Strategies and Policies on TNC-SME Linkages Country Case Studies: South Africa

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I am most appreciative of comments received from UNCTAD staff and my colleagues at the School of Development Studies. I hope the document has done justice to at least some of the pertinent issues raised within the context of this rather limited exercise. Any errors in the final text are of my own making.

The report has sourced input from Department of Trade and Industry documents and discussions with some officials. A number of discussions and personal communications were also conducted with former DTI officials in order to get a perspective of previous policies and programmes. However, despite a number of draft copies having been provided to officials a formal response to the report, verification of information and comment on its recommendations has not yet been obtained from the DTI.

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Acronyms

ABSA	ABSA Bank Pty Ltd
AIDS	Acquired Immune Deficiency Syndrome
BEE	Black Economic Empowerment
BBSDP	Black Business Supplier Development Programme
BRAIN	Business Referral Advice and Information Network
CBU	Completely Built Unit
CKD	Completely Knocked Down
COTII	Council of Trade and Industry Institutions
CSI	Corporate Social Investment
DAC	Durban Auto Cluster
DANIDA	Danish Aid Agency
DTI	Department of Trade and Industry
EPZ	Export Processing Zone
FDI	Foreign Direct Investment
FRAIN	Franchise Advice and Information Network
FOB	Free On Board
GATT	General Agreement on Tariffs and Trade
GDFI	Gross Domestic Fixed Investment (also referred to as Gross Fixed Capital Formation)
GDP	Gross Domestic Product
GEAR	Growth Employment and Redistribution Strategy
GVA	Gross Value Added
HDI	Human Development Index
HIV	Human Immunodeficiency Virus
IDC	Industrial Development Corporation
IDZ	Industrial Development Zone
ISO	International Standards Organisation
KZN	KwaZulu-Natal Province
KZNMAC	KwaZulu-Natal Manufacturing Advisory Centre
LBSCs	Local Business Service Centres
MAC	Manufacturing Advisory Centre
MBL	Market Access and Business Linkages unit (of Ntsika)
MIDP	Motor Industry Development Programme
MNC	Multi National Corporation
NAMAC	National Manufacturing Advisory Centre
NORAD	Norwegian Aid Agency
Ntsika	National Enterprise Promotion Agency
OECD	Organisation of Economic Cooperation and Development
OEM	Original Equipment Manufacturer
SA	South Africa
SADC	Southern African Development Community
SAITEX	South African International Trade Exhibition
SDI	Spatial Development Initiative

SEDA	Small Enterprise Development Agency
SMEs	Small and Medium Enterprises
SMEDP	Small and Medium Enterprise Development Programme
SMMEs	Small, Medium and Micro Enterprises
TEO	The Enterprise Organisation
TIPS	Trade and Industry Policy Secretariat
TISA	Trade and Investment South Africa
TMC	Toyota Manufacturing Corporation
TNCs	Trans-National Corporations
TSA	Toyota South Africa
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organisation
UK	United Kingdom
USA	United States of America
USTDA	United States Trade Development Agency
VW	Volkswagen
WTO	World Trade Organisation
ZCB	Zululand Chamber of Business

Introduction

This report has been prepared with the purpose of documenting and assessing selected South African experiences with regard to the promotion of linkages[1] between Trans-National Corporations (TNCs) and Small and Medium Enterprises (SMEs). These linkages can take different forms as can the policies, programmes and initiatives which might support them. The report will outline the context and intent of national approaches to the issue of TNC-SME linkages, provide some comment on perspectives on the effectiveness of such activities and look in some detail at two particular initiatives at the local and at the and sub-regional (i.e. within a province) scale. Such linkages are deemed important for a variety of reasons. In today's globalised world it has become imperative for firms to link into global supply chains that are often dominated by TNCs – access to such chains requires relationships to be built with the relevant TNCs. But such relationships are not just important in terms of access to markets, they are also critical paths through which the capabilities of developing countries to industrialise can be enhanced through technology transfer. Furthermore, simple business relationships can also be used to encourage learning and upgrading which are an essential element of competing in global and, due to trade liberalisation, also in domestic markets. Such links also make sense for the TNCs in many instances who are under increasing pressure to reduce supply costs and improve quality in their processes through better sourcing/outsourcing arrangements. Through effective management of linkages and cultivating improved relationships opportunities exist to enhance supplier relations.

Since its first democratic elections, in 1994, South Africa has moved rapidly towards increased economic integration with global economic processes. This shift from a protected economic environment, in which Apartheid policies created and entrenched race-based inequalities in opportunity, to one where international competitiveness has become *de rigueur* and government has sought to actively confront racial inequality has been a dominant theme in South Africa's first decade of democracy. During this period the government has managed a wide-ranging economic restructuring process and has identified the growing of foreign direct investment (FDI) as core to its strategy. Together with a move to facilitate greater export orientation it its policies government has also sought to encourage what it refers to as the Small, Medium and Micro Enterprise (SMME) sector through a range of supply-side type support measures. These have been matched by a series of reforms aimed at encouraging the growth of firms falling within these categories, especially historically disadvantaged black firms and emerging black entrepreneurs. With trade liberalization thrown into the mix, there have been many points at which both policy and practice has relating to TNCs and SMEs have intersected. At times these points of intersection have been the direct result of explicit programmes, whilst at other times they have been the indirect result of other initiatives.

[1] For the purposes of this study a very lose approach to defining linkages has been adopted which would incorporate both backward (sourcing of supplies) and forward linkages (with customers) as well as other spill-over type linkages as discussed in UNCTAD's 2005 report: "Improving the competitiveness of SMEs through enhancing productive capacity".

The case studies examine the commitment of large TNC firms in Richards Bay to small business development together with the example of the Durban Auto Cluster in order to provide an opportunity to describe and analyse some of this issues that have arisen in the South African context with regard to TNC-SME linkages. These issues include the role of corporate social investment (CSI), new forms of partnership and governance of co-operative processes and possible roles for different levels of government.

The report begins with an overview of the South African economic and investment context and is followed by a closer examination, in Part II, of policies and programmes of direct and indirect relevance to TNC-SME linkages and the case studies referred to above. The report concludes, in Part III, with some reflection on learning and an examination of factors which might impact on the future prospects of TNC-SME relations in South Africa.

The report has largely been the product of a desk study with access to materials gained from a range of sources including government reports and pamphlets, web sites and journals. The desk work has been supplemented by some primary research in the form of unstructured interviews and informal discussions conducted with role players from various government and business entities. The information on the Durban Auto Cluster has been obtained from a project the author has been involved in to examine case studies of inter-firm networking and cluster activities on the African continent.[2]

[2] The product of this work is to be published by UNU-Intech during the course of 2005.

PART I

Part I provides an overview of South Africa's recent economic performance and some insights into inward investment dynamics. This information will serve to assist in contextualising the discussions which follow on policy and programme related matters as well as the case studies.

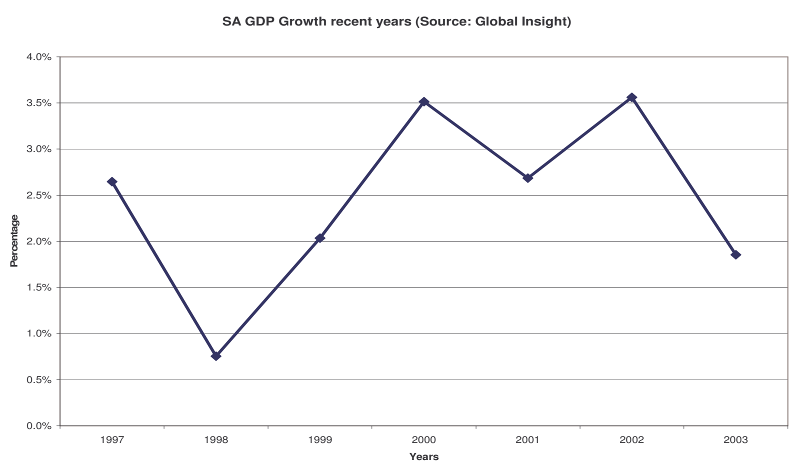
1.1 Economic profile

South Africa's economy has, in the past few years, been characterised by a great deal of stability and gradual improvement across key indicators of growth, lower inflation, rising manufactured exports and improvement in the performance on the current account. However, the country with its history of exploitation and oppression under Apartheid also continues to be characterised by deep and widespread poverty and growing levels of under and unemployment. The following discussion provides a limited descriptive and analytical insight into recent trends across these key indicators.[3]

Growth

In growth terms South Africa has had relatively stable Gross Domestic Product (GDP) growth in the past few years (see Figure 1), although this growth has been somewhat unremarkable when compared with the top developing country growth performers. This growth performance needs to be seen in the context of adjustment processes managed by government to place the management of the economy on a more sustainable footing and in a context of some global instability and relatively weak growth performance within the country's main trading partners.

Figure 1: South Africa's recent Gross Domestic Product (percentage change)

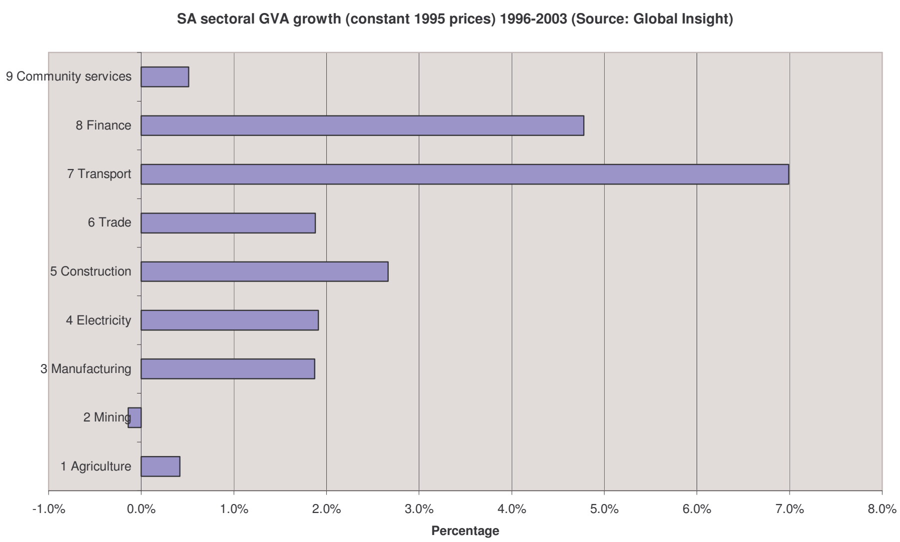


(Source: Global Insight data, 2004)

[3] For a fuller discussion on this see sources such as the 2004 UNDP South African Human Development Report (www.undp.org).

Figure 2 provides an indication of the broad sectors that have contributed to this growth performance over an extended period from 1996 to 2003. Of some significance has been the declining contribution of the mining sector, once the dominant sector in the country's traditionally primary industry focused economy[4]. Manufacturing growth performance has been positive, but has not yet shown the potential to drive growth rates at levels in excess of the GDP average. The figure also provides some evidence of the growing importance of the services sector in the economy with strong growth from financial services. The transport sector has also grown reflecting the country's relatively strong position in trade infrastructure relative to the rest of the continent. The services sector is also growing in terms of its absolute contribution to the country's economic activity.

Figure 2: South African Sectoral Gross Value Added (GVA) growth

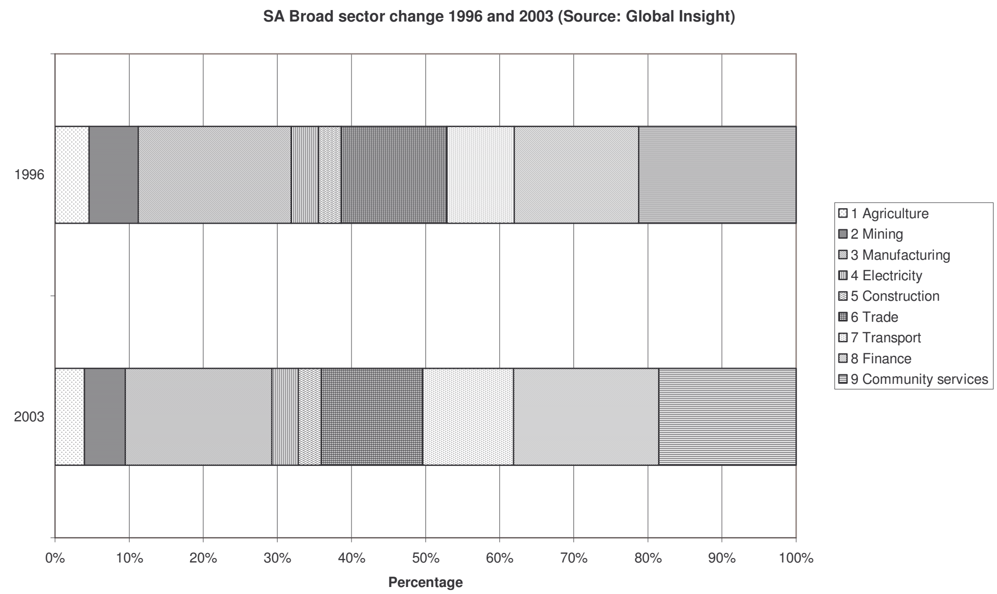


(Source: Global Insight data, 2004)

Figure 3, provides a further indication of the structural shift in the economy. The noteworthy adjustments mentioned above can be seen in terms of their changing percentage contribution to the national economy. Those sectors that have shown strong growth in the past few years have also increased their relative contribution to total economic activity. Financial services and transport have been the most significant leading many to make the case that South Africa's economy is maturing and taking on a greater services orientation.

[4] Although recent increases in minerals and metals related commodity prices has seen the sector regain some of its ground in national exports.

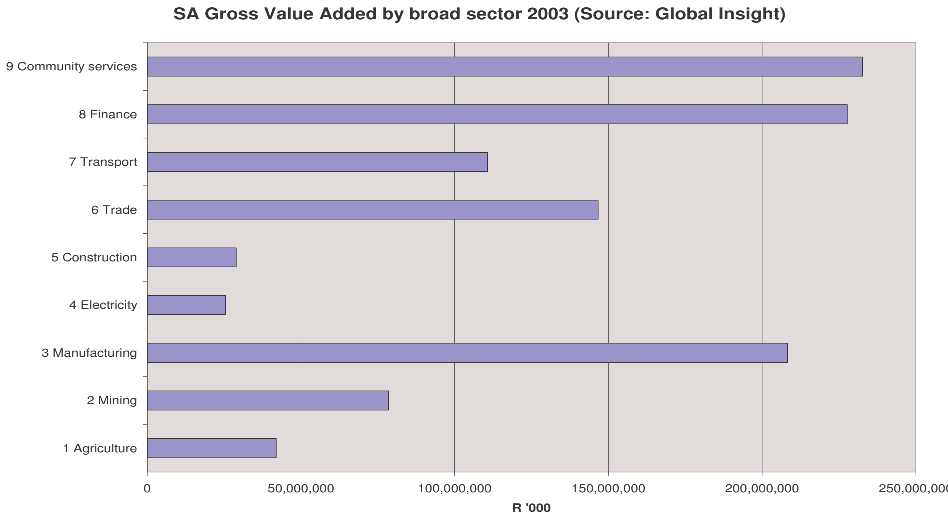
Figure 3: South African broad economic sector change



(Source: Global Insight data, 2004)

The relative contribution of the broad sectors to the country's Gross Value Added (GVA) for 2003 are detailed in Figure 4 (overleaf). The figure confirms the relative importance of manufacturing, services and government activity (largely captured under "community services") in the economy as a whole. The importance of retail and wholesale ("trade") is also noteworthy as is the transport sector incorporating a wide range of transportation related services (largely freight and storage, but this categorisation also captures telecommunications activity). South Africa is increasingly becoming a key trader, and in some cases investor, in the African continent in many of these dominant sectors. Examples include the investment being made in cellular communications infrastructure and distribution of South African fast moving consumer goods through branded South African retail channels. These significant sectors have also been of interest in terms of inward FDI to South Africa. The recent example of Barclays Plc of the United Kingdom buying a majority stake in the South African banking and financial services group, ABSA, is a sign of the interest in South Africa as a investment location, but also in terms of its potential pivotal role to access and take advantage of opportunities in the rest of continent.

Figure 4: South African Gross Value Added (GVA) by broad sector

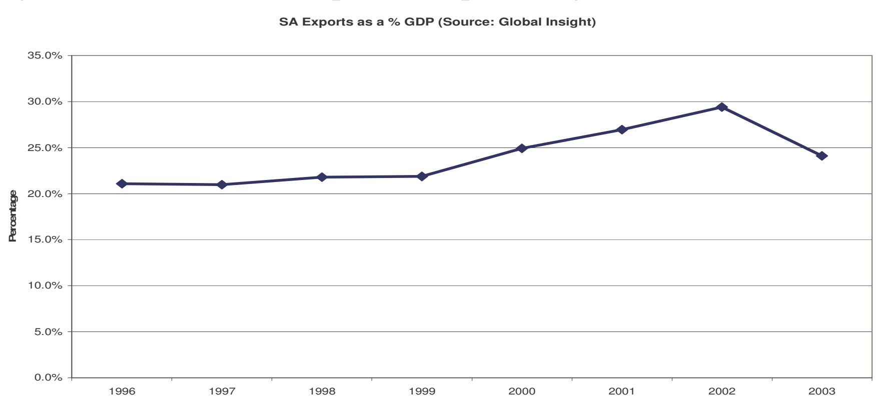


(Source: Global Insight data, 2004)

Trade and the manufacturing sector

South Africa's economic performance has also increasingly been influenced by its trade relations as it has shifted to greater integration with global economic processes and as policies towards export orientation have had some impact. Figure 5 shows the trend towards export activity being increasingly important in total economic activity. The decline in 2003 has been attributed to significant strengthening in the currency relative to that of the US$ and major trading partners and some demand uncertainty in global markets and is largely seen a temporary phenomenon. The growth in exports has seen a significant improvement in the country trade balance which has been positive for an extended period of time.

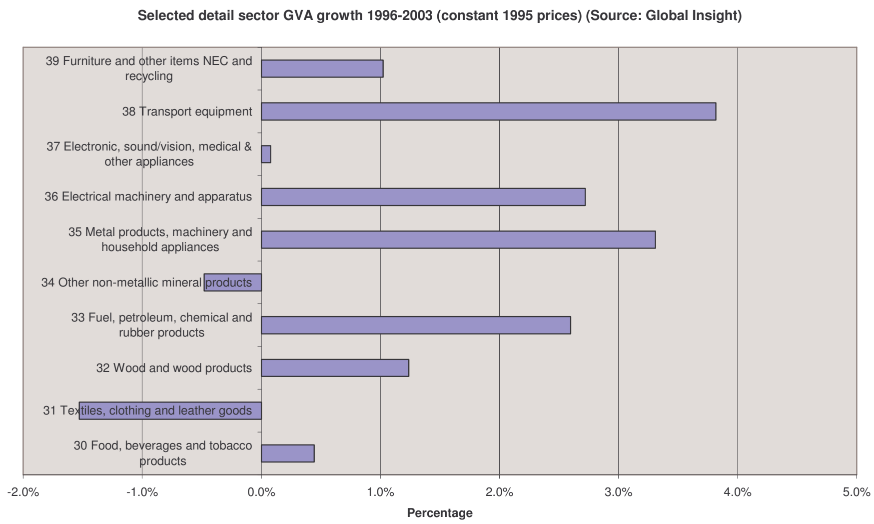
Figure 5: South African exports as a percentage of Gross Domestic Product (GDP)



(Source: Global Insight data, 2004)

In relation to export performance the main driver has been manufacturing (although services are also beginning to be of some significance). The automotive sector in particular has been a key element of South Africa's export growth performance reflected in the "transport equipment" category in the figure below (Figure 6 – growth performance of selected manufacturing sectors). South Africa also exports manufactured products such a chemical wood pulp, ferroalloys, semi-finished iron and steel products, machinery and a variety of food products (TIPS, 2004).

Figure 6: Selected South African sector Gross Value Added growth

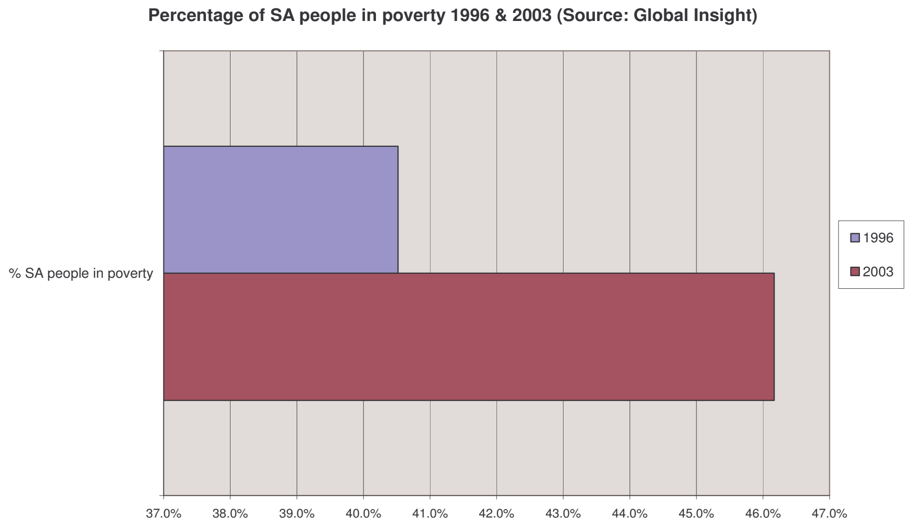


(Source: Global Insight data, 2004)

Poverty and unemployment

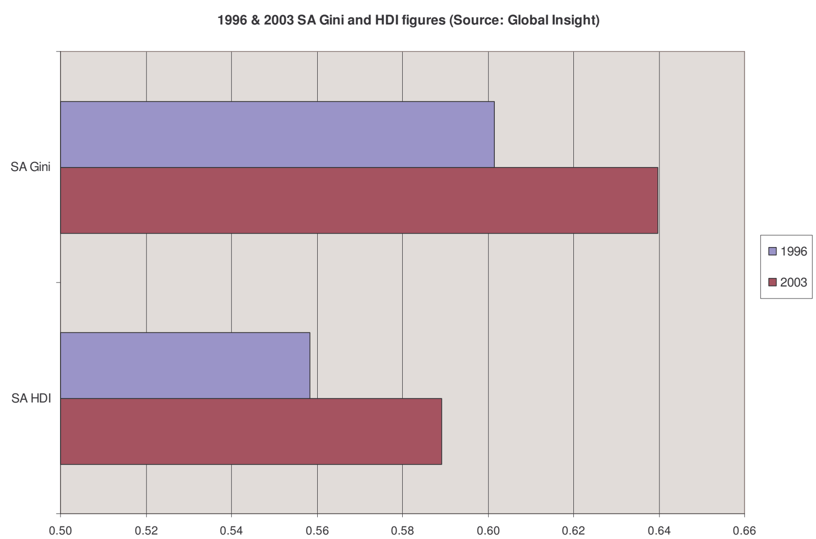
It is clear from the information presented in the discussion above that South Africa's economy has been increasingly moving to a firmer footing. However, it is also important to understand the economy and its trends from a broader perspective. As a developing country key development priorities relating to the reduction of poverty are also critical. The figure below (Figure 7) shows that the process of adjustment in the country has been characterised by some disturbing growth in the percentage of people living in poverty in the country. Figure 8, which follows, presents performance with respect to levels of inequality and the country's human development index (HDI). This shows that government's efforts to address access to basic needs and to improve health and education resources have had some impact on the human development prospects of the people. However, this improvement in the HDI has not been matched by a reduction in the country's very high level of inequality – still amongst the highest levels of inequality of any country in the world. In South African terms the government refers to the existence of a "dual economy", one growing, modern, formal and globally connected and the other informal, substance-based and trapped in poverty and under-development.

Figure 7: Percentage of South African people in poverty



(Source: Global Insight data, 2004)

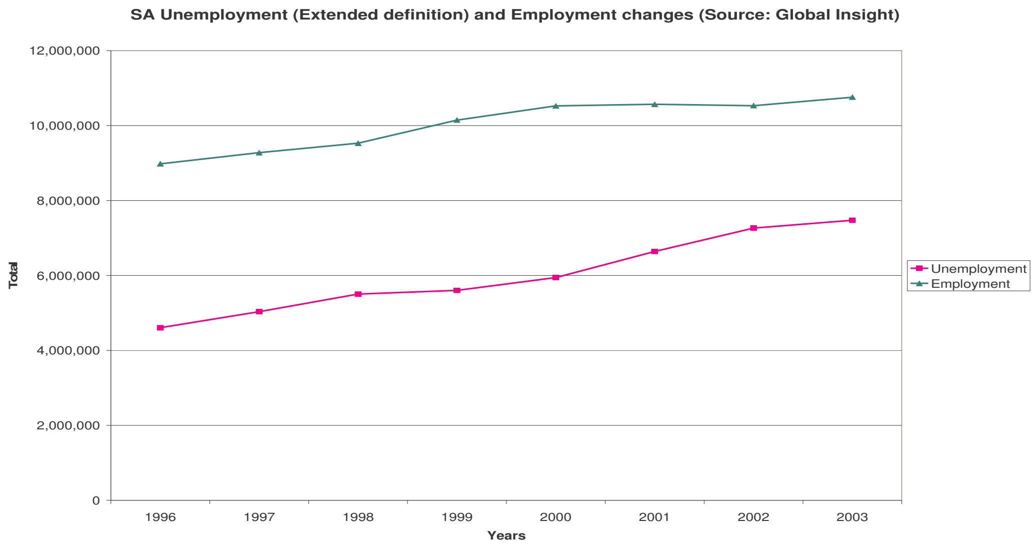
Figure 8: South African Inequality and Human Development Index (HDI) figures



(Source: Global Insight data, 2004)

These indicators need to be viewed in the context of the country's violent and destructive past. Furthermore, development prospects have been severely hampered by the challenges of HIV and AIDS. However, probably one of the most serious challenges facing the country in terms of its economic prospects is that of low growth in formal employment levels and the consequent sustained problem of unemployment. Figure 9, below, presents figures relating to the growth (using a broad definition) of unemployment. Levels of employment growth have not been at a scale sufficient to reduce unemployment let alone keep it at the already very high levels.

Figure 9: South African unemployment and employment



(Source: Global Insight data, 2004)

Investment

In looking specifically at foreign direct investment, South Africa has not featured amongst significant global recipients of global FDI flows. UNCTAD's World Investment Report Inward FDI performance index ranks South Africa below its potential at 77. This is above Australia (79) but below Malaysia (75) (www.unctad.org/wir). In US$ terms inward FDI has been relatively muted with the bulk of global FDI flows going between developed countries and between developed countries and a handful of developing countries, especially China.

Table 1 provides a US$-based summary of inward FDI into South Africa in the last few years. Whilst there have been exceptional years, the flow has been relatively constant in the past few years.

Table 1: South African Foreign Direct Investment

SA Recent inward FDI (Millions of US$)				
2000	2001	2002	2003	2004
888	6,789*	757	762	n/a

*Influenced heavily by the delisting of diamond mining giant De Beers
(Source: www.unctad.org/wir World Investment Report 2004)

According to Vickers (2002),

> "Despite sound macro-economic fundamentals, South Africa is performing rather poorly in attracting FDI, especially when compared to other emerging markets in the world economy. Its geographical anchor, Africa, also appears to be a lost cause: Africa attracted less than 1 per cent of global FDI flows in 2000, symptomatic of the highly iniquitous world economy." (Vickers, 2002: 1)

Vickers (ibid) also points out that South Africa has become an emerging role player in investment in the Sub-Saharan African region and beyond,

> "The share of South African investment in total investment into the 14-member Southern African Development Community (SADC) is significant, amounting to about 47 per cent of all deals made in the region. South African companies are also concentrated in Europe and the amount of direct investment in Oceania has increased by over 400 per cent since 1994." (Vickers, 2002; 2)

A survey carried out by the Edge Institute and University of London's Centre for New and Emerging Markets (Black and Gelb, 2004), of a sample of over 162 firms with substantial foreign business connections operating in South Africa, provided some interesting insights into some of the dynamics of FDI into South Africa. Eighty seven percent of the firms had parent firms from developed economies, dominated by the European region and followed by North America with the third largest grouping from East Asia (Black and Gelb, 2004: p183). In sectoral terms there were significant concentrations in Financial and Business Services (33), Machinery and Equipment (31), Intermediate goods (27), Basic consumer goods (21) and Infrastructure and construction (19) (Ibid, p183). The importance of the South African operations to the global business of the parent companies ranges from sector to sector (for example very limited in Financial and business services). The size of the South African operations also varies by sector with a dominant sector such as Financial and business services generally having small-sized local affiliates. The Egde/CNEM survey (Black and Gelb) also provides some very interesting insights into factors influencing investment choices in the target country. Key at a sector level are managerial capabilities together with established brands and appropriate technology.

Taking into account that South Africa's FDI to date has been dominated, in value terms, by major capital investments in large capital intensive businesses, it is interesting to note, from the Edge/CNEM survey that the primary sector with only 5 firms in the sample has almost double the median capital stock compared to the next largest medium stock level in trade, tourism and recreation. The primary sector in the sample has a median number of workers of 1500, giving further indication of the large size of the local firms held by foreign owned business.

The analysis of the Edge/CNEM survey by Black and Gelb (2004) also concludes that the majority of firms have entered into South Africa for market access rather than efficiency seeking reasons. This clearly has an influence on how parent companies might interact with local operations and partners. Only 15% of the firms in the sample had sales in global markets (these included the majority of primary firms in the sample). Where some increases in global sales from local partners and operations (other than the primary sector) were observed, such as in consumer goods, it is suggested by the authors, that this might have more to do with South Africa's currency depreciation rather than a long term efficiency seeking quest.

In summary, Black and Gelb argue that,

"The majority of new foreign investors entering South Africa during the 1990s established small or medium size affiliates with limited impact on employment creation or capital inflows. Nearly half the entries involved acquisitions of existing operations, rather than greenfields or JVs setting up new enterprises. Many investors mitigated risk by limiting the irreversibility of their investment, by outsourcing production and focusing on services. … The survey suggest (*sic*) that South Africa is not yet deeply integrated into global production processes, at least not on the basis of equity linkages with foreign companies. Although a large share of total sales of foreign affiliates is exported to global markets, this involves a small number of firms. Most affiliates are not exporting substantial shares of their output to global markets or to other affiliates of their parent company." (Black and Gelb, 2004: p210-211)

Small business activity

Little information is available on the nature of the contribution of the small business sector to the economy. South Africa last conducted a manufacturing census in 1996 and data from other surveys is limited. The table below (Table 2) Berry et al (2002), summarises the conclusions of various sources on the presence of SMMEs in the economy.

Table 2: Different indicators for the size of the SME sector

Source	Survivalist	Micro	Very small	Small	Medium	Large	Total
Ntsika, 1999	184,400	466,100	180,000	58,900	11,322	6,017	906,739
Stats SA/Ntsika, 2000	1,138,854		330,271	94,804	52,620	12,249	1,628,797
Business Partners	2,300,000		600,000		35,000	n/a	2,900,000
Management Sciences Group Survey, 1999	862,580	960,740	445,880				2,300,000
Eskom survey, 1999	900,000					n/a	3,000,000
Global Entrepreneurship Monitor, SA, 2001	730,000 – 1,150,000	1,709,142					2,440,000

(Source: Berry et al, 2002: 13)

Table 3 presents, according to Ntsika surveys (cited in Berry et al, 2002) the distribution of enterprises in South Africa across sectors.

Table 3: Sectoral distribution of South Africa's enterprises

Sector	Year 2000 distribution	Year 2000 Percentage
Agriculture and forestry	204,429	12.6
Manufacturing	163,343	10.0
Construction	147,830	9.1
Trade, repairs, hotels and restaurants	699,106	43.0
Transport, storage and communications	85,360	5.2
Financial and business services	111,996	6.9
Social and personal services	179,837	11.1
Total	906,690	100

(Note: The authors advise considerable caution when using these estimates)
(Source: Berry et al, 2002)

A range of surveys have tried to estimate the contribution of SMMEs to South Africa's economy both in employment and in terms of contribution to GDP. According to Ntsika Enterprise Promotion Agency (2000 cited in Berry et al, 2002: 21) small businesses contributed 13.9% and medium businesses 15.1% to South Africa's GDP. Berry et al (2002) refers to work by Abedian (2000) in presenting estimates on the contribution of SMEs by various sectors to gross fixed capital formation. Of significance in these estimates is that SMEs contribute 40% to manufacturing's contribution to GDFI [Gross Domestic Fixed Investment], (GDFI – also referred to as gross Fixed Capital Formation), 20% to transport and 20% to finance (Berry et al, 2002: 22).

Of particular interest form the Edge/CNEM (Black and Gelb, 2004) survey is that the mode of entry by employment size category as presented in the table below (Table 4). In the 10-50 firms size class Greenfield investment was the preferred mode followed by joint ventures. The dominance of greenfield projects is also repeated in the 51-100 size class followed by acquisitions. In the 101-250 class acquisitions dominate. Although only implied in the paper the larger the required labour force of any operations the greater the influence on the mode of entry is likely to be with risk-reducing partnerships becoming more important as employment size increases. The authors argue that,

> "More recently, mergers and acquisitions have become common options for developed country firms entering other *developed* countries, as firms attempt to leverage their existing strengths by integrating successful foreign firms into their operations. In many emerging economies, incomplete domestic markets for essential resources and high transaction costs may push foreign firms to source location-specific resources by linking with a local partner, either via acquisition or JV." (Black and Gelb, 2004: p189)

Table 4: Distribution by entry mode by affiliate size in 2000, South Africa (% of employment category)

Employees	Greenfield	Acquisition	Joint Venture	Partial Acquisition	No.of firms
10 - 50	38	22	31	9	55
51 - 100	43	27	10	20	30
101 - 250	20	50	23	7	30
251 - 1000	29	39	21	11	28
More than 1000	0	27	27	47	15
All Sizes	30	32	23	15	
No. of firms	48	50	37	23	158

(Source: Reproduced from Black and Gelb, 2004: p185)

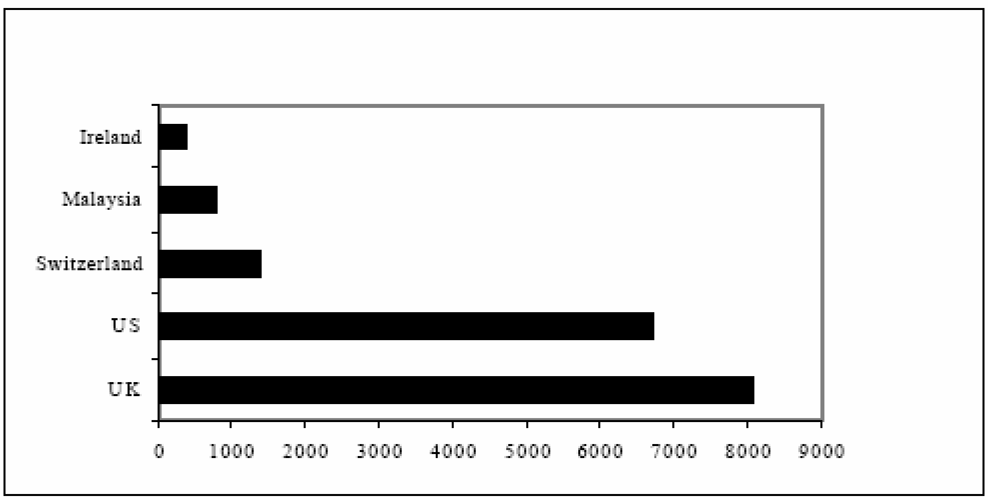
1.2 Investor profile

According to Vickers (2002), the following countries are responsible for the bulk of FDI into South Africa:

- USA
- UK
- Australia
- Germany
- Japan
- Malaysia
- Switzerland
- China
- Canada

The following figure (Figure 10) provides a record of FDI inflows in Rand terms in 1999 and shows the dominance in value terms of investment from the UK and USA.

Figure 10: FDI in South Africa by Country Source, 1999, R millions



(Source: Reproduced from TIPS, 2000: 105)

In some cases it has been a few large deals which dominate the investment (eg Malaysia), whilst in others it has been a host of smaller investments (eg China). In value terms the FDI has been focused largely on what Vickers (2002) describes as natural resource-seeking and market-seeking FDI. These have included investments in oil and energy, food and beverages and telecommunications. More recently there is some growth of investment in financial and business services. The example of Barclays Plc has been cited already (buying ABSA Bank) and there is also a growing number of cases of business process outsourcing investments (Lufthansa Call Centre and a number of US and UK financial services groups). However, four sectors have dominated in the past few years: energy and oil; automotive; food and beverages; and hotels, leisure and gaming (Vickers, 2002: 1). Inward FDI focused on the export sector has not been significant apart from the case of the automotive sector.

According to Vickers (2003), this investment has largely taken the form of mergers and acquisitions, with a significant proportion of these deals being through state initiated privatisation actions. Greenfield investments in previously un-developed sectors of activity have been rare. Vickers (ibid) argues that in some cases the FDI has had a crowding out effect of domestic investment in sectors including dairy, pharmaceuticals, steel, electric and electronic sectors. Vickers concludes that,

> "Most FDI into South Africa is capital-intensive and goes to already established service sectors and new manufacturing sectors." (Vickers, 2002: 1)

The Trade and Industry Policy Secretariat or TIPS (2000) report draws on a range of material to present a table (below, Table 5) which gives an indication of the ratio between Gross Domestic Fixed Investment (GDFI) and FDI in some selected sectors for the year 1998. It is interesting to note that aside from food and beverages many of the sectors that secured significant FDI were capital intensive and that there is a strong correlation with those sectors showing some growth. It is important to note that the information in this table should be treated with some caution in that sources used are not entirely compatible (see for instance the cases where FDI exceeds GDFI – due to the fact that FDI figures used incorporate a full cost to investor and therefore would include transaction and service costs etc).

Table 5: Sectoral Foreign Direct Investment compared to Gross Domestic Fixed Investment (1998, R million current prices)

Sector	**FDI**	**GDFI**	**FDI/GDFI**	**GDFI sector descriptions**
Other Manufacturing	2,608	949	274.8%	Machinery, Electrical machinery, TV, radio etc, Professional and Scientific Equipment
Metal Products and Minerals Beneficiation	2,704	8,489	31.9%	Basic Iron and Steel. Non-Ferrous metals and metals products
Hotel, Leisure and Gaming	2,936	6,984	42.0%	Catering and accommodation
Chemicals, Plastics and Rubber	3,498	4,470	78.2%	Basic and other chemicals, rubber and plastic products
Mining and Quarrying	3,959	11,776	33.6%	Coal mining, gold mining and other mining
Transport and Equipment	4,539	15,015	30.2%	Investment in transport equipment by transport and communication sector and total investment by the transport equipment sector
Motor Vehicles and Components	5,536	1,938	285.7%	Motor vehicles and components
Food, Beverages and Tobacco	5,642	4,793	117.7%	Foods, beverages and tobacco
Energy and Oil	8,517	8,850	96.2%	Coke and petroleum refineries, Electricity and water supply
Telecommunications and IT	8,768	9,561	91.7%	Total investment by the transport and communication sector less investment in transport equipment
TOTAL	48,706*	73,991**	65.8%	

* & ** Totals presented here are taken form the original source and differ slightly form the sum of the columns. This could be due to rounding off of figures in the original report.

(Source: reproduced from TIPS, 2000: 106)

In assessing the reasons for this performance it is worth noting that South Africa's rating in the World Competitiveness Report 2005 (IMD, 2005), South Africa has moved up from 49th position to 46th and has had positive ratings related to its infrastructure, levels of governance and general macro-economic management. Vickers (2002, 2003) presents some factors which he believes have contributed to a sub-optimal showing for South Africa in foreign direct investment stakes:

- Relative size of market – both SA of 44m and SADC of 190m have relatively small markets compounded by low levels of per-capita income;
- Low levels of domestic growth and low levels of domestic GDFI
- "Emerging" market contagion
- Crime
- Availability of skills and complexity of immigration systems
- Relatively high cost of capital
- Inflexibility of labour regime
- Regulatory uncertainty e.g. telecoms
- Poor levels of domestic confidence
- Ability to finance major projects locally.

PART II

This section provides an overview and assessment of the South African government's approach to support measures with a specific focus on those elements that are geared towards improving TNCs and SMEs. Included in Part II are two case studies covering issues related to business linkage formation.

2.1 The South African government's approach to support measures

South Africa's first democratic elections in 1994 heralded a comprehensive re-alignment of policy frameworks in support of efforts to reposition the country's economy away from the import-substitution industrialisation focus of the past to an export oriented economy. A raft of measures, that had for many years operated in support of the Apartheid policies of the pre-1994 government were removed, – many of them identified not only in terms of their historic role in entrenching racial inequality, but also as having distorting effects on economic outcomes.

The approach in industrial policy terms was subsequently confirmed in the Growth, Employment and Redistribution (GEAR) framework that has guided economic policy direction in the country since its approval by cabinet in 1996. GEAR, as it became known, proposed that the country follow prudent macro-economic policies with a strong monetary policy focus on reducing inflation and support by fiscal restraint. This relatively orthodox approach was complemented by a commitment to economic openness including reduction in exchange rate intervention, a commitment to the liberalisation agenda articulated in the Uruguay Round of the General Agreement of Trade and Tariffs (GATT) and ongoing elimination of industrial policy interventions deemed to have an anti-export bias.

> "The logic of this was to force domestic industry to sharpen its competitiveness and to reduce the cost of inputs for user-industries. Insofar as export subsidies were concerned, these were removed since they were very costly (the value of subsidies were approximately 0.5 percent of GDP at their high point in the mid 1990s), were subject to growing corruption, and were anyway becoming GATT-illegal." (Barnes et al, 2003: 4)

Taken together, these adjustments were expected to allow for increased macro-economic stability, promote growth, employment and encourage foreign direct investment seen to be so crucial in raising investment levels in a context of relatively low levels of domestic savings. However, as Barnes et al (2003) point out that,

> "the revision of these demand-side measures did not signify a withdrawal of the government from industrial policy. From the early 1990s, the government-in-waiting had begun a process of enquiry which ultimately resulted in a new industrial strategy. The upshot of this programme was a series of "supply-sided measures[5]" designed to promote the adoption of world class manufacturing capabilities." (Barnes et al, 2003: 4)

[5] These measures included: the promotion of technological capabilities through R&D subsidies – the THRIP programme; support to firms aiming at the adoption of World Class Manufacturing through the the

In addition to these policy framework adjustments, government (in the form of the Department of Trade and Industry), made a public a commitment to support the development of the Small, Medium and Micro Enterprise Sector (SMMEs).[6] This policy statement took the form of the publication of a White Paper on SMMEs that had been finalised after a series of National and Provincial President's Conferences on SMMEs. The White Paper argued that the presence of SMMEs in the economy had been undermined through the economic exclusion policies of Apartheid and biases in national programmes to large, often capital intensive, economic activities. In stark contrast to these past policies the government articulated a need to encourage small business development and enhance prospects for small business formation and survival. This was seen to have multiple benefits in terms of improving the competitiveness of the economy, raising levels of employment at a rate the larger enterprises would not be able to match and empowering entrepreneurs to generate an income in a context of severe poverty.

The White Paper proposed a number of measures to develop the SMME sector in the country. These included the rolling out of a network of support institutions at the local level that would provide SMMEs with access to business development support and an intervention to address problems such businesses were encountering in accessing capital through the financial markets. The White Paper also encouraged government to adjust its procurement activities to enable small businesses to access opportunity. Particular stress was placed on those businesses managed and owned by formally disadvantaged members of the black community, as well as those owned and managed by women and the disabled.

The initiatives around the White Paper were further supported through a commitment to encourage sensitivity towards, and opportunity for, SMMEs in trade negotiations, the application of competition policies and in processes to support SMMEs in accessing new markets through programmes such as the Export Marketing Assistance programme which offered higher levels of support to small and medium businesses wishing to test demand for their products in potential export markets. Although not initially a product of the White Paper itself, government later converted the Department of Trade and Industry's (DTI) small business desk into the Ntsika National Enterprise Promotion Agency – with a direct reporting path to the DTI, but operating under its own Board representative of small business interests. It was Ntsika that began to take on the responsibility for driving policy with regard to SMMEs and to provide backing for the network of business support agencies being rolled out in towns and cities across the country (known as Local Business Support Centres or LBSCs).

Competitiveness Fund; support to firms working to achieve collective efficiency in the form of the Sector Partnership Fund; programmes to assist in the adoption of new progressive labour processes – The Workplace Challenge; and schemes to promote industrial training – Skills Support Programme, subsidised apprenticeships and learnerships. (Barnes et al, 2003: 4)

[6] Policy in South Africa has tended to use the term Small, Medium and Micro Enterprises as opposed to the internationally preferred Small and Medium Enterprises (SME) term.

The DTI also took a close look at policies to attract FDI. This was given considerable emphasis in DTI activities and government took a close look the experiences of countries such as Ireland, Singapore and Malaysia in designing its approach. This led to the formation of Trade and Investment South Africa (TISA) as an agency for the promotion of trade with and investment into South Africa.[7] It was within TISA's mandate to work with existing and potential investors to encourage linkages with SMMEs although this was not seen as a priority in day-to-day activities. TISA was also tasked, through its trade development function, with assisting SMMEs in finding potential export markets for their product and often worked to do this through seeking to establish linkages with larger foreign-based firms. This was co-ordinated, to some degree, with Ntsika who often played the role of a conduit of small business requests relating to export markets and trading partners or who could supply TISA with some information on possible business partners to new investors in the country. It appears that this interaction ranged form the formal in terms of joint teams to more informal links based on contacts between staff members. The interaction was not in all instances consistent, and despite changes in the institutions it seems some of this lack of consistency has remained. This has not been helped by almost continuous institutional change and a high turn-over of staff. TISA also played a supporting role to the DTI in processes aimed at trying to maximise the benefits to SMMEs from the sale of state assets in the privatisation programme and in attempting to find partners in industrial participation and military purchase off-set arrangements.[8]

Beyond these interventions, the government has also sought to promote reforms of other factors contributing to the investment environment in South Africa. These have taken the form of a range of interventions from policy adjustment to confidence building measures. Vickers (2003) provides a useful summary of the main aspects underpinning this reform process.

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[7] TISA was originally managed under the framework of the Industrial Development Corporation – a parastatal financing institution reporting to the DTI, but has subsequently been incorporated under the DTI in a direct reporting relationship.

[8] Industrial participation arrangements were negotiated with major offshore suppliers to the state sector and with some other investors and involved securing a commitment by them to develop relationships with local partners, suppliers and distributors. The off-set arrangements were similar in nature, but focused on military procurement contracts where it became a requirement of the purchase contract that a portion of value-added activity would be outsourced to South African partner firms.

Table 6: Investment Climate Reform in South Africa

Investment Climate Reform in South Africa

Economic Policy Instruments	Components
1. Macro-economic policy: • **Reconstruction and Development Programme (RDP)** • **Growth, Employment and Redistribution Strategy (GEAR)** • **Micro-economic Reform Programme** • **Integrated Manufacturing Strategy**	• Economic environment • Fiscal policy • Monetary policy • Restructuring / Privatization • Deregulation, improved regulatory quality • Trade and industrial policy • Competition policy • Labour market • Best practice corporate governance • Security of property and contractual rights • Black Economic Empowerment (BEE)
2. Incentives, industrial support and supply-side measures	• Financial and fiscal • Spatial interventions (SDIs, IDZs) • Public-Private Partnerships (PPPs) • Infrastructure • Skills, training and education • Other
3. Voluntary and Obligatory Performance Requirements (PRs)	• Export PRs • Technology transfer PRs • Research and development PRs • Employment and training PRs • Joint venture or domestic equity PRs
4. Bilateral and multilateral legal instruments	• Bilateral Investment Treaties • Avoidance of Double Taxation Treaties • WTO: TRIPS, TRIMS, GATS
5. Investment facilitation and promotion	• Trade and Investment SA (DTI TISA) • Provincial investment promotion agencies • International Marketing Council • Presidential Working Groups: *Trade Unions, Big Business, Black Business, Commercial Agriculture.* ▪ Presidential International Advisory Structures: *International Investment Council, International Task Force on Information Society and Development.*
7. Socio-political context, governance and institutions	

(Source: Reproduced from Vickers, (2003), p7)

It is noteworthy that government recognised the range of factors which could have an impact on FDI, and has sought to identify a range of measures to address these. In recent times, after a period of focus on ensuring macro-economic stability, more effort has been directed to the building of relationships and a profile for South Africa through structures such as the Presidential Investment Council. This Council is made up of key global business leaders (including some South Africans) and has as its purpose advising the President on matters relating to improving the investment environment in the Country and is supported by the International Marketing Council which seeks to improve awareness of the Country globally.

In the late 1990s, the government began to take a much closer look at what has been termed Black Economic Empowerment (BEE). Influenced in part by the Malaysian Bumiputra experience, the government sought to address severe inequalities in business ownership and management to a variety of measures. Whilst the initial focus was on public procurement reform and encouraging so-called BEE deals in the corporate sector, the report of the Broad-based Black Economic Empowerment Commission led to a more programmatic and more prescriptive approach as it was felt the pace of BEE had been too slow and in many cases had only benefited a narrow band of emerging black capitalists. The key feature of the Commission's report was that all industry sectors should adopt an "Empowerment Charter" and utilise a common framework and set of guidelines and definitions to do so. The past few years have witnessed major industry players seeking to negotiate such "Charters" in sectors as diverse as agriculture and agro-processing, mining, financial services and information technology. The widespread presence of TNCs in the South African economic make-up has seen many of them being active participants in such processes and beginning to make time-bound commitments to address issues including the shareholding of local operations, representation at management and technical levels and relationships with suppliers and distributors. Some aspects of legislation such as that relating to workplace equity programmes has reinforced these commitments with government taking the view that it will only intervene in those sectors where Cabinet feels inadequate commitments and/or progress relating such commitments causes concern.

The Charters, although their focus is not necessarily on TNC-SME linkage creation as such, are an interesting tool in that that have had, and are likely to have impacts on TNC-SME linkages through their direct and indirect effects. As the Charters are still relatively new, no comprehensive analysis has been conducted of their impact, but there is considerable evidence of a renewed thrust by firms to ensure their ownership profile changes and that they publicly commit to a series of other empowerment-related endeavours such as appointing new management, embracing employee share ownership schemes and increasing procurement from firms that are themselves "empowered" in one way or another. For example, as a result of the charter-related processes, companies such as Microsoft seeking to increase the number of black-owned and managed service providers and retailers of its products. Microsoft's web site proclaims that,

> "For Microsoft South Africa empowerment isn't just about doing the right thing; it is good business practice…Microsoft South Africa has been an early advocate for the need for transformation within the ICT industry. By playing an active role in the development of the ICT Charter the company believes that it can help bring the benefits of information technology to all individuals and communities within South Africa." (http://www.microsoft.com/southafrica/corp/aboutmssa.mspx)

The overall effectiveness of these interventions has been mixed. In broad policy terms it is often difficult to determine which variables might have had a determining impact on eventual outcomes. Many observers have criticised GEAR and its associated policies as having failed to generate either sufficient growth or employment and furthermore that redistributive elements of government programmes have been slow to get of the ground.[9] However, the stability in macro-economic fundamentals resulting from the policy framework has only been matched by a handful of other countries in the developing world – a fact made even more remarkable in a context of considerable global instability

[9] According to Padayachee and Valodia, GEAR was largely successful in reducing the government's budget deficit and in meeting inflation targets, but it failed to meet targets on growth and employment (Padayachee and Valodia, 2001).

heralded initially by the Asian financial crisis of 1997. Inflation has systematically been targeted as was proposed and now stands close to the six percent target set by the South African Reserve Bank. The government deficit stands close to Organisation of Economic Cooperation and Development (OECD) standards (three to four percent range) and the currency is being let to find its own level in international markets. Some would argue that these identified policy outputs from the GEAR framework were never likely to generate levels of GDP growth and employment creation originally envisaged. However, it is worth noting that levels of global uncertainty in the past decade as well as considerable periods of unremarkable levels of economic growth in South Africa's main trading partners would have clearly impacted on growth and employment creation in a context of a policy engineered to try and take advantage of increased economic integration with global economic processes.

In more specific terms, programmes oriented to increase FDI had some erratic impacts in the past decade. In the main, major investments in fixed investment terms have been generated through sales of state interests in public enterprises and through a handful of large private investments (often where the state also played some role, either through granting of investment concessions such as that related to major aluminium investments or through a risk-sharing shareholding through the Industrial Development Corporation). In more recent times a number of large deals in the telecommunications and financial services sectors have also featured. The other main source of FDI was that related to the automotive sector and their significant investments to take advantage of the Motor Industry Development Programme. During this period the macro-economic management framework also attracted a mix of short and longer term capital inflows when the combination of global and local considerations made returns attractive.

However, the combination of relatively subdued levels of growth and domestic savings and related fixed investments did not secure the scale of FDI that was originally expected under GEAR. Government also slowed down the programmed sales of state assets as concerns had been raised by unions and other stakeholders that such activities had been counterproductive in terms of employment creation and had not in all instances released productive capacity and yielded performance improvements that those in favour of privatisation has envisaged. In the past two fiscal years government has committed to raise its contribution to gross domestic fixed investment by marginally raising the deficit cap and through taking advantage of more effective revenue collection processes.

With regard to SMME programmes the impact of government programmes has also been rather mixed. This has been reflected in part by the ongoing changes in institutional formations and mandates that have had explicit responsibility for this arena of work. However, it has also been pointed out by some analysts that small business growth (growing registrations of businesses and improved survival rates as well as the proportion of total GDP attributable to small business operations) has been hampered by low levels of GDP growth, the relatively high cost of capital and comparatively high levels of regulation (Berry et al, 2002). It could also be argued that the impacts of many government programmes will take a number of years to work themselves into changing patterns of entrepreneurial activity. For instance, reducing the labour legislation obligations of smaller firms and supporting their research and development capabilities might have a delayed impact on performance and new business formation rather than an immediate one as was originally expected. Some evidence form the developed world shows that consistent quality attention to issues of relevance to smaller businesses does yield results, but that in an environment where there is not a great deal of certainty that initiatives will be sustained entrepreneurial behaviour can often be very sensitive to risks of shifting government interest.

However, despite the reservations about the effectiveness of some aspects of policy and the resulting programmes, there remains consensus that a good deal of progress has been made in South African industrial and business support related policies and programmes. It is worth noting that in this period the country has moved from an economy dominated by unprocessed mineral exports to a country whose exports are dominated by a wide range of manufactured goods. There has also been a growing consensus between the government and private sector role players about the necessity to work to improve the prospects of small and medium firms, not only to improve the distributional performance of the economy, but also because they are seen to be central to the systemic competitiveness of the economy as a whole.

2.2 Policies, linkage promotion programmes and institutional implications

In supporting the development of the SME sector and in attracting FDI government has drawn on a variety of measures. These are discussed as specific interventions in this section. With regard to small business promotion, following the publication of the White Paper on Small Business Development in 1995, government introduced the Small Business Promotion Act to give some statutory grounding to its activities and the related institutional formations. A DTI Centre for Small Business Promotion (later Ntsika) was created to help drive the national programmes around small and medium business (although the overriding focus was on smaller businesses in the first instance). Whilst the institutional formations have shifted overtime, there has been a steady growth in the complexity and scale of government's small business development agenda. Activities undertaken in this field have included:

- *New investment grants for small and medium new investors in manufacturing and tourism establishments* – mainly through the Small and Medium Enterprise Development Programme. This involved a matching or partial cash grant for a new capital investment in a new enterprise or significant new investments. Applications are approved through the Manufacturing Development Board of the DTI. A range of qualifying criteria guide the decisions including that firms have less the R100 million in maximum qualifying assets.

- *Export Marketing and Investment Assistance* – a scheme by which small and medium business owners could apply for refunds of costs incurred in undertaking a trip to another country to assess export opportunities to such countries. The various aspects of the programme such as the export marketing research scheme, the sector specific assistance, outward selling trade mission scheme and inward buying trade mission scheme all have particular categories of additional support for SMEs that might wish to participate. It is also noteworthy that this programme has within it a foreign direct investment research scheme in support of local firms seeking to encourage foreign direct investors to participate in local opportunities.

- *Local Businesses Service Centres* – these were established in towns and cities with some DTI support to provide an access point for basic business advice for small businesses. This was subsequently enhanced through the launching of BRAIN (Business Referral Advice and Information Network) with an elevated set of services to what had characterised the Local Business Service Centres (LBSCs) originally and to improve the interconnectedness between such service providers. Subsequently government established FRAIN (Franchise Advice and Information Network) with the express role of popularising franchise-related business opportunities and assisting new entrants into this business arena. In both instances the national role players liaised with existing and potential foreign investors with regard to facilitating business linkages.

- *The Manufacturing Advisory Programme* saw the DTI and some of its institutional partners initiate the formation of a number of regional Manufacturing Advisory Centres (MACs) aimed at providing accessible links to relevant consulting services normally not available to small and medium firms. In some cases the Manufacturing Advisory Centre support activities did identify the formation of linkages between a particular local SME and a TNC with or without a presence in South Africa would be of benefit. This could have, for instance, involved providing guidance in for a local SME in accessing licensed technology for its production processes.

- *Incubators and mentorship* have also featured in the array of DTI activities focused on SMEs. The mentorship approach has been regularly adopted by the Manufacturing Advisory Centres and the Local Business Service Centres in their activities and the DTI has sought to encourage this. With regard to incubators the DTI has focused on supporting a number of technology related incubator-type facilities in the regions such as the Bandwidth Barn in Cape Town and SmartXchange in Durban. As with the LBSCs and the MACs the DTI has worked with local institutions and role players in the formation of such entities with the aim that services could be provided to emerging technology-related businesses at a common site and that the incubators could also facilitate linkages with larger businesses and potential customers. A number of the large TNC technology-related businesses have been active in the work of these incubators including Siemens and Microsoft with the duel interest of opening up new channels for their products and fulfilling their corporate social investment goals.

- *Khula wholesale finance support scheme* – this programme and the related institution sought to provide guarantee support to enable financial institutions to more readily make loans available to small and emerging businesses.

- *Broad-based black economic empowerment* – this initiative by the DTI has required that many of the existing support schemes make provision for BEE-qualifying businesses (see www.thedti.gov.za/bee/) to be made more accessible to such businesses. However, this is also to be matched by some new programmes being rolled out at present, including a grant programme for Black-owned Small and Medium Enterprises. The DTI also offers a Black Business Supplier Development Programme (BBSDP) cash grant scheme on an 80:20 basis to qualifying small and medium black owned or managed firms to enable them to access business development services to assist in them meeting the requirements of becoming industry approved suppliers. According to the DTI's 2003/2004 Annual Report (2004), the BBSDP programme assisted 259 enterprises in its first year of existence to access public and private sector tender opportunities. Figures for the next financial year have not been made available and no information on the financial value of the tenders or the success or otherwise of the support has been published.

- *Market Access and Business Linkages (MBL Programme)* – The MBL division of Ntsika sought to support business linkage formation with small business regardless of whether such linkages would be domestic or international. Funding for the programme came largely form the European Union (R50 million over a four year period). The key conduit for such support was through tender advice centres located primarily in the Local Business Service Centres (see above). Former staff working on the programme report that linkages in value excess of R100m a year were achieved through this initiative. The programme, despite its relative success, came to an end in March 2004. Consideration had been given to TISA sustaining aspects of the programme, but this was never finalised although the SEDA network being rolled out in the country at the time of preparing this report would have this as one of its mandates.

In the field of activities more directly relevant to FDI support and in support of promoting linkages from FDI the DTI also made available a range of programmes. These included:

- *National industrial participation programme* – Where government procurement contracts involved more that US$10 million in imports a requirement existed that suppliers built links with local businesses – in particular SMEs – to transfer technology and skills and to build global linkages for such locally based firms. The DTI would be notified of such potential procurement contracts and allocate staff to work on facilitating the necessary commitments (this is distinct from military off-sets referred to previously).

- *Spatial Development Initiatives* – in the mid 1990s the government adopted an approach at a national level which moved from the assumption that a handful of specialised spatially-focused investment initiatives (called Spatial Development Initiatives or SDIs) were necessary to build investment confidence, focus government attention and unblock obstacles (largely seen to be infrastructure related) to new investment. These involved the creation of specialist teams to develop a programme of activities and investment by the different spheres of government in order to leverage opportunity identified in a series of investment demand studies. Although variable in structure and focus, the SDIs – as interim institutional arrangements – did give some attention, when dealing with TNCs, to building linkages with local SMEs (as the case study on Richards Bay illustrates).

- *Industrial Development Zones* – the DTI also responded to global trends in seeking to establish a number of Industrial Development Zones (IDZs, as they are called, are a South African variant of Export Processing Zones or EPZs). These would provide a world-class manufacturing environment adjacent to a major port or airport where firms could process imported raw materials and intermediate goods duty free for export. To date progress has been made on four IDZ (East London, Richards Bay, Johannesburg International Airport and the new port of Coega near Port Elizabeth). Although none of these is fully functioning as of yet they have all been envisaged as having an institutional foundation to encourage linkages between IDZ-based firms and those potential suppliers located outside the designated IDZ area.

- *The Small and Medium Enterprise Development Programme* – has been discussed above under the small business support category.

- *Foreign Investment Grant* – This grant has been aimed at encouraging relocations of plants to South Africa and attracting new investments. The grant covers equipment and management relocation costs and is seen to be justified in that it encourages the transfer of technology to the country.

- *Productive Asset Allowance* – focused specifically on the auto sector to assist in the initiative to reduce the range of models being produced domestically by enabling firms to use credits earned through exports to offset duties on imports of fully built up vehicles (as key element of the Motor Industry Development Programme (MIDP) to be discussed later).

- *Strategic Investment Programme* – In very special cases the DTI has considered together with the Treasury providing other incentives to major investors whose activities are likely to have a lasting positive impact on the economy (for example through boosting foreign exchange earnings by increasing exports).

- *Critical Infrastructure Programme* – this grant can be accessed largely by local government in support of making infrastructure investment deemed necessary to enable a significant new investment to proceed.

Nearly all of the programmes referred to above reflect an intention that they leverage benefit for local SMEs in one way or another. In discussions with DTI staff, it was confirmed that while this is not always an explicit requirement for individual programmes, it forms a key aspect of discussions between the DTI and its client-base of firms. The use of these schemes has been quite variable and details on their impact are not always that easy to come by. At the level of small business support the Business Referral Advice and Information Network now has in excess of 400 affiliated small business development partners across the country – itself a considerable achievement considering the lack of availability of such services a decade ago. This network has also enabled improved access to various schemes offered by the DTI, which continues to operate in a relatively centralised manner. With regard to the Manufacturing Advisory Centres a 2003 publication by the National Manufacturing Advisory Centre (NAMAC) Trust-DTI outlined that a total of 42780 jobs had been sustained from MAC support activities and 2675 new jobs created in enterprises supported since the MACs were launched. 75% of these were historically disadvantaged firms and the MACs had been relatively successful in enabling enterprises they assisted in accessing relevant DTI programmes.

The scope and scale of the DTI's programmes is reflected in the budget breakdown below. The table gives some indication of the level of investment in key programmes of the DTI during the 2003/2004 financial year.

Table 7: DTI expenditure by main programmes

Programme	Number of enterprises supported	Expenditure
SMEDP – Small and Medium Enterprise Development Programme	3221	R353 997 million
RIDP – Regional Industrial Development Programme	53	R16,1 million
SMMDP – Small and Medium Manufacturing Development Programme	1238	R100 389 million
Subtotal	**4512**	**R454 402 million**
CF – Competitiveness Fund	391	R21 998 million
SPF – Sectoral Partnership Fund	64	R15 864 million
BBSDP – Black Business Supplier Development Programme	210	R2 781 million
Subtotal	**665**	**R40 643 million**
Critical Infrastructure Programme	7	R168 837 million
Strategic Investment Programme	15	n.a.
IDZ – Industrial Development Zones	1	R1,97 million
Grand Total	**5200**	**R681 722 million**

(Source: Reproduced from DTI, (2004): p 25)

Much of this activity is supplemented by an array of partnership relationships that the DTI and its agencies have with other entities around the world – often supported through official development assistance. These include programmes that have explicit objectives to promote linkages between South African and donor country enterprises. Some examples include:

- Business Opportunities Australia/South Africa;
- The NORAD matchmaking programme;

- The Swedish-South African Business Partnership Fund together with the Swedish Trade Council;
- UK-SA partnership programme;
- US TDA programmes to build business links;
- EU TIDP grant programme for South Africa;
- DANIDA Business to business programme; and the
- Dutch government backed initiative to encourage Dutch companies to form trading and other links with developing country businesses.

These rarely operate at scale, but they do offer a platform for linkage creation and development and have the potential to make a meaningful contribution. According to DTI officials some of the most remarkable stories of business linkage development come from schemes such as this where DTI officials have played a part in recommending local firms to participate in linkage programmes.

In terms of benefiting from FDI and targeting FDI the DTI has had some successes. One of these has been in the automotive sector where a sectoral focus choice by the DTI has seen considerable inflows of FDI and this has sustained, and in some cases even grown, the base of firms producing for this sector in the country. Efforts have been made in other sectors to target FDI, but these have had mixed results. For instance in the telecommunications sector the introduction of cellular licenses has had an enormous impact on the business community and has spurred the creation of businesses both at the retail and service/technology ends of the spectrum. However, the slow pace in deregulation of the fixed-line operator environment and related high costs of telecommunications bandwidth have seen FDI resulting from partial restructuring not really benefiting domestic business in the way it might have done had it been managed differently. High costs of telecommunications and data transfer as well a poor service can rapidly work to undermine potential linkages opportunities as these capabilities become a necessary foundation for business interactions.

Government's targeted efforts to develop the aluminium smelting sector – driven in part by the advantage of relatively cheap electricity – have also had some linkage benefits as stakeholders have worked with role players such as BHP Billiton and its predecessors to encourage sourcing from SMEs. However, attempts to encourage greater domestic downstream off-take from this production have been less than successful with a limited number of intermediate operators to supply the necessary grade product at the appropriate price and volume to make small and medium producer operations viable. Sustained efforts in this regard, with companies such as Huletts Aluminium have to date only yielded a handful of projects. This is also complicated in part by pricing arrangements similar to steel in South Africa where there is often little advantage to SMEs to buy from domestic intermediate suppliers as domestic prices are set at prices equivalent to FOB imports to the door of the purchaser. In this regard there appears to be no specific advantage, at least in price terms, to local downstream firms to being in close proximity to the large resource-based processors.

Since 2004 the DTI has committed itself, in line with the Micro Economic Reform Strategy, to develop what it refers to Customised Sector Support Programmes in selected priority sectors. This process has been gathering pace during 2004 and 2005, mainly driven by TISA. However, the content of the Customised Sector Support programmes is not yet public, although officials have indicated that they do make explicit reference to ensuring SMME development. This approach of tailoring SMME development activities (including SME-TNC linkages) to specific sectors is seen to offer some potential for government to offer more meaningful support. However, as the programmes are not yet activated no judgement can be made on their effectiveness in this regards.

2.3 Executing/governing agencies

A range of entities have played and continue to play relevant roles in relation to linkage-related activities. In terms of scale and capacity the most significant of these have been the national government supported initiatives. Most of these have been managed through the Department of Trade and Industry (DTI), which since 1994, has taken a considerable interest in the development of the SME sector and in promoting and facilitating FDI. The DTI built up its own in-house capabilities and worked to reform many of the policy offerings in line with a commitment to be more supportive to SMEs and to improve the country's FDI performance. The most significant entities active in the field have been the following:

The Enterprise Organisation (TEO) – Operating within the DTI structures, TEO has the role of managing many of the supply-side programmes of the DTI mentioned in the previous section. It administers applications to various schemes. In the 2003/2004 financial year it was reported that The Enterprise Organisation approved applications by 6 000 enterprises, thereby generating R1,3 bn in investment, creating 19 700 new jobs and sustaining 44 500 others (http://www.pmg.org.za/docs/2003/comreports/040607pctradereport.htm). No scheme managed by TEO has as its primary objective TNC-SME linkages, although such linkages could be a by-product of other commitments and schemes administered by other DTI units.

Ntsika Enterprise Promotion Agency – this agency, operating under the auspices of the DTI, but as a distinct agency with its own governance and management structures, was tasked with taking forward the business services support aspects recommended in the White Paper on SMMEs referred to previously. Ntsika facilitated the roll-out of a comprehensive network of small business service providers around the country and work to raise their capabilities and to in turn inform national government policy offerings through the insights it gathered from these activities. Ntsika was never envisaged at offering direct services to small business, rather to facilitate the access to such services through supporting a network of organisations and institutions. As Ntsika became more established (the Agency suffered from come considerable staff turn-over in its initial years) it began to play a greater role in working with other divisions and agencies in the DTI with the goal of making their activities more SME friendly. This included, for instance, making recommendations on involving SMEs in trade development activities, working with officials from the Trade and Investment South Africa Agency (TISA) to encourage investors to consider building linkages with local SMEs and designing grant programmes with the DTI's The Enterprise Organisation (TEO) in support of SMEs. Ntsika has been merged this year, together with National Manufacturing Advisory Centre (NAMAC), to form the Small Enterprise Development Agency. Ntsika has also assisted some regional entities in accessing the Trade Point programme which seeks to build linkages between local SMEs and international export supply opportunities.

National Manufacturing Advisory Centre (and the Provincial Manufacturing Advisory Centres) – was established to support the roll-out and operations of a series of provincially-based manufacturing advisory centres. These have as their focus supporting the improved performance of small and medium manufacturing enterprises through offering business development services and discounted technical expertise. In doing their work they indirectly support linkage activities in that the capabilities of their clients should be improved and they should therefore be able to access new markets or offer better prospects to potential business partners. Each MAC has selected a few sectoral focus areas that are deemed to match their operating contexts. NAMAC is a partnership between Ntsika, the CSIR and the NPI. The MAC structures are being incorporated together with Ntsika under the new Small Enterprise Development Agency.

Khula Finance – This agency, working under the DTI, has had as its purpose working with major financial institutions to improve small businesses access to loans through offering a loan guarantee scheme.

Trade and Investment SA – this agency was initially established as an entity with a separate governance structure to the DTI (as was Ntsika), but has subsequently been brought in house as an agency operating within the management system of the DTI. Its main focus areas are investment attraction and facilitation and trade development. According to www.thedti.gov.za (the DTI's web site), TISA has the following focus areas in terms of its activities:

- "Providing an efficient and effective investment facilitation service for local and foreign investors
- Identifying, packaging and promoting investment opportunities
- Identifying, researching and promoting market access opportunities for South African exporters
- Facilitating exports by matching potential exporters with foreign buyers
- Developing South African exporters through the provision of financial and non-financial support
- Leading the development and implementation of customised sector programmes in **the dti**'s priority sectors" (www.thedti.gov.za)

TISA works to facilitate foreign direct investment and markets the country as an investment destination. TISA also works, within the framework of the country's trade agreements, to encourage interest in foreign markets in purchasing South African products and services. TISA staff have a mandate to seek to encourage TNCs that they deal with to source product locally and have in the past worked with Ntsika to facilitate such opportunities. TISA works with the DTI in organising the annual South African International Trade Exhibition (SAITEX) exhibition which provides a platform for South

African firms to display their products and capabilities to a international audience. In the past the DTI has worked with a number of SMEs to assist them in exhibiting at SAITEX and in following up and exploiting potential business linkage opportunities. In the 2004/2005 financial year TISA is expected to absorb in the region of 12% of the DTI's budget. In the 2003/2004 financial year TISA reported that it had played a role in securing investments valued at R5,8 bn and had facilitated 305 projects. TISA does report specifically on linkage generating activities..[10]

BRAIN and FRAIN – the Business Referral Advice and Information Network and the Franchise Advice and Information Network, have both been established with the support of Ntsika and other stakeholders to improve learning between business development organisations and to encourage an improvement in practise. Both networks do encourage the participation of TNCs as businesses and the TNCs as supporters of business development through their CSI programmes.

Industrial Development Corporation (IDC) – The IDC is a parastatal financing entity which takes equity and offers loans to businesses, large and small, for projects deemed to meet its investment criteria. In some cases the IDC offers concessional finance and has been active in supporting a number of major black economic empowerment deals. The IDC has taken equity with TNCs in domestic projects and has provided finance for others. In such cases the IDC does use its funding as leverage to encourage resulting projects to build linkages with South African and local suppliers.

Local Business Service Centres – operate under a range of names as a network of on-the-ground business development service providers backed by Ntsika and often by BRAIN. They range in size and effectiveness from place to place and in some cases have taken on a role to work to development business linkages with corporates – including TNCs. For example the Thekwini Business Development Centre (in Durban) has had Toyota as one of its funders and has worked to get small businesses to supply some aspects of Toyota's massive local procurement needs. Many LBSCs offer data-bases of firms that other enterprises can access.

Provincial Investment Promotion Agencies – these operate in all the nine Provinces of the country and are funded by the Provincial Governments. Most of them market their regions for investment (mostly foreign, but also domestic), offer facilitation services for investments in sectors they deem strategic and facilitate access by firms to access export opportunities. The effectiveness of these entities has been highly variable (as has that of

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[10] According to the 2003/2004 Annual report of the DTI, TISA delivered on the following:
"Key outputs delivered by TISA include R5,8 billion in investments from 400 foreign investors, and the facilitation of 305 projects. It assisted 5 506 exporters to enter or expand their access to new markets. With regard to TISA's Export Marketing and Investment Assistance (EMIA) scheme, 50% of recipients were SMMEs and 21% were enterprises owned by HDIs. Some 23 national pavilions (exhibitions) abroad generated R324,8 million in export sales for participating companies, while TISA assisted with 45 inward investment and buying missions and 28 outward selling missions. At the same time TISA generated 3 600 investment leads. In terms of employment opportunities directly generated, over the past year 2 110 jobs were created." (DTI, 2004: p 25)

TISA). They do assist investors and potential exporters access various DTI programmes, but co-ordination between these entities and the DTI remains weak. A scan of the web sites of these entities shows that they often see their primary audience as potential foreign investors, but do also make mention of services to support such firms in linking with local firms and in specifically aiding SMEs accessing export markets.[11]

Council of Trade and Industry Institutions (COTII)[12] – During the course of 2000 leaders of many of the government organisations working in the trade and industry field were brought together to form the Council of Trade and Industry Institutions, known as COTII. This structure was formed by the DTI to improve coordination and operates as a forum to build consensus on activities and facilitate collective actions – in part because it was felt that coordination was lacking in the past. COTII's 17 organisations fall into one of three groupings: Development Finance, Regulatory and the Specialist Services. In total, COTII has some 6 500 employees and an operating budget of around R4,5 billion per annum (http://www.bulletinonline.co.za/archives/specfeat/febfeat03.php) According to DTI officials, COTII has begun to improve inter-agency and inter-organisation cooperation, but it is likely that some further institutional integration such as that in the small business sector with the formation of SEDA will further aid such alignment. It is envisaged that COTII will encourage forms of cooperation that in the past were stifled by inter-agency rivalry or were the result of one-off interactions and were never sustained. For example in recent times COTII has encouraged participating entities to examine what they can contribute to the DTI's customised sector programmes rather than seeing these purely as the responsibility of one of the DTI's units. COTII can also serve an information sharing, dissemination and general clearing house role particularly amongst the various groupings, but also across the groupings. Whilst the participants have in the past years all operated under the broad framework of the DTI, COTII has been seen as enabling new level of cooperation to go beyond formal reporting.

A note on performance evaluation

Across the Board performance evaluation of the work of these entities appears to have been erratic and of highly variable quality. In recent times, as the South African government has moved to outcome-based planning, the DTI has been far more explicit about the outputs it expects to deliver and has been reporting against these to parliament a number of times a year. This has often led to rigorous exchanges over the effectiveness or otherwise of the DTI's offerings. The new Small Enterprise Development Agency (SEDA – www.seda.org.za) has been set up within this framework of increased rigour

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[11] An interview was conducted with Trade and Investment KZN (or TIK as it is known) – one of the entities falling into this category. It was confirmed that TIK does focus on attracting FDI and trade development activities, but that it does work to build linkages with SMEs where appropriate. TIK could not provide specific examples, but did outline its intention to roll out an internet based portal providing a listing of KZN firms that could be access by foreign firms either wishing to invest or to trade.

[12] COTII institutions include: Department of Trade and Industry, Council for Scientific and Industrial Research, Industrial Development Corporation, Ntsika (now represented by Small Business Development Agency – SEDA www.seda.org.za), South African Bureau of Standards, National Manufacturing Advisory Centre (now also represented by (Small Business Development Agency – SEDA), Trade and Investment South Africa, Khula Finance, Competition Commission and Competition Tribunal and others,

around performance management and monitoring. As the DTI's own performance monitoring has been somewhat flawed, some of the entities that operate within its structures have also suffered from shortcomings in evaluation and monitoring. These problems have also presented themselves at the level of Provinces and Local Government, although new legislation and a commitment to new practice is being seen. What is available in the public domain is generally superficial and provided at a summary level that does not allow for the sort of rigorous assessment that is understood to take place within the structures of the DTI.

Table 8 DTI key SMME outputs delivered in 2003/2004

• More than 15 000 small enterprises were trained, mentored and assisted by Ntsika
• 213 training courses were provided by Ntsika and three new courses were developed
• 282 service providers were trained and 209 were supported by Ntsika
• Khula provided 628 credit guarantees to the value of R180 million
• R99,3 million in loans was disbursed by Khula
• 1 477 properties were provided to SMMEs by Khula's property portfolio
• Khula financed three new retail finance institutions
• Khula equity fund financed deals to the value of R19,6 million
• NAMAC assisted and supported more than 2000 manufacturing enterprises creating 1 744 new jobs and retaining 14 726 existing jobs

(Source: DTI, (2004), Annual Report, p19)

2.4 Good practices and analysis of success stories

Section 2.4, provides some general comment on the South African experience as outlined above and then provides two case studies in the KwaZulu-Natal Province that present what observers in South Africa consider to be some "good practice" insights.

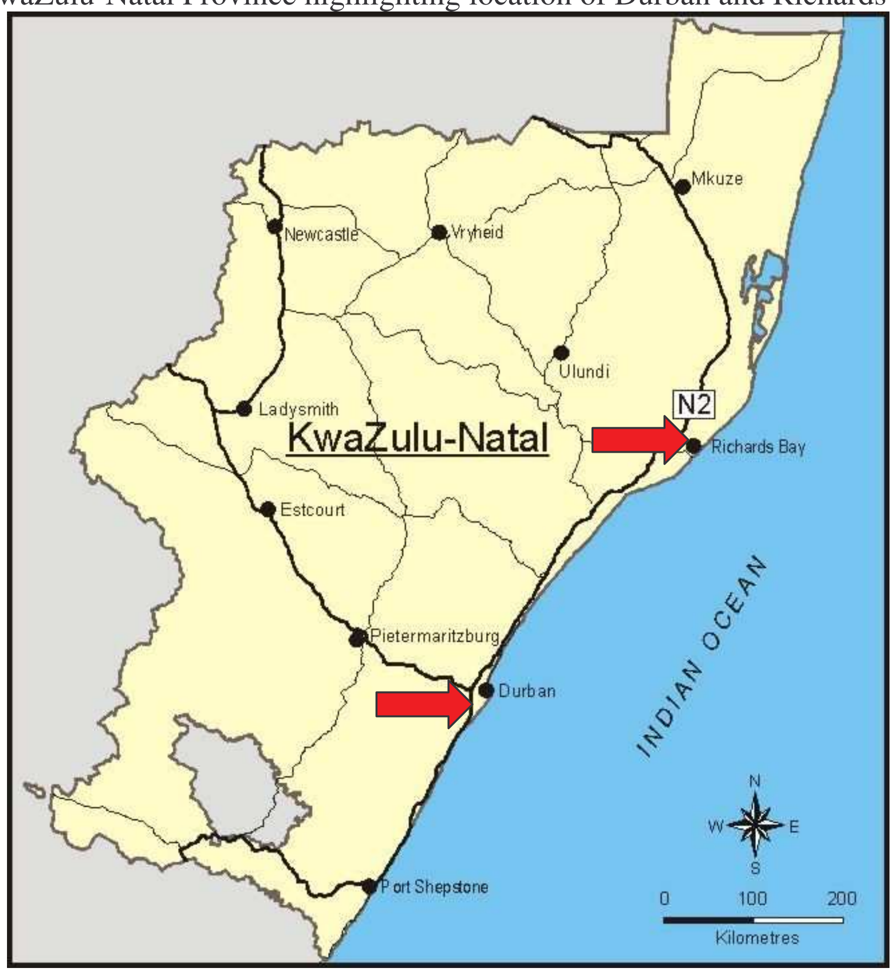
2.4.1 Reflecting on the SA experience

South Africa's experience in generating and sustaining TNC-SME linkages in the past ten years has been rather mixed. It is important to point out that the inherited policies and institutions that operated under apartheid did little to aid the translating policy into effective action. In this context some considerable attention was initially focused on building new and appropriate institutions with relatively clear and distinct responsibilities (eg a small business desk focusing on small business issues in a relatively narrow sense). The combination of this recent experience and changing social and economic conditions has, lately, allowed for new approaches to be tested and further institutional refinements to be implemented. These have begun to bear some fruits, although the limitations that exist on actual delivery with respect to the facilitation of TNC-SME linkages (beyond anecdotes) presents a researcher with considerable difficulties in gauging impacts. It should also be noted that many of the policy instruments previously available, under a far more interventionist and import substitution-type framework such as that which operated under Apartheid, are no longer available to assist in the generating of TNC-SME linkages. However, such linkages continue to be either a by-product of other programmes or get facilitated as one of a number of objectives in the range of activities supported by government. In particular imperatives around black economic empowerment are having a relatively widespread impact as the process of the development of industry charters continues.

2.4.2 KwaZulu-Natal case studies

This section will examine the Durban Auto Cluster and the TNC-supported business linkage activities in the Richards Bay area. Both case studies have not necessarily had enhancing TNC-SME linkages as their focus, but they have managed to impact on these relationships in the context of other activities to varying degrees. It is also worth noting that in both case studies the prime drivers for action were not national agents, but were instead processes that had their roots in local or regional endeavour. National policy and programmes did undoubtedly impact on the activities, but they often had a indirect rather than direct role in influencing the form and content of activities at a decentralised level.

Map of KwaZulu-Natal Province highlighting location of Durban and Richards Bay



The Durban Auto Cluster

Although the Durban region has for the past 40-50 years had a presence of auto-related manufacturing businesses, the ongoing presence of these was by no means guaranteed in a climate of rapidly escalating global competition and where the South African firms had little experience of operating in an environment that was not heavily protected. The Durban Auto Cluster (or DAC as it is commonly known) was formed out of processes sponsored by national, provincial (KwaZulu-Natal) and local government (the erstwhile Durban Metropolitan Council – now the eThekwini Municipality) during the late 1990s. These initial activities entailed the Industrial Restructuring Project at the then University of Natal in Durban (now University of KwaZulu-Natal) participating in a series of co-operative pilot competitiveness benchmarking activities with a number of local automotive components producers that had been active in the region for some considerable time.[13] These activities and the subsequent development of a co-operative working relationship between the researchers and the firms led ultimately to decision in the year 2000 to form the Durban Auto Cluster with an initial provincial-wide membership of in excess of thirty automotive-related manufacturing firms. The matter of TNC-SME linkages has been intrinsic to the work of the DAC and its predecessor formations as the automotive sector is a truly globalised production system dominated by very large and powerful OEM (Own Equipment Manufacturers) and component producing trans-national corporations.

The DAC emerged in a context of considerable policy adjustment in South Africa. Post 1994 trade liberalisation saw a dramatic reduction in tariff barriers, including high import tariffs on the importation of both vehicles and automotive components. As explained by Lorentzen et al (1994),

> "Duty levels on completely built up vehicles (CBUs) fell from 115 per cent in 1995 to 40 per cent in 2002 and are scheduled to reach 25 per cent by 2012. Tariffs on completely knocked down (CKD) components are lower still." (Lorentzen et al, 2004: 7)

However, despite the commitment to trade liberalization by the Department of Trade and Industry there was also a commitment to avoid potential pitfalls of de-industrialisation from rapid tariff adjustments and so a programme known as the Motor Industry Development Programme (MIDP) was formulated together with key industry role players. The MIDP sought to encourage consolidation of domestic production around the output of a reduced range of vehicles (for each OEM) allowing for export scale production of these vehicles. Through exporting these vehicles the OEMs would then be entitled to earn duty credits to import a considerable greater range of models from production sites in other parts of the globe. These policy adjustments were deemed favourable to the OEMs and they began, one-by-one, to systematically take advantage of an opportunity to build South Africa into their global operations when previously South African production activities had either been under license operations or been viewed as somewhat marginal to core global operations.

[13] This research team, led by Professor Mike Morris, drew inspiration and direct support from the experiences of Professors Raphie Kaplinsky of the Institute of Development Studies at Sussex University and John Bessant of the University of Brighton.

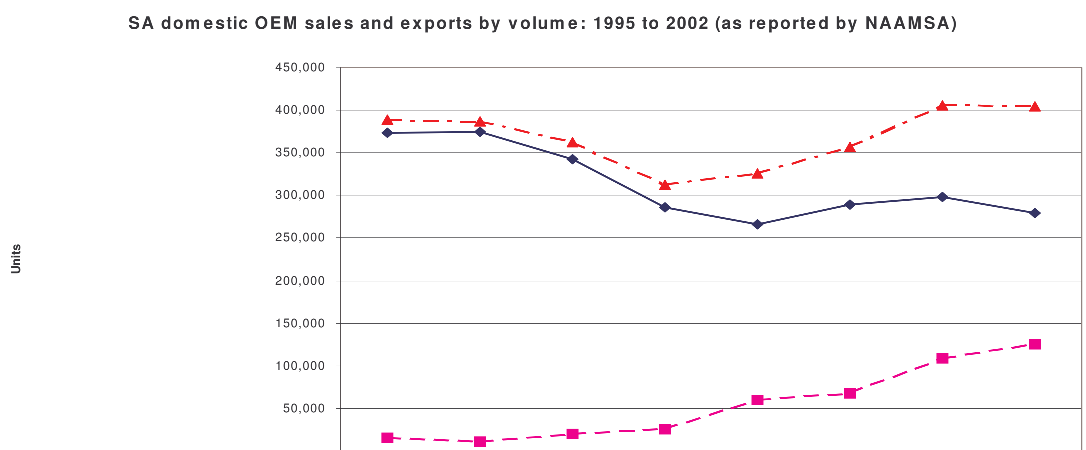
The impact of these national policy adjustments secured very substantial FDI commitments. Initially it was the German OEMs that moved to comprehensively reposition production of BMW, Volkswagen (VW) and Daimler (later Daimler-Chrysler). More recently US and Japanese-based OEMs have begun to follow suit. During these nationally driven processes the DTI did make a number of attempts to initiate a country-wide cluster process to attempt to more effectively bind in components producers into the dialogue and related policy processes. However, these were not sustained and the DTI subsequently agreed to make some resources available to spatially defined processes in the automotive sector, initially in the Eastern Cape and subsequently Gauteng Province and KwaZulu-Natal (KZN).

Lorentzen et al (2004) outline how,

> "The MIDP, together with the depreciation of the Rand from the mid-1990s, turned South Africa into a relatively competitive producer of both components and completed vehicles. The contribution of the auto sector to total manufacturing sales grew from 9.7 per cent in 1994 to 12.8 per cent in 2003." (Lorentzen et al, 2004: 8)

The figures below illustrate the growth exports and output as the MIDP began to take root in South Africa.

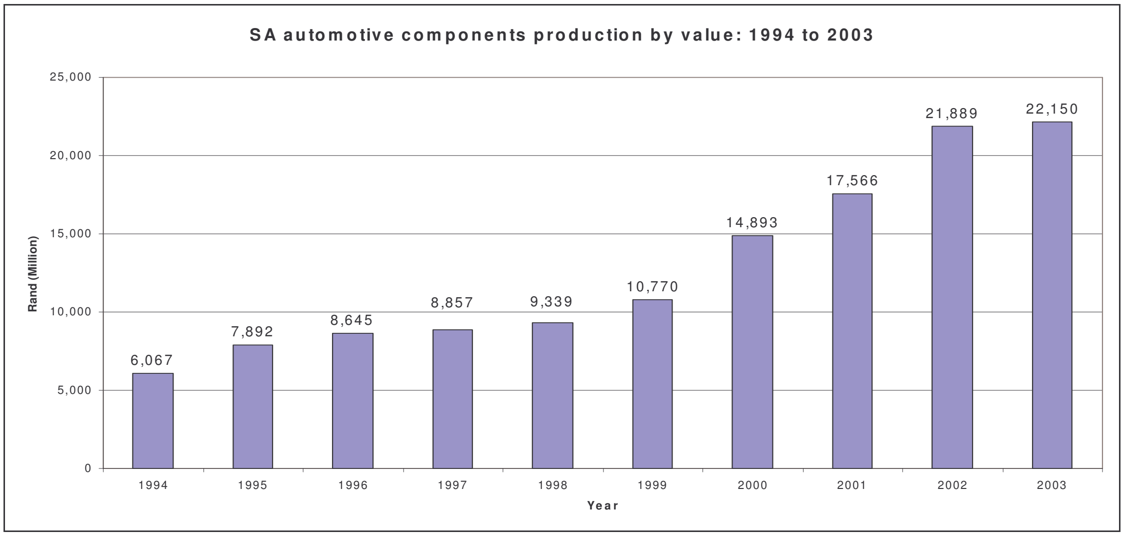
Figure 11: Domestic OEM sales and exports by volume



	1995	1996	1997	1998	1999	2000	2001	2002
Sales of domestically produced vehicles	373,712	374,758	342,535	286,159	266,349	289,333	297,856	279,135
Exports	15,764	11,553	19,569	25,896	59,716	68,031	108,293	125,306
Total domestic production	389,476	386,311	362,104	312,055	326,065	357,364	406,149	404,441

Source: Barnes and Johnson (2004: 6)

Figure 12: SA Automotive component output by value



Source: Barnes and Johnson (2004: 8)

However, for components firms the picture was not universally rosy. A depressed domestic market combined with often weak relationships with the headquarters of OEMs with a presence in South Africa left them somewhat exposed. The entry of OEMs with local operations into global supply chains also meant global sourcing and many local producers operating under license were placed under considerable pressure. However, the devaluation of the rand and the necessity for OEMs manufacturing for export to cultivate some proximate suppliers did open up new opportunities. In some instances this entailed large global component players entering the domestic production scene through acquisitions or other forms of partnership. In other cases OEMs and component producers worked in partnership to meet local content requirements of the MIDP and to use this production as a platform to enter into OEM parent company global sourcing arrangements. This somewhat delayed growth in output (by value) can be seen in Figure 12.

In KwaZulu-Natal, small and medium firms made up the greater proportion of components firms. This changing environment presented a number of challenges to them. In many instances these firms were significant suppliers to the Toyota plant in Durban. Despite the fact that the Toyota manufacturing operation was the largest in the country by some margin, protracted processes to shift from an operation under licence to a subsidiary integrated into Toyota's global operations resulted in somewhat delayed impacts related to the MIDP for many of the fifty or so regional components firms.[14] However, the fact that many of these firms were also suppliers to other OEMs or to the after-market enabled many to adjust to new conditions. In a number of cases component TNCs such as Federal Mogul and foreign direct investors such as those behind the Aunde

[14] License conditions for the then Toyota South Africa (TSA) from Toyota Manufacturing Corporation Japan stipulated the SA plant could only export a limited range of models to a handful of small African markets resulting in severe limitations being applied initially to TSA's prospects to take advantage of the export-driven benefits of the MIDP.

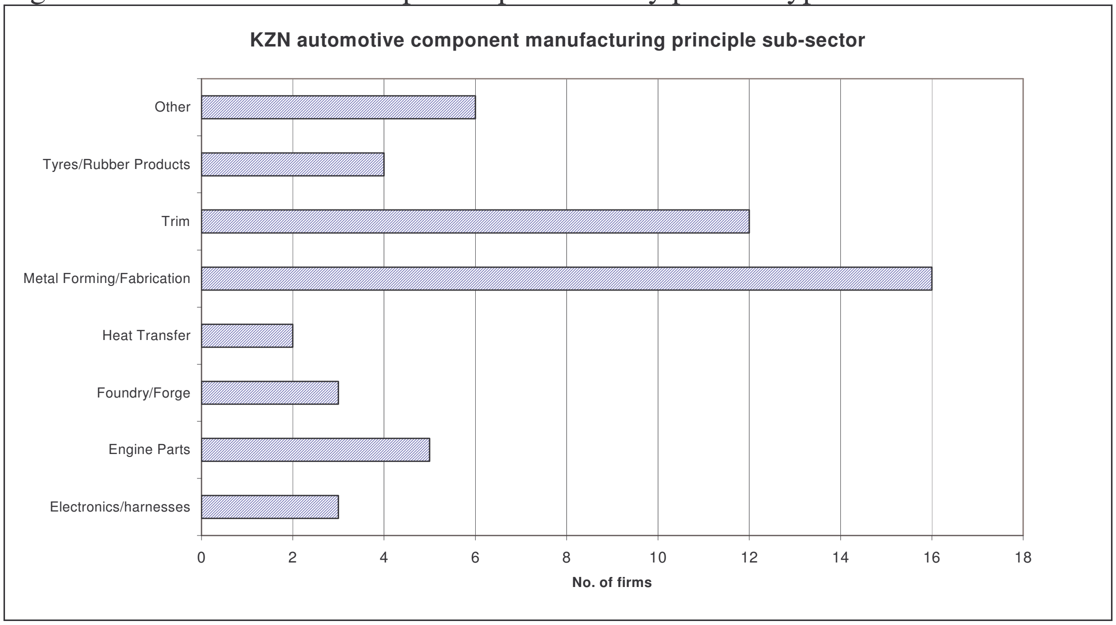
Car Trim enterprise made local acquisitions as they saw prospects to supply to both domestic and global markets form South Africa. The prospects of Toyota significantly scaling up production and entering Toyota's global supply chain also saw a handful of small and medium foreign direct investments in new plants such as the partially Toyota owned catalytic convert manufacturing subsidiary, Cataler.[15] Taken together with the experiences of the other OEMs and their suppliers in the country, the impact of the MIDP, in terms of improved FDI attractiveness in the country and in terms of prospects for suppliers, (many of them medium-scale enterprises), has been significant.[16]

However, the changes outlined above also brought with them massive pressure to bear on many KwaZulu-Natal-based component firms – and in particular those that were not first-tier global quality operations. In having to supply into OEM plants manufacturing for export these firms had to rapidly adjust to increasing quality requirements that come with the motor industries rigorous certification procedures, increased scale of production and flexibility. Whilst those that had been, or became, part of international operations could draw on a measure of global expertise many firms in the second and third tier supply categories needed to illustrate a rapid turn-around capability or face closure. Some breathing space was created by local content requirements of the MIDP where Toyota and other OEMs had little choice but to work in partnership with local suppliers to upgrade their capabilities. Toyota also made the case that this approach was not only one of obligation, but also formed a key element of good-practise in running and large, internationally competitive export business. However, the reality was that with a considerable reduction in models produced domestically and a move to common component platforms between models some firms that had survived off small lot production for low-volume manufactured models either had to diversify out of automotive components supplies or had to meet the escalating requirements of new manufacturing regimes.

According to Barnes and Johnston (2004) ten firms in KwaZulu-Natal are first tier suppliers, 20 are second and third tier, and ten supply the aftermarket while a range of others supply into a range of industries. Figure 3 shows the product profile of these firms. Barnes and Johnston point out that some second and third tier suppliers are not exclusive auto component firms and produce goods for other sectors but would have the auto sector as a significant, if not the most significant customer.

[15] Many of the OEMs have encouraged catalytic converter manufacture in South Africa as the fact that South Africa is a dominant global producer of platinum and palladium metals used in the product with their relatively high value makes them an attractive component to include in production to meet domestic content requirements in the MIDP.
[16] While the MIDP is celebrated in South Africa, a number of other countries, including Australia have raised some WTO-related concerns about the degree to which the programme might infringe on certain of South Africa's WTO commitments.

Figure 13: Profile of KZN component producers by product type



Source: Barnes and Johnson (2004: 16)

The Durban Automotive Cluster evolved from an initial university research-firm partnership benchmarking exercise referred to in the introduction of the case study. These initial benchmarking processes were subsequently supported by grants from the DTI's sectoral partnership fund, competitiveness fund and Workplace Challenge programme – all initiatives aimed at encouraging individual or collectives of firms to upgrade their performance. From these activities the KZN Benchmarking Club was formed during 1998 as a firm-driven co-operative venture, supported in part by government grants, to get firms to consistently evaluate their relative performance in terms of both meeting customer demands and against competitor manufacturing process activities and to then share ideas on how to use such information to upgrade their performance. The former university-based facilitators created a special-purpose company to carry out the facilitation activities and perform independent (domestic and international benchmarks).[17]

During 1999, the KZN Benchmarking Club was approached by the Economic Development Unit of the then Durban Metropolitan Council (now the eThekwini Municipality) to consider a proposal to broaden its membership and extend the nature of its activities beyond benchmarking-related processes. A process was entered into to consider the benefits to both existing Benchmarking Club participants and for other automotive-related firms in the Province. During the course of 2000, the results from the investigation and discussions yielded a strong commitment by almost 30 firms to work together in the form of the Durban Auto Cluster. Initial funding was secured from Durban local government and supplement by some funds from the DTI and the KZN Provincial Government. The DAC was to be driven by a firm based governance structure

[17] This company, now called B&M Analysts now runs benchmarking activities with auto firms in the Eastern Cape and Gauteng (www.bmanalysts.com)

and would be open to firms involved in the transformation of product for the automotive sector. Early members included Toyota and a few other smaller OEMs and a range of first, second and third tier firms. Firms were encouraged to join regardless of their ownership structure.

The initial business plan identified four working groups for the DAC:

- The KZN Benchmarking Club would continue to operate as a special interest group and require a higher funding contribution by participants;
- A working group focusing on logistics matters would seek to develop a common approach and work to reduce costs and bottlenecks;
- Human resource issues would be handled by a third working group with an emphasis on matters such as improving literacy and numeracy as well as dealing with matters relating to HIV and AIDS in the workplace; and
- A final workgroup would tackle matters of supplier development by working towards the adoption of common frameworks and accreditation and support systems.

Participants in the DAC could chose between levels of involvement. Some firms chose to participate purely in information sharing activities. However, if firms wanted to access programmes such as training sessions or collective logistics negotiations they would have to upgrade their membership. In a relative short space of time membership grew beyond 30 firms and the bulk of firms were committed to higher levels of participation. Research done by Lorentzen et al (2004) on the DAC shows that firms participated not only to get access to useful information, but also because they found they could use the information and resources to make better decisions in the workplace. Firms also indicated that beyond the formal processes of interaction, informal networking has provided some useful benefits to them.

In terms of the work of the DAC, it has been the Supplier Development Working Group that has had the most significant impact on relationships between the TNCs (inside and outside the DAC) and SMEs (which make up the majority of the DAC membership). In an industry with relatively high barriers to entry and increasingly sophisticated accreditation and technology management processes the working group programmes have enabled smaller firms to familiarise themselves with first tier and OEM requirements and to share knowledge on how best to meet the requirements. A Toyota official participating in one of the DAC meetings indicated that the confidence the company had shown in the region had been greatly reinforced by the processes of the DAC. The activities of the Supplier Development Working Group have ranged from sharing knowledge on complex certification and standardisation requirements to training purchasing managers and building a network of support from those firms wishing to upgrade their supply capabilities.

During the course of 2002, as the DAC moved to securing a greater proportion of its funding from its own membership, a decision was taken in conjunction with Durban local government and KZN Province officials to redirect public sector funds to supporting emerging, largely black-owned, SMEs on the periphery of the sector to become accredited suppliers. A number of firms were identified and the participating firms in the DAC committed themselves to working with the emerging firms through a variety of support activities. A government funded institution in the form of the KZN Manufacturing Advisory Centre was also persuaded to work to upgrade some of the more generic manufacturing-related capabilities of the firms where required. Through this programme and ongoing subsidised participation in the workings of the DAC, a number of SMEs have been upgraded and have increased their supply commitments to the automotive sector.

The impact of the collaborative work between multi-national auto firms (OEMs and components producers) and local firms can be seen in some of the results in Table 7 where performance has improved over time against international benchmarks. Whilst the impact of the opportunities offered under the MIDP might have not had sustained impacts on the competitiveness of firms, the building the DAC and its predecessor the KZN Benchmarking Club has ensured the space offered to producers has been utilised to upgrade rather than to postpone restructuring. This finding by Barnes et al (2003) has been reinforced by a survey done by Lorentzen et al (2004).

Table 9: Learning and comparative advantage in the auto components sector

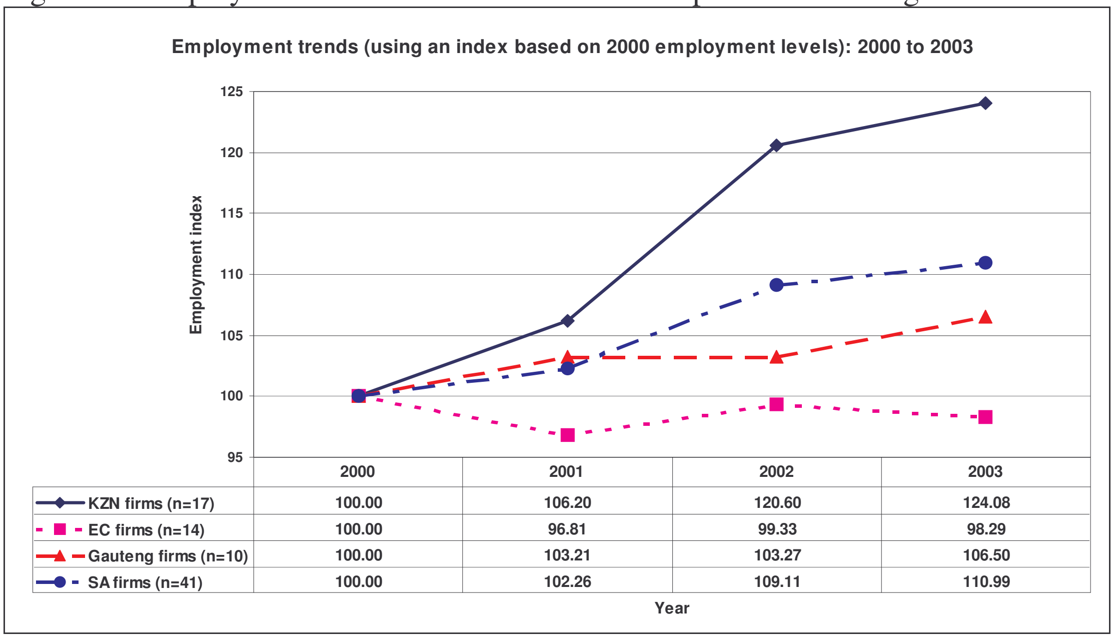
CSF	KPI	South African Firms						Comparator Firms	
		N	1998	1999	2000	2001	*Improvement 1998/99-01*	W. Europe N=14	Emerging economy N=12
Cost control	Total inventory (Days)	32	62.6	54.3	47.6	42.0	*32.8%*	31.2	38.6
	Raw material (Days)	32	32.3	27.9	25.2	21.8	*32.7%*	17.2	19.2
	Work in progress (Days)	32	12.4	8.9	8.1	8.2	*34.3%*	5.3	8.6
	Finished Goods (Days)	32	17.8	17.5	14.3	12.1	*32.0%*	8.6	9.5
Quality	Customer return rate (PPM)	23	3270	2638	1406	1240	*62.0%*	549	624
	Internal reject rate (%)	25		4.9	4.2	3.9	*20.7%*	1.9	3.5
	Supplier return rate (PPM)	21		21989	14637	18518	*16.0%*	8319	13213
Flexibility	Lead time (Days)	17		19.9	19.1	17.9	*9.9%*	16.8	12.0
	Supplier on time & in full delivery (%)	23		78.7	82.1	82.2	*4.5%*	92.2	92.3
	On time & in full delivery to customers (%)	25		92.2	92.8	92.7	*0.6%*	96.1	93.5
Capacity to change	Training spend as % total remuneration	30		1.3	1.7	2.0	*56.2%*	1.3	3.1
	Absenteeism (%)	27	4.4	4.3	4.1	4.0	*9.4%*	4.2	5.7
Innovation capacity	R&D expenditure (%)	24	1.64	1.70	1.67	2.12	*29.5%*	1.83	2.90

Source: (Reproduced from Barnes J, Kaplinksy R and Morris, 2003: p 11 - KwaZulu-Natal/Eastern Cape and Gauteng Benchmarking Club database[18]

18 These benchmarking clubs are 65% funded through the Sector Partnership Fund of the national government's Department of Trade and Industry. They operate as continuous improvement networks for automotive component manufacturers, with member firms benchmarked internationally and against one another on an annual basis. "Best in class" performers then host quarterly workshops where other Club members are exposed to the practices they have employed to generate world class performance levels. The benchmarking clubs are a clear example of firms taking advantage of the horizontal industrial policies created post 1994 (see www.bmanalysts.com)

The impact of the DAC processes and the general policy environment has also been a positive one in terms of employment and investment by the firms. The Figure below provides an indication of the degree to which employment levels amongst the DAC firms picked up during the period 2000-2003.

Figure 14: Employment trends in DAC members compared to other regions



	2000	2001	2002	2003
KZN firms (n=17)	100.00	106.20	120.60	124.08
EC firms (n=14)	100.00	96.81	99.33	98.29
Gauteng firms (n=10)	100.00	103.21	103.27	106.50
SA firms (n=41)	100.00	102.26	109.11	110.99

(Source: Source: Barnes and Johnson (2004: 20)

The environment in which this linkage activity has been made possible has been considerably influenced by national governments programmes to encourage small business development and in particular greater participation by black entrepreneurs in key sectors of the economy. This has, for instance, resulted in some of the major OEMs requiring their supplier development divisions make particular efforts to increase procurement from SMEs, and in particular black-owned SMEs. This pressure for change has begun to feed through the supply chain and also encouraged components suppliers to examine opportunities to spin-off or outsource various supply activities to existing SMEs or to support the creation of new ones. The DAC has provided a very effective, accessible and consistent form of support for such processes. Both domestic and foreign-owned firms have been able to make use of its processes and found ways of developing relationships and learning than might otherwise have been difficult without the so-called "spill-over" effects of knowledge sharing in the DAC.

It appears likely that the next five years will be very significant for the firms involved and connected with the DAC. Plans to double the Durban Toyota plants output to that of a world scale operation (250 000 vehicles) and to significant raise levels of local content in this process. Furthermore, the MIDP programme is due to be either scrapped or restructured in 2012. Signs are already being witnessed of greater TNC activity in the supplier base and of escalating pressures on local SMEs as new demands are introduced on their capabilities.

A note on the replicability of successful aspects of the Durban Auto Cluster linkage experience

The experience of the DAC has been shown to be replicable to some degree in the South African context as the same team that worked to establish the DAC has assisted in creating similar processes in other regions and in other sectors. While the focus has changed from place to place, the model of a business driven process supported by government has been a key element. However, the issue of linkages has not been as necessarily been as prominent in these processes as it has been in the DAC. Nevertheless, processes such as the Textile Industry Development Cluster has looked at the relationship between domestic producers and international suppliers and buyers and the KZN Textile and Clothing Cluster process has identified the development of links between largely SME domestic garment firms with TNC sourcing agencies and TNC retailers.

An advantage of the DAC process has been the potential for firms to co-operate meaningfully at a technical level as they operate within a common value chain and are part of a relatively integrated supply network. This would suggest that where appropriate initiatives should examine the prospect of working within value chains to try and weave together sustainable linkage commitments. The exposure of the DAC process to a number of assessments by external reviewers and an internal processes which reviews performance against targets has also provided a better platform to consider replicability as there is a much greater sense of benchmarks against which comparator initiatives could be measured.

Research work done on the DAC and its activities has suggested strongly that firms have used the space created by local context requirements in the Motor Industry Development Plans to upgrade their performance. The discipline of supplying components for vehicles destined for international markets has required that global standards be met.

TNCs and SME support in Richards Bay

Richards Bay is an industrial harbour town in KwaZulu-Natal approximately 200 kilometers north of Durban. Its key feature is that it is host to the country's high-volume bulk cargo export port (the Port of Durban on the other hand handles the bulk of the country's high value maritime cargo). The construction of the port arose out of the need for a purpose-built export outlet for the country's very significant coal exports (railed to the port on a dedicated line form the hinterland coalfields). During the early 1970s, the government used a combination of tax incentives, soft loans and equity from the IDC and discounted (from an already low base) electricity prices to encourage the location of a number of primary processing plants with very significant capital investment in the area. These plants were seen as contributing to the potential of the country to add value to its dominant primary goods exports. However, for many years very little downstream investment and activity was generated from the partially processed output of the plants and little evidence could be seen either of a foreign exchange benefit from the exports passing through these plants or from wider forms of benefit to the local communities beyond employment.

However, the 1990s heralded a change. Two major new capital investments in Richards Bay in the form of Richards Bay Minerals and the construction of an additional cutting edge aluminium smelter provided some fresh impetus to those seeking to develop linkages between local SMEs and the TNCs partners in the major investments projects. As government support was secured in both projects, as well as in the later expansion of the Foskor plant (initiated by the IDC), some pressure was brought to bear to encourage outsourcing of construction and plant development activities to local businesses. The major investors made some corporate social responsibility funds available to bring together a team of business development specialists to work with the TNCs and the local SMEs. This team established themselves in partnership with local business formations and under the banner of the government's new Ntsika-backed Local Business Support Centre programme.

Mixed results were achieved during this period, but considerable learning was achieved. According to stakeholders, factors that influenced the success or failure of the initiatives included:

- the relatively weak position of local SMEs in terms of skills and access to capital;
- lack of industry accreditation of suppliers and their products and processes (e.g. International Standards Organisation (ISO) standards),
- inaccessibility of, and changes to, ownership structures and management of the TNCs; and
- lack of experience by the large companies in working with smaller companies and the associated dynamics that come with these (ranging from sensitivity to payment periods to requirements for greater levels of communication, supervision and support).

Subsequent activities have been informed by these lessons, but according to interviews conducted with relevant stakeholders, have not necessarily resulted in greater success in linkage-related efforts. A decision by the DTI to launch one of its Spatial Development Initiatives in the area in the late 1990s heralded a focused government effort to try and work with the major investors (the Hillside Aluminium Smelter project was in full swing at the time) to secure a series of downstream investments that could potentially enable a greater avenue for linkages than the existing plants. Processes were also initiated together with the Port Authority to designate land adjacent to the Port as an Industrial Development Zone (IDZ). The IDZ was seen as offering a quality environment at competitive cost to companies seeking to use local products and duty free imports for export production. Plans for the IDZ involved an adjacent supplier park aimed at small and medium companies that would not meet the requirement to locate within the IDZ itself. Funds from the DTI were used to undertake detailed business planning as well as a series of studies into potential business opportunities relating to existing large operations in the area that had the potential to be exploited. DTI and local government funds also covered the costs of a few personnel who had the responsibility for managing the processes related to IDZ development, business linkages and investment facilitation.

To date the IDZ remains on the cards, but no formal progress has been made in registering the Zone through DTI processes. The SDI team has been successful, together with the DTI, in playing a role to encourage existing investors to make new investment commitments, but business linkage projects have been relatively limited and generally fall into the category of more marginal goods and services supplies (such as cleaning services, equipment maintenance or components spares suppliers). Medium-sized firms have not sprung up in the area in relation to these operations and generally the large TNCs remain comfortable sourcing supplies form places such as Durban and the East Rand (industrial areas around the east of Johannesburg and Benoni/Boksburg). Furthermore, the fact that the one major domestic user of Aluminium ingots (Hulett Aluminium, a supplier of intermediate and finished aluminium goods) is located in Pietermaritzburg, some 300km away, has not made for a strong case why downstream producers should locate in the shadow of the smelter. This is somewhat aggravated by the practice of primary processing industries such as steel, chemicals and aluminium to charge domestic buyers import-parity prices for goods supplied from SA operations. The result is locally based buyers have to pay the same for a supply of aluminium, even if they are located just meters from a very low cost producer, as they would if they wanted to import the same specified product from a supplier elsewhere in the world (i.e. the price would include amounts reflecting imported goods transport, tariff and other administrative costs).[19]

In this context, the Zululand Chamber of Business (ZCB)[20] and related business development role players have sought to focus on working with the TNCs to develop linkages with smaller suppliers of one sort or another or leveraging some of the technical and business expertise in the TNCs to the benefit of local firms. The TNCs remain committed to using CSI programmes as the main channel for such activities and have been consistent backers of the ZCB and its projects in the last decade. Some examples of TNC CSI programmes in partnership with the ZCB include:

- Hillside 3 project – BHP Billiton funded mentorship programme to support local SMEs involved in the expansion programme of the Hillside smelter. A number of the suppliers from this initial project are now regular corporate suppliers and the project has been identified as a best practice example;
- Business Community Park – donated by BHP Billiton as a site for offering business support services and a base for emerging businesses;
- Media and resources centre – donated and funded by FOSKOR;
- Business and Community Centre;

[19] The Department of Trade and Industry has launched a major investigation into the practice of import-parity pricing and has suggested that it is anti-competitive behaviour. It is expected that the findings of the investigation will be made public during 2006.

[20] The ZCB was established in 1926, but has gone through a number of processes top reinvent itself, particularly since the mid 1990s as greater efforts were made to reach out to black-owned business. Today the ZCB sees a primary role for itself in fostering and facilitating the growth of businesses in the Richards Bay area.

- Science learning centre; and
- Training venues for hire.

ZCB, in an effort to encourage linkages with their membership base have developed an accreditation programme in consultation with some of the larger public and private sector procurers. For a fee firms can be assessed by the Chamber and the accreditation allows for potential business partners to have increased confidence in the capabilities of accredited suppliers. As of June 2005, the ZCB has 359 paid up members of which 174 were accredited. This work of the Chamber and the support of the TNCs has been supplemented by other programmes of a shorter or longer term nature. These have included:

- Private Sector Procurement Project – funded by the DTI's Small Enterprise Development Agency (formed from the merging of Ntsika and Khula). This six month project aimed to provide local a selected group of 15 local SMEs with dedicated support to respond to local private sector tenders. However, due in part to a combination of poor timing with regard to the ebb and flows of procurement activity and in some cases a lack of corporate commitment the project yielded little in terms of actual business linkages. The DTI is considering extending this pilot initiative and efforts are underway to look at options to improve its impacts;
- The National Development Agency (a government funded national development entity) has funded a project to improve the availability of business development services in outlying areas;
- Local government funded business development out reach services to rural districts around Richards Bay;
- Business-to-Business Showcase – an annual exhibition where SMEs can exhibit their wares and capabilities to one another and to corporates. Procurement officers from local corporates are invited to present workshops on their tendering systems and requirements they might set for awarding contracts to SMEs. (The Annual Zululand Expo also has similar objectives).

Interviews with local stakeholders revealed that while there have been a number of success stories, there remains considerable work to be done to improve the scale and effectiveness of business linkage activities. Corporates have not been consistent in providing flows of information to relevant support bodies and tend to want to have their own processes with their own databases of potential suppliers so as to avoid complicating their relationships with their suppliers. Furthermore, the corporates have not readily embraced opportunities to work to develop domestic downstream customers for their product and are generally more comfortable supplying large volumes of output for export contracts. A handful of exceptions do illustrate that the potential exists but has not necessarily been fully exploited according to the local stakeholders.

In some instances access to high levels of skills and proprietary technology raises barriers to potential linkages. Although the TNCs have supported various activities to deal with potential suppliers that might be knocking on the door of opportunities at the less complex end of this supply spectrum. However, it was also pointed out that the nature of the activities undertaken by many of the local corporates (dune mining, aluminium processing, fertilizer manufacture) did not lend itself to developing consistent supply contracts in any manner comparable to say the approach a product assembler might where it sources on a regular basis hundred or thousands of different components each week. This left service related activities of which the companies mostly outsourced either the most basic and least skill intensive or the most specialised services which would make little sense to retain in house (eg calibration testing and verification of electronic processing equipment). Much of the mid-level service activity which was both very regular and relatively complex and routine was deemed appropriate to retain in house servicing. In some instances this was necessitated by the fact the service providers could not guarantee a continuous presence in Richards Bay as there was not a great enough density of regular business to justify a local office. To deal with these complexities a company such as FOSKOR has employed a dedicated supplier development facilitator to try and build improved relations with existing and potential suppliers. However, SMEs often fall foul of rigorous standards that many corporates set for example those related to ISO certification and a continuous effort is required to ensure that standards are not just being met, but being exceeded.

In an effort to deal with some of the gaps in existing activities to secure improved linkages, business and government partners in the area have applied for KZN Provincial Government support from the European Union funded Gijima project.[21] The Gijima project, managed under the Department of Economic Development and Finance of the KZN Provincial Government has offered annual rounds of funding in two main categories. The first has been aimed at government institutions in local areas and has been focused on improving their contribution to the quality of the local business environment. The second category has been for partnership projects between private and public role players in local areas where they have a plan meeting the requisite criteria to develop business opportunities and improve the competitiveness of local businesses. Richards Bay stakeholders hold out some hope that the increased support that would come with a successful application to these funds would improve the impact of their activities.

A note on the replicability of successful aspects of the Richards Bay TNC-SME linkage experience

The Richards Bay experience of linking TNCs and SMEs has not been an entirely successful one, although there have been moments that do stand out as having been significant. The commitment by the TNCs to develop and provide ongoing support to business development activities in the local environment is certainly something that could be reproduced elsewhere with the appropriate level of commitment from TNCs. Whilst this has not always translated into linkages as such, it can be said that the TNCs have contributed, through their CSI programmes to the development of local SMEs. It is possible that this focus on basic business development approaches could translate into opportunities in the longer term. It is also likely that persistent interventions by a variety of local and national actors could elicit a greater interest in linkage development by the TNCs, although general conditions in South Africa's investment environment and global

[21] Gijima means to run in Zulu – the majority indigenous language of KwaZulu-Natal.

trends in various product ranges are likely to see most of these opportunities take the form of service or supply contracts and not the development of downstream opportunities. The impact of entities such as the IDC, as well as the influence government can have through programmes such as the roll-out of black economic empowerment charters will encourage further transformation of business relationships between TNCs and SMEs. These contextual factors are likely to generate a set of unique outcomes in South Africa.

However, some of the Richards Bay stakeholders did indicate the increasingly TNCs are being placed under pressure to meet more transparent reporting requirements (for example in relation to triple bottom line reporting or labour practices of suppliers). This pressure could also result in TNCs seeking to replicate what might be considered best linkage practice in one way or another in other environments in which they operate. An example was given of one TNC active in Richards Bay bringing a delegation of government officials and community representatives from another country to Richards Bay to learn from local CSI-government partnerships in business development.

PART III

This section provides an overview of lessons learned from this overview of the South African experience, and in particular from the case studies discussed in the Part II. Part III concludes with a perspective on policy recommendations and future perspectives.

3.1 Lessons learned

Key lessons identified from the South African experience of working to cultivate TNC-SME linkages include the following:

Signalling in national policy frameworks is important
By giving some considerable attention to the issue in its public pronouncements and policy frameworks government has seen a range of role players pick up on the signals and act accordingly. This has been important in ensuring the range of DTI-related entities active in the field of FDI promotion, trade development, SME support and industry policy have all given the issue of building linkages some attention. However, it could also be said that SME-TNC linkage development could have received increased attention had it been identified as an explicit policy goal rather than a secondary aspect or a key output of other activities.[22] Despite some considerable reference to the topic in pronouncements by government officials (for example around military off-sets), government has chosen in its formal policy frameworks to see TNC-SME linkage creation as one of a number of activities under a range of policy thrusts such as Industrial Participation or SME development. A firm and explicit commitment to furthering TNC-SME relationships, not as a by-product of other processes, but as a goal in itself would have made a difference in the consistency of attention given to facilitating TNC-SME relations.

Clarity in expectations is needed
South Africa has been through just over a decade of considerable and rapid change. Whilst there has been considerable macro-economic stability, government has introduced a range of new legislation and policy frameworks impacting on the business environment from new labour laws to skills levies and equity programmes. In some cases this has led to some uncertainty from the investment community (for example significant withdrawal of foreign investment from the stock market over rumours about minerals rights policies). However, government has generally moved quite rapidly to clarify expectations and to emphasise the outcomes it would expect to see from business in relation to such legislative and policy frameworks.

Dealing explicitly with Apartheid's legacy
Through its broad-based black economic empowerment framework government has encouraged firms to recognise the importance of changing their ownership, management and employee profiles that were previous cast in a racial mould under Apartheid. This

[22] Although a former DTI official did make the point that South Africa's relatively weak FDI performance perhaps resulted in TNC-linked FDI processes getting less policy attention with regard to SMMEs than if levels of FDI had in fact been higher.

has created an opportunity in many instances to encourage TNCs with more complicated ownership structures to embrace new forms of partnership that might not have been acceptable to them in other countries. Government has moved to make clear its intentions and the development of industry specific charters has gone a long way to provide clarity on what government's expectations are and what the industry needs to commit to. Prior to the development of the charters, the policy uncertainty and often inconsistent messages from government did little to create an environment for effective responses by firms.

Institutional alignment, information sharing and co-operation is essential
In a context where many different agencies and entities are active it is vital that there is a willingness (if not a requirement) to share information (as a minimum) and to actively co-operate (ideally). Part of the rationale for the DTI deciding to bring entities such as TISA back within its structures was driven by the necessity for improved institutional alignment between those working on FDI and trade development matters and those working with sectoral programmes and SMMEs. However, despite this emphasis at an institutional level on integration officials do recognise that levels of information sharing and co-operation are not yet optimal.

Government does often have influence over TNC's and can use it
In many cases investment processes by TNCs in South Africa have required a range of state commitments. These have ranged from major investments in infrastructure, tax incentives, financing through parastatal institutions and various forms of regulatory approval from environmental to business process approvals. It is these points of interaction that the South African government has used to "encourage" TNCs to work with local businesses and to take a positive approach to various government initiatives such as those around Black Economic Empowerment. By formalising a policy around such approaches, the potential does exist to secure greater transparency and therefore improved capabilities to secure ongoing commitment to various agreements. The military purchase off-set programmes, whilst not universally successful, do point to the value of formal agreements and monitoring mechanisms both from the point of view of measuring performance and of ensuring a level of public scrutiny. The availability of middle-management and technical skills within South Africa has also assisted in ensuring that management are often familiar with the context and the need to create links between TNCs and SMEs.

National processes need to be supplemented with, and informed by, local level processes
Both the Durban Auto Cluster and Richards Bay case studies highlight the usefulness of processes initiated and driven at the local level. South Africa's previous experience with nationally driven cluster processes were seen to be over-elaborate and generally steered clear of day-to-day challenges many firms wanted to deal with. This can be contrasted with the DAC experience where the initiative established its foundations by dealing with these very same day-to-day issues in a meaningful way for firms before embarking on bolder strategic initiatives. However, the experience of the two case studies also suggests that there could be improved learning from such local processes in national activities. There is also a sentiment expressed that while national government influence on TNCs

has yielded some positive responses to local processes this could be improved to encourage greater commitment from TNCs to forming linkages. Whilst in the Durban case the local chamber of commerce and industry did not play a significant role, in the case of Richards Bay the ZCB has been an important role player and its capacity has enabled some effective local action (although not always sustained).

Monitoring and evaluation gaps lead to a lack of learning and a dearth of information
Whilst all role-players are moving to more effective monitoring and evaluation systems this remains an area of concern.[23] The DTI could set an example through its own reporting and encourage those using DTI funds to do the same. Furthermore, TNCs (and other firms) could be encouraged to report on linkage information in a similar way that many companies now report on environmental aspects of their performance.[24] Greater detail in trade statistics could also provide a clue as to the proportion of total trade SMEs are responsible for.

The governance of value chains has an impact on linkages
Approaches to governance within value chains can be important (Humphrey and Schmitz, 2001). Although many such value chains are global, there is some benefit as illustrated in the DAC case to work with elements of these value chains that are operating in the same geographic area. Not only do such firms potentially have something in common, they could also benefit from tackling value chain-wide problems and linkage issues collectively. The example of certification requirements in the auto sector as expected by first tier TNCs (and in turn by the OEMs) comes to mind here – local SMEs were able to co-operate through the DAC to avoid multiple certification processes taking up excessive cost, management time and by learning how best to prepare for these.

TNCs need to learn from their own best practice
The Richards Bay case study reflected on different approached to linkage issues by different TNCs – both due to different approaches to investment and management and due to differences in the industrial processes characterising the industry. Some exchanges of ideas have taken place and some sharing on information but these appear limited.

Linkages can be more easily created around services to production entities as opposed to core production or downstream supply
While there are contrasts between the DAC experience and that of Richards Bay primary processing industries TNCs generally reflected a willingness to seek to engage local SMEs in services-related contracts (often in less technologically complex activities). However, particularly in the Richards Bay example, the willingness of the TNCs to cultivate relationships with local SMEs as customers of their products seems less certain. Further research is required on this issue, which might have something to do with levels of trade protection or TNCs tendencies to want to trade within their own production

[23] For example the DTI has identified 55 indicators on which it intends to measure its impacts including some related to investment impacts on local firms and trade contributions of SMEs.
[24] Some companies do provide such information, however, in many instances this is more anecdotal than anything else.

structures (where for example more advanced downstream production facilities might be located in another country and developing domestic suppliers in the local economy might harm trading prospects of such an enterprise). TNCs also often show a tendency to trade with other large TNCs who are able to handle large output volume contracts (with an accompanying view that managing multiple small supply contracts adds transaction costs and has little strategic value). Furthermore, in the South African context the issue of import-parity pricing of outputs from SA operations of multi-nationals (where they charge domestic buyers a world market price inclusive of transport costs and tariffs that would apply should the local buyer want to import the same product from an alternative supplier) has recently received much public attention as a factor impeding the ability of down-stream business to thrive alongside primary processing plants that have historically received considerable state incentives.

3.2 Policy recommendations

In policy terms there could be some benefit from attention being given to the following issues:

- A move to greater transparency and reporting by TNCs active in developing countries as to their links with local firms – there is already some acceptance of this with regard to labour practices and environmental standards;
- Encouraging learning and co-operating between TNCs and facilitating improved commitments through charters and other voluntary instruments (in country of operation, through country of origin and globally). Once again the example of environmental performance by firms could provide some indication of how such processes could work. International gatherings of sector associations and gatherings such as the World Economic Forum meetings in various regions could provide the context for such initiatives;
- Setting up of business development partnerships (TNCs, local businesses and relevant government structures and other institutions) at the local or sub-regional level where TNCs operate – various government-to-government trade and investment agreements could assist in facilitating these commitments;
- The introduction of more explicit performance measures of government programmes around TNC-SME linkages in relation to trade development, FDI attraction and SME development;
- Introducing linkage development activities (trade and FDI connected) into value chain, cluster or inter-firm network processes – around service activities and around core supply and downstream transformation processes. This could take the form of encouraging networks of firms operating in similar value chains to share knowledge amongst themselves and to work to share such knowledge with the many firms operating on the periphery of the core elements of such value chains; and
- Empowering local, sub-regional and provincial level role-players (government, private sector and non-government) to offer improved and accessible services to SMEs seeking to build relationships with TNCs domestically and globally.

3.3 Future perspectives

In a context where a growing proportion of world trade, and economic activity more generally, is being concentrated within and between TNCs, the ability of developing country firms to engage with global economic processes on a sustainable footing is brought into question.[25] Market pressure on TNCs to outsource processes to developing countries and to relocate some aspects of production to these environments does create opportunity, but such opportunity is unlikely to be widespread without the TNCs adopting a more developmental approach in their business relationships and SMEs developing capabilities to offer value in such business relationships. A range of actors, domestic and global, government and private sector, have a role to play in processes that might facilitate improved opportunities for SMEs to export into TNC networks, to be effective consumers of TNC outputs and to work with TNCs as service and production partners in the territories where they operate.

It is critical that governance processes that frame the activity and behaviour of TNCs be subject to some scrutiny and that creative voluntary responses by TNCs be encouraged. Where such voluntary activity falls short there is a role to be played by government agents in both the developed and developing country environments to facilitate arrangements which create opportunity for SMEs in a context of rising barriers to entry and persistent market failures. Intermediaries also have a role to play such as those agents sourcing product from developing country SMEs for TNCs of one sort or another. Some have suggested that as outsourcing escalates the role of such agents (for example those in the clothing sector) will grow and that in trade terms this might further marginalise SME suppliers in global value chains as their relationship with TNCs becomes mediated through intermediaries rather than a direct relationship. Efforts should be made to encourage more developmental approaches amongst these intermediaries through TNCs taking greater responsibility for the manner in which such intermediaries might operate.

It is also likely that the role of developing country TNCs will escalate as major domestic corporations such as those in India and China take advantage of a strong position in massive domestic markets to build a profile of trade and investment at a more global scale. These TNCs should not be exempt from processes seeking to cultivate more developmental relationships between TNCs and SMEs as they often display many of the characteristics of their developed country equivalents. Growth in so-called South-South

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[25] "MNCs increasingly dominate world trade: *around two-thirds of visible trade is handled by MNCs*, and the share is growing particularly in activities with significant scale economies in production, marketing or innovation. Of the visible trade handled by MNCs, between 30 and 40 percent is *within* MNC systems, between affiliates and parents or among affiliates. Such internalized trade contains the most dynamic exports today, moving within integrated international production systems, where MNCs locate different functions or stages of production to different countries. Affiliates participating in such systems produce at massive scales and use the latest technologies, skills and managerial techniques. Examples of complex integrated systems in which developing countries are important are automobiles (mainly in Mexico, Brazil and Argentina) and electronics (Malaysia, Singapore, Philippines and Mexico) (Lall, Albaladejo and Zhang, 2004). The globalisation of the value chain is likely to spread across many other industries, and linking local production chains to them will become a major source of growth, technology transfer and skill development." (Lall, 2005: 24)

trade as well as the growing significance of some developing country markets provides some opportunity to attempt to engineer new forms of relationships that are not overly characterised by the legacy of exploitative behaviour which many longer established TNCs might still suffer from.

It is also possible that some advantage can be taken of growing awareness in some developed country market environments (consumers and investors) of issues of fair trade and ethical business relationships. This has already had some impact on the behaviour of some TNCs and could contribute to improved TNC-SME interaction. The fact that some consumers (and investors) are prepared to pay a premium for goods that have emerged from transformation processes with some developmental foundation could contribute further to opportunities.

In addition to these possibilities there is a need for much improved assessment of existing programmes to support and develop the capabilities of SMEs and to tackle ongoing problems at the domestic level which impact on their operating environments. Various assessments of the competitiveness of the business environments in developing countries suggests that many have a long way to go with the provision of an environment conducive to growing businesses. Lall (2005), Chang (2004) and others have suggested that some innovations need to take place in terms of industrial policy, technology policy and a variety of other policy frameworks to secure much improved support for SMEs in developing competitive capabilities.

> "The development of capabilities faces market and institutional failures. Overcoming such failures requires strategy, to tap foreign sources of knowledge, technology and skills, to absorb these locally and to build a base that can attract foreign resources. The countries that have developed the strongest capabilities in recent times, the East Asian Tigers, adopted a variety of strategies to overcome those failures (Lall, 1996, 2001, Lall and Urata, 2003). Africa has not adopted any of these different strategies successfully." (Lall, 2005: 2)

Chang (2004) suggests that this will also require some reform of international agreements and frameworks that have, to some degree reduced the scope of intervention of governments in being able to work with domestic firms to enhance their capabilities. The treatment of intellectual property rights, various forms of concessional finance to related and supporting industries operating within value chains and the manner in which tariff reduction processes are handled are but some of the issues that might deserve some more attention.

Furthermore, TNC activity in the services sector has been showing signs of considerable growth accompanied by a trend for activity of various sorts to be outsourced to developing countries. This will present new opportunities and new challenges as TNCs seek to restructure global services activities. Developing countries such as India have successfully tested new policy instruments to encourage FDI and business linkages in this regard and other developing countries will need to examine their own approaches that have for many years been conditioned by the dynamics of the manufacturing and commodity goods sectors.

These trends suggest an evolving environment which will require evolving policy responses and considerable vigilance from those tracking the changes and their impacts to promote outcomes of benefit to developing countries. While in the past developing countries had many instruments at their disposal to impact directly on the outcomes of TNC-SME relationships, these were often not used in a sustainable manner and today many of the tools are deemed inappropriate and in some cases against international agreements. A requirement exists for more discreet activities that can build on the power of networks and enable knowledge sharing, technology transfer and supportive changes in international frameworks. These must be underpinned by a solid local environment for business and ongoing efforts to encourage appropriate TNC responses.

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Discussions, personal communications and interviews were conducted with officials of the following:

- Department of Trade and Industry (present and former officials)
- eThekwini Municipality
- Trade and Investment KZN
- Durban Auto Cluster facilitators and members
- Zululand Chamber of Business and participants in linkage programme

Statistical sources
Unless otherwise stated data for charts was obtained from 2004 data on the SA economy gathered by Global Insight Southern Africa Pty Ltd www.globalinsight.co.za and published in the reports of the eThekwini Municipalities Economic Development and Facilitation Unit.