

A comparison of enterprise development models in South Africa using case studies

A Research Report for Masters in Development Studies

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DECLARATION

I declare that the research report is my own unaided work. It has been submitted for the degree of Master of Arts: Development Studies to the University of the Witwatersrand, Johannesburg. It has not been submitted before, for any other degree or examination, to any other university.

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TABLE OF CONTENTS

INTRODUCTION	5
CHAPTER 1: THEORETICAL FRAMEWORK AND LITERATURE REVIEW	7
I. Development is about catching-up.....	7
<i>A catch-up strategy is important for SME development.....</i>	<i>7</i>
<i>The development of technology capabilities is key to the catch-up process.....</i>	<i>8</i>
<i>Market failures constrain learning and technology acquisition</i>	<i>8</i>
<i>(Khan, 2009, p. 23)</i>	<i>9</i>
<i>Ensuring effort in learning-by doing needs to be prioritised</i>	<i>9</i>
<i>The market alone will not pull the development of technological capabilities</i>	<i>11</i>
<i>Theoretical lessons learnt from examples of other countries.....</i>	<i>11</i>
II. The challenges South Africa faces in catching-up.....	12
<i>Economic growth and job creation</i>	<i>13</i>
<i>Structure of the economy biased toward the mineral-energy-complex.....</i>	<i>14</i>
<i>Productivity</i>	<i>14</i>
<i>Global competitiveness</i>	<i>15</i>
III. Relating the problems of catching-up to the role of SMEs in South Africa.....	17
<i>Limits of the SME approach to development</i>	<i>17</i>
<i>The challenges facing SMEs in South Africa.....</i>	<i>18</i>
<i>Supporting SME development in South Africa</i>	<i>21</i>
IV. Enterprise Development as a component of BBBEE	23
<i>The requirements of BBBEE ED.....</i>	<i>23</i>
<i>Key terms and definitions</i>	<i>24</i>
<i>Measuring BEE compliance</i>	<i>24</i>
<i>Beneficiaries</i>	<i>25</i>
<i>BEE status levels.....</i>	<i>25</i>
<i>Enterprise Development calculation formula</i>	<i>26</i>
<i>Contributions matrix.....</i>	<i>27</i>
<i>Best practice</i>	<i>28</i>
<i>The history of Black Economic Empowerment</i>	<i>28</i>
<i>Enterprise Development and other components of BBBEE</i>	<i>30</i>
<i>ED global history and best practice.....</i>	<i>32</i>
CHAPTER 2: RESEARCH METHODOLOGY	34
<i>I. Research design</i>	<i>34</i>
<i>II. Case study methodology.....</i>	<i>34</i>
<i>III. Selection of cases</i>	<i>36</i>
<i>IV. Data collection</i>	<i>37</i>
<i>V. Ethical considerations.....</i>	<i>39</i>
<i>VI. Delimitations and limitations</i>	<i>39</i>

I. Case A: Developing a future supplier using an incubation programme	41
II. Case B: Focussing on the ‘missing middle’ and using an outsourced ED Fund	47
CHAPTER 4: COMPARISON AND ANALYSIS OF THE ENTERPRISE DEVELOPMENT APPROACHES	53
CHAPTER 5: THE IMPACT OF BBBEE ED ON DEVELOPMENT IN SOUTH AFRICA	64
CONCLUSION	65
REFERENCES CITED	67
ANNEX	76
<i>Steps in calculating ED scores</i>	<i>76</i>
<i>Copy of ethics clearance certificate</i>	<i>77</i>
<i>Permission from Edge Growth to conduct research</i>	<i>78</i>
<i>Permission from Raizcorp to conduct research</i>	<i>79</i>
<i>Example of participant information sheet</i>	<i>80</i>
<i>Example of informed consent form.....</i>	<i>81</i>
<i>List of interviews conducted</i>	<i>82</i>

INTRODUCTION

The key to a national strategy for sustainable development is not only the short term goal of creating jobs but the longer term view of an economy that grows and converges with those of developed nations. 'The wealth of developed countries results from their industrial and technological advantages.' (Lin, 2003, p. 277) Developing countries have made efforts to catch up these nations, struggling to industrialise and modernise traditional sectors and this is mostly due to a lack in capabilities to absorb technology. (Khan, 2009, p. 4) Being able to produce goods of high quality and at efficient levels of productivity is facilitated by having the necessary technological capabilities. So 'development is fundamentally about learning to use modern technologies to create jobs and prosperity in poor countries.' (Khan, 2009, p. 1) How this is done in different sectors of an economy is unique in every country and the purpose of this research is to find out whether this can be done in the SME sector of South Africa.

In South Africa there are an estimated 2.8 million small, medium and micro enterprises (SMMEs) contributing 57% to GDP and making up nearly 61% of employment (SA Yearbook, 2011: 138). According to Finance Minister Pravin Gordhan, 68% of people employed in SMEs are in businesses that employ fewer than 50 people and 43% of people are employed in businesses with less than 5 people. (Adcorp, 2012) What are the strategies that have aimed to leverage this sector and have these been overlooked in the past? In light of the current unemployment crisis (23.9%), poverty and inequality, an SME sector that contributes substantially to growth and employment in the country could play a significant role in alleviating these problems. The question is what role the SME sector contributes to economic transformation and development and more specifically does the establishment and growth of SMEs, through enterprise development, lead to sustainable job creation and economic growth?

Enterprise development (ED), which is the support and growth of SMEs, has been introduced as a component of broad-based black economic empowerment (BBBEE) policy in South Africa. Since 2007 the compliance target in the area of BBBEE ED for large companies has been to spend 3% of net profits after tax on establishing and growing sustainable SMEs. This entails the public and private sectors supporting SME development, financially and non-financially (in terms of business development services for example). BEE policy invariably guides the private sector's engagement with SME development in South Africa. The question asked in this study is how effective is BBBEE ED in creating sustainable jobs and economic growth and as a result impact on development in South Africa? This study uses qualitative case studies to analyse the implementation of two distinct approaches to BBBEE ED by firms that specialise in ED and offer services to companies in assisting them with SME development. The one approach centres on nurturing the entrepreneurial talents of individuals and the other focuses mostly on unlocking growth in high growth potential businesses. The study shows that ED is a complex process and that each approach has its merits and challenges. In terms of the impact that BBBEE ED has on development in South Africa this study offers insights that are useful to policy makers and for broader research on the ED industry and SME development in general.

The focus in this research is on the private sector's adoption of BBBEE ED. A key question is whether the private sector would ordinarily engage in the development of SMEs and why, if it were not for BEE? There are two main reasons why the private sector should be interested and excited ED component of Black Economic Empowerment however; and both of these reasons make business sense. Investing in BBBEE ED can lead to the development of its suppliers and the courting of potential future suppliers. Furthermore, if money toward ED is used as an investment in businesses, well planned and implemented ED, can lead to financial returns. Secondly it is an efficient and effective means of meeting BEE compliance requirements and in so doing achieving the spirit and letter of black economic empowerment, which is needed for soliciting business in South Africa. The ED component of BEE holds great potential for social impact through the creation of sustainable businesses, which leads to sustainable job creation and economic growth. For these reasons, the aim of this research is to understand how the private sector is making use of the opportunity to use BBBEE ED to grow the SME sector and how this impacts on development in South Africa.

This research is structured as a development studies investigation about SME development in South Africa and more specifically how the institution of black economic empowerment in the country influences SME development.

Chapter 1 begins by introducing the perspective on development that informs the study which is the catch-up model. The literature review explores the challenges that South Africa faces in catching-up, which is then related specifically to the role of SMEs. The literature review shows how enterprise development is shaped by the history and evolution of black economic empowerment and goes on to relate this to global ED history and practices. It provides the rationale for in-depth case studies about ED implementation in South Africa. Chapter 2 on research methodology outlines the appropriateness of the case study approach and challenges related to this study. Chapter 3 contains two detailed case studies of different approaches to ED. This is followed by analysis of these case studies in Chapter 4. This analysis is informed by the theoretical framework initially introduced. The theory that emphasises the importance of ensuring effort in learning-by-doing is an analytical tool for understanding the different factors that impact BBBEE ED. Chapter 5 discusses the impact of BEE ED and outlines some important considerations for further research on SME development in South Africa.

CHAPTER 1: THEORETICAL FRAMEWORK AND LITERATURE REVIEW

The purpose of this chapter is to position this research in the context of broader development issues and the challenges facing South Africa. Fundamental assumptions about economic development and the role of institutions in development form the foundation of a perspective that essentially argues that development is about catching up with developed countries.

I. Development is about catching-up

A catch-up strategy is important for SME development

A country's level of productivity determines the prosperity of its citizens and it is important for attaining sustainable improvements in incomes. (WEF, 2012) Upgrading any sector of the economy requires technological progress. (Khan, 2009, p. 96) An improvement in productivity could assist attaining increased market share globally, and this contributes to faster growth and the creation of jobs (World Bank, 2011, p. 23) South Africa, like many other developing countries, faces the challenges of catching up with developed countries and a catch-up strategy is one of the sustainable ways it can tackle the development challenges of high unemployment, poverty and inequality. In the literature review that follows, the specific development challenges that South Africa faces in catching up, will be explored.

Developing countries need to produce their way out of poverty in order to achieve sustainable development. (Khan, 2009, p. 1) Their challenge is being able to compete globally by producing products and services that are of the qualities and standards that allow for entry into global markets. Moving up the quality ladder is also very important to a catch up strategy. Countries need to do this at levels of efficiency that are competitive; and even if they have the advantage of lower wages and possesses some formal skills; their success is determined by their use of modern machines. This is why Khan (2009:1) argues that 'development is fundamentally about learning to use modern technologies to create jobs and prosperity in poor countries'.

Learning to use modern machines competitively 'cannot be learnt through manuals', therefore learning by doing is so important; and start-up firms in developing countries inevitably face a period of loss-making while this learning takes place. Just as technology upgrading involves this time of loss-making, there is a period during the establishment of SMEs and also the growing of SMEs that is similar to this loss-making time of learning by doing. 'The object of learning is to achieve the breakeven point of competitiveness where loss-financing is no longer required' Khan (2009, p. 137) argues. The focus of Khan's theory about the role of learning in acquiring technological capabilities is focused on the role of institutions and governance. The theory is developed around the catch-up model for development which is useful to SME development as an analytical tool for understanding and analysing the process of learning in SME development. Just as the aim of acquiring technological capabilities is important for developing more globally competitive industry, so too SME development needs to be aimed at competitiveness in order to ensure sustainability. SME development should not just be seen as a solution for unemployment but also about

building competitive and sustainable businesses. Developing countries should aim to produce high quality products and increase their levels of productivity to be competitive. 'If productivity were a simple function of the type of machinery used, developing countries could achieve global competitiveness by investing in the purchase of the appropriate machines' (Khan, 2009:11) For this reason we need to understand the different components that drive the process of upgrading for catch-up. This research uses this development paradigm at the level of the development of SMEs to understand how progress toward competitiveness through learning by doing can be ensured.

The development of technology capabilities is key to the catch-up process

The Commission on Growth and Development (2008) has identified the critical role of technology absorption for developing countries. Catch up growth is driven by technology absorption and it is a complex process in which the enhancement of productivity and increased competitiveness are crucial. (World Bank, 2011, p. 21) Similarly, the process of developing SMEs is a complex process that involves learning by doing. The factors that determine the process are important considerations for understanding the problem developing countries face in catching up with developed countries. (Khan, 2009, p. 11) Elements such as public goods and utilities and also levels of education and infrastructure in a country can impact a firm's productivity. So too, can the internal firm factors of the capital equipment and the experience of the workforce. Infrastructure development is an important consideration but Khan argues that an area that has not received enough policy attention is technological capabilities and more specifically the governance and institutional environment impacting technological capabilities. (Khan, 2009, p. 24)

Market failures constrain learning and technology acquisition

When it is not worth their while for investors to fund a venture there is a failure in the market for the provision of these funds. It is this market failure (the failure to invest in the learning period) that restricts technology acquisition (and SME development opportunities). The catching up process is determined by the different ways in which developing countries deal with these market failures. (Khan, 2009, p. 1) Investors need to be willing to finance the loss-making learning time, however they rely on ensuring levels of effort that can be difficult to enforce. For this reason, Khan (2009, p. 6) argues that it is institutional and political conditions that decide the possible success of catching up processes.

Firms and countries can finance the learning time in different ways; however the successes of the financing strategies are not only determined by the financial instruments used, but also by governance agencies, firm structures and political settlement. (Khan, 2009, p. 1) It is the interaction and appropriateness of these variables that Khan posits, will determine the effectiveness of the financial instrument to the learning process. Governance agencies are 'in charge of whether the terms of the financial instrument will be enforced'. The firm structure explains the 'internal order of an organisation and how it relates to the state and the market'. And the political

settlement expresses the allocation of power between different actors in the learning process. (Khan, 2009, pp. 37-46)

There are two reasons why private investors may not invest in opportunities that could make them better off. The first is a lack of information and the second is that they cannot get adequate assurance that their future profits will be actualised. (Khan, 2009, p. 21) Khan developed a matrix of the different kinds of market failures that affect learning and technology acquisition (which can be likened to SME learning), isolating five different market failure problems and their consequent policy implications as well as the corresponding recommendations. In some cases investors cannot privately capture enough of the total returns when investing in improvements in productivity and this is when appropriability problems arise. The result is a lack of investment. The example of the appropriability problem is the training of workers that then leave. The issue of intellectual property rights poses a challenge too. The next problem is a failure to invest in discovery learning. The institutional challenge of ensuring effort will be the focus of this study. (Khan, 2009, p. 23)

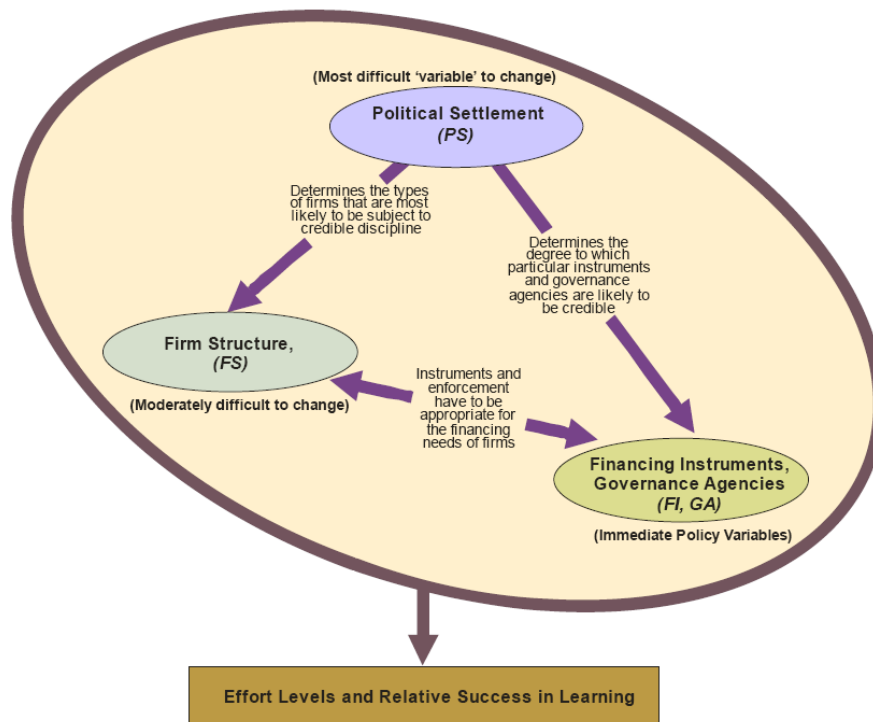
Market Failure Constraining Learning and Technology Acquisition	Policy Implications	Required (Growth-Enhancing) Governance Capabilities
Appropriability problems facing investments in skills Trained personnel can easily leave the firm	Co-financing of employment of new workers/workers in new sectors may be required	Requires agency with incentives aligned to ensure subsidies/co-financing not significantly mis-allocated
Appropriability problems facing innovators: Innovation companies avoid investing or training in developing countries	Protect IPRs but TRIPS may be too restrictive for developing countries: Weak incentives for MNCs to transfer core technologies	Requires strategies to create backward and forward linkages with domestic suppliers.
Appropriability problems facing discovery: Startups discovering new areas of national competence lose rents rapidly	Subsidize startup companies. But model based on specific technological and market competitiveness assumptions	Develop public-private partnerships to invest in discovery. Develop capability to stop subsidies beyond startup period
Failures of coordination can lower profits in complementary sectors and constrain investments in learning	Coordination of investments up to and including 'Big Push' strategies	Very significant governance capabilities required to coordinate and discipline investments across firms and sectors
Institutional problems in ensuring effort during learning: Both public and private investors in learning lose money	Co-financing of learning is often necessary but will fail unless high levels of effort can also be assured	Critical significance of country-specific institutions that can ensure high levels of effort during periods of loss-financing

Figure 2 Market Failures in Learning: Implications for Governance Capabilities

(Khan, 2009, p. 23)

Ensuring effort in learning-by doing needs to be prioritised

It is important to address the different market failures that constrain technology acquisition. The one constraint that should be prioritised above the others is that of the institutional problem in ensuring effort. This is because ensuring effort is linked to the problems of acquiring tacit knowledge and it is a widespread challenge that many firms face. (Khan, 2009, p. 45) The factors that ensure effort are financial instruments, governance agencies, firm structure and the political settlement. The interaction and interdependence of the different factors is critical to understanding how effort in learning by doing is ensured and Khan (2009, p. 48) developed a means of explaining how to think about the different factors in the diagram below:



Establishing policy to address the problem of ensuring effort is difficult because of the interdependence of the above mentioned elements. The result of this interdependence is non-linear and there is no single set of combinations that will solve this problem. (Khan, 2009, p. 40) The policy areas that should be focussed on are thus the financial instruments and governance agencies because these are variables are easier to address. The most important point is that the variables cannot be dealt with in isolation. Much research has tried to isolate finance as the main constraint and fails to address the other interdependent elements. In most cases the catch-up process of developing countries was state-led (Khan, 2009, p. 49) and the success of their efforts depended on the variables discussed here. Khan also argues that we need to consider the strategies of developing countries in both the 1950s and 60s as well as later stages to see the link between the technology capabilities developed in earlier stages and how it benefitted countries later. His argument is that the earlier technology capabilities development in some cases was vital for the later success experienced.

In a World Bank study on technology absorption in South Africa, the researchers argue similarly to Khan that incentives, access and capacity constrain technology absorption. Their argument is that technology transfers (like learning in SME development) take place through different channels and they describe a number of different factors that determine technology transfer in the following equation, which is a very similar way Khan expresses his idea. (World Bank, 2011, p. 32)

$$\text{Technology absorption} = f(K, L, \text{OPEN}, \text{IP}, \text{R\&D}, \text{HC}, \text{IC}, \text{PS})$$

K represent access to finance, L stands for firm employment, OPEN is the openness of the firm to international trade and knowledge from abroad, IP shows the ownership of intellectual property (patents and know-how), R&D points whether the firm conducts

R&D, HC indicates human capital, IC represents a catchall variable for the investment climate, and PS stands for public support for technology absorption. (World Bank, 2011, p. 32)

The market alone will not pull the development of technological capabilities

A fundamental working assumption is that the market itself will not pull sectors, regions and countries with low capabilities toward a path of sustainable development- and for this reason, specific policies are needed to develop technological capabilities. (Khan, 2009, p. 1)

Theoretical lessons learnt from examples of other countries

Khan's main argument is that countries that benefitted from global liberalisation in the 1980s did so because of success in the 1950s and 60s in using industrial policies to develop technological capabilities. This was predominantly in the form of infant industry protection at sectoral level. The types of instruments that were used included 'import protection, export subsidies, subsidised credit, subsidies on inputs and other related subsidies' (Khan, 2009, p. 4) The performance across different countries and even within countries was varied. Khan develops a discussion of the various lessons learnt about technology capabilities development from the varied experience in countries such as Thailand, India, Bangladesh and Tanzania. Other theorists also consider Taiwan a good example of the development of technological capabilities, where professionals and policy makers worked together to establish a successful venture capital industry. (World Bank, 2011, p. 35) In Taiwan, 'with well-developed urban industrial and financial systems', 'small enterprises benefited from subcontracting arrangements with larger firms and as a result have gained easier access to finance'. 'To ensure that such arrangements are mutually beneficial it is vital to avoid policies that favour imported inputs and in ensuring that the tax system does not penalise inter-firm transactions'. 'Direct interventions, such as India's policy of reserving certain products for small enterprises, may be counterproductive if they protect expensive, low quality goods.' (Luiz, 2011, p. 55)

Khan makes the important point that we can 'no longer assume that competitive financial markets are fundamentally efficient' (Khan, 2009, p. 100) and for this reason 'the feasible way of reducing the financing costs of long-run investment in developing countries is through the creation of new institutional arrangements like development banks'. The critical condition for success is not only finding the right financial instruments but also developing the right governance agencies, 'to ensure that financial instruments ensure high levels of effort'. The problem in many African countries is not only that the group of capitalists is small but also that the potential group is very small too. (Khan, 2009, p. 101)

II. The challenges South Africa faces in catching-up

A summary of the challenges facing the country describes an overwhelmingly difficult situation of high unemployment, inequality, many people living in poverty and a slow growth rate. Though South Africa is Africa's largest and most advanced economy, in terms of development its performance has been poor. A snapshot perspective begs the question about where the thinking and planning around solutions should start. It is important to think about how these challenges relate to the broader catch up problem and analyse trends and trajectories in a way that prioritises the issues and solutions in terms of short term and long strategies. These issues are the growth rate of the economy and the composition of this growth and job creation, the structure of the economy, productivity and the global competitiveness of the economy.

The NPC (2011, p. 2) summarises the key challenges that South Africa faces:

- "The economy does not serve the interests of all South Africans.
- Poverty levels are high and inequality is extremely high and persistent.
- The economy is shaped by its history as a commodity producer operating in an environment of abundant resources, and is highly resource intensive.
- Apartheid distorted the economy in ways that undermine both South Africa's competitiveness and the potential of its people.
- Power relations in the economy are highly unequal and this gives rise to outcomes that are highly unequal by international standards.
- While there are pockets of excellence, major parts of the economy are uncompetitive, with high rates of concentration, high margins and high cost structures in both the private sector and state-owned enterprises.
- The democratic government has failed to significantly alter the pattern of growth and development."

South Africa has to contend with several economic disadvantages, including:

- "Being a small open economy located far from lucrative markets.
- Uncompetitive practices and weak regulatory capacity in relation to both the public and private sectors, resulting in a distorted price structure and barriers to entry.
- The poor quality of network industries, which contributes to low productivity, and frequently high-priced services that do not sufficiently support diversification.
- Poor quality and quantity of education output, at basic, vocational and higher levels.
- Weak alignment between human settlements, economic opportunities, social services and transport, which raises stress and costs, and reduces productivity."

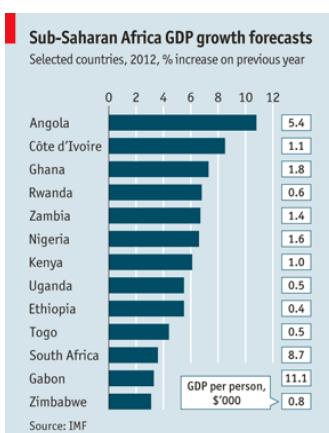
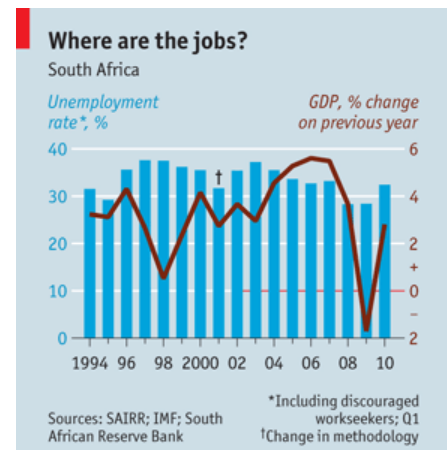
Economic growth and job creation

In South Africa, 'one third of people live in rural areas; 43% are under the age of 30 years; and 54% of South Africans are dependent on others for their income (33% obtain money from others and 21% from government grants)'. Furthermore, 44% of the adult population earn less than R2000 per month'. (FinMark Trust, 2011, p. 3)

'Only 41% of adults in South Africa work which includes informal activity, whereas in other developing countries this is generally around 60%. Furthermore the labour participation rate is 56.5%, which is below the average of 65% in comparable countries (NPC, 2011, p. 12) One of the reasons why labour statistics are so low has to do with the way the economy faced 'a skills-based technology change' where 'firms requiring workers with ever-higher skill levels as productivity rose, technology developed and global competition became more pronounced.' (NPC, 2011, p. 13)

A growth rate of between 6-7% is needed for job creation and 'over the 17 years that the ANC has been in power, growth has averaged just 3.5%.' (Economist, 2011) Due to the slowdown of the global economy real GDP growth is expected to be slightly lower at 2.7% (Gordhan, 2012, p. 6)

In 2011 in the state of the nation address the president set the target of creating 5 million jobs within a decade. That year, 365 000 were employed which is the country's best performance since 2008. The jobs that were created were jobs in the formal economy in sectors, by the private sector, and were in sectors like mining, transport, community services and trade. What lead to the success in the job creation according to the government was 'mainstreaming job creation in every government entity including state-owned enterprises' and 'strengthened social dialogue and cooperation between government, business and the community sector.' (SONA, 2012)



Success was also attributed to the 'accord' signed by government and social sectors to accelerate employment in the private sector. Unemployment was 25% and has fallen to 23.9 %. The private sector is calling for assistance. It is expected to create most of the jobs and business leaders say they need things such as 'the right business environment, including a relaxation of South Africa's labour laws, which are among the most rigid in the world, and greater policy certainty from ministers.' (Economist, 2011) The job creation potential simply of GDP growth is large but faster growth is needed. Compared to other African countries, South Africa is not predicted to grow as fast. (Economist, 2011)

Structure of the economy biased toward the mineral-energy-complex

'South Africa is one of the rare emerging markets to have failed to converge towards the club's average GDP per person over the past 16 years, the OECD notes' (Economist, 2010d) In recent years the strongest growth has been in transport, construction and financial services. Sectors that have been slow to grow were agriculture, mining and manufacturing. Growth has been in the tertiary sector (growth in services), from 56% in the 1980s to 67% of GDP in 2010. (NPC, 2011, p. 8) There has been growth of employment in the services sector. The problem is that this is what happens as an economy modernises and diversifies but the growth in services can constrain the expansion of goods production- which is the problem in South Africa. (NPC, 2011, p. 14)

A sector that has seen a decade of decline is the manufacturing sector (Rodrik, 2007) and it is argued that the reason for the decline is structural in nature. In 1981 the sector peaked at a contribution of 22% of the country's GDP and it now stands at around 14%. A focus on manufacturing has been highlighted in the New Growth Path. Furthermore, re-industrialisation is also central to the industrial policy action plan (IPAP2).

The South African economy has been dominated by the mining industry and what Fine and Rushtomjee (1996) term the minerals-energy-complex, because sectors like manufacturing, energy supply, construction and transport have been connected to mining. It is argued that globalisation has increased the country's dependence on the MEC. This has led to a lack in diversification of the economy. (Southall, 2010, p. 9)

'In South Africa, years of capital controls made it difficult for South African companies to invest abroad and the result was that it generated vertical and horizontal integration by South African firms.' This meant that big companies did not always have the incentive to sub-contract to smaller companies because they could try to do these activities in-house. It is argued that with the 'lifting of capital controls it is likely that large firms will increasingly shed non-core activities through subcontracting and outsourcing and that this will stimulate small business development.' (Luiz, 2011, p. 55)

Productivity

Productivity is notoriously difficult to measure and interpret (NPC, 2011, p. 3) but it is critical to 'sustainable growth and rising standards of living'. The National Planning Commission argues that productivity has not grown fast enough in South Africa. Also, in comparison to high-growth countries like South Korea and China 'South Africa's level of public and private investment is low'. In comparison to the third of GDP that those countries spend, South Africa averaged 20% in the mid 1980s and a high of 24% in 2008. (NPC, 2011, p. 4)

Very few South Africans are actually involved in any economic activity. The workforce in South Africa is estimated to be around 17 million people and unemployment stands at 40%. This year, global output is expected to increase by 3.3%; a growth rate of 1.2% is anticipated for advanced economies while growth of 7.3% is expected for developing Asian economies and the Sub Saharan region is estimated to grow at 5.5% (Gordhan, 2012, p. 4)

Skills shortage is a major obstacle to development in South Africa. 'The technical and vocational and training system as well as the higher education system has failed in South Africa' and this has resulted in the skills supply simply not meeting the skills demand. (World Bank, 2011, p. 34). Education is still dysfunctional in South Africa. '3 million young people between the age of 18-24 (that is half of the young people in that age category) are outside education, training or employment. And 7 out of 10 in the age group have no qualifications at all.' (Economist, 2012) Whites account for 40% of graduates and there is a 12% quota for whites in skilled or top managerial positions. (Economist, 2010a) Land reform is another major problem facing the country. The 1913 Land Act prohibited black people from own or even renting land outside of special black reserves. In 1994 87% of land was white owned and the plan was for the state to acquire the land by means of a willing-buyer, willing-seller approach and redistribute at least 30% of the land over five years, but only 6% has been redistributed. (Economist, 2010a) Furthermore, since 2003, demand for imports has exceeded exports, resulting in a widening trade deficit.' (NPC, 2011, p. 17)

Long term fixes include improving health and primary education. The foundation for innovation and technology absorption is education and for this reason quality education and training is vital for countries that want to move up the value chain. (World Bank, 2011, pp. 135-137) The most recent budget speech address emphasises the expansion of further education and skills development as a key long term priority and the improvement of the quality of basic education and broadening of access to adult education programmes alongside that. (Gordhan, 2012, p. 31) Key objectives of the National Development Plan are (Gordhan, 2012, p. 7) 'lowering costs for both households and business by increasing public infrastructure spending, growing our manufacturing and agricultural sectors, raising mining output, improving the functioning of the labour market, particularly to help young people access work; and raising competitiveness and exports.' Furthermore it was noted that 'special emphasis is given to improving competitiveness in industry, investment in technology, encouragement of enterprise development and support for agriculture.' (Gordhan, 2012, p. 3)

Global competitiveness

'Global competitiveness, and our ability to compete for the global investment pool against other countries, will be a key factor in our ability to reduce unemployment, poverty and our economic inequity'. (Pennington, 2011) Overall South Africa has moved up in its competitiveness rankings according to the WEF Competitiveness Report, from 54th to 50th place among 142 countries. The South African economy is the largest African economy and accounts for around 24% of the continents' GDP. It is one of the four upper middle income economies of the continent, including Botswana, Gabon and Mauritius. South Africa (50th) and Mauritius (54th) continue to lead in Africa's competitiveness. (WEF, 2012). GDP per capita of South Africa is ranked 76th at \$US 10,000 which is the same as the world average. Furthermore, South Africa has the 32nd largest economy in the world in \$US GDP terms and the 25th largest in \$US GDP measured in terms of Purchasing Power Parity. (WEF, 2012)

Areas where the countries aspects of competitiveness improved the most were the reliability of 'police service (104th to 95th), brain drain (62nd to 48th), intensity of local competition (63rd to 49th), availability of latest technologies (51st to 39th) and gross national savings as a percentage of GDP (98th to 72nd)'. The main findings from this year's World Economic Forum's Global Competitiveness report are that 7/10 of the most competitive economies of the world are European economies and the USA has continued to go down in the rankings to 5th position. China leads the large emerging markets, ranked 26th most competitive country; and South Africa (50th) is among the other BRIC economies including Brazil (53rd) and India (51st) that have risen in the competitiveness rankings. Fiscal imbalances are seen as a 'danger to future competitiveness in terms of the ability of countries to invest in those things that will be very important for competitiveness going forward.' (These include investments in things such as education and infrastructure.) And a noted trend has emerged regarding convergence between emerging economies and advanced economies. (WEF, 2012) 'South Africa also does reasonably well in more complex areas such as business sophistication (38th) and innovation (41st), benefiting from good scientific research institutions (30th) and strong collaboration between universities and the business sector in innovation (26th).' (WEF, 2012)

A challenge to competitiveness in South Africa is excessively importing from other countries at the expense of developing local industries. This is because the country is seen as a target market by countries that can produce at great volumes and with subsidies and support from their governments. This poses a threat to local industries. The other issue is that South African industries may 'not be competitive enough, even in the fair trade environment'. The history of the country's competitiveness entails 'a legacy of protection' because of a focus on being self-sufficient during the time of sanctions. 'It was able to develop competitiveness in the areas of defence, chemicals and agriculture.' (du Plessis, 2012) The one industry that is relatively competitive and well integrated globally is the automotive industry and it is argued that this is as a result of government support. The question is, to what extent is focussing on SMEs helpful in integration into global supply chains? 'To develop a globally competitive industry, a substantial local market is often required.' Challenges to global competitiveness are the 'lack of skills and perceived high electricity costs as well as currency volatility.' 'More importantly it seems that global industrial development is in fact the major obstacle.' 'It is suggested that industrial development be done in parallel with SME development'. (du Plessis, 2012)

The manufacturing industries of South Africa face the challenge of competition from industrialized countries and they also need to compete with other developing countries and emerging markets. There are only a few sectors in which South Africa that have a competitive advantage in terms of labour costs but it generally struggles to compete with other countries, especially Asian giants. The issue is that South Africa needs to increase productivity in order to compete with both knowledge-intensive and low-labour cost economies. (World Bank, 2011, p. 4)

What may impact trade with other economies is the negative growth forecast for the Euro area but because South Africa is still a major mining economy it should benefit from continued buoyancy in international commodity markets. (Gordhan, 2012, p. 5)

Globally there is a rising demand for agricultural and manufactured goods and South Africa should take advantage of this. In China, for example, 85 million manufacturing jobs are expected to shift to other countries in the next couple of years. The question asked in this year's budget address is whether South Africa has what is needed to take advantage of international changes, whether it has the right policies and conditions. (Gordhan, 2012)

III. Relating the problems of catching-up to the role of SMEs in South Africa

Small, medium and micro enterprises contribute substantially to job creation and GDP in many developing countries (OECD, 2006:1). The National Planning Commission of South Africa argues that this is no different for South Africa, where they estimate that 40% of the country's GDP is attributed to SMEs and that SMEs account for 60% of formal employment. (NPC, 2011: 10)

A reason for the focus on SME development is justified due to the estimate that '73% of workers are employed by firms with less than 50 employees; and that 45% of all employed people work in firms with less than 10 employees. (SBP, 2011, p. 5) An SME approach to development may not be the cure-all of development in South Africa but it is a strategy that requires serious consideration. Due to reality that expertise and funding has been made available through BEE policy, it is worth investigating the ways in which Enterprise Development is implemented by the private sector in South Africa.

Limits of the SME approach to development

A reason for the focus on SMEs is because they can be 'efficient and prolific job creator' and they can also be the seeds of big business as well as the engine of growth (Abor & Quartey, 2010, p. 218). It is argued that SME development can also lead to poverty alleviation and achieving wider socio-economic objectives. The way companies can benefit society is also 'simply by going about their normal business.' (Economist, 2010b) The advantage of SMEs over large business is that they are able to adapt more easily to market conditions and they are often more labour intensive than larger firms. (Abor & Quartey, 2010, p. 223) Comparative studies of large and small businesses, carried out in countries at all stages of development, confirm that small firms generally employ more labour per unit of capital, and require less capital per unit of output, than do large ones (Harper, 1984: 16). Not only do smaller firms have the capacity to absorb labour, but 'assistance to small enterprises displays sensitivity to poverty mitigation.' Luiz (2011, p. 54) notes that this makes small business assistance a 'political necessity'.

It could be argued that SME development has received 'a privileged treatment in development literature'. Before assuming that it is an answer to the issues facing South Africa it is worth engaging the well-structured critique of Castel-Branco against SME-led approaches to economic development in general. He highlights six pitfalls of the general SME-led approach to economic development. He argues that there is lack of clarity in the definitions for SMEs and they often vary according to different stages in economic development. He notes that the arguments that scholars and policy makers make in favour of SME development are often very different to each other and in fact they seem to 'have become too many to be of any practical use.' Thirdly, supporting SMEs has

become an objective in itself instead of a means to achieving development goals. A related argument to this is that it is not clear whether SME development does in fact achieve the development goals it sets out to achieve. The resulting policy recommendations promoting SME development also have become so varied. Lastly Castel-Branco questions whether mainstream approaches to SME development are really appropriate and relevant. (Castel-Branco, 2003, p. 1) (Bateman, 2010)

The GEMINI project offers interesting insights into entrepreneurship in Africa, drawing on 20 000 interviews across South Africa, Zimbabwe, Malawi, Botswana, Lesotho and Kenya, and essentially involves better understanding the challenges SMEs face over time. It explains how these enterprises grew and changed over time. From this study, Rogerson explains that any country's small enterprise economy is in a constant state of flux as the individual components of change can shift in opposite directions such that it becomes essential to try to interpret the 'churning' which takes place in the economy'. (Rogerson C. M., 2001, p. 117) He explains that 'the African experience appears to be that the majority of start-ups are the result of enforced entrepreneurship' rather than the pull of market opportunities. A reversal of this situation will only be the result of a changed macro-economic environment.' (Rogerson C. M., 2001, p. 117)

The profile of the start-up businesses are described as some of the 'least efficient and least remunerative small enterprises'. Interestingly they 'tend to start-up in greater numbers, particularly in low-return' with 'minimum barriers to entry, when the economy is languishing'. (Mead & Liedholm, 1999, p. 65) 'Very little is understood about the factors which influence the duration of firm survival and of those which determine closure' (McPherson, 1995, p. 32). 'A key lesson from the African small enterprise experience is therefore that closure of a business must not be equated with failure- better opportunities come up' (Rogerson C. M., 2001, p. 118)

Survival rates seem to vary considerable between sectors and 'among the estimated 20% that do grow, most grow only by a little' (Mead, 1994b, p. 14). This study was done more than ten years ago and then it was found that 'a striking finding from the surveys across Southern Africa is that less than 1% of firms will graduate from the micro-enterprise seedbed and become established enterprises which employ more than 10 workers.' (Mead & Liedholm, 1999, p. 67).

The challenges facing SMEs in South Africa

Some of the challenges that SMEs face include lack of finance, lack of managerial skills, equipment and technology, regulatory issues and also lack of access to international markets and high start up costs. Furthermore they often cannot afford the high cost of training and advisory services. (Abor & Quartey, 2010, p. 224) Rogerson summarises the three main challenges to SME development as finance, training and skills acquisition and the regulatory environment. In terms of matters relating to finance, literature can be grouped in terms of demand-side and supply side research. (Rogerson C. M., 2008, pp. 62-70) Research on skills development and training indicates there are a number of studies that show that South African entrepreneurs generally have limited skills. (Rogerson C. M., 2008, pp. 70-73) The regulatory environment issues have also generated much research in the field of SME development. (Rogerson C. M., 2008, pp.

73-77) The gaps in research that he identified include understanding the importance of training as a business success factor and understanding learning processes in SMMEs in different sectors, especially for emerging SMMEs. Also the impact of a changing regulatory environment appears under-researched. Research conducted by Olawale and Garwe (2010) has looked at the challenges facing the establishment of new business in South Africa. They found that 'most new SMEs do not grow; their failure rate in South Africa (75%) is one of the highest in the world.' (Olawale & Garwe, 2010, p. 729)

The government has focussed a lot of effort on driving the creation of new businesses to create jobs. This focus is at the expense of a focus on growing established businesses. In addressing the need to understand the potential for growing businesses, a new SME Growth Index has been established by the Small Business Place measuring employment generation and growth potential of SMEs. It released results of its first year in 2011. (SBP, 2011, p. 5) It is a longitudinal study of 500 small businesses and it will run for at least three years. It compares younger, established and mature firms. Young firms are those that have been operating for 2-5 years, established firms 6-20 years and mature firms more than 20 years. (SBP, 2011, p. 5)

The panel of companies represents companies that have between 10-49 employees. It has limited the study to looking at firms that have been in operation for at least 2 years. Most of the companies on the panel are in the three main geographies of Johannesburg, Cape Town and Durban. The main focus is on the sectors of manufacturing, services and tourism because these sectors have high volumes of SME activity. 'They are sectors that have been prioritised by government as critical economic growth areas and offer the potential of SME growth.' (SBP, 2011, p. 6) Two thirds of the panel of business owners were white. 19% were black and 11% were Asian and 5% were coloured. In this survey it stated that this was 'broadly comparable' to the results of a DTI study (2005-2007) SME annual review that indicated that 31% of SMEs are black owned in the formal sector. In this way the study under-represented black businesses. The representation of 29% woman owned businesses was closer to the DTI's estimate of 31%. The study offers a comparison by age of businesses highlighting 'how factors influencing employee growth vary at different stages along the continuum'. It also 'uncover the extent to which businesses tend to employ more people as they grow older'. (SBP, 2011, p. 5)

What is useful about the study is that it also includes 130 firms that are currently receiving business support services. This can be compared with the remaining 500 participating companies that do not receive such support. The support received is among the tourism firms under the Tourism Enterprise Partnership (TEP) programme. What the study revealed was that manufacturing firms have the highest longevity with more than half the firms being established firms (older than 20 years). In the businesses services sector 60% of firms were established (between 6-20). And in the tourism sector around 45% of firms were still young firms. (SBP, 2011, p. 8) 80% of the business owners in the manufacturing sector are older than 40. Many of them plan to retire in 10-20 years- 'in some cases with very limited prospects for a profitable sale of the business or a succession plan.' (SBP, 2011, pp. 11-12)

On average these manufacturing firms have an annual turnover of R10 million and employ 29 permanent staff and about 3 temporary staff. Half the employees are skilled and the other half semiskilled.

This table summarises the key findings about the other sectors from the study (SBP, 2011, pp. 11-15) that is of relevant to this research on SMES.

		Manufacturing Sector	Services Sector (Business Services)	Tourism Sector	TEP businesses receiving support
Turnover	Average annual turnover	R10 million	R 11 million	R 3 million	R 750 000
Employment	Average number permanent staff	29	22	17	10
	Average number of temporary staff	3	4	2	3
Business Growth in terms of employees	% of businesses that have grown their staff count in the last year	33%	36%	17%	31%
	% of businesses that increased staff over 5 years	43%	54%	30%	Sample group too small (2% older than 5 years)
	% of business that hope to grow	35%	50%	20%	50%
Longevity		best	medium	least	least

Key statistics about the business owners in general were that 26% of them were between the ages of 51-60. 32% of them were between the ages of 41-50; and 20% were between 31-40 years. Only 3% were between the ages of 20-30 and this is interesting considering 14% were between the ages of 61-70. (SBP, 2011, p. 9) The career histories of the business in the survey revealed that more than half the business owners had been employed in medium or large businesses before. Only 15% had been employed in small business before. The study suggests that this 'challenges the conventional wisdom of the entrepreneur as a bright young thing striking out on his or her own.' (SBP, 2011, p. 15) What is most useful about this study is that it indicates the challenges that SMEs face in growing their businesses. 40% had attributed the economic slowdown (which results in decline in volume of business) a barrier to growth. Just over 10% did not have plans to expand their business and were fully staffed. The other obstacles to growth were financial and cash-flow constraints (12%), labour regulations (19%) and skills challenges (11%). (SBP, 2011, p. 21) Some of the regulatory constraints in general include BEE (20%), SARS in efficiencies (14%), inflexible labour laws (32%) and government procurement processes (4%). (SBP, 2011, p. 28)

57% of the firms in the study had BEE accreditation and 49% of these were on a level 1-3 status in terms of those accreditations. 21% of the businesses were in the process of applying for BEE accreditation. The perception that BEE is a growth limiting constraint varies across sectors. The main reasons why it is viewed as such includes: having a low BEE score limits access to new business with large companies and government; SMEs

'find it difficult to accommodate black ownership- because shareholders are difficult to attract and businesses are often family owned. Furthermore they find it difficult to compete with the salaries offered to black managers by larger companies. They also find it difficult to find skilled BBEE candidates. The other matter is that the turnover threshold for exempted enterprises is reported to be too low (R5 million turnover). And the cost (also in terms of time and administration) of accreditation is a problem. (SBP, 2011, p. 29)

In terms of the financing of businesses it is worth noting that 60% of the businesses in the study had drawn on their own financial resources to start their businesses. This included savings, pensions and re-mortgaging homes. Only 8% relied on savings and a loan. 6% had also loaned from family and friends and a further 6% from private investors and shareholders. Only 2% had government funding such as an IDC loan. (SBP, 2011, p. 32) These are very useful insights relevant to this study that indicate where start-up capital came from for many businesses that are still in existence.

Furthermore in terms of finding further finance, 14% of the businesses said they did not engage with banks on the matter. Out of 45% that said they had difficulty accessing finance from banks said the reasons were: the banks' risk appetite, the National Credit Act, the requirements for collateral, their unwillingness to finance innovation/new products and demands for personal sureties. (SBP, 2011, p. 33)

Supporting SME development in South Africa

In Rogerson's ten year review of the government's SME programmes he highlights the main issues as being the weak state of official data, the fact that SMMEs do not contribute enough to job creation because they do not grow and that targeting microfinance and the informal economy has been largely unsuccessful. (Rogerson C. , 2004) The state is trying to consolidate small enterprise financing under a new subsidiary in the Industrial Development Corporation (Gordhan, 2012, p. 29) and this is aimed at bringing together a dispersed small enterprise finance sector in the country. Furthermore, according to the most recent Budget small businesses can benefit from tax relief in the form of a higher tax-free threshold. The rate of tax has been reduce from 10% to 7% taxable on income which applies to amounts up to R350 000. The number of turnover tax and vat payments to be made by micro-businesses with less than R1 million turn-over is also reduces from 18 to just 2 payments a year. (Gordhan, 2012, p. 19)

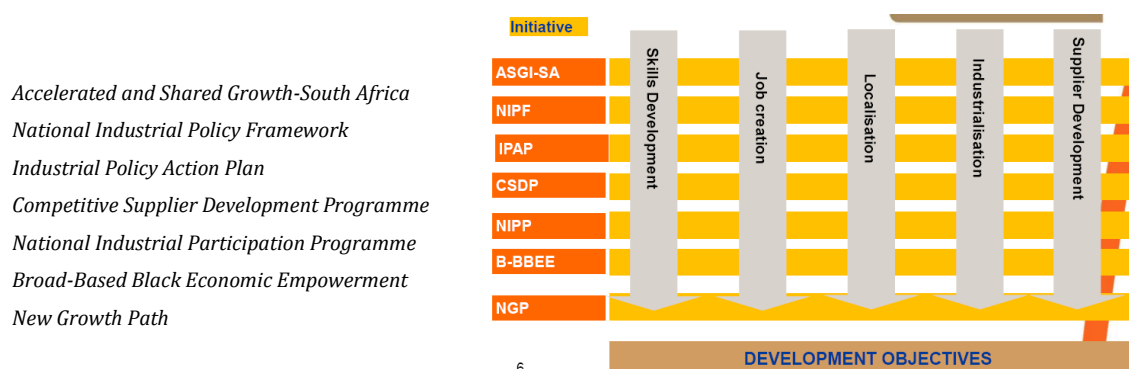
There are discrepancies regarding the results of SME research in South Africa. Whereas the GEM report estimates that 1 in 9 South African runs a business of some sort, Fin Mark Trust estimates this rather at 1 in 6. The issue is that this discrepancy is not discussed or thought through by government and its agencies. 'Both GEM and Finscope show that 'jobs are created by sophisticated small businesses, not informal ones.' A big issue in SME development is thus getting a real understanding of the SME landscape in the country. 'There is a need to segment the market according to 'need' and 'a big hindrance seemed to be that both 'big business and the government were not orientated towards being supplied by small businesses.' Another issue is that 'small businesses struggle to get tenders and government does not pay in time'. (Terreblanche, 2011)

There are about four different departments where South African funds and agencies are located for SMEs. Brazil has one funding agency, namely the BNDES whereas South Africa has the NEF, Khula, NYDA, Samaf and the IDC. (Timm, 2011) There was a merger of institutions to form SEDA (Small Enterprise Development Agency) in 2003.

The NEF jobs fund South Africa recently received 2 650 initial applications. It is a fund worth R9 billion. The applications that were received were to the value of around R320 billion but R2 billion had been set aside for that year's funding in 2011. The fund had underspent in its first year. The funding that was allocated is said to achieve the creation of around 133 000 new jobs which should meet a three year target of 150 000 jobs in only one year. The deputy chairman of the fund, Brian Whittaker, said that "in funds like this, it is inevitable that only a small portion will succeed. Our task is to ensure that the competitive process is fair and that we fund the best proposals." The jobs fund is run by the Development Bank of South Africa on behalf of the National Treasury and received applications from both the public and private sector. The application process has closed for now and has not been opened again. Start-ups are not eligible. If the business is in the private sector, the requirement is that there is a contribution of funding in equal proportion to the amount of funding by the jobs fund. (Sunday Times, 2012, p. 5)

The DTI wants to run a regular small business census and will approach SARS to assist them with it. There are a number of plans ahead and these include: 'revamping the 2005 Integrated Small Business Policy, amending the 2005 Small Business Act, by strengthening partnership and capacity at small business institutions and broadening small firms' access to markets.' 'It also wants to strengthen the role of the National Small Business Advisory Council.' Furthermore, working with business councils is proposed, and specifically 'formulating a national programme to develop and accredit quality business advisors'. It is reported that the DTI 'is already working with the Department of Higher Education to standardise training of business advisors.' Lastly 'expanding the number of business incubators from 30 to 250 is a big plan and the department has already received 20 proposals in line with this idea.' (BuaNews, 2012)

The overall approach of the government to development in South Africa is across a number of initiatives aimed at impacting on development through different channels. This diagram from the DTI's presentation at the Jobs Summit illustrates the government's overall approach. It shows that BEE is a part of the drive toward development and it works in conjunction with a number of other initiatives. (DTI, 2011)



IV. Enterprise Development as a component of BBBEE

The Department of Trade and Industry describes Black Economic Empowerment as “a specific government policy to advance economic transformation and enhance the economic participation of black people in the South African economy”. (DTI, 2007) Black Economic Empowerment policy is the ANC government’s policy for empowerment and transformation and the DTI is tasked with overseeing the implementation thereof. The department created a special unit to do this. Separate to this there is also an advisory council to the presidency that reports on BEE progress. The way BEE is measured is by means of a BEE scorecard.

The support that SMEs currently receive in South Africa is invariably shaped by broad-based black economic empowerment, however interventions aimed at supporting black owned business was only introduced to black economic empowerment policy since around 2006/7 which means the BBBEE ED industry in South Africa has only really been in existence for around four years. There is a lack in research on Enterprise Development in South Africa. In a recent report commissioned by TIPS, the researcher confirms that ‘to date there has been no study carried out on the impact BEE or preferential procurement has had on small business promotion.’ (Timm, 2011, p. 21) This could be because the industry is fairly new and because much of the BEE literature focuses mainly on ownership and management issues. Secondly the focus is often on matters of compliance and not on whether the practices and results are leading to sustainable development. It is helpful to begin with a clear explanation of what BBBEE ED entails. Explaining where ED came from and why it was introduced to BEE is then part of the broader history of the development of black economic empowerment in the country. Lastly, understanding some of the issues around compliance and implementation of BBBEE ED, shows why a case study approach is both relevant and important.

The requirements of BBBEE ED

According to Statement 600 of the Codes of Good Practice, Section 3.2 (DTI, 2007):

“Enterprise development contributions consist of monetary and non-monetary, recoverable and non-recoverable, contributions actually initiated and implemented in favour of beneficiary entities by a measured entity with the specific objective of assisting or accelerating the development, sustainability and ultimate financial and operational independence of that beneficiary. This is commonly accomplished through the expansion of those beneficiaries’ financial and/or operational capacity.”

ED is framed by the BEE codes and it is the BEE Act 53 of 2003 that forms the foundation of BEE. Enterprise Development is be funded by 3% of companies’ NPAT (net profit after tax) (for large companies) and has a weighting on the scorecard of 15% (15 out 100 score card points). ‘The only companies that have to comply fully with BEE requirements make up a mere 1.5% of all companies but contribute 62% to GDP.’ (Tangri & Southall, 2008, p. 712)

Section 3.2.5 of the codes lists the non-exhaustive list of Enterprise Development contributions and these include: grants, investments, loans, guarantees or securities, credit facilities, direct costs incurred, overhead costs, development capital, preferential credit terms, preferential credit terms in respect of supply of goods or services, contributions to settling service costs relating to operational or financial capacity or efficiency levels, payments to third parties, discounts given, capacity development and expertise, training and mentoring, maintenance of an enterprise development unit.

Key terms and definitions

There are some key terms that need to be understood for this definition to be more meaningful and these terms are 'measured entity' and 'beneficiary'. The category/type of company in terms of BEE classification is what is referred to by 'measured entity' and 'beneficiary' is specifically determined by the policy too. The BEE Act of 2003 classification of a company (known as a 'measured entity in the codes') is based purely on its turnover generated. Large enterprises are those companies generating an annual turnover of more than R 35 million; qualifying small enterprises (QSEs) generate an annual profit of between R5 and R35 million and lastly exempted micro enterprises (EMEs) are those companies that generate an annual turnover of less than R5 million. A 'measured entity' is therefore a company in one of these categories and the distinction holds implications for the extent to which these companies are required to comply with BEE policy. (Jack, 2007)

Measuring BEE compliance

A company measures their compliance with BEE policy by way of a BEE scorecard and there are different scorecards that apply to different types of companies. (It must be noted that there are also different BEE charters for different sectors/industries of the economy.) Firstly, for EMEs there is no obligation to comply with BEE. For large companies Enterprise Development is one of seven components on the BEE scorecard and carries a weighting of 15% (15 points out of 100 points). In the case of large enterprise, ED is a compulsory element for BEE compliance and scoring points on the BEE scorecard. For QSE's however, the ED component is an optional component that carries a weighting of 25% (25 points out of 100). Below is an example of the scorecards applicable to large enterprises (known as the adjusted generic scorecard) and the QSE scorecard. (Jack, 2007)

Generic Scorecard

Element	Weighting	Code Series Reference
Management Control	15 points	200
Employment Equity	15 points	300
Skills Development	20 points	400
Preferential Procurement	20 points	500
Enterprise Development	15 points	600
Socio-Economic Development	15 points	700

QSE Scorecard

Element	Weighting	Code Series Reference
Management Control	25 points	200
Employment Equity	25 points	300
Skills Development	25 points	400
Preferential Procurement	25 points	500
Enterprise Development	25 points	600
Socio-Economic Development	25 points	700

Beneficiaries

In respect to the beneficiaries that qualify to receive assistance in terms of 'Enterprise Development', approved beneficiaries include:

- 'Black micro- and small businesses
- Black-owned businesses that make a fair contribution to transformation
- White-owned companies that make a substantial contribution to transformation' (Jack, 2007: 326)

Contributions in terms of ED are further classified in terms of Category A or B beneficiaries.

- Category A contributions 'include contributions to exempted micro-enterprises (EMEs) or QSEs that are 50% black owned.'
- Category B contributions are 'contributions to any enterprise other than QSEs or MES that is:
 - 50% black owned
 - 25% black owned with a BEE status level between level one and level six (the importance of the 'contribution level' will be explained shortly)' (Jack, 2007, p. 328)

'A measured entity may recognise any Category A contribution at a multiple of 1, 25 of the actual amount spent.' (Jack, 2007, p. 329) In this way the contribution to Category A beneficiaries is incentivised above Category B beneficiaries. It must be noted that 'Category B refers to 'any other entity' apart from those referenced in Category A, meaning that EMEs and QSEs will not qualify as ED beneficiaries where they are 25% black owned and achieve a level six status. EMEs and QSEs must be 50% black owned to qualify as recipients of ED contributions.' (Jack, 2007: 328) The status level referred to above relate directly to the scores achieved on the BEE scorecard and these are as follows:

BEE status levels

BEE status	Qualification	Procurement Recognition Level
Level One Contributor	≥ 100 points on the generic scorecard	135%
Level Two Contributor	≥ 85 but <100 points on the generic scorecard	125%
Level Three Contributor	≥ 75 but <85 points on the generic scorecard	110%
Level Four Contributor	≥ 65 but <75 points on the generic scorecard	100%
Level Five Contributor	≥ 55 but <65 points on the generic scorecard	80%
Level Six Contributor	≥ 45 but <55 points on the generic scorecard	60%
Level Seven Contributor	≥ 40 but <45 points on the generic scorecard	50%
Level Eight Contributor	≥ 30 but <40 points on the generic scorecard	10%
Non-Compliant Contributor	<30 points on the generic scorecard	0%

The third column in this table above is a multiple that is used to amplify the recognition received by procuring goods and services from a company that complies with BEE at a certain level. This is done to encourage procurement from BEE compliant companies.

It is a component of the scorecard that holds a very close relationship with BEE ED as it creates an incentive to use ED to improve the recognised status of suppliers in 'order to bolster the recognition regarding procurement in terms of BEE'. (Jack, 2007, p. 84)

Infrastructure development can form part of BEE ED and if a company wishes to be involved in that way there are approved projects where scorecard points will be awarded for engagements- and they do so by working with the government. (Jack, 2007:322)

Enterprise Development calculation formula

The measurement formula for enterprise development according to the codes is as follows:

A: Qualifying Contributions are measurable on the following basis:

$$A = \frac{B}{C} \times D$$

Where

A is the score achieved in respect of the Qualifying Contributions made by the Measured Entity

B is the value of all Qualifying Contributions made by the Measured Entity measured from the commencement of the statement or the Inception Date to the date of measurement

C is compliance target in respect of the Qualifying Contributions as specified in the scorecard for statement 600

D is the Weighting points allocated to the criteria under the scorecard for statement 600.

The measurement of ED contributions can be complicated and Jack notes that 'the complexity lies in the measurement of the numerator and denominator of B. He outlines a number of steps in determining the numerator. (This is included in the annex) A Memorandum of Understanding (MOU) is crucial to the relationship between a measured entity and beneficiary. (Jack, 2007:450)

Some sectors have different focuses in respect to the scorecard and this has implications for the consideration for BEE ED and how it is implemented. It differs from mining, to finance to forestry etc.

Contributions matrix

This table shows the components and what percentage contributes to ED

QUALIFYING CONTRIBUTION TYPES	BENEFIT FACTOR
Grant and related contributions Support for enterprise development in any of the following ways:	
Grant contributions (in cash)	100%
Direct costs (monetary and/or non-monetary)	100%
Discounts given that are above and beyond normal business practice (e.g. early settlement discounts would not count)	100%
Loans and related contributions	
Interest free loan to any beneficiary enterprise with no security requirements	100%
Standard loan to a black owned EMEs or QSEs <i>only</i>	70%
Standard loan to other beneficiary enterprises	60%
Loan at an interest rate lower than prime to any beneficiary enterprise	Prime rate – Actual rate
Guarantees provided on behalf of a beneficiary enterprise	3% of value of guarantee
Equity Investments and Related Contributions	
Minority investment in a black owned EME or QSE. (minority means less than 50% shareholding)	100%
Minority investment in beneficiary enterprises other than EMEs or QSEs.	80%
Enterprise development investment where the financier takes lower dividends than the other shareholders	Ordinary dividend rate – dividend rate for financier
Contributions in the form of people capacity	
Professional services rendered at <i>no cost</i> (e.g. accounting or legal services)	80%
Professional services rendered at <i>a discount</i>	80%
Time of the employees of the <i>measured entity</i> (NOTE: If an accounting officer of the measured entity offers accounting services these would be valued based on the monthly salary, not the commercial charge out rate)	80%
Other Contributions	
Shorter payment periods for beneficiary enterprises	Percentage = 15 days – number of days from invoice to payment

(Jack, 2007:450)

Common mistakes

The most common reasons (IQUAD, 2011) for companies not achieving ED targets are:

- “- Lack of record keeping for contributions made
- Failure to document enterprise development agreements
- Recipients unable to prove their BEE status
- Contributions made outside of the period of measurement
- Incorrectly calculating the target expenditure where a company is not profitable
- Not understanding the impact of cumulative recognition”

Best practice

The best practice for the implementation of ED is to consider the development of suppliers. The argument is that better suppliers will be better for your business and thus to the advantage of the company considering enterprise development and that enterprise development can be seen as a trial period for mergers and acquisitions. It is also argued that effective ED can lead to accessing new customers. Notably the 'BEE policy is designed to encourage measured entities to use enterprise development in conjunction with the preferential procurement element; and the most effective manner of integrating the two is to invest in enterprise development opportunities within the entity's value chain.' As described in the codes the two primary concerns of BEE ED involve 'enhancing the financial and operational capacities of beneficiary enterprises.' (Wooley, 2005, pp. 19-20) ED is described as 'one of the key elements capable of creating the necessary stimulation to drive black business development'. (Jack, 2007:320)

The history of Black Economic Empowerment

BEE ED was introduced as part of the broad based elements of BEE policy. What follows is a further insight on the history and development of black economic empowerment policy. 'For centuries white South Africans had held all the country's assets almost exclusively in their own hands. It was in order to spread this wealth a little more evenly that the ANC introduced black economic empowerment (BEE).' (Economist, 2010c) It was through the Apartheid regime that they systematically and purposefully restricted the majority of South Africans from meaningful participation in the economy. (DTI, 2003: 3) This is why Southall (2007, p. 67) argues that black economic empowerment policies are the logical unfolding of the ANC's own history, and the democratic transitions and notably the structure of the white dominated economy. In the 2011 Budget Speech, President Zuma argued that 'we need black economic empowerment to address the monopoly domination of our economy, which remains an obstacle to the goals of economic transformation, growth and development.'

There have been centuries of oppression of the black population in the country however under apartheid this was intensified. The history of these limitations on the black population begins around 1948 when African capitalism was restructured by separate development. One of the first black capital organisations was NAFCOC- National African Federated Chambers of Commerce. There were limits on black capitalism imposed through development corporations and limits to competition. Limits to technology and finance were also instrumental. (Southall R. , 2004, p. 315) The Natives Laws Amendment Act of 1952 narrowed the definition of blacks with the right of permanent residence in towns. Meanwhile the 1959 Extension of University Education Act prohibited black students from attending white universities, and mandated separate tertiary institutions for different population groups. (Butler, 2007, p. 2) Black people were segregated into homelands by the Promotion of Bantu Self-Government Act and the 1951 Bantu Building Workers Act permitted the training of black people as artisans in the building trade, but this had to be in black areas only. (Butler, 2007, p. 2)

In terms of black business the Bantu Investment Corporation Act provided for the creation of financial, commercial, and industrial projects again in areas designated for black people but it was run by a white board of directors and the loans awarded to black businesses were very small in comparison to the support white businesses were receiving. (Butler, 2007, p. 3) After 1976 Soweto uprising however there was more promotion of black business. Southall (2007, p. 68) explains that as the apartheid system crumbled there were two processes that resulted, namely the occurrence of a shortage of white skilled labour and protests and international sanctions. At the time the private sector established the Urban Foundation, 'aiming to accommodate and coordinate, on an ongoing basis, the private sector's endeavours at improving the quality of life in the urban black townships'. (Butler, 2007, p. 8) When it initially started there were up to 150 large companies that were sponsoring the Urban Foundation. Interestingly this white business community had actually developed a Business Charter for Human Rights but because initially lobbying against apartheid was not generally morally based but rather evidence based. A couple of year later another organisation was formed, known as the Consultative Business Movement and it was in this forum that BEE was discussed for the first time (Butler, 2007, p. 9)

It is interesting that the original idea of black economic empowerment came from white business leaders and some have argued that it was a policy design to ward off attempts at nationalisation by a new incoming government (Economist, 2010a) Initially it was a voluntary engagement between business and the public sector, but due to the slow pace of transformation in the 1990s and BEE policy causing the enrichment of only a small group of black elites, a black economic empowerment commission was established in 1998, that set out to investigate these trends and the commission delivered a milestone report in 2001 which has been very influential in BEE policy making. (Economist, 2010a)

Following the BEE Commission report, transformation of the economy was outlined by the Department of Trade and Industry in its 2003 Strategy for Broad-Based Black Economic Empowerment. What happened in the beginning was that different industries set up different black economic empowerment charters to guide the empowerment processes in their industries and this is when the balanced scorecard measures were introduced. The DTI then introduced a generic scorecard and also a set of codes of good practice. Up until broad-based black economic empowerment was introduced, in the mid 2000s, BEE had focussed mainly on ownership and equity. It was only in 2005 that Enterprise Development (the support and development of black owned SMEs) was introduced as part of this scorecard and requirements to comply with this scorecard came into effect as late as 2007. The BEE Commission Report is very important because it made recommendations and basically shaped BEE going forward. Southall highlights the five recommendation made by the commission. These recommendations included establishing a national procurement agency and a national empowerment fund. It also called for an integrated national HR development strategy as well as a rural development agency and an empowerment framework for public sector restructuring. Most significantly, the BEE Commission report was the first makings of the broad-based elements that were to be introduced to BEE policy (Southall 2004- 321-322).

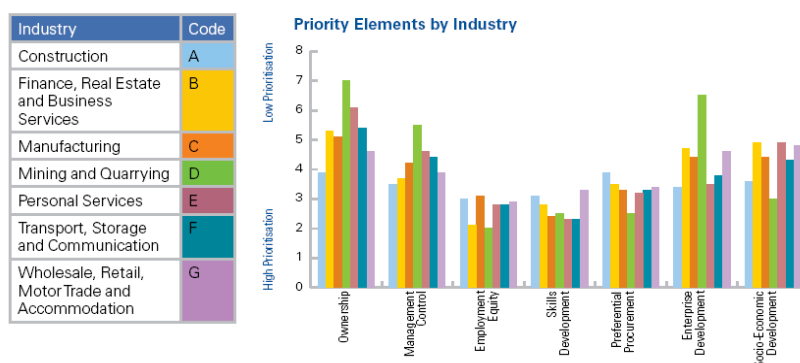
Enterprise Development and other components of BBBEE

In order to better understand the relationship between ED and other components of the scorecard two recent and relevant studies show how companies perform in terms of BEE compliance. According to the 2011 Grant Thornton International Business Report, “South African private business owners still regard BEE as vitally important to business success, with 64% believing it is an important factor in winning new business. This figure has remained relatively constant throughout the years, with 61% affirming this fact in 2010 and 63% in 2009.” “This survey is conducted annually and surveys 11, 000 Privately Held Business (PHB) owners across 39 economies and measures executives’ perceptions on factors that influence profitability and growth.” (Grant Thornton, 2011)

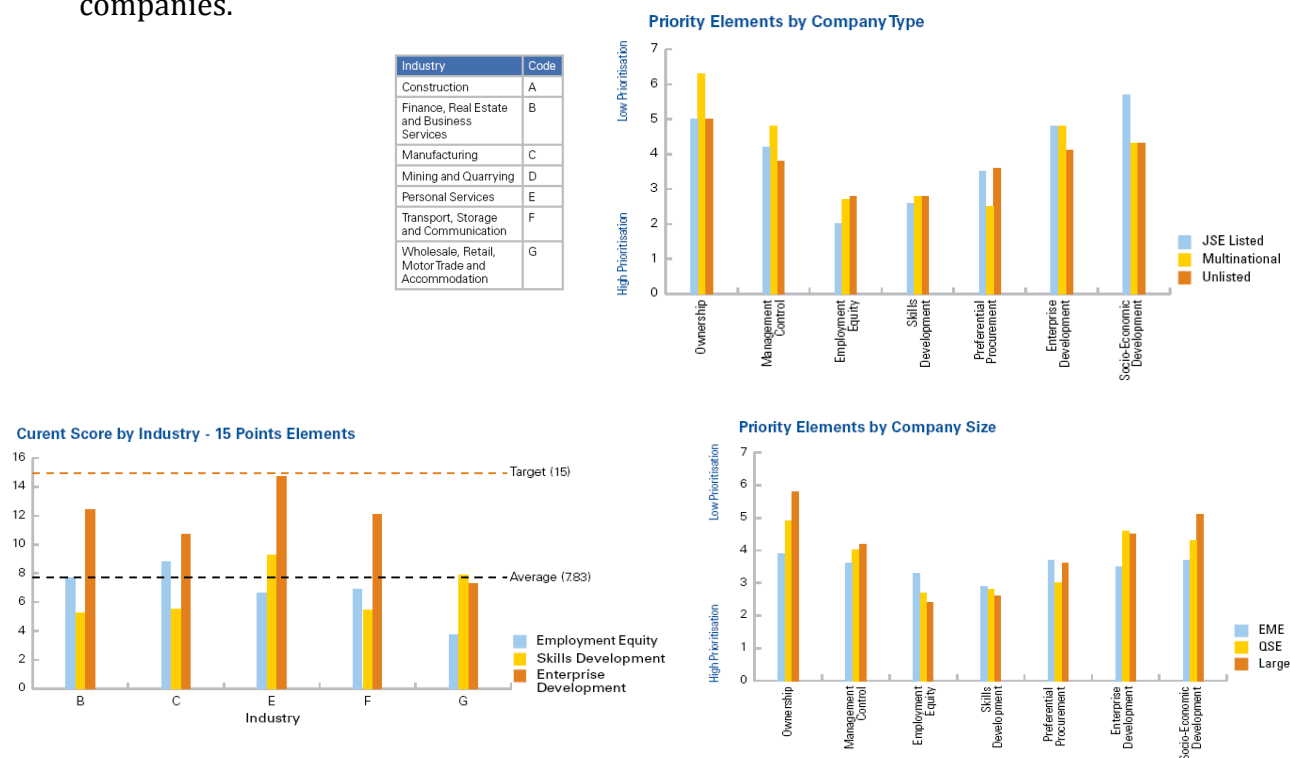
“When asked to rate the importance of each element of the B-BBEE scorecard to their business, skills development (55%), employment equity (49%) and management (44%) were ranked the highest.” The element of employment equity (49%) is followed by the elements of ownership (43%), socio-economic development (38%) and preferential procurement (38%). It is worth noting that enterprise development (33%) is being cited as the least important factor in the B-BBEE scorecard, in terms of private business practice.” (Grant Thornton, 2011)

The recent KPMG IQUAD BEE 2010 survey entitled ‘The Evolution of BEE Measurement’ offers useful insights into explaining how different types of companies and different sectors implement the various BEE components. They note that the big questions on BEE have become “Are we measuring the right stuff?” and “Have we legislated the appropriate measures for BEE?” (KPMG, 2010, p. 2)

This KPMG survey was launched in 2006 with a planned 10 year annual duration. This 10 year period slots in with the minimum duration of the DTI Codes of Good Practice set to be in operation from February 2007- February 2017. The sample for the 2010 survey is made up of 2 000 different sizes and types of organisation representing a variety of industries. KPMG (2010, p. 8) noted that parastatals were not included in the 2010 survey, although they have previously been included. The reason they were not included in 2010 survey was due to a lack in sufficient response for meaningful comparison. This graph from the survey illustrates the priority given by each sector, to different elements of the BEE scorecard. (KPMG, 2010, p. 13)



This prioritisation is further analysed in terms of company size and type as well. (KPMG, 2010, p. 14) From these three graphs collectively, it tells us that ED is not one of the high priority components in many industries and in different types and sizes of companies.



One of the reason why Enterprise Development may be listed as a low priority can be correlated to the results that show how Enterprise Development points are quite high and thus companies may generally be satisfied with their performance in terms of ED. (KPMG, 2010, p. 18)

These results from the KPMG survey are useful to understanding how enterprise development relates to the other elements on the scorecard. What these results do not tell us is what kinds of activities companies are engaging in, in order to achieve high enterprise development scores. As demonstrated in the graph above, it seems that listed companies are the most successful in achieving very high scores for Enterprise Development specifically.

Moeletsi Mbeki believes that ‘the BEE codes’ strong emphasis on black ownership has inadvertently created a rent-seeking behaviour among wealthy or skilled black business people, in effect curbing entrepreneurship among this group.’ He says “it strikes the fatal blow against the emergence of black entrepreneurship by creating a small class of unproductive but wealthy black crony capitalists made up of ANC politicians, some retired and others not, who have become strong allies of the economic oligarchy” (Mbeki 2009: 61). Nazeem Martin, managing director of small business financier Business Partners, reports that BEE ‘not only acts as a deterrence to entrepreneurship, but it means that the number of wealthier and perhaps more creative black

businessmen are drawn away from starting productive, innovative enterprises’ (Timm, 2011:21)

“The governing African National Congress (ANC), with its signature policy of black economic empowerment, is fixated on redistributing wealth rather than creating it.” (Economist, 2011) Studies have shown that the managers of companies disagree that BEE can lead to improvements in company performance and this is ‘specifically regard to overall and international competitiveness’ (Kruger, 2011, p. 207)

ED global history and best practice

In terms of understanding how the theory and practices around Enterprise Development has developed internationally (outside of the BEE framework), Jones and Miehlabradt delineate four key stages in enterprise development history, globally. Their analysis covers the international enterprise development industry since the early 1990s.

- The first stage that they discuss is the beyond-credit stage of the early 1990s where ED practitioners were questioning the sustainability of microcredit. Bateman (2010) notes there was no evidence to support that microfinance positively improved the lives of the poor and the industry itself had produced and artificial supply of microfinance- and results not in job creation but in job churn among poor societies. ED practitioners found that they needed to ‘ensure that would-be micro-entrepreneurs not only learned an income-generating skill, but were also able to access markets and to acquire finance to start up small businesses. Furthermore ‘exit strategies’ and progressive weaning started to play a role. (Jones & Miehlabradt, 2009, p. 305)
- The second phase of enterprise development to occur between the mid 1990s and early 2000s was that of ‘a programming paradigm’ that came from recognizing ‘need for a range of sustainable service options, which then became known as Business Development Services (BDS), pioneered by the Donor Committee for Enterprise Development.’ (Jones and Miehlabradt, 2009:307)
- Following this, a third phase they identified was the systems approach to ED, developed from 2002 and firmly established by 2005. It was called among other things ‘M4P, market development, pro-poor enterprise development and value chain development’ and it is the approach favoured for long-term development. (Jones & Miehlabradt, 2009, p. 309) Value chain analysis then started to appear from about 2003 and practical how-to guides became more and more popular.
- Lastly the fourth stage identified is that of inclusive systems. Putting poor people at the centre instead of enterprises became the main focussing with this strategy. There is a shift in focus not only to poor people in their role as independent producers but also as workers and consumers etc. It also encourages a focus on macro-level issues. (Jones & Miehlabradt, 2009, pp. 310-312)

Rogerson's analysis echoes the analysis done by Jones and Miehlsbradt regarding the different phases and paradigm shifts that enterprise development and SME development has experienced internationally. The main argument is that the shift in paradigm holds implications for the role of governments in SME development. It is believed that the establishment of the Committee of Donor Agencies in 1979 was an important development internationally for SME development. It 'sought to coordinate and improve the practices of donors in small enterprise development by commissioning research, sharing information and issuing guidelines of perceived best practice.' It is the Committee of Donor Agencies that has indeed encouraged a 'trend away from government-led support toward a greater role of the private sector in the delivery of business development services (BDS) to the SMME economy'. (Rogerson C. , 2006, p. 56) BDS can refer to multiple interventions in assisting SMMEs, essentially addressing 'critical constraints' as explained by USAID, which include: 'those of insufficient demand (market constraints), the need for new products, input access constraints, poor production techniques, inadequate management and business skills and inadequate or antiquated technologies' (Rogerson C. , 2006, p. 56) 'The international experience in the field of BDS shows that there was a 'paradigm shift' with the emergence of new high impact strategies that can reach large numbers of businesses in a sustainable manner' and the new focus is on 'the development of effective markets for private sector providers to offer services in order to help SMMEs develop and compete'. (Rogerson C. , 2006, p. 57) What happened in the 1970s is that governments would typically subsidize the delivery of SMME support services and even though the focus was on assisting small entrepreneurs these forms of assistance in developing countries did not always reach the entrepreneurs but were 'captured by more powerful groups' Direct service provision ended up being seen as a failure. (Rogerson C. , 2006, p. 57) What is said to have influenced the move away from this type of BDS is said to be some learnings from the field of micro-finance. It is the inclination to see the private sector as a better provider of BDS than the public sector and an emphasis on creating the best environment for business instead of a narrow focus on enterprises. (Rogerson C. , 2006, p. 58) The core challenge is to develop low-cost service products and delivery mechanisms in order to match the needs and willingness to pay of the smallest clients. This new 'best practice' approach also signifies a shift towards a stress upon the creation of an enabling environment for SMME competitiveness (Rogerson C. , 2006, p. 58) Typically, finance is most often argued to be the biggest challenge for SMEs in developing countries. It is a complex problem, driven by factors such as 'lower returns, higher risk perceptions, an uninspiring regulatory environment, and a lack of intermediary skills, experience and capacity'. (Dalberg, 2011: 17) The reason why banks do not loan to SMEs in developing countries is firstly because they have not really captured that market, secondly they do not see the need to, the administrative costs are higher lending to SMEs and they also have difficulty providing long term capital to SMEs. Furthermore, they find it difficult to tailor foreign exchange products and they also have limited information on SMEs. (Dalberg, 2011: 17-18)

Private Equity and Venture capital are the other financing challenges that SMEs face. Historically there are few providers and private equity and venture capital are still relatively new and the players are yet to expand past the developed world. The constraints are similar to the barriers to debt finance (such as information asymmetries and lack of information) but also SMEs do not know the equity model. Business Partners

has pioneered the field in this respect and Dalberg has identified 192 private equity funds supporting SMEs in emerging markets and developing countries. The capital related to this is worth USD \$7 billion. And many of these funds were created in the last five years, 60% of which is focussed on Sub Saharan Africa. (Dalberg, 2009 and 2011)

CHAPTER 2: RESEARCH METHODOLOGY

I. Research design

The research methods used to investigate enterprise development are guided by the overall research question posed and the consequent research design for the study. The broad aim of this research is to understand the impact that BBBEE ED has on development in South Africa. Development in the context of SMEs in South Africa should be understood to be the establishment and growth of sustainable businesses that lead to economic growth and job creation. More importantly the focus is on how the institutional practices of BEE ED are able to ensure the effort in learning required for SME growth. The case study methodology has been chosen as an appropriate methodology for answering the research question chiefly because it is a method that facilitates the in-depth analysis required to understand how enterprise development is implemented. It is a methodology suited to the research design of this study and the broader research question.

This research is not aimed at testing a hypothesis about ED; instead it aims to draw out implications of ED on development in an inductive manner. Little is actually known about specific ED practices in South Africa and this is why a qualitative study of BBBEE ED institutions and practices is useful. The study is located within the broad research area of the role of SMEs in the social and economic development. The literature review and information about SMEs and ED showed that the BEE framework informs SME development in South Africa. This is particularly with respect to the way the private sector engages the topic of SME development. The reason for comparing some of these approaches is to show how different approaches also impact on development of SMEs in different ways. The type of data needed to answer this research question is mostly qualitative in nature with some quantitative data about business results. It is focussed on the beneficiaries companies of ED interventions and the companies that implement BEE ED on behalf of investors. The research also focuses on the different agents and relationships, including the relationships between ED companies and their investors.

II. Case study methodology

‘A case study is an intensive analysis of an individual unit (e.g., a person, group, or event) stressing developmental factors in relation to context.’ (Flyvbjerg, Case Study, 2011, p. 301) It offers a description of how specific businesses received specific enterprise development assistance and how that intervention was structured and how that led to overcoming challenges and growing businesses. Furthermore it also offers a description of how specific institutional arrangements ensured the specific experiences of the beneficiaries.

In this research the main focus is on the institutional arrangement involved in implementing BEE ED in specific companies, facilitated by ED companies. The practice of ED is thus a central subject. The case study is a holistically study of this phenomenon. The ED practice or approach is the subject and the objective is to find out what was important in ensuring that a beneficiary business underwent ED and how their full participation and learning was ensured. (Thomas G. , 2011, p. 511)

The reasons the case methodology is an appropriate methodology relates to a number of aspects of this research. The first is that detailed information is needed to understand the rationales and the ways in which BEE ED is implemented in the first place. Broad, survey analysis of how many companies comply with BEE ED requirements would not really explain the intricacies of the different approaches to ED. It is important to understand the different ways ED is implemented in order to gain a better understand of the impact on development. Furthermore the specific focus on the institution of BEE and how it impacts SME development is considered through a focus on ensuring effort in learning in business development interventions. The other reason why the case methodology is appropriate is because of the level of detail attained from a case study can explain the relationships and the institutions that shape ED practices and in turn impact on development. This is important because there are different agents involved in the ED process and understanding the different roles that these agents play (ED companies, beneficiaries and investors) is relevant. A case study also represents a real life situation and contains many of the different aspects of BEE ED that need to be explored.

The case study offers and in-depth analysis of the process of Enterprise Development over a period of time and describes the relationships and challenges involved in SME development. The way a case study is done also involves a systematic way of doing the research because it involved selecting cases, collecting data, analysing the data and then compiling the case studies. This also helps to focus the purpose of the study and draw out important issues. Because the industry is not well understood it is also a way of looking at factors that may influence the process and in so doing establish groundwork and in-depth understanding needed for broader research. The case study itself is a way of doing the research and can be useful for generating and testing hypotheses. (Flyvbjerg, Case Study, 2011, p. 307) Thomas (2007, p. 301) explains that 'case studies are often a form of investigation aimed at informing development policy and public action.'

Flyvbjerg (2011) discusses five misunderstanding related to case study methodology. The first is that general, theoretical knowledge is often seen as more important valuable than concrete case knowledge. He argues however universal and predictive theories can never be found in the study of human affairs. For this reason concrete case studies are valuable because they are not the 'vain search' for universals. (Flyvbjerg, Case Study, 2011, p. 304) The second issue is that it is often argued that one cannot generalise from a case study. His counter argument lists a number of scientific theories (Galileo, Newton and the like) works that were based on specific experiments and cases. What exactly the case study methodology is useful for is a third contention. Whether it is for generating hypotheses or testing hypotheses and building theory is debated. He stresses a point made George and Bennett (2005, pp. 6-9) that case studies are actually very useful in

theory building because they trace processes (that often link to causes and outcomes); they detail causal mechanisms; develop a historical explanation and often lead to the formation of new hypotheses and questions. "Sometimes we simply have to keep our eyes open and look carefully at individual cases- not in the hope of proving anything, but rather in the hope of learning something." (Eysenck, 1976, p. 9) The other issue is that of the researcher's bias that could form part of the case study. His rebuttal is that it actually contains just as much bias as any other research inquiry. He asserts that 'experience indicates that the case study contains a greater bias toward falsification of preconceived notions than toward verification.' (Flyvbjerg, 2011, p. 311) The last argument Flyvbjerg tackles is that 'it is difficult to summarise and develop general propositions and theories on the bases of specific case studies'. He acknowledges that it is difficult and this is particularly regarding the case process. The point he makes is that it is not necessarily the methodology that makes it difficult to summarise the case but it is in fact the reality of what is studied that makes it difficult. (Flyvbjerg, 2011, p. 312)

III. Selection of cases

'Critical case' selection (Thomas & Mohan, 2007, p. 315) was used in this research, specifically to 'compare two sets of ideas'. These ideas were about whether start-up entrepreneurs or high growth potential mature firms should be the focus of SME development. Furthermore the way ED was designed around those two target beneficiaries was important. This is because the literature review showed that different types of business (start-ups versus growing businesses) impact on development different in terms of the jobs created and the sustainability of the enterprises. For this reason it was important to choose two cases where the types of business as beneficiaries were dissimilar.

The first imperative was to select two businesses that specialised in Enterprise Development. The choice to choose outsourced ED companies was based on the fact that they had to do reporting to their clients and they specialise in ED. The purposive sampling approach was taken in selecting two ED firms. The private sector in South Africa can either implement ED themselves or outsource the ED interventions to companies that specialise in this area. The focus of this study is on the interventions of these ED companies to which the task of ED is outsourced. The reason why the outsourced ED companies have been the focus point in this study is to isolate the ED component in its implementation from other BEE elements. The other reason is that these companies report to their beneficiaries and have a number of different offerings in the ED space that can be analysed. These companies are also key players in the sharing of best practice and they had substantial information made publically available about their service offerings, how they implement ED and some of their success stories (best practice cases).

The criteria in selecting relevant ED firms for this study was based on their reputation in the industry, based on media reports, industry conferences and referrals from industry experts. These firms also needed to have received substantial backing from large corporates. Lastly, the two approaches to enterprise development selected had to be very distinct from each other in their offering and be generally representative of ED practices in the industry. Initial reading about enterprise development indicated that

the private sector had adopted ED in a variety of ways and this needed to be shown in the selection of cases.

An exploratory strategy for case selection as well as data collection was used in this study. A recent publication called *ED Perspective 2011* was consulting to find out more about different ED companies. Internet searches were also done to find out what offerings ED companies made to clients and to find out who their clients were. The ones selected for this research had been mentioned in the *ED Perspective* publication. Furthermore, the ED practitioners at both companies had also been speakers at ED best practice conferences over the last couple of years. The companies were also based in Johannesburg which was important. Many of the big corporate clients are based in Johannesburg and the ED companies in the region consult to and assist these companies with their ED needs. Furthermore the Gauteng region is one of the areas of the country with the highest concentration of SMEs.

IV. Data collection

The selection of the specific ED examples discussed in this study was a process that came out of a four phase approach to framing the research and data collection. The first phase involved a review of all secondary sources on the industry and three interviews with industry experts. These exploratory interviews were conducted with one academic, the owner of a BEE advisory firm and also an owner of an ED company. (These are included in the schedule of interviews in the annex) They were semi-structured interviews that were not audio recorded. They provided insights into the ED industry and general discussion on key issues around SME development and the BEE codes. They were helpful interviews in scoping the ED industry. It is from these discussions that the idea to compare approaches had come from.

The second phase of the research involved the selection of the two ED companies (with distinct ED approaches) and the request for their participation in the study and their permission to study their companies. The above mentioned criteria of industry reputation, recognition of their approaches and substantial backing by corporates were used for the selection. The sample group of ED companies considered was 15 different ED companies based in Gauteng. The companies that were chosen were contacted telephonically and by email to request their participation. (All documentation regarding the request for permission and the information sheet and consent forms are included in the annex. The protocol for this research had also received ethics approval and this is included in the annex as well.)

The third phase of the research process was the most intensive phase and involved finding out more about each ED companies and their offerings and more specifically about the projects they have done and about the specific examples of beneficiaries they have worked with. More importantly the third phase of the research was where actual fieldwork was conducted and where possible, the ED beneficiary companies and their owners were visited. This part of the research was conducted over a period of six months from October 2011 to March 2012.

A mixed methodology approach was taken to the data collection in this study. It involved an analysis of secondary data on the companies from their websites and media reports (also video interviews and company presentations publically available) as well as the collection of primary data from semi-structured interviews, conducted both face to face and telephonically. Each interview was about 30-45 minutes and they were conducted at the ED company premises as well as at the ED beneficiary companies were possible.

At Raizcorp where there are 75 employees across the different incubation schemes and around 240 possible businesses to speak to, it was important to speak to the founder and CEO of the business and to first understand the philosophy and history of the company. This was one of the first interviews conducted as a semi-structured audio recorded interview and proved very insightful in explaining the two main approaches the company takes to SME development. Raizcorp has a specific business unit for ED and the CEO explained the history of how the company came to serve the corporate sector in that space. The CEO was a gatekeeper to accessing examples of the beneficiary companies. A decision was made to request permission to study cases that were publically available on the company's website. This was strategically done in order to have secondary information available on the cases and also because there was difficulty in gaining access to the different beneficiaries and thus the selection of key cases was based on how the company used these examples as showcase examples.

Other interviews that were conducted with Raizcorp included a semi-structured interview (audio recorder) with a sales consultant in the Arize division about their offering and how they dealt with corporate clients. It was also worth contrasting the offering of the Raizcorp business in the other business unit known as Partner Elite (not catered to BEE ED) and one of the beneficiary business owner in this division was also interviewed. This company is running their business from the Raizcorp incubator in Kramerville, Johannesburg. The main interview however that forms the basis of the case compiled on supplier development was done telephonically because the business owner was out of geographical reach at the time but was happy to do a recorded interview telephonically. A site visit to see the Raizcorp facilities was done and a guided tour of the physical incubator was offered to show their offering in practice.

With regard to collecting data on Edge Growth, preliminary interviews were first conducted with business analysts at the company. (Gaining access to the staff at Edge Growth was less challenging than Raizcorp). In total there are 15 staff members at the company and they are all based in one office in Sandton (though their beneficiary businesses are country wide). A total of six interviews were conducted with Edge Growth staff and this ranged from an interview with founder and directors of the company to business analysts and investment officers. These interviews were conducted from September 2011 to February 2012. Only two of the interviews were not audio recorded and were part of the preliminary process of better understanding the ED offering of the company. In two cases, important and strategic interviews with directors involved doing interviews while we travelled to the respective beneficiary companies they are working with. One of these companies is the final case selected to represent the fund solution offering of Edge Growth.

An invitation was extended in both cases by the business owners and their staff of the beneficiary companies to see the operations of their businesses. One of these was a cattle and crop farm near Brits where the farmer was a beneficiary of an ED project Edge Growth was facilitating. The other was one of the Opti-Baby centres in Pretoria and more specifically the Academy facility for learners. Both of these field trips were fundamental to understanding how different the Edge Growth approach was to a physical incubator programme. The interview conducted with the business owner of Opti-Baby was done separately to the field trip and on an independent visit to the owner.

The third phase of the research process had resulted in a wealth of primary data collected and a lot of experience gained about the different offerings of the companies. In total there were more than 10 hours of audio recorded information about the companies and their approaches and also the experiences of business owners. This led to the fourth phase of the research which was analysing the data and choosing specific cases to represent important and distinct approaches. With the end learning in mind, the choice was to focus on ED offerings that were very different to each other, especially in terms of financial instruments and especially the type of interventions made. More specifically the focus was also on looking at how different types of companies (start-ups versus growth enterprises) are accommodated by the BEE framework around enterprise development. Compiling succinct and holistic narratives on these experiences was the final phase of the research process that also involved analysis and reflection according to the research question posed.

V. Ethical considerations

The ethical considerations regarding the research entailed obtaining informed consent from interviewees and insuring confidentiality and anonymity where requested. Informed consent was obtained by way of a signed consent form that accompanied the information sheet about my research. It was only possible to ensure anonymity in terms of the reporting of the data as I knew by way of content discussed which individuals were associated with which interview but it was possible to ensure anonymity where this was requested. It was made clear that my research data will be stored for seven years in my personal keeping. Furthermore the results of my research are part of the research report only and for no other purposes, which is submitted to the University of the Witwatersrand and will be kept on university records.

VI. Delimitations and limitations

The purpose of the study is aimed at finding out in what ways the learning by doing process is facilitated and incentivised through outsourced enterprise development. For this reason framing the cases involved understanding the influences on the firms and the decisions they made as well as understanding the different aspects of each firm and its internal workings. Much of the research on BEE is focussed on matters of compliance and not sustainable development. This research is relevant and interesting as it aims to ask questions about the factors that drive compliance behaviour but more specifically about issues affecting the sustainability of enterprise development.

Some of the constraints to the research which form the limitations of this study involved time constraints, access to information and geographical limitations. In both cases it was not feasible to speak to all staff members, all investors and all beneficiaries- and thus in delimiting the study to key informants and specific projects and specific investors there are limitations to the scope of information obtained. The delimitation does not necessarily need to be seen as a limiting factor as the purpose of the study is to understand the firm's approach to enterprise development, which can be captured through targeted and selected interviews and information obtained from secondary sources. The delimitation of time serves the purpose of being able to engage with all the necessary staff, beneficiaries and investors within a reasonable time frame and at their availability. Furthermore the geographical delimitations do not inhibit the study as many of the ED interventions do occur in the Gauteng region.

I. Case A: Developing a future supplier using an incubation programme

This is a case study about the role of an ED company in developing a future supplier for a mining client.

ED Company Overview: Raizcorp Arize

'Raizcorp is Africa's only for-profit, unfunded business incubator model, which provides full-service business support programmes that guide entrepreneurs to profitability'. It was established in 2002 and has 8 physical business incubators known as Prosperators. (Raizcorp, 2012) The company is a Level 3 Empowered firm. It has an Enterprise Development division called Arize, which was started around the time that the new BEE codes were introduced. The division has four different Enterprise Development Programmes and corporates can earn BEE points by setting up a contract with Raizcorp and sponsoring a beneficiary on Arize programmes. (Raizcorp Arize, 2011, p. 12)

Overview of the Arize Programmes

'In its quest to truly advance the growth of entrepreneurship in South Africa,' Raizcorp Arize 'provides enterprise development services to the corporate sector.' (Raizcorp Arize, 2011, p. 5) The ED offering includes the Comprehensive Enterprise Development (CED) programme, Pre-Prosperator Programme, Supply Chain Support Programme, Bizgaze and Branded Prosperator and Business Support Centres. (Raizcorp Enterprise Development, 2012) The focus in this case study is on the journey of a new business owner through the Pre-Prosperator programme and onto her first year on CED. The company (known as the principal) involved in sponsoring this business was Shaft Sinkers (2010, p. 21).

Beneficiary company overview: Basadi Development Contractors

This company is in the business of secondary support services to mines. It was established in 2010. It currently employs 17 people, working in the mines on a 2-3 year contract recently awarded. (Matome, 2012) The business 'was developed from an idea with no resources to a fully fledged self sustaining business in just under two years' (Shaft Sinkers, 2010, p. 21). Today it is 'the only 100% female owned BEE Company in South Africa that offers secondary support services to the mining industry in the form of wetcrete, shotcrete and TSL' (Basadi Contractors, 2012) .

The technical services offered by the company include:

- 'Supply and application of shotcrete, fibrecrete and wetcrete and thin skin liner
- Supply, maintenance, installation and tensioning of mechanical anchors and trusses
- Installation and stripping of wiremesh and lace
- Supply and installation of oslo straps
- Installation of packs and sticks' (Basadi Contractors, 2012)

The company website states that they 'endeavour to offer value to their clients by practicing safe practices and always coming up with solutions that will ensure that the client is offered the most efficient and safest service.' (Basadi Contractors, 2012)

Last year the turnover of the company was estimated at around R1.2 million but the company ran at a loss. In 2012 projections are for R10 million turn-over with R4 million in profits. The company has secured a number of contracts, one of which is a 2-3 year contracts and the hope is to get even more contracts. (Matome, 2012)

The business idea: following a passion

The owner of the business, Ntombizanele Matome, 'grew up in the mining community in Rustenburg' and says it had always been her 'passion to eventually work in the industry.' (Raizcorp Arize Blog, 2010) Before approaching Shaft Sinkers to find out how she could get a contract from the company, she had no experience in mining. She had worked at Sasol as a junior procurement officer and for two years was stationed in Mossel Bay as an assistant to a business development officer. None of her family or friend were in the mining industry. She said her matric mathematics results prevented her from enrolling in a mining oriented degree. Her education included studying two years of a degree in communications at RAU. Despite the lack of experience, she realised there was potential for a niche business as a black female owned company offering secondary services in mining. She started her company at age 29. (Matome, 2012)

Deciding what to do

'With mining being a capital intensive industry', Zanele said she 'decided to focus on secondary support services because of its low barriers to entry.' She 'looked at various mine contracting companies, specifically those who were market leaders' and 'Shaft Sinkers came up as a world leader.' (Raizcorp Arize Blog, 2010) Initially she thought to try to get a contract in underground sweeping and vamping. Johan Mostert at Shaft Sinkers however suggested that she research shotcreet application instead as they had an oversupply of sweeping contractors. (Matome, 2012)

Getting onto the Raizcorp Arize programme

Zanele's vision was to be a sub-contractor to Shaft Sinkers so that she could 'learn from the best'. The initial presentation she did for the job was not convincing. 'After many meetings', Shaft Sinkers 'decided that they wanted to take her on board and develop her company.' This was 'so that she could be better equipped to become a service provider to them.' (Raizcorp Arize Blog, 2010) The company sponsored her participation on the Raizcorp Arize programme for Enterprise Development and she started on the programme in October 2009. (Shaft Sinkers, 2010, p. 21)

'In order for the company like Shaft Sinkers to receive its points on the BEE scorecard, there needs to be a line of sight between the funds paid and the final beneficiary of the funds. Raizcorp achieves this by contracting with the Principal as its service provider, simultaneously contracting with the beneficiaries of the Arize programme.'

Steps in the process include the Principal deciding on the budget they wish to allocate and which product is suitable. Their contract is established and payment is made to Raizcorp. Raizcorp then goes through a rigorous process of selecting beneficiaries. The beneficiary contract states the benefits that the beneficiary will receive and what their responsibilities are. The beneficiaries are also made aware of whom their Principal sponsors are.' (Raizcorp Arize, 2011, p. 12)

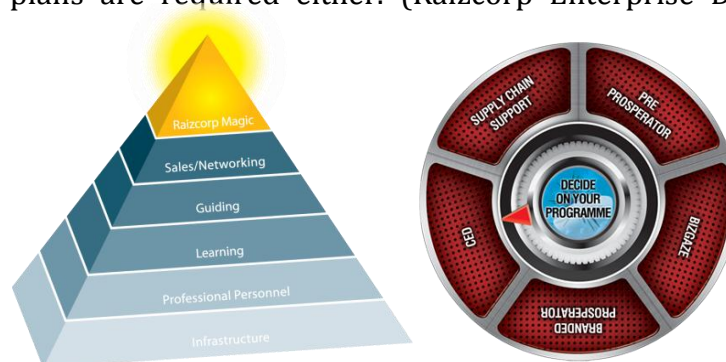
'Each quarter the principal receives a comprehensive report on the activities of its beneficiaries. At any point, the Principal and/or selected rating agency may audit the beneficiaries to verify their participation in various Raizcorp programmes.' Raizcorp has a 'performance measurement intranet system' that is used as a tool for compiling report. (Raizcorp Arize, 2011, p. 12)

Details of the Arize Pre-Prosperator Programme

When Zanele first joined Raizcorp for the training to support her business she began with the Pre-Prosperator programme (P3), aimed at helping her write a comprehensive business plan and think through the fundamentals of her business. (Raizcorp Arize Blog, 2010)

This programme 'offers 20-30 hours of practical entrepreneurship learning per month, approved by the CHE (Council for Higher Education) and the 'methodology incorporates both business skills and personal development learning'. (Raizcorp Enterprise Development, 2012)

Requirements for selection onto the P3 programme include that the participant intend to be the owner of a small business (minimum 51% black ownership) and be active in it; that they have a cell phone. They should have access to a computer and have an email address. They need to be responsible for your own transport and they need to be 18 years or older. 'Raizcorp is not a venture capital business and does not provide capital or company funding.' No minimum education level is required. Furthermore no financial or business plans are required either. (Raizcorp Enterprise Development, 2012)



These two images from the Raizcorp website illustrate the Raizcorp offering and the ED programmes

'The Raizcorp offering is represented by a six-tier model consisting of Business Infrastructure, Professional Personnel, Learning, Guiding, Sales/Networking and Raizcorp Magic!'

The infrastructure provided includes 'offices, hot desks, boardrooms, internet, meeting rooms and office equipment.' The Raizcorp personnel to support the business are 'a receptionist, cleaning staff, hospitality staff and a bookkeeper. The learning entails an accredited entrepreneurship course. The guides are 'specialists who focus on strategy, finance, marketing, personal development and sales. 'Furthermore 'Raizcorp is able to increase the sales of Raizcorp companies through various methods, including linkages into corporates, cross selling to the other 240 Raizcorp companies, direct introductions and various other methods.' The Raizcorp magic is the community of entrepreneurs that support each other and the environment at the physical Raizcorp incubators. (Raizcorp Enterprise Development, 2012)

Supporting herself during a difficult time

Zanele explains that her participation on this first programme was sponsored by Shaft Sinkers but she was responsible for her own transport from Secunda to attend the training in Johannesburg. Her husband has a job that supports her and their two sons, but to pay for the transport to attend this course, she needed to bake biscuits to sell. She sold these biscuits in the mornings at nearby clinics and schools. (Matome, 2012)

Learning the hard way

Zanele had to do a lot of research on the industry she barely knew. This involved reading up on the processes and materials, 'visiting equipment suppliers, going on site to see the actual production process and also meeting with competitors'. She says it was staff at Shaft Sinkers that were instrumental in teaching her the practical and technical skills of what to do. There were times of in service learning combined with four months of intensive learning that helped her build her business. She describes how one contract was priced at R35, 000.00 for her and her team of 7 workers. At the end of that contract she paid all of her workers but not herself. The challenges she faced in her first year of operation were staffing challenges and negotiating contracts with clients. There were also production problems and theft in the mines resulted in equipment being stripped. (Matome, 2012) 'The industry is currently male-dominated, so potential clients find it difficult to trust a women-owned company with a contract'. 'When they realise she knows what she is talking about their perceptions do start to change.' (Raizcorp Arize Blog, 2010)

The skills she learnt at Raizcorp 'equipped her to write a business plan, a marketing plan and to understand the financial aspects of running a company.' She says she also 'learnt a great deal about business process and compliance.' (Raizcorp Arize Blog, 2010) She needed this in order to get new contracts. She has since graduated from the Pre-Prosperator programme and Shaft Sinkers have continued their support by sponsoring her participation in the next programme which is the CED programme. (Raizcorp Arize Blog, 2010)

Zanele says that Shaft Sinkers generously gave her a grant of R500, 000.00 for the essential purchase of a vehicle for her business which has been a fundamental asset. (Matome, 2012)

The contribution to development

Zanele's core team of employees is made up of 7 people. They are fully trained and skilled in the trade of the business. When she got the new contract (2-3 years) she and her team trained an additional 10 people. Her employees go through a 3 month probation period after which they become a part of the team and she says her employees are typically young men and women between the ages of 19-35, black and white. They come from the nearby mining communities. Some of them have worked on the mines before. Others, especially the women, work in the mines for the first time when they join her team. 2-3 days a week Zanele is in the mines with her teams and the other days she is running the business, trying to secure new contracts. Her and her team work long hours and some Saturdays too. In most cases she is providing an opportunity for people to escape unemployment. The contribution to development is the jobs created for her employees and the skills training provided by joining her team. (Matome, 2012)

The role of the principal

'Shaft Sinkers is a specialised contracting company that provides mining and related solutions to clients in various industries.' The company 'got involved in large scale Enterprise Development during 2009 and spent in excess of R1.6 million on Enterprise Development during the year.' They 'are of the view that a sustainable way to create a better life for all South Africans is through job creation.' (Mostert, 2010)

Along with the grant for the bakkie and sponsorship on the Arize incubation programme Shaft Sinker assisted Zanele by 'linking her with industry experts to gain more info on the industry'. She was also invited underground with them to 'view the operations of the entire production process from start to finish.' 'They play an active role in the mentorship' and this support comes from senior management. (Raizcorp Arize Blog, 2010) 'Zanele was invited to be a guest speaker at the Shaft Sinkers Employment Equity year-end function at the end of 2009.' (Mostert, 2010)

Raizcorp assistance

Zanele explains that the support that she has received from Raizcorp has gone above and beyond her expectations. An example of this was the recent assistance she received from a legal specialist at Raizcorp. The terms of payment for a compressor she was hiring had been under dispute. Payments of R80, 000.00 for the equipment were to be made monthly. They wanted to change this to R15, 000.00 instalments on a weekly basis. The assistance of Raizcorp resulted in swift resolution of the dispute to prevent this change.

The entrepreneur's experience of other programmes

Zanele said she was aware of programmes for entrepreneurs that were government run and she mentioned Khula, NYDA as well as specific programmes of the Department of Minerals and Energy. Her perception and experience was that these programmes involved a lot of 'red tape' and did not seem worth her while. Business delegations often accompany the Office of the Presidency on trips to other countries. It offers an opportunity for building contacts. She says going on one of these trips may help, but being selected for these trips are a challenge. (Matome, 2012)

II. Case B: Focussing on the ‘missing middle’ and using an outsourced ED Fund

This is a case study about assistance to a business with high potential for growth and job creation. The focus is on the role of the Enterprise Development company Edge Growth and its Vumela Enterprise Development Fund (VEDF).

ED company overview: Edge Growth

Edge Growth was established in 2007. It is a level 2 Empowered firm, specialising in Enterprise Development. (Edge Growth, 2011, p. 2) Its offering encompasses ED Strategy, Business Development Services, SME Projects and Fund Management. (Edge Growth, 2011, p. 3) This case looks at one Edge Growth ED offering, namely its customised ED Fund.

ED Fund: FNB Vumela Fund

‘FirstRand selected a fund solution managed by FNB in alliance with Edge Growth finding it to be the most effective means of achieving their social, financial and BEE objectives.’ The VEDF was established in 2010 with an initial R86 million. It is ‘a socio-economic fund vehicle seeking to finance early stage growth enterprises that do not qualify for traditional bank funding’. ‘FirstRand expected to be paid back R86 million plus 5% by Vumela over a period of eight years.’ (Ndzamela, 2010)

Overview of the beneficiary company: Opti-Baby

Opti-Baby ‘is a high quality baby care facility, catering for ages three months to five years, with an emphasis on creative stimulation of the children and top tier equipment.’ The company was established in 2003 and six Opti-Baby centres had been opened by 2009 (Business Launchpad, 2010) ‘The business also provides young unemployed women with intensive training in early child hood development which equips them with the skills required to provide tailored care to children.’ (Edge Growth, 2011, p. 6) In addition, the business sells an Optima home stimulation programme and Opti-baby toys (Opti-Baby, 2012) ‘Passionate to grow her business yet unable to source additional funding from banks to do so, Ina (the owner of Opti-Baby) approached Edge Growth and FNB to expand operations in order to roll out the next 20 day care centres.’ (Edge Growth, 2011, p. 6)

The business challenge: planning and financing the growth of Opti-Baby

Ina had plans to grow her business through a franchise programme (Business Launchpad, 2010) and until Edge Growth VEDF had come on board it had been a struggle to secure enough funding and support for growing her business. For five years she had been searching viable options. Interest payable (and especially the timing of when payments were due) on funds and the collateral required were major limitations in the options she considered. From 2008 the business really struggled to open new facilities because of financing constraints. (van der Merwe, 2012)

Growth potential as well as the job creation potential of this business is core to its development story. In the next five years the aim is to open 23 Opti-Baby centres in the Gauteng region and at each centre, 20-25 women can be employed as Opti-Baby staff. (van der Merwe, 2012) The estimate is that this business has the potential to create 480 jobs. (Edge Growth, 2011, p. 4)

The solution offered by the VEDF

The FNB Commercial Head of Enterprise Development, Heather Lowe, explains that the Vumela Fund will make a patient investment consisting of both equity and debt with repayment holidays which would not require repayment while the business is growing. It 'will take (a stake of) anything between 25% to 49% (in the business funded)'. (Ndzamela, 2010)

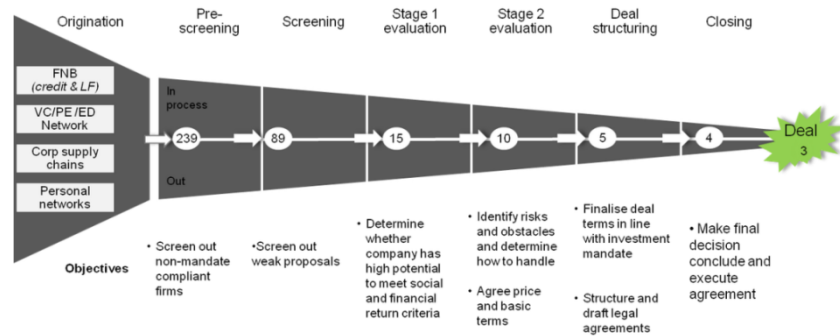
'Small enterprises could receive about R2 million to R20 million in funding'. 'The arrangement is that they be in partnership with Vumela for a minimum period of two years, depending on the contract agreed upon'. 'To exit the partnership entrepreneurs would be allowed to buy back the stake from VEDF.' (Ndzamela, 2010)

The owner's previous experience of ED

Ina (van der Merwe, 2012) explains that she had entered herself into the Enablis competition and won an entrepreneurs award in 2009. It included both funding for her business to the value of R2.3 million and support in the form of workshops run by Enablis. These funds had been made available from Khula Enterprise Finance through the Enablis channels. The arrangement was that it was a five year loan to be paid back. There was also an agreement that Enablis receive a one percent share of turnover. Initial instalments on the loan were already required six months after funds were received. These were conditions that placed a lot of strain on a business that Ina was trying to grow. Even though the funding was much needed, she says that the amount was not enough for the growth expected and the terms of the funding arrangement were not really beneficial to the business. Furthermore her experience of the Enablis workshops and the initial visit from a consultant were not enough. She paid back the loan over a period and continued to try to grow her business without those funds.

Establishing the partnership

The initial referral of Opti-Baby to Edge Growth had come from the FNB credit and leveraged finance division. Ina (van der Merwe, 2012) explains that Edge Growth went through a thorough strategic due diligence process in considering her business. The relationship with Edge Growth began around March 2011 and a contract establishing their agreed terms was signed in July of that year. The negotiated contract was a joint effort that took three months to finalise.



This diagram illustrates the deal pipeline of the Vumela fund at a point in time illustrating some of the steps in selecting different businesses as beneficiary partners.

This gave her ‘access to growth finance and technical and strategic support she requires to scale Opti-Baby by 300% over the next five years.’ (Edge Growth, 2011, p. 5) The Vumela Fund investment for Opti-Baby is R15 million over five years. More specifically the fund has taken 33% equity stake in the business, which is planned to be bought back by Ina at the end of the five year period. (van der Merwe, 2012)

Opti-baby fitted the ‘missing middle mandate’ of the Vumela Fund model

The Vumela Fund is a ‘socio-economic fund vehicle seeking to finance early stage growth enterprises that do not qualify for traditional bank funding’. For First Rand, it is ‘a bid it hopes will help address job creation and improve the lives of the poor.’ (Ndzamela, 2010) The fund has a ‘missing middle mandate’ that entails the following:

How has FR committed to the Vumela fund model?

FR has invested R86m in the first independent fund with a ‘Missing Middle’ mandate

Hurdle rate	• 5% Net financial IRR • >30% Net Social IRR • 80% BEE Points
B-BBEE credentials	• ED beneficiaries which include: Category A & B beneficiaries (Note: can be made Cat A or B post-investment)
Business characteristics	• Later stage growth companies (>1 year) OR start-ups* with secured income streams or strong competitive advantage and low barriers to entry • Businesses with >R20M turnover potential • EBITDA <R10m
Business model	• Sustainable comp. Adv. in a clear market niche or can secure performance based PP contracts • In proven growth markets, using proven technologies & business models • Strong cash generation ability within 2 – 3 years of deal
Deal characteristics	• Size: R2m-R15m total investment • Term: 2-5 year investment period at portfolio level; Fully exited portfolio within 8 years (extension option) • Application: Expansion; buy in / out; development; start up; replacement • Product: Mainly equity & quasi-equity deals (25-60% equity stake)
Management	• Owner/managers with significant personal upside and downside potential • Strong management team willing to receive intensive Board and management support if required • Key man dependency solution
Geography	• Gauteng focus but no limitation

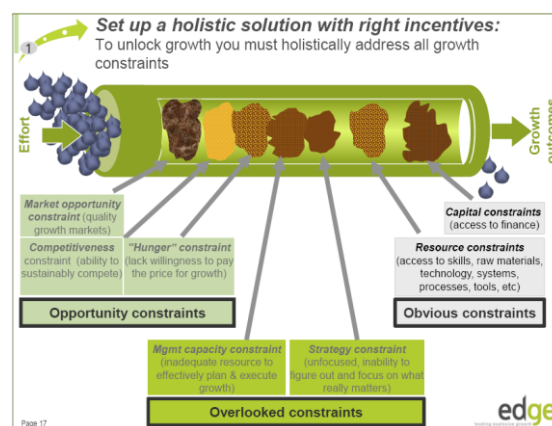
This image is from a presentation (slide 20) about the Vumela Fund delivered at the Microfinance and Small Banking Conference hosted by Omega Investment Research, 4 November 2010- made publically available

The term 'missing middle' refers to two things. It describes the occurrence of fewer small to medium sized businesses (versus micro businesses) in an economy (when comparing low-income countries to high-income countries). 'SMEs aren't missing because they wouldn't be profitable: they are missing because finance is not reaching them in an effective way. This shows that access to finance is a significant barrier, and that there is a massive profit opportunity for those who are able to successfully finance these firms.' (Harvard CID, 2012) Edge Growth (Edge Growth and FNB, 2010, p. 6) recognises the missing middle, arguing that 'Missing Middle Growth Equity with integrated BDS is the high impact socio-economic investment zone'. In developing the Vumela Fund, it has been central to impacting the type of investment decisions made. This is to achieve not only returns on investment but also social impact. The Opti-Baby business met the requirements of the above mandate.

Ways in which the VEDF and Edge Growth ED have helped

Ina (van der Merwe, 2012) says that the biggest help of the VEDF intervention was the time that the structure of the financing allows for growth of the business to take place. Key inputs from Edge Growth have been strategic planning sessions, the development of very useful cash-flow models and advisory services. Furthermore, Edge Growth has been instrumental in connecting the business with a number of valuable contacts and specialists in their network that have been able to assist with specific aspects of this business. Examples of this include a property specialist helping find the right locations for expansion.

They have also been connected with marketing specialists. (Alongside the Opti-Baby centres, the larger Opti-Co business also has a number of other things to market such as the Optima home stimulation programme, Opti-Baby toys and also the Opti-Academy. (Opti-Baby, 2012)) Other interventions include requirements for a change of auditor. The structure of the business is complicated and this process was described by Ina as a relatively painful process but she sees the value in the changes that were made. (van der Merwe, 2012) The approach that Edge Growth has taken to ED is to establish a holistic solution with the right incentives. The diagram below illustrates their approach:



(Edge Growth, Tshikululu Conference 2010: 17)

The approach entails not only helping the beneficiary overcome obvious constraints such as capital and resource constraints, but also helps them gain much needed clarity on their growth strategy. Ina (van der Merwe, 2012) explains that the Edge Growth engagement has involved regular onsite meetings and thorough reporting. Furthermore she says 'Edge Growth is made up of a team of highly qualified, highly experienced, highly committed and passionate individuals. With their expertise and guidance Opti-Baby will no doubt grow to be the leader in Early Childhood Development in the next five years.' (Edge Growth, 2011, p. 5)

For Ina, it was important to maintain the vision of expanding the business on a large scale and she feels that this vision has been kept. (van der Merwe, 2012) At the moment there are seven Opti-Baby centres in operation in various locations around Gauteng. These include Brooklyn, Eldoraigue, Fourways, Highveld, Midrand, Morelata Park, Northcliff and Rosebank; (four properties of which belong to the business).

Going forward, the plan is to rent properties instead of purchasing for the business (van der Merwe, 2012) Property financing was a major obstacle in the growth of the business. Residential properties were being purchased and changed into Opti-Baby centres and several such locations had been acquired in this way. The new credit act changed the game for Opti-Baby and these properties were often considered as separate to the business entity in applications for further funding. These were issues related to the zoning of the properties that complicated financing applications, despite substantial equity tied up in those properties. (van der Merwe, 2012) The business now has a clear growth strategy that can be executed with its available finance.

Contributions to development

It is still early to measure the impact of this partnership in terms of the growth of the business and the number of jobs created. Turnover of the Opti-Baby business last year was around R8 million and profits were R1.4 million (before the growth plan). The core team of employees at Opti-Baby, from operations manager to maintenance staff, comprise around 50 employees and in total the Opti-Baby business employs 170 people. (van der Merwe, 2012) The success of this story lies in leveraging the BBBEE ED framework to establish a fund that could serve the needs of a high growth potential business. This impacts the SME development landscape of the country. It makes available funding (patient capital) and business development services that these types of job creating business did not have access to before.

The social impact that the growth of the business will achieve is significant because growth in the establishment of each new centre means the opportunity for 20-25 new staff to work at the centres. Young women, both black and white, benefit from skills development and sustainable employment through the growth of these centres.

The training programme of the Opti-Academy is ideal for young women that have matriculated and do not have university exemption or cannot afford a university degree or have not decided what they would like to do. (van der Merwe, 2012) The cost of the 12 month training programme is R15, 000.00 and once trainees start their practical work they earn R2, 000.00 per month.

Junior assistants get paid R4, 500.00 a month, facilitators R12, 00.00 a month and managers earn between R15-20,000.00 per month in these centres. The Opti-Academy thus provides the necessary skills and training for the expansion of the Opti-Baby centres. This also maintains the quality standards of the service offering at the centres. In turn it also guarantees the job placements of the staff that get trained through the Opti-Academy- thus providing a decent and sustainable job.

At the Opti-Baby Stimulation Centres, qualified and trained personnel look after children, Mondays to Fridays at a cost to the client of around R3, 300 a month. This includes feeding. Security, hygiene and quality care are top priorities at the day care centre. The facility has fitted web cameras for parents to log-in to secure live online footage of their child at day-care. (Opti-Baby, 2012) (van der Merwe, 2012) The 'catch 22' as the owner describes (van der Merwe, 2012) is managing this growth and ensuring that the right numbers of centres are opened and the right number of staff are trained. The business model is proven to be a successful and sustainable one and the growth of Opti-Baby will expand the offering of a quality day-care and child development service to a growing market; also leading to skills development and sustainable job creation.

The rationale for outsourced ED in the form of an ED fund

The VEDF which was launched in 2010 was the first of its kind. 'It brought together elements for successful ED implementation, providing an end-to-end solution for corporate South Africa: strategy design, SME selection, SME support and fund management.' (Edge Growth, 2011, p. 11)

The rationale for outsourcing ED fund management to a company like Edge Growth is based on a 7 point argument. Firstly it reduces the time involved in the implementation of ED. After the first implementation which can take between 12-18 months, the second implementation can be expected to be 3-6 months with an ED fund. Secondly, there are 'cost efficiencies' gained from such a fund. Thirdly, the company 'leverages expertise in setting up a developmental fund'. This is also because a 'developmental fund is substantially different to a private equity fund'. Fourthly, there is access to 'immediate competency and capacity to invest/manage funds'. Fifth, 'legal and governance frameworks have been developed' for the fund. Sixth, 'systems and processes are embedded' in the fund. Lastly the ED business has established relationships necessary for successful BDS. (Edge Growth, 2010: Microfinance Conference, 25)

Furthermore, the use of a fund, 'turns developmental spend into an investment as opposed to it being equivalent to a 'tax' or a donation.' The fund that Edge Growth establishes for its clients also 'achieves maximum B-BBEE points for the investor quickly and efficiently with immediate points recognition for funds invested.' The approach is to provide a 'holistic, strategic solution' to investors. It can even 'contribute to the investor's core business' and be customised to the ED investor's needs. It 'integrates ED and Preferential Procurement thereby leveraging off the multiplier effect inherent in the Codes'. 'It provides a single point of accountability with system-driven governance and reporting'. Ultimately, 'it provides the opportunity for real, high impact, sustainable economic development.' (Edge Growth, 2011, pp. 14-15)

CHAPTER 4: COMPARISON AND ANALYSIS OF THE ENTERPRISE DEVELOPMENT APPROACHES

This comparison and analysis of the two approaches to enterprise development will focus on the factors that influence whether beneficiary companies are really incentivised to put effort into learning about and growing their businesses through BEE ED; and how the broader context of their support is framed. The purpose of this research study has been to explore the impact that BBBEE ED has on SME development in South Africa. To this end, the comparison and analysis of the two case studies aims to see whether the different approaches have the potential to help create financially and operationally independent business (as the BEE ED codes' mandate states); and whether this SME development can be linked to job creation.

It looks at how and why each approach positively or negatively impacts SME development. The BEE codes have spawned an industry of experts on Enterprise Development that exist primarily to serve the needs of companies that wish to comply with the codes. There are various factors that drive the different approaches to enterprise development. The two case studies explored here are by no means the only ways enterprise development is being implemented but they represent very different thinking about what enterprise development entails.

The analytical framework that is used to analyse these approaches is adapted from Mushtaq Khan's (2009, p. 1) focus on the role of institutions in developing competitive industries. He argued that the success of certain sectors in countries that he studied (Thailand, India, Bangladesh and Tanzania) was not only based on access to the market in a liberal economy. It was also the result of a combination of factors that 'combined specific financial instruments with the right governance, market and political factors that ensured high levels of effort, and therefore the achievement of globally competitiveness.' The concept of learning is central to this theoretical framework; and it is specifically the type of learning that happens by doing (the acquisition of tacit knowledge) that lead businesses to becoming globally competitive. His analysis of competitive industries was developed on a more macro scale whereas this analysis has a micro focus; using the concept of 'learning' as central to the business development process. This research has focussed on specific ED approaches and looked at BEE ED as an institution that is meant to ensure that business 'learn by doing' and receive the necessary support through ED to become financially and operationally independent businesses.

In order to understand whether BBBEE ED is ensuring high levels of effort in starting and growing SMEs, this analysis considers some of the variables Mushtaq Khan also considered in his analysis. These include looking at the financial instruments, governance agencies, firm structure and political settlement in each case. A couple of other variables are added as they became relevant. Instead of testing Khan's theory about the institutional problems of ensuring effort in learning, the analysis is used to build a body of insights on how BBBEE ED impacts on development. The comparison and analysis is structured according to the variables that play a part in ensuring effort in learning.

Limits to non-financial support and requirements of growth financing

This section explores the implications of the different financial instruments used to support beneficiary businesses. Funding is used to supply infrastructure and business support services (without financing) or it is used as a loan with preferential terms. Looking at the financial instruments used, the question that needs to be asked is what does each agent stand to gain in the process? Each financial instrument has rules about how clients contribute funds and how the ED money is spent and what benefits beneficiaries are to receive. There are incentives and responsibilities regarding each arrangement, and this analysis tries to show the pros and cons of each ED approach.

In both cases the ED companies are offering an outsourced solution to corporate who would like to comply with BEE ED requirements. The ED companies are presenting their specific offering and receiving either a fee or setting up a fund to meet their clients' needs. (In both cases the ED companies stand to gain financially from meeting their investors' BEE needs.) In Case A the ED company's reputation is at stake based on the performance of the beneficiary business whereas in Case B the ED company has a closer vested interest in the beneficiary company based on the equity stake it has in that company.

In Case A no capital or funding was provided directly to the start-up business by the ED company. The financial instrument that was used to ensure effort in learning was a sponsored bursary to the beneficiary company. This bursary ensured access to a chosen incubation programme for the beneficiary. (It did not finance the need for transport to the physical incubator.) This bursary was paid for by the sponsoring client to the ED company. In return for the payment for ED services, the ED company submits the necessary details required for the client to receive BEE ED points for their contribution. No data was gathered to suggest that this client received a return on investment. There is a contract established between the ED company and its client which is a legal agreement about how the ED budget is spent over a period of time. Furthermore a contract established between the beneficiary and the ED company outlines the benefits that the beneficiary receives as well as their responsibilities regarding the programme. (Details of these particular contracts were not obtained in this research.) What is known is that the offering is all non-financial support to the beneficiary business. The ED company structures their offering to clients in terms of priced programmes (products) and ensures that their offering is aligned with the requirements of the BEE codes.

The benefit of this financial instrument is that it ensures that money for BEE ED is spent on ED (creating infrastructure and business support centres) and BEE points are efficiently obtained. Contractual and legal agreements ensure the sponsorship of the programme for the beneficiary. The beneficiary gains access to infrastructure and business support that is not determined by their ability to pay for it. It is also a consistent and structured offering that is much cheaper than something the client may have attempted themselves. The disadvantage is that the client spending money for BEE points does not get a financial return on their investment. The other disadvantage is that the budget a client can spend on ED may determine whether or not they choose

this intervention. The disadvantage for the beneficiary is that other sources for financing need to be found.

In Case B funding and business development support was made available to the beneficiary company through an equity deal with the ED fund that is managed by the ED company. In managing the fund, the ED company is able to ensure a specific type of patient capital and business support be made available to the beneficiary business. The ED company as the manager of the ED fund has an agreement to pay a return on the ED investor's money at a specific rate over a period of 8 years for example. It also establishes a mandate with the investor that determines how the fund spends its money. The fund itself is a BEE beneficiary and the money spent by the investor can be claimed as BEE points. The onward investment to specific companies that the ED Fund invests in is done through specific equity deals that are structured in a way that ensures the exit of the ED company and ED Fund as equity partner after a specific period. Ensuring effort in learning becomes part of ensuring the success and growth of the business.

The benefit of the financial instrument used in Case B is that the investor receives a return on investment and the beneficiary receives suitable financing and business support. Furthermore the amount of money invested is a target amount not generally accessible to some SMEs, known as missing middle finance. The mandate established by the investor and fund manager also guides the type of investments made. The beneficiary as well as the investor also have a single point of contact regarding the intervention because both the finance and business development support are managed through the ED company fund solution. The disadvantage of the approach is that a large amount is required for an investor to establish a customised ED fund. This solution may not be suitable to all corporates. The fund solution targets high growth potential businesses and sourcing and structuring deals is a rigorous and time consuming process.

In Case B the ED Company has a strong financial incentive to ensure the success in learning and growth of the beneficiary company because it holds an equity stake in the beneficiary company. In Case A however the financial instrument used will secure the funding for the ED company to offer its service to the beneficiary. It is not clear from these approaches what drives the decisions corporates make to spend or invest BEE ED money the way they do. In Case A for example the client had identified a potential supplier and sought a suitable ED programme to help this supplier start a company. In Case B however, the investor sought to establish a specific ED solution that would be appropriate for its ED requirements. A broader survey on this topic could reveal more. There could be specific ED trends related to different sectors (driven by BEE sector charters) and there could be specific trends related to the amount companies spend on ED and the ED interventions that result. What is known however is that reward for ED spends includes BEE points and in some cases a return on investment. Specific mandates ensure that ED money is spent correctly. It would be interesting to find out how many corporate clients invest in such fund vehicles for ED and what return they get and how the different investment mandates compare. This would give a clearer indication on how ED is impacting the financing of SME development. Further insights

could be gained from comparing the investment mandates of outsourced ED companies with that of corporates that do ED themselves and with government enterprises too.

This analysis of the financial instruments of ED approaches has shown that a sponsored bursary programme ensures the availability of much needed business infrastructure and learning programmes and support needed for a start-up business. It does not secure continued support unless the sponsoring company continues support or the ED company finds another sponsor. In this case additional financing was needed to ensure that the beneficiary could access the opportunity.

In terms of the financial instrument of the fund solution, the contribution that this makes to SME development is to make available the necessary amount of patient capital that the beneficiary business was not able to access before. The financing is catered to the growth needs of the business and the holistic solution also contains the needed business support to see that growth is achieved. Because this approach targets high growth potential business with a relatively successful business model in a competitive and growing market it is likely to achieve more sustainable results. What this analysis also shows is that financial instruments ensures the learning process not only by making funding available but more importantly by providing the necessary business support for the money to be spent productively.

The financial instruments of ED offerings needs to be researched in a lot more detail and more broadly across ED offerings in South Africa. The main purpose would be to see what funding is being made available through ED and to which types of businesses this applies- and especially whether it is more 'developmental' in nature. The broader analysis should show whether ED funds are structured in such a way to ensure returns on investments and more beneficial terms for beneficiaries. Where business or organisation have failed to ensure commitments regarding funding and the commitment of beneficiaries, reasons for those failures need to be understood. It is also worth researching what types of businesses do not meet BEE ED investment mandates and because of such criteria are missing out on the business development support they could be receiving.

Legal contracts and investment mandates are key governance tools

The credibility of the governance agencies in BEE ED depend on whether they are able to enforce the rules set out in ED agreements. Governance agencies are the different capabilities that monitor the ED process and they are involved in enforcing the terms of the financing instrument. The governance agencies therefore depend on the type of financing used. In Case B where a fund vehicle is used, the structure of governance agencies is more complicated than the bursary option in Case A. There is a governing board as well as an investment committee established to oversee the investments made through the fund solutions. The advantage of this is that there are checks and balances that ensure that funding is deployed according to the mandate established between the investor and the ED company. This is also in line with Financial Services regulations. The advantage is that these governance agencies add credibility to the fund solution and offer the investor assurance that funding is used according to the mandate. The

disadvantage is that deals have to be sourced and funds deployed within a specific time period.

In Case A the governance agency ensuring that financing is deployed is the legal agreement between the client and the ED company in terms of their offering to the beneficiary. The ED company also states that the client is welcome to arrange for an independent audit at any stage to verify the participation of the beneficiary on the programme. The advantage of these governance agencies are that they help to ensure participation of the beneficiary on the programme.

What makes ED in South Africa unique is that the industry is shaped by the BEE codes. In both Cases A and B the money spent on ED can be claimed as BEE points. This is possible because BEE verification agencies in each case recognised the way the money is spent to be in line with the codes and are happy to award points for investments with the selected ED companies. The advantage of this is that these governance agencies are independent and their recognition of the spend leads to efficient BEE points being earned. The disadvantage is that this governance system is a mere tick-box approach measuring BEE ED compliance.

In each case the ED companies has specific mechanisms in place in order to select beneficiaries and do due diligence checks on these businesses (or potential business owners). This is in order to invest funds according to their investment mandates but also to ensure that they select the right candidates. The selection criteria of these two cases are very different and this speaks to the matter of the orientation of ED interventions. A broader study on the different selection criteria of various ED offerings would give insights into the delimitations of ED support. In Case A the selection criteria does not include business plans or any proof of a financially viable business. It caters for early stage entrepreneurs. In Case B however the selection criteria is different because of the missing middle mandate and the rationale for selecting high growth potential businesses. It would be worth investigating the reasons why businesses that almost get selected onto these programmes are 'failing' and use this information to guide broader SME development in the country.

Reporting mechanisms were mentioned in both cases as a means of communicating the progress of the beneficiary businesses receiving ED. These are very important tools in ensuring the learning of the beneficiary companies. Reporting was done on a regular basis, in some cases on a weekly basis. (In Case A the support received was based at a physical incubator where the beneficiary had access to advisors; whereas Case B's approach was onsite meetings and consultations). The advantage of the reporting mechanisms is that clients and investors can receive the required information about the ED interventions on a regular basis. In Case B for example a change of auditors was required in order to bring reporting standards in line with the requirements of the ED company. The disadvantage of this is that adjusting to reporting can take time for a business. In both cases the business owners reported that the ED interventions helped them with understanding the cash-flow of their businesses. This is one way in which the governance agencies involved in ED support can lead to sustainable business development. No data was gathered to prove that the governance mechanisms used in ED interventions help to bring businesses in line other regulations such as labour,

health and safety. In Case A the beneficiary did however mention that the learning and support received helped in understanding business processes and compliance.

What this analysis of the governance agencies of BEE ED has shown is that there are mechanisms in place to ensure the transparency of how funds are spent. This is particularly because ED is outsourced to a third party and information is required to create a line of sight in terms of the ED money spent (for BEE points to be earned). Contracts and investment mandates establish how funds are to be spent and reporting mechanisms offer up to date information on the progress of beneficiaries. Independent agencies such as verification agencies play a role in checking the practices of the industry in line with BEE guidelines. Even though transparency can be achieved it does not guarantee increased productivity of the beneficiary companies. As to how the governance agencies of the actual ED support ensures that learning takes place in the beneficiary business, this can be done through enforcing financial reporting requirements and regular progress reports. ¹

The age, size and market of the beneficiary businesses determine success

The firm structure of the beneficiary companies has an influence on how they respond to the business development support received. This is in terms of the size and age of the firm and also the market in which it plays. In Case A the focus was on a start-up business that was to become a supplier to the ED client. The advantage in establishing a female black owned company, specifically in the form of a safety applications business, is that companies may prefer to procure from such a supplier because they earn more BEE procurement points by doing so because of BEE Preferential Procurement guidelines. The impact of the procurement codes on the mining industry created a niche for the establishment of the company that was established in Case A. How long this company can maintain its competitive advantage is a question of how soon other black female owned companies of its kind will enter the market as competitors. The structure of the company at this early stage is still simple and employees of the company are employed on a temporary/contract basis. This type of arrangement does not secure the employment of many of the company's employees. They receive on the job training and this is facilitated by the owner and other employees. The owner mentioned trouble with staffing in the first year of operation and affects the operation of the business. The ED intervention of an incubation programme is focussed on the entrepreneur with the emphasis on equipping the company owner to run a sustainable business and does not focus on the specific skills required to learn the trade of the business. In Case A the fundamental learnings of techniques of shotcrete application were not gained through the incubation programme. Instead the learning was facilitated by the mining client.

A risk to the business in Case A is that its revenue is based on securing contracts and the size of contracts and requirements of the contracts impact the number of employees

¹ The DTI is working on a national programme to 'develop and accredit business advisors.' (BuaNews, 2012)

needed on the job (and the need to train new employees quickly). The owner of the business is involved in both managing the operations of the business as well as soliciting new business. These two conflicting demands can place strain on the business. The disadvantage of the physical incubation offering is that the business owner needs to attend ED programme while running the business which can become an inconvenience to the beneficiary. The advantage of the approach however is that the business owner receives various inputs in developing their capabilities of running a sustainable business. Much needed 'fire fighting' is also offered by the expertise of the incubation team as was the case in negotiating payment terms of equipment. This begs the question of the sustainability of the business post the ED programme and support offering. It not certain whether there are mechanisms in place to ensure the continued support until the business no longer needs to ED offering it started with.

The firm structure in Case B is a lot more complicated and the business had established itself over a number of years (since 2003) and proven to be relatively successful. In fact the business itself has separate entities and different components such as the actual day-care facilities and then the other businesses such as the training academy and product businesses. The needs of the business were very different to that of a start-up business. It required scaling of the business and growth strategy and finance. The fact that franchising the business had already proven a relatively successful process showed that the business had the potential to be scaled in a way that would allow for grow. The focus of the ED support was on growing the entire business and not just focussing on the entrepreneur. Enforcing the learning required for the training of new staff is facilitated by the in-house training academy of the business; and enforcing the growing of the every new facility according to the business model standards is facilitated by the franchise programme of the business. These are both structures of the firm that ensure the sustainability of both the service offering and the skills development requirements for the business and in so doing maintain its competitive advantage in the market. The advantage of this ED fund solution approach is its focus on the missing middle. It does not only offer much needed growth finance for high growth potential businesses but also ensures the acceleration of the growth through the business development support offered. Furthermore this is all housed within the one ED offering. This means that the support the business receives is tailored finance for the business in accordance with the growth strategy and needs of the business. The business does not need to seek finance that is arranged on terms that do not suit the growth needs.

In Case A the firm employs 17 people on a contract basis and due to the nature of the business and its firm structure; it is not certain what the growth of the business will be, especially in terms of employment growth. Ensuring the growth of the business rests solely on the performance of the entrepreneur and the ability to grow a supporting core team for the business. In Case B however growth projections over five years are projected at about 480 people. This is based on the expansion of the facilities and the number of secured staffing positions that the growth will establish.

In both cases, job creation can be linked to the growth of the beneficiary companies. The jobs created are suitable to young unemployed people and they offer on the job-skills training. In Case A the employment opportunity may be a form of job churn around the secondary services market. The owner mentions that some of the

employees have worked on the mines before and they could have worked for any other competitor. There is however the mention that some women in the community have gained access to employment and new skills training for the first time through this company and they were previously unemployed. Whether ED is creating new jobs is a very important question. The quality and the sustainability of those jobs must also be considered. In Case B, there is a fee to be paid to gain access to training at the centres' academy, however trainees receive payment for their practical experience time while they learn which pays back this cost to some extent. Furthermore, employment can be secured upon completion of the training. The structure of the firm thus ensures sustainable employment opportunities through its growth.

What this analysis of the firm structures shows is that ED support needs to filter through the entire business in order to create operationally and financially independent businesses. Best practice within ED is to look at developing suppliers and potential suppliers first. This is also to the benefit of companies in terms of preferential procurement. The opportunity cost however lies in foregoing the chance to innovatively finance and support the growth of other businesses. The private sector has the necessary tools and expertise for this however the way it chooses to implement ED, determines its focus on specific businesses. More importantly, choosing firms in growth markets and firms with competitive advantage and with the appetite for growth are actually fundamental principles guiding the sustainability of businesses. A key question is whether ED is resulting in the creation of new and sustainable jobs. This case studies comparison highlights the importance of surveying the types of businesses that are receiving ED support and looking at what markets they are in. Furthermore SME research in this area needs to show how many early-stage businesses are receiving support versus the more established and mature firms. The challenge of SME development in South Africa is not only choosing the right companies to develop but looking at what the interventions mean for skills development and the overall development in different sectors.

The implementation of BBBEE ED has power dimensions

The political settlement describes the bargaining power that different agents in the process have. In both cases the BEE framework shapes ED and invariably influences industry practices and approaches. In both cases ED companies are geared for serving a corporate sector in the area of complying with BEE ED codes. Their bargaining power lies in the offering to their clients and whether they can successfully execute their commitments and maintain the relationships they hold with clients and beneficiaries.

In Case A the beneficiary's bargaining power is limited by their contractual agreement to participate on the incubation programme and to meet the goals that they themselves set for their business. The client does not influence the offering of the ED company because the programme offering is structured by the ED company. It is however tailored to the needs of the beneficiary by way of the consultants that are available to the beneficiary to address specific challenges. The client in Case A did have a significant role to play in helping train the beneficiary in terms of the actual technical skills needed to be able to deliver the services of the new businesses. The client identified the beneficiary as a potential supplier to its business. Had the client not helped the

beneficiary themselves it is uncertain whether the beneficiary would have acquired the necessary practical skills and training required in the business. The story of the business is that the owner has learnt the trade herself and is involved in training her workers. The ED company still had a selection process in place that the beneficiary needed to go through in order to be accepted on the programme. The ED company thus structures a mandate around what type of entrepreneurs and business it will take on its programmes. Its bargaining power is thus the criteria it establishes for whether or not to invite a potential beneficiary onto its programme. This criteria does not include a business plan or financial success of a company. The one important BEE criteria however is that the company selected as beneficiary be 51% black owned. In this way the ED company ensures compliance with the ED codes. The advantage of this approach is that the selection of beneficiaries is already in line with BEE requirements. The disadvantage is that the intervention is structured programme that does not include tailored component such as specific practical skills training that the businesses needed.

In Case B the fund vehicle itself is a BEE entity. The money paid to the fund is recognised and earns BEE points for the investor. The onward investment to the beneficiary companies of the fund are not necessarily to black owned companies to start with- as is the case with the particular business discussed. By the fund taking equity in the business it becomes part black owned, post-investment, and in so doing meets compliance requirements. The advantage of the approach is that it prioritises a high growth potential business through the investment mandate.

In both cases ED companies can play a vital role in finding and selecting the business to become ED beneficiaries. They are also the designers of the ED interventions and approaches, ultimately steering the ED process. Corporates that do ED themselves may consult with these ED companies with respect to their approaches too. Where ED has been successful, these stories are shared as best practice examples that inform industry practices.

What this analysis of the political settlement shows is that the need to comply with BEE ED requirements drives the design of ED approaches and the selection of beneficiaries. The entities that implement the BEE ED play a significant role in shaping the quality and the approach of ED offerings. ED is generally not the core business of most corporates and meeting the ED requirements can be seen as a BEE tax or investment depending on the approach.

BBBEE ED and preferential procurement multiplier

The BEE codes have a built-in multiplier affect that results from clients procuring products or services from the companies that they develop through enterprise development. If a company procures from the business they have committed to in terms of ED, the spend is multiplied at a factor of 1.2. Companies can also have procurement spend recognised at a multiplied factor of 1.25 if their supplier is what is termed a value added supplier. A company is a VAS if its total labour and net profits before tax is more than annual its annual turnover. The example of how this recognition works in terms of procurement spend is illustrated below.

Company B (the supplier)	
Annual turnover	R10 000 000
25% of Turnover	R2 500 000
Payroll spend	R1 000 000
Net Profit Before Tax	R2 000 000
Sum of payroll spend and Net Profit Before Tax	R3 00 000
Since the sum of payroll spend and the net profit before tax is more than 25% of annual turnover company B is a value adding supplier.	
Benefit to company A (the measured entity)	
Total procurement from company B	R50 000
Company B's BEE recognition level (for example)	100%
Recognised BEE spend with company B	$R50\,000 \times 1.25 = R62\,500$

If R100 with a level four contributor (giving them a 100% procurement recognition level) who was value adding and received Enterprise Development contributions from your company, the recognition your company gets for the R100 spent is:

$$R100 \times 100\% \times 1.25 \times 1.20 = R150$$

No data was collected to show or suggest that the company in Case A that invested in ED for a future supplier could see to benefit from procurement in this way, but the ED intervention could facilitate such a combination of multipliers in spend recognition.

What this analysis shows is that there is a built in multiplier that incentivises the selection of certain suppliers for enterprise development. A broader survey on what impact this has on ED selection would be very useful in understanding the impact of ED on SME development.

Social impact measures

In Case A there is a focus on the success of the entrepreneur in building a sustainable business. The selection process and interventions are focused primarily on the person that builds the business. There is no public data to suggest that there is a mechanism for measuring or quantifying the potential social impact of the ED intervention although this can be built into the reporting mechanism mentioned. In Case B however there is a requirement for a specific social return on investment that is quantified and specified in the investment mandate and formulated and calculated by the ED company. The measurements of social impact and monitoring and evaluation systems used in ED are another theme worth exploring in more depth.

Geographies of the ED interventions

In Case A the beneficiary business owner needed to attend sessions at the incubation programme and had to travel to the physical incubator to participate. Maintaining this attendance can be challenging for participants. There are a number of incubators set up across the country and the programmes are said to be catered for urban and rural settings. The ED offering to clients is also to help them established branded incubators in new locations for ED. In Case B the ED specialists would assist their beneficiary on site. It's offering to clients is country wide as well. In both cases the beneficiary continues to operate their business while the ED is being done. (In Case A however the initial programme that was attended was in order to set up the business first.) Where ED interventions are being implemented and what types of business are benefitting is a question for a larger research scope. It would be useful in indicating the concentrations of ED offerings. It would also be worth learning whether or not certain sectors are practising a particular type of ED. Are mining companies for example mainly focussed on developing sub-contracting suppliers? And are financial corporates setting up funds or business hub centres catered for ED? It is worth seeing how the government and private sector offerings differ. It is worth finding out how the private sector can seek to compliment government efforts; and how government can assist private sector ED.

CHAPTER 5: THE IMPACT OF BBBEE ED ON DEVELOPMENT IN SOUTH AFRICA

The positive impact the South African BBBEE ED industry has on SME development is firstly that the framework has made available substantial funding and support for SMEs. In theory if there was full compliance with BEE in terms of ED, billions of rands would be available to SMEs for development. The incentive for companies to engage in ED is primarily to earn BEE points. (This is not necessarily a bad incentive as long as companies stand to benefit from improving their BEE ratings.) The other incentive they have is the possible returns on investment for ED money spent. The main issue is not compliance with the codes but more importantly the ways in which companies comply and spend ED money (and consequently design and implement ED interventions).

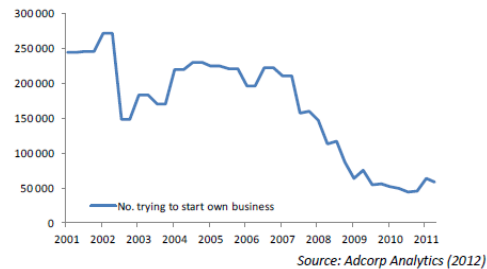
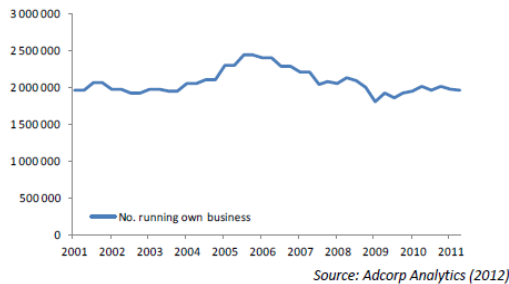
The fact that the development of SMEs is part of larger economic and transformation policy has allowed for there to be measures to ensure transparency and accountability around SME development through BEE. This is in terms of the reporting that companies do about their BEE compliance (and ED activities in particular); and the verification thereof by third party agencies (BEE verification agencies). The other positive aspect is that it has offered the private sector a channel through which to actively participate in development of the country. It is a uniquely South African phenomenon and something that may prove useful internationally if the buy-in and success of ED really takes off.

ED should be making more and cheaper funding available and offering specialised skills and expertise for the support of businesses. It has established an industry with the incentive to see results in helping businesses. What those results are (in terms of business growth and job creation) is not the main driver of the process. The drawback is that there may be practices in the industry that are not all helpful and may lead to the support of businesses that never had the potential to be financially and operationally independent in the first place. The system is skewed by the scorecard and there is pressure to find beneficiary business and deploy money or do things that would count as ED. Furthermore there is no comprehensive understanding as to the impact it is really having on SMEs in general. Broader research about ED practices relating to SME development needs to be conducted.

Whether the right (or highest potential) entrepreneurs and businesses are receiving ED inputs is another matter. Successful ED is about the creation of sustainable enterprises and ones that could have a significant social impact too. This is why a comparison of different ED approaches is useful and worthwhile studying. This research has focussed on key aspects of the ED process that ensures sustainable business development. These include the terms of the financing agreements with beneficiaries; the strategic intent of the interventions (whether the beneficiary really could become a better supplier or better independent business); the social impact potential of ED and the quality of the jobs created. 'There are a number of models on which ED as a practice might be based, each of which emphasises a different set of outcomes.' (Beney, 2011, p. 67) Challenges to ED include scaling ED, coordinating efforts, partnering and collaborating and learning from experience.'

CONCLUSION

It is estimated that around 100,000 small business closures are happening every year and 440,000 small businesses closures took place between 2006 and 2010. The other problem is that there has been a considerable decline in the establishment of new businesses. (Adcorp, 2012)



This research explored two distinct BBBEE ED approaches aimed at assisting new and growing SMEs respectively. The purpose of this comparison was to find out how BBBEE ED impacts on development in South Africa. The focus was on the contribution of SMEs to development in the country. What the research showed was that programme design and implementation of Enterprise Development is driven by compliance with BBBEE ED requirements.

An SME approach to development is not a panacea to the challenges that face South Africa, especially the job creation crisis. This is because the sustainability of enterprises and the jobs in the SME cannot be guaranteed. In fact, looking to SMEs to solve the unemployment problem may temporarily create more jobs but these could be jobs in businesses that are here today and gone tomorrow. The focus needs to be on creating a globally competitive economy in which sustainable and competitive businesses can thrive.

What the comparison of the two ED approaches showed is that ED aims at a range of different target beneficiaries, from start-up businesses to high growth potential businesses. The way ED programmes can be designed and implemented also ranges from non-financial businesses services support to preferential loans and financing. Companies can choose to develop SMEs in their supply chain or other SMEs. They are left to decide for themselves how best to assist SMEs. The assistance of SMEs is not core to the business of most companies and requires specialised skill in selecting and assisting the right companies in becoming sustainable businesses.

Some recommendations for further research include tracking the success of SMEs on incubation programmes in a longitudinal study on whether ED is producing sustainable start-ups. Finding out how many ED offerings are for start-up businesses versus businesses with the potential to grow is needed. Furthermore, establishing how many companies are developing their suppliers or choosing SMEs outside of their supply chains is important. This can be done with the aim of looking at the role of the preferential procurement multiplier in the selection of specific businesses. Lastly, a survey study of the types of businesses that receive ED and their experience of different interventions on a broad scale will reveal trends in industry practices.

Enterprise development cannot be left to companies alone. It is because they follow their own logic in doing enterprise development. The state should intervene in framing/orienting ED. The compulsions and the incentives could be established around sectors that are globally competitive firstly (and export based) and secondly on businesses that create more jobs. The agenda of companies is to meet compliance requirements and to make profits. Their imperative is to find ways to earn BEE points efficiently and effectively. As a result, an industry of experts and consultants has sprung up to serve the needs and/or to take advantage of the money to be made in offering their services. On a broad scale this is not developmental enough. The government needs to be preoccupied with the development of SMEs and strategically looking to leveraging the potential of growing sustainable businesses.

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Annex

Steps in calculating ED scores

(Jack V. , 2007, p. 450)

Determining the numerator:

Step 1: Categorise all qualifying enterprise development contributions since the commencement date or inception date, according to the benefit-matrix calculations, and multiply each category's contribution amount by the benefit-matrix factor.

Step 2: Sum the result of all the categories above and divide the result by the number of months since the commencement date of the Codes or the inception date.

Step 3: Multiply the result of step 2 by 12 to get the annualised average. The result of step 3 is the numerator.

Determining the denominator:

Step 4: Assuming there is a net profit for the year, or average net profit over the proceeding five years, and the net margin exceeds a quarter of the industry average net margin, sum the NPAT since the commencement date of the Codes or the inception date. Multiply the result by 3% to establish the target.

Step 5: Where there are net losses, average net losses or the entity's net margin is less than a quarter of the industry's average net margin: calculate 3% of the NPAT at the last instance where the entity's profit margin was greater than one quarter of the industry's average, divide by the turnover at that date, and multiply by the turnover for the period under review.

Step 6: Take the result of step 4 or 5, as appropriate, as the denominator

Determining the points:

Step 7: Divide the numerator (step 3) by the denominator (step 6)

Step 8: Multiply the result by the 15 weighting points

Step 9: The result is the measured entity's ED points, limited to a maximum of 15 points and rounded off two decimal places.

Copy of ethics clearance certificate



HUMAN RESEARCH ETHICS COMMITTEE (NON MEDICAL)
H110815 Ryan

CLEARANCE CERTIFICATE

PROTOCOL NUMBER H110815

PROJECT TITLE

A Comparison of Enterprise Development Models
in South Africa using Case Studies

INVESTIGATOR(S)

Ms G Ryan

SCHOOL/DEPARTMENT

Development Studies

DATE CONSIDERED

12 August 2011

DECISION OF THE COMMITTEE

Approved

EXPIRY DATE

12 August 2013

DATE 14 September 2011

CHAIRPERSON


(Professor R Thornton)

CC:

DECLARATION OF INVESTIGATOR(S)

To be completed in duplicate and **ONE COPY** returned to the Secretary at Room 10006, 10th Floor, Senate House, University.

I/We fully understand the conditions under which I am/we are authorized to carry out the abovementioned research and I/we guarantee to ensure compliance with these conditions. Should any departure to be contemplated from the research procedure as approved I/we undertake to resubmit the protocol to the Committee. **I agree to completion of a yearly progress report.**


Signature

19 / 09 / 2011
Date

PLEASE QUOTE THE PROTOCOL NUMBER ON ALL ENQUIRIES

Permission from Edge Growth to conduct research



14 September 2011

82 Grayston
Grayston Unve
Sandton
2195

Permission to conduct research on Edge Growth for Masters

Dear Georgina

This is to confirm that I give permission for Georgina Ryan to conduct research on Edge Growth for her master's thesis. Georgina is to reference all her insight as from Edge Growth and not to use this information for any other purposes other than her Master's thesis and that Edge Growth gains access to the findings

Kind regards

Mick Gill

Operations Manager

A handwritten signature in blue ink, appearing to read "Mick Gill", written over the typed name and title.

14 September 2011_Permission to conduct research

Permission from Raizcorp to conduct research

Raizcorp Kramerville
16 Desmond Street
Sandgate Office Park
Building 4, 1st Floor
Kramerville

13 March 2012

Georgina Ryan
PO Box 55518
Northlands
2116

Dear Georgina Ryan

Permission to conduct research on Raizcorp

This is to confirm that I give permission for Georgina Ryan to conduct research on Raizcorp for her masters research report on enterprise development. Georgina is to reference all her insights and not to use the information for any other purposes other than the master's research report.

Yours sincerely,

A handwritten signature in blue ink, appearing to be 'AS' or similar, written in a cursive style.

PARTICIPANT INFORMATION SHEET

STUDY TITLE: A Comparison of Enterprise Development Models in South Africa using Case Studies

My name is Georgina Ryan and I am studying masters in Development Studies at the University of the Witwatersrand.

DESCRIPTION: You are invited to participate in a research study on the different enterprise development models that are used in South Africa. The purpose of this research is to find out in which ways enterprise development can lead to sustainable business and job creation. If you choose to participate in this study, you will be asked to be interviewed by means of an audio recorded interview, concerning your involvement in enterprise development.

TIME INVOLVEMENT: Your participation will take approximately 45 minutes. Please note that there may be a request for a follow up interview if necessary. You will be asked to participate in the research study between September 2011 and February 2012.

RISKS AND BENEFITS: There are no risks associated with this study. The benefits which may reasonably be expected to result from this study include research results on effective practices in the enterprise development industry. I cannot and do not guarantee or promise that you will receive any benefits from this study.

SUBJECT'S RIGHTS: If you have read this form and have decided to participate in this project, please understand your **participation is voluntary** and you have the **right to withdraw your consent or discontinue participation at any time without penalty or loss of benefits to which you are otherwise entitled**. The **alternative is not to participate**. You have the right to refuse to answer particular questions.

CONTACT INFORMATION: If you have any questions about this research, its procedures, risks and benefits, please contact me, Georgina Ryan on +27 82 448 3363. My supervisor, Nicolas Pons-Vignon, can be reached by email at Nicolas.pons-vignon@wits.ac.za and nicopv@gmail.com.

The extra copy of this consent form is for you to keep.

If you agree to participate in this research, please complete the research consent form.

Thank you for your time.

INFORMED CONSENT FORM

STUDY TITLE: A Comparison of Enterprise Development Models in South Africa using Case Studies

DESCRIPTION: You are invited to participate in a research study on the different enterprise development models that are used in South Africa. The purpose of this research is to find out in which ways enterprise development can lead to job creation. If you choose to participate in this study, you will be asked to be interviewed by means of an audio recorded interview, concerning your involvement in enterprise development.

TIME INVOLVEMENT: Your participation will take approximately 45 minutes. Please note that there may be a request for a follow up interview if necessary. You will be asked to participate in the research study between September 2011 and February 2012.

RISKS AND BENEFITS: There are no risks associated with this study. The benefits which may reasonably be expected to result from this study include research results on effective practices in the enterprise development industry. I cannot and do not guarantee or promise that you will receive any benefits from this study.

PAYMENTS: This invitation to participate in this research study does not involve any form of remuneration.

SUBJECT'S RIGHTS: If you have read this form and have decided to participate in this project, please understand your **participation is voluntary** and you have the **right to withdraw your consent or discontinue participation at any time without penalty or loss of benefits to which you are otherwise entitled. The alternative is not to participate.** You have the right to refuse to answer particular questions. Your individual privacy will be maintained in all published and written data resulting from the study.

CONTACT INFORMATION:

Questions: If you have any questions about this research, its procedures, risks and benefits, please contact me, Georgina Ryan, on +27 82 448 3363.

If you are happy to proceed, please complete the following details below.

I give consent to be audio-taped during this study.

Please initial: ☐ Yes ☐ No

I give consent for tapes resulting from this study to be used for the purpose of compiling a research report

Please initial: ☐ Yes ☐ No

I give consent for my identity to be revealed in written materials resulting from this study:

Please initial: ☐ Yes ☐ No

The extra copy of this consent form is for you to keep.

SIGNATURE _____ **DATE** _____

List of interviews conducted

Date	Institution	Position	Name	Consent to be interviewed	Audio recorded interview	Consent to have identity disclosed
04/10/2011	Kio Advisory	Owner	Duma Gqubule	Yes	No	Yes
21/10/2011	Identity Partners	CEO	Polo Radebe	Yes	No	Yes
24/11/2011	Raizcorp			Yes	Yes	No
24/11/2011	Edge Growth	Director	Calvin Fambisayi	Yes	Yes	Yes
01/12/2011	Edge Growth	Investment Officer	Greg MacDonald	Yes	Yes	Yes
01/12/2011	Edge Growth	Director	Stuart Townsend	Yes	Yes	Yes
26/10/2011	Edge Growth					
31/01/2012	Raizcorp Arize	Raizcorp Arize Sales Consultant	Alan Gibson	Yes	Yes	Yes
02/03/2012	Dusty Gold (Raizcorp-Partner Elite)	Owner	Thandi Kunene	Yes	Yes	Yes
05/03/2011	Opti-Baby	Owner	Ina van der Merwe	Yes	Yes	Yes
05/03/2011	Basadi Development Contractors	Owner	Zanele Matome	Yes	Yes	Yes