

SMALL AND MEDIUM ENTERPRISE (SME) FINANCE IN SOUTH AFRICA:
IMPLICATIONS FOR PRIVATE SECTOR-LED DEVELOPMENT

by

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Submitted in partial fulfilment of the requirements
for the degree of Master of Arts

at

Dalhousie University
Halifax, Nova Scotia
October 2010

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DALHOUSIE UNIVERSITY

DEPARTMENT OF INTERNATIONAL DEVELOPMENT STUDIES

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Dated: October 29, 2010

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DALHOUSIE UNIVERSITY

DATE: October 29, 2010

AUTHOR: Elise Nicole Ray

TITLE: Small and Medium Enterprise (SME) Finance: Implications for private sector-led development

DEPARTMENT OR SCHOOL: Department of International Development Studies

DEGREE: MA CONVOCATION: May YEAR: 2011

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Abstract:

Efficient financing for small and medium enterprises (SMEs) is important so that SMEs can grow and be sustainable. This thesis applies a qualitative approach informed by the concept of private sector-led development (PSD) to examine the problems of SME financing in South Africa, and generates useful insight on the complexity of SME finance in a developing country. Results highlight how private SME finance can be an efficient driver of small business development. At the same time, results reveal a need to develop financing for 'transitional' SMEs, and to clearly define the role of private and government financiers, to improve the efficiency of the overall sector. The limits of private finance to widely fund all SMEs show a need to be critical and discerning when it comes to the involvement of the private sector to drive development initiatives. This limit, however, is also a core benefit of the private sector.

List of Abbreviations Used

BDS- business development services
BEE- Black Economic Empowerment
BOP- base-of-the-economic-pyramid
DAC- Development Assistance Committee
DFAIT- UK Department for International Development
DTI- South Africa Department of Trade and Industry
CEO- Chief Executive Officer
ESG- Environmental Social Governance Policy
FDI- foreign direct investment
GDP- gross domestic product
GEM- Global Entrepreneurship Monitor
IFC- International Financial Corporation
MDGs- millennium development goals
MEs- micro-enterprises
MFI- micro-finance institutions
NGOs- non-governmental organizations
OECD- Organization for Economic Cooperation and Development
OPIC- The Overseas Private Investment Corporation
PSD- private sector-led development
R- South African Rand
RFI- retail finance institution
SAMAF- The South Africa Micro-Finance Apex Fund
SEDA- The Small Enterprise Development Agency
SMEs- small and medium enterprises
SMMEs- small, medium, and micro enterprises
SEAT- Socio-Economic Assessment Toolbox
UNDP- United Nations Development Programme
USAID- United States Agency for International Development
USD- United States Dollars
WB- World Bank

Chapter 1: Introduction

1.0 Chapter Overview

This thesis adds to the existing literature on small and medium enterprise (SME) development in a developing country context by exploring how SME finance effectively contributes to small businesses development, using the example of South Africa. Situated amongst growing concepts advocating the role (and potential) of business in development, and how the core competencies and a business approach of the private sector can drive social development, this project also endeavours to answer a more latent question: the degree to which private finance is an efficient tool to develop SMEs.

This study is distinct since it looks at the supply side of SME finance to examine the issues of providing adequate and effective finance to SMEs in a developing context, whereas most studies on this topic look at the issue of SME finance from the perspective of borrowers or ‘demanders’ of finance. Green et. al (2006), for instance, identify a gap in supply-side research on small enterprises, including studies on the forms of finance available, and the links of different forms of finance and the impact on SME development (including poverty alleviation), as well as the role played by the private and public sector.¹ This study also takes a unique approach in combining international development and international business fields of study. Combining both disciplines allows for this research to bridge the social and developmental context of small business development in South Africa. Since this study is informed by the concept of private sector-*led* development (PSD), this approach also provides an enriched perspective on some of the issues of prioritizing small business development as a form of social development. Using qualitative methods in the form of 27 interviews across 11 SME financing firms, support agencies and key informants, this study outlines the various forms of finance available to SMEs and how they are positioned across the SME sector. This study also reviews the different models and approaches of some of the

8 main SME financial suppliers, to point to some of the characteristics and benefits of the private sector as an efficient provider of finance. In so doing, this research points to the broader potential downsides of private sector involvement to drive inclusive small business development. This thesis is designed to be a preliminary study for future research on the problems of efficient social and economic development, and the benefits of a private sector approach.

By “efficient,” I refer to a system that uses less time and money to satisfy the objective of SME development, and utilise the term interchangeably with effectiveness. Since SME success is dependent on more than just access to finance, this research finds that the private sector can be an efficient tool to establish, grow, and develop small businesses. First, private financiers look carefully at the character of the borrower, to detect elements of a successful entrepreneur and business venture. Second, private financiers become engaged in different phases of the business project, to educate and mentor the entrepreneur. Private sector providers are also in a position to supervise various styles of business development for SMEs. These interventions enhance the chances of small businesses to be successful in the long-run. Third, private financiers are also more efficient in bringing other investors to finance SMEs. Additional findings reveal a need to develop financing for ‘transitional’ South African SMEs between R10,000 and R250,000 (approximately 1,500 and 33,000 USD), and the need to clearly define the division of labour amongst private and Government financial suppliers. Specifically Government should play a facilitating role and focus on providing education and basic skills training, as well as programs to help poor and disadvantaged entrepreneurs take advantage of opportunities in the formal economy. Government should also provide funding to the under R250,000 market for SME finance. In some cases Government can indemnify the risk of banks and invest in private funds to lower the cost to lend to high-risk, untrained entrepreneurs. But ultimately Government should not

push redistributive funding for small business development to the point that it is at risk of competing with private capital. In this way, government funding may act as a deterrent to SMEs in situations when they can (more easily) access Government funding.

The limits of private finance to widely fund the entire SME sector, and a failure to recognize indigenous capabilities, suggest areas to improve so that the private sector can realize its potential as a driver of social development. These limits also show a need to be critical and discerning when it comes to the involvement of the private sector to drive development initiatives. Nonetheless, the efficiency of private sector to finance and develop the SME sector represents both a profit opportunity as well as a development opportunity. As such the results of this research trend towards arguments that development focused investors and Government should increase and prioritize investments into local SME financiers.

South Africa is particularly evocative and appropriate for a study of the problem of SME financing. Centuries of discrimination, marginalization and unequal economic development have had a striking effect on South Africa's economy. South Africa has a 'dual economy' characterized by the juxtaposition of a sophisticated technology-based economy that functions alongside, but in close symbiosis with, an underdeveloped sector.² Not only is South Africa experiencing high and rising unemployment, as the most developed nation in sub-Saharan Africa the country experiences high intra-continental migration which adds to the difficulty of securing employment. SME development is imperative to reduce unemployment and alienation amongst disadvantaged groups, since it can help shift poor, marginalized entrepreneurs from the informal into the formal economy. SME development can also increase income earning opportunities through job creation, and provide stability to the local economy and society.³ South Africa is also a recognized model to the African

continent, from which successful financial approaches can be extended and modified to other countries.

The purpose of this introduction is to situate the research amongst the issues of SME financing in a developing country. The section begins with a discussion of the economic and social benefits of SMEs, and the problems associated with securing adequate and efficient finance. Following is a review of the South African socio-cultural, economic, and business context. This review establishes the importance of SMEs to provide opportunities for employment and income, and the need for efficient SME finance models to develop and grow the SME sector in South Africa. The section concludes with an overview of the research methodology and a chapter breakdown.

1.1 The Contribution of SMEs and the Problem of Efficient Finance

SMEs are firms that employ anywhere from 5 to less than 250 employees. They represent an economically important sector in almost every country of the world. Small business sectors in developing countries can be engines for private sector development and the reduction of income-based poverty.⁴ This is especially true for developing countries where many people cannot access jobs in existing employment markets.

SMEs have been signalled as pillars of local development by leading development organizations and industry studies given an array of economic and social benefits.⁵ On the economics side, SMEs represent important sources of employment and income since small businesses are typically more labour intensive than larger enterprises. SMEs are also sources of economic dynamism, innovation, and entrepreneurship.⁶ Other studies have identified that as an indigenous form of business, SMEs represent an investment in local development. They possess an ability to draw on the local workforce, pay taxes to contribute to public

investments, and provide local services and goods that are better aligned with the needs of the local market.⁷

SMEs are also important foundations of social benefits. Liedholm and Mead (1998) have identified the social contributions of SMEs as increased household income and welfare, empowerment of the entrepreneur, and positive demographic change.⁸ Small business development is also an important social contribution in situations when local capital is leveraged to respond to the economic needs of communities. Local entrepreneurs identify local business opportunities and local needs, and establish a business to meet those needs and opportunities. As such, SMEs can be sources of indigenous (or ‘cultural’) entrepreneurship.⁹ SMEs can also be sources of social entrepreneurs, which are SME owners that set-up a business that also meets a social need or objective *in addition* to the pursuit of profit.¹⁰ All these benefits enable SMEs to reduce economic and social inequalities.

Adequate financing is a critical component of SME development. Financing is needed for business start-up, expansion and growth. Yet a lack of adequate financing inhibits small business sectors.¹¹ Developing countries in particular face added social, cultural, economic and political factors that add complications to the provision of small business finance, and the growth of the SME sector. In places like South Africa, SMEs often lack financial knowledge, collateral, and credit history to access formal financing. With an inability to access needed capital from commercial sources, SMEs are unable to grow into meaningful contributors to the local economy. As such, South Africa misses out on a potential driver of sustainable employment and wealth creation. This shortage of small businesses is referred to by Cliene Kauffmann (2005) and others as the ‘missing middle’ of the private sector.¹² However, simply increasing the amount of financing available to SMEs is not enough. The challenge is to improve the financing of SMEs, so that it can be efficient and effective.

Yet despite being signalled as pillars of local development, few financiers are motivated to invest in and finance small businesses.¹³ Supporting the growth of SMEs is challenging even in a developed country like Canada. In Canada, banks consider small firm loans very costly because of high transaction costs and low returns. This makes percentage cost much higher per loan. Thus, while SMEs are recognized as important contributors to the local economy, few actors are prepared to invest in them.

SMEs in developing countries face added problems. These countries are often deficient in the necessary support structures and enabling conditions for local enterprises to develop in a sustainable way.¹⁴ The sector tends to be extremely diverse and consists of formal and informal enterprises.¹⁵ Small business owners also tend to be poor with higher rates of illiteracy, and they lack collateral and business knowledge to meet the standard criteria of financial suppliers. In addition, SMEs can face economic uncertainty, social inequality, and high levels of legislative ‘red tape,’ which can impede business development.¹⁶ These factors are compounded when very low-income countries are unable to attract foreign investment,¹⁷ since outside capital does not flow into the local private sector. These issues create barriers to enterprise development, and access to finance.

Improving financial access for poor and disadvantaged SMEs is part of broader efforts to engender inclusive financial systems. Such financial systems service all people across societies and consist of multiple financial providers that offer a variety of services (such as credit, savings, insurance, remittances, pensions and mortgages).¹⁸ Finance for the *lower income market* is central to developing inclusive financial systems, since many of the world’s poor have been excluded from traditional finance.¹⁹ Access to loans and credit has been a major problem for much of South Africa, for instance, and in particular those living in rural areas. With a lack of access to collateral and physical facilities, as many as 17 million South Africans are unbanked, largely because access to formal banking is inconvenient and

expensive.²⁰ This exclusion has disproportionately affected the ability of the poor to acquire savings. More importantly, it limits the ability of the poor and low-income earners invest in maternal health, education, and environmental sustainability.²¹ As such, creating an inclusive financial industry is viewed as a core development objective to improve quality of life by development organizations and government agencies.²²

Efforts to make financial systems more inclusive are embodied in the micro-finance discourse. Micro-finance is the financing of micro-enterprises (MEs) that employ less than five individuals.²³ Often referred to as ‘micro-credit,’ micro-finance disburses micro loans and financial services to entrepreneurs largely in the informal economy.²⁴ This micro-credit helps individuals to earn a living wage and access basic necessities, which in turn increases the well-being of households.²⁵ The micro-finance market, often comprising of the poor (in particular, females), has traditionally been excluded from conventional banking services and other resources needed for micro-enterprise development.²⁶

Microfinance programmes are seen as one of the most important poverty reduction interventions. The Microcredit Summit Campaign, an advocacy group based in Washington, DC, reported more than 3,500 institutions active in microfinance during 2007. Together these institutions reached over 155 million poor clients and over 500 million families.²⁷ Yet results of micro-finance are mixed. A 1996 review of 32 research and evaluation reports on the impact of micro-credit across Asia, Africa and Latin America, found that micro-credit rarely led to sustained enterprise growth.²⁸ It also found limited impact on employment creation, since most credit schemes are used to finance *existing* (as opposed to ‘new’) businesses. In cases of new enterprise start-ups, many MEs employ family labour and therefore do not create employment for the wider community.²⁹ This is especially true in Africa, where evidence suggests that one-person MEs are typically less efficient and less remunerative than small and medium enterprises.³⁰

These shortcomings signify the boundaries of micro-finance to bring to scale the level of employment, wealth, and gross-domestic product (GDP) needed to reduce income-based poverty. These shortcomings also limit the contribution of micro-finance to build sustainable local private sectors, and lead to sustainable social improvements. As such, the need to provide efficient and adequate finance to SMEs (which can be larger contributors to employment, income, and revenue generation), is underemphasized. In other words, the importance of financing developing country SMEs has been overshadowed by micro-finance. A better approach to contribute to economic and social development is to focus on SME finance.

What distinguishes SME finance from micro-finance? SME finance is a step up in complexity. SME finance encompasses financing options that include loans, grants, venture capital, equity and risk financing.³¹ SME finance requires more technical skills, and invests in small enterprises operating in the formal economy. SME clients also represent a bigger risk exposure to financial institutions than micro-finance clients. Consequently, SME finance requires a different supplier skill set, and a more sophisticated review process for institutions. To work successfully with developing country SMEs, financiers also need to understand the constraints under which small businesses operate as well as their unique characteristics.

Providing SMEs with efficient financing will allow developing country SMEs to reach their potential and be sustainable contributors to local development. Efficient financing for SMEs also ensures that invested money will be effectively utilized. Since developing country conditions are unique, and the economic and social implications of small business development have an added urgency, studies are needed that look for the factors that make SME finance successful. Such studies are important to advance business strategy, development theory, and to guide policy makers and SME focused investors on how to develop and support private sectors in developing countries. It is important to note, however,

that finance alone does not guarantee small firm success. Rogerson's (2000) examination of key determinants of successful South African SMEs in the clothing manufacturing sector found that geography, access to markets, the use of enterprise clusters, and education and training are important success factors to South Africa's SMEs.³² These factors significantly enhance the longevity of small enterprises. Similar research across Africa has shown the same results.³³ Combining these 'success factors' with SME finance can significantly increase the chances of firm growth. Finance models that leverage these success factors will be looked for in this research.

1.2 The South African Challenge: SME Development

SMEs development is central to addressing South Africa's development needs, the issues of which are numerous and substantive in terms of how to rectify and improve.³⁴ A historical legacy of marginalisation, discrimination and unequal development permeates all aspects of social and economic activity. Under apartheid black Africans were systematically persecuted and exploited as a group.³⁵ The family structure completely fell apart due to resettlement reserves for blacks and parental separation.³⁶ Apartheid also generated a separate education system for blacks and white Europeans,³⁷ the effects of which are still felt today in the divergent quality received by black versus white students.³⁸

Apartheid has had a stark influence on the shape of the informal and formal business sectors, and the unequal development of South Africa's economy. McGrath (2005: 112) has shown the racial definition of the economic divide in South Africa, since the small enterprise sector is disproportionately white owned and managed.³⁹ Studies have also shown the stark racial contrast between opportunities to access capital.⁴⁰ Such findings also illustrate how apartheid has created dependency and entitlement. The entrepreneurial tendencies of the

indigenous population have been suppressed, while White Europeans have been given preferential status.⁴¹ As a result, the majority of South Africa's Black population has not been socialised or educated to become entrepreneurs. Relevant studies by the Global Entrepreneurship Monitor (GEM) have shown South Africa's entrepreneurship levels constantly below the average for developing countries and the international standard. Moreover, entrepreneurship levels have declined since 2001.⁴²

Not only has the GEM findings raised the issue of why entrepreneurship is relatively low in South Africa, these findings also raise questions concerning what interventions can stimulate entrepreneurship and small business development in ways appropriate to the local economy and culture. Uncovering the methods used to finance and support entrepreneurs can help shed light on these issues.

In addition to exhibiting limited entrepreneurial tendencies, small enterprises have notably low levels of specific business training among small enterprises (at 12.5%),⁴³ while other studies have shown that a lack of training and skills negatively impact business development. This leads to small firm failure.⁴⁴ So not only do many SMEs fail in South Africa due to a lack of access to needed capital and a lack of entrepreneurial tendencies and business training, a deficiency of mentors and support structures has resulted in a lack of 'soft skills.' This limits the ability of most South Africans to function successfully in the workplace and exercise economic independence. Together these factors have limited most black South Africans to the informal economy, where they remain trapped in a cycle of poverty.

A high incidence of HIV/AIDS (18% of adults) has an enormous effect on the health of South Africa's workforce and implications for how individuals live and work with the disease.⁴⁵ In addition, limited investments into public transport have restricted the economic integration of the poor. A high skills drain,⁴⁶ high rates of business crime,⁴⁷ a shortage of

local artisans and poor working conditions (particularly in rural areas),⁴⁸ and growing competition from well-educated and multi-skilled immigrant entrepreneurs,⁴⁹ have restricted the economic integration of the poor and emerging black entrepreneurs.

These factors have led to a strikingly high (and rising) rate of unemployment.⁵⁰ Both the World Bank's development indicators and Statistics South Africa estimate the size of South Africa's population as just over 49 million.⁵¹ Unemployment currently stands at 4.2 million, or 24.5%, of the economically active population.⁵² This signifies how the majority of the population are too discouraged to look for employment. The 15 to 35 year old age group represents two-thirds of the unemployed, most of them being women. Unemployment among black South Africans is as high as 30.5 per cent.⁵³ With the lack of opportunities for employment and barriers to entry in the formal job market, a large number of people are dependent on the social grant system: As of 2009, 13.5% of South Africans receive welfare grants, while only 5.4 million pay income tax (a high proportion of them white, coloured and Asian).⁵⁴

Informal micro-enterprises are thus a critical source of employment and income generation for many South Africans.⁵⁵ Almost two thirds (63.9 %) of all small businesses in Gauteng province can be classified as active in the (undeveloped) informal economy, while 34% of SMEs start a business because they could not find a job, and half of SMEs would take a formal job if it were offered.⁵⁶ This point is important since it illustrates how, in South Africa at least, the majority of small and micro businesses are survivalist in nature: people are not entrepreneurs by choice, but by necessity.

*Innovations and Advancements*⁵⁷

Important innovations and advancements in the country's social and economic sectors contextualize current studies of SME finance.⁵⁸ Given the historical legacy of South Africa, and the magnitude of the task to foster broad based socio-economic improvements, South

Africa is coping remarkably well. The country has enjoyed strong economic growth averages since 1994, including vast improvements in infrastructure, housing, etc.⁵⁹ South Africa's socio-political transformation (since the end of apartheid in 1994) has led to several targeted policy shifts to meet the needs of previously disadvantaged groups and the poor. In 2003 *Broad-Based Black Economic Empowerment* (BEE) Legislation was introduced to increase the representation of previously disadvantaged individuals, and has now become a strategic imperative for most businesses.⁶⁰ Important for this study, BEE aims to increase partnerships between large corporations and indigenous entrepreneurs or small businesses.⁶¹ In addition to economic development, BEE is of particular importance to South Africa's racial reconciliation and was repeatedly referenced during research interviews and throughout the archival and literature research.

A new emphasis on improved financial systems under *The Financial Services Charter* has seen efforts to increase access and reach.⁶² The charter has led banks to set detailed management, lending, and ownership targets to demonstrate their commitment to an inclusive financial industry.⁶³ Other relevant innovations include the introduction of mobile banking services in 2005. Individuals, who cannot meet basic literacy requirements or travel to urban centers to access banks, are now able to enjoy financial services.⁶⁴ Post Secondary institutions are moving to provide education and training opportunities to underprivileged students, and to nurture entrepreneurs. The Graduate School of Business at the University of Cape Town offers a low-cost business education to 100 underprivileged teenagers from South African townships each year. The idea behind the initiative is to contribute to poverty alleviation by encouraging people to develop their own business.⁶⁵ The initiative will help decrease the dependency of people on the social system and build a sustainable small business sector to provide needed employment and incomes.

1.3 Research Design and Methodology

Purpose and Objectives

The purpose of this thesis is to contribute to the literature on SME finance by investigating whether SME finance can be an efficient tool to develop a local private sector in a developing country. Given this research is situated in the context of circulating theories and ideas of the need to address social issues through the role of business, this study looks at whether private sector finance is an efficient source of SME funding. This study also endeavours to answer a secondary research question: What does the example of SME finance in South Africa reveal about the potential and limits of private sector-led development (PSD), and the assumption that it can be a good thing for social development?

Research Approach

This research is exploratory and takes a unique approach by combining international development and business management fields of study to explore the problem of small business financing. This combination is appropriate given the cross-disciplinary nature and complexity of the problem area, and solutions/interventions to address it. This combination also allows for an exploration of the concept of private sector-led development (PSD). Such an approach sets this project apart from strictly business focused or financial studies that do not usually consider the quality of life implications of SME finance, or the cross-disciplinary implications of small business development. In so doing this approach allows for the bridging of the economic and social implications of SME development. Moreover, strictly business focused types of investigations do not generally include a qualitative element in data collection. This project is also distinct since it looks at the 'supply' as opposed to the 'demand' of finance, to analyze the different forms, approaches and views of financial suppliers.⁶⁶

Research Sub-questions

The following research sub-questions and themes have been used to investigate the efficiency of SME finance. The questions were designed to gather specific information on the nature and impact of the different financing channels, to stimulate discussion, and uncover unique approaches used by the different firms.

Role of public vs. private finance

1. What types of SME financing exist in South Africa?
2. What are the client demographics?
3. What are the investment requirements?
4. What is the average volume of support?

Challenges to small business development

5. How are viable business investments and entrepreneurs identified?
6. Why and how are SMEs rejected for financing?

Community and economic impact

7. What are the production results and/or jobs created from SME funded projects?

Entrepreneurship and success models

8. What is the role or influence of “entrepreneurship” in SME finance?
9. What are the successful models of SME Finance?

Industry challenges and growth opportunities

10. What are areas for improvement and growth?

Methods and Design

The level of analysis of this study is the enterprise and industry level, and related individual perspectives. Since this thesis is exploratory, this study was designed using a two phased approach. Phase one consisted of an extensive literature and archival review. Phase two consisted of field research and the gathering of qualitative data. The qualitative method used is expert interviews of SME financiers and practitioners which gather inside information and views on the strengths and weaknesses of the different SME suppliers and financial models. This contextual form of data is often lacking in current macro statistical data analysis and firm-level studies, and cannot be answered from archival or document research

alone.⁶⁷ Such an approach allows for a more complete understanding of the topic, given that qualitative tools analyze the reasons *behind* a particular phenomenon, including human perceptions and reasoning as to why certain practices take place.⁶⁸ Qualitative methods also allow for a more thorough understanding of the attitudes and beliefs of people in relation to their history and culture. This form of understanding is significant for identifying what approaches to small business development (including finance) might be effective.

A purposive sample was selected to determine that financial suppliers have the available data to satisfy the study requirements.⁶⁹ In total 27 interviews (3 consultations) were conducted with a combination of SME finance practitioners and experts that consisted of executive directors, middle managers (or portfolio managers) and SME researchers, across 11 SME finance firms and organizations. The sample size reflects the small number of SME finance providers. It includes the three leading private SME financiers in South Africa, several micro-finance providers that play a critical role in bringing informal MEs into the formal small business sector, and the two main government agencies that fund and help transition very small entrepreneurs into the market for SME capital. Also included in the sample size are the 3 main SME support centres and small business hubs that do not provide financing but advise clients on what forms of financing are available. For this reason, the 8 finance organizations are discussed in detail in Chapter 4 and referrals to the support centres are used to provide a complete picture of the sector, including the positioning of suppliers and their level of interaction within the SME sector. This combination provides a fuller picture of the SME sector, and ensures the sample represents financial activities across different financial models and bands of capital within the SME sector. This sample also replicates the Government's aggregate definition of small, medium and *micro* enterprises (SMMEs).⁷⁰ This is important since the definition of SMEs is often determined by source

and context, and serves as a point of reference when conducting interviews and sorting through existing data.

Secondary data analysis involved a combination of archival data, industry reports, and field observations to substantiate interview findings. This secondary data analysis provided a quantitative base upon which the data resulting from in-depth interviews and observations was able to build.⁷¹ Once interviews were completed and transcribed, the qualitative data is analysed through content analysis by creating central themes to categorize.⁷²

Limitations of Research

Given time and length constraints, this study does not provide a thorough comparison of public vs. private finance. The sample size excludes venture capital firms and banks, which tend to finance the 'upper' SME segment, or those larger SMEs that are more sophisticated in their business nature (such as small technology or manufacturing companies). Another shortcoming is that the focus is largely on urban areas (where the suppliers are). This means the critical insight of rural areas is missing, even as a need for increased access to small business finance has been noted in these areas.⁷³ The largely qualitative focus of this study also limits the ability to make industry and country-wide generalizations given the diversity of firms and the difficulty of measuring intangible factors. Mixing both quantitative and qualitative would yield better results. The results should be considered as starting points for future research that can provide a more careful analysis of the complementarities of private sector and government, and for studies to track SME development over time against different forms of finance to determine whether some financial suppliers are better than others at developing sustainable small businesses. Future studies can also look at other African contexts to conduct comparative research. This investigation is designed to gather preliminary data to foster an understanding of the SME

finance sector, and the success factors (and limitations) of SME finance. This research sets the groundwork for the use of other, more quantitative-oriented techniques that can be employed in future research.

1.4 Thesis Breakdown

With the contextual foundation on which the research is built established, Chapter 2 introduces the theoretical framework and provides a literature review. The Chapter also outlines the formulation of the research questions and the study design. Furthermore, the Chapter presents a synthesis of the relevant studies on SME finance in South Africa to reveal a shortage of supply-side examinations of SME finance models. This review identifies a lack of studies that link the strengths and weaknesses of different financial suppliers, including a summary of investment criteria and how the different suppliers engage with the SME sector. In addition, existing studies do not identify the different financial channels with economic and social impact, nor identify the investment criteria of financiers and how financiers interact and engage SME owners. Chapter 3 presents private and public financial models of SME finance in South Africa. Taking a cross-sectional view, the chapter examines: how suppliers construct their financial offering; the investment criteria used; the ease of accessibility by SMEs; and the degree of partnership and interaction among suppliers.

The qualitative findings are presented in Chapter 4. Qualitative interviews focus on the success and efficiency of private and public-private finance models, the effectiveness of the SME finance sector as a whole, and areas for growth and improvement.

Chapter 5 presents the research conclusions. While results signal the private sector as an efficient supplier of SME finance, there is a gap in the provision of finance between R10,000 and R250,000 that must be addressed by Government. Government

should also expand financial and business support services to transition very small enterprises from the informal to the formal economy, working in partnership with private sector. Government should also institute a national tracking system for SME development.

The specific strengths and weaknesses of private sector finance yield new and useful insights that help clarify the potential (and limits) of these suppliers and of SME development more generally. On the one hand, the limitations of private sector to widely finance SMEs and to incorporate social development implications prevent its ability to realize its potential as a driver of social development. On the other hand, the limitation of private sector to finance a wider group of SMEs is also the *benefit* of private suppliers. By investing in those SMEs deemed 'more likely to succeed,' private suppliers ensure that invested money is being driven towards those SMEs that have a greater potential to be successful. This helps to dispense that success throughout the local economy in the form of additional business tax and GDP, stable employment creation, etc. Still, these limits show a need to be critical and discerning when it comes to the involvement of the private sector to drive development initiatives. These limits also show that the private sector has opportunities to establish social considerations within investment criteria and consider aligning with indigenous culture and capabilities, to potentially widen its coverage of SMEs.

Summary

SME development is important. Access to finance and business development services is a significant barrier to SME start-up and growth. But since SME success depends on more than just access to finance, efficient and adequate financing is needed so that small businesses can grow and be sustainable in the long run. Using the example of South Africa, this thesis explores the issues around adequate and efficient SME finance from a supply-side

perspective and is informed by both International Development and Business Management fields of study. This thesis describes the main forms of SME finance available to South African SMEs and adds a qualitative perspective to how suppliers construct their offering and the value of SME finance to a developing country. Not only does this research approach potentially model new ways of going about such studies by adding a qualitative element and an emphasis on a contextual understanding, this form of data collection may contribute to other studies that require such data.

Chapter 2: Literature Review and Theoretical Framework

2.0 Chapter Overview

This chapter summarizes the theoretical framework and the key sources of literature that influence this investigation. The theoretical framework presents the theories and ideas that posit SMEs as drivers of economic and social development. This section also situates the research within the emerging concept of private sector-led development (PSD). The example of SME finance will be used to come to a more refined conclusion as to the contributions and limits of private sector involvement in development, and to identify further concerns and implications for research. The literature review transitions from characteristics of South African SMEs to studies of Government SME finance and the regulatory environment, to the key issues related to SME finance in South Africa.

2.1 Theoretical Framework

With the numerous social and economic benefits derived from SMEs, some theories view SMEs as the drivers of inclusive and local development.¹ The role of SMEs is to actualize the opportunities of individuals to improve their quality of life and to serve as the foundation of local markets and private sectors. One strand of international development, sustainable livelihoods approach, maintains that investments in *capacity* (abilities, skills, and opportunities) will enable individuals and communities to solve many of their own social problems and improve quality of life.² This line of thinking is advocated by Economist Amartya Sen (1999a; 1999b), who suggests the goal of development is to expand the capabilities of people while lessening sources of ‘capability deprivation.’³ Small enterprise opportunities can therefore enable the poor to expand their abilities, skills and opportunities in line with established notions of ‘development as freedom.’⁴ More specifically, local

enterprises can potentially enrich people's economic livelihoods in ways that align with the local culture.⁵

Emerging business theories have drawn connections among quality of life improvement & access to markets and resources,⁶ grass-roots business development,⁷ entrepreneurship and innovation,⁸ and efforts to invest in and finance local entrepreneurs.⁹ Specifically, building entrepreneurship and social capital are seen as processes to create local business value since SMEs are considered to harness the social capital of individuals and the communities in which they operate. Steering that capital towards self-sustaining income earning opportunities, SMEs also act as a foundation for local private sectors. This local value contrasts traditional business models that have been driven by global patterns of economic growth. The idea underpinning the historical patterns of economic growth is that economic benefits would 'trickle down' to those at the bottom of the economic pyramid. Instead, theories of inclusive and local economic growth see economic and market development driven by grass-roots or local businesses and communities. SMEs are at the center of locally driven private sectors.

An important qualification is that, on its own, SME development cannot bring widespread livelihood improvements. This is because many other critical factors must be in place, such as health care, education, stable governments, critical infrastructure, etc. As such, these emerging theories rely on diverse forms of partnership between government and different business sectors and development agencies to ensure that all areas related to social and economic development are addressed. In this way, the related development and business theories point to how SMEs should be viewed as platforms, or pathways, of more equitable development.

SME development is one component of private sector-*led* development (PSD). By PSD, I refer to the ability of private sector to organize and initiate market forces to create

positive social results.¹⁰ The underlying methodology is that business can lead social development through procurement, value chains, and the services and products offered. While the private sector is commonly seen as the driver of economic activity, linking private sector with the pursuit of development goals (such as quality of life improvement and poverty reduction), is in recognition of the efficiencies of private sector. This view also rests on the idea that business thinking applies a market discipline to development investments and projects. According to this view, non-profit and public sectors are not self-sustaining in the way that the private sector is. They are dependent on uncertain funding, which can significantly hinder the implementation and activities of development organizations. In contrast, the private sector is able to take on additional risks, raise investor capital, and act more innovatively—methods deemed to be more efficient, more productive, and more conducive to economic dynamism.¹¹ In all this, it is the expertise and experience of the private sector that really drives PSD. This expertise and efficiency is valuable to developing local SMEs, and creating robust local private sectors.

The concept of PSD, however, is an extension of core ideas of Western capitalism that is sustained through economic growth. This is viewed as the main organizing principle of the global economy. The patterns of Western capitalism are often directly at odds with indigenous capabilities, which may not value commerce that is driven by the enterprising activities of individuals. The Western capitalist system also faces limited global regulation and accountability. This application of Western ideas concerning financial markets and business to achieve development goals is problematic. Traditionally this system has valued individuals over groups, ignored issues of unequal power relationships between global corporations and local people, and often necessitated private sector development *as essential* to the social development of communities.¹² Some development scholars and human rights activists may argue that if poverty alleviation is so important, it should not be left to the

private sector and instead fall to governments and the non-profit sector. Other development organizations, such as The Shell Foundation and The Overseas Development Institute, and scholars such as Alvord et al, (2004), suggest that if poverty is so complex, and traditional development models have not worked, innovative and multidisciplinary solutions are needed.¹³

Development institutions appear cognizant and open to the essential contribution of private-sector to lead the achievement of development goals (such as through the expansion of equitable and inclusive markets). Many development agencies now have explicit commitments to ‘pro-poor growth,’ or economic growth that reduces poverty.¹⁴ This normative shift is evidenced in numerous development policy and strategy papers. The UNDP’s *Unleashing Entrepreneurship—Making Business Work for the Poor* outlines a development agenda specifically focused on achieving the UN Millennium Development Goals (MDGs) through private sector driven models.¹⁵ The World Bank’s *Doing Business* and investment climate reports (begun 2004), and DFID’s *Private Sector Development Strategy: Prosperity for All: making markets work* (2008), reflect a growing consensus that applying business thinking to development models can leverage corporate activities, capital and expertise, to construct more equitable and sustainable markets. SMEs are at the center of these strategies.

Few (if any) studies look at the issue of private sector-*led* development. At the same time, Schulpen and Gibbon (2002) have noted that the concept is at an infancy stage and as such remains highly abstract.¹⁶ The development reports and dialogue around PSD illustrate a shifting relationship between traditional development actors and the private sector, yet largely at the macro-level. The reports also show how both the development and business communities are still learning about what private sector interventions can (and cannot) drive social development, and under what conditions. At the same time, these development reports

appear to bypass a fundamental question: whether ‘core business thinking’ is appropriate to developing countries and markets. This is an important oversight, since the mainstream literature seems to passively accept the positive contribution of the private sector. Another obvious observation in relation to PSD is the potentially ‘limitless’ interventions of private sector to contribute to social development. It is also not clear in the literature *how* and *to what extent* a private sector approach is the preferred, or more effective, intervention for development goals.

For these reasons, within the framework of private sector driven development, I explore some of the above issues and concepts using the example of SME finance. I investigate the defining characteristics (or strengths) of private sector finance, and what are the actual (in addition to the potential) impacts of these strengths. This includes building an understanding of the efficiency of private-sector investments, and how they contribute and limit small businesses development in a developing country. By asking questions to understand the financial model, the impact of financing agreements, the sector positioning and the perceptions and views of suppliers, this research comes to a more refined conclusion as to the contributions and limits of private sector approaches to invest in and develop SMEs. I directly ask financial suppliers as to the social development implications of their work, and the ways in which the private sector may be at the forefront of improvements. These extensive interviews are supported by field research and observations, methods which enable the research to question the optimism and assumptions of PSD as expressed in the source literature. This allows for the identification of further concerns and avenues for exploration on this topic.

2.2 Literature Review

The SME Sector in South Africa

In South Africa, SMEs are defined as between 5 and less than 200 employees, depending on the industry.¹⁷ The SME sector is very important to South Africa's economy. The sector generates between 28.7% and 32.9% of South Africa's GDP.¹⁸ The sector is diverse and ranges from informal street hawkers to small restaurants and internet cafes, to small shops, farms, and manufactures. However, foundational research on the SME sector (2006) has established that the average small business owner as: 1. a home-based business; 2. lacking financial literacy and business skills; 3. exhibiting low levels of entrepreneurship; 4. accesses needed finance from family and friends (as compared to formalized sources),¹⁹ and 5. generally unaware of support organizations.²⁰

The *National Small Business Act of 1999* identified different small enterprise segments to clarify SME policy objectives. The act defines the average small firm as those employing between five and 50 permanent employees, and medium-sized firms between 51 and 200 permanent employees. The act also aggregates the small enterprise sector to include micro-enterprises under SMMEs.²¹

As for the financing needs of SMEs, studies by Rogerson (2000) and FinMark Trust (2009) have shown the diverse financial needs of different sized-firms and different types of business owners.²² This means different financial tools and support structures must be in place to service the entire SME sector, which adds to the complexity and challenge to provide SMEs with adequate and efficient financing. This also relates to the 'missing middle' concept of SMEs: the largest portion of the SME sector is unable to access loans from banks, even as a plethora of micro-finance agencies service the very small and ME segments.

While problems in generating accurate data have been identified,²³ current data released by the Department of Trade and Industry (DTI) (2003), estimates the total number of

active small businesses between 1.8 million to 2.6 million.²⁴ The total number of micro and very small businesses was established at 90% of all registered companies.²⁵ Small businesses (overall, including micro, small and medium businesses), account for 75% of all employment.²⁶ While the DTI notes there is no data to track longevity at a national level,²⁷ the department estimates the number of new private registered SMEs (annually) is 20,000.²⁸

This data establishes the importance of SMEs to South Africa's economy; however, the data under-estimates the size of the informal economy. There is also no existing data on the success and growth of SMEs overtime. This lack of data means that critical insight on the sustained contribution of SMEs to economic and social development, since SME start-up numbers do not inform on the success of those businesses over time.

Government has identified small enterprise development as a leading contributor to economic growth. The Department of Trade and Industry's (DTI) *National Strategy for the Development and Promotion of Small Business in South Africa* outlines comprehensive objectives to develop the SME sector, which include an enabling environment, addressing disempowerment of black business, supporting women in industry, and stimulating long-term job creation and sector-focused economic growth.²⁹ The *National Strategy for the Development and Promotion of Small Business in South Africa* identifies key areas where Government can support financial access for SMEs while strengthening links between SMEs, commercial banks, micro-finance agencies, venture finance, and NGOs.³⁰ The Government's aim to leverage employment creation by supporting small businesses has been pursued in part through entrepreneurship promotion.³¹ The *Integrated Strategy On The Promotion Of Entrepreneurship And Small Enterprise* illustrates governmental recognition of the critical contribution of entrepreneurship to SME development.³²

Government Finance and Support for SMEs

Several development finance institutions have been created to operationalize Government objectives regarding SME development. The Department of Trade and Industry (DTI) established *Khula Enterprise Finance* (1996) to provide finance to retail financial institutions (RFIs). In 1998 *The National Empowerment Fund* was established to finance BEE transactions. In 2001, *The Umsobomvu Youth Fund* was created to make investments in job and skill acquisition opportunities for youth. A support entity, *The Small Enterprise Development Agency (SEDA)* (2004), was created to provide information on access to finance, market opportunities, how to initiate entrepreneurship, and where to access education and training. Later, *The Apex Fund (SAMAF)* (2006) was established to develop South Africa's micro-finance sector.³³ The implication of these initiatives is that a lack of access to adequate finance hinders the growth and development of the small business sector.

A review of the literature that measures/evaluates the role and performance of these parastatal agencies indicates they have been largely unsuccessful in bringing about the Government's SME objectives. A follow-up investigation of government SME grants through *Khula* found that various aspects of the program's structure and function negatively influence banks willingness to participate. They include high administration costs incurred by banks, and the way in which the agency calculates risk.³⁴ This means innovative and potentially efficient partnerships that can improve the access of finance to SMEs are lost. Monkman (2003) conducted research that analyzed the performance of government agencies to stimulate SME development against key objectives. The study found: 1. Gaps between the needs of businesses and the services offered; 2. An inability of Government to build entrepreneurship; and 3. High levels of administration that negatively influence the productivity of the Government funding process. It was also found that Government's separation of business development services (BDS) from the provision of financial services does not address the practical challenges facing South Africa's entrepreneurs. Similar

findings are discussed by the Centre for Enterprise Development (2004: 5). A 2006 WB assessment is also highly critical of the uselessness of government training systems for SMEs.³⁵

Other studies pertaining to the regulatory environment have pointed to inefficiencies of Government to create a business climate that stimulates small business start-up and development.³⁶ Of particular note are findings by the Small Business Project that conducted an in-depth survey of approximately 1,800 businesses to examine efficiency and compliance costs of small business regulation. The study found that there was no comprehensive database articulating all the regulations for South African businesses, while regulations create significant efficiency costs to the economy and SME development. Together, these discourage business growth in the formal economy (and particularly the entrepreneurial development of black South Africans.)³⁷ The costs of these regulations have been manifested in firm behaviour that exhibits disinclination to grow, reduced efficiency, and compliance avoidance.³⁸

Lack of Finance- or Lack of Business Training?

Next to the studies that point to the shortcomings of Government to successfully finance SMEs and create a conducive business environment, there is a plethora of demand-side studies focusing on the views and needs of financial borrowers. The implication of these studies is a lack of access to adequate finance for SMEs. They include surveys conducted of Johannesburg and Durban SMEs by the World Bank, which revealed a lack of formal credit to be the central constraint to firm growth, notably to emerging entrepreneurs.³⁹ A lack of collateral and credit history was identified as inhibitors of access; it has been shown that the use of personal savings or borrowing from friends is the most common form of small business financing.⁴⁰ This is likely reflections of how many SMEs are unable to access formal financing. More recently, Ladzani and Netswera (2009) surveyed 600 rural small

businesses in Limpopo province. They found approximately 80% of respondents agreed there are not many financial services available, that finance is the biggest problem facing business, and that government is not doing enough to facilitate financial access.⁴¹ The primary critique therefore is that financial access is a severe hindrance to the development of small enterprises.

Such findings, however, are not an adequate reflection of the financing needs of SMEs. More relevant studies have posited that the gap between the demand for finance may reflect business problems, and a lack of business experience (and not a failure of suppliers to provide enough credit to meet the demand for finance). Such problems are a result of managerial shortcomings and underutilization of capacity—and not a lack of available funds.⁴² This sentiment was also shared by many participants (involved in the supply of SME finance) in this study. This means a lack of access to finance is only one element of small firm failure to grow. Moreover, the fact that many entrepreneurs point to a lack of adequate business finance is often a ‘perception’ of SME owners. As such, studies must address the views and experience of financiers, and what they mean for the supply of SME finance and the process of investing in small enterprises. At the same time, a 2003 report showed how South Africa’s financial system was no more reluctant to support entrepreneurs than the financial systems of other developing countries participating in the study. Internationally, formal financial institutions provide funding to a small minority of entrepreneurs;⁴³ therefore, the financial system in South Africa is not under-financing small businesses against an international average.

A fundamental issue raised in the literature on access to finance is the fact that current Government programs that fund SMEs target ‘high growth firms,’ or those enterprises deemed ‘more likely to succeed.’ This is particularly true in the informal economy, where only a very small group of entrepreneurs are identified to access business

finance and business support services. Andre Ligthelm (2008) investigates this government bias and deems these forms of targeted selection appropriate. This is because firms with high endowments of entrepreneurship are more successful in South Africa (and the implication is that they will contribute the most to the local economy). If local development and growth is a desired goal, Ligthelm concludes that initiatives to promote small businesses need to focus on those with growth potential—or the upper portion of the SME sector that have the characteristics of a successful business—instead of broadly targeting the sector as a whole. Specifically, Ligthelm advises that policy initiatives should advance a dual approach. On the one hand, target small businesses on an individual basis through traditional support programs. On the other, design collective support programs to target survivalist businesses that exhibit limited growth potential, with a view to improve the overall business environment.⁴⁴ Such a strategy will ensure the efficient allocation of resources for SME development and growth.

Ligthelm's argument can be extended to private SME finance that focuses on high growth SMEs in the formal sector. Investments into those businesses deemed to succeed are justified because it ensures that investments are being efficiently directed to those firms most likely to be sustainable sources of employment and income in the long-run. Firms and institutions offering finance and business development services (BDS)⁴⁵ need to focus on specific segments of the SME sector to improve the efficient transfer of financial resources and investor capital. As such, the natural gate-keeping or due diligence process of private financiers effectively contributes to South Africa's economic development.

Finally, Rogerson (2008) offers a synthesis of the key literature on SME development, considering the themes of demand and supply of finance, training and skills acquisition, and the regulatory environment (such as government policy and programs to encourage entrepreneurship and business development). Rogerson identifies a key research

gap in the form of evaluations of the effectiveness of government-led versus a “financial market systems approach” to SME financing.⁴⁶ That is, there is a lack of studies that look at the contribution of private finance, and the degree to which private finance is an efficient form of financing for SMEs. Studies must also point to any failures or bottlenecks of this market systems approach. Consequently, attention must turn to the private sector and what is being done to improve financing and financial services to SMEs.

Summary

Strands of International Development and Business theory similarly posit small enterprise development as critical to improving livelihoods since they are vehicles of locally driven enterprising activities. The concept of PSD and its role in international development is a natural extension of how the private sector can contribute to business methodologies, strategies and approaches to the development of markets and economic growth. The concept of PSD, however, is predicated on the assumption that PSD is a good thing for economic growth and improvements in wellbeing. Using the example of South Africa and the case of SME finance, PSD will be used as a lens to examine the results of this research, to determine the contribution and limitations of private sector to social development.

The literature on SME finance and development in South Africa shows how existing Government programs to support the SME sector have had limited effect. Demand-side studies have looked at enterprise level dynamics and constraints, and analysed financial reach. These studies have been from the perspective of business owners and not financial suppliers. The limited supply-side studies do not address the efficiency or effectiveness of private SME finance. There is a lack of empirical data that identifies the different forms of financing available and the various financial suppliers within the SME sector. There is also a lack of studies that determine the best way of

assessing the impact of different finance channels. This research attempts to fill this gap by linking some of the central suppliers, type of financial services offered and how they help, and the way suppliers work in relation to one another. This research also identifies some of the defining characteristics and strengths of the different SME financial suppliers.

The following chapter analyses the SME finance environment and some of the main financial providers. The chapter distinguishes between the different types, forms, and target markets of SME finance models, investment criteria, and the relationship amongst the different finance supplies. This allows for an assessment of the industry and the different financial suppliers.

Chapter 3: The SME Finance Environment

3.0 Chapter Overview

As discussed previously, it is largely due to apartheid that the small business sector exhibits some of the characteristics as found in the literature, and that a poverty cycle, low levels of entrepreneurialism, and a dearth of skilled workers continues in the South African economy. With these issues in mind, this section provides an analysis of the SME finance sector. This allows for an assessment of how the sector contributes to SME development, including the various financial channels, investment criteria, and financial models. Presenting the information in this way illustrates the complexity of the overall sector. It also helps to determine the efficiency of the various SME financiers by comparing the different forms of finance available to the SME sector.

SME Finance Models

To assess the system of SME finance, we should first look at what is already established. SEDA identifies the forms of small business finance available to small business owners as: 1. Personal; 2. Family/friends; 3. Bank loans; 4. Equity and venture capital finance; 5. Risk finance and investor financing; and 6. Government (loans, grants, development finance).¹

Excluding personal finance and capital from family and friends, numerous non-profit, government, risk and equity financiers, commercial banks (asset financing), venture capitalists, micro-finance institutions, and public-private partnerships, provide SME financing. These systems target specific segments of the SME sector at different stages of business development and provide assistance within a certain band of capital:

Basic and low-cost banking services across the entire population (as provided by *Capitec Bank*);

Government agencies to transition informal small businesses to the formal economy (development finance agency *SAMAF*, up to R10,000);

Small enterprise finance (*Khula*, wholesaler fund, up to R3 million; *Anglo Zimele*, up to R5 million);

Private finance for small and medium businesses (risk financier *Grofin*, equity financier *Business Partners*)²; or

Finance for medium to large businesses (venture capitalists and commercial banks; credit band varies depending on the type of loan and institution, but generally starts above R250,000).³ Since these suppliers tend to target high growth and innovative firms, they are beyond the scope of this research project.

While a comprehensive discussion of the sources of funding available to South Africa's SMEs is beyond the scope of this thesis,⁴ the next section focuses on several prominent non-bank private SME financiers and Government institutions within each of the above SME segments. This sample size is useful to get a complete understanding of how the sector works, and what different financial options are available to small business owners.

SME Financiers

As noted above, the SME finance sector is a complex spectrum of different types and forms of financiers and support agencies. This supplier network is composed of wide ranging financial products (and earmarked finance), investment criteria, and other BDS. Still, there is a notably limited set of non-bank SME funders (next to a range of Government parastatals and agencies), despite opportunities for growth and efforts to make the financial industry more inclusive of small business. As table 1 shows, there is potentially more private funding available to SMEs than Government funding. The spectrum of BDS ranges from purely financial support, to a combination of financial and business support services, strictly

business support services and business mentoring, and business incubation centers. Together the sector can be conceived as a spectrum ranging from private to public finance. By taking a cross-sectional view of the SME finance sector, explicit contrasts and associations can be made according to the following topics of analysis: 1. How suppliers construct their offering; 2. Investment criteria; 3. Ease of accessibility; 4. Degree of institutional partnership; and 5. Gap in reach.

3.1 How Suppliers Construct Their Offering

The different suppliers structure their offering so that businesses can progress through the different forms of financiers (and suppliers) as SMEs grow in business sophistication.⁵ At what I will refer to as the lower end of the sector are found community based support schemes, such as government agencies and NGOs. These community schemes provide administrative advice to SMEs. Advice includes information on how to access finance, research industry and market opportunities, compile a business proposal, etc. The support schemes tend to serve informal, survivalist entrepreneurs whose motivation is to find a job to generate income.

At the upper end of the SME finance sector are the commercial financial institutions and venture capitalists. These commercial entities target those established or aspiring SMEs that already formalize and operate at a general level of business sophistication (i.e. have a formal business plan, have devoted some capital to business development, etc.).

In the middle of the sector are a range of suppliers: some private equity and risk financiers (Grofin, Business Partners, and Blue Financial), and development finance institutions (DFIs), whose role is to bridge the gap left in the private capital markets by directing finance to those that cannot access the formal capital market. Some suppliers

support a combination of small enterprises. For example: Blue Financial, a micro-finance company, targets entrepreneurs in micro, very small, and small business segments.⁶ To look more closely at these firms and how they contribute to the development of SMEs, the primary firms under investigation are identified next.

1.1 ABSA: One of South Africa's 41 largest banks, ABSA is currently testing different models to determine whether the bank can create a sustainable model for micro-finance at scale. ABSA has approximately 10 million clients, 5 million of which fall within South Africa's low income bracket. The bank also has a strong footprint across the country with more than 800 branches. Not only is moving into micro-finance a potentially good market opportunity for the bank, it is also a means for ABSA to contribute to local community development. ABSA is also trying to develop specific products to service low income savers.⁷ At present the portfolio for micro-finance is small —R2.5 million—and ABSA does not aggressively advertise at this stage. Still, under this portfolio ABSA has approximately 1,500 black clients 80% of whom are women, and is testing models in low income and rural areas.⁸

1.2 Grofin: Grofin is a specialized risk financier of small and medium enterprises that require finance in the range of R500,000 to R5,000,000. Begun in 2003, Grofin targets entrepreneurs looking to start-up or expand a business, and targets growth-orientated enterprises.⁹ Grofin's mission is to create sustainable wealth, employment, and economic growth (through the development of successful enterprises) while generating attractive returns for all stakeholders.¹⁰ Offerings include a combination of BDS and a variety of financial products tailored to the specific needs of the business. The company finances business opportunities in services, manufacturing, and commercial sectors. Grofin also finances franchisees. Target firms do not employ more than 100 employees. Still, Grofin will exclude potential entrepreneurs based on certain business practices. Deal flow is

generated through a network of intermediaries that refer clients requiring finance to Grofin.¹¹ Since inception, Grofin has financed 170 SMEs,¹² supporting more than 4,800 employees.¹³

1.3 Business Partners: This firm is an equity financier comprised of fund managers who make equity investments in formal small and medium enterprises. These firms are active in all sectors of the economy and require capital between R250,000 and R20 million. Business Partners was established in 1981. It is a private organization, yet the South African government is the central investor. Business capital is provided for start-up SMEs and business expansions. Capital can be used to assist in restructuring of debt, property investments, and the purchase of buildings for business operations.¹⁴ Business Partners also provides property brokering, property management, consulting and mentorship.¹⁵ Business Partners does not fund farming operations, non-profit organisations, or micro-entrepreneurs.¹⁶

The company is strongly committed to the enablement of black and women entrepreneurs. One unique aspect of Business Partners is that it targets the typical South African small enterprise, or what the Managing Director refers to as a 'life style business.'¹⁷ This means the owner has little aspirations for growth and instead wishes to maintain a certain level of income. As such Business Partners has transformed the traditional equity finance model so that it can profitably fund low-growth small businesses at scale. In terms of deal flow, prospective entrepreneurs can submit business plans directly to the company. However, 80% of deals come from one of two main sources: existing clients that either want more money or that refer others, and through intermediaries (real estate agents, lawyers, accountants, business brokers, bankers) whose clients require risk capital. These intermediaries are paid a referral fee upon deal generation.¹⁸ The company has invested over R6.6 billion in South African SMEs.¹⁹

1.4 Blue Financial: Targeting clients in the middle of the SME sector, Blue Financial is a private micro-finance organization lending to SMEs in the range of R15,000 to R3,000,000. Blue began in South Africa but is currently operating in 13 African countries. International investors include the IFC, the Dutch Development bank (FMO) and the Overseas Private Investment Corporation (OPIC).²⁰ In addition to SME loans, Blue offers a range of products: micro insurance, education loans, short-term loans, home loans, personal loans and debt consolidation loans.²¹ Blue's target market is divided into the following categories based on how much customers receive:

Micro (under 5 employees) less than R2,000;

Very small (10-20 employees) from R500,000 to R1,000,000; and

Small (under 50 employees) R3-6 million).²²

In terms of investment deals, Blue currently does not engage in broad based marketing. The majority of SMEs approach Blue, but fund managers also go into the market to identify potential enterprises.²³ In 2008, the number of jobs created in South Africa from Blue investments was 555, while family members supported from these investments were 2,275.²⁴

1.5 Khula: Khula is a wholesale venture capital and small enterprise financier funded by the DTI. Khula does not lend to SMEs directly. Funds are dispersed through partner institutions while Khula staffs provide business mentorship and support (such as business plan writing and tender information). Khula also advances interest-free seed capital or grants for new RFIs, and offers capacity-building services for both existing and new RFIs. The forms of finance available include loans, grants, equity/debt investments, and technical assistance.²⁵ Business loans provided by Khula to RFI's are not to be used to finance their operational costs but to finance business owners.²⁶ Khula is the main Government agency

that refers clients from the lower end of the SME spectrum to formal providers of finance, such as Business Partners.²⁷

Among the numerous products offered, two private equity funds are particularly relevant to this study because they are administered in partnerships with the two most prominent private sector SME financiers: Business Partners and Anglo Zimele. *The Business Partners-Khula Start-up Fund (2006)* is a joint venture between Khula and Business Partners to enable entrepreneurs to establish new businesses. The R150 million fund has financed 163 enterprises valued at R92.4 million.²⁸ *The Anglo-Khula Mining Fund* is a joint-venture with Anglo Zimele. The fund facilitates the entry of viable mining enterprises into the mainstream mining sector via Zimele's mining supply chain. It provides up to a maximum of R7.5 million in seed capital. In 2009, the fund invested in 11 junior mining companies that supported 810 employees, in the amount of R132 million (Anglo Zimele's contribution).²⁹ Four of these companies were new investments. For both fund models, Khula provides funding to partners that manage screening, review of businesses, fund disbursement, and loan repayment (also subject to Khula approval).

Khula also offers a credit indemnity programme with all South Africa's major banks for loans between R10,000 up to R3 million. Under the indemnity scheme, Khula agrees to pay for losses incurred when banks extend credit to high risk clients (or low-income SMEs). SMEs are referred to banks by Khula.³⁰ The scheme also secures bridging finance to emerging black contractors that have won tenders under the Emerging Contractors Fund. This finance can be used for projects up to a maximum R10 million.³¹ As of spring 2010, Khula is making a stark departure from working through intermediaries and will move into the direct financing of SMEs. This may be in partial recognition of the fact that its current model has not been as successful as government would like in terms of reaching potential clients. Operating in this way, Khula has no say in which SMEs receive finance. In addition,

Khula has not realized a sufficient return on investment.³² Of particular interest is that Khula is modelling its new approach after the success models of private financiers. Khula will use field workers (loan officers) to seek out potential entrepreneurs and to regularly interact with owners once funds have been disbursed. Khula will offer training and research opportunities for SME owners, will not go to market without insufficient capital, and will decentralize its staff.³³

1.6 Anglo Zimele: An enterprise and economic development initiative of Anglo American Corporation in South Africa,³⁴ Anglo Zimele is one of South Africa's largest and most legendary multi-national corporations. Begun in 1989, Zimele provides flexible debt-equity financing (including business development support and the transfer of technical skills) to black owned enterprises. The model involves investment funds that provide loans and equity finance to support start-up or expansion businesses. The goal is to ensure local black suppliers and local companies contribute to Anglo American's supply chain in South Africa.

Business development officers identify and put forward business plans for Zimele to assess. If considered viable, Zimele will take a minority stake in the firm and provide financial support and skills transfer. Sub-contracting is used to engage local businesses in Zimele's supply chain. Zimele also provides advice on strategy, markets, finance, systems, and corporate governance.³⁵ A key component of the model is an incubator approach. This allows for Zimele to mentor and train SMEs, so that the enterprise can gradually move to less dependence on Zimele. This transfer of skills and expertise also helps to ensure enterprise survival. Investments are divided into three separate funds: Supply Chain Fund (R75 million), Anglo-Khula Mining Fund (R132 million), and the Communities Fund (R111 million).³⁶ Through these funds, Zimele takes an equity risk in SMEs. Zimele invests in approximately 15 new ventures per year.³⁷ In 2009, Zimele supported 506 businesses that in

turn supported 9,570 people.³⁸ Moving forward, Zimele recently announced it will create 12 new enterprise development hubs in high unemployment areas. These hubs are expected to generate 25,000 new jobs over 7 years, as part of the company's commitment to community development.³⁹

1.7 SAMAF: At the lower end of the SME finance sector is the government micro-finance agency SAMAF. The agency on-lends capital to local non-profit organizations (or MFIs) that in turn fund MEs. SAMAF also provides finance to groups of micro-savers to assist in the transition of the informal savings group to the formalized banking system.⁴⁰ In total, SAMAF has supported 47,268 micro-survivalist entrepreneurs via 42 MFIs.⁴¹ Funds are administered through four (4) allotments of R480,000 at an interest rate of 10%. MFIs can on-lend at no more than 5% to their clients.⁴²

1.8 Capitec: A final and relevant participant to the industry is Capitec Bank. Capitec offers basic banking services (deposit and credit capabilities) at low rates, and utilizes modern technology (such as biometrics, paperless, and mobile banking). This model is reaching more than 2 million clients across South Africa, including low-income earners. While Capitec is not positioned as a bank for the low income demographic, the banks has structured its product offering so that it is affordable (and attractive) to a broad range of clients—including SME owners that require banking products for their business. The bank contributes to an inclusive financial system by making banking viable for low income clients next to South Africa's large corporate banks. Capitec is therefore important to the development of an inclusive financial system in South Africa.

3.2 Investment Criteria

Investment criteria differ substantially among these financiers depending on the offering and the targeted business segment. Private risk and equity financing firms examined in this study utilize in-house evaluations of entrepreneurs and business viability.⁴³ These rigorous client evaluations form critical components of risk management, and can be naturally onerous to the small business owner.

2.1 ABSA determines investment criteria based on business stability. Recognizing that small business have a high failure rate in South Africa, ABSA requires its clients to have been in business for at least one year and from the same fixed premise so that bank staff can maintain contact and a relationship with the owner (as compared to small businesses hawkers that freely move around). The second investment criteria is positive cash flow, with some assets to which the bank can follow a legal process and collect is needed. Age is also an investment criteria, and the banks targets 18-64 year olds. The bank finances small businesses across all sectors with a turnover of R500,000 a year. What really separates micro from the small business sector is the level of formality of the business. Often the micro clients do not have documentation and the bank will have to conduct an assessment of the client to create an income statement for the business and conduct reference checks (often through a neighbour).

2.2 Grofin assesses the finance needs of SMEs through what it terms ‘viability-based lending.’ Collateral, and a financial track-record, are not pre-requisites to obtain financing.⁴⁴ Instead, business viability is based on business potential, a sound business plan, affordability of repayments, past financial performance, financial projections, and the commitment and dedication of the entrepreneur.⁴⁵ Higher value is placed on entrepreneurial abilities and business potential, while collateral (if any) supports a risk-reward relationship.⁴⁶ Still, general investment required by entrepreneurs is approximately 20%.⁴⁷ To mitigate the risk of low levels of collateral and business experience, Grofin partners with the entrepreneurs

through on-going business mentorship and training. This increases chances of longevity, success, and financial return, for the length of the investment contract.⁴⁸

2.3 Business Partners similarly focuses on business viability, or cash-flow viability, which is based on a reasonable assumption of revenue and expenditure for the proposed business. The second investment criterion is the entrepreneurial capacity of the SME owner (which includes technical skills, managerial skills, etc).⁴⁹ Business Partners will also take BEE and gender considerations into account on an ad hoc basis.⁵⁰ While collateral is not the sole investment criteria, a larger amount of borrowed funds will cost the SME owner more than if he or she contributes a higher amount of cash up-front. The lower the collateral provided by the SME, the greater the risk to invest in the businesses. In cases such as these, Business Partners expects a greater rate of return on their investment (which is ultimately more costly to the entrepreneur and the business).⁵¹

2.4 Blue Financial invests on the basis of business viability, and not collateral, which General Manager of Small Business Development describes as much more lenient and faster than other commercial sources. But the cost of this is a higher interest rate than the banks.⁵² To assess financial and business viability, Blue looks at whether there is a market for the product or service. In addition, Blue takes care to assess management viability through a psychological metric test (administered by an outside company) that also tests attitude towards small business management to determine entrepreneurial potential and ability of person to take on risk. The company also considers a reasonable contribution from the entrepreneur (cash-in-kind), and tests the entrepreneur on the extent of business training to determine if additional training is needed.⁵³ In terms of risk management, Blue spends a great deal of time working directly with the entrepreneur. Skills training are a loan condition, including after-care activities to determine that funds are spent judiciously, while mentors work closely with clients receiving loans above R250,000.⁵⁴ Blue also uses the United States

Agency for International Development (USAID) credit guarantees.⁵⁵ Before exiting the business, entrepreneurs are put in contact with relevant people and processes that can assist them.⁵⁶

2.5 Anglo Zimele's investments are driven by the level of BEE compliance,⁵⁷ in addition to business viability and strong growth prospects, and a financial contribution from entrepreneurs.⁵⁸ Since Zimele's model deals mainly with small firms within its existing mining supply chain and through sub-contracting,⁵⁹ Zimele seems to operate with less risk than other risk financiers. On the other hand, Zimele has built expertise in working with small scale mining companies, and provides additional social services to the communities in which its mining supply companies are based.⁶⁰

2.6 Small enterprise investment criteria for Khula have typically been delegated to its partner organizations. Investee institutions include commercial banks, RFIs, and private equity funds.⁶¹ Yet high default rates have led to more stringent due diligence of investments made through partners and a re-evaluation of this model.⁶² If investee institutions meet Khula's eligibility criteria, including an emphasis on BEE considerations,⁶³ they can obtain loans for on lending to SMEs. With bank indemnities, banks approve a small business loan based on the business idea and business viability. Once approved by the bank, Khula's investment committee will review the investment before granting final approval.⁶⁴

2.7 SAMAF similarly operates at arm's length of SMEs where investment criteria is set by participant MFIs and its joint-venture partners. Criteria for SAMAF to invest in MFIs include: minimum operation for 12 months, minimum number of active loans of 500, a fully function board of directors and a managing director with at least 5 years experience, and at least one full year of audited financial statements.⁶⁵ This model is an example of government trying to outsource partners that possess the necessary expertise, but SAMAF must balance a trade-off between reporting and setting investment criteria.

2.8 Capitec does not typically invest in SMEs. Criteria for banking services are minimal. They are not based on assets, and the bank bypasses the issue of financial literacy by incorporating biometrics etc. and utilizing paperless banking.

3.3 Ease of Accessibility

Opportunities to access finance are fewer for informal SMEs than for established, formal SMEs. These SMEs are able to access networks of public-private finance ventures, as well as sub-contracting. With slight variations to each firm, a Business Development Officer may seek out viable small businesses for investment; small businesses may submit business plans to the firms for consideration, or SMEs may be referred through other intermediaries (including business support centers). As noted above, criteria for finance differ across suppliers and for the different sizes and type of SMEs. This means SMEs must navigate a complex array of financial and BDS.

Conversely, at the lower end of the SME market there is little requirement for collateral but with that comes limited forms of available finance. Here a network of walk-in business centers offer administrative support, legal and tender information, computer access, business mentoring, and business incubation services available for first-time SMEs and start-ups, particularly for micro-entrepreneurs on the fringes of the informal economy.⁶⁶ One such business service provider is the provincial government agency The Red Door. This organization typically works in areas of low literacy and where there is limited access to information and skills training. As noted during interviews, the Red Door offers limited funding (loans backed by the government) but the process is still in its infancy. These centers have tended to instead direct clients to where they can look for appropriate business finance. Advice includes referrals to banks and other financial agencies (if a client exhibits a

viable business plan), and referrals for customers to have a business or marketing plan created through partner consultants.⁶⁷ It was noted during interviews that those employees working at the Red Door often have a development background and not direct business experience.

Another relevant support mechanism for small business that is a growing area of success is small business center incubators, such as Raizcorp. With the goal of growing profitable entrepreneurial businesses, Raizcorp offers clients access to an entrepreneurial community and quality infrastructure, personnel, business skills training and personal development assistance, and assistance with sales and lead generation. While Raizcorp does not provide companies with finance, it provides 'soft financing' by absorbing up to 75% of the monthly costs of small businesses so that enterprises can focus on cash flow. Raizcorp does assist with capital raising through links to various financial sources (venture capital and private equity).⁶⁸

It is also evident that the positioning of SME financiers determines access to services and finance. Those SMEs better informed of what supports and financing opportunities are available are better placed to access services (and particularly by the banks if they have more solid business plans and financial literacy). This is a measurement of the entrepreneurial tendency of the SME owner and the strength of his or her business and cultural network. This factor may potentially screen for prospective entrepreneurs (since actively seeking for finance can be considered one way for investors to seek out promising investments), but leaves few options for those less informed and less pro-active from a business standpoint.

It is difficult to accurately measure the number of SMEs that access the different suppliers. Each organization maintains its own records on number of clients (SMEs) served, which may not indicate whether they are new clients or repeat clients. This lack of sophisticated tracking can result in shortcomings to data collection on the depth and outreach

of small business finance. In addition, many SMEs can potentially access more than one supplier and at different phases of business development; hence, as a firm grows in size and formality, they may access different intermediaries, or begin at one stage of the spectrum and re-enter at a different stage if expanding or starting a more sophisticated business.

3.4 Degree of Institutional Partnership

Not only does the positioning of financiers in the sector and their target market illustrate a (speculative) fluidity of small businesses between suppliers of finance as they grow, it illustrates the importance for suppliers to work closely with their clients. Overall there are limited providers of SME finance. Government institutions help bridge gaps between private finance and low income SMEs that are unable to access private finance through grants or public-private partnerships. Private equity and risk financiers rely on intermediary networks for deal generation. I propose conceiving the industry as an interdependent system, in which all suppliers are inter-related and mutually dependent. Envisioning the sector in this way is helpful in understanding that suppliers do not work in isolation. This is especially relevant in an enabling environment that is driving towards racial integration (under BEE legislation). Public-private partnerships, risk capital for new business start-ups, business center hubs, business incubation models, and micro-finance interventions, are all needed to both create a more inclusive financial system, and to finance the establishment and development of small business.

3.5 Coverage and Gap in Reach

Finally, this system reveals financing gaps that can be rectified and improved. It is still clear that SMEs get caught in what USAID South Africa and others have referred to as

‘the missing middle’ where loans needed for business start-up and development are too large for micro-loan agencies and too small for banks.⁶⁹ Business Partners and Grofin are the two main small enterprise financiers in South Africa, followed by Blue Financial and several government agencies.⁷⁰ On average, Business Partners funds 700 entrepreneurs per year, while Grofin funds 300 per year.⁷¹ These firms target the medium to large sized firms that have established business plans and whose businesses demonstrate entrepreneurial potential (viable, sustainable and potential for growth).

Given the size of South Africa’s population, and the potential size of the SME sector, suppliers of credit are inadequate to meet demand. In addition, there is a need for increased financial models and related support structures to help MEs make the transition to small formal enterprises. A subsequent shortage in funding identified in this research is funding below R250,000 but greater than R10,000. This capital band responds to the ‘missing middle’ concept of finance whereby small business owners will often require loans larger than micro-credit but not greater than R250,000. This capital band appears to be an important step-up for MEs seeking to transition into formal businesses. However, with limited models in this area, questions of how businesses transform or make the shift from MEs to successful small businesses are difficult to answer. By extension, identifying what financial models can help are equally difficult. Khula is addressing this issue by partnering with private sector.

Summary

With the wide stratification across South African small businesses, there is a range of financial products and services available (including various restrictions and funding criteria). These forms of finance target SMEs at different levels of business development and sophistication. The sector is structured to leverage the key competencies of each partner: Government is able to provide funding at a lower cost to borrowers than commercial

partners, whereas the private sector applies its expertise and experience of the market and business development to identify opportunities and support SME owners through the business process. This enables private funders to focus on identifying and working with those SMEs that demonstrate business viability.

Government services (such as walk-in centers) help reduce borrowing difficulties and the cost to private firms to work with SMEs that are ill prepared for the rigorous processes of applying for finance and navigating small business regulations. Government partners with banks through credit indemnity schemes to lessen the risk of lending to small enterprises (which cannot otherwise access formal SME risk and equity finance), provides funds through venture-partnerships. Private financiers raise capital through public and private funders to invest in viable small businesses. Micro-finance organizations target micro and very small business owners and bring them into the formal economy. Other firms, both public and private, offer business incubation services to help mentor and nurture viable businesses.

Looking at the whole of the SME finance sector illustrates how the main finance suppliers construct their offering, how small enterprises access the various forms of finance, and areas for industry expansion. Yet the system is not sufficient in covering the forms and types of BDS needed by aspiring SMEs. As table 1 shows, there is a gap in finance between R10,000 and R250,000. Also, private finance can be costly to SMEs with interest rates exceeding 20% on borrowed funds. The structure of the sector also reveals the limits of private sector contribution to SME and private sector development. The private sector tends to invest in those SME owners deemed most likely to succeed, and those SMEs that are better able to navigate through the various support structures. Adding the qualitative findings provides a more complete picture of the supply of SME finance and the strengths and efficiencies of the different financial suppliers. These findings are presented in the following chapter.

Table 1: Key Performance Indicators

	ABSA	Grofin	Business Partners	Blue Financial	Khula	Anglo Zimele	SAMAF	CAPITEC
Type	Commercial bank Micro-finance	Private risk finance	Equity finance	Private micro and small enterprise finance	Small enterprise finance	Private supply chain small enterprise finance	Government micro-finance	Commercial bank low cost banking
Total Portfolio	R2.5 million	230 million USD (R1.7 billion) spread across 13 African countries	R1.953 billion	R709 million	Credit Indemnities R98 million RFI loans R145 million	R318 million	R29.2 million	R5.0 million
Credit Band	R500 to R500,000	R500,000 to R5 million	R250,000 to R20 million	R39,000 to R3 million	R32,000 to R2 million	Up to R7.5 million per firm	Up to R10,000	Lines of credit up to R 100,000
Number of (as of 2009)	300 individuals 1500 savings group clients	170 investments	607 investments	77 investments	2,829 investments (includes through partners)	509 investments	29,714 clients	2 million clients
Average Loan or Investment Size	R3,000	1 million USD or R724,500	R1,539,00 (varies 2-5 million)	R486,654	Varies within credit band 31% of investments are below R250,000	Varies within credit band	R480,000	No loans
Key Demographics	Average age 18-64 80% female owned 100% black businesses	Average age 35-40 25% female owned	Targets female owned and previously disadvantaged groups	61% male owned 39% female owned 78% black businesses 22% white businesses	52% black businesses	Targets black businesses	Target 80% female owned	No specific target market
Size of Target Firms (turnover)	N/A	Up to R5 million	Varies	1. Less than R2,000 2. R500,000 to R1,000,000 3. R3-6 million	Not reported	Reports aggregate turnover of invested companies: R1566 billion	R2,000	No specific target market; offers services across the spectrum, from R1,000 income earners to R20,000 or higher
Interest Rate	N/A	28-32%	Determined on per deal basis	28-32%	Up to 15%	Not reported	10%	N/A Bank fees based on a percentage of deposit

Chapter 4: Interview Results and Discussion

4.0 Chapter Overview

This chapter presents qualitative findings. In a series of interviews and observations, qualitative information was gathered to understand the efficiency and shortcomings of the supply of SME finance. The data gathered from interviews is grouped under specific topics relating to the research sub-questions outlined in Chapter Three. The results are also organized under these themes to structure and clarify the subjects under investigation:

Challenges to Small Business Development

Entrepreneurship

Community and Economic Impact

General Attitude Towards Social Development

Role of Private vs. Public Finance

Challenges to SME finance development

Growth Opportunities

Success Models

4.1 Challenges to Small Business Development

The perspective of suppliers regarding the main challenge to starting a small business is central to this study. It provides a more holistic view of the efficiency of SME finance and the reliance on financial mechanisms for business success. 35% of interviewees (largely public sector working with informal clients) indicate finance is the biggest challenge, which is consistent with the literature that suggests access to finance is the biggest challenge to ME development. For instance, one non-profit interviewee, consulted as an expert on the SME finance sector, discussed how a lack of assets (including finance) hinders the ability to access

finance products for low income families and those operating in the informal economy.¹ The private sector suppliers discussed a range of challenges.

One of several managers cited handling the commitment of loan repayment as the main challenge, reflecting the lack of experience of first-time borrowers and business owners to deal with a formalized loan program and criterion. It was also suggested how this difficulty is compounded when clients have a diverse range of responsibilities to deal with while running a business (particularly women). All other firms and industry experts suggested a lack of business acumen and knowledge of entrepreneurship as the biggest challenge to SME development. These interviewees further cautioned that a ‘lack of finance’ often does not reflect the true needs of the business. For instance, a business owner might have a pricing issue or stock that does not turnover, and attribute this to a need for cash injections, and not a need to re-evaluate business operations.

The suppliers also went on to discuss other challenges to SME development, listed in table 2. As a portfolio manager at Business Partners aptly notes, finance is the biggest problem *from the entrepreneur’s perspective*. As a supplier, he also identifies problems of industry monopolization on the one hand, and competitive markets on the other, as the main challenges to small business development. This view reflects wider economic and industry obstacles.

The Business Manager for the Western and Northern Cape at SAMAF discussed how organization, planning, and location, are all key aspects to the success of micro-enterprises—and not access to finance for its own sake: “I always tell people when I do workshops: that you all want R500,000 or R5 million, but first show me what you can do with R500, and then we’ll go from there.”² This comment is interesting because it also suggests public sector managers apply a business approach to ME funding, where higher loan allotments are based on business performance.

One Business Manager in Philippi Township (Cape Town) suggested providing sustained, long-term support for small businesses is the challenge. The Managing Director of Business Partners went further by suggesting how establishing and entrenching a business culture in South Africa is the most important challenge to growth of the SME sector.³

An alternative perspective is offered by a Business Manager of a walk-in business center in Cape Town. It suggests a risk of access to grant money and support mechanisms alongside finance from the capital market as a disincentive for entrepreneurship. This is because improper presentation in the market can suppress competitive desire and risk taking, and essentially disempower individuals.

This perspective identifies how the challenge is not so much *access to finance* but access to the *right type of finance*, and the way these financial tools are presented in the marketplace. This perspective may also indicate disconnect between public and private approaches to provide SME finance, and the need to clarify joint-partnerships for funding and business development interventions. This perspective also cautions against providing too much business support.

The view of private suppliers might be biased because they must ensure a return on their investment, which also justifies the need for necessary restrictions and criteria to minimize risk. In other words, private sector suppliers will not lend to any SME owner. Still, the reasons why SMEs are turned down for finance points to underlying business problems, and not necessarily a failure of the system to provide finance to those that need it. It is also clear from discussions with Business and Portfolio managers that identifying a lack of financial and business knowledge does not address the *difficulty* SMEs experience in accessing finance. That is, private financiers are aware of the barriers and difficulties that SMEs face when trying to access formal credit.

4.2 Entrepreneurship

Entrepreneurship is an important concept in small business development, although it has been noted that entrepreneurial characteristics can place restrictions on financial access and narrow borrower eligibility.⁴ Many interviewees (74%) made a clear distinction between different kinds of SME owners: the ‘entrepreneurs’ that go looking for finance to meet business opportunities, as compared to ‘business owners’ that only rely on the business for income generation and have no aspirations for business expansion. This distinction points to an accepted notion of entrepreneurialism: not every business owner can be considered an entrepreneur, while every entrepreneur cannot necessarily succeed as a small business owner. As noted by a portfolio manager at Business Partners, determining entrepreneurial capabilities is an important component of investment criteria: “I’d say when our deals go bad, 80% of the time it’s around what the entrepreneurs could have done differently.”⁵

Entrepreneurship is therefore discussed as a key success factor when assessing business opportunities (63% of respondents). Business Partners and Grofin, for instance, have a specific mandate to finance entrepreneurs and employ their own system to identify entrepreneurial characteristics. A bility to assess entrepreneurial capabilities adds an interesting dynamic to an investigation of whether it is possible to track the effectiveness of SME finance and investments, since aspects of entrepreneurship—and how individuals might change after business training and mentorship—can’t always be measured. As a Business Manager at Raizcorp puts it: “Sometimes it’s quite subtle....he’s the same guy, he’s still plodding along. He doesn’t employ anymore people; but he’s a different person....he looks different; he walks different; he’s got more confidence. You can’t really value that.”⁶ In addition, the business manager went on to discuss the importance of individual self-belief as a fundamental tenant of entrepreneurship:

What's happened in South Africa is there is so much repression that some people lack the self confidence and the belief in themselves; it might sound weird but my 7 year old daughter has grown up with the belief that she can do anything. Whereas if you've grown up in a different society or come from a different society, that's just the way it was so you don't have any confidence. It's not instilled in you....In terms of my coaching sessions with clients, the biggest shifts happen there and often it's around that self-belief.⁷

Perhaps in light of such perspective, interviewees repeatedly noted how South Africa needs to inspire a culture of proactive individuals to start thinking of creating a business, rather than to work for a large corporation, which should begin at a primary education level. This sentiment reflects a view that access to finance alone does not encourage entrepreneurship.

Several interviewees in this study suggested entrepreneurs often get discouraged from starting a business since they would weigh the return of their efforts to run a small business against the social grants they receive from government. Three interviewees pointed to a division between standard notions of entrepreneurship and indigenous culture. One fund manager offered this explanation of the difference between the communal approaches of the indigenous black population as compared to the overarching Western business culture:

We are only 15 years (out of apartheid). That is not a long time and somewhere along the line, their parents will still be talking about (apartheid) and sometimes their parents may hold them back. And also in South Africa, the black community tends to look at extended families as opposed to small little families. So if I succeed and I come out of a black community, I am expected to share my wealth with a whole lot of people. Whereas in my community, if I succeed I am not expected to share my wealth with the rest of my family. It's very much like the European culture of business which is different than the black business culture. So they move on, but they don't create the same kind of wealth as others do.⁸

This statement reflects a pessimistic sentiment about a disconnect between the historical ruling class's approach to business, and those living at the base-of-the-economic-pyramid (BoP) that seek to enter and participate in the local market. It also reinforces the need to better align the communal business approach of South Africa's indigenous populations with that of the overarching Western European business culture.

One question worth pursuing in future research is whether access to finance *increases* entrepreneurial tendencies. Although small business support structures and tools have been identified as possible disincentives to entrepreneurship, there may be clear linkages between

financial access and enterprising activities that has not been addressed in the qualitative interviews.

Level of social impact of businesses is not a target of current efforts to fund small enterprises. For example, as table 2 shows, firms in this sample size did not have explicit criteria to consider the social innovation of entrepreneurs nor rank social innovation as investment criteria. This is unfortunate since there are potentially missed opportunities to invest in new areas that can improve social conditions and encourage social problem solving. Business Partners weighs aspects such as gender, race or a cultural need, higher than other investment criteria, but on an ad-hoc basis. Does this reflect a gap between current investment practices, and the propositions posed in the literature concerning the broader social implications of private sector to contribute to social development? The failure to integrate social considerations into investment criteria suggests private sector could be doing more to finance those entrepreneurs that are pursuing businesses with clear social implications (in addition to pursuing a profit).

4.3 Community and Economic Impact

Keeping in mind a general attitude about striving for improvement and identifying conditions of success, the extent to which SME finance organizations monitor community and economic outcomes is important. A particularly critical question asked if evaluation frameworks are in place to measure impact on community and the environment. Across the board, not one interviewee could answer this important question beyond the basic international standards of tracking number of jobs created and households supported (100% of respondents track these indicators). For instance, suppliers (both government and industry), as well as research centres, could monitor jobs sustained over time, the number of

households supported and where, or the value-add of the product or business idea. That is, while firms monitor economic impact, and all financiers view their work as an indirect contribution to social development, the vigour and depth of measurement are limited.

All firms measure their progress against the BEE scorecard and gender statistics (although not reflected in the collected data, Anglo Zimele is currently developing a fund to help women in Anglo's mining communities).⁹ This information is useful as a goal to increase participation of historically marginalized groups, but does not address more fundamental issues of power and the reinforcement of traditional female roles. For instance, what types of businesses are females heading? Are they domestically related—such as cleaning services or agricultural related—or are they involved in key industries such as mining or manufacturing? The fact that Anglo Zimele has yet to focus on women in mining seems to reflect a gender gap within the types of industries in which there are few women entrepreneurs.

Grofin notably stands out for utilizing an Environmental Social Governance (ESG) policy which includes the following indicators to assess community impact: 1. Jobs created and maintained; 2. percentage of jobs created for and maintained by females; 3. cost per job created and maintained; 4. percentage of investees that adopt an Environmental Social Governance policy; and 5. percentage of female ownership in investee companies.¹⁰ Zimele has also developed its own evaluation framework called SEAT (Socio-Economic Assessment Toolbox) to investigate and monitor impact.¹¹ Zimele also measures its performance against internal sustainability factors through its parent company Anglo American. Business Partners looks at environmental compliance of firms as part of its due diligence process,¹² and has internal targets to meet certain percentages of female owned businesses and those owned and operated by members of previously disadvantaged groups.

Where no comprehensive frameworks are in place to assess the wider social impact, and applicant follow-up is limited to the term of the loan, practitioners justified these gaps with reference to limited capacity (specifically human resources) to create and administer evaluation frameworks. This is particularly shocking since critical insight into business longevity and the contribution of SME finance suppliers to the local economy over time is missing.

4.4 General Attitude Towards Social Development

An important finding concerns the general attitude of local business experts and financial suppliers to view their work as a contribution to social development (52% of respondents). Participants would reflect on their development objectives and how private-sector based approaches can contribute to social improvement via SME development. All expressed belief in the importance of SME development to contribute to individual empowerment and community well-being. Practitioners described a transformation in the demeanour and attitude of the small business owners as a result of business development tools, finance, and business mentorship: they develop confidence, self-sufficiency, a sense of ownership, and income to sustain a comfortable lifestyle.

Private Sector interviewees stated their primary goal is to profitably finance and support SMEs—and not social development. While Business Partners Managing Director recognizes a clear development aspect to his organization's activities, the private organizations investigated do not make a conscious trade-off between generating profits and pursuing social objectives. At best they are developing clear social mandates to guide future growth.

Government and non-profit practitioners were more cognizant of a social development dimension in their discussions of the reach and impact of their activities but within the context of micro-finance initiatives to transition informal MEs into the formalized SME environment, and to use micro-finance for asset development as a central investment into household well-being.¹³

4.5 Role of Private vs. Public Finance

Approximately 90% of interviewees expressed the view that the most important role of private sector is to help mentor new businesses, while 100% recognized that private companies should not replace Government in basic skills training nor detract from efforts to improve primary education.

At the same time both public and private practitioners identified private finance as more efficient than public finance given the quicker turnaround time for due diligence (the demands of which is much higher in the public sector). Turnaround time is important since small businesses owners cannot afford to wait long periods to know whether an application for funding has been approved or not. However, it was also noted across all interviews that government funded programs are important to micro and small enterprises that require business loans under R10,000, where private finance is not available. Therefore, while private finance may be preferable, currently no private models target this market. Yet the potential to expand private models to this space, which is being pioneered by ABSA, may be limited. As one portfolio manager indicates, the high cost to the client to access capital in such a risky market as SME finance, may render the business unviable.¹⁴

The ability of private organizations to source a wider range of investments is also an efficiency factor of the private sector. Nearly all interviewees discussed how the private

sector is not (as) constrained by bureaucratic rules, legislative mandates, political considerations, and a fixed budget, which translates into a greater freedom of action and ability to act more quickly than public officials.

Unsurprisingly, private sector interviewees recommend government should facilitate and not drive the industry. This line of thinking points to a traditional business view that public sector should focus on social development and not to impede private sector development. It also aligns with views that the private sector, possessing insider business experience and knowledge, is a natural driver of entrepreneurialism and enabler of innovation. References to 'soft loans' manifested this sentiment. The term was used to describe capital coming from government that does not require interest payments (ie. grants), etc. These government loans are not deemed efficient by the private sector since borrowers do not learn to compete as they would in the capital market. This is seen to create confusion in the market since requirements and investment criteria differ amongst public and private providers. The underlying implication is that, because it may be easier to access government funding, more prospective business owners gravitate to the 'soft' money than that which is available in the capital market. However, not one interviewee looked at this difference as an organic streamlining effect that can help the market separate the 'entrepreneurs' from the small business owners.

Research observations substantiate these views. It is evident that private firms tailor their operations to different markets in ways that would be difficult for government programs, as discussed by the CEO of Blue Financial at a presentation to South Africa's financial community on Blue's operations throughout the African continent.¹⁵ This includes an ability to hire local staff to serve clients in their local language, while benefiting from the expertise and capacity of the parent organization. It is also clear that Government lacks capacity and recognizes private sector expertise in working with small business owners:

hence the practice of government providing SME funding through private suppliers (such as Business Partners), using bank indemnities, and wholesale finance models through partner MFIs and private equity funds.

4.6 Challenges for Sector Development¹⁶

Identifying challenges is important to determine how and where improvements can be made. In addition to identifying which actor(s) should drive the sector, numerous bottlenecks impede the growth and expansion of financiers. One manager at ABSA commented that a key challenge has been the level of skills in the supplier market, whereby the bank is finding it extremely difficult to locate staff with the right skills set. A second challenge identified in the interviews is that Government has not clarified the role it should play in the sector. The same manager at ABSA referenced how Government is moving into direct financing of SMEs, which could potentially distort the market because Government tends not to charge competitive rates to recover costs and sustain itself in the long-run.

A provincial director at SAMAF suggested parallel industry developments as a main challenge to growth of small enterprise finance, such as in the insurance market. High incidents of AIDS related deaths mean many MFIs have to write off high loan portfolios where the introduction of insurance can help to alleviate risk and extend the capabilities of MFIs. In addition, half (or 50%) of the practitioners identified how it is very difficult to start a business in South Africa¹⁷ (a fact underscored in the literature), and that easing the regulatory could improve industry development.

Another interesting perspective by a walk-in business support center Business Manager signals a very important role for government to take in the SME industry, as well as a more integrated approach to working with SME clients as they progress through

different stages during the development of the business. Since there is no national tracking system, there is a risk of duplication of numbers and reporting of SMEs in the market. Such a system would bring rigour to SME reporting and to help signal to the different suppliers an SME owner or entrepreneur who would be of interest from an investment perspective.

4.7 Growth opportunities

What is particularly compelling about an SME finance approach to development in South Africa is that there are increased opportunities to create sustainable new businesses given a growing middle class and increasing investments in infrastructure, education and health. There is now a national focus on equitable and shared development. Practitioners are optimistic concerning opportunities to reach more SMEs and expand available funds. All interviewees recognized how small enterprise finance is an untapped area, given a large market and limited suppliers. As such, there is room for both more privately driven models and for existing suppliers to increase their capacity (and available funds). When asked whether the SME sector is currently underserved, a portfolio manager at Business Partners said yes, and gave two reasons: 1) a lack of available funds to SMEs; and 2) a high risk market, whereby if suppliers do not understand the uniqueness of the SME market in South Africa they can lose a lot of money very quickly.¹⁸ In other words, suppliers risk high rates of failure given the high-risk nature of the SME finance sector.

The geographic footprint of suppliers is another means to determine the conditions under which SME finance successfully contributes to small enterprise development. The underlying assumption is that servicing entrepreneurs in their locale can facilitate access to financial services and the building of business relationships. Expanding reach is identified as a growth area: 100% of interviewees affirmed plans to expand their organization's

geographic footprint (although Business Partners and Blue Financial have already expanded into other African markets). The two leading SME financiers, Grofin (2 offices)¹⁹ and Business Partners (21 offices across South Africa),²⁰ are on the main located in urban and metro centres. This reflects where demand for small business finance is concentrated: one interviewee stated since that there are more opportunities in the city centers, there is mass migration to urban centers which seems to generate entrepreneurialism.²¹

Another way to explain the mostly urban presence is to note how these companies work through a network of intermediaries, which means their on-the-ground presence is mitigated through referral networks spread across the country (though arguably still mainly in urban centers). Therefore, as a Portfolio Manager at Business Partners notes, private SME financiers really need to determine if rural markets is where their target market exists.²² Since SME financiers do not provide traditional banking services, their physical presence is not as important as savings and other financial services, such as those provided by Capitec, which is expanding service to rural (and more impoverished) areas.²³ Blue Finance has operations spread across the country, and Khula has a presence in several smaller cities. It was, however, recognized by interviewees that suppliers must expand operations to typically underserved rural markets.²⁴

The growth rate of the SME finance sector is more difficult to assess. One perspective offered by a public micro-finance manager is that growth is slower for small business finance than finance for MEs: “I think the micro-finance sector is growing at a much much faster pace than the SMME sector; because [for] a lot more people it is a lot easier to take R500 and then to start selling rolls on the street then to get R500,000 to start a little factory; so even if I am retrenched and I take R500 to sell socks, or something like that, it’s growing at a much faster pace....the SMME sector in South Africa really starts at about R250,000 and works its way up from there.”²⁵

This perspective also demonstrates the difference between SME and micro-financing. While selling bread rolls is a more immediate means to create income for untrained entrepreneurs, the local economy does not benefit much from an oversaturation of informal bread sellers, nor can government earn tax revenue. The value-add of SME finance is that it assists the more ambitious and/or driven small business owners that can meet market needs, hire more people, etc. and potentially become a part of a corporate value chain (such as the model of Anglo Zimele). As such SMEs play a critical role in diversifying the local economy.

4.8 Success models

Interviewee perception of the success factors of his or her organization influence the identification of the successful models in the industry. The factors identified and listed in table 2 are markedly different between private firms and government supported agencies.

While private models apply (what I would call a 'standard') Western business approach to the local economy, managing directors and practitioners at public and non-profit agencies seem more willing to create business platforms that align with the indigenous culture. For instance, two practitioners and three expert interviews (approximately 18% of respondents) referred to indigenous communal orientations as a possible source to increase engagement of individuals at the low end of the SME spectrum, suggesting that local *stokvels* might serve as seedbeds for entrepreneurship to amplify chances for business success. This may prove a promising research area that should be investigated further.

The strongest strategy that emerged overall by private suppliers (and appears to be the norm) is finance combined with technical assistance. These models require close working relationships with clients to minimize risk. These models also compensate for a lack

of training and business acumen of borrowers by transferring skills and expertise. More important, business mentorship links small enterprises with growth opportunities. This helps small firms to expand existing operations or to connect with larger supply chains and tender opportunities. As South Africa's Business Manager at Grofin puts it, this mentorship goes beyond merely providing grass-roots funding to small entrepreneurs, because without training, the funds will not be utilized effectively and hence will go to waste. Grofin terms this type of small business support 'money with mentorship.'²⁶ Similar sentiments were expressed during interviews with Capitec Bank, Blue Financial and Business Partners.

Individual, tailor made financing is Business Partner's success model. The company developed a model to effectively finance SMEs at scale (as compared to venture capitalists). Constructing an expert database based on industry experience and market research has allowed Business Partners to streamline and mechanize the funding process. The company also draws on a well-developed network of intermediaries. Similar models are utilized by Grofin and Blue Financial.

An interesting innovation included in Business Partner's offering has been the development of an online enterprise development tool, the SME Toolkit.²⁷ A joint initiative with the International Finance Corporation (IFC) and IBM, it offers easily-accessible business information, resources and online training. The aim of the SME Toolkit is to get information and resources to as many entrepreneurs as possible via the internet, since access to this type of information is frequently one of the greatest challenges faced by aspiring business owners. The Toolkit offers how-to articles, business forms, financial tools, online training, and information resources developed by leading experts, as well as free software tailor-made for SMEs. All aspects of business set-up and management are covered, from business planning to accounting, financial management, human resources, etc.

Other features of successful models include human capacity. The General Manager of Small Business Development at Blue Financial identifies top calibre staff that possess industry knowledge and experience working with entrepreneurs as a central component to their success model,²⁸ as did managers and client practitioners at Grofin, Business Partners and Capitec. Public sector interviewees did not identify supplier skills as major component of their business success models.

Summary and Discussion

Adding the qualitative findings of SME financiers provides a more nuanced picture of the contribution and efficiency of approaches to invest in and finance small enterprises in South Africa. Exploring the interview responses provides insight into the expertise, strengths and characteristics of SME finance providers, and the reasons behind the models and approaches of the different suppliers.

An important discovery of the qualitative data is that looking solely at numbers of SMEs served and supported by financiers is not a sufficient metric on its own to determine the impact of different financiers. This is because private financiers target a specific segment of the population through screening and due diligence. Only a few SMEs will be successful in obtaining needed capital, and to establish a successful business that will be sustainable in the long-run. That success will be funnelled throughout the economy in the form of additional job creation, the expansion of access to services or goods, and through the contribution of local taxes to public sector budgets.²⁹ At the same time, the number of loans given or received does not reveal whether or not those SMEs are sustainable in the long-run.

Both public and private interviewees view the private sector as a natural fit to drive SME development. Private sector financiers are seen to exercise freedom for innovation, such as through ‘flexible financing’ or tailor-made financial products that allows funders to determine the best financial tools and products based on the business idea and the qualities of

the business owner. They also have the ability to acquire capital through investors, and to transfer business expertise through business mentorship. Investor accountability ensures that financial support is spent wisely in terms of being directed to viable businesses. This type of model ties performance with funding (such as business growth, sustainability, etc.). As such, the private models reviewed are not seen as handouts to entrepreneurs and business owners, but a means to self-determination. An important component of this model is that these financial suppliers are local (as opposed to foreign) owned and operated financial firms. This means the private firms have an expertise and understanding of the local markets and the needs of the local small businesses.

This type of investing is considered to inspire a ground-up approach for local people to see what they can do for themselves to improve their quality of life. Financing SME development is a proactive—rather than a reactive—approach to invest in the tools that people need to drive their own development opportunities via SME development. An interesting element is the ability of private sector to investigate and utilize new approaches that governments are unable to do with public tax dollars, including supply-chain financing which brings small scale local contractors into larger corporate value chains. Still, the sector appears to suffer from a lack of clarity concerning the role of government support mechanisms and private funders. Some of the attitudes and beliefs expressed in the interviews is that Government should assess its capabilities and define its priorities. This would allow Government to refocus on a facilitator role, and to regulate the downsides of private sector activity.

All financiers were careful to stress how development interventions that target MEs operating on the fringes of the formal economy are needed, but should not be confused with efforts to develop the formal small business sector. This sharpens the theories and concepts of SME development in developing countries. While SME development has both social and

economic implications that are hard to separate in developing contexts such as South Africa, business development is ultimately distinct and separate from social development.

The qualitative interviews also affirm how—at one level—a lack of access to finance for SMEs is often a symptom of a business problem (such as poor market research, inadequate costing and estimates, and lack of business and financial knowledge), and not a ‘cause’ of poor firm growth and success. This reinforces the importance of human capacity investments, such as ‘soft skills,’ entrepreneurial coaching and mentorship, as essential to successful and sustainable SMEs. Financial models that incorporate skills training and entrepreneurial development address some of the underlying causes of poor business performance, while increasing access to finance and business coaching that might otherwise be unavailable to many small business owners.

In terms of success factors, well-developed networks of intermediaries and stakeholders are critical. Networks are important for deal generation and client referrals to appropriate financiers and support agents. Still, one negative aspect of networks for the provision of finance and business support services is that only certain types of people can access and participate in these networks. In other words, those small business owners that are more ‘entrepreneurial’ or aware of the support agents are able to navigate the system of financiers better than others lacking that knowledge and ability. Thus the sector’s structure may unintentionally mask power relations and inequalities. This might also be improved by defining the roles of public and private financiers.

There is no explicit focus on the social implications of the business concept in the private sector investment criteria (beyond considerations of BEE implications). At one level, it can be argued that any form of SME in a developing context (such as South Africa), adds social value through its operations. This is because of the wider quality of life implications of SME development. Consequently, there may be explicit ways in which entrepreneurs and

SMEs add social value in developing countries that differ from developed countries. On another level, this indicates a growth area for financiers.

Questions as to whether investments made into the SME sector are sustainable over time cannot be answered (beyond the loan or finance agreement between supplier and SME). One interviewee suggested the institution of a national tracking and monitoring system of SMEs. Such a system could track the movement of poor SMEs through the financial system, which documents when and where SMEs access government funding and other services during the transition from a micro into a more sophisticated small business. Such positive progression through the SME support channels might be an indicator of a successful business owner and business idea. Identifying those proactive businesses would be of benefit to private financiers. Improvements in tracking the success and longevity of South African SMEs would significantly improve the study of SME finance, and is a potential area for Government and research institutions to address.

The next chapter summarizes the important insights of this study, contribution to theory, and areas of future research.

Table 2: Qualitative Results

Main Challenge to SME Development	Lack of Business knowledge:	Access to Finance:	Government Procedures:	Establishing culture of entrepreneurship:	Loan repayment and financial commitment:	Other:
	35%	15%	11%	11%	7%	21%
Entrepreneurship	% Using entrepreneurship as investment criteria: 63%	% Entrepreneurship not considered as investment criteria: 37%	% Using social entrepreneurship as investment criteria: 0%	Entrepreneurs seen as distinct from small business owners: 74%		
Community and Economic Impact	% Monitoring jobs created: 100%	% Monitoring gender statistics: 100%	% Monitoring households supported: 7%	% Monitoring BEE compliance: 100%	% Monitoring environmental impact: 18%	
Attitude Towards Social Development	% With clear social mandate: 37%	% Viewing work as contribution to individual empowerment: 52%	% Viewing work as contribution to community well-being/social development: 100%	% Viewing work as profit seeking: 100% of private financiers		
Main Challenge to Sector Development	Skills in the market: 23%	Parallel industry developments: 9%	Increasing sector transparency and SME tracking: 9%	Clarify role of Public and Private suppliers: 9%	Easing regulatory environment: 50%	
Growth Opportunities	Expand geographic reach: 100%	Further develop expertise: 75%	Tap into indigenous communities to enhance entrepreneurship: 18%	Public-private to provide transitional finance 23%		
Role of Private vs. Public Sector	Private sector mentor new business	Private sector provide quicker access to finance	Private sector exercise freedom for innovation and raise investor capital	Government fund finance suppliers at lower cost	Government provide basic skills training:	Government facilitate sector
Success Models	Internal capacity	Local industry knowledge and experience	Well developed networks of intermediaries	Ability to apply experiential learning	Individual, tailor-made financing	Shared risk with Government

Chapter 5: Conclusion

The most important goals of this research were to demonstrate how SME finance can be an efficient means to develop the SME sector at scale, and that more attention, from both academics and development investors, should focus on finance for developing country SMEs. Since finance is fundamental to business start-up and growth, the challenge is to develop appropriate financing models that are effective, both in terms of identifying viable small businesses and in meeting the business needs of SME owners. But SME success depends on more than access to finance, by exploring some of the different suppliers of SME finance, and in particular the private sector suppliers, this research finds that private SME financing is an efficient model to develop the local small business sector and, by extension, improve livelihoods. This research also identifies the potential downsides and limits of private sector involvement in international development, and makes suggestions to mitigate these limitations.

The private sector suppliers exhibit several key strengths that enable them to be efficient suppliers of finance. First, private financiers carefully look into the character of the borrower to detect elements of success (such as entrepreneurial characteristics and a capacity to handle the commitment of loan repayment). Private financiers also look carefully at the viability of the business, in light of the local market, to determine whether elements of success are present. This ensures that funds are directed to businesses more likely to contribute to the local economy and be sustainable in the long run.

Second, private financiers become engaged in different phases of the financing project and the development of the business. Private financiers educate and mentor entrepreneurs, transferring business knowledge and expertise. Not only does this coaching increase the likelihood of business success and longevity, this business training addresses the critical skills gap and limited levels of entrepreneurialism in South Africa. In addition, being locally

based, private financiers possess an investment in local development and can apply local market expertise and experience to supervise various forms of business development.

Third, private financiers are also more efficient in bringing other investors to finance SMEs, which means they can provide access to a greater pool of capital than government funds. Private financiers can be less subject to conditions of uncertain funding than is the case for public sector funds and agencies that are dependent on Government funding. Private sector finance is therefore a more sustainable source of funding for SMEs.

Another important finding of this research is that there is a significant gap between providing finance to micro-enterprises operating in the informal economy and SMEs operating in the formal economy. Small business financing begins at around R250,000 while micro-finance tends to serve those individual entrepreneurs requiring capital below R10,000. Not only are there few financiers in this space (both public and private), the step-up in complexity and skills for small enterprises are especially large. There is a need to address the below R250,000 market for SME finance. Financial models that can help transition smaller and less sophisticated businesses to more technical businesses are also needed. Since no private sector models can profitably finance this segment, leaving SME finance solely to the private sector financiers might exclude this group of aspiring entrepreneurs. Because of this gap, government can and should play a role to help bridge access to SME finance for transitional enterprises.

Government should also play a crucial preparatory role for SME development. This can be accomplished through ensuring a sufficient education and health care system, as well as business training and workshops, which will reduce some of the barriers and constraints faced by prospective SMEs such as administrative and legal aspects to business start-up. Yet issues of government corruption might restrict or prevent the positive government activity. Government can occasionally partner with the private sector to leverage the business

competencies of private enterprise while aligning those capabilities with Government resources to improve the quality of business training. Government can continue to partner with private sector to indemnify banks and invest in funds operated by private financiers. However, the literature has shown that these funds have had limited effect and that improvements can be made. The need to create appropriate public-private sector partnerships and division of labour also poses challenges. The suppliers interviewed in this research reiterated how an efficient and sustainable system of finance requires a careful presentation of public and private finance to the market for SME finance. Government should be careful not to push redistributive funding to the point that it is counter-productive to economic performance, and the cultivation of entrepreneurial tendencies. As such, Government should loan to the under R250,000 market (where private financiers are not active) to help small businesses grow bigger and to increase the pool of SME applicants that demand financing from the private sector. Government can also institute a national tracking system to monitor the access of SME to the different support programs and finance. This would play an important role by signalling to the private sector which SMEs exhibit signs of future growth.

Another important aspect of this thesis was to clarify and advance ideas concerning PSD. Specifically, how does the example of SME finance data speak to the assumption that PSD, and a business approach, is a good thing for improvements in wellbeing and/or social development? In addition, does the example of SME finance clarify what private sector interventions can (and cannot) drive social development?

On the one hand this research affirms that the private sector is an efficient financier of SMEs and that private sector can make positive contributions to social (in addition to economic) development. On the other hand, this research reveals the critical limitations of the private sector to realize its potential to drive social development. The downside of a private sector approach is that it provides financing to those small businesses that are

considered most likely to be successful. The coverage of private financiers is also concentrated on urban areas. This careful screening or due diligence is based on a subjective assessment of the risk to invest in small businesses, as well as the entrepreneurial capabilities of SME owners. This is not a scientific process that can be accurately measured and quantified. For these reasons, private finance runs the risk of exacerbating inequalities in developing countries. It also runs the risk of limiting the access of finance by local SMEs that do not have the ability to showcase their business ideas in a way that is attractive to private sector financiers. This is especially true in a country such as South Africa, where the western business culture of the private sector suppliers is not able to recognize the potential of the local indigenous people and community capacities. More importantly, private suppliers perpetuate western business thinking that simultaneously fails to regard the potential of indigenous capacities, and indigenous ways of approaching commerce and entrepreneurship. There is also a systematic lack of attention by the private sector to social development implications, despite a growing awareness (in the general sense) of the inter-relationships amongst business development, access to markets and enterprising opportunities, and quality of life improvements (including poverty alleviation). This lack of systematic attention means that while social development implications are on the radar of private sector financiers, they have not thought critically about how to introduce and integrate those social development implications into their business models and investment criteria.

While private sector finance is an effective tool to develop the SME sector, these findings indicate that there are significant shortcomings of private sector finance to develop an inclusive small business sector. As such, these shortcomings temper the optimism concerning private sector driven development as expressed in the literature of PSD. They also show a need to be critical and discerning when it comes to the involvement of the private sector to drive development initiatives. The private sector has opportunities to establish

social considerations within investment criteria and consider aligning with indigenous culture and capabilities, to potentially widen its coverage of SMEs. Not only is this thesis a starting point for future longitudinal studies comparing different financial channels for SME development, it is also a starting point to refine an understanding of how and where the private sector can be an engine for social development.

Endnotes

Chapter 1

1 Green et al., “Finance for small enterprise growth and poverty reduction in developing countries,” *Journal of Internal Development* 18 (2006): 1027.

2 It is a common sight to have world-class shopping malls, restaurants and convention centres side-by-side with poverty stricken townships and informal squatter settlements, spaces in which human survival is the priority of daily life.

3 Definitions of SMEs vary across countries and enterprise sectors, but Meghana Ayyagari, Thorsten Beck and Demirgüç-Kunt note the most common basis is employment. See “Small and Medium Enterprises Across the Globe,” *Small Business Economics* 29 (2007): 2. In South Africa, SMEs are defined as between 5 and less than 200 employees, depending on the industry. See The *National Small Business Act* (Department of Industry and Trade, 1996). International definitions draw distinctions between MSEs (micro and small enterprises) and SMEs (small and medium enterprises). See Donald C. Mead and Carl. E. Liedholm, “The dynamics of micro and small enterprises in developing countries” *World Development* 26 (1998): 61–74. The Global Entrepreneurship Monitor (GEM) defines small businesses by distinguishing between “opportunity” and “necessity” driven entrepreneurs, or those entrepreneurs that actively assess market opportunities and start a business, as compared to small business owners that create an enterprise to provide a needed source of income (and tend to operate in the informal economy). See http://www.gemconsortium.org/about.aspx?page=re_about_research. All these ways of defining small enterprises and the different factors that drive their creation speak to the complexity of this topic and the need to relate the macro theories and ideas to the micro context.

4 See Ayyagari et al. “Small and Medium Enterprises Across the Globe,” *Small Business Economics* 29 (2007): 2.

5 Stimulating small enterprise growth has been viewed as an important objective for developing countries and a key source to develop pro-poor markets by development agencies such as the Organization for Economic Cooperation and Development (OECD). See *Accelerating Pro-Poor Growth Through Support For Private Sector Development*, (OECD: Paris 2004), <http://www.oecd.org/dataoecd/53/21/34055384.pdf> (accessed August 6, 2010). The UK’s Department of Foreign International Development (DFID) and the United Nation’s Development Program’s (UNDP) view SME development as a central private-sector based strategy to improve livelihoods. See for instance United Kingdom Department for International Development (DFID), *Private Sector Development Strategy: Prosperity for All: making markets work* (DFID: London, 2008), <http://www.dfid.gov.uk/pubs/files/Private-Sector-development-strategy.pdf> (accessed September 5, 2009), and The United Nations Development Programme (UNDP), *Unleashing Entrepreneurship: Making Business Work for the Poor* (UNDP: New York, 2004). This includes strategies that target micro level support for the very poor and vulnerable groups, macro level policies to protect the interests of employees and poor entrepreneurs, and effective social policies in health, education and

welfare. Linda Mayoux. “Trickle Down, Trickle Up or Puddle?: Participatory Value Chain Analysis for Pro-Poor Enterprise Development,” (May 2003): 3-4. Linda Mayoux Website, http://www.lindaswebs.org.uk/Page2_Livelihoods/Ethical%20Enterprise/Ethical_Enterprise.htm (access August 6, 2010).

6 See World Business Council for Sustainable Development, *Promoting Small and Medium Enterprises for Sustainable Development*, 2. World-wide studies reveal how many poor people act as entrepreneurs and are engaged in more than one form of economic activity; this makes the business case that that people can both contribute to market development while at the same time improve their quality of life through establishing small businesses. See Abhijit V. Banjaree and Esther Duflo, “The Economic Lives of the Poor,” MIT Working Paper Series no. 06-29, under “Social Science Research Network” <http://papers.ssrn.com/sol3/papers.cfm?abstract-id=942062> (accessed July 16, 2010): 11. See also Collins et al. *Portfolios of the Poor: How the Poor Live on \$2 a day*, (University of Cape Town Press: Cape Town, 2009).

7 Banjaree and Duflo, “The Economic Lives of the Poor,” 3.

8 Donald C. Mead and Carl Liedholm, “The dynamics of micro and small enterprises in developing countries,” *World Development*, 26 (1998): 61–74.

9 A factor now recognized as a core component of economic development.

10 Since small business owners are often (though not always) “entrepreneurs,” SME’s have been posited as important sources of social value creation via social entrepreneurs. Social entrepreneurs are small business owners that seek to create a social benefit or meet a social need in addition to earning a profit. In this way, social entrepreneurs do not seek to earn a profit at any cost. For a good overview of social entrepreneurship and the cross-cutting areas of its research, see Johanna Mair and Ignasi Martí, “Social Entrepreneurship Research: a source of exploration, prediction, and delight,” *Journal of World Business* 41 (2006): 36-44. See also for instance The United Nations Educational, Scientific and Cultural Organization (UNESCO), <http://www.unesco.org/new/en/unesco/> (accessed September 6, 2010).

11 Green et al., “Finance for small enterprise growth and poverty reduction in developing countries,” 2006, 1022, note how inadequate access to credit and other financial services from formal financial institutions has long been recognised as a constraint to the expansion of micro and small enterprise sectors.

12 Celine Kauffman, *Financing SMEs in Africa*, (OECD Development Centre Policy Insights: Paris, 2005): 1. See also Christine Phillips and Seema Bhatia-Panthaki, “Enterprise Development in Zambia: Reflections on the Missing Middle,” *Journal of International Development* 19 (2007): 793-804.

13 At the outset it is important to clarify the important related concepts of SME finance in a developing country context. Development finance is a favoured tool of economic and private sector development. Specialized Development Financial Institutions (DFIs) drive sustainable private enterprise investments into developing markets. Some DFIs fund joint-

ventures in developing countries, while others make equity investments in businesses. Private equity funds are financial investments that take an equity stake in a business whereby the investor or funder becomes a shareholder of the business. These investment funds are macro level and driven through partner organizations or fund managers. Recipients are often larger SMEs or technology enterprises (and not grassroots businesses). Javier Santiso, *Banking on Development: Private Financial Actors and Donors in Developing Countries*, (OECD: Paris, 2008): 5-6.

14 It is not easy to establish a small business, as revealed in the WB's series of doing business reports. These reports draw attention to the need to improve local regulations and other critical business environment considerations so as to encourage local private sectors to flourish. The World Bank Group and the International Finance Organization, "Doing Business in South Africa 2010," in the Doing Business: Measuring Business Regulations digital database, <http://www.doingbusiness.org/> (accessed August 6, 2010).

15 Formal enterprises operate within formal market and business regulations, and contribute to the local economy through business taxes. Informal enterprises, on the other hand, operate in the unregulated sector and do not contribute to the formal economy. When the formal sector is unable to accommodate new entrants, informal (survivalist) businesses set-up. It is easier for the unemployed to start a micro-business than to find a formal sector job. See Banjaree and Duflo, "The Economic Lives of the Poor," (October 2006): 20. Survivalist businesses are often set-up to escape poverty rather than meet a viable business opportunity as conventional business theory would hold. Since these businesses are chiefly un-specialized, lack businesses training and collateral, entrepreneurs in the sector are considered too risky to access formal asset-based finance. Ibid, 10-14. Informal and formal SMEs have vastly different profiles and business needs; see Herrington et al. *Tracking Entrepreneurship in South Africa: A GEM Perspective*, (UCT: Cape Town, 2010): 117.

16 For a review of the cost of red tape in South Africa, see SBP, *Counting the Cost of Red Tape for Businesses in South Africa*, (SBP: Johannesburg, 2005), quoted in Rogerson, Christian M. "Tracking SMME Development in South Africa: Issues of Finance, Training and the Regulatory Environment." *Urban Forum* 19 (2008): 61-81.

17 World Business Council for Sustainable Development, *Promoting Small and Medium Enterprises for Sustainable Development*, 6.

18 United Nation's Capital Development Fund, *Building Inclusive Financial Sectors* (2006): 17, <http://www.uncdf.org/english/microfinance/pubs/bluebook/index.php> (accessed August 5, 2010).

19 The need for more inclusive systems has been emphasized by the recent 2007/2008 financial crisis and subsequent recession in much of the industrialized world. Developing economies, including South Africa, experienced significant economic slowdowns as a result, exacerbating their already disadvantaged position in the global market. The collapse of the American financial system was exported around the world via globalized financial markets, and led to falling international trade, rising unemployment, and low commodity prices. For an extensive overview of the financial crisis, see the Financial Time's

online “In Depth: Global Financial Crisis,” <http://www.ft.com/indepth/global-financial-crisis> (accessed July 30, 2010). While on the one hand these events call into question the underlying assumptions of liberalized markets, the crisis fallout has sharpened a call for sustainable financial systems and economies that meet the needs of all people.

20 South Africa is not unique in this regard. Globally there is little contact between formal financial institutions and the poor. This is due to a combination of high risks, high costs, and low returns. This renders banks cautious to supply credit. Banks also judiciously screen candidates (a process which often disqualifies poor candidates). See D. Porteous, “The landscape of access to financial services in South Africa,” *Markets and Social Frontiers* 3 (2003): 1-6, quoted in Andrie Schoombee, “South African Banks and the Unbanked: Progress and Prospects,” *South Africa Journal of Economics*, Economic Society of South Africa 72 no.3 (2004): 2. In addition, relevant studies on the banking sector in South Africa confirm the “missing middle” status of the SME sector. Banks continue to serve established rather than new SMEs, and service the upper income market of the SME segment at the expense of the lower end of that market (that require business loans in the range of 10,000 to 50,000 R, or lower). Schoombe (2000) found high risk of default, high costs associated with candidate screening, and difficulties in servicing the low income segment given cultural and language barriers, as reasons for banks to only reach the upper end of the SME market. Andrie Schoombee, “Getting South African banks to serve micro-enterprises: an analysis of policy options,” *Development Southern Africa* 17 (2000): 752.

21 For an introduction on this topic, see Asli Demirgüç-Kunt and Ross Levine, “Finance and Inequality: Theory and Evidence,” *The World Bank Development Research Group Working Paper no. 4967*, (World Bank: Washington, DC, 2009): 1-52. One explicit strand of research has investigated the role of financial sector development for micro and small enterprise development and the implications for poverty reduction and attainment of the United Nation’s Millennium Development Goals (MDGs). Green et al. (2006) summarize the arguments for income distribution; employment creation; acting as a seedbed for industrialization; savings mobilisation; and the production of goods and services that meet the needs of the poor. Green et al., “Finance for small enterprise growth and poverty reduction in developing countries,” (2006): 1018. See also World Business Council for Sustainable Development, *Promoting Small and Medium Enterprises for Sustainable Development*, 2007, which links the positive effects of SMEs to the ability of small enterprises to generate long-term, sustainable, and equitable poverty reduction.

22 Including The World Bank (WB), The International Monetary Fund (IMF), the International Financial Corporation (IFC), and The United Nations Capital Development Fund (UNCDF). The IFC published a study in 2009 that examined the status of SME banking in both developed and emerging economies. The guide noted an increase in banks targeting SMEs through tailored products, and outlined key strategic theme areas to enter and expand reach to SMEs. See *The SME Banking Knowledge Guide*, (The IFC: Washington DC, 2009), [http://www.ifc.org/ifcext/gfm.nsf/AttachmentsByTitle/SMEBankingGuidebook/\\$FILE/SMEBankingGuide2009.pdf](http://www.ifc.org/ifcext/gfm.nsf/AttachmentsByTitle/SMEBankingGuidebook/$FILE/SMEBankingGuide2009.pdf) (accessed August 6, 2010).

23 In both development literature and mainstream media, micro-finance is a popular private-sector approach to developing low income markets and continues to receive widespread attention as a market-based approach to alleviate poverty.

24 Micro-finance has been principally driven through development financial intermediaries and non-profits. In recent years micro-finance has become a lucrative market for private financiers.

25 Marguerite Robinson, *The Microfinance Revolution: Sustaining Finance for the Poor* (World Bank and Open Society Institute: Washington, DC, 2001); or Be atriz Armendariz de Aghion and Johnathan Morduch, *The Economics of Microfinance* (MIT Press: Cambridge, Massachusetts, 2005).

26 Ibid.

27 The Microcredit Summit Campaign, *State of the Microcredit Summit Campaign 2009*, 9, http://www.microcreditsummit.org/uploads/socrs/SOCR2009_English.pdf (accessed March 12, 2010), 9.

28 Jennifer Sebstad and Gregory Chen, *Overview of Studies on the impact of microenterprise credit* (USAID: 1996).

29 MEs typically employ less than 5 employees. The impact of micro-finance programs are contested in the literature. Given that the best evaluations of program success are loan repayment rates, there is a clear lack of substantive and sustained improvements to household incomes and livelihoods documented in the literature. For an introduction on these issues, see Armendariz de Aghion and Morduch, *The Economics of Microfinance*, 2005.

30 Donald C. Mead, “The Contribution of Small Enterprises To Employment Growth in Southern and Eastern Africa,” *World Development* 22 no.12 (1994): 1881-1894. As Summarized in Mike Herrington et al., a 2005 study in South Africa affirmed how formal small businesses were 4 times more likely than informal businesses to employ six or more people. See *Tracking Entrepreneurship in South Africa: A GEM Perspective*, 2010, 44.

31 See the Canadian Small Business Development Bank, <http://www.bdc.ca/en/about/overview/overview1.htm> (accessed 11 May 2010).

32 Rogerson, “Successful SMEs in South Africa: the case of clothing producers in the Witwatersrand,” 2000.

33 Location: Michael A. McPerson, “The Hazards of Small Firms in Southern Africa,” *The Journal of Development Studies* 32 (1995): 31-54; level of human capital and training: McGrath, S. and King, K, eds. “Learning to grow?: the importance of education and training for small and micro-enterprise development,” In *Enterprise in Africa: Between Poverty and Growth* (Intermediate Technology Publications: London, 1999): 211–222; sector: Mead and Liedholm, “The dynamics of micro and small enterprises in developing countries,” 1998; enterprise clusters/business incubators that bring about collective

efficiency: Lindile Ndabeni, "The Contribution of Business Incubators and technology stations to small enterprise development in South Africa," *Development Southern Africa* 25 no. 3 (2008): 259-268.

34 Despite the rather bleak picture painted of South Africa in this section, the country is a culturally rich "rainbow nation" comprised of four distinct racial groups and 11 official languages. The Constitution of the Republic of South Africa, sec. 6, no. 108, 1996.

35 Joyce Hickson and Susan Kriegler, *Multicultural Counselling in a Divided and Traumatized Society: The Meaning of Childhood & Adolescence in South Africa* (Greenwood Press: CT, USA, 1996): 33.

36 S. Burman and P. Reynolds, eds., *Growing up in a Divided Society* (Northwestern University Press: Evanston, Ill, 1986).

37 Hickson and Kriegler (1996) outline the disparities, inequalities and problems in South Africa's education system. White South Africans often benefited under the colonial education system, with the creation of Christian National Education for Whites and Bantu Education for Blacks. Under Bantu education, it was no secret that it was intended to ensure that blacks not be educated for jobs beyond their proper station in life (menial labourers) (118-127).

38 Of the one in four students who took matric maths in 2008, only 39% of black students passed (with a passing grade being 30%), compared with 98% of white students. It is worth noting that investments in primary education have levelled the field so that 98% of children between the ages of 7-15 enjoy full-time schooling, while the number of black university students has quadrupled over the past 15 years. The Economist, "No One Gets Prizes," January 14th 2010, http://www.economist.com/node/15270976?story_id=15270976 (accessed September 10, 2010).

39 Simon McGrath, "Skills for Productive Citizens for All: the place of skills development for micro and small enterprises in South Africa," *Journal of Education and Work* 18 no.1 (2005): 112.

40 Falkena et al. published a study distinguishing between the financial needs of traditionally white owned enterprises, that enjoyed access to finance through friends, family and collateral in the form of property, against the larger group of emerging black enterprises from previously disadvantaged communities that lacked strong networks to access informal capital and the collateral needed to access commercial sources.

"SMEs Access to Finance in South Africa: A supply-side regulatory review," (2001), <http://www.finance.gov.za/publications/other/Access%20to%20Finance%20in%20South%20Africa%20-%20A%20Supply-Side%20Regulatory%20Review.pdf> (accessed March 6, 2010). Similar results are shown by J. Orford et al. *Global Entrepreneurship Monitor: South African Executive Report*, (Graduate School of Business, University of Cape Town: Cape Town, South Africa, 2003).

41 One manifestation has been referred to as the “discouraged worker effect.” Individuals (particularly Black South Africans) do not bother to create work for themselves because they have very few skills and consider the return on their efforts to search for work as being too high. Geeta Ghandi Kingdon and John Knight, “Are Searching and Non-searching Unemployment Distinct States When Unemployment is High? The Case of South Africa,” Working Paper Series (Centre for the Study of African Economies: University of Oxford, 2000). Laura Poswell, *The Post-apartheid South African Labour Market: a Status Report* (Development Policy Research Unit, University of Cape Town: Cape Town, 2000), 6. Discontent over slow economic growth that has not translated into greater employment, higher incomes or improved public services has sparked xenophobic attacks in 2008 against migrant workers. African Economic Outlook, “South Africa” Social Context and Human Resource Development,” March 8, 2010.

42 As noted by Herrington et al. (2010), 60, entrepreneurialism in South Africa is three to four times *lower* than countries with similar GDP per capita (including Brazil, Argentina, Chile and Peru).

43 FinMark Trust, *Finscope Small Business Survey*, 2006, 45.

44 Andre Ligthelm and M.C. Cant, “Business Success Factors of SMEs in Gauteng: a Proactive Entrepreneurial Approach,” Research Report No. 311 (Bureau of Market Research, University of South Africa, Pretoria, 2002). Quoted in Christian M. Rogerson, “Tracking SSME Development: Issues of Finance, Training and the Regulatory Environment,” 2008.

45 Including an ability to secure employment, work productively with the disease, and for employment re-entry. HIV is now considered a lifestyle disease. As of 2007 HIV prevalence in South Africa was 18% of 15-49 year olds. It is estimated that approximately 5.7 million people are living with AIDS in the country (122) while there are 1.4 million AIDS orphans. See African Development Indicators, “2008/2009 Youth and Employment in Africa: the potential, the problem, the promise,” (The International Bank for Reconstruction and Development/The World Bank: Washington, DC, 2009), 100.

46 Human Sciences Research Council (HSRC), Factsheet 5: Skills migration and the brain drain in South Africa, (2004), <http://www.hsrc.ac.za/Factsheet-7.phtml> (accessed November 5, 2009).

47 High crime rates are a deterrent to corporations establishing a presence in South Africa. The World Economic Forum’s Global Competitiveness report for 2008/2009 reveals how high rates of crime negatively impacts South Africa’s business competitiveness. The World Economic Forum, *Global Competitiveness Report for 2008/2009* (Geneva, Switzerland: The World Economic Forum, 2008), <http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/PastReports/index.htm> (accessed August 6, 2010).

48 Skills shortages in South Africa: case studies of key professions, ed. J. Erasmus and M. Breier (HSRC Press: Cape Town, 2009).

49 Christian M Rogerson, “International migration, immigrant entrepreneurs and South Africa’s small enterprise economy.” Migration Policy Series no. 3. (The Southern Africa Migration Project, Cape Town, 1997); “The Gauteng manufacturing SMME economy: present status and future prospects,” Papers on education, training and enterprise, no. 12. (Centre of African Studies, University of Edinburgh, 1998).

50 Africa’s population is expected to double in 40 years, with increased mobilization of people from poor areas into more economically stable regions. See United Nations Population Fund (UNFPA), *State of the World Population 2009: Facing a Changing World: women, population and climate*, (UNFPA: New York, 2009), <http://www.unfpa.org/swp/2009/en/index.shtml> (accessed July 15 2010), 9 1. The United Nations Population Fund reports that by 2050 Africa’s 2009 population of 1 billion will reach just fewer than 2 billion. The report focuses on the affects of climate change on populations, health and poverty, and discusses the added impact of the movement of people whether because of climate displacement or to seek economic opportunities that will put pressure on local job markets and the communities that sustain them.

51 World Bank Development Indicators, “South Africa population total,” <http://data.worldbank.org/indicator/SP.POP.TOTL> (accessed August 12th, 2010).

52 Statistics South Africa, “Statistics South Africa Quarterly Labour Force Survey,” <http://www.statssa.gov.za/publications/statsdownload.asp?PPN=P0211&SCH=4503> (accessed March 10, 2010). Other estimates suggest the number climbs to 33% when it includes those individuals that are too discouraged to look for employment.

53 African Economic Outlook, “South Africa: Social Context and Human Resource Development,” http://www.africaneconomicoutlook.org/en/countries/southern-africa/south-africa/#/social_context_human_resource_dev (accessed July 8, 2010).

54 R.W. Johnson, “False Start in South Africa,” *New Left Review* 58 (2009): 71. The CIA World Fact book has listed the number of South Africans receiving social grants as one quarter of the population in 2010. CIA World Fact Book. “South Africa,” <https://www.cia.gov/library/publications/the-world-factbook/geos/sf.html> (accessed June 4, 2010).

55 Geeta Ghandi Kingdon and John Knight, “Unemployment in South Africa, 1995–2003: Causes, Problems and Policies,” *Journal of African Economies* 16 no.6 (2007): 813–848. Authors discuss the rise of unemployment in the post-apartheid period, including government policies, and the need to target job creation.

56 FinMark Trust, *FinScope Small Business Survey*, 2006, 97.

57 From a global perspective, the fact that South Africa was selected to host the FIFA Soccer World Cup in June 2010 seems to indicate that South Africa has “arrived” and returned to being a fully fledged member of the international community after decades of ostracism and isolation. Still, hosting soccer’s prestigious global tournament should not mask how tensions remain strong given the precarious and often disparate situation on the ground

that is seeing a widening disconnect between the rich and poor sections of the economy. Many issues remain unresolved—even as issues of government corruption are increasingly present in the local media. High crime and HIV rates, along with the failure to address rising unemployment, can only be considered large failures as well.

58 While this glimpse of South Africa’s social and economic context reveals how apartheid has stifled most community (indigenous) driven initiatives and local entrepreneurship, an important indigenous initiative particularly relevant to this project (and that has proven successful) is a community savings group (or form of rotating savings and credit association) known as a *stokvel*. These voluntary groups are formed on the basis of either trust between members, friendship, and mutual responsibility, or peer pressure, that allows members to save money outside of the formal banking system and within the local community. Variants of this type of savings vehicle are evident around the world, from Asia to Africa to Latin America, and are the basis of micro-finance and micro-credit programs. Members collectively agree upon the group's purpose, rules and outcomes. *Stokvels* are beyond formal regulation, but have allowed many poor communities to save (especially black women), with 2 million members across the country. Even with advances in the institutional environment, *Stokvels* have continued to exist alongside a sophisticated financial market in South Africa. The flourishing and success of local informal models to finance and savings that capitalize on the communal tendencies of the indigenous peoples speaks to the need to consider the strengths of the existing indigenous system and how to leverage those strengths into the formal financial system and economy. See FinMark Trust, *Finscope South Africa: 2005*, <http://www.finscope.co.za> (accessed August 20, 2010). For an informative examination of *stokvels* and the relationship to social capital and networks, see Margaret Irving, *Informal Savings Groups in South Africa: Investing in Social Capital*, (Centre for Social Science Research, Cape Town University, 2005).

59 Prior to 2008, South Africa maintained approximately 5.0% annual GDP growth rate. World Bank National Accounts Data and OECD National Accounts Data Files, <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG> (accessed June 4, 2010).

60 The benefits of BEE have been debated in the literature. BEE has equalized economic opportunities of indigenous workers and contributed to a growing middle class of black South Africans, but is seen to simultaneously deepen the divide between the rich and poor since it has brought unequal income distribution. Sampie Terreblanche, “The Developmental State in South Africa,” 108, in *The State of the Nation*, edited by Peter Kagwanja and Kwandiwe Kondlo (HSRC Press: Cape Town, 2008). Others express a concern BEE will dampen South Africa’s entrepreneurs given implementation concerns, complex codes, numerous grey areas of application, and potentially different impacts on large vs. small enterprises. See Tony Balshaw and Johnathan Goldberg, *Broad-Based Black Economic Empowerment* (Cape Town: Human and Rousseau, 2008): 36.

61 Ibid, 9; 19-20. This is accomplished by incorporating small firms into supply chains (ie. contract tendering), and to promote access to finance for black businesses. Compliance with the legislation is voluntary and self-regulating, and BEE status is determined by points against a measured scorecard. The elements of the scorecard are: 1. Ownership; 2. Governmental/management control; 3. Human resource development; 4.

Preferential procurements; 5. Enterprise development; 6. Socio-economic development. Stakeholders include: shareholders, customers, community, employees and suppliers.

62 Brought into effect by the financial industry in 2004, the charter has led increasing investments and extension of services to poor households and communities, as well as an emphasis on the procurement of services from black-owned businesses. Banking Council, "Financial Sector Charter and Scorecard (17/10/2003)," The Banking Association South Africa, <http://www.banking.org.za/search/searchdocs.aspx> (accessed July 16, 2010); "South Africa's Financial sector Publishes Transformational Charter (17/10/2003)," The Banking Association South Africa (accessed July 16, 2010).

63 Mark Napier, "Provision of Financial Services in South Africa," in *Liberalisation and Universal Access to Basic Services: telecommunications, water and sanitation, financial services and electricity* (OECD, International Bank for Reconstruction and Development, World Bank: Paris, 2006). FinMark is an independent trust fund of DFID established to facilitate a more effective and inclusive financial market in South Africa. See www.FinMarktrust.org.za, (accessed July 16, 2010).

64 Mzansi Money Transfer provides reliable, secure and instant means of sending money between 5,000 bank and Post Office outlets. This low-cost money transfer system is aimed at the poor and individuals entering the banking sector for the first time. Transfers are capped to a daily maximum, and users do not need a bank account. South Africa.info, "Mzansi Money Transfer Spreads its Net," September 8, 2005, <http://www.southafrica.info/services/consumer/mzansi.htm> (accessed July 13 2010). As of 2007, 99.8% of South African's had access to mobile phone technology, whereas 4,187,000 (or 8.6%) had internet access in 2008. The World Bank Development Indicators, "Access to Telecommunications-South Africa," The World Bank, <http://data.worldbank.org/indicator/IT.CEL.COV.R.ZS> (accessed June 4, 2010).

65 The Ackerman Academy of Entrepreneurial Development was founded with funding from Raymond Ackerman, founder of the local Pick'n Pay retailer. Cape Town Business School Director believes the GSB can play a crucial role in poverty alleviation and social development: Since the Academy was founded in 2005 some 85% of its students have gone on to jobs, further studies, or have started their own businesses. Ellen Groves, "Cape Town Business School Embraces Social Entrepreneurship." *Business Week*, March 17, 2010, http://www.businessweek.com/globalbiz/content/mar2010/gb20100315_353986.htm, (accessed March 20, 2010).

66 Whereas it is commonplace to interview borrowers and SME owners to determine problems and issues in obtaining financing, according to Robinson (2001), micro-finance impact assessments have focused on the demand or customer side of financing, and not supply. Marguerite Robinson, *The Microfinance Revolution: Sustaining Finance for the Poor*. (World Bank and Open Society Institute: Washington, DC, 2001).

67 Including The Department for International Development (DFID), The United States Agency for International Development (USAID), and the IFC.

68 John W. Creswell, *Research Design: Qualitative, Quantitative, and Mixed Methods Approaches*. 2nd ed. (Sage Publications: California, 2003).

69 B. Crabtree and W. Miller, *Doing Qualitative Research* (Sage Publications: London, 1999).

70 *The National Small Business Act* (Department of Industry and Trade, 1996).

71 Creswell, *Research Design: Qualitative, Quantitative, and Mixed Methods Approaches*, 2003.

72 Ibid.

73 Geeta Ghandi Kingdom and John Knight, "Race and the Incidence of Unemployment in South Africa." *Review of Development Economics* 8 no.2 (2004): 201.

Chapter 2

1 Focusing on SMEs as drivers of local development is shaped in part by a wider focus on quality of life issues and sustainability. The increasing emphasis on quality of life concerns in Western societies has come with a (partial) shift in the way in which the private sector is viewed, and a more critical attitude towards how the activities of corporations and capital markets impact societies. Investing in local SME development is viewed as an alternative to global business development that has been driven by multinational corporations.

2 DFID, *The sustainable livelihoods distance learning guide*, 2007, <http://www.livelihoods.org/info/dlg/Index.htm> (accessed October 10, 2010).

3 Amartya Sen, *Development As Freedom* (New York: Knopf, 1999) and "The Possibility of Social Choice," *American Economic Review* 89 (1999): 349-378.

4 Ibid.

5 Sarah H. Alvord, David L. Brown and Christine W. Letts, "Social Entrepreneurship and Societal Transformation," *Journal of Applied Behavioural Science* 40 no. 3 (2004): 267.

6 For instance, C.K. Prahalad (2005) argues that actively participating in the capitalist market can bring improvements in quality of life. This participation opens up needed products and services to low income earners and the world's poor (as both consumers and producers). *The Fortune At The Bottom of The Pyramid: Eradicating Poverty Through Profits*, (Wharton School of Publishing: USA, 2005).

7 Stuart L. Hart and Ted London, "Developing native capability: What multinational corporations can learn from the base of the pyramid," *Stanford Social Innovation Review* 3, no.2 (2005): 28-33.

8 Hart maintains that innovation and entrepreneurship are avenues to propel business models that can build more inclusive markets. Stuart L. Hart, *Capitalism At A Crossroads: The unlimited business opportunities in solving the world's most difficult problems* (New Jersey: Wharton School Publishing, 2005).

9 See for instance UNDP, *Creating Value for All: Strategies for Doing Business with the Poor*, (United Nations Development Program: New York, 2008).

10 I draw on definitions by the Organization for Economic Co-operation and Development (OECD) in the 1995 *Private Sector Development –a guide to donor support*, and the World Bank's 2002 *Private Sector Development Strategy*. These reports suggest PSD is a development strategy and approach that can lead to poverty reduction and quality of life improvement through economic activity. Economic activity is based on private ownership, market competitiveness, and risk taking. (Paris: The OECD, 1995); (World Bank: Washington, DC, 2002), 1 -119, <http://rru.worldbank.org/Documents/PapersLinks/699.pdf> (accessed October 10, 2009).

11 Lau Schulpen and Peter Gibbon, "Private Sector Development: Policies, Practices and Problems," *World Development* 30, no.1 (2002): 1.

12 Heloise Weber, "The imposition of a global development architecture: the example of micro-credit," *The Review of International Studies*, 28 (2002): 537-555.

13 Sarah H. Alford, David L. Brown and Christine W. Letts, "Social Entrepreneurship and Societal Transformation," *Journal of Applied Behavioural Science* 40 (3): 260-282. Africa, for instance, remains one of the poorest regions of the globe despite large investments of development assistance. For a critical perspective on the issue, see William Easterly, "Can the West Save Africa?" 2008. See also UNDP, *Creating Value for All: Strategies for Doing Business with the Poor*, 2008. One organization leading advocating and encouraging enterprise based solutions to poverty alleviation is The Shell Foundation. See http://www.shellfoundation.org/pages/our_approach.php?p=our_approach (accessed August 9, 2009).

14 Martin Ravallion and Shaohua Chen, "Measuring Pro-Poor Growth," *Economics Letters* 78 no.1 (2003): 93-99.

15 UNDP, *Creating Value for All: Strategies for Doing Business with the Poor*, 2008.

16 Schulpen and Gibbon, "Private Sector Development: Policies, Practices and Problems," 4.

17 *National Small Business Act*, (Department of Trade and Industry, 2006).

18 Department of Trade and Industry (hereafter abbreviated as DTI), *Annual review of Small Business 2003*, (DTI: Johannesburg, 2003), 50.

19 FinMark Trust, *FinScope Small Business Survey*, (Gauteng: FinMark Trust, 2006): 97-87. It is shown that South African banks service the upper portion of the SME sector with a variety of products at the expense of the lower end of that market, that only makes use of savings products.

20 Ibid. This study focused on Gauteng Province, South Africa's largest economic hub which produces just under half of South Africa's GDP and has the largest percentage of workers engaged in the informal economy.

21 Other countries refer to the micro and small enterprise sectors as separate business segments. This definition is problematic and generates confusion when analysing the literature since MEs, small, very small, and medium sized firms exhibit different characteristics and business needs, yet are all amalgamated into a single broad definition. Studies on the South African SME sector must carefully articulate the industrial sector on which they are focused, as well as firm size, to clarify analysis.

22 The Small Business Financial Diaries pilot study examined 26 businesses in Langa and Nyanga, Cape Town, to test a set of methodologies to yield accurate insight into the financial needs of small businesses that can guide the development of appropriate financial models and services. The FinMark research also provided a critical step to generate rigorous information about South African small businesses by defining and using a new Business Sophistication Measure (BSM). The BSM segmented small businesses into 7 groups to estimate market size and conduct needs analyses by segment. FinMark Trust, *Small Business Financial Diaries* (Johannesburg, South Africa: FinMark Trust, 2009); Christain M. Rogerson, "Successful SMEs in South Africa: the case of clothing producers in the Witwatersrand," (2000).

23 With the majority of SMEs un-registered and active in the informal economy, effectively measuring the sector is difficult. See C. Muller and D. Posel, "Concerns with Measuring Informal Sector Employment: An Analysis of National Household Surveys in South Africa, 1993-2001," *Journal for Studies in Economics and Econometrics* 28 (2004): 1-19.

24 DTI, *Annual review of Small Business 2003*, 40.

25 This number underestimates the total population and does not include sole proprietors and informal businesses. Ibid, 41.

26 Ibid, 43.

27 Ibid, 52.

28 Ibid, 53.

29 Republic of South Africa, *National Strategy for the Development and Promotion of Small Business in South Africa*, (The Department of Trade and Industry: Pretoria, 1995): 16.

30 Ibid, 30-33.

31 FinMark Trust, *FinScope Small Business Survey*, 2006, 6.

32 As a result, South Africa is promoted as an entrepreneurial nation, with commitments to better access to finance, skills training, and more flexible regulations for aspiring business owners. Republic of South Africa, *Integrated strategy on the promotion of entrepreneurship and small enterprise* (Department of Trade and Industry: Pretoria, 2005).

33 Napier, "Provision of Financial Services in South Africa," 206-207.

34 M. Nigrini and Andrie Schoombee, "Credit guarantee schemes as an instrument to promote access to finance for small and medium enterprises: an analysis of Khula Enterprise Finance Ltd's individual credit guarantee scheme," *Development Southern Africa* 19 (2002): 748.

35 The World Bank, *South Africa: Enhancing Effectiveness of Government in Promoting Micro, Small and Medium Enterprises* (Report for the Department of Trade and Industry, Pretoria, 2006), 6.

36 Recent findings reveal a general level of confusion among small businesses in relation to the regulatory environment, including "over-regulation." See Christian M. Rogerson, "Tracking SMME Development in South Africa: Issues of Finance, Training and the Regulatory Environment," *Urban Forum* 19 (2008): 74.

37 SBP, *Counting the Cost of Red Tape for Businesses in South Africa*, (SBP, Johannesburg, 2005), 14, quoted in Rogerson, Christian M. "Tracking SMME Development in South Africa: Issues of Finance, Training and the Regulatory Environment," 75.

38 Nancy Rankin, *The Regulatory Environment and SMMEs: evidence from South African firm level data*, Working Paper 06/113 (Development Policy Research Unit, University of Cape Town, 2006), quoted in Rogerson, "Tracking SMME Development in South Africa: Issues of Finance, Training and the Regulatory Environment," 2008.

39 Vandana Chandra and Bala Rajaratnam, *Constraints to Growth and Employment in the Informal Sector: Evidence from the 1999 Informal Survey* (World Bank: Washington DC, 2001); C Skinner, "Constraints to Growth and Employment in Durban: Evidence from the Informal Economy," Research Report No. 65, School of Development Studies, University of KwaZulu-Natal, Durban, quoted in Christian M. Rogerson, "Tracking SMME Development in South Africa: Issues of Finance, Training and the Regulatory Environment," *Urban Forum* 19 (2008): 61-81.

40 Rogerson, "Tracking SMME Development in South Africa: Issues of Finance, Training and the Regulatory Environment," 63.

41 Of those respondents, 9% received some form of loan while only 3% received funding from a commercial bank. Watson Ladzani and Godfrey Netswera, "Support for rural

small businesses in Limpopo Province, South Africa” *Development Southern Africa* 26 no.2 (2009): 234.

42 Graeme Buckley, “Micro-finance in Africa: Is it either the problem or the solution?” *World Development* 25 no.7 (1997): 1089.

43 As summarized in Herrington et al., *Tracking Entrepreneurship in South Africa: A GEM Perspective*, 47.

44 Andre Ligthelm, “A targeted approach to informal business development: the entrepreneurial route” *Development Southern Africa* 25 no. 4 (2008): 380.

45 Such as business and financial plan writing, business coaching and mentorship, etc.

46 Rogerson, “Tracking SMME Development in South Africa: Issues of Finance, Training and the Regulatory Environment.”

Chapter 3

1 Small Enterprise Development Agency (SEDA), <http://www.seda.org.za/index.asp> (accessed January 10, 2010).

2 Business Partners is defined as a private fund although it started with government money over 20 years ago. It is now a private fund manager with government as the largest investor. Interview with Managing Director, October 14 2009, Johannesburg.

3 A scan of the four major banks in South Africa indicate business loans begin (at a minimum) of R50,000 and up to R10 million or more.

4 Venture capital funds are not included in this study given they tend to be expensive sources of funding (venture capitalist take a significant ownership in the business start-up) and are largely reserved for innovative, high-growth start-ups that promise high returns on investment (and particularly in the technology sector). Therefore venture capital does not typically apply to the small businesses typical in developing country contexts. Developing countries tend to have largely service orientated small businesses, such as restaurants and retail outlets (which dominate the South African SME market). As a result, the impact of venture capital on the SME sector is limited.

5 As segmented in the BSM, for instance. See FinMark Trust, *The Small Business Financial Diaries*, 2009.

6 Interview with Blue Financial General Manager, Business Development, October 13, 2009, Pretoria.

7 Top managers of this small business unit are clearly dedicated but also frank about chances for success. During a presentation at a UN Inclusive Finance conference in Cape

Town, the Director of the micro-finance unit at ABSA Bank, conceded that he is not even sure they can adapt their traditional bank model to the micro-finance space, since “banks only think about the cost to them to interact with clients, they don’t consider the cost to the clients.” But the bank is nonetheless committed to answering that question. Interview with researcher, October 13, 2009, Johannesburg.

8 Interview with ABSA Micro-Finance Customer Value Manager, November 24, 2009, Johannesburg.

9 Grofin does not operate solely in South Africa; it is present in Ghana, Nigeria, Rwanda, Tanzania, Mauritius, Kenya, Uganda and Oman. <http://www.grofin.com/home.asp?pid=115> (accessed February 8, 2010).

10 Interview with Grofin Business Development Manager, November 24, 2009, Pretoria.

11 Interview with Grofin South Africa Business Manager, October 8, 2009, Pretoria.

12 Grofin, *Grofin Social and Development Impact Report—November 2009*, <http://www.grofin.com/home.asp?pid=284> (accessed August 6, 2010).

13 Ibid.

14 Interview with Business Partners Managing Director, October 14, 2009, Johannesburg; Interview Business Partners Portfolio Manager, November 16, 2009.

15 Business Partners, *Annual Report 2008/2009* (Johannesburg: Business Partners, 2009): 38. Shareholders comprise corporate bodies, banks, insurance companies, individuals and government. It is interesting to note that shareholders in Business Partner include leading banks in South Africa: ABSA, Standard Bank and Nedcore. As such, South Africa’s banks are involved in the small enterprise finance industry as investors with 17.6% of shares.

16 Business Partners Portfolio Manager, Interview with researcher, Cape Town, November 16, 2009.

17 Interview with Business Partners Managing Director, October 14, 2009, Johannesburg.

18 Ibid.

19 Business Partners, *Corporate Brochure* (Johannesburg: Business Partners, 2009).

20 Blue Financial Services, *Annual Report 2009*, (Pretoria: Blue Financial Services, 2009), 5. <http://www.blue.co.za/Home/About#> (accessed July 16, 2010).

21 Ibid, 92.

22 Interview with Blue Financial General Manager, Business Development, October 13, 2009, Pretoria.

23 Interview with Blue Financial SMME Loan Specialist, November 27, 2009, Cape Town.

24 Interview with Blue Financial General Manager, Business Development, October 13, 2009, Pretoria.

25 Khula, "Products and Services," Khula Enterprise Finance Ltd, <http://www.khula.org.za/content810.html> (accessed August 11, 2010).

26 D. Makina and L. M. Malobola, "Impact assessments of microfinance programmes, including lessons from Khula Enterprise Finance," *Development Southern Africa* 21 no.5 (2004): 804.

27 Interview with Business Partners Portfolio Manager, November 16, 2009, Cape Town.

28 Business Partners, 2008 *Annual Report 2008/2009* (Johannesburg: Business Partners, 2009): 21.

29 Anglo American, *Delivering Sustainable Value*, Anglo American report to society 2009, (Anglo American: London, England, 2010): 35, <http://www.angloamerican.co.uk/aal/development/reports/aareports/2010gr/> (accessed August 20, 2010).

30 Interview with researcher, November 24, 2009, Cape Town; See also Khula, "Credit Indemnity Scheme, <http://www.khula.org.za/content811.html> (accessed August 6, 2010).

31 The fund is managed by one of Khula's RFIs in the Eastern Cape province. Interview with Khula Regional Business Manager, Western Cape, November 24, 2009, Cape Town; Khula, "Emerging Contractors Fund," <http://www.khula.org.za/content834.html> (accessed February 10, 2010).

32 Ibid.

33 "Small Business: Khula flights new model," Financial Mail, Theba Mabanga, July 30, 2010.

34 Anglo Zimele is a global mining and natural resources company. See Anglo American, <http://www.angloamerican.co.za/aa/about/> (accessed February 8, 2010).

35 International Council on Mining and Metals (hereafter referred to as ICMM), "Case Study: Zimele boosts success of black firms," (2010),

<http://www.icmm.com/page/794/zimele-boosts-success-of-black-firms> (accessed March 12, 2010).

36 The fund was previously known as The Small Business Start-up Fund.

37 ICMM, 2010.

38 Anglo American, *Delivering Sustainable Value*, Anglo American report to society 2009, (Anglo American: London, England, 2010), <http://www.angloamerican.co.uk/aal/development/reports/aareports/2010gr/> (accessed August 20, 2010).

39 South Africa.info, "Anglo Launches Development Drive," (February 2010), <http://www.southafrica.info/business/economy/development/anglo-030210.htm> (accessed April 12, 2010).

40 Interviews with Outreach Coordinator, November 16, 2009, Cape Town; Business Manager November 25, 2009, Cape Town.

41 SAMAF, *2008/2009 Annual Report*, (SAMAF: Johannesburg, 2009), 9.

42 Interview with SAMAF Outreach Coordinator, November 16, 2009, Cape Town.

43 Interview with Business Partners Managing Director, October 14, 2009, Johannesburg; and Grofin South Africa Business Manager, October 8, 2009, Pretoria.

44 Grofin, "Over 4,800 S ME jobs in five years with Grofin approach," Grofin, November 17, 2009, <http://www.grofin.com/home.asp?PID=152&ToolID=2&ItemID=332> (accessed August 6, 2010).

45 Interview Grofin Business Development Manager, November 24, 2009, Cape Town.

46 Ibid.

47 Ibid.

48 Ibid.

49 Interview with Managing Director, October 14, 2009, Johannesburg.

50 Ibid.

51 Ibid; Interview with Business Partners Portfolio Manager, November 16, 2009, Cape Town.

52 Interview with Blue Financial General Manager, Business Development, October 13, 2009, Pretoria.

53 Interview with Blue Financial SMME Loan Specialist, November 27, 2009, Cape Town.

54 Ibid.

55 USAID offers a credit guarantee that covers up to 50% of defaulted loans made by private financial institutions. The USAID Development Credit Authority (DCA) reports that claims on its portfolio are approximately 1%, indicative of how underserved borrowers are profitable investments. See USAID, “Development Credit Authority,” http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/ (accessed February 9, 2010).

56 Interview with Blue Financial SMME Loan Specialist, November 27, 2009, Cape Town.

57 The Oil, Gas and Mining Sustainable Community Development Fund, The Anglo Zimele Model, 2008, <http://commdev.org/content/document/detail/2329/> (accessed August 6, 2010).

58 Survey of fund manager, October 27, 2009, Johannesburg.

59 Anglo Zimele *Showcase of Companies*, 2006.

60 See Anglo American, *Delivering Sustainable Value*, 2009, 35.

61 RFIs can be NGOs and other legal structures that offer financial services to SMEs.

62 Interview with Khula Regional Manager, Western Cape, November 24, 2009, Cape Town.

63 Ibid.

64 Ibid.

65 SAMAF, “Funding Criteria,” <http://www.samaf.org.za/content.asp?subID=8> (accessed February 14, 2010).

66 For this study The Red Door and The Business Place were researched.

67 One example is the City of Cape Town’s ‘business support voucher program.’ Small businesses owners and start-up entrepreneurs over 35 yrs old and that demonstrate a commitment to starting their business or potential for job creation, government procurements or sub-contracting. Vouchers can be exchanged at accredited business service providers for business training, financial skills or technical training. Those accessing the service are

monitored by The Red Door. See The City of Cape Town, “Business Support and Skills Development,” <http://www.capetown.gov.za/en/ehd/Pages/BusinessSupportandSkillsDevelopment.aspx> (accessed February 9, 2010).

68 Raizcorp, <http://www.raizcorp.co.za/offering.html> (accessed February 12, 2010).

69 USAID South Africa, “Economic Growth,” <http://www.usaid.gov/sa/uss05.html> (accessed September 27, 2009).

70 This excludes angel investors and venture capital, which tend to target “high potential firms.” Therefore, these financing channels will have less of an impact on the wider population of SMEs. For more information on these forms of financing, see Herrington et al. *Tracking Entrepreneurship in South Africa: A GEM Perspective*, 2010

71 Interviews with Business Partners Managing Director, October 14, 2009, Johannesburg, and Grofin South Africa Business Manager, October 8, 2009, Pretoria.

Chapter 4

1 Interview with Kuyasa Executive Director, November 30, 2010, Cape Town.

2 Interview with researcher, November 25, 2009, Cape Town.

3 Interview Business Partners Managing Director, October 14, 2009, Johannesburg.

4 Johnathan Morduch, “The Microfinance Schism,” *World Development* 28 (1999): 617-629.

5 Interview with researcher, November 16, 2009, Cape Town.

6 Interview with Raizcorp Business Manager, October 14, 2009, Johannesburg.

7 Ibid.

8 Interview with Khula Western Cape Regional Manager, November 24, 2009, Cape Town.

9 United Nations Development Programme Newsroom, “Anglo American unveils commitment to job creation in South Africa,” 29 March 2010, <http://content.undp.org/go/newsroom/2010/march/anglo-american-unveils-further-commitment-to-job-creation-in-south-africa.en> (Accessed August 29th, 2010).

10 The use of an environmental aspect appears unique to the country. See Grofin, “Social and Development Impact,” 2.

11 Survey, October 27, 2009, Johannesburg.

12 Business Partners Limited Corporate Services. *Business Partners 2009 Annual Report*. Johannesburg, South Africa: 2009, 34.

13 Interview with Kuyasa Executive Director, November 30, 2009, Cape Town.

14 Portfolio Manager Business Partners, interview with researcher, November 16, 2009, Cape Town.

15 Blue Financial CEO, "Doing micro-finance in Africa" (FinMark Trust Presentation, Old Mutual, Johannesburg, South Africa, September 29, 2009).

16 This theme was initially approached from a competitive environment perspective to determine how private vs. public providers of finance view competitors in the sector. It was soon evident practitioners do not view their counterparts as competitors. This is because the sector is so large and many practitioners consider the area underdeveloped.

17 Administrative red tape is one barrier to entry. According to the World Bank's annual *Ease of Doing Business* survey for 2009/2010, South Africa ranks 34 out of 183 economies for ease of doing business. Yet the county ranks 67 for ease of starting a business. The World Bank and The International Financial Corporation, "Doing Business in South Africa," <http://www.doingbusiness.org/> (accessed August 6, 2010).

18 Interview with researcher, November 16, 2009, Cape Town.

19 See Grofin, "Grofin Offices," <http://www.grofin.com> (accessed March 12, 2010).

20 Business Partners, *Business Partners 2009 Annual Report* (Business Partners: Johannesburg, South Africa, 2009), 18.

21 Interview with SAMAF Business Manager, November 25, 2009, Cape Town.

22 Interview with researcher, November 16, 2009, Cape Town.

23 "Capitec To Change The Banking Experience," July 2009, http://www.capitecbank.co.za/pdf/mediaReleases/2009/news2009_27July.pdf (accessed February 6, 2010). The company has 2 million clients across South Africa, and 360 branches in both low income and rural areas. Capitec, "Key Facts," <http://www.capitecbank.co.za/ir/about/keyfacts> (accessed February 6, 2010).

24 The 2001 GEM report found that those living in urban areas are more likely to be entrepreneurial: 10% of city dwellers were involved in a small business as compared to 2% in rural. Subsequent GEM reports argue this difference is due to smaller markets, limited infrastructure, and lack of skills training. As summarized in Herrington et al., *Tracking Entrepreneurship in South Africa: A GEM Perspective*, 42-43.

25 Interview with researcher, November 25, 2009, Cape Town.

26 Interview with Grofin South Africa Business Manager, October 8, 2009, Pretoria.

27 Business Partners Limited Corporate Services. *Business Partners 2009 Annual Report*. Johannesburg, South Africa: 2009, 35. Or access the online toolkit at <http://southafrica.smetoolkit.org/sa/en>.

28 Interview with Blue Financial General Manager, Business Development, October 13, 2009, Pretoria.

29 Contributing to local business tax is important to grow public sector income that can be directed to important infrastructure and social welfare projects.

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