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Gordon Institute
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University of Pretoria

Performance of enterprise development funds backed by Financial Institutions in South Africa: lessons learnt in Impact Investing

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A research project submitted to the Gordon Institute of Business Science, University of Pretoria, in partial fulfilment of the requirements for the degree of Master of Business Administration

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ABSTRACT

Enterprise Development (ED) is a worldwide concept which refers to the development of Enterprises. ED in SA includes the provision of financial and non-financial support to SMEs. The purpose of this research study is to gain an in-depth understanding of the performance of Financial Institution ED in SA as it relates to Impact Investing, the main focus being the funding of SMEs in SA by Financial Institutions. The key to reducing unemployment and poverty globally is through the creation and sustainability of small businesses which require funding to grow and develop.

The research scope covers Financial Institution ED Funding in SA which includes Commercial Banks, Development Finance Institutions, Insurance Companies, Fund Managers and Specialist Risk finance companies. Government alone cannot solve social problems and private capital from institutions needs to be playing a bigger role in solving social problems.

This research study is exploratory and qualitative in nature. The focus of the study is to obtain in-depth insights from ED funders. Qualitative data was gathered during the research process by interviewing participants from eleven (11) Financial Institution ED Funds in SA.

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KEY WORDS

ED	Enterprise Development
SF	Social Finance
SME	Small Medium Enterprises
II	Impact Investing
SRI	Social Responsible Investment
CSI	Corporate Social Investment

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DECLARATION

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science (GIBS), 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.

Althea Discala

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CHAPTER ONE

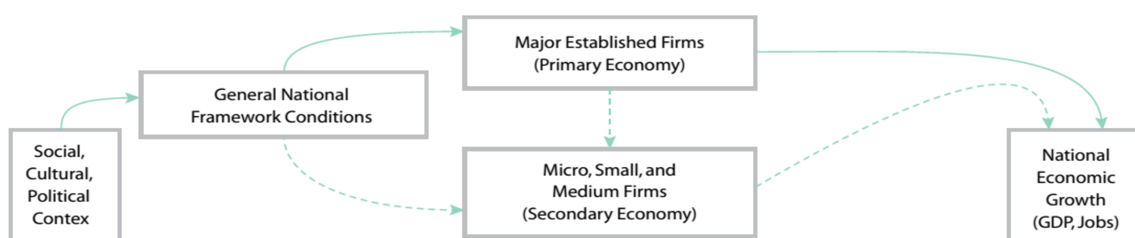
1 Introduction to Research Problem

This chapter gives a brief background and description of the research problem, together with the scope, motivation and academic need for the research. The research problem and the aim and objectives of this work are then discussed. The chapter concludes with the research problem statement and structure of the thesis.

1.1 Global Context of Small Business

It is widely accepted that the key to reducing unemployment and poverty globally is through achieving economic growth. The most significant driver of economic growth, is the creation of small business (Fröhlicher & Pothering, 2013; BEE Institute, n.d) Figure 1.1 illustrates the basic conventional model of national economic growth which states that that economic growth is driven by the environment (social, cultural, political) context of entrepreneurs. This entrepreneurial activity by individuals feeds into both the primary and secondary economies which are drivers for economic growth.

Figure 1.1: Conventional Model of National Economic Growth



[Figure credit: Singer, Amorós, & Arreola, 2015]

1.2 The South African Context

The Industrial Development Corporation of South Africa Limited (IDC) referred to research performed by the Global Entrepreneurship Monitor (GEM) which highlighted that small business contributed up to 45% of GDP and more than 50% of jobs created in South Africa (Industrial Development Corporation, 2014). The IDC article also referred to the National Development Plan (NDP) and the GEM

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which projected that 90% of new jobs will be generated by Small Medium Enterprises (SMEs) by 2030 (Industrial Development Corporation, 2014). The number of entrepreneurs in South Africa is low in comparison to other developing countries, particularly those in South America (Singer, Amorós, & Arreola, 2015).

In South Africa, "*small businesses only have a 37% chance of surviving longer than 4 years, 9% chance of surviving longer than 10 years, and 70%- 80% of small businesses fail in the first year*" (Rachelson, D., 2015). The lack of capital seems to be the primary reason for business failure and is considered to be the greatest problem facing SMEs (Olawale & Garwe, 2010). The GEM report stated that post-democracy (from 1994 onwards), South Africa started to focus on the growth of the number of SMEs and job creation. Prior to 1994, a majority of the people in South Africa, "*particularly African Blacks*", were marginalised from starting their own businesses. The unemployment rate in South Africa is currently (2015) as high as it was 20 years ago – ranging between 26%-40%. Government's efforts and intentions to address this scourge of unemployment gave birth to the Broad Based Black Economic Empowerment (BB-BEE) codes in South Africa. BB-BEE stems from the Broad Based Black Economic Empowerment Act 53 of 2003 (BB BEE Act) (Werksmans Attorneys, 2014).

Enterprise Development (ED) is a key pillar of the codes and is explained in greater detail below (Singer, Amorós, & Arreola, 2015). ED is defined as "*providing financial and non-financial support to establish, expand or improve businesses. Market development, commercial business services, and social enterprise all form part of enterprise development. As does finance; entrepreneurship development; investment in and development of SMME's, including initiatives that range from enabling the start-up of small businesses to providing business skills through training; mentoring and coaching."* (BEE Institute,n.d.). ED is a worldwide concept which refers to the development of enterprises. In South Africa, ED focuses on the development of small and medium enterprises (SMEs) with a turnover of less than R50 million. ED contributes to the growth of economies and job-creation (Edge Growth, n.d.). The concept of ED in South Africa emerged post-apartheid, as the driver for transformation. ED is one of the seven key pillars of transformation

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highlighted by the BB-BEE codes. Companies in South Africa who adhere to BB-BEE earn points which support their business operating environment.

Companies who adhere to the codes can benefit as a result of their compliance. It can assist companies to tender for government contracts and to obtain licenses in certain industries. It assists the ease of business conduct with companies and suppliers in SA (Werksmans Attorneys, 2014). ED is topical in South Africa and has been in the spotlight recently due to the amendment to the BB-BEE Codes which came into effect on 01 May 2015 (Werksmans Attorneys, 2014). These changes aim to assist companies in South Africa to "*…start thinking more strategically about their approaches to ED"* (Fröhlicher & Pothering, 2013). With the new codes, 40% of the total points rewarded are allocated to enterprise and supplier development representing the most significant part of points earned (Hatfield, D., 2015). An objective of the BB-BEE codes is promoting access to finance for SMEs Consequently, the creation and survival of small businesses are dependent on the funding and ED programmes available (Mhikze, 2014).

1.3 Research Scope

The research scope covers Financial Institution ED (Enterprise Development) Funding in South Africa. Financial Institutions include: Commercial Banks (Banks), Development Finance Institutions (DFI's), Insurance Companies, Fund Managers and specialist Risk Finance Companies.

1.4 Research Motivation and Academic Need

1.4.1 Supply of Funding

Research has shown that SMEs require funding to grow their business and thus create jobs. The rate of creation of new SMEs in South Africa is one of the lowest in the world and the failure rate is high. A reason for this is the non-availability of financing by the "formal sector", such as Banks. (Fatoki & Ashah, 2011). A review of the available literature has found that there has been largely, a focus on the demand-side of funding (i.e. funding required by SMEs). The literature discusses

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the challenges faced by SMEs in accessing funding. Suggestions for future studies are that there is need for more research on the supply-side of funding. This could either support the views expressed by SMEs when accessing funding or it could provide a different view (Fatoki & Ashah, 2011). Research on the supply-side of funding is required to examine the effectiveness and challenges faced by business development funders (Mazanai & Fatoki, 2011) and (Fatoki & Ashah, 2011).

ED (as defined in the background to this Chapter) attempts to provide a solution to assist funders in providing financial and non-financial support to SMEs. There is limited research in the ED space (Fröhlicher & Pothering, 2013). The 2013 ED Report stated that: if South Africa corporate follows an Impact Investing Approach in ED, it would create a more meaningful impact in terms of transformation, growing sustainable businesses while achieving their own objectives (Fröhlicher & Pothering, 2013). Impact Investing can also be defined as "making money while influencing positive change" (Combs, 2014). Impact Investing involves investment into business models that not only seek profit but that have a social impact as well. Social Impact Investment Taskforce (2014) define social impact investments as "intentionally" targeting social objectives and a financial return, whilst measuring the performance of both.

1.4.2 Impact Investing

Fetherston (2014) states that Social Finance (SF) offers an opportunity for institutions such as banks to make a difference in society, post the financial crisis, by "*doing good and doing well*". Impact Investing is one of the fast-developing and nascent fields in SF. However; further research is required to learn more about this particular field. The majority of the research available is produced by leading organisations, practitioners and institutions (Vakhidova, 2012) and (Brandstetter & Lehner, 2015). Jackson (2013) and Brandsetter & Lehner (2015) mention that the major players in Impact Investing are the United States and Europe. More research is, therefore; required in South Africa, to progress the South Africa Impact Investing field. Rangan, Appleby, & Moon, (2011), Berry & Junkus, (2013), Arjalie`s (2010) and Brandstetter &Lehner (2015) state that government alone cannot solve social problems. As such, private capital from institutions has a very significant (perhaps

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bigger) role to play in solving social problems. Players and actors in the Impact Investing industry have identified that more information needs to be shared and exchanged in order to grow the industry. There is a need for detailed evaluation, research and analysis to move the industry forward. In addition, it is fundamental that knowledge-sharing amongst all stakeholders in the industry is encouraged (Jackson, 2013).

The Impact Investing industry is growing through assistance by networks such as the Global Impact Investment Network (GIIN) and the South African Impact Investment Network (South AfricaIIN). The South AfricaIIN, however; is in its infancy (South African Impact Investment Network). The much needed solution to the problems faced in South Africa as well as some of the concerns that need addressing are summed up in this quote: "*South Africa is in many ways a perfect testing ground for Impact Investment. It contains some of the most sophisticated financial infrastructure and successful private sector businesses in the world. At the same time, it has an urgent imperative for growth and infrastructure development. Impact investment may also provide a mechanism for South Africa to pursue some of its other social objectives, like Broad-based Black Economic Empowerment, job creation and land reform. An underlying theme from all debates, was that there seems to be a disconnect between supply and demand for Impact Investing."* (South African Impact Investment Network).

The lack of financial performance, risk and return research in Impact Investing has been identified as a barrier to the advancement of the industry (Matthews, Sternlicht, Bouri, Mudaliar, & Schiff, 2015) & (Brandstetter & Lehner, 2015). In summary, as stated by Brandstetter and Lehner (2015), "*… much work lies ahead*".

1.5 Research Problem Statement

The objective of this Research Study is to gain an in-depth understanding of Financial Institution ED in South Africa, as it relates to Impact Investing. The objective of this study is to add to the existing body of knowledge, insights on Impact Investing and ED in South Africa. The focus of the research is on the funding of SMEs in South Africa by Financial Institutions.

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The study aims to explore whether these Financial Institution ED Funds meet the criteria for Impact Investing as mentioned by (Vakhidova, 2012). The research aims to explore the view of Financial Institution ED Funders in South Africa, based on the Impact Investment criteria described in the Literature Review (i.e. Chapter 2). An important feature of Impact Investments is that investors actively pursue social and non-financial objectives as part of their business model (Simon & Barmeier, 2010). This Research Study aims to answer the question on which business model Financial Institution ED funding follows.

Another objective is to provide further insight into these Financial Institutions ED Funds beyond the regulatory compliance to the BB-BEE codes which were amended on the 1st of May 2015, and placed a greater focus on ED.
Essentially this research aims to investigate and provide further knowledge on the following five main objectives:

1. Financial Institutions Enterprise Development (ED) Strategy;
2. The performance of South African ED Funds;
3. The business development support (BDS) provided to SMEs;
4. The reasons for the creation of Financial Institution ED Funds; and
5. The challenges and success factors faced by the Financial Institution ED Funds.

NB: All these objectives will be tested using a *Qualitative Exploratory Approach*, as explained in Chapter 4.

The benefit of this research will be predominantly for those involved in the ED and Impact Investing space. Fundamentally, this research will enhance the understanding of the different funding options available to SMEs in the context of ED. It will, hopefully, bring to light, the performance of these Funds from a qualitative and exploratory nature. Furthermore, the study seeks to highlight the concept of Impact Investing in the ED space. Overall, this research will be of benefit to the following parties:

1. SMEs who require financial and non-financial support; and
2. Institutions who want to make a social difference and make a financial gain.

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1.6 Structure of Thesis

This thesis is embedded in the larger SF and Impact Investing fields. The scope of the research is on Financial Institution ED Funds in SA. Chapter 1 introduced the background and description of the research problem, together with the scope, motivation and academic need for the research.

Chapter 2 contains the literature review. This chapter reviews the available literature on SF and its constituents, with a specific focus on Impact Investing. The literature presents, argues and reveals the need for the research problem. The background and evolution of SF and Impact Investing are explored. Lastly, the chapter reviews the literature on funding SMEs.

Chapter 3 presents the purpose of the research study as well as the research questions. The research questions form the basis of the study, results and conclusions, which are then presented in Chapter 5 and 6.

Chapter 4 presents the research methodology, design and approach used in this research study. The questions in Chapter 3 determined the methodology and research techniques adopted in Chapter 4.

Chapter 5 presents the results of the Research Study as per the Research Questions presented in Chapter 3. The results were collected as per the Research Methodology defined in Chapter 4.

Chapter 6 presents the research findings presented in Chapter 5, in relation to the literature reviewed in Chapter 2. Insights into the results are provided in this Chapter and conclusions to the research questions are presented in Chapter 6.

Chapter 7 summaries the conclusions in Chapter 6 and provides recommendations for Financial Institution and other ED funds/ers and practioner/s based on the results of this research study. The limitations of the research study and future research recommendations are discussed.

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CHAPTER TWO

2 Literature Review

This chapter gives a survey of the relevant literature. The literature explores Social Finance (SF) and its constituents. The literature provides background to SF and its evolution. The chapter defines and explains concepts within and related to SF. These include Corporate Social Responsibility (CSR, Corporate Social Investment (CSI), Social Responsible Investing (SRI) and Impact Investing. The focus of the chapter is on Impact Investing and its definition, measurement and criteria. Lastly, the chapter reviews the literature on funding SMEs. The differences and similarities between the above concepts are discussed and explained and summarised in the conclusion to this chapter.

2.1 Introduction

The concept of SF has gained much focus since the 2008 global financial crisis. Financial Institutions have realised that they now have more of a responsibility to stakeholders than ever before. Since then, there has been a greater focus on Financial Institutions to explore different funding models to that of the traditional "for profit" models. Financial Institutions have realised that they have a part to play in addressing social and environmental needs and that government needs assistance in achieving these goals. SF is a broad concept and there are many different forms of SF, including: Socially Responsible Investing (SRI), Impact Investing and Corporate Social Investing (CSI). The social investment spectrum, as depicted in the diagram below, has seen a spectrum of investments, ranging from non-profit to the traditional for-profit ones.

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Figure 2.1: The Social Investment Spectrum

[Figure credit: (RS Group, 2013-2014)]

The expectation of Social Finance (SF), as discussed by Jones (2010), was that "positive benefit" could be achieved for both non-profit and traditional for-profit models, as well as any combination models in-between. There has been constant debate as to whether social and financial objectives and returns can co-exist. A further debate is whether these funding models perform and if so, to what extent is the trade-off between financial and social returns? The literature review considers SF and its many sub constituents broadly. The focus of the literature review is, however; on Impact Investing, SRI and financial and non-financial support to SMEs.

The past few decades have seen an increasing role from the private sector in poverty alleviation through corporate social responsibility (CSR), corporate social investment (CSI), social enterprise (SE), Impact Investing, and corporate philanthropy. These terms are very similar in that they all sacrifice some level of economic profit for social impact and gain. The above-mentioned terms have also brought about a lot of confusion in their meaning, approaches and impact, both from an economic and social stance and in terms of what level of economic profit is required to be sacrificed to achieve a social impact (Clyde and Karnani, 2015). In light of this, the focus of this particular research is on SRI and Impact Investing within the broad field of SF.

2.2 Social Finance

Rangan and Appleby and Moon (2011), Berry and Junkus, (2013) and Arjalie`s (2010) social movement on finance, stated that the global financial crisis in 2008

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has caused an increase in demand for private capital to solve social problems. SF, as defined by Fetherston (2014), addresses the social needs through funding provided by the private sector. Government can assist the private sector with funding to address these social objectives. The core vision of SF, as described by Brandstetter and Lehner (2015) was to address the social and environmental challenges in the world through innovative funding solutions to entrepreneurs. This has been a developing field and there have been new market structures, investment vehicles and participants who have contributed to the coffers of SF. Government(s) could never be able to solve the social challenges alone and the need for institutions to assist was imperative (Brandstetter & Lehner, 2015). Fetherson (2014) states that SF offers an opportunity for institutions such as banks to make a difference in society (post the financial crisis), by *doing good and doing well*.

Brandstetter and Lehner (2015) explained that the risk and reward model is not fully understood by investors, which in turn makes it difficult for capital to be allocated to the social sector. Brandsetter further argues that consistent metrics to measure the level of social and financial risk and reward are non-existent (Brandstetter & Lehner, 2015). Berry and Junkus (2013) augment Brandsetter's argument that there is/was no theoretical framework to assess the level of financial risk in respect of profit given up for an increase in social benefit. Similarly, Clyde and Karnani (2015) questioned the level of economic profit required to be sacrificed for social impact and the difficulty in determining it.

The challenges SF faced was that the institutions that provided SF to organisations for social purposes faced a risk of the finance provided not being repayable. The risks were that these entities normally did not have sufficient equity or collateral for debt funding. Another challenge was that investors (or providers of funding) were required to be patient in achieving a return and the repayment of their capital. In other words, they were expected to have a tolerance level for a potential business failure by these entities (Fetherston, 2014).

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The triple bottom-line and sustainability focuses on social, environmental and financial objectives and returns. This has brought about the need to assess blended values and returns (Meyskens & Carsrud, 2013).

2.3 Corporate Social Responsibility (CSR)

CSR reflects a firm's obligations to its stakeholders and its considerations to society, community and the environment in which it operates. Firms have become more aware of the need to be responsible. The more responsible the firms are, the more they are able to manage risks and improve customer loyalty (Zhang, Ma, Su, & Zhang, 2014). Harris & Twomey (2010) states that an enterprise does not exist outside of its stakeholders which includes the community.

Corporates have become more externally focused on society, to ensure alignment with internal goals (Sen & Cowley, 2013). The more profitable firms find it easier to invest in CSR, which in turn leads to higher profitability for the firms. Notwithstanding, the different economic view-points on CSR can be summarised as follows:

- Neoclassical economists view CSR as a deviation from a business main goal, which is to maximise shareholder wealth through earning profits;
- Keynesian economics focuses on social and environmental responsibilities;
- New institutional economics (NIE) is a combination of Neoclassical and Keynesian views where profit maximisation, and social and environmental responsibilities are combined (Hinson & Ndhlovu, 2011). The NIE view is similar to that of Impact Investing, looking at both profits and social impact of a firm (Hinson & Ndhlovu, 2011).

Freeman's *Stakeholder Theory* states that a firm should consider all stakeholders it engages with, which will assist in increasing performance. For a firm to be responsible, it needs to manage its stakeholders effectively (Zhang, Ma, Su, & Zhang, 2014). Examples of key stakeholders include: Employees; Clients and Customers; Business Partners; Social; and Natural Environment and Shareholders (Maak & Pless, 2006). The *Stakeholder Theory* assists leaders in identifying economic and social trends more appropriately by engaging with stakeholders to

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respond appropriately. In addition, social responsibility involves both business and society. (Doh & Quigley, 2014).

2.3.1 Corporate Social Investment (CSI)

Corporate Social Investment (CSI) implies that a return is expected on the investment (whether socially or financially). It is different from Corporate Philanthropy, which implies that no return (in whatever form) is expected to the company. CSI brings benefits to firms participating in CSI (e.g. a good reputation) and enhances a firm's credibility and legitimacy amongst businesses, the community and the government. A large portion of South Africa's CSI comes from Finance and Mining companies (Hinson & Ndhlovu, 2011). Cooke shares a similar view – CSI is investment into the community but is not synonymous to philanthropy, which involves donations. CSI utilises an organisation's resources for "social good". Cooke's view is that there may be benefit to the company from CSI. The benefits are both to the organisation and to the community. CSI could take on many forms, such as managerial experience or money imparted for the benefit of the community. In essence, CSI is assisting the community with social good, while the business continues trading normally. It is an element of the corporate social responsibility (CSR) of an organisation and could impact the bottom line (Cooke, 2010).

2.4 Social Responsible Investment (SRI)

Arjalie`s (2010), Berry and Junkus (2013) and Scholtens and Sievanen (2013) view SRI as investment decisions taking into consideration environmental, social and governance (ESG) concerns. SRI considers the effects of people and the planet over and above profit. This is sometimes referred to as the "triple bottom line" and "sustainability". Firms constantly need to manage their financial risk and return trade-off when balancing the three "P's" (People, Planet and Profits), when being "socially responsible" (Berry & Junkus, 2013). It should be noted that SRI includes investing in the community and social venture capital funds and ensuring the social agenda is discussed at boards (Berry & Junkus, 2013). However; SRI excludes companies from investment portfolios which are socially irresponsible. This refers

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to making an investment decision based on social, rather than financial criteria (Sanders, 2014).

Arjalie (2010) and Fetherson (2014) purport that, *negative screening* has been the focus of SRI in the past. Negative screening involved screening for investments that were harmful (e.g. tobacco, gambling, weapons, pornography), commonly referred to as "sin industries". One of the first SRI funds was in Europe in the 1970's and came about as a result of a reaction against apartheid (Arjalie`s, 2010). SRI is progressively moving towards "positive screening" which focuses on investments which create a positive social impact such as Impact Investing (Buckland, 2014). SRI is still commonly referred to as including negative screening even though the focus is to include more positive screening which leads to Impact Investing.

SRI has grown rapidly due to the increase in concerns on social, environmental and governance requirements. A large portion of corporate social investment (CSI) is undertaken by large investors who participate in SRI Funds. SRI takes corporate social responsibility (CSR) aspects (e.g. "ethical, environmental, social and governance practices") into account, when making an investment decision (Berry & Junkus, 2013). Actors who participate in this field are institutional investors, banks, venture capitalists, government organisations, and international organisations who have a social agenda (Berry & Junkus, 2013).

2.5 Impact Investing

There are many definitions for Impact Investing which include two main/ key concepts: *social impact* and *financial return*. (Combs, 2014). SRI returns have proven to be weak in the past and Impact Investing is a recent phenomenon which indicates that returns can be achieved while doing good – more common referred to as "*doing well by doing good*" (Shulman & George, 2012). Jones (2010) defined Impact Investing as a for-profit model which addresses social and environmental problems.

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Impact Investing is defined, as placing capital in "businesses" and "funds" that are generating a return that is at least equal to the principal amount invested, while achieving social good. As a matter of principle, there has to be intent to create social impact. However; incidental social impact does not count. SRI is therefore different to Impact Investing in that SRI screens for harm and does not "explicitly" search for positive impact (Rangan, Appleby, & Moon, 2011). Some scholars argue that Impact Investing is an evolution of SRI (Buckland, 2014), whilst others argue that it is an asset class on its own (Buckland, 2014) and (Saltuk & Idrissi, 2015).
Doing good and doing well does not have to be a trade-off – both can be achieved when investing and allocating capital. Impact investors focus on "*doing good*" and "*doing well*" without having to choose one over the other (Emerson, n.d.). Impact Investing is further described by Brandsetter and Lehner (2015) as, actively pursuing social and financial returns and value within the SF space.

Social problems such as healthcare, education and alleviating poverty has brought about the need for Impact Investing (Rangan, Appleby, & Moon, 2011). Impact Investing challenges those views that social problems should only be addressed by grants and donations and that investments and funding should focus only on maximising wealth and achieving profits and a financial return (Saltuk & Idrissi, 2015). The ultimate purpose of Impact Investing (over and above achieving a financial return) is to alleviate poverty and to assist in doing social good (Hinson & Ndhlovu, 2011).

JP Morgan and the Monitor Institute[1] have estimated the size of the Impact Investing industry to be anywhere between 500 billion USD to 1Trillion USD. They further argue that this is a growing industry, a relatively new space with immense potential (Rangan, Appleby, & Moon, 2011). Overall, Impact Investing encompasses "Venture philanthropy, blended-value investment, double or triple-bottom-line investment" (Simon & Barmeier, 2010).

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[1] Background information to these institutions is presented in subsequent sections of this Dissertation.

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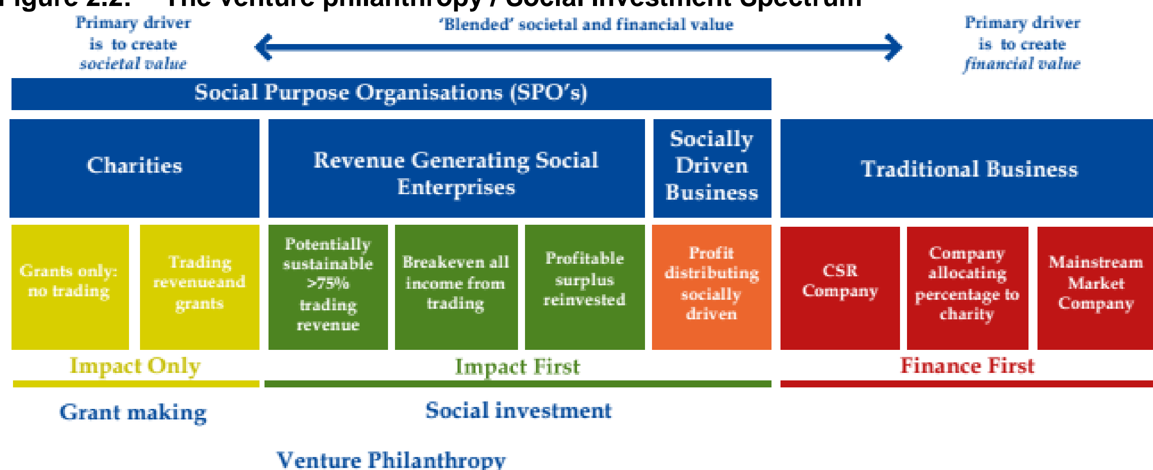
2.5.1 Hybrid Model

Rangan, Appleby, & Moon, (2011) and Doherty, Haugh & Lyon (2014) note that a new hybrid model is necessary – one which blends "for-profit "and "non-profit" sources of funds in implementing an organisation's mission and purpose but requires regulatory and government intervention. For-profit organisations pursue profit for shareholders, whilst non-profit organisations pursue social benefit (Rangan, Appleby, & Moon, 2011). Hybrid organisations which have a for-profit and a social motive tend to prioritise profit (Jones, 2010).

Social purpose organisations (SPO) have a social driver. As depicted in Figure 2.2 below, there are models that can be adopted by a SPO and these include grant making (which focuses on impact only), traditional businesses (which focus on financial profits only). Impact Investing is in-between a charity and a traditional business. As illustrated in Figure 2.2 below, there are many financially-driven objectives within each social investment model (Buckland, 2014).

Figure 2.2: The venture philanthropy / Social Investment Spectrum



[Figure credit: (Buckland, 2014)]

The Monitor Institute developed a model for segments of Impact Investing. The ideal place to be for impact investors is the top right-hand quadrant, which is the *Impact Investing space*. As depicted in Figure 2.3 below, within Impact Investing there are "*Finance first investors*" (who target financial and social returns, with the primary objective being financial return). On the other hand, "*Impact first investors*" target financial and social returns but the primary objective is social first. As

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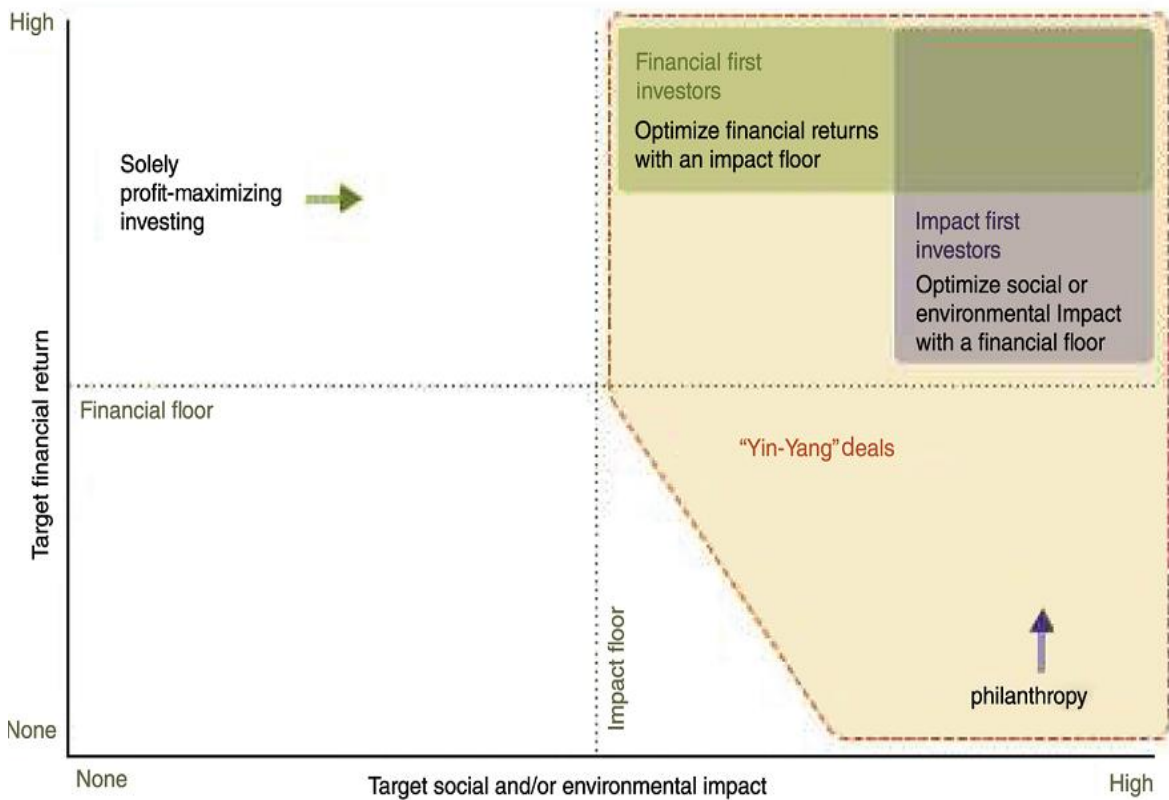
illustrated in the diagram, there are trade-offs between financial and social returns and funders set different objectives and floors, based on their mandate (Lyons & Kickul, 2013).

Figure 2.3: Segments of Impact Investors



[Figure credit: (Lyons & Kickul, 2013)]

2.5.2 Impact Investment

Impact Investments are defined as investments made into "…*companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return.*" Investments can occur within developed and developing countries. There is no specified return required but a range of returns can be targeted (Network, Global Impact Investment, n.d.). Impact Investments differ from traditional investments in that they have dual goals (Brandstetter & Lehner, 2015). Jackson (2013) defined Impact Investment as: *an investment which attracts capital for a financial return and a positive social impact*. There are three elements to an Impact Investment:

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1. There needs to be an **intention** by the investor to achieve the social impact (Jackson, 2013);
2. There needs to be evidence of **impact** of the achieved social impact (Jackson, 2013); and
3. Change in respect of outcomes expected needs to be evident in the capital advanced (Jackson, 2013).

Results of Impact Investments affect individuals, households and the community, it is imperative that the intended results on these three parties be assessed on a continuous basis (Jackson, 2013).

Impact Investments have the four main characteristics:

- Intention:- There needs to be an intention by the investor to make a "positive social impact";
- Return:- The investor needs to set an objective to create a financial return on capital (be it to return capital at a minimum, or otherwise);
- A range of return expectations and different asset classes:- Impact investments can range from below-market (concessionary) to risk-adjusted returns and can be made across asset classes; and
- Impact Measurement:- There needs to be measurement and reporting of both financial and social/environmental performance and progress (Network, Global Impact Investment, n.d.).

Fundamentally, a level of commitment needs to be evident in achieving financial and social impact returns and in addressing social needs for the investments to qualify as Impact Investments (Saltuk & Idrissi, 2015).

2.5.3 Actors in Impact Investment

According to Rangan, Appleby and Moon (2011), generally, investors in the Impact Investing space include:

- Commercial Banks;
- Development Finance institutions;

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- Retirement Fund managers;
- Boutique Investment Funds;
- Corporations;
- Community; and
- High net-worth individuals.

A common perception amongst investors is a lack of “appropriate capital” for Impact Investing and a shortage of investments of a high-quality nature which have a track record (Brandstetter & Lehner, 2015). It is a global practice for institutions such as commercial banks, development finance institutions, insurance companies and pension funds to create funds for Impact Investing (Matthews, Sternlicht, Bouri, Mudaliar, & Schiff, 2015). There are various actors in the Impact Investing industry, ranging from those who: own capital, deploy capital, receive capital and those who assist in market work such as service providers (Jackson, 2013). The scope of this research study is on those who *own capital* (asset owners) and those who *deploy capital* (fund managers). These include Financial Institutions such as Banks, Fund Managers, Insurance companies, Development Funding Institutions and specialist risk finance institutions.

Banks

The 2008 financial crisis caused many banks to consider being more socially responsible and making a positive social impact. The focus for banks has previously been on more social investment, as opposed to positively making a social impact and a financial return. In other words, the focus (in the past) was more on corporate social investment (CSI) and corporate social responsibility (CSR). Figure 2.4 below presents the different funders in the Impact Investing space: The Financial Services Industry is one of the 5 pillars of Social Impact Investment.

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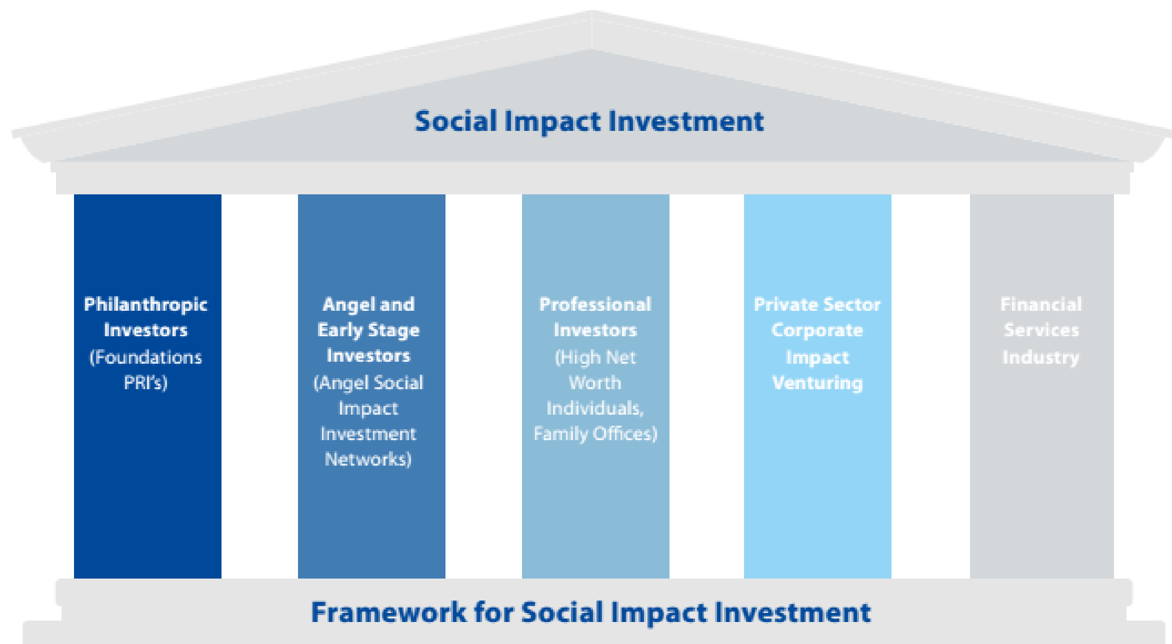
Figure 2.4: Role of Financial Services in Social Impact Investment



[Figure credit: (Buckland, 2014)]

The challenges faced by banks are as follows:

- The sector being new ;
- Use of cross-department resources;
- Ensuring that sufficient expertise exists; and
- Opportunity-cost of other opportunities which may be more urgent or offer a short-term gain (Buckland, 2014).

On the other hand, "drivers" making banks get more involved are as follows:

- Increased pressure from stakeholders (for banks to get involved); and
- Market-forces and consumers pushing for more social responsible investment (SRI) in this "nascent" sector, which could increase competition (Buckland, 2014).

European banks have become more explicit about social investment and about including this in their standard (core) business models and strategies. However, banks,; are still weary of raising "client" capital to invest in social private equity. This is because the risk /return spectrum is still undeveloped.

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In Europe, there is a combination of grant funding and social investment funding (which focuses more on debt and equity funding). Social investment includes “asset capital issuing loans, working and transitional capital, or growth capital” (Buckland, 2014). It is important to note, however; that Grant Funding and Social Investment Funding in Europe share seven characteristics:

1. The organisations who invest in these funding organisations are highly engaged with the companies they invest into or provide funding to;
2. Funding core operational costs (as opposed to individual projects), to ensure that operational capacity is built;
3. Providing financing solutions which meet the specific needs of the organisation and is specific to the organisation;
4. Non-financial support is provided to management;
5. Access to networks for the investee companies;
6. Supporting organisations for 3-5 years and then exiting when these organisations are financially or operationally sustainable; and
7. Measuring performance by planning, measuring social outcomes, achieving objectives set, financial accountability, and transparency (Buckland, 2014).

Grant funding cannot meet an entrepreneur’s rising capital needs as the enterprise scales up and grows (Buckland, 2014). The scope of this research study covers: Social Banks, Mainstream Banks and Social Impact Funds, as depicted in Figure 2.5.

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Figure 2.5: Funders in VP/Social Investment space

	Leader/Field-Building	VP/Social Investor	Advisor/ Intermediary
Government	Very important stimulus/policy role		
Social Bank	Demonstration role – social investment works! Leading by doing.	Significant social investment role, but limited VP	Significant intermediation role, but limited client lists
Mainstream Bank	Could be very significant leader sending signal to capital markets	Limited funds invested to date but huge potential due to patient capital availability	Key to mainstreaming of social impact investment
SI Fund	Limited weight/ muscle but leading by doing and strong expertise	Highly significant role due to focus and expertise	Some intermediation capability, but limited client lists
SI Intermediary	Limited weight/ muscle		Significant role due to focus and expertise
Charitable Foundations		Key VP/Social Investor: unlocking all assets for social mission	
Social/angel investors		Important VP/Social Investor: backing early-stage ventures	

[Figure credit: (Buckland, 2014)]

2.5.4 Capital Allocation and Financial Instruments

The key to managing capital resources is to manage overall performance of the company from a portfolio perspective (Emerson, n.d.). The assets under management in the Impact Investment sector indicates majority of investment into mature privately traded investments and growth-stage investments. Only 11% of assets under management are in publicly traded investments and the smallest percentage is in start-up and venture stage funding. Impact Investing is not limited to a specific asset class. Rather, it includes: “cash, senior debt, mezzanine/quasi-equity, public equity, venture capital, private/growth equity, real estate, other real assets, and hedge funds” (Rangan, Appleby, & Moon, 2011).

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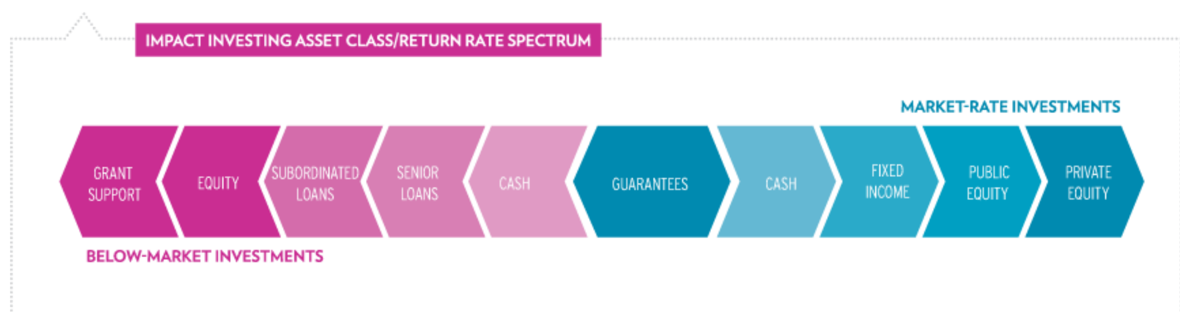
The Impact investment industry comprises the following financial instruments:

- Private debt – 40% of assets under management;
- Private Equity – 33% of assets under management;
- Quasi Equity – 8% of assets under management;
- Public debt – 2% of assets under management;
- Public equity – 3% of assets under management;
- Real assets – 3% of assets under management;
- Deposits and cash – 2% of assets under management; and
- Pay for performance instruments (e.g. social impact bonds) – less than 1% of assets under management (Saltuk & Idrissi, 2015).

The returns on the financial instruments are on the following market-related continuum for Impact Investing (see Figure 2.6 below):

Figure 2.6: Impact investment returns per asset class and financial instrument



[Figure credit: (Network, Global Impact Investment, n.d.)]

2.5.5 Performance

The concept of risk and return is a familiar concept in the traditional investment process. There are many questions around risk and return and its application to Impact Investing. There is often a trade-off between risk and return, although Impact Investing should assess impact, over and above the normal risk and return model which provides a holistic and much broader view to traditional investments (Emerson, n.d.). The performance of Impact Investments can be assessed on a three dimensional basis, as opposed to the traditional efficient frontier which seeks

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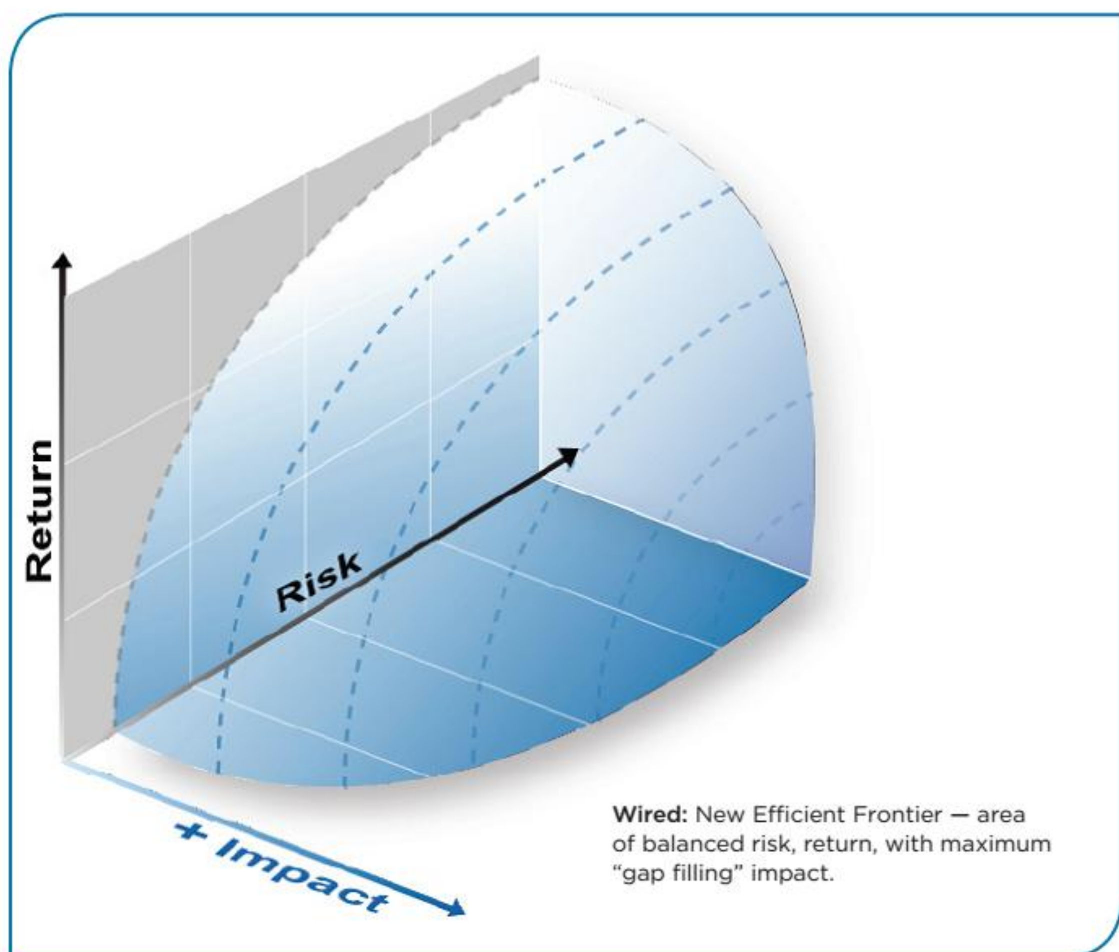
performance on both risk and return. Impact Investing seeks to consider impact, risk and return on a blended basis and not only on an "artificial" trade-off between risk and return. Many see Impact Investing as a new asset class or market which is emerging. (Emerson, n.d.)

Presented in Figure 2.7 below is the new "efficient frontier" which was described by (Emerson, n.d.) as three dimensional, focusing: on risk; return; and impact.

Figure 2.7: New Efficient Frontier: Risk, Return and Impact



[Figure credit: (Emerson, n.d.)]

Each Impact Investment is placed on this frontier, which compares *actual performance* to *targeted performance* from a risk, return and social impact perspective. By the same token, social intent (as defined in assessing performance) is key, and should not merely be a consequence of the investment.

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2.5.6 Risk and return trade-off: Link to Hybrid model

Some investors view Impact Investing as a separate asset class, where a separate pool of funds is set aside for Impact Investments. The balance of the investment portfolio focuses on traditional investments for pure financial performance. Other investors invest their entire portfolio into Impact Investing. There is no "correct" way of investing into Impact Investments – investors assess their own goals and objectives to meet those set goals (Emerson, n.d.). When assessing risk and return, the concept of patient capital emerges regardless of whether the investor needs access to his capital in the next "three to ten years", the investor's tolerance level (for losing his/her capital invested due to failed investments), the impact of these investments on the overall portfolio and the risks associated with having investments for a longer period than usual (Buckland, 2014).

Presented in Figure 2.8 below, are the results of respondents in the JP Morgan 2015 survey research (where developed markets were compared to emerging markets in terms of performance, and overall performance from both a financial and impact perspective were measured in terms of performance. Findings show that 78% of respondents met their financial objectives and 71% met their impact objectives. 27% exceeded their social objectives and 14% exceeded their financial objectives overall. As portrayed in the diagram (Figure 2.8), developed markets exceeded impact and finance performance when compared to emerging markets overall, albeit by only 4% in impact and 3% in financial (Saltuk & Idrissi, 2015). It was also found that actual performance exceeded investors' expectations from both a social and financial return perspective, across all markets (i.e. for both developed and emerging markets).

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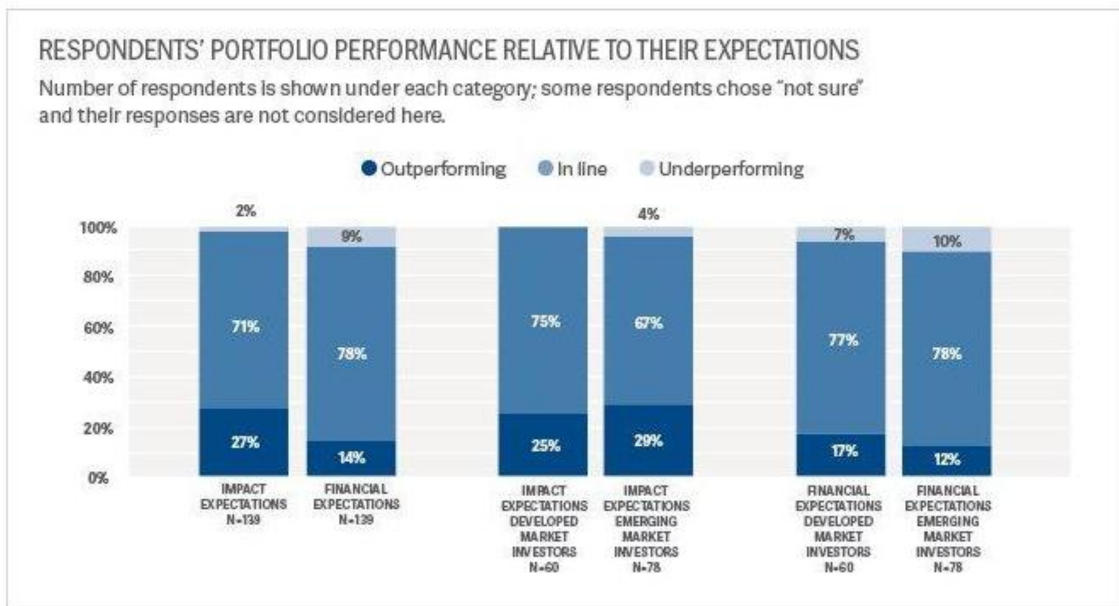
Figure 2.8: Portfolio Performance relevant to Target



[Figure credit: (Saltuk & Idrissi, 2015)]

Matthews, Sternlicht, Bouri, Mudaliar & Schiff (2015) showed that market-related returns are achievable with Impact Investing, despite perceptions by some investors that "concessionary" returns are necessary for Impact Investing. The Impact Investing Benchmark showed that during the period 1998-2010, the Impact Investing returned 6.9% compared to the "traditional" of 8.1% (Matthews, Sternlicht, Bouri, Mudaliar, & Schiff, 2015).

2.5.7 Measurement and Reporting

Measurement and reporting is a critical part of Impact Investing. Performance should be measured and compared to objectives, both from a financial and social perspective. Social impact is a set of outcomes that would not have happened were it not for Impact Investing (and the impact investor). "Impact" refers to significant changes in the lives of people as result of actions taken by the Impact Investor. As such, social objectives are measured by assessing the impact on people's lives as a result of the investment (Brandstetter & Lehner, 2015).

The industry (or asset-class of Impact Investing) is currently not standardised – there are inconsistencies in measurement and reporting by parties involved in Impact Investing. The measurement of Impact Investments is based on the amount

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of capital invested (the input) and the number of people who have benefited from these types of funds (the output). The actors in the Impact Investing industry need to go deeper into measuring the impact of their investments by assessing the granular effectiveness of their investments at all levels (i.e. social, cultural, political and environmental) (Jackson, 2013).

The industry requires standardised tools in order to assess the impact of their investments. The most important measurement of Impact Investing is the level of social positive change and the progressive development of the parties who received the funding. Fundamentally, measurement of financial and social returns needs to be quantifiable (Brandstetter & Lehner, 2015) and (Jackson, 2013). In the same light, social returns need to be measured and the impact determined on what difference it makes to people's lives (Hinson & Ndhlovu, 2011).

In order to maximise profit and impact, both need to measured. It is imperative that the desired outcomes are set up-front and measured on a periodic basis. There needs to be an observed change to what was initially in the outset. Measurement requirements are specific to the stage of the business or product (Puttick & Ludlow, 2012).The key aspect of measuring impact is "change" and the level of change that has occurred.

Some of the current measurement metrics and standards in the Impact Investing space are follows:

1. Impact Reporting and Investment Standards (IRIS);
2. Global Impact Investing Rating System (GIIRS);
3. Standard and Poor's or Morningstar rating systems;
4. Nexii, a social stock exchange based in South Africa;
5. The South African Social Investment Exchange (South Africa SIX); and
6. Social Responsibility Index (SRI).

The JP Morgan survey stated that 99% of respondents surveyed in 2015 measure the social and environmental performance of the investments made. The metrics

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are standardized and align with IRIS (Saltuk & Idrissi, 2015). It is critical in Impact Investing that investors measure and report on the social and environmental performance as well as the "progress of the underlying investments". There needs to be transparency and accountability.

Investors will have different approaches to measuring, based on their objectives and capacities. All the same, the major components of Impact Investing are as follows:

1. Social and environmental objectives need to be set upfront;
2. Performance metrics and targets need to be set up front and standardized if possible;
3. The performance of investees need to monitored and managed against targets set; and
4. The performance of social and environmental performance need to be reported to relevant stakeholders. (Saltuk & Idrissi, 2015)

The top three challenges identified by the JP Morgan survey were as follows:

- Lack of appropriate capital across the risk return spectrum;
- Shortage of high quality investment opportunities with a track record; and
- Difficulty of exiting investments (Saltuk & Idrissi, 2015).

2.6 SME Funding and Support

2.6.1 Measurement and Reporting

The JP Morgan survey showed that 73% of the respondents surveyed provided technical assistance to the investee companies, either through internal or external parties. Forms of technical assistance include: "*general management support, accounting and financial systems, industry specific skills enhancement and impact measurement*" (Saltuk & Idrissi, 2015). The control of the financial risks by a SME is critical to its enterprise development (ED) and sustainability. Raising funds and access to capital is a key financial risk that must be measured (Jun, 2014).

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2.6.2 Challenges faced by SMEs

A key challenge faced by SMEs in South Africa, is the inability to raise/obtain funding from Financial Institutions. The lack of market access and networks; management (in) capabilities; and lack of financial controls, were identified as challenges faced by SMEs. The lack of access to finance was focused more on the commercial banks that assess financial records such as a history of audited financial statements or lack of security. Another challenge raised was the lack of sufficient capital to sustain the business. These were challenges identified on the demand side (i.e. from the SME point of view). A recommendation in this study was that SME owners need to get mentors and coaches to assist with business development (Ramukumba, 2014).

One challenge raised with particular focus on the South African context, was the lack of marketability of finance available by Financial Institutions. The study identified that business support programmes available were not sufficient and efficient. To counter this deterrent, the study recommended more training and monitoring of business support systems provided by capital suppliers. It was suggested that more effective business development support (BDS) programmes needed to be implemented by the private sector. Further suggestions were that business development such as training and mentorship should be monitored and reported on, to see its effectiveness (Mathibe & van Zyl, 2011). Training and mentorship will assist in this. More awareness is required in terms of access to funding (Fatoki & Ashah, 2011).

In the same study, access to finance was a key challenge for SMEs from the demand side. Equally importantly, access to debt funding and awareness of BDS programmes is considered as a key challenge (Mazanai & Fatoki, 2011). Access to finance is critical and SMEs must be made aware of available funding in the market for SMEs and requirements (conditions for qualification) thereof. The lack of information provided to funders and lack of competencies are considered a key factor by funders for SME funding. One of the major reasons for business failure (other than access to finance, from an SME point of view) is the entrepreneur’s lack

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of managerial skills. The lack of technical and industry specific skills are major reasons for failures and challenges for SMEs. Entrepreneurs need development of financial and business skills which will assist in access to funding. The lack of managerial skills are usually due to a low level of education (Urban & Naidoo, 2012). One of the limitations and suggestions for future studies is pay closer attention to the supply-side of funding, as opposed to the demand-side of funding, when funding SMEs (Fatoki & Ashah, 2011).

A study conducted in Malaysia, established that a variety of funding types available in the country led to a greater accessibility to finance for SMEs in the country. The private and public sectors contributed to SMEs development and performance to ensure they remain sustainable and contribute to the economy. However; the lack of experienced entrepreneurs was seen as a challenge for fund providers due to lack of credibility, which made it difficult for funders of SMEs in Malaysia. It was also found that a high level of debt applications were approved. The SME profile in Malaysia was found to not be significantly different to those around the world. As SMEs grew, the demand for funding increased in order to develop and sustain the enterprise. The size of the funding and tenure of the funding was generally small, similar to South Africa (Abdullah & Manan, 2011).

Fatoki (2011) argues that, a “finance gap” exists when it comes to funding a small business. The lack of “investment readiness” could be the cause. Investment readiness refers to the SME being ready to take on the required funding. Generally, funding applications are assessed based on the quality of financial information presented, collateral provided and the competency level of the entrepreneur, the lack of which poses a challenge for the prospective funder (Fatoki & Ashah, 2011). The entrepreneur needs to improve the level of operational processes and governance for appropriate funding to be provided (Jun, 2014).

2.6.3 Government Influence

The government plays an important role in Impact Investing – it sets policy and legislation off social imperatives (Jackson, 2013). Social transformation should not only be for the government to rectify, instead, the private sector should also get involved. It was found that corporate social investment (CSI) in South Africa was

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driven primarily by legislation and the need to “correct the wrongs of the past”. The BB-BEE Act in South Africa focuses on addressing the “wrongs of the past”. Affirmative action and skills development is a major part of social impact in South Africa. This Act has placed pressures on companies in the private sector to focus on social issues and skills development and also to assist in alleviating poverty (Hinson and Ndhlovu, 2011). It is imperative that there be a collaboration between the private and public sector for CSI and corporate social responsibility (CSR) to work (Hinson and Ndhlovu, 2011). The Social Investment Taskforce (2014) states that governments play an important role in setting policy and regulations to facilitate Impact Investing in a country. The key is to create an “ecosystem” for Impact Investing. This task-force’s advice to governments across the world was that there is not a “one size fits all’ approach. They advised that policy-makers in each country should consider their “own context” and “environment”. Policy should be set to address the particular countries’ social agenda and concerns. Moreover, Government should try and create “incentives” for Impact Investing. Government’s role should be to build a market to assist SMEs and entrepreneurs to access funding and business development support.

There are two arguments: whether the government should get involved in influencing the private sector; or whether the private sector is free to choose and also whether they should be allowed some flexibility. (Zhang, Ma, Su, & Zhang, 2014).

2.7 Conclusion

SF is a field that has developed over the last few decades; its focus has been on providing funding solutions to social and environmental challenges which are addressed by the private sector through the use of private capital. There has been a movement away from social problems being solved by governments and non-profit organisations only. The private sector is becoming more socially aware through CSR, CSI, SRI and more recently Impact Investing. The private sector are building viable models which focus on social impact as well as generating a financial return. There is a risk/reward trade off argument when investing for social good. The social aspect of the literature focused on the development of SMEs.

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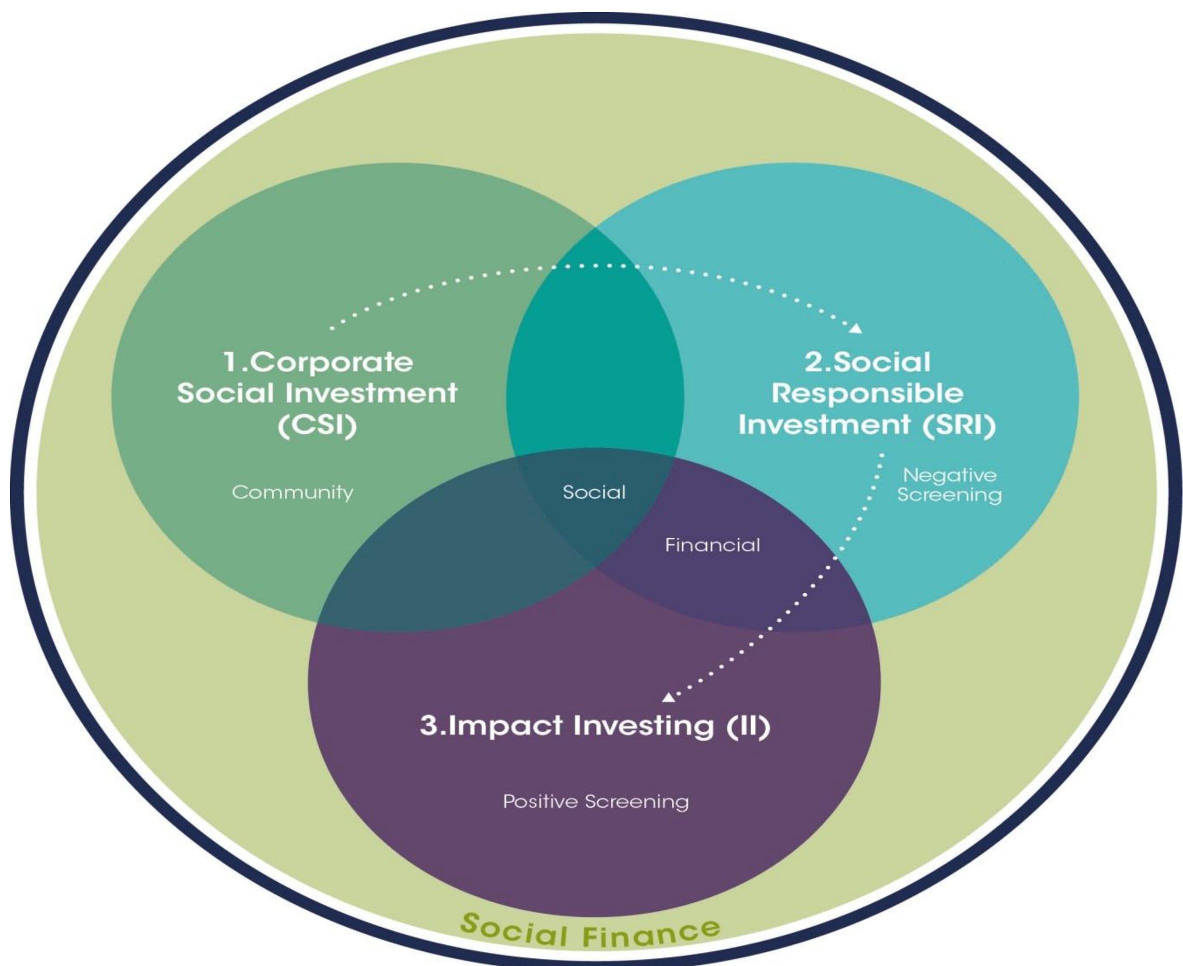
The diagram below (Figure 2.9) displays the evolution of SF from CSI, which focused on community and stakeholders without a specified targeted financial return. CSI evolved to SRI, which excludes specific socially irresponsible investments through negative screening. SRI evolved to Impact Investing, which focuses on intentional social impact through positive screening and financial returns. These concepts are still viewed in isolation of one another and as an evolution. The overlaps between the three SF concepts are shown below where "social" aspects are an objective of all three concepts, albeit, from a different perspective.

Figure 2.9: Evolution of SF



[Figure credit: A. Discala & N. Mokgele, 2015]

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CHAPTER THREE

3 Research Questions

The purpose of the research and research questions are presented in this chapter. The research questions form the basis of the study. The questions determined the methodology and research techniques adopted for the data collection. The questions were deliberately drafted to address the knowledge gaps identified in the literature review (body of knowledge, i.e. Chapter 2). The results to the questions are then presented in Chapter 5 and discussed in Chapter 6.

3.1 Purpose of the Research

This chapter discusses the research questions as it relates to the study of the Performance of ED Funds backed by Financial Institutions. The objective of the study was to explore the performance of ED Funds in SA and compare it to the literature on Impact Investing.

3.2 Research Questions

The following five research questions have been investigated in this research in the context of Financial Institutions:

3.2.1 Research Question 1

What are the ED Funds' strategies?

This research question sought to determine the strategy of ED funds in Financial Institutions. The objective of this research question was to determine if the strategy of Financial Institution ED funds was considered to be Impact Investing.

3.2.2 Research Question 2

Have ED Funds measured their performance and what has their result been?

This research question sought to explore if Financial Institution ED funds measure and report on their performance. Secondly, the research question sought to determine the actual performance of the Funds in comparison to objectives set for the Fund.

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3.2.3 Research Question 3

Do ED Funds offer business development support (BDS) to the small and medium enterprises (SMEs)?

This research question sought to explore what BDS was provided to SMEs funded to assist in their sustainability and growth.

3.2.4 Research Question 4

What are the Reasons and Motivation for creating ED Funds?

This research question sought to determine what the reasons and motivations were for the funds creations. It sought to identify whether there was a broader reason for the funds creation beyond compliance to the BB-BEE codes.

3.2.5 Research Question 5

What are the challenges and success factors faced by ED funds?

This research question sought to explore what the challenges and success factors were for Financial Institution ED funds.

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CHAPTER FOUR

4 Research Methodology

This chapter discusses the research methodology, design and approach used in this research study. Included in the research design and method is the research philosophy, the population and sample size (which is discussed in detail). The research study was qualitative and exploratory in nature. The research philosophy, methodology and specific methods followed are explained (within the context of qualitative research), in order to add validity and credibility to this study (Singh, 2015). The data collection process, analysis and techniques adopted support this approach and are discussed in this chapter.

4.1 Research Method and Design

Before commencing with the research design, the research onion, as referred to by Saunders and Lewis (2012, p. 103), describes the steps included in a research process. These include the research philosophy, approach, strategy, choice, time horizon, technique and process.

The study is exploratory in nature. This qualitative study focused on the collection and analysis of qualitative data to answer the research questions in Chapter 3. The method adopted for this particular study was *an in-depth qualitative data study*, which focused on collecting “text” data (Saunders & Lewis, 2012, p. 167). This methodology is rooted in the *exploratory research approach/design*, which seeks to explore and obtain new answers or insights (Saunders & Lewis, 2012, p. 110). The exploratory and qualitative methods were considered appropriate as in-depth insights into Financial Institutions enterprise development (ED) Funds needed to be gathered from participants, in light of the identified knowledge/information gaps. It was considered inappropriate to forward structured questionnaires to participants as deep insights into the Funds may have been lost if that approach had been adopted. Structured questionnaires are appropriate for a large number of participants in quantitative and descriptive research (Saunders & Lewis, 2012, p. 141). Face-to-Face interview technique was considered the most appropriate data

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collection form. To streamline (enhance focus) the chosen technique, a semi-structured questionnaire was constructed and employed.

An *Induction Approach* was followed, which sought to explore the ED Funds from Financial Institution perspective, to develop a theory in relation to a global context of Impact Investing. Saunders and Lewis (2012, p. 103) describe the Induction Approach as: collecting and analysing data, then developing a theory based on the data collected. As such, an inductive approach was used – information was gathered from the participants in this study to develop a theory. However; the literature reflected in Chapter 2 was used to formulate a semi-structured questionnaire. By using a semi-structured questionnaire, it allowed theory identified in Chapter 2 to be tested in the context of this study (Financial Institution ED Funds), adding an element of deduction. The results in Chapter 5 were analysed and compared to literature (Chapter 2) to answer the research questions (outlined in Chapter 3), as discussed in Chapter 6.

4.2 Research Philosophy

The research philosophy adopted was Realism, which Saunders and Lewis (2012, p. 105) explained as, *the existence of objects or realities in different perceptions*. The research followed a pragmatic and realistic view. Communication is emphasised and meaning is attached to results and solutions in pragmatism (Denzin, 2012). A pragmatic view focuses on the research question as the objective of the interview and study. This approach connects theory to data collected, both before and after the data collection period, referred to as “abduction” (Denzin, 2012).

4.3 Data Collection Methodology

Qualitative data was gathered through a process of interviewing participants (Saunders & Lewis, 2012, p. 167). To clarify the data collection methodology for this research, the qualitative data is firstly considered. Thereafter, the selection of the participants is clarified, by considering the population and explaining the sample process and selection. A two-phase data collection method approach was followed. The first phase was face-to-face in-depth interviews with representatives of the sample chosen of participants from Financial Institution ED Funds. The second

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phase was collection of data from websites, brochures, information memorandums and marketing material.

4.4 Qualitative Data

The research study focused on obtaining qualitative data through conducting interviews as a form of primary text data (Saunders & Lewis, 2012, p. 167). The process for the data collection was as follows:

1. Review available literature on SF, SRI, Impact Investing and SMEs;
2. Develop a semi-structured questionnaire to interview participants;
3. Set up meetings with participants;
4. Conduct interviews;
5. Transcribe the interviews;
6. Analyse results of interviews; and
7. Answer the research questions (posed in Chapter 3) in Chapter 6.

Generally, data can take two forms (i.e. primary and secondary data). For this particular study, the research method was qualitative in nature and the objective was to obtain primary data in the first phase of data collection (through the process of interviews). Eleven participants from eleven Financial Institutions were interviewed. Semi-structured questionnaires were used as a guide, to pose relevant questions to the participants (interviewees).

Secondary data in the second phase of the interview was obtained as a process of validation, further information gathering and triangulation. The Secondary Data was obtained from the following sources:

- Websites of companies interviewed;
- Company brochures;
- Company presentations;
- Financial Mail Enterprise Development 2014 and 2015 magazines; and

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- Relevant newspaper articles.

4.5 Population

The population of the study was Financial Institutions who fund SMEs through ED in South Africa, such as Commercial Banks, Insurance companies, Asset management and Fund Managers and Development Finance Institutions. This represents the "universe" (i.e. complete set of data) from which the sample is selected (Saunders & Lewis, 2012, p. 132).

4.6 Sample Frame

The initial intention to select the sample from the population was to obtain a complete list, a sample frame of all the Enterprise Development (ED) Funds in South Africa (Saunders & Lewis, 2012, p. 133). To ensure completeness, all Financial Institutions from the South African Venture Capital Association (South Africa VCA) and Private Equity Association member list and Financial Mail Enterprise Development Annual Booklet were chosen for testing. The South Africa VCA member list and the ED booklet include equity and debt investments into ED.

The South Africa VCA member list includes all the Venture Capital and Private Equity Fund members in South Africa (including private equity and venture capital funds that focus on ED). The challenge was that, the South Africa VCA member list had limited information on ED Funds and not all ED Funds were included on this list, for example those ED Funds that were debt-focused. The Financial Mail Annual Enterprise Development booklet is an annual booklet focused on ED and Supplier Development Programmes and Funds. Corporate South Africa companies feature in this booklet.

To ensure that the sample could be representative of the population, a *snowballing technique* was adopted. This also ensured completeness, and that no Financial Institutions were excluded. This was considered an appropriate sample frame for the research.

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4.7 Sampling Method and Size

The sample method for selecting Financial Institutions ED Funds in South Africa utilised *purposive sampling* and *snowballing*, both being non-probability sampling techniques (Saunders & Lewis, 2012, p. 137). The rationale for using these techniques was that it was uncertain as to whether the sample frames discussed above represented a complete list of ED Funds in South Africa. The sample frame and networks in the industry provided a stronger probability of selecting a representative sample. Furthermore, during the interview stages, the researcher enquired about further Financial Institutions involved in ED. To ensure completeness, the researcher ensured that the top four banks, top development finance institutions, top insurance companies and asset management and fund managers were included in the initial sample selected. Be that as it may, not all the Financial Institutions chosen as a sample could be tested and interviewed, for various reasons, as discussed in subsequent sections.

4.8 Sampling Method and Size

Purposive sampling was selected as the best sampling method to achieve the purpose of the research. For example, the top four commercial banks were selected purposively as this would be a good representation of banking within the Financial Institution ambit. Development finance institutions were purposively chosen, as these finance institutions focus on funding the development of SMEs in their bid to address the economic and social concerns of the country. Furthermore, Financial Institutions such as insurance companies, asset management and fund managers and SME-focused Financial Institutions were selected.

Purposive sampling is a common method of sampling when performing qualitative studies, in which case, a small sample is selected. The researcher uses their judgement in choosing the sample by assessing who would be in the best position to answer the research questions, deigned on the basis of the research objective (Saunders & Lewis, 2012, p. 138).

A *homogeneous purposive sampling* method was adopted. This method suggests that the sample chosen were similar in nature and allowed for in-depth characteristics to be explored and for “minor differences” to be revealed (Saunders

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& Lewis, 2012, p. 138). The sample chosen would be the best suited to answer the research questions based on the scope of the study, as identified by the researcher's judgement.

4.9 Snowballing

Saunders and Lewis (2012, p. 139) state that snowballing is identifying participants for sampling through earlier participants interviewed. *Snowballing sampling* was used (albeit to a lesser extent) to confirm completion of the sample selected. This included approaching and conversing with people in the industry and obtaining referrals from those interviewed. This particular technique assisted in identifying a "homogeneous sample" as referred to by Saunders and Lewis (2012, p. 140).

The value-add of snowballing to this research was that three more participants that were not originally included were added to sample. The sample selected were the top four commercial banks (three of which were interviewed), five development finance institutions (four of which were interviewed), two insurance companies (one of which was interviewed), three fund managers (one of which was interviewed). The final sample selected constituted 11 Financial Institutions in total:

- Top three commercial banks;
- Four development finance institutions to SMEs;
- Two fund managers/ asset managers;
- One specialist risk finance company; and
- One insurance company.

The sample selected of 11 participants was in line with the estimated number for a *homogeneous qualitative study* of approximately ten (10), until data saturation is experienced (Saunders & Lewis, 2012, p. 158).

Some of these institutions had more than one ED fund which led to a total of fifteen (15) ED Funds who focus specifically on the development and financing of SMEs, being tested and selected.

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4.10 Unit of Analysis

The research focused on Financial Institutions that fund Enterprise Development (ED) in South Africa. These Funds could take the form of debt or equity funds. The focus of the Funds is to assist funding and developing SMEs in South Africa. The unit of analysis included Commercial Banks, Development Finance Institutions, Insurance Companies and Asset Management and Fund Managers and specialist risk finance company.

4.11 Data Collection Process

The data collection process followed a two phase approach. The first phase was a collection of qualitative data through face-to-face and telephonic interviews (the majority of which were face-to-face interviews). The second phase involved a collation of data/information from websites, brochures, information memorandums and marketing material.

4.11.1 First Phase

The first phase sourced primary data through face-to-face interviews. Telephonic interviews were only held when necessary (i.e. if follow up discussions were required or if the participant was not in the same geographic location). The data collection process occurred over a period of three months. The research required face-to-face in-depth interviews with experts in the field who were not always readily available. The organisations were mainly large organisations such as banks, with thousands of employees. Once the sample was selected, research was performed to confirm whether or not these companies had ED Funds. Further research and inquiry through emails and telephone calls were made to determine the relevant people within the ED fund to conduct the interview on. Snowballing, through contacts in Banking and the ED industry was used to identify the correct contact persons to interview.

Cold calling, emailing and follow-up emails were then employed to secure interview appointments/meetings. Interviews were usually set for approximately up to a month in advance for the researcher to be accommodated in the schedules of the chosen participants.

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The duration of the interviews were, on average, an hour long. However; the duration ranged between 40 and a 100 minutes. Data was collected by conducting face-to-face and telephonic interviews, ten (10) of which were face-to-face and three (3) telephonic. Two of the three telephonic interviews were follow-up interviews, whilst the other telephonic interview was held with a Fund based in Cape Town.

The interviews were conducted with CEO's, Managing Directors and Fund managers of ED Funds.

Interviews were held at the offices of the respective companies with the exception of two interviews which were held in a public area. Certain interviews needed to be followed up with telephonic interviews to obtain further information, particularly in cases where the allocated interview time was exceeded (or proved insufficient). A very thorough interview process was followed to gain as much insight and depth into ED funding at Financial Institutions. General discussions were held regarding the background to ED Funds and participants within each company before commencement of the interviews. This proved to provide context to the interview.

Questions were not asked in the exact sequence of the semi-structured questionnaire as participants would go into detail on a question, which would lead to another related interview question. The questions were open ended to ensure that as much information as possible, was obtained. Relevant follow-on questions were asked by the researcher as the interview progressed.

The participants were eager to assist and were open to participating in the research and contributing to the limited body of knowledge in this field. The interviews were all held in Gauteng, with the exception of one interview which had to be held telephonically due to the participant being based in Cape Town. The Gauteng interviews were held in three geographical locations: Pretoria, Centurion and Sandton. Participants provided additional material relating to their Funds, by way of brochures, marketing material, access to websites and information memorandums.

Eight (8) of the eleven (11) interviews were recorded. Extensive hand-written minutes/notes were taken during the interviews. Even though fifteen (15) Financial

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Institutions were selected for testing, only eleven (11) were included in the research.

4.11.2 Second Phase: Collection of Secondary Data

The second phase included a process of triangulation to obtain additional secondary public data in order to obtain further information and insights into the research questions. The use of triangulation shows an attempt by the researcher to obtain an in-depth understanding of the "phenomenon in question" or the research study in question through many sources of data and information (Denzin, 2012). Secondary public data was analysed and reviewed to support primary data obtained from interviews. This assisted in enhancing the credibility and validity of data collected.

Secondary data was collected from public data available. These included company brochures, ED brochures, marketing material, information memorandums on the funds. This information assisted in answering the research questions.

4.12 Data Collection Tool

A semi-structured questionnaire was designed, as informed by the Literature Review (Chapter 2) and the Research Questions (Chapter 3). Most of the interviews were recorded with an audio recording device, while some participants preferred not to be recorded. The researcher took minutes and extensive notes of all interviews conducted including the interviews that were recorded.

4.12.1 Design of Questionnaire

The questionnaire was designed to answer the Research Questions (Chapter 3), which questions were deduced from the identified information/knowledge gaps, through literature review (Chapter 2). Appendix A constitutes a specimen of the semi structured questionnaire. Equally importantly, the questions were open-ended, so as not to impose the researcher's views and thoughts onto the participant. By so doing, the interviews were completely exploratory.

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4.13 Data Analysis

The transcribed interviews were analysed using qualitative data analysis software (QDAS) ATLAS.ti. (Atlas). The complete list of codes as per Atlas are attached in Appendix B. Manual analysis was also performed on the Atlas data and on data from other secondary data. Atlas assisted in creating a level of objectivity in the results, which in turn enhanced the credibility of results (Saunders & Lewis, 2012).

The recorded interviews were transcribed by an external professional audio transcription agency, thus independent (un-biased) transcribing. On the three interviews which were not recorded, the researcher used the in-depth notes that were written. The transcribed interviews were between 40 and 50 pages per transcription due to the in-depth nature and length of the interviews. All recorded interviews were backed-up onto Dropbox, with the Dropbox link sent to the audio transcription agency for transcription. All the transcribed interviews were then saved on the researcher's computer and backed-up on an external hard-drive to ensure that the data could be retrieved (revisited), even in the event of accidental or technical failure of the personal computer.

Two pre-interview testings were conducted. Pre-interviews were held with a development finance institution and an asset management company. After the pre-testing interviews, it was determined that the pre-interviewed organisations' focus was not on SME funding but on other forms of development finance. Consequently, these two interviews and potential participants were excluded from the research.

The transcribed interviews were imported into Atlas and then coded per interview as it related to a specific research question. Specific themes were then formed from the participant's interview answers and coded to align to the appropriate research question to which it related.

A report of the list of codes was drawn to identify all the codes per research question. The codes were then sorted in terms of frequency of codes identified per participant per research question. The codes assisted to identify common and different themes amongst the participants. Frequency tables were then drawn up in

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Microsoft Excel, on the basis of the results from Atlas. A report of all the quotes (per code and research question) was exported into excel and used in Chapter 5.

Thematic Analysis involves the identification of themes and common threads (Vaismoradi, Turunen, & Bondas, 2013). Thematic analysis was used in identifying and analysing the codes produced by Atlas, in order to develop specific themes. The coding of the data (per interview) took (on average) about an hour each. This denotes the depth of care taken in identifying the correct codes per interview. Outside of the Atlas programme, further analysis was undertaken on the data to ensure comprehensive identification of themes. The further analyses in Microsoft Excel also ensured deeper insight into themes identified, by comparing different ED Funds. *Content Analysis* ensures more comprehensive data analysis – data is analysed in many ways to quantify the output for further interpretation and for completeness (Vaismoradi, Turunen, & Bondas, 2013).

A list of comparisons between banks, development finance institutions, fund managers, the insurance company and the risk finance institution were compiled in Microsoft Excel. This was helpful as it provided in-depth comparison and insight into the workings of the ED Funds, their objectives and performance, details of which can be found in Chapter 5. The intention is to build a model in Chapter 6, for Financial Institution ED Funds as it relates to Impact Investing.

4.14 Data Reliability and Validity

Data Reliability refers to consistency in methods used to collect data. Consistency is key in analysing the data (Saunders & Lewis, 2012, p. 128).

Data Validity refers to the extent to which the findings can be relied upon, based on the data collection methods and measurement (Saunders & Lewis, 2012, p. 127), since there is a possibility of researcher bias in all research studies. In an attempt to reduce this bias, the researcher made an effort to be as objective as possible by giving credence to the participants' point-of-view and perspectives.

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4.15 Research Assumptions

It was assumed that the participants interviewed were in a position to represent the Enterprise Development (ED) Funds, based on their positions within the Fund. The participants interviewed were in senior positions and have been in the companies for a long period of time, so it was assumed they were experienced and knowledgeable about the Financial Institution, the ED Fund and the ED space.

4.16 Research Limitations

All research comprises of limitations and biases. In this particular study, the following limitations were identified:

- A Qualitative Study, by its nature, is exploratory. Therefore, further investigations might need to be undertaken, possibly through a quantitative approach (Sanders & Lewis, 2012);
- Researcher-bias and subjectivity-biases may exist due to the exploratory nature of research. The data was analysed from the researcher's interpretation and perspective based on the data collected (Saunders & Lewis, 2012);
- The data is obtained from the participants via interview. Consequently, it intrinsically reflects the views and perspectives of the participants interviewed;
- Non-probability sampling was used as a sampling technique. It can, therefore; not be inferred onto the entire population, as the sample was not chosen at random (Saunders & Lewis, 2012);
- The research was conducted primarily in a particular geographical area of South Africa Gauteng. All the same, a significant proportion of Financial Institutions such as Banks and DFIs' headquarters are based in Gauteng, the economic hub of South Africa;
- Protection of confidentiality was a concern due to the private data specifically relating to equity funds and Banking information, so specific financial data was not obtained to determine performance;

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- The interviews conducted were with employees of the Funds and Financial Institutions. There could be a propensity to reflect the Funds in a positive manner and avoid disclosing the negative aspects.

The research design and methodology discussed in this chapter was considered appropriate by the researcher given the objectives of the research.

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CHAPTER FIVE

5 Results

This chapter presents the results of the Research Study as per the Research Questions presented in Chapter 3. The results described below were collected as per the Research Methodology defined in Chapter 4. The research sample consisted of 11 interviews with 11 participants from 11 Financial Institutions in South Africa. Participants interviewed had knowledge and experience of the ED Funds they are employed by.

5.1 Details of Participants Interviewed

Presented in Table 5.1 is a summary of the details of participants interviewed: Financial Institutions, the number of ED Funds per institution, and the position of participants at these Funds. The participants selected enabled the researcher to gain in-depth knowledge of the ED Funds based on their positions at the Funds.

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Table 5.1: Details of Participants Interviewed

Financial Insitution	Number of funds	Particpant interviewed: Position at ED Fund
Commercial Banks		
Bank 1	1	Head : Enterprise Development
Bank 2	1	Head: Enterprise Development
Bank 3	1	Managing Director :Enterprise Development
Development Finance Institutions		
DFI 1	1	Head: Enterprise Development
DFI 2	1	Regional Head: Enterprise Development
DFI 3	1	Fund Manager
DFI 3	1	Fund Manager
DFI 3	1	Fund Manager
DFI 3	1	Fund Manager
DFI 4	1	Fund Manager
Fund Managers(Asset Management)		
Fund Manager 1	1	Fund Manager
Fund Manager 2	1	Managing Director: Enterprise Development Fund
Fund Manager 2	1	Managing Director: Enterprise Development Fund
Insurance company		
IC 1	1	Fund Manager
Risk Finance Company		
RF 1	1	Regional Head:Enterprise Development
	15	

[Table credit: A. Discala].

The data collected from the eleven (11) interviews was analysed using *Content and Frequency Analysis* in order to identify common themes, the process of which was discussed in Chapter 4. Thereafter, *Frequency Tables* were drawn up from the results collated from participants. The results were then ranked according to *Frequency Tables*, from most mentioned to least mentioned. A frequency of three (3) or more was discussed in detail, as this represented at least a third of the sample selected. The results of frequencies of less than three (3) were also presented (albeit in not as much detail), as this provided some insight into views of certain ED Funds. However, less emphasis was given to frequencies of less than three (3). The results of the *Content Analysis* process were captured onto Microsoft Excel files, to compare and analyse the different types of Financial Institutions. The *Content Analysis* process was discussed in detail in Chapter 4 (under the Analysis of Data sub-section).

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A semi-structured questionnaire was designed on the basis of the Literature Review (Chapter 2). The correspondence of interview questions to research questions are as follows:

- Research Question 1: Interview question 1, 4, and 13;
- Research Question 2: Interview question 2, 3 and 7;
- Research Question 3: Interview question 6;
- Research Question 4: Interview question 5; and
- Research question 5: Interview questions 8 to 14.

In the following section the results of the data collected are presented and discussed in detail. The results are discussed per research question and include relevant quotes from interviews to support the data collected from interviews held.

5.2 Results for Research Question 1: Strategies of ED Funds in Financial Institutions

5.2.1 Strategy

The objective of Research Question 1 was to identify the strategy for the various ED Funds, on the basis of the factors identified below (see Table 5.2). Atlas was used to determine the frequency of participants' answers to the identified factors (see Table 5.2) reflecting their strategies.

Interview Question 1 explored the financial and social objectives of the Fund, the investment criteria (including sectors), and life of the Fund. Interview Question 4 sought to determine the sources of funding of the Fund. Interview question 14 explored Corporate Social Investment (CSI) and its relation to the ED Fund.

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Table 5.2: The Strategy of the ED Funds

Ranked	Strategy of ED Fund	Frequency
1	Financial Objective	11
1	Social Objective	11
1	Corporate Social Responsible Investment	11
2	Sectors Included	9
2	Sectors Excluded	9
2	Captive Funding	9
3	Non captive funding	7
4	Grants	6
5	Life of fund	5
5	Percentage ownership	5

[Table credit: A. Discala].

Table 5.2 above identifies the top 5 ranked strategy factors of ED Funds. The top ranked strategy explored was the Financial Objective, Social Objective and CSI. All participants had a financial and social objective in place, and commented on CSI in relation to its strategy. The second ranked factor, excluding Captive Funding was the sectors ED Funds operate in and excluded specific sectors. Factors ranked 2 (Captive Funding), 3 and 4 related to sources of funding for the Fund. The life of a Fund and percentage ownership for equity investments were ranked 5th. The order of ranking does not indicate a level of importance compared to the other; instead, the ranking indicates what respondents disclosed when interview questions were posed.

5.2.2 Financial and Social Objectives

This part of Interview Question 1 aimed to explore whether there was a financial and social intention set at the start of the ED Fund. All participants had set financial and social objectives in place. The nature of the financial and social objective of each Fund is displayed in Table 5.8. This table reflects the comparisons in objectives for each fund. The difference in objectives for Banks, DFI's, Fund Managers and Specialist Risk Finance companies are also displayed in Table 5.8. The data revealed that all eleven (11) participants had a clear intention of setting financial and social objectives at the inception of the ED Fund.

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5.2.3 Financial Objectives

All ED Funds had a financial objective and target, set at inception of the ED Fund. The participants indicated that ED Funds need to be financially sustainable in order to make a social impact. The participants, however; had different mandates in terms of financial objectives and returns (refer to Table 5.6 i.e. Research Question).

"*The main objective is profitability and to make money and to be sustainable as a business.*" A Development Finance Institutions (DFI) underlined that an investment return is required for all transactions assessed and will determine the required interest-rate charged. Financial objectives researched included the following:

- Preservation of capital; and
- Return on capital.

Financial targets are either in the form of Return on Equity (ROE) or Internal Rate of Return (IRR), dependent on the type of funding provided. Twenty percent (20%) of participants revealed that a money multiple is set as a financial target. All participants stated that the preservation of capital is a key financial objective. Six (6) ED Funds required a hurdle of five percent (5%), over and above the capital preserved. Two (2) of the three (3) banks stated that the target return is in excess of their cost of capital, similar to other funding banking financial requirements. Only one (1) bank utilised equity investments as an instrument in the ED space, where the other two (2) utilised debt funding as an instrument.

5.2.4 Social Objectives

All participants had set social objectives. These objectives include job-creation, provision of funding to SMEs for growth, development and transformation of SMEs in South Africa. All Funds stated that their focus (whether directly or indirectly) was job-creation and the growth of small business in South Africa. One Development Finance Institution (DFI) interviewed had four ED Funds focused on the following social objectives:

- Transformation and entrepreneurship;

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- Business growth;
- Creating jobs and reducing unemployment; and
- Technological advancement in small businesses.

One of the banks quoted that their social objective was as follows: "…*providing* SMEs *with access to funding. The social objective is not the primary driver but is consequential to the funding.*" Another quoted bank remarked: "*The bank provides corporate solutions to SMEs, focuses on BB-BEE financing and support to BB-BEE … The focus is on supplying capital to SMEs. SMEs are defined as enterprises with a turnover of R50 million or less. Ninety five percent (95%) of Funding provided are to Broad-based Black Economic companies, as defined by the Act and includes previously disadvantaged parties such as women and people with disabilities"*.

One Development Finance Institution (DFI) interviewed was quoted saying, "*we fund black businesses, rural areas, entrepreneurs … mainly* SMEs *who have a high growth potential and job creation.*" Another DFI stated that their social mandate is aligned to the National Development Plan (NDP) of South Africa and they focus on socially responsible investing as a principle, in order to drive transformation.

A Risk Finance company said that they, "…*finance start-ups, high-growth and high-impact companies… Their objective is to* '*Do good and do well'.""* The focus of the funding provided is to finance SMEs and to create jobs. Their social objective is, "*to increase the footprint in South Africa and to reach as many entrepreneurs as possible*"*.* The social demographic focus is: "*women … black entrepreneurs … job facilitation … social responsible investing, albeit first Impact Investing…*" The risk finance company defined ED as follows: "*ED is investing in enterprise development, providing* SMEs *with access to funds and markets, support for entrepreneurs, due diligence and post investment support*".

The Fund managers considered in this study focus was on job-creation and growth of SMEs through providing funding to SMEs, while focusing on BB-BEE codes and transformation principles in South Africa (refer to Table 5.8 for the social objectives for each Fund).

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5.2.5 CSI Compared to EDF

All participants expressed that their ED Funds focused on a sustainable business model which included both financial and social returns. All participants stated that their funds were distinct from Corporate Social Investment (CSI). The Funds researched viewed CSI as philanthropy – investment for social good in the form of grant funding and no repayment of capital was expected. One bank stated that, "*CSI is grant money, no return of capital is expected, whereas with EDF, there is a financial return*". All participants mentioned that CSI was separate to their ED Funds objectives.

5.2.6 Sectors

All participants operated in most sectors except for specific exclusions. The excluded sectors were linked to the social mandates of the Funds. Nine (9) of the eleven (11) participants stated that they specifically excluded "sin industries". The intention to exclude these sectors was made at the outset and was part of the ED Funds mandates. One Development Finance Institution (DFI) was quoted as saying, "*We are across all sectors except morally irresponsible sectors.*" A bank stated that, "*All sectors are funded except for sin industries.*" Another Development Finance Institution (DFI) interviewed commented, "*although investing in alcohol will give us more money … it's not social impact.* "

Three of the ED Funds specifically excluded mining and agriculture sectors given the perceived long-term nature and risks associated with these sectors. One participant stated that, "*Agriculture is reliant on the weather and mining is capital intensive*". The balance of the participants interviewed stated that they included these sectors in their funding models. One participant mentioned that they excluded speculative real estate and construction from their Fund. Participants that identified significant job-creation as a priority social objective focused on sectors with a high potential for job-creation and social impact. These sectors include manufacturing, retail and service industries.

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5.2.7 Sources, Funding and Financial Instrument

Source of Funding

As mentioned in Chapter 4, eleven (11) participants were interviewed from eleven (11) Financial Institutions representing fifteen (15) ED Funds. A combination of captive and non-captive funding was provided to these Funds. DFI's had a combination of government funding and private sector funding. Private sector funding was from corporates in South Africa's allocated ED budget spend. Seven (7) of the fifteen (15) Funds had captive funding; six (6) Funds had non-captive funding, and two (2) Funds had both captive and non-captive funding.

The Banks, Insurance Company and Risk Finance company participants who were interviewed revealed that their source of funding was captive funding. The fund manager participants indicated that their source of funding was non-captive. The Development Finance Institution (DFI) participants had a combination of captive and non-captive depending on the Fund (refer to Table 5.4 for sources of funding).

All DFI funding capital investors expected capital to be preserved, retained and "recycled" in the ED Fund. Recycling (as referred to by the participants) was utilising the repaid funds from SMEs to fund new SMEs. A DFI participant stated that, "*It is not to say that providers of capital don't expect a repayment of their capital and return at some point in the future*". One DFI, however; stated that, "…*the investors don't expect the money back*". The DFI participants expressed the view that the providers of capital were patient and prioritised social impact.

The DFI participants revealed that their main source of funding was from the government. The fund manager participants revealed that funding was raised from corporates in South Africa's ED budgets ear-marked for BB-BEE spends. An interviewee said, "…*in the case of corporates, we take on loan funding. In the case of government incentives, they don't want the funds back. It's … in their mandate not to get it back. So what they'll say is, 'take the money and if you do get it back, recycle it into the fund'.*" A DFI participant mentioned that they would match funding raised by corporates for ED.

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Financial Instruments

Financial instruments were included (as per Interview Question 1), as part of types of funding and Investment criteria (see Table 5.3 below).

Table 5.3: Frequency of Type of Financial Instruments

Ranked	Financial Instrument	Frequency
1	Debt&Equity	6
2	Debt	5

[Table credit: A. Discala].

Six (6) participants indicated the utilisation of debt and equity instruments for funding SMEs. Five (5) of the eleven (11) participants indicated that they focused on debt funding only. Five (5) ED Funds, therefore; utilised debt instruments only, whereas ten (10) of the fifteen (15) ED Funds utilised a combination of debt and equity funding. Participants considered in this particular study did not mention the provision of grant funding as an instrument of funding to SMEs. As stated by one Development Finance Institution (DFI), "*we don't want to start … Grant funding, it doesn't work…*" Table 5.4 below presents the sources of funding and financial instruments per ED Fund.

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Table 5.4: Sources of Funding and Financial Instrument per ED Fund

Funding	Number of funds	Source of Funding	Type of funding	Preservation of capital	Recycle capital	Financial Instrument
Commercial Banks						
Bank 1	1	Captive	Bank Funding	✔	x	Debt
Bank 2	1	Captive	Bank Funding	✔	x	Debt
Bank 3	1	Captive	Bank Funding	✔	x	Debt and Equity
Development Finance Institutions						
DFI 1	1	Captive and Non Captive	Government and Corporate Grant Funding	✔	✔	Debt and Equity
DFI 2	1	Captive and Non captive	Government and DFI	✔	✔	Debt
DFI 3	1	Captive	Goverment	✔	✔	Debt and Equity
DFI 3	1	Captive	Goverment	✔	✔	Debt and Equity
DFI 3	1	Non Captive	European	✔	✔	Debt and Equity
DFI 3	1	Non Captive	UIF	✔	✔	Debt
DFI 4	1	Non Captive	Goverment	✔	Not disclosed	Debt and Equity
Fund Managers(Asset Management)						
Fund Manager 1	1	Non Captive	Corporates	✔	✔	Debt
Fund Manager 2	1	Non Captive	Insurance funding	✔	✔	Debt and Equity
Fund Manager 2	1	Non Captive	Corporate Grant Funding	✔	✔	Debt and Equity
Insurance company						
IC 1	1	Captive	Insurance funding	✔	x	Debt and Equity
Risk Finance Company						
RF 1	1	Captive	Goverment and Corporates	✔	x	Debt and Equity
	15					

[Table credit: A. Discala].

5.2.8 SME Criteria

Eleven (11) participants from fifteen (15) ED Funds stated that the objective of the Funds was to fund SMEs for further growth. The general consensus was that repayment ability by the SME to the Financial Institution was the most important criteria for all participants.

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Stage of Business

All participants said that they funded SMEs. The Development Finance Institution (DFI) participants targeted SMEs. However; they included start-up business funding in their mandates. Banks funded early-stage businesses, albeit at a later growth stage than a start-up. The DFI and Bank participants focused on SME growth and included expansion funding. The Fund managers participants' focus was on SMEs which had high growth potential. The Fund managers interviewed aimed to fund more medium size entities as opposed to start-ups. A bank and Fund manager said that they do not focus on start-up funding – their focus was on later stage growth funding. One Fund manager specifically said that they fund "…*established* SMEs *with at least a three-year track record.*" The insurance company and specialist risk finance company focused on funding start-ups and expanding start-up businesses.

Equity Investment – Percentage Shareholding

Ten (10) of the participants interviewed included equity as a type of funding instrument in their ED Funds. The participants revealed that they did not want to control the companies they invested into. The maximum shareholding they wanted was forty-nine percent (49%). They preferred that the entrepreneurs and management have majority control. All the equity investment ED Funds stated that they did not want control in the businesses invested in. The general consensus was that the majority investment would be a maximum of forty-nine percent (49%) in the businesses invested in.

Exit Period and Fund Life

The funds that had a defined exit period had a fund life of between 7 – 8 years. Twelve (12) participants indicated though, that there were exit periods defined. Capital was reinvested into the Fund indefinitely, as long as the Funds were applied as per the specified mandate. A return was, however; required and re-invested into the Fund to support new SMEs. The main financial objective was that capital be preserved (refer to Table 5.4 for specific detail).

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5.3 Results for Research Question 2: Fund Measurement and Performance

Research Question 2 aims to determine if the ED Funds researched in this study are measured in relation to objectives set for the Fund. In addition, the research question aims to answer how these Funds have performed in relation to the objectives set for the Fund. It also aims to explore the measurement tools (if any) that were used for these objectives and how frequently objectives were measured and assessed.

5.3.1 Financial Measurement and Performance

As presented in Table 5.5 below, eleven (11) participants mentioned that they measure financial performance. Nine (9) of the eleven (11) participants mentioned that they met their objectives, whilst one (1) participant did not disclose information on this. Moreover, one did not meet their financial objective.

Table 5.5: Measurement of Financial Objectives

Financial measurement and performance	Frequency
Financial performance measured	11
Financial objectives met	9
Financial objectives not met	1

[Table credit: A. Discala].

The frequency of measurement of ED Funds varied amongst participants' responses. All participants measure financial performance at least annually, with the majority measuring targets on a quarterly basis. Financial measurement is measured by reviewing management accounts and annual financial statements obtained SMEs.

A participant stated that, "*Financial performance is measured in terms of actual returns compared to targeted returns.*" Another participant indicated that "*We measure production, we give them targets*." Yet another participant said, "*Management accounts are provided by the small business twice a year and the*

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annual financial statements on an annual basis. These management accounts and annual financial statements are reviewed by the fund managers of these funds or dedicated post investment departments." One Development Finance Institution (DFI) stated that, "…*our measurements are basically based on our own targets …*"

Interview questions relating to financial performance of ED Funds were measured at three level intervals: High, Medium or Low. Financial performance of most Funds is private, especially for equity investments. The measurement criteria are listed below:

- High: Objectives have been exceeded;
- Medium: Objectives have been met; and
- Low: Objectives have not been met.

Five (5) participants mentioned that financial objectives were exceeded. One (1) participant indicated that performance was medium to high, in the sense that some objectives were simply met whilst some were actually exceeded. The balance of the participants (i.e. 5 participants) met their financial objectives. Two ED Funds managed by a Fund manager were still in their infancy stage, therefore; the Fund manager participant had not measured actual financial performance to date.

Below are a few comments mentioned from five (5) of the participants on the financial performance of their ED Funds:

1. "*Our ED fund had been very successful, repayments have been 100%.*"
2. "*The financial performance has exceeded objectives and has been high in terms of performance*"*.*
3. "*The key reason behind the performance is that the Bank will price for the additional risk it takes by funding to* SMEs".
4. "*We probably had a success rate of about 80%.*"
5. "*There have been no capital losses and they have exceeded their financial objectives."*
6. "*If targets are not met, grants will be converted to* loans *which would have to be repaid*" (from the point-of-view of the investor providing the grant)."

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7. "*Capital repaid by SMEs is recycled in the Fund and provided to future SMEs requiring funding, this way, corporate can continuously earn their points.*"

All participants reviewed financial performance returns on a portfolio basis. One participant said "…*if we had some deals that were more expensive or … wouldn't hit 19%, we had other deals that would get 40%, so it would average out over time throughout the whole fund.*"

Table 5.6 below presents the financial performance of ED Funds, on the basis of the participants interviewed.

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Table 5.6: Financial Performance of ED Funds as per Participants Interviewed

Funding	Number of funds	Financial Objective	Financial Instrument	Financial Return	Financial performace
Commercial Banks					
Bank 1	1	Preservation and repayment of capital	Debt	Bank ROE requirement	High
Bank 2	1	Preservation and repayment of capital	Debt	Economic return in excess of cost of capital	Medium
Bank 3	1	Preservation and repayment of capital	Debt and Equity	Preservation of capital plus 5 % hurdle	Medium
Development Finance Institutions					
DFI 1	1	Preservation and recycling of capital	Debt and Equity	Preservation of capital but no distribuion of returns	High
DFI 2	1	Preservation and recycling of capital	Debt	In excess of cost of capital, preservation of capital, pricing 10% to beneficiaries	High
DFI 3	1	Preservation and recycling of capital	Debt and Equity	Preservation of capital plus 5 % hurdle	Medium
DFI 3	1	Preservation and recycling of capital	Debt and Equity	Preservation of capital	Medium
DFI 3	1	Preservation and recycling of capital	Debt and Equity	Preservation of capital plus 5 % hurdle	Low
DFI 3	1	Preservation and recycling of capital	Debt	Preservation of capital plus 5 % hurdle	Medium
DFI 4	1	Preservation and repayment of capital	Debt and Equity	Commercially priced	Not disclosed
Asset management / Fund managers					
Fund Manager 1	1	Preservation and recycling of capital	Debt	Preservation of capital plus one year CPI	High
Fund Manager 2	1	Preservation and recycling of capital	Debt and Equity	Preservation of capital plus 5 % hurdle	Fund in infacy stage - not measured
Fund Manager 2	1	Preservation and recycling of capital	Debt and Equity	Preservation of capital plus 5 % hurdle	Fund in infacy stage - not measured
Insurance company					
IC 1	1	Preservation and repayment of capital	Debt and Equity	ROE - 19%	High
Risk Finance Company					
RF 1	1	Preservation and repayment of capital	Debt and Equity	Less than 20% IRR and capital preservation	Medium to High
	15				

[Table credit: A. Discala].

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5.3.2 Social Measurement and Performance

All participants intentionally set social objectives, as identified in Research Question 1. As illustrated in Table 5.7 below, ten (10) participants confirmed that ED Funds measure their social objectives. Measurement tools include the number of jobs created and cost per job. The job-creation target for the SME is set up-front by the ED Fund, whilst the measurement of social objectives is done periodically. The study discovered that if targets are not met, then the funding institution can re-price the funding provided to the SME or call for funding to be repaid to the Financial Institution. This denotes the significance and importance of social impact and objectives.

Table 5.7: Frequency Table of Social Performance Measured

Social measurement and performance	Frequency
Social performance measured	10
Social performance not measured	1
Social objectives met	10

[Table credit: A. Discala].

As depicted in Table 5.7 above, all eleven (11) participants indicated that their ED Funds measure social impact, except for one institution which is endeavouring to start measurement in the near future. It should be noted, however; that social measurement is not standardised across participants – all participants measure their social impact based on the social objectives set. Notwithstanding, the study identified some commonalities:

- Number of new businesses created;
- Number of jobs created;
- Number of transformation objectives achieved (e.g. women funded, black owners funded); and
- Cost per job.

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Some institutions go a step further, by using global measurement tools such as environmental, social and governance (ESG) and Global Impact Investment Network (GIIN). One Development Finance Institutions (DFI), mentioned that "*…every investment we do within the DFI, ESG gets embedded … and to score on enterprise development, I think is low-hanging fruit.*"

Social Performance

All participants indicated that social objectives had been met. However; three participants indicated that, *it is not easy creating jobs in start-ups, and assisting the entrepreneur to grow and be sustainable at the same time*. *The number of jobs created needs to be linked to the life stage of the business and whether they can practically create the required jobs*.

All participants researched in this study (except for one), report to either a Credit Committee or Investment Committee, depending on the type of financial instrument utilised. All the same, reporting of both social and financial objectives takes place. Evidence of this can be deduced from the responses of the participants interviewed. For instance, one participant said, "*We do report to our investors*". A DFI participant said, "*…job creation is another area where we achieved success*". One fund manager said, "*…we're creating jobs which are probably one of the most powerful social lead resident in an emerging market economy. We're strengthening supply chains, we're building black entrepreneurship in the country and we're getting our capital back while earning our BB-BEE points.*" Another fund manager indicated that, "*ED is growing businesses for a social purpose. The real difference is that the one is about supporting sustainable growth businesses to generate social outcomes*".

5.3.3 Trade-off between Risk and Return

Included in the assessment of the performance of ED Funds (as viewed by participants interviewed) was the concept of trade-off between financial and social returns. Nine (9) participants indicated that there was a trade-off, whilst one participant chose not to comment. All participants viewed the performance of ED Funds from a portfolio perspective. If an SME had a significant social impact but did

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not meet the required financial return, funding would be provided to the SME based on the significant social impact. The other SMEs in the Fund would "subsidise" the financially "underperforming" companies, from a financial perspective. As stated by one DFI participant, "…*two proposals are sitting side-by-side. In one we're making more money and the other we're making less money, but the one that we're likely to fund is the one that has more development*'. The extent of the trade-off was not identified by the participants. The DFI participants had *social first* as their intention. Although they had a finance objective, their mandate was *social first*. The banks, insurance companies and risk finance companies responded as putting *finance first,* albeit with a social objective. The ED Fund managers' responses denoted both *social and financial* as first. Although institutions had *finance first*, all the models had some level of concession. The concessions were across the board and were necessary to fund SMEs. Some of the concessions to traditional commercial funding were as follows:

- No security required by SME owners;
- No suretyships required by SME owners;
- 12 months no repayment moratorium on a debt facility;
- Discount in interest rates charged for social impact;
- Concession in terms of pricing and rates;
- Funding assistance for entrepreneur equity contributions; and
- Equity contribution alleviated or eliminated.

It should be noted that all participants had at least one of the above concessions. The Development Finance Institutions (DFI) would have a combination of one or more of the above. Even though concessions were in place, repayment of the funding provided was critical and expected by all the funds. One DFI participant said, "…*as a woman you could get a discount in our price*…" Another DFI said, "*We do have a financial target but what is most important is the development of impact*…" Table 5.8 below depicts the trade-off between financial and social performance.

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Table 5.8: Trade-off between Financial and Social Performance

Funding	Number of funds	Financial Objective	Social objective	Financial Concessions	Financial First/Social First/Both	Financial performace	Social Performance
Commercial Bank							
Bank 1	1	Preservation and repayment of capital	Provide SMME's with access to funding to grow and financially perform	✓	Financial first	High	High
Bank 2	1	Preservation and repayment of capital	Provide SMME's's with access to funding to grow and financially perform	✓	Financial first	Medium	Medium
Bank 3	1	Preservation and repayment of capital	Create jobs and to grow SMME's	✓	Both	Medium	Medium
Development Finance Institution							
DFI 1	1	Preservation and recycling of capital	Development and sustainability of SMME's	✓	Social first	High	High
DFI 2	1	Preservation and recycling of capital	Development and sustainability of SMME's	✓	Social first	High	High
DFI 3	1	Preservation and recycling of capital	Creation of high impact jobs	✓	Social first	Medium	Medium
DFI 3	1	Preservation and recycling of capital	Transformation objectives	✓	Social first	Medium	Medium
DFI 3	1	Preservation and recycling of capital	Significant Job creation	✓	Social first	Medium	Medium
DFI 3	1	Preservation and recycling of capital	Retention and creation of jobs	✓	social first	Medium	Medium
DIF 4	1	Preservation and repayment of capital	Development and sustainability of SMME's	Not disclosed	Not disclosed	Not disclosed	Not disclosed
Fund Managers(Asset Manager)							
Fund Manager 1	1	Preservation and recycling of capital	Development and sustainability of SMME's	✓	Both	High	High
Fund Manager 2	1	Preservation and recycling of capital	Development and sustainability of SMME's	✓	Both	Fund in infacy stage - not measured	Fund in infacy stage - not measured
Fund Manager 2	1	Preservation and recycling of capital	To grow and scale small businesses quickly	✓	Both	Fund in infacy stage - not measured	Fund in infacy stage - not measured
Insurance company							
IC 1	1	Preservation and repayment of capital	To grow small businesses	✓	Financial first	High	High
Risk Finance Company							
RF 1	1	Preservation and repayment of capital	Access to finance to SMME's and creating jobs.	✓	Financial first	Medium to High	Medium to High
	15						

[Table credit: A. Discala].

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5.4 Results for Research Question 3: Business Development Support to SMEs

Ten (10) of the eleven (11) participants have business development support (BDS) programmes in place. The BDS was provided by either internal employees or outsourced to external consultants. The cost of BDS was generally borne by the ED Funds.

The BDS question (i.e. Interview Question 6) focused on the following:

- Support provided to SMEs;
- Post-investment and loan monitoring; and
- Level of governance in place (including meetings held with entrepreneurs).

One interviewed participant said, "*Business Development Support (BDS) must be matched to the life-cycle stage of enterprises*". Another participant's response was that, "*the Business Development Support (BDS) ensured scalability and sustainability of the business*". Participants from bigger organisations had specific departments which focused on BDS. However; the Fund managers had less staff and did not have dedicated BDS departments. Consequently, it is the Fund managers who perform this function. The themes identified for this research question were: training, coaching and mentorship; monitoring (performance) and improving the level of governance in place.

5.4.1 Training, Coaching and Mentorship

All participants revealed that training and mentorship programmes were available to entrepreneurs but on different levels and scales. All DFI participants provided mentors (mentorship), coaching and training to entrepreneurs. One bank said that, "*The cost is borne by the bank to ensure that the business develops and has support to ensure that loans advanced can be repaid*". The Fund managers and DFI's focused specifically on transformation of the SMEs' they funded. Three of the Funds considered in this study focused on transformation of the supply chain of these entities, as well as transformation of the funded entity. The Fund manager participants' funds were extremely involved in BDS, transforming the entities they

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funded. Their focus was on developing ED programmes and solutions for the SMEs they funded, as well as in assisting corporate(s) with compliance to BB-BEE codes (in terms of ED). Participants who were debt providers monitored the performance of loans provided to SMEs, whilst participants who were equity providers were more involved in BDS.

5.4.2 Monitoring and Governance

All Bank participants revealed that they monitor their exposures extensively as a means of risk mitigation. The types of monitoring include: *bank covenant monitoring* (e.g. debt service cover and interest cover ratios). These ratios are calculated from management accounts and annual financial statements obtained from SMEs funded. All banks identified capacity constraints as a reason for insufficient meetings held with SMEs funded. As indicated by one participant, "…*meetings are only held when the loans are not performing well.*" To the extent that equity investments are invested into sizable companies, the investor will have representation on the Board of Directors (Boards) of the investee company. Two Fund manager participants mentioned that smaller companies do not have Boards. The investor would, therefore; have to meet more frequently with the entrepreneur.

All participants mentioned that small businesses required some level of governance structures to be implemented. According to the interviewees, SME financial systems and controls were at times non-existent. The participants mentioned that the ED funder would get involved and assist to create financial systems, structures and controls. What was evident from the interviews conducted was that the earlier the stage of the company invested in, the more the meetings and intervention required from the ED partner.

All participants revealed that the level of governance in place by SMEs is assessed upfront, during the initial assessment of funding required. In addition, all participants mentioned that extensive analysis, due diligence, and research is performed upfront. The general consensus amongst all participants was that, even though monitoring was taking place, there was not sufficient capacity to monitor all entrepreneurs sufficiently as per required levels of monitoring. This predicament is echoed by one participant who says, "…*a lot of what we do with these businesses*

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is, 'we try and create governance in them and we give ourselves the options to support and intervene … through our structures'."

5.5 Results for Research Question 4: Reasons and Motivation for creating these Funds

Research Question 4 sought to determine what the purpose of these Funds was. Interview Question 5 explored (through an open-ended discussion) why these Funds were established by the participants. The rationale is linked to whether or not funders perceive a business model in its establishment or whether they were for compliance reasons. The frequency table (Table 5.9) below reflects the reasons for the creation of ED Funds, from the participants of this particular study's perspective.

Table 5.9: Reasons ED Funds were created – Combined Frequency

Ranked	Reason for creation	Frequency
1	Development of SME's and Job creation	11
2	BB-BEE	8
3	Access to funding	4
4	Plug gaps in traditional funding model	2
4	Access to markets	2
5	New business	1

[Table credit: A. Discala].

The top three (3) ranked reasons for the creation of ED Funds (as revealed by participants) were: development of SMEs and job creation; compliance to the BB-BEE codes; and providing SMEs with access to funding.

All participants mentioned development of SMEs and job-creation as being imperative to their ED Funds creation. Eight (8) of the eleven (11) participants mentioned that compliance to BB-BEE codes were the reason for the creation of the ED Funds. All participants mentioned that growing SMEs was imperative and necessary for the country, despite the BB-BEE codes coming into effect. Two (2) particpants mentioned that the creation of their ED Funds was purely for financial business reasons as there was a "gap" identified in funding SMEs. Although these

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ED Funds focused on providing funding to “black” owners, it was not the reason for its creation.

Bank participants focused on funding “black entrepreneurs” and on growing small businesses in South Africa. Development Finance Institutions (DFI) participants focused on transformation and ED as defined by the Broad-Based Black Economic Empowerment (BB-BEE) Act. All Fund manager participants focused on providing solutions to corporates, ED compliance requirements through sustainable models which create social impact. Three (3) DFI participants specialised in providing ED solutions for corporates to invest into to earn BB-BEE rewards for compliance. All ED Funds that were considered in this study had an element of transformation, in terms of the BB-BEE codes embedded in their funds (whether intentional or not) at the ED Funds creation stage.

Four (4) participants mentioned providing SMEs with access to funding as the purpose of their Fund. These participants’ views expressed that they were, “*bridging the funding gap*”. The loan providers would relax certain of their standard credit requirements (e.g. requesting suretyships, equity contributions or assisting in funding equity contributions). In certain cases, security was also not required or was relaxed in terms of debt funding. All participants viewed their funding as a business funding model and not as grants.

The above highlights the top three (3) reasons for the Funds creation for the mere fact that more than three (3) participants mentioned these reasons for the creation of their ED Funds.

5.6 Results for Research Question 5: Challenges and Success Factors identified by Participants

Research Question 5 sought to determine what the challenges and success of Financial Institution ED Funds are. Interview Questions 8 to 14 explored (through open ended questions) what these challenges and success-factors were. The aim of the Question was to bring to light, challenges as well as successes faced in this industry. The frequency table (Table 5.10) below reflects the challenges raised by participants interviewed.

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5.6.1 Challenges

Table 5.10: Challenges faced by ED Funds

Number	Ranked	Challenges Identified	Frequency
1	1	Lack of skilled and experienced entrepreneurs	10
2	2	Insufficent patient capital	8
3	3	Size of funding too small for business growth and scale up	5
4	3	Lack of information ,records and financial systems from SMME's	5
5	4	Lack of suitable new businesses and entrepreneurs	4
6	4	Number of small business failures	4
7	4	Underestimating the performance of risk ad financial return	4
8	5	Lack of capacity, quick turnarund times and efficient processes	3
9	6	Lack of market penetration,overestimating the market and economy	2
10	6	Lack of sufficient business support	2
11	7	Competition amongst funders to small business	1
12	7	Complaints around pricing by SMME's	1
15	7	Retention of talent at SMME and funder	1
16	7	Sense of entitlement to grant funding by SME's	1
17	7	Difficulty in exiting the equity investment	1
19	7	Lack of security	1
21	7	Growth pace slow compared to other countries	1
24	7	No synchronised industry system	1
25	7	Lack of business readiness for funding	1

[Table credit: A. Discala].

The frequency table presented above (Table 5.10) highlights twenty five (25) challenges raised by the all participants interviewed. Due to the fact that this is a nascent and topical field with many challenges (as shown by the number of challenges raised by participants), it was prudent to discuss the top-five (5) ranked challenges. More than three (3) participants mentioned the top-five (5) challenges. The results, per the interviews, revealed the top-five (5) challenges as ranked in the above frequency table. These challenges are discussed in further detail below:

1. Lack of skilled and experienced entrepreneurs was ranked the number one challenge faced by ED Funds. Ten (10) of the eleven (11) participants identified this as a challenge. The business and financial acumen and experience in the relevant industry by the entrepreneur are a major concern for funders;

2. Insufficient patient capital by funders was the second-highest ranked challenge;

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3. Size of funding provided to SMEs for growth and lack of reliable information, , records and financial systems was the third-highest ranked challenge;
4. Lack of suitable new business and entrepreneurs to fund, the number of small business failures and underestimating the performance of risk and return was financial return was ranked as the fourth-highest challenge; and
5. Lack of capacity, turnaround times and efficient processes was the fifth-highest ranked challenge.

NB: Each challenge is discussed in more detail below:

(i) Lack of Skilled and Experienced Entrepreneurs

Lack of business and financial acumen and experience in the relevant industry by the entrepreneur is a major concern for ten (10) of the eleven (11) participants. One participant said, "*The lack of expertise of the entrepreneurs and business owners was a concern. For example, they would not submit Business Plans on time and quality of documents submitted for the funding application is lacking.*"

(ii) Insufficient Patient Capital

A general theme that emerged from the interviews was the lack (unavailability) of patient capital. It was evident from the participants that the traditional *risk and reward model* is not appropriate for Funds with an inherent social objective. Returns can be achieved but investors need to be patient with regards to when the return-on-capital will be achieved. SME growth takes time to scale the business and reach profitability, which in turn has an effect on the rate at which jobs are created. One participant said, "…*the problem with small enterprises is, they don't exist beyond their second birth date. The challenge is that patient capital is needed and patient capital often times are not so easy to come by.*"

(iii) Size of Funding Insufficient for the Small Business needs

The size of funding to SMEs as raised by 5 participants is that the size of the funding (usually R5 million or less), is insufficient to support the SME operationally and to scale the business to its next growth, and life cycle stage.

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(iv) Lack of Information, Records and Financial Systems

The participants who raised this as a challenge stated that assessing applications upfront can be difficult for the funder without credible and reliable financial records. The level of risk taken by the funder without these in place by early stage companies translates to more risk for the funder. As one participant purported, "…SMEs *may not have sophisticated records and financial systems*." This point was echoed by another participant who said, "SMEs *do not have sufficient documents in place, such as financial records in the form of financial statements … information may not sometimes be provided on time.*"

(v) Lack of Suitable New Businesses and Entrepreneurs

Four (4) participants mentioned that there is not a lack of funding available to SMEs, but rather, a lack of SMEs to fund. In this scenario, the challenge seen by funders is the lack of entrepreneurs and suitable businesses available in the market, which are fundable. These participants expressed that, they find it challenging to find black owners, women owners, and people with disabilities who are entrepreneurs. On this point, one participant said, "*One of the things I've heard people say, I have to admit, is for instance, statements like: 'you know generally, people with disabilities … all they want is to just have a safe job'.*"

(vi) Number of Small Business failures

Four (4) participants in this study revealed that the number of small business failures in South Africa is a concern and makes funding in this space risky. The need for development support (BDS) is therefore paramount. A participant said that, "*If funding is provided to a business and they are not ready for the funding … and they do not have the necessary skill, it may lead to failure.*"

(vii) Underestimating the Performance of Risk and Return

Four (4) participants stated that the traditional model of risk and return does not necessarily work in this space – funders can overestimate performance, based on the level of return they anticipate.

(viii) Lack of Capacity, Turnaround Times and Efficient Processes

Three (3) participants mentioned that the lack of capacity and turnaround times in the bigger Financial Institutions to which they belong, do not create an enabling

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environment for funding entrepreneurs. More focus needs to be placed on scaling the business, development of entrepreneurs, monitoring the businesses funded and supporting the SMEs. The turnaround times and processes for ED applications could be just as stringent and rigid as the rest of the Financial Institution operations as identified by a participant who said, "*Because the people always say 'No' in the end, we take too long to send back, but we look for certain things*".

5.6.2 Success Factors

Interview Question 9 aimed to explore the success factors (Table 5.11) identified by the participants, in order for lessons learnt to be shared with the greater ED community.

Table 5.11: Success Factors identified by Participants

Ranking	Success Factors Identified	Frequency
1	Funding growth of SME's	8
2	Access to markets and products	7
3	Job creation	4
3	Access to funding for SME's	4
4	Financial return on capital	3
4	Good committtees in place	3
5	Skilled , passionate people working in fund	2
5	Achievable mandate in terms of risk and reward	1

[Table credit: A. Discala].

Table 5.11 (above) highlights the frequency of success factors identified by the participants interviewed. The top-ranked success factor mentioned by eight (8) of the eleven (11) participants articulated that the major success for them was assisting SMEs to grow by providing them with funding. The second-highest ranked success factor, mentioned by seven (7) participants, was providing access to markets for entrepreneurs through Financial Institutions networks. The third-highest ranked success factor mentioned by four (4) participants was job-creation to assist in alleviating South Africa high unemployment rate. Providing SMEs with access to funding where they would not necessarily obtain it through the traditional form of funding was ranked third-highest. Other factors which may be relevant (as

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mentioned by three (3) participants) are good committees in place and skilled employees.

Factors which had a frequency of less than three (3) or a third of the sample chosen were not considered relevant to discuss in detail. One bank stated that, "*Providing finance to* SMEs *to assist them in growing is a success and making a return on the loans and debt provided whilst returning capital to the bank*". One Fund manager indicated that, "…*this solution provided by the Fund provides sustainable solutions as it directs capital to businesses to provide a real social and economic impact in SMEs. The fact that jobs are created and a business solution is provided for enterprise development…*" Another Fund manager said, "…*your ability to clear and supply the development space to create access to market … contractual opportunities for the unlined businesses*". One Bank stated, "*A key success factor is providing* SMEs*, black people, women and people with disabilities with access to capital who may not have gotten it through normal bank financing. An example of a success factor is to provide a business with funding that otherwise would have closed down and retrenched jobs*".

5.7 Conclusion

The results from the five research questions support the constructs identified in the literature in Chapter 2. The results add to the available literature and knowledge on Impact Investing, SME' funding and ED. The results are discussed in detail in Chapter 6 and provide further insights in relation to the literature reviewed in Chapter 2.

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CHAPTER SIX

6 Discussion of Results

This chapter discusses the research findings presented in Chapter 5 in relation to the literature reviewed in Chapter 2. Insights are provided to the results of the in-depth interviews conducted on sampled Financial Institution ED Funds. The chapter also provides answers and conclusions to the research questions presented in Chapter 3. The researched results provide insights into Financial Institution ED Funds in SA. The results look at ED in South Africa from a 'supplier of finance' perspective. The results provide insights into the performance of Financial Institution ED funds in SA in relation to Impact Investing.

6.1 Research Question 1: Results Discussion

The aim of Research Question 1 was to identify and explain the strategy of Financial Institution ED funds. As discussed in Chapter 2, in accordance to Jones (2010), Impact Investing requires a clear and focused strategy which addresses social and environmental needs through a for profit model.

6.1.1 Financial and Social Objectives of the Fund

Table 5.8 shows that all participants had set financial and social objectives at the inception of their ED Fund. The specific financial and social objectives for each Financial Institution are reflected in Table 5.8. As can be seen from this table, the financial and social objectives are similar in nature, irrespective of the type of Financial Institution. This is in line with Schulman & George's (2012) argument that: returns can be achieved while doing good – more commonly referred to as, "doing well by doing good" (Shulman & George, 2012). The concept of "doing good and doing well" was specifically mentioned by one of the participants interviewed. The financial and social objectives are discussed in further detail below.

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Financial Objectives

A common theme of preserving capital as a financial objective was prevalent amongst all participants. The majority of the Funds recycled capital invested in the Fund to assist in further funding of SMEs. Table 5.6 reflects the different financial objectives and financial returns set for each Fund. Financial returns included some level of return, in excess of the preservation of capital. Returns were also dependant on the type of financial instrument the Financial Institution utilised

This is consistent with existing literature which purports that, Impact Investing requires a financial return at least equal to the principal amount invested (Rangan, Appleby, & Moon, 2011) and (Jackson, 2013). Jackson (2013) also asserts that, a range of returns are available for impact investments (from below market to risk adjusted returns) and are also different for each asset class and financial instrument utilised. The recycling of capital was not a concept identified explicitly in this particular research. It is interesting to note that the Fund providers continually have a mandate to assist SMEs, however; this was not an indefinite mandate, as capital would be expected to be repaid.

Social Objectives

Social objectives varied. However, common themes amongst all participants interviewed was the growth and development of SMEs and job-creation. ED, as explained in Chapter 1, was a big focus for all funds as identified by participants. Table 5.8 reveals that all participants had set a specific social objective in relation to SMEs. These intentional social impact objectives had common themes such as growing small business, creating jobs, providing access to funding and markets for SMEs. The literature states that for funding to qualify as Impact Investing, the desired social outcome or impact needs to be set up-front (Puttick & Ludlow, 2012). There needs to be an “intention” by the investor to achieve the social impact (Jackson, 2013). All these funds had set a clear social intention for their funds.

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6.1.2 Corporate Social Investment (CSI)

The concept of CSI was researched as a social objective. All participants viewed CSI as grants or funds to the community that were not to be recouped. CSI was not viewed as having a financial benefit or as a sustainable business model, it was regarded as "donations". This is contrary to Cooke (2010) and Hinson (2011) who view CSI as more than corporate philanthropy and donations. Their view is that both the corporate and the community benefit from CSI. Financial benefits could accrue to the organisation as a result of CSI initiatives.

6.1.3 Sectors

Majority of participants identified significant job-creation as a primary social objective. Sectors which have a high potential to create jobs were the focus of these Funds. These included sectors such as manufacturing, retail and service industries. Nine (9) of the eleven (11) participants stated that they specifically excluded "sin industries" from their mandate. Arjalie`s (2010) and Fetherston (2014) define "sin industries" as industries such as tobacco, alcohol, gambling, and pornography. The nine (9) participants didn't consider these sectors as socially responsible. The specific exclusion of these "sin industries" is in line with the SRI which "negatively" screens for investments that are harmful. It is interesting to note that these funds focused on both positive screening and negative screening, which fits the definition for both Impact Investing and SRI.

6.1.4 Sources of Funding and Financial Instruments employed

Sources of Funding

Participants utilised a combination of their own funding or third party funding. Table 5.4 reveals how seven (7) of the eleven (11) Funds utilise their own funding (captive funding), six (6) Funds utilise third party raised funding (non-captive funding), and two (2) Funds utilise both captive and non-captive funding. The Banks, Insurance Company and Risk finance company used its own source of funds to fund SMEs. The Fund managers raised funding from third parties usually as part of the third parties ED allocated spend. The DFI's had a combination of captive and non-captive depending on the fund (refer to Table 5.4 for sources of

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funding). It is clear that a combination of funding sources can be used for Impact Investing, whether it be captive or non-captive funding. This is in support of available literature which does not restrict Impact Investing to owner capital only. The actors included in Impact Investing include those who own and deploy capital such as fund managers (Jackson, 2013).

Financial Instruments

The financial instruments by the researched ED Funds consisted of both debt and equity instruments, with debt being utilised by all participants ED Funds. Ten (10) of the fifteen (15) ED Funds utilised equity as well.

Table 5.6 reflects the detail of financial instrument utilised for each ED Fund. Furthermore, the ED Funds researched had a combination of debt and equity instruments as the financial instruments chosen. This augments existing literature which asserts that, Impact Investing is not limited to a specific financial instrument or asset class (Rangan, Appleby, & Moon, 2011). Saltuk & Idrissi (2015) shows that private debt and equity combined comprises 73% of the Impact Investment industry, with 40% in debt instruments and 30% in equity instruments. The results are aligned to this in the sense that, participants used more debt instruments than equity instruments.

6.1.5 SME Criteria

The research findings on SMEs were as follows:

1. **Stage of Business**: All participants had set aside funds to fund the growth and development of SMEs. The funding included funding various growth stages from start-up's to medium-size entities. The growth stage funding was dependant on the Financial Institutions' risk appetite and mandate. The Fund managers tended to focus on investing in later stage growth companies;
2. **Equity Investment – Percentage Shareholding**: Ten (10) of the participants interviewed included equity as a type of funding instrument in their ED Funds. The participants revealed that the ED Funds did not want control in the companies they invested into. The maximum shareholding

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they were comfortable with was 49%. They preferred that the entrepreneurs and management have the majority control of the business. The JP Morgan survey reflected that majority of investments were minority stakes, with a very small portion being majority stakes (Saltuk & Idrissi, 2015); and

3. **Exit Period and Fund Life**: The equity funds and the Fund manager funds had a defined life of circa 7 to 8 years. Patient capital was imperative for the ED Funds and investors had to be patient for a repayment of capital and return, given the stage of company the Funds invested in. Refer to Table 5.8 which reflects a theme by majority of ED Funds researched, of recycling capital in the Fund, in order to fund future SMEs.

6.1.6 Conclusion: Research Question 1

The strategy of ED Funds in SA was tested to determine if they fit into the required strategy for Impact Investing. All participants revealed that their ED Funds had set financial and social objectives for the Fund. Participants clearly stated that their Funds did not focus on CSI or grant funding. Majority of the ED Funds researched specifically excluded "sin" industries in their portfolios, as a means of being socially responsible. Participants either used debt or equity as a financial instrument, or a combination of debt and equity. The source of capital was either captive or non-captive funding. It can be concluded that the Funds Strategy is in line with both Impact Investing strategy criteria defined as per the literature and discussed under each point above. Over and above having an Impacting Investing strategy, the Funds tested have SRI mandates.

6.2 Research Question 2: Results Discussion

The aim of research question 2 was to explore the performance of ED Funds researched, in relation to objectives set for each Fund. This question sought to further determine the level of measurement and reporting conducted by the ED Funds considered in this study.

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6.2.1 Financial Measurement and Performance

All participants measure their actual performance in relation to financial objectives set for the Fund as is evident in Table 5.5. The frequency and the type of measurement tool utilised was different for each fund. Financial performance is measured on a case by case and portfolio basis by all participants.

The actual performance of the ED funds saw nine (9) ED Funds meet their financial objectives, of which five (5) exceeded its financial objectives.

Table 5.6 reflects the performance of each ED Fund as per participants interviewed. This in line with the views of Jackson (2013) & (Network, Global Impact Investment, n.d.) that, measurement and reporting of both financial returns and social impact of impact investments is paramount. (Saltuk & Idrissi, 2015) state that a level of commitment needs to be evident in achieving financial and social impact returns, and in addressing social needs for investments to qualify as Impact Investments. The performance is also in line with the JP Morgan (2015) survey which reflects majority of respondents meeting their financial objectives (Saltuk & Idrissi, 2015).

6.2.2 Social Measurement and Performance

Ten (10) of the eleven (11) participants measure the social impact of their funds as per frequency Table 5.7. The ED Funds measure the following according to participants interviewed:

- Number of jobs created,
- Cost per job,
- Number of new businesses created and
- Number of transformation objectives achieved.

The social metrics were, however; not standardised across institutions but was dependant on the specific social objective set for each Fund. Only a few participants use global standardised measurement tools such as ESG and GIIN.

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According to Puttick & Ludlow (2012), different measurement approaches can be followed in Impact Investing.

All ED Funds researched report to various committees and investors, depending on the institution and financial instrument utilised. This is in agreement with (Saltuk & Idrissi (2015) who state that, performance of social metrics set up-front need to be monitored and reported to stakeholders. Social impact is measured by the impact on people's lives as a result of the investment. The level of positive social change and the development of parties who receive the funding is the most important factor. The social changes need to be quantifiable (Hinson & Ndhlovu, 2011) and (Brandstetter & Lehner, 2015).Jackson (2013) state that, measurement is based on capital invested and the number of people who benefited. There needs to be an observed "change" when measuring social impact. There needs to be evidence of impact of the achieved social impact.

Of all participants who measure their social impact, ten (10) have met their social objectives in terms of social performance and impact. This echoes the available literature on the measurement of social impact on Impact Investing. Brandstetter & Lehner (2015) states that social impact is a set of outcomes that would have not have happened were it not for the impact investor.

6.2.3 Risk Reward / Trade-off

Performance of Impact Investing includes the concept of risk and return and the trade-off that exists between financial and social returns. Nine participants indicated that there was a trade-off between financial returns and social impact. The level to which there was a trade-off was not disclosed by participants. Returns were viewed on a portfolio basis as well as case-by-case basis. Participants had different mandates: the DFIs had a *social first* mandate; whilst the banks, insurance companies and risk finance companies had a *finance first* mandate. The Fund managers had both social and financial as a first mandate. Table 5.8 reflects the concessions made by the funds and whether finance was a "first" objective or social was a "first" objective. The Table also reflects the financial performance and social performance of each Fund in relation to its objectives. Each Fund stated that a

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financial concession is made when looking at social impact. The level and extent of the financial concession is, however; different for each Fund.

(Lyons & Kickul, 2013) argue that both finance first and social first investors qualify as Impact Investing, because both target financial and social returns. Social first investors put social objectives first and have a financial floor. Finance first investors put finance returns as a primary objective and have a social impact floor. Hybrid organisations which have a for-profit and a social motive will aim to first favour profit (Jones, 2010). This is consistent with the commercial banks, insurance company, risk finance company who have “finance first” as their primary objective.

Brandstetter and Lehner (2015) and Berry & Junkus (2013) found that the *Risk and Reward Model* is not fully understood by investors. They added that there was no theoretical framework to assess the level of financial risk in respect of profit given up for an increase in social benefit. This makes it difficult for capital to be allocated to the social space. Clyde and Karnani (2015) debate the level of economic profit required to be sacrificed for social impact. It is also asserted that firms constantly need to manage their financial risk and return trade-off when balancing the three “P’s” (i.e. People, Planet and Profits) when being socially responsible (Berry & Junkus, 2013).

6.2.4 Conclusion: Research Question 2

Measurement

All participants mentioned that their ED Funds measure their financial performance. Ten (10) participants mentioned that they measure their social performance except for one (1) participant who acknowledged that although they do not measure social performance, they plan to do so in the near future.

Performance

Nine (9) of the eleven (11) participants either met or exceeded their financial objectives. One (1) participant did not meet its financial objective and one (1) did not disclose. All participants who measure social performance met or exceeded their social objectives. All participants expressed that their funds report on the performance of the funds.

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Risk / Reward Trade off

A majority of participants stated there was a level of trade-off between financial and social returns. The level of trade-off is uncertain and was not disclosed. All participants agreed that concessions were made. The DFI's had a social first mandate, whereas the Banks, Insurance Company, Risk Finance company had a finance first mandate. The Fund managers had both a finance and social first objective.

6.3 Research Question 3: Results Discussion

The objective of research question 3 was to assess the level of BDS provided to the SMEs by Financial Institution ED Funds. The BDS themes that emerged in Chapter 5 are discussed below. The BDS provided by the Funds focused on Training, Coaching and Mentorship; and Monitoring and Governance (the detail of which is discussed below). Ten (10) of the eleven (11) participants had BDS programmes in place and monitored the performance of the SME and their exposure to the SME. The BDS cost was borne by the ED Funds.

6.3.1 Training and Mentorship

All participants had training and mentorship programmes in place for SMEs. The level and scale of training and mentorship provided were, however; different for each Fund. BDS provided by the ED Funds was either outsourced to external consultants or provided by internal staff. This is consistent with the JP Morgan survey which revealed that the majority of their participants surveyed provided technical assistance to investee companies, either through internal or external parties (Saltuk & Idrissi, 2015). This finding is also consistent with findings found in the Malaysian study of funding SMEs which showed that the private sector contributed to SME development and performance to ensure they remain sustainable and contribute to the economy (Abdullah & Manan, 2011).

The data obtained in Chapter 5 revealed that Fund managers were extremely involved in BDS and transformation of SMEs funded. Equity providers were more involved in BDS, as related to mentorship and coaching of entrepreneurs, than debt

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providers. The debt providers availed BDS only in relation to monitoring the exposures and as a means of risk mitigation.

European organisations are highly engaged with the companies they provide funding to. Non-financial support is provided to management and access to networks is provided for businesses funded (Buckland, 2014). Entrepreneurs need development of financial and business skills which assists in obtaining access to funding. This can be provided in the form of training and mentorship (Fatoki & Ashah, 2011).

On the basis of their studies, Mathibe & van Zyl (2011) argue that business support programmes available were not sufficient and efficient in South Africa. More training and monitoring of business support systems provided by capital suppliers need to occur. It was suggested that more effective BDS programmes needed to be implemented by the private sector. Suggestions were that business development such as training and mentorship should be monitored and reported to assess effectiveness (Mathibe & van Zyl, 2011).

6.3.2 Monitoring and Governance

All participants mentioned that there exposures are monitored. The level and type of monitoring differ for each type of instrument utilised. All participants mentioned that SMEs required some level of governance structures to be implemented. It was evident from the results that there was a lack of financial systems and controls in the SMEs funded. ED Funds who funded earlier stage companies were more involved with the SME monitoring and governance. The level of governance in the SMEs are assessed up-front. It was clear from the results that there is not sufficient capacity to monitor all SMEs as required. The entrepreneur needs to improve the level of operational processes and governance for appropriate funding to be provided (Jun, 2014). The control of the financial risks by a SME is critical to its enterprise development and sustainability. Raising funds and access to capital is a key financial risk that must be measured (Jun, 2014). Ramukumba (2014) raised the lack of financial controls in SMEs as a challenge.

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6.3.3 Conclusion: Research Question 3

BDS

All participants had BDS programmes in place. The level of BDS differed per Financial Institution and per financial instrument utilised. More BDS such as mentorship and coaching was evident in equity investments, however; debt funding had a level of mentorship and coaching programmes. It is evident from the study that non-financial support is provided to SMEs. The effectiveness of these BDS programmes were not tested in this study.

Monitoring and Governance

All participants monitor the performance of SMEs as a fund provider. The level of governance and financial controls in the SMEs are assessed upfront and improved as required.

6.4 Research Question 4: Results Discussion

The aim of research question 4 was to determine the rationale for creation of the Financial Institution ED Funds researched in this study. The objective was to determine if there was a business rationale behind the creation of ED funds or if its creation was purely due to compliance. Table 5.9 reveals a combined frequency of responses, indicating the reasons for creation of ED Funds. The top-three ranked reasons are discussed below.

6.4.1 Development of SMEs *and Job-creation*

The top ranked reason for the creation of ED Funds by Financial Institutions was the development of SMEs and job-creation. This was viewed as the primary reason by all participants interviewed. The participants view the creation of jobs and development of SMEs in South Africa as key to improving the economy and reducing the high level of unemployment. These factors were identified as successes for the Fund. According to Abdullah & Manan (2011), the development of SMEs and job-creation is critical to sustaining an economy and alleviating poverty. The high level of unemployment in South Africa is a social problem that requires addressing. Job-creation assists in doing good by reducing unemployment

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and thereby alleviating poverty. The purpose of Impact Investing is to assist in doing social good and in alleviating poverty (Hinson & Ndhlovu, 2011). There needs to be an observed change in what was initially set up-front (Puttick & Ludlow, 2012). Job-creation brings about a change in the economy and in people's lives. Shulman & George (2012) states that organic job growth comes from Impact Investing in entrepreneurial companies as opposed to non-entrepreneurial companies.

6.4.2 Compliance to BB-BEE

The second highest ranked reason for creation of ED Funds is compliance to the BB-BEE codes in terms of ED spend. Participants recognised the compliance aspect for creation of these Funds and the benefits of compliance to the BB-BEE codes. It was clear from the participants that transformation was a key objective in the funding of SMEs. All participants viewed their funding as a financial sustainable business model and not as grants. This is in agreement with the Social Impact Investment Task Force (2014) which stated that governments play an important role in setting policy and regulations to facilitate Impact Investing in a country. This task force advised that countries need to set policy according to their own context and social needs and create incentives for Impact Investing. This taskforce (consisting of the G8) suggested that governments should build a market to assist SME and entrepreneurs with access to funding and business development support.

6.4.3 Access to Funding

The third highest ranked reason was to provide SMEs with access to funding. This was considered key for the growth of SMEs. Access to funding was identified by four (4) participants. The focus of the access to funding was ED beneficiaries and transformation, but it was not limited to this. There is a need for SMEs to have access to funding to grow and to develop. The normal commercial funding requirements from Financial Institutions do not suit SMEs and therefore a "funding gap" existed which needed to be filled (Fatoki & Ashah, 2011) and (Ramukumba, 2014). Access to finance was raised as a key challenge for SMEs from the demand side (Mazanai & Fatoki, 2011). The participants researched stated that, providing

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SMEs with access to Funding was a success factor as discussed under Research Question 5.

6.4.4 Conclusion: Research Question 4

The top 3 ranked reasons for the creation of the ED funds are as follows:

- Development of SMEs and job-creation;
- Compliance to BB-BEE codes; and
- Providing SMEs with access to funding.

These reasons, as identified by the literature, are critical to the sustainability and growth of small businesses. The compliance to BB-BEE codes is a regulatory requirement and is specific to South Africa's transformation goals.

6.5 Research Question 5: Results Discussion

The research question 5 sought to determine what the challenges and success factors were in funding ED and SMEs in SA. As discussed in Chapter 1 and 2, SMEs raised many challenges in obtaining funding and developing their enterprises, however; limited research was available on the challenges faced on the supply side of SMEs and ED. As much as there are challenges in this space, there are success factors which needed exploring. These are discussed below.

6.5.1 Challenges

Table 5.10 indicates that twenty-five (25) challenges were raised by the participants in this research. It is clear from the number of challenges raised, that ED funders face many challenges. The top 3 challenges identified by the participants in this study were as follows:

- Lack of skills and experience;
- Lack of patient capital; and
- Funding-size insufficient and Lack of information

The top three challenges identified by the JP Morgan survey were as follows:

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- Lack of appropriate capital across the risk return spectrum;
- Shortage of high quality investment opportunities with a track record; and
- Difficulty of exiting investments (Saltuk & Idrissi, 2015)

Lack of patient and appropriate capital was raised as one of the top 3 challenges by participants in this research study. Similarly, this challenge was also raised by participants interviewed in the JP Morgan survey.

The top 3 challenges raised by participants in the JP Morgan survey were raised as challenges by participants in this research study as per Frequency Table 5.10. The lack of entrepreneurs and fundable business was raised as the fourth ranked challenged and identified by four (4) participants in this research study. The difficulty in "exiting" investments was raised by one (1) participant. The reason that one participant mentioned "exiting" as a challenge could be due to the fact these Funds are relatively new and have not reached the exit stage as yet. Majority of the Funds were started in circa 2011 have not been exited as yet due to investment period being circa 7/8 years.

The following challenges faced by European Banks in Impact Investing were as follows:

- Immaturity of the sector;
- Use of cross departments resources;
- Ensuring sufficient expertise exists;
- Opportunity cost of other opportunities which may be more urgent or offer a shot term gain (Buckland, 2014).

Save for ensuring sufficient expertise exists, the above challenges were not identified as challenges by the participants interviewed for this research study. However, the use of cross-department resources was mentioned when participants were interviewed for Research Question 3. Participants mentioned that other department resources were used for BDS functions where BDS was performed internally by the organisation. The top 3 ranked challenges are discussed in more detail below:

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(i) Lack of Skills and Experience

The lack of skills and experience of entrepreneurs and business owners of SMEs was the top ranked challenge raised by participants. Ten participants raised this this as a challenge for ED funds. The lack of business and financial acumen and the relevant industry experience was a concern for ED funders. This challenge is supported by (Buckland, 2014) who raised the lack of sufficient expertise as a challenge for SMEs. Ramukumba (2014) and Fatoki (2011) agree that the lack of management capabilities, skills, experience of entrepreneurs and lack of financial controls by SMEs was a challenge to funders. This is further supported by Urban & Naidoo (2012) who states that the lack of technical and industry specific skills are major reasons for SME failures. The lack of managerial skills usually due to low level of education

(ii) Lack of Patient Capital

The lack of patient capital was the second highest ranked challenge. As investments are into SMEs who are at a small growth stage, it often requires providers of capital to be patient. Providers of capital who have a social objective often need to be patient in seeing both a financial and a social change. It may require a business to scale up first in order to create the necessary jobs for example. As can be seen this is a global challenge faced by impact investors and SME funders (Saltuk & Idrissi, 2015). Fetherston (2014) agrees that this was a challenge in that funding providers and investors were required to be patient in repayment of their capital and in achieving a return. Brandstetter & Lehner (2015) also agree that there is a lack of “appropriate” capital when it comes to Impact Investing.

(iii) Funding-size insufficient

Five participants stated that the size of funding provided to SMEs is insufficient to support the SME operationally and to assist in its growth. The funding size was typically R5 million or less per SME and participants said that this was usually insufficient to grow the SME to the next life cycle of the business. Ramukumba (2014) agrees that SME view’s are that there is a lack of sufficient capital to sustain the business.

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(iv) Lack of Information

Five participants mentioned that the lack of reliable financial records and track record was a challenge for ED funders. Many start ups and SMEs do not have financial statements or records available for funders to assess the viability of the SME.

This is consistent with Ramukumba (2014) views of commercial banks which require security and a history of audited financial statements which is a challenge when funding SMEs. This is a key challenge faced by SMEs in SA which affects the ability of SMEs to raise funding from Financial Institutions due to the lack of information required by Financial Institutions. A lack of financial controls by SMEs was identified as challenges faced by SMEs (Ramukumba, 2014). Fatoki (2011) agrees that the lack of information provided to funders and lack of competencies are considered a key factor by funders for SME funding.

(v) Lack of Entrepreneurs and Fundable Businesses

Four participants mentioned that there is not a lack of funding available to SMEs but a lack of SMEs to fund. The challenge seen by funders is the lack of entrepreneurs and suitable businesses available in the market that are fundable. More specifically a challenge is to find ED beneficiaries from a transformation perspective. The lack of fundable businesses is in agreement with (Brandstetter & Lehner (2015) who stated that there is a shortage of high quality assets to fund which have a track record. Saltuk & Idrissi (2015) also identified this as one of the top 3 challenges faced by impact investors.

6.5.2 Success factors

The top 3 success factors identified by participants in this research study as per Table 5.11 are discussed in more detail below.

(i) Growth Funding for SMEs

Eight (8) participants identified funding the growth of SMEs as a success factor. This was the top ranked success factor Rangan, Appleby, & Moon (2011) identified that the majority of assets under management in the impact investment sector is into the growth stage investments. The smallest percentage of assets under

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management are in start-ups and venture stage funding. This implies that Impact Investing assist SMEs in growing and scaling their businesses (Abdullah & Manan, 2011). A study conducted in Malaysia on funding of SMEs indicated that the focus of funding was to ensure that SMEs developed and were sustainable. The focus was on growth funding. This ensured that SMEs could grow and contribute to the economy.

(ii) Access to Markets and Products

The second top ranked success factor, as identified by seven (7) participants, was providing entrepreneurs with access to markets they needed to grow their business. SMEs identified the lack of market access as a challenge to growing. The ED funder can therefore assist the SME with access to markets the entrepreneur would not ordinarily have if it weren't for the ED funder. (Ramukumba, 2014). Buckland (2014) agree that social investment in Europe assists investee companies with access to networks they would not ordinarily have if it were not for the Impact Investor.

(iii) Job-creation

The third highest ranked success factor as identified by 4 participants was the creation of jobs. Job creation assists in doing good by reducing unemployment and thereby assisting in alleviating poverty. The purpose of Impact Investing is to assist in doing social good and in alleviating poverty (Hinson & Ndhlovu, 2011). There needs to be an observed change in what was initially set up-front. (Puttick & Ludlow, 2012). Job creation brings about a change in the economy and in people's lives. Shulman & George (2012) reveals that organic job growth comes from Impact Investing in entrepreneurial companies as opposed to non-entrepreneurial companies.

(iv) Access to Funding for SMEs

Providing SMEs with access to funding was also raised as the third highest ranked success factor Ramukumba (2014) stated that SMEs found it a challenge to access funding from Financial Institutions due to some stringent requirements such as security or a history of audited financial statements. This is contradictory to the view of the ED funders researched in this study who make certain concessions in order to provide SMEs with access to funding.

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Mathibe & van Zyl (2011) stated that there was a lack of marketability of finance available by Financial Institutions for SMEs in South Africa. Access to finance was a key challenge for SMEs from the demand side (Mazanai & Fatoki, 2011). This is contradictory to the views of funders, who believe that funding is available and that there is a lack of fundable businesses. Perhaps Financial Institutions should make more of an effort to market the available funding to SMEs, as lack of finance is a challenge for SMEs, based on the literature Fatoki & Ashah (2011) agrees that access to finance is critical and SMEs must be made aware of available funding and requirements for funding in the market for SMEs.

6.5.3 Conclusion: Research Question 5

There are many challenges identified by funders of SMEs as identified by participants. The top 5 challenges identified are as per the identified challenges in the literature, which proves that funding SMEs can be challenging and challenges are consistent amongst funders. However, ED funds also experience significant success factors.

6.6 Conclusion to the Research Questions

The research objectives as presented by the 5 research questions in Chapter 3 have, therefore; been met and answered. The findings of this research study add to the current literature on Impact Investing and ED in South Africa. The model below (Figure 6.1) summarises the results of this research study in relation to Impact Investing.

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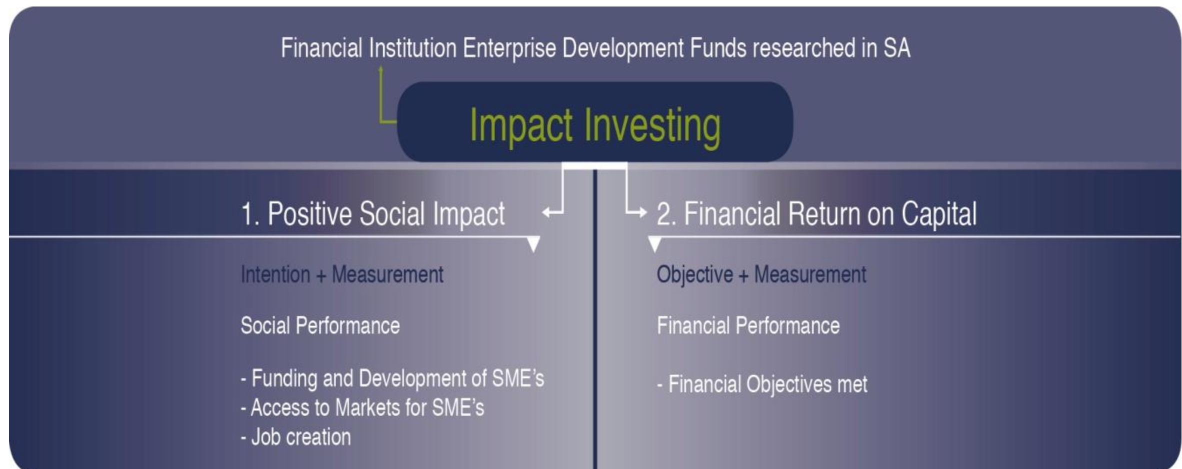
Figure 6.1: Summarised Results of ED in South Africa in relation to Impact Investment



[Figure credit: A. Discala, 2015]

Figure 6.1 summarises the results of this study performed on Financial Institution ED Funds in relation to Impact Investing. Evidence from this study shows that both a social impact and a financial return on capital can be achieved with ED in SA. The above model focuses on Impact Investing. It was clear from the study conducted that these Funds are also socially responsible but exclude CSI funding.

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CHAPTER SEVEN

7 Conclusion and Recommendations

This chapter discusses the Financial Institution ED Impact Investing model introduced in Chapter 6. The model is discussed in terms of the findings in Chapter 5 and insights and discussion of results in Chapter 6 as applied to the literature reviewed in Chapter 2. Recommendations for Financial Institutions and other ED funds/ers and practioner are presented in this Chapter. Lastly future research recommendations are discussed.

7.1 Principal Findings and contribution to literature

This study explored the application of Impact Investing to Financial Institution ED funds in SA. The study revealed that financers of ED view ED as more than a compliance tool. There were measurable social and financial objectives set for each fund. The study revealed specific social and financial objectives set per type of Financial Institution. The performance of these funds was explored and the results analysed in relation to literature in the Impact Investing space. Results were analysed further in terms of challenges and successes faced by the funders of SMEs. The outcome of this research provides valuable insights into South Africa's Financial Institution ED Funds, from a funder's perspective.

The first contribution from this study relates to Impact and Financial Institution ED Funds researched. The Financial Institution ED Funds in SA assessed in this study were considered to be Impact Investors, based on the Impact Investing criteria achieved. The Impact Investment criteria included setting and measuring social impact and financial objectives. In addition this study affirmed the literature on Impact Investing that social impact and financial returns can co – exist as defined by (Vakhidova, 2012).

The second contribution of this study relates to SRI and Financial Institution ED Funds researched. Findings indicate that investments made by ED Funds researched in this study are considered to be social responsible investments in that, certain industries such as "sin" industries are avoided due to "negative screening". In addition, this study echoed what was discovered in literature:

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responsibility excludes investing or financing “sin” industries Arjalie`s (2010) and Fetherston (2014) as indicated by participants researched. There can, however; be a trade-off between social impact and financial return and certain concessions may have to be made. The level of concessions (if any), may differ for each fund. Clyde and Karnani (2015) states that there is a constant debate on the level of economic profit required to be sacrificed for social impact.

The third contribution of this study was that ED in SA is not only viewed as compliance to the BB-BEE codes by funders of ED researched in this study. The number one reason raised by funders for the creation of their ED Funds was the development of SMEs and job-creation. According to Abdullah & Manan (2011), the development of SMEs and job-creation is critical to sustaining an economy and alleviating poverty.

The fourth contribution of this study is the creation of awareness of access to funding available for SMEs by Financial Institutions. This was identified as a success factor of these Funds and has been a challenge for SMEs. Fatoki & Ashah (2011) states that access to finance is critical and SMEs must be made aware of available funding and requirements for funding in the market for SMEs.

The fifth and last contribution was to express the challenges and successes faced by SME funders in SA. There are many challenges in this space, most of which have been identified in literature by SMEs. This study focuses on challenges and successes on the supply side, to hopefully assist in bridging the gap between funders and SMEs (Ramukumba, 2014). Table 7.1 summarises the contribution of the study to various components of the existing body of knowledge.

Table 7.1: Contribution of Study to Body of Knowledge

Dimension of contribution	Existing knowledge	Research contribution
Impact Investing and Enterprise Development	Impact Investing literature is limited globally and more so in SA. Focus is on setting and measuring Social Impact and Financial returns. More academic research was required.	The study confirmed that SA Financial Institution ED funds researched in this study predominantly follow an Impact Investing model. This research has not been conducted before through a Financial Institution funder’s point-of-view, based on global Impact Investment criteria and

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Dimension of contribution	Existing knowledge	Research contribution
		requirements. The research also confirmed the Impact Investing model in that financial returns and social impact can be achieved.
Social Responsible Investment and Enterprise Development	Existing literature exists on SRI, however; literature on ED in SA is limited.	The study added to the ED literature available in SA. It displayed the views of Financial Institutions ED funders on SRI.
Enterprise Development – BB-BEE	More than regulatory compliance	Focus is on the growth and sustainability of SMEs.
Supply of Funding to SME	Existing knowledge is from the SME point of view (the demand side of funding). The existing knowledge from a supplier of funding of SMEs is limited.	This research contributes to the funding available for SMEs from a suppliers perspective. The research indicates that funding is available for SMEs from Financial Institutions.
Challenges and Successes of funding and development of SMEs	The current literature provides for many challenges faced by SMEs in accessing funding and support of SMEs (demand side of funding).	This research study reflects the challenges and success factors faced by suppliers of funding for SMEs.

[Table credit: A. Discala].

7.2 Implications and Recommendations for ED funders

Recommendations for ED funders were developed from common themes discovered during this research study. Whilst ED in SA is perceived as a compliance tool, this research revealed a business and academic case for ED within the SF space.

This research revealed the views of funders in this space and explored ED funding from an Impact Investing business model and criteria perspective. As mentioned in Chapter 5 and 6 there are many challenges funders of ED and SMEs in SA face. However, there are also success factors to be proud of. This research adds to limited research on financing of SMEs and assists in bridging the gap between financers and SMEs from an awareness perspective.

The research highlights that the majority of Financial Institution ED funds researched set specific social and financial objectives. The performance of these objectives is measured frequently. The ED Funds performance researched in this study have been medium-to-high, in the sense that objectives have been met or

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have been exceeded. The results reveal that the concept of Impact Investing can and does work within the ED space, which reflects that financial returns and social impact can co-exist. The concept of "*doing good and doing well*" does exist based on the results.

It is evident from the results and findings that there is not much difference between the various Financial Institutions in terms of Impact Investing. The performance analysis, from an exploratory perspective, revealed that there are similarities in performance between "social" first and "finance" first impact investors in this space. Both qualify as Impact Investing.

Based on the insights from the challenges raised in Chapter 6, Financial Institution ED Funds could consider marketing the availability of finance in this space more aggressively, in order to encourage more SMEs to apply for funding or entrepreneurs to start their new businesses.

Capacity constraints in providing BDS can be an area of focus for ED funders as this was a common theme identified amongst ED funds. The lack of BDS was raised as a challenge by SMEs in the available literature. The effectiveness of BDS programmes could be given more attention by ED funders.

7.3 Limitations of research

All research comprises of limitations and biases. In this particular study, the following limitations were identified:

- A qualitative Study, by its nature, is exploratory. Therefore, further investigations might need to be undertaken, possibly through a quantitative approach (Sanders & Lewis, 2012);
- Researcher-bias and subjectivity-biases may exist due to the exploratory nature of research. The data was analysed from the researcher's interpretation and perspective based on the data collected (Saunders & Lewis, 2012);
- The data is obtained from the participants via interview. Consequently, it intrinsically reflects the views and perspectives of the participants interviewed;

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- Non-probability sampling was used as a sampling technique. It can, therefore; not be inferred onto the entire population, as the sample was not chosen at random (Saunders & Lewis, 2012);
- The research was conducted primarily in a particular geographical area of South Africa: Gauteng. All the same, a significant proportion of Financial Institutions such as Banks and DFIs' headquarters are based in Gauteng, the economic hub of South Africa;
- Protection of confidentiality was a concern due to the private data specifically relating to equity funds and Banking information, so specific financial data was not obtained to determine performance;
- The interviews conducted were with employees of the Funds and Financial Institutions. There could be a propensity to reflect the Funds in a positive manner and avoid disclosing the negative aspects.

7.4 Recommendations of future research

There is little academic literature available on Impact Investing in South Africa. Further research is required in this fast growing "nascent" field. Reliance on research in this space cannot only be on industry practitioners. SF has evolved and is growing into this interesting space of Impact Investing. Suggestions for future research are:

- It would be of value if the "gap" between funders of SMEs and SMEs views of access to funding is explored. This can assist in breaking down possible "false" perceptions of each party, which could assist in more entrepreneurs' starting their own businesses and more businesses being funded;
- The effectiveness of BDS should be investigated from a funders perspective as this was highlighted as a concern in the available literature;
- A quantitative study into the social impact of ED funders on SMEs could be investigated;
- The level of trade-off between social impact and financial return could be explored;

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- The level of marketing available of funding available for SMEs and business support available could be investigated

7.5 Conclusion

This research study added to the existing body of literature of on Impact Investing which is limited due to the nascent nature of the industry. The research provided valuable insights into Financial Institution ED Funds in SA and its relation to Impact Investing and SF in SA. The research findings have revealed an in depth view of funders of SME in SA including the challenges they face. The model of ED funds in SA developed in relation to Impact Investing proves that *"doing good and doing well"* and *"making money while influencing positive change"* can indeed be achieved (Combs, 2014).

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APPENDIX A: Semi Structured Questionnaire

Semi- Structured Questionnaire:

1. Overview of Fund and Strategy:
    a. Fund size (amount under management);
    b. Fund life and remaining life of the fund;
    c. Fund investment criteria (e.g. sector, investment amount, type of financial instruments used, stage of growth of the Investee Company, minority / majority stake, etc.); and
    d. Fund Objectives: financial (e.g. target IRR / money multiple) and otherwise (including social).

Financial Objectives		
Target IRR	Less than 20%	In excess of 20%
Money Multiple	Less than 5	More than 5
Other financial objectives such as ROE (no absolute numbers need to be provided)		
Social Objectives		

2. How are fund objectives measured? Both social and financial objectives. Has there been some trade off of financial return for social return and if so to what extent?

3. Please give a qualitative indication of the fund's performance to date by checking one of the classification below

	Low Performance: Most objectives (financial and social) not met	**Medium Performance**: Most objectives (financial and social) just met	**High Performance**: Most objectives (financial and social) exceed target
Your rating (put X in your chosen			

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column)			
Key reasons behind this performance			

4. What is the source of capital for the Fund? Is it captive or non-captive/independent funding?
5. Purpose of the fund, i.e. reason for its creation
6. Extent of the Funds' involvement in the companies invested in: e.g.
    a. Number of meetings between the Fund management team and the investee company per year;
    b. Type of meetings (e.g. board meetings, company function); and
    c. Topics discussed: e.g. financial (e.g. budget), operational, social, etc.
7. What type of companies has the Fund invested in? What investments do the funds comprise?
8. Key challenges faced by the Fund?
9. Your view on key success factors
10. What would you do to improve your fund performance?
11. What is constraining the fund's performance?
12. What is enabling the fund's performance?
13. What is the difference between your company's Corporate Social Investment programme and your company's EDF?
14. What advice would you give to other companies looking to set up their own EDF?

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APPENDIX B: Atlas Coding List

Code-Filter: All

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HU: Atlas - Results
File: [D:\Users\F4628594\Documents\Research topic\Ethics committee approval\...\Atlas - Results.hpr7]
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Date/Time: 2015-10-31 15:02:51

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CSI - Grants- no financial return
Financial Instrument: Debt, Eq..
RQ1-Financial Objective
RQ1-Measurement- Exits
RQ1-Social Objective
RQ2-Measurement-Social performance
RQ2-Measurement - Financial performance
RQ2-Performance- investment holding period
RQ2-Performance- Investment Size
RQ2-Performance- Objectives met or not
RQ2-Performance- Objectives met or not(not)
RQ2-Performance- types of companies invested in
RQ2-Performance-Investment Amount
RQ2-Performance-Ownership- Minority
RQ2-Performance-Sectors
RQ2-Performance-Stage of business invested
RQ2-Performance - Exit period
RQ2-Performance - Financial objectives(actual)
RQ2-Performance - Life of fund
RQ2-Sectors -Excluded
RQ3-CSI
RQ3-Trade off between Financial and Social Return
RQ4-Business Development support
RQ4-Business Development support-Training
RQ4-Business Development support & monitoring
RQ5- Reason for creation - BEE Points
RQ5- Reasons for creation - Year it was started
RQ5-Reasn creation - business
rq5-reason for creation - development of SMEs
RQ5-Reason for creation - Increase number of small business
rq5-reason for creation - job creation
RQ5-Reasons for creation- increase local development and competitiveness
RQ5-Reasons for creation- plug gaps in traditional funding model
RQ5-Reasons for creation-access to funding
rq5-reasons for creation - access to markets
rq6-challenges- competition in this space
rq6-challenges- complaints about pricing
RQ6-Challenges- failures of small businesses
RQ6-Challenges- Generating a financial return
rq6-challenges- retention of talent
rq6-challenges- sense of entitlement to funds , expect grants
RQ6-Challenges- size of funding too small
rq6-challenges- turn around time of funding
rq6-challenges- underestimating the performance risk

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RQ6-Challenges-difficult to exit
rq6-challenges-finding businesses owned by people with disabilities
rq6-challenges-lack of capacity
rq6-challenges-lack of entrepreneurs
rq6-challenges-lack of experience
rq6-challenges-lack of market penetration
rq6-challenges-lack of security
RQ6-Challenges-Lack of skills
RQ6-Challenges-Lack of skills of entrepreneurs
rq6-challenges-lack of sufficient business support
rq6-challenges-lack of sufficient information from smes
rq6-challenges-lack of sufficient records and financial systems
rq6-challenges-pace of growth is smal compared to other countries
rq6-challenges-scale up
rq6-challenges-stringent processes
rq6-challenges-systems in industry dont talk to each other
rq6-challenges - finding good black owned companies
RQ6-Challenges - funding the next stage of growth
rq6-challenges - overestimating the market and economy
rq6-challenges -need for patient capital
rq6-challlenges-business readiness for funding
RQ6-Fund improvement-Business Development Support
rq6-fund improvement -increase level of funding
rq6-imorovements-more assessment of entrepreneur
rq6-improvement-create more jobs
rq6-improvement-creating more businesses
rq6-improvement-more patient capital
rq6-improvement - reporting and mesurement of social impact
rq6-improvements-less stringent credit requirements
rq6-improvements-more corporates to build scale
rq6-improvements-more information and understand industry
rq6-improvements-more sustainable models
rq6-improvements-number of sources of capital
RQ6-Start up considerations - costly,capital , systsems and existing processes
RQ6-Success- financial return on capital
RQ6-Success- Funding SMEs to grow
RQ6-success- skilled , passionate people working in fund
rq6-success-good investment committtee
rq6-success-job creation
rq6-success-mandate achievable in terms of risk and reward
RQ6-Success-products and access to market
rq6-success factors-access to market
rq6-successs factors- acess to funding
RQ7-Capital-Captive Funding
RQ7-CAPITAL-Non captive funding
RQ7-Capital-Size of fund
RQ7-Capital - Grants
RQ7-Financial instrument-Debt
RQ7-Financial instrument-Debt&EQUITY
RQ7-Financial Instrunent - EQUITY
RQ7-Quasi equity

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APPENDIX C: Ethics Approval Letter

Gordon Institute of Business Science
University of Pretoria

Dear Miss Althea Discala

Protocol Number: Temp2015-00994

Title: Performance of Enterprise Development Funds backed by Financial Institutions in South Africa: Lessons Learnt in Impact Investing and Social Responsible Investing

Please be advised that your application for Ethical Clearance has been APPROVED.
You are therefore allowed to continue collecting your data.

We wish you everything of the best for the rest of the project.

Kind Regards,
GIBS Ethics Administrator

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