry. South African business did not see viable markets in black consumption. After the economic isolation of the majority of the population, market information about black consumption was, and largely still is, unavailable to much South African business. Without readily available information, new black markets will be difficult to access. The WISPECO case study indicates how an interfirm linkage between established and emergent businesses can assist the development of new market opportunities for existing business while creating new employment in emergent enterprises. Again, this case study finding confirms existing research in other countries (Cardoza, 1997; Stone, 1997; Tendler, 1997).

The Role of Linkage Allies[88]

In the case of the MNH/PROMAT business relationship, it is evident that one individual within PROMAT took a particular interest in the subcontracting success of MNH Clothing Manufacturers. PROMAT's small business staff (particularly Johan Potgieter) went far beyond simply advising MNH of tender potential. Interviews revealed that PROMAT extended unsecured loans of material to MNH in order to overcome the obstacle of needed working capital. A close working relationship developed between MNH and PROMAT, such that MNH owner Michael Mkhize often calls upon PROMAT technical staff to assist with production problems he may encounter (du Plooy, interviews, 1997-1998). This unusual degree of interfirm co-operation arose from internal allies within PROMAT who advanced the cause of MNH at every opportunity.

[88]First identified by Tendler (interview, 1996) as a subsidiary element in the early phase of some interfirm linkages, Tendler uses the phrase 'internal hero' to describe the individual or group that enables initial contacts between SMMEs and LEs. The internal hero or ally may be particularly relevant to South Africa's context. Past policies have distorted the market by restricting the free flow of information about potential subcontracting potentials, thus limiting naturally occurring interfirm linkages. In this regard, the 'hero' provides a needed function of providing missing information about linkage potential.

This resulted in access to information, skills training and access to working capital (or its equivalent in material) that provided a significant competitive advantage to MNH.

Inkqubela Sewing Group at Kei Road had no such ally within the large enterprise, but did benefit from being identified by a local NGO with contacts with PROMAT. Because the local NGO viewed Inkqubela not so much as a business as a community development project, PROMAT participated in an detailed needs assessment of Inkqubela. PROMAT, the NGO and Inkqubela agreed on the types of support needed to strengthen Inkqubela. This resulted in SABS production training provided on-site, and the long term loan of industrial sewing equipment to Inkqubela (purchased by PROMAT). In this instance, the presence and large firm contacts of the local NGO distorted local market forces and created a significant advantage for Inkqubela over many similar sewing groups in the area. The advantage consisted of increased skills training, provision of technical equipment advances that were made possible by equipment purchases by PROMAT. Without being championed by an NGO with PROMAT contacts, it is highly unlikely that Inkqubela would have developed a competitive advantage.

The role of an ally within the large enterprise that pushes innovative interfirm linkages received attention by Tendler (interview, 1996) but is absent in much literature on the subject of business linkage. This study appears to indicate that the gap of understanding between large enterprise culture and that of emergent SMMEs is so great as to require an individual or organisation that can effectively interpret the needs and capacities of each linkage partner. While SMME linkage allies cannot be legislated, the need for interested and business trained intermediaries is highlighted. In some instances this intermediary role may be carried out by staff of the LBSCs. The fact that linkages have worked better when such intermediaries exist may indicate a significant barrier to the creation of widespread linkages if such intermediaries are not available.

Problem-solving Orientation

The interfirm linkages noted above were remarkable to the extent that two enterprises that did not necessarily share the same goals became committed business partners in the linkage and began to conduct their business relationship in a problem-solving manner. In terms of facilitating the delivery of a quality product in a timely fashion (the two most common complaints when using small suppliers), the demands for performance were heard, interpreted and acted upon by the interfirm linkage ally. In the case of MNH Clothing and Inkqubela, an individual and an NGO acted almost like independent agents negotiating between linked firms. The interfirm ally was able to structure the work of the linked firms in a problem-solving direction, with automatic rewards and support forthcoming for good product results.

The benefit of approaching interfirm linkages with a problem-solving orientation is obvious for the small supplier (a mentor relationship through which to develop production capacity at an acceptable level). What is surprising is that the benefits for large enterprises are equally significant. Across the spectrum of interviews (Erasmus, interview, 1994-1996; Mamorare, interviews, 1996-1998; Hibbit, interviews, 1997-1998; Potigieter, interviews, 1994-1997), there is an expectation that interfirm linkages with emergent black entrepreneurs will have the short term result of increasing production costs, while in the medium term they will have the result of lowering supplier costs (by expanding the competitive market in which suppliers operate) and expanding markets for large business goods and services (by increasing access to black markets).

Winter (1995) notes that the effective management of relationships between suppliers and procurers is a world-wide issue of organisational competence for large organisations and that Toyota (automobiles), Liz Claiborne (apparel), and IKEA (household furnishings) are exemplary of ‘best practice’ standards in supplier/procurer relations. Prominent features of this international best practice include long term contracting, high and rising quality standards, intense communication, and a strong emphasis upon learning. In the cases above, suppliers are international and involve

SMMEs of varying capacities. The same paradigm of relations between procurer and supplier applies to interfirm linkage within South Africa as illustrated especially in the SAW joint venture and in Inkqubela and MNH Clothing's relationship with PROMAT. As the case studies have demonstrated, successful interfirm linkages have involved intense involvement of large firm staff with the operations of SMME suppliers, establishment of long term relationships, and an understanding that learning and quality improvement are ongoing concerns best addressed within a partnership relationship. From such a base, interfirm linkages have potential to develop the capacity of SMMEs and the individual workers themselves.

New Market Opportunities

Inkqubela began as a community-based subsistence-level co-operative using very basic sewing skills to address local clothing needs in the rural Eastern Cape. The market was relatively unsophisticated and responded most directly to price over quality. The market was limited geographically (products sold only at local markets), by the low production process technology available and by limited demand. Inkqubela's linkage with PROMAT immediately opened an entirely new market to Inkqubela, which it exploited well. What appears to be missing at this stage of development is the internal drive within Inkqubela to assert its presence as a quality textile subcontractor and to tender for new contracts in other markets. It is this area of developing new markets that may be a productive role for government SMME support policies.

MNH proprietor Mkhize was able to identify and access new markets in the early stages of MNH (the move from one-off clothing production to making work clothes for Forseco), but MNH was not able to adequately service the commercial market before the assistance provided by an interested and problem-solving-oriented linkage with PROMAT. The linkage with PROMAT opened new markets to MNH within PROMAT, but perhaps more significantly, afforded access to the necessary production process technology to service those new markets.

Somema is an enterprise that has and continues to be more able to service the local one-off domestic and small local tourist market than the commercial market. The linkages with Nestle' and PROMAT offered Somema the potential for growth in revenue, training equipment and markets. However, the commercial demands for quality and timeliness overwhelmed the co-operative nature of Somema. The new markets opened to Somema, and the challenges they presented, appears to have caused Somema to retreat to the safer and less demanding small domestic textile market.

Though not included as a case study, the role of WISPECO[89] indicates that some private sector support for small business is motivated by the desire to expand markets for existing products. A case in point is the WISPECO manufacturing business alliance with National Union of Mineworkers of South Africa (NUMSA) for the production and sale of metal window and door frames and security gates. It was long the wish of a WISPECO employee, Mr. J. Makete, to involve some unemployed welders he knew from Soweto in fabricating the steel window frames commonly made by WISPECO. A shop foreman for WISPECO, Makete sporadically suggested employing the welders on a casual basis. His suggestion attracted little interest until WISPECO sought to increase its market share in the township market in the late 1980s. By 1987, when WISPECO wanted to sell large quantities of window frames to retail outlets and contractors in Soweto, they discovered that the transport costs of selling finished frames in Soweto were prohibitive. While established (white) contractors could pick up finished frames at the WISPECO factory, black contractors required delivery of the frames. WISPECO learned early on that it was more economical to transport steel window frames in kit form to township and outsource the window frame assembly there than to do the assembly at the WISPECO factory and transport the fully assembled item. A truckload of fully assembled windows, for instance, totalled only one-fifth the number of units that could have been carried as window kits. Changing the transport and assembly of window kits made it more economical to ship and sell windows in the township in smaller lots, thus gaining direct access to small black contractors and to the large number of individuals buying directly for house expansion.

Thus, a change in transport and assembly facilitated WISPECO's entry into the new market of smaller volume consumers. The ability to penetrate the new township market would not have been possible if WISPECO had maintained its in-house assembly and transport mechanisms which were best suited to service high volume, traditional markets. The WISPECO case dramatically illustrates this market-based interest in outsourcing to emergent SMMEs, with increasing sales of the final product (besides the economics of the production process itself).

Through the ensuing arrangement, NUMSA identified retrenched mine workers with welding experience in the Johannesburg area. WISPECO then provided the teams of welders with bulk steel that needed to be formed according to WISPECO specifications into finished window frames and security gates ready for retail sale. Market share for WISPECO grew as finished windows were provided with reduced transport costs to emergent contractors and individual homebuilders in Soweto.

Transnet executives make a similar case for promotion of small business, in a more general context. The MD of Transnet, Professor Louise Tager, said, "We are concerned with development of black business because as the economy grows in all sectors, so will the demand for Transnet services. We cannot survive on our past markets; we must expand into markets that have not previously been served by Transnet" (1997).

[89] WISPECO, producer of metal security gates and window frames, was purchased by Duro Industries in 1997. The linkage with NUMSA welders mentioned here was terminated. Duro Industries executives would not specify the reasons for termination.

Access to Finance

Access to finance is routinely cited as the major obstacle to SMME development and expansion (DTI, 1995, 1997a, 1997b; Otero and Rhyne, 1994)[90]. Current policy directions of the South African DTI approach the need for finance as a first-level need of start-up enterprises. The DTI's requirement for SMMEs to receive some initial funding is little more than being able to put together a business plan and have it approved by the LBSC (North West Development Corporation, 1998; Greater Pretoria Metro Council, 1997; Department of Trade and Industry, 1997; Ntsika, 1997a, 1997b). It is assumed by the DTI, in contrast to research findings, that access to finance is most necessary at the beginning stages of an SMME.

Each of the SMME/ LE interfirm linkages studied demonstrated that access to finance by SMMEs was substantially eased with the advent of a linkage, and was done so in a market context. Interestingly, in no instance did the access to finance actually involve a monetary loan. Rather, access to finance was in the form of loaned machinery (Inkqubela), advanced training (Inkqubela and MNH), partial prepayment for CMT goods ordered (MNH), and access to raw materials at low or no cost (Inkqubela, MNH, Somema). Furthermore, the assistance provided to Inkqubela, MNH and Somema was provided at a later stage of business development, rather than at start-up. This may be instructive in that whatever assistance is anticipated for emergent SMMEs, that assistance may be most helpful at a later stage of business development. This tends to confirms the findings of Zanic (1997) and Mead (1998) regarding the dynamics of SMME development and strengthening. Problems with loan repayment were avoided by advancing material goods and services to the SMMEs rather than cash loans.

Interfirm linkages offer the opportunity to extend access to finance to SMMEs that have already passed the initial phase of development and which have passed some kind

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[90] This contrasts with Stone's (1997) findings on lending, though Stone does not differentiate between informal and formal SMMEs whereas Buckley (1997) does so and concludes that SMMEs that survive the start-up phase are a self-selected group of 'survivors' who are the best candidates for successful business growth.

of business screening process by a potential LE linkage partner. The mode in which finance is provided can be adapted to the specific market conditions (an industrial buttonhole sewing machine to Inkqubela, for instance) in order to meet actual demand. Cash often does not need to change hands, reducing interest payable, and avoiding the temptation to use business finance for personal use. Since interfirm access to finance is often in the form of durable goods, if the SMME defaults on work orders, most durable goods can be salvaged by the LE.

Access to finance is a complex issue, not adequately resolved with a dualistic yes/no approach. What does seem evident is that repayment of loans is problematic when loans are granted by impersonal third-party agencies (as proposed by Khula) (Cashpor, 1996) and that large inflows of capital loans often destroy as many new SMMEs as are assisted (Stone, 1997b). Interfirm linkages have potential to assist with SMMEs' need to access finance, with repayment, by entering into creative financial arrangements. Two examples from our case studies are relevant. PROMAT provided the equivalent of access to loan capital by purchasing industrial sewing equipment and then lending the equipment to Inkqubela for the term of linkage between the firms. PROMAT also provided cloth to MNH Clothing for production of workshirts under interfirm contract. In both instances PROMAT undertook the cash outlay, and repayment was secured by production of ordered goods (MNH) or by written agreement to return machinery at the end of contract (Inkqubela).

While interfirm linkages cannot be expected to meet all the financial needs of SMMEs, Khula lending strategies to SMMEs could give priority lending status to SMMEs in interfirm linkages, thus providing another incentive for generating such linkages, increasing the chances of loan repayment.

Criticism of Interfirm Linkages: A Cosmetic Face to Exploitation?

It is necessary at the outset to correct any possible misinterpretation or exaggeration of the importance of interfirm linkages within the overall business environment of existing business in South Africa. The WISPECO widow kit programme in total probably

accounted for no more than 1 per cent of the company's total window production (Timpsman, interview, 1997). Nedcor's goal for outsourcing of non-core products in 1998 is less than 2 per cent of total purchasing and is likely to increase to only 10 per cent by 2003 (Ward, interview, 1998). While PROMAT's total purchasing was R2.6 billion, procurement from emergent black business totalled R78m in 1997, or less than 4 per cent of total procurement. What then is the actual impact of such linkages?

A most prominent critique of interfirm linkages and outsourcing to black enterprises asserts that the benefits are, at best, minimal and probably amount to a reversion to "neo-colonialism of a special kind" (Bishop, *Mail and Guardian*, 14-20 November, 1997:40), meaning that the economic benefits will derive to a privileged few, while the majority are exploited.

One of the early instances of outsourcing, in which this potential was evident involved Anglo-American. Anglo decided to outsource certain in-house services including cleaning and maintenance of worker hostels and, in doing so, proposed to retrench its entire staff responsible for these activities. In order to stifle union opposition, Anglo proposed to re-contract with the same workers as subcontractors. Such an approach typifies the down-side potential of interfirm linkages in that the proposed subcontracting arrangement would merely have allowed Anglo to shed its long term responsibilities to permanent employees, while offering no gains in skills upgrading, job security or long term wages. Indeed, the workers would have lost generous Anglo-American fringe benefits (perhaps the motivation behind the move to subcontract) and would no longer have been protected by union membership. The union did not accept the proposed Anglo-American arrangement unless it endowed a benefit plan for the retrenched workers. In the face of labour opposition and work actions, Anglo agreed to the benefit plan for retrenched workers. In this instance, Anglo succeeded in outsourcing services without actually creating new jobs or empowering anyone with new skills. The critique of a new colonialism through outsourcing should not be minimised.

Criticism of the small percentage of procurement from SMMEs within Promat and other parastatals and private sector enterprises (Nedcor proposes 9% total SMME Affirmative procurement in 1999) (Ward, interview, 1998) is justified. It is not contested here that interfirm linkages are the only strategy for SMME development that ought to employed in South Africa. Rather, interfirm linkages are one strategy that has been neglected in current South African policy and that brings seeming benefits in terms of income migration, skills development, working relationships between white-owned and black owned business, opportunities for gender development, and market induced income redistribution through greater employment among disadvantaged persons.

Tokenism and Fronts

It is commonplace to assert that affirmative procurement benefits the large enterprise by reducing the need for capital investment and labour costs characterised by the new international division of labour (NIDL) (Christerson and Appelbaum, 1995; Barff and Austen, 1993). In political contexts where affirmative procurement either is required by some industries (as in Bangladesh) or is viewed as a political necessity in order to garner new contracts (South Africa), critics voice concerns of tokenism. The higher transaction costs concomitant with changing subcontracting arrangements have been well documented (Coase, 1937, 1960; Bolnick, 1982; Hamid, 1985) and some critics (Thamrin, 1993) suggest that such costs may well be a disincentive for the kind of dynamic new interfirm relationships envisioned by affirmative procurement. Consequently some large enterprises may find it useful and cost effective to establish 'black front' businesses that appear to implement affirmative procurement (Ross, 1997; Ngwenya, interview, 1998) without commitment to the kind of interfirm linkages that actually empower the SMME sector. Such empowering linkages have characteristics that include long term contractual relationships, high quality expectations, intense interfirm communication, and emphasis upon learning. Experience of affirmative procurement implementation in other countries indicates that the problem of 'front' businesses is an early stage phenomenon practised by a small minority of business (van

Diermen, 1997) and that affirmative procurement interfirm linkages can serve to enhance both large enterprise buyers and their affirmative procurement suppliers (Tendler and Amorim, 1996; Cardoza, 1997; Stone, 1997).

Ross (1997) suggests that the problem of black front businesses can be minimised through a "United States style" central computer registry of all eligible black owned SMME suppliers nation-wide. Suppliers would be registered and inspected annually, with occasional forensic audits to assure black enterprise ownership and control. Given the difficulty of several agencies (Pretoria Metropolitan Council, CSIR, TNDP and the DTI) to create and maintain even a simple database of potential SMME suppliers, without any critical evaluation of them, it seems unlikely that such a mechanism to control fronts will succeed in the immediate future. Procurement officers at Nedcor and Promat and officials of Nafcoc suggest that each large enterprise procurer must verify to its own satisfaction the ownership characteristics of SMME suppliers. In practice this suggests that relatively little consistent screening will be accomplished.

While the impact of interfirm linkages has not yet been quantified, it is possible to make some observations of their actual and potential effect. Total government and parastatal procurement in 1997, with potential to be purchased from local suppliers[91], amounted to more than R56 billion (Department of Trade and Industry, 1997d). Three of the largest South African parastatals (Transnet, ISCOR and ESKOM) have committed themselves in internal documents to a set-aside goal of not less than 50 per cent procurement from black enterprises by the year 2005 (Transnet, 1996). While many executives within the same parastatals suggest that a 10-15 per cent set-aside is more probable, even this lower estimate would result in a redirection of more than R5 billion in outsourcing from black enterprises for parastatals alone. If a 10 per cent set-aside for procurement from black enterprises were generally applied across the private sector as well, the potential new business for black enterprise would exceed R36 billion (DTI, 1997; Ntsika, 1997c).

[91] Due to technical requirements, some procurement is only available directly from non-South African suppliers and/or producers.

Not Economically Sustainable

It is undeniable that affirmative procurement involves higher transaction costs that influence productivity and competitiveness. The urgency of this critique was summarised by a Nedcor executive who (requesting anonymity) stated, "We've got to get this policy [affirmative procurement] right and settled quickly and with minimum disruption because our world-wide competitors are not spending a minute on this" (Nedcor, interview, 1998).

Increased transaction costs are inevitable as part of long term interfirm linkages. Partial government subsidy of increased transaction costs could help achieve other long term job creation goals of the DTI. For example, while job creation is a primary short term motivation for interfirm linkages in South Africa, the transfer of technology and production process improvement (Kam, 1991) is equally significant for longer term development. The concurrent processes of on-the-job learning and technology transfer necessarily involve a greater degree of LE involvement with SMME suppliers than in markets with more developed SMME sector. Thus transaction costs are increased, using Williamson's (1987) framework, in that the use of affirmative procurement subcontractors increases the instability of subcontracting relationships to the extent that SMME suppliers are unpredictable (in terms of quality, delivery, timeliness). Additional potential transaction cost increases arise from the degree of dependence either party has on the other (Janssen, 1982). In traditional procurement, most buyers maintain multiple subcontractors to supply the same product of service in order to reduce dependence on any single supplier (and reduce subcontracting instability). Interfirm linkages for affirmative procurement probably means the introduction of greater supplier dependence (even if more than one supplier is used) and certainly means that SMME suppliers will require more service and attention from the buyer in the contract completion phase.

The greater turbulence in subcontracting relationships incurred through affirmative procurement and the increased interaction of the buying large enterprise with the day-to-day operations of supplying SMMEs are probably not economically sustainable in a

purely free market for the long term. This parallels findings in Indonesia (Wie, 1994) and in Malaysia (Meyanathan and Salleh, 1994). Incentives to support long term interfirm linkages for affirmative procurement are an obvious point of potential policy intervention. As previously noted, the SMME policy support framework that continues to be promulgated by the DTI and its subsidiary agency Ntsika (1997a:5) mentions consideration of tax incentives to motivate "big business to systematically expand its links with small enterprises", but seems to undercut the legitimate need to soften costs incurred by large enterprises by stating that "the interest in joint ventures and the active involvement of foreign donor agencies in the facilitation of such ventures suggests that there may be no specific need for public funds for this purpose" (Ntsika, 1997a:11). Even if funding from foreign donors can be used to soften the transaction cost burden of affirmative procurement, this is no long term solution. Only government policy empowered by predictable subsidies can create a long term market environment in which beneficial linkages can be established between large and emergent enterprises (Levine, 1996). It is policy intervention that can contribute to the amelioration of the increased costs associated with interfirm linkages. Such policy intervention is entirely missing in current South African policy.

Policy Debate: How Should State Procurement be Targeted?

Should state procurement be targeted to labour intensive sectors, and should procurement be further targeted to those businesses that are black-owned? The irony of South African development at this time is that the state is relying upon global monetary orthodoxy to boost investor confidence and attract FDI, believing that such policies will lead to broad economic growth and gradually increasing employment, while at the same time recognising that the economic conditions of the masses must improve rapidly if the ANC electoral mandate is not to be threatened. Caught in the bind between global and local realities, state economic policy tends to be littered with the rhetoric of redistribution while remaining substantially market-growth friendly (Michie and Padayachee, 1997).

In the matter of state procurement, it might be reasonably expected that policy would be adopted to make businesses owned by PDIs more likely to succeed as suppliers of government purchasing. In fact, procurement tender policy is largely unchanged since 1984. Through implementation of stringent supplier assessment criteria, unpublished procurement guidelines and contract failure penalties that allow no room for negotiation between supplier and purchaser, current procurement policy heavily favours current over new suppliers. Further, tender policy is not uniform throughout the National State Tender Board, the nine provincial tender boards, the network of parastatals and local authorities nation-wide (Reddy, interviews, 1996,1997; DTI, 1997d). In fact, there appears to be no consistent tender policy that targets black-owned or any other SMME (Potgieter, interview, 1995).

It is not the focus of this thesis to suggest how national procurement policy should be targeted and to which beneficiaries. Our interest is in the potential for interfirm linkages between large and small enterprises to encourage SMME growth, income migration of employees and skills upgrading. Government procurement is one aspect that will have an impact on SMME development. It is here suggested that procurement practices that link large and small firms in a common objective will contribute to short-term employment provision, and will, more importantly, contribute to the skills residue that accrues to SMMEs from linkages with LEs

The needs of emergent SMMEs are often so complex that even a complex array of support services is unlikely to meet all the market driven requirements of black-owned emergent SMMEs. An effective way for emergent business people to acquire skills, access to finance and market access is often through interfirm linkages. Significant policy intervention is often required to encourage greater interfirm linkage activity, as has been demonstrated in Malaysia and Indonesia. The following chapter details the kind of benefit that can accrue to the South African SMME sector if policy encourages greater interfirm linkages.

CHAPTER NINE

WHAT DO INTERFIRM LINKAGES DELIVER TO THE PROCESS OF ECONOMIC DEVELOPMENT?

I was determined to penetrate the market.

Michael Mkhize, Owner-operator, MNH Clothing Manufacturers

Taken together, the three case studies presented, the proposed joint venture between SAW and a newly formed black-owned company, and the review of WISPECO, (beginning on pages 166 and following) present a familiar picture of small and micro manufacturing enterprises in developing economies. While SMMEs have been recognised as a potential significant source of new employment in many developing economies (Mead and Liedholm, 1998) and much of South Africa's economic policy is directed towards creating an environment in which SMMEs can flourish (DTI, 1995; Eastern Cape Provincial Government, 1997; *Daily Dispatch*, 24 September, 1997), there is little evidence that current SMME policy is having a positive effect. The growth of SMMEs in South Africa's economy is often touted by government as the engine of job creation (Department of Trade and Industry, 1995, 1996, 1997), yet recent economic indicators (World Bank, 1996; *Business Day*, 13 November, 1997; *SA Development Monitor*, 1997; Mampone, interviews, 1997-1998) cast doubt about the rate of growth of the economy nationally, and there is little indication of the positive contribution of the SMME sector.

The contribution of SMMEs in the South African dualistic economy is interesting, in that government policy documents assume that existing developed white-owned business in South Africa will have a role to play in the capacity development of the SMME sector. Inasmuch as whatever support established business provides to the emergent SMME sector, higher transaction costs seem inevitable. The question is whether higher transaction costs can be justified in terms of the benefits obtained by large to smaller enterprise linkages, and whether these interfirm linkages provide

greater potential benefits than other interventions to support SMMEs that involve escalated transaction costs. To ascertain tentative conclusions we will draw upon the interfirm linkage case studies cited, in reference to issues that are commonly identified as central to the growth of the SMME sector in a developing economy. These issues are access to credit and finance, acquisition of technology, skills upgrading, development of a culture of work, job creation, labour force development, and gender development.

Access to Credit and Finance

It is generally believed that a lack of credit is a major obstacle to overcome if the SMME sector is to grow significantly in developing economies (Microcredit Summit Campaign, 1998; APEC, 1998; Bowman, 1986). This popular led to the Microcredit Summit in 1997 attended by 2 000 representatives of 145 nations. Some have asserted that this "new world of microenterprise finance" has the "potential to do in finance what the green revolution has done in agriculture - provide access on a massive scale to the poor" (Otero and Rhyne, 1994:1). It remains unclear, however, whether easier access to finance actually encourages the growth and development of the SMME sector (Buckley, 1997).

The research and opinion regarding the finance needs of SMMEs is contested. The literature that has popularised microfinance as an SMME development strategy is widespread (Adams and Fitchett, 1992; Christen, Rhyne Vogel and McKean, 1995; Daly-Harris, interview, 1995), and heralds the ascendancy of microfinance institutions such as Grameen Bank as a substantial answer to an age-old problem confronting eager entrepreneurs hindered by intransigent bankers (Rubinstein, 1994).

It is believed that finance for small business is an obstacle to business development because traditional bankers seldom grant loans to enterprises without significant assets to act as collateral, thus eliminating many SMMEs. But if access to finance for SMMEs is one problem, the repayment history of loans made to SMMEs is equally

problematic. Repayment of SMME loans is unconvincing world-wide, which has been adequately illustrated in the Indonesian and Malaysian case studies and is referred to, yet not seriously engaged as an obstacle, in most of the literature on access to finance (Otero and Rhyne, 1994; Jackelyn and Rhyne, 1991; Yaron, 1991). The momentum for microfinance is being sustained by substantial donor finance, which has left the question of lending sustainability and repayment unanswered (Buckley, 1997). Yet microfinance provision continues to be a current fascination in part because loans are one of the easiest supports to provide for business, and the need for small business finance seems obvious to the casual observer. Indeed, one of the most prevalent plenary comments made at the recent President's Second Conference on Small Business (1997) and highlighted in the conference report is "the need for banks to provide more finance to start small businesses".

Buckley's (1997) study of microenterprises in Kenya indicates that the most successful SMMEs began informally with funding from family, savings or close friends, while additional finance was only sought in the formal sectors after significant business growth. Often outside finance was often first sought after the SMME began employing workers outside the immediate family. Buckley makes the point that lending is most successful and has the most significant impact at a stage of business well beyond start-up.

Several things are evident concerning SMME finance. First, most entrepreneurs begin with very little capital and are immediately reliant upon income from sales to purchase further materials for small-scale production. Research in Africa and Asia does indicate that new SMMEs do emerge despite the availability of only limited amounts of capital (Buckley, 1997; Industrial Bank of Korea, 1989). Buckley's research on credit indicates that there are currently five broad avenues of financial intermediation available to SMMEs in Africa: formal institutions (banks, government and NGO projects), moneylenders, merchants and traders, friends and relatives, and savings clubs.

Buckley (1997) found that the major source of enterprise start-up funding in over 50 per cent of African enterprises is the entrepreneur and his or her family. Individual funds for business start-up were often supplemented by gifts of flexible loans from other family members or friends (Buckley, 1997). The presence of finance made available from formal financial sectors is relatively uncommon in the enterprise formation stage. Finance, though limited is typically arranged through family networks. This finding is buttressed by Fugelsang and Chandler (1991). Chee (1992) indicated that more than 80 per cent of all SMMEs in Malaysia relied only upon family generated funds for start-up and development.

Reading such statistics on finance, it is tempting to assume that greater access to finance would speed SMME formation and development. Such thinking undergirds current South African government and DTI policy formation for the developing SMME sector in this country. Emergent SMMEs face daunting interest rates from commercial lenders, and most are unlikely to qualify for loans at any interest rate in the beginning stages of business development. A consistent theme throughout DTI SMME policy is the high rate of interest charged to South African SMMEs compared with interest charged to similar enterprises in Europe (Zanic, 1997; Brand, 1997). South African SMMEs often face interest rates of more than forty per cent per annum from commercial lenders and often more than one hundred per cent from unlicensed lenders (Mukoki, interview, 1998). Even the SMME development structures envisioned and beginning to be implemented by the DTI charge between sixteen and twenty-eight per cent interest to SMMEs. Faced with high interest rates that have not dropped in line with inflation declines, many entrepreneurs seek alternative sources of finance to start or expand enterprises. Family and community sources have historically played a significant role. The potential for large firms to assist enterprises with finance through access to raw materials, contract pre-payment or other interfirm transfers suggests that interfirm linkages may reduce finance costs for emergent SMMEs.

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It is probably not judicious, however, to assume that those who have not yet set up businesses have not done so because of lack of funds, nor that they would necessarily be able to make the best use of prospective funding for business start-up. At present more than half of all start-up enterprises are funded by the entrepreneur and family. The fact of being able to put together needed financing for business start-up from familial and other related sources can be construed as an appropriate screening device to determine who can best utilise further access to SMME support funding. It can be argued that if a person is not able to attract funds for business start-up (and these funds usually are minimal as evidenced by Somema) from those who know him/her best, it is improbable that a loan from a formal micro credit organisation would be likely to achieve business growth or get repaid.

Providing SMME finance at the start-up stage is likely to create a climate in which loans intended to be used for business formation and requiring repayment may be treated as grants for business or other uses without suitable enforcement of repayment. Effective, targeted and secure access to SMME finance is often a significant feature of interfirm linkages between large firms and emergent subcontractors. While few large enterprises make cash available to SMMEs, other arrangements serve to provide SMMEs with the equivalent of access to working of capital funds. In the Inkqubela case study, PROMAT provided several industrial sewing machines on long term loan to the business, the equivalent of a capital loan, but without interest or repayment schedules. With MNH Clothing, PROMAT provided workshirt material and buttons in bulk to MNH, the equivalent of an advance of working capital without interest charges. PROMAT, with other emergent businesses including Masterprint in Mariasburg, Gauteng, employs a preferred payment schedule that guarantees payment to SMMEs within three days after goods are delivered by subcontractors. This is in contrast to the 45-60 day payment policy employed by PROMAT for established enterprises. Wong (1991:7) came to similar findings regarding the motivation of SMMEs in Japan to link with larger enterprises. He stated that ‘the supply of raw material and the security of knowing that debts will be paid is a significant motivation

for SMMEs to subcontract with large enterprises' even if the per unit profit is less than by selling similar products directly .

Acquisition of Technology

"In the broadest sense, technologies can be classified as any means that creates or adds value, thus including capital-embodied, human embodied or organisationally embodied know-how, know-what and know-why that can be used to enhance productivity" (Wong, 1991:21). When we speak of acquisition of technology amongst SMMEs we are particularly concerned with the elements of process technology (the know-how needed to manufacture products efficiently) and human embodied know-how (the skill of the workforce). These elements of production are deficient in South African SMMEs.

The bulk of evidence regarding the transfer of technology via interfirm linkages has emphasised the acquisition of technological capacity in developing countries as a crucial determinant of successful industrialisation. A number of firm-level case studies have been conducted in several Asian, Latin American and African countries (Katz, 1987; Lall, 1987; Amsden, 1989; Wantanabe, 1987; and Stewart, Lall and Wangwe, 1992 among others). The conclusion of this literature showed that some of this capability accumulates automatically over time as a result of 'learning by doing' (Arrow, 1962), but that much must be acquired through focused, directed activity leading to technological learning - a purposeful commitment of time, and human and physical resources to technological learning (Dahlman and Westphal, 1981). Acquiring technology in the workplace involves less formal research than of practical, workplace problem-solving and technological adaptation to local conditions - the work of running a business in context.

While the prominent research on technological acquisition and industrialisation examines more advanced economies, the contribution of interfirm linkages to technological capacity of SMMEs in South African may be significant. Romijn's (1997) study of technology acquisition in Pakistan's informal metalwork industry

showed that the process of 'learning by doing' may be more important that originally perceived, and that the greatest boost to technological learning is 'upward diversification', that is, copying and reproducing products produced by larger enterprises. Upward diversification has been criticised (Powell, 1991) in that it does not increase the total wealth of technology (few innovations are made by new producers to actually improve existing or invent new technology). Upward diversification does serve to increase the base of workers and enterprises with basic manufacturing skill, knowledge and technology, a critical factor for South Africa's emergent SMME sector, so much of which is severely underskilled due to past historical imbalances.

Access to and acquisition of existing technological capacity promotes greater manufacturing efficiency, develops human capital, and promotes higher user capability of existing equipment (Romijn, 1997). His interesting study of the Pakistani informal metalworking industry found that the adoption of formal training and technological improvements was, not surprisingly, most effective with those workers with a relatively high degree of education (the South African equivalent of matriculation). For less educated workers in Pakistan, on-the-job training with gradual introduction of new methodologies was more effective in developing worker skill. In the case of Inkqubela, a long term linkage with PROMAT initially provided both technology and training in the form of industrial sewing machinery and outside training by the SABS. However, anecdotal evidence and interviews with Inkqubela workers and Eyethu staff (the outside NGO that assisted Inkqubela) indicate that it was the process of working with the new machinery and experimenting with different ways of sewing buttonholes and pockets that actually led to increased efficiency and productivity (Mhlope, interviews, 1993-1994). In the case of MNH Clothing, the process of 'learning by doing' increased the number of workers at a basic skill level necessary for MNH, but did not promote technological innovation. Again, working with an unskilled labour force, the skill acquisition needed was basic: adhere to consistent work hours, learn the most basic sewing skills first and gradually move up the skill ladder from cutting to basic sewing to pockets and buttonholes.

In the interfirm linkages in the three case studies presented, there is some evidence that the larger firm does promote greater use of new technologies by the SMME suppliers. However, the evidence is more profound if one seeks to know whether the interfirm linkage has assisted development of the skill level of the employees affected by the linkage. In this instance of increased skill level, the anecdotal evidence is convincing. It does appear that interfirm linkages between large enterprises and SMMEs significantly contribute to business training and 'learning by doing' in predominately manual labour manufacturing enterprises. The development of basic skills amongst a broad unskilled workforce is critical for future industrial and 'higher' technology development. This point is made forcefully by Sargent and Matthews (1997) who assert that the development of Mexico's high technology sector has come about because of past upskilling of workers who could then quickly develop new skills and technologies within a context of multinational Total Quality Management (TQM).[92] Thus, it may be that one contribution of interfirm linkages is as a work 'incubator' to gradually develop a semi-skilled labour force that can be further upskilled and incorporated into the workforce as higher technology production increases in South Africa.

Developing a Culture of Work

The popular press in South Africa is full of commentary on the declining culture of work in the labour force (Webster, L., 1997; Ensor, 1997; Webster, E., 1997; Grawitzky, 1997a), a sentiment widely echoed in casual conversation. Interviews in each of the case studies and with local NGO fieldwork staff (Mkhize, interviews, 1997-1998; Ntini, interviews, 1997-1998; Ngemela, interviews, 1995-1997; Mpunzi, 1994; Makgato, interview, 1998) indicate throughout the survey that a workplace culture that is competitive with most other industrialised nations is not present among most employees of emergent SMMEs in South Africa. In seeking to make some tentative

[92]The policy implications of this paper concern the development of interfirm linkages and their potential to enhance productive capacity. The comments about upskilling of workers in a TQM environment are equally significant for already skilled workers. TQM in developing countries requires further research and those interested should consult the study by Sargent and Matthews (1997).

assertions on how interfirm linkages might assist the development of a culture of work among subcontracted SMMEs, it is necessary briefly to review the types of work contracts available to workers in SMMEs. Five types of contracts were observed in the SMMEs studied: unpaid family work, apprenticeship, piecework, casual and regular employment. Each of the SMMEs examined employed workers on differing bases and employed different incentives for performance.

MNH Clothing Manufacturers relied most commonly upon piecework employment within a hierarchical manufacturing structure. Piecework payment was especially effective among MNH employees who, it was observed, arrived as early as 7a.m. and worked, with short breaks for meals until 5 p.m. six days weekly. Work was often taken home. At-home work involved unpaid labour that indirectly benefited the household by increasing production of the employed family member. New employees are brought into MNH employment through unpaid or subsistence 'apprenticeships' that can last for several months.[93] Within MNH, the only regular employee who was paid a salary regardless of production was the owner's wife. Casual labour was not observed, though it was stated that some casual workers were employed to assist in filling large orders. MNH employee incentive was primarily the guaranteed payment for each piece produced.

Somema, as a co-operative venture, 'employed' staff on an equal wage basis, depending upon total production revenue. Profits were divided equally at month's end. It was observed that work hours were more irregular, starting and closing times were more variable, and total hours worked per week by employees were less and more irregular in Somema than in MNH Clothing Manufacturers. Month-end wages paid to employees were also less than at MNH. The use of casual labour was not observed and few employees brought Somema work home in the evening, thus limiting the use of unpaid family labour. It was noted that Somema employees did return to use the

[93]It seems evident that apprenticeships are open to abuse by employers who extend apprentice contracts in order to benefit from longer periods of low cost or free labour. This confirms the findings of the World Bank (1995) and indicates a potentially more widespread use of apprentices in the SMME sector than previously noted by Mead and Liedholm (1998).

Somema premises on weekends to do their own sewing for work that could then be sold at an individual's personal profit. It was observed that Somema workers who availed themselves of the opportunity for private weekend work started work between 7:30a.m. and 8a.m. and worked a full weekend day, indicating anecdotally the incentive of pay for work produced. During the SOMEMA work week, the incentive for employees included an equal share of profits for the total labour of the group, relative freedom to come and go from the workplace at will without economic penalty, and close familial and community ties between workers. For those workers who used the Somema premises during the weekend for individual piecework the incentive was direct payment for work produced without sharing.

Inkqubela Sewing Group at Kei Road illustrates another patter in emergent SMMEs with a few employees. Inkqubela was supported in its formative stages by a local non-governmental agency. The support was financial and included training and other support for the SMME. Once the linkage with PROMAT was established, Inkqubela continued to seek out the NGO for various kinds of assistance, including pre-payment for work ordered by PROMAT, Christmas 'bonuses' and incidental loans (Jacobs, interviews, 1996-1998). While the NGO did not provide any of the requested assistance after the third year of Inkqubela operation, a culture of dependency had been established that continues to this day. Workers are paid for piecework, but the incentive of piecework pay is not yet stronger than the desire among most Inkqubela staff to be dependent upon a local NGO with foreign funding.

Interfirm linkages have the potential to develop existing human capital by establishing subcontracting relationships with SMMEs based on strict business practice. Though it has been previously noted that interfirm linkages can (and should) provide SMMEs with flexible and favourable payment schedules for work produced and, perhaps, with preferential access to raw material or capital equipment, the most effective interfirm linkages are those that treat the subcontractor as an independent business with the incentives and benefits resultant from excellent performance. The growth of MNH Clothing Manufacturers typifies such a benefit. Other incentives to the SMME sector,

which may derive from the desire to provide a short term competitive advantage to those sectors historically marginalised in South Africa, may have the effect of prolonging SMME dependence by undermining the development of an efficient culture of work.

This correlates with Neitzert's (1996) study of employment in the Kenyan informal sector which indicates that social factors, including the presence of outside 'beneficiaries', can retard individual workers in seeking the highest wages possible commensurate with their skill. For example, Inkqubela relied upon the local Eyethu RDMC to assume numerous business-related tasks (record keeping, ordering and marketing) for fully three years after the interfirm linkage was established. By accommodating Inkqubela's requests for assistance, Eyethu distorted the market in which Inkqubela operated and, coincidentally, slowed Inkqubela's business learning. In this instance, Neitzert's (1996) caution that most NGOs are not well suited to be agents of business development among the poorest in society seems to be demonstrated. This is often the result of NGOs viewing small business support as essentially a 'we-they' dichotomy in which poor people are viewed as morally good and the private sector (or government) viewed as morally suspect (Clark, 1995). Little research has been conducted on the effect of NGO assistance with SMMEs related to the process of business 'graduation' away from NGO assistance. Mead and Liedholm (1998) demonstrate that many of the most significant constraints faced by SMMEs (access to new markets, access to raw material, development of higher technological know-how) are crucial for business growth and yet are not the kind of services typically provided by NGOs. It is in this area that interfirm linkages have the greatest potential to fill a gap in the development of black owned enterprises manufacturing in South Africa.

Job Creation and Small Business Sustainability

The driving force behind the DTI's SMME support package is job creation (DTI, 1995, 1997a, 1997b; *Daily Dispatch*, 24 September, 1997; Government of South Africa, 1997a). The contribution of SMMEs to the creation and maintenance of new

jobs is a controversial issue around the world. While the government's SMME support package is aimed at creating employment through new enterprise creation, some have argued that SMMEs job destruction capacity renders the net gain in new, long term jobs from SMMEs much less (Nasar, 1994; Birch, 1979, 1987). There are several factors to consider. First, world-wide research (Behrman and Deolalikar, 1989) shows that 55 per cent or more new small and medium-sized businesses fail to survive five years after establishment. The failure rate of microenterprises employing one to five employees is as much as 85 per cent in the first year of operation (Siyawela, interview, 1998). Thus, the job creation potential of SMMEs may be short-lived as well as significantly offset by the number of jobs lost when SMMEs fail.

Somema and Inkqubela businesses were formed by unemployed persons to meet immediate and identifiable market needs within the local community such as school uniforms, dresses, and aprons. MNH Clothing was established out of the Mkhize home, to supplement family income, and to serve similar local market needs. None of the workers at Somema or Inkqubela have had employment in the formal sector. Michael Mkhize was employed formally and left that work to concentrate on MNH when his business grew with the advent of an interfirm linkage with PROMAT.

It may be that SMMEs will rapidly create employment at the micro business level in South Africa, particularly in the retail and hawking sector (Muller, 1998) and rapidly lose jobs through business failure. Retaining the jobs created by emergent SMMEs depends upon developing the capacity of SMMEs to compete effectively and successfully in the marketplace. Significant research shows that most African SMME manufacturers are substantially below the productivity frontier for their country due in large part to an "information poor environment" (Stone, 1997b) characterised by few linkages between firms, weak training, few information sources, and limited access to institutional supports commonly available to larger enterprises. For these reasons, most emergent SMMEs are likely to fail.

Thus it follows that technical skill training alone and in the absence of a specific market-driven demand is not sufficient to create productive SMMEs. Nor is generic new business training such as that intended to be provided by the DTI's Local Business Service Centres (LBSC) or their equivalent Tender Advice Centres (TAC). Advice and training on everything from how to manage small business finances and marketing to how to tender for large corporate subcontracts may well be necessary for small business growth, but the mechanism for providing this service through non-business oriented service providers appears to be flawed in both conception and purpose.

Alternatively, interfirm linkages between large, established buyers and emergent black-owned SMMEs have the potential to add a new factor to the ongoing dynamic of high SMME failure rates. Winter (1995:27) states that in SMMEs "the level of economic success and dynamism achieved is roughly proportional to the degree to which the enterprises are embedded in institutional support systems one level up." This derives from the market distortions that arise in SMMEs as a function of size. SMMEs do not have equivalent access to the flow of information, to raw materials, to markets and to economies of scale (including technology and expertise) that larger enterprises have.

These market distortions that disadvantage SMMEs could theoretically be addressed by government, but that kind of institutional support for small business is not provided effectively by governments even in advanced countries (Meyanathan, 1994; Winter, 1995). Thus, potentially the most effective model of SMME support in South Africa is not to provide by grand, society-wide government institutions that target generic assistance to a particular sector. Rather, SMME support is best found 'one level up' in market-related support and capacity development provided by larger firms to subcontracting SMMEs through interfirm linkages. The summary may be: ask not what can be done to support the innumerable SMMEs; ask what can be done to encourage and support the less numerous but potentially more valuable links between large firms and their smaller subcontractors.

Labour Force Job Migration

As with developing technical skills for a specific job, it is hypothesised that once a worker acquires a specific skill for a particular job in manufacturing, the resultant pay-off in monetary and job satisfaction terms will lead to a further quest by workers to acquire and develop additional skills and higher paying jobs (Toomey, 1998). While the topic requires further study, House, Ikiara and McCormick (1990) appear to have confirmed that upward job migration along with skill development is a dynamic in the Kenyan SMME sector. Interfirm linkages provide a channel of upward mobility for SMME workers, for both skills and employment. In fact, it may be that within the framework of an interfirm linkage exists one of the most effective ways to implement affirmative employment practices. That is, linkages provide ready opportunity for larger enterprises to identify promising employees within the linked SMME who might benefit the larger enterprise. While the departure of most skilled workers to larger enterprises may contribute to the failure rate of SMMEs, in the overall context of economic development, it is surely beneficial to identify and encourage those market forces that encourage skills development and worker initiative, as can be the case with upward job and skill migration through interfirm linkages.

Deepening the Structure of Employment

The structure of employment in South Africa continues to reflect apartheid history in what the Overseas Development Institute (1995:2) described as "the dominant interest of the old South Africa was the very small number of large corporate groups…whose relative status was enhanced and supported by institutionalised racism." Looking deeper than just the continued white dominance within the economy, and the high rates of black unemployment,[94] the structure of black employment offers scant hope of rapid black economic growth. Government agencies in the Eastern Cape state with a sense of resignation that, "Unemployment is growing at an alarming rate, and the formal economy does not have the capacity alone, to provide sufficient new job opportunities" (Eastern Cape Province, 1997:9). Faced with this reality, too many present

[94]Black unemployment continues to be reported at rates from 25 per cent to 55 per cent or more, depending upon source (DTI, 1995a, 1997c, *Eastern Cape News*, 30 October, 1997).

government initiatives to support SMMEs have focused on improving generic skills, with particular reference to the retail sector.

The trends in black employment in South Africa indicate that average black wage income has increased 4.5 per cent per year over the past two decades, but that the wage improvement increasingly favours higher income classes of blacks where education, training and experience contribute to sustained improvements in productivity and wages. The poorest quintile have experienced steadily decreasing wage income. Employment growth for all but the most highly paid blacks has been stagnant for the past decade. The highest rate of employment growth in the last decade is in the informal sector which has grown by at least 27 per cent (Government of South Africa, 1997b).

Despite inadequate statistical evidence on current employment, Ntsika (1997a) estimates that the predominant sector for employment growth will be in the survivalist informal retail sector. The migration rate from retail survivalist activity to more labour and capital accumulative small-scale manufacturing is quite low. Given that the manufacturing sector tends to provide greater potential for creating additional jobs than does the retail sector, a strategy to encourage and diversify small-scale manufacturing would appear to be a credible policy decision.

Interfirm linkages can assist the deepening of the structure of employment in South Africa by providing avenues for entry into manufacturing that might not otherwise have been available. In the case of Inkqubela, most of the women had previously been hawking in the retail sector. The opportunity to form a small scale sewing business arose because of the intervention and advocacy of a local non-governmental agency who provided initial support structures in which a linkage with PROMAT was

mediated and became possible.[95] Small-scale manufacturing and other sectors which require greater skills than retail will especially benefit by the 'learning by doing' aspect of manufacturing interfirm linkages.

Gender Development

Virtually every policy document and item of legislation in South Africa even remotely concerned with SMME development targets women as one of the historically disadvantaged groups intended to receive highest priority for SMME support (DTI, 1995, 1997a, 1997b, 1997c, 1997d; Government of South Africa, 1997b; Ntsika, 1997a, 1997b, 1997d). Yet, implicit in many policy documents is an assumption and expectation that women are and will continue to be concentrated in the informal sector. This is made evident by the recent Ntsika survey of Small Business in South Africa (1997e) indicating more than 70 per cent of women who contribute to family income do so through informal or unregistered work, largely hawking. Further, the targeted government SMME support suggested in many of the above documents focuses on increasing the volume of business (through credit access and preferential tendering) and regularising the tax status of women entrepreneurs rather than developing the skills of women in order to increase business migration from retail to manufacturing. Interfirm linkages in South Africa can enable the migration of women from informal to formal employment, and from retail to manufacturing.

The discussion here is based largely on research of women's employment in Botswana, Kenya Malawi, Swaziland and Zimbabwe conducted by Mead (1994) in which most, though certainly not all, women's employment tends to be informal and survivalist. Expansion of this type of employment (exemplified by the early stages of both Inkqubela and Somema) could be seen as a reflection of an economy's failure to

[95]With Inkqubela, as with WISPECO, one learning is that an ally for an interfirm linkage is often a necessary prerequisite to bring emergent SMMEs to the attention of larger enterprises and then to monitor the relationship as it develops. These transaction costs, outside the formal interfirm contract, may be the subject of South African government support once such linkages are formed. As government's persuasive power is increasingly directed to encouraging interfirm linkages, active linkage partners will be sought by larger enterprises and lessening the necessary role of the local hero. This follows the pattern of government encouraging interfirm linkages in Malaysia.

develop in ways that provide rising levels of welfare for the majority of the people. The opposite corollary is when small enterprises grow in response to demand and increasingly incorporate women as employees.[96] Studies of African non-farm employment[97] conclude that the overwhelming number of such enterprises are small and predominantly survivalist (Page, 1979; Liedholm and Mead, 1987). While studies show that women account for a large proportion of both management and employment in African non-farm enterprises in other countries (Milimo and Fisseha, 1986), and many survivalist enterprises are women-owned in South Africa, there appears to be little migration from retail to manufacturing amongst women entrepreneurs. In the cases of Inkqubela and Somema, women began survivalist manufacturing of clothing (usually one-person operations) in order to meet informal retail demand. Linkage with a larger enterprise assisted both businesses to migrate from informal and survivalist manufacturing to fully formalised manufacturing and up-stream linkage.

Current South African SMME support for women is general and fragmentary, epitomised by statements such as: "[L]ocal government can create employment and income generating opportunities for women entrepreneurs by only giving contracts to women entrepreneurs or local tenders who conform to a particular gender profile" (van Donk, 1997:2). The result often is limited assistance to women entrepreneurs who are treated as 'development projects' and who are consequently overly protected from the demands of the marketplace, and thus fail to develop competitive skills.

Still, women do enter the marketplace at a significant disadvantage. Due to educational disparities women are less likely to have as much technical training as a man and may be less marketable to potential employers. A woman is also less likely to know other women who are potential employers, thus encountering possible discrimination by the predominantly male employers. Women may be less likely to be able to network between female contacts for future employment. If then, women's ability to move in

[96]A fuller discussion of alternative paths to economic development can be found in Haggblade, Hazell and Owen (1989).

[97]Comparable studies have not been compiled for South Africa.

the job market is more limited due to gender, what strategies can be most effective to assist employment growth among women?

Legislation protecting or promoting the rights of women in the workplace often has the reverse effect if legislation is not accompanied by concrete strategies that actually improve the attractiveness of women to the manufacturing environment. Neitzert (1996) reports that faced with minimum wage legislation aimed at women, many small scale manufacturers in Kenya resorted to extended periods of ‘apprenticeship’ to maximise profit through labour intensity and avoidance of legislated wages. Similarly, Bangladeshi textile manufacturers often employ the same workers, day after day, on a casual basis (World Bank, 1995) to avoid wage regulations. While such policies would not be legal under South Africa’s Labour Relations Act of 1998, the point remains that legislation often serves to increase the incentives to avoid compliance.

Interfirm linkages, on the other hand, can serve to increase the incentives for SMMEs that may currently employ women to their disadvantage, to formalise and improve the conditions of women’s employment through the pressure exerted by larger firms on SMMEs to operate in a legal and open environment. Few larger enterprises, cognisant of the damage to a firm's reputation that can come from shoddy employment practices, will engage in downstream linkages with SMMEs that engage in suspect employment practices. Thus the lure of contracts with larger enterprises and the ongoing monitoring for quality and performance undertaken by the large firm may have some positive effect on improving work conditions for the least skilled female employees in the manufacturing sector.

Generating Learning Benefits

There is a broad literature on technological learning by developing countries which suggests that the *process* of acquiring or transferring skills to emergent enterprises is not simple (Heyer, 1996; Romijn, 1997; Cappelli, 1993). Neo-classical thought about enterprise development assumes that technology and knowledge is freely available to all and can be acquired freely, based on the needs of the enterprise. In this model, there

is little need to intervene to assist the process of technology and knowledge acquisition.

Of course, knowledge, technology, and access to both are not equally available to emergent entrepreneurs in developing countries as they are in industrialised nations. Factors of education, information technology resources, available equipment and access to capital are a few among many factors that inhibit technological acquisition in developing countries. In South Africa, those factors are compounded by the legacy of apartheid that has put most black owners of SMMEs at an even greater disadvantage.

Therefore, technological mastery and 'learning by doing' are not products that can be automatically transferred like a physical product (Lall, 1996). The mastery of new skills or production methods, let alone the ability to use new technology efficiently, requires the recipient to make a significant investment without the certainty of return. For most SMMEs the investment will not be quantified in monetary terms, but will be measured in terms of opportunity costs, and the slow process of learning new techniques which tends to retard business efficiency in the short term (Nelson, 1981). The process of skill and learning acquisition may appear to be relatively short and cheap where the equipment is simple and the range of skills limited. This is largely the case we find with emergent SMMEs in South Africa. But as Stiglitz (1987) pointed out, the process of learning may be distorted or abandoned as impractical if firms do not know how to go about learning, how much it will cost, how long it will take and where to look for needed information and skills on such training. These factors of the 'learning to learn process' will, in many instances, cause larger enterprises to forgo linkages with SMMEs with vastly different technological (in the broadest sense of the word) capacities. In a totally free competitive environment, most industries will bypass links with SMMEs in favour of more established and proven suppliers (Hibbit, interview, 1998). Similarly, some SMMEs (Somema, for instance) will choose to forgo linkages with large enterprises because effective linkages most often require significant changes in SMME operations.

Cardoza (1997) shows that acquisition of technological capacity and process know-how is a critical factor in SMMEs' success, a view confirming an earlier study by Wong (1991) in which 45 per cent of all Japanese SMMEs indicated that access to improved technology and know-how was a primary motivation for engaging in subcontracting.[98] LEs will only devote resources to transferring technical know-how to SMMEs if the expected returns outweigh the costs. In the South African context the direct and indirect costs of interfirm technical linkages is expected to be high given the relatively low skill levels among most SMMEs, the need to provide some SMMEs with very basic business skills, and to engage in intense communication between most SMME suppliers and LE buyers. Subsidisation of, at least, a portion of the expected transaction costs is a necessary role for government. Numerous findings indicate that the timing of such support (after the start-up stage), the duration of subsidies (at least two years but probably less than five), and targeting the subsidy to actual on-the-job, demand-driven needs are essential elements to successful policy implementation (Tendler, 1997; Mead and Liedholm, 1998).

The capacity gap between LEs and SMMEs, and an increasingly competitive environment, clearly indicates that little skills upgrading will occur within SMMEs unless the interactions between LEs and SMMEs can be assisted through interventions that provide incentives for such learning links. Protection of emergent industries is a historically popular intervention to develop SMME capacity. However, apart from the increased cost to the consumer that protection introduces, it dilutes any incentive to invest in capability development. Protection undermines the very process it was meant to foster.

Interfirm Linkage within Industrial Clusters

Clustering together LEs and SMMEs that are producing similar or complementary products is a world-wide tested strategy for creating an environment for the transfer

[98]Both Wong and Stone indicate that higher prices and greater profit do not figure as positive factors in SMMEs' decisions to engage in subcontracting. In fact, Wong (1991) and Meyanathan (1994) indicate that there is some evidence that unit cost for items subcontracted to SMMEs are often less expensive than the same units produced by traditional suppliers.

of 'learning by doing' skills and expertise. Developing and developed countries as various as the United States, Mexico, Singapore, Japan, Slovakia, Italy and Malaysia have utilised industrial or manufacturing clusters to increase outsourcing and subcontracting, develop SMME capacity and lower finished-product price. Most commonly, manufacturing clusters in developing countries (and in some developed countries) are areas in which, through targeted incentives, government attracts new industry to establish production operations (Wong, 1994; Advani, 1997). Clustering in South Africa emerged from a study of world-wide best practices undertaken by the Gear technical team seeking the most effective methods for enhancing the underdeveloped SMME sector (Heher, interview, 1997). Once an LE is established in a site, an attempt is made to draw SMMEs of all skill levels to set up business nearby, often in accommodation that is partially or totally subsidised for a specified period. Interactions between clustered enterprises are then often left to develop organically, though in many instances additional incentives (such as those previously mentioned) are offered to induce initial business interactions (Barnard, 1996; Heher, interview, 1997).

It has been the long term plan of the DTI to establish industrial clusters in eight to twelve sites nation-wide, including Port Elizabeth and East London (DTI, 1995a, 1995b; Government of South Africa, 1996b). During 1996 and 1997 the Department of Trade and Industry (DTI) conducted 16 industry-specific cluster studies aimed at understanding the potential for beneficial downstream linkages that existed in the manufacturing sector. Building upon the above-mentioned studies, the DTI launched a new cluster programme in June 1997 which takes the next step to begin addressing sectoral strategies for establishing manufacturing clusters.[99] Unfortunately, the idea of manufacturing clustering was itself clustered with the political need to promote economic development in certain geographic areas. Clustering thus became part of spatial development initiatives (SDIs) that are in the planning stages for the Maputo

[99]Clusters are planned in these sectors: wool and mohair, jewellery, plastics, electrical appliances, mining equipment, cultural industries, wheat, milling and baking, and textiles (DTI, 1997).

Corridor, the Eastern Cape Province SDI and the Mabopane-Centurion Development corridor, among others.

While there is nothing inherently wrong about utilising industrial clusters as part of a larger economic development initiative, it does appear that the opportunity to support SMMEs through clusters has been minimised and the opportunity to regularise existing businesses for tax purposes has been emphasised. This point is clearly evident in the Mabopane-Centurian Development Corridor (M-CDC) publicity stating that "effective tax assessment and collection" and "uniform property valuations" are among the chief goals of the M-CDC (1997a:2; 1997b:1)

The value of clusters to manufacturing development and eventually job creation is that clusters provide significant opportunity for interfirm interactions and linkages that are mediated by market forces rather than government coercion and intervention. As such, whatever can be done to assist and promote the development of manufacturing clusters will probably have a positive effect on the growth of manufacturing SMMEs and interfirm linkages.

In summary, interfirm linkages between two willing partners provide avenues for SMME development within a market context. Many of the obstacles that traditionally confront emergent entrepreneurs world-wide can be successfully addressed by a linkage relationship. It is significant that some of the most successful interfirm linkages are those in which both parties adopt a problem-solving approach, for problems with SMMEs are abundant. The problems most frequently cited by large enterprise doing business with SMME suppliers are those that are least able to be adequately addressed by the type of generic business training that is envisioned by the DTI in its SMME support strategy. The failure of the proposed SMME training to adequately expose small business to the risks of the marketplace can be addressed by encouraging interfirm linkages as has been discussed. It is a strategy that requires resources and long term commitment. If world-wide experience is accurate, interfirm linkage is also a

strategy that might gradually enable the development of a vibrant SMME sector in South Africa

CHAPTER TEN

CONCLUSION

> I think government knows very little about business and they do not show commitment.
>
> Comment by participant at the President's Second National Conference on Small Business, November, 1997

Assuming that one of the greatest challenges facing the South African government in the coming decades will be economic growth that brings tangible benefits to the vast majority of the population, this thesis addresses the issue of small, medium and microenterprise (SMME) development. SMMEs are playing an ever increasing role in the industrial structures of developing countries around the world. Changes in technology, management techniques, vertical disintegration of multinational enterprises, and international subcontracting are trends that have led one major periodical to envision "the incredible shrinking firm" as the industrial wave of the future (Economist, 1990: 65-66). Meanwhile the South African manufacturing sector is highly centralised, dominated by a few large enterprises and protected by tariffs and market access from significant competition whether internally or externally (though these protections are being phased out) (*Economist Intelligence Unit*, 199:32-33). In contrast to rapidly developing economies elsewhere, South Africa's economic structure is a dinosaur, based as it is in mining, heavy manufacturing and protected consumer goods.

South Africa's economic and state planners face an archetypal development question: how and how much should the state intervene in the markets in order to advance particular social, political and economic objectives? As we have seen, nearly every state exercises legitimate intervention in economic transactions, and some Asian economies have been profoundly successful in targeting certain industries for preferences that aid global competitiveness (notwithstanding current Asian turmoil). There has been some fear, as yet unfounded, that the political pressures of job creation

and wealth redistribution facing the new government would cause the South African state to intervene in the economy in ways that would hinder long term global integration and undermine the growth of competitiveness (exchange controls, protectionist tariff structures, a slowdown of privatisation, and limitations on capital flows).

This thesis starts with the assumption that economic growth in South Africa is predicated on significant global economic integration. The economic stagnation of sub-Saharan Africa from 1965 to 1985 and Africa's consequent further marginalisation in the world economy is seen by many, including South African policy makers, as a result of excessive state intervention in national economies. Too often interventions were designed to promote the financial interests of a small elite, or create public employment for political and social purposes, or protect non-competitive heavy industries. Such intervention nearly always resulted in a drag on economic growth (World Bank, 1995b). Structural adjustment programmes in which markets and terms of trade are opened to international market forces have been policy vehicles to lessen state intervention in developing economies, reform public employment, and design labour policies that are attuned to global market realities.

South Africa's Gear economic plan, the economic development framework of the nation since 1995, clearly adheres to essential elements of structural adjustment. Global economic integration is assumed by policy makers. The desirability of globalised economic development is contested, however, and structural adjustment policies have been roundly criticised. While much criticism of adjustment stems from the hardships caused by the dislocation of non-productive state employment and the withdrawal of financially unsound social spending, the most profound criticism is that structural adjustment changes and diminishes the role of the state as the central agent of economic development. This changed role of government in economic planning is especially pronounced in sub-Saharan Africa which experienced two decades of stagnation under highly centralised state development policies (Frischtak, 1992).

It is simplistic and incorrect to assert that the state has no role in development. The developed countries of Europe and North America have a long history of intervention designed to make certain products and industries internationally competitive. Similarly, the economies of the Asian Miracle have exercised a blend of market interventions designed to promote certain industries and sectors together with significant investments in human infrastructure and research to strengthen industrial growth. Asian state intervention created an environment in which a profitable export-oriented industrial sector of international quality could grow. State intervention supported industries that added value to primary materials before export, improved and maintained quality, provided financial incentives to produce technical components domestically, and encouraged the growth of skilled labour.

The state does have an important role in the economic growth of developing countries; a role of facilitating the flow of resources needed to generate vibrant growth, primarily n the private sector. The 'facilitating' state, as modelled in the high performing Asian economies (HPAEs) and in Ghana in sub-Saharan Africa has distinguishing characteristics. These include cautious market interventions that select certain industries for preferential support, (though not necessarily protection from global competition). Preference can be in the form of increased technical capacity, investments in research and development, product quality benchmarks, and the provision of industry-specific production-process and market information. A review of Taiwanese state intervention and support of the bicycle industry in two periods, from 1949 to 1962 (when bicycle production was protected and of low quality) and from 1969 to the early 1980s (when production was linked to international demand, and quality and product development were state-enforced) provided one view of how a facilitating state assists in small enterprise development.

Political activity of the 'facilitating' state includes developing consistent and coherent economic policies that encourage global integration and reduce the costs of doing business locally and internationally. The pressures for rapid economic benefits to accrue to the majority of the populace in South Africa makes a 'facilitating' role for the

state more difficult. The intense criticism of the Gear policy framework is ample evidence.

In summary, the foundations for a growing entrepreneurial sector include such features as: (i) the ability of all individuals to engage in secure and consistent transactions in market conditions that are consistent and well known, (ii) the ability to compete on a level playing field with other similar enterprises without preference awarded to certain firms, (iii) elimination of automatic preference for state-owned enterprises, (iv) the development of a system of skill and technological growth within enterprises, and (v) an efficient infrastructure to support business development (Iskander, 1996; Synergos, 1995; Jackelyn and Rhyne, 1991).

South Africa faces the complex challenge of reducing the regulatory protections enjoyed in certain sectors while increasing job creation and doing so with a vast pool of unskilled labour. The extensive market failures associated with apartheid, and the need to quickly create employment and redistribute wealth, have engendered new debate as to the role and degree of state leadership necessary to bring about economic transformation in South Africa. Despite the failure of state-led economic planning in Sub-Saharan Africa in the past two decades, and notwithstanding the Asian model of a less intrusive 'facilitating state' the market oriented approach of GEAR is widely unpopular with the majority of African National Congress supporters (Grawitzky, 1997b) who believe that the state should redirect additional resources to the alleviation of the egregious results of apartheid through rapid erection of houses, clinics and schools. Elimination of regulatory protections remains politically unpopular if precious jobs are put at risk.

As illustrated in the Taiwanese case and supported theoretically (Arrow, 1962; Solow, 1956, 1997; Tendler and Amorim, 1996; World Bank, 1995) the development of a human resource infrastructure that will enable South African industry to compete internationally is vital to the growth of small business. Presuming that the key to economic development in South Africa rests with the capacity of the majority of the

population to compete effectively in global markets, this thesis suggests that economic development in South Africa will be successful to the degree that labour is enriched with marketable skills. Human capital investments[100], when combined with market-driven education, training, and increases in physical capital were a significant element in the rapid growth of the HPAEs. Government plays an important role in directing and facilitating such market-driven investment in human infrastructure.

Chapter Five reviews the theory and proposed implementation of numerous government strategies to promote small business development in South Africa. The Department of Trade and Industry (DTI), along with the Departments of Finance and Labour have made a positive and significant contribution to the understanding of the obstacles which constrain the SMME sector in South Africa. There is, however, a gap between the substantially sound understanding of the obstacles restricting SMMEs in South Africa and the proposed policy solutions. In essence the DTI suggests that provision of generic business skills, targeted support for subsistence retail trading and agriculture, and access to low cost finance at the start-up level will be sufficient to boost SMME growth. Unfortunately, this approach ignores most SMME support experience world-wide, while it further fails to acknowledge the considerable need to develop the skills of the labour force. World-wide best practice tends to indicate that business skills are best acquired in the competitive market environment rather than through training programmes, that retail hawking operations have a high rate of business failure and seldom lead to substantial capital accumulation, and that the value of access to finance at the start-up stage is hotly contested. One might conclude that the South African strategy for SMME growth is supply-driven while experience from other developing economies suggests that demand driven-support for SMMEs is more likely to be effective in the long term.

Interfirm linkages between large enterprises and SMME are one strategy for developing a skilled labour pool, achieving market competitiveness, and providing

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[100] Human capital investments include access to formal and informal education, nutrition and primary health care.

access to finance and technology for emergent entrepreneurs. Malaysian and Indonesian SMME development strategies have experimented for some years with interfirm linkages as a mechanism to meet some of the needs of emergent entrepreneurs within a true market environment. The Indonesian experience concluded that the manufacturing sector (rather than retail or agriculture) should be targeted for SMME support. Further, long term SMME development required a significant investment in human capital and skills development. Access to finance was troublesome, both in theory and practice, and the Indonesian experience reflected the need for further study before concluding that finance is an inherent obstacle to SMME growth. In fact, the inconclusive experience of Indonesian strategies for SMME finance was, in part, responsible for the establishment of the Indonesian Foster-Father Business Partner programme which linked SMMEs with larger enterprises for sub-contracting and outsourcing. From the development of business partner linkages has arisen a substantial record of gradual improvement in the skill level and business acumen of Indonesian SMMEs.

The Malaysian positive experience with interfirm linkages is even more pronounced. Malaysian linkages have succeeded in providing emergent entrepreneurs with access to competitively priced raw materials, new market opportunities, market and demand-driven process technology training, new technological applications, and access to finance. Both the Malaysian and Indonesian experience showed that interfirm linkages, when designed so that both the larger and smaller enterprise obtain benefits, had the effect of creating an environment in which SMMEs could develop successfully. Further, in both cases the state played an important role of promulgating the linkage concept and facilitating the actual linkages between enterprises. In the formation of business linkages, there is healthy debate about the degree of persuasion or coercion that was exercised by the state. Clearly, though, the state has an important role to play in enabling linkages and providing incentives to ameliorate the increased transaction costs associated with such interfirm linkages.

Interfirm linkages are new to South Africa, though business involvement in development is not. The change of business focus from corporate social responsibility donations for good works is developing gradually in South Africa. Three case studies of interfirm linkages between large enterprise and SMMEs were considered. Additionally, a new joint business venture between an established textile producer and a new black-owned and operated company with a creative approach to increasing black equity ownership was reviewed. Each of the SMMEs in the case studies faced the obstacles typically encountered by emergent entrepreneurs anywhere in the world. While the case studies showed different degrees of success, there was clear evidence that interfirm linkages bring benefits to both large and small enterprises. For large enterprises, the actual per unit product cost in many instances was less when produced by an SMME than when purchased from previous suppliers. In the South African political climate, an enhanced 'profile' benefit accrues to large enterprises linked to emergent SMMEs. SMMEs benefit substantially from interfirm linkages in predictable ways: increased employee skill levels, greater market access, access to raw materials at advantageous prices, and access to finance.

Several case study findings were unexpected. First, there is indication that interfirm linkages are quite successful in raising skill and income levels of SMMEs to a certain wage threshold above subsistence. There is less evidence that SMMEs linked to larger enterprises exhibit a desire for business expansion, accumulation of capital, or acquisition of competitive advantage in the marketplace. While not conclusive, there was some indication of employee complacency once a wage level above subsistence had been achieved.

Second, in the absence of government policy to encourage or coerce interfirm linkages, most relationships between large and smaller enterprises came about as the result of an internal or external ally who facilitated the initial contact between the enterprises. This was evident particularly in the case of WISPECO (internal), Inkqubela (external), and Somema (internal). The potential for NGOs to fill this role of external linkage champion needs to be investigated further. Given that numerous NGOs throughout

South Africa benefit from corporate social responsibility grant-making, it would appear that NGOs would be in a prime position to facilitate links between the South African corporate sector and emergent entrepreneurs. It appears that few NGOs have taken on the role of business linkage 'matchmaker', perhaps because of an inherent distrust of the motives of the private sector.

Third, the problem-solving approach adopted by the technical staff of large enterprises linked with emergent SMMEs was highly regarded by SMME entrepreneurs. This feature of South African interfirm linkage was not noted in studies of Malaysian or Indonesian linkages, nor in the work of Tendler and Amorim (1996) in Brazil. Large enterprise staff in South Africa appear to assume that an intense working relationship, including skill development, is an inherent part of doing business with SMMEs. While the capacity deficits imposed upon emergent entrepreneurs because of apartheid were seldom mentioned by large enterprise staff, a problems-solving approach when working with SMMEs was common among all large enterprise staff who were interviewed. This sentiment would seem to provide a firm foundation for the development of an interfirm linkage policy by the government.

Fourth, the issue of access to finance for SMMEs is problematic. It is not clear from the evidence in our case studies that access to external finance is primary among the needs of SMMEs in the start-up stage, nor is it clear from world-wide practice when and how access to finance is needed at the developmental stages of SMMEs. While the case studies make clear that interfirm linkages can assist with some form of finance (advance contract payments, provision of raw materials or advanced technology) it is not evident how interfirm linkages might assist capital needs for business expansion, especially if the business grows beyond only servicing the larger enterprise to which it is linked.

Fifth, the income migration that is demonstrated in the case studies before and after the initial interfirm linkage appears to be impressive, but is quite fragile, often relying upon one individual to champion the cause of linkage. In the absence of and encouraging

policy, linkage between SMMEs and LEs is likely to remain under-utilised. The relationship between income redistribution and participation in interfirm linkages has not been studied sufficiently, though there is some indication in Indonesia that the promulgation of interfirm linkage policy did coincide with a period of decreasing income inequality. It would be most productive to study income data in a time series regression targeting rural and urban interfirm linkage participants to assess the impact of the Kuznets' hypothesis.

While the case studies do not prove that interfirm linkages are the single best means for developing SMMEs in South Africa, it is valuable to note that the studied SMMEs did grow significantly and across a spectrum of measurements while linked to one or more larger enterprises. Their growth fulfilled the goals of the DTI's *National Strategy for the Development and Promotion of Small Business in South Africa* (1995a). The SMMEs studied in this thesis did so without using any of the resources proposed by the DTI as outlined in Chapter Five and in the National Small Business Act (Government of South Africa, 1996b).

Perhaps most compelling is the potential long-term residue that accrues to a nation engaging with interfirm linkages. Employment, production know-how, tested business management skills, SMME access to sophisticated market information, a more skilled labour force, diffusion of technology, a developed culture of work and energetic competition among SMMEs are benefits that can be expected from interfirm linkages. The costs of establishing such linkages should not be absorbed entirely by either SMMEs (through lower wages) or by LEs (through cross subsidisation). Policy intervention to encourage linkages within the private sector and to absorb a portion of the increased costs, would be a welcome 'facilitating' role for the state in South Africa.

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