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FINANCIAL SECTOR PROGRAM

ANNUAL WORK PLAN PERFORMANCE REPORT
OCTOBER 1, 2008 – SEPTEMBER 30, 2009

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ACRONYMS

BA	Banking Association
BDS	Business Development Services
BDSP	Business Development Services Provider
BEE	Black Economic Empowerment
BPR	Business Process Reengineering
BSO	Business Services Organization
BUSA	Business Unity South Africa
CCRD	Consumer and Corporate Regulation Division of dti
CIPRO	Companies and Intellectual Property Registration Office
CRB	Credit Review Board (of the Development Credit Authority)
DCA	Development Credit Authority
DCA ODC	Development Credit Authority Office of Development Credit
dti	Department of Trade and Industry
EDC	Enterprise Development Centre of ABSA bank
FABCOS	Foundation for African Business and Consumer Services
FI	Financial Intermediary
fBDS	Financial Business Development Services
FSP	Financial Sector Program
GSA	Government of South Africa
IBA	Institute of Business Advisors
IDF	Identity Development Fund
IFC	International Finance Corporation
JEF	Johannesburg Equity Fund
KM	Knowledge Management
LOI	Letter of Intent
NCA	National Credit Act
NCR	National Credit Regulator
NRCA	National Register of Credit Agreements
NSBC	National Small Business Chamber
OCIPE	Office of Companies and Intellectual Property Enforcement
OMM	Old Mutual Masisizane
POF	Purchase Order Financing
RIA	Regulatory Impact Assessment
SAIBL	USAID South African International Business Linkages project
SAICA	South African Institute of Chartered Accountants
SAIPA	South African Institute of Professional Accountants
SEDA	Small Enterprise Development Agency
SME	Small Medium Enterprise
SOW	Scope of Work
SPV	Special Purpose Vehicle
TIGF	Thembani International Guarantee Fund
USAID	United States Agency for International Development
USG	United States Government

EXECUTIVE SUMMARY

The Financial Sector Program (FSP) seeks to expand access to financial services and lower financing cost for small and medium enterprises (SMEs) through reforming the legal and regulatory framework affecting the financial sector and business environment and improving the commercial viability of lending to primarily BEE SME[1]s in South Africa, thereby expanding their access to a range of high quality and affordable financial services. This 30 month base contract was awarded to the Chemonics consortium on May 22, 2008 with a possible extension option through May 2013.

This annual work plan performance report covers the period of October 1, 2008 through September 30, 2009 and summarizes the activities undertaken to support the four project components – SME finance, financial business development services (BDS), policy reform and knowledge management. The performance management summary for this first year is presented in Annex A.

Diverse program activities addressing the supply of, demand for and enabling environment for SME finance and business growth helped FSP successfully promote a number changes in the broad SME credit landscape during its first full year of program operations. Through partnerships with a variety of financial intermediaries (FIs), FSP supported the launch of four new loan products, two being offered through a bank that is cautiously entering the SME credit market with guidance from FSP. Moving away from a traditional development focus of targeting only the most prominent banks, FSP identified a fertile group of six nascent SME lenders who in the first year, exceeded FSP's Special Purpose Vehicle (SPV) loan volume targets by 916%. These FIs are nimble private funds eager to penetrate the relatively untapped BEE SME credit market but who require technical assistance to properly position themselves with appropriate products, streamlined processes as well as develop a cadre of technically adept credit professionals. To that end, FSP trained 37 loan professionals through four workshops presenting methodologies for SME due diligence, valuation techniques, problem loan management, new product processes as well as unveiling a new overall strategy in loan process management. Of particular note is that these funds are willing to focus their credit assessment on business viability as opposed to traditional collateral and guarantee requirements generally used by other more conservative lenders. To entice the latter more traditional group to expand their risk profile for SME credit provision, FSP generated significant interest in Development Credit Authority (DCA) guarantee possibilities, receiving four concept notes during the year. One Portfolio Loan Guarantee closed for generic SME loans, which over ten years is expected to generate approximately 500 loans, totaling $20 million with 60% of borrowers being SMEs considered BEE eligible

FSP had originally envisaged that a national framework for the accreditation or grading of business development services professionals was the right approach to improve the quality of services provision to help make SMEs more bankable. However, first year investigations invalidated many of the original assumptions and led to a shift in approach. FSP decided instead to find a private sector market leader with a demonstrated track record of successful BDS provision to serve a wide market of Business Development Services Providers (BDSPs)

[1] For the purposes of this report, BEE SMEs are those SMEs who were previously known as "historically disadvantaged" and can qualify under the South African Government's Black Economic Empowerment (BEE) strategy BEE refers to the economic empowerment of historically disadvantaged persons/businesses defined as all black people (Indians, Africans, Coloureds and Chinese) including women, youth, and people with disabilities and people living in rural areas. A BEE SME is a company y that is more than 25% owned by black people.

working with SMEs to ensure the quality of services delivery via a grading program. FSP identified a SME incubator, as a fitting partner to establish standards by which BDS providers can be measured and design a program by which BDSPs will be better positioned to offer improved services to SMEs. Additionally, FSP stimulated dialogue and undertook activities to develop a FI and BSO "link" as a way of developing a conduit for bankable SMEs for credit providers while enabling the BDS provider to understand FI requirements and tailor their BDS to meet the needs of both the FI and SME. To examine and convey effective practices on BDS provision in support to access to finance, FSP conducted a study reviewing impacts on FIs engaging in the delivery and/or promotion of financial BDS as it relates to SME. As a precursor to designing capacity building efforts for Business Service Organizations (BSOs), FSP began to identify what predominant hurdles SME lenders cite as impediments to approving SME loan applications. Additionally, FSP undertook a SME financial literacy gap assessment to determine what, if any, programs are in the market to support SMEs financial literacy needs. Identifying a deficiency, FSP designed an intervention to promote SME knowledge based financial literacy at the BSO level so BDSPs will be better positioned to help SMEs understand financial concepts and opportunities.

Significant strides were made in the improvements to the legal and regulatory framework affecting the financial sector and business environment stimulating SME growth. FSP worked with the Department of Trade and Industry (dti) to support the initial phases of the drafting of the Companies Act Regulations. To ensure that the Regulations are drafted in a democratic and highly participatory manner, FSP and the dti promoted a public-private dialogue wherein over 50 stakeholder points of view were voiced to be captured in the Regulations ensuring transparency and, full stakeholder participation. This massive task will continue next year and will fundamentally reform all aspects of corporate law and will result in the new Companies Act and Regulations coming into force mid 2010. As a complementary activity, FSP collaborated with the dti to draft and secure approval for the business case for the newly created Companies and Intellectual Property Commission established under the new Companies Act. As designed, it will smooth the progress of all registered companies interaction with the government. Special attention was given to small clients so as to encourage SMEs to transition to formality, expand their business, become better informed and subsequently more bankable. As a complementary activity, FSP also worked with the National Credit Regulator (NCR) to undertaken a multi-phased business process reengineering activity that resulted in materials improvements to the NCR Registrations Department.

FSP also supported the development of the business case for the development of the National Register of Credit Agreements (NRCA). This work has resulted in the NCR submitting to the dti a detailed proposal for the establishment and operation of the NCRA together with drafts of the legislative and regulatory changes required for Government consideration and submission to Parliament. FSP also undertook the evolutionary stages of development for several other key longer term policy initiatives including work with National Treasury to develop Regulatory Impact Assessment guidelines and standards, support the development of an Estate and Mortgage Broker and Agent policy reform and Bill and sponsored the South African delegation at the March OECD Round Table organized to recommend policy measures to assist SMEs to overcome the current credit crunch. Upon their return, the delegates led an internal dti workshop to discuss and inform the key government policy approaches to the crisis.

SECTION I: BACKGROUND

The Financial Sector Program is a 30 month USAID Southern Africa program awarded to the Chemonics consortium[2] on May 22, 2008 with a potential 30 month extension option though May 2013. The program was designed to contribute to the U.S. Government's Economic Growth Objective in South Africa. FSP is one of three main vehicles to promote vibrant growth of BEE SMEs and reduce unemployment and poverty — generating rapid, sustained and broad-based economic growth in South Africa.

The FSP team began to mobilize and engage in start-up and research activities in June of 2008 setting the stage for the first annual work plan development. This performance report summarizes the implementation of the activities presented in the first annual work plan for the period October 1, 2008 through September 30, 2009.

South Africa is Africa's largest economy, with strong financial, legal, energy, communications, and manufacturing sectors, abundant natural resources, and a thriving tourism industry. Yet underneath South Africa's developed economy lies a "second economy," comprised mostly of poor, historically-disadvantaged communities. A legacy of Apartheid, this second economy can be seen in the townships and outskirts of South Africa's cities and in rural areas where large numbers of the population live in shacks with little to no access to electricity, transport, or modern water or sewage systems.

FSP actively engages in activities which will help to integrate this second economy of BEE eligible enterprises into South Africa's larger economy and specifically assist SMEs fulfill their critical roles as drivers of the economy.

To that end, FSP employs a demand driven, results oriented four-pronged approach to increase SME access to a range of quality, affordable financial services to facilitate business growth and catalyze increased employment and incomes. The results of FSP activities are targeted to:

1) Improve financial intermediaries' capacity to serve SMEs in South Africa
2) Improve the "bankability" of SMEs
3) Reform the legal and regulatory framework affecting the financial sector and business environment stimulating SME growth
4) Strengthen the SME finance knowledge management system.

FSP has been designed to support the achievement of the U.S. Government Economic Growth Objective in South Africa. This program is contributing to the objective to help improve SME access to a range of quality, affordable financial services. Within the Economic Growth objective, FSP helps to mitigate market credit risk increasing SME access to a range of financial services (see Exhibit 1, Results Framework).

The results from each level of the framework support the achievement of the results on the level above – culminating in achieving the Mission Economic Growth objective of increased access to finance by SMEs. For each of the four Project Intermediate Results (PIRs), FSP has elaborated Key Result Areas (KRAs) that are representative of the overall strategies for

[2] The consortium members are as follows: Prime: Chemonics International Inc; Subcontractors: Crimson Capital, Shorebank Advisory Services, Khulisa Management Services.

achieving the intermediate results. These KRAs guided project staff in its year one activity planning and provided the basic structure for performance monitoring, evaluation and reporting. Each KRA has a technical leader, a set of activities, associated tasks, defined resources, and benchmarks. Each PIR and KRA year one activities are summarized in the technical sections to follow and identify the status of the annual benchmarks established.

The overall summary of the Performance Management Plan achievements are included as Annex A.

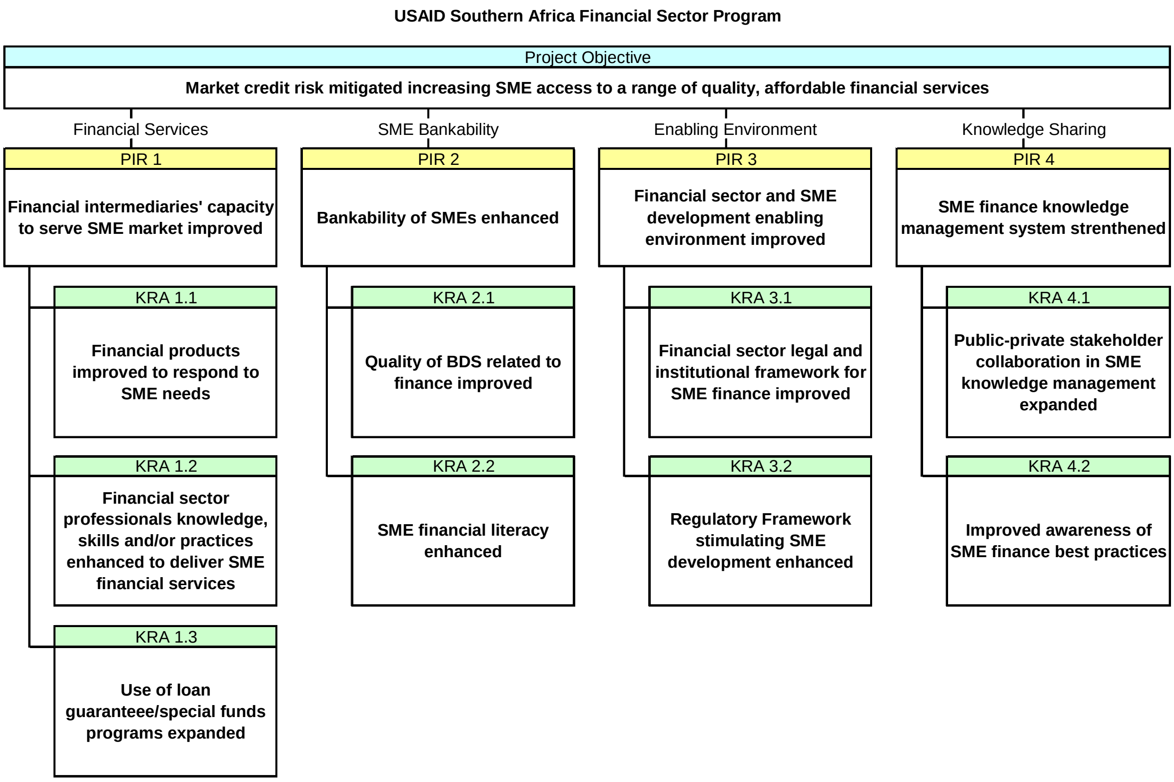

Exhibit 1: Results Framework

SECTION II: ACCOMPLISHMENTS BY TECHNICAL COMPONENT

A. PIR 1: Financial Intermediaries' Capacity to Serve SME Market Improved

The primary goal of this PIR is to improve the capacity of South African Financial Intermediaries to provide financial services to SMEs in an efficient, innovative and cost effective manner in response to market needs.

Research conducted at the outset of the Project indicated that South African financial intermediaries have addressed the needs of large corporate businesses and micro-enterprises adequately, but that there is a significant gap in meeting the financing needs of SMEs, particularly those considered historically disadvantaged enterprises, known as BEE enterprises under the government's Black Economic Empowerment strategy. On the supply side, the problem has been an overly conservative approach on the part of the country's big four[3] banks, and simply employing an inappropriate approach, i.e. treating SMEs as if they were large corporates or as consumers. In general this means that the big banks expect SMEs to have the same level of sophistication that large corporates have when it comes to providing financial information and knowing what kind of financing is needed while depending almost entirely on collateral. Of course, the level of sophistication is not the same, which means that SMEs predictably do not qualify when applying for loans. The banks need to dig deeper with SMEs to tease out sufficient information, but they are either unwilling or do not have the capacity to do so. On the demand side, the main problem is that SMEs tend to have poorly prepared loan applications, limited credit history, insufficient financial information and a poor standard of financial literacy which limits their abilities to properly complete a loan application.

During the first year, FSP attempted to engage the big four banks as partners, but with the exception of ABSA, found them disinclined to try new approaches to SME finance. Instead, FSP established working relationships mainly with medium sized and small banks, such as WIZZIT and Sasfin Bank, and a significant number of private funds, all of which are not only committed to SME finance but undertake a more liberal approach to creditworthiness assessments expanding the opportunities for SMEs to access credit.

The nascent stage of the private fund partners provides an opportunity to help them deeply penetrate the BEE SME market armed with the right tools and approaches. FSP's fund partners have a common philosophy in that they are willing to evaluate loan applications primarily from the standpoint of SME viability. Collateral and owner contribution to project cost, unlike traditional banks, are of secondary consideration. Given this approach, which will broaden the scope of SMEs eligible for finance, FSP concentrated capacity building efforts on the funds and intends to continue to work with them to improve their lending techniques, product line and human resource base. While the funds may not reach huge numbers of SMEs given their early stage of development and small staff, they will certainly pave the way for credible SMEs to utilize credit to expand their businesses and hopefully, through demonstration, lead the market into lending to these emerging BEE SMEs.

A summary of the FSP private fund partners, also known as Special Private Vehicle (SPV), is provided below:

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[3] Having a majority of the market share, Standard Bank, ABSA Bank, Nedbank and FNB are commonly referred to as "the big four" banks in South Africa.

Fund Name	Owner and/or Investors	Capital (R millions)	Focus	Estimated Avg. Size Loan or Investment	Start up Date
Old Mutual Masisizane	Old Mutual Group	400	Loans to Peri-urban & rural black women owned SMEs	R 1 million	May 2007
PPC Ntsika	Pretoria Portland Cement	70	Equity & loans to Black owned SMEs	R 8 million	Oct. 2007
Barloworld Siyakhula	Barloworld Group	40	Equity & loans to Black owned SMEs	R 4 million	Oct. 2007
Grofin	Management, IFC, Norfund, FMO, Shell, AfDB, others	\$ 170 million[4]	Viable SMEs	R 5 million	January 2004
Identity Development Fund	Khula	75	Equity Investments in Peri-urban & rural black women owned SMEs	R 5 million	August 2009
Thembani Int'l G'tee Fund	Shared Interest & Recherches et Applications du Financement Alternatif au Developpement	\$20 million	G'tees loans to MFIs and rural community agricultural enterprises	R 2.5 million	1996

Since project inception, FSP has established partnerships with ten FIs. Activities have included product development and refinement; streamlining of finance approval processes and procedures; and capacity building (training). Additionally, a significant amount of time was devoted to the development of several USAID DCA guarantee facilities. The details on these activities and their results are given below.

KRA: 1.1 Financial Products Improved to Respond to SME Needs

Activities:

KRA 1.1.1 Disseminate information on SME finance gap analysis. In an attempt to identify the opportunities to promote SME credit in the traditionally conservative South African lending market, FSP undertook a qualitative and quantitative survey to collect and analyze a broad range of detailed information on the financing needs of BEE SMEs. This study allowed FSP to better understand, in part, the perceived and real financing gaps in the market place.

A key finding of the qualitative research indicated that only a tiny proportion, 2% of the BEE SME owners in the focus groups, have ever accessed external financing. The primary reasons for this lack of access to finance was shown to include inappropriate approaches on the part of South Africa's banks when it comes to SME lending, along with inaccessibility of finance and high fees. On the SME side, lack of knowledge about where and how to apply for financing and BDS, poor financial literacy and inadequately prepared finance applications were the main obstacles. The supply side concerns led FSP to focus its attention on FIs who are willing to utilize better approaches to SME finance, primarily the second tier banks and the private funds. The activities undertaken to improve the inadequacies on the SME side are addressed under PIR 2.

[4] This is the amount of Grofin's latest fund, The Grofin Africa Fund

Benchmark 1.1.1	Actual
Workshop for dissemination of SME study held	Achieved

The survey findings were communicated on an informal basis to FSP's FI and other partners during the year as a basis for generating interest in expanding SME credit and identifying opportunities within the market segment. Additionally, at the BEE Awareness campaign working group in November 2008, FSP presented the results of the SME finance gap study which identified a lack of understanding on BEE benefits and opportunities for BEE.

KRA 1.1.2: Introduce new products via deposit mining. Shortly after the FSP Project began, WIZZIT, an innovative bank focusing on "banking the unbanked", decided to commence enterprise lending. To that end, FSP helped to identify possible clients via "Deposit Mining".

Deposit mining is a technique used to pre-qualify potential borrowers by evaluating a bank's existing deposit client base. This is a prudent way to initiate a commercial lending program, as the likelihood is high that clients who run high amounts through their accounts and handle them appropriately are more likely to be creditworthy and handle their loans properly.

WIZZIT pilots new SME products

As existing deposit clients are a good source of potential loan clients, with FSP's guidance, Wizzit "mined" its deposit client database in an effort to discover potential loan clients; over 500 "pre-qualified" loan prospects were identified.

FSP subsequently helped Wizzit develop two simple loan products suitable for its initial foray into commercial lending: a short term loan for working capital and an investment term loan as well as developed a policy and procedure manual.

Additional FSP support was extended to WIZZIT to start the deposit mined client calling program and further develop the SME loan process. Three loans were approved for SMEs during this consultancy in July with 17 additional loans approved before the end of the fiscal year.

FSP consultant Paul Wild and WIZZIT deposit mined client, Tom Molere (on left), owner of *"Uncle Tom", a general store.*

WIZZIT carried out the data mining exercise early in the fiscal year. Applying specific account and behavior parameters (such as account volume, minimum time account has been opened, lack of overdrafts), over 500 potential loan clients were identified. In recognition of the good potential for SME loans based on the deposit mining data, FSP fielded an international SME banking consultant in December 2008 to help WIZZIT establish appropriate loan products as well as draft policies and procedures and train loan staff (see KRA 1.1.4). The subsequent step to call on the pre-qualified loan clients was significantly delayed given WIZZIT's cautious approach to enter into SME credit in light of the economic recession as well as having a shortage of qualified staff to launch the initiative.

Benchmark 1.1.2	Actual
Deposit mining launched in one FI	Achieved

To help initiate the calling process, FSP fielded an SME lending expert in July 2009 to help WIZZIT recruit enterprise loan officers internally and further refined the enterprise lending process. Under the consultant's tutelage, WIZZIT called on 17 of the top deposit mined clients. Three loans totaling ZAR 50,000 were subsequently approved thereby officially launching the WIZZIT SME credit program.

Beginning in November 2009, IFC, a minority shareholder in WIZZIT, intends to provide technical assistance to help WIZZIT expand mobile phone banking in South Africa and other African countries as well as support the expansion of its SME lending process launched with FSP. IFC's assistance is expected to focus on the ICT aspects of SME lending. FSP ongoing support will complement this assistance and work to help WIZZIT implement the recommendations presented at the conclusion of the July 2009 Client Calling consultancy.

KRA 1.1.3: Refine loan products supported by DCA. New product development is ideally suited to augment the additionality of a DCA guarantee facility. During the year, FSP developed three different Action Packages for DCA facilities, of which two were approved by the Credit Review Board (see KRA 1.3.1). Negotiations around the DCA legal agreements took longer than expected and the closing documents were signed for Blue Financial Services' (Blue) Loan Portfolio Guarantee facility in August 2009. Subsequent discussion with Blue identified an opportunity to assist them develop a new construction loan product aimed at SME contractors. A construction lending expert will be fielded early in fiscal 2010 to review the feasibility of and subsequent design of a loan product to be supported by the DCA guarantee.

Benchmark 1.1.3	Actual
3 new loan products identified/designed with DCA FIs	Construction loan product was identified as an opportunity under the Blue DCA

As additional guarantees are finalized, FSP will work with other partners to examine new innovative loan product prospects to maximize opportunities presented by the DCA guarantee.

KRA 1.1.4 Introduce or refine financing products for FIs/private funds. Diversifying the types of financing products available helps increase access to finance as greater product variety provides SMEs the opportunity to identify and secure credit that is appropriate to their needs. During the fiscal year, FSP developed two new loan products for WIZZIT bank and did an assessment of and refined two pending SME products within ABSA bank.

Benchmark 1.1.4	Actual
1 new or refined loan product developed and piloted	Exceeded: 4 new loan products developed/piloted

Paramount in the design of the WIZZIT SME credit pilot program was the development of appropriate and relatively simple loan products for their target market, namely, small enterprises with an annual turnover between ZAR 200,000 -500,000. An FSP international banking consultant worked with WIZZIT to develop both a traditional term loan of up to three years for financing equipment purchases as well as an amortizing working capital loan of up to six months. Based partly on WIZZIT's consumer credit manuals, SME loan policy and procedure manuals were also drafted to ensure proper loan management and approval systems.

Since the pilot in July, WIZZIT has approved 20 SME loans totaling ZAR 86,400. The loans provided for a number of longer term business enhancements for WIZZIT clients. One client was able to fix the roof of their business premises. Another was able to purchase of a freezer. Yet another loan provided for traditional working capital needs for a business that sells and repairs food processing appliances and who needed to bridge the difference between payment terms on parts and collections from customers. WIZZIT is committed to expanding the SME lending operations and FSP is well positioned to continue to offer technical assistance in this regard.

In May 2009, FSP identified another opportunity for new product development and fielded an international trade finance consultant to assist ABSA Bank review its two new SME loan products, vendor financing (aka invoice financing) and purchase order financing (POF). ABSA had spent several months designing these products, but given their complexity and relatively high risk, they requested FSP to review and vet the proposed structure, approach and recommend enhancements. FSP assessed the product design and suggested refinements to streamline processes and mitigate inherent risks. In light of FSP recommendations, ABSA delayed its pilot launch from June until August in order to assimilate the considerations presented. The first POF loan was made in September 2009 in the amount of ZAR 1.6 million to an SME in the tourism sector. ABSA projects that by the end of 2010 it will make 200 such loans in various sectors.

To ensure a proper evaluation of the pilot phase of this launch, FSP will collaborate with ABSA to review these products in February 2010.

KRA: 1.2 Financial Sector Professional's knowledge, skills and/or practices enhanced to deliver SME financial services

Activities:

KRA 1.2.1 Expand the use of credit scoring. Credit Scoring is a good way to "mass produce" small SME loans. This approach uses a predetermined set of weighted criteria (e.g. certain financial ratios, applicant's previous loan repayment record, length of time borrower has been in business, borrower's character, etc.), against which each loan application is scored. Applications that score above a certain minimum level are approved. Utilizing this approach lends consistency and accelerates the approval process for small, uncomplicated, “vanilla” type loans for lenders with established approval practices and mature lending teams. While FSP had intended to introduce or refine credit scoring to its FI partners during Year 1, several unexpected limitations were identified forcing a delay.

Benchmark 1.2.1	Actual
2 credit scoring models developed/enhanced	Activity postponed
Credit scoring pilot launched	Activity postponed

As high volume lenders, all of South Africa’s big four banks use some form of credit scoring for smaller SME loans, but only ABSA expressed an interest in receiving assistance from FSP in this area. This request however was postponed as ABSA was pursuing other SME support activities deemed more critical.

Further, credit scoring was determined to be an inappropriate approach for many of FSPs partner institutions for a number of reasons. Sasfin Bank, as well as the private funds, provide loans that are relatively large and they emphasize the viability of SMEs in making their loan decisions, requiring that the assessment be more hands on, i.e. each loan proposal is analyzed independently and more thoroughly. In addition to this, these partners tend to tailor the credit provision for each borrower, often coupling it with BDS provision. As such, the loans are not simple “vanilla” type loans and thus not suitable to a credit scoring model.

FSP engaged in extensive discussions with WIZZIT for developing a credit scoring model given its intention to make high volume, small, simple SME loans. However, as its expansion into enterprise lending has been gradual and the development of an experienced leaning team slow to form, this activity has been postponed.

Blue Financial Services (a DCA beneficiary see KRA 1.3.1) may be a good candidate for a credit scoring review in the near future. Even though SME viability is Blue’s primary focus in evaluating a loan application, it does employ a simple credit scoring approach for its relatively simple and small loans. As credit provided under the DCA guarantee is expected to dramatically increase the loan volume, Blue has indicated that at some point it is interested in having FSP review its credit scoring system.

KRA 1.2.2: Provide capacity building for FIs/private funds staff. Capacity building of FI staff is a crucial step towards improving SME access to finance. Once lenders better understand how to approach and evaluate an SME credit application, the loan decision is more likely to be positive and the loan to be appropriately structured.

In the case of the big four banks, FSP suggested capacity building activities which would modify their mindset and demonstrate how SMEs need to be analyzed in a way different from large corporate, consumers or micro-enterprises. Again, however, FSP found that only ABSA recognized that its staff could benefit from such capacity building exercises but were not in a position to undertake the exercise at the time.

In carrying out a detailed training needs assessments of its private fund partners, FSP found that they were ripe for capacity building, as most of their staff are new to the SME lending space and need substantial, basic credit training. In addition they recognize their need for and ultimate benefit of capacity building. This was also true for WIZZIT as it was just embarking upon their SME credit launch with FSP support.

Benchmark 1.2.2	Actual
4 FI/private fund training needs assessment conducted	Exceeded: Training needs assessments of 6 private funds conducted.

Following the training needs assessments and subsequent requests from private fund partners, in March 2009, FSP carried out an interactive SME Due Diligence and Valuation Training program. This workshop was attended by 11 employees of six private fund partners[5] whose specialty is to provide investment financing for BEE SMEs, particularly those in rural areas. Two main modules were presented: comprehensive due diligence for long term loan applications and small company valuation in connection with equity investment financing.

The course evaluations indicated that all of the trainees either “strongly agreed” or “agreed” that the content of the program was appropriate and that they would use the material learned in their work and that the course met their expectations. 100% of the participants passed the “final exam” indicating an understanding and absorption of the concepts presented. Furthermore, participants formed an informal networking group that meets to exchange ideas and concepts of their work and expressed a strong desire for additional follow-up training programs.

Given the global financial crisis, FSP recognized the likelihood that South Africa’s recession would undoubtedly result in an increase in problem loans and delinquencies. To help its partner be better prepared to weather the financial crisis, FSP carried out SME Problem Loan Management Training program in August 2009 for 11 participants from 8 partner institutions.[6]

The first two case study based modules were delivered by an international banking expert who presented ways to structure a loan to reduce the chances of its becoming a problem loan as well as how to recognize “red flags” when monitoring loans. A South African collections specialist presented the collection and foreclosure processes for loans that cannot be rehabilitated as it relates to South African law and common collection practices. Finally a panel discussion led by local banking experts related actual problem loan experiences and discussed lessons learned.

As with the SME Due Diligence training, the constant, enthusiastic participation of the trainees, the good test results, positive testimonials and feedback (as given in the forms completed at the end of the training) indicated that the training was a success and

[5] Grofin, Barloworld Siyakhula, Thembani International Guarantee Fund (TIGF), PPC Ntsika, Identity Development Fund (IDF) and Old Mutual Masisizane (OMM).
[6] Grofin, ABSA Bank, Sasfin Bank, IDF, PPC Ntsika, OMM, WIZZIT and Blue Financial Services.

appropriated targeted techniques they could use in their day to day work. Even the most experienced trainees reported that they had picked up new loan monitoring tips. FSP will continue to listen to partner capacity training needs for group workshops as well as identify opportunities to work with individual partners on their specific capacity building requests.

During this reporting period, one fund was particularly eager to undertake a review of its loan processes to guide and enhance its SME lending program targeted primarily at women owned enterprises. Old Mutual Masisizane (OMM) had only been in existence for about a year and being in a formative stage, was therefore a perfect candidate for this type of review. The General Manager and her staff had limited experience in finance and recognized that they needed to build their internal capacity for provision of investment financing to SMEs. Furthermore, OMM's target clients are relatively risky as many are newer businesses, located in rural areas, and although they may have very good business ideas, they are relatively inexperienced. At the same time OMM has considerable potential, as the financial resources available to it are much greater than any of FSP's other private fund partners. During May 2009 FSP assessed and recommended significant changes in OMM's loan process system. FSP evaluated the loan products and defined appropriate purposes, tenors (according to the purposes) and repayment terms for those loan products and also streamlined OMM's underwriting proposals, all of which was captured in a new Credit Policy and Procedure manual. The consultancy concluded with one day of capacity building for five of OMM's staff, covering the newly recommended staffing, organizational structure and loan approval process.

FSP Promotes SME Valuation Techniques

One of the capacity building workshops held during the year, assisted FSP fund partners to better understand how to evaluate an SME loan application and undertake a company feasibility analysis or due diligence.

Workshop topics included screening criteria and interviewing techniques. By employing screening criteria, SME lenders can quickly determine which finance applications they should not spend time on. Special interviewing techniques, such as structuring questions around the SME's asset conversion cycle, allow for the financier to focus on the key facets of a business, rather than spending time on less important aspects. Through this participative session, with role plays and case studies, FSP's partners were given the tools to become more efficient in processing finance applications.

Polo Radebe, CEO of IDF exchanges ideas with the other participants in the SME Due Diligence and Valuation workshop lead by FSP international banking consultant Leigh Knight (standing).

OMM intends to implement the consultant's recommendations following formal approval by their senior management. In the interim, OMM has adopted some of FSP's recommendations, such as increasing the frequency of OMM Credit Committee meetings and changing the format of its credit memoranda. These changes have led to a modest increase in the number of OMM loans approved per month.

As part of the development activities to launch WIZZIT's SME credit products, international banking consultant provided capacity building for seven WIZZIT staff covering the two newly developed loan products, loan policies and procedures (see KRA 1.1.2).

In summary, a total of 37 financial sector professionals were trained on international standards by FSP. A total of 35 private fund loans SPVs) amounting to ZAR 76.2 million were extended, well in excess of what had been expected. The volume of SPV loans made was more than ten times what FSP projected (see Exhibit 2; Private Fund Lending Activity).

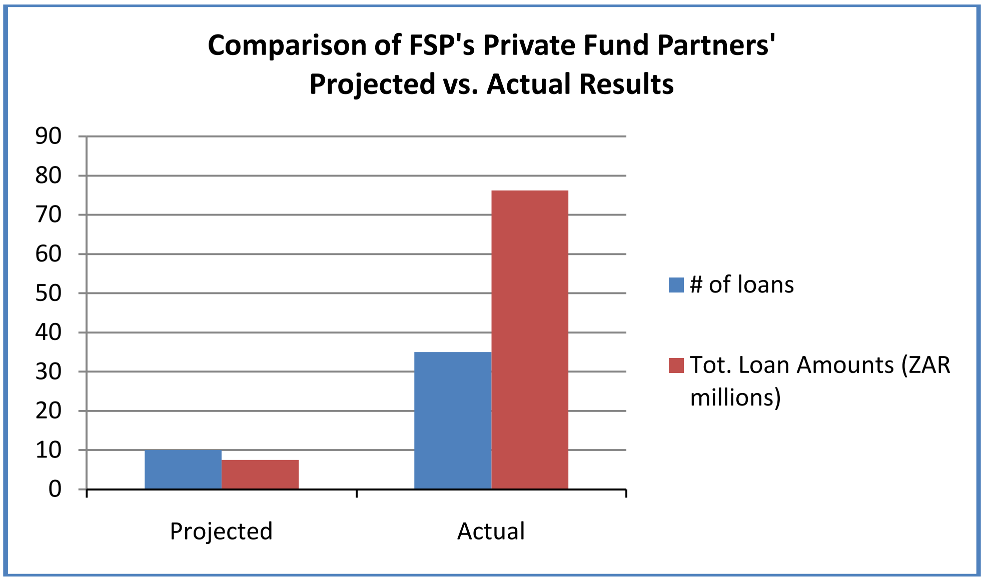


Exhibit 2: Private Fund Lending Activity

This dramatic uptake should not be surprising given the Funds' commitment to support higher risk primarily BEE SMEs, their willingness to focus, with FSP support, on SME viability as opposed to collateral and finally, their willingness to accept external technical assistance. Moreover, it is these same elements that make this group a perfect target for continued FSP support.

KRA: 1.3 Use of Loan Guarantee/Special Funds Programs Expanded

Activities:

KRA 1.3.1 Promote utilization of DCA. The main purpose of the USAID DCA Guarantee program is to try and address deficiencies in a credit market. The guarantee facilities are aimed at coaxing FIs to extend their lending risk profiles and try new credit approaches. The intention is that once they are comfortable with more liberal approaches and see the positive results, the beneficiary FIs will make the same kind of loans without the need for guarantees. With SA's big banks' approach to SME lending being very conservative, and smaller FI and private fund partners keen, though understandably cautious to try new approaches to SME credit, SA is fertile territory for DCA guarantees.

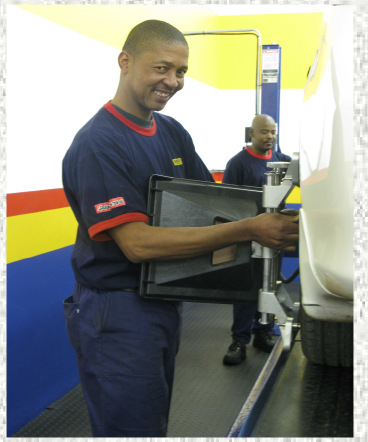
During the year FSP received and considered ten DCA facility inquiries. These led to four concept papers being drafted for Blue, Sasfin, True Group, and ABSA Bank. ABSA later decided not to pursue a DCA facility.[7] FSP prepared Action Packages from the other three concept papers, of which two were approved by USAID's Credit Review Board (CRB): a $5 million Loan Portfolio Guarantee (LPG) facility for Blue Financial Services and a $15 million Portable Guarantee for Sasfin Bank.

[7] However, ABSA recently informed FSP that the Bank now wishes to pursue development of a DCA LPG facility in FYE 09/30/2010.

Benchmark 1.3.1	Actual
3 DCA facilities applications submitted	Achieved

Blue Financial Services (Blue) was founded in 2001 and has grown into the largest micro-lender in Africa. Historically lending primarily to individuals and microenterprises, Blue began making relatively low risk SME loans in April 2008. As a complement to the credit facilities, Blue provides their clients embedded business development services requiring clients to use bookkeeping services and attend their "Simply Successful Management" course as a prerequisite for loan disbursement.

Blue's $5million LPG will allow it to extend its risk profile in making loans to SMEs, particularly BEE SMEs, thereby deepening access to finance. As this facility is expected to revolve twice during the ten year life of the guarantee, the maximum cumulative disbursement is the local currency equivalent of $20 million. It is projected that Blue will extend credit facilities to nearly 500 SMEs, of which 60% are expected to be black empowerment qualified SMEs. Blue commenced using its LPG during September 2009, placing eleven loans under the facility during the month for a total of ZAR 11 million in only two weeks.



This Speedy Tyre & Exhaust franchise in Pretoria is a SME borrowing client of Blue Financial Services. Blue, under the DCA, is targeting franchise operators along with other BEE SMEs for new loans.

Sasfin Holding Limited (Sasfin) is a specialist SME finance bank, with more than 50 years of experience, but does not have a retail deposit base and is thus dependent on funds raised in the capital markets to sustain its liquidity and growth. The $15 million DCA portable guarantee was approved to support the expansion of capital equipment, debtor, trade and other types of finance for SMEs. The guarantee would enable Sasfin to raise the local currency equivalent of $30 million in debt from private sector financial institutions, which would otherwise be unobtainable, especially in the current market conditions. In turn, Sasfin will provide capital equipment, debtor, trade finance, leasing and/or other facilities to SMEs in order to increase growth primarily in (but not limited to) manufacturing and production in the engineering, plastics, printing, construction and mining industries.

Even though the CRB approved FSP's Action Package for Sasfin, that bank has postponed signing the DCA Commitment Agreement pending review as to whether the guarantee is still needed for it to obtain additional funding. If carried out, this facility would allow Sasfin to greatly expand its capital equipment finance loan and lease portfolio, as well as roughly triple its proportion of loans to BEE SMEs from 10% to 30%.

True Group (TG) is a specialized SME long term lender and equity investor based in Western Cape Province. The Action Package for TG proposed $10 million Portable Guarantee was submitted to EGAT Washington, DC in May 2009. However, further work on the credit risk assessment needs to be carried out. It is expected that early in fiscal 2010 the CRB will consider this proposal, which is especially attractive because TG extends relatively longer term financing to high risk, mainly start-up or early stage expansion BEE SMEs. An added attraction to this facility would be the creation of a new, mezzanine finance, loan product.

At the end of the first year, two additional DCA concept papers were under development for Mettle Administrative Services (MAS) and Spartan Technology Rentals (Pty) Ltd (Spartan).

Established in 1990, MAS, a member of the Mettle Group, provides working capital finance mainly to "panel beaters" (vehicle body shops) by way of discounting invoices issued to various short-term Insurance companies and other corporates that self insure. Panel beaters are an essential and significantly underfunded service industry in the SA economy with a high concentration of BEE owners. In addition to supporting the guarantee facility, FSP envisions providing additional technical assistance to create a new loan product namely inventory (parts) financing. This product will broaden the SME finance product offering in the South African financial markets.

A 100% black owned business established in 1981, Spartan is a leasing company which specializes in the renting of IT equipment. Under its proposed DCA facility Spartan is aiming to greatly increase the proportion of SMEs (as opposed to large corporates) in its IT lease portfolio, which will address a huge void in the market as FSP research indicates that while over 90% of SMEs have cell phones, less than 20% have computers. It also aims to focus its efforts on SMEs in some of USAID's priority sectors, including automotive and agri-business.

Establishing a strategy for future DCA beneficiary partner selection coupled with ongoing promotion of new products, FSP will lay the foundation for broader reaching, more appropriate, affordable credit products for SMEs in South Africa.

KRA 1.3.2 Improve/develop other South African guarantee schemes. At the outset of the Project, FSP attempted to engage with the national government's SME loan guarantee scheme, Khula Enterprise Finance Ltd. (Khula), with a view to streamlining its rather cumbersome and rigid guarantee approval process. However, at the time, Khula was focused on starting up a direct lending program and was not particularly interested in reviewing its guarantee process.

Benchmark 1.3.2	**Actual**
Streamline 1 guarantee scheme process	Postponed

Since loan guarantees are an ideal way to leverage limited financial resources and to encourage FIs to lend to somewhat more risky borrowers, FSP looked to engage with at least one other guarantee scheme. In January 2009 the Project formed a partnership with Thembani International Guarantee Fund (TIGF), a private scheme supported by U.S. and Swiss NGOs. Part of the first year plan was to assist TIGF in streamlining its guarantee approval process, which would lead to a higher number and volume of guarantees being issued. Another possible activity FSP discussed with TIGF was development of regional loan guarantee schemes in select SA provinces. However, these activities were postponed as TIGF decided to focus first on rehabilitating problem projects for which it has guaranteed loans. After successfully turning around several large projects, TIGF resumed its operations (approving new guarantees) in September 2009. FSP anticipates carrying out at least one of the activities described above in the next fiscal year.

B. PIR 2: Bankability of SMEs Enhanced

The primary goal of this PIR is to improve the quality of business service provision to SMEs in a way that will promote access to finance, and to enhance the financial literacy of SMEs by working with a range of Business Development Service Providers (BDSPs) and/or their host organizations (BSOs).

Business service provision promoting access to finance is primarily concentrated in the SME market on preparation of business plans, and to a lesser extent, on capacity building of SMEs in the area, for example, of financial management (preparation of financial statements, basic record-keeping, etc.). FSP has identified opportunities to improve the quality, diversity, and relevance of financial BDS in the market.

During its first year of operation, FSP's interaction with financial intermediaries uncovered a growing lack of confidence in the quality of business services provided by independent BDSPs as well as a trend of FI's using their own staff to provide business service support to SME clients. This lack of confidence also served as an indicator as to the weak market of business service provision by BSOs and the failure of BSOs and FIs to engage effectively around SME bankability, as well as the weak demand by SMEs for BSO support.

BDS to improve SME bankability.
How or should an FI be involved?

FSP's study of global practices in the provision of BDS to enhance SME bankability discovered that no "best practice" exists in the way that finance related business services (fBS) are offered to SMEs by FI's. However, several case studies from around the world indicate the diversity of approaches adopted by FI's and reinforce what the significant contributing factors are to increasing SME bankability and the uptake of SME finance as well as FI market share.

These case studies support the belief that access to credit facilitation services substantially enhances bankability and access to credit for SMEs. However, to make this a sustainable success several other critical elements should exist. These elements include:

- making support to SMEs a central rather than peripheral strategy to SME lending
- creating an extensive and visible presence in SME communities,
- offering proactive support and education of SMEs in business finance and economic trends,
- providing responsive banking practices directed to SME vernacular, sophistication levels and needs
- making some form of subsidy or initial investment in a program of finance-related business service delivery.

Finally, it was verified that successful commercial partnerships and linkages between FI's and corporate companies and/or government agencies focused on finance related business service and support have contributed in some instances to significant SME financing and growth.
(See KRA 2.1.3)

The challenge for some of these institutions is, therefore, to identify and secure BDSPs who offer the necessary level of service to make SMEs more bankable, or to offer in-house business service provision to SMEs in a cost-effective and sustainable way.

FSP therefore focused its efforts in the market where it could achieve greatest leverage and with whom it could partner to achieve the broadest impact. Initial research showed that there were few BSOs offering services to promote access to finance, and that those who are, have limited reach. During the year, FSP has forged relationships with more than twenty FI's and BSO's who provide BDS to SMEs.

To the extent that poor delivery of BDS is one of several causal factors of SMEs failure to access finance, FSP's challenge has been to identify what intervention and with which partner it can achieve greatest impact. The details on these activities and their results are given below.

KRA: 2.1 Quality of BDS related to finance improved

Activities:

KRA 2.1.1 Facilitate development of a framework of BDSP accreditation. Currently in South Africa, BDSPs are not governed by any regulatory registration requirements nor is there a national standard to comply with in order to practice in the market. Rather, BDS providers are recognized by the institutions they work with or the professional bodies they register with, but as such, no standards exist to ensure their professional adequacy or measure their performance. As a result, the quality level of BDS in the market is inconsistent and risks delivery by well intentioned but inadequately qualified advisors.

While some "grading" exists in the market, current grading focuses on generic, rather than specific types of business support such as financial management. In the absence of a national standard, institutions create their own criteria of selection for BDS providers and focus on developing their skills to meet their individual institutional requirements.

During the first year, FSP consulted with a variety of stakeholders, including government's Small Enterprise Development Agency and Gauteng Enterprise Propeller, private sector and non government players, such as the Institute of Business Advisors, as well as USAID's South Africa International Business Linkages Project (SAIBL), private funds and the Banking Association. This consultation confirmed the need for a national standard to strengthen and assure the quality of business service provision in the market. Compliance to standards would ensure that BDS providers are adequately qualified and trained to provide different levels of service to the market and would also serve as a way to let the market know what level of service a provider is qualified to offer.

The development of a framework which defines standards for BDS providers is a prerequisite step to enable them to be assessed and graded as a means of letting the market know what level of service they are qualified to offer. It is also a way to enable the service provider themselves to identify how further to develop their skills in order to become better qualified.

With the development of a national framework in mind, in December 2008, FSP held a workshop with several parties interested in grading their BDS providers, including SEDA, the Banking Association, GroFin and Business Skills South Africa. FSP concluded that, while the need for standards and quality assurance exists across the board, application of a standard nationwide, to all business service organizations, would be challenging at best and impossible at the least.

FSP identified the following flaws in this national framework approach:

- In a market which is highly competitive and fragmented, a common framework would have limited support for and subscription by BDS providers and therefore limited impact;
- Each BSO interested in grading had its own model in mind or in use and specific institutional needs for their own standards so that impact would be limited by their scope of service;
- Business service organizations had limited capacity to implement a market wide program;
- In addition, a national approach would require the registration of standards with the South African Qualifications Authority, which is a long and complicated process.

These challenges led to FSP shifting its approach away from the development of a national standard and identifying an alternative means to facilitate quality assurance of BDS providers offering services in the SME market.

With that goal in mind, FSP investigated the area of standards and grading of BDS providers in other parts of the world. What FSP found is that to develop a successful approach to grading:

- A champion to lead the initiative must be identified to move the program forward and ensure long term sustainability;
- Business development service providers must see a clear market incentive in order to seek grading;
- Successful approaches must be developed based on a strong business case;
- Grading must be tied to professional development opportunities and benefits.

The FSP challenge was therefore to identify a market leader in BDS provision, with a clear interest in grading BDS providers who would be available to serve a wider market of BDSPs working with SMEs. In addition to this, such a host would need to have a demonstrated track record of effective business development service delivery to SMEs as well as provide significant incentive for the grading of BDSPs.

After an exhaustive search and a multitude of interviews, FSP identified a private company whose credentials meet those of a suitable champion for grading BDS providers. Raizcorp is known in the market for their innovative and successful approach to enterprise development and offers a for-profit model of service provision which has proven highly effective in incubating SMEs. Since inception in 2002, Raizcorp has supported over 500 enterprises with a 95% rate of those companies that participate in and comply with the Raizcorp program.

Raizcorp has committed to spearheading this initiative as it is a perfect complement to their current model and will provide a platform from which to expand the Raizcorp approach of BDS provision to the wider market. FSP has drafted a Scope of Work and indentified a standards expert to assist Raizcorp develop a framework of standards for grading and a process for assessing and developing BDS providers. Raizcorp will not only use this framework to assess their current BDSPs but will offer this as a service to the wider market, so that the number of graded BDS providers offering quality services in the market increases. Ultimately, it is anticipated that the motivation for a BDSP to secure a “grade” will be not only the access to SME clients in the Raizcorp system, but greater credibility in the market and a greater demand for services from BSOs, FIs and even government agencies supporting SME growth and access to finance.

Several BSOs have indicated interest in having their members assessed as BDS providers and their skills developed. Additionally several banks have expressed an interest in using the services of graded BDSPs.

Following the development of the framework, a business case will be developed to scale up Raizcorp's recruitment, grading and assessment activities of BDS providers. Further in the process, FSP may assist Raizcorp acquire international accreditation and local endorsement for its approach as well as design a strategy for expansion which will see its services replicated in other centers in South Africa.

Benchmark 2.1.1	**Actual**
Common framework for accreditation of BDS providers established	Strategy shift: Identified a private sector partner to lead initiative

KRA 2.1.2: Promote linkages between FIs and BDS organizations. A key issue in facilitating access to finance is to ensure that BDS offered to SMEs enables them to meet FI requirements. BDS providers however, do not always understand what FI's require from SMEs, and FI's are often not positioned to provide the kind of hands-on BDS support that SMEs need in order to become bankable. In addition to this, demand for finance related BDS will be determined by the extent to which they are relevant, affordable and help the SME to actually access finance and successfully use such credit to grow its business.

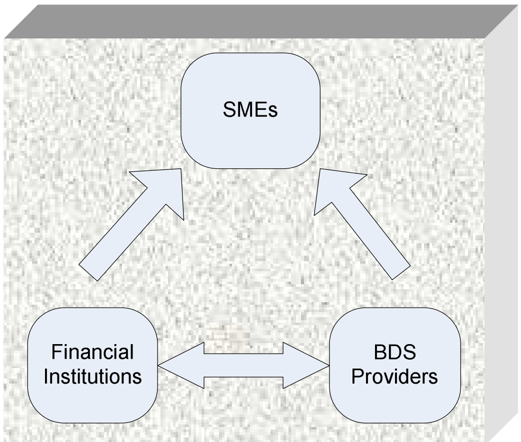


Exhibit 3: FSP Linkage Model

One such way to facilitate effective and sustainable BDS delivery is to develop a model whereby FI's and BSOs "link" as a way of providing the FI with a channel of bankable SME clients and to enable the BDS provider to understand FI requirements and tailor their BDS to meet the needs of both the FI and SME (see Exhibit 3: Linkage Model).

FSP determined to facilitate the development of a model which would promote formal linkages between one or more FI's and business service organizations or BDSPs quality assured through the process of accreditation established with FSP assistance.

Initially, FSP collaborated with the Banking Association to identify possible opportunities to motivate their members for the supply side of this equation. As a first step to rationalizing the support to members, Sizanani Advisory Services, the Banking Association's BDS provision unit was dissolved pending the development of a wider sector support approach. The Banking Association acknowledged that they should play a facilitator role in the market of BDS provision rather than to provide services direct to SMEs. To that end, they agreed to collaborate with FSP to undertake an on-line survey of FIs to determine the key hurdles facing FI's in the provision of finance to SMEs the intention being to inform areas wherein both FSP and the Banking Association can influence the expanded links expressed.

FSP, together with the Banking Association, promoted the rationale for and secured buy in from FI's participating in the survey. A database of more than 600 survey participants has been compiled using a stratified random sampling method. The sample was drawn from three tiers of staff within the population of financial institutions, including senior executives, credit managers and loan officers specifically responsible for SME financing. The financial institutions in the population consist of banks and private funds who provide finance to SMEs with an annual turnover between R200, 000 and R20 million.

The survey will be conducted on-line in November and the results will be presented at a forum to respondent banks.

Benchmark 2.1.2	Actual
FI-BDS organization formal linkages piloted	In process

FI's, as a way to meet the challenge of making SMEs more bankable, have adopted various approaches to providing BDS support to SME clients. In the absence of a broad based linkage model, FSP explored one-on-one opportunities within partner FIs to facilitate a linkage formation with a BDS organization.

Following numerous investigative meetings in this regard, ABSA identified a need to improve its BDS offering to SME clients through its Enterprise Development Centers (EDCs). Currently, the 13 EDCs located around the country offer enterprise development training workshops to SMEs but do not expressly link the services to the provision of an ABSA credit product. Numerous strategy meetings have resulted in opportunities for collaboration which will be explored in the next performance year.

KRA 2.1.3 Assess new models for FIs to directly provide financial BDS. Some contend that the imperfect market of financial BDS provision for SMEs has led to a trend in the market for FI's to assume responsibility for BDS support to SMEs. FSP conducted a study to identify global lessons identifying the pros and cons of FIs engaging in the delivery and/or promotion of financial BDS and how it impacts their SME portfolio.

Benchmark 2.1.3	Actual
FI/BDS model drafted	Study Undertaken to inform approach to accreditation and FI-BDS organization linkages.

Several case studies from around the world were developed and used to extract broad lessons learned and complement the conclusions drawn from the framework. The study was shared with several FSP partners to stimulate discussions around fBDS strategies and illustrate the challenges faced by FI's around the world in the way that financial business services are offered.

The lessons learned from the study will be augmented by the survey of hurdles faced by FI's in financing SMEs, ideally leading to market interventions that will promote appropriate delivery of finance related BDS.

KRA 2.1.4 Improve capacity of BDS organization to provide financial BDS. One of the weaknesses identified in the market of financial BDS is the failure of SMEs to use financial BDS as a means to access finance. As depicted in **Exhibit 4**, the underlying assumption is that a SME utilizing appropriate and targeted BDS will be better positioned to fit into a bank's lending criteria.

Initially, FSP focused on providing capacity building to FI partners offering BDS. Through discussions with FI partners such as GroFin, Old Mutual Masizinane, the IDF and PPC Ntsika, FSP identified the need for building the capacity of their staff involved in BDS delivery to SMEs. However, given their nascent stage of development it was determined that these partners were not suitably placed to absorb and benefit at that stage from this level of support.

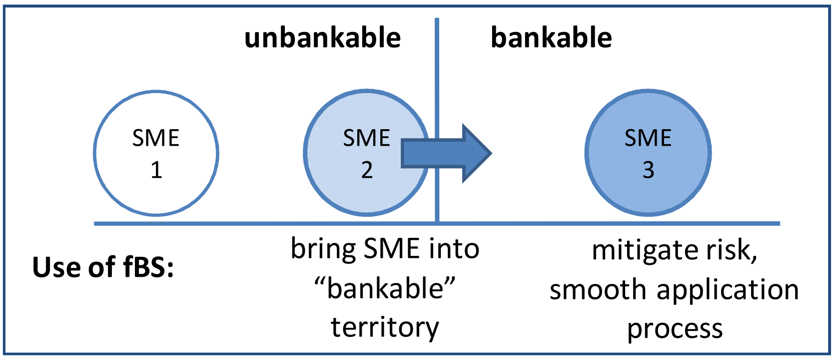


Exhibit 4: Using BDS to improve SME chances of securing a loan

FSP therefore turned its attention to assessing and identifying possible capacity building in financial BDS for business service organizations. To that end, FSP built a network with numerous and diverse business organizations to support the SME sector as illustrated in Exhibit 5 below.

Exhibit 5: FSP network with Business Service Organizations

Business Service Organizations and Financial Intermediaries offering BDS

Areas identified for potential collaboration

Name of Institution	Type of Registration	Type of Institution	Access to Credit	Grading	FINANCIAL LITERACY Knowledge & Information	FINANCIAL LITERACY Skills Development
ABSA/EDCs	Private	Both	Yes	x	x	x
Barloworld Siyakhula	CSI	FI	Yes			x
Blue Financial Services	Private	Both	Yes			x
Business Partners	Private	BSO	Yes	x		
Business Skills SA	Public	BSO	No		x	
Dept Economic Development	Govt	FI	Yes		x	
Enablis	NGO	Both	Yes		x	
Enterprise Room	Private	BSO	No		x	
FABCOS	Member based	Both	Yes	x	x	
Gauteng Enterprise Propeller	Govt	BSO	Yes	x	x	
GroFin/Optima	Private	Both	Yes	x		x
Instititute of Business Advisors	Member based	BSO	No		x	
Identity Development Fund	Govt	FI	Yes			x
Khula Direct	Govt	FI	Yes	x	x	
OMM	CSI	FI	Yes			x
PPC Ntsika	CSI	FI	Yes			x
Raizcorp	Private	BSO	No	x		
SAIPA	Member based	BSO	No		x	
SEDA	Govt	BSO	No	x	x	
The Business Place	NGO	BSO	No		x	
TIGF	NGO	FI	Yes		x	x
Wizzit	Private	FI	Yes		x	

Proposed activities include grading, assessment and development of BDSPs, building the capacity of these organizations to offer financial literacy to SMEs, and in the case of some FI partners, developing post-loan support for SME clients.

Undoubtedly, the greatest interest has been expressed in the development of a financial literacy program to build the capacity of partner organizations and their BDS providers. Preliminary activities under this key result area are therefore addressed through FSP's financial literacy proposal.

Benchmark 2.1.4	Actual
Capacity building plan for BDS organization developed	In process
BDS organization capacity building TA delivered	Not achieved

KRA: 2.2 SME financial literacy enhanced

Activities:

KRA 2.2.1 Development of financial literacy materials for the SME market. FSP research has indicated that a key flaw in the ability of SMEs to access finance rests with the SME itself, namely, their inherent lack of sophistication, limited finance knowledge, and general lack of understanding of what financers are looking for when considering a loan application. To determine what opportunity may exist to assist SMEs, FSP hired a literacy specialist who undertook a gap analysis of financial literacy materials available on the market specifically for SMEs. What it found is that more material has been developed for consumer financial literacy than for SMEs, and that the material that exists is limited in scope and often used for marketing specific products or providers. In addition, definitions of financial literacy range from the need for information about financial concepts and products, to the need, for example, for financial management and business planning skills required by SMEs.

FSP considered several strategy options to address this gap in the market, the most compelling of which is to develop information-based financial literacy material targeting SMEs which will be offered to business service organizations to strengthen their capacity to offer advisory and mentorship services as well as information seminars to their SME clients.

Bridging the SME Financial Literacy Gap

The key findings from the gap analysis of SME financial literacy products and services suggested the following:

- Most financial literacy material and programs target consumers, rather than SMEs;
- SME financial literacy initiatives tend to market specific finance providers and are not generic in nature;
- Information on sources of and access to finance is limited in content and scope;
- There is no generally accepted definition of financial literacy in the market; for many BSO's, the definition includes building the capacity of the SME to manage the finances of their business;
- Financial literacy alone is not sufficient to alter SME ability to access finance; additional services and support are required from both BDS and FI providers.
- Several channels for distributing information to SMEs in a cost effective way, include a service embedded in existing SME support programs, via the web, using SME networks and member organizations, media such as radio and print, and in partnership with organizations such as CIPRO, SARS and the NCR;
- To be effective and to facilitate access to finance, a financial literacy initiative will need to segment the SME market carefully as this is not a homogeneous market.

FSP Partner, Blue Financial Services embeds SME business development support services in its loan product delivery. Each prospective client must pass Blue's "Simply Successful Management" course before a loan is funded. FSPs financial literacy program will complement this SME empowering strategy.

FSP identified a consultant to develop a framework of modules and topics needed to build and deepen BSO and BDSP capacity in order to assist SMEs be better positioned to access finance. Topics will promote an understanding of relevant terms and concepts about finance and the financial sector, appropriate financial products and services for different stages in the enterprise lifecycle, how to meet FI requirements and where to source business support to access finance. FSP anticipates that demand for the program and for development of additional modules will grow as it becomes known about in the market place, and that several training programs will be held throughout the course of the coming year to equip business service organizations to offer this to SME clients.

Benchmark 2.2.1	**Actual**
Strategy for financial literacy for SME developed	Achieved
Financial literacy materials disseminated	Not achieved

C. PIR 3: Financial Sector and SME Development Enabling Environment Improved

The primary goal of this PIR is to support the development of an improved enabling environment for SMEs and help implement legal, regulatory and institutional reforms that will contribute to expanding access to credit for SMEs, especially BEE SMEs. During the first year of operation, the FSP team established excellent working relationships with the Department of Trade and Industry (dti) and the National Credit Regulator (NCR) as well as key stakeholders including the Banking Association, Business Unity South Africa (BUSA), South African Institute of Professional Accountants (SAIPA), South African Institute of Chartered Accountants (SAICA) and a number of policy stakeholder groups. These relationships were forged through the cooperative activities which have led this component to substantially achieve all objectives planned for Year One. In addition to those activities contained in this year's approved Work Plan, several additional activities arose during the year and were addressed under this component.

The details on these activities and their results are given below.

An integrated approach for maximum impact and sustainability

By way of illustration, the "Business Case" for the creation of the Commission will have a major impact on all aspects of the business environment; this will be reflected in "Doing Business" and other surveys, and will have a positive impact on the SME sector.

Building on this work, the follow on "Fee Structure" work ready to implement and to be undertaken shortly, is an integral part of the Companies Act Regulations but also moves FSP involvement from the legal/drafting stage to implementations and impacts. This work taken together truly focuses FSP on "encouraging entrepreneurship and enterprise efficiency, creating flexibility and simplicity in the formation and maintenance of companies and streamlining the registration process".

FSP, jointly with Treasury and dti, is currently starting the implementation of the Regulatory Impact Assessment (RIA) program. The Companies Act and the Regulations there under, as well as their proposed implementation by the newly created Commission will be undertaken.

The combinations of these components in no way presents a "conflict of interest" to FSP but rather an opportunity to assure that changes in the business environment are consistent, integrated and achieve a sufficient critical mass to be sustainable. Each component is led by highly qualified consultants who each bring their international best practice experience which together with the various South African government departments involved, assure excellence.

KRA: 3.1 Financial sector legal and institutional framework for SME finance improved

Activities:

KRA 3.1.1 Support the business process reengineering of the National Credit Regulator. The National Credit Act came into full force in June, 2007. This new Act repealed three existing usury laws and amended or partially repealed 15 other Acts. This far reaching Act was aimed at protecting consumers and SMEs and making credit and banking services more accessible. The National Credit Regulator (NCR) was created by this Act and was faced with the massive task of implementing what commentators have called "… perhaps the most comprehensive change in legal landscape (and the common law) since the adoption of the Constitution in 1996." To assist in this process, FSP undertook a detailed, two stage, Business Process Re-Engineering (BPR) to assist NCR in identifying constraints and weaknesses within the organization. FSP, working closely with the NCR, developed and implemented a BPR approach that included a workflow analysis and an assessment of service delivery options of the NCR registration department. The Phase One BPR consultant focused on the issues of document transmission, storage and security; annual renewal of fees; registration process flows; and credit providers' compliance with the Act. Over 40 recommendations were identified and submitted for NCR consideration and prioritization.

As a follow up to the initial stage, the FSP provided the BPR Phase II consultancy which included a workflow analysis and assessment of service delivery options of the NCR registration department. Extensive SWOT analysis drawing on the experiences of NCR Registration Department employees was undertaken and a number of critical process modifications identified. A number of materials improvements were adopted within the Registrations department addressing specific changes in the document transmission, storage and security; registration process flows; annual renewal of fees; and credit providers' compliance with the Act. As a result of this BPR work, NCR is currently conducting a Public Tender (closing September 25, 2009) to undertake a supplementary, comprehensive review of its business process as a lead in to a detailed revision of its Information and Communications Technology (ICT) strategy. Although significant input was provided to the development of policies and procedures and the related PMP within the ambit of the work undertaken (see Table xx – PIR 4), the Benchmarks as presented in our prior Annual Report 2008-09 failed to adequately recognize the dependence on the work of others outside of FSP control, the scope and complexity to achieve the stated Benchmarks.

Benchmark 3.1.1	Actual
New NCR policy and procedures manual developed	Partially achieved
Performance Management Plan submitted to the NCR	Partially achieved

KRA 3.1.2 Assist with establishment of the National Register of Credit Agreements (NRCA). Although, according to "Doing Business" South Africa has a world class credit reporting industry, little reliable information and credit history is available for the emerging SME sector. This constitutes a major obstacle for lending institutions in assessing credit

applications. Building on an ongoing dialogue with the NCR, FSP has contributed to major steps in the creation of the National Register of Credit Agreements (NRCA).

FSP promoted a constructive dialogue between NCR, the existing credit reporting industry and the Banking Association to move ahead with the creation of the NRCA. A workshop was organized and implemented by the NCR with the participation of representatives of the major banks, consumer credit providers, microfinance and SME institutions. All participants bought into the idea of establishing the NRCA and decided to set up a steering committee between key stakeholders. The Steering Committee decided end of 2008 that an interim Project Manager should be appointed to take care of the administration and coordination of the project and called on FSP to assist.

FSP provided an Interim Project Manager to work closely with the Steering Committee and to oversee the development of the business plan for NCRA. Deloitte was subcontracted to be the Interim Project Manager given that other Deloitte personnel were already engaged in the project. A detailed work plan was developed that included a list of steps required to set up the registry with a clear timeframe, a cost estimate, and a description of responsibilities and deliverables for each phase and was coupled with the funding proposal plan prepared by other Deloitte consultants hired by the NCR.

In reviewing the initial draft, FSP identified a number of areas of concern, principally as it related to the role of the NCRA and its interaction with the existing credit reporting industry, the nature and quantity of information to be gathered and the usage of that information outside the narrow credit reporting role of the NCRA and the regulatory role of the NCR; the constitutionally protected privacy rights especially appeared to be at risk. FSP also expressed concerns that the legal and regulatory modifications recommended did not go far enough to achieve the major NCRA objectives. These issues were fully reviewed by Deloitte with the Steering Committee and NCR management. All of FSP’s concerns were addressed in the final report and the business plan which also included draft recommendations for the modification of the NCA and the Regulations there under to facilitate the establishment, governance and implementation of the NCRA.

Benchmark 3.1.2	**Actual**
Steering Committee of the NRCA established	Achieved
NCRA Implementations plan completed	Achieved
Regulations for the NRCA submitted	Achieved

This work has resulted in the NCR submitting to the dti a detailed proposal for the establishment and operation of the NCRA together with drafts of the legislative and regulatory changes required for Government consideration and submission to Parliament. This process may be lengthy and difficult, since the creation of the NRCA may imply some amendments to the NCA that the dti may be reluctant to undertake.

NCR estimates that this process means that no additional steps can be taken until late 2010. Provided Parliament approves the proposal, FSP would expect continued support to NCR in promoting access to financial services and lowering financing costs for SMEs.

KRA: 3.2 Regulatory framework stimulating SME development enhanced

Activities:

KRA 3.2.1 Develop the business case for new Companies Commission. FSP has worked closely with the Consumer and Corporate Regulation Division (CCRD) of the Department of Trade and Industry (dti) to improve the regulatory framework affecting the development of SMEs. During the first year, FSP developed the "business case" as required by law for the establishment of the Companies and Intellectual Property Commission, a major advance in making Government service to SMEs and indeed, the entire business sector, simpler and more cost effective.

As designed, this Commission will significantly contribute in future years to assist SMEs transition to formality, expand, become better informed and more bankable entities by creating accessible and affordable processes and providing support and training specifically focused on SMEs. This work was fully completed and the results were accepted by the dti and form the basis for the creation of the new Commission.

As a result of this initial work, FSP was requested to undertake further work integral to the creation of the new Commission. FSP developed a SOW to develop a fee structure to minimize costs of incorporating and annual filings to SMEs and others, while, at the same time, creating an adequate cash flow to cover the costs to Government of the Commission, including the implementation of it advisory and education functions foreseen in the Companies Act. The same FSP consultant who developed the "business plan" will undertake this assignment starting in October.

Benchmark 3.2.1	**Actual**
Business Case Submitted to dti	Achieved

KRA 3.2.2 Draft the regulations for the new Companies Bill. The Companies Bill was passed into law by Parliament and became the Companies Act No.71 of 2008, received Presidential assent April 8, 2009 and was then "gazetted" on April 9, 2009 (Gazette 32121, Notice #421). This means that in terms of section 225, the Act will come into operation on a day to be determined by the President, but no earlier than April 8, 2010. The "transition provisions" in the Act revoke all previous legislation upon the coming into force of the new law and therefore, the Regulations must be fully drafted and approved before that date.

During Year One, the FSP team was heavily involved in assisting dti in preparing the Regulations. The work undertaken by FSP widely exceeds the scope of actions narrowly focused on the SME access to finance objective. It is difficult to overestimate the scope, complexity and impact of the Companies Act and Regulations on all aspects of economic life as it will impact all aspects of the business environment for years to come. The Text Box above provides more details of the scope of FSPs work.

Working closely with dti, FSP accepted the challenge to draft new Company Regulations in a democratic and highly participatory manner. The dti and FSP maximized transparency and participation by interviewing key stakeholders in the public and private sectors before starting the drafting process. The preliminary issues and questions raised by stakeholders were then presented in an “issues paper” and extensively debated in a workshop attended by over 50 leading experts in company law and business. At the conclusion of this broad public/private dialogue, dti invited further written comments. Business and legal experts addressed some of the more complex issues, providing dti with valuable advice in an open, cooperative environment. Only then did dti and USAID/FSP begin preparing a first draft of the new Regulations. The publication of that first draft will lead to further public comment, and dti will seek additional public-private dialogue before finalizing the draft. This approach received wide, positive public comment and the role of USAID/FSP was widely recognized in promoting this more open, participatory approach.

FSP is committed to assuring that the Companies Act and Regulations will have positive impact on the business environment, including small enterprises moving towards formality and gaining access to credit. The Act and Regulations will also eliminate the traditional vehicle for SME incorporation – the “Closed Corporation”. FSP has been key in assuring that the new Companies Act and Regulations are fully “scaleable” and designed and implemented in such a manner as to minimize the cost and administrative burden implicit in incorporating and maintaining a corporation for SMEs. Although the Companies Act and Regulations are medullar to the entire business environment, without FSP, it is clear that the impact of the new Companies Act and Regulations on the SME sector would have received relatively limited attention and comment. A time table has been established by dti which calls for the Companies Act and Regulations to come into effect in June/July 2010 and continuing assistance is planned throughout this period.

Benchmark 3.2.2	**Actual**
New Companies Bill regulations drafted	In process

KRA 3.2.3: Design and implement an awareness campaign on BB-BEE legislation for SMEs in Gauteng. Broad based black economic empowerment legislation has had a significant and far-reaching effect on corporate South Africa since its introduction is 2003. BEE compliance has become a set standard for business considerations but the impact and effect on SMEs is broadly debated. Following broad based consultations with over a hundred SMEs throughout Gauteng, FSP recognized the cynicism among SMEs with regard to BEE benefits. A study of small enterprises was conducted by FSP in Gauteng province and found that BEE SMEs did not know or understand the BEE legal and regulatory framework. Most participants were frustrated and unaware how the benefits and business opportunities created by this legislation were applicable to them.

Originally, a separate awareness campaign had been conceived to promote features and benefits of the BEE codes of good practice to SMEs with annual turnover under ZAR 5 million. The FSP team had hoped to work with a group of partners, including business services organizations and SME associations, to launch an awareness campaign aimed at explaining to SMEs the benefits available to them under BEE legislation and the growth potential it entails. A "Request for Proposals" was launched by FSP to locate a service provider capable of simplifying the elements of the Codes applicable to SME and designing the material. Outline materials were developed but it was decided to hold off dissemination. A detailed analysis of the study results and a review of proposals and concepts received, made it clear that this approach would not function and may simply further alienate exactly those we aim to assist.

It is unclear how, within the limited scope and resources available through FSP and without strong Government support in this regard, additional activities under this sub-component can achieve significant positive impact. Potential additional actions will be critically considered in developing the next work plan.

Benchmark 3.2.3	**Actual**
BB-BEE Materials developed and disseminated	Study conducted, concept and materials outlined, dissemination suspended.

KRA 3.3 Additional Activities Undertaken not included in the 2008-2009 Work Plan

The first year of FSP coincided with the rapidly developing Global Economic Crisis. In addition, the newly implemented NCA putting a brake on excessive lending in 2007 further reduced lending, especially to SMEs. According to the NCR, new loans were down some 42% during the last year. Although "loan books" of credit granting institutions remained the same or may even have increased slightly, this may reflect higher defaults and the capitalization of unpaid interest and charges, rather than new loans. The SME sector was heavily impacted by these credit constraints, especially those involved in the real estate sector. Much of the growth of the SME sector in recent years was exactly in the real estate and financial service sectors, accounting for as many as 44% of new company formation between 2004 and 2007. These gains were largely wiped out. Fortunately, the ongoing heavy investment in the run up to the 2010 FIFA soccer World Cup, has pushed national investment to unprecedented heights. South Africa thus had an ongoing "stimulus plan" even before the crisis hit globally.

KRA 3.3.1 OECD Workshop in Turin, Italy, March 2009. As a result of the current worldwide economic downturn and its severe impact on SMEs, FSP sponsored the South African delegation at the March OECD Round Table organized to recommend policy measures to assist SMEs to overcome the current credit crunch. Upon their return, the delegates led an internal dti Workshop to discuss the key government policy approaches to the crisis. The dti Workshop identified the need "...for the dti to have an economic risk management strategy to deal with all factors posing a threat to the stability of the economy and various sectors/especially the SMME sector." FSP continues to support the need to design the policy initiatives in the event the recovery is slower than expected and/or in anticipation of a future crisis. FSP is engaged in ongoing discussions with the dti to identify how best, and to what extent to support this ongoing activity.

KRA 3.3.2 Support to the Real Estate and Mortgage Brokers and Agents law reform. The dti requested that FSP support the Real Estate and Mortgage Broker and Agent law reform. Currently, the estate agents activities are regulated primarily by the Estate Agency Affairs Act of 1976 and so called "bond originators" are entirely unregulated.

The new land owners in South Africa and those living on and owning traditional land holdings have done little to formalize their titles. As a result these "dead assets" have not been used to access credit and generate a flow of income. In many cases the only access to advice they have on how to formalize their titles and/or unlock the equity in their properties is through real estate and mortgage brokers. Fewer than 3% of real estate/mortgage professionals operate in the areas where most such situations exist and belong to the previously disadvantaged category. It is exactly these agents and brokers, most likely to be consulted and most likely to understand and empathize with the issues presented which have been hard hit by the economic downturn. Especially the mortgage brokers – so called "Bond Originators" advertise access to credit widely and offer their services "free" stating that their costs will be borne by the lenders, an attractive proposition for the less sophisticated, less wealthy. Yet the "bond originators" are entirely unregulated. Anecdotal evidence abounds of fraud and abuse, especially victimizing those most in need of accessing their equity and least financially literate. A well regulated, inclusive and professionalized "bond originators" and realtors will protect consumers and land owners while creating a vibrant and growing group of financial service providers in areas and for those traditionally under serviced.

Current policy and legislation does not address the needs of the South African real estate industry and FSP proposes staged and limited assistance to develop appropriate policies and draft a Bill for parliamentary consideration. FSP has held preliminary discussions with the Banking Association which has indicated that its members have specifically indentified those SMEs engaged in the real estate sector as potential clients for credit. The NCR also has identified this as a priority area for unlocking credit flows. We plan to work closely with dti as well as the NCR and BA. Policy approaches were discussed with the dti/CCRD and based on this, a preliminary scope of work is in the final stage of discussion with the government and a highly qualified consultant has been identified. Implementation of this activity is anticipated to start in November, 2009.

KRA 3.3.3 Proposal for FSP Support to the Regulatory Impact Assessment Program of the South African Government. National Treasury requested FSP technical assistance to help with capacity building in its Regulatory Impact Assessment (RIA) Program since there is currently limited availability of skilled people to conduct the types of valuations and analysis required for a RIA in South Africa. FSP, jointly with Treasury, is currently starting the implementation of the RIA program. Together with Treasury and the dti, a regulatory impact assessment will be undertaken of the new Companies Act and Regulations as well as the proposed implementation by the newly created Commission. This request was clearly outside the scope of the Program as designed but, considering the importance and potential impact on the SME sector, USAID amended the FSP scope of work and found additional resources to undertake this task.

D. PIR 4: SME Finance Knowledge Management System Strengthened

The primary goal of this PIR is to strengthen SME finance related knowledge management, share innovative financing options and opportunities; disseminate successful approaches for SME development in collaboration with the private sector and donor and government programs.

FSP research in the first year indicated that much of the literature and work undertaken on accessing financial services tends to focus on consumers and in most cases does not provide a distinction between an SME and consumer credit. FIs often lack the adequate risk analysis tools to feel comfortable extending credit under different terms and conditions. At the same time SMEs are faced with credit officers whose lending guidelines are designed for large companies or individual consumers and not appropriate to the needs of an SME.

To address this disconnect, FSP identified stakeholders wanting to capture, codify and share valuable knowledge but also facilitate knowledge creation.

KRA: 4.1 Public/private stakeholder collaboration in SME knowledge management expanded

Activities:
KRA 4.1.1 Facilitate collaboration mechanism with stakeholders. The FSP qualitative study indicated that a primary hurdle faced by SMEs, in securing finance, revealed that almost 80% of SMEs were not aware of any other sources of funding except the traditional banks.

Subsequent investigation by FSP revealed that a large number of financial sector stakeholders produce valuable knowledge products, but such activities lack integration or widespread dissemination, which inhibits increased access to information about SME finance thereby reducing access to credit.

Lack of knowledge engenders insufficient access to financial services available to aid SME development. South Africa's economy is highly corporatized (because of inequities of the past) and thus the link between the macro and micro is too wide to permit any form of symbiotic development. Therefore, to increase access to information about SME financing services in South Africa during Year 1, FSP through a series of primary research analyses and consultations with key stakeholders, worked to identify appropriate partners to advocate knowledge sharing mechanism.

FSP developed a scope of work to review and assess existing SME knowledge management and evaluate tools capable of disseminating information about SME financial services between intermediaries. The survey and in-depth interviews to be conducted by the consultant was aimed at the FIs specifically at assessing the modalities of demand and supply of information, unraveling the salient dimensions of information sharing systems. However, with further consultations with key stakeholders, the stakeholders concurred that an additional research would not provide new data. Rather FSP shifted its focus to identify a champion to advocate and host knowledge sharing activities through its portal.

FSP is negotiating with the Banking Association of South Africa – the prime structure on SME financing in South Africa- to champion, host and lead the collaboration mechanism.

FSP anticipates launching the collaboration mechanism during the course of 2010 leading to deepened public/private collaborations to improve availability of SME financial services in the market.

Benchmark 4.1.1	Actual
Knowledge management collaborative mechanism established	Postponed

KRA: 4.2 Improved awareness of SME finance best practices

Activities:
KRA 4.2.1 Implement information sharing-compilation and dissemination. An FSP desk study showed that the SME finance informational landscape in South Africa is fragmented and characterized by disparities in knowledge accessing capabilities, network strengths and needs across sectors; and this reinforces the need for an effective knowledge brokerage. This knowledge furrow results not from lack of knowledge production activities but reflects the absence of a sharing mechanism among key stakeholders - the private and public spheres, across sectors of the economy, to the extant the knowledge variance mirrors the two economies that have developed within one economy.

FSP engaged several interested parties to discuss ways in which awareness about SME financial services can be improved. Collaborating partners agreed there is a need to maximize impact through fostering productive energies and leveraging resources to capture and make available a full spectrum of SME financing development information. Upon the finalization of the collaboration mechanism and identification of a champion, FSP will stimulate the collection of and dissemination of practices affecting SME credit.

Benchmark 4.2.1	Actual
Brief on best practices for information dissemination mechanisms	Cancelled
Roundtable on best practice dissemination techniques	Cancelled

With the strategy for disseminating information is still under discussion, the Year 1 benchmarks for this activity will be incorporate in the framework to be developed by private and public collaborating stakeholders in Year 2. During Year 2, FSP anticipates institutionalizing information about SME lending best practices, policy reforms, establishing hyperlinks with other service providers locally and internationally to increase the universe of FIs that share information and knowledge about SME financing resulting in increased access to SME financing information available.

SECTION III: ANNEXES
ANNEX A – PERFORMANCE MANAGEMENT PLAN SUMMARY

October 1, 2008 – September 30, 2009

#	*Indicator name*[8]	*Unit*	*Year 1 Actual*	*Annual Targets*	*Year 1 Variance*	LOP
1	**Number of financial agreements concluded**	#	67	500	- 433	1500
2	**Value of finance accessed**	ZAR	94,382,164	124,500,000	- 30,112,836	624,500,000
3	Number of management processes/practices modified due to USG assistance	#	4	2	+2	4
4	Days to turnaround SME loan application	#	50	45	-5	30
5	Number of new or adapted financial products developed as a result of USG assistance	#	4	3	+1	5
6	Number of consultative processes between financial intermediaries and SMEs as a result of USG assistance	#	1	3	-2	5
7	Number of financial sector professionals trained on international standards with USG assistance	#	37	50	-13	100
8	**Number of special fund loans issued**	#	35	10	+25	35
9	**Value of the USG supported special loans issued**	ZAR	76,184,625	7,500,000	+68,684,625	26,250,000
10	**Number of DCA guaranteed loans**	#	11	125	-114	375
11	**Amount of private finance mobilized with DCA guarantee**	ZAR	16,516,138	62,500,000	-45,983,862	187,500,000
12	Number of SMEs assisted to access finance	#	0	600	-600	1440
13	Number of financial advisory providers assisted (trained/TA)	#	0	100	-100	240
14	Number of SMEs assisted by BDS providers	#	0	1000	-1000	2400
15	**Number of SMEs that successfully accessed bank loans or private equity as a result of USG assistance**	#	0	250	-250	600
16	**Value of finance accessed through banks, private equity etc by USG assisted SMEs**	ZAR	0	162,500,000	-162,500.000	337,500,000
17	**Number of 11 core commercial laws and financial reforms put into place as a result of USG assistance**	#	0	1	-1	2
18	Number of applied research activities undertaken by USG implementing partners to inform policies and regulations that affect access to finance for SMEs	#	4	3	+1	5
19	Number of material improvements in the infrastructure that reduce market risk made this year with USG assistance	#	1	2	-1	3
20	Number of financial sector supervisors trained with USG assistance	#	20	20	0	40
21	Number of administrative procedures affecting the operations of SME improved	#	1	2	-1	3
22	Number of policy reforms analyzed as a result of USG assistance	#	2	2	0	3
23	Number of policy reforms presented and/or disseminated for public/private stakeholder presentations as a result of USG assistance	#	1	2	-1	3
24	Number of policy reforms presented for legislation/decree as a result of USG assistance	#	0	2	-2	3
25	Number of inquiries to knowledge management system	#	0	0	0	300
26	Number of collaborating partners	#	0	0	0	4
27	Number of dissemination events held by knowledge management collaborating partners (workshops, conference, media campaigns, etc.)	#	2	4	-2	8
28	Number of content submissions to knowledge management system	#	0	0	0	6

[8] Please note that all the highlighted indicators are USAID's Operational Indicators.

INTRODUCTION

Monitoring and Evaluation Summary

This annual progress report covers the results of activities undertaken by the Financial Sector Program (FSP) from October 1, 2008 through September 30, 2009. The Project Objective *"market credit risk mitigated increasing SME access to a range of quality, affordable financial services"* is segmented into four program areas and measured by 28 indicators. The report provides a summary of the activity outputs and outcomes as they contribute to the Performance Management Plan (PMP). The four program areas as reflected in the Results Framework are:

- Financial Services
- SME Bankability
- Enabling Environment
- Knowledge Sharing

STRATEGIC OBJECTIVE INDICATORS (SO):

Indicator number 1: Number of financial agreements concluded

Indicator number 2: Value of finance accessed

All FSP efforts for credit access via financial intermediaries (FIs) including traditional banks, private funds and DCA activities are summed and reported at the strategic objective level. For these indicators 1/2, they include the summation of indicator 8/9 for SPV contribution, 10/11 for DCA contribution and also account for additional traditional lending FIs who have undertaken penetration into the SME credit market, for this reporting period WIZZIT and ABSA Bank.

While FSP was 87% below its target of number of financial agreements concluded, it was only 25% below the value of credit introduced to the marketplace indicating that FIs remain timid with regard to the penetration of the SME credit markets, however, tend to provide larger than expected loans. The bulk of the contribution for these indicators unexpectedly came from the private fund partners (see indicators 8 and 9). To date, as a direct result of FSP support, 67 SMEs have received finance from implementing partners totaling ZAR 94,387,164**.**

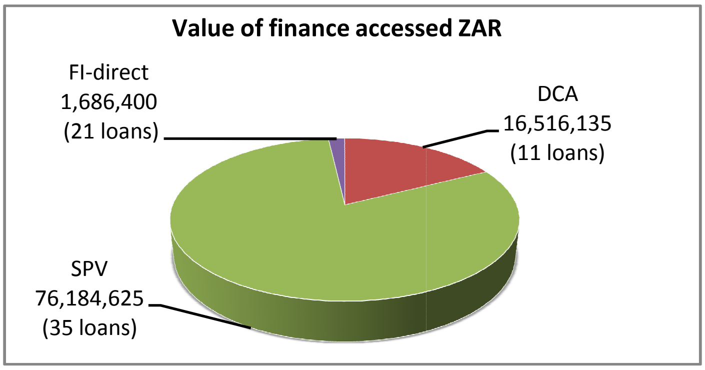


Figure1: Value of finance accessed by SMEs

Figure 1 illustrates the overall value contribution of the individual indicators (9 and 11) as well as traditional bank lenders to Indicator 2. They are USG supported special fund vehicles (SPVs) (Indicator 9), Development Credit Authority (DCA) Grantees (Indicator 11) and the balance being traditional credit financed through partner FIs (ABSA bank and WIZZIT).

As a direct result of FSP support to private funds, SPVs contributed ZAR 76,184,625 (81%) to the total value of finance accessed by SMEs made up of 35 financial agreements concluded. While the SPVs in this first year dominated the contribution to SME loans, this proportionate balance is expected to change over the next years. During the last two weeks of the fiscal year, ZAR 16,516,138 (17%) was mobilized from private sector finance to 11 SMEs with DCA guarantees, and FSP anticipates that this will grow dramatically over the next year. WIZZIT and ABSA banks contributed ZAR 1,686,400 (2%) to the total efforts expanding access to finance for SME during their pilots for their new products supported by FSP.

WIZZIT bank is cautiously expanding its service to the SME financing market by slowly introducing its newly developed productive lending SME program (developed with assistance from FSP). As an entry point, their average loan amount is of minimum size but there is clear momentum and demand from clients indicating a large potential for WIZZIT to provide increasing numbers and larger sized loans for previously unbanked SMEs. With a full launch of the newly developed SME program, WIZZIT projects that they will be approving about 500 SMEs loans by the end of fiscal 2010 averaging ZAR 15,000 per enterprise.

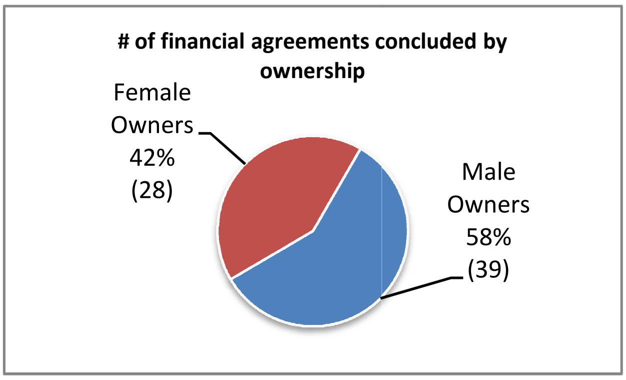


Figure 2: Number of financial agreements by gender

Through its recently launched Purchase Order Finance (POF) and Vendor Finance products (developed through assistance from FSP), ABSA seeks to provide credit to qualified SME suppliers in the production phase against purchase orders under contracts they have with corporate customers. Given ABSA's footprint in the South African banking sector, FSP expects dramatic growth in contribution to the number of SMEs receiving loans in Year 2. FSP is not only concerned with simply improving access to finance to SMEs, but also considers gender equality as a critical issue. **Figure 2** illustrates the breakdown between the number of financial agreements concluded by gender.

What is interesting to note is that while 58% of the 67 financial agreements concluded went to male owners, female owners received 65 % of the total value of finance accessed indicating that female entrepreneurs are taking larger loans. This is primarily due to the fact that the private funds, which tend to make larger loans, prioritize increasing credit to women.

OUTPUT PERFORMANCE INDICATORS

Indicator number 3: Number of management processes/practices modified due to USG assistance

FSP achievements were twice its annual target. These four management processes/practices modified with FSP support include changes that have directly influenced the outputs in the following areas:

- Old Mutual Masisizane (OMM) increased the frequency of credit committee meetings from once a quarter to once a month resulting in a more timely response to the SME applicants.
- The Deposit Mining approach helped WIZZIT identify many loan candidates whereby 20 enterprises were ultimately approved for SME loans. Additionally, the new loan processing practices developed helped to streamline the approval process.
- ABSA launched its Purchase Order Finance and Vendor Financing with FSPs support which enhanced the credit review and management processes.

Indicator number 4: Days to turnaround SME loan application

As a result of FSP's training and support to FI partners, the average turnaround time for loan decisions went from a baseline of 88 to 50 days as of yearend. While the target of 45 was not met, this 43% improvement in decision turnaround time has put funding in the hands of SME much more rapidly than previously.

Indicator number 5: Number of new or adapted financial products developed as a result of USG assistance

FSP has exceeded its annual target by 33% as four new products were developed during the year. These new products offer greater SME product diversification increasing SME market choices. These products include:

- Purchase Order Finance (ABSA)
- Vendor Finance (ABSA)
- Investment Term Loan (WIZZIT)
- Short Term Working Capital (WIZZIT)

Indicator number 6: Number of consultative processes between financial intermediaries and SMEs as a result of USG assistance

FSP partners have not engaged with the ultimate beneficiaries in the development of the new loan products to date, however; several consultative processes with corporate companies supplying SMEs with the above-mentioned products for Indicator 5, are scheduled and will be included in the next reporting period. Through the consultative processes, FSP anticipates that the number of SMEs approached by FIs to discuss an SME lending product will increase; therefore, more SMEs will purchase appropriate products leading to better SME business environment.

Indicator number 7: Number of financial sector professionals trained on international standards with USG assistance

Given FSP's approach to targeted training for partner professionals, four diverse professional training workshops were held involving 10 institutions and including 37 credit professionals as participants. FSP achieved 74% of the first year target of training financial sector professionals. **Table 1** illustrates the four training programs and the breakdown of participants.

Table 1: FSP Training Workshops

	Male	Female
SME Due Diligence and Valuation (6 FIs)	7	5
WIZZIT Loan Professional training	4	3
SME Problem loan training (9 FIs)	4	8
Old Mutual loan process reengineering	4	2
Total	**19**	**18**

Indicator number 8: Number of special fund loans issued
Indicator number 9: Value of the USG supported special loans issued

FSP has exceeded its Year 1 SPV target both in the *number of special fund loans issued* by 250% as well as the *value of the USG supported special loans issued* by 916%.

Well beyond the original expectations and startup assumptions, FSP partnered with six private funds trying to expand credit to SMEs, four of which reported during Year 1. As a direct result of the capacity development workshops for financial sector professionals together with the assistance for loan process modifications, FSP supported efforts of SPVs, which have, to date, extended 35 special fund loans at the value ZAR 76,184,625.

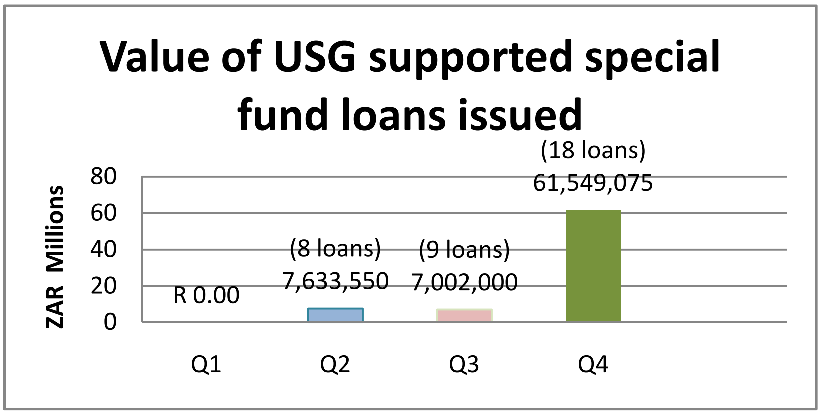


Figure 3: SVP Loan Volume to SMEs

While training and new loan processing mechanisms were introduced to SPVs, data suggests there was a time lag in implementing the new approaches indicated by slow-growth during the second and third quarter. However, the fourth quarter indicates, in the surge of SPV volume to SME, outcomes of FSPs' continual input to improving financial services provided to SMEs. **Figure 3** illustrates the dramatic increase in the growth of the SPV SME loans during the last quarter of the fiscal year.

Out of the 35 number of special funds issued to SMEs, Old Mutual Masisizine contributed 20 (57%) while PPC Ntsika contributed 6 (17%) and Grofin provided finance to 9 (26%) collectively increasing access to credit to SMEs, of which 60% were to BEE SMEs with 65% of the borrowers being women.

Indicator number 10: Number of DCA guaranteed loans

Indicator number 11: Amount of private finance mobilized with DCA guarantee

FSP helped to develop three applications from financial institutions seeking to expand their loan book for SMEs through DCA guarantees thus achieving FSPs annual benchmark. All proposals were accepted and two applications approved at the Credit Review Board (CRB). However, the only transaction completed during the reporting period was for Blue Financial Services, which became active in the last two weeks of FY 2009 and booked 11 loans totaling ZAR 16,500,000. Given pending additional CRB approvals and increased utilization of the guarantees, FSP anticipates significant increase in the following years.

Indicator number 12: Number of SMEs assisted to access finance

Indicator number 13: Number of financial advisory providers assisted (trained/TA)

Indicator number 14: Number of SMEs assisted by BDS providers

Indicator number 15: Number of SMEs that successfully accessed bank loans or private equity as a result of USG assistance

Indicator number 16: Value of finance accessed through banks, private equity etc by USG assisted SMEs

While the annual targets for these collective indicators were not reached, FSP achieved several annual benchmarks and the work contributing to these indicators has provided improved opportunities for 2010.

Specifically, a strategy for improved financial literacy of SMEs through enhanced qualified BDSPs has been developed in consultation with relevant stakeholders. This strategy, and subsequent program implementation, will lead to SMEs being better advised regarding access to finance and therefore should improve the levels of approval by FIs.

Indicator number 17: Number of 11 core commercial laws and financial reforms put into place as a result of USG assistance

While the target for Indicator 17 has not been met, FSP has achieved a number of benchmarks aligned to the requisite formal process for the formulation of a commercial law and reform in South Africa. The benchmarks include:

- Draft regulations of the Companies Act
- Recommendations for the establishment of the NRCA
- Business case for the establishment of Companies Commission paving the way for the merger of CIPPRO and OCIPE

FSP’s work has informed the reforms process in the regulatory and institutional framework pertaining to the operations of SMEs. FSP anticipates the approval of the Companies Act Draft Regulations in the second half of 2010 according to the South African government’s procedures.

Indicator number 18: Number of applied research activities undertaken by USG implementing partners to inform policies and regulations that affect access to finance for SMEs

FSP completed four research activities to enhance the enabling environment for SMEs through informing policy and regulatory framework exceeding its annual target by 33%.

Firstly, FSP undertook primary research to develop an informed view for project initiatives by assessing the SME market to identify general policy hurdles faced from an SME perspective.

Secondly, to ensure smooth transition into the Companies Commission, FSP embarked on a business case for the establishment of the Commission aimed to inform regulatory professionals about the new structure, their roles and assuage any employment insecurities. Following the enactment of the Companies Act, CIPRO and OCIPE will be merged into the more efficient and enhanced *Companies Commission* to help stimulate business formulation and growth.

Thirdly, to amplify the policy and law articulated in the Companies Act, FSP conducted an in-depth review of the Act, as well as corresponding Acts, which culminated in the development of draft Regulations.

Finally, in order to enhance the regulatory and institutional framework, and inform policies that affect access to finance for SMEs, an analysis of the NCA was undertaken to inform the development of a business case for the establishment of the NRCA. The establishment of the NRCA will lead to better monitoring of available credit, pricing and market conditions, trends in access to credit and debt, market conduct and competition thereby promoting access to financial services and enhance the credit environment for SME development.

Indicator number 19: Number of material improvements in the infrastructure that reduce market risk made this year with USG assistance

FSP conducted a business process reengineering activity with at the NCR to optimize, streamline, and enhance its functions to better service the industry. The materials improvements made within the Registrations department addressed specific changes in the following areas:

- Document transmission, storage and security
- Registration process flows
- Annual renewal of fees
- Credit providers' compliance with the Act.

Despite having achieved only 50% of the annual target for this indicator, the material improvement implemented contributes significantly to the development of a fair, transparent, competitive, sustainable, responsible, efficient and accessible credit market and industry, and ultimately protect consumers as mandated under the NCA.

Indicator number 20: Number of financial sector supervisors trained with USG assistance

Developing the capacity of financial sector supervisors to serve SMEs within the regulatory and institutional framework improves the quality of services enterprises receive from the financial sector as supervisors act as the quality control agent for the service agents. To this end, following the adoption of the Companies Act and the pending formation of the *Companies Commission*, FSP trained 20 financial supervisors thereby achieving the targets for Year 1. The capacity development will lead to better supervision and improved financial service techniques furthering access to finance by SMEs.

Indicator number 21: Number of administrative procedures affecting the operations of SME improved

While FSP did not achieve its annual target to modify and/or introduce administrative procedures affecting SME operations, FSP has undertaken extensive research reviewing relevant policies such as NCA and the drafting of Regulations for Companies Act. These activities will lead to specific opportunities for streamlining and the introduction of administrative procedures to reduce market-lending risk thereby increasing access to SMEs.

Indicator number 22: Number of policy reforms analyzed as a result of USG assistance

Indicator number 23: Number of policy reforms presented and/or disseminated for public/private stakeholder presentations as a result of USG assistance

FSP has achieved its annual target of analyzing two policy reforms to improve the regulatory framework affecting the development of SMEs via an in-depth analysis of Companies Act to develop its regulations as well as the review of certain aspects of the NCA for modifications need to amend it to permit the establishment of NRCA.
To inform the initial drafting of the Companies Act Regulations, FSP engaged public and private stakeholders in dialogues to improve the financial sector and SME development policy environment achieving 50% of its annual target for policy reform public/private stakeholder presentations. Over 50 stakeholders were represented at these discussions.

Indicator number 24: Number of policy reforms presented for legislation/decree as a result of USG assistance

While FSP did not achieve its annual target of presenting two policy reforms, it has undertaken extensive work toward achieving this target as elaborated in the policy results presented above.

Indicator number 25: Number of inquiries to knowledge management system

Indicator number 26: Number of collaborating partners

Indicator number 28: Number of content submissions to knowledge management system

During Year 1, through a series of primary research and consultations with key stakeholders, FSP identified appropriate partners to advocate a knowledge sharing mechanism. Insights from the research highlighted that while significant quantities of information production and knowledge dissemination activities take place, there is little to no synchronization of these activities. Most of the activities and technologies developed by financial intermediaries are internally focused and directed at their own clients.

This lack of harmonization highlighted to FSP the need for a platform through which the available information and knowledge can be brought together. FSP is in advanced negotiations with the Banking Association of South Africa to champion and lead a collaborative initiative and host a knowledge management platform.

There were not targets for these indicators in Year 1 and the efforts put forth have been in preparation for Year 2 activities.

Indicator number 27: Number of dissemination events held by knowledge management collaborating partners (workshops, conference, media campaigns, etc.)

During Year 1, FSP organized two dissemination events with collaborative partners, achieving 50% of the annual target. One addressed policy misunderstandings and potential opportunities for a BEE awareness campaign to explain and encourage SMEs to take advantage of the empowerment policy.

Additionally, FSP hosted a workshop to present the summary of and resultant upcoming changes within CIPRO and OCIPE from the upcoming implementation if the business case for the Companies Commission.

A total of 30 participants attended these events (10 and 20 respectively) representing FIs, SMEs as well as government managers.

ANNEX B – SUCCESS STORIES – SEE ATTACHED PDF