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The Role of South African Financial Institutions (public and private) in the Development of SME's and Entry Level Black Entrepreneurs in South Africa: Comparative Analysis with Respect to India and Brazil

By

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ABSTRACT

This study investigated whether the financial sector (private and public) is accessible to the SME's and entry level entrepreneurs dominated by Black and poor people. The study employed a comparative analysis method; it compared the structure of the South African financial sector to those of India and Brazil, as newly industrialised countries. The finding indicates that the South African financial sector lacked the presence of state-owned financial institutions as in the comparable NCI countries to support SMEs and entry level Black entrepreneurs. The study then recommended the creation of state-owned microfinance institutions, whose performance will determine the need of state-owned banks.

Key concepts: Access to finance, SMEs, Black Entrepreneurs, State-owned Banks

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I am extremely grateful to my mother Princess Makhosazana Zama, who raised my brother Vusi and I, under extreme hardship, but remained resilient and exemplary through her actions of hard work, and emphasis of education and continuous quest for knowledge.

DECLARATION

I, Wanda Zama, 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: Finance and Investment, in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

Wanda Zama (511623)

On the 23rd Day of February 2017

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1 CHAPTER 1: INTRODUCTION

1.1 Introduction

The Economic Development Minister, Ebrahim Patel, recently announced R23 billion Rands in funding towards black industrialists (Business report 2015). The South African government has, over time, allocated a significant number of resources directly or indirectly via its Departments, Agencies and Financial Developmental Institutions (DFI) to improve the lives of the previously disadvantaged black majority.

The initiative of the creation of the Black industrialist is one of government's ways to address unequal patterns in the South African economy. The Business report (2015) further reports that Black industrialists would be able to access a R 1 billion grant from the Department of Trade and Industry as a support measure. This grant is in addition to a syndicated pool of funds housed and intended for the creation of Black industrialists and this programme is led mainly by the DFIs such as the National Empowerment Fund (NEF), and the Industrial Development Corporation (IDC).

The South African government supports the notion that the creation of Black industrialists will be about letting black people enter critical spheres of the economy and ultimately, about uprooting poverty, inequality, unemployment, skills shortages and racism. The government initiatives are motivated by examples from countries such as Brazil, India, South Korea, Malaysia, and others with similar historical political, economic, and social challenges like those experienced by South Africa. The lessons drawn from such countries are that significant industrialisation has been achieved through the active support by government of its indigenous entrepreneurs.

Our research investigated whether the South African Financial Institutions are effectively geared to support the development of SME's in general, and Black industrialists in particular. Furthermore, the research draws lessons from newly

industrialised countries to formulate the effective strategies to support SME's and entry level Black industrialists.

The South African government development programmes seem not to be making a much-needed impact; instead the opposite effect is witnessed through increasing poverty and unemployment rates. We want to find out if there is an alternative / effective methods of accessing affordable financing by all South African SME's in general and entry level black entrepreneurs. Southal (2004) asserts the government policies such as BEE are capitalist and only producing a few black elite showing that the current financial sectors funding models having failed the South African Black majority, particularly those who fall at the bottom of the pyramid.

1.2 The Background of the Study

South Africa is dominated by private commercial banks with no state-owned commercial bank. South Africa, though, has some development financial institutions such as the Industrial Development corporation (IDC), National Empowerment Fund (NEF), Development Bank of Southern Africa (DBSA), Public Investment Corporation (PIC), which are intended to provide financial and non-financial assistance to SMEs and entrepreneurs, as well as targeting the previously disadvantaged entry level black majority, but there has not been a lot of progress as we see rampant unemployment, inequality, poverty and lack of entrepreneurship. Isenberg (2010) acknowledges that entrepreneurship is changing the world over and the best practices are surprisingly, coming from unforeseen places and suggests that for a government to ignite venture creation and growth, governments need to create an ecosystem that sustains entrepreneurship. Knight (2006) posits that South Africa has gone 20 years past Apartheid and into democracy but still has a strong legacy of soaring unemployment rates, as well as poverty manifesting itself in much social unrest in the country.

1.3 Research Problem

South Africa has seen increasing rates of unemployment, inequality, poverty and a lack of meaningful entrepreneurship amongst the previously disadvantaged Black majority. South Africa's post-apartheid government, in the hope of eradicating these huge problems, advocated for the Broad Based Black Economic Empowerment (BBBEE) policies and use of Development Financial Institutions to be in the centre in the fight against this rampant and increasing lack of entrepreneurship, inequality, poverty, skills shortage and unemployment. It seems that lack of entrepreneurship, lack of access to funding by aspiring entrepreneurs and therefore high unemployment within the Black majority is still a challenge despite these noble efforts, as the commercial banks, DFIs, SOE Enterprise Development Funds are not reachable to the majority who want to enter entrepreneurship and foster economic growth and alleviate poverty, as well as unemployment.

1.4 Research Objectives

The main objective of this study is to establish whether the South African financial Institutions (both public and private) can provide access to credit to SME's and the majority entry level black entrepreneurs; this is done by doing a comparative analysis with respect to other NCI economies such as India and Brazil. By entry level entrepreneurs, we mean newly motivated young South African who have started a business, but are lacking access to credit.

1.5 Research Question

The research question is as follows:

- Is the financial sector (private and public) accessible to the SME's and entry level entrepreneurs dominated by Blacks and the poor, and aligned to the government's reindustrialisation policy, and the creation of Black entrepreneurs?

1.6 Overview of Research Methodology

In order answer the research question, we used a comparative analysis. Firstly, we reviewed the financial sector of other newly industrialised countries (NIC) - this term describes a country whose level of economic development ranks it somewhere between the developing and first world classifications-, the selected countries are India, Brazil and China, and then presented the structure of the South African financial industry; this is presented in the literature review. Secondly, the methodology section used data on credit extension to do trend analysis on how credit extension can promote economic growth with the presence of state-owned banks. The use of credit extension data allows us to grasp the relationship between value added in the manufacturing sector and easy access to credit in the industrialised countries. Furthermore, it allows us to assess the effect of credit extension with the presence of state-owned banks on the promotion of economic growth, and the promotion of entrepreneurship. We combined the findings in the literature review with the statistical computations and trend analysis as this allows us to draw conclusions on the differences and similarities between the selected countries.

1.7 Significance of the Study

South Africa is classified as a newly industrialised country alongside India, Brazil and many others. The financial system is dominated by private domestic owned banks and foreign owned banks. The comparative analysis undertaken in this study has the advantage of providing information on the structure of other industrialised countries, which in turn, will benefit the South Africa government as a non-state-owned bank country. The current study provides insight on how industrialised countries have tackled problems related to financial inclusion and policy strategies that they have put in place.

1.8 Summary

As outlined in the previous section, the main objective of this study is to break down the structure of the South African financial system, bring out its weaknesses and strengths with a comparison with other industrialised countries such as India and Brazil. The question the study intended to answer is whether the current financial system in South Africa is strong enough to provide affordable credit to SMEs and entry level Black entrepreneurs. We intended to accomplish this by doing a comparative analysis of the financial system of industrialised countries. Our selected countries are India and Brazil. The study presents the financial industries of each country, with a particular focus on how different they are in term of private and state-owned banks, and the significance of private and state-owned bank is assessed by reviewing the policies and strategies that the governments in the selected countries have put in place to assist SMEs and young entrepreneurs to access finance.

1.9 Scope of the study

The following Chapter of this study (Chapter 2) presents the literature review on different financing models for creating entrepreneurship, and presents the financial system of comparable industrialised countries such as Brazil and India. Chapter 3 presents the research methodology, data, trend analysis and empirical analysis, and chapter 4 conclude with recommended solutions.

2 CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

Since the end of Apartheid in 1994, Black people in South Africa are beginning to penetrate the productive sector, but are faced with difficulties, and the most important of these is access to credit. The struggle in South Africa in term of financial inclusion has been tackled by other industrialised countries with new policies and strategies, and presenting an overview of the comparable industrialised countries would facilitate the development of new policy and strategies to tackle the issue of financial inclusion in South Africa. This chapter first, presents current policy strategies in support of entrepreneurship and second, reviews the structure of the financial systems of South Africa, India and Brazil.

2.2 Policy Strategies aimed at supporting entrepreneurship in South Africa

South Africa (SA) is one of the African countries with several racial groups and, at the same time, is the most developed with a sound financial system in Africa. Despite the advancement in term of development and well established financial systems, SA is still suffering from problems related to financial inclusion and this is distributed across gender and races, and most importantly, entry level black entrepreneurs are often excluded from the benefit that the financial industry offers (International Finance Corporation, 2006).

2.2.1 Black industrialist policy and Strategic partnership programme

Recent developments toward financial inclusion has been engaged by the central government to alleviate the pain of financial exclusion, and the government has also developed policy and strategies to provide access to credit to entry level Black entrepreneurs. According to the Department of Trade and Industry (DTI) report

(2005), the promotion of entrepreneurship and newly born small businesses are important to the South African government.

Firstly, strategies and policies have been developed to enhance the growth of entrepreneurship aimed at increasing the supply of financial and non-financial services to create a market for small businesses' products and to reduce constraints that they face (the department of trade and policy, 2005). Secondly, the creation of the South African Credit Bureau was one of the first actions undertaken by the SA's government to facilitate access to credit to those at the bottom of the pyramid (Government Gazette, Credit Act report, 2006).

Further actions have been taken by the government to resolve problems related to lack of access to finance by Black entrepreneurs. The government has introduced the Black industrialist policy which figures into the government development plan. It is aimed at creating a competitive Black owned industry in South Africa and will be financed through collaboration with banking institutions (the dti Black Industrialist Policy, 2015). The SA government intends to collaborate with the Development Bank of Southern Africa (DBSA), Export Credit Insurance Corporation (ECIC), Industrial Development Corporation (IDC), Land Bank, National Empowerment Fund (NEF), Public Investment Corporation (PIC) and Small Enterprise Financing Agency (SEFA) to finance the Black industrialist project. Table 2.1 is taken from the Black Industrialist Policy report (2015) and clearly defines the Black industrialist characteristics.

Beside the Black industrialist policy, strategic partnership has also been introduced by the Department of Trade and Industry. This programme is a PPP form agreement with the aim to supporting and promoting SMEs in South Africa. Most importantly, the programme focuses on board-based Black economic empowerment businesses.

One of the requirements for a private sector entity to be a partner in this programme is that at least 60% of the total SMEs supported by the strategic partner must be at least 51% owned by Black South African (DTI's Strategic Partnership programme report, 2016). This is in accord with Oladokoun et al

(2015)'s research in Nigeria. They address the problems facing the Nigerian agricultural sector in term of financing accessibility. They developed a model for the issue and argue that financing of real activities should be based on a partnership mode of contracts. In that instance, parties in partnership will be able to share profit as well as risk emanating from the business.

Table 2.1: Characteristics of Black Industrialist

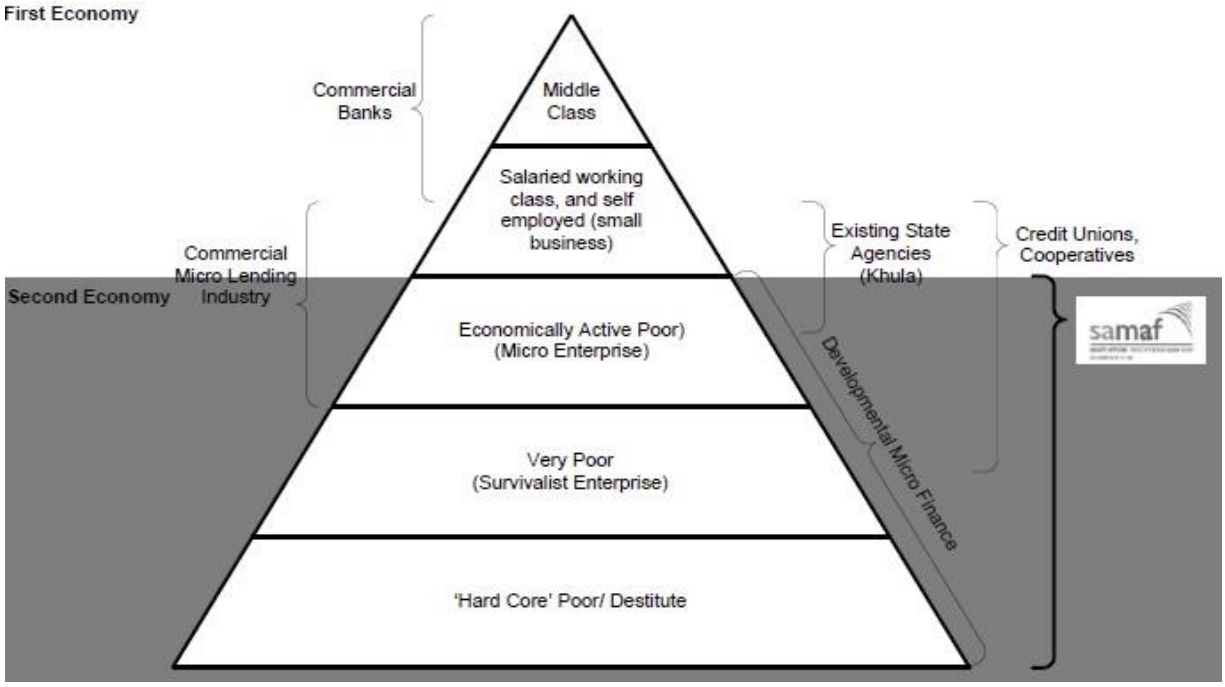
Black industrialist:	A juristic person and include co-operatives, incorporated in terms of the Companies Act (2008), owned by Black South Africans who creates and owns value-adding industrial capacity and provides long-term strategic and operational leadership to a business. A Black industrialist can also be a natural person. The following are characteristics of a Black industrialist: - provides strategic and operational leadership to the business; - has a high level of ownership (>50%) and/or exercises control over the business; - identifies opportunities and develops business to take advantage of these opportunities (entrepreneurial); · takes personal risk in the business; · does business in the manufacturing sector, with particular reference to IPAP focus areas; and - Makes a long-term commitment to the business and is a medium to long-term investor.
Black people	The term includes people of African, Coloured and Indian origin who are citizens of the Republic of South Africa by birth or naturalisation before 27 April 1994 or would have been entitled to acquire citizenship by naturalisation prior to 27 April 1994.
Economic transformation	The term is defined by the Strategy for Broad-Based Black Economic Empowerment as the transition from an economy that confined wealth creation to a racial minority to an economy that benefits all citizens; and is characterised by ownership, management and control of factors of production by previously marginalised communities (the DTI, 2003)

Source: BI-Policy Report 2015

In summary, Kirsten (2006) reviewed the initiative taken by the South African government to expand access to credit to the forgotten pool. He pointed out that the only thing the SA government has managed to do well since 1994 is that the government has been a facilitator than being a financial service provider.

Figure 2.1 was taken from Kirsten (2006) to illustrate the link between the economy and

the financial system. The figure says that the middle and the working class get access to finance from commercial banks while economically active in the category of SMEs and young entrepreneurs get funding from the commercial lending industry and existing state agencies as well as credit unions and cooperatives. The bottom of the pyramid, which constitutes the very poor (entry level Black entrepreneurs), were helped by developmental micro-finance institutions, which are rarely still in existence today. To assert the role of microfinance institutions, Hossain and Knight (2008) studied whether issuing micro-credit improves the livelihoods of the disadvantaged societies in Bangladesh. Their research analyses the role of micro-finance institutions in the promotion of rural livelihoods in Bangladesh. They find that despite the criticisms, micro-credit institutions play a significant role in boosting the livelihoods of disadvantages rural societies in the country.



Source: Kirsten (2006), World Bank

Figure 2.1: Finance provider and beneficiaries

2.3 Policy Strategies aimed at supporting entrepreneurship in other countries

2.3.1 General overview of successful policy strategies

Lardy (1995) notes that in almost two decades since economic reforms were implemented in China, the role of the foreign sector grew in an unanticipated manner. The volume of foreign trade and foreign capital improved dramatically to unimaginable levels. Foreign trade and foreign capital led to the acceleration of growth of the Chinese economy due to important reforms of institutions and the introduction of good policies introduced in the 1970s.The state-owned sector also performed adequately, improving incentives and productivity and thereby inducing a respectable growth performance. Moderate improvement in the state sector supported the virtuous cycle. Relative political stability enforced by dictatorship is also credited with China's economic success (Naughton 1994).

Brandt and Rawski (2008) view China's economic growth as partly from being a mediator of Asian trade with the United States which served the interests of all parties. China's economic abandonment of its former isolation in favour of deep engagement with the global market fostered its trade as its trade ratio jumped from 10% prior to reforms to 63.9% in 2005.

Breisinger and Diao (2008) posit that agriculture research and development adaptation of technologies; growth in manufacturing should be led by the sector and supported by government policies and public investments. Winner picking industrialisation strategies create a large industrial sector, but this often fails to establish close links with the rest of the economy. This creates huge indirect cost such as increased inequality and these selected industries have difficulty in being internationally competitive and capable of generating sustainable long term economic growth.

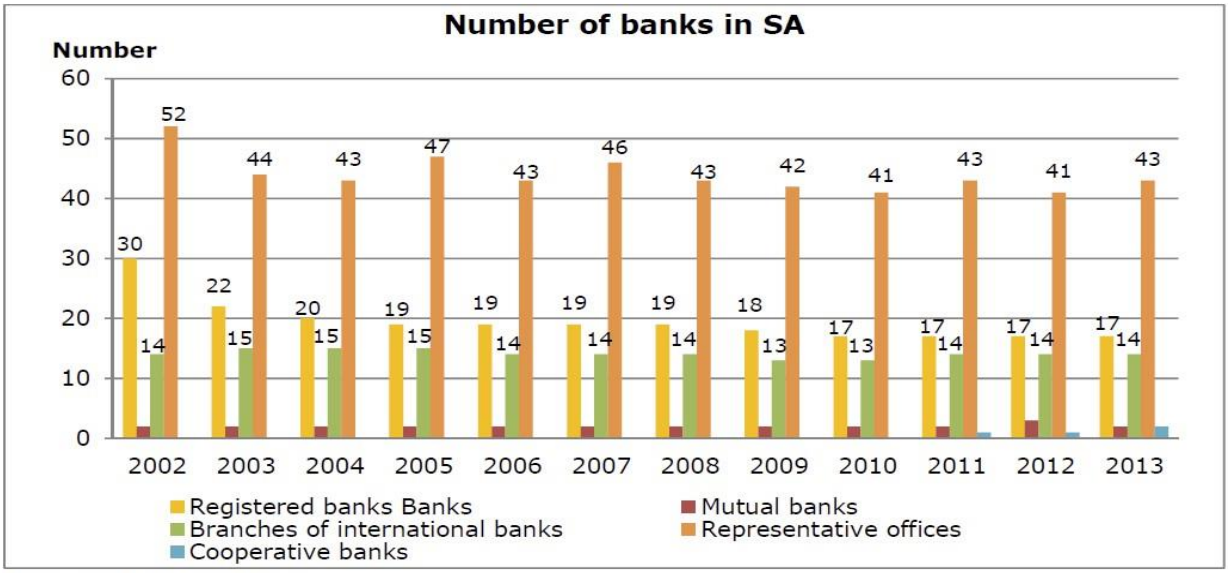
Fischer and Gelb (1991) pointed out four important contributions to the process of reforms in Central and East European countries are that they moved from a socialist system to a private market economy. Access to markets of industrial

countries are a vital component for growth, with intensive, well-coordinated technical assistance directly at firm level. Finance restructuring is needed by providing access to capital and debt relief as a cushion during the transformation process. Kim et al (2006) noted three forms of resources in pursuing start-up ventures; financial, human capital and cultural capital. Neither financial nor cultural capital resources are necessary conditions for entrepreneurship entry. Human capital was found to be statistically significant in entrepreneurship, but the level of human capital in South Africa might not be that high in terms of fostering entrepreneurship to encourage economic growth.

2.4 Structure of financial sector

2.4.1 South Africa: structure of the banking sector and ownership

Compared to other NIC countries, South Africa is dominated by private banks with no state-owned banks. The Annual Report of Bank Supervision (2014) reported that the shareholdings structure of the private South African banks is dominated by foreign holdings, 43 percent of the banking sector is owned by foreign shareholders while 28 percent is owned by domestic shareholding, further, the number of registered banks have not increase since 2002. The South African Banking Association report (2014) pointed out that Standard Bank has the highest market share, this amount to 25%, while ABSA bank and FirstRand Bank have 20% each and Nedbank with 17% of the market share and all the other banks hold 18%.



Source: SA Reserve Bank

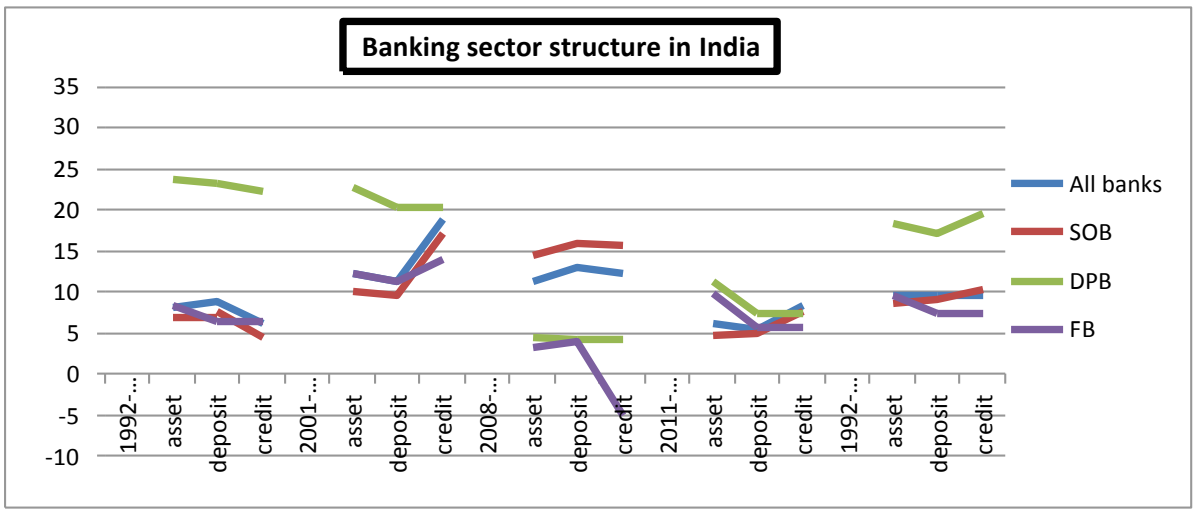
Figure 2.2: Number of banks in South Africa

Among all the banking institutions in South Africa, four of them hold 82% of the market share, those are Absa bank, Standard bank, FirstRand bank and Nedbank, but Capitec bank has recently picked up, and has been named the fastest growing banking institution in South Africa.

2.4.2 India: structure of the banking sector and ownership

Except for South Africa, State-owned banks dominated the financial system in 1980s. They significantly dropped out of the financial sector after that time and few countries have managed to keep State-owned banks as part of their financial system development (Hawkins & Dubrako, 2001). Among those countries are newly industrialised countries such as China, Russia, Malaysia, Brazil, and India. India is the largest country in South Asia with one of the largest financial system on the Asian continent (Reserve Bank of India report, 2014). The Indian financial system is built up of both state-owned banks and ordinary financial intuitions, but the banking system is the main provider of financial services in the country. Before 1990s' reform of the Indian financial system, the share of State-owned Banks constituted 75% and both foreign and private domestic banks constituted the

remaining share. Figure 2.3 illustrates the structure of the banking sector in India.



Source: Own computation

Figure 2.3: Banking sector structure in India

The above figure shows the trend of assets, deposits and credit of the three major types of banks in India. Before the financial crisis that started late 2007 and deepened during 2008, domestic private banks were the main financial service providers. During the financial crisis, state-owned banks became the main source of financial support to the Indian economy and provided most of the financial services. The growth of foreign assets dropped sharply during the crisis as compared to state-owned banks and domestic private banks. According to Kumar and Gulati (2009), State-owned banks are the largest in term of assets, credit and deposits. State-owned banks are seconded by the private domestic banks in term of assets, credit and deposits and foreign banks are placed in third position. However, the high concentration of public owned banks has significantly increased the lending to state-owned enterprises in India, compromising the performance of government owned banks in the country.

Table 2.2: Indian financial system structure

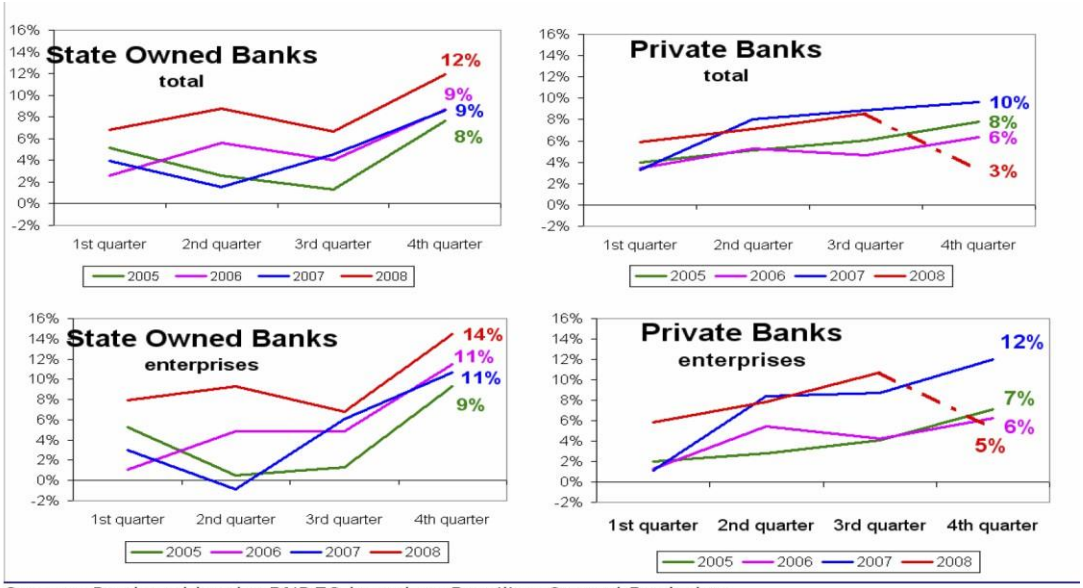
	All banks	SOB	DPB	FB
1992-2000				
asset	8.2	6.9	23.8	8.3
deposit	8.8	7.7	23.3	6.4
credit	6.1	4.4	22.3	10.4
2001-2007				
asset	12.2	10	22.7	12.3
deposit	11.4	9.6	20.2	11.3
credit	18.8	17.2	28.7	14
2008-2010				
asset	11.4	14.5	4.5	3.2
deposit	12.9	15.8	4.2	4
credit	12.2	15.7	4.3	-5
2011-2012				
asset	6.3	4.7	11.2	9.9
deposit	5.5	5	7.5	5.6
credit	8.3	7.7	11.2	7.9
1992-2012				
asset	9.7	8.7	18.3	9.5
deposit	9.7	9	17.1	7.5
credit	11.1	10.2	19.6	9.8

Source: Reserve Bank of India

SOB= State-owned Banks, DPB= Domestic private Banks, FB= Foreign Banks Source

2.4.3 Brazil: structure of the banking sector and ownership

Coleman and Feler (2015) studied how Brazilian State-Owned banks helped the prevention of the 2008-2010 financial crises and find that state-owned banks in Brazil acted as the main provided of credit to the productive sector during the financial crisis. They also found that these state-owned banks operate efficiently with no evidence of politically related credit allocation. In Brazil, some of the regional locations have more branches of state-owned banks while others have less; further, regional location with high concentration of state-owned banks is more productive than locations with low concentrations of state-owned banks. Figure 2.4 illustrates the source of capital for the productive sector per type of bank from 2005 to 2008 in Brazil. From the first to the fourth quarter of 2008, the credit provided by the state-owned bank grew by 12% as compared to only 3% of the private banks, examples are Banco do Brazil, Caica Economica Federal. In addition, state-owned banks and private domestic banks constitute the biggest lenders, but state-owned banks still stand as the largest credit providers as compared to the local private banks. One aspect of the Brazilian credit market is that it is segmented into earmarked and non-earmarked sections (Coleman & Feler, 2015).



Source: Produced by the BNDES based on Brazilian Central Bank data

Figure 2.4: Growth Rate of Credit Operations per type of bank (%)

Earmarked credit market refers to those entities, including government banks, that are obligated to lend a fixed portion of deposits and liabilities to the productive sector, such as agriculture and consumers' such as households, and this at a much lower rate than the market rate. On the other hand, non-earmarked credit market is not required to lend at a lower rate to designated sectors of the economy.

According to the EMIS report (2014), credit as percentage of GDP has moved from 43.7% in 2009 to 56.5% in 2013 and the long-term interest rate has drop to 5% in 2013 from its initial level of 6% in 2009. The four largest banks in Brazil are public owned banks. Bradesco and Itau are the largest private banks that have maintained their position in the top ten banks besides Banco do Brazil and Caisa Economica Federal as major stated-owned banks. The market shares of state-owned banks is about 51.2% in 2013 as compared to 33.2% for private domestic banks and 15.5% for foreign banks. In term of concentration, major banks hold 87.5% and 87.1% of total assets and deposits respectively, whereas other banks only hold 12.5% and 12.9% of total assets and deposits respectively. Furthermore, nearly 50% of credit in Brazil was provided by public banks in 2013.

2.5 Overview of the evolution and models used in financing SMEs and entry level entrepreneurs

Guirkinger (2008) tries to understand why households in Peru are more interested in seeking informal loans while the formal financial sectors lend at a lower rate. Understanding the coexistent of formal and informal loan credit markets in Peru is helpful in grasping the use of informal sector loans by households and farmers. The results suggest that the informal credit market enjoyed economies of scope and is almost at the door of its clients and this facilitates the access of proximity loans to household farmers. Gine (2011) investigated the access to credit in rural areas in Thailand using an estimated model to evaluate formal versus informal credit markets. He focuses on formal and informal lenders such as governments and commercial banks and analyses the possible transactions cost faced by borrowers when wanting credit from external markets. In conclusion, he finds that

banks faced limited ability to enforce the diversity of borrowers. Marakkath and Attuel-Mendes (2014) conducted a study on whether microfinance crowdfunding reduced financial exclusion in India and France. They argue that the choice of legal status, constraints for the operation model, compliance and sustainability are key issues. They clarify how the regulatory environment can be of fundamental importance in defining the scope of operation of a social innovation. They find that relaxing regulations could lead to the expansion of several types of crowdfunding, particularly those that direct funds to entrepreneurship, such as equity funds. They also document that local and regional regulation could be modified to be more welcoming for CFS and sustainability. The most important results they find are that, firms that engage in tax avoidance strategies use deferral-based strategies.

Fatoki and Asah (2010) have documented the literature on access to finance in South Africa. They particularly focus on the impact of firm and entrepreneurial characteristics on access to debt finance by small, medium and large firms in King Williams's town in South Africa. Compared to the main objective of our research, they focus more on the enterprise than targeting SMEs and Black entrepreneurs. They find that the firm's characteristics and entrepreneurial characteristics are important and have an impact on debt finance in South Africa.

Markelova et al (2009) proved that the opportunity for small firms to raise capital depends on their ability to compete in the market. They investigated the necessary condition that facilitates effective producer organisations for small firms to access finance. They also identified policies and interventions that facilitate collective action for market access among small markets shareholders. In conclusion, small firms that act in a collective way have the advantage of marketing themselves in the market and can access finance.

2.5.1 The role of Governments and commercial banks in facilitating assess to finance

Lu and Yao (2009) argue that, in an economy where the financial system has received shocks, a legal financial system enhancing may not be effective in such a depressed environment. They further argue that embracing such a system suppresses private investment and does not influence the financial depth even though it increases the share of the private sector in the banking sector as well as increasing competition in the sector. Morduch (2000) documented that micro-finance institution that follow the principles of good banking, will more likely alleviate the level of poverty than the profit maximisation financial system. Micro-finance institutions, as he says, encompass diverse programmes; most of these programmes provide financial services to poor households. Furthermore, he points out that it is not profit maximisation that makes a program efficient but what is important is having a hard budget constraint. Klapper (2006) discussed the role of factoring for financing small and medium enterprises. Factoring is transferring high-risk as a supplier to one's best buyer or buyer of high quality. This method allows countries that are not strong in enforcing contracts and have inefficient bankruptcy systems and imperfect records to uphold claims.

Leung (2009) discussed reforms in the banking and financial sector in Vietnam. He argued that building strong public institutions is necessary because it allows the inclusion of legal development and reforms in the public administration. His study focused particularly on macro-economic institutions such as state owned banks and the Ministry of Finance in Vietnam. The International Bank for Reconstruction and Development, in its research on access to financial services in 2006, argues that universal access to financial services has not been a public policy objective in developing countries. The study further recommends that countries can play a significant role in increasing access to financial services by strengthening institutional infrastructure and liberalising the markets to facilitate competition.

Gnyawali and Fogel (1994) studied the environmental conditions for entrepreneurship development. They documented that the common areas that need to be addressed by policy makers are the increasing opportunity for entrepreneurship and creating a general environment that fosters entrepreneurship and encourages economic agents by establishing institutions that support entrepreneurs. In addition, the government needs to provide financial support once the idea and the enterprise have seen birth. Yaron et al. (1998) provided understanding on the role of government subsidies and credit programmes in the promotion of the agricultural sector. They prove that the approach of subsidies and credit programmes have failed to provide support and alleviate poverty. They recommend the village bank system as it is used in Indonesia to provide financial services to millions of low income rural clients without relying on subsidies.

Aryeetey (1997) studied rural finance in Africa. He argued that the barriers to financial market development in Africa are not only related to lack of effective policy implementation, but also to structural and institutional origins. He pointed out that market integration is needed to remove constraints and facilitate efficient credit allocation. He mentioned that policy can be used to embrace the development of linkages between market segments by using the fiscal and regulatory system as well as supervising systems to provide incentives for formal institutions to allocate credit to deficit units and households of low income levels through informal agents.

What is important to our study is access to finance by SMEs and entry level Black entrepreneurs; in this regard, Beck and Kunt (2001) studied the small and medium size enterprise by looking at the constraints they face and how they access finance. They found significant evidence that small firms are constrained to growth, and have limited access to external finance. They argued that financing tools such as leading and factoring can be helpful in facilitating greater access to finance even in the absence of well-developed financial institutions.

Markelova et al (2009) proved that the opportunity for small firms to raise capital depends on their ability to compete in the market. They investigated the necessary condition that facilitates effective producer organisations for small markets share firms to access finance. They also identified policies interventions that facilitate collective action for market access among small markets shareholders. In conclusion, small firms that act in a collective way have the advantages for marketing themselves in the market and can access finance.

2.6 Summary: Newly Industrialised countries

The previous section reviewed the financial sector structure in the newly industrialised countries. We have chosen to review two, India and Brazil and we also presented methods used in other countries to promote SMEs and entrepreneurship. For example, the Brazilian financial industry is composed of private banks and state owned banks. The financial sector has significantly contributed to the economic growth in Brazil by a significant increase in credit to the private sector, but state-owned banks had a lot to do in the growth of credit extension. For example, there are regulations in Brazil where a fixed portion of credit allocated by a number of banks has to go to the agricultural sector at a rate below the market rate. State-owned banks in Indian are highly representative in the Indian banking industry, and have helped the financial sector during crises. Other research has also investigated policies and strategies needed to provide a better environment to SMEs and young entrepreneurs. For example, Aryeetey (1997) argues that market integration is needed to remove constraints and facilitate efficient credit allocation; he also mentions that policy can be used to embrace the development of linkages between market segments.

3 CHAPTER 3: RESEARCH METHODOLOGY AND DATA DESCRIPTION

3.1 Methodology

The main objective of this paper was to investigate whether the financial sector, dominated by private commercial banks, is accessible and providing financing to SMEs and entry level Black entrepreneurs. This study used comparative analysis of the South African financial industry and other comparable NICs; we have presented the structure of the comparable industrialised countries in the literature review. In this section, we used descriptive statistics and trend analysis with data on credit extension. We calculated the growth rate of credit extension in South Africa, Brazil and India; we added China, Indonesia and Malaysia to broaden the analysis. We compared the growth of credit extension in each country and drew conclusions. We added gross valued added in the manufacturing sector to be able to compare the effect of credit extension on manufacturing growth; this is relevant for us to point out the importance of facilitating access to finance to SMEs and entry level entrepreneurs in a country where the manufacturing output has been decreasing.

3.2 Data description

The data used in this research is obtained from the World Bank and range from 1990 to 2015. Quarterly data on credit extension for South Africa was obtained from the South African Reserve Bank (SARB). Yearly data are used for descriptive statistic computation and the quarterly data is used for regression analysis.

4 CHAPTER 4: RESULTS AND DISCUSSION

4.1.1 Trend and cross-correlation analysis of credit and GVA per sector

The analysis here consisted in looking at the trend of South African credit extension with the manufacturing sector's GVA and comparing it to other NIC's such as Brazil, Indonesia, China, India and Malaysia. Figure 3.1 presents the trending behaviour of manufacturing contribution to GDP and the domestic credit to the private sector by financial institutions to non-financial enterprises. Looking at the graph, the domestic credit to private non-financial companies exhibits an increasing trend for all the countries for the period 1994-2014.This implies that the domestic financial institution in the selected countries have been playing a major role by allocating credits to companies that need them. One of the most prominent sectors where credit to domestic enterprises is supposed to play significant role is the manufacturing sector.

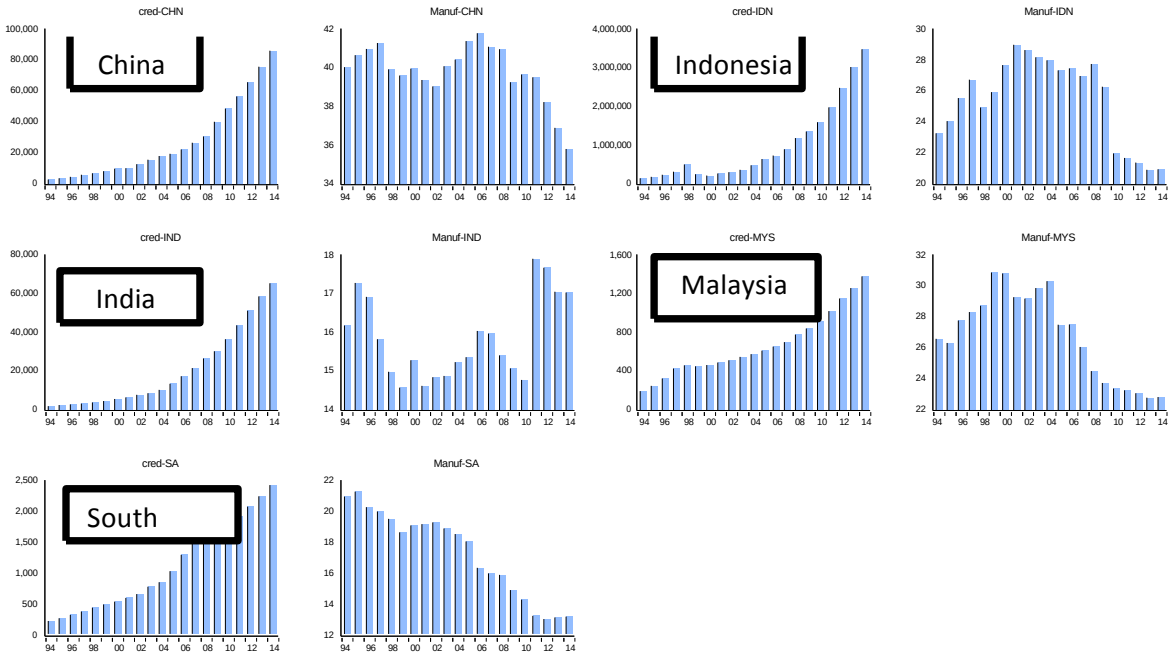


Figure 3.1: Manufacturing output per country

Source: own computation using data from the World Bank

By comparing the manufacturing output in South Africa to Malaysia, Indonesia China and India, South Africa's output in the manufacturing sector has been falling since 1994, even though the credit to private domestic firms has been increasing. China's on the other hand, has managed to maintain higher output in the manufacturing sector which is accompanied by higher levels of credit extension. The significant fall in output in China started around the financial crisis of 2008. The same is observed for Indonesia and Malaysia where the manufacturing product exhibited an upward trend before the financial crisis. India, however, manages to survive the crisis. The manufacturing sector's output has experienced a significant shoot up after the crisis as compared to other countries. This may be explained by the support of the state-owned financial institutions in the period of credit unavailability. South Africa is the only country where the manufacturing gross value added exhibits a completely downward trend while credit to private companies is increasing.

4.1.2 Relationship between credit extension and manufacturing GVA

Table 3.1 presents both the growth rate of credit extension and the growth rate of manufacturing output. This result is presented here to show the importance of credit extension to economic growth. The creation of a favourable environment for SMEs and young entrepreneurs to access finance has a significant and positive impact on growth. The figures show the relationship between the growth rate of credit and gross manufacturing value added since 1994.

Table 3.1: Growth Rates of credit and manufacturing output

Years	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Growth rate of credit extension											
Brazil	-47%	-4%	0%	-32%	1%	4%	-7%	2%	-7%	6%	8%
Indonesia	3%	4%	9%	-13%	-95%	-3%	2%	5%	8%	14%	0%
India	-5%	4%	1%	1%	7%	11%	1%	12%	-2%	13%	10%
Malaysia	13%	13%	11%	0%	-6%	-10%	-4%	-6%	-2%	-6%	-5%
South Afri	4%	1%	-3%	2%	13%	-1%	6%	-23%	5%	9%	8%
Years	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Growth rate of manufacturing GVA											
Brazil	-36%	-22%	-1%	-7%	3%	7%	1%	-6%	15%	5%	-2%
Indonesia	3%	6%	4%	-7%	4%	7%	5%	-1%	-2%	-1%	-2%
India	7%	-2%	-7%	-5%	-3%	5%	-4%	2%	0%	2%	1%
Malaysia	-1%	5%	2%	1%	7%	0%	-5%	0%	2%	1%	-10%
South Afri	1%	-5%	-1%	-2%	-5%	2%	0%	1%	-2%	-2%	-3%
Years		2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Growth rate of credit extension											
Brazil		11%	14%	12%	4%	11%	10%	7%	3%	4%	1%
Indonesia		-7%	3%	4%	4%	-1%	10%	11%	8%	1%	7%
India		9%	7%	8%	-3%	5%	0%	1%	1%	-1%	2%
Malaysia		-3%	-2%	-5%	14%	-4%	1%	5%	5%	1%	4%
South Africa		13%	2%	-13%	4%	2%	-7%	5%	2%	1%	-1%
Years		2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Growth rate of manufacturing GVA											
Brazil		-5%	0%	0%	-8%	-2%	-8%	-10%	-2%	-5%	-2%
Indonesia		0%	-2%	3%	-5%	-18%	-1%	-1%	-2%	0%	-1%
India		4%	16%	-4%	-2%	-2%	0%	-2%	-3%	-3%	1%
Malaysia		0%	-5%	-6%	-3%	-2%	0%	-1%	-1%	0%	0%
South Africa		-10%	-2%	-1%	-6%	-4%	-8%	-2%	0%	4%	-2%

Source: Own calculation using data from the World Bank

The growth rate of credit to the private sector in each of the countries tracks a long run relationship between the two variables. In other words, increase in credit to the private sector is accompanied by higher manufacturing gross value added while a decrease in credit extension is also followed by a decrease in manufacturing output. To better track the relationship between the two variables, we use quarterly data on credit extension and manufacturing gross value added from the Reserve Bank of South Africa (RBSA) to run the cointegration test.

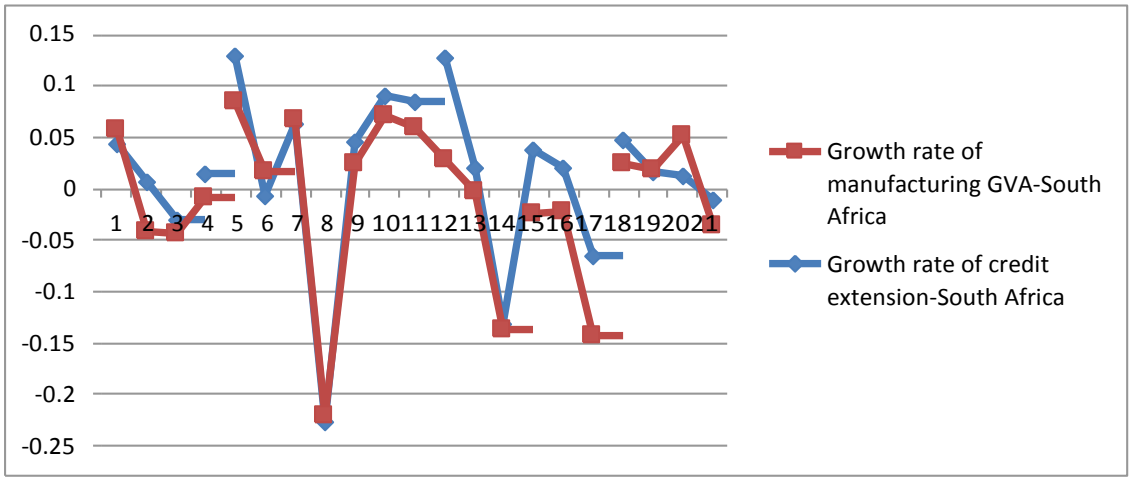


Figure 3.2: Growth rates for South Africa

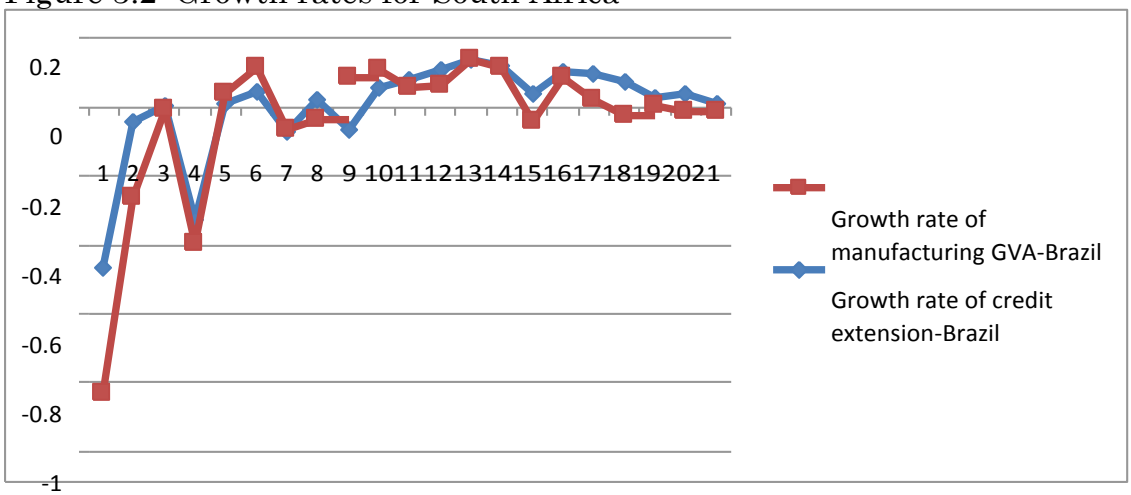


Figure 3.3: Growth rates for Brazil

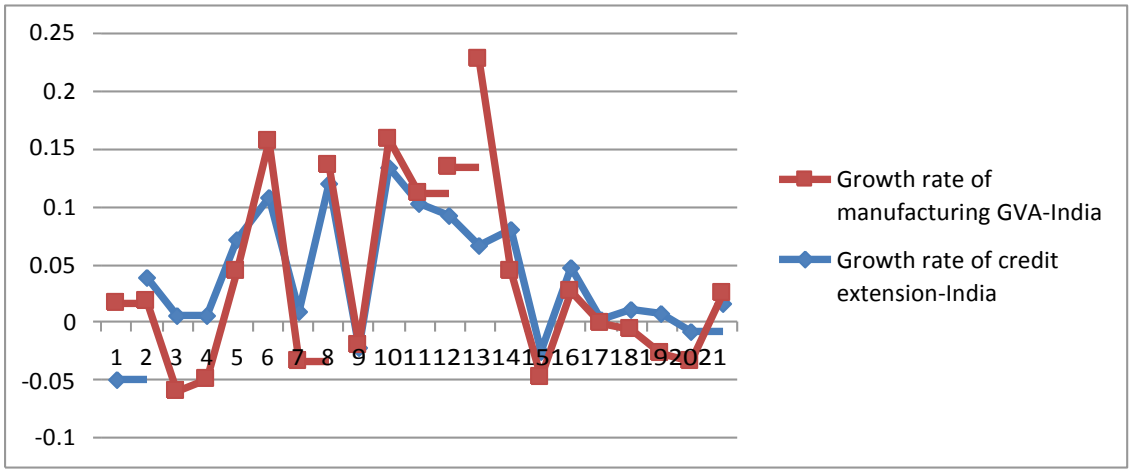


Figure 3.4: Growth rates for India

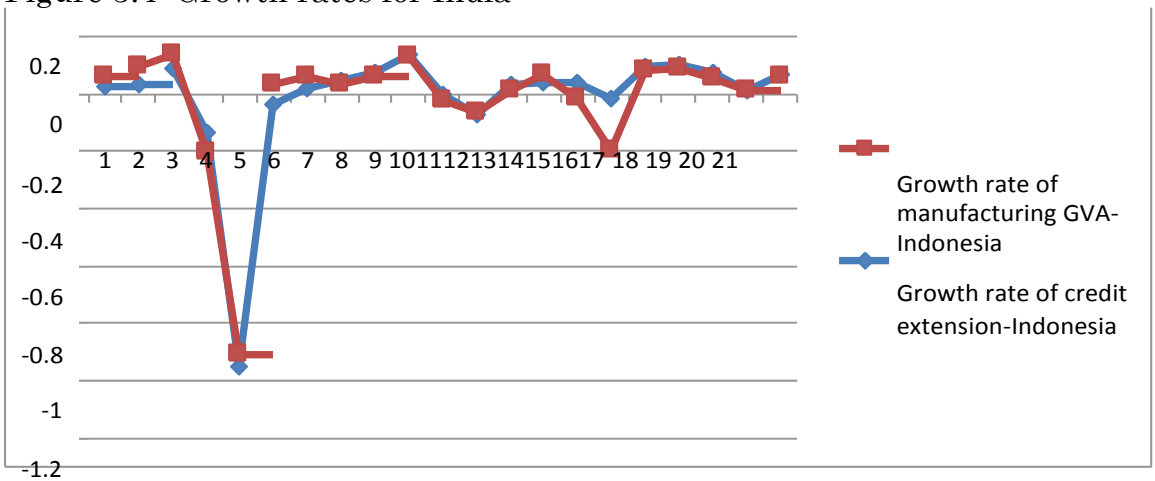


Figure 3.5: Growth rates for Indonesia

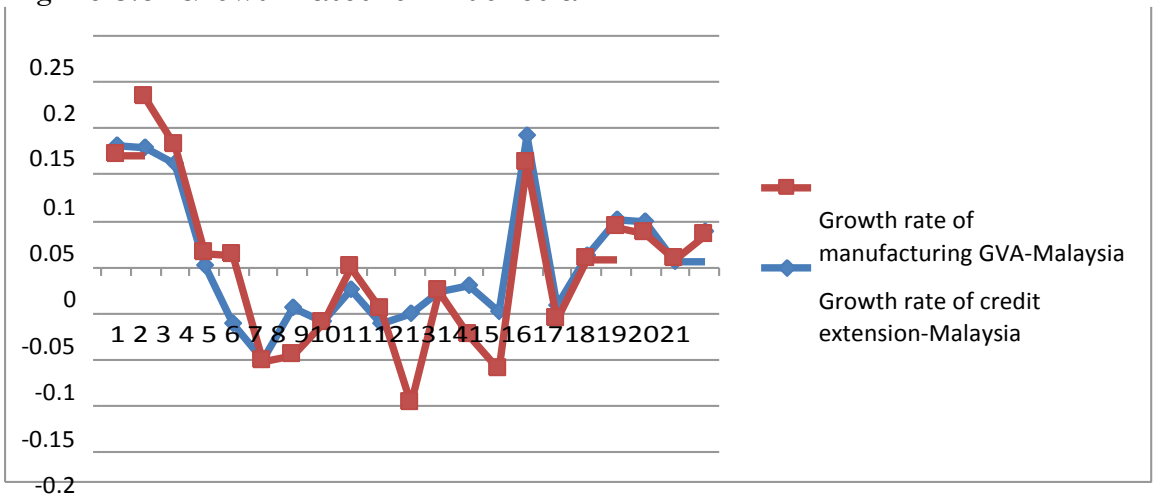


Figure 3.6: Growth rates for Malaysia

4.2 Empirical relationship between manufacturing output and credit extension

This section looks at the relation between the manufacturing output and credit extension in South Africa. We use time series quarterly data and run a simple Ordinary Least Square regression (OLS). We test for serial correlation and cointegration between the two variables. To test for cointegration between the variables, we predict the residuals and run a unit root test on the residuals. This then allows us to decide upon the cointegration relationship between the variables.

$$= {}_0 + {}_1 + {}_2 +$$

The above equation illustrates the relationship between credit extension and the manufacturing output. Firstly, we run the equation without the trend variable and add the trend variable to see what happens to manufacturing output over time. We test for unit root on the predicted residual to check whether there exists any long run relationship between the variables. The results are presented in table 3.2.

Table 3.2: Parameters estimation

variable	coefficients	std-errors	Dw (Durbin-Watson statistic
Credext-1	0.00069***	0.00019	
Constant-1	0.02***	0.0029	1.90
Credext-2	0.00062***	0.00019	
t	-0.000059***	0.000021	
Constant-2	0.03***	0.0038	1.97

**** is significance at 1% level, ** significance at 5% and * is significance at 10%

Table 3.3: Cointegration analysis

variables	AD Fuller test statistic	P-value
Predicted residuals-1	-13.07***	0.0000
Predicted residuals-2	-13.58***	0.0000

**** is significance at 1% level, ** significance at 5% and * is significance at 10%

The regression analysis indicates that, the relation between credit extension and manufacturing output is positive and significant at 1%. In South Africa, the manufacturing output is decreasing over time, but importantly, there is a long run relationship between the two variables. Table 3.3 shows no unit root in the predicted residuals, which indicates the presence of a long-run relationship between the variables. The implication here is that credit extension is an important variable for the development of the productive sector, which in turn, contributes significantly to the South African economy. Given the structure of the South African banking sector, the full impact of credit on the manufacturing sector needs a restructuring of the country's financial sector. The present commercial banks alone cannot efficiently do the job and redirect growth in South Africa. Production in the manufacturing sector has been falling since 1994 as compared to other NICs' economies, whose financial sectors are composed of both state-owned banks and private banks.

4.3 Comparative analysis

First, the South African government is aware of the lack of access to finance by SMEs and entry level Black entrepreneurs. They are equally aware of the importance of providing an environment that is favourable to young entrepreneurs to access finance. They have initiated number of projects that are currently running; among those are the Black industrialist project and strategic partnership programme. South Africa is dominated by commercial banks and the top largest banks in the country are privately owned by domestic and foreign investors. The top largest are the First National Bank (FNB), Standard Bank, Absa Bank and Nedbank. In India, the financial sector is composed of domestic private banks, foreign banks and state-owned banks. During the financial crisis, state-owned banks became the main source of financial support to the Indian economy and provided most of the financial services. The growth of foreign assets dropped sharply during the crisis as compared to state-owned banks and domestic private banks. According to Kumar and Gulati (2009), State-owned banks are the largest in term of asset, credit and deposit in India.

In Brazil, Bradesco and Itau are the largest private banks that have maintained their position in the top ten banks besides Banco do Brazil and Caisa Economica Federal as major stated-owned banks. In the literature review, we found that, during the financial crisis of 2008, state-owned banks played significant roles in the extension of credit to the private sector.

One particular finding in the financial sector in Brazil is that the credit market is segmented into earmarked and non-earmarked financial institutions. The earmarked financial institutions are required to lend to the productive sector at a much lower rate than the market rate, while non-earmarked financial institutions are free to lend at the competitive market rate. The other important finding in Brazil is that regional locations with high concentrations of state-owned banks' branches have easier access to finance than those with low concentrations of state-owned banks' branches. In the empirical analysis, we realised that credit extension in the other newly industrialised countries exhibit different patterns as compared to South Africa. Credit extension in South Africa exhibits an upward trend while manufacturing gross value added exhibits a downward trend. In other countries, credit extension is positively related to the manufacturing gross value added. The explanation behind this is that, the presence of state-owned banks in the other NCI countries have a supportive role and provide credit to the productive sector, while in South Africa, with no state-owned bank, private banks are free to choose the sector that is more profitable for them.

5 CHAPTER 5: CONCLUSION

5.1 Introduction

The main objective of this paper is to investigate the state of the South African banking sector, review its ability to provide access to finance to SMEs and entry level Black entrepreneurs and the role of the government in creating a better environment to facilitate access to finance to entry level Black entrepreneurs. The question we intended to answer is: Is the financial sector (private and public) accessible to the SME's and entry level entrepreneurs dominated by Blacks and the poor, and aligned to the government's reindustrialisation policy, and the creation of Black Entrepreneurs? We answered this by doing a comparative analysis of the South African financial industry to the comparable newly industrialised countries.

5.2 Barriers of access to finance

Beck (2007) investigated financing constraints that the SMEs face in developing countries. He argued that the cost of finance, the tax rate, the macro-economic instability, fixed transactions cost, the relationship between lenders and the borrower as well as asymmetric information between lender and borrower are the major factors constraining SMEs and entrepreneurs to access finance in developing countries. The role of government in easing SMEs access to finance remains unclear but he pointed out that the role of technology, such as credit scoring, may play a significant role in alleviating the constraints and boosting access to credit by individuals and SMEs in developing countries.

Beck et al. (2013), on the other hand, established a relation between the financial system structure and access to finance. The result suggested that countries with dominant banking systems are not helpful for access to finance by SMEs and young entrepreneurs. In addition, they documented that most of the SMEs have access to finance from Low-end financial institutions.

Firth et al. (2008), low-end financial institutions are: "credit unions, building societies, community banks, cooperatives, microfinance institutions, cash lenders, mutual banks, postal banks, rural banks, savings and loans institutions and thrift banks". They further argued that low-end financial institutions can provide access to finance in countries with low GDP/capita. Fatoki and Odeyemi (2010) investigated the determinants of access to finance by new small and medium enterprises in South Africa. The study used a logistic regression with survey data. The findings indicated that business information, networking, location are important determinants of access to finance by MSEs in South Africa. Aryeetey (1997) studied the rural finance in Africa and argued that the barriers to financial market development in Africa are not only related to lack of effective policy implementation, but also to structural and institutional origins.

He pointed out that market integration is needed to remove constraints and facilitate efficient credit allocation. He mentioned that policy can be used to embrace the development of linkages between market segments by using the fiscal and regulatory system as well as the supervising system to provide incentives for formal institutions to allocate credit to deficit units and households of low income levels through informal agents

5.3 Advantages of State-owned banks

According to Stiglitz and Uy (1996), Asian governments intervene financially at all levels during entrepreneurship development. They pointed out what were particular to the Asian economies and were not observed in other developing economies. The East Asian regulatory environment favours saving and regulates the financial industry. Beck and Demirguc-Kunt (2006) proposed leasing and factoring as potential ways of financing small and medium enterprises when better financial institutions are absent from the economy.

They also argued that most of the state-owned financial institutions direct their credit to SMEs that are not creditworthy. Leung (2009) discussed reforms in the banking and financial sectors in Vietnam. He argued that building strong public institutions is necessary because it allows the inclusion of legal development and reforms the public administration.

Levy-Yeyati et al. (2004) argued that state-owned banks provide support to market failure and provide credit to those at the bottom of the pyramid. They concluded that the role of state-owned banks can be accessed from two different angles: political view and development view. The development views address the role of state-owned banks in the sense that it promotes financial development and mitigates the effect of lower institutional quality

5.4 Disadvantages of State-owned banks

Sun and Tong (2002) found state own enterprises to have a negative impact on firm's performance. Levy-Yeyati et al (2004) studied the role of the state-owned bank in promoting economic growth and financial development. They argued that government intervention in bank ownership destroyed the credit allocation system and installed a political interest rather than an economic consideration. Firth et al (2008) analysed leverage and investment in a state-owned bank environment in China, they confirmed the hypothesis that state-owned banks impose less restrictive constraints on firms with lower performance and opportunities growth. They point out that state-owned banks tend to follow government objectives. Further, Caprio (2000), Yaron (2005) asserted that greater participation of state-owned banks in bank ownership lead to less financial sector development, lower productivity, less growth, less credit to needy sectors, greater concentration of credit in public owned enterprises and weaker monitoring.

5.5 Recommended Solutions

Kirsten (2006) stated that the only thing the South African government has managed to do well is being a facilitator of access to finance to SMEs and young entrepreneurs. Given the findings in the previous section, it is of great interest of the South African government to not only be a facilitator but also a provider of financial services to the needy pool of the population. This can be done by the installation of state-owned micro-finance institutions that will be less restrictive on the requirement for access to finance by SMEs and young entrepreneurs. The performance of state-owned micro-finance institutions will determine whether the installation of state-owned banks is necessary. Morduch (2000) documented that micro-finance institution that follow the principles of good banking, will alleviate the level of poverty more than the profit maximisation financial system. Micro-finance institutions, as he says, encompass diverse programmes, and most of these programmes provide financial services to the poor. Beck et al. (2011) argued that financing tools, such as leading and factoring, can be helpful in facilitating greater access to finance even in the absence of well-developed financial institutions.

The comparative analysis has revealed that Brazil and India have state-owned banks that are not only supportive during financial crises, but also direct credit to young entrepreneurs and the needy sector. State-owned banks supported the productive sector in those countries during the financial crisis of 2008 and have also made it easy for young entrepreneurs to access finance. For example, in Brazil, the credit market is segmented into earmarked and non-earmarked financial institutions, where earmarked financial institutions are required to lend to the productive sector at a much lower rate than the market rate. We recommend the same strategies to the South African government to support entry level Black entrepreneurs. For example, Yaron et al (1998) provided understanding on the role of government subsidies and credit programmes in the promotion of agricultural sector. They proved that the approach of subsidies and credit programmes have failed to provide support and alleviate poverty. They recommended the village bank system as it is used in Indonesia to provide financial services to millions of low income rural clients without relying on subsidies.

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