

2023



# Banking on small and medium-sized enterprises



# Foreword

As the managing director of The Banking Association South Africa (**BASA**), we have seen firsthand how challenging economic growth has been during 2023.

Despite good performances by our banks, quarter on quarter economic growth for Q2 of 2023 improved marginally to 0.6% with unemployment declining slightly to 32.6%. Tangible solutions to grow the economy remain elusive. With little employment being generated by the formal sector, national policy has pivoted to the small and medium-sized enterprise (**SME**) sector to drive employment and economic growth, with several initiatives being undertaken simultaneously in this regard.

As a Centre of Excellence in Financial Services (**COEFS**) board member, it was deemed timeous to commission this research. This is an important area to initiate dialogue for how the banking industry can assist the SME sector.

Documenting how banks already support SMEs, enables **BASA** to continue to play a meaningful role in how the banking industry could further support SMEs in the creation of a viable and dynamic sector, within a complex SME ecosystem.

It is hoped that this research will enable the banking industry to contribute meaningfully towards a better understanding of their role in supporting small and medium-sized enterprises.

**Bongiwe Kunene**

Non-executive director  
Centre of Excellence in Financial Services

The mission of the Centre of Excellence in Financial Services is to “...identify friction points in the financial services sector and initiate appropriate research to engage policy makers, regulators and industry participants, by initiating broader public dialogue through credible thought leadership.”.

The small, micro and medium enterprises have become a national focus area in South Africa, with many state and private institutions wanting to understand this complex ecosystem. Access to finance has been a popular narrative for the lack of growth of this sector, but it has many friction points that all contribute to the current state of SME development.

We are confident that the SME sector is a functioning ecosystem that merely lacks the data to evidence its contribution to the economy. Focusing on the banking industry and its contributions to the SME sector would in part define the limitations of banks.

Being able to overlay the banking industry’s contribution onto a well-structured SME ecosystem, would be invaluable for policy makers to focus on the area’s most likely to support and grow the SME sector.

**Mark Brits**

Executive director  
Centre of Excellence in Financial Service

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## Executive summary

Small and medium enterprises constitute a complex ecosystem in South Africa, with potential to contribute significantly to economic development. Access to finance is perceived as a key factor for the lack of growth of this sector, but funding is not the single point of failure for the SME sector. Other issues that impact SMEs include compliance, financial literacy, access to data and transparency.

What this research identifies is a series of information asymmetries and potential disconnects between SME ecosystem participants. Currently, the categorisation of SMEs by the banking industry and the reporting requirements of their activity, is based on thresholds, which can result in an SME being included in one reporting cycle and excluded in another, distorting the value of the data to the regulator.

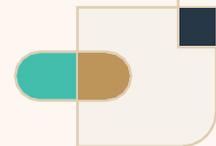
Banks are significant funders of SMEs and develop relationships with their SME customers over time. This relationship has different levels of support, based on the growth cycle and needs of the SME. Banks are well positioned to capitalise on the trust they have built with customers over time. For the SME, personalisation of that trust relationship, by leveraging the combined experience of the business and the individual behind the SME, into a value-added proposition has become a reality.

For decades, banks have been designing products for customers based on their own data. However, as more service providers emerge, the disaggregation of financial information means that

some of the financial activity of SMEs remain “unseen” by banks, diluting not only the credit information for the individual SME, but for the collective of SME businesses operating in that specific industry.

Data collaboration in support of the SME sector could be a key driver for a more comprehensive approach to managing credit risk. Non-financial data may be more fundamental to the credit process than initially thought, as credit providers try to understand the nuances of individual businesses, the industry itself, and the economy in which it must compete.

Appropriate data collection and analysis would allow for more meaningful economic and social planning through a deeper understanding of SME needs. This data can also be collected in conjunction with digital platforms to reduce the burden of SME compliance and allow large scale processing of SME data, which will enable the government and private sector to collectively better service the SME sector.



Due to the lack of a cohesive database of SMEs and their needs, whether formal or informal, a comprehensive understanding of what SMEs require to grow their businesses in various phases, is not always visible to those that support SME development. It is critical that government, the financial services sector and others in the SME ecosystem commit to ongoing collaboration to provide a meaningful understanding of the changing needs of this sector.

There is a perception that banks do not do enough to service SMEs, which was compounded during the COVID-19 pandemic, when the uptake on the loans proffered by government through the banking industry were lower than expected. What has been found in this research is that understanding the complexity of the SME sector is key for pragmatic and implementable solutions.



What differentiates a bank from any other institution is that they take deposits. It means it's somebody else's money - and often we forget that there's a custodial role [that bankers play]. They want to make a profit and will take some risk, but it's a calculated risk [when it comes to SME lending]. Based on their risk appetite, they ultimately come up with their strategy.

Faizel Jeena, Head Risk Support Prudential Authority, South African Reserve Bank



Traditional banking products are adapted for sector-specific industries to create specialised offerings, but additional tailor-made solutions are required to recognise seasonal cash flows and to customise the repayment terms appropriate for each growth phase. Invoice financing and projected revenue are becoming successful risk mitigants for the lack of collateral by SMEs. Streamlining loan application processes and leveraging digital platforms, is another area identified by banks, that can resolve their customers' pain points.

As SMEs grow, their borrowing requirements will change, and the challenge for credit providers will be to satisfy their requirements by understanding their specific business needs, while discharging their

fiduciary obligations. Traditional human-centric credit processes have become more expensive to maintain and banks are adopting digital onboarding, digital processing and digital credit decision making as they explore the appropriate balance.

The natural emergence of a successful SME from a small business to a medium-sized business creates a transition challenge that must meet higher compliance and regulatory requirements by the banks, or significantly higher funding costs through non-bank channels.

However, there is a general acceptance that funding is not the single point of failure for the SME industry. The 32 individuals interviewed for this research, which included people from eight banks and three regulators, raised key points in areas such as SME financial literacy, compliance, access to data, and employing an ecosystem approach that provides for greater cooperation between government and the financial services sector.

In the absence of a uniform approach to the definition of SMEs and standardised product offerings, the comparability of services and pricing between competing banks and non-bank institutions becomes challenging. While regulatory reporting may not be comparable, the competitive response to the complex SME business model, provides bespoke solutions and consistent segmentation of the SME over time.

While there are challenges in access to finance for SMEs, there are examples of the banking industry seeking new solutions. A stronger ecosystem approach, the development of collaborative evidence-based data on which to build new approaches to SMEs, and building supportive partnerships with other non-bank ecosystem members are among the solutions identified.

The SME sector can play a pivotal role in the South African economic growth strategy. Understanding the relationship between the banking industry and the SME sector will be critical for policymakers to focus their efforts on creating the environment for new businesses and sustainable job creation. However, a government led National Integrated Small Enterprise Development (NISED) masterplan, co-created with the SME ecosystem, implementable and with measurable results, is a key success factor. This will require government to invest in digital solutions to meet an increasing digital population and be responsive to emerging challenges.

# 1. Introduction

The aftershocks of the COVID-19 pandemic are having a long-standing effect on South African small and medium enterprises. Three years after the hard lockdown was lifted, many traditional businesses in the sector have not yet recovered, however new digital business models have emerged, capitalising on the accelerated digital transformation of the economy.

The relationship between the banking industry and SMEs is important, not only to the livelihood of millions of South Africans who work in the SME sector, but also for the future growth of the country. The financial services sector plays an important role in facilitating economic growth, providing financial stability, and broadening financial inclusion. The sector acts as an intermediary, mobilising savings, allocating credit, providing payment services, and facilitating trade.



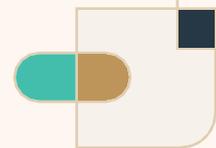
According to an interviewee, the banking industry funds 65% of the SMEs in the country, down from 80% in previous years.

The financial services sector is resilient, banking institutions are well capitalised and perform well against a set of financial stability and macroprudential indicators. The resilience of the financial system is illustrated by its ability to provide financial services during large economic and financial shocks, such as the COVID-19 crisis.

## 1.1 The post-COVID-19 context of the banking industry and SMEs in South Africa

During the COVID-19 pandemic, the government lockdown devastated the livelihoods of many SMEs. Substantial voluntary debt relief by the banks was complimented by access to emergency funding facilitated by the National Treasury and distributed through the banking industry. The process proved to be lengthy and at times, unrealistic requirements for access to this finance illustrated a lack of understanding. Despite some criticism, the emergency finance provided access to R18 billion in credit, that would not have been made available by the banks without this support, saving many businesses and livelihoods.

As Christoff Oosthuizen, Entrepreneurial Planning Institute, says, “This was an opportunity missed, and there is lots of scope for improvement. If we leave it to crisis time, it will be a failure. We must now look at how business advisors and the banking sector can [better assist SMEs].”



## About the SME sector in South Africa and SME financing

Of the estimated 2.6 million micro, small and medium enterprises in South Africa, about 37% are considered formal. Of the 2.6 million SMEs, 54% are micro-enterprises and 15% are located in rural areas. Two out of three SME owners run their own enterprises and do not have any employees, while 32% provide between one and ten jobs. While growth in the number of SMEs over the last ten years has been lower than economic growth, the contribution by these SMEs towards South Africa's gross value-added (which is equal to GDP before taxes and subsidies) increased from 18% in 2010 to 40% in 2020. According to the South African Reserve Bank (SARB) data on bank statistics, total SME credit exposure to banks was ZAR 631 billion at the end of 2020, which accounts for 25% of total business loans.

*Source: OECD, Financing SMEs and Entrepreneurs 2022: An OECD Scoreboard, 2023.*

Banks are constantly evolving to meet the changing needs of their customers. These changes impact not only the overall framework of how banks service their customers, but how they service SMEs.

**Some of the most recent trends shaping the financial services sector include:**

- **Digital transformation:** Financial institutions are investing heavily in digital technologies to improve the customer experience and offer new products and services.
- **Financial inclusion:** The emerging digital workforce combined with rapid technology developments will allow business and government to improve financial inclusion virtually.
- **Competition:** The financial services sector is becoming more competitive as new players enter the market and traditional financial institutions seek to expand their product and service offerings.

During Covid-19, rapid regulatory relaxations enabled banks to respond quickly to the unfolding pandemic and later to the rioting and looting. Competition in financing the highly complex SME sector has resulted in bespoke financing solutions, which may in part be lessons learned from this period, but equally may have made financial offerings difficult for SMEs to compare.

### 1.2 Objective of the study

This research stems from the perception that banks are not adequately supporting SMEs. The mission, says

Muzi Mhlambi, Senior Manager of The Banking Association South Africa, is to “reshape” this narrative. Interestingly, research demonstrates that banks are indeed the primary financiers of SMEs, yet this message fails to gain widespread traction.”

The Department of Small Business Development has been relatively inactive as a coordinator of the SME ecosystem until the support provided by the EU resulted in two policy documents and a bill under consideration by Parliament. He noted that “Consequently, we are witnessing a positive transformation, as they begin to vocally advocate for SMEs and assume a more active role.”

The objective of this research is to investigate the perceptions of the financial services sector, especially banks, regarding their support for SMEs. The study aims to validate these perceptions, identify potential industry issues, and provide insights that will aid in enhancing the sector's contribution to SMEs

For this publication, the Centre of Excellence in Financial Services conducted formal and informal interviews with various industry stakeholders to explore and better understand the relationship between the banking industry and SMEs.

**Several key questions were addressed, including:**

- Could a common definition of an SME be agreed upon between the banks to enable consistent data collection to support a banking industry view of SMEs?
- Are there regulatory or other statutory requirements that inhibit banks from doing more, and what could be done to improve the situation?
- Apart from funding SMEs, how does the banking industry support SMEs and what other services and participants are available to the SME ecosystem?
- Are there potential solutions that banks could offer to build a stronger SME ecosystem, while remaining competitive, to demonstrably address their support for the sector?

This study explores the SME ecosystem to see where SMEs could be better assisted, through potential partnerships and collaboration, and presents recommendations based on insights from the interviews and desktop research. The intention is to contribute to a better dialogue between the BASA members and the SME ecosystem, and to create a framework for problem-solving to assist the banking industry in serving the SME community.

## 2. About the banking industry and SMEs



South Africa has a large and sophisticated financial services sector with total assets estimated to be around R17.7 trillion or 300% of gross domestic product (GDP), well above most emerging markets. The banking industry accounts for about 44% of total financial sector assets and expressed as a percentage of GDP at 132%.

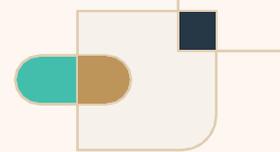
The South African banking industry is world-class and regulated at the highest standards. Regulatory safeguards protect banking customers from becoming over-indebted or being treated unfairly and are embedded into the regulations. Within these regulatory safeguards, banks service the SME customer with due consideration for their fiduciary responsibility to protect depositors, their own risk appetite, and the funding needs of the rest of the economy, including government, large businesses, and individuals.

Classifying the SME is challenging, as there are different definitions within the sector for what constitutes small and medium enterprises. The government, regulators, and each business, applies their own definition, programmes, and policies. This complicates the ability of the ecosystem to co-create

solutions, since appropriate evidence-based datasets are required to make strategic, policy and programmatic solutions.

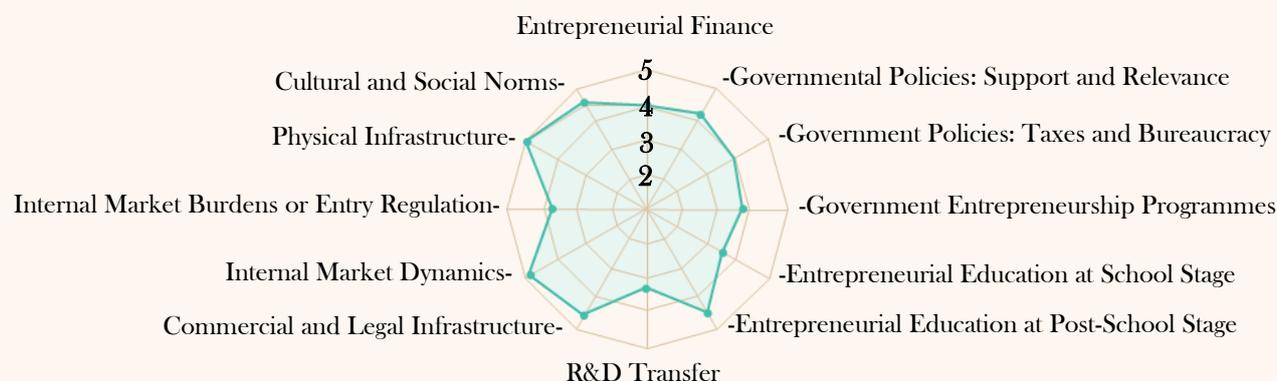
### 2.1 Access to finance for SMEs in South Africa

Access to finance for SMEs is necessary to support an economic environment that enables these businesses to grow and prosper. SMEs in South Africa face significant barriers to finance. The Global Entrepreneurship Monitor use their entrepreneurship framework conditions to highlight entrepreneurial finance, defined as the availability of financial resources for SMEs in the form of debt and equity, as one of the key factors for stimulating and supporting entrepreneurial activity.



## Entrepreneurial Framework Conditions in South Africa

Most recent data: 2022. Expert Ratings: 1 = highly insufficient, 5= highly sufficient



Source: *Global Entrepreneurship Monitor, Entrepreneurial Behaviour and Attitudes, 2022*

South Africa ranks well in terms of physical infrastructure, commercial and legal infrastructure, entrepreneurial education at post-school level, but less so for entrepreneurial finance and government policies and programmes.

Documenting the state of the SME sector, is a far cry from changing the SME environment. The Policy Board for Financial Services conducted a study over twenty years ago titled “SMEs access to finance in South Africa – a supply-side regulatory review” that addressed most of today’s issues. While digitalisation has introduced new opportunities, and may provide a catalyst for change, without a co-created, implementable programme of reform, the SME environment will take many years to organically evolve.

### 2.2 How the banking industry views SMEs

A challenge for SME data is how SMEs are defined, not only by government and the broader ecosystem but even by individual banks.

One of the many definitions is provided below:

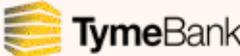
Category of SME in South Africa	Annual turnover
Start-ups, micro enterprises	<R500 000
Very small enterprises	R500 000 - R2 500 000
Small enterprises	R2 500 000 - R10 000 000
Medium enterprises	R10 000 000 - R20 000 000

Source: *Banking Association of South Africa, Small Business Definition, 2022*

Individual banks each have their own definition of an SME, which determines how they develop strategies, programmes and product offerings. Some banks define SMEs as less than R20 million, others as less than R30 million. Others still have more granular definitions, while some do not treat SMEs any differently to other customers.

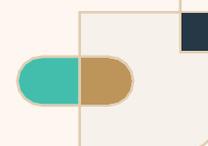
Recognising the complexity of the SME sector, it is unlikely that standardised bank definitions will improve the value of research into the sector. Comparisons between independent research from different SME researchers will not help policy makers to make informed decisions, unless all participants adopt a single definition.

## 2023 Banking Industry SME Definitions

Organisation	Definition
 African Bank	<ul style="list-style-type: none"> <li>• SME Banking &lt;R30 million</li> <li>• Corporate Banking R30 million - R300 million</li> </ul>
	<ul style="list-style-type: none"> <li>• SME Banking &lt;R20 million</li> <li>• Commercial Banking &lt;R20 million - R500 million</li> </ul>
	<ul style="list-style-type: none"> <li>• The Business Banking segment definitions are structured against turnover levels. (All individuals not linked to a business or corporate customer)</li> <li>• Emerging Business &lt;R5 million</li> <li>• Business Banking &gt;R50 million - R 750 million</li> <li>• Corporate Banking &gt;R750 million</li> </ul>
	<ul style="list-style-type: none"> <li>• Capitec does not provide any segmentation. They offer one product for all customers focusing on providing fair value and accessibility.</li> </ul>
	<ul style="list-style-type: none"> <li>• Gold &lt;R5 million</li> <li>• Platinum R5 million - R60 million</li> <li>• Enterprise R60 million +</li> </ul>
	<ul style="list-style-type: none"> <li>• SME Banking &lt;R30 million</li> <li>• Corporate and Commercial Banking R30 million - R750 million</li> <li>• &gt;R750 million Corporate and Investment Banking Segment</li> </ul>
	<ul style="list-style-type: none"> <li>• Enterprise Direct &lt;R5 million</li> <li>• Enterprise Portfolio R5 million - R10 million</li> <li>• Growth R10 million - R100 million</li> <li>• Premium R100 million - R300 million</li> <li>• Enterprises with higher turnover would fall into Commercial Banking (large enterprises) and Corporate Banking segments.</li> </ul>
	<ul style="list-style-type: none"> <li>• Tyme Bank introduced a Business Advance product in July. This offering is similar to its Retail Capital product, which also applies for SMEs.</li> </ul>

Source: COEFS interviews August - October 2023





## 2.3 The banking industry plays a critical role in SME financing

Banks are the largest funders in the SME ecosystem and provide a range of financial services to individuals and businesses. Banks play a central role in SME lending through various financial products, including business loans, plant and equipment finance, vehicle asset finance, credit lines and trade finance.

Competition amongst credit providers and the regulatory construct of each, can limit access to finance when the business scales, as new finance partners are needed. We introduce the concept of a missing middle to present a cohort of SME businesses that are being lost to the banking industry as they search for additional funding during certain growth phases.



In many countries, SMEs account for over 90% of businesses and the National Development Plan seeks to reach 90% for South Africa by 2030.

In many countries, SMEs account for over 90% of businesses and the National Development Plan seeks to reach 90% for South Africa by 2030.

Growing the SME sector through the banking industry may be challenging due to a number of factors, including:

- SMEs are often perceived as being riskier borrowers by banks.
- SMEs may have difficulty providing the collateral that banks require for loans.
- SMEs may not be aware of the range of banking services available to them.

While banks serve as the primary providers of SME financing, the stringent lending criteria, collateral requirements and market related interest rates, pose challenges for small businesses. Although banks are continually working to streamline their processes and introduce innovative solutions to cater to the SME sector, continuity of funding for the SME missing middle could be an inhibitor to the 2030 growth aspiration.

Unlike many in the SME financial ecosystem, banks also face a series of stringent regulatory and legislative requirements. The legislative and regulatory framework plays an important role in determining how the banking industry works with the SME sector, but it is not the only stakeholder that can influence financing of SMEs in South Africa.

The SME landscape has undergone a number of legislative and policy changes over the years, with the culmination in the National Integrated Small Enterprise Development Masterplan in 2022 and the recent draft South Africa SMMEs and co-operatives funding policy. Government is set to play an important role in shaping this sector.

## 2.4 Overview of the SME financial ecosystem

Since the COVID-19 pandemic, many new SME financiers have entered the sector, which resulted in shifts in the potential sources of financing and support for SMEs. In presenting the key role players in the South African financial sector ecosystem, the focus of the study was on entities that should directly impact the SMEs ability to access financing.

The financial ecosystem is complex, with a dynamic network of stakeholders that play a vital role in the country's economy. The ecosystem includes banks and non-bank financial institutions, FinTech companies, regulators, incubators and accelerators, government agencies and other supporting organisations.



## 2023 SME financial ecosystem

The following is an abbreviated list of organisations within the ecosystem; the list is not comprehensive, as the SME financial ecosystem is continuously evolving, with new entrants and services on offer.



### Government and regulators

- Companies and Intellectual Property Commission
- Department of Agriculture, Land Reform and Rural Development
- Department of Small Business Development
- Department of Trade, Industry and Competition
- National Treasury
- Small Enterprise Development Agency
- South African Reserve Bank
- South African Revenue Service



### Development finance institutions

- Development Bank of Southern Africa
- Industrial Development Corporation of South Africa
- Ithala Development Finance Corporation
- National Empowerment Fund
- Small Enterprise Finance Agency



### Incubators and accelerators

- Black Umbrellas
- Fetola
- Founders Factory Africa
- SAB Foundation
- Startup Wise Guys
- The Innovation Hub Management Company



### Business and advisory associations

- Black Business Council
- Business Unity South Africa
- Institute of Business Advisors Southern Africa
- National Small Business Chamber
- Small Business Institute
- South African Chamber of Commerce and Industry
- South African Institute of Chartered Accountants
- South African Institute of Professional Accountants
- Southern African Venture Capital and Private Equity Association



### Banks

- Absa Bank
- Access Bank
- African Bank
- Bidvest Bank
- Capitec Bank
- Discovery Bank
- FirstRand Bank
- Investec Bank
- Nedbank
- Standard Bank
- TymeBank



### Alternative lending, fintechs and payment platforms

- Floatpays
- GENFIN Business Finance
- JUMO
- Lulalend
- Merchant Capital
- Mobicred

- PayGate
- Retail Capital
- Spartan
- YOCO



### Academic and research institutions

- Gordon Institute of Business Science
- Stellenbosch University
- University of Cape Town
- University of Johannesburg
- University of KwaZulu-Natal
- University of Pretoria
- University of South Africa
- University of the Witwatersrand



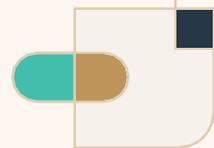
### Support organisations

- Finfind
- South African Mobile Devices Distributors and Repairers Association
- Municipalities and government



### Venture capital, private equity and angel investors

- African Business Angels Network
- Angel Investment Network
- Anza Capital
- Business Partners
- EXEO Capital
- Knife Capital
- SA SME Fund
- Women's Development Business



SMEs are highly vulnerable to economic cycles. During an economic downturn, credit providers have some discretion to support SMEs by adjusting repayment terms. However, in extreme cases the government is primary source of support for SMEs, which may need to be in the form of temporary equity or debt, convertible into grant funding under specific conditions, or a credit repayment subsidy.

Our COVID-19 research in 2022 concluded that developing crisis resilience to support the economy requires products to be designed jointly with financial sector partners, and in advance, in order that they can be deployed with immediate effect.

## 2.41 Established and traditional finance companies

**Banks.** The South African banking industry is well established and compares favourably with those in many developed countries. The industry is undergoing a profound transformation driven by powerful megatrends, causing banks to rethink their business models. This rapid evolution is reflected in the emergence of low-cost digital solutions, traditionally launched by non-bank financial institutions, as well as the ongoing transformation of the banks to address changing customer, regulatory and technological needs.

**Non-bank financial institutions.** Non-bank lending is a key part of the financial ecosystem and is an industry that requires long-term sustainable funding, paired with appropriate regulation, to impact meaningfully on the South African economy.

**Development finance institutions.** The development finance institution (DFI) provides financing, technical support, and development services to support businesses, infrastructure projects, and initiatives that contribute to the country's socioeconomic advancement. DFIs provide targeted finance and support for specific sectors and developmental goals. DFIs often offer more flexible terms, longer repayment periods and lower interest rates, as well as a variety of loan products to SMEs, including term loans, working capital loans, and equipment finance.

**Microfinance institutions.** The microfinance institution (MFI) provides small loans and other financial services to low-income individuals and businesses.

MFIs play an important role in providing financial services to SMEs, which often have difficulty accessing loans from banks. MFIs typically offer smaller loans with shorter repayment terms than banks, and they are often more willing to lend to SMEs with poor credit histories albeit at risk adjusted higher interest rates.

## 2.4.2 Emerging and non-traditional organisations



Alternative funding organisations have grown, with new categories emerging, that can significantly impact how SMEs source financial support.

**SME private debt funds.** SME private debt funds play an important role in the financial sector by providing financing to SMEs that may not be able to access loans from banks. Private debt funds typically offer loans with longer repayment terms and lower interest rates than bank loans.

**Venture capital.** Venture capital (VC) firms provide investment capital to early-stage and high-growth companies. These firms provide equity funding to SMEs in exchange for an ownership stake in the business. At the end of 2021, the Southern African Venture Capital and Private Equity Association (SAVCA) estimated the South African VC asset class had R8.13 billion invested in 1 021 active deals. This has increased substantially compared to 2020, where R6.87 billion was invested in 841 active deals. The indication of VC investment shows that there is a body of fundable SMEs and start-ups in South Africa, many of which may be receiving banking industry support.

**Private equity.** The private equity market in South Africa is relatively small but growing steadily. As of 2023, it is estimated by SAVCA to have assets under management of around R150 billion. Private equity firms supply investment capital to expanding and well-established enterprises. By offering this financial support, private equity investors typically acquire a minority equity stake in SMEs and also assume a role in management oversight, often through a seat on the board. This involvement allows private equity firms to actively contribute to the growth of the businesses they invest in.

**Fintech companies.** FinTech companies are using technology to disrupt the traditional banking industry by offering innovative financial products and services.

They offer alternative lending platforms, peer-to-peer lending, invoice financing and digital banking solutions to make financing more accessible and efficient to SMEs and have disrupted traditional lending, providing quicker loan approval processes, less stringent criteria and innovative financing models. Regulatory frameworks and trust in digital platforms remain challenges for FinTech companies.

**Angel investors.** Angel investors are individuals who offer financial backing to start ups and early-stage businesses, which are often considered riskier propositions than what most funders are willing to support.



Angel investors are typically high-net-worth individuals who use their personal funds in businesses with the goal of generating a return on their investment.

In addition to providing financial support, angel investors offer valuable mentorship and connect the companies they invest in with industry contacts.

**Peer-to-peer lending.** Peer-to-peer lending is a type of business loan generated by a large number of private investors (individuals, businesses or institutions) to SMEs, usually through an online platform. Peer-to-peer lending matches those with money to lend with those who want to borrow, removing financial institutions from the equation and allowing lender and borrower to share on the saved over-head costs of traditional borrowing/lending.

**Crowdfunding platforms.** Crowdfunding platforms allow individuals and businesses to raise money for projects or ventures from a large number of people.

### 2.4.3 SME business support and associations

**Incubators and accelerators.** Incubators and accelerators are key players in the start-up ecosystem, providing entrepreneurs with essential resources, mentorship, and networking opportunities. They offer programmes tailored to specific sectors, helping start-ups refine their business models, access funding, and scale their operations.

**Government agencies.** Government initiatives and policies play a crucial role in nurturing the small business ecosystem. South Africa has a dedicated Department of Small Business Development and with its related agencies, the Small Enterprise Finance Agency and Small Enterprise Development Agency, provides funding, mentorship, and resources to small businesses. In addition, agencies that provide support to SMEs include the Technology Innovation Agency and the Department of Trade, Industry and Competition.

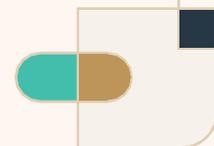
**Academic and research institutions.** South African universities and research institutions have become valuable contributors to the SME ecosystem. Collaborations between academia and entrepreneurs lead to the transfer of knowledge, research-driven innovation, and commercialisation of technologies.

**Chambers of commerce and industry associations.** Chambers of commerce and industry associations advocate for both financial institutions and SME interest, provide guidance and facilitate networking and knowledge sharing within specific sectors. The associations play a vital role in representing SME concerns and needs, influencing policy decisions and fostering a supportive ecosystem for SMEs.

### 2.4.4 Regulators

The financial sector has adopted international best practice aimed at safeguarding consumers and ensuring financial system stability. Government and regulatory bodies devise policies and incentives to foster SME lending, creating a conducive environment. Key oversight is provided by regulators such as the South African Reserve Bank (**SARB**), the Prudential Authority, the Financial Sector Conduct Authority, and the National Credit Regulator.

The SARB focuses on financial stability across the financial sector and will ensure that non-bank SME funding does not compromise the safety and soundness of the broader financial system. The Prudential Authority conducts stress tests of each bank's ability to survive an external shock, testing the risk capital underpinning their loan portfolios.



The international standards for banking adopted by the SARB, incorporates a natural diversification benefit to SMEs that makes SME lending slightly more attractive to an alternative of corporate lending, but it is not as bold as the European Central Bank SME support factor, which specifically reduces the risk weighting factor for SME exposures up to a specific threshold.

## 2.5 Complexity in the SME financial ecosystem

The South African SME financial ecosystem is complex and evolving, with a variety of nuances. Some of the key contributors to these subtleties are as follows:

**Clear DFI funding mandates with measurable outcomes.** The SME financial environment features diverse funding entities, each with distinct objectives for supporting SMEs. While banks and DFIs are major contributors to SME financing, they frequently impose similar credit requirements for SME funding. DFIs play a pivotal role in delivering impactful funding yet may lack the capacity for innovative funding alternatives and have protracted loan approval processes, leading to delays in fund disbursement.

**Limited equity financing and high cost of finance.** Private equity, venture capital and angel investments are on the rise, providing increased access to equity financing options for SMEs. However, many SMEs are reluctant to pursue equity financing, as they are inclined to preserve ownership and control of their businesses and prefer debt financing. The cost of finance for SMEs is often high, which makes it difficult for SMEs to afford to borrow money and limits their growth potential.

**Support services are fragmented and dependent on external funding.** Sustaining the viability of incubators and accelerators can be problematic, as they depend on financial support from government grants and corporate sponsorships. The accessibility of funds from these sources can become challenging,

particularly during economic downturns, as shifting priorities within these entities may reduce the resources available for incubators and accelerators to effectively assist a substantial number of SMEs.

**Sectoral diversity of SMEs.** The SME sector encompasses a multitude of industries, each characterised by unique financial requirements and challenges, spanning from agriculture and manufacturing to technology and services. Traditional banking products and services must be adapted to address the diverse needs of SMEs operating in various sectors and at various stages of development.

Despite these challenges, the SME financial ecosystem is advancing, marked by several noteworthy developments. For instance, the emergence of alternative finance providers has expanded the financing options available to SMEs, offering SMEs competitive alternatives to traditional lenders.

### Leveraging options in the SME ecosystem

Various initiatives have been introduced to support SMEs. One example is the Khula Credit Guarantee Scheme, which provides an important risk underpin, by safeguarding commercial banks and other financial institutions against SME credit defaults, offering indemnities covering up to 90% of loan amounts. However, it is underutilised, and an upcoming World Bank diagnostic of the Khula Credit Guarantee Scheme will provide an integrated package of reforms that if fully implemented, will improve the schemes' viability.

A promising development is the success of the Intergovernmental FinTech Working Group Regulatory Sandbox. The sandbox provides a safe space to test new products under appropriate regulatory oversight.

These developments indicate that the South African SME financial ecosystem is adapting. Nevertheless, significant effort and collaboration within the ecosystem is still necessary to cultivate a robust SME sector.

## 3. Key insights and learnings

The banking industry is a key source of funding to the SME sector. For the sector to grow to its full potential, within a changing economic environment, leveraging technology as an enabler, while co-creating solutions with government, will ensure appropriate bank funding within the constraints of the legal framework.

As an increasingly competitive market evolves, the banking industry is developing solutions to help grow the sector to promote job creation and drive economic growth. Here are some of the main insights garnered from the participants in the research.

### 3.1 Key insights

#### Insights on SME sector challenges

- Dual economies
- The SME sector as an ecosystem
- Categorising SMEs is challenging
- Banks believe they are serving the sector well
- Accessing appropriate financing by SMEs can be challenging
- Many SMEs lack financial literacy



#### Insights on broader banking industry challenges

- Each bank has a different risk appetite
- Regulation has an impact
- Important SME financial activity is invisible to banks
- A collaborative approach to a competitive environment
- Lack of credit information sharing hampers assessment of SME viability



#### Opportunities and solutions

- An ecosystem approach is vital
- Digitisation provides an opportunity as an enabler
- Reducing the administrative burden for loans will assist SMEs
- Innovation in credit scoring
- Government support is required
- Partnerships with non-financial organisations can help





## Insights on SME sector challenges

### Dual economies

South Africa's financial system accommodates a dual economy. One is a highly regulated and formal economy demanding complex financial solutions, aided by sophisticated products and digital tools. The other is less formal, largely cash-based, and faces systemic challenges in transacting and integrating with the more formal economy.

### The SME sector as an ecosystem

The SME sector is a segment of the economy covering all industries ranging in size and complexity. By viewing the SME sector as a growth pipeline and recognising that each SME may be unique, will require the broader SME ecosystem to understand how they contribute to this growth pipeline for SMEs, and where the appropriate touch point is for that specific SME to maximise its growth potential.

### Collecting SMEs data is challenging

The SME sector is not homogeneous and includes small and medium enterprises with unique needs from different industries. Universally agreed upon definitions among government may add some value, but could also be restrictive, as SMEs need to be recategorised as they move across these thresholds for regulatory reporting. Banks segment their customer base according to the relationship with the customer and service their needs according to their level of sophistication.

### Banks believe they are serving the sector well

Participating banks have dedicated teams working on innovative solutions to service the SME sector. However, not all feedback supported this view.

Mpho Tsheole of the business incubator OBPI says "...business bankers...don't even know their own banking rules [and] may not know where to go to solve an issue that they are faced with when they are sitting across the table from an SMME." The perception in the mining industry is that bankers are "...brutal and cold... but I think it's how they [banks] empower [their]

people."

A clear national SME strategy, from cradle to grave, of contributing service providers would boost the confidence of SMEs and clearly set the expectations for banks within this ecosystem.

### Accessing appropriate financing by SMEs can be challenging

SMEs are faced with many financing options, from banks and FinTechs to government agencies, friends and family. Banks have stringent requirements that must be met, while alternative funders may be more flexible, but demand a higher risk premium, and government funding may take longer to acquire.

SME businesses are often complex and require specific financial solutions, but a significant investment in time is required to evaluate all options within this competitive financing landscape. Access to financial advice may not yet be appropriate for the SME sector.

### Many SMEs lack financial literacy

A significant number of SMEs have limited financial literacy, and this impacts their ability to manage the business effectively and as a result, limits access to bank financing. This lack of financial literacy affects their readiness to apply for loans as they cannot present their business proposals effectively to banks or lenders. The SME may not have a practical understanding of financial concepts, such as budgeting, cash flow management, financial planning, and loan application processes.

To mitigate this, some banks provide extra support for SMEs. Ronnie Mbatsane, Managing Executive of SME Business at ABSA Bank says, "In our own analysis, the reason for [SME] failure is mainly [lack of] skills to run the business, ability to manage the business, and that is not really a function of the bank. But we have seen that there's a need for us to be able to be closer as we have vested interest [as a lender] in terms of the business being sustained."



## Insights on broader banking industry challenges

### Each bank has a different risk appetite

Banks vary in their risk tolerance levels, which can influence their credit appetite for SMEs. Some banks may be more risk-averse and cautious, leading them to have a lower appetite for lending to SMEs. SMEs are often perceived as riskier investments by lenders due to their small size and limited financial history.

Banks must factor in the risk-adjusted returns associated with SME clients, but are also influenced by other factors, including their lending segmentation strategies, the regulatory environment, the growth prospects of the economy and the industry the SME is in. Banks are also compelled to evaluate the profitability of their SME lending activities. They must factor in potential returns, transaction costs, and risk-adjusted returns associated with SME clients. Banks' credit appetite for SMEs is also influenced by other factors, including their segmentation strategies, the regulatory environment and the growth prospects of the economy and the industry the SME is in.

### Regulation has an impact

The banking industry operates under greater regulatory and legislative requirements than the more informal lending alternatives available to SMEs. These regulations are designed to protect depositors' money placed with the banks, while other regulations such as the National Credit Act introduce affordability tests and protect SMEs from becoming over-indebted through reckless lending by credit providers. Know your customer requirements impose administrative requirements that cannot be waived, while credit granting processes require a standardised set of documents to efficiently process high volumes of applications.

### Important SME financial activity is invisible to banks

An important segment of the financial activity of SMEs remains invisible to banks due to the cash-based nature of their transactions and their lack of record-keeping, limiting the data profile a bank can build around the SME.

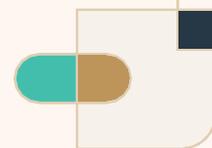
Sharing credit information and data on SME borrowers, potentially through credit bureaus, would strengthen the information banks have available. By sharing insights on SME behaviour, creditworthiness can be more accurately assessed. This, in turn, enables banks to extend loans to deserving SMEs with limited credit histories, reducing a barrier of access to financing.

### A collaborative approach to a competitive environment

South African banks must maintain their own view of their customer, which includes details provided by the SME, and independent environmental scanning. When combined with the SMEs personal credit information, it shapes the credit narrative.

“In most other OECD countries, banks are required to report various details related to SME lending, including interest rates, the percentage of outstanding business loans, new ECB (extended credit bureaus) lending, non-performing loans, collateral requirements, rejection rates, and more. However, in South Africa, none of this information is reported, leading to a lack of transparency in lending practices.”

Darlene Menzies, FinFind



To supplement own bank data with value added complimentary data is challenging in a competitive landscape where the credit skill of the bank is proprietary. However, with the change in data privacy laws, it may be possible for the SME to share basic data collected by banks and other organisations, to improve the overall credit risk profile of the SME.

Aggregated banking industry information combined with other SME ecosystem participants data, would provide much needed context to the emerging narrative of a struggling SME sector.



## Opportunities and solutions

### An ecosystem approach is vital

There is a need for greater collaboration between the private and public sectors to assist SMEs. The SME ecosystem has an extensive number of institutions and organisations that support SMEs with financial services. Many supporters of the ecosystem are not aware of all the avenues available to SMEs, and do not always know what complementary or competing services exist.

Small businesses do not always know where to access funding information. There is room for greater collaboration, information sharing, and the building of evidence-based networks to further assist and grow the success of the SME sector. Recognising and measuring the value of the contribution to get SMEs funding ready, needs an ecosystem approach.

Government can play a critical role in facilitating the ecosystem approach, establishing the SME pipeline and identifying opportunities in collaboration with the private sector.

### Digitalisation is an opportunity as an enabler

Digitalisation is proving to be a value-added service for SMEs. Digitised records combined with biometric onboarding has expanded the bank offering to previously unbanked customers, providing rapid results. Banks have invested in predictive models for assessing SME credit worthiness, based on new sources of data such as point of sale devices, and reduced the dependency on personal credit scores to supplement intuitive lending. In the interim though, human interaction is still considered important, as it is during this time when SMEs can most benefit from financial guidance.

Government must invest in digital solutions, including open API, to remain responsive to the digital economy and the digital entrepreneur.

### Reducing the administrative burden for loans will assist SMEs

Simplifying the loan application process, within the constraints of the law, is crucial. This may include reviewing documentation requirements and administrative procedures to make accessing financing less daunting for SMEs. Leveraging digital platforms for document submission and verification, can streamline the process, making it quicker and more efficient.

### Innovation in credit scoring

Banks are developing innovative credit scoring models that consider a wider range of factors, including business performance metrics, industry trends, and customer feedback. These models enable more accurate risk assessment for SMEs with limited credit histories. However, banks and financial institutions are doing this work in competitive silos, meaning best practices are not willingly shared across the industry and the benefits for SMEs will take longer to manifest.

### Government support is required

Collaboration between the banking industry and government agencies could result in the creation of favourable guarantee schemes and incentives that encourage SME lending. Government support could take the form of credit guarantees, interest rate subsidies, or targeted funding programmes to bolster SME growth. In addition, the SARB could consider an equivalent European Central Bank SME support factor, which would reduce the risk weighting for bank capital.

According to Don Mashele, Head of Business Development with the Small Enterprise Finance Agency (sefa), Government's primary arm for financing small business, "...the role of a DFI is to address market failures, in other words the focus is to assist SMMEs and cooperatives that are not adequately assisted by private sector lenders."

One area is early-stage risk sharing "first-loss schemes", which could potentially mitigate risks associated with lending to SMEs. A first-loss scheme where government absorbs market failure risk could provide a safety net for banks when lending to SMEs in certain categories. Some drawbacks would be that this approach may not be universally accepted, and it would change the risk profile of SMEs.

With the SME sector underpinning planned economic

growth, a predetermined strategy to address the support required during an economic crisis or significant economic downturn to preserve jobs is needed. This was one of the COEFS recommendations from the "Lessons from the Covid-19 pandemic in South Africa".

### Partnerships with non-financial organisations can help

Banks can form strategic partnerships with non-financial organisations such as business incubators, accelerators, and industry associations. These collaborations should aim to provide holistic support to SMEs, including mentorship, networking opportunities, access to markets, and industry-specific expertise.

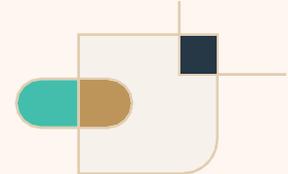
#### Is the banking industry doing enough for SMEs?

The issue of different perceptions remains. On one hand, banks serve the entire market and SMEs are one portion of this market. The numbers reveal that the lending is limited, but the issue is deeper – is it purely in the lending? Denver Tavira, Investment Officer at FMO, a Dutch investment bank, says, "I think banks are doing enough. If you look at the financial sector charter, there are substantial reporting requirements placed on banks regarding enterprise and supplier development and transformative SME lending. In that I believe banks are doing enough. It may never be entirely sufficient, but as it stands, my answer is yes.

"Where banks can make a significant shift, and they should be working on this, is by allowing more digital funding applications and facilitating engagement through these platforms until in-person processes are necessary, such as document signing. Banks should aim to bridge the gap by conducting deeper discussions through digital platforms.

Currently, there's a lack of understanding of SME businesses in the current SME banking landscape. In the past, relationship managers would visit clients and understand their businesses deeply, but this practice has waned. Using digital platforms for such conversations can improve this understanding and productivity for SMEs, reducing the need for them to visit a bank in person for extended periods. It's about pushing banks in the right direction to adapt to these changes."





Banks support SMEs in various ways, including enterprise and supplier initiatives that provide patient capital, grants, training and more.

Zizipho Nyanga, Head of Strategic Partnerships, African Bank



### 3.2 Key learnings

#### **SMEs need funding – but even more than money, they need support**

Many respondents indicated that non-financial support – such as business development, access to markets, management capability, and financial skills – are just as crucial as funding for SMEs. SMEs require a multifaceted approach to support, that includes mentorship, education, and access to a supportive ecosystem.

Understanding the SME journey is important, as the needs vary at each stage in development. Comprehensive support is essential for SMEs to thrive, grow, and effectively overcome the challenges they encounter in their business journey, in particular, overcoming the difficulties faced with regards to financial literacy.

#### **Leveraging SMEs as an opportunity for innovative product offerings**

Working with SMEs offers an opportunity to experiment in the design of innovative financial products. The SME sector is multi-faceted and characterised by a diverse range of business types, serving multiple industries, each with its unique challenges and needs. Traditional banking approaches may not always work when addressing these complexities.

Some opportunities in this sector can be realised through enterprise and supplier development and enterprise development with specialised, tailor-made

financial products that align with the intricate cash flow patterns, risk profiles, and industry-specific requirements of SMEs. Embracing innovative thinking and crafting flexible, customised solutions, the banking industry is able to test their offering as they meet the ever-evolving needs of SMEs, ultimately fostering growth and resilience within this vital sector of the economy.

#### **Reviewing collateral alternatives and seeking improved credit scoring models will offer options**

SMEs often need repayment terms that match their cash flow patterns. Banks must work within their legal framework to create loan packages that accommodate customised repayment schedules, grace periods, and seasonal adjustments to fit the unique financial circumstances of SMEs. Additionally, banks could consider alternative forms of collateral beyond traditional assets. Accounts receivable, inventory, future sales or projected revenue could be used as collateral, allowing SMEs with limited physical assets to qualify for loans.

Developing innovative credit scoring models that consider a broader range of factors, such as business performance metrics, industry trends, and customer feedback, can enable more accurate risk assessment for SMEs. These models could provide SME-specific indicators to enhance creditworthiness evaluation.

### 3.3 Implications for the SME sector

#### The banking industry and SMEs need to develop stronger relationships

Stronger relationships between SMEs and banks will play an important role in navigating both challenges and opportunities. SMEs need banks as reliable financial partners to access essential funding, expertise, and support. In turn, banks can benefit from deeper connections with SMEs by gaining a better understanding of their specific needs, risk profiles, and growth potential, to improve credit decisions.

**“...the building blocks of the Grameen Bank model, that cooperative type setup, just the assistance and understanding, the support that comes through that model...is what is turning the tide within the Indian economy...”**

**Mark Alard, Director, Department of Trade Industry and Competition (DTIC)**

A strong working relationship can be mutually beneficial when SMEs and banks work collaboratively. They may be able to develop tailored financial solutions, provide mentorship and guidance, and contribute meaningfully to a supportive ecosystem that contributes to the sector’s resilience and long-term success.

#### Creating credit-worthy SMEs is essential

While there may be more the banking industry can do, it must comply with the legal framework for both banking and credit. The lack of owner equity investment makes it difficult for banks to assess the entrepreneur’s commitment to the business and their willingness to share in the risk. SMEs can meet banks on their terms, by developing greater financial literacy and building an asset base to use as collateral.

Improved financial literacy equips SMEs to make informed decisions regarding loans and utilise available funds effectively. Banks partner with industry experts to provide education on the loan application process, financial management, and business planning, yet this is not well known by most SMEs, who often operate without sufficient mentorship or guidance. Access to

experienced mentors and business advisors is limited, leaving SMEs to navigate the complex world of financing on their own.

#### The case for alternative financing and stronger customer relations

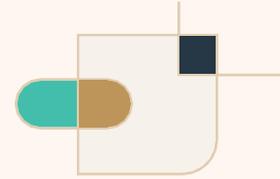
Encouraging the development of alternative non-bank financing options, diversifies the sources of funding available to SMEs. SMEs can gain access to venture capital, angel investment networks, and peer-to-peer lending platforms to provide them with more options to raise capital. Banks could also form partnerships with these providers, redirecting SMEs they cannot help to these partnerships that could potentially receive their funding from the bank, and collectively benefit from shared data.

Until digitalised banking services are able to replace individual services at a greater level, assigning dedicated relationship managers to SME customers will continue to provide personalised guidance. However, the in-depth knowledge required to service an SME may result in banks rather specializing in specific industries within the sector. Mpho Tshoele from business incubator OBPI says, “We believe we can play a significant role if we have someone at the bank who we can work with and be our go-to person, because the business bankers change every six months...”

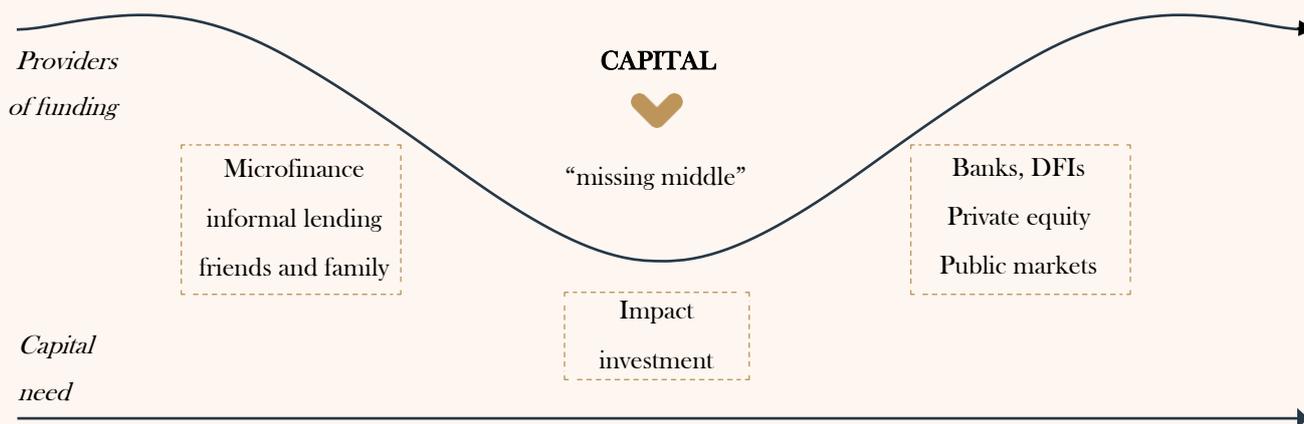
Establishing feedback mechanisms is essential for banks to gather input from SMEs about their lending experiences. This feedback can help banks continuously improve their offerings and address challenges faced by SME borrowers in real time.

#### Catering for the missing middle

There are many SMEs with up to R10M in turnover that provide employment but cannot get access to finance from the banking industry. There is a product offering gap between banks’ strict lending criteria with lower rates and FinTech’s or development financial institutions more lenient requirements offering higher interest rates. The result is that SMEs look for alternative solutions, such as bootstrapping, tapping into home loans and overdraft facilities, and finding alternative financing methods.



## The missing middle in South African SMEs



Micro-enterprises < R1million	SMEs – Impact Investments >R1 million – R10 million	Large enterprises > R10 million
<ul style="list-style-type: none"> <li>• Microfinance</li> <li>• Friends &amp; Family</li> <li>• Incubators &amp; Accelerators</li> <li>• Angel investors</li> <li>• Crowdfunding</li> <li>• FinTechs</li> <li>• DFIs</li> <li>• Peer-to-Peer Lending</li> <li>• Banks</li> </ul>	<ul style="list-style-type: none"> <li>• Venture Capital</li> <li>• FinTechs</li> <li>• DFIs</li> <li>• Peer-to-Peer Lending</li> <li>• Banks</li> </ul>	<ul style="list-style-type: none"> <li>• Banks</li> <li>• DFIs</li> <li>• Venture Capital</li> <li>• Private Equity</li> <li>• Private Debt</li> <li>• Public Markets</li> </ul>

Source: COEFS research team with insights from interviews

### The importance of developing a pipeline to take SMEs to larger-sized businesses

Creating a structured pipeline together with ecosystem partners, with targeted support and resources at each stage, could potentially help address the challenges faced by SMEs, and guide them toward sustainable growth and success. Incubators and accelerators could also be leveraged to create a pipeline of funding for SMEs, which could prime them for entry into dialogue with the banking industry.

For SMEs, the missing middle represents the disparity between the financial requirements of SMEs for

growth, and the funds accessible to them. These SMEs are in a unique category, being too large for government funding, yet too small to garner the interest of private funders. Potential initiatives to bridge this gap could be facilitated by government. The SME finance ecosystem converted into a recognised growth pipeline by government could offer blended finance, combining grants and debt funding to mitigate credit risk and lower interest rates, enhancing affordability for SMEs at the point of market failure.

Following the key insights, key learnings and implications for the sector, the next chapter presents the conclusion and recommendations.

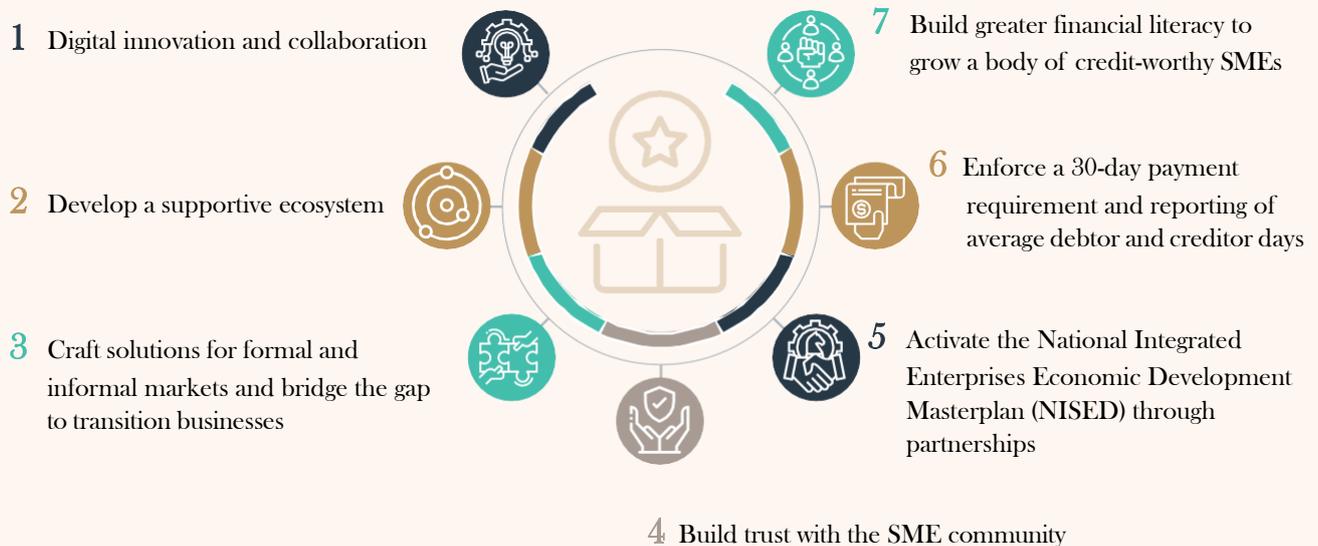
# 4. Conclusion and recommendations

## 4.1 Conclusion

Some small and medium enterprises are challenged by a lack of financial acumen and general business skills that limit their access to finance and growth.

The SME sector holds immense promise, not just as an engine of economic growth but also as a source of entrepreneurship, innovation, and job creation. But government must take a central coordinating role, co-creating solutions with the SME ecosystem that enable government to design its own solutions to market failures while empowering collaboration in a competitive landscape.

## 4.2 Recommendations



## 1 Digital innovation and collaboration



The rapid adoption of digital innovation has created the opportunity for more credible and useful data to be gathered in support of the needs of banks and credit providers, to evidence the decisions that they take in relation to credit. From the internet of things, where data from sensors can be collected without human intervention, to decentralised finance that provides opportunities for alternative funding, all provide a window into the health and viability of the business.

Collaboration on data that is not limited by concerns around collusion, or privacy of information, needs to be encouraged. It may be possible for the entrepreneur to use information that is digitised as a token or issued as a credential on a digital identity, to reduce compliance friction costs.

With data held among organisations known to each other, an entrepreneur can prove they have not missed a payment with anything from a utility bill to credit instalment, without providing details of those relationships, in a tokenised format. For the credit industry, the collective knowledge of the entrepreneur becomes invaluable for decision making.

A digitally enabled capable state would enhance the digital identity narrative, helping e.g. to make the issuance of tax compliance certificates and recognition thereof on the Central Supplier Database, automatic and seamless. The potential for the entrepreneur to participate digitally in tenders or to negotiate better terms from suppliers can be simplified.

## 2 Develop a supportive ecosystem



Respondents indicated that access to finance was not the most important element and that a supportive ecosystem would make a valuable contribution to the success of SMEs. Issues such as market dominance can be examined within a cooperative ecosystem, while promoting better payment terms can be supported with a cooperative approach.

In addition, through partnerships with third-party banking and non-banking technology providers, banks can leverage existing, best-in-class services rather than building products and services from scratch. This can include partnerships with FinTech companies, retailers, and other financial institutions. Ecosystem banking has emerged as a business model in which banks partner with other companies and organisations to provide a wider range of products and services to their customers.

## 3 Craft solutions for formal and informal markets and bridge the gap to transition businesses



Recognition of a dual economy, one digitally enabled and the other cash-based, by government and the ecosystem, would assist with focused solutioning.

Criticism of the administrative burden for entrepreneurs does not always recognise that the legal system has evolved, and its complexity reflects the underlying need for the protection of society, or the regulatory compliance requirements of banks as they work with depositors' money.

**“...formalisation is a challenge. Tax compliance is a challenge. We also find that a lot of SMEs are challenged by getting local business trading licenses and permits. There’s a myriad of other challenges that SMEs themselves face, which, if that landscape was simpler, would give us more validations or data points to make better risk decisions, which could lower the cost of credit.”**

Amrei Botha, Divisional Executive, Capitec.

She also asks, “How do we think differently? How do we remove the traditional barriers and red tape so that we are able to offer greater access to financial services to more South African business owners? We're not necessarily in the mindset that someone else needs to prepare people so that they can enter the banking world. Our approach is very different: we ask how we can rethink our world so that we extend into the untouched areas.”

There are many organisations, in particular banks, that are working with their customers to educate and provide tools for the entrepreneur to gain knowledge in this complex environment of business ownership. Relationships with the customer are the main area of competition amongst banks, and therefore a uniform approach is often impractical.

#### 4 Build trust with the SME community



There is an extensive financial ecosystem to support SMEs, yet most enterprises are not aware of the opportunities to engage with different stakeholders. Banks can leverage the capabilities of partners to expand options for SMEs.

“...there's a trust deficit. It's between SMEs and [the] formal sector”, says Lesego Mashigo, Head of the South African Financial Inclusion Programme at FinMark Trust. “If I get a bank account, will the bank then share my information with SARS...government and the private sector are there to support, you say that you're a government entity and you're doing developmental finance. Development means that you're going to have to take a bit of risk. You're going to have to do a lot of handholding. There's a lot more that's required from a developmental perspective versus when you are a financier, or your business is financing.”

#### 5 Activate the National Integrated Enterprises Economic Development Masterplan (NISED) through partnerships



Through associations and industry bodies, more can be done to strengthen cooperation between the government and the financial sector. The banking industry has expertise in data management, which can assist government initiatives in building a database to create more bankable SMEs.

A central point would be the Department of Small Business Development to engage with the ecosystem and develop relationships with vendors of services. Each bank could be encouraged to provide the services that they supply to SMEs, from access to financial products to business support. The education system would also be empowered to leverage such resources for entrepreneurial studies.

Establishing or enhancing credit guarantee schemes in partnership with government agencies or industry associations can significantly reduce the risk for banks. These schemes can partially back SME loans, reducing the risk and encouraging banks to lend to a broader range of businesses.

According to Muzi Mhlambi from BASA, “The [NISED] policy is structured around four distinct pillars, each with its own focus and significance. The crux lies in successfully implementing these pillars, transforming them from abstract concepts into tangible actions. One of these pillars pertains to forging partnerships – the intricate collaboration between the government and the private sector.

This entails navigating the dynamic landscape of interactions and activities to ensure a harmonious and productive relationship. Furthermore, another pillar centres around research. This involves the production of an annual report that offers insights into the state of the SME environment. The goal is to provide a comprehensive overview of the prevailing conditions, trends, and dynamics within the SME sphere.”

A consistent narrative from government, factual and accurate would go a long way to developing the SME ecosystem. Creating comprehensive online resource centres with informative guides, calculators, and case studies can assist SMEs in understanding different financing options, preparing loan applications, and managing their finances effectively. These resources should be easily accessible and user-friendly.

## 6 Enforce 30-day payment requirements, with public disclosure of average debtor and credit days



The increasing complexity of the larger firm to process payments due to lengthy internal processes has been absorbed by SMEs. The increasing complexity of the larger firm to process payments has inadvertently allowed corporates to borrow from SMEs, using the SMEs' credit facility to fund their operating costs.

For the SME, predictable cash flows are critical. It may be worth considering regulating a 30-day payment requirement from the delivery of the goods or services, for a registered SME business with an annual turnover of up to R1 million, or a non-profit organisation prevented from borrowing. A punitive interest rate, perhaps prime, could serve as an automatic interest calculator following the 30 days. As a best practice for corporates, voluntarily reporting their average debtor days and creditor days could provide insight into their approach to funding their businesses. If their average debtor days are longer than creditor days, it may reveal something about the ethos of the corporate.

The banking industry could assist in supporting the

current recommendation for a Small Business Ombud Office under consideration. In order to protect the corporate from being taken advantage of by the SME, under a proposed 30-day payment rule, access to an ombud would be required. Through the ombud, valuable information can be shared with the credit provider to understand where the specific or general areas of contention exist.

## 7 Build greater financial literacy to grow a body of credit-worthy SMEs

Tailoring structured solutions appropriate for each growth stage allows SMEs to scale and progress continually. Addressing these aspects is vital in easing the financial constraints faced by SMEs.

According to Andiswa Bata, head of SMEs at FNB, "Much of the financial activity of SMEs remain "unseen" by banks due to the cash-based nature of their transactions and lack of record-keeping by SMEs, which limits the data profile a bank can build around the SME. Which is why we continuously strive to make banking solutions more easy, accessible, trusted and cost effective, to try bridge this gap."

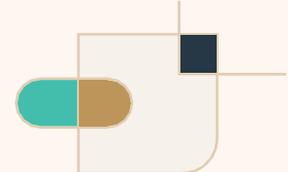


These recommendations serve as a beginning to a dialogue on how to grow the SME sector. The relationship between SMEs and the banking industry is complex and yet offers many opportunities. The banking industry potentially plays an important role in assisting to develop this all-important sector for the South African economy and into the future.

# 5. Appendices

## Appendix I: Interview list

	Date of interview	Name	Surname	Title	Name of organisation
1	04.08.23	Muzi	Mhlambi	Senior Manager	The Banking Association South Africa
2	14.08.23	Darlene	Menzies	CEO	Finfind
3	16.08.23	Denver	Tavira	Investment Officer	FMO: Dutch Entrepreneurial Development Bank
4	23.08.23	Gary	Taylor	Partner & Head of Credit	Origin Funding Partners Ltd
5	24.08.23	Lesego	Mashigo	Financial Inclusion Consultant	FinMark Trust
		Abel	Motsomi	Senior Data & Analytics Specialist	
		Akhona	Mabasa	Financial Inclusion Specialist	
		Jabulane	Khumalo	Data Analyst	
		Dr Kingstone	Mutsonziwa	Executive: Data & Analytics	
6	25.08.23	Mpho	Tsheole	Centre Manager	OBPI Incubator
7	25.08.23	Atul	Padalkar	Co-Founder	Bizfarm
8	31.08.23	Amrei	Botha	Divisional Executive	Capitec Bank
9	04.09.23	Paul	De Bruyn	Executive: Business & Commercial Banking	Access Bank
		Subaash	Maharajh	Head: Credit Risk Management	
10	04.09.23	Glenn	Pratt	Manager: Enterprise Banking Propositions	Standard Bank
		Jenine	Zachar	Head: Value Propositions & Client Experience	
		Tandiwe	Njobe	Head: Relationship Banking Propositions	
		Naledzani	Mosomane	Head: Enterprise Development	
11	05.09.23	Mark	Frankel	CEO	Black Umbrellas
12	07.09.23	Coenie	Smith	Head: Specialised Segments & Acquisition	Nedbank Group
		Zamokuhle	Nkosi	National Franchise Manager at Nedbank	
13	14.09.23	Don	Mashele	Head: Business Development	Small Enterprise Finance Agency
14	14.09.23	Zizipho	Nyanga	Head: Strategic Partnership	African Bank
15	19.09.23	Ngoako	Mabeba	Manager	National Credit Regulator
		Bongani	Gwexe	Senior Supervisor	
16	21.09.23	Ronnie	Mbatsane	Managing Executive, SME Business	Absa Group
		Vignesh	Subramani	Head: Sales Planning SME	
17	29.09.23	Mark	Alard	Director	Department of Trade Industry and Competition
18	10.10.23	Christoff	Oosthuizen	Founding CEO	Entrepreneurial Planning Institute
19	12.10.23	Faizel	Jeena	Head Risk Support Prudential Authority	South African Reserve Bank
20	19.10.23	Hannalie	Marsh	Managing executive of business banking	TymeBank
21	19.10.23	Andiswa	Bata	Head: SME	First National Bank



## Appendix II: Reference list and acronyms

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## Acronyms

BASA	The Banking Association South Africa
COEFS	Centre of Excellence in Financial Services
DFI	Development finance institution
GDP	Gross domestic product
MFI	Microfinance institution
NISED	National Integrated Small Enterprise Development
SARB	South African Reserve Bank
SAVCA	Southern African Venture Capital and Private Equity Association
sefa	Small Enterprise Finance Agency
SME	Small and medium-sized enterprise
VC	Venture capital

## About the Centre of Excellence in Financial Services

The Centre of Excellence in Financial Services was registered on the 23rd of December 2016 as a non-profit organisation. COEFS's vision is to bring together thought leaders, both local and international, to interrogate the role financial services can play in achieving national and international objectives, in collaboration with industry experts and academics.

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