USAID | SOUTHERN AFRICA
FROM THE AMERICAN PEOPLE

FINANCIAL INSTITUTIONS' HURDLES TO SME FINANCING

March 2010

This publication was produced for review by the United States Agency for International Development. It was prepared by Exploration Station, a subcontractor for Chemonics International Inc.

FINANCIAL SECTOR PROGRAM

FINANCIAL INSTITUTIONS’ HURDLES TO SME FINANCING

Contract No. 674-M-00-08-00043-00

CONTENTS

ACRONYMS

ABSA	Allied Bank of South Africa
BA	Banking Association
BDS	Business Development Service
BEE	Black Economic Empowerment
DFI	Development Finance Institution
FI	Financial Institution
FICA	Financial Intelligence Centre Act
FNB	First National Bank
FSP	Financial Sector Program
IDC	Industrial Development Corporation
IT	Information Technology
PPC	Pretoria Portland Cement
SAB	South African Breweries
SME	Small and Medium Enterprise
TIGF	Thembani International Guarantee Fund
VAT	Value Added Tax

EXECUTIVE SUMMARY

USAID's Financial Sector Program (FSP) has, as one of its key result areas, to enhance the bankability of SMEs by improving the quality of business development service (BDS) related to finance and enhancing the understanding of BDS providers of the world of small and medium (SME) finance.

In the last quarter of 2009, FSP, in partnership with the Banking Association of South Africa, undertook a survey to identify, from the perspective of finance providers, what hurdles they face in financing SMEs and to propose solutions or interventions, if any, needed to facilitate provision of business development services to SMEs on behalf of FI's.

This report documents the rationale, methodology and results of the survey which was delivered as an online questionnaire and targeted at banks, private funds and development finance institutions. Eighteen out of twenty seven financial institutions (FI's) approached participated in the survey. In each institution, senior executives, credit managers and loan officers involved in SME financing were identified and included in a database from which a random sample was drawn.

From a universe of 2977 candidates identified by their institutions, a sample of 683 was derived. Of these, 179 completed the survey, a response rate of twenty six per cent (26%).

The survey focused on the overall success rating of SMEs applying for finance, what criteria FI's use when evaluating and financing SMEs, what prevents them financing SMEs, why, in their view, SMEs fail to access finance, what services they offer to assist SMEs to access finance (or promote bankability of SMEs) and what interventions are required on the part of FI's to promote or improve access to finance for SMEs.

Questions and answers related to specific categories of SMEs defined in terms of annual turnover. The categories used were start-ups, annual turnover less than R500k per annum, between R500k and R2,5 million per annum, between R2,5 million and R10 million per annum, and between R10 million and R20 million per annum. The classification of SME complied with the definition used by the Banking Association.

The results of the survey show that most funders fund all categories of SME but that successful financing is greater amongst SMEs with a higher turnover whereas the lower end of the SME market require greater ancillary support prior to becoming a candidate for finance.

Of the evaluation criteria used to assess finance applications, the most important was the financial status of the SME, namely the ability of the SME to repay the loan (cash flow) and their contribution to the deal. The FIs also need what SME applicants are not particularly strong at, namely good, accurate and up to date financial records, especially financial statements, a good sales pitch by the entrepreneur, good business skills and plans (which are understood by the SME) and demonstrated knowledge of their chosen field.

FIs seem less concerned about age and educational qualifications and quite tolerant of aspects that can be fixed or addressed, such as FICA compliance, submitting the correct paperwork, accurate costing and pricing.

FIs felt that, to ensure more successful applications and increase their market share, they should make the criteria for evaluating finance applications more appropriate to the SME market, particularly as far as the requirement for collateral is concerned. They recognise the need to be more lenient in assessing applications, the need to take more risk, offer advice and support to SMEs, and the need to offer products which are new, more appropriate to SME financing needs, more broad in spectrum and with improved costs and value.

Most FI's offering business support in the form of information, advisory services, referral services to third party business support and coaching/consulting/mentoring. These efforts were considered to be successful however there was unanimity that service providers need to be graded in some way and on that basis, would more likely be referred to by FI's.

The primary areas where it was felt that SMEs could do more to ensure successful financing include the need to be more familiar with and do more research on their chosen field and market, to focus on submitting business plans which are viable, and to take steps, where required, to clean up their credit record, develop their own financial statements and actively develop their business skills. This result suggests greater potential for influence by consultants/coaches and mentors.

Interventions to overcome hurdles in SME financing should focus on helping SMEs to evaluate their own financial status and make their own risk assessments before they approach FI's for financing. Services should be offered pre the finance application stage and focus on one-on-one assistance as well as mentoring and training. Assistance would then focus on helping SMEs reduce their risk status, prepare and understand their own financial statements, proposals and business plans and actively develop their business skills, particularly in managing their finances, understanding cash flow in the business and understanding the market in which they operate.

While the services mentioned above may exist in one form or another, indications are that FI's are already offering services to help SMEs become more bankable. In some cases, the services are offered in house, in others, they are outsourced to third parties. What is clear, however, is that FI's would make more use of third parties if they were assured of the quality of service – or provider – offered. In this respect, grading of providers will go a long way to assisting SMEs to become more bankable, however, it is equally important that SMEs need to be matched with mentors and experts and that some form of facilitation in the market could assist with this. The opportunity therefore exists to link graded consultants to FI's and to facilitate referrals of consultants to SME clients.

The services offered to SMEs should be on an individual basis and should focus on helping SMEs understand their own businesses and the needs of the FIs. In this respect, facilitating access to finance is a huge need which, if offered in a way which is relevant to both SME and FI, could impact significantly on helping FI's overcome the financing hurdles they face.

Finally, it is clear from comments made by the FI's themselves that they are working with a financing model that is inappropriate for this market of largely previously disadvantaged entrepreneurs. These entrepreneurs are unsophisticated when it comes to financial and business matters, and have limited resources, although they could very well be greatly qualified and potentially successful in their chosen field. There is a significant need for Financial Institutions to create a **different and more appropriate model** for evaluating risk and individuals, as well as **products** that are more suitable for this market.

SECTION 1: INTRODUCTION AND SURVEY OBJECTIVE

The Financial Sector Program (FSP) supports the accomplishment of the U.S. Government's Economic Growth Objective in South Africa. This task order is one of three main vehicles to promote vibrant growth of historically disadvantaged small and medium businesses (SMEs) and reduce unemployment and poverty. The objectives of this program are to expand access to financial services and reduce financing costs for SMEs through reforming the legal and regulatory framework affecting the financial sector and business environment, and improving the commercial viability of lending to historically disadvantaged SMEs in South Africa, thereby expanding SME access to a range of high quality and affordable financial services.

Activities under FSP will focus on improving and expanding financial services and products; managing and mitigating financial risk and transaction costs; improving bankability of SMEs and business development services (BDS) by linking financial services with business service activities that can build SME capacity, productivity and competitiveness, as well as improve the capacity of financial advisory services to serve SMEs; support the emergence of an efficient credit industry regulator that promotes an enabling environment for financial intermediation and risk management, and boosts the private sector's role and participation in the provision of financial services to SMEs; promote reforms to commercial laws, regulations, and administrative practices affecting the private sector and SME development; and, improve knowledge management through an accessible repository of knowledge about SMEs and finance in South Africa.

One of FSP's goals is to enhance the bankability of SMEs by improving the quality of BDS related to access to finance and enhancing financial literacy. In order to facilitate demand led BDS provision, FSP recognized the need to identify – from the perspective of finance providers – what hurdles they face in financing SMEs, and on the basis of this, to determine what BDS, over and above those offered by some finance providers, might assist SMEs to overcome those hurdles.

FSP therefore embarked upon a research program in partnership with the SME Committee of the Banking Association of financial institutions to understand better:

- What criteria Financial Institutions use when financing SMEs;
- What prevents Financial Institutions lending to SMEs – or why SMEs fail to access finance;
- What services Financial Institutions offer to assist SMEs to access finance and how these are provided;
- What interventions are required on the part of FIs to promote or improve access to finance for SMEs.

The survey focused broadly, on two things: financing of SMEs (criteria used to evaluate finance applications, reasons why SMEs fail to obtain finance) and services offered to assist SMEs to access finance. Two firms were appointed by FSP to undertake the research: one, a market survey firm to prepare the questionnaire and analyze the results, the other, to create an internet based system for distributing the questionnaire by email to a designated sample of survey participants and for capturing the responses online into a single database for use by FSP.

SECTION 2: SURVEY METHODOLOGY

The Sample

Drawing a representative sample from an unknown universe is a difficult task. There is no comprehensive list of institutions involved in granting finance to SMEs so when the project was embarked upon, FSP contracted a consultant to develop a reliable sampling framework.

Given the objective of the survey, to understand what hurdles financial institutions face in financing SMEs, FSP targeted for its survey sample those FI's who operate in the SME financing space, including banks, private funds and public funds such as development finance institutions (DFIs), government agency funds and non government funds. A list of such institutions was compiled based on consultant and FSP knowledge of the sector; in total, 27 institutions were invited to participate in the survey. FI's were included in the list that are known to be involved in financing SMEs rather than micro enterprises.

Of the twenty seven (27) institutions approached, only 18 finally participated in the survey. The breakdown by type of institution that participated is provided below; (see Annex 1 for names of participating FIs).

	Approached	**Participated**
Banks	13	8
Private Funds	10	9
Public Funds (NGOs, Govt., DFIs)	4	1
Total	**27**	**18**

In addition to identifying types of institution involved in SME financing, the survey was designed to question different levels of interviewee involved in making or influencing decisions to award finance to SMEs.

The following steps were undertaken to create the sample database:

- Each of the Financial Institutions was contacted and the levels of staff involved in making financing decisions related to SMEs were identified (Executives, Credit Managers and Loan Officers);
- The numbers of staff at each level were identified;
- These positions and staff were listed (a total number of 2977 staff were listed);
- An optimum sample of 693, offering a 95% confidence level, was identified;
- A random sample was drawn;
- The Financial Institutions were contacted again and 693 names and email addresses were obtained within the categories of Executives, Credit Managers and Loan Officers.

The proportions of the sample drawn were as follows:

	Total Universe	**Total Sample**
Total	2977	693
Executives	115	70
Credit Managers	824	269
Loan Officers	2038	334

The sample of 693 was sent the questionnaire via email with a link to the questionnaire. A covering letter was included, telling each respondent about the survey and asking for their participation.

A total of 26% responded overall - an excellent response rate - giving a final sample of 179 respondents and broken down as follows:

	Final Sample	Response Rate
Total	**179**	**26%**
Executives	36	51%
Credit Managers	53	19%
Loan Officers	90	28%
Banks	144	
Private Funders	19	
Public Funder	16	

Method and Extent

There are many ways to conduct research. Which methodology one chooses to use depends on the requirements of the research. In this case, the following needs were stated:

- To use a quantitative sample, representative of the universe of people involved in making decisions about financing for SMEs in Financial Institutions;
- To acquire as in depth information as possible within the parameters provided of targeting banks, private and public funds;
- To make the research time and cost effective.
  - Under ideal circumstances, the preferred method would have included a series of face to face interviews and/or a focus group discussion with target market respondents to identify the issues to be measured, followed by structured telephone interviews with the target market respondents.

However, the decision was made to conduct the study using an online approach and without preliminary interviews, notwithstanding the benefits, limitations and risks of this approach, which are documented below:

Benefits:	▪ Most of the target market is contactable via email so theoretically a representative sample is available online. ▪ An online study is fast to administer and analyse, so results will be available within a very short period of time (days rather than weeks). ▪ There is a significant cost saving over personal or face to face interviews.
Limitations/Risks:	▪ The issues for assessment were identified by FSP ‘s technical experts rather than in preliminary interviews with the FI’s, however, these were verified with the FI’s via a pilot and found to be adequate; Provision was made in the questionnaire for additional comments where respondents may have thought that the options given were insufficient; ▪ Response rates from surveys conducted by means other than contact with an interviewer are notoriously low – anything from just 2-3% to 15%. Offering incentives, letters of encouragement from the survey team, or in this case, from the respondent’s employer, add to the likely % response rate, so, while a large representative sample from the FI’s was identified, there was no guarantee that the total sample would be completed. In fact, it was likely that more than 60-70% of the sample would not reply and that FSP would therefore lose their participation, however, this risk was mitigated by extensive communication with respondents via their senior executives and correspondence from within some of the FI’s by people appointed to coordinate the surveys internally.. ▪ The online format prescribes that the questionnaire be quite tightly structured, excluding the opportunity for probing from an interviewer and so limiting the depth of information that can be obtained. As an alternative, ▪ Some open ended questions were included to solicit broader comments; these are included further in the report and highlight some of the nuances obtained from broadening the approach in this way.

Questionnaire

Having determined to conduct a self-administered, online survey, the basic requirements of the questionnaire were as follows:

- The questionnaire needed to be as short as possible to encourage respondents to complete it;
- The number of open ended questions needed to be limited as they do not work well in a self completion environment: Respondents do not explain themselves fully which often results in ambiguous and difficult to understand responses. In addition, self completion questions often appear to be too much trouble and stop the respondent from continuing with the questionnaire. The questionnaire designed needed to generate lists of possible responses wherever possible. FSP and industry experts were used to generate these lists which were then tested via pilot to assess user-friendliness of the online method, whether the questions met the research objectives or not, and whether there were any significant omissions that the survey needed to address.

Throughout the questionnaire, SMEs were categorised in the following way, with the primary reference being annual turnover:

- Start up
- Less than R500k
- Between R500k and R2,5 million
- Between R2,5 million and R10 million, and
- Between R10 million and R20 million.

The questions asked in the questionnaire are enclosed in the table below in order to illustrate the rationale behind the questions.

Question	Rationale
1. Does your organisation provide finance to SMEs?	Basic filter question to make sure all respondents qualify for the survey
2. Please indicate the overall success rate of SME finance applications in each of the following turnover categories of SME: *Start up; Less than R500K; R500K to R2.5m; Over R2.5m to R10m; Over R10m to R20m*	To establish which SME segment is the most in need of aid (i.e. which are the least successful in their applications)
3. What criteria does an SME have to satisfy to be successful in their application for finance/ for your institution to successfully provide finance to an SME? List provided: *Ability to provide collateral;* *Number of years they have been in business;* *Good track record of loan repayments;* *Strong entrepreneurial characteristics;* *Good business plan;* *Cash flow sufficient to repay the loan;* *Complete information on the application form;* *Satisfactory reputation and trustworthiness;* *Sufficient amount of owner equity contribution;* *Other (State)*	To establish what criteria the Financial Institutions consider when SMEs apply for finance
4 FOR EACH CRITERIA: Please rank the criteria you mentioned from most important (starting with 1) to least important	To establish a hierarchy of criteria – which are the most important
5 What are the main reasons why SMEs fail to obtain finance from your institution? – recorded by category List provided: *No/insufficient collateral* *No/inadequate business plan* *No/insufficient track record* *Poor credit record of applicant/s* *Over indebtedness* *Inappropriate market/business*	To establish what prevents Financial Institutions lending to SMEs within each segment of SMEs

Question		Rationale
	Inaccurate assessment of size of market for their product or service... they do not understand the market *Poor/incomplete paperwork* *No/poor financial statements* *Poor/weak cash flow* *Poor/weak costing and pricing* *No/poor business management skills* *Applicant is not really an entrepreneur* *SME does not understand their business plan or financials* *Educational qualifications of applicant/s* *Non compliance with FICA / other regulations* *Age of applicant/s* *Other (State)*	
6	Which of the following services does your institution have in place to offer assistance to SMEs in their application for finance? NB: The focus is on what your institution already does or has done in the past List provided: *Information (e.g. brochures, booklets, company directories, websites)* *Once off advisory services by staff (e.g. what type of loan to apply for)* *Referral service to experts/consultants* *Consulting / mentorship / coaching services (e.g. feasibility studies, assistance with business plans)* *Training (e.g. courses, workshops, seminars)* *Networking events (e.g. to introduce them to other companies)* *Road shows (e.g. to promote products and services offered by your institution)* *Other (Please list)*	Identifying what Financial Institutions do to assist SMEs in getting finance and how successful each is. Who/what they use to provide such assistance
7	What form do/did these services take (ask for each service)?	
8	In your opinion, how successful are these efforts/services? (For each service/form mentioned) – if 5 = very successful and 1 = not at all successful	
9	In your opinion, what could your financial institution do to increase your share of the SME financing business or of the SME market? In what way(s) do you believe your Financial Institution must change how it evaluates SME loan applications, such that it could increase its volume of SME lending but still be reasonably prudent? (Open ended)	To identify what interventions/ changes the Financial Institutions could make to help SMEs be more successful in applying for finance
10	And what, in your opinion, should SMEs be doing to increase their own chances of obtaining finance from your institution?	To identify what interventions/ changes the SMEs could make to help themselves be more successful in applying for finance
11	As you are probably aware, there are many consultants of differing levels of professionalism offering business services to SMEs (such as writing business plans etc). Do you believe that these consultants should be accredited or graded in a similar way to, for example, financial planners?	Additional questions relating to accreditation of business consultants
12	IF YES: If there was a system to accredit or grade business service consultants, would you be more likely to recommend the services of such consultants to SMEs?	

The Pilot Study

A small pilot study was conducted to ensure the questionnaire delivered the type of information expected.

A total of 12 respondents were chosen for the pilot study, three from each of South Africa's four main banks. Seven questionnaires were completed which was sufficient to assess the questionnaire and whether it would enable FSP to meet the research objectives.

- Some changes were made to the online functions to make the questionnaire less confusing and easier to navigate.
- The pilot demonstrated that the list provided for Question 3 was highly relevant – all respondents ticked all criteria. FSP therefore relied on the ranking to provide discrimination between the attributes.
- The open ended questions were responded to by three and four respondents each.

Overall the questionnaire delivered the anticipated results in line with the objectives.

Timing

The timing and steps for the study was as follows:

	August	September	October	November	December
Proposal endorsed by the Banking Association	■				
Introductory letters sent to Senior Executives to cascade through FI's	■				
Survey work plan & concept presented to SME Committee (BA)			■		
In house FI communication provided by designated point people & IT departments			■		
Pilot launched in "big four" banks				■	
Survey conducted over 4 weeks – starting 23rd November 2009				■	
Regular reminders until cut-off date: 18th December 2009					■

The Banking Association played a key role in ensuring that executives at senior level in the banks were notified of the survey: an introductory letter explaining the purpose and procedure of the survey was circulated by the Banking Association; the survey proposal was presented to the SME Committee of the Banking Association, who assisted with the survey by designating people in house to the banks who would coordinate the survey internally.

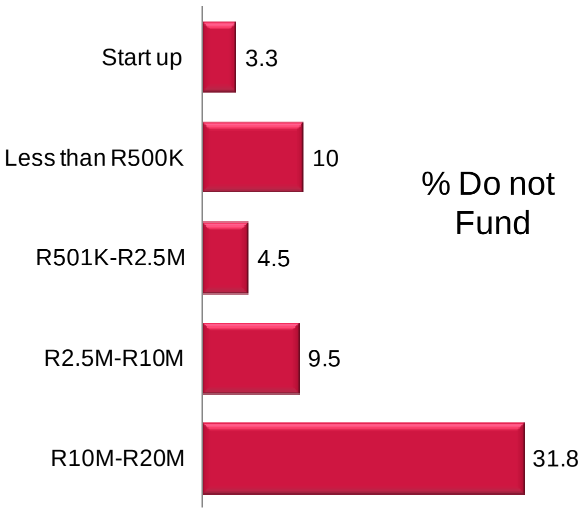
In addition to this, FSP met or liaised with the IT departments of the larger institutions to ensure access to participants and to maximize participation. Once the questionnaire had been tested and modified, the questionnaire was launched and conducted over a period of two weeks, extended to four to the end of December and supported by regular email reminders sent to participants who had not completed the survey in order to encourage maximum participation.

SECTION 3: SURVEY RESULTS

Note that the results presented in this report refer to the full complement of respondents to the survey and are not disaggregated by type of institution or level of person responding. The reason for this is that the data sets from the responses are too small to make disaggregation meaningful.

The survey achieved a twenty six per cent (26%) response rate which is particularly good for an online survey and notable given that it was done right at the end of the year. This also means that the sample of 179 is sufficiently robust for useful conclusions to be drawn. However, due to the small number of respondents in the sub samples, drilling down to the type of funder is not really possible.

3.1. Funding of SMEs



- Most respondents in most institutions claimed to fund all categories of SME
- Somewhat surprisingly, the results showed that the biggest category **not** funded was the one with the largest turnover – the SMEs in the R10m-R20m category. 33% of banks and 42% of Private Funders claimed not to fund SMEs in the R10m-R20m category. On further examination it was discovered that the respondents who claimed not to fund this category were responding in terms of their own divisions and not taking the broader view of the entire institution.
- Although the sub samples are small and the observations that can be made within the small sub samples are limited, it would appear that the Public Funder tended not to fund at the bottom end of the SME turnover scale. (63% indicated that they did not fund the Less than R500k category; 19% indicated they did not fund the R500k-R2.5m category.)
- Banks were most likely to fund at the bottom end.

3.2. The success rate of financing by category of SME

Respondents were asked what the success rate of financing was of the specified turnover categories of the SMEs. They were given various options:

- Largely successful
- Mostly successful, some unsuccessful
- About half, half

- Mostly unsuccessful, some successful
- Largely unsuccessful
  And
- Do not finance

- The smaller the turnover category, the lower the success rate of finance applications of SMEs tended to be.
- SMEs operating in the highest turnover categories – and therefore presumably more sophisticated and successful businesses – were rated as the most successful.
- Only about 11% of the Start Ups enjoyed much success, and some 21% of the Less than R500k, while 38% of the R10m-R20m enjoyed success.
- In contrast, some 36% of R500k-R2.5m, 43% of R2.5m-R10m and 38% of R10m-R20m categories were mostly or largely successful.
- Overall, there was a tendency for Loan Officers to rate each category slightly higher in terms of success than the Executives or Credit Managers.

	Start Up	Less than R500k	R500k-R2.5m	R2.5m - R10m	R10m-R20m
	%	%	%	%	%
Largely successful	1.7	1.7	4.5	9.5	13.4
Mostly successful, some unsuccessful	8.9	19.0	31.8	33.5	24.6
About half, half	20.7	30.2	29.6	21.8	8.9
Mostly unsuccessful, some successful	39.7	25.7	21.8	17.9	10.6
Largely unsuccessful	25.7	13.4	7.8	7.8	10.6
Do not finance	3.4	10.1	4.5	9.5	31.8

3.3. Criteria Used for Evaluation

Respondents were asked to indicate what criteria they used to evaluate the SMEs' applications for finance. They were given a list of criteria and asked to indicate which ones applied to their evaluation process.

- As discovered in the pilot phase of the research, all the criteria offered were considered applicable and were therefore highly relevant.
- All criteria were said to be applicable by between 96% and 77% of respondents.
- The most highly applicable criteria were those which related to the applicant's ability to pay and their financial status.
- The least applicable criteria were those related to information on the application forms and about the SME him/herself.
- In order to obtain some discrimination between the criteria respondents were asked to rank each criteria in importance, where 1 = most important and 10 = least important.
- The most important criteria remained cash flow and other financial status indicators, while criteria related to the individual were least important.

	% That Apply	Mean Score
Cash flow sufficient to repay the loan	96	2.6
Sufficient amount of owner equity contribution	90	3.9
Ability to provide collateral	89	4.1
Good business plan	89	4.2
Satisfactory reputation and trustworthiness	83	5.1
Strong entrepreneurial characteristics	82	4.1
Good track record of loan repayments	79	4.5

	% That Apply	Mean Score
Number of years they have been in business	78	5.2
Complete information on the application form	77	6.4
Other (State)	23	

- Twenty three per cent (23%) mentioned other criteria.
- These were mentioned mostly by respondents from Banks and most comments were pre emptive of what was covered later in the questionnaire.
- There were three broad categories of responses mentioned, namely, criteria to do with:
  - Financial Viability of the business
  - The Applicant
  - The Business

About Financial Viability	- Respondents were looking for some confirmation of solvency, mainly good financial statements or audited financials - They wanted a personal balance sheet from the SME himself - They wanted credit bureau clearance - They looked for confirmation of future business e.g. contracts, letters or some evidence of sustainability
About The Applicant	- Some respondents wanted an indication of how professional the SME was in management or of his/her ability in terms of running the business - Others looked for the SME's knowledge of the industry they were in and/or whether they had done any market research
About the Business	- A few respondents questioned the validity and desirability of the business or sector and whether the industry sector was high risk - Others looked at the business environment in terms of the competition and economic conditions

One respondent from The Public Funder mentioned 'BEE qualifications' (probably implied for the rest of the sample), and another mentioned 'Return on investment'.

A comment on the question itself was given by a respondent from a bank who said:

"This structure [the question] does not show the subtlety well.
All aspects of the finance application must be looked at."

3.4. SME failure to obtain finance

To understand why SMEs fail to obtain finance, respondents were offered a list of attributes which they were asked to rank as the reasons why they felt that SMEs for each category of turnover failed to obtain finance from their financial institution.

The following tables show the lowest ranked reasons for rejecting a finance application followed by the highest ranked, or reasons most mentioned for a finance application failing.

Rank	Start Up	Less than R500K	R500K-R2.5m	R2.5m-R10m	R10m-R20m
1	Cash Flow	Cash Flow	Cash Flow	Cash Flow	Cash Flow
2	Credit record	Financial Statements	Financial Statements	Financial Statements	Over indebtedness
3	Business skills	Credit record	Collateral	Collateral	Collateral
4	Collateral	Collateral	Over indebtedness	Over indebtedness	Financial Statements
5	Financial Statements	Over indebtedness	Credit record	Credit record	Credit record
6	Business Plan	Business skills	Business skills	Business skills	Business Plan
7	No understanding of financials/ BPlan	Business Plan	Business Plan	Business Plan	Business skills
8	Don't understand their market	Track record	Track record	Track record	Don't understand their market
9	Track record	No understanding of financials/ BPlan	No understanding of financials/ BPlan	Don't understand their market	Costing/Pricing
10	Over Indebtedness	Don't understand their market	Don't understand their market	Costing/Pricing	Inappropriate business

Rank	Start Up	Less than R500K	R500K-R2.5m	R2.5m-R10m	R10m-R20m
17	Age of applicant	Age of applicant	Age of applicant	Age of applicant	Age of applicant
16	Educational Qualifications	Educational Qualifications	Educational Qualifications	Non compliance FICA etc	Non compliance FICA etc
15	Non compliance FICA etc	Non compliance FICA etc	Non compliance FICA etc	Educational Qualifications	Educational Qualifications
14	Entrepreneurial skills	Entrepreneurial skills	Entrepreneurial skills	Entrepreneurial skills	Entrepreneurial skills
13	Costing/Pricing	Inappropriate business/market	Paperwork	Paperwork	Paperwork
12	Paperwork	Costing/Pricing	Costing/Pricing	Costing/Pricing	Inappropriate business/market
11	Inappropriate business/market	Paperwork	Inappropriate business/market	Inappropriate business/market	No understanding of financials/ BPlan

- Responses were strikingly similar across the SME turnover categories: the reasons why SMEs failed were largely the same no matter what the turnover of the company was; all SMEs fail on the same things
- It was interesting to see that mostly, SMEs failed to get finance due to aspects related to the bank's interests – the financial status of the SME and how much of a risk they were, whereas aspects of the application that related to the SME's business skills were less important; and
- Aspects that could be rectified (such as FICA compliance, paperwork, etc) were least important.

- Over Indebtedness of the owner became more important to FI's in larger businesses as a reason for rejecting a finance application
- Business skills were of more importance in Start Ups.

Annex 3 provides the numeric breakdown of results, illustrating ranking of criteria by per cent of responses and how the criteria is ranked from among the list of criteria given.

Although the facility was offered, there were few "other" reasons mentioned as to why SMEs fail to obtain finance, however, most of these could be categorized in the criteria listed above. The other reasons given were:

- Owner contribution not high enough/lack of capital
- Being in a risky industry
- Prevailing economic conditions
- The lifestyle of the applicant – whether they are drawing too much out of the business or drawing too much too soon.

3.5. Services offered to SMES

Respondents were asked which of a list of services given their financial institution currently (or in the past) offers to assist SMEs to access finance.

- Most financial institutions claimed to offer considerable help to SMEs in the form of advice and skills training. There is a significant amount of 'how to' kind of help and advice as well as much printed matter available for the SME.
- Mostly, financial institutions offer information in the form of printed matter (brochures etc) and once off advisory services.
- Some 70% offer a referral service to experts and consultants.
- Others offer some form of training and assistance with skills in the form of mentoring, coaching and training.
- Just over half offer networking events and road shows.

The following table shows what is offered within each type of service:

Service Offered	% Offering	What Form	% Offering
Information Service	83%	Process and procedures	82%
		Regulations	43%
		How to start a business	43%
		BEE registration/benefits	29%
		VAT and how to register	22%
Once off Advisory Service	79%	Where to go for assistance	100%
		What product is best	91%
		How to start a business	51%
Referral Service	70%	Business plan developers	63%
		Accountants	50%
		Marketing experts	38%
		Bookkeepers	37%
		Other investors	24%
Consulting/ Mentoring/ Coaching	60%	Business plan preparation	72%
		Cash flow management	69%
		Feasibility studies	56%
		Industry specific mentor	56%
		Franchise training	42%
		Bookkeeping	41%
Training	55%	How to:	
		Develop a business plan	76%

Service Offered	% Offering	What Form	% Offering
		Manage finances	75%
		Start up a business	69%
		Financial statements	56%
		Manage loan repayments	54%
		Keep records	46%
Networking	55%	Introduction to products offered	76%
		Introduction to experts	62%
		Introduction to suppliers	36%
		Introduction to buyers	28%
Road Shows	51%	Products offered	86%
		How to access finance	79%
		Financial management	55%
		Sales and marketing	51%
		Regulatory issues	41%
		BEE registration/benefits	31%

When asked how successful these efforts are in assisting SMEs in their application for finance, all were rated very similarly: On average, ratings were given of 3 out of 5 in terms of success (where 5 = very successful and 1 = not at all successful).

However, if one takes the % of respondents who rated each service either a 5 or 4 (out of 5), then it is evident that Information and Consulting/Coaching/ Mentoring services are perceived to be the most successful in assisting SMEs, and roadshows are perceived to be the least successful in assisting SMEs to access finance.

Service Offered	Mean Score	Top Box %
Information Service	3.6	51
Once off Advisory Service	3.3	37
Referral Service	3.4	44
Consulting/ Mentoring/ Coaching	3.4	52
Training	3.2	37
Networking	3.3	39
Road Shows	3.2	30

3.6. How to increase FI market share

Respondents were asked to indicate what they thought their institution could do to help SMEs be more successful in their applications, in other words, increase their FI's own market share. No list was offered – this question was open ended and relied on the respondents to insert their responses.

- Twenty two per cent (22%) of respondents said there was nothing additional they could do to help SMEs be more successful in their applications for finance.

- Most comments related to the FI's own **evaluation criteria and process**. Primarily this was that the FI should relax the criteria which the respondents felt were too stringent for the SME market. This was especially, but not entirely, those criteria related to collateral; the view was that the FI should be more lenient. This also included looking at the SME as more than a financial risk - evaluating the individual as well as the business. This category of responses accounted for 41% of all mentions.

- In addition, respondents said that they should offer more **support** in the form of advisory and consulting services, and make the services ongoing rather than once off. This accounted for 16% of all mentions.

- Others felt that their own **internal systems** should change, primarily developing more specialised skills in their own organisations. This represented 12% of all mentions.

- Tailor-making the FI's **product** to suit the SME market was also seen as a way to ensure more successful SME applications – creating new products, products that were more appropriate to the market, offering a broader spectrum of products and improving costs and value. These comments represented 9% of all mentions.

- A few mentions (3% of all mentions) were made of improving their own **advertising and marketing**.

The details of these responses are shown below:

Category of Mentions	Comments	% of Mentions
Evaluation	• Relax criteria/all criteria but especially collateral (mainly) • Improve appetite for risk/take more risk • Understand applications n more depth/look at them holistically/ in depth analysis of individuals • Understand SME market/Look at the market differently • Model the turn down decisions • Assess the applicants ability/focus more on the individual's potential • Make more use of/improve credit scoring techniques • Look at the business as a whole • Evaluate the SME more effectively	**41%**
Support	• Offer mentorship/coaching/training • Improve/offer advisory services/ongoing assistance • Networking events/workshops/seminars • Involvement in skills development • Make relationship continuous	**16%**
Internal Systems	• Upgrade skills/more knowledgeable staff/frontline staff • Dedicated SME consultant/specialists/develop SME unit • Develop a sales ethic • Set targets • Measure credit managers on approvals	**12%**
Product	• Create unique programmes/specific loan packages • More flexible deals/broader spectrum deals • Provide value adds • Improve cost structure/reduce premiums • Shorten due diligence/process • Offer buy back arrangements to franchisors	**9%**
Advertising/ Promotion	• Change marketing/target advertising • Promote to SMEs	**3%**

3.7. How can the SME ensure more success?

Respondents were asked to tell us what they thought the SME could do to be more successful in their applications. Again, no list was offered – this question was open ended and relied on the respondents to give their responses.

Much of what the respondents said has been covered before in the previous questions. However, it is interesting that the highest mention here related to the SME making sure s/he was familiar with the market they intended to operate in and the need to do their own market research.

The following table shows the responses:

	%
Do market research/be familiar with their chosen field/get as much info as possible	24
Submit a business plan/a good plan/a viable business plan	12
Clean up their credit record/establish a good credit record	10
Sound/correct/up to date financial records	7
Supply all relevant documentation/information	7
Retain equity in the business/owner equity/sizeable contribution/invest in their own business	7
Ensure affordability/that they can repay the loan	5
Provide collateral/risk their own assets	5
Decrease their spending/prudent management of money/financial control	5
Involvement in own business plan/financials/be hands on	3
Transparency/full disclosure/be frank and upfront	3
Understand the needs of the bank	3
Submit a good cash flow report/plan	3
Study and live the business plan/take ownership	3
Have experience in their chosen field	2

3.8. The accreditation of consultants

Finally, respondents were asked if they felt that Consultants should be accredited or graded in a similar way to, for example, Financial Planners and if they would be more likely to recommend the services of such consultants to SMEs if they were graded

About two thirds agreed that this would be a positive move; while a third felt that they would recommend consultants who were accredited in this way.

	%
Should Consultants be Accredited?	
Yes	**68**
No	**9**
Not Answered	**23**
If Accredited, Would You recommend them?	
Yes	**62**
No	**10**
Not Answered	**28**

Given the many consultants offering various levels of professionalism to SMEs, some of the comments made in relation to this are documented below:

Positive Comments:

“Currently consultants are not held accountable for the quality of output they deliver, both by the SME and the financial institution using the information to make a difference. The result is poor quality information at a high cost.” (Senior Exec, Bank)

“There are many "professional" business planners out there who do not do justice to the plans or the entrepreneurs whose plan they are formalising. A grading system will sift out the bad from the good.” (Senior Exec, Bank)

“Accreditation would ensure that practitioners have the necessary abilities to provide quality & reliable information that the banks can use. It will also give the entrepreneur the peace of mind that the person is qualified to assist." (Senior Exec, Bank)

"One would have the opportunity to track the approval rate of the submissions together with the progress of each new business. It would essentially eliminate fly by nights who do not have the customers interests at heart." (Senior Exec, Bank)

"The accredited consultants would offer services at a standard fee; would will be held accountable for their advice; and ensure minimum qualification standards."
(Credit Manager, Public Funder)

"The standard and level of expertise of business consultants vary significantly. The grading system will assist in standardising this and also in identifying industry specific consultants." (Loan Officer, Public Funder)

"We have a service supplier list on our procurement list which can include these accredited consultants." (Credit Manager, Public Funder)
"If a professional 5 point plan can be done and all documents is in place the deal will be approved much quicker." (Loan Officer, Bank)

"Should the consultants be accredited they would then have the knowledge of what the requirements are for the SMEs to obtain finance, they would be able to evaluate the risk assessments prior to sending the clients to the banks." (Loan Officer, Bank)

"This would firstly ensure that non viable business plans are not submitted to financial institutions. Secondly, this would ensure that relevant information, for investors to make informed decisions, is contained in the business plan. It also enables the due diligence process to flow smoothly such that better turn-around times are achieved." (Loan Officer, Private Fund)

Negative Comments:

"It is too easy for the entrepreneur to hide behind a consultant and not take personal responsibility for their projections, costings, business plan and the like." Senior Exec, Private Fund)

"The current business broker service does not really know what banks want. They structure according to outdated accounting principles which do not take into account the "African business concept"." (Loan Officer, Bank)

"Regulation will only increase the cost of these services. The system will sift out the wheat from the chaff." (Credit Manager, Bank)

Qualified Comments:

"Recommend consultants specialised in certain fields, and they give training/assistance in certain fields, for example franchises. Must not be general consultant." (Credit Manager, Bank)

"It's imperative that all consultants have a relevant educational and industry knowledge."
(Credit Manager, Bank)

SECTION 4: SUMMARY AND CONCLUSIONS

The survey undertaken by FSP and the Banking Association served to highlight what hurdles FI's face in financing SMEs and what some of their interventions are to overcome those hurdles.

Funding

Most FI's fund all categories of SME, however, the higher the turnover of the SME, the more successful the applicant was likely to be in their application for finance.

The category of SME least likely to be funded was shown to be SMEs with an annual turnover of R10million to R20million although further investigation shows that these SMEs are often dealt with in a different division to the SME division and are still funded by the institutions.

Banks are most likely to be the institutions funding Start Ups and the lower end of the market and the Public Funder was shown to be the least likely to fund the low end of the market.

Clearly, SMEs in the Start Up and Less than R500k turnover categories need the most help.

Hurdles to Financing

Of the criteria used to evaluate an application for finance, all criteria presented in the survey were used by almost all FIs, and all were considered important. Most important was the financial status of the SME – what affects the bank the most. This was the ability of the SME to repay the loan (cash flow) and then what the SME was bringing to the party – their collateral, equity etc.

The FIs also need what the SMEs are not particularly good at – good documentation, especially financial statements, a good sales pitch of the individual, good business plans (which are understood by the SME) and demonstration of knowledge of their chosen field.

SMEs across the turnover categories fail for the same reasons. Mostly, it is their financial status and submission of good, accurate and up to date financial records. If they are financially viable, their next stumbling block is likely to be a good, well thought out business plan as well as their business skills.

FIs seem less concerned about age and educational qualifications and quite tolerant of aspects that can be fixed or addressed, such as FICA compliance, submitting the correct paperwork, accurate costing and pricing.

What is needed to overcome financing hurdles

FIs felt that, to ensure more successful applications and increase their market share, they should make the evaluation criteria more appropriate to the SME market, particularly as far as the requirement for collateral is concerned. They recognise the need to be more lenient in assessing applications, the need to take more risk, offer advice and support to SMEs, and the need to offer products which are new, more appropriate to SME financing needs, more broad in spectrum and with improved costs and value.

Most FI’s said they were offering support in the form of information (i.e. brochures), advisory services, referral services to third party business support and coaching/consulting/mentoring. These efforts were considered to be successful at least half the time.

Almost all FI’s agreed that accrediting or grading consultants would be a good idea and that if consultants were accredited, they would recommend such to SMEs.

The primary areas where it was felt that SMEs could do more to ensure successful financing include the need to be more familiar with and do more research on their chosen field and market, to focus on submitting business plans which are viable, and to take steps, where required, to clean up their credit record. This result suggests greater potential for influence by consultants/coaches and mentors.

Conclusion

From the survey, it is clear that Start Up and lower turnover businesses need the most help, presumably because, amongst other things, they have fewer of their own resources.

The survey suggests that third party providers can play an important role in assisting SMEs, and that there are a range of services that SMEs need:

- SMEs clearly need help in evaluating their own financial status and to make their own risk assessment before they approach a Financial Institution. FIs are much more concerned with the risk profile of an applicant, therefore if SMEs can make their own assessments they will have a more realistic idea of what they can expect and are likely to submit therefore a more realistic application that is more likely to succeed. A **pre-financing service** is recommended which serves to review the finance proposal with the SME so that they can gauge for themselves whether they are bankable or not.
- In addition to this, SMEs need assistance to understand how to reduce their risk status. This would include obtaining credit clearances and dealing with their existing debt. This assistance would form part of the pre financing service.
- A large stumbling block for SMEs is the need for collateral. FIs understand that this is difficult for SMEs but are working with an old financing model. Offering some kind of guarantee would reduce the burden of collateral for both the SME and the FI.
- SMEs need help in preparing a good set of financials and a business plan. In addition, they need to understand them. Such help is likely to be most effective where it is given **one-on-one** as consultants need to work with SMEs to make sure that the applications for finance relate directly to the SME’s business and not to a standard template (or “cut and paste” approach) which disregards the reality of the applicant’s business.
- SMEs need to actively develop their business skills, particularly in terms of managing their finances, understanding cash flow in the business and understanding the market in which they work. **Mentoring and training** would be of great value in addressing these needs of SMEs.

While the services mentioned above may exist in one form or another, indications are that FI’s are already offering services to help SMEs become more bankable. In some cases, the services are offered in house, in others, they are outsourced to third parties. What is clear however, is that FI’s would make more use of third parties if they were assured of the quality of service – or provider – offered. In this respect, grading of providers will go a long way to assisting SMEs to become more bankable, however, it is equally important that SMEs need to be matched with mentors and experts and that some form of facilitation in the market could assist with this. The opportunity therefore exists to link graded consultants to FI's and to facilitate referrals of consultants to SME clients.

The services offered to SMEs should be on an individual basis and should focus on helping SMEs understand their own businesses and the needs of the FIs. In this respect, facilitating access to finance is a huge need which, if offered in a way which is relevant to both SME and FI, could impact significantly on helping FI's overcome the financing hurdles they face. Finally, it is clear from comments made by the FI's themselves that they are working with a financing model that is inappropriate for this market of largely previously disadvantaged entrepreneurs. These entrepreneurs are unsophisticated when it comes to financial and business matters, and have limited resources, although they could very well be greatly qualified and potentially successful in their chosen field. There is a significant need for Financial Institutions to create a **different and more appropriate model** for evaluating risk and individuals, as well as **products** that are more suitable for this market.

SECTION 5: ANNEXURES

ANNEX 1: LIST OF FINANCIAL INSTITUTIONS PARTICIPATING IN THE SURVEY

Banks	Private Funders	Public Funders
ABSA Albaraka Bank of Athens FNB Mercantile Bank Nedbank SASFIN Standard Bank Wizzit	Blue Financial Services Business Partners GroFin Mettle Administrative Services Old Mutual PPC Ntsika SAB – Kickstart TGIF	IDC

ANNEX 2: TABLES USED FOR ANALYSIS OF SURVEY RESULTS

The survey results were analyzed according to the following list of tables:

Table	Question/Description
1	Q2. Please indicate the overall success rate of SME finance applications in each of the following categories of SME: Start Up
2	Q2. Please indicate the overall success rate of SME finance applications in each of the following categories of SME: Less than R500K
3	Q2. Please indicate the overall success rate of SME finance applications in each of the following categories of SME: R501K to R2.5M
4	Q2. Please indicate the overall success rate of SME finance applications in each of the following categories of SME: Over R2.5 M toR10M
5	Q2. Please indicate the overall success rate of SME finance applications in each of the following categories of SME: Over R10M to R20M
6	Q3. What criteria does an SME have to satisfy to be successful in their application for finance?
7	Q4. Please rank: Ranking + mean score of Ability to provide collateral
8	Q4. Please rank: Ranking + mean score of Number of years they have been in business
9	Q4. Please rank: Ranking + mean score of Good track record of loan repayments
10	Q4. Please rank: Ranking + mean score of Strong entrepreneurial characteristics
11	Q4. Please rank: Ranking + mean score of Good business plan
12	Q4. Please rank: Ranking + mean score of Cash flow sufficient to repay the loan
13	Q4. Please rank: Ranking + mean score of Complete information in the application form
14	Q4. Please rank: Ranking + mean score of Satisfactory reputation and trustworthiness
15	Q4. Please rank: Ranking + mean score of Sufficient amount of owner equity contribution
16	Q4. Please rank: Ranking + mean score of Other
17	Q4. Please rank: Ranking + mean score of Other
18	Q4. Please rank: Ranking + mean score of Other
19	Q5. What are the main reasons why SMEs fail to obtain finance from your institution? Start Up
20	Q5. What are the main reasons why SMEs fail to obtain finance from your institution? Less than R500K
21	Q5. What are the main reasons why SMEs fail to obtain finance from your institution? R501K to R2.5M
22	Q5. What are the main reasons why SMEs fail to obtain finance from your institution? Over R2.5 M toR10M
23	Q5. What are the main reasons why SMEs fail to obtain finance from your institution? Over R10M to R20M
24	Q6. Which of the following services does your institution have in place to offer assistance to SMEs in their application for finance? NB The focus is on what your institution already does or has done in the past
25	Q7. What form do/did these services take: Training
26	Q7. What form do/did these services take: Once off advisory services by staff
27	Q7. What form do/did these services take: Referral service to experts/consultants
28	Q7. What form do/did these services take: Information
29	Q7. What form do/did these services take: Consulting / mentorship / coaching services
30	Q7. What form do/did these services take: Roadshows
31	Q7. What form do/did these services take: Networking events
32	Q7. What form do/did these services take: Other
33	Q7. What form do/did these services take: Other
34	Q7. What form do/did these services take: Other
35	Q8. In your opinion, how successful are these efforts/services? Distribution of score + mean score: Training
36	Q8. In your opinion, how successful are these efforts/services? Distribution of score + mean score: Once off advisory services by staff
37	Q8. In your opinion, how successful are these efforts/services? Distribution of score +

Table	Question/Description
	mean score: Referral service to experts/consultants
38	Q8. In your opinion, how successful are these efforts/services? Distribution of score + mean score: Information
39	Q8. In your opinion, how successful are these efforts/services? Distribution of score + mean score: Consulting / mentorship / coaching
40	Q8. In your opinion, how successful are these efforts/services? Distribution of score + mean score: Roadshows
41	Q8. In your opinion, how successful are these efforts/services? Distribution of score + mean score: Networking events
42	Q8. In your opinion, how successful are these efforts/services? Distribution of score + mean score: Other
43	Q8. In your opinion, how successful are these efforts/services? Distribution of score + mean score: Other
44	Q8. In your opinion, how successful are these efforts/services? Distribution of score + mean score: Other
45	Q9. In your opinion, what could your financial institution do to increase your share of the SME financing business or of the SME market? TO BE CODED
46	Q10. In what way(s) do you believe your Financial Institution must change how it evaluates SME loan applications, such that it could increase its volume of SME lending but still be reasonably prudent? TO BE CODED
47	Q11. And what, in your opinion, should SMEs be doing to increase their own chances of obtaining finance from your institution? TO BE CODED
48	Q12. As you are probably aware, there are many consultants of differing levels of professionalism offering business services to SMEs (such as writing business plans etc). Do you believe that these consultants should be accredited or graded in a similar way to, for example, financial planners? (YES / NO)
49	Q13. IF YES: If there was a system to accredit or grade business service consultants, would you be more likely to recommend the services of such consultants to SMEs? (YES / NO)

ANNEX 3: REASONS, BY CATEGORY, WHY SMES FAIL TO OBTAIN FINANCE

	Start Up		Less than R500K		R500K-R2.5m		R2.5m-R10m		R10m-R20m	
Total Funding in Each Category	**173**		**161**		**171**		**162**		**122**	
	%	*Rank*	*%*	*Rank*	*%*	*Rank*	*%*	*Rank*	*%*	*Rank*
No/insufficient collateral	66.5	4	64.6	4	65.5	3	64.2	3	60.7	3
No/inadequate business plan	61.3	6	50.9	7	46.8	7	47.5	7	41.0	6
No/insufficient track record	46.8	9	44.1	8	38.6	8	37.7	8	28.7	11
Poor credit record of applicant/s	69.4	2	65.8	3	56.7	5	51.9	5	46.0	5
Over indebtedness	46.8	10	59.6	5	57.3	4	64.2	4	64.8	2
Inappropriate market/business	32.4	11	27.4	13	28.7	11	27.1	12	27.9	10
Inaccurate assessment of size of market for their product or service... they do not understand the market	49.1	8	32.9	10	35.1	10	37.0	9	32.0	8
Poor/incomplete paperwork	33.0	12	31.1	11	24.6	13	26.5	13	22.1	13
No/ poor financial statements	63.6	5	70.8	2	67.8	2	69.8	2	59.0	4
Poor/weak cash flow	72.3	1	76.4	1	79.5	1	74.7	1	74.6	1
Poor/weak costing and pricing	33.0	13	29.8	12	28.1	12	33.3	10	29.5	9
No/poor business management skills e.g. financial management, selling	67.6	3	55.9	6	48.5	6	48.8	6	39.4	7
Applicant is not really an entrepreneur	27.2	14	19.9	14	21.6	14	17.9	14	16.4	14
SME does not understand their business plan or financials	53.8	7	41.0	9	35.1	9	29.0	11	25.4	12
Educational qualifications of applicant/s	9.3	16	7.5	16	8.2	16	12.4	15	9.8	15
Non compliance with FICA / other regulations	11.6	15	9.9	15	9.4	15	11.1	16	9.0	16
Age of applicant/s	4.1	17	1.2	17	1.8	17	3.7	17	3.3	17
Other	6.9		5.6		2.9		5.6		7.4	