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Support for Small Enterprises in South Africa: Impressions from interviews with firms, their corporate customers, and their service providers

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These observations are organized in the following manner. First, I report some findings about what has worked best in SME (small and medium enterprise) programs elsewhere, as well as their common weaknesses, as related to similar patterns found in South Africa. Second, I report some impressions on SMEs and SME support systems in South Africa today, based on interviews with small firms, large customer-firms engaged in subcontracting to them through "social responsibility" or "linkage" programs, parastatals--both producers and service providers--and nongovernment organizations (NGOs). I include some suggestions in this section as to what the Department of Trade and Industry (DTI) might do to support SMEs in reaction to its draft white paper on a proposed program of support to this sector. The discussion is relevant most to lower-end SMEs--micro and small enterprises, often informal.

I - Patterns in SME support services

Generic vs. sector- and product-specific assistance. Initiatives and organizations assisting the SME sector tend to be generic rather than sector-, firm-, and/or product-specific rather than customized or problem-driven. This is understandable, because of the high cost involved in providing more assistance tailored to a particular firm, sector, or set of firms. In order to reach a significant number of firms, then, SME assistance tends toward generic assistance across firms and sectors. Some of the most successful interventions, however, are sector-specific ones--both outside and inside South Africa (e.g.s later). These are the interventions, moreover, that are driven by the kind of problem-driven, demand-driven processes that the Department of Trade and Industry endorses in its draft proposal for SME support. The challenge is, then, to identify problem-driven or sector-specific interventions that are not costly--either because the cost per firm of working this way has been reduced, or because there are strong indirect or spillover effects on other firms or on the local economy in general. This is what the successful programs in other countries, and in South Africa, have achieved--sometimes intentionally, sometimes not.

Identifying Critical Interventions. Related to the above, successful SME programs are usually different from the rest in that they define their programs in terms of an initial, and then ongoing, diagnosis of the problems of a sector--identifying critical bottlenecks and marginal interventions that could break them--and then work back to figuring out what exactly the intervention should be. But many SME programs start out by offering a generic service--training, credit, marketing, etc.--regardless of the specifics of a particular sector and the particular region in which they're working. Again, this tendency is understandable, since an organization wants to develop competence in delivering a particular kind of service. The problem with this supply-driven approach is that it does not ground itself in the economy, and the particular economic problems that have given rise to the need for an SME initiative in the first place. Examples can be seen in the following two observations.

Retail vs. manufacturing. Many SME assistance organizations that are well-run and succeed in reaching reasonable numbers of firms work mainly with retail firms, as opposed to services and manufacturing. But in most countries, and particularly in South Africa, the SME initiative is closely linked to a larger policy environment of great concern about unemployment and the need to get growth going. This means that SME initiatives should be, as much as possible, linked to their potential for stimulating growth and employment.

An SME clientele that is mainly retail firms, as is the case of many of the institutions we visited, including those that were quite well run, contributes less to the solution of these problems than one that focuses on the more labor-using and growth-related manufacturing and service sectors.

It is not that retail is not necessary or important. Rather, retail is much easier for SME organizations to assist and, hence, tends to be their default option, rather than the result of an explicit policy decision to go for retail. Retail is easier because:

(a) it lends itself to the generic approach more than services and manufacturing--one can offer courses in business management and in marketing to firms selling quite different products, whereas this kind of generic training accomplishes less with manufacturing firms;

(b) retail firms by definition have to be "out in the open," it is easier to find them, they are more likely to be registered and pay some form of taxes, and they are more amenable to contact with the world of assisting organizations since, unlike backyard manufacturers, they are unafraid of being discovered by tax or labor inspectors;

(c) with retail firms, "the collateral problem" is more easily resolved for SME credit institutions than with manufacturing firms, because of the collateral embedded in the retail firm's inventory;

(d) the activity pattern of retail firms enables repayment of credit to start earlier than for manufacturing firms; and the steadier flow of retail sales revenues throughout the year, in comparison to manufacturing, adds to the greater certainty with which credit-granting agencies face potential retail-vs.-manufacturing borrowers;

(e) in South Africa in particular, there is a general belief that black entrepreneurs take to retail but not to manufacturing, or do better at the one than the other--a belief that may be true in some places but is distinctly not true, from observations I could make even from a brief visit, in others. Even if it is correct that black entrepreneurs are more prevalent in retail than manufacturing (more on this later), things are rapidly changing as a result of the lifting of constraints on black businesses, particularly in areas where demand for light manufactured goods is concentrated, or where large firms are located and are interested in outsourcing.

For all these reasons, prudent SME agencies tend toward retail clientele. And because of the bias, assisting small manufacturing firms and facilitating their growth requires a distinct strategy to do so, involving (a) an identification of bottlenecks to be broken that may "release" existing production potential, and (b) a style of operating that, unlike the approach to the retail sector, cannot be generic.

Black business. Another sign of the lack of a problem-driven, sector-specific approach to SME assistance in South Africa is a remarkable lack of knowledge about the number of black firms now existing, particularly those in the townships and in the manufacturing sector. Ignorance of the basic distribution and size of this sector, particularly in manufacturing, is common in many countries--even though such knowledge can be gained with a quite unsophisticated and rudimentary "mapping" process, one township at a time, whereby such firms are simply counted by sympathetic "census-takers" interested in, and acceptable to, the communities where they work. The greater lack of "maps" of small black businesses in South Africa, particularly for the informal sector, is rather remarkable, given the proliferation of SME activities and SME-assisting NGOs in the country in the last years. The lapse in information is evidenced by the persistence of the kinds of statements noted above with respect to the lack of a black presence in manufacturing, even among NGOs and others (like the Small Business Advisory Bureau in Potch [SBAB]) working closest to this sector. This lapse can be explained by:

(a) the strength of the stereotypes, in lieu of any real information to the contrary, even among the most sympathetic actors;

(b) the marked changes of the last years--namely, the lifting of restrictions on migration and on black businesses; the effect of new "linkage" programs in stimulating expansion of SME activities in some townships (even though the size and impact of such programs may be insignificant in the aggregate); and even the effect of the 20,000 welders previously working in mining and other activities who were retrenched in the mid- and late-1980s and, with their severance pay, have started backyard metal-working businesses in the townships where they live--all these changes have given rise to a considerable increase in informal manufacturing (and service) activity, which may not appear in recent surveys and which SME organizations may simply be not aware of;

(c) the tendency of SME-assisting organizations to work with retailers rather than manufacturing firms, as discussed above, and hence to be unaware of what exists "in the backyard" of the very same townships where their retailing clients live;

(d) the related tendency to use generic and supply-driven rather than problem-driven and sector-specific approaches to providing service. A problem-driven or sector-specific approach that was linked to employment- and output-increasing concerns would, by definition, have to start with the mapping of existing firms in the manufacturing sector; and (e), as discussed next, the tendency to define SME initiatives in social rather than economic terms.

The "social" approach to SME support. The "social" or "welfare" approach that many SME initiatives take to informal-sector firms, or those at the lowest end of the SME spectrum, contributes to the common phenomenon of NOT linking these initiatives to the manufacturing potential that exists in the informal sector and, hence, to the opportunities therein for employment and for linking that employment to growth. The concerns that underlie the "social" approach, of course, need to be taken dead seriously (more later), but not at the cost of missing the opportunities for linking the informal sector dynamically to the rest of the economy.

The social approach, moreover, shares some of the problems of the generic approach to SME support--where well-known "needs" running across a large spectrum of the population are identified and, in response, a particular service is brought forth to meet them. The social approach, in other words, tends to preclude or drive out the problem-driven, sector-specific approach noted above--which may require a different intervention or type of service depending on the clientele, the region and its particular industrial structure, and/or the state of the economy at any particular moment.

There should, of course, be a distinct "social" content in an initiative like that of the DTI, at least when it seeks to support firms and individuals at the lower end of the SME spectrum. But that tends to get confused with the issue I am stressing here. Namely, connecting up with firms in the informal sector, particularly in a country like South Africa, requires a different style and organization of work than does working with more established, larger, and sophisticated firms. In South Africa, the gulf that lies between firm owners and production processes in the formal and informal sectors has been widened even more by the institutions of the apartheid system. The social dualism between informal and formal sectors requires that SME-assisting initiatives pay more attention to issues of inspiring trust among the clients they want to serve and the communities in which they are embedded--and a speaking of the language of their clients. This has obvious implications for the kinds of staff that are hired, the way they are trained, and the way they are deployed.

Working with informal firms in the townships will not simply result from requiring that a medium-firm agency or unit work with informal firms. In many cases, a different cast of characters will be required, as happened in so many instances in the agricultural sector in many countries, when attempts were made to get agricultural extension agencies working with large farmers to switch to small peasant farmers.

SME programs working at the lower end of the spectrum have to be "social," finally, in that they may require more subsidy for startup and learning costs, and simply for providing assistance that can create real growth and output effects, than those working with the larger, more sophisticated SME firms.

SME programs should, indeed, take explicit account of these two "social" aspects of initiatives to assist the lower-end SMEs. But this is quite different from my critique, which is that when such initiatives are labeled "social," they tend to ignore the potential to link lower-end producers to the opportunities for growth and increases in jobs in the economy at large. And they therefore do not do the work it takes to identify those opportunities, and to make the requisite change in their style of operating. This is the real danger of seeing the lower end of an SME initiative as distinct from what is being done at the upper end, even if certain aspects of organizational style and of subsidization may differ.

One activity vs. many. Successful SME organizations or programs tend to focus on one activity rather than several. Or, at least, they stay with that one activity until they completely master it, being highly attentive to the problems of their approach as they come up, and working out the "bugs" as they go along; in addition, they tend to stick with one activity until they have reached a large and significant number of clients, or until that single-minded activity has had substantial indirect developmental effects in a sector or region. When one encounters a multi-task organization that is successful, then, one usually finds that it started out with and perfected a single task. Grameen Bank and "minimalist" credit is a good example; the Get Ahead Foundation in South Africa seems to be moving on a similar path, though distracted with other activities that are more difficult and less successful.

When one encounters a multi-task agency in its early stages, in turn, one usually finds several years later that it has either narrowed down its array of activities to those that worked out best; or, it has continued coping with many activities, each of which is not having any significant impact on the SME sector. The Small Business Development Corporation (SBDC) may be an example of the latter--an organization that many hoped at its inception would specialize only in SME credit, but that quickly spread out to so many other activities that there are significant complaints about its performance, even with respect to its "specialized" function, credit.

Although there are clearly many exceptions to the best-practice pattern noted above--i.e., successful multi-task service-deliverers that start out that way--the DTI/SME proposal is particularly unsuited to the multi-task approach because of the plethora of institutions that will be participating and because of its choice of a decentralized and demand-driven structure. Because many of the service deliverers will be small and operating within local orbits, they are more likely to be burdened by taking on a variety of tasks than larger, more centralized institutions with more access to capital and human resources, and over which central government has more power and capacity to monitor.

It bears emphasizing that the multi-task approach tends to be the "default option" of institutions operating in the SME sector, as well as of planners who design broad initiatives in this area, including that of DTI. This happens for the following reasons:

(a) this approach derives from an "integrated" understanding of the problems of a sector, which in this case range from input-supply to finance to production to marketing;

(b) the approach corresponds to widely-held beliefs about what "the good organization" looks like--in SME, for example, the “good” organization does training, credit, and marketing assistance; if it does "just" credit or marketing, it is seen as somehow not addressing the SME problem;

(c) multi-task programs often result from the presence of multiple donors, each wanting to identify a particular program as its own and as distinct from that of "the other donor"; or each thinks that the organization's existing focus is "old," and wants to stimulate and take credit for "new" and "innovative" work on the part of its grantee.

SME planners are correct, of course, in saying that SMEs suffer from a variety of problems, and that it would be desirable for all of them to be tackled. It does not follow, however, that organizations can function well when they tackle more than one problem at once; in fact, they tend to do better when they take on one at a time. Despite the existence of "needs" across various sectors, then, it should be recognized that the "first-best approach" of working on several fronts at once won't yield "first-best" or even "second-best" results.

These considerations should apply not only to the kinds of organizations DTI recognizes as fit to participate in this program, but also to its strategy of funding. Namely, DTI should support organizations to concentrate on one particular activity in which they have excelled, and/on one particular activity that would have bottleneck-breaking impacts in creating output and employment increases in the local economy where they operate.

II - SMEs in South Africa today

Although I did not intend to look into the existing or incipient experiments of “linkage” programs that attempted to get large private and public firms to outsource to small firms (Hoechst, Anglo-American, Eskom, Wispeco, NEI/BOC-Johannesburg, Nedcorp/IFC), I could not help but be drawn to them because, strangely enough, they met--more than anything else I saw--some of the important attributes of successful SME programs noted above. Particularly, and by the very nature of the set of interests driving the "service design," they were product- and sector-specific, and customized to a set of firms. In addition, to the extent that NGOs or public-sector institutions were involved in the linkage program (NEI/BOC-Johannesburg, NISDA [National Informal Steel Designers' Association], Get-Ahead, SBDC, NWDC [ex-BNDC]), they played an important intermediating function--linking the interested large firms (the "service deliverers") to potential SME supplier firms beyond their reach, in terms of culture and place.

Large corporations contracting out to SMEs could be seen as a very powerful form of "demand-driven" service provision to SMEs--in some ways more effective in getting output, employment, and skills increases than that based on the demand of SME firms themselves to public-sector or NGO service agencies. The dynamic worked through the "demander" large corporate firms working closely with informal supplier firms so that the latter would produce a product that was acceptable in terms of delivery, cost, and quality. Although this “service provision” was clearly self-interested on the part of the large firms doing it, it also resulted in permanent improvements in product quality and in skills upgrading, both of which were clearly transportable in terms of enabling client firms to diversify to other clients and other products--that is, to permanently move onto a new plateau. There are clear limitations to channeling services to lower-end SMEs through large firms (see below), even when intermediated by NGOs or public-sector institutions. Nevertheless, these linkage stories contain important lessons with respect to designing service delivery by public-sector or NGO institutions themselves. Procurement by large public-sector enterprises, moveover, presents a distinct opportunity to structure SME service delivery in a demand-driven way combined with, at the same time, a greater commitment to social objectives than the large corporate sector can ever have. To the extent that large parastatals like ISCOR (steel) and ESKOM (electricity) are obligated more than large private corporations to serve publicly-mandated goals, they are in some ways a quite apt, instrument through which to encourage the kind of approach illustrated below.

Linkage and its limitations. Let us review the clear limitations of the linkage approach, not only because it is important to be aware of them, but because they suggest the choices that DTI should make if it were to support such a program through financing or, perhaps even more powerfully, through the regulatory or fiscal environment. The limitations, as observed by myself and expressed by many of those I interviewed, fall into the following categories:

(a) the corporate sector is not really interested in outsourcing at this moment--the Japan example and the knowledge of it notwithstanding (some large firms, in fact, reported that they were even more inclined than ever at the current moment to keep everything in-house, despite their admiration for the East Asian experience and the restructuring that large firms in other countries were undertaking--given the current uncertainty in the environment surrounding the large South African corporation;

(b) the linkage experiences that exist are merely "cosmetic" and "tokenistic"--reflecting the desire of large firms to look politically correct vis-a-vis the New South Africa;

(c) the subcontracting relationships in which this "service delivery" is embedded involve, by definition, strong monopsony power by the "service providers"--the large corporate client firms--over their suppliers, making the supplier firms increasingly and dangerously dependent on one client; this would be of concern for lower-end SME planners in any country, but is of particular concern in South Africa because of the implication in terms of increasing white corporate power over unorganized black outworkers;

(d) a variation on the previous, outsourcing of large firms to the informal sector is a form of getting around unions and, hence, (is part of a larger agenda of “union-busting” (some SME service in the NGO and parastatal sector even talked of how they "sold" outsourcing to large corporations on these grounds); and, finally,

(e) if large firms find outsourcing profitable, they have the resources to do it on their own--they don't need public-sector support for it; and, a variation on the same argument, any public-sector financial support for such programs would be paltry, by definition, in relation to the resources commanded and generated by these large firms--and, hence, of little effect.

Linkage and performance. Although many of these assertions are accurate, they are also incomplete. First, and most interesting, even though it is probably quite true that most firms have gotten into linkage in order to look good in terms of "social responsibility," some of them have--through this process--learned to their surprise that the result turned out to be a supplier product that was competitive with previous large-firm sources or in-house production in terms of cost, quality, and delivery times (e.g. ESKOM's incipient work with small garment producers for the production of protective uniforms, on which it spends millions of rands annually; or WISPECO's window-kit program--more on this later).

In most of these cases, moveover, one unit in the corporation (often, the increasingly common small-business units in large companies) had to "do battle" with management, or with another unit in the company that actually bought or used the input, in order to sell them the idea. (ESKOM's small-business unit had to "prove" to the unit buying protective uniforms that it could "deliver" SME-produced uniforms at the same price and quality as those it currently purchased from large firms; a single "believer" in WISPECO did battle for several years against a skeptical management that it would be worth the company's while to outsource the final stages of the assembly process of windows to the townships where these windows are bought by small contractors and the many individuals undertaking expansions of their houses (usually two additional rooms and a garage); he is now head of a new "window-kit" division at WISPECO.

This chain of events--with a "true-believer" person or unit of a large private firm or public enterprise having to “sell” subcontracting to small black firms to another part of the firm by coming up with an equally competitive product--is remarkably similar to some recent cases in Latin America in which public-sector procurement was successful in procuring from SMEs at equal price and quality with past larger and more sophisticated suppliers; in these latter cases, the "true believers"--a unit in the trade-and-industry department of government, or semi-public SME support agency--had to "sell" the idea to a highly skeptical public purchasing agency (a department of education, in the case of school desks; a department of agriculture in the case of small metal grain storage units; a department of public works in the case of implements for public-works programs).

What made these initiatives successful, in other words, was demands for performance on the part of the "uncommitted" party to the transaction, the purchasing agency, in terms of facilitating the delivery of a quality and competitive product. These demands and pressures structured the work of the "committed" parties in a problem-oriented direction, with automatic rewards and support forthcoming for good results in terms of product quality and cost by the supplying firms. In addition, and as in the large private-sector cases in South Africa noted above, it was as if the large firm or public enterprise were really acting as if it contained two separate firms, each at arm's length to the other; this arm's length relationship helped produce the desirable results by forcing the committed party or units to prove themselves and structure their work in certain ways.

These examples help illuminate two different aspects of the SME debate. One is that SME service providers in the public, parastatal, and NGO sectors almost never have to work under these kinds of demanding and results-oriented performance pressures. That's why, in part, their programs often show little results in terms of impact on output and employment in a region, even though they may be perfectly well-run programs.

A second aspect of the debate that these examples illuminate relates to the argument that the linkage programs are tokenistic and of marginal significance within the firms. The ESKOM and WISPECO examples cited above, that is, reveal a tug-of-war between units within large firms or public-sector organizations--as distinct from a simple position taken by the firm publicly with respect to any particular issue. Namely, although these organizations may in general not be particularly interested in SME development, there may be individuals or units within them that are; if they are committed and effective, they may be able to convince their managements or purchasing units to act differently--as they succeeded in doing in ESKOM and WISPECO.

All this means that it may not be particularly significant or relevant, or ill foreboding, if the large firm is not, at the start of a linkage program, committed to lower-end SME development--or if its motives are suspect. What matters is the existence of individuals or units within the firm that are given the wherewithal to experiment and convince the others. This is an endeavor that can be significantly affected by finance or other forms of facilitating or coercive support from the public sector--even if the value of that support, in relation to the firm's total sales and purchase, is paltry.

Finance or other forms of support, in other words, can play a key role in providing the "true believer" within the firm--or "believer units"--with the financial and, perhaps even more important, moral support to conduct a campaign within the firm to experiment with outsourcing, and to sell the idea to resistant other units or management. The "paltry" support, then, serves to shift the balance of power within the firm to the true believers, at least enough that they can do what they want to do.

Tokenism and learning. Another conclusion to be drawn from the analysis of these examples is that large firms are not outsourcing, let alone outsourcing to the lower-end SME sector--partly because they have no experience with it and can't afford to experiment on any significant scale in today's tight market conditions and the disarray of the South African economy. In a sense, then, it is good that there is a "cosmetic" justification for experimenting with outsourcing, since it would not occur at all without such a justification. Without the "cosmetic" motivation, the learning that shows that outsourcing can be at least as efficient as current production structure where outsourcing is minimal, would never have taken place. An interesting example comes from WISPECO.

WISPECO learned that it was actually more economic to transport its steel window frames in kits to the townships and outsource their assembly there (through the backyard welders) than to do the assembly in house. A truckloadful of completely assembled windows, for example, could carry only one fifth the number of units as a truckloadful of windowkits only. This made it more economic to ship and sell windows in the townships in smaller lots to small black contractors and to the large number of individuals buying directly for house expansion. The ability to tap into the market of smaller-volume customers, in turn, opened up the township market to WISPECO in a way that would not have been economically feasible if this large corporation were to have continued producing windows for this more fragmented market in-house. I return to this particular point below, because it relates to an important motivation for outsourcing among various South African corporations that is related to the logic of sales and marketing, as opposed to production. (So as to correct any possible misimpressions or exaggerations of the importance of the window-kit program as an example of WISPECO outsourcing, the window kits account for an insignificant percentage of total window production by the company--probably not greater, at the most, than one percent.)

Up to now, this discussion of existing linkage initiatives might be interpreted as a valiant attempt to put the best face possible on the outsourcing that has taken place or is just starting or on the drawing board (NEDCORP franchising, some of ESKOM's SME-directed procurement itself, BOC's intermediating efforts, etc.) But the examples I lay out above represent the only way to show a powerful sequence that can lead from "cosmetic" motivations to more economic and self-interested motivations on the part of large corporations. This sequence suggests that a lower-end SME program can have an important influence by surrounding the cosmetic programs with incentives and supports that encourage and reward the kinds of learning experiences carried out by "true believers" within large organizations both private and public, which would not normally be interested in outsourcing. (More specifics below.)

<u>Parastatals and SMEs</u>. Another implication of the above discussion is that the DTI should seriously include in its list of implementing organizations for the lower-end SME support initiatives the large producer organizations over which the government actually has some power--namely, the parastatals in the production sector. These firms are conspicuously absent from the DTI proposal, even though they present the "right" environment for highly effective demand-driven and product-specific programs of support that the proposal recommends, and even though they are more subject to public-sector direction than large private corporations. In addition, the parastatals feel themselves more impelled by the environment of "political correctness" than private corporations to act in socially responsible ways.

In addition to the ESKOM program cited above, ISCOR (the steel-producing parastatal) also felt vulnerable to the pressures to behave in "socially responsible" ways exerted by a new national association of informal-sector welders (NISDA) to sell these informal welders steel at bulk discounts. NISDA was formed mainly by some retrenched mining workers (of which there are now 20,000 throughout the country) who bought basic welding equipment--gas bottle, goggles, blowtorch, etc.--with their severance payments. Many of them are now producing burglar bars, window and door frames, and metal tables, chairs, and beds in various townships throughout the country (at least 400 alone, for example, in Soweto).

Parastatal production companies like ESKOM are more subject than others to pressures from the public to behave in socially responsible ways. ESKOM's work in electrification provision and maintenance takes its workers constantly into the townships and is made difficult and more costly when the public in those communities does not feel positively toward them. ESKOM staff is even more exposed to community pressures than usual these days--if that can be believed--because of their current large program of expansion of the distribution network in black residential areas.

Although negative reactions of the community to the supply and quality of electricity are certainly not new in South Africa, ESKOM is now being exposed to an additional source of pressure, which is perhaps having a more positive effect in supporting any proclivities some of its staff may have toward lower-end SME development. Seen by many township dwellers as the only representatives of "the government" visible to citizens in many of the communities where ESKOM is carrying out reticulation projects, ESKOM's workers are receiving constant inquiries and pressures about "RDP" and other government programs not necessarily related to electricity supply--when RDP is coming, how citizens can benefit (including as small contractors and individual building tradesmen) and, most relevantly, about what ESKOM can do to help.

Much as Raven Naidoo described with respect to likely pressures on the staff members of projected SME service centers in provinces throughout the country, ESKOM staff find it difficult to simply tell the truth and leave it at that--that is, that the management of RDP has nothing to do with them and they cannot help. Their discomfort provides another strong stimulus and support, within the organization, to seriously consider the possibilities for lower-end SME procurement across the list of the more than 1,000 different items ESKOM procures annually--as well as to engage in "friendly persuasion" of their corporate suppliers (e.g., of transformers and other large equipments, like GEC or

SIEMENS) to themselves outsource from SMEs.

Capturing markets through subcontracting. Heightened expectations about booming consumer markets in black settlements ran across several of my interviews with firms and their financiers. On the one hand, many large producers of consumer products are worried that growing black retail networks will edge them out, as reinforced by boycotts of the products of the white corporate sector, or threats of them. On the other hand, these firms see the black townships and other settlements as where a booming market is about to unfold--as a result of the expectation that things can only get better for these consumers under the new government and, more pointedly, because of the expectations about the jump-start to the economy of these settlements that everyone expects to result from the RDP program.

All parties seem to have this high expectation about RDP and the impact of its expected large expenditures--whether black or white, conservative or radical, racist or not, anti-state-intervention or pro-state-intervention. In that sense, the constant talk of RDP has contributed--even before it has even started, or before it is even known or understood what exactly its magnitude will be and how it will work--to a major surge of optimistic expectations about the South African economy and black markets and incomes in particular. Whether or not these expectations will be borne out--and whether or not a possible disappointment of such high hopes would create more political problems and, ultimately, economic slippage, than a quieter and less public period of planning for RDP--these expectations have caused large firms to be highly interested in marketing in the black community. Hence the interest, among some of these firms, in outsourcing there, to the extent that it helps them get a strong toehold in that market.

The WISPECO case dramatically illustrates this market-based interest in outsourcing to lower-end SMEs, which relate partly to an interest in increasing sales of the final product, as distinct from the economics of the production process itself. Perhaps for this reason, therefore, the “marketing motivation” for outsourcing is not as noticed by outsiders as is the "cosmetic" reasons for experimenting with it. WISPECO, that is, has been for some time very anxious to break into the black township market--beating out not only potential large competitors (of which there are only two in the country), but informal black welders and their small firms already selling windows and other steel-using product (tables, chairs, burglar bars) in the townships where they live and work. (WISPECO brands the informal-sector-produced windows, in its marketing in the townships, as "inferior.")

As noted above, the only way WISPECO can economically tap into the township market, given the current structure of demand, is to get down the costs of transporting and selling in smaller volumes to smaller customers--which is what the outsourcing accomplishes. Crucial to this marketing--as opposed to production--strategy is outsourcing to individuals and firms producing in the very same communities where the expanding markets are located. The outsourced individuals and firms, through the training process that accompanies the outsourcing, are won over to the "superior" qualities of WISPECO windows, and sell them as such--in the course of selling their own product--to consumers and small black contractors in that same community.

The location of the outsourcers in the same community as the expanding black township market, moreover, encourages the large outsourcing firm to engage in "socially responsible" projects in that community. WISPECO, for example, sponsored "WISPECO builders' clubs" among small black buyers of its windows, even before initiating the window-kit program. These clubs gave special discounts to small builders who purchased

WISPECO's windows, which in turn reduced the costs of inputs to these builders and facilitated their expansion.

Up to that point, the WISPECO clubs might have been characterized as pure self-interested public-relations efforts by WISPECO, though they also had the important effect of reducing the costs of windows to small black contractors. Eventually, however, the club members insisted that WISPECO help them get discounts from other large building-materials suppliers in return for their product loyalty; WISPECO correspondingly invited other large building-supply firms to join in, but the latter responded that it was not worth their while if the clubs continued to carry the WISPECO name. WISPECO agreed to take its name off the clubs, therefore resulting in even more important cost reductions to small township builders and contractors.

I have discussed the WISPECO example at some length in order illustrate how the market-oriented dynamic works in getting large firms to be interested in changing their production processes toward outsourcing--not only to SMEs, but to lower-end SMEs located in the very communities where they sell. This dynamic is quite relevant to many other firms, as explained momentarily, at the current South African moment. Interestingly, moreover, this market-driven interest in outsourcing would not exist, obviously, in manufacturing firms directed toward the export market, where hoped-for consumers would be located outside the country and hence not embedded in the communities in which outsourcing firms were located.

In order to take advantage of such possible market-motivated proclivities of certain manufacturing firms to become interested in SME outsourcing, DTI might want to target certain incentives, persuasions, requirements, and financial supports on those particular firms or sectors--such as building materials--that have a keen marketing interest in the black townships at the current moment. It could do this directly, or indirectly through the criteria and instructions it sets for the decentralized institutions through which the lower-end SME program would be implemented.

It should not be difficult for DTI to identify the sectors and the firms that are in these particular circumstances--some obvious candidates, in addition to building-supply manufacturers, are manufacturers of low-end apparel (small garment firms as finishers, an activity that could complement the customized work that is often the core of their business, and even out the seasonal fluctuations of that work with individual consumers) and auto components (auto mechanics as purchasers and possible outsourcers).

Subcontracting and monopsony power. I turn now to the concerns about the possibilities for monopsonistic exploitation of outsourcers in linkage exercises and the opportunities that they open up for undermining of fair wages and health and safety standards, at least as enforced by labor unions. Even in cases where this concern is warranted, the monopsonistic power of the outsourcing corporations will not necessarily lead to actual exploitation. Some reasons and examples follow.

Even if large customer firms set up outsourcing arrangements that bind small suppliers to them in highly unequal relationships--a darker interpretation one might give to the welding contractors making the WISPECO window kits--the increased productive and management capacity of the small outsourcing firm that results from the arrangement increases the ability of that firm to find other customers and produce other products. One senses that something of this nature is happening with some of the WISPECO kit-makers who belong to the new national welder's association, NISDA.

NISDA approached WISPECO with a request to provide its members with training to go beyond assembly and welding of the kit frames to production of the frames themselves--bending of the steel, etc. This would, of course, have taken the production process further out of WISPECO's hands than it wanted, so WISPECO declined this request. NISDA, however, persisted in its efforts to train its welders in skills that allow them to take the production process backward a few more steps than WISPECO allows; it has avidly sought out more advanced training through various formal-sector associations of sophisticated steel-product manufacturers and their research and design institutes. (This has also created a certain amount of tension between WISPECO and NISDA.)

Two important lessons are to be learned from this story of a group of outsourcers having the power to get out from under the hold of a monopsonistic consumer:

(a) WISPECO's very approach to its new outsourcers, which involved considerable training in production techniques and business skills, has endowed these welders with permanent and transportable skills. This enabled them to improve their production of other products (mainly, metal beds, tables, and chairs--the latter two items being sold to restaurants as well as individuals--and burglar bars, a veritable booming small industry among welders in black townships, which did not exist three or four years ago). The WISPECO tutoring, moreover, has itself provided the welders with the sophistication and confidence to go out in the world of formal-sector institutions to seek support elsewhere for the kind of training they unsuccessfully requested from WISPECO.

(b) The role of the association of welders was key in giving these firms the strength and the capability to get out from under their relationship with a monopsonistic customer a little, in order to progress even more--diversifying their customers and their products.

Both these aspects of the WISPECO/NISDA story have significance for DTI's thinking about lower-end SME support. First, DTI should have a clear idea of the kinds of linkage relationships that result in permanent and transportable endowments of skills and capacity by the large subcontracting firm, and those relationships that do not. The WISPECO/NISDA example already provides an outline of what to look for:

(a) an outsourcing arrangement that involves the provision by the customer firm of some kind of permanent and transportable increase in the capacity of the outsourced firm; and/or,

(b) the presence of an independent intermediary--an association of outsourcers, a labor union, an NGO or public-sector advocate--that provides some strength to the outsourcers as a group, and/or is able to effectively protect the outsourcers' interests by virtue of their greater numbers (in the case of an association of outsourcers) or of their greater expertise and/or links to powerful institutions in the formal sector--like banks, training institutes, parastatals, and the customer firm itself.

I spell out a few examples below, in order to show that it is quite feasible to specify the types of outsourcing arrangements that an SME program should and should not encourage and support, as well as the kinds of institutional players one should support, which are likely to act in the interests of the outsourcers, rather than their large customers.

An example of both the desirable and undesirable aspects of outsourcing as a form of lower-end SME intervention comes from the Anglo-American company, one of the earliest and the few large corporate actors to institute a significant linkage program. Among other outsourcing activities, Anglo-American decided to retrench workers in certain in-house service areas like cleaning and maintenance of worker hostels and, in order to avoid union opposition, offered to re-contract these same workers as outsourcers. This arrangement would not seem to have been particularly attractive for SME support, since it did not lead to a WISPECO-like upskilling of these workers; indeed, they may have actually been worse off since they would not be receiving the fringe benefits they had previously received as employees, and as protected by the miners' union. The union, however, would not accept the proposed Anglo-American arrangement unless it endowed a benefit plan for the retrenched workers, which Anglo-American conceded in doing. As with NISDA and WISPECO, then, an intermediary association (the union in this case) bringing together the outsourced workers or firms was crucial in righting somewhat the unequal balance of power between a large buyer and several of its powerless outsourcers.

Another example comes from the Get-Ahead NGO, which has recently been receiving calls from large firms who request that Get-Ahead provide them with names of workers from the townships, which these firms can then contract on an individual basis. Get-Ahead advertises in the newspapers of the townships with which it is familiar through its programs, and also comments on any resulting applicant that is known to it. In so doing, it performs an intermediation function for these workers and for the firm, which can now hire out of a larger pool of workers unknown to them because it gets free screening from the NGO. Get Ahead, however, plays no role in brokering the contractual negotiations between the worker and the firm; it does not coach the job applicants on what to expect and how to protect their interests, nor does it pick and choose from among the large-firm requesters those that seem to offer jobs that will provide better working conditions and/or upskilling.

This example is not meant to cast aspersions on Get Ahead or its programs, which concentrate in other areas; but it is meant to show, on the one hand, the opportunities that such intermediary organizations represent for reducing the costs to large firms of information search for outsourcing (and of moral hazard, as the economists say, or the risks of entering into a relationship with an unknown supplier). On the other hand, it illustrates--by way of contrast to the WISPECO case--the kinds of outsourcing activities that an SME program might not want to support. Or, at the least, Get-Ahead might want to charge firms for providing this "employment-agency-like" service, using the returns to subsidize its own activities that do increase the capacities of SME producers.

Another example of the ambiguity over whether the outsourcing relationship with a monopsonistic customer is necessarily exploitative or empowering also comes from Anglo-American. With some of the products or services it is now outsourcing, it actually "graduates" the outsourcers it has trained after a certain period, pushing them out of the nest and moving on to assist new ones. It justifies this on the grounds of developmental impact and social responsibility--the more supplier firms it helps to strengthen, the more impact it will have.

At the same time, it is clear that the company also has a self-interested reason for pushing its outsourcers out of the nest: it wants to make sure that the firms to which it is outsourcing are experiencing competition from similar firms when they (the outsourcers) bid for its contracts, and hence will keep down their prices and not be able to challenge the large customer firm's superior bargaining power in the market for imports and services. The monopsonistic firm, in other words, helps its new outsourcer to operate out in the market on its own, partly out of concern that it (the monopsonistic customer firm) will become too "dependent" on that newly-created and coddled outsourcer by purchasing only from that firm!

Producer associations and labor unions. In the DTI proposals for SME suppport services, a more explicit role needs to be given to lower-end outsourcers and other producer associations like the welders' association in the NISCA/WISPECO story, and to labor unions--as distinct from "NGOs" in general. There are two reasons for this:

First, the producer associations or labor unions not only represent the outsourcers themselves, but they are, for this reason, usually managed and led by blacks. This contrasts with many of the best existing NGOs, which are led by white professionals; though these latter groups often have very needed expertise and links to the powerful actors to which potential lower-end SME producers need access, they nevertheless represent a different tier of institutional actors. Though they are often profoundly committed to affirmative action, and many of these organizations have made serious strides in this direction, it will still take a long time before they have predominantly black staff and managers. In the meantime, their presence and their favored positions with donors generates understandable resentment by black-led organizations. Though the committed white-led NGOs have valuable contributions to make to the DTI's SME initiative, and should not be excluded, the resentment will not abate if black-led associations of SMEs are not explicitly targeted for support in such a program.

Second, and perhaps even more important, business and producer associations--in contrast to service-delivery institutions in the public and nongovernment-nonprofit sectors--tend to, by their very nature, request the kind of sector-and product-specific support, and to knowledgeably identify strategic bottlenecks to increasing output, sales, and profits. This is the kind of process that I identified in the introduction as characterizing successful SME efforts.

Some of these worker or business associations may have less management expertise, and may present more distinct weaknesses, than the middle-class professional NGOs. But this doesn't mean that they should be left out of the picture. To the contrary: precisely because they are important to bringing a problem-solving approach to SME support, let alone to increasing the presence of black-dominated organizations in the SME field, it is necessary to take extra pains in such a program to build up their capacity. This can be done in the course of helping them to work on the specific bottlenecks to expanding production that they identify out of their intimate experience with the business and its producers.

Whether or not these black business and producer associations formally participate in the meetings surrounding the DTI's SME initiative, then, a special effort should be made to find out their assessment of the specific bottlenecks facing their members, and to offer them support in breaking them. A few examples, which I ran into or heard about when I was here are NISDA, the Black Builders' Association, FABCOCS, NABCOC and, in particular, their sector-specific member associations like the garment-makers belonging to the fashion-designers' association.

Finally, with respect to the possible disadvantages of the linkage programs, which inhere in the monopsonistic relationship between large client firms and their lower-end SME contractors, I would suggest explicitly bringing some actors from the large formal-sector labor unions into the institutional picture of the DTI's SME initiative. As it currently stands, the SME initiative and its strong defenders among the NGO lobby and the large corporate firms sometimes borders on sounding like a strategy to avoid unions and the legislation, regulations, and workplace structures that protect workers.

Important and well-respected liberal NGOs, like the Sunnyside Group, lobby vigorously on behalf of their member NGOs--many of which are respected providers of support services to the lower-end SME sector--for a relaxation of the labor and other legislation with respect to small firms. Although their position derives from an interest in increasing the income-earning opportunities of the poorest workers, it is also true that the most exploited workers are those working for informal-sector firms. Even if big labor is sometimes intransigent or unreasonably self-interested, there is nevertheless good reason to be concerned about the conditions under which these workers earn their incomes.

Though the better-performing NGO service-delivery organizations are clearly needed for the important contribution they can make to the SME initiative, the program may inadvertently contribute to increasing the polarization between unions and large firms, and between unions and government, by including NGOs so centrally in its SME programs but not labor unions. The latter, after all, are ultimately much more powerful actors on the political scene than NGOs.

Perhaps more importantly, labor unions have often opposed initiatives to help informal-sector workers or reduce the regulatory requirements of small firms, perceiving a distinct threat to the gains they have made for workers and the power they hold. Or, they have simply been absent from the vigorous debates of the last decade, in South Africa as well as other countries, about how government can act so as to reduce the poverty and unemployment in the informal sector. Indeed, the unions' absence from these debates, together with the growing importance of informal-sector workers, may have contributed in some small part to the decline in their power--in that their absence represents a missed opportunity to organize in new sectors.

The ambivalence of labor unions toward the question of the informal sector is understandable. At the same time, the expertise of the unions and their power is needed for the work being done in this increasingly important area. Like large firms and large parastatals, moreover, even the most intransigent unions have individuals, or groups of them, who are more thoughtful on these issues, and anxious to grapple with them. There is significant reason, in sum, for the SME initiative to go out of its way to bring some union presence into the program.

III - Two final points

Defining performance. I have argued that lower-end SME initiatives can and should have an impact on employment and output in the regions where they operate, or in sectors where they concentrate their efforts. I laid out reasons this has tended not to happen in SME programs at the beginning of this memo. A final reason this tends not to happen is that funding entities--whether government agencies or outside donors--do not judge implementing agencies according to whether they contributed to increased unemployment and output among assorted firms, or generally in a region, and do not demand this kind of performance in return for continued funding.

SME support programs, rather, tend to obtain funding or funding renewals according to, at best, whether they are well-run and honest--often no mean feat; and/or whether they perform according to very limited conceptions of their responsibilities, namely indicators that relate more to inputs rather than outputs--numbers of courses given, numbers of businesses participating in the courses, number of firms visited, etc. Rarely are more significant indicators of performance required--increase in the output of assisted firms, increase in employment, clear linkage effects in terms of the growth of labor-using supplier industries to the assisted firms, or increased production by intermediate customers of the assisted firms' products.

Clearly, it is sometimes difficult to establish causality between the assisting agency's actions and the effects observed--which may be the result of other economic factors working themselves out in the region. But there are simple ways of chronicling such effects; even if one cannot necessarily establish causality, one would certainly want to exclude for funding those programs working in sectors or with firms in which nothing was happening, or that registered declines. If the DTI, as the central-government apex of the SME initiative, were simply monitoring these indicators among the various decentralized initiatives it was supporting, and making it known to institutional participants in the program that it would be judging future requests for support on these grounds, this in itself would create awareness among the implementing organizations of the importance of trying to achieve such impacts, and would represent a significant step forward.

My proposal of an outside monitoring function for a decentralized SME initiative, which would be seated in the central government, is quite consistent with one of the findings about the workings of state industrial policy in the East Asian success cases. In Taiwan in particular, as well as some of the others, the state not only granted subsidies to parastatals and private firms in the manufacturing sector, but it also demanded performance of them in terms of simple indicators--namely, increased exports or export shares of production. These clear performance targets were set in return for lavish subsidization, along with sunset clauses or distinct dates by which the performance would be evaluated and continuation of suspension of the subsidies suspended. There is no reason that the central government cannot play a loosely analogous role with respect to the organizations that will be receiving public monies to carry out a program of SME support.

Mapping the manufacturing sector. A final suggestion with respect to the need, as discussed earlier, for a mapping of informal-sector manufacturing firms, if only on a township-by township, case-study basis. This would be a gargantuan and costly task if done on a national scale, and quickly become out of date. But national-scale, or even province-wide mapping is not necessary. Case-by-case mapping--a township at a time--could inform better the thinking of support organizations about how to design their support systems, about where significant potential lies to expand and upgrade lower-end manufacturing capacity, and where same-sector firms are spatially clustered, providing particular opportunities for grouping of these firms in associations and the attendant strengths of supporting them this way. This kind of simple local mapping would also help to fill the information gap of large-firm customers with respect to possible places to look for outsourcing capacity.

One simple and not very costly approach to rectifying the lack of information, which is consistent with the decentralized style of the proposed program, is to link up to universities and other research institutions with students who must prepare master's and doctoral theses. DTI's program, that is, could fund small scholarships for students supervised by their professors to carry out such mapping activities, which are very labor intensive--they require, for example, walking down streets and listening, door by door, for the sound of anvils or other tools working in the backyard--as well as confidence by the community in the researcher.

These kinds of studies, by the way, are excellent training exercises for students if done in a single community or township. Students and researchers in anthropology, planning, and sociology in particular are often interested in this kind of research; black students, of course, might have a distinct advantage in gaining access to households and to this kind of information, so that this might be a particularly appropriate scholarship for black students, and a particularly powerful approach to their training.