THE BANKING ASSOCIATION SOUTH AFRICA

National Assembly Portfolio Committee on Small Business Development

26 October 2022

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- Overview of SA Banking Industry
- What is a Bank
- The Role of Banks
- The business of banks
- Where do banks get their money
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Presentation outline

- Introduction
- Overview of SA Banking Industry
- What is a Bank
- The Role of Banks
- The business of banks
- Where do banks get their money from?
- What is the composition of bank loans?
- How much do banks contribute to taxes, GDP and employment?
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South African Banking Industry

Total number of banks operating in South Africa: 41 of which,

- 14 South African Commercial Banks
- 4 Foreign-Controlled South African Banks
- 13 Foreign Banks
- 3 Mutual banks
- 7 Cooperative Banks

The majority of banks operating in South Africa are members of The Banking Association South Africa (BASA) – cooperative banks are not yet members.

Source: SA Reserve Bank

What is a Bank?

A financial intermediary that collects deposits from savers and provides loans to borrowers

In this process, **lenders' requirements** are:

- Minimisation of risk

- Minimisation of cost

- Liquidity – holding assets that easy to convert into cash

Borrowers' requirements are:

- Funds at a specific date

- Funds for a specific period of time

- Funds at the lowest possible cost

The Role of Banks

Size transformation: collect smaller amounts of deposits and pool them together to meet the requirements of large borrowers

Maturity transformation: funds lent for a short period of time (demand deposits) transformed into medium-, and long-term loans

Risk transformation: banks are able to minimise the risk of individual loans by diversifying their investments, pooling of risks, screening and monitoring borrowers and holding capital and reserves as buffers for unexpected losses

Banks also help with the **flow of money** and facilitate payments

Barbara Casu, Claudia Girardone, Phillip Mollyneux, 2nd Edition (2015) Introduction to Banking; Glen Arnold (2014) Financial Times Guide on Banking

The Business of Banks

- The primary business of banks is to **lend money to borrowers** who meet certain criteria.
- Banks want to lend to as **many people**, households and businesses as possible subject to applicants meeting the **affordability criteria**.
- Banks are the **largest lenders** to the household, business and public sectors.
- Banks have to comply with a number of **regulatory requirements** including those provisions of the National Credit Act that **prohibit reckless credit.**

Where do banks get their money from?

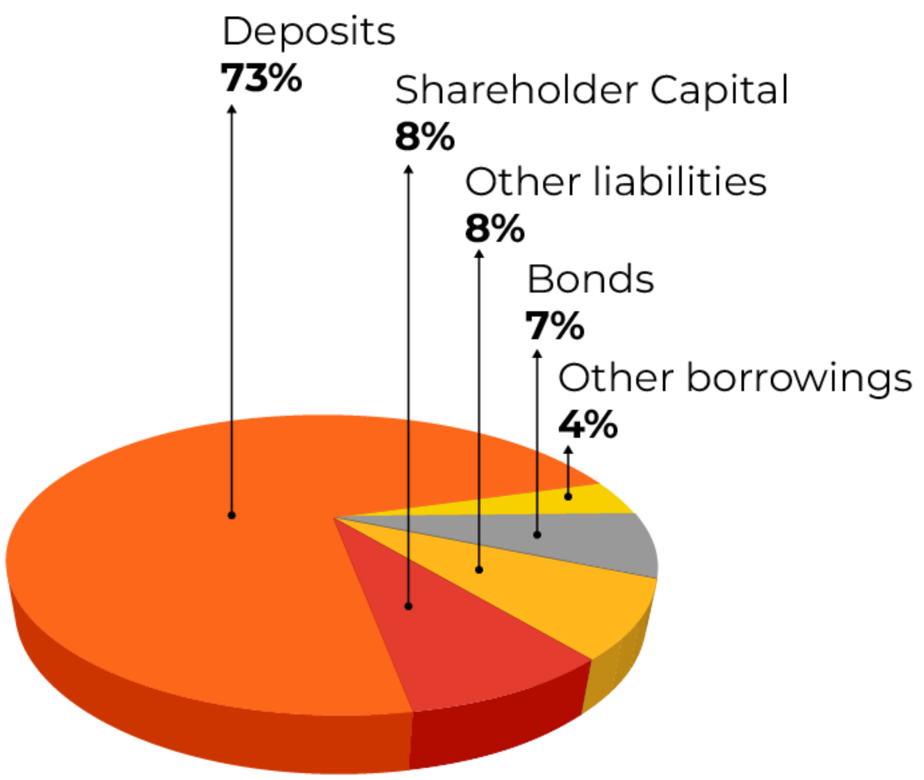
The main **sources of funding** for banks are deposits by the household and business sectors – it is not their money.

Shareholders have to put some of their own funds to fund a bank.

Banks account for deposits as a **liability** in their books because it does not belong to the bank, it must be returned to its owner – on demand.

Banks have a **fiduciary duty** to protect people's deposits and not lend recklessly to those who may not be able to repay the loan.

Banks hold R4,9 trillion in deposits from the public.



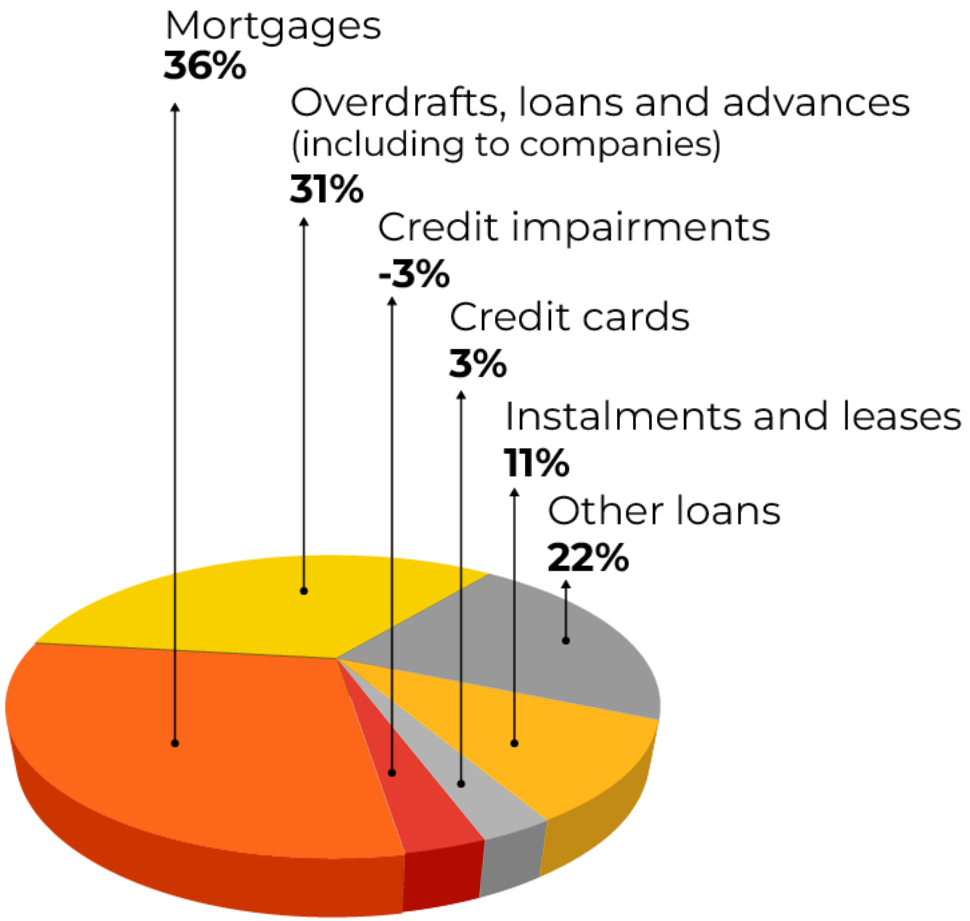
What is the composition of bank loans?

Loans are categorized as **assets** because the borrowers have to return the money to the bank.

Two-thirds of loans that banks make finances; homes, business premises, business operations, and general consumption – buying of household goods.

When borrowers **do not repay** their loans, the assets of a bank decline, which puts its **profitability and sustainability** into question.

Profits made by banks from loans **go to depositors**, shareholders and some of it is retained to increase the capital of a bank which enables them to **lend more**.



How much do banks contribute to taxes, GDP and employment?

The financial services industry pays **30%** of all corporate tax **(R63 billion in 2021)** despite making up only **23%** of GDP.

The six largest banks employ over **154,000** people

What factors determine bank lending?

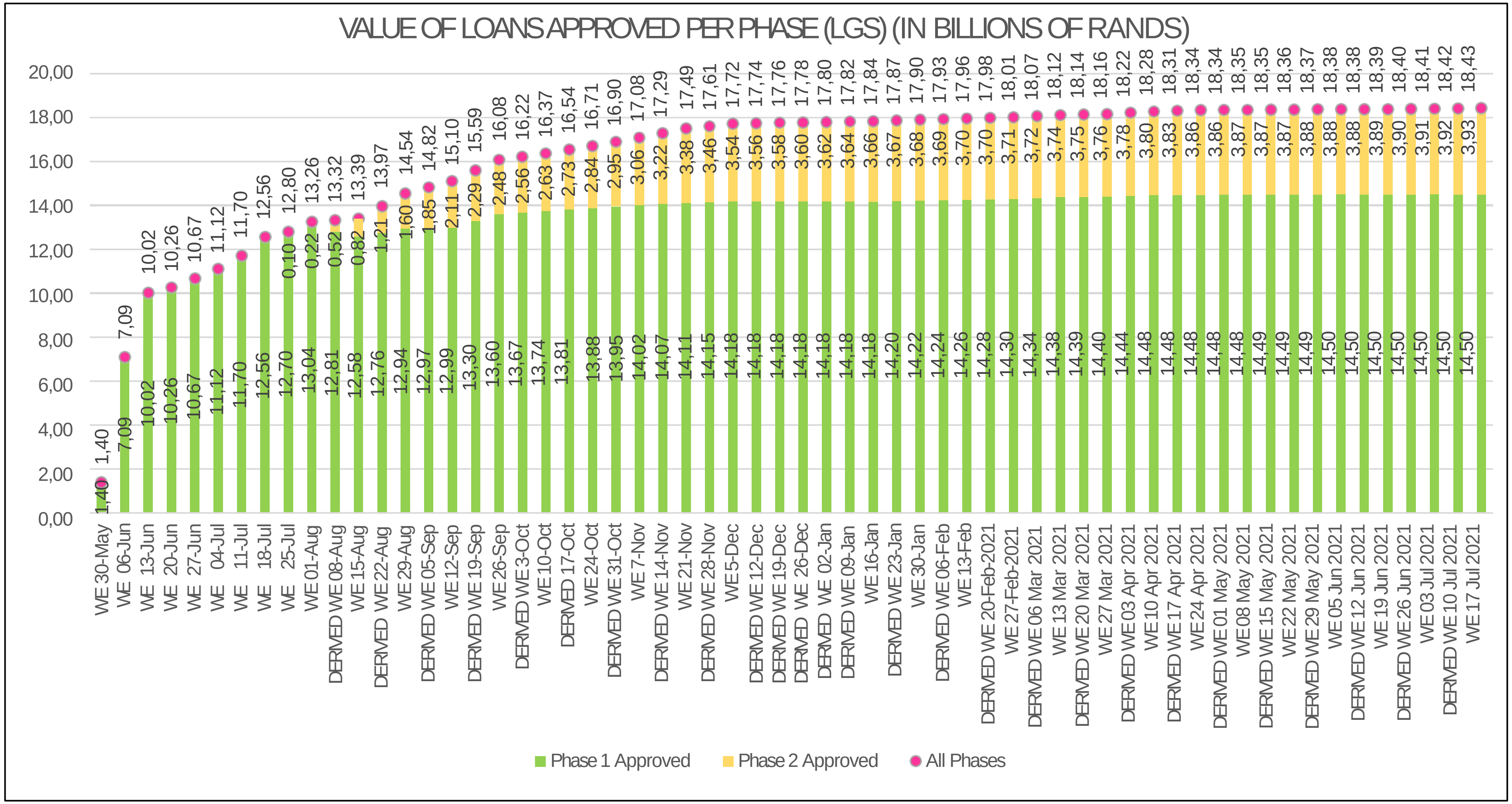
The lending role of banks to businesses depends on:

- **Demand** by entrepreneurs.
- Ability of applicants to demonstrate **credit-worthiness.**
- **Health** of the economy, which affects market conditions for businesses

What happened during Covid-19?

- The Government announced **R200 billion**. (Guarantees not cash)
- **R100 billion** was initially made available
- Banks contracted for **R62 billion**
- Small businesses only applied for **R54 billion**. (est.)
- Banks approved **R18 billion** under the scheme.

LGS Value of Loans Approved per Phase



- **R 18.43 billion** in Covid-19 loans has been approved and taken up by qualifying businesses

Statistics are cumulative as at 17 July 2021

Banks provided relief to their customers even before the introduction of LGS

- In **February 2021**, banks restructured loans – provided financial relief – to business and retail customers of **R293 billion**.
- **R165 billion** of this was to corporate customers, of which **14%** were **small and medium enterprises.**
- The **total value** of loans (corporate and retail) restructured due to Covid-19, reached **R617 billion**.

Lending during Covid-19 cont.…

- Contrary to the **perception** that banks do not want to lend to **SMEs**, they account for a majority of the finance extended at approximately 69% of all funding to **SMEs.**

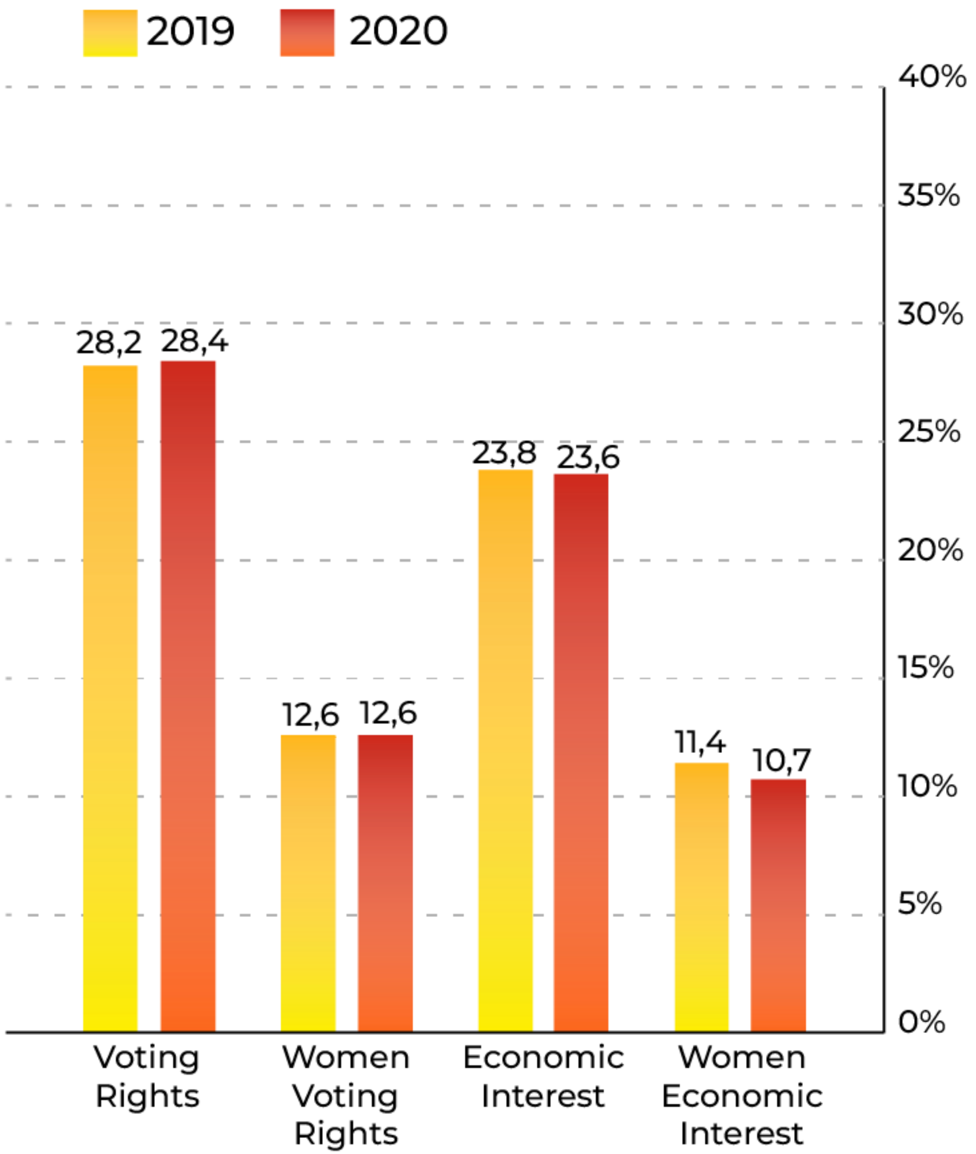
Indicator	Jan 2020	Dec 2020
Value of SME Loans	R164.5 Billion	R167.8 Billion
Volume of Loans	1,101,500	1,077,109

Transformation

In 2020, banks spent **R33 billion** on procurement from black-controlled businesses, up from **R30 billion** in 2019. They spent **R56 billion** on small businesses out of total spend of **R154 billion**.

Banks provided **R19 billion** in finance to black SMEs, **R10 billion** to black farmers and **R47 billion** to affordable housing.

Banks are also transforming their workforces. In 2020 **87%** of junior management and **65%** of middle management were black. The challenge is senior management which is **45%** black.



Source: Bank submissions. Based on Financial Sector Charter calculation methodology

Profile of Micro Small and Medium Enterprises?

- **The total size of SMMEs is estimated at 5.78 million including both formal and informal**
- **Survivalist Entrepreneurs -** 2.89 million entrepreneurs (50%) – essentially self-employment –
- **Informal -** 2 million are informal (36%) – not registered-
- **Formal** - Over 800k enterprises (14%) – anemic growth over the last 10 years.

Source: IFC-Unseen Sector Report

Key considerations in understanding the rate of lending in the economy

- **The Economy** - health of the economy is a key driver for bank lending.
- **Economic growth** was already anemic and approaching a recession even before COVID-19.
- The **Lockdown** removed economic activity thus raising the prospect of higher defaults.
- **Access to markets** is of critical importance because it talks to the sustainability of the enterprise and is very important when banks consider the enterprises' ability to service a loan.
- **Late payments** for services provided by both the public and private sector affects the cash flow of small businesses.

Challenges

- **Uncertainty** due to the turmoil in the market because of war and inflation – prices, cost of shipping goods, commodities, and disruptions in supply chains.
- Lack of **Financial Information**: SMEs often have inadequate or insufficient financial information to enable banks to process their loan applications. Borrowers know more about the viability of their investments and their ability and intention to repay compared to banks- high-risk perception.
- Difficulty with **Planning** in general especially because SMEs are not always equipped and capacitated with financial planning skills and the cost swings are playing havoc with their pricing and profitability.
- Limited access to **Collateral:** Banks rely on tools to address moral hazards to assess credit risk and ensure repayment of the loans.
- Limited use of **Movable assets** as collateral constraints banks' ability to capture opportunities at the lower end of the market.

Solutions and support provided by Banks

Banks have diverse and targeted initiatives to close some of the gaps identified above:

- **Non-financial support.**
- Accounting packages to help **SMEs** manage their books.
- **Point of Sale** solutions for informal enterprises that want to offer cashless transactions but cannot afford traditional **POS devices**.
- **Digital innovation** to improve their reach and decrease their cost of serving **MSMEs**, including digital KYC and account opening procedures through banking apps.
- Banks are helping **SMEs** use credit successfully by providing accounting and invoicing software, enterprise development (education, business training, or post-lending management advice)

The role of other players

Multiple sources of funding beyond banking for the expansion of available sources of funding because bank funding is not always appropriate.

Development Finance Institutions (DFIs) can play an important developmental role and act as a bridge to commercial funding.

Partnerships between the DFIs and commercial banks are important and should be encouraged.

THANK YOU