LITERATURE REVIEW ON SMALL AND MEDIUM ENTERPRISES' ACCESS TO CREDIT AND SUPPORT IN SOUTH AFRICA

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Literature Review on Small and Medium Enterprises' Access to Credit and Support in South Africa

Prepared for

National Credit Regulator (NCR)

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List of Acronyms and Abbreviations

AMFISA	Association for Pro-poor Micro Finance Institutions for South Africa
APS	Adult Population Survey
BBBEE	Broad Based Black Economic Empowerment
BDS	Business Development Services
BSM	Business Sophistication Measure (FinScope)
CBOs	Community Based Organisations
CDE	Centre for Development of Enterprise
CIE	Centre for Innovation and Entrepreneurship
CIPC	Companies and Intellectual Property Commission
CIPRO	Companies and Intellectual Property Registration Office
CPPP	Community Public Private Partnership
DED	Department of Economic Development
DGRV	German Co-operative and Raiffeisen Confederation
DST	Department of Science and Technology
FNB	First National Bank
FSCs	Financial Services Cooperatives
GDP	Gross Domestic Product
GEM	Global Entrepreneurship Monitor
HDIs	Historically disadvantaged individuals
IDC	Industrial Development Corporation

IFC	International Finance Corporation
Khula	Khula Enterprise Development Fund
LBSC	Local business service centres (Ntsika's)
LDCs	Less developed countries
LFS	Labour Force Survey (Statistics SA)
MACs	Manufacturing Advisory Centres (MACs
MCP	Microcredit Program
MFIs	Microfinance institutions
Namac	National Manufacturing Advisory Centre
NCA	National Credit Act
NCR	National Credit Regulator
NGOs	Non Governmental Organisations
NSB Act	National Small Business Act of 1996 as amended by the National Small Business Amendment Act of 2003 and 2004
NSBAC	National Small Business Advisory Council
NYDA	National Youth Development Agency
OCIPE	Office of Companies and Intellectual Property Enforcement
OECD	Organisation for Economic Co-operation and Development
PFMA	Public Finance Management Act
SA	South Africa
Samaf	South African Micro Apex Fund
SEDA	Small Enterprise Development Agency
SEF	Small Enterprise Foundation
SESE	Survey of Employers and the Self-Employed (Stats SA)
SETAs	Sector Education and Training Authorities
SMBs	Small and Medium Businesses
SMMEs	Small, Medium and Micro-Enterprises
TCP	Tšhomisano Credit Programme
the dti/DTI	Department of Trade and Industry
UCT	University of Cape Town
UN	United Nations
UNIDO	United Nations Industrial Development Organisation
WB	World Bank

EXECUTIVE SUMMARY

1. Introduction

There is consensus among policy makers, economists, and business experts that small and medium enterprises (SMEs) are drivers of economic growth. A healthy SME sector contributes prominently to the economy through creating more employment opportunities, generating higher production volumes, increasing exports and introducing innovation and entrepreneurship skills. The dynamic role of SMEs in developing countries insures them as engines through which the growth objectives of developing countries can be achieved.

It is estimated that SMEs employ 22% of the adult population in developing countries[1]. United Nations Industrial Development Organisation (UNIDO) estimates that SMEs represent over 90% of private business and contribute to more than 50% of employment and of gross domestic product (GDP) in most African countries (UNIDO, 1999). A recent study conducted by Abor and Quartey (2010) estimates that 91% of formal business entities in South Africa are SMEs, and that these SMEs contribute between 52 to 57% to GDP and provide about 61% to employment.

The democratically elected Government of South Africa (SA) realised, as early as 1995, the importance of SMEs to the economy. The White Paper on National Strategy for the Development and Promotion of Small Business in South Africa (1995) highlighted the fact that "Small, medium and micro enterprises represent an important vehicle to address the challenges of job creation, economic growth and equity in our country".

2. Background

Despite their significant importance and SME contribution to economic growth, SMEs across the whole world, and in SA in particular, are still faced with numerous challenges that inhibit entrepreneurial growth. Apart from SME funding and access to finance (which is the focus of this study), the Global Entrepreneurship Monitor (GEM) Reports (2001-2010) noted that SA SMEs also suffer from poor management skills which is a result of lack of adequate training and education. This results in high rates of business failure (SA has one of the lowest SMEs survival rates in the world).

[1] According to Daniels, 1994; Daniels &Ngwira, 1992; Daniels &Fisseha, 1992; Fisseha, 1992; Fisseha& McPherson, 1991; Gallagher & Robson.

This study investigates the extent of access to credit and support by SMEs in SA. The study was commissioned by the National Credit Regulator (NCR) and it seeks to understand what has been researched and written on SME access to credit and support in relation to juristic persons as defined by the National Credit Act (NCA). The study is intended to assist the NCR make policy proposal to the Minister for the Department of Trade and Industry (the dti) on matters affecting the consumer credit industry in order to improve access to credit for persons contemplated in the Act.

3. Study Methodology

This report is entitled *"Literature Review on Small Medium and Enterprises' Access to Credit and Support in South Africa"*. As the title suggests, the methodology adopted for this study is the literature review. A research literature review is a systematic, explicit and reproducible method for identifying, evaluating and synthesizing the existing body of completed and recorded work produced by researchers, scholars and practitioners. This report provides an organised critical account of information, ideas and knowledge that has been published (or is available in the public domain) on SME access to credit.

The main limitation of the literature review, as a study methodology, is that it relies on information which has already been researched (secondary information), and if there is none, then specific questions on the new study might not be adequately answered. Secondly, owing to different objectives and methodologies (and study designs) of previous studies, the data might not be in the right format or specific enough to answer the current study. Because of these limitations, a literature review is always conducted in preparation for primary and more detailed research.

Despite the above limitations, this study employed the literature review process in a systematic way following the "input-processing-output" approach. This involves sequential steps to collect, know, comprehend, apply, analyse, synthesize and evaluate quality literature in order to provide a firm foundation to the topic under study.

4. Access to Credit Gap

The main objective of the study is to assess the access to credit and support by SMEs in SA. The main research question was *"Is there an SME financing gap in South Africa?"* The term "financing gap" refers to a situation where a sizeable proportion of economically significant SMEs cannot obtain financing from banks, capital markets or other suppliers of finance. Furthermore, it is often alleged that (i) many entrepreneurs or SMEs that do not currently have access to funds would have the capability to use those funds productively if the funds were available; (ii) but due to structural characteristics, the formal financial system does not provide finance to such entities.

To adequately answer the question "Is there an SME financing gap in SA?", the study divided the SME sector into two markets; (i) demand for and (ii) supply of credit. The analysis reveals that, just as for the rest of the SA economy, the SME sector is divided into two; (i) the first economy (where formal SMEs are operating) and (ii) the second economy (informal SMEs).

Using the definition of financing gap given above, only formal SMEs (by virtue of being formally registered and having a bank account) have access to banks, capital markets or other suppliers of finance. Informal SMEs are excluded completely from the formal financial market.

Financing gap in terms of SME numbers

Description	Number of SMEs		
	FinScore Survey (2010)	**Stats SA LFS (2007)**	**Label**
Total SMEs	5 979 510	2 432 000	A
Registered SMEs (Formal): 17.3%	1 034 455	420 736	B
Ave applying for a loan: 84.4%	873 080	355 101	C
Avge loan application success rate (Formal): 33.2%	343 439	139 684	D
Those who receive funds after succeful appl: 27.3%	93 759	38 134	E
Financing Gap (C-E)	779 321	316 967	F
Total Informal: 41.8%	2 334 439	1 016 576	G
Less: Informall served (15.3%)	357 169	155 536	H
Total Financially Excluded (G-H)	1 977 270	861 040	I
Total Financing Gap (Formal and Infromal): F+I	**2 756 591**	**1 178 007**	**J**

Source: Author's calculations based on the figures above and analysis of the literature

Based on the above table, SA has between 2,4 to 6 million SMEs. Around 20% of these SMEs are registered with Companies and Intellectual Property Commission (CIPC)[2] and have a bank account. Of the formal SMEs, less than 100,000 (27.3%) successfully apply and receive funds from the formal financial sector. Almost half of the SMEs are not registered hence are operating informally. Owing to their informality, most (84.7%) of them are financially excluded. That is, they do not have access to the formal financial markets. Thus, the total financing gap (both formal and informal SMEs) is estimated at around 45-48% of all SMEs in South Africa.

[2] The Commission was formerly established on the 1st of May 2011 as per the New Companies Act (Act 71 of 2008). The Commission brings together skills, knowledge and manpower from the Office of Companies and Intellectual Property Enforcement (OCIPE) and the Companies and Intellectual Property Registration Office (CIPRO).

The broad picture that emerges from the various surveys of SME financing "strongly suggest that business owners in South Africa view access to financing as a significant problem for business activity" (Turner et al, 2008: 15), i.e. that there might be a "financing gap" despite the various public and private sector initiatives to facilitate access to financing. Respondents to the FinScope Small Business Survey (2010), however, when asked to identify the single most significant obstacle to growth, access to finance ranked third[3] with 8.7% of small business owners citing the lack of access to finance as a reason[4]. This finding may be attributable to the fact that South Africa has a relatively well developed financial sector with a ratio of domestic credit to GDP of 78%.

This study's analysis of supply side of the SME credit market reveals that South Africa has a variety of funding programmes and financing schemes by both the public and private sector funding agencies. It was also noted that despite the availability of an array of funding programmes, awareness of these programmes and the uptake has been very low (DTI, 2008), especially for Government supported schemes. For those SMEs who apply for finance, the rejection rate has been high, particularly for bank sponsored schemes. There seems to be: (i) a general lack of awareness of the funding programmes; (ii) a mismatch between the products offered on the supply side and that which is required by the SME market; and (iii) a gap between the minimum requirements for a business loan and status (especially on the issue of formality) of the majority of SMEs. This means that even registered microenterprises are less likely to have access to credit. Furthermore, a large proportion of the SMEs are completely excluded from the financial market.

Even those SMEs who are in the formal market, a further complication faced by entrepreneurs trying to access finance is that banks are not set up to cope with small loans. For example, only 59% of small and medium enterprises had any credit products as compared to 82% for large firms. Micro finance institutions (MFIs), on the other hand, do have structures in place for smaller loans, but the loans are at high interest rates that most small businesses cannot afford. Other factors inhibiting SMEs' access to credit include the lack of business managerial experience and skills, insufficient information on available products, relatively low levels of financial literacy, poor business plans and other external factors.

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[3]Access to finance was more likely to be identified as an obstacle to growth in Mpumalanga and the Northern Cape.

[4] Space to operate ranked highest with 16.2% citing this as a significant obstacle followed by competition (12.5%). Approximately one in 5 small business owners responded that there were no obstacles to growing their business (FinScope 2010). A survey conducted by the Centre for Development of Enterprise (CDE);in 2007 of Sowetan entrepreneurs in 2007 to get a picture of what the entrepreneurs considered to be obstacles to their success found that crime, infrastructure, informality and regulation, corruption, labour problems, increased competition and negative public perceptions were considered to be the major obstacles (CDE, 2007b: 5-7 as cited in the DTI, 2008: 49).

5. Conclusion and Recommendations

The literature review revealed that there are a number of sources of credit for SMEs. However, it is not possible to determine with any degree of accuracy whether the financing available is sufficient to meet the needs of the SME sector due to the lack of information, especially with regard to the demand side and the specific causes for the lack of access. Therefore, more research is needed in this area to (1) identify the specific needs of the SME sector when it comes to financing and (2) whether the financing available meets those needs in terms of both "quantity" and "quality".

There is a possibility that there is sufficient credit being made available, but the terms and conditions under which it can be accessed are not favourable for the SME sector it is intended to serve. In other words, there is sufficient "quantities" of funding available, but the "quality" of funding (i.e. the product design/services being offered) does not match the needs of the sector. In this case, the policy response should not be designed to increasing the amount of credit available to the sector, but should involve revisiting the product offering of the credit already available and ensuring that it meets the needs of the SME sector it is intended to serve.

Another possibility that needs consideration is that in which credit is available and sufficient to meet demand, but the lack of access is attributable either to the specific characteristics of the SMEs applying for the loan or the lack of awareness that the financing is available. In these instances, the policy response required would necessarily be different from that of increasing funding available, or indeed, changing product design/service offering.

If there is, in fact, a shortage of finance (quantity of loanable funds), the Government can increase the supply of funds through funding of existing agencies like the National Youth Development Agency (NYDA), Khula and other Government owned institutions.

With regard to the scenario where sufficient credit is available, but the terms and conditions of accessing the financing is problematic for the SMEs due to poor product design/service offering, then interventions will need to address this particular deficiency. With respect to private entities, it is hoped that competition and the desire to increase returns from catering to this segment will improve product design and services offered. For Government funded programmes, the evaluation and monitoring of the various schemes and programmes on a regular basis should help the Government keep abreast of the applicability of the various programmes and schemes.

Thirdly, with respect to situations where credit is available, but access is constrained by SME specific factors, then interventions will have to be targeted to deal with these specific SME characteristics. To summarise, the characteristics being referred to relate to: (1) the lack of information available with respect to the business, or where there is information available the information is of very poor quality; (2) the lack of collateral; (3) the failure to access financial services, including credit, due to various perceptions small business owners have of the requirements needed for access; (4) the poor level of managerial competence and skills of the small business owner; (5) the age of the enterprise; and (6) the legal status of the enterprise.

The main recommendations arising from the study are interventions that focus on:

(i) Increasing the levels of formality of SMEs – this can be achieved through the compulsory registration of SMEs that have not yet registered, at minimal or no cost to the SME.

(ii) Training and capacity building – building on current programs and establishing new ones if warranted to improve the levels of managerial competence of the small business owner.

(iii) Establishing of a Government department to deal specifically with SMEs, entrepreneurship and support to this sector.

(iv) The monitoring and evaluation by Government of its SME funding programmes on a regular basis. This will help the Government keep abreast of the applicability of the various programmes and schemes. The immediate objective of the evaluation of current programmes and schemes is identifying the reasons why awareness and uptake has been low.

1 INTRODUCTION

1.1 Introduction

There is consensus among policy makers, economists and business experts that small and medium enterprises (SMEs) are drivers of economic growth. A healthy SME sector contributes prominently to the economy through creating more employment opportunities, generating higher production volumes, increasing exports and introducing innovation and entrepreneurship skills. According to Bashir Ahmad Fida (2008), SMEs are the first step towards development in economies towards industrialisation. The dynamic role of SMEs in developing countries positions SMEs as engines through which the growth objectives of developing countries can be achieved – a role that has long been recognised.

One of the significant characteristics of a flourishing and growing economy is a vibrant and blooming SME sector. SMEs play a pivotal role in the development of a nation. They contribute to socio-economic development in various ways; namely, by creating employment for a rural and urban growing labour force and providing desirable sustainability and innovation in the economy as a whole. Fayad (2008) propounds that most of the current multi-million dollar enterprises have their origin in SMEs. Nevertheless, SMEs in developed and less developed countries (LDCs), as in other countries, are still facing a number of difficulties and obstacles that are impeding and complicating their operations and growth.

1.2 Importance of SMEs in the economy

The value of the small business sector is recognised in economies world-wide, irrespective of the economy's developmental stage. The contribution towards growth, job creation and social progress is valued highly and small business is regarded as an essential element in a successful formula for achieving economic growth (Vosloo, 1994: i). It is estimated that SMEs employ 22% of the adult population in developing countries (Daniels, 1994; Daniels & Ngwira, 1992; Daniels & Fisseha, 1992; Fisseha, 1992; Fisseha & McPherson, 1991; Gallagher & Robson). UNIDO (1999) estimates that SMEs represent over 90% of private business and contribute to more than 50% of employment and of GDP in most African countries.

An earlier study by the Competition Commission (2004) estimated that 99.3% of South African businesses were SMEs and that these SMEs accounted for 53.9% of total employment and contributed 34.8% to GDP.

Table 1: Contribution of SA SMEs to the economy

%	Survivorlist	Micro(0)	Micro (1-4)	Very Small	Small Enterprises	Medium Enterprises	Large
Numbers of Firms	19.6	31.3	19.8	20.5	6.8	1.3	0.7
Employment	2.2	3.5	6.5	13	15.7	13	46.1
GDP	5.8			13.9		15	65.2

Source: Falkena et al. (2004)

The World Bank (2007), however, estimated that the SME contribution to employment generation was 39% in South Africa. China's SME sector contributed 78% to its total employment.

Table 2: SME participation and contribution to the economy (selected countries)

Country Name	Structure of the MSME Sector (% of all MSMEs)			SME Participation in the Economy		
	Micro	Small	Medium	SMEs	SMEs per 1,000 people	SME employment (% total)
Brazil	93.9	5.6	0.5	4 903 268	27.4	67.0
China	n/a	n/a	n/a	8 000 000	6.3	78.0
Egypt	92.7	6.1	0.9	1 649 794	26.8	73.5
United Kingdom	95.4	3.9	0.7	4 415 260	73.8	39.6
Ghana	55.3	42.0	2.7	25 679	1.2	66.0
India	94.0	3.3		295 098	0.3	66.9
Mexico				2 891 300	27.9	71.9
Malawi	91.3	8.5	0.2	747 396	72.5	38.0
Russian Federation				6 891 300	48.8	50.5
United States	78.8	19.7	1.5	5 868 737	20.0	50.9
South Africa	92.0	7.0	1.0	900 683	22.0	39.0

Source: World Bank (2007)

A recent study conducted by Abor and Quartey (2010) estimates that 91% of the formal business entities in South Africa are SMEs and that these SMEs contribute between 52 to 57% to GDP and account for approximately 61% of employment.

The 2009 GEM report emphasises that "… there is a very tight correlation between the level of entrepreneurship in a country and its rate of economic growth".

Bartel and Martin (1990: 775) state that a major reason why entrepreneurship has been receiving increased attention from both scholars and the public press is the growing recognition of the substantial economic and social contributions entrepreneurship brings. The economic contributions include economic growth, maintaining a favourable balance of payments and balance of trade and employment creation. Socially, entrepreneurship results in poverty eradication and improved standards of living. SMEs are, therefore, an essential panacea for improving the standards of living in a society and the stability of a country.

The democratically elected Government of South Africa realised as early as 1995 the importance of SMEs to the economy. Trevor Manuel, then Minister of Trade and Industry, clearly articulated these issues when he said:

> *"With millions of South Africans unemployed and underemployed, the Government has no option but to give its full attention to the task of job creation, and generating sustainable and equitable growth."*
>
> *"Small, medium and micro-enterprises represent an important vehicle to address the challenges of job creation, economic growth and equity in our country."*
>
> *"We believe that the real engine of sustainable and equitable growth in this country is the private sector. We are committed to doing all we can to help create an environment in which businesses can get on with their job."*
>
> (Extracts from the White Paper on National Strategy for the Development and Promotion of Small Business in South Africa)

Despite this acknowledged importance and SME contribution to economic growth, SMEs across the globe, and in South Africa in particular, are still faced with numerous challenges that inhibit entrepreneurial growth. Apart from SME funding and access to finance, the GEM Reports (2001-2010) noted that South African SMEs also suffer from poor management skills, which is a result of a lack of adequate training and education. This results in high rates of business failure - SA has one of the lowest SMEs survival rates in the world.

This study investigates the extent of access to credit and support for SMEs in South Africa. The study was commissioned by the NCR, and it seeks to understand what has been researched and written on SME access to credit and support in relation to juristic persons as defined by the NCA. The study is intended to assist the NCR in making policy proposals to the Minister of the Department of Trade and Industry (the dti) on matters affecting the consumer credit industry in order to improve access to credit for persons contemplated in the Act.

The report is structured as follows. This section introduces the report and offers some background information. The following section summaries the methodology adopted in this study. Section 3 presents an overview of the characteristics and definitions of SMEs from an international perspective and then South Africa.

The main findings of the study are discussed in Section 4 and 5. Section 4 estimates the market size of SME and the demand for credit, whilst Section 5 presents the supply side of the market. Section 6 investigates the possibility of an SME access to financing gap and Section 7 concludes with some policy recommendations.

It is also important for the reader to take note of the Annexures to this report. Almost all sections in the main report have a detailed Annexure (A-F), which offers valuable background information. In summary, the annexures are presented as follows; Annexure A provides the terms of reference (ToR) to this assignment while Annexure B details the background to the project. Annexure C presents an evaluation of selected SME schemes. This evaluation helps understand why most of the Government schemes are not performing well and gives an insight on what to be done to increase SME uptake on these programmes. Annexure D provides a summary of provincial funding programmes. Annexure E and F revisit the issue of SME definitions, chronicle the subject from an international perspective, and conclude with the local SME classifications.

2 STUDY METHODOLOGY

2.1 Background

2.1.1 Project rationale

The NCR seeks to understand what has been researched and written on SME access to credit and support in relation to juristic persons as defined by the NCA. The proposed project is a literature review on “Small Medium and Enterprises’ Access to Credit and Support in South Africa”. It is intended to assist the NCR in making policy proposals to the Minister on matters affecting the consumer credit industry in order to improve access to credit for persons contemplated in the Act. **Therefore, the main objective of the proposed research is to assess and measure how small and medium enterprises have access to credit and support in South Africa.**

2.1.2 Problem statement

The NCR noted that there is a body of literature in the SME support and development space that sought to bring to the fore the challenges, dynamics and funding issues faced by small enterprises. Furthermore, there are Government policy programmes geared towards the support and funding of small enterprises through a variety of funding agencies and institutions. However, it remains unknown the extent to which these initiatives have succeeded in addressing the funding and support challenges faced by SMEs or juristic persons as defined by the NCA.

2.1.3 Study objectives

The study seeks to understand what has been researched and written on SME access to credit and support in relation to juristic persons as defined by the NCA. Therefore, the main objective of the paper is to assess and measure the access to credit and support by SMEs in South Africa.

2.1.4 Scope of the study

The project (study) is entitled: “Literature Review on Small Medium and Enterprises’ Access to Credit and Support in South Africa”. The scope of the study is SME access to credit in South Africa. However, to gain a thorough understanding of the South African SME market, a benchmarking exercise is carried out between South African SMEs and other countries.

According to the Terms of Reference (ToR), the scope of work on this assignment includes:

i. Conducting detailed quantitative and in-depth research into the SME industry;
ii. Identifying suitable publications (e.g. journals, books, Government documents and popular media);
iii. Conducting desktop research of other related research already conducted by other institutions; and
iv. Assessing the SMEs access to credit support gap in South Africa.

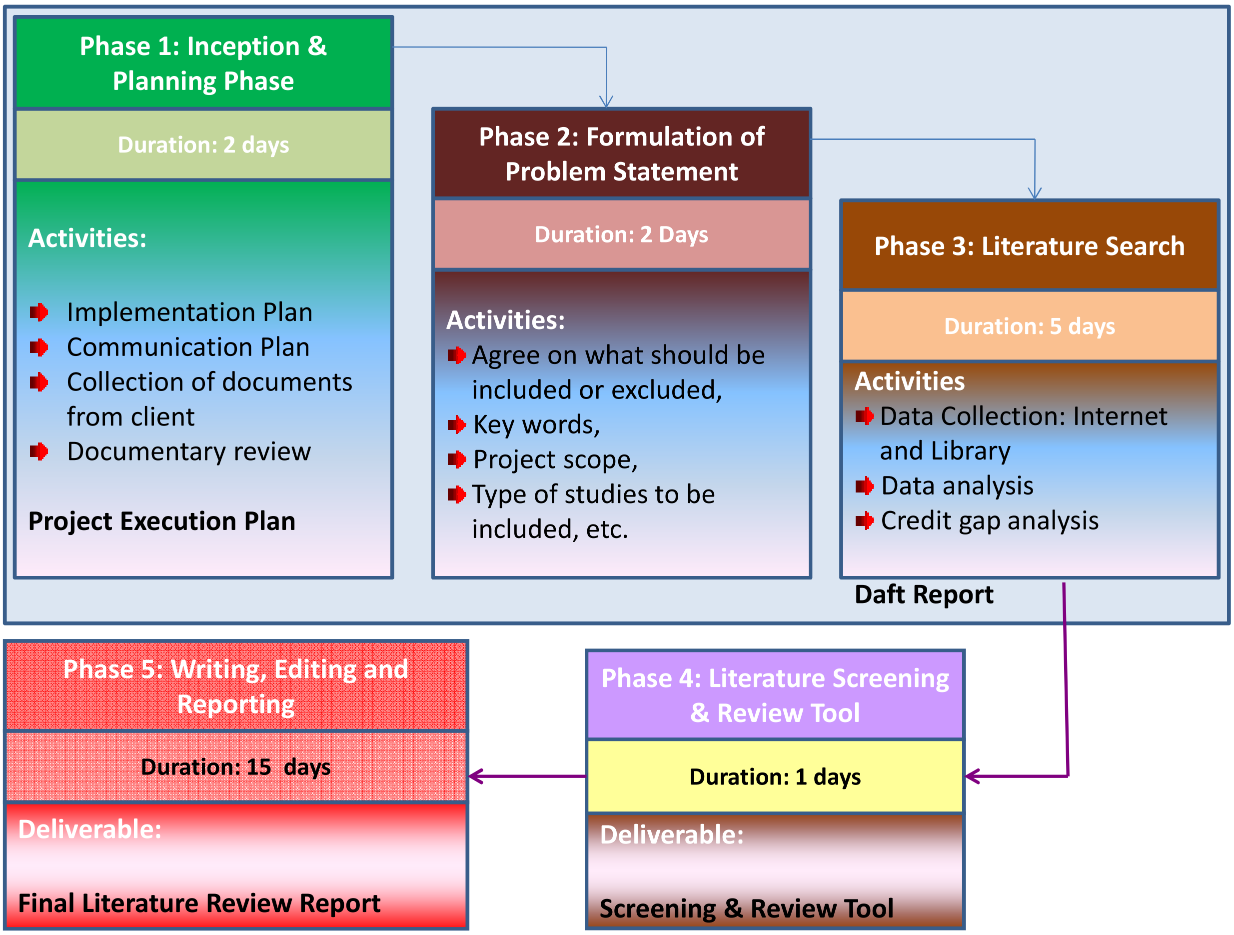
2.2 Study Methodology: Literature and Document Review

2.2.1 Introduction

The methodology adopted for this study is the literature review. A research literature review, as a process, is a systematic, explicit, and reproducible method for identifying, evaluating and synthesising the existing body of completed and recorded work produced by researchers, scholars and practitioners (Fink, 2010). As a noun, literature review is an organised critical account of information that has been published on a specific topic, (for example, SME access to credit) and provides an organised synthesis of the information, ideas and knowledge.

The methodological approach is illustrated below (Figure 1). It involves both quantitative and qualitative analysis of secondary data.

Figure 1: Methodological Approach



Source: Author's illustration

2.2.2 Literature search

A comprehensive literature search of published academic, peer reviewed professional literature using a variety of databases including journal articles, conference papers, books, dissertations and technical papers, both published and unpublished, was conducted. The main sources included libraries - both public and university (University of Pretoria, UNISA) libraries and the Internet. Literature reviewed included:

i. Published journal articles, working papers and other theoretical publications on SME access to credit;
ii. Papers/articles found on the websites for suppliers of credit, development financial institutions, banks and other funders; and
iii. Papers/articles found on the websites for credit regulators and SME advocacy organisations.

The collected data or information was categorised in groups, for example, the definition of SME was viewed within a global, regional and South African context. Various definitions were explored and analysed for their inclination and specificity to developing countries. Most of the literature search was based on what others have come up with concerning SMEs' access to credit in general and focusing on the South African context. This approach helped the researchers to bring to the fore a developed countries' concept of SMEs and less developed countries context. In conducting the literature search the main focus was to identify the critical drivers of SME failure in accessing credit, what constitutes credit support and what the challenges are for both SMEs and fund managers. While the literature research was being conducted, every effort was made to ensure that the sources were as relevant and focused on the subject at hand as possible. The GEM reports and publications from SA development financial institutions were drawn for comparison with similar state or private institutions. The literature sources were also categorised accordingly either as quantitative (e.g. those focusing on methodology or policy) or qualitative (e.g. case studies) for easy analysis and summarisation. The literature search was broad enough to cover all relevant detail.

2.2.3 Thematic content analysis

The content analysis focused on literature relevant to make recommendations to policy makers, development agencies, entrepreneurs and SME managers to ascertain the appropriate strategy to improve the SME sector in SA. The methodology employed by different authors and researchers was also put under the spotlight. For example, case study research excels at bringing us an understanding of a complex issue or object and can extend experience or add strength to what is already known through previous research. Case studies focus on a detailed contextual analysis of a limited number of events or conditions and their relationships. Qualitative reports, based on case study methodology, were used in the literature review. On the other end of the spectrum, survey reports (mainly quantitative) such as the GEM reports, adult population surveys (APS) and FinScope were also used to assess the level of entrepreneurship of and access to credit by SMEs. Just like the GEM reports, this study also consulted international data sources such as the World Bank (WB), International Finance Corporation (IFC), the International Monetary Fund (IMF) and the United Nations (UN) in reviewing international best practice on SME funding and support.

2.3 Methodological Limitations

The main limitation of the literature review as a study methodology is that it relies on the information which has already been researched (secondary information), and if there is none, then specific questions on the new study might not be adequately answered. Secondly, owing to different objectives and methodologies (and study designs) of previous studies, the data might not be in the right format or specific enough to answer the objectives of the current study. Because of these limitations, a literature review is always conducted in preparation for primary research.

In spite of the growing number of papers and articles that have been written about small, medium and micro-enterprises (SMMEs) in South Africa, very little is really known about them. The Statistics South Africa Labour Force Survey estimated that there were a total of 2,4 million small business in 2007. According to a 2009 *Sunday Times* (20 September 2009)[5] article, there were 2,4 million registered companies in South Africa of which 2,2 million were SMEs. The latest FinScope Survey (2010) found that there are currently approximately 6 million small businesses in South Africa. However, it is almost impossible to obtain accurate statistics of small business in each category (namely micro, small and medium), or in the various sectors of the economy. This information is unavailable on both a provincial and country-wide level. The lack of accurate data makes the assessment and quantification of access to credit gap a mammoth task. It also hampers research and the ability of Government agencies and nongovernmental organisations (NGOs) to offer the correct targeted assistance to businesses in the small, medium and micro arena.

The lack of data is particularly noticeable among unregistered businesses that employ either casual labour or offer employment only to the owner. While in many developed countries these businesses are considered marginal in their contribution to employment and GDP, in South Africa (as in many developing countries) these informal and micro-enterprises are key to the livelihood and survival of millions of people[6].

Adding to the confusion and difficulties in SME measurement and general understanding are the differences in definitions. As will be highlighted in the section below, there are several definitions used in international literature and in most of the empirical studies (or surveys) carried out in SA. For example, the most constant and widely quoted survey, the GEM Reports, measure entrepreneurship, and not the number of SMEs, to make international comparisons on the rate of entrepreneurship across countries. On the other hand, most of the Government agencies use the dti definition[7], but a recent FinScope Survey (2010) used a slightly different definition[8].

[5]http://www.gemconsortium.org/download/1322826213035/GEM%20SA%202009%20-%20Tracking%20Entrepreneurship....pdf
6 South Africa GEM Report (2009)
[7] As defined in the National Small Business Amendment Act of of 1996 as amended in 2003 and 2004. See Section 3, below.
[8] FinScope definition of a small business owner:

- 16 years or older;
- perceiving themselves to be business owners/generating an income through small business activities; and
- Employing less than 200 employees.

3 DEFINITIONS OF SMES

3.1 International Overview

While the importance of the SME sector and the informal sector is acknowledged internationally, defining an SME is a challenging task, as every country has its own definition. There is no single, uniformly accepted definition of a small firm (Storey, 1994). Firms differ in their levels of capitalisation, sales and employment. Hence, definitions which employ measures of size (e.g. number of employees, turnover, profitability and net worth) when applied to one sector might lead to all firms being classified as small, while the same size definition when applied to a different sector might lead to a different result.

This section provides a broad overview of small enterprise definitions used across the globe with the objective of understanding what an SME really is[9]. This understanding will go a long way in comparing and benchmarking results from different studies.

SME definitions can be broadly categorised into two, "economic" and "statistical" definitions. Under the economic definition, a firm is regarded as small if it meets the following three criteria: (1) it has a relatively small share of their market place; (2) it is managed by owners, or part owners, in a personalised way and not through the medium of a formalised management structure; and (3) it is independent in that it is not part of a larger enterprise.

The "statistical" definition, on the other hand, is used in three main areas: (1) quantifying the size of the small firm sector and its contribution to GDP, employment and exports; (2) comparing the extent to which the small firm sector's economic contribution has changed over time; and (3) in a cross-country comparison of the small firms' economic contribution. These definitions, however, have a number of weaknesses. For example, the economic definition, which states that a small business is managed by its owners or part owners in a personalised way and not through the medium of a formal management structure, is incompatible with its statistical definition of a small manufacturing firm which might have up to 200 employees.

According to UNIDO[10], the definition of SMEs is a significant issue for policy development and implementation and depends primarily on the purpose of the classification. For the purposes of policy development, UNIDO generally advises countries to take into account the quantitative and qualitative

[9] See Annexure E and F for a more detailed discussion on SME Definitions.
[10] http://www.abj.org.jo/AOB_Images/633547381649218750.pdf

indicators for SME definition. The following table summarises the main qualitative indicators that may be used in order to differentiate between SMEs and large companies.

Table 3: Application for Qualitative Indicators

Category	SMEs	Large Companies
Management	•Proprietor entrepreneurship •Functions-linked personality	•Manager-entrepreneurship • Division of labour by subject matters
Personnel	•Lack of university graduates • All-round knowledge	•Dominance of university graduates • Specialisation
Organisation Sales Buyer's relationships Production Research development	•Highly personalized contacts •Competitive position not defined and uncertain •Unstable •Labour intensive •Following the market, intuitive approach	•Highly formalised communication •Strong competitive position •Based on long-term contracts •Capital intensive, economies of scale •Institutionalised
Finance	•Role of family funds, self financing	•Diversified ownership structure, access to anonymous capital market

Source: UNIDO[11]

It is also important at this juncture to define entrepreneurship[12]. Put simply, 'entrepreneurship' is the creation of new enterprise, which includes SMEs[13].

Table 4: Synopsis of SME Definitions by Region

						BRIC					
	EU	USA	ASIA(Mlysia)	EGYPT	GHANA	BRAZIL		RUSSIA	INDIA	CHINA	RSA
						Industrial	Commercial				
WORDS	Small and Medium Enterprise	Small and Medium Business	Small and Medium Enterprise	Micro,Small and Medium Enterprises	Micro,Small and Medium Enterprises	Small and Medium Enterprise	Small and Medium Enterprise	Small and Medium Enterprise	Micro,Small and Medium Enterprise	Small and Medium Enterprise	Small, Medium and Micro Enterprise
# of EMPLOYEES											
Micro	< 10	0	< 5	1 to 4	up to 5	Up to 19	Up to 09	0	0	0	< 20
Small	< 50	<100	5 to 50	5 to 14	6 to 29	20 to 99	10 to 49	15 to 100	0	<300	50-99
Medium	< 250	<500	51 to 150	15 to 49	30 to 99	100 to 499	50 to 99	101 to 250	0	300 to 2000	100-200
TURNOVER											
Micro	$3m	0	RM250.000	0	$10 k	0	0	0	<Rs50m	0	<R150k
Small	$13m	0	RM250.000 to< RM10m	0	$100k	0	0	400 m RUB max	Rs50-60m	<Y30	R2m to R4.5m
Medium	$67m	0	RM 10m to RM 25	0	$1million	0	0	1 B RUB max	Rs60-99m	Y30 to Y300m	R4.5 to R50m

Source: Author's compilation from various sources

[11] http://www.abj.org.jo/AOB_Images/633547381649218750.pdf
[12] The Global Entrepreneurship Monitor (GEM) Reports, one of the main sources of data for this study, tracks the level of entrepreneurship in a country.
[13] http://www.gemconsortium.org/download/1322827631223/GEM%20SA%202009%20-%20Tracking%20Entrepreneurship....pdf

The abbreviation "SME" occurs commonly in the European Union (EU) and in international organisations such as the World Bank (WB), the United Nations (UN) and the World Trade Organisation (WTO). The term "small and medium businesses" or "SMBs" is predominantly used in the USA. In South Africa the term is “SMME” for small, medium and micro-enterprises, and elsewhere in Africa, MSME is used for micro, small and medium enterprises.

3.2 Defining an SME in South Africa

3.2.1 The “official” definition

Like other countries, the issue of what constitutes a small or medium enterprise is a major concern in SA. Various authors have usually given different definitions to this category of business. “A common definition of SMEs includes registered businesses with less than 250 employees” (IFC, 2009: 9). In practice, SMEs are defined in a number of different ways, generally with reference either to the number of employees or to turnover bands (or a combination of both, as in the National Small Business Act 1996, which also allows for variations according to industry sector). The definition of SMEs by size is necessary, but it is not sufficient for an understanding of a sector where the realities are not only complex, but also dynamic.

In SA, a ‘small business’ is official defined in Section 1 of the National Small Business Act of 1996 as amended by the National Small Business Amendment Acts of 2003 and 2004 (NSB Act) as:

> *“ … a separate and distinct business entity, including co-operative enterprises and nongovernmental organisations, managed by one owner or more which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or sub sector of the economy mentioned in Column I of the Schedule[14]... ”.*

The NSB Act further categories small businesses in SA into distinct groups, namely; survivalist, micro, very small, small and medium, hence the use of the term “SMME” for small, medium and micro-enterprises. However, the terms ‘SMME’ and ‘SME’ are used interchangeably in SA. The SME definition uses the number of employees (the most common mode of definition) per enterprise size category combined with the annual turnover categories, the gross assets excluding fixed property; as summarised in Table 5 below.

[14] See Annexure F.

Table 5: Broad Definitions of SMMEs in the National Small Business Act

Enterprise Size	Number of Employees	Annual Turnover(S A. Rand)	Gross Assets, Excluding Fixed Property
Medium	Fewer than 100 to 200,depending on Industry	Less than R4 million to R50 m depending upon Industry	Less than R2 m to R18 m depending on Industry
Small	Fewer than 50	Less than R2m to R25 m depending on Industry	Less than R2m to R4.5 m depending on Industry
Very Small	Fewer than 10 to 20 depending on Industry	Less than R200 000 to R500 000 depending on Industry	Less than R150 000 to R500 000 depending on Industry
Micro	Fewer than 5	Less than R150 000	Less than R100 000

Source: Falkena et al., (2001)

i. **Survivalist enterprise:** The income generated is less than the minimum income standard or the poverty line. This category is considered pre-entrepreneurial, and includes hawkers, vendors and subsistence farmers. In practice, survivalist enterprises are often categorised as part of the micro-enterprise sector.

ii. **Micro-enterprise:** The turnover is less than the value added tax (VAT) registration limit (that is, R150,000 per year). These enterprises usually lack formality in terms of registration. They include, for example, *spaza* shops, minibus taxis and household industries. They employ no more than 5 people.

iii. **Very small enterprise:** These are enterprises employing fewer than 10 paid employees, except for the mining, electricity, manufacturing and construction sectors, in which the figure is 20 employees. These enterprises operate in the formal market and have access to technology.

iv. **Small enterprise:** The upper limit is 50 employees. Small enterprises are generally more established than very small enterprises and exhibit more complex business practices.

v. **Medium enterprise:** The maximum number of employees is 100 or 200 for the mining, electricity, manufacturing and construction sectors. These enterprises are often characterised by the decentralisation of power to an additional management layer.

The NCA, which established the NCR, adopts and uses the definition of small business in the NSB Act, 1996 as amended and categorises any lending to small business as developmental credit. The NCA uses the NSB Act definition for small business, and it further distinguishes between natural and juristic persons.

Table 6: NCA Definition (Juristic Persons)

Natural persons	Juristic persons
• Personal customers • Sole proprietors • Trusts with two or less natural person trustees	• Partnerships • Close corporations • Companies • Trusts[15] with three or more trustees

Source: NCA (2006)

Only certain provisions of the NCA apply to juristic persons. Provisions relating to marketing, over indebtedness and reckless credit do not apply to juristic persons. The NCA in its entirety does not apply to juristic persons with an asset value or annual turnover of more than R1 million, nor does it apply to juristic persons with an asset value or annual turnover of less than R1 million who enter into a mortgage agreement or an agreement with a loan value of more than R250,000. Thus, the NCA only covers small business which are sole proprietors, partnerships, close corporations, companies and trusts with an annual turnover of R1 million or less and enters into a loan agreement of not more than R250,000.

3.2.2 A common understanding of SMEs?

Compared to developed-country standards, SA thresholds are low. Many businesses which Americans or Europeans regard as SMEs would be regarded as large enterprises in South Africa. Moreover, the fact that the NSB Act distinguishes between enterprises in the different economic sectors and further uses different thresholds for the different sectors is an acknowledgement that what is considered "small" in the different economic sectors will vary depending on the nature of the activity undertaken.

Despite the categorisations having been stipulated in the Act, these categories are not used consistently by state agencies or by private sector data-bases and research studies, making comparisons difficult and unreliable. Moreover, the qualification in the dti's Annual Review of Small Business in South Africa 2005 – 2007 (2008: 4) that the "report will embrace as comprehensive a definition of small businesses as possible, provided that the economic activity remains below the thresholds for a large enterprise" is indicative of the fact that there is no common understanding and/or definition.

The dti report goes on to state that "the terms 'small business' and 'SMME' are used as synonyms, whereas the term 'enterprise' refers specifically to entities (especially close corporations, cooperatives

[15] but does not include a stokvel.

and companies) registered with CIPRO" (DTI, 2008: 4) emphasising the fact that there are different concepts of businesses. For statistical purposes, it would make a great deal of sense for the various data-gathering bodies in the public and private sectors to arrive at, and use, agreed categories covering the SME sector (SBP, 2000b).

3.3 SA Policy and Institutional Framework

3.3.1 Background

For the past fifteen years, the South African Government has invested in a plethora of initiatives aimed at supporting and growing the SME sector. South Africa's small business policy was principally informed by the 1995 "White Paper on national strategy on the development and promotion of small business in South Africa" (Timms, 2011: 20). The 1995 White Paper outlined, among other things, the need for the Government to create an enabling legal framework, facilitate access to information and advice, boost procurement from small firms and to improve access to finance and affordable physical infrastructure.

On the policy front, the NSB Act was passed in 1996, and stipulations pertaining to the sector were built into the Broad Based Black Economic Empowerment (BBBEE) Codes of Good Practice (SBP, 2009a). The objectives of the 1995 White Paper now finds practical expression in the Integrated Small Business Development Strategy for 2005 to 2014. The strategy is based on three pillars:

- Increasing the supply of financial and non-financial support;
- Creating demand for SMME products/services; and
- Reducing regulatory constraints.

3.3.2 The institutional framework

The Government's main agencies and funds are distributed across mainly five different departments: (1) the Department of Trade and Industry (the dti); (2) the Department of Economic Development (DED); (3) the Department of Science and Technology (DST); (4) the Presidency; and (5) the Department of Agriculture[16].

[16] See Annexure D for a brief description of the provincial institutions.

3.3.2.1. Department of Trade and Industry (the dti) - www.thedti.gov.za

Small business falls under the Minister of Trade and Industry and specifically under two of the Department's units; the Enterprise Organisation and the Empowerment and Enterprise Development Division. The department has various entities under it, namely:

i) Small Enterprise Development Agency (Seda) - www.seda.org.za

An agency of the dti mandated to support small enterprises, Seda, was formed out of a merger between Ntsika Enterprise Promotion Agency, National Manufacturing Advisory Centre (Namac) and the Community Public Private Partnership Programme (CPPP). The Godisa Trust and the Technology Programmes were integrated into Seda in 2006, becoming Seda Technology Programme (STP).

ii) National Empowerment Fund (NEF) – www.nefcorp.co.za

Set up in 1998 and operational in 2004, the NEF aims to fund black-owned and empower (both big and small) businesses. Between 2003 and March 31 2010, the fund made 208 disbursements of over R1.5 billion. Of these, 156 worth R457 million went to small black-owned businesses or franchisees (through the Imbewu Fund).

iii) National Small Business Advisory Council (NSBAC)

The National Small Business Advisory Council (NSBAC)17, launched in 2006, falls under the dti and reports to the minister of Trade and Industry. The council has eight members and serves to advise the Minister on ways to boost support to small businesses. The first council collapsed after two years in 1998 amid allegations of mismanagement.

3.3.2.2. Department of Economic Development

The Department of Economic Development (DED) was set up in 2009 to co-ordinate the South African Government's economic policy. The Department oversees various entities, including:

i) Khula Finance Limited - www.khula.org.za

The Government's small business finance organisation was set up in 1996 to help fund small businesses. Khula is a wholesale finance institution which operates across the public and private sectors through a network of channels to supply funding to small business. Khula operates through a network of financial intermediaries across the country. Its channels include South Africa's leading commercial banks, retail financial institutions and specialist funds and joint ventures in which Khula itself is a participant. Its primary aim is to bridge the "funding gap" in the SME market not addressed by commercial financial institutions. Khula lending comprises of four (4) components;

[17] http://www.info.gov.za/speeches/2007/07070414151003.htm

a) Funding for retail financial institutions (RFI);
b) Credit guarantee scheme;
c) Equity capital; and
d) Gearing capital for public and private sector funds targeting small enterprises in specific sectors.

ii) Industrial Development Corporation (IDC) - www.idc.co.za

The Government's development finance institution was set up in 1940, and the funding of small businesses forms a large part of its mandate. The IDC falls under the Department of Economic Development. The IDC financed 159 small enterprises to the tune of R2.13 billion (from a total of R10.9 billion) in 2008/2009. This compares to 94 dispersals the year before, valued at R933 million (out of a total of R8.4 billion). One hundred and forty two of the net approvals during 2010 (67% of the total number of approvals) were for SMEs. R2.103 million (more than 23% of the total value of approvals) were for these SMEs (companies with fewer than 200 employees, turnover less than R51 million and/or less than R55 million total assets).

iii) SA Micro-finance Apex Fund (Samaf)

The South African Micro-Finance Apex Fund (Samaf) was established to provide access to micro-loans and support to the social capital mobilisation. Samaf is a wholesale funding institution tasked to facilitate the provision of affordable access to finance by micro, small and survivalist businesses for the purpose of growing their own income and asset base. The primary purpose of samaf is to reduce poverty and unemployment and also to extend financial services to reach deeper and broader into the rural and peri-urban areas. As a wholesale institution, samaf provides micro-finance to financial intermediaries such as Financial Services Cooperatives (FSCs) and MFIs who in turn on-lend to their members and clients. Therefore, anyone who wants to obtain a samaf-backed loan should first join an FSC or apply to the MFI for a loan. Samaf offers two types of loans via its financial intermediaries, microenterprise loans and development loans.

The Micro-enterprise loan is offered to financial intermediaries who then on-lend to poor people to establish and grow their micro survivalist businesses. To qualify, the loan applicant must earn not more that R3,500.00 per month. Development loans are aimed at FSCs and MFIs for on-lending to client households earning R1,500.00 and below per month. Clients can use development loans for paying school fees, medical fees and improvements to the household.

3.3.2.3. Department of Science and Technology

i) Technology Innovation Agency (TIA) - www.tia.org.za

A new umbrella body set up in 2009 and launched in 2010 for funding innovation includes the Tshumisano Trust which housed the technology transfer stations, the Innovation Fund, the Council for Scientific and Industrial Research (CSIR)'s Advanced Manufacturing Technology Strategy.

3.3.2.4. The Presidency

i) National Youth Development Agency (NYDA) - www.nyda.org.za

Born in 2009 out of a merger between the National Youth Commission and the Umsobomvu Youth Fund, the NYDA aims to assist the youth with career skills and to help start their own businesses. The NYDA funds training and gives out loans. The Agency disbursed 7,500 micro loans to value of R23 million and a further R4 million in loans in the 2009/10 financial year.

3.3.2.5. Department of Agriculture,

i) Micro-Agricultural Financial Institute of South Africa (Mafisa)

The Micro-Agricultural Financial Institute of South Africa (Mafisa) was established to contribute to the working poor's ability to run existing agricultural businesses; to start new ones and be able to develop these into fully commercial operations. Mafisa propels and facilitates the development of financial services intended to uplift very small and micro level farmers, farm workers, farm tenants, small holders, landless emerging farmers and processes, etc.

3.3.3 Conclusion

Through these departments/agencies, numerous programmes, for funding or otherwise, have been implemented. This set up has however proved problematic for strategic coordination purposes as programmes tend to be implemented in isolation of each other; and also risks the effectiveness of funding programmes to small businesses, a problem that has been identified by a number of commentators, including the dti (DTI, 2008; SBP 2009a; Timms, 2011).

4 DEMAND FOR CREDIT AND SUPPORT BY SMES

4.1 Introduction

As stated above, the main objective of the study is to assess the access to credit and support for SMEs in SA. In order to determine whether there are indeed any gaps in terms of financing and other support to the SME sector, it is important firstly to have an understanding of the following issues:

- What specifically is meant by the SME sector in the South African context? How is this sector defined? This is important as these businesses in the SME sector are the parties to which the financing and support under consideration are targeted, i.e. the "clients".
- What are the needs of the SME sector? What types of financial services/products and support products do they need or want? This is important as the interventions, private or public, have to match what is needed/demanded otherwise the intervention will not be successful in meeting its objectives. The uptake by the SME sector will be very low.
- What financing support is available? Does the financing support available meet the needs of the SME sector? In other words, is there a financing gap? The same applies to other support that is available to the SME sector. This is important because, as stated above, the interventions, private or public, have to match what is needed/demanded in order to meet the desired objectives.

Some of the above questions were answered under the section on definitions above. The other questions will be discussed in this and the following sections.

4.2 Identifying the Needs of the SME Sector

Statistics on small business in SA remains insufficient with no official repository for data on the number of small enterprises. SA's statistics are typically derived from a variety of sources. These include the Statistics SA Labour Force Survey (LFS), Statistics SA Survey of Employers and the Self-Employed (SESE), the Adult Population Survey (APS) of the GEM reports, Statistics SA Integrated Business Register, CIPRO[18] New Enterprise Register, Statistics SA statistics on liquidations of close corporations and companies and the CIPRO Register of Co-operatives (DTI, 2008: xxiii); and consolidated periodically in the dti's Annual Review of Small Businesses in South Africa. Even then, surveys tend to be conducted sporadically and it can be difficult to put together the pieces from

[18] Now CIPC

different data sources. Consequently, it is not clear how many small businesses there are, how many people they employ and what the sector contributes to GDP (SBP, 2009b).

In order to develop effective interventions for the small business sector, it is important to have an understanding of the sector, the specific challenges faced by small business owners and the capacity they have to deal with those challenges (FinScope, 2010: 1). A lack of clear and accurate statistics is a major stumbling block to SA's bid to developing more effective policies and support schemes for small enterprises (Timms, 2011: 18). Most important of all, small business development initiatives must get down to the level where small businesses actually operate, and must be targeted specifically in the different sectors and value chains, and in specific localities to address small businesses' diverse characteristics, needs, constraints and opportunities (SBP, 2009a: 8).

The problem of data has been identified in a number of forums and publications. Not only are the information sources poor, but can also be very difficult to access, including the official statistics (SBP, 2009: 3). Also to be encouraged is the consistent use of categories (preferably those defined by the Act) by all state agencies and private sector data bases and research studies to facilitate comparability (SBP, 2000b).

The FinScope Small Business Survey undertaken in 2010 goes a long way in addressing some of the issues noted above. For the full benefits to be derived from this initiative[19], however, the definition of the SME sector (or small businesses as they are referred to in the survey) should be agreed in consultation with relevant stakeholders and the survey conducted at regular intervals to provide time series data and facilitate impact assessments of the various interventions over time.

4.3 Demand of Credit and Support by SMEs

According to the Global Bank Alliance (2011), a key obstacle to the growth of SMEs globally is the challenge in accessing capital for their businesses. This sub-section presents an argument on why SMEs' access to finance is low from the SME (demand side) perspective.

4.3.1 Demand for finance and SME market size

Much has been documented about the lack of financing for SMEs, not just in South Africa (Herrington et al., 2010), but in many other parts of the world as well (Turner et al., 2008; OECD, 2006; Kauffmann, 2005). Some of the objectives of the FinScope Survey of 2010 were specifically to

[19] And possibly avoid duplication in the collection of data.

determine the levels of access for the small business sector and identify and describe the drivers of, and the barriers to the usage of financial services and products for the small business sector in South Africa.

Table 7: Growth phases and funding requirements of SMEs

	Start-up Phase	Growth Phase	Stable/ Consolidation	Exit
Type of SME	Source of Finance			
Traditional small business. Provides employment for individual, family and friends	Family, friends, savings, **equity in residential property, loans underwritten by government**	**Asset-backed finance, bank debt, factoring,** trade credit	**Bank debt** if required	N/a
High Potential. Possibly export business	Angel finance, **Team's equity,** some venture capital	Venture capital, private equity, **asset-backed finance, some bank debt**	Venture capital high-yield debt market, **bank debt**	Exit via capital markets or direct access to stock market
High-tech, information and life sciences intellectual Property	Angel finance, venture capital, corporates	Venture capital, corporates, **Asset-backed finance**	Corporates, bank **debt**	Exit typically through trade sale

Source: Felkana et al., (2001)

As illustrated above, the nature of funding required by an SME depends on its development phase. Businesses in the start-up phase generally rely on personal savings, friends and families, while those businesses which are stable rely on bank loans for financing.

Difficulty in accessing finance has remained one of the top three constraints mentioned by the national expert panel in several surveys and SME studies in South Africa. The GEM 2002 and 2003 reports showed that a significant number of entrepreneurs from disadvantaged communities did not keep financial records and that cash constraints were widespread amongst entrepreneurs from disadvantaged communities with registered businesses. Cash flow difficulties were significantly reduced in firms that kept a cash book, kept a record of debtors, practised active debtor management and controlled inventory. Implementing any of these practices was associated with a minimum of 33% reduction in the probability of an exhausted overdraft and doing all four appeared to reduce this probability by as much as 61%. Implementing these practices also significantly increased the probability that a firm would succeed in an application for term loan finance. The GEM 2003 report concluded that a policy priority in SA was implementing programmes, including mentorship and training programmes, that addressed the apparent financial management weaknesses in many small enterprises (Orford et al., 2003)[20].

Defining small business owners as individuals who are: (1) 16 years or older; (2) perceive themselves as business owners and generating an income through small business activity; and (3) employing fewer than 200 employees, the FinScope Small Business Survey of 2010 found that there were approximately 5,579,767 small business owners in South Africa owning 5,979,510 small businesses. On the other hand, Stats SA estimated that they were 2,4 million small business in 2007.

Table 8: Number of Small Business in South Africa

	Category of employer/ self-employed	March 2005	Sept 2005	March 2006	Sept 2006	March 2007
Business owners	Number of persons of working age (15-65) working on [their] own or with a partner, in any type of business (including commercial farms)	1,836,000	2,060,000	1,999,000	2,105,000	1,942,000
	Number of elderly persons (66+) who run or do any kind of business, big or small, for [themselves]	56,000	87,000	73,000	65,000	59,000
Subsistence farmers	Number of persons of working age (15-65) working on [their] own small farm/plot or collecting natural products from the forest or sea	385,000	240,000	585,000	425,000	374,000
	Number of elderly persons (66+) who do any work in [their] own or the family's plot, farm, food garden, cattle post or kraal, or help in growing farm produce or in looking after animals for the household	64,000	42,000	89,000	71,000	57,000
	Total	2,341,000	2,429,000	2,746,000	2,666,000	2,432,000

Source: Stats SA Labour Force Survey (2008).

The information provided by the FinScope Survey (currently the most up-to-date) included the number of small businesses in operation in 2010, their geographical distribution, the types of activities undertaken/services offered and their level of sophistication[21], the age of the businesses and the profile of the business owners with respect to their gender, level of education, financial literacy and money management skills. The FinScope Small Business Survey provides useful data on which interventions can be designed, implemented and assessed and thus provides a good starting point upon which the current policies and interventions can be assessed in terms of their suitability/appropriateness of the locality/segment to which they are targeted.

[20] Orford, J. (2005). The Role of Provincial Governments in Supporting Small Enterprise Development. Working Paper 8 – 2005. TIPS, Pretoria, South Africa.

[21] Using the Business Sophistication Measure (BSM). The BSM aims to segment small businesses along a "business sophistication continuum" – from informal street vendors (BSM 1) to more sophisticated businesses (BSM 8). Considerations in determining the BSM includes business registration, compliance with tax laws, ownership structure, customer base, business premises, access to facilities (e.g. water, electricity, etc), business equipment (e.g. fax, computer, cell phone, etc), record keeping and use of financial services.

For instance, the largest proportion of small business owners resided in Gauteng (23%). 34.2% were service providers of which 10.4% rendered a professional service (e.g. medical or legal service) and 58.9% a skilled service (e.g. plumbing or hairdressing). The probability for Business Sophistication Measure (BSM) 7 and 8 type small businesses was highest in this province (11.8% and 9.0% respectively). Small businesses in Gauteng tended to be larger than small businesses in other provinces and their contribution to job creation the most significant (3.691 million). Small business owners in this province had the highest likelihood of having post-matric qualifications.

This profile is very different from that of Limpopo province, for example, where 9.8% of small business owners reside. 78.2% offered retail services of which 66.7% sold something in the same form that it was bought and 20.3% bought something to sell but added value before reselling. The probability for BSM 1 and 2 type small businesses was highest in this province (29.2% and 31.4% respectively). Small businesses in Limpopo tended to be smaller than those in other provinces and their contribution to job creation the fourth lowest at 0.877 million. Small business owners in this province had the highest likelihood of having achieved, at most, primary school levels of education.

Considered together with the results from the World Bank Enterprise Survey and other studies referred to in this paper, there is likely to be greater demand for credit in the Gauteng Province as it has the largest number of small business owners as compared to, for example, demand for financing in Limpopo. Demand for credit is more likely to be for investment purposes in Gauteng and therefore of a longer term nature due the nature of business activity (service providers wanting to upgrade premises or buy equipment as compared to retailers in Limpopo who would demand credit for working capital purposes, i.e. buying stock).

Small business owners in Gauteng are more likely to be able to access credit because the probability of BSM 7 and 8 type businesses is highest and therefore more formalised. This is in contrast to small businesses in Limpopo which has the highest probability for BSM 1 and 2 businesses and, therefore, are more likely to be of the microenterprise type and informal for whom access to finance is likely to be problematic. Lastly, with respect to financial literacy and education, the types of intervention needed in the two provinces would differ taking into consideration the differences in the average minimum level of education.

Table 9: Average Loan Size by SME Category

Sector	Description	Number of employees	1. Annual turnover 2. Loan sizes 3. Access to banking facilities
Survivalist	• Income generated is below poverty line	• No employees	1. < R10 000 2. Average R500 3. None
Micro (0)	• Turnover is less than VAT registration limit • Not usually formally registered for tax or accounting purposes	• No employees	1. R10 000 to R25 000 2. Average R1 000 3. Possibly individual account
Micro (1-4)	• Same descriptors as Micro (0) except the number of employees are 1-4	• Less than 5 employees	1. R25 000 to R50 000 2. Average R7 000 3. Individual account
Very Small	• Operate in formal market	• Less than ten employees	1. R50 000 to R200 000 2. Average R25 000 3. Entry Level Business Account
Small Enterprises	• Distinguished by some form of managerial co-ordination	• Less than 50 employees	1. R200 000 to R5 000 000 2. Average R70 000 3. Business account
Medium Enterprises	• Further decentralization of decision making • More complex decision making • Increased division of labour	• Less than 100 employees (200 in mining)	1. R 500 000 to R50 000 000 2. Loan size is dependent on sector, region and institution providing finance. Average R150 000 3. Business Account with additional facilities

Source: Felkana et al., (2001)

From this analysis, one would expect higher levels of financing to be made available in Gauteng as compared to Limpopo, the financing available to be skewed towards financing for investment in line with the needs of the small business owners and interventions with respect to access to credit to focus more on SME specific characteristics such as improving the provision of information and less on financial literacy and education compared to interventions for small business owners in Limpopo which might have more of a focus on financial literacy and education due to the low levels of education.

Further research is required to determine whether the current support programmes are appropriate. Programmes then need to be evaluated to determine their effectiveness. Ongoing monitoring and evaluation mechanisms need to be put in place. It should not be left until the programme is due to come to a close before an evaluation is done (Timm, 2011). The FinScope Small Business Survey 2010 provides a useful starting point for evaluating whether the SME support programmes that have been put in place so far are targeted and appropriate for the needs of the SME sector

4.3.2 Other needs of the SME sector

In a similar vein, the FinScope Small Business Survey revealed that space to operate was ranked highest as an obstacle to business growth with 16.2% of respondents citing this as a factor. Yet there is only one SME support programmed aimed at addressing this need. The Khula Property Portfolio initiative aims to provide business premises to business start-ups or those expanding to medium sized businesses. “The rental charged is highly subsidised in order to encourage small business operators to move into formal operating space” (DTI, 2010: 65).

Contrary to what might have been expected, when asked to identify the single most significant obstacle to growth, access to finance ranked third[22] with 8.7% of small business owners citing the lack of access to finance as a reason[23]. This finding is contrary to “the broad picture that emerges from the various surveys of SME lending [that] “strongly suggests that business owners in South Africa view access to financing as a significant problem for business activity” (Turner et al., 2008: 15) despite the various public and private sector initiatives to facilitate access to financing, i.e. that there is in fact a “financing gap”. Turner et al. (2008) do acknowledge, however, that other concerns such as crime and corruption may make credit appear to be less of a problem.

Turner et al. (2008: 15) go on to state that “ ... nonetheless, South Africa witnesses a robust level of SME activity in the formal and informal sectors, facilitated by a vibrant system of trade credit. The evidence suggests that trade financing may be serving as a substitute[24]. This fact may explain high levels of South Africa SME activity in the informal sector, particularly when compared to other middle income countries[25]”.

[22] Access to finance was more likely to be identified in Mpumalanga and the Northern Cape provinces.

[23] Space to operate ranked highest with 16.2% citing this as a significant obstacle followed by competition (12.5%). Approximately one in 5 small business owners responded that there were no obstacles to growing their business (FinScope 2010). A survey conducted by the Centre for Development Enterprise (CDE) in 2007 of Sowetan entrepreneurs to get a picture of what the entrepreneurs considered to be obstacles to their success found that crime, infrastructure, informality and regulation, corruption, labour problems, increased competition and negative public perceptions were considered to be the major obstacles (CDE, 2007b: 5-7 as cited in the DTI, 2008: 49).

[24] The FinScope survey results found that 2 in 5 small business owners offered credit to their customers, 9% of whom stated that their customers included other small businesses.

[25] The FinScope survey results found that only 8.3% (465,632) of small business owners had registered their businesses with CIPRO. The main reasons given for having registered the business was “to comply with the law” (54.1%) and “to avoid harassment from the authorities” (14.1%).

5 SUPPLY OF CREDIT AND SUPPORT TO SMES

5.1 The Public Sector

5.1.1 Funding and support programmes available to the SME Sector

Despite the lack of financing being cited as a constraint in other publications, there are a variety of funding programmes and financing schemes through the use of guarantees that are available, in addition to other support programmes. Awareness and the uptake of these schemes, however, have been very low (DTI, 2008). A number of publications, most of which can be accessed on the dti website, provide information on the various Government SME support programmes available. These include the dti's annual reports, A Guide to the dti Incentive Schemes (2011), the dti Medium Term Strategic Plan 2011-2014 and the dti's National Directory of Small Business Support Programs. In addition to these publications, information is also available on the respective implementing entities/programmes websites. The "National Directory" is probably the most comprehensive of the publications as the Directory is an attempt by the dti to cover all SME support programmes, both public and private, that are available.

Support programmes can be classified into three broad categories: access to finance, market access and business support. South Africa has a wide range of support schemes that target small business owners in the areas of research and development, business and marketing support, exports and support for setting up manufacturing, tourism and co-operatives. The majority are in the form of incentive schemes which pay out matching grants to business owners, with either half or a large percentage of the project costs being funded by the applicants themselves. Information relating to the support programmes can be found from a number of sources, the most comprehensive of which is probably the dti website and compiled in the dti's National Directory of Small Business Support Programmes.

The key national support programmes identified by the dti in the National Directory are Khula Enterprise Development Fund (Khula), the National Youth Development Agency (NYDA), the Small Enterprise Development Agency (Seda) and the Tshumisano Trust (DTI, 2010: 5-7). The Directory provides information on 90 programmes. The Programmes have been grouped into 18 categories as shown in the Table 10 below. Table 11 provides a brief description of selected SME Government schemes.

Table 10: SME support programmes

Programme category	Number
Key national support programmes	4
Business competitions and awards	5
Credit indemnities/guarantee	2
Exhibitions	3
Export development	2
Finance – national	9
Finance – youth	1
Finance – women	3
Finance – provincial [26]	8
Incentives and grants	5
Incubation	22
Industry – specific programmes	5
Linkage & Partnerships	2
Mentorship	2
Networking	1
Other support programmes	3
Premises	1
Technology advice and transfer	5
Industry specific support	2
Training and technical assistance	5
Venture capital	1
Women enterprise programs	3
Total	90

Source: The DTI National Directory 2010

In addition to the selected SME Government schemes, support to the sector includes financing schemes through the use of guarantees, one of which is provided by Khula. The Khula Credit Indemnity Scheme was established to give access to finance to people who wish to start or expand small to medium sized businesses but do not have sufficient collateral or security to support facilities provided by participating banks. The scheme covers facilities from R10,000 to R3 million. Entrepreneurs seeking a Khula credit indemnity can either approach a Khula Credit Indemnity partner financial institution (ABSA, First National Bank, Nedbank and Standard Bank) or a Khula Regional Office for assistance with business plan development and/or advice. The partner financial institution will then assess the business plan and facilitate the application in terms of its lending criteria. Once the application has been approved, the financial institution will approach Khula for indemnity cover and a mentor may be appointed to help with implementation of the business plan, setting up operational systems and general business management. The financial institution manages the facility and collects payments for the duration of the facility. The full payment of the facility remains the responsibility of the applicant.[27]

[26] Gauteng (1), Mpumalanga (2), KZN (1), Eastern Cape (2), Free State (1) and Limpopo (1).
[27] An assessment of Khula's guarantee scheme is given in Annexure B.

Table 11: Selected SME Government Schemes

The Enterprise Organisation	Description	
The Black Business Supplier Development Programme (BBSDP)	A cost-sharing grant offered to black-owned small enterprises to assist them in improving their competitiveness and sustainability. Grants of up to R1 million are given out for enterprises with an annual turnover of up to R35 million.	BBSDP: Since its inception in 2002 till March 31 2010, 9 657 enterprises with total disbursements of R187.5 million have benefited.
The Export Market and Investment Assistance (Emia):	This scheme assists businesses to attend trade fairs or to conduct trade visits by refunding a significant portion of their air fare, accommodation, transport of samples and marketing material.	Emia: In 2008/09 a total of 1 276 businesses benefited from R110.9 million in funding through the scheme. This is down from the 1 332 assisted in the 2008/2009 year, when R106.4 million was disbursed in funding. Emia supported 779 projects in 2009/10.
The Co-operative Incentive Scheme:	Provides start-up funding from R10 000 to R300 000 to co-operatives, with the Government covering 90% of the funding in the form of a grant.	Co-operative Incentive Scheme: From 2006 to September 7 2010, 357 co-operatives had been assisted to the tune of R71.2m
The Enterprise Development Programme:	Matching grants are provided to small manufacturing firms and businesses in the tourism sector.	The Enterprise Development Programme: 164 tourism projects (to the value of R417 million) and 290 manufacturing projects (R1 billion) had been approved up to the end of February 2010
Support for Industrial Innovation (Spii)	Spii funds research and development (R&D) for new innovations in manufacturing, through a grant of 50% to 75% of up to R3m and has been in operation since 1993.	Spii had funded 1 025 projects to the tune of R933 million up until March 31, 2010. In 2007 the programme was chosen by the OECD and World Bank as the best incentives programme within the South African Government
Technology and Human Resources for Industry Programme (Thrip).	Thrip supports scientific research and aims to foster a collaboration between academic institutions and industry through a cost-sharing grant offered by the department. The programme is managed by the National Research Foundation (NRF).	Thrip: Between 2006/07 and 2009/10, 866 SMMEs were funded to the tune of R240.3m.
Workplace Challenge Programme	Cluster-based initiative run by the Department of Trade and Industry and managed by Productivity SA, an agency of the Department of Labour. The programme aims to increase the productivity of businesses big and small, by getting them to work together in a cluster and share learnings.	In all 19 clusters consisting of 187 enterprises in all were up and running in the 2010 financial year

Source: Timm, (2001)

The other guarantee scheme identified in the literature is the Thembani International Guarantee Fund (TIGF). Thembani International Guarantee Fund (TIGF) was established in 1996 as a Section 21 (not-for-profit) organisation through a partner initiative founded by black South Africans living in exile in the United States. TIGF uses loan and grant capital raised from individuals and organisations in the United States and Europe as security for guarantees to cover loans from South African banks. TIGF provides partial guarantees (up to a maximum of 75% of the loan amount not exceeding R10 million) for loans from South African banks to approved borrowers, for a period of 1 to 3 years. Local banks and borrowers are required to share the credit risk. TIGF does not lend money directly to borrowers. TIGF monitors progress on projects to which credit guarantees have been issued. Loans must be repaid regularly according to the loan agreement.

According to the FinScope survey, 75% of small business owners were not aware of any organisations that gave advice and support to small business owners, with the figure being the highest for the Northern Cape at 58%. Only 10.3% were aware of the existence of the Umsobomvu Fund and/or the NYDA, 9.3% of the support provided by the banks, 4% - Seda, 3.0% - Khula, 2.3% - the Sector Education and Training Authorities (SETAs), and 1.2% South African Micro Apex Fund (Samaf).

Clearly, the lack of awareness of the existence of these programmes will affect access. So, for example, even if the financing is available, it will not be accessed by those who might need it. A study by Chimucheka and Rungani (2011) found that 28% of SMMEs surveyed had never applied for financing from a bank. The main reasons given were not knowing the procedures for applying for a loan (53%), not knowing about the sources of finance available from the banks (23%) and the high interest rates (7%). 17% indicated that they had enough capital to start and run their own businesses.

In exploring the barriers to financial inclusion, the FinScope survey found that the most significant barriers to entry were neither regulatory nor supply related, but mainly attitudinal or perceptual in nature, similar to those stated above. Most business owners felt that the irregularity and the size of their income did not justify having a bank account. Secondary to income-related reasons for not having a bank account comprised not qualifying for an account (including the business not being registered), high bank charges and the minimum requirements being too stringent. These findings point to the significant need for financial education amongst small business owners. Therefore, it is important to ensure that interventions are targeted to achieving this objective. The literature review did not reveal any interventions and/or programmes, either by the private sector or the public sector, aimed at financial education.

5.1.2 How effective is public sector support of small business?

A variety of independent studies suggest that very few small enterprises are aware of Government's initiatives to support small enterprises (Berry et. al., 2002; Foxcroft et. al., 2002). According to the SME Annual Survey (2004), which sampled over 2,500 SMEs and focused specifically on SME perceptions of Government support, over 60% of businesses were aware of the SETAs, 45% of businesses were aware of the Industrial Development Corporation (IDC) and less than a third of businesses surveyed had heard of the Competitiveness Fund. However, less than 15% of businesses had heard of any of the other Government support structures. Use of Government support structures was even lower. Only 1% of businesses had made use of Ntsika[28], the MACs, Khula, Brain and Umsobomvu. The only two structures that had been used by more than 10% of the businesses surveyed were the SETAs and the Competitiveness Fund.

Table 11: Small-business awareness and use of Government support

Government initiative	% of businesses which are aware of programme	% businesses which have used programme
SETAs	61	32
IDC	45	7
Competitiveness Fund	32	11
Ntsika	13	1
Export incentives	12	2
Manufacturing Advisory Centres	11	1
Khula	9	1
Brain	9	1
Umsobomvu	4	1

Source: SME Survey, 2004

A lack of awareness stems from poor marketing[29]. The SME Survey found that 70% of the businesses surveyed felt that the Government communicates its incentives poorly. The SME Survey also found that 63% of small businesses think that the impact of general Government incentives is either very bad or bad, and 54% think that the impact of support structures is either very bad or bad. In addition, there was no evidence that use of a specific Government service results in businesses being more likely to rate Government support for small businesses as useful or very useful.

Overall evidence from a variety of sources, including anecdotal evidence from interviews conducted by the GEM team in South Africa, suggests that small businesses in general are not aware of most of

[28] In response to perceived failings of the then small enterprise support infrastructure, the Government has decided to merge Ntsika and Namac to form SEDA.

[29] Orford, J. (2005). *The Role of Provincial Governments in Supporting Small Enterprise Development.* Working Paper 8 – 2005. TIPS, Pretoria, South Africa.

the Government's efforts to support small enterprises and, even when they are aware of them, are sceptical about their value to their business.

5.1.3 Why has Government support of small businesses failed?

There are a number of reasons for the failure of Government support to small businesses. Some of the reasons identified include: (1) lack of awareness (outreach); (2) uneven distribution (concentration in metropolitan areas); (3) the high cost of searching for support services which has not been mitigated by effective information on how and where to access support; and (4) cumbersome administrative requirements of Government programmes resulting in user fatigue and high levels of disappointment (Berry et. al., 2002).

Using the performance of Ntsika's Local business service centres (LBSC) programme as an example, it is suggested that the institution overestimated its capacity as well as the capacity of the local business service centres (Berry et. al., 2002). The institution was unable to access enough funding from Ntsika and, as a result, most of the LBSC programmes had to devote resources to raise funds and/or rely heavily on service fees. The need to maximise service fees also resulted in a reluctance to refer clients to qualified service providers as initially envisaged. Both were detrimental to the LSBC programme's ability to service small businesses in the way initially envisaged. In contrast, the Manufacturing Advisory Centres (MACs) which have a much more focused role and which utilise expert service providers were able to achieve much better results although with a more limited range of businesses.

Evidence from the GEM reports suggests that, in addition to the factors mentioned above, an important reason for the failure of Government programmes to support small businesses is due to poor delivery (Orford et. al., 2005); specifically; the incompetence of the people delivering Government support. An example is the Khula Mentorship programme. Findings from research conducted by the University of Cape Town (UCT) Centre for Innovation and Entrepreneurship (CIE) suggests that mentors can play a critical role in supporting small enterprises; indeed, the centrepiece of a highly successful loan programme run by the UCT CIE aligns loan recipients with mentors. However, the key to these mentors adding value to their clients lies in recruiting suitably experienced mentors. In the case of the Khula Mentorship Programme, however, many of the mentors used have little or no business experience, struggle to understand basic accounting concepts and are consequently not capable of adding value to their clients. The result is a highly expensive programme with little or no impact[30].

[30] Unpublished review of Khula mentorship programme completed in 2003 by the UCT CIE.

The 2001 GEM report noted that "Government interventions were poorly implemented and ineffectively marketed. Khula Enterprise Finance and the dti were heavily criticised, whereas more targeted programmes such as the National Manufacturing Advisory Centre were identified as being more successful"[31]. The 2002 GEM report highlighted the need for informal businesses to have an effective community-based micro- finance infrastructure, stating that "there is a definite lack of microloan organisations offering smaller loans (R300 – R3500) without exorbitantly high interest rates".

5.2 The Commercial Banking Sector

5.2.1 Role of the Banking Sector

In most countries, the commercial banking sector is still the main source of external finance for SMEs. It is important, therefore, for the commercial banking sector to develop viable and sustainable means of extending credit to the SME sector. In most OECD countries, banks perceive SMEs as an attractive line of business and have developed effective monitoring systems. These include investing in credit scoring models and other sophisticated techniques to discriminate between high and low risk borrowers in overcoming the information asymmetry problem. It is worth noting that in most cases funds supplied under official Government programmes are modest compared to that supplied by banks at their own risk (OECD, 2006).

5.2.2 The South African Banking Sector

As of 31 December 2010, there were 17 operating commercial banks and 13 local branches of foreign banks. There were two mutual banks and 41 representative offices of foreign banks. The four largest banks, Standard Bank, Nedbank, ABSA and First National Bank (FNB), accounted for 84.6% of total banking sector assets[32]. As shown below, an estimation of the total SME loan book of the four major banks revealed[33] that Standard Bank had an SME market share of 35% while FNB had the lowest at 12%.

[31] http://www.gemconsortium.org/download/1323090949593/GEM%20SA%202009%20-%20Tracking%20Entrepreneurship....pdf

[32] http://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/3778/07%20July(1)%202011.pdf

[33] Falkena et al. (2004). *Competition in South African Banking.* Task Group Report for the National Treasury & the South African Reserve Bank. Pretoria. South Africa.

Table 12: Small business book of major banks[34]

	Standard	Nedbank	ABSA	FNB	Total
SME clients	367 500	346 500	210 000	126 000	1 050 000
Total book			R2.6 billion		R13 billion*
Average size of loan	R39 000		R47 000		
Market Share	35%	33%	20%	12%	100%

(Split of market share and average size of loan based on SME Report, Falkena et al., 2001)

* Probably on the low side but no data from Banking Council to date

Source: SME Report, 2001, and ABSA Annual Report

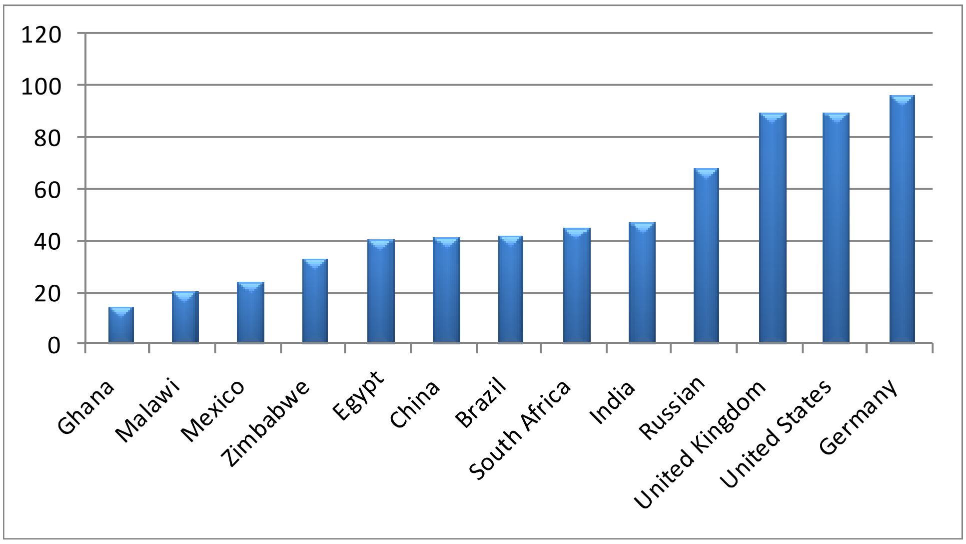
Over the past decade, commercial banks have significantly increased their exposure to SMEs, with the historically disadvantaged individuals (HDIs) of their clientele rising. This includes an increase in black middle and upper-class account holders. Banks have also realised that, since many future holders of conventional accounts start as micro-enterprises, greater attention to this relatively cost-intensive market segment will pay off in the longer run.

In this transformation process, the changing ownership and board composition of banks also play a role. Similarly, the negotiated Financial Sector Charter (through the BBBEE policy framework) is likely to accelerate transformation in future years. While risk assessments about small enterprises may not have changed much among bankers, the increase in special funding schemes, often with sector or industry focus and some element of public sector support, have facilitated the expansion of SME funding.

The figure below shows that access to financial services in SA is higher than comparable countries such as Brazil, China, and Egypt. The composite indicator measures the percentage of the adult population with access to an account with a financial intermediary.

[34] Gaps on the table show that data was not available.

Figure 2: Composite measure of access to financial services



Sources: Honohan (2007) and World Bank.(2007)

A 2007 study by the World Bank reveals that barriers to accessing loans in South Africa's banking institutions were very low. As shown below, South African financial institutions take an average of 4.13 days to process an SME loan as compared to an international average of 11.03 days. It is important, however, to note that an SME application takes around two times more days than other business loans. This is probably owing to the lack of quality information being provided on the part of applicants.

Table 13: Barriers to loan services: business and SME loans

			Physical access	*Affordability*				*Eligibility*	
	Number of banks responding	Loan market share	Locations to submit loan applications (out of 5)	Minimum amount business loan (% of GDPPC)	Fee business loan (% of min. loan amount)	Minimum amount SME loan (% of GDPPC)	Fees SME loan (% of min. loan amount)	Days to process business loan applications	Days to process SME loan applications
Brazil	4	48.61%	4.85	19.19	2.10	8.08	2.10	10.32	3.63
China	2	23.63%	2.00	—	0.00	—	0.00	50.00	40.00
Egypt, Arab Rep.	2	32.08%	2.81	14.61	0.35	0.00	0.00	19.29	14.43
Germany	3	23.72%	3.42	0.00	0.62	0.00	0.62	3.87	4.25
Ghana	4	68.72%	2.63	1044.39	1.31	1448.07	1.54	19.07	29.20
India	4	37.75%	2.44	57.77	0.93	145.17	0.84	19.98	10.75
Malawi	3	59.73%	2.12	306.05	1.32	1929.34	1.00	15.39	3.71
Mexico	3	45.74%	4.20	101.93	1.27	87.80	1.61	15.70	9.86
South Africa	***3***	***69.39%***	***5.00***	***15.98***	***0.65***	***15.98***	***0.65***	***2.73***	***4.13***
United Kingdom	2	18.46%	5.00	26.12	1.32	6.05	1.32	12.32	10.47
Zimbabwe	4	43.45%	2.85	263.49	2.54	240.12	2.54	7.91	3.91
Minimum	1	5.61%	1.77	0.00	0.00	0.00	0.00	1.00	1.00
5th percentile	1	14.43%	2.00	0.00	0.00	0.00	0.00	1.99	1.99
Median	3	43.17%	3.05	55.28	1.26	39.86	1.28	10.64	9.09
Average	3	45.19%	3.23	2259.06	4.73	337.58	4.67	12.68	11.03
Maximum	6	100.00%	5.00	64216.77	100.35	3141.17	100.35	50.00	43.26
95th percentile	5	80.46%	5.00	9845.42	15.54	1876.04	16.13	31.54	31.54

Source: World Bank (2007).

Each of South Africa's four major banks have small business lending, support desks or portfolios. Almost all banks sponsor or run promotional services or workshops to help SMEs.

In 2007, Nedbank signed an indemnity agreement with Khula Enterprise Finance to boost SME development. The agreement signaled a turning point for SME financing, as it placed considerable emphasis on developmental imperatives, such as increased regional focus in favour of more rural and peril-urban entrepreneurs in an attempt to lift the lending patterns of loan sizes under the R250,000 mark. "The original agreement signed between Nedbank and Khula on 24 January, 1997, allowed small businesses access to a maximum loan amount of R1 million. With the history of growth experienced in the SME sector and the ever-increasing costs of establishing a new business or franchise and the expansion of existing small business, the new agreement allows access to funding on a matrix scale from R10,000 up to R3 million".[35] The agreement was hailed by commentators who noted that it will pave the way for other commercial banks to consider moving in the same direction.

The other bank which is prominent in the SME support sector is FNB. The FNB Enablis Business Launchpad is South Africa's biggest annual business plan competition for entrepreneurs who want to start a new business or expand an existing one. The business plan is used to source funding.

5.3 Donors, NGOs and the Private Sector

5.3.1 Donor funding

Outside the public sector, two seemingly contradictory processes have picked up momentum in recent years. On the one hand, many of the non governmental organisations (NGOs) and community based organisations (CBOs) active in the small enterprise support sphere have faced declining public or foreign (donor) funding, which forced them to rationalise, scale down the range and spread of activities, merge with other bodies or close down altogether. At the same time there has been a rapid increase in the number and activity range of private, profit-based service suppliers focusing on particular needs of small enterprises. These include private persons helping entrepreneurs with the preparation of their business plans, mentors, marketing agents and more generally, the suppliers of financial, business and property services, as well as training and related consultancies. Some of these services are supplied as part of service packages of financial, marketing, insurance and human

[35] Khula Enterprise Managing Director.

resources service suppliers, whereas others focus more narrowly on specific needs of small enterprises (TIPS, 2005).

In many cases, these private services are financially supported by public sector support programmes (through vouchers for example,) which means the private service supplier is only the implementing agency. This approach is highly recommended in international circles of small enterprise support agencies.

Since the early 1990s, international organisations, as well as small enterprise support agencies in donor countries (e.g. Germany's Friedrich Ebert Foundation), have played some role in the funding, design and research of South African small enterprise support. Their inputs have often been critical in the development of new support programmes or the spread of programmes to less developed areas. Though literature on SME credit support by donors and NGOs is scarce, one of the most prominent funder is the German Co-operative and Raiffeisen Confederation (DGRV).

DGRV is involved in technical co-operation programmes with partners in many countries all over the world. In the Republic of South Africa, contacts date back to 1995. DGRV is providing advice and assistance to co-operatives in South Africa. These activities range from agricultural co-operatives, to savings and credit co-operatives, to co-operatives in the SMME sector (e.g. bakeries) and to co-operatively organised self-help initiatives in townships[36]. DGRV also focuses on fostering both local and economic development (especially SMME) and to contribute to poverty alleviation. In fulfilling its mandate, DGRV consults co-operatives in South Africa, and its activities range from agricultural co-operatives, co-operatives in the SMME sector, to savings and credit cooperatives, as well as other self-help initiatives.

By 2006, approximately 5,460 local co-operatives with more than 16 million members, regional and national co-operative centres and a system of specialised federations were affiliated to DGRV. By supporting cooperative structures, the DGRV is making an important contribution to black economic empowerment in South Africa. The DGRV supports cooperatively-organized business initiatives by assisting in the procurement of goods and marketing as well as in accounting, management and in training and advanced training. By building up savings and credit cooperatives, the target group is to be enabled to obtain and maintain access to financial services over the longer term.

In particular, DGRV assists and advises the Yebo Co-operative Ltd in its efforts to provide services and support to its member groups and co-operatives. Yebo was founded in 2003 as a central advisory

[36] http://www.dgrvsa.co.za/Publications/Case%20Study%20on%20Stokvels.pdf

and service cooperative of member groups with DGRV support. Yebo functions as a support centre for the approximately 80 cooperatively-organized member groups during their foundation phase. It provides education and training to support their development and self-governance structures and makes available funding from a credit fund[37]. The DGRV also advises Government institutions in shaping or improving framework conditions in South Africa, for example regarding the revision of the Cooperative Act and the introduction of cooperative auditing.

5.3.2 Microfinance Sector

Microfinance institutions have also emerged to serve the smallest of these enterprises, while banking institutions have typically served the larger corporations. The microfinance credit industry experienced rapid growth in the early 1990s, when microcredit was effectively legalised at the end of 1992 by an exemption to the Usury Act that removed price controls on small and short term loans, enabling the large flow of capital into the sector. The exemption notice was superseded with the enactment of the NCA in 2005.

The sector can be broadly classified into two. Those MFIs which are registered with Microfinance South Africa (MFSA), a representative body of registered and legal micro credit providers with a membership of approximately 1,500[38]. In the second category are the "developmental" microfinance institutions registered with the Association for Pro-poor Micro Finance Institutions for South Africa (the AMFISA). The AMFISA currently has a membership of 14 developmental micro finance institutions that have reached an estimated 100,000 clients in the last 15 years, with loans outstanding as at 30 May 2008 of over R100 million to small and survivalist businesses[39]. Two examples of MFIs registered with the AMFISA are the Small Enterprise Foundation (SEF) and Marang Financial Services.

SEF began operations in 1992 with the aim of enabling the poor to increase their incomes through the provision of microcredit and the accumulation of savings. SEF provides small loans through two programmes, the Microcredit Program (MCP) and the Tšhomisano Credit Programme (TCP). that since inception the organisation has disbursed 412,820 loans to the value of R532 million (December 2007). As at December 2007, MCP has 15,677 active clients whereas TCP serves 30,063 clients[40].

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37 http://www.dgrv.de/en/services/internationalrelations/projectsworldwide/southafrica.html
38 Statistics on this sector were not readily available.
39 http://www.amfisa.org.za/
40 http://www.sef.co.za/

Table 14: Summary of SEF microloans

Minimum loan size	Max 1st loan size	Max loan size	Loan term (months)	Repayment	Interest rate
R500	R1,200	R12,000	4, 6 or 10	Biweekly or monthly	80.7%

Source: Skowronski, G (2010)[41]

Established in 2000, Marang Financial Services is a non-profit MFI dedicated to making financial services accessible to poor households in South Africa and has been a significant player in the micro enterprise finance arena in South Africa[42]. Marang serves approximately 24,000 clients, mai8nly women, via 23 branches and 19 satellite offices in five provinces[43].

Table 15: Summary of Marang microloans

Minimum loan size	Max 1st loan size	Max loan size	Loan term (months)	Repayment	Interest rate
R500	R1,500	R10,000	4 to 9	Monthly	Not available

Source: Skowronski, G (2010)[44]

5.3.3 Other Sources of SME Funding

Also falling within this category is the steadily expanding trend of larger enterprises providing development services or outreach programmes for small enterprises – be it their clients, their suppliers or some other target group(s). This can be in the sphere of procurement, in training programmes or in the sponsoring of vouchers (for discounts on service charges).

Finally, reference has to be made to the attention given to small business concerns and support by (small) business organisations, whether they are linked to the national federations (Chambers of Commerce and Industry, Sakekamers, Nafcoc, Fabcos, etc.) or part of smaller regional, local or sectoral bodies like traders' associations and professional bodies. Once again, the organisational efficiency and capacity of most of these associations need further development, but their role in the mobilisation of support and the channelling of member concerns (business owner feed-back) is becoming increasingly important.

We can also include education and training institutions here (e.g. SETAs) since many have steadily expanded their offerings of training programmes or short courses for small enterprise managers or entrepreneurs.

41 http://www.microfinancegateway.org/p/site/m/template.rc/1.9.42096/
42 http://www.marang.co.za/
43 Eastern Cape, Gauteng, KwaZulu Natal, Limpopo and Mphumalanga.
44 http://www.microfinancegateway.org/p/site/m/template.rc/1.9.42096/

6 POSSIBLE CREDIT AND SUPPORT GAP

6.1 Introduction

Despite the pivotal role of SMEs in precipitating growth and employment creation in developing countries, a number of bottlenecks affect their ability to realise their full potential. SME development is hampered by a number of factors, including finance, lack of managerial skills, equipment and technology, regulatory issues, and access to international markets (Anheier and Seibel, 1987; Steel and Webster, 1991; Aryeetey et al., 1994; Gockel and Akoena, 2002). The lack of managerial know-how places significant constraints on SME development. Even though SMEs tend to attract motivated managers, they can hardly compete with larger firms. The scarcity of management talent, prevalent in most countries in the region, has a magnified impact on SMEs. The lack of support services or their relatively higher unit cost can hamper SMEs' efforts to improve their management because consulting firms are often not equipped with appropriate cost-effective management solutions for SMEs.

Despite the numerous institutions providing training and advisory services, there is still a skills gap in the SME sector as a whole (Kayanula and Quartey, 2000). This is because entrepreneurs cannot afford the high cost of training and advisory services, while others do not see the need to upgrade their skills due to complacency. In terms of technology, SMEs often have difficulties in gaining access to appropriate technologies and information on available techniques (Aryeetey et al., 1994). In most cases, SMEs utilise foreign technology with a scarce percentage of shared ownership or leasing. They usually acquire foreign licenses, because local patents are difficult to obtain.

6.2 Access to finance: Some definitions

6.2.1 Equity versus debt financing

According to Demirguc-Kunt et. al. (2006: 933), there are two primary sources of external finance for new SMEs, equity and debt. External equity in the form of venture capital or the stock exchange is usually not available for new SMEs, primarily due to the relatively small levels of financing desired by a new SME. The lack of external equity makes many new SMEs dependent on bank loans and overdrafts and suppliers credit for early stage financing. Despite the dependence of SMEs on debt finance, access is very limited for new SMEs, especially in developing countries (Mengistae et. al., 2010).

6.2.2 What is financing gap?

There is no generally agreed definition of the term "financing gap, but it is basically used to mean that a sizeable share of economically significant SMEs cannot obtain financing from banks, capital markets or other suppliers of finance. Furthermore, it is often alleged that i) many entrepreneurs or SMEs that do not currently have access to funds would have the capability to use those funds productively if they were available; ii) but due to structural characteristics, the formal financial system does not provide finance to such entities" (OECD, 2006: 16).

6.2.3 Indicators of access

Objective indicators of access used by the World Bank Enterprise Survey of 2008 include whether the firm has any credit products (e.g. overdrafts, loans or line of credit), loan applications and rejections, percent of finance for working capital and investment, and interest rate. Subjective indicators of access include whether the firm claims access is one of the top three obstacles and whether the firm states "no need for a loan" as a reason for not applying for a loan.

6.2.4 Measures of quality access

External finance is used by firms to finance working capital requirements and investment in productive assets. Thus, two commonly used measures of the "quality of access" are (1) percent of bank finance used by firms to pay for their working capital and (2) the percent used to pay for investments. According to the World Bank Enterprise Survey of 2008, South Africa scores average on these two indicators with bank finance covering only 7% of firms' working capital needs and 26% of investment needs (Mengistae et al., 2010: 113).

6.3 Do we have an SME access to credit gap in South Africa?

Much has been documented about the lack of financing for SMEs, not just in South Africa (Herrington et al., 2010), but in many other parts of the world as well (Mengistae et al., 2010, Turner et al., 2008; OECD, 2006; Kauffmann, 2005). MFIs have emerged to serve the smallest of these enterprises, while banking institutions have typically served the large corporations. However, there are still those SMEs that fall between these two markets where there is a finance gap commonly described as the "missing middle" (IFC, 2009: 10).

The broad picture that emerges from the various surveys of SME lending "strongly suggest that business owners in South Africa view access to financing as a significant problem for business activity" (Turner et al., 2008: 15), i.e. that there might be a "financing gap" despite the various public and private sector initiatives to facilitate access to financing". Contrary to what might have been expected, respondents to the FinScope Small Business Survey (2010), when asked to identify the single most significant obstacle to growth, access to finance ranked third[45] with 8.7% small business owners citing the lack of access to finance as a reason[46].

This finding may be attributable to South Africa having a relatively well developed financial sector with a ratio of domestic credit to GDP at 78%. Though concentrated, the banking sector is fairly competitive with a relatively high capital ratio of 8.3% and low and declining nonperforming loans. Therefore, for the formal sector, access to finance might not be as much of a policy concern as it is for the less formal sector of the economy as reflected in only 14% of firms in the 2008 South African Enterprise survey citing access to financing as a major obstacle. The survey provides more nuanced results which reflect that registered microenterprises are less likely to have access to credit as noted below (Mengistae et al., 2010: 111).

The extent of the financing gap can only be determined by comparing the supply of financing to what is demanded by the SME sector, i.e. what financing is available and whether the financing available meets the needs of the SME sector. Beck (2007) argues that the availability of finance to new SMEs can be influenced by both borrower-specific (internal factors) and systemic factors (external factors). Moreover, suppliers of finance may choose, for various reasons, to offer finance at interest rates that would leave many potential borrowers without access to credit. These reasons relate to problems of having to deal with uncertainties such as agency problems, asymmetric information, adverse credit selection and monitoring problems. Although not specifically related to SMEs, the specific characteristics of SMEs are such that these reasons negatively impact SMEs more than larger companies (OECD, 2006).

Barbosa and Moraes (2004) point out that borrower-specific factors include variables largely controllable by a firm such as managerial competencies, quality of business information, availability of collateral and networking. Other factors that negatively impact SMEs' ability to access funding

[45] Access to finance was more likely to be identified in Mpumalanga and the Northern Cape

[46] Space to operate ranked highest with 16.2% citing this as a significant obstacle followed by competition (12.5%). Approximately one in 5 small business owners responded that there were no obstacles to growing their business (FinScope, 2010). A survey conducted by the Centre for Development (CDE) in 2007 of Sowetan entrepreneurs in 2007 to get a picture of what the entrepreneurs considered to be obstacles to their success found that crime, infrastructure, informality and regulation, corruption, labour problems, increased competition and negative public perceptions were considered to be the major obstacles (CDE, 2007b: 5-7 as cited in the DTI, 2008: 49).

include: (1) the variability that SMEs experience in their earnings which can fluctuate significantly on an annual basis; (2) the low survival rate of SMEs; and (3) the difficulty of separating small business owner's personal finances from that of the business.

Providers of finance will also want to monitor the SME to ensure that the terms of the contract are being followed, to follow the progression of the SME and have the means to oblige the SME to act in the supplier of fund's best interests. This is more difficult for smaller firms thus increasing the probability that suppliers of credit will be less willing to lend to SMEs. Providers of finance will want to ensure that the borrower acts in a manner that maximises the probability that the loan will be repaid. However, once the loan has been obtained, the borrower is more likely to undertake risky projects to maximise profitability. This problem is more serious in SMEs than in larger firms because of the blurred lines between the business owner and the business, and due to information asymmetries (OECD, 2006).

6.3.1 Internal factors (SME-specific characteristics)

SME specific characteristics that affect access to financing include the following.

6.3.1.1. The size of the SME

All around the world, SMEs have less access to finance than large firms. South Africa is no exception. According to the Word Bank Enterprise Survey 2008, one of the most important objective indicators of access, actual use of credit products, only 59% of small and medium enterprises had any credit products as compared to 82% for large firms. Microenterprises are more likely to report access to finance as one of the top three obstacles to growth, are less likely to have a bank account, and less likely to have access to any of the credit products (loans, overdrafts or lines of credit). As firms grow larger, access becomes easier (Mengistae et al., 2010).

Related to size, SMEs tend to seek finance for relatively small amounts. The costs involved in the credit assessment and monitoring of a loan or investment make it disproportionately more expensive to provide funds to an SME (Falkena et al., 2004). In most OECD countries, however, banks perceive SME finance as an attractive line of business and have developed effective monitoring mechanisms as a result (OECD, 2006).

6.3.1.2. Demand for loans

On the demand for loans, microenterprises are less likely to apply for a loan, partly because of the high perceived rejection rates (17%) as compared to 7% for small enterprises and 4% for medium enterprises. Microenterprises are also likely to cite "no need for a loan" as a reason for not applying for a loan (at 46%, as compared to 52% for small enterprises and 72% for medium enterprises). Moreover, microenterprises are more likely to cite that "application procedures are too complicated" at 18% (as compared to 14% for small enterprises and 6% for medium enterprises), suggesting that microenterprises have a demand for loans but less ability to access loans than small enterprises and medium enterprises in turn (Mengistae et al., 2010).

Similarly, a study by Chimucheka and Rungani (2011) found that 28% of South African SMEs surveyed had never applied for financing from a bank. The main reasons given were not knowing the procedures for applying for a loan (53%), not knowing about the sources of finance available from the banks (23%), the high interest rates (7%). Seventeen percent indicated that they had enough capital to start and run their own businesses.

In 25% of the cases, the banks did not respond to the SMEs request for reasons why their applications had not been approved.

6.3.1.3. Loan application rejections

The table below shows that out of the 84.4% SMEs which apply for an unsecured bank loan, only 25% are likely to be successful. The analysis further reveals that of the 25% of successful applications, 85% of applicants accept the loan but only 18% will finally get the loan. This could be due to failure to meet some terms and conditions of the loan by the applicant (borrower).

Table 16: Finance applications success rates for SMEs

Application for Finance HDI SMEs >3 yrs old				
Category	*% applying for loan*	*% who were successful*	*% accepted*	*% who received finance*
Bank secured or unsecured	84.4	25	85.2	18
Bank overdraft	18.8	62.5	76.7	9
Bank credit card	2.3	83.3	60	1.2
Micro lender	3.1	0	0	0
Stokvel	1.2	33.3	100	0.4
Mortgage	0.8	100	100	0.8
Venture Capital	0.4	0	0	0
Average		**33.2**	**82.4**	**27.3**

Source: Competition in Banking Commission, SA (2004)

The study by Chimucheka and Rungani (2011) went further in exploring the reasons why South African SME applications for finance from banks were unsuccessful. Reasons cited included the lack of collateral (37%), the lack of a financial deposit (17%), poor business plans (7%) and non-viable business ideas. The findings are comparable to the World Bank Enterprise Survey of 2008 in which 31% of micro and 39% of small firms cited unacceptable collateral as a reason for loan application rejections.

Coco (2000) points out that collateral helps to reduce informational asymmetries and moral hazard problems that arise between banks and entrepreneurs. Collateral can be repossessed by the creditor in case of default thus enhancing creditor protection. On the importance of collateral, one commentator said "Finance is difficult to secure without collateral. Also a large number of entrepreneurs do not know how to approach banks and financial institutions"[47].

According to the same survey, 10% of firms cited problems with credit histories as a reason for loan application rejections, a sign that credit bureaus are effective in limiting access to firms with poor credit histories.

6.3.1.4. Experience of the small business owner

Typically, a bank will be interested in the skills and experience of the small business owner. Historically disadvantaged individuals (HDIs) score poorly in these categories. Studies by Shane and Stuart (2002) and Rudez and Mihalic (2007) positively associate managerial competencies with new venture performance. The higher the level of managerial competency exhibited by the owners of a new firm, the greater the viability and survival of the new SME, the more successful they are likely to be in accessing credit.

6.3.1.5. Ownership of the SME

According to the World Bank Enterprise Survey of 2008, African owners are more likely to use bank finance for working capital, even though they report more subjective obstacles. South Africa's history has undermined the accumulation of traditional sources of start-up capital by black entrepreneurs. Hence both own funds and fixed assets which can provide security for loans are relatively rare (Falkena et. al., 2004). African owners are less likely to report "no need for a loan" reflecting relatively larger demand for loans, but it is possible that they may have different perceptions of difficulties with access, while in reality they may have access that is similar to that of any other firm.

[47] Dr Mike Herrington, Director of the University of Cape Town (UCT) Centre for Innovation and Entrepreneurship (CIE), and research team leader of the Global Entrepreneurship Monitor (GEM) South Africa (www.*succeed*.co.za).

The GEM 2003 report also reported evidence of lack of access to business finance by black-owned small enterprises.

6.3.1.6. Availability of information

On a general level, SMEs have problems providing good quality reliable information (and media and stockbroker reports are rarely available). A new entrant into the lending market for SMEs may face substantial problems in accessing information about the credit standing and risk characteristics of the SME borrower (Falkena et al., 2004).

According to Kitindi et. al. (2007), creditors, banks and other lenders use business information provided by firms to analyse their present performance and predict future performance. Business information reduces information asymmetry. If an entrepreneur has spent time developing a comprehensive and a priory business plan at an early stage in the project, the risk perception should be reduced and the likelihood of obtaining capital should increase. Explaining why SMEs fail to get credit, Herrington[48] said:

> *The country would benefit from a massive campaign on how to write a business plan. Some entrepreneurs present ideas, which are neither feasible nor realistic… And then they (ideas) are not supported by a properly written business plan.*

It is no surprise, therefore, that firms with external auditor reports are more likely to use credit products, less likely to be rejected and less likely to state access as one of the top three obstacles, while owning land is not significantly related to access (Mengistae et al., 2010).

6.3.1.7. Registration and legal formality

Another internal factor that affects an SME's ability to access finance is whether it is registered or not. It is often difficult to separate small business owners' personal finances from that of the business, a factor that often negatively impacts an SME's ability to access finance (OECD, 2006). This is a case of formal business registration, which at law separates the business from the owner(s). Being registered makes it easier to distinguish between the small business owner's personal finances and that of the business. The degree of a firm's formality can be measured by whether it is registered or not for microenterprises[49] and its legal status (i.e. whether it is a limited liability company as opposed

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[48] Dr Mike Herrington, Director of the University of Cape Town (UCT) Centre for Innovation and Entrepreneurship (CIE), and research team leader of the Global Entrepreneurship Monitor (GEM) South Africa (www.*succeed*.co.za).

[49] Firms are classified as registered if they have at least one of the following: (1) registered name with the Office of the Registrar (CIPC, in South Africa) or other government institution responsible for approving company names; (2) registered with the Office of the Registrar, the local courts, or other government institutions responsible for commercial registration; (3) an operating or trade license or are otherwise

to an unlimited liability firm such as a sole proprietorship or partnership). Limited liability is another step towards formality as it involves further separation of individual ownership and the firm identity.

According to the World Bank Enterprise Survey of 2008, 80 out of 120 firms microenterprises sampled were registered. With respect to the use of credit products; none of the unregistered firms made use of any credit products although 13% had applied for a loan but all had been rejected, whereas 25% of registered firms did. Registered firms were rejected but with slightly less frequency at what is still a high rate of 85%. Furthermore, unregistered microenterprises at 58% were more likely to report access as major obstacle.

Among SMEs and larger firms, those with limited liability status had more use of credit products (66% compared to 55%) and lower rejection rates (17% compared to 30%). Limited liabilities companies were more likely to state "no need for a loan" as a reason for not applying for a loan and least likely to claim access as a major obstacle (at 13%), reflecting that they had the least unmet demand for loans.

Moreover, more formal firms finance a higher percentage of working capital and investment using bank finance and were more likely to rely on supplier credit than less formal firms. Unregistered microenterprises did not use supplier credit, registered microenterprises used 12%, unlimited liability firms used 22% and limited liability firms used 23% to finance working capital. Supplier credit, therefore, cannot be considered a substitute for bank finance as unregistered microenterprises appear not to be able to access supplier credit any more than they can access bank credit. Both registered and unregistered microenterprises depend more on their own funds and funds from family and friends (Mengistae et al., 2010).

6.3.1.8. The Age of the SMEs

Younger firms without a track record face more problems accessing credit. These firms are less transparent as less information is available about them to the banks. These firms are more likely to fail and are therefore more risky (OECD, 2006). According to the World Bank Enterprise Survey of 2008, only 47% of firms under 5 years old had any credit products compared to 55% of firms 6 to 10 years old and 73% for firms older than 10 years. The subjective indicators mirror this picture and show obstacles declining with the age of the firm. Furthermore, loan applications for firms in the middle age category are more likely to be rejected. Younger firms are more likely to pay higher interest rates

registered for a general business license with any municipal agency; and (4) obtained a tax identification number from the tax administration or other agency responsible for tax registration (Mengistae et al., 2010: 122).

to reflect their comparatively higher risk profile. There was not much difference, however, in the sources of working capital and investment for firms in the different age groups.

Compared to other similar countries (see Table 16 below), South Africa's SMEs are generally young (start-ups). The high ratio between start-ups and new firms, unlike other similar countries, suggests that in South Africa many businesses either never progress beyond the start-up phase or close.

The non-availability of microfinance for informal, start-up and survivalist entrepreneurs has for long been another sensitive issue in the sphere of "access to finance"[50]. During the early 1990s several NGOs and CBOs started to enter this field, in the hope that Khula would capitalise them and on an on-going basis financially support these microfinance agencies. Unfortunately, a number of these agencies turned illiquid and Khula lost substantial funds, which tarnished both the sector and Khula.

At the same time, the number of private (for profit) micro finance agencies increased rapidly in South Africa, many of them turning out sizeable profits and a reasonable return on the investment. Admittedly, only a relatively small percentage of the vast number of new loans were for business finance, but even those aggregates were significant as an addition to the small enterprise funding supply. With the introduction of tight controls and oversights through the Microfinance Regulatory Council (MFRC)[51][52], many of the harmful practices of these agencies have now been addressed. These steps will not "solve" the financing dilemma of thousands of emerging informal sector operators, but a "quantum leap" in this sphere will in any case need the combination of efforts in fields like education, social welfare, community and youth development as well as sector-development promotion and changing attitudes of conventional banking institutions.

The table below shows that South Africa has consistently shown a high ratio between start-ups and new firms, similar only to Peru.

[50] TIPS (2005). Review of Ten Years of Small Business Support in South Africa 1994 – 2004.

[51] The MFRC was established through an exemption notice to the Usuray Act but ceased to exist with the establishment of the NCR under the NCA.

[52] The National Credit Regulator (NCR) took over the responsibilities of the enforcement of the Exemption Notice to the Usury Act from the Micro Finance Regulatory Council (MFRC).

Table 17: Start-up, new firm and established business entrepreneurial activity (%) for efficiency-driven economies

Country		2001	2002	2003	2004	2005	2006	2007	2008	2009
Argentina	Start-up	7.6	8.3	12.4	9.1	5.8	6.2	7.8	8.5	6.1
	New firm	2.7	6.2	8.5	4.5	3.9	4.1	7.1	8.5	9.3
	Establish	4.5	12.3	9.3	9.2	6.1	8.1	10.0	13.5	13.5
	Ratio**	2.8	1.3	1.5	2.0	1.5	1.5	1.1	1.0	0.7
Angola*	Start-up								19.3	
	New firm								4.1	
	Establish								4.1	
	Ratio								4.7	
Brazil	Start-up	7.3	5.6	6.5	5.0	3.3	3.5	4.3	2.9	5.8
	New firm	4.1	8.4	6.9	8.8	8.2	8.6	8.7	9.3	9.8
	Establish	4.6	10.1	9.0	11.9	10.9	13.4	9.9	14.6	11.8
	Ratio	1.8	0.6	0.9	0.6	0.4	0.4	0.5	0.3	0.6
Chile	Start-up		10.3	10.8		6.0	5.7	7.3	7.7	9.6
	New firm		5.5	7.1		5.3	3.9	6.5	5.6	5.6
	Establish		8.0	8.0		4.3	7.6	8.7	6.7	6.7
	Ratio		1.9	1.5		1.1	1.5	1.1	1.4	1.7
China*	Start-up		5.5	3.9		5.5	6.5	6.9		7.4
	New firm		7.4	7.4		9.4	10.5	10.0		11.8
	Establish		11.6	19.4		15.2	10.6	8.4		17.2
	Ratio		0.7	0.5		0.6	0.6	0.7		0.6
Croatia	Start-up		2.6	1.7	2.5	3.9	6.2	5.3	4.9	3.5
	New firm		0.9	0.9	1.0	2.5	2.4	2.0	2.8	2.2
	Establish		3.0	3.1	2.9	4.3	5.0	4.2	4.8	4.8
	Ratio		2.9	1.9	2.5	1.6	2.6	2.7	1.7	1.6
Hungary	Start-up	5.5	3.3		2.7	1.0	3.1	3.8	3.8	5.4
	New firm	3.6	3.6		1.5	0.8	3.0	3.1	2.8	3.7
	Establish	8.0	6.6		3.2	2.6	6.7	4.8	5.3	6.7
	Ratio	1.5	0.9		1.8	1.3	1.0	1.2	1.3	1.5
Peru	Start-up				30.7		29.7	15.1	19.7	16.1
	New firm				12.8		14.9	12.2	6.8	5.1
	Establish				20.9		15.6	15.2	8.3	7.5
	Ratio				2.4		2.0	1.2	2.9	3.2
Russia	Start-up	3.0	0.9				3.1	1.3	1.7	1.8
	New firm	2.9	1.4				1.7	1.3	2.0	2.3
	Establish	1.3	1.5				1.8	1.7	1.1	2.3
	Ratio	1.0	0.6				1.8	1.0	0.8	0.8
South Africa	Start-up	3.2	4.5	2.7	3.7	3.5	3.4		5.7	3.6
	New firm	1.2	1.9	1.9	1.6	1.6	1.7		2.1	2.5
	Establish	1.6	2.5	1.7	2.2	1.5	2.5		2.3	1.4
	Ratio	2.7	2.4	1.4	2.3	2.2	2.0		2.7	1.4

Source: GEM (2009)

Commercial banks and trade creditors are hesitant to lend to new SMEs. FinMark Trust (2006) provides evidence that only 2% of new SMEs in South Africa are able to access bank loans and that the use of suppliers' credit by new SMEs is virtually non-existent. In addition, Foxcroft et. al. (2002) report that 75% of applications for bank credit by new SMEs in South Africa are rejected. Balkenhol and Evans-Klock (2002) put the use of trade credit by new SMEs in South Africa at only 0.2%.

6.3.2 Systemic factors (external factors)

The ability of SMEs to access finance are worsened if the business environment, for example, lacks transparency as is often the case where there are high levels of informality in the economy and the legal system is weak. The situation is compounded where the levels of crime are high and when bad macro-economic conditions (such as a recession in the economy) make it difficult for firms to use debt positively thus negatively affecting the firms ability to repay the debt. Some of the external factors are briefly discussed below.

6.3.2.1. The phenomenon of "informality"

The OECD refers to the phenomenon of "informality" in emerging markets in which many enterprises operate outside the formal system (OECD, 2006: 10). Factors that favour informality include few perceived positive benefits by SMEs of operating transparently, the avoidance of being regulated and taxation in the formal sector and the Government's lack of administrative capacity to enforce the law (OECD, 2006). As noted above, according to the World Bank Enterprise Survey of 2008, 25% of registered firms had applied for a loan, 85% of which had been rejected compared to 13% of unregistered firms that had applied for a loan, all of which had been rejected.

6.3.2.2. Inefficient legal systems

Market imperfections such as those caused by inefficient legal systems can constrain the ability of firms to access external finance. This is because providers of finance are not able to recover their funds in a timely manner, if at all, in cases of default making financiers more reluctant to deal with those sectors where the rate of default is likely to be relatively high. Therefore, firms in countries with more efficient legal systems should be able to obtain more external financing than firms in countries with less efficient legal systems. The World Bank (2003) reveals a relatively inefficient legal system in South Africa compared to developed countries (especially compared to the BRIC[53] countries). There is a shortage of judges and magistrates, backlog of cases and lower creditor protection in practice.

6.3.2.3. Crime and corruption

Crime and corruption in South Africa are high and widely believed to restrain investment. The World Bank (2008) finds that 30% of enterprises in South Africa rate crime as a major or very severe constraint on investment, putting crime amongst the four most frequently mentioned constraints. The rate of corruption in South Africa is relatively high compared to developed countries (Transparency International, 2008). Consequently, business owners are less likely to want to increase their levels of investment to grow their businesses.

[53] BRIC is a grouping acronym that refers to the countries of Brazil, Russia, India and China, which are all deemed to be at a similar stage of newly advanced economic development. It is typically rendered as "the BRICs" or "the BRIC countries" or the BRIC economies" or alternatively as the "Big Four". With the introduction of South Africa into the BRIC economies, acronym was expanded to BRICS.

6.3.3 Financial Exclusion

6.3.3.1. The access to finance gap,

The FinScope Survey (2010) assessed the access to finance by SMEs in terms of financial inclusion vs. exclusion. The 'financially excluded' are the number of adults (out of a given population) who do not have/use any financial products and/or services – if borrowing, they rely only on friends/family. The 'financially included', on the other hand are adults who have/use financial products and/or services – formal and/or informal.

Using this categorisation and methodology, the FinScope Survey (2010) found the following, on small businesses in South Africa:

- 41.8% (2,334,439) were financially excluded i.e. used no financial products or services to manage their business finances;
  - Small business owners in BSM 1-2 were most likely to be financially excluded
- Of those who were financially included:
  - 15.3% (853,264) were informally served
  - Small business owners in BSM 5 were most likely to use informal mechanisms
- In terms of formal financial services, small business owners were more likely to use bank services or products than non-bank services or products such as insurance, microfinance, etc:
  - 46.9% (2,615,729) of small business owners were banked

Overall, service providers were more likely to be financially served than retailers, 58.6% compared to 49.5%. Drilling down the analysis further, the landscape of access was skewed towards savings products (52.9%) and, to a lesser extent, transactional products (45.5%). With respect to borrowing, retailers were most likely to borrow for day-to-day operations (37.65) and buying stock (28.1%) compared to 23.9% and 16.7% respectively for service providers. Service providers were most likely to borrow for reasons related to investing in, or upgrading their businesses[54].

The above statistical analysis demonstrates that the majority (41.8%) of South African small businesses are excluded from the financial (credit) market. This group do not even apply for credit as they do not have information about financial products on the market. Even if they get the information, they lack the minimum loan application requirements such as credit records and bank statements.

[54] 23.9% to upgrade business premises, 14.6% to buy property, 13% to buy machinery and 7.6% to buy technology.

The second layer is those who at least have an account but they are informally served (15.3%). These business owners use products or services from financial institutions that are not regulated (informal financial institutions and mechanisms) and/or use community-based organisations/mechanisms to save or borrow money. Because of the informal nature of their financial transactions, they may not qualify for credit from formal institutions which are regulated by the Banking Act.

The third layer consist of those individuals who have or use products or services from financial institutions that are regulated through an Act of law (formal financial institutions) – the 'formally served' segment of the population. According to the FinScope Small Business Survey of 2010, 51.5% (2,872,049) were formally served. These businesses, theoretically, can lodge an application for funding with a formal financial institution.

Table 18: Financing gap in terms of SME numbers

Description	Number of SMEs		
	FinScore Survey (2010)	Stats SA LFS (2007)	Label
Total SMEs	5 979 510	2 432 000	A
Registered SMEs (Formal): 17.3%	1 034 455	420 736	B
Ave applying for a loan: 84.4%	873 080	355 101	C
Avge loan application success rate (Formal): 33.2%	343 439	139 684	D
Those who receive funds after succeful appl: 27.3%	93 759	38 134	E
Financing Gap (C-E)	779 321	316 967	F
Total Informal: 41.8%	2 334 439	1 016 576	G
Less: Informall served (15.3%)	357 169	155 536	H
Total Financially Excluded (G-H)	1 977 270	861 040	I
Total Financing Gap (Formal and Infromal): F+I	**2 756 591**	**1 178 007**	**J**

Source: Author's calculations based on above figures and analysis of literature

6.3.3.2. Costs to being excluded.

Consideration of the financially excluded should not just be confined to small business owners because a high proportion of small businesses in South Africa still use personal accounts. Therefore the data and analysis of the financially excluded at household level will still be applicable in some instances.

Falkena et al. (2004: 81) demonstrate that there is a premium to be paid to being unbanked. For communities, the non-availability of financial services can also mean that the development of economic activity is severely constrained in that area. This "exclusion" is a function of both consumers and suppliers of credit. Customers cite a number of reasons for financial exclusion which include the high charges/process of financial products/services, inappropriate products (e.g. products having a number of inappropriate conditions attached to them) and not knowing how to manage an account (financial literacy) or the reluctance to deal with banks.

6.3.4 Poor uptake of the initiatives

As chronicled under the Supply Side above, South Africa is not short in terms of available funds. Funds are available from both the public and private sectors. However, the level of awareness and utilisation of these programmes have been disappointingly low (DTI, 2008; FinScope, 2010). South Africa still lags behind other developing countries in promoting the growth and sustainability of small businesses. One of the reasons, it is believed, for this poor uptake of facilities available, including financing, is the lack of a "single source of information", a one stop shop if you like of all available support programmes and how to access them (DTI, 2010).

In a bid to strengthen the integration of SME support programmes offered by the Government, private sector and donor institutions, the dti developed the "National Directory of Small Business Support Programmes". The Directory is intended to serve as a "one stop shop" and provide information that will be easily accessible to small business owners of the programmes available, how they work, who qualifies to use them, what procedures to follow to get assistance and the how to contact the institutions implementing the programmes.

The Directory covers programmes offered by national, provincial and local government and their institutions, and those offered by other players such as donors and large corporations and will be revised annually. Although fairly comprehensive, there is an acknowledgement that some programmes may have been left out and, as such, users are requested to forward information they have on programmes not covered for inclusion in future editions (DTI, 2010).

However, a number of analysts have proposed that the institutional arrangements need to be streamlined through the establishment of a centralised agency to coordinate all small business support programmes and funding (Herrington et al., 2010).

7 CONCLUSIONS AND POLICY RECOMMENDATIONS

7.1 Conclusion

The literature review revealed that there was consensus among researchers and policy makers that SMEs play a pivotal role in economic development through the creation of employment opportunities, generating higher levels of production, increasing levels of exports and promoting innovation and entrepreneurial skills. Despite their importance, SMEs face considerable challenges that inhibit their growth, which includes limited access to finance. The purpose of this study was to assess, through a review of the literature, SMEs access to credit and support in SA and then make policy recommendations.

The main conclusions of the study are presented herein;

7.1.1 Characteristics of the SME Sector

This study noted that the small business segment of the economy is heterogeneous with businesses ranging in size from micro-enterprises to relatively large firms. Small businesses are very diverse and have different needs. They operate in the formal and informal economies. Some are simply survivalist whereas others are run by people with an entrepreneurial flair. Some are start ups; some are growing rapidly; others are experienced and highly sophisticated. They operate in different markets, local, national and global (DTI, 2008; SBP 2009b).

No single policy can cover all these businesses, formal and informal, operating in different industrial sectors and with many sector specific challenges. Thus, data categories should be sufficiently differentiated to provide detailed and nuanced information to support targeted policy approaches and practical interventions. It is worth reconsidering whether SMEs should be considered as "one group" as the acronym infers. For policy purposes, a one- size-fits-all approach certainly will not work.

7.1.2 Defining SMEs

It is not surprising, therefore, that there is no uniformly accepted definition of SMEs. Firms differ in their levels of capitalisation, sales/productivity and employment. Consequently, definitions which employ measures of size (e.g. number of employees, turnover, profitability and net worth) when applied to one sector could lead to all firms being classified as small, whereas the same size definition applied to a different sector might result in all firms being defined as large.

In SA, the official definition is provided for in the NSB Act of 1996 as amended in 2003 and 2004. The classifications given in the Act, however, are not used consistently by state agencies or by private sector data bases and research studies making comparisons of the different studies and research done difficult and unreliable. For statistical purposes, it would make sense for the various data-gathering bodies in the public and private sectors to arrive at and use agreed categories covering the SME sector, i.e. the definition of the SME sector needs to be agreed and used consistently in the research/studies.

In this regard, the official definition as given in the NSB Act might be the starting point in coming up with a common uniformly accepted definition for SA. In view of the fact that the Act has been in force for a number of years, it may be time to reconsider whether the classifications contained therein are still appropriate in the context of SA based on the experience gained thus far. The definition in the Act can then act as the basis on which any research is undertaken to ensure reliability and comparability of research findings in future.

7.1.3 Data Availability

Moreover, the study revealed that statistics on small business in SA was inadequate with no official repository for data on the SME sector. Studies, when they are conducted, are conducted sporadically and statistics derived from numerous sources making it difficult to put together the pieces from different data sources. In order to have effective interventions, it is important to have an understanding of the SME sector, the challenges it faces and the capacity it has to deal with those challenges.

The study further revealed that the availability of data was also problematic and where data is available, information sources can be poor and difficult to access, including the official statistics (SBP, 2009: 3).

The problem of data has been identified in a number of forums and publications. Some considerations for improving the quality and usefulness of small business data include: (1) the allocation of a unique identifier number that would allow the firm to be tracked across different public sector databases; (2) the possibility of matching information across data sets to provide a composite picture of industry sectors; (3) the tracking of company performance by sector and over time to identify trends and factors affecting their growth or failure; (4) a national baseline study to be followed periodically by a small business sector census (e.g. every 5 years); and the consistent use of categories (preferably those defined by the Act) by all state agencies and private sector data bases and research studies to facilitate comparability (SBP, 2000b).

7.1.4 Access to finance gap

The literature review revealed that there are a number of sources of credit and support for SMEs. Moreover, the study also reveals that much of the information in terms of access to finance and SME support available relates to government programmes. Information on support offered by the private sector is not readily available. There is need, therefore, for more studies in this area to determine what support programmes are available and where the gaps lie.

It is not possible, however, to determine with any degree of accuracy whether the financing available is sufficient to meet the needs of the SME sector due to a lack of information (as noted above), especially with regard to the demand side and the specific causes for the lack of access. Therefore, more research is needed in this area to (1) identify the specific needs of the SME sector when it comes to financing and (2) whether the financing available meets those needs in terms of both "quantity" and "quality". Most of the studies and research focused on the supply side and (possible) constraints to access.

7.1.4.1. Increase the supply of finance available

If it is the case that there is insufficient financing available, the required policy response should be designed to increasing the amount of credit available to the sector. As noted above, there are an array of funds available in SA from both the public and private sector. However, the analysis was not conclusive as to whether the supply of credit is sufficient. Further research is therefore recommended.

If the findings reveal that the credit available is insufficient to meet demand, then Government would have to put in place programmes that will increase the availability of sources of funding (both public and private) for institutions that provide credit to the SME sector. The Government can provide credit directly as it currently does and simply increase the finance available to the SME sector, either through existing programmes and institutions, or through the establishment of more institutions. As far as possible, however, Government's aim should be in providing an enabling environment and to act as a catalyst to enable market participants to interact productively and minimise the distortional effects of Government intervention.

7.1.4.2. Problem of poor product design

On the other hand, it may be that there is sufficient credit being made available, but the terms and conditions under which it can be accessed are not appropriate for the SME sector it is intended to serve. In other words, there is sufficient "quantities" of funding available, but the "quality" of funding (i.e. the product design/services being offered) does not match the needs of the sector.

In this case, policy interventions will need to address the issue of poor product design and inappropriate services being offered. With respect to private entities, it is hoped that competition and the desire to increase returns from catering to this segment will improve product design and services offered. For Government funded programmes, the evaluation and monitoring of the various schemes and programmes on a regular basis should help the Government keep abreast of the applicability of the various programmes and schemes.

7.2 Recommendations

In summary, the recommendations arising from the study are interventions that focus on the following.

7.2.1 Increasing the levels of formality of SMEs.

As the study revealed, registered SMEs were more likely to have a bank account and making use of a credit product. Moreover, because of the difficulty of separating small business owner's personal finances from that of the business, registering made it easier to make the distinction because business registration separates the business at law from its owner, thereby reducing the probability of an application for credit being rejected. Increasing levels of formality also mean additional reporting requirements, thus promoting the availability of information available on a business, the lack of which can also be an impediment to accessing financing. In this regard, interventions to increase the levels of formality in the SME sector would have a positive impact on the SME sector being able to access finance.

This can be done through the compulsory registration of SMEs that have not yet registered, at minimal or no cost to the SME. SMEs can be incentivised by highlighting the benefits to registration such as access to financing from the various Government (and private) schemes available and access to other support programs such as business development services (BDS), also at minimal or no cost.

7.2.2 Improving information available on small businesses

As noted above, the additional reporting requirements resulting from registration would increase the information available on the business as well as improve the quality of that information. Other policy interventions aimed at improving the availability and quality of information available to reduce the problems of information asymmetry include:

(a) *Encouraging the reporting of trade credit information to private commercial credit bureaus to increase SMEs access to financial credit*. This information would help lenders in assessing the credit risk profiles of small businesses. The availability of information could also serve to spur the development of trade credit as a substitute for financial credit (Turner et al., 2008).

(b) *The introduction of credit ratings for SMEs.* Credit ratings provide a business owner and other stakeholders with an independent opinion of the SMEs credit worthiness. The introduction of credit ratings will help SMEs access credit and negotiate rates with suppliers of finance. To promote this initiative, Government may consider subsidising the cost of obtaining a credit rating by an SME.

7.2.3 Improving on SME-specific characteristics

The third possibility that needs consideration is one in which credit is available and sufficient to meet demand in both “quantity” and “quality”, but the lack of access is attributable either to the specific characteristics of the SMEs applying for the loan, or the lack of awareness that the financing is available. In these instances, the interventions will have to be targeted to deal with these specific SME characteristics, notably: (1) the level of formality of the SME (i.e. its legal status); (2) the lack of information available with respect to the business, or where there is information available, the information is of very poor quality; (3) the lack of collateral; (4) the poor level of managerial competence and skills of the small business owner; (5) the age of the business; and (6) the failure to access financial services, including credit, due to various perceptions small business owners have of the requirements needed for access or (7) lack of awareness of the facilities available.

Some of the key SME characteristics are discussed below.

7.2.2.1. Improving the levels of managerial competence and skills

Regarding the poor level of managerial competence and skills of the small business owners, interventions should focus on providing training and courses that will improve the human resource capacities in this regard. Though currently, various training programmes are provided and support is given to various sectors of industry, including SMEs through the SETAs, awareness and uptake of these programmes has been very low.

The Government is therefore encouraged to continue building on current programmes and establishing new ones if warranted, to improve the levels of managerial competence and skills of the small business owner. The majority of training programmes are implemented through Seda. To improve the effectiveness of the current programmes, Seda needs to be capacitated by improving staffing levels with individuals with the appropriate skills and experience, and making better/more use of consultants.

The programme designs should be anchored on;

(c) Loans linked to business support services,
(d) Mentorship/incubation programmes,
(e) Financial literacy and education,
(f) Marketing and awareness campaigns, and
(g) Monitoring and evaluations.

7.2.2.2. The lack of collateral

Establishing a collateral registry would improve lending at small costs as lenders would have greater confidence in the value of collateral in the event of default. This would mitigate the problems arising from potential borrowers not having adequate collateral to access financing (Turner et al., 2008).

7.2.2.3. Age of the business (Mentorship/incubation programmes)

The review of literature reveals that there is a strong correlation between the age of an enterprise and its risk profile. Most businesses fail within the first three years of business. The poor sustainability of start-ups highlights the need for interventions aimed at supporting and mentoring entrepreneurs through the early stages of the business cycle

7.2.2.4. Small business owners' perceptions on credit access criteria

Some studies also highlighted that some SME owners did not understand the products and terms on offer owing to financial illiteracy. Interventions should therefore focus on increasing financial education and improving financial literacy. Both the public sector and private sector have a role to play. The private sector benefits by increasing awareness and the uptake of their products/services thereby increasing their incomes and profitability.

7.2.4 Establishment of a Government Department to deal specifically with SMEs, entrepreneurship and support for this sector.

As noted above, the Government has a number of agencies spread across different departments providing finance and support to the SME sector. The funds for the SME sector are distributed across mainly five different departments, the dti, DED, DST, the Presidency and the Department of Agriculture.

This set up has proved problematic for strategic coordination purposes as programmes tend to be implemented in isolation of each other. Streamlining the current institutional arrangements through the establishment of a centralised agency whose responsibilities, in addition to those listed below, would be to coordinate small business support programmes and funding.

To improve the effectiveness of the various initiatives, it might be more practical to have all the Government agencies and programmes falling under one umbrella body, possibly through the establishment of a department to deal specifically with SMEs funding and support.

Main roles of the proposed harmonised department of SMEs and Entrepreneurship include;

(h) Facilitate compulsory registration,
(i) Act as a SME one stop shop,
(j) Information dissemination and SME awareness campaigns,
(k) House central repository of information on the SME sector,
(l) Establishment of a collateral registry, and
(m) Monitoring and evaluation of the schemes available.

7.2.5 Monitoring and evaluations of current Government programmes

Failure of different development projects and programmes to fulfil intended objectives has led to adoption of people-centered and results-based development. The new administration, headed by President Jacob Zuma elevated the importance of performance and results-based development in Government by setting up a Department for Performance Monitoring and Evaluation in The Presidency[55]. Monitoring and evaluation of current SME schemes is therefore very important.

The FinScope Small Business Survey (2010) can be used as a baseline study to evaluate the appropriateness of the current financing and support schemes, thus ensuring that what is provided in

[55] The newly established Department for Performance Monitoring and Evaluation (DPME) is headed by Minister Collins Chabane.

terms of support really does meet the needs and what is being demanded by the small business sector. Where necessary, the support programmes may need to be redesigned to make them more appropriate for the sector they are intended to serve. As part of the evaluation, an assessment can then be made as to the effectiveness of the programmes.

The gap in SME support programmes may not lay so much in the non-availability of support programmes, but rather the manner in which the available schemes are managed and administered. There is need to minimise the levels of bureaucracy embedded in the programmes. Administration needs to be streamlined, turnaround times improved and staff with an appreciation of what is involved in running a business employed.

7.2.6 Marketing and product awareness

As noted above, there is generally low uptake on available products, especially on Government schemes. One of the reasons, it is believed, for this poor uptake of facilities available, including financing, is the lack of a "single source of information", a one stop shop if you like of all available support programmes and how to access them (DTI, 2010). The introduction of the DTI*'s* National Director of Small Business Support Programmes will go a long way providing small business owners with information of the different types of support available. The publication of the National Directory, although a good starting point, will not achieve much if the small business sector is not aware of its existence.

Several studies indicated that most SMEs were not aware of the financial products on the market (or other support available). There is a need to increase awareness among small business owners of the products and services available. Clearly, the lack of awareness of the existence of these programmes will affect access which affects their uptake, thus making it appear that the programmes themselves have been ineffective. So, for example, even if the financing is available, it will not be accessed by those who might need it.

The poor level of awareness indicates an urgent need by Government to put in place measures to increase awareness of the availability of these programmes. Much needs to be done, therefore, to increase awareness. So, as for the Directory, there is a need to publicise the various schemes and programmes through a wide variety of media on an on-going basis, ensuring that the targeted recipients are reached. The Global Entrepreneurship Week, in conjunction with other forums, provides an ideal opportunity to increase the awareness of support available.

7.2.7 Promotion of developmental credit products/services

Section 3 of the NCA sets out all the specific objectives of the Act; that is "to promote and advance the social and economic welfare of South Africans, promote a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry, and to protect consumers, by: (a) *Promoting the development of a credit market that is accessible to all South Africans*, and in particular to those who have historically been unable to access credit under sustainable market conditions".

The NCA further categorises funds loaned to small businesses as developmental credit.

One of the options the Minister and the NCR could consider is to give incentives to banks and other private sector credit providers to loan to SMEs. The idea is to promote developmental credit, especially to small viable businesses.

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ANNEXURE A: TERMS OF REFERENCE

Terms of reference (TOR): To conduct a literature review on what has been researched on SME access to credit and support in South Africa

1. Introduction

The National Credit Regulator (NCR) was established in terms of section 12 (1) of the National Credit Act (Act 34 of 2005) and came into being on 1 June 2006. The purpose of the Act amongst other things is to promote the development of a credit market that is accessible to all South Africans, and in particular to those who have historically been unable to access credit under sustainable market conditions. This includes small enterprises and similar operators. The Small and Medium Enterprises (SME) or juristic persons as defined by the NCA have faced numerous challenges in terms of funding their business operations through credit and other forms of finance.

2. Background

Section (13) 1(c) of the National Credit Act (NCA) enjoins the NCR to monitor consumer credit by small businesses or persons contemplated in the Act. The Act stipulates that the NCR should conduct research and propose policies to the Minister in relation to any matter affecting the consumer credit industry in order to improve access to credit for persons contemplated in the Act.

There is a body of literature in the small enterprise support and development space that sought to bring to the fore the challenges, dynamics and funding issues faced by small enterprises. In addition there are government policy programmes geared towards the support and funding of small enterprises through a variety of funding agencies and institutions. It remains unknown the extent to which these initiatives have succeeded in addressing the funding and support challenges faced by small and medium enterprises or juristic persons as defined by the NCA.

3. Objectives of the study

The NCR seeks to understand what has been researched and written on SME access to credit and support in relation to juristic persons as defined by the NCA.

4. Purpose

The purpose of this proposal is to appoint a professional service provider to conduct a literature review on what has been researched and written on SME access to credit and support within South Africa.

5. Scope of work

A qualifying professional service provider will have to do a qualitative study of the literature review considering some of the following activities:

- International literature on SME access to credit with specific focus on South Africa;
- South African academic institutions have published substantially on SME support measures and access to credit;
- All spheres of government have in different ways taken initiatives in SME support and access to finance;
- Experts in the field of SME support and development have either advised policy makers or published on issues facing SME's especially access to finance;
- Different organisations and institutions that are stakeholders in SME support and access to finance have voiced their opinions on the question of access to credit and development support;
- Regular commentary in various publications including ones dedicated to SME support and development has added to body of literature on this question;
- Unpublished sources in various institutions need also to be explored to gain an in-depth understanding of the challenge of access to credit and general support.

6. Outputs

- A comprehensive preliminary report detailing what has been found in literature review with regard to access to SME credit and support;
- A workshop with NCR research team to present the key findings of the literature review;
- A draft final report incorporating NCR research team comments and suggestions;
- A final report to be submitted to the NCR within the agreed timeframe;

ANNEXURE B: PROJECT BACKGROUND

1. The National Credit Regulator

The National Credit Regulator (NCR) was established in terms of section 12(1) of the National Credit Act (NCA), Act 34 of 2005 and came into being on 1 June 2006. The purpose of the Act amongst other things is to promote the development of a credit market that is accessible to all South Africans, and in particularly those who have historically been unable to access credit under sustainable market conditions. This includes small enterprises and similar operators. The Small and Medium Enterprises (SME) or juristic persons as defined by the NCA numerous challenges in terms of funding their business operations through credit and other forms of finance. The mandate of the NCR in terms of Section 13(c) of the NCA is to monitor and report on:

- Credit availability, price and market conditions, the conduct of participants, and trends;
- Access to consumer credit by small businesses, historically disadvantaged persons, low-income persons, and persons in isolated or sparsely populated areas;
- Levels of consumer indebtedness and the incidence and social effects of over indebtedness; and
- Any other matter relating to the credit industry.

The NCR is responsible for the regulation of the South African credit industry. It is tasked with:

- Carrying out educational and research programmes;
- Monitoring and advising on policy developments;
- Investigating complaints and ensuring compliance with the NCA; and
- Registering credit providers, credit bureaux and debt counsellors.

2. The National Credit Act

Section (13) 1(c) of the National Credit Act (NCA) enjoins the NCR to monitor consumer credit by small businesses or persons contemplated in the Act. The Act stipulates that NCR should conduct research and propose policies to the Minister in any matter affecting the consumer credit industry in order to improve access to credit for persons contemplated in the Act. There is a body of literature in the small enterprise support and development space that sought to bring to the fore the challenges, dynamics and funding issues faced by small enterprises. In addition there are Government policy programmes geared towards the support and funding of small enterprises through a variety of funding agencies and institutions. It remains unknown the extent to which these initiatives have succeeded in addressing the funding and support challenges faced by small and medium enterprises or juristic persons as defined by the NCA.

ANNEXURE C: EVALUATION OF SELECTED SME SCHEMES

A recent study conducted by Timm (2011) provides useful lessons to be learnt from other emerging countries, specifically India and Brazil, on improving SME support in South Africa.

1. Financial support – credit guarantee scheme, Khula

Compared to its Indian counterpart, the Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE), Khula's guarantee scheme's performance has been very poor since its inception in 1996. The scheme is aimed at business owners who lack sufficient collateral to access traditional bank finance. The scheme disburses amounts ranging from R10,000 to R3 million, covering between 50% and 90% of the loan amount, depending on security available. Since its inception, the number of guarantees given out by Khula has not exceeded 800. The highest number of guarantees given out was 797 in the 2001/2002 financial year.

Khula's default rate on its guarantee scheme between 2005/2006 and 2009/2010 came to 42.15% of the total loan amount, with 80.1% or 1,381 loans in those five financial years in default. In India, the equivalent figure in terms of the total value of loans in default was 2.5%. The non-repayment of loans in South Africa is a big problem. Unless this problem is attended to as a matter of urgency, any attempts to increase lending to small businesses will make little impact.

Timm (2011) makes a number of proposals to improve Khula's performance drawing on lessons learnt from its Indian counterpart, the CGTMSE. Recommendations made include, firstly, targeted lending[56]. He suggests that the Financial Services Sector Charter could be used as an important tool to encourage banks to be more involved in lending to SMEs and drive bank's involvement in Khula's guarantee scheme as banks can score valuable points on the BEE scorecard for meeting targets under the charter.

The second recommendation made is improved turnaround times for applications using "strong IT systems" such as the use of a web portal which allows member banks to feed applications for guarantees back to Khula's offices for processing[57]. With an online system, business owners can

[56] The Indian Government's priority lending policy requires commercial banks to lend 40% of their net bank credit to priority sectors of which small business are an integral part. Foreign banks are required to lend 32% to priority sectors with 10% specifically earmarked for the small-scale sector. Banks that fail to meet these requirements are penalised.

[57] In India, all branches of banks participating in the guarantee scheme have access to the CGTMSE's website using a user ID and password which the banker uses to access the scheme's website and feed an application into the system. This system has helped streamline the handling of applications.

apply for and receive a guarantee within 24 hours. The longest waiting period would be 2 to 3 days if the application is made on a weekend. While Khula currently aims to finalise applications within 3 days, member banks' processes can take weeks to finalise. There is no back end IT system at Khula and applications to the guarantee are simply emailed to Khula by the banks.

The third recommendation is the holding of regular workshops and meetings with banks to explain to them the significance of the guarantee scheme and get the banks buy in. Getting the buy in from banks has been difficult for Khula. It is necessary for Khula to meet regularly with the banks to review processes and the banks needed to ensure that the banks' staff members assigned to the scheme were committed.

The fourth, and possibly the most important recommendation is improving the rate at which Khula responds to paying out defaulting loans, a big concern for the banks. Khula requires the banks to seek a default judgement first against a business owner before lodging a claim, which can take from one to 3 months[58]. Moreover, the process for making a claim is cumbersome and must be supported by 5/6 pieces of documentation to support the claim. In contrast, the CGTMSE makes the first payment the same day the application is posted[59] and very little documentation is required[60], the scheme's "unique selling proposition". Although Khula settlements are made in one lump sum within 30 days of receipt of all information, banks first have to secure a default judgement and all sureties in court before they can lodge a claim.

The fifth recommendation is the "sharpening of the assessment process". The Khula assessment is more intensive and documentation requirements are more onerous than for most banks' internal credit applications. Despite this, the default rate for Khula backed loans is higher than the bank's own business credit portfolio, a sign that the Khula's assessment criteria are not as robust as they could be[61]. Moreover, the administration of the Khula scheme is costly.

It is evident from the above, that the "gap" in this case is not a result necessarily of financing not being available, but rather the manner in which the scheme is administered does not promote access to financing via this route because the banks are reluctant to lend on the basis of a Khula guarantee[62].

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[58] And up to 5 years in extreme cases.
[59] 75% of the guaranteed amount. The balance is paid once the legal process to recover the loans is completed.
[60] When filing the claim, the applicant has to indicate (by ticking the relevant boxes) whether: (1) the guarantee is valid; (2) the loan has been classified as nonperforming; (3) they have issued a recall notice; (4) they have filed in the appropriate forum; and (5) there is certification from an AGM-level officer.
[61] This problem is probably compounded by the "entitlement culture" with "loans being perceived as grants" by borrowers as the loans are funded from public money and therefore does not have to be paid back (Timm, 2011: 37).
[62] i.e. perceived benefits by the banks are not worth the effort.

Therefore, any improvements in the performance of the Khula guarantee scheme can only be achieved by changing the manner in which the scheme is managed and administered.

2. Business support - Seda

The availability of quality, affordable business advice and support is just as important, if not more so, than access to finance and markets. Seda was established in 2004 by the Small Business Act and is mandated to support enterprises. Its performance, however, has been criticised on a number of fronts, including its focus on unsophisticated, micro-enterprises (whose capacity to generate employment is questionable) and for offering generic, rather than sector specific support. Absent from Seda's support profile are medium sized firms, despite the agency's assertion that it focuses 20% of its support to these firms. And although it was intended to be a one stop shop, Seda has no control over the Government's many small business support programmes.

There are many lessons to be learnt from its Brazilian counterpart, Sebrae. The first is the use of innovative methods to widen the agency's reach. Sebrae uses a variety of channels (such as television, radio, print media, competitions and blogs) to reach business owners, in addition to its call centre, website and branch networks. As noted by the FinScope Small Business Survey, only 4% had heard of Seda and a mere one percent of business owners had accessed Seda branches. There is a need, therefore, for Seda to increase its presence through a variety of methods. The launching of Seda information kiosks in 2010 is a move in the right direction and will serve to increase Seda's brand more effectively whilst doubling as an efficient business information supply service.

Another lesson from to be learnt by Seda from its Brazilian counterpart, is to make more use of private sector consultants. While Sebrae makes use of over 9,500 private sector consultants, Seda was cutting back on the number of consultants it uses in favour of in-house business advisors who have little or no business training. Although Seda has increased its internal training capacity, the people providing the training and advice have no or very little business experience which will limit Seda's effectiveness in offering more sophisticated and focused (sector specific) support as no amount of training can substitute for real experience a consultant would have gained from running his/her own business. There is need to improve the number and quality of consultants in South Africa and Seda should focus on initiatives that would upskill private sector business consultants rather than training in-house business advisors.

The third lesson to be learnt, according to Timm (2011), is for Seda to target more sophisticated clients. The dilemma that Seda faces, is whether to support more high-growth businesses which are traditionally run by more skilled and wealthy entrepreneurs, but which create many more jobs; or, to support micro-enterprises which offer those without a job the possibility of income, but which will either soon fail or will amble along without creating more than one or two jobs.

Lastly, with respect to Seda, Timm recommends that the Seda puts in place systems to monitor the impact of interventions. The systems can be used to motivate consultants and internal staff to deepen the impact of their support to entrepreneurs as incentive schemes can be tied in to those interventions which perform well.

3. Market support – set asides for SMEs

Business owners also need access to markets to succeed. Government can increase its support in this area by setting aside certain types of procurement for SMEs, as a number of countries like South Korea[63], the United States and Japan do. Small businesses have the potential to grow if they are able to participate in Government's planned expenditure in infrastructure, for instance. To date, efforts to put set asides in place have been vetoed by the National Treasury on the grounds that they are unconstitutional. Moreover, the National Treasury probably shares the concern that many other governments have that set asides may serve to inflate the costs of procurement.

A study by Nakabayashi (2009), however, that evaluated Japan's policy of allocation approximately 50% of construction contracts to small firms revealed that the increase in costs associated with procuring more from small firms was "neutral" (Timm, 2011; 46). On its own, the policy of set asides may not be sufficient and needs to be accompanied by developing "e-procurement" systems which would have the effect of reducing the bidding costs, thus making tendering more accessible to all and the reduction in the time it takes for Government to pay suppliers. In addition to business support and finance, the Government should, therefore, consider how public procurement can be used to facilitate small business growth in South Africa.

4. Other initiatives

In addition to the above, Timm (2011) notes that South Africa could do much to create a successful awareness campaign to promote entrepreneurship. South Africa needs to create role models which will inspire others to become entrepreneurs and embark on a massive, ongoing entrepreneurship campaign. At the moment, there is not enough acknowledgment of the contribution that entrepreneurs make to the economy. According to the GEM 2009 Report, "GEM studies over the years have conclusively shown that the low rate of early stage entrepreneurial activity in South Africa is influenced by the low level of overall education, social and entrepreneurial factors that do not

[63] South Korea, whose miracle economic growth was largely driven by the promotion of small businesses, has had a set aside policy for small enterprises since 1965 (Timm, 2011: 43).

encourage entrepreneurship as a career path of choice, a lack of access to finance and a difficult regulatory environment" (Timm, 2011: 48).

Timm concludes his study with what he terms as "key learnings" being the development of a national entrepreneurial vision with measurable targets and backing from the President, establishment of more forums based on private public sector partnerships, the simplification of the Government's support structure, implementation of effective real-time monitoring mechanisms in place and improving the capacity of Government agencies.

ANNEXURE D: PROVINCIAL FUNDING PROGRAMMES AND SCHEMES

1. Mpumalanga Economic Growth Agency (MEGA)

The Mpumalanga Economic Growth Agency (MEGA) was formed in terms of the Mpumalanga Economic Growth Agency Act (Act No. 4 of 2005) through a merger of the Mpumalanga Economic Empowerment Corporation and the Mpumalanga Investment Initiative. The enterprise development division within the Mpumalanga Economic Growth Agency promotes the development and growth of SMMEs, including co-operatives, in the Mpumalanga Province. Mega offers the following products and services to enterprises:

- Loan funding, through term loans of between R10 000 and R1 million
- Bridging finance, linked to an existing contract
- Facilitation of mentorship to funded enterprises
- Development of co-operatives
- Development of strategic partnerships with e.g. the IDC, Seda and the Umsobomvu Youth Fund.

For SMEs to access the MEGA facility they should meet or fall within the stipulated and comply with a number of qualifying criteria.

- Enterprising individuals who are 18 years and older, preferably from a historically disadvantaged background, are considered;
- The business must be located in the Mpumalanga province.
- The business must be registered as a close corporation or (Pty) Ltd co-operative.
- It is recommended that applicants should fall within the priority sectors.
- The applicant must operate the business on a full-time basis. Where the business is owned by more than one shareholder, one member must be involved in the business in a full-time capacity.
- The business must have a BEE shareholding of at least 26, 1%.

2. Gauteng Economic Development Agency (GEDA)

GEDA is an agency of the Gauteng Department of Economic Development. It is mandated to implement approved departmental policies designed to grow the economy, attract investment and develop sustainable social-economic infrastructure. In particular, GEDA's responsibility is to implement policies in the areas of economic production, investment and trade. Its mission is to promote economic growth, encourage new investment and maximise opportunities for skills transfer and job creation.

3. Gauteng Enterprise Propeller (GEP)

The mandate of the Gauteng Enterprise Propeller (GEP) is to provide both non-financial and financial support to SMMEs and co-operatives in Gauteng.

4. Western Cape Department of Economic Development and Tourism

The primary responsibility of the Western Cape Department of Economic Development and Tourism is to:

- develop, constantly refine and expand the Micro-economic Development Strategy;
- inform other provincial strategies; and
- Intervene in the economy to achieve the ikapa elihlumayo goals.

The enterprise development sub-directorate within the Department of Economic Development and Tourism initiated the RED Door project, a one-stop shop for new and existing businesses looking for help and advice. The sub-directorate aims to promote the development of small and/or black-owned enterprises, including co-operatives. For example the Red Door Centres offers a free interest loan with a qualifying amount between R10 000 and R100 000.To qualify the following criteria must be met;

- The cooperative must be a fully registered;
- Only applicants that reside within the boundaries of the Western Cape Province are considered;
- Applicants must prove South African citizenship by producing an ID.
- The maximum loan repayment period is 36 months.
- Applications must be submitted via a RED Door centre.
- All beneficiaries will undergo a pre-funding mentorship programme of one month and a post funding mentorship of at least six months.

5. Limpopo Business Support Agency (Libsa)

The Limpopo Business Support Agency (Libsa) was formed in response to the Limpopo Provincial Growth and Development Strategy, which focuses on exploiting opportunities in all economic sectors for business development and promotion among existing and aspiring entrepreneurs in the Limpopo Province. Libsa offers credit and support services to small businesses.

6. Limpopo Economic Development Enterprise (LimpDev)

The Limpopo province has yet another agency, Limpopo Economic Development Enterprise (LEDEV) LimpDev is a juristic person established in terms of the Northern Transvaal Development Corporation Act No. 5 of 1994 and operates as a Provincial Government Business Enterprise, entitled to make profit, as listed in schedule 3D of the Public Finance Management Act, Act No. 1 of 1999 (as amended by Act No. 29 of 1999).

LimDev's mandate is to provide development finance to SMMEs to stimulate the growth and development of the Limpopo economy.

7. The Northern Cape Economic Development Agency (NCEDA)

The Northern Cape Economic Development Agency (NCEDA) was established through a partnership between the Northern Cape Provincial Government and the Industrial Development Corporation (IDC). NCEDA offers credit and business support to small businesses in the following sectors:

- Agriculture and agro-processing / value adding.
- Mining and beneficiation.
- Tourism infrastructure.

8. Ithala Development Finance Corporation

Ithala Development Finance Corporation (Ithala), the KwaZulu-Natal Provincial Government's economic development agency, is a catalyst for economic development and empowerment in KwaZulu-Natal. As such, Ithala funds only businesses that are domiciled within the province of KwaZulu-Natal.

9. Trade and Investment Kwazulu-Natal

Trade & Investment KwaZulu-Natal is a provincial trade and investment promotion agency, developed to promote the province as an investment destination. The agency offers a range of service which include facilitation of joint ventures, and business linkages between small and big business and assisting investors to secure project and operational financing.

10. The Free State Development Corporation (FDC)

The FDC was established by the Free State Development Corporation (FDC) Act, and mandated to establish and develop sustainable SMMEs in the Free State Province by providing them with both financial and non-financial services to them.

ANNEXURE E: DEFINITIONS OF SMES - INTERNATIONAL CONTEXT

1. International Definitions

According to the Organization for Economic Cooperation and Development (OECD, 2004), the characteristic of SMEs not only reflects the economic patterns of a country but also the social and cultural dimensions. These unique patterns are noticeably reflected within various definitions and criteria of SMEs adopted by different countries: whereas some refer to the number of employees as their distinctive criteria for SMEs, others use invested capital, and some use a combination of the number of employees, invested capital, sales and industry type.

2. The European Commission

The definition of the European Commission (EC) takes into cognisance three different indicators; staff headcounts, annual sales and assets. The EC suggests that, medium enterprises are those enterprises that employ fewer than 250 people and have annual sales not exceeding $67 million and/or total assets not exceeding $56 million. Small enterprises are defined as those enterprises employing less than 50 persons and with annual sales or total assets that do not exceed $13 million. Lastly, micro-enterprises are defined as those which employ fewer than 10 persons and with annual sales or total assets that do not exceed $3 million.

3. Asia Pacific Economic Cooperation

The most common criterion used within the economies of Asia Pacific Economic Cooperation (APEC) is the number of employed personnel within the business itself. Therefore, APEC defines SMEs as enterprises with less than 100 people, whereby, a medium sized enterprise employs between 20 and 99 people, a small firm employs between 5 and 19, and a micro firm employs less than 5 employees which include self employed managers (USAID, 2004).

4. United Nations Industrial Development Organization

The UNIDO Investment Promotion Unit (UNIDO/IPU) offices in Amman refer to the local definition that has been set by the Ministry of Industry and Trade (MIT), which defines SMEs as follows;

- Micro-sized enterprises are those employing between 1 and 9 employees and/or have a registered capital of less than $42,300
- Small enterprises employ between 10 to 49 employees and have a registered capital of more than $42,300

- Medium enterprises employ between 50 to 249 employees and have a registered capital of more than $42,300.

Large enterprises, on the other hand, are those employing more than 250 employees and have a registered capital of more than $42,300

5. Multilateral Investment Guarantee Agency and International Finance Corporation

The Multilateral Investment Guarantee Agency (MIGA) and the International Finance Corporation (IFC) define small enterprises as those that meet two of the following three conditions:

i. Less than 50 employees
ii. Less than $3 million total assets
iii. Less than $3 million total annual sales

On the other hand, according to USAID (2004), medium enterprises are those that meet two of the following three conditions:

i. Less than 300 employees
ii. Less than $15 million total assets
iii. Less than $15 million total annual sales

6. Arab Countries

The definitions, a compilation from various local and international organizations, use some economic indicators Gross National Income (GNI), Income Group, and contribution of SME sector to the total employment. These economic indicators are useful in investigating the linkage between economic growth, poverty reduction and the SME sector.

Table 19: Definition of SMEs in Selected Arab Countries

Definition according to number of Employees					Economic Indicators			
Country	Source	Micro	Small	Medium	GNIper Capita ($)	Income grp	MSMEs per 1000 population.	MSMEs employment as a 100% total
Egypt	UNDCF	1-4	5-14	15-49	1,240	Lower middle	26.8	73.5
Lebanon	MET	0.9	10-49	50-99	3,760	Upper Middle	47.2	n/a
Israel	ICBS	0.9	10-49	50-100	18,620	High	67.8	n/a
Jordan	DOS	1.4	5-19	20-99	2,190	Lower Middle	26.8	50.0
United Arab Emerites	HSBC	*0.9	10-49	50-499	19,420	High	34.2	86
Tunisia	UNIDO	<10	10-49	50-99	2,080	Lower Middle	0.9	n/a

Source: MSMEs Database-World Bank2007

Note: Although it is not possible to have a micro-enterprise with 0 employees, the range has been displayed within the table as provided by the source itself.

7. Developing Countries

Fisher and Reuber (2000) populate a number of characteristics of SMEs in developing countries under the broad headings: labour characteristics, sectors of activity, gender of owner and efficiency. Given that most SMEs are one-person businesses, the largest employment category is working proprietors. This group makes up more than half the SME workforce in most developing countries. The working proprietors' families, who tend to be unpaid but active in the enterprise, make up roughly another quarter. The remaining portion of the workforce is split between hired workers and trainees or apprentices.

According to Fisher and Reuber (2000) definition, SMEs in developing countries are more labour intensive than larger firms and therefore have lower capital costs associated with job creation (Anheier and Seibel, 1987; Liedholm and Mead, 1987; Schmitz, 1995).

7.1. Ghana

Kayanula and Quartey (2000) propound that, SMEs have been variously defined, but the most underlining criterion used is the staff complement of the enterprise. This definition is often confusing in respect of the arbitrariness and cut off points used by the different official sources. According to the Ghana Statistical Service (GSS), firms with less than 10 employees are regarded as small scale enterprises (SSEs) and their counterparts with more than 10 employees as medium and large-sized enterprises (MLSEs). Steel and Webster (1990) and Osei et al. (1993) in defining SSEs in Ghana used an employment cut off point of 30 employees to indicate and SSE. The latter however disaggregated SSEs into 3categories: (i) micro-employing less than 6 people; (ii) very small, those employing6-9 people; (iii) small-between 10 and 29 employees.

7.2. Malawi

In the case of Malawi, the official definition of enterprise sizes dates back to 1992. The definition is based on three criteria, viz.: the level of capital investment, number of employees and turnover. An enterprise is defined as small scale if it satisfies any two of the following three criteria, that is; (i) it has a capital investment of US$2,000 -US$55,000, (ii) employing 5 - 20 people and (iii) with a turnover of up to US$110,000 (using 1992 official exchange rate). For manufacturing enterprises, capital investment is taken to mean the cost of plant and machinery, including working capital and the cost of land and buildings. It may be observed that since this official definition was given in 1992, the economic situation in the country has changed drastically, with the value of the kwacha falling from an official rate of MK3.60 to US$1 in 1992 to MK15.30 toUS$1in 1996 and to MK43.15 as of January1999. The implication is that the existing official definition is out of date and needs to be revised (Kayanula and Quartey, 2000).

ANNEXURE F: SMME CLASSIFICATIONS

Threshold for the classification for micro, very small, small and medium enterprises

Sectors or sub-sectors in accordance with ·the Standard Industrial Classification (SIC)	Site or Class	Total full-time equivalent of paid employees (Less than)	Total annual turnover (Rm) (Less than)	Total gross asset value (fixed property excluded) (Rm) (Less than)
Agriculture	Medium	100	5.00	5.00
	Small	50	3.00	3.00
	Very small	10	0.50	0.50
	Micro	5	0.20	0.10
Mining and Quarrying	Medium	200	39.00	23.00
	Small	50	10.00	6.00
	Very small	20	4.00	2.00
	Micro	5	0.20	0.10
Manufacturing	Medium	200	51.00	19.00
	Small	50	13.00	5.00
	Very small	20	52.00	2.00
	Micro	5	0.20	0.10
Electricity, Gas and Water	Medium	200	51.00	19.00
	Small	50	13.00	5.00
	Very small	20	5.10	1.90
	Micro	5	0.20	0.10
Construction	Medium	200	26.00	5.00
	Small	50	6.00	1.00
	Very small	20	3.00	0.50
	Micro	5	0.20	0.10
Retail and Motor and Repair Services	Medium	200	39.00	6.00
	Small	50	19.00	3.00
	Very small	20	4.00	0.60
	Micro	5	0.20	0.10
Wholesale Trade, Commercial Agents and Allied services	Medium	200	64.00	10.00
	Small	50	32.00	5.00
	Very small	20	6.00	0.60
	Micro	5	0.20	0.10
Catering, Accommodation and Other Trade	Medium	200	13.00	3.00
	Small	50	6.00	1.00
	Very small	20	5.10	1.90
	Micro	5	0.20	0.10
Transport, Storage and Communications	Medium	200	26.00	6.00
	Small	50	13.00	3.00
	Very small	20	3.00	0.60
	Micro	5	0.20	0.10
Finance and Business Services	Medium	200	26.00	5.00
	Small	50	13.00	3.00
	Very small	20	3.00	0.50
	Micro	5	0.20	0.10
Community, Social Personal Services	Medium	200	13.00	6.00
	Small	50	6.00	3.00
	Very small	20	1.00	0.60
	Micro	5	0.20	0.10

Source: Schedule 1 *to the National Small Business Act of* 1996 *as amended in* 2003 *and 2004*