Brief on Business Bounce-back Support and the Credit Loan Guarantee Schemes for Small, Micro and Medium Enterprises (SMMEs)- June 2022

Parliamentary Budget Office

PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

The Parliamentary Budget Office

- The Parliamentary Budget Office (PBO) was established in terms of the Money Bills Amendment Procedure and Related Matters Act (Act no. 9 of 2009)
- The PBO provides independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money Bills
- The PBO supports the implementation of the Act by undertaking research and analysis for the finance and appropriations committees
- This presentation provide researched analysis and comments on the 2022 Business Bounce-Back Support (BBSS) and the 2020 Credit Loan Guarantee Schemes (CLGS); specifically what they mean for South Africa's SMME landscape and economic recovery (ERRP) amid the pandemic, July 2021 civil unrest and the 2022 floods in KZN

Outline

- Background
- SMME Context in South Africa
- Macroeconomic environment impacting SA businesses
- SMME Landscape in South Africa since COVID-19
- The COVID-19 Loan Guarantee Scheme
- The Bounce-Back Support Scheme
- International experiences of similar schemes
- Potential implications for the ERRP
- Key areas of oversight and measures for consideration

Background

- GDP of the South African economy declined by 6.4 per cent in 2020 due to COVID-19 lockdown restrictions. This recession was the worst since the Great Depression
- Small, micro and medium enterprises (SMMEs), which constitute over 90 per cent of formal businesses and contribute about 34 per cent to GDP, were hardest hit
- At this time, consumer spending and business revenues abruptly declined and the livelihoods of an estimated 60 per cent of businesses were threatened
- The R200 billion COVID-19 Loan Guarantee Scheme was a major part of government's supposed R500bn relief package
- The SARB would administer the guarantee in partnership with commercial banks to provide emergency and distress relief loans to struggling businesses
- However, the scheme proved to be a failure with minimal take-up and only a small portion (R13.4 billion) of the available funds disbursed to businesses
- Given the slow uptake and flaws in the scheme's design, it was revised to make loans more attractive to businesses. On 26 July 2020, National Treasury, SARB and BASA announced various changes to the Scheme to make funds more accessible to the public
- Despite the improvements to the Scheme, there was still no significant uptake of the loans, with only R18.2 billion of the R200 billion disbursed
- Based on lessons derived from the 2020 Loan Guarantee Scheme, the National Treasury launched the Bounce Back Support Scheme on 25 April 2022. The Scheme aims to assist eligible businesses in recovering from constraints in accessing finance due to COVID-19 lockdowns, the July 2021 civil unrest as disasters like the floods affecting KZN

SMMEs Context in South Africa

- According to United Nations Industrial Development Organization (UNIDO), the definition of SMMEs is a significant issue for policy development and implementation
- Unfortunately, the informal sector is often neglected in business support policies and interventions. The informal sector is also not fully accounted for in economic reporting
- Like other countries, the issue of what constitutes a small or medium enterprise is a major concern in SA. Various scholars have usually given different definitions to this category of business
- In practice, SMMEs are defined in a number of different ways, generally with reference either to the number of employees or to turnover bands (or a combination of both, as in the National Small Business Act 1996, which also allows for variations according to industry sector)
- The definition of SMMEs by size is necessary, but it is not sufficient for an understanding of a sector where the realities are not only complex, but also dynamic
- The National Small Business Act of 1996 as amended by the National Small Business Amendment Acts of 2003 and 2004 (NSB Act) as:
- *" … a separate and distinct business entity, including co-operative enterprises and nongovernmental organisations, managed by one owner or more which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or sub sector of the economy"*

SMMEs Context in South Africa (Cont.)

- The NSB Act further categories small businesses in RSA into distinct groups, namely; survivalist, micro, very small, small and medium, hence the use of the term "SMME" for small, medium and micro-enterprises
- Despite the categorisations having been stipulated in the NSB Act, these categories are not used consistently by state agencies or by private sector data-bases and research studies, making comparisons difficult and unreliable

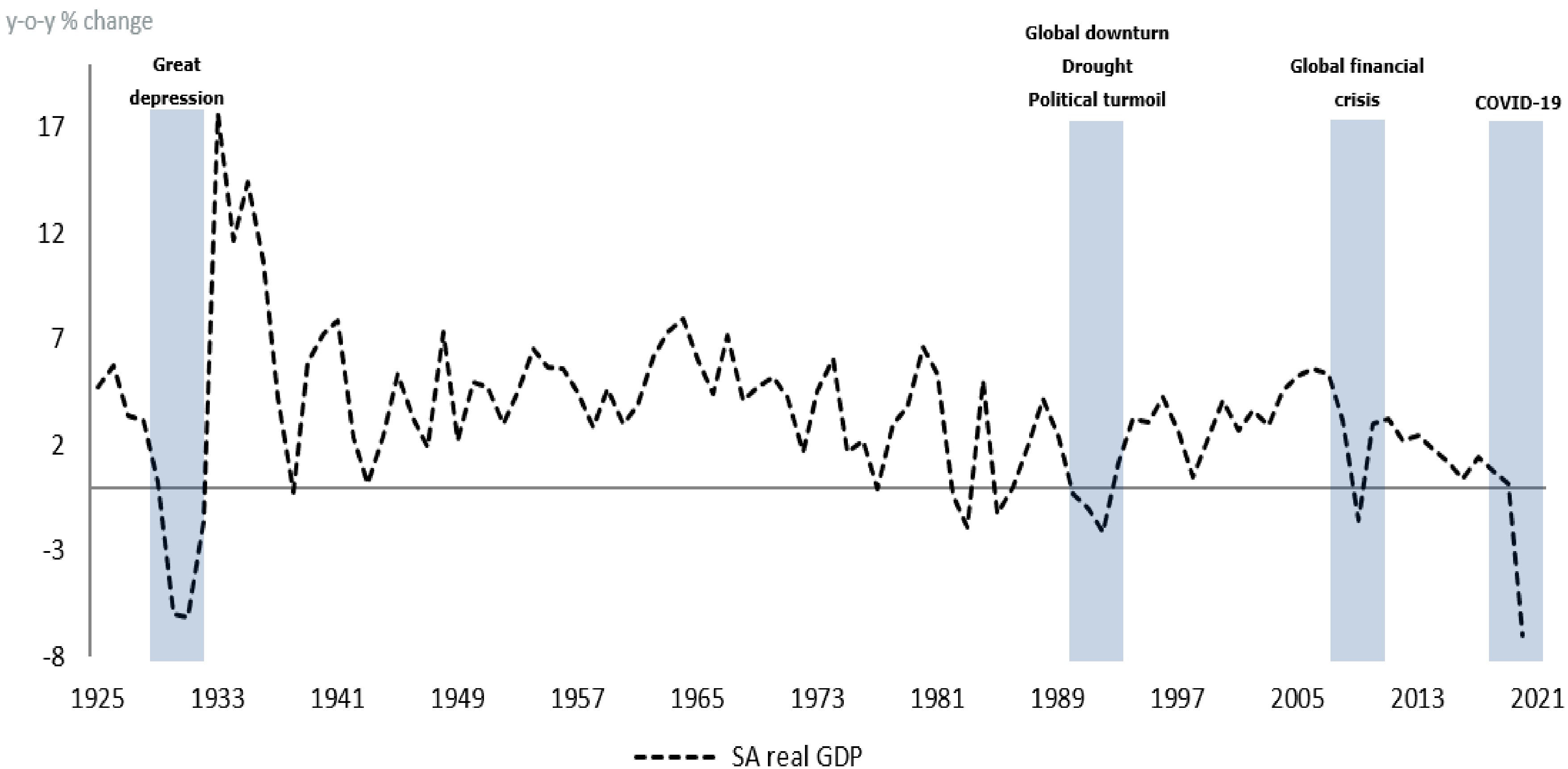
Enterprise Size	Number of Employees	Annual Turnover(S A. Rand)	Gross Assets, Excluding Fixed Property
Medium	Fewer than 100 to 200,depending on Industry	Less than R4 million to R50 m depending upon Industry	Less than R2 m to R18 m depending on Industry
Small	Fewer than 50	Less than R2m to R25 m depending on Industry	Less than R2m to R4.5 m depending on Industry
Very Small	Fewer than 10 to 20 depending on Industry	Less than R200 000 to R500 000 depending on Industry	Less than R150 000 to R500 000 depending on Industry
Micro	Fewer than 5	Less than R150 000	Less than R100 000
Survivalist enterprise	Less likely to hire staff; includes hawkers, vendors and subsistence farmers	The income generated is less than the minimum income standard or the poverty line	

The macroeconomic environment impacting SA businesses

Global macroeconomic outlook

Domestic macroeconomic outlook

SA economy contracted by a historic 6.4% in 2020 due to COVID-19



Data:StatsSA

Global macroeconomic outlook

The global economy has deteriorated due to:

- Ongoing disruptions caused by Covid-19 have increased global unemployment and negatively affected global output and value chains
- Negative effects of climate change events, including extreme weather, cause suffering and negatively impacts global growth and inflation
- The Russian invasion and continued war in Ukraine has exacerbated supply chain disruptions, increased global shortages and prices of food and fuel
- Strict lockdown protocols in major cities in China have negatively affected its real GDP growth and further exacerbated global supply chain disruptions
- Much of current international inflation is due to supply-side difficulties
- Household finances and poor investment levels globally still constrain demand, therefore interest rate increases are a blunt instrument
- Developed countries have increased interest rates but their real interest rates generally remain negative indicating hopes for a 'soft landing'
    - The US Fed raised interest rates in May but the real interest rate remains negative
    - The ECB has not increased interest rates, their nominal rate is -0.5 per cent. It has indicated that it will increase rates in July

South African macroeconomic outlook

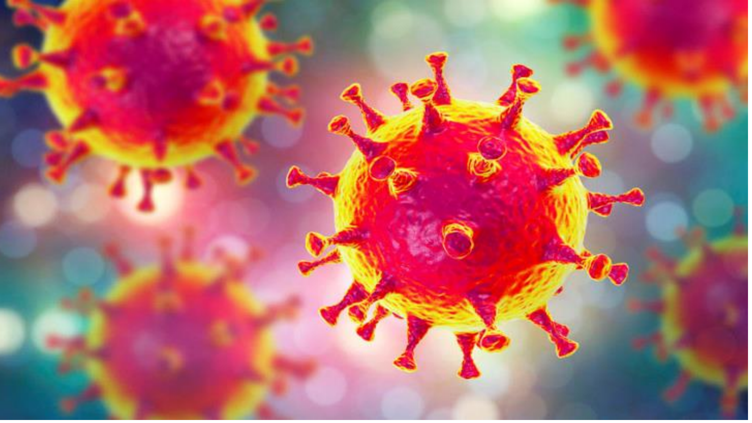
- Domestically, several constraints add additional downward pressure to key macroeconomic variables, such as inequality, unemployment, inflation and growth:
  - Continued fiscal consolidation
  - The latest resurgence in COVID-19 infections that exacerbate its ongoing impact
  - The impact of climate change and severe weather events, such as the adverse impact on health, education and economic activity of the recent devastating floods in KZN and the drought in Nelson Mandela Bay
  - Rising unemployment rates that worsen structural inequality
  - Increased incidences of load-shedding and continued poor service delivery
  - Downward pressures on household aggregate demand, which has been negatively affected by declining real aggregate disposable incomes due to weaker labour markets, public sector wage freezes, higher inflation and interest rates and minimal increases in child support and old age grants
- Some sectors of the SA economy, most notably mining, may still be benefitting from higher commodity prices (including those caused by the war in Ukraine) but global demand and price outlook remain uncertain

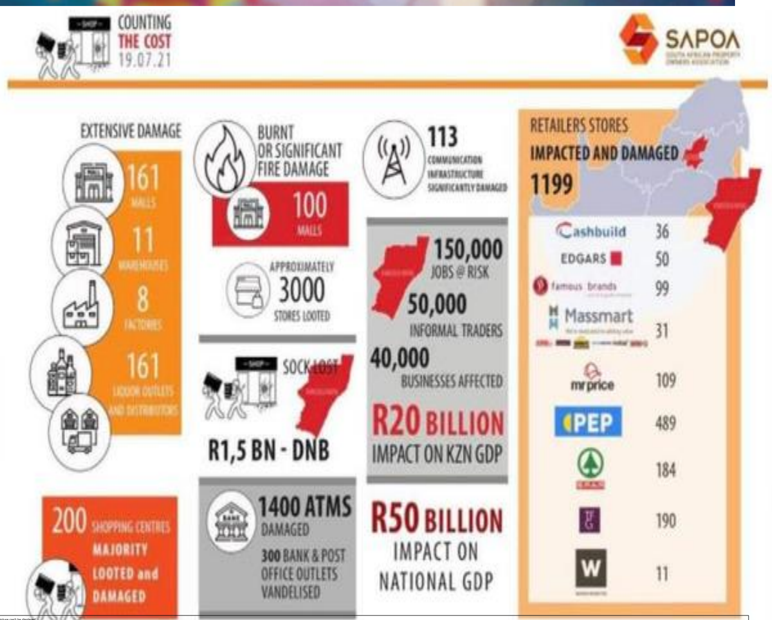
Growth outlook

GDP growth outlook - calender*	2022	2023	2024
National Treasury - Budget 2022	2.1%	1.6%	1.7%
South African Reserve Bank - Mar 2022	2.0%	1.9%	1.9%
South African Reserve Bank - May 2022	1.7%	1.9%	1.9%
IMF - World Economic Outlook - Jan 2022	1.9%	1.4%	-
IMF - World Economic Outlook - April 2022	1.9%	1.4%	

* Growth projections correspond to publication date and not forecast date

Data: National Treasury, SARB, IMF



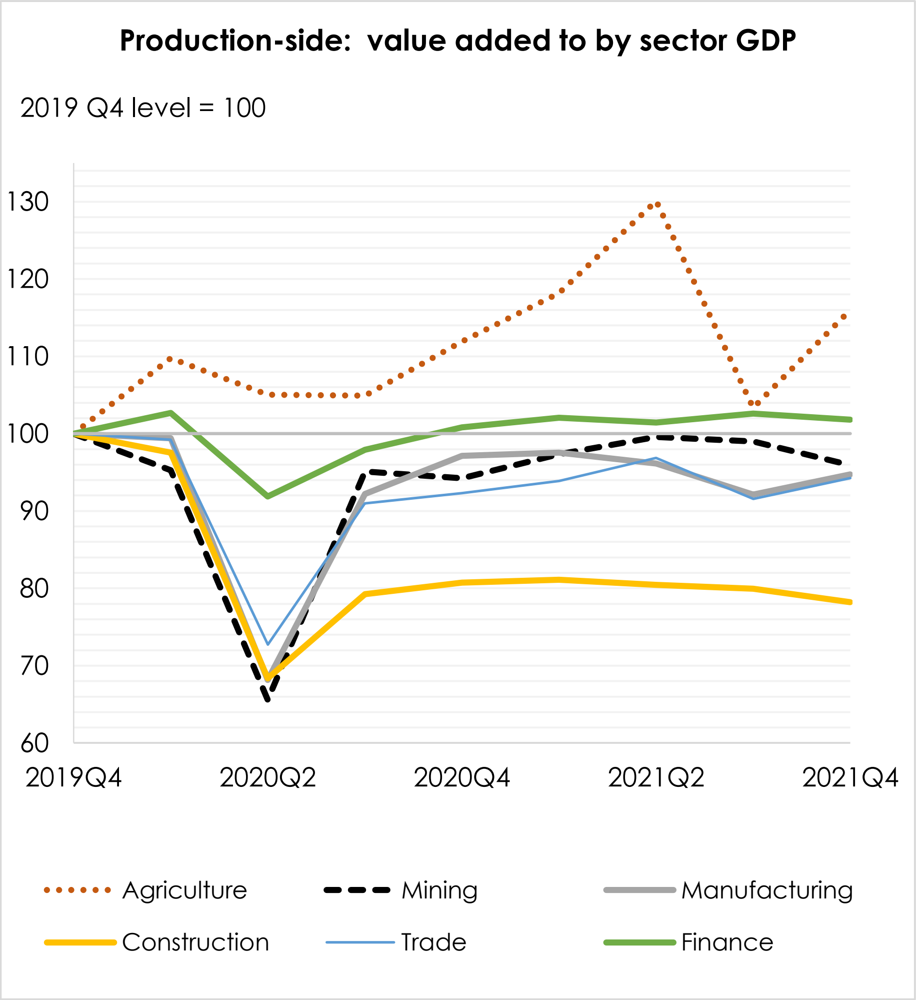


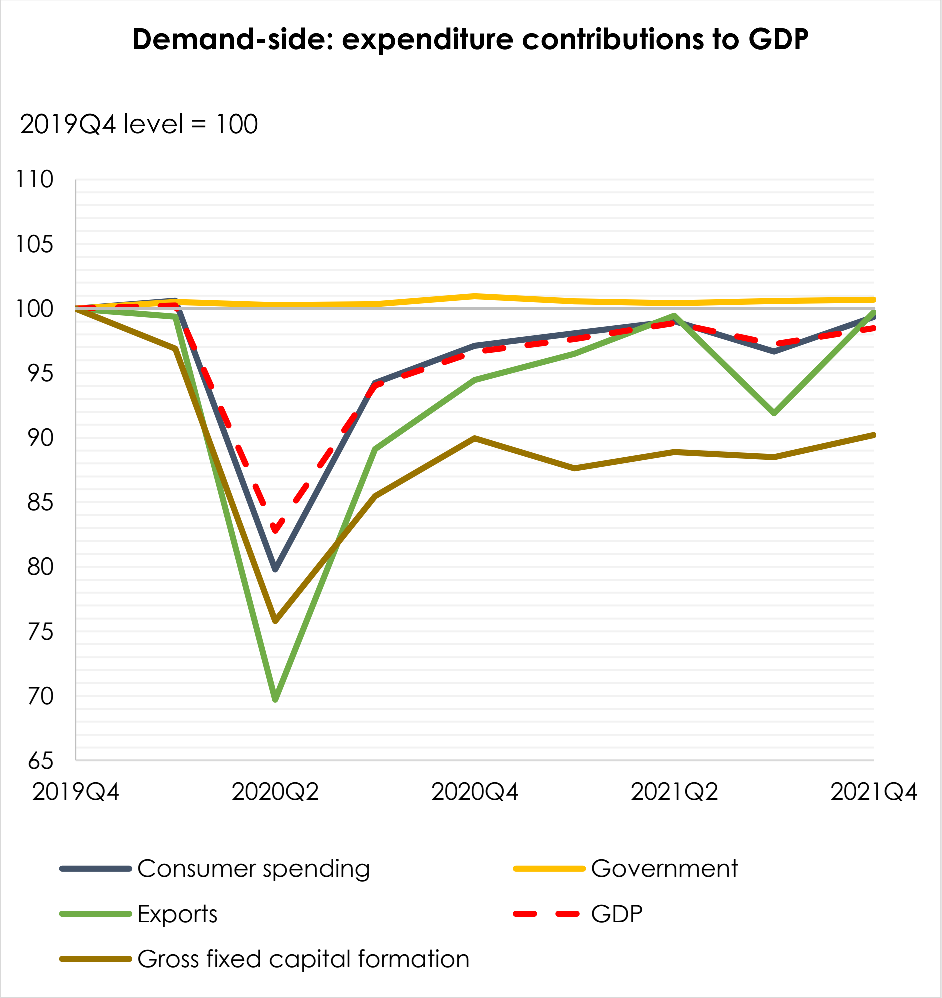
Counting the cost of COVID-19, civil unrest & KZN floods

- Weakened resilience of a population and businesses in an economy already suffering from high inequality, poverty and structural unemployment, poor living conditions and basic services, and high HIV and TB infection rates (amongst other health concerns)
- Job losses and lower consumer confidence that further reduce aggregate demand
- Poor aggregate demand, heightened uncertainty and other shocks to business confidence further constrain job creation and fixed investment
- Lost sales and production of businesses
- Knock-on effects from supply chain disruptions – Durban port, warehouses, freight railway line and trucking industry
- Costs and insurance payouts largest in decade of riots locally. SASRIA required R18.1 billion from government

Divergent economic performance across sectors

- Except for agriculture, finance and government spending, all other sectors remain below pre-pandemic levels



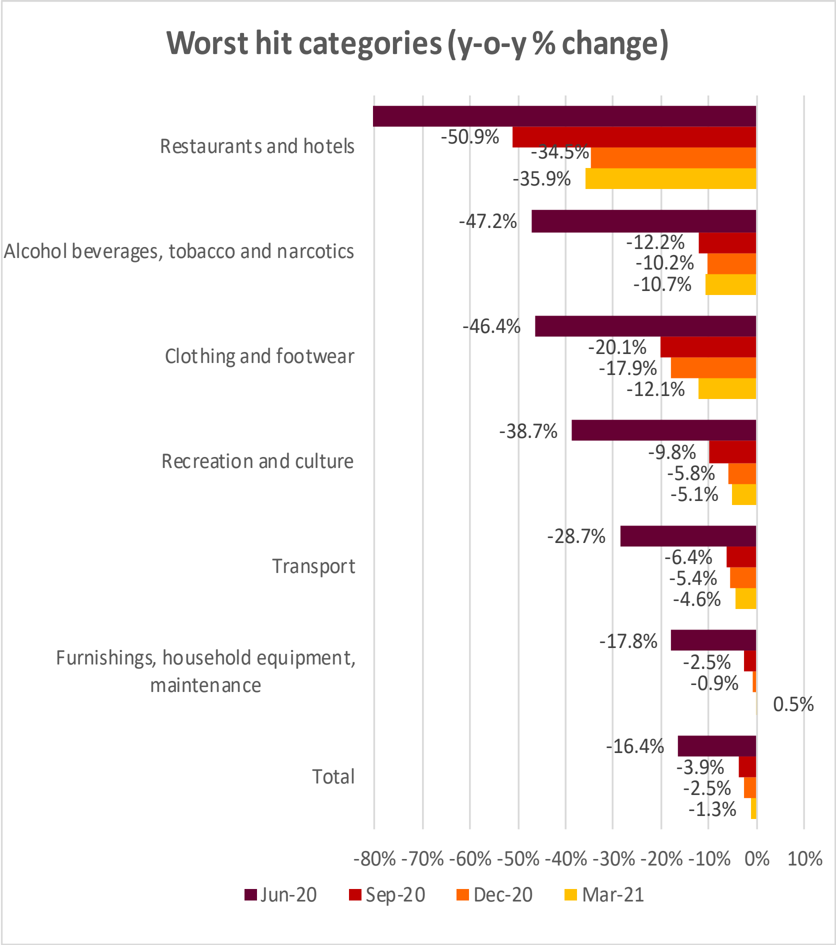


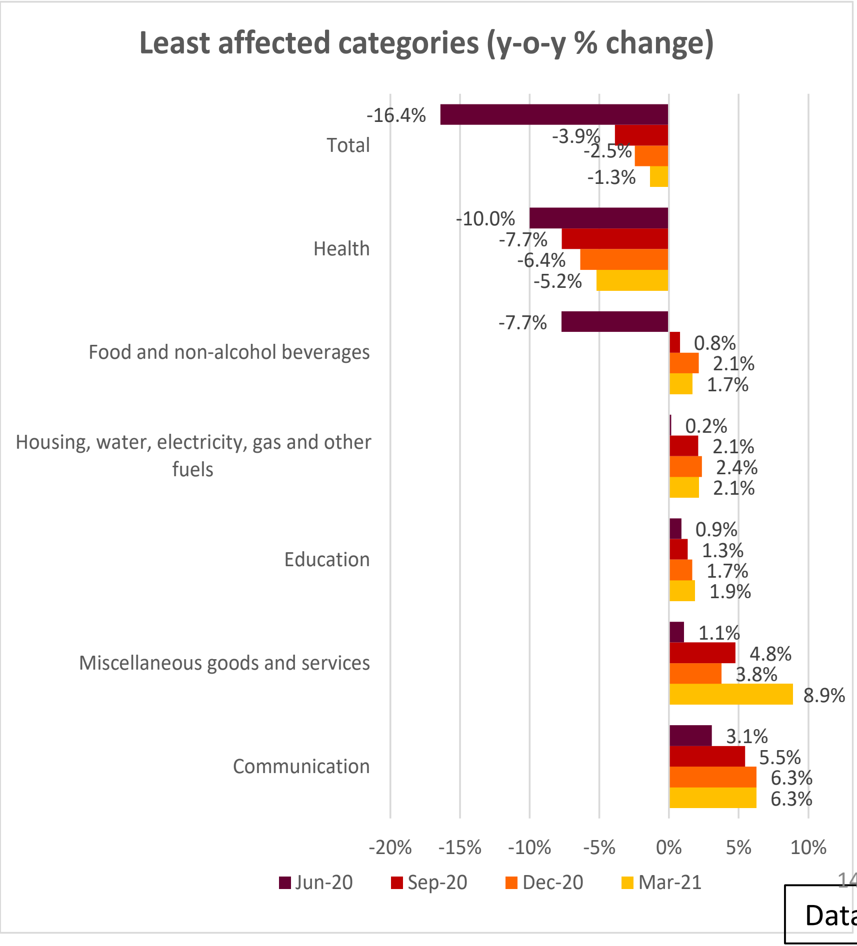
Data: PBO Calculations using StatsSA data

Impact of COVID-19 on different consumer spending categories

- Lockdown restrictions resulted in households spending less on services (mainly restaurants and hotels) and retail businesses (alcohol, clothes, furniture etc). While sectors like communication benefited from employees working from home

Growth in final consumption expenditure* (compared with 2019)

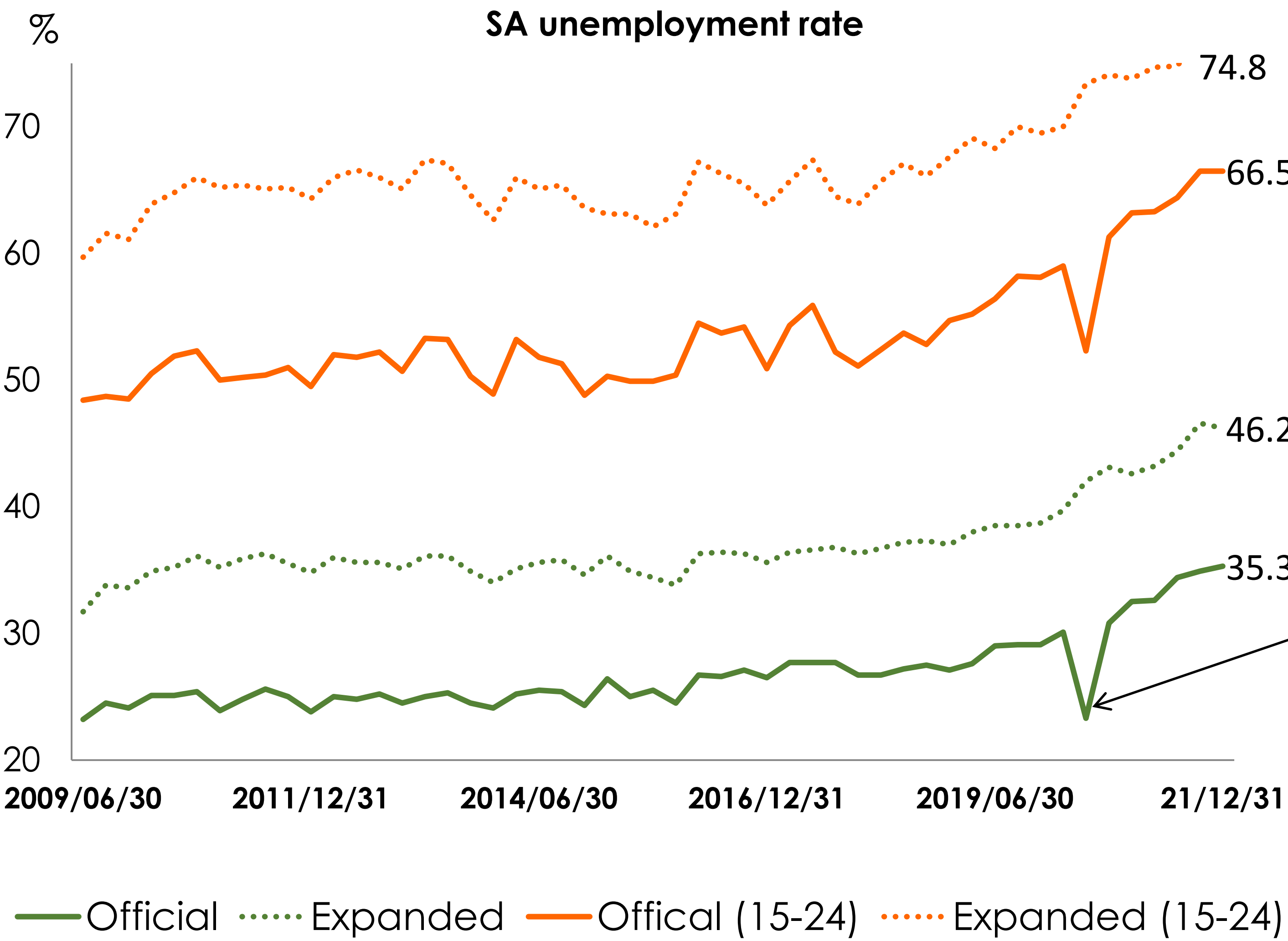




*Value added to GDP

Data: StatsSA

Unemployment has reached an all time high with no clear signs of a significant labour market recovery



Effect of the national lockdown (Official definition of unemployment in South Africa requires that people look for work and are available for work)

Data:StatsSA

QLFS – Jobs lost/gained per sector

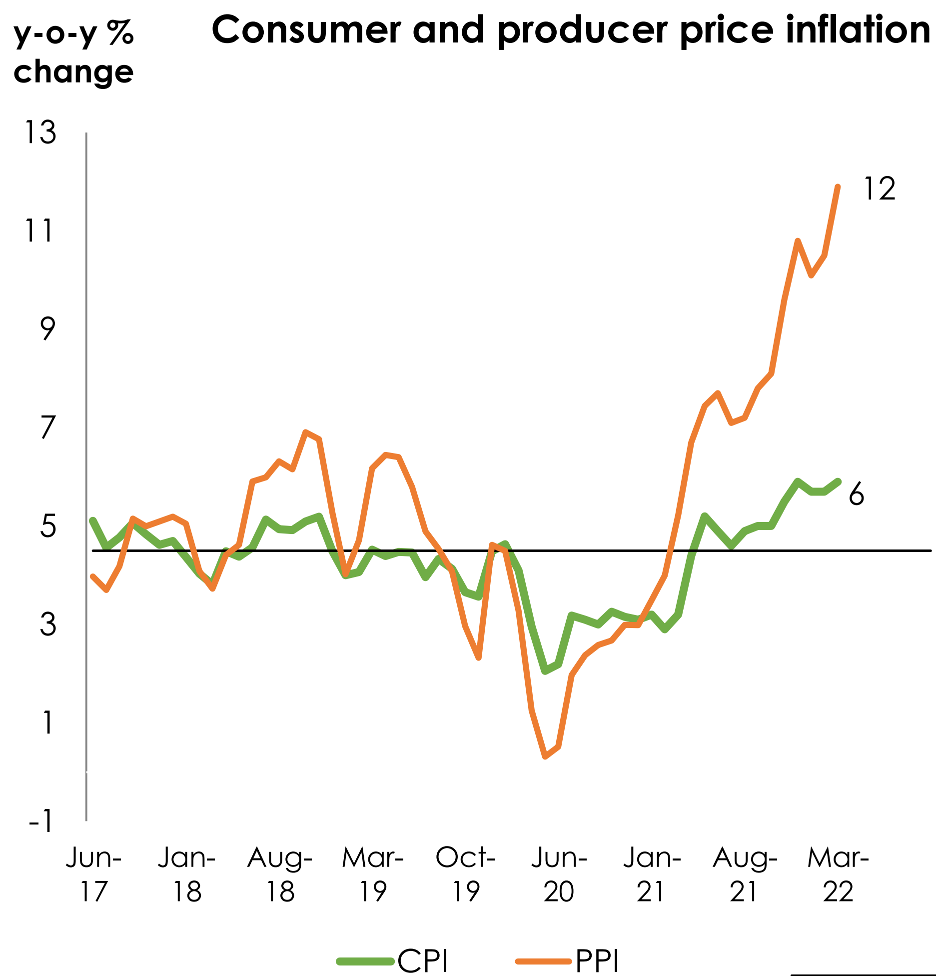
- 479 000 jobs were lost between 2020Q4 and 2021Q4
- Decreases in the number of people employed for economic sectors, include:
  - Community and social services (287 000),
  - Manufacturing (174 000),
  - Trade (168 000) and
  - Construction (33 000) industries

(000s)	2020Q4	2021Q4	Y-on-Y Change
Total (formal & informal)	15 023	14 544	-479
Agriculture	810	868	58
Mining	383	370	-13
Manufacturing	1490	1316	-174
Utilities	99	82	-17
Construction	1166	1133	-33
Trade	3063	2896	-167
Transport	943	951	8
Finance	2312	2404	92
Community and social services	3551	3264	-287
Private households	1197	1258	61

Data:StatsSA

SA businesses operating in a high inflation and interest rate environment

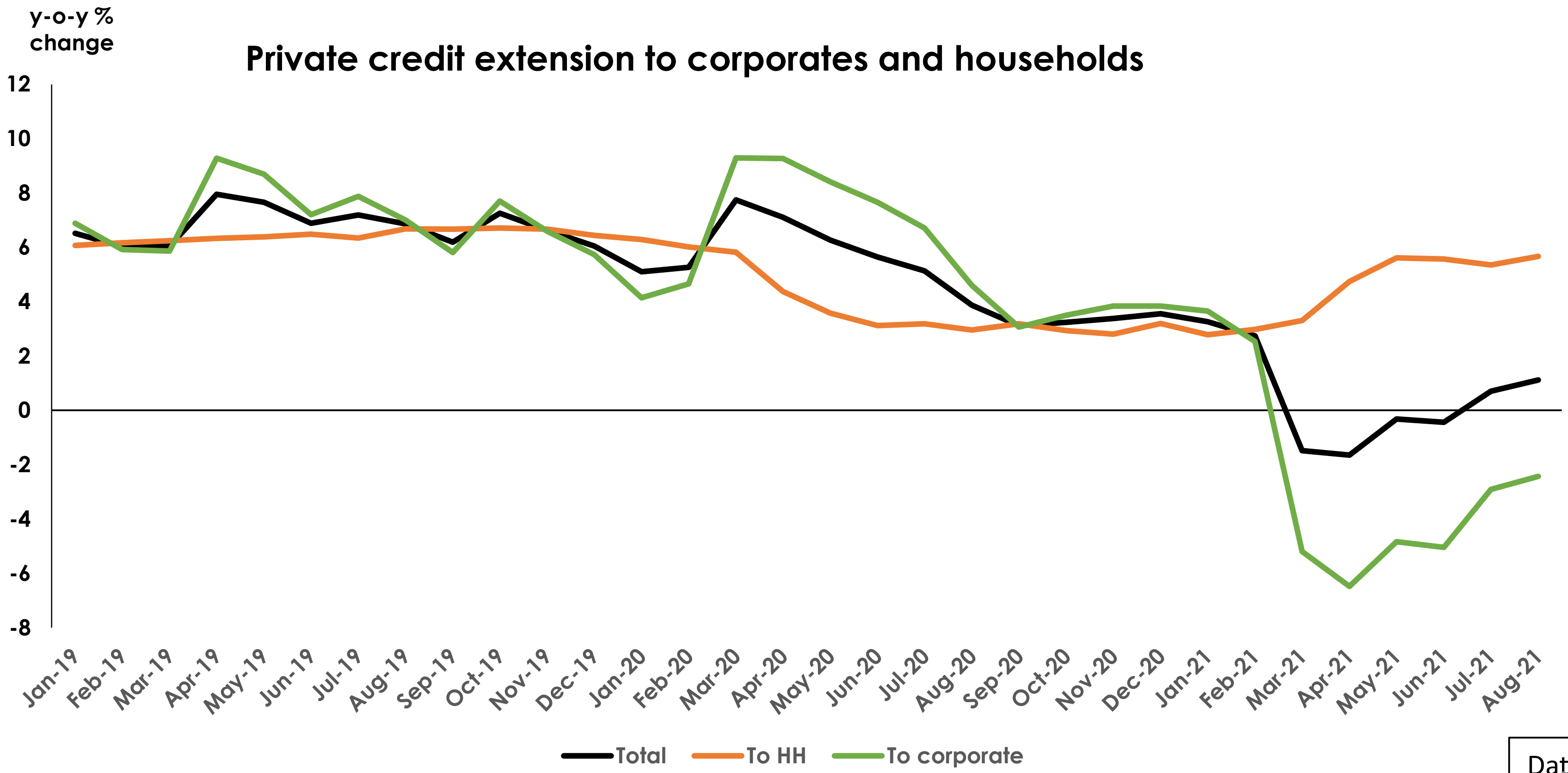
- Annual producer price Inflation was 11.9% in March 2022
- Consumer Price Inflation rose to 5.9 per cent y-on-y in April
- Supply chain disruptions caused by COVID-19 and Russia-Ukraine war have led to higher commodity, energy and food prices
- Given the higher inflation and interest rates in advanced economies as well as a weaker rand exchange rate, the SARB has begun to increase interest rates, thereby raising the cost of borrowing for businesses and consumers



Data:StatsSA

Private credit extension to corporate sector still declined despite the introduction of the Credit Loan Guarantee Scheme

- Credit extension to corporates declined by 16 per cent from April 2020 to April 2021 and about 10 per cent from January 2021 to April 2021 - and hasn't recovered to positive territory



Data:SARB

The SMMEs Landscape in South Africa since COVID-19

COVID-19 lockdown puts 11 per cent of SMMEs out of business

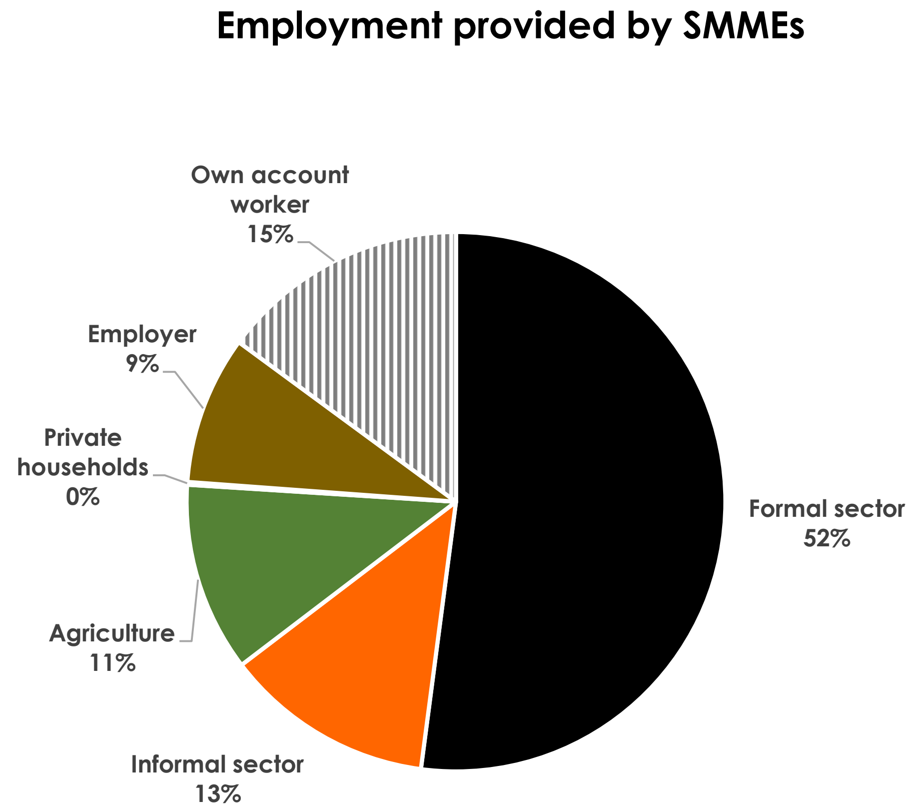
- The number of SMMEs in South Africa (SA) declined by 11 per cent (or 290 000) year-on-year (y-o-y) from 2.65 million in the 3rd quarter of 2019 to 2.36 million in the 3rd quarter 2020

KEY INDICATORS	2019Q3	2020Q2	2020Q3	q-o-q change	y-o-y change
Number of SMMEs	2 653 424	2 421 780	2 363 513	-2,4%	-10,9%
Number of formal SMMEs	779 297	816 671	653 530	-20,0%	-16,1%
Number of informal SMMEs	1 791 431	1 461 578	1 580 155	8,1%	-11,8%
Number jobs provided	11 592 677	15 106 060	10 058 355	-33,4%	-13,2%
% operating in trade & accommodation	40,6%	38,6%	39,0%	0,4% pts	-1,6% pts
% operating in community services	13,0%	12,2%	12,9%	0,7% pts	-0,1% pts
% operating in construction	14,2%	14,0%	14,3%	0,4% pts	0,2% pts
% operating in fin. & business services	13,4%	12,8%	13,1%	0,2% pts	-0,3% pts
% black owned formal SMMEs	73,1%	75,4%	75,2%	-0,2% pts	2% pts
% contribution of SMEs* to turnover of all enterprises#	37,2%	38,8%	38,8%	0% pts	1.7% pts

Data: StatsSA, Small Enterprise Development Agency (SEDA)

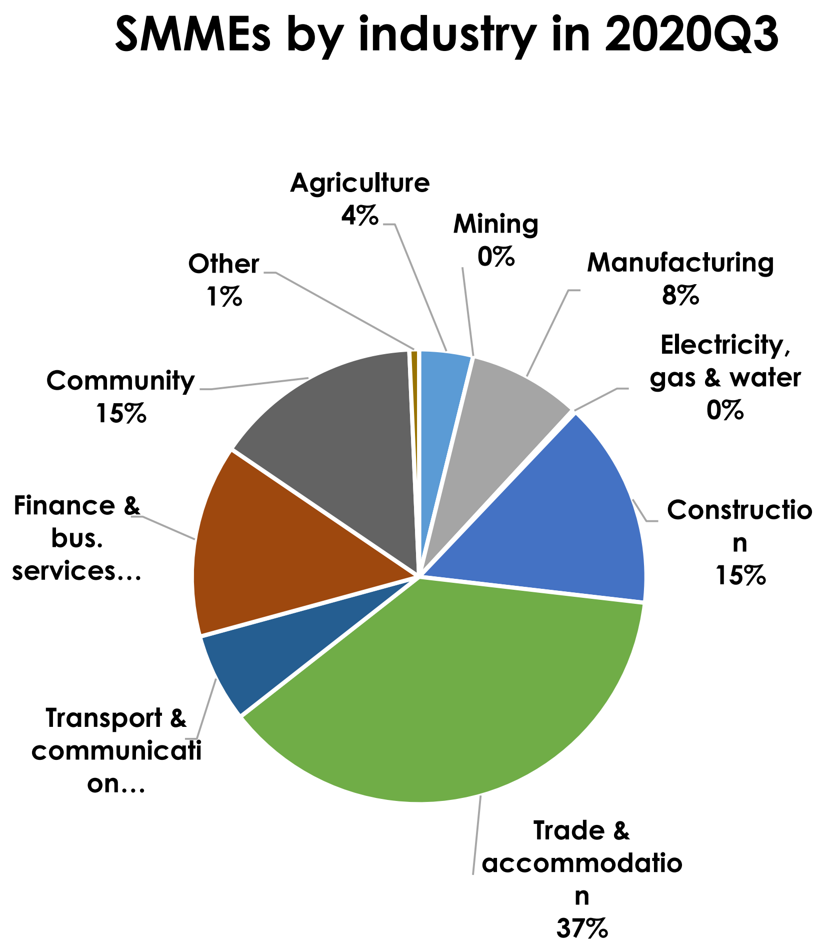
SMME employment contracted sharply after Covid-19 lockdown

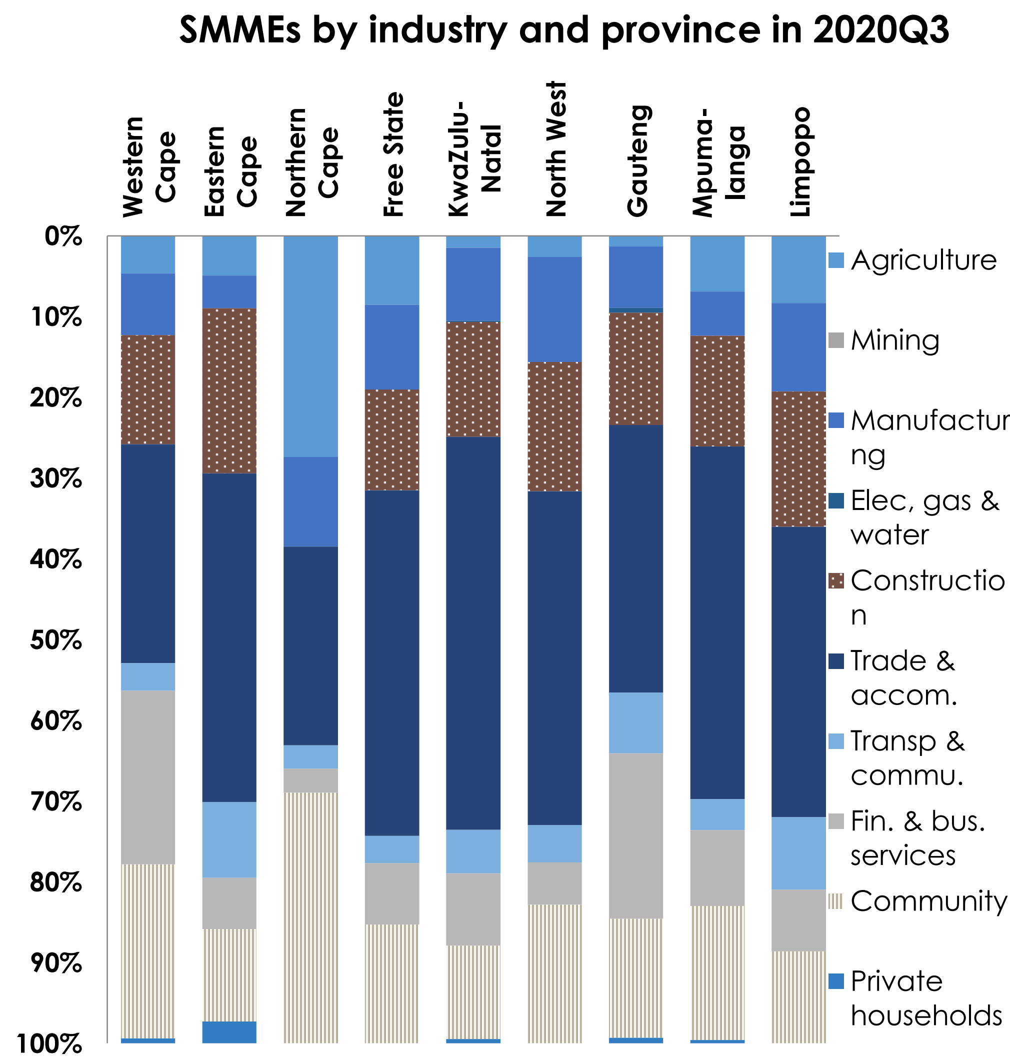
- Of all the jobs lost in the economy, 90 per cent were lost in the SMME sector
- Including owners, SMME employment contracted by 1.5 million in the year from the 3rd quarter of 2019 to 3rd quarter of 2020
- The decline would have been worse, were it not for the increase in SMMEs and employment in agriculture in the 15 months to 2020Q3
- Total employment provided by SMMEs declined by 14 per cent between 2019Q3 and 2020Q3 to 10.1 million



Data: StatsSA,SEDA

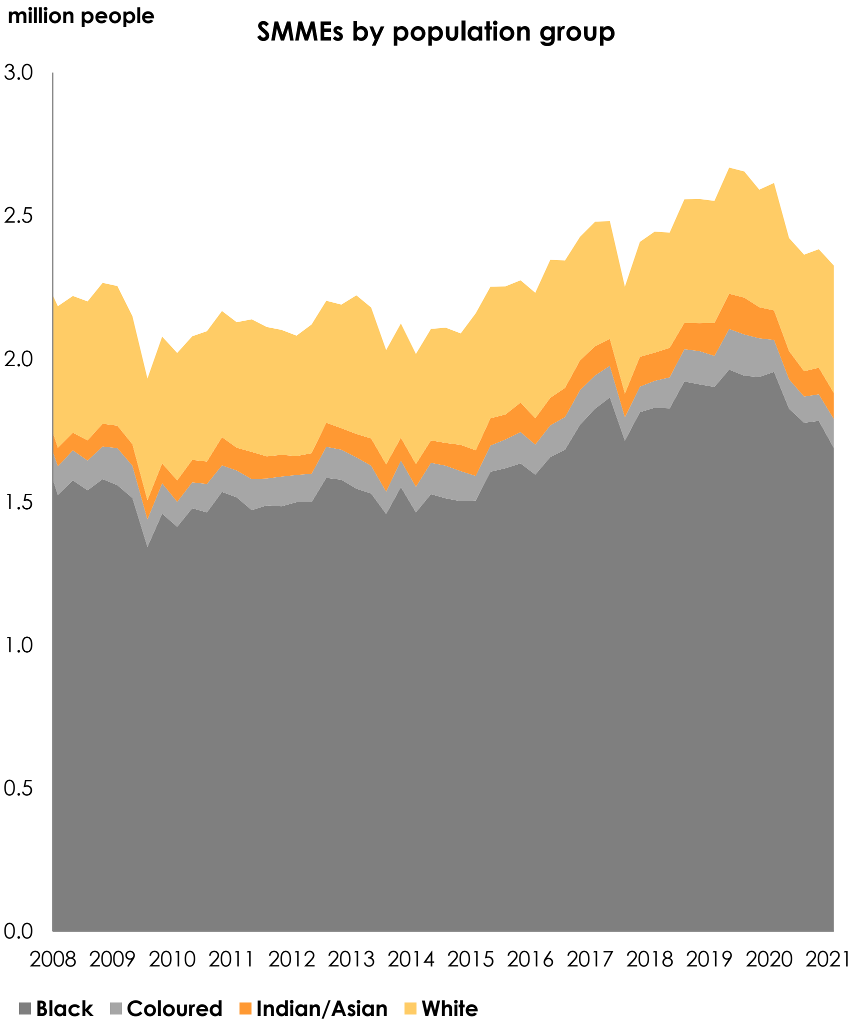
The trade sector accounts for nearly 40 per cent of SMME closures

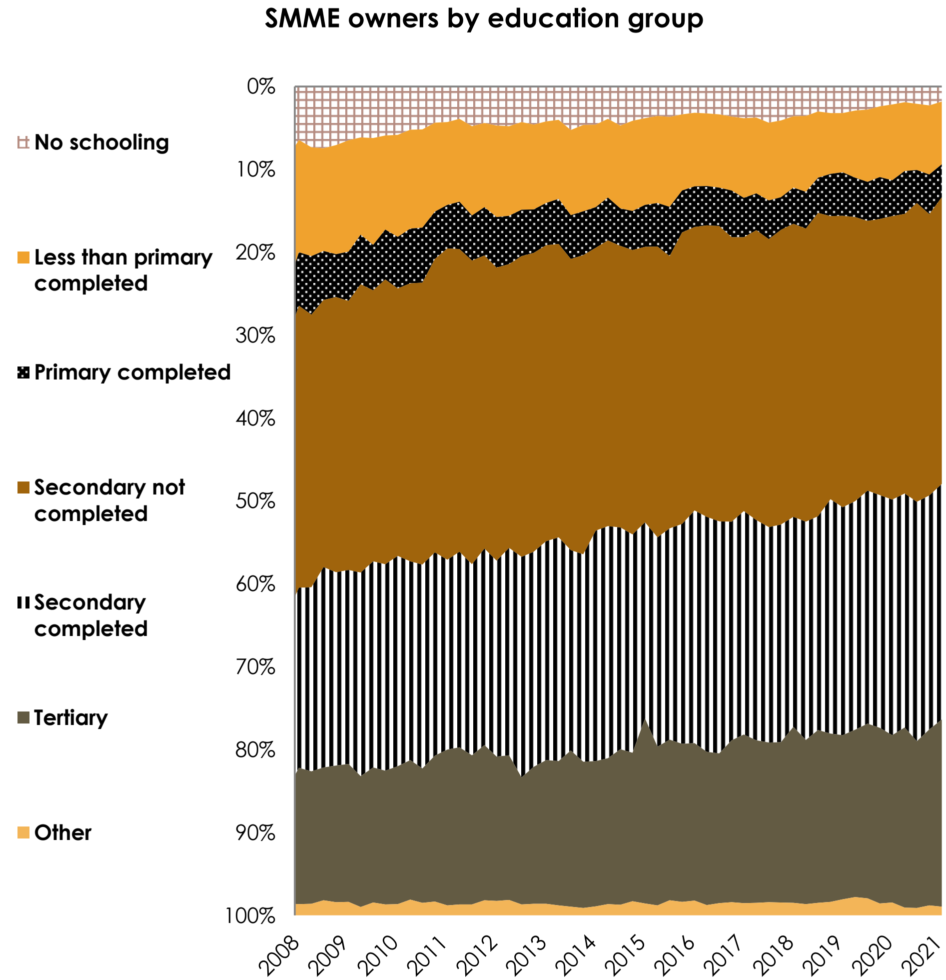




Data: StatsSA,SEDA

The share of black ownership of SMMEs declined while more educated SMME owners were the first to recover

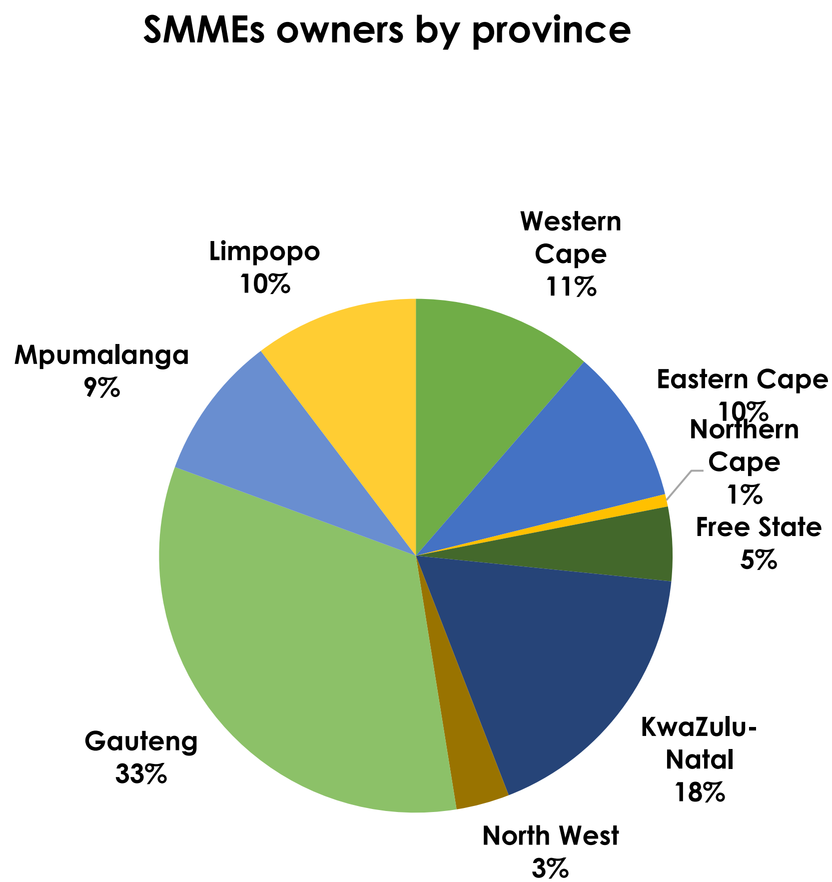




Data: StatsSA, SEDA

Covid-19 Lockdown restrictions inhibited tourism-heavy Western Cape

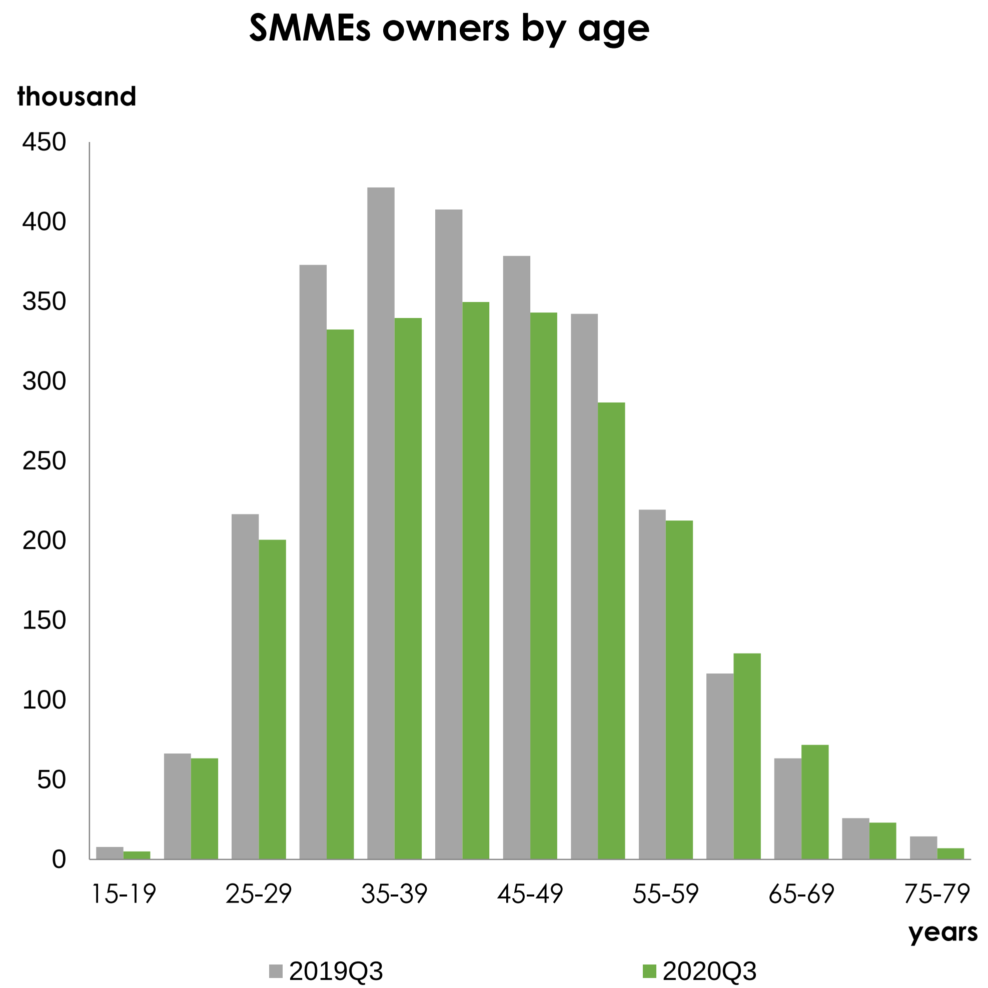
- The Western Cape lost the largest absolute number of entrepreneurs due to the COVID-19 lockdown. It comes as no surprise given large the tourism and wine producing sectors, both of which were severely restricted during the lockdown periods
- Other provinces that showed severe impacts were those with relatively large informal sectors, such as North West and Limpopo
- In contrast, the Free State gained some SMMEs, presumably due to the importance of agriculture in the region. Agriculture impacted the least by lockdown restrictions



Data: StatsSA,SEDA

Lockdown hit the SMMEs owned by 25 to 55 age group hard

- The COVID-19 lockdown impacted especially hard on SMME owners aged 25 to 55 - 14 per cent of them closed their businesses. This owner age cohort accounted for 80 per cent of all SMME closures
- There was also a small increase in the number of owners who are 60 to 70 years old
- SMMEs that survived to the 20-year plus cohort increased by 12 per cent



Data: StatsSA,SEDA

SMMEs challenges and concerns

- According to the Department of Trade and Industry and the Small Enterprise Development Agency, some of the challenges faced by SMMEs in South Africa include:
  - Limited access to finance and credit given their perceived risk profile by financial institutions
  - Inadequate supply of infrastructure: the lack of access to physical infrastructure is a key impediment to business growth and adds significantly to the cost of doing business
  - Late payments for services provided by both the public & private sector which affects the cash flow, particularly of small businesses
  - Bureaucratic inefficiencies and regulatory constraints: e.g. delays in the time required to obtain permits and licences, lack of coordination in government SMME programme planning and implementation, onerous labour laws, etc.
  - A poor macroeconomic environment which limits enterprise growth
  - High level of crime which force SMMEs to increase security spending but also drags investment confidence
  - Lack of access to markets: small businesses located in rural areas are at a disadvantage compared to their urban counterparts

Challenges faced by SMMEs in accessing finance

- A report by Finfund and several other studies identify access to funding as a major hurdle for many formal small and medium-sized enterprises in South Africa
- Some common problems faced by SMMEs when accessing finance include:
  - Not knowing who the funders are or how to find them
  - No or poor credit history
  - Limited cash flow
  - Lack of knowledge required to choose the appropriate type of funding product
  - Lack of collateral or third parties to stand surety
  - Poor business and/or financial records
  - Lack of technical and management skills
  - Does not have a bank account with the institution it approached
  - Poor planning skills thus struggle to forecast the growth and financial cash flow of the business

Interventions by government to support SMEs during the pandemic, civil unrests and floods

Tax measures

- Tax subsidy of R500 per month for 4 months for employees earning less than R6500.
- accelerate the payment of employment tax incentive reimbursements
- National disaster benefit scheme
- delay of PAYE liabilities for tax compliant businesses with turnover less than R50m
- Employment Tax Incentive
- Reduce CIT rate to 27 per cent

Labour market

- use of Temporary Employer/Employee Relief scheme to avoid layoffs
- UIF reserves to support employees in SMMEs
- solidarity fund to combat the spread of the virus
- Compensation fund for COVID-19 ill workers

Business Support:

- R3bn industrial funding package via the IDC and DTI
- R200m to assist SMMEs in the tourism and hospitality sector
- suspension of UIF contributions
- exempting banks Competition Act to enable a coordinated response.

Credit Loan Guarantee Scheme

- debt relief fund and business resilience facility

SONA and Budget Announcements:

- More than R1.3 billion has been provided in support mainly for small- and medium-sized businesses.
- The Department of Small Business Development has allocated R4 billion over the medium term to township and rural enterprises, including blended finance initiatives.
- Creating a larger market for small businesses and designate 1,000 locally produced products that must be procured from SMMEs.
- Departments of Small Business Development and Trade, Industry and Competition are supporting SMMEs to access larger domestic and international markets.
- Support for black small-scale farmers is being stepped up, with a large beverage producer committing to expand their procurement sharply.
- Since the signing of the clothing, textile, footwear and leather masterplan in November 2019, the industry has invested more than half a billion rand to expand local manufacturing facilities, including SMMEs.
- Nearly half of the procurement spend on construction of the bulk earthworks and top structure at the Tshwane Special Economic Zone during this phase is expected to be

The COVID-19 Loan Guarantee Scheme(CLGS)- 2020

Background

- The National Treasury in partnership with the South African Reserve Bank (SARB) and the Banking Association of South Africa (BASA) launched the COVID-19 Loan Guarantee Scheme on 13 May 2020
- The main purpose of the loans is to enable businesses to withstand the economic pressures of the COVID-19 pandemic by having access to borrower-friendly loans for operational expenses (salaries, rent and lease agreements and contracts with suppliers)
- The National Treasury initially provided R100 billion to the banking industry through the South African Reserve Bank, with the option to extend the scheme to R200 billion if required
- All commercial banks could access the guarantee scheme, though the Reserve Bank reserved the right to limit the amount that can be accessed by an individual bank
- Absa, Bidvest Bank, First National Bank, Grindrod Bank, Investec, Mercantile Bank, Nedbank, SASFIN Bank and Standard Bank participated in the Scheme

Conditions of the funding

- Initial conditions of the funding were, amongst other things, that the businesses needed to:
  - have a turnover of less than R300 million
  - be existing bank clients
  - good standing with their banks at 31 December 2019
  - be financially distressed as a result of the COVID-19 pandemic
  - be registered with the South African Revenue Services (SARS)
  - apply for only one loan
  - repay that loan over a five-year period
- All commercial banks could access the guarantee scheme, though the Reserve Bank reserved the right to limit the amount that can be accessed by an individual bank
- Banks were required to check the qualifying criteria of applicants and use their existing processes and infrastructure to process loan applications. As such, banks had discretion on whether they extended a loan to an applicant

Structure of the Scheme

- The National Treasury provided a guarantee to the Reserve Bank, which was recorded as a contingent liability on the government's account
- The Reserve Bank lent money to commercial banks at the repo rate (3.50 per cent) plus a 0.5 per cent credit premium
- Banks disbursed this money to small and medium-sized businesses at the repo rate plus a fixed spread of 3.5 per cent (7.75 per cent, equal to the prime lending rate)
- The banks were prohibited from making profit from the scheme and the 3.5 per cent margin was used to provide funding for losses, i.e., before the banks and the Treasury incur losses
- The government and commercial banks shared the risks associated with these loans. The South African Reserve Bank took no financial risk in the scheme as its loans to banks were guaranteed by the National Treasury

Phase II: Revisions to the Scheme 2021

- As a result of the slow uptake of the potential R200 billion in funding, the Scheme was revised to make loans more attractive to businesses
- **The most notable change to the Scheme were:**
  - The turnover cap was replaced with a maximum loan amount of R100 million. Banks could also provide syndicated loans for loans larger than R50 million
  - The interest and capital repayment holiday was extended from three months to a maximum of six months after the final draw down
  - Bank credit assessments and loan approvals were made more discretionary and less restrictive, in line with the objectives of the scheme
  - Clients could access the loan over a longer period. The draw down period was extended from three months to a maximum of six months
  - No security, suretyships or guarantees were explicitly required in terms of the scheme. However, banks could require this in terms of their individual credit risk management practices

Performance of the Scheme

- 40 292 applications were received as at March 2021
- 14 827 loans were approved by banks valued at R18.2 billion
- Average value per loan: R1.2 million
- 82 per cent of the loans approved went to enterprises with a turnover of up to R20 million
- The number of loan applications received since the beginning of 2021 is 1 787
- Of these, banks approved 551 applications, of which only 97 were taken up by clients
- A significant amount of applications were rejected due:
  - Failure to meet the eligibility criteria for the loan as set by the National Treasury and the South African Reserve Bank
  - Not meeting the commercial bank's risk criteria (about 25% of applicants)

Reasons for failure to realise the scheme's objectives

- 40 per cent of the supposed R500 billion in relief was allocated to a scheme that the evidence suggest it was poorly thought-out as SMME financing has not been a great success in SA
- Many distressed businesses were reluctant to assume more debt given the uncertainty in their income stream under COVID-19
- Lack of transformation of the financial sector or failure of the sector to understand the SMME sector
    - Banks insisted on personal surety from business owners before granting them loans, even though loans were government-guaranteed
    - Banks did not have an incentive to disburse the loans given that they could not profit from them. The 3.5 per cent margin was used to provide funding for losses
    - The scheme was poorly advertised, not reaching businesses operating in the rural, township and informal sectors of the economy
- Business owners complained about the scheme's administrative problems; reasons for banks turning down loan applications were apparently not explained, rejected business owners were then allegedly offered more expensive loans by banks

Reasons for failure to realise the scheme's objectives (Cont.)

- Government and banks negotiated the terms of the scheme and launched it during a time when the country was already six weeks into lockdown
  - Banks had already forged ahead with offering their customers debt relief measures worth R33 billion, such as payment holidays and debt relief, reducing the demand for loans under the original loan guarantee scheme
- Flaws in the scheme's design:
  - The scheme failed to address the requirement to ease creditworthiness assessments, whilst still ensuring that the banks could provide credit in a responsible manner to candidates that are likely to be able to repay the loans
  - Slow processing of loan application: Considering that the purpose of the loans was to assist distressed businesses with paying pressing obligations, such as salaries and rentals, the long processing time meant that the scheme was not as useful to businesses as had been expected prior to its launch

The Bounce-Back Support Scheme (BBSS)- April 2022

Background

- Based on lessons derived from the 2020 Loan Guarantee Scheme, the National Treasury launched the Bounce Back Support Scheme on 25 April 2022
- The purpose of the scheme is to assist eligible businesses in recovering from constraints in accessing finance due to COVID-19 lockdowns, the July 2021 civil unrest as disasters like the floods affecting KZN
- The scheme also seeks to contribute towards the growth the South African economy and to facilitate job creation
- It includes a loan guarantee mechanism of R15 billion and a smaller equity linked scheme. The smaller equity linked scheme will be introduced later in the year as a complementary tool of R5 billion
- The Bounce Back Support Scheme loans will be accessible through participating banks, Development Finance Institutions (DFIs) and non-bank Small and Medium Enterprise (SME) finance providers
- Access for DFIs and non-bank SME finance providers to the Bounce Back Support Scheme will be facilitated through participating banks, and such participating banks will still have to perform due diligence in accordance with regulatory standards

Features of the Scheme

- The National Treasury has provided a guarantee to the South African Reserve Bank (Reserve Bank). This guarantee is recorded as a contingent liability on the government's account
- The Reserve Bank will lend money to participating banks at the repo rate (currently 4.25 per cent) plus a 0.5 per cent once-off charge of the amount disbursed
- Participating institutions will lend this money as well as their own funds for the unguaranteed portion (79.5 per cent) of the loan amount at a preferential capped rate (repo plus 6.5 per cent). The repo rate at the time of the launch on 25 April 2022 is 4.25 per cent
- Government and lenders (participating banks, DFIs and nonbank SME finance providers) are sharing the risk of non-repayment of these loans with government taking the first 20.5 per cent of losses
- Businesses will be required to repay the loan over a period of up to five years after any deferred interest period agreed to by the lenders
- Loans can have rescheduling options at the discretion of the lenders (pay as you grow), for up to a period of ten years from the first draw down in the event of businesses being initially unable to pay any repayment due approval of the lender

Criteria for businesses to access the loan

- Businesses must have a relationship, either through lending or transactional banking with a participating bank and meet the participating bank's specific requirements
- Be registered with the Companies and Intellectual Property Commission (CIPC) or registered for Value Added Tax in terms of the Value Added Tax Act, 89 of 1991 with the South African Revenue Service
- Eligible businesses must have a maximum turnover of R100 million per annum
- The maximum loan amount will be set at R10 million per businesses (and a minimum loan amount of R10 000)
- In the case of small and medium enterprises, the turnover cap is a maximum turnover of R100 million with a maximum loan amount of R10 million
- For non-bank lenders loans may be made for a maximum amount of R100 million per non-bank lender subject to the approval of the lender

Differences between the BBSS and CLGS

- The size of the scheme has been reduced from R200 billion to R20 billion
- The BBSS has introduced equity-linked financing, which will allow finance providers (mainly development finance institutions) to offer business owners loans that can be converted into equity if the borrower defaults on loan repayments
- The scope of the new scheme has been extended beyond just helping businesses impacted by COVID-19. Businesses impacted by the July 2021 civil unrest and the floods affecting KZN are also eligible to apply
- The participation of banks in the new scheme is voluntary, unlike in the original scheme, which forced them to flex their balance sheets

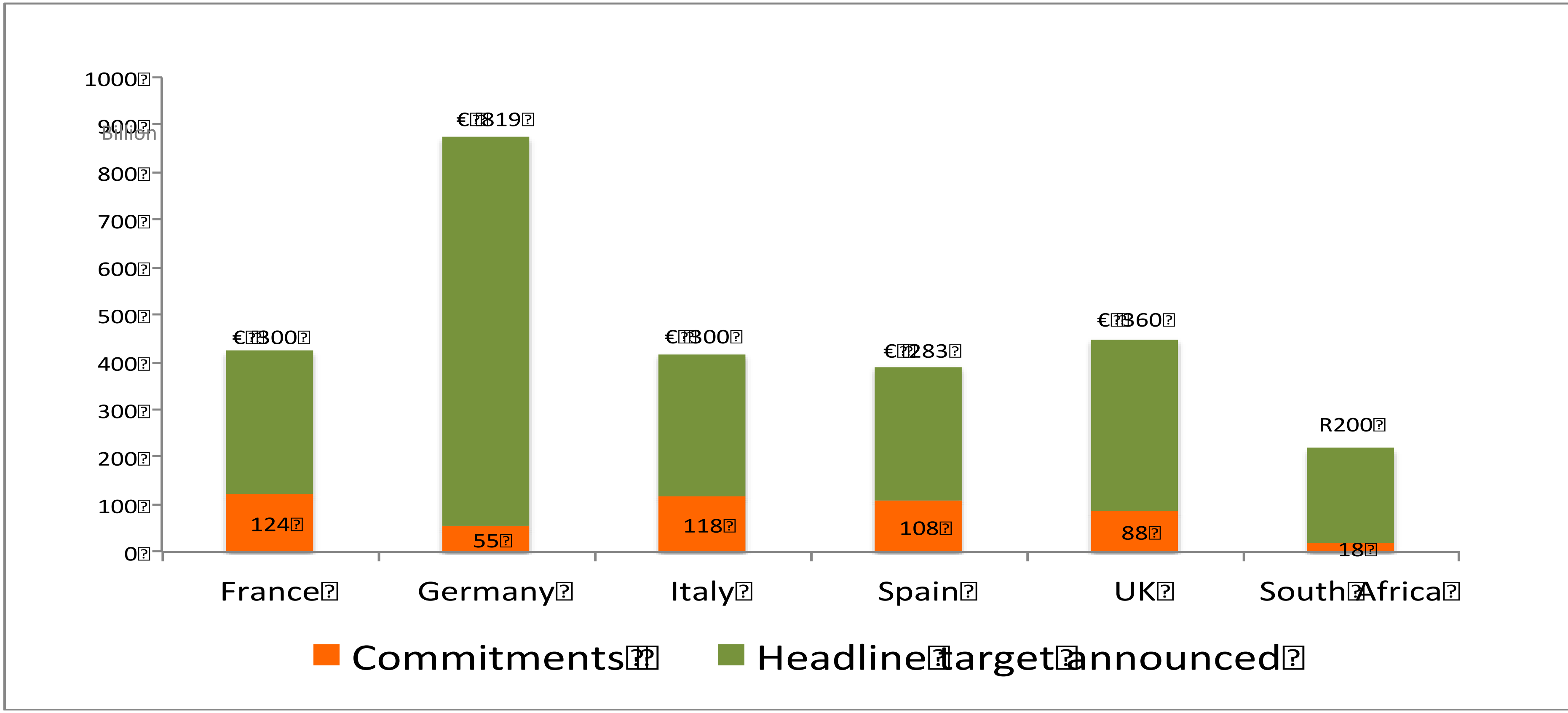
Differences between the BBSS and CLGS (Cont.)

- The CLGS was facilitated only through participating commercial banks, while the BBSS also extends loans through qualifying Development Finance Institutions (DFIs) and Small Medium Enterprise (SME) finance providers
- The new scheme removes administrative burdens for banks, making it easier to administer loans
  - The requirement for collateral or personal surety from business owners has been removed
  - There are also fewer requirements on how business owners can use the loans from the scheme
  - While the loan scheme is designed for business owners to use the loan proceeds to shore up the working capital requirements of their businesses, they can use the money to pay out dividends

Differences between the BBSS and CLGS (Cont.)

- Banks can profit from extending these loans. The CLGS offered business loans at favourable interest rates (repo rate plus a fixed spread of 3.5 per cent). Whereas, under the BBSS, business owners will receive loans at an interest rate of no more than the repo rate (4.25 per cent) plus 6.50 per cent
- In the original scheme, banks took the first loss, depending on the amount and life of a loan. The BBSS has removed the first-loss buffer
- Government will now take the first loss of 20.5 per cent of the entire loan portfolio, with banks assuming the risk for remaining guaranteed losses
- The National Treasury has put a figure of R15 billion for these expected losses whereas, in the original scheme, its budget for expected losses was zero
- Government expects this amendment to shift the appetite of banks to borrow, as they can better plan and model expected losses if they participate in the new loan scheme

International experiences of similar schemes



- About 51 countries have implemented some sort of bank loan scheme to date
- Generally, schemes have fallen short of targets worldwide due to flaws in the scheme's design and administrative problems. South Africa is no exception in this regard
- Also, like South Africa, the rate of growth has tempered over time, despite changes to the terms of schemes

International experiences of similar schemes (Cont.)

- Generally, the success of schemes is directly related to the degree of risk transferred out of the banking system and onto the national governments balance sheets

- Where changes to schemes have been made they have generally followed a pattern of:

    - Increasing the extent of the government guarantee (up to 100 per cent of loans)
    - Prescribing banks' credit vetting processes to limit rejection rates
    - Lowering interest rates (in some cases to extended interest-free periods)
    - Development Finance Institutions have played a critical role in credit extension to businesses

- Despite cases where loans are 100 per cent guaranteed and banks are forced to accept all applications based on self-declared data from applicants (e.g. the UK Bounce Back loan scheme), borrowing levels have plateaued at levels far short of targets

Linking the Bounce-Back Scheme to the Economic Reconstruction and Recovery Plan

- The Economic Reconstruction and Recovery Plan (ERRP) stipulates that SMMEs, cooperatives and start-ups have an important role to play in facilitating economic transformation and empowerment
- As a result, the provision of a supportive ecosystem to SMMEs, cooperatives and start-ups is seen as a critical enabler for recovery and reconstruction by the ERRP
- The ERRP identified the following interventions to support SMMEs, cooperatives and start-ups:
  - Reviewing and integrating government support for formal and informal SMMEs, start-ups and cooperatives, including removing red tape and reducing timeframes for relevant licenses and permits to improve the ease of doing business
  - Designing more appropriate financing products, such as microfinance, gap housing products and blended financing including for emerging farmers
  - The support to SMMEs to participate in the localization opportunities

Linking the Bounce-Back Scheme to the Economic Reconstruction and Recovery Plan (Cont.)

- The COVID-19 Loan Guarantee Scheme had a target of R200 billion. Meanwhile, the Bounce-Back Support Scheme only comprises of a loan guarantee mechanism of R15 billion plus R5 billion in the form of a equity-linked scheme
- What does this imply for SA's economic recovery given that the R200 billion scheme (earmarked for business support) was the single largest plank of the government's R500bn COVID-19 economic stimulus package?
  - Real GDP and real GDP per capita in 2021 were 1.8 per cent and 4.3 per cent below pre-pandemic levels, respectively
  - SA economic recovery will continue to lag its global counterparts who have better fiscal space to respond to idiosyncratic shocks
  - The SA economy will continue to be trapped in a chronic low-growth environment leading to further unemployment, rising poverty and inequality, stagnating incomes as well as increased pressure on public services and government borrowing

Key areas of oversight and measures for consideration

- Under the new scheme, banks, DFIs and non-bank SME finance providers still have sole discretion on which businesses can access finance
- **Implications:**
  - Financial institutions are inherently risk adverse towards SMMEs. As a customer segment, SMMEs represent one-fifth of global banking revenues but lending to SMMEs makes up only 8 percent of the credit exposure of the South African banking sector *(Department of Trade and Industry, 2018)*
  - Potential to entrench the misallocation of capital in the SA economy - financing of large enterprises in sectors such as mining, utilities and professional services at the expense of job creating small and medium enterprises in sectors such as manufacturing
  - Financialisation of the SA and global economy has allowed financial institutions to remain profitable without investing in the real economy

Key areas of oversight and measures for consideration (Cont.)

- The new scheme is still implemented through a financial system architecture that is not suitable for the informal, township and rural nature of many SMMEs
  - Despite the easing of some requirements under the new scheme, it is larger formal SMMEs that are the most likely to receive financing given their administrative and operational capacity to meet the credit criteria of the commercial banks
  - SMMEs are expected to have an existing relationship of either lending or transactional banking with banks or development finance institutions, which automatically excludes unbanked businesses
- The scheme lacks a transformation mandate as provided for by the Financial Sector Charter and in line with the ERRP’s objective of facilitating economic transformation and empowerment
- No evidence that priority is given to businesses that were hit the hardest by the three respective economic shocks (i.e. COVID-19, civil unrest and floods)

Key areas of oversight and measures for consideration (Cont.)

- Inconsistent policy and regulation, unreliable electricity supply, uncertain business conditions, and a weak economic outlook will continue to discourage businesses from incurring more debt
- The R20 billion earmarked for the Scheme is insufficient in proportion to the needs of SMMEs amid the damage caused by the three respective economic shocks
- The timing of this type of assistance is critical as to the impact. The scheme may be a little too late given the number of businesses that have already failed, particularly those in the tourism and services sectors
- The scheme remains poorly advertised. Government should commit to a joint advertising campaign with the banking sector, which entails radio, press and TV adverts conducted in local languages
- Given the scheme's poor track record, there seems to be low appetite among major banks to participate in the new scheme. At the time of launching the new scheme, only one major bank had fully opted-in

Key areas of oversight and measures for consideration (Cont.)

- Given government's financial commitment to the scheme, it is critical that the National Treasury engages financial institutions and businesses on an ongoing basis to ensure funds are fairly and transparently allocated
- The Reserve Bank is expected to publish an annual report setting out how much each bank would have used from the scheme and the performance (default rate) of each bank's loan portfolio.
- The report will be important for assessing the impact and success of the scheme
- SMMEs make up about 98.5 per cent of all businesses in South Africa, yet they continue to struggle with accessing the capital they need to grow and thrive.
- The pandemic, civil unrest and the floods in KZN demonstrated that the financial resilience of businesses (which provide the most jobs in the economy) is important for macroeconomic and financial stability

Key areas of oversight and measures for consideration (Cont.)

- The Bounce-Back Support Scheme on its own will not fundamentally address the financial and operational challenges facing SMMEs in SA
- Some of the legislative reforms proposed in recent literature on SMME development in SA include:
  - Amending the National Credit Regulations Act to lower barriers that prevent SMMEs operating from personal bank accounts, particularly in the informal economy
  - Current affordability assessment regulations, in particular, could be amended to accommodate informal businesses and start-ups and to allow for innovative technology enabled credit vetting strategies that are being developed
  - PFMA and MFMA amendments to allow provincial- and municipal-pooled finance vehicles to support their own SMME lending/grant/equity style programme

Key areas of oversight and measures for consideration (Cont.)

- Banks and the financial system in SA have historically been similar to the UK and USA. Development finance has constituted a very small share of total credit extended.
- Businesses have largely financed expansion out of retained profits or issuing bonds and equity. While small businesses continue to be at a disadvantage
- SMMEs also pay a higher Effective Tax Rate than large businesses. This is due to compliance costs and capacity issues related with them claiming any tax benefits
- The bounce-back scheme (as with the credit guarantee loan) is an attempt by the National Treasury to be seen as supporting businesses and promoting job creation without having the expenditure on budget.
- A contingency liability has been created on a financing scheme that has proved to have poor uptake even in the midst of the pandemic

Thank You

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