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**PROMOTION OF SUSTAINED PRIVATE  
SECTOR-LED ECONOMIC GROWTH WITH  
BROAD PARTICIPATION IN THE BENEFITS  
BY PREVIOUSLY DISADVANTAGED GROUPS  
IN SOUTH AFRICA**

**Final Report**

**U.S. Agency for International Development**

**Prepared for: USAID/South Africa and AFR/SD/PSGE**

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## **ABBREVIATIONS**

<b>BIFSA</b>	<b>Building Industries Federation of South Africa</b>
<b>BMI</b>	<b>Business, Marketing and Intelligence Consulting Firm</b>
<b>FABCOS</b>	<b>Foundation for African Business and Consumer Services</b>
<b>GATT</b>	<b>General Agreement on Tariffs and Trade</b>
<b>GDP</b>	<b>Gross Domestic Product</b>
<b>HPAE</b>	<b>High Performing Asian Economies</b>
<b>MAPS</b>	<b>Manual for Action in the Private Sector</b>
<b>NAFCOC</b>	<b>National African Federated Chambers of Commerce</b>
<b>NEDLAC</b>	<b>National Economic Development &amp; Labor Council</b>
<b>NGO</b>	<b>Non-Governmental Organizations</b>
<b>OECD</b>	<b>Organization for Economic Cooperation and Development</b>
<b>RDP</b>	<b>Reconstruction Development Program of the Government of South Africa</b>
<b>SMME</b>	<b>Small, Medium and Micro-enterprise</b>
<b>U.N.</b>	<b>United Nations</b>
<b>USAID</b>	<b>United States Agency for International Development</b>

## FOREWORD

The end of apartheid and the peaceful transition to democratic, majority-based rule in South Africa opened a new era of promising possibilities for sustained economic growth with broader and more equitable participation in the benefits of growth. The government and other stakeholders prepared new economic strategies while donors sought to assist them.

The United States Agency for International Development (USAID/South Africa), a donor that pioneered bilateral programs of assistance for private sector-led growth, has recently reviewed its private sector development activities and conducted an assessment and strategy exercise. To assist in the tactical implementation of USAID/South Africa's new strategy, USAID commissioned a series of activities known as "MAPS" (Manual for Action in the Private Sector).

MAPS was designed to assist USAID in describing a country's economy, diagnosing constraints to growth, dialoging with stakeholders and developing a strategy. It is especially useful in countries which have recently undergone major economic reform or where there are newly established foreign assistance programs. The exercise creates a "map" of the private sector, by sector and sub-sector of activity. In addition to assisting USAID, this, and the other products that form a MAPS are useful to governments, NGOs, business associations and other stakeholders and donors.

In South Africa, the MAPS exercise was modified significantly to reflect the unique circumstances of the country and the present political transition, thus making the process very different than it in other regions. USAID's objective for private enterprise activities in South Africa is the economic empowerment of those who are most disadvantaged. From the outset it was realized that the MAPS products in South Africa could make a valuable contribution not only to USAID but to a variety of business associations, NGOs, government agencies, other donors and other stakeholders as they engage in a process of dialogue over South Africa's economic development. Each product was developed with an eye to making it useful to a wider community, as summarized below.

First, the MAPS team collected and annotated over 100 existing studies related to the economic empowerment of previously disadvantaged groups in South Africa. This work is contained in a document entitled "Black Economic Empowerment in South Africa: An Annotated Bibliography". It is believed to be the most complete compilation of such works currently existing in South Africa. The economic issues in South Africa have been well studied, but the team found that these are not always well disseminated. Among those groups interviewed, there was wide interest and enthusiasm for having a user-friendly and comprehensive bibliography. USAID, after reviewing the bibliography and initial procurement of studies, requested that five additional sets of the materials be procured for distribution to key government agencies and private sector organizations.

Second, these descriptive and analytical studies were useful in preparing the next product, the "Establishment of Benchmarks" which describes the state of economic participation by race, gender, and other socio-economic variables. This work, prepared by Christo Abrams of BMI under the supervision of J.E. Austin Associates, can be extremely important not only to USAID but to policy makers and others who will be seeking to measure progress toward black economic empowerment in the coming months and years. The availability of this hard data, assembled from 12 different and reliable sources including the most recent government household survey, can help elevate the debate and focus energy and attention on attacking the problems that are the root cause of the disparities which this study puts into sharp focus. This piece of the study forms the "description" phase of the MAPS exercise.

Third, in order to identify those sectors of the economy with high potential for expanding black economic participation and to identify the constraints to growth in those sectors, a sectoral MAP of the economy was developed. This study is contained in a report entitled "Black Economic Empowerment: Sectoral Analysis" which identifies specific sectors with potential for expanding economic participation. It analyzes constraints to growth and identifies opportunities for positive intervention. These sectoral analyses, which form the "diagnosis" phase of MAPS, also help provide a clearer picture of some of the problems and challenges facing the country.

All of these studies are available from USAID/South Africa. The fourth component is contained in the present report, which assesses the findings of these studies, evaluates their implications, and makes recommendations for action in the private sector. Toward the end of this study, sharp budget cuts were announced resulting in cutbacks for USAID private sector activities in South Africa. In retrospect, it was important to have designed this exercise to be of maximum utility to a broader audience of stakeholders. USAID may not be in a position to design as ambitious a program as had originally been planned. The challenge now becomes leveraging resources to have the maximum positive impact, and identifying the most useful interventions to spur rapid and sustained economic growth with broad economic empowerment. The goal is to incorporate as rapidly as possible that large segment of the population that for many years found itself on the sidelines, disenfranchised from meaningful economic participation.

One last comment must be made regarding the "ethnic" nature of these exercises. To some it will seem anachronistic and counterproductive to gather benchmark data and do sectoral analyses by ethnic background. It is distasteful to continue thinking about the economy along definitions apartheid created. The government seeks to devise the conditions necessary for an open economy of equality and to move beyond the racial distinctions which have created divisions. There is an effort to move toward a "color-blind economy." The authors are sympathetic to these views. The benchmark data will show that not all South Africans are equally placed at the starting line of this new economic race. The data cannot be ignored; moreover, it can contribute to an intelligent "facing of the facts" to enable donors, government and the private sector to formulate the kinds of strategies which will work to end the legacy of apartheid and give reality to the phrase of "massive enfranchisement." The data show how daunting this challenge is but also provide the shock of reality required to focus energy, effort and attention to making the new South Africa an economic as well as a political reality.

## EXECUTIVE SUMMARY

In early 1995, the United States Agency for International Development (USAID) requested J.E. Austin Associates, through Coopers & Lybrand and the Private Enterprise Development and Support Project (PEDS III) to conduct a "MAPS" exercise in South Africa. MAPS, or the Manual for Action in the Private Sector, is a set of tools designed to assist in developing strategies for rapid and sustained economic growth with broad sharing in the benefits of growth. The MAPS team and USAID/South Africa decided early on to tailor this exercise to the unique conditions in South Africa following the demise of apartheid and the first truly democratic election which took place in 1994. It was also decided to make this as useful as possible to the wider community of stakeholders in South Africa. This report summarizes the earlier work completed: the annotated bibliography, the benchmarking exercise, and a sectoral analysis. It goes on to recommend strategies for private sector development in South Africa with an emphasis on economic empowerment for previously disadvantaged groups.

The **Benchmarking** exercise reveals significant obstacles to black economic empowerment. The greatest of these is illiteracy. Only 46 percent of the black population has completed Standard 6, a good proxy for functional literacy and a more reliable measure than the 79 percent rate reported on a self-declared basis. The disadvantaged also lose 8-10 years of life. Some 41 percent of blacks are unemployed. The informal sector provides employment for 1.9 million people but generates only 7 percent of GDP, a figure which is reliable but sharply below some of the wilder estimates which have recently been used. Economic empowerment also refers to **job quality**. Some 36 percent of blacks with jobs are in the lowest of the 19 Peromne job categories, unskilled labor. The Breakwater Monitor survey revealed that about 3 percent of managers in South Africa are black, although the number is increasing rapidly. **Business ownership** is another form of economic empowerment and there are approximately 800,000 small businesses or self employed people in the formal sector. Finally, **asset ownership** is yet another form of economic empowerment and it was found that 26 percent of the black population have savings accounts and 11.4 percent of black households have vehicles.

The **Sectoral Study** identifies those sectors holding the greatest promise for economic empowerment of disadvantaged groups. These include certain manufacturing sub-sectors, building and construction, finance/business services, and tourism-related industries. The study analyzes prospects in these sectors and identifies constraints to their growth.

The complete study builds on these previous works to present general **constraints** to both economic growth and economic empowerment. Initiatives to relieve those constraints include: 1) improving the policy environment, 2) increasing domestic and foreign investment, 3) promoting small and medium enterprise, 4) enhancing competitiveness and exports, 5) increasing employment, and 6) developing infrastructure.

The **initiatives** which are presented in detail focus on policy support, unbundling and privatization, direct support for emerging business, direct support to small and disadvantaged

**business and strengthening skills and capabilities of the previously disadvantaged.**

**It is hoped that these four tools provided by the MAPS exercise will be of use to those wishing to assist in the process of stimulating rapid and sustained economic growth and the empowerment of previously disenfranchised groups in that context.**

## I. SUMMARY OF THE BENCHMARK STUDY

The benchmark study provides hard data from 12 important sources and thereby documents the large disparity between the previously disadvantaged population, quantifies the magnitude of the challenge, and provides a clear reference point by which to measure progress in the future. The study indicates sources by which to track progress. The key findings include the following:

### A. Economic Empowerment: Quality of Life

- Only 46 percent of Blacks Are Functionally Literate

While 79 percent of blacks are declared literate, only 46 percent have completed Standard 6, which is a better measure of functional literacy. A majority of blacks have not received even the most basic education to equip themselves for economic participation in a modern economy.

- The Disadvantaged Lose 8-10 Years of Life

The disadvantaged populations live 8 to 10 years less, with "colored" males having a life expectancy of only 58 years, compared with 61 for black males and 69 for white males. Women, on average, live 6-8 years longer than men in all ethnic categories.

- Infant Mortality Rates Have Come Down, But Are Still Highest Among Blacks

Although infant mortality has been cut dramatically, it still remains unacceptably high at 54 per thousand among blacks compared with only 7.3 among whites.

- Disposable Income Per Capita Among Blacks is 13 percent of the White Income

Black income is reported as R3,686 compared to R27,847 among whites. Colored and Asian levels fall in between. This is one of the most anomalous income distribution situations worldwide.

### B. Economic Empowerment: Employment

- Some 41 percent of Blacks are Unemployed

This compares to 6 percent of whites, 17 percent of Asians and 23 percent of coloreds. Moving this large group of people into economically productive jobs or

businesses is a critical challenge and should be considered at least as important as moving existing job holders into more advanced positions. Some 4.7 million blacks have jobs in the formal sector but another 4 million are unemployed! An additional 1.1 million are in the informal sector, many in survivalist activities.

- The Informal Sector, Generating Much Employment, Only Contributes 7 Percent of GDP

This study may help clear up a great deal of confusion and widely fluctuating estimates for informal sector contribution to the GDP which have ranged as high as 24 and even 40 percent in some studies. The great size and importance of the South African formal sector dwarfs the informal sector contribution to GDP. Errors in definition and measurement are largely responsible for this confusion. For example, a street vendor ("hawker") is actually adding very little informal sector value to formally produced goods which are registered in the GDP. Some studies count the entire sales value as "informal." The informal sector is important and deserves attention and support, but it is not providing highly productive employment and cannot, alone, provide the solution.

### **C. Economic Empowerment: Quality of Employment and Managerial Participation**

- Some 36 percent of Blacks Are in the Lowest "Peromne" Job Category

Most blacks are stuck in very low level, unskilled or very low skilled jobs. The data reveal the historical "glass ceiling" at job category 13. For those few making it to better jobs, salary discrimination does not appear to be an issue, and indeed, there may now be a salary premium for qualified blacks in high level technical, professional and managerial positions.

- Approximately 3 percent of Formal Sector Managers Are Black

The Breakwater Monitor, a study tracking the progress of different groups in corporations with over 1 million employees, reports that 3 percent of the 42,782 managers in their survey were blacks. Approximately 290 directorships out of 7,200 are filled by blacks according to McGregor's On-Line Information. These numbers, while small, seem to have risen sharply from previous years.

#### **D. Economic Empowerment: Business and Asset Ownership**

- There are Approximately 800,000 Small Businesses and Self-Employed in the Formal Sector

Most blacks who are self-employed are in trade, catering or other services, transport, or construction.

- Over 1.2 million People Are in The Informal Sector

Of these, about 1 million are black, many of them in survivalist activities. Participants in the informal sector are overwhelmingly and disproportionately women. Most are in community, social and personal services.

- Asset Ownership Is Still Limited Among Blacks, but 26 percent Have Savings Accounts

Unfortunately, good data on ownership of housing stock is unavailable by ethnic background. Some 625,000 black households have vehicles, about 11.4 percent of all black households.

## II. SUMMARY OF THE SECTORAL ANALYSIS

Black economic empowerment is defined in the study as including expansion in black employment, advancement to higher level positions such as managerial functions, development of black business and its development in the formal economy beyond small scale enterprise, and expansion in asset ownership. The overall purpose of this portion of the study is to examine in detail those sectors of the economy that would likely have the greatest impact on Black economic empowerment.

### A. Objectives and Methodology

The objectives of the sectoral study are to:

- identify sectors with a high potential for expanding black economic empowerment;
- identify constraints to growth in general and in specific sectors; and
- identify useful interventions to mitigate these constraints.

The study attempts to identify those sectors or sub-sectors of the economy that hold the most potential for expansion and have the highest propensity to increase participation in ownership, management and employment for the formerly disadvantaged

The research is based on available sources identified in the MAPS Bibliography and the MAPS Benchmark Study which are companion pieces to this sectoral study. It is also based on inputs from a number of South Africans, who are considered knowledgeable in their respective fields.

The criteria used for identifying key sectors include:

- current economic importance of the sector as measured by GDP;
- current under-representation of blacks in the sector indicating room for expansion;
- ease of entry based on existing success of market entry by black enterprise; and
- potential for growth in the sector.

Applying the criteria, the team selected promising sectors then examined them in more detail to assess their potential, constraints to growth and possible interventions to remove or reduce these constraints.

### B. General Constraints to Economic Growth

The study pointed out that since the informal sector accounts for only 7 percent of GDP, it is unlikely to hold the long term solution for black economic empowerment despite the fact that almost 2 million people find employment there.

In the formal sector, the employment picture has also been grim as nearly 200,000 jobs were lost between 1980 and 1993. Only strong economic growth can rescue this situation and provide economic opportunity for blacks. It is generally felt that a minimum growth rate of 5 percent per capita per annum is required to provide jobs for new entrants and slowly expand opportunity for over 4 million unemployed. But the South African economy has not shown such dynamism recently. The critical conditions for economic growth, according to a recent study of high performing Asian economies are:

- Gross investment of 30 percent of GDP
- Private sector investment of 20 percent of GDP
- Heavy investment in education, literacy and human capital
- Productivity growth from high internal competition and outward orientation
- A strong enabling environment (clear rules, business-government dialogue)
- Strong role of export led growth
- Commitment to sharing the benefits of growth (water, schools, health, roads)

If these are the key factors for success of high performing economies, South Africa faces some rather imposing constraints. Savings and investment levels are low, literacy and education levels are extremely low and unequal, competitiveness is low; the enabling environment, while improved, is still poor; and the benefits of growth are unevenly distributed -- in fact South Africa has one of the worst records in the World in terms of sharing the benefits of growth. The overriding political interest in coming to terms with big business and labor unions also seems to distract the government from taking the bold steps required to promote a competitive economy when such steps could hurt existing interests. These general constraints are imposing and they form the backdrop against which the following sectoral analysis is made. At the macro-level, perhaps the key question is whether the government can create the enabling environment which will attract the minimum private sector investment of 15-20 percent of GDP, required to achieve 5 percent growth in GDP on a sustained basis.

### **C. Promising Economic Sectors**

The most important sectors in terms of contribution to the GDP are manufacturing, finance/business services, and wholesale/retail trade/catering and accommodation.

Blacks are most under-represented in terms of employment in the manufacturing and finance/business service sectors. These are the same two sectors in which black business ownership in the formal sector is also most under-represented.

Greatest ease of entry for black business entrepreneurs has been in the wholesale/ retail trade, catering/accommodation, building and construction and certain manufacturing sub-sectors.

In the informal sector, greatest ease of entry by blacks has been in community, social and personal services, wholesale/ retail trade, catering/ accommodation and certain

manufacturing sub-sectors.

The strongest growth is expected in the following sectors:

- ◆ Tourism related sectors: Catering, accommodation, trade and other services
- ◆ Building and construction
- ◆ Finance and business services
- ◆ Certain manufacturing sub-sectors

On the basis of these criteria, the study singled out four main sectors for further study: certain manufacturing sub-sectors, building and construction, finance and business services and tourism-related sectors. The sectors are considered to offer the most potential for black economic empowerment. These are discussed in more detail below.

## 1. Manufacturing

Manufacturing is by far the largest sector of the South African economy, in terms of value added and in terms of employment. It also provides some of the most productive, hence better paying employment that is currently available without a college degree. The sector as a whole has not been growing, although some sub-sectors have. Manufacturing has provided 868,978 jobs for black in both the formal and informal sectors. Some 27,000 blacks own a business or are self-employed in the manufacturing sector. Even though these numbers are impressive, blacks are still under-represented in this sector, which means that there is room for expansion. Apartheid limited black ownership of manufacturing enterprises. Most black businesses in manufacturing, according to some limited regional studies, has turned up in the clothing, food, wood products and fabricated metal products sub-sectors.

Manufacturing production grew by 2.5 percent in 1994 in real terms compared with 0.2 percent in 1993, and the decline in manufacturing employment was arrested. Although production improved in almost all sub-sectors of manufacturing, certain sectors did significantly better than others. This implies that those sub-sectors have a larger growth potential. An example is the furniture sector where production increased by 17 percent during the last six months of 1994, and exports increased sharply. Another example is the fabricated metal products sub-sector where production increased by 2.6 percent and exports by almost 80 percent. The clothing sub-sector increased production by 3 percent, and the textiles sub-sector increased by 6 percent.

Manufacturing is a varied sector and as mentioned above, looking at manufacturing as a whole can mask important sub-sectors with potential for expanding black economic participation. The analysis identifies fabricated metal products and furniture and fixtures as two sub-sectors with potential.

## ■ Fabricated Metal Products

One of the first sub-sectors of the manufacturing sector into which black-owned micro-enterprises entered is that of metal bending and processing. This is a sector with low entry barriers (both the capital as well as the skill requirements are minimal) and a close market-black townships. At present many entrepreneurs are active in this sub-sector resulting in the market reaching its saturation point. Few entrepreneurs have expanded into the more lucrative white household markets or into higher-value-added products. Competition amongst entrepreneurs is fierce, and margins are extremely low in the sector. Large numbers of entrepreneurs continue to enter the sector and little growth is taking place within existing enterprises.

The costs of inputs in the sub-sector are very high because micro-enterprises tend to source in very small volumes. Also, the supply market is highly concentrated with ISCOR (local steel company) producing the bulk of all steel in this country and only two other producers providing the rest.

The main vehicle to address the first problem is to encourage diversification into more lucrative segments of the market. For example, the production of metal furniture requires a similar base of knowledge of metal processing, yet there are few manufacturers in this sector. Given that metal furniture production is one of the fastest growing segments of the furniture market internationally, and that it is just beginning to become popular in South Africa, this sub-sector has potential for growth. The reasons that black businesses have not identified this market and penetrated it are: lack of information; fear of risk-taking implied by moving out of a secure market; and most important, shortages of skills.

Entrepreneurs in nearly all sectors identified shortage of skills and lack of information as constraints. Serious efforts are needed to redress these problems. Given the high level of competition in this sub-sector, it appears to be unlikely that business owners would be able to join forces to alleviate constraints. Nevertheless, such joint efforts appear to be a solution. For example, the constraint of high input costs could be addressed through cooperative buying.

In summary, the sector seems suitable for expansion of black economic participation because:

- A large number of black entrepreneurs are already in the metal processing sector;
- Technology and skill requirements are not prohibitive;
- Any support for entrepreneurs can be directed at skill or asset deepening rather than start-up, because of a large existing entrepreneur base;
- The potential for greater value-added through diversification; and
- The market for the final products is likely to grow in the near future.

## ■ Furniture and Fixtures

Another sub-sector of manufacturing with potential for increased or expanded participation of black entrepreneurs is furniture production. There are currently about 1,300 registered furniture manufacturers and another 300 unregistered furniture manufacturers. The majority of the enterprises in the furniture industry are SMMEs. Though the majority of the small firms are white-owned, a substantial number of black-owned enterprises exists. Micro-enterprises tend to be clustered in the upholstery sector, because the skills, technology and capital requirements are the lowest in this segment of furniture making.

A few firms dominate the supply of inputs, with only four mills producing over 70 percent of all sawn timber. In addition, one manufacturer produces 40 percent of all manufactured furniture in South Africa, further restricting entry into the sub-sector and leaving small manufacturers with marginal market shares. Distribution channels are highly concentrated, with seven retail groups selling more than 90 percent of all furniture. Less than 10 percent of all furniture is sold through independent retailers, and this activity serves the upper end of the market. Only a marginal proportion of all furniture is produced for export.

The constraints to growth of black businesses in the sector relate to the finance of working capital. Manufacturers are usually paid 90 days after delivery. Therefore, they are in fact financing the credit sales of the retailers to a certain extent. Cash flow problems are often debilitating small manufacturers, for whom access to overdraft facilities is limited. Another problem is the concentration of buyers. The structure of the industry, as described above, makes it difficult for small manufacturers to penetrate the market. Because the large retail chains have a national presence, consistency of the quality of supply is essential. The large retailers therefore more likely to source from larger manufacturers, who can supply the volumes that they require. The third problem relates to managerial capacity. Most entrepreneurs do not understand the requirements for growth.

Despite these problems, several reasons make this a sector in which black economic participation can be expanded:

- The implementation of the Government's Reconstruction Development Program (RDP), specifically the housing program, will boost the furniture industry. Black entrepreneurs can meet this increase in demand at the lower end of the market.
- The implementation of a procurement policy aimed at promoting small (black) enterprise. Government is a major purchaser of furniture, yet past procurement policy has been heavily biased against smaller producers. An explicit shift in this policy will take place, with a positive spin off for small producers.
- Low technology requirements, but potential for value-added through technology transfer and innovation.

- Moderate risk of import penetration. Furniture is a bulky and heavy item, resulting in high transport costs.

## **2. Building and Construction**

The sounds of builders in South Africa's major cities echo the data which reveals that nearly a quarter of a million blacks work in construction. Some 44,000 describe themselves as either business owners or self-employed, but most of these are in the informal sector and not business owners. Blacks have had some difficulty breaking into building and construction as contractors and subcontractors. However, the sector seems poised for growth. According to a planning exercise recently performed by the Building Industries Federation of South Africa (BIFSA) and other industry associations, the gradual stimulation of the building industry through the construction of affordable housing could increase employment by a total of 530,000 sustainable new jobs. Small black builders are generally regarded as the most appropriate and desirable vehicles for achieving these goals.

The principal constraints in this sector are the shortage of skilled and reliable labor, lack of managerial skills, access to finance and to markets. Although the shortage of skilled labor is a general constraint to the whole industry it is a more serious problem for black business. The training facilities of industry organizations are only accessible for those businesses that contribute fees and dues. Small and informal builders often cannot afford to pay these fees. On the managerial side many majority builders fail to keep even the most rudimentary records, neglect planning, and maintain weak cost accounting practices, which often lead to working on unrealistic prices. To overcome this lack of management capacity among black entrepreneurs, they need training in management skills such as tendering, project management, resource control and marketing techniques.

Another constraint is that financial institutions are reluctant to support black participation in the sector because black building firms are stereotyped as high-risk enterprises, run by unreliable entrepreneurs, who lack good track records.

Despite these constraints, black builders do control the market for renovations and additions in black townships, but the most lucrative market is that of new housing, which white-owned businesses dominate. Black builders do not have easy access to this market because of the lack of working capital and they are often confronted with a bias in favor of white contractors. Furthermore, black builders have never seriously attempted to penetrate the home building and renovation market in white residential areas.

Further constraining entry into the building and construction sub-sector, are a number of subtle rules and procedures. For example, existing businesses with the cooperation of labor unions, would like to see minimum wages and rules requiring registered contractors to provide deposits equal to a salary period with the industrial council. Such measures sound very convincing and reasonable but they act as a barrier to entry. Similar kinds of measures are found in many sectors.

The way tenders are let may also discourage small contractors if they are let in large scale lots with no provisions for some minimum small business subcontracting. If there is a strong expansion in the housing construction market, the challenge will be to analyze systems and procedures so as to generate high levels of good jobs and also opportunities for expanding black business.

### 3. Finance and Business Services

Finance and business services is now the second largest sector in the South African economy in terms of GDP, generating one of the highest growth rates. The sector accounts for over a half million jobs, 186,000 of which have been created since 1980. These are some of the most highly productive and best paid jobs in the economy. The sector is likely to continue to grow as foreign investors return to South Africa and economic expansion resumes. Moreover, as the rest of Southern Africa recovers from war, restores trade and implements better economic policy, South Africa may become the primary provider of services for the region. As black firms begin to grow and prosper, demand will increase for financial and business services. Already some very successful black accounting firms, black marketing firms and even international joint ventures between U.S. and black South African consulting firms, exist.

Black South Africans are significantly under-represented in the finance and business services sector as employees, managers, and entrepreneurs. The main constraint to increased black participation in the sector is education and training. The universities have a large role to play to eradicate these constraints. Large financial institutions have a role to play with their affirmative personnel policies and in-house training programs. Certain professions such as accounting, advertising, public relations, computer services, technical consulting and service repairs, have greater ease of entry for trained professional and these are important occupations on which to focus. Interventions in the area of business and financial services by government, universities, (*technicons*), private companies, NGOs and other groups include scholarships (local and international), exchange programs for black professionals with local and international firms, direct technical assistance to majority-owned firms, and special funding programs for professional training departments at South African educational institutions. Specific assistance can be targeted by sector, for example approaching the Big 5 accounting firms (KPMG Peat Marwick, Price Waterhouse, Deloitte-Touche, Coopers & Lybrand and Ernst & Young) for contributions to set up world class accounting programs at technicons and universities that have previously been inadequate. Such programs would also produce skilled professionals that would allow these firms to have teams reflecting the diversity in the country in which they operate. Firms such as Monitor and Gemini, which have a major presence in South Africa, might sponsor the business program of a technicon or university committed to affirmative action training.

### 4. Tourism

Tourism is one of the sectors which provides an opportunity for massive entry of very low skilled or unskilled workers into the economy. As tourism develops, it provides increasing opportunities

for entrepreneurship and employment in areas including tour operators, food service, transport, artisanal production, retail trade and many others. The sector is also underdeveloped relative to its potential, and appears poised for growth.

South Africa's national accounts do not track the aggregate contribution of tourism. It cannot be considered as a sector but should be considered as a market. Employment through tourism is generated in several sectors:

- Direct employment in businesses that sell goods and services directly to tourists, such as hotels, restaurants, transport operators and shops (1 to 1.4 employee years per bed);
- Indirect employment stimulated by tourist expenditures in manufacturing and wholesale distribution (2 to 3 employee years per bed); and
- Investment related employment in construction and other capital goods industries (2.7 employee years per new bed).

Tourism-related sectors are considered to be growth sectors in South Africa. The average contribution to the GDP of tourism in other countries of the world is about 10 percent whereas it is only 3.4 percent in South Africa. The average number of employees involved in tourism is about 10 percent in the global workforce, while in South Africa it is only 1.4 percent. Foreign tourism has increased substantially over the past 8 years at a rate of more than 18 percent per year. South Africa's emergence from international isolation has already resulted in a massive growth of the sector. Currently, domestic tourism generates more income than foreign tourism, accounting for 60 percent of total tourist expenditure. The emergence of the "black" market will result in additional increases of domestic tourism.

The barriers to entry to most activities in the tourism industry are relatively high: financial barriers are high, skill requirements are significant, and tight networks hinder entry. The start-up costs for most activities in the tourist industry are relatively high. For instance, the conversion of private accommodation for use by tourists often requires structural changes to private homes, and the start up of a travel agency requires a minimum deposit with the travel industry regulatory body. Very few black Southern Africans have accumulated the necessary skills and experience in the tourism industry, and even fewer have management experience in the industry. The running of successful tourism operations, whether they are travel agencies, tour guide operations, or specialized accommodation businesses, requires a high level of professionalism. Any degree of inefficiency will be immediately felt, since the lead time for customers to react to perceived inefficiency in this business is very short. Central booking agencies, compulsory membership of professional associations, and the general exclusive nature of the tourist industry are some of the barriers inhibiting easy entrance by new entrepreneurs. Access to and availability of information is likely to play a critical role in allowing or inhibiting new entrants to the sector.

The principal constraints which emerge from the sectoral analysis include the following:

- ▶ a wide range of regulatory and legal impediments stemming from the past policies of apartheid and low priority to small and medium business
- ▶ serious lack of skills among blacks at all levels from basic literacy to work skills related to specific job categories
- ▶ lack of access to information on markets, technology, finance, business services
- ▶ financial markets which do not address the needs of small and medium businesses

### III. CONSTRAINTS TO ECONOMIC GROWTH AND EMPOWERMENT

#### A. Key Factors for Rapid and Sustained Economic Growth

Twenty years ago, the literature of economic development presented a confusing picture regarding the causes of success or failure in generating rapid and sustained economic growth with broad sharing in the benefits of growth. The jury was out. Nearly 20 years later the jury has come back and the verdict is clear. There has been a controlled experiment taking place in the last half of the 20th century in the post-war, post-colonial economic environment. Hundreds of countries participated. Certain countries and areas chose certain kinds of economic policies and prospered. Others chose different policies and fell behind, impoverishing their people in the process.

The World Bank recently conducted a study, led by its chief economist, John Page. This study entitled The East Asian Miracle, focuses on the key determinants of rapid economic growth among the "High Performing Asian Economies" or HPAEs. Between 1965 and 1990, these countries grew at average rates of over 5 percent per year in per-capita terms, much higher than the developed OECD economies, or the Latin, South Asian, Middle Eastern and African countries. More important, such growth was generally well distributed. There were clearly identifiable sources of this growth:

1. High levels of savings and investment, mainly private sector investment. Rates of investment for the HPAEs moved from about 20 percent in 1965, similar to many other regions, to well above 30 percent by 1987. Private sector investment rose to levels of about 20 percent of GDP--a full 10 percentage points more than private investment in other regions. Macroeconomic stability played a key role as indicated by very low relative volatility in interest rates and foreign exchange rates.
2. High Investment in Education and Human Capital. Successful economic strategies invested heavily in basic literacy, basic education and human capital and had a focus on primary education.
3. Productivity Growth From High Internal Competition. Successful countries got additional boosts in productivity by:
  - a. Fostering internal competition
  - b. Being open to foreign technology, ideas and investment
  - c. Building a bank-based financial sector
4. A Positive Enabling Environment:
  - a. Having clear rules
  - b. Maintaining Business-Government communications
  - c. Combining cooperation with competition
  - d. Placing a central role on export led growth

## 5. Sharing the Benefits of Growth (versus "trickle down")

Successful governments did not just passively wait for benefits to "trickle down" but entered into an explicit or implicit social contract which their populations which demonstrated they could deliver tangible benefits to all social classes. These governments invested heavily in ways that assisted the masses to enter into economic life and make productive contributions: infrastructure, education, and health. The implicit social contract was that the government would deliver the goods and people would see visible results in their neighborhoods: schools, electricity, health services, better roads, water, educational opportunities for their children, etc. In general, most of the HPAs were able to achieve relatively good income distribution while also achieving high rates of economic growth.

The World Bank findings are similar to those presented in other USAID/South Africa documentation regarding constraints. For example, the USAID-commissioned DAI/Ebony "Private Sector Strategy" draft of March 1995 mentions as requisites the following: competitive environment, outward-looking environment, appropriate economic policy, appropriate level of functioning infrastructure, political stability and economic stability.

### **B. Performance to Date for South Africa and Constraints**

South Africa has woefully under-performed in most of the above-mentioned areas identified as critical for achieving rapid growth with broad participation.

#### **1. Low Levels of Savings and Investment, Especially Private Investment**

Performance: South African rates of savings and investment have been extremely low. Gross savings fell to 16.5 percent in 1992 after having averaged 24.5 percent in the 1980s and gross investment had also fell to about 16 percent in the same year. More important, as USAID/South Africa Mission Economist Richard Harber points out, net domestic saving fell to less than 5 percent of GDP since 1990. "After 1981 net domestic investment fell to less than 10 percent of GDP, and fell to less than 5 percent of GDP after 1985. In 1992, net domestic investment was a mere 1.1 percent of GDP" rising to 1.9 percent in 1993 (Harber, "South Africa's Growth Dilemmas, May 19, 1995, p. 4). These levels, even if they have changed since the election, are a far cry from the levels needed to generate 5 percent real growth in GDP, a target often cited for South Africa.

Constraints: Constraints to savings and investment mobilization include uncertainties regarding political and economic stability, concerns for personal security, incentives which work against savings, and slow progress in making structural changes to a more competitive, export led economy. Foreign investment alone cannot compensate for low domestic investment. It will probably not account for more than about 20 percent of the total according to Alan Hirsch, Chief Director of Industry Technology Strategy for the

Department of Trade and Industry of the Republic of South Africa.

## **2. Extremely Low Literacy and Education Levels**

**Performance:** The MAPS Benchmark Study documented the very low literacy and education levels. Literacy as measured by the completion of standard six is only 45 percent for blacks and 64 percent for coloreds.

**Constraints:** Lack of trained teachers, inadequate budgets to deal with the problem, language barriers, historical deficiencies in educational infrastructure, lack of and poor quality of school supplies, understaffed and under-funded vocational training facilities, and deficient preparation are among the constraints to making rapid headway in literacy and educational development.

## **3. Lack of Internal Rivalry, Competition, and Competitiveness**

**Performance:** The MAPS Sectoral Study, drawing on the recent Monitor study, documented that South Africa is not competitive in many key industries. From textiles to agriculture to auto manufacturing, South Africa falls short of international competitiveness. Previous USAID studies have documented the sharp concentration of private sector economic activity in relatively few firms.

**Constraints:** South Africa has been protected from international competition. At the same time, South Africa's unique circumstances resulted in high levels of domestic industry concentration. Cut off from much foreign investment, foreign trade and foreign competition for many years, South Africa faces special obstacles in making the economic transition agreed to in the GATT accords which allow 5 years and in some cases 6-8 years to make the transition to the new tariff regime. The "Industrial Council" structure, and the corporatist model -- big business, labor unions and government -- work against early movement to an economy characterized by high and intense internal competition.

## **4. Poor Enabling Environment**

**Performance:** Political stability, the ultimate enabling factor, was for many years in doubt because of the minority government and the armed struggle to oppose it. The economic future was also in doubt. South African economy under apartheid featured excessive financial, foreign exchange, and trade and investment controls.

**Constraints:** Continued political and economic uncertainties, concerns for personal security, lack of trained human resources, and shortcomings in the policy and regulatory framework continue. An environment conducive to export-led growth has yet to emerge.

Efforts have been made through the NEDLAC process<sup>1</sup> to engage in an open, participative and transparent dialogue among business, labor and government and this has contributed to confidence building. The task of removing historical barriers of access for the majority population is a long one which only begins with the dismantling of formal legal impediments.

## 5. Shared Growth

**Performance:** The benchmark data reveal an exceptionally poor sharing of growth in all indicators including income distribution. Blacks have R3,686 in annual income while whites have R27,847. Life expectancy, infant mortality, housing statistics, and other standard of living and infrastructure statistics in the Benchmark Study present a similar picture of an abnormally skewed concentration indicating a terribly unequal infrastructure investment policy in earlier years.

**Constraints:** These include:

- ▶ Deficit in educational investment
- ▶ Disparities in health investment
- ▶ Disparities in infrastructure investment (townships, homelands)
- ▶ Significant policy biases, and structural impediments and discriminatory activity which continues to favor the inefficient, protected, larger and more capital intensive companies and which discriminate against new entrants to the labor market and against emerging black business.

In many ways, identifying the constraints which impede widespread participation in economic activity is relatively easy. What is more difficult is devising interventions and initiatives which will alleviate the constraints without creating additional distortions in the economy or create unwieldy, expensive and unsustainable government programs with high recurring costs.

The following chapters build on experience elsewhere and outline concepts for attacking the major constraints which have been identified. In some cases, the recommended initiatives being recommended may lend themselves to international donor financing. In other cases, the private sector must take up the responsibility and in others, resources and management will have to come from Government. The initiatives outlined below are designed to minimize the creation of market distortions for alleviating constraints, indeed mitigating many of the biases against the previously disadvantaged businesses will require the removal of existing distortions

Table III-1 on the following page summarizes an overall strategy for alleviating the constraints. They focus on the key priorities of improving the policy environment, promoting business,

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<sup>1</sup> The NEDLAC process refers to a organized forum for participatory style debate on issues related to the policy environment. NEDLAC is comprised of Government, Business and Labor.

increasing investment, exports, employment and infrastructure development. The following chapters provide more details on the recommended initiatives. The recommendations are based on the constraints identified and on experience with similar actions elsewhere. The recommended actions would require further design work before they could be put into place.

Table III-1, shows infrastructure as a key priority. It is impossible to examine the constraints to increased economic participation of the majority population without encountering the lack of basic infrastructure in the townships. In many cases, basics such as electricity and water are necessary for initiating a small business. Infrastructure has been included in the table, but is beyond the scope of this study to suggest interventions to deal with this problem.

**Table III-1 Summary Priorities and Constraints**

Priorities	Constraints	Public Sector Initiatives	Private Sector Initiatives
Policy Environment which Fosters Increased Economic Participation of Previously Disadvantaged Groups	Development of Clear Pro-Business Policy, including affirmative procurement, affirmative employment, privatization, etc.	Develop a Policy Analysis and Implementation activity in Collaboration with the Private Sector	Pro-active Initiative to Collaborate with Government Policy Analysis and Implementation Initiative
Promotion of SMME Development through Training and Support Services	Lack of Access to Information, Finance, Technology, Skills	Develop Business Support Services Centers to Address the Needs of the Small and Medium Businesses	Through Business Organization, Provide on a Sustainable Basis, Business Services to Address this need. Use these Services to Assist Majority Businesses to Participate in Unbundling and Privatization Deals
Increasing Investment, Domestic and Foreign	Lack of Clear Trade and Foreign Investment Policies and Promotion Efforts.	Articulate Clear Policies, including Time frame for Implementation of Tariff Reductions. Promote Foreign Investment	Make Government aware of Position on Constraints to Investment and Seek Joint Ventures with Foreign Investors
Increasing Competitiveness and Exports (Unbundling and Privatization and Policy Reform)	Lack of a Competitiveness Strategy and Export Promotion Efforts	In Conjunction with a clear Trade Policy, develop a Competitiveness Strategy to enable local Businesses to Increase Exports	Develop Strategies for becoming Competitive, making necessary Adjustments to take advantage of the New Policy Environment
Increasing Employment	Lack of Adequate Education, especially Skills Development	Promote Skills Development Program. Explore alternative Financial Mechanisms, set Goals for moving majority population through the Job Ceiling	Pro-active Programs to Develop Workers Skills as part of Competitiveness Strategy.
Infrastructure Development	Lack of Basic Infrastructure in Majority Areas such as Electricity, Water, Communications hinders the Development of Businesses	RDP and other Government Initiative to Spread Basic Services	Privatization, Co-generation, sub-contracting to Small Business, Build-Operate-Maintain Schemes

#### IV. STRATEGIC INITIATIVE 1: Policy Analysis and Policy Implementation

Many of the constraints which have been identified above are policy or regulatory issues. Thus the transformation of the policy and regulatory environment from one which hindered majority participation in the economy to one that fosters their participation must be a major objective of any development program in South Africa. Policy reform is not a one time event, but rather needs to be an ongoing part of the development of the sector. Policy reform should be participatory in nature. The Government will obviously be a key player, but the private organizations which represent small and medium businesses and organizations which represent labor will also have important roles. A key donor intervention in this area is a "Policy Analysis and Implementation activity." The policy analysis, design and implementation process will benefit from expertise and experience of expatriate technical assistance. Expatriate advisors, in addition to bringing new perspectives, do not have vested interest to protect. For this reason such an activity would be well suited to support by an international donor.

The **purpose** of such a Policy Analysis and Implementation activity would be twofold: a) to strengthen the capacity of both the Government and majority business and labor organizations to analyze and design policies and regulations conducive to increased black economic participation; and b) to analyze a priority list of policy and regulatory issues and design and implement the appropriate reforms. This model allows for institution building while conducting actual policy analysis and reform, using the process to serve as the learning laboratory. This model produces policy reform while strengthening policy institutions.

Both the government and the private sector require assistance in policy analysis and policy reform design. This poses the central design issue of whether a single advisory group can work effectively with both the public and private sector. Even within the private sector can a single activity provide analytical support to both business interests and labor, small business, micro-enterprise and large business? These issues will need to be further analyzed and resolved. One alternative would be to "house" the project in the new Government Department created for this purpose, but with the express mandate to work with and to provide analytical assistance to the private sector organizations which represent majority-owned businesses and labor. This might be done by creating a series of working groups around different policy issues to analyze and reform policy priorities. The working groups would be made up of both Government and private sector persons with interest in the issue. The working groups would, with the guidance and assistance of the advisors, pull relevant information together to analyze the issue and then to design the policy reforms and the implementation strategy. The groups would work in a collaborative style with all members taking an active part in the work.

Another option might be to "house" such an activity in a private sector university or think-tank which is viewed as unbiased toward Government, business or labor and which has credibility with all sectors. Still another alternative might be housing the activity in an existing business organizations such as NAFCO, the National Small Business Council or others. However, these private organizations might not have the minimum staff required to support and absorb the effort.

In another scenario, a donor-funded advisory team could set up offices outside of the government and business organizations (with the consent of both the government and the majority business organizations). This arrangement might encourage the various players who should be involved in policy issues to interact with the advisory group.

By involving both Government and the private sector interests in the analysis and design of reforms, consensus can be reached which results in more effective implementation of the reforms. The effectiveness of this arrangement depends on the willingness of the parties to work together toward the shared goal. If key private sector actors and key Government officials agree on the goal, i.e., that policy and regulatory reform is necessary and that both Government and the reformed policies and regulations should foster increased participation of the majority population in the economy, then coming to some agreeable working arrangement should be possible. There must also be agreement that compromises will be necessary. Not all players will agree with certain positions and this is normal. Compromise can resolve these differences bearing in mind the common goal.

**A. Strengthening Capacity of Black Business Organizations in Policy Analysis, Advocacy in Support of a Market-oriented Economy**

Whatever arrangement is agreed upon for a Policy Analysis and Implementation effort, the advisory team would work with those black business organizations interested in policy reform. To create maximum capacity in these organizations, they would need to dedicate staff with the appropriate training to work closely with the advisory team. The advisory team, in close collaboration with business organizations' staff, will be engaged in the gathering and analysis of information on a set of policy issues agreed upon at the outset. The staff of the previously disadvantaged business organizations would be part of a policy analysis unit along with Government analysts and members of the advisory team.

Training and strengthening of these previously disadvantaged business organizations would, for the most part, take place in the form of experiential learning. By actively participating in the analytical and policy reform process with the advisors and other members of the work groups, staff would gain insight and expertise in the use of analytical techniques and tools as well as how to apply them. Participants would also learn how to deal with divergent views and how to develop consensus among key players. The activity should include some formal training such as short courses in policy analysis, group dynamics, consensus building and visits to other policy reform efforts where lessons could be learned. The advisory team could also conduct a regular seminar series on topics which are being analyzed as part of the ongoing work of the project.

A major task of the policy analysis unit, under the guidance of the advisory team will be dialogue with members of majority business organizations obtain input into policy reform design and to build ownership and consensus for the reforms developed. This will require that staff members of the business organizations be in touch with and understand the needs of their members. In the case of business organizations which do not have staff participating in the policy analysis efforts, members of the policy analysis unit will have to make special effort to obtain their input.

## **B. Strengthening the Capacity of the Government to Analyze, Design and Implement Policies which Stimulate the SMME Sector**

The Policy Analysis and Implementation advisory team would also work closely with the Government unit designated to develop and implement policy for the small and medium business sector. The Government would have to designate adequate staff with appropriate training to work with the advisory team. As with the majority business organizations, the advisory team would engage in the analysis of specific policy issues, and Government policy analysts would work along side the advisors as integral members of a policy analysis unit.

The bulk of the training of Government staff would be experiential as part of the ongoing work process. An important aspect of this participatory training will be in the practical application of analytical techniques and in actively seeking the views and input of the people and organizations which the policy is to affect. Government staff would also take an active part in the seminar series and some formal short courses may be incorporated.

In addition to the above, this activity might attempt to strengthen the capacity of labor organizations to conduct policy analysis and policy reform. Labor organizations could be treated in a manner much like the Government or the majority business organizations. They would be invited to participate in the process and to attend the seminar series. Another area where the project may have a significant impact is with the provincial governments. They will be developing local policies designed to promote business development in their respective geographical areas. In the course of these activities, they may require expertise not available in their departments. In any case, the Policy Analysis and Implementation advisory group should be in communication with provincial government officials to ensure that policies and regulations at the local level are in harmony with those at the national level.

Based on the research conducted for this study several policy issues are of high priority. Perhaps most important is the area of **trade policy**. It will be important both for local businesses and for foreign investors to know the Government plan for implementing the new tariff regime, the phase out of quantitative restrictions and the removal of surcharges. There will be a need to review the **tax laws** both from the perspective of the rates and their complexity. The much talked about Government affirmative **procurement policy** also needs to be developed along with implementing regulations. A policy to encourage affirmative procurement by the private sector should also be given attention. There is a need for laws which provide some protection to small firms when dealing with larger companies (**antitrust or a competition policy**). An **investment promotion policy**, including foreign investment promotion is important. Technical assistance from the Foreign Investment Advisory Service and the Multilateral Investment Guarantee Agency can assist in this area. In addition, the policies to promote **unbundling, privatization, and subcontracting** should be considered without introducing market distortions.

Given the urgent need to increase exports in order to bring about GDP growth rates needed to increase majority participation in the economy, an **export promotion policy** needs to be carefully considered. This would involve the completion of the competitiveness analysis, some survey

work on potential markets, and an assessment of such initiatives as have been successful elsewhere. In order to provide access to finance for exporters, the concept of tradeable export certificates or other methods of creating instruments which can serve as collateral should be explored.

An assessment of **financial markets** is another area of high priority. This assessment should try to determine ways to increase competition in the sector and to deepen financial markets. This would involve financial intermediaries such as credit unions, the stokvels or other such mechanisms that have elsewhere developed into full service financial intermediaries and provide alternatives to commercial banks. The assessment should look for innovative methods of replacing traditional collateral and in ways to promote relationship banking. Businesses need financing on an ongoing basis, not just once. Businesses also utilize other bank services and the bank (or financial intermediary) should function almost as a business partner. This is not happening in the case of majority owned businesses and needs to be fostered.

The policy analysis work should include an assessment of the current **labor laws**. Collective bargaining, wage and labor standards and working conditions laws and regulations should be reviewed to ensure they protect workers while also encouraging significant employment growth.

**Expected Outcomes:** The expected outcomes of the Policy Analysis and Implementation activity will be refined at the time such an effort is to be implemented. Section III above identifies a number of policy and regulatory issues which will need to be addressed. Some are more important in the short run, some are more important for increasing majority access to ownership of assets, and others will lead to increased participation through employment. During design of this activity or in the early stages of implementation, the list will should be prioritized and agreed upon in order to set the plan of work for the advisory team. At that time, those specific policy and regulatory issues which to be analyzed, reformed and implemented during the course of the activity can be added to the list of expected outcomes.

For the purpose of clarity, the following illustrative list of expected outcomes is presented:

1. Existence of an institutional mechanism whereby policy and regulatory issues are analyzed, reformed and implemented in a collaborative mode involving widespread participation of government, majority businesses and labor organizations.
2. List of specific policy and regulatory issues which have been reformed and are being implemented as a result of the activity.
3. A specific number of persons at various levels in both government and majority business and labor organizations who have improved skills as a result of either experiential or formal training under the project.
4. Existence of budget and mechanisms to access local and possibly external technical assistance in the analysis and reform of difficult policy and regulatory issues for the future.

## V. STRATEGIC INITIATIVE 2: Unbundling and Privatization

Access to and ownership of assets is at the center of many of the constraints limiting the economic participation of the previously disadvantaged groups in South Africa. Unbundling and privatization can respond to this and will also increase competition and promote a more market-oriented economy. Increased competition will have a tendency to reduce prices. Lower prices, especially for wage goods, are the equivalent of an increase in income and this will benefit the majority population to a larger extent because they spend a greater portion of their income on wage goods.

Unbundling and privatization are activities which are not new in South Africa. However, the pace of action could be accelerated by certain actions which would be appropriate for donor support. Unbundling and privatization can be complicated in both the financial and legal sense. Often the proposed new majority owners may lack adequate managerial capacity to ensure the success of the venture. This aspect also affects both the willingness of current ownership to agree and on the willingness of the financial intermediary to provide the resources necessary to consummate the transaction. Outside assistance to the new majority owners in the areas of feasibility assessment, business planning, due diligence, legal advice, financial engineering and cash flow analysis, as well as post acquisition managerial support are all essential elements. The problem is not so much the availability of the talent, but how to finance this assistance. In some cases, it may be possible to pay for such assistance from the cash flow of the business after the acquisition.

Lack of access to finance is a problem for start-up, expansion of existing businesses and for mergers and acquisitions. A number of funding mechanisms have been created in an attempt to deal with this problem. However, due to a lack of adequate savings on the part of the majority population, most activities will have a high risk profile, regardless of the quality of the feasibility and financial engineering work. Majority owned businesses and start-up businesses will have risk profiles which fall on a continuum from extremely high to moderate. Commercial and merchant banks might be induced, with the proper deal engineering, to pick off the better of these, but even this is seen as unlikely by many South African observers.

It is also important that those experts who are assisting in the structuring of deals have some stake in the outcome. This would ensure that the analyses are sound and that post-deal assistance is provided to increase the chances of success. In addition, the deals need to be structured with attention to social responsibility and not just to maximize short-run profits.

It is for these reasons that donor assistance could play a major role. An endowment or trust fund could be structured with input from donors, government and the private sector. Even loan funds from a donor could be passed through by the government to set up such an operation. A nonprofit organization could be established to manage such a fund and to structure deals, as well as provide access to technical assistance in management and production, access to information and corporate "best practices," and financing on a matching fund arrangement. Such an organization could also undertake developmental activities such as creating local franchises. For example, based on the data presented in the sectoral analysis, there are a large number of small

and liquor establishments. These businesses will come under increasing competition from large retail corporations as the South African economy develops and grows. One way to assist these operations to become more competitive would be to create a local franchise which would be able to assist in volume purchases of inventory, standardized accounting and joint advertising campaigns. Without this type of assistance, many of these small retail businesses will fail as the economy modernizes.

Such a nonprofit organization would have several sources of revenue. It could invite corporate participation through the sale of shares, memberships or donations to the endowment fund. Clients would purchase services from the organization. Fees would be charged for structuring deals, for technical assistance, for providing training and publications. The organization would generate revenue from the sale of franchises, from the equity positions it would take in various deals and from interest on funds loaned to enterprises. The organization might create quality assurance programs and other activities for which demand exists. The organization would be run as a business and the balance between developmental and pure business activities would depend on the ultimate structure of the finances. If a donor provided grant resources for a few years, the organization could engage in more developmental activities than would otherwise be the case. In order to keep overhead low and to ensure good management, the employees would be permitted to share in the earnings generated by the activities of the organization. In keeping with the social responsibility theme of the organization, the incentive portion of employees earnings should be limited with the remainder of earnings being destined to replenish the fund.

A donor or the government could contribute some of the initial capital to the endowment or trust fund. Assuming other resources could be attracted and that the terms for amortization of donor or government provided capital were not too onerous, such an arrangement would be feasible. The financial engineering would need to be developed and it might require some element of grant financing or corporate sponsorship in the start-up phases. However, without the existence of a socially responsible organization with the right expertise, equity and working capital finance and the right incentive structure, many majority owned business, either existing or potential, whether created as a result of unbundling, privatization or otherwise, will not prosper.

Another example of an initiative designed to assist majority owned firms to overcome the access to finance constraint, is the Equity Access Systems project currently being designed by USAID/South Africa. This project will provide technical assistance to both the majority owned firms and the financial intermediaries. The technical assistance will not only help structure the deal, but will be available for post financing assistance. This project is also pioneering the innovative use of "standing offer" or "indefinite quantity" type contracts with local consulting firms as the implementing mechanism.

## VI. STRATEGIC INITIATIVE 3: Direct Support for Emerging Businesses

In many countries, small and medium businesses lack access to information about business opportunities, markets, technology, equity and working capital and managerial expertise. Next to the policy and regulatory environment, lack of access to this range of business services by the majority population of South Africa has been identified as an important constraint. Majority entrepreneurs and representatives of organizations representing these businesses often mention one or more of these access issues as a major impediment. Sustainable growth of majority owned businesses will require that these services be available on a sustainable basis.

There are a large number of small entities providing some business services to majority owned firms. However, many of these are poorly funded and staffed and most provide only limited services. Many businesses need access to better information - information on markets, management, new opportunities (government or big business tenders, export markets, etc.), technology, financing, etc. Access to the right information needs to be supplemented with some hands-on follow-up technical assistance by advisors who have experience in the field. The challenge for a donor or government-sponsored activity in this area will be to find a way to effectively utilize or incorporate the existing fragmented services into some kind of coherent system. This same activity should include a training component. Management and technical skills training are frequently mentioned as constraints for majority owned businesses.

The **purpose** of the Business Services activity would be to create the institutional mechanism for the sustainable provision of critical services required by majority businesses to expand and to compete effectively in the market economy. The provision of this diverse set of services may come from different sources, but they must be demand driven. The providers must be adaptable and responsive to the needs of the clients. Some of the services can be paid for on a fee-for-service basis, but there is a role for developmental activities as well.

Trade policy liberalization in South Africa and the ratification of the Uruguay Round of the GATT will require that businesses become more competitive. These policy moves create new opportunities, but they also create new challenges. The Business Services activity will provide technical assistance, training programs and access to information and technology to help the private sector make the transition and to overcome obstacles such as the lack of awareness of market opportunities, limited experience in areas of production and processing, lack of information on appropriate technologies, capacity to assess the feasibility of new investments, and other similar services.

Building institutions that support majority businesses will lead to higher production, productivity, competitiveness, export revenues, and employment. Development of this capacity will require the development of an institutional mechanism and a financial support mechanism. It will be possible to garner more support for local, base organizations than for a national level entity. In fact, national or federated organizations must be built upon a foundation of strong base organizations. As mentioned above there are a number of organizations in South Africa which provide some services. If it appears desirable to harness these existing facilities and talent, a free standing (i.e., not affiliated with any one organization) activity which would permit resources to be directed to

those existing organizations which were most able to absorb them is recommended. Over time, the most able organizations would emerge and would become stronger.

The new Government is in the process of creating local service centers as a vehicle to provide business support. This is being done in response to a recognized demand for the services and to the fact that existing organizations lack capacity to provide the services. No single organization will be able to provide the range of services required across all sectors and for all sizes of businesses. These centers should have the same characteristics as those outlined below for service providers and they should be organized in a manner which results in the staff being responsive to the clients.

This activity should encourage from the outset, the sustainability of these service providers. Service providers should charge fees for services. Service providers might also undertake developmental activities for which it is often difficult to charge directly. Here it might be important to consider some matching grants, provided by government, directed to specific developmental activities. Developmental activities are those which have not been proven as viable, but for which some demand exists. For example, if a service provider identifies demand for a new service, (i.e., access to the U.N. Conference on Trade and Development's Trade Points electronic database of international trade opportunities) there will be start-up costs and the number of businesses which are willing and able to pay may be limited during the initial phases of a new service. It is appropriate that these costs be partially offset by Government or alternatively, by a donor. Care must be taken and cooperation with the Government will be necessary so as not to create a dependency for either government subsidies or donor assistance. Another consideration for developmental activities is to attempt to have them underwritten by large businesses. In some cases, large business may wish to avail themselves of a service being provided, thus creating the critical mass of demand necessary to make that service affordable to smaller businesses. Differential pricing schemes for large and small businesses is another technique which might be explored for the sustainable financing of services.

Donor funds for a Business Services activity would provide for technical assistance, training and possibly matching funds for developmental activities. To strengthen the capacity of service providers, business specialists to provide long-term technical assistance to the service providers would be required. Also, donor funds should be available for short-term technical assistance to resolve specific technical and managerial problems as well as to conduct, hands-on skill training programs. The Business Services activity would utilize the services of local experts, local consulting firms and other institutions, such as the university community and possibly expertise from large corporations for both training and technical assistance whenever possible. Some expatriate technical assistance may be needed, for example, if there were demand for analyzing potential for exports to certain foreign markets or helping to establish the quality standards for products destined for foreign markets. This strategy of using and building local capacity is essential, if the services provided are to be sustainable. Only by using local technical and training resources can the cost of providing the services to majority businesses be kept in a range which will be affordable.

Another mechanism for providing support for majority owned businesses would be to establish a roster of retired South African business persons who would be available on a volunteer basis to provide a wide range on support service through one of the service providers. This could reduce the cost of providing technical as well as managerial training and technical assistance to majority owned firms. This could operate much like the International Executive Service Corps of the United States, but on the local level and using local executives. The roster should include the widest possible range of skills from executive level to clerical and accounting to skilled labor.

Although the team did not conduct needs assessment, the Business Services activity would likely need to provide the following types of services:

**Access to Information:** Small businesses frequently cite lack of information. Often the information needed is on markets for products, information such as prevailing prices of products in various markets, domestic and foreign, product standards, packaging requirements, etc. How to access new markets and which new markets to access is another frequently mentioned area where small businesses have difficulty obtaining information. Prior to launching production trials on potential products, a thorough analysis of the market for those products must be completed. Information on available financing and how to develop a proposal and move it through the channels of the available financial intermediaries is another area. A number of initiatives, such as affirmative procurement, franchising, mergers and acquisition of portions of conglomerates and the like are underway or are being planned. Small businesses will need to obtain information on how to participate in these initiatives. Much of this information is available, but may be too costly for individual small businesses to obtain. A service provider who is making the information available to a number of small businesses can thus spread the cost and make the information affordable to all.

**Technology:** Access to the most cost effective production technology will also be necessary in order for majority businesses to compete in the local and international markets. Production technology is often available in the market, but may need adaptation to the particular production situation. Service providers will be strengthened in their ability to locate and transfer technology for members. As in the case of information, small businesses may not be able to pay the cost of searching and obtaining technology, but if service providers can perform this function more efficiently and spread the cost over more than one client, then it becomes affordable.

**Access to Equity and Working Capital:** Access to equity finance and working capital are frequently cited as problems for majority small business in South Africa. One of the principal limiting factors for the previously disadvantaged groups is the lack of adequate savings, which limits their ability to meet collateral requirements. While a number of funds and financial intermediaries have been created for the purpose of fostering majority small businesses, these intermediaries require the venture to be packaged. As mentioned in the section on information above, knowing about these programs and the requirements of each has a cost. Business organizations could provide majority small businesses with a great service by helping them sort out these details. In some cases, more than information

is required. Some clients may require financial and economic feasibility studies, business plans and cash flow analysis. The competitiveness of the post-GATT markets will mean that the economic feasibility of any product will have to be tested. Service providers must develop a capacity to assist clients with these analyses. Technical assistance to the financial intermediaries may also be required. Given the closed and protected structure of the old South African economy, lenders may not be accustomed or familiar with innovative and modern techniques of risk management. Technical assistance may be able to provide lenders with new methods which would result in increased access to financial resources for the majority population.

**Managerial Support:** Another constraint to small business development is poor managerial capacity. This is especially true during a major business expansion, launching of a new product, acquisition or merger, or assuming a major new client or supply contract. Managerial needs include assistance with firm accounting, management information systems for decision making, work organization and the like. This type of support would likely involve hands-on technical assistance provided directly by staff of service providers or through subcontracts with management consulting firms. In any case, service providers would assist the majority-owned business with all the arrangements.

**Institutional Development:** The services to be provided, some of which are specified above, will continue to be required by businesses for some time. Service providers must be flexible and responsive to the needs of their clients. The services provided will change over time as the needs of the majority businesses community changes as a result of growth and maturity. To be most effective, service providers need to accommodate the developmental mandate, but operate like businesses. Without the developmental aspect, service providers would be nothing more than consulting firms. Usually, these organizations are membership organizations and not-for-profit. Financial sustainability is usually the greatest challenge facing these organizations. Donor or Government assistance may be required to create new or strengthen existing service providers. They will likely need strengthening in their human resources as well as initial financing.

Critical to the success of the development of business services will be communication among service providers. Service providers, whether private or public will have much to gain from each other. A national network of organizations working in this area should be established. In addition to service providers, the network should eventually include businesses. Many businesses can learn from each other, but there must be an effective communication mechanism to foster this process. Here might be an appropriate role for the Government. Initially, the network could be established by having a small secretariat responsible for distributing a newsletter, developed from material submitted by members of the network. Communications among network members would be primarily by mail, telephone and fax. In the longer-term the network could be linked by computer through such intermediaries as the Internet. This would also enable the network to link up with other such organizations in other countries.

**Expected Outcomes:** The initiatives described under **Unbundling and Privatization** and **Direct Support for Emerging Businesses** are not mutually exclusive. In fact, a single activity could be designed which would combine many or all of the ideas presented above for alleviating the constraints. For this reason the expected outcomes are being combined into one section.

1. One or more socially responsible, nonprofit entities devoted to provided a wide range of business services, including finance, to majority owned business ventures.
2. A given list of corporate conglomerates that have been divested of non core activities, these now being majority owned and managed.
3. A given list of parastatal companies that have been privatized, now being majority owned and managed.
4. Increased ownership of productive assets by the majority population.
5. Increased access to innovative financing schemes for majority owned business start-ups, expansions, unbundling, privatization and franchises.
6. Increased access to a wide range of business services on a sustainable basis by majority owned businesses.

## **VII. STRATEGIC INITIATIVE 4: Direct Support to Small Disadvantaged Businesses**

As pointed out in the Benchmark the study, majority owned and managed businesses fall on a continuum from those described as "survivalist" to businesses that even in the South African context would be considered large. The objective of a program to increase majority participation in the economy will focus on moving businesses along the continuum. The policy reforms being undertaken will, of course affect all businesses, but the larger ones will be in a position to benefit more from these reforms than the smaller ones. The other activities described above will tend to help those businesses able to use the matching fund concept and which have a better risk profile. Special attention must be focused on the smaller businesses.

Some will say that programs should focus on small business without making any false distinctions between "advantaged" or "disadvantaged." It is the spirit of the age and of the New South Africa to get people working together and not have separate standards or separate programs for so called "disadvantaged." The authors are sensitive to this argument and the spirit that motivates it. But it is also true that disadvantaged businesses are often located in different regions of the country and sections of the city and have been under-served. They have special and often different needs. They have different levels of prior training. They cannot always be reached through the same channels or by the same people and programs as are devoted to the larger small business community. The needs may be more basic. Trust may be a factor. Local promoters from the neighborhood or town may be required. If the most sophisticated companies target their market with different products, different distribution channels, and different advertising campaigns, programs to promote business must think in a like manner.

Responsibility for directing programs to assist small previously disadvantaged businesses will fall largely on the National and Provincial Governments. The development of the Small Business Agency, the National Small Business Council and the local service centers indicate a recognition on the part of national leaders of this fact. The challenge is how to put together effective programs which move these smaller businesses along the growth path.

In addition to efforts led by Government in the development of businesses on the small end of the continuum, NGOs can play a significant role. Financial support of NGOs is an appropriate role for international donors. USAID's NGO clearinghouse will provide one mechanism for providing support to NGOs. NGOs can provide small and medium businesses with much of what they lack. There are many examples of effective NGO credit programs. NGO can also be effective in providing hands-on training in both production skills and managerial skills. This can also be a vehicle for access to information. NGO programs can provide essentially the same services as those described above for the business support services organizations. The principal difference being that they are not usually designed to become financially self-sufficient. These should be directed to that part of the small business sector which cannot yet participate in the fee-for-service organizations. The objective, however, should be to graduate clients from the Government sponsored and NGO supported programs as they become successful.

## VIII. STRATEGIC INITIATIVE 5: Strengthening the Skills and Capabilities of the Previously Disadvantaged

The Benchmark Study summarized earlier clearly shows that there is a serious gap in the current capacity of the previously disadvantaged and the white population. This gap presents a significant obstacle to increased economic participation by the majority population. Both immediate and longer-term actions need to be taken to strengthen the capacity of the previously disadvantaged. One of the activities described above would strengthen capacity through hands-on training taking place as part of the technical assistance. While this type of training is valuable and important, it will not reach any significant number of the majority population. A variety of more formal educational and training activities must be designed and financed to reach a significant number of the majority population.

The most pressing priority for upgrading human skills for economic empowerment is a crash literacy program for the large pool of persons who have not completed Standard 6. This problem should not be over-simplified because it is complicated by multiple languages. This is primarily the responsibility of the government with a supporting role of the churches, NGOs, donor agencies and volunteer programs. Massive literacy campaigns are the single most important intervention affecting the ability of people to enter the labor force. An effort should be made to learn from the handful of countries which have achieved rapid mass literacy.

The next level of priority is basic skills training for currently unskilled or low skilled people. This should include teaching people basic skills for work in the clothing, tourism, construction, manufacturing and other easy entry occupations. This type of program, which should be based in areas of large unemployed populations, can do much to enable existing workers to upgrade their skills and to help the unemployed to get their first job. This type of program must be demand driven and to the extent possible the training delivered by industry or specialized vocational training centers contracted by industry.

A third priority area is to upgrade the existing primary and secondary schools, by emphasizing mathematics, language, computer, and even business skills. A number of local leaders are stressing the need to incorporate entrepreneurial modules into the curriculum of primary and secondary schools to help create a culture and expectation of playing a role as senior professionals, managers and entrepreneurs. Recent publications, such as Ian Heatherington's The Forgotten Heroes provides a guide to the important effort of developing case studies on black business pioneers and role models to serve the next generation.

At the next level, there is a need for upgrading and expanding the vocational and technical schools, the Technicons, so as to train people in practical skills who have had the benefit of secondary education.

At the university level there is a need to develop programs which can quickly bring historically disadvantaged groups with secondary (but still deficient) education, to qualify for admission at the universities. The universities which served the blacks and coloureds have been somewhat deficient. The historically black universities were said to have mainly liberal arts programs and

Some universities, such as UCT Business School, have to their credit developed special intensive management training programs especially geared to those whose educational backgrounds are more limited than those people going into MBA programs. There is an urgent need to adjust the curriculum of many of the management programs to include case studies of black enterprise.

There is also a need for training geared to the needs of specific sub-sectors. Here there is a dilemma with regard to delivery. The original approach was for government quite reasonably to let that private industry and the private sectoral associations should play the lead role. In some cases, dues might even be assessed to business or labor with the funds then going to the industry association or industrial council to develop training programs. This approach works rather well for existing companies within an industry and for upgrading the skills of those already working or who are likely to get a job. It does not address the needs of the unemployed.

The failure of the industrial council approach to truly address the needs of unemployed blacks in townships led donors to bypass the industrial council system and seek out black business associations. In some cases there were multiple associations, such as in the construction industry where black builders were divided into groups affiliated with either NAFCOC or FABCOS. Donors such as USAID designed their projects to avoid taking sides and training assistance encouraged the groups to work together. In many cases, channeling training through black business associations has not been effective in actually providing the requisite training to large numbers of people in a cost-effective manner. Dialogue sessions with black business leaders revealed a large degree of skepticism regarding the effectiveness of newly appearing or even veteran associations reliably managing the funds and resources in ways that benefit the large body of constituents who are the intended beneficiaries. Donors would do well to look beyond the "authenticity" of the representative to get to the "authenticity" of the results.

Another delivery mechanism for training would be to design "results-based" projects. This kind of project design would provide a first tranche of funds, sufficient for one course, to any group which can demonstrate four things:

1. Whom they will train and how they will get their trainees
2. What they will train (curriculum)
3. What standards they will train to and how they will measure these
4. Who will do the training and their qualifications
5. Where they will train
6. How they will account for the funds.

A second tranche of funding will be provided when it is demonstrated that the first course has been delivered with acceptable results. This would encourage the emergence of a number of training groups and it would strengthen existing training facilities. It would also be more cost-effective than existing methods for specific kinds of training.

## CONCLUDING REMARKS

The above mentioned strategic interventions are, of course, not exhaustive. Others may agree or disagree with many aspects of the strategies outlined above. It is meant to serve as a point of departure not the definitive guide. This should be considered as initial spade work for those who are to build. It is time to review just what has been accomplished by this effort.

First, those wishing to build programs and make successful interventions have an existing foundation of over 100 studies, reports and articles now available in one place in five libraries in South Africa. To those wishing to study the problem to death, the authors would like to say, "You do not have to reinvent the wheel." The MAPS Annotated Bibliography provides an excellent background of data, research, and analysis. It is user-friendly. It also includes many other studies.

Second, those wishing to find key data now have a reference to use in the form of the MAPS Benchmark Study. It is a clear reference point to measure progress. These indicators will serve as the acid test to see if this and future governments are "delivering the goods." The tragedy embedded in the numbers should provide motivation for the struggle. Behind the statistics lie human beings. These are real people -- unable to read, without piped water, with shorter lives, in poorer houses, without jobs. Donor agencies and NGOs can also be measured by the progress that everyone hopes will be registered the next time such a study is compiled.

Third, the sectoral study presented the critical factors for sustained economic growth with broad participation in its benefits, a path which many East Asian countries have already traveled. It also analyzed and discovered some critical sectors and sub-sectors of the economy which could provide the best opportunity for large scale expansion of black economic empowerment.

Finally, this fourth study has explored strategies and specific interventions for international donors, government agencies, private companies and social enterprises interested in developing a comprehensive strategy. This effort is meant to be a beginning, not an end. Much more work needs to be done in each of the areas mentioned and in others as well that were beyond the scope of this study to cover. But it is hoped that those who are serious about democratizing the economy and promoting black economic empowerment in a high growth environment will have found at least some of the tools provided by the MAPS exercise to have helped in their effort.