AN INVESTIGATION OF SMALL AND MEDIUM ENTERPRISES PERCEPTIONS TOWARDS SERVICES OFFERED BY COMMERCIAL BANKS IN SOUTH AFRICA

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ABSTRACT

This paper reports on findings of a unique study which collected information from the demand side of finance to understand the perceptions of small scale businesses from rural and semi-urban areas towards commercial banks.

The study is an empirical investigation of perceptions and attitudes of Small and Medium Enterprises (SMEs) towards commercial banks and consequently the importance SMEs regard of commercial banks as an important source of funding. The study reveals that SMEs from rural areas have a very poor understanding of the services commercial banks offer and understanding of the bank loan procedures. This leads to their weak bargaining position in terms of interest paid, asset and liability disclosure, misuse of loan funds and generally bad preparedness when applying for business loans.

The study, recommends the importance of building a good relationship between SMEs and the commercial banks as a way to improving access to finance by the SME sector.

Key words: Small and Medium Enterprises, commercial banks, funding

GEL codes: G15 G18 G21 G57

I. INTRODUCTION

The main problem facing the development of small and medium enterprises in both developed and developing countries is finance and this has been supported by the work of Bosa (1969), Levy (1993) and Keasey and Watson (1994). However, some commentators have refuted this fact and feel that the problem is not access to finance but how the finance is applied by small businesses. As a developing country, South Africa is included in this quandary and the government has tried varied options to improve access to finance. In this regard development financial institutions like Khula Finance Ltd which on lends to retail finance institutions, the Industrial Development Corporation (IDC), National Empowerment Fund, National Development Agency (NDA), and Umsobomvu Youth Fund (UYF) have been established to facilitate SMEs access to finance. Apart from the IDC which caters for the upper end of the SME market, many SMEs still have difficulties in accessing finance in South Africa.

In a recent article, Christianson (2005) supports the problems SMEs face in accessing finance. He asserts that SMEs in South Africa are often quoted as not being able to access money from banks to grow their businesses. This is cited as the biggest inhibitor to growth, as SMEs contend that banks just do not know how small business works. This statement implicitly suggests that there is a lack of an effective dyadic relationship between the commercial and the SMEs in South Africa.

For an effective relationship to exist, leading to mutual benefit, theory suggests that there are certain roles expected from the partners in the relationship to determine the nature of the benefits to be realized Binks et al (1992). That is, the SMEs are expected to meet certain criteria for the banks to be able to assist them with their financial needs. For these roles to be fulfilled, it is important that expectations from both parties are well understood by both the SMEs and the commercial banks.

The nature of bank and SME relationship is that the commercial banks tend to operate devoid of a good knowledge of needs and how the SMEs run their businesses. The reasons forwarded for this are that the clients are regarded as high risk and unprofitable. This orientation is not typical to South Africa only but a reality in the developing countries Eyiah (2001).

This article explores perceptions of SMEs towards commercial banks in South Africa. A good understanding of these would improve the ability of commercial banks to better meet the financial needs of SMEs. Hence, this article contributes to the debate on what issues commercial banks need to take into consideration in developing long term relationships with SME clients whilst minimizing risks in this market segment. No study from the supply side has been conducted in South Africa, hence FIMARK Trust commissioned this empirical investigation to provide information to be used in enhancing relationships between commercial banks and SMEs and to feed into the process in developing the Financial Black Economic Empowerment Charter; all aimed at making financial markets work for the poor in South Africa.

II. LITERATURE REVIEW

The International Finance Corporation (2007) reports that small and medium businesses comprise of 80 percent of the private sector in Africa. As a result of this, many governments have given policy priority in supporting the development of this sector. Governments including South Africa have supported financial intermediation in various forms. To this end development financial institutions have been established to offer appropriate financial vehicles to SMEs. Examples of these financial institutions (as already pointed out above) include the Industrial Development Corporation, National Empowerment Fund, the National Development Agency and Khula are a case in point. As pointed out above apart from IDC, the others have attempted to facilitate access to finance but for many SMEs this issue if far from being resolved. This area is a potential interesting area for further research and this paper cannot extensively discuss this problem.

To support the financial intermediation efforts, business development support has been instituted through the creation of government agencies like the Small Enterprise Development Agency (SEDA) at the Department of Trade and Industry (DTI). SEDA merged the Ntiska Enterprise Promotion Agency, National Manufacturing Advisory Centers and the Community Public Private Partnerships. The mandate of SEDA is to strengthen support for Small, Medium and Micro Enterprise (SMME) access to finance, providing enabling policy environment and the expansion of market opportunities for certain types of enterprises SEDA (2007). The success of SEDA still has to be seen as it was only set up towards the end of last year.

Though the above support mechanisms are in place and have been for a number of years, the problem which has been identified by IFC (2000) in other developing countries also seems to exist in South Africa, that there seems to be, "… lack of expertise at banks… and the risks associated with lending to less established entrepreneurs means that smaller companies in the region often cannot access the cash they need to develop and expand". Schoombee (2000) supports the existence of this in South Africa when he states that, "Although the government has addressed this issue (access to finance), private banks are still not interested in serving micro enterprises".

Though IFC has established finance programmes especially in the poor countries, these initiatives might not bear any fruit if the attitude of banks towards SMEs in countries like South Africa does not change. Eyiah (2001) in his article states that empirical and theoretical analysis exists which supports the, "…importance of developing a closer working relationship between the bank and the small businesses in addressing the problem and hence, improving the latter's access to bank loans". Also see Boots and Thakor (1994); and Seal (1998).

Relationship marketing entails that a business should go beyond meeting the needs of consumers to developing a long term mutually beneficial relationship Kotler (2005). This theory goes beyond merely getting a customer to engage in a transaction to recognizing that marketing is a series of exchanges which are relational by nature especially in the service industry Sheth and Parvatiyar (2000). Within a retail banking context, relationship marketing suggests the "activities carried out by banks in order to attract, interact with, and retain more profitable or high net-worth customers" Leverin and Liljander (2006). The typical exchange episodes in this relationship include the exchange of information, financial transactions and social exchanges Zineldin (1995).

Levitt (1983) suggests that applied to the banking sector, the use of relationship marketing would imply that the quality and duration of the buyer seller relationship which would make possible easy access to finance would be a result of the ability of partners in managing their relationships. However, he emphasises the role of the seller, the banks, in this dyadic relationship.

The extent to which the banks in South Africa have developed relationships in the SME sector is far from their expected role. SMEs seem to have a very negative view of the banking sector as revealed in Finance Week (2004). A disgruntled SME business owner reported as follows, "All the major banks continually bombard us with their promises of providing advice and superior services to small businesses. Nothing is further from the truth".

It is further reported by Harris (2004) that the R[1]1 m to R3m turnover segment of SMEs must have some of the highest fee structure in the industry". The gripe which Harris (2004) poses is present in the electronic bank transfers system and the high transactional fees charged to SMEs as compared to lower fees charged to the large corporations. This points to the existence of a "gone approach" as opposed to a "going approach" among most of the commercial banks in South Africa Seal (1998). This needs to give way to developing long-term relationships between banks and the embattled SME sector in South Africa.

For bank relationship marketing to occur there is a need for the banks and clients to gather and share as much information as possible and use this in developing the relationship. This study will provide commercial banks useful information about the clients. This approach is supported by the work of Zineldin (1995) whose work emphasized the importance of social exchanges to cement the relationships which include, "… the exchange of social symbols… confidence, trustworthiness, ethics, and friendship…"

Contrasted to the above, commercial banks regard lending to the SMEs as high risk and as such bring into play prudential policies that tend to create mistrust among SMEs. This is compounded by the realities of business uncertainty as a result of SME susceptibility to volatile market and economic conditions. In

[1] Rand is the South Africa Currency. 1US Dollar is about Rands 7 (May 29th 2007)

addition to this are the high transactional costs related to doing business with SMEs which make the cost of lending to SMEs high and unattractive Eyiah (2001). In South Africa this has led commercial banks not doing much in terms of financial intermediation to the SMEs and the poor.

Overall this paper will provide useful strategic data to South African commercial banks to help them develop long-term working relationships with the SME sector. This should give way for the unlocking of access to finance to the SMEs.

III. DATA AND METHODOLOGY

The research was funded by the FINMARK Trust South Africa and aimed at determining perceptions and revealing attitudes SMEs have towards commercial banks. Once this information is revealed it should lead to commercial banks knowing what to do to develop strong banking relationships with the SMEs. The following were the major issues around which information was collected.

a. To determine the understanding of SMEs have on loan application procedures and the extent to which SMEs perceived banks to be useful in assisting them.

b. To determine aspects which SMEs consider important in building relationships with commercial banks.

c. And to reveal SME behaviours / practices which help or hinder the development of relationships with commercial banks, important in influencing their success in accessing finance from the banks.

A qualitative research methodology was used to collect data. This involved having focus group meeting with groups of SMEs. The SMEs selected were those with a possible need of financial assistance in terms of loans between R75, 000 to R500, 000 or currently in business with annual revenue of R250, 000 to R2 million. The respondents were drawn from metro, peri urban and rural areas in Limpopo and Gauteng provinces in South Africa. In total 45 SMEs were interviewed from the metropolitan, peri urban and rural areas. The break down is as follows:

Area	Metropolitan	Peri Urban	Rural
Limpopo	9	5	9
Gauteng	10	8	4

IV. EMIPRICAL RESULTS

The results of the study are presented in two broad areas, namely perceptions of SME towards commercial banks and factors deemed important in building relationships.

A. Perceptions of usefulness of banks in assisting SMEs.

Schiffman and Kanuk (2005) state that perceptions are important in marketing as "individuals act and react on the basis of their perceptions, and not on the basis of objective reality". The perceptions which are reported by the SMEs will eventually as being useful or not useful in meeting their financial needs.

The study results show that SMEs have the same need of finance just as big corporations for acquiring plant, land, equipment and for working capital requirements. The source of this capital is mainly from personal income (retirement packages) and government support programmes. Interestingly, burial societies[2] and stockvels emerged as a very common source of capital for most of the SMEs interviewed. However, when capital requirements were higher, it was indicated that commercial banks were used though this was identified as an ineffective source.

The fact that commercial banks were not identified as an effective source of finance for SMEs suggests that commercial banks are failing to meet the needs of SMEs. This view was more common among SMEs from rural areas than those from the urban areas. This difficulty is explained by the lack of security by SMEs from rural areas and the relatively low levels of sophistication and understanding of the bank loan procedures. Hence, their perceptions were negative and did not particularly regard commercial banks as being useful.

Further, negative perceptions emerged with banks being described as being too conservative, uncooperative, and exploitative. Conservativeness was due to banks overemphasis of

[2] Burial societies and stockvels are savings clubs. Members drawing from the pool of resources at the time of a funeral or when there is an urgent need for finances.

figures only in making decisions and requiring collateral for all types of loans. Respondents described commercial banks as uncooperative as banks were seen to be more interested in handing out forms for loan applications and were very quick at rejecting applications at the slightest mistake or problem. In one case, it was reported that the bank awarded a loan at prime plus 4 percent interest rate! This latter point is also reported by Harris (2004) where commercial banks are accused of exploiting and benefiting from SMEs.

Most importantly, it would seem that the underlying factor causing the above negative perceptions is that SMEs from the rural areas do not understand bank loan application procedures. As a result of this, expectations are high and any delays from the bank or when banks try to get more information on the client from other banks is seen as undesirable. This makes the SMEs regard commercial banks as not being interested in assisting them.

B. Factors considered important for building relationships

Relationship theory above suggests that in any beneficial long term relationship, both parties need to bring something of value to the exchange process. The most important exchange episode is the exchange of information, nature of the environment in which the transaction takes place and the manner in which the exchange process is managed. If these three important episodes are lacking, suspicion enters and the exchange might not meet the expectations of the SMEs and commercial banks.

Firstly, on the disclosure of information, a point has been made above that there is a need for banks to disseminate information on their products to SMEs especially those in the rural areas. Many SMEs in the rural areas feel that this information is kept to the commercial banks and not disseminated to them.

Whilst information does not seem to be flowing from the commercial banks to SMEs, the results show that SMEs are not comfortable in disclosing information on assets in case they over expose themselves if the business venture is in financial problems. Further, it was reported that they would hide information on their liabilities to make themselves look good. This orientation is well known by banks and this makes them use a more prudential approach in evaluating loans. This brings about controls leading to suspicions in the exchange process. Unfortunately, this tends to be a short term measure and does not build long term relationship. What needs to be done is to ensure that trust exists in the relationship for SMEs to have confidence and trust for them. In this situation, the SMEs are more likely to fully disclose the required information. The work of Seal (1998) supports the importance of trust between banks and SMEs.

Secondly, the environment in which the exchange episodes take place is also important in the dyadic relationship between commercial banks and SMEs. The environment can either be seen to be friendly or threatening and this will influence the perceptions formed by either party in the exchange process.

The results show an interesting perspective and shed further insights into the perceptions SMEs have about commercial banks. SMEs from rural areas reported that "they feel nervous, scared, and uncertain of the outcomes, feel too small, bad and felt that commercial banks only favoured big corporations and that they were given less attention and poor services". This suggests that the banks have a non-caring attitude towards the SMEs and this does not help the building of a relationship. This makes SMEs feel that they are at the mercy of commercial banks and in the course of action they do things which do not promote trust building.

These negative perceptions differ from the responses of urban SMEs who felt "welcome, happy and honoured and comfortable with their commercial banks". This suggests that different relationship strategies are needed for SMEs in different areas and at different levels.

The SMEs need to know the services offered by the banks and the commercial banks to know them better. The lack of this currently causes problems in the relationship. However, to correct this problem was seen as something that would be expensive due to the large numbers of SMEs but nevertheless important for commercial banks to undertake. It was suggested that information dissemination through mass media channels like Internet, cell phones, workshops and network meetings might improve the situation.

C. Needed SME and commercial bank behaviours in building relationships.

The SMEs considered certain positive behaviours as important in building a long term business relationship with the commercial banks to improve their chances of their loans being approved. They also point out a number of wanted behaviours from the commercial banks which would enhance the relationships.

The SMEs reported that the following behaviours are needed from them to maintain and build a good relationship with the banks:

a) "Keep your accounts in order and maintain a positive cash flow for the commercial bank to know you better". For this, an account has to be opened, maintained properly to trace the banking behaviour of SMEs.

b) SMEs need to invest more time to know bank loan requirements and provide the required information by banks. Issues of not understanding their own business is a major weakness which banks find unacceptable.

c) SMEs need to maintain an open communication with banks in both situations when the SMEs are doing well or when they are in difficulties. This would give the banks an idea of how best to assist at present and in future.

d) Generally SMEs need to be honest in how they conduct their financial transactions by managing their cash flow to reduce unwanted overdraws on their accounts.

From the side of commercial banks, SMEs expected certain simple practices to be exhibited for relationship building. The SMEs reported that they expect the commercial banks to provide different SMEs from rural areas with more information on loan applications; spend more time and visit SMEs at their premises. These actions would make the banks better understand the environment in which the SMEs operate in. This would go a long way in building relations. As all these were not being done at present, the exchange environment is generally not good.

V. CONCLUSION

The study concludes that the SME sector cannot be treated as being similar as within this group differences exists. It is clear from the study that the SMEs from rural areas tend to have more negative perceptions on the services offered by commercial banks than their counterparts in the urban areas. This is caused by the low levels of sophistication and the absence of information provided at a level which would make it easy for them to understand the bank loan procedures and services they offer.

The absence of information and poor attention placed to this group has led the SMEs to mistrust and wrongly perceive banks not to be very useful in assisting them. To obtain the needed financial assistance their behaviours are not usually acceptable by banks and this leads to more frustrations making any efforts aimed at building relationships fruitless.

The study recommends that further information is needed to assist both banks and SMEs to build long-term dyadic business relationships. This will define information to be exchanged, needed behaviour from both parties and the benefits to be realised by both. At present, it seems the banks have nothing to gain by getting closer to SMEs. However, this study has provided information to show that SMEs see benefits in establishing a long term business relationship with commercial banks.

Further, deliberate strategies aimed at changing perceptions and attitudes of SMEs for them to have confidence whenever they are applying for a loan will need well-targeted interventions to deal with the negativity. This will involve capacity building exercises by BANKSETA, Khula, and UYF and other government agencies mandated to facilitate SME access to finance.

What is encouraging is that from the side of SMEs there is an understanding that relationships which will assist in getting better assistance from banks is wanted and what is needed from the commercial banks is clear. Therefore, it remains for the commercial banks to rise up, come to the game, keep their prudential policies but be engaged in relationship building activities to reduce the negative perceptions in the SME market. This will go a long way to possibly improving access to finance to the SMEs. The time has come for commercial banks to treat SME clients differently.

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