

**AN INVESTIGATION INTO
THE FINANCIAL SUPPORT AVAILABLE TO
SOUTH AFRICAN SMALL AND MEDIUM ENTERPRISES**

BY

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CONFIDENTIALITY CLAUSE

15 September 2004

TO WHOM IT MAY CONCERN

RE: CONFIDENTIALITY CLAUSE

Due to the strategic importance of this research it would be appreciated if the contents remain confidential and not be circulated for a period of five (5) years.

Sincerely

096317

D.Naidoo

DECLARATION

This research has not been previously accepted for any degree and is not being currently submitted in candidature for any degree.

Signed.....

Date: 15 September 2003

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I am eternally grateful to God for granting me the strength and ability to complete my Master of Business Administration degree and in particular this research study. I am also thankful to the respondents of the questionnaires, various role players from various organizations, especially The South African Department of Trade and Industries, Industrial Development Corporation (IDC) and Khula Enterprise Finance Limited, and my colleagues who have all significantly contributed towards this dissertation.

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GLOSSARY

(i) **Small Business**

According to the National Small Business Act (1996), a separate and distinct business identity, including co-operative enterprises and non-governmental institutions (managed by one owner or more - including its branches or subsidiaries), is predominantly carried on in any sector or sub-sector of the economy as classified in classes of micro, small and medium.

Table 1: Detailed definitions from the Government White Paper

Class	Descriptor	Total Employees	Annual Turnover	Gross Asset Value
<i>Micro</i>	Informal Business Survivalists	<5	Less than R150k	R100 000
<i>Very Small</i>	Formal Business with Access to technology	<10-20	R400k- R4million	R400k-R1.8m
<i>Small</i>	More established businesses with business management experience	<50	R2m-R25m	R2m-R4.5m
<i>Medium</i>	Developing & well industrialized	<100-200	R4m-R40m	R4m-R18m

(ii) Classical Beneficiaries

This refers to the typical and normal (reflective of the old paradigm of SMEs traditionally served). This predominantly was white-male owned SMEs.

(iii) Micro-Lending

Term is used to describe lending of small amounts viz. ranges from R100-R200k.

(iv) Financial Support

Support to SMEs in the form of loans, matching grants, seed financing and venture capital investment.

(v) Non-Financial Support

Support to SMEs in the area of business planning, marketing, legal support, training, etc.

(vi) Intermediaries

Comprises of financial and non-financial support intermediaries. Intermediaries act as retailers to national programmes in order to get better outreach and interaction with end users/beneficiaries of programmes and schemes.

(a) Financial Support Intermediaries

Financial service providers used by Khula to disseminate funding in localities. Khula is wholesaling and are therefore partners with identified retailers in the country (e.g. banking institutions), to make funding available to SMEs.

(b) Non-Financial Support Intermediaries

Public Sector institutions which promote The Department of Trade and Industry (DTI), through its schemes and also attracts clients through its outreach programmes.

(vii) Industrial Marketing

A targeted approach to marketing, in order to get co-operative relationships simulated between public, private and big/small businesses.

(viii) Firm Readiness

Refers to how ready an SMEs might be to continuous improvement, business development and upgrading, export and joint ventures.

(ix) Targeted Programmes

Specific programmes aim to serve targeted segments of the SMEs base, e.g. Small manufacturers, new ventures and previously disadvantaged persons.

(x) Survivalists

Informal businesses, with lower levels of capacity and infrastructure.

(xi) Venture Capital

Financing of new viable ventures. Normally coupled with high tech start-up businesses with high innovative products/process potential.

(xii) Informal Venture Capital

Addresses the need of informal businesses with high innovative potential. Normally coupled with a strategy like business angels or looks at the set-up of alternative mechanisms (e.g. Funding/training programmes) to address the needs of informal business start-ups.

(xiii) Business Angels

Business partners that invest in SME products/process ventures which are of strategic importance to big business and which address a niche market with potential for high return on investment. This is therefore coupled with:

- (a) Strong business involvement from the “big business brother”;
- (b) An intense market research for investment persuasion and decision purposes.

Business Angels have been well demonstrated in countries like Australia, USA, Mauritius, as a type of venture capital process to get big and small business working together in mentorship and mutually advantageous modes.

ABSTRACT

Since the democratization of South Africa, there has been a fundamental need for the creation of employment and economic growth.

South African companies have, however followed international business trends through merges, acquisitions and the introduction of sophisticated technology. The result of the above policies, have significantly contributed to the countries high unemployment rate, with the current official unemployment rate of 30,5 (according to the 1996 census). Furthermore, the legacies of apartheid have left a large portion of the population to be unskilled and therefore unemployable.

As a result of the above, the government has been burdened with the creation of employment, single-handedly finding innovative financing schemes for the small and medium enterprise sector, while simultaneously ensuring economic growth, despite prevailing economic conditions.

In order to achieve economic growth and create employment opportunities, it is my opinion that primary focus needs to be given to the development of small and medium enterprises. In this regard emphasis should be given to the enhancement of potential and existing small and medium entrepreneurs, to enable them to become competitive forces.

It has however, become common for good entrepreneurial ideas to “die as ideas” largely due to the inability of these entrepreneurs to secure adequate venture capital, to fund their ideas into successful businesses/innovations. This chronic shortfall of financial resources for SMEs is largely attributable to a financial strategy focused on larger firms with a perceived lower risk based on the belief that such firms were “to big to fail”.

The challenge is therefore, for government to create innovative ways to finance initiatives by existing and potential entrepreneurs, thereby stimulating economic growth and employment.

It is also prudent to highlight the fact that in addition to the contribution SMEs make to a countries wealth and employment, they also serve as the primary vehicles by which new entrepreneurs provide the economy with a continuous supply of ideas, skills and innovations.

Start-ups are estimated to have created 140 000 jobs in South Africa, between January 1999 and July 2002, while new firms are estimated to have created nearly one million. Furthermore, the 2002 Global Entrepreneurship Monitor (GEM) places South Africa below the average rate of entrepreneurial activity when compared with 36 countries. S.A also ranks lowest of all developing countries including Chile, Brazil, India, Argentina and Thailand. These results show that SA is in the bottom quartile of all countries on measures of opportunity entrepreneurship and new firm activity – both critical gauges for economic growth potential.

GEM 2002, which is an annual international research project coordinated by London Business School, found that the greatest obstacles facing entrepreneurship is a lack of/ ineffective financial support, education and training, government policies and programmes.

The aim of this study is to identify innovative ways of funding small and medium enterprises (SMEs) and the strategic implications of these initiatives on the South African economy. Furthermore, it is recommended that government big business and the select few wealthy individuals form strategic alliances, in order to promote the growth of this business sector, considering that the number of companies registered by the DTI has risen to 110 000 last year, of which 80 percent were small, black owned businesses. According to the National Small Business Act (1996), the small business sector absorbs nearly 44 % of the people formally employed in the private sector, and contributes to about 32.7 % to the country's gross domestic product. Given the significant increase in the number of registered enterprises since the 1994 General Elections, the sector holds further promises in order to generate economic growth and hence the need to develop and invest in this sector.

Despite the existence of schemes, access to finance has been identified at the recent Job Summit as one of the problems and barriers to job creation and growth of small enterprises in South Africa.

A recent media reports have highlighted the frustration of members of parliament, about the failure of the Department of Trade and Industry (DTI) to help SMEs, with the Director General, admitting that his department had not been doing enough, or visibly enough.

While the DTI claims to have various loan assistance schemes in place, emerging Black entrepreneurs do not seem to have access to these facilities. A major concern is that the DTI continues to rollover massive amounts of unspent funds (from its annual budget of R2.2 million), that indicates that their target market is not being reached.

Accordingly the focus in the future should be to increase the outreach of various programmes, targeting them more specifically at the SME sector.

This research project therefore reviews the implementation of policies and programmes aimed at SMEs access to financial assistance in order to highlight barriers that hinder this process and recommendations to rectify the existing status quo.

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CHAPTER ONE



INTRODUCTION

CHAPTER ONE: (INTRODUCTION)

1.1 INTRODUCTION

Despite the shortages of capital and natural resources, many economies have grown remarkably in terms of GNP and exports. In the process of economic growth, the financial system plays a vital role in mobilising domestic and foreign savings.

Financial institutions, more especially commercial banks, have become the largest source of institutional finance, yet they are unable to adequately address the financial needs of SMEs. Furthermore, the high rates of interest levied to SMEs (whom the commercial banks regard as high risk), their inflexible collateral requirements, stringent lending criteria and minimal government intervention, continue to deprive SMEs of the opportunity to positively contribute to the economy and assist in the alleviation of unemployment.

Commercial banks will however, contend that the controls on interest rates and on the lending and borrowing of financial institutions coupled with the perceived high failure rate of this category of borrowers, have compelled them to concentrate their lending on low-risk larger borrowers.

As a consequence of the above, many efficient small and medium enterprises are deprived from accessing institutional finance.

There is a common perception among SMEs that the importance of this business sectors financial needs has only been superficially emphasized by government and SMEs continue to be a neglected sector within the South African economy.

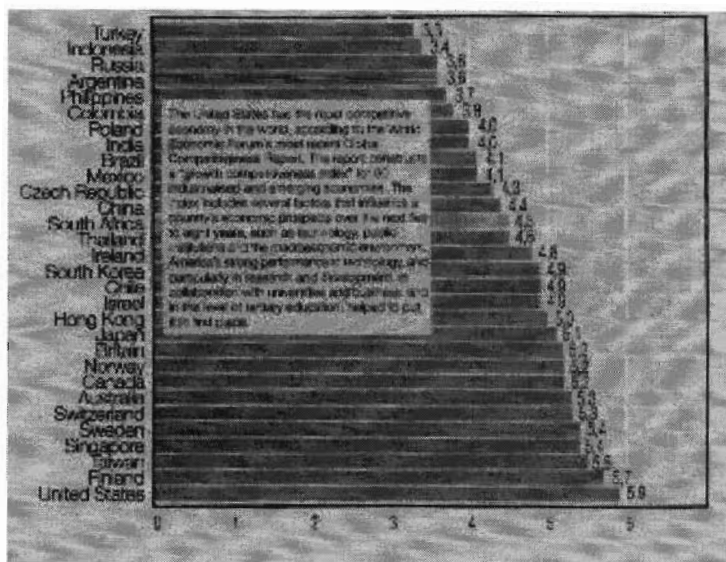
Current incentives offered by government, example export incentives appear to favour larger firms that have access to financial resources. Furthermore, SME initiatives initiated by government appear to be ineffective, with its target market not being reached.

Hence, SMEs tend to produce for domestic consumption and light industries, which are often not their target sectors. According to the World economic Forums most recent Global competitiveness report, which considers economic factors that influence economic prospects

over the next 5-8 years, South Africa features favourably when compared to economies like Thailand and South Korea, while it is expected to outperform many economies e.g. India, China, Russia and Brazil. This competitiveness ranking is detailed in figure 1 below.

Against this backdrop, this research project aims is to examine the financial support available to South African SMEs, by attempting to determine the reason(s) that SMEs face difficulties in accessing support through financial schemes, through financial institutions and more especially those that have been designed by government.

Figure 1.1: Competitiveness ranking



Source: World Economic Forum

1.2 BACKGROUND

According to the 1996 national South African national census, the official unemployment rate is estimated to be 30,5 percent of the economically active population. Approximately 20 % of the total estimated population of 45,3 million (with an estimated growth rate of 2,2 percent per annum), were employed in the formal sector, while another 4 % were employed in the informal sector. However, the unemployment rate for Africans was 36.9 % against 5.5 % for Whites.

The enabling environment is made up of a mix of financial support schemes and incentives (DTI, IDC, Khula), non - financial support services and SME programmes at a provincial level (Local Business Service Centres) that have the prime responsibility of monitoring and implementing strategies through programme design and resource allocation.

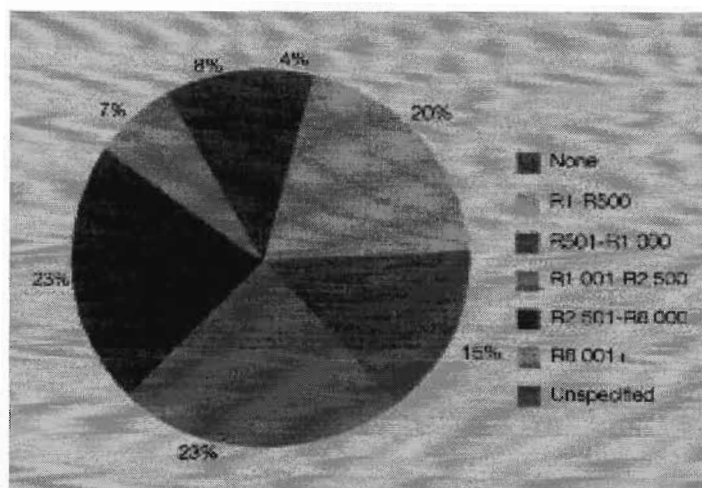
Despite the enabling policies that the Government has undertaken small business continues experience difficulties in accessing funding, thereby impeding further employment creation and economic growth.

According to the Statistics South Africa, Labour Force Survey (2002), approximately 52 percent of South African's either earn either no income or an income below R2500 per month (refer to figure 2 for a detailed breakdown of income distribution).

Therefore, the promotion of SMEs is expected to stimulate growth thereby creating employment and increasing the current disposable income of South Africans.

The strategy employed by government, primarily the introduction of financial support schemes for SMEs, remains suitable. However, the non-delivery of these schemes can be attributed largely due to governments total reliance on commercial banks to fulfill the delivery of governments strategy. This major shortcoming has precluded emerging SMEs from significantly contributing towards the enhancement of the lives of many South Africans, through economic growth and employment creation/enhancement.

Figure 2: Workers by monthly income



Source: Labour Force Survey September 2002, Statistics S.A.

1.3 MOTIVATION FOR RESEARCH

Global research on SMEs is unequivocal on the primary benefits that this sector is able to offer, namely creation of employment and economic growth. Furthermore, international experience suggests that an efficient SME sector is conducive to rapid industrial growth and a flexible industrial structure. Hence, SMEs appear to weather the storm in economic crisis, better than larger industrial firms.

Despite the above, government and commercial banks have failed to adequately address and implement strategies that would support the financial needs of this sector.

The researcher is a manager at a commercial bank and is fully aware of the integral part that commercial banks play in the development of SMEs and the pivotal role SMEs play in the economic development of a country.

However, the stringent lending criteria of commercial banks (especially collateral requirements) and their reluctance to promote schemes initiated by government (due to the cumbersome procedures, low profitability and high failure rate), has made financial resources less accessible to this sector.

However, the researcher is frequently in contact with entrepreneurs who were initially unable to secure finance through formal institutions, but finance obtained through informal and/or the pooling of their personal resources, has resulted in success stories.

1.4 BENEFITS OF THIS RESEARCH

To promote small enterprises, the focus must not only be in creating jobs but on encouraging emerging entrepreneurs who will create their own jobs. Entrepreneurs need to be equipped to create their own jobs as well as those for their communities, not once but continually, in the process of self-employment that adapts to changing market conditions and lasts a lifetime.

If the focus is on emerging entrepreneurs creating their own employment, one needs to consider tangible resources, such as self-esteem, skill and diligence as well as the more usual tangible job resources, such as finance. The classic definition of entrepreneurship is the ability to combine resources. Therefore, even at the small enterprise level, the emerging entrepreneur must be able to acquire and combine tangible and intangible resources. The success of the business is embedded in this interaction.

A business begins when an emerging entrepreneur perceives a market opportunity, looks within himself and sees a will and ability to exploit this opportunity and looks externally and recognizes the resources that can be used to realize this opportunity.

The questions the entrepreneur asks himself/herself are:

- Can I do this?
- How can it be done?
- What resources are required?

Skills for exploiting business opportunities can be taught. The capacity to perceive resources as well as needs in the disadvantaged communities is partly a skill and partly a frame of mind. The confidence to apply business skills and perceptions is harder to come by and will also depend on community attitude to business. Community consent cannot be achieved by external intervention. Consenting to business involves:

- Recognizing the skill and diligence for emerging entrepreneurs to succeed.
- Acknowledging the right of the individual to succeed.
- Affirming the value of business success at every level.
- Providing resources and support necessary for resources.

Setting up a small business is normally seen as a last ditch effort by the financially desperate to create self-employment. South African financial institutions are not “small enterprise friendly”, and consequently consent to financial assistance is often withheld.

Small enterprises may not be perceived to be legitimate activity, hence the surrounding social networks will not translate into business networks, thereby leaving the emerging entrepreneur to succeed or fail on his own.

The benefits of this study is to examine what benefits will accrue to the emerging entrepreneur, community and economy, focusing on:

- Encouraging and training emerging entrepreneurs,
- Successfully promoting the development of resilience, self-reliance and ability to combine tangible and intangible resources.

1.5 PROBLEM STATEMENT

International research has unequivocally concluded that SMEs significantly contribute towards eradication of unemployment and stimulation of sustained economic growth.

However, technological advancements have made big business more capital intensive, hence unskilled and elementary workers are negatively affected (as detailed in table 1.1)

Table 1.1: Sources of change in skills structure of total employment

1984-1988	Final demand (%)	Exports (%)	Imports (%)	Net trade (%)	Technology (%)	Employment change (%)
Skilled	0,29	0,33	-0,12	0,21	1,37	1,87
Semi-skilled	-0,08	0,76	-0,44	-0,32	-0,65	-0,41
Unskilled	0,33	0,82	-0,35	0,47	0,13	0,94
Elementary	3,78	0,62	0,36	0,98	-6,06	-1,30
Total	4,29	2,60	-0,57	2,03	-6,10	0,22
Employment change	288 437	174 986	-38 337	136 649	-410 414	14 673
Total direct effect	3,6	1,46	-0,24	1,22	-4,61	
1988-1993						
Skilled	-0,49	-0,09	-0,22	-0,31	2,38	1,58
Semi-skilled	-1,33	-0,46	-0,25	-0,72	-0,41	-2,46
Unskilled	-0,95	-0,25	-0,40	-0,65	0,78	-0,82
Elementary	-1,78	-0,08	-0,13	-0,21	-2,43	-4,42
Total	-4,63	-0,87	-1,04	-1,91	-0,32	-6,66
Employment change	-312 271	-58 950	-70 054	-129 004	-21 303	-462 579
Total direct effect	-2,54	-1,11	-0,10	-1,21	-3,11	
1993-1997						
Skilled	1,39	0,75	-0,74	0,01	1,70	3,09
Semi-skilled	1,91	1,20	-1,32	-0,12	-3,83	-1,84
Unskilled	1,77	1,23	-1,13	0,10	-5,18	-3,31
Elementary	4,97	2,01	-1,03	0,98	-9,66	-3,72
Total	10,23	5,28	-4,32	0,96	-14,82	-3,83
Employment change	642 176	331 899	-271 463	60 436	-930 853	-228 241
Total direct effect	7,20	3,40	-2,68	0,72	-11,56	

Source: Edwards, L (2000)

There is also a trend in developing countries towards re-orientating economies to market signals and incentives. Privatization, deregulation and private sector development are among the by-words of current economic change around the world. In this swiftly moving current of reform, many developing nations, including South Africa, and developing institutions are placing renewed emphasis on the increased availability of credit within developing countries.

In the light of the above, SMEs (which are less capital intensive than their “big brothers”) can make a significant contribution to the economy. However, their access to formal financial resources continues to be their major impediment, despite government initiatives.

The vital question therefore is:

Do the existing financial support mechanisms, available to small and medium enterprises, address this sectors unique financial needs and has government together with commercial banks focused sufficient attention on this sector?

1.6 OBJECTIVES

There is a growing perception amongst the SME sector that there is slow delivery on the existing support schemes. Therefore, the need to understand the obstacles and barriers that give rise to these perceptions.

Furthermore, the issues of institutional support for SMEs and the raised perceptions of lack of co-ordination and inefficiency of services, is to be investigated.

This research analyses a number of findings with respect to beneficiary profile, key barriers, success and rejection factors, best practices and implementation trends together with views and perceptions of the entrepreneurs.

Existing policies have also been evaluated to determine their strengths and limitations.

The primary objectives of this study are to:

- ✓ Determine the effectiveness of schemes such as Khula, through Banks and Retail Financial Intermediaries (RFIs), Department of Trade and Industry - supply - side measures and Industrial Development Corporation - (IDC).
- ✓ Evaluate initiatives by governments and private sector, within South Africa and other economies.
- ✓ Offer programmatic and strategic recommendations to assist SMEs in accessing finance through formal channels, thereby contributing to South Africa's economic growth and employment creation.

Furthermore, these objectives highlighted, will aim to provide recommendations on issues of policy and delivery environment, that attempt to achieve:

- A coordinated implementation strategy to support SMEs,
- The implementation of targeted marketing efforts,
- The drafting of support programmes, by investigating alternative institutional mechanisms that would effectively assist the SME sector.

1.7 RESEARCH METHODOLOGY

The methodology deployed is as a combination of qualitative and quantitative methods. The study contains descriptions, explanation, finding and recommendations.

The research project aims to discover shortcomings encountered and to assess the limitations of the research methodology and involves the analysis of several research variables. The secondary research satisfied its requirements through the literature review.

The section begins with a description of the research methodology and continues with the construction of the questionnaires of which findings were evaluated and appropriate recommendations and conclusions were drawn, the rationale behind the selection and the measurement and techniques used.

The data in this study was adapted from both a literature survey and the information from the completed questionnaires. Information was received from managers targeted at different financial institutions that were intended to facilitate SME support. This research project makes recommendations in addressing the identified challenges.

Consultations occurred with the eighteen scheme managers and twenty bank managers to get their feedback on their experience to date, challenges to attract proposals from the SME sector, concerns, rejections and failures factors, etc.

Feedback was also ascertained from fifty entrepreneurs who fit the profile as being ideal candidates for the schemes, i.e. a large percentage of these would be small and medium-sized manufacturing firms (black-owned), women - owned businesses, emerging and new businesses (which have a high level of technological advancement).

These questionnaires were administered personally, via electronic mail and telephonically. Prior to the construction of the questionnaires, informal interviews were conducted with bank managers and numerous entrepreneurs in order to establish the importance of the study and whether in fact these parties could benefit from this research study. This also assisted in the construction of the questionnaires. Since it is vital that the data collected is accurate and reliable in order to provide the most suitable recommendations.

Due to the sensitive nature of the study the names of respondents from the business sector are kept confidential due to the fear of being prejudice if ever they should need financial assistance. Many of the banks and government schemes also had reservations in using their names. Accordingly the names of entrepreneurs, bank managers (together with the relative banks which they represent) and employees within government departments have been kept confidential.

This research project has drawn from literature from national sources, however research will focus on financial institutions and government institutions who's existence is primarily to offer financial support to SMEs.

At the outset a letter was sent to the to four commercial banks, in order to ascertain their view on the importance of the SME sector.

This request was presented in the form of a memorandum (a specimen of which is detailed in appendix one). This allowed the completion of the questionnaires by the Business Managers at various reputable commercial banks.

The data collected has been analysed and used to develop a suitable model for easier availability and accessibility to finance by SMEs. Data analysis point to the issues in the policy and delivery environment, a coordinated implementation strategy to support SMEs, the implementation of targeted marketing efforts, the design support programmes aimed to strengthen capacity and competency for the SMEs and to look at alternative institutional mechanisms for mass market problems.

1.8 LIMITATIONS OF RESEARCH PROJECT

The initial primary objective of this research project was to facilitate the transfer of knowledge and experiences from other economies, which have successfully implemented financial support strategies for SMEs.

The simultaneous objective was aimed at identifying possible gaps in existing provisions of financial support t to South African SMEs, and the scope for government and commercial banks in closing these gaps.

From the initial data gathering and analysis, it became evident that there would be enormous difficulties in meeting the entire objectives stated above, mainly due to time constraints. While every effort has been made to collate the appropriate information and to extrapolate relevant data, it is prudent to mention at the outset that further extensive research should be undertaken to fully evaluate and recommend appropriate financial support strategies to be implemented by government, commercial banks and the general private sector.

1.9 STRUCTURE OF THE STUDY

Chapter two: Financial support to small and medium enterprises in context.

This chapter details the findings of initiatives by foreign governments to stimulate the growth and support of SMEs. Furthermore, an assessment is made of current lending criteria of government schemes and commercial banks and their efforts to extend financial support to South African SMEs.

Chapter three: Research Methodology

In order to undertake an assessment of the difficulties experienced by SMEs, in accessing finance through normal channels, and to fully understand the frame work within which commercial banks and government schemes operate, three separate questionnaires were drafted for each role player, namely:

- Commercial banks (sample size of twenty)
- Government schemes (sample size of twenty)
- Small and medium entrepreneurs (sample size fifty)

Chapter four: Analysis and interpretation of results:

The primary data obtained from the questionnaires administered to the various

Respondents is detailed in this chapter, with the following being the primary findings:

- Government schemes rely on commercial banks to implement governments strategy for SMEs.
- Commercial banks perceive lending to SMEs to be of high risk, with cumbersome administrative procedures.
- Government and SMEs are of the opinion that neither commercial banks nor private investors are committed to assisting SMEs.

Chapter five: Conclusion and recommendations:

Based on the analysis and interpretation of the results, the following main conclusions and recommendations have been made:

- ✓ **Short term Recommendation:**
Adopt a uniform definition of SME.

- ✓ **Medium term recommendation:**
Promote the establishment of a business angels network.

- ✓ **Long term recommendations:**
Introduction of a specliased bank to cater solely for the financial needs of SMEs.

CHAPTER TWO



FINANCIAL SUPPORT TO SMALL AND MEDIUM ENTERPRISES IN CONTEXT

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2.1 INTRODUCTION

The Department of Trade and Industry has undertaken substantial research within the small business sector and these studies conclusively reveal the economic benefits of small business. However, these studies have the following, shortcomings:

- Research has primarily been focused within the agricultural sector.
- Inadequate and ineffective training facilities have been established.
- Financial institutions have not been convinced to relax their lending criteria, when assessing the requirements of this sector.
- Available government support facilities, example Khula Guarantee Scheme, have not reached its target market.

The proposed research will attempt to rectify the above, by focusing primarily on the manufacturing and retail sector. Furthermore, this research will attempt to highlight opportunities and making recommendations that will benefit this sector, which is pivotal to economic growth and employment creation. .

Reports and previous relevant studies pertaining to SMEs in South Africa and the international business community have been used in the literature review – these includes:

- a) The White Paper on National Strategy for the Development and Promotion of Small Business in South Africa (March 1995)
- b) The Department of Trade and Industries industry strategy and information on the relevant loan assistance schemes.

Furthermore, strategic models and theories have been examined in an attempt to fully assess the difficulties faced by the SME sector, in accessing financial assistance through formal institutions.

2.2 THE PIVOTAL ROLE OF THE SME SECTOR

South Africa presently accounts for more than half of the African continent's exports, with its economy being exceedingly large by developing countries standards (nominal GDP of US\$104 billion in 2002).

Contrary to general perceptions, the South African economy's revenue base is no longer dominated by the production of primary products and commodities, which currently contribute a mere 10% of GDP. The primary contributor to South Africa's national income has rapidly become its tertiary sector (which includes wholesale and retail trade, tourism, transport, communication and services e.g. financial, business and government). Furthermore, technology intensity is not unique to the tertiary sector as it is prevalent across all sectors and industries. Consequently, the economy requires more highly skilled labour, with declining opportunities for generalist and the unskilled.

Despite the high levels of unemployment, there is considerable frustration among the labour force which lacks the desired skills but aspires to work. Against this backdrop of pervasive poverty, high unemployment has led to a variety of social ills ranging from sheer human suffering to crime and disrespect for law and order.

While the South African economy is growing, this growth rate is currently insufficient to significantly impact on its large unemployment rate.

Recent global trends have focused on the development of the SME sector, for the creation of economic growth at a level that would exceed the unemployment rate.

Accordingly, the SME sector could be regarded as agents of change, primarily due to their contributions towards innovation, creation of employment opportunities and their contribution to the GDP of a country.

2.3 ASSESSMENT OF CURRENT GOVERNMENT INITIATIVES:

The primary hurdle faced by new entrepreneurs is the raising of finance and this constraint is enforced by the GEM's 2002 survey.

To address this problem government has devoted considerable resources to increasing the amount of finance and access to it for SMEs. Results are however, below expectations, with many SMEs still claiming that accessing formal finance is difficult. South African SMEs are, however not alone. The 2002 GEM survey concluded that of the 34 countries surveyed, 19 countries ranked lack of financial support as the main national weakness.

Due to the inability for vast amounts of SMEs accessing finance from formal institutions, most rely on informal investors e.g. family, friends and colleagues. GEM's investigation of the above has revealed that \$300bn was invested into new businesses by informal investors (research undertaken in 24 countries during 2001), with this being nearly five times the amount invested by institutional venture capitalists (with Israel being the only country where informal investments were exceeded by formal venture capital investments to SMEs and SA venture capital being a mere 8 percent of informal investment).

According to the GEM 2002 survey, 84 percent of non-white SMEs applying for external finance from financial institutions applied for loans, of which only one quarter of these applicants receiving successful outcomes.

Approximately 75 percent of unsuccessful applicants attributed their misfortunes to inadequate financial records, absence of collateral, with a significant portion being declined due to no obvious reason for rejection being apparent.

Against this backdrop, the director-general of the South African Department of Trade and Industries (DTI) Mr. Alister Ruiters recently confirmed, to the media, that the DTI had not done enough or visibly enough to help small and medium enterprises. While there has been a shift in the use of DTI incentives schemes from previously white businesses to black businesses, this is primarily through Pretoria-based consultants who have made it their business to understand these schemes.

Despite an annual budget of R2.2 billion being allocated by the South African Government, to the DTI, to help SME's and promote black economic empowerment, the DTI has conceded that these existing schemes were not reaching the right people and accordingly more innovative schemes were needed to rectify this imbalance. Nevertheless, the DTI maintains that it has managed to reduce the massive rollover of unspent funds it had been reporting each year, especially for its incentive programmes, which could indicate that funds were being put to good use.

The DTI has undertaken to increase their focus in order to increase the outreach of various programmes, targeting them more specifically at certain sectors.

SMEs access to financial assistance is a depiction of findings in relation to aspects of policy, implementation and support services, and beneficiaries reflected in the table below.

Table 2.1: Beneficiary Profile Findings

Policy Integration	Khula/Banks	Khula/RFI's	DTI/IDC
Historical disadvantaged SME's	mainly white owned SME's	mainly survivalists	Well established
Women	- Largely male	- Largely black	mainly white owned
Black Business	Start-up- mostly franchise	-	mainly male businesses
Rural SME (youth)	-	-	-
TOTAL AMOUNT	R766 million	R122.9million	R165.6million

The following criticisms were highlighted with regard to the findings above:

- Targets for supporting the SME sector have not been met.
- Poor communication and marketing of incentives
- Absence of a coordinated SME support implementation strategy
- Stringent pre-requisites to access financial assistance
- Underestimation of the capacity problems of black SMEs to access finance in the traditional lending environment of banks.

Further aspects to be considered in both the policy and the delivery environment are:

a) Policy

Setting the appropriate delivery mechanisms in place to increase target group usage of the schemes and to address transformation gaps - specifically pertaining to capacity and competency of the SME market in South Africa is vital. Ensuring a standard SME definition as most of SME support organisations are using different definitions which also excludes a clear definition of 'survivalist' must be considered. The need for addressing needs of innovative and new SME start-ups needs attention.

b) Effective delivery

Need for better marketing and communication - particularly DTI schemes, co-ordination between SME support institutions, building capacity of SMEs to become eligible for finance and most importantly there is a need for structured support programmes to address problems on SME readiness for financial support programmes.

Several external pressures, including a softening of the economy, continue to limit governments initiatives, example:

- Banks are experiencing torrid and disruptive period, with the recent demise of Saambou, BoE, the insolvency of micro lending units.
- Government initiatives have suffered as a result of the above.
- Support by way of donor funds and grants to support government programmes, are reaching expiry. Hence, government has to locate additional reserves to fund SME initiatives.

The most successful government initiative for SMEs, appears to be The Industrial Development Corporation of South Africa Limited, which is a self-funding, national development finance institution that was established in 1940, by an act of parliament. The IDC focuses on contributing to economic growth, industrial development and economic empowerment through its financing activities and continues to create in excess of twenty thousand new jobs every year.

The IDC's strategy is to focus on sectors with potential economic development, hence approvals for new business in this area accounts for forty six percent of all its approvals (in value terms), within a wide range of business sectors.

2.4 AN OVERVIEW OF AVAILABLE GOVERNMENT SUPPORT SCHEMES

2.4.1 Khula Guarantee – Standard Scheme:

- The maximum amount of guaranteed facility, subject to Khula indemnity cover is one million Rand.
- Maximum indemnity cover provided by Khula is eighty percent.
- An indemnity fee of three percent of the initial indemnity amount of the facility is payable annually in advance.
- Collateral to be provided: save for an unlimited suretyship of the partners/members/director or shareholder/trustees of the business, additional collateral may be requested at the commercial banks discretion.
- A minimum of ten percent of the maximum capital amount of the facility, is to be injected by the entrepreneur.
- The purpose of the indemnity cover is to fund the expansion or purchase of an existing viable (solvent, liquid and profitably trading) business or to establish a new business.

2.4.2 Empowerment Scheme:

- The maximum capital amount of the facility, subject to indemnity cover is five million Rand.
- The maximum indemnity cover provided is sixty percent.
- An indemnity fee of two and a half percent of the initial indemnity amount of the facility is payable annually in advance.
- Collateral to be provided: save for an unlimited suretyship of the partners/members/director or shareholder/trustees of the business, additional collateral may be requested at the commercial banks discretion.
- A minimum of ten percent of the maximum capital amount of the facility, is to be injected by the entrepreneur
- One or more of the following criteria shall apply in relation to the nature, purpose or business effect of the SME, namely:
 - a) Substantial job creation in an area where very little economic activity takes place;
 - b) Labour intensive project;
 - c) The bank grants economic empowerment transaction, which entitles borrower to acquire controlling interests in the SME within a period of two years from the date the facility.
 - d) The bank grants management buy-out, which entitles the borrower to acquire a controlling interest in the SME within a period of two years from the date the facility.
 - e) Sub-contracting.
 - f) Outsourcing transaction.
 - g) Any similar economic empowerment venture.

2.4.3 Emergent Entrepreneur Scheme

- The maximum capital amount of this facility, subject to the indemnity cover is one hundred thousand Rand.
- Maximum indemnity cover is ninety percent.
- An indemnity fee of four percent of the initial indemnity amount of the facility is payable annually in advance.

- The duration of this indemnity cover is twenty-four months from the date of take-up and the payment of fees.
- The indemnity period can be extended by three individual annual extensions of twelve months and may be applied for upon the anniversary of the original indemnity tenure.
- A fee of four percent on the outstanding balance of the facility is levied at the time of extension.
- An own contribution of at least ten percent of the maximum capital amount is payable.
- Collateral to be provided: save for an unlimited suretyship of the partners/members/director or shareholder/trustees of the business, additional collateral may be requested at the commercial banks discretion.
- The purpose of this facility is to fund the expansion or purchase of an existing viable business or to establish a new business.
- Application may only be made for the Emergent Entrepreneur Scheme if the credit facility approved by a commercial bank is approved subject to pre- and post-loan mentoring through the Thuso Mentorship Programme or it's approved alternative.

2.4.4 Technology transfer guarantee scheme:

- The maximum capital amount of this facility, subject to indemnity cover, is one million rand.
- The maximum indemnity cover is ninety percent.
- An indemnity fee of three percent of the initial indemnity amount of the facility is payable annually in advance.
- Collateral to be provided: save for an unlimited suretyship of the partners/members/director or shareholder/trustees of the business, additional collateral may be requested at the commercial banks discretion, depending on the residual value thereof plus the registration and other costs relating to such securities.
- The purpose of this facility is to fund the acquisition of manufacturing technology by SMEs.
- The applicant requires a minimum contribution of ten percent.
- The aim of this scheme is to provide loan guarantees for SMEs, for the purpose of acquiring manufacturing technology.

2.5 CHALLENGES FACING GOVERNMENT SUPPORT INITIATIVES

The future source of funding for these initiatives will largely through shareholders, as donor funds e.g. The European Union Commission, Swedish International Development Agencies, Norwegian Agency for development Co-operation, United Nations Volunteers and United Nations Development Programmes, near maturity.

Government support centers are dependent on commercial banks for the fulfillment of their objectives. Hence, it is paramount that commercial banks and RFI's understand the products offered by these organizations and actively promotes these schemes to the target market.

The risks inherent in the business of financing SMEs will have to be overcome, to allay the fears of commercial banks, private individuals and the private sector. This will be vital to ensure that these institutions become more receptive towards SMEs.

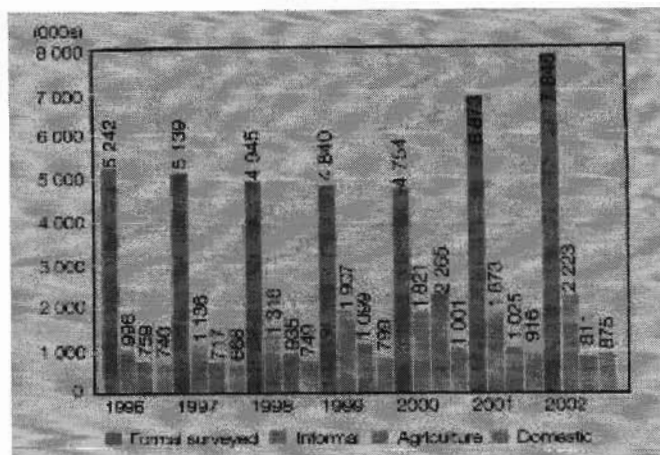
2.6 EMPLOYMENT OVERVIEW

In 2002, employment in the formal sector has shown a marked improvement, growing at 1.2 percent annually (refer to table 2.1). However, despite this positive development the total labour market development remains out of line with the objectives and targets of the country's macroeconomic strategy. The gross level of unemployment however, remains high and continues to increase, with the following statistics (in million) evident as at September 2002:

○ Total employed	:	11.02
○ Current official unemployment rate	:	4.8
○ Economically inactive	:	12.1
○ Official unemployment rate	:	30.5% .

Khula claims to have created in excess of nine hundred and seventy thousand jobs, since its inception in 1996, but confirm that more focused efforts could have contributed significantly more.

Table 2.2 Employment per sector



Source: Labour Force Survey September 2002, Statistics S.A.

Although South Africa has experienced a measure of positive economic growth and stability, in recent years, it has not had a significant effect of increased employment, except in the formal sector.

Presently there are approximately five hundred thousand new entrants into the job market annually, with the economy being unable to absorb this influx of job seekers. This phenomenon is known as jobless growth and is the major obstacle to combating the high unemployment. Table 2.2 below details the employment data and highlights consistent decrease in the number of employed individuals in the formal non-agricultural sector, which reflects an annual decrease of 1.3 percent.

Formal sector employment, however reflected an increase of 1.2 percent between September 2002 and December 2002.

South Africa’s disappointing employment performance since democracy has been attributed to:

- Trade liberalization (e.g. import tariff reductions, elimination of non-tariff barriers and the termination of most export incentive schemes
- Implementation of new labour- saving, capital-intensive production processes.

Hence, to stimulate employment growth, the promotion of SMEs (which are often labour intensive) and the introduction of export incentives aimed at this sector would have a positive impact on South Africa's employment rate.

Table 2.3 Employment Overview (number)

	Dec 1999	Dec 2000	Dec 2001	Dec 2002
Mining, quarrying	417 777	405 531	408 379	415 946
Manufacturing	1 304 335	1 276 695	1 250 914	1 289 070
Electricity	40 268	39 131	38 879	38 605
Construction	224 832	222 414	213 441	214 169
Wholesale, retail, motor, catering, accommodation	897 583	875 828	892 645	886 694
Transport, storage, communication	234 209	217 279	209 340	200 416
Financial institutions	198 395	196 448	192 343	187 175
Community, social, personal services	1 482 143	1 445 202	1 442 790	1 471 384
Total number of employees	4 799 542	4 678 528	4 648 731	4 703 459

Source: Survey of Employment and Earnings, December 2002, Statistics S.A.

2.7 LESSONS TO BE LEARNT FROM OTHER GLOBAL SME INITIATIVES

The global market is currently undergoing a process of rapid integration, spurred by the removal of trade and investment barriers. Therefore, to sustain healthy growth and a balanced economic structure, the promotion of SME's is becoming increasingly important to many industrialised nations. To illustrate the impact of SMEs on an economy, it is prudent to highlight a few success stories, within certain economies that would compare favourably with South Africa:

2.7.1 KOREA:

SMEs totals 2.67 million and constitutes 99.7 per cent of all manufacturing companies and 72.1 per cent of all manufacturing employees. This sector employs 9.1 million people, representing 80 percent of their national workforce. They can therefore be regarded as the

mainstay of this economy and the driving force behind the sustained economic growth and balanced economic structure in the 21st century.

The contribution of this sector towards the Korean economy cannot be disputed, with visible contributions existing in the creation of employment, innovation, export value, and flexibility to adapt to changes in the total and regional economies.

The key roles of SMEs:

- Enhancement of industrial restructuring
- Stimulation of local economies on a balanced basis.
- Driving force for sustaining economic growth
- Promotion of social stability by the creation of employment
- Satisfaction of diversified consumer tastes
- Promotion of international trade and cooperation
- Promotion of ability to meet changing market situations.

In 1998 the Korean government implemented steps to assist SMEs to enhance their international competitiveness, with major focus on their access to finance.

Priority was given to the development of policies focusing on the serious funding shortages and credit crunch threatening the SME sector. In an attempt to alleviate the fund shortages, the bank of Korea raised a loan of UD\$6.3 billion and provided an additional US\$1 billion to the credit guarantee system (securing a total of US\$24.8 billion). Furthermore, to minimize bankruptcies of SMEs the government developed a bill insurance system whereby they insured SME's debtors.

Furthermore, to ease funding shortages, an SME Management Stabilisation Fund was created, with US\$567.3 million provided for attaining policy goals, including export promotion, commercialization of new technologies, quality and management innovations, etc.

The Korean governments commitment to developing this sector has been further demonstrated through the following initiatives:

- The operational system of providing SME assistance funds have been improved by simplifying the assistance procedures and establishing an evaluation system for fund allocation.

- The restrictions placed on commercial banks were eased.
- The Enterprise Improvement Fund was established to purchase stocks and bonds of SMEs, to help improve their financial structures
- US\$475 million was provided in 1999, as a form of direct lending to SMEs, to help improve management and production
- Various business foundations and fostering centers were established.
- Government and private sector have jointly provided funds to establish a Venture Investment Association, entrusted to professional fund managers to generate investments into venture enterprises.

2.7.2 VIETNAM:

SMEs generated approximately a quarter of the GDP, employed approximately 50 percent of the Vietnamese labour force and is the fastest growing enterprise.

In 1998 the Law on Promotion of Domestic Investment was revised, thereby eliminating more than 100 business licences that restricted entry in different sectors, simplified business start-ups, that contributed to the registration of more than 10 000 business start-ups in the first nine months of 2000.

Government policies on mobilising financial resources have been implemented through taxation, interest rate management and investment promotion strategies.

Recent policy changes include:

- The majority of external resources, e.g. foreign direct investment, that were allocated to the state sector and now being channeled to the SME sector.
- Irrational regulations that have hampered capital mobilization of SMEs e.g. regulation on short term credit issued by the State Banks giving preferential treatment to state owned enterprises, that enjoy cheaper financing, have been abolished.
- The prerequisite for SMEs to provide collateral to banks, before obtaining finance, has been relaxed.

- Establishment of financial institutions to cater for the needs of SMEs and act as trustees for a number of foreign funds, e.g. the SME Development Fund, which provides technical assistance for private sector SMEs.

According to the World Bank, Vietnamese SMEs were the most cost effect to generate non-agricultural employment, with a required capital investment of a mere US\$800 for the creation of a single job generated as opposed to US\$18 000 for a state owned enterprise.

2.7.3 SWITZERLAND

Approximately seventy seven percent of Switzerland's economically active population is employed by SMEs.

The Swiss Government has established a tradition of support to SMEs, by cultivating and improving the climate for self-employment and entrepreneurial management, inter alia through investment aid schemes, credit guarantee schemes and credit facilities directly through the Swiss Credit Co-operative (that provide loans to SMEs similar to that provided by commercial banks, but without the stringent facility requirements).

Local authorities, to promote development of the SME sector, also provide financial assistance such as low interest loans and low tax schemes.

2.8 MODELS / THEORIES

The popular theorems viz. PERT Analysis and a SWOT Analysis have been used to:

- Examines different activities that enable SMEs to perform better by evaluating their projects and hence contribute more profoundly to the economy.
- Assess the situation and provides an analysis of strengths, weakness, opportunities and threats.

2.8.1 SWOT Analysis

A central technique used to draw together both external and internal aspects that are critical to understanding the current position of SMEs in the economy.

These assessments have been detailed below, to highlight the dynamics of this complex environment together with opportunities and challenges for the creation of an enabling environment for SMEs and their access to financial through formal schemes.

A scale of -5 to +5 (with (-) being adverse and (+) being positive) has been used to fully assess the strengths, weaknesses, opportunities and threats that a prevalent.

Strengths:

- Government has identified the critical role that SMEs play within South African economy. (+5)
- Government has initiated financial support mechanisms e.g. Khula Guarantee Scheme, to aid SMEs in obtaining financial support. (+3)
- Great opportunities exist for the development of SME's in South Africa. (+5)
- South Africa's high unemployment rate has become a major catalyst to spur its citizen's entrepreneurial spirit. (+5)
- Globalisation has open new markets for existing and new SMEs. (+4).

Weaknesses:

- Poor marketing, by government, of existing schemes resulting in the relevant target market no being effectively reached. (-5)
- The S.A. commercial banks are unwilling to revise their lending criteria to SME's, with its current policies being geared towards a fist world economy. (-5)
- Ineffective mentoring schemes are unable to assist SME's, resulting in the demise of many SME's. (-5)
- No specialized bank exists to cater for the specific financial needs of SME's. (-4)
- No government incentives (e.g. tax incentives) exist to spur investors to investment in SME's. (-4)

- South Africa's high illiteracy rate. (-3)
- Minimal private sector support exists for SME's. (-5)
- Lack of capacity and expertise within commercial banks and government to effectively assess the specialised needs of SME's. (-5)
- Ineffective and to an extent, non-existent, mentoring facilities. (-4)
- The recent influx of foreign banks, into South Africa, has tended to focus their strategies on larger and established businesses and wealthy individuals. (-4)

Opportunities:

- Introduction of a specialized SME bank. (+5)
- Governmental initiatives are becoming more efficient through time. (+3)
- Increased entrepreneurial spirit. (+4)
- Commercial banks possess the infrastructure and knowledge to effectively reach, mentor and assess the financial requirements of this sector. (+5)
- Decrease of the unemployment pandemic that exists, through new business development and the resultant employment creation. (+5)
- Matching of private sector efficiency and public sector support structures can be effectively used to support SMEs. (+5)

- The introduction of central government tax incentives, to promote investment by wealthy individuals (both local and foreign). (+5)
- Duplicate success of other global initiatives. (+5)

Threats:

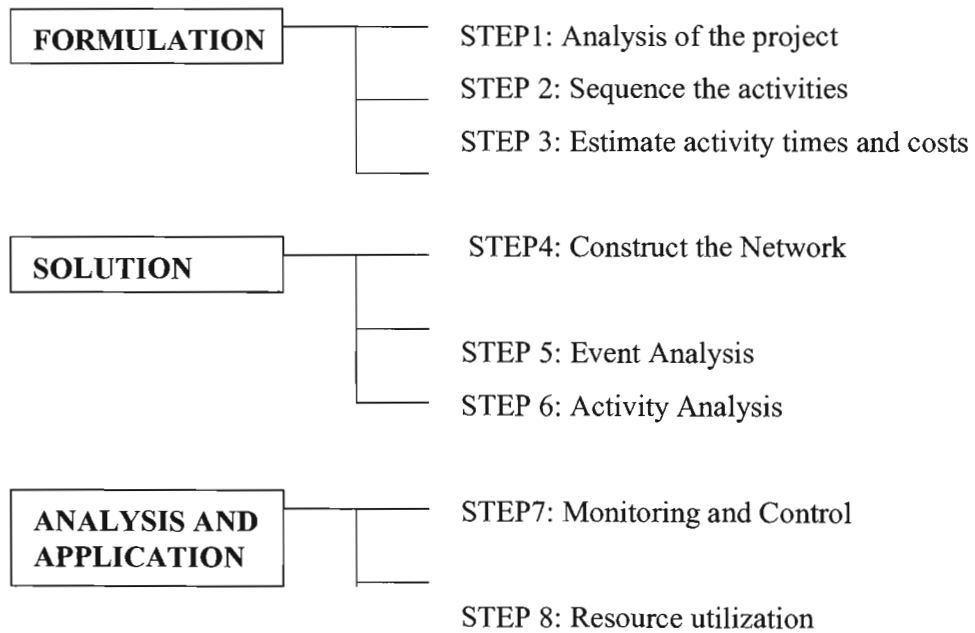
- Existing formal SME support structures, lack of coordinated effort. (-4)
- Stringent lending criteria by commercial banks. (-4)
- High failure rate of SMEs (primarily as a result of ineffective mentorship programmes). (-5)
- Inflexible collateral requirements of commercial banks and government schemes, that often deter potential entrepreneurs from realizing their full potential. (-5)
- Corporate business unwillingness to recognize and support SMEs. (-4).

2.8.2 The PERT (Project Evaluation and Review Technique) Analysis

This technique is based on the assumption that all businesses consist of separate, independent activities, with each with its unique risks.

Hence, the impact of such risks tends to cancel each other out. Such a technique identifies both optimistic and pessimistic activity duration for all activities, to enhance SMEs within the South African economy.

The application of PERT for SME projects may be divided into 3 phrases and 8 steps viz.:



PHASE ONE: FORMULATION

STEP 1: Analysis of project:

SMEs offer a wide spread of innovative ideas, thereby resulting in creative initiatives for project delivery. The mission of government is to promote sustainable access to loans and equity by SMEs through commercial banks by offering a range of financial resources and information to the public.

STEP 2: Sequence the activities:

Development of support schemes to meet the financial needs of SMEs.

Marketing of schemes, to the target market, through commercial banks, media and local regional representation.

Failure to include commercial banks in the initial policy formulation, hence the disinterest evident by most commercial bank's in supporting existing government initiatives.

STEP 3: Estimate activity times and cost:

The majority of SME support schemes were launched shortly after South Africa's first democratic national election. The major costs relating to the set up of these schemes and the funds available to assist SMEs, were obtained through foreign donors and low interest loans.

The aim of Khula is to ensure that by 2006, their business loans grow to R660 million, credit guarantees to one billion and one hundred million in invested in equities.

PHASE TWO:

STEP 4: Construct the network:

In most instances commercial banks, are the sole assessors and point of contact for potential applicants of the various schemes. The Industrial Development Corporation (IDC) is the only scheme that remains independent and houses its own credit assessors.

commercial banks remain skeptical when lending to SMEs and their lending criteria remain too stringent.

STEP: 5 Event analysis:

Government remains eager to report success stories, but often fail to report areas of development, where the relative schemes and more especially the commercial bank have failed in meeting their objectives.

STEP: 6 Activity analysis

Commercial banks and government track and report business written and employment created through the various schemes. These institutions purposefully omit to disclose the fact that most commercial banks are not interest in supporting these schemes and that the decline rate of applications, is often high primarily due to the lack of effective mentorship programmes.

PHASE THREE:

STEP 7: Monitoring and control

Government has effective monitoring and control structures, however they remain subjective and their reporting therefore has a tendency being bias. The Banking Council should play an active role in this process.

STEP 8: Resource utilisation

The DTI has been fortunate in securing foreign donors and a large portion of the national budget, to fund its activities. However, at the end of each financial year, the various schemes have tended to report unused resources, which are returned to the national treasury. This shortcoming highlight the fact that these schemes are not very effective

and government has tended to reduce their annual budget allocations toward these schemes.

2.9 EXPECTATIONS OF SMEs FROM COMMERCIAL BANKS

- ✓ Stability of finance i.e. guaranteed line of credit if credit criteria is observed.
- ✓ Transparent criteria necessary to obtain finance.
- ✓ Reduced negotiating time.
- ✓ Objective reasons for declines, when necessary.
- ✓ Lending terms and conditions which clearly details the borrowers rights and obligations.
- ✓ Appropriate service and advice.
- ✓ Good personal understanding with the representatives.
- ✓ Willingness to assist solve financial difficulties when necessary, instead of “pulling the plug” on lending support.
- ✓ Desire and capacity to deal with SMEs.
- ✓ A helpful partner in business, rather than an opponent.

2.10 CURRENT COMMERCIAL BANKS LENDING CRITERIA FOR SMEs

The primary criteria detailed below are the framework within which commercial banks operate.

2.10.1 Business (non-financial) Risk:

Business risk is sub divided into management and environmental issues:

a) Management:

Management should:

- Have a clear record with the credit bureaus. If judgments exist, a letter of explanation and/or written confirmation from the judgment creditor that the debt has been settled.

- Be in full time employment of the business.
- Be technically qualified or have the necessary experience in the industry (or have access to training by a franchisor, if the business is a franchise operation). In the case of start up venture finance, a detailed curriculum vitae is required.
- Have the necessary management, financial and marketing skills required to run the business (or access to suitably qualified professional expertise in these areas).
- Strong personal financial position, with good net value outside the business.
- Contingent liabilities must be minimal.
- Are succession planning evident.
- Adequate personal and business assurance.

b) Environment

1. Risk portfolio of industry

Certain industries are regarded as high risk, due to RFI's incurring substantial losses in these industries. RFI's are therefore very cautious when lending to the following industries in particular:

- Food and beverage industry: overtraded and fiercely competitive.
- Building/Construction/Contractors: notorious for operating with limited capital in highly market. Barriers to entry low.
- Insurance brokers/financial consultants: tend to over state potential income and underestimate expenses. Borrow against expected income, which sometimes fail to materialize.
- Hardware retailers: Thinly capitalized, severe competition and slow moving stock
- Transport services: Cash flow is often erratic. Highly overtraded and contracts often cancelled at short notice.
- Motor dealers/repairers: Severe competition and shrinking margins.
- Fashion design: Fast changing nature of fashion and specialist expertise required.

- Service stations: Threat of deregulation. Becoming overtraded through franchises.

When considering financing to any of the above industries, RFI's therefore seek additional tangible collateral (outside the core business) from applicants.

2.10.2 Financial risk:

- For a start up ventures the owners investment, as a percentage of total set up costs, should be between twenty and fifty percent.
- A strong and detailed cash flow to support borrowings.
- Financial ratio's to be in line with stipulated bank norms, failing which tangible collateral is to be provided.
- Security is often generally sought in some form, particularly in view of the psychological effect in encouraging borrowers to meet the banks terms and conditions of lending. This security should ideally be outside the business and must be easily reliable.

2.10.3 Other general conditions:

- The pricing is in accordance with the banks perceived risk, to ensure that the bank receives a reasonable return.
- Additional collateral to be requested in the event of deteriorating financial information.
- Lending to highly geared businesses should be avoided.

2.11 INTERMEDIARY FINANCIAL INSTITUTIONS

The choice of an intermediary financial institution has important long-term implications for the size and eventual institutionalization of a loan fund. There seem to be three major options, each with its own advantages and disadvantages: funds may be distributed through a bank, a financial intermediary that specializes in SMEs or a non-governmental organization (NGO). Combinations example a bank and an NGO, or a government department and a bank, are additional alternatives. The choice of an intermediary depends largely on which local institutions are both willing and able to carry out the project to reach SMEs and in particular entrepreneurs in the rural areas.

2.11.1 BANKS AS INTERMEDIARIES:

Ideally, commercial banks should be the institutions that extend credit to SMEs. The advantage of using commercial banks as intermediaries is that, in contrast to development banks, these institutions have a network of branches and some experience in evaluating small and medium borrowers and collecting debt. Since commercial banks already have the necessary infrastructure, they offer the greatest potential for carrying out a large-scale effort. Assuming these banks are willing to participate, banks still find it difficult to adapt to lending to small and medium sized businesses.

The problems bank projects typically have is that they:

- Present obstacles (legal registration, guarantees, property titles, collateral requirements, etc.), effectively barring of the potential borrowers.
- Intimidated entrepreneurs, many of who have never stepped into a bank.
- Expensive to borrowers because of the excessive documentation, repeated visits and lengthy waits. Expensive to banks because the criteria for larger loans are applied to smaller loans and,
- Provide credit ill-suited to the needs of business owners at this level, default and late payments often emerge as subsequent problems.

Careful consideration must be given to the following, when assessing credit projects involving banks: guarantees required for borrowing via banks, the transaction costs to both the borrower and the bank, the amount of time it takes to approve a loan, the supervision of loans once they are granted and the loan terms.

It is vital that the SME be profitable enough to the banks that they continue to participate in these special projects and, ideally expand them on their own.

2.11.2 SPECIALIZED INTERMEDIARIES

A global approach that has worked well is using intermediaries that specialize in reaching this sector. The Grameen Bank and the Rural Banks of Ghana are examples of this approach, where they are separate entities not administered directly by another bank.

NGO's or other institutions can be encouraged to become a specialized financial intermediary with the assistance of the central bank. The indigenous savings and credit associations that are common to South Africa might also be used as financial retailers.

2.11.3 NGO's AS FINANCIAL INTERMEDIARIES

There are advantages of NGO's being intermediaries reaching this sector. The obvious advantage is a willingness to undertake projects of this type. In many countries NGO's are the only entities reaching the rural and urban SME sector. The major strength of projects involving NGO's is that they would provide services beyond credit, such as technical assistance.

Disadvantages of using NGO's as intermediaries include:

- Staff have good outreach in communities, but little business experience.
- There is little capacity to manage revolving loan funds.
- Welfare and business goals are often mixed.
- Projects are often too complex.

- Projects run by NGO's tend to be expensive and highly subsidized and reach a minor few.

If NGO's are to be successful as financial intermediaries, they must be more like commercial banks in terms of the management sophistication, yet maintain their socially orientated goals.

The following should be assessed when dealing with NGO's: their capacity to manage a credit fund, cost of providing assistance, application of simple monitoring systems to track performance and their ability to move beyond small/medium pilot projects to reach a significant group of beneficiaries.

2.11.4 PARTNERSHIPS

Developing partnerships as an option for reaching this sector needs to be explored further, example:

- Government can set the policies and provide resources.
- The banks can add their management expertise.
- NGO's can focus on what they do best – outreach, training and making the imitative work at a local level.

2.12 NON-INSTITUTIONAL FINANCING

“Asymmetric information between lenders and borrowers is a major barrier small business faces in accessing institutional financing” (Bae 1897, pp 187).

This form of finance, as is also evident from the research undertaken, is a vital source of finance that complements formal sources of finance. The main sources of non-institutional finance are:

2.12.1 Unorganized financial markets:

Within this market, financing intermediaries do not interact in the exchange of financial claims.

2.12.2 Internal financing:

Often due to the inability of SMEs to access formal external resources, internal financing becomes the only source of finance. Accordingly, this form of finance has become a vital financing source for SMEs, which is achieved through the retention of profits, etc.

2.12.3 Inter-business financing:

While banks apply stringent and often inflexible credit criteria, SMEs are compelled to resort to this method of finance. Suppliers, often allow small credit facilities, which are periodically reviewed in the light of trading and repayment ability. Furthermore, larger companies offer SMEs assistance to meet the requirements of a specific project, as these larger firms have the ability to assess the project's potential and the ability of the SME to successfully complete the project.

2.13 ENTREPRENEURIAL CHALLENGES

Further to the models already used, Downie and Heath (1983) agreed that the problems of SMEs, specifically from previously disadvantaged groups in assessing finance cannot be seen in isolation from the historical imbalances that limit their capacity to operate in a rigorous global business environment.

Their study clearly shows that the key barriers of access to finance are linked to the individual's level of sophistication, education, access to information, management experience, networks and possession of assets and general experience and exposure.

There are also other environmental factors that pose a challenge to the SMEs . These include regulatory issues that are being addressed by the regulatory review committee. However there are indications that regulation will not significantly improve access to finance to SMEs.

A change in market forces e.g. the emigration of people with higher incomes from predominantly black areas to suburbs erodes buying power and competition from larger business pursuing the same markets is also an important factor that poses a challenge to SME's in the economy.

The challenged that SMEs face, includes, narrow vision and imagination, poor product and service quality, difficulty in monitoring operations, weakness against competition and barrier to entry by younger people.

2.14 CO-ORDINATED SUPPORT SERVICES

Lack of co-ordinated support services at retail level leads to duplication and frustration to the entrepreneur. The support needs and their cost implication must be clearly understood in order to determine.

The type of needs e.g. financial and technical skills. In many cases the lack of business skills cannot be addressed by training only but also through continuous guidance and monitoring.

The local business service centres in their present form do not have the capacity or resources to meet this challenge. The networking and partnership formation of service providers must be encouraged. The support should be linked to opportunities for the SME's e.g. spatial development zones, access parks etc.

2.15 PROCUREMENT SCHEMES WITH FINANCIAL AND NON-FINANCIAL SUPPORT

The various government departments, parastatal's and private sector have procurement schemes to ensure that the SMEs from previously disadvantaged communities get the opportunity of supplying them with goods and services. While there is some success in SMEs getting the contracts the problems they encounter in accessing finance result in the loss of the opportunity to the larger business with financial muscle. This has been experienced by a number of SMEs in the construction sector. This requires the co-ordination of activities of RFI's and Tender Advice Centres (TAC's). The fact that commercial banks had rejected the level of frustration shown by entrepreneurs, who had won tenders, could be an indication of having no available resources after their application.

2.16 SME DEVELOPMENT AND POVERTY ALLEVIATION

It is quite clear that social development is on the South African National Agenda. Documentation highlighting this is ample but a gap exists in how to transform a poverty stricken survivalist sector with low literacy levels to enterprises that can create jobs and wealth rather than sustain lives.

The expectations of what the survivalist sector can deliver in terms of job creation are high. This is more so if they are relying on loan finance to achieve this. This is more so if they are relying on loan finance to achieve this. An evaluation study of a national RFI indicates that the impact of loans on 54 % of its survivalist borrowers interviewed was an improved standard of food consumption. This indicates the level of marginalisation of this sector, which is paying very high interest rates as a result of small loans required.

The same evaluation study indicated that:

- 86 % of beneficiaries saved regularly
- Of these 60 % saved more than R100 per month
- 20 % of borrowers kept savings at home
- The most popular financial product borrowers expressed interest in was a savings facility
- the next one was individual loan.

The above indicates that there is an opportunity to find a financing mechanism, which includes a savings mobilisations component for this sector.

2.17 CONCLUSION

The Job Summit document (1998:59) refers to the Social Welfare Development Fund from which community based savings group can borrow for the establishment of SMEs as a means of encouraging entrepreneurship and self-reliance. This document does stipulate how this is to happen e.g. who is supposed to facilitate the access to this fund for these savings groups?

The need for the integration of financial and non-financial support for SMEs has been recognised and practised by some banks and provincial development corporations.

The success of government schemes depends on good professional advice, understanding of client's needs and background, affordability of the service, motivation of the mentor, accessibility to the mentor and involvement of other major stakeholders, namely RFI's, private investors and public companies.

CHAPTER THREE



RESEARCH METHODOLOGY

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 INTRODUCTION

This chapter contains information on research methodology as well as the rationale behind the formulation of the questionnaires used in the primary research. It also contains surveys conducted in order to establish recommendations and evaluate problems presently encountered by banks, government and SMEs.

3.2 QUESTIONNAIRE CONSTRUCTION

A total of three questionnaires were constructed in order to address the research problem namely:

- First questionnaire: This questionnaire was designed for and completed by bank managers involved with small, medium enterprises in the four major banks.
- Second questionnaire: was completed by managers at different government schemes e.g. Khula and DTI.
- Third questionnaire: was completed by randomly selected entrepreneurs, from various business sectors.

3.2.1 Questionnaire One

The aim of this questionnaire was to establish the problems experienced by banks in accessing finance to small and medium entrepreneurs and the role that can be played by banks in order to overcome these obstacles.

It is important to remember that the banking fraternity plays an integral part in the growth and development of the economy and small business. The selection was made easy because of the degree of diversity, together with easy access as the researcher works for Standard Bank.

A sample of four banks was used, in which five banking officials were selected at random, with a total sample size of twenty being used. All respondents are actively involved in the financing of SMEs and are highly skilled in assessing credit lending for this sector.

The questionnaire required opinionated responses and intended to identify concerns by banks, relating to financial assistance to SMEs, and therefore the obstacles faced by SMEs in accessing financial assistance through this formal channel.

3.3.2 Questionnaire Two

The aim of this questionnaire was to provide an indication of the lending criteria, adopted by government schemes to SMEs, and the obstacles faced by these organisations. The questionnaire is aimed at revealing certain control measures that the respondent deemed necessary to make access to finance a smoother process.

The questionnaire targeted the major government lending organisations, including Business Partners, Khula, Get Ahead Foundation, Retail Financial Intermediaries, Industrial Development Corporation and South Cross Business Development.

A total sample size of twenty has been used.

The researcher either administered these questionnaires telephonically, via electronic mail and/or personally.

3.3.3 Questionnaire 3

The aim of this questionnaire was to assess the financial needs and difficulties of SMEs, to better understand their plight and to review current government and bank policies aimed at SMEs.

It also aimed at ascertaining channels of communication needed and steps that need to be taken in order to succeed in acquiring finance.

The questionnaires were mainly targeted at businesses requiring finance for start-up's, existing businesses and women in the industry (to try and establish problems of gender that might occur).

The researcher and/or his assistants administered these questionnaires either via electronic mail, personally or telephonically.

3.4 PROBLEMS ENCOUNTERED

The sudden resignation of the researchers initial supervisor, namely Professor Lord, resulted in the delay in finalising the questionnaires and locating an able replacement.

Due to time constraints, the researcher enlisted the assistance of friends and colleagues to administer the questionnaires. These completion of the questionnaires were initially incorrect and a training session was necessary to ensure uniformity and completion of all questions correctly.

With the researcher being a business manager at a retail bank, respondents to questionnaire three were initially sceptical, however once the reasons for obtaining their input was understood, this obstacle was overcome.

. The language barrier was an identified as an initial problem as all questionnaires were administered in English. This hurdle was overcome when the researcher enlisted the assistance of a colleague who is well versed in many of the indigenous South African languages.

3.5 CONCLUSION

The success of the high response rate was due to the fact that,

- The researchers current network of friends/associates includes many bank managers and persons employed within the government schemes surveyed.
- Trained assistants assisted the researcher.
- Numerous follow-ups were done in order to ensure that responses were as accurate and individual.

Through all of the above, programmatic and strategic recommendations were developed in the attempt to create appropriate mechanisms to make accessibility of financial assistance to SMEs, achievable.

CHAPTER FOUR



ANALYSIS AND INTERPRETATION OF RESULTS

CHAPTER FOUR

(ANALYSIS AND INTERPRETATION OF RESULTS)

4.1 INTRODUCTION

The White Paper on the National Strategy for the Development and Promotion of Small Business (1995) identifies access to finance as one of the most urgently felt needs even though there are other problems that aggravate the financial situation of the SME sector.

The foundation for an enabling environment has been laid - this needs to be enhanced, targeted for integrated much higher than what it is at the moment.

Overall collation of the questionnaires revealed the following:

- There is no shortage of funds, the challenge lies in targeted promotion and usage schemes in line with SME and market needs.
- Collateral is a problem for black business, which have not had an opportunity to accumulate capital through property investments, etc.
- There is a lack of a co-ordinated implementation strategy support, especially the packaging of financial and non-financial support.
- The survivalist sector cannot be referred to as 'business, i.e. there is no indication of profit or wealth accumulation, just survival or poverty alleviation.

This chapter presents the results derived from the primary research conducted.

The aim of this chapter is to analyse the results as well as the findings in the literature survey and begins by analysing policy and practical issues, an examination of the different schemes in place and detailing the results of the three questionnaires.

4.2 POLICY AND PRACTICAL ASPECTS

In certain instances steps are already in place to re-address the policy and delivery areas that have not met their original aims and goals.

However, for those that require further consideration and a revised strategy, the enclosed recommendations will attempt to rectify the existing shortcomings.

4.3 INDUSTRIAL POLICY AND THE TRANSFORMATION CHALLENGE

The DTI schemes have been designed against the backdrop of industrial development and competitiveness improvement policy aims and goals, i.e. 'tools' to stimulate, enhance and improve industrial development in the context of globalisation and macroeconomic targets. These schemes do have a focus on upgrading the SME sector and bringing them into this mainstream of economic development.

However, as a result of factors like competitiveness, exports, manufacturing development programmes, etc, it is mostly the existing, technologically advanced innovative types of small enterprises that are likely to get involved in scheme participation.

Most of the schemes are primarily designed for the higher size spectrum (medium and large firms). It is important to note that as a result of these scheme designs, the focus is on stimulating and enhancing current operations. Job creation is an important focus of the schemes.

These schemes are world -class designed with sophistication for developed and industrialisation countries. Like most newly industrialised countries, South African is faced with managing the dual challenge of meeting globalisation demands whilst at the same time addressing the transformation gap that is shown in figure 4.1

Figure 4.1

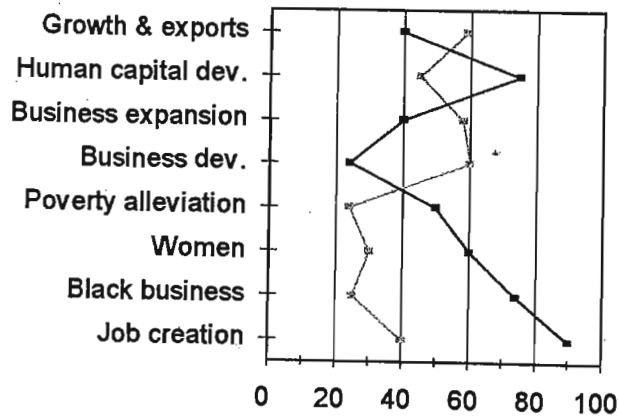


Figure 4.1 highlights the need for setting up programmes and delivery platforms to address the gap in developing capacity of the previously disadvantaged SME sector. The DTI incentive schemes can stimulate the development of human capital in the historically disadvantaged sectors. However, this needs to be more vigorously implemented and the DTI needs to implement strategies and programmes to reach its target market. Especially as an evaluation of the current schemes reveal low levels of impact on the current market.

4.4 JOB CREATION AS A MEASURE TOOL

Most schemes are focused on modernisation and competitiveness issues, which would normally be coupled with the use of current technology. However, as technology has led to the loss of jobs, the statistics provided by the relative schemes, in terms of job creation, cannot be accurately interpreted in terms of the enterprise spin-offs.

4.5 SME DEFINITIONS AND SIZE CLASSIFICATIONS

There appears to be no congruency in the definitions used by the DTI and IDC. The DTI's, Ntsika and Khula, definitions abide with The White Paper definition and classification of SMEs.

The IDC's definition however focuses on the aspects of the asset base of the SME. In view of this broad definition by the IDC, primary focus is on medium-large size SMEs.

4.6 IDC SCHEMES

The aim of these schemes should predominantly focus on increasing participation among Black SMEs, by providing financial advisory services. However, the stringent collateral requirements remain a deterrent.

Figure 4.2 Responses received to questionnaire 3: feedback regarding accessibility of financial assistance.

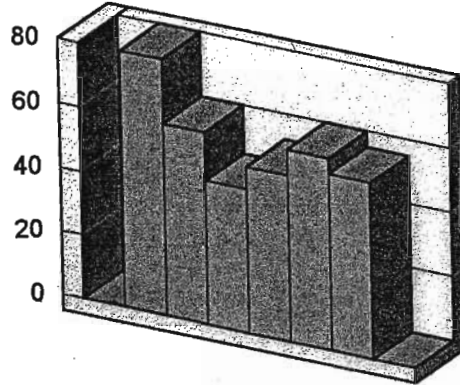
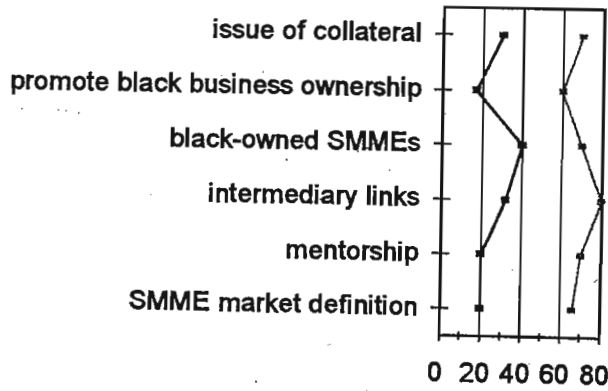


Figure 4.3 Illustration of difficulties experienced by entrepreneurs, due to stringent collateral requirements

IDC schemes assessment



4.7 KHULA ENTERPRISE FINANCE LIMITED

Khula Enterprise Finance Limited, Annual report as at 31/03/2001 reflects the following:

Table 4.1 Total beneficiaries and sectional distribution of 1996 – 2001:

	Khula- Start	RFI	Credit Guarantee Scheme Individuals	Credit Guarantee Scheme Portfolios	Thuso Mentorship Scheme	Regional Equity Funds
Total number of beneficiaries	11 875	89 354	1 420	762	677	282
Number of respondents	566	407	232	56	181	30
Economic sector of beneficiaries	%	%	%	%	%	%
Retail	59.9	46.4	34.5	73.2	35.9	6.7
Wholesale	0.5	2.7	4.3	0.0	8.2	0.0
Construction	0.5	4.2	6.9	0.0	3.9	6.7
Manufacturing	21.4	16.2	14.7	3.6	12.1	20.0
Catering	2.1	7.9	9.5	12.5	4.4	3.3
Motorvehicle repairs	0.7	3.7	6.9	0.0	1.7	0.0
Agriculture	7.1	0.5	0.0	0.0	1.7	0.0
Personal services	4.6	9.3	8.2	7.1	13.8	10.0
Art and culture (handcraft)	1.6	1.0	2.2	1.8	4.9	13.3
Repairs and household goods	0.7	1.0	0.4	1.8	0.0	0.0
Cleaning services	0.2	1.0	1.7	0.0	0.6	0.0
Crèches and after-school centres	0.7	1.5	2.2	0.0	0.6	0.0
Security	0.0	0.5	0.9	0.0	2.2	0.0
Information services	0.0	1.0	3.4	0.0	1.7	16.7
Transport services	0.0	2.5	1.7	0.0	4.4	13.3
Bookkeeping	0.0	0.0	0.4	0.0	1.1	6.7
Accommodation	0.0	0.0	0.4	0.0	0.0	1.7
Other	0.0	0.7	1.3	0.0	1.1	3.3
Total	100.0	100.0	100.0	100.0	100.0	100.0

Figure 4.2 Loan Features

		Khula- Start	RFI	Credit Guarantee Scheme Individuals	Credit Guarantee Scheme Portfolios	Thuso Mentorship Scheme	Regional Equity Funds
Percentage of beneficiaries with only a Khula supported loan	%	97.7	95.1	95.3	96.4	-	-
Average loan size	R	1 127,62	109 973,24	252 288,64	12 239,29	193 916,53	2 404 800,00
% of beneficiaries assisted to secure a loan	%	19,1	29,7	15,1	10,7	-	3,3
Source of assistance							
Khula mentorship	%	44,4	37,2	28,6	16,7	-	-
Non-governmental organisation	%	26,9	28,1	14,3	0,0	-	-
Friend/family/colleague	%	25,9	28,1	2,9	83,3	-	-
Other	%	2,8	6,6	54,3	100,0	-	-
Application of loan							
Start-up of business	%	30,2	52,6	67,0	26,8	-	56,7
Extend business	%	69,1	41,8	23,7	17,9	-	36,7
Consolidate credit	%	0,9	2,2	2,2	0,0	-	0,0
Continuation/maintenance of business	%	0,0	2,9	5,4	32,1	-	0,0
Other	%	0,2	0,5	3,6	25,0	-	6,6

Table 4.3 Employment features

	Khula- Start	RFI	Credit Guarantee Scheme Individuals	Credit Guarantee Scheme Portfolios	Total
Average employment size					
Male	0,34	4,90	8,17	1,95	-
Female	1,58	3,44	3,84	1,50	-
Total	1,92	8,34	12,01	3,45	-
Full-time	1,85	7,19	10,68	2,98	-
Part-time	0,07	1,15	1,33	0,47	-
Total	1,92	8,34	12,01	3,45	-
Estimated total employment*					
Male	4 038	437 835	11 601	1 486	454 960
Female	18 763	307 378	5 453	1 143	332 737
Total	22 801	745 213	17 054	2 629	787 697
Full-time	21 968	642 455	15 166	2 271	681 860
Part-time	833	102 758	1 888	358	105 837
Total	22 801	745 213	17 054	2 629	787 697
New jobs created by Khula loans	15 489	109 505	12 847	721	521 307

Table 4.4 Utilization of funds

<u>Available Funds as at 31.3.2001</u>	<u>Funds Distributed</u>
R2.2 billion	TOTAL: R890m
	- Business loans – R50m
	- Credit Guarantee – R300m
	- Facilities not yet taken up – R540m

The rollover of massive amounts of unspent funds is indicative of the fact that Khula's target market is not being reached.

4.8 AN ASSESSMENT OF THE SUCCESS OF RFI'S

Khula's annual report as at 31/03/2001 reflects the following:

- Total number of beneficiaries: 89 354 (35 200 as at 3/99)
- Average size of loan : R109 973
- Start-up loans : 52,6%
- Estimated new jobs created: 109 505.

The substantial increase in beneficiaries can be attributed, primarily to Khula's partnership with the Department of Land Affairs (DLA) and the creation of the Land Reform Credit Facility (LRCF). The LRCF is used (via Khula), to enable retail borrowers, that conform to the DLA criteria, to access funding.

: Table 4.5 Gender issues of beneficiaries:

		Khula- Start	RFI	Credit Guarantee Scheme Individuals	Credit Guarantee Scheme Portfolios	Thuso Mentorship Scheme	Regional Equity Funds
Gender of respondent							
Male	%	14,3	46,2	74,6	71,4	71,8	93,3
Female	%	85,7	53,8	25,4	28,6	28,2	6,7
Gender of employees							
Full-time Male	%	17,8	59,1	69,0	60,5	-	-
Full-time Female	%	82,2	40,9	31,0	39,5	-	-
Part-time Male	%	14,3	56,5	59,9	30,8	-	-
Part-time Female	%	85,7	43,5	40,1	69,2	-	-
Gender of individual clients*							
Male	%	35,1	46,7	52,1	41,6	-	-
Female	%	64,9	53,3	47,9	58,4	-	-

The above statistics does not provide details, regarding the breakdown of assistance in terms the various race groups. Accordingly, the research projects unable to determine if the previously disadvantaged Black sector is being reached.

4.9 QUESTIONNAIRE 1

These questions were directed at business managers at financial institutions, in the aim to establish the problems encountered by commercial banks in assessing/ granting credit facilities to SMEs, and ways to overcome these hurdles.

The responses from all questionnaires revealed that access to finance problems are more severe in the following categories:

- ◆ SMEs in rural areas.
- ◆ Start - up enterprises
- ◆ Those owned and run by owned and blacks.
- ◆ Certain higher - risk businesses e.g construction.

4.9.1 SUMMARY OF FINDINGS:

Commercial banks concur that SMEs are major contributors to the counties economy and the banks. Nevertheless, a significant portion of loan applications are declined by these banks and rarely re-routed through to available support schemes, should the only unfulfilled criteria be the inability of the applicant to provide the bank with collateral.

While respondents are of the opinion that their institutions are geared to handle the financial requirements of SMEs, only two commercial banks, namely ABSA and Standard Bank, are currently actively involved in promoting the various government support schemes. These banks commitment has further been demonstrated through the establishment of a specialised department to promote government schemes.

It has also become evident that the credit assessment processes for SME loan requests are cumbersome. Hence, commercial banks tend to focus on larger, well-established business, where the derived revenue to the bank is greater, the credit assessment process less cumbersome. Furthermore, these borrowers are often able to secure better credit facilities, due to their strong financial statements and/or their ability to furnish the bank with tangible collateral.

The government schemes in place are view as effective and appropriate, by the majority of respondents. However, these respondents view SMEs as high risk, primarily due to the high failure rate of this business sector and their inability to furnish the bank with tangible security. Hence, the reluctance of these banks to apply a flexible SME lending criteria. The majority of respondent's recommendation to improve financial assistance to SMEs, is to introduce a specialised bank to cater solely for this sectors financial needs.

The answers to the main questions posed is summarised below:

Table 4.6: (Question 3.1)

Purpose for which financial assistance most frequently requested by SMEs.

PURPOSE OF FINANCE	% of survey sample
Start up business	22
Expand business	12
Working capital	58
Other	8
TOTAL SURVEY SAMPLE	100

Table 4.7: (Question 3.3)

Opinions of financial institutions regarding the largest impediment facing SMEs in securing financial assistance.

RESPONSES	% of surveyed sample
No Business Plan	10
Too risky sector	5
Lack of management skills	25
Inadequate financial training	15
Inability to provide collateral	45
Other	0
TOTAL SURVEY SAMPLE	100

Table 4.8: (Question 8)

Commercial banks main criterion to provide financial assistance to SMEs.

MAIN CRITERION	% of surveyed sample
Good business plan	25
Provision of tangible security	40
Management Expertise	30
Other	5
TOTAL SURVEY SAMPLE	100

Table 4.9: (Question 9.1)

Main reason for regarding SMEs as high risk:

REASON	% of surveyed sample
Lack of financial controls	15
Generally high failure rate	45
Insufficient collateral offered	40
Other	0
TOTAL SURVEY SAMPLE	100

Table 4.10: (Question 10)

Opinion of banks, with regards to the most effective method to improve financial assistance to SMEs.

OPTIONS	% of surveyed sample
JV between banks and government	15
Introduction of specialized bank	65
Offer Tax incentives to investors	20
Additional government schemes	0
Other	0
TOTAL SURVEY SAMPLE	100

4.9.2 GAPS IDENTIFIED

The following were identified as being the difficulties encountered during the process of the application:

- No commercial bank offers any financial advisory service for SMEs.
- Insufficient interventions for building capacity of SME firms (especially black business and the historically disadvantaged segment)
- Lack of mentorship/financial advisory services to assist SMEs and increase their participation in these schemes.
- Need for a stronger link with intermediaries and SME programmes to support in the non-financial and softer issues.
- There is a need to focus on funding for start-ups (low - tech, high - tech).
- There is a need for a targeted marketing and communication effort to:
 - (a) Create awareness of the schemes
 - (b) To communicate the specific benefits of each scheme in relation to the enterprise growth-cycles and to a firm's specific developmental needs.
- There is a need to assess aspects of firm readiness and to provide after care and follow up services (e.g. in the case of export programmes like EMIA)

- Administrative procedures on proposal appraisals to be made efficient and effective through better capacity and competency development and better project management systems.
- Outreach to less urban areas to be increased (through marketing efforts, partnership links.)

The premise is that the government policies towards SMEs are developmental in nature whereas the implementation adheres to the business as usual approach.

Commercial Banks as intermediaries are a problem, as they are profit-making institutions. These banks cannot be forced to use the credit guarantee scheme and this sector can only rely on their goodwill to do so. Bank managers are evaluated according to the profitability of their portfolios and therefore there is no incentive for them to lend to individuals they cannot “trust or do not know”.

The advantage of using commercial banks is their established infrastructure, and therefore accessible to most people. However, they are not geared to lend to all categories of SMEs and hence they allege not have the capacity to service SMEs at these levels.

According to most respondents from the banks, the financial performance of RFI’s especially in the survivalist sector is complicated by the collection problems due to the following:

Unreliable Address

Borrowers who live in informal settlements are difficult to trace. One RFI has as a result stopped lending to borrowers who live in informal settlements who are not zoned by municipalities.

Repayment Culture Differs From Region to Region

The repayment culture differs from region to region. One national RFI - manager stated, “in some regions the payment rate is 100 %, and others 20 %. It is estimated that the success rate of collection through the judiciary system is 20 % (GAF evaluation report). The letters written by lawyers are simply ignored. There is a very low success rate of collections when delinquent groups are handed over to collection agencies.

Violence / Crime

Where loan officers also collectors they become victims of violence and abuse and there is reluctance on the part of loan officers to follow up defaulters. This is more dangerous for women loan officers.

Accessibility of Outlets

Outlets based in townships are more difficult to access than the ones in the city centre or in the peripheral areas because of transport.

4.10 QUESTIONNAIRE 2

Interviews with government support schemes e.g. Khula, indicated that there are concerns from both partners about the operation of the scheme, resulting in the following responses:

- “The scheme has become too complicated to use” - Banking Council
- “There is not commitment on the part of the banks to use the scheme. They do not even market it within their institutions” – Khula
- “Khula refuses to honour guarantees on technical grounds” - Small business manager.

4.10.1 SUMMARY OF FINDINGS:

The general aims of these organisations was to be a SME wholesaler of first choice, through the promotion of sustainable access to loans and equity by SMEs via RFI's, by offering a range of financial resources and information to new and existing SMEs.

Unlike commercial banks, government assistance schemes do not focus on collateral being offered/requested, instead the primary tool is a good and realistic business plan. The major impediment facing this sector, according to the abovementioned organizations, remains the inability of SMEs to provide a good business plan, with the lack of financial training ranking as a high priority.

These organizations are also of the opinion that most commercial banks are reluctant to offer financial assistance to this sector, due to the cumbersome assessment process, marginal profit margins to banks and the high risks associated due to the SMEs lack of adequate training in administrative and financial matters.

There appears to be an even spread of reasons for which SMEs seek the assistance of government schemes, with the highest percentage of requests being for start-ups and capital expenditure. These schemes also concur that they depend largely on RFI's in the fulfillment of the aims and objectives. While process has been made in assisting the target market, the goals set are not being met, due to the lack of commitment from most commercial banks. Hence, these institutions believe that the introduction of a specialist SME bank, controlled by the Department of Trade and industry, would be the most effective way to reach

Table 4.11 (Question 2)

Main criterion when assessing financial assistance to SMEs:

CRITERION	% of surveyed sample
Good business plan	90
Provision of tangible security	0
Management expertise	10
Other	0
TOTAL SURVEYED SAMPLE	100

Table 4.12 (Question 3)

Most serious impediment for SMEs in securing formal loans:

IMPEDIMENT	% of surveyed sample
No/inadequate business plan	55
Too risky sector	5
Lack of management skills	15
No/inadequate financial training	25
Inability to provide security	0
Other	0
TOTAL SURVEYED SAMPLE	100

Table 4.13 (Question 6)

Main purpose for which financial assistance requested:

Purpose for facility	% of surveyed sample
Start up business	45
Expand business	15
Working capital	10
Capital expenditure	25
Other	5
TOTAL SURVEYED SAMPLE	100

4.10.2 KEY BARRIERS

Information received from government schemes with regard to pending applications and terminated services indicated that the reasons for delays in processing and termination of facilities are:

- ◆ Limited experience of promoters of RFI's
- ◆ Lack of focus and inability to supply outstanding information by RFI's
- ◆ Governance and financial management problems
- ◆ Non-compliance with agreement
- ◆ Poor performance of the RFI's in the pilot stage.
- ◆ All respondents in this questionnaire agree that the biggest RFI's lend on the range of R3000 - R6000 because these loans are exempted from the Act and therefore high interest can be charged. They attribute majority of the problems to the following:
 - ◆ The RFI's are prohibited from taking deposits and this makes it difficult for RFI's to incorporate savings mobilisation component in their services.
 - ◆ The RFI's are measured according to specific targets set for them i.e recovery rates, loan losses, etc. This is strictly applying business approach to institutions that are servicing pre-enterprise sector.
 - ◆ Private individuals or enterprises should be allowed to access business loans to improve reach and efficiency of RFI's
 - ◆ There is a very thin spread of services for enterprises with needs for R10 000 - R100 000.
 - ◆ There is lack of focus on providing finance in areas with specific economic advantage e.g. spatial development initiatives, tourism, and procurement initiatives.
 - ◆ Khula and other schemes have not been proactive in finding RFI applications especially in rural areas (until after the jobs summit) and this has limited a further spread of RFI's.
 - ◆ It seems that in the survivalist sector there are more jobs sustained than jobs created as expected of SME's
 - ◆ There seems to be an inherent problem for lending in the poverty - stricken survivalist sector and these results in difficulty in achieving self - sufficiency.
 - ◆ The NGO's have limited lending experience and are historically under-resourced and under-capitalised and will need hands-on assistance to become self - sufficient. There also seems to be a particular mind set amongst NGO lenders in respect of being soft on debt recollection.
 - ◆ Micro - lending is fairly new and there seems to be limited or no examples to base achievable performance targets.
 - ◆ There are no mechanisms in some RFI's to check whether the loan given is for consumption or starting a business.

- ◆ There are provinces which are under-serviced e.g. Northern Province
- ◆ There is no mechanism of assisting the survivalist to reach the enterprise level.

4.11 QUESTIONNAIRE 3

According to the Banking Councils Annual Report (1999), traditional sources of assistance for starting new enterprises, such as financial institutions, frequently “close their doors” to the aspirant entrepreneur, because the applicant fails to meet the lending criteria set by the banks.

Questionnaire 3 saw an increase in criticism of banks from many quarters, for their unwillingness to lend to small enterprises especially those owned by previously disadvantaged groups. This is so even though Khula is providing guarantees of up to 80 % for entrepreneurs who have viable business plans but lack collateral requirements.

Banks accordingly consider themselves unable to lend people who cannot conform to their list of stringent requirements, to enable them to assess risk.

Non-governmental organisations are in the forefront of the Government’s support plan for micro enterprises. In the past the non-governmental organisations were increasingly involved in supply of micro loans to survival enterprises. However, these organisations were not focused on lending operations and rather combined social development motivations with lending. They were also mostly dependent on grant funding.

Their management and board did not necessarily have financial lending expertise, but were rather prominent community figures. This tended to inhibit their capacity to run self-sufficient operations. On the other hand these non-governmental organisations have accumulated vast experience and understanding of their beneficiaries funding needs and their repayment patterns.

According to the 80% of the respondents, the limitations of the previously disadvantaged entrepreneurs stem from the lack of:

- Access to information and technology. Access to information is critical for generation of business ideas and for identifying niche markets. Previously disadvantaged entrepreneurs

get their business ideas by replicating what they see as successful around them - hence most businesses in previously disadvantaged communities are mostly trade related as compared to services and manufacturing or bulk breaking.

- Lack of confidence to articulate their financial requirements with banks and negotiate with suppliers.
- Lack of understanding or appreciation of consequences of signing legal documents - resulting in debt and black - listing.
- Other factors related to un-preparedness for the highly competitive business environment as a result of lacking basic business literacy.
- Lack of networks and contracts with other businesses in the sector.
- Loss of opportunity to accumulate capital through investments, savings or property.

The other 20% believe that the above limitations make the black entrepreneur vulnerable however the following contribute to making find it difficult to survive especially in the start - up stage of the business:

- ◆ Information needs
- ◆ Lack of management and administrative skills
- ◆ The findings indicate a lack of integration of financial and non- financial assistance before and after the phase of obtaining the loan.
- ◆ Transparency seems to be a miss between Khula and the banks about the credit guarantee scheme operation. This results into counter allegations by both parties involved on who is responsible for the poor performance of the scheme. These removes the focus from the most important person in this process who is the entrepreneur caught up in the crossfire.
- ◆ Costly duplication of services by Khula and the banks for e.g. both running a credit check on the same applicant.
- ◆ Black entrepreneurs are disadvantaged in obtaining loans because of restrictions they endured in property ownership rights, i.e. acquiring assets that could have served as collateral. They have therefore missed out from the long -run process of capital accrual and growth through rising property values and share prices. As a result they over invested in township properties that banks do not consider as collateral.
- ◆ The majority of beneficiaries of the credit guarantee scheme are mostly white males.

- ◆ There is an indication that in addition to quality, non - financial support, the following practices will contribute to successful implementation.
- ◆ Good marketing of the schemes to all stakeholders e.g. bank managers and responsible staff, small business managers and entrepreneurs themselves.
- ◆ A clear community strategy.
- ◆ In order to integrate the public sector's development thrust with the efficiency of private sector e.g. banks, there needs to be co-operation between the two sectors.
- ◆ The banks seem to find SMEs to be a high - risk area with no profit margins due to perceived high costs on their loans.

4.11.1 SUMMARY OF FINDINGS:

The majority of respondents were in the twenty five to thirty five age group, with the most common business structure being that of a sole proprietor, employing an average of four staff.

While there was a spread of the sources of start up capital, (with the majority of respondents viz. sixty four percent, seeking capital ranging from R25 001 to R100 000), the major source of capital (fifty two percent) was through the utilization of the applicants personal resources, with friends and/or relatives accounting for sixteen percent. In comparison, banks accounted for a mere eight percent, as a source of start up capital.

Sixty four percent of respondents have not applied for any bank loans and prefer to utilize their personal resources, with the majority of respondents agreeing that the banks procedures were too complicated and these banks were also not equipped to assess their financial requirements. Furthermore, fifty six percent strongly believe that the banks collateral requirements are too stringent and their perception is that banks are doing little to revise their lending criteria to this sector.

Of major concern is the fact that a significant portion of respondents were unaware of government financial support initiatives, hence the marketing and accessibility thereof must be reviewed as a matter of priority.

Table 4.14: Capital required to commence business

CAPITAL REQUIRED	% OF SURVEY SAMPLE
R0 – R10 000	8
R10 001 – R25 000	6
R25 001 – R50 000	12
R50 001 – R70 000	32
R70 001 – R100 000	20
R100 001 – R125 000	6
R125 001 – R150 000	4
R150 001 – R200 000	4
R200 001 – R250 000	0
R250 001 – R300 000	4
GREATER THAN R300 000	2
NO RESPONSES	2
Total survey sample	100

Table 4.15: Main sources of start-up capital.

RESPONSES	% of survey sample
No money needed	4
Assistance/borrowings from friend/relative	16
Money from stokvel	2
Loan from private money lender	4
Credit from customer, agent and suppliers	2
Loan from bank	8
Loan/assistance from government institution	4
One or more co-investors	2
Own resources	52
Other	4
No response	2

Table 4.16: Respondents that that have applied for a business loan from a bank.

RESPONSES	% of survey sample
Yes, Successfully	10
Yes, loan not yet approved	2
Yes, unsuccessfully	24
No	64
TOTAL OF SUVEY SAMPLE	100

Table 4.17: Unsuccessful bank loan applications or not having tried to obtain a bank loan - the respondent's main reasons.

RESPONSES	% of survey sample
Procedures too complicated	18
Costs too high	16
Respondents lack guarantee required	14
Banks not interested in business	12
Respondents unaware of how to proceed	8
Respondents prefer own resources	26
Other credit sources more easily accessible	4
Reason for refusal not explained by bank	2
Other	0
TOTAL SURVEY SAMPLE	100

Table 4.18: General questions posed to SMEs

QUESTIONS	% of survey sample				
	SD	D	N	A	SA
Obtaining finance through a bank is a simple task	52	22	12	14	0
I am aware of the various financial options available:	12	28	6	36	18
I am aware of the various governmental assistance schemes available:	36	40	8	12	4
Banks are fully equipped to access my financial requirements	56	32	2	8	2
The banks collateral requirements are too stringent:	2	10	4	28	56
Banks should relax their lending requirements for SMEs	0	12	4	32	52
Governmental assistance schemes are effective	30	48	14	6	2
Big business and wealthy individuals should become more involved in assisting SMEs accessing financial support:	0	6	0	66	28
Banks and government should provide financial training to enable me to effectively run my business	0	2	0	22	76
Banks are committed to assisting in the development of SMEs	32	62	2	4	0
Government is committed to assisting in the development of SMEs	16	36	2	42	4

- SD** - **Strongly disagree**
- D** - **Disagree**
- N** - **Neither agrees nor disagrees**
- A** - **Agree**
- SA** - **Strongly agree**

4.12 VIEWS AND PERCEPTIONS OF APPLICANTS THAT HAVE AND HAVE NOT SUCCEEDED IN SECURING FINANCE THROUGH FORMAL SOURCES.

4.12.1 Successful Applicants

Entrepreneurs that have succeeded have gained in terms of business improvement (through quality improvements, machinery) aspects. This was evident out of IDC and SPF proposals. Other entrepreneurs have gained in terms of increasing exports, through technological programmes like THRIP and SP11. Other entrepreneurs have benefited by having better access to research development and technological expertise and have thus introduced and or improved their innovations and products.

Those that have entered into a consortium approach felt that it is a safer approach with stronger commitments and outputs. This is limiting in that potentially individual entrepreneurs get rejected as a result of risk minimisation needs by investors and not too many SMME proposals are consortium - related.

4.12.2 Unsuccessful Applicants

Those that did not succeed felt that the reasons for rejection were not clear. Further rejected proposals were seldom referred to other programmes and schemes that could help them.

Those that got rejected because of inadequate information in the business proposition financing proposal felt that they would have benefited greatly with assistance from experts that understood the scheme thoroughly, i.e. brokers/consultants.

4.13 CONCLUSION

This chapter dealt with the statement of results from the questionnaires completed by commercial bank representatives, representatives from government assistant schemes and randomly selected entrepreneurs.

The general trend from the questionnaires results, indicate that substantial effort needs to be focused on the SMEs sector, through assistance schemes that are able to deliver on their commitment. Furthermore, commercial banks appear to be the main drivers of most government schemes, despite the fact that these banks are sufficiently geared to assess applications. In this regard only two commercial banks, namely Standard Bank and ABSA Bank have established a specialized department (which consists of an average of only three staff per province) to assist SMEs access the relative government schemes.

The information above has assisted in finding possible answers to the following:

(A) HOW MANY SME'S COULD BE SUPPORTED BY THE VARIOUS SCHEMES, ON AN ANNUAL BASIS?

According to Ntsika's – "State of Small Business in South Africa", between 10 000 to 50 000 SME's can be supported, based on current funding/resources available.

(B) WHAT ACCESSIBILITY BARRIERS EXIST?

- ◆ Communication and marketing of schemes are weak.
- ◆ Criteria for emerging and newly established businesses are too stringent, which limits entry into these schemes.
- ◆ Lack of assistance to help potential SME's in terms of financial planning and proposal design assistance.
- ◆ Too much time is spent on scheme administration, which leads to a high frustration rate by SME's.
- ◆ Perceived slow delivery of the schemes to this sector has caused a slow rate of entry for scheme usage.
- ◆ Seed financing for small innovative ventures and for conducting market studies are not available.

CHAPTER FIVE



the dti



THE DEPARTMENT
OF TRADE AND INDUSTRY
SOUTH AFRICA



CONCLUSIONS AND RECOMMENDATIONS

CHAPTER 5:

(CONCLUSIONS AND RECOMMENDATIONS)

5.1 INTRODUCTION

The role of SMEs, particularly in the private sector, is crucial in aiding development by harnessing latent entrepreneurial zeal.

The SME sector in South Africa, has the potential to absorb between sixty to eight percent of employment, in a country that has with high unemployment. Comparing other economies like Spain where more than ninety percent of the economically active population are employed in the small business sector can support this statement.

Against this backdrop, the conclusions and recommendations reached in this chapter will assist in making the appropriate recommendations and contribute to the business environment / economy as a whole.

5.2 GENERAL RECOMMENDATIONS

A clear plan towards financial self-sufficiency with defined and clear objectives in the areas of financial performance, internal processes and customer relations, requires drafting. The following issues are paramount to ensure future success of financial assistance schemes:

- Management to possess a good mix of skills, in respect of banking developments and financing experience.

- Focused strategic leadership of the Board of established agencies, with the expertise to understand the needs of the end users.
- Motivated consultants.
- Appropriate Management Information Systems
- Commitment from commercial banks “to lend a helping hand”
- Innovative recipes for integrated financial and non-financial support.
- Schemes are to be localised and focused.
- Focused marketing, to reach the desired target market.

The illustration below best describes the above and also provides a strategic assessment and recommendations for SMEs, by providing ideas on marketing, start-ups, mentorship and intermediary relationships.

5.2.1 MARKETING

- ◆ The DTI needs to invest in a targeted industrial marketing strategy, which will aim to communicate the schemes to the appropriate market, through the SMME support programmes and intermediaries. Industrial marketing involves sector-focused sessions with the aim of soliciting targeted and quality proposals. The DTI has a good focus on sector programmes and increased promotion of appropriate schemes to specific sectors, would make good industrial marketing exercises.
- ◆ Time and effort is to be spent to get networks and consortium proposals established. Creative strategies such as sub-supplier chain development networks, SMME networks and clusters could be deployed.

5.2.2 ADDRESSING THE NEEDS OF START- UPS

- ◆ Mechanisms to address the needs of emerging start-ups must be established.

- ◆ Focus on increasing the innovative potential and technological capabilities of SMEs, through targeted marketing efforts.

5.2.3 INTERMEDIARY PARTNERSHIPS

- ◆ An alliance needs to be formed with intermediaries that are reaching out to the target market, namely government to provide the resources and policy, banks to provide their management expertise and NGO's their ability to reach the target market to also provide training.

The varied definitions used by The DTI and IDC, creates confusion among the target market, in terms of beneficiaries, qualifiers for assistance, etc. Monitoring and evaluation would also be simplified, and it is therefore paramount to reach consciences with regards to the definition of SMEs, in terms of:

- Size
- Assets
- Turnover.
- ◆ Intermediaries can assist in promoting the targeted schemes, through targeted marketing efforts.

5.3 RECOMENDATIONS FOR KHULA, COMMERCIAL BANKS AND RFI's

5.3.1 KHULA AND BANKS

There is a need to integrate the public sector development thrust with the efficiency of the private sector banks. This can be achieved through:

- Incentive schemes to encourage commercial banks to lend more to SMEs, are to be investigated.

- Better co-ordination of financial and non-financial support for SMEs i.e. the above institutions should assist potential clients in accessing relevant information.
- Consultants should be adequately qualified and required to provide non-financial support to this sector.
- Establishment of clear and well-developed guidelines for accessing financial assistance by SMEs.
- Relax collateral requirements, if proposals appear viable.

5.3.2 KHULA AND RFI'S

- Continuous monitoring and evaluation of their effectiveness is recommended, in order to assess their impact on SMEs.
- Institutional mechanisms to be established to deal with the survivalist sector
- Targeted industrial marketing and communication strategy to be established.
- New schemes to be established to deal with existing gaps, in assisting viable start-up businesses.
- A pool of consultants/brokers to be established for mentorship and attracting new business.
- Invest in firm readiness assessment tools to be used by consultants/brokers.

5.4 SHORT, MEDIUM AND LONG TERM RECOMMENDATIONS

5.4.1 SHORT TERM RECOMMENDATIONS

Policy Issues

- Ensure standard definition for SMEs.
- Expand and develop credit guarantee systems for SMEs.

Industrial Marketing

- Embark on a targeted marketing and communication strategy.
- Work with selected intermediaries and SMME support programmes to create awareness of schemes and to attract a larger clientele base.

Mentorship Programmes

- Ensure that Khula/Ntsika mentorship schemes have a strong focus on financial assistance and non-financial mentorship services.

Relationships with SMME intermediaries and other National Programmes

- Enter into partnership arrangements with select intermediaries for assisting their SMME clientele e.g. MAC Programme.
- Form harmonious relationships with programmes like TWIB, to get closer to addressing the needs of the previously disadvantaged sectors.

5.4.2 MEDIUM TERM RECOMMENDATIONS

- A key to promoting an efficient and dynamic SME sector is to create an environment in which SMEs may prosper in the absence of long-term dependence on government support.
- Measure the transformation gap in terms of SME capacity development to enter the marketplace challenges.
- Monitor internal DTI capacity development to meet market needs and challenges.
- Establish a pool of Business Angels, which would mentor/encourage future entrepreneurs. The DTI could possibly research to possibility of offering these Business Angels certain incentives.
- Larger sized Business Angels to offer support to SMEs, as part of their social responsibility.
- Offer tax incentives and devise reasonable financial policies to attract investment from the public. In this regard government policies must assist in mobilizing financial

resources through the implementation of taxation, interest-rate management and investment promotion strategies.

- Introduction of subsidized credit.
- Legislation to compel commercial bank's to allocate a stipulated percentage of their portfolio to SMEs.
- Reduce interest rate differential between SMEs and larger firms, as this differential makes more difficult to compete against larger firms (higher cost to borrow) & also places an additional burden on SME resources. SMEs therefore forced to resort to alternative sources of finance (if available). Consider fixed interest rates – not affected in interest rate hikes.
- Increased support for business angels. These business angels are informal investors (normally wealthy retired individuals who are willing to utilise their financial resources to make risky investments based on their business acumen, experience and interests). To link these business angels to SMEs, a formal network should be initiated

5.4.3 LONG TERM RECOMMENDATIONS

- Measure the impact of intermediaries and other delivery programmes in the access to the finance chain.
- Assess the relationships between financial and non-financial support in the S.A. context.
- Establish a SME venture capital fund and introduce legislation to reduce taxation. (zero percent venture capital gains tax for FDI. Hence, in the absence of no tax impediments venture capital can be attracted.
- Expectations from this sector are high, as this sector is expected to create employment and create wealth. While there are isolated pockets of success and substantially more failures, the overall impact has been small in relation to expectation.

- Existing frameworks are either the product of over creative thinking or tend to be borrowed from overseas experience – irrespective of its relevance to the South African situation. Therefore frameworks need to be tailor made for South Africa, in order to be effective.
- Commercial banks to revise their lending criteria to SMEs, which criteria are presently inappropriate for a developing economy.
- The introduction of a specialist SME bank is to be investigated. This bank should ideally be under the control of central government and the policies and procedures must be SME friendly. The staffing of this bank should be from a combination of commercial banks and government schemes, to ensure that their pooled resources and synergies improve service delivery to SMEs.
- A variety of central bank policies can help to induce domestic banks to lend to all categories of SMEs, which would have the effect of influencing the net income of the domestic bank.
 - ✓ One is mandatory portfolio legislation, which requires that a percentage of a commercial bank's portfolio be earmarked for SME. Should the bank not perform the required percentage of lending, and then its costs are increased by the central bank through a variety of possible penalties. This policy has been used most widely in India, where banks are required to allocate one percent of their loan portfolio to this programme.
 - ✓ The second policy affecting lending to SMEs is preferential repo rates. The repo rate is the interest rate that the central bank charges domestic banks for borrowing funds. Accordingly, as the central bank is the primary source of funds for domestic banks, it can provide an incentive for domestic banks to lend to SMEs by providing funds at a lower interest rate.
 - ✓ The establishment of a revised reserve ratio requirement for SME lending by domestic commercial banks. This reserve is the monies that the central bank compels the commercial bank to hold in reserve as security against outstanding loans. This has the effect of inducing banks to lend to SMEs by reducing the cost of funds held in reserve.

- ✓ Reduce administrative fees and regulations. Commercial banks often charge arrangement fees, have excessive paperwork and collateral requirements often mandated by government. To promote lending to SMEs, central bank can mandate reduction of fees and collateral.
- ✓ Use of deposit incentives, whereby government departments deposit their funds in those banks that actively promote lending to SMEs.
- ✓ Central bank may lift usury laws on interest rate that commercial banks charge to SMEs borrowers. The benefit thereof is that providing a profit incentive to commercial banks can increase the flow of capital to SMEs.

5.5 CONCLUSION:

To make the most of scarce resources, support should also be targeted at particular groups of entrepreneurs depending on their needs and potential to generate economic returns. In this regard the research by GEM is already playing a major role in identifying such groups.

The key objective of government policy should be aimed at ensuring that markets work for SMEs, by allowing this sector to acquire and leverage capital resources namely, many key personal assets in townships e.g. property, are either heavily or entirely disregarded by financial institutions in calculating an individuals net worth. Government policy should ensue that rural and urban land markets are reformed, thereby ensuring that assets like these are not eroded in value due to social imbalances.

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APPENDICIES

APPENDIX ONE

(Specimen letter addressed to reputable South African commercial banks)

The Manager
(Name of Bank)

01 July 2003

Dear Sir/Madam

Request for input regarding lending to Small Business

I advise that I am currently a student, enrolled on the Master of Business Administration, through the University of Natal.

Part of the requirement, for the completion of this degree, is the submission of a research study. In the light thereof, I have decided to research the financial support available to the Small and Medium Enterprises.

My aim is to identify the requirements of financial institutions and difficulties experienced, when assessing requests from this sector. Accordingly, I seek your assistance on the subject, and would appreciate your views, suggestions and recommendations.

Kindly note, that all information will be treated as confidential and that my contact details are as follows:

Telephone : 031- 5085607 (b)
Cellular : 083-555-055-7
e-mail : dnaidoo@sbic.co.za

Continued...../// Your kind.....

Your kind assistance herein is greatly appreciated.

Yours faithfully

Mr D.Naidoo

APPENDIX TWO

(Questionnaire completed by financial institutions)

Purpose of questionnaire: To assess the role financial institutions play, in providing the SME sector with financial assistance.

Structure of questionnaire: Ten main questions addressed to managers of financial institutions.

1. Do you think that the small and medium sized businesses are major contributors to the economy of South Africa?

YES
NO

2. As a manager in the retail banking industry, are you often approached by the Small and medium enterprises for financial assistance?

YES
NO

3. If you have answered YES to (2) above, please answer the following questions:

3.1 For what purpose is financial assistance most frequently requested? :

Start up business
Expand business
Fund capital expenditure
Working capital
Other (please specify) _____

3.2 Are the majority of applicants successful in obtaining financial assistance from yourselves?

YES
NO

3.3 What, in your opinion, is the largest impediment facing SMEs in securing financial assistance, through financial institutions?

- No business plan
- Too risky sector
- Lack of management skills
- Inadequate financial training
- Inability to provide collateral
- Other (please specify) _____

4. In your opinion, do you think that commercial banks are equipped to handle the financial assistance sought by the SME sector?

- YES
- NO

5. Are SMEs, profitable to the bank?

- YES
- NO

6. Do you think that government has adequately addressed and implemented financial support structures for SMEs?

- YES
- NO

7. Does your bank currently provide a financial advisory service to SMEs?

- YES
- NO

8. What is your banks main criterion to provide financial assistance to SMEs?

- Good business plan
- Provision of tangible security
- Management expertise
- Other (please specify) _____

9. Do commercial banks regard lending to SMEs as a high risk?

- YES**
NO

9.1 If you answered YES to (9) above, what would be the main reason?

- Lack of financial controls**
Generally a high failure rate
Insufficient collateral offered
Other (please specify) _____

10. In your opinion, which do you think would be the most effective method to improve financial assistance to SMEs?

- JV between banks and government**
Introduction of a specialized bank
Offer tax incentives to promote support
Additional government schemes
Other (please specify) _____

THANK YOU FOR YOUR VALUABLE INPUT

APPENDIX THREE

Questionnaire completed by government parastatal's, that offer financial support to SMEs

Purpose of questionnaire: Establish the lending criteria of governmental initiatives and their success in addressing the financial needs of SMEs.

Structure of questionnaire: Thirteen questions addressed to managers at the Department of Trade and Industry, Khula and Nsika.

1. What are the main aims of your organization, concerning SMEs?

2. What is your organizations main criterion when assessing requests for financial assistance, from SMEs?

- Good business plan
- Provision of tangible security
- Management expertise
- Other (please specify) _____

3. Which of the following would you regard as the most serious impediment for SMEs, in securing finance through formal channels:

- No/inadequate business plan
- Too risky sector
- Lack of management skills
- No/Inadequate financial training
- Inability to provide collateral
- Other (please specify) _____

4. Does your organization provide training to equip/enhance the financial skills required by SMEs?

YES
NO

5. In your opinion, do you think that commercial banks are adequately equipped to assess the financial requests of SMEs?

YES
NO

6. For what purpose is your organizations financial assistance most frequently requested?

Start up business
Expand business
Fund capital expenditure
Working capital
Other (please specify) _____

7. In your opinion, which do you think would be the most effective mechanism? which would improve financial assistance to SMEs?

JV between your organization and banks
Introduction of a specialized bank
Offer tax incentives to promote support
Additional government schemes
Other (please specify) _____

8. Do commercial banks possess the necessary expertise to assist SMEs?

YES
NO

9. What is the main channel of communication that exists between your organization and SMEs?

Printed media
Electronic media
Commercial banks
Other (please specify) _____

10. What is your organization's mission statement?

11. Has your organization been successful in achieving its aims and objectives?

YES
NO

12. Are any modifications/changes planned by your organizations to intensify your focus in aiding SMEs access finance?

YES
NO

13. If you have answered YES to (12) above, what the primary modifications/changes?

THANK YOU FOR YOUR VALUABLE INPUT

APPENDIX FOUR

Questionnaire completed by randomly selected SMEs.

Purpose of questionnaire: Assess the needs and the difficulties faced by SMEs, in accessing finance through formal financial structures.

Structure of questionnaire: Ten main questions addressed to SMEs, from various sectors.

1. Age of owner:
- 18-24
 - 25-30
 - 31-35
 - 36-40
 - Older than 40

2. Business structure:

- Informal sole owner
- Formal sole owner
- Informal partnership
- Formal partnership
- Close corporation
- Other: (Specify) _____

3. Number of employees (including self):

4. Main business activity:

5. What was the main source of your capital?

- No money needed
- Own savings
- Assistance/borrowings from friend/relative
- Money from stokvel
- Loan from private money lender
- Credit from customer, agent and suppliers
- Loan from bank
- Loan/assistance from government institution
- One or more co-investors
- Other: Specify _____

6. For what purpose have you sought financial assistance?

- Start up business
- Expand business
- Fund capital expenditure
- Working capital
- Other (please specify) _____

7. How much did you need to start your business? R _____

8. Have you ever applied for a business loan from a bank?

- Yes, successfully
- Yes, loan not yet approved
- Yes, unsuccessfully
- No

9. If you answered UNSUCCESSFULLY or NO to (8) above, please indicate what the main reason was:

- Procedures too complicated
- Costs too high
- Respondents lack guarantees required
- Banks not interest in business
- Respondent unaware how to proceed
- Respondent prefers own resources
- Other credit sources more easily accessible
- Reason for refusal not explained by bank
- Other: _____

10. Please answer the following questions by placing a cross in the appropriate box:

- SD - Strongly disagree
- D - Disagree
- N - Neither agrees nor disagrees
- A - Agree
- SA - Strongly agree

10.1 Obtaining finance through a bank is a simple task:

SD	D	N	A	SA
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10.2 I am aware of the various financial options available:

SD	D	N	A	SA
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10.3 I am aware of the various governmental assistance schemes available:

SD	D	N	A	SA
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10.4 Banks are fully equipped to assess my financial requirements:

SD	D	N	A	SA
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10.5 The banks collateral requirements are too stringent:

SD	D	N	A	SA
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10.6 Banks should relax their lending requirements for SMEs:

SD	D	N	A	SA
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10.7 Governmental assistance schemes are effective:

SD	D	N	A	SA
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10.8 Big business and wealthy individuals should become more involved in assisting SMEs in accessing financial support:

SD	D	N	A	SA
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10.9 Banks and government should provide financial training to enable me to effectively run my business:

SD	D	N	A	SA
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10.10 Banks are committed to assisting in the development of SMEs:

SD	D	N	A	SA
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10.11 Government is committed to assisting in the development of SMEs:

SD	D	N	A	SA
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THANK YOU FOR YOUR VALUABLE INPUT