

# Draft Paper on Prospects and Streamlining Development Finance Institutions in South Africa: “Reflections on the Review of the DFI’s in South Africa

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# Presentation outline

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- Spread or distribution of DFI's
- Composition of DFI's in South Africa
- Argument for Decentralisation
- Implications for the Gauteng province
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## Purpose

- The objective of this paper is to look at how best to reposition DFI's to meet the current and the future needs of South Africa's economy.
- To look at the state of entrepreneurship and the finance gap in South Africa; and
- Solutions and possibilities

## Introduction

- In light of the ailing economy and the high salary bill that South Africa faces, the country had to review its DFI's;
- Deepen the understanding of DFI's on how best to reposition them to advance the radical economic agenda;
- Most DFI's had not been reviewed to address the post-apartheid development needs;

## Definition of Development Finance Institution

- DFI is a generic term used to refer to a range of alternative financial institutions including microfinance institutions, community development financial institution and revolving loan fund;
- It is also defined as an institution promoted or assisted by government mainly to provide development finance to one or more sectors or sub-sectors of the economy;
- DFI's have a general mandate to provide finance to the private sector for investments that **promote economic growth and development**;
- To ensure investment in areas where otherwise, the market fails to invest sufficiently, areas where the private sector is discouraged to invest

## Lessons learnt from the case of Kenya

- State intervention led to poor performance of DFI's in Kenya;
- The Structural Adjustment of the 80's and 90's forced government to stop **over-emphasizing their development role at the expense of profit**;
- DFI's take steps to become not only financially viable, self-sustaining BUT to **justify their continued existence by providing good returns** to their shareholders;
- There was a call for DFI's to act like banks and not become **extensions of government departments**.

# Cont...

- The Structural Adjustment policies in Kenya advocated for an equal or level playing field between government and the private sector;
- It created a more level playing field by **eliminating preferential treatment, including monopoly rights**;
- This defeats the purpose of DFI's to make up failure for the financial markets;
- Move from **development to commercialisation** and rationalize in line with the Corporate Plan;
- No Political interference in the running of Public Enterprise and that all businesses must perform in a commercial and transparent manner.



# Global access to finance

- Access to finance is perceived as the second most important obstacle to business development (after crime);
- Small businesses experience more difficulties in interest rates, collateral requirements and credit procedures;
- SMME's employ more than half of the labour force in the OECD countries and account for 99% of private enterprises in the EU countries.
- In South Africa, they **account for about 91 percent of the formal business entities** and contribute about 57% to the GDP.



# Funding realities

- About 27.3% (less than 100 000) of SMME's in SA successfully apply and receive funding from formal financial sector;
- Owing to their informality, most (84.7%) of SMME's are financially excluded;
- The total financing gap for both formal and informal SME's) is estimated at around 45-48% of all SMME's in SA.

# Current realities

67% death rate of businesses because of financial reasons and non profitability

40% recorded slump of SMME's within the 24-34 year cohort

77.2% of SMME'S in Tsakane, KwaTema, Bophelong & Evaton not registered

Unemployment -27.7%

**South Africa's established business rate is disturbingly**

**low. – it has declined by 26% since 2015 and is the lowest since 2011.**

Half of early stage entrepreneurs are active in the wholesale and Retail

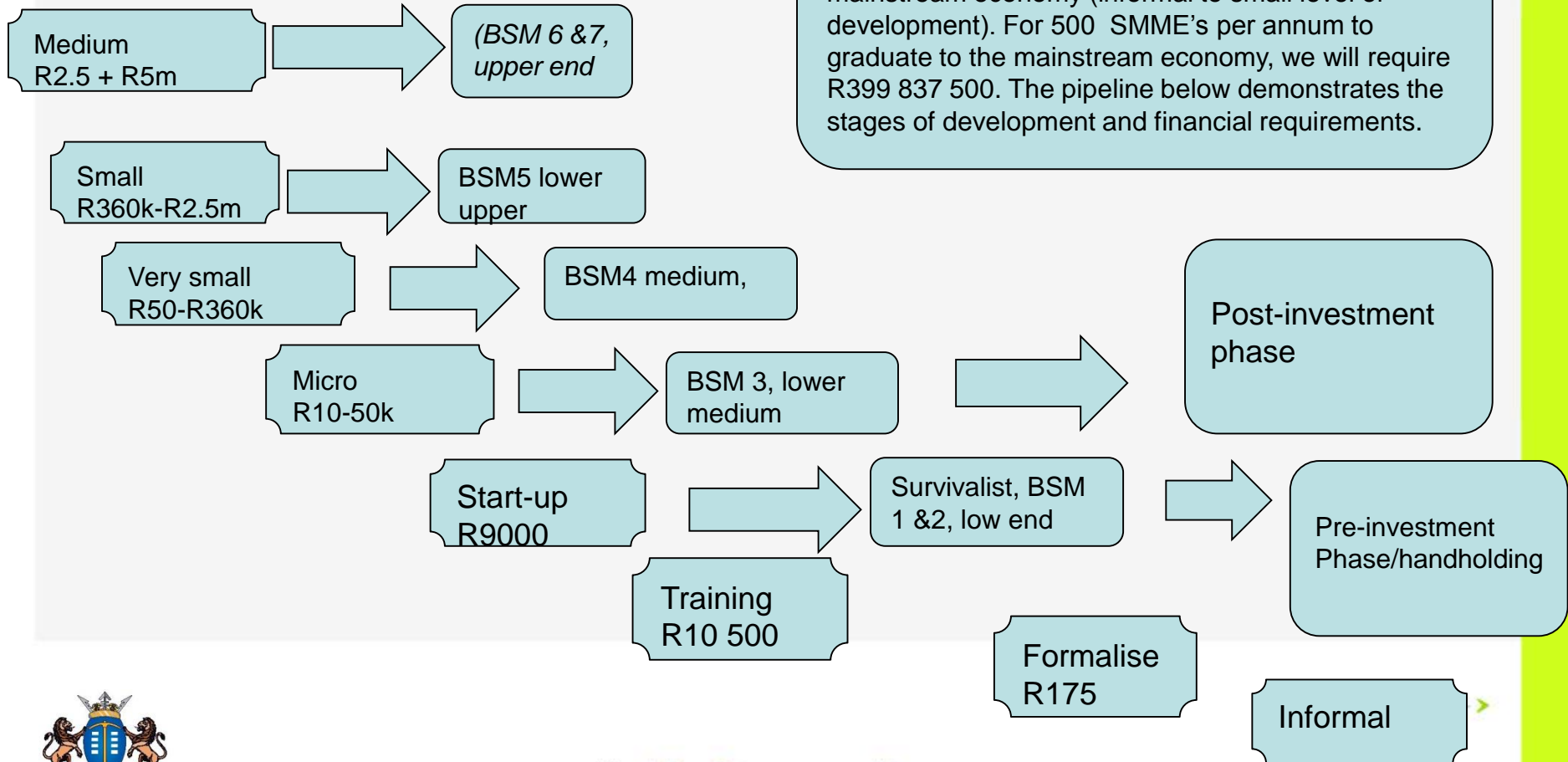
Transportation is the growth sector for entrepreneurs in SA

Total Finance gap to SMME's in SA is 45-48%

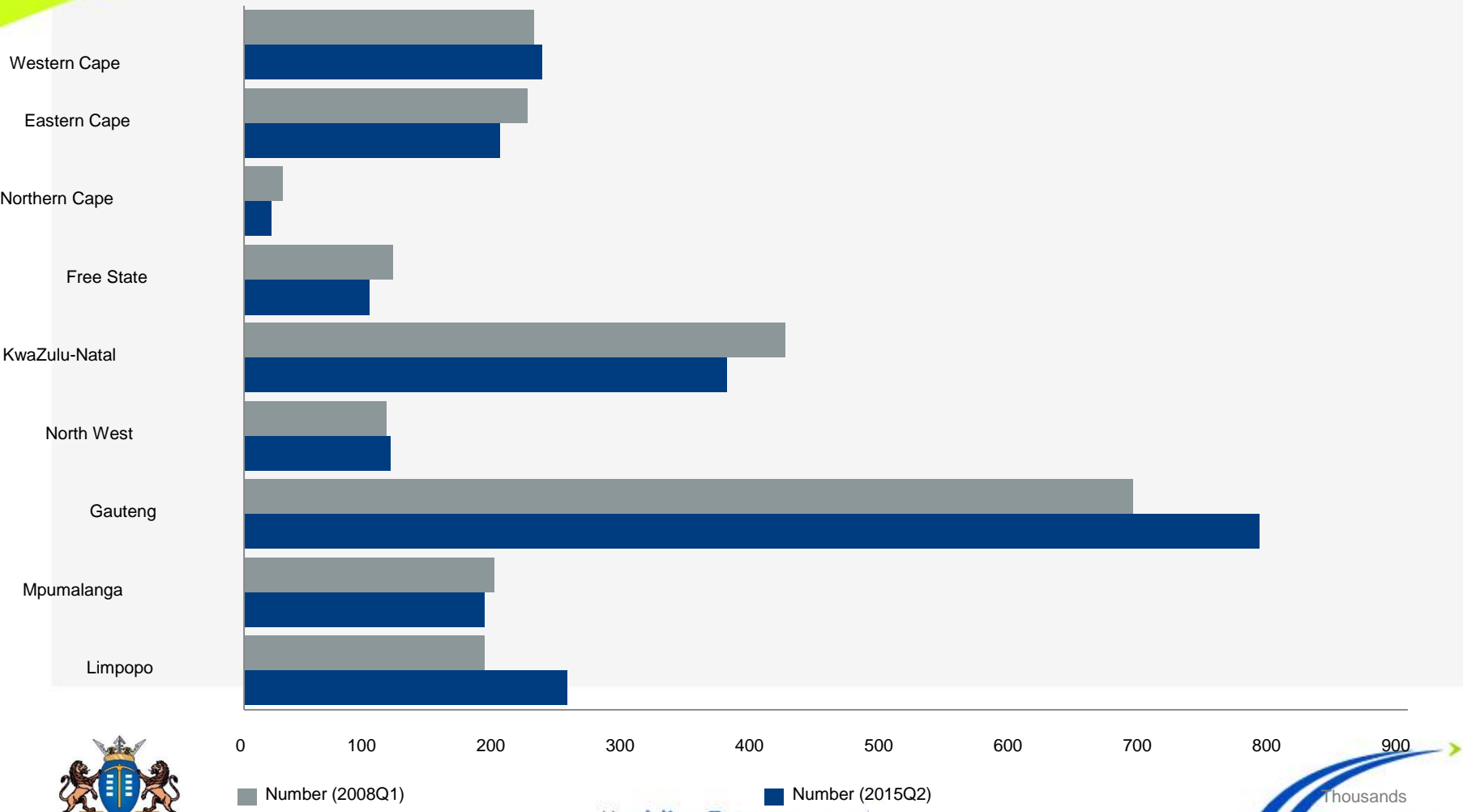
84.7% informal businesses are financially excluded

# GEP Development Pipeline

It will require GEP to spend R799 675 (at a minimum level) for an SMME to graduate from marginal to the mainstream economy (informal to small level of development). For 500 SMME's per annum to graduate to the mainstream economy, we will require R399 837 500. The pipeline below demonstrates the stages of development and financial requirements.



# SMME distribution in SA



StatsSA: BER, 2016

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## State of SMME's in SA

- There are about 2 251 821 in SA;
- About 667 433 are formal SMME's whilst the number of informal businesses is 1 497 860;
- Black owned SMME's constitute 34% of the formal SMME's;
- South African SMME's are estimated to account for over 60% of employment compared to the global average of 77%;
- Only 10.6% of SA adults population is involved in early stage entrepreneurship compared to 17% in Brazil

# The Composition of DFI's in South Africa

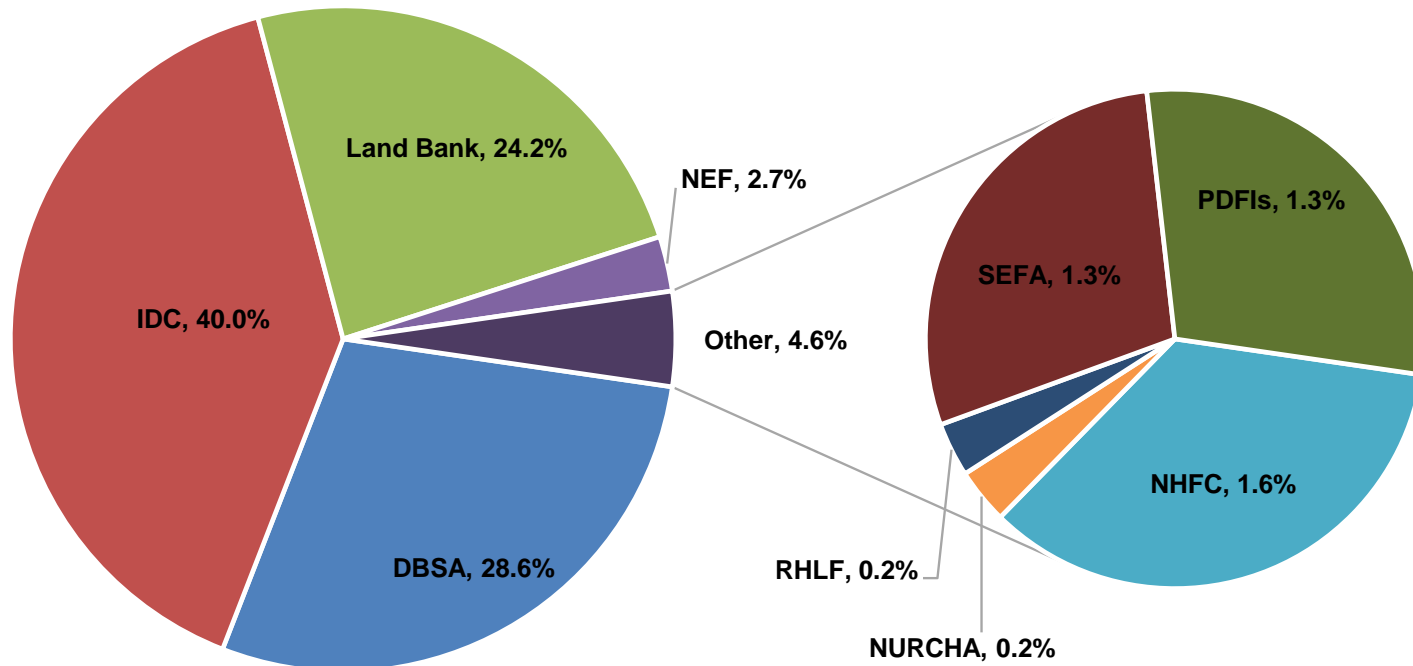
- There are 16 DFI's in South Africa;
- About 8 of DFI's reside at a national level and boast 91% of all the sector assets;
- The other 8 at a provincial level only own 4.5% of the assets;
- The IDC, the Land Bank and the Development Bank of Southern Africa (DBSA) account for over 91% of the total assets
- It is estimated that over R160 billion are allocated to financing activities;
- In contrast, PDFI's account for only 1% of assets allocated to financing by all DFI's

- Ownership share of DFI's in South Africa

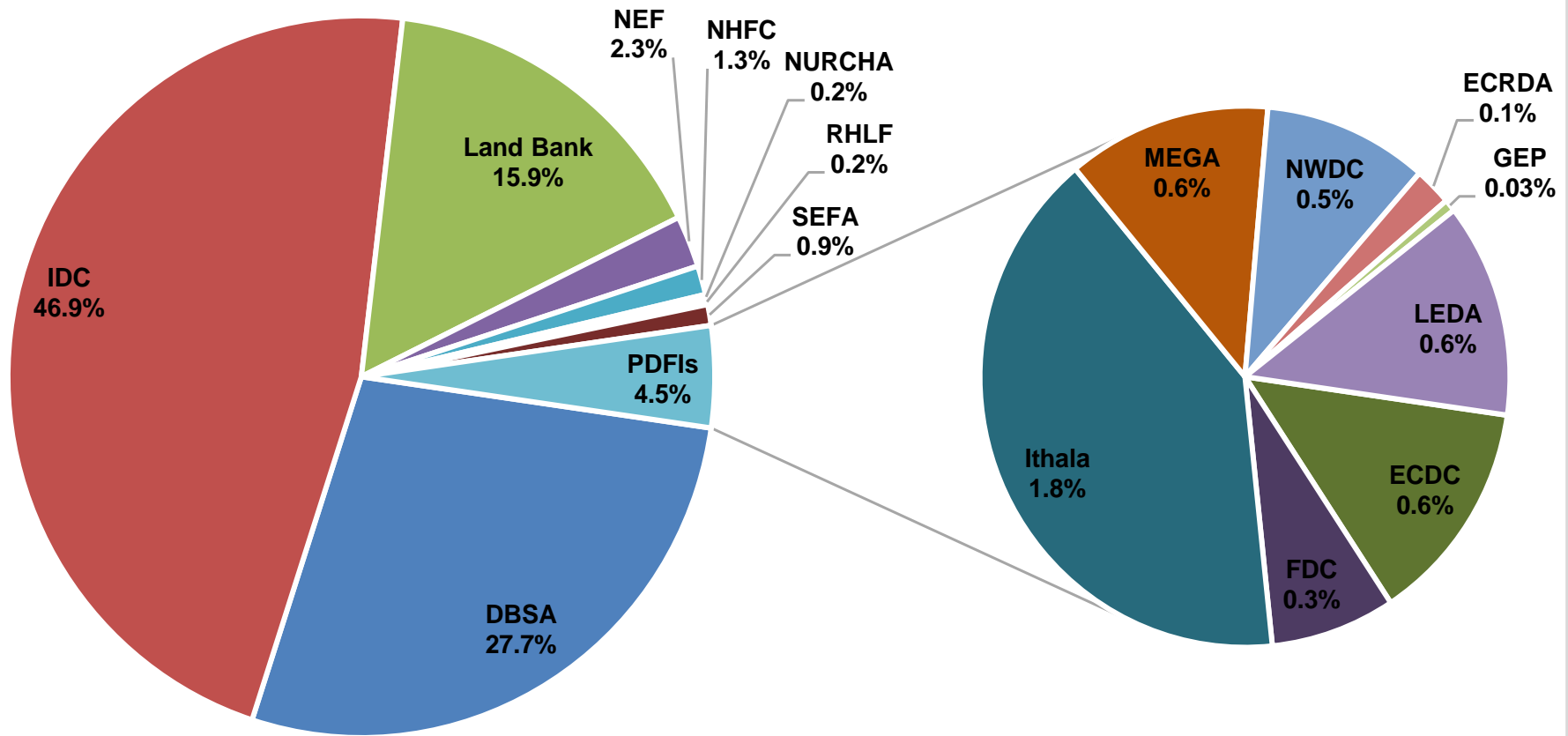


# Finance assets (loans and investments) similarly concentrated

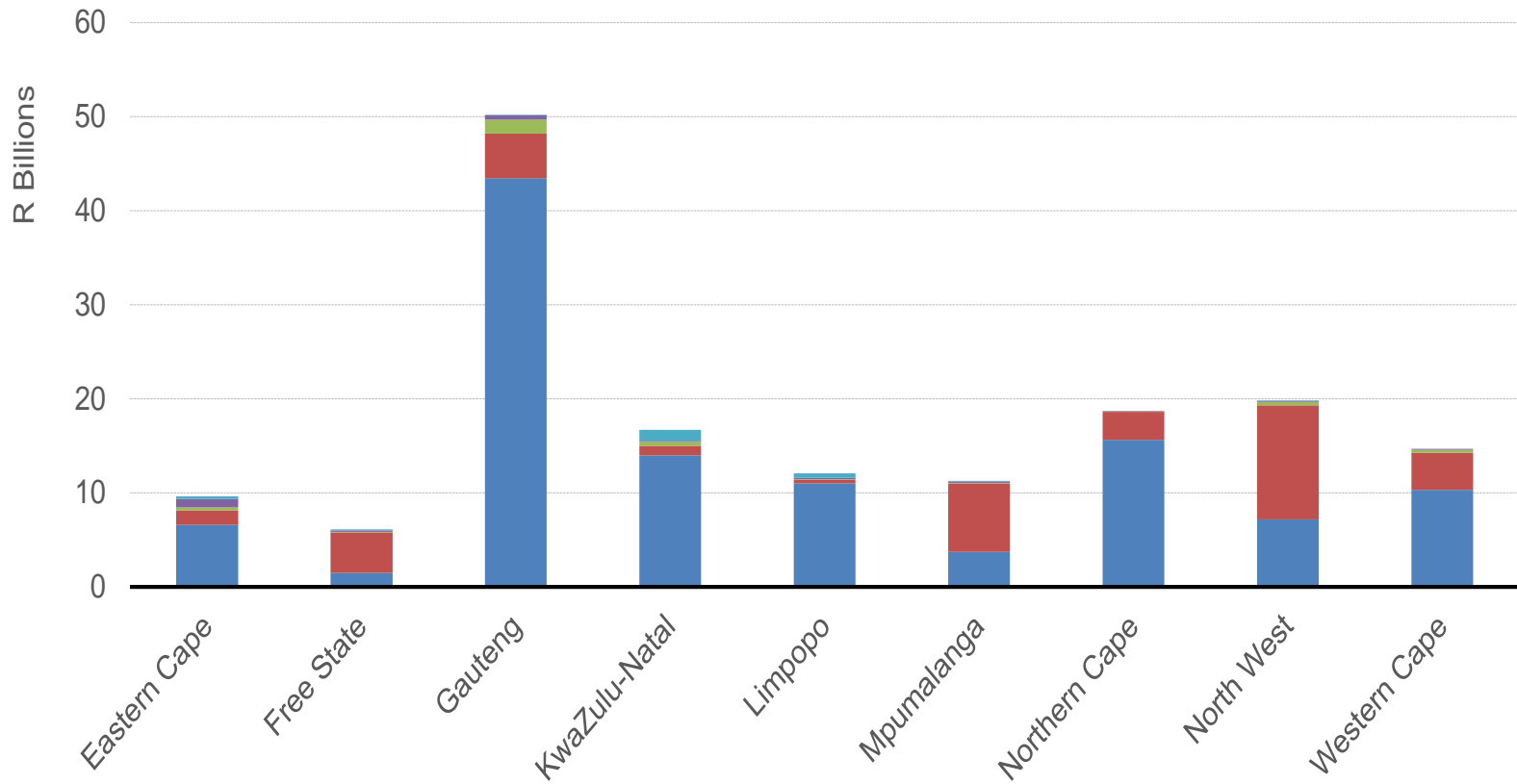
Investment and financing assets held by DFIs (2014/15, percentage of total assets)



# Assets held by DFI's



## Distribution of DFI's by province



■ DBSA / IDC / NEF

■ Land Bank

■ Housing NDFIs

■ SEFA

■ PDFIs

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## The spread of DFI's

- Provinces that are relatively under-developed such as Eastern Cape, Limpopo, Free State and Mpumalanga attracted low levels of development finance;
- Both PDFI's and NDFI's struggle with financial sustainability;
- Among the NDFI's the main concern is attempting to **balance economic efficiency, developmental effectiveness and financial sustainability**;
- Among PDFI's financial sustainability is complicated with varied operational activities, asset bases that do not necessarily lend themselves to sustainable revenue generation.

# The structure of DFI's

- Most PDFI's were created through merger of former homeland agencies and development corporations;
- This along with subsequent mergers and amalgamations as well as their role as provincial implementing agencies, operating in areas far beyond development finance;
- **Development finance is a very small part of what they do;**
- Some are primarily property management while others specialises in infrastructure development;
- Most have significant property portfolios of which the bulk have been inherited from the former homeland administration

# Service offering of PDFI's in South Africa

	Banking services	Development finance	Non-financial business support	Property management	Agricultural business activities	Trade and investment promotion	Special project implementation (e.g. infrastructure development)	Housing finance	Mining exploration	Public transport
ECDC	No	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No
ECRDA	No	Yes	Yes	No	Yes	No	Yes	No	No	No
FDC	No	Yes	Yes	Yes	No	Yes	No	No	No	No
GEP	No	Yes	Yes	No	No	No	No	No	No	No
IDFC*	Yes	Yes	Yes	Yes	Yes	No	No	Yes	No	No
LEDA	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
MEGA	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No
NWDC	No	Yes	Yes	Yes	No	Yes	Yes	No	No	No

Source: Based on individual PDFI review reports.  
The IDFC provides banking services through its subsidiary Ithala SOC.

# Argument for repositioning of NDFI's

- In SA, the problem is not just limited resources to meet the ever-growing needs BUT the structure and concentration of DFI's;
- The fact that 91% of DFI's assets is concentrated at a national level is an anti-thesis of the post-apartheid development agenda which emphasises the implementation of policies at local and provincial levels;
- This is further worsened by the fact that 84.6% of the financial sector assets is owned by 4 big banks;
- The DFIs at a local and provincial level constitute 4.5%;
- This implies slow growth and exacerbation of poverty and unemployment;
- The DFI structure further contradicts the NDP which advocates for the creation of jobs where people live.



# What are the implications for Gauteng

- The Gauteng's economy is highly concentrated, self-sustaining and oligopolistic;
- Decentralisation of NDFI's would present long-term benefits for the province;
- The call for decentralisation of NDFI's would assist in addressing the township radical economy;
- Assist in reversing the massive in-migration patterns, reduce housing backlogs, heavy burden on infrastructure;
- Strengthen the already eroded social fabric in other provinces;
- Assist the province to address the ownership patterns, equitable distribution of resources and expedite the NDP goals

# Recommendations

- A big portion of NDFI's should be decentralised to foster growth in the provinces and address the apartheid economic geography;
- An approach of this nature would assist in unlocking latent opportunities, increase entrepreneurial cognition and access to resources;
- DFI's should identify their own niches and avoid being thinly-stretched;
- Revisit the stringent lending measures;
- Measures to sustain DFI's beyond grant funding

## Recommendations

- Entrepreneurship Supplier Development should play an integral part in stimulating the local economy and promote small businesses,
- Best practices show that countries that stimulate their economies from below have low poverty and inequality levels

Thank you



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