

**SMALL ENTERPRISE GROWTH
THROUGH
BUSINESS LINKAGES
IN SOUTH AFRICA**

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FOREWORD

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The six studies on Small, Medium and Micro Enterprise (SMME) Development: **1.** Enhancing Economic Development by Fostering Business Linkages between Pharmaceutical Companies and the Traditional Medicines Sector by E.C. Bbenkele, **2.** Promoting the Growth of Micro and Micro and Small Enterprises through Business Linkages in the Northern Province by C.L. Machete and F.D.K. Anim, **3.** Business Linkages Involving SMMEs with Umgeni Water and Hulett Aluminium in KwaZulu-Natal by T. McEwan, D.C. Mead and N.M. Ndlovu, **4.** Linkage Promotion in South Africa: Insights from Research Conducted in Durban and Richards Bay: An Exploratory Study by F.O. Skae, **5.** The Role of Business Linkages in Restructuring the Footwear Industry in the Greater Pietermaritzburg Metropolitan Area by B. Strydom, and **6.** Small Enterprise Growth through Business Linkages in South Africa by D.C. Mead were carried out between September 1997 and March 1998. Five of the studies were carried out in KwaZulu-Natal Province under an agreement between the University of Natal, Pietermaritzburg, the United States Agency for International Development, and Harvard University, through a sub-agreement with Michigan State University. The final study was arranged between the same American principals and the University of the North, Sovenga, Northern Province, in South Africa.

The choice of where to carry out these studies on SMME developments was not entirely accidental. The Northern Province, for example, was found to be the poorest of South Africa's nine provinces in the 1996 census with an average income of R17,900 (approximately US\$3,000) and 46 percent of its 4.9 million population unemployed, which is the second highest after Eastern Cape (49 percent) in South Africa.

Third in terms of high unemployment (with 39 percent), was KwaZulu-Natal Province, which has the largest population (8.4 million) of South Africa's 40.8 million population. The average income is barely R24,3000 (approximately US\$4,200), despite the large contribution made by the Durban Greater Metropolitan Area to the South African and Provincial economies. Because the principal source of investment in the past has come from South Africa's white population, large disparities still exist which distort average income calculations, according to the 1996 census. Among unemployed Africans, for example, the average income for women is R12,000 and R16,000 for men. This compares with an annual income for men of R30,000 and R20,000 for women across the whole working population in South Africa.

There are also daunting development backlogs in both provinces. For example, nearly one million people in KwaZulu-Natal have received no formal education, and a further 700,000 are classified as "functionally illiterate". A further half a million households live in traditional

housing with no direct access to electricity or potable water supplies. (The Sunday Times Report, 25 October 1998, p.5). The Income Distribution for the province (Gini Coefficient) is 0.7 which indicates the same skewness as for the rest of South Africa, compared with an ideal coefficient zero. However, the Human Development Index for the province, which measures life expectancy, income and literacy rate, etc., was 0.59 when data was last collected in 1991, compared with 0.69 for the rest of South Africa and an ideal index of 1. (Source: Industrial Development Report on the Pietermaritzburg Spacial Development Initiative, 1997).

Northern Province is the least urbanized province in South Africa and 90 percent of its population still live in traditional housing or shacks in the rural areas on the outskirts of towns. It also has the highest proportion of women (54 percent of the population) compared with 52 percent across South Africa. The highest population of uneducated or “functionally illiterate” people live in this province, and over 60 percent of households still use wood for cooking and heating purposes.

As if high unemployment, illiteracy and restricted rural development are not burdens enough for any province to have to carry in the New South Africa, KwaZulu-Natal and Northern Province have also still to come to terms with the added problems of HIV/AIDS and, in the case of KwaZulu-Natal, politically-motivated crime and violence.

Accurate data on HIV/AIDS infection is hard to come by, notwithstanding the commendable efforts of specialists and other experts in the field, because the full extent of the problem only attracted full media attention in South Africa earlier this year when the Deputy-President, Thabo Mbeki, made an eloquent plea for more sympathetic understanding of those infected, and also called for rapid action plans of contain the spread of this pandemic. If forecasts are accepted, they make chilling reading as 53 percent of the beds in the University of Natal’s Medical School hospital are already occupied by HIV/AIDS patients. Over one in four people in KwaZulu-Natal is probably HIV/AIDS positive and, nationally, South Africa is already planning to cope with an estimated two million orphans, or abandoned children, as well as one-third of all women attending ante-natal clinic being infected with HIV/AIDS, over the next 10-15 years.

It would be out of place to comment much further here about a subject of which we possess no expertise. Two things which are relevant to the SMME studies need to be stated. Firstly, a major consequence of South Africa’s economic and political history up to 1994 was the gradual decline of the “Lobola” system, whereby families were started before the African version of Western “marriage” took place. Women remained in rural areas with their families to raise new off-spring, whereas the men left to find work in urban/industrial areas so that they could raise the money to pay off the “Lobola” dowry to the woman’s parents and support their families. Since then, the 1996 Census reveals that the migration of men to rural areas has become a permanent feature of the South African economy. For example, 63 percent of African males under the age of 20 live in rural areas but this figure declines to only 40 percent by the age of 30. This trend begins to reverse itself after the age of 55, with almost 70 percent of males returning to their rural homelands by the age of 70 years.

Secondly, in view of this cycle of male migration, the prominence given to SMME development in the South African economy is easily justifiable since, although African women are also becoming more urbanized, this occurs at the lower rate. For example, 63 percent of African women are born in rural areas yet almost three-quarters remain at home throughout the most economically active period of their working lives. Raising the living standards of African women and their children through SMME development is an obvious way of combating HIV/AIDS in rural and urban communities since less migration and greater discrimination against African women, in terms of equal pay and job opportunities, means that over 50 percent are unemployed, compared with a national average of less than 30 percent. Starting up SMMEs is even less common and, in the six studies performed we experienced great difficulty in finding more than a few SMMEs in KwaZulu-Natal which were owned and run by women.

Politically-motivated crime and violence have also retarded economic development in South Africa and nowhere more so than in KwaZulu-Natal. Recent statistics indicate that more people have been killed in KwaZulu-Natal since 1994 than in the whole of the former Yugoslavia (SABC News Report, 3 November, 1998). Again, the reasons are far too complicated for detailed discussion in this report. However, that the Zulu nation is the largest ethnic group in South Africa, yet has failed to secure what might be regarded as an equitable share of political and economic power, because of divided support for the two largest political parties, provides part of the explanation why political-motivated crime and violence has brought economic development (eg. tourism) almost to a halt in some regions of KwaZulu-Natal. It also reinforces the argument for learning more about SMME development in the expectation that, if ever political differences can be reconciled, then the expansion of appropriate economic activity among African people in particular should proceed far more rapidly in KwaZulu-Natal.

This research project attempts to explore the business interests of two very different sets of South Africans. On the one hand, there are the senior and middle managers employed by two well-known, undoubtedly successful organizations in Pietermaritzburg. Mostly, but not solely white, these represent the buyers and include well-informed managers, trained in modern business practices, who see their primary functions as raising productivity and expanding their markets in ways which will eventually benefit all of the expanding population of the Greater Pietermaritzburg Metropolitan Area. As part of how they go about achieving these aims, the managers of both companies are committed to purchasing goods and services from Small, Medium and Micro Enterprises (SMMEs) amongst the historically disadvantaged Zulu Community in particular.

On the other hand, the “sellers” in the list of companies provided by “buyers” included a mixture of successful white-owned SMMEs alongside a wider range, in terms of financial performance, of entrepreneurs from the Zulu Community. In passing, it should be noted that Indian SMMEs were deliberately excluded because these were already being studied in a separate survey. The Zulu entrepreneurs could be divided into a small portion of successful medium-sized enterprises, as defined by the South African Department of Trade and Industry (DTI), which are clearly well-run and trade regularly with the largest companies in KwaZulu-Natal without need of any assistance from third parties, including government agencies.

Outside of this small apex of successful, largely self-made, black enterprises lies a large phalanx of Zulu-run SMMEs which are owned and operated by up to three, but mostly one, individual. Of the original list of over 1,200 SMMEs provided by both corporates, more than 80 were invited to participate in view of the limited time available. Of these, over one-third finally took part in the survey.

The research questions we sought to answer were based on the premise that around the world, modern, forward-looking businesses interact with other enterprises through a complex web of commercial relationships. This is because many efficient managers find it cost-effective not to try to do everything themselves “in-house”. Instead, they purchase some of the goods and services they require for their production activities from other enterprises that specialize in particular aspects of the production process. These purchases and sales, which we refer to as business linkages, are a pervasive characteristic of efficient and productive economies.

South Africa is expanding the scope of these commercial transactions. Many large corporations are moving toward a lower degree of vertical integration; many are reaching out more beyond their traditional corporate patterns, sometimes to smaller suppliers. While there is a long tradition of support for small business in South Africa, much of the energy in the past has been devoted to the promotion of small, white-owned businesses. In recent years, there has been considerable discussion of the way in which that process can be opened up to newly-established enterprises that had been excluded under the old Apartheid regime.

A research project at the University of Natal and the University of the North, in cooperation with Michigan State University, funded by the US Agency for International Development, set to examine the nature of these business linkages, as well as the extent to which they currently provide opportunities for improvement for historically disadvantaged small enterprises, and the kinds of steps that can be taken to expand such opportunities in the future.

In the first of these studies, Professor Bbenkele set out to identify existing and potential business linkages between the traditional medicines sector and registered pharmaceutical companies in South Africa. He also investigated how these business transactions could be developed to create an estimated 1,000 jobs per year in Durban, plus a smaller number of job opportunities in Pietermaritzburg.

His findings indicate that it cannot be assumed that expansion of the traditional medicine sector is straight-forward or a foregone conclusion, as different types of business linkages in an increasingly complex chain or network first need to be explored. These linkages involve gatherers, traditional healers, local authorities, National Parks Boards, pharmaceutical companies, the South African Medical Control Council and Ministry of Health, as well as health authorities overseas. All would need to be consulted further before the potential growth in job creation can be achieved. Job creation of this magnitude is of importance not just because it would help to reduce the high unemployment in the two Metropolitan Areas, but also because many of these envisaged new jobs would be taken up by rural women as gatherers of traditional medicine ingredients in the raw material form.

In the second study, Charles Machete and Francis Anim studied business linkages between small suppliers, in mainly black-owned businesses, and large buyers, in mainly white-owned businesses, and attempted to evaluate their contributions to SMME development in The Northern Province by seeking answers to the following questions: What are the distinguishing characteristics of small suppliers with, and without, business linkages? What are the determinants of business linkages? How can knowledge of these factors promote and strengthen new and existing business linkages? What are the constraints on the establishment of business linkages. Finally, what measures need to be taken to promote successful business linkages in The Northern Province?

In the third study, two interview teams led by professors McEwan and Mead identified existing and potential business linkages by carrying out a detailed study of 29 SMMEs which supply two leading corporates in Pietermaritzburg. These corporates were selected because of their public commitment to assisting historically disadvantaged enterprises, which predates the creation of the “New South Africa” in 1994, but also because the policy of both corporates is directly influenced by national and regional government agencies which seek to act in a beneficial or interventionist manner.

In-depth interviews were carried out with entrepreneurs and managers using a standard survey instrument, which preceded a comprehensive study of the values, objectives, strategic behaviors and the problems encountered by both suppliers and buyers, most of whom were situated in the Natal Midlands along the Durban-Pietermaritzburg corridor of the proposed Eastern Seaboard Spatial Development Initiative project. This study is far from exhaustive and much more needs to be known about other contributing factors affecting the vital task of enabling larger numbers of historically disadvantaged people to participate in business activity in the Natal Midland and play a fuller part in expanding the South African economy.

In the fourth study, Owen Skae studied the existing and potential business linkages of 32 SMME suppliers located in the Durban and Richards Bay Metropolitan Areas and their business linkages with 15 other companies, which are large buyers in the same Eastern Seaboard “corridor”.

These suppliers may be regarded as representative of the wide range of SMME activity in both coastal industrial centres, since no fewer than 26 different manufacturing and service sector enterprises have been included in this survey. In-depth interviews were carried out with entrepreneurs and managers using the same standard survey instrument used in the previously-mentioned study, which resulted in a comprehensive analysis of the motivations, aims, strategies, outcomes, and difficulties experienced by both suppliers and buyers. More still needs to be known about how to enable increasing number of historically disadvantaged people to participate in business activity in this region of KwaZulu-Natal, thereby helping to expand the South African economy, but a valuable start has been made in this research project.

In the fifth study, Barry Strydom carried out a detailed analysis of existing and potential business linkages of 32 SMME’s and larger companies which make up the declining footwear

industry, mostly based in the greater Pietermaritzburg Metropolitan Area. These enterprises either purchase from or supply other companies both in and outside South Africa.

The reasons for the steady decline of the South African footwear industry are complex and probably came to public attention for the first time as a result of the lifting of tariffs following South Africa's readmission to the Global Economy in 1994. However, international isolation, the failure to introduce new technology in the past, inadequate training, low productivity, coupled with a genuine concern by the industry to avoid shedding manual jobs carried out by historically disadvantaged people, have all contributed to this loss of market share. More than 4,000 jobs were lost in the Greater Pietermaritzburg Metropolitan Area alone, between 1994-1998, and the situation is likely to deteriorate further as the industry braces itself for the full impact of further cuts in tariffs under the GATT Agreement which are due in 1999. However, many local SMME's and larger companies have shown themselves to be both adaptive and resilient in the face of unavoidable change, and this study succeeds in identifying key forward, backward and horizontal linkages which will have to be evaluated and probably implemented during the next 18 months, if the South African footwear industry is to survive intact into the 21st century.

Special thanks are due to Professor Donald C. Mead, Michigan State University, for helping negotiate these last-minute arrangements; and also for sharing some of the interview load undertaken by Barry Strydom, with further assistance by Professor Tom McEwan. It should be noted that the six papers are a part of an ongoing study, and some analysis has been excluded because it forms part of a Masters dissertation, which has still to be assessed. Since completing this study, however, members of USAID/EAGER team have been invited to carry out an evaluation of the government-backed Workplace Challenge initiative, which will explore ways of improving collective bargaining and introducing new technology into the local footwear industry. A further report on this research is planned for 1999.

In the final study, Professor Mead undertook the task of drawing the disparate research findings together into a coherent whole which will hopefully be useful to all stakeholders with an interest in the successful expansion of the SMME sector in South Africa. Attention should be drawn to the following synopsis of his findings which would seem to have a wider range of application in South Africa outside the provinces of KwaZulu-Natal and the Northern Province.

The research shows that buyers establish business linkages with three principal motivations in mind; namely, either because it is good business to do so; or out of a sense of community service, or because they wish to shift to a production pattern that enables them to escape payment of taxes, or evade the impact of rules and regulations, usually imposed by Government agencies. While the last of these motivations was clearly true in many cases, a number of other suppliers paid all relevant taxes and fees while employing workers who were members of unions and were covered by the standard labor benefits. These enterprises were generally the most efficient of the small suppliers, and the ones that were growing the most rapidly.

Some linkage contracts were much more helpful than others to historically disadvantaged small suppliers. The key determining factors of these arrangements were the characteristics of the contract (size, period covered, stability), and the degree to which the contract provided a channel for the supplier to learn how to do things better. Where the motivation for the contract was based on community service, these factors were much less likely to be present. In such cases, linkages generally resulted in frustrations for the buyer and little development impact for the supplier. In contrast, where the motivation was commercial, the buyer had an incentive to serve as mentor to suppliers, for example by helping them improve their efficiency and productivity. Unfortunately, our interviews uncovered relatively few cases where the buyers played a significant role in mentoring their suppliers in either KwaZulu-Natal or the Northern Province.

Since there is considerable interest on the part of both buyers and suppliers in expanding the involvement of historically disadvantaged small enterprises in business linkages, with several initiatives currently under way and others just starting, it is clear from our research that to be most effective, institutional support for the promotion of business linkages needs to be based on a number of clear principles:

Firstly, the driving force must be economic, not a paternalistic goal of community service. All linkage promotion activities must have an orientation that starts from markets and works back to suppliers, thereby helping them take advantage of these identified market opportunities.

Secondly, the institutional structure must be cost-effective, taking account of the limited resources available to support this type of activity. Specialization and focus among promotion agencies can be important in helping achieve this objective. Buyer mentoring, a key factor in many successful linkages, also contributes in important ways to the goal of cost-effectiveness.

Thirdly, there are three specific building blocks which support the promotion of linkages; namely, information, capacity-building, and capital. While each may be needed to bring a particular contract to successful fruition, in general, one organization should not attempt to supply all three because the risk of inefficiency increases.

Fourthly, issues of imbalance between buyers and sellers are important and must be addressed in establishing equitable policies or programmes for linkage promotion, and some of these approaches are discussed in the papers.

Fifthly, much has already been achieved in the expansion of business linkages involving historically disadvantaged small enterprises in South Africa, thanks to the efforts of Ntsike Enterprise Promotion, the Centre for Small Business Promotion and the National Small Business Council. The interviews we carried out make clear that there is a strong will on all sides to do more. With stronger institutional support, there is much more that can be done.

It would be impossible to express thanks to the large number of people who either assisted or participated in this project, but special mention must be made of the contribution of Professor David Maughan Brown, Senior Deputy Vice Chancellor at the University of Natal, who

supported the research programme from the start and made it much easier to implement. Mr. Hollie Clarkson and Mrs. Cheryl Pratt from the University Finance Department have to be thanked for their professional monitoring of expenditure which ensured that compliance with rigorous US funding regulations was achieved.

Charmagne Howe, Kathy Acutt, Joy Gauche and Debbie Bowen, from the Department of Business Administration, must also be thanked for their administrative support, without which many interviews would never have been arranged and the two large workshops in Pietermaritzburg would certainly never have run so smoothly. Special mention must also be made of Nhlanhla Moses Ndlovu, who proved to be an outstanding research assistant, and provided invaluable support in "breaking the ice" during interviews with Zulu-speaking respondent, and who stored and analyzed data in an accurate way which augurs well for his own future research into SMME developments. We must also express our gratitude to Professor Anthony Lumby, Dean of the Faculty of Economics and Management at the University of Natal Durban Campus, for supporting Owen Skae's study of emerging SMME activity in the Durban-Richards Bay region of KwaZulu-Natal province; and additional thanks are due to Mel Clarke, KwaZulu-Natal Regional Economic Forum, for "opening doors" which resulted in us gaining quick access to the key players in the local footwear industry. Finally, the patience, helpful advice and insights of Alwyn Pollock, Commercial Manager at Umgeni Water, and his assistant Jill McEwen and Dennis Ndlovu, were much appreciated, along with those of Mervyn Webb, Senior Purchasing Manager at Hulett Aluminium, as was the interest shown by Andrew Layman, Director of the Pietermaritzburg Chamber of Commerce and Industry, and the coverage provided by Johan Beukes, Business Editor of the Natal Witness, South Africa's oldest daily newspaper.

Special thanks must also be expressed to the various English- and Zulu-speaking entrepreneurs who took part in the various surveys. They ranged from the obviously successful to those who run their fragile businesses on tightly-stretched shoe stings in back gardens, on in houses converted into make-shift workshops, with small children at play in the room next door. Here, in the townships or on run-down industrial estates, we interviewed mostly male respondents, many of whom possessed little knowledge of basic business skills and practices, which are essential in order to survive.

Their dire situation raises fundamental questions about the nature of the "Transformation" process in the New South African civic society. Simply put, in our view, if whatever has been inherited by the more fortunate, as either wealth, health, education, or even as better career opportunities, was at the expense of the near-defeated in society, then natural justice insists that better ways must be found of helping these brave, anxious, inadequately-trained "survivalist" entrepreneurs to place their tiny businesses on a sounder economic footing in the future. Otherwise, for them, "Transformation" and "Redistribution" will become two long, meaningless words in South African newspapers and dictionaries, which some are unable to read and most are unable to purchase.

Ever optimistic, some of these respondents asked if they could see our final reports, and it is with this commitment in mind that most of the following studies have been compiled with the

minimum number of tables , diagrams and calculations which, for reasons outside their control, most said they might not be able to understand, We hope that better ways of assisting these people to run their small enterprises more effectively occur as a result of the publication of our reports which indicate that their business aims are simple enough and, not surprisingly, very similar. They wish to raise their living standards more rapidly by dint of their own efforts, enjoy better health, educate their children beyond the basic standards they achieved, and take their rightful place in a civic society of which they and all other South Africans can feel justifiably proud.

ABSTRACT

This paper summarizes the data and findings of five separate studies of business linkages in South Africa. While separate, each of these studies shared a focus on the nature and performance of business linkages between small, medium and micro enterprises (SMMEs) and larger firms, and they thereby permit some pooling of results. Contrary to expectations, it was found that some of the outsourcing business linkages involve core activities of the corporate firm. Where the SMME is able to provide quality goods at competitive prices, firms are willing to contract for such supply. Similarly, the summary points to findings regarding the level of technology employed by SMME firms and their consequent earning potential, noting that these were, in some cases, higher than expected.

The summary draws evidence from the ancillary studies to propose that, of the two primary motivations for business linkages with traditionally disadvantaged SMMEs (i.e., directly commercial versus community service objectives), it is those linkages based on commercial interest that seem to generate the most dynamic and profitable SMME businesses. Based on this finding, the author proposes that linkages should be based on economic and not social objectives, lest the relationship become distracted from sustainable business growth. Other major findings include: access to capital, capacity-building and information is needed for successful linkages; mentoring by larger firms can be useful to SMMEs; and, those who provide support to SMMEs through training or business assistance ignore market conditions at their own (and their clients') peril.

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EXECUTIVE SUMMARY

Around the world, modern, forward-looking businesses interact with other enterprises through a complex web of commercial relationships. Many efficient managers find it cost-effective not to try to do everything themselves “in-house.” Instead, they purchase some of the goods and services they require for their production activities from other enterprises that specialize in particular aspects of the production process. These purchases and sales - which we refer to as business linkages - are a pervasive characteristic of efficient and productive economies.

South Africa is expanding the scope of these commercial transactions. Many large corporations are moving towards a lower degree of vertical integration; many are reaching out more beyond their traditional corporate partners, sometimes to smaller suppliers. While there is a long tradition of support for small business in South Africa, much of the energy in the past has been devoted to the promotion of small, white-owned businesses. In recent years, there has been considerable discussion of the ways in which that process can be opened up to newly-established enterprises that had been excluded under the old Apartheid regime.

A research project at the University of Natal and the University of the North, in cooperation with Michigan State University, funded by the US Agency for International Development, has recently examined the nature of these business linkages, the extent to which they currently provide opportunities for improvement for historically disadvantaged small enterprises, and the kinds of steps that can be taken to expand such opportunities in the future. Among the major findings of the study are the following.

There are many business linkages currently in place involving transactions between major corporations and historically disadvantaged small suppliers. Interviews with about 75 large enterprises indicated that virtually all did some purchasing from small, historically disadvantaged suppliers. Most bought from only a few, but some buyers had on-going commercial relationships with twenty or more small, disadvantaged suppliers. Many of these are in the service areas: catering, office cleaning, transport, or construction-related activities. Others were in manufacturing, and in some cases were close to the core activity of the large partner. The clearest example of this was in footwear, where several steps in the production process were routinely handled on an outsourcing basis. Among the service activities, several appeared to be quite efficient, growing rapidly and generating good returns for workers and owners.

Buyers established linkage contracts with three principal motivations: because it is good business to do so; out of a sense of community service; and to shift to a production pattern that escapes payment of taxes, rules and regulations. While the last of these was clearly true in many cases, a number of other suppliers paid all relevant taxes and fees while employing workers that were members of unions and were covered by the standard labor benefits. These were generally the most efficient of the small suppliers, and the ones that were growing the most rapidly.

Some linkage contracts were much more helpful than others to historically disadvantaged small suppliers. The key determining factors were the characteristics of the contract (size, period covered, stability), and the degree to which the contract provided a channel for the supplier to learn how to do things better. Where the motivation for the contract was community service, these factors were much less likely to be present. In such cases, linkages generally resulted in frustrations for the buyer and little developmental impact for the supplier. Where the motivation was commercial, by contrast, the buyer had an incentive to serve as mentor to suppliers, helping them improve their efficiency and productivity. Unfortunately, the interviews uncovered relatively few cases where the buyers played a significant role in mentoring their suppliers.

There is considerable interest on the part of both buyers and suppliers in expanding the involvement of historically disadvantaged small enterprises in business linkages. Several initiatives are currently under way, and others are just starting. To be most effective, institutional support for the promotion of linkages needs to start from several principles:

- i) The driving force must be economic, not a paternalistic goal of community service. All linkage promotion activities must have an orientation that starts from markets, working back to suppliers to help them take advantage of these identified market opportunities.
- ii) The institutional structure must be cost-effective, taking account of the limited resources available to support this type of activity. Specialization and focus among promotion agencies can be important in helping achieve this objective. Buyer mentoring, a key factor in many successful linkages, also contributes in important ways to the goal of cost-effectiveness.
- iii) There are three building blocks for the promotion of linkages: information, capacity-building, and capital. While each may be needed to bring a particular contract to successful fruition, in general, one organization should not attempt to supply all three.
- iv) Issues of imbalance of power between buyers and sellers are important and must be addressed in establishing policies or programs for linkage promotion. The paper discusses some approaches to this issue.

Much has already been achieved in the expansion of business linkages involving historically disadvantaged small enterprises in South Africa. The interviews make clear that there is a strong will on all sides to do more. With stronger institutional support, there is much more that can be done.

1. Introduction

Around the world, modern, forward-looking businesses interact with other enterprises through a complex web of commercial relationships. Many efficient managers find that it is cost-effective not to try to do everything themselves, “in-house.” Instead, they purchase some of the goods and services they require for their production activities from other enterprises that specialize in particular aspects of the production process. Many of them also sell their output to other businesses, either for further processing or for marketing and distribution. These purchases and sales - which we refer to as business linkages - are a pervasive characteristic of efficient and productive economies.

The degree to which such arrangements create opportunities for historically disadvantaged small enterprises in South Africa is determined by three inter-related factors:

i) To what extent do large businesses choose to perform these functions themselves, rather than purchasing them from others? In the past, this choice has sometimes been expressed as one of “make or buy;” but, in fact, the options available are considerably more complex, since the decision to buy can be implemented in a variety of different ways.

ii) If a larger partner chooses to buy a good or service from others, with whom do they do business? Do they deal only with companies that are part of their own conglomerate, or do they also have contracts with others, including newer and/or smaller companies? Do they do business only with members of their own ethnic group, or are they ready to undertake commercial transactions with others as well?

iii) What is the nature of the relationship between buyers and suppliers? Is it restricted to an arms-length relationship, or are there other types of interactions, reflecting an attitude of partnership? Are contracts written and implemented in such a way that they are conducive to an improvement in the performance by suppliers?

In South Africa, there is movement on each of these fronts. Many large corporations are moving towards a lower degree of vertical integration; many are reaching out to undertake more commercial transactions with other businesses beyond their traditional corporate partners, sometimes to smaller suppliers. In part, this reflects pressures of competition, as the economy opens up more to the outside world and corporations find they must look for more efficient ways of doing things. In part, it also reflects increasing competence on the part of a variety of new suppliers, and a resulting increase in confidence in the reliability of markets. While there is a long tradition of support for small business in South Africa, much of the energy in the past has been devoted to the promotion of small, white-owned businesses. In recent years, there has been considerable discussion of the ways in which that process can be opened up to newly-established, smaller enterprises that had been excluded under the old Apartheid regime.

A research project at the University of Natal and the University of the North, in cooperation with Michigan State University, funded by the US Agency for International Development, has recently examined the nature of these business linkages, the extent to which they currently provide opportunities for improvement for historically disadvantaged small enterprises, and the kinds of steps that can be taken to expand such opportunities in the future. Five other papers report on particular aspects of those studies (see bibliography). This paper provides an overview of the results of the study. Among the major findings of the study are the following.

2. There are many business linkages currently in place involving transactions between major corporations and historically disadvantaged small suppliers.

Interviews with 75 large enterprises indicated that virtually all did some purchasing from small, historically disadvantaged suppliers. Most bought from only a few, but some buyers had on-going commercial relationships with twenty or more small, disadvantaged suppliers. Many of these relationships are of recent origin, a fact that supports the wide-spread impression that the level of transactions of this type is increasing.

2.1. Sectoral focus of the contracted activity: the research started with the hypothesis that large enterprises would choose to outsource only non-core activities, keeping their core operations in-house. A subsidiary hypothesis was that opportunities for commercial dealings with large corporations were generally limited to service activities; manufacturing processes, by contrast, would all be done in-house by the large corporations.

In fact, this set of hypotheses turned out to need significant qualification. It is true that, in many of the heavy manufacturing activities, the production process itself has been done entirely in-house; outsourcing has been limited to service activities such as catering, office cleaning, transport, or construction-related activities such as maintenance, electricity installation, or painting of offices or sheds. Even for the heavy manufacturing activities, however, the distinction has not always been clear-cut. Hulett Aluminium, for example, hires an outside enterprise to convert scrap into ingots that can be used for further processing, a relatively capital-intensive if technologically un-sophisticated process that is close to its core activity of supplying semi-processed aluminium.

Shoe manufacturing presents an interesting case here. The stitching of the top part of the shoe - closing of uppers, as it is called - is a central function in the making of a pair of shoes. It involves work that requires considerable skill, and is very important to the quality of the finished product. Yet a number of the most efficient shoe manufacturers in Pietermaritzburg undertake this task making use of CMT (cut-make-trim) operators, separate enterprises specializing only in the closing of uppers. Several other steps in the process of making shoes are also frequently handled in this way (e.g. stitching and lacing, or the manufacture of inner soles or heels).

In sum, many large businesses choose to handle the core of the manufacturing process themselves, either to control quality or because it requires substantial skills or high investments of capital which they feel would not be available to small suppliers. Yet where there were smaller enterprises able to provide products or services of the required quality at competitive prices, large enterprises have been prepared to engage subcontractors to supply goods and services that were of central importance to the final product.

There has been some skepticism in discussions of business linkages, reflecting the view that linkage suppliers are constrained only to service activities, where the opportunities for the use of improved technology are severely limited and levels of income are destined to remain low. Our research suggests that this is not correct. Some of the subcontracts we observed went beyond services to the manufacturing process, sometimes including manufacturing activities that are of central importance to the quality and price of the final product sold by the large enterprise. Furthermore, it is a mistake to assume that services are always restricted to activities involving low levels of technology and income. On the contrary, some of the most dynamic companies, including some office cleaning, catering, and construction-related activities, were supplying services in ways that used modern techniques and generated substantial incomes both for owners and workers in the enterprise. Employment in some of these service-based linkage suppliers has been growing very rapidly.

2.2. **Motivations for buyers to establish linkages:** corporations participate in linkage activities for two basic reasons: because they are **good business**; and out of a sense of responsibility for **community service**. To say that they are good business means that the linkage contracts provide the corporate buyer with needed inputs of the required quantity and quality, at competitive prices, delivered in a timely manner, thereby reducing costs and enabling the corporation to concentrate its capital and management skills on a more limited range of activities (its “core business”). Corporations generally say that both of these motivations play a role; but the relative emphasis given to each differs widely from corporation to corporation, and even from one linkage contract to another in the same corporation.

There is also a third type of motivation, which corporations are less ready to discuss but which their critics emphasize: the desire to **avoid the rules**: to avoid paying taxes, to escape the regulations, or to employ workers in patterns not consistent with union agreements or bargaining council decisions. Our interviews make clear that this factor is indeed an important one, in many of the linkage contracts. But there is also a significant number of small, historically disadvantaged linkage partners who operate fully in compliance with all rules and regulations. Their workers are members of unions and receive all of the standard employment benefits, the enterprise pays all required taxes and has the required permits and licenses. In general, these are the linkage suppliers that are most competently managed, that are growing most rapidly and that are generating the highest returns for both owners and workers in the enterprise. It is not necessary for small suppliers to operate outside the rules for them to be a part of a competitive and efficient supply system.

3. Some linkage arrangements are good for both buyers and suppliers; others are not.

In general, the interviews indicate that activities motivated by community service bring results that are not satisfactory to either the buyer or the supplier. For buyers, the product or service often falls short of their requirements in terms of one or more of the criteria listed above (quantity, quality, price, or timeliness of delivery). For the supplier, the developmental impact of such contracts is generally limited and temporary, often just enough to keep the enterprise in operation but not enough to enable it to prosper. Only when the buyer treats the relationship as a commercial one does the linkage have a significant developmental impact. It is in such cases that the buyer recognizes that it is in his interest (as well as that of the supplier) that the supplier be dealt with on terms that enable the supplier to thrive. This is reflected in the length of the contract, the terms of the contract (in particular, the price and payment terms), and the kinds of interactions and counseling in which the buyer engages to help ensure that the supplier succeeds.

Characteristics of linkages that are good for suppliers: the degree to which the linkage arrangement is an effective development mechanism for suppliers is determined by two sets of factors: the characteristics of the contracts; and the degree to which the linkage provides a mechanism for a transfer of skills or knowledge, or for expanding the capital stock of the supplier.

Looking first at contracts, a major complaint frequently voiced by suppliers was that their linkage contracts were too small, of too short a duration, and too variable and unreliable. Small and short-term contracts may be sufficient to keep suppliers from going out of business, but not enough to help them do well. One of the large buyers indicated that their goal in this area was to ensure the survival of the supplier enterprises. Such an approach led them to take any given set of orders and divide these among all qualified suppliers. The result was that each supplier received just enough orders to keep it from going under, but not enough to enable it to prosper.

A corollary of this community service approach was the intention expressed by the buyer that no small supplier would be excessively dependent on a single buyer, but would sell to a variety of customers. Again, this resulted in a decision to keep the purchases from any one supplier to a modest amount, forcing them to look for other clients. While the idea of providing an incentive for suppliers to search for other markets is laudable, the limited purchases channeled through the linkage contract for any one supplier - clearly reflecting a priority given to community service over commercial considerations - sharply restricted the ability of the supplier to reach a level of efficiency where it could offer a competitive product, either to the partner in the linkage contract or to other customers.

A related problem concerns the variability of the contract. In one case met in the course of the interviews, a supplier had invested Rand 300,000 (about \$60,000) in equipment to supply a major buyer. After about a year of operation, the orders were abruptly suspended, with no explanation given, a suspension which lasted for about 18 months before purchases were suddenly resumed. Such a pattern shows a complete lack of concern for the needs of the supplier. Incidentally, it is

distressing to report that, at the conclusion of those 18 months of “down-time,” when the supplier contacted ten workers who had been laid off when the market disappeared, all ten immediately reported back to work, indicating that they had been unable to find any alternative employment in the meantime.

Larger and longer-term orders enable suppliers to plan, to invest, and to achieve economies of scale that can lead to improved economic efficiency. All of these are in the economic interest of suppliers, but they are also very much in the interest of buyers. When buyers choose to ignore these imperatives, it suggests that they are giving priority to community service objectives in ways that impose economic efficiency costs both on themselves and on their suppliers.

A second key dimension of contracts that are beneficial in terms of their developmental impact for the suppliers is that they provide a mechanism for suppliers to learn. The learning here includes issues of product specification and product design: how must the product be made, if it is to meet the requirements of the market? This might include details of the raw materials, machinery or processing techniques that must be used in making the product. It might include any of a number of management skills (e.g. ability to cost the product, to control inventories, to manage the process of quality control), the absence of any of which could make the product unacceptable to the buyer in terms of the standard requirements of price, quality, quantity and timeliness.

When linkage contracts are working well, they provide a channel for such learning to take place. Often this involves a significant role for the buyer, in a role that is often referred to as “buyer-mentoring,” discussed further below. Alternatively, institutional arrangements might involve outside organizations operating in such a way as to contribute to this learning process, to enable the linkage contracts to flourish.

Our interviews suggest that very little of this learning is taking place in South Africa today. In general, suppliers have been forced to rely on the abilities and skills that they bring to the table from their own experience, or that they are able to seek out and acquire on their own. This set of issues is discussed in more detail below, where we explore alternative approaches to remedying this situation.

4. While much is going on now to promote linkages, there is also interest in doing more and in doing it better.

In the current economic and political climate in South Africa, there is considerable interest in increasing the opportunities for people who were previously excluded to be drawn into the economic mainstream. The expansion of business linkages is an important part of that conversation. This has led to a number of different initiatives for the promotion of business linkages. At a government level, the most important initiatives have focused on the **Local Business Service Centres** (LBSCs). While these centres have a number of responsibilities, one

important one concerns their role in the promotion and support of business linkages. We discuss the operations of the LBSCs in more detail in section 5 below.

The **Business Linkages for Under-utilized Enterprises** (BLUE) project has done very effective work in the promotion of business linkages. Using an approach that involves the avoidance of duplication but the strengthening of existing institutions to enable them to improve their effectiveness, the project has succeeded in generating a substantial expansion in employment and sales through linkage contracts in a number of different provinces of South Africa. Regrettably, the project is due to end in September, 1998.

The **Private Sector Initiative** (PSI) of the Small Business Project is a new undertaking involving several of South Africa's largest corporations, working together to "develop and expand the role of the corporate private sector in generating decentralised growth through collective support for small and medium-sized enterprise development" (from the PSI mission statement). A major focus of their work is in developing more effective patterns of business linkages, and sharing information about the effectiveness of different approaches currently being used.

Several **individual companies** have developed extensive programs for the promotion of small, medium and micro enterprises through business linkages. The best known of these are perhaps Anglo-American and Eskom, who have been involved in this type of program for a number of years; but a number of other corporations have also made major commitments in this area, including several that were included in our study (e.g. Tongaat-Hulett and its subsidiaries, and Umgeni Water).

While much is currently being done to encourage an expansion of business linkages, our interviews make clear that **both buyers and suppliers want to do more**. Several of the large corporations have expressed a clear intention of expanding their purchases from historically disadvantaged suppliers. Correspondingly, many suppliers fervently wish to increase the level of their sales to large buyers. Both sides are looking for more effective institutional arrangements for the promotion and support of such linkages. In the following section, we present suggestions for approaches to encourage such an expansion. These suggestions arise from the interviews with buyers and suppliers in South Africa, as well as from experience with similar projects in other countries of the region.

5. Some principles for the design of institutional arrangements supporting the growth of good business linkages.

5.1. **The driving force must be economic**, for both buyer and supplier. An attitude of charity on the part of the buyer, or of rights to special treatment on the part of the supplier, can quickly divert the endeavor, converting it into a charitable activity that not only distracts people from a principal focus on the promotion of sustainable, market-based linkages, but is also likely to

hinder the spread of the idea that business linkages can be a commercially rewarding way of organizing business behavior.

5.2. Cost-effectiveness is a key part of the equation. Neither the South African government nor international donors nor corporations are ready to provide deep pockets for long-term support for projects to promote linkages. This means that the limited resources that are available must be used carefully and in a focused way. In general, this means avoiding comprehensive, holistic programs in favor of approaches that are targeted and focused, providing only the bare minimum of assistance that is required in support of any one linkage in order to be able to provide help to as many clients as possible.

5.3. There are three building blocks to business linkages: information, capacity building, and capital. All three are required, if a linkage is to succeed, although that does not necessarily mean that one organization or institution needs to provide all three.

Information is needed about potential partners in linkage contracts. Buyers need to know who are potential suppliers, for goods or services they wish to procure. Suppliers need to know who are potential buyers, for goods and services they are ready to offer.

The task of providing this information in a way that meets the needs of both buyers and suppliers, and particularly of doing this in a cost-effective way, has proven to be a formidable challenge. Several internationally-funded projects have been aimed at the establishment of subcontracting exchanges involving the assembly of comprehensive data bases on potential buyers and suppliers. In general, these appear to have been quite expensive and to have had only limited success in contributing to an expansion of linkages. One problem has been that rapid changes in the universe of small enterprises mean that such lists quickly go out of date. If a buyer is provided with a list of ten potential suppliers for a product he wishes to purchase, only to discover that four of these suppliers have gone out of business, three have moved and cannot be located, one has switched to other activities and two have phones that do not work, this means he must invest quite a lot of time for very little benefit. Keeping an up-to-date, comprehensive data base is no small task

Of course, individual corporations keep lists of their own suppliers, with information (either written or in people's minds) about their own experience with each. A sensible approach might be a simple sharing of this information among buyers in a particular locality. In some cases, there may be some reluctance to share such information with potential competitors; but in general, this seems like a useful approach, and several members of the business community have expressed an interest in pursuing it.

The Local Business Service Centres in both Durban and Pietermaritzburg have sought to provide such information, although with only limited success. In Durban, problems appear to have resulted from excessively ambitious goals in this area. Relatively few potential suppliers have been vetted in considerable detail and are then included in their data set, which was presented in an attractive form but then sold at an unacceptably high price. In Pietermaritzburg, the problem appears to have been that the LBSC staff sought to control the linkage contract by selecting only

one potential supplier to suggest to the buyer. This may have reflected an understandable suspicion on the part of the LBSC staff that the large buyers had already made up their minds as to the supplier they would purchase from, and were going through the motions of approaching the LBSC only to show their supposedly good intentions. If such arrangements are to work, however, then inevitably the buyers must make the decision about suppliers, based in the end on their own investigations.

In our view, this key function of information-sharing and match-making can best be performed by an intermediary organization operating largely on an *ad hoc* basis, responding to requests from buyers for a short list of perhaps five potential suppliers. Before supplying such names, the intermediary would need to check to make sure that the enterprise still exists, that its contact numbers are operational, that the enterprise is interested in supplying a particular product or service, and (based on a very brief inquiry) that it has the capacity to supply that product or service, with a record of those to whom they have previously sold, who could be contacted as reference if a new buyer so desires. The more detailed follow-up and the final selection of the enterprise to be given the contract must be solely the buyer's responsibility.

Over time, an intermediary operating in this way would accumulate a list of buyers actively interested in procuring particular products or services. With the buyers' permission, such information could then be shared with other suppliers that approach the intermediary seeking outlets for goods or services that they have to offer.

Capacity-building: Many micro and small enterprises would like to enter into contracts to supply larger businesses; but often their capacity to do so falls short in one or more dimensions. This means that there is undoubtedly a need to provide a mechanism through which suppliers can improve their capacity to perform as reliable partners in linkage contracts.

This capacity-building can be done using any of a variety of different institutional arrangements. It can be done by the buyer; by private sector companies, on a fee-for-service basis; by governmental training or counseling agencies; or by Non-Governmental Organizations (NGOs). Each of these exists, often in profusion, in South Africa.

The most effective forms of capacity-building must start from a need to pay attention to cost-effectiveness, and to ensuring that activities undertaken in this area are done in a context that takes account of the demands and opportunities of the market. These issues are discussed in more detail in the following sections.

Capital: enterprises seeking to expand or to improve their productivity generally require new capital investments, at a rate that often exceeds what can be financed from their own reinvested profits. This means they will often require outside capital, to enable them to take advantage of the market opportunities that linkages present to them.

Linkage relationships help suppliers address these needs in three ways. First, linkage contracts can reduce the need for working capital, since they can help truncate the design process, reducing

search times for markets or for requisite machinery and equipment. Secondly, orders from buyers can strengthen a supplier's application for a loan from a financial institution. Third, the buyer can provide a variety of facilities that help meet the supplier's capital needs: by direct provision of raw materials or intermediate products, by providing advance payment for a portion of the cost of an order, or by guaranteeing a loan application submitted by a supplier to a financial institution. Such arrangements clearly can help the supplier reduce costs and increase his efficiency, which can also be of direct benefit to the buyer.

In general, it is a mistake for linkage promotion agencies to become directly involved in the provision of credit. This is a highly specialized field, which does not match the comparative advantage of most linkage promotion projects' staff. What they can do is to help facilitate access by small suppliers to capital, either from formal financial institutions or through discussions with the buyers, to encourage the larger partner to play a more active role in providing support in this area.

5.4. All activities must start from markets, working back from there to suppliers. We have seen a number of cases in South Africa where this basic idea was ignored, with disappointing results. This has come either because training was too generic (e.g. business management, or book-keeping, in general), or because the training was in areas that are already saturated (e.g. dressmaking). A more effective approach would first explore the market, then provide assistance to enable small enterprises to take advantage of identified market opportunities.

Business linkages provide a particularly appealing way of approaching this question. A key feature of the linkages approach to small enterprise promotion is that it focuses on helping suppliers respond to identified market opportunities. With the limited resources available for capacity-building among small enterprises in all countries of the world, including South Africa, it is particularly desirable to use those limited resources to help small enterprises respond to opportunities known to exist, as represented by buyers ready to purchase specific things from appropriate suppliers.

5.5. Specialization and focus can help achieve a goal of cost-effectiveness. Just as large businesses do best when they decide what is their core business, then focus their energies on doing that as effectively as possible, so intermediaries can make their most effective contribution when they do not seek to do everything for all possible clients, but rather choose a particular focus for their activities, interacting with others with different specializations for other functions. To try to provide all three of the business linkage building blocks for all possible clients often means a lack of focus, with a resulting decrease in quality and increase in cost of services provided.

There is a major danger that such a dispersal of effort will rob the LBSCs of their effectiveness. When they seek to provide training, counseling and advice to address the whole range of problems faced by small enterprises, resource constraints make it virtually impossible for them to give adequate attention to their match-making role, helping buyers identify historically-disadvantaged potential suppliers while providing suggestions to these suppliers about possible

clients to whom they might sell. The LBSCs are in a unique position to be able to perform this match-making, information-exchange function, a function for which there is a great demand on the part of both buyers and suppliers. It would be a great shame if dilution of focus should lead them to miss the opportunity to make a major contribution in this area.

5.6. Buyer mentoring is central to many successful linkages. Buyers are the ones who know best exactly what product specification and what quality they require. They are the only ones who are in a position to know which dimensions of quality can be treated with more relaxed levels of tolerance and which are crucial to the provision of an acceptable final product. Often, they are the ones in a position to say to the supplier, “if your product is to be acceptable to us, it must be made using this specific raw material, and manufactured in this particular way.”

This buyer mentoring will take place only if the buyers come to view their relationship with their suppliers as a partnership. Mentoring requires time, energy and resources on the part of buyers. They will only be ready to invest in such relationships if they believe that the supplier is capable of achieving an efficient and competitive level of production, and if they recognize that success in the linkage contract in terms of improved supplier competence is in their own business interest, since it will result in supplies that are more desirable in terms of price, quality, quantity and timeliness.

Our interviews with suppliers in South Africa show quite an uneven pattern in this regard. The majority of suppliers appear to have been left almost entirely on their own, to do the best they could to meet buyers’ requirements based on pre-existing skills and equipment, combined with whatever capacity-building they could arrange on their own. This was particularly the case where the buyers viewed their involvement in business linkages as a form of community service, with little expectation that the suppliers could in fact become efficient and competitive. In such cases, even where some advice or support was offered to suppliers, it was relatively perfunctory. Most of the small, historically disadvantaged suppliers who benefitted from linkages were strong enough when they start the linkage activity, so they were able to succeed in spite of the limited support that was available to them.

Of course there were exceptions. Some of the large partners visited regularly with their suppliers, seeking to understand their needs and helping them deal with their problems. Interview responses made clear that these were the cases where the linkage contracts were of the greatest benefit to the supplier, providing the smaller firm not only with access to markets but also with assistance in helping the supplier meet the competitive standards required to sell in those markets. In addition to helping the supplier, the result was a much higher level of satisfaction on the side of the buyers.

5.7. Issues of power imbalance are important and must be addressed. When a large buyer makes purchases from a small supplier, the buyer generally has overwhelming power to dictate the terms of the contract. There is a widespread concern in South Africa that this can result in an exploitation of small suppliers by larger partners in linkage contracts. What steps can be taken to mitigate this power imbalance? We would offer three suggestions, and comment on a two other approaches which are popular among some circles in South Africa but which appear to be more problematic.

Multiple buyers: if a small supplier can sell to several different customers, that can make the supplier somewhat less dependent on the terms offered by any one of them. Of course one should not exaggerate the gains to be derived here, particularly if the number of potential suppliers is large while there are only a few buyers who may well confer with each other; but this flexibility in terms of wider options in selling can be an important step in the direction of addressing this issue.

Education of buyers: forward-looking buyers recognize that it is not in their interest that a supplier be squeezed to the last penny. A supplier who is being marginalized will often offer products that are of marginal quality, with problematic delivery schedules, which can add immeasurably to the headaches of the buyer. Suppliers need to earn a fair return, particularly if they are seeking to improve their efficiency and productivity. There is an educational role to play in ensuring that buyers understand that.

Independent assistance in costing: a major area of weakness among many small suppliers is that they do not know how to determine what would be a fair price for the product or service they are offering. An outside agency, perhaps using accounting students at a university under the supervision of their professors, could offer a useful service here in helping them think through what would be a reasonable price.

Associations of suppliers? It is often argued that the best way to deal with this issue of power imbalance is to group suppliers into some form of association, so they can bargain together with buyers. While this idea is appealing in principle, we have rarely seen it work in practice. It is particularly problematic where the grouping is done at the instigation of outsiders, rather than arising from an effort by the people themselves to address their common problems jointly. Cooperatives and business associations formed in response to pressures from the government have a dismal record in Africa and elsewhere in the third world.

LBSCs or other NGOs as partners to the linkage contract? One idea popular in some circles in South Africa is that, in order to protect small suppliers from exploitation by large buyers, an intermediary organization should be a partner to each linkage contract. In an extreme form of this arrangement, the buyer would enter into a contract with the intermediary organization, which in turn would have a contract with the supplier. Our interviews make clear that such an arrangement is quite unacceptable to buyers. If intermediaries insist on trying to operate in this way, the buyers will simply ignore them, by-passing them to make their own arrangements directly with the suppliers, making it very difficult for the intermediary to play a significant role in the promotion of linkages.

Power imbalances are a serious issue that needs to be monitored. It is important, however, to do this in a way that leaves the core of the linkage as a contract directly between a buyer and a supplier. For all their risks, linkage contracts provide opportunities for previously excluded enterprises to participate in dynamic segments of the economy through access to growing markets and access to opportunities to learn to do things better. These opportunities constitute the core appeal of business linkages. It is important to address the challenges of power imbalances in ways that do not seriously impair those opportunities.

6. Concluding Comments

South Africa, with its history of apartheid which has so clearly disadvantaged the majority of the population, has left in its wake a mentality that emphasizes the need for special help. This has led to a widespread (although certainly not universal) belief that historically disadvantaged suppliers inevitably produce low quality goods and services; that much needs to be learned by disadvantaged suppliers, to enable them to change that situation; and that the learning process is certain to be very slow. Reflecting a combination of paternalism and guilt on the one side and the demand for special treatment on the other, this mentality runs the risk of getting in the way of defining commercial relationships between business partners in business-like terms. To the extent that an interest in business linkages arises from such a mentality, the result is a presumption that, for the foreseeable future, the promotion of business linkages must be viewed as a form of community service. As suggested above, where this has been the motivation for the establishment of business linkages, the results have been disappointing for all concerned.

There is a small but growing body of literature that emphasizes the importance of trust in economic development. Where such trust exists, the participants see one another as partners. When one component thrives, the others benefit as well; when one participant suffers, all participants are harmed. This reasoning applies at three different levels: between workers and owners in a particular enterprise; in the relationship between different enterprises in commercial transactions; and in the relationship between the private sector and the government.

As it emerges from its apartheid legacy, South Africa appears to have an unusually low level of trust at all three of these levels. Newspapers report that labor unions often view themselves as being engaged in a war with the capitalists. Relationships between employers and employees are often seen as a zero-sum game, where improvements for one can only come at the expense of the welfare of the other. Relationships between buyers and sellers are often thought of in the same terms. In such a situation, there is little incentive for buyers to take account of the needs or interests of suppliers, to help them do better.

If business linkages are to work as an effective development mechanism for small suppliers, then the large participants in linkage contracts must come to approach these relationships as partnerships. This is a perspective that says: "if the small supplier who sells to me does better, that helps me: it provides me with a product or service at a better price, in a more timely and reliable manner, at a quality level that meets my needs. If my supplier fails to meet my requirements in any of those dimensions, it hurts me in my business. If his business fails, that imposes real economic costs on me. It is therefore in my business interest to find out how my suppliers are doing, what problems they face, and to work with the suppliers to help them find ways of addressing those problems."

In order for a corporation to approach linkages in this way, the key decision-makers must believe that such an approach has a reasonable chance of success. If they have this belief, then it becomes worth their while investing their time, energy and resources to making this happen. If on the

other hand they believe that, in the great majority of cases, such results are not likely to ensue, then their linkage activities move over into the category of community service, which might also be called paternalistic charity. In such cases, they are ready to tolerate mediocre outcomes for extended periods, with no real efforts to work to change things, since such efforts would be expected to be generally fruitless.

If a corporation recognizes the need for some form of capacity-building to help suppliers move to the stage where they can be efficient and reliable partners, it may choose to address this task in-house: by adding such responsibilities to the job description of existing purchasing agents, or by setting up a special small enterprise support unit. Alternatively, the corporation and its suppliers may turn for help to outsiders, either the business support centers, private firms, or NGOs. In many successful cases, several of these approaches have been combined.

What is most clear is that, when they choose to do none of the above, the linkage is likely to have only very limited developmental impact. Small, historically-disadvantaged suppliers may find out about new markets, but they would receive no help in their efforts to improve their capacity to sell in those markets. From the buyer's perspective, unmentored linkages are unlikely to bring a satisfactory outcome in terms of meeting their business requirements. Charitable linkages for community service may look good in the company's public relations materials and may serve (temporarily!) to allay political pressures; but they will make little real contribution to the development of the disadvantaged. Only a business-like approach to business linkages can deliver the sustained and expanding benefits that South Africa needs today.

Opportunities to sell to large buyers have provided some expanded access to expanding markets for historically disadvantaged small suppliers. In general, supplier enterprises have had to rely on pre-existing experience and skills. With improved institutional arrangements to expand knowledge about such opportunities, and with improved mechanisms for strengthening the capacity of suppliers to perform as partners in linkage contracts, there is great potential to expand this set of opportunities and thereby to reap more of the benefits of sound business linkages. Progress will require more focused and informed efforts on the part of corporations, local business support centers, and training institutions. While much has already been achieved, our interviews make clear that there is a strong will on all sides to do more. With stronger institutional support, much more can be done.

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