



S.A. GUIDE TO SMALL BUSINESS FINANCE: A TECHNICAL REVIEW

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FINANCIAL SECTOR PROGRAM

**S.A. GUIDE TO SMALL BUSINESS FINANCE: A TECHNICAL
REVIEW**

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EXECUTIVE SUMMARY

This report describes the process followed and conclusions drawn from technical review of the “*South African Guide to Small Business Finance*” (hereafter referred to as the Guide) aimed at improving South African business advisors’ grasp of the business finance landscape so that they are better equipped to advise their small and medium (SME) clients on how to gain access to finance.

The idea of a Guide to financing for business advisors has its origins in a study by the USAID’s Financial Sector Program in which the need for a better understanding among SMEs of the external world of business finance was identified, and a three-phase project was devised in order to deliver comprehensive knowledge of business finance to the market.

- Phase 1: Development of a curriculum outline (or framework) of modules for presentation to FSP’s business service organization (BSO) partners in order to verify which modules would most meet their needs, by what method and at what level of sophistication;
- Phase 2: Development of content of the Guide and packaging of the material into appropriate format (namely, a web-based resource to be delivered via a short training course);
- Phase 3: Delivery of content via the format preferred by BSO partners.

The framework of the Guide endorsed by FSP’s partners consisted, at the time of the review, of 5 sections, each consisting of a number of modules (see Annex 1 for the structure of the Guide). The 5 sections address:

The different kinds of finance needs in business;
Different types of finance to suit those needs;
The sources of finance;
How to approach the financiers; and
How to deal with the outcome of a finance application.

A sample of the modules were developed for comment and review by select BSO’s, and based on agreement of the approach to implementing the Guide, viz. to train business development workers, business advisors and accountants in its use, the complete content of the Guide was developed. This collaborative process laid the foundation for the overall approach to the Guide, including the level of sophistication of the content, the type of language and style of writing to be adopted. Subsequent to completion of the content, a technical review was undertaken of the Guide to ensure the accuracy and reliability of its content.

Over a period of five days, the Guide was reviewed in great detail to establish its technical accuracy, identify any gaps where information on a topic may be inadequate, provide direction where information may need to be changed in any way, and to provide feedback during face to face meetings with the author of the Guide. Feedback was given in such a way that any changes made to the Guide as a result of the technical review, would not need to be reviewed a second time.

This report contains a summary of the notes provided to the author of the Guide (see Annex 2 for summary feedback notes on the Guide). Overall, the review was extremely positive, confirming the value which the Guide should provide to business advisors. The review confirmed that the style of the Guide is appropriate for its purpose, namely for business advisors to assist their SME clients in accessing finance, and that it contains sufficient legal and technical information regarding the various financial products and services it describes. Recommendations were made about inclusion of additional information regarding, for example, equity finance, the National Credit Act, franchising, how to address a bad credit record, specific financiers, and most significantly of all, how to approach facilitation of access to finance (a module addressing the market opportunity for a specialized business service).

The technical review was the last piece in the development of the content of the Guide prior to its submission for language editing and subsequent packaging into a web-based resource. As such, the technical review of the content was an important step in ensuring its validity and relevance to business advisors wishing to facilitate access to finance on behalf of their SME clients.

SECTION 1: BACKGROUND

This report describes the process followed and conclusions drawn from a technical review of the “*South African Guide to Small Business Finance*” (hereafter referred to as the Guide) aimed at improving South African business advisors’ grasp of the business finance landscape so that they are better equipped to advise their small and medium (SME) clients on how to gain access to finance.

The idea of a Guide to financing for business advisors has its origins in a study by USAID’s Financial Sector Program¹ from which it emerged that no comprehensive resource exists in the market with information about where or how to access finance for SMEs. The need for a better understanding among SMEs of the external world of business finance was identified, and a three-phase project was devised in order to deliver comprehensive knowledge of business finance to the market.

- Phase 1: Development of a curriculum outline (or framework) of modules for presentation to BSO partners to verify which modules would most meet their needs, by what method and at what level of sophistication;
- Phase 2: Development of content and packaging of the material into appropriate format (namely, a web-based resource to be delivered via a short training course);
- Phase 3: Delivery of content via the format preferred by BSO partners.

During phase 1, key informants among Business Service Organizations (BSOs) were approached for their insights into how best this could be achieved. A comprehensive resource aimed at business development workers, business advisors and accountants was proposed, coupled with a training course on how to use the resource. An outline of the Guide, conceived as an electronic encyclopedia on business finance in South Africa, was designed (refer to Annex 1). The outline described a Guide with 5 sections: The different kinds of finance needs in business; different types of finance to suit those needs; the sources of finance; how to approach the financiers and how to deal with the outcome of a finance application. Each of the five sections consists of a series of modules, and, in some cases, sub-modules and/or case studies².

This phase also identified that the delivery format most preferred by FSP partners is training of BDS providers complemented by a web-based or electronic resource in order to effectively assist their SME clients.

In addition to this, samples of modular fact sheets were developed and evaluated by FSP’s partners in order to assess usefulness to their members and ensure that the content and format meets with market requirements. Under this phase, program content was agreed to and endorsed by FSP partners and program managers.

During phase 2, the entire content for the Guide was developed and each section reviewed in order to ensure technical integrity of the content of the Guide and to ensure that the

¹ Development of Strategy Options for SME Financial Literacy (2009)

² It is noted that subsequent to this assignment, the Guide was restructured by the author into six steps to reflect the chronological decision-making process involved in accessing finance

information contained in the modules well represents the South African SME credit environment.

This report provides a summary of the issues which emerged out of the technical review of the Guide.

SECTION 2: METHODOLOGY

Content for the Guide was developed prior to the technical review assignment being undertaken. The technical review therefore involved a number of key steps undertaken during five days in which the Finance Expert who undertook the review met with the author and FSP in order to provide written and verbal feedback (summarized in Annex 2 of this report) on each of the modules that had been developed.

By way of preparation for the technical review, the report “SME Financial Literacy Program: development of sample financial literacy modules” (January 2010) was read in order to understand the background to the development of the Guide.

On completion of this exercise, a thorough reading and study of the *SA Guide to Small Business Finance* was undertaken in order to understand the reasons for its development, particularly to understand the market at which it is aimed i.e. the small business development adviser, to recognize and take cognizance of the relevant legislature and regulatory environment and finally, to determine the appropriateness of the content and the possible need for additional information.

Specific aspects of the review involved:

- Assessing the technical accuracy of the content of the Guide;
- Identifying any gaps where information on a topic may be inadequate;
- Providing direction where information may need to be changed in any way;
- And providing feedback according to the timeframe agreed to at the outset of the assignment, using a combination of written summary and face to face feedback.

It was agreed that the feedback given should be sufficiently comprehensive so that the author could modify the content accordingly without needing the material to be re-reviewed.

The final task of the assignment was completion of this report.

SECTION 3: GENERAL OVERVIEW AND ASSESSMENT OF THE GUIDE

By definition the SME market is a difficult one for providers of finance to understand and manage effectively. Both barriers to entry and exit barriers tend to be low and therefore the turnover of businesses and failures in this sector is relatively high.

The need of SMEs for accurate, sound, business advice is acute so that this Guide should be of considerable use to business advisors in assisting their SME clients to obtain finance. It is estimated that there are more than 5000 business advisors in the South African market so that the potential to impact SME access to finance is notable. Training advisors in the use of the Guide will not only stimulate provision of a much needed advisory service, currently lacking in the market, it will contribute significantly to enabling the advisors to provide a better quality service to their clients.

The Guide is well written for its purpose. It is not an academic text of the content which it covers, which, if it were so, would be far less user friendly, too technical and inaccessible to the target group for whom it is intended. While its style is appropriate for the purpose of guiding business advisors, there is nevertheless sufficient legal and technical information regarding the various products and services to make it meaningful and extremely useful. It should therefore be of practical use to business advisors of small and medium enterprises.

Based on review of the content, it was recommended that the Guide needs to mention additional legal requirements in areas such as equity finance (namely, offers to the public and pyramid schemes), additional information with regard to the National Credit Act and additional information regarding different types of finance was also suggested. This information was not of major legal or regulatory significance but rather an enhancement of practical aspects pertaining to the products and markets described, for example:

- The provisions of the Banks Act with regard to deposit taking;
- Overdrafts payable on demand;
- Term loans become payable on demands on default;
- The necessity of a prospectus in the equity market;
- The requirements of the Financial Services Board, and in particular
- Regulatory requirements regarding collective investment schemes;
- Emphasis, when necessary, on the National Credit Act.

Much of the input was agreed to during the feedback process so that this report is of necessity brief but as such, should not detract from the usefulness of the time spent with the author of the Guide and the executive staff reviewing the Guide.

No material inaccurate statements or omissions were determined during the technical review. It was recommended that additional modules be added to the Guide dealing with franchising finance, how to address a bad credit record, and most significantly of all, how to approach facilitation of access to finance (a module to help business advisors consider and understand the opportunity that exists in the market to facilitate access to finance as a specialized business service).

The technical review was the last piece in the development of the content of the Guide prior to its submission for language editing and subsequent packaging into a web-based resource.

As such, the technical review of the content was an important step in ensuring its validity and relevance to business advisors who wish to assist their SME clients to access finance.

SECTION 4: ANNEXURES

ANNEX 1: STRUCTURE OF THE SA GUIDE TO SMALL BUSINESS FINANCE³

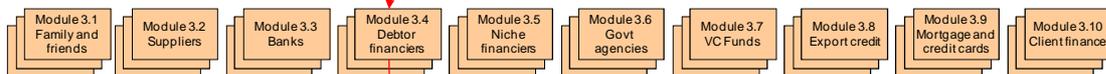
Section 1: Your finance need and the types of finance best suited to it



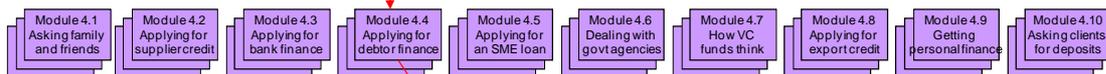
Section 2: Types of Finance and how they work



Section 3: South African sources of finance



Section 4: How to approach the financier



Section 5: Dealing with the outcome



³ Original map, subsequently changed after the technical review

ANNEX 2: SUMMARY OF TECHNICAL REVIEW NOTES

SECTION 1: YOUR FINANCE NEED AND THE TYPES OF FINANCE BEST SUITED TO IT

Module 1.1: Does your client really need business finance

This module is an excellent start to the Guide as it makes the advisor consider the client's business request right from the outset to determine whether the request for finance is a legitimate one or not.

As the Guide points out, requests for finance are often non-starters and do not have a reasonable chance of success. The advice given here right at the start of the Guide should prove a valuable reminder to advisors.

The list of business problems which may have led up to a request for finance for the wrong reasons is comprehensive enough to get the advisor thinking along the right lines. These common business faults are well described and explained.

Module 1.2: If your client needs start-up finance

Defines start up finance and the sources thereof and the issues that accompany such issues. It is my experience that, as the writer points out, this is the most difficult area of finance. The problem of obtaining outside funding of this nature is discussed together with the issues that potential providers of such funding would have. Other factors which often arise under the problems of how financiers "see the world" would be the difficulty of assurance as to a source of repayment or return on investment as well as a performance and delivery risk. For these reasons as well, private equity investors usually avoid green field projects. The recommendations of considering "own contribution" as well as family support is good. Types of finance to be considered is correct.

Module 1.3: If your client wants to buy an existing business

- Suggested an explanation as to how such a transaction would work.
- What is being bought?
- Is it the existing business entity as a whole or, as more often is the case, only the assets of the business?
- With the recent changes in the Companies Act it is possible under certain conditions to use the assets of a business as security to finance the purchase of shares of such a business.

Module 1.4: If your client needs to buy equipment and machinery

- No financial editing comments.

Module 1.5: If your client needs working capital

- No financial editing comments.

SECTION 2: TYPES OF FINANCE AND HOW THEY WORK

Module 2.1: Equity finance

Two legal issues needed to be covered here.

- The first one is that should an offer of shares be made to the general public then, in terms of the Companies Act, a prospectus has to be issued (the format of which is prescribed in the Companies Act).
- Secondly, the Financial Services Board has the power under the collective investment schemes legislation to outlaw pyramid investment structures.

Advisors should be made aware of these legalities.

Module 2.2: Term Loans

- Although term loans are for a fixed period and subject to a repayment program, it must be stated that default clauses will trigger immediate demand for repayment should default occur.
- The clauses of the loan agreement should be well understood and carefully considered.
- Interest can be on a variable rate or a fixed rate basis and therefore interest rate risk needs to be considered.

Module 2.3: Overdraft

- Care should be taken with overdraft finance. Overdrafts are a feature of the South African banking market which followed the British model. An overdraft should, strictly speaking, only be used for temporary cash flow fluctuations and should not manifest in a permanent source of fixed funding.
- As such, overdrafts are repayable on demand and South African banks are starting to limit the use of this product.

Module 2.4: Debtor Finance

- No financial editing changes or additions necessary.

Module 2.5: Supplier Credit

- Consignment stock whereby the goods remain the property of the supplier and are only invoiced and paid for after they are sold by the advisor's client needs to be included and explained.
- Trade finance, forwarding finance and confirming finance need to be included and explained.

Module 2.5: Contract Finance

- No financial editing changes necessary.

Module 2.6: Contract Finance Case Study

- No financial editing changes necessary.

Module 2.7: Asset Finance

- The three basic ways in which formal asset finance is provided are subject to relative legislation and this should be stated.
- Often the suppliers of assets - especially capital equipment - will be able to provide asset based finance.

Module 2.8: Export Finance

- No financial editing changes necessary.

Module 2.9: Personal Credit

- The advice regarding personal credit and the National Credit Act while very important, needs to be professionally worded.

Module 2.10: Customer Deposits

- No financial editing changes necessary.

SECTION 3: TYPES OF FINANCE AND HOW THEY WORK

Module 3.1: Family and Friends

Again, two legal issues need to be covered here.

- The first one is that, should an offer of shares be made to the general public, then in terms of the Companies Act, a prospectus has to be issued (the format of which is prescribed in the Companies Act).
- Secondly, the Financial Services Board has the power under the collective investment schemes legislation to outlaw pyramid investment structures.

Advisors should be made aware of these legalities.

Module 3.2: Supplier Credit in South Africa

- Consignment stock whereby the goods remain the property of the supplier and are only invoiced and paid for after they are sold by the advisor's client needs to be included and explained.

Module 3.3: The Banks

The Guide is absolutely correct in respect of the changes that the banking industry has made generally in South Africa, especially with regard to the changes regarding relationships and the method of credit decision making on the part of banks. However this should be conveyed more carefully as the banks remain very important potential providers of finance to the SME market.

- The National Credit Act needs to be highlighted here.
- Banks other than the main four need to be considered for mention.
- A complete list of banks regulated by the South African Reserve Bank appears on their web site under Bank Supervision.

Module 3.4: Debtor financiers in South Africa

- No financial editing changes necessary. Other parties are being identified.

Module 3.5: Niche SME Financiers

- No financial editing changes necessary. Other parties are being identified.

Module 3.6: Government Agencies

- No financial editing changes necessary. Other parties are being identified.

Module 3.7: Venture Capital and Angel Investors

- No financial editing changes necessary.

Module 3.8: Export Finance in South Africa

- No financial editing changes necessary.

Module 3.9: Personal Finance

- The aspects on the National Credit Act need to be highlighted.
- The wording regarding personal finance raised before embarking on a business venture needs to be reviewed.
- Name of S.A. Home Loans to be checked.
- Mentioned costly surrender of a life insurance policy.

Module 3.10: Customer Deposits in South Africa

- No financial editing changes necessary.

SECTION 4: HOW TO APPROACH THE FINANCIER

Module 4.1: Approaching family and friends

- The risks of donations tax need to be highlighted and explained.

Module 4.2: Approaching Suppliers for credit

- No financial editing changes necessary.

Module 4.3: Approaching the banks

- Reword “lip service”.
- Stress the need for advisors to build up their own data base of where to apply in their market.

Module 4.4: Approaching Debtor Financiers

- No financial editing changes necessary.

Module 4.5: Approaching Niche SME Financiers

- No financial editing changes necessary.

Module 4.6: Approaching Government Agencies

- No financial editing changes necessary.

Module 4.7: Approaching Venture Capitalists and angle investors

- No financial editing changes necessary.

Module 4.8: Approaching Export Financiers

- No financial editing changes necessary.

Module 4.9: Approaching lenders for personal finance

- No financial editing changes necessary.

Module 4.10: Approaching customers for deposits

- No financial editing changes necessary.

SECTION 5: DEALING WITH THE OUTCOME

Module 5.1: Managing the financier relationship

- No financial editing changes necessary.

Module 5.2: What to do if your client's application for finance gets turned down

- No financial editing changes necessary.