



FABCOS

Foundation for African Business and Consumer Services

REPORT ON THE FABCOS SEMINAR:

**ADDRESSING THE CHALLENGES FACING SMMES IN
ACCESSING FINANCE**

June 2009
The Hilton Hotel,
Durban

“Lack of access to finance frustrates our members and kills their entrepreneurial spirit. We end up with a situation where people take pride in being employed rather being the owners of their own destiny through ownership of their own enterprises.”

Mxolisi Zwane, FABCOS President

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EXECUTIVE SUMMARY

Small businesses face daunting challenges to make it in any environment. It becomes doubly difficult when the environment is poisoned by legacy issues including poor repayment records and mistrust between lenders and business owners. FABCOS, South Africa's leading small business development organisation, zeroed in on these issues at a seminar held in Durban on 30 June 2009 that was attended by leading minds from key stakeholders including banks, the government and business.

Lack of government support emerged as one of the key impediments to the development of a sound small business sector in South Africa. While countries such as China and India actively support their small businesses, in South Africa the three spheres of government were found to be fragmented in their approach to SMMEs with very little co-operation. Where government provided funds for on-lending, it was often found too often the money never reached those it was intended to help and entrepreneurs were often subjected to bureaucratic bungling when seeking help.

For the banks key issues raised at the seminar included the financial health of the enterprise, management skills of the entrepreneur, security provided by the borrower and the environment where the business operated. Challenges faced by banks included borrowers not using finance for business purposes and entrepreneurs not providing sufficient information to enable financial institutions to make decisions on viability of projects. The banks had started to realise that offering finance without business support did not sufficiently address the challenges faced by SMMEs.

FABCOS perspective was to support institutions that worked with SMMEs and therefore understood them better. Many lenders had now added a business support component to their offering. FABCOS was also helping its members to compete with larger operations entering the townships by, among others, upgrading the appeal of its members' businesses and buying in bulk at discounted prices on behalf of members.

The seminar agreed it was important for all stakeholders to increase cooperation, particularly the role of business chambers in developing policies that had a direct impact on the success of SMMEs. To that end, FABCOS invited financial institutions to work with small businesses to help unshackle their growth potential. Similarly, an invitation has been extended to the government to make a positive contribution through deliberate and meaningful policies and structures.

1. INTRODUCTION

In June 2009 FABCOS held a business seminar in Durban, KwaZulu-Natal, themed: “Addressing the Challenges Facing SMMEs in Accessing Finance”. As the title suggests, the seminar discussed difficulties faced by small businesses in accessing finance. It was addressed by KwaZulu-Natal MEC for Agriculture, Environmental Affairs & Tourism, Lydia Johnson and representatives of three financing institutions – Khula Enterprise Finance, Ithala Bank and Standard Bank. FABCOS executives also addressed delegates on funding problems faced by their members. The seminar ended with an interactive session between speakers and delegates, who were drawn from small businesses throughout the province. This report summarises the key issues raised at the seminar and presents thoughts on how FABCOS could respond to some of the issues.

2. KEY ISSUES RAISED BY SPEAKERS

2.1 MEC for Agriculture, Environmental Affairs & Tourism - Lydia Johnson

Agriculture, Environmental Affairs & Tourism MEC Lydia Johnson acknowledged that in pursuit of political transformation, the government may have neglected economic transformation. She noted that efforts to help the informal sector rise to the level of formal businesses remained one of the key challenges facing the government. Small to Medium Micro Enterprises (SMMEs) need assistance and information to help them make the transformation. Johnson said agriculture, land reform and rural development formed part of the key priorities of the new political administration. She said agriculture was vital in addressing poverty and growing the economy. The MEC also stressed the importance of encouraging the formation and sustenance of co-operatives as part of the strategy of dealing with food security and collective income generation.

Of concern, she said, was the government’s inability to fully provide small businesses with the support they need to grow. Johnson said the government was struggling to identify appropriate support to help entrepreneurs transform their ideas into viable businesses. To this end, the provincial government had launched a greening and poverty alleviation campaign called “One home, one garden and two trees” in a bid to balance agricultural development with environmental awareness, she said. The MEC said high inflation and escalating food prices required a rethink on how food was produced. She encouraged communities to form co-operatives and income generating schemes to deal with food security while at the same time empowering themselves.

She said the government was looking at ways of assisting SMMEs access finance. One intervention suggested involved facilitating access to land, resources, markets and skills. The MEC said her department looked at these as priority areas and was looking at a model for providing support to entrepreneurs to prevent repossessions of their property in the event of their businesses failing. In future, the department would train new farmers to become productive and sustainable by introducing mentorship and management skills training, she said. In closing, the MEC called on Ithala to assist small farmers who needed funding and promised that her department would ensure provision of the requisite skills. She also called on government departments to pay service providers within 30 days of receiving invoices in order to improve their cash flows.

2.2 Divisional Manager: Business Finance, Ithala - Nelisiwe Shezi

Ithala is one of KwaZulu-Natal's (KZN) premier financing institutions for SMMEs. Its lending activities cover four sectors – trade, tourism, construction and manufacturing. The institution provides long, medium, and short-term loans as well as bridging finance. Its products are geared towards providing working capital and not loan repayments. Its products are geared towards providing working capital and not loan repayments. Ithala moves in with funding once the KZN Government approves projects for funding. The company only assists with government orders and provides a 5% pay-back as an incentive.

Ithala's divisional manager, Nelisiwe Shezi said the institution recognised that providing finance alone was not enough and that there was need to also provide business support. She said Ithala faced challenges including a 95 percent default rate in the last financial year and misuse of borrowed funds. Business loans accounted for the bulk of Ithala's portfolio and covered assets such as equipment, property and other movable assets. In a bid to grow and sustain SMMEs, Shezi said Ithala had formed a Business Support Unit which would assist cooperatives access finance and acquire the necessary skills to operate in the new milieu.

Individuals or SMMEs seeking to buy shares in other companies she said, could access Ithala finance provided they managed those companies. "It is important that entrepreneurs seeking finance ensure that they can articulate their own business plans and demonstrate passion and confidence in their enterprise. If the applicant cannot explain the business plan, the bank loses confidence in the proposition and asks the question – 'can you run this business?'" She added borrowers needed to service loans as failure to do so would harm their enterprises, and in turn discourage Ithala and other lenders from assisting them.

2.3 Acting COO: Khula Enterprise Finance Limited - Mkhululi Mazibuko

Khula is a government agency which provides wholesale financial services to intermediaries. Their product offering is equivalent to that of a guarantor when an applicant's risk profile is deemed too high. The institution minimises the risk that commercial banks take when extending loans. Khula does not provide direct funding but works through various financial intermediaries such as Ithala and commercial banks. Like Ithala, Khula also offers business support service to SMMEs.

Khula Enterprise Finance Limited Acting Chief Operating Officer Mkhululi Mazibuko said prevalent debt amongst SMMEs made lending institutions increasingly less inclined to offer small loans as they judged them expensive to administer. He said funding was not the major problem but the challenge was how to access funds, particularly in rural areas where demand for funding was high. "This is compounded by cases where prospective borrowers do not know where to go for funding. Due to constraints in accessing finance, Khula, government and financial institutions are forming partnerships with member-driven associations and organisations to ensure SMMEs benefit," he said. Khula had a ring-fenced risk sharing fund with FABCOS, which was awaiting ministerial approval before members could access it.

2.4 Director of Lending Products: Standard Bank – Sean Robertson

Standard Bank is South Africa's largest bank and is FABCOS financial partner. The bank's presentation started with a general overview of the state of the economy, observing that:

- The current depressed market conditions were expected to last for a while, resulting in most financial decisions for enterprise support – both small and large - being put on hold;
- The slump would last between 3 to 5 years before the economy returned to normal levels. However this would not dissuade the bank from lending to enterprises that demonstrated the ability to service their loans over the agreed period;
- Due to the slowdown in consumer spending, corresponding slowdown in business activity would continue, resulting in limited growth prospects for existing enterprises;
- The rate of new business formation would potentially result in a high business failure rate;
- Insolvencies (both voluntary and forced) would likely increase;
- The high levels of retrenchments could lead to retrenched re-entering the economy as new business owners or as members of co-operatives;

- When the economy went through a period of distress there was a slowdown in credit extension as people cut back on financial commitments. As a result, credit demand had been significantly curtailed due to many businesses opting to put investment decisions on hold.

The second part of the Standard Bank presentation examined the approach the bank followed when it assessed the risk profile of a borrower with a view to arrive at a mutually beneficial decision. This was done by addressing questions such as:

- How stable was the business?
- What could be done to improve the business?
- How diversified was the business?
- How much volatility was in the sector in which the business operated?
- How much pricing power has the business?
- How much debt does the business have compared to assets?
- How strong was its cash flow position?

The presentation concluded by examining the criteria used to assess lending risk. This included financial criteria, management skills of the entrepreneur, security provided by the borrower and the environment where the business operated. The bank pointed out that to assist with risk assessment it expected borrowers to share as much information as possible. Challenges faced by the bank included borrowers not using finance for business purposes and entrepreneurs not committing themselves fully to their enterprise. Once credit had been granted, managing the relationship with the bank played an important role in facilitating future access to credit facilities. The borrower who fell into distress needed to engage the bank to work through the difficulties and find alternative solutions. The sooner the borrower communicated their difficulties the more opportunity the lender had to help find alternative solutions. This would be achieved when borrowers were transparent and openly shared information with lenders. The bank was willing to act as a partner at all times.

2.5 Chief Operations Officer: FABCOS - Alan Campbell

FABCOS is a member-driven business chamber and an SMME growth pioneer. FABCOS is committed to ensuring the retention of money within the townships and rural areas and is looking for better and innovative ways of dealing with challenges faced by entrepreneurs. One of these is ensuring availability of finance to struggling enterprises without red tape. Addressing the seminar, FABCOS chief operating officer, Alan Campbell said to enable easier access to finance for members; the



organisation had formed a relationship with Standard Bank, through which lending risk was shared. He said FABCOS was in a better position and capable of absorbing the risk because those receiving finance were longstanding members whom the organisation, unlike the bank, knew very well.

“FABCOS is better placed to assess business risk as it operates a number of its own businesses and has, at some point, encountered some of the challenges encountered by its members in accessing resources to run their businesses successfully,” Campbell said. From the seminar, he hoped FABCOS would come up with sustainable and creative ways of dealing with the problems through discussions with relevant stakeholders.

Campbell said the organisation subscribed to a business concept called doing business at the ‘base of the pyramid’, or BOP. “When looking at a pyramid, the base is large and the apex is small. This reflects the structure of the economy in South Africa where the bulks of the people are the poor and are at the base of the pyramid.” He said big business generally believed that there was no money to be made at the bottom of the pyramid which was not correct as the bulk of the consumption was at the base. “All one needs to do is walk the streets and see who is the bulk buyer of clothing, footwear, food and alcohol products and services. It is people from outside of the main towns and cities. These consumers are from the rural and township areas. FABCOS believes there is need for a strong relationship between itself, big business, and those that trade within those communities. Therefore there is a lot of business that big business can do at the base of the pyramid with FABCOS as a strategic partner.”

Campbell emphasised that FABCOS was both a business chamber and an operator of businesses. He said the purpose of this was dual. On the one hand, FABCOS needed to continue running as an organisation where 20% of funding was derived from membership fees which were needed to run its operations, while on the other hand it would continue running its business under the umbrella of FABCOS Enterprises. These provide the bulk of its funding.

In conclusion, he said FABCOS Enterprises was committed to addressing members concerns and would continuously look at ways and means to lessen the burden that SMMEs faced in their quest to be part of the formal economy, trade with confidence and actually be regarded as serious participants in the economy. “Big business is an important partner and it is through cooperative business that the economy will grow.”

2.6 FABCOS President - Mxolisi Zwane

“For FABCOS, business activity is not employment, it is an occupation” – Mxolisi Zwane, President, FABCOS

FABCOS president, Mxolisi Zwane said FABCOS was engaging various stakeholders to tackle issues confronting its members and small entrepreneurs, in particular those deterred from business by the previous government. He said to achieve the foundation’s aims of developing solid business people with a passion to start and operate their own businesses, there was a need for training and finance. “Financial institutions and government need to look at ways to increase their investment in the development of communities if the country is to see the economic and social development needed to make South Africa continue to be regarded as an African superpower.”

Zwane said it was a misnomer that black people were unable to run businesses when past legislation had prevented them from effectively running their own enterprises. “Now there is legislation that promotes the participation of black people to run their own businesses. However if this is not accompanied by the requisite support then South Africa will fail to build the entrepreneurial spirit of its people. It is imperative that we create a value system where people are more proud of being entrepreneurs rather than being employed.”

He said FABCOS believed that the South African economy would only grow when a critical mass of entrepreneurs was developed and afforded the necessary support to run successful enterprises. This would best be achieved through the extension of finance, training and access to markets. “In all recorded history, there are successes in countries where governments have focused on business development and poverty alleviation on a massive scale like in China and India. These governments help their people through training and promoting business ownership so that the people can do it for themselves.” Zwane said while new governments changed all the time, it was important that strong policies and the correct institutional framework outlived politicians and created generations of entrepreneurs, who would help drive economic growth and social stability.

3. SUMMARY OF ISSUES RAISED DURING THE QUESTION AND ANSWER SESSION

Presenters at the seminar made a strong case for the development of the SMME sector, underscoring the pivotal role finance played in ensuring the growth of entrepreneurs. Of equal

importance was the discussion and debate that arose during the 'question and answer' session that followed formal presentations. This section provides a comprehensive summary of the comments, views and questions from delegates, including responses from the speakers.

- ⊕ The three spheres of government are fragmented and do not co-operate with one another, resulting in limited benefits for small businesses. It is therefore important for all stakeholders to explore ways and means in which cooperation can increase, particularly the role of business chambers in developing policies that have a direct impact on the success of SMMEs.
- ⊕ Lending institutions receive funds from government but the money often does not filter down to those it is meant for. There is an information and resource flow gap that needs correcting.
- ⊕ Entrepreneurs are often subjected to long-winded bureaucratic processes when dealing with support institutions and lenders, which sometimes caused them to give up seeking assistance.
- ⊕ There is a need to support institutions that work with bodies that are closer to SMMEs, who understand SMMEs better. This is one of the reasons that Khula works with FABCOS because of the latter's membership base and its understanding of the sector. This makes it easier to improve communication with and provide support to SMMEs.
- ⊕ Ithala has previously experienced capacity challenges in delivering support to SMMEs. Until four years ago, the institution was operating on a relatively smaller scale. When it started receiving government funds to support government-contracted entrepreneurs, its delivery capacity could not support the demand, resulting in frustrations due to delays in processing applications.
- ⊕ Ithala has developed a strategy to improve turnaround time. The most complex application, where business evaluation is required, should not take more than two months and applications for bridging finance should take no more than two weeks. However, human resource shortages still hamper progress. For example, there is no capacity to train co-operatives and there is a limited number of business centres. Training partnerships with colleges are being sought to assist with capacity building while plans to increase the number of outlets are being reviewed.
- ⊕ Offering finance without business support does not sufficiently address the challenges faced by SMMEs and lending institutions have added a business support component to their offering.
- ⊕ FABCOS' approach to agriculture and rural development efforts is fully integrated in order to help develop small black farmers so they farm profitably, thereby addressing food security concerns.

- FABCOS is also helping its members to compete with larger operations entering the townships by, among others, upgrading the aesthetical appeal of its members' businesses and buying in bulk at discounted prices and delivering to members, who benefit from competitive prices. FABCOS is also introducing franchises such as dairies and butcheries for members countrywide.

4. POST-SEMINAR INITIATIVE BY FABCOS

In response to some of the issues raised at the seminar, FABCOS is assessing the possibility of developing a training programme that would equip SMMEs with capacity to improve access to finance. The programme is expected to cover, among others, the following topics:

1. Overview of small business finance products and concerns in lending to small businesses
2. How lenders assess client credit worthiness, carry out credit scoring and risk mitigation
3. How to maintain a positive business credit profile and dealing with credit bureaus
4. Elements of a successful small business loan application
5. Managing the post-loan relationship with the lender.

5. CONCLUSION

An increasing number of South Africans have taken to entrepreneurship in growing numbers. This groundswell has not been accompanied by requisite policies, programmes and facilities. These are needed to provide support that will ensure profitable and sustainable small to medium enterprises. In addition to challenges around accessing finance, training and market access are also a stumbling block for SMME development. Government and the private sector are encouraged to work closely with organisations such as FABCOS to ensure seamless communication and responsiveness to stated needs to increase opportunities. To that end, FABCOS is inviting financial institutions to work with small businesses to help unshackle their growth potential. Similarly an invitation is extended to all levels of government to make a positive contribution through deliberate and meaningful policies and structures that help support small business. A framework where all stakeholders work together will ensure sustainable solutions to the challenge SMMEs face in accessing finance so that a strong foundation can be laid for successive generations of entrepreneurs.

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