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Scaling up South Africa's Black Industrialist Scheme (BIS): Opportunities and Challenges

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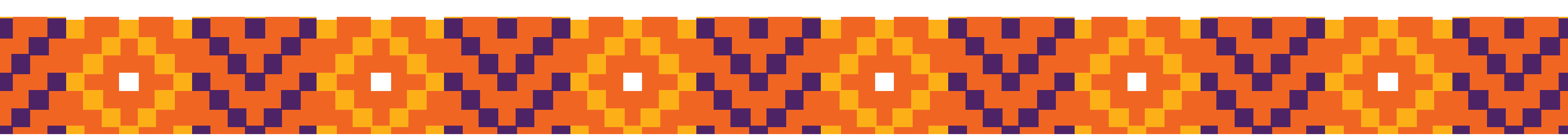
Abstract

This paper explores ways to upscale South Africa's Black Industrialists Scheme (BIS) – a government initiative that was established in 2016 with the purpose of developing a pool of black-owned local firms that operate in the productive sector of the economy. Performance of the BIS since has revealed significant potential for beneficiary firms to catalyse productive investments and contribute to local industrial capacity development and employment creation. Notwithstanding, there are multiple challenges that limit the full potential of the scheme, including macroeconomic constraints and institutional arrangements within which the scheme is located. These challenges impact directly on the ability of black industrialists to enter and grow within value chains. In that context, this paper explores ways for upscaling the BIS, through a two-dimensional approach to upscaling: 1) programme-level upscaling; and 2) firm-level upscaling.



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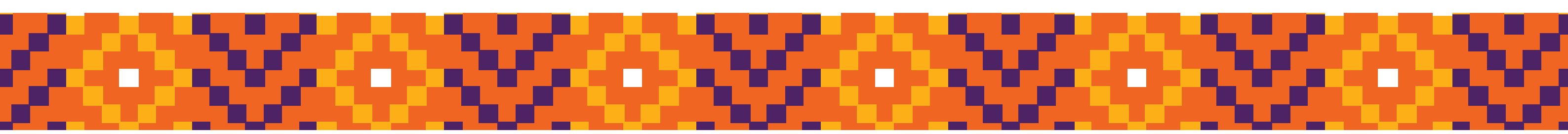


1. Introduction

The South African Government's Black Industrialist Scheme (BIS) is a strategic industrial policy incentive with significant potential for contribution to meaningful and sustainable economic growth. The BIS is a financial support incentive aimed at supporting enterprises owned and/or controlled by historically disadvantaged persons (HDPs) to make fixed investments into the productive sectors of the economy. The previous work (see Bosiu et al, 2020, 2019) evaluating the BIS highlighted significant potential for the incentive to make impactful contributions to the wider economy. However, challenges were also identified that can constrain the programme from reaching its full potential, including complex and cumbersome application processes; limited working capital funding facilities; uncoordinated activities of co-funders; etc. In that context, together with national budget constraints, this paper analyses ways to upscale the incentive towards 'increasing the quantitative and qualitative participation of SMEs controlled and/or owned by historically disadvantaged individuals (HDIs)' as the policy states, to maximise the impact on inclusion and economic growth.

South Africa is a developing and middle-income country with additional legacy challenges of the apartheid economic systems that were underpinned by racial segregation, heavy reliance on resource extraction and high levels of concentration, whose effects continue to characterise the present economic structure (Andreoni and Tregenna, 2018; Bell et al., 2018; CompComSA, 2021). In this context, meaningful and sustainable economic growth refers to growth that is inclusive and anchored on strong local industrial capacity and structural transformation. This requires sustained fixed investments that are not only targeted at productive and high value sectors but are also inclusive in terms of participation of SMEs and historically disadvantaged persons (HDPs). High levels of fixed investment which build industrial capabilities in sectors that provide increasing returns lead to rising productivity, enhancing export competitiveness, and alleviating the balance-of-payments constraint to growth (Thirlwall, 2002).

In that regard, the BIS is an important strategic intervention in the sense that, by design, it provides funding (in the form of grants and debt) to qualifying firms (henceforth referred to as black industrialists) to make such investments in line with manufacturing sectors identified in the Industrial Policy Action Plans (IPAPs). This impacts directly on local industrial capacity development, structural transformation, and inclusion imperatives. The outcomes in terms of contribution to investment and employment particularly have been quite substantial, as we discuss in section 4 below. This is quite important in the context of an economy characterised by high unemployment rate overall and stagnant productive investments, and highlights the significant potential of the programme to contribute even more positively if sufficiently supported. Therefore, it is important to significantly support and upscale the programme in order to realise the maximum potential impact. Unfortunately, the programme has not been adequately supported due to fiscal constraints and the limiting manner in which the national development finance institutions (DFIs) provide industrial financing. Thus, the paper explores ways to upscale the BIS within the context of the prevailing macroeconomic constraints. The paper considers upscaling through two dimensions: 1) programme-level upscaling; and 2) firm-level upscaling. The former entails unpacking challenges and opportunities related to mobilising the correct form and quantum of funding necessary to support an even larger cohort of black industrialists. The latter focuses more on existing black industrialists and the form and

quantum of funding necessary to support them to upgrade and expand operations. The analysis is largely anchored on a case study approach underpinned by in-depth and extensive interviews with key stakeholders, to bring a nuanced perspective on industrial financing and inclusion.

The paper is structured as follows: section 2 provides an overview of the framework that anchors our analysis; section 3 discusses the specifics of the approach and the kind of data used; section 4 provides a contextual background to the BIS; sections 5 and 6 analyse the challenges and opportunities for programme-level and firm-level upscaling drawn from firm-level interviews and engagements with key stakeholders; and section 7 concludes.

2. Analytical Framework

The analysis is conducted through a framework that interlocks three key bodies of work: structural transformation; barriers to entry; and black economic empowerment (BEE). Industrial development and structural transformation – which together imply industry-led productive transformation of an economy to higher value-adding activities – have been recognized as critical drivers of inclusive economic growth (UNIDO, 2020). Structural transformation refers to changes in the structure of the economy from sectors of low to high productivity and complexity towards higher value-added activities within sectors with the scope for sustained high growth in productivity (Andreoni et al., 2021a).

Since the beginning of the democratic era in 1994, South Africa has struggled to sustain an adequate process of structural transformation, with overall growth and upgrading in industries being constrained by low levels of investments. Moreover, despite some areas of partial success, there has been premature deindustrialization and lack of sufficient development of local production capacity (Andreoni et al., 2021a). Despite the manufacturing sector having features that accord it a special role as an engine of growth, it has continued to perform poorly for South Africa, particularly downstream manufacturing. In contrast, there has been stronger performance of upstream resource-based sub-sectors led by coke and refined petroleum products over the 1994 – 2019 period (Andreoni et al., 2021a).

These outcomes have been exacerbated by a political settlement that sustains the high levels of concentration and patterns of ownership of economic resources across several of South Africa's industrial sectors, and the emerging phenomenon of financialisation (Bosiu and Vilakazi, 2021; Andreoni et al., 2021b; Mondliwa and Roberts; Bosiu et al., 2017). Andreoni et al. (2021c) argue that structural transformation depends on a country's political settlement, specifically on coalitions of interests that support the organization of industries for long-term investment. The reality in South Africa has been stagnant levels of productive investment measured in terms of gross fixed capital formation, in contrast to substantial rents generated by the country's large and leading firms as exemplified by massive growth in valuations of the JSE-listed companies. Elsewhere across developing countries, internally generated revenues and reinvested profits have been the primary source of funding for firm-level investment (UNCTAD, 2016), and thus important for industrial growth. However, in the case of South Africa, the recent experience has been of low investment levels despite high retained earnings (Bosiu et al., 2017).

At the level of specific sectors and industries, the South African economy remains characterised by high barriers to entry that prevent effective participation of SMEs and

historically disadvantaged individuals (Vilakazi and Bosiu, 2021). There are two types of barriers to entry identified in the literature: structural and strategic. Structural barriers arise primarily from market characteristics, the nature of specific industries, presenting economic hurdles that any new entrants need to overcome such as high levels of capital investment requirements or regulatory features. Structural barriers include, but are not limited to, natural barriers (e.g., physical location), sunk costs, switching costs, economies of scale as well as network effects (Bain, 1956; Von Weizsacker, 1980; Lutz et al., 2010). On the other hand, strategic barriers refer to anticompetitive practices and/or the behaviours of incumbent firms that deter further entry or expansion by actual or potential rivals (Geroski et al., 1990; Banda et al., 2015). This behaviour can include, but is not limited to, foreclosure of rivals, predatory pricing conduct and/or practices that directly or indirectly raise rivals' costs through making key inputs more expensive or unfairly restricting access. Importantly, strategic barriers can reinforce and exacerbate the challenges rivals face in overcoming structural barriers (such as practices that deny entrants the scale to earn sufficient revenues to stay in the market or reinvest), and vice versa.

The previous work on BIS has identified the need for substantial investments (and high sunk costs), accompanied by lack of access to funding from the country's financial institutions (including development finance institutions), as a key barrier to entry for black industrialist SMEs in South Africa (Bosiu et al., 2020). The second key barrier identified is challenges with access to markets. The two work together in a reinforcing manner that stifles new entry and expansion/upgrading along value chains. In most instances, markets are typically concentrated, meaning entrants need to enter at substantial scale, in turn implying significant financial requirements. However, to provide the matching capital, financial institutions require applicants to show that they have already secured markets by providing offtake agreements as a form of security. However, it can be challenging to secure contracts with key customers. For instance, in the Fast-Moving Consumer Goods (FMCG) value chains, supermarkets are a key route to market for suppliers of food and household consumables. However, concerns have been raised that large supermarkets place stringent demands that small and medium-sized local suppliers often find difficult to fulfil given lack of capabilities and financial resources (das Nair and Chisoro-Dube, 2017). Furthermore, the use of exclusive agreements between large retailers, processing firms and property firms, make retail spaces and channels inaccessible to as-efficient challenger firms (Banda et al., 2015; Bosiu et al., 2017).

South Africa also faces the challenge of creating an inclusive economy with full participation of HDIs and SMEs. This has resulted in various policy initiatives to increase participation of HDIs across the mainstream economy, collectively termed black economic empowerment both as a specific policy programme (Broad-Based Black Economic Empowerment, B-BBEE) and a wider set of public programmes to drive inclusion. BEE initiatives were initially aimed at the labour force through skills development, and acquisition of ownership stakes by HDIs in existing established corporates previously owned by non-HDIs. In the process, this has led to unintended consequences of enriching a few and politically connected individuals without achieving broad-based empowerment outcomes (Vilakazi and Bosiu, 2021; Vilakazi, 2021). Subsequently, modifications have been made to BEE and B-BBEE to enhance its effectiveness, including a revision to the legislation which came into effect in 2014. Outcomes have remained poor against the broader objectives of the policy, despite some significant gains (Vilakazi, 2021), and interventions have evolved to target interventions that

fast-track progress in particular parts of the economy – the establishment of the BIS is such an initiative.

The BIS contributes to the broader empowerment initiatives in a targeted way, by providing funding for HDIs to establish new enterprises (not acquire stakes in existing ones) in selected sectors of the productive economy. That is, it is focused specifically on black owned firms in the manufacturing sector, underpinned by industrial policy tools. This has the envisaged effect of addressing both the empowerment and structural transformation imperatives, reduction of certain barriers such as access to markets and funding, and specifically supporting expansionary investments – in this way, the programme bridges an important gap between industrial policies for achieving structural transformation, competition policy and reduction of barriers to entry, and black economic empowerment. It is this interface with central threads of the South African economic policy focus that motivates a critical analysis of how such a programme could be designed and scaled up to have a wider and meaningful impact in the economy.

3. Data and Methodology

The study has employed a case study approach anchored on in-depth and semi-structured interviews with key stakeholders, primarily the beneficiaries of the incentive (i.e., black industrialists), as well as the co-funders. The black industrialists interviewed included a mix of medium-sized enterprises from different productive sectors. In addition, the study has also drawn insights from a survey of black industrialists conducted by CCRED in 2019, which included 39 respondents. In total, insights were drawn from about 49 black industrialists across different sectors, including two funders and two industry associations. Table 1 provides a brief profile of all the stakeholders that formed part of the study.

The list comprises black industrialists that are at different stages of the BIS programme, that is, application stage, approval stage, disbursement stage and post investment stage. Further, the enterprises are at different operational maturities. Some are at the construction phase and have not yet commenced operations, while others are existing businesses that were either expanding or upgrading to new technologies. The list also includes firms that were declined funding. This mixed set of participants has been useful to provide a range of perspectives that inform our understanding of the potential and challenges of the programme.

Interviews with beneficiaries largely focused on challenges and opportunities for firm-level upscaling, and covered the following key thematic areas: constraints/opportunities for growth /expansion; constraints/opportunities with regards to market access (including export markets and the role of the African Continental Free Trade Area (AfCFTA)); constraints/opportunities with respect to public procurement, localisation and B-BBEE policies; constraints/opportunities with enterprise supplier development (ESD) programmes; and the role of finance.

Regarding funders, researchers engaged with the Department of Trade, Industry and Competition (DTIC) and the Industrial Development Corporation (IDC). Engagements largely focused on programme-level upscaling and covered the following key areas: strategies to incorporate more firms under the BIS, and maximise impact; constraints experienced in funding new black industrialists and lessons learnt; the successes and limitations of the co-funding model in de-risking projects and attracting more private funding; and ways to

mobilise more private funding including consideration of alternative models such as venture capital (VC) and angel funding.

Table 1: Profile of stakeholders that participated in the study

Stakeholder code		Stakeholder type	Engagement type	Date of interview	BIS Beneficiary?	Value of investment	Purpose of investment
1.	BII01	Firm	Interview	8 February 2023	Yes	R2,000,000,000	New operations
2.	BII02	Firm	Interview	10 February 2023	Yes	R39,177,067	New operations
3.	BII03	Firm	Interview	15 February 2023	Yes	R245,000,000	New operations
4.	BII04	Firm	Interview	16 February 2023	Yes	R20,000,000	Repair damages
5.	BII05	Firm	Interview	17 February 2023	Yes	R147,000,000	New operations
6.	BII06	Firm	Interview	23 February 2023	Yes	R120,000,000	New operations
7.	BII07	Firm	Interview	16 August 2022	Yes	R55,000,000	Expansion
8.	BII08	Firm	Interview	12 August 2022	Yes	R60,000,000	Expansion
9.	BII10	Firm	Interview	24 November 2022	Yes	R55,000,000	Expansion
10.	BFI11	Firm	Interview	18 August 2022	No	R8,000,000	Expansion
11.	BFI12	Firm	Interview	3 August 2022	No	R30,000,000	New operations
12.	BIS01	Firm	Survey	31 May 2019	Yes	R38, 000, 000	New operations
13.	BIS02	Firm	Survey	31 May 2019	Yes	R323,416,000	New operations
14.	BIS03	Firm	Survey	31 May 2019	Yes	R116, 000, 000	New operations
15.	BIS04	Firm	Survey	31 May 2019	Yes	R27, 000, 000	New operations
16.	BIS05	Firm	Survey	31 May 2019	Yes	R137,800,000	Expansion
17.	BIS06	Firm	Survey	31 May 2019	Yes	R95,000,000	New operations
18.	BIS07	Firm	Survey	31 May 2019	Yes	R49,000,000	New operations
19.	BIS08	Firm	Survey	31 May 2019	Yes	R128,800,000	New operations
20.	BIS09	Firm	Survey	31 May 2019	Yes	R88,700,000	New operations
21.	BIS10	Firm	Survey	31 May 2019	Yes	N/A	New operations
22.	BIS11	Firm	Survey	31 May 2019	Yes	R63,874,090	New operations
23.	BIS12	Firm	Survey	31 May 2019	Yes	R103,174,000	New operations
24.	BIS13	Firm	Survey	31 May 2019	Yes	R87,550,856	New operations
25.	BIS14	Firm	Survey	31 May 2019	Yes	R53,215,999.00	New operations
26.	BIS15	Firm	Survey	31 May 2019	Yes	R66,349,275.00	Expansion
27.	BIS16	Firm	Survey	31 May 2019	Yes	R388,995,472	New operations
28.	BIS17	Firm	Survey	31 May 2019	Yes	N/A	New operations
29.	BIS18	Firm	Survey	31 May 2019	Yes	R241,633,520	New operations
30.	BIS19	Firm	Survey	31 May 2019	Yes	R253,885,405	New operations
31.	BIS20	Firm	Survey	31 May 2019	Yes	R39,177,067	New operations

32.	BIS21	Firm	Survey	31 May 2019	Yes	R50,000,000	New operations
33.	BIS22	Firm	Survey	31 May 2019	Yes	R50,000,000	N/A
34.	BIS23	Firm	Survey	31 May 2019	Yes	N/A	New operations
35.	BIS24	Firm	Survey	31 May 2019	Yes	R52,045,820	Expansion
36.	BIS25	Firm	Survey	31 May 2019	Yes	R81,120,000.00	New operation
37.	BIS26	Firm	Survey	31 May 2019	Yes	R30,000,000.00	N/A
38.	BIS27	Firm	Survey	31 May 2019	Yes	R157,812,000	New operations
39.	BIS28	Firm	Survey	31 May 2019	Yes	R69,940,000.00	New operations
40.	BIS29	Firm	Survey	31 May 2019	Yes	R99,783,000	New operations
41.	BIS30	Firm	Survey	31 May 2019	Yes	R64,500,000.00	New operations
42.	BIS31	Firm	Survey	31 May 2019	Yes	R164,268,011	Expansion
43.	BIS32	Firm	Survey	31 May 2019	Yes	N/A	N/A
44.	BIS33	Firm	Survey	31 May 2019	Yes	R48,860,611	New operations
45.	BIS34	Firm	Survey	31 May 2019	Yes	R63,876,500.00	New operations
46.	BIS35	Firm	Survey	31 May 2019	Yes	R52,350,000	New operations
47.	BIS36	Firm	Survey	31 May 2019	Yes	R90,653,900	New operations
48.	BIS37	Firm	Survey	31 May 2019	Yes	N/A	N/A
49.	BIS38	Firm	Survey	31 May 2019	Yes	R97,150,000	Expansion
50.	BIS39	Firm	Survey	31 May 2019	Yes	N/A	N/A
51.	BISCF01	Funder	Interview	27 January 2023	N/A	N/A	N/A
52.	BISCF02	Funder	Interview	12 October 2022	N/A	N/A	N/A
53.	IAI01	Industry association	Interview	30 November 2022	N/A	N/A	N/A
54.	IAI02	Industry association	Interview	7 February 2023	N/A	N/A	N/A

Note: BIS ~ Black Industrialist, BISCF~~ Black Industrialist Co-Funder, IAI~ Industry association

4. Analysis of the Impact of the Black Industrialist Scheme

Cabinet approved the Black Industrialists Policy in 2015 to increase participation of black South Africans in productive enterprises in key sectors and value chains (DTIC, 2021a). Three key institutions have set up funding schemes – Black Industrialist Schemes (BIS) – to support the development of black entrepreneurs. They are the DTIC, the IDC and the National Empowerment Fund (NEF). The DTIC provides grant funding to eligible entrepreneurs while the IDC and the NEF provides loan funding. [1]

The Black Industrialist Scheme (BIS) of the DTIC was launched in 2016 as a funding incentive to expand the industrial base of the country, while simultaneously increasing the quantitative and qualitative participation of SMEs controlled and/or owned by HDIs. An important feature of the scheme is the need for qualifying black industrialists to be

[1] Note that the IDC and NEF host similarly named programme with similar objectives, albeit with different participation parameters. These programmes focus on a wider set of targeted sectors, and a wider cross-section of firms in terms of the size of project or stage of development of the company etc. Although the analysis in this paper focuses on the DTIC BIS, we consider this programme alongside the other programmes partly because government reporting has evolved over time to reflect on the inputs and outcomes of these programmes together rather than as distinct programmes.

operating in identified manufacturing sectors in line with the Industrial Policy Action Plans (IPAPs). In that regard only enterprises operating in the following sectors are eligible, while other manufacturing activities may be considered based on economic impact in terms of job creation, geographic spread and strengthening supply chains (Bosiu et al., 2020).

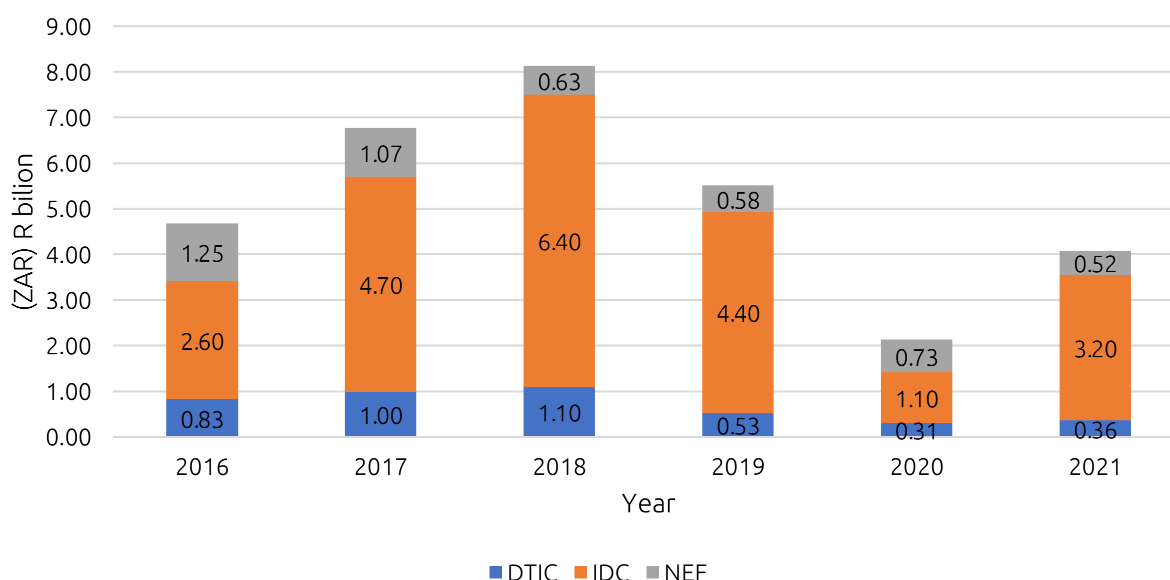
- Blue/Ocean economy, including vessel building and repair
- Oil and Gas
- Clean Technology and Energy
- Mineral Beneficiation
- Aerospace, rail and Automotive Components
- Industrial Infrastructure
- Information Communication Technologies
- Agro-Processing
- Clothing, Textiles/Leather, and Footwear
- Pulp, Paper, and Furniture
- Chemicals, Pharmaceuticals and Plastics
- Nuclear
- Manufacturing related logistics
- Designated Sectors for localization

The BIS of the DTIC is a cost-sharing incentive between the DTIC and other co-funders including DFIs and commercial banks, with the DTIC providing grant funding using a claim-based system (the applicant is required to fund the investment or project and then subsequently submit a claim for reimbursement), whilst the other co-funders provide the debt component. The minimum qualifying investment value is R30 million. The grant component of the DTIC ranges from 30% to 50% of the approved funds to a maximum value of R50 million. The quantum of the grant depends on the applicant firm's scores in terms of its level of black ownership, management control, and the project value, alongside other selection criteria specifically related to the project for which funding is being sought. The maximum grant of R50 million may be utilised for: capital investment costs; feasibility studies towards a bankable business plan (to the maximum of 3% of projected investment project cost); post-investment support (to the maximum of R500 000); and business development services (to the maximum of R2 million).

In regard to the IDC component of the BIS, the firms have to align their applications for funding from the IDC with the request to the DTIC for the BIS Grant. The reason for this is due to that the DTIC grant is approved on the basis that co-funding has been raised or obtained. As a result, the grant allows for the Black Industrialist to claim their approved funds to align with IDC (or other funders).

The DTIC's BIS has had mixed outcomes in terms of its impact on the economy overall, particularly in relation to participation of black-owned SMEs in the mainstream economy, productive investments, and employment outcomes. Figure 2 below provides a breakdown of the investments made by the BIs as measured by funding approved from the three entities: DTIC, IDC and NEF.

Figure 1: Breakdown of BIS Approved Funding by DFI (2016-2021)



Source: DTIC (2022) and NEF Annual Reports

The IDC has been the major funder when considering the quantum of funding (Figure 1). Overall, funding had been increasing since 2016, before declining between 2018 and 2021. It's unclear why funding declined between 2018 and 2019, however the 2020 trough is likely the impact of the COVID-19 national lockdown, although it is interesting to note that NEF funding increased during that year. Overall funding picked up in 2021, largely driven by the IDC, as lockdown regulations got relaxed and the economy began getting back to production. An important point to note is that DTIC funding declined the most between 2018 and 2021, by 73% compared to IDC's 50% and NEF's 17%. The reason is that the DTIC's grant component of the BIS has not been recapitalised since the initial capitalisation.[2] Of the three entities, the DTIC is funded directly from the fiscus whilst the IDC and NEF are self-funding.

Nevertheless, capital expenditure by the BIs accounted for about 24.5% of the total capital expenditure by all the SMEs in the country in 2021.[3] Further, investments by BIs are equivalent to an average of 3% of the total manufacturing sector gross fixed capital formation (GFCF) between 2016 and 2021.[4] What is important is that the investments by black industrialists are not only fixed and long-term, but are in predetermined industrial sectors earmarked for development, meaning they contribute directly to the development of local industrial capacity. These outcomes indicate the need to upscale the programmes to have more black industrialist SMEs investing in the productive sectors of the economy.

Considering the total participation of firms across the DTIC's BIS and the related programmes anchored with the IDC and NEF, a total of 900 beneficiaries have been supported, against an estimated 667 786 formal SMEs in the economy, and 200 627 SMEs in the manufacturing sector[5] in particular (SEDA, 2022). This means only 0.13% of the formal

[2] Interview with BISCF02, 12 September 2022
[3] Calculations based on SEDA (2022) data, as well as data presented in Table 2 below.
[4] Calculations based on DTIC (2021a) and Quantec data
[5] Including those involved in the production of electricity, gas and water.

SMEs in the South African economy are black industrialists supported through these programmes. In particular, the programme beneficiaries account for about 0.45% of the total SMEs in the manufacturing sector. While the representation of black industrialists by number may appear insignificant, their investments are quite substantial.

On employment, the black industrialist programmes across the institutions have made a notable contribution. Table 2 summarises the employment contribution of the BIS and shows that since 2016, more than 130 000 jobs have either been created or retained. According to the IDC (as cited in DTIC, 2021b), every direct manufacturing job sustains four other jobs in the rest of the economy. By design (under the Black Industrialists Policy framework), black industrialists are largely manufacturers, meaning for the 130 000 jobs created/sustained by black industrialists, approximately 520 000 other jobs are sustained in the rest of the economy. Thus, a total of 650 000 jobs are sustained by black industrialists in the South African economy. The total employment as at third quarter of 2022[6], was 19 965 914, this means, other things being equal, that one in every 30 jobs in the economy is sustained by black industrialists.

Table 2: BIS total contribution to employment, as at 2021

	IDC	DTIC	NEF	Total
Value Approved	R24.5 billion	R4 billion	R4.3 billion	R32.8 billion
Projected jobs to be created	22719	11899	28833	63451
Projected jobs to be retained	46063	8535	11711	66609
Total	68792	20464	49544	**130 060**
Cost per job	R356 146	R194 465	R86 791	**R252 191**

Source: DTIC (2021a)

However, it may be argued that the jobs have come at a substantial cost to the economy given that the cost per job is about R252 191, as measured by total approvals over total number of jobs created/sustained. However, the DTIC funding is in grant form whilst funding from the other DFIs is largely in the form of debt. This means (using figures in table 2 above) R4 billion of the total value approved under the Scheme is in the form of grants and therefore not recoverable.[7] However, a significant R28.8 billion is in the form of loans and thus repayable back to the DFIs with interest (except for non-performing investments), meaning it is essentially not a cost to the economy in the medium- to long-term. Thus, other things being equal, the real cost to the economy is only about R30 755 per job created/sustained.

In addition to the demonstrated impact on investment and employment, the programmes have contributed to the development of primary and adaptable capabilities in some firms. For example, during the COVID-19 lockdown a black industrialist that manufactures cooler boxes was able to produce components that were needed to produce CPEP ventilators when global supply was disrupted, even though this product was not its primary line of production.[8] Given that some of the BIS beneficiaries would not have managed to go ahead

[6] Quantec data
[7] Although there is demonstrable value-for-money through investment contributions and other economic benefits.
[8] Insights from the Black Industrialists conference held in October 2022.

with their investments had it not been for the support provided through the BIS, this demonstrates how the support contributes to the development of productive capabilities that can be adapted towards the production of other goods over time (a pro-developmental, dynamic outcomes).

The above discussion demonstrates the significance of the BIS in the context of wider economy in terms of contribution to racial and structural transformation, local industrial capacity development, and employment. There are significant measurement and data gaps in the reporting of the government department departments and agencies involved with various iterations of the black industrialists programme, however the preliminary high-level data support further inquiry, and contributes to making the case for maintenance and scaling up of the programme over time.

'Scaling up' relates to enhancing the programme/s not only to include more firms, but also to improve the various aspects of support (and monitoring and evaluation) offered to the firms such that they can accumulate resources for reinvestment over time. Importantly, supporting improvements in the competitiveness of the beneficiaries, such as around access to markets constraints discussed below, enables more firms to graduate out of the programmes over time which frees up state resources. When firms accumulate sufficient own resources and working capital, they rely less on government financial support, thereby opening opportunities for other black industrialists to receive support from government particularly given the context of highly constrained fiscal resources. The key question thus becomes one of 'how to do more with less'?

Against this background, the next two sections explore opportunities for upscaling the BIS drawing on insights from the interviews conducted and secondary data analysis, in the context of a constrained fiscal environment and limitations with respect to the ability of DFIs to provide sufficient patient financing.

5. Firm level upscaling – challenges and opportunities

We consider two dimensions of upscaling: 1) firm-level upscaling; and 2) programme-level upscaling. This section focuses on the former, which entails consideration of firm-level challenges and opportunities relating to the form and quantum of financial support needed by existing black industrialists to upgrade and expand operations. Whilst attention tends to be drawn to startup businesses, existing enterprises equally need support to survive and expand beyond the first few of years of establishment (Vilakazi et al., 2020). The section discuses two main challenges to upgrading/expanding emanating from the interviews conducted: namely, access to markets, and funding. These constraints can also play out in a reinforcing manner, further constraining the ability of black industrialists to grow, as we demonstrate below.

5.1. Access to markets

When firms acquire access to new markets and customers, they can expand production of existing products, increase revenues, and grow. Moreover, even without increasing production, they are able over time to switch production to higher value and 'premium' products that command better prices in the market. This increases firms' revenues and allows for accumulation of financial resources that can then be reinvested to grow and/or strengthen business operations. When firms accumulate sufficient resources for reinvestment purposes, they lesson the burden on national DFIs and government budgets to

provide enterprise finance. The limited government resources can then be used to develop other new and existing firms.

Black industrialists have indicated that they continue to face challenges with accessing markets. Firstly, pricing and high-volume requirements (especially from retail customers) are difficult to meet. Retail customers typically require high volumes and the ability to supply all stores nationally, which can be challenging for BIs that in most cases are small- and medium-sized enterprises. On price, private sector clients tend to be sensitive to price and cost increases and therefore readily look for cheaper imported alternative goods.[9] Further, retail customers typically impose stringent listing requirements and subsequent audits, with the effect of favouring established incumbent suppliers.[10]

Secondly, in cases where there are long-term supply agreements and strong personal relationships between potential customers and incumbent suppliers, it becomes difficult for customers to shift from existing suppliers to relatively new and unknown suppliers.[11] Moreover, in some instances, incumbent and established suppliers (competitors of BIs) own storage facilities at customers' premises, making it difficult for BIs to access such facilities and be able to supply those customers.[12] Typically, large customers are also concerned with the ability of new firms and SMEs to fulfil supply requirements in terms of quality and product specifications.[13] This creates (and relates to) a mistrust of new SMEs, with customers choosing to go with tried and tested suppliers.

Thirdly, customers are seemingly becoming reluctant to provide formal commitments in the form of offtake agreements, and instead prefer issuing letters of intent.[14] They avoid committing to binding and long-term contractual supply obligations with suppliers, protecting their freedom to switch between suppliers as and when they deem fit. The other reason for reluctance to commit to BIs and SMEs arises when the product on offer is new and unknown, with customers unsure of how it will perform.[15] To illustrate this point, one BI that produces building materials noted that the market is accustomed to standard building materials provided by lead suppliers, resulting in the rejection of alternative building technologies which are highly energy efficient and cost-effective due to a lack of knowledge and awareness.

Addressing some of these challenges with gaining access to markets could lead to significant opportunities for upscaling of firms owned by black industrialists, enabling them to become effective rivals that can compete and reinvest in the economy. Critically, finding mechanisms to facilitate greater access to markets can support the sustainability of BIs and the programmes overall – other things being equal, if firms can earn greater revenues and access a wider base of customers including through exports, they are able to achieve economies of scale, reinvest and reduce their cost bases per unit of output, and achieve greater levels of retained earnings over time which lessens their dependence on state resources to fund further entry and expansion. This is effectively a win-win situation, and part of the solution to mitigating the effect of the under-funding of BI support programmes,

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[9] Survey responses from BIS31, BIS30, BIS24.
[10] Survey responses from BIS14, BIS17, BIS21, BIS38.
[11] Survey responses from BIS06, BIS10, BIS11, BIS12, BIS13, BIS15.
[12] Survey response from BIS12.
[13] Survey responses from BIS05, BIS09, BIS13, BIS15.
[14] Interview with BII06, 23 February 2023; Survey responses from BIS04, BIS19, BII02.
[15] Survey responses from BIS15, BIS22, BIS23, BIS27.

rendering the programmes and firms more sustainable in terms of their contribution. Despite the obvious benefits, our assessment finds that in reality too little, if any, attention is paid to addressing challenges of accessing markets (the focus has tended to be on funding), notwithstanding the strong body of evidence demonstrating the related challenges and barriers to entry firms face in entering and expanding in markets across sectors in the South African economy (Vilakazi et al., 2020).

Addressing barriers to entry and expansion, and in particular barriers in accessing markets, requires a concerted and coordinated effort. At present, it is not the responsibility of any one department or agency to apply focused attention towards addressing these issues, despite the potential benefits. These roles are loosely distributed across agencies including the competition authorities in dealing with strategic barriers to entry through anticompetitive practices employed by large firms with market power (which themselves can restrict market access), however this does little to address specific challenges such as the formal and informal rules and norms which mean large firms and state enterprises do not contract with BIs and SMEs (Vilakazi et al., 2020; Bosiu et al., 2020). In this regard, we propose a formal structure or unit within the implementing department and agencies of the BI programmes, and involving the competition law agencies, that would be solely dedicated to addressing market access challenges. This is similar to the Black Industrialist State-Owned Enterprises Procurement Forum (BISOEPF) which has not materialised or achieved effectiveness[16], although with wider coverage to include opening up local private sector market opportunities, state procurement and export markets. Moreover, such a unit is envisaged have legal powers to enter into both voluntary and enforceable obligations with the private sector and government entities, and to implement and monitor compliance with such obligations (akin to the industry commitments made as part of sector masterplans that run the risk of not being implemented without formal monitoring and leadership).

The mandate of such a structure should also include exploring other market opportunities for BIs, including through enterprise supplier development (ESDs) programmes of large and lead corporates that operate in the country, and export markets, especially opportunities that will arise under the African Continental Free Trade Area (AfCFTA) agreements. Regarding ESD, there are significant market opportunities that lie with South Africa's large and lead firms, with many of them having established supplier development programmes to include SMEs in their supply chains. Several of South Africa's large corporates that have established ESDs include Shoprite, Pick n Pay, Woolworths, Spar, Game/Massmart, Siemans South Africa, etc. However, the full potential of these programmes has not been unlocked, with none of the mentioned corporates spending above 0.8% of total revenues on ESD for the 2019/20 financial year (das Nair, 2023).

One policy channel for unlocking access to the ESD programmes and funds is through the B-BBEE policy tools, although we argue that there is also a role for a dedicated unit in supporting the individualised or sectoral engagements of BIs and SMEs with lead firms in their value chains (there is anecdotal evidence in our prior research on the BIS that the support of the DTIC in engaging lead firms alongside BIs has in some instances made a difference and unlocked access to major value chains; Bosiu et al., 2020). Importantly, agreements that arise through these engagements will be most effective and fruitful if they involve both mandatory and voluntary, mutually beneficial outcomes for both lead firms and

[16] Interview with BISCF02, 12 October 2022.

BIs, as envisaged under the national priority sector masterplans. Commitments made should be monitorable and mutually binding where applicable – as it relates to larger firms, there are obvious benefits in the medium- to long-term in terms of diversifying supplier networks, B-BBEE status, achieving 'bang-for-buck' from ESD investments, and contributing to a growing economy which over time benefits all firms.

The opportunities that can arise through new and existing ESD programmes should not be considered narrowly – for example, successful ESD support of firms should not be separated from ensuring beneficial offtake commitments from the same firms if they meet stipulated requirements that are fair and mutually beneficial. Positive and adverse lessons from other mechanisms such as contract manufacturing and farming, or the findings of the Competition Commission's Grocery Retail Market Inquiry, need to be drawn on, as the underlying principle is essentially the same. In particular, experiences of some SMEs interviewed that have gone through such ESD and contract manufacturing and farming programmes have not always been positive because the terms of trade are not set in mutually beneficial ways, highlighting the potential for ESDs to stifle rather enhance the growth of SMEs (REFS).

One BI that's currently under an ESD programme with a large corporate indicated that it is not in the interest of large corporates to develop SME suppliers because of the fear that the BIs would in turn gain bargaining power to negotiate prices. For instance, the BI highlighted that a large corporate buyer was upset after discovering that the BI is increasing supply to a competing brand.[17] Anecdotally, the large buyer's concern was that if the competing brand increased quantities sourced from the BI, the BI would be significantly empowered to negotiate better prices with the large buyer, despite the fact that the large buyers had persistently refused to adjust prices offered to the BI in line with rising inflation and increases in the cost of inputs. That is, because of the asymmetry in bargaining power between smaller firms and lead firms, offtake arrangements can be structured in a manner that undermines the potential growth of the BIs and SMEs over time, whereas it is this growth that would enable the BIs to reduce their offered prices to large buyers and achieve economies of scale in production – a mutually beneficial, pro-developmental outcome. In the above example, the BI is in the process of exiting the agreement with the large buyer for these reasons, on the back of commitments by the rival buyer to increase volumes sourced from the BI.

This is seemingly a common practice with ESD arrangements in general. In another instance, an SME that is currently a participant in the ESD programme of a large packaging firm indicated that whilst the agreement on paper was for the buyer to procure a large number of units from the BI on a monthly basis, in practice the buyer only procures about 10% of the committed units, citing better prices from other large suppliers as the main the reason. This has significantly reduced the growth prospects of the SME, contrary to the initial projections and commitments. Two other SMEs highlighted similar experiences, indicating that they had to exit such programmes because the prices offered by large corporate buyers were too low to allow for accumulation of sufficient financial resources to reinvest in the businesses and grow.[18] Thus, while the ESD model has the potential to bridge some of the market access challenges, in the present form these programmes seem to deliver greater benefits to SMEs and BIs that are entrants or in the early stages of their development (that is, one offtake

[17] Interview with BII02, 10 February 2023.
[18] Interview with BII07, 16 August 2022, and BFI12, 3 August 2022.

agreement has a larger net impact on a smaller SME etc., sometimes regardless of the terms of trade on offer so that they can prove to other buyers in future that they can cater for lead firms). However, the objective of the BIS programme is broader in our reading, with a greater emphasis on substantive or meaningful economic participation – to which we would add a greater mandate to address both barriers to entry *and expansion* in the context of building sustainable, effective rivals that can reinvest and contribute to generating dynamic efficiencies and higher value addition throughout key value and supply chains. This cannot be achieved in the context of the current, uncoordinated and unmonitored arrangements that exist between BIs and their more established counterparts – proactive, focused engagement with these issues is required, and government has a key role to play in this regard if it is to achieve 'value-for-money' from investments made and to be made in BIs.

The examples drawn on above illustrate what is being missed in existing ESD programmes – that the growth and expansion of established SMEs (especially those supplying inputs into the production processes of lead firms and state enterprises rather than simply providing ancillary services such as cleaning and security) can lead to dynamic economic efficiencies over time, that are mutually beneficial. Said differently, few firms regardless of size will benefit in the medium- to long-term from a stagnant economy in which productive capabilities are not developed and investments are limited. The political economy risks of such an environment are also significant (just as the benefits are large from engaging meaningfully with these issues), although we do not engage with this issue in the present paper (see Vilakazi & Bosiu, 2021).

In addition to unlocking the full potential of the ESD model, there are significant market opportunities through state procurement. Regrettably, state procurement levers have not been utilised effectively. While the public sector spends a substantial proportion of its budget on goods and services, creating important demand for local production, this demand has been difficult to leverage as offtake by BI firms to underpin capacity expansion.[19] The reason is that demand (and systems to access procurement spend) is highly disaggregated, uncoordinated and dispersed across many government entities, making individual transactions insignificant in scale or costly for BIs to pursue relative to the large actual and opportunity costs incurred in engaging with cumbersome government procurement processes.

Black industrialists, and firms generally, are more likely to invest in increasing productive capacity when there is predictable and substantial offtake or demand for their goods. Competitiveness is improved over time under similar conditions, not least because of the significance of achieving economies of scale and scope in production in many key industrial sectors. Firms that are cost competitive in turn become more effective rivals over time, which is critical for addressing the pressing South African challenge of entrenched economic concentration and stifled dynamic rivalry. Ring-fencing procurement spend for SMEs and black industrialists is a key starting point, although its effectiveness (such as through the localisation policy) is also dependent on predictable and substantial spend, greater coordination within the state, and provision of durable (such as multi-year), fair commitments and terms of trade to the beneficiary firms. The net benefits of fairer private and public sector procurement and engagements with BIs and SMEs are likely to outweigh the short-term costs, giving rise to more dynamic, growth-enhancing outcomes and inclusive

[19] Interview with IAI02, 7 February 2023, and IAI01, 30 November 2022.

structural transformation over the medium- and long-term – a situation that benefits all stakeholders. Getting this right, requires more serious engagement with the detail of industries, economic barriers and value chain relations that inhibit greater market access for BIs and SMEs.

5.2. Access to finance

Access to finance of the form and quantum required for sustained growth remains a major challenge for South African SMEs (Bosiu et al., 2019, 2020; Goga et al., 2019; Herrington and Kew, 2015; Ncube et al., 2016; SA SME Fund, 2018; Seed Academy, 2018). The black industrialists interviewed and surveyed have corroborated this observation, irrespective of the form of financial support required (i.e., start-up capital, expansionary investment capital or working capital) (Bosiu et al., 2020). The main reasons why black industrialists find it difficult to access funding are that applications for financing are typically cumbersome and lengthy, with entrants often assessed against historical performance, and the requirements for significant collateral and shareholder contribution especially for businesses that do not have a long-term track record (Bosiu et al., 2019).[20]

In addition, financial institutions tend to require BIs to have offtake agreements with potential customers. However, as discussed above, there are challenges with access to offtake agreements as customers prefer to issue letters of intent over legally binding agreements. One BI indicated that this became a strong point of contention with the IDC, as the DFI did not initially want to accept a letter of intent from a customer as a firm commitment.[21] The BI had to arrange for the IDC to have a physical meeting with that customer to satisfy themselves that indeed the customer has the intention to procure from the BI. Additionally, the BI had to provide extensive evidence regarding the viability of the business if the customer does not honour its commitment to procure from the BI. In that regard, the BI demonstrated the superiority of their product in terms of quality and price, and that more than 50% of the product is presently imported, with the BI's production expected to fulfil only about 10% of that demand. The IDC eventually accepted the letter of intent instead of a formal offtake agreement. This interaction highlights the mechanism through which challenges of sustainable market access are intertwined with the constraints of gaining access to finance.

Challenges with obtaining access to working capital have implications for firms' ability to upscale. Whilst entrant firms struggle with access to start-up capital to cover setup costs including the construction of plants and purchasing equipment, the challenges can be quite different for firms that are already operating and need to ramp up production. In the main, there are specific issues with accessing to working capital to fulfil orders or aggressively market products. In relation to the former, access to working capital is relatively easy because there are multiple private and government instruments in the form of invoice discounting.[22] This is because financiers can easily secure their lending through agreement with the client to cede the invoicing rights to the financier. That is, such arrangements typically allow financiers to have the first claim to the proceeds of sales that are due to the applicant following successful fulfilment of the order.

[20] Interviews with multiple BIs
[21] Interview with BII06, 23 February 2023
[22] Interview with BII05, 17 January 2023

On the other hand, there are challenges accessing working capital for marketing purposes,[23] most likely because there is little or no guarantee to financiers that the marketing expenditure (typically classified as a sunk cost) would yield financial returns for them to recover funding provided. Yet, marketing is critical for brand promotion, and can have implications for market access. One of the BIs has struggled to reach the desired markets because of working capital challenges that have restricted its ability to market aggressively.[24] Presently, the BI supplies customers mainly through contract manufacturing which does not require brand promotion, and only supplies less than 10% of its output to national retailers where brand promotion is important. Challenges with access to working capital have limited the BI's ability to increase the share of production that is sold to retailers, which has contributed to capacity utilisation only reaching around 50% of total available capacity.

The Black Industrialist Scheme does not have a working capital facility, except for what is offered by the individual co-funders such as the IDC under different funding mechanisms (and requiring additional applications). However, the particular BI found the IDC's working capital terms of funding to be unfavourable ('too expensive'), given that the BI is presently servicing the initial debt that was used for capital investments. The monthly repayments on that debt amount to about R1.5 million, for an initial borrowing of R44 million. The BI indicated that the repayment commitment is already quite extensive, with the company identifying it as one of its key financial risks. Thus, acquisition of more debt for working capital purposes would collapse the business.

The challenge for such firms is not necessarily the availability of working capital funding facilities, but the cost thereof. The DTIC's grant component only covers capital expenditure in the form of machinery and equipment, and not working capital. This means there is an opportunity for the DTIC to intervene, not necessarily through grants but zero-rated loans given that the type of firms targeted would already be operational and relatively established with more reliable revenue streams. The purpose of zero-rating would be to lessen the burden of interest repayments. While grants are not repayable, zero-rated loans are repayable (although without interest) and therefore not entirely burdensome on the fiscus over the medium- to long-term.

Lastly, the co-funders (IDC in particular) tend to offer repayment moratoria as a form of patient capital, with the moratoria offered to the sample of the BIs in the study averaging 10 months. Whilst many BIs consider this to be sufficient, concerns have been raised that a repayment moratorium is sometimes provided with respect to capital repayments only, not interest repayments.[25] One startup BI indicated that the IDC moratorium was not lenient in that it did not cover interest payments on funding obtained for new investments, and therefore required of the BI to pay interest even as the plant was not yet operational and generating revenues.[26] It is crucial that the BIS considers the design of repayment moratoria more holistically to ensure that it cushions growing firms rather than increasing financial pressure on cashflows. Careless consideration of the issue can have detrimental financial

[23] Interview with BII02, 10 February 2023
[24] Interview with BII02, February 2023
[25] Interview with BII01, 8 February 2023
[26] Interview with BII01, 8 February 2023

implications for firms, even possibly leading to firm exits, in turn undermining the very objective of the industrial development financing offered in the first place.

One SME that received funding from the Land Bank had to exit the market due to cashflow challenges that resulted from the mishandling of the moratorium issue on the part of the DFI.[27] The SME indicated that the agreement with the Land Bank entailed provision of a 3-month moratorium, along with working capital to carry the business along until realising its first revenue stream. However, the Land Bank reneged on the agreement and demanded immediate loan repayments, leading to a standoff between the SME and the DFI. As a result of the standoff the Land Bank refused to release the working capital funds that were critical for operations. The matter did not get resolved, with the SME subsequently exiting the market.

6. Programme level upscaling – challenges and opportunities

This section builds on the previous discussions on firm-level issues to provide an analysis of systemic issues, constraints and opportunities for scaling up the BIS programme/s overall. Specifically, we discuss key underlying factors that have contributed to the outcomes we see in terms of firm-level upscaling and the number of firms that have been supported. Two factors are identified in subsections 6.1 and 6.2: namely, the quantum of funding available overall, and the institutional arrangements within which the BIS exists. We supplement the discussion (in subsection 6.3) by exploring some alternative funding instruments that can be leveraged, including mobilising private sector support to increase the pool of funding available for the BIS.

6.1. Overall funding available for the BIS

Of the total R32.8 billion approved between 2016 and 2021 under the BIS programmes, 78% was approved by the IDC (see Table 2 above). The IDC is therefore the main institution (in terms of the value of the programme) through which BIs can access funding. However in terms of the number of BIs supported, the NEF leads with 414 BIs as at April 2021, followed by the IDC with 313 and DTIC with 135 (DTIC, 2021a).

The development finance system in South Africa is smaller than in comparator countries as shown in the table below. South Africa's main DFIs, including the IDC, receive no funding from government and are self-sustaining. This is outside of the norm for development finance institutions internationally; BNDES in Brazil, for instance, is supported by the fiscus. Since the IDC receives no capitalisation from external sources, it generates funds through raising loans, internal profitability, capital growth, and sales of mature investments (Goga et al., 2019).

Table 3: DFI assets and share of GDP for comparator developing countries, 2020

	2020 GDP (USD Million, constant 2015 prices)	GDP per capita 1994 (USD, constant 2015 prices)	GDP per capita 2020 (USD, constant 2015 prices)	2020 Total Assets (Million USD)	DFI assets (% of GDP, 2020)

[27] Interview with BII08, 12 August 2022

Brazil	1,749,103.39	6,358.70	8,204.20	170,841	9.8%
Thailand	344,099.36	3,371.30	6,042.00	123,081	35.8%
Malaysia	431,857.37	5,453.90	10,374.20	65,102	15.1%
Türkiye	1,015,326.66	5,376.20	12,072.40	44,442	4.4%
South Africa	335,640.15	4,330.70	5,726.30	20,488	6.1%

Source: Authors' calculations based on Xu, et al. (2021) and World Bank World Development Indicators

As far as loan funding is concerned (under which the BIS programme falls from the perspective of the DFIs involved), the IDC uses loans raised to on-lend to businesses , meaning that the pay-back period associated with loans is generally associated with the IDC's own borrowings. Furthermore, the interest rate associated with lending is broadly determined by the interest rate at which it borrows funds (Goga et al., 2019). The BIS programme is therefore constrained by the funding model of the IDC. BIs have noted that the interest rates offered by the IDC are no better than those offered by commercial banks. In fact, one interviewee noted that IDC interest rates are higher than commercial banks.[28] However, unlike the commercial banks, the IDC is more willing to fund start-ups[29] and, in this sense, is a greater risk-taker than commercial banks. The higher interest rates offered by the IDC may thus be pricing in the higher risk that it is taking as far as start-ups are concerned. As a self-funding institution though, the IDC is limited in providing patient finance.

As with any commercial lending institution, BIs applying to the IDC for funding are required to provide collateral. In the case of the DTIC programme, the DTIC will fund 30-50% of the project cost with the incentive/grant being capped at R50 million. If the BI cannot find a co-funder to fund the remainder of the project, they will need to fund the investment from their own resources. Whilst the rationale for this approach is relatively clear, the requirements can constrain BIs (Bosiu et al., 2020). The principle of having 'skin in the game' implies that the entrepreneur is invested in the business, the reality is that many black South Africans do not have a source of collateral or funding that they can leverage. In the context of a highly concentrated economy as well as a historically unequal society in terms of income and wealth, the requirements relating to collateral and own funding are particularly problematic.

Since the BIS grant component funds projects to the value of R30 million to R50 million, the programme is supported by the fiscus. However, while the DTIC's programme supported 109 BIs between 2016 and 2019 (Bosiu et al., 2020), as of 2020 this number had only increased by a further 26, as a result of the National Treasury not having allocated any further funding to the BI programme due to fiscal constraints.[30]

The continuation and further upscaling of the DTIC's BIS programme is dependent on on-going capitalisation of the programme through the fiscus. It also depends on the funding available for on-lending through the DFIs involved with the programme. In both cases, there appear to be hard constraints in terms of the ability to increase funding for the programme, necessitating engagements about how to achieve more with the same funding base, deriving value-for-money from investments made, and seeking alternative funding channels (at least in the medium-term) including through partnerships with private sector funders

[28] Interview with BII01, 8 February 2023.
[29] Interview with BII03, 15 February 2023.
[30] Interview with BISCF02, 12 October 2022.

that already have an understanding and history of co-funding certain bankable projects under the BIS, as we discuss further below.

6.2. Institutional arrangements

Coordination between funders

There are a number of institutions involved in the BIS programme including the DTIC, the IDC and the NEF. The Black Industrialists Funding Forum (BIFF) was meant to be established under the BIS programme and consist of representatives of the major DFIs with a view to assisting the DTIC in the coordination and facilitation of funding for the programme. Under the BIFF, DTI and co-funders were to collectively process and evaluate applications, provide uniform screening procedures, and align the disbursement schedules (Bosiu et al., 2020). The BIFF has not kicked off as envisaged in the BIS plan at inception,[31] and the institutions at present appear to largely work in silos, interacting in an ad hoc manner. There is a need to revive the BIFF to support BIs in a few key areas:

- Improve the coordination of the BIS programme between funders, particularly where co-funding is occurring. The BIFF has the scope to be a forum where BIs can access different funders, negating the need to approach them independently (Bosiu et al., 2020).
- Mentoring as far as the application process is concerned where potentially promising applicants are struggling with the application process. Some BIs that accessed funding noted that the application process was challenging, and they required some support.[32]
- The BIFF can be used to strengthen the relationship between DFIs, the DTIC and government institutions for, among others, the purposes of enhancing local procurement for BIs. Where necessary, the BIFF can be used to help find creative solutions to regulatory barriers like environmental authorisations together with the relevant government institutions.
- The BIFF should be positioned as a transparent and coordinated platform for drawing in co-funding and partnership with private sector funders, including addressing programme administrative efficiency and coordination towards more rapid and predicable accessibility of funding, given concerns about the time it takes from application to disbursement. Government plays a key role (particularly given the DTIC's claim-based, grant funding model, in de-risking projects which should increase the bankability of projects from the perspective of private funders and DFIs.

Funding of smaller projects

The DTIC's grant component funds projects for a minimum investment value of R30 million. As a result, there is a cohort of smaller projects that cannot be funded through the BIS – the greatest concern in our analysis is for firms that are just at the margin of the threshold, with large expansionary projects that require funding that is just below the R30 million threshold but above the thresholds of other DFIs. Furthermore, the DTIC's BIS specifically targets businesses that have a track record of operation. The DTIC notes the limits of the design of the programme, saying that it has found it difficult to capture the "right kind of black

[31] Interview with BISCF01, 27 January 2023.
[32] Interview with BII04, 16 February 2023; and BII05, 17 February 2023.

industrialist who meets the threshold of the programme, for instance, the R30 million threshold on the level of investment".[33] It was noted at the BIS conference that the German manufacturing industry has a cohort of smaller manufacturing businesses that are tech and export-oriented and very dynamic.[34] The design of the system may therefore be missing a cohort of dynamic smaller businesses. Other DFIs or incentive schemes like SEFA and the NEF can fill this gap providing a layer of support preparing or developing potential BIs to levels needed under the BIS. However, there is little coordination between the BIS and 'smaller' DFIs to build this pipeline of black industrialists.

6.3. Alternative funding instruments

South Africa is operating within a constrained fiscal environment. The government budget is limited, and other priorities such as energy security, municipal debt, and infrastructure investments are more pressing as outlined in the 2023 budget.[35] The DTIC's BIS programme has not received capitalisation since 2019 as evidenced by the low number of new black industrialists supported since 2019. The IDC does not get funding from the fiscus. As a result, creative funding for the BIs needs to be considered. A few alternatives, partly informed by concerns raised in the interviews conducted, are outlined below:

Use of competition case settlements and public interest funding commitments to support supplier development funds (SDF): One example of funding committed under competition law case remedies is AB Inbev being required to establish a supplier development fund when they bought SAB worth R200 million, which they committed across three programmes as depicted below. Walmart also had to create a supplier development fund when it acquired Massmart. The fund supported about 33 local suppliers (not only black-owned firms). One of the beneficiaries of the Walmart/Massmart SDF is a BI that manufactures cooler boxes. As noted above, during the COVID-19 pandemic period the company was able to produce components that were needed to produce CPEP ventilators for the healthcare industry when global supply was disrupted (BIS Conference, 2022). We do note though that a full impact assessment of these funds is required.

Figure 2: SAB's Public Interest Commitments

[33] Interview with BISCF02, 12 October 2022.
[34] Black Industrialists Conference, 20 September 2022.
[35] https://www.gov.za/speeches/minister-enoch-godongwana-2023-budget-speech-22-feb-2023-0000

Source: SAB (2017), accessed at https://static.pmg.org.za/180613SAB.pdf

Leveraging venture capital and/or angel funding: According to the Southern African Venture Capital and Private Equity Association (SAVCA), venture capital (VC) refers to financing that investors provide to high-growth businesses in the start-up and early growth phases, predominantly in the form of equity (SAVCA, 2022). VC investors typically look for high growth returns that are underpinned by other factors such as access to large untapped markets, or by differentiators such as exclusive operating licences or comparable enablers that give the investments substantial advantages over their peers (SAVCA, 2022).

There are three main classes of venture capital investors: angel investors; captive funds; and independent funds (SAVCA, 2022). Angel Investors are high net-worth individuals who inject funding for start-ups in exchange for ownership/equity stakes or convertible debt. Under captive funds, one shareholder (typically a corporate or parent organisation) contributes most of the funding from its own internal resources. Captive funds may be subsidiaries of, or divisions within, financial institutions or industrial companies. On the other hand, independent funds tend to be managed by fund managers in which third party investors are the main source of capital and no one investor holds a majority stake.

New investment vehicles and regulatory incentives, as well as emerging market opportunities across the continent continue to broaden the VC space, as well as the business focus and sectors where investments are made. In South Africa, the VC landscape has grown significantly over the past decade, with about R8.13 billion invested in 1021 active deals between 2010 and 2021, as shown in Figure 4 below. Interestingly, the VC investments have not been significantly different from the total funding committed under the DTIC and NEF BIS programmes of R8.3 billion. Most of the VC funding is provided by captive funds (50.9%), followed by independent funds (44.4%) and angel investors (4.7%) (Figure 5). With respect to the stages of development of businesses funded, most investments are made into growing, existing businesses (40.3%), followed by start-up operations (33.3%), late-stage operations (18.3%), seed operations (3.9%), and others (Figure 6).

Figure 3: Venture capital investments (2012 – 2021)

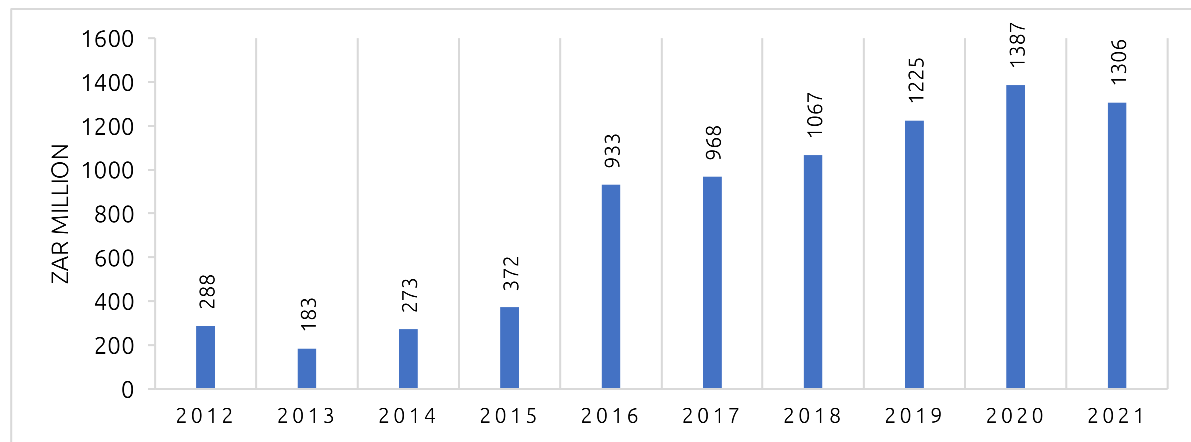


Figure 4: Investment by VC type

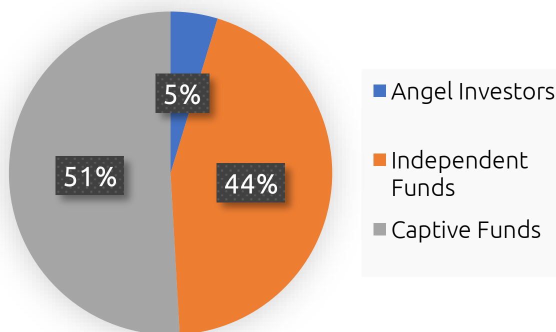
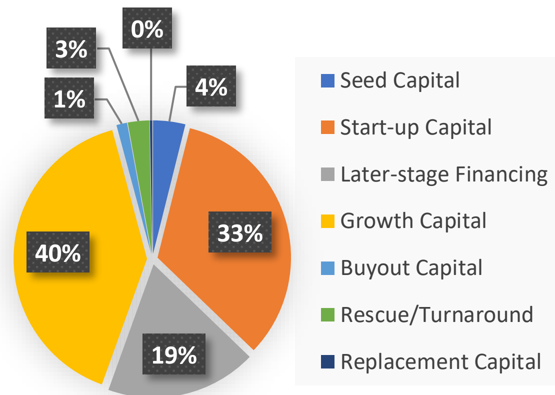


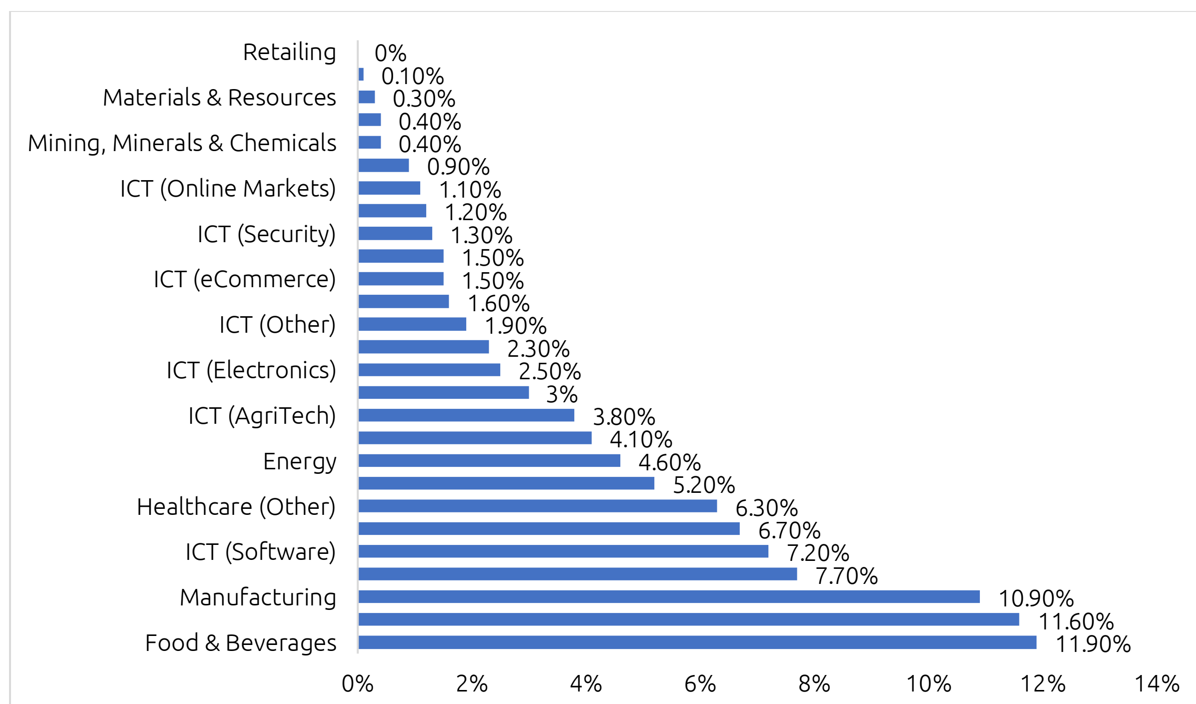
Figure 5: VC Investment by stage of business



Source: Adopted from SAVCA (2022)

Interestingly, a majority of the VC investments have been in the sectors aligned with those targeted by the BIS (Figure 7 below). For instance, the leading sector funded is food & beverages, which falls under agroprocessing as per the list of priority sectors provided in section 4. Similarly, information communications technology (ICT), manufacturing, consumer products, energy, healthcare, and chemicals, are all BIS target sectors. This provides a great opportunity for the VC investments to be directed to black industrialists relatively easily as most of the sectors may already be aligned, although this would require further disaggregation and analysis to match manufacturing activities targeted under the BIS and IPAP in particular.

Figure 6: VC Investments by sector



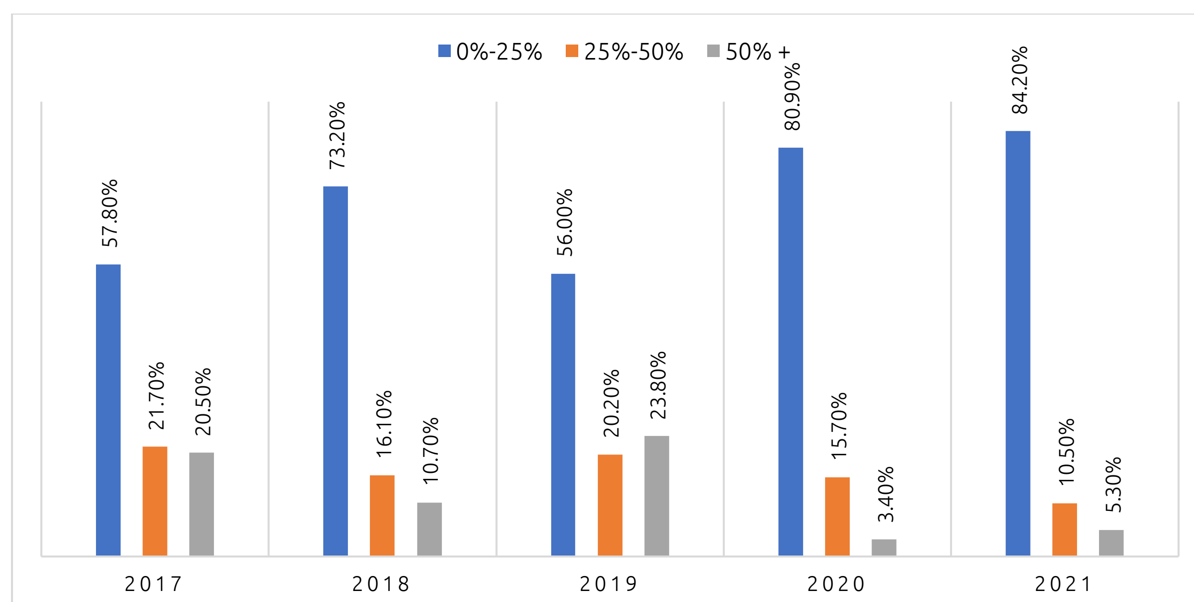
Source: Adopted from SAVCA (2022)

The above figures provide a glimpse of the potential that lies with other private sector (excluding commercial bank) sources of funding that can be leveraged to upscale support provided to black industrialists. Unfortunately, venture capital and private equity in the current form automatically excludes 90% of the current SME landscape in South Africa (My Growth Fund, 2020). Moreover, it is notable that investments into early-stage business development (i.e., seed funding), which are typically made by angel investors, have been low overall. According to one of the VC companies in the country, ecosystems with more early-stage investors have a better chance of attracting more capital compared to those without (My Growth Fund, 2020). However, investors typically say there are insufficient investment-ready businesses, while start-ups on the other hand complain of lack of seed-stage investments (My Growth Fund, 2020). Others argue that the reason for low early-stage investments is not lack of investment-ready businesses, but unwillingness of investors to do the heavy lifting of supporting businesses during the early stages of development (My Growth Fund, 2020).

In this context, it is evident that there is a need for additional support to get businesses to a point where private investors are comfortable to provide additional funding. This is an area where incubation can play a critical role. Clearly private investors are willing to provide funding as long as businesses are investment-ready, as demonstrated by the substantial funding extended to start-up and expansion operations, relative to seed funding activities. However, there are generally very few accelerators and incubators in South Africa that offer deep and robust infrastructure to get businesses to a point where the investors are comfortable to onboard (My Growth Fund, 2020). There are several reasons for this; but key amongst them is funding, as it can be quite costly to prepare an investment-ready business (My Growth Fund, 2020).

One more issue that needs to be considered as part of leveraging venture capital is the implications on ownership. The BIS by design requires the entrepreneur to be black and own/control 51% of the enterprise. On the other hand, venture capital is typically in the form of equity investments, and thus there is a need to balance the interests of investors that prefer large equity stakes with the racial transformation objectives of the Scheme. In other words, the maximum equity stake that VC investors can take in black industrialist firms is 49% based on the current policy prescriptions. Figure 8 below shows that most VC investors prefer to take up equity stakes not exceeding 25%, while about 17% of them on average prefer higher equity stakes of up to 50%, which suggests that they may be an opportunity for partnership with BI firms under clearly specified, mutually beneficial conditions.

Figure 7: VC Equity Interests



Source: Adopted from SAVCA (2022)

International experiences – the case of Turkey: Like South Africa, SMEs in Turkey have limited access to start-up capital due to a lack of financial records and collateral required by banks (OECD, 2022). However, Turkey has managed to mobilise venture capital to significantly transform its SME financing landscape over the past two decades. For example, the Turkish Investment Initiative (TII) is a dedicated *Fund of Funds* that was established in 2007 to bring together a selected group of investors to provide access to finance to new, established, and experienced funds (OECD, 2022). Further, the Istanbul Venture Capital Initiative (iVCi) was established with initial commitments worth EUR 50 million. Total funds raised by iVCi portfolio funds have reached EUR 1.5 billion. Investments under iVCi are the product of a multi-step due diligence process undertaken by a dedicated investment committee. When iVCi was established, there were only two independently managed venture capital or private equity funds in the Turkish market (OECD, 2022). iVCi stimulated the market and enabled several other funds to be established.

In addition to setting up the VC funds, the law regarding the regulation and promotion of angel investments were enacted in 2012 (OECD, 2022). The legal framework provides a mechanism for licensing 'business angels', and has eased access to finance for entrepreneurs and institutionalised a business angel investment market (OECD, 2022). Some of the

incentives provided to licensed business angel investors include income tax deductions of 75% of the capital they invest in innovative and high growth SMEs whose shares are not traded in the stock market (OECD, 2022). The 75% deduction rate is increased to 100% if SME projects invested in are supported by the Ministry of Industry and Technology, the Scientific and Technological Research Council of Turkey (TÜBİTAK) and the Small and Medium Enterprises Development Organisation (KOSGEB). The use of tax incentives has also been applied in South Africa, with positive effect on mobilising VC investments. Section 12J of the Tax Act came into effect in 2019 and offered taxpayers a 100% tax deduction in the year of investment if they invest in SMMEs by way of subscription of shares in a Section 12J Venture Capital Company (SARS, 2020).[36] The tax incentive was discontinued in 2021 however, and as a result, sourcing money from individuals through retail investments saw a significant drop (SAVCA, 2022).

7. Conclusion

The black industrialist scheme has had a positive impact on the development of local industrial capacity and employment. Importantly, one in every 30 jobs in the national economy is sustained by existence of black industrialists. While these outcomes are clearly significant, more remains to be done in terms of sustaining existing black industrialists that may require funding for further expansionary investments and supporting new black industrialists under these programmes of government. Performance in that regard has been poor, with supported BIs accounting for only 0.13% of the total number of formal SMEs in the country.

There is a good justification to upscale the programme to not only include new BIs but to support existing ones to upgrade and become effective challenger firms that can reinvest and contribute even more to local industrial development. The underlying premise is that when firms are supported sufficiently they will be able to access new market opportunities, thereby expanding operations and/or switching from production of low to high value products that achieve better prices in the market. This will increase revenues and allow firms to accumulate resources that can be used for reinvestment, thereby relieving government and DFIs of requests for further support that can rather be directed to other firms.

There are however a number of challenges constraining the full potential of the BIS. At a firm-level, these include challenges with access to markets, as well as access to finance. These tend to reinforce one another thereby further weakening the ability of firms to expand and/upgrade. For start-ups, offtake agreements are critical but not easy to come by, with implications on their ability to access funding as these are a key requirement of development finance institutions. Further, the requirements for collateral and shareholder funding contributions can be quite onerous on black-owned start-up businesses. For existing businesses that need to expand, access to working capital is a more significant challenge, primarily in terms of the cost of capital rather than availability of these funding mechanisms (for example, the IDC has working capital facilities). Given that many beneficiary firms would have received initial debt funding for setting up operations, acquiring more debt for working capital becomes unaffordable given that they would still be repaying the initial debt. This means they cannot promote their brands effectively or improve their operations

[36] https://anuvainvestments.co.za/wp-content/uploads/2021/01/lapd-it-g30-guide-on-venture-capital-companies.pdf

and products to be able to access a broader share of key markets, which has the effect of limiting their ability to expand and grow.

At the programme-level, key challenges to upscaling include fiscal constraints that have meant DFIs have had to source funding from the private sector and operate in a self-funded manner, limiting their ability to avail sufficient patient, appropriately structured funds for the BIS (relative to other competing uses of available funding). The effect has been the use of stringent application processes for funding, especially cumbersome due diligence processes, that have resulted in the notion that there are simply not enough investment-ready businesses to support. This creates a gap between the available SMEs that require funding and the types of business ventures that funders feel comfortable providing funding to. The emerging gap necessitates measures for developing those SMEs to the level where they are ready for BIS investment, and that can either be through the BIS itself or other institutions outside of the DTIC such as SEFA, SEDA, incubators, etc. However, these would similarly need to be funded to fulfil such a mandate, as it costly to develop a business to investment-ready stage as has been the experience of VC firms.

In that context, the study identified two key opportunities for upscaling the BIS: 1) strengthening the institutional framework within which the BIS operates; 2) exploring alternative funding sources, including mobilising private sector funding. With respect to former, there has been lack of coordination of co-funder activities within the BIS, with co-funders essentially operating in silos. Thus, a forum such as the BIFF needs to be re-established and tasked with coordinating the activities of the different co-funders involved in the BIS, as set out above. Moreover, the overall ecosystem of funding that includes the large and national DFIs, relatively smaller DFIs (i.e., SEFA, SEDA, NYDA, etc), incubators, and all other non-financial support programmes, needs to be strengthened in order to bridge the gap in funding for available SMEs that are considered investment-ready as per the BIS evaluation criteria.

A novel recommendation that we make is that a dedicated unit or forum is established within the DTIC or otherwise that is tasked with developing practical mechanisms for addressing market access issues. Such a forum should take the form of the initially proposed BISOEPF, but with wider scope and mandate to address all market access-related challenges and open up market opportunities for BIs in the private sector, public sector and export markets. Addressing market access issues has the potential to free up state and funder resources over time, as BIs with adequate, fair market access (including through removal of strategic barriers to entry and expansion by competition law agencies) can compete on the merits with capacity to generate own funding and retained earnings to support their own growth over time.

Lastly, the BIFF should be tasked with mobilising alternative funding sources to supplement the current quantum of funding provided by the BIS. This should include mobilising private sector funds such as venture capital and angel funding and drawing lessons from international experiences on the kinds of incentives and regulatory reforms needed to attract these funds into the BIS, such as those profiled from Türkiye. Moreover, other existing arrangements such as ESD programmes and supplier development funds should be leveraged effectively, including exploring ways in which programmes arising from competition law remedies and fines can act as catalyst funding for supporting SMEs directly, noting that building firms' capabilities and granting them fair and favourable access to

markets and value chains (rather than simply funding) is a more sustainable way to support them towards building a dynamic and competitive economy.

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