WEALTH CREATION IN HISTORICALLY DISADVANTAGED COMMUNITIES THROUGH SHARE PARTICIPATION IN SMALL BUSINESS VENTURES

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WEALTH CREATION IN HISTORICALLY DISADVANTAGED COMMUNITIES THROUGH SHARE PARTICIPATION IN SMALL BUSINESS VENTURES

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WELVAARTSKEPPING IN HISTORIES AGTERGEBLEWE GEMEENTSKAPPE DEUR AANDEELHOUDING IN KLEINSAKE ONDERNEMINGS

Die doelwit van die studie is die ontwikkeling van 'n alternatiewe finansieringsmodel wat aanvaarbaar sal wees vir beide die finansieringsinstelling en die lener.

'n Verdere doelwit is om 'n buigbare en uitvoerbare finansieringsmodel te ontwikkel waar die tradisionele lenignsvereistes van finansieringsintellings nie van toepassing is nie.

Die metode van ondersoek wat gevolg word sluit in 'n literatuur - en empiriese studie wat ondersoek instel na die beskikbaarheid van krediet aan opkomende entrepreneurs sowel as die tekortkominge in die stelsel ten opsigte van agtergeblewe gemeenskappe.

Uit die teoretiese agtergrond word 'n finansieringsmodel ontwikkel wat voorsiening maak vir die tekortkominge in die huidige stelsel. Die model maak ook voorsiening vir werknemers aandeelhouding en welvaartskepping.

'n Empiriese toetsing van die model word gedoen onder die vernaamste rolspelers in die kleinsake finansieringsveld ten einde die aanvaarbaarheid van die model te bepaal.

Die resultaat van die toetsing van die model is dat dit aanvaarbaar is en die algemene aanduiding is daar dat dit werkbaar en van toepassing is en dat dit beslis aanleiding sal gee tot die skepping van welvaart in agtergeblewe gemeenskappe.

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1 INTRODUCTION

It has been recognised all over the world that the small business sector plays an important, if not, critical role in the economic and social development of a country. This also applies to South Africa where the small business sector has been neglected in the past.

There is ample evidence that the labour absorptive capacity of the small business sector is high and the average capital cost per job created is usually lower than in big business.

Although the statistical base of small business in South Africa is still poor, there can be little doubt about their relative significance.

According to the Department of Trade and Industry's White Paper on the development and promotion of small business in South Africa (February 1995:9) there are more than 800 000 small, medium and micro- enterprises (SMME's) in the country absorbing about a quarter of the labour force of 15 million people. This is in addition to about 3,5 million people involved in some or other type of survivalist enterprise activity.

Compared to big business, small business faces a wider range of constraints and problems and are less able to address the problems on their own. The constraints relate, among others, to the legal and regulatory environment confronting SMME's, the access to markets, finance and business premises (at affordable rentals), the acquisition of skills and managerial expertise, access to appropriate technology, the quality of the business infrastructure in poverty areas and, in some cases, the tax burden.

In the South African context the constraints have been particularly hard on entrepreneurs in rural areas and on women. (White Paper on small business in South Africa . February 1995:11)

An enabling environment should be created for small enterprises in order to accelerate the establishment of small business ventures. This will create employment opportunities and meet the demands of the Reconstruction and Development Programme.

The issues of growth and economic empowerment have been placed high on the agenda of the Government of National Unity of South Africa and small business should become an important vehicle in addressing the challenges of job creation, economic growth and equity.

Wealth must be created through economic development. Not only is the process of economic development expected to lead to significant material betterment, but it is also expected to contribute greatly to the improvement of human life through better health and education, increased leisure, and the like (Spiegelglas & Welsh. 1970:2)

Of all the above-mentioned constraints the access to financial resources is regarded as the most important constraint facing small businesses and emerging entrepreneurs in this country.

2 PROBLEM DEFINITION

The problem is that there is no alternative to the conventional ways of financing entrepreneurs where proper security and a substantial own contribution is required. The existing financing system does not make provision to accommodate emerging entrepreneurs from disadvantaged communities simply because they cannot meet the lending criteria.

It is a well known fact that financial institutions will not advance any monies for the establishment of new business undertakings without obtaining sufficient security or collateral. In most instances the entrepreneur cannot meet these requirements. This is in particular applicable to black businessmen operating in rural areas and within formerly disadvantaged communities.

The drastic curtailment of property ownership rights of blacks and the tribal system made it impossible for them to acquire assets that could serve as collateral for loan financing; it also excluded blacks from the long-run process of capital accrual and growth through rising property values and share prices.

3. OBJECTIVE OF THE STUDY

The objective of the study is to develop an alternative financing model which will be acceptable to both the lending institution and the borrower.

If we want small business to come off the ground, an alternative to the existing ways of financing small businesses will be necessary.

The main aim will be to develop a flexible and manageable financing model where the traditional lending criteria of financial institutions will not apply. A further aim will be to include worker's share-participation in the model, in order to address the issue of wealth creation.

4 METHODOLOGY

The method of investigation that is followed comprises of a literature and empirical study of the availability of credit to emerging entrepreneurs and the shortfall in the system with regards to disadvantaged communities.

From the theoretical background a financing model which caters for the shortfalls of the existing system will be developed. This model will also address the issues of workers share-participation and wealth creation.

An empirical testing of the model will be done amongst the major role players in the financing field in order to establish the acceptability of the model.

5 LIMITATIONS OF THE STUDY

The study is limited to the South African scene and does not embark on investigating the international small business finance field in general.

There are dozens of non-governmental organisations (NGO's) active in the financing of micro-enterprises. This study only refers to one of these NGO's.

6 DEMARCATION OF THE RESEARCH

CHAPTER 2

A literature overview which comprises of a discussion on traditional financing methods and criteria applied in financing small businesses. It also explores the issue of employee share-participation in the establishment of small business ventures.

CHAPTER 3

This chapter consists of the development of an appropriate financing model which allows for employee share-participation and where application will enable disadvantaged communities to gain access to financial resources for the establishment of new small business ventures.

CHAPTER 4

The testing of the model developed in Chapter 3 amongst existing role players in the field of small business development. The chapter summarises the views and recommendations of such role players.

CHAPTER 5

A summary of the major findings of the study and recommendations.

CHAPTER 2
LITERATURE STUDY

1. INTRODUCTION

The study undertakes the investigation of existing literature pertaining to the availability of financial resources to small business development in general. It explores the accessibility to credit for SMME's and it investigates the lending criteria applicable. Special emphasis is placed on the provision of collateral or security as a condition by lending institutions.

A further aim of the study is to establish if there are any existing models on worker's share-participation schemes, either in this country or elsewhere in the world, which can be applied in the development of a new model suitable for application in South Africa.

The study is partly empirical as some of the information was obtained from financial institutions presently active in the advancing of funds to the small business sector of the economy.

The literature and empirical investigation comprises of the following:

- the availability of credit to small businesses and new entrepreneurs in South Africa;
- the lending criteria applied by financial institutions and the importance of collateral to these institutions; and
- employee share-participation in general and the financing of shares to individuals as a method of funding the establishment or expansion of a business venture.

2. THE AVAILABILITY OF CREDIT TO THE SMALL BUSINESS SECTOR IN SOUTH AFRICA

The government recognises in the White Paper on small business that access to finance is one of the most urgently felt needs amongst small enterprises. The financial needs of different types of SMME's vary widely, with access problems particularly severe in rural areas, amongst start-up micro-enterprises and among those owned or controlled by women as well as other formerly disempowered groups, and in certain high risk business categories (White Paper on Small Business in South Africa. February 1995:29).

In an article by Hendrikse (1994:4) he mentioned that the major barrier to entrepreneurship and economic development by SMME's is access to finance.

South Africa's commercial banks have in the past been reluctant to provide comprehensive services for the fragmented, risk-prone and geographically dispersed small enterprise sector. This applies in particular to black emerging enterprises.

Mr Z Rustomjee, director general of Trade and Industry, said some of the impediments to SMME's identified during workshops at the President's Conference on Small Business included access to finance, human resource development and specific support mechanisms. He also said that solutions to these problems range from legislation changes to the passing of new legislation. (Smith 1995b:34)

In the White Paper on Small Business (1995:24) it is stated that the government is committed to passing a number of enabling acts. A new act, or the addition of relevant clauses to existing legislation, could address a number of fundamental issues regarding the access to finance by SMME's. This could include steps to encourage existing financial institutions to become more active in the SMME-market segments.

Neville Edwards, general manager of Nedenterprise, points out that small enterprises' greatest need is not for finance alone, but rather for skills transfer coupled with finance. (Smith 1995a:66).

2.1 THE MAIN PLAYERS IN ENTREPRENEURIAL FINANCE AND SMME-FOCUSED FINANCING INSTITUTIONS

From the previous paragraphs the impression might arise that there is no money available for the development of small businesses in this country, but the opposite is in fact true.

During recent years there have been welcome signs that commercial banks are giving increasing attention to the needs of SMME's, with many innovative financing schemes having been introduced to assist particular types of SMME clients.

Never in South Africa's history has there been a better time to look for entrepreneurial finance. Although things are still difficult and many will be disappointed, the chances of finding backing today are better for both the formal and informal sector, the modestly substantial and the micro-enterprise, the blue chip franchise and the inventor with nothing more than a great idea.

The range of finance available to the new South African entrepreneur is by no means perfect, but it offers a wider choice than ever before. For the first time too, the institutions offering it are truly committed to the development of small businesses.

In the informal sector, a bustling gaggle of poverty banks, lending tiny amounts of capital to the most unlikely entrepreneurs; and getting it repaid - have been making their presence felt. Here Pretoria's Get-Ahead Foundation and East London's Independent Business Enrichment Centre (IBEC) are probably the outstanding performers.

On a different level, black-owned institutions like African Bank and Future Bank, while staying closer to the known path, have shown a real sensitivity to the need for business finance of their constituency. (Rogers 1995:54) Two of the biggest players, the Small Business Development Corporation (SBDC) and the Standard Bank's Small Business Development and Advisory Bureau pioneered the field in the early eighties. None of the mainstream banks find it practical to lend amounts below R30 000 or R40 000. The plain fact is that lending R100 000 to a sophisticated borrower takes less work than lending R500 to an uneducated borrower who needs a step-by-step introduction to the subject.

At Community Bank a client's borrowing capacity is dependent on his first saving. Workshops introduce clients to concepts like interest rates, the importance of saving and the consequences of non-payment.

Filling a position in the market that has always been neglected, is Nedenterprise's new venture capital fund. The fund will put up 49% or less of the needed capital for approved projects.

About a dozen former homeland development corporations (or their small business subsidiaries) have over the years tried to fill part of the vacuum in SMME funding. These institutions are essential for the type of loans where the risk and transactional costs are still too high for commercial banking practice.

2.1.1 NEDENTERPRISE

Nedenterprise has been described by Lot Ndlovu, executive director of the Nedcor Group, as arguably the largest small business catalyst outside the SBDC (Smith 1995a:66)

Filling a position in the market that has always been neglected is Nedenterprise's new venture capital fund. The fund will put up 49% or less of the needed capital for approved projects.

These might include business expansion, management buyouts and ventures in engineering, manufacturing, service industries and retailing. (Rogers 1995:55)

The primary aim of Nedenterprise is to help finance and develop small and medium enterprises by providing appropriate financial products and professional services at desired profit margins and acceptable credit risks. The division is particularly committed to identifying and developing emerging markets and fostering a positive attitude towards small business within the banking group. (Witthaus 1995:18)

Nedenterprise set up a franchise fund and a venture capital fund to assist in the establishment of a variety of types of small businesses. The financial instruments used are ordinary shares, debentures and shareholders' loans. Nedenterprise will arrange debt and asset financing as part of its normal business.

They also offer a comprehensive range of products in the franchise market, including:

- franchise start-up loans
- franchise expansion loans
- leasing of equipment
- suspensive sale agreements
- working capital finance

2.1.2 FIRST NATIONAL BANK

First National Bank's small business unit has several regional offices. The small business person who approaches one of their offices is shown how to prepare a business plan and is taken through a business exercise to test the project's likely viability.

They decide what sort of facility suits the client's needs best. They recommend an overdraft facility or repayment over a given term. After the loan has been granted the business development manager visits the borrower not less than every three months to see that everything is going smoothly. They say that if you are going to lend money you must be able to provide the support services.

Like other formal banks it is difficult for First National to provide loans under R30 000 or R40 000 but for an essentially sound existing business thy are sometimes willing to go as low as R10 000.

Edgar Blomeyer, assistant general manager Bank Marketing Division of First National Bank, says the mission of the small business unit is to assist essentially "unbankable" entrepreneurs. "We are not interested in investment business or manager-run businesses. We expect the client to be personally involved. We will nurse-maid him for a few years. We want to see him become a sound commercial client. After that he has a track record and can be assisted by his branch manager. At that stage he no longer needs us." (Rogers 1995:59)

First National Bank strongly supports franchising as a business concept which opens doors to aspirant entrepreneurs and believes it can play an instrumental role in the transformation and strengthening of the South African economy.

About five hundred of First National Bank's branches are equipped to address the requirements of potential franchisers and franchisees. Serving these branches, regional development managers have been appointed, whose function is to identify local small business people as potential franchisees and even to introduce them to the franchiser. (Witthaus. 1995b:9)

First National Bank is aware that the majority of South Africans have traditionally been discouraged from considering a franchise by the substantial capital amounts required, and that there is a need for the active involvement of the banking sector to help entrepreneurs enter the market. They are on the verge of launching a new franchising package which will assist aspirant franchisees from disadvantaged backgrounds and place this opportunity within reach of more South Africans.

2.1.3 STANDARD BANK SMALL BUSINESS DEVELOPMENT AND ADVISORY DEPARTMENT (SBDAD)

The SBDAD also has the conviction that of all the small business options, franchising has the most to offer South African entrepreneurs.

"A strong entrepreneurial culture will have to emerge in our country to ensure an economic revival," says Malcolm Kietzmann Senior Manager of SBDAD. "Franchising is a mechanism that can be used to stimulate a larger number of entrepreneurs." (Witthaus 1995c:14) A franchise is less daunting to the new entrepreneur than a stand-alone operation, since statistics show that franchises have a considerably low failure rate.

The SBDAD was founded way back in 1981 when small business was not highly regarded by large financial institutions. They offer a wide range of products specifically designed to cater for the small business sector.

2.1.4 COMMUNITY BANK

Community Bank is a private initiative in the arena of credit for the poor. Cas Coovadia, chief executive, believes that being registered as a mutual bank, the Community Bank is better placed than its commercial counterparts to service clients in the low-income bracket. (Cargill 1995:40)

Community Bank's credit to small business ranges between R500 and R15 000. Their aim is to help people get access to credit, especially in the small business sector (Van Zyl. 1995:32).

2.1.5 FUTURE BANK

Future Bank is a black-owned company that serves the entire community. With a mission that is aimed at supporting small and medium business, Future Bank defines their client enterprises as consisting of an individual, a partnership, a close corporation, a company or co-operative with assets not exceeding R2 million.

They must engage in profit-making activities and be likely to create additional employment opportunities. This is a small bank that leads the field in terms of technological support.

Having refined their fully-automated loan approval system to the ultimate degree they are able to lend far smaller amounts than most mainstream banks. They operate at a level other banks see as not being commercially viable. Their ability to make decisions faster allows them to process loans more economically (Rogers. 1995:55).

2.1.6 AFRICAN BANK

African Bank is also a black-owned financial institution. They go right down to R10 000, admitting that these loans may not always be viable for the bank, but citing their commitment to the small businessman as the reason they operate at that level. On the other end of the scale they lend amounts as high as R1 million to an individual client.

Finance is provided for a wide range of enterprises. Dealerships, manufacturing, building and service industries have all received African Bank support.

2.1.7 GET AHEAD FOUNDATION

The Get Ahead Foundation was the first organisation to employ the group lending method in South Africa. Inspired by the famous Grameen Poverty Bank in Bangladesh, their way of lending fits very closely to the pattern of traditional African communalism. (Rogers. 1995:56) The amounts lent by Get Ahead make formal bankers shake their heads in either wonder or bewilderment. Their stokvel loans are for amounts between R200 and R5000. By their calculations a job is created for every R350 that they lend.

2.1.8 THE SMALL BUSINESS DEVELOPMENT CORPORATION (SBDC)

The SBDC remains the largest supplier of loan capital to small and medium businesses. They receive over 1 200 enquiries daily and 50 000 to 60 000 formal applications for finance a year. Approximately 8000 were granted in the last financial year.

SBDC management is well aware of the criticism that they ignore the lowest levels of business. They have designed a number of programmes that reach down into the informal sector, some of them providing micro loans for as little as R1000. They accept this part of their activities as a loss-making exercise.

The informal sector takes more time. The risk is higher and they find obstacles in recovering payments. If they were purely profit-driven they would stay away from it.

Various financing packages are offered to serve the needs of entrepreneurs in the different stages of their development. They cover the full spectrum, ranging from informal micro enterprises in disadvantaged areas and communities, to sophisticated new and expanding SME's.

Business financing programmes fall into two categories. Firstly, certain programmes cater for the needs of micro and small scale enterprises such as the Mini-loan Programme, Comprehensive Assistance Programme and Small Builders Bridging Finance.

- The Mini-loan Programme provides for the needs of micro enterprises which usually need money urgently for a fairly short period. Loans up to R6000 are considered, with a maximum repayment period of 24 months.

- The Comprehensive Assistance Programme provides for the special requirements of informal and semi-formal enterprises. Support services are combined with financing to ensure a comprehensive package of services to the entrepreneur. Currently, finance up to a maximum of R75 000 per enterprise is available in terms of this programme.

- Small Builders' Bridging Finance is intended to provide bridging finance to small builders who require ready cash to finance contracts until progress payments are received. The maximum amount considered per contract is R40 000 while the maximum exposure per client is R100 000.

Secondly, the General Finance Programme, Start-up Programme, Support Programme and Fisheries Financing Programme are aimed at the more advanced type of SME's.

- The General Finance Programme is aimed at the more sophisticated enterprise and business start-ups which, besides financing, require limited further support. Amounts do not normally exceed R100 000 and are provided through term loans, equity and asset based finance.

- Small Business Start-up Finance is intended for entrepreneurs starting a small business for the first time or expanding into a new product or service and who require more support and more lenient loan conditions. Job creation, import replacement and export potential are the primary criteria in granting loans under this fund.

- Small Business Support Finance is intended for entrepreneurs whose continued existence is jeopardised by external circumstances beyond their control and who require a high level of support. Amounts up to R1 000 000 are considered.

- Fisheries Development Finance is intended to provide finance to bona-fide commercial fishermen for whom fishing is the only source of income, as well as allied industries.

- The Bank Indemnity Scheme mobilises the resources of formal financial institutions for the benefit of SME development. The scheme underwrites up to 70 per cent of the risk to which a participating institution exposes itself when advancing credit to a qualifying enterprise.

2.1.9 FORMER HOMELAND DEVELOPMENT CORPORATIONS

Former homeland development corporations have over the years been involved in the financing and support of SMME development. They are all offering finance more or less on the same basis as the SBDC programmes.

While government firmly believes that the primary source of finance and related financial services for the small enterprise sector should be the established and newly evolving banking and financial-services sector, and that tax payers' funds cannot be used to fill any major gap in the supply of funds required by the small business sector, some assistance seems necessary to fill certain of the funding gaps that still exist (White Paper on Small Business. 1995:30)

Support is envisaged along the following lines, with details still to be worked out in consultation with local institutions and foreign technical advisors:

- initial start-up equity and overhead cost of these specialised agencies has to come from local or foreign donors or through a government (marketing) grant

- concessionary (lower-interest) loan capital for on-lending has to be provided by local or international wholesale financing agencies (like the Development Bank of Southern Africa or an evolving small enterprise finance trust)

- commercial funding to supplement the other two courses, but at market related interest rates

- ongoing subsidisation or matching grant finance for aftercare and other support services necessary to safeguard the portfolios and fulfil a development role.

3. THE LENDING CRITERIA APPLIED BY FINANCIAL INSTITUTIONS AND THE IMPORTANCE OF COLLATERAL AND SECURITY TO THESE INSTITUTIONS

According to the previous paragraphs there is an abundance of money available to SMME development. Why do we then still insist that the access to finance is the major barrier to emerging entrepreneurs? The reason is simple: the major financiers - banks and development agencies require some form of security from the potential borrower. The prospective business persons, the majority of whom have come out of a political wilderness, have not been part of the political environment which facilitated property ownership and asset formation. (Hendrikse. 1994:4)

It's a classic chicken and egg case: One needs personal assets in order to provide the security to obtain finance to give one the resource to start and run a business to give one a profit to create wealth in the form of business and personal assets.

In most cases financial institutions also insist on a substantial own contribution. Mr Godfrey Skwatsha who managed to raise a R10 000 loan from the SBDC says "I got the loan because I had my own money. It was not difficult to get the loan once I pledged my savings as surety" (Jaffer. 1995:86)

The majority of independent businesses need outside finance at some time. When that time comes all have to content with bankers' demands that have the same entirely reasonable aim - to minimise risk to their institutions. The criteria they all look at are the quality of the person to whom they will be lending, the viability of the business to repay the amount in question and the kind of security on offer.

What follows is a summary of the lending criteria applied by the financial institutions earlier discussed.

3.1 NEDENTERPRISE

Neville Edwards, Nedenterprise's general manager, says one of the major problems facing previously disadvantaged entrepreneurs is that they are unable to provide collateral or security and some own contribution (Smith 19951:66).

For both the venture capital and franchise funds certain criteria will be applied. For example, the entrepreneur must invest at least 15% of the total capital required; must have a controlling interest in the franchise outlet; and it must be a legal entity - a company or joint venture.

As for would-be franchisees among the traits they need are entrepreneurial flair, passion for their business, a willingness to take risks and constant commitment. (Witthaus 1995a:19) They are looking for a willingness on the part of the entrepreneur to invest significantly in the business.

Like any other merchant bank they look carefully at a potential client before getting involved with him. He has to have an undying ambition to be his own boss. He must believe in a concept that will create wealth for him. And flowing from that, he must have the will to work exceptionally hard. They expect the borrower to put in somewhere between 15% and 30% of capital from his own resources. They also try to secure as much of the remainder as possible.

3.2 FIRST NATIONAL BANK

"We are not in favour of excessive guidelines for loan applications" says Edgar Blomeyer, assistant general manager Bank Marketing Division of First National Bank. "We do not want to put the entrepreneur in a straight jacket. We want him to think laterally. Our demands are simple. The business must be viable, the owner must be skilled in his field, he must make a contribution towards the business and he must offer some collateral so that he too will have something to lose if it fails." (Rogers. 1995:59)

3.3 STANDARD BANK SMALL BUSINESS DEVELOPMENT AND ADVISORY DEPARTMENT

Standard Bank's attitude is that the onus is on the borrower to make the banker feel comfortable. The only way to make a banker feel comfortable is to minimise his risk. Almost without exception, everywhere in the world, banks require either some form of collateral and financial contribution by the borrower or both. Only by putting his own money or possessions on the line is he going to give the project everything he can to make it succeed. (Rogers. 1995:58)

Management skills and the viability of the business are not negotiable. A deal that offers even 100% collateral will be declined if these are not in place.

3.4 COMMUNITY BANK

Where others require collateral, the Community Bank creates its own. Their average client would not warrant serious consideration by one of the more formal institutions.

It is a pre-requisite that the borrower first puts in savings. No one who has not saved for six months and bought at least one R20 share in the bank can qualify to borrow money.

If a person has been saving R100 a month they know that person is able to repay that amount. His ability to conduct the enterprise for which the money is being borrowed is also a fundamental factor.

3.5 FUTURE BANK

Future Bank has a very strict screening process when qualifying applications for financial assistance. Less emphasis is placed on the provision of collateral or security. Not in any of their loans does every penny have to be secured. They assess the unsecured part by relating it to the viability of the business. (Rogers. 1995:58)

The computer is Future Bank's first line of approval, resulting in consistent standards. Their computer programme limits the risks involved in any transaction. It forecasts a range of scenarios, giving the operator a band of possible cash flows and the effect each will have on the business. In their determination to reach the small businessman they have structured their collateral demands to suit him as well. Vehicles and equipment bought with the money can be used as security.

Future Bank feels strongly about the fact that the necessary skills have been acquired by the prospective borrower. If necessary the applicant must have access to suitable mentoring and they must be convinced that a real market opportunity exists. (Rogers. 1995:58)

3.6 AFRICAN BANK

When approving a loan African Bank will look at a total package that includes factors like the nature of the business, its management, the suppliers, the location of the business and its cash flow in relation to the location. From this total view of business and owner they will establish the applicant's ability to repay the loan.

Collateral functions along true African lines. While they will accept a building or other assets as security they will also look at guarantees from partners or where it is a family business, from other family members. In such a case pressure within the group will usually persuade the borrower to honour his debt. (Rogers. 1995:57)

Like other formal banks they look for a contribution from the borrower of between 20% and 30%.

3.7 GET AHEAD FOUNDATION

"When someone first comes to us for a loan he usually gets it under our stokvels loan scheme" says managing director Don McRobert. "To qualify he must find others who need loans. They will form a group that will be mutually responsible for each other's loans. It is essential that they should be able to trust each other." (Rogers. 1995:56) More than just a circle of friends is needed though. If a person goes to them needing a loan for, say, his welding business they prefer him to have started it by himself. They like to see a commitment to the business before a loan is granted.

3.8 THE SMALL BUSINESS DEVELOPMENT CORPORATION (SBDC)

The following information was supplied by the SBDC in terms of loan conditions and security requirements:

3.8.1 GENERAL FINANCE PROGRAMME

- Profitability should be good.
- Management should not require assistance.
- Own contribution should preferably not be less than 30%.
- Cash flow should be positive from the start.
- Security covers should not be less than 75%.

- Development contribution would probably be in the areas of technology, import replacement and export whilst the cost per job created or maintained should be moderate.

3.8.2 SMALL BUSINESS SUPPORT FUND

- Profitability may be negative but must become positive within three years.
- Short term financing difficulties must be attributable to unusual circumstances in the national or regional economy, and not bad management.
- Own contribution could be nil.
- Security cover could only consist of a personal suretyship.
- In exceptional circumstances the loan may be utilised to prevent the liquidation of the business by its creditors provided that they all agree to it.
- Replacement finance to ensure the survival of the business and the retention of a large number of jobs will be considered on merit.
- The business must be economically viable and competitive in the long term.
- Confirmation that the loan will cause the retention of existing employees and continuous provision of employment.

3.8.3 SMALL BUSINESS START-UP FINANCE

- Profitability must be good
- Management is probably technically competent but requires assistance in the fields of financial, marketing and general management.
- Own contribution should preferably not be less than 20%.
- Cash flow must be positive after loan is taken into consideration.
- Security cover should preferably not be less than 75%.

3.8.4 MINI LOAN PROGRAMME

The Mini-loan Programme provides for the needs of micro-enterprises who usually need money urgently for a fairly short term.

- Maximum amount of loan is R6000,00.
- The repayment period usually does not exceed 12 months.
- The applicant must be actively involved in the business, either on a full time or part time basis.
- The applicant must be contactable, i.e a fixed residential address.

3.9 FORMER HOMELAND DEVELOPMENT CORPORATIONS

These institutions also normally require substantial security and an own contribution as conditions for the provision of loan financing.

4. THE FINANCING OF SHARES TO EMPLOYEES AS A METHOD OF FUNDING THE ESTABLISHMENT OR EXPANSION OF A BUSINESS VENTURE

The government through the White Paper on Small Business, (1995:17) encourages the expansion of ownership participation of formerly disempowered people. There is an increasing awareness of the need for black empowerment in the economy of the country. We are experiencing the emergence of black power groups and company take-overs by these groups at the moment. What we do not see however is workers share-participation in small business. All this is happening on corporate level.

Neither the government nor the banking sector has any plan or strategy in place which makes provision for the promotion of employee share-ownership in small companies.

4.1 LOANS TO EMPLOYEE STOCK OWNERSHIP PLANS

Employee Stock Ownership Plans (ESOP's) are found in nearly every industry in America. The vast majority of ESOP's in place are maintained by non-public companies. ESOP's have become a powerful tool in reshaping corporate ownership throughout America. (Mcleod. 1994: 485)

Loans are extended to these ESOP's and there are many tax advantages to an ESOP loan. A company sponsoring an ESOP can (within certain limits) deduct amounts contributed to the plan to repay a loan to the ESOP. Thus, loan repayments consisting off both principle and interest can be deducted.
Mcleod (1994:485-498) focuses in detail on Employee Stock Ownership Plans (ESOP's) and the following resembles a summary of the main features of these plans.

4.1.1 ESOP LOAN TAX LAW REQUIREMENTS

An ESOP loan must meet certain technical requirements under the code. The following describe these requirements:

- ENABLING LANGUAGE

  In order to borrow money, an ESOP must be formally designated as an ESOP in the plan document. The plan must also state that it is designed to invest primarily in employer securities and the plan document itself must permit the plan's trustees to borrow money to purchase employer securities.

- USE OF LOAN PROCEEDS

  The ESOP must use the proceeds of the loan within a reasonable time after receipt only for purposes of acquiring company sponsor stock (shares) or repaying a previous loan.

- LOAN TERMS

  The loan to the ESOP must be for a specific term and may not be payable upon demand, except in the case of default. An ESOP loan must also be without recourse against the ESOP. In particular, the only classes of assets of the ESOP that may be given as collateral for the loan are those acquired with the proceeds of the loan and those used as collateral on a prior loan that is repaid with the proceeds of the current loan. Thus the ESOP itself may not pledge as collateral anything other than the employer securities (shares) acquired with the proceeds of the loan. The lender may require additional guarantees and collateral from other parties.

- RELEASE FROM ENCUMBRANCE

  An ESOP lender usually requires that the company sponsor stock acquired with the proceeds of an ESOP loan be pledged as collateral for such loan. The code requires that the company sponsor stock held as collateral must be released as the loan is repaid.

- PAYMENTS ON ESOP LOAN

  There are limits on the sources of ESOP loan repayment. Payments made by the ESOP on a loan during a plan year must not exceed company sponsor contributions made to the ESOP to repay the loan. The sale of existing plan assets in a preconceived, periodic manner to provide loan repayment funding is not permissible.

4.1.2 STRUCTURING AN ESOP LOAN

In general, ESOP loans may be secured or unsecured and may involve a direct loan to the ESOP or what is known as "back-to-back" loans.

- SECURED VERSUS UNSECURED

  A traditional secured ESOP loan generally involves a minimal number of parties with the ESOP pledging as collateral the shares of company sponsor stock it acquired with the proceeds of the loan. In addition, certain other parties (e.g the company and/or company management) might be required to guarantee the repayment of the loan.

  Unsecured ESOP lending is a much more complex transaction and is rarely found in circumstances other than a leverage buyout of a company.

- DIRECT VERSUS BACK-TO-BACK LOANS

ESOP financing may be structured as a direct loan to the ESOP itself. alternatively, ESOP financing may be structured through a back-to-back loan technique, whereby the lender first loans proceeds to the company sponsoring the ESOP, with the company sponsor subsequently "reloaning" such funds to the ESOP itself.

4.1.3 SPECIFIC ESOP LOAN ISSUES

A number of issues will arise impacting the company sponsor stock to be acquired with the ESOP loan and the ability of the ESOP borrower to repay the loan.

- STOCK ACQUISITION PRICE

Unless the ESOP loan is made to an ESOP sponsored by a company with publicly traded securities, an appraisal of the company sponsor's stock must generally be obtained prior to the closing of the loan.

- LOAN INTEREST RATE

The interest rate charged on the ESOP loan will generally be commensurate with the degree of risk associated with such loan.

- INTEREST INCOME EXCLUSION

The interest rate charged by the lender is typically a function of a variety of factors, including the risk to the lender, collateral pledged and any additional guarantees on the loan. A bank may exclude from income 50 per cent of the interest it receives on a loan made to an ESOP provided the ESOP owns more than 50 percent of the company's shares prior to or after the loan transaction. In addition participants in the ESOP must be granted full voting rights on the stock purchased with the proceeds of the loan. The term of the loan cannot exceed fifteen years.

- SOURCE OF LOAN REPAYMENT

Invariably, the source of ESOP loan repayment will be company sponsor contributions to the plan. Dividends paid on company sponsor stock acquired with the ESOP loan may be used to repay the loan. In fact, the company sponsor is entitled to a tax deduction if dividends are used in such a manner. Note, though, that if a dividend paid on a stock which had been allocated to a participant's account is used to make a loan payment, additional company stock with a value equal to the dividend must be allocated to the participant's account.

- EMPLOYER CONTRIBUTION LIMITS

  Because the source of ESOP loan repayments will consist of company sponsor contributions to the plan, both the ESOP lender and company sponsor must be aware of the limitations on such contributions. The maximum tax deductible contribution that a company is allowed for a contribution to a leveraged ESOP is limited to 25 percent of the payroll. However, provided not more than one-third of employer contributions during the year are allocated to highly compensated participants.

4.1.4 CONCLUSION

In many respects, ESOP financing resembles conventional financing. Company cash flow and a sound company business plan become crucial in an analysis of the potential risk associated with such loan. (Mcleod. 1994:498)

5. SUMMARY

It can be summarised that finance to small business in South Africa is readily available provided the loan conditions set by financial institutions are met. These loan conditions and other criteria eliminate the formerly disadvantaged and rural communities to a very large extent as it is a fact that these people just do not have the means to comply to it. Only in the micro-lending field is access to credit easier for the prospective borrower.

There are no known structured employee company share participation schemes in operation amongst the major role players in the SMME financing arena.

This literature study managed to identify an existing scheme in America which caters for workers share-ownership and the financing of these shares by lending institutions. Some of the principles of the American plan will become very valuable in the development of a workers share participation model suitable to local conditions.

CHAPTER 3

DEVELOPMENT OF AN EMPLOYEE SHARE PARTICIPATION FINANCE PLAN

1 INTRODUCTION

Economic empowerment of disadvantaged communities will not take place overnight and it is therefore necessary to develop instruments to accelerate the process. The transformation of the small enterprise sector requires and justifies concerted policies of wider scope as well as the deliberate creation of an enabling environment.

There needs to be a shift in lending criteria from security and collateral as the number one consideration by banks and other financial institutions.

This chapter introduces a scheme which will enable disadvantaged communities to gain access to financial resources for the establishment of new small business ventures. Job creation, the advancement of skills and wealth generation are seen as key elements of this finance plan. For the large numbers of previously disadvantaged people who have the potential to contribute to these goals by starting their own business, access to capital is usually the biggest hurdle in the path of success as we have seen in the previous chapter.

The main objective is that the application of the proposed finance plan should contribute significantly to the economic advancement and empowerment of previously disadvantaged groups and to economic growth in South Africa in general.

2 AN EMPLOYEE SHARE PARTICIPATION FINANCE PLAN

2.1 PURPOSE OF THE PLAN

The purpose of the plan is to help previously disadvantaged business people and entrepreneurs to own their own businesses and also to help the employees of these businesses to obtain a stake and in this way contributing to the creation of jobs and the generation of wealth. It will further assist such people to obtain the necessary technical and management skills.

2.2 WORKING OF THE PLAN

The plan regards equity financing as a means of financing the start-up, expansion or purchase of a business whereby the equity financier gets an agreed portion of the share capital in return for providing the required funding. This is commonly known as venture capital funding. A bank or other financial institution will provide the equity financing.

The same bank or financial institution will then as part of the plan also provide loan financing to an Employee Share Participation Trust (ESPT). The purpose of this loan financing will be for the ESPT to purchase shares in an operating or holding company.

The plan can be seen as a combination of venture capital funding, as practised by Nedenterprise, and Employee Stock Ownership Plans (ESOP's) as practised in America and as discussed in Chapter 2.

This is not the normal run of the mill type of financing as we know it. This plan is more people-orientated and the emphasis of selection will be on entrepreneurship, commitment, dedication, drive and less on previous formal training, experience, skills and the capacity to make a material financial contribution.

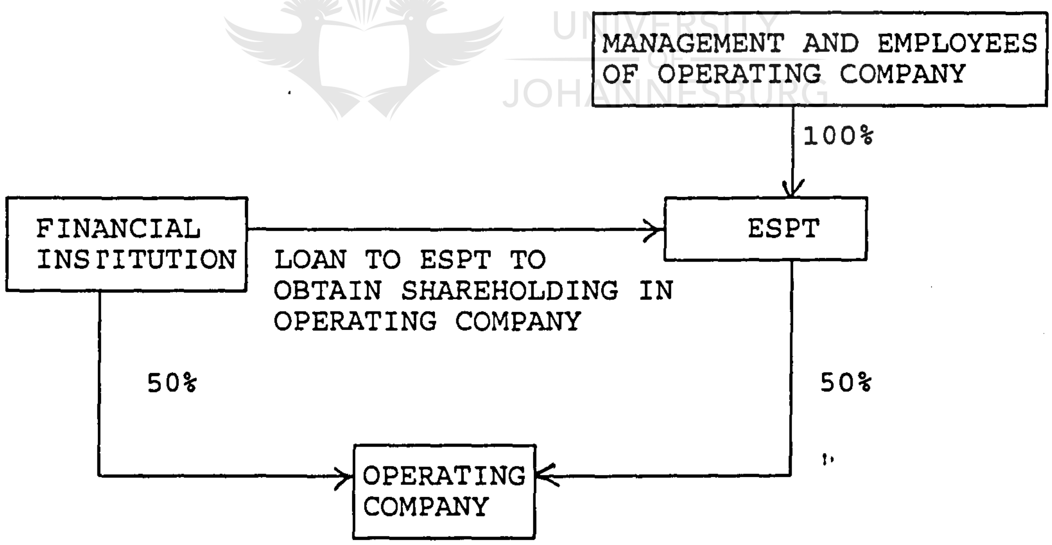
Banks and other financial institutions should become involved in this scheme as part of their normal day to day activities. The participation of banks should be an integral part of the plan and there should be great incentives to them to encourage their involvement.

The beneficiaries of the ESPT will be the new entrepreneurs and employees of the operating company.

The proposed structure can be illustrated as per figure 3-1:

FIGURE 3-1

PROPOSED STRUCTURE OF AN EMPLOYEE SHARE PARTICIPATION SCHEME WHERE THE FINANCIAL INSTITUTION AND THE ESPT ARE THE ONLY SHAREHOLDERS



2.3 CONDITIONS OF AN ESPT LOAN

It is necessary to determine standard conditions for the granting of ESPT loans because it would ensure that no interest group is overpowered by another. The following conditions are proposed:

- the ESPT must pledge the shares obtained in the operating company through the loan as collateral;
- the loan to the ESPT must be for a specific term and may not be payable upon demand;
- the ESPT should hold not less than 50 percent of the shares in the operating company;
- the management and highly paid employees of the operating company should not acquire more than one-third participation in the ESPT because it will ensure an even spread of shareholding amongst all the employees of the operating company;
- the ESPT loan may only be paid back from contributions received from the operating company;
- the interest rate charged on the ESPT loan will generally be commensurate with the degree of risk associated with such loan;
- the operating company and/or company management might generally be required to guarantee the repayment of the loan;

- the financial institution should provide ongoing mentorship and aftercare; and
- the new venture should be a viable proposition to invest in.

2.4 VIABILITY OF THE PROPOSED BUSINESS VENTURE

At the heart of any application for finance for start -ups is the viability study or business plan, where the major considerations are the marketing plan and the financial plan.

The viability study is to first convince the entrepreneurs that there is a fair prospect of the business succeeding on an on-going basis. In the second instance, it is there to convince the financiers that the return on their money is greater than the risk of failure.

The financial plan will address the following considerations:

- What is the operating company going to use the funds obtained from the bank and the ESPT for?

  - Long-term needs: fixed assets (equipment, vehicles, furniture)

  - Short-term needs: financing of stock and monthly overheads.

- How will the operating company be able to provide sufficient contributions to the ESPT to service the loan?

This requires a detailed cash flow forecast identifying monthly inflows and outflows that take into account regular and periodic funds that flow in and out of the bank account.

- Identify the profitability of the business. This important exercise involves a sales forecast, an operating budget and the calculation of the return on investment and the break-even turnover.

2.5 MENTORSHIP AND TRANSFER OF SKILLS

A mentoring and training programme should form an underlying aspect of the new finance plan. This mentoring plan should address key aspects such as management, production, financial management and marketing. The financial institution must monitor all projects in which it has invested and help the management to run the business and produce financial accounts. To ensure success, small businesses need support and aftercare.

The biggest need for our economy to prosper is training and mentoring in business skills. It is therefore of paramount importance that each ESPT borrower needs to be assigned to a mentor or business consultant who assists in the implementation of the venture, with special emphasis on cash flow management, bookkeeping and the preparation of annual financial statements. The extent of the involvement will be based on both the size of the venture and the loan.

2.6 TRUSTEES OF THE EMPLOYEE SHARE PARTICIPATION TRUST (ESPT)

In order to gather a nucleus of business knowledge, the trustees of the ESPT could comprise of the following:

- one person with a direct interest in the operating company. It should preferably be the managing director;

- one person with a legal background. Preferably someone with no interest in the financial institution involved;

- one person from the business community with no direct interest in the operating company; and

- one person from the participating lending institution.

2.7 TAXATION AND A SMALL BUSINESS FINANCE ACT

A new act, or the addition of relevant clauses to existing legislation, could address a number of fundamental issues regarding the access to finance by SMME's. This could include steps to encourage existing financial institutions to become more active in the SMME-market segments, the facilitation of deposit-taking by lender NGO's, the recognition of certain non-conventional collateral types and the widening of scope for more specialised lending and investment institutions focusing primarily on SMME needs (White paper on Small Business. February 1995:25).

This ESPT loan scheme should be made attractive to lending institutions by introducing the following legislation:

- no tax payable on interest received on ESPT loans; and

- no tax payable on dividends earned on shares in the operating company.

The operating company participating in the ESPT loan scheme should also enjoy tax benefits by introducing the following:

- The full amount of the contributions to the ESPT to repay the loan to the lending institution should be tax deductible. This will include the interest as well as the principle portion of the repayment; and

- If dividends are used to repay the ESPT loan; that those dividends not be taxable.

2.8 PHASING OUT OF SHARES HELD BY THE FINANCIAL INSTITUTION

Once the loan to the ESPT has been fully redeemed the lending institution should phase out its share holding by advancing further loans to the ESPT to acquire those shares. The objective should be that the ESPT eventually holds 100 percent of the shares in the operating company.

2.9 GOVERNMENT CREDIT GUARANTEES

A further dimension could be added to the plan in order to minimise the risk of the lending institution.

The government should establish a credit guarantee scheme particularly for this type of high risk lending to encourage banks even further to participate.

The scheme can underwrite up to a certain realistic percentage of the risk to which a participating institution exposes itself when advancing credit to a qualifying ESPT.

By providing partial cover of financial risk, careful management of the exposure and regular actuarial valuation of the risk portfolio covered, the scheme should be able to carry an exposure in excess of the cash resources in its underwriting fund.

2.10 THE QUALIFICATION OF WORKERS TO BECOME PARTICIPANTS IN THE ESPT

This is a matter which should be decided upon by the groups of people involved in the establishment of the operating company who can be regarded as the founding entrepreneurs. Certain principles should be decided upon beforehand such as the following:

- proportionate participation, could for instance, be awarded in accordance with seniority. The reason for this is to ensure an even spread of shareholding. The initial entrepreneurs or founders of the company will for instance obtain 10 000 shares in the ESPT at R1,00 per share whilst a labourer will only qualify for 1000 shares; and

- to ensure a fair distribution of shares it is recommended that management and high salary employees should not own more than one third of the shareholding or participation. This will ensure economic empowerment for all the beneficiaries and not just for a privileged few.

2.11 EXPECTED BENEFITS OF SHARE PARTICIPATION BY THE EMPLOYEES

The following assumptions are made with respect to the expected benefits that could derive form the proposed finance plan:

- turning employees into shareholders will make them work harder and smarter and so boost the company's productivity and profits to the benefit of all its shareholders (Anon., 1989:14);
- there is no evidence available to prove or disprove the link between productivity and shareholding or profit sharing. The commonsensical assumption is that a company will rarely get less and will usually get more out of a worker (and a manager) under profit-sharing than under an inflexible reward system (Anon., 1989:15);
- the average owner manager performs better than the average employee manager. Ultimately, nothing should work better than people having a stake in the company (Anon., 1989:15); and
- workers will benefit in more pay, larger dividends and a higher share price.

3 JOINT VENTURES AS A FURTHER DIMENSION TO THE EMPLOYEE SHARE PARTICIPATION FINANCE PLAN

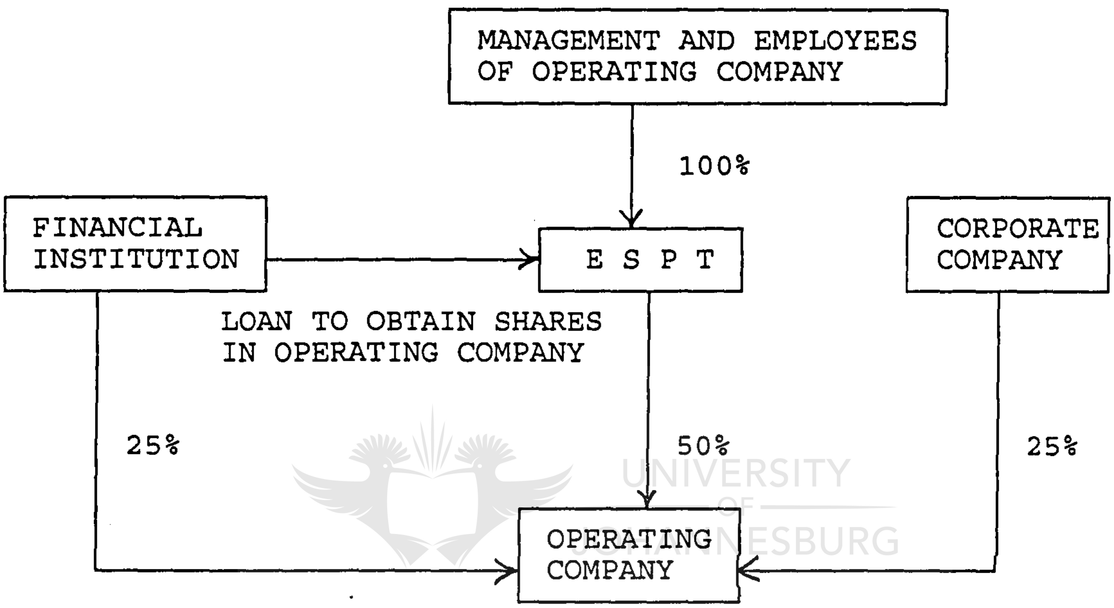
Shareholding of corporate companies could be attracted to form proper joint ventures which will allow experienced entrepreneurs to share their knowledge and expertise with less experienced partners.

The corporate company must have no say over the ESPT.

The proposed structure can be illustrated as per figure 3-2:

FIGURE 3-2

PROPOSED STRUCTURE OF AN EMPLOYEE SHARE PARTICIPATION SCHEME WHERE A JOINT VENTURE IS FORMED WITH AN ESTABLISHED CORPORATE COMPANY



The joining corporate company should also qualify for tax incentives such as tax free dividends or incentives on experienced staff seconded to the employee share participation scheme.

Large companies can include such joint ventures in their social responsibility programmes and they can also use these ventures for sub-contracting purposes.

The objective will also be to reduce their shareholding by selling it off to the ESPT.

4 HOUSING FINANCE DIMENSION TO THE EMPLOYEE SHARE PARTICIPATION FINANCE PLAN

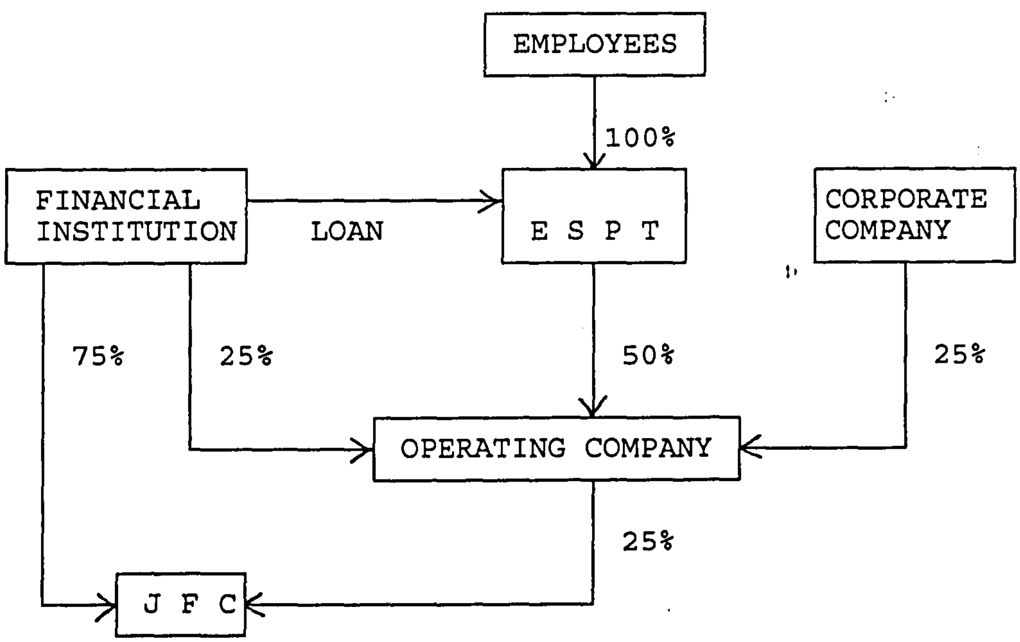
Further wealth apart from the shareholding can be created by the addition of a house financing scheme. With the housing finance plan incorporated in the plan, surplus funds will be channelled to a Joint Finance Company (JFC) between the lending institution and the operating company.

The purpose of the JFC will be to grant housing loans to the workers of the company. Where the workers qualify for the R12 500 government subsidy for a house then the JFC can issue interest bearing debentures to the workers for say five years in return for a 100% housing loan.

The proposed structure can now be illustrated as per figure 3-3

FIGURE 3-3

EMPLOYEE SHARE PARTICIPATION SCHEME INCORPORATING A JOINT FINANCE COMPANY



The joint finance company (JFC) can in practice operate as follows:

Assume that the operating company has surplus moneys available from its cash flow to the amount of R40 000 after one year's trading and there are six workers who wish to become house owners. It is assumed furthermore that these workers qualify for a R12 500 government subsidy. Should the lending institution be prepared to provide 75 percent of the funding of the JFC the picture will be as follows:

Surplus funds from operating company	R 40 000
Debentures issued to employees	R 75 000
25% of total funding available	R115 000
75% of funding provided by bank	R345 000
Total funds available in JFC	R460 000

The six workers can now obtain 100% housing loans from the JFC and after five years they will have the option to cash in their debentures or to swop it for shares in the JFC in which instance the operating company will dispose of its shares in relation to the value of the debentures at that stage.

The housing loan scheme within the operating company should be tax-friendly and the surplus funds contributed towards the JFC should be regarded as a normal expense for the company.

5 CONTRAVENTION OF COMPANIES ACT

The proposed plan will be a contravention of article 38 of the Companies Act 61 of 1973. Article thirty eight's heading reads as follows:

No financial assistance to purchase shares of company or holding company.

The act further states that no company shall give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person or for any shares of the company, or where the company is a subsidiary company, of its holding company.

Article 38 of the Companies Act will have to be amended to make provision for ESPT loan schemes which in its proposed format does not comply with the act.

6 SUMMARY

The whole ESPT loan scheme with all its components can be illustrated as per figure 3-4.

With the combined effort of large companies and the banks, ESPT loan schemes can fulfil the vital function of opening doors to small enterprises and thus be harnessed to the needs of the South African economy as it enters this new period of growth. The ultimate goal would be the empowering and enriching of the community at large, in turn, the country as a whole.

The emphasis in selection must be more on entrepreneurship, ownership commitment, dedication, drive and less on previous formal training, experience, skills and the capacity to make a material or financial contribution.

Nobody has a model of what black economic empowerment should be but we do know that black people must be assisted to get into the mainstream economy. The banks can tackle the obstacles which face black entrepreneurs and business groups namely lack of capital and expertise by participating in the proposed employee share participation scheme.

While black communities have the ability and desire to succeed, historical forces have denied them access to resources and therefore banks have a pivotal role to play in furthering black economic empowerment.

This type of share participation scheme will be to the benefit of the community as a whole in the sense that it will improve the standard of living of all participants and not only one or two people as it used to be.

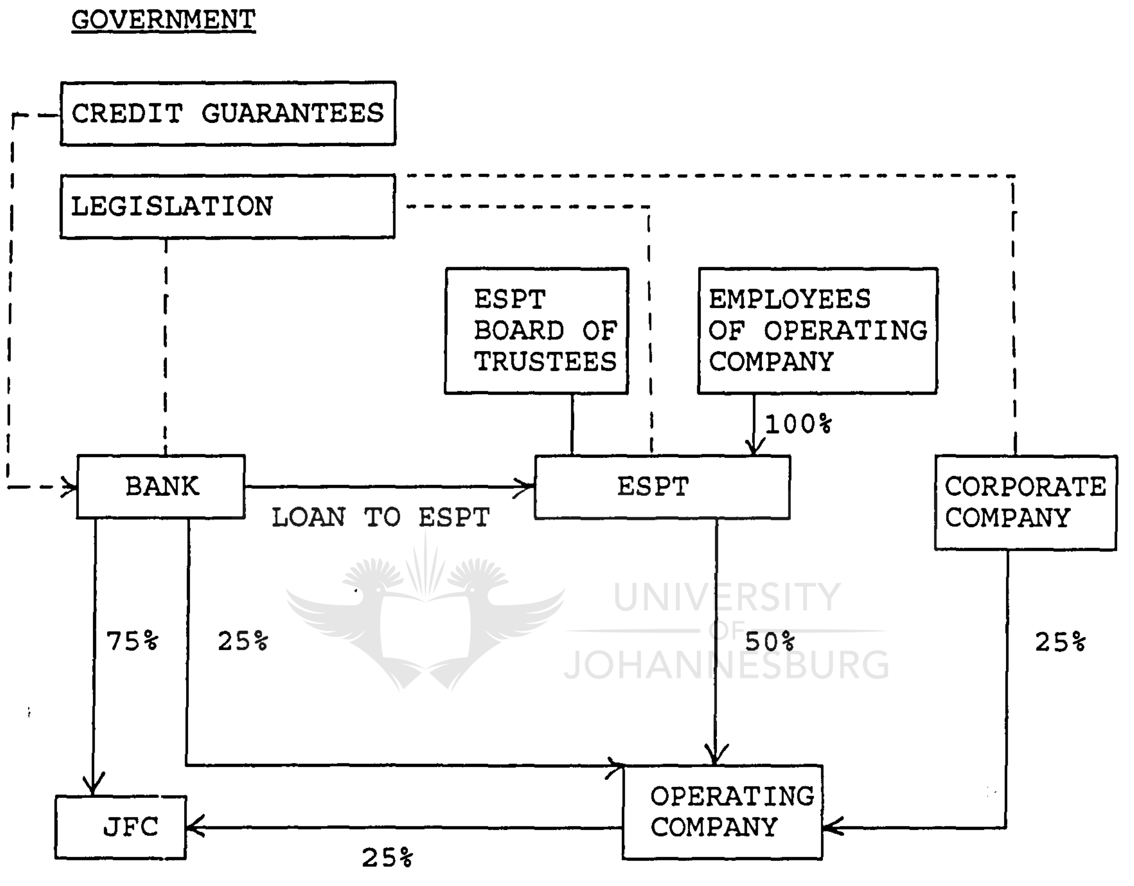
Employees will be motivated as this profit-sharing scheme will represent a genuine attempt to make managers and workers share the same goals.

An integrated and sustainable programme can be introduced into the community and it will be a people driven process where the people driving the process will reap the benefits.

By empowering the people they can be assured that the project will support development, reconstruction and profitability and it will also support democratisation in the workplace irrespective of the co-owners, race or sex.

FIGURE 3-4

EMPLOYEE SHARE PARTICIPATION LOAN SCHEME



CHAPTER 4

TESTING OF THE ACCEPTABILITY OF THE ESPT LOAN FINANCING SCHEME AMONGST SOME OF THE MAJOR ROLE PLAYERS IN THE SMME ARENA

1 INTRODUCTION

In the previous chapter an employee share participation finance plan with possible variations was developed. In this chapter the ESPT loan scheme is being exposed to the opinions, criticism and views of some of the major role players in the small business finance and development field.

2 METHODOLOGY

Fifteen organisations including the Department of Trade and Industry (DTI), attorneys and chartered accountants were selected to participate in the answering of a questionnaire. This selection aimed to include the major interest groups in SMME development such as banks, development corporations, NGO's, government, attorneys and chartered accountants. The questionnaire was accompanied by chapter 3 of this study where the proposed ESPT loan scheme is explained. The questionnaire is attached to this study as Annexure 1 and categorises a number of questions related to the loan scheme in socio-economic, economic, financial and political related questions. The selected participants were telephonically briefed about the questionnaire prior to sending it to them to respond. The DTI and Standard Bank refused telelphonically to participate.

The following participants agreed to take part in the studying of the plan and the completion of the questionnaire:

- Kwazulu Finance and Investment Corporation Limited;
- Small Business Development Corporation Limited;
- North West Development Corporation Limited;

- KwaNdebele National Development Corporation;
- Northern Transvaal Development Corporation Limited;
- Get Ahead Foundation;
- Strive Foundation;
- Nedenterprise;
- African Bank Limited;
- First National Bank Limited;
- Grobler Levin and Soonius attorneys; and
- Roodman & Nel Chartered Accountants.

All the above responded to the questionnaire. Three managers from North West Development Corporation responded. In total fourteen questionnaires were received back.

3 RESPONSE TO DIRECT QUESTIONS IN QUESTIONNAIRE

In general the ESPT loan scheme was received favourably by the respondents. The responses received are summarised in Annexure 2 attached to this study.

3.1 SOCIO ECONOMIC QUESTIONS

Ninety-three percent of the respondents are of the opinion that the plan will empower disadvantaged communities, that there will be an advancement of skills and that the community will accept the plan.

Only sixty-four percent believe that organised labour organisations would be in favour of the plan. Twenty-one percent of the respondents feel that employees would not understand the plan and fifty percent think that employees would not accept that shares be distributed in accordance with seniority.

Forty-three percent are of the opinion that it is not possible for workers and managers to share the same goals.

The majority of the respondents (93%) are confident that participants will not be seen as sellouts by the community.

3.2 ECONOMIC QUESTIONS

An equal positive response was received to the economic related questions in the questionnaire. Ninety-three percent of the respondents believe that the ESPT plan would create an enabling environment for entrepreneurs.

Fifty-seven percent are of the opinion that banks will be willing to shift their lending criteria to accommodate the plan whilst eighty-six percent believe that the proposed tax incentives would encourage banks to participate in the plan.

Ninety-three percent feel that the proposed tax incentives would encourage corporate businesses to participate.

The majority of the respondents think that the plan would be feasible. From a bank's point of view 64%, from the government's point of view 86%, from the would-be-owners point of view 93% and 93% from the community's point of view.

The majority also feels that the scheme would be economically viable. From a bank's point of view 79% and from the operating company, the employees (ESPT) and the joining corporate company's point of view 93%.

Twenty-one percent of the respondents feel that the plan will not be sustainable but ninety-three percent think that small business development will be enhanced.

Hundred percent of the respondents are sure that the plan will contribute to economic development in general. Thirty-six percent expect negative reaction from the formal business sector and thirty-six percent expect negative reaction from the informal business sector.

3.3 FINANCIAL QUESTIONS

All the respondents believe that financial institutions will have the funds required to implement the plan and they believe that government credit guarantees will make the plan more acceptable to banks.

Seventy-nine percent feel that financial institutions would have the necessary human resources to handle the loan applications but only seven percent (one respondent) believes that financial institutions would have the human resources to handle the aftercare and mentoring portion of the plan.

Hundred percent believe that employees would benefit financially by the plan. Only seventy-one percent of the respondents think that the housing finance part of the scheme is feasible. Eighty-six percent believe that the plan will make credit more accessible to small business.

3.4 POLITICAL QUESTIONS

Only seven percent of the respondents (one person) is of the opinion that government would not be in favour of the plan and thirty-six percent believe that the plan can be misused for political gain.

4 SPECIFIC RESPONSE TO THE QUESTIONNAIRE

The respondents did not hesitate to make specific comments with regards to the ESPT loan scheme. The following summarises some of the comments:

4.1 ORGANISED LABOUR

According to Don Gxoyiya (1995) organised labour would accept the plan provided acceptable shareholding is discussed with them. Organised labour will be sceptical at first but there will be eventual adaptation (Soonius, 1995). "The proposal will basically eliminate the need for union representation" (Brown, 1995).

4.2 EMPLOYEES ACCEPTANCE AND UNDERSTANDING OF THE PLAN

Employees will understand the plan only if explained to them through organised labour and NGO's. Shareholding must be discussed thoroughly with employees (Gxoyiya, 1995). Employees would only understand the plan after an extensive introduction (Soonius, 1995).

Brown (1995) says that employee education would be required with regards to the concept.

4.3 SHARING OF THE SAME GOALS BY WORKERS AND MANAGERS

Soonius (1995) believes that workers and managers would only share the same goals to a certain extent whilst Brown (1995) feels that it is very unlikely in view of the current trend of strikes and mass action.

4.4 HIGH RISK FOR BANKS

The banks will not be interested in the plan because their exposure will be hundred percent (Tati, 1995). Banks would be discouraged by the high risk factor involved in this market. It will be difficult for them to be sure about factors like commitment and dedication without referring to track record (Gxoyiya, 1995). Sekokotoana (1995) is of the opinion that banks would definitely entertain government guarantees to minimise the risk factor.

"In view of the lower risk involved lower interest rates may be negotiated especially when a government guarantee could be obtained" (Nell, 1995). Soonius (1995) also feels that the scheme is a high risk scheme from a bank's point of view and that it will only be sustainable if well implemented and controlled. There will be slow progress at first from banks willing to shift their lending criteria but they will gradually increase their involvement.

4.5 MENTORING AND AFTERCARE BY FINANCIAL INSTITUTIONS

The scheme will be costly for banks as they will have to provide mentoring and training which are very expensive. The trend is that financial institutions should not also have to provide mentoring and training. This must be done by separate NGO's (Booyens, 1995). Mentoring will bring extra cost to the financial institution (Tati, 1995).

"Owing to the profit motive the South African banks are stuck to, mentoring and aftercare may have to come at a price which in some cases may defeat the goals of the scheme" (Khutsoane, 1995).

Banks do not provide aftercare and mentoring in the normal course of business (Booyens, 1995). Brown (1995) says that except for development corporations and certain NGO's he cannot see other financial institutions providing a mentoring service.

4.6 MARKETING OF THE CONCEPT

Tati (1995) believes that the plan needs careful marketing. A proper marketing effort of the idea will have to be undertaken to overcome the suspicious nature of people targeted for economic empowerment through the ESPT concept. This effort which should precede implementation of the concept will go a long way to address some of the crucial questions in the questionnaire (Khutsoane, 1995).

Only if properly explained to the community would the participants in the scheme not be seen as sellouts (Allan, 1995). The scheme needs professional lobbying by bodies like the Sunnyside Group (Tati, 1995).

4.7 THE HOUSING FINANCE PART OF THE PLAN

The current inability of the banks and government to sort out the problems around implementation of the Mortgage Indemnity Scheme (MIS) in respect to the Reconstruction and Development Programme (RDP) houses may be an indicator of the feasibility of the housing finance part of the plan (Khutsoane, 1995).

Gxoyiya (1995) says that the housing finance part of the scheme is unrealistic and based on a "maybe notion". The JFC part is a long term plan - say, after redemption of the ESPT's indebtedness (Sekokotoana, 1995).

4.8 THE TRUSTEES OF THE ESPT

Khutsoane (1995) thinks that the nomination of ESPT trustees as proposed may dampen the entrepreneurial spirit of aspirant businessmen/women. This is more so if the operating company will not be involved in community based social projects. He would rather have membership being advertised and curriculum vitaes of would-be trustees being analysed and evaluated against predetermined criteria by a panel formed along the lines of a social compact with proportional representation of initiators, community representatives, financial institution representatives and maybe government representatives.

4.9 REMARKS ON GOVERNMENT AND POLITICS

- "Proper control and involvement of non-political groups would help to neutralise politics" (Gxoyiya, 1995).

- Any plan of this nature lends itself to misuse and strict control can minimise such misuse (Soonius, 1995)

- "Whilst I believe government would be in favour of the plan I cannot see them providing the necessary tax incentives" (Brown, 1995).

- The government will be in favour of the plan because it addresses the grass root needs (Sekokotoana, 1995).

- Government will have a loss in revenue and a possible increase in expenses (claims) (Cromhout, 1995).

- The government should be in favour of the scheme as it will facilitate delivery on RDP (Khutsoane, 1995).

- Our fledgling democracy lends itself to a lot of posturing and misuse of schemes such as this one by political parties to score political points (Khutsoane, 1995).

- The acceptability of the government credit guarantees will depend on the stability of government (Soonius, 1995).

5 GENERAL COMMENTS

- Banks have very scarce resources and skills in the business of ventures capital and very few banks are involved in venture capital already. Banks do not invest in venture capital unless discussions, as with the low cost housing are encouraged (Gxoyiya, 1995).

- Sustainability of the plan will depend on the profitability of the plan (Allan, 1995).

- As regards the current tax and companies acts it is going to be a lengthy process to get the proposed changes effected (Sekokotoana, 1995).

- Banks in South Africa have proven to be very rigid in applying their lending criteria particularly to members of previous disadvantaged communities. The banks' resistance to change can be seen in the present paralysis of the MIS (RDP housing). Relatively generous incentives would need to be in place before South African banks can commit to such a scheme (Khutsoane, 1995).

- Depending on the interest rates involved this plan will have a bright future (Nell, 1995).

- Banks are diversifying in awareness for the need in developing SMME's. They are establishing development units eg ABSA and Nedenterprise (Sekokotoana, 1995).

- The plan will empower disadvantaged communities but the progress will be very slow and wealth will only gradually be generated (Soonius, 1995).

- This will be a practical RDP orientated plan to achieve capacitating, empowerment and skills transfer to benefit the disadvantaged (Sekokotoana, 1995).

- The ESPT must move towards full ownership after the loan has been paid (Tati, 1995).

- Employee participation must not weaken the entrepreneur's power and authority in any way (Tati, 1995).

- Entrepreneurs in disadvantaged communities would not be prepared to share business information with employees. The scheme might have an effect on confidentiality (Booyens, 1995).

- Any community-conscious person would want to know if prior consultation has taken place at the grass-roots level before this proposal went to the market (Alexander, 1995).

- To improve the profitability of the operating company the local structures could also be involved, in some way, in the plan (Nel, 1995).

- Employees must also guarantee the repayment of the loan and not just the management (Tati, 1995).

- Only individual employees will be empowered and not the community at large (Allan, 1995).

- "If properly implemented and managed I believe that the plan will accelerate the redistribution of wealth to disadvantaged communities far quicker than through the granting of micro loans, short term employment projects eg building of roads and infrastructure handouts, etc" (Brown, 1995).

- It sounds in general like an excellent plan (Alexander, 1995).

6 SPECIFIC CRITICISM ABOUT THE SCHEME

There has also been some direct criticism against the ESPT loan scheme as proposed in chapter 3. The following are examples:

- Alexander (1995) wanted to see a step by step working of the plan.
- It is only the real strong businesses that will benefit (Booyens, 1995).
- The document is written for the lowest level but not at their level (Alexander, 1995).
- The subsidy of R12 500 should be the deposit the government pays on behalf of the employee and debentures should not be issued for the R12 500 (Nel, 1995).
- The forming of the JFC does not create wealth (Nel, 1995).
- Dividends received are at present not taxable (Nel, 1995).
- The share of the entrepreneur in the ESPT is too small (Nel, 1995).

- Entrance and exit conditions of participants in the ESPT should have been stated (Tati, 1995).

- Large companies must not include such joint ventures in their social responsibilities programmes. To get commitment this must be out of investment funds (Tati, 1995).

- Diagram 3-3 would be easier to understand if the flow of funds was explained (Tati, 1995)).

7 RESPONSE TO CRITICISM

The following is a reply to the specific criticism voiced above:

- A step by step working of the plan could not be included in this study because specific policies and procedures will follow as a next phase after the plan has been accepted by all role players.

- The statement that only the real strong businesses will benefit does not hold water as any business could be strong irrespective of size. The issue should rather be a matter of viability.

- Although this study addresses the needs of the historically disadvantaged it was not the objective of the study to make it understandable to them per say. This is only a framework and general proposal of a financing plan.

- The R12 500 government subsidy should not just be seen as a deposit in isolation. This subsidy is rather an attempt by government to create the opportunity to become a house owner. This plan makes provision to accommodate just that.

- It is true that the forming of the JFC does not create wealth as such but the eventual application of the objectives of the JFC will do so.

- Dividends are paid out after tax, but an allowance could be built into it to encourage the operating company to redeem the debt of the ESPT.

- The entrance and exit conditions of participants in the ESPT was not stated because the purpose of the plan is to be as flexible as possible and not to be prescriptive.

- Large companies are not as a rule inclined to enter into joint ventures with black businesses. If their involvement is based on investment decisions only, the chances are remote that they will participate at all.

- It maybe is true that diagram 3-3 will be easier to understand if the flow of funds was explained; but many things in the study would be easier to understand should it have been included. Complete case studies for each variation of the plan, could for example, be included.

8 SUMMARY AND CONCLUSION

It can be concluded that the ESPT finance plan was well received by the respondents. The general indication is that the plan is workable and applicable and that it will definitely create wealth within disadvantaged communities. An enabling environment will be created and all interest groups will benefit through their participation.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

1 INTRODUCTION

In Chapter 1 the objective of the study was stated as being the development of an alternative financing model which will be acceptable to both the lending institution and the borrower. The study is also an attempt to develop a flexible and feasible financing model where the traditional lending criteria of financial institutions will not apply. A further aim is to include workers share participation in the model in order to address the issue of wealth creation.

In Chapter 2 a literature study is undertaken which investigates existing literature pertaining to the availability of financial resources to small business development in general. It explores the accessibility to credit for SMME's and it investigates the lending criteria applicable. Special emphasis is placed on the provision of collateral or security as a condition by lending institutions. A further aim of the literature study is to establish if there are any existing models on worker's share-participation schemes, either in this country or elsewhere in the world, which can be applied in the development of a new model suitable for application in South Africa.

Chapter 3 consists of the development of an appropriate financing model which allows for employee share-participation and which application will enable disadvantaged communities to gain access to financial resources for the establishment of new small business ventures.

In Chapter 4 the new financing model developed in Chapter 3 is being exposed to the opinions and views of some of the major role players in the small business finance and development field. The chapter summarises the views and recommendations of such role players.

2 CONCLUSION

The scheme has been scrutinised by a representative selection of interest groups and the response was favourable.

On the positive side it can be concluded that:

- wealth will be generated through the application of the model;
- disadvantaged communities will be empowered;
- there will be an advancement of skills;
- an enabling environment will be created for entrepreneurs;
- banks will be encouraged to participate, as their profitability will not be negatively influenced;
- the ESPT loan scheme would be viable and feasible from all the participating parties' point of view;
- the plan will be sustainable;
- the plan would enhance small business development and it will contribute to economic development in general;

- not much resistance is expected from the formal or the informal business sector;

- financial institutions will have the financial resources available to implement the plan;

- government credit guarantees would make the plan more acceptable to banks;

- employees would benefit financially;

- the housing finance part of the scheme is feasible;

- the plan will make credit more accessible to small business;

- government would be in favour of the plan; and

- that the plan is not expected to be misused by politicians in general.

There are not many negative opinions about the plan but the following concerns should be highlighted:

- there is a possibility that the employees will not accept the distribution of shares in accordance with seniority;

- workers and managers would not always share the same goals;

- banks might be hesitant to shift their lending criteria; and

- banks will not have the resources to handle the aftercare and mentoring portion of the plan.

3 RECOMMENDATIONS

It is recommended that all attempts be made to have the ESPT loan scheme immediately implemented in this country.

All negatiave aspects should be addresed as it will determine whether the plan will succeed or not. An action plan should be compiled and well trained people should be involved in the implementation of the plan.

Existing tax legislation will have to change and of critical importance is the changing of section 38 of the companies act to make provision for the ESPT loan scheme.

A marketing and lobbying effort must come off the ground in order to involve all the parties and in particular the government.

NGOs and private consultants should be recruited to handle the vitally important mentoring functions which cannot be accommodated by financial institutions.

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ANNEXURE 1

RESPONSES TO THE QUESTIONNAIRE ON THE PROPOSED ESPT LOAN SCHEME

		YES	NO
1	SOCIO ECONOMIC		
1.1	Do you think that the plan will empower disadvantaged communities?		
1.2	Will wealth be generated?		
1.3	Will there be an advancement of skills?		
1.4	Would organised labour organisations be in favour of the scheme?		
1.5	Would the community accept the plan?		
1.6	Would employees understand the plan?		
1.7	Would employees accept the distribution of shares in accordance with seniority?		
1.8	Would workers and managers share the same goals?		
1.9	Do you think that participants would be seen as sellouts by the community?		
ANY FUR THER COMMENTS:			
....			
....			
....			
....			
2	ECONOMIC		
2.1	Would the scheme create an enabling environment for entreperneurs?		
2.2	Do you think that banks will be willing to shift their lending criteria to accommodate the plan?		
2.3	Would the proposed tax incentives encourage banks to participate?		

	YES	NO
2.4 Would the proposed tax incentives encourage corporate business to participate?		
2.5 Would the scheme be feasible from:		
2.5.1 a bank's point of view?		
2.5.2 the government's point of view?		
2.5.3 the would-be owner's point of view?		
2.5.4 the community's point of view?		
2.6 Would such a scheme be economically viable from:		
2.6.1 a bank's point of view?		
2.6.2 the operating company's point of view?		
2.6.3 the employees (ESPT) point of view?		
2.6.4 the joining corporate company's point of view?		
2.7 Will the plan be sustainable?		
2.8 Will the plan enhance small business development?		
2.9 Will the plan contribute to economic development in general?		
2.10 Do you expect negative reaction from the formal business sector?		
2.11 Do you expect negative reaction from the informal business sector?		
ANY FURTHER COMMENTS:		
....		
....		
....		
....		

	YES	NO
3. FINANCIAL		
3.1 Would financial institutions have the resources to implement such a plan in respect of:		
3.1.1 funds?		
3.1.2 human resources to handle the loan applications?		
3.1.3 human resources to handle the after-care and mentoring?		
3.2 Would government credit guarantees make the plan more acceptable to banks?		
3.3 Would the employees benefit financially?		
3.4 Is the housing finance part of the plan feasible?		
3.5 Will the plan make credit more accessible to small business?		
ANY FURTHER COMMENTS:		
....		
....		
....		
....		

		YES	NO
4	POLITICAL		
4.1	Do you think that government would be in favour of the plan?	93	7
4.2	Do you think that the plan can be misused for political gain?	36	64

ANY FURTHER COMMENTS

....

....

....

....

NAME : ....

ORGANISATION: ....

POSITION : ....

TEL NO. : ....

FAX NO. : ....

ANNEXURE 2

RESPONSES TO THE QUESTIONNAIRE ON THE PROPOSED ESPT LOAN SCHEME

		YES %	NO %
1	SOCIO ECONOMIC		
1.1	Do you think that the plan will empower disadvantaged communities?	93	7
1.2	Will wealth be generated?	100	-
1.3	Will there be an advancement of skills?	93	-
1.4	Would organised labour organisations be in favour of the scheme?	64	36
1.5	Would the community accept the plan?	93	7
1.6	Would employees understand the plan?	79	21
1.7	Would employees accept the distribution of shares in accordance with seniority?	50	50
1.8	Would workers and managers share the same goals?	57	43
1.9	Do you think that participants would be seen as sellouts by the community?	7	93
2	ECONOMIC		
2.1	Would the scheme create an enabling environment for entreperneurs?	93	7
2.2	Do you think that banks will be willing to shift their lending criteria to accommodate the plan?	57	43
2.3	Would the proposed tax incentives encourage banks to participate?	86	14

	YES	NO
	%	%
2.4 Would the proposed tax incentives encourage corporate business to participate?	93	7
2.5 Would the scheme be feasible from:		
2.5.1 a bank's point of view?	64	36
2.5.2 the government's point of view?	86	14
2.5.3 the would-be owner's point of view?	93	7
2.5.4 the community's point of view?	93	7
2.6 Would such a scheme be economically viable from:		
2.6.1 a bank's point of view?	79	21
2.6.2 the operating company's point of view?	93	7
2.6.3 the employees (ESPT) point of view?	93	7
2.6.4 the joining corporate company's point of view?	93	7
2.7 Will the plan be sustainable?	79	21
2.8 Will the plan enhance small business development?	93	7
2.9 Will the plan contribute to economic development in general?	100	-
2.10 Do you expect negative reaction from the formal business sector?	36	64
2.11 Do you expect negative reaction from the informal business sector?	36	64

		YES %	NO %
3.	FINANCIAL		
3.1	Would financial institutions have the resources to implement such a plan in respect of:		
3.1.1	funds?	100	-
3.1.2	human resources to handle the loan applications?	79	21
3.1.3	human resources to handle the after-care and mentoring?	7	93
3.2	Would government credit guarantees make the plan more acceptable to banks?	100	-
3.3	Would the employees benefit financially?	100	-
3.4	Is the housing finance part of the plan feasible?	71	29
3.5	Will the plan make credit more accessible to small business?	86	14
4	POLITICAL		
4.1	Do you think that government would be in favour of the plan?	93	7
4.2	Do you think that the plan can be misused for political gain?	36	64