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Black industrialists – it's not just about funding

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Introduction

Too little of the discourse on an economic growth strategy for South Africa has focused on addressing barriers to entry and putting in place mechanisms for ensuring effective participation of black-owned firms and small and medium enterprises in established value chains. The focus from the President's office has mainly been on raising investment commitments from large enterprises as was demonstrated by last year's investment summit outcomes.

The risk of this approach is that the country embarks on an economic growth path which (once again) is not truly inclusive and is pinned on the investments and activities of only existing, well-established firms with substantial market power in highly concentrated industries. It should by now be clear that the lack of rivalry and investment in the economy has much to do with a failure to open the economy effectively for greater participation and competition. Many large incumbent companies, especially those with significant, entrenched market power, are not inclined to innovate and make large-scale investments – their position is so well protected that they simply do not need to.

The case for investing in smaller businesses

As part of research by the Industrial Development Think Tank, based at the University of Johannesburg, we are reviewing the Black Industrialists Scheme (BIS) of the Department of Trade and Industry (DTI) amongst other government and private sector-led initiatives to support small and medium enterprises. The research, which will be made public in the coming months, shows that potential for investments and growth in the economy is not only vested in the large, well-established firms.

The close to 150 firms that have benefited from the BIS since 2016 illustrate that medium-sized manufacturing firms can bring much-needed dynamism and investment to the economy. Many of the firms supported by the BIS have made substantial investments of their own and operate in sectors where they are well positioned to innovate, compete with incumbents, and create jobs. Given the scheme's focus on those in manufacturing, many of the major investments made by

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these beneficiaries include importing new plant technologies and parts, and product and service innovation.

Smaller firms as "challengers" and innovators

BIS funding has primarily been allocated to firms operating in sectors linked to the DTI's Industrial Policy Action Plan. Based on publicly available information, the majority of grants were to businesses in chemicals, plastics, pharmaceuticals, agro-processing, manufacturing-related logistics, and clean technology and energy. Several of these are sectors with potential for growth, employment and increased local value-add, as well as to adopt and integrate new technologies and skills.

There is a more fundamental reason for continuing with initiatives that encourage new rivals to grow into effective competitors. As these new and smaller firms challenge incumbent firms and bring new products and production technologies into the market, there is a competitive reaction from the existing firms to adapt and innovate to retain their share of the market. This results in a cycle of improved productivity and value addition over time, and with substantial benefits for customers (including downstream industries) in terms of competitive pricing, product quality and choice.

Barriers to market access

One of the key challenges for newcomers is to access routes to market, such as through the major grocery retail chains. Fees, terms of access and standards remain exclusionary, and there has been very limited policy focus on how retailers can support what should be a key objective of bringing emerging companies into supermarkets and onto store shelves.

New technologies, social media marketing channels, and the significant growth of online retail offer alternative routes to market for smaller firms and, therefore, reduce barriers to market entry. Despite significant growth in recent years, these channels, however, are still very small compared to the volume of trade which takes place through the main retailers in South Africa, partly due to associated entry costs and small domestic market size.

A related challenge faced by BIS beneficiary firms in terms of accessing main markets involves public procurement channels. This is an important area which the scheme, and other programmes like it, need to address over time through proactive arrangements with major retailers and effective procurement coordination across government departments if the benefits of investments in and by the beneficiaries are to be fully realised.

There are a range of other positives worth noting and replicating across government and private sector initiatives to support new entrants and smaller businesses. A focus on existing firms with significant potential for growth and upscaling means that the scheme can attract companies that have already developed competitiveness and capabilities to some extent, which are usually substantial shortcomings when focusing only on start-ups, for example. Start-ups are in any event expected to be supported by other government programmes such as the Small Enterprise Development Agency, with the BIS being complementary to these core initiatives.

Financing challenges worsened by poor coordination

On the other hand, as the BIS is applying a claims-based grant system where industrialists first have to invest alternative funding before claiming from the DTI pool, it means the companies make a credible commitment to investing in their own productive capacity. In making these investments, beneficiaries however have to confront the pervasive challenge of not being able to access bank or development finance on favourable terms. Addressing the latter requires effective coordination of alternative funders and that these take greater risks with longer-term commitments to the companies to account for the time it takes to learn and grow a strong business.

There are also specific challenges with the BIS itself (and which can too be said of other financial and non-financial support initiatives that we have looked at) that need to be ironed out. These include the constraint that emerging firms face to access further capital, and in particular working capital, to sustain their businesses in the critical growth phases. Across different initiatives, the time taken from application, approval to disbursement of funds is too long. This places companies at risk of missing out on opportunities with potential customers and suppliers.

This situation illustrates the (low) degree of effective coordination between government funding agencies and co-funders generally. Many of the firms that we have interviewed have expressed their desperation of being stuck within (differing) government department processes and struggling to manage their businesses given the uncoordinated timing of funding disbursements by funders and co-funders.

Importance of getting the basics right

In keeping with global trends of adopting new technologies, it is in the interest of the wider economy to prioritise reducing the barriers to market entry and promote greater inclusion in the economy for two main reasons. First, new firms can bring new ways of thinking and technologies which challenge the ways in which production and product innovation have traditionally been thought of locally. Second, without a concerted effort by government and incumbent businesses to increase participation by a larger, more diverse pool of businesses that can compete effectively, the status quo of high concentration and pervasive abuses of market power will remain. More so, the benefits to consumers and downstream industries of increased productivity and competition will be missed.

A positive policy and national response to address these challenges entails getting the fundamentals right in terms of skills upgrading, dealing with high data costs, electricity challenges and barriers to entry. Such a policy platform, if it goes beyond soliciting investment commitments from existing large firms that can entrench their market power, may encourage the development of new pockets of innovation and firms which bring greater competitive dynamism into the economy over time.

Addressing these basics and persistently high barriers to entry can have a critical positive impact on the feasibility, growth and employment potential of new "challenger" firms and will, in turn, benefit consumers, investment and overall productivity.

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