The effectiveness of Development Finance Institutions in South Africa in Relation to Small and Medium Enterprises (SMEs)

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Declaration

I, **Nonkosi Xaba** declare that this research report is my own work except as indicated in the references and acknowledgements. It is submitted in partial fulfilment of the requirements for the degree of Master of Management in Finance and Investments, Wits Business School, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

Nonkosi Xaba

Signed at …Centurion…………………………………………………

On the …29th……………………… day of …September……………………… 2022.

Dedication

To my grandparents, my beloved grandfather Zithulele and my late grandmother Nana Xaba. I am forever grateful for you, and all that I am is because of your love and support. And to my husband, your continuous love and support humbles me and makes me better at everything; thank you.

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This work would not be possible if it wasn’t for God, who has guided me to preserve through my studies and difficulties experienced along the way.

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Finally, I am thankful for my husband Kwanele Sakhela; I really would not have made it so far if he was not such a pillar of strength, a source of motivation and encouragement.

Abstract

With dire economic challenges in South Africa and understanding that Small and Medium Enterprises (SMEs) can play a role in fostering economic growth, there was a need to understand the effectiveness of state-owned Development Finance Institutions (DFIs). This was due to DFIs being mandated to assist SMEs access finance, since they tend to be excluded from traditional financiers. The main objective of this research was to uncover facts around the effectiveness of DFIs in relation to their mandate to support Small and Medium Enterprises. The study adopted a qualitative research methodology to achieve these objectives, using interviews as a data collection method and thematic analysis for data analysis. It was found that there were challenges with the process of accessing finance where DFIs were stringent and lengthy with their internal processes, which prioritized ensuring that SMEs were able to service the debt facility. Although DFIs provided business support to aid SMEs, the level of support was perceived to be misaligned with the specific needs of the SME. These findings led to the conclusion that state-owned DFIs in South Africa are moderately effective in relation to SMEs and only support SMEs to a limited extent. It was recommended that, to balance out the sustainability of DFIs without abandoning the development objectives; DFIs together with the government, can agree on a specific capital adequacy ratio (CAR). This allows for some flexibility within the DFIs internal processes so that they are not long or stringent because the focus is on being profitable.

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CHAPTER ONE: INTRODUCTION

1. Introduction

Development Finance Institutions (DFIs) are financial institutions that provide a range of services in developing countries and aim to bridge the gap between public aid and private investment (Dickinson, 2008). These institutions are known to foster economic growth, sustainable development and they even finance small and medium enterprises (SMEs) that may be viewed as "too risky" for private investments (Dickinson, 2008). DFIs can operate nationally or internationally depending on their mandate, with majority ownership by national governments where they source their funds and this in turn provides them with creditworthiness which ensures that they can compete in broader capital markets (Dickinson, 2008).

In 2011, the President of the Republic of South Africa at the time declared the year as "the year for job creation", following the intense governmental push for the implementation of the New Growth Path (NGP), a program that required key institutions such as DFIs to be leveraged in order to improve the quality of life for South Africans (Public Sector Manager, 2011). South Africa has a wide range of DFIs that have different mandates and projects, structures, financial resources, etc., but among these different DFIs there is a common goal: improving quality of life, economic growth, infrastructure and job creation (Qobo & Soko, 2015).

The role DFIs play with respect to economic growth stimulation and wealth creation as a key driver for poverty eradication cannot be ignored, especially for countries like South Africa where there is high unemployment rate among the youth (Kingombe, Massa & te Velde, 2011). According to Gyimah & Agyeman (2019), DFIs are key players in providing capital to small and medium-scale enterprises (SMEs). The support afforded by DFIs to these enterprises is of great importance, particularly towards economic growth since SMEs increase employment, trade and boost economic activity (Gyimah & Agyeman, 2019). Fatoki (2011) defines SMEs in South Africa as enterprises which meet the criteria in Table 1:

Table 1: Definition of SMEs in South Africa

Sector	Type of enterprise	Total full-time employees	Total annual turnover (<)	Total gross asset value (<)
			(R million)	
Manufacturing	Medium	200	40	15
	Small	50	10	3.75
Retail	Medium	120	30	5
	Small	50	15	2.5
Wholesale	Medium	120	50	8
	Small	50	25	4
Business services	Medium	120	20	4
	Small	50	10	2

Source: Fatoki (2011)

Therefore, for the purposes of this inquest, the word "SME" is understood to be as according to Fatoki's criteria.

South African SMEs feature majorly in the formalised business sector, albeit bedevilled by challenges that could spell high SME failure rates. Ninety one percent (91%) of the formalised business sector in South Africa is made up of Small and Medium Enterprise (BASA, 2019). Furthermore, SMEs employ about 60% of the labour force and their contribution to the Gross Domestic Product (GDP) is to the tune of 34% (BASA, 2019). Despite this clarity in the role and contribution of SMEs in emerging economies these enterprises are not precluded from experiencing challenges, chief amongst, being access to finance, and strategic, administrative and operational issues (Okpara, 2011).

Fatoki (2014) describes how SMEs fail because of either internal factors which are mostly controlled by the firm (i.e., lack of management and functional skills, poor staff training, poor customer attitudes, etc.) or external factors over which the firm has limited control (i.e., high competition, rising costs of conducting business, finance, crime, etc.). According to Harash *et. al.*, (2014), one of the major limitations that hinder successful growth of SMEs is finance or lack thereof. In developing countries, SMEs are restricted in accessing the finance they require for growth and expansion and confirm that access to finance as one of the major limitations they face (Harash *et.al*., 2014). In South Africa, the failure rate of SMEs was estimated to be around 70 – 80%, with 440 000 SMEs closed in last five years according to Adcorp (2012) as cited by Fatoki (2014).

The high failure rate of SMEs in South Africa is discouraging when considering the potential of these businesses to meaningfully contribute towards economic growth through job creation and poverty reduction to name a few (Fatoki, 2014). Harash *et.al*., (2014) argue that financial access is a critical development and growth tool for SMEs especially in the emerging market context and see finance as an engine that propels improved SME performance.

The presence of Development Finance Institutions as fully functional entities which are mandated to support SMEs is questionable. When considering the challenges faced by SMEs, it is not clear if these institutions are as effective as they ought to be. Questions on their ability to achieve set objectives with funding and their effectiveness in assisting SMEs with the pursuit of growth, arise. Thus, it is important to understand the role played by DFIs in providing access to finance for SMEs and if these institutions are effective (achieve set objectives) with respect to assisting SMEs with finance and business support.

1.1 Research Problem

South Africa, like other developing countries, is faced with major economic challenges which include high unemployment rate, slow economic growth, inequality, and poverty. According to Statistics South Africa (STATSSA) at the end of the fourth quarter in 2020, the unemployment rate was sitting at 30.1% which is 1% higher than at the end of the fourth quarter in 2019 before the Covid-19 pandemic, and this rate has been consistently high with the youth (aged 15 – 34) as the most affected age group (STATSSA, 2021).

The real GDP growth for the country was 0.2% in 2019 (African Development Bank, 2019) while India – which is another developing and emerging economy, had a real GDP growth of 4.2% (The World Bank, 2021). The year 2019 is used as an example to demonstrate that South Africa had these issues before the global pandemic. Since 1994, the country has seen a year-on-year escalation in the poverty rate with deepening inequality. In 2015, the welfare of the poor in South Africa slipped further below the international poverty line (calculated at $1.90 per day) as indicated by the poverty rate of 18.8%, 2.4% worse than 2011 (The World Bank, 2018).

According to research by Kingombe, Massa & te Velde (2011) and Gyimah & Agyeman (2019), the DFIs play a significant role in stimulating economic growth by providing SMEs with capital thereby contributing in nation poverty reduction drives. The role of SMEs in any emerging economy is well understood, with some authors such as Gyimah & Agyeman (2019) and Okpara (2011), attributing job creation, trade and economic activity boost to these enterprises. However, access to finance has been identified as one of the key challenges affecting SMEs. This creates an urgency to understand how, these key players interact, namely, the DFIs and SMEs.

Analysis of the body of knowledge indicates that the result of the engagements between DFIs and SMEs has been less than desirable, especially in relation to the effectiveness and overall impact. Qunta (2015) in her study reviewed the effectiveness of DFIs in KwaZulu Natal, Marakalla (2018) studied the effectiveness of DFIs in providing financial and non-financial support to women entrepreneurs and Hasheela (2017) studied the impact DFIs have on SME growth in Windhoek, Namibia. This study purported to embark on an exploratory investigation and pursue a qualitative initiative which seeks to fill a gap on the understanding of effectiveness of DFIs in South Africa in relation to SMEs.

This study aimed to understand the effectiveness of DFIs rather than their operational efficiencies to gain insight on whether these institutions are operating as per mandate and leading to growth of SMEs. The focus was limited to three government owned DFIs (namely, Small Enterprise Finance Agency, National Empowerment Fund, and Industrial Development Corporation), whose chief mandate is providing access to capital for SMEs with the intent to make a positive impact on the country’s economic growth.

1.2 Research Question

The impact of capital on SME success is undeniable, to the effect that it has been resolved by the world governments that for SMEs to experience growth, institutions such as the DFIs should be established for such purposes. Though it seems there is healthy levels of interactions between SMEs and DFIs with government overseeing some of the engagements. However, the otherwise contrary to the expected economic outlook of South Africa points to some challenges. This aberration leads to the following **primary** research question:

How effective are the Development Finance Institutions in South Africa in relation to Small and Medium Enterprises?

The primary question spawns the following **secondary** question:

- How does the interaction between DFIs (considering their effectiveness or the lack thereof) and SMEs contribute towards how SME grow and are supported by DFIs?

1.3 Research Objectives

The main objective of this research is to empirically uncover facts around the effectiveness of Development Finance Institutions in relation to their mandate to support Small and Medium Enterprises. It is important for the study to gain insight on how such institution influence the growth of SMEs in South Africa. The nature of the objective of this research is rather complex and for simplicity it was split into the following sub-objectives during the research process. Therefore, this study aims to:

- Assess the effectiveness of DFIs in relation to their responsibility to support SMEs
- Explore the prevalent relationship between DFIs and SMEs, the roles, and responsibilities of each party to delineate factors leading to effectiveness of DFIs

1.4 Significance of the Research

Growth of formalised business and economic activity is one of every state's key objective, this is also true for South Africa. Initiatives and policies such as the National Development Plan (NDP), Growth, Employment, and Redistribution (GEAR) and Growth National Path (GNP), recognise SMEs as key combatants against high unemployment rates, currently at 30.1% - STATSSA (2021), and formidable forces in the fight against poverty and sluggish economic growth. Development Finance Institutions have been recognised for their role in assisting SMEs thereby making them key allies to the government's economic growth and poverty irradiation objectives.

According to Gumede *et al.* (2011), successful DFIs do two things well:

i. They perform their development financing roles effectively
ii. They play key roles in the country's economic development and broader industrialisation

Some DFIs may perform well as development financiers but may be ineffective in being key drivers for the country's broader development strategies and objectives Gumede *et al.* (2011). This is what the study perceives and aims to explore with this research, recognizing that effective DFIs provide interventions and transformation initiatives that accelerate economic development and growth, partly through SMEs.

Through a thorough literature review, the study should provide much needed context on the much less understood topic of 'effectiveness of DFIs against their mandates in relation to SMEs' and how this effectiveness is measured. The consequence thereof, should shed some light on what is needed to ensure that DFIs empower SMEs to growth. Moreover, the empirical research output should find use within policy making spheres and provide cues for strategic intervention where necessary.

CHAPTER TWO: LITERATURE REVIEW

2 Introduction

This section focuses on the literature review based on the subject matter. The literature review critically analyses the supportive role played by DFIs towards SMEs. The available body of knowledge contributes to the understanding of both the efficiency and effectiveness of DFIs, the framework for successful DFIs and the challenges faced by DFIs. Herein, a few key state-owned DFIs, challenges faced by SMEs in relation to finance, drivers of SME growth and the role played by DFIs in assisting SMEs are evaluated. This section, therefore, provides context on sustained success of SMEs as driven by government supported DFIs.

2.1 Development Finance Institutions

Pragash (2016) defines a development bank (synonymous with development finance institution) as financial institution that lends money on subsidised rates with the aim to promote development in various sectors such as agriculture, housing, industry, etc. Development banks are distinguished from traditional banks by a few characteristics such as the fact that do not accept deposits from clients and are specialised for specific purposes. They provide business support services in addition to financial support, prioritise the service to public interest over earning profit and lastly, they offer support to both public and private sector institutions (Pragash, 2016). Generally, DFIs are state-owned entities that obtain government grants and use them to raise capital in broader financial and capital markets and they in turn provide capital in form of subsidised loans (Abdulsaleh and Worthington, 2013; Mopeli, 2019).

Mopeli (2019) observed that DFIs in South Africa are not a new phenomenon and have been previously established by pre-democratic regime to promote exclusive economic welfare that served the elite few white capitalists. The difference now is the shift in the DFI mandate which focuses more on inclusive economic growth. According to Qobo and Soko (2015) DFIs are pivotal instruments of the South African government's post-apartheid strategy to stabilise the domestic economy, facilitate regional economic growth and achieve various objectives with the aim of improving quality of life, public service delivery, infrastructure, and job creation.

South African DFIs are diversified in terms geographic concentration, scope, ownership structure, priority areas and the scale of financing (Mopeli, 2019). For example, while the Industrial Development Corporation (IDC) is mandated to finance businesses in competitive industries, the National Empowerment Fund (NEF) is mandated to catalyse Broad-Based Black Economic Development (Public Sector Manager, 2011). Thorne and Du Toit (2009) argue that it is crucial to understand the role played by DFIs in addressing market failures since many emerging economies still experience long term finance shortages, especially for high-risk sectors.

2.1.1 Role of DFIs in SME support

The role DFIs play in an economy as it relates to SMEs is crucial, because there exists a need to fill the finance gap SMEs experience from commercial banks, which remains a concern (Marwa, 2014). This is due to the fact that there is a mismatch between SME operations as well as SME characteristics and the requirements for obtaining a commercial bank loan (Marwa, 2014). DFIs have been established as part of government initiatives and programs to assist SMEs with access to external financing. This is due to governments recognising the continued decline in SME access to finance which has negatively impacted the role SMEs play in fostering economic growth and development (Abdulsaleh and Worthington, 2013).

Thorne and Du Toit (2009) describe how DFI support in relation to SMEs goes beyond financial assistance and access but also includes developmental services such as technical assistance, research, and advocacy. This type of support is particularly important because SMEs are prone to fail due to internal factors such as poor management and functional skills such as planning, leading, organising and so on (Fatoki, 2014). Figure 1 summarizes the role of development finance institutions in filling the gap between private funding (which SMEs have very limited access to for various reasons) and government funding (for projects with little to no cost recovery) (Thorne and Du Toit, 2009).

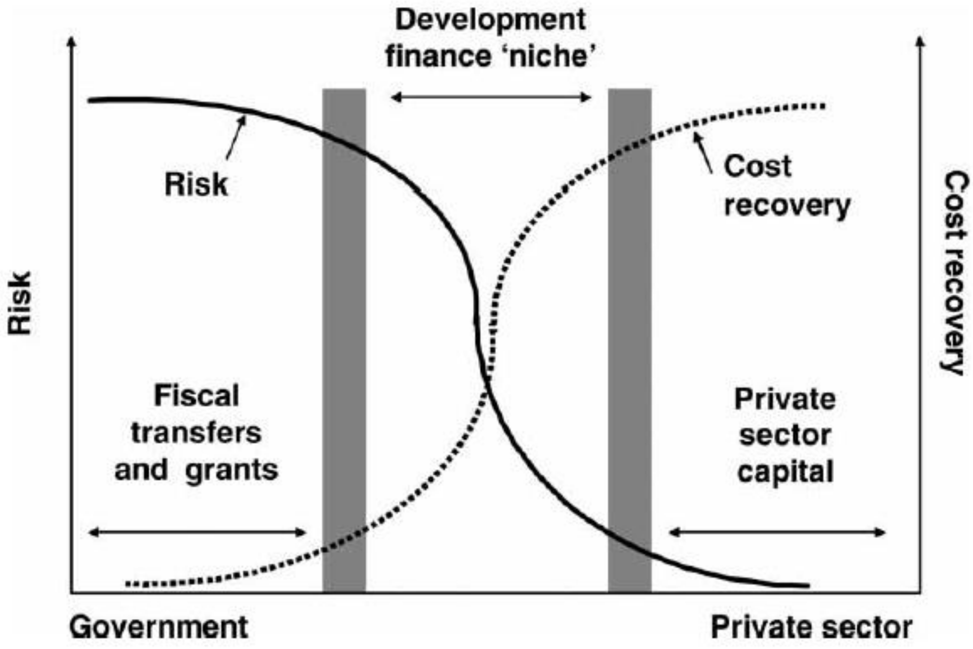

Figure 1: Role of Development Finance Institutions
Source: (Thorne and Du Toit, 2009)

2.1.2 Challenges faced by DFIs

Thorne and Du Toit (2009) discuss how numerous national development banks in developing countries suffered publicised failure in the 1970s and 1980s due to poor controlled spending and lack of delivery in terms of related to development but instead contributed to fiscal crises. These issues align with some of the dimensions mentioned in the macro-framework developed by (i.e., poor governance, poor macro-economic stability and poor performance). Although development banks are prone to failure, their crucial role in addressing market failures still needs to be corrected so that economic growth and development are not hampered (Thorne and Du Toit, 2009).

One of the issues that DFIs face include the double bottom line, where these institutions must conduct robust investments to generate profits whilst pursuing (and attempting to facilitate) economic development (Dickinson, 2008). This process can be contradictory, complex and time consuming since difficulties have been experienced in terms of measuring a project's social impact (Dickinson, 2008).

2.1.3 Overview of some DFIs in South Africa

South Africa has a wide range of DFIs with a varying and diversified mandates that aim to achieve economic development in different industries and geographical locations within the country. For this study, the DFIs were narrowed down to three because of their purposeful mandates to actively support SMEs in the country.

2.1.3.1 Industrial Development Corporation (IDC)

The IDC is a state-owned DFI that was established in 1940 with the aim of promoting industrial development and fostering economic growth by purposefully growing industries, supporting entrepreneurs and improving lives (IDC, 2020). It has the mandate to fund innovative businesses that aim to enhance the country's, and by extension, the continent's industrial capabilities (IDC, 2020).

The IDC provides non-financial business support (at pre- and post-investment stages) as a measure to protect their investments. Furthermore, the IDC contributes positive impact on its clients by assisting with different business strategies, optimising business operations and providing business enabling systems and tools (IDC, 2020). Financial support is provided from various funding instruments which can be structured in different ways including debt, equity and quasi-equity, guarantees, trade finance and venture capital (IDC, 2020).

2.1.3.2 Small Enterprise Finance Agency (SEFA)

SEFA is another state-owned DFI in South Africa that prides itself in providing accessible development finance to qualifying SMEs and cooperatives according to the National Small Business Act of 1996 and amended in 2004 (SEFA, 2020). SEFA is mandated to provide access to finance in an efficient and sustainable manner by using financial instruments such as credit facilities and credit guarantees (SEFA, 2020).

This institution is committed to providing the best service and expertise, innovative development of SMEs and cooperatives. They offer access to credit between R50 000 to R15 million (SEFA, 2020). This DFI also provides non-financial support through creating strategic partnerships with different institutions to ensure that SMEs and cooperatives have access to enterprise development and support (SEFA, 2020).

2.1.3.3 National Empowerment Fund (NEF)

The NEF was established by the National Empowerment Fund Act 105 of 1998 with the mandate to drive, promote and facilitate black economic participation through the provision of financial and non-financial support to black owned and black managed businesses (NEF, 2020).

In terms of financial support, the NEF has various strategically positioned funds which use various funding instruments between secured senior debt and unsecured options or equity as well as hybrids of the two in order to support its clients (NEF, 2020). Non-financial business support is provided at the pre-investment stage as well as the post-investment stage where a range of support services are offered including mentorship and technical assistance (NEF, 2020).

2.1.4 Framework for successful DFIs

Thorne and Du Toit (2009) describe a macro-framework with the key dimensions that contribute towards successful development banks, as seen in Figure 2 below. Accordingly, the features of the framework are an enabling environment, mandate, regulation and supervision, governance and management, financial stability and lastly, performance assessment.

- An enabling environment is described as one with macro-economic stability, political stability and availability of different complementary institutions (Thorne and Du Toit, 2009). The DFI mandates address their key role of providing capital where commercial banks fail,
- Regulation and supervision speak to how DFIs are controlled (e.g., State intervention must be limited to allow DFI to have autonomy),
- Governance and management focus on how DFIs are run which is the largest determinant of success for development banks,
- Financial stability addresses how development banks access funding either through government subsidies or their ability to raise capital in financial markets and lastly,
- Performance assessment centres around their ability to make a difference or to achieve their set objectives thereby posing questions of effectiveness (their effectiveness – do they achieve set objectives?

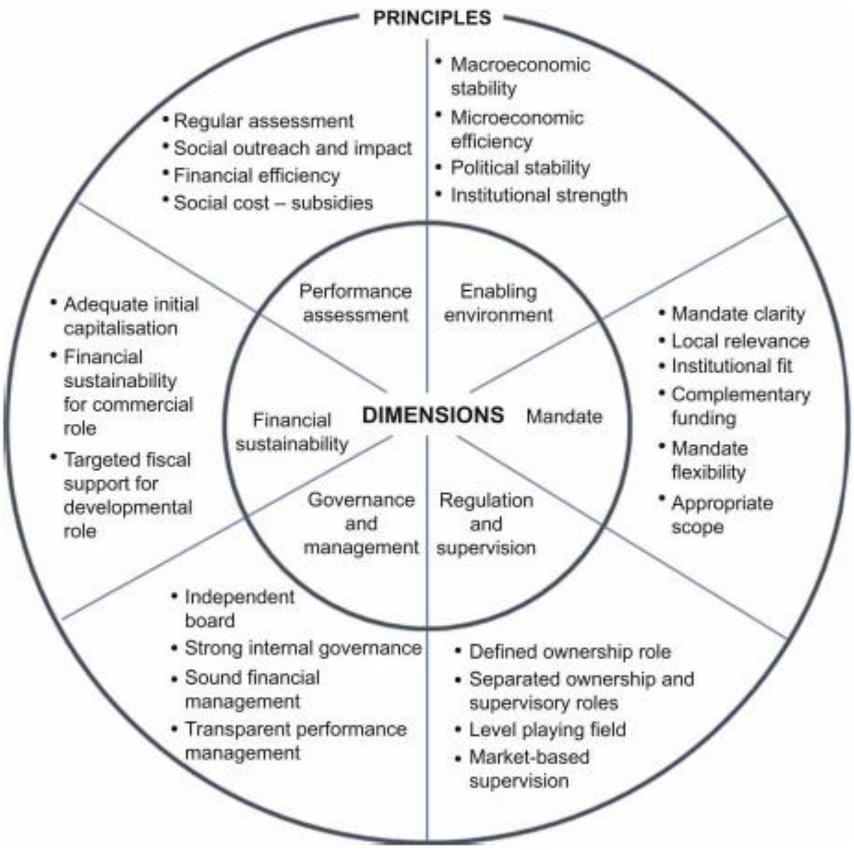

Figure 2: Macro framework for development banks
Source: (Thorne and Du Toit, 2009)

2.1.5 Defining effectiveness in development finance

Valderrama and Cejas (1997: 86) as cited by (Qunta, 2015) defined three concepts in relation to activities performed by any entity and these are:

i. Economy – amount of utilised resources in producing a goods or services,
ii. Efficiency – how much goods or services were obtained in relation to input resources and lastly
iii. Effectiveness – relationship between objectives and output.

Measuring effectiveness in the government context is not an easy task since government entities tend to be tasked with doing more with less resources. However, it does refer to the degree with which the entity meets the need for a specific service at an acceptable level of service quality (Qunta, 2015).

2.1.6 Concept of measuring effectiveness and levels thereof

According to Ashraf (2012), no single effectiveness model can adequately and sufficiently fit all organisations and that is why this study adopted three approaches to evaluate DFI effectiveness. These approaches were adopted from the organizational effectiveness models developed by Cameron (1978) as cited by Ashraf (2012) and can be seen in Table 2 below.

Table 2: Adopted approaches to measuring effectiveness

Model	**Description of model approach**	**Application in this study**
Goal-orientated approach	Focus given to the essential operating objectives of the organisation, e.g. quality of service. Goals must be specific and involved people must be committed to them. Organisation is observed to be effective if these goals are achieved.	DFIs considered effective based on ability to demonstrate goal/objective focus in supporting SMEs.
Process approach	Focus given to the process of converting resources to product/service. Organisation observed to be effective by observing the extent to which resources are used to provide product/service.	DFIs considered effective based on the extent of converting resources into services provided to SMEs.
Strategic constituency approach	Focus given to the effect of an organisation on the main stakeholders and their interests. Organisation is observed to be effective if there is satisfaction of all strategic constituents.	DFIs considered effective based on SME satisfaction with the service/support provided.

Source: Ashraf (2012)

Each organizational effectiveness approach was then weighed on the effectiveness scale to gauge the level of the DFIs effectiveness. Table 3 below presents the effectiveness scale.

Table 3: Effectiveness scale

Code	Description
1	Not effective
2	Moderately effective
3	Effective
4	Very effective
5	Extremely effective

The combination of the adopted approaches to measuring effectiveness and the effectiveness scale were then utilized to conclude on DFIs effectiveness in relation to SMEs.

2.2 Small and Medium Enterprises

Yeboah (2021) discusses how “business growth” is generally referred to in various factors such as an increase in total sales volumes or production capacity or employment, etc. Although these indicate growth, they do not give a specific definition of growth thus business growth must be typically measured with absolute or relative changes. Delmar *et al*. (2003) as cited by Yeboah (2021) argues that the two most important firm indicators of growth are sales and employment, with employment an easy accessible factor to measure and sales though a good indication, are susceptible to inflation thus researchers must use multiple indicators when studying a firm’s growth. Human capital, firm’s resources, environmental and market characteristics are key internal and external factors that influence SME growth and business growth is largely linked to the creation of employment which is a key role of SMEs in the economy (Yeboah, 2021).

2.2.1 Challenges faced by SMEs in relation to finance

Gyimah and Agyeman (2019) conducted a detailed case study of the international finance corporation with the aim to understand how DFIs support SMEs. Their research discussed how SMEs struggle to access finance that boosts their operations since they are considered small to raise capital from financial markets (Gyimah and Agyeman, 2019). Following a detailed study of various research products including that of the World bank in relation to factors driving SME survival, Harash *et.al*. (2014) asserts that access to finance is a key influencer of business performance. In the African context alone, studies found that a funding deficit of 140 billion US dollars exists due to more than 70% of SMEs in the continent not having access to medium to long term finance (Gyimah and Agyeman, 2019).

SMEs could opt for private financial institutions instead of DFIs but these institutions often lack adequate information and tools to monitor or evaluate SME projects which leads to burdensome and often non-existent collateral requirements (Gyimah and Agyeman, 2019). Gyimah and Agyeman (2019) further argue that not only do SMEs struggle with traditional financing since they lack collateral, but their financing gaps are also due to their tendency to lack profitability which only attracts high risk investors and venture capitalist.

Kersten *et.al.* (2017) and Marakalla (2018) discuss the simplified theory of change in how SME financing assistance is expected to function in bringing about meaningful change in the economy (See Figure 3 below). This theory proposes that financing SMEs allows them to invest in their own research and development, and in turn improve their performance (i.e., increase revenue) which may also lead to improved access to finance and investments. Moreover, SME financing can go beyond the above mentioned leading to higher productivity, job creation, poverty reduction and subsequently foster economic growth (Kersten *et.al.*, 2017).

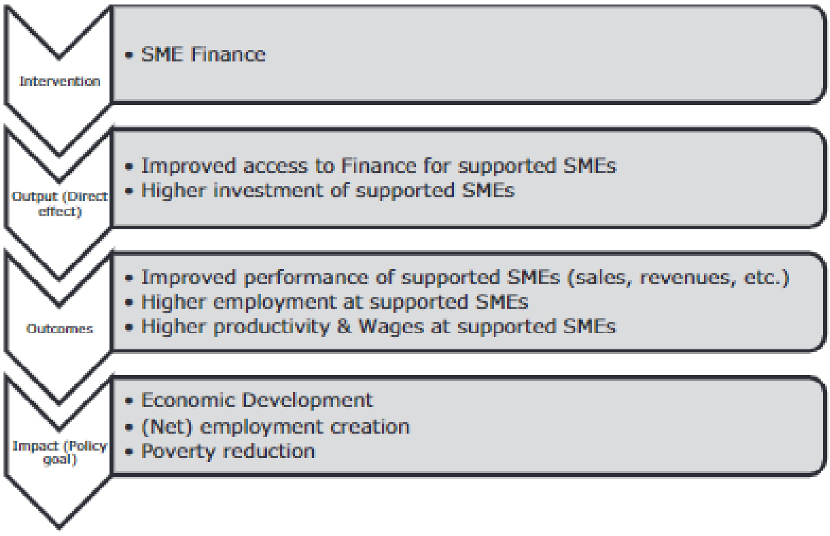

Figure 3: Simplified theory of change of SME Finance Programs
Source: Kersten *et.al.,* (2017)

2.2.2 Support offered by DFIs to SMEs

The resource-based theory suggests that a company's available resources enables its competitiveness in the market because this enables it to quickly adapt to a changing environment (Marakalla, 2018). Both non-financial and financial support are key role players in ensuring that a company remains compatible. This is because the former improves competence and capabilities while the latter provides access to opportunities for growth (Marakalla, 2018).

Financial support alone cannot guarantee the survival and growth of SMEs especially in the emerging market context. This assertion validates an observation made by Kersten *et.al.* (2017) that "providing a certain group of SMEs with access to finance will not automatically lead to economic growth and (net) employment creation". This points to the fact that a two-pronged approach with regards to SME support as employed by various DFIs is a necessity.

2.2.2.1 Financial support

Xiang and Worthington (2017) define financial support as loans, grants, tax breaks that a business is offered, which can also take form in indirect assistance such as subsidised credit programs and credit guarantees. There are various ways in which the government provides SMEs with financial support through the DFIs and these include direct loans where the loan is offered directly to SME and government-guaranteed loans where SME has the option of access the loan elsewhere (Marakalla, 2018).

2.2.2.2 Non-financial support

Non-financial support includes support that is necessary to equip the business with the required skills and advice that will help grow the business (Marakalla, 2018). Rabie *et.al.,* (2016) include training and development initiatives, access to networks, leadership and management training as well as customer service training as part of key non-financial support that drives growth and performance of SMEs.

2.3 Conclusion

This section delved into detail about the role of DFIs and how they are mandated to assist SMEs grow. Majority of these DFIs have been in operation for decades and they have built systems and tools to assist both the public and private sector to access finance for development and economic growth. While DFIs have these systems in place, SMEs continue to fail which begs the question of DFI effectiveness.

CHAPTER THREE: RESEARCH METHODOLOGY

3. Introduction

The aim of this section is to discuss the research methodology which was adopted as an attempt and means to address the research questions and achieve the objectives thereof. It discusses the research design and the strategy to be implemented. Furthermore, it describes the population of the study and the sampling procedure which includes the following research instruments, collection, analyses, and interpretation of data as well as the ethical considerations and the limitations of the study.

3.1 Research Design

There exist vast amounts of literature in the world of academic research which talks to justifiable research processes. The researcher is both empowered and limited by the nature of their research to choose any of the available research design to achieve their objectives. This study adopted qualitative research methodology because of its exploratory nature. Arguably this approach aided the researcher in gaining a better understanding and satisfaction of their curiosity with respect to the topic of interest.

The study aims to understand why it seems as if SMEs fail to play their role in the South African economy where government owned DFIs exist to support them with both financial and nonfinancial support. According to Lowhorn (2007), qualitative research aims to explain a current situation for a particular group being studied to arrive at a theory on why that is.

The researcher aimed to use the advantage of qualitative research which is the provision of informative and diversified insights, as well as the holistic approach that offers in depth understanding of the full complex picture when discrete variables cannot meaningfully give insight (Forman *et.al*., 2008). Furthermore, the qualitative approach added a different dimension to interventional investigations that could not have been achieved through numerical data alone (Pathak *et.al*., 2013).

3.2 Data Collection

3.2.1 Population and sample size

3.2.1.1 Development Finance Institutions

According to le Pere (2020), there are sixteen state-owned DFIs in South Africa which operate between national and provincial levels. le Pere (2020) further describe that DFIs post 1994, can be categorized into two: (i) those offering loans and equity financing to aid development, and (ii) those who provide grant-based funding and other non-financial support to drive development. The study population was formed by state owned DFIs that operate on the national level since the study aims to understand effectiveness of DFIs in the country and fall within any of the two categories of financing development.

Key DFIs in South Africa are the Industrial Development Corporation (IDC), the Development Bank of Southern Africa (DBSA), and the National Empowerment Fund (NEF) and these typically fall within the first category described above le Pere (2020). In order to limit time constraints and achieve study objectives (Majid, 2018), the key DFIs that serve South Africa were chosen as the sample for the study with the exception to the DBSA. The study decided to adopt the Small Enterprise Finance Agency (SEFA) instead of DBSA to add a grant-based type DFI to the sample size so that both categories formed part of the study. Dealmakers and Investment Officers from SEFA, the NEF and the IDC were targeted firstly because of their accessibility, secondly and mostly importantly, because they could provide the relevant required information and shed light on the problems and issues that were to be explored (Creswell and Poth, 2016).

3.2.1.2 Small and Medium Enterprises

The SMEs that formed part of the population were firstly SMEs according to Fatoki's criteria (see Table 1: Definition of SMEs in South Africa) and must have received funding from a state owned DFI no later than at least 12 months ago. The 1-year mark was chosen as it was perceived as adequate time to assess impact over one financial period. Business owners or entrepreneurs involved in the day to day running of their businesses and who have received development finance from the chosen DFIs above were sampled for this study. The study aimed at least two SMEs per DFI.

3.2.2 Sampling

This research study followed the non-probabilistic sampling techniques which has four different types namely, convenience sampling, quota sampling, judgement sampling, and snowballing sampling (Babin and Zikmund, 2015). Snowballing was chosen for this study as a non-probability sampling method because it allowed the researcher to ask a key participant (e.g., a DFI dealmaker or another SME owner) to refer potential participants who meets the criteria of the study (i.e., an SME that has been supported by the DFI). The advantage to this was an increase in the number of participants (Hennink *et.al*., 2020).

The researcher was aware that finding the targeted participants was going to be difficult, thus electing to use the DFIs as ground zero proved advantageous in achieving the study objectives. SMEs that have received funding from DFIs could be readily found in the DFIs web pages. Platforms such as LinkedIn and the DFI pages as well as the researcher's network were used as an attempt to gain access to more participants to give momentum to the snowball effect.

According to Guest *et al.* (2006), guidelines for determining non-probabilistic sample sizes are close to none-existent and studies would adopt the concept of saturation to assist with determining the sample size. The concept of saturation refers to the point where no new themes are observed in the data. Guest *et al.* (2006) conducted sixty in-depth interviews and found that saturation occurred within the first twelve interviews, meta themes were present by the first six interviews and that variability followed similar patterns. Boddy (2016) also illustrated how data saturation cases occur with twelve samples when they are drawn in a relatively homogenous population. The study aimed to target twelve participants: six from DFIs and six from SMEs.

3.2.3 Research instruments and procedure for data collection

Interviews as a less or semi-structured research instrument were adopted as the main research instrument for this study with the aim to gain perspective on the research problem and attain answers to the research questions. This less structured approached was deployed in order to allow the researcher to focus on the particular phenomenon being studied which may differ between participants (Maxwell, 2012). Participants were all interviewed over Microsoft Teams platform to keep in line with Covid-19 safety protocols and the interviews were recorded to allow for transcription of data. Open-ended style of questions (see Appendix A: **Sample of Interview Questions**) as well as the literature review, were used to gain perspective from DFIs with regards to their effectiveness and allow SMEs to divulge and express how they have experienced DFI support and impact thereof.

According to Sarantakos (2012), conducting qualitative research through interviews allows for flexibility, adaptability, high response rates, easy administration and ability to correct misunderstandings by respondents. Interviews ensure completeness as the presence of interviewer ensures all questions will be attempted (Sarantakos, 2012). These advantages were surely evident in the study, albeit not without some challenges. The researcher ensured that the impact of limitation of using interviews for qualitative research such as cost, susceptibility to interviewer's bias, lack anonymity and consumption of time (Sarantakos, 2012), were minimised.

3.3 Data Analysis and Interpretation of Findings

Kalof *et.al.,* (2008) describe that qualitative data analysis should lead to "explanations for descriptive patterns, identification of relationships between categories, and theoretical developments". Onwuegbuzie *et.al.,* (2012) describe some of the common qualitative data analysis methods as stipulated in Table 4:

Table 4: Qualitative Analyses for research synthesis

Type of analysis	**Description**
Qualitative content analysis	Systematically reducing source(s) to codes deductively or inductively, then counting the number of codes
Narrative analysis	Considering the potential of stories to give meaning to research findings, and treating data as stories, enabling reviewers to reduce data to a summary.
Discourse analysis	Selecting representative segments of language use, such as several lines of an interview transcript involving a researcher, and then examining the selected lines in detail for rhetorical organization, variability, accountability, and positioning.

Thematic analysis	Involves a search for relationships among domains, as well as a search for how these relationships are linked to the overall cultural context.

Source: Onwuegbuzie *et.al.,* (2012)

This study adopted the thematic analysis approach, coding the text with the aim to categorise it and then form themes one transcript at a time. Transcripts were formed by transcribing data from recorded interviews.

3.3.1 Coding transcribed text

Terry *et.al*., (2017) describe coding as the process of identifying meaningful segments from the data set that are relevant to the research question and tagging them with a few words or a phrase such that the data is captured meaningfully. Good coding is expected to be open, inclusive, must identify and label all segments of interest (Terry *et.al*., 2017). In this study, this process was done according to the prescripts of Kalof *et.al*., (2008). They describe coding as mapping data into set categories which summarise the text, provide theoretical statements and represent a broader theme with respect to the study objectives. Table 5 below gives an example of a code:

Table 5: Example of how data extract is coded

Data	**Code**
I could do a different job, but I wouldn't be able to do the job that I do and enjoy and have a child. There just isn't enough in me to do that, or to do either well.	Having children limits capacity Invested in being in a competent job

Source: Terry *et. al.,* (2017)

3.3.2 Theme development

Terry *et.al.,* (2017) describe theme development as an active process where patterns are identified and formed by examining codes, combining, or collapsing codes together into meaningful patterns. According to Braun and Clarke (2012), a good thematic analysis involves "interpretative story telling about the data in relation to a research question". This study followed the six-phase process in forming themes as described by Braun and Clarke (2012):

1. Data familiarisation and identification of potential interests – the researcher listened to the recordings of the interviews to gain intimate familiarity with the data
2. Generation of codes – text transcribed from the interviews was extracted to highlight matters of interest which formed codes,
3. Theme search – the codes were then elevated into categories which then turned into themes,
4. Review of themes – the generated themes were reviewed and cross-checked against other themes as well as codes to give rise to robust thematical analysis,
5. Definition of themes – the reviewed themes were then given definitions to give rise to meaning, and
6. Reporting on defined as well as identified themes.

3.3.3 Reliability and validity

In order to prioritise the importance of avoiding to reach inaccurate conclusions from research study, the assessment of research findings was largely centred on the issues of validity and reliability, as suggested by Kalof *et.al.,* (2008). All the data was collected in a stable, repeatable, and consistent manner by ensuring the same person conducted the interviews and the research implements, and tools were used for their original purpose.

Kalof *et.al.,* (2008) describe two common types of validity; internal validity where conclusions are inappropriately drawn from data and external validity where generalising the study to a larger population can't be done. Guest *et.al.,* (2012) assert that researchers tend to adopt a trustworthiness criterion to ensure rigour of findings, and this criterion as adopted by qualitive researchers includes dependability, credibility, transferability, and confirmability.

This study adopted this trustworthiness criterion to ensure reliability and validity of the findings through the following ways:

i. Credibility – this study used peer debriefing technique to increase validity and credibility of the research as prescribed by Franklin and Ballan (2001). Peer debriefings provide the researcher with the opportunity to discuss interpretations at various stages of the process with uninvolved but able colleagues to remain objective.

ii. Transferability – refers to the extent at which the findings of the research can be transferred to other context (Guest *et.al.*, 2012). The researcher provided descriptions of the characteristics of the population used to help others understand how it can be applied in different contexts.

iii. Dependability – reflects the stability of findings over time for example, ensuring that research findings are supported by the gathered data (Guest *et.al.*, 2012). The dependability of this research was ensured by applying an audit trail where the researcher accounted for all research decisions and keeps record of activities (data collection, recording and analysis) so that an auditor may conduct a thorough audit of the data.

iv. Confirmability – refers extent to which the findings can be corroborated or confirmed by other researchers (Guest *et.al.*, 2012). The researcher documented and stored all data from interviews such as sources, detailed notes, recordings, transcripts, tapes, and dates.

3.4 Ethical Considerations

The ethical challenge for this research was ensuring that the researcher and the research output were abiding to the prescripts according to (Zegeye *et.al*., (2009). The study dealt with human participants, therefore, researcher had to consider the following research ethics:

(i). Basic principles - respect for person/autonomy, beneficence and justice;
(ii). Informed consent must be informative comprehendible and signed;
(iii). Participant's privacy and confidentiality must be protected;
(iv). protection of vulnerable persons must be done and lastly; as well as
(v). Avoidance of deception and misconduct.

This was further achieved by Obtaining ethics approval from the concerned university's ethics committee and issuing to participants an informed consent form (

Appendix B: **Invitation to Participate**) which covers intent of the study, rights of the participants and care of data prior the interview as a first ethical consideration. Further to this, at the start of every interview the researcher informed the participants about the details and nature as well as aim of the study, their right to terminate their participation at any time.

The participants were informed about the methods adopted to maintain anonymity of the respondents, confidentiality, or sensitive information, as well as inform them about the usage of data. Finally, since the study adopted a quasi-snowballing sampling procedure, the researcher asked the participant for consent from the referral to use their data (i.e., mobile number or email so that the researcher can contact them) as per POPI Act (Appendix C: Consent).

3.5 Limitations of the Study

The data analysis and interpretation of findings are impacted by the adopted boundaries inherent to the type and nature of study. This leads to a set of expected limitations:

- Boundaries adopted – the study focused on government-owned DFIs and SMEs that have been in operation and received development finance for specific periods.
- Time constraints – fulfilling the research commitments of validity and reliability may be time consuming as peers and academics have varying schedules which may limit the researcher's access to these resources. Virtual meetings, emails and other technology instruments were used to reduce impact of this constraint.
- Since this study adopted the qualitative research methodology where the researcher as an active role in driving the research, the study became prone to researcher bias and subjectivity. The researcher was, however, bound by ethical consideration to employ steps discussed in sections above in ensuring validity and reliability to reduce influence of researcher bias.

CHAPTER FOUR: RESULTS AND DISCUSSION

4. Introduction

4.1 Results

This section presents the results obtained from the interviews conducted for the study. The response rate and respondent characteristics sections give insight to the success rate of the sampling methodology as well as describe the calibre of participants, respectively. The synthesis of the data collected uncovers the three overarching themes relating to matters of support and effectiveness as it relates to the interactions between DFIs and SMEs.

4.1.1 Response Rate

The study originally targeted twelve participants: six from DFIs and six from SMEs. Eight participants were contacted in the DFI population and six responded on time. Thus, the six participants from the DFIs were obtained without challenges. Seven participants were contacted on the SME population, but only four participants formed part of the study and others either did not meet the study criteria or did not respond on time.

It is acknowledged that there was less participation from the SMEs in comparison to the DFIs, which usually impacts the robustness of the results. However, Malterud, *et al*. (2016) propose that adequate sample size for qualitative studies may be determined using the concept of information power where “the more information the sample holds, relevant for the actual study, the lower amount of participants is needed”. According to Sandelowski (1995), an adequate sample size is a matter of judgement, adequate evaluation of the collected information, research method adopted and the purposeful sampling strategy. The study advanced because upon evaluation of the collected data from SMEs, it was apparent that the data was rich in relevant information and thus not necessitating an increase in the sample size.

4.1.2 Respondent Characteristics

This section provides a brief view of the characteristics of the respondents which includes both DFI experts and SME participants. Figure 4 below shows the distribution of participants as a function of the DFIs that were involved in the study. For ease of reference, DFI expert participants were labelled DFI Respondent 1-6 while SME participants were labelled SME Respondent 1-4.

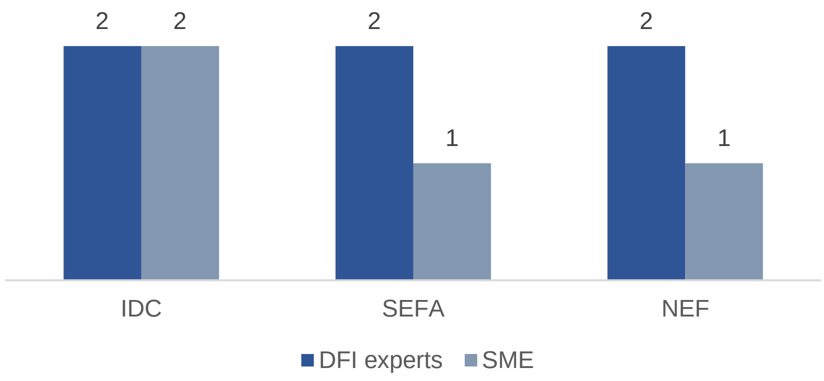

Figure 4: Characteristics of participants

Two DFI experts were found and participated in the study per targeted institution. It is important to note that 50% of these experts were dealmakers while the other 50% were investment officers. Two of the SMEs had experience with the IDC, whilst one had experienced the SEFA and the other the NEF.

A further description of SME participants as per qualifying criteria is shown below in Figure 5.

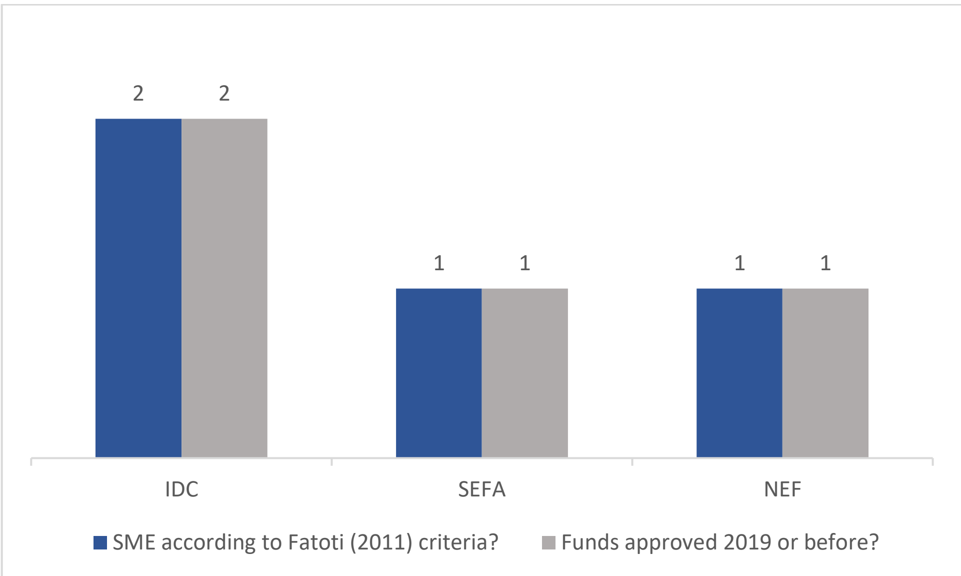

Figure 5: Depiction of SME participants as per qualifying criteria

The SMEs all met the qualifying criteria for the study, qualifying as SME according to Fatoki (2011) and having received DFI funding no later than a year ago.

4.1.3 General SME Support Structure

The general process followed by DFIs towards providing holistic support (in the form of financial and non-financial support) to SMEs was observed to be categorised into three stages: pre-investment stage, funding applications stage and the post-investment stage, respectively as seen in Figure 6 below.

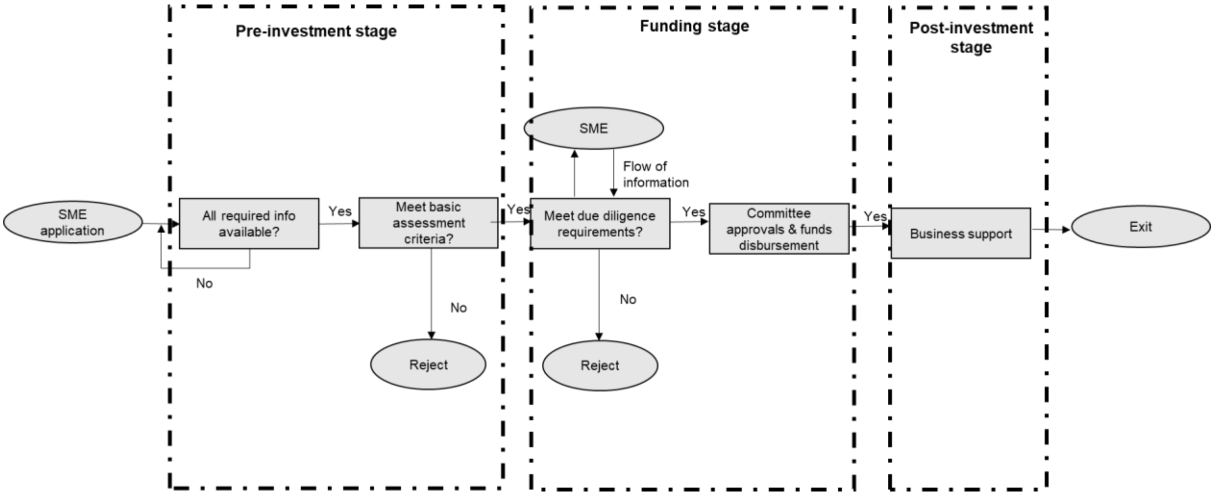

Figure 6: General structure of support to SMEs

The Pre-investment stage was an administrative process characterised by SMEs submitting all relevant documentation, meeting the qualifying criteria and passing the basic assessment. It also included a form of non-financial support where for example, if DFIs observed merit on an SME’s business case but required more information to assess such as financial projections, they would assist an SME in providing that information.

The funding stage is obviously more involved because it includes the due diligence processes, committee approvals, funds approvals and the disbursement of funds. Post-investment stage involved mostly monitoring which is the stage where DFIs check in on the SME’s financial health to successful operation.

Different themes emerged from the different stages of support offered to SMEs, these themes are discussed further in the sections below and used to evaluate the effectiveness of DFIs.

4.1.4 Evaluation of DFI Effectiveness

This section was designated to investigate the effectiveness of DFIs in their relation to SMEs. This inquest was aimed at answering the research questions, or at the least build towards the answer. The data analysis obtained by coding the transcribed interview text revealed prevalent factors that emerged from evaluating the effectiveness of DFIs. These factors formed the main themes as depicted in Table 6 below.

Table 6: Main themes found from data analysis

Challenges with the process	Challenges with funding	Support availability
1. Long duration of overall process	1. High interest rates	1. Business support availability
2. Rigorous due diligence	2. Delays in disbursement of capital	

Each of the main themes observed above had sub-themes or categories that were precursors to the theme and gave insight on the effectiveness of DFIs. The effectiveness was judged based on the institutions ability to meet its development objectives/mandates (job creation, building the “black economic sector, and creating sustainable SMEs) in relation to SMEs.

The effectiveness of DFIs was measured based on three approaches discussed earlier (section 2.1.6) as these were more relevant to the results from the study. Figure 7 below indicates these approaches and how they were related to the main themes.

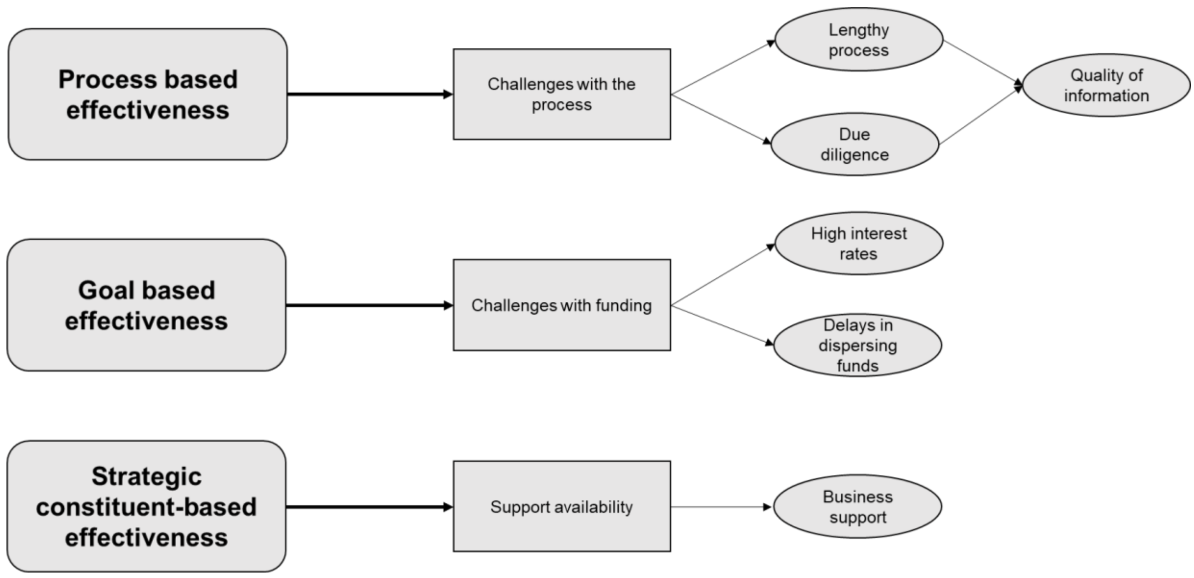

Figure 7: Measures of effectives in relation to the main themes

These themes were explored further below and then related to the different approaches of measuring effectiveness in the discussion section. Process based effectiveness was linked to the challenges with the process as that evaluates how effective DFIs with respect to their processes. Goal based effectiveness was linked to challenges with funding as the main objectives of DFIs include supporting SMEs through access to funding. And lastly, strategic constituent-based effectiveness was linked to support availability as that evaluates how satisfied SMEs with support provided by DFIs.

4.1.5 Challenges with the process

The process in the context of this section refers to the general overall stages that SMEs undergo and their experience in accessing capital from DFIs. While SMEs undergo the same stages, their experience with this process may differ. This strongly emerging theme included the overall process being long as well as rigorous due diligence.

4.1.5.1 Long duration of overall process

There was no defined duration of how long the process of accessing finance is or should be, DFI experts indicated how the duration was dependent on the quality of information provided by the SMEs and the complexity of the deal. If the quality of information provided by SMEs was compromised or the information is asymmetric

(SMEs do not share the whole full information with DFI), that created a back and forth which lead to delays in accessing finance.

> "It will depend on the complexity of the transaction…. A typical transaction, you are probably looking at between 8-12 weeks." [DFI Respondent 4]

> "I know our processes are long but there are reasons for that… The type of entrepreneur or SME that comes to SEFA, is an SME that has been excluded from traditional financing. So now what you get with a lot of these guys, is there is a big information asymmetry… We spend a lot of time trying to figure out what the entrepreneur is actually trying to do and where we can come in, how we can mitigate risk and how we can actually include this SME in the financial system." [DFI Respondent 6]

SME respondents indicated how lengthy the processes were and these long durations were found to be a point of frustration for SMEs, especially in cases where entrepreneurs were under pressure to obtain capital. The following extracts demonstrated this observation.

> "Pre-investment from the time of application, it took about nine months, eight to nine months. It took a really long time ...I had already signed up with the with an investor by the time they responded. I mean I couldn't wait, I ended up having to give up a certain percentage of the business to someone so that they can fund it." [SME Respondent 4]

> "So it was, I would say, probably a year, if not more, of just the application stage." [SME Respondent 2]

Even with the knowledge that the quality of information and information asymmetry as a source of delays in the process, DFI expert respondents admitted a portion was attributed to their internal processes as well. Internally, DFIs conduct extensive and stringent processes to ensure that SMEs do not only meet development targets e.g. job creation but they also met their sustainability targets e.g. ability to service the debt.

> "I think we need to find a way to lean our processes, make them shorter so that we quickly assist our entrepreneur. I don't know how 'cause everything needs to be above board, but yeah, we need to find a way of making this thing work easier than before. Look, we are in the fourth industrial revolution, everything is just out there and there are ways of making things faster…These are things which are

actually regulated, they are policy based and you can't really now skip them when you are doing the transaction. You have to go through this process which is quite lengthy." [DFI Respondent 5]

"Banks are very quick. Our processes are very long, and clients find them intimidating and long." [DFI Respondent 1]

"So, you know, it makes our processes a bit stringent and you'll find that when entrepreneurs are dealing with the NEF they do get a bit frustrated because, even DD processes are quite intensive, and it's not what people expect from a DFI but then we have to do that, because we're trying make sure that we invest in businesses that will still be able to come and repay us." [DFI Respondent 3]

The sub-theme of internal stringent (due diligence) processes started emerging strongly in the study as part of the challenges experienced in the process of accessing finance. This sub-theme was explored further for its influence and impact on SME support.

4.1.5.2 Rigorous due diligence

Due diligence was found to be a part of the process in accessing finance, where thorough assessment of the SME is conducted to ensure that the business has merit, and the SME can service the facility provided e.g., a loan. To conduct this process smoothly, DFIs required quality and symmetrical information to perform thorough due diligence. With the DFIs contradictory mandates which require balance between staying afloat and creating economic activity, there's a significant requirement to use the scarcely available resources efficiently. This means SMEs are put through a strict due diligence criterion in order to sieve out those that negatively impact the DFIs sustainability targets, i.e. SMEs who didn't meet debt service coverage ratio (DSCR) targets.

DFI experts suggested that this was a necessary step to ensure that they remain sustainable as a business and sustain low impairment rates as they do not hold any collateral. The respondents expressed that the need to remain sustainable as a business comes from being state-owned but not receiving funds from the government. Thus, they have become reliant on income from dividends, loan repayments and in other cases rental income as well.

> "It's such a thin line to try and be sustainable. But then, we become so rigorous in our due diligence processes; as in our requirements, because, [we need] to be sustainable and maintain low impairments. Also, considering the fact that we are cash flow-based funder and not an asset-based funder like the banks." [DFI Respondent 3]

The strict criteria applied to SMEs at due diligence caused further frustrations as there were further delays in accessing the funds. The extracts below demonstrated this observation.

> "Yeah, but the process took a bit of time because we had to do a lot of due diligence and we did that until we got the funding." [SME Respondent 1]

> "They went through the process of due diligence and then there was more people brought in like marketing and all the different segments. Some were looking at the financial projections. So, I'll have like meetings with them or when there was information that they weren't sure of, they will ask… but it was probably like six months or so later that the thing [application] went to the first committee for review." [SME Respondent 2]

The challenges with the process were beyond the quality of information provided by the SMEs and included how DFIs conduct their internal processes which prioritize ensuring that SMEs were able to service the debt facility. The back and forth caused by the quality of information and/or information asymmetry showed the extent of support DFIs offer SMEs to ensure that they go through with the process and SMEs are not cut off then and there.

However, these strict internal processes within DFIs impact SMEs as they hinder access to finance for some SMEs who do not meet the sustainability targets and are perceived to have high default risk. Delays within the process also impact SMEs as the market can change while SME waits for funding or bigger market players can grab the opportunity first.

Although DFIs go through a certain extent to contribute towards supporting SMEs access finance, do they understand the impact on how delays and stringent processes may affect their ability to effectively support SMEs?

4.1.5.3 Challenges with funding

The challenge with funding was another strongly emerging theme. This emerged in the form of high interest rates imposed on loans from DFIs and the experienced delays in the disbursement of funds. The interesting observation about these challenges was how they came after the SME was approved to receive funding, but approval does not always call for celebration on the SME's part.

4.1.5.4 High interest rates

Thorne and Du Toit (2009) described how successful DFIs have financial stability which included the ability to raise capital in financial markets. The DFI experts (particularly IDC and NEF respondents); expressed that one of their key challenges is that as state-owned institutions, their credit rating being linked to that of the government and that impacts the lending rates they receive from capital markets. And as a result, the interest rates they charge SMEs can be high. DFI experts attributed the high interest rates to again, their need to remain sustainable.

> You know, we depend a lot on repayment of these loans and the fees we get from that. But then what used to happen is the equity book actually subsidized the debt funding side. But because now what happened is the economy slowed down and equities were hit so bad… Our dividends dried up so there goes our source of funding. So now we have to borrow in the market and the market is now pricing us at this government rating that we've got. So, our cost of funding has become seriously prohibiting to funding. [DFI Respondent 2]

> "Our money, which is IDC money is borrowed at certain rates which we have to be able to service and sometimes because of the economy… You know these S&Ps and Moody's they will then rate us and then obviously based on that [rating], when we borrow money, we are not getting favourable interest rates. We still have to take into account the cost of funds and be able to loan [SMEs] at a rate which allows us to make a profit and be able to pay back what we owe to our lenders." [DFI Respondent 1]

The SEFA DFI respondents suggested that they do not impose high interest rates, but this only applied to SMEs who meet more than one development criteria. This particular DFI expert respondents expressed the availability of discounts if an applicant meets development criteria such as being youth, female, disabled and being previously disadvantaged. The following extract demonstrated this observation.

Although the cost of capital may be high, all DFI expert respondents confirmed the availability of some conditional grants for applicants which reduce the loan amounts for applicants and thus debt payments.

> 'We are quite cheap… Our interest is calculated on prime plus the risk of the business minus the developmental impact of the business.' [DFI Respondent 5]

> "…But then you get a situation now where a business hits development stats. Where now if it's a youth owned business, there's a specific fund for youth owned businesses, majority of youth owned businesses, right? It's called the Youth Challenge Fund. The rates for the Youth Challenge Fund is 5%, right? It's not prime linked but 5% fixed. Because it is a youth owned business, it starts to qualify for a grant and that grant portion is now put into a scorecard, you know that calculates. The maximum that the grant scorecard can actually kick outs is 35%." [DFI Respondent 6]

However, even with the availability of grants SMEs still expressed how expensive it is to service debt from DFIs. The extracts below demonstrated this observation.

> "It's just like a bank. The only difference is that it's a DFI. Exactly what the bank would have offered. Yeah, there's nothing, there's no benefit… You get the same interest rate, or worse, quite honestly. So, to answer your question, it's expensive." [SME Respondent 4]

> "It's just too expensive to service this debt. I really needed to finish it because they charge you; the interest rate was very high and every time you want money, you are frustrated. You will just agree with anything that they are offering, or you can try and negotiate, but the longer you negotiate, the longer it takes time." [SME Respondent 3]

They high interest rates were not the only inhibitions SMEs experienced when attempting to access funds from the DFIs, they also experienced delays in disbursement of funds once they had been approved.

4.1.5.5 Delays in disbursement of funds

A key finding was the observation that approval of funds doesn't not mean the applicant will have immediate access to funds. All DFI experts confirmed that DFIs include conditional precedents (CPs) on legal agreements to ensure the commitment of the SME and to ensure that by the time funds are disbursed, the SME is operational enabling their ability to service the debt.

> "It's a condition precedent, which is the condition that must be met prior to the money being drawn by the client. These are there on the legal agreement, and sometimes those clients don't even read the legal agreements. It's also long and difficult to understand. So yeah, sometimes clients don't even read the agreement, they just sign but you can sign it but if you haven't met the condition then their money won't flow… Small businesses usually, they will do whatever they need to do to get their money because they need it a lot more and they're not profitable enough sometimes to go to banks. You know, banks have already rejected them, for example. They when they come to us, maybe they've already been to a bank, and they were rejected. When they come, they will make sure that they do what they need to do to get it." [DFI Respondent 1]

> "A condition precedent, it needs to happen [be achieved by SME] before we actually pay out the funds… The thing is, what that does is one; it shows [the SMEs] commitment." [DFI Respondent 6]

The SME respondents showed understanding of these conditional precedents, but also expressed the inconvenience caused by delays in achieving the conditions since some also require money. The concern included how while they waited for funds, prices went up, market turned (due to Covid-19 for example) and how entities with readily available funds could potentially grab the market while the SME is delayed.

> "… But if one of the CPs for you is to get the geotechnical investigations done and completed. Those geo-technicals can cost you millions before you get the funding. So, you need to have some money somewhere to complete the requirements before you can access your funds." [SME Respondent 1]

> "The conditions to release the funds to me was that I needed to have a liquor license and there was a few others… The time it takes, it was outside my control because I [had to] apply with the liquor boards and then before that I needed to find premises, which I needed to have signed a lease agreement with the landlord who wanted six months upfront deposit… I had to sign a lease agreement that legalises the application process which took like 6-7 months. When they finally released the grant, we realized that the condition for the licenses was that I needed to have the equipment in place and for equipment, I needed to have the funds available to buy the equipment. So, there was another month. Because of those conditions, the

> project was 11 months delayed which then for me means that you know I had 11 months of spending on rental and all the other running costs without production." [SME Respondent 2]

The challenges with the funding process was an interesting discovery since approval means the SME met both development and sustainability targets imposed by the DFIs. However, this funding comes at an expensive cost to the SME and because of the nature of the SMEs that are typically funded by DFIs, they have no other alternative but to accept these high rates.

The impact of delays in disbursement of funds was quite dire on SMEs as they needed to fulfil conditions that require funds while waiting for capital from the DFI. These delays created gap periods where, according to projections an SME was supposed to be operational so they can start servicing the debt, but they are not since these conditions have not been met. This was observed to also put the SME at risk of defaulting on the loan. Although DFIs provide (expensive) finance, do they understand the extent to which delays in accessing capital may inhibit their mandate to support and grow SMEs?

4.1.5.6 Business support availability

The availability of support as a theme emerged in the form business support offered to SMEs which was mostly non-financial. The availability of business support at the pre- and post-investment stages of the process was observed to be a fundamental support structure provided to SMEs by DFIs.

The availability of support demonstrated how DFIs have a level of understanding of SMEs as clients they are mandated to support. When DFIs were asked about their level of support, the responses indicated that there was a lot done to foster the commitment to support SMEs as demonstrated by the following excerpt.

> "There's a program, ... Where we go and train entrepreneurs, they get trained by qualified investment professionals, entrepreneurs and industry dealmakers on entrepreneurship and how to run businesses. That program runs throughout the whole year and across all the all the provinces. They get taught a whole lot." [DFI Respondent 3]

Pre-investment business support enabled DFIs in partnering with SMEs in ensuring their applications are up to standard so that they are easily convertible to bankable transactions.

> "We try to be more of a partner, so if your business plan comes to us and you and we can see that, maybe everything is not really there yet. We tend to play that role of packaging the transaction to make it bankable. So that's maybe not official position, but that's what happens in practice because these clients can often not afford to go do elaborate business plans." [DFI Respondent 2]

> "But we have a sister company which is the Small Enterprise Development Agency… SEDA will [then] assist with a business plan, as far as possible because some other business parts of the plan need to be done by the entrepreneur, unless it's a dire situation where the entrepreneur is actually illiterate, for lack of a better word. SEDA will assist as far as possible with financial projections, but basically SEDA will look at this business because it's [SEDA] a developmental agency. They look at it with an eye of providing non-financial support." [DFI Respondent 6]

Post-investment support showed the commitment of DFIs in putting effort in ensuring funded SMEs succeed through monitoring the SMEs financials. And when the SME struggled with debt repayment, they would assist with trying to turn the business around, restructuring the facility (extend the term or renegotiate interest rates) or even offer loan moratoriums.

> "We are not about taking you to court... That's the last, last, last resort. … We are more about making this thing work because your success is our success." [DFI Respondent 4]

> "If something starts to go wrong, we are not like the banks who will immediately call up the loan and close you down. We will actually try and restructure their facility first. So, we'll say, "OK, maybe something went wrong, and you couldn't start when we said you will start." Then we will give an extension on their loans… and then even if that doesn't work, then we first have a business turnaround department who will actually go in and see how can we turnaround this thing, before we finally have to get to a legal [process] where we then know if there's really no hope then we will go get our assets and see what we can sell." [DFI Respondent 2]

Interviewed SME respondents acknowledged the awareness of these support structures and did not have issues with pre-investment support. However, SME respondents commented on how post-invest support does not provide support but is basically a monitoring stage that can have over-interference from the DFI. It was also observed that the availability of business support at post-investment did not work for all SMEs.

> “There's very little, almost non-existent post investment support and I guess it's probably how they operate. I think they're more like a bank... There's little post investment support.” [SME Respondent 1]

> “It's not really support, it's just people who collect data every month to check and to find out how you are doing… There is a post investment account manager honestly speaking they're not really doing much. It's just that with me, because of Covid, I had asked them for moratorium to say I cannot pay you until there’s stability in my business.” [SME Respondent 3]

> “… Then I applied for extra funds because then we had run out of money without having started production. Uh, then then Covid happened uh, like a few months later… All the loans were due for repayments and then we had Covid with the alcohol bans. I couldn’t produce, I couldn’t make money. So, I applied for them to restructure the whole facility, which they declined ... They asked for projections which I mean, I can’t project because no one knows when Covid is going, no one knows how long it would be… then they took me legal.” [SME Respondent 2]

Business support was available at different stages. At pre-investment to get SMEs started with the process of accessing funds. At post-investment when SMEs struggled with servicing the debt facilities, but this support contributed towards assisting SMEs to a certain extent. This was observed because the post-invest support was just data collection and monitoring which may not have been what the SMEs required. And when there were high pressures on the macro-economic environment due to the global Covid-19 pandemic, deficiencies in the ability of DFIs to offer support were exposed. Although DFIs provide business support to aid SMEs, do they understand extent of the service provided and how it impacts SMEs?

4.2 Discussion

The results that emerged from the thematic analysis are discussed in this section in line with the objectives of the study, which were to evaluate levels of effectiveness in

DFIs and explore the prevalent relationship between DFIs and SMEs. This section summarises the main findings of the study under each theme and relates the findings back to the different approaches adopted to measure effectiveness.

4.2.1 Evaluation of DFI Effectiveness

- *Challenges with the process*

The results pointed towards challenges with the process being caused by long durations which were influenced by the compromised quality of information (including information asymmetry) provided by SMEs and the intensive internal processes at the DFIs. These stringent and long processes served the DFIs and not the SME because of these reasons:

i. They hinder access to finance for some SMEs who do not meet the sustainability targets and are perceived to have high default risk. Does that then mean DFIs must not fund start-ups for instance?
ii. They delay SMEs who meet all targets because the DFIs must be thorough in their assessment while the market conditions change for the SME

DFIs implement rigorous due diligence to be sustainable while achieving the development impact but there was a drawback on this – the process being lengthy and some SME elimination from funding. Moreover, rigorous due diligence ensures financial stability of DFIs (selecting SMEs that can service their debt) which in turns means DFIs can also service their debt in the capital markets.

The balance between sustaining DFI as a business and having development impact is perhaps the most important aspect of succeeding as a development bank. Dickinson (2008) highlights this specific challenge by stating that one of the challenges faced by these institutions is that they must conduct robust investments to generate profits whilst pursuing economic development. This double bottom line emerged as one of the biggest challenges faced by DFIs in the country, with their goals leaning more towards being profit driven (sustainable) than being development driven.

Thus, when evaluating the effectiveness of DFIs based on the process approach, it was concluded that they are moderately effective based on the effectiveness scale. This was concluded because process effectiveness focuses on the process of converting resources to product/service. And while DFIs that they have processes in place, the processes had significant drawbacks with serious consequences which limit SME support.

- *Challenges with the funding*

It was found that the contributors towards challenges with funding were the high interest rates that DFIs offered in the loans they provided SMEs and the delays in DFIs disbursing funds to SMEs. Imposing high interest rates was once again a measure DFIs used to ensure they remained sustainable as businesses. This was perceived to be exploitational on SMEs as they generally have no other alternative but to accept these high interest rates.

Delaying disbursement of funds was perceived to be a risk mitigation action on the DFIs side with dire consequences on SMEs as it could potentially cause default on the loans. This was also observed to be an unintended consequence that enables DFIs to be sustainable financially through ensuring that certain pre-requisites are met before funds are accessed. For example, SME has liquor licence before equipment to brew is bought for the SME. The intention was not to delay funds but more of a thorough risk mitigation process.

Thorne and Du Toit (2009) suggested that financial sustainability of a DFI is imperative to the entity's success. They defined financial stability for a development bank as its "capacity to attract required capital to pay creditors, sustain the interests of the shareholder (government) and support their own growth". The ability to remain financially sustainable emerged as another biggest challenge faced by DFIs in the country as it started incentivising non-development orientated behaviour.

This was demonstrated through low-risk appetite (rigorous due diligence: elimination of "risky" SMEs, delays in funds disbursement: stringent risk mitigation) and reduced development services (high cost of capital offered to SMEs). Albeit, DFIs have no control on the credit rating they receive which influences their lending rates. Thus the government also has a role to play in the financial stability of these institutions, through provision of subsidies and tax and dividend exemptions (Thorne and Du Toit, 2009). How can the government better support these institutions so that their focus leans more towards development?

Thus, when evaluating the effectiveness of DFIs based on goal-orientated approach, it was concluded that they are moderately effective based on the effectiveness scale. This was concluded because goal-orientated effectiveness focuses on the essential operating objectives of the organisation, for DFIs it is to support the growth of SMEs by providing access to finance. DFIs may have an appearance of achieving this goal while the cost SMEs pay for this funding goes unnoticed.

- *Support availability*

Business support was found to be available at different stages, i.e., pre- and post-investment. The extent of the support especially at post-investment stage was inadequate since it was just data collection and monitoring which may not have been what the SMEs required.

DFIs provide support with the aim to ensure SMEs do not fail as stated by Fatoki (2014), that non-financial support is important because SMEs are prone to fail due to internal and external factors. The intended aim of the support is good however it is perceived to fail in meeting the specific needs of the SME. It almost seems like a paper exercise done just to check the SME is financially healthy and instead of a proactive technical approach in assisting SMEs prevent failure from internal and external factors.

According to Thorne and Du Toit (2009), DFI support in relation to SMEs goes beyond financial access but also includes developmental services such as technical assistance, research and advocacy which did not emerge from the study. Thus, when evaluating the effectiveness of DFIs based on strategic constituent approach, it was concluded that they are moderately effective based on the effectiveness scale. This was concluded because strategic constituent effectiveness focuses on the effect of the DFI on the main stakeholders [SMEs] and their interests. And with support availability, the interests of the SMEs weren’t fully taken into consideration.

4.2.2 Prevalent relationship between DFIs and SMEs

These institutions partner with SMEs and demonstrate the understanding of their role and how they fit into the South African context when it comes to development finance. This was observed through their delivery of the business support, enabling the availability of these services with understanding that the country has previously disadvantaged citizens. Ensuring that they assist with business plans to easily convert their applications into bankable transactions.

DFIs play their role to support SMEs as discussed in the above sections, however SMEs also have a responsibility towards ensuring that DFIs are effective in their objectives to support them. This came up in the study where delays in the process were influenced by the quality of information SMEs provided. They also have a responsibility to not mismanage funds leading to failures that are due to internal factors. Such factors may reduce pressure from DFIs and ensure sufficient SME support.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5. Conclusion

This study had an objective to determine the levels of effectiveness of DFIs in relation to their responsibility to support SMEs and explore the prevalent relationship between the two parties to delineate factors leading to effectiveness of DFIs. The findings suggested that DFIs act in accordance with their mandate, to support SMEs but there are challenges within their own processes to do so, there are challenges SMEs experience with accessing funds and the availability of support does not generally cater to SMEs needs. It was also found that a functional relationship is required between these two parties so that DFI effectiveness is not inhibited.

This has led to the conclusion that state-owned DFIs in South Africa are moderately effective in relation to SMEs. This conclusion was made based on the following:

- When evaluating the effectiveness of DFIs based on the process approach, it was concluded that they are moderately effective. This was concluded because process effectiveness focuses on the process of converting resources to product/service. And while DFIs that they have processes in place, the processes had significant drawbacks with serious consequences which limit SME support.
- When evaluating the effectiveness of DFIs based on goal-orientated approach, it was concluded that they are moderately effective. This was concluded because goal-orientated effectiveness focuses on the essential operating objectives of the organisation, for DFIs it is to support the growth of SMEs by providing access to finance. DFIs may have an appearance of achieving this goal while the cost SMEs pay for this funding goes unnoticed.
- When evaluating the effectiveness of DFIs based on strategic constituent approach, it was concluded that they are moderately effective. This was concluded because strategic constituent effectiveness focuses on the effect of the DFI on the main stakeholders [SMEs] and their interests. And with support availability, the interests of the SMEs weren’t fully taken into consideration.

5.1 Policy Recommendations

The following recommendations were made with the aim to improve the levels of effectiveness of DFIs in South Africa as they relate to SMEs.

- *Challenges with process*

In order to balance out sustainability and development objectives without DFIs abandoning the development aspects; DFIs together with the shareholders (government) can agree on a specific capital adequacy ratio (CAR) as proposed by Thorne and Du Toit, (2009). What the CAR can achieve is ensuring that the DFIs have enough capital on reserve to fund risky SMEs and handle some losses before it can be at risk of insolvency. This might allow for some flexibility within the DFIs internal processes so that they are not long or stringent because the focus is on being profitable.

- *Challenges with funding*

There is limited control DFIs have on their credit rating as it was found to be linked to the government. However, the government can play a role in supporting DFIs with not imposing high interest rates on SMEs. This can be achieved by provision of subsidies/grants which must be separated from the commercial activities of DFIs to limit the governments political interference (Thorne and Du Toit, 2009).

DFIs could also adopt the Subsidy Dependence Index where:

Index value	Indication
less than 1	DFI can cover all subsidies at market interest rates
zero	DFI is financially self-sustainable
greater than 1	DFI requires subsidies to survive

Source: (Yaron, 1992)

This index will enable the DFIs to where they stand based on their financial stability.

- *Support availability*

The DFIs must relook at their mandates to understand the relevance of the support they provide is to SMEs. According to Thorne and Du Toit (2009), one of the dimensions that make development banks successful is their understanding of how they fit into the local economic environment. This understand will hopefully provide a fresh perspective on how SMEs can be supported adequately.

5.2 Suggestions for Future Research

- A quantitative study on the effectiveness of DFIs in South Africa in relation to SMEs
- The impact of governance and management on the effectiveness of DFIs in South Africa in relation to SMEs
- Application of the Models-based Organizational Effectiveness Scale on DFIs in South Africa

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APPENDICES

Appendix A: Sample of Interview Questions

Appendix A1: DFI interview questions

Section A: General information about DFI

	DFI	Participant's role in the DFI	Main Areas of operation	Type of businesses that are funded
Purpose	Demographics			

Section B: Effectiveness of DFI and extent to which it impacts SMEs

Question	Purpose	Source
What are the DFIs objectives in supporting SMEs both financially and non-financially?	Understand and explore the effectiveness of DFI and extent to which it impacts SMEs	Author's own
Are these set objectives measured? If so, how?		
What measures are put in place to ensure that these objectives are met in a specified given amount of time?		

What challenges do the DFI face in supporting SMEs?		

Sections C: Role of DFI in supporting SMEs - Financial Support

Question	**Purpose**	**Source**
What kind of relationship does the DFI have with the SMEs that they finance or support?	Explore the role of DFI in supporting SMEs with financial Support	Author’s own
Does the DFI have set objectives on the number of SMEs that get funds per financial period?		
What has your experience been when observing how this DFI has given an SME access to funds? Does it always mean success, if not why not?		

Sections D: Role of DFI in supporting SMEs - Non-financial Support

<table>
<tr><th>Question</th><th>Purpose</th><th>Source</th></tr>
<tr><td>What are the roles and responsibilities of the DFI when offering SMEs non-financial support?</td><td rowspan="3">Explore the role of DFI in supporting SMEs with non-financial Support</td><td rowspan="3">Author’s own</td></tr>
<tr><td>How do you measure the type of non-financial support each SME requires?</td></tr>
<tr><td>Is there a measure on how non-financial support impacts SME?</td></tr>
</table>

Appendix A2: SME interview questions

Section A: General business and operational information

<table>
<tr><th></th><th>Industry</th><th>Business type & Main Areas of operation</th><th>Business Age</th><th>How long have you been receiving development finance?</th><th>From which institutions have you received development finance?</th></tr>
<tr><td>Purpose</td><td colspan="2">Demographics</td><td colspan="3">Qualifying criteria & business experience</td></tr>
</table>

Sections B: Challenges faced by SME in relation to finance

Question	Purpose	Source
What has your experience been with accessing external finance, from commercial banks and the like?	Understand challenges faced by SME in relation to finance	Author's own
What are some of the major challenges with accessing finance from DFIs?		
Do DFIs provide support in terms of addressing these challenges experienced? If so, how?		

Section C: SME experience with DFIs – financial & non-financial support

Question	Purpose	Source
What are the roles and responsibilities of the SME when offered non-financial support by DFI?	Understand SME experience with DFIs – financial & non-financial support	Author's own

What is the biggest challenge your business faces?		
Can you approach the DFI for non-financial support with challenges experienced?		

Section D: SME experience with DFIs – impact on SME

Question	**Purpose**	**Source**
How has financial and non-financial support from DFs impacted your business?	Understand SME experience with DFIs – impact on SME	Author's own

Appendix B: Invitation to Participate

Dear Participant

My name is Nonkosi Xaba, I am currently a student enrolled at the Wits Business School with the hope to attain my Master of Management in Finance and Investments. The topic of my research is “The effectiveness of Development Finance Institutions (DFIs) in South Africa in Relation to Small and Medium Enterprises (SMEs)”.

My research will be based on understanding how effective DFIs are in terms achieving their set objectives in terms of assisting SMEs with financial and non-financial support. I will be interviewing both DFIs and SMEs to gain perspective from the two parties. The interview should take between 30 to 60 minutes and will be hosted at a location most convenient to you or virtually using any of the safe platforms, with recording functionality that are available and convenient to you (i.e., Skype, Zoom, Google Meets or Microsoft Teams).

Confidentiality: Please note that all personal details of the SMEs and DFI representatives will be kept anonymous and confidential, recordings will be stored safely in the university should any information need to be verified.

Rights: Every participant has the right to withdraw from the interview at any point and for any reason known to them. You have the right also to refuse to be recorded; in this case, other means of documenting the insights will be used.

Use of the information: All information that is collected in this interview will be used strictly for the purposes of this research. Upon successful completion of the research, information will be stored safely by the Wits Business School and only the results of the study will be put on the public domain.

Your participation will be highly appreciated.

I .... have read and
understood the above and give consent to participate in the research project.

Signed at... On this date...

Signature..

Appendix C: Consent to share contact details

Dear SME Owner/DFI Employee (chose relevant)

I am currently assisting Nonkosi Xaba, a researcher currently a student enrolled at the Wits Business School with the hope of obtaining a Master of Management in Finance and Investments. Her research is "The effectiveness of Development Finance Institutions (DFIs) in South Africa in Relation to Small and Medium Enterprises (SMEs)".

Based on my discussions with her, and my previous engagements with you her research could benefit from your participation as a subject of her study. Would you mind if I share your contact details with her so that she could explain the process to you in details. I would appreciate if you could give consent for me to share your personal information limited to your name, business name and industry as well as contact details. You may give consent by email, instant messaging in any available platform or by signing this consent request below:

I (insert name), ... business owner of ………………………….. hereby give written permission consent to my personal information as defined in this document being shared for the purposes in this request.

Signed at.. On this date...

Signature..