Wholesale&Retail
LEADERSHIP CHAIR

Collaboration opens the window to a world of opportunities

Limited Access to Financing Opportunities for SMMEs in the Retail Sector

A SUMMARY

W&RSETA
WHOLESALE & RETAIL SETA
Skills Development for Economic Growth

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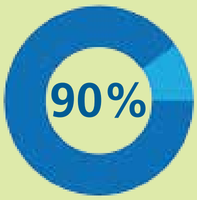
Two of the most important factors contributing to the weak sustainability of SMMEs are limited funds, and limited access to financing opportunities.

INTRODUCTION

Small, Medium and Micro Enterprises (SMMEs) are defined by South Africa's National Small Business Act, Act 102 of 1996, as follows:
"A separate and distinct business entity, including co-operative enterprises and nongovernmental organisations, managed by one owner or more which, including its branches and subsidiaries, if any, is predominantly carried on in any sector or subsector of the national economy."

The Act classifies these businesses, in the retail industry, in terms of their number of full-time employees as follows:

ENTERPRISE	NUMBER OF FULL-TIME EMPLOYEES
Micro	0-5
Very small	6-20
Small	21-50
Medium	51-200



In general, SMMEs constitute approximately 90% of all businesses in South Africa

Research shows that they contribute between 30% and 57% of the gross domestic product (GDP) of the country.

They provide employment to between 61% and 80% of South Africa's workforce, thereby contributing significantly to reducing unemployment and alleviating poverty.

Despite the significant contribution they make to the economy, SMMEs in South Africa have one of the worst sustainability rates in the world. An estimated 70% to 80% of SMMEs close their doors within three to four years of being in operation, with approximately 10 000 SMMEs failing each month.

The weak sustainability of South African SMMEs has been blamed on a number of macro- and micro-economic factors, but two of the most important factors are limited funds, and limited access to financing opportunities. These factors are interpreted in terms of two theories, the so-called finance gap theory, namely that SMME management lack the knowledge to identify sources of funding and/or have trouble satisfying loan requirements to secure external funding, and the so-called resource dependence theory, which holds that the external resources of a business is an important element of the strategic and tactical management of the company. There is plenty of evidence to support these theories: For example in a 2016 survey, out of 1 423 South African entrepreneurs that were approached, it was found that 85% were self-funded.

It is unclear whether limited access to financing opportunities is based on perceptions or real phenomena in the marketplace, because little is known about the different perceptions of finance providers and finance seekers regarding accessibility. A research study was therefore undertaken to explore barriers to financing opportunities for South African small retailers, from the perspectives of both finance providers and finance seekers. The study also highlighted measures for overcoming these hurdles.

METHODOLOGY

Research design

The research study was exploratory and qualitative, influenced by grounded theory, in order to obtain detailed and rich data through the use of personal semi-structured interviews. A total of 16 managers from banks and other financial institutions - including independent financial advisors and industry representatives (representing finance providers) –as as well as 20 small retail business owners and managers (representing finance seekers) were interviewed.

Data collection and sampling

Efforts were made to ensure that participants came from a range of different companies, positions within companies and personal backgrounds, as illustrated in the table.

SAMPLE OF RESPONDENTS	
Finance providers	**Finance seekers**
7 managers from five banks	20 owners or managers of small fashion, furniture, liquor, groceries and fuel retailers, as well as one small wholesaler.
3 managers from two financial institutions	
2 agency managers from government	
2 independent finance advisors	
2 retailing experts	

The sample of finance providers all had several years' experience in the banking and/or retailing sector and claimed to have a good understanding of the situation of small retailers in relation to the accessing of finance.

A semi-structured interview guideline with open-ended questions was used, and these were further developed and adjusted as more insights evolved during the data collection in May and June 2016. Interviews were recorded and transcribed, and analysed by one researcher.

Data analysis

Transcribed interviews were analysed using the software atlas.ti. Firstly, about a quarter of the interviews were analysed individually and coded according to a predeveloped coding scheme, which was continuously adapted and improved as more interviews were analysed. Secondly, findings relative to the themes across the already analysed interviews were compared. This helped to achieve a better understanding of the different perspectives. Thirdly, the remaining interviews were analysed, continuously improving the coding and, lastly, the analysis was brought together in a conclusive summary. The findings were then peer reviewed and critiqued by a focus group made up of researchers, some of the original interviewees and other retail experts to further explore the results and improve their interpretation.

THE SOUTH AFRICAN RETAIL ENVIRONMENT

In order to place the barrier of "limited access to financing opportunities" in perspective, a literature review of the economic environment of South Africa, the South African retail industry, and limited access to financing opportunities for SMMEs in the South African retail industry was undertaken.

Previous studies have described the South African economic environment as "harsh", since:

- More than 60% of South Africans live in poverty;
- The cost of living in South Africa is high;
- In 2014 the number of unemployed South Africans was estimated at 13.77 million; and
- Crime in South Africa is regarded as amongst the worst in the world.

The Wholesale and Retail (W&R) sector is a significant component of the South African economy, contributing about one third to the national GDP. Approximately 75 000 retail companies are registered with the Wholesale and Retail Sector Training Authority (W&RSETA), but it is generally agreed that they represent only about two thirds of the total number of approximately 114 000 retailers.

The sector is increasingly moving towards urban mall-based retailing, and is characterised by intense competition for market share and the cyclical volatility of retail sector sales. Retail sales are expected to expand slowly but steadily, driven mainly by the emergence of a black middle class.

Since the early 1990s the direct influence that limited access to financing opportunities has on the sustainability of South Africa's SMMEs has been highlighted in many research studies. However, "limited access to financing opportunities" can be widely interpreted, and these studies have not articulated what this barrier actually means.

FINDINGS AND DISCUSSION

The finance providers identified a lack of financial knowledge and competence in marketing and brand building as general hurdles to growth among small business retailers. The current economic situation was described as a specific obstacle hindering small retailers in South Africa, as evidenced by high interest rates, a weak rand and reluctant consumers. The unstable political situation in 2015 and 2016 did not help to build business confidence. Other barriers described by finance providers included theft, fraud and general ethics; deficiencies in infrastructure and public transportation; and the lack of reliable and fast access to mobile and internet communication. Access to finance was identified as a specific barrier by finance seekers, with one retailer quoted as saying:

> *"Listen, external finance, it's a massive problem I would say, because the interest rates that the banks charge are astronomical."*

The research demonstrated that small business owners were not fully aware of all financial instruments available to them. Finance managers believed that banks were still the most powerful providers of finance, and retailers themselves were ignorant of alternative funding opportunities through private companies outside the banking sector and government support agencies. Banking representatives, and even some retailers themselves, pointed out the poor financial knowledge of many business owners, who generally have inadequate financial training when they set up their businesses, and who incorrectly believe that it is better for them to show losses than profits in their financial statements. A finance provider was quoted as follows:

> *"I think one of the biggest obstacles is definitely that they have no clue about their numbers."*

Especially new businesses that lack a track record seem to struggle to access funding. Even though banks do need to do some kind of due diligence before they approve credit applications, legal requirements are not at the heart of the problem, but rather the requirements and standards set by the banks and other financial institutions. Typically banks ask for financial statements, tax clearance certificates, owners' CVs, personal credit records, positive track records, convincing business plans, cash-flow projections and underpinning securities. Specifically the latter makes it difficult for small businesses to access finance, as the following statement testifies:

"They wanted sureties and they wanted someone else to sign surety, which I would have to ask my father or something but he wouldn't do it. It's too much of a risk. So it's difficult. It's not easy to get money from the bank."

A significant hurdle for white retailers is the Black Economic Empowerment (BEE) requirement. The retailers agreed that they need a convincing BEE plan in order to increase their chances of a successful loan application, even though this was not mentioned by a single finance provider interviewed.

A lot of time is needed to prepare all the documents to apply for finance, and without the help of external advisors and accountants a small retailer will struggle to comply with the requirements. This also means that to access finance, small retailers need finance to pay their advisors.

Another problem is that banks' requirements are too standardised – everyone is treated the same no matter their personal background. Both finance providers and finance seekers agreed on this, as can be seen from these quotes:

"I'll be the first one to say, look, banks are not doing enough to help especially entrepreneurs from the townships." – Finance provider

"I think they use certain standard requirements for each and every individual, whether you are a big or small business." – Finance seeker

Interestingly, finance experts identified two reasons inherent to typical small business owners that prevent them from meeting the requirements for funding: Many of them seem reluctant to take risks, so they are unwilling to provide securities even if they could, and many are not on top of their financial figures, which makes them dependent on expensive external help in applying for finance.

In the opinion of interviewees from the banking sector, the application process itself is lean and results can be provided in a short period of time, but interviewees from the small retail sector saw this differently, often criticising the time banks needed to give a final decision on credit applications.

The finance providers stressed the importance of government agencies such as the Small Enterprise Financing Agency (SEFA), the Small Enterprise Development Agency (SEDA) and the Industrial Development Corporation (IDC), but government agencies seem to take a long time to react, and delays in the approval or rejection of a loan application can have far-reaching consequences. There was also much criticism regarding their efficiency. In addition, among white retailers there was a perception that one had to be of a certain racial group in order to qualify for finance. This was not based on own experiences but rather on expectations.

From the finance providers and experts' perspective, it was important to build a relationship with small business owners. Because they see the retail segment as a target market for future growth, they would like not only to offer loans to those clients, but also to have them move over all their commercial business. This gives them an important incentive for investing in small retailers in terms of training and mentoring.

Electronic data processing and automation of loan applications in recent years has obviated the need for human interaction, which has led to less personal relationships between financial institutions and retail clients. From the perspective of most retailers, a good relationship with banks is essential, and some believe that banks should be more proactive.

PROPOSALS FOR IMPROVED ACCESS TO FINANCE

The interviewed finance providers and finance seekers provided plenty of ideas on how access to finance could be made easier for small retailers.

One recommendation was that the application process and methods used to prequalify retailers should be done more holistically, giving due recognition to the business owner's personality and capabilities.

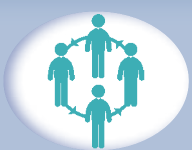
Another was that banks should find ways to better understand clients' needs and be more flexible on loan conditions.

Banks could also mentor small retailers more intensely during the period needed to pay back loans.

Commonly managed funds could be a way of sharing risk by being supported by government, and government should look for new ways to support small retail businesses.

Another suggestion was that small retailers should establish stronger bonds among themselves, in the form of partnerships or industry co-operatives.

Some interviewees saw small retailers' financial knowledge and ability as one of the most decisive hurdles to growth. The finance and retail experts saw the need to train and educate small business owners, not only in financial matters, but also in general business knowledge. Retailers tended to agree: Some small retail business owners identified room for improvement in the area of their own financial education.



Quite a few experts stressed the importance of establishing a business angel network in South Africa. This is especially important when considering that new small retail businesses, compared to established players, have limited opportunities to access finance because of not having track records. Finally, the view was expressed that successful South African business leaders should be more strongly engaged in mentoring programmes and government efforts to help small retailers.

A final area of improvement concerns the marketing of available funding. One finance provider was quoted as follows:
"From my view, I think as financial institutions, we need to inform more. We need to advertise more about what is available. Let's eliminate the level of discomfort."

LIMITATIONS OF THE STUDY

Firstly, the majority of interviewees were based in the Western Cape. Secondly, retailing is a very broad industry that can be divided into numerous subcategories. A study as broad as this one can never claim to explain "the retail industry" as such. Thirdly, most finance managers interviewed occupied high-level positions within their organisations. Lastly, not all retailers interviewed were actually in need of finance, and it could be argued that small businesses in need of finance have different characteristics and views on the accessibility of finance than companies that don't need finance.

CONCLUSION

Although access to finance may not be the only growth obstacle for small retailers in South Africa, it is surely a serious one. Access to financing opportunities for SMME retailers is limited, even from the perspective of bank and finance managers. Some of the major reasons are inherent to small retailers, others have to be attributed to financial institutions and government support agencies.

Overall, the findings shed some interesting light on the accessibility to finance. Indications are that if financial institutions and government agencies merely make money more easily available, this may not necessarily result in growth. The managers of South Africa's small retailers often lack the financial knowledge to make the right business decisions. Because these business entities do not have proper paper trails, they are regarded as risky by many financial institutions.

In order to overcome the challenges that small retailers face when trying to access available financing opportunities, it seems that various measures should be implemented in a common effort by all relevant stakeholders. These measures include new approaches to pre-qualify retailers during the application process, improved financial education for retailers, and the establishment of mentoring programmes and strong business angel networks in South Africa.

RECOMMENDATIONS

With the insights from the different perspectives of finance providers and finance seekers gained by this study, there should be enough information to develop a suitable questionnaire that could be used in a quantitative study, representative of a specific retail segment within South Africa. This questionnaire could then be used in different segments to compare the individual needs within the industry. Considering a quantitative analysis, based on this exploratory study, we offer the following propositions for further research:

Small retailers' ability to access funding opportunities depends on:

- **their general financial abilities;**
- **their abilities to build and maintain relationships with financiers and suppliers;**
- **their attitude towards growth and**
- **the efficiency of programmes initiated by government agencies.**

THE W&R SECTOR

W&R is the fourth largest contributor to GDP and the 30 000 tax-registered retail enterprises employ about 20% of the total economically active workforce according to Stats SA.

About 86% of registered enterprises in this sector are small and micro enterprises, 9.5% medium size and 4.5% large companies. Only 66% of operational retail traders are formally registered and contributing to the fiscus, suggesting there are over 100 000 informal (unregistered) traders in the sector accounting for 10% of national retail turnover.

The main employment increase has been in the informal /SMME sub-sector.

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THE WRLC

The Wholesale and Retail Leadership Chair (WRLC) at the Cape Peninsula University of Technology (CPUT) was established in 2013, based on an initiative by the Wholesale & Retail Sector Education and Training Authority (W&RSETA) to contribute towards sector research and professional qualifications development at Higher Education levels.

A national survey report entitled Priority Research Needs of the South African Wholesale and Retail Sector marked the first step taken by the WRLC towards the creation of a basis for relevant research in this dynamic business sector.

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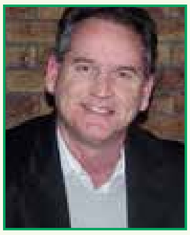

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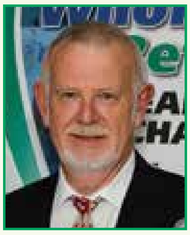

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The full report is available at http://wrlc.org.za/research-2-2/completed-research/

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