



**SOUTH AFRICAN BANKS' RISK ASSESSMENT PRACTICES
WHEN FINANCING ENTREPRENEURIAL VENTURES – A
COMPARATIVE ANALYSIS**

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Abstract

The development of Small, Medium and Micro Enterprises (SMMEs) contributes significantly to job creation, social stability and economic welfare. Obtaining finance for start-up and growing entrepreneurial ventures has proved to be crucial for SMME growth and is therefore the prime concern of this research. This research will specifically investigate the risk assessment practices used by South African commercial banks when providing funding to entrepreneurial ventures.

In addition, the research seeks to establish whether there is consistency amongst the South African commercial banks in their risk assessments practices. Lastly to establish the impact of the global economic crisis of 2008 on the risk assessment practices of the South African commercial banks. To achieve this, a qualitative study in the form of expert interviews supported by structured research questionnaires with representatives of the four large banks was undertaken.

In summary, the findings of the research demonstrated that risk assessment practices of the South African commercial banks were consistent with the integrated theoretical framework and amongst each other. Respondents ranked the character, capacity and collateral of the business as the most important criteria when assessing term loan applications. Furthermore, the impact of the global economic crisis of 2008 resulted in the lending policies of the banks being more strictly adhered to.

Declaration

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements of the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

Boitumelo Sefolo

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10 November 2010

Dedication

This research is dedicated to my husband, Tshegofatso. Your unwavering support and encouragement throughout this process has been a pillar of strength to me. To my parents, Oupa and Maryanne Maruping, you continue to be the inspiration that drives me to work hard and achieve new heights in my life. Your prayers are constantly guiding me. To my parents' in-law: Abednico and Lydia Sefolo and the rest of my family: Pontsho, Mosa, Suping, Lesego, Kabelo and Lesego, thank you for your support and accommodating my absence in your lives for the past two years.

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1. INTRODUCTION TO THE RESEARCH PROBLEM

1.1 RESEARCH TITLE

South African banks' risk assessment practices when financing entrepreneurial ventures – a comparative analysis.

1.2 RESEARCH PROBLEM DEFINITION AND SCOPE

South Africa faces numerous economic, political and social challenges in its new democracy, of which a key challenge is that of massive and growing unemployment (Herrington, Kew & Kew, 2010). While South Africa's unemployment rate had fallen steadily from 2002 through to 2007, helped by the strong economic cyclical upswing, it had never fallen below 20 percent and by the first quarter of 2010 was back above 25 percent, near 2004 levels (Statistics South Africa, 2010).

Given the inability of the existing formal sector to absorb the growing labour force, the South African government has prioritised small business and entrepreneurial development (Herrington *et al*, 2010). The Department of Trade and Industry has committed to ensure that small businesses progressively increase their contribution to the growth and performance of the South African economy in critical areas such as job creation, equity and access to markets (Department of Trade & Industry, 2005).

According to the 2008 Department of Trade and Industry Report, the Small, Medium and Micro Enterprises (SMME) sector grew by 27% between 2004 and 2007, with the most significant growth associated with medium-sized enterprises at 208% (Department of Trade & Industry, 2008). Thus the development of SMMEs contributes significantly to job creation, social stability and economic welfare (Ladzani & Van Vuuren, 2002).

Finance is needed in the establishment of new businesses and growth of entrepreneurial ventures and yet entrepreneurs find difficulty in obtaining the necessary finance for start-up and growth purposes (Driver, Wood, Segal & Herrington, 2001). In many cases, lack of finance is cited as a reason for business failure and non start-up. In South Africa, lack of financial support is the second most reported contributor to start-up failure, after education and training (Orford, Wood, Fisher, Herrington & Segal, 2003).

The financial sector is a vital service sector in the South African economy, in terms of size and growth. However, it is not in itself a significant generator of increased employment. It does nevertheless, have the capacity to encourage employment in other sectors, to the extent that it influences economic growth positively (Hawkins, 2004). The capacity of the banking industry to provide finance and funding for businesses exists. However, banks are conscious of the need to generate profits for their shareholders whilst managing their risk appetite. This sometimes appears to be at odds with the desire of entrepreneurs to expand their business through banking finance (Hawkins, 2004).

In 2000, the South African financial sector contributed around 20 per cent to economic activity measured in terms of Gross Domestic Product (GDP). However, the sector appears to have levelled off over recent years within the 19 – 20 per cent range (Hawkins, 2004). The banking industry contributes an estimated 35 per cent of the value added of the financial sector, as calculated using the gross values of net interest income and non-interest income (Wallis Report, 1997).

According to Hawkins (2004) in 2002, the value of assets of the South African banking industry had reached R1.1 trillion and were 100.2 per cent of GDP. The value of loans and advances were R800.2 billion and 72.8 per cent of GDP. It could be argued that the size of these assets relative to GDP underlines the importance and potential influence of the banking sector to the South African economy.

The impact of the period of liberalisation followed by a period of consolidation of the banking and securities industries is revealed in part by an examination of the number of fully registered local banks. The number of banks increased more or less constantly until 2000. In 2001 it fell slightly and in 2002 dropped sharply by 28 per cent from the previous year (Hawkins, 2004). The decline in numbers since 2000 is a consequence of the demise of a number of the smaller South African banks. These are essentially all local banks except Investec and the Big Four i.e. ABSA, Standard Bank, Nedbank and First National Bank (Hawkins, 2004).

The top four banks still account for around 70 per cent of the industry’s assets, although this understates their dominance in terms of certain market segments (Hawkins, 2004). In 1994, the four major banks plus Investec made up 87 per cent of the market, but by 2001 this had slipped to just over 75 per cent (Hawkins, 2004). The loss of market share by the top four players and the related increase in share won by smaller niche and foreign banks since 1994 has meant that in 2001, foreign and other banks together made up close to a quarter of the share of banking assets in South Africa (Hawkins, 2004).

The research scope is limited to the four largest South African commercial banks in terms of market capitalisation, namely: First National Bank, Standard Bank, Nedbank and ABSA. According to Okeahalam (2001), the four largest banks account for 96 per cent of the small business market segment in South Africa. The market share distribution of the banks in the small business sector is shown in Table 1.

Table 1 Banking services for small business – market shares of major banks (Okeahalam, 2001)

Bank	ABSA	Standard Bank	First National Bank	Nedcor (Nedbank)	Other banks
Market share	27%	33%	19%	17%	4%

Based on the above market shares, the risk assessment practices of the four largest commercial banks will be significantly representative of the practices for the whole sector in South Africa.

1.3 RESEARCH PROBLEM CONTEXT

Pretorius and Van Vuuren (2003) state that in South Africa, as in many other countries, the national strategy for the development and promotion of small business development and the empowerment of entrepreneurs is the most important avenue for economic growth.

Japan's SMME sector accounts for the bulk of the country's business establishment, providing vital support for employment, for growth in regional economies and, by extension, for the day-to-day life of the Japanese people (Japanese Ministry of International Trade and Industry, 1997). In Taiwan, the SMME sector generates approximately 98 per cent of the economy's gross domestic product. Although these businesses are relatively small in scale, have limited funds and weak in structure, they make significant contributions to national economic prosperity, create employment and promote social stability (Scarborough & Zimmerer, 1996).

The Global Entrepreneurship Monitor (GEM) is an executive report that is produced annually in order to assess the current state of entrepreneurship in a specific country from a global perspective. The primary measure of entrepreneurship used by GEM is the Total Early-stage Entrepreneurial Activity (TEA) index. TEA indicates the prevalence of business start-ups (or nascent

entrepreneurs) and new firms in the adult (18 to 64 years of age) population – in other words it captures the level of dynamic entrepreneurial activity in a country (Herrington *et al*, 2010).

According to the GEM report (Herrington *et al*, 2010), South Africa’s TEA in 2009 stood at 5.9 per cent, having peaked in 2008 at 7.8 per cent. This is significantly lower than Brazil (15.3%), Argentina (14.7%), Columbia (22.4%) and even the United States (8%). The GEM report suggests that there is an inverse correlation between the TEA index and the unemployment rate. Therefore countries with a higher TEA index have a lower unemployment rate and *vice versa*. This is confirmed by South Africa’s high unemployment rate in 2009 of approximately 24.3 per cent of the labour market (Statistics South Africa, 2010).

Table 2 South Africa compared to Global Total Entrepreneurship Activity (TEA) & Unemployment Statistics – 2009 (Herrington, Kew & Kew, 2010)

COUNTRY	South Africa	Colombia	Argentina	Chile	Brazil	United States	Norway
TEA Index 2009	5.9%	22.4%	14.7%	14.6%	15.3%	8%	8.5%
TEA Index 2008	7.8%	24.5%	16.5%	14.1%	12%	10.8%	8.7%
Unemployment Rate 2008	23.96%	6.5%	7.3%	7.3%	7.9%	5.78%	2.55%

Table 3 South Africa Total Entrepreneurship Activity: 2001 – 2009
(Herrington, Kew & Kew, 2010)

YEAR	2001	2002	2003	2004	2005	2006	2008	2009
South Africa's TEA	4.3%	6.2%	4.1%	5.1%	5%	5%	7.8%	5.9%

Table 3 displays South Africa's TEA Index from 2001 until 2009. As shown above, South Africa's TEA in the past eight years ranged between 4.1% (lowest) in 2003 and 7.8% (highest) in 2008. This demonstrates that South Africa has made very little progress in improving its TEA index and thus entrepreneurship in the country.

The Gini-coefficient of inequality is the most commonly used measure of income inequality. The coefficient varies between zero, which reflects complete equality and one, which indicates complete inequality (one person has all the income or consumption, all others have none). South Africa's gini-coefficient is one of the highest in the world at 0.578 (United Nations University, 2010). Entrepreneurship will not only offer employment but also will create further employment through the entrepreneur's supply chain and facilitate in narrowing the income inequality gap.

The South African government recognised the dilemma of funding entrepreneurial ventures and as such has implemented a strategy for the development and promotion of SMMEs in South Africa in February 1995, under the umbrella of the Department of Trade and Industry. From the National Small

Business Act 102 of 1996, it appears that the government is clear in its intention of creating entrepreneurial ventures and thereby assisting with the creation of jobs.

1.4 RESEARCH AIM

Obtaining finance for start-up and growing entrepreneurial ventures has proved to be crucial for SMME growth and is therefore the prime concern of this research. This research will specifically investigate the risk assessment practices used by South African commercial banks when providing funding to entrepreneurial ventures. The research will be limited to entrepreneurial ventures that have a turnover of between R5 million and R40 million as opposed to start-up ventures thus focusing on the sustainability of entrepreneurial ventures. The turnover range selected is also motivated by the 2008 Department of Trade and Industry report which showed the most significant growth was associated with medium-sized enterprises. Businesses within the R5 million to R40 million turnover range would be deemed medium-sized enterprises.

Businesses that are most likely to be job creators also tend to be businesses that have passed the initial start-up phase (Herrington *et al*, 2010). Foxcroft, Wood, Kew, Herrington, & Segal (2002) found that banks are less likely to grant loans than to offer credit via credit cards or overdraft facilities, thus preferring short-term financing versus long-term financing in the form of term loans. Only one quarter of applications for bank term loans by SMMEs were reported successful in South Africa.

When evaluating the funding of an entrepreneurial venture, the banking institution will always consider risk as a prime factor, together with management skills and expertise relating to the type of business or venture before committing any funds (Shaw, 2002). It is propositioned that banks, as financiers, examine several different factors before granting term loans to entrepreneurial ventures. The intention is primarily to compare and contrast these factors against each other and the risk assessment theoretical framework stated in the literature. Then to assess whether there was consistency in the risk assessment practices of the various banks. Lastly, to explore how the lending practices of banks when funding entrepreneurial ventures, have been altered since the global economic crisis of 2008, taking into account the macroeconomic factors that influence bank lending.

The lack of financial support has been widely reported as the main problem facing entrepreneurs in South Africa (Herrington *et al*, 2010). The main contribution of the research will be to identify the critical success factors for entrepreneurial ventures when applying for bank funding from a risk assessment perspective.

Another contribution of the findings is that it will highlight the changes in lending practices of the banks since the global economic crisis. Thus providing more information and greater clarity to entrepreneurs, SMMEs and entrepreneurial ventures when they submit term loan applications, especially about the factors that are critical to the decision making process of the banks and thereby enhancing the success rate of their applications.

The study aims to look at the risk assessment practices by South African commercial banks when funding entrepreneurial ventures that have a turnover of between R5 million and R40 million i.e. medium-sized enterprises.

2. LITERATURE REVIEW

2.1 DEFINITION OF ENTREPRENEURSHIP

Despite the modern enthusiasm for entrepreneurship, there is no universally accepted definition. The many guises an entrepreneur can take may be one explanation for this anomaly. Definitions have focused on the wealth creation and economic growth properties of entrepreneurship (Spencer, Kirchhoff & White, 2008; Wennekers & Thurik, 1999). Examples of entrepreneurs can be found in literature going back hundreds, if not thousands, of years. The word 'entrepreneur' is attributed to Richard Cantillon, in the 18th century, who wrote about individuals who buy materials and means of production at prices enabling them to combine them into a new product (Hisrich & Peters, 1998).

Joseph Schumpeter (1954), regarded as the founder of modern entrepreneurial theory, portrayed entrepreneurs as innovators. He coined the phrase 'creative destruction' to describe the process by which entrepreneurs discover new opportunities and stimulate change in society. Entrepreneurship in this context is seen in revolutionary terms as the ability to bring about something new, whether this is a production method, technological development, product/service, distribution system, or even a new organisational form. The second dominant view of entrepreneurship, based on the work of Knight (1921), viewed the entrepreneur as the person able to recognise opportunities by managing risk and uncertainty in order to create wealth.

Finally, Kirzner (1985), who built on Knight's work of emphasising opportunity recognition, developed a new theory of entrepreneurship taking it to mean having an alertness to profit opportunities (Spencer *et al*, 2008). In an attempt to synthesise all three traditions, Herbert and Link (1989, p.39) defined an entrepreneur as 'someone who specialises in taking responsibility for and making judgement decisions that affect the location, form and the use of goods, resources and institutions'.

From a South African perspective, Nieman & Nieuwenhuizen (2009, p.9) define an entrepreneur as 'a person who sees an opportunity in the market, gathers resources and creates and grows a business venture to meet these needs. He or she bears the risk of the venture and is rewarded with profit if it succeeds.'

2.2 ENTREPRENEURIAL FINANCE

Entrepreneurial finance refers to the sources from which someone obtains the funds necessary to start-up or operate a business. There are several sources available for such funds these include self-financing, friends and family, bank funding, government agencies, venture capitalists and angel investors (Burns, 2001). Globally, the more prevalent source of entrepreneurial finance appeared to be entrepreneurs' savings and their ability to access informal investments from friends, family and colleagues (Herrington *et al*, 2010).

Nieman & Nieuwenhuizen (2009) highlight that as part of the supportive environment for entrepreneurs, finance is an important resource in new venture creation and sustainability. Whilst in South Africa, entrepreneurial finance is normally supplied by financial institutions such as banks, there are institutions such as venture capital firms, that are prepared to make a certain amount of risk capital available (Nieman & Nieuwenhuizen, 2009).

There are several factors that influence an entrepreneur's ability to obtain bank funding such as a carefully prepared loan application, available collateral, persistence, creativity and a comprehensive knowledge of the various funding options (Burns, 2001). Hisrich & Peters (1998) encourage entrepreneurs to draw up a business plan, as it describes all the relevant external and internal elements involved in starting-up and operating a business. A business plan is an important tool for the entrepreneur as well as the potential financier (Timmons, 1999).

Entrepreneurs are encouraged to prepare a business plan for presentation to banks, financial institutions and venture capitalists to enhance the chances of obtaining financial resources. Timmons (1999) emphasises the importance of the business plan to prospective investors and how they can use it to begin their due diligence. Timmons (1999) further postulates that even when negotiations are at an advanced stage, differences between entrepreneurs and banks can occur on the terms of the potential funding and viability of the business. The business plan is then used as the guideline for action.

There are also various stages of the funding process, starting with seed capital or the initial capital required to get a business off the ground. The first-stage funding includes the funds required to attract customers and the second-stage and third-stage funding are usually used for expansion purposes. Bridge financing either from debt or equity is used as interim financing and an initial public offering (IPO) are funds raised through registering with a Securities Exchange (Burns, 2001).

Short-term borrowing, which is defined as being repaid in a year or less, is generally used to fund working capital whereas long-term debt is more often used to finance the purchase of property or equipment, with the purchased asset serving as collateral for the loan (Herrington *et al*, 2010). The entrepreneur can also raise capital for a business using an equity loan on his / her home or other assets that he / she may own as collateral for a bank term loan. Many entrepreneurs seek a bank term loan in the name of their business. However, banks will usually insist on a personal guarantee by the business owner (Burns, 2001).

In South Africa, the Khula Enterprise Finance Ltd, an agency of the Department of Trade and Industry of South Africa, is dedicated to the development and sustainability of small business enterprises as a wholesale finance institution. Khula operates across the public and private sectors, through a network of channels to supply much-needed funding to small business. Khula's channels include South Africa's leading commercial banks, retail financial institutions, specialist funds and joint ventures in which Khula itself is a participant. Its primary aim is to bridge the "funding gap" in the SMME market not addressed

by commercial financial institutions. In these programmes, Khula guarantees a portion of the term loan to the issuing bank and thus relieves the bank of some of the risk of extending the term loan to a small business (Khula Enterprise Finance, 2010).

Each bank has a variety of different financing products that it offers to businesses, which tend to change from time to time depending upon market and regulatory circumstances (Herrington *et al*, 2010). These products include the following:

- **Cash flow:** credit card solutions, invoice finance, overdraft facilities and debtor finance.
- **Vehicle and Asset Finance:** Financing of all types of capital equipment, such as industrial plant and machinery, aircraft, trucks, material handling equipment, computer hardware and office equipment etc.
- **Commercial Property Finance:** Finance for commercial, industrial, retail and residential development.
- **Business term loans:** Medium to long-term loans to finance working capital, capital expenditure or to alter, expand or acquire business premises.
- **Leveraged Finance:** Finance for businesses that can demonstrate sustainable and predictable cash flows and that require finance for an acquisition etc.

There are a number of advantages and disadvantages associated with using debt finance:

Table 4: Advantages and Disadvantages of Debt Financing - (Herrington, Kew & Kew, 2010)

Debt Financing	
Advantages	Disadvantages
<ul style="list-style-type: none"> • Amount borrowed can vary according to needs • Does not dilute shareholding provided it is paid back • No interference by the bank provided regular payments are made 	<ul style="list-style-type: none"> • Creates a debt obligation • Interest repayment affect income statement and cash flow • Collateral is usually required by the bank • Can increase the length of time to break-even in a start-up venture

2.3 THE SOUTH AFRICAN COMMERCIAL BANKING INDUSTRY

South Africa has the largest economy in Africa, as well as the most advanced banking system on the continent (SARB, 2008/09). It is the economic powerhouse of Africa, with gross domestic product (GDP) comprising around 25% of the entire continent (SARB, 2008/09). According to the World Economic Forum's Financial Development Report, South Africa was ranked 31st place out of 57 countries on the Financial Development Index. The strength of its insurance sector, particularly life insurance coverage and density, contributed to the healthy performance of its non-banking financial services sector. Its banks and financial markets showed solid scores in line with South Africa's overall score. The strength of its financial intermediation and commercial access was

reported to be good, yet its business environment was an area of weakness (World Economic Forum, 2010).

South Africa is also host to the five biggest banks in Africa (The Banker, 2008). As at the end of December 2008, there were 33 banking institutions reporting data to the office of the Registrar of Banks. In addition, 43 international banks have authorised representative offices in South Africa (SARB, 2008/09). The sector is highly consolidated, with the largest commercial banks – which include ABSA, Standard Bank, First National Bank and Nedbank – accounting for 84.4% of the banking sector assets at the end of December 2008 (SARB, 2008/09).

In South Africa, commercial banks are by far the most frequently used source of short-term finance by the entrepreneur when collateral is available. The funds provided are in the form of debt financing, and as such, require some tangible guarantee or collateral. According to Hisrich & Peters (1998), collateral can be in the form of business assets (land, equipment or buildings belonging to the venture) or personal assets (the entrepreneurs' house, car, land, stock or bonds).

In almost all cases, term loans are rarely given to start-ups and substantial collateral as well as suretyships would be required (Herrington *et al*, 2010). According to Schoombee in Rwigema & Venter (2004), there are a number of reasons for this, which includes the following:

- As a result of the general conditions of poverty and limited resources, entrepreneurs do not have adequate collateral to secure their term loans.
- The administrative costs involved in screening term loan applications from entrepreneurs are high.
- Banks face low returns when investing in the SMME sector.

Nieman & Nieuwenhuizen (2009) further includes the following reasons for the lack of access to start-up and expansion finance for entrepreneurs:

- Risk aversion of the banking sector towards SMMEs, since SMMEs are traditionally seen as “high risk” borrowers. This is exacerbated by the high number of SMME business failures.
- Although financial institutions are willing to finance SMMEs, the business proposals submitted by the SMMEs are not well researched or presented properly.

Other factors include a lack of upfront market research by entrepreneurs and the risk of under-capitalisation and/or delays in reaching break-even points. These factors can adversely influence profitability, cash flow and the business’ solvency over the first few years (Ntsika, 2002).

Driver *et al* (2001) report that South African financial institutions have a history of dealing mainly with large corporations that undertake large projects. Their management skills in handling smaller businesses were not properly developed as they focused on large businesses with sufficient resources. They also state

that “fund managers have to show a good return on capital invested” and therefore focus on their own goals rather than that of the entrepreneur. There is often not enough of an incentive for them to take risk with a potentially high upside, because at the same time there could be a personal cost for them if they make the wrong lending decision.

As a result, the situation incentivises the financier to be more concerned on the upside risk (potential) and at that point, the entrepreneurs and financiers disconnect with each other. This is evidenced by the R68 million lost by the financial sector during the period of 2001 and 2005, as a result of the failure of 117 245 small business enterprises that were receiving government assistance (Streek in Rwigema & Venter, 2004).

2.3.1 MACROECONOMIC FACTORS AFFECTING BANK LENDING

In recent years, the increasing interest in financial stability as an autonomous policy target, along with monetary and micro-economic stability, has encouraged the analyses of the linkages between the macroeconomic environment and the soundness of the banking system (Quagliariello, 2009). There is substantial literature supporting the hypothesis that macroeconomic conditions affect the performance of the banking sector.

Salas and Saurina (2002) observed that macroeconomic shocks were quickly transmitted to Spanish banks’ balance sheets. During economic booms, intermediaries such as banks tend to expand their lending activity, often relaxing their lending criteria; in the following downturn, poor performing term

loans markedly increase, producing losses. Using a panel of Italian banks, Quagliariello (2007) found that loan loss provisions and bad debts increase in bad macroeconomic times.

Pesola (2001) shows that the high level of both corporate and households' indebtedness, along with shortfalls of GDP growth below forecast levels, contributed to the banking crises in the Nordic countries. Baum, Caglayan & Ozkan (2005) suggested that when macroeconomic uncertainty increases, the cross-bank dispersion of the share of risky loans to total assets diminishes, as uncertainty hinders the bank's ability to foresee investment opportunities. They claim that higher uncertainty makes the signals on expected returns noisier. Uncertainty would therefore push banks to rebalance the composition of their assets according to new signals provided by credit markets, adversely affecting the allocation of financial resources. This fosters herding behaviour and leads banks to behave more homogeneously than in quiet periods (Pesola, 2001).

Quagliariello (2009) sought to assess to what extent the macroeconomy affects banks' performance (cyclicality) and whether, in turn, banks' reaction to changing macroeconomic conditions further affects the macroeconomy, reinforcing cyclical fluctuations (procyclicality). Quagliariello (2009) confirms that banks' balance sheets are affected, simultaneously or with some delay, by the business cycle and claims that banks' behaviour is procyclical.

2.3.2 BANK STRATEGIC RISK FRAMEWORK

Risk management is defined as the process of planning, organising, leading and controlling the activities of an organisation in order to minimise the effects of risk on the said organisation's capital and earnings (Basel Committee, 1999). Enterprise risk management expands this process to include not just the risks associated with accidental losses, but also financial, strategic, operational and other risks as well (Basel Committee, 1999).

There are three basic types of risks faced by the banking industry, namely: Credit Risk, Market Risk and Operational Risk (Gupta, 2009).

- Credit Risk is the likelihood that a borrower or counterparty will not honour their obligations in accordance with the agreement. The goal of credit risk management is to maximise a bank's risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters (Gupta, 2009).
- Market risk can be defined as the risk of loss from adverse movements in financial market rates and prices (Hendricks & Hirtle, 1997).
- Whereas Operational Risk, which is intrinsic to the bank in all its material products, activities, processes and systems, is emerging as an important component of the enterprise-wide risk management system (Gupta, 2009).

Since exposure to credit risk continues to be the leading source of problems in banks worldwide, banks should have a keen awareness of the need to identify,

measure, monitor and control credit risk as well as to determine whether they hold adequate capital against these risks and that they are adequately compensated for risks incurred (Gupta, 2009).

According to Gupta (2009), the risk of banks with respect to SMME lending is:

- Opaque financials due to financials of SMMEs being tax planning orientated
- Asymmetric financial data which cannot be extrapolated for projections
- Credit risk correlated with parent industry segment as well as parent corporate
- SMME term loans have high credit process costs
- Exhibit high variation in expected losses within segments

2.3.3 BANK RISK ASSESSMENT PRACTICES

Brewer (2007) confirms that lending to small businesses is difficult because of the problems of information asymmetry and finding innovative ways to address these problems have the potential to increase credit availability to these firms. To overcome this problem, credit scoring, a statistical approach to predicting the probability that a credit applicant will default or become delinquent is used (Berger & Frame, 2007).

Though this underwriting method is well established in consumer credit markets, it has only been widely applied to small commercial credits for about the last decade. Similar statistical techniques, such as discriminant analysis, are

also used in lending to larger businesses but these are typically not focused on the personal credit history of the owners (Saunders, 2000).

As stated by Berger & Frame (2007), credit scoring of small business term loans is one of a number of transactions lending technologies for business credit based on “hard” quantitative information. The hard data for transactions technologies are easily observed, verifiable and transmitted, taking less time to accumulate than used in relationship-based funding. This difference between credit-scored and relationship-based term loans is important.

The typical relationship-based term loans are based on a business relationship built over years of lending, allows for substantial flexibility in loan terms. A long-term relationship funding arrangement allows the bank to offer concessionary rates to a borrower facing temporary credit problems, which the bank can later make up for when the firm returns to health (Brewer, 2007). Credit-scored term loans are likely to have less flexible terms set to maximise a lender’s profit period-by-period rather than over the life of a relationship (Brewer, 2007).

The evidence that Berger & Frame (2007) present on the effects of small business credit scoring seems to suggest that the use of small business credit scoring has increased at large banks and this greater usage has increased the availability of credit to small businesses especially to relatively risky borrowers or borrowers requesting longer loan maturity. As banks make greater use of credit scoring technologies, the nature of the lending to small businesses will be altered and will enhance the relationship between the small business borrower

and the lender (Brewer, 2007). The relationship is enhanced as banks rely more on easily verifiable and quantifiable financial data rather than on information obtained via long-term relationships.

According to Yeung (2009), in addition to the credit score, credit managers use the so-called '**5Cs**' criteria for term loan assessment:

- **Character:** the reputation of the applicant in terms of credit records, such as no records or bad debts and the mutual trust between the loan applicant and credit manager.
- **Capital:** the leverage or liability of the applicant, normally measured by debt-asset ratio.
- **Capacity:** the volatility of earnings (income) in terms of liquidity (cash flow) and usage of loans and receivables (including potential returns on projects), i.e. whether the applicant has the ability to repay the term loans on time.
- **Collateral:** normally in the form of physical fixed assets, especially real estate (due to its ease of tradability in the market), but can also be in the form of loan guarantees. Loan guarantees are normally in terms of a personal guarantee or through a guarantee institution e.g. an organisation normally funded by government, such as Khula.
- **Cycle:** macro-economic cycle, the periodic fluctuation in the rate of economic activity, as measured by levels of employment, GDP, prices and production.

In some selected cases where the credit score is just below the cut-off point, the character and collateral of the loan applicant are important for the final decision to lend or not. For instance, credit managers can approve the loan application should the applicant have a good track record of loan repayment and / or the applicant has collateral with a market value to cover part of the loan's principal (Yeung, 2009).

It is possible for credit managers to approve loan applications based on a set of informal (unwritten) policies, i.e. the formal criteria for loan assessment can be *de facto* bypassed. The unofficial criteria may include ownership of the SMME, size of the SMME and industrial sector (Yeung, 2009).

Gupta's (2009) approach to risk assessment of SMMEs includes the following:

- Industry: Correlation with industry trends, corporate linkages and length of relationships
- Business: Length of operations and sustainable levels
- Management: Experience, collateral and market standing (trade references)
- Financial: Sales, cash flows and availability of informal credit
- Transactional: Payment history, cash flows, defaults, return of collections etc

There are no standard criteria for credit lending since banks tend to set their own credit lending policies. Therefore, based on the above literature, a comprehensive model has been compiled by combining the key aspects

highlighted in the literature. Based on the above literature the following factors impact the credit risk assessment process:

Table 5: Risk assessment criteria used by South African commercial banks when financing entrepreneurial ventures.

CRITERIA	EXPLANATION
CHARACTER	<ul style="list-style-type: none"> • Credit history based on credit score • Trade references - reputation of business with suppliers and customers • Letter of good standing - bank report based on existing relationship with the potential lending institution. • Management skills and experience
CAPITAL	<ul style="list-style-type: none"> • Leverage of the business, normally measured by debt-asset ratio • Strength of balance sheet
CAPACITY	<ul style="list-style-type: none"> • Business profitability • Volatility of income • Existing and projected cash flow • Financial ratios including profitability ratios, liquidity ratios, efficiency ratios, debt ratios with interest cover being one of the most important
COLLATERAL	<ul style="list-style-type: none"> • Normally in the form of fixed assets or loan guarantees
CYCLE	<ul style="list-style-type: none"> • Macroeconomic cycle: rate of economic activity - economic growth; rate of unemployment; GDP; Consumer Price Index; Production
INDUSTRY	<ul style="list-style-type: none"> • Industry performance; • Performance of business relative to its competitors and the overall industry; • Consumer demand; • The bank's current exposure to the industry sector – risk appetite;

	<ul style="list-style-type: none"> • The bank's impairments relating to the industry sector
THE LOAN	<ul style="list-style-type: none"> • Loan: amount of the loan, interest charged by the bank and loan maturity

This integrated theoretical framework will be used to compare and contrast the risk assessment practices of the largest South African commercial banks when funding entrepreneurial ventures with term loans. In addition, the research explores the changes in lending practice of the banks since the global economic crisis in 2008.

3. RESEARCH QUESTIONS

Entrepreneurs and small business owners who apply for funding express reservations about the availability of finance from financial institutions. The views of the financial institutions are that funds are available but a limited numbers of **viable** business projects are forthcoming. Initial exploratory investigation, however, indicated that access to finance (start-up and expansion) is the most cited reason for business non start-up and failure (Herrington *et al*, 2008).

What causes concern is the apparent lack of common perception between funders and entrepreneurs. It is important to note that while banks may still be conservative in their lending strategy, entrepreneurs applying for finance are often under-prepared and do not provide sufficient relevant information (Herrington *et al*, 2010).

Many aspirant and existing entrepreneurs complain that there is a lack of access to funding in South Africa. However, studies done by the Global Entrepreneurship Monitor clearly show that South Africa is no worse off with regards to access to funding than other developing countries (Herrington *et al*, 2010). Banks are understandably reluctant to lend to SMMEs without sufficient collateral or surety, since they are the custodians of their clients' money and are required to produce an acceptable return on investment to shareholders (Herrington *et al*, 2010).

Initial pre-investigation discussions (informal) with financial institutions and entrepreneurs indicated that financiers are not willing to take any risk, however minimal, in funding entrepreneurial ventures and this triggered the investigation. The findings of Herrington *et al* (2008), confirm that financial institutions are not able to interact effectively with entrepreneurs, thus supporting this statement. This statement also underlines the importance of the investigation.

The research is therefore to establish whether there is consistency in the risk assessment practices of the commercial banks amongst each other and compared to the integrated theoretical framework discussed above. The research will be limited to the four major banks and their decision-making in funding entrepreneurial ventures that have a turnover of between R5 million and R40 million.

To investigate the problem as stated above the following research questions are set to govern the thinking during the investigation:

Research Question 1

- What are the risk assessment practices used by South African commercial banks when funding entrepreneurial ventures and do they differ from the integrated theoretical framework based on various literature sources?

Research Question 2

- Is there consistency of the risk assessment practices amongst South African commercial banks when funding entrepreneurial ventures?

Research Question 3

- How has the impact of the global economic crisis of 2008 affected the risk assessment practices used by South African commercial banks when funding entrepreneurial ventures?

4. RESEARCH METHODOLOGY

The purpose of the research is to establish whether there is consistency in the risk assessment practices of the South African commercial banks when funding entrepreneurial ventures for business term loans. In addition, the research seeks to explore the impact of the global economic crisis of 2008 on the risk assessment practices used by South African commercial banks when funding entrepreneurial ventures for business term loans. The research will be limited to the four major banks, their procedures and how it could affect potential decision-making.

4.1 RESEARCH DESIGN

The research will largely follow a qualitative approach. However, where meaningful quantitative analysis is possible, it will be performed. Such quantitative analysis will be largely descriptive in nature. The qualitative research will be conducted through a combination of questionnaires followed by interviews (Bell, 2006), which will enable detailed analysis and the synthesis of data to extract common themes and concepts.

Qualitative research through expert interviews methodology will be followed in this study due to the exploratory nature of the study. In order to decide on the methodology to be used, the critical condition to decide on the research methodology is to decide on the type of questions to be used (Yin, 2003). Yin further says that the “how” and “why” questions are likely to favour the use of expert interviews. The methodology would provide valuable insights on the risk

assessment practices by South African commercial banks when funding entrepreneurial ventures.

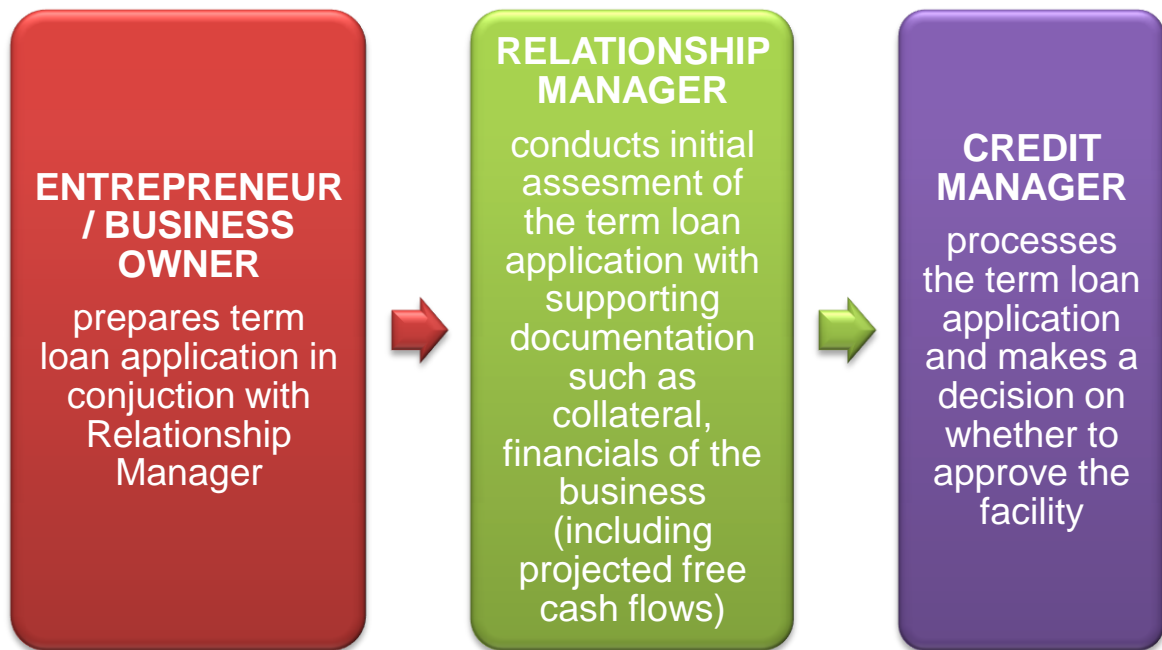
4.2 UNIT OF ANALYSIS

In order to determine the unit of analysis, a researcher needs to make a decision whether the level of investigation would focus on the collection of data about the entire organisation, departments, work groups, individuals or objects (Zikmund, 2003). In this instance, the Unit of Analysis is the banks namely: First National Bank, ABSA, Standard Bank and Nedbank.

4.3 POPULATION OF RELEVANCE

The research seeks to establish, compare and contrast risk assessment practices used by South African commercial banks when funding entrepreneurial ventures, so the population of relevance in this study would be the Credit Managers of the banks. In addition, the Relationship Managers who prepare the loan applications and act as the primary filter of whether a term loan application reaches the Credit Managers.

Figure 1: Term loan application process



A targeted group of respondents have been identified at each bank using convenience and snowballing techniques (Zikmund, 2003) by identifying which Relationship Managers manage portfolios of entrepreneurial ventures that have a turnover of between R5 million and R40 million i.e. medium-sized enterprises. Thus, the term loan applications that these Relationship Managers would process would be for expansion or long term financing requirements. These Relationship Managers would then refer the applications to the relevant Credit Managers who support them.

4.4 SAMPLING METHOD AND SIZE

A non-probability sampling method will be applied in this study. Judgement sampling will be utilised in this study in order to ensure that only individuals that have the responsibility of assessing risk of entrepreneurial ventures will be part of the study. Zikmund (2003) recommends a non-probability judgement sampling method when the researcher based on his/ her judgement selects only individuals with the appropriate characteristics required for the study. The sample will consist of four Relationship Managers and four Credit Managers from each bank. Therefore a total sample size of sixteen respondents will be contacted.

4.5 DATA COLLECTION PROCESS

The data collection will be conducted using expert interviews (face-to-face) guided by a questionnaire which require asking the population of relevance to rank the various criteria that comprise of the risk assessment framework of their organisation when funding entrepreneurial ventures. In addition, they will be required to comment on the changes (if any) in the risk assessment framework since the global economic crisis of 2008.

The interviews will be directed to members of the team who are responsible for the preparation of the loan application, i.e. Relationship Managers and those who are mandated with the final decision of granting the term loan to the entrepreneurial ventures, i.e. Credit Manager. The idea is to learn how and why they grant funding to entrepreneurial ventures. Interviews allow the researcher

to ask open-ended questions will allow the respondents to give insights and opinion about the issues at hand (Yin, 2003).

4.6 DATA ANALYSIS APPROACH

Data analysis involves “breaking up” the data into manageable themes, patterns, trends and relationships (Mouton, 2001). The data collected from interviews will be analysed in two ways: Content analysis for the open-ended questions and cross-case analysis using the prior theory (Yeung, 2009; Gupta, 2009; Brewer, 2007; Berger & Frame, 2007). Companies will be codified and then given categories based on the theory. Frequency analysis would be utilised in the surveys. Frequency analysis is a method of defining the number of observations for all the values of a variable.

4.7 VALIDITY AND RELIABILITY

4.7.1 EXTERNAL VALIDITY

External validity of research is the extent to which the research findings apply to situations beyond the research itself (Bell, 2006). This has to do with the extent to which the conclusions drawn could be generalised to other contexts.

In order to ensure external validity, the research will be conducted amongst Relationship Managers and Credit Managers who are currently involved in the term loan application process of entrepreneurial ventures, i.e. within Business Banking. In addition, the level of individuals that will be selected to complete the questionnaires will need to have sufficient experience within the banking sector,

i.e. not less than four years, in order to provide reliable responses to the questions asked. Only these individual will be able to shed insights on lending practices prior to the global economic crisis in 2008.

4.7.2 INTERNAL VALIDITY

Internal validity refers to the extent to which the research design and the data it yields allows the researcher to draw accurate conclusions (Bell, 2006). This entails taking whatever precautions necessary to eliminate other possible explanations for the results. The research will ensure internal validity through an extensive literature review. Furthermore, in order to increase validity, triangulation was used by piloting the research questionnaire. Lastly, the questionnaire will be used as a basis for semi-structured interviews. A combination of the above approaches will increase the internal validity of the research outcome.

4.7.3 RELIABILITY

Reliability is the extent to which a test or procedure produces similar results under constant condition on all occasions (Bell, 2006). It has to do with the extent to which another researcher conducting similar research will arrive at similar conclusions.

In order to increase the reliability of this research, individuals that will be interviewed will have sufficient experience within the banking sector, i.e. at least

four years. Furthermore, all assumptions will be clearly stated in order for other researchers to identify underlying assumptions when following similar research.

4.8 RESEARCH LIMITATIONS

- Given that the study will be exploratory, providing qualitative information, the interpretation of the information will be judgemental.
- Conclusions will be subject to considerable interpreter bias.
- Risk management practices evolve over time therefore findings of the study may change in the future or be inconsistent between banks.
- The usage of open-ended questions in the interviews might result in perceptions of the interviewee being tested and not the actual organisational situation.

4.9 CONSISTENCY MATRIX

See **Appendix B** for the consistency matrix in relation to the methodology used.

5. PRESENTATION OF RESULTS

5.1 INTRODUCTION

This chapter will present the findings of the research, which will be divided into three sections with reference to the three research questions formulated as part of the literature review. For each research question, the researcher posed a set of questions through a questionnaire to the interviewees in order to contextualise the issues being considered. This was then followed by an expert interview and discussion to understand the interviewee's approach to the research questions. The results will be presented under the following sections:

- The risk assessment practices used by South African commercial banks when funding entrepreneurial ventures compared to an integrated theoretical framework.
- Consistency of the risk assessment practices amongst South African commercial banks when funding entrepreneurial ventures.
- The impact of the global economic crisis of 2008 on the risk assessment practices used by South African commercial banks when funding entrepreneurial ventures.

In order to present context to the study, it is important to firstly provide a profile of the respondents.

5.2 PROFILE OF RESPONDENTS

Set out in Table 6 is the profile of the sample of participants surveyed:

Table 6: Profile of respondents

Number	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Male or Female	M	F	M	F	F	F	F	F	M	M	F	M	M	F	F	M
Role at the bank	Zone Head of Credit	Commercial Banker	Commercial Banker	Credit Portfolio Manager	Credit Manager	Credit Manager	Business Manager	Business Manager	Account Executive	Account Executive	Credit Manager	Credit Manager	Former Managing Exec Small Business	Rel Manager	Rel Manager	Credit Official
No of years in role at the bank	10	4	7	6	6	8	4	7	6	4	7	6	4	4	5	6
Size of businesses in portfolio	R6mil – R40mil	R5mil – R40mil	R5mil – R60mil	R5mil – R60mil	R7mil – R50mil	R7mil – R50mil	R7mil – R50mil	R7mil – R50mil	R5 mil – R100mil	R10mil – R50mil	R5mil – R100mil	R5mil – R100mil	Up to R10mil	Up to R10mil	Up to R10mil	Up to R10mil
Maximum mandate	R7,5 mil	R500k – system approvals	R500k – system approvals	R750k	R2mil	R4mil	All approved by credit	All approved by credit	All approved by credit	All approved by credit	R2mil	R2mil	R6mil	All approved by credit	All approved by credit	R3mil

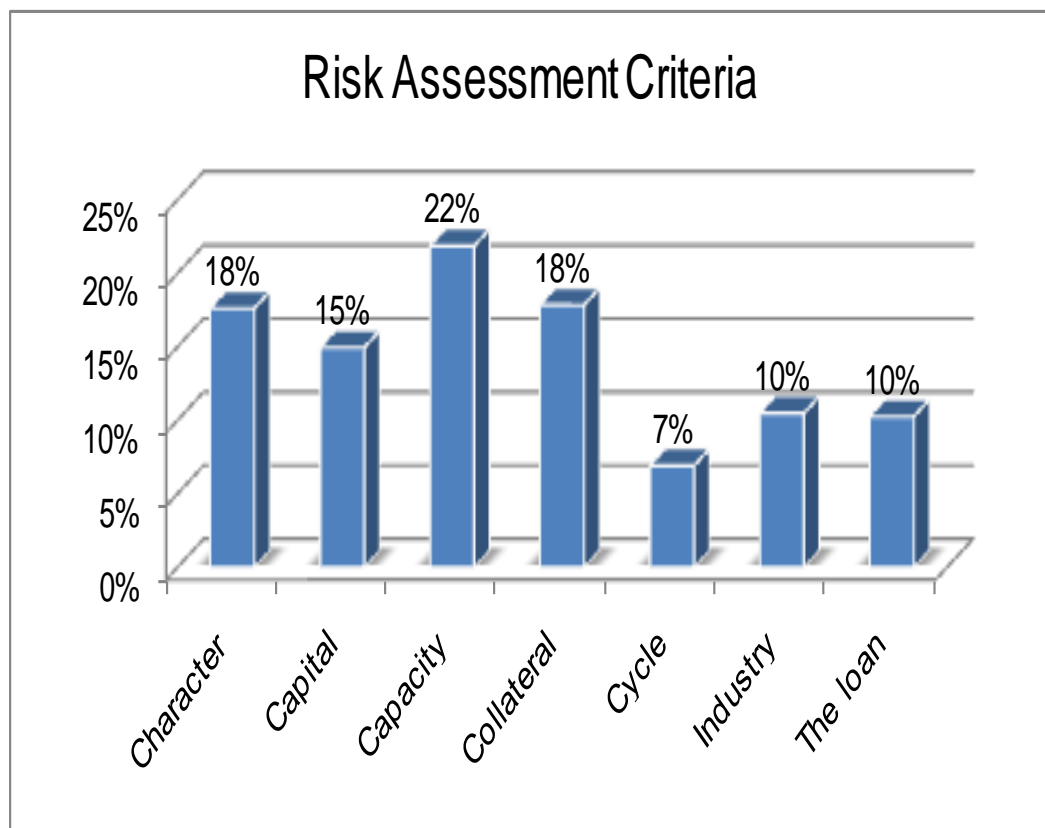
A total of sixteen participants were provided with survey questionnaires followed by expert interviews guided by the questionnaire provided.

The next section will present the results of both the interview questionnaire and the actual interviews. These will be summarised in a graph format, presenting the common themes emerging from the various discussions and the questionnaires. Each theme summary will be followed by detailed presentation of the results from the study.

5.3 THE RISK ASSESSMENT CRITERIA COMPARED TO AN INTEGRATED THEORETICAL FRAMEWORK

Set out in Figure 2 is a presentation of the risk assessment criteria that the respondents were asked to rank, in order of importance, when processing a term loan. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important when funding entrepreneurial ventures.

Figure 2: Risk assessment criteria used by South African commercial banks when funding entrepreneurial ventures



There was consensus amongst the respondents that all the criteria played a role in the assessment of credit risk in the term loan application process. The combined criteria assisted in formulating a complete view of the business. The majority of the respondents ranked the capacity of the business as the most important criterion when funding entrepreneurial ventures. The ability of the business to repay the loan on time influenced 22% of the decision.

This was followed by:

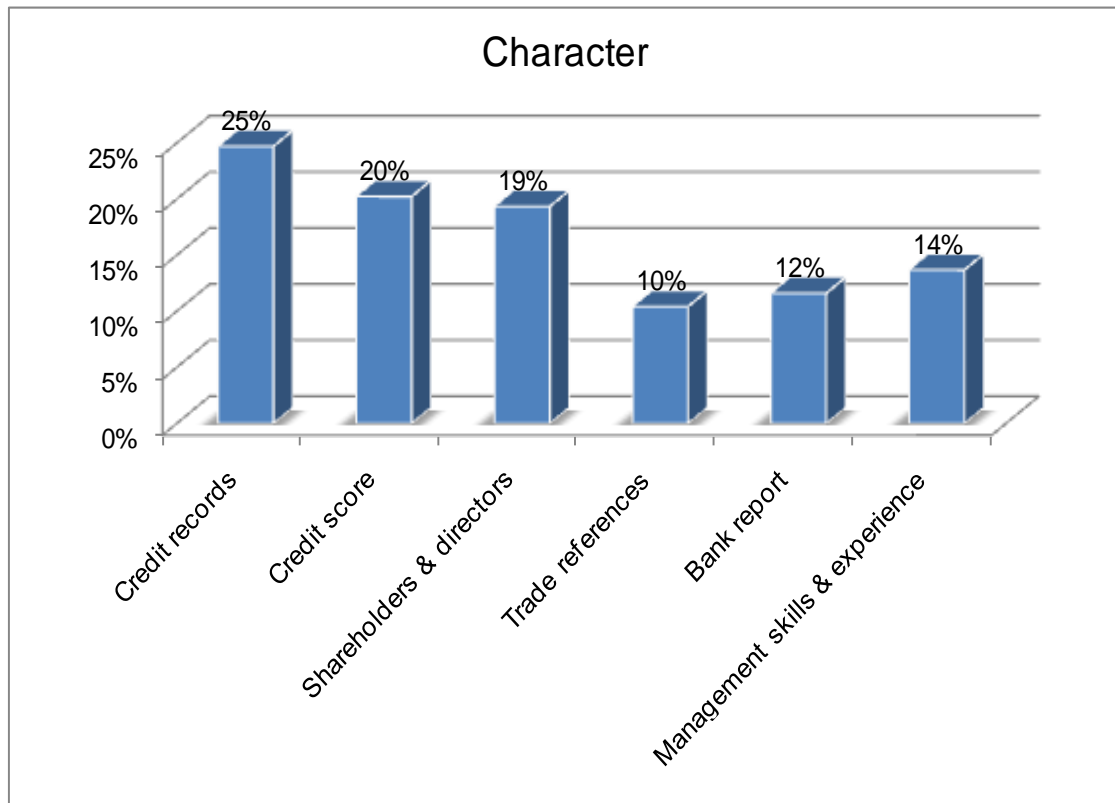
- Character (18%): reputation of the business and;
- Collateral (18%): security that the business provides against the loan.

The top three criteria accounted for 58% of the decision. The macro-economic cycle (7%) was the criterion that was ranked as the least important by the majority of respondents, the main reason being that the underlying business is more important than the macro-economic cycle.

5.3.1 EVALUATING THE BUSINESS' CHARACTER

Survey participants were asked to rank, in order of importance, the criteria used to evaluate business' character when processing a term loan. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important, when processing a term loan as well as whether there were any additional factors considered as part of the business' character.

Figure 3: Evaluating the business' character



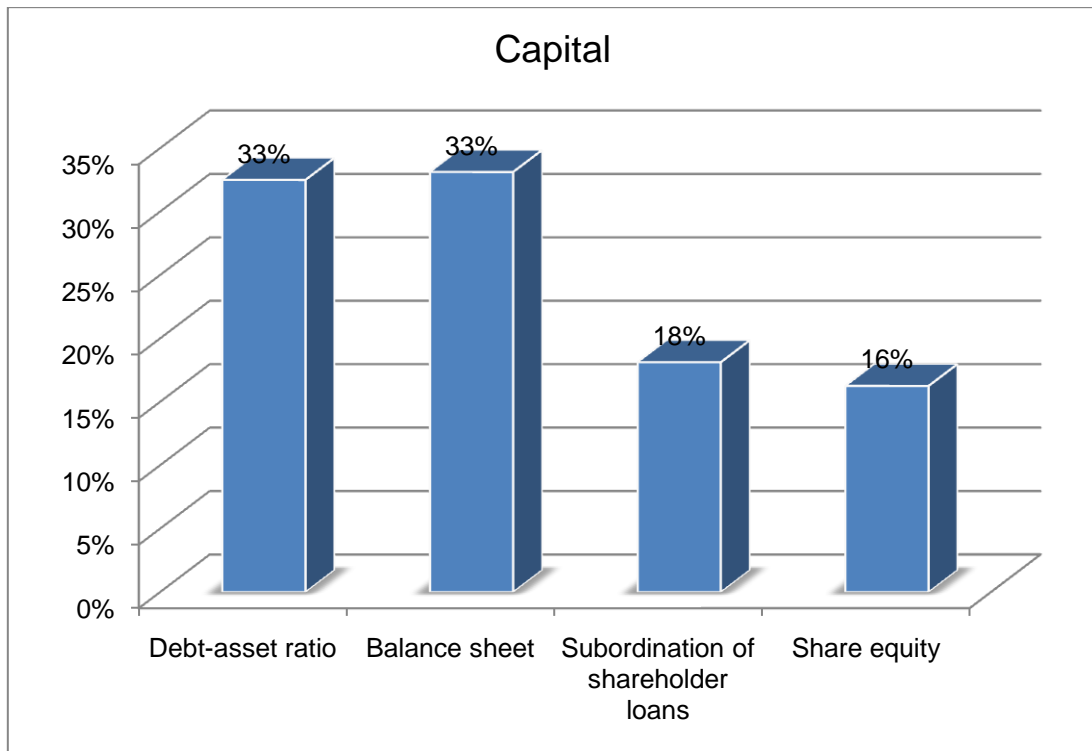
The majority of respondents ranked the business' credit records (25%) as the most important criterion as it influenced a quarter of the business' character. This was followed by the credit score (20%) and the shareholders and directors (19%) of the company. The least important criterion was the business' trade references (10%). The main reason being that trade references were mainly considered when assessing debtor financing.

5.3.2 EVALUATING THE BUSINESS' CAPITAL

Survey participants were asked to rank, in order of importance, the criteria used to evaluate business' capital when processing a term loan. In addition, respondents were asked to provide reasons for the criteria that were ranked as

most important and least important, when processing a term loan as well as whether there were any additional factors considered as part of the business' capital.

Figure 4: Evaluating the business' capital

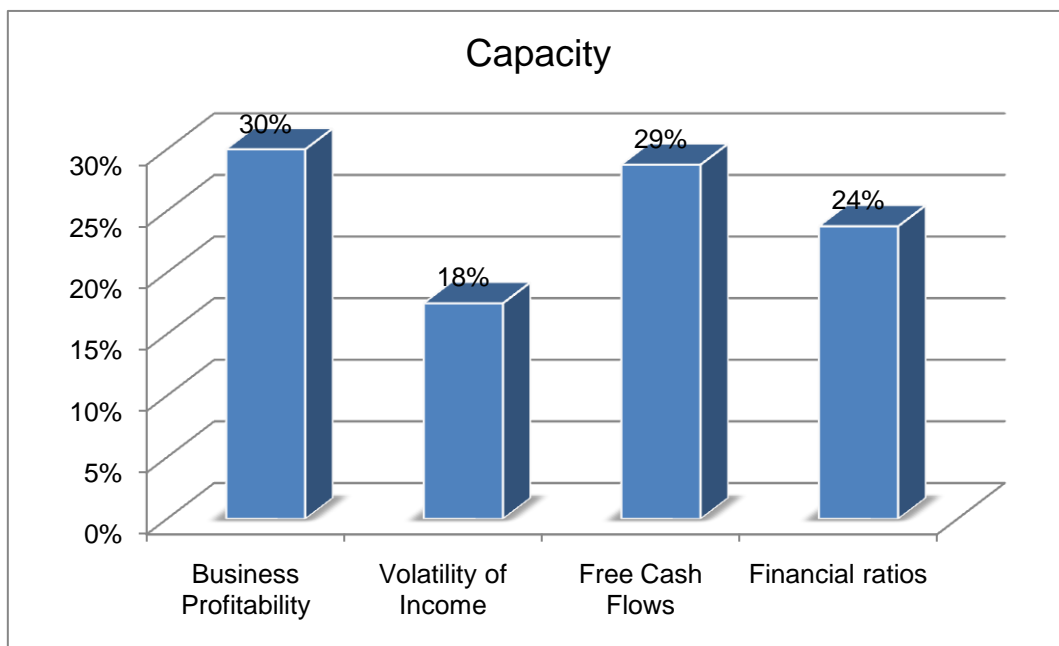


The majority of respondents ranked the business' debt-asset ratio (33%) and strength of balance sheet (33%) as the most important criteria. These two criteria accounted for 66% of the business' capital. The least important criterion was the business' share equity (16%), the main reason was that whilst this measure was a good indication of the investment made by the shareholders into the business, the bank has limited influence on how that would change in the future.

5.3.3 EVALUATING THE BUSINESS' CAPACITY

Survey participants were asked to rank, in order of importance, the criteria used to evaluate business' capacity when processing a term loan. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important, when processing a term loan as well as whether there were any additional factors considered as part of the business' capacity.

Figure 5: Evaluating the business' capacity

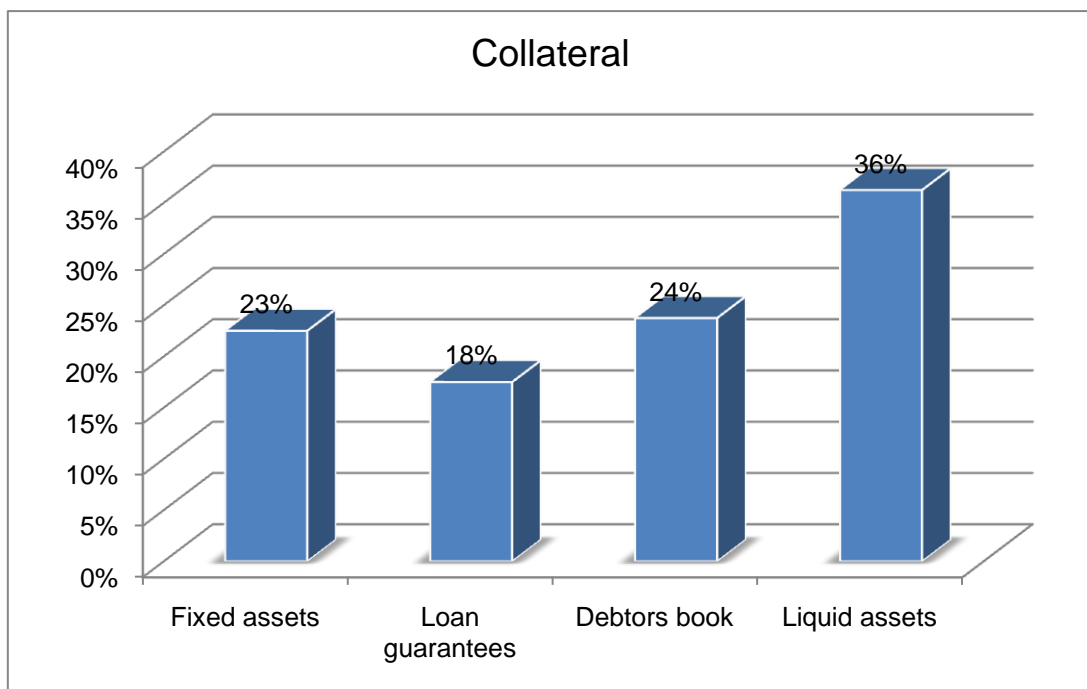


The majority of respondents ranked the business' profitability (30%) and free cash flows (29%) as the most important criteria. These two criteria accounted for 59% of the business' capacity. The least important criterion was the volatility of income (18%), the main reason being that there are substantial businesses that are in cyclical industries where volatility of income cannot be avoided.

5.3.4 EVALUATING THE BUSINESS' COLLATERAL

Survey participants were asked to rank, in order of importance, the criteria used to evaluate business' collateral when processing a term loan. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important, when processing a term loan as well as whether there were any additional factors considered as part of the business' collateral.

Figure 6: Evaluating the business' collateral



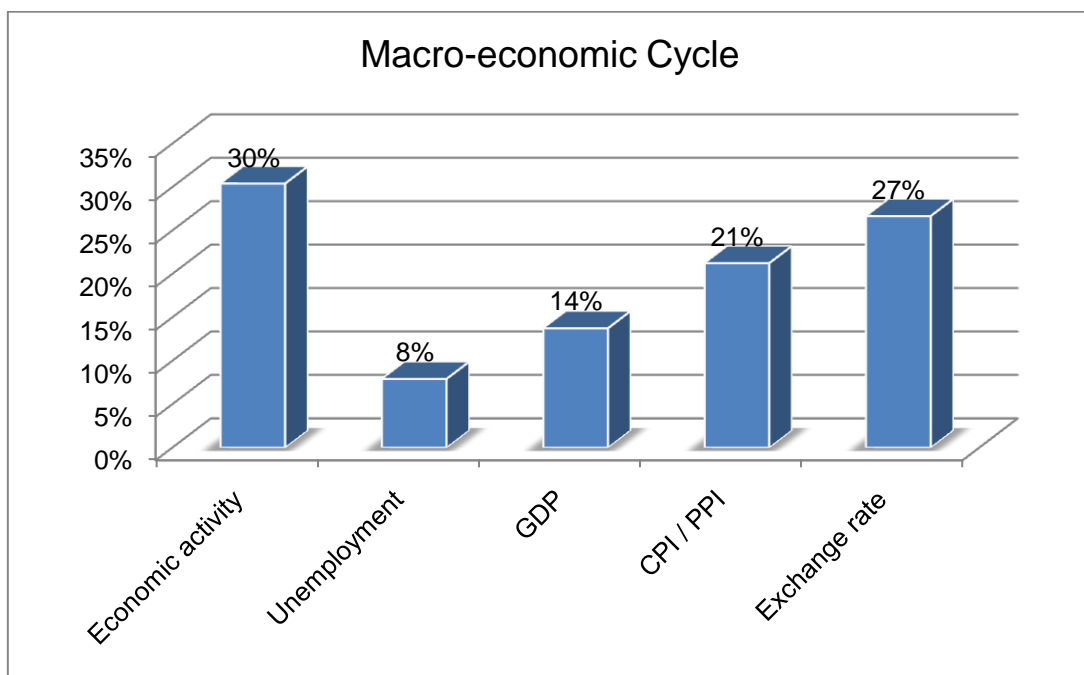
The majority of respondents ranked the business' liquid assets (36%) as the most important criterion. The liquid assets can be in the form of cash or inventory. The debtor's book (24%) was the second most important criterion. The respondents emphasised that the spread, quality and age of the debtor's book were important factors in evaluating the overall book. The least important

criterion was the loan guarantees (18%), the main reason being that often business owners do not have sufficient assets to underpin their personal sureties and if they do, it is in the form of illiquid assets, such property or insurance policies.

5.3.5 EVALUATING THE IMPACT OF THE MACRO-ECONOMIC CYCLE

Survey participants were asked to rank, in order of importance, the criteria used to evaluate the impact of the macro-economic cycle on the business when processing a term loan. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important, when processing a term loan as well as whether there were any additional factors considered as part of the macro-economic cycle.

Figure 7: Evaluating the macro-economic cycle

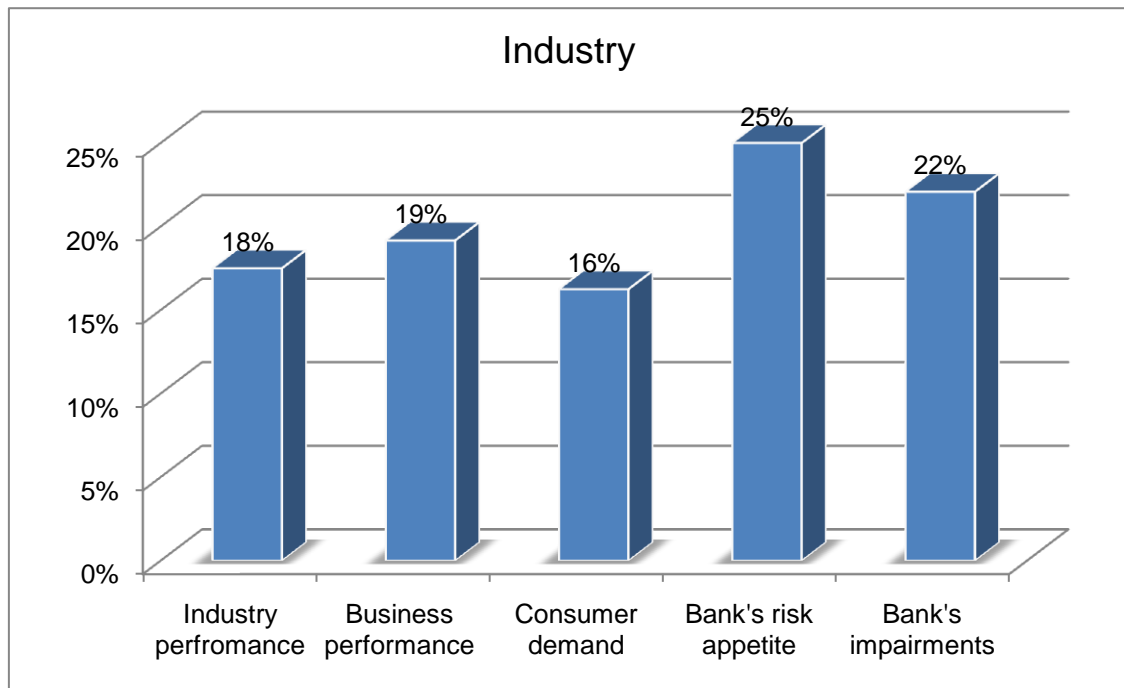


Whilst there was consensus amongst the respondents that overall the macro-economic cycle was the least important criterion in the risk assessment practices of South African commercial banks when funding entrepreneurial ventures. The majority of respondents ranked the rate of economic activity (30%) as the most important criterion in evaluating the impact of the macro-economic cycle on the business when processing a term loan. This is supported by theory that when the economy is growing, the benefits are widespread resulting in the majority of businesses experiencing revenue growth. The least important criterion was the unemployment rate (8%) in the country, mainly because the bank did not focus on the impact of unemployment on a specific business.

5.3.6 EVALUATING THE IMPACT OF THE INDUSTRY

Survey participants were asked to rank, in order of importance, the criteria used to evaluate the impact of the industry on the business when processing a term loan. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important, when processing a term loan as well as whether there were any additional factors considered as part of the industry.

Figure 8: Evaluating the industry

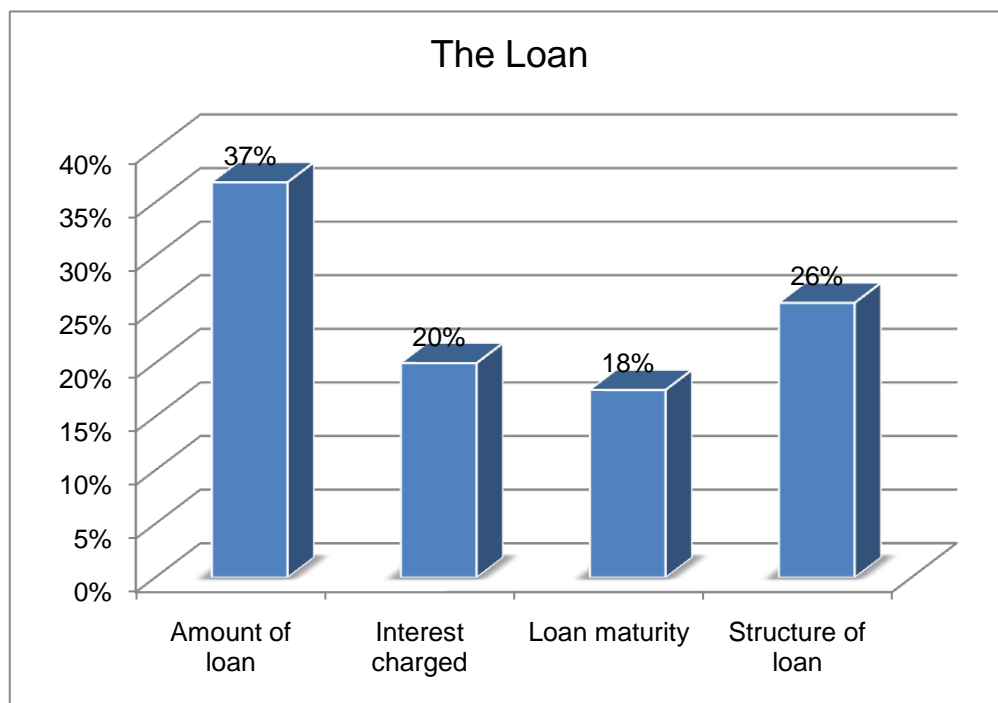


A substantial number of respondents mentioned that they did not have access to detailed industry data thus impacting on their ability to adequately assess the impact of the industry on a specific business. Most of the institutions had general reports that were circulated within the bank. The respondents ranked the bank's risk appetite (25%) and bank's impairments (22%) as the most important criteria in impacting the business when applying for a term loan, as these directly relate to the bank's performance in that specific industry. The least important criterion was the consumer demand (16%), primarily because the institutions did not have access to this information pertaining to the specific business.

5.3.7 EVALUATING THE BUSINESS LOAN

Survey participants were asked to rank, in order of importance, the criteria used to evaluate the business loan. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important when evaluating business loan as well as whether there were any additional factors considered as part of the business loan.

Figure 9: Evaluating the business loan



The majority of respondents ranked the amount of the loan (37%) as the most important criterion as it sets the basis of establishing the affordability / capacity of the business to service the loan. The least important criterion was the loan maturity (18%); the main reason being that maturity of the loan can be restructured during the term of the loan if necessary.

5.4 CONSISTENCY OF THE RISK ASSESSMENT PRACTICES USED BY SOUTH AFRICAN COMMERCIAL BANKS

The risk assessment criteria used by the various banks included in the study were consistent. However, different banks placed greater emphasis on different factors. This meant that all the banks concurred that all the risk assessment criteria were all important in the assessment of a term loan application.

The main area of difference was the term loan application process followed by the various banks. The first difference was that in some of the banks, the loan application process was more systematised than in others. As a result, loan applications for amounts lower than a certain amount, were system processed without the credit representative being involved.

Secondly, in certain instances the relationship managers / account managers / commercial bankers / business managers (client facing officials), played a greater role in the vetting of the loan application than in others. This meant that they not only collated the loan application information, but they also ensured that the correct product was being applied for by the business. Some of the client facing officials were even permitted to decline a loan application at source based on an initial evaluation without involving the credit official.

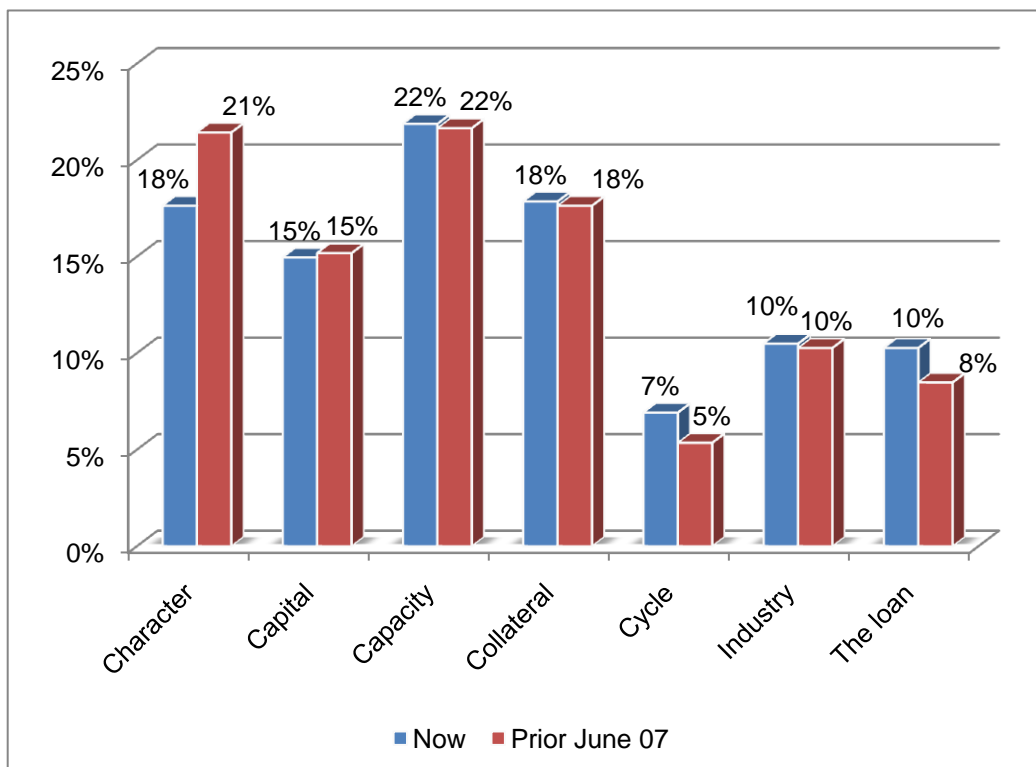
Lastly, the various credit managers / officials had different mandates in terms of the amount of the loan they were authorised to approve. They all typically had a team of client facing officials that they were responsible for and the management of their portfolios. Should a loan application be for an amount that

was beyond their mandate, they could either team up with another credit official to evaluate the application or refer it to the next level of credit official, i.e. their manager.

5.5 THE IMPACT OF THE GLOBAL ECONOMIC CRISIS OF 2008 ON THE RISK ASSESSMENT PRACTICES

Set out in Figure 10 is a presentation of a comparison of the risk assessment criteria that the respondents were asked to rank in order of importance pre and post to the economic crisis, when processing a term loan.

Figure 10: Impact of the economic crisis on risk assessment criteria



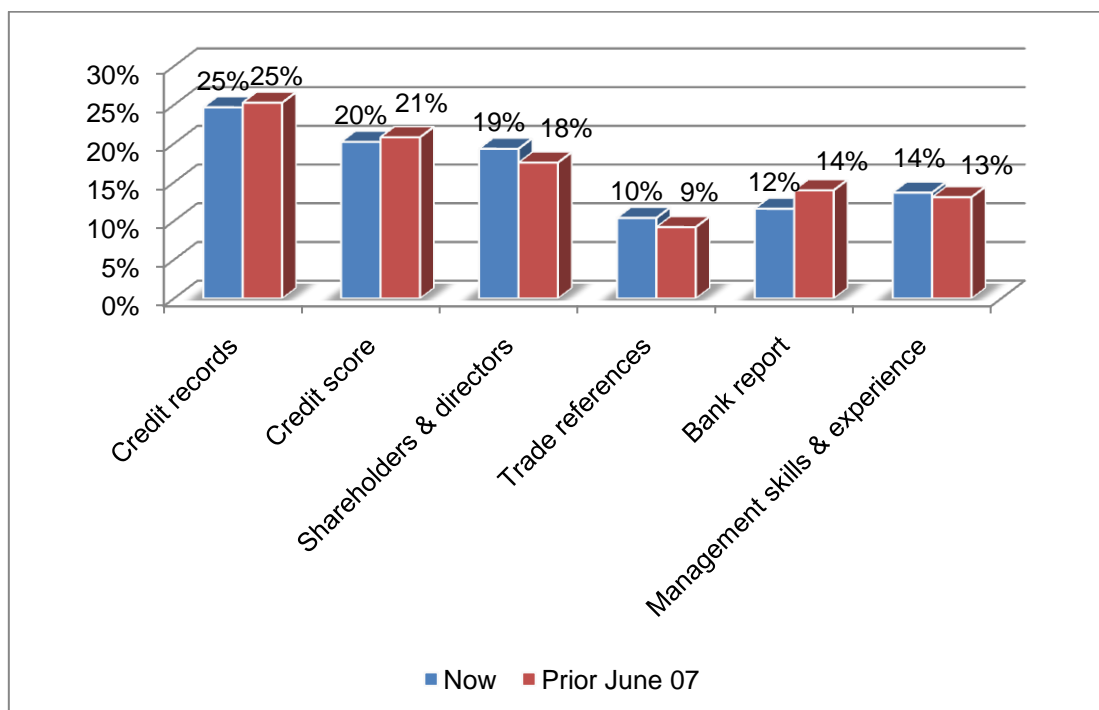
There was consensus amongst the respondents that the economic crisis had a slight impact on lending practices. All the respondents confirmed that the

greatest impact of the economic crisis was the fact that lending policies were adhered to more strictly than before. However, the lending policies themselves were not changed. This is demonstrated by the above results where four of the seven criteria were not impacted at all.

5.5.1 THE IMPACT OF THE BUSINESS' CHARACTER

Survey participants were asked to rank in order of importance, the criteria used to evaluate business' character when processing a term loan, prior to and post the economic crisis. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important when evaluating business' character when processing a term loan.

Figure 11: Impact of the economic crisis in evaluating the business' character

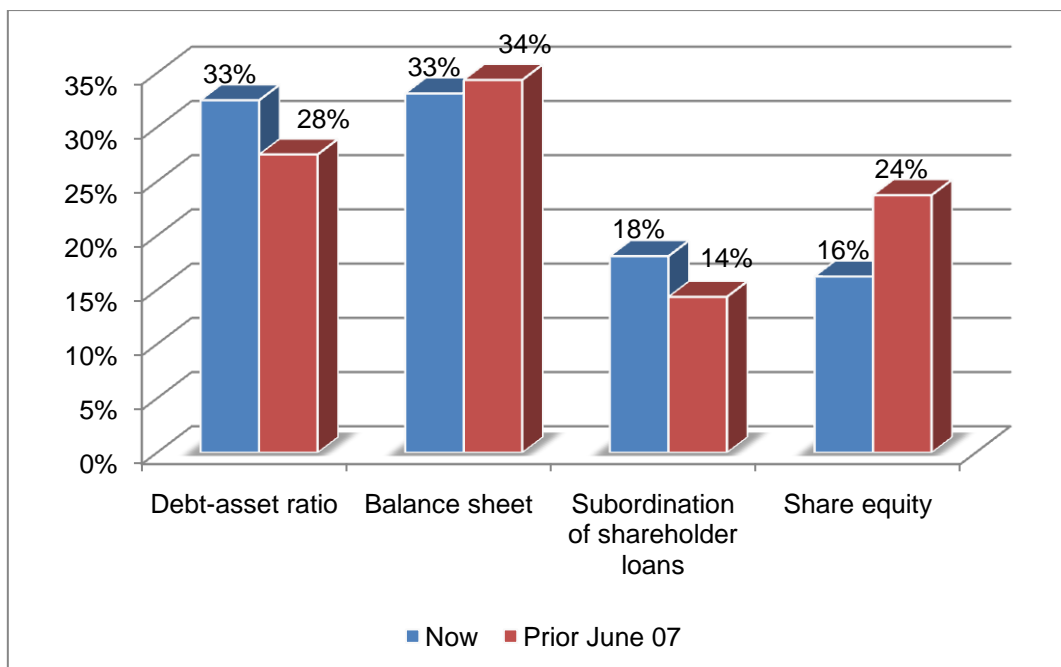


Credit records (25%) remained as the most important criterion followed by the credit score and the shareholders and directors of the company. The least important criterion remained the business' trade references.

5.5.2 THE IMPACT OF THE BUSINESS' CAPITAL

Survey participants were asked to rank in order of importance the criteria used to evaluate business' capital when processing a term loan, prior to and post the economic crisis. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important when evaluating business' capital when processing a term loan.

Figure 12: Impact of the economic crisis in evaluating the business' capital

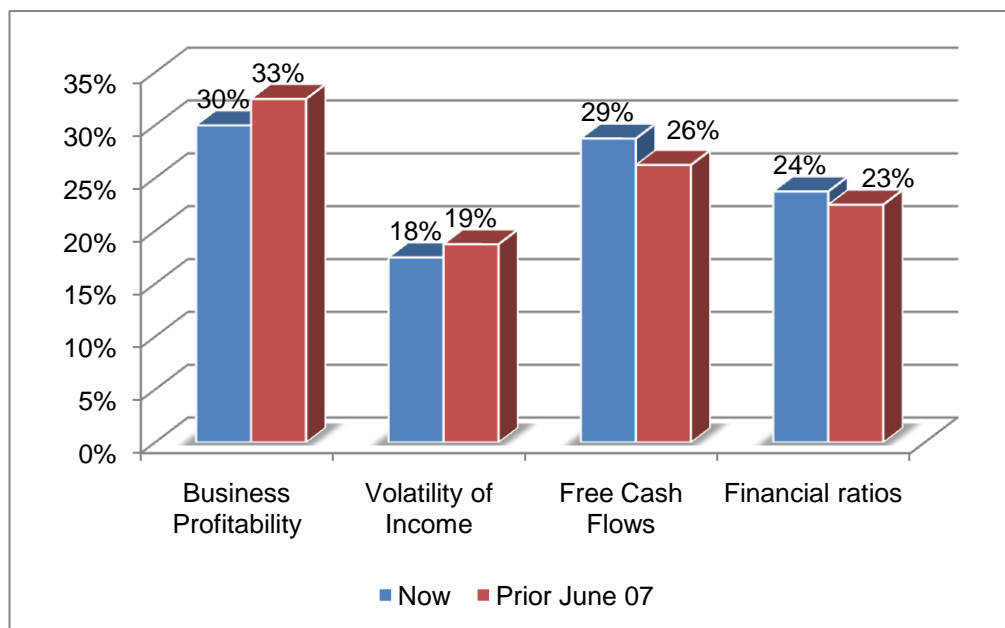


The strength of balance sheet of the business was the most important criterion followed by the debt-asset ratio, whereas now they are equally important. The least important criterion was the subordination of shareholder’s loans and greater importance was attributed to share equity.

5.5.3 THE IMPACT OF THE BUSINESS’ CAPACITY

Survey participants were asked to rank in order of importance the criteria used to evaluate business’ capacity when processing a term loan, prior to and post the economic crisis. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important when evaluating business’ capacity when processing a term loan.

Figure 13: Impact of the economic crisis in evaluating the business’ capacity

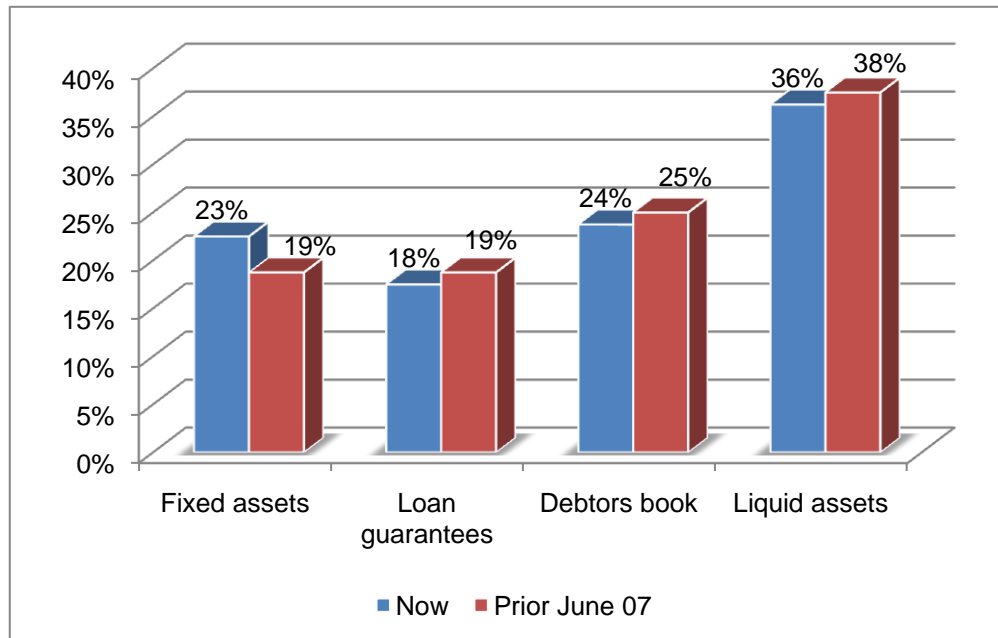


The business' profitability and free cash flows remained as the two most important criteria. The least important criterion remained the volatility of income.

5.5.4 THE IMPACT OF THE BUSINESS' COLLATERAL

Survey participants were asked to rank in order of importance the criteria used to evaluate business' collateral when processing a term loan, prior to and post the economic crisis. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important when evaluating business' collateral when processing a term loan.

Figure 14: Impact of the economic crisis in evaluating the business' collateral

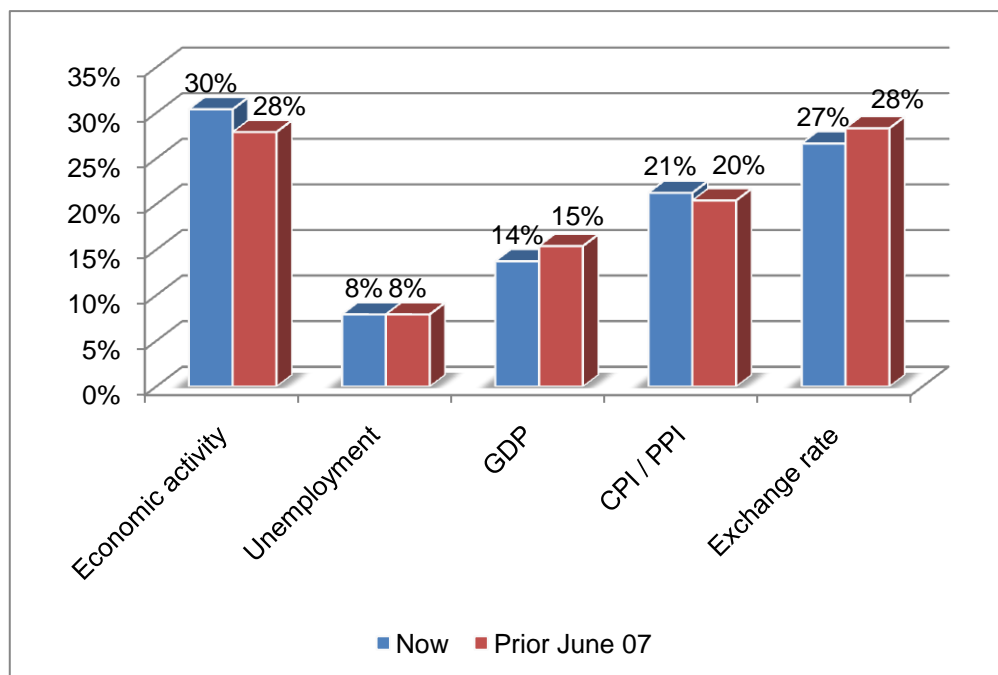


The business' liquid assets remained the most important criterion. The least important criterion remained the loan guarantees.

5.5.5 THE IMPACT OF THE MACRO-ECONOMIC CYCLE

Survey participants were asked to rank in order of importance the criteria used to evaluate macro-economic cycle when processing a term loan, prior to and post the economic crisis. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important when evaluating the macro-economic cycle when processing a term loan.

Figure 15: Impact of the economic crisis in evaluating the macro-economic cycle

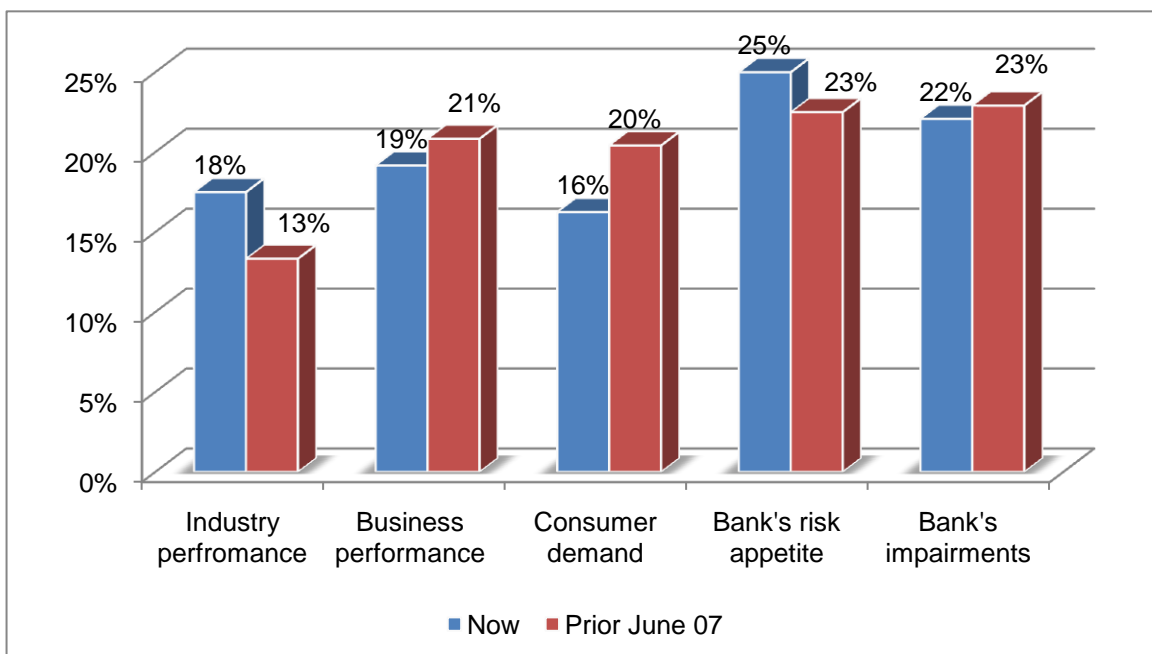


The rate of economic activity remained the most important criterion in evaluating the impact of the macro-economic cycle on the business when processing a term loan. This was followed by the exchange rate which impacted businesses that were in the import or export trade. The least important criterion remained the unemployment rate in the country.

5.5.6 THE IMPACT OF THE INDUSTRY

Survey participants were asked to rank in order of importance the criteria used to evaluate the industry when processing a term loan, prior to and post the economic crisis. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important when evaluating the industry when processing a term loan.

Figure 16: Impact of the economic crisis in evaluating the industry

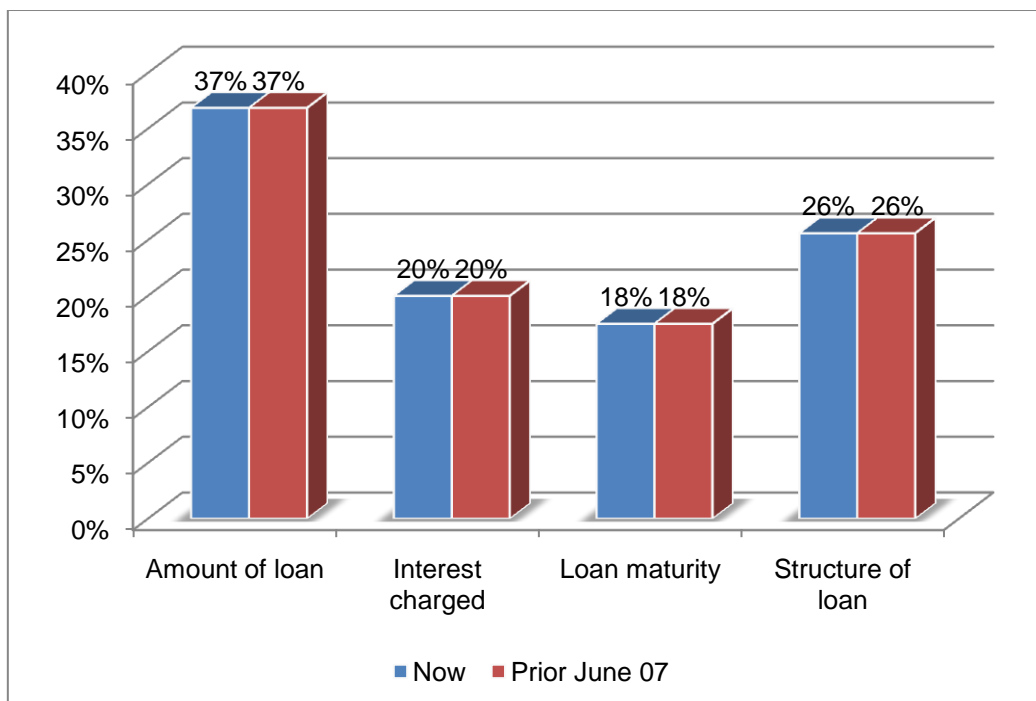


The bank's risk appetite and bank's impairments were equally important criteria in impacting the business when applying for a term loan. The least important criterion was the industry performance, primarily because the majority of industries were performing well prior to the economic crisis. Whereas currently the least important criterion is the consumer demand.

5.5.7 THE IMPACT OF THE FEATURES OF THE BUSINESS' LOAN

Survey participants were asked to rank in order of importance the criteria used to evaluate the business' loan when processing a term loan, prior to and post the economic crisis. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important when evaluating the features of the business' loan when processing a term loan.

Figure 17: Impact of the economic crisis in evaluating the business' loan



The amount of the loan remained the most important criterion. The least important criterion remained the loan maturity. All the various factors that are considered when evaluating the actual loan have not been impacted by the economic crisis.

5.6 SUMMARY OF RESULTS

In summary, the risk assessment practices used by South African commercial banks when funding entrepreneurial ventures were compared to an integrated theoretical framework. In addition, the impact of the global economic crisis of 2008 on the risk assessment practices used by South African commercial banks was investigated. This was done with a sample of sixteen respondents from the large four commercial banks, with an equal mix of credit and client facing officials in business banking.

They were asked to rank a set of predetermined criteria in order of importance on a questionnaire, beginning with an overarching set of criteria then various factors within each criterion. The completion of the questionnaire was followed by expert interviews using open ended questions, to gain further insight into their responses as well as gain clarity on the processes followed when processing a term loan application. Both the questionnaire and the expert interviews were guided by the research questions mentioned in 5.1 above.

The respondents agreed that all the criteria included in the integrated theoretical framework were important as they assisted in portraying a complete view of the loan application and the business. However, the three most important criteria ranked by the respondents were:

- Capacity – the ability of the business to repay the loan on time;
- Collateral – security for the loan and

- Character – the reputation of the business in terms of past financial behaviour.

Together, these criteria influenced 58% of the loan application decision and were the three most important criteria even prior to the economic crisis.

The impact of the economic crisis was a subtle one in that lending policies and risk assessment criteria were not amended due to the economic crisis. However, what did take place was that post the economic crisis the lending policies were more strictly adhered to resulting in the risk assessment criteria being applied thoroughly. This meant that businesses, who previously found it easier to borrow from the banks, were analysed in greater depth post the economic crisis.

Lastly, there was consistency in the risk assessment practices of the various banks. The main difference was in the processes that the banks followed, whether this was the level of the systematisation of the processes or the level of involvement of the client facing officials in the lending process or the mandates of the various credit officials.

6. DISCUSSION OF RESULTS

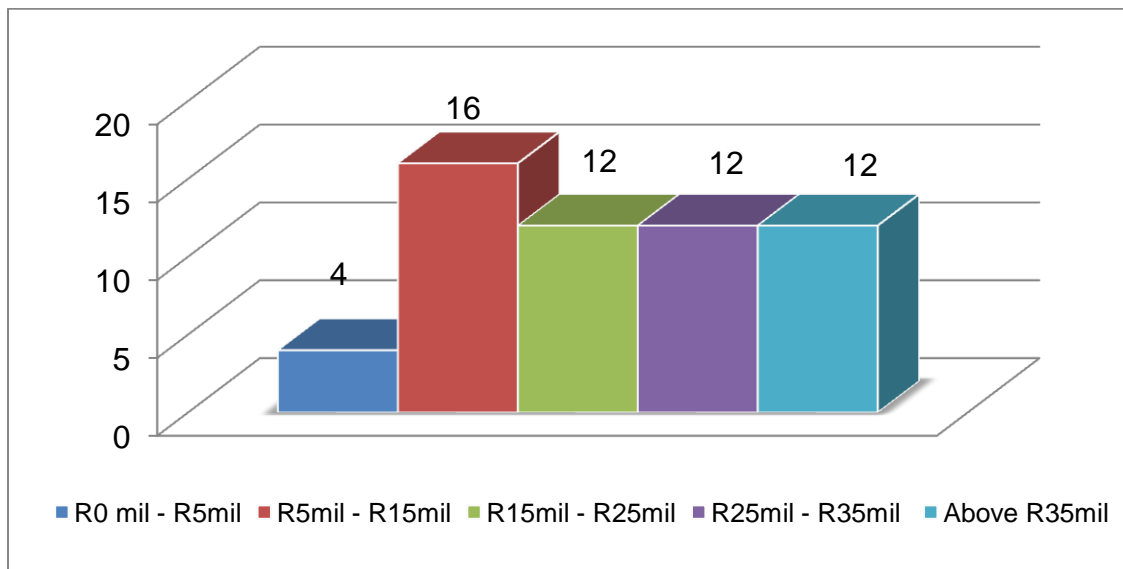
This chapter evaluates the research findings presented in Chapter 5 with reference to the literature review in Chapter 2 as well as research questions in Chapter 3.

6.1 ANALYSIS OF RESEARCH RESPONDENTS

The sample of respondents included in the study were within the business banking divisions of the four major commercial banks in South Africa, i.e. ABSA, First National Bank, Standard Bank and Nedbank. The various banks have different classifications of businesses that are within the R5mil – R40mil turnover range. Therefore, each respondent was requested to disclose the size of businesses in their portfolio to ensure that the correct respondents were sourced.

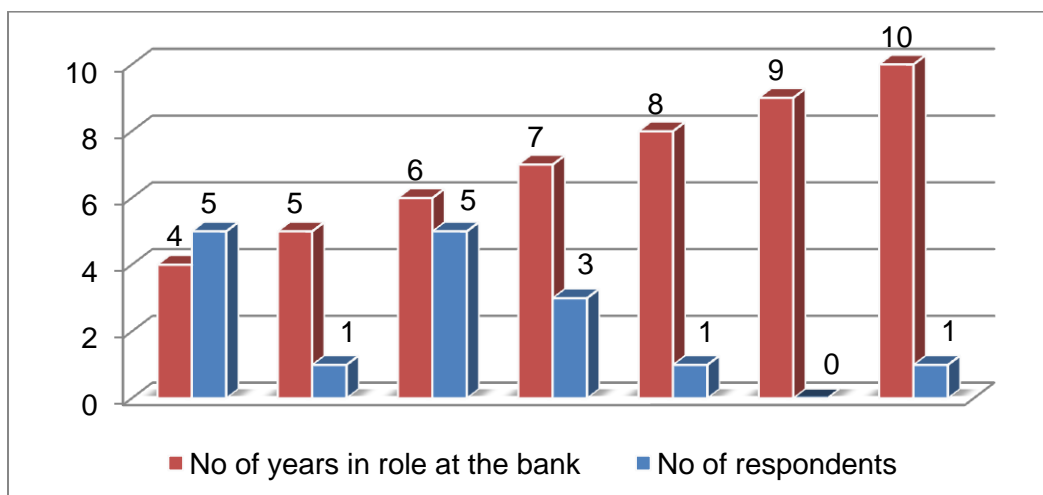
Figure 18 represents the size of businesses in the respondents' portfolios. All sixteen respondents managed businesses with a R5mil – R15mil turnover range. Twelve of the sixteen respondents managed businesses with R15mil and above turnover range. Of these respondents, the majority of their portfolios were in the turnover range of R15mil – R60mil, with a few outliers above the R60mil mark.

Figure 18: Size of businesses in the respondent's portfolios



The sample of respondents included an equal representation of credit officials and client facing officials. In addition, eleven of the sixteen respondents have been in their roles for between four and six years at the bank as depicted in Figure 19. This meant that they were able to adequately comment on the economic crisis.

Figure 19: Experience of respondents



6.2 THE RISK ASSESSMENT CRITERIA COMPARED TO AN INTEGRATED THEORETICAL FRAMEWORK

In compiling the integrated theoretical framework, a combination of Yeung (2009) and Gupta's (2009) perspectives were used. This resulted in the seven risk assessment criteria that make up the model i.e. character, capital, capacity, collateral, macro-economic cycle, industry and the loan.

The above risk assessment criteria were the criteria that the respondents were asked to rank in order of importance. Two of the respondents commented as follows:

Respondent 1:

“It has always been important in our business to look at our clients in a holistic manner and assess the overall desirability of the client. Risk mitigation plays an important role, but overall, if our client is reputable and supported by mitigated credit risk then we are more than halfway in making a good lending decision.”

Respondent 5:

“We always need to understand who we are dealing with and how they operate, to be able to understand their financial performance. Therefore all the criteria play a role in us gaining a better understanding of the client.”

The views of Burns (2001) and Berger & Frame (2007) were reinforced in the respondents ranking the capacity of the business as the most important criterion when funding entrepreneurial ventures, followed by character and collateral. These three criteria play a significant role in the lending decision and should either one of them not be satisfactory, would potentially result in the loan application not being approved. One of the respondents commented as follows:

Respondent 6:

“Even if all the other criteria have been met, if the business does not have the capacity to service the loan, the application will be declined. This is because a term loan is a contractual debt.”

What also emerged was that the assertion that Brewer (2007) made that banks would offer concessionary rates to a long-term client who is facing temporary credit problems was true. A significant number of respondents stated that since the recession, they have seen a growing number of businesses who are current clients of the bank but not able to service the requirements of the short-term funding such as overdraft facilities. One of the respondents commented as follows:

Respondent 2:

“We have approached a number of existing clients who were not servicing their overdraft facilities properly to covert a portion of their facility into a term loan, dependant on the reason for them battling to service their overdraft. Should the reason be a long-term problem that

could alleviate some pressure from the business, then we would enter into an agreement with the client to put into place a term loan facility. In other instances, we've had clients approach us and make us aware that they are experiencing problems. This has resulted in a flow of term loan facilities being put into place, provided the business has the capacity to service the term loan. I must emphasise that capacity is major deciding factor.”

6.2.1 THE CHARACTER OF BUSINESS

Berger & Frame (2007) highlight the importance of credit scoring in assessing a business' character. They suggest that the use of small business credit scoring has increased at large banks, resulting in risky borrowers being assessed on “hard” quantitative information. This is confirmed by the majority of respondents who ranked the business' credit records and credit score as the two most important criteria in assessing a business' character. One of the respondents commented as follows:

Respondent 6:

“The credit records provide all the necessary information about the company; however the quality of the shareholders / directors involved in the business are also important as they make certain decisions that could severely impact the business.”

In considering any additional factors that could influence the character of the business, a number of respondents mentioned that within their portfolios there

were certain shareholders and directors who had interests in more than one business. In this business segment, often the shareholder is also the director of the company as these businesses are not listed businesses i.e. not public companies. This means that the shareholders / directors could have exposures in more than one business. One of the respondents commented as follows:

Respondent 3:

“In addition to the factors that have been listed in assessing the business’ character, it’s important to assess any linked entities or businesses that the shareholders or directors have. This portrays a more comprehensive idea of the individuals behind the business.”

6.2.2 THE CAPITAL OF THE BUSINESS

The respondents ranked the business’ debt-asset ratio and strength of balance sheet as the most important criteria. They stated that the debt-asset ratio indicates the leverage in the business. Certain businesses are highly geared therefore long-term financing such as a term loan would not be suitable and would result in excessive interest payments for the business. Two of the respondents commented as follows:

Respondent 9:

“The balance sheet is important as it indicates the solvency and liquidity of the business as well as the reserves such as retained income, non distributable reserves and revalued assets in the business.”

Respondent 4:

“We would also consider cession of loan accounts depending on the size of the loan based on the equity of the business.”

In considering any additional factors that could influence a business’ capital, one of the respondents commented as follows:

Respondent 2:

“An additional aspect that we sometimes consider includes the retained earnings in the business as well as the revaluation of assets. These can further strengthen the business’ capital.”

6.2.3 THE CAPACITY OF THE BUSINESS

The Ntsika (2002) report highlighted that the lack of prior market research by entrepreneurs and the risk of under-capitalisation can adversely influence profitability, cash flow and the business’ solvency over the first few years. This is in line with the respondents that ranked the business’ profitability and free cash flows as the most important criteria. One respondent commented as follows:

Respondent 10:

“Free cash flow is critical to the survival of any business coupled with profitability. A business can be profitable but not have positive cash flows. Therefore we always look at the free cash flow that is available to fund the debt.”

Gupta (2009) stated that the risk of banks with respect to SMME lending included opaque financials and asymmetric financial data which cannot be extrapolated for projections. This was confirmed one of the respondents in commenting:

Respondent 16:

“It is also important for businesses to submit their two year projected cash flows. If the term of the loan is for five years, then five year projected cash flows to match the term of the loan would be appropriate. Correctly formulated financial projections with realistic assumptions are very important in assessing the capacity of the business.”

6.2.4 THE COLLATERAL OF THE BUSINESS

Burns (2001) states that many entrepreneurs seek a bank term loan in the name of their business. However, banks will usually insist on a personal guarantee by the business owner as well. This collateral can be in the form of business assets (cash, inventory, land, equipment or buildings belonging to the venture), personal assets (the entrepreneurs’ house, car, land, stock or bonds) (Hisrich & Peters, 1998).

The respondents ranked the business’ liquid assets as the most important criterion. The liquid assets can be in the form of cash or inventory. The debtor’s book was the second most important criterion. Two of the respondents commented as follows:

Respondent 4:

“Liquid assets in the form of cash or stock remain the first choice of collateral. If the collateral is in another form, the business needs to ensure that it can easily be converted into cash”

Respondent 7:

“It is important to note that in the current trading environment, less reliance is being placed on the debtor’s book. Primarily because the majority of businesses have been experiencing some sort of strain. A careful assessment of the debtor’s book is essential to determine the concentration, spread and quality of the debtors.”

In considering additional factors that impact on the business’ collateral, the sustainability of the business is a factor that was suggested. One of the respondents commented as follows:

Respondent 3:

“Another aspect that we consider in assessing the collateral of the business, is the business continuation. This can be in the form of keyman or buy and sell insurance.”

6.2.5 THE MACRO-ECONOMIC CYCLE

As stated, the respondents felt that the macro-economic cycle was the least important criterion overall unless it had a direct impact on the business. The factor that the respondents felt played most significant role in most businesses

was the rate of economic activity. This was followed by the exchange rate as the second most important factor. Two of the respondents commented as follows:

Respondent 11:

“It is obvious, that if the economy is strong and buoyant as we saw prior to June 2007, then the benefits are widespread. When the economy weakens, it has the opposite effect and some sectors can be more affected than others.”

Respondent 7:

“Exchange rate fluctuations are critical to a business that is involved in importing or exporting as this can severely impact on their profitability.”

In considering additional factors that can impact the business on a macro-economic level, legislative changes were mentioned. This is significant in South Africa as some industries are highly regulated. One respondent commented as follows:

Respondent 15:

“Another macro-economic factor that could impact a business is legislative changes, especially amendments that can influence how the business is operated.”

6.2.6 THE INDUSTRY

The respondents ranked the bank's risk appetite and bank's impairments as the two most important criteria in impacting the business when applying for a term loan. This is in line with Gupta (2009), who states that since exposure to credit risk continues to be the leading source of problems in banks worldwide, banks should have a keen awareness of the need to identify, measure, monitor and control credit risk as well as to determine they hold adequate capital against these risks and that they are adequately compensated for risks incurred. This was confirmed by two of the respondents in saying:

Respondent 13:

“The bank's risk appetite in a specific industry plays a critical role as well as the bank's impairments relating to that industry. Although it may happen that there is a business that is not following industry trends and due to the quality of its management is able to overcome the industry challenges. This business would be assessed on its actual performance as opposed to the industry's performance.”

Respondent 8:

“Because a business may be in a high risk industry sector, it does not necessarily mean the business itself is bad. Other factors are taken into account as they can have a bearing on the medium to long term performance of the business.”

6.2.7 THE BUSINESS LOAN

The respondents ranked the amount of the loan as the most important criterion followed by the structure of the loan. They also highlighted that often businesses are not realistic in their lending needs and sometimes request amounts that the business cannot sustain. This was further confirmed by one of the respondents in saying:

Respondent 8:

“The amount of the loan has to be backed up by a solid business case and strong financials. We have focused on ensuring that we price the loan correctly, should any risks be identified.”

Although financial institutions are willing to finance SMMEs, the business proposals submitted by the SMMEs are not well researched or presented properly (Nieman & Nieuwenhuizen, 2009). This includes businesses seeking the incorrect type of funding from the banks. One of the respondents commented as follows:

Respondent 12:

“Other aspects to consider include the reason for the loan. This ensures that the client is using the correct bank product and is not financing a short-term need with a long-term product or funding. In this manner we can ensure that the loan is structured in a way that best suits the needs of business.”

6.3 THE IMPACT OF THE GLOBAL ECONOMIC CRISIS OF 2008 ON THE RISK ASSESSMENT PRACTICES

There was consensus amongst the respondents that the economic crisis had a slight impact on lending practices on a day-to day basis. What was evident was that the more senior the respondent was within the bank, the more aware they were of the economic crisis on the bank. However, this does not appear to have filtered down to the level of the individuals that deal with clients directly.

The client facing respondents and first line credit officials were of the opinion that the only impact was that the lending practices were more strictly adhered to. This was confirmed by one of the respondents in commenting as follows:

Respondent 14:

“Not much has changed in the way we do things, except that now there is absolutely no deviation from lending policies. Many facilities already in place were placed on reduction in order to reduce the bank’s exposure, if the client was under pressure. Margining of debtors when calculating collateral has been changed drastically – there is almost no reliance placed on it.”

The more senior officials in the banks stated the follows:

Respondent 13:

“Our response to the economic crisis has been threefold. Firstly we have a pro-active collection strategy which includes closely monitoring our

current portfolio of clients to ensure that they meet their obligations. Secondly ensuring that there is a tightening of the scorecard and that it is properly adhered to. Lastly we have ensured that lending is done responsibly.”

Respondent 9:

“The global economic crisis had many varying impacts. The most notable at the start was the cost of funding which pushed up interest rates and caused a liquidity shortage in the market. Then we have seen a general dwindling of revenues and profitability, while smaller businesses went to the wall resulting in increased impairments. As a result we had to be more circumspect and risk averse, taking more security and better security became the order of the day.”

Respondent 1:

“The recent global financial crisis has resulted in increased political and regulatory pressure on banking systems worldwide. Some of these are likely to materialise in South Africa. The South African Reserve Bank is expected to implement the Basel III proposal based around capital and liquidity. The impact of 2008 was obviously felt by everyone but our lending principles did not necessarily change. Maybe our approach in a number of instances changed but not our lending principles. It must be understood that the collapse of the Lehman Brothers and the knock on effect to a number of other large foreign international banks (e.g. Bank of Scotland etc) was self-inflicted. In our bank, there may have been some

bad lending decisions in the past but our principles remained the same and although we may have tightened our belts, the process remains the same. We now have a huge challenge to grow our overdraft and loan book as we see bad debts reducing. Demand is still not at the levels we would like to see and the overall utilisation of facilities is under 50% of the overdraft book.”

7. CONCLUSION AND RECOMMENDATIONS

7.1 INTRODUCTION

This chapter will provide a summary of the findings of the study and conclusions with reference to the context and research questions discussed at the beginning of the study. Finally the study will be concluded by suggestions of areas of further research.

7.2 SUMMARY OF RESULTS AND RECOMMENDATIONS

In South Africa, finance is needed in the establishment of new businesses and growth of entrepreneurial ventures and yet entrepreneurs find difficulty in obtaining the necessary finance for start-up and growth purposes (Driver *et al*, 2001). The capacity of the South African banking industry to provide finance and funding for businesses exists. However, when evaluating the funding of an entrepreneurial venture, the banking institution will always consider risk as a prime factor, together with management skills and expertise relating to the type of business or venture before committing any funds (Shaw, 2002).

It is in this context that the researcher sought to explore the risk assessment practices by South African commercial banks when funding entrepreneurial ventures by considering the following:

- Compare and contrast the risk assessment practices used by South African commercial banks when funding entrepreneurial ventures compared to an integrated theoretical framework.
- Assess whether there was consistency in the risk assessment practices amongst South African commercial banks when funding entrepreneurial ventures.
- Explore the impact of the global economic crisis of 2008 on the risk assessment practices used by South African commercial banks when funding entrepreneurial ventures.

The first research question was explored by requesting the respondents to rank, in order of importance, the risk assessment criteria drawn from the literature in order of importance when processing a term loan. In addition, respondents were asked to provide reasons for the criteria that were ranked as most important and least important when funding entrepreneurial ventures.

In considering the above factors, the researcher found that the integrated theoretical framework encompassed the risk assessment criteria used by the South African commercial banks. All the respondents agreed that all the risk assessment criteria contribute in depicting a holistic view of the business applying for the term loan. Whilst certain banks ranked certain criteria more important than others there was consensus amongst the banks that three most important criteria are:

- Capacity – the ability of the business to repay the loan on time;
- Collateral – security for the loan and
- Character – the reputation of the business in terms of past financial behaviour.

The macro-economic cycle was the criterion that was ranked as the least important, primarily because the underlying business is more important than the macro-economic cycle. The ability of the business to demonstrate its financial viability and capacity to service a term loan, far outweighs the activities in the macro-economy.

In terms of the second research question, the researcher found that there was consistency in the risk assessment practices of South African commercial banks. The main difference was in the manner in which they processed term loan applications for entrepreneurial ventures. These included the following:

- the level of systematisation of certain processes,
- the level of influence of client facing officials in the loan application process and
- the loan approval mandates that the various credit officials were authorised to approve.

The foremost impact of the economic crisis of 2008, was that the lending policies of the various banks were more strictly adhered to, resulting in the risk assessment criteria being applied more thoroughly. The character, capacity and

collateral remained the most important criteria, pre and post the economic crisis. An interesting aspect that emerged was that the more senior respondents in the various banks were more aware of the impact of economic crisis and how it has affected their specific bank in particular. They had a very clear understanding how their bank had responded to the economic crisis.

It is important to note that lending policies of the South African commercial banks are well established and do not change significantly overtime. However, the application of these lending policies is adhered to a varying degree in reaction to the macro-economy that the banks are operating in. During economic boom times, lending policies are more flexible and *vice versa*. This substantiates Salas and Saurina (2002), who observed during economic booms, intermediaries such as banks tend to expand their lending activity, often relaxing their lending criteria; in the following downturn, poor performing term loans markedly increase, producing losses.

7.3 RECOMMENDATIONS FOR STAKEHOLDERS

The research revealed that it is essential that entrepreneurs / business owners familiarise themselves with how their applications for finance will be assessed by the bank that they apply to. In so doing, they will be able to submit applications along with supporting documentation that will make it easier for the banks to grant them funding. The majority of the respondents were emphatic in their assertion that, regardless of what is taking place in the industry or macro-economy, should the business have a convincing financial case for funding,

they will receive the funding. They need to ensure that the character, capacity and collateral of their business is in a favourable manner.

Furthermore, the entrepreneurs / business owners need to ensure that the kind of funding they require is correctly matched to the requirements of the business i.e. long-term requirements funded with long-term funding and *vice versa*.

7.4 SUGGESTIONS FOR FURTHER RESEARCH

This section provides some ideas and thoughts for further research which would enhance or build on some of the findings in this report:

- This research was conducted amongst the largest four South African commercial banks. It would be interesting if a similar study was conducted amongst entrepreneurial ventures to assess the role of bank financing in their growth.
- The research is qualitative in nature due to the lack of access to bank data on the exact loan approval rate of each bank. Should access be granted in order to enable one to perform statistically meaningful analysis, a quantitative study to establish whether the granting of loan facilities was a function of inadequate loan applications or excessively stringent bank lending policies.

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9. APPENDIX A: QUESTIONNAIRE TO RESPONDENTS

RESEARCH QUESTIONNAIRE

1) Please indicate your position / title within your organisation: _____

2) Please indicate the number of years that you have been in the above role at the bank: _____

3) Is your role limited to dealing with businesses in a specific industry sector? _____ If yes, please indicate which sector:

4) Please indicate the size of businesses that you handle in your portfolio:

0 – R5 million	R5 million – R15 million	R15 million – R25 million	R25 million – R35 million	Above R35 million

5) Please indicate the maximum mandate amount for loans that you are permitted to approve: _____

6) Please indicate the average number of term loan applications your process per month: _____

7) Please describe briefly the process followed by your organisation in processing a term loan application? _____

8) Please **rank** the following 7 risk assessment criteria in order of importance when processing a term loan application: *(1 – being most important and 7 – being least important) Please note prior to June 2007 is before the global economic crisis.*

NOW	PRIOR TO JUNE 2007*	
		<ul style="list-style-type: none"> • Character: the reputation of the applicant in terms of credit records and credit score; Trade references - reputation of business with suppliers and customers; Letter of good standing - bank report based on existing relationship with the potential lending institution; Management skills and experience
		<ul style="list-style-type: none"> • Capital: the leverage or liability of the applicant, normally measured by debt-asset ratio; strength of balance sheet
		<ul style="list-style-type: none"> • Capacity: whether the applicant has the ability to repay the loans on time; Business profitability; Volatility of income; Existing and projected cash flow; Financial ratios including profitability ratios, liquidity ratios, efficiency ratios, debt ratios including interest cover
		<ul style="list-style-type: none"> • Collateral: normally in the form of physical fixed assets or loan guarantees are normally in terms of a personal guarantee or through a guarantee institution.
		<ul style="list-style-type: none"> • Cycle: macro-economic cycle, the periodic fluctuation in the rate of economic activity, as measured by levels of unemployment, GDP, prices, and production.
		<ul style="list-style-type: none"> • Industry: Industry performance and performance of business relative to its competitors and the overall industry; Consumer demand; The bank's current exposure to the industry sector – risk appetite; The bank's impairments relating to the industry sector
		<ul style="list-style-type: none"> • The Loan: amount of the loan, interest charged by the bank and loan maturity

Please provide reasons for the criteria that were ranked as most important and least important? _____

9) Please rank the following 6 risk assessment criteria in order of importance when processing a term loan application:

CHARACTER: (1 – being most important and 6 – being least important) Please note prior to June 2007 is before the global economic crisis.

NOW	PRIOR TO JUNE 2007*	
		<ul style="list-style-type: none"> • Credit records
		<ul style="list-style-type: none"> • Credit score
		<ul style="list-style-type: none"> • Shareholders and Directors
		<ul style="list-style-type: none"> • Trade references - reputation of business with suppliers and customers
		<ul style="list-style-type: none"> • Letter of good standing - bank report based on existing relationship with the potential lending institution
		<ul style="list-style-type: none"> • Quality and length of service of management, skills and experience

Please provide reasons for the criteria that were ranked as most important and least important? _____

Are there other factors that are considered as part of the applicant's character? _____

10) Please rank the following 4 risk assessment criteria in order of importance when processing a term loan application:

CAPITAL: (1 – being most important and 4 – being least important) Please note prior to June 2007 is before the global economic crisis.

NOW	PRIOR TO JUNE 2007*	
		<ul style="list-style-type: none"> • The leverage or liability of the applicant, normally measured by debt-asset ratio
		<ul style="list-style-type: none"> • Strength of balance sheet
		<ul style="list-style-type: none"> • Subordination of shareholders' loans
		<ul style="list-style-type: none"> • Share equity

Please provide reasons for the criteria that were ranked as most important and least important? _____

Are there other factors that are considered as part of the business' capital? _____

11) Please rank the following 4 risk assessment criteria in order of importance when processing a term loan application:

CAPACITY: (1 – being most important and 4 – being least important) Please note prior to June 2007 is before the global economic crisis.

NOW	PRIOR TO JUNE 2007*	
		<ul style="list-style-type: none"> • Business profitability
		<ul style="list-style-type: none"> • Volatility of income
		<ul style="list-style-type: none"> • Existing and projected cash flow
		<ul style="list-style-type: none"> • Financial ratios including profitability ratios, liquidity ratios, efficiency ratios, debt ratios including interest cover

Please provide reasons for the criteria that were ranked as most important and least important? _____

Are there other factors that are considered as part of the business' capacity? _____

12) Please rank the following 4 risk assessment criteria in order of importance when processing a term loan application:

COLLATERAL: (1 – being most important and 4 – being least important) Please note prior to June 2007 is before the global economic crisis.

NOW	PRIOR TO JUNE 2007*	
		<ul style="list-style-type: none"> • Fixed assets
		<ul style="list-style-type: none"> • Loan guarantees e.g. personal surety or loan guarantee institution
		<ul style="list-style-type: none"> • Debtors book
		<ul style="list-style-type: none"> • Liquid assets

Please provide reasons for the criteria that were ranked as most important and least important? _____

Are there other factors that are considered as part of the business' collateral? _____

13) Please rank the following 5 risk assessment criteria in order of importance when processing a term loan application:

CYCLE – MACROECONOMIC CYCLE: (1 – being most important and 5 – being least important) Please note prior to June 2007 is before the global economic crisis.

NOW	PRIOR TO JUNE 2007*	
		<ul style="list-style-type: none"> • Rate of economic activity – economic growth
		<ul style="list-style-type: none"> • Rate of Unemployment in the country
		<ul style="list-style-type: none"> • GDP
		<ul style="list-style-type: none"> • Prices – Consumer Price Index / Production Price Index
		<ul style="list-style-type: none"> • Exchange rate for importers / exporters

Please provide reasons for the criteria that were ranked as most important and least important? _____

Are the other factors that are considered as part of the macroeconomic cycle? _____

14) Please rank the following 5 risk assessment criteria in order of importance when processing a term loan application:

INDUSTRY: (1 – being most important and 5 – being least important) Please note prior to June 2007 is before the global economic crisis.

NOW	PRIOR TO JUNE 2007*	
		<ul style="list-style-type: none"> • Industry performance and forecasted performance
		<ul style="list-style-type: none"> • Performance of business relative to its competitors and the overall industry
		<ul style="list-style-type: none"> • Consumer demand
		<ul style="list-style-type: none"> • The bank's current exposure to the industry sector – risk appetite
		<ul style="list-style-type: none"> • The bank's impairments relating to the industry sector

Please provide reasons for the criteria that were ranked as most important and least important? _____

Are there other factors that are considered as part of the business' industry? _____

15) Please rank the following 4 risk assessment criteria in order of importance when processing a term loan application:

THE LOAN: (1 – being most important and 4 – being least important) Please note prior to June 2007 is before the global economic crisis.

NOW	PRIOR TO JUNE 2007*	
		<ul style="list-style-type: none"> • Amount of the loan
		<ul style="list-style-type: none"> • Interest charged by the bank
		<ul style="list-style-type: none"> • Loan maturity
		<ul style="list-style-type: none"> • Structure of loan e.g. is it interest only / capita balloon payment at the end of loan

Please provide reasons for the criteria that were ranked as most important and least important? _____

Are there other factors that are considered as part of the business' loan? _____

16) Please comment on the impact of the global economic crisis of 2008 on the lending practices of your organisation: _____

17) Are there any additional comments that you would like to add? _____

Thank you for your participation

The End

10. APPENDIX B: CONSISTENCY MATRIX

RESEARCH QUESTIONS:	LITERATURE REVIEW	DATA COLLECTION TOOL	ANALYSIS
<p>Research Question 1 What are the risk assessment practices used by South African commercial banks when funding entrepreneurial ventures and do they differ from the integrated theoretical framework?</p>	<p>Yeung, 2009; Gupta, 2009; Brewer, 2007; Berger & Frame, 2007</p>	<p>Questionnaire and interviews</p>	<p>Analysis of themes / trends / common approaches compared to integrated theoretical framework ; Frequency analysis</p>
<p>Research Question 2 Is there consistency of the risk assessment practices amongst South African commercial banks when funding entrepreneurial ventures?</p>	<p>Yeung, 2009; Gupta, 2009; Brewer, 2007; Berger & Frame, 2007</p>	<p>Questionnaire and interviews</p>	<p>Analysis of themes / trends / common approaches compared to integrated theoretical framework ; Frequency analysis</p>
<p>Research Question 3 How has the impact of the global economic crisis of 2008 affected the risk assessment practices used by South African commercial banks when funding entrepreneurial ventures?</p>	<p>Yeung, 2009; Gupta, 2009; Brewer, 2007; Berger & Frame, 2007</p>	<p>Questionnaire and interviews</p>	<p>Analysis of themes / trends / common approaches compared to integrated theoretical framework ; Frequency analysis</p>