NBFI MAPPING STUDY SANITISED VERSION

October 2011

This publication was produced for review by the United States Agency for International Development. It was prepared by Nexii South Africa (Pty) Ltd under subcontract for Chemonics International Inc.

FINANCIAL SECTOR PROGRAM

UNDERSTANDING THE UNIVERSE AND ABSORPTIVE CAPACITY OF NON-BANKING FINANCIAL INSTITUTIONS (NBFI) SUPPORTING SME LENDING ACTIVITIES IN SOUTH AFRICA

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

CONTENTS

ACRONYMS

BBEEE	Broad-based Black Economic Empowerment
BDSP	Business Development Support Provider
DCA	Development Credit Authority
DFI	Development Finance Institutions
DTI	Department of Trade and Industry
ED	Enterprise Development
FI	Financial Intermediary
FNB	First National Bank
FSB	Financial Services Board
FSP	Financial Services Program
IDC	Industrial Development Corporation
MFI	Microfinance Institutions
NBFI	Non-Banking Financial Institution
NCA	National Credit Act
NCR	National Credit Regulator
NEF	National Empowerment Fund
OPIC	Overseas Private Investment Corporation
RSA	Republic of South Africa
SA	South Africa
SEDF	Soros Economic Development Fund
SME	Small and Medium Sized Enterprise
SMME	Small, Medium, and Micro Enterprises
SPV	Special Purpose Vehicle
TIGF	Thembani International Guarantee Fund
ZAR	South African Rand

EXECUTIVE SUMMARY

Small and medium enterprises (SMEs) provide approximately 66% of employment opportunities in developing countries overall and up to 78% in low income countries (World Bank, April 2011). As such, their success is critical to driving growth and job creation. However SMEs in these economies suffer from lower rates of productivity and sales growth largely due to a lack of access to finance, a need for business development services and policy barriers.

These findings are common the world over and reflect strongly the significant barriers that face growth and development of the SME sector in emerging economies. Aware of these barriers, the United States Agency for International Development's (USAID) Financial Sector Program (FSP) has spent significant resources over the past four years working to expand access to financial services and lower financing cost SMEs.

USAID's FSP activities have addressed various levels of the problems faced by SMEs including working to reform the legal and regulatory framework affecting the financial and business environment for SMEs, providing business development and technical services to improve the capacity and commercial viability of SMEs in South Africa and expanding SME access to a range of high quality and affordable financial services.

In its work to increase access to affordable finance, USAID and the FSP made available a Global Triple A-rated DCA credit guarantee facility to certain Non Bank Financial Intermediaries (NBFIs) who on-lend to SMEs, with a view that they would be able to access more affordable capital from banks and other financial providers to scale their work. This program did not meet with much success because of the aversion to perceived risk in the underlying SME portfolios of NBFIs on the part of the banks, and the disregarding of the track record of the NBFIs themselves as the key managers of risk and on-lending practices of such finance to SMEs.

Based on this experience, USAID and the FSP believe it may be necessary to raise a debt fund from institutional life and pension fund assets, secured by the DCA credit guarantee, in order to meet this purpose. To explore the options and appetite for this, the FSP commissioned a body of research to look at (a) the appetite for a debt fund amongst fund managers; (b) the nature of the structure that could most effectively address the barriers to credit and investment capital flows for NBFIs to on-lend to SMEs and (c) the appetite for credit amongst NBFIs given the activity and demand of their underlying investment pipeline.

The first part of the research called for expressions of interest from asset managers keen to raise and manage a debt fund designed specifically to provide for SME on-lending. Eight asset managers submitted expressions of interest and indicated that the financing pipeline for NBFI and SME lending was considerable. This research reinforced the USAID FSP's belief that there is a definite and critical need for access to affordable capital amongst NBFIs and SMEs. The fact that a small sample of NBFIs in the preliminary study indicated an ability to relatively easily absorb more than R2 billion within 12 months, suggested a potentially significant market for capital allocation.

This second body of work has focused more specifically on understanding the actual nature and requirements of the NBFIs as critical finance providers on-lending to finance to SMEs, and specifically on understanding the actual financing requirements that exist in order to ascertain what optimal size and shape a dedicated SME debt fund should take. The research process throughout this study has constantly sought to verify the general percept that it is a lack of access to capital that most limits SME on -lending and has sought to determine whether the more critical – or at least as critical – issue is a lack of sufficiently high quality SMEs to on-lend to.

Given this objective, this study sought to answer the following key questions:

- How many NBFIs are engaged specifically in providing finance to SMEs in South Africa and how many SMEs do they support?
- What is the absorptive capacity with respect to the SMEs in their pipeline and specifically the capital requirements that these SMEs have in the next 12 and 24 months?
- What are the key challenges that NBFIs face in working with SMEs? Are they most affected by a lack of capital or is a lack of quality SMEsin their investment pipeline the most critical constraint?

Methodology

In seeking to gain a comprehensive understanding of the landscape in which NBFIs and SMEs are operating in South Africa, this research made use of various tools to collect the data that forms the subject of this analysis. In particularly the methodology included the following:

- Desk based research on the current SME finance landscape in South Africa and a broad mapping of organizations providing finance to SMEs
- Face to face in-depth interviews with various NBFIs and Business Development Support Providers (BDSPs) as well as directly with SMEs to identify their financing sources;
- A series of surveys with a broad array of stakeholders supporting the growth and development of SMEs in South Africa.

The research was initiated with an introductory survey that was sent out to 200 potential NBFIs. This initial survey received a 15% response rate and additional engagement was then sought both with this target database as well as with NBFIs from other sources. Most specifically, a list of over 800 finance providers registered with the Financial Services Board (FSB) and the National Credit Registry (NCR) was developed. These organizations were approached with a revised survey that both focused on the three core questions that this research sought to answer as well as with a summary of the research findings from the first respondents which included a provocative suggested conclusion that access to finance was not the critical barrier. At the end of the survey process, a total of 58 participants partially completed the survey and 29 participants completed it in full. Together with the data from 6 depth NBFI interviews this resulted in a total sample size of 35 respondents making up this data analysis. Data from the partially completed surveys was considered in some of the areas to ascertain where relevant the input from additional respondents.

Conclusions

The findings do indicate that there is a significant and growing demand for finance amongst NBFIs that are on-lending to SMEs. Specifically they indicate a demand for the type of debt fund that USAID is proposing. The average financing requirement in current lending activities can be estimated at ZAR 72 million per NBFI (range extends up to ZAR 300 million) but the anticipated demand in the next twelve months is estimated to increase to ZAR 200 million per NBFI suggesting a demand size amongst these respondents of ZAR 4.8 billion. This more than doubles in the following 12 month period to give a total estimate of almost ZAR 10 billion within the next twenty-four months. The depth interviews with NBFIs support this conclusion as they report turning away quality SMEs due to a lack of available capital to on-lend to them.

In addition, of the total responses received to the question of whether or not it is more difficult to access capital for on-lending than it is to access high-quality SMEs, 72% of NBFIs indicated that access to capital is indeed more of an issue than access to investible SMEs. Several described that there has been an increase in the number of high quality SMEs seeking finance but they do not have the funding capacity to engage with those opportunities.

Despite initial concerns expressed in the interim report that capital may not be the biggest constraint, it is clear from the follow up survey responses that there is indeed significant demand and in fact critical need for a larger pool of capital to support the lending activities of NBFIs servicing SMEs.

SECTION 1: INTRODUCTION

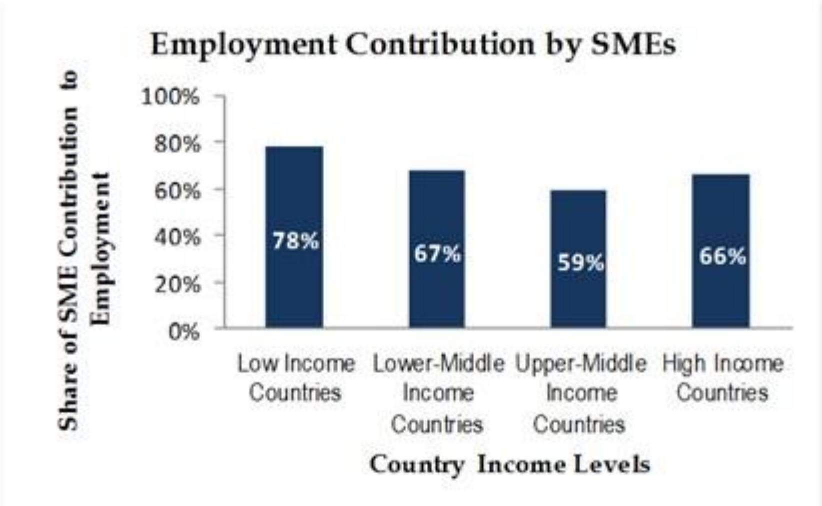
General perception suggests that the pipeline for SME finance is large; however there is limited research in South Africa that has really been able to quantify the scale or quality of this pipeline or the real quantum of finance requirements of SMEs. This research has attempted to delve more deeply into the nature of NBFIs, their SME lending practices, performance records and default rates and their pipeline need for financing and represents a first attempt to comprehensively "map" the NBFIs in South Africa that are focused on SME lending activities.

SME growth, development and financing

Small and medium-sized enterprises (SMEs) – increasingly referred to as small and growing businesses (SGBs) – are important catalysts of growth in most developing countries. According to the International Finance Corporation (IFC), SMEs range in size from 10 to 300 employees, with total assets and/or sales up to $16 million[1].

These businesses are powerful vehicles for securing sustainable livelihoods, increasing employment and driving economic growth. In high income "developed" countries, small and medium enterprises provide approximately 60% of employment opportunities and are a primary engine of economic growth contributing approximately 39% to GDP.However, in low income "developing" countries, formal small and medium businesses typically comprise around 30% of total employment and generate only 16% of GDP[2]. Given these differences, we can understand how, without a vibrant SGB community, emerging markets in the developing world will remain limited in their growth and wealth creation potential.

Figure 1: Employment contribution by SMEs

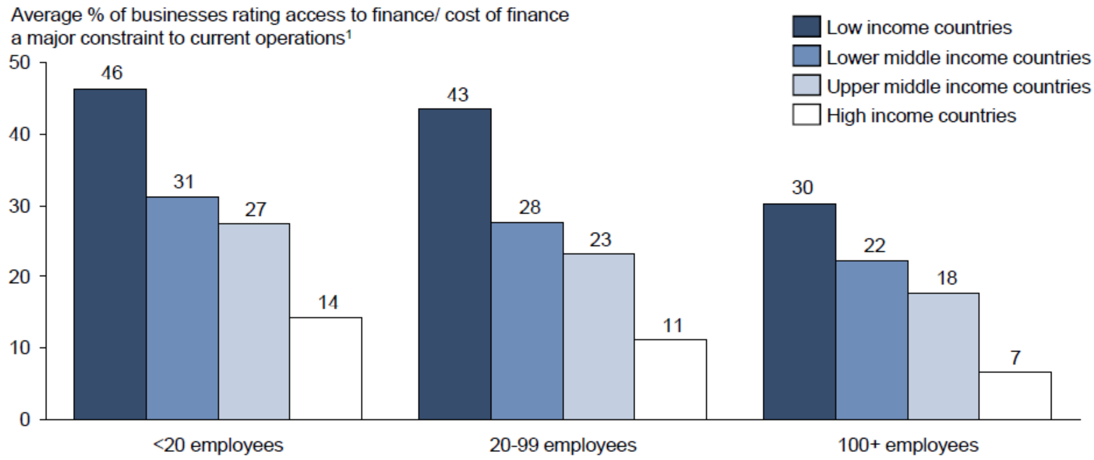


Developing world countries have significantly lower levels of access to finance and the cost of that finance is a major constraint to the ease of doing business. Figure 2, below taken from

[1]See Annexure 6 for the definition of SMEs according to the South African Department of Trade and Industry.
[2]IFC. (2009). The SME Banking Knowledge Guide.

the Dalberg[3] analysis of the World Bank Enterprise Survey in 2008 illustrates the significant percentage of businesses in lower income countries that rate access to finance and the cost of finance as a major constraint to current operations. This situation is unlikely to have improved given the economic downturn which commenced in 2008.

Figure 2: Rating of access to and cost of finance as a constraint to business activity



(Note: Countries weighted equally within income groups to calculate overall average)

SMEs especially in developing countries face a "missing middle" for both debt and equity financing and are often limited to obtaining finance from family and friends or as personal loans from the banking sector or from brokers in the micro-lending industry. These tend to offer relatively small amounts of capital and charge high interest rates due to the perception of high risk associated with SME lending.

Smaller enterprises are also unlikely to use commercial banks for financing because of the costs. Banks also typically lack incentives to serve SMEs due to limited competition and perceive SME lending as high risk because of a lack of credit information, financial records or detailed business plans.

In addition, whilst microfinance institutions (MFIs) are active in developing countries, most do not serve the SME sector where the capital needs are typically larger than most MFI loans. The differences in lending processes and requirements also generally limit the MFIs' abilities to service this market.

Access to affordable, appropriate growth finance is generally considered to be the single greatest and most critical limiting factor for the growth and scaling of SMEs. Growth capital for SMEs is typically understood to range from US$20,000 to US$2,000,000. It is also referred to as "the missing middle" – and is regarded as characteristic of entrepreneurs who capable of servicing a certain level of debt and therefore qualifying as" too rich" or "too big" for microfinance but are mostly "too small" or "too poor" for the low end of commercial lending activities. This missing middle can be understood as existing between the following types of finance:

---

[3]Dalberg, (July 2008). *Aspen Network for Development* Entrepreneur. Background Analysis. http://www.aspeninstitute.org/sites/default/files/content/docs/aspen%20network%20of%20development%20entrepreneurs/ANDE_SGB_BACKGROUND_ANALYSIS_JULY_2008%5B1%5D.PDF

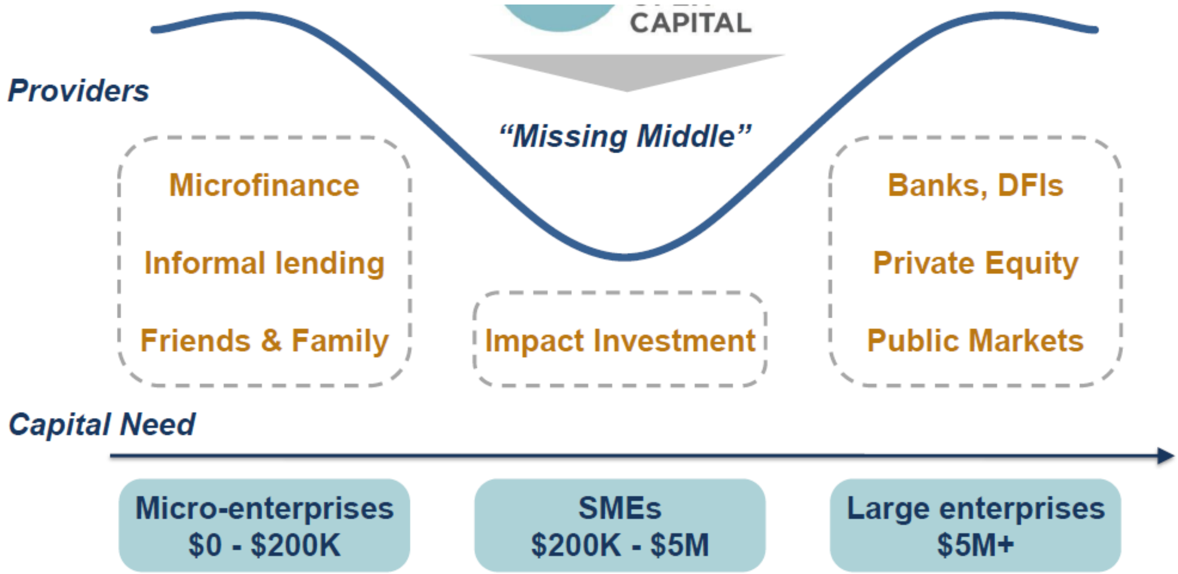
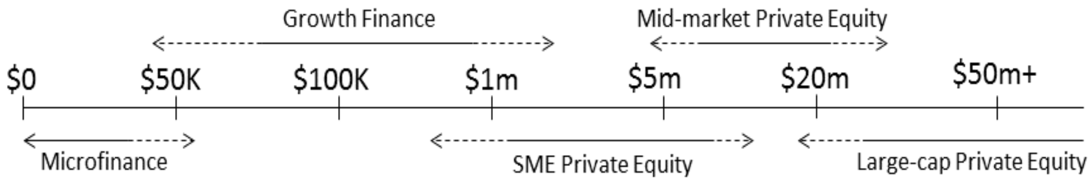


Figure 3 below depicts the different kinds of capital and the relative boundaries of each.[4] The funding gap for financing SMEs refers, as can be seen below, to the space between receiving commercial rate capital or SME Private Equity and microfinance. Lack of growth finance in this band restricts the majority of SMEs accessing appropriate and affordable capital.

Figure 3: Boundaries of investment spaces



Note: $ amounts indicate typical transaction sizes

The OECD's 2006 research into this "financing gap" points out that the size and nature of a country's financing gap seems to ultimately depend on whether the business environment is sufficiently transparent and robust to enable borrowers and lenders to interact with confidence on an "arm's length" basis"[5] This study indicates that asymmetric information and performance monitoring difficulties make it less likely for SMEs to access credit. The same report considered the existence of a financing gap in OECD and non-OECD countries and found that the experience with regard to SME financing was significantly different in OECD and non-OECD countries as follows:

- OECD countries do not report any generalized SME financing gap. Most SMEs in OECD countries are able to obtain sufficient credit from banks and other credit institutions, supplemented in some cases by a modest volume of official guarantees.

- Most non-OECD economies by contrast report a widespread shortage of SME finance. Even though SMEs typically account for a large share of enterprises, employment, and output in many emerging and developing countries, they receive a

[4] Shell Foundation 2011,"Growth in finance in Sub-Saharan Africa: Routes to scale and sustainability".
[5] OECD, 2006: "The SME Financing Gap, Theory and Evidence" Vol. 1

very low share of credit, with the majority often being denied any access to the formal markets. This development is closely related to the phenomenon of "informality" in emerging markets in which many enterprises operate outside the formal system. There are three factors favouring informality:

- established financial institutions are not interested in dealing with SMEs and, hence, there are few positive incentives to operate transparently;
- entrepreneurs in SMEs seek to avoid regulation and taxation in the formal sector; and
- governments lack the administrative capacity to enforce laws and regulations.[6]

South Africa's financial services sector

Unlike many other developing countries, South Africa has a relatively well developed capital markets system with numerous players in the investment market. The financial services sector is backed by a sound regulatory and legal framework with dozens of domestic and foreign institutions providing a full range of services - commercial, retail and merchant banking, mortgage lending, insurance and investment.

South Africa's banking sector compares favorably with those of industrialized countries. Foreign banks are well represented and electronic banking facilities are extensive, with a nationwide network of automatic teller machines (ATMs) and internet banking facilities available.

The Financial Services Board (FSB) oversees the regulation of financial markets and institutions, including insurers, fund managers and broking operations but excluding banks, which fall under the South African Reserve Bank (SARB). The Johannesburg Stock Exchange (JSE), incorporating the Bond Exchange of South Africa (BESA) is an independent, licensed exchange, constituted as a public company, and responsible for operating and regulating the equity, debt securities and interest-rate derivative markets in South Africa. The JSE and BESA have been at the forefront of market developments in South Africa for a long period of time.

The size of the SME market in South Africa is estimated to comprise of 1.5 million small and medium sized enterprises, which accounts for around 60% of the country's total labour force.[7] SMEs in South Africa face the same main barriers reflected in most research on the SME sector, which indicates that access to, and cost of finance are significant constraints to small businesses in developing countries.

In 2003, the JSE launched the Alt-X, an alternative exchange board for midsized pre-profitable companies which many thought may well support SME development in the country. However, the level of regulation and sophistication places the majority of the companies considering the Alt-X as a means of raising capital outside of their reach. Here again the interplay between a lack of early stage capital, technical assistance and human resource capacity have come into play, making the Alt-X relatively inaccessible to most SMEs as a means of raising affordable risk capital unless they are highly capacitated already.

[66] Ibid.
[7] "Entrepreneur of the Year 2010". Sanlam and Business Partners.

More recently, various efforts to establish a dedicated exchange board for SMEs and other high social impact business initiatives (referred to as “impact investments”)[8] have emerged. These are focused on establishing the right kind of intermediation infrastructure through which information asymmetries can be addressed, standards for application and reporting on credit can be promoted, sector information and investment offerings can be co-located and a variety of related services and product offerings, designed to not only increase access to capital for SME, businesses and organizations in these sectors but also to increase the capacity, technical assistance support providers and market linkages for SMEs.

Efforts are currently somewhat fragmented but increasingly moves towards creating an industry body are gaining traction and it is hoped that this research can lend further support for this industry wide effort at coordination and defragmentation.

[8]An Impact Investment is an investment in a company, organisation or business enterprise that has the primary intent of addressing a social or environmental financial need and achieves this by applying a sustainable business model using market based income generating strategies. Such enterprises can deploy capital investment and provide financial returns in addition to social and environmental performance and impact.

SECTION 2: ABOUT THE RESEARCH

Objectives

The key objectives of the research were to answer the following questions:

- How many NBFIs are engaged specifically in providing finance to SMEs in South Africa and how many SMEs do they support?
- What is the absorptive capacity with respect to the SMEs in their pipeline and specifically the capital requirements that these SMEs have in the next 12 and 24 months?
- What are the key challenges that NBFIs face in working with SMEs? Are they most affected by a lack of capital or is a lack of quality SMEsin their investment pipeline the most critical constraint?

Approach and Methodology

The research methodology involved a variety of different information collection mechanisms. Secondary research included in-depth analyses of organizations websites, service offerings, network connections and membership bodies as well as additional connections through word-of-mouth referrals within the SME community.

This included engagement with the Financial Services Board, FAIS department and the National Credit Regulator who provided comprehensive lists of registered entities, which was filtered to the criteria matching the NBFI profile defined as of interest to the FSP.

Initially a series of interview questions were created, which focused on profiling NBFIs and BDSPs within the SME community in South Africa. Research was conducted on more than 200 NBFIs from different groups including, nongovernmental organizations (NGOs), asset managers, investment consultants, impact investment funds, social venture capital funds, debt providers, and capital aggregators.

Twenty candidates were contacted via email to test the format of the interviews and surveys and subsequently 10 face-to-face interviews and 6 phone interviews were conducted for data analysis. Each face-to-face or telephone interview was between one and two hours in length, and covered 26 interview questions spanning the following key focus areas:

- Understanding the nature of specific service offerings, service requirements and the nature of finance provision to SMEs in South Africa
- Enablers and/or impediments – who are the gatekeepers
- Regulation and legal structure to support or detract from finance provision to SMEs
- Impact measurement and reporting

Additional information was gathered using Survey Monkey and covering detailed information on product and service offerings, financial information, track records and the company's structure and operations. All responses were aggregated and analyzed quantitatively and qualitatively.

Upon receiving the full database of NCR and FSB FAIS registered entities, a second survey including previous survey results was sent out to around 1,600 organizations. These organizations were invited to provide feedback on the results and respond with commentary on the need for a debt fund exclusively focused on increasing access to capital for SMEs. All participants' information provided has been kept confidential and results aggregated. Commentary from individual interviewees has not been included, unless permission was obtained.

Scope and limitations

The FSP requested Nexii to undertake a body of research to identify and "map" the NBFIs in South Africa that are focused on SME lending as well as other business development support activities where these were provided in conjunction with financing activities. However, it was felt that expanding the scope of the research to include Business Development Support Providers (BDSPs) would provide valuable insight and perspective to inform the understanding of the entire landscape, despite that fact that BDSPs would not utilize the debt fund directly. In addition, the research also included several banks to further the contextual understanding of the sector and challenges.

The response to the surveys was poor for the purposes of really developing a robust assessment of demand in the market (15%). Follow-up calls and emails did increase these numbers and indeed a summary conclusion that provocatively suggested it was not about money elicited additional responses from the initial target NBFIs.

Whilst the research has attempted to triangulate estimates from various vantage points to give an indication of the boundaries of the sector, it is possible that the small number of responses may have limited the overall findings. This may be indicative of the vastly different capacities at the polar ends of the NBFI spectrum or could be the result of survey fatigue and the fact that many recipients felt that the survey wasn't relevant to the products and services they provide specifically in terms of equity lending or business development as opposed to finance providers. The low response rate is, nevertheless, somewhat surprising, given that the research was positioned as a first opportunity to register as potential beneficiaries of the SME Debt Fund.

The second survey opportunity to engage with NBFIs on-lending to SMEs was based on input from the FSB and NCR, which provided the opportunity to grow the target database and reach a broader scope of financial providers to SMEs. The number of survey responses increased from the initial round of surveys however, the pool of respondents was still limited. There was however a wider range of responses and additional input providing very valuable feedback on the demand for an SME Debt Fund and to support our the initial hypothesis that there is a need for access to greater amounts of affordable capital by NBFIs acting as critical sources for on-lending to SMEs.

Lastly, a number of respondent organizations actively involved with the SME ecosystem have positioned their organizations as NBFIs when in fact they do not directly provide finance to SMEs. Clearly this indicates a lack of understanding around what defines an NBFI.

After conducting a broad based mapping, it was found that NBFIs are not completely segmented from organizations providing support services for SMEs and they are therefore classified together, which results in a blurring of the role of NBFIs. Additionally, the FSB and NCR lists seem to be outdated and difficult to filter due to a lack of field information. These systems need to be refined to create a more nuanced system for mapping the ecosystem that differentiates the roles of NBFIs from other support programmes in the SME ecosystem.

Based on all of the above factors and the number of partially completed surveys, the findings presented in this report are not based on complete survey responses to all questions. However, responses to comparable core research questions have been aggregated to support this quantitative analysis and provide support for the findings that this report specifically sought answers to. Additional qualitative and quantitative information gleaned from first target responses has also provided some color to the overall understanding of the NBFI sector in South Africa. Taking all of these activities and comparisons into account, we do believe that the results do give a good estimate of the baseline demand and at least some detailed understanding of the boundaries of the SME market in South Africa. This may well be significantly higher but as an understanding of active and present demand we are confident that the picture is sufficiently accurate for USAID FSP to draw conclusions regarding absorptive capacity in the market
.

SECTION 3: KEY RESULTS AND FINDINGS

THE SIZE AND SCOPE OF NBFIS ON-LENDING TO SMES IN SOUTH AFRICA

In order to create a comprehensive database of NBFIs financing SMEs and assess the size and scope of the NBFI market, our broad mapping of NBFIs included sourcing data from the following:

- Development Finance Institutions list of finance providers
- Financial Services Board (FSB) list of intermediaries
- National Credit Registry (NCR) list of SME Financiers
- Identifying which finance providers SMEs are approaching for funding
- Desk based research on NBFI activity in South Africa
- Referrals from interviews with NBFIs

These resources were compiled into a database of 1600 potential NBFIs who were targeted in this research. As explained above, the response rate was low and the total number of completed survey participants totaled 35. Nevertheless we believe the status and size of those NBFIs who did respond gives a good estimate of the activity in the sector.

Results

The list of potential NBFIs and finance providers compiled from the NCR and FSB registries range between 181 to 11,500organizations, suggesting there is a much greater market of potential NBFIs than the specific 800 targeted NBFIs and 35 actual respondents that this report encompasses. The conclusions of this research are, however, based on only those who answered the survey and might in fact indicate the list of those who are among the more established and sophisticated NBFIs given their engagement. Nevertheless, we believe the range of the NBFI databases depict there is a potentially a much more significant market of NBFIs though their activities and capabilities may not be well understood.

It is clear that there are obvious and usual targets and indeed, when NBFIs or SMEs were asked to suggest others active in the field that they were aware of, the same list of organizations always emerged. There was relatively little mention made of any other NBFIs, which could suggest that there exists a need to strengthen and raise the profile of growing and emerging NBFIs, most especially where these may be providing "competitive" service offerings that could begin to drive down cost through competition.

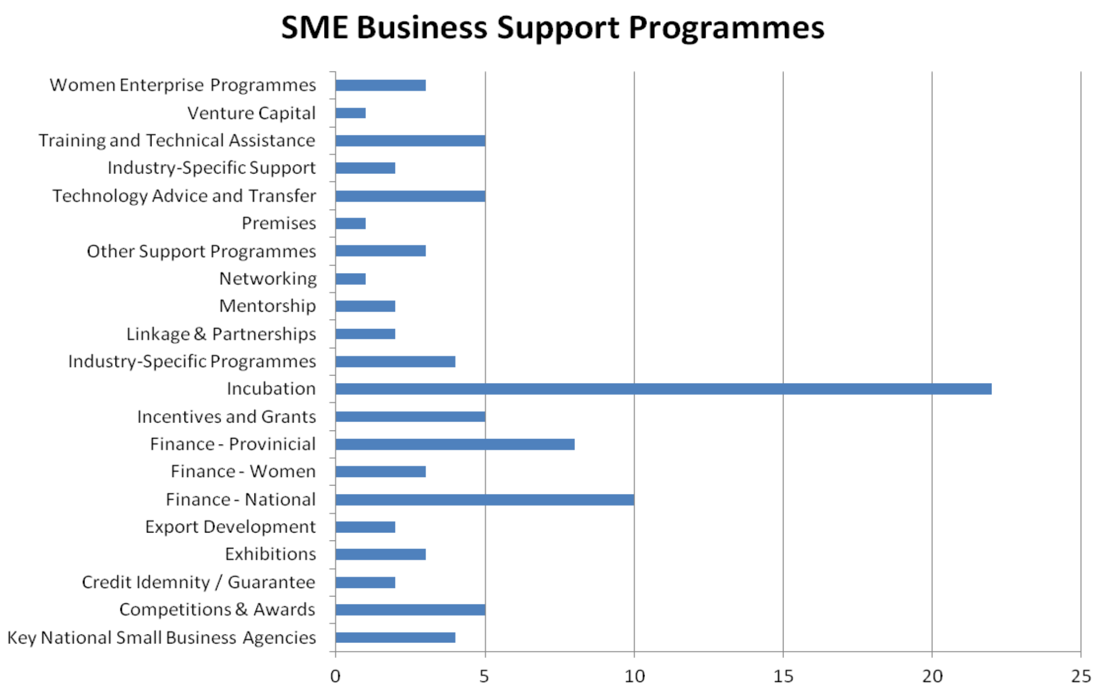
In this regard NBFIs do report that there is low competition for deals between them since they each have a specific product offering or niche market focus and tend not to enter each other's markets. This could effectively reduce the ultimate growth and deepening of service provision in the area which would not serve the SME agenda well. The fact that there is also little connection or cross-referrals between NBFIs adds to this problem. Better referral systems between NBFIs lead to greater efficiencies and better service delivery to the SMEs.

The NBFIs in the research target various SME markets including: waste management, financial services / products, transport, retail, wholesale, service industries, franchising and housing. In addition, all NBFIs we engaged with provide loans directly to the end user and only four respondents have provided loans via partnerships with other lending institutions as well.

Overall this research has not elicited a comprehensive understanding of the NBFI sector in South Africa and there is still a lack of consistent information regarding the resources available to SMEs to access finance given there is not a regulated industry body committed to advocacy, education and standards development in the SME sector.However, we do believe this research has made progress in identifying the key actors who are, currently at least, responsible for the most significant activity in SME on lending and understanding the constraints the sector faces. It may well be that NBFI capacity development programs would be beneficial in terms of growing the ability of NBFIs registered but relatively under-resourced to increase the footprint and flow of capital to SMEs, most particularly in less resourced rural provinces where activity seems to be low.

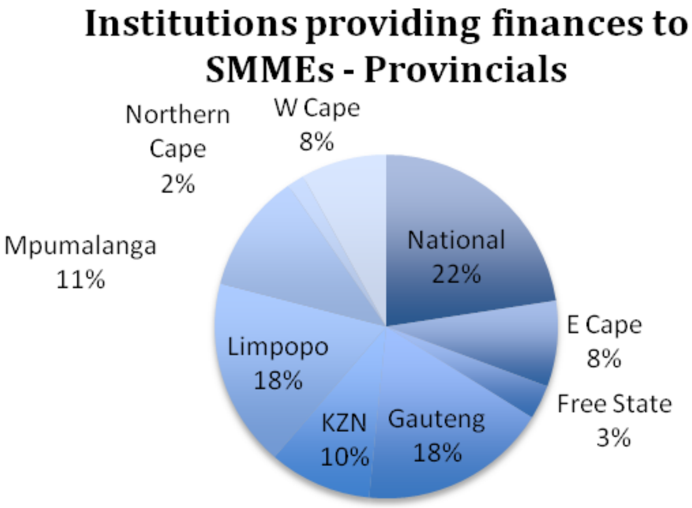
In this regard a developing initiative of the Ministry of Trade and Industry would be worth USAID's FSP potentially engaging with. This will see the development of a National SMME Directory which intends to create and provide a database through which SMEs can identify resources to access capital. The table below illustrates the landscape of SME finance providers and support programs based on the National SMME directory, and provides a good classification of the types of service providers for SMEs.

Figure 4: Business Development Support Programs for SMEs



Taken from the same data source, the chart below illustrates the landscape of finance providers servicing SMEs based on provinces.

igure 5: Institutions providing finance to SMMEs by province



The National SMME Directory may provide a much needed single source of information for SMEs to identify potential resources to access capital. Whilst not available as yet, we believe it responds to the need identified by USAID's FSP in undertaking this research and has the potential to become a critical resource for directing SMEs to appropriate resources. Further program activity would be useful in strengthening this aspect of the field and we believe it may be possible for the FSP to engage with and catalyse this based on its understanding and the potential to provide technical assistance for the delivery of this database and to match it with other FSP service offerings including finfind.

SECTION 4: UNDERSTANDING THE FINANCING REQUIREMENTS AND ABSORPTIVE CAPACITY OF NBFIS ON-LENDING TO SMES

The table below reflects the key financial data averaged from the survey respondents as well as a more accurate representation of current absorptive capacity. The most significant figures in the table below are the current average financial commitments NBFIs have to the SME market (ZAR 72 million), the average anticipated commitments based on pipeline in the next twelve months (ZAR 200 million) and the average anticipated commitments based on pipeline in the next twenty-four months (ZAR 400 million).

These results suggest a growth of almost 300% between current activities and forecasts in the next 12 months and a further doubling of that (100% growth) within the twenty-four month period. Whilst the growth in the next twelve months seems extraordinarily high, it does support the expressed view from NBFIs that they are turning away SMEs due to a lack of access to capital to on lend and thus may indicate a pent up demand that is not currently being met and which is forecast to come online in the next 12 months as the markets and economy improves.

Overall these estimates point to significant absorptive capacity and suggest that within twenty-four months the market demand could be as high as ZAR 10 billion. We should caution, however, that there is no clarity from the research results that the anticipated pipeline is secured or that there isn't double counting in the assessment of demand based on SMEs approaching various NBFIs who are all considering their demands. Notwithstanding this it is evident that the market demand for capital is present and growing and that this assessment is based on the input from sophisticated, active NBFIs in the sector.

Table 1: Current financing activities and future requirements by NBFI respondents

	Rand Value per annum	Survey Size
Average Rand Value Disbursed Per NBFI	R 312,227,817	N = 19
Average Number of Individual SMEs Supported Per NBFI	328 SMEs	N = 15
Average Number of Loans Disbursed Per NBFI	987 Loans	N = 13
Average Loan Size	R 523,870	N = 13
Range	R 11,000-R 2,500,000	N = 13
Average financial requirements for on-lending to SME market currently	R 72,250,000	N = 6
Range	R 250,000 – R 300,000,000	N = 6
Average financial requirements for on-lending to SME market for the next 12 months	R 202,807,692	N = 24
Range	R 1,000,000-R 1,700,000,000	N = 24
Average financial requirements for on-lending to SME market for the next 24 months	R 441,131,157	N = 21
Range	R 3,500,000- R1,634,865,000	N = 21

**N= number of survey participants*
Due to varied response rate and partially completed surveys our findings included incomparable data

Future Financial Requirements

The NBFI respondents listed the following as their current financial requirements and over the next 12 and 24 months:

Table 2: Estimated financing requirements in next 24 months from NBFI respondents

	Current (R)	12 Months (R)	24 Months (R)
Min	250,000	1,000,000	3,500,000
Max	300,000,000	1,700,000,000	3,500,000,000
Average	72,000,000	202,000,000	440,000,000
Sample size	N = 6	N = 24	N=21

SECTION 5: EVALUATING THE NUMBER OF ACTIVE SMES IN THE SECTOR

The methodology to evaluate the number of individual SMEs supported by NBFIs included research from actors in the field as well as data released by Companies and Intellectual Properties Commission (CIPC). Formal research conducted by Business Partners has estimated the size of the SME market in South Africa at 1.5 million SMEs in total. These account for around 60% of the country's total labor force.[9]

In looking for comparative evidence for this number, the research consulted the Companies and Intellectual Properties Commission (CIPC) records which detail the number of registered companies as at September 2011. These are indicated in Figure 6 below.

Figure 6: Active entities registered with the CIPC to September 2011.

Close Corporations	923412
Public Companies	2998
Private Companies	258342
Non Profit (Section 21)	26311
Limited By Guarantee	81
External Companies under Section 21A	15
External Companies	1263
Incorporated (Professionals)	7144
Company Unlimited	5
Co-Operative	33288

Based on this data, and if one assumes SMEs are comparative to Close Corporations (at least where they are in the formal economy) one can see that this number is close to the 1 million mark. Adding to this the number of private companies and nonprofit companies (Section 21 companies) one achieves a total close to 1.3 million (as compared with the Business Partners estimate of 1.5 million SMEs). Whilst this is a very rough comparative and it should be assumed that some, if not many, of these may not be SMEs, it is equally reasonable to assume that there are a large number of SMEs that are operating informally or as sole proprietorships which would increase this number.

Most of the NBFIs and BDSPs consulted estimate the size of the SME market based on the number of applications they receive. Based on this method, they suggest that the sector is large and growing. NBFIs interviewed report receiving a wide ranging set of business plans each month – with the bottom end suggesting 400-450 business plans submitted each month (80% originating through word-of-mouth referrals) to some 10-40 applications per day or 2,200 to 8,000 per month. Yet another records an unquantifiable but "overwhelming demand" from SMEs and currently reject 70% of applications they receive even where these may be good quality.

From the survey results we cannot determine the extent of the overlap between NBFIs considering or financing the same SMEs and so it is difficult to formally quantify the number of SMEs active in the country and even more difficult to understand the number of quality

[9] "Entrepreneur of the Year 2010". Sanlam and Business Partners.

SMEs. One figure that could be assumed from the data from NBFI respondents in this research, assuming no overlap between them, is that the number of individual SMEs supported by the first sample of NBFIs is approximately 5,000 individual SMEs; an insignificant percentage of SMEs if the total estimated number of SMEs is 1.5 million.

In order to cross check this estimate, one could consider the specific activity of a single NBFI and extrapolate this to the sample. Assuming therefore one of the BDSP's activity mentioned above, it could be assumed that if this NBFI is currently funding an average of 350 SMEs per annum, it would suggest that they are, in fact, receiving at least 1,200 applications per annum (70% rejection rate). Applying this average to all 24 NBFI respondents who estimated the future demand pipeline, an estimate of an actively capital seeking SME market of approximately 28,800 individual SMEs could be assumed. Whilst this is still significantly smaller than the estimated 1.5 million SMEs in the country, it is perhaps more indicative of the number of SMEs who are sufficiently able to access NBFIs and therefore which have the most likely opportunity for accessing BDSP and growing capacity in the nearer term.

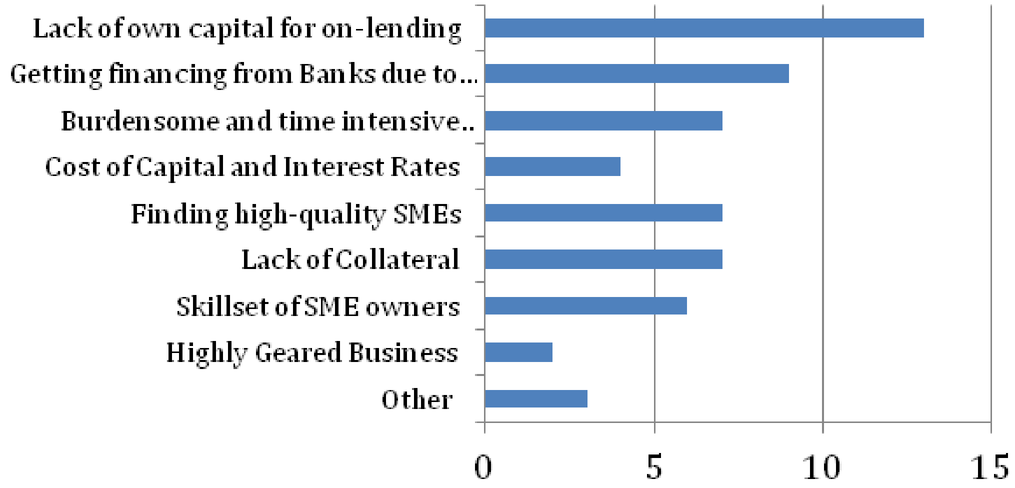
Another method of estimating the size of the SME market in South Africa can be deduced from data collected from survey respondents. By using the average number of SMEs supported per NBFI (350 SMEs) and assuming an NBFI market size of 5,850 (the midpoint of the range from 181 to 11,500 as suggested by the NCR and FSB databases) one could assume an SME market size at approximately 2 million SMEs. This figure is likely to be an overestimate given that the NBFIs surveyed were among the more sophisticated and established NBFIs and therefore, have the capacity to support a larger pool of SMEs. However it does perhaps give an understanding of the outer boundary of the market size.

Overall it is clear that the true picture is not particularly evident or easy to determine. We do believe it is safe to assume that there are likely to be at least 1 million SMEs in the country but that only a very small percentage of these are actually making some progress in developing further and growing capacity. These various calculations provide an additional viewpoint to market sizing and overall also support the suggestion that there are perhaps two very different SME markets in the country – one (the smaller one) being the capacitated and resources SMEs who are accessing active NBFIs and driving most of the demand for finance, and another one that is relatively less visible and known, less resourced and capacitated and so not accessing the capital or the capacity support to grow and expand but rather falling into the pile of rejected applications by the NBFIs consulted in this study.

SECTION 6: KEY CHALLENGES TO SME ON-LENDING ACTIVITIES

The following graph depicts the 8 key challenges NBFIs face as they engage in on-lending to SMEs:

Figure 7: Key challenges facing NBFIs.

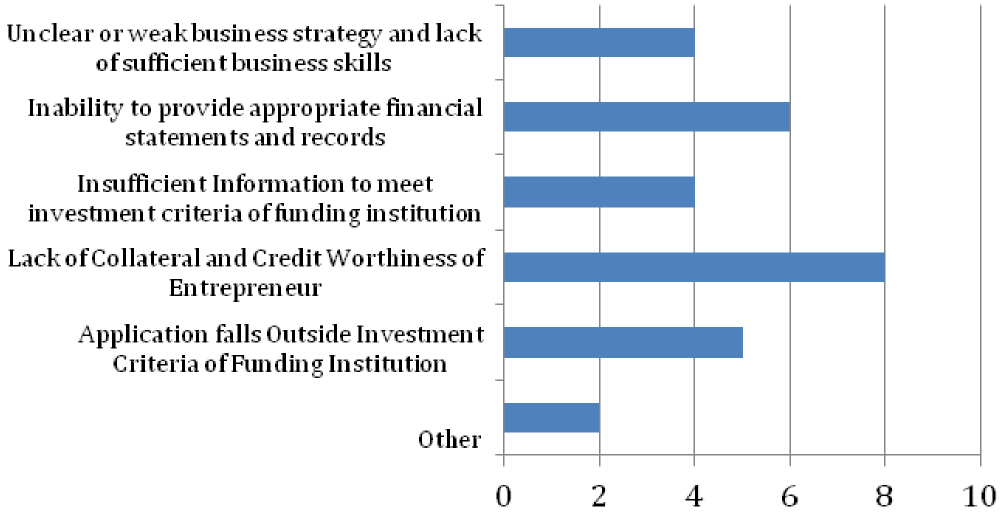


Of the main challenges, lack of own capital for on-lending is cited as the most common with almost 50% of the sample of NBFI respondents indicating it is a critical barrier to their SME lending activities. Add to this the difficulty of getting financing from other sources, most especially the banks, the high cost of capital when it is achieved, and the bureaucratic process of getting financing from government agencies, it is more than evident that the most significant challenges affecting the majority of NBFIs all revolve around access to affordable capital with just 8 respondents suggesting the quality of SMEs is the major limiting factor. Three NBFIs indicated "other" as a challenge, which included issues such as the perception of risk and corruption in the country specifically when working with municipalities. Overwhelmingly these results give additional support to the need for an affordable source of finance to increase on-lending to SMEs.

In further understanding the capacity constraints of SMEs and how investment readiness affects on-lending, the graph below depicts the main barriers NBFIs identified with regard to the quality of SME applicants and how this affects their on-lending even though this issue is regarded as less significant than access to financing. Here it is evident that the lack of collateral and credit worthiness of entrepreneur ranks as the most common challenge for NBFIs seeking high quality SMEs and this issue feeds back into the access to capital barrier with respect to the perception of risk and the lack of any risk mitigation opportunities for SMEs themselves.

The second most common challenge is SMEs not being able to provide the appropriate financial statements and records which specifically speaks to a capacity constraint with regard to management and governance and is one of the key areas requiring business development support services. Indeed, NBFIs point out that it is critical for NBFIs and BDSPs to collaborate and partner more with the common aim of growing a strong and investment ready SME pipeline and many suggested that establishing an industry body to support practices and standards in this regard would be a positive development for the sector.

Figure 8: Barriers faced by NBFIs with respect to investment readiness of SMEs.



SECTION 7: PERCEPTION OF THE SME SECTOR OVER THE NEXT 24 MONTHS

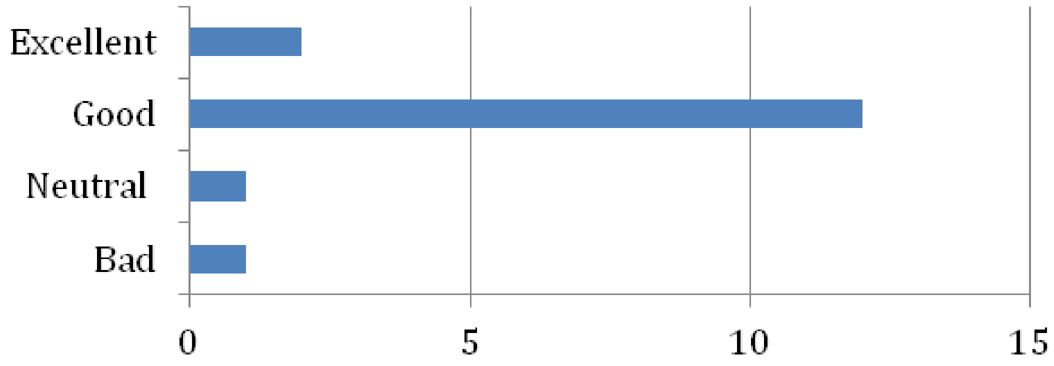
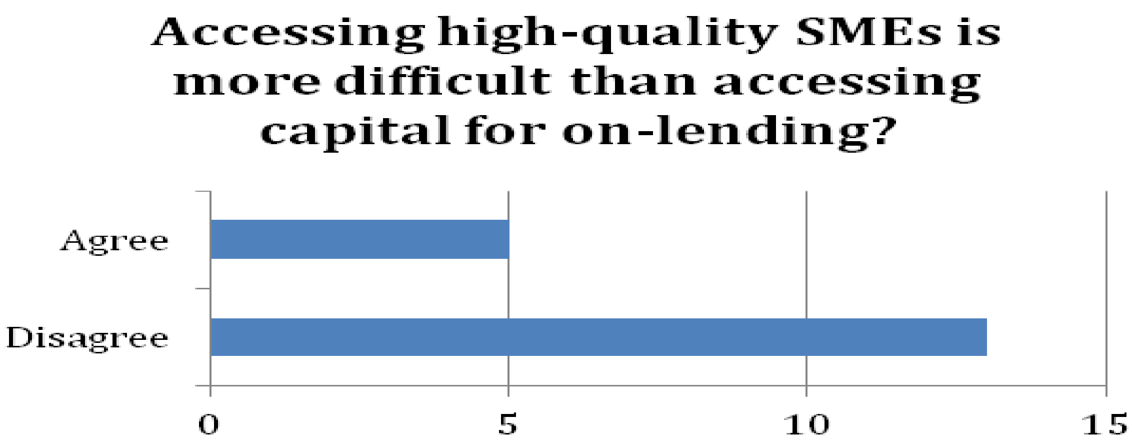


Figure 9: Expectations for the South African SME market over the next 24 months.

The current perception of the provision of finance to SMEs is viewed by NBFIs as low to adequate. However, NBFIs indicated a much more positive outlook around their future expectation of the South African SME market over the next 24 months. Of the 17 NBFIs that responded, 12 indicated their expectation of the SME market was good. Several described their positive outlook was based on the future growth expectation of the SME market and the high demand for capital. Additionally, one response described the increase in entrepreneurial activity in the country due to jobs in the formal sector being limited and the economy offering more opportunities to people who can use them.

The general sense was that respondents feel there has been in increase in support for the SME sector and therefore that the growth of quality SMEs will result. The positive outlook of the sector illustrates that there is business available and SMEs actively seeking finance, though NBFIs do insist they are constrained by a lack of resources, most particularly lack of access to affordable capital, with which they can further the growth of the sector.

Figure 10: Accessing high quality investment ready SMEs is more difficult that accessing capital for on-lending?



The follow up survey conducted by Nexii specifically asked the question of whether access to capital was the critical constraint for NBFIs on-lending to SME or whether in fact it was more simply a lack of quality, investable SMEs for these NBFIs to on-lend to. As is apparent from the graph alongside, the response was not in agreement with the suggestion that quality of pipeline was the major limiting factor but rather that there was a clear need for increased access to affordable capital for on-lending.

SECTION 8: THE ROLE OF BUSINESS DEVELOPMENT SUPPORT SERVICES IN SME FINANCING

The NBFI mapping expanded beyond strictly finance providers to include several BDSPs, which has proven to capture many of the weaknesses of "silo" mindsets as well as the possibility of significant missed opportunities within the SME sector.

The responses and feedback received from BDSPs demonstrate that many BDSPs perceive their service offerings as separate activities from NBFIs and thus, were unwilling to participate in the survey. When asked about how they supported their clients access finance in order to build their businesses, the responses were also relatively vague with typical referrals to the same usual suspects.

To further examine this issue, we conducted interviews with several BDSPs to understand their relationships with finance providers and view of the market supporting SMEs. The general business development processes have differing toolsets including training, mentorship, technical assistance, capacity development and pre and post investment support, which are structured around the business lifecycle and stage. Once the SME is in a position to access finance, the BDSP will operate on a referral system by suggesting the client either approach a bank or NBFI.

Importantly, however, it is perhaps a positive development to note that several BDSPs are now looking to raise, or in the process of raising dedicated funds to serve their clients, enabling them not only to get the technical assistance they need but also provide them with the ability to access finance. The feedback suggested that many BDSPs are not aware of the financial products available for clients and cannot adequately direct client to appropriate financiers. This further speaks to the need for an integrating an industry effort to build connections and communications between actors and better facilitate mutually beneficial and compatible service provision to SMEs across the board.

The provision of business development services to SMEs seems to be most commonly delivered through three major channels:

- Pricing business development support services into their financial product offerings and investment officers providing the BDS support
- Developing a separate fund for BDSP to subsidize costs
- Hiring outside consultants to assist

Furthermore interviews clearly indicate that support services have increasingly emphasized the inclusion of access to networks and mentors as part of the service delivery. Other core services offered include:

- Training in understanding financial statements / accounting / tax /
- Cost accounting and financial management training
- Operating a small business
- First aid
- Employment and HR skills
- Care and maintenance of trucks
- Capacity building and technical services

- Mentorship
- Assistance with insurance claims
- Administrative support, including access to Internet/email/secretarial support, and para-legal services
- Business skills training
- Borrower Education (financial literacy)

When addressing questions about the impact and quality of these services and whether they were really meeting the needs of SMEs, interviewees suggested that the recent and growing influx of BDSPs entering the market to service SMEs had increased the range of services on offer and driven down the cost of accessing support services. Importantly, however, there was some consensus that the lower cost services are mostly due to the lower caliber of BDSP entering the market, and one that may not be fully equipped to serve the market adequately in order to address its real capacity development and technical assistance requirements.

At the same time, the effect had been that high-caliber BDSPs were struggling to compete given their service fees, most especially with little regulation or accreditation mechanisms through which SMEs could be guided to differentiate quality and appropriateness – as well as potential result – from the services they sought. Thus whilst BDSPs believe there is no shortage of players in the ecosystem, they believe there is a shortage of quality and standards of service. This points to some additional important efforts that an industry body could undertake in growing standards of practice, accreditation of support providers and rating systems – effectively the various elements of an integrating intermediation infrastructure.

Related to the above, BDSPs do play a critical role in educating SMEs about the nature, type and terms of the various services and products – including financial products – available to them. They have identified the lack of real-time information for SMEs, particularly around best practices, financing opportunities, networks etc. as critical barriers to SME activity. Obviously active engagement and communication between BDSPs and financiers is important if this information is going to be relevant and pertinent to the needs of financiers and this speaks again to a need for more collaborative approaches to SME development between these various actors.

An ongoing separation and division between business development support providers and financiers will no doubt be an important contributor to maintained – and indeed given an influx of new entrants into an unstandardized market - increased fragmentation between organizations servicing SMEs and indeed seems to not be serving either side as increasingly technical assistance providers get stuck on the need for capital whilst financiers get stuck on the lack of capacity and constraints around the investment readiness of the business overall.

The lack of communication, transparency and coordination between financiers and BDSPs has created a gap between them and indeed potentially a significant breach or breakdown of the SME support supply chain. There is a need for integration and collaboration between BDSPs and NBFIs in order to create a more holistic continuum of offerings for SMEs. This provides an opportunity to bring together an uncoordinated group of actors and build a functional and integrated ecosystem that can leverage systems, information and knowledge and structure partnerships to result in more customizable and end-to-end product and service offerings for SMEs.

SECTION 9: THE ROLE AND EXTENT OF SOCIO-ECONOMIC AND ENVIRONMENTAL IMPACT ASSESSMENT

The role of integrating socioeconomic and environmental impact considerations into SME financing strategies has been widely considered by finance providers and believed to be of critical value in building an investment proposition. However, the progress made to implement standards and metric systems to monitor and assess impact is lacking in practice and there remains little understanding of what metrics would be appropriate.

Our research shows that those currently tracking social and environmental impact are mandated to do so by their investors. In particular, NBFIs that have received funding from DFIs are usually required to monitor social and environmental impact and their financial activities have to remain compliant with social and environmental standards. For example, IFC requires financial institutions that receive funding to conduct a SEMS analysis, which includes social and environmental due diligence prior to loan disbursement and adequate supervision of the projects during the term of the loan.[10]

Most NBFIs are currently measuring financial metrics only, though many express the desire and intention to develop and implement impact metrics as they believe it is integral to their mission and increasingly important in providing a differentiator and clear benefit proposition for accessing additional financing. Despite the fact that many intend to implement such systems, the large majority have not yet taken action largely because there is a general lack of understanding about what metrics to use, how to measure outcomes and how to integrate them into existing reporting systems. Developing skills and products in this area could provide an important opportunity to support NBFIs by providing education on how to use impact metrics as a measure of their investment return. This could also enable BDSPs to provide an additional value add service to SME clients.

That it is possible to implement globally applicable impact measurement systems into SME lending activities is clear from the work of Business Partners who have adopted the Impact Reporting Investment Standards (IRIS) and who have participated as one of the first test funds utilizing the Global Impact Investment Rating Standards (GIIRS) developed by the Global Impact Investing Network (GIIN). Including a training module in impact metrics as an optional part of the BDSP or NBFI accreditation programme could add weight and support in this field.

[10] SEMS 101 – IFC Presentation

SECTION 10: INTEREST IN OPEN ACCESS INFORMATION AND MATCHING PLATFORM

The NBFI mapping initiative coincided with the FSPs call for proposals for prospective host institutions to manage and develop the **finfind** program and service offering. Because several of the survey and interview participants are already listed on **finfind**, it provided an opportunity for us to explore whether and how the **finfind** product has been received and what additional features could be included to make it more useful.

In particular it was interesting to hear expressed needs for (i) an industry body to coordinate, aggregate and build standards for the SME sector; (ii) a controlled access matchmaking system based on automated minimum matching standards (a kind of "dating platform" for SMEs, BDSPs and NBFIs with minimum compatibility matching acting as an initial screen for NBFIs and providing BDSP ratings for SMEs); (iii) an information, education and training portal lead by a coordinating industry body and covering the various issues related to ratings, impact measurement, technical assistance standards, accreditation etc. This platform would meet the significant demand for a platform that connects appropriate resources to SMEs by building skills and connections between actors in this ecosystem.

The NBFIs interviewed were all hesitant about being listed on **finfind** as a public directory because they already felt overloaded by the number of applications they were receiving on a monthly basis and felt this could increase unilaterally without any control mechanisms if SMEs were able to simply contact them directly. Having said that, all were interested in how the system could provide some kind of minimal screening and matching solution based on key criteria that would have to match on SME requirements and NBFI profiles.

This system could potentially act as a simple initial screening and filtering mechanisms to guide SMEs through a vetting process to match them with the appropriate financier provider or business development support provider. There are examples of how these systems have been developed (e.g. Echoing Green fellowship applications) which could be relatively easily developed to add into the **finfind** system which we be would be worth exploring because of the exponential increase it could have in integrating the ecosystem and making connections based on more appropriate initial criteria.

SECTION 11: CONCLUSIONS AND RECOMMENDATIONS

Over the past 8 months, we have actively been researching the demand for capital for Non-Bank Financial Institutions (NBFIs) on-lending to small and medium size enterprises (SMEs). The primary objective of our research was to assess the need for a Debt Fund that would exclusively focus on providing capital to NBFIs acting as critical sources for on-lending to SMEs.

Our initial body of research indicated that access to capital may not be the most critical barrier for NBFIs but conversely it was the lack of access to high quality SMEs. Due to the low rate of response from the initial surveys, we conducted further research to investigate whether there was a real demand for affordable capital or whether a more critical need exists for increased for capacity building and technical assistance provision to improve the quality of investable SMEs.

Our final conclusions indicate that indeed there is demand for a Debt Fund to support the capital requirements of NBFIs, illustrated by the current shortfall of funds NBFIs have to on-lend to SMEs approaching them for capital. Furthermore, this research suggests that the Debt fund must be structured in a way to include business development support services alongside finance and supports the development of a good, quality pipeline of SMEs for NBFIs on-lending activities. As importantly it suggests that the FSP may be well placed to build an industry body to better facilitate collaboration and common action including the development of practice standards and training support programs for both SMEs and for finance providers needing a greater understanding of the sector and its true risk features and reward opportunities.

The following specific recommendations are supported by the responses and feedback received by respondents in this research, and provides potential pathways for future activities to be supported by the FSP. They certainly indicate that an SME Debt Fund would provide significant potential to increase the growth and development of SMEs in South Africa.

Advocacy to work with Banks to help develop and tailor products for NBFIs

Even with a global triple A-rated DCA credit guarantee available to them, some NBFIs have been unable to access additional capital for on-lending to SMEs. However, one specific fund structure has proven a successful model of how to partner and work with banks to increase access to capital.

Structuring the SME Debt Fund to Strengthen and Raise the Profile of NBFIs

The type of SME Debt Fund that USAID is proposing aims to also demonstrate the potential and build the track record of NBFIs as a recognized intermediary presence in the SME ecosystem. This could significantly unlock capital from the banks, more assured of the risk management processes implemented by NBFIs. In this regard it is important that the Debt fund be structured to ensure the correct guidelines are in place to verify that NBFIs have secured quality SME pipeline and have sufficient capacity to take on funds. Measures should be taken and procedures put in place to enable the clear demonstration of the targeted SME needs and capacity and to provide measurement reporting to understand the longer term economic benefits that financing has delivered. Additionally, for the NBFIs that are not able to access the SME Debt Fund due to a lack of track record, capacity or sophistication, USAID FSP could work to design a process of training NBFIs to meet the standards.

Offering Integrated Financial Solutions Supported by Business Development Support

In order to strengthen the SME sector, our findings have emphasized that business development support, capacity building, access to information and technical assistance is necessary as an integrated support service offering providing alongside finance. Additionally, banks require better education with regards to SME financing and credit guarantee schemes offer an opportunity to help banks learn more about the SME market and risk involved. Building the systems to create complementary finance and business support product offerings that together create a more integrated and end-to-end solution for SMEs is critical to sustainable growth in the sector.

Building coordination between actors in the ecosystem, collating information and breaking the artificial barriers between different, but complementary, service providers

There is a strong expressed demand for an industry body to coordinate, aggregate and build standards for the development of NBFIs and BDSPs. An industry body to regulate and aggregate information in a controlled manner is needed to disseminate information regarding products and services available to SMEs to allow appropriate matching of supply and demand. An information, education and training portal to direct users to the right products and services and controlled by a coordinated industry body would help defragment the sector and connect appropriate resources with SMEs. This type of industry body provides an opportunity to bring together an uncoordinated group of actors and build a functional and integrated ecosystem that can leverage systems, information and knowledge and structure partnerships to result in more customizable and end-to-end product and service offerings for SMEs.

Supporting the establishment of an industry body committed to advocacy, education and standards development

There is a strong demand for an industry body to coordinate, aggregate and build standards for the development of NBFIs and BDSPs and to regulate and aggregate data, tools and services in a controlled manner in order to provide better access to information regarding products and services available to SMEs. This will also facilitate more appropriate matching of supply and demand. An information, education and training portal, managed by a coordinated industry body, could help defragment the sector, connect appropriate resources with SMEs and indeed connect BDSPs and NBFIs to better integrate service offerings. This type of industry body provides an opportunity to bring together an uncoordinated group of actors and build a functional and integrated ecosystem that can leverage systems, information and knowledge and structure partnerships to result in more customizable and end-to-end product and service offerings for SMEs.

Creating regional directories to better define the SME ecosystem and provide clearer definitions of product and service offerings available

There is a need for an open-source directory or central repository system of regional databases that registers organizations supporting the SME sector. This type of initiative requires further feasibility about the potential of creating an SME directory or working with partners to build on existing initiatives in this space. There should be minimum requirements for listing and a developmental program to support those requiring additional capacity to engage with and benefit from admission. A basic directory with minimum requirements for companies to register could be complemented or integrated with a higher standard of platform that services providers would be incentivized to list on. For example, this platform could serve as a menu of options for corporations to select and distribute funds to in order to meet their enterprise development requirements. This type of system should look at the incentives for buy-in, how to effectively add value, define the standards, and look for academic, local provincial and government collaborators. Eventually, this platform would drive competition and build a better understand of high quality BDSPs and NBFIs in the ecosystem.

Finding ways to provide more affordable, stage appropriate capital across the full continuum of stage and capital size requirements

Financial providers targeting SMEs must develop products and services that are stage appropriate and allow SMEs to continually scale and grow. The majority of current solutions for SMEs does not offer a continuum of financial products according to the stages of SME development but instead refer the SME to a different financier. The need for partnerships and collaboration between NBFIs to create a more sustainable value chain for SMEs is critical to providing holistic product offerings best suited for SME growth. This type of information can be sourced through a directory that is made available online and through print and must be distributed through a combination of marketing strategies to meet businesses in various stages of growth.

Limiting the regulations required to access finance and to make it less complicated and time intensive to tap into those government loans.

The major barriers NBFIs face in accessing finance for lending activities is due to the challenge in getting finance from banks as SMEs are seen as too high risk as well as the bureaucratic, time intensive process of accessing finance from government. Advocating for policies, tax producers, and incentives to promote investments in SMEs is crucial to gaining mainstream support and increased finance to flow to small and medium enterprises. Working with financial institutions and policy makers to create incentives around SME financing would be a useful first target. In addition, working with Treasury to advocate for additional tax structures, that can provide benefits for risk and lower return scenarios could increase SME financing as it has done in other parts of the world.

South Africa is struggling to address its unemployment problems and job creation policies are at the top of the agenda for government, the private sector and development finance institutions alike. The real challenge is not only to create more jobs, but to create better quality jobs that will promote inclusive growth and development and address the wide range of socio-economic issues that the country is facing. SMEs do and can employ a large number of people and ultimately create more jobs than large firms. We therefore need to overcome the barriers to their growth, which barriers range from a lack of access to finance, a need for business training and literacy programs, and policies addressing other constraints such as taxes, regulations and corruption. In addition, policies to improve entrepreneurship and innovation are likely to be important, since lack of dynamism is a distinguishing feature of most developing countries and indeed is particularly low in South Africa relative to others. We believe that an SME Debt Fund represents a sound component in the programmatic interventions that USAID and the FSP implement and that alongside other suggestions in this report could make a significant difference to the development of this sector.

SECTION 12: ANNETURES

ANNEXURE 1: GENERAL OVERVIEW OF SURVEY RESPONSES

This section provides the survey data from the NBFI responses and highlights certain correlations that appear which are primarily qualitative in nature and which are supplemented by comparable data from the NCR and FSB registries.

General characteristics of respondents

The number of years that NBFIs have been operative and providing SME finance covers a span of 14 years – taking this activity back to the period of 1996/1997 post democracy when a number of changes in the political space led to fundamental changes in approach to financing of small business and particularly small black owned businesses. The years of operation can be understood as follows:

Statistic	Value
Range	14
Max	13
Min	1
Mean	7.71
Median	7.00
Std Dev	4.18

The majority of NBFIs are private companies, with several public companies being included in the mix (one of which has various private subsidiaries). One was a trust and one a close corporation.

NBFIs indicate that they serve all sectors although some NBFIs have targeted specific sectors such as:

- Financial services and products, including advisory and consulting services
- Franchising
- Healthcare
- Housing
- Previously disadvantaged sectors
- Procurement and supply chain management
- Retail
- Service Industries
- Transport
- Waste
- Wholesale

The general sector targeting isn't a surprising result; the specific sectors indicated speak strongly to where there is a developmental need, and accordingly, niche competitive market opportunities for NBFIs, for example providing asset finance specifically for waste transport trucks or taxis. The NBFIs with focused sector targeting also tends to offer additional non-financial services to their clients, specifically focused on the sector needs (for example, care and maintenance of trucks or assistance with insurance claims). The NBFIs that don't have a sector specialty offers general financial products and general technical assistance, business development and business skills services.

Of the initial survey responses respondents, 76% are registered with the NCR, 35% are registered with the FSB, and 38% indicated that they have additional registrations, such as:

- Credit Rating from Moodys
- IFSC status
- BEE Certificate
- Micro Finance South Africa
- Retail Financial Intermediary
- Rural Housing Loan Fund (RHLF)

FSB registration helps improve the opportunities for financial service offerings from NBFIs as well as for attracting capital.

Application Process

The turnaround time from submitting the application form to the payout ranges from 1.5 hrs to 5 months. The shorter timelines seem to be attributable to:

- specialized services to one sector
- very clear and defined application process (ticking checkboxes)
- small loans
- existing government contracts / networks

The longer timelines can be due to:

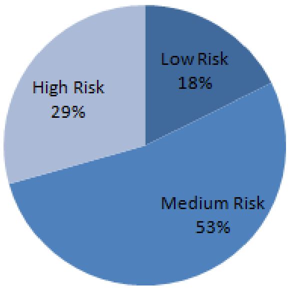
- 3 committees to approve application
- multiple stage approval process, esp. if including banks or government agencies
- if financial product is more complex to structure, for example equity finance

Target Market

All NBFIs provide loans directly to the end user and only four respondents provide loans via partnerships with other lending institutions as well. The NBFIs rated the risk profile of their clients are follows:

Risk	Percentage of Respondents
Low Risk	18%
Medium Risk	53%
High Risk	29%

Risk Profile of NBFI Clients



This risk classification is interesting, given that the SME sector is generally regarded as high risk, whereas the actors in this sector do not perceive the risk in the same light.

The difference in risk classification between medium and high does not, it appears, translate into a higher interest rate being charged on products. Understanding of how the NBFIs define risk and price risk accordingly should be further investigated.

Only 41% of the NBFIs target SMEs based on the SME lifecycle whereas 53% do not. Of those that do target SMEs based on lifecycle, the NBFIs defined the lifecycle stages as:

Start-up definition:

Mostly unemployed persons

- Has no existing client base or market acceptance information
- An SME that may have been awarded first contract by the municipality
- The SME market that has, historically, been neglected and under-serviced by the traditional commercial banks and private financial institutions
- New company, but with a good contract in need of bridging finance. We will assist them.

Emerging / Growing definition

- Has some existing clients and proof of market acceptance with initially low turnovers and probably not yet at breakeven levels
- Repeat business with NBFI
- Already operating with an established infrastructure, although may not be up to a high standard.
- Must have been in business for 1 year

Firm size	Employees	Assets (Rand)	Annual sales (Rand)
Small	<50	<21,0 million	<21,0 million

Established definition

Expansion means typically SMEs have reached breakeven but want to expand the product range or service offering or geographic reach. In most instances they must have been in business for 4 years

Firm size	Employees	Assets (Rand)	Annual sales (Rand)
Medium	<300	<105,0 million	<105,0 million

Similarly, 35% of the NBFIs target SMEs based on the SME turnover whereas 59% do not. The classification of turnover was as follows:

Firm size	Employees	Assets (Rand)	Annual sales (Rand)
Micro	<10	<700,000	<700,000
Small	<50	<21,0 million	<21,0 million
Medium	<300	<105,0 million	<105,0 million

Established business with infrastructure, client and track record.
Monthly residual cash flow from taxi business in excess of a specified minimum. Affordability assessed, SMMEs are required to net R6, 000 for smaller vehicles (minibus) net and R10, 000 for larger vehicles (minibus).

Of the NBFI respondents, 29% target SMEs based on the number of employees 65% do not. The classification for this targeting used includes:

Firm size	Employees	Assets (Rand)	Annual sales (Rand)
Micro	<10	<700,000	<700,000
Small	<50	<21,0 million	<21,0 million
Medium	<300	<105,0 million	<105,0 million

From this target market classification, there seem to be three common identifiers between the NBFIs that do use lifecycle stage, turnover, or number of employees to classify their target market. These identifiers are:

- If the NBFI works in a specialized sector and not across a spectrum of sectors
- If the NBFI offers financial products and services
- If the NBFI has been active in the SME space for an average of 10 years

Products and Target Markets

In this section, each type of product and the related target market will be reviewed together. Prime is currently 9%. Term loans, asset finance and supplier finance are the most popular product offered. Additionally, the results from 13 NBFIs indicated the average loan disbursed is R 523, 870 ranging from a minimum of R 11,000 to a maximum of R 2,500,000.

None of the NBFIs surveyed offered client deposits. Some NBFIs also offer customized products, such as:

- Reverse factoring
- Performance Guarantees
- Short term bridging finance
- Private equity

Additional Services

14 NBFI respondents offer additional services to their clients either directly or via a third party supplier or a combination of both. The additional services offered are detailed in Section 2 with the key findings. These additional services seem to align to the extra criteria needed when applying for finance or a financial product; for example, most NBFI respondents did not require a high financial literacy level, but do offer financial literacy training and support to their clients.

Additional Costs

41% of the NBFI respondents charge additional costs over. Examples of the cost types and values are:

Type of Cost(s)	Amount
Administration and documentation fee	R35,000
Facility fee on successful application	1.5% of capital raised
Administration fee	R500 per successful application can be waved.
Initiatiation and Administration fee	R1140 and R57 respectively
Loan Investigation Fee.	R4 500
Registration of security	Depends on the loan size
Administration fees, initiation fees	Depends on the transaction and product offered

Operational Challenges

The NBFI respondents detailed the operational challenges they face. Some of the challenges listed are commonly known in this sector and supported by various research reports. From 29 responses, the 8 main challenges NBFIs face are:

- Lack of own capital for on-lending
- Getting financing from Banks
- Slow decision making processes and burdensome administrative processes in receiving government funding
- Cost of Capital and Interest Rates
- Finding high-quality SMEs
- Lack of Collateral
- Skill set of SME owners
- Highly Geared Business

The main challenges NBFIs face with finding quality SMEs are due to:

- Unclear Business Strategy
- Lack of Entrepreneur /Business Skills
- Inability to provide proper financial records of business
- Viability of business
- Insufficient Information
- Integrity/Credit Worthiness of Entrepreneur
- Application falls Outside Investment Criteria of Funding Institution
- Weak capability among SME entrepreneurs in managing functional areas of business
- Size of Deal
- Acceptable assets for collateral are limited
- Lack of owner's contribution
- SMEs do not prepare financial statements or if any, are not acceptable to creditors

On-lending Guarantees

Only 6% of the NBFIs answered yes to the question "Are there any organizations that provide you with guarantees towards your capital for on-lending?" Of those that do on lend, they receive guarantees for the capital to on lend from local and national government funds.

In addition NBFIs that were interviewed but did not participate in the survey received guarantees from several development finance institutions, international funds dedicated to development and a South African Bank.

Desire to be registered on a public platform

76% of respondents were keen to be listed on a public platform and believed that this could significantly assist in building the sector – most especially if it was organized effectively.