



REPORT ON THE FEASIBILITY STUDY INTO THE
POSSIBILITIES TO SET UP AN ENTREPRENEURSHIP DEVELOPMENT CENTRE AND AN SMME
EQUITY FUND
IN THE WEST COAST, SOUTH AFRICA

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1. Introduction

In the framework of the 2g@there program of the Dutch Ministry of Economic Affairs, Agriculture and Innovation, a consortium was formed to research the possibilities of a long term involvement of Dutch industry in the development of the Saldanha Bay Area.

The Saldanha Bay Municipality has embarked on an ambitious programme that should lead to the integrated development of the Saldanha Port, the Saldanha Industrial Development Zone (IDZ), Saldanha Municipality and the Saldanha/Langebaan Coastal and Nature areas on the West Coast of South Africa. Due to the nature of the area, the expected development of the region is to be combined with the delicate environment, thus striking a balance between economic growth and environmental preservation and protection.

The consortium of 14 Dutch companies focuses mainly on port development, water management, clean technology and broad based decision-making. However, also the institutional capacity building of local organizations is a major part of the consortium activities. It is for that reason, that IntEnt Foundation and Rebel Group became part of the consortium. IntEnt focuses on the possibilities of entrepreneurship development and the transfer of knowhow and technology for entrepreneurship centers in the area. RebelGroup is interested in setting up a dedicated SMME Equity Fund, and carried out a feasibility study for such fund in the context of the 2g@there program.

2. Description of the activities

a. Entrepreneurship Development Centre

In the original application the goal of IntEnt was to do a feasibility study on the possibilities of setting up an infrastructure for entrepreneurship development in order to enhance sustainable economic development and stimulate SMME development in South Africa's Western Cape. The agreed deliverables were as follows:

- A. Mapped existing structures and marketplace for entrepreneurship development in South Africa Western Cape.
- B. Identified partner mandated in the Saldanha Bay region to be local development centre
- C. Prepare the start of an entrepreneurship centre
- D. Set up model for cooperation between corporates and the local development centre
- E. Identified areas for further capacity building
- F. Agreed tentative programme for capacity building with local development centre

The activities started with desk research and information gathering in the Netherlands. Due to the good relations with the South African Embassy IntEnt was provided with an overview of organizations in South Africa that focus on entrepreneurship development. Furthermore, contacts with Ecorys were good and provided us with an insight of the activities Ecorys would undertake, among which a skills audit in the Saldanha Bay Municipality. The questionnaire that was used for this skills audit, also had questions on entrepreneurship and the intention of starting a business. Together with Rebel Group the roles in the study were defined.

Item A: In cooperation with the local representative of Ecorys, Rebel and IntEnt visited the Saldanha Bay region and Cape Town from July 18 – July 23, 2011. The purpose of the visit was factfinding and getting introduced to various organizations in the Saldanha Bay area and Cape Town. During the visit it became clear that entrepreneurship development in combination with the creation of jobs has a high priority for the South African government. Various organizations are active in this field, offering a variety of services to start ups and micro enterprises. The kind of services they provide differs per organization. However, one common thing is that the programmes offered, lack guidance and assistance during and after the start. This results in a large number of startups that fail in the first year.

Financing of start-ups is a problem, there are hardly funds available for seed capital. There are banks that provide "contract funding", meaning that they provide loans for existing SMME based on signed contracts with clients. The advantage is that there is less attention on the skills and competences of the entrepreneur and more on performance of the entrepreneur. As long as he or she fulfills the contractual obligations the bank will provide funding.

Another trend in South Africa is the so called "unbundling" of tenders by government. Large government projects, such as infrastructure, are cut into pieces offering SMME to apply for parts of the tender.

Item B: In the Saldanha Bay area a local entrepreneurship centre is active, the West Coast Business Development Centre (WCBDC), located in Vredenburg. The WCBDC is active since 1998 and develops and enhances the growth of Small, Medium and Micro Enterprises (SMME) in the West Coast region through training, business linking, export development and project management. The WCBDC is supported by local and provincial government as well as the corporates in the area.

The factfinding mission made it clear that the WCBDC focuses mainly on the development of technical skills and less on entrepreneurial competences. It is in that field, that IntEnt could complement the programme that is offered by the WCBDC.

The Jobs Fund application

During the factfinding mission, it became clear the South African Government had embarked on an ambitious scheme to piloting new and upscaling existing innovative approaches to employment creation. One of the schemes is the initiative of the national government to create the "Jobs Fund". The focus areas of the Jobs Fund are enterprise development, infrastructure investment, support for work seekers and institutional capacity building. The total available budget for a period of three years is R 2,500 million. In consultation with the WCBDC, Ecorys, IntEnt and the Rebel Group, it was decided to apply for a grant from the Job's Fund, focusing on the enterprise development and institutional capacity building. The proposal submitted by the partners consists of three phases;

- Gap analysis and capacity building within the WCBDC
- A pilot with five SMME's receiving direct and tailored advice to increase their sales to corporate clients
- Replication of the pilot with 15 other and newly emerging SMME's.

The phased approach to the project will allow partners to continuously monitor the impact of the activities and on jobs creation. The capacity building of the WCBDC will include the staff functioning as understudies to the international experts in providing their advice and training to the supported SMME's. The continuous coaching and advice provided to the WCBDC staff will gradually build their capacity and ultimately allow them to become business advisors and trainers that will continue their SMME support independently according to international best practice.

The total budget to execute above activities is R 10,2 million of which an amount of R 7,5 million is requested from the Jobs Fund. The partners themselves would make a contribution of R 0.5 million and contribution for other sources (Corporates, the Western Cape Department of Economic Development and Tourism) is calculated at R 1,2 million.

Item C: As there is an existing infrastructure for entrepreneurship development there was no need to prepare for the setting up of an entrepreneurship centre. The choice has been made to work together with the WCBDC and to compare the two training curricula to see where there is an overlap and where they are complementary. The cooperation between WCBDC and IntEnt would focus on two major issues, one the institutional and capacity building of the WCBDC, mainly carried out by IntEnt and Ecorys and, two, the SMME support to existing vendors and start ups.

For the existing vendors, the plan entails a strategy for capacity enhancement of existing micro enterprises. The industry in the region uses small vendors to supply specific goods to industry, but the structure of the small vendors is too weak to create sustainable business. In order to enhance these micro entrepreneurs a plan was drafted to assess a number of these vendors and determine in what way their company could be strengthened on issues like marketing, sales, human resource management. This plan is included in the application that was filed at the Job's Fund.

Item D: The local enterprise development centre (WCBDC) already has a structure in place in which corporates and the centre work together. The corporate are funding the centre and are part of the centre's Supervisory Board, just as municipal and provincial government.

Item E: It has become clear that the WCBDC is strongly focused on the training of technical skills and not so much on entrepreneurial competences. IntEnt will be able to fill that gap in the training curriculum, as the IntEnt methodology is aimed at development of entrepreneurial skills. Together with WCBDC and Ecorys a plan has been drawn up in the framework of the Job's Fund application for the following areas of capacity building and training;

- Gap Analysis
- Strategy and Action plan
- Training needs assessment
- Development of training program
- WCBDC tool-kit adaption
- Training programme
- Ensuring sustainability

Item F: Between IntEnt/Ecorys and the WCBDC agreement has been reached on capacity building as part of the application that was filed with the Job's Fund.

The activities and study in 2011 was mainly focused on insight and contacts with government funded organizations on entrepreneurship development. However it became apparent, that industry is also very active on this issue as part of their Corporate Social Responsibility (CSR). In order to explore other options of entrepreneurship development outside the scope of government, it was decided to look into the possibilities of working together with industry on entrepreneurship development.

This led to additional goals to be included in the study, namely:

- A. Assess the potential to develop market opportunities to sell the enterprise development model towards corporate companies through the organization of an expert meeting between corporates, SMME, IntEnt, Ecorys
- B. Assess the local market opportunities on the basis of potential start-ups based on the results of the skills study.

In order to get information on these issues, a visit to the Saldanha Bay region took place in March 2012. This visit provided information on the manner in which the corporates have organized their CSR budgets. Among them there is still a discussion going on about the possibility of setting up a communal CSR fund, to combine the different CSR budgets in a foundation and so be able to get a more coordinated approach to the division of funds. Most of the corporates do support the enhancement of their vendors, but mostly they don't know which corporate uses which vendors. The original idea was to set up an expert meeting with corporates and other stakeholders. However, later it was decided not to organize such a meeting. There is a general idea that quite a few international consultants visit the region and have a lot of meetings, that in the end do not deliver tangible results. IntEnt could not yet make solid commitments on continuation of her efforts in the region, given the scope of the research. Instead the visit was used to attend a meeting on CSR issues with corporates and meet with some of them to discuss the possibilities and the possible added value IntEnt can provide to entrepreneurship development. A result of attending the meeting with all corporates was that support of entrepreneurship development as done by the WCBDC is supported by the corporates, although with limited funding. The individual meetings confirmed the focus on development of technical skills and the lack of development of entrepreneurial skills.

Part B of the assessment has not taken place yet.

b. SMME Equity Fund

In the application of 2g@there, the objective of this part of the assignment was the execution of a feasibility study on the attractiveness of setting up an SMME Fund either in South Africa or specifically for the Western Cape. The agreed working program consisted of the following steps:

- A. Carrying out a desk research on existing financing sources and/or dedicated funds for small and medium enterprises in South Africa and more particularly the Western Cape, including identification of a potential funding gap
- B. Drafting an initial setup for an SMME fund that could fill any identified funding gap for SMME investments
- C. Testing the drafted initial setup with experts in the SA fund and SMME investments market
- D. Identification of key partner stakeholders and definition of their roles
- E. Testing with the identified key partner stakeholders the possible interest to participate
- F. Reporting on the attractiveness of an SMME Equity fund

Step A: The activities started with desk research and information gathering in the Netherlands. The identified potential sources of funding included (1) international funds and equity providers, (2) entrepreneurial (inter)national banks, (3) sector based funds and (4) existing generic fund providers for SMME in South Africa or the Western Cape.

The *desk research* consisted dominantly of the Rebel experience with setting up an SMME Fund in East Africa. Rebel is co-initiator of and shareholder in InReturn, a fund manager established in Nairobi. InReturn has launched and currently managing the East Africa Investment Fund (EAIF). During the feasibility phase of InReturn, relevant documentation was developed and collected, that was used for understanding and drafting an SMME for South Africa.

For the *international funds and equity providers*, Rebel has access to an international network of equity providers. These include various investor firms, investments vehicles funded by dominantly pension funds and DFIs. A longlist was drafted consisting of some 15 potential investors. For each potential investor, Rebel carried out a check on the eligibility criteria applied by each of the 15 potential investors. This check was carried out by using Rebels existing resources and database. Additionally, information on these investors was collected by contacting these investors directly, sometimes supported with data gathering through internet. On the basis of the collected information, it was concluded that this group of investors does not invest in the SMME sector. Typically, individual equity contributions start around a level of R 50 million or above.

For the scan of potential *(inter)national banks*, Rebel made a distinction between the international banks and the national South African banks. For the international banks, Rebel made use of the existing network and frequent contacts in other financing and arranging assignments. For the South African national banks, Rebel made use of the information available with Rebels South African partner, Andreas Bertoldi, and the South African Ecorys representative. From the collected information, it became clear that no international banks provide equity to the SMME sector in South Africa. For the national banks, the conclusions were less straightforward, so two of the banks were identified for follow up meetings during step C.

The *sector based South African investors* are typically linked to the large industrial groups in South Africa and provide capital for SMMEs that service the related industrial group. To some extent, these investment initiatives are related to South African legislation requiring large companies to invest in SMME development. For the purpose of this study, this source of capital provision is deemed relevant in the sense that certain types of SMMEs (i.e. the SMMEs in sectors that service the existing large industries) can avail of resources. The conclusion was drawn that the SMME equity fund could therefore dominantly concentrate on SMMEs that cannot access the resources provided by the large industries funds.

The existing *generic fund providers for SMMEs* in South Africa were identified in various stages. During the first stage, existing funds were sought by internet and database searches. Secondly, the existing network of international banks and funds were contacted to collect any interesting points of entry. Finally, the South African Rebel partner and the local Ecorys representative were requested to identify any possible capital providers. All possible active local funds were included in the long list of follow up interviews to be carried out during step C.

Step B: On the basis of the initial results identified in step A, an initial thesis on a funding gap was developed. Given the assumed funding gap, Rebel developed a conceptual setup of an SMME fund that would be matching such funding gap. Key elements of such conceptual setup are the governance of the fund, access to capital, link between public sector and private sector, and a rough indication of the earnings model. In order to be able to draft such conceptual setup, Rebel made use of its hands-on experience with various real life funds, like InReturn, Access to Energy Fund, Green for Growth fund and various funds managed by the International Financial Institutions (IFIs) (e.g. Marguerite Fund managed by the EIB). The conceptual setup was documented in preparation of the visit during Step C.

Step C: In cooperation with the local representative of Ecorys, Rebel and IntEnt visited Johannesburg, Cape Town and the Saldanha Bay region from July 18 – July 23, 2011. The purpose in the context of this part of the research was twofold: (1) following up on any existing capital resources for SMMEs in South Africa and/or

the Western Cape, following the assessment of Step A and (2) testing the initial assumptions regarding a funding gap and matching SMME Equity Fund.

During the visit an additional component was added, which is the intensive involvement of the South African public sector with SMME development. In the course of the visit, it was investigated to what extent these public sector initiatives can be supportive to the SMME Equity Fund and/or would render such SMME Equity Fund initiative abundant.

During the field visit, the following entities were visited:

(1) two large South African commercial banks. One of these banks demonstrated clear interest to get involved in the initiative and indicated that it would investigate a possible future role.

(2) three possible capital providers. The conclusion of these visits was that the type of value added of an SMME equity fund were not provided by these three entities (nor any other entity, according to these interviewees), since the entities focused on either advising roles, intermediate roles or particular cash services.

(3) three public sector entities involved with SMME equity provision. From these interviews, it became clear that capital provision to SMMEs was dominantly linked to other public sector programs, and not oriented towards successful SMMEs seeking a next phase capital support. On the other hand, two of the three entities indicated a possible interest in participating in the SMME Fund setup.

(4) various local stakeholders in the Saldanha region. These visits were used to verify whether the observations made during the other interviews could be confirmed and were equally applicable to the Western Cape/Saldanha Bay region. This appeared the case.

Step D: on the basis of the findings from Step C, the initial findings on the setup of the SMME Equity Fund were modified and elaborated. The elaboration included the definition of key roles during the various phases of setting up the Fund. For each of the defined roles, a number of possible partners were identified for each of the key roles.

The overview of key roles and potential partners was included in a position paper, which was distributed to each potential partner.

Step E: A second visit to Cape Town and the Saldanha Bay region was held from March 5 – March 8, 2012. The purpose of this visit was twofold: (1) checking whether the interviewees recognized the assessment of the value added of the SMME Equity Fund and (2) testing the interest of the potential partners in the participation and further investments in the SMME Equity Fund.

The results of the visit were roughly as follows:

(1) one large South African commercial banks was visited. The bank confirmed that the assessment in the position paper was correct. The bank indicated that they would decide whether to participate in the initiative and make the linked investments during April 2012.

(2) two semi public entity were visited. The entities confirmed the assessment in the position paper, and indicated that they would probably not decide to participate and invest. The reason for such decision was dominantly linked to the SMME Equity Fund being outside their scope of activities.

(3) other meetings were held with relevant individuals and entities. Each of the interviewees confirmed the assessment in the position paper. No other potential partners or investors were identified.

Step F: On the basis of the findings from Step E, the final report was prepared. The report has been attached as Appendix 1 to this document.

3. Conclusions and recommendations

On the Entrepreneurship Development Centre

The feasibility study has shown that entrepreneurship development in the Western Cape is undertaken by various organizations in different ways. The focus is mainly on the development of technical skills and not so much on entrepreneurial competences. There is a lack of assistance and guidance after the start, resulting in a high failure rate.

Entrepreneurship development in the Western Cape has a focus on improving existing micro enterprises, mainly the vendors that supply the corporates in the area. However, the corporates do not work together in a coordinated effort to strengthen the suppliers.

The industry is involved in entrepreneurship development, for example, in funding the local entrepreneurship centre. It has become clear, that funding by industry is scattered and not channeled through one specific body that works for all the corporates. As a result of this, many different small scale projects are funded on an ad hoc basis instead of making strategic choices for a structural approach to spending of the CSR funds of industry. Industry is looking at ways to work more closely together.

In the Saldanha Bay region the organization for entrepreneurship development is the West Coast Business Development Centre, located in Saldanha Bay. The organization focuses mainly on the enhancement of technical skills. Based on the meetings with the centre, it can be concluded that the centre lacks institutional capacity. IntEnt and Ecorys have put forward a proposal to assist the centre in improving those skills.

Taking into consideration the present infrastructure of entrepreneurship development, IntEnt has no intention of setting up a centre by itself. If the IntEnt methodology (or parts of it) shall be introduced in the Western Cape it shall be done in cooperation with a local partner.

On the SMME Equity Fund

The feasibility study demonstrated the potential of an SMME Equity Fund, predominantly on the level of South Africa and possibly the neighbouring countries. Attracting equity for SMMEs proves currently limited, leaving a funding gap for successful expanding SMMEs.

The funding gap is widely recognized by both public and private sector entities. The concept of a dedicated fund for the SMME sector was confirmed as sufficiently promising.

Key question for the near future is the composition of the investors taking the initiative to the next level. It is estimated that Rand 1 million to Rand 5 million needs to be invested as sweat capital in order to get the Fund 'live'. Although interest was expressed by some public and private entities, no key sponsor was identified at this stage.

The timing of such investments may have to be postponed for some time. It is quite likely that the relative importance of the SMME sector in the South African economy will grow. Such growth will lead to an increased demand for capital provision. Once demand for capital

provision increases, the risks for setting up an SMME fund will reduce. Once the risks reduce, the potential interest from sweat capital providers is likely to grow.

For Rebel itself, it is essential to team up with a key sponsor. Learning from the InReturn experience, Rebel discovered that the key sponsor is necessary for cost efficiency of the set up process and the fair allocation of the investments between later beneficiaries of the Fund. Rebel will keep an active eye on the SMME market in South Africa. By setting up a new Rebel branche in Johannesburg, which is anticipated for 2013, and its shareholding in InReturn, Rebel will be able to restart the initiative once the timing is easier and a key investor can be identified.

Appendix 1 Setup of an SMME Fund in South Africa

Appendix 2 Proposed concept on cooperation