

Rules and Rands: Credit Legislation and Developmental Credit to Micro and  
Small Enterprises in South Africa.

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by

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## **ABSTRACT**

The role played by Micro and Small Enterprises in many economies globally is huge and important. It is even more significant for economies in Africa such as South Africa where there are high levels of poverty and unemployment. In South Africa, Micro and Small Enterprises can contribute towards addressing the challenge of poverty and unemployment, given their proven history of job creation. However, their contribution is constrained by the lack of access to credit for growth, which is a result of a deficit of credit information among other contributing factors. This inhibits their growth.

In South Africa, developmental credit was introduced through the National Credit Act 34 of 2005 to improve access to credit for low-income earners, including Micro and Small Enterprises. This type of credit is different from other types of credit because it bypasses the challenge of credit information, allowing the credit application of Micro and Small Enterprises to be assessed without the use of credit information (credit history). However, since the introduction of the Act, there has been little uptake and granting of developmental credit. This dissertation aimed to determine the reasons for this.

This dissertation uses a qualitative research approach. Interviews were conducted with Micro and Small Enterprises and questionnaires administered with developmental Credit Providers, and the National Credit Regulator. Therefore, qualitative information from the above credit market stakeholders was analysed to get to the findings.

The findings of this research are three-fold. In respect of credit providers, findings show that, despite the legislative provisions, there is still the use of credit information by large financial institutions, which adversely affects access to developmental credit. Findings for Micro and Small Enterprises reveal that there is a lack of knowledge of this type of credit. This is affected by the fact that Micro and Small Enterprises perceive credit as being difficult to access because of the use of credit information, which they lack, and therefore do not explore various types of credit available and suitable for their businesses. Furthermore, there are only a few credit providers, which provide developmental credit in the country; this affects their footprint in the country and different provinces. Lastly, the findings on legislation are that the requirements to register as a developmental credit provider limit the number of credit providers, which can register to provide developmental credit.

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## LIST OF ACRONYMS

DTI	Department of Trade and Industry
NCA	National Credit Act
NCR	National Credit Regulator
SARB	South African Reserve Bank
SARS	South African Revenue Services
SEDA	Small Enterprise Development Agency
SEFA	Small Enterprise Finance Agency
SME	Small and Medium Enterprises
SSA	Sub-Saharan Africa

**Key words:** micro and small enterprises, developmental credit, South Africa

## **CHAPTER 1: INTRODUCTION**

### **1.1 Introduction**

The role played by Small and Medium Enterprises (SMEs) in all economies across the world cannot be denied. Similar to large enterprises, SMEs contribute to Gross Domestic Product (GDP), job creation, and Government revenue through taxes (Abor, Agbloyor, & Kuipo, 2014; Abor, 2011). However, in the context of developing and least developed countries, their most important role is their contribution to employment, innovation, and product or service diversification (Abor, 2011). In countries such as South Africa and many other African countries where poverty and unemployment are very high, the role played by SMEs becomes critically important.

There are more than 274.2 million SMEs globally (SME Finance Forum, 2019). In most countries, there are significantly more small and medium enterprises than large enterprises. According to the SME Finance Forum (2019), 90% of enterprises globally are SMEs and they are concentrated in East Asia and the Pacific, South Asia, and Sub-Saharan African regions respectively. They are the backbone of the global economy and individual economies, contributing 50% of GDP, and two-thirds of jobs globally (SME Finance Forum, 2019).

There is a similar significance of SMEs in African countries. Abor and Quartey (2010) noted that SMEs contribute approximately 70% and 57% to Gross Domestic product; as well as account for 91% and 61% to employment to the economies of Ghana and South Africa respectively. The contribution of SMEs is even more prominent in other African countries such as Kenya, where up to 85% of the labour force is employed within the SME sector (Amsi, Ngare, Imo, & Gachie, 2017).

Although SMEs contribute greatly to the economy, they are faced with several challenges. Greater participation of SMEs in the economy is often constrained by challenges such as limited access to finance, lack of management and financial management skills, and regulatory burden (Abor, 2011). Several studies have been done to determine the challenges faced by SMEs globally and they have had similar findings. Research by the Organisation for Economic Co-operation and Development (OECD) in 1997 found that the greatest challenges facing SMEs globally were financing because of high interest rates and the lack of collateral and regulatory burden resulting from an inability to deal effectively with issues arising from regulations

(OECD, 1997). More than two decades on, a series of other studies also found that limited access to credit because of high interest rates and collateral requirements and the regulatory burden remain the greatest challenges for SMEs (Chikalipah, 2018; Mamman, Bawole, Agbebi, & Alhassan, 2018; Quartey, Turkson, Abor, & Iddrisu, 2017).

Key to the challenges of micro and small enterprises is access to finance in the form of credit, which limits their growth and contribution to employment and the economy. Some of the critical factors that contribute to the lack of access to credit are collateral, as mentioned above, and credit information. South African SMEs in South Africa are not any different from SMEs globally, they are characterised by being credit constrained due to the lack of credit history making credit providers reluctant to provide them with credit (Quartey et al., 2017). This information deficit is a result of SMEs not being granted credit or getting credit often, and therefore, having no credit history from which their credit applications could be assessed. To provide credit, credit providers assess the consumer's ability and willingness to repay a loan using income information as well as credit information (credit history).

In attempting to improve access to credit for low-income earners, including micro and small businesses it is acknowledged that there is a significant information deficit for this segment of the economy. Hence for decades, there have been attempts to develop and implement schemes that would improve access to credit for micro and small enterprises (Bastelaer, 2000). These schemes have been based on targeted development policies aimed at adding SME growth through access to credit.

However, Yifei (2015) stated, "Government has yet to make effective fostering policy for the development of small and micro-enterprise and establish special policy-related financial institutions offering small and micro-enterprise financing service and financial support, so, the government fails to create a favourable external market environment and social service system for small and micro enterprises". In line with this view, Oladele, Amos, and Emmanuel (2014), recommend that the government should develop strategies and policies to force the private financial institutions to create an environment conducive to micro and small enterprises to access credit by creating flexibility in interest rates and qualifying criteria. Strategies by the government that encourage banks and other credit institutions to provide credit to low-income

segments of the population, including small businesses, should be made law. Otherwise, they would not be implemented or enforceable.

There is evidence of policy-based schemes to improve micro and small enterprise access to credit. These include the United States Community Reinvestment Act of 1977 became law to resolve the failure of credit institutions to provide credit to low and medium-income communities, consumers, as well as small and minority-owned businesses (Rupasingha & Wang, 2017). In Africa, Nigeria's Small and Medium Industries and Equity Investment Scheme (SMIEIS) served a similar purpose. The scheme was developed and implemented to improve access to credit to small and medium enterprises and to minimise the cost of credit to small and medium enterprises (Central Bank of Nigeria, 2005).

In South Africa, an approach similar to that of the United States was adopted. In 2005, South Africa passed the National Credit Act [NCA], (Act 34 of 2005). Broadly, the Act aimed to address challenges in the credit market. One of the main challenges that the Act aimed to address was the lack of access to credit and the high cost of credit to low-income earners. The development of this legislation followed findings that there was an imbalance in the credit market, in particular the granting of credit to low-income consumers including Small, Micro, and Medium Enterprises (SMMEs) relative to middle and high-income consumers including large companies (Parliament of the Republic of South Africa, 1995, Department of Trade and Industry [DTI], 2004).

The Act sets out provisions for ensuring that credit is accessible to all consumers. There is consistent treatment of consumers by credit providers, protection of consumers from reckless borrowing, and discouraging credit providers from reckless lending. One of the provisions that the Act introduced to facilitate access to credit was the formalisation of credit bureaus for the keeping, reporting, and sharing of credit information (NCA, No. 34 of 2005). Credit information is critical for the challenges that the Act aimed to address. Credit information is necessary for credit providers to assess the creditworthiness of the credit applicant fairly, therefore, allowing access to those that can afford credit and discouraging those that cannot afford it from becoming over-indebted.

While the Act introduced formalisation of the credit bureaus, SME credit information remained limited because few SMEs have had access to credit and therefore credit information remained limited. According to Smith, Pretorius, Kotecha, Menzies, and Erwin (2017, pg.44), "South Africa has good consumer credit record data but that is not the case for SMME credit record data". The NCA, therefore, provides an alternative method for assessing credit applications that are classified as developmental credit, which is not based on credit information. Developmental credit provisions allow for the affordability assessment that is unique to each credit application, where credit applications can be assessed without using credit information, instead of using available information for each micro and small enterprise. This mitigates the challenge of information asymmetry, therefore, making it easier for micro and small businesses to access credit.

While South Africa's approach to improving access to credit was similar to that of the United States in that it was legislated, and targeted at micro and small enterprises, South Africa's legislation went beyond, it addressed the broader challenges in the credit market as well as created targeted provisions not only addressing access to credit. In attempting to improve access to credit, the Act dealt with the main source of the lack of credit namely, namely, credit information. To address the lack of credit information, which results in limited credit for micro and small enterprises, the Act introduced developmental credit. Section 10 of the Act sets out the type of credit and conditions to improve access to private credit to low-income earners, namely the developmental credit provision. Developmental credit is defined as credit for education, buying or renovating low-cost housing, and starting a business. For this research, the focus will be on the developmental credit granted for the development of a small business.

## **1.2 Background**

As background, this section provides an overview of micro and small enterprises globally by region, sources of finance, and a summary of the state of access to credit. The purpose is to contextualise the type of enterprise that is studied in this research. To bring context to South Africa's legislative measures targeted at micro and small enterprises, policy or legislative measures in different countries are briefly discussed. The section also discusses in detail the provision of the NCA that aims to facilitate access to credit to micro and small enterprises, namely developmental credit as per section 10 of the Act.

### **1.2.1 Definition of Micro and Small Enterprises**

Micro and Small enterprises have characteristics that distinguish them from larger enterprises. To distinguish them, they are defined by both economic definitions and statistical definitions. The economic definition reveals how they are managed, resourced, and the challenges they face. Stokes and Wilson (2010) cite the Bolton Report as the foundation of the economic definition; however, they refer to it as a qualitative definition. They state that small enterprises are mainly characterised by the management of the company by its owners, and their small market share. Also, Abor (2011) and Yifei (2015) characterise micro and small enterprises as labour intensive, having difficulties accessing finance, and lacking technology. Abor (2011), also states that they are innovative.

The qualitative definitions of micro and small enterprises reveal that they have several challenges. To assist in resolving those challenges, policymakers would need to understand exactly which enterprises should be targeted for interventions or to provide assistance, given their contribution to employment and economic growth. For example, the United Kingdom following the outcomes of the Committee of Inquiry on Small Firms, which are in the Bolton Report, developed several policy interventions to support enterprises, which the report identified as small and medium enterprises. According to Blackburn (2002), the number of policy interventions and financial support to small enterprises in the United Kingdom increased from 13 before 1971 to 33 and 103 by 1981 and 1989 respectively.

Similarly, in South Africa after the 1995 White Paper on the National Strategy for the Development and Promotion of Small Business identified some challenges faced by small and medium enterprises, among which was the lack of access to finance (Parliament of the Republic of South Africa, 1995), the country developed interventions to support small and medium enterprises. Included in the interventions was the establishment of government entities that would provide financial support to small and medium enterprises, namely the Khula Enterprise Finance Agency and South African Micro-Finance Apex Fund (Parliament of the Republic of South Africa, 1995).

For such interventions to reach the targeted enterprises, a statistical definition is used. There are common indicators used globally in the definition, namely; the number of employees, turnover, revenue, and the value of assets. The statistical definition in most countries comprises

three of the four indicators, and therefore; there are some differences between countries. For example, South Africa and China define enterprises using the number of employees, total assets, and revenue, according to Liu (2008), while countries in the European Union use turnover and the value of the balance sheet, according to the European Commission (2019). In addition to the differences in indicators in different countries, the measure also often varies. According to Berisha and Pula (2015), the measure of the definition of micro, small, and medium enterprises is not universal; it is rather dependant on the country and even varies within a country, is the definition is dependent on the institution that is defining it or. For example, a micro-enterprise in Brazil, Japan, and Kenya has up to nine employees, up to 19 employees in the United States, while in Botswana and Eswatini it would have up to four employees and three employees respectively (SME Finance Forum, 2019).

Furthermore, some differences exist between sectors in a country. China and South Africa are two of the countries where the differences in sectors are most evident. In China, small enterprises are defined as enterprises with a number of employees up to 20 in the wholesale sector, 50 in retail, 100 in accommodation, restaurant, information, software, tenancy, and up to 300 employees in the property management sector (SME Finance Forum, 2019). South Africa's differences within the sector are based on the definition by annual turnover and the value of assets. Enterprises are defined as small if they have an annual turnover of up to R3 million in the agriculture sector; R6 million in catering, accommodation, and other trade; R13 million in finance and business services; R19 million in the retail and motor trade and repair services; and R32 million in the wholesale trade, and commercial agents and allied services sectors (National Small Business Development Act, No 102 of 1996, No. 26 of 2003, No 29 of 2004). The definition of micro and small businesses is determined by the needs of each country or the sectors (Stokes & Wilson, 2010).

The number of employees is the most commonly used definition globally. Accordingly, for ensuring that to some extent there is a comparison of micro and small enterprises between countries, the indicator of the number of employees is used to draw comparisons globally.

#### **1.2.1.1 The Americas**

In the Americas, the definition of micro and small enterprises differs between countries. Shown in Table 1 are the definitions of micro and small enterprises in five countries in the Americas

region. Argentina uses a definition where the measure is different for each sector. In other countries such as Brazil, Canada, and the United States, while the definition differs between these countries, the measure of the definition is standard across sectors in each country. In the United States, micro-enterprises are defined as enterprises with less than 20 employees and small enterprises are those with 20 or more but less than 100 in all sectors.

**Table 1: Definition of Micro and Small Enterprises in the Americas**

Country	Micro Enterprises	Small Enterprises
Argentina	<5 Industry; <5 Trade; <4 Services	6-24 Industry; 6-23 Trade; 5-17 Services
Brazil	0-9	10-49
Canada	1-4	5-99
Mexico	0-10	11-50
United States	0-19	20-99

Source: SME Finance Forum (2019)

Micro and small enterprises comprise the largest number of enterprises in many countries. Beck (2013) notes that the number of SMEs globally shows that SMEs account for approximately 95% of businesses. As per the definitions above, the number of micro and small enterprises in the United States accounts for 99% of total enterprises. Other countries in the region have a similar share of enterprises. The number of micro and small enterprises in Brazil and Canada accounts for approximately 98% of enterprises (SME Finance Forum, 2019). This is in line with the global trends of enterprises.

Small and Microenterprises make a significant contribution to the economies in America. In Mexico, SMEs contribute 75% to total employment and 62% to Gross Domestic Product (GDP) while in Argentina and Brazil they contribute 70% and 60% to employment, as well as 54% and 34% to GDP respectively (Peñaloza, 2015).

**1.2.1.2 European Union**

In the European Union (EU), the definition of micro and small enterprises is the same across all member states and all sectors. However, the measure is below that of countries such as the United States and Canada, where the number of employees in a micro-enterprise can be up to

nine between 10 and 49 in a small enterprise. In addition to the number of employees, the EU defines enterprises by turnover and the balance sheet. Turnover and balance sheet of lower than 2 million euros and 10 million euros for micro and small enterprises respectively (European Commission, 2019).

The EU is one of the regions with the largest number of micro and small enterprises. According to Eurostat (n.d), micro and small enterprises account for 97% of business enterprises in the EU. Countries such as France, Spain, Italy, Belgium, and Greece have micro and small enterprises accounting for 98% of total businesses. Countries with the smallest share of micro and small enterprises have them accounting for 92% of total enterprises (Eurostat, n.d). This is still a significant share of enterprises. The contribution of small and medium enterprises in the EU is 67% of employment and 58% of GDP (Peñaloza, 2015).

**1.2.1.3 Asia**

Asian countries such as China and Korea have more diverse definitions of micro and small enterprises by sector, while Japan and Indonesia have more standard definitions that cut across all sectors. In China, more than any other country in the world, the definition varies by sector, each sector has a different definition. Looking at the definition by the number of employees as depicted in Table 2 below, each sector has a different maximum number of employees by which the sector can be classified as either micro or small enterprise. More interesting in the definition of small enterprises in China, is that the number of employees may be above 100 and up to 300 employees. Comparatively, a small enterprise in China in sectors such as property management, postal service, and transportation is significantly larger than a small enterprise or is classified as a medium or a large enterprise in other countries.

**Table 2: Definition of Micro and Small Enterprises in Asia**

Country	Micro Enterprises	Small Enterprises
China	<5 Wholesale; <10 Retail, Accommodation, Restaurant, Information, Software, Tenancy, Other; <20 Heavy Industry, Transportation, Warehouse,	5-20 Wholesale; 10-50 Retail; 20-100 Warehouse; 10-100 Accommodation, Restaurant, Software, Tenancy, Information, Other; 20-300 Heavy Industry,

	Postal; <100 Property management	Transportation, Postal; 100-300 Property management
Indonesia	1-4	5-19
Japan	1-9	10-49
Korea, Republic	< 10 in Manufacturing, Mining, Construction, Transportation ; < 5 in other	<50 in Manufacturing, Mining, Construction, Transportation ; < 10 in other sectors
Russian Federation	<16	16-100

Source: SME Finance Forum (2019)

#### 1.2.1.4 Africa

In Africa, the measure of the definition slightly differs from that of other countries, mainly the developed countries. The numbers of employees, which determine the size of the enterprise, are lower than countries in other regions. As shown in Table 3, a microenterprise in most African countries can have up to 10 employees, there are countries whose numbers are even lower. In South Africa, micro-enterprises are enterprises that have up to five employees. The definitions in Ghana, Kenya, Mali, Namibia, and Nigeria are higher by the number of employees, with up to nine or 10 employees defining a micro-enterprise. Furthermore, Mozambique is a unique and interesting case in Africa; the country does not have micro-enterprises, small enterprises have between one and nine employees. In Eswatini a micro-enterprise can have up to three employees, while Botswana, Lesotho, and Malawi can have up to four employees. Small enterprises are those with employees up to 20, 30, or 50, except for Lesotho and Eswatini whose definition of small enterprises comprises a smaller number of employees with up to nine and 10 respectively.

**Table 3: Definition of Micro and Small Enterprises in Africa**

Country	Micro Enterprises	Small Enterprises
Angola	1-9	10-19
Botswana	1-4	5-29
Cameroon	<6	6-20
Eswatini	0-3	4-10
Ghana	1-9	10-30
Kenya	1-9	10-40
Lesotho	1-4	5-9
Malawi	1-4	5-20
Mali	<10	10-50
Mozambique	-	1-9
Namibia	1-10	11-30
Nigeria	1-9	10-49
South Africa	<5	6-50

Source: SME Finance Forum (2019)

### 1.2.1.5 South Africa

Similar to other African countries, South Africa's definition comprises annual turnover, the value of assets, and contribution to the economy through employment, as indicators. The National Small Business Development Act No 102 of 1996 defines small businesses as "a separate and distinct business entity, including co-operative enterprises and non-governmental organisations, managed by one owner or more". Furthermore, it is an entity that fits the definition as per the number of employees, and the value of assets, as well as prescribed turnover. The Act categories small enterprises into three groups; namely micro, very small, and small. Table 4 below provides a summary of micro, very small, and small enterprises according to the number of employees and annual turnover.

**Table 4: South Africa's Definition of Micro and Small Enterprises**

Size of class / Sector	Agriculture	Mining and Quarrying	Manufacturing	Electricity, Gas and Water	Construction	Retail and Motor Trade and Repair Services	Wholesale Trade, Commercial Agents and Allied Services	Catering, Accommodation and other Trade	Transport, Storage and communications	Finance and Business Services	Community, Social and Personal Services
<b>The total full-time equivalent of paid employees</b>											
Small	50	50	50	50	50	50	50	50	50	50	50
Very Small	10	20	20	20	20	20	20	20	20	20	20
Micro	5	5	5	5	5	5	5	5	5	5	5
<b>Total turnover</b>											
Small	R3m	R10m	R13m	R13m	R6m	R19m	R32m	R6m	R13m	R13m	R6m
Very Small	R0.50m	R4m	R5m	R5.10m	R3m	R4m	R6m	R5.10m	R3m	R3m	R1m
Micro	R0.20m	R0.20m	R0.20m	R0.20m	R0.20m	R0.20m	R0.20m	R0.20m	R0.20m	R0.20m	R0.20m
<b>Total gross asset value (fixed property excluded)</b>											
Small	R3m	R6m	R5m	R5m	R1m	R3m	R5m	R1m	R3m	R3m	R3m
Very Small	R0.50m	R2m	R2m	R1.90m	R0.50m	R0.60m	R0.60m	R1.90m	R0.60m	R0.50m	R0.60m
Micro	R0.10m	R0.10m	R0.10m	R0.10m	R0.10m	R0.10m	R0.10m	R0.10m	R0.10m	R0.10m	R0.10m

Source: National Small Business Development Act (No. 29 of 2003)

The definition of enterprises, as shown in Table 4 above is prescribed in the National Small Business Development Act, No. 29 of 2003 and it differs for each sector in terms of annual turnover and the value of assets. Micro enterprises are those enterprises that have a turnover of up to R200 000 per year across all sectors. Very small enterprises are those enterprises whose turnover ranges between R200 000 and R6 million. There are vast differences in the size of the turnover, depending on the sector. A very small enterprise in the agricultural sector turnover is

up to R500 000, while in other sectors the turnover of a very small enterprise would be between R1 million and R6 million. For example, a very small enterprise in the wholesale sector; the catering and accommodation sector; and electricity, water, and gas sector would have a turnover of up to R6 million and R5,1 million respectively. Similarly, a small enterprise in the agricultural sector is an enterprise with an annual turnover of up to R3 million, while small enterprises in other sectors would be an enterprise with up to R32 million in turnover. An enterprise in the wholesale trade can have up to R32 million in turnover and still be defined as a small enterprise, in retail and motor trade (R19 million), manufacturing (R13 million), and mining and quarrying (R10 million).

In line with international trends, micro and small enterprises in South Africa account for the largest share of all enterprises. The OECD (2018), reported that there were approximately 2.25 million SMEs in South Africa in 2015, and of that number 1.5 million were informal SMEs (not registered). This means approximately 750 000 registered SMEs.

SARS (2019) further reported that there were approximately 802 000 registered enterprises in the country in 2017. As shown in Table 5 below, 97% of registered businesses were small businesses, including micro, very small, and small enterprises. Looking closely to the enterprise annual turnover of enterprises, SARS reported data shows that 81% were micro-enterprises, 13.4% very small, and 2.5% small enterprises. While medium and large accounted for 2.1% and 0.4% of total enterprises respectively (SARS, 2019).

**Table 5: Businesses in South Africa by Income in 2017**

Category	Income Classification	Businesses
Micro	R1 - R1 000 000	81.5%
Very Small	R1 000 000 - R5 000 000	13.4%
Small	R5 000 000 - R10 000 000	2.5%
Medium	R10 000 000 - R50 000 000	2.1%
Large	R50 000 000 - R200 000 001 +	0.4%

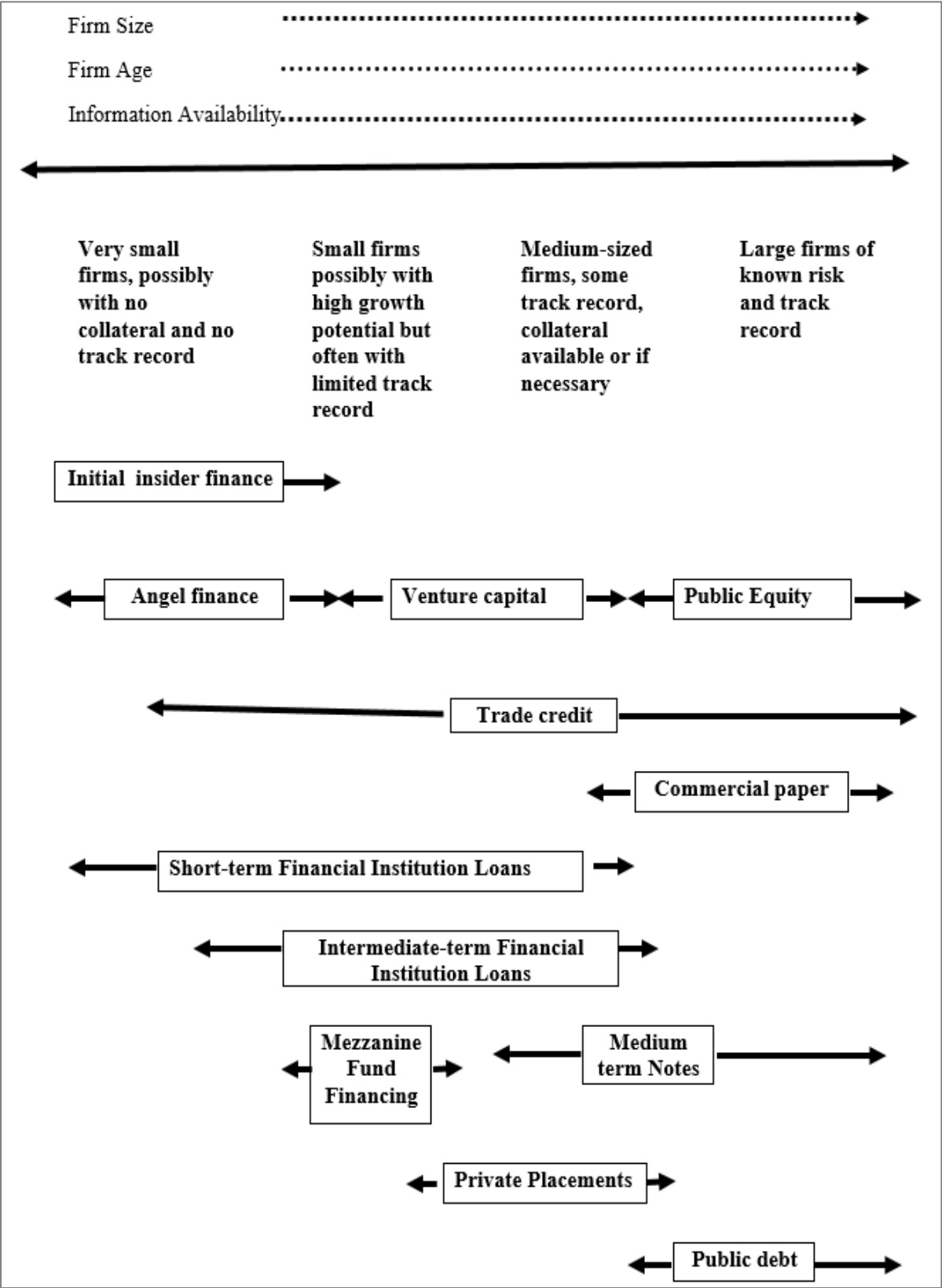
Source: South African Revenue Services (2019)

### **1.2.2 Sources of Finance**

The limited access to finance for micro and small enterprises, particularly bank credit is due to the size and age of the enterprises, and the availability of credit information. This is better explained by Berger & Udell (1998) in the firm continuum and sources of finance. They depict and explain which options of finance are available to firms at different stages. The continuum in Figure 1 explains that as companies grow in size so does their track record; credit particularly credit information available and its assets, which can be used as collateral. Because the availability of these improves with size, micro-enterprises have less access to debt forms of credit. Instead, they have access to equity-type financing which is initial insider finance, which is the start-up capital, provided by the owner as well as angel finance.

According to Abor (2011), angel finance is provided by wealthy individuals to entrepreneurs as equity in small enterprises which have a potential of growth intending to sell their stake in the businesses for a profit when the businesses have grown. Small enterprises also have access to trade credit, venture capital for funding to expansion of enterprises, and to some extent short-term bank loans. The number of sources of finance available increases to medium-term loans, public equity, and public debt among others for medium and large enterprises.

**Figure 1: Firm Continuum and Sources of Finance**



Source: Berger & Udell (1998)

Furthermore, Abor (2011) noted that banking institutions have very few strategies that are targeted at lending to micro and small enterprises. Their strategies are focused on larger enterprises. This is evident in the small number of small enterprises with access to bank finance globally presented in Table 6. According to the World Bank (2020a), only 33% of small enterprises surveyed globally have a bank loan. This is even worse in Sub-Saharan Africa and the Middle East and North Africa, where only 21% and 23% have bank loans respectively. While medium and large enterprises have more access to finance according to the survey, 42% of medium and 51% of large enterprises have a bank loan. The outcomes of the surveys indicate that bank credit is more accessible to medium and large enterprises because, for medium and large enterprises, fewer loan applications are rejected, therefore, more enterprises use bank finance to finance investments, and fewer medium and large enterprises than small enterprises identify access to finance as a major constraint (World Bank, 2020a).

**Table 6: Access to Bank Finance Globally by Region**

Region	Size of Enterprise	Percentage of firms with a bank loan/line of credit	Proportion of loans requiring collateral (%)	Percentage of firms not needing a loan	Percentage of firms whose recent loan application was rejected	Percentage of firms using banks to finance investments	Proportion of investment financed internally (%)	Proportion of investment financed by banks (%)	Percentage of firms identifying access to finance as a major constraint
Sub-Saharan Africa	Small	16.5	84.7	36.8	20	16.1	77.5	7.9	41.0
	Medium	27.6	85.5	41.2	15	22.3	72.7	11.3	34.8
	Large	40.2	83.6	48.1	5.3	28.5	72.8	15.2	28.2
Latin America & Caribbean	Small	41.5	69.3	46.3	4	36	64	21	28.2
	Medium	56.9	74	44	3.9	40	59.4	25.8	24.8
	Large	68.8	72.6	45.9	2.2	43.8	59.6	28.7	18.2
Europe & Central Asia	Small	32.6	68.8	59.5	12.3	24.9	76	13.3	16.3
	Medium	46.7	77.1	55.3	5.6	27.7	74.2	14.6	17.4
	Large	53.3	80.4	51.7	2.9	34.5	73.5	17	15.7
Middle East & North Africa	Small	22.5	76.6	54.6	17.9	23.2	74.6	11.5	25.6
	Medium	33.7	83.1	50.6	8.9	23.7	72.3	13.3	24.3
	Large	38.9	73.1	57.7	1.7	30.8	70.4	18.3	23.1
East Asia & Pacific	Small	26.8	81.3	52.6	12.6	20.5	73.4	12.5	14.1
	Medium	44.4	84.9	43.9	1.4	28.5	72.6	15.9	14.1
	Large	49.8	85.6	40	2	28.9	72.7	15.8	9.5

Source: World Bank (2020)

Yifei (2015) says, in addition to internal challenges that limit micro and small enterprises from accessing credit and financial system rules that limit lending to micro and small enterprises, the government has not developed policies to limit the impact of these challenges. This prompts the government to develop strategies through policies to improve access to credit for micro and small enterprises beyond the finance provided by government institutions.

### **1.2.3 Policy/ Legislated Credit Interventions**

#### **1.2.3.1 Nigeria**

In 2001, Nigeria implemented a policy through the Small and Medium Industries and Equity Investment Scheme (SMIEIS) (Central Bank of Nigeria, 2005). The scheme was developed to improve access to credit for small and medium enterprises and to minimise the cost of credit to small and medium enterprises. The SMIEIS followed several government-funded interventions to support small businesses in Nigeria, however, the interventions were unsustainable because of limited government funding (Woodstock Institute, 2004). To ensure a sustainable flow of financial resources to support small businesses, the Government developed a policy and scheme to access private financial resources.

To support small and medium enterprises, all banks in Nigeria are required by the Small and Medium Enterprises Equity Investment Scheme require to 10% of their annual after-tax profit to finance these enterprises (Central Bank of Nigeria, 2020). According to the bank, financing can be in a form of equity or loan offers. Akinlo, Goldman, Ogechukwu, Akinlo, and Goldman (2015), note that the funding for the scheme was earmarked for projects that contribute to stimulating economic growth, job creation, and technology advancement. Furthermore, the interest charged under this scheme is limited to a single-digit interest rate (less than 10%). This addresses the high cost of bank credit to small and medium enterprises. Before the scheme, the interest rates were between 23% and 26% (Akinlo et al., 2015).

While this is a scheme rather than legislation, it is voluntary. There are stringent conditions and consequences for non-compliance. Since the start of the scheme in 2001 and 2003, only 21% of the reserved funds had been taken up (Woodstock Institute, 2004). Furthermore, the finance had not reached all the intended beneficiaries. The Woodstock Institute in 2004 reported that small and medium enterprises in urban areas benefited from the scheme, while those in rural

areas remained unfunded. Therefore, fines were imposed on the banks that failed to comply with the attached conditions (Akinlo et al., 2015)

### **1.2.3.2 United States**

The United States developed legislation to address the lack of access to credit to certain communities. The Community Reinvestment Act of 1977 became law to resolve the failure of credit institutions to provide credit to low and medium-income communities, consumers, as well as small and minority-owned businesses (Rupasingha & Wang, 2017). This Act followed the realisation that credit institutions, while they were taking deposits from low incomes consumers, were not providing credit to these consumers (Rupasingha & Wang, 2017).

The Community Reinvestment Act requires financial institutions including national banks, savings associations, and state-chartered commercial and savings banks to provide credit to low and medium-income communities in the form of mortgages, small business credit, and consumer loans (Bull, 2017). These loans should be for the development of communities. According to the Act, community development is defined as activities that promote the provision of affordable housing; community services for low- or moderate-income individuals; financing businesses or farms; and the revitalisation or stabilisation of low and medium-income communities determined by rates of poverty, unemployment, and population loss; or population size, density, and dispersion (Federal Financial Institutions Examination Council, n.d.).

To ensure compliance, the credit institutions are required to report to the financial sector regulatory institutions, on an annual basis, on the loans they have given to low and medium-income communities, low-income consumers, and small businesses. The reporting of information forces compliance because, according to Macey and Miller (1993), the information that is reported is considered when the credit institutions apply to the credit regulators, which are; the Office of the Comptroller of the Currency (OCC); the Board of Governors of the Federal Reserve System; and the Federal Deposit Insurance Corporation (FDIC), for other services such as merger approval and expansion of their business to other geographies within the United States. This forces credit institutions to support low-income communities and small businesses because should they do not provide sufficient support, as would be reflected in their reports, opportunities to expand their business may be hindered.

### **1.2.3.3 South Africa**

Access to credit remains one of the important issues for creating an inclusive economy in South Africa. In the past, policies promoted inequalities in participation in economic activities including getting credit among the different racial and income groups. In 2005, the country passed into law the NCA 34 of 2005, which aimed to correct imbalances in the credit market. Before that, the Credit Agreements Act (No. 75 of 1980) and the Usury Act (No 73 of 1968) mainly regulated the credit market. This piece of legislation was developed to address some market distortions or imbalances in the credit market between low-income and high-income earners, as well as between small enterprises and larger enterprises. Factors that contributed to the imbalances included a lack of collateral and racial bias. Among the challenges it aimed to resolve were: the limited access to credit and the high cost of credit for the low-income earners, and the racial bias and subjective nature of credit information at the time (DTI, 2004). The development of this legislation followed a review of the credit market, which revealed that there were imbalances in the credit market and that those imbalances were limiting access to credit to certain groups of people.

The imbalances mainly disadvantaged low-income earners and small enterprises. At the time, the credit information that was used to assess credit history limited access to credit where mainly black people would have an adverse listing (DTI, 2004). As a result, the review found that there was limited access to credit for low-income consumers. In particular, 67% of the population received less than 6% of the total credit granted and the cost of credit was as high as 175% of the credit granted to low-income earners. In terms of small businesses, only 22% of small, micro, and medium enterprises received credit, and bank financing accounted for merely 7% of the total credit of small, micro, and medium enterprises (DTI, 2004). Therefore, the Act aimed to create a credit market that would grant equal access to credit for all South Africans and all businesses.

To resolve these challenges, the Act set out provisions that ensure credit would be accessible to all, there would be a consistent treatment of consumers by credit providers, there would be sufficient protection of consumers against reckless borrowing, there would be measures to deter credit providers from reckless lending, and credit information regulated (DTI, 2004). Firstly, to ensure consistent treatment of consumers, the Act introduced processes for assessing credit applications that credit providers are required to follow which include considering the

consumer's credit history, their current financial situation, and their financial obligations as well as prospects, and the risks of providing the credit, as well as the rights and obligations of a consumer. Secondly, the Act introduced maximum interest rates that should be charged for the different types of credit to manage the cost of credit. Thirdly, it introduced the formalisation of the credit bureaux. Credit bureaux are required to safe keep, report, and share credit information when it is needed for purposes of assessing credit applications. It further outlined how credit information should be recorded to ensure that it is not subjective (NCA No 34 of 2005).

In addition to the previously recognised forms of credit, the Act introduced developmental credit, which aims to address the challenge of limited access to credit for low-income earners and small businesses due to the lack of credit information. In attempting to ease access to credit for low-income earners and micro and small businesses it is acknowledged that there was a significant information deficit for this segment of the economy. Therefore, it made provisions for a form of credit that would allow credit providers to grant credit without having to assess credit history, namely developmental credit. Section 10 of the Act, sets out types of developmental credit, to whom, how, and by whom developmental credit should be granted.

#### **1.2.4 Developmental Credit Provision**

Access to credit is critically important for anyone to develop through education or by starting a business. However, in the past low-income consumers and SMEs were disadvantaged because of limited credit information. Credit products for starting a business, education, and other purposes for low-income consumers were limited (DTI, 2004). Developmental credit aims to fill this gap.

##### **1.2.4.1 Definition of Developmental Credit**

The purpose of developmental credit is to open access to segments of the population that have limited access. Evident in the definition, is to target those groups, individuals, and communities, which have been previously disadvantaged in accessing credit. According to section 10 (1) (b) (i), (ii), and (iii) (aa), (bb), and (cc) of the Act, developmental credit is credit granted to an individual or an enterprise to pay for education, for the buying, renovating, building and expanding a low-cost housing, or the development of a small business. The Credit

Law Review identified these consumers as being credit constrained mainly because of the lack of credit information and lack of collateral.

#### **1.2.4.2 Providers of Development Credit**

As previously stated, the Act also requires all credit providers, credit bureaus, and debt counsellors to register with the NCR. In addition to the normal registration for all credit providers to provide developmental credit, there is an additional registration requirement for credit providers to register to become developmental credit providers. Similar to the normal credit provider registration, the developmental credit provider registration is done through the NCR. The application for registration is approved when a credit provider meets the requirement for internal resource capacity and has sound administrative processes to assess applications. According to the Act, the NCR grants a registration certificate to credit providers that have "sufficient human, financial and operational resources to enable it to function sufficiently and carry out its functions in terms of the Act, or present a credible plan to acquire or develop those resources". Furthermore, the credit provider should have "adequate administrative procedures and safeguards to justify the application of statutory exception from this Act, or present a credible plan to develop such". Because of the unique manner in which developmental credit applications are assessed, developmental credit providers must develop administrative processes to perform such assessments. Those require financial and human resources.

#### **1.2.4.3 Developmental Credit Assessment**

Credit information is critical for ease of getting credit. The World Bank in its assessment of the Ease of Getting Credit in different countries notes that credit information is a critical element. In this regard, it uses the index of the depth of credit information. This index considers the existence of credit bureaus, information coverage, and access to that information by credit providers (World Bank, 2020b). The World Bank concludes, that the more credit bureaus there are, the greater the coverage; and, the more accessible credit information is, the easier it is to access credit. Credit providers can assess creditworthiness and therefore become more open to granting credit.

In development credit applications, credit history is not a requirement for the assessment of the applications. The Act allows for the assessment for this type of credit to be unique to each

credit application, where credit applications can be assessed using available information for each individual or micro and small enterprise. While the legislation introduced formalisation of credit bureaus to ensure safekeeping, reporting, and sharing of credit information, micro, and small enterprise credit, information was and remained limited because few micro and small enterprises could access credit. At the time when the Act became law, merely 22% of small, micro, and medium enterprises had received credit (DTI, 2004), meaning that the majority of enterprises had no credit and therefore no credit history/information. This emphasises the need for developmental credit.

#### **1.2.4.4 Cost of credit**

The interest rate represents the cost of the credit granted (a loan). One of the other problems identified in the credit market was the high cost of credit. The NCA introduced maximum interest rates that could be charged for each type of credit. These are detailed in the regulations to the Act. The cost of credit as stipulated in the NCA Regulations is shown in the table below. While developmental credit allows for bypassing the problem of lack of credit information, it does not resolve the problem of a relatively higher cost of credit. The population groups to which developmental credit is granted continue to be perceived as having high risk, therefore, credit providers would grant credit at a higher interest rate to compensate for the risk. This is not unique to South Africa, Peñaloza (2015) while researching the determinants of access to credit for SMEs in Latin America found that interest rates on loans to small and medium enterprises tend to be very high. He notes that in countries in Latin America, they are double the interest rates of other types of loans because the risk associated with smaller enterprises remains, despite measures to improve access to credit. That risk is transferred to a higher interest rate charged to the small enterprise.

Developmental credit to small businesses is charged at a maximum rate of repo rate (RR) plus 27% of the amount of credit. This interest rate is higher than that of other types of credit even higher than unsecured credit, and the maximum initiation fees that can be charged are also relatively higher for developmental credit.

**Table 7: Cost of Credit in South Africa**

Credit Type	Maximum Interest Rates	Maximum Initiation Fees
Mortgage Agreements	RR + 12% per annum	R1100 per agreement and 10% of the amount in access of R10 000 but should not exceed R5 250
Credit Facilities	RR + 14% per annum	R165 per agreement and 10% of the amount in access of R1000 but should not exceed R1 050
Unsecured Credit Transactions	RR + 21% per annum	R165 per agreement and 10% of the amount in access of R1000 but should not exceed R1 050
<b>Developmental Credit</b>		
Small Business	RR + 27% per annum	R275 per agreement and 10% of the amount in access of R1 000 but should not exceed R2 600
Low Income Housing	RR + 27% per annum	R550 per agreement and 10% of the amount in access of R1 000 but should not exceed R2 600
Short-Term Transactions	5% per month on the first loan and 3% on a subsequent loan in the same year	R165 per agreement and 10% of the amount in access of R1000 but should not exceed R1 050
Other Credit	RR + 17% per annum	R165 per agreement and 10% of the amount in access of R1000 but should not exceed R1 050
Incidental Credit	2% per annum	Nil

Source: Department of Trade and Industry (2015)

### 1.2.5 Advantages and Disadvantages of Developmental Credit

While developmental credit is beneficial for development, there are several advantages and disadvantages for both credit providers and consumers, in this case, the micro and small enterprises.

### **1.2.5.1 Advantages and disadvantages: Consumer (micro and small enterprise)**

Developmental credit is an alternative to the traditional models of assessing credit, which leads to SMMEs not being able to get credit. The exclusion of credit information from the assessment, or as part of the assessment criteria, is beneficial to micro and small enterprises because it allows them access even without such information, therefore removing one hindrance to accessing credit.

Notwithstanding the ease of access developmental, credit affords micro and small enterprises by excluding credit information, it fails to address the issue of the relatively high cost of credit. The cost of acquiring developmental credit is higher than other forms of credit, both the administration costs and the interest rates (DTI, 2015). This still reinforces the perceived high risk associated with low-income consumers including the micro and small enterprises because information asymmetries still exist. The higher cost of credit could deter micro and small enterprises from getting credit because they are already credit-constrained may not want credit at a high cost.

On the other hand, the interest rate charged on developmental credit is relatively higher than other types of credit, but it is significantly less than what micro and small enterprises had been charged before the existence of this Act. The credit law review of 2003 revealed that microloans were among excessively priced types of credit, with interest rates as high as 360% per annum (DTI, 2004). The excessive interest rate followed the exemption of microloans from interest rate caps provided under the Usury Act, therefore, rendering credit providers free to charge whatever interest they may want (Campbell, 2007). The exemption was meant to address limited granting of credit to low-income groups including micro and small enterprises who could not access credit because credit providers were not willing to lend to micro and small enterprises according to the prescribed interest rate caps under the Usury Act (Schraten, 2019). Prior to that exemption, credit providers had no incentive for providing credit to micro and small enterprises because the returns were too small to recover the costs of providing a small amount of credit (Bamu, Schuckman, & Godfrey, 2005; Schraten, 2019). As a result, if interest rates were lower, the supply of credit would be limited, consequently limiting access to credit.

### **1.2.5.2 Advantages and disadvantages: Credit Provider**

Contrary to the cost of credit possibly being a disadvantage for micro and small enterprises, for credit providers, it is an advantage. According to Varghese, Walker, Roche, and Rodman (2008), because of information asymmetries in business information held by credit bureaus, banks use interest rates as well as credit rationing to maximise profits and minimise losses. Bamu et al., (2005, pg.46) stated that “the primary reason for allowing developmental credit providers to recover the maximum possible interest is to facilitate full cost recovery in light of the higher risks involved and the unconventional methodologies that they may use....”. Furthermore, the NCR (2009) suggests that the higher interest rate is incentive for credit providers to provide credit to micro and small enterprises. Bamu et al., (2005), are also of the view that a higher interest rate encourages developmental credit lending.

Additional requirements on credit providers, such as additional registration and providing proof of resources and alternative assessment criteria for developmental credit, are necessary to protect the micro and small enterprises. They possibly create an administrative and financial burden for the credit provider. In their study of whether the NCA, particularly whether the developmental credit provisions will increase access to credit for small and micro enterprises Bamu et al., (2005), reported that, during the development stages of the implementation of the Act, credit providers noted that the additional requirements could be costly, therefore negatively affect the sustainability of developmental credit lending.

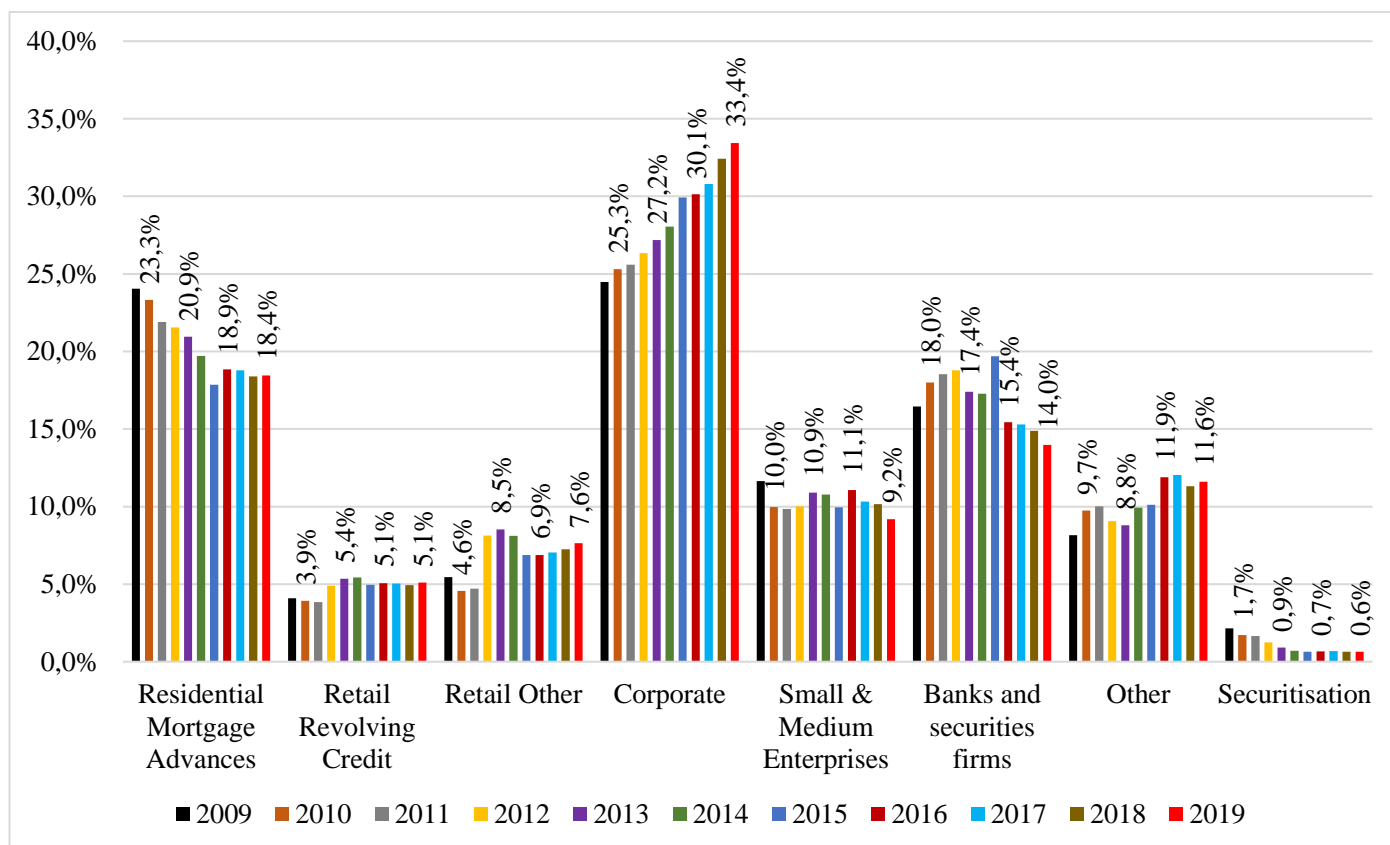
### **1.3 Problem Statement**

There are more than 7 800-registered credit providers in South Africa (National Credit Regulator [NCR], personal communication, July 02, 2020). Most of the credit providers are non-bank credit providers. However, in 2019, banks accounted for 82% of the credit granted in South Africa (NCR, personal communication, July 02, 2020). Bank credit data from the South African Reserve Bank (SARB) is the most reliable credit data, which shows the recipient of credit. It is the only source where it is possible to get an indication of the extent of credit advanced to small and medium enterprises.

Figure 2 below depicts South Africa’s bank credit data between 2009 and 2019. This data shows that small and medium enterprises have received around 10% of total credit over the past decade. In March 2019, only 9% of credit granted in South Africa was to small and micro-enterprises, while large enterprises received 33% (SARB, personal communication, May 27,

2019). It is evident from the data that, while there has been an increase in credit to larger enterprises (corporates) from over 25% in 2010 to 33% in 2019, credit to small and medium enterprises has remained relatively stagnant around 10%. Furthermore, there has been a decline of the share of credit in the two years from 10.2% in 2018 to 9.2% in 2019 (SARB, personal communication, May 27, 2019).

**Figure 2: Bank Asset Breakdown (2009 – 2019)**



Source: (South African Reserve Bank, personal Communication, May 27, 2019)

In South Africa, a large number of small enterprises cite access to finance as a constraint compared to medium and larger enterprises. The World Bank access to finance indicators shows that approximately 77.4% of small enterprises rely on internal finance, compared to 64% and 65.8% of medium and large enterprises respectively (World Bank, 2007). Furthermore, approximately 21% of smaller enterprises cited access to finance as a major constraint while 13% and 5% of medium and large enterprises respectively cited access to finance as a major constraint in South Africa (World Bank, 2007). This provides evidence of the need for finance by small and medium enterprises.

Governments play a critical role in the credit market by ensuring fair access to credit for all. Beck, Demirgüç-Kunt, and Pería (2008) noted that approximately 86% of developed countries and 71% of developing countries have programmes that support SMEs' access to finance. In South Africa, the government has several initiatives that aim to facilitate access to credit through public entities such as the Small Development Finance Agency (SEFA). SEFA provides developmental credit to micro and small enterprises (Small Development Finance Agency, 2019). However, it is widely known that government entities tend to have limited financial resources required to fulfil the demand.

To supplement the finance provided through its entities, the South African government enacted a legislative provision that would facilitate access to micro and small enterprises credit from the private sector. The NCA 34 of 2005 that came into effect in June 2007 introduced provisions for Developmental Credit. Developmental credit is a form of credit, which is ideally more accessible for low-income consumers including micro and small enterprises. The key to Developmental Credit, and how it is accessible particularly for micro and small enterprises, is that it eliminates the requirement for the credit information/ credit history of the applicant in the assessment of a credit application. Credit information is one of the factors that hinder access to credit for micro and small enterprises globally, and particularly in South Africa.

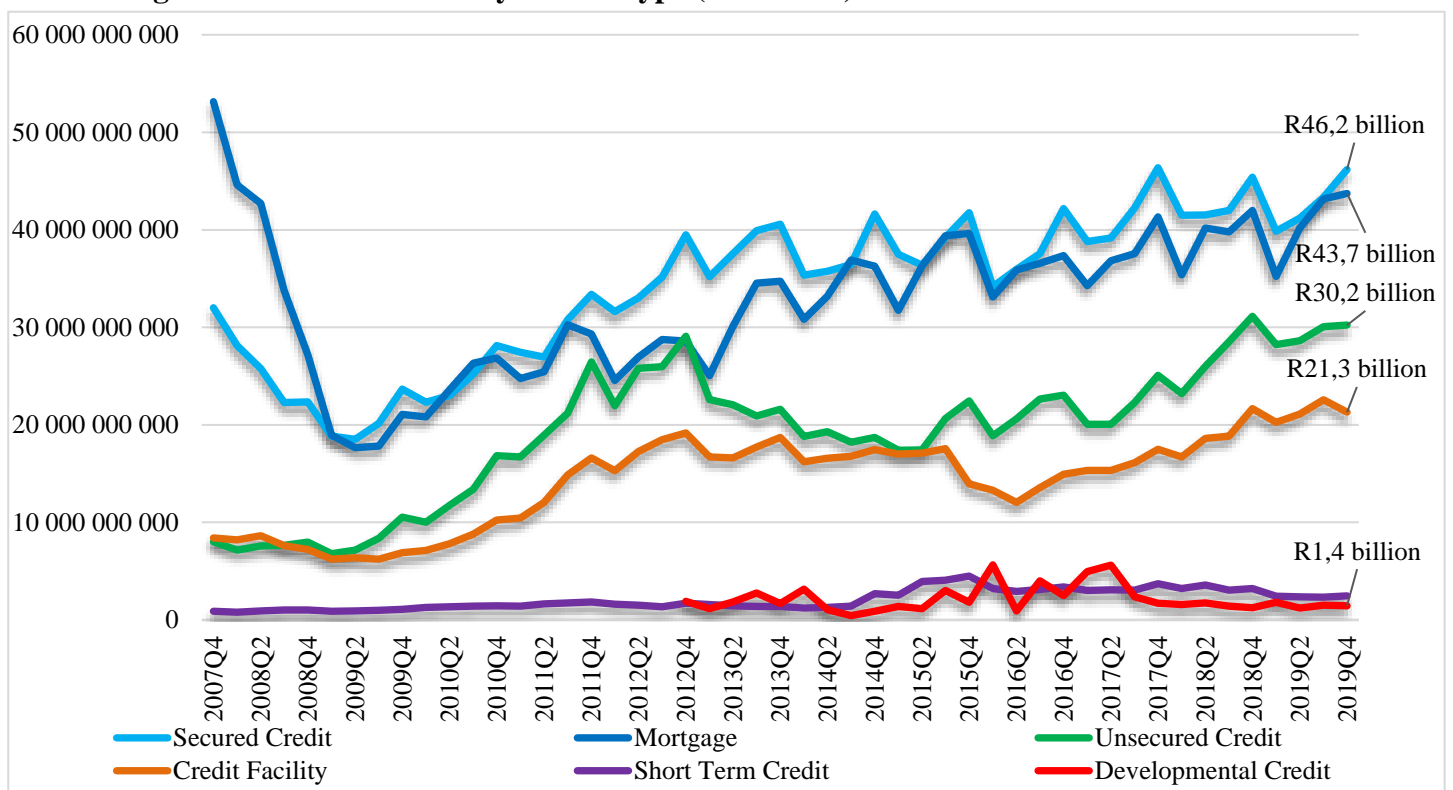
For all other types of credit, the assessment of credit applications requires the credit provider to consider the consumer's credit history, their current financial situation, obligations and prospects, as well as the risks of providing the credit, and the rights and obligations of a consumer (NCA, No 34 of 2005). Payment history is an indicator of future payment patterns. However, Quartey et al., (2017), noted that SMEs in South Africa and globally are characterised by being credit constrained due to the lack of credit history making credit providers wary of providing credit. Smith et al. (2017, pg. 44), stated "South Africa has good consumer credit record data but that is not the case for SMME credit record data". Furthermore, the International Finance Corporation (2018, pg. 88) also stated that there is "inadequate coverage of business credit information sharing".

It has been established that there is a need for credit by small and micro enterprises and that there is a supply of developmental credit in the form of the registered developmental credit

providers. Furthermore, the impediment of credit information in assessing applications can be bypassed. However, the uptake of developmental credit had been very slow to date. While the data for other forms of credit is available from the fourth quarter of 2007, the uptake of developmental credit was only registered five years later, in the fourth quarter of 2012 (NCR, 2020). In addition, it has been relatively smaller than other forms of credit, developmental credit averaged 1.8% of total credit between 2013 and 2019.

The NCA differentiates between six forms of credit, namely, secured credit, unsecured, mortgage, credit facility, short term, and developmental credit. At the end of the fourth quarter of 2019, approximately R145.4 billion in credit was granted. The data reported by the NCR (2020) shows that secured credit accounts for the largest share of credit granted at approximately 32% of total credit granted. It is followed by mortgages, unsecured, credit facilities, which account for 30%, 21%, and 15% of total credit respectively. Short-term and developmental credit are the smallest forms of credit, with a 2% and 1% share of total credit respectively. The figure below shows credit granted by a form of credit since the NCA came into force.

**Figure 3: Credit Granted by Credit Type (2007-2019)**



Source: National Credit Regulator (2020)

While the Act came into force in June 2007, developmental credit-granting only started late in 2012. It was significantly lower than other forms of credit. As shown in Figure 3 above, in 2013, developmental credit granted was 1.6% of total credit. Over the past eight years, developmental credit remained significantly smaller than other forms of credit. Additionally, developmental credit has not grown like other forms of credit despite the need for credit by micro and small enterprises. In 2019, developmental credit was merely 1.1% of the total credit granted (NCR, 2020).

Looking closely at this developmental credit data, this type of credit is divided into three groups by type of the consumer, namely juristic persons, individuals, or groups. The bulk of developmental credit, 99% is a credit to individuals, the remaining 1% to juristic persons, while credit to groups is almost non-existent. This suggests that developmental credit is given for other purposes such as education, for the buying, renovation, building, and expansion of low-cost housing rather than to juristic persons for the development of a small business. Of the R1.4 billion development credit granted in 2019, merely R12.3 million was granted to start a business. This is concerning because developmental credit for small businesses is significantly less than small business funding needs. According to Smith et al., (2017), approximately R40.9 billion in funding was required by SMMEs in South Africa in 2017.

While in the same year the SARB reported bank credit to small and medium enterprises to be approximately R618 million, which is 10.3% of total credit. By 2019, while the amount of credit advanced to small and medium enterprises had decreased to R612 million and in 2019 approximately 9% of credit granted by banks is to small and medium enterprises which are R612,6 million (SARB, personal Communication, May 27, 2019). Micro and small enterprises' need for credit is evidently greater than the credit provided. It is important to gain an understanding of why this type of credit is not granted or taken up, despite it aiming the address the biggest challenge to accessing credit, namely, credit information.

#### **1.4 Research Objectives and Questions**

The levels of developmental credit are significantly low. They are even lower for micro and small enterprises despite the legislative framework that aims to facilitate access to credit through developmental credit provisions. To understand why granting of this type of credit remains relatively low and the extent to which the legislation has been effective in addressing information asymmetry, this research has the following objectives and research questions;

- (i) **Research Objective 1:** To determine what challenges are encountered by credit providers in granting developmental credit to micro and small enterprises in South Africa.

*Research Question 1:* What are the reasons for the low levels of developmental credit provided to micro and small enterprises?

- (ii) **Research Objective 2:** To determine what challenges have been encountered by micro and small enterprises in accessing developmental credit in South Africa.

*Research Question 2:* What are the reasons for the low levels of uptake of developmental credit by micro and small enterprises?

- (iii) **Research Objective3:** To determine the impact of credit information on granting developmental credit in South Africa.

*Research Question 3:* What is the role of credit information in access to developmental credit to micro and small enterprises?

## 1.5 Justification for the Research Study

In the context of South Africa that has experienced low levels of economic growth and high levels of unemployment, the contributions made by micro and small enterprises to job creating and growth are important. However, in South Africa, a large share of SMEs fail within the first two years of inception, mainly due to financial pressures (Small Enterprise Development Agency, 2019). It is important, therefore, to ensure that measures that aim to improve access to finance for SMEs are effective, including the developmental credit provisions in the NCA.

There is a need for credit by SMEs. However, this is fulfilled through other forms of credit, which are more difficult to access for micro and small enterprises. The Banking Association of South Africa (2018) reported that just 26% of credit by the banking sector is granted to SMEs. This amount is even lower for micro and small enterprises. Micro and small businesses tend to access less credit than medium and large enterprises. This has not improved much in almost a decade. The World Bank Business Survey in 2007 found that only 23% of small enterprises in South Africa had bank credit. The low number of SMEs with access to bank credit is also evident in the low uptake of Developmental Credit. Recent lending data from the NCR show that developmental credit accounts for only 1% of total credit in South Africa and that this amount has not grown significantly since 2013 (NCR, 2020).

The low uptake of developmental credit since the legislation came into force in 2007 is concerning. Furthermore, no research studies on the impact of developmental credit on access by small and micro enterprises to credit nor the reasons for the low uptake of this type of credit have been found. This is important because 97% of businesses in South Africa are micro or small (South African Revenue Service [SARS], 2019). This study intends to determine the reasons for the low level of the granting of developmental credit and the challenges experienced by micro and small businesses in accessing this type of credit. Findings will assist in informing future policy developments targeted at improving access by micro and small enterprises to credit. In addition, information gathered from this research would shed light on the challenges faced by micro and small enterprises in accessing development credit. This would possibly assist credit providers to unblock the bottlenecks to developmental credit access.

This research study will be of interest to policymakers, in particular, the government and the lawmakers. It will also be useful for the credit regulator and other relevant credit market stakeholders that are involved in facilitating access to credit. The outcome of the research will assist policymakers to have a better understanding of whether the provisions of the Act do facilitate access to credit to SMEs and to what extent are they are effective. Where the legislation has failed to facilitate access, policy and lawmakers may consider strengthening the legislation to address the challenges that will be outlined in the outcomes of the research.

## **1.6 Organisation of the Paper**

The research study is divided into five chapters. This chapter (Chapter 1) introduces the study and provides a background on micro and small enterprises globally and in South Africa, in particular, on small enterprise access to bank credit, policy legislative measures that seek to promote small enterprise access to credit. Chapter 2 presents a review of existing literature on small enterprise access to finance. Chapter 3 outlines the methodology that was used to undertake this research. Chapter 4 provides a discussion of the findings. Chapter 5, presents the recommendations and areas for future research.

## CHAPTER 2: LITERATURE REVIEW

### 2.1 Introduction

This Chapter explores the literature available globally, and in America, Europe, Africa, and South Africa. The literature focuses on three important areas, namely, the theory of information asymmetry and access to credit, as well as empirical evidence on Access to Credit and SME growth and Credit Information Sharing and Access to Credit. The literature covers information asymmetry as it relates to access to credit because the type of credit that is being researched in this paper is based on the foundation of lack of credit information for micro and small enterprises in South Africa.

### 2.2 Theory of Information Asymmetry and Access to Credit

The theoretical foundation of this study rests in the theory of information asymmetry, which leads to moral hazard and adverse selection, leading to credit rationing. Information asymmetry arises when there are two parties involved in a transaction, however, one of the parties does not have the same or complete information needed for a decision on a particular transaction. In a perfect market with no information asymmetries, the interest rate would represent the price/cost of the credit granted (loan) and would determine how much credit is supplied and demanded. However, in markets where there is imperfect information, credit rationing would result. Jaffee and Stiglitz (1990), differentiate between four types of credit rationing. These are defined in Table 8 below:

**Table 8: Types of Credit Rationing**

Type	Definition
Interest rate (or price) rationing.	The credit granted is less than the loan required (applied for) at a particular interest rate. Additional credit would be granted at a higher interest rate.
Divergent views rationing	The interest rate, which the consumer thinks it is appropriate for them to pay for credit is different from that what is quoted by the credit provider. At a higher interest rate, the consumer believes the credit is more costly than it should be.
Redlining	A credit provider rejects a loan application at a certain risk level when the required rate of return is not achieved.

Pure credit rationing.	One consumer's credit application is rejected while another's is accepted. The two consumers are identical in that the loan terms are the same. This arises when there is imperfect information.
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Source: Jaffee and Stiglitz (1990)

The theoretic foundations of credit rationing are explained by Jaffee and Russell (1976) as a phenomenon where credit providers set interest rates then proceed to consider other factors beyond the interest rate in their decision of credit available and where there is information asymmetry limit credit made available because the interest rate alone is not an effective determinant of the cost of credit. Economic theory suggests that in perfect markets interest rates are the cost of credit and should determine how much credit is demanded and supplied. However, the theory of credit rationing alludes to the fact that this is not always the case, interest rates fail to play this role. In a study of credit rationing in the context of loan market equilibrium, Stiglitz and Weiss (1981) note that credit rationing is an outcome of the ineffective interest rate on its own to determine supply and demand for credit.

In the case of Small and Medium Enterprises and credit providers, the credit provider may have little information on the SME's ability and willingness to pay back the loaned amount and are therefore unable to determine whether to grant the credit or what amount of credit that should be granted. The credit provider cannot differentiate between an SME that is willing and will be able to repay the loan and one which is not. On the other hand, an SME knows its adverse credit history, where it got into a credit agreement and defaulted on payment making credit providers less willing to lend or lending at very high-interest rates in future or to other SMEs to compensate for the risk (Rao, 2003).

When there is little or no information less credit tends to be granted. Empirical support for this view can be found in Duffee (2009) and Yifei (2015) who find that, when credit providers do not have information on borrowers, they often resort to granting less credit. Moro, Fink, and Maresch (2015), support this view, in a study of the relationship between information asymmetry and access to short-term credit to SMEs. The study found that even a small reduction in information symmetry leads to a significant increase in credit granted to SMEs. Jappelli and Pagano (2000) explain the role and importance of credit information sharing through credit registries and recommend a central registry for keeping credit information that

can be used and shared by credit providers. Further, they note that sharing credit information is "drawing credit simultaneously from many banks without any of them realizing". This means that a prospective credit provider would benefit from the information and access to such information does not affect or cost the previous credit provider.

## **2.3 Empirical Review of Credit Information Sharing and Access to Credit**

### **2.3.1 Global**

It has been widely established that access to credit is important for small business growth along with other factors. Given its importance, it is studied extensively globally. In surveying the existing literature on bank financing for SMEs Beck (2013, pg.11) states that "regulatory policies can be important in moving the Banking system towards the frontier of SME lending, equally they may prevent the Banking system from moving to the frontier". The study concluded that access to finance by SMEs is influenced by the collateral requirement, as well as methods used to assess creditworthiness. This is corroborated by Nana (2014) in the findings of a study of 134 countries globally of the effects of legal systems and information sharing on private credit. Using credit information sharing data, these countries found that, in countries where there is greater information sharing, private credit as a share of Gross Domestic Product is greater than in countries where there is less credit information sharing. More recently, Kusi and Ansah-Adu (2015) also concur that information sharing improves access to credit. Before these studies, other studies that showed similar findings include Beck and Demirgu, (2006); Djankov, McLiesh, and Shleifer, (2007).

### **2.3.2 Europe**

Blumberg and Letterie (2008) undertook a research study to identify conditions that should be satisfied for the bank to approve credit applications in the Netherlands. The research focused on a sample of 1 140 individuals who were considering starting a small business over two years between 1998 and 1998. Approximately 30% of those individuals had applied for credit over that period to start a business. They found that small firms had rich information that could be used to assess their creditworthiness, however, that information was not freely available to credit providers. They found that for small firms information asymmetries worsened because credit providers do not have an incentive to collect such information since the loans required by such firms tend to be smaller. Secondly, incurring the cost of gathering information on each of the small firms that apply for credit against the return on credit required does not make

business sense for credit providers. Additionally, they found that small firms know their chances of approval of their credit applications based on the information they have available. As a result when those chances are low then they refrain from applying for credit.

The findings of Behr and Sonnekalb (2012) on the effect of information sharing between lenders on access to credit slightly differ from other findings. They studied the impact of credit information on the cost of credit, access to credit, and loan performance. Their findings were that improvement in credit information sharing through credit registries does not improve access to credit. Additionally, they found that the availability of credit information does not affect the cost of credit, however, does improve loan performance. In their study of the loan market in Albania pre and post the introduction of a credit bureau it is suggested that access to credit did not improve because the assessment methods of credit applications by credit providers did not improve, consequently access to credit did not improve. On the other hand, the introduction of credit registries made consumers want to have positive credit information, and as a result, refraining from defaulting, therefore, improving loan performance.

Dierkes, Erner, Langer, and Norden (2013) examined the impact of business information sharing on the default risk of private firms in Germany. They used a panel dataset from the credit bureau. They found firm credit information sharing to be important; in particular that credit information sharing made default rates more predictable. Meaning that they observed credit providers were able to assess the creditworthiness of the firms and could identify in advance firms that would likely default payments. They further found that firms that have more credit information were less likely to default, because the building up of that credit information is a result of efficient credit allocation.

### **2.3.3 Africa**

Triki, Gajigo, Kayizzi-mugerwa, and John (2012) investigated the impact of Credit Bureaus and Registries and access to finance in Africa. Using a sample of 17 240 firms of all sizes from 42 African countries, including South Africa, over a period of 4 years, the Enterprise Survey data used shows that credit registries are an important factor of access to credit. However, findings show that firms in countries that have private credit bureaus have more access than those in countries that have public credit bureaus. They suggest that this is because private

credit bureaus report on both positive and negative credit information, making it easier for credit providers to assess creditworthiness, therefore, making it easier for firms to access credit.

Boateng and Abdulrahman (2013) have another perspective on credit information and SME access to credit. Investigating determinants of SME access to bank credit in Ghana and Nigeria, they found that firm size, age, ownership, and the relationship with the bank determine access to credit. They link credit information with the relationship of the SME with the bank where the relationship is measured by the number of times the SME makes cash deposits. Therefore, they argue that those visits to make deposits are a source of credit information that a bank can use to assess a credit application and reduce information asymmetry. Boateng and Abdulrahma (2013) state ".....relationship banking is one of the important means to reduce the information gap between lender and small business and consequently facilitate bank credit".

## **2.4 Empirical Review of Access to Credit and SME growth**

### **2.4.1 Global**

Small and Medium Enterprises' growth has been widely studied globally, in particular factors that inhibit growth. However, the majority of studies on SMEs focus on specific countries and regions. A few studies investigate SMEs at a cross-country or cross-regional level. Those that research across regional boundaries focus on developing countries. Nichter and Goldmark (2009) assessed factors that determine small firm growth in developing countries, using the existing literature as a methodology. They categorised factors that determine firm growth in developing countries as being the firm owner, characteristics of the firm, firm relationships, and contextual factors. They found that the age and formality of the firm as well as access to credit are key firm characteristics that determine small business growth. The literature further emphasised that smaller firms have difficulty assessing credit than bigger firms and perceive this as one of the inhibiting factors to their growth.

More recent studies by Wang (2016) and Ayyagari, Juarros, Peria, and Singh (2016) had produced similar findings. Both these studies used data from the World Bank Enterprise Survey to determine obstacles to the growth of SMEs and access to finance and job growth in developing countries respectively. Wang (2016) identified the biggest obstacles to the growth of SMEs in 119 developing countries. Countries from Sub-Saharan African were prominently featured with 34% of the countries being from the region. Her findings pointed to the size, the

number of years in existence (age), and ownership of the SME as being the key determinants of growth. Furthermore, she linked access to finance to the type of ownership of SME. She argued that small firms that are publically owned have more access to finance than those that are privately owned. Therefore access to finance is a determinant of growth for privately owned SMEs.

Ayyagari et al., (2016) examined the impact of access to finance on job growth in 70 developing countries, 26% of which were African countries. Job growth can is often used as a proxy for firm growth (Ahiawodzi & Adade, 2012; Fowowe, 2017). Their research is comprised of both small and large firms. In respect of small firms, they found that access to finance has a positive impact on job growth. Further, they found that the impact of access to finance on growth is significantly greater for smaller firms than in larger firms, and that small firms have less access to finance than larger firms in developing countries.

#### **2.4.2 The Americas**

Studying the impact of access to credit on business growth and development in the United States, Meisenzahl (2016) found that businesses that face challenges in accessing credit register 3.5% lower levels of employment growth compared to those that are not. Employment was also used as a proxy for growth. These were findings of the research analysis conducted from data of 3 561 and 4 240 companies which were surveyed in 1998 and 2003 respectively in the United States.

Rupasingha and Wang (2017) investigated the impact of capital in the form of loans on small business growth in the United States. In their research, Rupasingha and Wang used panel data from 3 050 counties in the United States for a period of 14 years between 1996 and 2014 to regress the impact of CRA loans on SME growth. In the study, there is differentiation by the size of the loans. Loans up to \$100 000 are considered small, those between \$100 000 and \$250 000 are medium and between \$250 000 and \$100, 000 are large. Based on this classification of the size of the loan, findings showed that a 1% increase in the small loan amount granted would result in a 7.35% growth in small business while the same increase in a medium loan would increase growth of a small enterprise by 13% (Rupasingha & Wang, 2017).

Rupasingha and Wang's research is important for this research as it focuses on a type of credit that is legislated as with this study on developmental credit. Similarly, their study investigated access to capital in the form of business loans, which are legislated by the Community Reinvestment Act of 1977 (CRA). The CRA was enacted to facilitate and encourage banks and savings associations to lend to low-income earners and communities (Office of the Controller of Currency, 2014) as means of addressing the challenge of limited access to credit for small businesses.

### **2.4.3 Africa**

Studies in Africa of access to credit and firm growth, have similar findings to those from the rest of the world. In a study of access to finance and the performance of firms in 30 African countries, Fowowe (2017), found that lack of access to finance has a significantly negative impact on the growth of firms, in particular employment. Fowowe (2017), studies 10 888 firms using two approaches, a subjective and an objective approach. The subjective approach used responses from a survey to determine how firms have ranked access to finance as a factor that inhibits business growth. While the objective approach used a regression analysis to determine the effect of access to finance on firm growth. Using firm employment as a proxy for growth, the study found that the lack of or limited access to credit adversely affected firm growth in all firms in the observed countries (Fowowe 2017).

Similarly, a study that was done seven years before on factors that inhibit SME growth in Sub-Saharan Africa (SSA) found similar results (Fjose, Grunfelt, & Green, 2010). The study also used an objective approach to that of Fowowe (2017). Fjose, et al. (2010), used the World Bank Ease of Doing Business Index data and the World Enterprise Survey to identify constraints to SME growth in SSA. Findings pointed to regulations on labour, economic growth, access to finance, and access to electricity, as factors that inhibit small business growth. In addition to limiting small business growth, Fjose et al., (2010), notes that these factors also discourage entrepreneurs from starting businesses. These factors determine the ease of doing business in particular countries. Furthermore, they provide evidence that in countries where it is easier to do business, the number of small businesses is significantly greater than in SSA, where it is more difficult to do business.

Ahiawodzi and Adade (2012) surveyed 78 SMEs operating in the Ho Municipality in the Volta Region in the manufacturing sector in Ghana. In addition to the survey, it used a statistical model to determine the impact of access to credit on SME growth. To determine this, employment growth was used as the proxy for firm growth (the dependent variable) and independent variables were access to credit, age of the firm, number of employees, total investment, total income, sales output, educational level, start-up capital, and turnover. Findings from both the survey and quantitative analysis showed that access to credit has a positive impact on SME growth (Ahiawodzi & Adade, 2012). Ahiawodzi and Adade (2012), therefore limited access to credit constrains growth. The survey results show that 58% of respondents stated that access to credit constrains their business growth while findings from the quantitative analysis show that increasing credit by 1 unit would result in SME growth of 10,5 units (Ahiawodzi & Adade, 2012).

In a study of microfinance credit variables' effect on SME performance in Kenya, Amsi et al., (2017) found that interest rates, collateral, and repayment period have an adverse impact on SME performance. In particular, interest rates contribute 36.3% to SME performance while collateral requirements and repayment period contributed 22.3% and 8.8% respectively. These are factors that inhibit access to finance.

#### **2.4.4 South Africa**

Olawale and Garwe (2010), investigated factors limiting SME growth in South Africa. In the study, a principal component analysis was used with data collected through questionnaires administered to SMEs. The study covers SMEs in East London, a city in the Eastern Cape Province in South Africa. They found that the top five challenges to SME growth were: lack of access to finance, lack of collateral, insufficient owner's equity contribution, crime, and insufficient government support. What is interesting in these findings is that three of the top five challenges related to the financing of SMEs, furthermore, the challenges of insufficient government support also to some extent relates to financing SMEs as government support in the country is mainly financial while there is also non-financial support. Furthermore, these findings are in line with the findings of other studies in African countries. Ahiawodzi and Adade (2012) investigated the impact of access to credit on SME growth in Ghana and Amsi et al., (2017) studied the effect of microfinance credit on SME financial performance in Kenya and had similar findings.

## **2.5 Conclusion**

The chapter explored the theory of information asymmetry as it relates to access to credit for small enterprises. It further explored evidence from different regions globally on the impact of information sharing on access to credit. Lastly, provided evidence from different regions on how access to credit can improve small enterprise growth, consequently contributing to economic growth and employment.

## **CHAPTER 3: METHODOLOGY**

### **3.1 Introduction**

This Chapter outlines the methodology used to conduct the research study. It is the method that the research followed to gather and process the information needed to answer the research questions introduced in Chapter 1. The chapter is divided into three subsections: the research approach, research design and research limitations. The first two sub-sections explain the process that the researcher followed to gather data, in particular, which sources were used and how the data was collected and analysed.

### **3.2 Research Approach**

The research was done through a qualitative inquiry. There are mainly two distinct types of research approaches that are used by researchers, namely the qualitative and quantitative research approaches. Qualitative research is said to be used on exploratory studies and tends to be more flexible in design while quantitative research tends to be more rigid in design and is based on statistical analysis (Adams, Khan, & Raeside, 2014). However, Creswell and Creswell (2018) note that in recent years there has been an increasing use of a combination of elements from both qualitative and quantitative approaches together and calls this a mixed research approach. The topic that is being researched is exploratory in nature and given limited prior research in this area, the choice was a qualitative method.

The lack of information and data in this area has informed the decision on the research method to be used. A qualitative research method was used. According to Corbin and Strauss (2015), reasons for using a qualitative method include limited prior research on a certain topic and the need for exploring experiences of different groups or individuals. Developmental credit is a relatively a new form of credit in South Africa. There is limited use of it hence limited data and limited prior research that has been done on it. These are some of the reasons motivating the use of the qualitative method in this study.

Furthermore, citing Peshin (1993), Leedy and Ormrod (2013) identified several purposes for which qualitative methods are useful including the "evaluation" purpose. They state that qualitative methods ".....provide means through which a researcher can judge the effectiveness of particular policies, practices, and innovations" (Leedy & Ormrod, 2013,

p.140). This emphasises the need for a qualitative method in a study of this nature as it aims to determine the impact or effectiveness of the credit legislation on developmental credit.

This research study uses the study of Beck et al., (2008) on Bank Financing for SMEs as a reference study. This study was qualitative in nature. Access to finance research studies found are mainly quantitative, however, they are based on survey data hence confirming the views of (Corbin & Strauss, 2015) that qualitative research is used to determine variables for quantitative research in the future. A significant portion of the literature on SMEs that is quantitative is based on survey data or data from interviews of the SMEs in the region or countries that are being investigated. The approach used is similar to that of previous studies that used survey or data from interviews to study SMEs (Ahiawodzi & Adade, 2012; Ayyagari, et al., 2016; Beck & Demirgüç-kunt, 2011; Beck, Lu, & Yang, 2015; Beck & Pería, 2008; Wang, 2016). However, this research focused only on the qualitative analysis of the data from interviews.

Additionally, studies found do not focus on a specific type of credit, as a result, no reference study on developmental credit was found. Studies found focused on the provider of credit rather than the type of credit, for example; Bank financing of SMEs (Beck & Demirgüç-kunt, 2011; Beck et al., 2009).

### **3.3 Research Resign**

#### **3.3.1 Data Collection**

This research aims to answer questions on access to developmental credit, therefore, the information is sourced directly from credit providers, the consumers, i.e. the micro and small enterprises, and the NCR. There is evidence that shows that access to credit varies between micro-enterprises, small enterprises, and medium enterprises (International Finance Corporation, 2019). To ensure that access to credit for these differences is captured, different sized micro and small businesses and credit providers were included in the study. In addition, to complete the value chain, the NCR as the regulatory body in the credit market also formed part of this research. The NCR is responsible for approving and registering credit providers to provide developmental credit as well as monitoring access to credit in South Africa's credit market (NCA, No.34 of 2005).

The researcher used two methods for gathering the data from the micro and small enterprises, and credit providers, namely telephonic interviews and questionnaires. The researcher initially opted to do telephonic interviews to ensure that the questions are asked correctly, and answers are captured correctly. According to Creswell and Creswell (2018), one of the advantages of doing interviews is that it ensures that the researcher has ‘control over the line of questioning’. This is important because access to credit is a sensitive topic in South Africa. A discussion on access to credit may lead to participants focusing on other issues, which they have experienced and they believe that make credit less accessible and other types of credit rather than the specific type of credit being researched. However, in instances where the participants were not available for a telephonic interview, the researcher decided to use a questionnaire. In those instances, the participants filled in the questionnaires in their own time.

Thirteen micro and small enterprises were interviewed telephonically and two answered a questionnaires. The researcher used the same questions in the interviews that were in the questionnaire, except in instances where further explanation was needed from the interviewee. Before starting the interviews and sending the questionnaires, the researcher had short telephonic conversations with all the micro and small enterprises to explain the purpose of the research. The interviews lasted between 12 minutes and 33 minutes. Questionnaires were also sent and responded to the credit providers and the Regulator.

As stated previously, there is little information on access and accessibility to developmental credit in South Africa as such the research is exploratory in nature hence the qualitative research method. The aim is to gather as much information as possible that may assist in explaining the limited granting or uptake of developmental credit by micro and small businesses in South Africa. According to (Leedy & Ormrod, 2013), the sample selected should provide information beyond what is expected. Therefore, there are two categories of questions; the first category consists of profiling questions that aim to understand the participant’s position in the market, while the second category consists of questions that aim to determine the need for, and access to credit, and to the question of access to developmental credit.

The first category (profile questions) aims to get an understanding of the business owner and the business, particularly the size and sector, and the extent of its contribution to the market in terms of employment and revenue. According to (Flick, 2018), in qualitative research, and an

exploratory or open-minded approach should be used. This was the basis for the second category of questions. This category consists of questions that are open-ended aimed at sourcing information on each participants' experience with accessing developmental credit.

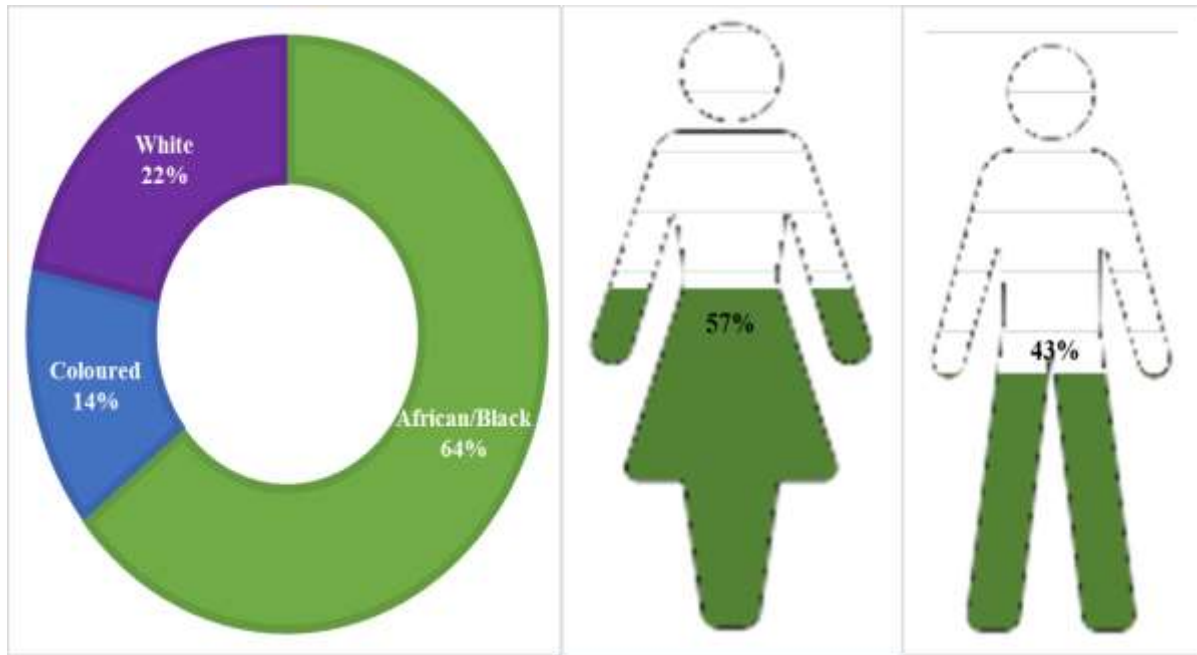
### **3.3.2 Population and Sampling**

The size of the population is not the focus of qualitative research instead, the focus is on ensuring that the sample of SMEs is representative of the whole sector. Flick (2018), advises that “sampling for purpose” be used in qualitative research, which means that the sample should include the differences of participants in the sector. To ensure representation across the sector, the researcher ensured that in the sample there are micro, as well as small enterprises as defined by the National Small Business Act, (No. 26 of 2003).

The researcher had planned to use government entities to source the list of registered small and micro enterprises to be used in the research study. The researcher contacted two government entities that assist small businesses, however, was unable to get a list of registered enterprises due to issues of confidentiality. Therefore, the researcher used the internet to look for registered micro and small enterprises. Furthermore, the researcher requested each of the enterprises initially interviewed to recommend other enterprises that they thought would be willing to participate in the study. The researcher contacted twenty-two (22) small and micro enterprises, fifteen (15) responded and willing to participate in the study. Of the fifteen, one was subsequently excluded, which the owner classified the enterprise as a small enterprise, the enterprise did not fit the definition of a small enterprise. Based on the National Small Business Development Act's definition of enterprises, the enterprise is a medium enterprise. This means that fourteen enterprises formed part of this study.

Figure 4 below shows the micro and small enterprise owners that participated in the study. Of the total participants, 64% were African/Black, 22% were White and 14% Coloured. In terms of gender, 57% were female and 43% were male. This represents three white owners (one male, two females); two coloured owners (both females); and nine African/black owners (five males, four females).

**Figure 4: Sample - Micro and Small Enterprise Owner Profile**



Source: Author’s research

Table 9 and Table 10 below provide an overview of micro and small enterprises that participated in the study by industry, as well as providing a profile of each of the participating enterprises by age, number of employees, and annual turnover.

**Table 9: Sample – Business Sector and Industry**

#	Sector	Industry
1	<b>Clothing and Textiles</b>	Hand-woven textiles
2		Arts and crafts: home décor
3		Clothing and textiles
4		Arts and crafts: beaded jewellery and other beaded products
5		Production of textile homeware, retail and wholesale sales of these textiles and products
6	<b>Medical and Wellness Products and Services</b>	Pharmacy and Clinic
7		Wellness products distributor
8	<b>Food and Beverages</b>	Wine producer, distributor, and marketer
9	<b>Transport</b>	Transport business - Transporting fuel and paraffin
10	<b>Services</b>	Automotive repair and services

<b>11</b>		ICT Services: Supplier of computer hardware and software, and ICT services
<b>12</b>		Corporate Strategy and events
<b>13</b>		Financial and Auditing Services
<b>14</b>		Computer repairs and internet support

Source: Author's Research

To ensure that confidentiality of information is maintained, the businesses numbered in table 9 do not necessarily correlate to business information in table 10. This means that business described by sector number one in Table 9 is not necessarily business one described by age, employment, and turnover information in table 10.

**Table 10: Sample – Enterprise Profiles by age, number of employees, and turnover**

#	Business Age	Number of Employees	#	Turnover
<b>1</b>	9 years	1	<b>1</b>	R300 000
<b>2</b>	11 years	12	<b>2</b>	R12 million
<b>3</b>	1 year	5 permanent, 5 Contract	<b>3</b>	R2 million
<b>4</b>	8 years	7 permanent, 17 interns	<b>4</b>	R2 million – R3 million
<b>5</b>	1 year	19	<b>5</b>	R2 million
<b>6</b>	16 years	12	<b>6</b>	R3 million
<b>7</b>	11 years	14	<b>7</b>	R24 million
<b>8</b>	4 years	11	<b>8</b>	R3,2 million
<b>9</b>	13 years	9	<b>9</b>	R3,5 million
<b>10</b>	14 years	3	<b>10</b>	R5 million
<b>11</b>	4 years	16	<b>11</b>	R300 000 - R500 000
<b>12</b>	10 years	50	<b>12</b>	R5 million - R10 million
<b>13</b>	12 years	5	<b>13</b>	R60 000 - R80 000
<b>14</b>	2 years	1	<b>14</b>	R5 million - R10 million

Source: Author's Research

In terms of credit providers, including different and differently sized credit providers including banks and non-bank credit providers was important. A study by Devnomics in 2012 on the implementation of the NCA revealed that all the main banks were registered as developmental credit providers (Devnomics Research and Surveys, 2012). Therefore, including the banks would provide insights on the provision of this type of credit by the big players in the market. While the non-bank providers would have provided a different perspective and they account for the number of developmental credit providers in the country.

Based on the number of registered developmental credit providers and the type of developmental credit they provide, the researcher identified and contacted eight credit providers. Of the eight, four were banks and four were non-bank credit providers. However, two responded and were willing to participate in this study. One is a large financial services organisation while the other is a non-bank credit provider, which provides developmental credit to one particular industry. While the interviewees account for 25% of the identified credit providers, there is a good balance of differences. As shown in Table 11, the credit providers differ in size, typical customer and experience in providing developmental credit, which had should benefit this research.

**Table 11: Sample: Credit Provider Profile**

	<b>Credit Provider 1</b>	<b>Credit Provider 2</b>
<b>Years registered as a Credit Provider</b>	14 years	7 years
<b>Typical Customer</b>	Individual Customers Large Enterprises Medium Enterprises Micro and Small Enterprises	Micro and Small Enterprises
<b>Credit Profile</b>	Secured Credit -20% Mortgage -25% Unsecured -25% Credit Facilities - 30%	Secured credit - 100%

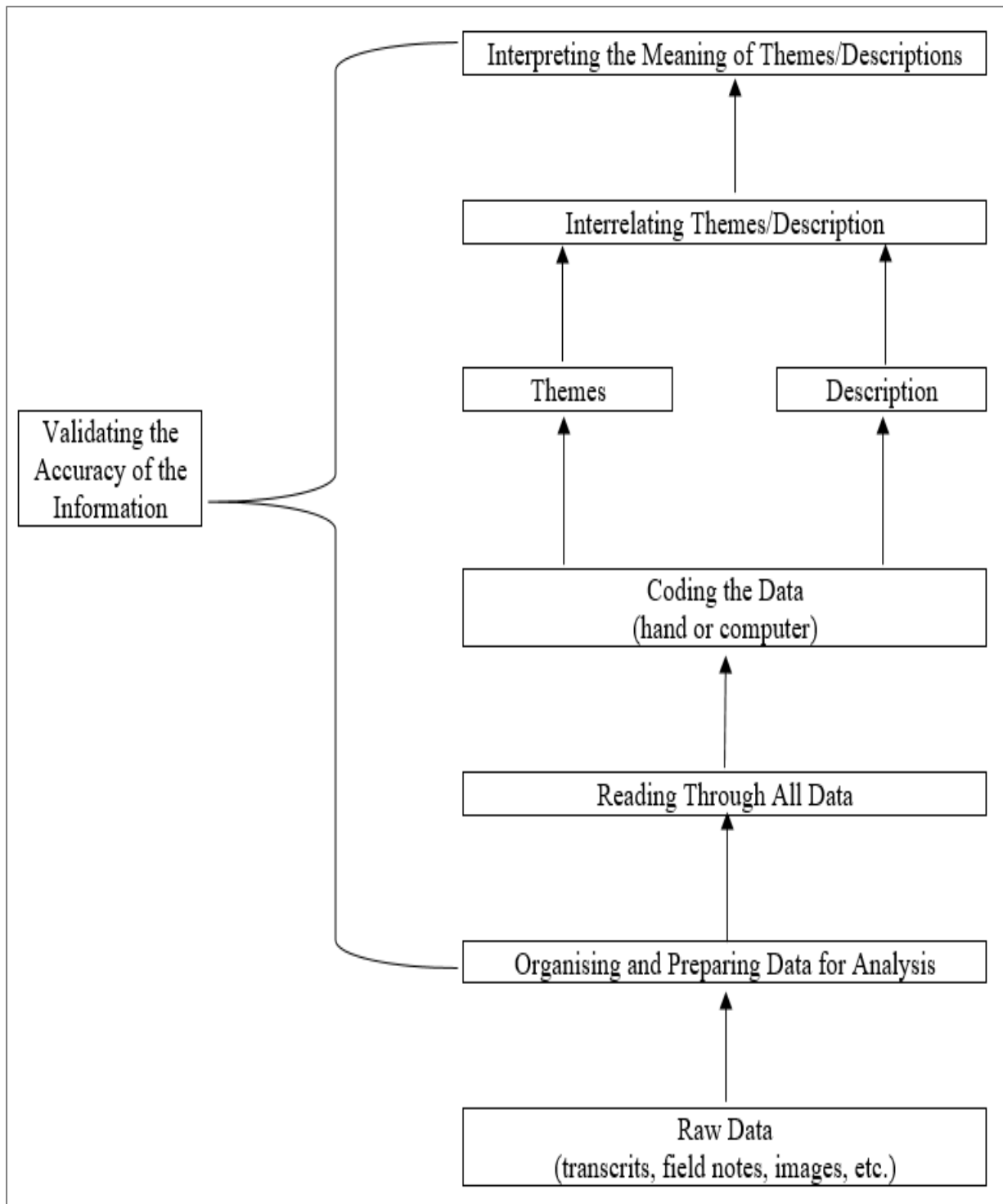
Source: Author's Research

### **3.3.3 Data Analysis**

In this research study, data was collected through interviews. To analyse the data the researcher used coding and categorising to determine common themes emanating from the data. This approach is used a lot in qualitative research studies particularly when data is collected through interviews, focus groups, or observation (Flick, 2018). This was the core of the data analysis.

In this regard, the researcher followed the five-step process for analysing qualitative data proposed by Creswell and Creswell (2018), which also puts coding and categorising at the core of the analysis. Leedy and Ormrod (2013), propose a similar four-step process that is based on Creswell's data analysis spiral, namely; organising the data, perusing the data to ensure completeness, identifying common themes, and integrating and summarising the data Creswell (2007). Figure 5 below presents the research process.

**Figure 5: Data Analysis in Qualitative Research**



Source: Creswell and Creswell (2018, p.194)

*(a) Organising and preparing data*

Through this process, the researcher organised the data ensuring that it is typed and easy to read and understand. According to Leedy and Ormrod (2013), in this step data is broken down into smaller pieces such as sentences and phrases.

*(b) Read all the data*

This step allows the researcher an opportunity to ensure that the data is complete. The researcher should also check for the usefulness and credibility of the data in this stage (Creswell & Creswell, 2018). While reading through the data, the researcher may already be getting a sense of possible themes (Leedy & Ormrod, 2013).

*(c) Coding the data*

Creswell and Creswell (2018, p.93) citing Rossman and Rallis (2012) stated that “coding is the process of organising the data by bracketing chunks (or text or image segments) and writing a word representing a category...”. Generally, this step involves a process of storing the collected data into categories.

*(d) Generating themes and descriptions*

Developing a detailed description and themes for the codes previously generated. It is advised that in qualitative research, a researcher should have between five and seven themes for a research study (Creswell & Creswell, 2018).

*(e) Representing the descriptions and themes*

Having collected, prepared, and coded the data; the last step involves presenting the information to the audience. This can be done in several ways in qualitative research such as direct quotations of the participants, articulating the information in a text format, tables, and graphs.

### **3.4 Research Limitations**

Developmental credit data was insufficient due to the low uptake since inception. Therefore, it was not possible to undertake a quantitative study, which would have been beneficial in answering the research questions.

Due to time constraints, the research focused on micro and small enterprises in Cape Town. This study would be better rolled out nationally, since the legislation is applicable nationally. That would result in more comprehensive answers to the questions that can be generalised and better inform policy.

Sampling method was not strict. The researcher used the internet to identify micro and small enterprises to participate in the study, each of the identified enterprises recommended at least one other enterprise that may also be willing to participate. This limited the number of enterprises that could be included in the study. A more reliable, preferably government database to source micro and small enterprises would have been useful and would have strengthened the credibility of the sample.

The micro and small enterprises sample size was relatively small because of the low response from the enterprises. The low response can be attributed to the COVID-19 pandemic. Getting hold of enterprises during this time was greatly difficult, several micro and small enterprises could not participate, as they were busy with other administrative processes, which were necessary to avert the impact of COVID-19 on their businesses. The small sample size would therefore limit some of the findings.

Furthermore, the response from credit providers was also low and this would limit some of the findings. Having more credit providers would have provided more diverse experiences therefore, strengthening the research findings. However, having different types of credit providers both in business activity/ target market and in size enhanced the findings.

### **3.5 Conclusion**

This chapter provided a summary of the methodology that was used to conduct the research. Sample participants in the study were credit providers, micro and small enterprise, and the NCR. The enterprises were interviewed telephonically or by completing a questionnaire while the Regulator and all credit providers completed a questionnaire. This chapter concluded by providing a summary of the limitations of the research.

## CHAPTER 4: RESEARCH FINDINGS, ANALYSIS, AND DISCUSSION

### 4.1 Introduction

This chapter provides an analysis of the findings of this study’s research questions as outlined in Chapter 1. The questions were as follows:

**Research Question 1 (RQ1):** What are the reasons for the low levels of developmental credit provided to micro and small enterprises in South Africa?

**Research Question 2 (RQ2):** What are the reasons for the low levels of uptake of developmental credit by micro and small enterprises in South Africa?

**Research Question 3 (RQ3):** What is the role of credit information in access to developmental credit to micro and small enterprises in South Africa?

As outlined in the previous chapter, three credit market stakeholders were part of the study. Each of the stakeholders contributed to answering at least one of the research questions. The findings are grouped into three categories, namely demand side, supply side, and regulatory factors. Demand side factors are factors that limit the uptake of developmental credit. Supply side factors are factors that limit the granting of developmental credit, while regulatory or legislative factors are provisions in the Act that constrain either demand or supply of developmental credit. A summary of the finding as they relate to the stakeholders holders and research questions is shown in Table 12 below:

**Table 12: Credit Market Stakeholders and Research Findings**

Research Question	Stakeholder (s)	Findings Category
<i>(RQ1)</i>	Credit providers	Supply-Side
	Credit Regulator	Legislative/Regulatory
<i>(RQ2)</i>	Micro and Small Enterprises	Demand-Side
<i>(RQ3)</i>	Micro and Small Enterprises	Demand-Side
	Credit providers	Supply-Side

Source: Author’s Research

### 4.2 Research Findings and Analysis

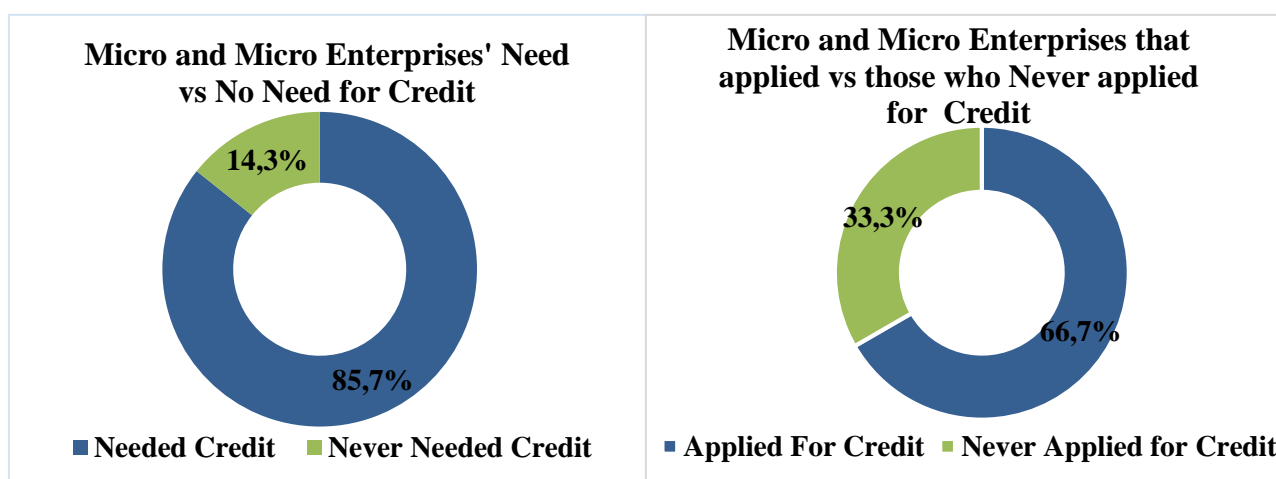
This section provides findings to the questions of the low levels of uptake of developmental credit and credit information on access to developmental credit. However, before the research questions, which relate to the specific type of credit, could be answered, there needed to be a

foundation built on micro and small enterprise experience with access to credit in general. Questions on the experience with accessing credit and taking up credit revealed micro and small enterprises have negative experience with accessing credit.

#### 4.2.1 Access to Credit

Fourteen enterprises were included in this research, and 85.7% of the interviewees revealed that they have needed credit or need credit for business operations or to expand the business. The remaining 14.3% did not need credit because the enterprises either had enough capital or had minimised operational costs and not distributed profits instead invested then back in the business. This information is captured in Figure 6. Some enterprises cited that they need access to markets rather than credit.

**Figure 6: Micro and Small Enterprise Need for Credit**



Source: Author's Research

Twelve enterprises needed credit, and 66.7% of the micro and small enterprise that needed credit applied for credit. The remaining 33.3% did not apply despite their need for credit. Among the reasons that the micro and small enterprises site as preventing them from applying for credit were high interest rates, collateral requirements, lack of constant income, the documentation requirements, and the type of credit provided. These factors are in line with the literature on access to credit for micro and small enterprises and are widely studied except for the type of credit provided as impediments to accessing credit.

Micro and small enterprises noted that they refrain from applying for credit because the credit offered to them does not suit their business needs. One enterprise stated "...the banks do not want to provide credit for inputs. My business requires credit to buy inputs because in this line of business you are paid after you have delivered the final product. Focusing on machinery is an old fashion model of providing credit". Emphasising this point another enterprise stated, "... banks often would grant credit for machinery but not credit for inputs". Furthermore, enterprises were also of the view that it is easier to get other forms of credit than credit to develop or expand a business. Hence, they do not even attempt to apply for business credit. As a result seven of the 14 enterprises noted that the owners have large credit cards and overdraft limits, as much as R100 000, which the enterprises use instead of applying for business credit.

Of the enterprises that applied for credit, 75% of applications were declined. Among the reasons that enterprises believe were major factors in the applications being declined were the credit history of the owner, race, and the requirements. The owners' credit history is a significant factor in accessing credit for micro and small enterprises. Both the enterprises that did not apply for credit, noted that they refrained from applying for credit because of the owners' adverse credit history, and 50% of those whose applications were rejected believe that the owners' unfavourable credit history was a result.

In terms of race, 50% of enterprises whose applications were rejected cited race as being a factor that contributed to the applications being rejected. One enterprise stated, "Banks have no appetite to invest in black small businesses". Another stated, "I am a black man, banks consider that when they lend money". Furthermore, it was found that most micro and small enterprises believe that credit providers, mainly banks refrain from providing business loans to small, and black owned businesses. This is empathised by an enterprise owner who said "The banks do not want to give money to small business owners for the business, however, they would gladly offer you a home loan, car financing, rather than giving you money for your business. My business cannot get a loan but if I go to the bank today, I will get a home loan of R5 million".

Lastly, credit provider requirements on the micro and small enterprise were found to be a contributing factor to declined credit applications. 33% of enterprise applicants were of the view that requirements such as six months bank statements, collateral, and the use of credit for

specific purposes contributed to the rejection of applications. In terms of the purpose of credit, enterprises believe that their applications were declined because they applied for credit to cover operational costs rather than to purchase physical machinery. "My business requires credit to buy inputs because in this line of business you get paid after you have delivered the final product. Focusing on machinery is an old fashioned model of providing credit", stated one interviewee. Another remarked, "The banking products were not suitable for my business, banks want to finance the buying of machinery but my business is labour intensive, no machinery is used". This limits access to credit for those enterprises.

While the application process was not explicitly cited as being an inhibiting factor in the access to credit, when asked about the process of applying for credit responses suggest that it is not easy for enterprises to apply for credit. Access may be limited as a result. Of the nine enterprises that applied for credit, seven responded to the question of their experiences in the process to apply for credit. It was found that five of the seven interviewees found the process to be difficult, long, with a lot of documents required. On the question, *how did you find the process of applying for business credit (loan)?* The enterprises responded:

- (a) "Time-consuming and very complicated".
- (b) "It is a complicated process that requires lots of paperwork."
- (c) "There is a lot of information that is needed, information that the business does not have especially in the early stages of the business."
- (d) "The process is a cumbersome process."
- (e) "There is too much red tape in the banking sector."

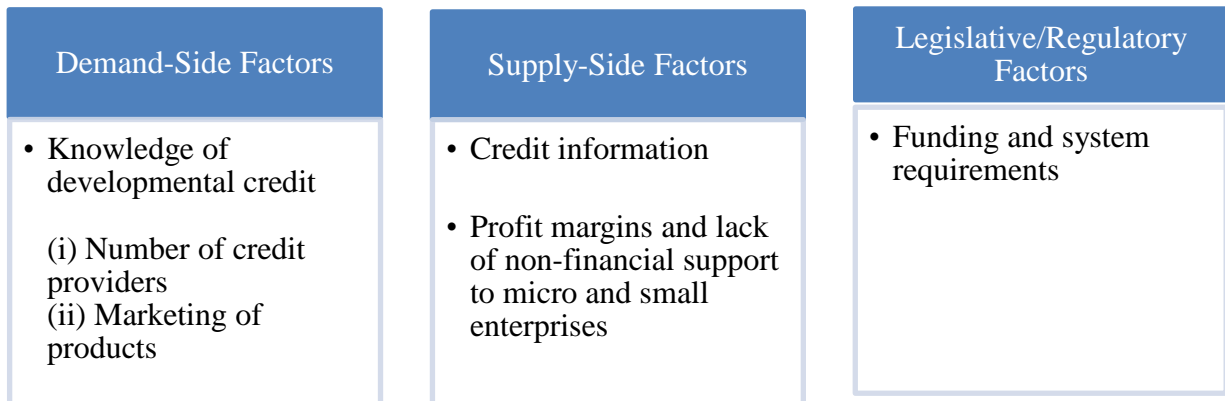
The remaining two that did not experience challenges with the application process explained:

- (a) "The process was easy because we have an accountant that could get all the financial documents that are needed. However, many documents are required. This could be a challenge for other small businesses that do not have an accountant or time to put together and submit the documents."
- (b) "The process was easy"

## 4.2.2 Access to Developmental Credit

On the questions that aimed to provide the reasons for the low uptake and low granting of developmental credit and the role of credit information in access to developmental credit, findings are summarised in the Figure 7 below:

**Figure 7: Factors Contributing to the Low Levels of Developmental Credit**



Source: Author's research

### 4.2.2.1 Demand-Side Factors

Demand side factors are factors that limit the uptake of developmental credit. These result from the size of the business and its capabilities. As noted in Chapter Two, small enterprises face several challenges that limit their access to credit consequently limiting their growth. These factors have also been found in this study to limit the uptake of developmental credit and are consistent with those that are outlined in literature in Chapter Four.

Eight interviewees applied for credit, of which three (38%) applied for developmental credit. One enterprise applied to both the bank and a government entity, while two applied to a government entity only. However, of the three applicants, only one applicant was successful in their application for the development of credit from which they applied from the bank. The applicant has a development of credit account for between 10% and 20% of the SMS total debt and pays the interest that is between 20 and 30% on the development of credit. This interest rate is in line with the regulated interest for developmental credit for small businesses (DTI, 2015). One enterprise that was not approved for the developmental credit attributes this to very strict criteria for small and micro-enterprises loan and also no response to applications made through a government entity. The other was still in the process of applying for developmental credit.

The remaining four enterprises that applied for credit but did not apply specifically for developmental credit, all stated that they did not know about developmental credit. Furthermore, the four enterprises that needed credit but did not apply for any form of credit stated that they also did not know about developmental credit. Therefore, knowledge of this type is the main reason micro and small enterprises have not been able to access developmental credit, resulting in the low uptake.

#### **4.2.2.2 Knowledge of Developmental Credit**

As alluded to in the literature, micro and small enterprises lack information. This was evident in the number of micro and small enterprises aware of developmental credit, despite this form of credit being targeted specifically at them. Seventy one per cent (10 of out 14) of the interviewed micro and small enterprises did not know about developmental credit. At a basic level and based on the findings, this could be attributed to the small number of registered developmental credit providers in the country, lack of education and awareness and lack of targeted marketing of this type of credit.

Furthermore, the lack of knowledge of developmental credit can be linked to levels of financial literacy. While this did not delve into the levels of financial literacy for the micro and small enterprises, there is evidence that knowledge or lack of knowledge of financial information can be attributed to low levels of financial literacy. Eniola & Entebang (2015), attributed the lack of financial information to financial literacy. They noted that lack of financial literacy is a major concern for small and micro enterprises as it affects their financial decisions. Concurring with this view, Ye & Kulathunga, (2019), state “financial literacy has been identified as a vital knowledge resource for financial decision making”

In a study of the relationship between access to finance and growth of SMEs in developing economies, Okello, Bongomin, Ntayi, & Munene (2017) use financial literacy as a moderator to determine the relationship between access to finance and small and medium enterprise growth as well as the impact financial literacy of on access to finance. They found a “positive and significant” for both relationships. Particularly for financial literacy and access to finance, it means for lower levels of financial literacy finance would be less accessible and as the levels of financial literacy improve, access to finance will also improve.

Additionally, financial literacy is critical in the upkeep of a micro and small enterprise's financial records, which could in turn aid access to developmental credit. Financial records of an enterprise do not provide credit history, however, they provide some information on the income and expenses and well the prospects of the enterprise. This is information that can be used to assess a developmental credit application and facilitate the grating of credit.

#### 4.2.2.3 Number of Developmental Credit Providers

According to the NCR, as of March 2020, there were 7 837 credit providers in South Africa, and only 178 credit providers have been registered to provide developmental credit. Since the NCA became law, 83 registered developmental credit providers had been deregistered due to "business closed down, mergers/takeovers, registration lapsed due to non-payment of fees" (NCR, personal communication, July 02, 2020). Furthermore, eighteen registered developmental credit providers do not actively provide developmental credit, which means that just 160 credit providers are actively providing developmental credit (NCR, personal communication, July 02, 2020). Approximately 2% of the registered credit providers provide developmental credit. This is presented in Table 13 below.

**Table 13: Developmental Credit Providers in South Africa**

Credit providers	Number
Registered Credit Providers	7 837
Registered Developmental Credit Providers	178
Developmental Credit Providers (actively providing developmental credit)	160
Registered Developmental Credit Providers – not actively providing credit	18
Deregistered Developmental Credit Providers	83

Source: National Credit Regulator (personal communication, July 02, 2020)

It is also worth noting that over 65% of those credit providers are based in Gauteng, while fewer than 10% are based in the Western Cape and even less in other provinces. Furthermore, a significant number of developmental credit providers provide low-cost housing finance rather than micro and small enterprises. With fewer developmental credit providers available, there are fewer opportunities for small businesses to be exposed to developmental credit, and so they would not be able to access it.

The low number of developmental credit providers limits access to credit for micro and small enterprises. The fewer developmental credit providers there are, the less accessible they consequently, the less accessible developmental credit is. The number of registered development credit providers in South Africa is unacceptably low. The total micro and small enterprises population is almost 800 000 in South Africa (Small and Medium Enterprise Finance Forum, 2019). According to the National Credit Regulator, merely 160 credit providers (2% of total credit providers) are registered and actively providing development credit (NCR, personal communication, July 02, 2020). Furthermore, the majority (152) of developmental credit providers are relatively small, while only eight are larger credit providers, particularly banks. With a large micro and small enterprise population, the number of developmental credit providers is not adequate to improve access to this type of credit. To ensure adequate provision of developmental credit, more credit providers should be registered and actively providing developmental credit.

While the credit providers included in this study did not identify any significant challenges in registering as developmental credit providers, however, the small number is concerning. The National Credit Regulator considers funding requirements and systems requirements that need to be in place for a credit provider to be registered as a developmental credit provider as factors that are impediments to more credit providers registering to developmental provide credit (NCR, personal communication, July 02, 2020). This may particularly be true for smaller credit providers, which may not have the additional financial resources to meet the funding and systems requirements. Credit providers may be opting to provide other forms of credit instead of developmental credit.

#### **4.2.2.4 Marketing of Developmental Credit**

One of the two interviewees noted that the large financial institution does not market developmental credit any differently from other types of credit. The credit provider provides credit to individual customers, large enterprises, medium enterprises, and micro and small enterprises in all sectors. This means that the credit provider does not treat credit (developmental credit) to micro and small enterprises any differently from that which is provided to its other consumers, while the other interviewee uses the suppliers that supply the micro and small enterprises to market and distribute information on the developmental credit product the interviewee offers. This is easier for this credit provider because they provide credit

to a particular industry, all the targeted enterprises in that industry would at some point or another procure from the suppliers, and at that point, they are provided with different financing options including the developmental credit offered by the specific credit provider.

The lack of targeted marketing by the large financial institution is a factor affecting access to developmental credit. Micro and small enterprises do not know about developmental credit because the large financial institution provides all types of credit, and thus it is easy for a smaller type of credit to be overshadowed by the rest, which account for a bigger share of the credit provider's business such as mortgages. Furthermore, the credit regulator has no education and awareness programmes on developmental credit for micro and small enterprises.

### **4.2.3 Supply-Side Limitations**

Supply side factors are factors that limit the granting of developmental credit. The factors that have been found in this study to limit the supply of developmental credit are in line with those limitations to granting credit to small businesses that are outlined in the literature in Chapter Three.

#### **4.2.3.1 Credit information**

Credit information was a common issue for both the demand side (micro and small enterprises) and on the supply side (credit providers) but, not explicitly for developmental credit on the demand side but for access to credit in general. One credit provider, a large financial institution, stated that the credit history of the business is “extremely important and is always taken into consideration” when assessing developmental credit application. This is contrary to the intention of this type of credit and the provisions of the Act.

However, for the other credit provider, credit information is not considered. This is in line with the aims of the developmental credit provisions in the Act. In response to the role of the credit history of the business, the credit provider stated “each application is seen as an individual SMME so there is no prior credit history to review for the business”. Instead, this credit provider focuses on the affordability assessment to determine whether to grant the credit or not.

In terms of the credit history of the owner, all credit provider interviewees noted that, because businesses apply for developmental credit as legal entities, the credit history of the owner is not important. One interviewee said, “the owners’ credit history is not the deciding factor” while another interviewee stated that “it is used as a guideline, but is not the key factor to assessing credit”. Therefore, there is not a definite indication that it is not considered, it should not be according to the Act.

#### **4.2.3.2 Continued Use of Credit Information**

It is evident that there is still use of credit information in one form or another in the assessment of developmental credit applications despite the legislation prohibiting this. Credit providers responding to the questionnaire for this study continue to use credit information in assessing all credit applications including developmental credit; however, the extent of use varies. One credit provider, a smaller credit provider, providing credit to a particular sector noted that they use credit information for purposes of affordability assessment. An affordability assessment relies heavily on credit information and is the strictest form of assessment in credit applications, the guidelines of which are set out in regulations of the NCA. Furthermore, it is clearly stated in Regulation 23 of the National Credit Act that developmental credit is exempt from affordability assessments.

Smith (n.d) in a presentation on the Legal and Regulatory Framework for Developmental Credit confirms that developmental credit is exempt From Affordability Assessment. However, notes that credit providers should consider the consumer’s credit information as well as the enterprise’s prospective income and expenses. Hence, another credit provider, a large financial institution, acknowledged that developmental credit is exempt from affordability assessment. Therefore, noted that while they use credit information in assessing developmental credit applications, the criteria is less strict than other forms of credit.

These findings confirm findings on micro and small enterprises’ limited access to developmental credit. Micro and small enterprises alluded to credit information being one of the key contributors to limited access to credit including developmental credit. Micro and small enterprises either did not apply for credit because they know that they have adverse credit information or believe that their credit applications were rejected because of adverse credit information.

None of the credit providers were upfront about the reasons why they continue to use credit information for developmental credit. However, from the above findings, two things are emerging; a smaller credit provider may afford to grant developmental credit without a thorough assessment of the risk associated with that credit. It can be argued that because the credit provider is smaller, they have more to lose without a strict assessment and in-depth determination of which micro or small enterprise to grant credit and which credit application to decline credit. This is in contravention of the legislation, therefore, there needs to be greater enforcement of the Act.

Secondly, despite the intentions of the legislation, total exclusion of credit information may not be possible. The findings showed that even a large financial institution continues to use credit information. It can be argued that therefore there is no doing away with credit information while improving access to credit. Therefore, the theory of information asymmetry continues to remain valid, where there is no credit information to assess the risk of a consumer, credit providers shy away from granting credit.

These two findings may be an indication that the incentive of a higher interest rate for development credit may not be sufficient to compensate for the risk to credit providers for providing this type of credit. One credit provider alludes to this stating that “access to funding at rates that allows for sufficient net interest margin” is one of the key challenges for their business providing developmental credit. Varghese et al., (2008), stated, “the absence of information certainly raises the costs of lending given that it raises the costs of assessing risk”. In the case of developmental credit in South Africa, the interest rate as with other types of credit is capped, as a result credit providers are unable to go beyond the maximum interest rate. As a result, credit providers may be using some credit information to reduce that risk because the interest rate is not sufficient hence access to developmental credit remains minimal.

In a research paper on Imperfect Information, Social Capital and the Poor's Access to Credit, Van Bastelaer (2000) articulates that for decades governments across the world have developed and implemented schemes aimed at improving access to credit for the poor. However, he notes that those schemes have not been as successful as envisaged because they failed to address “information uncertainties” instead they created inadequate incentives for credit providers and

had inefficient systems. From the above findings, this is seemingly the case for developmental credit in South Africa.

#### **4.2.3.3 Profit Margins and Additional Non-Financial Support to Micro and Small Enterprises**

On the question of whether it makes economic sense for credit providers to provide developmental credit, the concept of interest rates came to the fore. This question was meant to measure the appetite for providing developmental credit. Credit providers are businesses that are driven mainly by a profit motive; therefore, if an activity does not generate profit, credit providers may not have appetite for it. It was also used to determine whether credit providers have other motives for providing developmental credit besides profit. Both credit providers acknowledged that it makes economic sense to provide developmental credit because the interest rate is higher for this type of credit compared to other types. This acknowledgment confirms what Bamu et al. (2005) and Schraten (2019) allude to in highlighting the lower interest rates in the absence of credit information as one of the challenges contained in the previous pieces of legislation.

It is evident that, if the interest rates were lower, less developmental credit would be provided. Interest rate rationing would result. Jaffee and Stiglitz (1990) define interest rate rationing as the control of the amount of credit granted depending on the interest rates, at a lower interest rate the amount of credit granted is reduced, and vice versa. Both credit providers specifically confirmed that because of the high interest rate providing developmental credit makes economic sense. An interest rate of 28% was cited, which is in line with the interest rate caps as per the regulations. However, a large financial institution asserted that the interest rate on developmental credit is not any different from that of other types of credit, the rate purely depends on the risk of the customer.

Both credit providers noted that what is lacking is support to micro and small enterprises beyond the provision of credit. To make complete economic sense, they believe that the high-interest rates charged should be coupled with non-financial support to small enterprises. One credit provider believes that non-financial support should be provided for in legislation, and a large financial institution stated, “the current legislation only allows for higher charges and fees. It would be more useful if credit providers were also given an obligation to assist these

consumers (specifically where the credit is for SMEs) to run their businesses”. The other credit provider believes that credit providers should take the responsibility for non-financially support of micro and small enterprises. According to the credit provider, “.....although the maximum interest rate is high to result in a lucrative interest margin it does place certain responsibilities on the credit provider in assisting the development of the SME”.

#### **4.2.4 Legislative/Regulatory Limitation**

Two of the most important legislative requirements for developmental credit are: the subsequent registration of already registered credit providers to register as developmental credit providers; and the requirement for these credit providers to have adequate financial resources and systems to be approved for developmental credit. In the assessment of developmental credit registration applications, the NCR considers the type of developmental credit that the applicant will provide, the applicant's financial human and operational resources, the administrative procedures, and whether the applicant is registered as a business in South Africa (NCR, personal communication, August 04, 2020).

Of the criteria that are outlined above, it was found that those funding requirements, which relate to the financial resources and systems requirements that are part of the administrative procedures, are some of the factors that are believed to impede on the registration and the provision of development of credit. Because of these requirements, credit providers tend not to register for developmental credit. This limits the number of developmental credit providers, consequently access to this type of credit by micro and small enterprises.

### **4.3 Recommendations**

The fundamental reason for this study is to understand the reasons behind the low levels of developmental credit, consequently shining a light on hindrances to access. Having shone the light on them, recommendations should be made to the three key players in the credit market, namely, the consumers that are the micro and small enterprises, the credit provers, the policymakers who would contribute to solutions to increase access to credit.

#### **4.3.1 Small and Micro Enterprises**

Micro and small enterprises should explore the different types of credit available to them. Exploring various credit types would allow micro and small enterprises to apply for the correct

type of credit, four of the six enterprises whose applications for business loans were declined use the owner's credit card and overdrafts. Furthermore, all six enterprises did not know of developmental credit.

This research found that the use of credit information in assessing credit applications causes micro and small enterprises to refrain from applying for credit. They associate access to credit with positive credit information of the owner, and therefore in some instances do not even attempt to apply for business loans. Instead they apply for overdrafts and credit cards as means of financing the businesses. Micro and small enterprises should explore credit options such as developmental credit.

#### **4.3.2 Credit Providers**

Most micro and small enterprises have a negative perception and experiences of access to credit. They see the number of documents required as being the key burden in the process, hence making credit inaccessible.

Credit providers should seek to reduce the "red tape" associated with applying for credit. In particular, they should reduce the number of required documents for the application. Information requirements such as the number of documents required for credit applications make it difficult to access credit and should be reduced. Micro and small enterprise owners are often busy running their businesses and are therefore unable to gather the documents without that taking up a significant amount of time away from their business.

In this regard, several micro and small enterprises proposed that there should be coordination of information between credit providers and government with respect to business information. Credit providers should be able to access government information on enterprises including registration information from the Companies Intellectual Property Commission (CIPC), taxation, and related information from the South African Revenue Service (SARS), among others. Access to such information would ensure that less documentation is required from the enterprises, thereby making it easier to apply for credit.

Additionally, application processes were found to be long and complicated. As a result, two micro and micro-enterprises remarked that they had considered using external service providers

to apply on their behalf, but they did not go through with that because such services are expensive. Furthermore, one enterprise noted that, while online applications are convenient because one need not physically go to the bank, they “lack personal touch”, meaning that micro and small enterprises are not able to effectively articulate their businesses, plans, and ideas through online applications. As a result, credit providers may reject applications based on a lack of understanding of the business of the applicants. Therefore, credit providers should attempt to simplify the application processes, particularly for new, inexperienced enterprises.

Lastly, credit providers should provide targeted and flexible credit products for micro and small enterprises. In terms of developmental credit as an existing form of credit, it should be marketed to micro and small enterprise, because micro and small enterprises do not know about this form of credit.

### **4.3.3 Policy Makers**

Strict requirements to credit providers were considered to be impediments to the provision of developmental credit, specifically, funding and systems requirements. Policy makers should consider re-evaluating the legislative provisions in this regard to ensure that it is easier for credit providers to provide developmental credit. Consequently, this would improve access to credit for micro and small enterprises.

There should be oversight on implementation of provisions of developmental credit as per the Act. The research found that a large financial institution regards credit information as key in assessing developmental credit applications. This is contrary to the provisions of the Act. Therefore, the Regulator should ensure that credit providers comply with the provisions of the Act and also those of developmental credit.

## **4.4 Conclusion**

This chapter provided detailed analysis of research findings on the research questions on the reasons for the low levels of developmental credit provided to micro and small enterprises, the reasons for the low levels of uptake of developmental credit by micro and small enterprises, and the role of credit information in access to developmental credit. The research showed that the main hindrance to accessing developmental credit is lack of knowledge of this type of credit, which is affected mainly by the low number of developmental credit providers. It also

showed the lack of non-financial support to micro and small enterprises hindered the granting of developmental credit. Lastly, credit information, contrary to the provisions of developmental credit in the legislation, is key in the assessment of developmental credit applications. The chapter concludes by providing recommendations to micro and small enterprises, credit providers, and policymakers, which are intended to improve access to credit.

## **CHAPTER 5: CONCLUSION**

The purpose of this paper was to determine the reasons for the low uptake and granting of developmental credit as well as the role played by credit information in assessing developmental credit applications. To determine these, three research questions were developed and three stakeholders in the South African credit market, namely micro and small enterprises, credit providers, and the Credit Regulator were identified as key in answering these questions. The findings of this study as well as recommendations for each of the stakeholders are summarised below.

The main limitation to the uptake of development credit is the lack of knowledge of this type of credit. This is affected by the perceptions of the micro and small enterprise perception that it is difficult to access credit because of credit information considerations. The small number of credit providers registered to provide developmental credit and the lack of marketing initiatives for this type of credit have also affected knowledge of developmental credit.

The granting of the developmental credit, the lack of non-financial support to micro and small enterprises, the small number of credit providers, and use of credit information by financial institutions are all factors that have an adverse impact on the supply side of developmental credit.

Given these findings, the study makes the following recommendations:

- (a) Micro and small enterprises should explore different types of credit available. This would assist them to find credit products that are suitable for their business.
- (b) Credit providers should consider reducing the required documents for credit applications to make the process easier and marketing for developmental credit differently and in a targeted manner in order to make it a more attractive credit product.
- (c) Legislators should consider re-evaluating the funding and systems requirements imposed on credit providers to register as providers of developmental credit.
- (d) The Regulator should ensure enforcement of the legislation, particularly in terms of the use of credit information in the assessment of developmental credit applications.

- (e) The Regulator should consider making the provision of developmental credit a requirement for all credit providers as part of their registration requirements to assist micro and small enterprises as has been done in other parts of the world.
- (f) The credit regulator, in line with its mandate of promoting access to credit should consider developing having education and awareness programmes for micro and small enterprise on accessing developmental credit.

Developmental credit remains the lesser-known and studied form of credit, mainly because it is a relatively new type of credit in South Africa which has not gained traction over the years. While this paper provides some insights in to factors that limit access and granting of this type of credit, more research is necessary given the importance of developmental credit if accessible to micro and small enterprises. Areas that may be explored in the future include these listed below.

- (a) There could be a comparative case study on micro and small enterprises that have accessed developmental credit in comparison to those that accessed other types of credit, focusing on the ease of getting developmental credit relative to other credit types, given the purpose of making developmental credit available.
- (b) A study should be undertaken on incentives to credit providers to provide developmental credit. The interest rate alone is not effective given the risks.
- (c) If the data becomes sufficient, a quantitative study of factors affecting developmental credit is needed.

**APPENDIX: KEY QUESTIONS AND FINDINGS**

<b>Players in the Credit Market</b>	<b>Questions</b>	<b>Themes</b>	<b>Codes</b>	<b>Categories</b>
<b>Micro and Small Enterprises</b>	<p>What are the challenges you experienced in applying for credit?</p> <p>How did you find the process of applying for developmental credit?</p>	<p><b>Demand side factors</b></p> <p>Information about Developmental Credit is not known by micro and small enterprises</p>	<p>(a) Information</p>	<p><b>Demand side factors</b></p> <p>(a) Knowledge of developmental credit</p>
<b>Credit Provider</b>	<p>What is the role of credit information (credit history) of the business in assessing developmental credit applications?</p> <p>What is the role of credit information (credit history) of the owner(s) in assessing developmental credit applications?</p>	<p><b>Supply side factors</b></p> <p>(a) Some credit providers use credit information to assess all credit applications including developmental credit applications.</p> <p>(b) Profit margins, while sufficient to entice credit providers to provide credit, are not sufficient as an incentive for credit providers to provide non-financial support to micro and small enterprises.</p>	<p>(a) Credit history</p> <p>(b) Interest rates</p> <p>(c) Non-financial support</p>	<p><b>Supply side factors</b></p> <p>(a) Credit information</p> <p>(b) Profit margins and lack of non-financial support to micro and small enterprises</p>

	What challenges has the company experienced in providing Developmental Credit?			
<b>Credit Regulator</b>	<p>What is the process and documentation required by the NCR for developmental credit provider application and registration?</p> <p>What factors does the NCR regard impediments to the provision of developmental credit?</p> <p>If any of the challenges relate to legislation or processes, how is the NCR addressing those challenges or processes as the credit regulator?</p>	<p><b>Regulatory /legislative factors</b></p> <p>Funding and system requirements which are in the Act that credit providers need to comply with to become developmental credit providers prevent credit providers from providing developmental credit</p>	<p>(a) Number of developmental credit providers</p> <p>(b) Funding requirements</p> <p>(c) System requirements</p>	<p><b>Regulatory /legislative factors</b></p> <p>(a) Funding and system requirements</p>

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