

**HURDLES FACED BY FINANCIAL INSTITUTIONS IN FINANCING
SMALL AND MEDIUM ENTERPRISES (SMME)**



EXECUTIVE SUMMARY

This report presents the results of a study commissioned by the Banking Association of South Africa (BASA) as a follow up to one conducted in 2010 by the Financial Sector Programme. The purpose of this study was to review whether the findings of the 2010 study still hold true and whether there has been progress on solutions and interventions proposed in the 2010 study, to assess whether there are new and additional hurdles, and to examine the extent to which ongoing hurdles still impact on the ability of SMMEs to access finance. The review also sought to assess whether, and to what extent, the interventions identified by the 2010 research had been addressed in the overall SMME finance ecosystem. The ultimate purpose of the current study was to highlight gaps in terms of responses to the hurdles identified in the 2010 study. While, similar to its 2010 predecessor, the current review focuses mainly on financial institutions, its scope also included a limited assessment of the views and experiences of SMMEs themselves. This provides an important counterpoint to the views expressed by financial institutions.

The key findings of this study are as follows:

1. Access to finance remains a definite challenge particularly for start-ups which are associated with high cost of servicing and volatility, and for smaller businesses and smaller loan sizes, where demand is greatest. One recent study shows that a total of 44% of SMMEs seek funding of up to R250,000, with a combined 73% seeking funding of up to R1 million (29% seeking funding between R250,000 and R1 million), whereas financiers mostly offer funding from R250,000 to R5 million, pointing to a mismatch between funding demand and supply. International literature suggests that this is not a uniquely South African problem. However, recent OECD analysis suggests that South Africa's low ratio of SMME financing relative to overall private sector financing is out of the norm.
2. The funding gap remains very large, with SMME funding estimated by the OECD at only 26% of total private sector funding, and the overall funding gap estimated by Finfind at between R86 billion and R386 billion. Financial sector sources show that the sector continues to fall below its annual Financial Sector Charter targets. The highest estimates show that some R14 billion of financing was offered to SMMEs in 2013 by institutions affiliated to the Financial Sector Charter Council. This compares poorly to the R40,9 billion reportedly sought by just around 11,000 SMMEs on the Finfind platform in 2017, even taking into consideration the passage of time from 2013 to 2017.

3. While most respondent financial institutions assert that there has been improvement in SMME access to finance from the institutions themselves, they also agree that in general access has only increased marginally or not increased at all since 2010. SMMEs, on the other hand, don't see any improvement at all. Therefore, the overall finding is that there has been no meaningful improvement in access to finance since the previous study.
4. Factors accounting for lack of increase in access to funding remain largely similar to those identified in the 2010 study and are to be found: (a) within the financial institutions themselves, (b) within SMMEs, and (c) within the external environment which both the financial institutions and SMMEs have no control over. SMME issues largely have to do with unviable business proposals, lack of financial management knowledge and discipline, and seeking the wrong type of funding. Financial institution issues, especially within banks, largely derive from strong risk aversion towards SMMEs, particularly start-ups and smaller businesses. In the external environment several factors have a bearing on access to finance: (a) the weak state of the economy which results in high SMME failure rate, (b) the regulatory environment, especially the National Credit Act with its regulation of reckless lending, (c) late payment by government, which has resulted in government business being seen as a risky and unreliable source of cashflow to service the loan, and (d) lack of effective risk mitigation measures such as credit guarantees. Operational difficulties associated with the SEFA credit guarantee scheme have resulted in banks withdrawing from the scheme, leaving it facing total collapse and removing what was meant to be an important risk mitigation measure for SMME lending.
5. Available literature points to a significant problem with the availability and quality of data on SMME lending in the country. This makes it difficult to appreciate the full extent of SMME funding issues and dynamics.
6. Overall, the study finds that the proposals contained in the 2010 FSP report still hold valid as there is not much evidence that there have been any significant changes since then, both in terms of access to finance and the nature of hurdles preventing increased access. This study recommends six actions to be undertaken by the broader SMME support ecosystem, to improve access to finance for SMMEs:

- Action 1: Undertake a review of the impact of the National Credit Act on SMME lending.
- Action 2: Invest in developing the business and financial acumen of entrepreneurs, particularly those starting out, so that they can identify viable business opportunities and formulate business and funding proposals that demonstrate their full grasp of the opportunities they seek to pursue.
- Action 3: Have an open conversation about the problems experienced by both sides, namely banks and SEFA, with the SEFA credit guarantee scheme and fundamentally redesign the scheme to make it more user-friendly. Simultaneously investigate other risk mitigation mechanisms used successfully in various parts of the world, such as mutual guarantees, to determine their suitability for the South Africa market.
- Action 4: Support initiatives aimed at helping entrepreneurs that have ‘thin’ credit files to develop positive credit profiles.
- Action 5: Have an open, public dialogue with various stakeholders, including government and SMME representative organisations, about the negative impact that lack of disciplined financial management behaviour and a culture of non-payment on the part of borrowers has on the general environment for SMME financing in the country.
- Action 6: Work with institutions such as the Department of Small Business Development, Financial Sector Charter Council, National Credit Regulator, and South African Reserve Bank to confront the challenge of lack of accurate and credible data on SMME financing in the country.

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ACRONYMS

AfDB	African Development Bank
BASA	Banking Association of South Africa
B-BBEE	Broad-based Black Economic Empowerment
BDS	Business Development Services
ED	Enterprise Development
FI	Financial Institutions
FSCC	Financial Sector Charter Council
FSP	Financial Sector Programme
IFC	International Finance Corporation
ILO	International Labour Organisation
IT	Information Technology
KZN	KwaZulu-Natal
NCA	National Credit Act
NCR	National Credit Regulator
OECD	Organisation for Economic Cooperation and Development
SAVCA	South African Venture Capital Association
SEFA	Small Enterprise Finance Agency
SMME	Small, Micro and Medium Enterprise
USAID	United States Agency for International Development

I. BACKGROUND

In 2010 the Banking Association South Africa (BASA), in partnership with USAID's Financial Sector Programme (FSP), which had as one of its key result areas "to enhance the bankability of SMMEs by improving the quality of business development services (BDS) related to finance and enhancing the understanding of BDS providers of the world of small and medium enterprise (SMME) finance", commissioned research titled *Financial Institutions Hurdles to SMME Financing*.¹ The aim of the study was to identify, from the perspective of financial institutions (FIs), what hurdles they faced in financing SMMEs and to propose solutions or interventions, if any, needed to facilitate provision of business development services (BDS) to SMMEs on behalf of financial institutions. The 2010 study examined:

1. The overall success of SMMEs applying for finance
2. The criteria used by financial institutions to evaluate and approve SMME applications for funding
3. Hurdles preventing financial institutions from financing SMMEs
4. Factors that account for SMME failure to access finance
5. Services, if any, offered by financial institutions to assist SMMEs improve their access to finance or promote bankability of SMMEs
6. Interventions required on the part of financial institutions to promote or improve access to finance for SMMEs.

The study found that while most financial institutions financed all categories of SMMEs, greater financing success was recorded among SMMEs with higher turnovers compared to those at the lower end of the market spectrum, where a greater level of ancillary support was required before the SMME could successfully apply for finance. The study also found the most important criteria for evaluating SMME applications for finance were the ability of the SMME to repay the loan, based on its cash flow status, and its own contribution. There was also strong focus in lending processes and decisions on:

1. Accurate and up to date financial records, especially financial statements
2. A good sales pitch by the entrepreneur
3. Good business skills and business plans, with the SMME being required to demonstrate understanding thereof
4. Demonstrated knowledge by the SMME of its chosen field of operation.

¹ USAID Southern Africa, *Financial Institutions Hurdles to SMME Financing*, March 2010.

Financial institutions identified three key actions they needed to undertake internally to increase the levels of success by SMMEs in accessing finance.

TABLE 1: Internal actions identified by financial institutions to increase SMME financing

- Make the criteria for evaluating applications for finance more appropriate to the SMME market, with particular reference to the requirement for collateral
- Recognise the need to be more lenient in assessing funding applications, greater willingness to take more risk, and need to offer SMME advice and support
- Offer new products that are more appropriate to SMME financing needs and that are broader in spectrum, with improved costs and value

In addition, financial institutions also felt that SMMEs themselves needed to make certain important improvements in order to ensure their success in seeking financing:

1. Do more research on their chosen markets
2. Prepare and submit viable business plans to back up their finance applications
3. Clean up their credit records, where required to do so
4. Prepare their own financial statements instead of relying on outsiders to do this for them
5. Actively develop their business skills.

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Based on these observations by financial institutions and its overall findings, the study recommended four areas of focus for interventions by financial institutions to improve the success rate of SMMEs applying for finance:

TABLE 2: Recommended financial institution actions to improve SMME access to finance

- Help SMMEs to evaluate their own financial status and make their own risk assessments before approaching an FI for financing
- Offer services prior to the application for finance stage, focusing on one-on-one assistance as well as on mentoring and training
- Focus assistance on helping SMMEs to reduce their risk status and to prepare and understand their own financial statements, proposals and business plans
- Assist SMMEs to actively develop their business skills, particularly in managing their finances, understanding cash flow, and understanding their market

II. PURPOSE AND FOCUS OF THE CURRENT STUDY

BASA commissioned this study as a follow up to the 2010 one, to review whether the findings of the 2010 study still hold true and whether there has been progress on proposed solutions and interventions since the previous study, to assess whether there are new and additional hurdles, and to examine the extent to which ongoing hurdles still impact on the ability of SMMEs to access finance. The review also sought to assess whether, and to what extent, the interventions identified by the 2010 research had been addressed in the overall SMME finance ecosystem. The ultimate purpose of the current study was to highlight gaps in terms of responses to the hurdles identified by the 2010 study.

In broad terms, the current study sought to examine whether:

- a) Any changes have taken place within the financial institutions themselves to better service SMMEs, and, if so, what they were.
- b) Any new offerings have been introduced by financial institutions to assist SMMEs improve their chances of obtaining finance and, if so, what these are.
- c) As a result of (a) and (b) above, there has been any meaningful reduction in obstacles faced by SMMEs, and whether new obstacles have arisen.
- d) Any gaps remain in terms of responses to the hurdles identified in the 2010 study.

While, similar to its 2010 predecessor, the current review focused mainly on financial institutions, its scope also included a limited assessment of the views and experiences of SMMEs themselves. This provides an important counterpoint to the views and claims expressed by financial institutions. This broadening of the study to include SMMEs has proved useful in shedding light on those areas where there is broad convergence of views between financial institutions and SMMEs, and where there is divergence. The latter raises an important question as to how a more common definition and understanding of the challenges can be inculcated, without which chances of finding common ground and successfully tackling the obstacles to SMME financing would seem to be remote.

III. METHODOLOGY AND LIMITATIONS

The methodology for the study comprised literature review on SMME financing and a sample survey of financial institutions and SMMEs. A limited number of face-to-face interviews were conducted with officials dealing with SMME financing and development at the country's four major commercial banks. It bears stressing at the outset that this study, more limited in scope and duration than its predecessor, is largely exploratory in nature and was not meant to be representative of either the financing sector or SMMEs. It merely sought to explore key issues in the field, without an intention to generalise across the field. The report should therefore be read with that caveat in mind.

A. SOUTH AFRICAN AND INTERNATIONAL LITERATURE REVIEW

In 2015 the Banking Association of South Africa commissioned Osiba Management to undertake a desktop review on SMME financing in South Africa.² This covered an extensive review of both South African and international literature on the subject. Thus, an extensive review of literature was not intended in the current study, which must be read in conjunction with the 2015 review report, to gain a complete picture on issues pertaining to SMME financing. In this section we firstly present a brief synopsis of the findings of the 2015 review. This is followed by a review of the limited material that has been published on the subject more recently.

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1. ISSUES IN SMME FINANCING –BRIEF INTERNATIONAL OVERVIEW

In 2010 the International Finance Corporation (IFC) conducted an extensive review of literature on SMME financing in the developing world and an analysis of 164 cases of SMME finance interventions in G20 member countries, non-member countries, development finance institutions, and a variety of private sector players.³ The key highlights from the study were as follows:

1.1 Access to finance is one of the barriers to SMME growth

The IFC study found that in middle income countries (South Africa falls within this group), access to finance ranks among the top six barriers to growth, which include corruption and regulations⁴ (just over 40% each), electricity and tax rates (just under 40% each), competition in the informal sector (just over 30%) and access to finance (30%), making the latter the sixth most significant

² *Desktop study on financing of SMMEs in South Africa: Mapping the Ecosystem and Assessing the Gaps*, July 2015

³ *Scaling-Up SMME Access to Financial Services in the Developing World*, October 2010

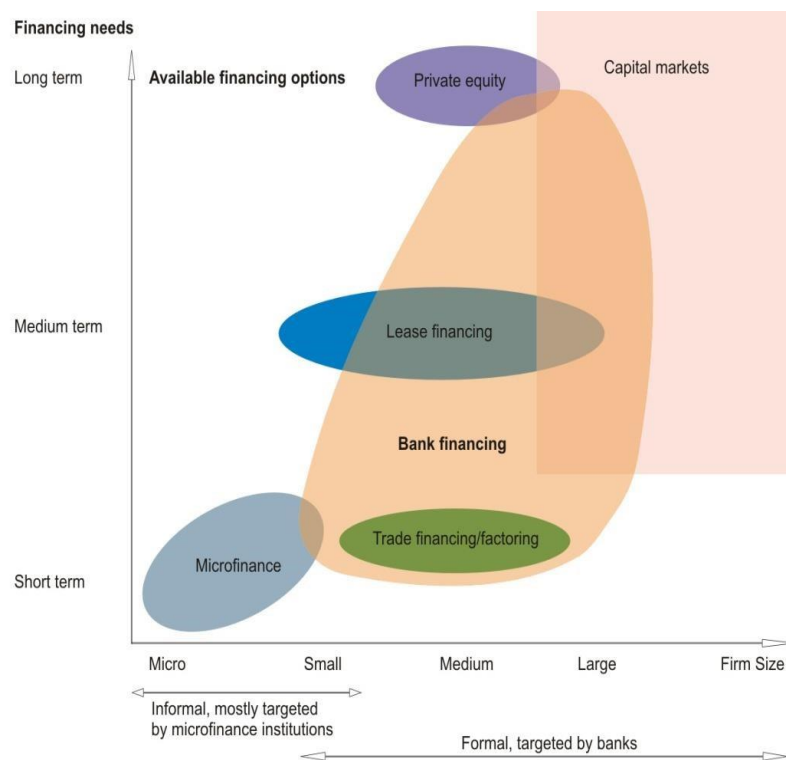
⁴ Regulations include licenses and permits, tax administration, labour regulation, and functioning of courts.

barrier to SMME growth in the countries examined. In high income countries, access to finance ranked fifth in importance.

1.2 Banks are a key source of SMME finance but offer limited access to start-ups

The IFC study observes that bank financing remains by and large the most important source of external finance for SMMEs and that “SMMEs typically need a variety of additional financial services (cash management, insurance, transfers, and other transactional products) that only commercial banks are well-positioned to provide.” Using the typology below, the report depicts the types of external funding needed by SMMEs during the different phases of their growth, clearly showing bank financing to a significant external funding source for formal small and medium firms.

Figure 1: Typology of external funding needed by SMMEs during their lifecycle



Source: Cited in Rethinking Small Business Support in South Africa, the dti, 2011, p64.

Similarly, a UK Banking Review report, cited in a 2004 report compiled for South Africa’s National Treasury, showed that banks are one of the main sources of external funding for operating small businesses. However, it is worth noting that banks do not feature at all as a source of finance for start-up SMMEs in this particular study.

TABLE 3: SMME growth phases and funding cycles in the UK

Type of SMME	Main source of funding			
	Start-up phase	Growth phase	Stable	Exit
Traditional, providing income for an individual, family or small group of employees	<ul style="list-style-type: none"> • Family • Friends • Savings • Equity in residential property 	<ul style="list-style-type: none"> • Asset-backed finance • Factoring • Bank debt • Trade credit 	<ul style="list-style-type: none"> • Often none, but debt if required 	<ul style="list-style-type: none"> • Not applicable
High potential, with growth aspirations	<ul style="list-style-type: none"> • Angel finance • Team equity • Some venture capital 	<ul style="list-style-type: none"> • Venture capital • Private equity placement • Asset-backed finance • Some bank debt 	<ul style="list-style-type: none"> • Venture capital • High-yield debt market • Bank debt 	<ul style="list-style-type: none"> • Either exit via capital markets or direct access to competitive capital markets
Attractive, with high-tech information and life sciences IPR	<ul style="list-style-type: none"> • Angel finance • Venture capital • Corporates 	<ul style="list-style-type: none"> • Venture capital • Corporates • Asset-backed finance 	<ul style="list-style-type: none"> • Corporates • Bank debt 	<ul style="list-style-type: none"> • Exit typically via trade sale

Source: Cited in Hans Falkena, et al., *SMMEs' access to finance in South Africa – A supply-side regulatory review*, 2004, p47.

1.3 Generally, there are greater SMME financing difficulties in developing countries

The IFC study found that an estimated 45 to 50 per cent of formal SMMEs in developing countries are completely unserved – they need credit but cannot access it. Just under one-quarter (21-24%) are underserved and therefore also identify access to financing as a constraint. Only 8-10 per cent had a loan and did not identify any financing constraint, and 16-20 per cent reported that they did not need credit at all. Very small formal enterprises were significantly (49-59%) more likely than their medium-size counterparts (18-22%) to have difficulties accessing finance. SMMEs in Africa and Asia were more likely to experience significant difficulties in gaining access to finance.

However, a 2014 study carried out in the United States would seem to suggest that limited access to finance is a challenge in some developed countries too. The United States study observed that, “A majority of small firms (with revenue less than \$1m) and start-ups (under 5 years in business) were unable to secure any credit. It’s a tough market for the smaller firms and start-ups.”⁵ Consequently, US start-ups and growing firms identified lack of credit availability as their number 1 and 2 challenges, respectively, with growing firms identifying it as their number two challenge.

⁵ Federal Reserve Banks of New York, Atlanta, Cleveland and Philadelphia, *Joint Small Business Credit Survey Report 2014*.

TABLE 4: Top three challenges faced by SMMEs in the US during the first half of 2014

Start-ups (<5 years in business)	Growing firms (Profitable and increased revenues)	Mature firms (>5 years in business, 10+ staff)
1. Lack of credit availability	1. Uneven cash flow	1. Uneven cash flow
2. Difficulty attracting customers	2. Lack of credit availability	2. Increased business costs
3. Uneven cash flow	3. Hiring and/or retaining staff	3. Lack of credit availability

Source: Based on the US Federal Reserve Banks 2014 study (see footnote 5)

Micro and small businesses in the US study were more likely to not receive any of the funding they had applied for, compared to their medium-sized and larger counterparts. This confirms the other studies cited earlier that show that younger and smaller businesses face greater hurdles in accessing external funding.

Figure 2: Outcome of SMME funding applications (USA)



Source: Based on the US Federal Reserve Banks 2014 study (see footnote 5)

1.4 However, there are stronger indications of bank-SMME engagement in East Africa

In 2012 the African Development Bank (AfDB) carried out a study on bank financing for SMMEs in four East African countries,⁶ prompted by a World Bank assertion that (according to the AfDB study) only 20 per cent of SMMEs in Sub-Saharan Africa – less than half the number in Latin

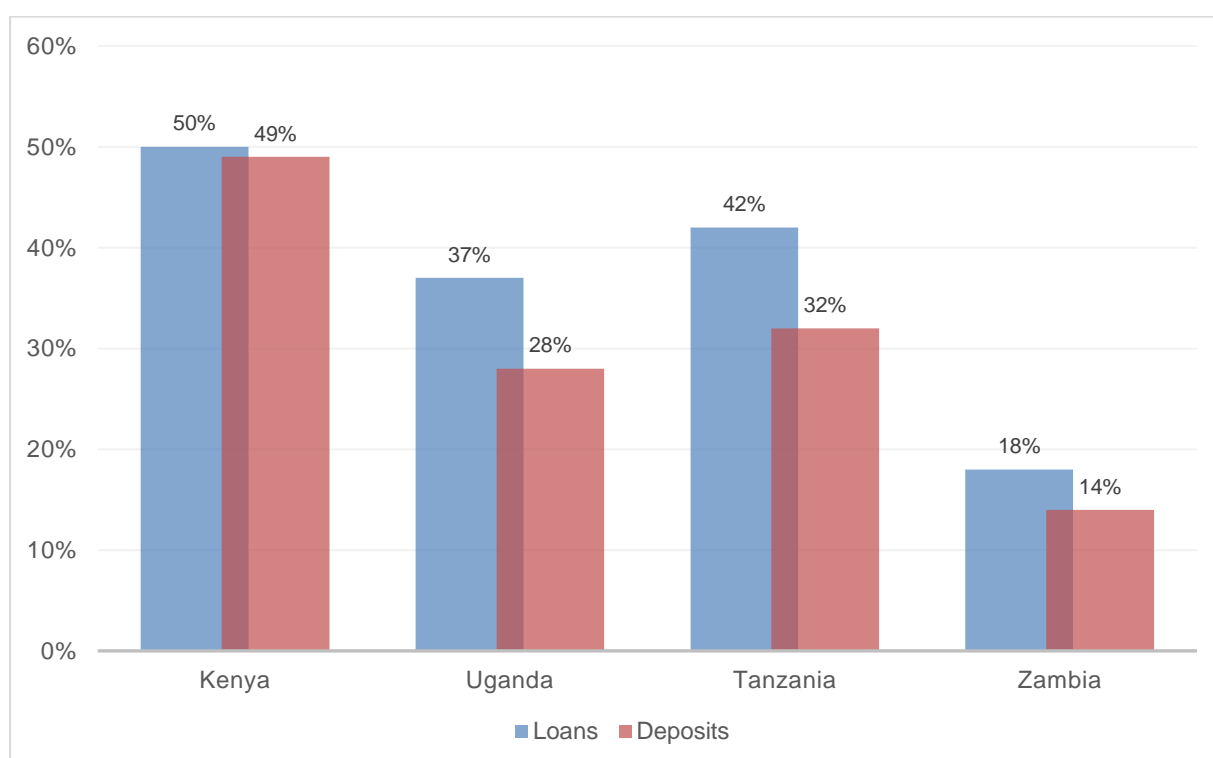
⁶ Pietro Calice, Victor M. Chando and Sofiane Sekioua, *Bank Financing to Small and Medium Enterprises in East Africa: Findings of a Survey in Kenya, Tanzania, Uganda and Zambia*, African Development Bank Group Working Paper Series No 146, March 2012.

America and the Caribbean – have a line of credit from a financial institution. The AfDB study sought to investigate the main drivers and obstacles to SMME financing in East Africa, as well as banks’ operational approaches towards SMMEs. The main highlights of the findings of the study are briefly as follows:

1.4.1 Bank engagement with SMMEs

The study found a relatively high level of bank engagement with SMMEs in Kenya and significant engagement in both Tanzania and Uganda, as depicted by the average amount of SMME deposits and loans as a percentage of total private sector deposits and loans.

Figure 3: Average SMME loans and deposits relative to total private sector

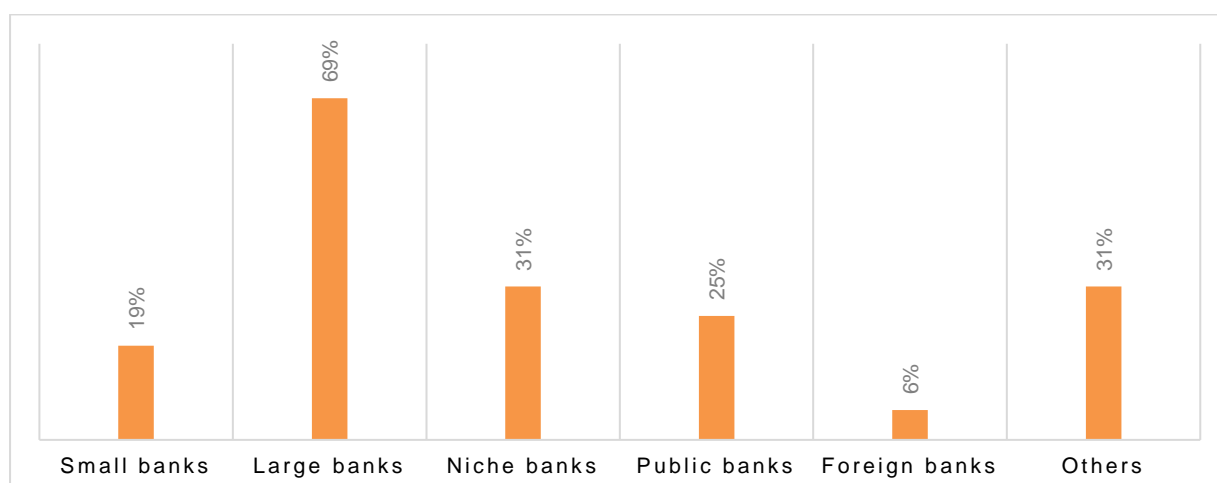


Source: Based on the AfDB 2012 study (see footnote 6)

1.4.2 Large commercial banks dominate SMME lending

Although the region boasts a diversity of institutions dealing with SMMEs, including a mix of public and private banks plus domestic and foreign banks, large commercial banks play a dominant role in financing SMMEs. This is partly in response to intense competition from small and niche banks, some of which are former microfinance institutions with a strong tradition of serving SMMEs.

Figure 4: Main players in the SMME lending market

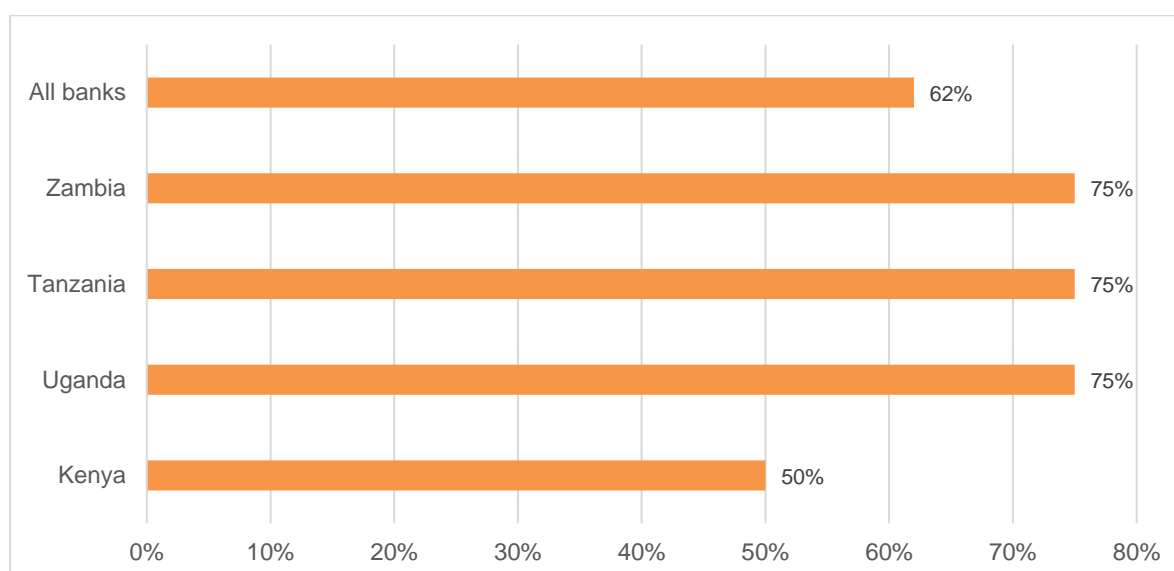


Source: Based on the AfDB 2012 study (see footnote 6)

1.4.3 SMME lending is predominantly driven by this market segment's profitability

Regional banks view SMMEs as a large market with a positive future growth outlook and see lending to them as a profitable activity.⁷ SMMEs are also seen as presenting an important opportunity for cross-selling. Besides profitability and future growth prospects, other reasons for involvement in the SMME market were intense competition for corporate business (33%) and the opportunity to use existing relationships with large corporate clients to seek out new SMME clients linked to the large client companies' value chains (20%).

Figure 5: Profitability of the SMME segment the main attraction to banks



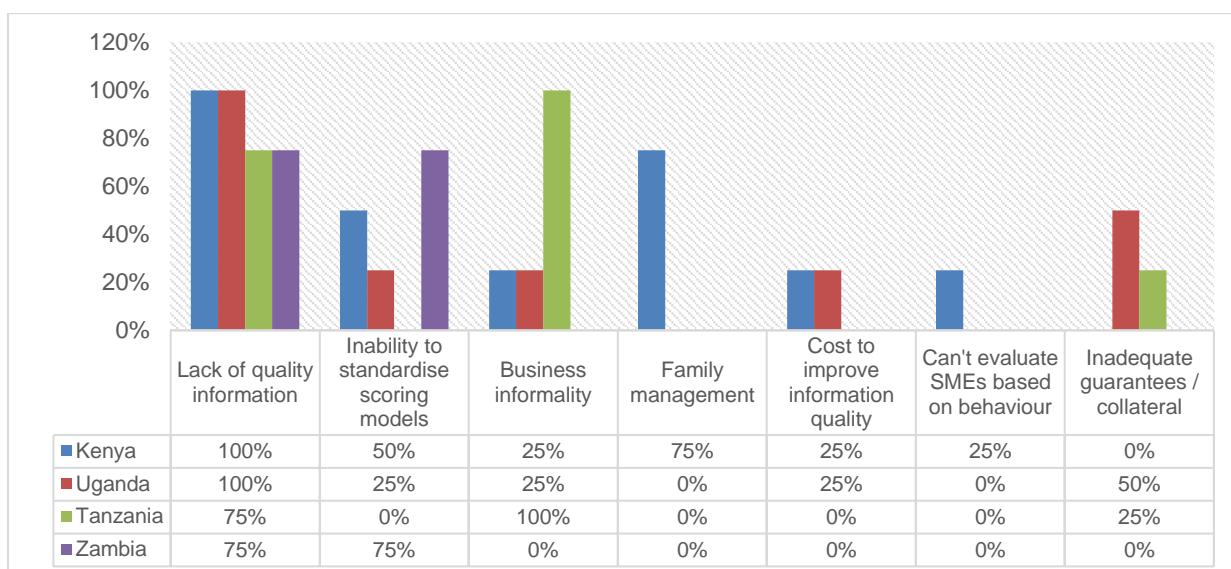
Source: Based on the AfDB 2012 study (see footnote 6)

⁷ Sixty-three per cent of respondent banks were drawn by the high profitability of the SMME segment, which compensates for the relatively high costs associated with servicing the segment

1.4.4 Lack of quality information the main challenge in SMME lending

Lack of quality information was the main barrier to banks' dealings with SMMEs across the region. In Kenya and Tanzania, the SMME information quality challenge was considered so pressing that some of the banks reported that they had allocated internal budgetary resources to assist SMMEs through business training.

Figure 6: SMME-related obstacles to bank lending

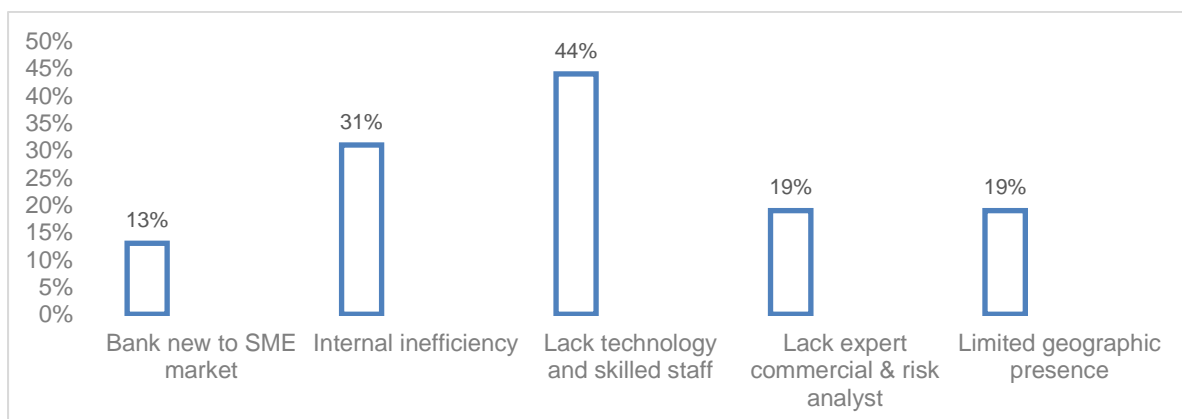


Source: Based on the AfDB 2012 study (see footnote 6)

1.4.5 Banks cite lack of technology and skilled staff as the main internal challenges

Bank-related barriers did not feature prominently among the impediments to lending to SMMEs. The main barrier in this category was lack of appropriate technology and skilled staff, with general operational inefficiency coming in second.

Figure 7: Bank internal barriers to SMME lending



Source: Based on the AfDB 2012 study (see footnote 6)

Thus, while there is some debate about the extent to which access to finance is a real problem faced by SMMEs, the main conclusion of the studies reviewed for the 2015 report on SMME financing, and some more recent ones (discussed next in this report), is consistent, namely, that access to finance remains one of the key challenges facing small businesses, particularly in developing nation contexts. There is general acknowledgment that the access to finance challenge is significant, with access to finance cited among all studies reviewed as falling within the top five challenges faced by SMMEs, warranting ongoing analysis and focused efforts to find workable responses to the issue at both governmental level and within the financial services industry itself.

2. OVERVIEW OF SMME FINANCING IN SOUTH AFRICA

In the main, recent reports in South Africa point to ongoing challenges in SMME financing.

2.1 The OECD Economic Survey

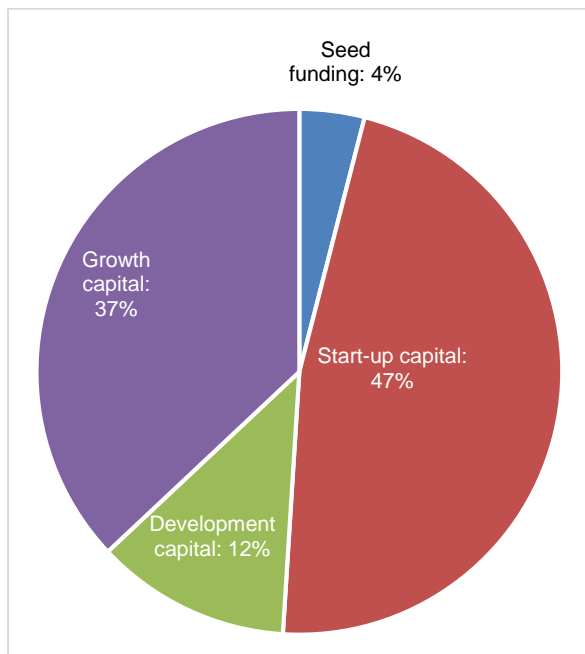
The 2017 OECD Economic Survey of South Africa concluded that formal SMME lending in the country is dominated by banks and, most importantly, is relatively low, accounting for just about one quarter (26%) of all business lending in 2016. Informal finance, an important source of financing for start-ups, is less accessible and there has been a sharp decrease in microfinance provision. Consequently, in a 2016 ILO study, respondents ranked microfinance last out of eleven possible sources of funding.

2.2 SAVCA Review

The 2017 SAVCA survey report⁸ reveals significantly higher investment, in percentage terms, in start-ups by the venture capital industry compared to the commercial banking industry. This is followed by growth capital as the second highest area of investment. Seed funding is a paltry 4%. Almost all of the country's venture capital is invested in only two provinces – Gauteng and Western Cape – with the two accounting for 90% of all investment.

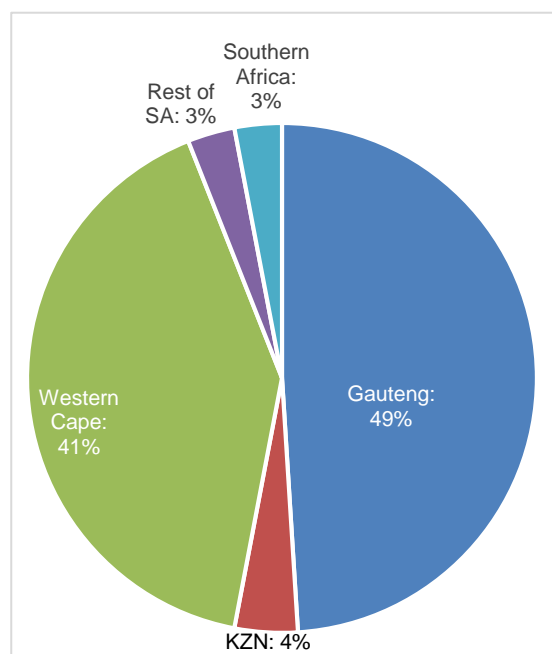
⁸ SAVCA 2017 Venture Capital Survey (no date).

Figure 8: Investment by stage and value



Source: SAVCA, 2017 (see footnote 8)

Figure 9: Investment by province and value



Source: SAVCA, 2017 (see footnote 8)

GLOSSARY OF VENTURE CAPITAL TERMS

Seed funding – initial capital used to start a business, typically used to pay for market research and product development. Seed Funding is not usually provided by VC fund managers in Southern Africa.

Start-up capital – early funding used for setting up operations, commercialising intellectual property, and for other start-up activities.

Development capital – finance used after start-up capital to further launch the business and to support growth in market share in order to become profitable.

Growth capital – funding used to assist established but still high-risk ventures in expanding activity such as launching into foreign markets, creating new product/technology lines, accelerating production and/or acquiring competitors.

Source: SAVCA, 2017 (see footnote 8)

2.3 Financial Sector Charter Council Review

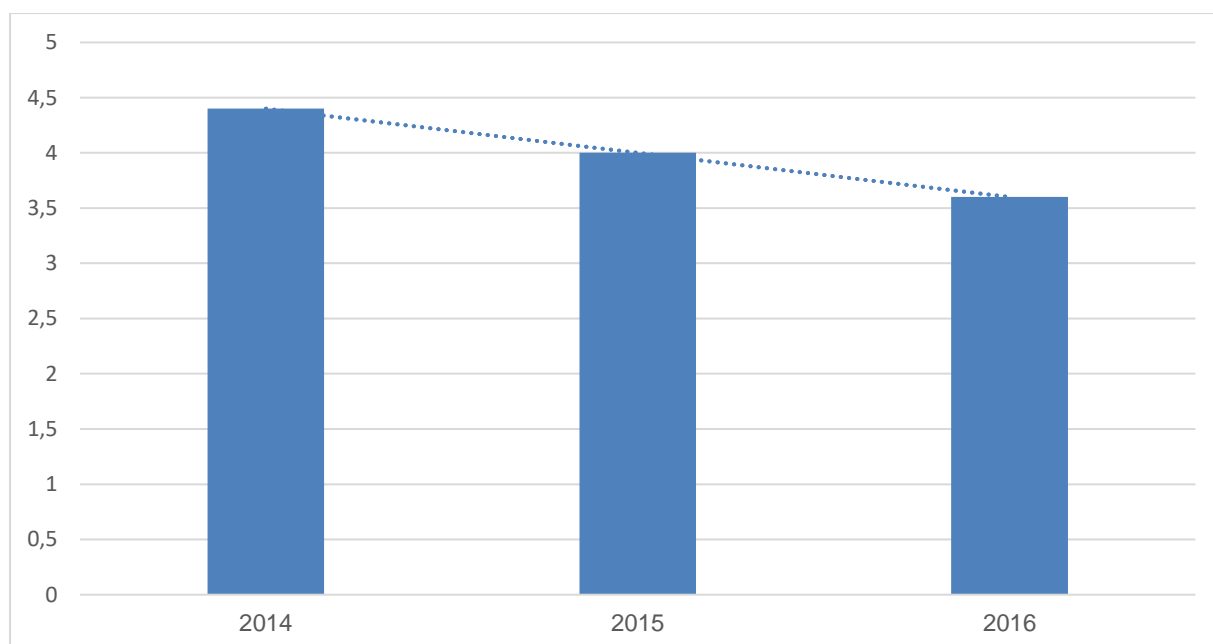
Empowerment financing, which measures several areas of targeted investments that include Black SMME financing, Black agricultural financing, affordable housing initiatives and transformational infrastructure, features as one of the two unique elements in the financial sector’s Broad-based Black Economic Empowerment (B-BBEE) Code.

According to the latest FSCC report (2016), annual financing targets for this broad element were R48 billion for the banking industry (FS601) and R27 billion for the long-term insurance industry (FS602), a combined total of R75 billion.

There are no specifics as to the exact target amount for SMME financing alone as a specific component. This combined target represents a low figure compared to the funding gap for SMME financing alone, which is estimated by Finfind to be in the region of R86 billion to R346 per annum. If this estimate is correct, reading the two figures together would indicate that South Africa is a long way from meeting the funding needs of SMMEs.

The FSCC report further indicates that over the period 2014 to 2016, the sector fell short of meeting its funding targets, particularly in 2016, meaning that even the seemingly significantly low SMME financing targets (compared to estimated demand) are not being met (figure 10). Indeed, while stating that “the level of performance in the Enterprise Development (ED) element...is encouraging”, the FSCC report also, importantly, acknowledges that “transaction financing is the weakest area.”⁹

Figure 10: Enterprise development average score (out of 5)

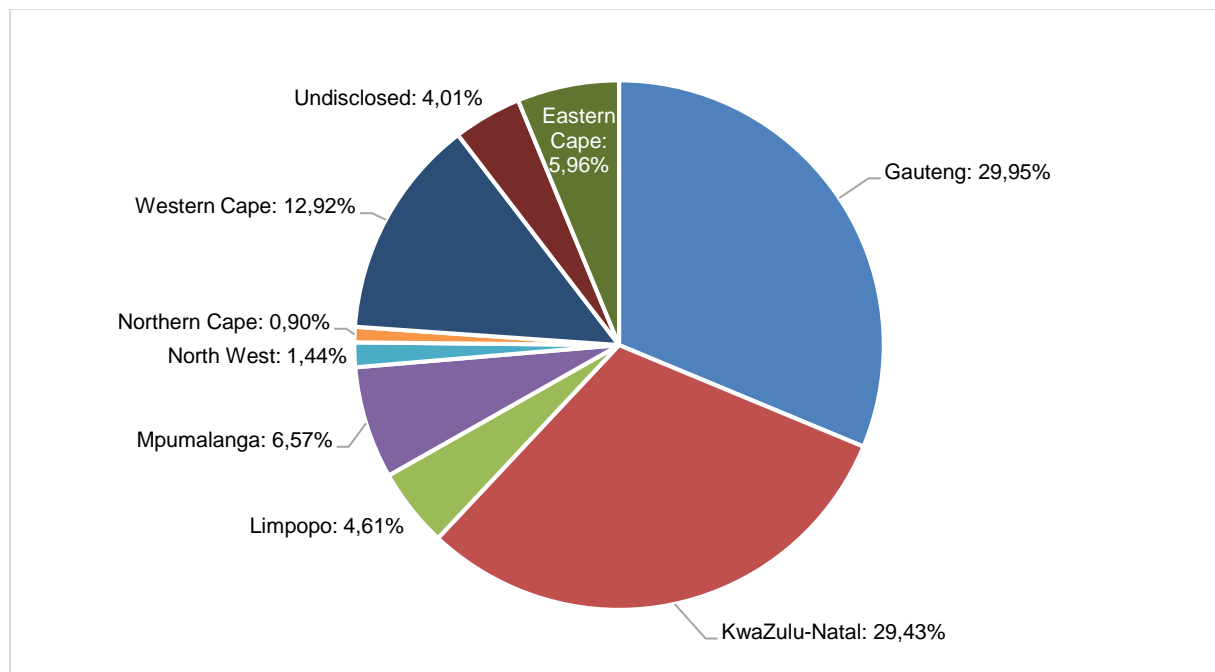


Source: FSCC, 2016 Review (see footnote 9)

⁹ Financial Sector Charter Council, *Transformation of the South African Financial Sector, 2016 Annual Report Summary*, pages 43, 45 and 46.

The 2013 FSCC annual report presents the geographical profile of the sector’s SMME financing spend, showing that almost 60% of total spend was in just two provinces – Gauteng and KwaZulu-Natal.¹⁰

Figure 11: Geographic profile of SMME financing, 2013



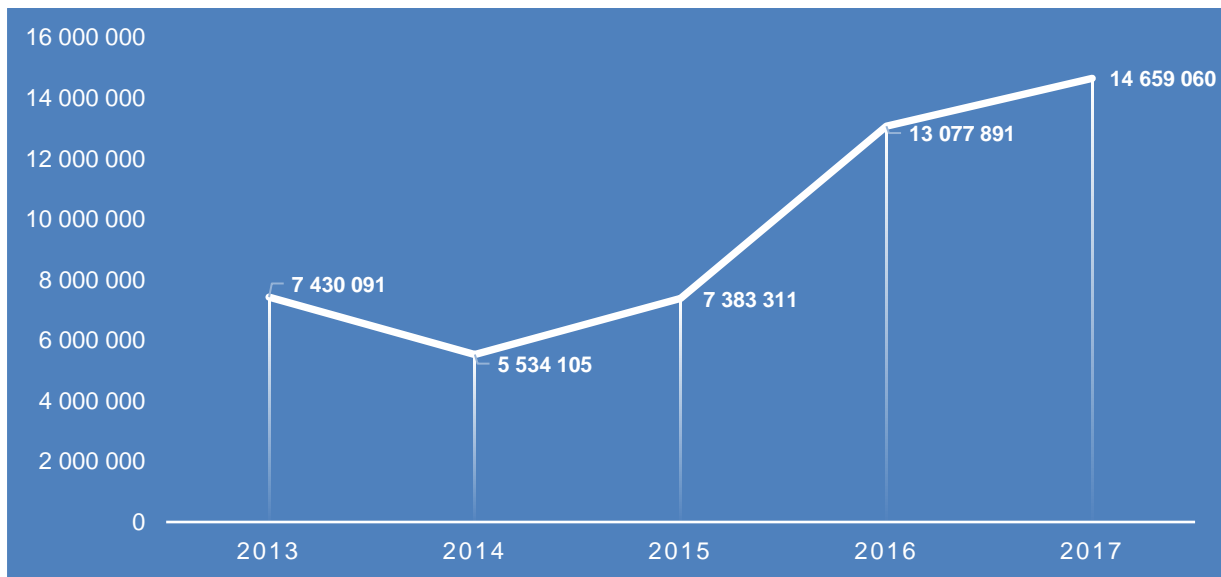
Source: FSCC, 2013 Annual Review (see footnote 10)

2.4 National Credit Regulator Review

The National Credit Regulator publishes statistics on “developmental credit”, a broad category that encompasses SMME financing; educational loans; and acquisition, rehabilitation, and building or expansion of low-income housing. Similar to the case of the Financial Sector Charter Council discussed earlier, it is not possible to ascertain the exact proportion of SMME financing within this broad category, but it can be used as a rough proxy for SMME financing activity. Figures published in various Consumer Credit Market Reports show that a total of some R14,7 billion in developmental credit was granted in 2017, representing a 97% increase over 2013. However, although the trend in credit granted is still upwards, the rate of increase over 2016 was only 12%.

¹⁰ Financial Sector Charter Council, *Review on the Transformation of the Financial Sector of South Africa, 2013 Review*, pages 49.

Figure 12: Developmental credit granted, 2013-2017 (R000)



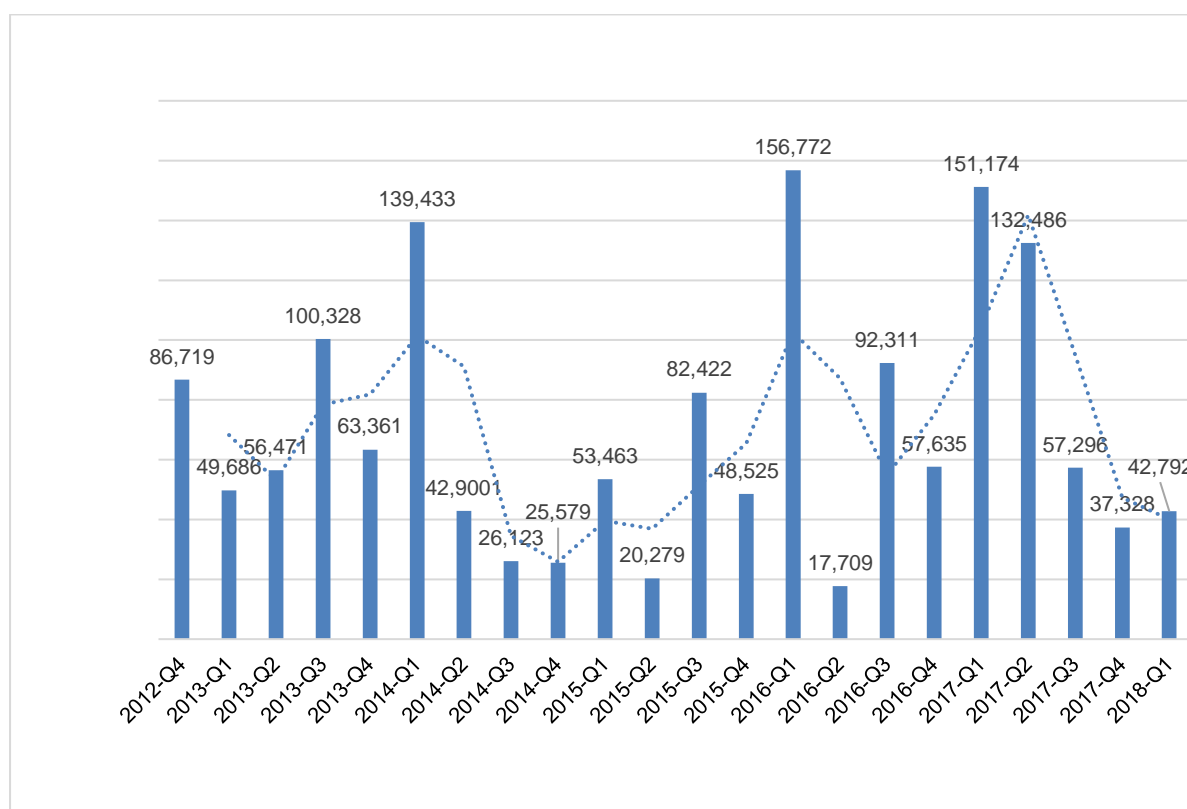
Source: Based on various Consumer Credit Market Quarterly Reports.

DATA ISSUES

It is worth noting that the 2013 Financial Sector Charter Review cited earlier reports total SMME financing spend across the financial sector of R14.8 billion for that year. This does not tally with the NCR's "developmental credit" figure for the same year, which shows almost exactly half that amount (R7,4 billion) for a broad category that includes a number of financing beneficiaries, with SMMEs being just one of them. This, and other facts discussed elsewhere in this report, point to major data challenges in reporting SMME financing activity in the country. This is a critical gap that requires urgent attention and correction by all players in this field.

Data on the actual number of developmental credit accounts issued since the fourth quarter of 2012 right up to the first quarter of 2018 show major fluctuations, with the trend since the third quarter of 2017 generally downward.

Figure 13: Developmental credit granted (number of accounts, Q4/2012 to Q1/2018)



Source: Based on various NCR Consumer Credit Market Quarterly Reports.

AN ENTREPRENEUR'S VOICE

“Clearly there’s lack of support for newcomers. In fact, most financial institutions only look at your business once you have been in operation for at least 36 months. The question is: how much money will I need as an entrepreneur to keep the lights on for 36 months before I get funded?”

Co-founder: Black Beard

Johannesburg-based technology SMME behind SA’s first “robo-advisory” platform, established in 2016. Current clients include Outsurance, Investec, Discovery and Merchant Capital, and the firm has offices in Cape Town and Pretoria, and a recent office opening in Dublin, Ireland

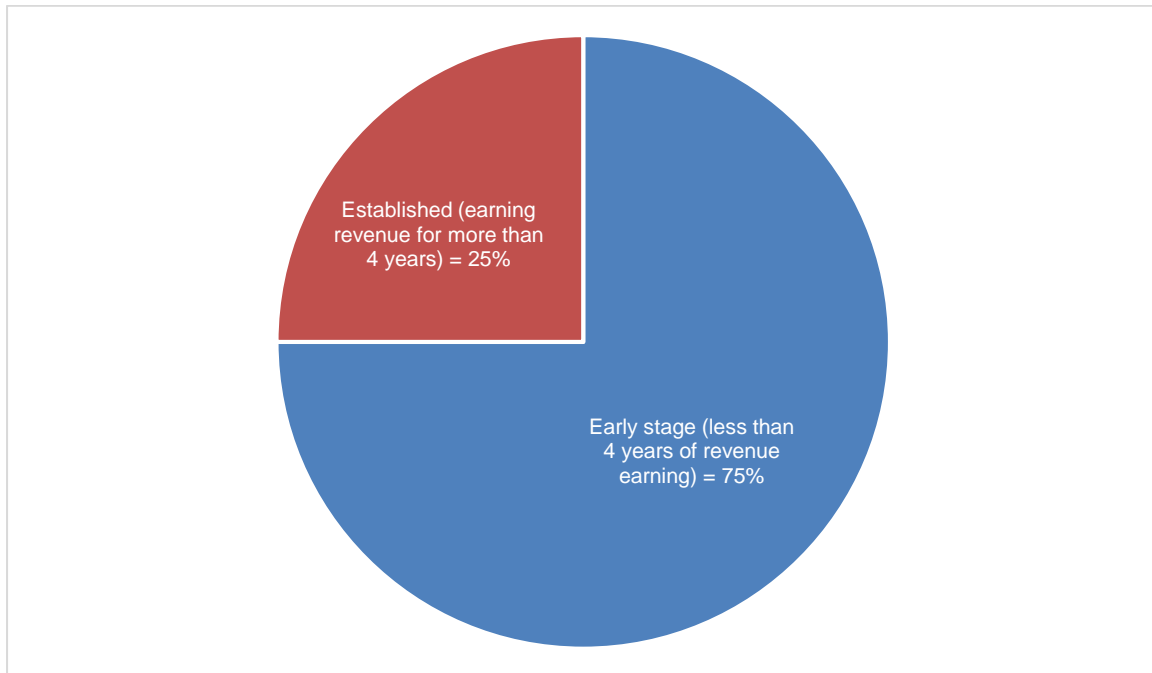
Source: Financial Mail, August 16-22, 2018, p.17.

2.5 The Finfind Study

The most recent work on the topic of SMME financing is a report released in 2018 by Finfind. Finfind collects data from SMMEs seeking funding, who complete an online funding request form on its platform, providing detailed information about the business owner and the business and its state of funding readiness.

The platform matches SMMEs seeking finance with an up-to-date database of more than 450 finance offerings from public and private sector funders.¹¹ The study was based on 11,033 SMMEs who sought financing in 2017. Funding requests of less than R50 and more than R50 million were excluded from the analysis. The graph below indicates clearly that the majority of those who sought funding via the platform in 2017 were early-stage businesses with less than four years of revenue-earning operation.

Figure 14: Finfind 2017 funding requests, by stage of business

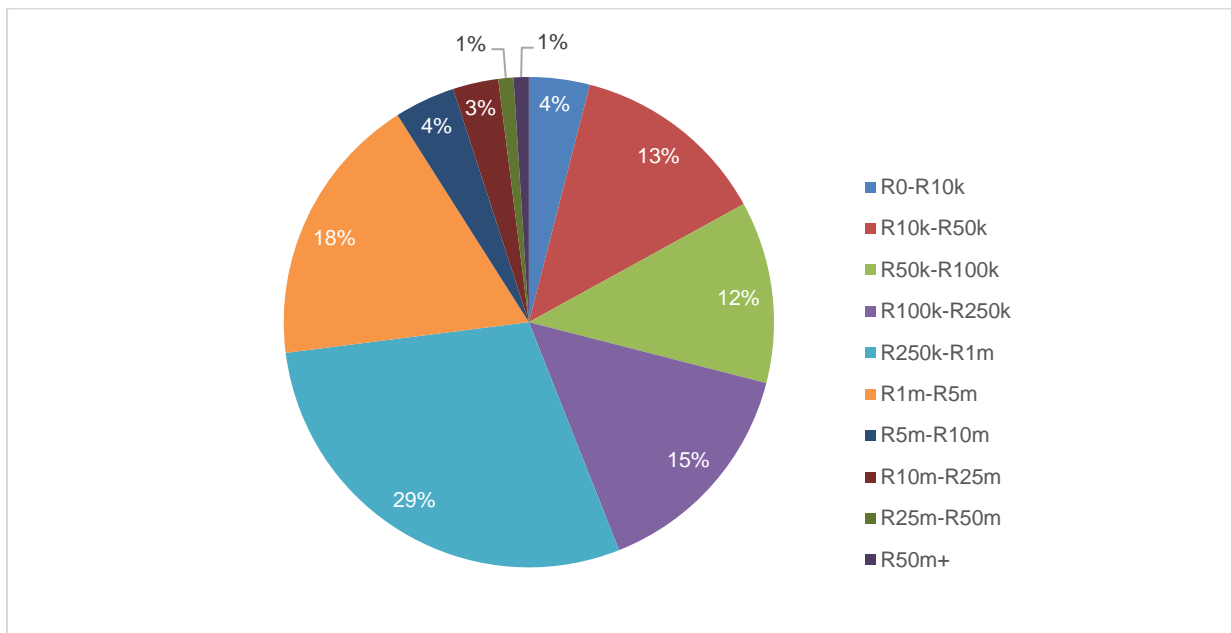


Source: Based on Finfind, *Inaugural South African SMME Access to Finance Report*, released July 2018

The Finfind study finds that the single largest number of applicants (29%) sought financing of between R250,000 and R1 million, followed by those seeking funding ranging from R1m to R5m (18%). Taken together, those seeking funding of less than R250,000 constituted 44% of all applicants, meaning that a combined 73% of applicants sought financing of below R1 million.

¹¹ Including start-up finance, expansion finance, equity finance, cash flow bridging finance, debtor finance, contract finance, asset finance, franchise finance, supplier finance, import and export finance, finance to buy out a partner, property finance and grant funding.

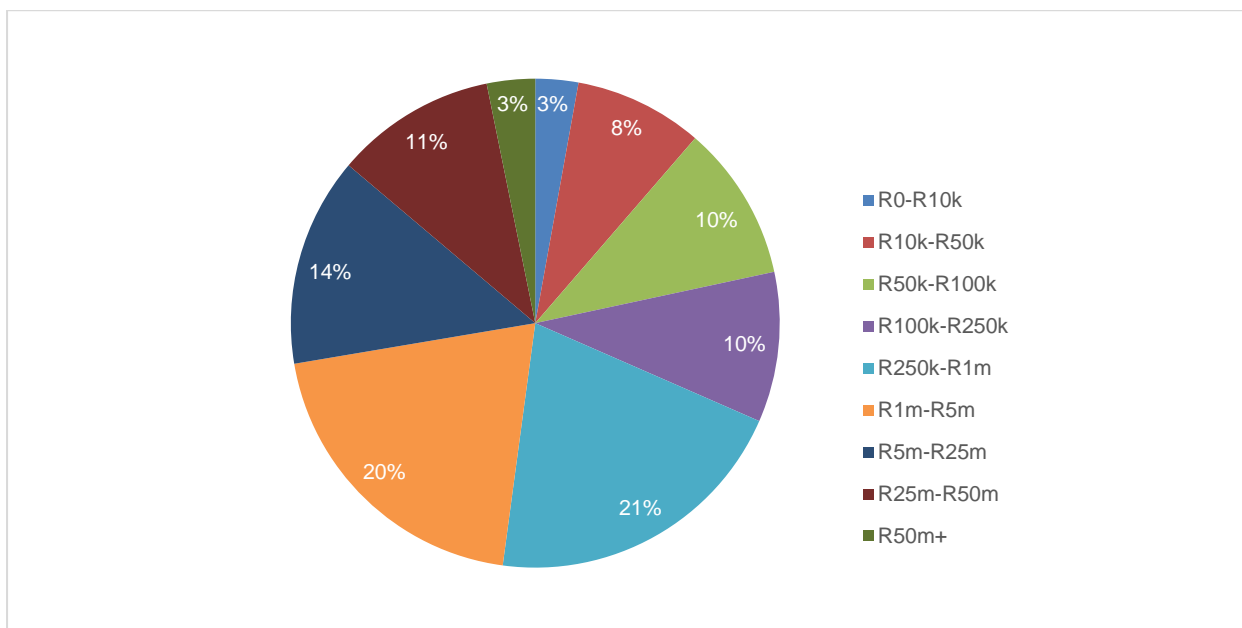
Figure 15: SMME funding request, by size of amount



Source: Based on Finfind, 2018

Funders, on the other hand, mostly offered funding above R250,000, with most offering amounts between R250,000 and R5 million. The report observes that, “the appetite to fund smaller amounts is significantly less than the appetite for larger loan sizes. While most funding products say that they do offer funding for requests under R1 million, qualitative evidence suggests that many SMMEs are still struggling to raise funding in this range.”

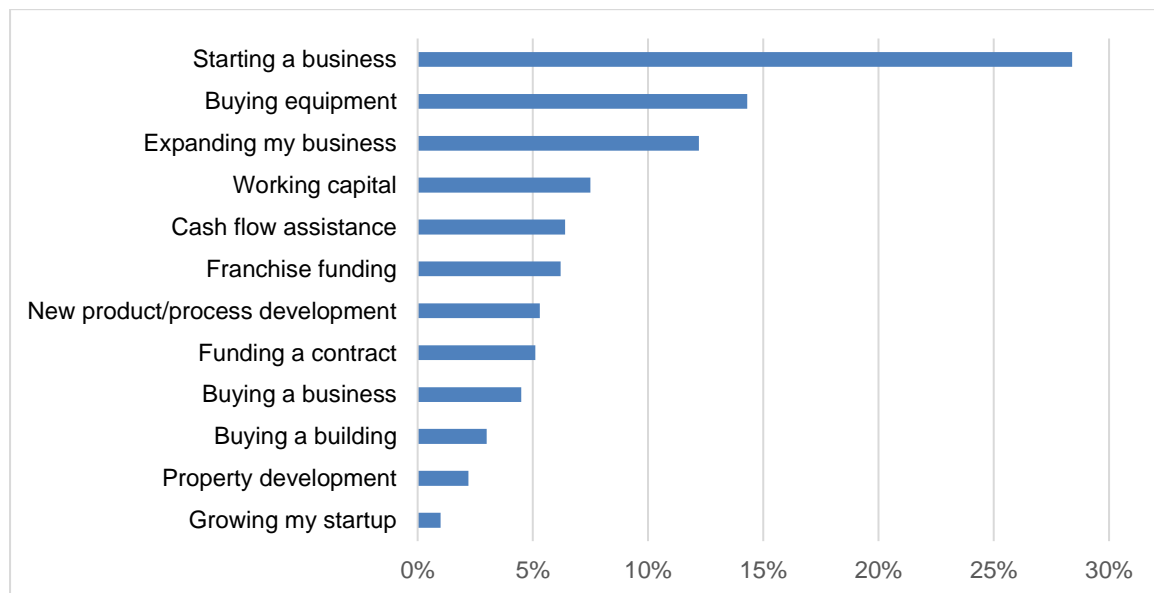
Figure 16: Funder product offerings, by size of amount



Source: Based on Finfind, 2018

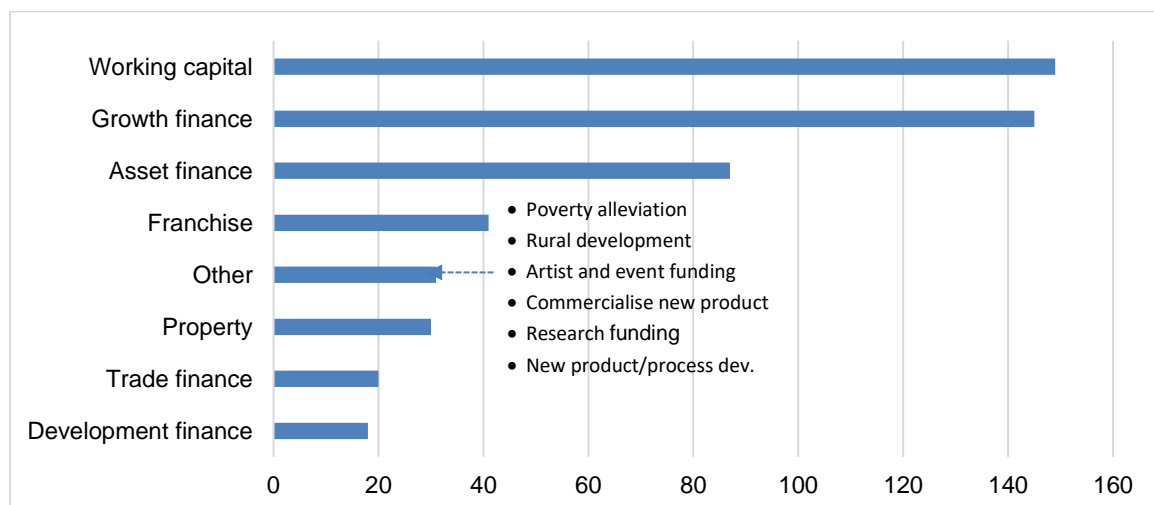
The study found that the single most dominant reason for seeking funding was to start a new business, with just under one-third of all applicants seeking funding for this purpose (figure 17). On the other hand, funders are mostly offering funding for working capital and growth financing to existing businesses, meaning that funding for start-up operations is largely non-existent (figure 18). Based on this comparison of demand and supply, the Finfind report concludes that, “...there are definite SMME funding gaps. Whilst there is good supply of funding for working capital, asset finance and growth finance, there is a lack of appetite for funding start-ups and early-stage businesses.”

Figure 17: SMME funding request, by funding need



Source: Based on Finfind, 2018

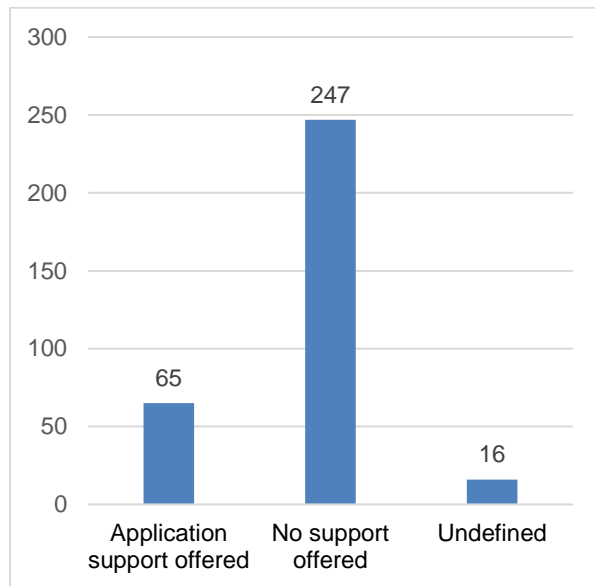
Figure 18: Funding products on offer (number of products)



Source: Based on Finfind, 2018

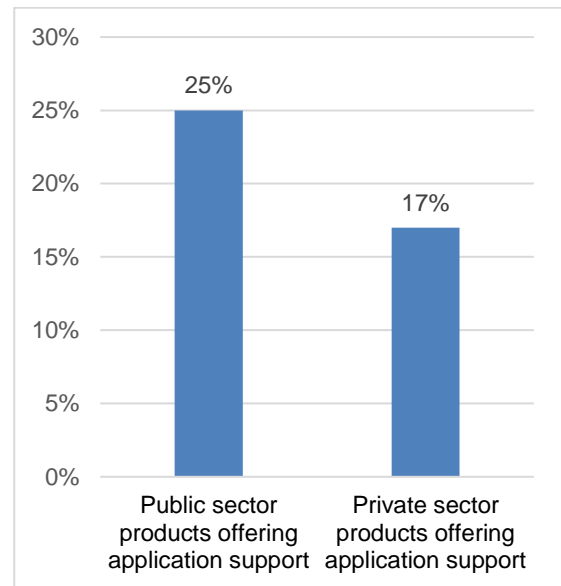
Lastly, the Finfind study found that only a small number of funders offer funding seekers support to prepare their funding applications, with more public sector funders offering this type of support than their private sector counterparts. With evidence showing that one of the main reasons for SMME applicants failing to receive the funding they require is the poor quality of applications submitted, the small number of products offering application support points to a service gap in this important aspect.

Figure 19: Support for funding application



Source: Based on Finfind, 2018

Figure 20: % of products offering support



Source: Based on Finfind, 2018

Additional key issues are:

- The funding gap is significant, estimated at between R86 billion and R346 billion. Just the 11,033 funding seekers analysed in the study requested R40,9 billion in 2017. This is a tiny portion of the country's total SMME population.
- Size and stage of business have significant impact on success in acquiring funding, with early-stage and micro businesses less likely to receive funding.
- Given that many applicants lack the knowledge, principally in the financial area, needed to raise funding, the limited application assistance available means that many applicants that might be eligible for funding fail to meet the application quality requirements of funders and can therefore not access the funding they require.

- Similar to the SMME field as a whole, there are significant data gaps in the field of SMME financing and there is lack of transparency relating to number of SMMEs seeking funding, the reasons for applying, financing terms, rejection rates and reasons, interest rates, non-performing loans and factoring volumes. This makes it almost impossible to fully understand the full picture of the state of SMME funding in South Africa. The OECD survey similarly found that, "...overall, there is a dearth of data on finance for small businesses" in South Africa.

B. THE QUESTIONNAIRE SURVEY – FINANCIAL INSTITUTIONS AND SMME

1. TARGET RESPONDENTS AND THEIR SELECTION

As described earlier, the study targeted financial institutions and SMMEs. Within financial institutions, the aim was to survey respondents occupying different roles that are relevant to SMME financing and general support. Within SMMEs, the owner of the business was the target respondent. Similar to the 2010 study, the survey took the form of an online questionnaire sent electronically to the prospective respondents. However, because there was no pre-existing database with accurate contact details of the respondents to the 2010 study to select prospective respondents from, the process had to start with each financial institution being contacted by telephone and requested to identify the appropriate person to participate in the study. Each identified individual was then contacted by telephone to introduce the study and request participation. Once the individual agreed to participate, he/she was emailed the questionnaire. Once the questionnaire was sent, the individual was called the second time to alert him or her about the email and to request completion and return of the questionnaire. In the majority of cases, individuals had to be called several times to return the completed questionnaire. BASA was also approached to intervene and encourage participation in the study, particularly by commercial banks.

2. RESPONSE RATE

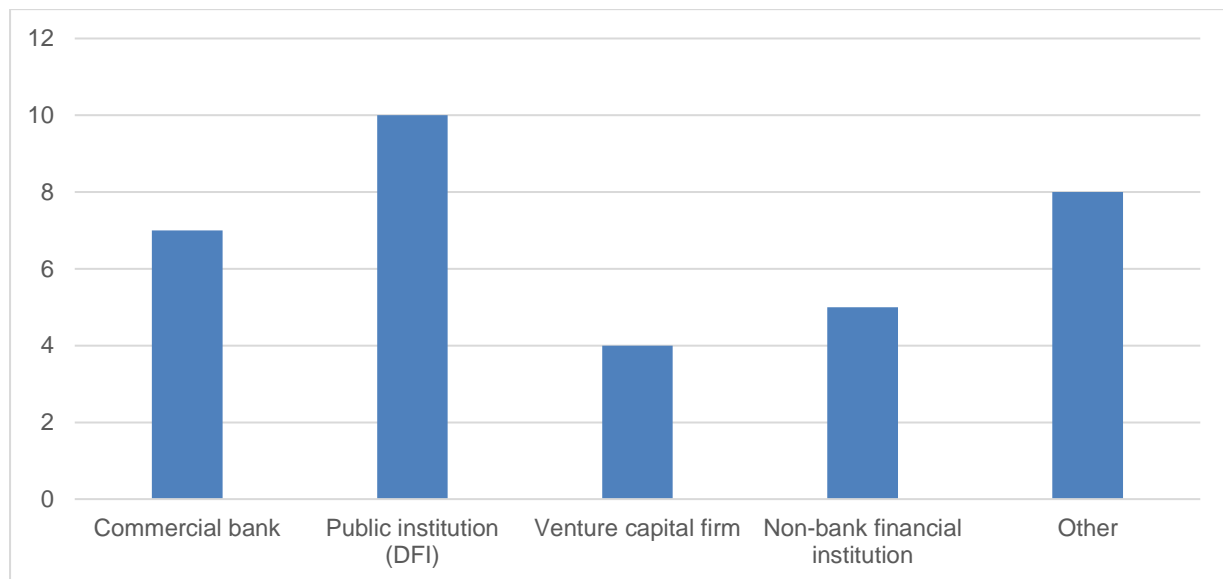
In the end, while eighty-one (81) pre-contacted individuals within financial institutions had promised to complete and return the questionnaire, only thirty-four (34) did. Against a target of ninety respondents, this was a 37,78 percent response rate, which is considered a reasonable

response, in comparison to the 26 percent response rate for the 2010 study.¹² A target of thirty (30) to forty (40) SMME respondents was set at the beginning of the study and a final total of thirty-two (32) SMMEs responded, meaning that the target was achieved within this group. All in all, there being no existing sampling frame, the respondents were selected on the basis of their willingness to participate in the study. While the number of respondents was not large, some useful insights were gleaned from the responses received, which are considered beneficial for the exploratory study that this was.

3. RESPONDENT MAKEUP

Figure 21 presents financial institution respondents by type of their institutions. A third of the respondents were from public finance institutions, followed by commercial banks. The “other” category includes private equity firms, property finance institutions, and crowdfunding institutions.

Figure 21: Respondents, by type of financial institution

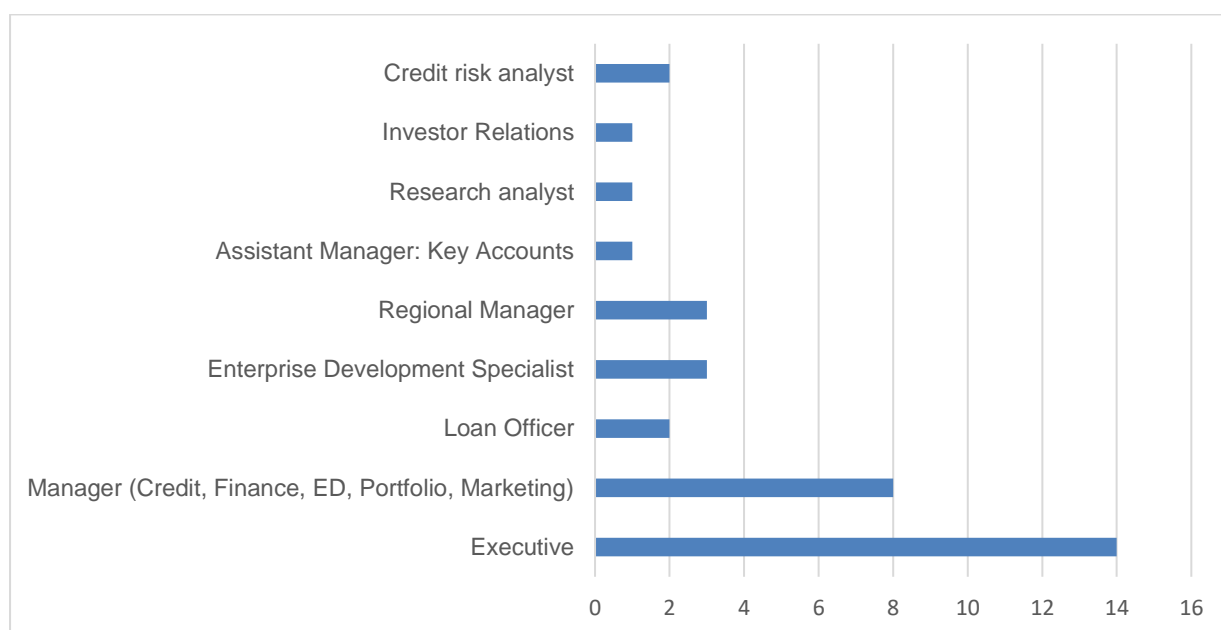


Source: Questionnaire survey, 2018

Figure 22 presents the respondent makeup by role within their employer financial institutions. On the part of SMMEs, the study sought to gauge the views of the owner of the business.

¹² The 2010 study had a sample of 683 prospective respondents, out of which here, 179 completed the survey. Being a review of the previous study, the current study had proposed 50% (total of 90) of the previous number of actual respondents (179) as a reasonable respondent target.

Figure 22: Financial institution respondents' roles



Source: Questionnaire survey, 2018

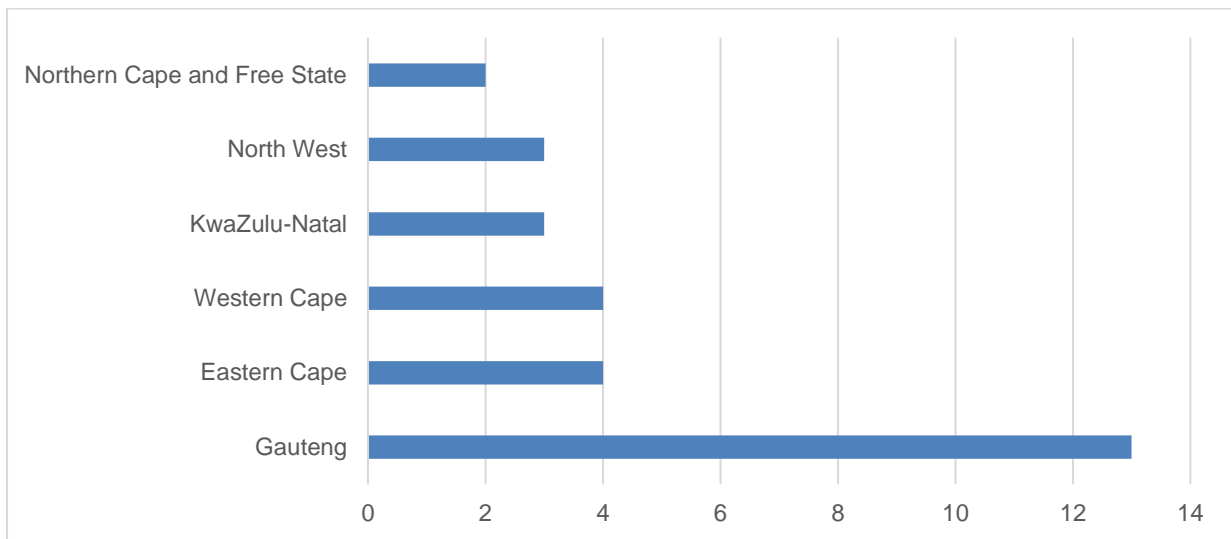
SMME respondents comprised 18 male and 14 percent female, meaning that the gap in gender distribution was not too large. The businesses represented by respondents were quite diverse, covering a wide range of industries and activities.

TABLE 5: Nature of business of SMME respondents

• Event technology	• Wholesale	• Export
• IT (software)	• Education and training	• Transportation
• Media	• Market research	• Tourism
• Hospitality	• Agriculture	• Recycling
• Manufacturing	• Medical	• Fashion design
• Engineering consulting	• Construction	• Photography
• Event management	• Technology and development	

Geographically, most SMME respondents were located across Gauteng, followed by Eastern Cape and Western Cape.

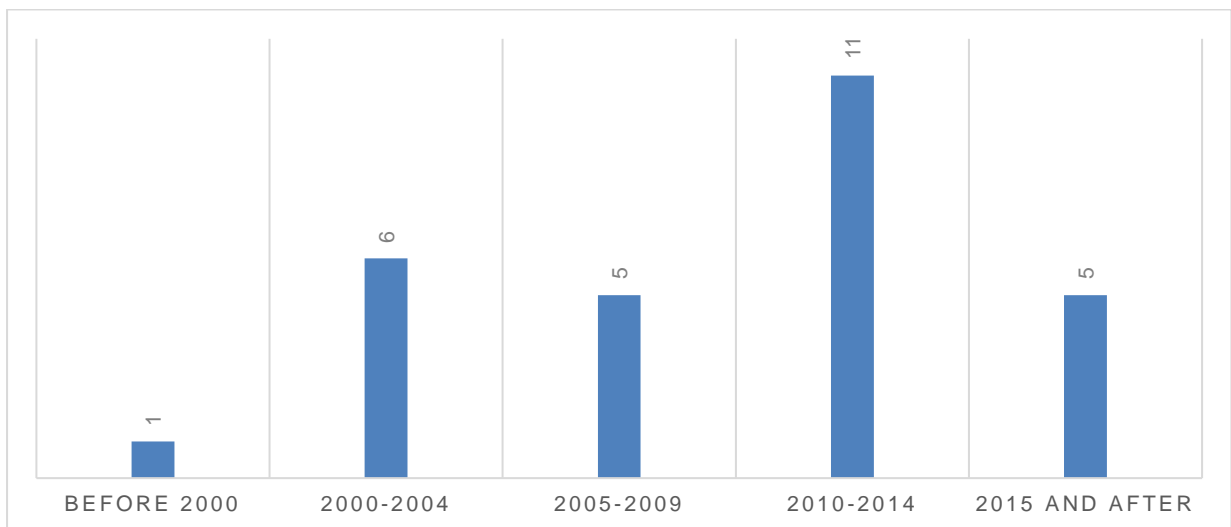
Figure 23: Location of SMME respondents



Source: Questionnaire survey, 2018

The businesses represented by SMME respondents were mostly well established, with the majority having been in operation for longer than three years, namely since 2014 or earlier.

Figure 24: Establishment year of respondent SMMEs

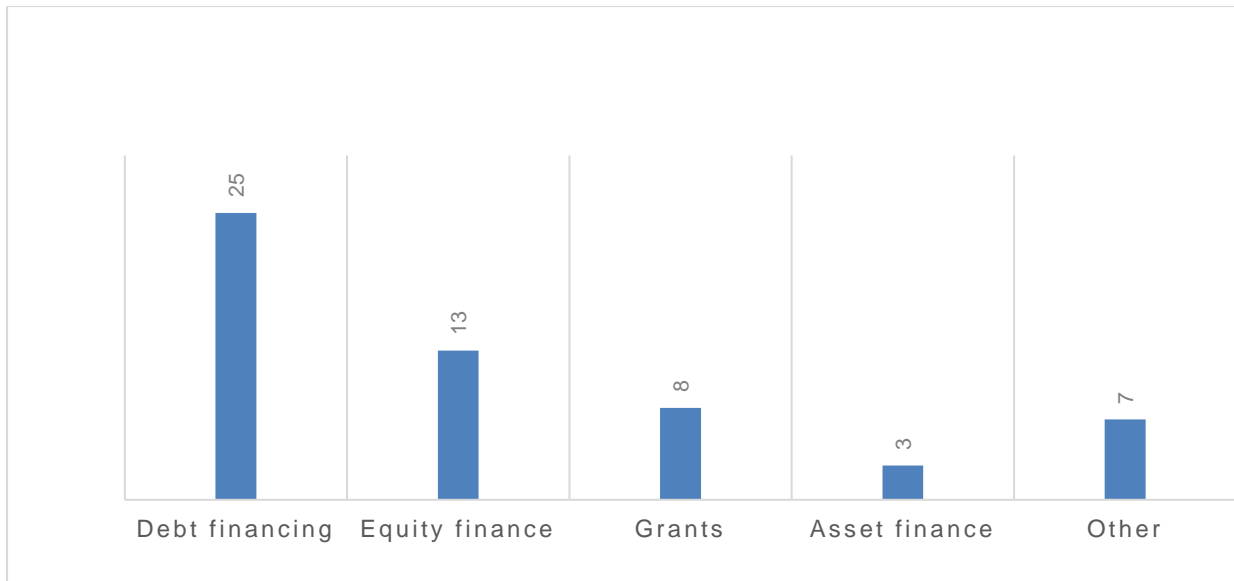


Source: Questionnaire survey, 2018

4. PRODUCTS OFFERED, AND SIZE PROFILE OF SMMEs SERVED

Debt financing is by far the most prevalent product offered to SMMEs, with equity financing coming in at a distant second. This underlines the importance of finding ways to overcome the hurdles that impede access to this type of finance, or to increase access to other forms of finance in order to reduce dependence on debt financing.

Figure 25: Type of financing offered by respondent financial institutions

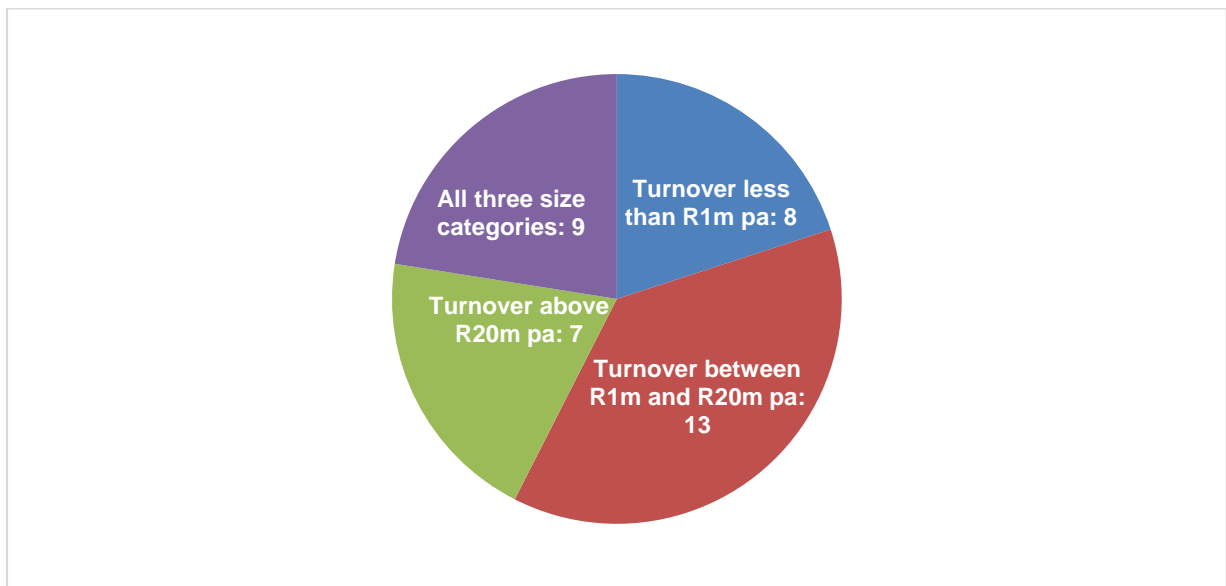


Source: Questionnaire survey, 2018

Note: "Other" includes customised finance solutions, asset finance, bridging finance, working capital finance, start-up finance, and merchant cash advances. Figures don't add up to 34 because some institutions offer more than one type of product.

Similar to the 2010 study, this review finds that SMMEs with higher turnovers (between R1m and R20m per annum) are more likely to be successful in their application for financing compared to those with lower turnovers (below R1 million), with more than one-third of respondents indicating that they offer financing in the former turnover range, compared to less than a quarter that offer financing to applicants with less than R1m in turnover. This picture becomes even more pronounced when those reporting financing of clients with more than R20m in annual turnover is taken into account.

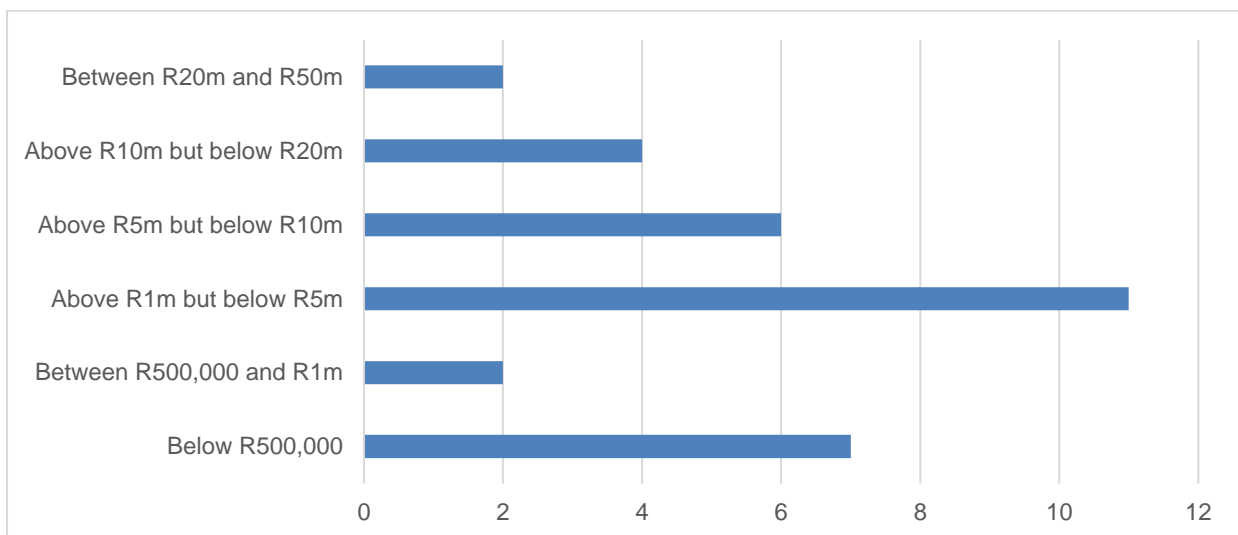
Figure 26: SMMEs financed, by size of turnover – number of respondents



Source: Questionnaire survey, 2018 (Note: Figures don't add up to 34 because institutions offer finance in more than one turnover band.)

Lastly, just over two-thirds of respondent SMMEs had approximate turnover of between R1m and R20m, matching the main category of SMME client financed by respondent financial institutions.

Figure 27: Respondent SMMEs by size of turnover



Source: Questionnaire survey, 2018

C. INTERVIEWS WITH COMMERCIAL BANKS

Following the survey component of the study, and with the assistance of the Banking Association of SA, face-to-face interviews were arranged with the SMME divisions of the country's four largest commercial banks – Absa, First National Bank, Nedbank, and Standard Bank – and these were conducted during June and July 2018. Participants in these interviews were as follows:

Table 6: Commercial bank interview respondents

Bank	Participant designation	Number
Absa	• Collections Strategic Manager	5
	• Product Manager	
	• Head: Enterprise Credit Risk	
	• Enterprise Business Support	
	• Enterprise and Supplier Development Chain	
First National Bank	• Head: Transformation, ESD and Alternative Funding	1
Mercantile Bank	• Head of Business Banking	2
	• Head of Business Banking and Centralised Operations	
Nedbank	• Head: Strategic Initiatives	4
	• National Acquisition Manager	
	• Head: Retail Relationship Banking Credit Assessment	
	• Retail Relationship Banking Sales	
Standard Bank	• Credit Evaluations Manager: Business Banking (x4)	7
	• Credit Evaluation Officer	
	• Credit Evaluation: Business Banking Lending	
	• Business Lending Modernisation	
Total		19

31

The results of these interviews are presented first, followed by the results of the survey component of the study. The results of the financial institutions and the SMME surveys are presented separately for the sake of clarity.

IV. RESULTS – FINANCIAL INSTITUTION INTERVIEWS

The main issues that came out of the in-depth interviews with the four banks are as follows:

- Banks argue that they see SMME lending as a definite opportunity to increase market share. Therefore, the fact that lending to this market segment remains so low is not because of lack of willingness to extend financing but because of the riskiness associated with it.
- Banks report significant barriers to financing SMMEs, particularly start-ups, due to factors they argue are beyond their control.
- The key factors influencing the rate of SMME financing are attributable to SMMEs themselves, banks themselves, and the external environment.

A. SMME LENDING OFFERS AN OPPORTUNITY TO GROW MARKET SHARE

The Finfind report argues, based on a fairly extensive review of international literature, that the high rate of concentration within South Africa's banking industry is one of the key reasons why there are ongoing challenges in terms of increasing lending to SMMEs. It says, "in South Africa, six banks hold 90% of the assets. A highly concentrated banking sector has been found to lower access to finance in SMMEs." The results of the African Development Bank study cited earlier suggest that one of the factors driving deeper penetration of SMME lending in the countries studied is higher levels of competitiveness in those markets, which forces banks to seek new growth opportunities, with SMME lending clearly being seen as one key opportunity.

South African banks counter the assertion that high levels of concentration have a negative bearing on SMME financing, arguing that, to the contrary, the South African banking scene is highly competitive, and banks do, in fact, see SMME financing as a market share growth opportunity. They argue that the reasons for ongoing challenges in SMME financing lie in the various difficulties associated with the dynamics of this market segment, and also have to do with external factors such as regulation and late payment (discussed later) and to some extent on other factors within the banks themselves. "All banks want to grow market share, so if they don't lend to SMMEs it's because there are problems in that market," said one respondent. One bank respondent, however, did remark that South Africa's banks are too concerned about earning big profits and less concerned about increasing their contribution to the development of the South African economy.

B. SMME MARKET DYNAMICS HAVE STRONG BEARING ON FINANCING

Banks argue, in the main, that the SMME market, particularly the start-up and lower end of it, is highly risky. Its riskiness is principally associated with several factors attributable to both SMMEs themselves and to the external environment. SMME-related factors include:

- High rates of failure, which significantly push up bank losses.
- High costs of servicing the market relative to returns earned.
- Lack of business, particularly financial, acumen and industry knowledge and experience on the part of entrepreneurs.
- Weak financial structure of the applicant's business, with limited equity to support the level of facilities requested.
- Many applicants present unviable business proposals which they fail to clearly articulate for funding because they are so dependent on consultants to prepare their business plans.
- Lack of quality business information to enable the bank to correctly assess the prospective borrower's application and the risk associated with it.
- Negative, ill-disciplined borrower behaviour, especially misallocation of funds to activities they were not given for. This places demands on the banks to 'micromanage' borrowers, which also contributes to costs of servicing this market.
- Bad or inadequate credit profile on the part of the borrower.

Banks argued that they have tried various measures to deal with the challenge of poor business acumen on the part of borrowers. These have included offering business skills development seminars and training, and provision online business knowledge resources and mentorship. The impact of these measures, it seems, has not been particularly great, with some banks reporting that they have since either significantly curtailed these activities or discontinued them altogether.

C. CERTAIN FACTORS INTERNAL TO BANKS REDUCE SMME FINANCING

Banks acknowledge a rather strong sense of internal risk aversion towards participating in the start-up and lower end of the SMME market, with some confirming that their lending to this sub-segment of the market has declined over the years. Some have also attributed lack of appetite to serve this market to the high costs associated with lending to it, weak internal understanding of SMMEs, and products that are too generic and are not sufficiently tailored to the specific needs of SMMEs. Part of the challenge with the quality of applications submitted to banks' credit committees was attributable to too strong a focus on the part of bank branches on driving sales volumes, resulting in inadequate due diligence on applications. This, in turn, drives up rejection rates or subsequent default and impairment rates.

“Banks need to understand the dynamics of SMMEs and provide appropriate products. They should train staff on SMME needs and employ innovative ways of lending,” observed a respondent.

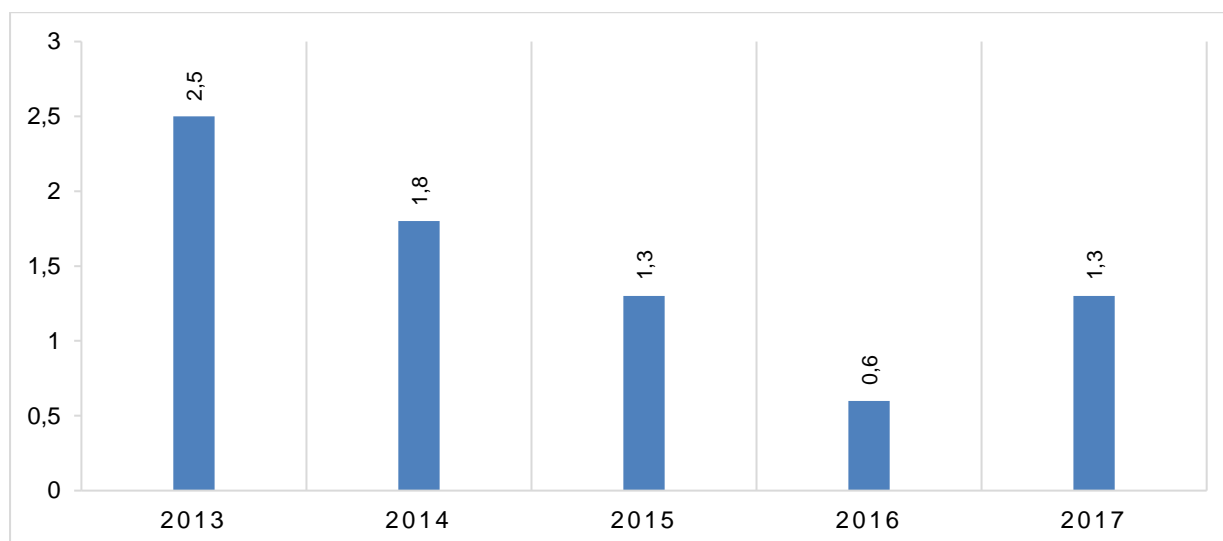
D. SEVERAL EXTERNAL FACTORS REDUCE SMME FINANCING

Banks insist that there are significant, mutually-reinforcing, external factors that work against increased financing of SMMEs, which neither banks nor SMMEs have any control over. Four factors, in the main, were identified:

1. WEAK ECONOMIC PERFORMANCE

The weak performance of the country’s economy, which has persisted over a fairly extended period of time (figure 28), with resultant limited availability of viable business growth opportunities and high SMME failure rate, has significantly subdued bank interest in lending to SMMEs.

Figure 28: South Africa's GDP, 2013-2017 (%)



Source: Based on <https://www.focus-economics.com/countries/south-africa>

2. CREDIT REGULATION

One of the most lamented external factors in reducing SMME lending is the stance of the National Credit Regulator on reckless lending. A significant amount of information is required to assess the borrower’s ability to afford the credit being sought, which many prospective borrowers are not able to furnish.

A finding of reckless lending against the institution attracts penalties. This has contributed to an increase in lending risk aversion towards the SMME market. “The regulator (NCR) is controlling us, the regulation is a barrier,” said one respondent. “NCA is the most difficult. It is one of the reasons (SMME) lending is not improving,” said another. The effect of Basel III, which sets capital requirements for banks, has also been cited as a factor that has contributed to subdued appetite to lend to SMMEs. Yet another regulatory issue that was cited as creating funding difficulties for SMMEs is South African Revenue Service (SARS) investigations, which can take lengthy periods of time and in their course impair the tax compliance status of affected SMMEs, meaning that they cannot access government business, which in turn affects their sustainability and ability to service their credit facilities. “It’s hard for us, but even worse for our customers,” concluded a third respondent.

3. LATE PAYMENT BY CUSTOMERS

A demonstrated ability to pay back credit extended to them is one of the key factors in decisions to approve or decline financing to SMMEs. The cashflow position of the borrower business plays an important role in this regard. Because late payments have such devastating effect on the cashflow positions of SMMEs, they have been singled out as one of the key contributors to bank reluctance to lend to SMMEs. Besides, with healthier cashflows, SMMEs would not be so much in need of external financing, and so the magnitude of the financing problem would be somewhat reduced.

35

Almost without exception, all banks said they view the presentation of a government contract by prospective borrowers as a source of loan repayment funds as an instant “red flag”, because of the problem of “stretched” payment. The sentiment on the issue was expressed by some respondents as follows:

- “It has become increasingly difficult for businesses to secure finance: most of my clients deal with government and government is the stumbling block; it does not pay on time and is therefore considered an extreme risk by the banks. That disqualifies the clients (borrowers).”
- “We look at government contracts differently because of stretched payments.”
- “SMMEs charge very thin margins in order to get business. Non-payment has a catastrophic effect, it’s a disaster. We cannot place reliance on government contracts anymore.”

4. LACK OF EFFECTIVE RISK MITIGATION MEASURES

With the SMME market in general, and start-up and smaller SMMEs in particular, being seen by financing institutions as posing high levels of risk, and therefore negatively impacting their

access to finance, having effective risk mitigation measures in place would go a long way in easing access to finance for them. This is what the government's credit guarantee scheme, operated by SEFA, was meant to do. But all indications are that the scheme has virtually ceased to operate in any meaningful way. The scheme is reported to have guaranteed loans of a paltry R12 million in 2015/2016.¹³ All four major banks reported during the interviews that they had either significantly scaled down or completely phased out the use of the SEFA credit guarantee scheme, citing extreme difficulties in successfully processing claims under the scheme, due to its stringent rules governing claims.

It is important to note that the financing challenges discussed above are not affecting commercial financiers alone, but also public sector financiers. SEFA, the government's main SMME financing agency, is reported to have suffered impairments of around 58% on its direct SMME lending operations during the 2015/16 financial year, forcing it to resolve to cut back on extending new funding while concentrating on recovering outstanding loans.

The agency attributed the increase in impairments to both difficult market conditions, and the behaviour of borrowers: in efforts to mitigate risk, the agency often opens joint bank accounts with its clients so as to control the use of funds paid into those account, but there are instances where clients simply switch to another account, thereby making it impossible for the agency to monitor the client's financial activities. One of the most important risk mitigation measures the agency relied upon for its direct lending operations is cession of government contracts by client SMMEs. This is, however, prohibited by National Treasury rules, thus taking away this instrument as a risk mitigation tool.¹⁴

V. RESULTS – FINANCIAL INSTITUTIONS SURVEY

The next section of the report presents the main findings of the financial institution's questionnaire survey.

A. KEY REASONS FOR SMME FAILURE TO OBTAIN FINANCE

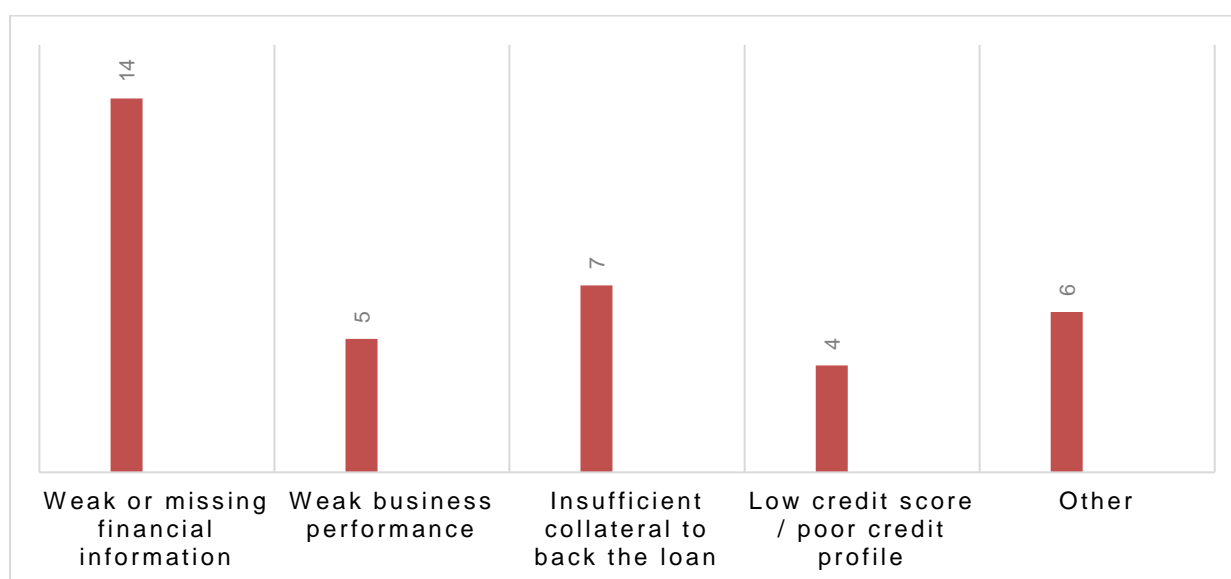
The 2010 study found the most important criteria for evaluating SMME applications for finance were the ability of the SMME to repay the loan, based on its cash flow status, and its own contribution.

¹³ Stephen Timm, "Small business financing: Less help for now," 21 April 2016.

¹⁴ Stephen Timm, "Small business financing: Less help for now," 21 April 2016

This review confirms that these two factors remain a key obstacle to accessing finance for SMMEs. With weak or missing financial information supplied by the SMME applicant, identified by respondents to this study as the main impediment to SMME financing, financial institutions have a difficult time assessing the ability of SMME applicants to meet their loan repayment obligations. Similarly, insufficient collateral to back the loan remains a key financing obstacle. Therefore, there has been no change in this aspect since the 2010 study. Financing impediments remain pretty much the same, eight years later.

Figure 29: Main obstacles to SMME financing

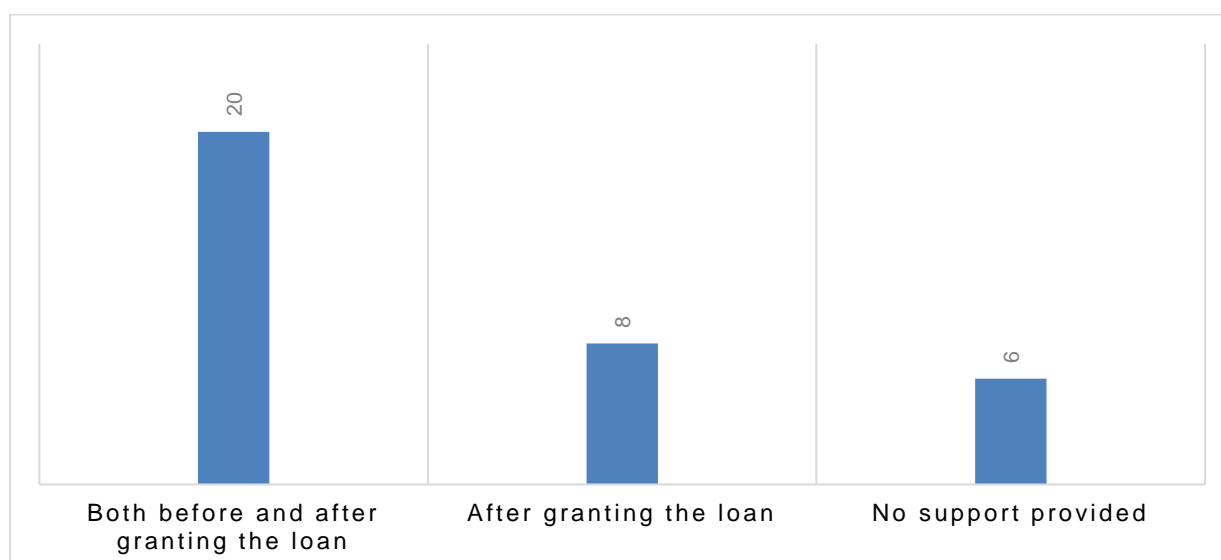


Source: Questionnaire survey, 2018. (Note: "Other" includes absence of personal or business relationship with the client and that the financial institution does not finance the applicant's industry or type of business).

B. SUPPORT OFFERED TO SMME APPLICANTS BEFORE FUNDING

Nearly two-thirds of the respondents indicated that they offer support to their SMME applicants both before and after granting the finance applied for, with only a handful reporting that no support at all is offered. This finding does not tally with the Finfind report, which showed that only 17% of private sector products offer this type of support. An explanation of this might be that the Finfind study covered a much wider range of products that do not offer support, thereby diluting the role of commercial banks, in particular, in offering support. Indeed, during face-to-face interviews almost all commercial banks reported that they offer financial support of one kind or the other to SMMEs approaching them for funding. This suggests that financial institutions are making efforts to go beyond just offering finance, to providing some form of business development support both as a means to mitigate their financing risk and to assist their client SMMEs improve their business performance.

Figure 30: Pre- and post-financing support to SMMEs



Source: Questionnaire survey, 2018.

In the main, this support takes the form of mentoring, training, business skills development, and offering other specific measures aimed at assisting SMMEs reduce their risk status. In the majority of cases (22 out of 34) this support is delivered directly by the financing institution itself, whereas others use external service providers. The main reasons for using an external provider, where this is the case, is that the financial institution either lacks internal capacity or expertise to deliver the service or that it costs the institution less to use an external provider.

TABLE 6: Business support offered to SMME clients before financing

Help SMMEs assess their own financial status and risk profile before applying for finance	11
Offer SMMEs one-on-one or group support such as mentoring or training	19
Assist SMMEs implement specific measures to reduce their risk status	19
Assist SMMEs to prepare and understand their own financial statements	14
Assist SMMEs to prepare and understand their own business plans and finance applications	17
Assist SMMEs to develop their business skills	19
Other (financial education, marketing strategy development, overall business modelling)	5

Source: Questionnaire survey, 2018. (Note: Figures don't add up to 32 because institutions offer several types of assistance to SMMEs).

C. IMPROVEMENTS TO PRE-FUNDING SUPPORT OFFERED TO APPLICANTS

Seventeen respondents reported that their financial institutions had introduced improvements to their existing pre-financing support measures. The balance of respondents said their institutions had not introduced any improvements. Some of the improvements cited included:

TABLE 7: Business support improvements during the past eight years

- Introduced specialist programmes such as Technical Assistance Programme, Individual Liability Programme, Larger Loan Programme, and financial education
- Funded SMMEs participating in business incubation programmes
- Increased national footprint to reach SMMEs with non-financial support and targeted products introduced to support targeted groups, namely, women, youth, and entrepreneurs with disability
- Introduced technical committees to review the application before being tabled for final investment decisions. Also introduced investment readiness workshops to ensure that SMMEs receive the necessary assistance before applying for funding
- Established a dedicated function within the institution, with primary focus on SMME support
- Invested in more qualified staff and better capacity as well as the launch of the S12J Fund
- Introduced an in-house credit rating team that assists SMMEs to put together their funding proposals before these are sent for funding assessment
- Increased the speed at which the institution can fund a business from point of application

D. IMPROVED PROCESSING OF APPLICATIONS AND STAFF UPSKILLING

In addition to improvements to pre-financing support offered to SMMEs to improve their chances of obtaining financing, almost all financial institutions, with a small exception, reported that over the past eight years they had made changes to the way they process SMME funding applications.

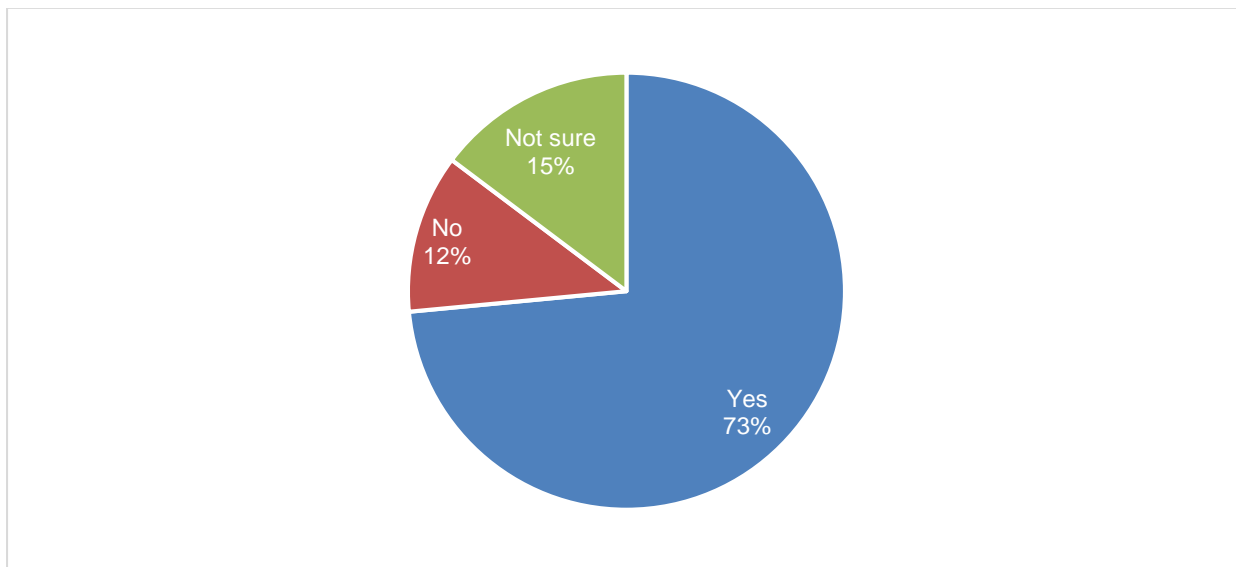
TABLE 8: Changes to the processing of SMME finance applications

Introduced new policy on handling SMME applications for finance	16
Introduced a degree of lenience in assessing SMME funding applications	9
Introduced new products that are more appropriate to the financing needs of SMMEs	19
Introduced a higher level of risk tolerance / appetite towards financing SMMEs	11
Introduced new processes for assessing SMME finance applications	15
Made special efforts to better understand SMME financing needs and challenges	21
No change	2

Note: Figures don't add up to 34 because some institutions made more than one change.

Moreover, over 70 per cent of the respondents reported the introduction by their financial institutions of capacity and skills development initiatives aimed at sensitising credit and SMME financing personnel about the specific needs of SMMEs.

Figure 31: New measures aimed at sensitising financial institution staff about SMME needs?



Source: Questionnaire survey, 2018.

Some of the reported impacts of the staff sensitisation and upskilling initiatives are:

TABLE 9: Effect of staff sensitisation and upskilling

- The credit quality of information coming through has improved and better informs decision-making
- Faster turnaround times in processing of applications and more accurate understanding of the needs and capacities of SMME clients
- Staff with different roles now able to provide assistance to clients
- Increase in the number of SMMEs formalising their businesses
- A more SMME-centric process, resulting in a material difference in the quality of assessment and engagement with SMME clients
- Improvements in the quality and efficiency of due diligence assessments by the funding and the incubation team
- SMME clients now have a better understanding of what financial institutions look at when assessing applications
- Increase in the number of youth beneficiaries supported and value of funding channelled to them
- Staff are now more skilled and have better understanding of the clients' cash flow constraints
- Higher approval rates and lower impairments. SMME book has grown month on month and institution has attracted more customers
- There has been growth in number of clients, increase in loan size, and improved client profitability
- Staff empathy has increased, resulting in more appropriate processes for SMMEs

These new and improved measures, and staff upskilling initiatives, have reportedly had fairly marked impact in improving SMME access to finance, with a combined 22 respondents giving them a strongly positive impact rating (rated 4 to 5).

TABLE 10: Effect of internal measures on improving access to finance over the past 5 years

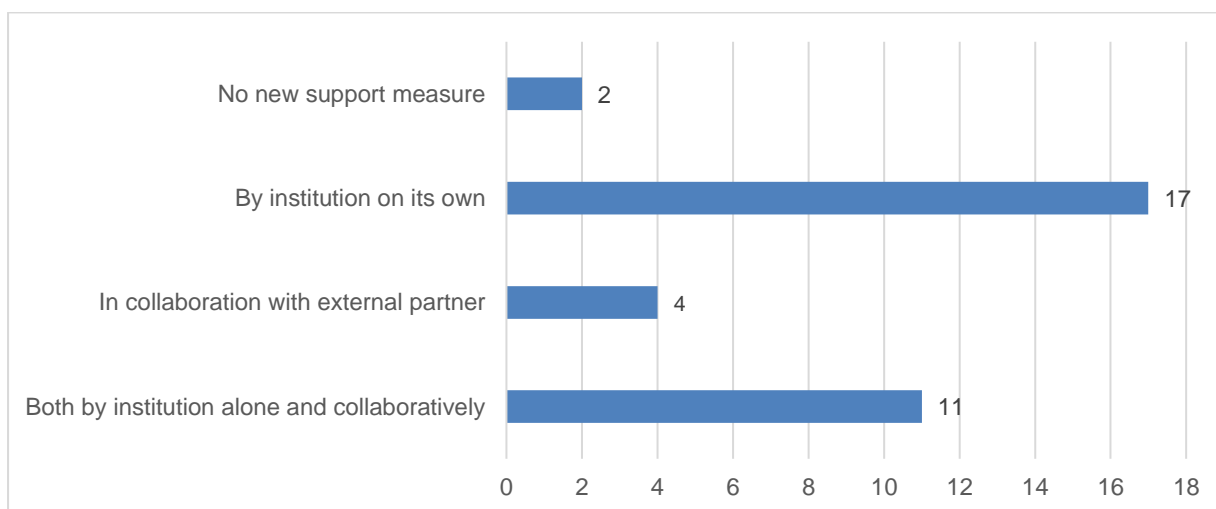
1 No impact	2	3	4	5 Significant impact
4	-	6	15	7

Accordingly, the majority of respondents (31) believe that SMME access to finance from their institution is better now compared to 8 years ago.

E. NEW POST-FINANCING SUPPORT MEASURES

A larger number of respondents reported the introduction of new post-financing support measures over the past eight years, with most (17) of these having been introduced by the financial institution on its own, while in other cases these were introduced in collaboration with other partners.

Figure 32: Post-financing support measures introduced by financial institutions



The most important reasons for introducing these new post-financing measures were to assist SMMEs to improve their business success prospects (which, of course, has a direct bearing on their ability to repay the funding extended to them) and to mitigate the financial institution's funding risk.

Coupled with the third major reason for introducing these measures, namely to ensure that SMMEs repay the funding they have received from the institution, it is clear that overall risk mitigation is by far the most important motivation for financial institutions extending non-financial support to their SMME clients.

TABLE 11: Reasons for introducing new post-funding support

Mainly to assist SMMEs to improve their business success prospects	27
Mainly to mitigate the financing risks faced by the institution	19
Mainly to ensure SMMEs repay the financing offered to them by the institution	18
Mainly to ensure retention of existing SMME clients	11
Mainly to grow the institution's SMME market share by attracting new SMME clients	13
Other (identify growth opportunities for SMMEs, enhance institution's investment returns)	2

Note: Figures don't add up to 34 due to multiple responses.

This raises the question as to whether financial institutions would extend any support at all to non-client SMMEs, motivated purely by a desire to contribute to the growth of SMMEs per se. The fourth most important reason for introducing this support, namely to grow the institution's SMME market share, might seem to provide an affirmative answer to this question. However, even here, the financial institution's interests, namely attracting new SMME clients, hold supreme.

F. GAPS IN POST-FINANCING SUPPORT

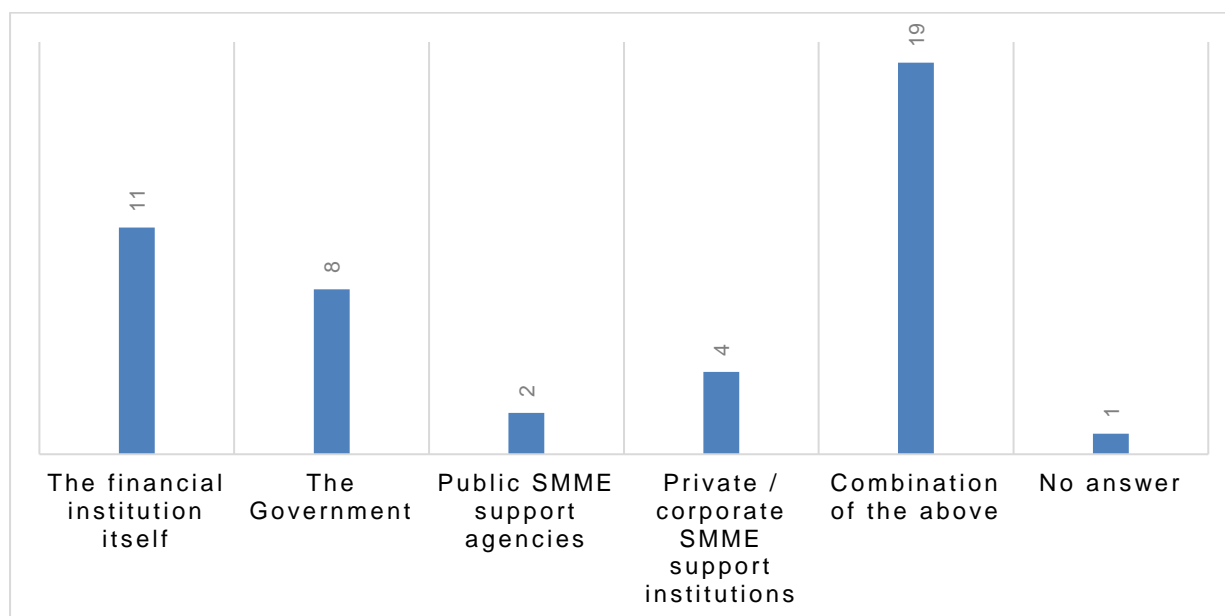
Although respondents believed that there are gaps in the provision of post-funding support to SMMEs, no specific gaps were consistently identified by any significant number of them. Responses were all over the place, indicating the existence of a felt need but one that respondents could not define with any degree of certainty. Gaps mentioned included:

- Risk management and strategic planning for SMMEs themselves
- Ongoing skills development
- Provision of specialised industry knowledge and skills
- Continuous, customised support as and when an SMME needs it
- Access to markets

While respondents may not have been able to pinpoint with any degree of specificity specific gaps in post-financing support, they were clear that closing existing gaps is a shared responsibility for all players in the SMME support environment, with the financial institutions themselves and the government bearing a significant portion of this responsibility.

This suggests that a need exists for much closer working together among the various players to find effective solutions to issues of SMME financing and support more generally, something that is lacking to a large extent.

Figure 33: Responsibility for closing post-financing support gaps



Source: Questionnaire survey, 2018. (Note: Figures don't add up to 34 due to multiple responses).

G. SUPPORT MEASURES INTRODUCED BY EXTERNAL PARTIES

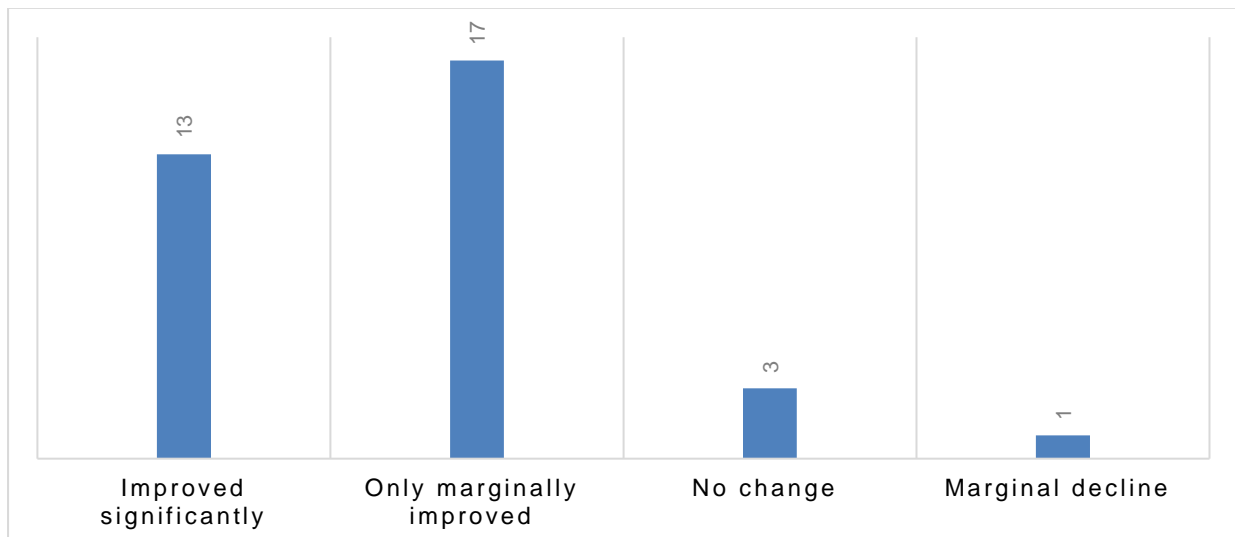
In contrast to the higher number that reported the introduction of improved or new support measures by their institutions, more than half (17) did not know of any measures introduced or currently being offered by stakeholders outside of the financial institution to ease SMME access to finance. Third party measures mentioned by the other 15 respondents included pre-investment support, online business tools, franchisors partnering with finance providers to ensure the continued growth of their franchisees, large corporates offering enterprise development support and partnering with banks to help grow and finance SMMEs they deal with in their programmes.

H. OVERALL STATE OF SMME ACCESS TO FINANCE

Although the majority of respondents (29) believe that SMME access to finance from their own institution is better now compared to 8 years ago, half of all respondents (17) believe that access to finance by SMMEs generally has only marginally improved since the 2010 study, compared to just 13 who believe that access has improved significantly.

Taking into account the balance who believe that there has been no change or there has been a marginal decline in access, then the state of access to finance by the country's SMMEs clearly remains precarious.

Figure 34: Access to finance by SMMEs in general



Source: Questionnaire survey, 2018.

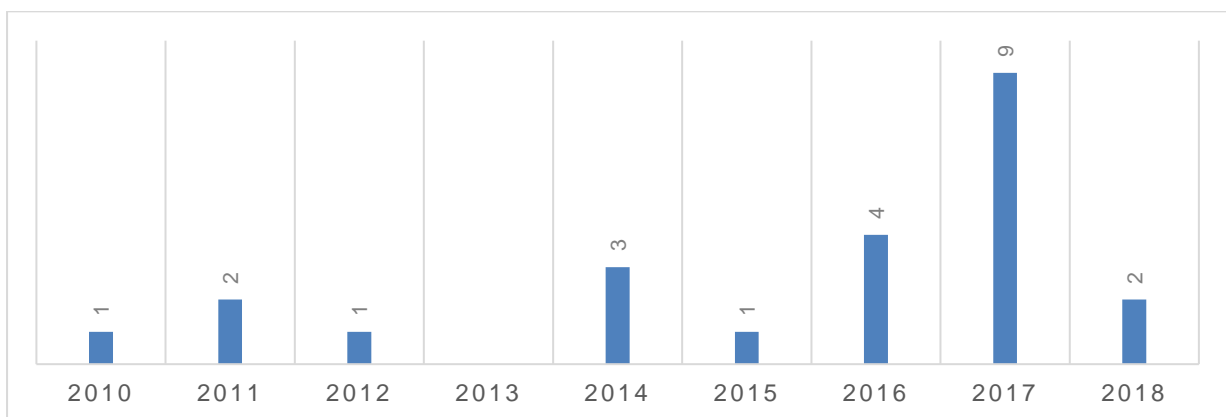
VI. RESULTS – SMME SURVEY

This section presents the results of the questionnaire survey completed by 32 SMMEs.

A. APPLICATION FOR FINANCE

Twenty-three respondent SMMEs had approached a financial institution to seek finance for their businesses during the past eight years, with the largest number having applied for finance during the past two years (2016 and 2017).

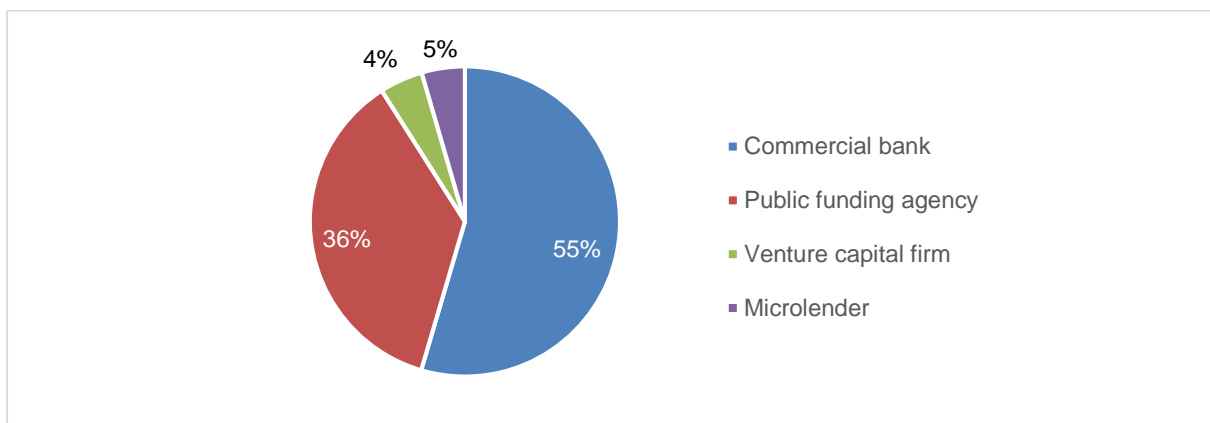
Figure 35: Year SMME applied for finance



Source: Questionnaire survey, 2018.

Commercial banks were approached by more than half of the SMMEs that sought funding, while public financial institutions were approached by over one-third of applicants. This clearly indicates the importance of these two types of institutions, and the main type of financing they offer, namely loan financing, as the main source of business financing for SMMEs.

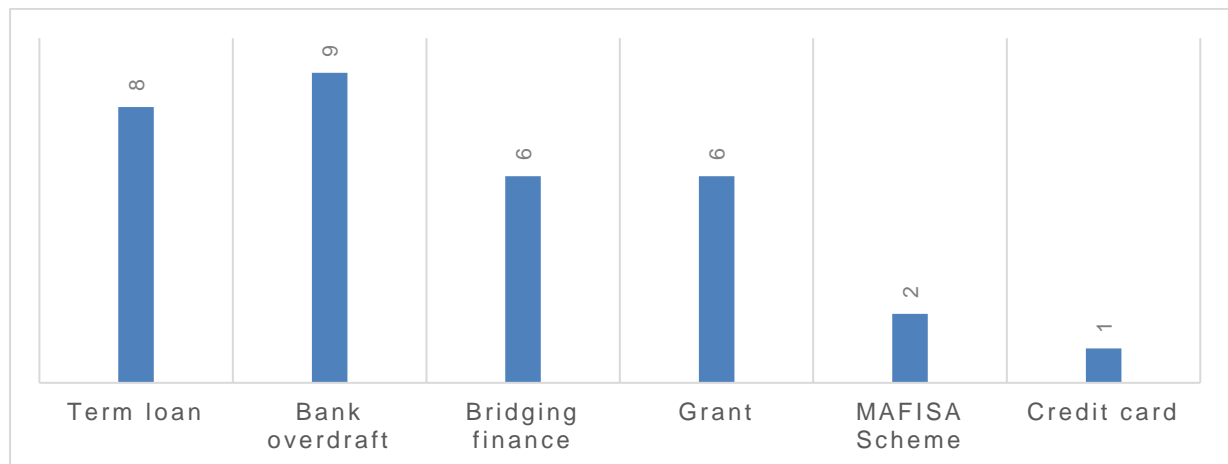
Figure 36: Type of financial institution approached for finance



Source: Questionnaire survey, 2018.

Of those who approached commercial banks to seek financing for their businesses, the largest number (27) approached the bank their business normally banks with. Some of the reasons given by those who chose to approach a bank other than the one their businesses normally bank with were “to secure more favourable terms” and “we knew our bank would not approve our application”. Confirming the observations made earlier, bank overdrafts and term loans were the two types of products most applied for. In third place were bridging finance and grants.

Figure 37: Type of finance applied for



Source: Questionnaire survey, 2018.

The amounts requested varied from a low of R20,000 to a high of R5million, with the average of just over R500,000. This confirms the earlier report that most SMMEs seek financing between R250,000 and R500,000. The main reason for seeking finance, cited by eighteen of those that applied for finance, was cash flow and working capital, followed by asset finance.

B. PRE-APPLICATION SUPPORT

Most of the respondent businesses that applied for finance neither sought nor received pre-application support. Of the six that did receive pre-application support, four received it from a source other than a financial institution, while a third received it from a financial institution.

C. APPLICATION OUTCOMES AND REASONS

Of those that applied for finance (23), thirteen reported that their application was not successful. Of the ten whose applications were successful, just over one-third received all the funding they had applied for, while the rest received less than the full amount they had applied for. A third of the unsuccessful applicants were not furnished with reasons why their applications were declined.

For the rest who were informed why their applications were unsuccessful, or why less than the full amount applied for was approved, the main reasons were insufficient collateral (one-third), weak business performance, and poor credit profile (in that order of importance). This stands in contrast to the reason given by financial institutions as being the main obstacle to access to finance, namely, weak or missing financial information (figure 29).

D. VIEWS ON GENERAL SMME ACCESS TO FINANCE

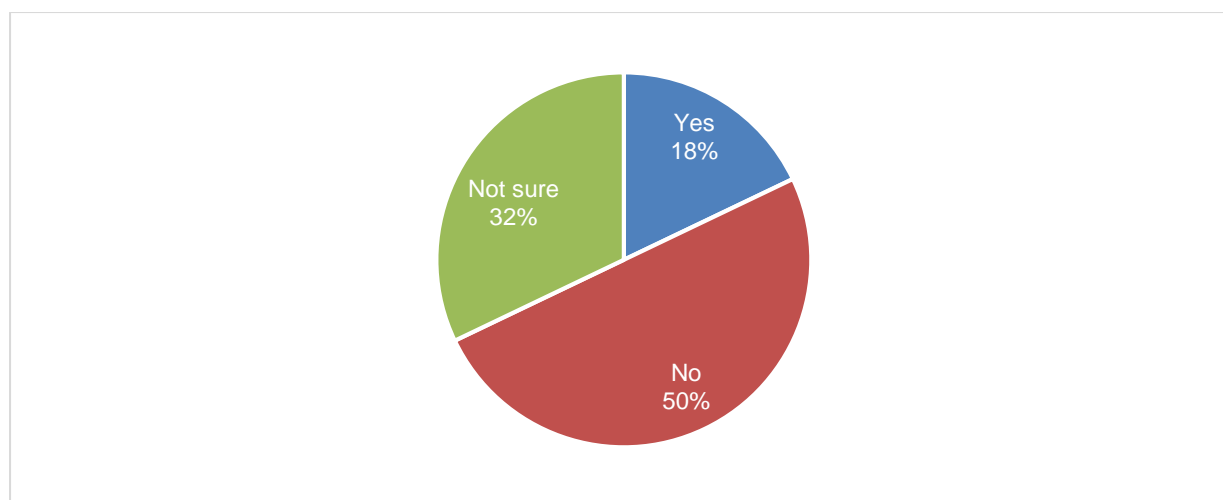
Contrary to the view expressed by financial institutions that access to finance for SMMEs in general has improved significantly, only three out of the thirty-two SMMEs agreed that there has been marked (rated 4 to 5) improvement in access over the past five years.

TABLE 12: Has access to finance for SMMEs has improved over the past 5 years?

1 Strongly disagree	2	3	4	5 Strongly agree
13	4	12	2	1

Similarly, only six out of the thirty-two SMMEs believe there has been improvement in the ways financial institutions treat small businesses applying for finance, with half (16) saying there has been no improvement and one-third not sure.

Figure 38: Has treatment of SMMEs by financial institutions improved over the past 5 years?



Source: Questionnaire survey, 2018.

Of the top impediments to access to finance identified by SMMEs, lack of collateral was named as the number one obstacle. Red tape came in second, while weak cash flow and poor creditworthiness came in joint-third.

VII. CONCLUSIONS AND RECOMMENDATIONS

This study does not find evidence of significant shifts in SMME financing since the 2010 FSP study. In fact, with the exception of the Financial Sector Charter Council, which takes a more positive view on the matter, the OECD, Finfind and the National Credit Regulator convey the message that access to finance for SMMEs remains a challenge. Indeed, face-to-face interviews with the country's four largest commercial banks revealed that they face significant challenges in their efforts to finance SMMEs. These challenges are both within, but mainly outside the financial institutions themselves, and relate to both borrower capacity and behaviour and the regulatory and economic environment.

Out of this study emerges two somewhat divergent views on the current status regarding access to finance for SMMEs. While both financial institutions and SMMEs share the view that access remains difficult, financial institutions paint a more positive picture than do SMMEs. For instance, financial institutions believe access to finance has improved since the 2010 study.

SMMEs take a clearly different view on this, seeing the situation as having largely stayed the same. Financial institutions assert that weak or missing financial information is the biggest impediment to financing SMMEs, followed by insufficient collateral and weak business performance. SMMEs place collateral at the top of the list by a significant margin, followed by weak business performance, red tape, weak cash flows and poor credit record. Just over 60 percent of financial institutions report that they provide pre- and post-financing support to SMMEs and report improvements to existing support, application handling processes, and staff upskilling, plus introduction of new support measures. They credit these actions for what they see as improved access to finance for SMMEs, at least from their own institutions. Yet over 80 percent of SMMEs say they never received any support when they approached financial institutions for financing and refute the claim that access to finance has improved. In fact, half of SMME respondents believe that treatment of SMMEs by financial institutions has not improved, while the other one-third is undecided on the question, leaving only a small number affirming that treatment has become better.

One area where there seems to be agreement between both financial institutions and SMMEs is that there remain some significant gaps in the overall provision of finance-related support to SMMEs. Most respondents among financial institutions believe these gaps need to be tackled collaboratively by several stakeholders, including financial institutions themselves, the government, corporates and public SMME support agencies.

The 2010 FSP study recommended four actions to achieve four outcomes aimed at improving access to finance for SMMEs:

Outcome 1: Improve financial institutions internal systems to approve SMME financing

Outcome 2: Develop new products for the SMME market

Outcome 3: Promote use of loan guarantee schemes

Outcome 4: Facilitate an enabling regulatory and legislative environment

In general, these proposals still hold valid as there is not much evidence that there have been any significant changes in any of the areas above since the last study. To the above, this study would add that six key actions need to be undertaken to improve access to finance for SMMEs:

- Action 1: Undertake a review of the impact of the National Credit Act on SMME lending.
- Action 2: Invest in developing the business and financial acumen of entrepreneurs, particularly those starting out, so that they can identify viable business opportunities and formulate business and funding proposals that demonstrate their full grasp of the opportunities they seek to pursue.
- Action 3: Have an open conversation about the problems experienced by both sides, namely banks and SEFA, with the SEFA credit guarantee scheme and fundamentally redesign the scheme to make it more user-friendly. Simultaneously investigate other risk mitigation mechanisms used successfully in various parts of the world, such as mutual guarantees, to determine their suitability for the South Africa market.
- Action 4: Support initiatives aimed at helping entrepreneurs that have 'thin' credit files to develop positive credit profiles.
- Action 5: Have an open, public dialogue with various stakeholders, including government and SMME representative organisations, about the negative impact that lack of disciplined financial management behaviour and a culture of non-payment on the part of borrowers has on the general environment for SMME financing in the country.

Action 6: Work with institutions such as the Department of Small Business Development, Financial Sector Charter Council, National Credit Regulator, and South African Reserve Bank to confront the challenge of lack of accurate and credible data on SMME financing in the country.