

## **5 SME Promotion Policies, Programs, Institutions, and Activities**

### **5.1 Policy Direction for SME Development**

#### **5.1.1 National Small Business Strategy**

The National Strategy for the Development and Promotion of Small Business in South Africa constitutes the basic national policy document on SME promotion. The Strategy is quite comprehensive, and includes visions, objectives, basic principles, support frameworks, organizational restructuring, and action programs for the period through 2005.

There is no consolidated law concerning SMEs and their promotion. SMEs are therefore regulated by applicable laws and regulations governing respective fields, including finance, taxation, employment and labor, and business deals. On the other hand, some SME promotion organizations are founded upon special acts that give them authority and power.

The National Strategy recognizes the need for a comprehensive SME promotion law, as seen in successful examples in other countries, and calls for at least legislation on business transaction, government procurement, and financing.

Meanwhile, laws and regulations related to SMEs have been reappraised in the National Small Business Regulatory Review, which evaluated the existing legal system from the standpoint of effects on SMEs and made recommendations, based on which amendments are considered (with some amendments effectuated).

#### **5.1.2 Background**

In March 1995, the new administration submitted a White Paper to the Parliament, delineating its intention to promote employment and economic growth through development of SMEs. The White Paper gives particular attention to the contribution by SMEs to the Reconstruction and Development Program, through, namely "The National Strategy for the Development and Promotion of Small Business in South Africa ("Strategy"). The Strategy was derived from the "Discussion Paper on Strategies for the Development of an Integrated Policy and Support Program for Small, Medium and Micro-Enterprises in South Africa, which was submitted by DTI (then MTI) in October 1994, based on which extensive discussions were held at 60 workshops throughout the country. As the Discussion Paper was prepared so as to reflect opinions of SME related organizations and other related parties, and as the Strategy was made to take into account a number of comments and proposals, the Strategy covers a broad range of issues to be

addressed and sets forth a strategic direction of SME promotion on the basis of previous experience including lessons learned.

Nevertheless, in 1995, the government was still in transition from the previous administration when comments and proposals for policy reforms were received from all concerned organizations, groups and individuals. Thus, the Strategy was positioned as the basis of the transition and reform process to be implemented over a long period of time, rather than as a proposition of a general framework for SME promotion.

### **5.1.3 Basic standpoint and objective**

The Strategy consists of the following seven parts:

- 1) Process and vision
- 2) The small-business sector in South Africa's economic development
- 3) Objectives and principles
- 4) Elements of the support framework
- 5) Institutional reform
- 6) Action program
- 7) Funding the national strategy

#### **Basic standpoint**

Subsequent to the elections of April 1994 the issues of economic empowerment and growth have been placed high on the agenda of the Government of National Unity of South Africa. With millions of South Africans unemployed or underemployed, the government has no option but to give its full attention to the fundamental task of job creation, and generating sustainable and equitable growth.

The Strategy, in its Foreword, positions SMEs as an important means to achieve the goal. It points out that SMEs worldwide have been playing an important role in employment, penetration of new markets, and creative and innovative economic growth and expansion, and sets forth the basic standpoint of SME promotion in the country, namely to leverage such characteristics of SMEs as these, and enable them to contribute to diversification of the South African economy, productivity improvement, investment promotion, and the stimulation of entrepreneurship.

At the same time, the Strategy sets forth the desirable role of the government sector in SME promotion, namely that the government is to make maximum efforts to improve the business environment, while sustainable and balanced growth should be promoted under the leadership of the private sector.

### **Objective of SME promotion**

Based on this point of view, the national strategy sets the objectives for small business development as follows:

- To create an enabling environment for small enterprises
- To facilitate greater equation of income, wealth and earning opportunities
- To address the legacy of apartheid-based disempowerment of black business
- To support the advancement of women in all business sectors
- To create long-term jobs
- Stimulate sector-focused economic growth
- Strengthen cohesion between small enterprises
- Level the playing fields between bigger and small business as well as between rural and urban businesses
- Prepare small businesses to confront the challenges of an internationally competitive economy

### **5.1.4 Commitment to SME promotion**

#### **Government stance**

In the Strategy, the government states its policy stance in SME promotion as follows:

- 1) To see the different segments of the SME sector as closely interconnected parts of the larger economy, which also includes big(ger) businesses, multinationals, parastatals, NGOs and other non-business activities.
- 2) To commit towards a dynamic, demand-driven and creative approach which in the first instance recognizes the multiplicity of needs of SMEs, with a breaking away from the traditional and static approach to small business development based narrowly on the provision of financial support.
- 3) To apply a “fee for service culture” to the small-business sector; wherever possible services received by enterprises should be paid for.
- 4) To link to compliance with generally accepted standards of business behavior. This relates as much to labor and managerial standards as it should apply to taxation, sector registration and reasonable social standards as well as financial and costing disciplines of firms, both small and medium in size.
- 5) To make small firms be dynamic and highly competitive, while striving for socially acceptable labor standards, adopting new and more efficient technologies and effective work organization techniques. This can be achieved through a range of organizational practices which include increased co-operation, co-ordination and

networking among smaller firms in specific sectors so that services such as marketing, research and development, skills acquisition and even production can be shared.

- 6) To regard the demand side of the small business sector as an important factor in SME growth and development. Thus, the national framework will include steps to improve access of small enterprises to state procurement, big business purchases and export markets.
- 7) To place emphasis on black advancement in the enterprise sphere, including in this context all the groups disempowered through the apartheid era.
- 8) To recognize the scarcity of public resources available for SME support constitutes a fundamental constraint upon all support policies.
- 9) To accept the market orientation of the economic system and of the government's fundamental budget constraints, and look at alternative funding, the leveraging of public funds, the effective use of foreign donor funds and technical assistance, the introduction of tax and other incentives to change private-sector attitudes, and self-help or local community efforts to support small enterprises.
- 10) To accept as a fundamental principle that the overall share of budget support available for small enterprises - at central, provincial and local government level - is currently too low compared to the important role of this sector in the economy
- 11) To curtail the range of support programs, at least in the initial years given the wide range of constraints or problems experienced by small enterprises and given their diversity, resulting in dangers, such as results that are failures, or the overlapping of programs.
- 12) To make the restructuring to be gradual, taking into account the fact that the implementation capacity cannot be created easily.
- 13) To diversify the range of development support agencies, both at national and at regional/local levels.
- 14) To take it as undisputed that an overall economic policy stance that facilitates high economic growth and fiscal as well as price stability, constitutes the most significant macro-economic "support policy" for an expanding small business sector.
- 15) To ensure that South Africa's evolving small business-support strategy and its general approach towards small business promotion are not isolated from the broader southern African (SADC) scene.
- 16) To ensure that the principles underlying this strategy are not static, and that each one is pursued fully right from the start. Gradualism is recognized as being inevitable, being a consequence of financial and human resource capacity constraints.

### **Key principles of the strategy**

Ten key principles underlying the government's national small-business strategy are set forth as follows:

- 1) The strategy is based on a joint vision for big, medium and small business in South Africa.
- 2) All the segments of the small business sector - survivalist, micro, small and medium enterprises - need attention.
- 3) The business efficiency and competitiveness of the whole small enterprise sector has to be developed, with due recognition of social, financial and other compliance standards relevant to an internationally competitive economy.
- 4) An integrated support strategy has to give attention to both the supply and demand side of small business activities.
- 5) Black advancement in the enterprise sector is a key factor in all spheres of the strategy; special emphasis also falls on other marginalized or disadvantaged groups.
- 6) The scarcity of public funds demands careful prioritization of support programs and the skilful matching of different resources.
- 7) Support policies will be sector-focused and -targeted. Given this, there must be awareness of the justification for use of public funds and of implications of the market orientation of the economy.
- 8) The institutional framework for small business support has to be restructured in order to reflect the evolving institutional diversity, the provincial thrust of policy implementation and effective bottom-up and top-down cooperation and coordination.
- 9) Ultimate responsibility for the national strategy rests with the Department of Trade and Industry.
- 10) The private enterprise sector, cooperatives, NGOs, business associations and foreign assistance programs all have a critical role to play in an integrated small business strategy.

### **5.1.5 Framework for SME promotion**

#### **Elements of the support framework**

The Strategy pointed out the requirements for the promotion framework, as follows:

- 1) Creating an enabling legal framework
- 2) Streamlining regulatory conditions
- 3) Access to information and advice
- 4) Access to marketing and procurement
- 5) Access to finance

- 6) The physical infrastructure
- 7) Training in entrepreneurship, skills and management
- 8) Industrial relations and the labor environment
- 9) Access to appropriate technology
- 10) Encouraging joint ventures
- 11) Capacity-building and institutional strengthening
- 12) Differential taxation and other financial incentives

## **5.2 Current Organizational Setup for SME Promotion and Development Activities**

An outline of the organizational setup for SME promotion is depicted in Figure II-5-1. This section discusses a set of programs focusing on SMEs, while the details of individual SME support programs that are underway are shown in 5.2.4.

In addition to the SME promotion programs described below, South Africa implements various programs aiming at general industrial promotion, which does not necessarily provide favorable treatment for SMEs. Among them, the following two programs are considered to have some bearing on SMEs and their promotion.

- 1) Cluster development initiatives designed to develop specific industrial sectors in each region, which benefit SMEs that belong to any of the target clusters
- 2) Export promotion programs that are implemented as part of general industrial policy, which also have significant impacts on SMEs that are directly or indirectly related to export industries. (See II-3.4.1 for export program programs for the automobile and automotive parts industries.)

### **5.2.1 Organizational setup and activities before the “National Strategy”**

A number of institutions have over decades developed a limited, often fragmented range of small business-support policies and programs, some operating in competition with each other, and virtually all of them racially and gender-biased. The parastatal institutions included the homeland-based development corporations and some specialized SME-support agencies (like Transido); furthermore the Development Bank of Southern Africa (DBSA), the Small Business Development Corporation (SBDC) and the Industrial Development Corporation (IDC) as financiers, and some of the commercial banks.

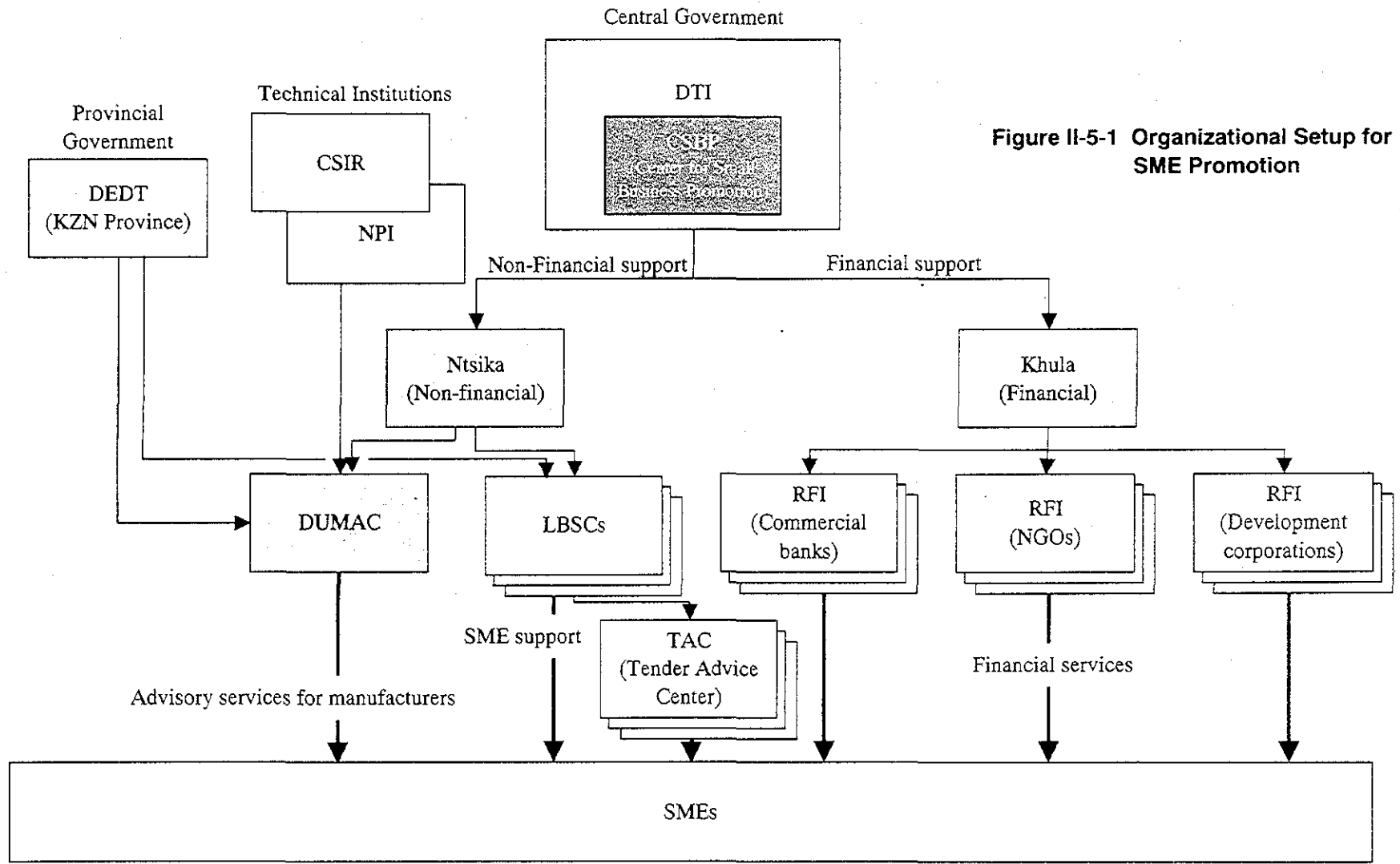


Figure II-5-1 Organizational Setup for SME Promotion

II-5-7

At the level of central government there was little cooperation extended directly to the black business sector. For example, government procurement was largely channeled to white businesses. Most of the university-based small business units, while receiving financial support from the state, have until recently not succeeded in effectively addressing the needs of the black small business sector. In the private and NGO sectors a wide range of small business support bodies have evolved over the last decade, often operating in competition with each other. While largely ineffective in their overall impact, this trend reflects the rise of attention to and support for small businesses among local stakeholders and donors, and it is also indicative of a growing stream of foreign aid allocated for small business support.

### **5.2.2 National level**

Within the central government, DTI is responsible for overall management of the National Small Business Strategy, while its implementation will be delegated to various organizations that understand SMEs and their conditions. DTI therefore serves as the facilitator to provide (1) financial support and (2) support for capacity building of service providers, i.e., small organizations providing field service.

Within DTI, CSBP (Center for Small Business Promotion) is in charge of management and implementation of the Strategy, including implementation, monitoring and evaluation, as well as planning of activities, legislation, and support for capacity building of related organizations.

Under CSBP, two national organizations have been newly established under the Strategy, namely Khula Enterprise Finance and Ntsika Enterprise Promotion Agency. The former is responsible for financial support for SME promotion and the latter non-financial aspects.

As for two organizations established under the previous administration, SBDC (Small Business Development Corporation) and IDC (Industrial Development Corporation), their activity focuses will be reviewed in line with the Strategy.

#### **Non-financial support for SME development**

The major SME development activities are undertaken by Ntsika. Ntsika was established by DTI in 1995 as a corporation under Section 21 (public corporation and became an organization under the National Small Business Act in 1996. In 1997, it became a public entity. Ntsika serves as a central organization to provide non-financial



support for SMEs and implement development projects through other organizations. Ntsika provides support for implementation organizations, not providing related services by itself. In FY98/99, Ntsika received more than R47.55 trillion from DTI. Ntsika's major activities are summarized as follows.

The major activities evident in KZN are the support for establishment and operation of Local Business Service Centers (LBSCs). The Ntsika identifies service providers who provide quality business development services to SMEs, and accredited them as the accredited LBSC. They also support the establishment of new providers of the basic business development services to SMEs in areas where there is minimal service provision from other sources.

Another important activity of Ntsika is development of Tender Advice Center (TAC). This center is to assist SMEs to participate in tenders by the Government or large enterprises, aiming at establishment of linkage with them.

The Ntsika has established Manufacturing Advice Center (MAC) in Durban and Port Elizabeth together with the Provincial Department (DEDT in the case of KZN), CSIR, NPI and DTI. The Center is to promote competitiveness and growth among manufacturing SMEs.

The other major services provided by Ntsika include the following:

- 1) BRAIN (Business Referral and Information Network): This is the Web-based program for facilitating access to information useful for SMEs, including information supplied by outside sources. The service includes the referral of service providers, guidance for business methods, and information exchange among LBSCs and the local community.
- 2) SMEDP (Small and Medium Enterprise Development Program): The program subsidizes a part of new investments of enterprises in designated industrial sectors. The investments covered by the program are mostly those of labor-intensive businesses, and those for machines and equipment, in conjunction with foreign investments.

Besides the supporting activities of Ntsika, the Department of Agriculture and Department of Social Affairs have provided the support for SMEs, focusing particularly on small and micro operations. One of the features of these departments are the cooperative activities.

The Department of Finance is providing SMEs with preferential treatment in Government procurement.

Many technical institutions have departments which provide SMEs with support within the arena. The major institutions include CSIR, NPI, and SABS.

Most of chambers of commerce and industry provide technological and managerial services in the form of seminars and workshops.

Many private enterprises have voluntary small business support programs, mainly contributing to nurturing of small businesses (see 5.3 for details).

NGOs, universities, and private consultants are also active in providing services to SMEs (Detailed information on the relevant organization is included in Annex 4).

#### **Financial support for SME development**

For SME financing, the commercial banking sector plays a dominant role. Generally, established SMEs can obtain bank loans relatively easily because they offer good profitability for commercial banks. In contrast, smaller startups often feel difficulty in borrowing from banks.

Similarly, microenterprises cannot expect favorable treatment from banks because higher costs are required. For an upstart microenterprise, therefore, bank loans are hard to obtain because it is considered to be highly risky and costly.

In South Africa, Khula is responsible for the institutional lending program for SME promotion.

Khula was established in 1996 by DTI to provide access to finance for small businesses. The major sources of funds for Khula's operations are Government disbursements, and grants and loans from foreign donors. The Khula operates through Retail Financial Institutions (RFIs), which include commercial banks, NGOs and Development Corporations at the provincial level.

The major activities of Khula are supply of business loans through RFIs, and credit guarantee to the RFIs. The grants from foreign donors are the main sources of these loans.

The major programs provided by Khula are as follows:

- 1) KhulaStart: This is an program primarily to first-time borrowers who need small amounts of money. The loans are provided through MCOs (Micro Credit Organizations), which are established in seven provinces and comprise in all 22 organizations. The average loan amount is around R859 per borrower.
- 2) Micro Lending Program: This program provides a larger loan than the above. The loan is provided through RFIs (Retail Financial Intermediaries) such as commercial banks and NGOs. The size of loans varies from R600 up to R500,000. Most borrowers are not able to obtain loans through commercial banks.

- 3) Credit Guarantee Scheme: This program assists the entrepreneurs to obtain larger sized loans. The Khula facilitates credit guarantees for the commercial bank loans for those who are not in a position to provide the necessary security or collateral. The scheme is utilized annually by 550 to 800 applicants on the average throughout the country.
- 4) Equity Funds: This is for even larger size loans. Khula becomes an equity partner in the business.
- 5) The Thuso Mentorship Program: The program provides both pre-loan support (business plan development and advisory service), and post-loan assistance (mentoring) to small and medium entrepreneurs applying for commercial bank loans. The objective of the scheme is to stimulate and increase the utilization of the Khula Credit Guarantee Scheme. The Khula has established a network of experienced mentors, both individuals and organizations, and will dispatch the mentors at the request of the applicants.

In addition to the loan and credit guarantee schemes, Khula is responsible for capacity building of RFIs and MCOs.

Other than Khula, IDC (Industrial Development Corporation) is a nonbank financial corporation that provides SME loan and credit service. In fact, IDC recently emphasizes SME loans, which account for 40% of its loans in 2000 on an approval basis (16% in 1996). Notably, it gives priority to the Black Economic Empowerment (BEE) program.

### **5.2.3 Provincial level**

#### **General**

At the Provincial level, the SMME Desk is organized within DEDT in the case of KwaZulu-Natal, coordinating the implementation of the National Strategy. Under the auspices of DEDT, several LBSCs have been established.

LBSCs are regarded as the main service provider to SMEs in the non-finance service field. DUMAC (Durban Manufacture Advice Center) is the organization, established under the Manufacturing Advice Center Program of Ntsika, providing advisory service on manufacturers. Services in the following areas are most popularly demanded for DUMAC:

- Quality system
- Access to finance
- Marketing
- Productivity improvement

- Human resource development

There are also chapters of the major technical institutions, such as CSIR, NPI, and SABS, which provides services within the scope of their respective activities.

There are quite a few numbers of NGOs that are providing various kinds of business services mainly for PDI. Business consultants in the private sector and university sector also provide business services. Their services for SMEs are mostly limited to those under Government programs.

Many large enterprises offer programs to provide business opportunities particularly for PDIs. These include procurement programs and provision of office space for business, etc.

Provincial Governments provide SMEs with special preferential conditions in favor of them in the government procurement. They use a lowered evaluation criteria for SMEs, and divide the orders into small units to make it easy for SMEs to submit bids. However, the SMEs which can provide appropriate services are very limited, particularly in the field of manufacturing.

As for the financial services, Ithala is the only public organization providing financial services to SMEs. SMEs, however, rely mostly on commercial banks, because the commercial banks are familiar with them through day to day contact.

#### **LBSCs**

LBSCs are responsible for provision of non-financial services for SMEs and is positioned as a core of field support activities for SMEs. In KZN, LBSC has an office in each of the five regions under Ntsika's umbrella, including satellite centers in Region 3. Most of them are established with support from local community and industry such as the local municipality, chamber of commerce and industry, and large private enterprises. The Ntsika have promoted their establishment by providing a part of fund for their establishment, with cooperation of DEDT.

The major activities of LBSCs are business training, information dissemination, and advisory services, including the activities of Tender Advice Center, which in most cases is attached to the LBSCs. LBSC is responsible for channeling every support provided by private enterprises and foreign donor organizations to SMEs in respective regions.

However, the basic concept of Ntsika regarding the LBSCs is independent operation based on the revenue obtained from their services. The LBSCs in metropolitan areas (Durban, Richards Bay) or the areas with big private enterprises, can find a source of funds for service projects, but those in small cities found their operation difficult due to the lack

of funds. The revenue from business support programs, such as training courses, seminars and workshops, cannot sustain the LBSCs operation, since their customers lack capacity to pay big fees.

#### **Service Providers Forum (SPF)**

SPF is a forum of organizations, chaired by DEDT, that is involved in SME promotion in the state. At SPF, LBSC activity reports are made and service providers explain individual programs, together with the exchange of information. Participants include representatives of the following organizations.

- Government organizations (state and field offices of the central government): Metro Council, Tender Board, Department of Labor, Department of Transport, and Department of Agriculture
- SME promotion organizations: Ntsika, Ithala, DUMAC and IDC
- Research and technology support organizations (including field offices of central organizations): NPI, CSIR, SABS and Pretoria Technikon
- Consultants, NGOs, and Large private enterprises
- LBSCs
- Local chambers of industry and commerce

#### **Ithala Development Finance Corporation**

Ithala is a public corporation established under DEDT in 1999, and took over the former KwaZulu Finance and Investment Corporation (KFC). The Ithala is the sole financial intermediate established by the Provincial Government, but it is operated independently from the government. The Ithala is one of the RFIs designated by Khula, but they raise the funds at the interest rate of 10.5 to 14.5%, and lend to SMEs at 16.5 to 18.5%, which is not attractive compared with rates at commercial banks.

Ithala has developed many industrial parks and industrial complexes throughout the province, and has provided consulting services to the firms seeking to locate in the *industrial parks and complexes*.

### **5.2.4 The current implementation system and major issues related to implementation activities**

As stated above, the Strategy recognizes that SMEs worldwide have been playing an important role in employment, penetration of new markets, and creative and innovative economic growth and expansion, and it sets forth the basic standpoint for SME promotion in South Africa, namely to leverage such characteristics of SMEs and enable them to

contribute to diversification of the South African economy, productivity improvement, investment promotion, and the stimulation of entrepreneurship. As for the present implementation system of the Strategy and activities executed under the Strategy, it must be pointed out that there has been an emphasis on promotion of PDI enterprises. Improvement of productivity and competitiveness of SMEs was not covered within the framework of SME policy. Rather it has been addressed as part of industrial policy and has been treated directly by the central government (DTI) and related industries. As a result, a major objective of the present study – qualitative improvement of SMEs that are classified in the second- and third-tier suppliers – is inevitably treated as part of regional development policy or industrial policy focusing on the automotive industry cluster, not within the framework of SME policy.

Does this mean that previous and ongoing activities have devoted resources for SME promotion to promotion of PDI enterprises? Not necessarily. Table II-5-1 lists promotion programs for PDI enterprises offered by various organizations, which programs are classified according to purpose. Despite the fact that a large number of programs are available to meet various objectives of promotion of PDI enterprises, visible results have not been obtained. In particular, *creation of black-owned enterprises has been limited to a small number.* Furthermore, these enterprises have not used the programs fully.

Critical comments on the programs by those who are directly involved in implementation vary greatly but can be classified into the following categories<sup>1</sup>:

- 1) A number of programs have been announced but not implemented quickly.
- 2) Existence of programs is not known.
- 3) Programs are not attractive in terms of content.
- 4) Implementation organizations (particularly intermediaries and service providers) do not understand each program's content very well and/or lack skills required for proper implementation.
- 5) Many training programs focus on theory and are not useful for practical application.

Judging from these comments, many programs are simply difficult to implement or cannot be implemented due to there being lack of a clear target for support. More precisely, they may not meet wants of both SMEs that aim to improve productivity and competitiveness, and PDI entrepreneurs who intend to start their own business.

---

<sup>1</sup> Comments in the workshop held in November 2001, in Pinetown to discuss the SME development plan in the course of the current study.

**Table II-5-1 Major SME Support Programs Which are Currently Available**

	Provision of Business Opportunities					Start-up Support for Utilizing the Business Opportunities Provided			Operation/growth Support				Infrastructure Building	
	Affirmative action in Government Procurement	Affirmative Action in Private/Public Enterprise Procurement	Facilitation of partnership/business matching	Facilitation of Development Projects under Private Initiative	Increased Business Opportunities through Economic Development	Business Information	Basic Business Plan Support	Co-operative/ consortium formation for create businesses or contracting	Business and Technical Skill Support for Operation and Management	Credit Guarantee for access to funding	Loans and/or equity participation	Training support for nurturing middle management	Training support for basics of employees	Financial Schemes targeting SMME
<b>National SMME Support Programs</b>														
<b>DTI</b>														
<i>BRAIN (Business Referral and Information Network)</i>						X								X
<i>National MAC Program</i>									X					
<b>DTI Incentive Schemes</b>														
<i>Competitiveness Fund</i>														
<i>Short-term Export Finance Guarantee Scheme</i>														
<i>EMIA (Export Marketing and Investment Assistance Scheme)</i>														
<i>Venture Capital Scheme</i>														
<i>Standard Leased Factory Building Scheme</i>														
<i>Entrepreneurial Finance and Economics Empowerment</i>														
<i>Low Interest Rate Empowerment Scheme</i>														
<i>Standard Credit Guarantee Scheme</i>														
<i>Emerging Entrepreneur Scheme</i>														
<i>SMEDP (SME Development Program)</i>										X				
<b>LED Program</b>														
<i>Unpackaging of Investment Projects</i>		X												
<i>CPPP (Community Public Private Sector Partnership)</i>		X												
<i>Emerging Contractor Development Program</i>	X					X							X	
<i>National Small-scale Mining Development Framework</i>					X		X		X					

(Source: Information from respective organizations)

	Provision of Business Opportunities				Start-up Support for Utilizing the Business Opportunities Provided			Operation/growth Support			Infrastructure Building			
	Affirmative action in Government Procurement	Affirmative Action in Private/Public Enterprise Procurement	Facilitation of partnership/business matching	Facilitation of Development Projects under Private Initiative	Increased Business Opportunities through Economic Development	Business Information	Basic Business Plan Support	Co-operative/ consortium formation for create businesses or contracting	Business and Technical Skill Support for Operation and Management	Credit Guarantee for access to funding	Loans and/or equity participation	Training support for nurturing middle management	Training support for basics of employees	Financial Schemes targeting SMME
<b>Ntsika</b>														
<b>Service provider supporting programs</b>														
<i>Local Business Service Centres</i>														X
<i>Training of Trainee Program</i>														X
<i>Service Provider Organizational Development</i>														X
<i>Materials Development</i>														X
<b>SMME support programs</b>														
<i>Mentorship Program</i>								X						
<i>TAC (Tender Advice Center) Program</i>						X	X							
<i>TIDP (Trade and Investment Development Program)</i>								X						
<i>Targeted Assistance Program</i>							(X)	(X)						
<b>Khula Enterprise Finance Ltd</b>														
<i>KhulaStart Program</i>										X				
<i>Micro Lending Program</i>										X				
<i>Capacity building programs for MCOs/RFIs</i>													X	
<i>Credit Guarantee Scheme</i>									X					
<i>Khula Mentorship Program (Thuso Mentorship Program)</i>							X	X						
<i>The Equity Funds</i>										X				
<b>Ordinary Products</b>													X	
<b>IDC</b>														
<i>Equity investments</i>										X				
<i>Quasi equity investments</i>										X				
<i>Highly flexible commercial loans</i>										X				
<i>Wholesale financing</i>										X				





The second problem is that while the Strategy addresses a broad range of elements in a comprehensive manner and is supported by the legal framework and the organization setup, its implementation does not progress smoothly for several reasons.

First of all, core organizations of SME promotion – Ntsika, Khula, and state government's SMME Desk – were newly created under the present administration by spending considerable time and effort. Furthermore, many LBSCs are still in the stage of setting up shop. Thus, much effort has been devoted to the institutional setup, meaning that it is early for substantial results to be produced.

Secondly, programs are formulated and decided on the basis of agreement by a large number of related organizations, and a consensus must be formed by spending a great deal of time. While it is important to obtain understanding of all stakeholders or develop a program that meets the needs of recipients and other affected parties, the present consensus process is clearly time consuming and often works against the interests of SMEs as recipients, who have to wait an unduly long period of time for a program to be implemented.

It is true that program design and development should be carried out carefully by using inputs from related organizations, e.g., understanding of the current situation, analysis of limiting factors, and drafting of and discussion on program proposals. Therefore, once a program is designed, it is important to set up an implementation system and institution quickly in order to ensure the smooth start of the program according to the schedule.

Thirdly, the financial management policy for the SME promotion system appears to impede smooth implementation of many programs. For the purpose of SME promotion, many organizations including LBSCs have been newly established, and LBSCs are supposed to secure operating funds from service fees (user charges) and contributions from local industries and government organizations. In reality, however, many recipients cannot afford such service fees (thus, they need public support) and management in some areas becomes difficult if industries cannot provide contributions.

Finally, many projects to create or support entrepreneurs and businesses are simply lacking the "market-in" concept. They seem to meet the needs of recipients, e.g., SMEs and PDI entrepreneurs, rather than the market needs.

For SMEs and would-be entrepreneurs, there are a number of hurdles to clear before starting their businesses, including the making of a number of applications, and obtaining permits and approvals, as well as fund raising. Then, they look for customers. At present, it is difficult for many small enterprises to find customers and they soon use up the initial capital. It is therefore imperative to understand the market needs from the

beginning and develop a business plan that meets such needs, including appropriate product development and timely marketing efforts.

Instead, many small enterprises are limiting themselves to customers who give them favorable treatment, such as government procurement, purchases by private enterprises as part of social contribution, and purchases by charity organizations. These customers certainly serve as a good starting point, but further sales expansion requires efforts to explore more competitive markets outside the protected environment. In this connection, SME promotion efforts should include the planning and implementation of large scale projects, such as tourism development, which will play a core role in stimulating satellite projects as the ripple effects of the core projects.<sup>2</sup>

### **5.3 Contribution by Private Enterprises to the SME Promotion**

Many large and medium-sized enterprises have social contribution programs that include support for small enterprises, especially black-owned enterprises and entrepreneurs. Notably, these programs are conducted under the leadership of the management (individual company or group). Generally, social contribution programs of private enterprises take one of the following three forms:

- 1) Affirmative activities;
- 2) Employment equity; and
- 3) Social investment activities.

It should be noted that social investment activities are usually conducted by a foundation that is established by a contributing company as a non-profit seeking company under Section 21.

Affirmative activities include incubation support for PDI entrepreneurs and procurement of goods and services from PDI enterprises.

An example is when a large enterprise provides office space for small enterprises free of charge, together with electricity, water and other utilities. The motivation for this can typically be that the large enterprise wishes to procure goods and services from black-owned enterprises but has had difficulty in finding qualified suppliers. This is especially the case regarding black-owned enterprises in the manufacturing and engineering sectors.

---

<sup>2</sup> MIDP is considered as one type of the up-front, precursory project in a sense that it will promote improvement of competitiveness as driven by export promotion, which will in turn stimulate activities of the automobile and automotive parts industries, followed by increased procurement of goods and services. To maximize the effect of the precursory project, it should be concurrently linked with a project to increase supply of goods and services.

Provision of office space and free services can enable the large enterprise to secure a supplier.

Automobile assemblers have been conducting similar activities, especially by giving favorable treatment to PDI enterprises in the procurement process. Nevertheless, they find it difficult to procure automotive parts by this method to the extent that major portions of their procurement requirements are met. They have to find suppliers who can deliver parts that meet strict safety and accuracy requirements that are indispensable in production of automobiles. At the same time, parts must contribute to competitiveness of automakers that are facing fierce competition in the international market. In fact, automakers, under intense competitive pressures, are in the process of rigorously selecting suppliers. However, most PDI enterprises lack the production technology, management know-how and experience needed to supply assemblers with competitive products and are *not in a position to become reliable suppliers for automakers.*

In fact, only four PDI enterprises supply automotive parts to automakers in KZN and none of them are critical safety parts or require high levels of production techniques or skills. Also, parts supplied by PDI enterprises do not always satisfy automakers' CQD requirements.

On the other hand, there is one supplier that has made success by acquiring a white-owned manufacturer with employees and customers. The supplier has inherited management methods and customers and is recognized by automakers as a quality manufacturer.

## **5.4 Human Resource Development**

### **5.4.1 Significance of human resource development in South America**

In South Africa human resource development is a critical issue for sustainable development of the national economy as well as from the standpoint of SME promotion.

The country suffers from the high unemployment rate of 37%. Most of jobless persons are young and have completed at least nine years of school education. But they do not have enough skills to find jobs. On the other hand, industries have difficulty in finding qualified workers and have to pay high wage for a limited number of skilled workers.

Given the situation, however, neither jobless persons nor employers are enthusiastic about vocational training. Unemployed persons become street vendors or work at a low-

level jobs such as at a car wash or a parking facility, because these jobs do not require capital or skill. Similarly employers try to find persons with skills and experience because they know that, if workers are trained from the beginning, they will move to other companies for higher wages.

#### **5.4.2 History of the education and training system in South Africa and its future outlook**

In the apartheid era, the country's vocational training system was primarily made up of apprenticeship training courses, which were mainly offered for white youths in a range of fields. Then, subsequent technological advancement and the changes in work methods and organization management have rendered apprenticeship training obsolete. Meanwhile, training courses have increasingly become theory-oriented and have lost practicability.

In 1981, the Manpower Training Act (MTA) was enacted to bring about an end to racial discrimination in the training area; it also reflected supply shortages in the labor market in the 1970s. As mandated by the MTA, the National Training Board (NTB) was established and the National Training Strategy was discussed. In 1994, NTB prepared the *National Training Strategy Initiative (NTSI)* as the basis for further discussion, and it was later adopted as the general framework for future policy making and organizational development.

In 1995, the South African Qualification Act was enacted and the South African Qualification Authority (SAQA) was established. SAQA is responsible for, among other things, the formulation of the National Qualification Framework (NQF).

NQF seeks to merge the (separately developed) education and training systems into a new unified qualification structure that integrates learning in formal institutions with that in workplaces as well as in the development sector.

The same year, the NEDLAC (National Economic Development and Labor Council) proposed a levy grant system to secure an additional financial source for the *National Training Strategy*.

In 1997, DoL submitted the Skill Development Strategy Green Paper and it was decided to launch the following institutional buildup for a new learning system on the basis of the NTSI.

- 1) NSA (National Skills Authority): An advisory body for the minister, consisting of related parties
- 2) SETAs (Sector Education and Training Authorities): Responsible for skill planning, grant disbursement and quality assurance for sector-based industrial education and training programs
- 3) A new learning system linked to NQF: New modular courses to replace the previous apprenticeship program, which include both OJT and non-OJT learning and integrate general and technical skills
- 4) New skills levy system: To collect 1% of salary and wage to all employees and reimburse it to certified companies that provide training
- 5) National skill fund: An ad-hoc fund to support the country's strategic objective, especially support for long-time unemployed and other target groups

Based on the Green Paper, the following acts were promulgated:

- Skills Development Act (SDA) (November 1998)
- Skills Development Levies Act (SDLA) (April 1999)

In 2001, the National Skills Development Strategy (NSDS) was proposed and is now considered as a guideline for human resource development in the following five years. The strategy was developed by DoL with cooperation of NSA and on the basis of extensive discussions with labor unions, corporate managers, educational experts, local governments and public organizations, representatives of handicapped citizens, foreign governments, labor relations experts, and other parties.

The strategy is currently being finalized through detailed discussion with SETAs. Then, required funds will be budgeted for implementation. It appears that it will take a few years to start implementation of the strategy.

#### **5.4.3 Current state of the human resource development system and direction of future development**

The country is currently developing a new education and training system on the basis of review and analysis of problems identified in the previous human resource development system. The new system is being developed to meet the following objectives:

- 1) To develop and maintain education and training as an integrated system, as they have evolved as different elements under the previous system;
- 2) To provide education and training that meet the industry needs;
- 3) To recognize and take into account the facts of the previous system and the fact that

- many people were excluded from it; and
- 4) To make education and training more prominent throughout the country in terms of recognition so as graduates are perceived as having certification.

The nationwide education and training system is under development in order to achieve these basic objectives.

#### **The new education and training system**

The new education and training system adopts its basic concept from the NSDS and consists of the following elements.

- 1) Reimbursement of Skill Development Levy to companies providing training

The Skill Development Levy will be collected from every private enterprise at a rate of 1% of employee payroll (effective in April 2001; the rate was 0.5% when the levy was introduced in April 2000) and will then be provided to companies that provide employee training as a subsidy. It is designed not only to provide an incentive for companies to conduct their own training programs but also to mitigate the unfair condition for companies who provide training for workers, who then leave to work for other companies.

The levy system was introduced under the authority of the Skills Development Levies Act (SDLA) and was started in April 2000. 20% of the collected levy is allocated to the NSF to carry out strategically important activities such as support for unemployed youths, 10% to activities of SETAs, and remaining 70% to subsidy.

The subsidy is paid through each SETA. It is paid in each stage of training (e.g., planning and implementation). However, small enterprises are virtually unable to receive subsidies for two reasons. First of all, they cannot afford to provide in-house training, while there is no outside organization to provide adequate training, as discussed later. Secondly, they do not have resources to prepare the detailed report and application that are required for receiving the subsidy. In fact, few small enterprises actually receive the levy. Thus, the subsidy system is virtually inaccessible to employees of small enterprises.

- 2) Establishment of NQF and SAQA's certification for trainees

NQF is designed to integrate education and training (previously treated separately) within the same framework (Figure II-5-2). Certification will be made on the basis of criteria shown in NQF and training courses will be reviewed and accredited by EQTA (Education and Training Quality Authority). Anyone who has completed an

Figure II-5-2 Structure of the National Qualification Framework (NQF)

Band	NQF Level	Type of Qualifications and Certificates	Locations of Learning for Units and Qualifications			
Higher Education and Training Certificate (HETC)	8	Doctorates Further research degrees	Tertiary/ Research/ Professional Institutes			
	7	Higher degrees Professional qualifications				
	6	First degrees Higher diplomas	Universities/ Technikons/ Colleges/ Private/ Professional Workplace, etc.			
	5	Diplomas/ Occupational certificates				
Further Education and Training Certificate (FETC)	4		Schools Colleges Trade certificates Mix of units from all	Formal high schools Private/ state schools	Colleges: Technical/ Community/ Police Nursing/ Private	RDP and Labor market schemes Industry training boards Unions/ Workplace, etc.
	3					
	2					
General Education and Training Certificate (GETC)	1	Senior phase	ABET Level 4	Formal schools (Urban/ Rural/ Farm/ Special)	Occupation/ work-based training RDP/ Labor market schemes Upliftment/ Community programs	NGO's Churches Night schools ABET programs Private providers/ Industry training boards Unions/ Workplace, etc.
		Intermediate phase	ABET Level 3			
		Foundation phase	ABET Level 2			
		Preschool	ABET Level 1			



accredited course will be certified to have a respective skill, regardless of the identity of the training organization (including in-house training), with the certification to be recognized nationwide. As shown in Figure II-5-2, the criteria will be established by NSB for each field of training.

3) Development of training programs on practical skills by the National Skills Authority

In South Africa, many large enterprises have their own training programs partly because outside training organizations fail to provide training that is useful to acquire practical skills. This means that employees of SMEs that do not have their own training resources are deprived of training opportunities. To provide skill development programs that meet the industry needs effectively, SETA was established for each field under NSA and is currently developing details of its program content. Each SETA is organized by representatives of labor unions and management in the respective industry and has an Education and Training Board responsible for actual program development.

It should be noted that, as seen in NQF's structure (Figure II-5-2), the new training and education system has the following features: 1) Consideration is given to adult workers who have not received sufficient education, including ABET (Adult Basic Education and Training), and the establishment of courses for those who have not finished the middle school; and 2) In addition to educational institutions, training programs conducted within the shop or community are accepted as a module, thereby increasing access to and providing incentive for more workers.

**Development of a new education and training system for the machinery, metal and engineering industries**

Within the framework of the above education and training system, efforts are underway in the machinery, metal and engineering sector to develop a mechanism related to formulate and implement a Sector Skill Plan (SSP). The work is led by MERSETA (Manufacturing, Engineering and Related Services SETA).

The following table lists subsectors in the sector and the numbers of establishments and employees in each subsector.

Chamber	No. of employers	No. of employees
Auto	7	33,000
Metal	9,760	255,000
Motor	14,230	180,000
Plastics	800	32,000
Tire	4	7,969
Total	24,801	507,969

Source: MERSETA, "SSP Executive Summary".

The current state of education and training in the sector is briefly described on the basis of MERSETA's SSP Executive Summary.

The actual level and intensity of education and training varies greatly among subsectors and individual enterprises (primarily depending on corporate size). In several subsectors, training is mostly conducted within each company and there is no outside organization accredited by the former Training Board. While training organizations covering specific occupations exist, none has been accredited by MERSETA.

According to MERSETA's survey, training costs have traditionally been shared among companies, government (Department of Manpower) and employees. Over time, however, more and more companies changed their perception of training from a cost to an investment. Nevertheless, their resources are limited and they find subsidies attractive, but they are afraid that the subsidies may become difficult to obtain under MERSETA's system.

As for the future vision of education and training, the following viewpoints have been agreed between management and labor<sup>3</sup>.

- 1) Future training should be related to practical skills and be of high quality.
- 2) The highest priority should be given to ABET and industry-wide efforts should be made in the sector. At present, the level and content of education varies among individual enterprises, but the ABET system should preferably be linked to a normal learning process (problems to be solved are duration of ABET, course materials and language, and incentive for participation in ABET in terms of remuneration).

<sup>3</sup> Here, questions were asked by dividing education and training into the following five categories: (1) ABET; (2) general workplace skills; (3) production-related training; (4) technical and apprenticeship training; and (5) higher education.

- 3) Production-related training, covering industrial skills, should be continued to keep abreast of technological advancement and automation and to augment the skills profile of the workforce.
- 4) General education in the workplace and teaching life skills (especially educational programs regarding HIV/AIDS, and personal financial management), should be emphasized to support the betterment of workers in personal life.
- 5) Skills related to advanced technology (particularly from level 4 to 7) should be emphasized and should be linked to a clearly demarcated learning process.
- 6) For managers and others in the management area, training on general management (software) skills, including communication and human relations, should be provided.
- 7) Training related to labor relations and skill development laws and regulations should be emphasized.
- 8) Support should be provided for workers in terms of skill development.

However, no agreement has been reached on the following viewpoints and further discussion will be made.

- 1) To improve international competitiveness, all-around skills, teamwork and quality training should be emphasized.
- 2) IT training opportunity should be expanded to the extent required in work.

In KZN, the Natal Training Center was recently closed as it lost eligibility for subsidies under the new system. Now, there is only one training center used for training of workers in the machinery, metal and engineering industries. This is operated by sugar mills to train engineering and maintenance staff and accepts trainees from companies other than sugar mills. Basically, however, the center and its program are designed for apprenticeship purposes and do not cover broad fields. Thus, there is no external training facility that meets the practical needs of the machinery, metal and engineering industries.

In the plastics industries, the Plastics Federation has a training program although its details are not available at present.

MERSETA believes that its technical colleges can accommodate additional trainees and is considering use of available capacity.

#### **5.4.4 Future direction of skill training**

The need for skill training is talked about in many places. Now it is time to discuss it in specific terms to define its content, purpose, eligibility and other details.

More precisely, skill training related to SME promotion should be approached from

the following two viewpoints: (1) improvement of competitiveness of SMEs; and (2) creation of employment opportunities for the PDI population group and support for business startups.

**Viewpoint 1: To improve competitiveness of SMEs**

Competitiveness of SMEs can be driven by human resource development in the areas of management and technology (i.e., senior and middle managers and engineers) and active participation of field supervisors and workers in business operation and production management. From this viewpoint, the following are in highly demand.

- 1) Managers (owners and senior managers) and engineers who have acquired management skills and production management techniques on the basis of production management in a broad sense (level 1);
- 2) Middle managers who understand the above management skills and production management techniques and are capable of initiating appropriate action under direction from above (level 2);
- 3) Field workers who have acquired practical skills and basic knowledge on production management (level 3); and
- 4) Unemployed who have acquired basic knowledge or skills that make them eligible to work at a production facility (level 4). At present, many part-time workers who are engaged in unskilled jobs have not reached this level. Also, a large number of full-time workers lack basic knowledge or skills. For SMEs, it is a heavy burden to provide this level of training within their facilities.

While there are a number of vocational training institutes and schools that provide level 4 training and some of them face difficulty in filling all their trainee seats, many companies have to provide basic training for new employees because many of them do not have basic knowledge and skills. Despite availability of training facilities, these people do not receive proper training before employment for various reasons, e.g., they cannot afford tuition, or training facilities were not easily accessible.

On the other hand, level 3 training needs vary greatly among industries and individual companies. Large enterprises have their own apprenticeship system for this purpose. SMEs are supposed to provide level 3 training in the form of OJT, but this barely meets requirements. Recently, many apprenticeship programs of large enterprises have been conducted at levels below capacity because of reductions in new hiring. As a result, their apprenticeship programs are operated at a higher cost per person. Training primarily covers machining. Engineering skills are taught at the training center operated by Sugar Miller Association and some SMEs send their employees there.

Clearly, the above training facilities and opportunities are not good enough in various aspects. In particular, for the fields covered by the present study, new training opportunities in the following areas are required: (1) die design for metalworking; (2) mold design for plastics molding; and (3) engineering technology in the field of plastics molding, such as the setting of molding conditions, and basic knowledge on production management and data collection.

Finally, training for skill levels 1 and 2 is not provided at present. This presents a problem, as efforts are not made to meet the need for improvement of competitiveness.

**Viewpoint 2: To increase opportunities for PDI employment and business startup**

It is often pointed out that the lack of basic skills among the PDIs is a major obstacle to employment and business startups. Basic skills in this sense are primarily linked to two levels as follows:

- 1) Basic work skills (level 4): As discussed above, there are a number of organizations to provide this level of education and training. However, a large number of people cannot receive it due to the lack of money, time or basic education.
- 2) Level 3 skills: Many SME owners want to acquire this level of skill because they want to expand business but are unable to do so due to the lack of knowledge on production management. However, in this case, different types of skills are demanded according to the type of business and other factors, and practical levels of skill training is required. To meet demand, therefore, consultation service may be appropriate in some cases.

It is often the case that owners of microenterprises do not have knowledge on basic business skills, such as bookkeeping, business planning, and sales techniques. These skills are currently taught at LBSCs or in projects implemented by service providers. Ongoing education and training is mostly close to level 4. While it is important to teach basic business skills, it is questionable to encourage business startups through such training. In fact, many people started their business and ended up in closing it soon. As pointed out earlier, the problems are not limited to the lack of business skills. It is multi-faceted and should be solved by providing broad support including finance, marketing and procurement of raw materials.

## **Part III: Conclusion and Recommendations**

# 1 Conclusion

## 1.1 Rationale and Need for SME Promotion in KwaZulu-Natal Province

Judging from the various characteristics that clearly distinguish SMEs from large enterprises, they are expected to play a unique role in vitalization and strengthening of industry and economy, and at the same time, they are often placed in a vulnerable position. In fact, their characteristics and weaknesses for the most part originate in their small size.

While SMEs in South Africa have similar characteristics to their counterparts in industrialized countries, they are generally less developed and fail to make much contribution to the economy in terms of job creation and formation of competitive supporting industries.

The fact that SMEs are relatively easy to establish is reflected in that the manufacturing sector (formal) in the country is dominated by SMEs, which account for 94.3% of total manufacturing establishments<sup>1</sup>. Corporate registration data (the number of business establishments registered annually) indicate that closed corporations (CCs) that primarily consist of small enterprises and microenterprises are five times as numerous as private companies (Pty Ltd) that are mainly medium-size and large enterprises. Thus, a large number of small enterprises including microenterprises have been established and are in operation in the country, numerically overwhelming larger enterprises.

Nevertheless, growth of small enterprises do not necessarily contribute to regional dispersion of enterprises. The following table shows the number of entrepreneurs per 1,000 population in each province. Clearly, a relatively high percentage of entrepreneurs - over 4% - is seen in the provinces having large cities, making a sharp contrast to rural provinces where the percentage hovers at 2% to 3%. This indicates that companies are mainly established in urban provinces. A high percentage of the PDIs in rural provinces may be attributable to the low ratio of entrepreneurs in rural areas.

---

<sup>1</sup> In addition, there is a large number of manufacturing establishments in the informal sector, which is estimated to be around 2.6 times those in the formal sector. As they are presumably small enterprises, the total number of SMEs in both formal and informal sectors holds a more than 98% share.

### Number of Entrepreneurs per Unit Population by Province (1999)

Province	No. of entrepreneurs	Population (thousand)	Enterprise density (B/A) (%)
Western Cape	179,992	4,171	4.3
Eastern Cape	200,140	6,769	2.9
Northern Cape	24,764	890	2.8
Free State	87,022	2,813	3.1
KwaZulu-Natal	382,021	9,003	4.2
North West	97,583	3,592	2.7
Gauteng	382,021	7,778	4.9
Mpumalanga	124,242	3,000	4.1
Northern Province	151,601	5,310	2.8
Total	1,628,797	43,325	3.7

(Source) Ntsika, Annual Review 2000.

SMEs are generally labor intensive. As seen in the table below, SMEs account for 43.5% of total employment in the manufacturing sector, much higher than their GDP share of 33.7%.

### Contribution of SMEs in GDP and Employment

	GDP			Employment		
	SMEs	Large enterprises	Total	SMEs	Large enterprises	Total
Manufacturing	33.7	66.3	100.0	43.5	56.5	100.0
All sectors	34.8	65.2	100.0	54.5	45.5	100.0

(Source) Ntsika, Annual Review 2000.

Also, SMEs appear to serve as supporting industries for large manufacturers as they are specialized in small-lot, large-variety production, as seen in the case of automotive parts suppliers, and play the vital, supplemental role of providing niche services, a function



that is not viable for large corporations.

Compared to industrialized countries; however, SMEs in South Africa still make lower levels of contribution in terms of the number of enterprises, output and employment, as shown below.

**Economic Contribution of SMEs in Selected Countries**  
(Percentage Share of All Sectors)

	South Africa	Japan	U.S.	U.K.	Italy
No. of enterprises	94.3	99.1	99.7	99.8	99.9
Employment	54.5	78.0	53.0	59.0	80.0
Turnover	34.8 <sup>*)</sup>	51.3	51.0 <sup>*)</sup>	56.3	76.2

(Note) \*) GDP share

(Source) Small Business Agency of Japan, "White Paper on SMEs in 1998"

For South Africa; Ntsika, "Annual Review 2000"

SMEs in South Africa, in actuality, do not play full social and economic roles that could enable them to leverage their inherent characteristics and strengths.

Firstly, SMEs do not fully contribute to industrial diversification, although they operate in a variety of product and service areas which large corporations find unattractive. As a result, both industries and consumers have to depend on imports in many areas.

Further, in regard to formation of the industrial base, the country has still to develop SMEs that have high levels of technology and competitiveness in various industries – which is required for them to serve as supporting industries (for instance, see the discussion of supporting industries in the automotive industry, in II-3.5). Thus, development of competitive SMEs is one of the most important issues for the country's industry to improve international competitiveness.

In addition, many SMEs operate in unstable conditions. Under the present government policy of pursuing liberalization of trade and investment, SMEs are exposed to competition with foreign products and many of them have been forced to go out of business.

At the same time, a major issue peculiar to South Africa is a clear disparity in employment and entrepreneurship conditions among population groups. Although no data showing this issue are available, an employment gap is evident from a significant

difference in unemployment rate between major population groups. Also, the very small number of black population who own or manage manufacturing establishments in KwaZulu-Natal Province is one evidence of such gap in entrepreneurship.

## **1.2 Issues Related to Socioeconomic and Industrial Development in South Africa and the Need for SME Promotion**

At present, South Africa is in the process of market-opening and liberalization of external trade and investment in order to transform the industrial base from the traditional one relying on protectionism to an internationally competitive one. The country cannot expect sustainable growth of the national economy unless it makes a successful transformation.

At the same time, the country has inherited the distorted economic structure that was developed under the apartheid policy, the which aftereffects of which remain in the form of a high unemployment rate. This is a serious problem that must be dealt with in the socioeconomic development process.

Thus, there are two major challenges for the country to overcome in order to ensure the development of an economic base for sustainable and equitable growth.

Promotion of SMEs is expected to contribute greatly to the national economy that in turn must address difficult challenges. In other words, if the country fails to address the issue of SME promotion, the challenges will turn into major obstacles to the country's much-needed transformation.

### **Role of SME in development of competitive industry**

Firstly, SME plays a significant role in the following, in view of development of internationally competitive industry:

- 1) Facilitation of diversified industries, and
- 2) Building up of competitive parts supply industries

In general, many SMEs develop markets that do not directly compete with large corporations. More precisely, they serve the niche markets that are not feasible for large corporations to enter due to the small demand or special niche requirements, e.g., products or services using proprietary technology, or highly customized needs. For a country where these SMEs have yet to emerge, it has to import such products and services or procure from foreign companies that can provide them. This is why industrial development in less developed countries faces difficulty, i.e., imports create cost pressure on local production and result in production inefficiency.

Development of SMEs is therefore critical to the buildup of a multi-layered and self-sufficient industrial structure, which is the prerequisite to healthy economic and industrial development. In South Africa, there are a number of industries that lack SMEs that under more conventional conditions would constitute the lower tiers of the industries' production systems. This absence necessitates imports of important parts and use of foreign companies for specific services. In addition, there is a risk that industrial hollowing-out will accelerate if market opening and liberalization of investment and trade are promoted while competitiveness of SMEs is left unimproved. In fact, in South Africa, most SMEs have failed to make modernization efforts because they have long been protected by the government from competition, particularly during the apartheid period when economic sanctions were imposed by many countries on South Africa and the country encouraged the development of diverse industries. As the government started to open the domestic market and liberalize external trade and foreign investment, however, SMEs have been exposed to direct competition with foreign products and services. As a result, many companies have gone out of business because they could not stand on their own feet without government protection. As seen in the case of shipbuilding and related industries, several industries have been declining due to their inability to establish competitiveness, and many SMEs have gone out of business or changed their line of business. Also, a variety of imported products are now sold in the domestic market and create strong competitive pressure on many manufacturers.

The decline in employment after 1997 seems to reflect the situation at least to some degree.

In addition to SMEs that serve niche markets by supplying unique products and services, there is another type of SMEs. They supply a variety of parts and/or services to industries that use diverse materials, parts and services, such as the machinery industry. They form the supplier base for a specific industry(ies) and are considered as supporting industries. The automotive industry constitutes a major element of the machinery industry in South Africa and uses a production process in which a substantial number of suppliers participate. As a result, competitiveness of automobile manufacturers is determined by the aggregate competitiveness of suppliers that make individual parts and components. Clearly, industry-wide efforts to develop competitive suppliers, if properly made, determine viability of the automotive industry to a large extent; so long as a competitive supplier base is established and maintained, automobile manufacturers can assure themselves of competitiveness by managing the supply chain and their own production system properly.

Suppliers are generally classified into first-tier (primary) suppliers that deliver parts and components directly to automobile manufacturers, and second-tier (secondary) suppliers that deal with primary suppliers, together with third-tier suppliers that exist in some areas of parts and components. First-tier suppliers are often specialized in specific parts and assemble larger parts by using internally made components and those purchased from other suppliers. They virtually form an integrated production system with automobile manufacturers by sharing the same or similar production management techniques and process technology. Furthermore, some suppliers having advanced technological capabilities recommend new production techniques to customers. Thus, first-tier suppliers are already forming a major source of competitiveness of automobile manufacturers.

On the other hand, second- and third-tier suppliers consist of SMEs. While some of them supply parts directly to automobile manufacturers, they are considered as lower tier suppliers in terms of the nature of their operation or form of contract. Overall, most suppliers make simple, low-value-added parts and components. Efforts to upgrade or modernize their management and production techniques should be given the highest priority in the SME promotion process.

The automotive industry is by no means free from such competitive pressure and is required to augment its competitiveness, including that which is derived from the supplier base (both materials and parts). Recently, lower ranked automotive parts suppliers (in terms of sales) have faced a further decline in orders, and an unfavorable business environment. By contrast, suppliers in higher ranks have received more orders and enjoy good business. The situation reflects the fact that automobile assemblers tend to concentrate their job orders to competitive suppliers in order to reinforce their own competitiveness. The automotive industry will intensify this pattern and suppliers that cannot survive in the competitive market will disappear. In particular, efforts to encourage second-tier suppliers to improve competitiveness, together with selection of suppliers based on competitiveness, are underway.

At the same time, some assemblers use model changes as opportunities to switch sourcing of parts from local to import if their local production offers no advantage in terms of value added or technology. Also, some attempt to diversify local sources by encouraging suppliers that operate on an international basis to establish production bases in South Africa.

### Creation of employment opportunities through promotion of PDI enterprises

Promotion of SMEs in South Africa is important from the standpoint of creating employment opportunities for the population group which suffered unfavorable treatment under the previous regime. The high unemployment rate in the PDI group is evident in the table below.

**Unemployment Rate by Race (1999) (%)**

	African	White	Colored	Asian	Total
KwaZulu-Natal	30.3	3.1	14.1	17.3	25.9
Total South Africa	29.2	4.7	15.2	15.6	23.3

(Source) Statistics South Africa 2000

On the other hand, the population engaged in economic activity is summarized as follows. 66.4% of the working population rely on SMEs as employers.

**Breakdown of Working Population by Business Size and  
Formal / Informal Sector (1999)**

(Unit: 1,000 persons, %)

	Large enterprises	SMEs	Total
Formal sector <sup>1)</sup>	3,489	4,175	7,664
Informal sector	0	2,705	2,705
Total (% of total)	3,489 (33.6)	6,880 (66.4)	10,369 (100.0)

(Note) <sup>1)</sup> Estimated by allocating working population by the ratio of employment in large enterprises to that in SMEs.

(Source) Statistics South Africa 2000 and Ntsika 2000

As promotion of SMEs has the multiple effect of reducing the unemployment rate and creating employment opportunities in rural areas, it should not necessarily be focused on PDI enterprises if creation of employment opportunities for the PDI group is its primary objective. In fact, the PDI group is very limited in the ability to create new entrepreneurs and enterprises, because of the fact that the population group was confined to limited areas and was allowed to conduct a few types of businesses for a long period of time. Furthermore, they did not receive sufficient general education, not to mention business

education and training. Under these circumstances, capital formation required to start business was impeded. As a result, the vast majority of the PDI group is still deprived of the opportunity to participate in economic activities and is unemployed or underemployed.

Promotion of PDI enterprises finds its foundation in the grave situation that the PDI group, which accounts for the highest percentage of the country's population, is alienated from production and consumption activities. To promote economic equality for the unjustly disfavored population group, therefore, public support for PDI entrepreneurship and business operation is justified by assuming that they have a strong desire to start up their own business and there are business opportunities that the PDI group can capitalize on.

Here, promotion of PDI enterprises is linked to promotion of SMEs because SMEs are relatively easy to start and can adapt themselves to diverse niche markets. Public support for PDI entrepreneurs is therefore one of the most important issues that should be addressed in promotion of SMEs in the country. As members of the vast majority group of the population start up SMEs, they participate in economic activities and create employment opportunities for their neighbors, contributing greatly to reduction of unemployment and underemployment. It should be noted, however, that promotion of PDI enterprises should not be justified from the standpoint of creating employment opportunities for that population group, because existence of such linkage has not been established.

The PDI group lacks both business experience and basic knowledge required to start and operate businesses. In particular, successful cases of business startups by black people are very limited. Clearly, promotion of PDI enterprises requires much more time, cost and effort than promotion of SMEs in general. It is therefore required from the standpoint of correcting for the social and economic injustice that prevailed for so long in the past.

### **1.3 SME Promotion Policy**

#### **1.3.1 Basic consideration**

Promotion of SMEs is desirable not because SMEs exist, but because SMEs including new startups help solve problems that impede social and economic development of South Africa.

The Small Business Development Strategy states that promotion of SMEs is essential in promoting diversification of the South African economy, improvement of productivity,

and promotion of entrepreneurship. It is based on the recognition that SMEs have been playing a major role worldwide in absorption of surplus labor, exploration of new markets, and creative and innovative initiatives in economic expansion. The present study shares this view and position, which should therefore be the rationale for promotion of SMEs in the country.

The study focuses on SMEs that serve as supporting industries for the machinery (especially automobile) sector for the following reasons.

Economic sanctions imposed by the international community up to 1994 have protected domestic industries within a closed and uncompetitive economy, and they have lost the ability to adapt themselves to the highly competitive environment in the world market. Although large companies, mainly state enterprises, benefited primarily from the protectionism by establishing monopolistic or oligopolistic dominance in the local markets, SMEs were also protected from competition with imports because everything was purchased from local sources under conditions of strict import restriction. As a result, they do not understand how tough it is to compete as the market is completely liberalized.

In fact, as economic sanctions are lifted and the government implements its market opening policy, large companies are exposed to international competition and opt for global sourcing, instead of giving priority to local suppliers as they had traditionally done so. As a result, economic growth causes increases in imports of capital goods and raw materials, often outpacing the economic growth rate, and creating recession conditions in the relevant domestic industries.

Market liberalization also makes maintenance of existing levels of labor productivity in South Africa untenable in the new international context, and domestic industries need to take drastic measures for productivity improvement. Thus, due to the effects of two factors - stagnation of domestic industries and the rise in labor productivity, economic growth effects will not be directly expressed in the form of employment growth.

It has become apparent that growth of large companies and core industries alone are not sufficient to maintain overall economic growth. This is because the growing sector (large companies and core industries) does not accompany broad based industries that previously supported large manufacturers. Instead, these industries are liable to lose their market share to imported products and put a drag on growth of handful sectors.

Thus, to ensure attainment of full-fledged growth of the South African economy, there must be improved competitiveness in the supporting industries, that must broaden their own bases in keeping with the growth of large companies and basic industries. Large companies alone cannot serve as an engine hauling the rest of the economy.

At the same time, large companies cannot maintain competitiveness, which they have gained with government support, so long as they rely on imported materials and parts. From this standpoint, supporting industries need to be strengthened to form the foundation for the country's major industries that have international competitiveness.

As a high unemployment rate persists in South Africa and no signs of improvement can be seen, creation of employment and opportunities to start businesses are undoubtedly the most important social and economic issue. In fact, the government has recently been emphasizing the need to give priority to the issue. However, employment opportunities should be created in keeping pace with improvement of labor productivity to the level of international competitiveness. The government may be tempted to intervene and create jobs regardless of productivity. If jobs are created this way, their effect will be short-lived and the market will enforce adjustment of the work force in a more harsh way; the economy cannot simply grow by protecting an excessive number of workers and accepting labor productivity that is below the international level. This means, artificial job creation works against the objective of improving international competitiveness. Instead, job creation efforts should start with development or expansion of industries having competitiveness. Then, sharing of the fruits of growth can be ensured through improving competitiveness of supporting industries. As entire industry groups thus grow as a result of competitiveness, they can create employment that is long lasting and stable.

To produce the maximum effect from economic development efforts and use it as the basis of the next round of development led by further augmentation reinforcement of industrial competitiveness, it is imperative to foster supporting industries that follow the growth path of major industries that they serve.

This multi-tier approach is also a powerful and indispensable tool to accomplish two major goals of economic growth and job creation. And promotion of SMEs should play a crucial role in pursuing these goals.

### **1.3.2 SME promotion policy**

SMEs in KwaZulu-Natal Province are diverse in nature and face varying issues to be resolved, depending upon their social and economic positions and the status of industrial development. SMEs that belong to supporting industries for the machine sector - which



are the subject of the present study<sup>2</sup> - are broadly classified into three types as follows, with their respective development challenge.

1) SMEs in the automotive parts and related industries

They need to attain international competitiveness together with the automotive industry. This is an urgent imperative to achieve it in a relatively short period of time.

2) Other SMEs

They have to realize that they have been protected from competition by government policy and must strive to build up the foundation of their companies (technical, financial and other aspects) in order to survive and grow in the highly competitive environment created by market opening and liberalization of trade and investment.

3) PDI enterprises and potential PDI entrepreneurs

In recognition of the fact that various promotion policies and programs have been implemented since 1994 without substantial results, it is the time to review and reappraise them and develop effective policies and programs.

Because each of the three groups of SMEs have the different needs, in devising the SME promotion measures, the target group should be clearly defined, and measures and programs should be planned reflecting their specific needs. SME promotion policy for each group is outlined as follows.

**(1) Promotion policy for SMEs that serve as parts suppliers or related service providers for the machinery industry, mainly the automotive industry**

Promotion of SMEs in this group has direct bearing on the major development challenge faced by the machinery industry (primarily the automotive industry), i.e., improvement of international competitiveness. Thus, the promotion policy has the nature of industrial policy, rather than SME policy.

Automakers throughout the world are engaged in fierce competition and those with a presence in South Africa are required to reposition their production bases in the context of their global business strategy. They also must decide whether to expand or reorganize their operations in South Africa. In this conjunction, improvement of competitiveness of parts suppliers, which is a critical element of international competitiveness, is an urgent

---

<sup>2</sup> In KwaZulu-Natal Province, there are other industries that constitute the economic base of the province, including textile and apparel, wood, paper and printing, but the present study has not placed the focus on these industries.

issue for automakers must address.

The general organization of automotive parts suppliers and related manufacturers in KwaZulu-Natal Province is illustrated in Figure III-1-1. The present study focuses mainly on 24 out of 40 first- and second-tier suppliers (primarily making automotive parts); metalworking service companies serving automobile assemblers and parts suppliers; and other manufacturers that have the potential to become automotive parts suppliers.

Characteristically, SMEs in the automotive parts industry in KwaZulu-Natal Province establish themselves as second-tier suppliers that provide component parts for first-tier suppliers or processing companies that undertake a parts production process, such as metalworking and surface treatment. Generally, they are engaged in a relatively simple process that does not present a significant problem related to production technology. Instead, the major challenge is to build a highly efficient production chain that is integrated with the assemblers. In particular, suppliers in the country like South Africa, where the domestic market is small and many models are competing, are required to excel at small-lot and large-variety production, which requires sophisticated production management techniques and process technologies. Thus, a primary goal for promotion of SMEs in this group is to teach them such techniques and technologies to become small-lot and large-variety suppliers.

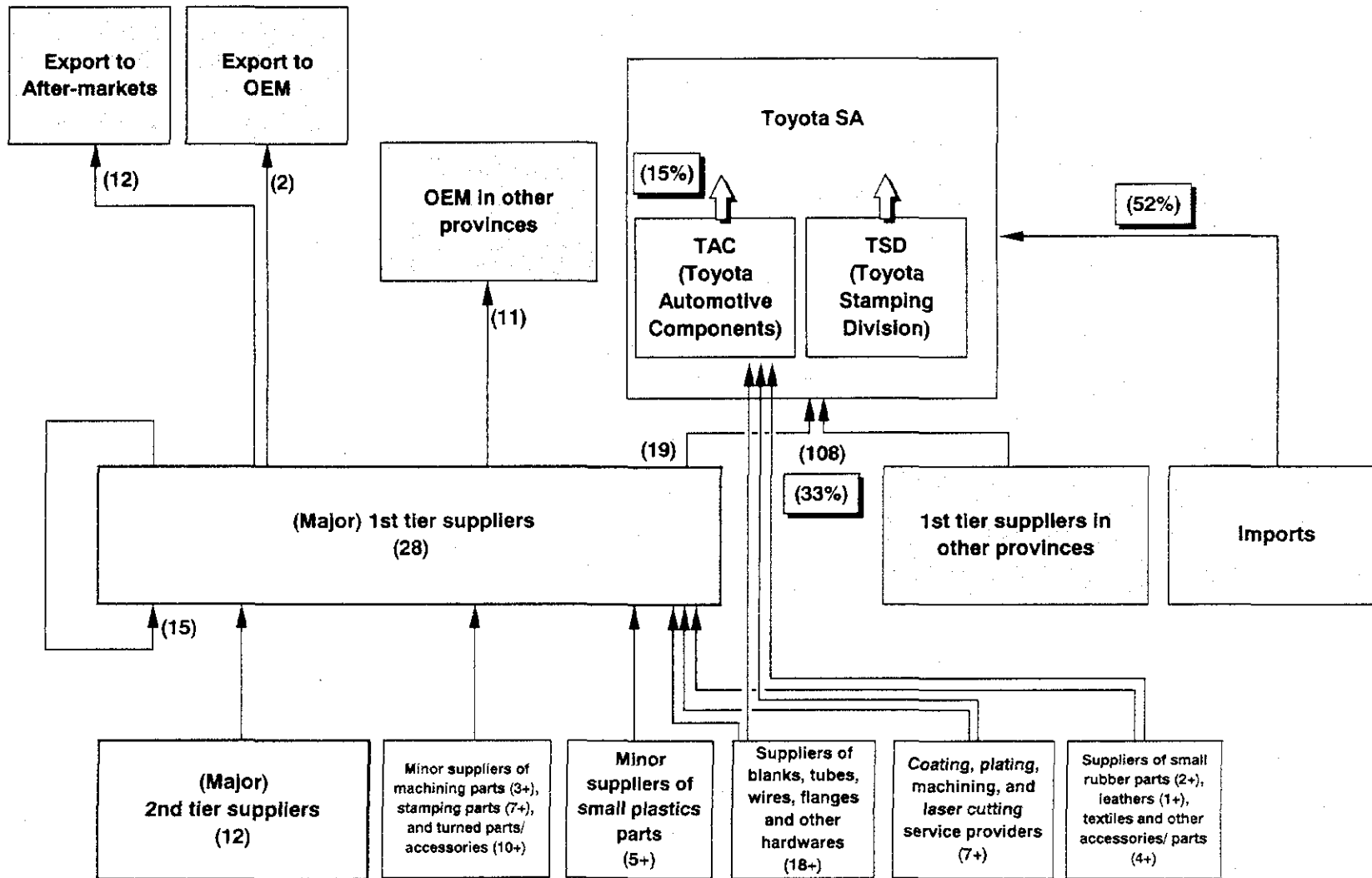
In the following section, the current state of the automotive parts industry and major issue facing it are discussed.

**Recent trends in production of automotive parts and components,  
and major issues related to development of the competent supplier base**

Previously, the government enforced a local content requirement on the automotive industry and 60% of automotive parts and components were procured from local sources. Then, after the requirement was terminated and the MIDP and IEC programs were launched, local production has been increasingly concentrated on specific parts while other parts are imported. As a result of specialization, locally made parts are being exported in increasing quantities in addition to those that are used for in-country assembly.

The automotive parts industry in KwaZulu-Natal is roughly classified into two groups of suppliers. The first group consists of suppliers that make parts and components for Toyota that has assembly facilities in Durban, and the second group is made up of suppliers that serve other markets, including other automobile assemblers operating in the country, foreign manufacturers, and domestic and foreign aftermarkets. In KwaZulu-

Figure III-1-1 Estimated Automotive Parts Supply Structure in KwaZulu-Natal Province



III-1-13

Notes: Figures in brackets mean the estimated number of companies involved on the flows or the jobs.

Figures in boxes mean the approximate percentage of parts supplied to Toyota SA, through the route.

Natal, there are several other manufacturers that procure parts from local suppliers, including Bell that makes construction vehicles, MAN (truck manufacturer) and Defy (household appliances).

As for OEM supply, automobile assemblers opt to procure parts and components selectively according to their global sourcing strategy, i.e., those offering comparative advantage over those available in other countries, assuming that the MIDP and IEC programs will continue for years to come. The move is more visible among European automakers, which are encouraging suppliers in their home countries to come to South Africa in order to establish cost and other advantages. On the other hand, Toyota has been pursuing a local sourcing strategy in combination of in-house production and procurement from local suppliers. Now, Toyota of Japan plans to increase investment in Toyota SA, which is expected increasingly to follow the global sourcing strategy of Toyota Group.

It is therefore critical to establish a competitive supplier base in the OE market. Small- and medium-sized suppliers in KwaZulu-Natal Province are mostly those supplying their parts directly to Toyota, or to first-tier suppliers serving Toyota (or OEM companies in or outside the province, as discussed above). In addition, a similar situation applies to suppliers who serve automobile assemblers in other provinces or foreign countries.

Assuming the continuation of MIDP and IEC, the production of parts destined for the foreign aftermarket will be increasingly important. The situation is particularly applicable to the parts manufacturers in KwaZulu-Natal Province, since the province has a major locational advantage in access to Durban port, and thus, suppliers need to improve their competitiveness to capitalize on this advantage.

In consideration of the challenges discussed above for the automotive parts industry, it is apparent that the industry has several weaknesses in the field of production.

First of all, the industry lags far behind counterparts in industrialized countries in the areas of production management and process technology. The situation is very serious and may adversely affect competitiveness of automobile manufacturers operating in the country. In fact, some European manufacturers are already moving to bring European suppliers to South Africa in order to take advantage of their excellent production management capabilities. These suppliers are large in size and will likely deprive local

SMEs of opportunity to supply their products directly to European automakers<sup>3</sup>.

Another weakness is found in the lack of product development capabilities. Vehicle models made in the country have been developed and designed elsewhere. Automobile manufacturers operating in the country have been procuring parts that are made according to their specifications. They never asked local suppliers to develop and design new parts. For new models to be manufactured in the future, however, automakers are expected to meet the varying market needs and accordingly are likely to introduce new models in shorter cycles than in the past. This necessitates local development of some parts and components. As a result, suppliers are required to have their own development capability.

Moreover, wages in South Africa are considered to be in the middle level in the world. To sell to automakers that pursue global sourcing strategy, it is important for suppliers to recognize that they have to achieve productivity and advanced production capabilities that match the wage level – and then achieve them. Global sourcing strategy means that automakers opt to look for foreign sources if they cannot maintain competitiveness using local sourcing.

#### **Opportunity for SME promotion in the automobile related industries**

The automotive industry is typically supported by a broad supplier base. Even in a country where local content remains at such low levels as 40-60%, each automobile assembler procures materials and parts from over 100 suppliers. Further, there are many SMEs in various industries, which are not directly related to automotive parts manufacturing, but make equipment and tools required by the automobile and automotive parts industries. They have found niche markets in this area. Their markets will expand if the machinery industry in the country, as led by the automotive industry, attains competitiveness and grow on a sustainable basis.

The automotive industry is trying to increase their competitiveness with implementation of MIDP and IEC programs. The strengthening of their supporting industries, which are comprised mainly of SMEs, is one of the essential factors to this aim. Furthermore, there has been a big pressure on export initiatives for parts suppliers from automakers as well. So long as the automotive industry maintains an important position

---

<sup>3</sup> However, the adverse effect on local SMEs is short-lived and operation of foreign suppliers should be welcomed in consideration of various benefits to be brought to the South African economy as a whole. First of all, foreign suppliers will bring latest production technology and equipment and will train local engineers and workers who work in the sophisticated production environment. Then, some of them will start their own business by applying management techniques and industrial skills that they have learned. In the long run, the increase in the number of SMEs with sophisticated production techniques and skills will create opportunities for the parts industry to explore new applications and markets.

in the manufacturing sector, there are opportunities for promotion of SMEs in production of automotive parts and their components. This tendency has been further accelerated by continuous depreciation of Rand.

Automobile manufacturers and large suppliers are willing to support promotion of SMEs for two reasons. First of all, they realize that their competitiveness is largely affected by competitiveness of lower tier suppliers that make parts to be incorporated into their products. Secondly, they view promotion of SMEs as an effective means to support PDIs. Clearly, their positive attitude toward public support for SME promotion is very encouraging and is expected to serve as a strong impetus for actual efforts.

#### **Constraints on SME promotion**

One must not forget that there are various constraints (limiting factors) on promotion of SMEs in the automotive parts and related industries.

- 1) There is a significant gap in terms of management capability and production techniques between manufacturers that are currently making automotive parts (including SMEs) and those that do not. There is a formidable barrier facing the latter SMEs if they seek to enter the automotive parts business.
- 2) Furthermore, there is a widening disparity among automotive parts suppliers, some of which excel at management and technology, while others are considered to be poorly managed and have inferior technology. Automobile assemblers are already selecting preferred suppliers, while the other suppliers lose business. Thus, existing suppliers are required to make efforts that enable them to survive in the industry.
- 3) Automobile manufacturers have to meet the diverse needs of customers in a domestic market that is fairly small in order to stay in business. As a result, suppliers must have flexible production capabilities to make a variety of products in small lots.
- 4) The South African economy is not based on a low-wage labor force and the manufacturing sector cannot rely on labor cost advantage as a source of competitiveness. Instead, it has to compete with industries in countries where the wage level is higher (by making higher value added products).
- 5) Liberalization of trade and investment is irreversible and directly exposes SMEs to international competition, resulting in dropout of manufacturers who fail to comply with the conditions imposed by liberalization.
- 6) Large suppliers are increasing the number of their alliances with foreign companies. For SMEs that do not have proprietary technology or foreign partners, there will be limited opportunity to enter promising fields.
- 7) SMEs do not have product development capabilities as they have been making parts on a contract basis. Unless they develop and market their own products to

customers, they will not be able to free themselves from the limitations inherent in relying on producing only to meet the customers' orders.

## **(2) Promotion policy for other SMEs**

SMEs in this "other" group are expected to play a supplemental role in serving niche markets that are not feasible for large companies to enter, and thus prevent industrial hollowing-out. However, they often retain attributes that have been acquired under import substitution and protectionist policies. Thus, they have to build up the corporate foundations (technical, financial and other aspects) they need to have in order to survive and grow in the highly competitive environment created by market opening and liberalization of trade and investment.

These companies are found in a variety of industries, and the approach for their promotion should be considered in the context of SME development, rather than industrial policy.

For the purpose of this study, "other SMEs" refer to those in supporting industries for the machinery sector (mainly the automotive industry) and other than manufacturers that primarily make automotive parts. In other words, those listed in Figure III-1-1, except for SMEs in the automotive parts and related industries, are classified in this group.

In KwaZulu-Natal Province, there are a number of industries that form the economic base of the province, such as textile and apparel, wood and paper products, and printing, in addition to metal, machinery and engineering sectors. A large number of SMEs presumably belong to these industries. Also, food, furniture and construction materials industries contain an appreciable number of SMEs, although the present study did not cover them. Also, the study is not concerned with SMEs in metal, machinery and engineering sectors, which are engaged in manufacture and processing service of non-automotive parts, e.g., shipbuilding, sugar mill machinery, agricultural machines, and other metalworking services.

Thus, SMEs in this group (primarily those in metal, machinery and engineering industries) are essentially machine shops and engineering service companies specialized in manufacture of industrial machinery and its auxiliary equipment and tools used for industrial activities common in KwaZulu-Natal Province, including ship repair, sugar milling, forestry, and textile and apparel production. They may also incorporate equipment and accessories into imported machinery and deliver it to customers.

More precisely, they include job shops specialized in metalworking operations, such as

casting, forging, sheet metal work, and/or machining of small parts, custom production of auxiliary machinery and equipment for hydraulic systems (e.g., construction equipment), tanks and other industrial machinery, and manufacture of chain blocks, special chains, and safety harnesses. While many are capable of providing diverse engineering services, they face difficulty in staying in business because their traditional markets, such as ship repairing and machinery engineering service, are on the decline. Although some companies have successfully shifted to production of automotive parts, most of them cannot be considered as potential suppliers in view of the limited demand as well as their technology and management capabilities.

Rather, they should be positioned as a group of companies that can meet diverse demand that is not suitable for large companies and play a flexible role in supporting industrial diversification.

In the register of the Durban Chamber of Commerce and Industry, 65 companies are listed as those in the machinery industry, although they include companies that are classified as automotive parts suppliers in KwaZulu-Natal Province (Figure III-1-1).

In addition to the companies in the metal, machinery and engineering sectors, most plastics processing companies (estimated to be around 200 – 300) may be classified in this group.

Most of them are managed almost exclusively by the owner. If the size of the company is small enough to be managed by the owner, the company may not have any serious problem, though it may not be so profitable. However, once the scale of operations grows, the companies face problems of management. Their management expertise is insufficient when they have to work at a larger scale.

They have various types of managerial and technological inefficiency. However, most of the owner-managers do not realize that there is a problem. They firmly believe that their way of management is the most appropriate, and that the problems are mainly those out of their control.

Most of the managements of these SMEs think that difficulty in access to the market is the most constraining factor for their success. It is true that market access and market analysis is essential, but, before seeking access to the market (or potential customers), they need to understand their position in the market. There are many competitors in the market with similar technical capability. Market access alone will not improve their businesses.

The major obstacle to promotion of these companies is the lack of incentives for reforming and augmenting the corporate foundation, as compared to SMEs in the



automotive parts industry. Major problems related to “other SMEs” are summarized as follows.

- 1) Lack of awareness about the necessity to upgrade management skill, including market analysis
- 2) Lack of knowledge of production management concepts
- 3) Difficulty in nurturing middle-management
- 4) Lack of availability of credit guarantees for loans from financial institutions
- 5) Need for provision of basic skill training for workers together with basic education as needed

Most programs and measures that are deemed necessary share common elements with those required for companies in group (1). The major difference is that development goals cannot be clearly defined for the former group of programs because target companies are operating in diverse industries. Therefore, they have to be proposed as general support programs.

### **(3) Promotion policy for PDI enterprises**

*Promotion of PDI enterprises is primarily designed to provide support for willing PDI entrepreneurs in the startup, management and expansion of businesses, thereby to allow this population group to enjoy the fruit of industrial development initiatives.*

Key elements of promotion of PDI enterprises are twofold: the provision of comprehensive support; and market creation. First of all, PDI enterprises generally face problems that are related to diverse aspects of business startup and management. They must be addressed in a coordinated manner by implementing multi-faceted programs if public support is to provide effective help for PDI enterprises facing difficulty. Secondly, previous projects to create business opportunities for PDI enterprises are essentially of “product out” type. They emphasized the planning and development of products and services, but gave little attention to their marketability, i.e., they failed to develop a product or service that was based on the actual market needs. As a result, many projects were unable to find customers or were confined to a small market without a prospect for expansion.

The present study did not collect detailed information on PDI enterprises that are classified in this group. The study team therefore has a limited understanding on the current stage of PDI enterprises, as discussed in II-4.3.

Notably, there are few automobile parts suppliers that are classified in this group. According to Toyota SA, the company has made or makes procurement of automotive parts from only five PDI enterprises in KwaZulu-Natal Province. Two companies are operated by Asians and three by blacks. All of them supply interior parts and accessories, not structural or functional parts. In consideration of technical and management capabilities of PDI enterprises, it is difficult to expect that they can enter the business of supplying key parts and components to the automotive industry within a short period of time.

Nevertheless, they can serve as suppliers of non-automotive parts because the automotive industry purchases large quantities of them from local sources. For instance, Toyota SA procures the following products from PDI enterprises.

#### Procurement from PDI Enterprises by Type of Product

(Unit: Number of enterprises)

		Building & construction	Commodities	Service & maintenance	Parts & accessories	Total
Black		2	4	3	3	12
Asian		0	17	11	2	30
Colored		0	1	3	0	4
Total	No. of enterprises	2	22	17	5	46
	R 1,000 (%)	8,142 (27.7)	5,519 (18.8)	12,735 (43.4)	2,971 (10.1)	29,367 (100.0)

(Source) Toyota SA

This means that the strengthening of the automotive parts industry leads to increased competitiveness of the automotive industry as a whole, and sustainable growth of the automotive industry leads to increased procurement of a broad range of products and services. In other words, increased participation of SMEs in the automotive parts industry is not the only one way to promote equal distribution of fruits of economic development to all the population groups. The increase in employment and procurement of non-automotive products and services are proven to be effective measures to help achieve the goal.

Nevertheless, there are few PDI enterprises, particularly those owned by members of the black population, which are or can become reliable suppliers to automobile assemblers by meeting their procurement requirements.

### **Need for support for startup and continuance of PDI enterprises**

In South Africa, promotion of SMEs is also important in that creation of SMEs results in provision of job opportunities for the PDIs. They used to be permitted to conduct limited types of businesses in very limited areas. Also, they have faced difficulty in receiving business education and training as well as general education. Naturally, they were unable to stock or mobilize capital to start their own business, except for a very few fortunate cases. As a result, there are few employment opportunities for them, who are chronically jobless or underemployed.

As SMEs can be easily started, they have the potential for getting established in niche markets. Thus, support for PDI entrepreneurs who have a clear business plan and willingness to start and continue a company is an effective means to create employment opportunities for themselves and their neighbors who have difficulty in finding employment.

Nevertheless, promotion of PDI enterprises should not be considered as a major solution for the unemployment problem. As discussed below, PDI entrepreneurs generally lack knowledge or experience in business planning and management. In terms of cost effectiveness, therefore, focused support for potential entrepreneurs with basic knowledge and skills is desirable, rather than for PDI entrepreneurs. So far as they lack knowledge and experience, PDI should acquire them by working for companies. Unfortunately, however, learning opportunities are also limited because they cannot find employment easily in the current job market situation. Thus, public support for PDI entrepreneurs cannot be discussed from the economic viewpoint alone.

### **Constraining factors for promotion**

It should be noted, however, that public support for the PDI is a formidable challenge because most people have no experience in undertaking business and lack basic knowledge required to start and operate a business. Further, there are very limited cases of successful business startup and operation particularly by black population.

The majority of PDI enterprises in KwaZulu-Natal Province have been started by members of the Asian population. There are a significant number of SMEs which are owned by Asian population. The problems they are facing include: 1) distribution and sales capability, 2) fund raising, and 3) technical capability. Also there are some cooperatives established with the support of the government or NGOs, which are mainly operated by members of the black population. The problems faced by them are almost similar to those mentioned for Asian population, with the most critical ones being

distribution and sales.

What should be considered is to conduct such a business on a purely commercial basis, while support projects should be implemented in conformity with market principles.

What PDI entrepreneurs need to start their own business are business skills, including technology and management. They also require working capital for the initial few years, in addition to equipment purchase costs.

Therefore, they require a comprehensive support program that provides coordinated support and assistance in the following areas:

- 1) Education and training for business skills and entrepreneurship, including basic education, if required;
- 2) Development of a marketing and distribution system for products and services to be provided by recipients, which should be designed on the basis of elaborate market analysis; and
- 3) Provision of a loan scheme focusing on small enterprises and new startups.

#### **Promotion potentials**

However, the limited examples of success cases reveal that PDI enterprises have the potential to become involved in an ordinary economic activities, if the appropriate measures are devised to support the recovery from the disadvantageous position of PDIs.

In fact, it is not easy to teach management skills through lectures. Rather, the business owners should have opportunity to learn from experienced managers in the actual business environment by joining a cooperative operation, or being employed by a private company.

### **1.4 Institutional Setup for SME Promotion**

#### **Current state**

The South African government has a three-tier structure consisting of the central government, provincial governments, and district regional governments. In planning and implementing an SME promotion program for KwaZulu-Natal Province, the provincial government and the Durban Metro government (if the program covers Durban) become important stakeholders. In particular, the provincial government has legislative power and administrative authority regarding regional development and promotion of commerce and industry, so far as it can take responsibility.

In reality, however, industrial policy is solely planned by the central government (DTI) and is implemented under DTI's authority. Thus, industries contact DTI directly to discuss policy matters.

In KwaZulu-Natal Province, DEDT within the provincial government is responsible for both SME promotion and industrial development. In addition, Durban Metro (or Durban Unicity) supports industrial promotion in the Durban district.

Basic policy related to SMEs (including basic strategy) is planned directly by DTI and is implemented by Ntsika and Khula according to their areas of responsibility by formulating programs. Programs are basically implemented by service providers. The state government (DEDT) plans and implements its own programs, while providing coordination and guidance for service providers in relation to implementation of programs planned by the central government. Nevertheless, the state government's budget allocated to SME promotion programs is fairly limited. The program results are accordingly limited. The central government's programs are implemented by a variety of service providers, including local agencies of the central government, financial institutions, public laboratories, universities and educational institutions, LBSCs organized under Ntsika and NGOs. As a result, it is difficult to make every service provider understand the intent of a program, its content and implementation procedures, so that in some cases programs do not work as intended.

#### **Demarcation of responsibilities between the central and local governments**

Each provincial government is expected to promote industrial and/or regional development that is primarily concerned with its own province. In reality, however, most industrial policies currently implemented in South Africa, which deal with issues related to international coordination, rather than those concerning an individual province. Thus, it is very difficult for the provincial government to handle industrial policy in terms of staffing and budget, and it seems that it will continue to be the central government that is solely responsible for industrial policy.

Similarly, SME policy is difficult for the state government to deal with due to human resource and budget constraints, although it is often concerned with an individual province or region and it is therefore desirable for the provincial government to take leadership in planning programs and coordinating their implementation in the future. Moreover, SME policy must address three strategic areas, namely improvement of competitiveness of SMEs, promotion of PDI enterprises, and improvement of the business environment for SMEs. Among them, improvement of competitiveness is closely related to industry

policy and should preferably be handled by the central government. On the other hand, promotion of PDI enterprises entails implementation of carefully designed programs, so that the central government sets policy direction and the state government leads program development and coordination.

**Program implementation and use of service providers**

Use of service providers for program implementation has major advantages in that it introduces the market principles to public programs and ensures competition among service providers, and that it relieves government organizations from staffing requirements (not only in number but also in expertise and knowledge requirement). Thus, the current system merits continuation in the future, provided that care be taken to allow recipients to benefit from a program and receive its service fully by defining and communicating the program's intent, content and implementation procedures to the service provider. Also, in the program preparation stage, an organization that has expertise and experience in the field covered by the program should be used for efficient and effective program design.