STRATEGIC ANALYSIS IN THE CONTEXT OF SOUTH AFRICAN ECONOMIC DEVELOPMENT

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RESTRICTION

Due to the confidential and sensitive nature of the information contained in this study, this document is restricted for a period of five years.

DECLARATION

I, Wade van Rooyen declare that the work presented in this dissertation is my own and has not been submitted previously to any other university or technikon. Any work done by other persons has been duly acknowledged.

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ABSTRACT

The South African Department of Trade and Industry administers supply side incentive programmes aimed at promoting industrial development. This report presents a strategic analysis of the Chief Directorate: Manufacturing Development, and the Small Medium Manufacturing Development Program (SMMDP), in the context of South African Economic Development.

Principles of corporate strategic theory are applied to analyse the SMMDP, a key element of government's basket of supply side measures. The programme has been implemented under the direction of the Board for Manufacturing Development whose objective is "To promote manufacturing Growth by way of incentives or concessions with regard to requirements within the framework of the economic policy of the republic."

The success of the SMMDP is measured by the extent to which it accomplished the objectives of Wealth Creation, Employment Creation, Development of Entrepreneurship, Promoting the Utilisation of Raw Materials, Ensuring the Long Term Sustainability of Projects Receiving Incentives, Creating Opportunities for the Introduction of New and Advanced Skills into South Africa, and Facilitating International Competitiveness.

Its effectiveness is hindered by policy conditions embodied in the SMMDP. Policy requirements that are within the Board for Manufacturing Development's control, ranked in order of severity are: Plant and Machinery, Equity, Turnover, and Human Resources.

The requirement that has the highest frequency of non-compliance and the greatest effect is the Plant and Machinery requirement. Since this requirement has no bearing on the achievement of objectives and is only in place for the board's convenience, it should be removed from the programme.

A strategy that focuses on clusters of industry that produce high numbers of employment relative to the investment made would be better suited to the objective of employment creation. Employment creation can also be more easily achieved if the Board allows the use of second-generation machinery. Insufficient correlation between the Board for Manufacturing Development's strategy and that of the labour authorities negate the positive effects of incentives on employment creation.

The strategy was acceptable to the stakeholders at the time of implementation, but since many of the intended outcomes did not materialise, a post implementation assessment does not find the strategy acceptable.

In assessing the feasibility of the strategy, the resources and competencies of the Chief Directorate: Manufacturing Development are considered. Many industrialists loose incentives due to the exclusion of expansion projects from the scope of the SMMDP. However, since the exclusion is due to lack of resources, the strategy cannot be feasible if expansions are included within the scope of the programme.

Although the SMMDP has failed to achieve most of it's objectives, the overriding objective of the Board for Manufacturing Development, is the creation of wealth. The programme has achieved this requirement, in spite of its failures, and should therefore not be considered a total failure.

The study recommends that:

- The Plant and Machinery requirement be removed from the SMMDP.
- The equity ratio is re-evaluated to produce a more desirable outcome.
- The Board for Manufacturing Development employ's a bird's eye economic approach to stimulate growth in industries that will produce the most favourable economic outcomes. In other words, blanket incentives should be traded for specific incentivisation.
- Expansions are included in the scope of industrial incentives.
- The Board for Manufacturing Development adopts a transparent approach so that industry and government may work together to produce favourable economic outcomes.

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Chapter 1: Introduction

1.1. Introduction

The South African Department of Trade and Industry has administered a variety of Industrial Incentive schemes over the past two decades. The objective of these incentive schemes is to promote industrial development and investment in the manufacturing sector. This is achieved through the payment of a cash subsidy to qualifying industrialists.

The incentive programmes have evolved from demand side measures, to supply side measures, and the current programmes are aimed at reducing structural constraints in the economy, which limit the supply of goods on the open market.

The South African economy wrestles with structural problems such as high unemployment, limited application of technology, and the high cost of capital. The incentive programmes attempt to address each of these problems by including requirements in the approval regime, which address employment criteria, minimum investment levels, turnover targets, and accounting requirements indicating long-term sustainability.

Promotion and administration of incentive programmes is conducted within government agencies, such as the Industrial Development Corporation (a section 21 company with the government as it's sole shareholder), independently appointed consulting agencies, and a division of the Department of Trade and Industry (DTI) known as the Board for Manufacturing Development.

Since 1981 three generations (known as schedules) of incentive programmes have been implemented, by the DTI. Schedule 4 was implemented in 1981 and revised in 1991. It comprised the Regional Industrial Development Programme (RIDP) and the Simplified Regional Industrial Development Programme (SRIDP). In 1996 Schedule 5 replaced the RIDP and SRIDP with the Small Medium Manufacturing Development Programme (SMMDP),

and the Tax Holiday. Schedule 5 implementation ended in September 2000, and September 1999 respectively, and has been replaced with Schedule 6, comprising the Small Medium Enterprise Development Programme (SMEDP), and the Strategic Programme.

This report presents a strategic analysis of the Chief Directorate: Manufacturing Development, and the SMMDP, in the context of South African Economic Development. The study analyses the SMMDP, in order to determine whether the strategy employed by the Government's Board for Manufacturing Development, is suitable, feasible, and acceptable, and will be effective in forwarding the objectives that it set out to achieve.

Although the SMMDP represents a past programme that is no longer being implemented, the scope of this study has been deliberately limited to the SMMDP for the following reasons:

- All programmes have been structured in a manner that allows the industrialist to claim incentives for a contractual period of 3 to 6 years.
- An industrialist approved for incentives under the RIDP in 1996, receives his last subsidy in 2001.
- There is a long period of delivery before one can evaluate the effectiveness of a particular incentive programme.
- The RIDP and SRIDP (Schedule 4 incentives) are historic and a study relevant to them would be in vain
- The SMEDP and Strategic Investment Programme (Schedule 6 incentives) are too new to make an assessment of their effectiveness.
- Analysis of the SMMDP at its current stage of maturity makes its analysis appropriate.

The timing is therefore ideal to make an assessment of the SMMDP, and there is a base of beneficiaries that can be analysed to determine the effectiveness of the programme in accomplishing it's stated objectives.

1.2. Motivation for Conducting Research

The Enterprise Organisation (TEO), a division within the Department of Trade and Industry (DTI), has been allocated a budget of R2.2 Billion per year to assist in economic development (Loxton, 2001). These programmes are funded through taxpayer's funds and TEO must be accountable for distribution.

TEO is a new organisation replacing a past administrative body under the Chief Directorate: Manufacturing Development. This study will make reference to the Chief Directorate: Manufacturing Development, and its role in the implementation of the SMMDP.

It is a matter of public interest to know that incentives are paid to deserving companies, in an equitable manner.

Policy implementation and regulation has a severe impact on the effectiveness of such incentive programmes. The question begs to be answered as to whether the policy and guidelines implemented by the Board for Manufacturing Development have hindered or aided the accomplishment of its objectives.

Furthermore, equitable distribution of subsidies and effective promotion cannot be achieved without sound implementation. Was the Chief Directorate: Manufacturing Development adequately geared to handle the demands of a global economy, changing at a rapid pace, and if not, will TEO be able to provide a more solid foundation for the implementation of future programmes?

1.3. Value of the Study

The evolution of the incentive programmes offered in South Africa has been dynamic. At the close of applications for Schedule 4, intensive evaluation was conducted on the success of Schedule 4 incentives (Nkuhlu et al, 1988). The results of these studies were used as building blocks for Schedule 5. These reports have formed part of the literary review of this study.

A core difference between Schedule 4 and 5 is that Schedule 5 was only available to Greenfield's establishments, while Schedule 4 allowed for existing companies to expand more than once. Schedule 6 has reverted back to Schedule 4 precedents and allows both new companies and existing companies expanding to apply for incentives, but only one expansion may be made per company.

The findings of this study can be used in a variety of purposes:

- Developing future incentive products.
- Identifying and remedying weaknesses in current products.
- Assessing the impact that incentives have on manufacturing businesses.
- Assisting TEO to refine organisational structure to better meet the needs of investors.

The study is worthwhile both as an exercise in the implementation of management principles in government departments, and as a means of assessing the future success of programmes to which the government has already committed future funding.

1.4. The Research Question

The study aims to answer three important questions:

- Did the Chief Directorate: Manufacturing Development utilise all possible means and methods available to ensure achievement of its objectives?
- What, if any policy and regulations were included in the SMMDP, that were in conflict with and hindered achievement of it's objectives?
- Has the SMMDP achieved its objectives in the context of South African Economic Development?

1.5. Methodology

The study has utilised a case study method to evaluate the Chief Directorate: Manufacturing Development, and has followed the process outlined below:

- Secondary data was gathered and used to determine the historical objectives of the Board for Manufacturing Development
- A literary review was conducted to gain an understanding of the regulations of the incentive programmes, their workings, their benefits, and their application.
- Past reports of Schedule 4 incentives were studied to gain insight into the effectiveness of the programmes, the criteria used for evaluation, and to make comparison between the objectives of each of the incentive programmes.
- Interviews were conducted with key personnel employed by the Chief Directorate: Manufacturing Development throughout the implementation of Schedule 4, 5 and 6 incentives, to gather the primary data that has been referenced throughout the case.
- A non-probability convenience sample was drawn from the population of participants in the SMMDP. The sample was selected from the client base of a Durban based consulting firm, specialising in the administration of industrial incentives. The data is not designed to be externally valid, but rather to provide internal validity by indicating the shortfalls in the incentive programme.
- The structure and programmes of the Board for Manufacturing Development were then analysed in relation to their stated objectives.
- Problematic requirements identified within the sample were analysed and traced back to the historical policy and reason for inclusion in the programme, to determine whether the implementation of regulations has hindered the accomplishment of objectives, and whether such regulations are absolutely necessary.

1.6. Limitations

The study has been limited to the application of the SMMDP. It's scope excludes any reference to the Tax Holiday, it's concurrent sister programme implemented in Schedule 5.

The sample group from which evidence has been gathered was only taken from the Kwazulu Natal Region. It is a convenience sample, and therefore statistical findings cannot be inferred upon the broad population.

The assumptions and methodology applied can, however, be applied to a statistical analysis in the future, and may also be applied to the evaluation of programmes post Schedule 5.

1.7. Structure of the Study

This research study is of great importance in the arena of industrial development incentives. Much uncertainty exists as to the true impact of Industrial Development incentives. TEO has recently also been widely criticised for it's slow implementation, and prescriptive policies which do not lend themselves to use by industry (Natal Mercury, 8 Nov 2001)

Criticism of this nature is evidence of a strategic failure. This study aims to identify whether this criticism is unfounded, and if not, what the cause of strategic failure is.

Chapter 2 of this report begins by assessing the theory of effective corporate strategy, and adapting the theory relevant to this study to suit an application in a non-profit governmental organisation. Chapter 3 then outlines the facts of the SMMDP case that form the subject of this study. In Chapter 4 a strategic evaluation of the case is conducted, followed by recommendations and conclusions in Chapter 5.

1.8. Conclusion

The SMMDP is administered by the Chief Directorate: Manufacturing Development, and is a key element of the government's basket of supply side economic measures.

Equitable distribution of subsidies cannot be achieved without sound programme implementation. An evaluation of the programme's implementation is of public interest, because the subsidies are funded from

taxpayers' funds, and the public are the ultimate beneficiaries of favourable economic outcomes.

The study aims to answer three important questions:

- Did the Chief Directorate: Manufacturing Development utilise all possible means and methods available to ensure achievement of its objectives?
- What, if any policy and regulations were included in the SMMDP, that were in conflict with and hindered achievement of it's objectives?
- Has the SMMDP achieved its objectives in the context of South African Economic Development?

A case study approach was utilised to conduct the analysis that included the gathering of secondary data, conducting of a literary review and primary research in the form of interviews with key DTI personnel.

Chapter 2: Corporate Strategy for Non – Profit Organisations

2.1. Introduction

Since the beginning of time when Cane Conspired to kill Abel, the existence of strategy has governed the decisions made by man. Jacob successfully stole the birthright from Esau by deceiving Isaac, and Noah appeared a fool for breaking the norms of society.

In more recent times, what possessed Enron to move away from it's roots in traditional energy production and distribution to trading and securitisation in water, real estate and derivatives. Or why did MTN lose ground to Vodacom after a generating enormous early marketing promise.

Strategy has always influenced and will always influence the decisions made by people in their dealings with others. Strategy is the blue print used by men and women when they are required to make a decision, after finding themselves in the midst of a changing environment. In its greatest form, strategy is the tool used by people to change their environment.

Strictly applied to a commercial environment, a sound strategic plan will determine the extent to which a company can remain adaptable to social, economic, technological and political factors which surround the company, and will enable the company to steer it's way through the rapids of change, and arrive safely at the prescribed strategic destination.

This chapter addresses basic strategic methodology that will be applied to analyse the SMMDP case in Chapter 3. The corporate strategic theory discussed is relevant to a company with a profit-making objective and takes into account various organisational considerations. In this study, principles of strategic theory are applied to analysing the product of an organisation, and the principles are therefore adapted at the end of the chapter to a non-profit governmental organisation.

The following paragraphs address issues such as the definition of corporate strategy, factors affecting corporate strategy, deciding on a company's strategy, identifying organisational resources and developing competitive advantage through the value chain.

2.2. Formal Definition of Corporate Strategy

Lynch (2000: p 8) defined corporate strategy as "the pattern of major objectives, purposes, or goals and essential policies or plans for achieving those goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or is to be."

2.3. What Shapes a Companies Strategy?

A company's strategy is naturally affected by its business objectives, the environment in which it operates, and the resources it has at its disposal. The predominant stakeholders in the organisation in turn determine the business objectives.

A non-profit organisation such as a hospital or charity would therefore have different objectives to an organisation whose principle objective is to make a profit. Even organisations with similar business objectives may have different agenda's. For example the Managing Director of a large listed company may focus on developing long-term wealth and future increased profits for the firm in order to satisfy the demands of the companies' shareholders. The owner of a small medium sized firm is more concerned about maximising profit in the current financial period, in order to maximise his personal gains in the short term.

It is therefore imperative, that when deciding on an appropriate business strategy, these factors are taken into account, together with any other factors that may have an impact on the organisation.

Figure 2-1 is adapted from Thompson and Strickland (2001) and indicates the potential factors that impact on the appropriate choice of company strategy in a normal organisation with a profit-making objective.

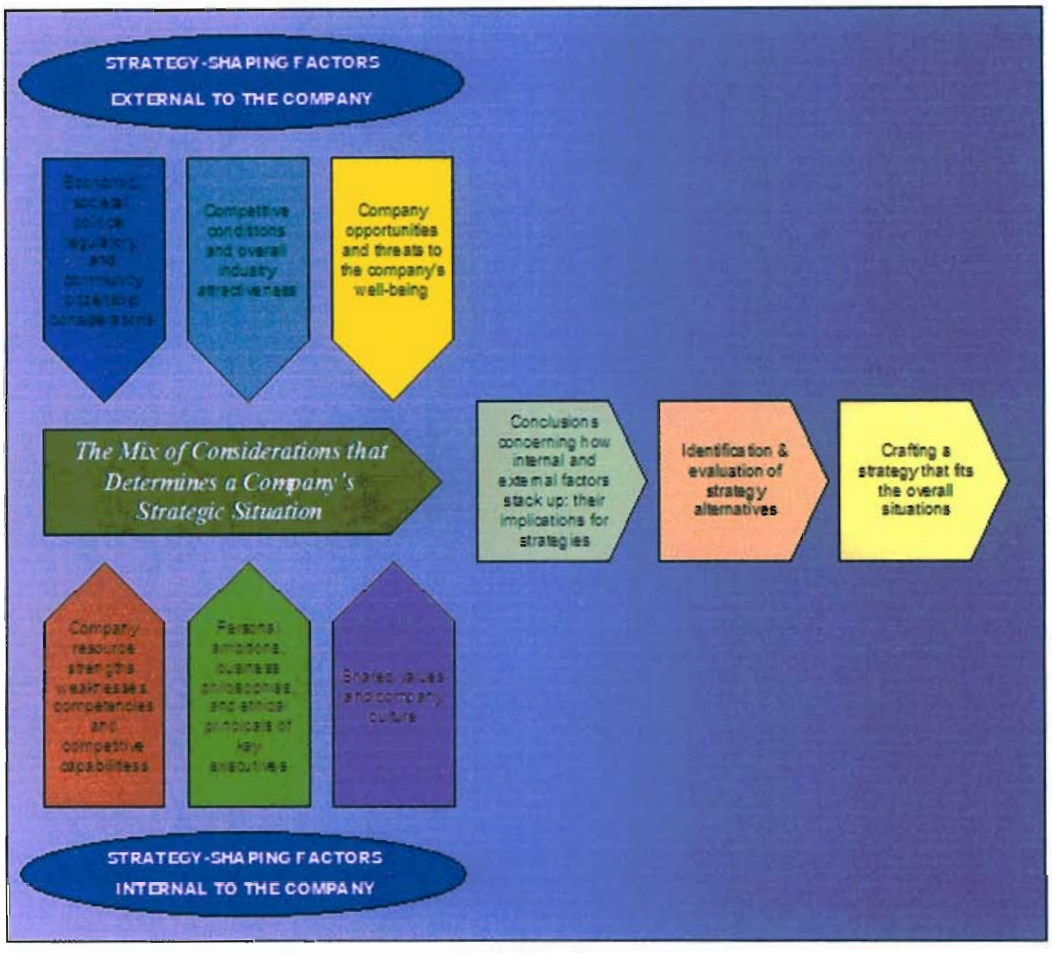

Figure 2-1: Factors Facing the Choice of Company Strategy

Source: Thompson & Strickland, Factors Shaping the Choice of Company Strategy, 2001.

2.4. Deciding on a Companies Strategy

The core purpose of a company's chosen strategy should be to add value, which can be distributed amongst the company's stakeholders. The key elements of a strategic decision are (Lynch, 2000).

- The strategy must be sustainable
- It must develop the delivery process
- It must result in the company gaining a competitive advantage
- It must exploit linkages between the organisation and it's environment

2.4.1. Sustainable Strategy

Strategy implementation often necessitates substantial investment in tangible and intangible resources. The result of selecting a strategy that is not appropriate could potentially have a negative impact on the company's objectives. In addition, the cost of changing and re-implementing the chosen strategy may result in an equally negative impact.

This does not necessarily imply that a strategy is cast in stone, and cannot be altered. Indeed, a firm that is nimble and able to respond quickly to changing circumstances in it's environment will almost certainly possess a competitive edge over one that is not able to suitably adapt it's strategy in a time frame that is acceptable to the market place.

2.4.2. Develop Process to Deliver the Strategy

Having a good strategy without a means of delivery is like being in possession of a GSM cellular telephone without a cellular network to transport packets of communication. A strategic delivery process must be developed in order to give effect to a company's strategy.

2.4.3. Result in Competitive Advantage

The result of an effective strategy is to place a firm in a more advantages position in the market place, relative to its competitors. The result of this competitive advantage is usually greater profitability, resultant from increased sales, or the ability to charge a premium over the normally accepted market price. In the case of the non-profit governmental organisation, competitive advantage is measure by how much additional economic benefit can be derived from a particular course of action.

2.4.4. Exploit Linkages Between the Firm and it's Environment

A business organisation is merely a network of linkages that enable it to provide a product or service that cannot easily be replicated by a customer or competitor. When customers or competitors are able to replicate the

linkages, the firm has lost its competitive advantage, and the informal mandate granted by its customers to conduct business.

It goes without saying then, that a good strategy will aim to maximise these linkages, and minimise items that can easily be replicated by customers and competitors. Richard Clarke, regional president of a non-profit organisation once said of the organisation that he represented, "We must maximise what makes us different, because that's what makes us great!" (Clarke, 1995: Personal Communication).

2.5. Three Core Areas

There are three core areas in the arena of corporate strategy (Lynch, 2000).

2.5.1. Analysis

Strategic Analysis deals with the process of analysing a corporations mission and objectives. This analysis would also include a study of the resources available to the organisation.

2.5.2. Strategy Development

Strategy development refers to the process of identifying the options that are available to the organisation that would result in the achievement of the company's objectives.

2.5.3. Implementation

Strategic implementation involves the selection of the appropriate strategy and the carrying out of action plans associated with the strategy. A sound strategy must be coupled with the ability to implement the strategy. Implementation may require the use of existing resources, or may require the acquisition of resources that are not currently held by the organisation.

The identification of an organisation's core competencies is a process that will aid in selecting an appropriate strategy. A strategy that relies on an organisation's core competency is likely to cost less, be easier to implement, and be more effective in magnifying the organisation's competitive advantage.

Building sustainable competitive advantage is a core function of an organisation's operational strategy.

2.6. Emergent v Prescriptive Strategy

There are two different approaches to the development of corporate strategy (Lynch, 2000) the prescriptive approach, and the emergent approach.

"A prescriptive corporate strategy is one whose major objective has been defined in advance and whose main elements have been developed before the strategy commences." (Lynch, 2000: p 23)

"Emergent corporate strategy is a strategy whose final objective is unclear and whose elements are developed during the course of its life as the strategy proceeds." (Lynch, 2000: p 24)

Emergent strategies concentrate on human issues, while prescriptive strategies are focused and well developed. An emergent strategy would therefore be well placed in an environment that is constantly changing, and where stakeholders cannot predict from one day to the next what circumstances they may find themselves in.

Non-profit organisations often utilise the prescriptive approach because they are usually established with clear objectives in mind, and their mandate is to organise or source resources, to be used in accomplishing the organisational objective.

The emergent approach or a combination of approaches is generally used by other organisations.

Mintzberg suggests, however, that the two approaches need not be mutually exclusive (Lynch, 2000).

2.7. Key Factors for Success in an Industry

Strategies are affected by more than one outside force. The most efficient strategies will focus on the areas that will have the most impact on an organisation. This practice is in accordance with the pareto principle, which

when used in a sales context for example, states that 20% of an organisation's customers will yield 80% of the income. It follows that the organisation should utilise most of its resources in the 20% of customers that will generate the bulk of its income.

In a strategic context, the pareto principle can be applied to the factors which impact on an organisation. Kenichi Ohmae, suggested 3 principal areas in which an industries Key Success Factors can be classified:

- Customers
- Competition
- Corporation

Table 2-1 is adapted from Lynch (2000), and outlines some possible Key Success Factors for an industry. Note that these key factors are directed at all companies in the industry, not just the target company for strategic development.

IDENTIFYING KEY FACTORS FOR SUCCESS

Customers

Who are our customers? Who are our potential customers? Are there any special segments that we dominate? Why do customers buy from us? And from our competitors?

PRICE- Is the market segmented by high, medium and economy pricing? Example: European ice cream.

SERVICE- Do some customers value service while others simply want to buy the product? For example, top-class fashion retailers versus standard clothing shops.

PRODUCT OR SERVICE RELIABILITY- Is product performance crucial to the customer or is reliability useful but not really important? For example, heart pace makers and pharmaceuticals.

QUALITY- Some customers will pay higher prices for actual or perceived quality differences. Does this provide a route to success? For example, organic vegetables.

TECHNICAL SPECIFICATIONS- In some industrial and financial services, technical details will provide major attractions for some customers. Is this relevant to the organisation? For example, specialist financial bond dealers.

BRANDING- How important is branding for the customer? For example, Coca-Cola and Pepsi Cola.

Competition

Who are our competitors? What are the main factors in the market that influence competition? How intense is competition? What is necessary to achieve market superiority? What resources do competitors possess that we lack and vice versa?

COST COMPARISONS- Which companies have the lowest costs? Why? For example, Toyota until the mid-1990's.

PRICE COMPARISONS- Which companies have high prices? For example, Daimler-Benz does not make cheap cars.

QUALITY ISSUES- Which companies have the highest quality? Why? How? For example, Xerox (USA) in the light of fierce competition from Japanese companies such as Canon.

MARKET DOMINANCE- Which companies dominate the market? For example, Nestlé with strongest coffee product range in the world and the largest market share.

SERVICE- Are there companies in the industry that offer superior service levels? For example, industrial markets, such as those served by Asea Brown Boveri, which need high levels of service to operate and maintain sophisticated equipment.

DISTRIBUTORS- Which companies have the distributive network? Lowest costs? Fastest deliver? Competent distributors that really know the product or service? For example, major glass companies such as St Gobain (France) and Pilkington (UK).

Corporation

What resources do we have? How do they compare with competitors? What do they deliver to customers? Where are the majority of our costs concentrated? A small percentage reduction to a large part of our cost will deliver more than an equally large percentage reduction in an area of lower total costs.

LOW-COST OPERATIONS- Are we low-cost operators? How do we compare to competitors? For example, Aldi (Germany) and Somerfield (UK) are both low-cost supermarket operators.

ECONOMIES OF SCALE- Do these exist in the industry? How important are they? For example, large-scale petroleum chemical refinery operations such as those operated by Royal Dutch/Shell.

LABOUR COSTS- Does our industry rely heavily on low labour costs for competitive operations? For example, Philips (Netherlands) which has moved its production to Singapore and Malaysia to lower labour costs.

PRODUCTION OUTPUT LEVELS- Does our industry need full utilisation of plant capacity? For example, European paper and packaging companies.

QUALITY OPERATIONS- Do customers need consistent and reliable quality? How do we compare with others in the industry? For example, McDonald's has applied the same standards around the world in its restaurants.

INNOVATIVE ABILITY- Does our industry place a high reliance on our ability to produce a constant stream of new innovations? For example, computer hardware and software companies such as Apple, Epson and Microsoft.

LABOUR/MANAGEMENT RELATIONS- Is our industry heavily reliant on good relations? Are there real problems if disputes arise? For example, European large-scale steel production, at companies such as Usinor.

TECHNOLOGIES AND COPYRIGHT- Does the industry rely on specialist technologies, especially those that are patented and provide a real competitive advantage? For example, News International (Australia) which has exclusive global control over the decoder cards for satellite television and as a result a virtual monopoly in some countries of viewer payment

SKILLS- Does the organisation possess exceptional human skills and people? For example, advertising agencies and leading accounting companies.

Table 2-1: Key Factors For Success in an Industry

Source: Lynch, Identifying Key Factors for Success, 2000.

All organisations are influenced by the demands of customers or stakeholders. Customers are merely the physical representation of stakeholder objectives. In other words, if the objective of a stakeholder is to generate a profit, and this is done through providing a product or service to a customer, then the organisation must view it's customers as the most important term in the strategic equation, because through servicing customers the organisation is able to achieve the objective of the stakeholders, i.e. to generate a profit.

The demands and expectations of customers therefore, will determine, in the vast majority of cases, what the Key Factors for Success in an industry are.

In the context of the non-profit governmental organisation, these 'customers' should be viewed as the industries to which it's product offerings are aimed. If these industries are viewed as the target market, then the identification of the target market becomes a factor that is crucial to the success of the organisation, and any factors that prevent the target market from becoming a recipient of the product offering should be deemed to be a Key Factor for Success in the non-profit organisation.

2.8. Identifying Organisational Resources

An organisation is required to organise resources, or source resources that may be used to accomplish organisational objectives. The mandate of management is therefore to ensure that the organisation has access to sufficient resources to complete its task.

Organisational strategy is about building sustainable competitive advantage, and this is most easily accomplished by focusing on core areas that are unique to one organisation and not another. Each organisation possesses resources, which it has gained from experience, developed over time, or purchased from others. These resources are classified by Lynch (2000) in three areas:

- Tangible resources
- Intangible resources
- Organisational capabilities

2.8.1. Tangible Resources

Tangible resources are physical resources that are possessed by the organisation such as buildings, equipment, sound investments, stable cash flow etc.

2.8.2. Intangible Resources

Intangible resources include items that are possessed by the company such as brand names, networks of industry contacts and influential relationships etc.

2.8.3. Organisation Capabilities

Some organisations are more effective at doing certain things than others. For example, Sony is an innovator of consumer goods, and has been able to lead the development of new trend setting product over the last two decades such as the Sony Walkman, the Sony Discman, and the Sony Playstation.

An organisation must be able to identify the resources that differentiate it from its competitors and rivals, and must maximise these resources. These resources are sometimes referred to as an organisations core competencies. Being able to identify the core competencies of an organisation is an integral part of developing an effective strategy *i.e. a strategy that will maximise what makes the company different, and will make it great by developing a sustainable competitive advantage.*

2.9. Developing Competitive Advantage through the Value Chain

The premise of Michael Porter's Value Chain approach is that a company applies a series of activities to a product or process, and that through these activities value is created (Porter, 1985). This value can be seen in a tangible product or service, or can be measured in financial terms by the additional shareholder value created through each process.

This sequence of processes or events can be graphically illustrated for a company, and Porter (1985) developed a generic model, which applies to almost any organisation. This model is shown in Figure 2-2 (Lynch, 2000: p 267).

Figure 2-2 : The Value Chain

Source: Adapted from Porter, Competitive Advantage: Creating and Sustaining Performance, 1985.

The model represents two categories of activities; primary activities and support activities. Primary activities account for the majority of value added in the company, as these represent the transformation of inputs with limited value, to outputs of maximum value. For example, a manufacturing company may purchase a raw material in the form of HDPE pellets, process this raw material through a plastic injection moulding process, and produce a plastic jug, which can be distributed through wholesalers and then retailers to final consumers. The plastic pellet is of no use to a final consumer, and the company has therefore added form utility to a material that ordinarily has no use to a consumer.

Support activities account for a support system that enables the manufacturing company to conduct the primary activities, by procuring raw materials, providing financial resources and a management system that co-ordinates inputs and outputs.

The theory suggests that competitive advantage can be created by improving efficiency in any one of the representative components of primary or support activities.

2.9.1. Primary Activities

The primary activities are Inbound Logistics, Operations, Outbound Logistics, Marketing and Sales and Service.

2.9.1.1. Inbound Logistics

Inbound logistics refers to all the activities incorporated in the process of gathering the raw materials or inputs, transporting them to the manufacturing premises and storing them until required in the manufacturing operation.

Additional value can be added to the company in this process by reducing the time it takes to transport the goods, or reducing the cost of transportation. Reducing the lead times required by operations for supply of the raw material will also generate value by reducing inventory holding costs. This is epitomised in the 'just-in-time' procedures now widely implemented in world class manufacturing concerns.

2.9.1.2. Operations

The operations process in this example accounts for the activities that result in the transformation of a raw material (HDPE) into a finished product (a plastic jug). These activities would include placing the HDPE in a hopper, applying heat to the compound, forcing the melted compound through a high-pressure nozzle into a purpose built mould, de-moulding, inspecting and packaging. The output of the operations activity is a finished product that can be distributed.

Any improvement in the efficiency of the manufacturing operation will result in a cost saving which will generate value to the company in the form of an increased profit margin.

2.9.1.3. Outbound Logistics

The finished plastic jug must be distributed to the consumer, and this is done though a series of outbound logistics. The product must be sent to distribution houses and distributed to retailers through wholesalers or any number of middlemen. Retailers then sell to the final consumers for whom the product was developed and manufactured.

A reduction in the number of intermediaries will result in additional value added for the manufacturing company, which benefits from an increased margin in it's selling price.

2.9.1.4. Marketing and Sales

The manufacturing company must manufacture products for which there is consumer demand. The marketing and sales function is the process of identifying consumer needs and presenting the relevant products offered by the company to satisfy consumer needs.

The marketing philosophy has become prominent in the 1990's, and results in value added for the company. The marketing philosophy states that companies must produce products that are specifically demanded by consumers, as opposed to companies developing products for development's sake, and forcing their product offering on consumers. Adoption of the

marketing philosophy will result in added value for the company by ensuring that it creates products that are in demand, and thus reducing the risk of developing products that will not sell.

2.9.1.5. Service

Some products require a service to be performed before they can be of use to a final consumer. An example of this type of product is a split-level air conditioning unit, which must be installed by professional technicians before it can be operated. Another example, already alluded to, is the provision of a GSM cellular network by a cellular service provider, before a cellular product can be utilised by the final consumer.

In this activity, any reduction in time taken to provide the service will generate additional value, by reducing costs of service delivery.

2.9.2. Support Activities

While support activities are not directly concerned with producing a product offering, without these activities no primary activities could take place.

2.9.2.1. Firm Infrastructure

An organisation must have an infrastructure within which to conduct business. Organisations have administrative facilities, manufacturing facilities, networks of service providers, and established relationships with stakeholders. This infrastructure enables the firm to conduct business transactions and processes.

Porter states that firm infrastructure includes background planning and control systems that allow companies to administer and direct development. This therefore also includes corporate strategy.

2.9.2.2. Human Resource Management

In order to conduct primary activities, companies must have 'hands to do the work', and 'hands to manage the work'. The process of organising the 'hands' is essential in delivery of primary activities. This organisation process

must include recruitment, training, performance management and remuneration.

Any improvement in the management of human resources will result in increased value through either a reduction of cost, or more often, an increase in productivity.

It is also important to foster an environment that will stimulate innovation, and development of new ideas and processes. The correct management of this element of the value chain will result in significant improvements of other areas of the chain, since human intervention is responsible for all changes in other areas.

2.9.2.3. Technology Development

Development of technology will result in a company maintaining value in other value chain areas. Innovation and development of new technological processes will result in enhanced value of primary activities, and occasionally have spin-off effects on other support activities.

2.9.2.4. Procurement

Companies capitalize on established networks of procuring goods and services. These networks may be enhanced if companies can procure similar goods and services at lower costs, shorter time periods, or superior quality.

The function of procurement therefore has significant potential to increase value and increase profit margins.

This discussion is specific to a company, whose objective is to generate a profit, and create value for its shareholders. Efficient management of the various components of Porters value chain will result in added value. In some cases, this additional value can be passed on to the end user or consumer, but in most cases, the value is reflected in an additional margin, which bolsters the organisations profits. This type of value treatment creates wealth for the organisations stakeholders.

In the non-profit governmental organisation, additional value creation is immediately transferred to the final beneficiary. The result of this transfer is the creation of wealth, and through this creation, the objectives of the governmental stakeholders are accomplished.

Porter's model can be amended to apply more specifically to the non-profit governmental organisation. Under conditions of non-profit objectives, the organisation may be guided by different underlying principles. These principles are utilised below in an adaptation of Porter's Value Chain, for application in the non-profit governmental organisation. The Key assumptions in this adaptation are:

- Profit generation is not an objective.
- The organisation must however be funded, and it may be necessary to generate a surplus in order to pay for some support activities.
- Additional Net Value added is passed on to the beneficiaries of the non-profit organisation.
- The organisational objective is influenced by social, economic, or political factors.
- Sound management may be in short supply.
- All employees or volunteers must 'buy-in' to the organisational objective.

2.10.The Value Chain in Non-Profit Governmental Organisations

The value chain may be amended to apply specifically to a governmental department whose objective is determined by political, economic and social circumstances. This application is derived specifically for Chief Directorate: Manufacturing Development and is shown in Figure 2-3. Table 2-2 shows a comparison between the two value chain models.

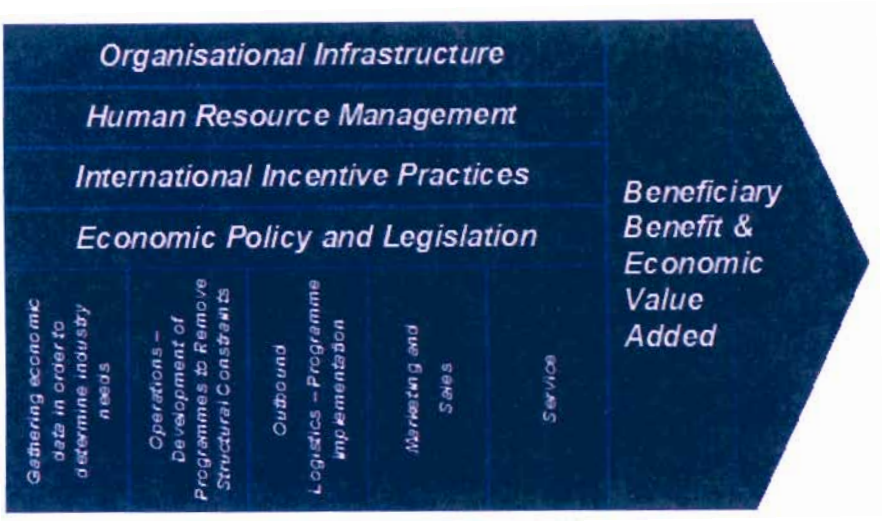

Figure 2-3: The Value Chain for Non-Profit Governmental Organisations

Source: Adapted from Porter, Competitive Advantage: Creating and Sustaining Performance, 1985.

2.10.1. Primary Activities

The primary activities for the Chief Directorate: Manufacturing Development are centred on the provision of industrial incentives that will remove the structural constraints imposed upon industrialists by the economic situation in South Africa.

2.10.1.1. Identification of Constraints

The inbound logistics of Chief Directorate: Manufacturing Development involves the identification of constraints hindering economic growth.

The accomplishment of the organisational objectives is entirely dependant upon whether the organisation has accurately surmised the cause of the symptoms that the organisational products are aimed to address. Failure to make an accurate assessment will result in total organisational failure.

It is therefore imperative that the inbound logistics of The Enterprise Organisation are well orchestrated and based upon information that is accurate, relevant, and timely.

An increase in the accuracy of information, or the utilisation of information that is more current will result in more effective accomplishment of organisational objectives.

Porters Model	***Porters Model - Manufacturing***	***Porters Model adapted for the Chief Directorate: Manufacturing Development***
Firm Infrastructure	Firm Infrastructure	Organisational Infrastructure
Human Resource Management	Human Resource Management	Human Resource Management
Technology Development	Technology Development	International Incentive Practices
Procurement	Procurement	Economic Policy & Legislation
Inbound Logistics	Activities included in gathering raw material inputs and handling until further processing	Gathering of economic data in order to determine industry needs
Operations	Activities resulting in transformation or delivery of product or service	Development of programme that will result in the removal of constraints identified inbound logistics
Outbound Logistics	Distribution of finished goods	Implementation of products and processes
Marketing & Sales	Marketing & Sales	Marketing & Sales
Service	Service	Beneficiary aftercare and assessment of effectiveness

Table 2-2: Porters Model vs. Chief Directorate: Manufacturing Development Value Chain

Source: Secondary Data

2.10.1.2. Operations

The core operational function of the Chief Directorate: Manufacturing Development is the development of programmes that will result in the removal of structural economic constraints. A manufacturing company adds value by converting a raw material into a commodity of use. The non-profit

organisation identifies a constraint, and creates value to the beneficiaries that the organisation serves, by removing a constraint that would ordinarily hinder the relevant beneficiaries.

Any amendment to an existing programme or creation of a new programme, that addresses a constraint more effectively, creates additional value to the organisation.

2.10.1.3. Outbound Logistics – Programme Implementation

Regardless of how well a programme is designed, if the non-profit organisation does not have sufficient resources to implement and effectively monitor the programme through to it's completion then all other activities have been in vain.

Programme implementation is the process that accounts for the delivery of the basket of measures developed to remove the structural constraints identified.

The addition of marginal resources until the point of saturation will gradually increase the effectiveness of the programmes.

2.10.1.4. Marketing and Sales

All product offerings must be promoted and sold to the final consumer. The non-profit organisation is not immune from the task of promoting it's offering to potential beneficiaries.

As with programme implementation, the most effective process is of no value unless it is brought to the attention of the target market. The target market must also be clearly identified, and according to the organisational objectives.

2.10.1.5. Service

The non-profit organisation must also ensure that after process delivery has taken place, its customers are satisfied with the delivery, and that it has satisfied the intended objectives. The process of determining effectiveness and satisfaction is important because this information can be used to improve and develop future offerings.

2.10.2. Support Activities

In the same way that support activities enable primary activities to take place in the profit organisation, the non-profit organisation requires similar processes to allow it to perform it's primary objectives.

2.10.2.1. Organisational Infrastructure

In the governmental organisation, organisational infrastructure is governed by parliamentary guidelines, and influenced by prevailing political regimes. If value is to be created in the support process of organisational infrastructure, then the structure must be geared towards delivery, must be endowed with the resources necessary to effectively perform primary processes, and must be managed by experienced and competent individuals that understand the demands of stakeholders and predetermined beneficiaries.

As with any organisation, a fine balance must be struck between creating physical infrastructure and large resources that enable easy implementation of primary activities, and the opposing demand to keep support costs to a minimum in order to maximise 'margins' or minimise deficit's in the case of the non-profit organisation.

Creation of value is accomplished in this support activity by establishing the point at which marginal output reduces or ceases with the addition of an additional resource.

2.10.2.2. Human Resource Management

The human resource function does not change in the non-profit organisation. Managers must ensure that the recruitment and selection process is effective, that jobs are allocated and created in a way that results in orderly efficient implementation of tasks, and that performance is managed competently, while employees are rewarded appropriately.

2.10.2.3. Research and Development

Organisations with a profit motive are required to be current with technological developments in order to retain competitive advantage. The Chief Directorate: Manufacturing Development must remain at the forefront of

international incentive practices in order to increase it's competitive advantage over other investment destinations, and to ensure that it's product offerings follow methodology that is accepted as 'best practice' internationally.

2.10.2.4. Economic Policy and Legislation

The support function of Economic Policy and Legislation replaces the ordinary support function of Procurement in the non-profit organisation. Non-profit organisations are still required to procure goods and services from appropriate service providers, but more value is created or lost, through the effect that economic policy and legislation has on the implementation of The Chief Directorate: Manufacturing Development's primary activities.

The success or failure of Chief Directorate: Manufacturing Development is influenced directly by the prevailing economic policy and legislation put in place to govern the power and authority of the Board for Manufacturing Development.

Economic policy is either the cause of the structural constraint hindering output (e.g. a high interest rate resultant from monetary policy decisions), or else the catalyst in stimulating the effectiveness of investment opportunities (e.g. the African Growth and Opportunities Act (AGOA)).

It is clear that the non-profit organisation can effectively create or destroy value for its beneficiaries and stakeholders by the way in which it manages the factors discussed in this section. The task for the effective strategist is to know how these elements of the value chain can be pieced together to unlock the puzzle that governs effective execution of organisational objectives. First and foremost in this process is to understand the objectives of the organisations stakeholders, and the requirements of the organisations customers, or in the case of the non-profit organisation, it's beneficiaries.

2.11.Factors Shaping the Success of Chief Directorate: Manufacturing Development

When the key factors influencing a company's strategic situation are adapted for the non-profit organisation and specifically, Chief Directorate: Manufacturing Development, the following mix of factors is attained.

2.11.1. Strategy Shaping Factors External to the Organisation

The Strategy Shaping Factors External to the Organisation are: Economic, Societal, Political, Regulatory and Community Citizenship Considerations; and Competitive Conditions and Overall Industry Attractiveness.

2.11.1.1. Economic, Societal, Political, Regulatory and Community Citizenship Considerations

In the context of the non-profit governmental organisation economic, societal, political, regulatory and community citizenship considerations are of greater importance than in an organisation that has a profit-making objective. Indeed, the crux of governmental departments is to satisfy the mandate of it's democratically elected government.

This mandate is often directly related to the accomplishment of some economic objective, as is the case with Chief Directorate: Manufacturing Development. Societal considerations are vital as the mandate is carried out, and ensure that the benefits of the strategy are realised amongst all sectors of society.

Government is responsible for creating the regulations in which it operates, and therefore has some degree of influence over the regulatory environment, notwithstanding the necessity to account for compliance with policies and procedures created by the regulatory framework in which it carries out it's mandate.

2.11.1.2. Competitive Conditions and Overall Industry Attractiveness

Chief Directorate: Manufacturing Development is influenced by competitive forces from two arenas. It must first compete with attractive investment destinations abroad, and ensure that potential foreign investors and South African residents decide to invest in South Africa, and not elsewhere. It must then ensure that the investment that takes place is viable, and allocated to the most attractive industry sectors, in order to maximise the effect on the economy.

Unlike a profit maximising corporate, any similar products available to the Board for Manufacturing Development's target market, will aid and not hinder the accomplishment of it's objective. The existence of competing investment incentives within the boundaries of South Africa therefore offers no threat to Chief Directorate: Manufacturing Development.

2.11.2. Strategy-Shaping Factors Internal to the Company

The Strategy-Shaping Factors Internal to the Company are: Company Opportunities and Threats to a Companies Well-being; Company Resources, Strengths, Weaknesses, Competencies and Competitive Capabilities; Personal Ambitions, Business Philosophies, and Ethical Principles of Key Executives; and Shared Values and Company Culture.

2.11.2.1. Company Opportunities and Threats to a Companies Well-being

Opportunities and Threats for the Chief Directorate: Manufacturing Development presents themselves in the form of changing political regimes, governmental policy and objectives. Due to the long time periods between implementation of products, and generation of favourable results, the withdrawal of any successful incentive programme will result in an investment lag, and hinder achievement of the stated objectives.

New governments however, require the achievement of different objectives, and the threat of having to cut short an investment incentive due to a change in parliamentary policy is real.

The viability of governmental organisations set up to administer the incentives is threatened by these changing objectives, because new objectives necessitate new programmes, and vast expense on systems development, implementation, and training. The time period for new programmes to have an effect is also a period 'lost' to the accomplishment of vital objectives.

2.11.2.2. Company Resources, Strengths, Weaknesses, Competencies and Competitive Capabilities

The resources of the non-profit organisation are discussed in paragraph 4.3.3.

2.11.2.3. Personal Ambitions, Business Philosophies, and Ethical Principles of Key Executives

While one acknowledges the existence of personal motives in a non-profit organisation, the presence of such ambition is often overshadowed by a greater influence for political power and recognition of governmental influence.

The implementation of the non-profit strategy of Chief Directorate: Manufacturing Development is not without significant influence from this sphere of internal strategy shaping factors.

2.11.2.4. Shared Values and Company Culture

All organisations are affected by internal values and cultures, either positively or negatively. The Chief Directorate: Manufacturing Development is not immune to the effect of good and bad valise and culture.

2.12.The Theory of Economic Incentives: Supply Side Policy vs. Demand Side Policy

Paragraph 2.12 is an adaptation of an unpublished document on the government's progression from macroeconomic stabilisation to

microeconomic reform. The document was prepared by van Rooyen et al (2001).

Trevor Manuel's opening statement in the 2001 budget speech stated that the South African government was shifting policy from 'macroeconomic stabilisation to microeconomic reform'. In 1995 the aim of the government was to create economic stability. The assumption made was that stabilisation would lead to economic growth (predicted at 6% by the year 2001). To achieve stabilisation the government focused on reducing the budget deficit, stabilising the exchange rate and reducing, then stabilising interest rates. The intention was to impress upon the rest of the world that South Africa could be a disciplined economy and thus stimulate interest for foreign investors. Although the government had had relative success in stabilising the South African economy by 2001, the expected growth rate had not been achieved. Government's tight fisted approach may have resulted in macroeconomic stabilisation, but the lack of emphasis on correcting structural problems facing the South African economy may account for the government's failure to meet its targets set in the 1999/2000 budget.

The primary goals for the South African government are increased economic growth (increased production), full employment, price stability and appropriate income distribution.

In order to address government's failure to meet targets set in 2001, the 2002 budget placed more emphasis on supply side factors. More importantly, however, is the fact that government elected to move away from 'blanket' supply side policies and has taken a more specific approach to supply side factors at a microeconomic level (policy which affects the individual person & specific sectors of the economy) – hence the term '*microeconomic reform*'. The 2002 budget indicated the decision to increase spending on wealth and education in order to correct the structural problems facing South Africa.

The structural problems facing the South African Economy are at the heart of this study. Without correcting structural failures, the economy cannot realise its production potential. Structural failures create production ceilings in the

economy, and limit growth. Government intervention is aimed at stimulating growth, and must therefore address structural failures as part of its intervention strategy. The SMMDP, is one aspect of government intervention in an economy, and addresses some of structural constraints such as the high cost of capital in South Africa relative to first world countries.

This section identifies some of the demand and supply side policies deployed by the South African government and comments on the impact that they may have on unemployment and economic growth. These policies are relevant in assessing the relative importance of the SMMDP as an element of government's supply side policy, and consequently determining it's effectiveness in addressing economic development hindered by structural economic constraints.

2.12.1. Demand Side Policies

Demand Side Policies comprise Fiscal and Monetary Policy.

2.12.1.1. Review of Fiscal Policy

Fiscal policy is under the control of parliament and is usually initiated by the executive branch of the government. The major instruments of fiscal policy are tax rates and government spending. One of the central facts of policy is that the effects on the economy are not fully predictable, neither in their timing nor in the extent to which they affect demand or supply. This is true for fiscal policy. The failures of stabilisation policy are due, amongst other things, to the uncertainty about the way stabilisation policies work. Fiscal policy is becoming increasingly more unpopular in world markets because of its crowding out effect (a reduction in private sector borrowing and spending caused by increased government borrowing).

Government Spending

Fiscal policy affects aggregate demand directly, for instance; an increase in government spending (G) increases aggregate demand (AD), tending to raise output (Y). Higher output levels raise interest rates (i) in the assets markets, and dampen the effects of fiscal policy on output. Higher interest rates also

reduce the level of investment spending, or cause the crowding out of investment. Thus a fiscal policy that increases demand through government spending may actually reduce the rate of investment. Between 1996 and 2001, government spending in South Africa decreased. The 2002 budget saw an increase in government spending. In order to steer away from crowding out, government spending was focused on building infrastructure in areas that needed development. The aim was to create a crowding in effect (government spending on infrastructure that will create momentum enabling investment by the private sector). There still remains the question of whether government spending increased sufficiently enough to create the momentum needed to stimulate significant investment.

2.12.1.2. Review of Monetary Policy – Interest Rates

Monetary policy operates by stimulating the interest rates – the responsive component of aggregate demand, primarily affecting investment spending. The Reserve Bank can decrease interest rates that will lead to an increase in investment spending thereby raising aggregate demand. This results in an increase in production as well as an increase in output levels. However, in SA a decrease in interest rates alone has not been enough for investors to invest in South Africa. A decrease in interest rates has not lead to a significant increase in the level of local investment. Investors would not buy significant capital in South Africa. A decrease in interest rates acts as a deterrent for international investment. The return on investment is not great enough to attract international investment. Together with a volatile Rand, investors do not make enough profits by investing in the South African economy. Sentiment is another important factor that should be considered as it plays a large role in the investing community. Negative publicity about South Africa has caused negative sentiment and resulted in the scaring away of investors. Both Fiscal and Monetary Policy did not solve the economic problems that the South African economy faced a decade ago.

In theory, if demand is stimulated (through demand side policies such as Fiscal & Monetary policies) then inflation should increase and unemployment decrease? When this does not occur, (i.e. inflation increases as well as

unemployment,) supply side factors should be considered (Schiller, 2000). Demand side policies alone can never succeed completely; they will always cause some unwanted inflation or unemployment. Demand side policies also have a short-term benefit. The Keynesian view indicates that an increase in government spending and a decrease in taxation should be the required catalyst for a stagnant economy, but the Keynesian approach must be combined with long-term supply side policies to sustain the momentum generated by the initial catalyst.

2.12.2. Supply Side Policies

According to Schiller (1998) supply side policies are those policies that focus on the supply side of the market. These supply side policies often involve the use of tax cuts and incentives to increase supply (and not just demand), regulation and deregulation, resource development and other mechanisms to increase the ability and willingness of companies to invest and produce goods and services (Schiller, 1998). In South Africa, the government had employed GEAR (Growth, Employment and Redistribution), a supply side policy in an effort to improve economic growth. With GEAR, the government had hoped to increase the country's GDP by 6% per annum, it had hoped to create employment for +/- 400 000 people by year 1999, redistribute social services and most importantly reduce the budget deficit (Sunday Times, 16/11/97). Unlike demand policies that advocate increased government spending and reduced taxes to stimulate or increase consumption, the idea behind GEAR was that, macroeconomic stability (achieved through decreased inflation and the decreased budget deficit) would lead to economic growth (South Africa Survey, 1997-1998).

Macroeconomic stabilisation did not lead to economic growth in South Africa as by year 1999, the country had only achieved a 3% growth on GDP against the budgeted 6%. Even the 3% was achieved at the expense of full employment as South Africa's labour force continued to experience job losses (Daily News, 27/08/99). Keynesian economists would argue that GEAR's lack of emphasis on fiscal and monetary policies is the reason why the policy didn't deliver on the set targets. GEAR's focus on cutting the budget deficit

meant that there could be no substantial spending on the part of the government. This is in conflict with fiscal and monetary policy that argues that an economy needs to be fuelled by government spending in order to grow (Dias, 2001)

It would however seem unfair not to state any winnings or achievements brought about by GEAR. South Africa, between the period 1996 to 1999 has reduced its budget deficit by a sizeable amount and inflation dropped to below 8%. One could also argue that without GEAR, South Africa would not know what it knows now about the structural problems that exists within its economy (South Africa Survey, 2000/2001).

Tax cuts have been implemented in South Africa as a supply side policy. The aim of the tax cuts has been to increase savings. The government can stimulate consumption spending and saving by households in the economy by decreasing personal income tax. When the taxing of households decreases (T), the result is an increase in disposable income (Y), tending to increase consumption by households (C) and savings (S), and resulting in an increase in aggregate demand (AD). This in turn causes an increase in production and investment, resulting in an increase in employment. An increase in employment is accompanied by an increase in income. The problem in South Africa is that, when the government reduces taxes, they are not enough to encourage saving and people tend to spend all their disposable income on consumption. This could be because the tax cuts are aimed at the lower income group who will increase consumption spending and not saving when they have a rise in disposable income. Thus a decrease in taxes in South Africa does not result in an increase in investment funds in the investment market as would be expected in other economies but rather leads to an increase in demand for consumables. Tax cuts in South Africa, although implemented as a supply side policy will in all likelihood end up having a demand side effect. The tax cuts will result in an increased demand for consumables as opposed to the expected increase in savings.

South Africa faces a number of problems that are unique to its economy. The problems are structural in nature and it is argued that a lack of focus on

these structural problems has resulted in the low economic growth and increased levels of unemployment. The 2001/2002 budget has made allowances for new investments in oil and gas pipelines and in electricity cables, phone lines and railways (South African Budget, 2001/2002). The main structural problems can be classified into 3 broad areas, namely Resource Constraints, Labour Market Structure, and External Shocks. These problems are outlined briefly below together with certain supply side measures that have been implemented to address these problems.

2.12.3. Structural Problems of the South African Economy

The main structural problems faced by the South African Economy are resource constraints, the structure of the labour market, and external economic shocks.

2.12.3.1. Resource Constraints

Resource Constraints are those constraints that limit the provision of the factors of production to an economy.

Capital

Due to a variety of circumstances there is a reluctance to invest in capital in South Africa. Investor sentiment is one reason; another can be attributed to the comparatively high costs of finance and another to the weakening currency.

Research and Development

Numerous funds exist to encourage Research and Development and reduce the cost of such intangibles to industry. The Competitiveness Fund offers a 50% reimbursement grant on all development costs aimed at increasing competitiveness.

Technology

As part of a strategy for promotion of technology in South Africa's manufacturing industry, the government has implemented the Support

Programme for Industrial Innovation (SPII) to provide an incentive for the development of innovative products and processes.

By stimulating the development of innovative processes, the government has attempted to provide a climate that will lead to implementation of new technologies.

2.12.3.2. Labour Market Structure

The largest resource in any nation is its people and thus the *quantity* of these people available for the production of goods and services in any economy is extremely important. If the labour force is increased then output increases. Equally important, however, is the *quality* of this work force, i.e. the skills and knowledge of the labour force also adds to the nation's potential output. The labour market has been constrained due to the empowerment of the trade unions. This has resulted in restrictive "hire and fire" policy that has caused a shift away from the use of labour in production. This has resulted in decreasing levels of employment in spite of rising levels of output. Hence there is a move toward capital-intensive production rather than labour intensive production. In South Africa the labour market has been constrained by structural problems such as the skills gap, and the brain drain.

The Skill's Gap

South Africa is experiencing a structural unemployment problem. In other words there is a surplus of unskilled and unemployed workers but a shortage of management, financial and IT skills (Financial Mail, 21 May 2000). The result of this 'skills gap' is that the product market is unable to supply goods and services as fast as is required resulting in price increases. In its attempt to close this 'skills gap', the South African government realises that the key to the future is education, aggressive skills training and re-education programmes and has addressed this through the Skills Development Act. This requires all businesses to pay a payroll-training levy that will be refunded if they conduct in-house training. Government has perhaps placed too much responsibility on the private sector and needs to take more of an active role in decreasing the skills gap.

The Brain Drain

The Skills Crisis is further aggravated by a continuing brain drain. According to the Central Bureau of Statistics, as many as 1.6 million people in skilled, professional and managerial professions have left the country since 1994, and at least one in every five South Africans with a tertiary education now lives abroad. This has cost the government an estimated R2.5-billion a year (Business Times, 25/03/2001). The government has looked at the other end of the spectrum for a solution to this problem and has embarked on the controversial Immigration Bill that deals with creating mechanisms to attract skilled foreign labour. In the short term importing skills is seen as a prerequisite for economic growth and job creation.

2.12.3.3. External Shocks

External Shocks are events that take place outside of the borders of South Africa, but which have an impact on the South African Economy, such as the Oil Crisis of the 1970's and the more recent Asian Crisis.

Oil Crisis

South Africa like the rest of the world is not immune to the ever-changing oil prices. When international oil prices increased sharply, twice in the 1970's and later in 1990, inflation became inevitable. Again when the prices rose sharply in early 1999, South Africa was at first able to shake off the initial impact, but when the supply continued to be more restrained South Africa was no longer able to protect its consumers, because local prices are linked to international prices. (Financial Mail, 15 Sep 2000). Local growth is seriously affected by increasing oil prices. High oil prices put high price pressures on the economy. More so since high oil prices have a huge impact on production costs in the form of transportation. However, production is just one of the areas that are affected by fluctuations in oil prices, the bond market is another area that is severely affected. The volatility in the South African Rand, bond and stock markets leave South Africa in a very vulnerable situation. It could be argued that South Africa should not focus on trying to control inflation as it is affected by external factors such as the oil price.

By November 2000, corporate debt, other than bank debt, was recorded at record high of 46% of GDP. (Financial Mail, 2 November 2000). This is because bank loans have become more costly. In the past, borrowers have been able to move between the bond market and the banks. High debt by the corporate sector will eventually mean that these companies are more selective in their investment ventures, hence impacting negatively on production.

East Asian Crisis

The huge liberalisations of capital flows accompanied by weak banking systems are believed to have contributed largely to the collapse of the economies of East Asian countries. The free market policy carried with it great vulnerability to shifts in market sentiment, which triggered massive shifts in capital. In this kind of economic environment, investments are more risky. So when doubts about the market emerged, exaggerated by lack of transparency of government policies, they sent foreign investors fleeing to safer havens. With domestic corporations rushing to buy foreign exchange, which eventually led to a disastrous collapse.

The disastrous results of the Asian crisis on the world economy were inevitable, with the developing countries and other emerging markets hardest hit. For developing countries, the overall economic growth rate fell below the 6% average of the 1990's (internet 1). The East Asian crisis combined with the declines in oil and other commodity prices plunged the South African economic growth into further decline.

2.12.4. Globalisation

For better or worse, South Africa is married to the concept of Globalisation – that process which facilitates the integration of economies around the world. (Engineering news, Terrence Creamer).

At present South Africa is operating from a base of declining aggregate demand as a result of declining investor demand. This has had a cascading effect on the economy, causing production and income levels to decline. The

net effect has been an increase in unemployment. In order to break this cycle, South Africa needs to reverse this lack of demand by attracting the foreign sector and embarking on globalisation.

"A foreign investor may be seen as essentially a money lender who seeks to earn the highest return relative to risk in the global market" (Dias 2001). The foreign investor should be viewed as the customer and in order for South Africa to conclude a sale, our offer has to be competitive. Competitiveness of the South African industry will eventually result in increased exports, which can be regarded as the key driver of growth. Supply side support schemes, export co-ordination programmes and small business development projects are critical in ensuring export growth and ultimately the future of South Africa as a global player.

The DTI has formulated a framework for a global economic strategy. This framework comprises of six main elements.

2.12.4.1. A Plan for Global Integration

The South African plan for global integration comprises tariff reduction, regulations regarding foreign and domestic investment, and anti dumping measures.

Tariff Reduction

Tariff protection was serving to shelter the economy from world trends and making it inefficient and high cost.

Foreign Investment

Regulations have been designed to decentralise the economy and create space for foreign investors to enter the economy.

Domestic Investment

Initiatives are in progress towards small-business development to foster interest in the domestic economy and thus create a competitive environment.

Anti-Dumping Measures

These measures have been put in place to stamp out unfair trade.

2.12.4.2. A Multilateral Strategy

The government's strategy is to engage proactively in the multilateral system in organisations such as the World Trade Organisation, the World Bank and the International Monetary Fund. One of the problems facing small countries such as South Africa, and other developing countries is that they will find it difficult to gain some access to major economies. To this end the DTI is obtaining support and consensus of other developing countries in an effort to display a united front on developmental issues at the next round of negotiation.

2.12.4.3. Regional Integration

South Africa has embarked on two major regional integration projects, one in the Southern African Development Community (SADC) and the other with the European Union (EU). The DTI now plans to use these as a springboard and market these agreements highlighting the opportunities that they present.

2.12.4.4. A South African Economic Development Blueprint

The South African Economic Development Blueprint involves opening new trade routes with other developing countries in Africa, Asia, and Latin America. Although the countries of the North will remain important markets and sources of investment and technology, these Southern countries are significant in their own right and offer lucrative opportunities.

2.12.4.5. Strengthening Institutional Capabilities

This strategy revolves around building institutional capabilities to ensure that domestic companies are in a position to take advantage of greater market access. The main vehicle for this is the creation of export councils in various industry sectors.

2.12.4.6. Promotional Strategies

This is focused on promotional programmes to support and build a sustainable global strategy. These range from investment incentives through to export support schemes.

The second phase of the DTI's plan is to disaggregate the process down to sector or cluster level in an attempt to develop a series of strategic frameworks for specific clusters or industries. A major focus during the next few years will be to encourage partnerships in specific industrial sectors to encourage export-centred investment, particularly foreign direct investment.

Overall, South Africa's industrial policy reveals a great deal of hope in realising globalisation, as well as a commitment from its leaders to playing an important role in ensuring greater market access for the whole developing world. This commitment is born out of the belief that globalisation can indeed reduce poverty and increase the living standards of those in South Africa.

2.12.5. Concluding Evaluation of Supply Side and Demand Side Policies

The South African government has tried a number of policies over the past few years. None of these policies has resulted in the achievement of the required growth rates and in addition, unemployment has been on the increase. South African policy needs to be made within the context of the South African situation. Over the past few years South Africa has managed to reduce the budget deficit and in so doing has tightened the belt on government spending. This has been a restraining demand side policy. Tax cuts have not been substantial enough to encourage savings and spending has been on consumables rather than on investment and therefore has not lead to a substantial increase in growth. Interest rates have been kept relatively low and this has led to a decrease in savings and investment. On the supply side, GEAR has focused on stabilisation policies that have been aimed at the macroeconomic level. This has resulted in a blanket approach being applied to the economy resulting in a failure to alleviate the structural problems in the economy.

In order to ensure the desired economic growth, the Government must succeed in removing the structural constraints that inhibit growth. The appropriate mechanisms for removal of these constraints have not yet been determined, and those that have been attempted have not yet proven effective.

Policy needs to be focused on the structural problems in the economy at a microeconomic level. The government needs to focus on specific sectors in order develop the infrastructure in those sectors. This will result in crowding in of investment as a result of government spending in those sectors. On the supply side the government needs to address the resource and labour structure problems in order to provide the factors of production to the market.

The South African economy requires sustained recovery. This means inflation must kept relatively low and export revenue must grow strongly enough to fund the import bill. South Africa needs to become a global player. The only way out is to replace the lost jobs of the past by creating the skills needed to fill the jobs of the future. South Africa now needs to focus on the structural problems restricting the growth in the economy. By focusing on the labour market government will be able to give people the skills needed in order to bring the level of unemployment down and result in necessary growth in the economy.

The shift from 'macroeconomic stabilization to microeconomic reform' should result in increased growth and decreased levels of unemployment.

2.13.Conclusion

Strategy in its greatest form is the tool used by people to change their environment. Various factors must be taken into account when developing a good strategy, such as external factors influencing the organisations decisions, the sustainability of a strategy, the required delivery process and the desired competitive advantage to be achieved.

In order to achieve this competitive advantage an organisation must exploit linkages between itself and the environment. In deciding which linkages to

capitalize on, the organisation must take into account it's mission and objectives, the options that are available for exploitation in the environment, and the selection criteria to evaluate competing strategic alternatives.

Non-profit organisations generally employ a prescriptive approach to developing strategy because their objectives are clearly defined, well focused and developed, but an emergent strategy is more appropriate in a constantly changing environment. Non-profit organisations could benefit from a combination of the two approaches, if they operate in a volatile environment.

An organisation should focus its resources on the Key Factors for Success in its industry that will have the most impact on achievement of its objectives. In the non-profit organisation, it is vital that the product offering of the organisation is targeted at the group of beneficiaries that will generate the most economic benefit from assistance, and produce favourable economic outcomes.

Porters Value Chain can be adapted for application in the Chief Directorate: Manufacturing Development, and is useful in identifying areas of weakness in a strategy. The model indicates that the accomplishment of organisational objectives is entirely dependant upon whether the organisation has accurately surmised the cause of the symptoms that the organisational products are aimed to address.

An understanding of structural economic constraints is therefore important in assessing the effectiveness of a supply side measure such as the SMMDP.

Chapter 3: The Chief Directorate: Manufacturing Development and the Small Medium Manufacturing Development Programme (SMMDP)

3.1. Introduction

A key tool in South Africa's Supply side policy is the implementation of incentives and subsidies made available to qualifying companies within the Republic of South Africa, under the direction of the Board for Manufacturing Development.

These incentive schemes are administered by the Department of Trade and Industry. Within the Department of Trade and Industry lies an administrative body known as The Enterprise Organisation. The Enterprise Organisation is the newest face of an old administrative system that has traditionally been responsible for the administration of capital based incentive schemes. Under the old structure this administrative function fell under the direction of the Chief Directorate: Manufacturing Development. This study is focussed on the Chief Directorate: Manufacturing Development.

The department is empowered by the Manufacturing Development Act, No 187 of 1993.

This Chapter outlines the establishment and composition of the Board for Manufacturing Development; it's powers, objectives and functions. The specific product implemented by the Board for Manufacturing Development in the governments quiver of supply side measures, is the SMMDP.

Background to the SMMDP is given, and the details of the programme are presented. This chapter also discusses requirements that are assessed in Chapter 4 in terms of their strategic importance, and their impact on the achievement of organisational objectives.

3.2. The Manufacturing Development Act, No 187 of 1993

The Manufacturing Development Act no 187 of 1993 provided for a Board for Manufacturing Development to be established to provide for the development of programmes for manufacturing development, and provide for all incidental matters related to the development of manufacturing.

The key points of the act that are pertinent to this study are outlined below:

3.2.1. Establishment and Composition of Board (s2(1) and (2))

The Manufacturing Development Board was established as a juristic person. The members of the board are appointed by the minister and consist of:

- A chairperson designated by the minister,
- An official of the Department of Trade and Industry designated by the Minister,
- An official of the South African Revenue Service designated by the Director-General: South African Revenue Service,
- An official of the Department of State Expenditure designated by the Director-General: State Expenditure,
- An official of the Department of Finance designated by the Director-General: Finance
- Nine members designated by the minister who in his or her opinion have adequate expertise, knowledge or experience with regard to trade, industry or the economy, as well as the developmental problems and potential of the Republic, to represent and promote the interest of the inhabitants of the Republic
- Three members designated by the Minister, one of whom has adequate expertise, knowledge or experience with regard to tax matters, one of whom has adequate expertise, knowledge or experience in small, micro and medium manufacturing enterprises,

and one of whom has adequate expertise, knowledge or experience in labour an employment matters.

3.2.2. Executive Committee (s3)

The Board may appoint an executive committee consisting of the Chairperson and not more than two members designated by the Board from the nine economic and industry representatives above, to perform functions on behalf of the Board. Decisions taken by this committee are subject to ratification by the Board at the next Board Meeting.

3.2.3. Objectives of the Board

The objective of the Board is (SMMDP Annual Report, 1998):

"To promote manufacturing Growth by way of incentives or concessions with regard to requirements within the framework of the economic policy of the republic."

3.2.4. Functions, Powers and Duties of the Board

The Board has the power to formulate recommendations on policy in respect of manufacturing development programmes to the Minister for approval (s5(2)).

The board has the responsibility to develop, manage, administer, and implement any manufacturing development programme established in terms of the act (s5(2a)).

The board determines:

- The acts in respect of which incentives or concessions may be granted in terms of a programme (s5(2f)).
- The basis on which incentive or concessions may be paid in terms of a programme (s5(2h)).
- The prerequisites for assistance in terms of a programme.

The Board is obligated in terms of section 3(c) to constantly monitor every programme in order to evaluate whether the objects of such programme are being achieved.

3.2.5. Programmes for Regional Industrial Development (s10)

Section 10(2) states: "The minister may...set out the objects of the programme; and in general, make provision for any other matter which in his opinion or her opinion is necessary or expedient in order to promote or attain the objects of the programme..."

The act further states "the Regional Industrial Development Programme of 1982, the Regional Industrial Development Programme of 1991 and the Simplified Regional Industrial Development Programme of 1993 shall be deemed to have been instituted under the Provisions of the Manufacturing Development Act, and be in force as such."

This provision grants power to the Board to govern the administration of contracts still in force that were instituted under the provisions and guidelines of these past incentive schemes. The last contracts approved under the Regional and Simplified Regional Industrial Development Programme will be valid until 2003.

3.3. Structure of Administrative Bodies

Under the direction of the Board for Manufacturing Development, the Chief Directorate: Manufacturing Development of the Department of Trade and Industry was responsible for the day to day administration and implementation of the decisions made by the Board for Manufacturing Development.

In 2000, the Chief Directorate: Manufacturing Development of the Department of Trade and Industry was restructured in line with an attempt to make the department more outwardly oriented. The restructuring of the Chief Directorate coincided with the implementation of the revised incentive programme, which was to replace the Tax Holiday and SMMDP. The new programme is known as the Small Medium Enterprise Development

Programme. The new administrative body is called The Enterprise Organisation, and is headed up by a Chief Executive Officer.

3.4. Objectives of The Chief Directorate: Manufacturing Development

The Manufacturing Development act defined set objectives for the Board for Manufacturing Development. The Board for Manufacturing Development had further clarified these objectives into smaller objectives, and as per the 1998 annual report of the Board for Manufacturing Development the mission, objectives and responsibilities of the Board were:

3.4.1. Mission

"Promotion of investment in new competitive and sustainable manufacturing activities."

3.4.2. Objectives

"The investment incentives have been designated in accordance with the Growth Employment and Redistribution Strategy (GEAR) of the Government with the aim to:

- Raise fixed investment in manufacturing;
- Restructure domestic manufacturing towards international competitiveness;
- Facilitate a higher degree of labour absorption; and
- Encourage small- and medium sized manufacturing.

3.4.3. Responsibilities

The Board for Manufacturing Development is responsible for the implementation of the 1991 RIDP, 1993 SRIDP as well as the Tax Holiday Scheme (THS) and the SMMDP introduced on 1 October 1996.

3.5. Products and Services

The Chief Directorate: Manufacturing Development was responsible for the:

- 1991 Regional Industrial Development Programme
- 1993 Simplified Regional Industrial Development Programme
- SMMDP
- Tax Holiday Scheme
- Competitiveness Fund
- Foreign Investment Grant
- Export Marketing Investment Assistance (TISA)
- Support Programme for Industrial Innovation (SPII)

The scope of this study is limited to the SMMDP.

3.6. Background to the Implementation of the Small Medium Manufacturing Development Programme (SMMDP)

The Regional Industrial Development Programme (RIDP) was introduced in 1982 and revised in 1991, and the Simplified Regional Industrial Development Programme (SRIDP), was introduced in 1993 (Ernst & Young, 1996). The RIDP and SRIDP are known as Schedule 4 incentives. Schedule 4 incentive programmes were implemented against the political backdrop of the pre–democratic South African government.

The key objective of the RIDP, was to (Truter, 2002):

- Subsidise growth points in certain areas,
- Assist self governing and independent states, and
- Transfer emphasis from already developed areas, to undeveloped areas.

To this end, large geographical areas were excluded from qualifying for these incentives. In keeping with these objectives, the administration of Schedule 4 incentive schemes was undertaken by the Department of Land Affairs.

After the election of the new democratic government in April of 1994, there was no longer political backing for the continuation of the RIDP and SRIDP that pursued objectives set by an apartheid government.

At a meeting between the Minister of Trade and Industry and MEC's of all the provinces, in December 1994, it was decided that the Regional Industrial Development Programme be evaluated with the aim of bringing the programme in line with the trade and industrial development goals of the newly elected democratic government (Evaluation of the Regional Industrial Development Programme (RIDP) conducted by NEDLAC).

"The Japanese Grant Fund (JGF) Subcommittee identified industrial incentives as a key area for consideration. This was in keeping with discussions on supply side measures which occurred in NEDLAC and previously in the National Economic Forum", (Evaluation of the Regional Industrial Development Programme (RIDP) conducted by NEDLAC).

A Counterpart Group subcommittee was formed to manage the evaluation. The research brief of this evaluation comprised component studies relating to:

- The actual performance of the RIDP
- Provincial government legislative powers, capacities and requirements with regard to industrial development
- The RIDP's policy initiatives relating to support for manufacturing, spatial development and regional industrial location
- A comparative account of contemporary regional industrial development policy.

The recommendations from the evaluation report were used as the basis for developing the Tax Holiday and Small Medium Manufacturing Development Programme (SMMDP).

The primary recommendations were:

- Changing from a cash grant to a tax-based (partial or Tax Holiday) incentive scheme for a period of 5 years with qualifying criteria based on employment creation, sectorial and spatial objectives.
- Withdrawal of establishment grant's, except for Small Medium Manufacturing Enterprise's (SMME's), with the introduction of a new restructuring grant for SMME's.

On 20 Sep 1996, consideration of the RIDP report was finalised and 2 new programmes were adopted:

- The RIDP was to be replaced by a tax-based incentive scheme as announced in Governments Growth, Employment and Redistribution Strategy. The tax-based incentive scheme in GEAR comprises:
    - An accelerated depreciation tax allowance for expansions.
    - A Tax Holiday, up to a maximum of 6 years, based on qualification criteria relating to labour absorption, regional priorities and priority industries, for new projects with an investment in qualifying assets above R3 000 000.
- The SRIDP would be replaced by the SMMDP, which would provide an establishment grant and a performance based profit output incentive, for a combined total of 6 years.

The Trade and Industry Chamber of NEDLAC agreed on 26 March 1996 that investment incentives be prioritised as a support measure within government's supply side strategy (Evaluation of the Regional Industrial Development Programme (RIDP) conducted by NEDLAC)

In addition to the implementation of Schedule 5 Incentives, comprising the Tax Holiday and SMMDP, the administration of the incentive schemes now fell under the arm of the Department of Trade and Industry.

The Manufacturing Development Board was established and incorporated the administration and management of all the past incentive schemes.

3.7. The Small Medium Manufacturing Development Programme (SMMDP)

The scope of this study is limited to the SMMDP, and consequently all subsequent factors discussed relate only to the SMMDP, and not to the Tax Holiday.

3.7.1. The Incentive

The SMMDP was implemented on 1 October 1996.

"The incentive package provides for the following (Guidelines to the SMMDP):

- An establishment grant payable for three years on approved qualifying assets
- A profit/output incentive payable for one year thereafter;
- A profit/output incentive payable for an additional two years provided the industrialist can meet or exceed the human resource remuneration to value added ratio of at least 55% as measured in the fourth and fifth financial year; and
- A foreign investment grant, limited to US$50 000 per project."

The incentive applied to all areas within the Republic of South Africa.

Unlike the RIDP, the incentive only applied to newly incorporated manufacturing entities, and not to expansions of existing entities.

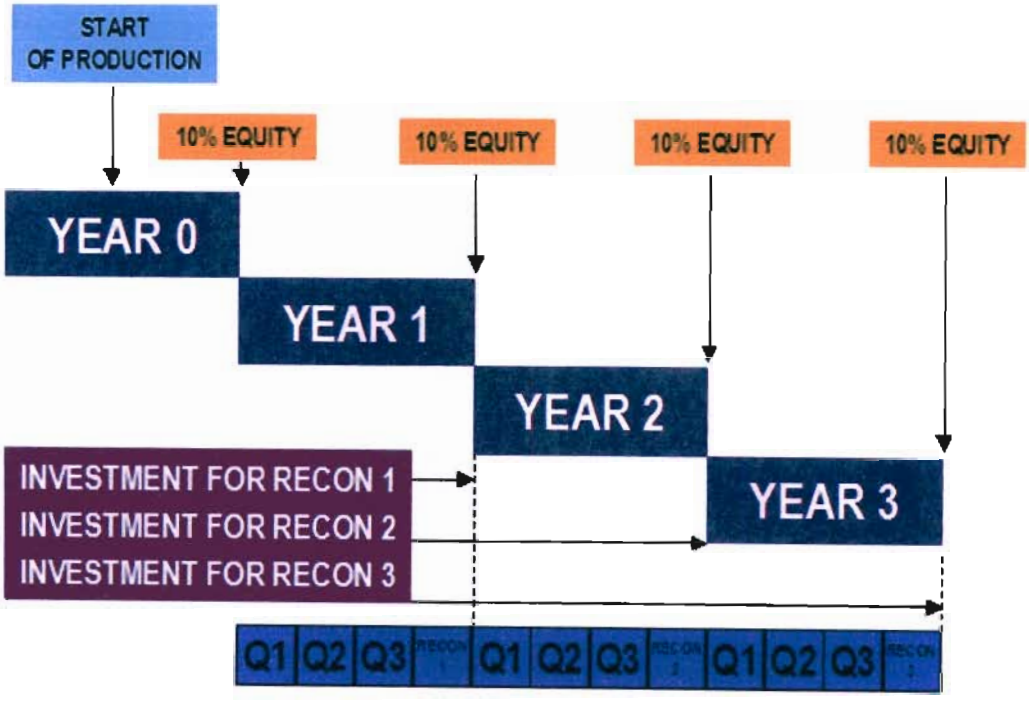

Figure 3-1: Timing and Analysis of SMMDP Incentives during the Establishment Grant Phase

Source: Secondary Data

The maximum investment allowable in terms of the SMMDP is R3 000 000, in qualifying assets, comprising Land and buildings, Commercial Vehicles, and Plant and Machinery (SMMDP Guidelines, 1996).

Figure 3-1 indicates the timing of incentives to be paid during the establishment phase of the approved incentive term.

3.7.1.1. Establishment Grant

The establishment grant is payable for a period of three years, commencing on the first day of the financial year after commencement of production.

Applicants must apply for the incentive within 180 days of commencement of production.

The establishment grant is calculated as a percentage of 10.5% of the qualifying investment. The qualifying investment is deemed to be the total investment in Land and Buildings, Plant and Machinery, and Commercial Vehicles.

The 10.5% is calculated as 70% of a 15% interest rate. In effect, the grant amounts to an interest rate subsidy, of 70% of the first 3 years finance costs, if the finance costs are based on a prevailing interest rate of 15%.

Therefore, if an industrialist invests in Land and Buildings of R800 000, Plant and Equipment of R1 500 000, and commercial vehicles of R200 000, the total qualifying investment is R2 500 000, and the establishment grant payable is 10.5% of R2 500 000, or R262 500. If the industrialist financed the project with 100% debt, at an annual interest rate of 15%, the annual incentive of R262 500, amounts to 70% of the annual finance cost of R375 000.

Land and Buildings would qualify for the establishment grant whether they were owned or rented. In the case of rented premises, the industrialist would receive incentives on the deemed value of the building. The deemed value is calculated according to the capitalization method at a discount rate of 15%. Thus, an industrialist that paid an annual rental of R120 000, would receive incentives on the deemed value of the building i.e. R800 000 or R120 000/15%. If the industrialist rented the premises from a related company, the deemed value would be limited to the lesser of the actual historical cost of the building, the capitalized rental, or the market value.

During the establishment grant phase of incentives the industrialist is required to meet the following requirements:

Equity

The company must maintain an equity ratio of 10% throughout the asset phase or establishment grant. The equity ratio is calculated as a percentage of shareholders funds, to total assets, and must be achieved in each of the asset-based years.

The following items are considered qualifying for equity purposes (SMMDP Contract, 1996):

8.1.2 *Equity Requirements*

Qualification for payment of the establishment grant is subject to compliance with the following general conditions pertaining to the SMMDP:

8.1.2.1 *Establishment grant payments will commence only after a minimum equity of 10% as defined in paragraph 8.1.3, calculated as a percentage of total assets as per balance sheet, is proved by way of audited/certified financial statements and audited/certified reconciliation claims*

8.1.3 *Calculation of Equity/Member's Interest*

8.1.3.1 *Companies and Close Corporations*

For purposes of this calculation, shareholders'/members' equity/own capital includes account recognised as constituting shareholders' equity/members' interest, own capital namely:

8.1.3.1.1 *Permanent issued share capital/members' interest/own capital, excluding debentures;*

8.1.3.1.2 *Share premium (elements of share premiums to be disclosed);*

8.1.3.1.3 *Other realised non-distributable and distributable reserves;*

8.1.3.1.4 *The shareholders'/members'/intercompany loan agreements must be submitted to the Board for consideration, and must be kept in place during the entire establishment grant period;*

When the controlling interest is vested in a foreign entity or in a public company listed on the Stock Exchange it is exempted from this requirement;

8.1.3.1.5 *Accumulated profit or loss;*

8.1.3.1.6 *Deferred taxation (credit balance).*

8.1.3.2 *Disqualification of specified equity, for example certain elements of share premium, redeemable preference shares, non-distributable reserves etc., or the offsetting of inter- and intra-group or related party debit balances, investments, inflated values and non qualifying assets, can be effected at the discretion of the Board.*

8.1.3.3 *When calculating the equity/total assets ratio, the balance sheet values of total assets will be reduced by the corresponding value by which equity is reduced in respect of unrealised assets, intra-company and related party debit balances, non-qualifying assets, revaluations, intangibles and other items as applicable.*

8.1.3.4. *Loan (s) from one entity to another*

8.1.3.4.1 *The loan(s) can be regarded as equity provided that:*

There is common shareholding and or a controlling interest in its subsidiaries or associated companies, on condition that the loans are of a long-term nature. Should the loans be made available to associated or subsidiary companies (in other words recorded under Assets), only the net movement in the loan will be accepted as equity i.e. loan(s) obtained and loan(s) made available will be set-off against each other.

8.1.3.4.2 *Loans appearing in the Financial Statements as current liabilities.*

No loan which appears in the Balance Sheet as a current liability can be regarded as part of equity even if an agreement has been concluded between the parties concerned as there is a specific reason why the auditor regarded the loan as short term, whether it is a current account for intercompany transactions or the short term portion of a long term loan which is repayable within the following year.

8.1.3.4.3 *Amendment to historical financial statements:*

No amendments to historical data, on approved and accepted financial statements by the directors and/or shareholders and /or members, to reclassify any loans with a view to qualify for equity, will be allowed.

8.1.3.5 *If a loan or a portion thereof has been ceded to a third party, the cession together with the loan agreement must be submitted to the Board for consideration and acceptance. If it transpires from the cession that it will negatively effect the equity requirement, the loan may at the discretion of the Board, be considered in determining the equity.*

8.1.3.6 *Partnerships and Sole Proprietors:*

Own funding will be measured as own funds expressed as a percentage of total assets.

8.1.3.7 *Equity Erosion and Conversion:*

If the equity erodes to below 10% as reflected in the compulsory audited/certified financial statements and audited/certified reconciliation after the end of the first, second or third financial year, the incentives will automatically be converted to the profit/output incentives for the remainder of the incentive claim period subject to the conditions of paragraph 9. The last 2 (two) years of the incentive claim period is also subject to the conditions of paragraph 10. In the case of previous establishment grant payments already made on the strength of past audited equity certification, this conversion will apply for the remainder of the incentive claim period, subject to the conditions of paragraph 9, with effect from the commencement of the subsequent financial year. The last 2 (two) year of the incentive claim period is also subject to the conditions of paragraph 10. Provisional quarterly payments made in respect of the financial year during which the erosion occurred, will be deemed to be the incentives for the entire financial year, with forfeiture of incentives for the remainder of such financial year. Accordingly no adjustments will be made. In the case of no previous establishment grant payments, this conversion will apply retrospectively for your entire incentive claim period, subject to the conditions of paragraph 9. The last 2 (two) years of the incentive claim period is also subject to the conditions of paragraph 10.

Failure to meet the equity requirement at any given year will result in loss of asset-based incentives and conversion of the contract to a performance based profit output incentive. The Industrialist would therefore forfeit incentives for the year in which equity was not met, or for the remainder of the year if the industrialist had claimed quarterly, and would claim a profit-based incentive for the remainder of the approved incentive term.

Plant and Machinery

All plant and machinery must be kept productively in use in an ongoing manner in order to qualify for incentives. Failure to utilize the machinery in production will result in termination of the incentive contract.

In addition, no payments will be made unless the industrialist can prove that he has acquired at least 50% of the plant and machinery that he projected that he would acquire, at the end of year 1 and year 2 of the contract

respectively. Failure to meet the plant and machinery requirement will terminate the contract.

The contract further requires that any second hand machinery that is purchased must be matched with an equivalent Rand value of new machinery. Such second hand machinery may only qualify for incentives, if the company that the machinery was acquired from did not receive concessions in the past. Furthermore, any machinery that is purchased from a "qualifying source" is deemed to be new machinery. A "qualifying" source includes dealers in second hand machinery, auctioneers, and liquidators. Equipment purchased from connected persons does not qualify for incentives.

Turnover

The industrialist is required to project an annual turnover for year 1 and year 2 of the incentive term. He is required to achieve 25% of year 1's projection and 50% of year 2's projection. Failure to meet the required turnover targets within the given range will result in the forfeiting of incentives for the year in which the requirement was not met, or for the remainder of the year if the industrialist had claimed quarterly, and the conversion of the contract to a performance based profit output incentive for the remainder of the incentive contract.

3.7.1.2. Profit Output Incentive

The profit output incentive is payable for the 3 years immediately after the 3 year establishment grant. The industrialist is therefore eligible for a total of 6 years incentives.

The profit output incentive is calculated as a percentage of qualifying profits. Qualifying profits are deemed to be all profits earned in the process of manufacture. The incentive is 25% of the Profit before tax.

The following guidelines are relevant to the Profit Output phase (SMMDP Contract, 1996):

9 ***Profit/Output Incentive:***

(Refer to Section 10 (zH) of the Income Tax Act,1962 concerning the taxability of this incentive)

The equity/own funding requirement is not applicable in the case of the profit/output incentive.

9.1 *Basis of calculation of Profit/Output Incentive*

The profit/own incentive will be calculated according to the following profit/output formula:

25%of PBT, not to exceed the annual establishment grant paid for the second financial year as calculated in paragraph 8 above, up to a maximum amount of R315 000 per annum, whichever the lesser.*

**PBT: In the case of Companies and Close Corporations it is the Profit Before Tax, based on audited/certified annual financial statements prepared for the shareholders/members in terms of the Companies Act/Close Corporation Act.*

In the case of sole proprietors and partnerships the net income will be regarded as the net income before owner(s) remuneration.

In the case of partnerships and sole proprietors the income tax return as well as the tax assessment must be submitted together wit the annual financial statements for the calculation and payment of the profit/output incentive.

Qualifying income is income derived from transactions relating to the approved products manufactured by means of the approved qualifying production process.

For the purpose of calculating the profit/output incentive, all transactions in the income statement must be at an arm's length. Any transactions between connected persons (as defined in Section 1 of the Income Tax Act, no 58 of 1962) must be certified as being at a market related price. Also refer paragraph 15.5.

NB: All of the above calculations must be applied consistently in accordance with Generally Accepted Auditing Standards (GAAS) or Generally Accepted Accounting Practice (GAAP). In the event of any changes in the claimant's accounting policies, the Board reserves the right to make adjustments if the changes made will result in higher incentive claims.

9.2 *Method of Payment of Profit/Output incentive*

9.2.1 *In addition to the establishment grant, the profit/output incentive will be payable annually for a further period of one year following on the three year establishment grant. This incentive shall not exceed the*

establishment grant calculated on the actual total approved qualifying assets, as calculated at the end of the second financial year (se paragraph 8), in any given year for which the profit/output incentive is payable, up to a maximum amount of R315 000 per annum.

9.2.2 *If the establishment grant is forfeited on account of equity/own funding erosion and the project is converted to the profit/output incentive in the first, second or third year, payment will be limited to the maximum theoretical establishment grant which would have been calculated for each of those years, and further limited to the maximum amount approved as set out in paragraph 2.1 and paragraph 8, after which the profit/output incentive will apply as per paragraph 9.2.1 above.*

9.2.3 *Where the decrease in qualifying assets during years three, four, five and six results in a lower maximum incentive level than the incentive level determined at the end of the second year of the establishment grant, then the maximum level for that specific year will accordingly be adjusted to the lower level.*

9.2.4 *However, if the investment increases again, the level can be adjusted to the new level but not to exceed the amount as determined at the end of the second full financial year.*

9.2.5 *It is a condition of this contract that if it is established from your claims and accompanying financial statements that your project is in a loss situation, excluding accumulated losses, for two consecutive years, during the profit/output incentive period the contract terminates automatically and you will not be entitled to further incentives.*

If an industrialist generated a profit of R1 000 000 before tax, and after deducting non-qualifying items, the annual incentive would be R250 000, or R1 000 000 x 25%. The maximum incentive is furthermore limited to the incentive claimed at the end of the 2nd financial year, so if a profit of R1 500 000 before tax had been generated, from a qualifying investment of R2 500 000, then the incentive would be limited to R262 500, in spite of the 25% of R1 500 000 being equal to R375 000.

Aside from a Human Resource Criterion applicable in the 5th and 6th incentive year, there are no other requirements for the profit-based phase of the SMMDP. The Equity, Turnover, and Plant and Machinery requirements are not applicable to this phase.

Human Resource Criterion

The industrialist must achieve a given Human Resource Criterion in the 4th and 5th full year of production in order to claim incentives in the 5th and 6th year i.e. the criteria must be met at the end of year 4 to claim incentives in year 5, and must be met at the end of year 5 to claim incentives in year 6.

The criteria is a measure of Human Resources Remuneration to Gross Operating Surplus and is calculated as follows (SMMDP Contract, 1996):

10. ***Profit/Output Incentive (Human Resource development)***

(Refer to Section 10 (zH) of the Income Tax Act 1962, concerning the taxability of this incentive)

10.1 *In addition to the three years establishment grant and the one year profit/output incentive, a further two years profit/output incentive (as per paragraph 2.1.3), will be payable annually, provided that the minimum requirement as stipulated in paragraph 10.2 is achieved, and shall not exceed the establishment grant based on the actual total approved qualifying assets, as calculated at the end of the second financial year (see paragraph 8), in any given year for which the profit/output incentive is payable, up to a maximum amount of R315 000 per annum.*

10.2 *The labour remuneration to value added ration must be equal to/or exceed 55% and will e monitored during year two, three and four and also year five. Years five and six of the approval will be forfeited if this minimum percentage is not achieved at the end of year four. Year six of the approval will be forfeited if the minimum percentage is not achieved at the end of year five.*

10.3 *The ratio is determined in accordance with the formula:*

$$V = (B / (A + B)) X 100$$

In which formula:

"V" represents the percentage
"A" represents the gross operating surplus
"B" represents total Human Resource remuneration.

10.4 *"A" and "B" are calculated according to Table 1 (included in Annexure A) and must be certified by a Chartered Accountant in the case of Private Company of Close Corporation or a Commercial Financial Accountant or Chartered Secretary in the case of a sole proprietor or partnership and submitted annually to the Board.*

10.5 *For purposes of this table all accounting terms referred to shall bear the meaning as assigned thereto in terms of GAAP.*

Figure 3-2 defines part A and B as mentioned in the contract.

Part A: Gross Operating Surplus	**Part B:** Total Human Resources Remuneration
Net Profit / Loss Before Tax PLUS: Interest Paid (Internal and External) Net Profit / Loss Before Interest and Tax PLUS: Total Depreciation PLUS: Expenses Related to Property Rent Royalties Other PLUS: Net Capital Losses Loss on Sale of Assets Goodwill Amortization Other PLUS: Other Expenses defined in Accounting Statements AC 103 & 307 MINUS: Interest Received (Internal and External) MINUS: Total Government Subsidies / Concessions / Incentives Board for Manufacturing Development (BMD) General Export Incentive Schemes (GEIS) Motor Industry Development Programme (MIDP) Other MINUS: Income Related to Property Rent Royalties Other MINUS: Other Investment / Sundry Income MINUS: Net Capital Gains Profit on Sale of Assets Other MINUS: Other Income as defined in Accounting Statements AC 103 & 307	Wages Salaries Members' Remuneration Bonuses (including waged & salaried employees, directors / members) Other Fringe Benefits (as per IRP5) Contributions to Pension Funds Contributions to Provident Funds Contributions to Medical Aid Funds UIF Contributions Workmen's Compensation Fund Contributions Bursaries Training Expenses: Literacy Training Internal Training Extramural Training Levies (Industrial Training Boards & Other)

$$\frac{\text{Total Human Resource Remuneration}}{\text{Gross Operating Surplus + Total Human Resource Remuneration}} > 55\%$$

Figure 3-2:Part A and Part B – Human Resource Calculation

Source: Graphically illustrated from SMMDP Guidelines (1996)

3.7.1.3. Foreign Investment Grant (FIG)

Companies that are considered as Foreign Direct Investment i.e. be financed with capital held outside of the borders of the Republic of South Africa, and

have a more than 50% foreign shareholding, are entitled to a further grant called a Foreign Investment Grant.

The Foreign Investment Grant is a grant that assists in the relocation of new machinery from abroad, and is payable on the transportation and commissioning costs of the equipment.

Companies must be approved under the SMMDP to be considered for the Foreign Investment Grant.

3.7.2. Qualifying Entities

The following entities qualify for the SMMDP

- Companies (Private & Public)
- Close Corporations
- Co-operatives
- Partnerships
- Sole Proprietorships

The following entities do not qualify for the SMMDP:

- Trusts & Non-legal entities
- Entities with qualifying assets exceeding R3 million
- Connected persons manufacturing generically the same product
- Entities approved for Tax Holiday
- Projects that are considered to be expansions of existing entities.

Projects must also be engaged in one of the following qualifying activities:

- Manufacturing
- Processing, or
- Assembly

3.7.3. Qualifying Assets

The following classes of assets will qualify for incentives:

- Owned land & buildings (at cost)
- Leased land & buildings (capitalized at 15%)

- Owned machinery & equipment (at cost)
- Leased machinery & equipment (as capitalized in the balance sheet)
- Commercial vehicles (owned and/or leased)

3.7.4. Objectives of the Small Medium Manufacturing Development Program (SMMDP)

Prior to development of the SMMDP, the findings of the Evaluation of the Regional Industrial Development Programme also referred to and prioritised important objectives for the future. The report stated that supply side industrial policy measures were aimed at promoting *industrial competitiveness, productivity, growth and development*. In achieving these objectives, the report highlighted the specific areas of focus in order to bring about effective supply side policy (Ernst & Young, 1996).

- Human resource development;
- Industrial development finance;
- Technology development;
- Productivity improvement;
- Small and medium sized business development;
- Investment incentives; and
- Cluster development."

When the SMMDP was presented to the Minister for approval in terms of the Manufacturing Development Act, the following objectives were proposed and adopted for the SMMDP (De La Rey, 2002):

"The envisaged strategic objectives are as follows:

- Wealth Creation
- Employment creation
- Further Development of Entrepreneurship
- Promoting the utilisation of local raw materials
- Ensuring long term sustainability of projects, receiving incentives
- Creating opportunities for the introduction of new and advance skills in South Africa.

- Facilitating International Competitiveness."

The objectives as stated in marketing and promotional materials are simplified as follows:

> "To encourage investment in manufacturing, and encourage small and medium sized manufacturing and facilitate a higher degree of labour absorption" (SMMDP Guidelines, 1996).

3.8. Conclusion

The inclusion of the SMMDP in government's basket of supply side measures should have an impact on growth, but while it may not be effective in entirely alleviating resource constraints, labour market limitations and external economic shocks, it has nevertheless been aimed at addressing some of these constraints.

The success of the SMMDP in alleviating the problems that it has been targeted to address, is the core of this study. These objectives have been discussed in more detail in Chapter 4.

The SMMDP has been implemented under the direction of the Board for Manufacturing Development. The powers and objectives of the board are governed by the Manufacturing Development act no. 187 of 1993.

Monitoring requirements have been incorporated into the SMMDP. Some of these requirements aid in the achievement of objectives, and others hinder the impact that the programme could have on alleviating structural constraints. The monitoring requirements are a prescribed equity ratio, a Plant and Machinery requirement, a Turnover requirement and a Human Resources requirement.

Chapter 4 discusses the congruency of related objectives, the resources of the Chief Directorate: Manufacturing Development, conducts an internal an external assessment of relevant factors, addresses the impact of the incentive on structural constraints, and evaluates the feasibility, acceptability, and suitability of the organisations strategic choice.

The monitoring requirements are specifically discussed in terms of their contribution to the suitability of the strategic choice.

Chapter 4: Evaluation of the Small Medium Manufacturing Development Program (SMMDP)

4.1. Introduction

In order to evaluate the SMMDP, its objectives must first be understood, together with the way that the objectives have been incorporated into the blue print for manufacturing development, or the Board for Manufacturing Development's strategy.

An appreciation of South African structural constraints is essential if one is to assess the effectiveness of the Board for Manufacturing Development's programmes, which in theory should be aimed at removing structural constraints within the economy, or reducing the impact of these constraints on manufacturing entities within the Republic.

In brief, the strategy of the Board for Manufacturing Development is to offer government subsidies that remove or reduce the impact of structural economic constraints, in order to increase production in the economy, and foster economic growth that will uplift all South Africans. The effectiveness of the Board for Manufacturing Development in implementing subsidies to accomplish it's objectives has been hindered by policy conditions embodied in the SMMDP, as well as prevailing external factors that could not be addressed within the scope of a single incentive or subsidy.

This chapter will identify the hindrances to the achievement of the objectives, supported by evidence amongst participants in the SMMDP, as well as the external factors that could not be addressed within the scope of the SMMDP.

The suitability, acceptability and feasibility of the organisations strategic choice are assessed. A model has been developed to assess the impact of the programmes monitoring requirements on the suitability of the strategy. Porters Value chain is also applied in the determination of suitability.

Data from a sample of SMMDP participants has been analysed and is referenced in this chapter to arrive at and support the assessment.

4.2. Aim

The aim of the SMMDP is derived from a hierarchy of interlinking governmental objectives. A company's strategy is naturally affected by its business objectives, the environment in which it operates, and the resources it has at its disposal. The predominant stakeholders in the organisation in turn determine the business objectives. A clear understanding of the objectives of the Chief Directorate: Manufacturing Development and its associated stakeholders is therefore necessary in evaluating the effectiveness of the organisations strategy.

The Economic, Societal, Political, and Regulatory requirements are of utmost importance in the context of the non-profit governmental organisation. The economic objectives are highlighted in paragraph 4.2.1 and discussed in more detail in paragraph 4.2.2. Competitive conditions and overall industry attractiveness are less relevant as the objectives of the organisation in question are broad sweeping and affect a wide spectrum of industries. Opportunities and threats to a companies' well being are discussed in paragraph 4.3.2.

4.2.1. Hierarchy of Objectives

The objectives of the Board for Manufacturing Development, the Chief Directorate: Manufacturing Development, and the SMMDP can be combined to form a three-tier hierarchy of objectives, which provide the overall direction for the organisation. This Hierarchy is illustrated in Figure 4-1.

The governmental policy prevailing during the SMMDP's development and implementation centred on Growth, Employment and Redistribution (GEAR). Through GEAR, the government had hoped to increase the country's GDP by 6% per annum, it had hoped to create employment for +/- 400 000 people by year 1999, redistribute social services and most importantly reduce the budget deficit (Sunday Times, 16/11/97).

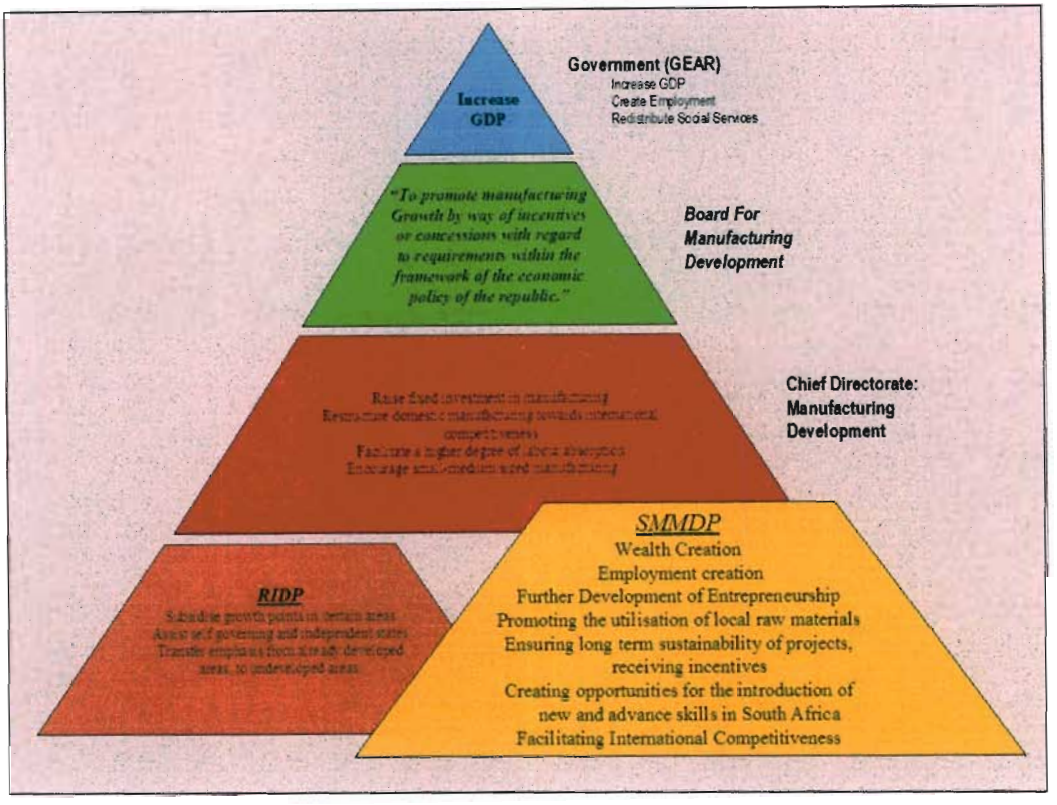

Figure 4-1: Hierarchy of Objectives

Source: Secondary Data

The objective of the Board for Manufacturing Development, in line with gear is to "promote manufacturing Growth by way of incentives or concessions".

The Chief Directorate: Manufacturing Development, directly responsible for implementation of the Board for Manufacturing Development's programmes, promotes manufacturing growth by promotion of investment in new competitive and sustainable manufacturing activities. Specifically quantified, it's objectives become: Raise investment in manufacturing, Restructure domestic manufacturing to become more competitive internationally, increase the proportion of labour relative to total cost, and encourage small to medium sized manufacturing.

The SMMDP, evidence of the Board for Manufacturing Development's strategy, encompasses roots level objectives i.e.

- Wealth Creation
- Employment creation

- Further Development of Entrepreneurship
- Promoting the utilisation of local raw materials
- Ensuring long term sustainability of projects, receiving incentives
- Creating opportunities for the introduction of new and advance skills in South Africa.
- Facilitating International Competitiveness.

In keeping with good corporate strategic principles, these objectives are clearly defined, and add value to the organisation. In the non-profit governmental context, value added translates into any activity that results in greater economic output. The extent of this value added is illustrated in paragraph 4.2.2, as each objective is evaluated.

Evidence suggests that the strategy is sustainable, as the methodology employed in the SMMDP, stems from the early Regional Industrial Development Programme, and has continued beyond the SMMDP to the Small Medium Enterprise Development Programme.

The delivery process for the SMMDP is carried out by the Chief Directorate: Manufacturing Development. The delivery of increased output to the economy takes place through an un-established network of Small to Medium Enterprises. The reliance upon this sector of the economy to make the greatest contribution to the economic output of the country is based upon the assumption that manufacturing constitutes a large portion of the GDP of South Africa. The testing of this assumption is outside of the scope of this study.

Organisations that do not understand stakeholder objectives will never be able to effectively implement a strategy that will accomplish them. It is vital therefore that the objectives of all these parties are congruent. The objectives of the Government, the Board for Manufacturing Development, the Chief Directorate: Manufacturing Development, and the SMMDP, are clearly closely related and are congruent in every respect.

The roots level objectives are evaluated below.

4.2.2. Evaluation of Objectives

The primary economic question that must be addressed by a country is what to produce, how to produce it and for whom to produce it. When countries make choices that produce outcomes that are smaller than they are capable of, market inefficiency occurs (Schiller, 2000). Government can intervene to produce more efficient outcomes, by changing the mix of products and services produced in an economy. Government's failure may also occur if government is unable to produce a favourable result through intervention. The primary objective of intervention is however to create economic wealth, and favourable economic outcomes such as full employment.

The hierarchy of objectives is discussed below in light of government's economic considerations and the purpose of intervention.

4.2.2.1. Wealth Creation

The objective of any economy is to create wealth. The creation of wealth should be the overriding consideration that determines all governmental policy. Wealth is created though the production of goods and services in an economy and is measured by the gross domestic output. Any increase in the gross domestic output of an economy will result in an increase of wealth amongst the members of the economy.

In a developing economy like South Africa, a large portion of the Gross Domestic Product is derived from the manufacturing sector. This sector is therefore a good starting point to provide stimulation for growth. By assisting the manufacturing sector to produce more goods and services, the economy is capable of producing more output and therefore increasing it's Gross Domestic Product.

The incentive provided by the SMMDP should theoretically result in Small to Medium sized enterprises being able to invest in manufacturing equipment which will facilitate increased output in the economy.

4.2.2.2. Employment Creation

The level of employment in an economy is a barometer of economic stability and the state of the economy. At full employment, economies can provide the greatest participation in wealth to its members, because all members of the economy are able to earn income, and purchase goods and services. As more goods and services are purchased, the demand for goods and services increases, and there is a stimulus for the economy to supply additional goods and services. The result is more jobs, more saving, and increased capacity for investment.

Employment creation is therefore high on the list of economic priorities, and the Board for Manufacturing Development has not lost site of this objective.

In the modern context, as levels of technology increase, and manufacturing equipment becomes less labour intensive and more capital intensive, the Board for Manufacturing Development must strike a balance between stimulating investment in capital equipment and creating employment.

4.2.2.3. Further Development of Entrepreneurship

Schiller (2000) defines entrepreneurship as "the assembling of resources to produce new or improved products and technologies".

An economy without entrepreneurs is lifeless, and does not have the means to create opportunities for generating income, and increasing wealth or employment. The art of entrepreneurship must be fostered within an economy, and when a spirit of entrepreneurship abounds, an environment is created that is conducive to creating employment, and increasing output.

Small to Medium Sized Enterprises are recognised as being able to make an increasingly proportionate contribution to the economy, and providing additional employment for the unemployed. Entrepreneurs drive this sector of business and entrepreneurs must therefore be developed.

4.2.2.4. Promoting Utilisation of Local Raw Materials

Economies are more efficient when they are able to make optimal use of scarce resources. Utilising raw materials that are freely available but are under-utilised will create opportunities to produce more goods and services that will increase the output of the economy.

4.2.2.5. Ensuring Long Term Sustainability of Projects Receiving Incentives

A large proportion of small businesses fail at start-up. The SMMDP is able to provide a 'life line' to small business during the start-up phase in the form of a cash injection, which should reduce the risk of failure of start-up firms.

4.2.2.6. Creating Opportunities for the Introduction of New and Advanced Skills in South Africa.

New skills result in increased output and increased wealth. With the introduction of skills into South Africa that are available on a global market, South African Manufacturers are able to compete in the Global Village.

4.2.2.7. Facilitating International Competitiveness

South African companies have become increasingly reliant on global trade, and building a competitive advantage over competing countries will result in increased output for the economy. Competitive advantage results from a combination of exploiting resources that are freely available in South Africa, and not elsewhere, and ensuring that South African companies do not lag behind competing counterparts in other areas. The SMMDP is aimed at facilitating international competitiveness by allowing companies' access to equipment that would otherwise be unaffordable to Small and Medium Sized Enterprises.

The SMMDP therefore had the task of accomplishing all of these objectives. The success of the SMMDP must therefore be measured by the extent to which it had an impact on these factors.

The specific level objectives are designed to give effect to the broader governmental objectives. This is done in accordance with good corporate

strategy, which dictates that the organisational objectives must be aligned with the objectives of its stakeholders.

These objectives adopted by the organisation provide a clear path forward, and require that the programmes implemented by the Board for Manufacturing Development raise fixed investment in manufacturing create international competitiveness, increase jobs, and encourage small to medium size manufacturing.

4.3. Analysis of Internal Resources

A strategic analysis is not complete without an understanding of the internal factors that shape the organisation's objectives and strategy.

4.3.1. Mechanics of Incentivisation

The cycle of re-investment shown in Figure 4-2 and the explanation that follows is adapted from Ernst & Young (1996).

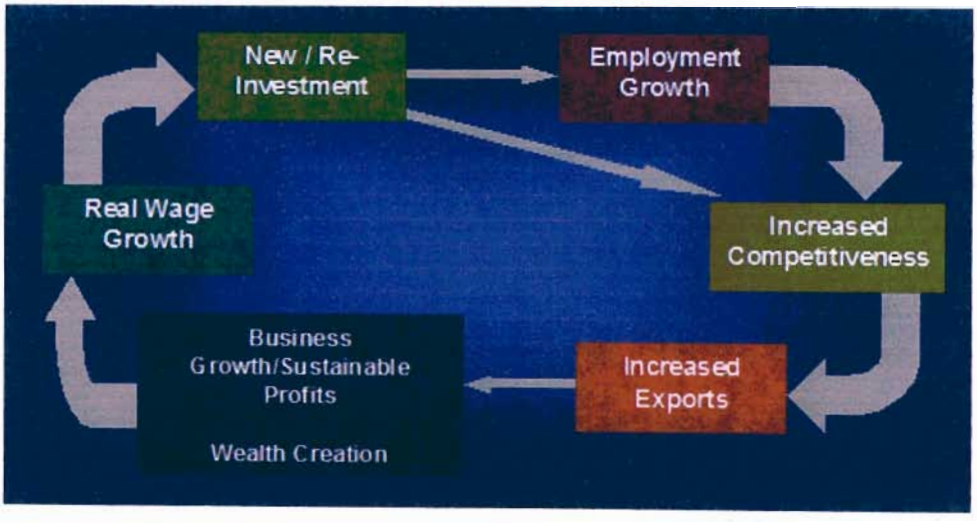

Figure 4-2: Re-investment Cycle

Source: Ernst and Young, Evaluation of the Regional Industrial Development Programme (1991 RIDP and (1993 SRIDP), 1996.

The cycle begins with an investment, which takes place in a manufacturing entity, either a new entity or an existing entity expanding its productive capacity. The new investment inevitably leads to an increase in output, and an increase in the number of jobs available, and therefore an increase in

employment, unless the investment is technologically advanced and results in a decrease in the number of employees required. The investment may also lead to superior quality of product, and will therefore provide a competitive advantage over the organisations competitors.

The competitive advantage gained from the investment, results in increased competitiveness of the company, and increased output. Increased competitiveness will result in increased exports, or alternatively import substitution, which will protect the country's balance of payments. This in turn will lead to sustainable profitability and business growth, creating wealth in the process.

As the organisation benefits from increased competitiveness and additional output, it can provide real wage growth, and in addition plough back its profits into re-investment, thus repeating the cycle.

It follows then, that providing incentives for investment per se, will result in employment growth, and increased competitiveness. Increased exports and real wage growth are possible outcomes from the investment, employment growth and increased competitiveness.

Incentivisation of investment therefore, aids in accomplishing three of the seven roots level SMMDP objectives i.e. Wealth Creation, Employment Creation and Facilitation of International Competitiveness. The remaining four objectives (Facilitation of Entrepreneurship, Promoting Utilisation of Raw Materials, Creating Opportunities for Skills Advancement, and Ensuring Long-Term Sustainability of Projects receiving incentives) cannot directly be achieved through incentivising investment, and therefore requirements must be built into the respective incentive framework that require companies to make progress in the other four areas if they are to receive incentives for investment.

The assumption that companies will of their own accord implement measures to achieve these objectives is tested as the effects of the incentive are discussed below. Furthermore, the incentive scheme attempts to force

companies to comply with these four remaining requirements by building them into the qualifying criteria for receiving incentives.

4.3.2. SWOT Analysis

An analysis of the strengths, weaknesses, opportunities and threats of the SMMDP, will provide a basis for analysing the appropriateness of the chosen strategy.

4.3.2.1. Strengths

- The SMMDP is based on extensive experience gained from the Regional Industrial Development Programme and the Simplified Regional Industrial Development Programme.
- The SMMDP is able to reduce the cost of capital to investors and offer a greater return in the start-up phase of the project.
- The programme is available to all manufacturing sectors.
- The programme is available to all geographical regions within South Africa.

4.3.2.2. Weaknesses

- The Chief Directorate: Manufacturing Development is understaffed and displays a lack of human resources and trained personnel.
- Some manufacturing sectors are in greater need of assistance than others.
- The programme does not adequately compensate for the global pressures placed on South African manufacturers as a result of the reduction in trade barriers.
- The SMMDP is not able to create sustainable employment directly.
- The effect of the 'lifeline' to small business is limited, as borne out by the high failure rate of businesses in the sample group.

4.3.2.3. Opportunities

- Any increase in internal efficiency will have a multiplier effect on economic output. The Chief Directorate: Manufacturing Development can therefore have a greater effect by increasing

efficiency within its key functional areas, as suggested by the value chain analysis.

- Offer specialised sector specific incentives to address more specific market failures e.g. pressure on specific industries resulting from removal of trade barriers and tariffs.

4.3.2.4. Threats

- Any change in governmental objectives could result in the SMMDP chasing objectives that are not congruent with governmental policy. The Chief Directorate: Manufacturing Development risks having its programmes made redundant in an instant by a change in government policy.
- The programme is not available to existing manufactures investing in increased capacity.
- Payments are too slow to have an impact.

4.3.3. Organisational Resources

The key resources of the Chief Directorate: Manufacturing Development are:

- Governmental funding
- Experience in industrial incentivisation
- All resources possessed by the South African economy

The Board for Manufacturing Development must harness the resources endowed upon it by South African economy (including raw materials, existing competitive advantage of South African industry, and a first world infrastructure) and channel these resources into areas that will have the greatest overall impact on the South African economy.

Individual industrialists have Capital and Entrepreneurship, and individually can make a marginal contribution to the economy, but lack total economic perspective. The Board for Manufacturing Development should impart the insight gained from a bird's eye perspective to the economy by encouraging (through incentivisation) investment in industries that will make the biggest contribution to GDP, and discouraging investment in marginal industries.

This economic decision is well illustrated in Figure 4-3, adapted from Schiller (2000). The principle is that government must allocate scarce resources into the production of various products, in this instance Guns, and Butter. The more butter is produced, the less guns can be produced. An efficient outcome must be attained, because the country needs both guns and butter.

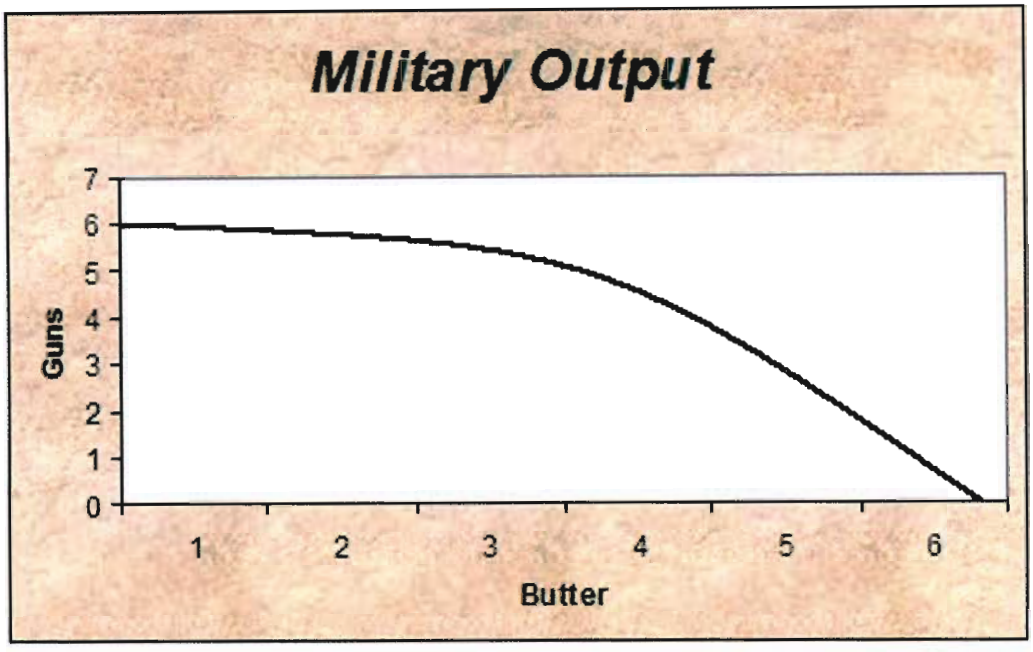

Figure 4-3: Guns vs. Butter Continuum

Source: Adapted from Schiller, The Economy Today, 2000.

The same principle applies to the incentivisation of industry. Government must maintain a balance between industries producing various products, and favourable economic outcomes such as wealth and employment.

This argument therefore builds a case toward industry specific incentivisation, and in principle, discourages broad sweeping economic incentives. Greater growth can therefore be achieved through sector specific incentivisation, provided that the sectors are appropriately selected. This premise also leans towards a more emergent approach to development of strategy as opposed to a prescriptive approach.

4.4. External Analysis

An analysis of the external environment in which an organisation operates is aided by the identification of Political, Environmental, Social and Technological Factors.

4.4.1. PEST Analysis

The following factors are relevant when assessing the strategy of the Chief Directorate: Manufacturing Development.

4.4.1.1. Political

- There is an unspoken perception that "big is bad" I.e. a prejudice against large industries that are perceived to be able to fund themselves without assistance.
- World Trade Organisation regulations prevent governments from offering sector specific incentives.
- Labour laws have an impact on the investment decision, numbers of employees, and success of start-up ventures.
- The RIDP addressed needs of a previous government, and it was necessary to implement a programme that addressed the objectives of the post 1994 political regime (Truter, 2002).
- New Government objectives required that all areas were opened up, on account of the Reconstruction and Development Programme, which required the redevelopment of urban areas (Truter, 2002).

4.4.1.2. Environmental

- The intention of the incentives was to broaden the economic base of industry (De La Rey, 2002).
- A programme takes 3 to 4 years to get momentum and show results.
- The Tax Holiday was expensive, and results were difficult to achieve (De La Rey, 2002).
- Globalisation has an impact on export duties. Coastal regions are therefore preferable for establishment, and establishments took place near harbours and international ports. The railways failed in their

attempt to give services to areas targeted by the RIDP, pricing by volume rather than by weight (De La Rey, 2002). This resulted in a trend for Small Medium enterprise to move towards coastal areas.

4.4.1.3. Social

- South Africa has a need for employment creation. The SRIDP gave better rates of employment to investment than the RIDP. Therefore, small enterprises were more beneficial (De La Rey, 2002).
- Government required that empowerment objectives were furthered. The post 1994 government was voted into power by small groups of people who were largely unemployed. The government therefore had an obligation to assist these groups in return. Hence the strong emphasis on small medium enterprises and on empowerment.
- The profile of political supporters required strong assistance in the areas of training and development, access to funding, and research and development.
- Small Businesses have a high failure rate, and a need for assistance to reduce the failure.

4.4.1.4. Technological

- The pace of technological development in industry requires that companies continue to invest in equipment that will allow them to remain competitive.
- The cost of new machinery is prohibitive amongst small to medium enterprises.

4.5. Structural Constraints

The predominant structural economic constraints in South Africa are a high cost of capital, lack of technology, insufficient research and development and the structure of the labour market. Some of these constraints can be addressed by the SMMDP, and others are better addressed by other intervention.

Gathering economic data in order to determine industry needs is the first primary activity in the value chain of the non-profit governmental organisation. Industry needs are determined by prevailing constraints, and the identification of which constraints to be targeted therefore forms the primary input logistics for the Chief Directorate: Manufacturing Development. Providing incentives that attempt to address the symptoms of market failure rather than the cause will have very little effect on bringing about a sustainable economic result. The identification of these structural constraints should therefore be given absolute priority within the Board for Manufacturing Development.

The SMMDP did not bring about a major change in the philosophy of incentivisation employed by the Board for Manufacturing Development. Additional research aimed at identifying causes of structural failure may conclude that constraints exist that cannot be addressed by an interest rate subsidy. Some of the known constraints are further discussed.

4.5.1. Resource Constraints

The SMMDP can effectively deal with the high cost of capital, but not research and development and technology, or the structure of the labour market.

4.5.1.1. Capital

South Africa's cost of capital in comparison to other countries is relatively high, as can be seen in the Table 4-1. South Africa ranks 5th in a comparison of the short-term interest rates of 22 countries.

The high cost of borrowing money in South Africa is a deterrent to investors who require investment in capital-intensive projects. The SMMDP is, in effect, an interest rate subsidy and is well suited to address this structural constraint by effectively reducing the net cost of borrowing for an investor. This resource constraint is efficiently dealt with in the SMMDP.

Ranking	Country	Three-Month Interest Rate Latest %
1	Russia	21
2	Brazil	20.9
3	Argentina	14.2
4	Indonesia	13.9
5	South Africa	13.5
6	Mexico	7.3
7	Poland	7
8	India	5.5
9	South Korea	4.9
10	Australia	4.8
11	Britain	3.7
12	Europe*	3.2
13	Malaysia	3.1
14	Chile	2.8
15	Canada	2.7
16	Taiwan	2.1
17	Thailand	1.9
18	China	1.7
19	United States	1.3
20	Singapore	1
21	Switzerland	0.6
22	Japan	0

Table 4-1: Comparative Short Term Interest Rates

Source: Financial Mail, Economic Indicators, November 2002

4.5.1.2. Research and Development and Technology (R&D)

The SMMDP offers no incentive for Research and Development (R&D). Projects with a high degree of technology, usually resultant from some kind of R&D are more likely to be approved for incentives than projects with less technology and R&D.

The SMMDP does not address this constraint directly but favours projects that undertake R&D, and promote a high level of technology.

4.5.2. Labour Market Structure

The creation of sustainable employment in South Africa is dependant on the ability of South African's to skill themselves to a level that is sufficient to

address the skills gap. The SMMDP is not able to directly address this constraint.

The programme can, however, put measures in place to discourage investors from making investments in capital equipment that will reduce the number of sustainable job opportunities in the market place. The Human Resources requirements inherent in the programme are only good enough to dissuade investors from making investments that reduce employment.

The results of the study conducted showed that in aggregate, companies that applied for the incentive, failed to employ the number of people that they had projected to employ. Conversely, the investment in plant and machinery was more than they had projected to employ. Individually, eight companies employed more than they had projected and the balance employed less. These results are summarised in Figure 4.4. This exercise demonstrates simplistically that the incentive did not lead to the creation of additional jobs that would not have existed had the project not been incentivised.

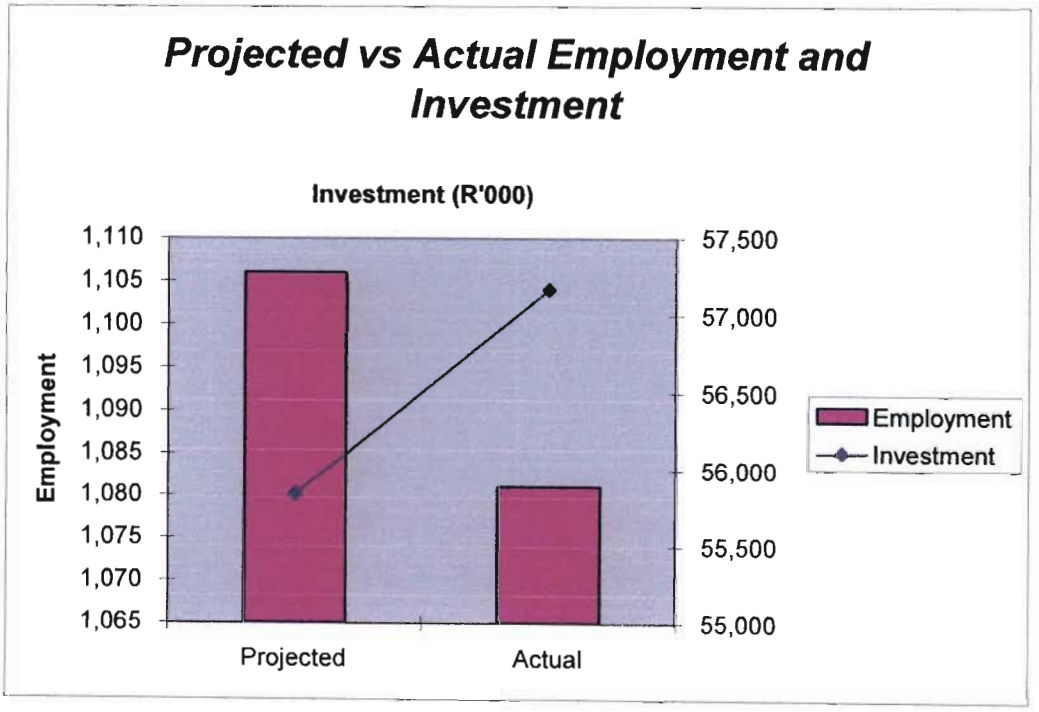

Figure 4-4: Projected vs. Actual Employment and Investment

Source: Secondary Data

Thus it can be concluded that the programme itself will not create employment in any way. The creation of jobs is a downstream result of creating sustainable business enterprises that have a reasonable ratio of jobs created to investment in plant and machinery.

Consider the results of 25 companies that benefited from the interest rate subsidy in terms of the SMMDP. The companies were randomly selected from a population of 120 approved SMMDP contracts. Prior to receiving the incentive, start-up the companies projected that 1106 jobs would be created. The total projected investment for the 25 companies was R55 842 168. On average, the companies projected that one job would be created for every R50 490 invested in qualifying assets.

After 2 years, when the actual investment was measured and the actual number employed quantified, the 25 companies had created 1081 jobs, with a total investment in qualifying assets of R57 184 063, or an average of one job per R52 899 invested.

Prior to the companies qualifying for the incentive, they had projected on average 44 jobs per project. After receiving the incentive an average of 42 jobs per project had been created. There is in fact no correlation between the receipt of an interest rate subsidy, and the employment of additional employees.

This data is consistent with similar information drawn from the 1998 DTI annual report indicating that 148 projects, with a total qualifying investment of R303 974 000, yielded 5091 direct job opportunities, or one job per R59 708 invested.

What the data does support, however, is the fact that projects with an average total qualifying investment below R3 000 000, produce more job opportunities than projects with a total investment above R3 000 000.

The Evaluation of the Regional Industrial Development Programme (Nkuhlu et al (1988) indicated that in Kwazulu Natal (the same area from which the sample was drawn) 173 approved RIDP projects, with a total qualifying

investment of R2 324 100 000, employed a total of 5825 employees, or on average one employee per R398 987 invested in qualifying assets.

Table 4-2 summarises the three studies referred to in the preceding paragraphs.

The study concludes that the SMMDP has been aimed at a target group of companies that when combined will generate more employment opportunities than the target group of the Regional Industrial Development Programme. The SMMDP on it's own, however, is not sufficient to create employment that would not have existed without the availability of the incentive.

	Employment	*Projects*	*Investment*	*Average Investment per Project*	*Rand Investment per Job created*
Sample group	1081	25	57,174,063	2,286,963	52,890
1998 Annual Report	5091	148	303,974,000	2,053,878	59,708
Ernest and Young RIDP evaluation	5825	173	2,324,100,000	13,434,104	398,987

Table 4-2: Summary of Employment Data

Source: Compiled from Secondary Data, Annual Report of the SMMDP (1998), and Ernst and Young, Evaluation of the Regional Industrial Development Programme (1991 RIDP and 1993 SRIDP) (1996).

4.5.3. External Shocks

The SMMDP is not able to prevent external shocks, but by providing assistance that increases cash reserves and drives up return on investment, companies that participate in the programme are better able to absorb the effects of external economic shocks than companies that did not receive assistance.

4.6. Strategic Choice

The development of corporate strategy can theoretically be approached through an emergent approach or a prescriptive approach (Lynch, 2000).

Non-profit organisations more often utilise a prescriptive approach, due to their objectives having been clearly defined by stakeholders prior to the development of the strategy. It was also noted, however, that an emergent strategy is better suited to an environment that is constantly changing, and where stakeholders cannot predict from one day to the next what circumstances they may find themselves in.

In the global competitive environment in which South African companies compete, the government may be foolish in expecting that the business environment will be the same tomorrow as it is today. In the not too distant past, organisations have been severely effected by changing conditions in global financial markets, the East Asian crisis, and regulations imposed upon countries by the World Trade Organisation. In an environment like this, an emergent strategy would be more appropriate.

The strategic choices made by the Chief Directorate: Manufacturing Development are based on traditional tried and tested approaches to government intervention in manufacturing, and while effective when appropriately employed, are somewhat stayed in their effect. Perhaps the time has arrived for a more radical approach to incentivisation. This suggestion is made with the acute awareness of the administrative, budgetary, and capacity constraints faced by the Board for Manufacturing Development, but nevertheless if results different to those achieved in the past are desired, then different methods should be employed in the future. The scope of this study is limited to the evaluation of methods employed in the SMMDP. The available choices implemented in the past are discussed below.

4.6.1. Choice of Alternative Incentives:

The government has a host of mechanisms at its disposal that could be used to address market failures. In the context of manufacturing development it has successfully used some alternatives in the past, which are listed below:

4.6.1.1. Labour Subsidy

Labour subsidies offer a direct grant per waged employee employed. These schemes would directly create employment by encouraging employers to employ additional staff, and reducing the cost of employing them.

This kind of incentive is open to broad scale abuse, and fraudulent claims can easily be lodged. In addition, productivity of workers becomes less of a priority because the employer is not bearing the full cost of employment. It is therefore not a practical solution to creating employment.

Perhaps more relevant than a failed past incentive mechanism, is the adverse effect that labour legislation has on the ability of employers to be competitive. The effect of the comprehensive regulation that takes place in the labour market is to convert the labour component of manufactured good to a fixed cost. Labour input should be a variable cost of production that varies according to the number of units produced. The effect of legislation is to force employers to maintain a constant labour force regardless of output. The increase in fixed cost associated with this phenomenon results in an increase in the risk of failure of the manufacturing concern, because a small reduction in turnover will render the company unable to cover its fixed costs.

The effect of the SMMDP should therefore be balanced with corresponding legislation in the labour area if is to be effective

4.6.1.2. Rental Subsidy

A subsidy of rental assists companies to reduce the costs of doing business and therefore increases returns.

4.6.1.3. Transport Subsidies

A rail rebate, road transport subsidy or any other form of transport rebate will assist companies in outlying areas to be competitive with companies in a closer proximity to their markets. The effect of these subsidies is to remove the primary constraint preventing companies from establishing themselves in locations with high levels of unemployment. The impact of this subsidy is therefore directly seen in an increase of employment levels in rural locations,

and the development of towns and infrastructure surrounding factories in outlying areas.

These companies are also able to benefit from locating themselves close to the source of raw materials, reduced costs of labour, and cheaper utilities. Pollution can also be controlled in this manner.

The transport subsidy is therefore an effective tool for a variety of differing objectives. Like the wage subsidy, however, this subsidy is open to some abuse.

4.6.1.4. Relocation Grant

Relocation grants are offered to companies to aid in the relocation of plant and equipment. Their application is particularly relevant where organisations are required to move into decentralised areas, and incur relocation costs as a result of their move. When these relocation costs would make moving unattractive, the provision of relocation grants by government would remove one of the reasons for not desiring to move.

The use of relocation grants has been employed as an element of the SMMDP, entitled the Foreign Investment Grant. The Foreign Investment Grant is aimed at assisting foreign direct investors to import machinery, by paying for a portion of the relocation costs of plant and machinery. It is only payable on new machinery.

This tool is particularly useful when foreign investors are considering alternative countries to house their projects, and has been employed in the past with good results.

4.6.1.5. Training Allowance

Training Allowances are provided to assist companies to train their employees. The allowance may take the form of a tax rebate for training completed, or a direct cash grant to assist in the provision of training.

A training allowance is an effective tool to encourage companies to invest money in the training of employees. In light of the South African structural

constraints associated with an unskilled labour force, a training grant would be appropriate.

4.7. Evaluation of Strategic Choice

The strategic choice employed by the Board for Manufacturing Development within the SMMDP, can be evaluated using three broad sweeping criterion:

- Suitability
- Feasibility
- Acceptability

Within these criteria, quantitative methods can be employed to make decisions, and evaluate strategic choice. This paragraph discusses the strategic choice within the scope of these three criteria.

4.7.1. Suitability

"Suitability concerns whether a strategy addresses the circumstance in which the organisation is operating" (Johnson and Scholes, 1999: p 355). Johnson and Scholes further state that "the main purpose of strategic analysis is to establish an understanding of the basis on which the suitability of strategies can be judged." This would possibly include "assessing the extent to which a strategy:

- Exploits the opportunities in the environment and avoids the threats;
- Capitalizes on the organisations' strengths and core competences and avoids or remedies the weaknesses;
- Addresses the cultural and political context" (Johnson and Scholes, 1999: p 355).

In assessing the suitability of the SMMDP, this study has focussed on the assessment of requirements inherent in the programme, and the effect that these requirements have had on the accomplishment of the objectives of the SMMDP. A discussion of these requirements follows in paragraph 4.7.1.1 in view of assessing their acceptability as a component of the chosen strategy. A model has then been developed to quantify the effect of these requirements

and to be used as a decision making tool to eliminate requirements of least importance.

To aid in the assessment of these requirements, a study was conducted on a sample selected from a population of participants of the SMMDP, in the Kwazulu Natal region. The sample was selected for convenience from the client-base of a Durban based consulting practice. Some of the findings of this study are included in the assessment below.

4.7.1.1. Monitoring Requirements

Some monitoring requirements that the Board for Manufacturing Development has imposed upon the industrialist are aimed at indirectly facilitating salient objectives such as labour absorption. Other requirements are aimed at ensuring that the project materialises and that incentives are not paid to phantom projects, and further requirements are aimed at ensuring that the projects are sustainable.

Regardless of the purpose of these requirements, they may be enforced to the detriment of deserving projects, causing a hindrance to the achievement of the strategic objectives. Other requirements further the cause of the incentives. The effect of selected requirements is discussed below.

Equity

The ratio of equity to total assets prescribed in the contract is 10%. The effect of this ratio is to ensure that the shareholders of the project have invested a minimum interest of 10% of the total assets in the project, and therefore have placed themselves at risk.

A further requirement in certain instances is that the shareholders loans are sub-ordinated in favour of 3rd party creditors, making it impossible for shareholders to benefit at the expense of creditors in the event of the company closing down.

The effects of forcing companies to achieve minimum equity ratio's are:

- Gearing – Companies that are adequately geared can lever their profits upwards through the use of debt financing. The equity ratio ensures that companies are able to utilise gearing to maximum effect, by allowing up to 90% debt financing
- Risk – Too much debt financing increases the risk of failure in the business, and the board forces industrialists to avoid 100% debt financing, thus reducing the risk of failure
- Subordination – The Board for Manufacturing Development also requires that shareholders loans be subordinated in favour of 3rd party creditors, thus protecting the interests of 3rd parties, and ensuring that the investors are responsible for business failure.
- Financing consequences – When companies have high ratios of equity to total assets, they will find it easier to obtain funding from financial institutions.

On the other hand, the enforcement of the equity ratio can penalise an entrepreneur who has taken a large risk to commence business and make a contribution to the economy. The incentive is aimed at small to medium sized manufacturing concerns. Sourcing funding is an obstacle in the way of the establishment of small businesses by emerging Entrepreneurs. Consider the following scenario:

A start-up company has a viable project, and has a capital structure of 80% long-term loans and 20% shareholders loans. The company therefore has an equity ratio of 20% at start-up, and is within the Board for Manufacturing Development requirements. After one year of trading, the company has incurred a loss (which is to be expected in the first two years of operations of this project, and is primarily resultant from the utilisation of an accelerated depreciation allowance) that when taken into account reduces his equity ratio to 8%. The contract then converts to an output-based contract, because the industrialist failed to meet the equity requirement at the end of the first year, and is not eligible for any incentive in that year. At the end of the second year he does not make a profit and therefore is not eligible for an incentive in the second year.

The industrialist in this example has a viable project that financial intuitions are willing to fund. Cash flow has not been severely affected by the loss because the loss was resultant from accelerated depreciation allowed for tax purposes. This company has not received incentives in the crucial start-up phase of its existence. The incentive, if granted would have made a significant difference to the companies expected growth path, because while it may not be cash strapped, it is also not able to fund an accelerated growth path.

This Entrepreneur has been adversely affected by the Equity requirement.

What is also of concern is the way in which the ratio was determined. Interviews with Francois Truter (2002) revealed that there was no scientific basis for arriving at the required equity ratio. The ratio was arrived at by means of a judgement call made by developers of the programme. For the advantages of a sound equity ratio to be truly effective, the ratio should have been much higher, thus ensuring that companies are appropriately geared to lever growth opportunities but sufficiently covered to reduce financial risk. The result of setting the equity ratio at a low level is that the advantages of sound capital structure are not achieved, and the disadvantages of having the ratio in the first place are still prevalent.

The study found that many industrialists fail to meet the equity ratio at year end, but with assistance from professionals and careful planning, most can overcome this shortfall after restructuring and making additional financial contributions to increase the equity ratio. Ultimately, 4 of 120, or 3.33% of industrialists were unable to meet the equity ratio.

Turnover

The incentive had to be linked to some measure of performance, to avoid the scenario that could potentially result from companies having little to no sales, and receiving incentives that would enrich shareholders at the expense of the economy. The most logical link to performance is turnover, and since this requirement is determined entirely by values projected by the applicant, its implementation is more than justifiable.

The turnover is also utilised to determine in conjunction with other financial ratios whether the project is sustainable into the future. Projects that cannot sustain themselves without incentives should not be subsidised, as the effect of subsidising these projects is to delay the inevitable collapse of an organisation that was not viable in the first instance.

A minimum sales requirement is also necessary to ensure that incentives are paid to companies that are generating income, and not merely to subsidise investments by industrialists in property.

In the study conducted it was found that 5 of 120 or 4.17% of industrialists failed to meet the turnover requirement. Perhaps of more relevance is the fact that 60% of the 5 industrialists that failed to meet the turnover, later closed down their businesses, or lost the incentive due to non-compliance with a later requirement. The non-achievement of the Turnover requirement appears to be a predictor of future failure. More statistical analysis is needed to determine whether this can accurately be applied to the population.

The study also found that 24 of 120 or 20.00% of companies closed down or liquidated during the first 3 years of operation. The incidence of turnover not being achieved is understated due to the fact that many of the 24 liquidated companies would also not have achieve their minimum turnover requirement, but have been counted separately.

Human Resources

The human resource criterion is intended to ensure that industrialists maintain a reasonable mix of labour to capital in the production process. Its intention is sound, and the ratio, when achieved by an industrialist, results in a significant portion of the value added by the manufacturing process, being distributed to the providers of human labour.

The calculation however has the unfortunate effect of penalising companies that are profitable. The simplified illustration Table 4-3 demonstrates how an increase in profitability results in the company not achieving the prescribed 55% ratio. The result of this is that companies that are profitable do not

receive the profit output incentive in the 5th and the 6th years, and are placed at a disadvantage to their competitors who received the incentives during this period.

SCENARIO 1		SCENARIO 2	
Part A - Gross Operating Surplus		**Part A – Gross Operating Surplus**	
Net Profit / Loss before Tax (PBT)	700,000	Net Profit / Loss before Tax (PBT)	1,000,000
PLUS : Depreciation	200,000	PLUS: Depreciation (on ALL assets,	200,000
PLUS: Expenses related to property	120,000	PLUS: Expenses related to property	120,000
GROSS OPERATING SURPLUS	1,020,000	**GROSS OPERATING SURPLUS**	1,320,000
Part B - Total Human Resources		**Part B - Total Human Resources**	
Wages	1,000,000	Wages	1,000,000
Salaries	200,000	Salaries	200,000
Members' Remuneration	120,000	Members' Remuneration	120,000
UIF Contributions	1,800	UIF Contributions	1,800
TOTAL HUMAN RESOURCE	1,321,800	**TOTAL HUMAN RESOURCE**	1,321,800
Part B	1,321,800	Part B	1,321,800
Part A + Part B	2,341,800	Part A + Part B	2,641,800
Human Resources Ratio	**56%**	**Human Resources Ratio**	**50%**

Table 4-3: Effect of increase in profitability on Human Resource Criterion

Source: Secondary Data

Only 14 industrialists in the sample have reached years 4 and 5 of the incentive term, and of these companies, 10, or 71.43% have failed to achieve the criteria.

The Human Resource criterion has definitely had an impact on the effectiveness of the SMMDP. The inclusion of the criteria certainly does not promote employment creation, as even projects with high numbers of employees relative to their investment; fail to achieve the criteria when they are highly profitable.

At best, companies that are on the border of achieving the criteria, would be encouraged to increase their human resources costs through increased wages, increased benefits, and increased training. This will have a positive effect on the labour force and will be a positive outcome of the inclusion of this

criterion. Its effect will be limited because only a small percentage of companies are on the border of achieving or not achieving the criteria. The positive outcome will also be limited by the tendency of management to increase their own salaries prior to increasing training and other components of the human resource remuneration. Directors and management fees are included in the human resource remuneration component of the calculation.

Used Plant and Machinery

Both new and used machinery qualifies for incentives in terms of the SMMDP. The requirements regarding second hand machinery limit the use of second hand machinery in manufacturing projects. The intention behind the requirement is twofold. Firstly, encouraging the purchase of new equipment aids in the implementation of new technology within South Africa. The objective of technology development was outlined in the Evaluation of Findings of the Regional Industrial Development Programme, referred to earlier in this study.

Secondly, the use of second hand equipment within manufacturing projects has been associated with instances of fraudulent misrepresentation. In the past, manufacturers have been able to claim incentives on the same machinery over extended periods of time within different legal entities by transferring assets between companies, and utilising the services of unscrupulous dealers in the process. Some industrialists have been able to earn more return on their assets from government subsidies than actual utilisation of the assets in the process of manufacture. This practice is unacceptable and must be stopped.

Arguments for the use of second hand machinery stem from industries that have not experienced rapid technological innovation. In these industries, industrialists are able to produce product of sufficient quality in sufficient time, by utilising second hand machinery. It would not be prudent for an industrialist to acquire new machinery, when it offers no advantage over second-hand machinery.

Where global competitiveness can only be achieved through the acquisition of new machinery, the board's requirements regarding used machinery have inadvertently penalised industrialists once again. A new printing press would cost in excess of R3 000 000, and therefore a company acquiring such equipment could not benefit from the SMMDP.

There are therefore arguments both for and against allowing second-hand machinery within the SMMDP. The Board for Manufacturing Development have achieved a delicate balance, which has not penalised many within the SMMDP, and the requirements have not had a material impact on qualifying entities, since the Tax Holiday also allows for the use of second hand machinery. Second hand equipment must however be matched with an equivalent investment in new equipment for purposes of the Tax Holiday.

With the renewed influence on black economic empowerment, the policy on second hand equipment is applied at the board's discretion for projects that have a shareholding of previously disadvantaged individuals.

Total Plant and Machinery

The industrialist is required to invest a minimum of 50% of his projected investment per the application. Failure to meet this requirement results in termination of the incentive contract.

Spatial

The SMMDP does not have any spatial component attached to it. It's objectives were not the same as the Regional Industrial Development Programme that included a spatial element. The Tax Holiday however includes a spatial element, allowing companies establishing within the applicable areas an additional two years Tax Holiday.

The effect of the spatial element in the Regional Industrial Development Programme was to stimulate large numbers of additional employment in the areas in which the incentive was applicable. The Regional Industrial Development Programme was successful in creating jobs, and this was

primarily because companies established themselves in areas of high unemployment.

While this was not part of the SMMDP objectives, a spatial component could have been a catalyst for increased employment.

The exclusion of the spatial component is however in line with the accomplishment of the varied SMMDP objectives, and therefore consistent with requirements of corporate strategy.

Profit Output Incentive

The inclusion of an output based subsidy, or a profit-based subsidy was done on recommendation from the Report of the external auditors of the Regional Industrial Development Programme. The requirement encourages companies to declare profits in the 3rd to 6th years of the incentive term. The effect of this encouragement is that the SMMDP effectively funds itself, by ensuring that companies contribute to the tax base of the economy before claiming incentives. The limitations of the profit-based incentive are not unreasonable, and the inclusion is in line with good principles of corporate governance.

The objective of the SMMDP regarding productivity improvement, if accomplished would result in an increase in profitability of the company. The profit output incentive therefore encourages companies to become more profitable by rewarding them for profit generated.

In the sample, 31 companies were in the profit phase of claiming incentives and 22 were expected to claim a profit output incentive. The profit output requirement therefore penalises 9 companies, or 29.03% of those in the profit phase.

4.7.1.2. Evaluation of Suitability of Monitoring Requirements

In order to evaluate the importance of the monitoring requirements and their impact on the achievement of the objectives of the SMMDP, the monitoring requirements have been ranked and compared to the frequency of effect.

The result of this model is a matrix that can be used as a decision tool to eliminate requirements that do not contribute to, but hinder the achievement of strategic objectives.

Ranking of Requirements

The requirements have been ranked on a point system developed for this purpose. Each requirement is allocated one point for a positive answer to each of the questions below. A positive response would increase the likelihood of the requirement having a detrimental effect on the achievement of strategic objectives. Requirements that are not scientifically founded are further penalised. The response to each question must be made on a worst-case scenario basis.

- Can the requirement result in a loss of incentives?
- Can the requirement result in a loss of incentives without the industrialist having ever received assistance from the SMMDP?
- Would the loss be a loss for a full year, or merely for the last quarter of the year?
- Would the loss be a permanent loss of incentives as opposed to the loss of merely one year's incentives?
- Does failure to meet the requirement result in contract termination rather than conversion to profit-output?
- The inclusion is not aimed at the achievement of a specific stated objective (Answer yes if this statement is true).
- The requirement is unfounded or not based on a scientific study (Answer yes if this statement is true).

A score of 5 or 6, or above 80%, indicates that the requirement is terminal and elimination should be considered if the frequency is high enough to have a material impact.

Table 4-4 lists the causes of termination or conversion to profit output, and graphs the scores to each of the questions above.

	Could result in Loss of Incentives	Could result in Loss of incentives without claiming	Permanent loss of incentives as opposed to single year	Results in termination rather than conversion	Inclusion aimed not aimed at specific stated objective	Definite Loss of full year as opposed to loss of merely last quarter	Inclusion unfounded or not based on scientific study	Total
Plant and Machinery	1	1	1	1	1	1	0	6
Human Resources	1	0	0	0	1	1	1	4
Turnover	1	1	0	0	1	0	1	4
Equity	1	1	1	0	1	0	1	5
Closed down Liquidated	1	1	1	1	N/A	1	0	5
Consecutive Nil Values	1	0	1	1	N/A	1	0	4
Voluntary Other	1	N/A	N/A	N/A	N/A	N/A	N/A	1
Involuntary Other	1	1	N/A	N/A	N/A	N/A	N/A	2
Unaffected	0	0	0	0	N/A	0	0	0

Table 4-4:Score Evaluation of Reasons of Termination

Source: Wade van Rooyen (2002)

The analysis can only include factors that are within the control of the Board for Manufacturing Development. This would therefore exclude companies that had closed down or liquidated, companies that terminated voluntarily, or other reasons out of the Board's control. Some of the factors in Table 4-4 are therefore excluded from further analysis.

The factors are then ranked according to those with the greatest potential to negatively affect industrialists, and by implication hinder the accomplishment of objectives as shown in Figure 4.5. The frequency of incidence is shown on the secondary axis.

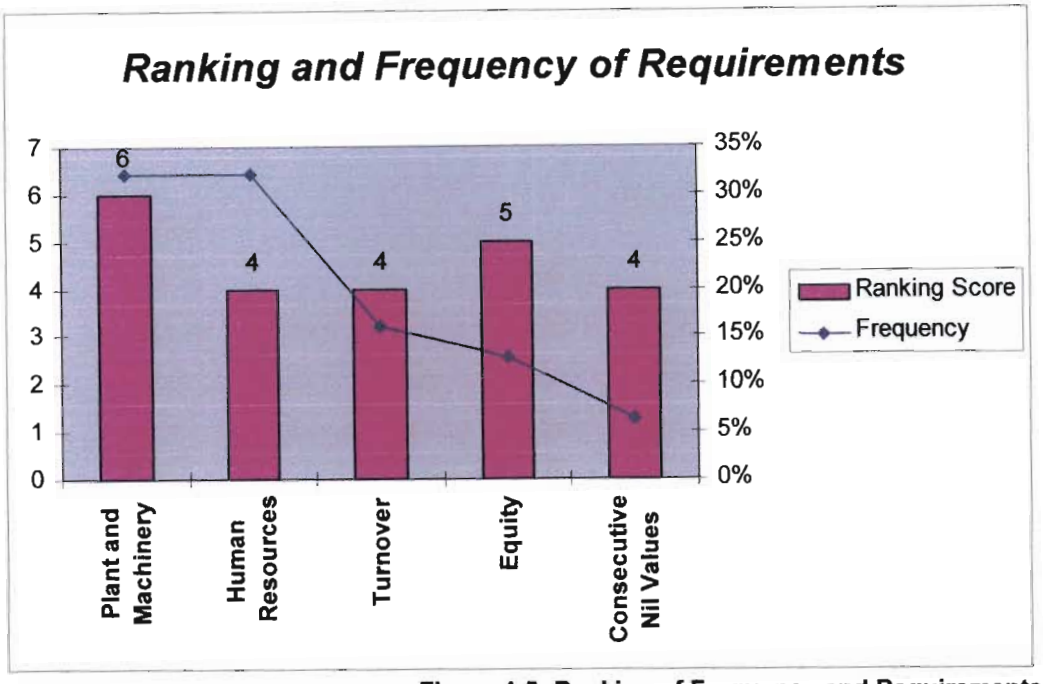

Figure 4-5: Ranking of Frequency and Requirements

Source: Secondary Data

The ranking and frequency is combined on a matrix in Figure 4.6. The result is a visual assessment of the degree of impact of each of the requirements within the Board for Manufacturing Development's control, on the ability to claim incentives. The diagram is divided into four zones, each with different severity.

- Zone 1 – Requirements falling into this zone are severe enough to have a material impact on the industrialist, but the incidence of non-compliance of the requirement is not high enough to justify removal from the programme
- Zone 2 - Requirements falling into this zone are severe enough to have a material impact on the industrialist, and have a high incidence of non-compliance. These requirements can justifiably be removed from the programme.
- Zone 3 – Requirements falling into this zone are not severe enough to have a material impact on the industrialist, and have a low incidence among industrialists. Removal is unjustified.

- Zone 4 – Requirements falling into this zone are not severe enough to have a material impact on the industrialist. Their high incidence does not therefore justify removal from the programme.

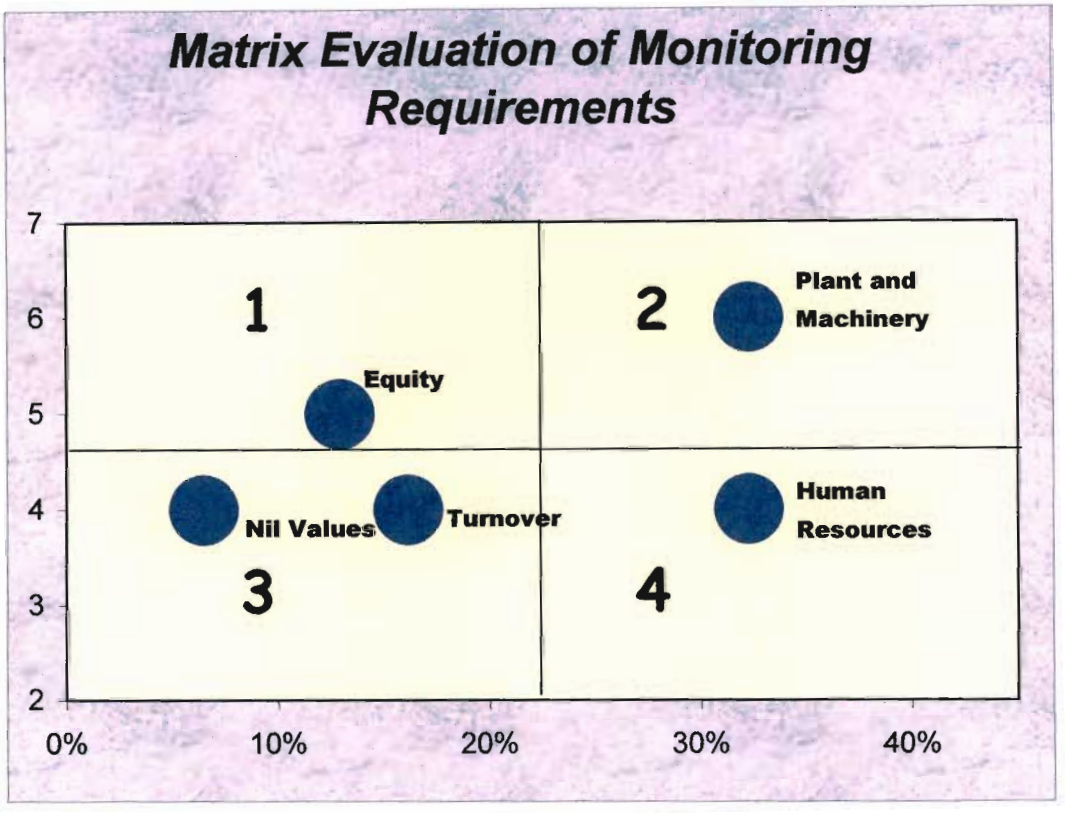

Figure 4-6: Matrix Evaluation of Requirements

Source: Secondary Data

The conclusion of this evaluation tool is that the Plant and Machinery requirement has a severe impact on the ability of industrialists to benefit from the programme. It has a high incidence of causing industrialists to lose their incentives, and therefore must be evaluated against the reason for its inclusion.

The only justifiable reason for including the Plant and Machinery criteria within the programme is that it ensures that the Board for Manufacturing Development can budget for subsidies to be paid. An industrialist who has projected an investment in plant and machinery of R2 000 000, and after commencing production determines that he can utilise R800 000 worth of machinery effectively for his requirements should not be penalised. In the majority of cases, industrialist who have failed to invest more than 50% of

their projection, are unable to invest because the anticipated growth of their project since inception has not materialised. An objective of the incentive is to reduce the failure rate of start-up businesses. If a business is not growing according to plan, it is probably being affected by adverse economic conditions. The effect of the Plant and Machinery requirement is to further penalise an industrialist that is already under pressure from the business environment. The failure of the Board for Manufacturing Development to support this industrialist, and in effect to rub salt in his wounds, is against the spirit of the incentive programme, and contributes to the high failure rate of small businesses.

The evaluation therefore concludes that the Plant and Machinery requirement should be removed from the SMMDP, particularly since it is not aimed at direct accomplishment of any objectives.

4.7.1.3. Facilitating Labour Absorption

The objective of facilitating labour absorption is affected by employment creation, labour legislation and technology.

Employment Creation

The SMMDP did not include a direct labour element, but as previously discussed, the rationale was that by encouraging investment in smaller manufacturing concerns, more jobs would be created for each Rand invested.

Jan de La Rey (2002) expressed the success of the RIDP in creating employment, by encouraging establishment outside of metropolitan areas. In 1982, 3% of industries were located outside of metropolitan areas, and in 1996, 31% were located outside of metropolitan areas. The effect was creation of significant labour (De La Rey, 2002). What was deemed significant under RIDP was quantified by the Ernest and Young RIDP evaluation (Nkuhlu et al, 1988) as 5825 jobs from an investment of approximately R2 300 million.

It can therefore be seen that the industrialists targeted by the SMMDP render far greater returns in respect of job creation than those targeted by the RIDP. In spite of this, the SMMDP cannot directly result in job creation.

The 1998 SMMDP annual report provided some insight into the effectiveness of this strategy. The following data was gathered from the 1998 SMMDP Annual Report (Department of Trade and Industry, 1998).

During 1998, the Board for Manufacturing Development approved 148 SMMDP projects, which generated a total investment of approximately R304 million. These 148 projects provided an additional 5092 jobs to the economy. An average of R59 814 was invested per job created.

Abbreviation	*Description*
FOOD	Manufacture of food products and beverages and tobacco products
TEXTILES	Manufacture of textiles and leather goods
WOOD	Manufacture of wood and products of wood and cork
CHEMICALS	Manufacture of chemicals and chemical products, rubber and plastic
MINERALS	Manufacture of other non-metallic mineral products
METALS	Manufacture of basic metals, fabricated metal products, machinery and equipment
ELECTRICAL	Manufacture of electrical machinery and apparatus
ELECTRONIC	Manufacture of radio, TV and communication equipment
TRANSPORT	Manufacture of transport equipment
FURNITURE	Manufacturing of furniture and manufacturing not elsewhere classified

Table 4-5: Summary of SIC Classification

Source: Adapted from Department of Trade and Industry, Annual Report, 1998

Investment in these projects took place in various sectors, allocated as per the Standard Industrial Classification of Industries. A brief description of

these classifications is contained in Table 4-5. The percentage of investment in each sector is illustrated in Figure 4.7.

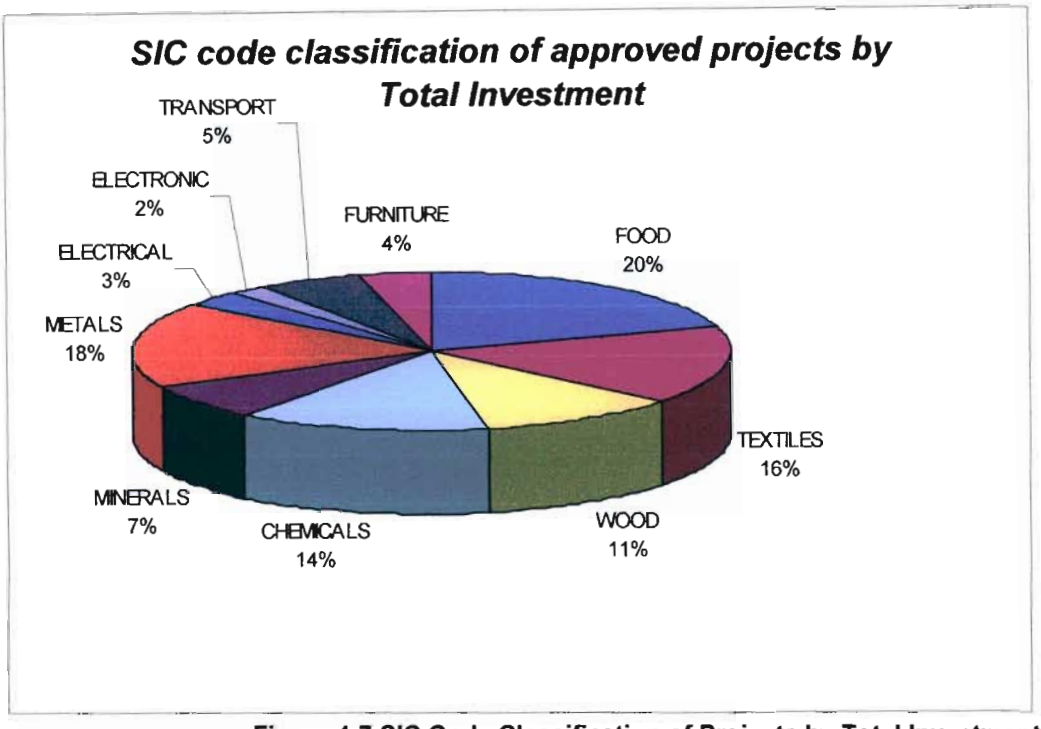

Figure 4-7 SIC Code Classification of Projects by Total Investment

Source: Adapted from Department of Trade and Industry, Annual Report, 1998

Each of these sectors has an average investment per job created. It follows that by encouraging investment in the sectors that create the most jobs for the lowest investment, the Board for Manufacturing Development can provide a catalyst for job creation. Figure 4.8 compares the number of jobs created per project to the Rand value per job created. The most favourable balance would be projects with the highest number of employees employed per project, and the lowest Rand investment per job created. The comparison indicates that the most favourable industry sectors are Furniture, and Textiles. Second most favourable would be the cluster of Mineral, Metal, and Food, and the third cluster Chemicals, Wood and Electrical. The least favourable industries to encourage are electronics and Transport.

A strategy better suited to the objective of employment creation would be one that focuses on industry sectors, or employment clusters, defined as a group

of industries that demonstrate similar investment per job created and average employment per project characteristics.

The strategy for creating employment through the SMMDP is well suited in that the target group generates a high number of jobs per Rand investment, but could be improved by clusterisation (The favouring of industries producing favourable employment outcomes).

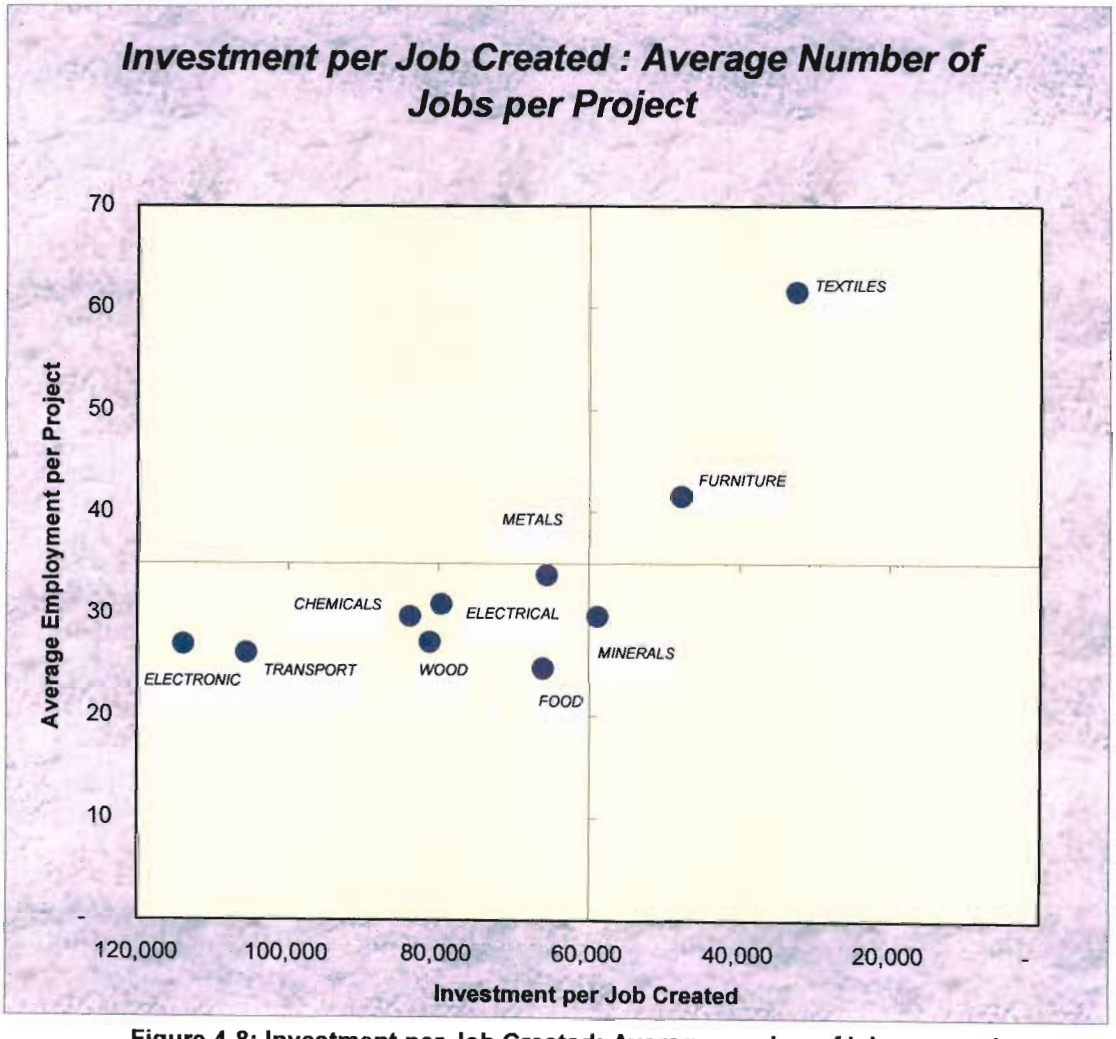

Figure 4-8: Investment per Job Created: Average number of jobs per project

Source: Secondary Data

Government must allocate scarce resources into the production of various products. It should allocate additional resources into industries that produce favourable economic outcomes.

Clusterisation is another tool that can be used to improve the suitability of the SMMDP strategy.

Labour Legislation

An interview with a prominent industrialist in the plastics industry revealed a problem that is currently being experience in the plastics industry. The Manufacturing Sectorial Training Authority, in conjunction with the National Union of Metal Workers, has prescribed that the minimum wage in the plastics industry should be R12 per hour (Daniels, 2002). International companies with which Greg's company competes, employ skilled labour at cost of $2 per day. At an exchange rate of approximately R10:$1 this amounts to R2.50 per hour. South African companies cannot compete globally on this basis.

There is no merit in government stimulating the manufacturing industry through supply side measures that attempt to remove structural constraints in the economy, when adverse legislation exists that creates structural constraints in the economy. There should be closer interaction between labour and DTI, in order to ensure that their efforts to accomplish competing objectives do not hinder growth in totality.

Impact of Technology Development on Labour Absorption

The investment cycle begins with an investment resulting in expanded productive capacity. According to Ernst & Young (1996) this investment ultimately leads to an increase in employment, *unless the investment is technologically advanced and results in a decrease in the number of employees required.*

South African manufacturers are able to compete better on a global scale when they utilise a mix of capital equipment and manual labour. The technology of the completely automated production facilities that are available in Europe and the United States is prohibitively expensive when acquired by South African Manufacturers, due to the high interest rates, and the weak currency relative to other hard currencies. When this technology is utilised in South Africa, the required return is too high for companies to make adequate

returns on their investments. In addition to the prohibitive cost of technology, South Africa has an abundant labour force that can be skilled with the right resources. A mix of second generation machinery and a high labour input results in a greater return than fully automated expensive first generation machinery imported into South Africa, because South Africa's skilled labour is less expensive than skilled labour in the countries that possess greater technology.

The two objectives of Employment Creation and Technology Development are therefore in conflict. South African manufacturers must strike a balance between these two factors to become globally competitive. These two governmental objectives as outlined by Ernst & Young (1996) are to a degree mutually exclusive.

The objective of technology development is therefore not entirely suitable to the strategy if employment creation is a more important objective.

4.7.1.4. Value Chain

A value chain analysis can be used to establish the rationale of a selected strategy. Porters Value Chain model adapted to the non-profit organisation concludes that any enhancement in the primary activities of the value chain would create value for the organisations stakeholders.

Of more importance than creating value for the stakeholders in the non-profit organisation is the fact that achievement of its objectives would create a sustainable economic benefit for the country. This is in line with the assumption that the stakeholders in the non-profit organisation are representatives appointed by government to look after the interests of the public that place the government in power through majority vote.

The primary activities within the value chain for non-profit governmental organisations are further discussed below in light of the case study findings.

Identification of Constraints

The SMMDP is aimed at addressing structural constraints in the economy, particularly the high cost of capital in South Africa. The more effective the identification of constraints, the more efficiently they will be addressed.

Operations

The operations function must find solutions to convert structural problems into competitive strengths. The structural constraint of a high cost of capital is addressed by the SMMDP but research and development and technology improvement while encouraged by the programme are not facilitated by it. The programme also ignores the structural constraints of the labour market structure, and external shocks.

The SMMDP comprises an interest rate subsidy. The effects of this subsidy have been discussed throughout this study, but fundamentally an interest rate subsidy can only directly solve the structural constraint of South Africa's high cost of capital. All other effects of the subsidy are incidental and outside of the control of the intervener.

Structural problems outside of high interest rates have been left to chance by the SMMDP. This is key to the success of the programme and is the core reason why the SMMDP did not achieve all of it's stated objectives.

An interest rate subsidy cannot be used to stimulate employment, and the same premise holds true for other economic problems and structural constraints contained in the roots level objectives of the SMMDP.

The Board for Manufacturing Development must consider alternative mechanisms to the SMMDP if it is to effectively eliminate the structural problems in the economy.

Programme Implementation

An effective strategy must develop the delivery process. This entails being able to deliver the components of the strategy through employment of the appropriate resources to bring about the stated objectives of the stakeholders.

Delivery of the SMMDP, in addition to the substantial financial resources that have been made available by government to fund the grant, requires substantial human resources to deliver and administer the incentive programme. The provision of human resources is also subject to budgetary limitations, and further hampered by the training period associated with developing new staff members for the delivery process.

The implementation of the programme must be flawless if it is to accomplish it's objective without hindrance. Indeed, a core element of evaluating the effectiveness of the strategy employed by the Chief Directorate: Manufacturing Development, is assessing whether that which was intended to be done within the strategic blue print was carried out according to plan. This requires an assessment of the administrative capabilities of the Chief Directorate: Manufacturing Development.

The following statement was made in 1996 about the administration of Schedule 4 incentives:

"A large number of administrative problems have been raised, many by more than one province. These include lack of experienced people; poor communications slow processing of claims, insufficient marketing, inadequate monitoring and support, especially for SRIDP applicants. Most of these problems were confirmed by the BRID (Board for Regional Industrial Development), who are concerned about the lack of resources and skills" (Nkuhlu et al, 1988).

This statement was made in 1996, and could be repeated today by anyone associated with the Chief Directorate: Manufacturing Development. The Chief Directorate: Manufacturing Development, under the new departmental structure is known today as The Enterprise Organisation (TEO). Interviews

conducted with independent consultants dealing with TEO regularly, revealed the following problems in dealing with TEO.

- Personnel are slow to respond to queries, are often not available, and do not return telephone calls.
- New systems and procedures are slow to be implemented, and when implemented result in substantial delays regarding processing, payments and status queries.
- Contractual documents are slow and are not printed within reasonable time frames after amendments have been approved.
- When firm decisions and advice are required, one cannot speak to a person with authority to provide a response.
- Documentation is returned in error, resulting in time delays.
- Unnecessary queries, probably resulting from untrained and inexperienced personnel are raised to industrialists whose submissions are complete in every respect.
- Clerks lack communication skills and dialog is difficult.

The same body ostensibly administers these responses relating to different schedules of incentives, with a 10-year time lapse between them. The statements when compared to one another reflect the same administrative problems being experienced 10 years later. No improvements have been made.

A possible explanation as to why there has not been any improvement could be that the department has not been given the necessary resources, by government, to administer the programmes.

An interview with Jan De La Rey (2002), a management official within the department for all of that time revealed the following:

- In 1996 and 1997 the government identified the need to reduce administrative costs in the department. Since then the cost of government services has been cut by 10% per annum regardless of operational needs.

- The administrative performance should have been worse under the circumstances.
- Programmes have been simplified in an attempt to reduce the administrative burden of the incentives. E.g. Stock and Debtors have been removed from the programme, divisions no longer qualify, and profit output incentives were removed post SMMDP.

A strategic mistake has therefore been made. While the government should have been increasing resources to the Chief Directorate: Manufacturing Development, they were actually being reduced. This has resulted in the need to simplify incentive schemes, and lead to a decrease in benefits for industrialists. It has also resulted in casualties and bone fide investments not receiving assistance to which they should have been entitled, creating anomalies in the market place.

An example of such an anomaly is a comparison between two companies investing in similar equipment, on an existing project and another a new project. The existing company requires the new equipment to keep pace with technological advancement, and the new company because such equipment represents the only new machinery available in the industry. The new company is eligible for assistance, while the existing company is not. The anomaly has not directly resulted from administration problems, but had been affected by the removal of government funding, that also caused the administrative problems.

Administrative problems, anomalies and lack of funding all impact on the implementation of the programme. By addressing these issues, the Chief Directorate: Manufacturing Development can create value in the value chain.

Marketing and Sales

The marketing and sales function within the Chief Directorate: Manufacturing Development is non-existent. The only efforts made to market programmes are occasional road-shows that are badly presented, insufficiently promoted, and have little to no impact on getting the offering to the market place.

The spreading of programmes takes place primarily by word of mouth, industrialists who have benefited in the past and are embarking on new ventures, and the assistance of intermediate consultants that earn revenue by marketing and administering the incentive schemes.

In this area too, large contributions can be made to total value by developing a team with a marketing function, and enhancing the promotional aspects of the Chief Directorate: Manufacturing Development.

This marketing function must also change the negative perceptions about incentives. Some industrialists feel that by accepting incentives they will be required to pay back in some other means at a later date, or will be tied into certain business requirements.

Service

The issue of quality of service overlaps somewhat with administrative problems. The Chief Directorate: Manufacturing Development should be made aware of these problems through effective feedback mechanisms. It may be that the management feel that they do not have sufficient resources to address the problems and would therefore rather not be made aware of them. Inadequate service levels therefore point back to the removal of funding needed to support the implementation process.

4.7.2. Acceptability

The acceptability of a strategy is determined by whether or not it meets the expectations of the stakeholders. After the change in government, the RIDP was no longer acceptable to the new government and hence the development of the SMMDP. This acceptability was determined by the objectives that the RIDP was aimed at achieving, which were no longer in line with revised government policy.

It follows then that the SMMDP would be acceptable to it's stakeholders if it resulted in the achievement of objectives that were acceptable to the stakeholders. The fact that cabinet approved the SMMDP indicates that they

found the objectives to be in line with their requirements, and therefore found the strategy to be acceptable.

The mere fact that the government found the strategy acceptable, is not an indicator that the strategy would accomplish it's objectives, but rather that government believed that the mechanisms entailed within the strategy would yield results that were in line with their objectives. Whether these results were achieved or not can only be assessed after implementation of the strategy.

This study has found numerous areas that have hindered achievement of the desired results, and if the stakeholders were to reassess the acceptability of the strategy with evidence gathered post implementation; they would find that the strategy is not entirely acceptable, as many of the objectives that were intended to be achieved through the SMMDP have not been achieved.

4.7.3. Feasibility

"The feasibility of a strategy is concerned with whether an organisation has the resources and competencies to deliver a strategy" (Johnson and Scholes, 1999: p 392).

A key question in assessing the feasibility of the strategy of the SMMDP is whether or not the organisation has the resources to administer the incentive, and to fund the incentive.

4.7.3.1. Resources

The lack of financial resources stemming from budgetary constraints lead the Chief Directorate: Manufacturing Development to exclude expansions from the incentive programme. This decision contributed to the feasibility of the strategy, because had expansions been included, the organisation would not have had the financial resources to deliver the strategy.

Scope of SMMDP

An analysis of the scope of the SMMDP is relevant in determining the feasibility of the strategy.

The SMMDP applies to all establishment projects that have an investment in qualifying assets at start of production that is less the R3 000 000, and are engaged in manufacture, processing or assembly.

The effect of this scope is to exclude from the incentive programme any expansion project that takes place. Investment in additional productive capacity by existing manufacturers has the same effect as establishment of new companies and manufacturing facilities. Expanding enterprises are affected by structural economic constraints, they provide additional employment opportunities by virtue of the investment, and they increase their competitiveness globally by increasing output capacity, product quality or efficiency. The exclusion of expansion activities from the incentive programme therefore does not appear to be founded on logical conclusions.

An interview with Francois Truter (2002) at the Board for Manufacturing Development revealed that budgetary constraints were the primary reason for the exclusion of expansion projects from the incentive programme.

The effect of this exclusion was to disqualify legitimate investors from qualifying for incentives like their start-up competitors. Furthermore, this requirement encouraged the establishment of new businesses in cases where an expansion project could be sufficiently differentiated from the existing concern. This increased the administrative burden placed on the registrar of companies, the South African Revenue Service, accounting practices and audit firms, not to mention the companies themselves, creating a whirlpool of inefficiency in the name of industrial incentives. Many of these new businesses failed early or were closed down as soon as incentives terminated, and these closures contribute to the high failure statistic of start-up businesses, perhaps polluting the measurement criteria of the SMMDP's stated objective – to decrease the failure rate of small businesses.

The replacement programme of the SMMDP, implemented in October 2000 and called the Small Medium Enterprise Development Programme, was once again made available to new and existing entities, or establishment and expansions projects. The split between new and existing projects shown in

Figure 4.9 provides insight into the extent of lost growth opportunity resultant from exclusion of expansions due to lack of budget. Sixty five percent of projects resulting in investment in manufacturing capacity are undertaken by existing companies expanding.

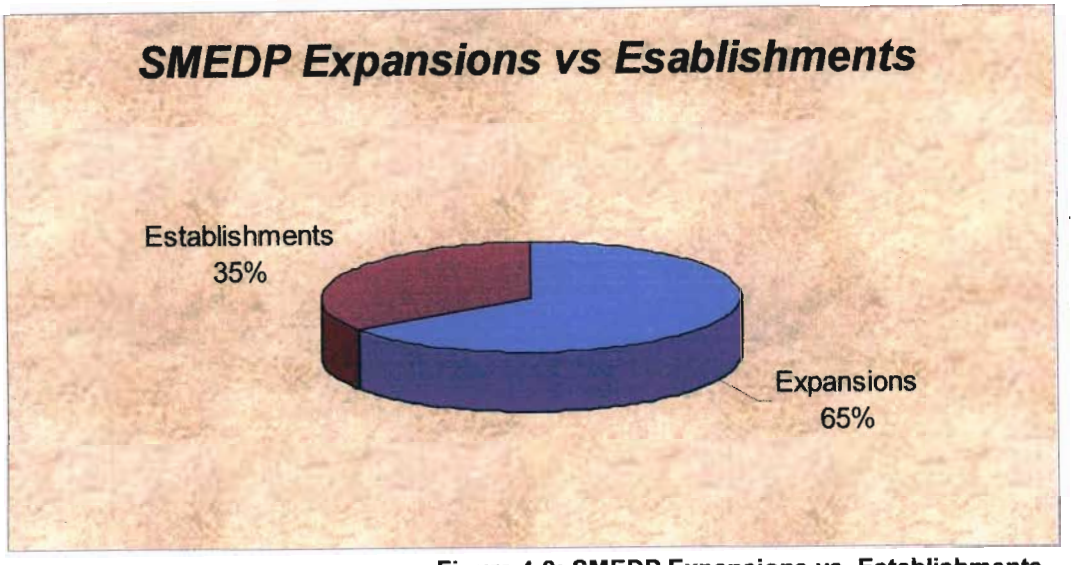

Figure 4-9: SMEDP Expansions vs. Establishments

Source: Secondary Data

4.7.3.2. Competencies

In spite of the administrative problems, the Chief Directorate: Manufacturing Development had experienced staff that administered the RIDP and SRIDP. The staff were capable of implementing a programme of this nature and the organisation therefore possessed the internal competency necessary for initial implementation. This factor contributed to the feasibility of the strategy.

The lack of resources aimed at supporting the implementation process should have been more carefully considered at strategy development stage.

While the exclusion of expansions and the reduction in internal administrative resources had an effect on the effectiveness of the SMMDP, a strategy that included expansions would not have been feasible because there were not sufficient resources to implement and deliver the strategy. Amendments were made to the programme to ensure that the strategic choice was therefore feasible under the circumstances

4.8. Conclusion

Government interference always creates distortions. The extent of the distortion must be weighed against the benefits obtained from intervention. In effect, the decision amounts to the effective allocation of resources, and deciding which resources will generate the most benefit.

An evaluation of the SMMDP must commence with the analysis of its stated objectives. The objectives of the SMMDP were found to be congruent with the objectives of the organisation's stakeholders i.e. the Board for Manufacturing Development, the Government, and the interests of those that placed the government in power to act on their behalf.

The fact that objectives are congruent at different levels does not however ensure that they will be accomplished through the chosen strategy, but is a starting point in evaluating the strategy employed. The success of the SMMDP is measured by the extent to which it accomplished the objectives of Wealth Creation, Employment Creation, Development of Entrepreneurship, Promoting the Utilisation of Raw Materials, Ensuring the Long Term Sustainability of Projects Receiving Incentives, Creating Opportunities for the Introduction of New and Advanced Skills into South Africa, and Facilitating International Competitiveness.

The provision of incentives for investment will result in employment growth and increased competitiveness. The remaining objectives can only be achieved through additional requirements built into the contract.

The SMMDP only addresses the structural constraint of the high cost of capital in South Africa, and cannot remove any other structural constraints.

The programme has been aimed at a target group of companies that in aggregate will have the greatest impact on the economic development of the country.

The Board for Manufacturing Development in implementing the SMMDP has chosen between a range of competing incentives including inter alia a labour

subsidy, rental subsidy, transport subsidy, relocation grant and training allowance.

Monitoring requirements have been included in the strategy that may be detrimental to the accomplishment of objectives. These requirements are Equity, Turnover, Human Resources, Plant and Machinery and Profit Output.

Requirements that are within the Board for Manufacturing Development's control can be ranked in order of degree of impact on industrialist. When ranked from most severe they are: Plant and Machinery, Equity, Turnover, and Human Resources.

The requirement that has the highest frequency of non-compliance and the greatest effect is the Plant and Machinery requirement. Since the requirement has no bearing on the achievement of objectives and is only in place for the board's convenience, it should be removed from the programme.

A strategy that would be better suited to the objective of employment creation would be one that focussed on clusters of industry that produced high numbers of employment relative to the investment made. This can more easily be achieved if the Board allows the use of second-generation machinery. Insufficient correlation between the Board for Manufacturing Development's strategy and labour authorities negate the positive effects of incentives.

Analysis using an adaptation of Porters Value Chain can be used to identify problem areas within the strategy. It suggests that the Board for Manufacturing Development should conduct more research into the identification of structural constraints in the economy, to enable them to develop programmes that will better address these constraints. It found that the operations function of the Chief Directorate: Manufacturing Development ignored structural constraints such as external economic shocks and the labour market structure. Structural problems outside of high interest rates have been ignored. Implementation of the strategy was lacking effectiveness due to a shortage of internal resources for administration. This has resulted in unnecessary simplification of the incentive programmes, and penalisation of

industrialists in certain instances. The value chain analysis also found that more emphasis needed to be placed on the marketing and sales function, and a mechanism for feedback to improve service levels.

The evaluation found that the strategy was acceptable to the stakeholders at the time of implementation, but since many of the intended outcomes did not materialise, a post implementation assessment may not have found the strategy acceptable.

In assessing the feasibility of the strategy, the resources and competencies of the Chief Directorate: Manufacturing Development were considered. It was suggested that many industrialists lost incentives due to the exclusion of expansion projects from the scope of the SMMDP. However, the exclusion was due to lack of resources and the strategy would not have been feasible had expansions been included within the scope of the programme.

Chapter 5: Recommendations and Conclusion

5.1. Introduction

This study has been conducted with the intention of analysing the effectiveness of the Chief Directorate: Manufacturing Development in its employment of the SMMDP. The SMMDP is a component of the South African government's supply side economic policy, and as such contributes to the economic development of South Africa.

Through a strategic analysis of the SMMDP, the effectiveness of the policies implemented by the Board for Manufacturing Development, can be assessed. The Board is the legislative body that has been empowered with the task of "promoting manufacturing growth by way of incentives or concessions with regard to requirements within the framework of the economic policy of the republic". Three important issues were identified at the outset, that have been addressed by this study:

- Did the Chief Directorate: Manufacturing Development utilise all possible means and methods available to ensure achievement of its objectives?
- What, if any policy and regulations were included in the SMMDP, that were in conflict with and hindered achievement of it's objectives?
- Has the SMMDP achieved its objectives in the context of South African Economic Development?

In order to conduct this analysis, it is necessary to have a body of theory that can be applied to the case at hand. To provide this base of knowledge, basic theory of corporate strategy was adapted to a non-profit context and then applied to the case.

Corporate strategy was defined as "The pattern or plan that integrates an organisation's major goals or policies and action sequences into a cohesive whole". This plan is shaped by a host of factors, but most importantly, the

objectives of the organisation. A non-profit organisation has objectives that are different to profit-making organisations, and therefore requires a different approach to corporate strategy.

Various factors must be taken into account when developing a good strategy, such as external factors influencing the organisations decisions, the sustainability of a strategy, the required delivery process and the desired competitive advantage to be achieved.

In order to achieve this competitive advantage an organisation must exploit linkages between itself and the environment. In deciding which linkages to capitalize on, the organisation must take into account it's mission and objectives, the options that are available for exploitation in the environment, and the selection criteria to evaluate competing strategic alternatives.

Non-profit organisations generally employ a prescriptive approach to developing strategy because their objectives are clearly defined, well focused and developed, but an emergent strategy is more appropriate in a constantly changing environment. Non-profit organisations could benefit from a combination of the two approaches, if they operate in a volatile environment.

An organisation should focus its resources on the Key Factors for Success in its industry that will have the most impact on achievement of its objectives. In the non-profit organisation, it is vital that the product offering of the organisation is targeted at the group of beneficiaries that will generate the most economic benefit from assistance, and produce favourable economic outcomes.

Porters Value Chain can be adapted for application in the Chief Directorate: Manufacturing Development, and is useful in identifying areas of weakness in a strategy. The model indicates that the accomplishment of organisational objectives is entirely dependant upon whether the organisation has accurately surmised the cause of the symptoms that the organisational products are aimed to address.

An understanding of structural economic constraints is therefore important in assessing the effectiveness of a supply side measure such as the SMMDP.

5.2. The Facts of the Case

The inclusion of the SMMDP in government's basket of supply side measures should have an impact on growth, but may not be effective in entirely alleviating all structural economic constraints.

The SMMDP has been implemented under the direction of the Board for Manufacturing Development. The powers and objectives of the board are governed by the Manufacturing Development act no. 187 of 1993.

Monitoring requirements have been incorporated into the SMMDP. Some of these requirements aid in the achievement of objectives, and others hinder the impact that the programme could have on alleviating structural constraints. The monitoring requirements are a prescribed Equity ratio, a Plant and Machinery requirement, a Turnover requirement and a Human Resources requirement.

5.3. Findings

The strategy employed by the Board for Manufacturing Development is to offer government subsidies that remove or reduce the impact of structural economic constraints, in order to increase production in the economy and foster economic growth.

5.3.1. Objectives

The objectives of the SMMDP are congruent with the objectives of the Chief Directorate: Manufacturing Development, and the Board for Manufacturing Development, as well as the Government's policy of Growth Employment and Redistribution. The objectives of the SMMDP and their success are discussed below:

Wealth Creation

The SMMDP can be considered to have successfully created wealth in the economy. An interest subsidy has the effect of reducing the cost of investment, making it more likely that investments will generate returns above the cost of capital, and therefore create profit that leads to addition of value in the economy.

Employment Creation

The SMMDP did not directly result in the creation of employment that would not have existed without incentive having been granted. Recommendations are made in paragraph 5.4.4.

Further Development of Entrepreneurship

While the target market of the SMMDP is appropriate for the development of Entrepreneurship, the SMMDP is an interest rate subsidy and can have no bearing on the development of Entrepreneurship. The only effect, if any, will be that the risk of failure of a business participating in the SMMDP is lower than the risk of failure of companies that do not receive assistance. The Entrepreneur participating in the SMMDP therefore has a greater margin of error.

Promoting the Utilisation of Local Raw Materials

This objective is only evaluated in the assessment of an application for the SMMDP, and the industrialist is not aware that this evaluation takes place and will make him more likely to be approved for the grant. It can have no effect on industry unless it is published in advance of applications being made, and a more direct approach to incentivisation is taken.

Ensuring Long-Term Sustainability of Projects Receiving Incentives

No evidence was found that ensures long-term sustainability as a direct result of receiving the incentive. The greatest risk of failure for small businesses is the start-up phase. If start-up businesses can successfully navigate the

pitfalls of start-up, then they are likely to succeed in the long term. Companies that are unable to navigate start-up rapids are generally those companies that fail to receive the incentives for failing to meet the requirements. Attainment of the requirements takes careful planning. In cases where they are not met, the incentive has had no effect on the long-term sustainability of projects.

Sustainability is also evaluated in the assessment of applications, but once again, without these requirements being publicised, industrialists cannot aim to achieve them, and the provision of an incentive can therefore not have an impact on accomplishing long-term sustainability.

Creating Opportunities for the Introduction of New and Advance Skills in South Africa

An interest rate subsidy can have no bearing on the creation of new skills.

The requirements promoting creation of advanced skills by implementing 1st generation technology (through the selective exclusion of second hand machinery from the programme) are in conflict with the objective promoting labour absorption.

Facilitating International Competitiveness

International competitiveness has been aided by the reduction in the cost of borrowing through an interest rate subsidy, allowing companies to sell their wares cheaper on the global market.

The effect of reduced capital costs is negated by the devaluing currency making the costs of acquiring machinery higher, adverse labour conditions causing the conversion of variable costs to fixed costs, and the promotion of wage payments in excess of that paid by internationally competing firms.

The SMMDP has therefore lead to the achievement of the Wealth Creation objective and played a role in developing entrepreneurship. Overall, the programme has failed to achieve its objectives. It should be noted however that the overriding reason for the existence of the Board for Manufacturing

Development, is the creation of Gross Domestic Product, or wealth. The programme has achieved this requirement, in spite of its failures, and should therefore not be considered a total failure.

What should be questioned however, is the effectiveness of the strategy employed by the Chief Directorate: Manufacturing Development in implementing the SMMDP to accomplish its lower level objectives. This strategy is flawed and has failed to produce all of the desired outcomes. The consequence of this failure is that the strategy cannot be considered as acceptable.

5.3.2. Monitoring Requirements

Certain requirements have been enforced to the detriment of deserving projects, causing a hindrance to the achievement of strategic objectives. A decision tool was utilised to evaluate the severity of requirements in relation to one another, and determine the propensity to result in failure of achievement of SMMDP objectives.

The requirements that pose the greatest threat are the Plant and Machinery requirement and the Equity requirement. The Equity requirement does not occur in a frequency great enough to have a negative impact on overall achievement of objectives. The Human Resource requirement has a larger frequency of occurrence, but ranks lower down on the severity scale and therefore also does not poise a large threat. The failure of industrialists to achieve the Turnover requirement is generally an indicator of future failure due to business closure or not meeting other requirements.

5.3.3. Labour Market Structure

The SMMDP is not able to directly address labour market structure constraints. The study concluded that the offering of an interest rate subsidy did not result in additional jobs being created. In fact, the opposite is probable, as most companies employed less employees than had been projected when applying for the incentive.

It follows that the jobs that were created through the establishment of companies would have existed with or without the provision of incentives. The incentive is however able to put measures in place to discourage investors from making investments in capital equipment that will reduce the number of sustainable job opportunities in the market place.

The SMMDP has been aimed at a target group of companies that when combined will generate more employment opportunities than the target group of the Regional Industrial Development Programme. The SMMDP on it's own however, is not sufficient to create employment that would not have existed without the availability of the incentive.

5.3.4. Programme Implementation

No improvements have been made by the Chief Directorate: Manufacturing Development since it's administration of Schedule 4 incentives. A strategic mistake has therefore been made. While the government should have been increasing resources to the Chief Directorate: Manufacturing Development, they were actually being reduced. This has resulted in the need to simplify incentive schemes, and lead to a decrease in benefits by industrialists. Consequently, the likelihood of achieving objectives must therefore have decreased.

The lack of administrative resources has an impact on the effectiveness of a programme in achievement of its objectives.

Inadequate funding has also resulted in low service levels from the Chief Directorate: Manufacturing Development.

5.3.5. Marketing and Sales

The Chief Directorate: Manufacturing Development has not taken sufficient steps to market and promote the incentive programmes.

5.3.6. *Suitability, Acceptability and Feasibility*

The study concludes that the strategy employed by the Chief Directorate: Manufacturing Development was overall suitable and able to address the circumstances in which the organisation was operating.

Numerous areas have been found that have hindered achievement of the desired results, and if the stakeholders were to reassess the acceptability of the strategy with evidence gathered post implementation; they would find that the strategy is not entirely acceptable, as many of the objectives that were intended to be achieved through the SMMDP have not been achieved.

The strategy was made feasible by the exclusion of expansions from the programme.

5.4. Recommendations

The Board for Manufacturing Development should implement the following recommendations to increase its effectiveness in achieving the desired objectives.

5.4.1. *Bird's Eye Perspective*

The Chief Directorate: Manufacturing Development, by virtue of its association with manufacturing companies, is able to make comparisons between companies and industries and evaluate which industries are most likely to achieve desirable economic outcomes. The Guns v Butter Continuum, illustrates how government is required to make strategic choices between allocating resources to various products in an economy that will meet the needs of citizens.

The Board for Manufacturing Development, through the Chief Directorate: Manufacturing Development can use a similar strategy to identify industries with the highest probability of achieving desirable economic outcomes, and incentivise those outcomes, in the appropriate industries.

The effect of incentivisation will therefore be greater, swifter and have a long-term effect.

5.4.2. *Interest Rate Subsidy*

The Chief Directorate: Manufacturing Development should continue to offer an interest rate subsidy as it addresses a major structural constraint. The incentive should however not be offered in isolation, as it only addresses a single constraint.

Other desirable outcomes should be identified and be clearly defined, published, and measured throughout the incentive term in order to ensure that the objectives are achieved.

The interest subsidy can therefore be can be used as a base subsidy, and can be increased or decreased according to the number of desired outcomes that have been achieved by the company in the period.

At present, other outcomes are intended to be addressed by the programme, but cannot be addressed through an interest subsidy. For example the constraint of research and development and technology cannot be addressed by the interest subsidy. Companies benefiting from an interest subsidy can be offered a greater percentage if they commit certain funds to research and development.

Another example is the utilisation of local raw materials, which is one of the stated objectives of the SMMDP. An interest subsidy of 70% may be offered to qualifying companies, but an additional 5% may be offered to companies that utilise local raw materials and create up-stream demand and employment.

The SMMDP at present evaluates whether an industrialist utilises local raw materials, and if so, the industrialist is more likely to be approved for the programme. However, industrialists are not aware that this is an objective of the programme. They are not incentivised to utilise local raw materials either, because they will qualify for the incentive whether they do or don't make use of local raw materials.

5.4.3. Alternative Incentives

There are numerous alternative incentives methods, some acceptable and others not.

A labour subsidy is open to broad scale abuse and is therefore not feasible. As an alternative to labour subsidies, government should rather address the negative effects of labour legislation on economic output, and the ability of South African companies to be globally competitive.

A rental subsidy is effective, and is incorporated into the SMMDP. This subsidy should be continued.

Transportation subsidies like wage subsidies are open to broad scale abuse and are not feasible.

Relocation grants are effectively employed within the SMMDP and are suitable for the purpose.

A training grant is appropriate in the context of South African structural constraints, and should be employed to facilitate training of an unskilled labour force.

5.4.4. Employment Creation

By encouraging investment in the sectors that create the most jobs for the lowest investment, the Board for Manufacturing Development can provide a catalyst for job creation.

The strategy for creating employment through the SMMDP is well suited in that the target group generates a high number of jobs per Rand investment, but could be improved by clusterisation (The favouring of industries producing favourable employment outcomes).

A strategy better suited to the objective of employment creation would be one that focuses on industry sectors, or employment clusters. The study found that the textile industry and furniture industry created the most jobs for the

least amount of investment. Incentives should be targeted at these industries first, and then the metals, minerals, and food industries.

A further conclusion is that there should be greater co-operation between the Department of Trade and Industry, and the Department of Labour, to avoid the implementation of competing objectives that negatively affect one another. Growth and employment can be created if growth is the predominant objective, because employment is a natural consequence of growth (provided the correct mix of equipment is used). However, if employment is sought first, it will come at the expense of growth.

5.4.5. Monitoring Requirements

The following changes should be made to the monitoring requirements of the programme.

5.4.5.1. Equity

The equity requirement is implemented for the purpose of reduction of financial risk to the industrialist. Its promotion encourages good practice by the industrialist. In order to have an impact on the financial profile of the company, the required equity percentage needs to be larger than 10%. For this reason, the requirement has limited up-side benefit, but significant downside benefit if it is not achieved.

The frequency of occurrence is low, and therefore it does not threaten the achievement of objectives.

This study recommends that the equity ratio be increased to a percentage to be determined through additional study, which will maximise the benefits to be attained through sound financial practice, and minimise financial risk. The result of requiring a higher equity ratio will be a reduction in the failure of start-up businesses, resultant directly from minimising financial risks.

A further recommendation is that companies that are unable to achieve the prescribed ratio at start-up should be paid incentives in advance, in order to increase the equity ratio, and facilitate the acquisition of further funding from financial institutions.

5.4.5.2. Turnover

The Turnover requirement is determined by the industrialist, and therefore poses limited threat to the industrialist. Failure to achieve the requirement generally indicates a future failure of some sort, and therefore the attainment of a Turnover requirement is an essential component of the programme.

5.4.5.3. Human Resource Criterion

The Human Resource Criterion has had an impact on the effectiveness of the SMMDP. Its inclusion does not promote employment creation. The percentage can be manipulated and abused by increasing directors and managers remuneration. This manipulation would be against the spirit of the requirement.

Since this requirement does not have a significant impact, but poses some risk to the industrialist, it should be re-evaluated.

Inclusion of a spatial component within the SMMDP could be a catalyst for job creation in certain areas.

5.4.5.4. Plant and Machinery

The Plant and Machinery requirement ranks highest in the severity scale, and has the greatest frequency of occurrence. Its inclusion in the programme serves no benefit other than to facilitate budgeting by the Board for Manufacturing Development. The requirement should be abolished.

In addition, the requirements regarding the acquisition of second-hand machinery have a negative impact on the objective of promoting labour absorption. This matter needs to be researched more fully, but a preliminary recommendation of this study is that the programme allows the use of second hand machinery, on the basis that it facilitates greater labour absorption. Naturally, related party machinery remains non-qualifying to curb abuse of the incentive. This recommendation is made in light of the South African economic circumstance and the fact that labour absorption is a more important consideration than technology development. This is evidenced by the fact that technology development was stated in the recommended

objectives of the SMMDP (Ernst & Young, 1996) but not included in the roots level objectives.

5.4.6. *Expansions and Establishments*

The exclusion of expansions from the programme while resulting in ultimate feasibility of the strategy, has limited the benefits derived from incentivising investment, and expansions should therefore be included in the future.

5.4.7. *Transparency*

The true objectives of the SMMDP are unknown to most industrialists. While they benefit from them, they are not able to mould their businesses in a manner that will facilitate greater furtherance of all SMMDP objectives.

It is therefore recommended that the objectives and reasons for requirements be published to industrialists both in advance of the application, and during the incentive term, in order to stimulate provision of outcomes outside of the effect of an interest rate subsidy.

5.5. Recommended Additional Research

The following topics are required for further research resultant from this study.

- Identify a causal relationship and establish probabilities that failure of a business to achieve it's turnover requirement will result in failure to achieve a later requirement and ultimately total business failure
- Determine the optimum equity ratio for a start-up business that will result in lowest financial risk, and greatest leverage of debt.
- Establish to what extent the use of second hand machinery represents second-generation machinery, and facilitates greater labour absorption than the use of 1st generation machinery.
- Re-evaluate the construction of the Human Resources requirement.

5.6. Conclusion

The provision of incentives has little effect on the decision to invest. Government would be better off identifying specific industries that have the

potential to accomplish objectives, and providing incentives for industrialists to enter those industries. This would create an environment in which industries would naturally flourish, and a foundation would be built toward accelerating the benefits that the industry can provide the economy.

In the process of offering direct incentives, government has overlooked the importance of removing the causes of market failure. I.e. government intervention in the labour market has resulted in an unsustainable situation in the plastics industry. Failure to address and remove the effects of such undue intervention will result in failure of companies within the sector, and the economy will suffer a greater loss, than can be compensated for by providing capital incentives for new projects.

Porters Value Chain analysis suggested that the Board for Manufacturing Development should conduct more research into the identification of structural constraints in the economy, to enable them to develop programmes that will better address these constraints. It found that the operations function of the Chief Directorate: Manufacturing Development ignored structural constraints such as external economic shocks and the labour market structure. Structural problems outside of high interest rates have been ignored. Implementation of the strategy was lacking effectiveness due to a shortage of internal resources for administration. In addition, more emphasis needs to be placed on the marketing and sales function, and a mechanism for feedback to improve service levels, and the total effect of the subsidy.

The Chief Directorate: Manufacturing Development therefore has not utilised all possible means and methods available to ensure achievement of its objectives.

The policy regulation that has been the greatest hindrance to achievement of the objectives of the SMMDP is the Plant and Machinery requirement. Regulations regarding second hand machinery have also caused conflict amongst competing objectives of employment creation and technology development. The Equity requirement has not caused great strategic failure but it would be appropriate to re-evaluate the prescribed equity percentage in

order to utilise equity as a tool for economic development. If this is done, a contingency plan must be developed to prevent the loss of incentives due to non-attainment of the ratio.

The SMMDP has failed to achieve four of its six stated objectives. In spite of this failure, it did result in the creation of wealth. Since the creation of wealth is the overriding consideration in the context of economic development, the programme has had an effect on South African economic development. The creation of employment is also important in the South African context and careful attention must be given to this in the future. An interest subsidy is however not the appropriate mechanism for employment creation.

To more effectively address labour absorption, the Chief Directorate: Manufacturing Development, should employ a bird's eye economic approach, and develop incentives to stimulate growth in areas of industry that will produce the most favourable growth of jobs in relation to the investment made.

Expansions must be included in the scope of industrial incentives, and the Board for Manufacturing Development should adopt a more transparent approach, so that industry and government may work together to produce favourable economic outcomes.

The achievement of all the objectives embodied in this study is dependant on the extent to which parties can rely on one another, and work together to identify structural constraints, and solutions to these constraints. Corporate strategy accounts for this interaction be requiring that the strategy is built upon a foundation of stakeholder objectives. The result of proper strategic development in the governmental context is that the interests of all parties are taken into account by government implementing objectives that suit the requirements of the population that placed the government in power. Through properly constructed strategies, the beneficiaries of the strategy are ultimately responsible for the objectives upon which it was founded.

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