SOUTHERN AFRICAN VENTURE CAPITAL AND PRIVATE EQUITY ASSOCIATION

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Feature: Enterprise & Supplier Development

Daniel Hatfield, Managing Director of Edge Growth, speaks about the growing relevance of enterprise and supplier development ("ESD") in the South African business landscape.

What qualifies as enterprise development?

According to the BEE codes, enterprise development refers to financial and non-financial support given to black-owned businesses with a turnover of less than R50 million. Support can take the form of loans at favourable terms, preferential payment terms, investment, or assistance with some aspect of business management. Integrating enterprise development beneficiaries into the supply chain is becoming increasingly important in terms of how the ESD pillar is evaluated.

How will amendments to the B-BBEE Codes affect enterprise development?

Government is focusing heavily on small business development and job creation. Creating sustainable jobs is the most effective way to alleviate poverty – and the way to create these jobs is through small business. This focus is coming through in the new codes which shift ESD to being a priority pillar alongside ownership and skills development. From April 2015, 40% of a company's BEE score will depend on ESD. Financial companies will be measured according to the financial services charter which looks set to weigh ESD at 32%.

Does private equity investment come into this space?

There are only a handful of players who would invest in businesses of the size and stage that qualify for ESD. Their size means that they require a great deal of management time alongside funding. Often processes need development and investee management teams aren't as established. In theory, the capital available for this niche sector could be much larger. If you allocated 3% of after-tax revenue of JSE-listed companies to ESD spend, you would have a pool of R20 billion in investable funds. While the economic model is hard to make work, the innovation involved alongside the rewards of growing promising businesses makes our work worthwhile. At Edge Growth, our vision is 5 x 500 in 5, which means we are looking to create at least 5 direct jobs in 500 different businesses in the next 5 years. A year into this vision we have created 450 direct jobs – no mean feat considering our tough economy.

How do you identity qualifying SMEs that are going to thrive despite the odds?

In the early days of Edge Growth we quickly realised not to advertise. Today, we identify potential businesses through a number of influential networks and this has been a successful strategy. We work with VC networks, and corporate finance institutions as well as business incubator programmes. We also consult to corporates on supply chain development and this often yields potential investees. Like any other investment decision, the fundamentals must be in place. We look at market demand, competitive advantage, the management team and the financial model. More often than not, we work with the businesses prior to funding to truly get to know and trust each other.

Would you like to touch on any trends in the ESD space?

There are a few major shifts in enterprise development. The one shift is that enterprise development is now exclusively focused on black-owned enterprises; black-*empowered* enterprises no longer qualify. In my view, restricting investment to only black-owned enterprises diminishes the pool of potential investees and undermines the principles of broad-based black economic empowerment, specifically the creation of sustainable jobs.

Another fundamental shift is that companies will have to incorporate two-thirds of the businesses they support into their supply chain. This means that corporates will potentially procure much more from their enterprise development beneficiaries, which if done well would result in massive localisation benefits. This is a positive move as it will encourage greater growth prospects for black-owned businesses.