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The 'missing middle' lost in funding for entrepreneurship

By Lelanie Bason

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Entrepreneurs are often hailed as the country's future saviours by politicians - the lifeblood of the economy, the heroes of modern times. After all, it was small and medium-sized enterprises (SMMEs) that policymakers looked to drag economies out of the 2008 recession and provide new employment opportunities. Unfortunately, not much was done to ensure that SMMEs can absorb the impacts of future financial crises such as the current harsh realities stemming from the Covid-19 pandemic.

Source: www.pexels.com

Creating a supportive environment is urgently needed and issues of access to financing must be addressed. A distinct gap exists between the amount of money available to SMMEs from funders and the number of businesses that successfully obtain these funds.

Who are these entrepreneurs?

Informal businesses, generally speaking, are not registered, have a small asset-base and are run by - as the definition would suggest - informally employed workers. On the other hand, a small business is considered one that employs under 50 employees, has a turnover of between R2m-R25m and holds an asset base ranging from R2m- R4.5m. However, it’s the entrepreneurs in the gap between these two that creates the true element of concern.

Generally speaking, these businesses employ between one and 20 people, have a turnover that ranges from survival to less than R2m and are likely registered but often not fully complying. This is what our firm refers to as the ‘missing middle’.

Why the concern?

The country’s National Development Plan (NDP) envisions that by 2030, nine out of ten new jobs will be generated by SMMEs. And according to the Companies and Intellectual Property Commission (CIPC), 510,000 companies were registered in 2020 – a staggering 32% leap from 2019’s figures. At face value, one would argue there’s alignment, but when in reality it signals distress. The distress is caused by the aftermath of recent recessions, and by adding COVID-19 to the mix, a true recipe for disaster is produced.

Twenty-two million South Africans live in townships and informal settlements, which account for 38% of the country’s working-age population and 60% of the country’s unemployed. Moreover, South Africa is home to over five million SMMEs, most of which are located within the informal sector. There is a lack of resources for entrepreneurs in these situations, and their reality is rarely understood, especially by those who are in power to move capital. In fact, a recent report has revealed that in 2018, only 6% of entrepreneurs received government money, and a mere 9% had received funding from non-governmental sources.

Township and township-based entrepreneurs in particular struggle to access traditional sources of capital, we see it daily. Although it may not be deliberate, they are kept in the dark about how to access or apply for funding that could aid their enterprises. This extends to mentorship and support too.

More gaps to bridge

Most funding platforms require businesses to be registered, tax and UIF compliant, with further requirements including six months of bank statements and financial projections. That brings us to another gap – that of eligibility as most are unable to tick all these boxes. These prerequisites need to be relaxed and fast. Application requirements must be less stringent, and businesses owned by foreign nationals need to be included in the assistance since there is currently no funding available for foreigner-owned small businesses employing local South Africans.

There is, in fact, plenty of money out there. Local and international investors alike are queuing to find an innovative venture to put their money behind. Regrettably, the way lending institutions determine who receives funding is heavily biased against the young entrepreneur. This introduces a further gap - the one of misleading funding information.

Funding requirements are often ambiguous and many don’t know where to seek help for clarity. A practical solution would be for various sources of funding to be centralised, well-advertised and readily available in local vernaculars. In addition, consideration should be given to how loans saddle the SME owner with extra debt. Within practice parameters, grants should be the preferred form of assistance.

Waiting periods between the funding application and the disbursement are also too long for businesses in distress and present an additional gap. Anyone who attempts to pitch a concept to a government department, agency, state-owned or corporate firm often finds themselves hindered by the bureaucracy involved. We understand that every approval takes time, but in most cases, it is exactly time that is of the essence when launching a new product or service.

It is frequently more important to get your idea to market rapidly than it is to have a brilliant idea in the first place. It generates significant bottlenecks when a business owner is unable to make quick, discretionary judgments on the fly. The speed at which funding is deployed is critical but so too is an understanding of why an application was denied in the first place. This feedback loop is mostly non-existent.

Next steps for SME and SA survival

Uncertainty surrounds the timing of the pandemic's climax in South Africa, both township and informal settlement entrepreneurs will need a major overhaul of mindset and infrastructure if they are to be the job creators that policymakers hope for. It calls for a seismic collaborative effort to bridge the divide as current practices risk failing both entrepreneur and country.

As a basic starting point, corporates more generally could enable SMMEs by focusing their supplier development for longer-term scale and competitiveness. That's the quick win. What will however result in real change is acknowledging that we're all part of the problem and therefore the solution. The only way to move the needle and make a significant social impact is to take a collaborative approach to re-configuring obsolete components of our economic system. Not only will this help to buffer the worst effects of the current crisis on people's livelihoods, but it should assure a quicker economic recovery for everyone.

ABOUT THE AUTHOR

Lelanie Bason, MD: Academy & Venture Departments at MyGrowthFund Venture Partners,

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