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POLICY BRIEF 8: THE NATURE OF FUNDING MATTERS - MAKING DEVELOPMENT FINANCE WORK FOR SOUTH AFRICA'S SMES IN THE COVID-19 CRISIS

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Teboho Bosiu[1]

Industrial Development Think Tank[2]

The COVID-19 pandemic is an unfortunate wakeup call regarding the state of enterprise funding in South Africa, although the crisis also presents a unique opportunity for development finance to play a critical role in reviving economic activity and achieving structural transformation in the economy. To do this, the forms and nature of funding need to change to align with what the evidence suggests businesses actually need to be sustainable. Indeed, while a lot of funding has been put on offer by private and public sector funders, it may amount to a waste of resources if the *types* of funding on offer and *conditions of access* are poorly aligned with the reality of barriers faced by firms. In our view, while there is a high cost of funding various initiatives proposed here and by government to sustain existing businesses, such as a credit guarantee scheme, the cost of completely rebuilding lost productive assets and capabilities will be far more severe and long term.

There has typically been a lack of sufficient patient and effective concessional funding to develop new entrants and SMEs to become effective participants in the mainstream economy. In the context of a concentrated economy such as South Africa's, concessional enterprise funding is critical and necessary to level the playing field and ensure that entrants and SMEs are not only sustainably integrated into different stages of value chains in the economy, but that they become effective competitors to large incumbent firms, many of which received substantial concessions pre-1994.

Concessional funding comes in various forms, including patient capital, grants, complete interest-free loans and below-market interest rates. Patient capital typically constitutes longer-term maturities on loans and moratoria on loan repayments for new entrants (including for distressed enterprises as is the case with many during the State of National Disaster). Patient capital can also be thought of in terms of equity, where 'long-term' is typically understood to mean that the investor intends to hold the investment for a multiyear or an indefinite time period, and maturity of

[1] Researcher at the Centre for Competition, Regulation and Economic Development (CCRED), University of Johannesburg. Thanks to Reena das Nair, Pamela Mondliwa and Thando Vilakazi at CCRED for their helpful comments. All errors are the author's own.

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equity is effectively unlimited.[3] This brief proposes a number of practical 'patient' funding measures that South Africa's development finance institutions (DFIs) could immediately implement to respond meaningfully to COVID-19, drawing lessons from underlying research on barriers to entry and access to finance in South Africa.

Patient capital plays a critical role in ensuring that SMEs have sufficient time to build capabilities to compete with established incumbents, particularly in sectors where scale is important. Moreover, patient capital is needed to help startups overcome the challenge of incurring losses in the first few years of operation, before they have built up capabilities and become profitable.[4][5] Importantly, it is necessary for financial institutions to exercise some level of patience during periods of economic crises when distressed businesses are struggling to stay afloat, as is the case currently with the global COVID-19 pandemic that has severely depressed economic activity.

Local DFIs have not provided adequate forms of patient capital since 1994

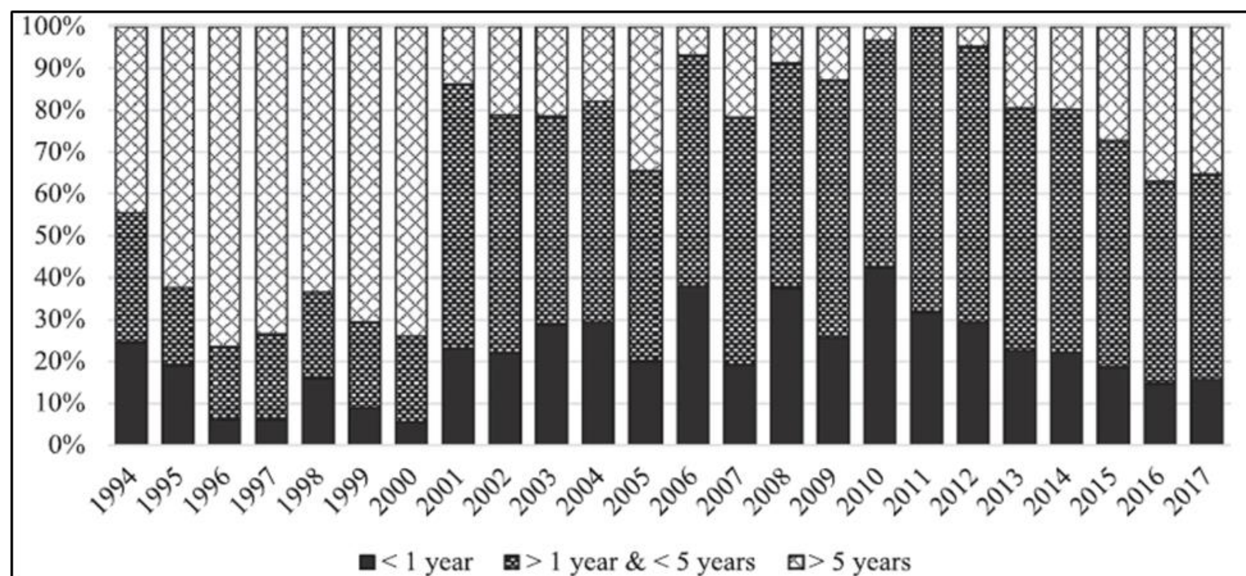
Regrettably – and largely due to legislative design – South Africa's financial institutions (majority of which are privately owned) typically provide only short- to medium-term finance, with SMEs still experiencing significant challenges in accessing this finance.[6] Similarly, the country's DFIs have failed to step up to the challenge, not least because of its scale, yet by their very nature they should be playing a much bigger role in the provision of patient capital especially to SMEs.[7] To illustrate this point, we use Industrial Development Corporation (IDC) data to show that business loan repayment periods have not been adequate in the post-Apartheid South Africa. Whilst there are other DFIs in the country, the IDC is used as an example because it is the largest development funder of businesses in South Africa, and due to the availability of data. Other national enterprise-financing DFIs include the National Empowerment Fund (NEF), Small Enterprise Finance Agency (SEFA), and the Land Bank, which is also relatively large but with funding limited to land and primary agricultural activities. On the other hand, the Development Bank of Southern Africa (DBSA) is also relatively large, but does not fund private businesses.

Loans advanced by DFIs have generally been of shorter durations (maturity) than what is required to give businesses (especially SMEs) enough financial relief to develop requisite capabilities necessary for sustainable participation in an economy with overall high levels of concentration. This is confirmed also through various studies of barriers to entry in the economy. Analysis of IDC's loan book since 1994 indicates that the majority of loans mature between one and five years, especially since 2001 (Figure 1). Despite this categorisation being quite broad and lacking detailed breakdown, when compared with international standards, the

[3] Deeg, R. & Hardie, I. (2016). What is patient capital and who supplies it? Socio-Economic Review 14 (4), 627–45.
[4] Herrington, M., Kew, J. & Kew, P. (2015). 2014 GEM South Africa Report. South Africa: The crossroads – a goldmine or a time bomb? Global Entrepreneurship Monitor.
[5] Ncube, P., Nkhonjera, M., Paremoer, T. & Zengeni, T. (2016). Competition, barriers to entry and inclusive growth: Agro-processing. Centre for Competition, Regulation and Economic Development, Working Paper No. 2016/6. CCRED, Johannesburg.
[6] Chandrasekhar, C. (2016). National development banks in a comparative perspective. doi:10.18356/ 8c01d4b6-en; FinFind (2018). Inaugural South African SMME access to finance report. SA SME Fund; and see note 3 above.
[7] Luna-Martinez, J. & Vincente, C. L. (2012). Global survey of development banks. World Bank Policy Research Working Paper No. 5969. World Bank, Washington, DC.; Chandrasekhar, C. (2016). National development banks in a comparative perspective. doi:10.18356/ 8c01d4b6-en.

IDC's loan maturities are inadequate as many DFIs offer loans with maturity of more than six years.[8]

Figure 1: Maturity of IDC's loan book (1994–2017)



Source: Sumayya Goga, Teboho Bosiu & Jason Bell (2019): Linking IDC finance to structural transformation and inclusivity in post-apartheid South Africa. Development Southern Africa, DOI: 10.1080/0376835X.2019.1696181.

The picture does not change significantly when zooming into some of the specialised programmes such as the Black Industrialists Scheme (BIS), aimed specifically at the provision of concessional funding to black-owned industrial enterprises. The BIS is a government-initiated co-funding programme between the Department of Trade, Industry and Competition (DTIC) and financial institutions (acting as co-funders), that is divided into two components; a grant component from the DTIC and a loan component from a co-funder. IDC is the major co-funder participating in this programme, along with other DFIs and private sector funders.

A survey of beneficiaries[9] of the BIS conducted by CCRED in 2019, shows that on average black industrialists (BIs) were expected to repay their debts in 72 months (6 years), with the most frequent period being 60 months (5 years) (see Figure 2 below). Moreover, in terms of moratoria (grace periods), black industrialists were given about 10-months' grace period on average before the first repayment instalment. Given that it can take up to 3 years before a start-up of relatively large scale realizes profits[10], an average of less than 1 year (10 months) of grace period is severely constraining on the business and adds extra burden on working capital. Consider, for example, the case of Grain Fields Chicken (GFC) in the poultry industry, which only became

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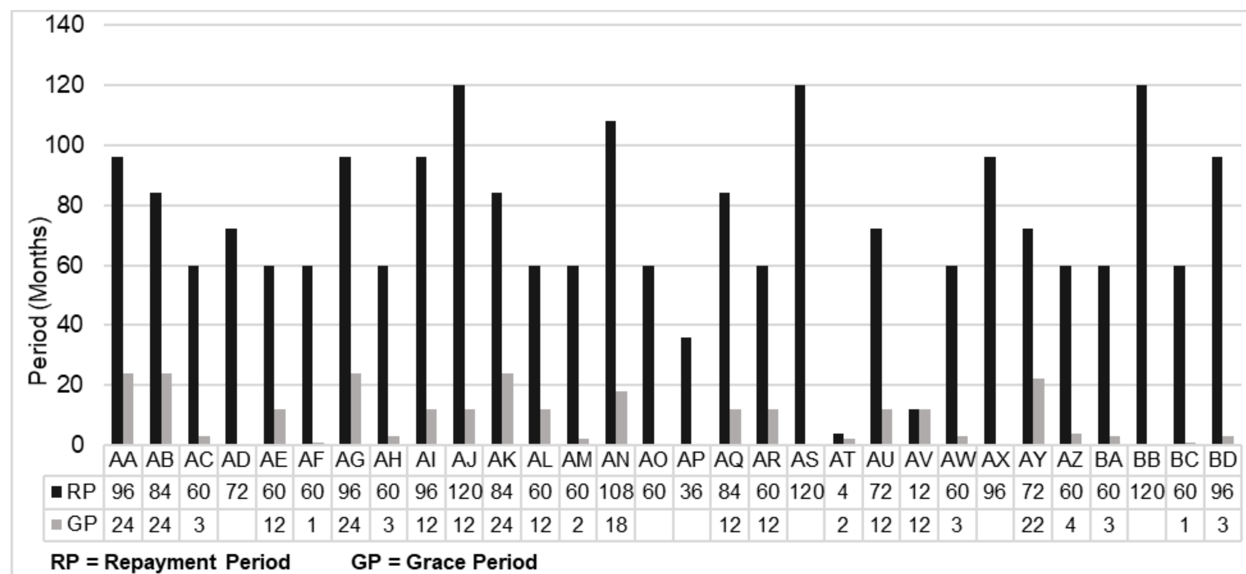
[8] Luna-Martinez, J. & Vincente, C. L. (2012). Global survey of development banks. World Bank Policy Research Working Paper No. 5969. World Bank, Washington, DC.

[9] A total number of 39 beneficiaries were surveyed.

[10] Interviews with other Black Industrialists confirmed this. See also Chavis, L. W., Kapper, L. F. & Love, I. (2011). The impact of the business environment on young firm financing. The World Bank Economic Review 25(3), 486–507.; and Ncube, P., Nkhonjera, M., Paremoer, T. & Zengeni, T. (2016). Competition, barriers to entry and inclusive growth: Agro-processing. Centre for Competition, Regulation and Economic Development, Working Paper No. 2016/6. CCRED, Johannesburg.

profitable four years after entry.[11] A loan with a 5-year maturity and with a 10-months moratorium would have been inadequate and placed significant pressure on the company's working capital during the first 3 years of operation, in the absence of access to other capital.

Figure 2: Periods of loan maturities and moratoria for a sample of BIs[12]



	AA	AB	AC	AD	AE	AF	AG	AH	AI	AJ	AK	AL	AM	AN	AO	AP	AQ	AR	AS	AT	AU	AV	AW	AX	AY	AZ	BA	BB	BC	BD
RP	96	84	60	72	60	60	96	60	96	120	84	60	60	108	60	36	84	60	120	4	72	12	60	96	72	60	60	120	60	96
GP	24	24	3		12	1	24	3	12	12	24	12	2	18			12	12		2	12	12	3		22	4	3		1	3

Source: Bosiu, T., Nsomba, G. & Vilakazi, T. (2020). South Africa's Black Industrialists Scheme: Evaluating programme design, performance and outcomes. CCRED Working Paper 1/2020

In addition to patient capital, DFIs also generally provide concessional funding in the form of lower interest rates and grants, as well as other non-financial support initiatives linked to finance provided. Lower interest rates are particularly important given that one of the challenges for SMEs is the relatively high cost of finance associated with the private banking sector. Counterintuitively, DFIs do not generally provide lower interest rates on their loans. For example, the IDC's pricing of loans is not necessarily more competitive than commercial banks, with businesses often approaching the IDC as a lender of last resort. However, as will be elaborated further in the following sections, this is primarily caused by the fact that the IDC is required to be self-funding, unlike DFIs in other countries, having last received government funding in 1954.[13]

Working capital challenges are severe currently, but definitely not new

High interest rates mean high costs of servicing debt, further adding pressure on working capital. This component of overall capital requirements is critical for small and medium-sized companies since, unlike large companies, they cannot afford to fund operations without consistent cash flow. The CCRED survey of black industrialists shows that the majority (63%) of these businesses experience challenges with working capital (as shown on the left panel in Figure 3 below).

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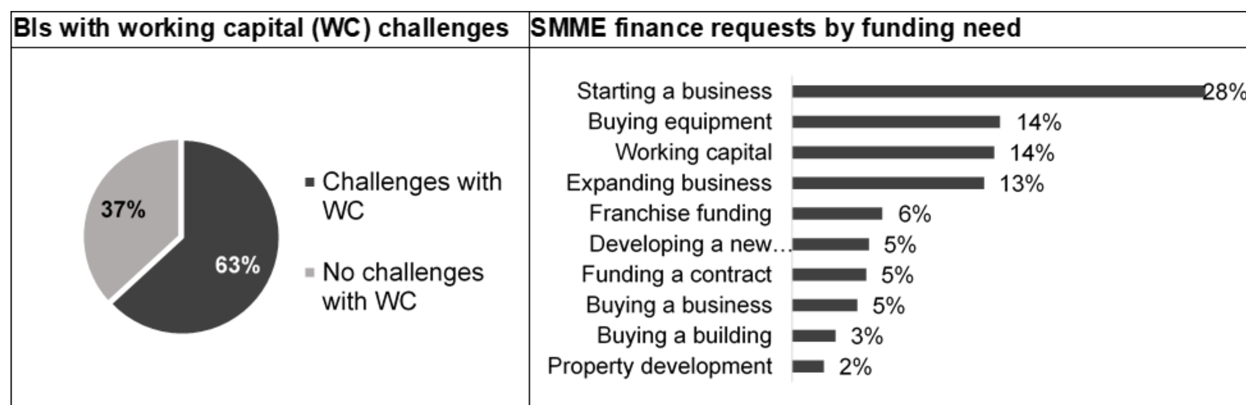
[11] Ncube, P, Nkhonjera, M, Paremoer, T & Zengeni, T. (2016). Competition, barriers to entry and inclusive growth: Agro-processing. Centre for Competition, Regulation and Economic Development, Working Paper No. 2016/6. CCRED, Johannesburg.

[12] A total of 39 black industrialists (BIs) were surveyed

[13] Goga, S., Bosiu, T., & Bell, J. (2019). The role of development finance in the industrialisation of the South African economy. CCRED Working Paper 9/2019.

Moreover, another survey of the overall SMEs sector in South Africa, by FinFind, shows that working capital is amongst the top 3 funding needs of SMEs (right panel in Figure 3 below).

Figure 3: Funding needs of SMEs[14], and proportion of Black Industrialists (BIs) with working capital challenges[15]



Source: Source: Bosiu, T., Nsomba, G. & Vilakazi, T. (2020). South Africa's Black Industrialists Scheme: Evaluating programme design, performance and outcomes. CCRED Working Paper 1/2020. And, FinFind (2018), Inaugural South African SMME access to finance report, SA SME Fund.

To understand if there could be some association between working capital challenges and number of years in operation, the CCRED survey revealed that **working capital constraints do not only affect new start-up SMEs, they also affect SMEs that have been in operation for a longer period of time**. Half of the black industrialists that have challenges with working capital are relatively younger businesses, having been in operation for not more than four years, whilst the other half have been in operation for more than four years. Nevertheless, the severity of the working capital challenge is likely to be more for new start-up SMEs than for older businesses because of the exposure to losses during the initial years of operation.

Concessional funding and the current COVID-19 pandemic

The challenges facing SMEs in South Africa are not new. The current COVID-19 pandemic amplifies these problems and increases the urgency with which they need to be addressed. The national lockdown has caused businesses to close their doors, negatively impacting revenues and cashflow. This has deepened the severity of the working capital challenges discussed above, not least because businesses have to pay rent and other running costs, but also because some businesses have elected to continue to sustain their payrolls.

An interview with one such SME during the national lockdown time confirms the scale of the challenge that must be met by South Africa's DFIs. Being a manufacturer of condiments largely for restaurants, the company has been hit hard as a result of complete shutdown, and it has had to send 26 employees home. However, the company has decided to continue paying salaries even during this period, although it cannot afford to pay full salaries. That is, the company was only be able to pay 75% of the salary bill for April 2020, and only 50% for May. This has placed significant pressure on working capital given that there are other running costs such as rent and

[14] The FinFind report used a sample of 11 033 SMEs
[15] A total of 39 black industrialists were surveyed

finance costs. Unlike enterprises that produce essential products/services, which are still operational, there are many other SMEs that are in similar situations, requiring urgent assistance to stay afloat. **To meet this challenge, it cannot be business as usual for private and public sector lenders – while many funding mechanisms exist, the forms and terms of funding are not sufficiently patient, flexible or accessible (such as only supporting businesses in perfect financial or tax standing, which is not realistic given that many SMEs have been under pressure due to the depressed state of the economy even before the lockdown)**.

The COVID-19 pandemic presents an opportunity for DFIs to step up and provide concessional finance to many small and medium enterprises that have been severely impacted negatively by the lockdown. It is worth noting that there are already a number of much-needed and welcomed response measures that our DFIs have put in place thus far to assist affected qualifying businesses. For example:

- The IDC has established the 'Covid-19 Distressed Funding', which is an initiative to assist businesses that are unlikely to be able to pay all of their debt as it becomes due and payable, and those that are unable to fund their operating activities.[16] However, no further details are provided regarding the exact form and shape of the assistance, and there is no clarity in terms of whether moratoria will be granted or loan maturities extended.

- In addition, the IDC has also established the 'COVID-19 Essential Supplies Intervention' to provide funding to companies for the acquisition and/or the manufacturing of essential supplies on an urgent basis. **While this will contribute to ensuring sufficient supply of essential goods, it does not benefit other businesses not involved in or requiring these activities.** Businesses that supply essential goods are less negatively affected by the lockdown than others, because of continued production on the back of the increased demand. In an interview, one manufacturer of toilet paper explained that their business has not been impacted negatively by COVID-19 precisely because they produce essential goods. Moreover, the business has not experienced working capital challenges beyond what would generally have been the case even in the absence of COVID-19.

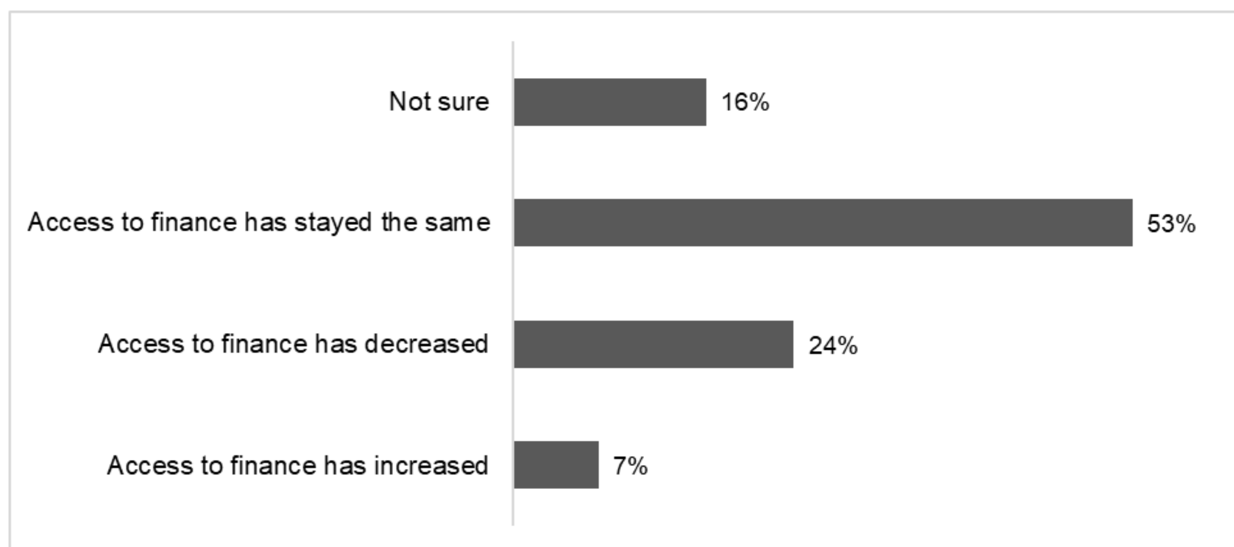
- The NEF, SEFA and the Department of Small Business Development (DSBD) have also established some response measures. One of these is the DSBD's 'SMME Debt Relief Scheme', aimed at assisting existing businesses in order to keep them afloat during the COVID-19 pandemic for a period of 6 months.[17] The longer period of assistance is certainly better than what has generally been offered (not more than 3 months) by other financial institutions, given that the impacts of the lockdown will most likely last much longer than any lifting of hard restrictions or phased reopening of the economy.[18] **The additional costs of restarting operations in the first weeks and months alone may surpass the ability of entities to immediately start paying off loans, which means even 6 months may not be enough, at least on the part of DFIs. Our interviews with businesses suggest that a moratorium period of 12 months or longer may be more helpful**.

[16] See IDC brochure , Accessed 29 April 2020
[17] See DSBD brochure , Accessed 29 April 2020
[18] The ABSA and Standard Bank relief measures offer moratoria of up to 3 months. Accessed 13 April 2020, and 29 April 2020

- The other measure is the restructuring of existing SEFA-funded loans to provide a moratorium/holiday to SMEs for a period of 6 months. Similarly, the NEF has established a 'COVID-19 Black Business Funding Solution' to fund black-owned SMEs that produce essential goods. The facility provides for a moratorium of a maximum of 12 months, over a 60-month overall repayment period. These measures are important, and mirror the proposals we make below.

Nevertheless, while all these measures are obviously important and necessary, ***ease of access at a much wider scale is even more critical***. That is, qualifying criteria should not be too stringent. For example, the requirement by DSBD for businesses to be 100% owned by South African citizens appears to be restrictive, as many of the businesses may have some level of foreign ownership yet employing largely South African citizens. Ease of access to existing facilities cannot be overemphasized, especially when businesses continue to report inability to access funding even during this period. A recent survey of 709 businesses by Statistics South Africa (covering the period 30 March 2020 to 13 April 2020) reveals that the majority of businesses do not feel that there have been improvements in the ability to access funding since the beginning of the pandemic period (Figure 4).[19] Although it is important to be prudent in interpreting results given subjective inputs from participants, it is significant that only 7% of the businesses report that ability to access finance increased, with 24% saying access has actually declined. Importantly, meaningful access is not only about the availability of pools of funding – the terms of that access really matter and what it takes to access that funding (including onerous due diligence processes, equity-debt trade-offs, untimely disbursement and suppressive payment terms, etc.) can severely harm businesses rather than help them.

Figure 4: Ability to access finance during the COVID-19 period



Source: Statistics South Africa

Moreover, we propose a number of key measures that DFIs should undertake to provide effective response to COVID-19. ***DFIs should urgently impose a moratorium on loan repayments for***

[19] Statistics South Africa (April 2020). Business impact survey of the COVID-19 pandemic in South Africa. Accessed 29 April 2020

their existing clients where this has not been done already, the period of which should not only be based on the duration of the lockdown, but also on the immediate period following the lockdown as businesses would be scrambling to recover lost production during and after a phased reopening. Furthermore, even after the lockdown is officially lifted the practice of social distancing is likely to continue until the vaccine is developed, meaning demand is likely to remain depressed for quite some time. These factors need to be factored in when determining the appropriate length of the moratorium.

In addition, ***DFIs should extend the overall loan maturities of their existing clients in line with the above-proposed moratorium***. In essence, DFIs could completely restructure their loan agreements with affected SMEs such that post-lockdown repayment premiums are lower than the pre-lockdown levels. This is not only to be consistent with the recent reductions of the repo rate by the Reserve Bank, but also to recognize the likelihood that the overall impact of the COVID-19 pandemic will last for several months after the lockdown and demand will take some time to recover. The priority should be on doing what is necessary to support the retention of productive capabilities particularly in industries with high sunk costs, otherwise even greater levels of finance will be required in the near future to rebuild lost capacity from the ground up.

Furthermore, in addition to the restructuring measures, DFIs should provide ***additional working capital facilities that will enable SMEs to cover other costs apart from finance costs***. Some of the DFIs already have working capital facilities in place, however, these will definitely need to be expanded and made easily accessible. For instance, to some extent, the IDC has been able to bridge the working capital gap through its Working Capital Fund and the revolving credit facilities. However, access to these facilities (and IDC funding in general) has been limited because application processes are typically complex and time-consuming.[20] A fast-track working capital funding process needs to be put in place, with a rapid approval and application mechanism that extends to firms other than those that have activities in the production of essential goods and services – these facilities exist but are very low risk for the DFIs as the funds are essentially backed by the underlying contract that the firm may have to produce a certain essential product, which will have a guaranteed demand.

Although there is a general acknowledgement that proper due diligence is important for sustainable provision of finance, there is also a need for timely decision-making and risk taking in light of the scale of the challenge. Moreover, innovative ways of conducting due diligence and assessing risk need to be developed drawing from international experience and available technologies, at the very least for existing clients, as opposed to the traditional methods typically used. It is simply not the time for business as usual.

It is commendable that the DFIs are already undertaking some of these measures, however a lot more can still be done to intensify these interventions and ensure much wider reach. Moreover, the overall sizes of these funds will have implications not only for coverage but for qualifying criteria as well. Currently, the relief funds seem to be insufficient, and are likely to leave many SMEs without support. For example, the total combined value of the IDC's 'Essential Supplies Intervention' (R800m), SEFA's 'Debt Relief Finance' (R200m) and NEF's 'Black Business Funding Solution' (R200m) is R1.2 billion.[21] The experience with the R1 billion Rupert family fund – the Sukuma Relief Programme – shows that the programme exceeded capacity in just three days,

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[20] Interviews with black industrialists
[21] See IDC website, Accessed 29 April 2020; and NEF COVID-19 brochure, Accessed 29 April 2020

with over 10,000 applications to a total value of R2.8 billion.[22] Other measures, such as the Solidarity Fund seem to be targeted necessarily for healthcare system and household support.

Substantially more funding is needed for SMEs during and after COVID-19, even as the government seeks out additional resources to support the healthcare system. To put this into perspective, the abovementioned CCRED study of the BIS programme shows that over R12 billion was needed to support just over 135 businesses over three years (the majority of which are SMEs) to become more sustainable and effective participants in the economy.[23] While it may be argued that the circumstances surrounding the BIS funding may be different from the current COVID-19 circumstances, these experiences certainly support the point that the recently established funds may not be sufficient to provide adequate support, particularly given a lack of access to private sector funds for many vulnerable businesses which is exacerbated by this crisis. The quantum of the BIS fund should give a clear indication for the scale of funding needed to support businesses in a post-lockdown environment to make new investments, revive capacity, rehire staff, and rapidly build new capabilities to take advantage of opportunities that are opening up in international markets due to disruptions in lead manufacturing countries.

Alternative (additional) sources of funding for COVID-19 and beyond

Critical to an effective developmental funding response to COVID-19 is identifying the sources of funding to make these measures viable, which many of the current COVID-19 response proposals have not adequately engaged with. In the absence of donations by prominent families and businesses, which are neither mandatory, predictable nor sustainable going forward, where should the additional funding come from? These questions are especially important in the context of the country's budget deficits, the pressure to bail-out ailing (but critical) state-owned enterprises such as Eskom and SAA, and the contestable calls for austerity measures.

The South African DFIs are generally not sufficiently well funded to provide sufficient concessional funding for development of enterprises and building capabilities for long-term structural transformation of the economy. This has been highlighted by the patchwork responses to the current COVID-19 pandemic which are in the public domain, notwithstanding the additional actions at the sector level such as in tourism.

A 2019 CCRED study[24] looking at the role of development finance in the industrialization of South Africa's economy, argues that the root cause of this is the requirement that some of the DFIs should be self-funding. Essentially, the largest industrial enterprise financier in the country (the IDC), has to source funding from private financial markets in order to provide development finance. Specifically, the large proportion of IDC funding, as a proxy for other DFIs as well, comes from commercial banks (both domestic and foreign) as shown in Table 1 below. This is counterintuitive given that the IDC is expected to provide concessional finance (lower interest rates and longer repayment periods), yet it does not have access to long-term, cheap funding.

[22] Staff Writer (7 April 2020). Johann Rupert's R1 billion coronavirus fund hits capacity in three days. BUSINESSTECH, Accessed 13 April 2020

[23] Bosiu, T., Nsomba, G. & Vilakazi, T. (2020). South Africa's Black Industrialists Scheme: Evaluating programme design, performance and outcomes. CCRED Working Paper 1/2020.

[24] Sumayya Goga, Teboho Bosiu & Jason Bell (2019): Linking IDC finance to structural transformation and inclusivity in post-apartheid South Africa. Development Southern Africa, DOI: 10.1080/0376835X.2019.1696181. For a more detailed discussion, refer to the CCRED Working Paper 9/2019. Accessed 13 April 2020.

Although the IDC manages to get some concessional funding from other international DFIs, this source of funding has been limited, having accounted for just less than 10% of total borrowings.

Table 1: IDC's sources of borrowings (2017/2018)

Borrowing sources (R'million)	**Budgeted Borrowings for FY 2017/18**		**Actual Borrowings (1 April 2017 – 1 February 2018)**		**Budgeted Borrowing for FY 2018/19 (Base)**	
Domestic borrowings	**8775**	**68.2%**	**5070**	**66.4%**	**8333**	**66.7%**
Public bonds	*2900*	*22.5%*	*730*	*9.6%*	*2000*	*16.0%*
Bank loans	*3875*	*30.1%*	*2340*	*30.6%*	*2333*	*18.7%*
Private placement bonds	*2000*	*15.5%*	*2000*	*26.2%*	*4000*	*32.0%*
Foreign borrowings	**4098**	**31.8%**	**2566**	**33.6%**	**4167**	**33.3%**
DFIs/Multilateral agencies	*1142*	*8.9%*	*402*	*5.3%*	*1667*	*13.3%*
Bank loans and other	*2956*	*23.0%*	*2164*	*28.3%*	*2500*	*20.0%*
Total borrowings	**12873**	**100%**	**7636**	**100%**	**12500**	**100%**

Source: Goga, S., Bosiu, T., & Bell, J. (2019). The role of development finance in the industrialisation of the South African economy. CCRED Working Paper 9/2019.

In the context of these limitations, and the general government budgetary constraints, the Minister of Finance has stated that the country will seek external funding (at least for healthcare related expenditure) from sources such as the International Monetary Fund (IMF), as the need arises. Indeed, much of the recently announced R500 billion stimulus package by the President – part of which (R200 billion) is earmarked for businesses – is planned to be raised from global partners, major private banks and international finance institutions. While the stimulus package is significant and commendable, we argue that **there is still room to mobilise funding domestically**, to ease pressure on the already high levels of debt-to-GDP. For consideration, based on the information that is publically available, we propose the following:

- There is still room for some DFIs to tap into their reserves and expand the size of their existing COVID-19 response funds (notwithstanding the more structural funding constraints in the longer term). IDC, for example, has accumulated reserves of about R7.3 billion over the 2017/18 and 2018/19 financial years, that can be tapped into to increase the size of its 'Covid-19 Distressed Funding' and other measures proposed above to ensure that companies that are not IDC clients also have direct and easy access to this funding. Moreover, ***DFIs should themselves consider proposals to their funders (especially commercial banks) seeking moratoria and complete restructuring of their own debt.*** This will ease the pressure on DFI resources, potentially unlock further funds (where private funders may view it as less risky to fund DFIs than multiple vulnerable businesses), and ensure immediate availability of cash that can be deployed for more urgent developmental interventions.

- Furthermore, UIF has about R101 billion in reserves that could be drawn on – the reality is that the demands on the core funding and functions of the UIF for supporting those that have lost employment may be far greater and long-term in future if substantial productive capacity is lost in the economy due to a lack of appropriate funding mechanisms to retain those capabilities in the coming months. The R101 billion is over and above the 'technical reserves'

(R42 billion: 2018/19) that are set aside annually to "cover the cost of future benefit payments in respect of contributions collected as at the valuation date".[25]

The UIF has already pledged some of the technical reserves (R30 billion) to assist employees affected by the lockdown.[26] Moreover, the President has also alluded to the possibility of raising some of the announced stimulus funds from the UIF. Whilst some of UIF's non-technical reserves may be illiquid to be readily used to respond to the current COVID-19 pandemic, they could certainly be unlocked for future purposes, ***where they can be loaned at zero-percent or low interest rates to other enterprise-financing DFIs*** such as the IDC, SEFA, NEF, etc. So, for instance, the current UIF facility (which disbursed approximately R1.17 billion in 2018/19 financial year) with the IDC can be increased significantly to ensure much wider reach. Using UIF reserves to fund a DFI would not be unique to South Africa - for example, Brazil's major DFI (BNDES) is significantly funded from that country's unemployment insurance fund – known as the Workers' Assistance Fund (FAT). Of the total FAT collection, 40% is secured to BNDES by the Brazilian Federal Constitution, the cost of which is mainly pegged to the Long-Term Rate (TLP) set by the central bank, or to the London Interbank Offered Rate (Libor), plus dollar variation.[27]

- Finally, this is perhaps the opportune period to critically ***explore the limits of the role that the South African Reserve Bank (SARB) can play in not only responding to the COVID-19 pandemic, but even during general periods of economic slowdowns*** as has been the case with our economy for the past couple of years.

  Globally, in this and past economic crises, we have seen that central banks can play a key role, and have resources and powers, to protect and stimulate depressed economies. Central banks across the world have typically and recently implemented various measures (including different forms of quantitative easing (QE)) in trying to lift their economies out of economic depression. For example: the Bank of Japan implemented what was known as the 'Window Guidance'[28], in the period following the WWII; the USA's Federal Reserve Bank implemented a series of QE measures following the 2008/9 financial crisis, including the recent announcement of QE4 in response to COVID-19[29]; and, including the recent programme of QE announced in March 2020, the Bank of England's total purchases of government bonds since 2009 total £645 billion.[30]

  Moreover, central banks have directly intervened in the development of many economies through steering of credit to designated sectors. For instance, ILO research shows how the Reserve Bank of Bangladesh (Bangladesh Bank) intervened in ensuring access to finance for farmers at highly reduced rates, access to finance for SMEs and women enterprises, and

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[25] UIF 2018/19 annual report. Accessed 13 April 2020
[26] Paton, C. (8 April 2012). UIF's R30bn support for workers hit by the lockdown is ready for claims. BusinessDay, Accessed 13 April 2020
[27] BNDES 2018 annual report, Accessed 13 April 2020
[28] Weiner, R. (2003). Princess of Yen: Japan's Central Bankers and the Transformation of the Economy, Accessed 13 April 2020
[29] Lu, M. (10 April, 2020). The Fed's Balance Sheet: The Other Exponential Curve. Visual Capitalist, Accessed 13 April 2020
[30] Bank of England website. Accessed 13 April 2020

many others.[31] In a similar manner, modern-day Canada was transformed into an industrial nation with its central bank (Bank of Canada) at the centre of industrial and infrastructural development, through involvement in monetary financing to support fiscal expansion, economic growth and industrialisation.[32]

The experiences of these countries show that, implemented prudently without losing sight of inflation, monetary policy measures beyond inflation-targeting, measures such as quantitative easing, credit guidance, etc., can be utilized to shape the trajectory of growth and without necessarily eroding the currency and/or leading to hyper-inflation in the economy.[33] The debates may be unhelpful in a time of crisis. What is more important is to ensure that funding made available through different measures that SARB can take yield desired outcomes and reach the intended recipients rather than getting stuck in the financial system where commercial banks may not have a propensity to invest in riskier or vulnerable businesses in the first place despite lower repo rates, for example – ***mechanisms need to be in place to ensure sufficient earmarking of injections into the economy***. Typically, central banks in the instances mentioned above inject funding into the economy through commercial banks, whilst making sure that there are regulatory measures in place to ensure that banks lend to identified sectors – we propose that this approach is considered as an alternative for the funding of DFIs to enable a more comprehensive response in support of SMEs in the economy, many of which simply will not qualify under the programmes proposed by the commercial banks.

Alternatively, a mechanism could be explored wherein the SARB can earmark funding for the productive sectors by directly funding DFIs (such as the IDC) at zero or low interest rates over longer-term periods. Such interventions could be explored within the existing legislative framework, including in terms of section 10 and 13 of the SARB Act.[34] Over the longer term, the IDC could take the form of an industrial development *bank*, akin to the format which supports BNDES in relation to the Central Bank of Brazil.[35] Whichever format is explored in a rapidly changing international environment, **earmarking development funds for investment in *productive assets* rather than speculative and short term financial portfolios is critical.** We suggest that channeling this funding through the IDC (and other DFIs) can ensure that funds are injected into the productive economy directly, not least because of the corporation's mandate and expertise.

[31] ILO (2017). Rethinking macroeconomic policies for full employment and inclusive growth: Some elements. Working Paper No. 238, Accessed 13 April 2020
[32] See Nkosi, R. (2019). SOUTH AFRICA'S MORIBUND ECONOMY: Searching for recovery in the wrong places. PRIME PAPERS: AFRICA 2019/1, Accessed 13 April 2020
[33] See Malikane, C. (1 April, 2020). Is the SA Reserve Bank doing Quantitative Easing? Accessed 13 April 2020.
[34] Refer to the SARB Act
[35] BNDES 2018 annual report. Accessed 13 April 2020