



Promoting inclusive business and small business development

ECONOMIC INTELLIGENCE REPORT
QUARTER 2

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1. Defining Inclusive Business Models

Inclusive business models are commercially viable models that benefit low-income communities by including them in a company's value chain on either the demand side as clients or consumers, or on the supply side as producers, entrepreneurs or distributors in a sustainable way. Inclusive business models build bridges between private sector and the poor for mutual benefit. The benefits for business go beyond immediate profits and higher incomes and include driving innovations, building markets and strengthening supply chains. And for the low income communities, benefits include access to essential goods and services, higher productivity and greater empowerment.

The supply side perspective of inclusive business models presents an opportunity for the empowerment of small, medium and micro enterprises (SMMEs) ultimately ensuring their financial viability. The impact that inclusive business models have either directly or indirectly on local employment, advancement of productive skills, more competitive local enterprise sector and more efficient local institutions approach bode well with especially localization, rural development (to some extent), manufacturing and job creation as the strategic pillars of DEDaT. This report seeks to firstly, show case the success stories of inclusive business models in South Africa, secondly to provoke thoughts on the possible use of the models (supply side perspective) as an engine for attaining the objectives of localisation and or job creation in pursuit of economic development.

2. Salient features of Inclusive Business Models

Some of the common features in various inclusive business models include:

- **Building the capacity of producers, suppliers, distributors, retailers or customers from disadvantaged communities**, e.g. private business can equip their potential suppliers or distributors with skills to enhance the quality of products and services they provide;
- **Financing producers, suppliers, distributors and retailers;**
- **Adapting and creating products targeting new users including poor consumers and disadvantaged communities and**
- **Using distribution approaches to reach the disadvantaged consumers in rural areas.**

3. Policy and Legislative Framework in support of Inclusive Business Models

This section lists the policy initiatives and legislation upon which inclusive business models may be premised, in expedition of local procurement (localization):

3.1 National Development Plan

The National Development Plan (NDP) was adopted by cabinet in 2012. The NDP advocates that only through effective partnership across society can a virtuous cycle of rising confidence, rising investment, higher employment, rising productivity and income be generated (National Planning Commission, 2012). Furthermore, the NDP recommends that supermarkets/ retailers must be encouraged to open up value chains by partnering with local producers in rural areas.

3.2 The Preferential Procurement Policy Framework

The Preferential Procurement Policy Framework is another policy document that is in support of promoting local suppliers in government organisations. The policy includes interesting legislation such as that an organ of state may include specific tendering conditions, that only locally produced goods, services or locally manufactured goods with a stipulated threshold for local production and content will be used.

3.3 Buying local initiative

The business associations, government and organised labour signed a “buying local pledge” in an effort to promote procurement of locally manufactured goods and services. The signing took place at the Proudly South African Buy Local Summit, in Johannesburg. The summit recognised the fact that local producers must be more competitive in terms of quality, price and that there is still a challenge in terms of desirability of South African goods. The buying local initiative is the brainchild of Proudly South African. Proudly South African is an organisation that promotes the procurement of local products and supports local manufacturers at the same time creating valuable jobs for South Africans.

3.4 Local Procurement Accord (2011)

According to the National Economic Development Department (EDD), the government and other parties signed the Local Procurement Accord on 31 October 2011, as an outcome of social dialogue on the New Growth Path. The purpose of the Accord is to empower South Africans to implement the wide ranging commitments and mobilize the private sector, organised labour, communities and government in a strong partnership to promote local procurement in the country. This is a platform for creating five million jobs by 2020.

The parties that signed the accord include:

- Government represented by the Department of Trade and Industry (DTI), the Department of Public Enterprises (DPE), the Economic Development Department (EDD), and the Department of Energy (DOE)
- Community constituents at NEDLAC
- Business Unity South Africa (BUSA), Business Leadership South Africa (BLSA), National African Chamber of Commerce and Industry (NAFCOC) and Foundation for African Business and Consumer Services (FABCOS)

The parties to this accord recognise the importance of local procurement on jobs creation and industrialisation. They aspire to achieve a 75% localization in the procurement of goods and services, both by the public sector and by the private sector. Promotion of locally manufactured goods is critical to South Africa for growth and job creation.

3.5 The Broad-Based Black Economic Empowerment Act (BBBEE)

The Broad-Based Black Economic Empowerment Act is another legislative framework in support of black economic empowerment. Some of its objectives include promoting economic transformation in order to enable meaningful participation of black people in the economy. It also promotes access to finance for black entrepreneurs and empowers rural and local communities by enabling access to economic activities, land, infrastructure, ownership and skills.

3.6 South African Supplier Diversity Council (SASDC)

SASDC was founded by large business across various sectors such as SASOL, ABSA, Uniliver, De Beers, Johnson Control and First Rand. SASDC seeks to be the leading corporate council in South Africa dedicated to promoting sustainable supplier diversify value-addition, through targeted procurement and black supplier development. The Council enables members to practice supplier diversity as a strategic business objectives, by

- Establishing and maintaining a database of a certified bona fide black suppliers
- Sharing knowledge, experience and best practice in supplier diversity
- Supporting member commitments in growing procurement and development opportunities for black-owned suppliers

Supplier diversity is the active business process of sourcing products and services from previously under-used suppliers. In South Africa it involves the process of growing pool of competitive black suppliers into corporate supplier chains, using targeted procurement and enterprise development to achieve this.

3.7 DTI's designated products and sectors

The Department of Trade and Industry has designated sectors and products¹, which government departments, agencies and state-owned enterprises have to procure from local manufacturers or suppliers.

3.8 The Mining Charter

The Mining Charter serves as a compulsory regulation that mining companies have to comply with. The charter set targets for mining companies to procure 70% of services and 40% of consumer goods from BEE entities by 2014.

¹ For further reading on designated products and sectors visit www.dti.gov.za

4. Case studies for inclusive business models

The Woolworths Enterprise Development (ED) programme has been designed primarily to support emerging black-owned organisations in the Woolworths greater supply chain, including primary and secondary suppliers. Based on individual needs analysis approach, Woolworths is able to assist emerging black-owned suppliers to become truly sustainable businesses (Woolworths Holdings, 2013).

Assistance is provided by:

- Ensuring that the Enterprise Development beneficiary is on shorter payment terms to assist with cash flow;
- Identifying development needs and assisting in ensuring that there is a programme of interventions to address gaps; and
- Making finance available through the ED loan fund.

The ED support is afforded to black enterprises for a three-to five-year period, after which it should be demonstrated that the enterprise has reached a certain level of sustainability. Woolworths has intensified support to 51 enterprises, which are receiving business development support and financial assistance. Woolworths has disbursed R 27 million in loans and provided business opportunities worth R 650 million to these small enterprises. Over 5 000 people are either employed or supported by the employees of these small enterprises.

Case Study : Elukwatini Tomato Farmers²

In the farmlands of Elukwatini, Mpumalanga, lie several small plots of land that are bringing renewed hope to an impoverished community of former subsistence farmers. Elukwatini farmers produce healthy vegetable crops, but the distance to market had effectively destroyed any attempts by small-scale farmers to make a profit, forcing them to remain subsistence farmers.

Woolworths in partnership with Technoserve (Enterprise Development partner) and Qutom (Woolworths tomato supplier), stepped in to provide training, mentoring, technical assistance and establish essential links to both finance and retail markets. The farmers were also assisted with a grant and have since used “top up” and production loans. Woolworths has given a production loan for R 350 000.

The pilot project started in 2011 with 13 one-hectare crops of tomatoes. The first crop was harvested in April 2012. They harvested 570 tons of round tomatoes of which 202 tons went to Qutom (with 80% of those being packed for Woolworths) and 268 tons went to local traders and some were exported, with an additional 100 tons sold by the farmers locally. With an increase in yield in 2013, the top farmers generated net profits of more than R 75 000 from 1.5 hectares. The farmers are creating employment for 80 -90 local people during nine-month tomato production period.

One of the farmers said the Woolworths Enterprise Development programme and the training received have helped her become a more successful farmer. She has five permanent employees and also hires seasonal workers during harvest time.

² See Woolworths The Good Business Journey Report 2013

Case Study: Chic Shoes

When their previous employer shut its doors in 2004, three of the managers took over the machinery and started Chic Footwear. Despite their skills and the hard work of their 95 employees, difficulties with raw materials supply and shortage of funds stood in their way. When they approached Woolworths it was apparent that some changes were needed before they could supply a world-class leather product at a competitive price. So the buying and designs teams stepped in to help with product development. Woolworths helped them to get their production line operating more efficiently and their raw materials suppliers came on board. A loan of R 1.9 million financed through the Woolworths Enterprise Development programme, helped them procure fabric and cover operational costs.

In November 2011, they delivered their first order of 5 000 pairs of leather pumps to Woolworths. By mid-2012, they had produced over 100 000 pairs, employed 110 staff, and had started looking forward to a brighter future. Today they have 250 employees and have produced over 400 000 pairs of leather pumps for Woolworths to date.

5. Constraints and challenges in inclusive business

While the opportunities for creating inclusive business are extensive, there are significant challenges. The following are some of the challenges that are encountered when conducting inclusive business:

a. Lack of basic infrastructure

Rural areas often lack basic infrastructure that is conducive for promoting business such as roads and other physical infrastructure, basic market information and business support services. Poor infrastructure is a critical barrier to accelerating growth and alleviating poverty. Properly developed infrastructure will reduce the cost of doing business, enable access to markets and advances in agriculture, facilitate trade, regional and global integration.

b. Regulatory constraints

Government and relevant agencies must make it easy for small businesses to register their companies and acquire relevant documents without pro-longed delays.

c. Access to finance

Accessibility of finance remains a key challenge while doing business with small businesses. Some of them have limited and irregular cash flows and often need financing in order to participate in inclusive business models either as suppliers, distributors or producers. Commercial banks rarely approve loans requested by small businesses and entrepreneurs, therefore innovative financing solutions is needed in order to include the poor and disadvantaged in value chains.

Whilst funding could be a barrier for small businesses, inclusive business models present opportunities that eliminate the irregular cash flows and afford small business to participate in the value chain as suppliers, distributors or producers. Inclusive business models thus present innovative financing solutions needed in order to include the poor and disadvantaged in value chains. This eliminates the constraints associated with commercial banks' reluctance to avail funds to smaller businesses. A practical example is the Woolworths Enterprise Development Programme that makes funds available through their loan fund. These loans are tailor made to suit small local businesses with corresponding low interest rates and repayment terms

d. Access to information

Communities, individuals and small businesses in rural areas rarely have access to internet and other sources of information.

Even though the above listed can serve as challenges to inclusive business models, the opportunities and strengths of the models far outweigh these threats. For instance, inclusive business models can cushion the current infrastructure challenges through introduction of advisory one-stop centres especially in rural towns and villages. These advisory one stop centres would capacitate small business entrepreneurs, farmers and suppliers on a range of issues. Again, there are opportunities for training and development. When working with small business or co-operatives from poor communities, big established companies often need to invest time and capital in building the capacity of the business partners.

6. The retail industry in South Africa

Retail plays a significant role in the domestic economy and South Africa has the biggest retail market in Sub-Saharan Africa (ICCO Cooperation, 2013) and it is dominated by the following retail companies:

- Spar
- Pick n Pay (including Boxer)
- Shoprite Checkers (including Ok foods)
- Fruit and Veg city
- Massmart/ Wal-Mart (including Makro, Game, Jumbo Cash and Carry and Cambridge Foods)
- Woolworths

6.1 Retailer supplier relationships

Over the past years, the major food retailers have collectively changed the way in which fresh produce is bought and sold in South Africa. There has been a significant move away from

the municipal markets, as retailers enter into direct supply agreements with “listed” suppliers.

Commercial farmers are issued with growing programmes by the retailers on a bi-annual or seasonal basis. These programmes detail the product, pack size and volume or quantity (broken down per week or month). Orders are then placed daily with the farmer in line with the growing programme (ICCO Cooperation, 2013).

In almost all instances the buyer or procurement person is the custodian of the relationship with the farmer. Prices, promotions and all advertising deals are negotiated between the buyer and the farmer, with due consideration given to the current market price.

6.2 Distribution Centres

Most, if not all the large retailers have moved away from direct deliveries (to the back door) by suppliers and have centralised their distribution and logistics which are operated out of large regional Distribution Centres (DCs), strategically located throughout the country.

Stores place orders, which are consolidated at the distribution centres, then communicated to the respective suppliers, for delivery into the distribution centre the following day. The length of the lead time for placing orders varies from retailer to retailer (minimum 24 hours and maximum is 48 hours). Product is received from the suppliers, sorted and dispatched to the various stores for overnight delivery. Due to the geographical size of the country, many distribution centres will deliver to stores that can be very far.

6.3 Retail store formats/ model

The retail format or model that is adopted by a specific retailer will determine the manner in which they order and receive fresh produce. Woolworths, Massmart, Boxer and Shoprite Checkers operate only corporate or company owned stores, while Pick n Pack, SPAR and Fruit and Veg City have company owned and “franchisee” or “owner run” stores. In terms of Company owned or corporate stores, all products are supplied to those stores via the distribution centre and listed suppliers.

Franchise stores or owner run stores are able to buy outside of the retailer’s centralised buying structure and procure products direct from farmers and suppliers. This is an area of opportunity for emerging rural farmers wishing to supply a retail store.

6.4 Challenges faced by retailers sourcing from emerging farmers

- a) **Pricing-** some of the emerging farmers have lack of understanding and knowledge of various elements that go into pricing when supplying to retailers (e.g. emerging farmers will normally want to inflate or charge higher prices when supplying to retailers than informal market).
- b) **Continuity of supply and availability of product-** the variety of products that is available from emerging farmers is limited. The farmers lack the ability to plan their planting cycles to ensure that they will have sufficient volumes to meet retailer’s orders.
- c) **Logistics and distribution:** the high cost of fuel and the small volumes being delivered directly impacts on the cost per unit. SPAR and Shoprite stated that the emerging

farmers did not want to deliver to distribution centres, but rather to local stores in their area (ICCO Cooperation, 2013).

- d) **Quality:** Retailers have a stringent product and quality specifications in place, emerging farmers have very little understanding of product specifications and the need to comply. Emerging farmers have limited if any, quality and sortation process in place, which means that product that is supplied is inconsistent in terms of size, shapes, colour, maturity and quality. For these reasons retailers subscribe mentorship model with commercial farmers who can guide, train and assist the emerging farmers with quality. In these instances the product is sorted, graded and packed at the commercial farmer's pack houses.
- e) **Food safety criteria:** Retailers have stringent food safety criteria that all suppliers must comply with. Comprehensive product specifications are in place that detail the quality, size, the use of sell by and best before dates, traceability and cold chain requirements. In addition, retailers require their farmers to have annual food safety/certification audit. Global GAP is the mostly widely prescribed standard required by the retailers. These audits are paid for by the suppliers. All the criteria requirements make it very difficult for emerging suppliers to comply and supply the retailers.

7. Creating an enabling environment

Inclusive business models need an environment that is conducive to growth, sustainability and profitability. All stakeholders participating in inclusive business models have a role to play to ensure they create that kind of environment.

Government is also encouraging the growing political importance of nurturing strong private sector-led growth, which creates jobs and enable wealth creation, supported by regulated institutional framework and reinforced by properly functioning government institutions.

Government can create enabling environment for inclusive models by taking the following actions:

- Supporting public goods and investment in basic infrastructure such as roads, ICT, electricity, water and sanitation
- Protect new markets entrants by ensuring fair competitive practices
- Improving the business environment by reforming regulations, reducing bureaucracy and engaging in public-private dialogue
- Conducting research, disseminate information and learning from other countries ways in which we can promote inclusive business models
- Government together with relevant agencies must make it easy for qualifying entrepreneurs and farmers access finance
- Introduce incentives that will promote big companies to include small businesses and suppliers into their value chains
- Promote Public-Private Partnerships as a solution to some developmental challenges
- Ensure that small businesses and aspiring entrepreneurs receive adequate support in terms of registration, tax compliance, licenses and other regulatory matters
- Support and capacitate emerging farmers in order to participate in the value chain of large retail companies

- Introduce and build capacities of advisory one-stop centres especially in rural towns and villages, which will offer small business entrepreneurs, farmers and suppliers on a range of issues

8. The role of private businesses in promoting inclusive models

The private sector can play a pivotal role in growing the economy and creating jobs by taking the following actions to promote inclusive business practices:

- Companies need to review and analyse their procurement strategies to support local suppliers and producers
- Identify economically viable opportunities to bring local suppliers into their value chains, empowering women, youth and unemployed population
- Set targets to increase procurement from local suppliers and report annually on the attainment of their procurement targets
- Review value chains to identify non-core activities that can be sourced to local suppliers
- Partner with relevant stakeholders to support capacity building and skills development initiatives to enable the local suppliers and community members to be competitive and acquire relevant skills (e.g. through workshops, quality accreditation scheme etc.)
- Establish a database of local suppliers and update it regularly
- Continuous research and development of new products, innovations and services
- Companies need to make clear their quality, standards and requirements to the prospective suppliers and include that in the Service Level Agreements (SLA)
- Financial institutions can assist small local suppliers by introducing micro-finance products that is tailor made to suit small local businesses with corresponding low interest rates and repayment terms
- Big businesses procuring from small suppliers can implement measures or processes to avoid suppliers waiting long for payments, because most of small suppliers do not possess enough cash flow to sustain their operations for excessive periods without payments

Conclusion

Whilst inclusive business models directly focus on supply side issues relating to supplies, distributions, creation of new markets and so, their ripple effects are far reaching and impact on job creation, income generation and poverty alleviation amongst others. What makes the models suitable and appropriate to the province, is their ability to not only promote the reliance of an economy to the primary sector, especially agriculture but also to unleash the performance of the manufacturing sector (clothing and textile for instance). There is a crucial need for the province to revive the performance of the manufacturing sector and as such inclusive business models are a possible engine towards attaining this objective.

The nature of inclusive business models completely compliments the strategic focus of the department, which is largely premised on the four pillars namely localization, rural

development, job creation and manufacturing. To ensure their promotion, feasibility and realisation, research on the most suitable approaches and best practices to inclusive business models in the province and or the country is key. The possible benefits of inclusive business models call for consideration of their promotion, especially in the semi-rural province like the Northern Cape.

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