PRIVATE AND PUBLIC PROCUREMENT AND THE SOCIAL ECONOMY PROJECT

International Labour Organization

ACCESS TO FINANCE FOR SOCIAL ENTREPRENEURS IN SOUTH AFRICA

A SCOPING STUDY

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Access to Finance for Social Entrepreneurs in South Africa: A Scoping Study

Private and Public Procurement and the Social Economy Project

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COVER PHOTOGRAPH | GREATER UITENHAGE SEWING CO-OPERATIVE

FOREWORD

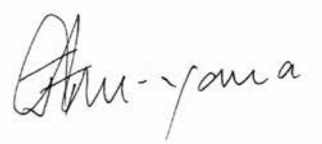
The social economy has gained visibility at international, national and local levels. In South Africa, social economy enterprises have grown in number, with increased interest in the sector as a way to provide decent employment and social protection. Both the government's New Growth Path and the South African Decent Work Country Programme identify the development of this economy as having the potential to create jobs.

The National Growth Path, adopted in late 2010, specifically refers to the need to "encourage state procurement from, and service delivery through, organisations in the social economy". The South African Decent Work Country Programme was drawn up by organised business and labour, community and government, in consultation with the ILO and is governed by the National Economic Development and Labour Administration Council (Nedlac). It also identifies developing the social economy as a strategic way to create decent jobs in sustainable enterprises.

Social enterprises can be defined as enterprises that have a social purpose, but are run on business principles, and reinvest any profit or surplus into the social purpose of the entity. In response to promoting the sustainability of this sector, the Government of Flanders funded the Public, Procurement and the Social Economy project in South Africa. This focused on both the demand side and the supply side of public procurement from the social economy. The demand side includes clarifying and influencing the interpretation of procurement regulations, and creating greater procurement opportunities. The supply side includes building the capacity of social economy enterprises to respond to these opportunities.

This is being following by a second phase, the Private and Public Procurement and the Social Economy (PPPSE) Project. The PPPSE Project supports social economy businesses to take advantage of the regulatory space for procurement of their goods and services through both government and private sector businesses. It does this with a mix of advocacy, advisory and training services targeted at procurement officials in government and public and private sector business, and through capacity building support for owner-managers of social enterprises. The project works closely with provincial departments of economic development and a range of local partners to achieve its objectives. The main geographic focus is on social enterprises in the KwaZulu-Natal and Free State Provinces.

To inform its work in the sector, the ILO has undertaken research on a number of aspects during both phases, including this one that looks at barriers to access to finance for social entrepreneurs. Others include a review of the legal and policy framework, and a report on best practice case studies of private and public procurement and the social economy, including two international ones and six in South Africa.



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| ITEKENG BASADI SETSOTO COFFIN PROJECT (FREE STATE)

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CONTENTS

ABBREVIATIONS

ADG	African Dynamics Group
ASEN	African Social Entrepreneurs Network
BBBEE	Broad Based Black Economic Empowerment
CBDA	Co-operative Banks Development Agency
CFI	Co-operative Finance Institution
CIS	Co-operative Incentive Scheme
dti (the)	Department of Trade and Industry
ED	Enterprise Development
EDTEA	Economic Development, Tourism & Environmental Affairs (KwaZulu-Natal)
FSC	Financial Sector Charter
IDC	Industrial Development Corporation
ILO	International Labour Organization
MFI	Microfinance Institution
MIX	Microfinance Information Exchange
NEDLAC	National Economic Development and Labour Administration Council
NEHAWU	National Education Health and Allied Workers Union
NGO	Non-government organisation
PPI	Progress out of Poverty Index
PPPSE	Private and Public Procurement and the Social Economy Project
SACCO	Savings and Credit Co-operative
SMEs	Small and Medium Enterprises
SMMEs	Small, Medium and Micro Enterprises
Seda	Small Enterprise Development Agency
SEF	Small Enterprise Foundation
SEFA	Small Enterprise Finance Agency
UK	United Kingdom
UN	United Nations
WEF	World Economic Forum

EXECUTIVE SUMMARY

This scoping study provides insights into the way in which social enterprises are accessing financial products and services in South Africa. The report is based on the findings of a literature review of existing research, focus group discussions, and interviews with social entrepreneurs and financial service providers.

Interest in social enterprise has been growing both in South Africa and across the globe. Increasingly, governments are looking to social enterprises for innovative and cost-effective ways to address social problems. At the same time an increasing number of investors are looking for opportunities that have a positive social impact while earning a financial return.

Despite this, studies have shown that a lack of access to finance remains a major constraint to the growth of many social enterprises in South Africa (Steinman, 2010). This suggests a misalignment between supply and demand of financial products for social enterprises. Studies of the small and medium enterprise (SME) sector in South Africa have found a relatively low uptake of loan finance. This is not because there is no finance available, nor is it the result of a lack of demand by the SMEs, rather, it is a result of the high number of applications being from enterprises that financial service providers regard as being “unbankable”, high barriers to access, and a lack of information about the kinds of finance that are available (see finfind, 2011).

The findings in Section One suggest that social enterprises face similar obstacles to those faced by the broader SME sector. However, these are compounded by the perception of social enterprises as being particularly high risk, a lack of financial products and services that are designed for their particular needs, and the lack of a formal legal structure for social enterprises.

A recurring theme throughout the research was the distinction between micro enterprises operating at the base of the economic pyramid, and more established small and medium enterprises that are integrated into mainstream economic activity. This report therefore distinguishes between “survivalist and micro enterprises” and “small and medium enterprises”.

The survivalist and micro enterprises that participated in this research were mostly structured as co-operatives. These enterprises were far less likely to have accessed any financial products or services than more established small and medium enterprises. However, most of these enterprises were more concerned with finding markets for their products and services and learning basic business and financial skills than they were with accessing financial products and services.

Small and medium enterprises with some track record were better able to access financial products and services. However, many of these enterprises did indicate that they found it difficult to find information about different financial services and products, and that the application process was often onerous and time-consuming.

Based on these findings, Section Two makes recommendations for the ILO to support the development of an online platform that provides social enterprises with information and acts as a referral mechanism for financial service providers. A number of initiatives that have been established to support SMEs in accessing financial services are highlighted. It is recommended that the ILO seeks to collaborate with these initiatives to develop a platform that caters to the specific needs of social enterprises.

INTRODUCTION

| GREATER UITENHAGE SEWING CO-OPERATIVE

The concept of a social enterprise, and more specifically social enterprise finance, was relatively new in 2011 when GreaterCapital wrote *A Guide to Finance for Social Enterprises in South Africa*. Since then, recognition both globally and locally of the importance of social enterprises in tackling some of our most pressing and intractable problems has been growing along with and an increasing pool of financial products to fund them.

A number of countries, including France, the United Kingdom (UK), Canada and parts of the United States have introduced measures aimed at stimulating investment in the social economy. These include establishing special banks mandated to support social enterprises, setting up special legal structures for private enterprises that deliver a societal benefit, and providing guarantees on investor capital to support innovative financial structures, such as social impact bonds.

Locally, the New Growth Path (EDD, 2011) recognises the development of the social economy as one of the pillars of its national development strategy framework. National Treasury has also participated in a pilot study to establish a social impact bond aimed at developing and growing small businesses. In addition, promulgated changes to the Broad-Based Black Economic Empowerment (BBBEE) codes will incentivise South African businesses to support small black-owned businesses and to include those businesses in their supply chains.

There is also increased interest from the private sector in supporting businesses that can deliver social impact as well as financial returns. Both locally and internationally, impact investing is gaining traction as a mainstream investment strategy. As a result, a growing number of funds are seeking investment opportunities in social enterprises.

Despite these developments, studies have shown that a lack of access to finance remains a major constraint to the growth of many social enterprises in South Africa (Steinman, 2010). This suggests there is a misalignment between supply and demand.

THE SOUTH AFRICAN GOVERNMENT'S NEW GROW PATH RECOGNISES THE DEVELOPMENT OF THE SOCIAL ECONOMY AS ONE OF THE PILLARS OF ITS NATIONAL DEVELOPMENT STRATEGY FRAMEWORK

It is in this context that the ILO's programme for supporting access to finance for social entrepreneurs takes place. The aim of the study is two-fold. First, it examines the nature and extent of this gap between supply and demand. Second, on the basis of the findings of the gap analysis, recommendations are made for a mechanism for addressing the gaps and linking social enterprises to financial service providers more effectively. This mechanism should mainly focus on addressing the asymmetry of information between social enterprises and financial institutions.

RESEARCH OBJECTIVES AND METHODOLOGY

The Private and Public Procurement and the Social Economy Project aims to support social economy businesses in South Africa to penetrate the regulatory space for the preferential procurement of their goods and services through government and the corporate sector.

The purpose of this study was to:

- Gather information on the demand for financial services among social entrepreneurs to ensure that they can (better) engage in the value chains as supported by the project, and the extent to which this demand is, or is not, met by financial service providers operating in the market, and
- To suggest, in detail, a sustainable mechanism for linking social enterprises involved with the project (and after the life of the project) to financial services.

The approach taken in carrying out this study was primarily qualitative. The purpose of the research was not to make statistical findings about social enterprises in South Africa, but rather to get deeper insights into the specific issues that constrain or enable access to finance for social enterprises. Three main sources of information have been drawn on to make these findings. First, a review of the available literature on access to finance for social enterprises and co-operatives in South Africa was conducted, including publically available information for financial service providers. The research team drew on quantitative findings from other studies of small business and entrepreneurship (notably the FinScope Small Business Survey (FinMark Trust, 2010) and the Centre for Inclusive Banking in Africa (2013) Microfinance Review) to provide the context for this study.

Second, a number of qualitative interactions with representatives of social enterprises were conducted. This comprised of a series of four focus group discussions (two each in the Free State and KwaZulu Natal), as well as telephone interviews with representatives of social enterprises from the Western Cape, Eastern Cape and Gauteng.

Third, telephone interviews were conducted with a number of financial service providers. This included a range of service providers that make loans of as little as R1 000 and as much as R83 million, and lend to a wide range of businesses in every sector of the economy.

SECTION ONE | SCOPING STUDY

SOCIAL ENTERPRISES IN SOUTH AFRICA

Interest in social enterprise has been growing both in South Africa and across the globe. Increasingly, governments are looking at social enterprises for innovative and cost-effective ways to address social and economic problems. Philanthropic institutions and high-net worth individuals are participating in “venture philanthropy”, while impact investors are looking to place capital in organisations in which they can achieve specific social or environmental outcomes in addition to financial returns. Talented young people are increasingly likely to pursue careers where they can feel they are “making a difference”.

The ILO has identified social enterprises as a way to combine social and economic goals, and has been instrumental in supporting the development of the social economy both in South Africa and around the world. The promotion of the social economy furthers the objectives of the ILO’s Decent Work Agenda. For example:

Rights: The values and principles on which social enterprises are based include respect for the ILO’s fundamental principles and rights at work.

Employment: In some countries, social enterprises provide employment for more than 10 percent of the workforce.

Social protection: Social enterprises have extended social protection and social services to people and communities not covered by formal social security systems.

Social dialogue: Many social economy organisations represent the voice and interests of those not normally represented by trade unions or employers’ organisations. For instance, small farmers may be represented through agricultural marketing and supply co-operatives, and people working in the informal economy may be organised in street vendor associations. The social economy can play a crucial role as a bridge in the transition from the informal to the formal economy.

As Fury (2000) argued: “The impetus for this interest is in part driven by perceived advantages that social enterprise has: over government — in efficient delivery of services; over conventional business — on trust, accountability, and purpose; and over charities and non-governmental organisations (NGOs) — due to financial sustainability and access to capital.” In South Africa this interest is also in part driven by BBBEE regulations, which are designed to catalyse the transformation of the country’s economy through a number of mechanisms, including through investment in emerging black-owned enterprises.

Anecdotal evidence suggests that there are an increasing number of social enterprises and an increasing pool of capital seeking to invest in social enterprises (Table 1).

TABLE 1 | FACTORS DRIVING GROWTH IN THE NUMBER OF SOCIAL ENTERPRISES AND CAPITAL ALLOCATED TO THE SECTOR

Factors driving growth in number of social enterprises	Factors driving increasing allocation of capital to social enterprises
• Increasing recognition that the private sector has an important role to play in addressing socio-economic challenges • Emergence of successful models of scalable businesses that create social and environmental value • Increased interest in careers that are making a difference	• The rise of impact investing • BBBEE codes compelling corporate investment in emerging black-owned enterprises • Venture philanthropy • Government initiatives to support the social economy through grants and loans • Reduced donor and government funding to traditional models of civil society organisations

Despite these developments, studies show that a lack of access to finance remains a major constraint to the growth of many social enterprises in South Africa (Steinman, 2010). This suggests a misalignment between supply and demand of financial products for social enterprises. Studies of the SME sector in South Africa have found a relatively low uptake of loan finance. This is not because there is no finance available, nor is it the result of a lack of demand by the SMEs. Rather, it is a result of the high number of applications from SMEs that financial service providers regard as being “unbankable”, high barriers to access, and a lack of information about the kinds of finance that are available (finfind, 2011). Social enterprises face similar obstacles to the broader SME sector, but these are compounded by the perception that social enterprises are particularly high risk, and a lack of financial products and services that are designed for their particular needs.

One of the primary obstacles social enterprises face is the lack of an agreed definition of a social enterprise, and the resultant confusion of financial services providers about their unique nature and business models.

DEFINING SOCIAL ENTERPRISE

Despite the interest around the concept of social enterprise, there is little consensus as to what a social enterprise actually is. In some countries, notably the United Kingdom, Canada and to some extent the United States, there are government policies that set legal parameters for what constitutes a social enterprise. In most cases, these policies set special tax dispensations for these enterprises, making it easier for them to raise capital.

In South Africa, there is some evidence to show that government departments recognise the importance of social enterprises. The New Growth Path, a broad policy document developed by the Economic Development Department, highlights the “social economy” as an important source of economic growth and job creation. A task force was established to develop alternative policy frameworks for social enterprises.

A white paper was submitted to National Treasury in 2013, which accepted some of the recommendations and has commissioned further research on others. There is also some evidence that provincial departments are developing strategies for assisting with the development of social enterprises. For example, the KwaZulu-Natal Department of Economic Development, Tourism and Environmental Affairs (EDTEA, 2009) identified "developing and supporting social enterprises" as a strategic objective in its five-year strategic plan. Despite these encouraging signs, however, there is no legal definition of "social enterprise" in South Africa and there are no formal policies on social enterprise.

Some government documents seem to treat the term "social enterprise" as interchangeable with "co-operatives". This has resulted in some confusion with these being understood as one and the same thing. Co-operatives have played an important part in developing the concept of social enterprise around the world. Co-operatives by definition seek to organise on democratic principles for the benefit of their members. In South Africa, the majority of co-operatives are established for the benefit of members who are poor, and in many cases belong to marginalised groups. The South African government recognises "the important role that co-operatives can play in absorbing the unemployed and the poor into employment as well as in providing services in poor communities" (RSA, 2009).

However, co-operatives are only one possible form that a social enterprise can take. Other forms of social enterprise include for-profit businesses that have a particular social mission or non-profit organisations that undertake trading activities to advance their social goals.

MASISIZANE WOMEN'S HOUSING CO-OPERATIVE (IVORY PARK, GAUTENG)

> **One commonly used definition is the one used by the ILO. This dates back to 2009, when it was adopted at a national conference on the enabling environment for social enterprise development in South Africa: A social enterprise's primary objective is to address social problems through a financially sustainable business model where surpluses (if any) are mainly reinvested for that purpose.**

This is by no means a universally agreed definition. As Fury (2010) points out, "while the first two elements of the definition – that it has a core social purpose and is financially sustainable are accepted, it is the point about whether to restrict the definition to include only those enterprises where 'surpluses ... are mainly reinvested' that is unclear, as this potentially excludes a number of for-profit enterprises which have at their core a social mission." Even within United Nations (UN) initiatives there appears to be some ambiguity surrounding the definition of a social enterprise. The UN Global Compact (2012), for instance, defines a social enterprise as a business that aims for positive social or environmental outcomes while generating financial returns. Unlike the ILO definition, this makes no mention of whether or not these financial returns are re-invested.

The lack of a legal definition is far more than an academic issue. Under the status quo, social entrepreneurs will often register a non-profit trust in order to accept grants and donations and offer tax benefits. However, these trusts cannot legally operate as trading companies; nor can they offer equity to potential investors (since non-profit trusts cannot be owned). Thus social enterprises will often register a separate legal entity for trading activities – a Pty (Ltd) company or in some cases a non-profit company. This puts a significant burden on enterprises that have to choose between taking on the burden of operating two separate legal structures, often doubling up on business administration and red tape, or forgoing the opportunity to raise certain kinds of capital.

THE GROWTH OF IMPACT INVESTING IN SOUTH AFRICA

Impact investing is receiving increasing attention from investors, philanthropists, academics and policymakers around the world. There are now dozens of regional and global conferences and events which aim to bring together a range of actors in the impact investing industry. In 2013, for the first time, impact investing was at on the agendas at both the World Economic Forum annual meeting in Davos, Switzerland, and the G8 meeting in Enniskellen, Northern Ireland.

The Monitor Group has identified four main factors that have converged to drive the growing interest and activity in impact investing (Friereich and Fulton, 2009):

- The global financial crisis of 2008-2009, which led to renewed debate regarding considerations of risk in investment decisions
- Growing recognition that existing resources are insufficient to address the world's most intractable problems such as poverty, inequality and environmental destruction, particularly as developed nations continue to reduce aid budgets and social spending
- An emerging set of activities demonstrating that it is possible to finance scalable businesses that create social and environmental value; and
- The growth in the number of young high net worth individuals who are seeking to promote their values both through philanthropy and impact investing in order to achieve social and environmental goals.

Analysis conducted in 2012 by the Bertha Centre for Social Innovation and Entrepreneurship at the University of Cape Town's Graduate School of business found that 54 percent of asset managers made some reference to the concept of "impact" on their websites and marketing materials, but that only six percent identified themselves as impact investors. The same research found that 51 percent of private equity and venture capital firms make reference to impact in their marketing materials, while only three percent identify themselves as "impact investors".

ACCESS TO FINANCE FOR SMALL ENTERPRISES

While most small enterprises are not social enterprises, almost all social enterprises are small enterprises. It is therefore useful to understand the challenges that businesses in the small, medium and micro enterprise (SMME) sector face in general when trying to access finance, before focusing on the issues that are faced by social enterprises in particular.

> **Most entrepreneurs find it problematic to obtain funding... especially those intending to start a business and those in the early stages. In many cases, the entrepreneurs in question do not have the required track record nor have they been able to acquire the required collateral demanded by the financial institutions.**
>
> **Turton and Herrington, 2013**

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The World Economic Forum's Global Competitiveness Survey 2013/2014 rates South Africa as second out of 148 countries for the availability of financial services to businesses (WEF, 2014). However, while there may be an impressive range of financial products available and sufficient finance for more established businesses, there is some evidence to suggest that not enough of this is directed towards new ventures. The Global Entrepreneurship Monitor (Turton and Herrington, 2013) found that South African entrepreneurs see access to finance as crucial for the growth of their businesses.

According to the FinScope South Africa Small Business Survey of 2010 (FinMark Trust, 2010), remarkably few South African small businesses had ever borrowed any money. The FinScope survey distinguished between three broad categories of small business, based on their size and sophistication:

- **Survivalist enterprises**: Informal businesses, typically with a monthly turnover of less than R4 000. At the time of the survey there were an estimated 3.35 million of these businesses in South Africa, comprising 60 percent of total small enterprises.
- **Microenterprises**: Slightly more established businesses, typically with monthly turnover of between R4 000 and R27 500. At the time of the survey there were about 1.68 million of these businesses, 30 percent of the total number of small enterprises. About 75% of these businesses were informal.
- **Small businesses**: More established formal businesses – 74 percent of these businesses had a monthly turnover in excess of R10 000 and about half had a turnover in excess of R27 500.

Across all three categories, the vast majority of small businesses had never borrowed any capital at all, and most of those that had, borrowed from friends and family (Table 2). Paradoxically, most of the focus group participants in this study said that being able to take loans was either "quite important" or "vital" for their enterprises over the next five years. This again suggests considerable misalignment between the supply of and demand for credit for SMMEs in South Africa, highlighted also in the other studies detailed in this section, which found similar problems in accessing finance rather than the demand for finance.

TABLE 2 | BORROWING HABITS OF SMALL BUSINESSES (%)

	Survivalist	Microenterprises	Small businesses
Businesses borrowing money			
Borrowed for business past 12 months	2.1	3.5	5.5
Borrowed for business previously	1.6	1.6	8.6
Sub-total	3.7	5.1	14.1
Largest source of borrowing:			
From bank	2.6	19.3	72.4
From Microfinance Institution (MFI), microlender or NGO	4.6	2.9	0.9
From government	7.7	0.6	0.4
From stokvel (savings club)/burial society	4.7	6.9	0.1
From informal moneylender	13.5	8.5	0.4
From friends and family	62.5	57.9	19.6
From employer	1.3	0	0.9
Buy on credit from supplier	2.9	3.8	5.2

Source: FinScope Small Business Survey (2010)

ACCESS TO FINANCE FOR SOCIAL ENTERPRISES

While there has been very little research on the different financial needs of social enterprises as compared to standard for-profit enterprises, experiences from more developed markets suggest that social enterprises are more likely to seek external finance than other SMEs. A recent study of social enterprise in the UK, for example, found that almost half of social enterprises had sought external finance in the preceding 12 months – twice the rate of other SMMEs (Social Finance UK, 2013). Yet social enterprises face a range of obstacles in accessing finance that their traditional for-profit counterparts do not. Thus while social enterprises might exhibit a greater demand for access to finance than conventional SMMEs, they are less likely to successfully access many forms of finance.

The participants in this study experienced different degrees of success in accessing finance. Unsurprisingly, the more established, larger organisations were more successful in accessing all types of financial products and services, while the smaller organisations, many of them survivalist co-operatives, had struggled to access most forms of finance. Where these organisations were able to access credit, it was either through a savings group (or stokvel) or through unsecured loans from a bank. In these instances, these were made to individuals rather than to the enterprise.

Table 3 lists the different challenges faced by survivalist and micro social enterprises, and also small and medium social enterprises.

TABLE 3 | BARRIERS TO ACCESS TO FINANCE FOR SOCIAL ENTERPRISES

Small/medium	• Lack of a legal category for social enterprises makes it difficult to attract investment • Seen as "too profit-driven" by grant-makers and "too socially-driven" by banks and other credit providers • Confusing organisational structures, particularly when there is more than one legal entity on the application (for example both a trust and a non-profit company) • Perceived as "high risk" by financial service providers • Organisations operating in areas under tribal authority struggle to meet banking application criteria, and cannot offer land as security for credit
Survivalist/micro	• A lack of collateral / security • A lack of financial and non-financial skills • In the case of co-operatives, perception that they were set up to access grant money through the Co-operative Incentive Scheme, rather than for business reasons • Low levels of penetration by microfinance institutions • Lack of appropriate financial records • A lack of an established track record • Entrepreneurs or co-operative members who have no credit history or are blacklisted • A distrust of co-operative structures, and the perception that co-operatives often dissolve as a result of conflict between members • Low levels of awareness of different types of financial services • Organisations operating in areas under tribal authority struggle to meet banking application criteria, and cannot offer land as security for credit • An inability to access markets without making upfront capital investments, and an inability to borrow for capital investments without demonstrating access to markets – a "chicken and egg" scenario.

Most of the organisations that participated in the focus group discussions and interviews saw being able to access grant funding as more important for their enterprises than being able to access loans. This was particularly true for NGO participants, several of which saw debt finance as an option of last resort. However, co-operatives and even for-profit social purpose businesses were often more interested in grant finance rather than debt.

There are a number of reasons why social enterprises might be reluctant to seek debt finding. First, the increase in the number of social enterprises is such a recent phenomenon that many of them are only in their first few years of operation and are not yet in a position to take on debt. As a growing number of social enterprises begin to mature and develop more stable revenue streams, demand for debt finance is likely to increase. Second, this is in line with the widely held perception that many social enterprises in general, and co-operatives in particular, see these business forms as ways to access free money through grant funding that they would not be able to access through standard business structures. To the extent that perception remains, there is little incentive for them to take out loans they will have to repay.

Third, social enterprises understand that developmental projects, particularly innovative projects that are testing new approaches, are inherently risky. One NGO that operates a number of social enterprises in the tourism sector in the Eastern Cape said they were "extremely reluctant" to borrow money for developmental projects because they believed that lenders were unlikely to understand the associated risks. Another social enterprise, which works with smallholder farmers in the Eastern Cape, said they avoided taking loans to finance their projects because ultimately they had to take the risk but had only limited control over whether or not the farmers they worked with delivered.

MICROENTERPRISES

64.3%

USE PERSONAL ACCOUNTS

13.2%

USE BUSINESS ACCOUNTS

In cases like these, credit guarantee mechanisms might be a useful way of mitigating risk for social enterprises and graduating them from a dependence on grant funding to a more sustainable approach to generating revenue.

The following sections consider the different financial services providers available to social enterprises, and the obstacles in obtaining finance from each of them, drawn from publically available information, key informant interviews with representatives of financial service providers, and focus group discussions and interviews with social enterprises.

FRIENDS AND FAMILY

Some focus group participants had borrowed from friends and family either to start up their enterprises or to get them through a difficult period. As expected, the repayment terms for these loans were very flexible, and seldom was there any formal loan agreement drawn up between the parties. This is in line with FinScope research into the small business sector in South Africa which found that although survivalist enterprises, microenterprises and small businesses are unlikely to borrow money, those that do borrow money overwhelmingly tend to approach friends and family first.

With few exceptions, loans from friends or family did not come with any conditions or non-financial support. A small minority of respondents, however, did indicate that they had taken loans from friends who they considered to be mentors, and in these cases the lenders took an active interest in the business and provided advice and support to the entrepreneur.

SOUTH AFRICA HAS AN ADVANCED BANKING SYSTEM THAT COMPARES FAVOURABLY WITH THOSE OF DEVELOPED COUNTRIES

For survivalist enterprises operating at the base of the pyramid, borrowing from friends and family is limited because few people in their families or broader social circles have enough money to meet their own needs, let alone lend to others.

A number of more established social enterprises participating in focus groups and interviews said they had borrowed from friends and family, often to top up their own savings, to start their enterprises. None of these enterprises, however, had taken these kinds of loans more than once. Entrepreneurs offered a number of reasons for preferring to look elsewhere for finance once their enterprises became more established. These included wanting to source investment that was accompanied by specific expertise or access to networks, the need to operate “a proper business”, and a reluctance to be seen to be asking for “handouts”.

BANKS

South Africa has an advanced banking system that compares favourably with those of developed countries. While many of the primary banks offer entry level accounts with low fees, as well as unsecured personal loans, insurance, and money transfer services, uptake of these services is still relatively low in the small business sector (Table 4). The Centre for Inclusive Banking in Africa (2013) suggested that “South Africans remain largely deprived of a middle tier of institutions to serve the needs of a middle income country”.

The FinScope survey found that many survivalist and microenterprises did not use bank accounts for their businesses, and even those that did were usually using a personal rather than a business account. Even more formal small businesses only use separate business accounts 57 percent of the time.

TABLE 4 | UPTAKE OF BANKING SERVICES BY SMMES IN SOUTH AFRICA (%)

	Survivalist	Microenterprises	Small businesses
Use personal account for business	19.3	64.3	39
Use business account for business	0.5	13.2	56.8
Banking products used:			
Savings account	17.6	73.1	65.9
ATM card	18.8	71.8	75.3
Current account	0.1	5.4	65.9
Overdraft	0	0.3	16.1
Credit card	0	3.3	40.4
Fixed deposit	0.4	8.1	21.6
Internet banking	0	0.1	26.6

Source: Centre for Inclusive Banking in Africa, 2013

With so few businesses making use of bank accounts, and fewer still registering separate business accounts, it is little wonder that these businesses find it difficult to borrow from banks.

Enterprises operating in rural areas face an additional set of challenges in that they often cannot provide the collateral or documentation that banks require. An NGO operating in the tourism sector in the Eastern Cape explained:

MASISIZANE WOMEN'S HOUSING CO-OPERATIVE (IVORY PARK, GAUTENG)

> **"When you're in communal areas you can't get proof of address because you are on traditional land and it is owned by the chief. When businesses try to get finance from financial institutions they have to produce proof of residence and if they cannot, then they won't get finance."**
>
> **NGO, agricultural sector, Eastern Cape**

The banking sector in South Africa is conscious that access to financial services remains very uneven. One of the key aims of the Financial Sector Charter (FSC)[1], which promoted transformation throughout the financial sector, was to increase access to financial services. The FSC set specific targets for access to financial services, including, for example, that all South Africans are within five kilometres of a transaction point where they are able to draw cash or make purchases using their bank accounts. The Charter also set targets for banks to meet targets on the number of accounts for people with low incomes.

When lending to social enterprises, banks use the same criteria as for any other business. These include cash flow, the provision of security, the track record of the applicant, other financial interests and commitments, and recommendations from references (Steinman, 2010).

Some start-up social enterprises complained that it was impossible to borrow from banks without demonstrating that they had contracts with clients, but that it was impossible to secure these contracts without making an upfront capital investment into equipment and raw materials.

GREATER UITENHAGE SEWING CO-OPERATIVE

> **"We want to buy materials to make crafts. We need cloth, paints, sewing machines – otherwise how will we make our product? But we can't get a loan from the bank until we can show them orders, and we can't get orders until we have [the equipment and materials]"**
>
> **Co-operative, arts and crafts sector, Free State**

None of the major South African banks offer specific products for social enterprises. However, most banks do have enterprise development (ED) programmes as part of their BBBEE strategies. The structures of these ED programmes differ from bank to bank. Absa, for example, has a number of Enterprise Development Centres that offer workspace and non-financial support in the form of mentorship and assisting with access to markets, with the aim of developing these businesses to the point where they are ready for debt finance. FNB's Vumela Enterprise Development Fund makes equity investments to emerging black-owned enterprises that are too large for microfinance, but do not yet meet the requirements of credit providers or traditional private equity and venture capital investors. These programmes do not require that these businesses have a social mission.

[1] The FSC was a voluntary agreement that came into effect in January 2004 as a result of agreements reached at the NEDLAC Financial Sector Summit in August 2002. It has since been replaced by the Financial Sector Code, which was gazetted as a sector code in terms of the Broad-Based Black Economic Empowerment Act, of 2003 on 26 November 2012.

Most focus group participants indicated that a mainstream bank would be their first choice to apply for finance. Many of the participants felt that they could trust banks more than other types of lenders – one participant summed up this attitude saying "the banks do not try to trick you".

GREATER UITENHAGE SEWING CO-OPERATIVE

> **"Banks are efficient and you don't have to prove your track record because they already know the businesses financial history and the banks constantly do credit checks."**
>
> **NGO, tourism sector, Eastern Cape**

A significant number of participants believed that their only options for borrowing money were either through banks or informal loan sharks, who often charged extortionate interest rates and fees, and were not aware of any other potential sources of loan funding.

Many participants used banks for day-to-day transactions, including saving money, drawing cash, using bank cards to make purchases and sending money through cellphone or internet banking. Participants who operated survivalist or micro social enterprises generally did not have a separate bank account for their business, though the majority did have a personal account. Co-operatives generally had registered bank accounts, often citing the Co-operative Incentive Scheme (CIS), which requires co-operatives to submit a copy of their bank statement, as a motivating factor for getting a bank account. This scheme is now administered by the Department of Small Business Development.

Larger, more established social enterprises maintained separate accounts for their business, and in some cases had more than one account, including, for example, savings accounts, transactional accounts, as well as company credit cards.

In general, there appeared to be very low barriers to entry in opening a bank account. However, few participants had ever applied for a loan from a bank, and fewer still were successful with their applications.

For survivalist and micro enterprises, those which had accessed finance from a bank had taken out personal loans (rather than business loans). There was a widespread view that banks saw co-operatives as too risky and would not lend to them directly, though some co-operative members reported pooling personal loans from all of their members. A handful of organisations had made use of an overdraft facility to assist them with short-term cash flow problems.

MICROFINANCE INSTITUTIONS

There was very little awareness of MFIs among focus group participants. Some had never heard the terms "microfinance", "microlending" or "microloans" before. Among participants who were aware of MFIs, there was a widespread perception that interest rates were too high and loan amounts too small for them to realistically consider it as a funding option for their social enterprise.

Microfinance appears to have a reputational problem. This was evident during the focus group discussions and interviews, but can also be seen in sentiments expressed in the media. One prominent commentator labelled microfinance as a "crime against the poor"[2].

[2] Adrian Saville, Chief Investment Officer at Canon Asset Managers, said this while appearing on *The Money Show*, a popular daily financial news radio programme on Talk Radio 702 and 567 Cape Talk.

MICROCREDIT FROM A REPUTABLE MICROFINANCE INSTUTION PROVIDES A GOOD ALTERNATIVE FOR LOW-INCOME INDIVIDUALS

This represents a major change in sentiment. It was less than a decade ago that Muhammed Yunus, the pioneer of microfinance, won the Nobel Peace Prize for developing a model that could sustainably extend unsecured microloans to poor rural women. Since then, however, irresponsible lenders have done serious reputational damage to the sector. This is particularly true in South Africa where so-called “payday lenders”, essentially loan sharks who charge exhorbitant fees for short-term loans that must be paid back out of the borrowers next paycheque, have come under fire for exploiting the poor and working class. In the aftermath of the Marikana massacre, these lenders came under scrutiny for their practices and were criticised for deliberately trapping their clients in cycles of debt with very high interest rates. While these lenders are not MFIs, their activities do affect the reputation of the microfinance sector.

At the same time, lenders that have been under pressure to grow their number of clients and increase the size of their debtors’ book have sometimes been guilty of relaxing their own lending criteria. As a result, the quality of their debtors’ book has deteriorated and the rate of default has increased. In 2013, three large micro-enterprise credit suppliers in South Africa closed down: Marang Financial Services, the microfinance division of Women’s Development Business, and the Absa Micro-enterprise Finance Division (Centre for Inclusive Banking in Africa, 2013). In addition, Africa Bank was put under curatorship in 2014 after being bailed out by the South African Reserve Bank and a number of other investors. The financial woes of Africa Bank are mainly attributed to the aggressive growth in the number of unsecured loans it made and the resulting high default rate on its loan book.

Despite these potential problems, microfinance can still play an important developmental role in South Africa. A microlender that is often hailed as a success story, both for its financial sustainability and for the impact it has on the lives of its clients is the Small Enterprise Foundation (SEF).

While the overall picture for the microfinance sector seems nascent, it has potential. In 2013 SEF operated only in Limpopo, Gauteng, the North West Province, and to a lesser extent in KwaZulu-Natal. It continues to grow its number of branches and clients. In addition, the Association for Pro Poor Micro Finance Institutions for South Africa has been re-launched with new members and resources and initiatives. And, finally, the government wholesale funding organisation, the Small Enterprise Finance Agency (SEFA), has developed policies to provide stronger support to the sector (Centre for Inclusive Banking in Arica, 2013).

Microcredit from a reputable MFI provides a good alternative for low-income individuals who do not have the credit record or collateral available to apply for a loan through a mainstream bank. While it comes at the price of high interest rates and fees, group lending through a relationship banking model has built-in support structures that assist borrowers through their decision making and ensures that they meet their repayment obligations.

It is, however, rare that an MFI would make a loan of greater than R10 000. SEF, for example, indicated that only about 10% of their clients have taken a loan of R10 000 or greater, with an average loan size for first-time borrowers of R1 323. Thus while microfinance might be suitable for survivalist and micro-enterprises, it is unlikely to be a feasible option for larger social enterprises.

LENDER FOCUS: THE SMALL ENTERPRISE FOUNDATION

According to the Centre for Inclusive Banking in Africa, SEF is by far the biggest microlender in the country, with over 95 000 active loans (in 2013, the next biggest, Phakamini, had only 8 000).

When interviewed for this research, SEF indicated that its first-time borrowers typically borrow between R1 000 and R2 000 (average R1 323) and make repayments over a four-to-five-month period. They follow a group lending model, in which groups of about five people come together to form a group of borrowers. While the loans are unsecured in that SEF does not require any collateral, the group does stand as security for its members in that group savings are used to avoid default if any of the individual members are unable to make repayments on time. SEF follows the Grameen model for microlending, and thus mainly lends to women; more than 99% of their clients are women.

Like most microlenders, SEF does have relatively high interest rates; about 31% annually, plus a number of initiation fees. SEF runs a "relationship banking" model, in which its branch managers have close relationships with clients and assist them with solving problems they might face. SEF also offers its members financial literacy training as well as basic health and HIV education. This makes SEF a resource intensive operation, and some of this cost has to be passed on to their clients in the form of interest and other fees.

While SEF sees fighting poverty as central to its business mission, it does not perceive its clients as social enterprises. According to the SEF operations manager: "Our clients are mainly survivalist businesses. They are not social enterprises because none of them of them are large enough to be one. They perform an important social function in that they provide a source of income for entrepreneurs and often support extended families, but they aren't social enterprises that set out to achieve particular social goals."

SEF has been instrumental in developing social impact metrics for microfinance in the South African context. SEF uses a Progress out of Poverty Index (PPI) to understand the impact of their loans by measuring improvements in their clients' food intake and housing. It regularly makes submissions to the Microfinance Information Exchange (MIX), and has been rated by M-CRIL, a ratings agency specialising in microfinance organisations, which rates both financial and social performance. SEF was given a social rating of alpha, the second best possible rating.

According to the Financial Inclusion Lab, access to microenterprise lending is limited: there are only 12 municipal districts in the entire country where organisations specialising in lending to microenterprises have branches. These are concentrated in rural areas of Limpopo, KwaZulu Natal and the Eastern Cape.

CO-OPERATIVE FINANCIAL INSTITUTIONS AND CO-OPERATIVE BANKS

The Co-operative Banks Development Agency (CBDA), an agency within the National Treasury, was established to provide supervision and support to financial co-operatives. It was established in 2009, following the promulgation of the Co-operative Banks Act. The CBDA's original mandate was to regulate and supervise primary co-operative banks that hold deposits of between R1 million and R20 million and have a membership of at least 200 members. In 2012, this mandate was expanded to include the regulation and supervision of co-operative financial institutions (CFIs) that meet the registration requirements of having at least R100 000 in share capital and no fewer than 200 members. The stated intention of bringing co-operative banks and CFIs together under one regulator is to promote the growth of CFIs into co-operative banks.

There are only two registered co-operative banks in South Africa. The CBDA identified a further 16 financial co-operatives that meet the size requirements to become co-operative banks. However these had not yet met all of the other prudential requirements (Centre for Inclusive Banking in Africa, 2013).

None of the focus group participants had borrowed from co-operative banks. This is hardly surprising as none of them service the areas in which focus group discussions took place. In addition, there was some evidence of confusion between CFIs and stokvels, particularly among survivalist and micro-enterprises.

At the time of writing, there were only 20 registered co-operative financial institutions, according to the website of the CDDA. During focus group discussions, participants who indicated that they had taken a loan from a CFI were asked to provide the name of this institution. None of the names matched any of the names of co-operative financial institutions listed on the CBDA website. These loans were thus almost certainly not taken from a CFI, and were most likely taken from stokvels that were not formally registered as CFIs.

The CFIs that have registered with the CBDA have been established to provide financial services to particular member groups. In some cases, they provide services to the entire population of a particular rural area, in others they have been set up to provide services to workers at particular companies, or members of particular trade unions. There is limited publically available information about the lending practices of these organisations. However, the National Education Health and Allied Workers Union (NEHAWU) publishes information about its SACCO on its website. Table 5 details the products it offers.

TABLE 5 | NATIONAL EDUCATION HEALTH AND ALLIED WORKERS UNION PRODUCTS

Product type	Amount that can be borrowed	Rates and terms
Emergency loans	R200 – R1 500	Flat fee of R15 per R100 borrowed, payable over a period of between one and three months. Only one loan may be taken at a time.
Short-term loans	R1 500 – R10 000	Interest rates determined on the basis of security, starting at 28% per annum. Loans must be repaid within 24 months.
Debt consolidation loans	R10 000 – R30 000	Members' access to loans depends on their savings balances. Only those who have shown ability to repay will get this service. Interest rates start at 28%.

These products are only available to National Education Health and Allied Workers Union (NEHAWU) members and employees who have paid a once-off joining fee of R200. Any surplus generated by the Savings and Credit Co-operative (SACCO) is redistributed to these members at the end of every financial year.

The Centre for Inclusive Banking in Africa identified the lack of effective and affordable banking technology platforms and a shortage of skills at all levels as two key challenges constraining the growth and development of co-operative banks. Assuming that these challenges can be addressed, they see co-operative banks as having the potential to play an important role in promoting financial inclusion.

STOKVELS AND COMMUNITY SAVINGS GROUPS

Stokvels are informal savings and credit mechanisms that remain popular throughout South Africa. There are two main stokvel models: accumulating and rotational. Accumulative stokvels collect regular contributions into a central fund that builds over a period of time. This capital could be invested or used to make loans to members and, in some cases, other community members. Rotational funds pay all of the contributions for a single period to a different stokvel member on a rotational basis. For instance, in a rotational stokvel with 10 members each contributing R500 a month, each member would receive R5 000 once every 10 months.

According to research conducted in 2012 by African Response (2012), 11.4 million South African adults participated in 811 830 stokvels, saving about R44 billion every year. Generally, stokvels operate like a rotating credit union, where members make regular (normally monthly) contributions to a central fund.

Stokvels are established for a range of purposes. An estimated 43 percent of stokvels are savings stokvels, while 22 percent are burial stokvels that aim to assist members to meet funeral expenses. About 16 percent are grocery stokvels, which use group buying to get lower prices for their members, while the rest are a mix of school fee stokvels, investment stokvels and other goal-specific stokvels (African Response, 2010).

Participants in focus group discussions that had borrowed from stokvels typically cited two reasons for using a stokvel as opposed to any other financial service provider. The first reason is trust; participants were likely to refer to "our" or "my" stokvel, indicating a sense of ownership and community. They highlighted the importance of trusting relationships between all stokvel members. This supports research that has argued that stokvels fulfil a social role as much as a financial one.

2012
11.4 MILLION
SOUTH AFRICANS
811 830
STOKVELS
R44 BILLION
a year

The second reason was convenience. None of the participants who borrowed money from a stokvel had to produce any documentation to access a loan. Some participants admitted that they were blacklisted, and thus unable to obtain personal credit from a mainstream lender, but were still able to borrow from their stokvel. There was generally no paperwork to process to access the loan, and no formal document setting out the terms of the loan agreement.

The most frequently mentioned disadvantage of borrowing from a stokvel is that it is expensive. Rates differ from stokvel to stokvel: one participant said that she was charged 20 percent a month; another said 50 percent every six months, a third said 40 percent a year. However, some participants indicated that their stokvels charge simple (non-compounding) interest. For example, the person who was charged 20 percent a month only had to pay 20 percent of the initial loan amount for every month that there was an amount outstanding, so that a R1 000 loan would require a repayment of R1 000 plus R200 a month until the loan was paid off. While this is still an expensive form of finance, it would be far more expensive if stokvels charged compound interest, as most formal lenders tend to do. Table 6 illustrates how stokvel loans can be more affordable than loans charging compound interest (as would be the case with most other financial service providers). For comparison purposes, this example is based on full payment of the loan being made at the end of the 12 months, rather than reducing the loan amount every month.

Stokvels generally only lend to contributing members, and thus these loans are made to individuals rather than to co-operatives or social enterprises. Stokvels generally make only small loans – participants generally reported taking loans of less than R2 000 (though in some cases these a number of loans were pooled together by co-operative members).

CASH FLOW MANAGEMENT AND BRIDGING FINANCE

Often the biggest client for a social enterprise will be a government department. While this has been an important driver of growth for social enterprises, many complained that government departments take too long to pay their invoices.

DEAF HANDS @ WORK (CAPE TOWN)

> **Our contract with government is such that they must pay on invoice after 30 days. However, this is not always the case and payments can take 60 to 90 days. This places a huge burden on our cash flow.**
>
> NGO, agribusiness, Eastern Cape

TABLE 6 | SIMPLE VERSUS COMPOUND INTEREST

Repayments on a R1000 loan: simple vs compound interest					
Scenario 1: 20 percent compound interest			Scenario 2: 20 percent simple interest as used by stokvels		
Month	Compound interest	Total repayment	Month	Simple interest	Total repayment
1	R 200	R 1 200	1	R 200	R 1 200
2	R 240	R 1 440	2	R 200	R 1 400
3	R 288	R 1 728	3	R 200	R 1 600
4	R 346	R 2 074	4	R 200	R 1 800
5	R 415	R 2 488	5	R 200	R 2 000
6	R 498	R 2 986	6	R 200	R 2 200
7	R 597	R 3 583	7	R 200	R 2 400
8	R 717	R 4 300	8	R 200	R 2 600
9	R 860	R 5 160	9	R 200	R 2 800
10	R 1 032	R 6 192	10	R 200	R 3 000
11	R 1 238	R 7 430	11	R 200	R 3 200
12	R 1 486	R 8 916	12	R 200	R 3 400

This suggests that there may be demand for credit providers that can offer invoice factoring or similar services. Essentially these service providers advance working capital to businesses in exchange for the right to collect their invoices.

All of the major South African banks offer invoice factoring, and a number of non-banking financial services specialise in providing invoice factoring and invoice discounting services. However, banks require financial statements, management accounts, cash flow projections, and an analysis of debtor and creditor aging. This means that the barriers to accessing this kind of finance are too high for many small businesses, particularly those that are in the early stages of development.

However, some companies have begun to develop interesting financial innovations to address the problem of late payments by government. African Dynamics Group (ADG), a food supply and manufacturing company that supplies many SMEs that operate school feeding schemes, has piloted a project whereby they advance working capital to their suppliers on proof of them invoicing the relevant government department. This allows the SMEs to continue operating and paying salaries even when there are delays in payments from government. By ensuring these SMEs are better able to cope with payment delays, ADG also ensures that its clients will be in a position to continue buying from them.

A MAJOR STRATEGY OF THE SOUTH AFRICAN GOVERNMENT FOR DEVELOPING THE SOCIAL ECONOMY IS THROUGH SUPPORTING CO-OPERATIVES

GRANT FUNDING

A number of NGOs that participated in this study, as well as one Pty (Ltd) social purpose business, had received grants from other sources, including philanthropic foundations and through companies' corporate social investment. However, few of the co-operatives had received any funding from anyone other than a government department. The only exceptions were co-operatives that had received grant funding as part of an award from the ILO in a business competition.

Most of the focus group participants did not seem to be aware that they could qualify for enterprise development funding under the BBBEE codes.

Non-profit organisations were often heavily reliant on grant funding, and tended to rely on well-connected and highly skilled fundraisers who are able to find potential donors and identify ways in which their organisations can create value for these donors.

Raising grant funding often takes a lot of time. Many grant applications take six months to process, and in some cases organisations claimed to have waited for over two years between the date of their initial application and funds eventually reaching their bank account.

One social enterprise based in the Western Cape had accessed funding through the IDC. While this funding was structured as a loan, the debt would be written off upon delivery of particular developmental goals

THE CO-OPERATIVE INCENTIVE SCHEME

A major strategy of the South African government for developing the social economy is through supporting co-operatives. The most prominent programmes driving this support are run through the Department of Trade and Industry (the dti) and include the CIS which makes grants of up to R350 000 to qualifying co-operatives[3].

Many of the co-operatives that took part in this study seem to have chosen to register their co-operatives to access a CIS grant. When asked to name institutions that supported co-operatives and social enterprises, the dti and the Small Enterprise Development Agency (SEDA) were mentioned frequently. These entities were also singled out for taking a long time to process applications and for not responding to enquiries. A number of participants said that apart from an acknowledgment of receipt, they had received no feedback on their funding applications, which had been submitted more than a year previously.

> **"There are some co-operatives that are set up because they have heard that they can get a grant if they set up a co-operative. And those are the ones that are doomed to fail. They throw together five individuals and write a business plan, but they don't know anything about the difficulties of working as a democratic unit."**
>
> **Financial service provider, Welkom, Free State**

ITEKENG BASADI SETSOTO (FREE STATE)

[3] This scheme is now being administered by the Department of Small Business Development.

LACK OF A DEDICATED AGENCY DESIGNED PRIMARILY TO SUPPORT CO-OPERATIVES ON A FOCUSED BASIS RESULTED IN UNTARGETED AND UN-COORDINATED SUPPORT

The dti itself has found that the survival rate for co-operatives in South Africa is worryingly low (See Table 7). In its 2012-2022 Integrated Strategy on the Development and Promotion of Co-operatives (the dti, 2012) the department found that the mortality rate of co-operatives in 2009 was 88 percent. In other words of all registered co-operatives in 2009, 88 percent of them had ceased to function.

TABLE 7 | CO-OPERATIVE SURVIVAL RATES

	Active co-operatives	Inactive/ "dead" co-operativesrate	Survival rate	Mortality
NATIONAL	2 644	19 975	12%	88%
KwaZulu-Natal	1 044	7 653	12%	88%
Eastern Cape	287	3 957	7%	93%
Western Cape	69	934	7%	93%
Northern Cape	20	778	2.5%	97.5%
Limpopo	405	1 474	22%	78%
Mpumalanga	187	1 309	12.5%	87.5%
Gauteng	394	1 971	17%	83%
Free State	71	829	8%	92%
North West	167	1 090	13%	87%

the dti, 2012

The dti offers the following reasons for this high mortality rate[4]:

- Lack of a dedicated agency designed primarily to support co-operatives on a focused basis, resulting in untargeted and un-coordinated support, characterised by poor mentorship,
- Lack of investment dedicated to co-operatives,
- A sense of neglect throughout all spheres of government and their respective enterprise development agencies,
- The tendency of co-operatives to be established for the purpose of accessing free money through the CIS instead of genuinely building a co-operatives movement, evidenced by widespread conflict among co-operative members over issues of money and the use and ownership of assets, and
- Poor management and a lack of co-operation among co-operative members.

The dti's strategy for increasing the supply of financial support services to co-operatives is segmented according to the size, sophistication and needs of different types of co-operatives. This includes making grants through the CIS; promoting the availability of micro-loans for survivalist and micro co-operatives; and the provision of technical assistance, business loans and credit guarantees.

4 This list is adapted from the dti (2012).

UNINTENDED CONSEQUENCES OF A CONDITIONAL GRANT

An agricultural co-operative from the Free State was established with a grant from a provincial government department. While this funding allowed the co-operative to start trading, co-operative members say that some of the conditions imposed on them are making it impossible to grow a successful business.

"We were very happy when we got the news about the grant" says Ofentse*, one of the founding members of the co-operative "they didn't give us cash, but they provided land and some equipment. It was enough to get us started."

The co-operative operates a feeding lot – mainly for cattle – in a rural part of the Free State province. Their stated social purpose is to assist underprivileged cattle farmers to get better prices for their livestock. Animals are sold to the co-operative by smallholder farmers from in and around 30 villages in a rural district of the Free State. The co-operative then prepares the animals for market before selling them on to abattoirs. "For a while things were going well," says Ofentse "but it is difficult now. We are struggling."

There are two main problems that the co-operative faces. First, as recipients of grant funding, they have been forced to take decisions that they know are harmful for their business. "They [the government department that supplied the initial grant funding] issued a directive saying that we must buy any animal that community members want to sell." As a result, the co-operative was forced into buying cattle that it knew it could not find a buyer for – animals that were often old and unlikely to produce meat suitable for human consumption. "Those cattle are eating our money" says Ofentse.

Second, the co-operative has struggled to access finance for working capital or new equipment. "The banks want security. But the land does not belong to the co-operative, this land still belongs to the government," Ofentse explains. The only assets that are registered to the co-operative are a tractor and a few other pieces of equipment, which according to Ofentse the banks will not accept as security.

Despite the best intentions of the government department concerned, this co-operative seems bound for failure. Through a mechanism designed to provide local farmers with a marketplace for their livestock, the co-operative is forced into operating a business model that is not sustainable in the long term. And by providing grants that allow for access to land, but do not allow the co-operative to build an asset base, they are limiting the options for raising further capital.

This is partly due to the relationship dynamic that emerges in a grant funding situation. In this situation, the government department sees itself as buying outcomes from the co-operative: in exchange for a grant of access to land and equipment, the government expects the co-operative to deliver a marketplace for smallholder farmers in rural areas. However, if the government were to approach the co-operative not as an outcomes buyer, but rather as an investor it might take a different approach. It is difficult to imagine that an investor would try to dictate which supplier a business is obliged to use in the way that this co-operative was forced into buying from some suppliers as a condition of their grant funding.

- Not his real name

SAVINGS

Only a small minority of the participants in this research were saving money regularly. Generally, these tended to be more established organisations. A range of motivations were offered for saving: some were trying to build a reserve fund; others were saving to purchase their own premises or pieces of equipment for their businesses. More established organisations generally kept their savings in bank accounts, though a small number had investments, typically in unit trusts. Of the smaller organisations that did have save regularly, these were also generally kept in bank accounts.

ITEKENG BASADI SETSOTO (FREE STATE)

> **"By saving with a bank there is some interest generated but most importantly the funds can be accessed immediately"**
>
> **NGO, tourism sector, Eastern Cape**

A number of co-operative members indicated that they were members of stokvels. While these savings belonged to the individual co-operative members (rather than to the co-operative as a business), in practice there is often little distinction between personal and business finance, particularly for smaller co-operatives operating at the base of the economic pyramid.

Some MFIs have compulsory savings plans in place. SEF, for example, has partnered with PostBank and Nedbank to facilitate its clients' savings. SEF follows a group lending model, with each group meeting once every two weeks. It is compulsory for every client to save at every fortnightly meeting but clients may withdraw whenever they wish. The minimum amount that must be saved is set at a low R10 per person per fortnight. After the first loan, 10 percent of the subsequent loan is required as up-front savings. These group savings provide security against default by any of the individuals in the group and also provide members with savings for emergencies or business expansion.

LEASING SERVICES

Very few of the enterprises that participated in this research made use of any leasing services. Those that did were larger, more established organisations. These organisations leased technological equipment (computers, servers, photocopiers and so on) from established commercial leasing agents. Generally, organisations indicated that the application process was quite straightforward, and while in some cases they were required to provide bank statements, they did not have to provide collateral. These services were seen as highly accessible, and some organisations reported that they are frequently contacted by competing sales people trying to convince them to change service providers.

OLD MUTUAL MASISIZANE FUND R1 BILLION TO PROMOTE JOB CREATION

A number of smaller organisations indicated that they rented some equipment on an ad hoc basis when it was necessary, but did not have longer-term leasing agreements in place. This is mainly the result of the sporadic nature of business for many of these enterprises.

MONEY TRANSFERS AND PAYMENT SERVICES

The most commonly used payment services by social enterprises of all sizes was online banking, most often to pay salaries, but also to pay suppliers and municipal accounts. Participants were aware of other types of money transfer services, particularly those offered at supermarket "money counters", however, these were generally not used for business purposes. None of the respondents reported using mobile money services such as M-Pesa.

INSURANCE

None of the survivalist and micro enterprises which participated in the research had any form of insurance for their business. More established businesses commonly had general liability policies, as well as policies for property, vehicles and specialised equipment. Participants that did not have any insurance policies indicated that this was because they were unable to afford insurance, though almost all participants said that it is "quite easy" or "very easy" to take out an insurance policy.

INVESTMENT FUNDS

Globally there has been increased interest in the field of "impact investing". In South Africa there are a number of funds that specifically target both financial and social returns. Asset managers with funds that explicitly target social as well as financial returns include Old Mutual, Cadiz Asset Management, Atlantic Asset Management, Mergence and Future Growth.

In recent years many intermediary organisations have emerged – these are mostly business incubators and accelerators that seek to find innovative new social enterprises that have the potential to scale up, and to help assist these organisations as they grow by offering technical assistance and sourcing appropriate investment. Despite this growth, however, these efforts have mainly been sporadic and have not been able to attract investment beyond a handful of pioneering funds and private equity firms.

FROM DONOR TO LENDER: OLD MUTUAL MASISIZANE

When Old Mutual demutualised and became a listed company in 1999, 3.2 million policyholders were allocated shares. A small minority of these shares, however, were never claimed. The funds raised from the sale of these shares – almost R1 billion – were used to establish the Masisizane Fund. The fund supports black-owned enterprises, with a strong bias towards women, youth and disabled people, and a geographic target of rural, townships and peri-urban areas and small towns. The fund also offers non-financial support such as financial education and mentorship.

For the first decade of its existence, the fund took what, by its own admission, was a "soft" approach. It made loans even when it was clear that the borrower would not be able to pay the loan back, reasoning that when these loans were written off they could be treated as grants.

In 2012, realising that the money would eventually run out if it was simply given away, there was a strategic overhaul of the fund, which now aims to be sustainable in the long term. The due diligence process for potential deals has thus become a lot more robust.

During the due diligence process, Masisizane might identify areas of business weakness. In these cases, Masiszane will either provide training directly or they will pay for a third party to provide specialised assistance. This could consist of financial training, the development of governance systems, marketing assistance or training in specific farming or manufacturing techniques. At the time of the research Masisizane carried the cost of all training, though in future it plans to cover these costs either through donor funding or through including it in the cost of finance to their borrowers.

Until 2012 the fund was only investing the interest earned on its R1 billion endowment. However, as part of its new strategy, it aims to be fully invested in the next few years. This represents a significant investment that is earmarked for small black-owned businesses in the medium term.

Masisizane makes loans of between R350 000 and R4.5 million, though it may consider larger deals as it begins to invest more of the fund. Companies must have been operating for a minimum of six months to be considered. It has flexible interest rates, depending on the potential social impact and deal size. Rates could be as low as prime minus five percent or as high as prime plus five percent. For small businesses, particularly those with a limited track record, these rates compare favourably with mainstream banks.

While Masisizane makes loans to both individuals and to companies, it tends to avoid lending to co-operatives. When interviewed, the Client Liaison Manager for Masisizane said "Co-ops are just problems. Nobody takes responsibility." Referring to the CIS grants she added "most of them are established because the government paid them to do it – which is a bad reason to start a business".

Masisizane's experience of co-operatives has been that they tend to lead to conflict because all members share equally in profits and ownership, even when some co-operative members clearly contribute more to the business.

However, while Masisizane might avoid making loans to co-operatives, they actively encourage their borrowers to form groups. In the agricultural sector, for example, they cluster smallholder farmers into borrower groups. This allows them to negotiate better prices and to meet bigger orders from large clients. It also allows Masisizane to save some cost by carrying out financial training and mentorship in groups.

A NUMBER OF FUNDS AIM TO ASSIST BUSINESSES TO GROW AND CREATE JOBS

Asset Management companies tend only to consider loans worth more than R5 million, and in some cases much larger. These funds are thus unlikely to lend directly to small businesses.

There are a number of lenders that target loan sizes of between R150 000 and R5 million. These include the Old Mutual Masisizane Fund (which has a developmental mandate to promote job creation) and Business Partners' debt fund (which has purely financial goals).

There are a number of similar funds operating in the country. These include Cadiz Asset Management's Enterprise Development Fund, which aims to pool companies' enterprise development funding as part of their BBBEE strategies and invest them in emerging black-owned enterprises; and Business Partners Ltd's SME finance fund, which makes loans to entrepreneurs and small businesses. There are also funds operated by large companies, usually as part of their own BBBEE strategies. Perhaps the best known example is Anglo Zimele, a programme run by Anglo American that aims to develop a cohort of black-owned businesses that have the potential to become suppliers to Anglo American.

While these funds do not have a particular focus on social enterprise, they all aim to assist businesses to grow and create jobs. They generally combine access to finance with non-financial assistance and training. None of the social enterprises that participated in this study had received financial or non-financial services from any of these types of funds, and only a handful were aware that these types of funds existed.

As a step to filling the gap, the IDC has established a social enterprise investment fund. The IDC has previously invested in social enterprises such as Trade-Mark, which provides an online platform to connect skilled artisans with employers, and Shonaquip, which designs specialised wheelchairs for children to improve posture and reduce spinal complications and bedsores.

The IDC's investment in these organisations took the form of loans, but repayments are written off on the achievement of specific targets, effectively making these loans conditional grants. However, these loans are only available to more established organisations and are generally for more than R1 million, making this form of finance unsuitable and unattainable for smaller organisations.

NON-FINANCIAL NEEDS

ACCESS TO MARKETS

A common view expressed during focus group discussions was that government encouraged people to establish co-operatives, but did not offer them the necessary support to find markets for their goods and services, or to implement basic business structures that would position them for growth. A number of co-operatives attending workshops had never actually traded, and were effectively dormant. Some of these co-operatives had bid for tenders with government departments. Their proposals were generally rejected, and in a number of instances they were told that co-operatives were ineligible to bid. Some co-operatives expressed confusion that on the one hand they felt that government departments were encouraging them to form co-operatives, while on the other hand departments would not consider awarding contracts to co-operatives.

For these nascent co-operatives that had not yet begun trading, a common view was that access to markets was a far more pressing concern than access to finance. Many felt that they were not yet in a position to seek debt finance as they did not yet have any customers, and thus would not have the cash flow available to service any debt.

There have been some encouraging policy developments that recognise this elsewhere in government, and a number of different government departments and agencies have identified the lack of access to markets as a major constraint to growth for co-operatives. Some provincial governments have set targets for a certain level of procurement spending to be directed towards co-operative enterprises. The Limpopo government, for example, has announced that it would channel 10 percent of procurement spending to co-operatives. If similar standards were set throughout all provinces, this would mean that about R15 billion would be set aside for procurement from co-operatives[5].

TECHNICAL ASSISTANCE AND TRAINING

Enterprises of all sizes and stages of development participating in this study saw the lack of crucial skills – both financial and non-financial – as a potential threat to the future wellbeing of their enterprise.

LIMPOPO
10%
PROCUREMENT SPENDING FOR CO-OPERATIVES
R15 BILLION
ESTIMATE

Early stage businesses participating in this study often had a range of training needs. For survivalist and micro enterprises, these training requirements were often very basic – one co-operative member said they knew they needed a business plan to apply for funding, but did not know how to put this kind of document together.

More established enterprises were generally comfortable with the level of financial skills that they had internally, but had often identified other areas in which they needed training. These included monitoring and evaluation, human resources, the development of governance systems, BBBEE, and marketing.

Early stage enterprises generally saw the government (through SEDA) as the main source of training. However, the financial service providers that participated in this study questioned the quality of this training. One fund manager said that business plans they received from co-operatives applying for finance were "clearly cut-and-paste jobs", with little evidence of a real understanding of business processes or customer research.

TOWARDS BETTER ACCESS TO FINANCE FOR SOCIAL ENTERPRISES

Throughout the focus group discussions and interviews, there was a clear distinction between, on the one hand, established small and medium social enterprises and, on the other hand, survivalist and micro enterprises (often in the form of co-operatives). The challenges these two broad categories of social enterprise faced were vastly different, and to improve access to finance, different strategies are needed.

[7] Based on estimated total government procurement budget of R150 billion

IMPROVING ACCESS TO FINANCE NEEDS TO INCORPORATE CONNECTING MICRO AND SURVIVALIST ENTERPRISES WITH TECHNICAL ASSISTANCE IN THE FORM OF FINANCIAL AND NON-FINANCIAL TRAINING

The larger, more established organisations were far more likely to have accessed all types of financial products and services than smaller organisations. Many of these enterprises said that it was relatively easy to access loans through banks, though some organisations felt that this was too expensive and preferred to finance growth through savings.

In contrast, when micro-enterprises or survivalist enterprises were able to access credit, it was either through a savings group (stokvel) or through unsecured loans from a bank. In these instances, these were made to individuals rather than to the enterprise.

Small and medium enterprises with some track record of operations tended to highlight inconvenience and difficulties in finding information about different financial products and services available to them. The challenges described by micro and survivalist enterprises are different: not knowing how to design a business plan; a lack of access to markets; a lack of financial and business skills; and a lack of a documented track record.

As a result, these enterprises are often considered “unbankable” by mainstream financial service providers.

What is needed, therefore, is a dual strategy for improving access to finance that is able to serve both of these groups. This strategy needs to incorporate connecting micro and survivalist enterprises with technical assistance in the form of financial and non-financial training. Some microfinance providers can provide this kind of technical assistance parallel with access to small loans, which could allow these enterprises to build a track record of borrowing and repaying while learning the necessary skills to grow their businesses.

More established social enterprises, however, highlighted the need to access information about different financial products and services and how to apply for them.

Many of the financial services providers interviewed indicated that they would be interested in a mechanism that connects them with social enterprises which could potentially become clients.

The ILO can play a catalytic role in improving access to finance both micro/survivalist and small/medium social enterprises by developing a mechanism that connects these enterprises to the information they need. This mechanism could take the form of an online information portal.

SECTION TWO | SUGGESTED MECHANISM FOR IMPROVING ACCESS TO FINANCE FOR SOCIAL ENTERPRISES

HOUT BAY RECYCLING COOPERATIVE

To help address the misalignment between supply and demand of financial services outlined in this study, the ILO aims to support the development of a sustainable referral mechanism. As section one of this report has shown, social enterprises face a range of obstacles in accessing the finance they need to sustain and grow their businesses.

According to the Terms of Reference for this study (ILO, 2014), the main aim of such a mechanism should be to "improve access to financial products by the target group [i.e. social enterprises], specifically through the development of a sustainable referral/linkage mechanism for social enterprises".

There are some initiatives that aim to connect social enterprises with resources and information, most notably the African Social Entrepreneurs Network (ASEN), which aims to provide its members with "with access to latest tools, resources, training, information and news"[6]. However, neither ASEN nor any other initiative aiming to support social enterprises that was encountered during this research had particular focus on connecting social enterprises to financial services and products.

Recommendations for the type of mechanism that should be supported by the ILO are based on four key insights:

- **Treating social enterprises as a homogenous category is unlikely to be successful.** The financial and non-financial needs of survivalist co-operatives in rural areas is vastly different from the needs of NGOs looking to generate revenue through trading activities, which are again vastly different from those of larger-scale enterprises that aim to have a positive social or environmental impact. It is therefore best to consider developing a number of mechanisms, rather than a single mechanism designed to serve an impossibly wide range of target groups.
- **The small businesses that struggle to raise capital – both social enterprises and conventional small businesses – are often seen by potential lenders as not being investment ready.** In some cases, this is because of a lack of collateral or a track record, but more often it is because these businesses lack some basic information. They often cannot demonstrate that they understand their target market, or even that they have done any market research; basic financial systems are not in place and businesses do not have tax clearance certificates, for example. These organisations need to access training and mentorship programmes and other business development services providers.

6 http://asenetwork.org/about/

- **The decreasing cost of smartphones and of mobile data will make online information increasingly accessible.** There appeared to be a generational split in the information-seeking strategies pursued by the entrepreneurs who took part in this study, with younger, more technologically savvy participants with more years of formal education preferring online and mobile resources, and older participants, particularly those in more rural areas, tending to favour walk-in resources within their communities. However, as no-frills internet enabled smartphones become more accessible, they are likely to become as commonplace as ordinary cellphones are today[7].
- **There are other initiatives aimed at building a mechanism to improve access to finance for small businesses in general and social enterprises in particular**. These include resources such as the online platforms SME Toolkit South Africa and finfind, as well as crowd-funding platforms such as Thundafund. The ILO could have a greater impact by collaborating on these initiatives rather than by starting a new initiative in isolation.

Based on these four insights, the most useful mechanism for improving access to finance for social entrepreneurs should:

- Recognise the different contexts that businesses are operating in and offer resources based on business sector, size and track record of company).
- Combine information about financial services and non-financial services.
- Be online and accessible through mobile platforms.
- Build on what is already available through collaborations with existing platforms.

Many of the more established social enterprises encountered during this research said that a single online resource that provided a searchable database of potential sources of finance would be extremely useful.

> **One central portal with a list of potential funders, what they fund, what their requirements are, how long the process takes, etc. would be very useful for sure.**
>
> **Non-profit trust with job creation focus, Western Cape**
>
> **There should be a central place, like a website, where small enterprises can go to see all the various requirements of financial institutions to get loans or grants. This would save them from travelling long distances only to find out that there are documents they want but you did not bring.**
>
> **NGO, tourism sector, Eastern Cape**
>
> **It would be great if there was a directory of potential funders.**
>
> **NGO, agribusiness sector, Eastern Cape**

7 Trade figure from Pep Stores (South Africa's biggest cellphone retailer) showed that in the last half of 2013, only one percent of all handsets sold were smartphones. In the first half of 2014, that figure had increased to 13 percent.

Online platforms have the advantage of being accessible anywhere that it is possible to connect to the internet. This could create serious savings in time and money, particularly for entrepreneurs in rural areas who would otherwise travel to urban centres to complete applications or ask for advice. One focus group participant, who lived in a rural area 55 kilometres from Bloemfontein, observed that a return trip to town cost him R200, but that he has felt that he had to make the trip a number of times while trying to find out about access to finance for his enterprise.

To be useful, this online resource must go beyond simply listing a database of financial service providers. It should include a description of application processes, the types of organisations that the financiers are looking for, the geographical areas that they serve, and other relevant information. The ILO's Guide to Finance (2010) would provide a useful starting point for developing such a database provided that the information contained in the guide was updated. There are a number of things that could be done to make this information more accessible. These include:

- Investing in developing a better user experience for navigating the guide. In its current form, the database is searchable, but cumbersome, text heavy and confusing.
- Adding value by providing access to non-financial services. For some organisations, barriers to accessing finance include obtaining a tax clearance certificate or business registration documents. An easy to follow guide that directed social entrepreneurs to technical assistance providers.
- Making the resource available in official languages other than English.

Where possible, the ILO should aim to collaborate with initiatives that have similar aims and have already invested in developing user-friendly platforms that aim to assist small businesses to access finance. See Table 8.

TABLE 8 | INITIATIVES ASSISTING SMALL BUSINESS TO ACCESS FINANCE

INITIATIVE	DESCRIPTION
The SME Toolkit South Africa	A collaboration between the International Finance Corporation; the IBM foundation; and Business Partners, a South African company that specialises in providing finance and consulting services to SMEs. The SME Toolkit offers access to information, resources and online training relevant to SMEs in a large number of industries and business sectors. Companies can download forms and get advice on developing business plans, tax and legislation and marketing and sales. There is no particular focus on social enterprises.
finfind	A USAID-funded initiative that has received support from the dti, finfind is an online tool that is designed to assist SMMEs to identify the appropriate type of financial product to meet their needs and to identify potential finance providers.
Thundafund	South Africa's answer to international crowdfunding platforms, Thundafund provides a place for South African and African entrepreneurs to test ideas and raise capital for innovative ideas through crowdfunding. Thundafund also offers mentorship services. Thundafund takes a fee out of the total amount raised on its platform (five percent for certified NGOs; seven percent for individuals and other organisations). Projects on the website vary in size and across sectors, from a R10 000 to help launch an eco-tourism company to R2 million to transition one of the country's oldest independent cinemas to digital technology.

The ILO could add value to these platforms by developing special streams that focus on social enterprises (as opposed to conventional SMEs). For these platforms it has the advantage of growing their client base by appealing to both social enterprises and impact investors who have a special interest in finding social enterprises in which to invest.

CONCLUSION

ITEKENG BASADI SETSOTO
(FREE STATE)

The findings of the scoping study illustrate a clear need for better linkages between the supply and demand for access to finance for social enterprises. The barriers to accessing finance are different for different types of social enterprises. Survivalist and micro enterprises often lack basic business and financial skills and struggle to find access to markets for their products. As a result, many of them are seen as "unbankable" by potential financial service providers. There is thus a clear need for technical assistance in parallel with financial products and services for this market segment.

Larger, more mature businesses reported using financial products and services at much higher rates than survivalist and micro enterprises. However, these enterprises still reported that accessing information and applying for finance were time-consuming. Some organisations highlighted specific challenges that social enterprises face in trying to access finance that mainstream SMEs did not face. These include the lack of a common legal structure for social enterprises in South Africa, and being perceived as high risk by financial service providers.

Interviews with financial service providers, and the growing literature on the subject of socially responsible and impact investing, suggest a growing appetite among financial service providers for investment in social enterprises. However, these financial service providers have concerns about the lack of investment opportunities that have a positive social impact but still offer market related financial returns.

This section argues that to promote more effective linkages between social enterprises and financial service providers, the ILO should consider supporting the development of an online platform to provide information on access to finance and to connect social enterprises with financial service providers. This platform should provide targeted information based on the maturity of the social enterprise; combine information about financial services and non-financial services; be online and accessible through mobile platforms; and build on what is already available through collaborations with existing platforms.

While there are a number of strategic considerations that must be taken into account before pursuing such a partnership, on balance, the advantages of investing in an online resource appear to outweigh the disadvantages.

It is unlikely that social enterprises at the lower end of the market would be able to afford to pay to use this platform. Other than charging the enterprises that make use of the platform, there are a number of other potential sources of revenue for such a platform. This could include selling advertising space or charging a "finder's fee" to financial service providers when the platform makes a referral that results in a deal being made. Further research is needed to explore these options and to develop a sustainable business model for this platform.

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| HOUT BAY RECYCLING COOPERATIVE

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