A STRUCTURED APPROACH TO THE STRATEGIC POSITIONING OF ASSET-BACKED SHORT-TERM FINANCE: A SOUTH AFRICAN PERSPECTIVE

by

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submitted in accordance with the requirements for the degree of

DOCTOR OF COMMERCE

In the subject

BUSINESS MANAGEMENT

at the

UNIVERSITY OF SOUTH AFRICA

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JUNE 2017

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A structured approach to the strategic management of asset-backed short-term finance: A South African perspective

I declare that the above thesis is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

_____ _____

SIGNATURE DATE

ACKNOWLEDGEMENTS

"To know is to know that you know nothing.
That is the meaning of true knowledge" – Socrates

I would like to express my sincere gratitude to my supervisor, Professor Jackie Young, for his guidance, his patience and his continuous mentorship. It was a long journey, but he never gave up on me. I am truly grateful for what I have learned from him.

Dr Wynand Boshoff – for his time, wisdom and ability to give constructive criticism on whatever I have attempted with the study. He also was a great help to compile my work and to give me advice to structure the study in a way that helped with the overall sensibility of the dissertation. He gave input and helped to obtain the best references and literature to support so that the study may have a proper academic foundation.

Mr Richard Nortjé – who was always willing to look for appropriate study material and reference books. Whenever I requested, he was willing to go to the library, and he helped me to find the correct literature for a specific subject problem.

Among those who provided detailed comments on earlier drafts of sections of my dissertation is Prof. Jannie Rossouw, Head of the School of Economics and Business Sciences at the University of Witwatersrand.

Prof. Johan Strydom, Department of Business Management at the University of South Africa – who gave valuable advice and direction on how to approach the study and what was expected from me with the dissertation.

Consulta – an independent professional research firm, was responsible for approaching the respondents with my questionnaires to complete the empirical survey. They did a sterling job, which I sincerely appreciate.

Ms. Jackie Viljoen, general language practitioner, who edited the text. She claims that it is her passion and it shows – I confirm the truth of that statement!

Last but not least, I thank my family for their support day after day.

I dedicate this thesis to my twin grandsons, André and Daniël Betts, with the advice never to give up!

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ABBREVIATIONS AND ACRONYMS

BFASA	Bridging Finance Association of South Africa
BFC	Bridging Finance Company
BWS	Best- Worst Scaling
CDO	Collateralised Debt Obligation
CMM	Corporate Money Managers
CTR	Cash Threshold Report
DCE	Discrete Choice Experiment
EAO	Emolument Attachment Order
FIC	Financial Intelligence Centre
ICMA	International Capital Market Association
ICMORG	Institute of Credit Management of South Africa
IMF	International Monetary Fund
LCR	Liquidity Coverage Ratio
LSM	Life Style Measure
MNL	Multinomial Logit
NPS	National Payment System
RSA	Republic of South Africa
SACVP	South African Council for the Property Valuers Profession
SAICA	South African Council of Chartered Accountants
SAIV	South African Institute of Valuers
SCA	Supreme Court of Appeal
SD	Standard Deviation
SVS	Schwartz Value Scale
Unisa	University of South Africa
WTP	Willing to Pay

SUMMARY

The emerging financial industry of asset-backed short-term finance was investigated by this study. Literature indicated that banks, locally and globally, are forced by regulation and the use of information technology, to rely less on human judgement and more on programmed decision-making, when evaluating loan applications. This leads to time-consuming processes with non-standard loan applications and loss of opportunities for business persons. Asset-backed short-term finance is a market response to this tendency. Due to the emerging nature of this industry, no previous academic description of or investigation into this industry could be found – a gap in academic literature which this study aims to fill. The industry is strategically positioned in relation to banks by focusing on functionality for urgent non-standard loan applications (period between application and decision, and access to decision-makers) as value proposition, where banks are found lacking. Relatively high interest rates form the profit proposition, as firms in this industry have limited access to funds. Collateral is central as risk-mitigating strategy, forming a part of the profit proposition. The people proposition is essential, as the industry is distinguished by individualised decision-making. A survey among customers of this industry identified four clusters of potential customers: The first had no needs unfulfilled by banks, while the other three clusters were attracted by either functionality, or the evaluation of collateral in contrast to repayment ability, or a combination of the two. A survey among providers revealed hesitance to supply information and a low level of agreement on strategic matters – possibly due to the emergent nature of the industry. It is asserted that the basis for further study was laid.

Key words: Asset-backed short-term finance; Bridging finance; Strategic positioning; Collateral; Risk management; Financial regulation; Independent credit providers; Best–worst scaling; History of South African banking.

PART A: INTRODUCTION

CHAPTER 1

INTRODUCTION TO THE STRATEGIC POSITIONING OF INDEPENDENT CREDIT PROVIDERS

1.1 INTRODUCTION

A structured approach to the strategic positioning of independent providers of asset-backed short-term finance in South Africa required well-grounded research. First of all, it was clear from a preliminary ad hoc study that the banks in South Africa do not provide this product. Second, it seemed that banks are not always geared for quick decision-making. This research report includes a literature review of the current views on the financial sector and the credit industry, resulting in, inter alia, better understanding of the reluctance of banks to provide asset-backed short-term finance. It also includes an empirical investigation to verify the need and set conditions for a successful operation of asset-backed short-term finance. To this end, the research involved customers and providers of asset-backed short-term finance as part of the empirical analysis.

As will be indicated in Chapter 3, the South African credit industry is highly concentrated in five major banks and a number of smaller banks, while independent credit providers are institutions who are neither banks (deposit-receiving institutions), nor affiliated to banks.

The aim of this chapter is to outline the research focus, and to provide a general introduction to the study consisting of a literature review as basis for the empirical analysis in support of this study. Regarding the approach to the study, in this chapter, the research focus; the importance and benefits of the study; limitations, delimitations and assumptions employed in the study; an overview of the literature review; and finally a discussion of the research design, methods and data analysis as approached in this study are reflected.

1.2 THE CONCEPT OF ASSET-BACKED SHORT-TERM FINANCE

In this section, the concept of asset-backed short-term finance is described in terms of a general description of and background to the industry.

1.2.1 Description of the industry

Asset-backed short-term finance, or the provisioning of bridging loans, is an established component of the financial sector, fulfilling a well-defined credit need (Investopedia, 2017). A typical transaction would involve, for example, a property developer who needs a certain amount of money to complete a construction or building development in order to sell the property, or to finance it conventionally through the banks. The provider of short-term finance reaches a decision within a short period, compared to banks. In exchange, the loan provider requires an asset as collateral and the interest rate is considerably higher than expected from banks. As such, banks are hesitant to serve this market, which induces private credit providers to fill the void (Bridgebank Capital, 2011; Goodman, 2013; Paragon Lending, 2010). Despite the essential role of asset-backed short-term finance, it seems that the concept does not enjoy the same recognition as other industries in the financial sector. This is illustrated by the Global Competitiveness Report (GCR) 2013–2014 of the World Economic Forum (WEF) (Schwab, 2013), which evaluates, amongst other factors, the financial markets of countries. The GCR attends to the ease of access to loans with a good business plan without collateral, availability of venture capital for risky ventures, and soundness of banks (Schwab, 2013). However, access to short-term finance for high-risk ventures *with* sufficient collateral, is not attended to.

The apparent lack of recognition for asset-backed short-term finance might be due to a general absence of sufficient information on, and theoretical support for the concept. Therefore, this study could prove to be valuable by filling this theoretical information gap. The concept of asset-backed short-term finance is the topic of Chapter 4.

1.2.2 Background to the industry

Lending and borrowing of money is as old as money itself. Banking functions, such as currency exchange, trading in bills of exchange and (most importantly) money lending at interest rates reaching even 100%, had been well established by the thirteenth century in Italian trading cities such as Genoa and Florence (Van Doosselaere, 2009, p. 130). The functions of banks, as currently seen in South Africa, were developed in the late seventeenth century in London and refined during the Industrial Revolution (Jones, 1996, pp. 3–4).

The development of banking in South Africa started when the economy was first transformed from a pastoral to a mining and then to an industrial economy. Different territories with different economic structures were united in the Union of South Africa in 1910, soon followed by regulation of the financial sector.

The banking sector of South Africa developed accordingly. In 1793, the Lombaard Bank was established, although the local monetary economy was still very small (Rossouw, 2009, p. 1). According to Verhoef (2012a, p. 206), several independent banks developed since 1830, but the modern approach to banking only started with the arrival of the so-called 'imperial banks' during the 1860's (Verhoef, 2012a, p. 206). The Standard Bank was the first such institution to survive, and was established in 1862 in Port Elizabeth (Jones, 1996, pp. 10–11).

Between 1860 and 1960, South African banks did not regard capital for long-term projects as their proper function, but rather the supply of working capital for existing businesses (Jones, 1996, p. 4). As such, the primary business of banks during the period 1860–1960 was lending money and providing a means of making and receiving payments. The four sources of revenue for banks had been the discount, loans by overdraft, payment of accounts (earning commissions), and exchange operations (Jones, 1996, pp. 3–6). The banks, by way of these sources of revenue, mainly served the primary and secondary industries of wine and wool, although mining of diamonds and gold soon overshadowed agriculture (Verhoef, 2012a, p. 206). In addition to this, during the two Anglo-Boer Wars (1880-1881 and 1899-1902) the Standard Bank also assumed the role of central bank, when large amounts of money flowed into South Africa to finance the British armed forces (Jones, 1996, p. 7).

Rossouw (2009, pp. 2-4) points to the formation of the South African Reserve Bank (SARB) in 1921 as an important development in the country's financial services. He mentions that, although proponents had argued in favour of such an institution since 1879, it was the financial crisis following the First World War which forced the government to create a central bank. From the beginning, the SARB was privately owned, but it has also worked strictly according to a legal framework in order to determine monetary policy for the country (Rossouw, 2009, pp. 2–4).

Not all developments in the banking sector had been market-driven in the strict sense of the word. A social problem had started to arise by the end of the nineteenth century,

when agriculture could not absorb new Afrikaner entrants to the labour market anymore; they became a kind of economic refugee class in the English-dominated cities, being unskilled and culturally handicapped, which led to an aggregate of poverty, marginalisation and social disintegration the so-called ‘poor white problem’ (Davenport, 1989, p. 319). Religious leaders realised that a deep cultural revitalisation was necessary to create an appropriate approach to land, labour, self-respect and money (Kestell, 1941; Nienaber, 1946, pp. 103–119). Financial institutions created for this reason, together with the imperial banks, contributed to the sophisticated financial environment of the early twenty-first century (Verhoef, 2012a, pp. 478–480).

After the end of the Second World War in 1945, South Africa was economically modernised and rapid economic growth followed, which involved the banking sector. The period from 1960 to 1990 witnessed the formation of accepting banks, investment banks and private banks (Verhoef 2012a, p. 479).

During the whole period of 1860 and even after 1960, bank managers needed to keep independent relations with the influential clients in their areas. According to Jones (1996, p. 20), the ability of the imperial banks to withstand these pressures (as their policies were determined in London) enabled them to survive when local banks failed (Jones, 1996, p. 20). Currently, several mechanisms aim at prudent and transparent business practices in the banking sector, as will be set out in the literature overview.

The banking industry is regulated by the following laws and institutions:

- Financial Services Board (FSB);
- Financial Intelligence Centre Act (FICA);
- The National Credit Act (National Credit Act, 2005 as amended by the National Credit Amendment Act, no. 19 of 2014);
- The financial sector charter (Banking Association of South Africa [BASA], 2012); and
- The regulatory role of the Reserve Bank (Rossouw, 2009).

It is important to note that South African regulatory arrangements and institutions are not domestically devised. These are informed by the non-compulsory guidelines set out by the Basel Committee on Banking Supervision (popularly known as Basel I, II and III) (Basel Committee on Banking Supervision [BCBS], 2013; SARB, 2014).

With the historical and regulatory background in mind, it was possible to attend to the research focus.

Credit provisioning on a global scale, as part of the background to asset-backed short-term finance in South Africa is the topic of Chapter 2, while credit provisioning in South Africa is discussed in Chapter 3.

1.3 A STRUCTURED APPROACH

Definitions of the word 'structure' refer to "the arrangement of and relations between the parts or elements of something complex" (Oxford Dictionary, 2016) and "the aggregate of elements of an entity in their relationships to each other" (Merriam-Webster, 2016). A structured approach to asset-backed short-term finance as presented in this study, aims to provide background to the industry in order to identify the different elements of and risks relevant to the industry, which will result in orderly guidelines for use by current enterprises and prospective entrants.

1.4 STRATEGIC POSITIONING

This section briefly outlines the strategic positioning of asset-backed finance in relation to banks, and the graphic representation of this positioning, and ultimately customers' preferences relative to it. Strategic positioning is informed by the market position discussed in section 4.3, and the graphic representation is used in Chapter 7 for depicting the results of the empirical survey among customers of asset-backed short-term finance.

1.4.1 The strategic positioning of asset-backed finance in relation to banks

According to the Institute for Strategy and Competitiveness of the Harvard Business School (2016):

Strategic positioning reflects choices a company makes about the kind of value it will create and how that value will be created differently than rivals. Strategic positioning should translate into one of two things: a premium price or lower costs for the company.

Kim and Mauborgne (2009) regard this as the definition for a structuralist approach to strategic positioning – an approach which accepts the market structure and the requirement to compete either on cost or differentiation. In addition, they identify the reconstructionist approach. This latter approach can be followed when a role player

can successfully compete both on cost and differentiation, and in the process reconstructs the industry. Asset-backed short-term finance follows a structuralist approach, competing on differentiation. The positions and choice are graphically compared in Figure 1.1.

The argument developed in the preceding paragraphs is that asset-backed short-term finance is a financial industry exploiting a niche, which was formed in the credit market as a result of macroeconomic developments. Therefore, the industry follows a structuralist approach, competing on differentiation.

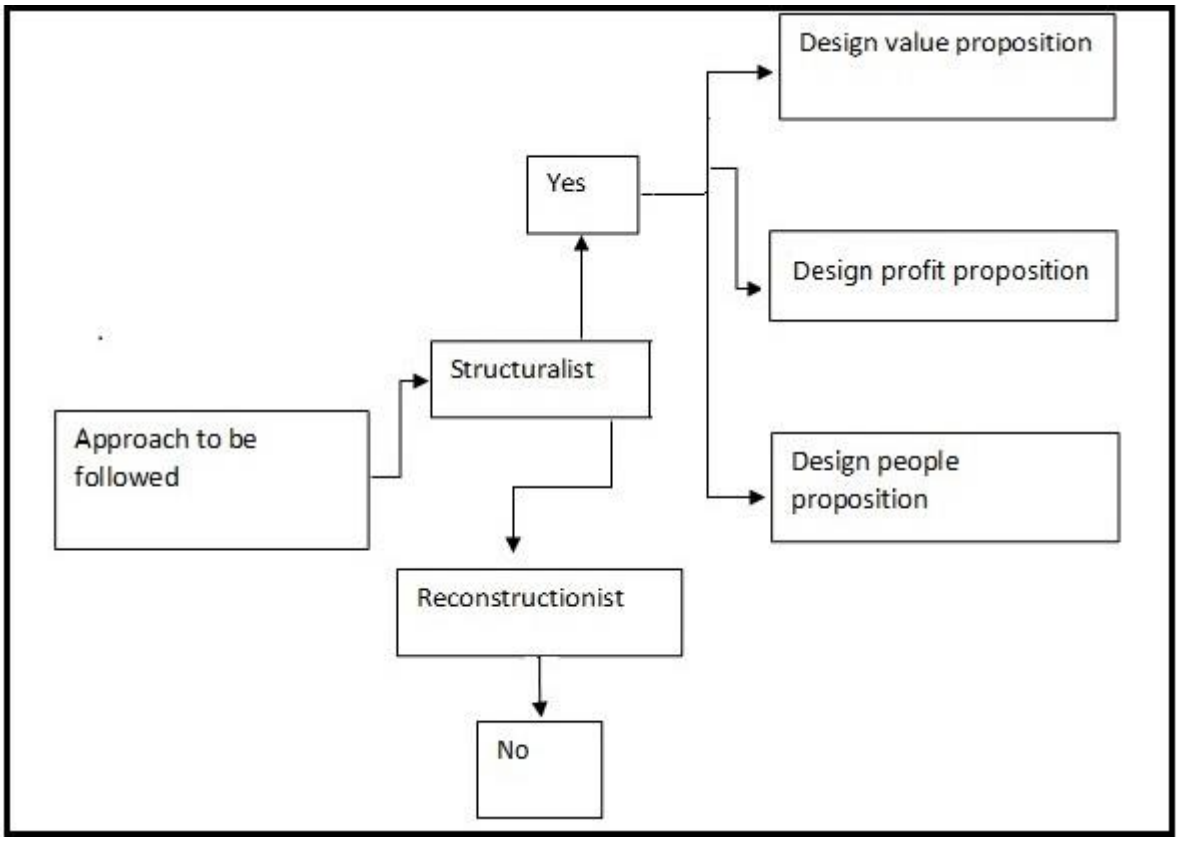

Figure 1.1: Strategic positioning of asset-backed short-term finance

Source: Compiled by author

The execution of propositions is discussed in Chapter 5.

The description of and background to the industry of asset-backed short-term finance discussed in section 1.2 focused on the contrast between banks as mass producers of financial services and independent credit providers as the opposite (service factories in contrast to service shops, as discussed in section 2.2.3.4). This is the main driver of the structuralist approach that was followed as depicted in Figure 1.1, which can also be termed the 'strategic positioning of asset-backed short-term finance'.

1.4.2 Graphic representation of strategic positioning of asset-backed short-term finance

Radar charts are used in chapter 7 to depict the graphic representation of strategic positioning of asset-backed short-term finance in relation to banks, as well as indicating the preferences of customers and potential customers of asset-backed finance, as investigated by way of a survey (methodology described in Chapter 6 and results in Chapter 7).

A radar chart is a graphical method of displaying multivariate data in the form of a two-dimensional chart of three or more quantitative variables represented on axes starting from the same point (Fusion Charts, 2017). Each of several aspects of an entity form individual axes which are arranged radially around a point. The value of each aspect is depicted by the node (anchor) on the spoke (axis). A line is drawn connecting the data values for each spoke, depicting all data values on a single plane. When two entities are compared, colour coding aids in correlating and contrasting the entities visually over the chart's diverse aspects (Fusion Charts, 2017).

In the case of positioning asset-backed short-term finance in relation to banks, the eight features of loan provisioning mentioned and investigated in section 6.4.1.5 were used. These features are –

- loan decisions based on repayment ability alone;
- period between loan application and decision;
- fees, for example administration or initiation fees;
- access to contact person who can and may reach a conclusion on loan applications;
- brand prominence of credit provider;
- impressive facilities;
- loan decisions based on security; and
- interest rates.

A simplified representation can be gained by collapsing fees and interest into favourable cost, facilities and brand prominence into image, and waiting period and access into functionality. In addition, evaluation of loan applications on repayment ability, or value of collateral is part of the representation. The findings of the survey (comprehensively discussed in section 7.2), collapsed into five categories, were used

to populate a radar chart for indicating the positions of banks and independent providers of asset-backed finance. Results are summarised in Table 1.1 below.

The values for the four clusters of respondents (discussed in section 7.2.1) are results from the empirical survey, which indicated customers' expectations when a loan of any amount (very rarely less than R50 000) to acquire anything of value for business ends, to be repaid within six months either by reselling or refinancing, guaranteed by other assets, is required (section 6.4.1.4). The maximum value on the chart (45) (figure 1.2) is determined by the highest empirical result (44.1 for functionality by Cluster 2), as presented in section 7.2.3.

Each of **image**, **functionality** and **favourable** cost is each a compound of two features, which inflates the respective scores. Therefore, the values for **repayment** and **collateral** are multiplied by two.

The values for **asset-backed** and **banks** were derived from the literature review, where **banks** were discussed in Chapter 2 (internationally) and Chapter 3 (South African), and **asset-backed short-term finance** in Chapter 4. The aim is to present graphically what was found qualitatively from literature, to form a reference for the empirical results.

Table 1.1: Loan features used for populating radar diagrams

	Asset-backed	Bank	Cluster 1	Cluster 2	Cluster 3	Cluster 4
Image	10	45	2,9	1,2	2,4	2,7
Functionality	45	15	29,8	44,1	22,5	38,4
Favourable cost	15	30	35,6	34,4	37	38,3
Repayment	10	45	18,4	11,1	18,2	13,6
Collateral	45	15	13,3	9,2	19,9	7,1

The radar diagram presented in Figure 1.2 depicts the tension between the five features mentioned and the different ways in which banks and independent providers of asset-backed short-term finance respond to it.

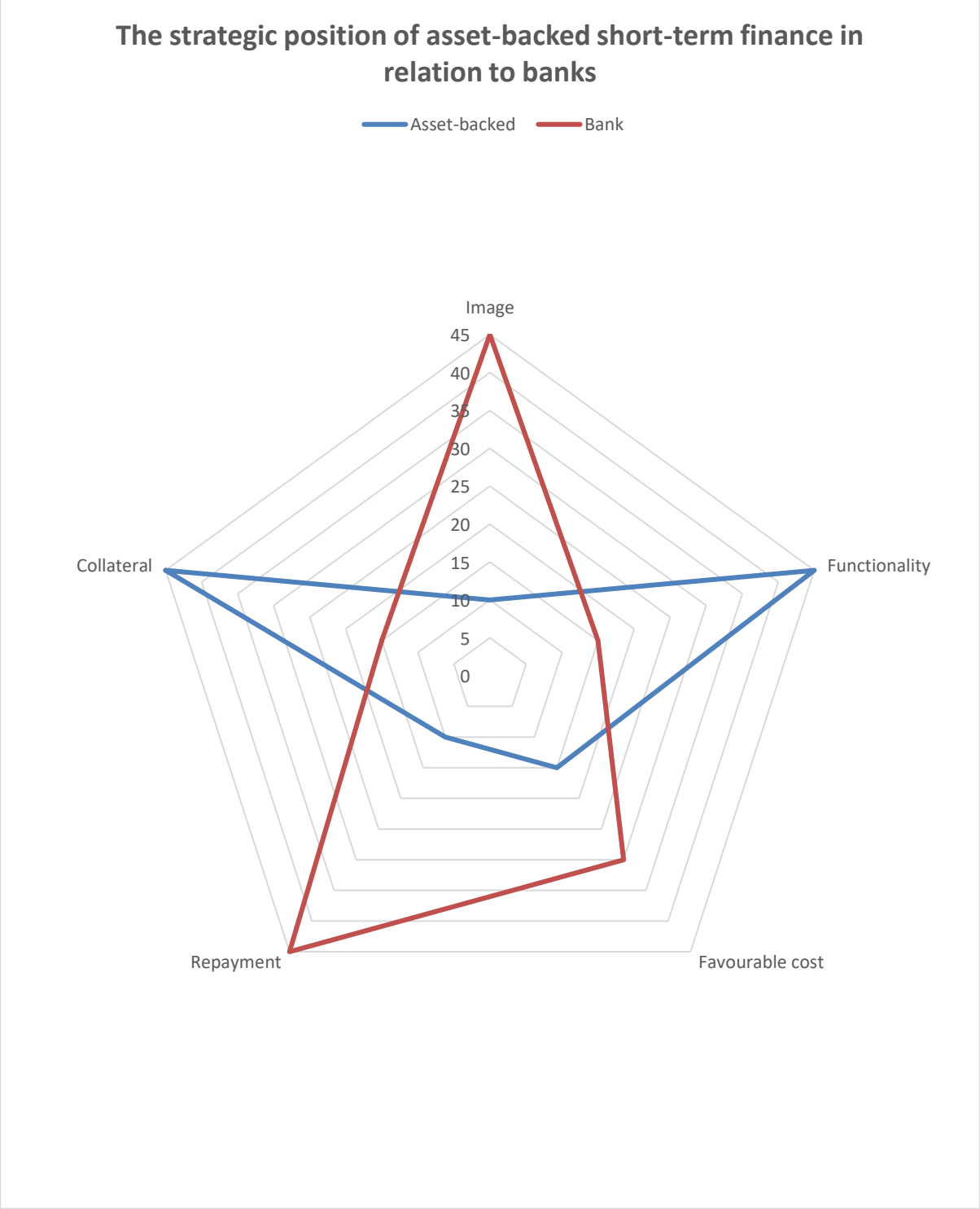

Figure 1.2 The strategic positioning of asset-backed short-term finance in relation to banks

Source: Author's own compilation

In this figure, it is shown that certain ranges of needs can only be fulfilled by banks and providers of asset-backed short-term finance, while other ranges can be met by either of the two.

This positioning will be referred to in Chapter 7 when the results of the survey among customers of asset-backed short-term finance are discussed.

1.5 RESEARCH FOCUS

In section 1.1, the value of short-term asset-backed finance to overcome temporal, but critical, liquidity challenges is discussed. The historical and regulatory overview of banking presented in section 1.2, serves as background to asset-backed short-term finance. The research problem, discussed in terms of problem statement, research question, research aim and objectives will be dealt with in the ensuing sections.

1.5.1 Problem statement

This study addresses the lack of recognition, in academic and commercial circles, of asset-backed short-term finance as a financial industry.

The existence of asset-backed short-term finance (described in section 1.2) is confirmed by several sources which indicate that banks do not offer this type of finance (Beneficio Finance, 2012; Bridgebank Capital, 2011; Goodman, 2013; Paragon Lending Solutions, 2010). A lack of directly relevant reported research might cast doubt on the legitimacy and long-term feasibility of the industry.

The need for this industry is created by banks' operational risk measures which limit the autonomy of individual bank officials and force banks to deal with non-standardised loan applications in a time-consuming way (Young, 2014, pp. 48–62). Earlier perspectives refer to banks being unresponsive to customers' needs (Meyer 2008), monopolistic (Mlambo and Ncube, 2011) or "oligopolistic" behaviour (Verhoef, 2009, p. 157), or even foul play (Thomas, 2013). Discussions on loyalty to banks (Pitta, Franzak, and Fowler, 2006) and Chipunza (2008) conclude that loyalty depends on the availability and quality of alternatives.

This study, creating a framework for asset-backed short-term finance as an alternative to banks, is a contribution to the body of academic literature on finance. It can enhance the financial sector to be able to serve more customers' needs – thereby promoting economic growth.

1.5.2 Research question

In support of the rationale for this study and a general perceived lack of theory in support of asset-backed short-term finance the primary question was:

Can a structured approach to ensure the strategic positioning of an independent credit-providing enterprise, specialising in asset-backed short-term finance, ensure the success of such an initiative?

1.5.3 Research aim and objectives

Based on the research question, this study aimed to develop a structured approach for the strategic positioning of an independent credit-providing enterprise, specialising in asset-backed short-term finance, which could assist in ensuring success in the credit provisioning market.

The objectives in support of the aim of this study were:

- to determine why some business people prefer private asset-backed short-term loans to credit from commercial banks;
- to identify the most relevant risks to providers of asset-backed short-term finance; and
- to develop a framework for asset-backed short-term finance as a structured approach that could assist the existing and potential market players to ensure a successful enterprise.

In support of the abovementioned objectives, the importance and potential benefits of the study are dealt with in the ensuing section.

1.6 THE IMPORTANCE AND BENEFITS OF THE PROPOSED STUDY

A structured approach to the strategic positioning of private providers of asset-backed short-term finance is important, both from a practical perspective regarding the financial system of South Africa, as well as from a theoretical perspective in the academic discipline of finance. Benefits should accrue to direct stakeholders, referring to providers and customers, but also to indirect stakeholders, such as auxiliary industries and other financial institutions.

1.6.1 Importance from a South African perspective

In his preface to the Global Competitiveness Report of the World Economic Forum (WEF), Schwab (2013) emphasises that the distinction between ‘developing’ and ‘developed’ countries will soon be replaced by the distinction between ‘innovation-driven’ and ‘innovation-poor’ economies. Therefore he urges policymakers and civil society to create an environment where innovation is nurtured (Schwab, 2013, p. xiii).

According to the Global Competitive Index of the GCR, factor-driven economies should progress to efficiency-driven economies. The GCR rates South Africa as one of 31 economies in the efficiency-driven stage of development (Schwab, 2013, p. 11); a position confirmed in the youngest report (Schwab, 2016, p. 38). From the position of an efficiency-driven economy, countries should strive to progress to the position of an innovation-driven economy (Schwab, 2013, p. 9).

Financial market development is regarded as one of 12 pillars of competitiveness (Schwab, 2013, pp. 4–8), in the category of efficiency enhancers (Schwab, 2013, p. 33). In 2012 South African financial market development ranked second in the world (Schwab, 2013, p. 21), despite the country's overall competitiveness ranking of 53, (Schwab, 2013, p. 16), while it decreased to the eleventh position despite the country's overall improvement to the 47th position (Schwab, 2016, p. 324). Analysing South African financial market development performance, reveals a nuanced reality, as seen in Table 1.2.

Table 1.2: Factors determining the global rank of South African financial market development

Indicator of financial market development	South Africa's rank in in 2012	South Africa's rank in 2016
Regulation of securities exchanges	1	3
Legal rights	1	68
Soundness of banks	3	2
Financing through local equity market	2	1
Availability of financial services	2	2
Affordability of financial services	13	27
Ease of access to loans	22	12
Venture capital availability	29	53

Source: GCR 2013–14 (Schwab, 2013, p. 347; Schwab, 2016, p. 324).

The two market development indicators where South Africa underperforms are determined by the following two questions:

- Ease of access to loans: How easy is it to obtain a bank loan with only a good business plan and no collateral?
- Venture capital availability: How easy is it for entrepreneurs with innovative but risky projects to find venture capital?

Asset-backed short-term finance does not contribute to ‘ease of access to loans’, but it does contribute to ‘venture capital availability’ as defined above. If, as a result of this study, venture capital availability is improved, it should contribute to the efficiency of financial market development. This could even contribute to South Africa progressing from an efficiency-driven economy to an innovation-driven economy, provided an overall performance in that direction be maintained.

It is safe to assert that this study and implementation of its findings could contribute to South African financial market development to the benefit of the national economy.

1.6.2 Importance from an academic perspective

In the problem statement, reference is made to the perceived general lack of academic or theoretical literature specifically covering the field of asset-backed short-term finance. If management theory follows business practice, as suggested by Bennis and O’Toole (2005) as well as Miller (1999, p. 97–98), this study will contribute to the body of academic literature and knowledge in this field.

1.6.3 Importance to direct stakeholders

Direct stakeholders in asset-backed short-term finance can be defined as active providers of finance for customers who have an immediate need for funds, for example for an unexpected business opportunity. A building development opportunity may present itself as a result of the outcome of a favourable rezoning of land. Most of the customers are property developers, although this kind of finance could, in principle, be used by anyone (see section 1.1). Clarity regarding the positioning of independent providers of asset-backed short-term finance would be beneficial to all these stakeholders.

A multitude of legislation regulates South African financial markets. Criminal intent is not the only cause for illegal activities, as ignorance could also have serious consequences. The security offered for a loan may also be sufficient, but some cases,

due to administrative oversight,[1] the lender cannot lawfully take possession of the security, as discussed comprehensively in section 4.7.2. The risks associated with asset-backed short-term finance may seem prohibitive to potential providers, leading to insufficient supply in the potentially lucrative industry of asset-backed short-term finance. Potential users of asset-backed short-term finance may have a negative perception of this relatively obscure industry. Such entrepreneurs could unlock profitable business opportunities with asset-backed short-term finance, but might be deterred by a lack of knowledge of the product, ignorance of the existence of providers of such finance, or even by being suspicious about the legitimacy of the industry.

The importance of the present study to direct stakeholders is that it could provide clarity on the aims, methods and regulatory environment of asset-backed short-term finance. Current or prospective providers of asset-backed short-term finance could accordingly plan their operations to enhance efficiency and reduce risks, and inform themselves of potential opportunities.

1.6.4 Importance to indirect stakeholders

Indirect stakeholders in asset-backed short-term finance are those entities affected by the industry, although they are not directly involved. Indirect stakeholders can mainly be found in three spheres: auxiliary industries, end-users, and financial institutions for property developers. Auxiliary industries would be architects and related professions, building contractors, as well as their suppliers and employees. End-users would be future tenants and owners. Financial institutions mainly refer to banks.

An efficient asset-backed short-term finance industry with wide market penetration should enable developers to make prompt payments. This will have a positive effect on auxiliary industries, enhancing stability, which translates into increased employment stability in the construction sector. Unplanned delays should be reduced, which will benefit end-users whose properties will be likely to be delivered on time.

Banks should also benefit from this study because they could, in the Information Age, deliver routine services efficiently. However, their ability to meet specialised needs,

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[1] Administrative oversight refers to, for instance, failure to confirm that the customer is authorised to offer the relevant collateral.

such as finance where approval of the loan is needed in a very short time for an individual customer, will be impaired. A symbiotic relationship between the banking industry and the asset-backed short-term finance industry should, or could, evolve from a point where a joint agreement exists. Banks are equipped to provide long-term finance in a programmed way, while providers of asset-backed short-term finance meet the occasional cash-flow crisis.

1.7 LIMITATIONS, DELIMITATIONS AND ASSUMPTIONS

Limitations, inherent to any study, suggest additional research. Delimitations refer to all aspects related to the topic under consideration, but identify which are beyond the scope of the investigation. Assumptions from which research departs should not be seen as limitations. However, these assumptions need to be explicitly recognised (Simon, 2011). The following section deals with the limitations, delimitations and assumptions of the present study.

1.7.1 Limitations

Asset-backed short-term finance is dominated by independent credit providers, who are not compelled to publish their financial results. Therefore, there seems to be a general lack of publicly available information, and only secondary data from providers of asset-backed short-term finance, who were willing to co-operate, could be used.

1.7.2 Delimitations

The primary focus of this study was the positioning of asset-backed short-term finance as a potential feasible business proposition. The demand for this kind of finance and operational considerations in meeting the demand, were included in the primary focus. The secondary focus was on marketing, capital formation and some aspects of the theory of banking.

For the long-term feasibility (often called ‘sustainability’) of an asset-backed short-term finance enterprise, the success of its customer is relevant. This study forms part of the broader discipline of management studies, but efficient business practices are only discussed insofar as they are relevant to the particular industry of asset-backed short-term finance.

1.7.3 Assumptions

In this research, it was assumed that the business environment, in which a provider of asset-backed short-term finance operates, is a free market where the profit motive is central, similar to any business venture. Asset-backed finance is therefore only viable if the profit generated reflects the risks taken, capital employed and knowledge required. In addition, the supplied credit must play an indispensable role to unlock profit-making possibilities for the customer.

Reckless credit is a major ethical consideration. This study assumed that a private provider of asset-backed short-term finance would refrain from this unethical practice.

In conclusion, it may be assumed that the economic, ethical and regulatory system at the time of the research was applicable for this study. Although radical changes might not be impossible, it was beyond the scope of this study to do a sensitivity analysis of possible socio-political shifts.

1.8 LITERATURE REVIEW

There is a multitude of literature available on credit and banking. Independent providers of asset-backed short-term finance work in the credit industry in conjunction with banks, but are to be distinguished from banks. The purpose of the literature review was to outline the concept of credit provisioning, to focus on credit provisioning in South Africa, and to reveal what can be learnt about asset-backed short-term finance from the literature. The literature review pointed the way for the empirical investigation.

1.8.1 Concept of credit provisioning

Credit refers to the function of financial markets for raising finance for a multitude of borrowing entities through various techniques, whether for a long or short term (Skerritt, 2009, p. 14). The following section investigates the concept of credit with reference to credit in the modern monetary economy and principles for credit provisioning.

1.8.1.1 Credit in the modern monetary economy

Credit is an integral part of modern economy. The essence of credit is that a lender supplies funds to a borrower, enabling the borrower to acquire something of value immediately, but delaying payment. It is part of a financial system, which facilitates the flow of funds between contracting parties (investorwords.com., 2017).

Business ventures can be financed by credit, as well as by the issuance of equity. Indications are that financing through issuance of equity is the least preferred way of financing businesses, as discussed below. According to Denis and Mihov (2003), business credit, in the preferred order, comprises public borrowing, private borrowing from banks and private borrowing from non-banks (such as individual lenders or independent providers of asset-backed short-term finance).

Banks play a central role in financial systems and provisioning of credit. According to Heffernan (2013b), the main defining characteristics of a bank are the intermediary role it plays and the provisioning of liquidity for customers' changing needs. Strahan (2010) identifies banks' traditional role as creating funding liquidity by transforming liquid deposits into illiquid loans, for example twenty-year bonds.

Increasingly, centralised decision-making in banks impedes the ability of banks to provide funding liquidity when detail of the relevant project is crucial. The potential

agility of independent providers of asset-backed short-term finance enables them to finance a project for a short period at a relatively high interest rate, until the project meets the requirements of mainstream finance (Goodman, 2013).

There are several principles which should be taken into account with the provisioning of credit. A discussion of some of the most important principles follows.

1.8.1.2 Principles for credit provisioning

Five principles for successful credit provisioning are discussed in section 2.3. These principles can be distinguished from another, but they cannot be separated from each other. Adequate information is the first principle. This refers to the imperative for credit providers to obtain adequate information to evaluate potential agreements. Risk reduction is the second principle, which is discussed in terms of different types of risk. The third principle is regulation. Although the nature and extent of credit regulation varies with jurisdictions, the universal aspects of regulation are discussed in this section. The fourth principle is customer relations. As credit provisioning is a service, the needs of customers are the drivers of credit provisioning. The fifth principle is competition, the defining principle of free market economies.

1.8.1.2.1 Adequate information

Adequate information is a fundamental principle for credit provisioning (Song, 2002). In recent history, originating, funding and servicing of mortgages in the United States of America were divided between unrelated finance providing institutions, leading to a paucity of information. The result was that credit was over-extended to customers, which led to a collapse of that country's credit market in 2007–2008, with international repercussions (Lehnert, 2010). Timely warnings by authoritative writers, such as Bernanke and Blinder (1988), were not heeded: The inadequacy of information leading to the credit crisis of 2007–2008 revolved around informational asymmetry between borrowers and lenders.

A prediction relevant to the present study came from Schmenner (1986) who observed that information and computer technology (ICT) would vastly increase the service efficiency of banks. This would create 'service factories', referring to large units, which provide high quantities of standardised services. This would, he opined, open the way for 'service shops', referring to small units, which provide specialised services

individually tailored to the needs of each customer and project. Tinnilä (2013) points to the validity of this prediction. ‘Service factories’ and ‘service shops’ both need adequate information, but have different ways to obtain it. The distinction will be discussed in section 1.6.3.2. On the other hand, the comprehensive relationships of banks enable them to overcome informational asymmetry in customer relations. Hughes and Mester (2010) discuss two approaches towards information: the **structural approach** of cost minimisation, profit maximisation and utility maximisation; and the **non-structural approach**, relying on certain ratios, for example return on assets, return on equity, and ratio of fixed costs to total costs.

Independent providers of asset-backed short-term finance need to be sensitive to their informational advantages and disadvantages, and position themselves accordingly. While banks have the advantage of access to a customer’s long-term financial information, independent credit providers have to acquire detailed information of a proposed venture, as well as the collateral offered.

Adequate information in the global context is discussed in section 2.3.1, while the South African context is discussed in section3.3.

1.8.1.2.2 Risk reduction

The reduction of risk is a multi-faceted principle in credit provisioning (Heffernan, 2013a; The Banks Act, 1990).

Credit risk is the risk that lenders do not meet their obligations towards the bank, a risk which increases when loans are originated by institutions which are not responsible for the collection of payments (Brunnermeier, 2008, p. 2). **Liquidity risk**, on the other hand, is the risk that banks cannot meet their obligations towards depositors (Heffernan, 2013, p. 1–2). A perception of pending liquidity risk leads to bank runs, as witnessed during the credit crisis of 2007-2008 (Goldsmith-Pinkham & Yorulmazer, 2010).

According to Crafts and Toniolo (1996), political risk is beyond the control of individual banks and has forced several reforms of the entire financial system. Other authors, such as Kepplinger and Roth (1979), support this view by describing similar dynamics in the winter of 1973–1974, when the German Federal Republic imported unprecedented quantities of oil. The mass media were warning that an energy crisis

might occur, which led to a run on petrochemical products, similar to a bank run (Kepplinger & Roth, 1979). El-Gamal and Jaffe (2009) link bank crises to oil crises by alleging that the growing dependence on oil in America and the rest of the world has created a repeating pattern of banking, currency and energy price crises. Young (2014, pp. 10–11) refers to this category of risk as “country risk”.

Systemic risk is the result of increasing integration by the banking sector, causing a crisis to spread across the system (De Bandt, Hartmann, & Peydró, 2010). **Operational risk** is defined by Young (2014, p. 21) as follows:

Operational risk is the exposure of an organisation to potential losses, resulting from shortcomings and/or failures in the execution of its operations. These losses may be caused by internal failures or shortcomings of people, processes and systems, as well as the inability of people, processes and systems, to cope with the adverse effects of external factors.

Risk reduction is relevant to all credit providers, as even the oldest (and one of the biggest) investment bank in the United Kingdom, Barings Bank, was in fact destroyed by unauthorised risk taking by a senior official in Singapore (see section 2.3.2.1.8).

Independent providers of asset backed short-term finance have to be acutely aware of the risks involved with each transaction. All the above-mentioned risks of banking (except systemic risk) are relevant to such a business, but some risk-mitigating measures are not. Essential to a structured approach to the provisioning of asset-backed short-term finance, is the management of risk, especially credit risk and operational risk.

Risk as a feature of credit provisioning in general is discussed in section 2.3.2, while a discussion of risk focusing on asset-backed short-term finance follows in section 4.7.

1.8.1.2.3 Regulation

Regulation is seen as a principle of credit provisioning, while credit is pivotal to other industries and benefits from a healthy economy. However, the short-term interest of institutions or officials may be in conflict with the common good. Pursuing the common good is regarded as the role of regulatory authorities. In this section, international banking regulation is discussed to confirm the rationale for regulation as principle.

Banks are regulated to enforce prudence, because banks have the power to create money by turning liquid deposits into illiquid loans (Strahan, 2010). If loans are granted recklessly and a high default rate follows, a liquidity crisis will follow (see 1.6.2.2 above) and depositors' funds will be at risk. Therefore, capitalist governments are involved in the internal financial policies of banks, while the same involvement in other industries would be unacceptable (Flannery, 2010).

Kane (2010) adds another rationale for the principle of regulation by describing it as a 'back-office financial service', which generates benefits and costs, such as any service. Banks benefit by being regulated, because regulation could improve customer confidence and influences the balance of power between role players in the market.

Bank regulation on a global scale is discussed in section 2.3.3, in South Africa in section 3.2.2, and in relevance to asset-backed short-term finance, in section 4.5.

1.8.1.2.4 Customer relations

Customer relations, as a principle for credit provisioning, focuses on the need to engage with those clients whose needs are best met by the specific type of credit provider. Pitta et al. (2006) argue for the need to appraise the value of a client over the lifetime of a customer relationship and not a single encounter or transaction. This contradicts a possible notion that a customer's needs must be met at all costs. According to Berger (2010), banks are 'service factories' which employ 'transactional lending technologies'. Private credit providers are 'service shops' using 'relationship lending technologies' (see section 1.6.1.2.1). This means that banks have the ability to meet standardised needs of customers in a superior way. Private credit providers focus more on 'soft' information about how a firm conducts business (Udell, 2008), and are able to meet non-standardised methods in a superior way.

Seiler, Rudolf, and Krume (2013) discuss the link between service value, customer satisfaction and customer loyalty, factors which Aldlaigan and Buttle (2009, p. 354) synthesised into the concept of a positive attachment inventory. O'Loughlin, Szmigin, and Turnbull (2004) investigated the influence of a bank's image, which they found unimportant to customers. Skudiene, Everhart, and Slepikaite (2013) argue that more empowered frontline employees have a positive effect on the value perceived by customers. These studies are testimony to the importance of the principle of customer relations, but also to its complexity.

Customer relations in credit provisioning are discussed in detail in section 2.3.4.

In conclusion it can be stated that the principle of customer relations should encourage all credit providers to regard themselves as either service factories or as service shops. The distinction between customers' standardised and non-standardised needs should lead credit providers to serve customers, or refer them to an appropriate credit provider.

1.8.1.2.5 Competition

Competition is fundamental to the free market (Skerritt, 2009, p. 1). It follows that competition is also a principle to credit provisioning. Porter (2008) proposes a model of five competitive forces. According to this model, the competition for a business is not only direct competitors in the same industry, but also suppliers, customers, substitutes and possible new entrants to the market. All these entities compete for a firm's profit (Porter, 2008, p. 28).

Moore (1993) suggests an alternative approach to the interaction between firms. He uses the metaphor of an ecosystem, where species both co-operate and compete, at different times. A business ecosystem normally has a recognised leader, which co-evolves with a multitude of other firms, towards a shared vision. The concept of niches is also explained by Moore (1993). A crisis might shift the leader to the periphery, and peripheral firms to the centre. Different ecosystems compete against each other, although all boundaries are blurred. Implications for the management process receive attention in a book titled *The death of competition leadership and strategy in the age of business ecosystems* (Moore, 1997). The discourse is continued, amongst others, by Moore (2006) and Muegge (2013).

The relevance of Porter's model for competition (Porter, 2008) as a principle for credit provisioning, is the focus on suppliers and customers, in addition to existing competitors, substitutes and new entrants. The business ecosystem model (Moore, 1997) adds conceptual and practical value to the discussion. In the multi-faceted credit market, role players do not merely compete for the same profits; they also facilitate each other's activities. Private providers of asset-backed finance, as a case in point, fill a distinct niche. While commercial banks provide long-term finance and facilitate changes of ownership, these banks are not always in a position to solve short-term liquidity crises. This is the specialisation of providers of asset-backed short-term

finance. Asset-backed short-term finance is a supplement to commercial banks, not a substitute.

Competition in the credit market is discussed in detail in section 2.3.5.

The principles of adequate information, risk reduction, regulation, customer relations and competition are universal to credit provisioning. In the next section, the focus is narrowed to the nature of credit provisioning in South Africa.

1.8.2 Credit provisioning: A South African perspective

Having discussed the concept of credit provisioning, an overview of credit provisioning in South Africa follows in order to provide clarity on the subject. The history and current reality of the banking industry in South Africa are discussed first, followed by an outline of credit management in this country. The section concludes by distinguishing private providers of asset-backed short-term finance from private providers of unsecured microloans.

1.8.2.1 The banking industry in South Africa

In this sub-section, the composition of the South African banking system is outlined. The regulatory framework is touched upon, followed by perceptions on the quality of banking services in South Africa, as found in the literature. The section concludes with remarks on the auxiliary role of private providers of asset-backed short-term finance.

The South African banking industry consists of 10 locally controlled banks, 6 foreign-controlled banks, 3 mutual banks, 15 branches of foreign banks and 36 foreign bank representatives (SARB, 2016). Despite the large number of role players, four banks control more than 80% of the market (Verhoef, 2009, pp. 180–197). Verhoef (2012a, 2012b), Singleton and Verhoef (2010) as well as Jones (1996) describe the evolution of South Africa's current economic and banking structure, while the current state of banking affairs is described in the South African Banking Sector Overview (BASA, 2013) and the annual report of the Bank Supervision Department of the South African Reserve Bank (SARB, 2013). Hawkins and Torr (2009) also deal with all aspects of the South African banking industry.

The SARB, established in 1921, is one of the oldest national regulatory authorities worldwide (Rossouw, 2009). The SARB is continuously adapting to changing regulatory demands, as indicated by its proposed 'twin peaks model of financial

regulation'. This will divide the regulatory landscape into a prudential regulator and a market conduct regulator (Financial Steering Committee, 2013).

An orderly regulatory dispensation has the advantage that systemic risk (see section 1.6.1.2.2) is surprisingly low for an emerging market, as discussed by Esterhuysen, Van Vuuren, and Styger (2011). The sophisticated National Payment System (NPS) is described as an advantage of the orderly financial scene in South Africa (South African Reserva Bank, 2008, pp. 39-43; South African Reserve Bank, 2017).

Not all scholarly contributions on the South African banking industry are uncritical. Mlambo and Ncube (2011) regard the South African banking industry as an efficient service sector, although they also accuse commercial banks of monopolistic tendencies. In their investigation into private banking divisions of large commercial banks as a form of relationship banking, Abratt and Russel (1999) were critical of service levels. Bick, Brown, and Abratt (2004) found that South African banking customers were enerally not satisfied. In contrast, however, Haasbroek (2010) found that customers are by and large satisfied, but that customer satisfaction does not imply customer loyalty. Chipunza (2008) found that loyalty decreases when competitors' levels of service increase.

Consulted literature indicated that South Africa has an efficient and sophisticated banking industry, as suggested by the GCR of 2013–2014 (Schwab, 2013), but that room for improvement still exists. For instance the present study focused on the possible role of non-banks, such as private providers of asset-backed short-term finance, to fill voids in the banking industry, or to create a niche by offering superior service.

An extensive perspective on the credit industry in South Africa is presented in section 3.2.

1.8.2.2 Credit management in South Africa

The credit market in South Africa can be divided between the short-term, or money market (Botha, 2010), and the long-term, or bond market (Van Zyl, 2009). Various institutions determine the functioning of the credit market in South Africa.

Bonds are traded on the Johannesburg Stock Exchange (JSE) Debt Market, since the JSE had acquired the previous Bonds Exchange in 2009 (JSE, 2013a).

The SARB oversees and regulates the commercial banking sector. It uses interest rates as an instrument to reach monetary policy goals and is responsible for prudency regulation of the banking industry (SARB, 2010).

In terms of Chapter 2 of the National Credit Act (Act no. 34 of 2005), the National Credit Regulator (NCR) was established. All credit providers are compelled to register with the NCR and adhere to its requirements (NCR, n.d.). This is the regulating authority for private credit providers.

Chapter 3, section 43 and 44 of the National Credit Act (Act no. 34 of 2005), respectively determine the roles for credit bureaux and debt counsellors. Credit bureaux have the right to receive reports and investigate consumers' credit histories. The law determines that debt counsellors have the right to facilitate heavy indebted consumers' rehabilitation. This right is exercised in accordance with section 86 on debt review. These entities also need to register with the NCR.

Credit management is regarded by its practitioners as a profession, organised by the Institute of Credit Managers of South Africa since 1957 (Institute of Credit Managers of South Africa [ICMORG], 2013). To increase the level of knowledge and professionalism, the institute developed a four-part course, which their members are obliged to follow (Institute of Credit Management of South Africa, 2013).

An important addition to the instruments of credit management, is business rescue (Companies and Intellectual Property Commission [CIPC], 2011). The Companies Act of 2008 (Act no. 71 of 2008) added this procedure to prevent the liquidation of businesses which are in financial distress, but which can still be rescued. In a test case, the court ruled that this process may not be used in a malignant way to prevent or frustrate the payment of debt (Tselane, 2012).

Private credit providers should be at the cutting edge of credit management. As private credit providers may not take deposits, they have to rely on equity and loan capital to meet the finance requirements of their customers (Republic of South Africa, 1990, section 12) As such, their financial distress does not result in systemic risk and the central bank will not act as a “bank of last resort” (Brunnermeier et al., 2009, p. 8).

In the following section, two important categories of private credit providers are compared. These are microlenders and providers of asset-backed short-term finance.

Credit management as found in South Africa is discussed in full in section 3.3.

1.8.2.3 Comparison of micro lending and asset-backed short-term finance

The origins of micro lending lie in socially conscious entrepreneurs who proved in Bangladesh that poor people could be uplifted by advancing credit, while still making a profit (Investopedia, 2017). At the time of this study, this is a very active industry in South Africa (Wonga, 2013). The benevolent character of short-term lending, however, has been replaced by a pure profit motive. Loans are unsecured, and lenders depend solely on the credit history of customers, as obtained from credit bureaux (Goodspeed, 2010, p. 111–112). The problems that African Bank, and subsequently all major banks in South Africa, encountered during August 2014 were a timely reminder of the risks involved in this sector (Marcus, 2014; Ndzamela, 2014).

In contrast, asset-backed short-term finance is aimed at high net worth persons with a temporal shortage of liquidity. As the term indicates, the borrower needs to offer an asset to serve as collateral (Bridgebank Capital, 2011; Beneficio Finance, 2012; Investopedia, 2017).

The fundamental difference between the two industries is the approach of each industry to security. A detailed description of asset-backed short-term finance is provided in section 4.2. Having sketched a background of credit provisioning, the focus can be narrowed to the industry under consideration in this study, which was asset-backed short-term finance.

1.8.3 Asset-backed short-term finance as a financial industry

The aim of the research, as presented in section 1.3.3, was to develop a structured approach for the strategic positioning of an independent credit-providing enterprise, specialising in asset-backed short-term finance, which could assist in ensuring

success in the credit provisioning market. Existing literature contains not only conceptual and contextual background, but also information on asset-backed short-term finance, which is spread across commercial websites, magazine articles and court reports. This section synthesises relevant information to a coherent description of the industry, but also identifies aspects to be investigated empirically.

1.8.3.1 Regulatory requirements

The regulatory framework for private credit providers is determined by South African law on banks (Republic of South Africa, 1990), and the National Credit Act (Republic of South Africa, 2005, as amended by the National Credit Amendment Act, no. 19 of 2014 [RSA, 2014]).

In terms of the Banks Act (Act no. 94 of 1990), several categories of banks, as well as financial services co-operatives, may receive deposits from respectively the public and the members of these institutions. Private credit providers, who are not registered according to these requirements, may only fund their loans through equity and loan capital, as confirmed in the Supreme Court of Appeal by judges Ponnan and Majiedt (2011, pp. 19–20).

The goal of the National Credit Act, no. 34 of 2005 (RSA, 2005) has been mentioned in section 1.6.2.2 as creating a fair credit dispensation in South Africa. Section 3(e) of the Act states the need to address and correct imbalances in negotiating power between consumers and credit providers (National Credit Act, no. 34 2005 [RSA, 2005], as amended by the National Credit Amendment Act, no. 19 of 2014 [RSA, 2014]). This explains why section 4 of the Act excludes loans to borrowers whose asset value or annual turnover exceeds a periodically determined limit.

The above interpretation of the law was confirmed by the Supreme Court of Appeal (SCA) in the case of *African Dawn Property Finance 2 (Pty) Ltd v. Dreams Travel and Tours CC* (Ponnan & Majiedt, 2011). In this case, the latter, a juristic person owned by a wealthy business person, asked the court to set aside a loan from the former. The borrower argued that the loan was usurious and transgressed the National Credit Act of 2005. The application was rejected on the grounds that Dreams Travel and Tours CC was a juristic person whose asset value and annual turnover had exceeded the threshold determined by the Minister of Trade and Industry. The loan it received from

African Dawn was therefore not subject to the National Credit Act of 2004 (Ponnan & Majiedt, 2011, p. 11).

Independent providers of asset-backed short-term finance are therefore regulated according to the Bank Act of 1990, insofar as these credit providers are not allowed to pretend they are banks. They are also subject to the National Credit Act, no. 34 of 2005 in terms of registration, but free from sections designed to protect vulnerable consumers. More information on this topic is provided in section 4.5.

1.8.3.2 Target market

The target market for asset-backed short-term finance can be deduced from the term itself. ‘Asset-backed’ implies ownership of sufficient assets to back a loan. The relevant asset has to be free from preferred claims, or else the lender will not be able to take it in possession in case of default. ‘Short-term’ points to a repayment period of 12 months or less (Botha, 2009, p. 209–210). This implies the need to bridge a temporary cash-flow deficiency.

Possible scenarios in which an asset-backed short-term loan is attractive, are sketched on a commercial website of one provider (Beneficio Finance, 2012). All these scenarios point to a target market of active business persons. They can boast sufficient past success to have built up valuable assets, but are engaged in new projects, which, for some reason, experience cash-flow constraints.

Another provider’s commercial website (Paragon Lending, 2010) considers only real estate as collateral and only considers applications of R1,5 million or more.

It is clear that the target market of asset-backed short-term finance is asset-rich business persons with cash-flow constraints, which can be proved to be temporary.

The target market for asset-backed short-term finance is fully described in section 4.6.

1.8.3.3 Risk

In section 1.7.1.2.2, risk reduction as a principle for credit provisioning was discussed. Credit risk, political risk, systemic risk and operational risk were described briefly. The term ‘credit provider’ implies that credit risk is central. Effective management of credit risk is therefore a crucial operational requirement. In other words, **operational risk**, as discussed in 1.8.1.2.2 is as essential to a private provider of asset-backed short-

term finance as **credit risk**. As discussed, operational risk revolves around people, systems and external event (Young, 2014, p. 21),. In the following paragraphs, security risk, reputational risk and legal risk are discussed. These are crucial elements of operational risk for a private provider of asset-backed short-term finance, which were not discussed under risk as a principle for credit provisioning.

1.8.3.3.1 Security risk

Asset-backed short-term lenders limit their risk by demanding sufficient security. The associated security risk is managed by requiring a first bond to be registered in the lender's name and a maximum loan of 60% of the valuation of the asset (Paragon Lending, 2010). This increases the cost of default to the borrower and the probability that the lender will recover the full loan amount, and limits security risk as well as liquidity risk.

1.8.3.3.2 Reputational risk

Reputational risk is defined as a threat or danger to the good name or standing of a business or entity. This could occur –

- directly as a result of the actions of the company itself;
- indirectly due to the actions of an employee or employees; or
- tangentially through other peripheral parties, such as joint venture partners or suppliers (Investopedia, 2017). See in this regard also section 2.3.2.1.7 where different types of risk are discussed.

Reputational risk is exemplified in the Supreme Court of Appeal (SCA) judgement in the case of *African Dawn Property Finance 2 (Pty) Ltd v. Dreams Travel and Tours CC* (Ponnan & Majiedt, 2011). In this case, the owner of Dreams Travel and Tours CC argued that the lender demanded excessive interest and that the loan should be nullified on grounds of unethical lending practices (Ponnan & Majiedt, 2011, p. 4–6). In its finding, the court confirmed the legality of above-average interest for asset-backed short-term finance, taking risk and the usage of own funds into account (Ponnan & Majiedt, 2011, pp. 10–13).

1.8.3.3.3 Legal risk

Legal risk manifests in the case of African Dawn Property Finance 2 (Pty) Ltd v. Dreams Travel and Tours CC (Ponnan & Majiedt, 2011), Desert Star Trading v. No 11 Flamboyant Edleen (Ponnan, 2010), and Swart v. Beagles Run (Joubert, 2011).

The dispute settled in *Desert Star Trading v. No 11 Flamboyant Edleen*, arose when the providers of an asset-backed loan wanted to liquidate the customer on default of the loan. The application was dismissed on the grounds that certain aspects of the loan were disputed (Ponnan, 2010). In the case of *Swart v. Beagles Run* as discussed by Joubert (2011), the borrower in an asset-backed loan transaction attempted to delay payment by applying for business rescue. It was dismissed, as the lenders could indicate that the business could not realistically be rescued.

Risk in this industry is discussed in full in section 4.7.

1.8.3.4 Implementation

The implementation of a structured approach to the provision of asset-backed short-term finance is discussed in three sections: legal requirements, institutional requirements and operational requirements.

Implementation of asset-backed short-term finance is discussed fully in section 4.9 and also in 5.6.

1.8.3.4.1 Legal requirements

The section on legal requirements links closely with section 1.6.3.3.3 on legal risk.

Credit provisioning in South Africa is governed by the National Credit Act, no. 34 of 2005. In terms of section 14 of this Act, all credit providers (including credit bureaux and debt counsellors) must register with the newly established NCR. This includes providers of asset-backed short-term finance.

Another legal requirement for providers of asset-backed short-term finance resides in the Financial Intelligence Centre (FIC). The FIC requires information on the identity of customers of all financial service providers in order to combat fraud and money laundering (FIC, 2013).

As indicated in section 1.6.3.3.3, the purpose of the National Credit Act (no. 34 of 2005) is to protect consumers against an inherently imbalanced relationship between

lenders and borrowers. This imbalance, however, does not apply to the target market of asset-backed short-term finance, as described in section 1.6.3.2. Therefore, in terms of section 4 of the Act, the protective sections of the Act do not apply to juristic persons with a turnover above a threshold determined by the Minister of Trade and Industry. Referring to section 1.6.3.2, the target market for asset-backed short-term finance is excluded from these protective sections.

The said legal requirements and exemptions must be read in the context of South African commercial law. Therefore a dependable law team is indispensable to a provider of asset-backed short-term finance.

The legal framework for asset-backed short-term finance is the topic of section 5.2.1.2.

1.8.3.4.2 Institutional requirements

Section 7 of the Companies Act (no. 71 of 2008) states that companies are created to facilitate economic growth and development, inter alia through encouraging entrepreneurship, efficiency and good governance. However, the NCR states that a credit provider is not compelled to register as a company (NCR, 2011).

Minimum institutional requirements should adhere to all legal requirements mentioned in section 1.6.3.4.1. Private providers of asset-backed short-term finance should regard company registration as an institutional requirement for the reasons mentioned in the Companies Act of 2008.

Institutional requirements for this industry is also discussed in section 5.2.1.2

1.8.3.4.3 Operational requirements

Operational requirements require that all legal and institutional requirements be met. This implies a sufficient administrative infrastructure. The infrastructure should have the added ability to follow up payments and deal with defaults.

The literature review is concluded with the section on asset-backed short-term finance as a financial industry. Following that, the focus shifts to the research design, research methods and data analysis. The empirical investigation and remarks on the original contribution of the study follows.

Operational requirements are discussed in section 4.9, as well as in 5.3, 5.4 and 5.5.

1.9 RESEARCH DESIGN, STRATEGY, DATA COLLECTION METHODS, DATA ANALYSIS AND RESEARCH ETHICS

The literature review (section 1.6.1.2.5) supports the notion that the business environment consists of competing 'ecosystems', each internally engaged in dynamic co-operation between co-evolving business entities (Moore, 2006; Koenig, 2013). The purpose of the empirical investigation was to develop a structured approach for the strategic positioning of a private credit-providing enterprise, specialising in asset-backed short-term finance, which could assist in ensuring success in the credit provisioning market.

1.9.1 Research design

The present research is exclusively quantitative, using a Best-Worst Scaling questionnaire for customers and potential customers of asset-backed short-term finance and a Likert-scale questionnaire for providers of asset-backed short-term finance. is the most important instrument in a quantitative investigation. The underlying theory and skills needed to design a questionnaire, which reaches the predetermined aim is discussed by Stone (1993), Williams (2003), Viera and Garret (2005) and Saunders, Lewis, and Thornhill (2012).

Two surveys were necessary to meet the research objectives (identified in section 1.5.3), as the perspectives of both customers and providers of asset-backed short-term finance are required. Respondents had to prove or disprove suggested reasons for using this industry, as well as point out the relevant risks for providers, identified in the literature review (Chapters 2, 3 and 4). The information to be obtained from each group was fundamentally different, leading to the need for different surveys.

1.9.2 Research strategy

The researcher contracted a professional market research company, which also serve academic research needs, to conduct the empirical research (Schreuder, 2017). The two questionnaires mentioned in section 1.9.1 was prepared by the researcher and delivered to the mentioned market research company. The researcher contributed to the training of consultants by presenting the background of the study to them.

The market research company invited potential respondents to take part in the survey, by either personal interview, telephonic interview or filling out an electronic form. The researcher received prepared results and analysed it in order to reach conclusions.

In the first survey, customers of asset-backed short-term finance were stratified according to loan size, to reflect the number of lenders in different categories, as follows:

Table 1.3: Number of respondents according to loan amounts

Loan amount	Number of respondents
R10 000 001 and more	3
R5 000 001 – R10 000 000	3
R2 500 001 – R5 000 000	4
R1 000 001 – R2 500 000	10
R500 001 – R1 000 000	15
R500 000 or less	25

Table devised by author

In the second survey, respondents were not stratified.

Although two surveys were conducted among two different groups of respondents, the research strategy remained the same.

1.9.3 Data collection methods

Best-worst scaling and Likert-scale questionnaires were used for data collection.

The selection of Best-Worst Scaling as a form of conjoint analysis (Louviere, Street, Burgess, Wasi, Islam & Marley, 2008), was informed by the specific nature of customers' choices. It is described in section 6.2.4.2.5 that, together with several co-workers, Louviere, has developed Best–Worst Scaling (BWS) questionnaires since 1991 (Louviere et al., 2008), which confronts customers with a number of possible items (called 'utilities') of which the most preferred and least preferred have to be indicated. These are repeated until all utilities have been compared to all others. This enables the researcher to put all the utilities in order from most to least preferred, without requesting respondents to deal with more than four items at a time (Louviere, Lings, Islam, Gudergan, & Flynn, 2013). This is discussed in section 5.2.4.2.4.

A simple Likert-scale questionnaire is suitable to obtain the information required from providers of asset-backed short-term finance; it is concerned with the nature of their enterprises and the ways in which they deal with risks.

The universe of asset-backed short-term credit providers is small (Bridging Finance Association of South Africa [BFASA], 2015) resulting in an attempt to present the survey to all relevant enterprises which could be reached. Only six respondents were prepared to contribute to this study.

Data was collected from the two different groups of respondents with two different methods.

1.9.4 Data analysis

Data collected by Best-Worst Scaling was analysed by determining frequency counts determined across scenarios to provide summary estimates of the best and worst selections for participants. A marginal level analysis followed, estimated by weighted least squares (WLS), which uses the log of the adjusted frequency of best–worst counts for each attribute level as the outcome. In order to avoid a saturated model, one attribute is used as a reference case. This is the attribute which is found to have the least utility. This marginal analysis, using WLS, is an approximation to an individual level analysis using conditional logit regression. This is discussed in section 6.4.1.9.

Data collected by the simple Likert-scale questionnaire was analysed by descriptive statistics. This method involve frequency description, which indicates how many valid responses there were for each question in a survey, according to each option. Percentages of all responses are given, as well as percentages of valid responses. This information can be presented by way of histograms, bar charts and pie charts and is regarded as transparent and unproblematic.

1.9.5 Research ethics

Research ethics is fundamental to any research project. In this study confidentiality is the main ethical concern, because respondents are requested to provide sensitive information. The level of confidentiality is enhanced by using a third party for data collection. As such, the researcher himself has no access to the sensitive information.

Preparation of the study included a review of the research proposal by the *Finance, risk management and banking research ethics review committee* of the University of

South Africa (Unisa). A decision named *Ethics approval* was received on 2 March 2016, and is included as Appendix 1.

1.10 SUMMARY

In this chapter, the concept of and background to asset-backed short-term finance was discussed. The research question and aim pertaining to strategic positioning of asset-backed short-term finance were outlined, followed by an explanation of the importance and benefits of the study. This research is deemed important from the perspective of the South African economy, but it is also of importance to academics, direct stakeholders and indirect stakeholders. Limitations, delimitations and assumptions were discussed before reviewing relevant literature. The literature review investigated available knowledge on the concept of credit provisioning, a South African perspective on credit provisioning, and asset-backed short-term finance as a service within the financial sector. This is followed by a discussion of the research design, methods and data analysis as applied in this study.

1.10.1 Layout of chapters

The chapter layout is as follows:

Part A: Introduction

Chapter 1: Introduction. Consists of a background to the study and the purpose in terms of objectives and sub-objectives.

Part B: Literature review

Chapter 2: The concept of credit provisioning. This chapter entails a detailed literature review on credit provisioning, which is seen as the underlying concept regarding asset-backed finance.

Chapter 3: A South African perspective on credit provisioning. This chapter consists of the current approach to credit provisioning in South Africa.

Chapter 4: Asset-backed short-term finance. This chapter reflects a structured approach to asset-backed finance as an integral part of the financial sector that could add value to positive growth of the economy.

Part C: Empirical investigation

Chapter 5: Research methodology. This chapter provides the theoretical background to the research process. It presents an evaluation of the most appropriate sampling method and confirms the implementation of a research design that enhanced the accuracy and dependability of the results obtained from the research process. This chapter also reflects the statistical results achieved from the application of the appropriate analysis methods and procedures on the data obtained per individual question as presented in the assessment instrument. Conclusions are made on the results achieved and, where applicable, these conclusions are linked to the theoretical findings in earlier chapters.

Chapter 6: Empirical findings: This chapter presents the findings from the previous chapters and the importance of each conclusion in the development of the proposed structured approach to asset-backed finance as a prospering business.

Chapter 7: Conclusion and recommendations. The research study is summarised and conclusions are drawn based on the results from the findings of the empirical research to provide a structured approach to asset-backed finance as a service within the financial sector.

1.10.2 Conclusion

In this study, a literature review indicated that banks, locally and globally, are obliged by regulation and the use of information technology, to rely less on human judgement and more on programmed decision-making when evaluating loan applications. This leads to time-consuming processes with non-standard loan applications and a loss of opportunities for business persons. Asset-backed short-term finance is a market response to this tendency. Due to the emerging nature of this industry, no previous academic description of or investigation into this industry could be found – a gap in academic literature, which this study aimed to fill. The industry is positioned strategically in relation to banks by focusing on functionality for urgent non-standard loan applications (period between application and decision, and access to decision-makers) as value proposition, where banks are found lacking. Relatively high interest rates form the profit proposition, as firms in this industry have limited access to funds. Collateral is central as a risk-mitigating strategy, as part of the profit proposition. The people proposition is essential, as the industry is distinguished by individualised decision-making. A survey among customers of this industry identified four clusters of

potential customers: The first had no needs unfulfilled by banks, while the other three clusters were attracted by either functionality, or the evaluation of collateral in contrast to repayment ability, or a combination of the two. A survey among providers revealed hesitance to supply information and a low level of agreement on strategic matters – possibly due to the emergent nature of the industry. It is asserted that the basis for further study is laid.

In the next chapter, the concept of credit provisioning in the modern monetary economy is investigated in terms of the phenomenon of credit and principles for credit provisioning.

PART B: LITERATURE REVIEW

CHAPTER 2

THE CONCEPT OF CREDIT IN THE MODERN MONETARY ECONOMY

2.1 INTRODUCTION

In Chapter 1 the concept of asset-backed short-term finance and the intention of this study to contribute to the relevant body of knowledge were explained. The following three chapters will present a review of current knowledge on the concept of credit in the modern monetary economy, credit provisioning in South Africa, and provisioning of asset-backed short-term credit as a financial industry.

This chapter, dealing with the concept of credit in the modern monetary economy, is focused on the phenomenon of credit and principles for credit provisioning.

Credit is discussed by defining basic terms in the study of credit and highlighting the distinct principles of credit in traditional and modern economies, which are adequate information, risk reduction, regulation, customer relations, and competition.

The chapter concludes by indicating the relevance of its contents to the theme of the dissertation.

2.2 THE PHENOMENON OF CREDIT

Credit is a phenomenon as old as humankind, yet modern. In this section, basic terms in the study of credit are discussed, followed by the nature of credit in traditional societies. The nature of credit in modern monetary economies is discussed, taking into account finance as a scientific discipline, classification of loans, the role of banks, and globalisation of trade and credit.

2.2.1 Basic terms in the study of credit

The most fundamental term in this study is credit. **Credit** means to enter into a contract, according to which a lender enables a borrower to receive something valuable immediately, but paying for it later. Normally, interest is paid to compensate the lender (Investopedia, 2017; investorwords.com., 2017).

Financialisation of the economy is defined as the increasing role of financial motives, financial markets, financial sectors and financial institutions in the operating of domestic and international economies. This causes the financial system both to expand and become increasingly fragile (Esterhuysen, Van Vuuren & Styger, 2011).

Financial systems can be investigated at the following levels: global, regional or firm-specific. The **financial system** of the firm is the set of implemented procedures that track the financial activities of the company; on a regional scale, the financial system is the system that enables lenders and borrowers to exchange funds (Investopedia, 2017).

The scientific discipline of finance investigates financial systems, usually in one of three categories: public finance, corporate finance and personal finance (Investopedia, 2017). The provisioning of asset-backed short-term finance to juristic persons as discussed in Chapter 1 is a topic in corporate finance.

Different views on finance are discussed in section 2.2.2 in terms of traditional economies, and in section 2.2.3 in terms of the nature of credit in modern economies.

2.2.2 The nature of credit in traditional economies

Discussing credit in traditional economies as part of this study, serves to put credit provisioning in its context as a basic economic activity. The fact that credit has been a formalised economic activity, even before the modern monetary economy (as indicated in this section), is an important aspect in expounding the phenomenon of credit.

It can be stated without risk of contradiction, that disaster is part of the human condition (Ferris, 2010, p. 1). Therefore humans emerge from prehistory not as individuals but as communities of interdependent individuals. There is no evidence of an ethnic group where economic activity was conducted in an unorganised, individual way. Co-operation is a central theme, as much as private ownership (Potgieter, 1977, pp. 104–105).

While money was unknown in primitive cultures, the concept of value could be divided in practical, social and ceremonial value; to be in a position to extend a helping hand to someone else who was struck by disaster, enhanced one's social position. In addition, assistance given would constitute a claim for assistance when needed (Potgieter, 1977, pp. 111–112).

An example is traditional African societies where a chief acquired cattle by way of fines, taxes and ceremonial gifts. These cattle were not personal property, but a 'bank' for the whole tribe. Apart from the chief's obligation to be generous and hospitable,

tribesmen hit by disaster could depend on the chief to loan cattle until their own herds were replenished. Subjects established a claim on assistance when needed, by honouring the expectation of compulsory gifts of cattle (Potgieter, 1977, pp. 115–125).

In ancient Israel, interest on loans was explicitly forbidden. In Leviticus 25, it is stated clearly that land could only be sold for the period to the next jubilee, when all land should fall back to the original owners or their heirs. In verse 36, it is decreed that money may under no circumstances be lent on interest to a fellow Israelite. The prohibition of interest (usury) was confirmed by Jesus in Luke 6:35.

In Biblical times, the economy was based on natural resources, especially land and the yield of land. That is why Leviticus 25 explains that land is never sold, only the harvests until the next jubilee. In such circumstances people were also prohibited from 'coveting' (the tenth commandment, given in Exodus 20) from desiring an excess of possessions. This economic thinking excluded the possibility of inflation.

The prohibition of coveting and interest were two sides of the same decree. If one did not borrow money to acquire excessive possessions, and worked hard as expected, the necessity for lending would only present itself following a disaster. It would be evil to profit from a fellow Israelite's misfortune.

Jesus' confirmation of the prohibition of usury led the Roman Catholic Church to forbid all credit at interest. This was qualified in such a way, however, to permit the Church itself to lend at interest (Rothbard, 2010). None of the prohibitions forbade Jews to lend money to gentiles. This meant that in presenting relationships between Jews and Christians in Mediaeval Europe, Jews are invariably portrayed as moneylenders (Roth, 2003).

According to Rothbard (2010) the Reformation of the sixteenth century was part of a broad cultural revolution in Europe, which led to a commercialised monetary economy. An important aspect of this revolution was the French/Swiss reformer, John Calvin, who repealed the prohibition on usury. According to him, money was not sterile and it came to life when used to create profit. There could be no profit in lending without interest. In time, European thought conformed to this Calvinist view (Rothbard, 2010). Indeed, the pioneer-sociologist, Max Weber, contended that the religious asceticism and emphasis on the spiritual value of hard work preached by Calvin, led to the secular work ethics of capitalism (Weber, 1905).

The dawn of modern economy is described by Kagan, Ozment, and Turner (1987, pp. 563–564) as follows:

The commercial spirit and values of the marketplace clashed with the traditional values and practices of the peasants and the guilds. The desire to make money and accumulate profits was hardly new, but beginning in the eighteenth century, it was permitted fuller play than ever before in European history.

The historical overview presented above, serves to highlight both continuous and discontinuous aspects of credit. Continuity is created by noticing that humans, in all historic periods, periodically needed something of value immediately, although being unable to provide the necessary compensation simultaneously. However, credit as a commercial pursuit in itself is a modern phenomenon, closely associated with the acceptance of desire as not being a vice, but a driver of economic growth. This historic supplies context to describing the nature of credit in modern monetary economies, as discussed in section 2.2.3.

2.2.3 The nature of credit in modern monetary economies

As indicated in section 2.2.2, in modern monetary economies, credit is fundamentally different from credit in traditional economies, the reason being that, in a modern monetary economy, the desire to maximise profit for private use is regarded as legitimate and ethical (Kagan et. al., 1987, pp. 563–564).

The discussion on the nature of credit in modern monetary economies commences by describing finance as an academic discipline, moving to classification of loans and the dominating role of banks in credit provisioning, before the effect of globalisation of trade and credit on credit provisioning is highlighted. However, even as credit is advanced in order to make profit, there is still a social contract in this regard. In times of financial distress (such as the crisis of 2007/08 and its aftermath), governments invest in the financial viability of large banks to ensure the continuous supply of credit to citizens. There is evidence that the largest banks (who also receive the highest state investment) disregard this social contract, which is a reason for fundamental rethinking of the financial system (Baradaran, 2013, pp. 1283–1286).

This section was devoted to explaining the nature of credit in modern economies in order to identify the niche for private providers of asset-backed short-term finance.

2.2.3.1 Finance as a scientific discipline

Merton Miller (a Nobel laureate in Economy for his lifelong contribution to Finance) (Miller, 1991) assisted to lay the foundations for Finance in the 1950s (Miller, 1999, p. 95). He states that Finance deals with:

- the cost of capital;
- the funds a firm should use to acquire assets in a world where:
    - the yields of those assets are uncertain; and
    - capital sources can range from pure debt to full equity (Modigliani & Miller, 1958, p, 261).

A more recent definition adds the investment of surplus funds and the sub-disciplines of private finance, corporate finance and public finance, focusing on respectively individuals, businesses and governments (Investopedia, 2017).

In 1958, Miller and Franco Modigliani, his colleague at the Carnegie Institute of Technology (currently Carnegie Mellon University), contributed the so-called Irrelevance Theory to the study of Finance, also called the Modigliani–Miller theorem; the essence of this theorem is that, in a perfect market, the source of finance is irrelevant (Modigliani & Miller, 1958). In reality, according to Villamil, 2013, p. 2) only non-perfect markets exist, but it remains valid that the value of a firm is determined by the income stream it generates, and not by its capital structure.

In order to retain the largest possible portion of a firm's income stream (either to reinvest or to appropriate), the irrelevancy theory (Modigliani & Miller, 1958) predicts that credit would be the capital source of choice, as it does not dilute ownership. The following citations confirm this prediction:

- Denis and Mihov (2003) found that corporations in the United States of America overwhelmingly preferred credit to equity for external capital needs. They also found that companies with a high credit value prefer public borrowing, intermediate ones prefer banks and low credit-quality firms prefer non-bank borrowing.
- According to Alexander (2013), corporate credit in Europe gradually follows the American example of preferring public borrowing to bank loans.

The overview of finance draws attention to credit, as the preferred form of finance. In the next section, loans are classified.

2.2.3.2 Classification of loans

Loans may be classified according to different criteria. This section explains the distinction between secured and unsecured lending, which was relevant to this study. The assumption that secured loans are per definition ‘safe loans’ is disproved.

Unsecured loans refer to a form of consumer lending, which the Federal Reserve Bank of Atlanta (2013) recommends should only be advanced to borrowers with an adequate net worth and ample liquidity. The Bank further recommends that unsecured debt should not exceed 1.5 times an applicant’s monthly net income, be limited to less than 10% of a borrower’s net worth, or 50% of the borrower’s unencumbered liquid assets, with terms limited to 12–18 months (Federal Reserve Bank of Atlanta, 2013, pp. 1–2).

Secured loans refer to any loan where an asset is offered as guarantee. In addition to mortgages on property, Song (2003) identifies pledges on deposits, inventory and equipment, as well as guarantees or ‘letters of comfort’ issued by the state, banks or other reputable institutions, where the value of security depends on its inherent quality, or the integrity of the guarantor.

Ibanez and Scheicher (2010) describe how, since the late 1950s, banks had started to securitise and sell household mortgages to investors. This gradually extending practice greatly accelerated after 2000. The incentives for originators of loans differed from those responsible for collecting payments, resulting in more risk-prone loans being created and ultimately the credit crisis of 2007/08 (Brunnermeier, 2008, p. 2; Ibanez & Scheicher, 2010). While both Ibanez and Scheicher (2010) and Brunnermeier (2008) write from an American perspective, García-Herrero, Lis, and Santiago (2008) add a wider perspective by discussing the similar nature of the preceding Spanish housing boom and subsequent bust, which resulted in secured loans, which could not be redeemed.

The preceding section illustrated that both secured and unsecured lending require thorough investigation. In unsecured lending, borrowers have to be investigated individually, and in secured lending, this applies to the security offered, while the value

of security depends on the quality of the underlying asset. Providers of asset-backed lending need to be aware of the fundamental requirements of exercising due diligence regarding the assets, which back their loans.

The primary focus of this study was private provisioning of asset-backed credit. These entrepreneurs operate in an environment currently dominated by banks, as indicated in section 2.2.3.1. Therefore, it was imperative to study the role of banks, as is reflected in section 2.2.3.3.

2.2.3.3 The role and income of banks

Banks have several roles to play in the functioning of financial systems.

Allen and Carletti (2010) state that, together with stock markets and bonds issued by the state and private firms, banks form the financial system. Banks share risk by diversifying and smoothing out fluctuations, although they can also be at the centre of financial crises and can help to spread the risk. In certain economies, bank officials have positions on other firm's boards, which enable them to influence corporate governance. Banks help the economy to grow by supplying funds to firms, and they help overcome asymmetric information problems by forming long-term relationships with firms (Allen and Carletti, 2010).

Strahan (2010) sees the supply of liquidity to firms as the most important function of banks, which they perform by transforming liquid deposits into illiquid loans (Strahan, 2010). This ability, which can be described as pretending that long-term loans are safely covered by short-term deposits, is what King (2016, p. 96) describes as the "alchemy of banking", in other words, the ability to create gold from less valuable materials – an ability which King believes contributes significantly to the recurrence of banking crises.

Banks are also entities that act as the mediators between two parties in a financial transaction (Investopedia, 2017). Therefore, Choudry (2011, pp. 3–4) identifies the three income streams of banks, each related to a specific function (see section 2.2.3.4). These are interest income on lending activities, fees and commissions as a result of services, which are provided to customers, and trading income, which is generated through participation in financial markets.

Accusations of excessive fees are made in the United States and the United Kingdom (Treanor, 2016; US Treasury, 2016), as shown in this paragraph. Regulatory authorities in the United Kingdom investigate ways to remove barriers from shifting bank accounts from the 'Big Four banks' (HSBC [Hong Kong and Shanghai Banking Corporation], Royal Bank of Scotland, Lloyds Bank Group and Barclays) to smaller banks, as these banks reportedly use exit barriers to trap consumers in accounts with excessive costs (Treanor, 2016). British regulatory authorities investigate claims that punitive charges for unplanned overdrafts (four times as costly as 'payday loans') burden vulnerable customers with excessive costs (Jones, 2016). In an advisory note to consumers, the treasury of the United States warned consumers to be aware of all charges and not to hesitate to switch between banks when excessive costs are charged (US Treasury, 2016). This is discussed in South African terms in section 3.2.3.3, also in relation to the present study.

2.2.3.4 The role of information and computer technology in banking

Domination by banks is partly retained by their being an adaptive industry, mainly driven by information and computer technology (ICT). In 1986, on the eve of the ICT explosion, Schmenner predicted fundamental changes in banking, resulting from the implementation of ICT. His prediction was that service companies, including banks, would have to choose between being 'service factories' or 'service shops'. Service factories would have low interaction with customers. ICT would enable companies to produce standardised services on a large scale. Service shops, on the other hand, would be labour-intensive, meaningfully engaging with customers on the detail of their businesses (Schmenner, 1986). In 2013, the accuracy of Schmenner's prediction was confirmed by Tinnilä. Some important results of the shift to ICT are discussed in the paragraphs that follow.

Riddiough (1997) explains how ICT enabled loan brokers to originate loans, pool these loans and then divide it into 'packaged' securities to be resold to investors.[2] This

[2] Riddiough (1997) refers to this kind of loan as 'asset-backed lending'. It is important to distinguish between this concept and asset-backed lending as outlined in Chapter 1. The essential difference is that the detail of a loan and the asset backing it is central to the definition in this study, while Riddiough describes the opposite, where the detail gets lost when loans are pooled.

innovation facilitated large capital mobilisation, but also led to a decline in lending standards, and ultimately the 2007/08 credit crisis (Brunnermeier, 2008, p. 2).

According to Gary Palmer, owner of Paragon Lending, as broadcast by CNBC Africa, use of ICT resulted in banks shifting their focus from secured to unsecured lending, based on consumer spending. Prospective borrowers were screened on monthly income and credit record, which credit bureaux verified by means of ICT (CNBC Africa, 2013).

The use of ICT in banks adds to operational risk, as new ways of defrauding customers are created. This is discussed in section 2.3.2.1.8.

The discussion above indicates that banks still have a dominating role in the credit industry, despite the challenges created by regulation and new competitors. The use of ICT resulted in the ability to process more credit agreements, but with less attention to detail. Emphasis on loan criteria shifted from security to credit record. Relevant to this study, was the emergence of small-scale credit providers, willing to investigate the detail of a security before reaching a loan decision. In the next section, the effect of globalised trade and credit on the nature of credit in modern, monetary economies is discussed.

2.2.3.5 Globalisation of trade and credit and the effect of financial crises

Credit is part of the global financial system. Economic prosperity and crises alike could have grave consequences in countries far from the source of either prosperity or crisis. Globalisation involves the social, cultural and economic spheres of life (Saloojee, 2014). However, only its effect on trade and credit was directly relevant to this study.

Globalisation is a term, which old neutrally refer to a process of progressive interaction between people from different parts of the world, which can be traced back to the empires of Greece and Rome. However, it also refers less neutrally to a process in which Western civilisation has been extending its domination globally. More recently, the so-called “Washington Consensus” in the 1980s brought accelerated globalisation by decreasing the role of the state in the economy and the tearing down of national borders, forming ever-increasing markets. This “neo-liberal globalisation” is criticised for marginalising working class people in industrialised countries as well as developing countries, in order to benefit the elites in industrialised countries (Saloojee, 2014).

Brogan (1988, pp. 528–530) asserts that the general public only took notice of the global interconnectedness of trade and credit with the Great Depression starting in 1929. As the United States was the only solidly prosperous state after World War I, it supplied credit to the rest of the industrialised world. When economic disaster struck the United States in 1929, it instantly spread to all industrialised countries and commodity supplying regions (Brogan, 1988, pp. 528–530).

In the aftermath of World War II, economic devastation was so intense that globally co-ordinated reconstruction was necessary (Crafts & Toniolo, 1996). Just as post-war reconstruction seemed complete, the energy crisis of 1973–1974 occurred. In the winter of 1973–1974, the German Federal Republic imported the highest volume of oil in its history (Kepplinger & Roth, 1979). Nevertheless, the mass media were warning that an energy shortage might occur, whereupon the population became nervous and bought more crude oil products than ever before. As a consequence, short-term difficulties of supply from industrial producers seemed to confirm the warnings (Kepplinger & Roth, 1979).

In the context of recurring international crises, which inevitably seemed to be systemic, the importance of multi-national economic blocs increased. For instance, the Group of Ten (G-10) wealthiest member nations of the International Monetary Fund (IMF) often had to stand ready to lend, in order to prevent economic collapse somewhere in the world, which might prove to be globally contagious (Business dictionary, 2014).

The credit crisis of 2007–2008 demonstrated how the world's growing dependence on oil had created a repeating pattern of banking, currency and energy-price crises. El-Gamal and Jaffe (2009) created a complex picture in which transfers of wealth to and from the Middle East resulted in a perfect storm of global asset and financial market bubbles,[3] increased unrest, terrorism and geopolitical conflicts, and eventually rising costs of energy. They contend that only by addressing long-term energy policy challenges in the West, economic development challenges in the Middle East, and the

[3] A financial bubble occurs when an economic cycle, equity prices, and/or the price of any kind of security, increases above the underlying value it represents. This is followed by a sudden decrease in prices, or market correction (Investopedia, 2015).

investment horizons of financial market players, can policymakers ameliorate the forces that have been causing repeating global economic crises (El-Gamal & Jaffe, 2009).

Another interpretation of the financial crisis in 2007–2009 is that it is “a symptom of another, deeper, systemic crises of capitalism itself” (Esterhuysen et al., 2011, p. 271). The ongoing decrease in the gross domestic product (GDP) rates in the West since the early 1970s created growing surplus capital that did not have sufficient profitable investment outlets in the real economy. The alternative was to place this surplus into the financial market, which became more profitable than productive capital investment, especially with subsequent deregulation. This phenomenon has led to recurrent financial bubbles (such as the Internet bubble of the early 2000s, and it is believed to be a deep cause of the financial crisis of 2007–2010 (Esterhuysen et al., 2011, p. 271).

This sub-section reflects the conclusion that the assets taken as security by asset-backed credit providers could decrease in value, due to international events. Even a private credit provider cannot ignore the global context in which it operates.

The section on the nature of credit in modern monetary economies reflected a discussion on finance as a scientific discipline in the modern monetary economy, as well as the classification of loans, the role of banks and the effect of an increasing globalising system of trade and credit. The present study presents a topic in the discipline of Corporate Finance, specifically regarding secured loans with a maturation time of at most twelve months (see Chapter 1). Banks still have a dominating role in the credit market, but ICT contributes to a trend towards larger-scale operations, with less emphasis on loans requiring detailed evaluation. This opens a niche for private credit providers, especially for liquidity-constrained, high net-worth customers. Although evaluation of the assets offered for security is paramount, global trends need to be taken into account, to prevent disastrous devaluation of said security.

2.3 INFORMATION AND RISK IN CREDIT PROVISIONING

The next section is devoted to the importance of, and control over information and risk in credit provisioning.

2.3.1 Adequate information

Heffernan (2013b) and Hughes and Mester (2010) contend that the intermediary role of banks survives because banks have easy access to the information which might determine the risk associated with a specific loan. Bernanke and Blinder (1988, p. 1) add that banks and other credit-granting institutions specialise in gathering information and monitoring the performance of borrowers in ways that elude the anonymous auction market. Although banks have, according to Bernanke and Blinder (1988, p. 1) a comparative advantage to private credit providers regarding access to information, imperfect information is an inevitable part of any credit agreement.

Song (2002, p. 5) opines that adequate information is central, even when collateral is offered, and that adequate information is also needed on the collateral itself. Liquid collateral is dependent on sufficient information on its condition, location, liquidity and marketability. In verifying documentation for collateral, the registration of security should be confirmed for the security agreement to be enforceable (Song, 2002, p. 5). The opinion of Bester (1987) is that lenders mainly regard collateral as an incentive for the borrower to honour the agreement. As such, the borrower's desire to retain the collateral, balances the risk of imperfect information.

Pitta et al. (2006, pp. 421–422) consider the potential of ICT to restore informational imbalances. Despite their positive opinion on ICT, they conclude that it is not a substitute for personal knowledge and experience with prospective lenders. Pretorius and Shaw (2004) conclude that the scarcity of people with the knowledge and ability to judge character, forced banks to abandon the role of the local bank manager. All applications are judged by ICT, which means credit record and assets are supreme, with business plans only being evaluated when these are sufficient. In fact, Brunnermeier (2008, p. 2) concludes that the separation between personal knowledge and technologically driven information played a role in the credit crisis of 2007–2008. This confirms an earlier conclusion (see the second last paragraph of section 2.2.3.4) that credit providers with the ability to investigate the detail of credit applications, have an important role to play in credit provisioning.

Coval, Jurek, and Stafford (2009) analysed how mortgage loans of different qualities were 'pooled and tranched' so that loans were backed by assets, but information on the specific assets was lost. This form of inadequate information is called asset-

backed commercial paper, the inadequacy of which Acharya and Schnabl (2010) regard as central to the 2007–2008 credit crisis. Berger, Molyneux, and Wilson (2010) accuse the creation of 'structured investment vehicles' (SIVs) of being a mechanism to hide information, especially when mortgages are 'pooled and tranched'.

At the centre of acquiring adequate information is the information technology (IT) system of the bank. The purpose of an IT system is to collect, transmit, process and store data on the resources, programmes and accomplishments of an organisation, and to present it in a form which enhances decision-making (Babu, Sing, & Sachdeva, 1998). Vos and Matthee (2011) found that information systems are often problematised by the introduction of new systems that enhance efficiency. 'Legacy systems' (those in use for several years), however, have to be retained, as they contain irreplaceable expertise (Vos & Matthee, 2011). Udell (2008) also mentions 'soft' information on the way a firm deals with suppliers and customers, which cannot be transmitted through the bureaucracy of a large bank. This paragraph therefore indicates that an information system is more complex than acquiring appropriate computer hardware and software. Different generations of software, as well as the knowledge of employees, are all part of an efficient information system.

Adequate information is a fundamental principle to the provisioning of credit. Information on the borrower's income stream is imperative with unsecured lending, while information on the security offered is imperative with asset-backed lending. In addition, ICT facilitated the creation of new lending practices, which are asset-backed, but does not link a specific lender to a specific borrower (i.e. asset-backed commercial paper). The indispensability of ICT to any credit provider cannot be questioned. However, when a timely decision is essential, where the owner/manager's personal knowledge and experience form an important part of the information system, a private credit provider has an advantage over corporate credit providers where several sources of information need to be consulted.

Adequate information as a principle for credit provisioning has been discussed. In section 2.3.2, the topic is risk.

2.3.2 Risk management

One of the major tasks of a bank is to share in their customers' risk in order to earn interest (Allen & Saunders, 2010). According to Docherty and Viort (2014, p. 48), all

economic activity will cease if risk has to be avoided completely. As every risk comprises exposure and uncertainty, risk analysis means to identify the unknown elements of each credit agreement and to determine the appropriate level of exposure (Holton, 2015).

In dealing with risk, credit providers have to measure risk, estimate a price for risk which takes surprises into account, decide which risks to take and which to avoid, monitor and mitigate the risk, and ultimately absorb the losses that are an inevitable by-product of a risk-taking enterprise (Docherty & Viort, 2014, p. 48). Therefore, risk management includes –

- **risk identification**: compiling a register of risks, using loss history (focusing on the past), as well as self-assessments and scenario sketching (focusing on the future); and
- **risk assessment** to identify key risk indicators (focusing on the present).

This culminates in a risk profile to suggest ways of risk mitigation and control (Young, 2015, pp. 882 & 888).

All risk management processes must be linked by effective, multidirectional communication, to ensure that each level of management and operation is equipped with appropriate information (Young, 2015, pp. 881–882).

Before the crisis of 2007–2008, some economists claimed that risk has been conquered by using sophisticated mathematical models to predict the financial future; however, in the real world, unforeseen circumstances do occur, which means that risk is as relevant as ever (King, 2016, pp. 124–127).

In the following sub-sections, the facets of risk identified for comprehensive analysis –market risk, credit risk, liquidity risk, political and legal risk, systemic risk, reputational risk, operational risk and strategic risk – are discussed.

2.3.2.1 Types of risk

The nine types of risk prevalent in the financial sector are discussed below.

2.3.2.1.1 Market risk

Chance, Grant, and Marsland (2007, p. 587) identify market risk, which is associated with interest rates, exchange rates, stock prices and commodity prices. Although these

aspects can be contemplated in isolation, they are unified by a common exposure to supply and demand. Docherty and Viort (2014, p. 121) draw attention to market risk as risk that arises when trading assets of a bank (those named by Chance et. al.) change in value, a pro-cyclical phenomenon discussed in more detail in section 2.3.3.3.4 on regulation and economic cycles.

Chance et al. (2007, p. 587) remark that, before the credit crisis of 2007–2008, “much of the evolution that had taken place in the field of risk management has emanated from a desire to understand and control market risks …”. Docherty and Viort (2014, p. 141) however assert that, after the crisis, methodologies for market risk assessment were inappropriate, an illusion of ‘low risk’ caused excessive risk-taking, which remained largely invisible until the crisis erupted. It can be stated that market risk is a remaining challenge in credit provisioning.

King (2016, pp. 140–145) points towards the role of derivative instruments in creating market risk. While these instruments are meant to ameliorate risk (for example, by fixing the exchange rate for a future transaction across currency borders), they can also introduce risk into the financial system. This happens when a derivative is used to generate an income in the present on the expectation of profit, which should (but might not) realise in future. In addition, when derivatives are created on derivatives, it is, according to King (2016, pp. 143-144) like two men playing chess for a bet of $10, but thousands of bankers each take a bet on the outcome of the game of chess. When this happens, derivatives introduce risk into the financial system rather than insuring against it. Warren Buffet is reported by King (2016, p. 143) to have called derivatives “weapons of mass destruction” in 2002. Although King recognises its usefulness, he points towards the potential for reckless speculation. According to Boyd (2015), in 2015 outstanding contracts were equal to eight times the world GDP, which was an indication of the magnitude of the risk these contracts posed at that stage.

Fees comprise another aspect of market risk. Regulatory requirements force banks to keep reserves in cash or in accounts with the central bank where little interest is earned. Banks compensate for this loss by increasing the fees charged to customers (Admati & Hellwig, 2014, pp. 92 & 172). While this trend has already drawn low-income consumers away from commercial banks, it is argued that more affluent consumers will not withdraw from banks altogether, but may consider alternatives for certain

services (The Economist, 2008). In section 3.2.3.3, the ramifications of this risk in terms of the South African financial sector are discussed.

2.3.2.1.2 Credit risk

Credit risk is defined as “the risk caused by a counterparty or debtor’s failure to make payment (Chance et al., 2007, p. 587). The three issues a credit provider has to take into account are default probability, credit exposure, and rate of recovery expected from bankruptcy proceedings (Holton, 2015).

Chance et al. (2007, p. 587–588) problematise their own definition of credit risk:

- the emergence of derivatives, or the trading of credit instruments, caused credit risk to increasingly resemble market risk; and
- the onset of the ‘over-the-counter’ (OTC) derivative market led to proliferation and increased complexity in credit markets, which has placed new demands on the understanding of credit risk. In addition, OTC derivatives contain no explicit guarantee.

In 2007, Chance et al. (p. 588) were confident that “significant progress in developing tools to measure and manage this risk” had been made. With the advantage of hindsight, Brunnermeier (2008, p. 2) states that risk increases when loans are originated by institutions which are not responsible for the collection of payments.

According to Holton (2015), credit providers attempt to predict the credit quality of an obligation (or the counterparty’s ability to perform on that obligation) by credit scoring and credit analysis. Credit scoring is an exclusively quantitative process taking the counterparty’s annual income, existing debts and similar factors into account, which are then processed and expressed as a number – the person’s credit score (Holton, 2015). This methodology is followed for individuals and small businesses. For larger institutional counterparties, however, the more comprehensive process of credit analysis is followed. Credit analysis involves internal and external information regarding the business, its industry and the wider economic environment (Holton, 2015).

Credit risk is one of the facets of risk to be revisited in Chapter 4 on the implementation of asset-backed short-term finance (see section 4.7.1).

2.3.2.1.3 Liquidity risk

Liquidity risk is the inverse of credit risk, as it is the risk that banks cannot meet their obligations towards depositors (Heffernan, 2013b, p. 1–2).

According to King (2016, pp. 149–151), there is a common illusion that markets will always be liquid, in other words, that there will always be money available to buy assets; however, each financial crisis is characterised by a temporary liquidity shortage. Choudry (2011, p. 244) asserts that during the entire history of modern banking, banks have never matched their asset maturity with their funding liability maturity, and have continuously needed to manage this gap, creating, in effect, liquidity risk (Choudry, 2011, p. 244).

A perception of pending liquidity risk leads to bank runs, while disproving the perception may end the run, as discussed below. Goldsmith-Pinkham and Yorulmazer (2010) refer to the fate of Northern Rock, one of the major United Kingdom banks affected by the credit crisis of 2007–2008. When information reached the market that the assets of the bank were under pressure, the first bank run since 1878 was witnessed in the United Kingdom. However, when the government announced that it would guarantee Northern Rock's deposits, the run was contained.

According to Choudry (2011, pp. 241–244), the banking crisis of 2007–2008 would have been prevented had banks adhered to the basic principles of containing liquidity risk, which had been common practice as little as ten to fifteen years before the crisis. These principles would have dealt with liquidity in a holistic way. Deposits should be preferred to wholesale funding, and long-term wholesale funding to short-term wholesale funding. Furthermore, banks should maintain liquidity buffers, establish liquidity contingency plans, which should include a ready knowledge of which facilities of central banks are accessible, and exhibit utmost caution when obligations are created by sponsoring a third party, as is the case with backing asset-backed commercial paper (Choudry, 2011, pp. 241-244).

2.3.2.1.4 Sovereign and political risk

"Sovereign risk is a form of credit risk in which the borrower is the government of a sovereign nation" is the short definition supplied by Chance et al. (2007, p. 594). these authors advise that, in addition to normal credit evaluation on financial grounds,

lenders must also take into account how willing the government is to honour its credit obligations, alternative means of financing, and other financial stability measures, such as currency devaluation. The global financial crisis following the Russian decision to default on international loans (see also 2.3.3.3.4) was reportedly the result of Russian unwillingness to pay, rather than its inability, which underlines the connected nature of political and sovereign risk (Chance et al., 2007, p. 595).

Crafts and Toniolo (1996) emphasise that political risk is beyond the control of individual banks, and that it has more than once forced reforms of the entire financial system. As a case in point, Kepplinger and Roth (1979) describe bank crises as a result of the energy crisis of 1973–1974, and El-Gamal and Jaffe (2009) provide an overview of the link between bank crises and oil crises (see section 2.2.3.4).

2.3.2.1.5 Legal risk

Chance et al. (2007, p. 592) regard legal risk as the possibility of loss arising from failure by the legal system to enforce a contract in which an enterprise has a financial stake, while Young (2014, p. 16) defines it as failure to operate within the constraints of law.

Legal risk is also directly linked to sovereign and political risk, as legislation is part of the political process. New legislation, regulating the rights and responsibilities of different parties in a financial transaction, can open or close opportunities in an industry. A South African example is the National Credit Act (no. 34 of 2005, which introduced new concepts to the law if the country, such as affordability, reckless lending and debt counselling (Logan, 2008, p. 3). The Act has an influence on all aspects of the consumer credit life cycle, affecting the role of attorneys in drafting and enforcing credit agreements, and debt collection procedures (Logan, 2008, p. 6). Legislation regarding ‘business rescue’ is another example, discussed in section 3.3 on credit management in South Africa.

Tax risk, although discussed as a separate risk by Chance et al. (2007, p. 593), could also be regarded as a form of legal risk. The origin tax risk is confusion and inconsistency in the application of tax laws in the market possibly resulting in losses which were not (and could not) be anticipated when a credit agreement was made (Elgood, Paroissien, & Quimby, 2004, p. 3).

This section emphasised the essential role of legal knowledge or assistance for any credit provider, as inadequate legal risk management could lead to losses or even unfavourable legal judgement.

2.3.2.1.6 Systemic risk

Systemic risk occurs when a crisis in one bank spreads across the whole banking system. This is the result of the increasing integration of the banking sector, meaning that banks have assets and liabilities with each other; therefore a crisis in one bank may affect the ability of all banks to meet their obligations (De Bandt et al., 2010). Eisenbeis had warned in 1995 that increasing volumes of international payments would intensify international repercussions of a possible crisis, as indeed happened in 2007–2008. As one of the main purposes of bank regulation is the containment of systemic risk, the topic will be revisited in section 2.3.3 on bank regulation.

2.3.2.1.7 Reputational risk

Reputational risk is a threat or danger to the good name or standing of a business or entity, which might occur directly as a result of the actions of the company itself or indirectly due to the actions of an employee or employees, or tangentially through other peripheral parties, such as joint venture partners or suppliers (Investopedia, 2017).

2.3.2.1.8 Operational risk

Operational risk is defined in section 1.8.3.3.2 as risk events due to the shortcomings of people, processes and systems within the firm itself (Young, 2015). The level of operational risk depends on strategic and management decisions internal to each business. Young (2014, p. 139) points to operational risk as an emerging study field, although one of the primary forms of risk. As indicated in section 1.7.3.3.2, operational risk started demanding attention when Barings Bank in the United Kingdom was forced to declare bankruptcy in 1995, following unauthorised trading by a senior official in Singapore (Kong, 2009).

Technology risk (the risk that the ICT system may fail) is part of operational risk (Härle, Havas, & Samandam, 2016). As such, technology risk is an increasing cost item with banks, as a breach in the integrity of customer information could cause permanent

harm to the reputation and performance of a bank (Bevan, Ganguly, Kaminski, & Rezek, 2016). One of the main reasons for concern is that banks use third-party vendors to provide essential elements of the ICT system (Bevan et. al., 2016). This risk is exacerbated by customers' insistence on faster and more cost-effective service. The use of more powerful information systems gleaning information from public spaces (such as social media) is envisaged as a way to ease banking from the customer perspective, but at the cost of increasing risk (Härle et al., 2016). For example, it was reported in 2017 that twenty customers of major South African commercial banks each lost between R1 million and R2 million as a result of Internet and SIM card fraud (Swanepoel & De Lange, 2017).

The above paragraphs indicate that each facet of risk requires specific attention. Laeven and Levine (2009) found that banks with equity holders highly involved in management decisions seem to suggest that the ability and authority to maintain a holistic view on risk increases risk appetite, or differently stated, a holistic view on risk creates confidence, which allows decision-makers to regard situations as less risky than they seem. In section 2.3.2.2 the degree to which collateral can mitigate risk, is discussed.

2.3.2.1.9 Strategic risk

Strategic risk, as indicated by the term itself, is the risk of harmful or sub-optimal strategic decisions. The main purpose of strategic risk management should be to influence the ability of firms to deal with risks that may affect long-term competitive advantage and corporate longevity (Sax, 2015, p. 4). Serafin (2013, p. 4) refers to the role of the business strategy and strategic objectives of an organisation. Bromiley, Rau, and McShane (2014, p. 6) emphasise the external role of macro-structural decisions which determine internal risk taking. They regard strategic decisions as different to other decisions, because once taken, strategic decisions determine the operational decisions that follow. Sax (2015, p. 13) identifies shifts in customer demands and competitor moves as additional risk exposures.

Perspectives on strategic risk vary with the discipline from which it is approached. According to Sax (2015, p. 193), the two relevant disciplines are strategic management and management accounting. These two disciplines are respectively associated with central thinking and enterprise-wide planning by top management

(criticised for resulting in rigid, bureaucratised operations), as opposed to middle managers who act on immediate risk events (criticised for resulting in incoherent operations). Both perspectives are valid and should result in top management-led planning, with sufficient input from middle management (Sax, 2015, p. 15).

Risk may be regarded as the possibility of negative events. Sax (2015, p. 11) emphasises, however, that strategic risk management should measure risk in terms of the probability of falling below (downside) or above (upside) performance aspirations.

It is stated in summary that strategic leadership entails steering a firm through an environment in which not all factors are known into an unpredictable future, strategic risk is an unavoidable part of conducting business. Whether part of a cognitive, scientifically oriented planning activity, or the result of intuitive decision-making, successful firms are those who read the current and future environment accurately, followed by appropriate decision-making.

This sub-section concludes the discussion of types of risk. The next section will reflect the role of collateral as tool in risk management.

2.3.2.2 Collateral as a tool in risk management

Collateral is defined as –

Property or other assets that a borrower offers a lender to secure a loan. If the borrower stops making the promised loan payments, the lender can seize the collateral to recoup its losses. Because collateral offers some security to the lender in case the borrower fails to pay back the loan, loans that are secured by collateral typically have lower interest rates than unsecured loans (Investopedia, 2017).

King (2016, pp. 269–272) regards collateral as the key to rebuilding a resilient financial system in the aftermath of the crisis of 2007–2008. According to him, central banks should conceptualise themselves not as “Lenders of Last Resort” but as “Pawnbrokers for all Seasons”. This means that commercial banks have to place collateral with the central bank, on which they can draw in case of a banking crisis. This measure is an extension of conditions already set on banks in the process of quantitative easing (see King, 2016) since 2008, in which central banks require claims on certain assets in order to supply liquidity (King, 2016, pp. 269–272).

While Song (2002, p. 3) emphasises the fact that collateral should not be a substitute for proper risk analysis, King (2016, p. 266) found that collateral liberates the lender from following every favourable and unfavourable complication in the business environment of the debtors, as credit is guaranteed by the collateral, irrespective of the profitability of the firms.

The views of Song (2002) and King (2016) are supplementary. Therefore Song's suggestions (2002, p. 7) remain valid, whichever perspective is emphasised:

- Collateral cannot be a substitute for comprehensive assessment of the borrower.
- Collateral should only be regarded as a secondary source of repayment in case of default.
- Value of collateral could be affected negatively by enforcement actions instituted by other lenders.
- Lenders should establish clear legal title to collateral.
- Lenders should make legal arrangements to limit making the same collateral available to multiple counterparties.
- Loan classification should take into account the borrower's current financial condition and paying capacity, current and realisable value of collateral and other factors influencing collectability.
- When classifying a troubled loan, collateral should be valuated conservatively, and should not have to stand in for interest. In seriously delinquent loans, accruing of interest income should stop.
- One factor (like value of the collateral) is normally not sufficient to determine the impairment status of a loan.

In 1997, ten years before the credit crisis of 2007–2008, Riddiough referred to pool diversification and loan building as packaging strategies to mitigate risk for uninformed outside investors. He suggested that the junior security holder should renegotiate the debt with pooled debt structures, because of better asset value information and a first loss position (Riddiough, 1997). Even after the credit crisis, Allen and Saunders (2010) observed that for many banks, risk management means to sell loans in the form of financial derivative products.

This study concurs with King (2016) and confirms the approach of Song (2002), especially in the case of private providers of asset-backed credit. The principle deduced from this section regarding collateral as a tool in risk management, is that each loan with its collateral should be treated as a viable unit; collateral is required in order to shift the risk back to the borrower.

Bank regulation is a principle to credit provisioning, which gains in importance. This is the topic of section 2.3.3.

2.3.3 Bank regulation

Banks need to be regulated as they are private-sector institutions with the extraordinary power of creating money as a by-product of credit – one of the most serious fault lines in the management of money in current society (King, 2016, p. 86).

Furthermore, authorities need to protect vulnerable consumers (Ponnan & Majiedt, 2011), and prevent or mitigate systemic risk (see section 2.3.2.1). While the protection of vulnerable consumers can be accommodated by national legislation (National Credit Act, 2005 [RSA, 2005] as amended by the National Credit Amendment Act, no 19 of 2014 [RSA, 2014]) and national institutions (SAinfo reporter, 2013), co-ordinated bank regulation on a world-wide scale is dictated by the different interests of the several national jurisdictions (Gordy & Heitfield, 2010). This discussion revolves around bank regulation, as the credit market is dominated by banks (see section 2.2.3.3). Private credit provisioning is discussed in Chapter 4.

The next section comprises a description of bank regulation, systemic risk as a banking phenomenon, different policies regarding bank regulation, the relationship between regulation and economic cycles, and closes with a description of the Basel Accords on international banking regulation. The intended result is a comprehensive description of bank regulation as a principle in credit provisioning.

2.3.3.1 Description of regulation

Regulation is exercised in coherence with supervision. ‘Regulation’ refers to rules and ‘supervision’ to enforcement (Kane, 2010, p. 315). The fundamental question, however, is why either regulation or supervision is applied in free markets, as governments in capitalist countries are normally not involved in the internal financial policies of firms in their jurisdictions.

According to Flannery (2010) banks are different from other firms in capitalist countries, as many citizens are directly affected by the success or failure of banks. Normally, the market will punish excessive risk taking, but when governments guarantee deposits, banks are induced to take on more risks. Regulators need to compensate for the increased risk by enforcing prudency (Flannery, 2010). Brunnermeier (2009, p. 2) adds the need to constrain monopoly, the difficulty of obtaining critical information, and the existence of externalities where costs of market failure exceed both the private costs of failure and the extra cost of regulation. Choudry (2011, p. 1) explains the disastrous extent of market failure in 2007 and beyond. Society as a whole (even globally) was forced to pay the price for a naive belief that high-risk loans in the United States could be turned into low-risk investments for investors all over the world. Only huge financial injections through low interest rates offered by central banks all over the world prevented the global economy from freezing.

Vento (2010) draws attention to the perspective that regulation is an expensive public good, which has to be applied only as far as the interest of the saving public or system-wide financial stability is at stake. Kane (2010, pp. 326–327) adds the perceived importance of not letting banks (as national assets) fall into foreign hands.

In most countries, central banks are responsible for regulation and supervision of the financial system. The most important tasks of central banks are to provide settlement services to large-value payments, oversee banks for the sake of financial stability, act as lenders of last resort, and implement monetary policy. It is by exercising these responsibilities that banks transmit financial policy to financial institutions, by exercising control over money supply through interest rates and increasing or reducing liquidity (Aglietta & Mojon, 2010).

While the rationale for regulation is similar all over the world, the exact mechanisms and policies are different for each country, according to the experience and circumstances of each country (Choudry, 2011, pp. 23–28). Changes in the policies of authorities and innovation by banks to circumvent regulation normally lead to the so-called ‘re-regulation’, or the closing of loopholes (Kane, 2010, pp. 317–318).

Gordy and Heitfield (2010) draw attention to the importance of co-ordinated bank regulation on a world-wide scale. They assert that each national regulator might want

other authorities to act prudently, but allow its own banks to be less prudent, in order to increase their competitiveness. Globally co-ordinated regulation could reduce compliance costs, especially for global banks acting in several bank jurisdictions; encourage transparency and therefore facilitate comparison between jurisdictions; and supply 'best practices' to smaller and less experienced regulatory authorities. Data used for regulatory purposes should pass an 'internal use' test to be accurate, but that is difficult as long as standardised regulations are not in place (Gordy & Heitfield, 2010).

This description of regulation is concluded by referring to Kane (2010, pp. 319–321), who maintains that bank regulation is not a tax on banks, but a back-office financial service, generating benefits and costs. 'Benefits' relate to improving customer confidence, improving customer convenience, and supporting or resisting efforts to accumulate and exercise market share.

2.3.3.2 Regulation and systemic risk

De Bandt et al. (2010) state that the concept of systemic risk is wider than the risk of a run on a particular financial institution; it is the risk of a crisis in one part of the financial system which is propagated and even amplified across the system, even internationally. Choudry (2011, p. 255) adds that regulatory risk is the inverse when banks need to expend effort or incur costs which cannot be commercially justified, only because it is required by authorities (p. 255).

Historically seen, banking crises are indeed serious. Kane (2010, pp. 328–329) cites studies by Caprio and Klingebiel (1996) and Honohan and Klingebiel (2003), which found that between 1977 and 1995, the net worth of the banking systems in 58 countries were almost or entirely eliminated. Rescue efforts typically involved 1 to 10% of GDP and constituted successful attempts to shift banks' debts to taxpayers.

According to Brunnermeier et al. (2009, p. 27), there are four levels of likeliness that a bank will cause systemic risk. These levels of "value at risk" (VaR) are differentiated as follows:

- Individually systemic: Institutions so large and interconnected with other financial institutions that their failure will create a systemic risk on its own.

- Systemic as part of a herd: Individual institutions, which are too small to create systemic risk, but if many of these institutions act similarly for a system-wide reason, it poses systemic risk.
- Non-systemic large and not highly levered institutions pose little systemic risk.
- Very small institutions, especially if unlevered, pose hardly any risk.

The potential of systemic risk involving the first two categories demand regulation, while the last two categories do not (Brunnermeier et al., 2009, p. 27).

Kane (2010, p. 335) observes that the frequency of rolling crises regarding banking and currency (or systemic risk events) is on the increase. This is a result of globalised banking services and government guarantees, through the use of ICT, which also facilitates silent runs (through electronic fund transfers) from suspect banks. In addition, he asserts that lenders, securitisers, credit rating agencies and supervisory authorities are not compensated in ways that make them accountable for the slow-developing but inevitable losses that their policies engender. Docherty and Viort (2013, p. 51) confirm Kane's observation by stating that it is, despite sophisticated modelling, still impossible to measure or control risk adequately. Nevertheless, they assert that, if all financial institutions diversify their risks into non-correlated businesses, aggregate risk will remain the same, but systemic risk will be reduced (Docherty & Viort, 2013, p. 55).

In the above section, it was demonstrated that systemic risk manifests when a risk event in one part of the financial system creates a crisis involving the whole system. In order to prevent regulatory risk, it is important to limit regulation to institutions likely to cause systemic risk. The criteria for such a classification are size and interconnectedness in the financial system. ICT enabled increasing financial integration, and consequently increased systemic risk. Sophisticated risk models are also created with the aid of ICT in order to contain systemic risk, but success is still limited. Diversification seems to remain the most dependable way to prevent risk events from becoming systemic.

Section 2.3.3.3 reports on possible options in terms of regulatory policies.

2.3.3.3 Regulation and policy

Brunnermeier et al. (2009, p. 1) disprove a possible expectation that financial regulation is a coherent process gradually moving towards a predetermined dispensation. In contrast, financial regulation is normally extended incrementally as a reaction on a specific fraud or disaster. According to these authors, only the crisis of 1929–1933, and maybe that of 2007–2008, was serious enough that regulators returned to fundamental principles or underlying theory. Indeed, as is shown below, some crises are even induced by regulation. This is followed by a discussion of possible approaches to regulation, which are presented according to oppositions: macro prudence v. micro prudence, light touch v. strict regulation, leaning against the wind v. go with the flow.

2.3.3.3.1 Regulation-induced crises

Kane (2010) strongly argues that crises are, in some cases, not prevented by regulation, but induced by it. Regulators are required to consider political factors, which may contradict banking-related requirements. If left unchallenged, this dualism might tempt client banks to expose themselves to excessive risk (Kane, 2010, pp. 315–316). According to Kane (2010, pp. 334–335), these contradictory signals lead to misallocation of capital. A credit crisis like the one of 2007–2008 is prepared literally over decades, with bank supervisors relaxing some standards in coherence with political policy, as potential losses are guaranteed by the state. The crisis emerges when doubt arises whether the state will still be willing and able to guarantee the extent of losses.

Kane (2010, pp. 321–326) argues that the contradiction mentioned above is between regulators' obligation to guard against the extension by banks of loans to high-risk customers, and governments' desire to extend the advantages of the commercial economy to as many citizens as possible. For instance, political pressure encourages banks to facilitate widespread home-ownership through sub-prime lending, while the resulting increase in risk is subsidised by governments' deposit guarantees. Defective monitoring and control of the subsidies often fail to make anyone directly accountable for the size of these subsidies. When the enterprise-generated net worth of a bank drops to below zero, and net worth is sustained by government guarantees, the bank loses its ability to act independently. Rescuers demand higher than normal interest,

which decreases positive outlooks for the future. A lack of public trust emerges when doubts arise whether the government will be able to honour its guarantees. At this stage, a banking crisis erupts (Kane, 2010, pp. 321–326).

A crisis creates the opportunity to rectify misguided policies. However, when the acute stage of the crisis has been contained, public pressure recedes, while the cost of fundamentally rectifying contradictory regulation leads to abandoning the attempt, with the crisis re-emerging after a few years (Kane, 2010, pp. 326–334).

Kane's view of regulation-induced crises could lead to calls that the banking industry needs to go back to its roots, particularly in the area of risk assessment (Docherty & Viort, 2014, p. 53). However, Docherty and Viort (2014, p. 54) persist that a return to decentralised processes "based on human gutfeel" would be disastrous. Based on the assumption that centralised bank regulation is inevitable, approaches to enhance its effectiveness are investigated, as discussed in the following paragraphs.

2.3.3.3.2 Macro prudence v. micro prudence

According to Brunnermeier et al. (2009, pp. 5–7), “macro prudence” is found where a whole system acts prudently, while “micro prudence” is found where a specific institution acts prudently. The direct interest of owners and management lies with micro prudence, while regulators are primarily involved with macro prudence. Macro prudence dictates that banks are discouraged from virtually unlimited lending when the economy is expanding, while the negative results from an economic downturn is contained (Brunnermeier et al., 2009, pp 5–7).

The capital adequacy ratio (CAR) of banks (Brunnermeier, 2009) is an important tool used by regulators to impose macro prudency. Before the 2007–2008 crisis, it was believed that banks with adequate capital would always be able to raise extra funding when liquidity problems arise. This had not been the case, because the crisis caused the capital base to devaluate, deepening the crisis (Brunnermeier et al., 2009, p. 9).

The Bank for International Settlements (BIS), which is responsible for co-ordinating global bank regulation (see BIS, 2013), recognised the flaw identified by Brunnermeier (discussed above) in their system. According to the BIS (2013, pp. 3-12), the financial crisis developing in 2007 emphasised the fact that, even with adequate capital, a bank could fail to survive if liquidity to finance outflows for 30 days under stress conditions is not available. To this end, the liquidity coverage ratio (LCR) was issued in January 2013, to be implemented by regulatory jurisdictions by January 2015 and phased in until full compliance is reached by 2019. This ratio requires that stock of high-quality liquid assets (HQLA) divided by total net cash outflows over the next 30 calendar days must be larger than or equal to 100%. When stress occurs, it is completely appropriate to use some of the HQLA, which means that it will fall below the required rate (BIS, 2013, pp. 3–12). The defining qualities of HQLA are its certainty of value, and security, and ease of trading, especially during a crisis (BIS, 2013, p. 13–14).

Macro prudence does not exclude micro prudence, but goes beyond it (Brunnermeier, 2009, p. 9). The additional requirements for HQLA indicate that the BIS is aware of the need for macro prudence, and acting upon it.

2.3.3.3.3 Light touch v. strict regulation

It can be assumed that if banks had a natural inclination to do what regulators deem necessary, regulation would have been unnecessary. Brunnermeier (2009, p. 11) warns that a restrictive regulatory dispensation will induce banks to use instruments which are not reflected on their balance sheets and are therefore not regulated. The preferred alternative, Brunnermeier et al. (2009, p. 11) contend, is a form of regulation that would convince bankers towards operations of which regulators approve, referred to as “light touch” which should be counter-cyclical and effective.

In the United Kingdom, the Financial Services Authority works according to its so-called principle-based regulation (PBR) style of financial regulation. It attempts to maintain ‘light touch’ regulation by agreeing on certain outcomes or principles towards which banks have to regulate themselves. This approach was confirmed after the onset of the global financial crisis of 2007–2008 (Alexander, 2008).

Gonzales (2005) investigated whether a strict regulatory environment tends to cause more or less risky behaviour by banks. He concludes that banks value their charters highly, especially when regulations are less strict. The lower the charter value, the more banks tend to take risks. Gonzales therefore accepts that ‘light touch’ regulation should be accompanied by low availability of bank charters.

Flannery (2010) suggests the use of market signals as a mechanism towards ‘light touch’, but effective, regulation. He contends that investors have sufficient access to information and the insight to recognise risky behaviour, as they disinvest from a bank in the first stages of a crisis. Therefore, he suggests that certain market signals should be identified, on which regulators either need to take action or clarify why it is unnecessary to do so (Flannery, 2010).

The essence of ‘light touch’ regulation is for regulators to find ways to convince banks to take the actions regulators find necessary, without exerting too much pressure. Timely recognition of an imminent crisis could assist in this process.

2.3.3.3.4 Regulation and economic cycles

The cyclical nature of the economy is a well-known phenomenon. If regulation, as stated above, is meant to reduce systemic risk, care should be taken to reduce the

effects of the economic cycle. Macro-prudential regulation should be changed to be counter-cyclical, in contrast to the status quo (Brunnermeier et al., 2009, p. 11).

Brunnermeier et al. (2009, pp. 16–22) explain pro-cyclicality as follows:

During an economic upswing, assets have a higher value, enabling banks to lend more. During a downswing, when liquidity is needed, assets have a lower value. Minimum capital ratio deepens the downswing of a cycle, because capital must be added exactly when it is at its most difficult to find; and liquid assets become illiquid when liquidity is most needed.

To counter the economic cycle, regulation should be most strict during a price bubble – normally after some form of financial liberalisation or innovation. A bubble, however, can only with certainty be identified once it has burst (Brunnermeier et al., 2009, p. 32). An example is discussed in the following paragraphs.

According to Docherty and Viort (2014, pp. 7–14), the financial world experienced successive and linked crises, originating with banking deregulation in the United Kingdom in 1986, the creation of the euro as a single European currency in 1999, and exaggerated confidence in computerised risk models. First, a serious setback for hedge funds occurred, then the 'dotcom crash' (see Beattie, 2002) and then the financial crisis of 2007–2008.[4]

Deregulation in UK banking and increasing European integration created a new, large-scale and liquid capital market (Docherty & Viort, 2014, pp. 7–8). One response to this financial environment was revived interest in 'hedge funds' in the 1990s (see Gad, 2017). These funds employ sophisticated computerised models, processing previously unimaginable amounts of data, to calculate 'safe' risk positions and investment strategies superior to those of 'less sophisticated' investors. The 'odd circumstance' to assail their positions could only be expected once in ten thousand years. However, in 1998, Russia defaulted on its international bonds and triggered a "flight to quality" by international investors. Hedge funds were seriously affected, and

[4] The purpose of this section is to provide an example of regulation-induced financial crises, not a full and critical discussion of hedge funds, the 'dotcom crash' or the 2007–2008 financial crisis.

one of the most highly regarded funds (long-term capital management [LTCM]), had to be rescued by the United States Federal Reserve. Around $5 billion were lost, but a crisis was averted (Docherty & Viort, 2014, pp. 7–8).

Optimistic investors believed that Internet-based businesses would create high financial yields. They inflated these share prices (as represented by the NASDAQ index), until it became clear by the end of 2000 that the relevant concepts were hard to convert into profits. The resulting ‘dotcom crash’ destroyed more than $8 trillion in shareholder value, but its financing model (investors saw their investment hugely inflating before it collapsed) meant that damage could be contained. The result was only a mild recession (Docherty & Viort, 2014, pp. 8–9).

Low interest rates were the response to the dotcom crash (Docherty & Viort, 2014) as well as political uncertainties following the terrorist attacks of 9 September 2001. Banks were encouraged to take a more aggressive approach to risk, by indicating that the Federal Reserve would be prepared, as its governor Alan Greenspan said, to “mitigate the fallout when it occurs and, hopefully, ease the transition to the next expansion” as its governor Alan Greenspan said (2002, cited by Docherty & Viort, 2014, p. 9). Interest rates remained below 2% up to the end of 2004 which encouraged risk taking by banks. In addition, information technology gave rise to ‘financial engineering’, or the practice of loan brokers to originate loans, pool these loans and then divide it into ‘packaged’ securities to be resold to investors, with the ultimate result of the 2007–2008 financial crisis (Docherty & Viort, 2014, pp 10–14), also discussed in Riddiough (2007) and referred to in section 2.2.3.3.

The account taken from Docherty and Viort (2014) confirms the statement of Brunnermeier (2009) above that regulation should have been most strict during the price bubble. Docherty and Viort (2014, p. 97) consider it an error that the Basel II agreement and national regulators relied on “market discipline” as an effective free market regulatory force.

The allegation of regulatory induced crisis in 2007–2008 is echoed by Gordy and Heitfield (2010) who suggest that regulators should not employ simple capital ratios as regulatory criteria, but should also take into account the risk involved in the lending portfolios of banks. Betancourt and Baril (2009) agree that earlier recognition of loan losses could have prevented much of the downturn of 2007–2008. They identify capital

regime, bank accounting loan–loss practices, and the interaction between valuation and leverage as policy areas to be investigated for more effective regulation.

Brunnermeier et al. (2009, p. 31–33) suggest that regulators employ additional mechanisms to prevent a crisis of the magnitude of 2007–2008 occurring again in future. Docherty and Viort (2014, p. 99–101) suggest that regulations and supervisory standards and codes were adequate, but that regulators suffered from a lack of vision. They allege, “Unfortunately, the focus on compliance with prescriptive rules may have resulted in a negligent lack of oversight and a lack of flexibility in approach (Docherty & Viort, 2014, p. 100).

These insights, which evolved in the aftermath of the financial crisis of 2007–2008, were put to test with the United Kingdom’s referendum decision to exit the European Union. The Financial Policy Committee of the Bank of England announced on 4 July 2016 that the countercyclical buffer rate, which had been built up since the financial crisis of 2007–2008 was sufficient to be drawn upon with the uncertainty which followed on voters’ decision that the United Kingdom must leave the European Union (Financial Policy Committee, 2016, p. 2). Therefore, the buffer rate has been reduced from 0.5% of banks’ UK exposure to 0%, making available 150 billion pound sterling for lending to businesses and households in the United Kingdom (Financial Policy Committee, 2016, p. 2).

Concluding on regulation and economic cycles as a component of regulation and policy, it seems appropriate to concur with Docherty and Viort’s opinion (2014, p. 90) that regulators are expected not to be influenced by the psychological effect of economic cycles. In this section, it was shown that regulators were at least partly responsible for the crisis of 2007–2008, as they acted in synchronisation with the economic cycle, not “leaning against the wind”, as Brunnermeier et al. (2009, p. 32) poetically formulated an anti-cyclical approach.

In the next section, the effect of the so-called ‘Basel Accords’ on financial regulation is discussed.

2.3.3.3.5 The Basel Accords on financial regulation

According to its official website (BIS, 2013), the Basel Committee on Banking Supervision (often just called the Basel Committee or the BCBS) is an organ of the

Bank for International Settlements (BIS), based in Basel, Switzerland. It is a forum for co-operation between member countries on banking supervision, which aims at financial stability by improving knowledge levels and quality of banking supervision in all relevant countries. The aims of the Basel Committee are attained by setting minimum standards, which improve techniques of exchanging information on the banking industry between co-operating countries. It also co-operates with similar bodies in other financial industries (BIS, 2013).

According to Lebor (2013, pp. xvii-xix) the foundations of the BIS were laid in 1930 and onwards to facilitate international flow of funds, especially regarding the management of reparation payments imposed on Germany after World War I. Founding members were central bankers of Britain, France, Germany, Italy, Belgium and a consortium of Japanese banks. The United States regarded membership of the BIS as contrary to its national sovereignty, resulting in the country's shares being taken up by JP Morgan, First National Bank of New York and First National Bank of Chicago. The BIS was conceptualised as a bank for central banks, a decade-old dream, "powerful, independent, and free from interfering politicians and nosy reporters", and remained active right through the World War II (Lebor, 2013, pp. xvii–xix).

Other functions of the BIS are the Committee on the Global Financial System, the Committee on Payment and Settlement Systems, and the Irving Fisher Committee, dealing with statistics provided by central banks of member countries statistics. The BIS largely escapes public scrutiny, although it is central to the international financial system (Lebor, 2013, p. xxii).

Extension of the operations of the BIS followed when the Bretton-Woods system of managed exchange rates broke down in 1973 (see BIS, 2013). Over-exposure to foreign exchange led to closure of banks in West Germany and the United States, with international repercussions. The BIS took the initiative and in 1974, with central bank governors of the G10 countries, established a Committee on Banking Regulations and Supervisory Practices, later to be called the Basel Committee on Banking (BIS, 2013). Since 1975, the Basel Committee has met three or four times a year. It was a G10 body until 2009, but in 2013 included 27 banking jurisdictions. The Group of Central Bank Governors and Heads of Supervision (GHOS) oversees the Basel Committee (BIS, 2013).

Despite the extended membership, the BIS is allegedly dominated by the ten most important central bankers, who attended a weekly meeting in Basel, characterised by total confidentiality. The Swiss government has no jurisdiction over the BIS, similar to the independence enjoyed by the United Nations and the IMF. Top officials enjoy full diplomatic privilege (Lebor, 2013, pp. xi–xvi).

Countries are represented on the Basel Committee by their central bank or similar institution. The decisions of the Basel Committee are not binding on co-operating countries, but there is an expectation that countries would reform their financial systems towards the vision of the Committee. It is also expected that this process would lead to internationally harmonious supervisory approaches. The first set of suggestions was the so-called Concordat of 1975 (see Miller, 2013), which has been revised several times; most recently in September 2012 (BIS, 2013). The so-called Basel Accords are known as Basel I, II and III. In 2017 the so-called Basel IV was still under consideration (PwC, 2017).

Basel I is the shortened name of the Basel Capital Accord, released in 1988. It deals with capital requirements of banks, and aims to set international standards in that regard. It was repeatedly revised in an evolutionary process until 1996 (BIS, 2013). This was followed by Basel II.

Basel II is the shortened name of the Revised Capital Framework, which was released in 2004. It is built on three pillars, namely minimum capital requirements expanding the rules of Basel 1, supervisory review of the capital adequacy and internal assessment process of institutions, and effective use of disclosure as a lever to attain these aims. Different countries interpreted Basel II differently and followed different time frames, which challenged successful implementation (BIS, 2013). This was followed by Basel III.

Basel III had already been underway when the credit crisis of 2007–2008 erupted. It was issued in December 2010, and revolves around liquidity. Banks need to have sufficient liquid capital to accommodate crisis situations. There are three levels of review: ensuring timely adoption, ensuring regulatory consistency with Basel III, and ensuring consistency of outcomes (BIS, 2013).

The BCBS Charter was released on 13 January 2013, setting out the purpose, intended role and operations of the BCBS (BCBS, 2013).

There is a variety of opinions on the Basel Accords, some of which are discussed below.

The website of the Bank for International Settlements (www.bis.org) provides information on the Basel Accords from its own perspective, some of which have been cited above.

Brunnermeier et al. (2009) consider the Basel Accords as necessary and benevolent, but argue that they have had an unintended pro-cyclical effect. This pro-cyclical effect was largely created by enforcing CARs. The interaction between the pro-cyclicality of the CARs and of the emerging mark-to-market, fair value accounting system had not been apparent beforehand, although it is now well understood (Brunnermeier et al., 2009, pp. 10–12) (also see section 2.3.3.3.1 above).

Kane (2010) argues that the Basel Accords tend to be inflexible and assume that the same regulatory measures should be effective in different financial jurisdictions. He argues that derivative markets should be employed to identify the odds of defaults in individual countries and industries, and that models should take fluctuating risk into account. His suggestion implies that staff members of supervisory institutions might not always be above suspicion, and that they should not be in a position to act in an unscrupulous way (Kane, 2010, p. 337).

Docherty and Viort (2014) are appreciative of the continuous evaluations by the BIS of the role and effectiveness of the Basel Accords (Docherty & Viort, 2014, pp. 113–163). The authors identify the need to reach a balance between a complex, insightful approach and a simple, easy-to-use approach, but contend that the Basel Accords are neither insightful nor easy-to-use (Docherty & Viort, 2014, pp. 137–138).

Lebor (2013) suggests that the BIS is unaccountable and that the Basel Accords might serve specific interests rather than the common good (Lebor, 2013, pp. xi–xvi)

The Basel Accords are the dominant influence on international banking regulation, and objectivity seems to be a reasonable requirement. Despite the availability of facilities to process huge amounts of financial data, Docherty and Viort (2014, p. 140) maintain that judgement on risk is subjective and cannot be quantified objectively. By using past experience to formulate regulations for the future, the inevitable element of human

judgement[5] is inherent to the Basel Accords. As there will always be other humans who would have judged differently on such important matters (especially with the advantage of hindsight), the Basel Accords will always be contentious.

The discussion on the Basel Accords concludes the section on bank regulation. The essential role, possible pitfalls and different approaches to regulation were highlighted.

The next section focuses on another principle of credit provisioning, namely customer relations.

2.3.4 Customer relations

Having discussed the concept of credit and the principles of adequate information, risk reduction and bank regulation as principles of credit provisioning, it is important to remember that credit cannot be provided without a lender (credit giver) and a borrower (credit receiver). Banks are both lenders and borrowers, as their role is that of intermediaries (see section 2.2.3.3). Both depositors (from whom banks borrow) and lenders (to whom banks lend) are banking customers. Good customer relations is valuable to banks, as indications are that a customer retention rate of 5% can boost profits with between 25 and 95% (Pitta et al., 2006, p. 423).

In an empirical investigation focused on retail banks with different business units, thousands of employees and millions of customers, Gelade and Young (2005, p. 17) found that satisfied customers were not more likely to make additional purchases than dissatisfied customers; however, this does not mean that customer satisfaction is irrelevant. These customers are indeed likely to make more positive referrals and to make more purchases with the organisation as a whole, although not necessarily with the business unit which had created the satisfaction.

This section investigates customer relations by referring to a choice between mass communication and personal communication, the significance of brand identity and the so-called servicescape (see (Ishaq, Bhutta, Hamayun, Danish, & Hussain, 2014), which is a combination of employee behaviour towards customers and physical facilities.

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[5] Even the opinion that risk could be quantified objectively implies a certain human judgement.

2.3.4.1 Mass communication versus personal communication

The several different approaches towards customer relations in the banking sector are categorised in this study as building the bank customer relationship by means of mass communication or personal communication.[6] Pitta et al. (2006, p. 423) explain why a spectrum from mass communication to personal communication is appropriate: From the point of view of the banks, not all customers are equally profitable over the long run, leading to the concept of "lifetime customer value". Customers with a high potential lifetime value should receive special treatment, in contrast to those who might even be a loss (Pitta et al., 2006, p. 423).

Personal communication is embodied by so-called 'relationship banking'. In academic terms, 'relationship banking' refers to a very specific situation in which the bank makes its decisions based on 'soft' information on the way a firm deals with, for example, suppliers and customers (Udell, 2008). Berger and Udell (2002) found that relationship banking is resilient, even during a time of consolidation in the banking industry, while Berger (2010) found that small businesses, due to their relative lack of formal financial statements, profit from relationship banking.

Fiordelski, Monferra, and Sampagnaro (2013) regard duration of bank–firm relationships and creditor concentration as defining features of relationship banking. However, Elsas (2005) found that in the German Hausbank (relationship banking in its German guise), the most important characteristic is not duration of involvement, but bank access to firm information and percentage of debt supplied by the bank (Elsas, 2005).

Due to the high concentration of South African banks (see section 3.2.3.2), each bank has millions of customers, which can only be reached by mass communication. Private providers of asset-backed short-term finance can be regarded as "service shops" (see Schmenner, 1986; section 4.10.1.2) and of necessity communicate more personally.

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[6] Mass communication can also be personalised with the aid of information technology, but it remains mass communication (Merriam-Webster Dictionary, 2017).

One aspect to be investigated in the empirical research is whether being a service shop might be one of the main advantages of this category of loan providers.

2.3.4.2 Brand identity

The brand of a business is its emblem for customer relations through mass communication. This emblem is defined as a distinguishing symbol, mark, logo, name, word, sentence or a combination of these items that companies use to distinguish their product from others in the market (Investopedia, 2017). **Brand equity** is the value premium that a company realises from a product with a recognisable name as compared to its generic equivalent. Inherent traits and mass marketing campaigns help to create brand equity (Investopedia, 2017). **Brand loyalty** follows when consumers are committed to a brand and will consistently purchase products from their preferred brands, regardless of convenience or price (Investopedia, 2017). Brands are also important in the banking environment. Imeson (2008) attaches financial value to the top banking brands and rank them accordingly. Timewell (2006) agrees that the brand is one of a bank's most valuable assets, but regards it as difficult to quantify. An important perspective by O'Loughlin et al. (2004) is that bank managers regard the image (or brand) of the bank as very important, while customers fail to perceive any real difference between the brand identity of banks and base their loyalty on functional value, such as rates and service levels.

As indicated in the definitions of brand, brand equity and brand loyalty, the image of a bank (or any business) presented by mass communication, needs to be confirmed by customers' own experience. The interface between brand orientation of a bank and customers' experience is partly filled by the staff of the bank. Therefore, Wallace, Buil, and De Charnatony (2013) suggest that local managers should take part in formulating brand values, as these values change customers' experience when embodied by staff members' interaction with customers. Similarly, Skudiene et al. (2013, p. 10) found that professional staff members, empowered to make good decisions immediately, significantly contribute to customers' positive bank experience. To balance the views expressed in this paragraph, it is necessary to refer to Aldlaigan and Buttle (2005), who found that many factors, some unobservable, determine customers' level of loyalty towards a bank.

According to its definition (section 1.2.1), providers of asset-backed short-term finance cannot have the brand prominence of large commercial banks. This may discourage customers from using the services of providers of asset-backed short-term finance. On the other hand, as indicated in this section, large commercial banks might be unwilling to provide credit to customers with a paucity of information. Less prominent asset-backed credit providers may exactly meet the less popular customers if the provider is prepared to investigate the security, which the customer presents.

2.3.4.3 Servicescape

Bitner (1992, p. 57) introduced the term “servicescape” to academic literature on service industries, including banks. The combination of facilities (buildings, furniture, music, space, function, symbols and signage) and the attitude of employees form the servicescape. Customers have a holistic experience of the servicescape, which result in reactions of attraction or avoidance (Bitner, 1992, p. 57). Celik (2015, p. 13) confirms the application of servicescape to banking, and identifies the elements of the hospitality of employees and the ambience created by the exterior and interior features of the building.

Ishaq, Bhutta, Hamayun, Danish, and Hussain (2014, p.164) note that, during their study, 137 scholarly articles dealing with servicescape had already been published; however, they also found that empirical evidence on the topic was still scarce (Ishaq et al., 2014, p.166).

Private providers of asset-backed short-term finance do not have the resources to invest in the servicescape that commercial banks have. It can even be claimed that every rand expended on facilities is a rand less to lend. Therefore, in formulating a structured approach to the industry, the importance of servicescape for customers should be determined – or at least an indication has to be found. The importance of employees with the knowledge and authority to make loan decisions in asset-backed short-term finance as well as the importance of the facilities of these providers was empirically investigated in this study (see section 5.2.4.2.4.3.2).

This section indicates that the relations bank have with customers range from mass communication aimed at building a credible and attractive brand, to personal communication aimed at meeting selected customers in their respective needs. As

indicated in section 2.3.1, banks are increasingly dependent on computerised systems for information on customers. Section 2.3.2.1, especially referring to operational risk, shows that internal systems are increasingly implemented to prevent operational risk.

The environments of banks are not only populated by customers, but also by competing institutions. The relationship between competitors in this sector is discussed in section 2.3.5.

2.3.5 Competition

The fourth principle of credit provisioning to be discussed is competition. According to the Merriam-Webster online dictionary (2017), competition is the act or process of trying to get or win something (such as a prize or a higher level of success) that someone else is also trying to get or win, or the act or process of competing (Merriam-Webster, 2014). It seems that, in terms of credit provisioning, competition would refer to a contest between financial institutions for customers' business, or even between a bank and its customers, for their respective most favourable conditions.

Perfect competition exists where –

- all firms sell an identical product;
- all firms are price takers (have to accept prices offered for their products);
- all firms have a relatively small market share;
- buyers know the nature of the product being sold and the prices charged by each firm; and
- the industry is characterised by freedom of entry and exit (Investopedia, 2017).

As indicated in Chapter 3, this is not the case in the South African banking sector with its significant barriers to entry and exit (Verhoef, 2009, p. 197).

One academic approach to commercial competition is formulated by the five competitive forces model of Porter, first published in 1979 in the *Harvard Business Review* by Michael Porter. According to Porter (2008), the competition of a firm does not comprise direct competitors in the same industry only, but also suppliers, customers, substitutes and possible new entrants to the market (Porter, 2008), also discussed by Grundy (2006).

Another academic approach was presented by Moore (1993) who suggests that the business environment resembles a natural ecosystem, where different entities co-exist

in a dynamic balance. In an ecosystem, there is often a leader, although competition for leadership may occur. A crisis may bring marginal ‘species’ to the centre and obliterate dominant ones. An ecosystem co-evolves according to shared dreams or visions (in the business environment). Ecosystems compete with each other, such as the Apple-led ecosystem against the IBM-led ecosystem (Moore, 2006). Moore (1997, pp. xv–xvi) further maintains that a group of companies co-evolve. Although the business environment is increasingly competitive, it is also increasingly important for a community of businesses to share a dream and work towards it.

The two approaches above give rise to distinctly different views on the various role players in the credit industry. For example, according to the five forces model, banks and private credit providers would compete for the same customers. The ecosystems-model would consider that decision-making by banks is delayed by measures against operational risk. Therefore, banks would amicably tolerate (and even finance) private credit providers, who can finance a business person swiftly, if adequate collateral is presented. In conclusion, the two approaches shed light on different aspects of the industry. Credit providers will vie for the same businesses, while customers will insist on the most favourable conditions. This dualistic relationship between different firms is also described as ‘coopetition’ (see Bengtsson & Kock, 2000), defined as co-operation between competing companies (Investopedia, 2017). Certain businesses gain an advantage by using a judicious mixture of co-operation with suppliers, customers and firms producing complementary or related products (Investopedia, 2017). The coopetition of different credit providers is investigated in more detail in Chapter 4.

The discussion on competition ends the section on principles for credit provisioning, and therefore the chapter on the concept of credit provisioning. The last section is devoted to a summary of the findings in this chapter.

2.4 CONCLUSION

Credit in traditional economies was fundamentally different from credit in modern monetary economies. While the first was a benevolent activity, the latter is driven by the profit motive. Credit provisioning is a mainstay of the modern economy and is comprehensively studied as part of the scientific field of finance. Loans are classified

according to different criteria. ‘Asset-backed’ and ‘short-term’ were the two relevant distinctions for this study.

Two basic principles for all credit agreements are adequate information and risk reduction. Due to the nature of computerised information systems, large commercial banks tend to focus on unsecured loans. Credit bureaux are consulted electronically for prospective the credit histories and remuneration of customers, leading to a prompt response. These computerised systems cannot process information on non-standard applications, or high net-worth customers with cash-flow constraints. The information gathered by a knowledgeable owner/manager could put a private credit provider at an advantage. Risk is multi-faceted and adequate information on all these facets are imperative. Collateral is an effective tool to reduce lender’s risk. The lender normally does not wish to own the collateral, but losing it is an incentive for the borrower to pay as agreed.

Bank regulation is a topic of much discussion in financial and academic circles, and also a principle for credit provision. Due to the danger of system-wide financial crises, which result from the interconnectedness of banks, regulation is essential. The dilemma is, however, that regulation does not always have the proposed effect. Indications are that some crises are even regulation-induced. It is important for regulation to aim at system-wide prudency (macro prudency) and not only prudency in specific institutions (micro prudency). Opinions still do not converge on the appropriateness of ‘light touch’ or strict regulation. It is agreed, however, that regulation should be countercyclical. The Basel Accords, on which the most important national regulators base their policies, are continuously revised towards this end.

In terms of customer relations, banks do not expend equal time and effort on all customers. The distinction is made between building customer relations through mass communication and personal communication. Personal communication is reserved for those customers with whom such communication may be conducted profitably. Regarding competition, contest is contrasted to a more complex scenario of coopetition, according to which co-operation and competition between firms are interspersed in an ecological model of the economy.

Asset-backed short-term finance is presented as part of a ‘credit provisioning ecology’. As Pitman (2012) points out, high-quality firms with sufficient assets may also

encounter liquidity shortages, which banks are unable to meet on short notice due to considerations of risk reduction and regulation. This creates a niche market, which private providers of asset-backed finance could serve in a superior way. The reasons for this superiority and the mechanisms employed to avoid risk and maintain financial integrity, is the topic of Chapter 4.

The concept of credit provisioning is wide-ranging and increasingly complicated, as the world economy is increasingly integrated. The general perspective presented in this chapter, is followed by a description of credit provisioning in South Africa. Against the background created by Chapters 2 and 3, Chapter 4 argues that asset-backed short-term finance is a legitimate, and even essential, niche in the credit market, created by developments in the global and national economies.

CHAPTER 3

CREDIT PROVISIONING: A SOUTH AFRICAN PERSPECTIVE

3.1 INTRODUCTION

The previous chapter outlined the nature and role of credit in a modern monetary economy. Topics that may influence private providers of asset-backed credit in South Africa were highlighted. This chapter provides a South African perspective on credit provisioning in order to provide insight into the direct environment in which private providers of asset-backed finance operate. Risk events in recent history forced the financial sector to exert more stringent regulations for credit provision by banks, creating a market for private providers of asset-backed finance. The international origins of these trends include the credit crisis, which erupted in the United States and spread globally in 2007–2008, as well as the closing down of Barings Bank due to excessive risk-taking by an official acting on his own, both discussed in Chapter 2). The resulting regulatory developments are reflected in the South African financial sector, and are discussed in this chapter.

This chapter starts with a brief history of the credit industry in South Africa, which is followed by a comprehensive outlay of the regulations of the domestic credit industry. Regulations fundamentally determine the operation of private credit providers and formed a crucial part of this study. The next section deals with a description of the contemporary credit industry in South Africa, including service delivery by banks. The primary purpose of this chapter is to provide a secure knowledge base on the institutional backing for credit management that could provide a secure platform for the potential and practicing private credit provider. As such, the next section provides a background to the credit industry in South Africa.

3.2 THE CREDIT INDUSTRY IN SOUTH AFRICA

In this section, the South African credit industry is discussed in terms of historical development, financial regulations that refer to regulatory legislation, and institutions as well as the primary role players in the domestic credit industry.

3.2.1 History of banking in South Africa

South Africa and the United Kingdom are the only countries with a modern banking sector, which had not experienced a collapse of their banking systems during the twentieth century (Jones, 1996, pp. 263–271). An overview of the banking history of South Africa explains this remarkable achievement, and is divided as follows: the periods of origins until 1921; the foundation of the SARB in 1921; the period until 1942 when banking legislation was fundamentally revised; and the period between 1942 and 1990 when the next revision occurred.

3.2.1.1 Founding and development until 1921

As indicated in Chapter 2, a formal credit arrangement depends on the existence of a monetary economy. As such, the banking industry in South Africa emerged as part of the commercial economy, which is illustrated by the timeline in Table 3.1 below.

Table 3.1: Important events in the early banking history in South Africa

1823: Privately incorporated banks allowed in the Cape Colony
1830s: In South Africa, 28 local banks thriving thanks to agricultural prosperity
1860: London & South Africa Bank: the first imperial bank to open doors in South Africa
1862: Standard Bank is established
1865, 1876, 1881, 1890: Banking crises which wipe out many local independent banks. Only seven banks remain active in the Cape Colony
1854: Natal Bank established. In Natal, this is soon followed by Standard Bank and London & South Africa Bank
1862: Bloemfontein Bank established. Imperial banks soon follow in the Republic of the Orange Free State
1888: Netherlands Bank for South Africa established in the South African Republic (Transvaal)
1890: National Bank formed under concession of the Transvaal government, backed by a consortium of financiers from London, Amsterdam and Berlin
Circa 1910: National Bank of SA acquires Natal Bank, National Bank of the Orange Free State and Bank of Africa. Standard Bank acquires African Banking Corporation

1926: Barclays Bank (Dominion, Colonial and Overseas) acquires National Bank
1934: Volkskas established

Source: Verhoef (2012b, p. 212)

According to De Villiers (2012, pp. 40-44) early commercial development in South Africa (or a lack thereof) can only be understood by referring to the policies of the Vereenigde Oost-Indische Compagnie (United East Indian Company, usually abbreviated as VOC), which was founded in 1602 and based in Amsterdam. This was the first truly globalised company in history, which sourced commodities in the Orient and traded in Europe. The Dutch Republic granted it a charter to enter into agreements, and founded settlements wherever needed for its commercial ventures. The settlement at Table Bay, named the Cape of Good Hope and founded in 1652, was conceived as an outpost with the single function of providing food and fresh water for ships sailing between Europe and the Orient. The supreme authority of this new colony was not the Dutch government, but the board of directors of the VOC. This body soon regarded the Cape as an unavoidable drain on their funds, and expended no more than the minimum attention and funds on it. This myopic approach led to outsourcing of food production to the newly created class of Vryburgers (free burghers) in 1657, a step which resembled abandonment, rather than emancipation. In addition, in a worldwide system where corruption was endemic, employees of the VOC entered into private trade with the company, excluding Vryburgers. The majority of Vryburgers moved into the African interior, where their distribution was only contained by the end of the nineteenth century. Their economy tended to self-sufficiency, with little need for banking services (De Villiers, 2012, pp. 40-44). Towards the end of VOC rule, it established the Lombaard Bank in 1793, which was fully owned by the government, but had commercial objectives (Rossouw, 2009, p.1).

With the British takeover of the Cape Colony in 1795 (which became permanent in 1815), private ownership and the right to trade with visiting ships were guaranteed. Agriculture developed an almost commercial approach with the arrival of the 1820 British Settlers. During these years, shop owners provided consumer goods, but also acted as import–export agents and providers of credit (Verhoef, 2012a, pp. 204–205).

The emergence of a commercial economy slowly led to a need for financial services. Therefore, small banks were established, such as the Cape of Good Hope Savings Bank in 1831, the Eastern Province Bank in 1838 in Grahamstown and the Port Elizabeth Bank in 1847. During this era, 25 local banks were also established, but with the depression which followed late in the 1860s, many did not survive. However, the interest of British banks was aroused by rising wool exports from the Cape Colony since the 1840s, but the state of the economy and politics in Europe prevented these banks from investing before the 1860s. The first European bank to open its doors in South Africa was the London and South Africa Bank (LSAB) in 1861, then the Standard Bank in 1862, and finally the Oriental Bank Corporation in 1873. The depression of the 1860s led to most of the small local banks to be taken over by either LSAB or Standard Bank (Jones, 1996, pp. 17–18; Verhoef, 2012a, pp. 205–206).

Until 1856, the territory of Natal was regarded as part of the Cape Colony, but with little commercial activity. English-speaking farmers gradually moved into Natal with the express purpose of producing commodities, for instance sugar, maize and cotton, for British industries. One result was the founding of the Natal Bank in 1854, with branches of the Standard Bank and LSAB following in the 1860s (Verhoef, 2012a, pp. 208–210).

Economic growth in the Free State was slow, but exports of wool and leather slowly created a monetary economy. In 1862, the first two banks were founded, namely the Bank of Bloemfontein and the Bank of Fauresmith. The Standard Bank and LSAB also opened branches, but conflict with government led to a prohibition on all foreign banks (Verhoef, 2012a, pp. 212–213). Nevertheless, the Oriental Bank and another colonial bank, the Bank of Africa, were allowed (Jones, 1996, p. 27).

Before the mineral revolution, there was no competition in Transvaal for the branch of the Standard Bank founded in Pretoria in 1877. This was not the result of constrained competition, but of the lack of commercial activity (Jones, 1996, p. 27).

Jones concedes that the early imperial banks mobilised latent capital, but maintains that bank advances were, as elsewhere, the most important source of deposits. The levels of investment created by the world-wide economic recovery of the late 1860s enabled Britain to export capital and knowledge. Imperial banks introduced banks to South Africa with large capital bases, branch banking, regular payment of interest on deposits, skilled management and effective hierarchical management, which enabled

the head office in London to control affairs in South Africa (Jones, 1996, pp. 3–4, 12–13, 20).

The principles according to which imperial banks conducted business in Southern Africa were:

- no lending on accommodation bills;
- no lending against real estate;
- note issuing to be undertaken with caution;
- no unsecured overdrafts; and
- no exchange speculation.

In time, however, lending against real estate was undertaken (Jones, 1996, pp. 11-12).

This section indicated how the foundations for a modern banking industry in South Africa were laid, while the economy was still relatively undeveloped. The next section describes the fundamental changes to banking, following the discovery of diamonds and gold, in 1867 and 1886 respectively.

3.2.1.2 Banking and the mineral revolution

With the discovery of minerals (diamonds in 1867 and gold in 1886), South African rural economy based on barter, was transformed within a few decades into a modern market economy with credit markets (Verhoef, 2012a, p. 203). The result was not only a steep rise in exports (£600 000 pounds in 1850 to £7.6 million in 1900) but it also created a domestic market for agricultural produce (Verhoef, 2012a, p. 205).

At the beginning, digging of diamonds seemed like a gamble. The distribution and nature of diamond-laden ore were still unknown. Instant riches and months' work with no findings were all part of the reality. Banks extended credit easily, and the inevitable banking crisis occurred in 1881. Concurrently, there were several conflicts, leading to the most serious depression in the history of the Cape Colony to that date, from 1882 to 1886 (Verhoef, 2012a, pp. 207–208).

Discovery of gold in Transvaal[7] in 1886 magnified the fundamental change to the South African economy. The colonies and republics of Southern Africa were integrated with the world economy, with its cycles of credit 'booms' and 'busts' (Verhoef, 2012a, pp. 214–215). The great distance of mining areas from existing coastal towns forced respective southern African governments to invest heavily in infrastructure. This created a platform upon which a commercial economy, including rudimentary manufacturing and domestic food production, could be built (Verhoef, 2012a, pp. 210–211).

Discovery of gold did not lead to a multiplication of banks, as might have been expected, because it followed directly after an economic downturn and the failing of many banks. Furthermore, gold mining in South Africa was (and still is) very capital-intensive. The banking sector, in fact, was consolidated (Jones, 1996, pp. 17–18). The capital-intensive nature of the country's deep level mining resulted in South African banks traditionally being well capitalised. This created a platform for successful international expansion when the opportunity arose (Singleton & Verhoef, 2010, p. 541).

One new entrant was the National Bank, created for political reasons (see Jones, 1996). Although the head office was in the South African Republic, its investors were mostly British or British South African (Jones, 1996, pp. 17–18).

Competition was not restricted in the South African banking sector. The character of the local economy, however, led to concentration of the banking sector. During the course of history of the Cape Colony, 19 local banks had been taken over by other banks and 14 had been liquidated. In both Natal and the Free State, only one local bank had survived its first years, which was also eventually taken over. In Transvaal, no banks existed before the entrance of the Standard Bank in 1877, which has been operating in the Cape Colony since 1862. The state supported the newly formed National Bank after its founding, but did not restrict its competitors (Jones, 1996, pp. 23–27).

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[7]The Zuid-Afrikaansche Republiek (the ZAR) was also known in English as the South African Republic, or Transvaal. These terms are used as synonyms in this dissertation.

The era of the mining revolution in South Africa was further characterised by competition for political dominance of the sub-continent. The economic dominance of the relatively well-developed British-ruled Cape Colony was replaced by the South African Republic, with its newly exploited gold reserves. The explosive potential of this situation erupted with the Anglo Boer War of 1899–1902, which brought all South African territories under British rule. When the economy had recovered by 1906 (Verhoef, 2012a, p. 208), banking was conducted in a new environment: an all-British South Africa. This is the topic of the next section.

3.2.1.3 A central bank for an all-British South Africa

After the Anglo Boer War, the British High Commissioner in South Africa, Lord Alfred Milner, was resolute to rebuild the area into an economic and cultural beacon. Political unification was preceded by a Customs Union in 1908. This Union formalised the emerging economic unity of all the territories (Verhoef, 2012b, p. 217). Like other industries, banking moved towards uniformity across South Africa, which became a political union in 1910, in turn leading to the formation of the SARB in 1921, which introduced a new era to South African banking.

Political reality after the conquest of the two republics prompted National Bank to compete actively against Standard Bank in all four territories. This attempt, backed by the mining houses of the Witwatersrand, led to intense competition and little room for other banks (Jones, 1996, pp. 23–27). Shortly before unionisation of South Africa in 1910, National Bank paid a high price for both the National Bank of the Orange River Sovereignty and Natal Bank, the latter of which suffered under bad debts. In order to challenge Standard Bank for countrywide domination, National Bank acquired the Bank of Africa in 1914, with its substantial interests in the Cape Province. This expansion, which included a large percentage of illiquid assets, also came at a high price. Subsequently, National Bank pursued acquiring the other important colonial bank, African Bank Corporation. However, the capacity of National Bank for take-overs was exhausted, and Standard Bank acquired this bank in 1920 (Jones, 1996, pp. 31–40).

As a result of increasing economic integration, several calls were made for a central bank in South Africa. The matter was first mentioned in 1879 by the Afrikaner Bond (a political party in the Cape Colony) (see Winch, 2014), and subsequently advocated by

the reverend SJ du Toit. Calls were also made that the formation of the Union of South Africa should coincide with the formation of a central bank. This did not happen then, but the economic downturn following World War I made it clear that a central bank would play a constructive role in stabilising the economy (Rossouw, 2009, p. 1).

Rossouw (2009, p. 2) relates that during World War I, the South African currency was pegged to the British pound, which was pegged to the US dollar, which was set on the gold standard. After the war, the pound was separated from the dollar and depreciated against the American currency. It was therefore possible to redeem South African bank notes for gold, and sell it at a premium in London. In order to keep the required gold reserve, commercial banks had to purchase gold at this premium and therefore had to trade at a loss. A call on government to release them from this obligation followed, which led to a Gold Conference in Pretoria in October 1919 (Rossouw, 2009, p. 2). One of its resolutions was to request government to form a central bank with, amongst others, the authority to issue bank notes. A distinguished British banker, Sir Henry Strakosch, was employed to turn the recommendations made at this conference into practice. This led to a parliamentary act in 1920 to establish the SARB (Rossouw, 2009, p. 2).

The SARB opened its doors on 30 June 1921, as one of the earliest central banks in the world. The name ‘Reserve Bank’ was chosen in following of the Federal Reserve System of the United States, a tendency since followed by several other countries. The first banknotes were issued on 19 April 1922, and commercial banks were prohibited to issue their own notes from 30 June 1922 (Rossouw, 2009, p. 3). The heads of both De Nederlandsche Bank voor Zuid-Afrika and the Standard Bank in South Africa (Messrs HC Jorissen and JP Gibson respectively) were opposed to this important step. Nevertheless, Jorissen was appointed as first deputy governor of the Reserve Bank and Gibson was appointed to its board (Rossouw, 2009, p. 2).

A new era in South African banking followed. The newly formed Reserve Bank assumed a regulatory role in South Africa and laid one of several foundations for the country’s diversified economy, which is discussed in more detail in section 3.2.2.5. The next era is discussed in section 3.2.1.4.

3.2.1.4 South African banking 1921–1942

While the first two decades of the twentieth century had been taken up by political unification and World War I, the economic structure did not change fundamentally. Industrial development was promoted after the war and gained momentum with a change in government in 1924. By 1950, industry overtook mining to be the largest contributor to the South African gross national product (GNP) (Verhoef, 2012b, pp. 460–462). The present study delineated the transition between the formation of the SARB in 1921 and the implementation of a new Banking Act in 1942.

The first upheaval in South African banking after 1921 occurred in 1925. National Bank, after a phase of growth by expensive acquisitions, could not withstand the pressures resulting from the post-war economic downturn. A take-over of National Bank was facilitated by the Reserve Bank. Barclays in London formed the Barclays Dominion, Colonial and Overseas (Barclays DC&O) by merging De Nationale Bank of South Africa, the Colonial Bank of the West Indies and the Anglo Egyptian Bank (Singleton & Verhoef, 2010, p. 541).

During the same period, the legal framework changed from unlimited to limited liability for equity holders of banks. This led to an explosion of branches of colonial banks across the British Empire. Despite this relaxation, risk remained high, and strong centralised oversight was exercised in the two colonial banks, Barclays DC&O and Standard, which would dominate the local scene for decades to come (Jones, 1996, pp. 10–11).

A financial disaster could have followed if the largest South African bank, National Bank, could not be rescued. The basic weak point was local control, where managers could not refuse the influence of their own, sometimes reckless, directors. With the developments of 1926, English control and strict prudence became a characteristic of South African banking. The two dominating banks discreetly agreed on suitable rates, effectively forming a banking cartel (Jones, 1996, pp. 42–50).

While stability was attained, concentration of banks and the formation of a cartel led to a period of complacency and little innovation. A trade union for bank clerks, which was more concerned with employment conditions than customer service, gained power. University graduates were hardly ever employed, as knowledge and skills were transferred by way of apprenticeship-type in-house training. All taken into account,

however, the cartel might have been beneficial. When the international depression and drought claimed a large portion of the economy in 1933, intensely competing banks might have been unable to withstand the pressure (Jones, 1996, pp. 52–58).

In section 3.2.1.3, it was mentioned that returning to the gold standard was a central goal when establishing the SARB. This did not follow in a sustainable way. The gold standard was restored at pre-war rate on 18 May 1925, following the same step in the United Kingdom on 25 April 1925. After the Great Depression had descended upon the United States and the rest of the world in 1929, the United Kingdom abandoned the gold standard on 21 September 1931. In South Africa, however, it was retained. This led to massive speculative capital outflows, until government was forced to abandon the gold standard on 28 December 1932 and join the sterling area (British currency) in1933 (Rossouw, 2009, p. 3–4).

Ethnic empowerment of Afrikaners proved to be a powerful driver behind the creation of institutions for financial services. Important in this regard was the reverend John D Kestell (see Kestell, 1942). In analysing widespread poverty among Afrikaners, Kestell focused on external factors, as well as a loss of self-respect (Kestell, 1941, pp. 22–31), workshyness (Kestell, 1941, pp. 33–38) and a reluctance to save. As much as saving souls, he laboured for saving of money with saving banks (Kestell, 1941, pp. 39-47). The main aim had to be to put people in a position of self-reliance, rather than ‘doing something FOR anybody’, which he believed would perpetuate personal poverty (Nienaber, 1946, pp. 105–117). As a result of his and others’ activism, Santam and Sanlam were founded in 1918, Volkskas in 1934 and Federale Volksbeleggings (FVB) in 1942 (Verhoef, 2012b, p. 464–465). Santam and Sanlam subsequently played important roles as respectively short- and long-term insurers, Volkskas as a commercial bank and FVB as an investment company.

From 1921 to 1942, several foundations for the development of a relatively diversified South African economy were laid, including a well-developed financial sector. In section 3.2.1.5, the era from 1942 to 1990 is discussed.

3.2.1.5 Banking for growth, followed by decline: 1942–1990

In political history, 1948 and 1994 are identified as major turning points in South African history. In banking, however, 1942 and 1990 are more significant dates. Modernisation in the economy, for which the foundations were laid in the period 1921–1942, was reflected in the updated banking law of 1942 (see Verhoef, 2013). More recently, liberalisation of world trade manifested in a less restricted South African banking dispensation with new legislation in 1990. The relationship between economic and political transitions, however interesting, was beyond the scope of this study.

In this section, the development of the banking industry in South Africa is followed. Important in this narrative is strict monetary control, which gradually relaxed until 1990, with the adoption of the Banks Act (Act no. 94 of 1990), which still applied in 2017. The structure of a highly concentrated banking industry was nevertheless retained. Reference is also made to the evolution of banking institutions.

Comprehensive regulation of banks was first reached with the Banks Act, no. 38 of 1942. Bank institutions were classified according to their functions: commercial banks, deposit-taking institutions, people's banks and loan banks (Verhoef, 2009, p. 163). Commercial banks had a disproportionate ability to create money by lending activities. They were therefore regulated more strictly, leading to a relative decline in their market share, to the benefit of building societies and 'quasi banks'. To level out the playing field, a new law, the Banks Act, no. 23 of 1965, was accepted. Different deposit-taking institutions were classified, according to function, as commercial banks, merchant banks, hire purchase banks, discount houses, general banks and saving banks and another category of general institutions including trust and executor companies. These were regulated on an equal basis by the SARB. Commercial banks still dominated the scene, because of their superior money-creation capacities. Banks could not be owned by non-bank companies; only by other banks or bank-controlling companies. This led to commercial banks extending their activities through subsidiaries to all said possibilities. The Reserve Bank was particularly opposed to the potential merger of banks with insurance companies, as this could lead to enforced marketing and conducting business on less than optimal conditions (Verhoef, 2009, pp. 163–166).

The period between 1945 and 1971 was characterised by governments all over the world preferring financial stability and national interest to the possible efficiencies of

international free trade, resulting in no pure banking crises occurring during this time, as was also the case in South Africa (Singleton & Verhoef, 2010, p. 539).

Domestically, the dominance of imperial banks in South Africa was challenged by new, Afrikaner-controlled banks, Volkskas and Trust Bank. The nationalist government, which came into power in 1948, shifted its business, mainly to Volkskas. The imperial banks reacted by closing ranks and competing against the new banks where possible. The Netherlands Bank (Nedbank) responded pragmatically. In the long run, Trust Bank had been too competitive for its own capacity and in the 1970s headed for insolvency. Volkskas was more prudent, but nevertheless, by the 1970s the imperial banks had regained some of their losses (Jones, 1996, pp. 60–65). In comparison to the earlier history, Jones (1996, p. 42) contends that the close ties between Volkskas and the government, was a mirror image of the relations between National Bank and the Transvaal government half a century earlier. However, Volkskas' prudency prevented it from ever being caught in an illiquid position. In that regard, Jones (1996, p. 42) identifies the Trust Bank as the later counterhalf of National Bank.

According to Verhoef (2009, p. 166) the South African government of the 1960s was resolute to curtail excessive creation of money through credit. Banks found ways around most restrictions, creating the so-called Register of Cooperation (Rocco) (see Verhoef, 2009) as one of many defensive strategies. Rocco was an agreement on fees and commissions between Standard Bank, Barclays and Nedbank. Volkskas was accepted as member in 1972, but Trust Bank preferred to stay outside. Although service levels declined, order and discipline were guaranteed in a potentially destructive small commercial bank market. Nedbank, as a small player, was on the one hand protected against unequal competition, but on the other hand not allowed to expand by imaginative innovation. Government was also confronted with two issues: monetary regulation relied on direct non-market measures, while government actually wanted the bank sector to work according to market forces (Verhoef, 2009, pp. 166–172).

The global banking system entered a new phase in 1971. In that year, the Bretton-Woods era of fixed exchange rates collapsed due to different rates of inflation in different countries (King, 2016, p. 21). The result was less restrictive economic legislation, especially in Europe. Growth in European manufacturing led to savings as

well as opportunities in other parts of the world. The channelling of savings from anywhere in the world to opportunities anywhere in the world created an increasing global flow of funds. To facilitate this, the Bank for International Settlements (BIS) (see Chapter 2) was created (Verhoef, 2009, pp. 159–163).

With political pressure mounting on South Africa since the late 1960s, concentration of South African banks, especially banks under foreign control, became an increasing risk. The prospect of a financial system controlled by hostile foreigners had to be avoided. Therefore, by the mid-1970s, banks were required to increase local equity to at least 50% (see Singleton & Verhoef, 2010). This was cast as law with the Financial Institutions Amendment Act, no. 101 of 1976, and led to the two imperial banks, Standard and Barclays (DC & O) to be listed on the Johannesburg Stock Exchange (JSE) (Verhoef, 2009, pp. 170–172). Nedbank incorporated in South Africa in 1951, and the majority of its shares were transferred to South Africans in 1973 (Singleton & Verhoef, 2010, p. 543).

Direct monetary controls were replaced in 1980 with market-oriented monetary policy. Interest rates, as a true reflection of the cost of borrowed money, played a central role in determining the value of the rand. In 1986, the SARB announced growth targets for a money supply aggregate as monetary policy framework. The targets were low profile and adjustable (Rossouw, 2009, p. 6).

Relaxation of monetary controls was the result of money supply and inflation, which kept rising, despite these controls. In 1978, the De Kock Commission (see Kantor, 1986) investigated an appropriate response. Reports of the De Kock Commission in 1979, 1982 and 1985 recommended relaxation of monetary control, in accordance with the international trend. This led to a fundamental shift in financial policy, embodied in the Financial Institutions Amendment Act, no. 106 of 1985, followed by the Deposit Taking Institutions Act, no. 94 of 1990. On the one hand, barriers between different kinds of financial institutions as created in 1965 were removed, as well as the ban on financial institutions from foreign countries to conduct business in South Africa (Verhoef, 2009, p. 178). Exchange rates were also deregulated, in order to be determined by market forces. On the other hand, capital requirements were increased, in line with the guidelines set by the Basel requirements for risk management. Foreign banks conducting business in South Africa had to obtain permission from the Registrar

of Banks, or even the Minister of Finance, and had to adhere to the same prudency regulations as South African banks. Although competition increased, concentration remained, with the four main commercial banks still dominating the banking scene of the 1990s (Verhoef, 2009, pp. 173–180).

It would be misleading to view the said reforms as a purely rational process flowing from learned enquiry. In 1984, 44% of South Africa's foreign debt was borrowed by South African banks and 16% by the public sector. Two thirds of this credit had to be repaid within less than a year. In 1985, American banks, led by Chase Manhattan, withdrew South African credit lines, causing banks to default on their loans. It was clear that fundamental reforms needed to follow (Singleton & Verhoef, 2010, pp. 545–546).

Deregulation as a result of the legal reform of 1985 caused building societies to demutualise and render conventional banking services (Verhoef, 2009, pp. 180-181). However, they found it hard to compete and were absorbed by the major banking groups. Disinvestment from South Africa for political reasons in the 1980s led to the exit of British shareholding of Barclays and Standard Bank. Barclays received a new identity as First National Bank. Rand Merchant Bank unified their interests with First National Bank and created the First Rand Group. United and Allied Building Societies merged with Volkskas to form the Amalgamated Banks of South Africa, ABSA (or Absa). Soon afterwards, Bankorp, the heir of Trust Bank, became part of Absa. Nedbank's position was enhanced by joining the Old Mutual group. The result of deregulation was intensified competition between banks, but it led to neither higher rates of efficiency nor a decline in concentration. However, each of these groups succeeded in expanding its business abroad. For a considerable time, liberalisation meant that South African banks acquired international assets and not that South African banks were victims of international expansion of other banks (Bresler, 2013, p. 30–31; Verhoef, 2009, pp. 180–197).

By the end of the era under consideration, South Africa had not yet been accepted back in international circles. The country had developed, nevertheless, a financial infrastructure, which soon enabled South Africa to be integrated into the global economy. In section 3.2.2, the current financial landscape is investigated in terms of regulation.

3.2.2 Financial regulation in South Africa

Financial regulation in South Africa is the purpose of the Banks Act of South Africa (no. 94 of 1990) and the National Credit Act (no. 34 of 2005), applied by the NCR, the Financial Intelligence Counsel and the SARB. Each of these laws and institutions is discussed below.

3.2.2.1 Introduction to financial regulation in South Africa

In section 3.2.1, banking in South Africa was discussed as an industry in the prudent British tradition. Currently, the US-based Political Risk Services Group (see McKee, 2017) portrays South Africa as a largely free economy with good financial infrastructure, although faced by challenges on social terrain (Political Risk Services Group, 2012). This seems to suggest that the South African financial system is a stable platform for building a growing economy.

The positive evaluation of South Africa's financial sector is largely due to an absence of incidents leading to systemic risk, or the multiple and simultaneous defaults of large financial institutions (Esterhuysen, Van Vuuren, & Styger, 2011). Regardless of a history of prudence, the so-called Basel III requirements could force banks to be even more cautious in granting mortgaged home loans than before the credit crisis of 2007–2008 (Venter, 2012). While stability should be retained through effective regulation, the present study found that new opportunities (such as asset-backed short-term finance) are created by the evolving regulatory landscape.

The prudence of banking in South Africa can be linked to a tradition of self-regulation in an unforgiving economic environment, but South African banks have also been accused of using their overwhelming power to disregard the interests of individual customers (Thomas, 2013). If the criticism is legitimate, it might contribute to the success of private providers of asset-backed finance.

The mechanisms of and rationale behind regulation in the South African financial industry are discussed in the following sections. An overview of relevant institutions and legislation is followed by a description of regulatory aspects of the Bank Act of 1990 (no. 94 of 1990), the National Credit Act of 2005 (no. 34 of 2005) and the role of the SARB, as these laws and this institution contributes to a full picture of the South African perspective on credit provisioning.

3.2.2.2 Institutions and legislation to regulate the credit industry

There are several institutions and pieces of legislation, which regulate the credit industry in South Africa. The Banks Act (no. 94 of 1990), the National Payments System Act (no. 78 of 1998), the Financial Intelligence Centre Amendment Act (no. 1 of 2017, the Financial Advisory and Intermediary Services Act (FAIS) (no. 37 of 2002), the National Credit Act (no. 34 of 2005, the Consumer Protection Act (no. 68 of 2008), the Home Loan and Mortgage Disclosure Act (no. 63 of 2000, and the Competition Amendment Act (no. 1 of 2009) each regulates an aspect of the industry (Bresler, 2013, pp. 21–25). The rationale for these institutions and legislations is threefold: protecting vulnerable consumers, ensuring the smooth functioning of the financial system, and preventing money laundering and similar offences (SAinfo reporter, 2014).

The boundaries of which transactions private providers of asset-backed short-term finance may enter into are set by the Banks Act (no. 94 of 1990) and the National Credit Act (no. 34 of 2005), which will each be discussed in a separate section.

3.2.2.3 The Banks Act of South Africa (Act no. 94 of 1990)

The preamble to the Banks Act (Act no. 94 of 1990) explains the purpose of the Act clearly: “To provide for the regulation and supervision of the business of public companies taking deposits from the public; and to provide for matters connected therewith” (Republic of South Africa, 1990, preamble). Although the topic of this study does not include banks, the financial sector is dominated by banks, and private credit providers operate within the spaces created by the services which banks do not deliver. Relevant provisions of the Act are the following:

Section 12 of the Banks Act of 1990 determines that the Registrar of Banks shall not grant an application for bank registration, made under section 12 of the Act, unless he or she is satisfied that:

- the establishment of the proposed bank will be in the public interest;
- the business the applicant proposes to conduct, is that of a bank;
- the applicant will conduct the proposed business of a bank in the capacity of a public company incorporated and registered under the Companies Act (no. 71 of 2008;

- the applicant will be able to establish itself successfully as a bank;
- the applicant will have the financial means to comply, in the capacity of a bank, with the requirements of this Act;
- the business of the proposed bank will be conducted in a prudent manner;
- every person who is to be a director or an executive officer of the proposed bank is, as far as can reasonably be ascertained, a fit and proper person to hold the office of such director or executive officer;
- every person who is to be an executive officer of the proposed bank has sufficient experience of the management of the kind of business it is intended to conduct; and
- the composition of the board of directors of the proposed bank will be appropriate having regard to the nature and scale of the business it is intended to conduct (Republic of South Africa, 1990 p. 21-22).

The 'business of a bank' is transforming deposits into loans (Strahan, 2010), which means that private credit providers are not allowed to take deposits unless they fulfil all the requirements and register as banks. If they exclusively lend money, they only need to fulfil the requirements of the National Credit Act (no. 34 of 2005) (see section 3.2.2.4 below).

Although private credit providers have different legal requirements from banks, they incur many of the same risks. The Banks Act (no. 34 of 1990) anticipates solvency risk, liquidity risk, credit risk, currency risk, market risk (position risk), interest rate risk, counterparty risk, technological risk, operational risk and compliance risk (RSA, 1990, p. 8).

It is shown above that the Banks Act of 1990 is of utmost importance for the total South African credit provisioning enterprise, because banks dominate the South African credit market. However, the importance for private providers of asset-backed short-term finance is that this law prevents independent credit providers from accepting deposits, which is purely a bank function.

3.2.2.4 The National Credit Act

The National Credit Act (no. 34 of 2005) is most relevant to credit provisioning in South Africa, and is aimed at all bank and non-bank lenders. The main purpose of this Act is

to protect vulnerable consumers from reckless lenders, as indicated below. Asset-backed short-term finance provides a service to asset-rich business persons, and does not target vulnerable consumers; therefore, the effect of the Act is limited to administrative requirements, as is illustrated below.

The preamble to the National Credit Act states the intent of the Act to open the credit market for people who are viewed as historically disadvantaged, and to protect such consumers from unscrupulous credit business practices. Accordingly, credit providers previously had to register with the NCR if they had more than 100 credit transactions or if the value of their creditor books was more than R500 000 (RSA, 2005; RSA 2014, sections 40 and 42), but the amount has been reduced to R0 in a government notice (dti, 2016). In section 46 and 47, the Act also requires of natural persons in charge of registered credit providers to comply with criteria regarding integrity, prudence and moral hazard.[8] In addition, section 49 stipulates that credit providers are continuously monitored and that they can be deregistered if contravention of the requirements is proved. Section 74 deals with prohibited aggressive marketing practices. Over-indebtedness and reckless credit are dealt with in Chapter 4 Part D of the National Credit Act. Debt review is discussed in section 86, as a mechanism to ensure that credit providers are not reckless in granting loans to vulnerable consumers (RSA, 2005; RSA, 2014).

Section 4(1) excludes juristic persons with an asset value or annual turnover beyond a ministerial determined level (still determined at R1 million, according to Mpahlwa [2006]) from the full protection of the Act, pertaining to large transactions – which mortgage transactions are, by definition (section 4(1)(b)).

From the explanation above it can be concluded that providers of asset-backed short-term finance are not explicitly required to register with the NCR, but it might be advisable in order to prevent a perception of being an illegitimate credit provider. It is clear that asset-backed short-term finance is less constrained by the Act than

[8]'Moral hazard' refers to risk behaviour changes when the cost of a risk event is shifted to another party. Credit providers may provide credit recklessly if they are convinced that another party (the state) will create shelter against large-scale losses (Beattie, 2015b).

unsecured lending. Providers of asset-backed short-term credit who want to be free of these limitations, should not expand into unsecured consumer lending.

3.2.2.5 The Financial Information Centre Act (FICA)

International concerns about money laundering and the flow of money to terrorist groups led to a new set of laws and authorities. The so-called Financial Intelligence Centre and Counter-Money Laundering Advisory Council was established by the FICA, 2001 (Act no. 38 of 2001) (Preamble to the Act) (RSA, 2001), supported by the Money Laundering and Terrorist Financing Control Regulations (FIC, 2012, pp. 71–108). This is qualified by a policy statement, Exemptions in terms of the FICA, 2001 (FIC, 2012, pp. 109–127), and affirmed by the Prevention of Organised Crime Act, 1998 (FIC, 2012, pp. 128–209), and the Protection of Constitutional Democracy against Terrorist and Related Activities Act, 2004 (FIC, 2012, pp. 210–254).

All accountable financial institutions are required to register with the Financial Intelligence Centre (FIC), and have to adhere to the following:

- verify the identity of persons with whom they do business;
- keep records of all transactions for five years;
- provide information obtained through transactions to an authorised representative of the FIC when requested to do so;
- report any cash transaction above a prescribed limit to the FIC;
- report any transaction with an entity which has committed or attempted to commit acts of terrorism; and
- report any other suspicious and unusual transactions (FIC, 2012, pp. 22–26).

At the time of the present study, the prescribed limit above which cash transactions must be reported (the so-called Cash Threshold Report [CTR]) is R24 999.99 (FIC, 2016).

As independent providers of asset-backed short-term finance are accountable financial institutions, they need to comply with this legislation.

3.2.2.6 The role of the South African Reserve Bank (SARB)

A South African perspective on credit provisioning will be incomplete without explaining the current role and functions of the SARB. The SARB is mainly concerned

with regulating banks, which excludes private providers of asset-backed finance. However, it is important to understand the potential influence of the SARB on the concept of credit provisioning in South Africa.

Section 224 of the Constitution of the Republic of South Africa states that the primary objective of the SARB "is to protect the value of the currency in the interest of balanced and sustainable economic growth in the Republic". In pursuit of this objective, the SARB "must perform its functions independently and without fear, favour or prejudice" (De Vos, 2010). Therefore, the SARB aims to protect the value of the currency by maintaining the stability of the financial system and aiding the enactment of financial policy. This includes bank supervision, acting as a 'banker for banks' in crisis situations, responsibility for the settlement of interbank claims, the supply of banknotes and coins, being banker for the state, and administering exchange control measures (Rossouw, 2009, pp. 24–44).

In order to ensure performance in terms of the financial policy, the SARB may employ certain mechanisms, which will be dealt with in the ensuing sections.

- Conduit for financial policy: The Monetary Policy Committee (MPC) of the SARB formulates monetary policy on a continuous basis. This policy is enacted by requiring banks to hold a cash reserve; which the SARB bridges on condition that banks adhere to its monetary policy (Rossouw, 2009, pp. 17–20). In addition, the SARB ensures compliance with the monetary policy by means of:
    - on-site visits (SARB, 2014b, p. 22);
    - scrutinising special-purpose vehicles to prevent its usage for hiding risks (SARB, 2011, pp. 718–722); and
    - investigating policies regarding the payment of bonuses to executive officials (SARB, 2011, p. 715).
- Regulating for prudence (conservative lending practices) in the South African banking industry. Prudent banking stabilises the financial sector. Therefore, ensuring prudence is an important purpose of the regulatory function of the SARB, on which it annually reports to the public (SARB, 2014b).
    - A measure of prudence employed by the SARB is the capital adequacy ratio (CAR). According to South African law, banks need to hold 8% of their liabilities in own capital; in other words, a minimum CAR of 8% is

prescribed and enforced by the SARB. The Registrar of Banks (a function of the SARB) requires an additional 1.5%, to counter systemic risk, increasing the required CAR to 9.5% (SARB, 2011, p. 705). The reputation of South African banks for prudence is confirmed by the fact that their actual capital ratio is 15.56%, safely above the required minimum (SARB, 2014b, p. 6).

- Liquidity coverage ratio (LCR): This ratio requires that stock of high-quality liquid assets (HQLA)[9] divided by total net cash outflows over the next 30 calendar day must be larger than or equal to 100%. The LCR is implemented because even a bank with adequate capital can fail if liquidity is not available for 30 days under stress conditions. The BIS in Basel issued the LCR in January 2013 (BIS, 2013, p. 13–14) and it is phased in by the SARB (SARB, 2014b, p. 2).
- South African banks are, as indicated above, regarded as prudent because their aggregate capital ratio is above 15% (see above). This means that 85% of loans issued by banks are in fact borrowed from depositors and other financial institutions. Private credit providers are significantly more prudent than banks, as they are not entitled to take deposits (see section 3.2.2.3). If only equity capital is lent out, it means that a capital ratio of 100% is maintained, if all available funds are lent out. If a buffer of available funds is retained, the ratio is even higher. It can be asserted the high level of prudence maintained by private credit providers, means that these providers pose virtually no systemic risk

[9] High-quality liquid assets (HQLA) have the following characteristics:

- low risk;
- ease and certainty of valuation;
- low correlation with risky assets;
- listed on a developed and recognised exchange;
- traded on an active and sizable market;
- low volatility; and
- historically regarded as a safe asset during systemic crises (BIS, 2013, p. 13–14).

- The strategy of the SARB for risk prevention in banks (with the emphasis on operational risk) is dealt and aligned with the detail included under section 2.3.2, and in terms of asset-backed short-term credit, in section 4.7. South African banks are required to provide information on the ways in which they deal with different types of risk. If the Registrar of Banks views these measures as insufficient, it may require the specific bank to increase its capital reserve (SARB, 2011, p. 715). Regarding a capital charge for operational risk in South Africa, a total of 12.38% of the total minimum capital requirements for the banking sector is required (SARB, 2014a, p. 28). For this purpose, banks need to appoint an operational risk management committee, explain the roles of internal and external audit, involve independent parties (if applicable), and implement regulatory and reporting structures (Van Wyk, 2014a, pp. 2–5), which all contribute to time-consuming decision-making.
- The measures used by the SARB to enforce prudence and contain risk in banking operations were discussed above. As each of these measures require the attention of high-level staff members, decisions are increasingly time-consuming. Prompt decision-making is mentioned in section 1.1 as the essential feature of asset-backed short-term finance. It can be concluded that the business model of private providers of asset-backed short-term finance (discussed in Chapter 4 of this dissertation) enables them to answer a need, which is created by the increased regulation of banks.
- The SARB as a ‘Banker for Banks’ or ‘Lender of Last Resort’:
    - Failing banks can depend on the SARB to help either prevent failure or limit the harm done by such failure. Therefore, it is called a Banker for Banks’ or ‘Lender of Last Resort’. When a bank experiences a serious liquidity shortage, the SARB could advance the necessary funds on condition that sufficient collateral is offered, and the SARB is convinced that the management of the bank has the capacity and integrity to turn a short-term deficit into a long-term favourable situation (Rossouw, 2009, pp. 38–39).
    - The main driver of any decision to render assistance is the systemic stability of the banking system as a whole (see section 2.3.2.1.6 on systemic risk). When the judgement of SARB is that a bank will not be

able to recover, even with assistance, it will act as curator of such bank (Rossouw, 2009 pp. 41–44). An example played out during 2014, when the holding company of African Bank, African Bank Investments Limited (Abil) could not meet its obligations. The SARB decreed that Abil's business interests be divided into a 'good bank' and 'bad bank'. The SARB undertook to facilitate funding for the 'good' bank and to fund the 'bad' bank itself, in order to limit resulting systemic risk (Marcus, 2014).

- As part of its role as 'Banker to Banks', the SARB also acts as the custodian of the cash reserves that banks are legally required to hold or prefer to hold voluntarily with the SARB. The SARB has the authority to change the minimum cash reserve requirements of banks and can use such adjustments to influence bank liquidity and the amount of money in circulation (Committee on Payment and Settlement Systems [CPSS], 2012, p. 379).

Private credit providers must take note that they cannot claim similar assistance when they encounter liquidity shortages. The rigid regulatory framework for banks is mirrored by assistance available to banks. Private credit providers, on the other hand, are less subject to regulation (as they do not take deposits), and they are therefore entitled to less assistance from the SARB. Private credit providers should therefore be careful not to overextend their lending abilities. A safety net of available funds should enable them to continue operations even when an unexpected increase in loan defaults occur.

Having discussed present regulatory measures, it is also necessary to refer to potentially important regulatory developments that are already underway.

3.2.2.7 Potentially important regulatory developments

In the near future, credit provisioning in South Africa will be influenced by two regulatory developments, the effects of which are still difficult to determine. The first is the Banking Association's existing Charter for Black Empowerment, and the other the proposed 'twin peaks model for financial regulation', as discussed below.

The Charter for Black Economic Empowerment is the result of attempts by the Banking Association to take part in the socio-political transformation of South Africa, and is

based on the terms of the Broad-based Black Economic Empowerment [BBBEE] Act (no. 53 of 2003) (BASA, 2012). As private credit providers are not banks, this charter is not directly applicable to them. However, similar measures may be required in future from private credit providers in terms of the same law, as Anthea Jeffery of the South African Institute of Race Relations warns that goal posts regarding black economic empowerment are continuously shifted (2014, pp. 24-25).

The other developing regulation is the 'twin peaks' model for financial regulation (see Financial Steering Committee, 2013. According to the twin peaks model, the financial regulatory landscape will be divided between a prudential regulator functioning under the SARB, and a market conduct regulator under the FSB (Financial Steering Committee, 2013). The Financial Sector Regulation (FSR) Bill, which embodies the twin peaks model, was accepted by Cabinet in December 2013, and the public was invited to comment until 7 February 2014, later extended to 7 March 2014 (Parliamentary Monitoring Group] [PMG], 2014).

In conclusion it can be stated that the increasingly strict regulatory framework in South Africa should not have a large effect on providers of asset-backed short-term finance, as they neither fund their activities by deposits from the public nor do business with financial unsophisticated customers.

3.2.3 Role players in South African credit provisioning

The previous section focused on financial regulation and the institutions involved in regulation, with emphasis on the SARB. This institution was singled out because it regulates banks, which dominate credit provisioning in South Africa. The following section deals with credit providers as part of the purpose of this chapter to provide a comprehensive perspective on credit provisioning in South Africa. The main part of this section relates to banks, due to their domination of credit provisioning in South Africa.

3.2.3.1 Overview of the banking sector in South Africa

The purpose of an overview of the South African banking sector is to reflect the structure of the sector and its efficiency, and to follow important operational developments. These factors point towards increasingly large-scale banking operations, with increasingly sophisticated bureaucratic requirements, which reduce

their ability to serve individual customers with non-standard needs, as will be indicated in the paragraphs below.

The structure of South African banking is highly concentrated, as a small number of banks dominate the industry. Although regulatory relaxation led to an increase in the number of banks during the 1990s, the number decreased again during the 2000s. By the end of 2013, South Africa had 17 banks, 3 mutual banks, 14 branches of international banks, 43 representative offices, 15 controlling companies, and 2 banks in final liquidation (SARB, 2014b, p. 5). However, this number is misleading, as four major banks represent more than 80% of all banking assets, namely Absa, Standard Bank, First National Bank and Nedbank (BASA, 2013). Esterhuysen et al. (2011) found that, during the financial crisis of 2007–2008, the systemic risk of South African banks increased, but less than in other countries. This was unexpected, as Esterhuysen et. al. (2011) expected that a concentrated banking sector would be subject to higher levels of systemic risk.

The Banking Association of South Africa (BASA) (2013) asserts that South Africa is regarded as the dominant gateway from other economic areas (Europe, America and Asia) to Africa. This is due to the First World standard of South African financial services, of which the banking sector is a critical component.[10]

The South African status as gateway to Africa leads to increased international interest in South African banks; in December 2013 48% of the South African banking sector was owned by foreign shareholders, 24% by domestic shareholders and 28% by individual shareholders owning less than 1% (SARB, 2014b, p. 5). Controlling interest in two of the main commercial banks, Absa and Standard Bank, were respectively acquired by Barclays (United Kingdom) and the Commercial Bank of China (Banking Association, 2013).

Another aspect to consider in this overview of the banking sector, is the tendency of commercial banks to operate in the sphere of other financial intermediaries, including

[10]A position challenged by Mauritius, a country which aims to divert the advantages of being the gateway to Africa to itself (Wallace, 2013).

investment banking, asset management, insurance and insurance brokerage (Skerritt, 2009, p. 18).

High concentration in the banking sector, as well as the wide variety of services offered by South African banks, led several authors to investigate the efficiency of banking in South Africa. Van der Westhuizen (2013) concludes that there is room for improvement, as a large proportion of the population are unbanked or still preferred face-to-face banking, rather than electronic banking. Nevertheless the banks operate in the proximity of being fully technical efficient (Van der Westhuizen, 2013). This confirms a similar finding by Mlambo and Ncube (2011).

Concerning the size of banks, Tshinu, Botha, & Herselman (2008, pp. 40-41) suggest that an upward spiral is created where size causes the role of ICT (ICT) to increase, which increases economies of scale and further contributes to consolidation in the sector. According to a survey among bank executives by PricewaterhouseCoopers [PwC] South Africa (2013, p. 9), each of the four major banks in South Africa projected to spend R3 to R5 billion on technology over the medium term, while their combined staff number was expected to grow only marginally from 150 768 to 154 354. This may entrench the trend of efficient execution of standard operations, but decrease the ability to attend to non-standardised needs of customers.

The findings mentioned in the previous two paragraphs seem to indicate that at the time, the tendency in banking was towards increasing size, which poses the question whether new entrants to credit provisioning can be feasible. Bank executives, as expressed in the PwC tri-annual bank survey (2013) regarded entrance of a foreign bank as possible, while they also acknowledged the threat posed by non-traditional competitors, such as retailers and mobile service providers (PwC, 2013, p. 8).

Private providers of asset-backed short-term finance, with specialised knowledge and skills, can fit into the category of ‘non-traditional competitors’. The specialised knowledge and skills are discussed in Chapter 4.

3.2.3.2 South Africa’s dominant commercial banks

According to the 2012 Bank Overview (Banking Association of South Africa [BASA], 2013), the four major banks (Amalgamated Banks of South Africa [Absa], the First Rand Group, the Standard Bank of South Africa and Nedbank) represent 84% of all

banking assets in South Africa, while Capitec was named as an emerging major bank (Bresler, 2013, pp. 32–33). Private provisioning of asset-backed short-term finance is only feasible if these banks can be outperformed. Therefore, a description of these banks is in effect an investigation into the main competition, which is indispensable in a strategic positioning process. That is the purpose of the following section. Table 3.2 gives an indication of the large scale of the major banks.

Table 3.2: Portion of total bank assets and number of employees of four major South African banks

	Standard Bank	Absa	First Rand	Nedbank
Portion of assets	31%	26%	23%	20%
Employees	45 755	34 244	36 398	28 494

Source: Adapted from BASA (2013)

These banks also seem to dominate South African banking in terms of quality, as illustrated in the latest banking survey of PricewaterhouseCoopers (PWC) (2013), as shown in Table 3.3. Table 3.3 summarises the results of a peer review process, in which the chief executive officers (CEOs) of 13 banks were asked to rank the quality of South African banks in a number of service areas. A first place was awarded 3 points, second place 2, and third place, 1 (PwC, 2013, p. 77).

Standard Bank Limited offers the full range of financial services and had since 1988 expanded into other African countries. It has interests in 11 African countries, as well as Jersey, Isle of Man, Hong Kong, Russia, Brazil, Argentina and Turkey. It has approximately 52 000 employees,[11] 1 222 branches and 31% of the South African market share. It focuses on individuals earning more than R100 000 per annum (Bresler, 2013, p. 29).

Before the 2017 divestment from Absa by Barclays Bank in the United Kingdom (Hartdegen, 2017), Absa had been a full subsidiary of the Barclays Africa Group (Absa Overview, 2014). Although the majority of its shares were held by Barclays Bank in

[11] Bresler counted global employee numbers, while only domestic numbers are represented in Table 3.2. There are more discrepancies between the numbers provided by BASA (2013) and Bresler (2013), but in terms of this chapter, the differences are inconsequential.

the United Kingdom, Absa was registered as a locally controlled bank. It has equity holdings in banks in several other African countries and employs approximately 35 000 staff members. Its South African market share is 25%. The bank focuses on individuals earning more than R100 000 per annum (Bresler, 2013, p. 30) and is a merger of four different banking brands which was concluded in 1991, the integration of which was hotly debated (Daffey & Abratt, 2002).

Table 3.3: The ranking of banks on selected service items as placed by CEOs of thirteen banks in South Africa

	First	Second	Third	Fourth
Business banking	Standard	First Rand	Nedbank	Absa
Corporate banking	Standard	First Rand	Nedbank	Absa
Underwriting	First Rand	Standard	Absa	JP Morgan
Infrastructure funding	Standard	Nedbank	First Rand	Absa
Property finance	Nedbank	Investec	First Rand	Standard
Trade finance	Standard	Absa	First Rand	Nedbank
Home loans	Standard	Absa	First Rand	Nedbank
Vehicle and asset financing	First Rand	Absa	Standard	Nedbank
Credit cards	Standard	Absa	First Rand	Nedbank
Personal loans	Standard	Capitec	First Rand	Absa
Micro lending	Capitec	African Bank	Standard	First Rand
Private banking	Investec	First Rand	Nedbank	Absa
Electronic banking (retail)	First Rand	Standard	Absa	Nedbank

Source: Adapted from PwC (2013, pp. 77–82)

The First Rand Group operates under various brands. In the traditional retail market, it is represented by First National Bank and in asset financing, by Wesbank. It operates in several African countries and also has a presence in Mumbai, India. It has 24% of

the South African market share and employs roughly 29 000 people, amongst others through 734 branches. Its focus is on individuals earning more than R100 000 per annum (Bresler, 2013, p. 30–31).

Nedbank is the continuation of co-operation between the Netherlands and the South African Republic in the nineteenth century. The current South African-owned and -controlled entity was formed by several mergers during the twentieth century. It offers the full range of services through roughly 28 000 employees and more than 1 000 branches. There is a discrepancy within Bresler's numbers, as Bresler (2013) mentions that Standard has 31% market share, Absa 25%, FNB 24%, while he does not mention Nedbank's share, but asserts that the four major banks together make up 84% of the total. That leaves 4% for Nedbank, although Table 3.2 above indicates that Nedbank owns 20% of the country's bank assets (Bresler, 2013, pp. 31–32).

Capitec was mentioned above as an emerging major bank in South Africa. A survey by Business Day (Correspondent, 2014) indicated that Capitec was the most popular bank among respondents, followed in descending order by Nedbank, Standard and Absa. Service levels appeared to be the most important factor, although only online banking and mobile banking were investigated. Six product categories (current account, credit card, home loans, savings accounts, car loans, fixed/notice deposits) were considered. Divanna (2007) describes Capitec as one of the most innovative banks globally. A reason might be the implementation of technology in such a way that customers' expectations of an easy to use bank are met (Divanna, 2007).

The preceding two sections described a well-capitalised banking sector, dominated by a small number of institutions operating on a scale, and investing money in information technology, which might seem to prohibit the emergence of private credit providers. The following section reports on perceptions of service delivery by South African major banks, as private credit providers might be able to deliver specialised services in a superior way, exactly as a result of smaller-scale operations.

3.2.3.3 Perceptions of service delivery by South African major banks

In this section, perceptions of service delivery by South African banks, as represented in literature, is discussed. As mentioned in section 3.2.2, banks are required to follow time-consuming processes when considering non-standard loan applications. It has

been suggested in section 3.2.2 that the limitations of banks in this regard are not always appreciated by customers and that they may perceive it as bad service delivery. In section 1.1, it is suggested that prompt service delivery is the keystone of success for private providers of asset-backed short-term finance.

According to Parasuraman, Zeithaml, and Berry (1985, pp. 44–46), it is impossible to judge service quality objectively, with expected levels of service as the most important determinant.[12] Bresler (2013, pp. 36–38) explains the "zone of tolerance" as the area between the minimum level of service that a customer would tolerate and the ideal level a customer would hope for. An empirical study by Bick et al. (2004) suggested that South African banking customers were generally not satisfied, although those who use electronic banking are more likely to be satisfied. This may indicate that electronic banking enables banks to operate within customers' zone of tolerance. However, it seems inaccurate to presume that less human contact in banking leads to higher levels of satisfaction, as Meyer (2008) found that poor service delivery in banks was a direct consequence of insufficient training of staff who are consequently unable to assist customers according to their expectations.

According to Abratt and Russel (1999), South African banks responded to perceptions of insufficient service delivery by introducing relationship banking, or private banking, with emphasis on lasting relationships and service, which is extended to stock broking and estate management. The aim of relationship banking is to provide a comprehensive service for wealthy customers; however, Abratt and Russel (1999) proceed by stating that private banking had only been partly successful.

It stands to reason that the time-consuming process discussed in section 3.2.2 to contain operational risk, means that even private banking customers' liquidity constraints cannot be solved by the bank on short notice. It is conceivable that these

[12]This phenomenon is discussed in more detail in section 5.2.4, referring to the SERVQUAL instrument for measuring perceptions of service delivery.

customers regard the ‘privileges’ of private banking as less valuable, if credit is not readily available when most needed.

Seiler et al. (2013) indicate that retention of loyal customers is preferable to acquiring new customers, which is an important rationale for maintaining service quality. In this regard, Haasbroek (2010) states that South African bank customers are mostly satisfied, but their satisfaction does not imply loyalty.[13] Chipunza (2008) argues that loyalty depends on the availability and quality of competitors rather than on customer satisfaction.

The literature cited in this section is not unanimous on the South African public’s perceptions of service delivery by banks. While Haasbroek (2010) identified general satisfaction, Abratt and Russel (1999), Bick et al. (2004), and Meyer (2008) found the opposite. Chipunza (2008) argues that even satisfied customers are not necessarily loyal customers, especially when a competitor delivers superior service.

When discussing perceptions of service delivery by banks in South Africa, the cost of these services is relevant. It was noted in section 2.3.2.1.1 on market risk that banks globally tend to increase service fees (or non-interest revenue) to compensate for lower interest income. In South Africa, Nedbank reported in 2016 that non-interest revenue had reached 47% of total revenue (Nedbank, 2016, pp. 4b–5b), while the corresponding figure reported by Barclays Africa was 42%, and for Capitec, it was 32% in 2015 (Capitec, 2015, p. 2). In order to position asset-backed short-term finance strategically, the level of these customers’ sensitivity for increasing fees (or a perception thereof) needs to be determined.

It is posited that private providers of asset-backed short-term finance could succeed against the major banks, if they have the ability to deliver a superior service.

3.2.3.4 Credit providers other than banks

The discussion on a South African perspective on credit provisioning largely focuses on banks, due to their dominance of the credit market. This section shifts the attention

[13]In this context, **loyalty** refers to the willingness of customers to stay with a certain bank, even at the cost of price or inconvenience (Bresler, 2013).

to credit providers other than banks. This is a large and diverse group of credit providers, which have only the fact that they are not banks in common. The section includes information, which cannot be linked to asset-backed short-term finance directly, but which is important for a comprehensive perspective on South African credit provisioning.

It has been mentioned in section 2.2.3.1 that Denis and Mihov (2003) found in the United States that firms with a high credit value prefer public borrowing, intermediate ones prefer banks, and low credit-quality firms prefer non-bank borrowing. As public borrowing can also be defined as 'non-bank borrowing' (see Dennis & Mihov, 2003), this section makes a distinction between public borrowing and borrowing from private credit providers.

3.2.3.4.1 Public borrowing

Public borrowing is entered into by means of a bond, which is a form of credit in which the borrower sells or issues a bond, undertaking to buy it back at a specific date in the future (the maturity date). The lender is compensated by an annual or semi-annual coupon payment (Van Zyl, 2009, p. 272–273).

Ojah and Pillay (2009) mention that government institutions had traditionally been the only South African entities to raise money by issuing bonds (thus lending from the public), but that bonds are currently also used by parastatals and the private sector.[14] However, communication costs for issuing bonds are very high, limiting bonds to only very large and profitable business entities (Ojah & Pillay, 2009).

3.2.3.4.1 Independent credit providers

The nature of independent credit providers covers a wide range – from informal, through co-operative and benevolent, to profit-driven business entities. Goodspeed (2009) refers to all non-bank financial institutions providing services to poor and low-income customers as providers of microfinance. Independent credit providers are,

[14] The Bond Market Association (BMA) was formed in 1992, and became the Bond Exchange of South Africa (BESA) in 1996. In 2009, it was acquired by the JSE, and has since been known as the JSE Debt Market (JSE, 2013).

however, not limited to microloans to vulnerable customers, as providers of asset-backed short-term finance are also independent credit providers. There are a number of categories for private credit providers that could be used to position asset-backed short-term finance, such as stokvels and micro lending.

The most informal of credit providers are the so-called stokvels, which can be regarded as the South African version of what is internationally known as rotating savings and credit associations (ROSCAs). The underlying principle is that a collective of people contribute an agreed amount to a communal fund every month and pay the full amount to each member in turn. Members may also borrow against the stokvel (Matuku & Kaseke, 2014, p. 504). Arko-Achemfuor (2012, pp. 127–128) states that stokvels are common among poverty-stricken communities. In Ghana, he found that ROSCAs significantly contribute to the establishment of small, micro and medium enterprises (SMMEs), but in South Africa, most of the money paid by stokvels is used for domestic expenditure (Arko-Achemfuor, 2012, pp. 127–128). Stokvels operate in a market which is beyond the scope of private providers of asset-backed short-term finance, as the two types of credit providers operate at opposing ends of the socio-economic spectrum.

Financial services co-operatives and some co-operative banks is a statutory intervention which aims to regulate financial services currently provided by stokvels (Jones & Dallimore, 2009). Therefore financial services co-operatives are subject to the Co-operatives Act (no. 14 of 2005) (RSA, 2005) and co-operative banks to the Co-operative Banks Act (Co-operative Banks Act (no. 40 of 2007) (RSA, 2007).

Funds held by stokvels were estimated to exceed R44 billion (Arko-Achemfuor, 2012, p. 130), while financial services co-operatives and co-operative banks held deposits of approximately R195 million and extend loans of approximately R140 million (Supervisors, 2014). If financial co-operatives and co-operative banks are supposed to be regulated stokvels, and stokvels held R44 billion against R335 million by the other two categories in 2014 it seems to indicate that stokvels are not easy to regulate.

Microfinance, or micro lending, is another category of non-bank credit provisioning. According to Investopedia (2017) it was pioneered in the 1970s in Bangladesh as a way to alleviate poverty. The principle is to lend small amounts (usually less than $1 000) to poor people with employment (the ‘working poor’). Loan decisions were

based on the applicant's good reputation and a fixed income. These unsecured loans were used to develop micro-businesses with the potential to lift the owners out of poverty into the mainstream economy. As these borrowers were regarded as high-risk customers, microlenders offset the risk by above average interest – reportedly around 35%. Socially conscious entrepreneurs had proved this business model as viable for two decades (roughly 1970 tot 1990), after which new investors entered the market in the 1990s for purely commercial reasons (Investopedia, 2017) Globally, microfinance is a lightly regulated industry, as non-bank lenders are not deposit-taking institutions and consequently have a low effect on systemic risk (Vento, 2010).

Microfinance emerged in South Africa as a result of a 'credit gap' between persons so poor that they qualify for subsidies and grants on the one hand, and those wealthy enough to source credit from commercial banks on the other hand (Mahembe, 2011; (Ellis, 2012). However, providers of microloans are repeatedly held responsible for reckless lending and exploitation of vulnerable consumers by giving unsecured loans and applying for emolument attachment (garnishment) orders[15] in case of default (dti, n.d.; Moputi, 2014; Nkomo, 2013, pp. 4–5). According to Cairns (2014), the high level of emolument attachment orders in South Africa has led to hardship and acute resentment on the side of borrowers (Cairns, 2014). Resulting from this reckless lending, the National Credit Act (no. 34 of 2005 (RSA, 2005) was published, which decreed the NCR into existence, with the aim to protect vulnerable consumers from reckless lending (RSA, 2005; RSA, 2014). In an attempt to prevent the whole industry from being discredited, a group of microlenders established a self-regulating structure, opposing reckless lending practices, named MicroFinance South Africa (MFSA) (2015).

In summary, asset-backed short-term finance can be regarded as the third category of private credit providers, primarily aiming at financial gain, which feature distinguishes it from benevolent or co-operative non-bank credit providers. The

[15] A legal process whereby payments towards a debt owed by an individual can be paid by a third party – which holds money or property that is due to the individual – directly to the creditor. The third party in such a case is generally the individual's employer and is known as the garnishee (Investopedia, 2017).

fundamental distinction between asset-backed short-term credit providers and microlenders is the nature of intended customers and measures to be taken when borrowers default on their loans. Asset-backed short-term credit providers only provide loans to juristic persons with sufficient unburdened assets to act as security for the intended loan. This category will be dealt with in more detail in the next chapter.

Section 3.2 and its sub-sections reported on the credit industry in South Africa. It was found that South Africa has a well-established and prudent financial system, which had started by serving the needs of commercial agriculture in the middle of the nineteenth century, but took part in and facilitated the mining revolution of the late nineteenth century and the industrial revolution of the twentieth century. The financial sector in South Africa is closely regulated in accordance with international and domestic requirements. Internationally initiated regulations aim at preserving the integrity of the financial system, while domestically initiated regulation aims at protection of vulnerable customers. Attention was also given to role players in the South African banking sector, which is dominated by Standard Bank, the First Rand Group, Absa, Nedbank and Capitec. Other credit providers are formal and informal co-operative financial institutions as well as commercial microlenders. This comprehensive description is essential in outlining the business environment in which private provisioning of asset-backed short-term finance must be positioned strategically. In the next section, credit management in South Africa is investigated, as credit management is a key performance area for credit providers.

3.3 CREDIT MANAGEMENT IN SOUTH AFRICA

The purpose of this section is to discuss credit management, a key performance area for credit providers, including private providers of asset-backed short-term finance.

The importance of professional credit management is underlined by the activities of the South African Institute of Credit Managers. Their Certificate in Credit Management aims to maintain and expand knowledge and professionalism as features of credit management in this country (Institute of Credit Management of South Africa, 2013a).

Lehnert (2010) describes how insufficient knowledge in credit management contributed to the financial crisis of 2007–2008. The functions of originating mortgages, funding the loans and collecting payment is traditionally performed within one institution, such as a bank or building society. All the information gathered is

available to those divisions who need to perform each following function. Before the crisis of 2007–2008, however, these functions became increasingly fragmented, resulting in credit management, which was often based on insufficient information. If all parties involved had been aware of customers' creditworthiness, the sudden increase in defaults might have been prevented or mitigated (Lehnert, 2010).

Chetty (2007) found that South African banks approach credit management in an inconsistent way: sales departments strive to increase the quantity of loans, while credit departments prefer high-quality loans. In addition, the South African government compelled credit bureaux to remove adverse information older than five years from consumers' credit records; with the result that, even with a credit check, credit providers may be unable to find the relevant information (De Bie, 2013).

The other factor in credit management identified above is professionalism. Pretorius and Shaw (2004) argue that the most important flaw in South African credit management is the scarcity of bank personnel with the knowledge and ability to judge character, which is, at least partially, a reflection on their professional abilities.

Credit management not only depends on the internal environment of credit providers (as described in the previous paragraphs), but also on the external, legal environment. A legal development, which may impair credit management, is the system of business rescue enacted in 2008; the purpose of this system is to prevent the liquidation of businesses, which could be assisted towards financial stability (Companies and Intellectual Property Commission [CIPC], 2011). According to Joubert (2011) and Tselane (2012), there were fears that this system may be abused to delay payment of debts, but these fears were laid to rest by a judgement of the North Gauteng High Court.

Sufficient information, dealt with by competent staff members, and adequate support by the legal system, were identified as the basis for effective credit management. This is also pivotal to the success of private providers of asset-backed short-term finance.

3.4 CONCLUSION

The history of banking in South Africa is discussed comprehensively, as a historical understanding is indispensable in creating a South African perspective on credit provisioning. A description of financial regulation has the function of creating the

context of credit provisioning in South Africa, but important findings for this study are also made, as described below.

- Private credit providers may not take deposits from the public. Therefore:
    - private credit providers may only lend out equity funds; and
    - because no deposits are taken, systemic risk is significantly reduced, leading to a more lenient regulating environment than for banks.
- Private credit providers are subject to the National Credit Act (no. 34 of 2005) (RSA, 2005). Therefore:
    - all credit providers have to register with the NCR; and
    - credit providers must abstain from reckless lending and unethical collection methods, as indicated in section 3.2.2.4.
- Providers of asset-backed short-term credit are exempted from most provisions of the National Credit Act (no. 34 of 2005) (RSA, 2005), as their customers are wealthy juristic persons and not vulnerable consumers.
- The strict regulatory environment for banks, especially in terms of prudence and operational risk, leads to time-consuming processes for non-standard loan applications, which may be perceived by customers as low service levels. This may contribute to the existence of a market for asset-backed short-term finance.

A description in this chapter of the role players in South African credit provisioning, identifies commercial banks as the dominant providers of credit. Private credit providers operate within the spaces left open by commercial banks. Service levels of banks, as perceived by customers of asset-backed short-term finance, should be compared empirically to the perceptions of a control group with similar wealth profiles, but who are not customers of asset-backed short-term finance. This should indicate the potential room for expansion in this financial industry.

Credit providers other than banks are public lending for very big companies, as well as co-operative financial institutions (formal as well as informal), and microlenders. Asset-backed short-term credit providers are distinct from all these non-bank credit providers. They do not operate on the scale necessary for public borrowers, but also do not target vulnerable consumers for unsecured lending, such as other private credit providers.

It was found that credit management should be based on sufficient knowledge, high levels of professionalism and continuous awareness of the business environment.

In conclusion, this chapter dealing with a South African perspective on credit provisioning, indicated that private providers of asset-backed short-term finance have a necessary role to play in the credit market, due to regulatory intervention in the banking sector.

The next chapter focuses on asset-backed short-term finance as a financial industry. The purpose is to discuss available literature on the nature of and requirements for a successful enterprise, which provides asset-backed short-term finance. This should contribute to the strategic positioning of such enterprises, and ultimately to success in the credit provisioning market. While the present chapter focused on the whole spectrum of credit provisioning in South Africa, the next chapter focuses exclusively on asset-backed short-term finance as a financial industry.

CHAPTER 4

ASSET-BACKED SHORT-TERM FINANCE AS A FINANCIAL INDUSTRY

4.1 INTRODUCTION

In Chapter 1 (section 1.1), asset-backed short-term finance was identified as an established component of the financial sector, although not recognised to the same degree as other non-bank financial industries, such as microfinance. Asset-backed short-term finance is the provisioning of 'bridging' finance, or liquidity funding for a period of no longer than 12 months, secured by an asset. It is characterised by a swift process to evaluate applications and the asset(s) offered as collateral, but above-average interest rates compensate for swiftness and risk.

Chapter 2 presented an overview of the concept of credit provisioning. After viewing the contrast between benevolent credit in traditional societies and commercial credit in modern societies, principles for commercial credit provisioning are discussed. These principles relate to adequate information, risk reduction, regulation, customer relations and competition. Based on the identified principles, the following key conclusions were reached:

- Changes in banking practices during the last decades (roughly since 1990) substituted personal knowledge of customers, the merit of their loan applications and the merit of security offered by decision-making based on ICT, only taking into account the applicant's income (cash-flow considerations) and credit record.
- In terms of customer relations, it is important to determine the importance of employees who have the knowledge and authority to make loan decisions as well as the physical facilities (forming the so-called servicescape).
- The so-called Basel Accords for banking regulation comprise one of the drivers of stricter regulation, with the purpose of creating and maintaining stability in the international financial system. Regulatory requirements include:
    - increased levels of capital reserves and LCR; and
    - decision-making by teams, rather than individuals, in order to contain operational risk (the risk that a bank's personnel, systems or disasters may impede the ability of the bank to function properly).

These conclusions indicate that, as a result of international trends, swift credit decisions by banks, based on an individual's discretion, irreversibly belong to the past. As such, it can be deduced that asset-backed short-term credit is a need created by these international trends.

Chapter 3 contributes towards a South African perspective of the concept of credit provisioning. The most important conclusions are:

- The banking industry in South Africa dominates the financial sector and is prudently managed, highly concentrated, well capitalised, and highly sophisticated.
- The financial sector is regulated by several laws and supervisory institutions, which determine the conditions for all commercial lending. Banks are regulated by the SARB in accordance with, for example, the guidelines provided by the Basel Accords.
- The international considerations creating a need for asset-backed short-term finance, also apply to South Africa.

Chapter 3 confirms the notion that asset-backed short-term credit is a legitimate financial industry, created by local and international trends in financial services.

This chapter provides clarity on the concept of asset-backed short-term finance, as well as the position of this type of finance within the financial sector. It includes the role of collateral, regulatory requirements, the target market, associated risks and implementation guidelines for a provider of asset-backed short-term finance.

Figure 4.1 below was used in section 1.5 to illustrate the strategic positioning of asset-backed short-term finance in relation to banks. It is repeated at the beginning of this chapter for the sake of convenience, as the relevant aspects are attended to in sections 4.3 and 4.4 respectively.

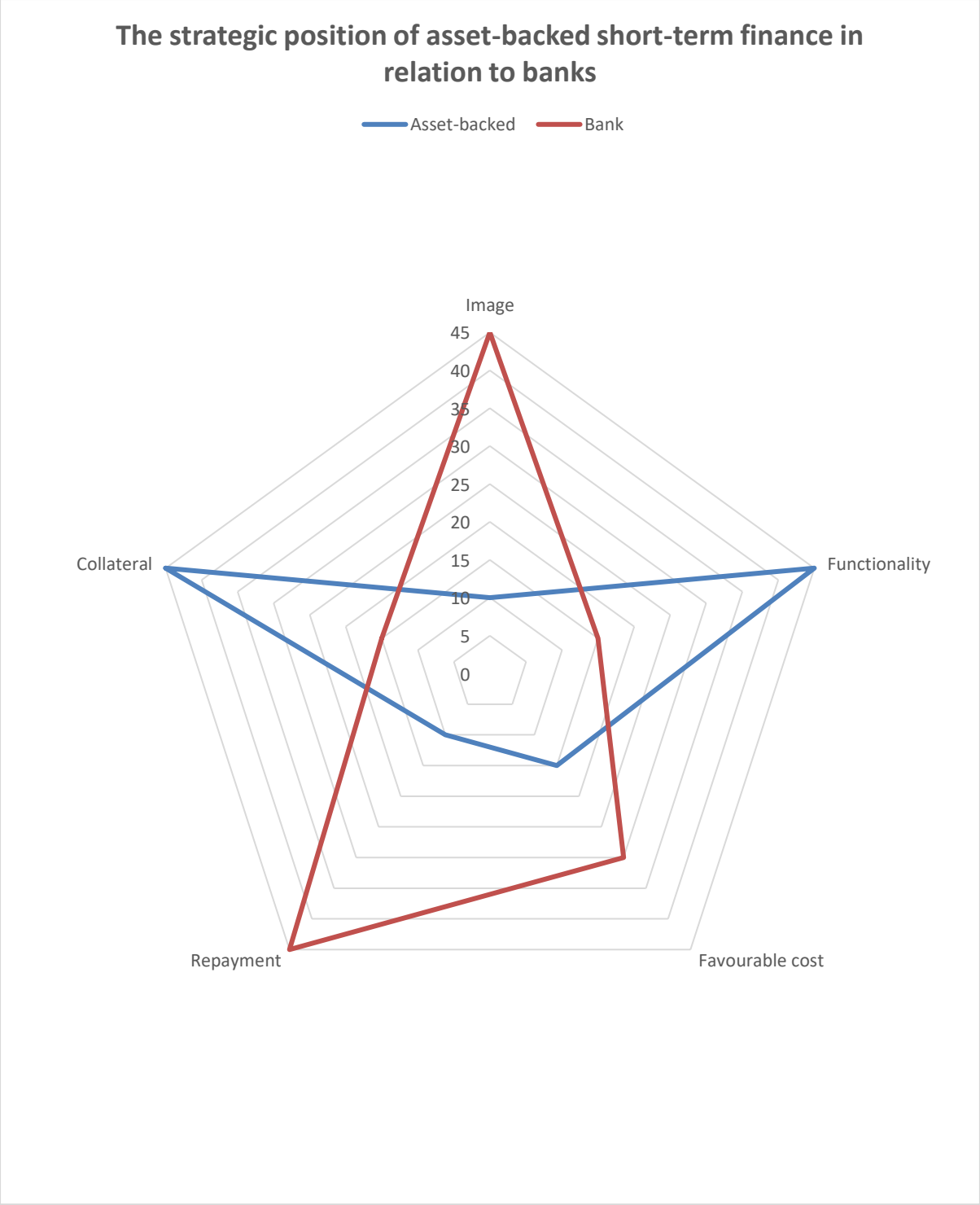

Figure 4.1: The strategic positioning of asset-backed short-term finance in relation to banks

Source: Author's own compilation

4.2 DEFINING ASSET-BACKED SHORT-TERM FINANCE

This section explains the concept of asset-backed short-term finance, first by indicating what it is not (negative description) followed by what it is (positive

description). This includes differentiation from other concepts using terms such as ‘bridging’ and ‘asset-backed’ loans, credit or finance.

According to Haldane and Kruger (2001) **Bridging finance** is used in a multi-national context by financial institutions such as the International Monetary Fund (IMF). These institutions may require restructuring of the national economy as a condition for funding. This restructuring is designed to produce sufficient additional income or savings to finance itself, but only after a while. Funding of this waiting period is referred to as bridging finance (Haldane & Kruger, 2001).

The term ‘bridging loan’ is also used in context of the so-called uTshani Fund (see Ellis, 2012). This fund assisted poor South African urban residents in building their own homes, by bridging the period between commencement of building and the payment of housing subsidies by the state (Baumann & Bolnick, 2001).[16] Bridging finance or asset-backed credit, as the topic of this study, is a commercial enterprise aimed at wealthy persons (as indicated in section 1.4.1), in contrast to uTshani’s benevolent lending to poor households.

A specific form of asset-backed lending, which became notorious during the credit crisis of 2007–2008 and is discussed in section 2.2.3, should also not be confused with the topic of this study: That is the so-called ‘collaterised debt obligations’ (CDOs or sometime also called asset-backed loans) (see Coval, Jurek & Stafford, 2009). CDOs are mortgage loans of different qualities, which are pooled, divided into small units, reconstituted in securitisation structures and then sold to investors. The final investment product is indeed backed by assets, but in some cases, the detail of the specific assets had been lost (Coval et al., 2009). Critical in the loss of detail of the assets, is the fact that different entities were responsible for each of the different functions: originating the underlying mortgage loans, creating securities offered to investors, rating the quality of securities, and collecting payment (Ibanez & Scheicher, 2010). Before the crisis, the notion was that the securitisation process explained above

[16] uTshani Fund encountered a crisis when the dysfunctional subsidy system prevented loans from being repaid. By 2001, some borrowers had already for six years been paying the loan out of their own funds, but others could not pay the favourable interest rate of 12% per year (Baumann & Bolnick, 2001, p. 108).

were packaging strategies that could mitigate risk for uninformed outside investors (Riddiough, 1997). Riddiough's view proved to be wrong, as the quality of screening of applications deteriorated to the extent that a rise in interest rates (especially in the subprime sector) led to a general loss of value for the investors, leading to the credit crisis, which reached its apex in September 2008 (Lehnert, 2010). The essential difference between the type of asset-backed finance described in the previous paragraph and the topic of this study, is the level of individual and informed attention expended on the collateral backing of each loan.

Asset-backed short-term finance as referred to in this study, is defined as a short-term loan used until a person or company secures permanent financing, or removes an existing obligation. This type of financing allows the user to meet current obligations by providing immediate cash flow. The loans are short term (up to one year) with relatively high interest rates, and are backed by a form of collateral such as real estate or inventory (Investopedia, 2017). The owner of a South African asset-backed short-term credit providing company declares that the purpose is to finance real estate for a short period, for instance to complete construction or renovation, before selling or arranging a mainstream mortgage (Goodman, 2013). However, as indicated in the previous paragraph (Investopedia, 2017) assets other than real estate may also be accepted. Referring to categories used by the Federal Reserve Bank of Atlanta (2013) (see section 2.3.2), asset-backed short-term finance excludes unsecured consumer lending, but may include commercial real estate lending and asset-based lending (accepting collateral other than real estate) but not financing the asset itself (Federal Reserve Bank of Atlanta, 2013, pp. 1–10).

For this study, the essential features of asset-backed short-term finance were:

- an asset is required as collateral; and
- the loan term does not exceed 12 months.

Other features are discussed in sections that follow, for example swift decision-making, interest rate, required nature of customers and collateral, as well as regulatory requirements, inherent risks and practical implementation (a business model for asset-backed short-term finance).

4.3 MARKET POSITION OF ASSET-BACKED SHORT-TERM FINANCE

It was indicated in Chapter 2 (section 2.3.1) that the increasing role of ICT in preserving customer information led to decision-making on loans according to pre-determined criteria, at the expense of human judgement. Banks attempt to counter the resulting de-personalisation of banking relations with so-called 'relationship banking' (as described in section 2.3.4). Success in the South African market is limited (see section 3.2.3.3), as banks are bound by the regulations as mentioned. The current section suggests that private providers of asset-backed short-term finance could benefit by the de-personalisation of banking, by positioning themselves as knowledgeable providers of finance, with the ability to reach decisions on non-standard loan applications swiftly.

Providers of asset-backed short-term finance operate in a new credit environment, created by the collapse in the credit market, as banks tightened their lending criteria after the international crisis of 2008 (Muller, 2010). Banks had shifted their focus from secured to unsecured lending, based on consumer spending. Customers' eligibility for loans depend on their monthly income and credit record, which can be determined through credit bureaux (CNBC Africa, 2013). To focus entirely on this section of the credit market, could be risky, as experienced by Cambist, a firm which built an entire business on selling emolument attachment orders (EAOs) on the salaries of non-paying microlenders. The business collapsed, allegedly because courts are increasingly hesitant to grant EAOs (Cairns, 2014).

Asset-backed short-term credit providers have a competitive advantage over other credit providers if they can deal with loan applications on an individual basis and investigate all relevant detail (Beneficio Finance, 2012). A personal relationship can be established between lender and customer, but the lender does not provide the full spectrum of banking services; therefore, the lender cannot rely on relationship lending technologies (Berger, 2010; Uchida, 2011; Udell, 2008) (see section 2.3.1 for discussion) to mitigate credit risk. The solution of providers of asset-backed short-term finance is to require an asset, deemed to be sufficient to cover the proposed loan (Beneficio Finance, 2012). In marketing material, a provider of asset-backed short-term finance asserts that customers benefit by the fact that the lender commits one person to deal with the whole lending process, from application until a decision is reached (Beneficio Finance, 2012). This confirms a notion posited by Skudiene et al.

(2013) that empowered frontline employees have a positive effect on the value perceived by customers, as they are able to reach well-motivated decisions.

Another role player in South African asset-backed short-term finance asserts that a possible negative connotation with second-tier lenders (non-bank lenders) is quickly dissipating, ascribing it to the entering of several reputable role players and the inability of commercial banks to deliver some services, especially lending on security (Paragon, 2011). This is confirmed by a transaction in the United Kingdom, in which a major European bank agreed to finance a provider of asset-backed short-term finance (Goodman, 2013a).

An attempt to remove a possible negative connotation to asset-backed short-term funding was made by a collective of providers, by founding the Bridging Finance Association of South Africa (BFASA) and drafting a Code of Conduct (BFASA, 2015a). This code sets standards for the conduct of asset-backed short-term credit providers towards authorities, customers, peers and the association itself. In the introductory paragraph, it is declared, “Each Bridging Finance Company (BFC), by accepting this Code of Conduct, is committed to the promotion of good business practices and the formalisation of the bridging industry. (BFASA, 2015a)” However, as indicated by the Association itself, it has no regulatory power, offers no advice on a structured approach to asset-backed short-term finance, and the Code of Conduct merely aims towards ethical business practices (BFASA, 2015a). Despite this attempt at organising asset-backed short-term finance as an industry, the need for a structured approach to ensure success (as envisaged by this study) persists.

Asset-backed short-term finance positions itself strategically on its ability to evaluate loan applications in terms of collateral offered. This results in swift decisions and effective management of risks. The central role of collateral to asset-backed finance is discussed in more detail in section 4.4.

4.4 THE ROLE OF COLLATERAL IN ASSET-BACKED FINANCE

The discussion on asset-backed short-term finance implies a positive value attached to collateral, an assumption, which is explicitly investigated in this section.

Collateral is defined as property or other assets that a borrower offers a lender to secure a loan. If the borrower stops making the promised loan payments, the lender can seize the collateral to recoup its losses (Investopedia, 2017).

There is difference in opinion on the suitability of collateral in loan agreements, as described in section 2.3.2.2. Godlewski and Weill (2011) found that adequate information is superior to collateral in mitigating adverse selection problems in a loan market. Song (2002, pp. 3–5) confirms this view by warning against omitting proper risk analysis when collateral seems sufficient, as it can be expensive to liquidate collateral in case of loan default, meaning that repayment of the loan according to the initial agreement is preferable. Furthermore, legal establishment of a claim on collateral is prudent, not in order to possess the collateral, but to serve as an incentive for conscientious repayment (Song, 2002, p. 4). In addition, the claim on collateral does not apply to the asset as a whole, but only to the value of outstanding payment, as confirmed by the South African Supreme Court of Appeal (Malan, 2011). In this case, a lender was prohibited from taking full possession of an asset, as more than the outstanding amount was realised by liquidating the asset. King (2016, p. 266), on the other hand, firmly believes in the value of collateral, as it guarantees the loan, irrespective of temporal swings in the fortunes of a firm. He emphasises that collateral is an indispensable, stabilising factor in loan provisioning. If all loans were collateralised and all collateral prudently valuated, it would preclude systemic risk.

Regardless of the perspective taken, when collateral is indeed taken, Song (2002, p. 7) recommends the following:

- collateral cannot be a substitute for comprehensive assessment of the prospective borrower;
- collateral should only be regarded as a secondary source of repayment in case of default;
- value of collateral can be affected negatively by enforcement actions instituted by other lenders;
- lenders should establish a clear legal title to collateral;
- lenders should make legal arrangements to prevent borrowers to make the same collateral available to multiple counterparties;

- loan classifications should take into account the borrower's current financial condition and paying capacity in addition to current and realisable value of collateral and factors influencing collectability;
- collateral should be valuated conservatively. The lender should only use the collateral to recover capital, not interest; and
- collateral should be evaluated in context of the borrower's ability to pay and risk inherent to the objective of the loan.

The usefulness of collateral is increased by a decision by the South African government that credit bureaux have to remove adverse credit information older than five years. The resulting informational asymmetry was expected to lead risk-averse lenders to insist on collateral (De Bie, 2013).

From this section, it is clear that collateral is not a single solution for all lenders' problems, but it remains an important risk-mitigating instrument for private credit providers. This study diverges from Song's view that collateral should cover only capital and not interest. For a credit provider, interest is the source of income and needs to be protected. Therefore, collateral is indeed used to protect the loan provider's claim on capital and interest. The next section deals with regulatory requirements for asset-backed short-term credit providers.

4.5 REGULATORY REQUIREMENTS

Systemic risk (the risk that the collapse of a financial institution may spread across the whole system) is the main reason for banking regulation (see section 3.2.2.3). In South Africa, non-banks are prohibited from taking deposits, which virtually eliminates systemic risk originating outside the banking sector (see section 3.2.2.2). In addition to preventing systemic risk, financial regulation in South Africa is aimed at protecting vulnerable consumers through the National Credit Act (no. 34 of 2005 (RSA, 2005) (see section 3.2.2.4).

According to the National Credit Act of 2005, credit providers need to register at the NCR if they have more than 100 customers or lend more than R500 000 (RSA, 2005; RSA, 2014, section 40 and 42). Requirements to be eligible for registration attempts to screen out persons with a known history of reckless credit provisioning or other commercial misdeeds (section 46), while prevention of reckless credit as such are set

out in section 81. The most important regulation for this study, however, is section 4 on exceptions: Section 4(1)(a)(i) stipulates that the law does not apply to a juristic person whose asset value or the annual turnover of all related juristic persons, at the time the agreement is made, equals or exceeds the threshold value determined by the minister of trade and industry in terms of section 7(1) (RSA, 2005). Asset-backed short-term credit is aimed at high net-worth persons (see section 4.6 below); therefore, the only requirement for providers of asset-backed short-term finance is to register with the NCR.

Despite the concession discussed above, asset-backed credit providers are subject to commercial and common law. This was proved when two providers of asset-backed short-term finance applied for liquidation of an entity who did not repay its loan. The application was dismissed by the Supreme Court of Appeal (SCA) on the grounds that aspects of the loan were disputed (Ponnan, 2010). On the other hand, a defaulting borrower pursued his case to the SCA, as he argued that the interest rate charged by an asset-backed short-term credit provider was excessive. The court found that the borrower was not a vulnerable consumer, but a high-net worth, sophisticated business person. The borrower needed the money for a prospective business deal, which he believed would be highly profitable. The loan application was turned down by several credit providers, and only the asset-backed short-term credit provider was prepared to advance the funds – in exchange for a lien on a fixed property. The court found that the borrower ran a deliberate risk and could not expect the court to set his obligations aside (Ponnan & Majiedt, 2011).

It is also indicated in section 3.2.2.4 that independent providers of asset-backed short-term finance have to register with the Financial Intelligence Centre (FIC) and report suspicious transactions, but also all transactions with entities known to be (or to have been) involved with acts of terrorism, and all cash transactions exceeding R24 999.99.

As such, it is clear that regulatory requirements for asset-backed short-term finance seem more relaxed than for banks, as the result of the absence of systemic risk. The nature of the target market for asset-backed short-term finance is discussed in 4.6.

4.6 TARGET MARKET

Asset-backed short-term finance is defined in section 4.2 as loans advanced for up to 24 months, guaranteed by an asset. Section 4.3 reflected the market position of asset-

backed finance as non-consumer lending, supplying a temporal need for liquidity. The role and nature of collateral in asset-backed short-term finance was discussed in section 4.4, implying ownership of sufficient assets by borrowers. It was also stated in section 4.5 that the requirements of the National Credit Act (no. 34 of 2005) are meant to protect vulnerable consumers. According to the Act, juristic persons with an annual turnover which exceeds R1 000 000 are not regarded as vulnerable consumers, and therefore loans they make are not subject to the National Credit Act. The target market for asset-backed short-term finance, which usually comprises wealthy persons with a temporal need for liquidity, is therefore not covered by the Act. In the paragraphs below, the target market is explicitly indicated, referring to the requirements of different providers.

The spokesperson of a provider of asset-backed short-term finance maintained to a journalist that its customers are not entities in danger of financial annihilation, but high net-worth persons with their investments tied up in other instruments, needing a cash injection for commercial purposes (Correspondent, 2012). This provider of short-term finance accepts only real estate as collateral and juristic persons as customers. The minimum loan offered is R1.5 million, with no maximum. These criteria confirm the target market as business persons with a high net worth (Paragon Lending, 2010).

Another provider of asset-backed short-term finance accepts any type of asset, but loans do not exceed 60% of its value. Possible scenarios where asset-backed funding may be the appropriate type of credit are identified as:

- immediate access to capital for a ‘once in a lifetime’ business opportunity;
- short-term liquidity problem arising from funds taking longer to realise than planned (for example an asset which is sold, but payment is delayed);
- delay in approval of a building project due to institutional delays;
- business transactions which were delayed;
- funds depleted just before completion of a project;
- all equity tied up in fixed assets, but an immediate cash crisis arises; and
- bank loan is approved but payment is delayed.

In summary: the cost of a liquidity shortage exceeds the cost of above-average interest rates associated with asset-backed short-term finance (Beneficio Finance, 2012).

Based on the above-mentioned literature, it is clear that asset-backed short-term credit is not conceived as consumer credit. The target market can be seen as high net-worth juristic persons in need of liquidity for commercial reasons. While the aim of advancing an asset-backed short-term loan is profit, the aim of borrowing should be the same. In section 4.7, the risks associated with asset-backed short-term finance are discussed.

4.7 RISKS

Section 2.3.2 focuses on risk management in credit provisioning. Attention was given to –

- market risk (the risk of interest rates);
- liquidity risk (the risk of not being able to meet short-term obligations);
- credit risk (the risk of loan default);
- sovereign and political risk (the risk that political pressure may lead to changes in legislation or law enforcement);
- legal risk (the risk that the legal system fails to enforce a contract);
- systemic risk (the risk that a crisis in one part of the financial system contaminates the whole system);
- reputational risk (the risk of acquiring a reputation for recklessness, fraudulence or any negative feature); and
- operational risk (the risk that people, systems or natural disasters impede the ability of the organisation to function well).

In this section, risk is discussed in terms of the facets most applicable to asset-backed short-term finance in the South African context.

4.7.1 Credit risk

In this section the concept of credit risk and measures to mitigate credit risk are discussed.

4.7.1.1 The concept of credit risk

The fundamental risk in credit provisioning, is credit risk, or the risk of borrowers defaulting on their loans (Docherty & Viort, 2014, p. 125), or, as Chance et al. (2007, p. 587) define it, “the risk of loss caused by a counterparty or debtor failing to make a payment”. The financial crisis of 2007–2008 was caused by borrowers who were unable to pay their loans after interest rates had started to rise (Strahan, 2010).

4.7.1.2 Measures to mitigate credit risk

Private providers of asset-backed short-term finance mitigate credit risk by following the process which Holton (2015) describes as credit analysis – an individualised, detailed investigation into each loan application. These credit providers also take responsibility to collect the payment of loans which they originate, a practice which decreases credit risk (Brunnermeier, 2008, p. 2).

Ultimately all loans are repaid. In collateralised loans (see section 4.4), a delinquent loan is repaid by liquidating the collateral. When all attempts to recover an unsecured loan fail, it has to be written off, shifting payment to equity holders of the credit provider. On a large scale, this might even lead to bankruptcy of the credit provider, dividing payment between depositors (in case of a bank) and equity holders (Docherty & Viort, 2014, p. 21–23). When central banks or governments have to intervene to prevent serious financial disruption, payment is shifted to the government, or in other words, to the entire society (Docherty & Viort, 2014, p. 29–32). Credit risk can be conceived as the risk that an entity other than the borrower will have to repay the loan.

A South African provider of microfinance, which diversified into asset-backed loans and was in turn financed by a major commercial bank, was highly exposed to the property market, as it financed aggressive development projects. Defaults on loans increased, and in 2009 had reached such a high level that the bank exercised its security and became the single largest shareholder, substantially diluting the original owners' equity. In this case, the commercial bank was compensated for its risk obligation by acquiring ownership (Board of Directors, 2014). This emphasises that avoidance of reckless credit is an important measure to reduce credit risk.

4.7.2 Legal risk

In this section the concept of legal risk and measures to mitigate credit risk are discussed.

4.7.2.1 The concept of legal risk

In Chapter 2, section 2.3.2.1.5, Chance et al. (2007, p. 592) describe legal risk as the possibility of loss arising from failure of the legal system to enforce a contract in which an enterprise has a financial stake, while Young (2014, p. 16) points to failure to operate within the constraints of law.

Section 3.2.2.4 explains that the National Credit Act (no. 34 of 2005) was enacted to protect vulnerable consumers who collectively form a strong political force. This Act is in itself testimony to the importance of legal risk, as it introduced new concepts to the country's law, such as affordability (see section 79), reckless lending (see section 80) and debt counselling (see section 46) to protect vulnerable consumers (Logan, 2008, p. 3). Another example followed the unrest at the Marikana mining area in 2012. This uprising is reported to have altered the ease with which judges grant emolument attachment orders, as it has a negative influence on unsecured lenders' ability to collect payments all over South Africa (Cairns, 2014). As asset-backed credit does not target this market of unsecured lending, as such, this aspect of legal risk was discounted for the purposes of this study.

Even with mortgaged lending, loan providers need to ensure that they act within the constraints of the law. In a judgement of the North Gauteng High Court, it was ruled that an elderly couple's loan (capital as well as interest) had to be waived completely, as the couple was clearly unable to repay the loan and it therefore was reckless lending by the bank (Versluis, 2016).

More relevant to asset-backed short-term lenders is the new process of business rescue (see Joubert, 2011). The purpose of business rescue is to replace the old system of judicial management for companies in financial trouble, by a process aimed at rehabilitating the commercial prospects of a firm in financial distress. In commercial circles, there was uncertainty whether this would be a blanket remedy for all companies with financial problems, to postpone liquidation. A High Court judgement, indicated that courts would take circumstances in consideration and only grant business rescue to those with a realistic chance to be rehabilitated (Joubert, 2011; Tselane, 2012).

Legal risk is exemplified by two cases in South Africa's Supreme Court of Appeal:

- In one case asset-backed lenders were denied exercising their security, as the contract was deficient (Ponnan, 2010).
- In another case, an asset-backed borrower was ordered to pay an outstanding amount of R3.9 million, but twenty six months elapsed between ceasing payment and being ordered to resume (Ponnan & Majiedt, 2011). This means that for longer than two years, the lender was under risk of losing payment, as

well as incurring legal cost. Even if it had been convinced of a favourable judgement, it operated with an unexpected discontinuity in cash flow.

Legal risk should be considered a real risk, even when all precautions are taken to prevent it. Legal risk events may emanate purely from the opponents perspective, even when not upheld by a court of law.

4.7.2.2 Measures to mitigate legal risk

A private provider of asset-backed short-term finance should ensure that all contracts are above suspicion and measures should be taken to prevent business rescue from being used beyond its legitimate aim. Legal due diligence by a specialised legal team is indispensable. For example, an outdated or fraudulent title deed can be presented, which will only be clear once an extract from the records of the Registrar of Deeds is obtained.

4.7.3 Operational risk

In this section the concept of operational risk and measures to mitigate operational risk are discussed.

4.7.3.1 The concept of operational risk

In section 2.3.2.1.8, operational risk is defined as risk events due to the shortcomings of people, processes and systems, as well as natural disasters (see Young, 2014, p. 21).

The case of the private credit provider discussed in section 4.7.2 also illustrated operational risk. Personnel and board members did not act according to the law, with serious implications for the whole business. In this case, the provider decided to divest from, among others, property acquired by exercising securities on defaulting asset-backed loans (Board of Directors, 2014).

Another example of operational risk is a disaster which struck one of the major commercial banks in South Africa. A fire in a store room, where the original copies of mortgage loan agreements were stored, caused the bank to be unable to provide these documents when applying for summary dispossession orders. In a particular case, this resulted in a failed application (Brand-Jonker, 2014).

4.7.3.2 Measures to mitigate operational risk

Operational risk partly depends on the integrity of people involved. Appointment of dependable personnel and meticulous personnel management are essential. All possible measures should be taken to guard against failure of systems. Either internal capacity or outsourcing key functions like information systems should ensure that information is backed up and that all systems are resilient. The occurrence of natural disasters are beyond human control and should be mitigated by using strongrooms to store essential documents and assets and by insurance against floods, fire and acts of God (Ferris, 2010).

4.7.4 Reputation risk

In this section the concept of credit risk and measures to mitigate credit risk are discussed.

4.7.4.1 The concept of reputation risk

Reputation risk is globally rated by executives of large companies as the top strategic business risk, which is driven by other business risks; key stakeholders for reputation risk are customers, while loss of revenue and brand value are the key effects (Serafin, 2014, p. 1). The Deutsche Bank (2015) confirms this view by stating that its business model is based on trust, which means that all transactions which might undermine public trust are avoided.

According to Jain (2012), financial institutions tend to deal with risk in isolation, creating “risk islands”. However, it appears that reputation risk is a risk of risks, where which each risk has an effect, insofar as the brand value of the bank is reduced in the public perception. The author suggests a holistic approach to risk, which culminates in reputation risk being reduced. Brown (2007) says that a tarnished reputation rather than intrinsic weaknesses in the bank itself led to the high volume of withdrawals, which forced Northern Rock in 2007 to be rescued by the Bank of England.

Asset-backed short-term credit providers are, according to the CEO of one such institution, exposed to the reputation risk that they provide reckless credit. He expands on this view by stating that the typical customer of the industry is a high net-worth individual, with investments tied up in other instruments, who needs a cash injection for commercial purposes (Correspondent, 2012).

4.7.4.2 Measures to mitigate reputation risk

As reputation risk is described as a risk of risks, it is mitigated by avoiding all other risks. Reputation takes time to build, but can instantly be destroyed by indiscretions such as fraud and bribery, interruptions of key services, poor customer service, joint ventures with other organisations with a bad reputation and breaches of law and regulations (Young, 2014, p. 15). In asset-backed short-term finance (as in other industries), one firm does not have control over the operations of another firm in the same industry. The only mitigating measure for operational risk under a specific firm's control is the integrity and dependability of its own operations. In order to prevent bad reputation, no compromise on the above issues can be tolerated.

4.7.5 Liquidity risk

In this section the concept of liquidity risk and measures to mitigate liquidity risk are discussed.

4.7.5.1 The concept of liquidity risk

As stated in Chapter 2 (section 2.3.2.1.3), liquidity risk is the risk that banks cannot meet their obligations towards depositors (Heffernan, 2013a, p. 1–2) while Choudry (2011, p. 144) refers more broadly to the ability to maintain or generate sufficient cash reserves to meet the payment obligations of banks in full as they fall due, on acceptable terms. Banks use loans from the SARB as a central measure to mitigate liquidity risk, which is inaccessible for private credit providers.

In an interview with the deputy head of market operations of the SARB, it was confirmed that, within the limits of monetary policy, and given necessary collateral, the SARB can supply liquidity to banks indefinitely (Hugo, 2017). This facility is not available to providers of asset-backed short-term finance.

Borrowers who fail to repay their loans on schedule pose considerable liquidity risk for private credit providers. Even though collateral can be liquidated, it takes time, especially if borrowers resort to legal measures to postpone or avoid payment (see also section 4.7.2 for a discussion on legal risk). Liquidity risk is therefore entirely the responsibility of the private credit provider.

4.7.5.2 Measures to mitigate liquidity risk

Based on asset-backed short-term credit provisioning as defined in section 4.2 above, these providers are not banks and can therefore not accept deposits. The provider can only be financed by equity and debt, which removes the risk of unexpected withdrawals of funds. The fact that the provider knows exactly which amount is available for lending (the absence of upside risk that more deposits than expected are received), means that the provider is less likely to overextend its resources. Both these factors place a considerable limit on liquidity risk. However, as equity holders and creditors need to be compensated according to a predetermined schedule, liquidity risk must still be considered.

The measures to be taken could be the same as those for credit risk. A private credit provider's main instrument to contain liquidity risk is meticulous collection of payments. Sufficient funds should always be available to meet all obligations, even when payments are not received on schedule. There is no indication in literature of the appropriate level of reserve funds, and this will be determined by fixed costs. This matter is suggested as a topic for further study.

4.7.6 Strategic risk

In this section the concept of strategic risk and measures to mitigate strategic risk are discussed.

4.7.6.1 The concept of strategic risk

In defining strategic risk, Serafin (2013, p. 4) emphasises those risks created by the business strategy and strategic objectives of an organisation. Bromiley et al. (2014, p. 6) approach the concept in coherence with strategic management as an academic discipline, indicating that macro- structural decisions that determine internal risk taking are as important as the risks inherent in the strategic decisions of the company. These authors add that strategic decisions are different to other decisions, because once taken, they determine operational decisions that follow (Bromiley et al., 2014, p. 6). Strategic risk is unavoidable. The decisions that define a firm has the upside risk of guiding it towards success, and the downside risk of either leading to its ruin or the firm not fully realising its potential. A single very important policy decision could pose strategic risk inasmuch as a set of policies could lead to taking a number of

inappropriate small risks. Therefore the CEO and Board of a company are responsible for managing strategic risk (Bromiley et al., 2014, p. 7).

4.7.6.2 Measures to mitigate strategic risk

The CEO and Board of Directors of a private provider of asset-backed short-term finance should at all times analyse strengths, weaknesses, opportunities and threats in the firm's business environment, and act upon it (see Bull, Jobstvogt, & Bohnke-Heinrichs, 2016 for a brief discussion of SWOT). The decisions to conduct asset-backed loans as opposed to unsecured loans, and short-term rather than long-term loans are key strategic decisions. Other strategic decisions deal with the level of fixed expenses, referring to physical facilities, staff appointments, and the level of reserve funds to be maintained. Strategy should aim to realise income opportunities, while maintaining the resilience of the firm to risk events.

The sub-sections above demonstrated that risk is omnipresent in the credit industry. Some facets of risk can be avoided, while others need to be managed. In crafting a structured approach to asset-backed short-term finance, the theory gleaned from the literature mentioned above is combined with empirical evidence acquired from questionnaires completed by providers of asset-backed short-term finance.

The case study in the next section involved risks which were managed inappropriately.

4.8 CASE STUDY: AFRICAN DAWN: UNSUCCESSFUL PROVIDER

To avoid a purely abstract discussion on risk, the narrative of an unsuccessful provider of asset-backed short-term finance is discussed in this section, in order to observe which critical risks were not attended to.

4.8.1. Narrative

African Dawn Property Finance 2 (Property) Limited (or Afdawn) was a microfinance company, which diversified into asset-backed loans. By 2009, it was highly exposed to the property market, as it financed aggressive development projects and were in turn financed by Nedbank. However, defaults on loans increased, and in 2009 reached such high levels that Nedbank exercised its security and became the single largest shareholder. An investigation revealed instances of fraud and bad management leading to the replacement of key managers and board members (Cobbet, 2009). Nedbank's share was sold to PCI Fintrade. In 2014, Afdawn planned to divest from,

among others, properties in possession as a result of exercising securities on defaulting loans (Board of Directors, 2014, p. 3).

The deterioration in Afdawn's fortunes was indeed dramatic. On 1 October 2009, Moneyweb reported that the CEO, the Chief Operational Officer and the Financial Director of Afdawn had not been re-elected during the annual general meeting of the company, and their remuneration (which had already been paid) was disapproved. The three individuals received a combined amount of R4.92 million in salaries, and bonuses in excess of R6 million. It emerged that a large amount was lost through exposure by the subsidiary of the firm, Allegro Holdings, to Corporate Money Managers (CMM), which was placed under curatorship earlier that year. Nedbank played an important role in the decisions, as loans to Afdawn had been converted into shareholding, upon default (Cobbet, 2009).

In the *Financial Mail* of 2 April 2012, it was noted that the total share price of Afdawn as traded on the JSE, had decreased from more than R1 billion in 2008, to R24 million in April 2012, which the report blamed on the operational plan if the company, which did not perform as expected (Hasenfuss, 2012).

Part of Afdawn's deterioration unfolded with CMM's curatorship report in 2012. It emerged that approximately R1.15 billion was lost by CMM, Cash Managed Funds (CMF) and ten related companies. CMM was a subsidiary of Afdawn, which consequently lost the same amount. The funds were sourced from investors, amongst which Afdawn's subsidiary, Allegro, under pretext that it would be invested in safe money market funds. However, the money was used for supplying bridging finance in property deals, as well as property developments. The economic downturn, following the international recession of 2007–2008, destroyed a substantial part of these investments. In addition, approximately R1 million was used for personal expenses,[17] although an attempt was made to account for it as management fees. Absa had been a trustee of CFM, leading the curators of CMM to hold this bank liable for the indiscretions (Van Zyl, 2012).

[17] Including accompanying the Springbok rugby team on a European tour.

It must have been a relief to Afdawn that legal proceedings to annul a loan due to excessive interest charged, was dismissed in the Supreme Court of Appeal (Ponnan & Majiedt, 2011). This judgement removed doubt on the legality of asset-backed short-term finance, although it would not alleviate Afdawn's situation.

Afdawn's situation was not alleviated, because the collection of payments on bridging loans remained a challenge. In its audit condensed consolidated financial results for the financial year ending 28 February 2013, 'bridging finance' was named as one of its three business segments, which, despite a profit of R5.3 million in 2012, incurred a loss of R11.5 million in the 2013 financial year (Thornton, 2013, p. 8) and R8.9 million in the 2014 financial year. This debt book was theoretically worth R54.7 million, but R44.3 was provided for bad debts (Board of Directors, 2014, p. 74). Indeed, "Comments from the Board" in the 2014 Annual Report, mentioned that "bridging business remains a debt book which is extremely challenging to meet" (Board of Directors, 2014, p. 8). It is not surprising that Afdawn's bridging segment did not grant any new loans and "[was] only in the process of winding up all existing loans" in co-operation with the company's credit committee (Board of Directors, 2014, p. 76). The company consequently changed its strategic vision "to become an active investment holding company, acquiring shareholding in entrepreneurial companies with a strong innovation drive" (Board of Directors, 2014, p. 3). In section 4.8.2, risks which were unattended by Afdawn are identified.

4.8.2 Unattended risks

It seems that African Dawn and its subsidiaries did not sufficiently attend to their credit risk exposures. For example, Afdawn's bridging segment erred by granting excessive loans during a bubble,[18] which proved to be uncollectable in adverse circumstances.

The literature that was consulted did not indicate losses due to legal risk. Legal risk had appeared as a substantial risk, until the Supreme Court of Appeal judged in Afdawn's favour (Ponnan & Majiedt, 2011). No reference to losses due to business rescue processes was made. In 2.3.2.1.5, reference is made to Chance et al. (2007,

[18]A 'bubble' is defined as an economic cycle characterised by rapid expansion followed by a contraction (Investopedia, 2017).

p. 592), who regard legal risk as the possibility that the legal system fails to enforce a contract in which an enterprise has a financial stake. As narrated in Chapter 2, a borrower claimed that Afdawn's lending practices were reckless and contrary to the public good. The Supreme Court of Appeal upheld Afdawn's claim that it functioned within legal parameters. This removed the fear of possible legal risk for providers of asset-backed short-term finance in South Africa.

Operational risk was pertinent in the case of Afdawn. Fraudulent conduct of directors and board members which had been uncovered, was an operational risk to be blamed on both people and systems. It seems highly unlikely that the relevant people had thought that they acted in accordance with the law and good business practice. Nevertheless, the question arises why there was no internal structure able to prevent either the misdeed or the cover-up.

The critical failure, however, concerns strategic risk. Over-optimistic lending was conducted before the recession, and no mention is made of a credit committee before the top management was replaced. The target market of lenders and processes of due diligence (or a lack thereof) are strategic decisions which turned out to be catastrophic for the business.

The risks discussed above culminated in, inter alia, reputational risk, attested to by the fact that Afdawn had opted for rebranding the group (African Dawn Capital Limited, 2014).

Having discussed the example of Afdawn as an unsuccessful provider of asset-backed short-term finance, the provisioning of asset-backed short-term finance is discussed in the following section in terms of implementation.

4.9 IMPLEMENTATION OF ASSET-BACKED SHORT-TERM FINANCE PROVISIONING

According to the case study above, it is clear that the implementation of asset-backed short-term finance as a viable business venture needs well-defined and practical guidelines. The purpose of this section is to present a structured approach to the provisioning of asset-backed short-term finance. This is approached by naming institutional requirements, before providing an inventory of requirements and essential

factors to consider in order serve as a guideline during the process of granting an asset-backed short-term loan.

The notion that a juristic person should be created in order to conduct business was taken as a point of departure for this study. In 3.2.2.4, requirements set by the National Credit Act (no. 34 of 2005, are discussed. In summary, the requirements determine that credit providers need to register with the NCR if they have more than 100 customers or lend more than R0 (RSA, 2005; RSA; 2014 sections 40 and 42). In sections 46 and 47, the Act also demands that natural persons in charge of registered credit providers must comply with criteria regarding integrity, prudence and moral hazard. In addition, section 49 of the Act determines that credit providers be monitored continuously and that they can be deregistered if contravention of the requirements is proved. Aggressive marketing practices are explicitly prohibited (section 74), while over-indebtedness and reckless credit are prevented by the conditions in Chapter 4 Part D of the National Credit Act (RSA, 2005; RSA; 2014).

Underlying the National Credit Act is the responsibility to protect vulnerable consumers from ruthless credit providers. However, high net-worth business persons are the target market for asset-backed short-term finance, and not vulnerable consumers. According to section 4(1)(a)(i) of the National Credit Act, “a juristic person whose asset value or annual turnover of all related juristic persons, at the time the agreement is made, equals or exceeds the threshold value determined by the Minister in terms of section 7(1)” (RSA, 2005; RSA; 2014, is not protected by the Act. This ministerial level is still determined at R1 million (Mpahlwa, 2006).

The importance of the preceding two paragraphs is that providers of asset-backed short-term finance are compelled to register with the NCR, but are not constrained to the same extent as providers of unsecured loans.

The following paragraphs suggest eight steps to be taken when a registered provider of asset-backed short-term finance consider loan applications. Step 8 (ensure own liquidity) could also be conceived as step 1, as it deals with the requirement to ensure that sufficient funds are available to survive foreseeable risk events.

4.9.1 Steps for implementation of asset-backed short-term finance

In the following paragraphs eight steps for implementation of asset-backed short-term finance are discussed.

4.9.1.1 Step 1: Preliminary interview

A preliminary interview should be arranged to establish the needs of the customer and to screen the ability of the customer to provide security. The speed with which providers of asset-backed short-term finance can reach decisions and provide funds to customers, is an essential feature of this form of finance (see sections 4.1 and 4.2 above). However, prompt payment depends on all documentation relating to the customer as well as the collateral being available and in order. When a movable asset is offered as collateral, the asset itself has to accompany the application. After the screening process, a formal meeting is arranged. This step should indicate the level of credit and legal to be expected.

4.9.1.2 Step 2: Determine exact purpose of the loan

Section 4.2 defines asset-backed finance as commercial lending backed by an asset, in opposition to unsecured consumer lending. A credit relationship can only be established if the customer's needs match what the provider offers. This will assist in estimating credit risk.

4.9.1.3 Step 3: Evaluate merit of prospective loan in a comprehensive discussion

According to section 4.3 above, asset-backed short-term finance is an outflow of the inability of banks (due to legitimate considerations) to enter into individualised customer relations. Private providers of asset-backed finance can assist customers with non-standard applications by entering into comprehensive discussions on the merit of the application and the customer's unique circumstances. This step could also indicate the level of credit risk.

4.9.1.4 Step 4: Determine value of the offered collateral

It was noted in section 4.4 that providers of asset-backed short-term finance are prepared to advance 60% of the value of an asset, with two purposes in mind:

- for the customer, the potential loss in case of loan default is increased, serving as incentive to repay the loan; and
- in case of default, forced sale of the asset may lead to a deflated price being realised, putting the lender's investment at risk.

Due to the above-mentioned factors, an accurate valuation is essential. If the proposed collateral is real estate, it is advisable to use the services of a professional valuer. In South Africa, professional valuers are required to register with the statutory South African Counsel for the Property Valuation Profession (SACVP). Valuers with different speciality areas and in all regions of South Africa can be found on the website of the SACVP (SACVP, 2016). There is also the voluntary South African Institute of Valuers (SAIV), which can assist in finding a suitable valuer (SAIV, 2016).

However, the use of a valuer is not compulsory, as untrustworthy valuations only compromise the loan provider, whose demise poses no systemic risk (section 2.3.2.1.6).

Collateral is used to limit credit and liquidity risk. It also indicates whether the loan is within strategic limits, hence, limiting strategic risk.

4.9.1.5 Step 5: Determine customer's legal title to collateral

Section 4.4 highlighted the necessity to ascertain that a customer has the legal right to offer the proposed collateral. Proof of ownership and proof that no other legal claim to the relevant collateral exists have to be supplied. The credit provider must be able to confirm customers' claims. A current title deed to real estate is required, to prevent a customer from registering a mortgage after obtaining a replacement title deed. This step could address credit, legal and liquidity risk.

4.9.1.6 Step 6: Establish own legal claim to collateral

In section 4.4, the importance of establishing a legal claim to collateral was accentuated, the absence of which can render a loan unredeemable. A contract which exactly stipulates the rights and obligations of both parties is essential. This step is primarily aimed at legal risk.

4.9.1.7 Step 7: Take possession of collateral

Section 4.4 indicated that possession of collateral enables credit providers to exercise security when borrowers default on their loans. With real estate, payment must be withheld until the mortgage is registered. Movable assets must be physically possessed until all obligations are met. This step concludes the steps taken to mitigate credit risk.

4.9.1.8 Step 8: Ensure own liquidity

As outlined in section 4.5, private credit providers are not allowed to take deposits and can only lend own or bank-borrowed capital. Banking regulatory requirements on capital adequacy ratio (CAR) and liquidity coverage ratio (LCR) are not applicable to private credit providers. Authorities employ these ratios, because the cost of failing banks is often shifted to the state (section 4.7.1). Because no central bank or regulatory authority will rescue private credit providers, these entities have to ensure their own liquidity. Literature does not indicate the percentage of available capital which should be lent out by private credit providers. This self-determined level should vary with the ratio of equity to borrowed capital and enable the private credit provider to survive foreseeable credit and liquidity risk. This step is taken to prevent liquidity risk.

The eight steps discussed above provide an analysis of a successful loan cycle, where the borrower gains by the availability of funds to pursue an opportunity for profitable business, and the lender gains by advancing a loan which is concluded on profitable terms. From the lender's point of view, it is not critically important whether the profitable conclusion is the result of scheduled payment or of trading an asset.

Operational risk is incurred when internal people, processes and systems or external events fail, resulting in losses for the firm (Young, 2014, p. 21). It is therefore recognised as an underlying risk regarding all said steps.

4.10 STRUCTURED APPROACH TO STRATEGIC POSITIONING OF ASSET-BACKED SHORT-TERM FINANCE

Cant (2009b) emphasises the need to focus on the macro environment in order to position itself strategically. This is the purpose of the following section.

4.10.1 The macro environment

In this section the macro environment in which providers of asset-backed short-term finance operate, is described.

4.10.1.1 What the macro environment includes

The macro environment refers to conditions in the economy as a whole, rather than a particular sector or region (Investopedia, 2017). Cant (2009b, pp. 24–25) states that

the macro environment is so diverse that it is virtually impossible for one person to observe, analyse and incorporate it fully into strategic planning. Cant (2009b, pp 26–35) identifies technological, governmental/legal, economic, social/cultural, demographic and international factors, which are discussed in terms of asset-backed short-term finance in the sections below.

4.10.1.2 Technological factors

In section 2.2.3, the nature of credit in modern monetary economies is discussed. In reference to the role of banks, the increasing role of ICT in delivering bank services efficiently was mentioned. This is the context in which banks as 'service factories' (delivering routine services fast and inexpensively using ICT) were mentioned, followed by the observation that 'service shops' (delivering non-routine services to specific needs using human judgement and knowledge) is an inevitable result. Banks increased their use of ICT, which resulted in a decreased capacity to evaluate non-standard loan applications, creating a niche in the market for credit providers with the knowledge and skills to deliver a differentiated service.

4.10.2.3 Governmental/legal factors

It was noted in section 3.2.2 that the South African financial sector is internationally regarded for its well-regulated nature. The most important pieces of legislation are the Banks Act of South Africa (no. 94 of 1990) (RSA 1990), which prohibits private providers of finance to accept any deposits (in other words, to act like a bank) and the National Credit Act (no. 34 of 2005) (RSA 2005). The aim of this part of the Act is to protect the interests of vulnerable customers against reckless lending practices. The Act unequivocally excludes wealthy customers from its protection and permits borrowers to obtain loans against security of some valuable item ('pawn lending' – see Robinson, 2012). The strategic position of asset-backed finance as set out in section 4.2 is to provide loans to high net-worth business persons, who offer sufficient collateral to redeem the loan amount in case of default. This position is affirmed by the governmental and legal factors mentioned.

Legislation concerning business rescue is another legal factor which might influence providers of asset-backed short-term lenders. According to this process, the collection of overdue debt from businesses in distress, but which might still be saved, can be

postponed. In section 4.7.2, it was indicated, however, that South African courts are intolerant to attempts to frustrate legitimate debt collection through business rescue.

4.10.2.4 Economic factors

The description of asset-backed short-term finance in sections 4.1 to 4.3 and 4.6 indicated that customers use asset-backed short-term finance for different reasons during different stages of the economic cycle. In a bull market, many opportunities present themselves, and entrepreneurs tend to demand loan decisions within a short period to avoid losing an opportunity. In a bear market, loan providers may be more sceptical about borrowers' repayment ability. In the first instance, the provider of asset-backed short-term finance has the competitive advantage of a quick loan decision, and in the second instance, of being prepared to evaluate collateral and to provide a loan, even if the purpose of the loan appears risky.

4.10.2.5 Social/cultural factors

In section 3.2.3.3, the desire of banking customers to interact with the bank on a human level was discussed. This desire convinced banks to offer 'private banking' to their wealthy customers, in order to mitigate the depersonalising effect of the increased use of ICT. The deduction is made (and was tested in the empirical investigation) that customers do not merely demand (or at least prefer) human contact, but direct contact with a person authorised to make the relevant decisions. This is a need specific to wealthy customers with irregular incomes (the typical customer of asset-backed short-term finance, according to section 4.6), as other customers may find all their answers from a computer-literate official.

4.10.2.6 Demographic factors

An important demographic factor named by Cant (2009b, p. 34) is the increased age of people in developed communities, who also have fewer children (due to a declining birth rate in such communities) and therefore more wealth for a longer time. People in this group have normally acquired assets of high value, although their regular real income declines due to inflation. These customers may find it hard to meet banks' standards for loan provisioning, but can lever some of their assets to obtain finance from an asset-backed loan provider.

4.10.2.7 International factors

International financial regulation is an imperative in the present, globalised economy, as dramatically illustrated with the economic crisis of 2007–2008 and discussed in section 2.3.3. According to the Basel Accords of bank regulation (see 2.3.3.3.5) as applied by the SARB, commercial banks are required to increase their CAR, as well as their LCR (discussed in 3.2.2.5.1). These international trends decrease the ability of banks to lend, and force borrowers to credit providers who are not subject to the same measures. The reason for this regulatory advantage is the fact that private lenders only lend out their own money and are less likely to cause systemic risk, as discussed in 2.3.2.1.6.

4.10.2.8 Strategic position of asset-backed short-term finance

Providers of asset-backed short-term finance take advantage of their high levels of knowledge, skills and experience to evaluate non-standard loan applications. They are favoured by several macro-environmental factors:

- draining of the above-mentioned knowledge from banks, due to the role of ICT (see discussion in 2.2.3.3);
- international financial regulations which damp down the lending appetite of banks;
- applicants' social and functional preference to interact directly with decision-makers;
- demographic trends, which increase the size of the target market;
- a domestic regulatory framework, which aims to protect vulnerable consumers without unnecessary restrictions on loans to the target market; and
- provisioning of a service which can benefit by periods of economic growth and constriction.

The strategic position of asset-backed short-term finance is the provisioning of loans to customers who possess sufficient collateral to cover the cash-flow constraints they experience. Due to changes in the macro environment, banks are decreasingly inclined to service the needs of such customers, which opened the niche for private credit providers, which was the topic of this study.

4.11 THE CONCEPT OF A STRUCTURED APPROACH TO STRATEGIC POSITIONING

The title of this dissertation is “A structured approach to the strategic positioning of asset-backed short-term finance: A South African perspective”. Therefore the present (and last) chapter of the literature review (dealing with a description of asset-backed short-term finance as an industry), merits an overview of a structured approach to strategic positioning of the industry. Individual firms, which investigate and plan their strategic positioning, follow the steps of strategic analysis, investigating market strategies and strategy implementation, according to Jooste, Strydom, Berndt, and Du Plessis (2009, p. 11–14).

According to the Harvard Business School (President @ Fellows of Harvard University, 2016), strategic positioning reflects the choices a company makes about the kind of value it will create and how to be discerned from its rivals’ choices. The choice is between differentiation and cost leadership. **Differentiation** entails commanding a premium price through distinctive value, while **cost leadership** means to deliver acceptable quality at the lowest possible cost (President @ Fellows of Harvard University, 2016), which resonates with the discussion of ‘service shops’ (focusing on differentiation) and ‘service factories’ (focusing on cost) in section 2.2.3.3.

Kim and Mauborgne (2009) refer to the definition in the previous paragraph as the structuralist approach, i.e. a business accepts that its options are bound by the structure of its environment, and selects to compete either on cost or differentiation. The authors also identify the alternative of a reconstructionist position, which can only be followed when a firm can compete on cost and differentiation – in such a case, the entire environment is reconstructed. They posit that the three propositions of **value** (customer’s perspective), **profit** (owner’s perspective) and **people** (employees and suppliers) need to be aligned with the strategic approach of the firm. As will be indicated in the next section, asset-backed short-term finance is an industry which exploits a niche in the credit market and therefore follows a structuralist approach.

The sequence of choices to reach a strategic position is schematically presented in Figure 4.2, which has also been presented as figure 1.1, where it indicates the strategic positioning of asset-backed short-term finance.

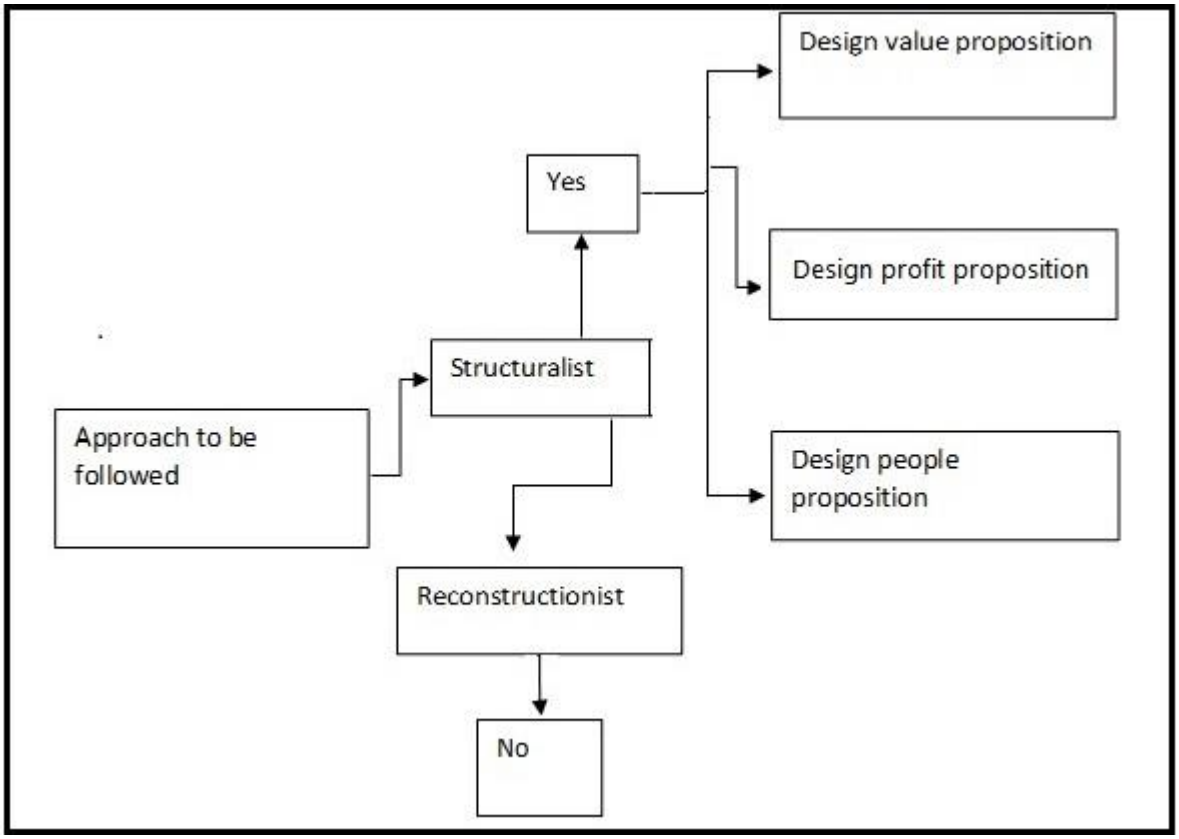

Figure 4.2: The sequence of choices to reach a strategic position – devised by the author

In terms of the present study, the following sequence of decisions was decided upon, as will be indicated:

- A **structuralist approach** was followed, as the emergence of asset-backed short-term-finance as an industry is a direct result of changes in the structure of the macro environment, as indicated is section 4.10.1.
- The **value proposition** is explained in section 4.3. It can be summarised as supplying liquidity to firms when time is prioritised above interest rate.
- The **profit proposition** is explained in section 4.2. It can be summarised as the ability to supply liquidity at an above average interest rate and securing payment either as scheduled or by taking possession of an asset of sufficient value.
- The **people proposition** involves the following:
    - The **internal** people proposition demands that staff have the ability and authority to evaluate a loan application with the security offered, and to make a prompt decision, as discussed in section 4.2.

- The **external** people proposition may include **suppliers**, which in this case involves the creditors of the provider of asset-backed short-term finance. In section 4.5, it is explained that providers of asset-backed short-term finance do not have access to the supply of liquidity central banks have, while sections 4.7.1 and 4.7.5 highlighted the significant credit and liquidity risk incurred. It is therefore recommended that only equity capital be employed, which rules creditors out of the external people proposition.
- The external people proposition also includes **customers**. As asset-backed short-term finance is a relatively new and academically unexplored industry (section 1.2), this aspect needs closer investigation. In order to refine the operations of a provider in this industry, the ranking in order of preference of different types of loans under different circumstances from the customer's point of view needs to be explored. This is the unique contribution to the body of academic knowledge made by this study.

4.12 CONCLUSION

As indicated in Chapter 1 (see section 1.3.3), this study aimed to develop a structured approach for the strategic positioning of a private credit-providing enterprise specialising in asset-backed short-term finance, which could assist in ensuring success in the credit provisioning market. The objectives in support of the aim of this study were:

- to determine why some business persons prefer private asset-backed short-term loans to credit from commercial banks; and
- to develop a framework for asset-backed short-term finance as a structured approach that could assist the existing and potential market players to ensure a successful enterprise.

Indications of the reasons why some business persons prefer private asset-backed short-term loans to credit from commercial banks were gleaned from literature and set out in this chapter. Banks' appetite for lending is limited by the increased capital requirements due to strict regulatory guidelines, such as proposed, for example, by the Basel Accords, and operational risk measures, which limit the discretion of

individual bank officials. In addition, due to the development of ICT, it is cost-effective for banks to employ computerised decision-making systems, based on predetermined criteria regarding income and credit record. The result is a necessary waiting time between loan application and decision-making, especially when individual circumstances and the value of collateral have to be considered. A possible notion that banks will realise the need for decision-making by human judgement and reinstate the traditional bank manager will most probably not realise,due to regulatory requirements discussed in section 4.5. Private credit providers, who are unregulated due to the absence of systemic risk and who are equipped with the knowledge and skills to evaluate credit applications on individual merit, can be expected to partly fulfil this need.

A framework for asset-backed short-term finance was presented in section 4.7 by attending to different concepts of risk and mitigating measures relating to each relevant risk; followed in section 4.8 by an inventory of requirements and steps to follow in the provisioning of asset-backed short-term finance.

The strategic positioning of asset-backed short-term finance followed in section 4.9. It was found that this industry is favoured by the present macro environment, on condition that executive persons have high levels of knowledge, skills and experience, and that the target market of customers with sufficient assets to cover their loans be strictly adhered to.

A discussion of the concept of a structured approach to strategic positioning in section 4.11 indicated that the value and profit propositions of providers of asset-backed short-term finance were satisfactorily gleaned from the literature review. Chapter 5 provides a framework for the implementation of asset-backed short-term finance.

CHAPTER 5

FRAMEWORK FOR THE IMPLEMENTATION OF ASSET-BACKED SHORT-TERM FINANCE

5.1 INTRODUCTION

In the previous chapters, the financial industry of asset-backed short-term finance was put into context against the global phenomenon of credit provisioning (Chapter 2) and credit provisioning in South Africa (Chapter 3), before the industry itself was described and an analysis presented in Chapter 4. The aim of this chapter is to reflect a framework for operating an asset-backed short-term credit provisioning enterprise. The aim was to create a framework, which identifies strategic considerations, systems, processes and people essential for operating such an enterprise, without being prescriptive on implementation.

5.2 ANALYSIS OF ENVIRONMENT

In this section, the external and internal environments in which a provider of asset-backed short-term finance operates, are discussed. The function of this discussion is to show the strategic position which informed subsequent deliberation.

Political instability and low growth rate are the most important downward drivers in the rating by credit ratings agencies of South Africa's sovereign credit rating, while ‘deep local capital markets’, strong policy institutions and a favourable government debt structure are the positive factors (Staff Reporter, 2016).

5.2.1 External environment

The external environment influencing a framework for the implementation of asset-backed short-term finance is discussed in this section, referring to the macro-environment and regulatory requirements.

5.2.1.1 Macro-economic environment

The macro environment for asset-backed short-term finance was described in Chapter 2 (credit in a modern monetary economy) and Chapter 3 (credit provisioning in South Africa). These findings were summarised in section 4.3 (market position of asset-backed short-term finance), 4.5 (regulatory requirements) and 4.7 (risk). The most important finding was that global regulatory requirements compel banks to implement

time-consuming processes before non-standard loan applications can be decided upon, and that South Africa is no exception. This created a market for asset-backed short-term finance as a legitimate and growing financial industry.

In creating a framework for prospective providers of asset-backed short-term finance, the general business environment in South Africa is part of the external environment. The country's credit rating had by 2016 been downgraded to just above junk status by the major credit-rating agencies, with political instability and a low growth rate reported to be the most important downward drivers in this regard (Staff Reporter, 2016). In April 2017 two rating agencies (Fitch and Standard & Poor) downgraded South Africa to junk status, while Moody's kept the country above junk status, but with a negative outlook (Van Wyk, 2017).

In the 2016–2017 GCR, South Africa's shortcomings are identified as:

- stalled infrastructure development;
- power shortages;
- diminishing institutional quality;
- increased political uncertainty;
- less transparency in terms of governance;
- security concerns;
- business leaders having less trust in politicians;
- slowdown of Chinese economy (as South Africa supplies commodities to China);
- exchange rate volatility; and
- unlikeliness of improvement in the high unemployment rate (Schwab, 2016, p. 30).

Any of these negative indicators might cause a serious downturn in the South African economy, in which case collateral provides superior guarantee to an emolument attachment order, which is a common alternative for collateral (Cairns, 2014).

While banks lend depositors' money and have access to central banks in times of credit crisis, the independent credit provider is fully responsible for all unrecoverable loans. Therefore banks take a long-term view on credit provisioning, which may be regarded as imprudent for the independent credit provider. This is important, because

this type of credit provider may tend to focus on acquiring assets (repossessed collateral) if focus on the short term becomes blurred. This may even put the lender in the predicament of its customers, of having valuable assets, but insufficient liquidity.

The next section reflects regulatory requirements for independent credit providers.

5.2.1.2 Regulatory requirements

While every business is subject to the laws of South Africa, the financial sector is regulated according to sector-specific legislation, as described in section 3.2.2.

The only institutions legally entitled to receive deposits, are banks. This excludes independent providers of asset-backed short-term finance (Banks Act, no. 94 1990) (RSA, 1990).

The National Credit Act of 2005 (no. 34 of 2005, section 4) requires every provider of credit “at arm’s length” to register with the NCR. Credit providers who lend out less than R500 000 per year had been exempt from this provision, but this exception had effectively been repealed, when a government notice in 2016 determined the lower limit for compulsory registration as R0 (dti, 2016).

The Financial Intelligence Centre and Counter-Money Laundering Advisory Council (see Hendricks, 2015) was established by the FICA (Act no. 38 of 2001) (RSA, 2001) (Preamble to the Act) and is supported by the Money Laundering and Terrorist Financing Control Regulations (FIC, 2012, pp. 71–108). This is qualified by a policy statement, Exemptions in terms of the FIC Act (no. 38 of 2001) (FIC, 2012, pp. 109–127), and affirmed by the Prevention of Organised Crime Act (no. XX of 1998) (FIC, 2012, pp. 128–209), and the Protection of Constitutional Democracy against Terrorist and Related Activities Act (no. XX of 2004) (FIC, 2012, pp. 210–254).

All accountable financial institutions are obliged to register with the FIC and to adhere to the following:

- verifying the identity of persons with whom they do business;
- keeping records of all transactions for five years;
- providing this information to an authorised representative of the FIC when requested to do so;
- reporting any cash transaction above a prescribed limit to the FIC;

- reporting any transaction with an entity which has committed or attempted to commit acts of terrorism; and
- reporting any other suspicious and unusual transactions (FIC, 2012, pp. 22–26).

The prescribed limit above which cash transactions must be reported (the so-called 'cash threshold report' [CTR]) is R24 999.99 (FIC, 2016). Independent providers of asset-backed short-term finance are accountable financial institutions and need to comply with this legislation.

Regulatory requirements for asset-backed short-term finance can be summarised as not receiving any deposits, registering with the NCR and adhering to the provisions of the FICA and related legislation.

5.2.2 Internal environment

The internal environment of a business is highly individual. Considering the risks relevant to this industry, as described in section 4.7, certain guidelines can be presented.

Credit provisioning requires intensive management to prevent any credit, legal, operational, reputation, liquidity and/or strategic risks. A prospective credit provider must therefore be committed to the time-consuming and demanding tasks of evaluating each loan agreement and associated collateral, to monitor payments and to act decisively on customers' failure to pay. It could be quipped that nothing focuses the mind like the prospect of losing one's own money.

To lend money, means to share in the risks of others (Holton, 2015). This highlights the importance of having sufficient funds to stay in operation, even when delays in repayments are experienced. As can be observed in the case study in section 4.8, lending out borrowed money is an intolerable risk.

Another aspect of the internal environment is the business architecture, which may be designed with higher or lower fixed costs. This involves the decision either to employ or to outsource staff for essential business roles, as well as the choice of premises and other physical facilities. The continuous rule is to keep fixed costs as low as possible in order to enhance the resilience of the enterprise (Investopedia, 2017).

The case study in section 4.7 can again be referred to as an example where high margins hid the focus of management from a high cost structure and the risks posed by borrowers' risks. An appropriate strategic response to the external and internal environment is provided in the next section.

5.2.3 A structuralist strategic approach

In section 4.10.2, the features of a structuralist strategic approach were contrasted with a reconstructionist approach. A reconstructionist approach is appropriate for an enterprise which can alter the entire environment in which it operates, while a structuralist approach subdues itself to its own limitations, given the structure of the market (section 1.4.1). This leads to a decision on market position, which is discussed in section 5.3.1. Suffice here to state that, as indicated in section 4.4 and repeated in section 5.2.1, the market for asset-backed short-term finance was created by changes in the market structure. The aim of this industry can therefore be seen as not to recreate the credit industry, but to utilise an opportunity created by it.

From the discussion above follows that it is strategically important for providers of asset-backed short-term finance to follow a structuralist approach, inhabiting a clearly defined niche in the credit market with emphasis on a lean business structure, prudent in the choice of premises and keeping permanent staff as low as possible. As will be indicated in section 5.4, this staff policy must be balanced by close co-operation with independent professional service providers.

In the following sections, the value proposition (the viewpoint of customers) offered by a provider of asset-backed short-term finance will be followed by the profit proposition (the viewpoint of the enterprise itself) and people proposition are discussed.

5.3 Value proposition: Market position

As indicated in section 4.10.2, the industry of asset-backed short-term finance was created partly as a result of increased bank regulation, which precludes prompt decision-making within banks. By identifying the market position of the industry, this section on the value proposition reflects a review of the position of asset-backed short-term finance within the credit provisioning environment, and provides an operational description to illustrate the market position. A more complete description of operations, however, follows in section 5.4 on the profit proposition, which gives an overview of systems and processes employed.

Competition as a business principle was discussed in section 1.8.1.2.5. Porter's (2008) model of five competitive forces, which views suppliers and customers as competitors, together with direct competitors, substitutes and possible entrants to the market, was investigated. However, Moore's metaphor (1993) of businesses interacting like elements of an ecosystem (sometimes competing, sometimes co-operating and with frequent changes in leadership), was found more accurate. This is coherent to the structuralist approach described in section 5.2.1.

Key to understanding asset-backed short-term finance as an industry is the realisation that the operation of banks has changed irrevocably. As indicated in section 2.3.3, globalisation of the economy and the easy flow of money expanded the scope of irregular management of the public's funds – spectacularly illustrated by the demise of Barings Bank as discussed in section 2.3.2.1.

Bank regulators and the industry itself responded by curbing the authority of individual managers. This was enabled, but the effect also compounded, by advances in ICT as discussed in section 2.2.3.4. The local bank manager with knowledge and experience of customers' characters and local property values and the authority to base decisions on it, has been superseded by junior personnel who obtain the response to loan applications from computer programmes.

Market position also dictates the location and nature of premises. Providers of consumer credit (banks, microlenders and pawn shops) vie for attractive premises in busy areas, which may constitute a substantial part of the fixed costs of the firm. However, the same factors do not apply to providers of asset-backed short-term finance.

Unlike consumer credit, asset-backed short-term loans are not routine business. Some kind of crisis needs to arise before a high net-worth business person will contemplate pledging a valuable asset to guarantee a loan, which the person may find embarrassing. It is also unnecessary to convince a visitor of taking up a loan. Premises should therefore be located outside normal business areas and not be too clearly identified as a credit provider, except for the compulsory indication of NCR membership (section 4.5).

Security also does not need to be on a par with consumer credit providers. No cash is handled, as the normal transaction involves electronic payment in exchange for

documents without direct value. A strongroom is nevertheless essential for the storage of these documents, as fire and damage caused by thieves looking for something valuable could be serious.

The value proposition of independent providers of asset-backed short-term finance may therefore be summarised as the 'service shop' in contrast to the 'service factory' (discussed in section 2.2.3.4). This is an element in the ecology of credit provisioning where banks are sometimes competitors but always partners (discussed in section 5.2.1). Independent credit providers follow a structuralist approach in contrast to a reconstructionist approach, which means that independent credit providers position themselves to gain advantage by gaps in the market structure. The specific traits which enable this industry to survive in a harsh ecology are the knowledge and experience to evaluate applicants and the value of the collateral customers offer, and a handy business model which enables independent credit providers to decide an act on a loan application with more speed than corporate credit providers.

The following section deals with the systems to be mastered in order to provide asset-backed short-term finance profitably.

5.4 Profit proposition: Management of systems and processes

It stands to reason that a value proposition can only be maintained in a free-market system if the associated profit proposition is successful. In this section, the profit proposition is analysed according to the systems for marketing, loan life cycle, finance, external relations, purchasing and administration. The aim of each system, as well as processes to manage it,[19] is discussed.

5.4.1 Managing the marketing system

'Marketing' refers to the flow of products or services from an enterprise to a consumer to realise the primary goal of the enterprise and to meet the needs of consumers

[19] "A system is often a set of connected things or parts forming a complex whole, or a set of principles or procedures according to which something is done. A process is a series of actions or steps taken in order to achieve a particular end. Processes and systems are often synonymous" (Hill, 2015). The systems mentioned here, can also be regarded as processes (for example (Cronje et al., 2004). 'System' does not necessarily mean 'computer system'.

(Cronje, Du Toit, Marais, & Motlatla, 2004, p. 339). This includes advertising, selling and delivering products to people (Investopedia, 2017). The aim and processes of the marketing system will subsequently be discussed.

5.4.1.1 The aim of the marketing system

This study concurs with Armstrong, Adam, Denize, and Kotler (2015, p. 4) who formulate the twofold aim of marketing as attracting new customers by promising superior value and keeping and growing customers by delivering satisfaction. Although the nature of marketing varies across industries, it can always be described as being driven by this twofold aim described by Armstrong et. al. (2015, p. 4). The processes of the marketing system are discussed below.

5.4.1.2 Processes of the marketing system

Marketing can be planned according to the so-called 'marketing mix', which consists of product, price, promotion and place (Economic Times, 2017) to which can be added people, processes and physical evidence (Acutt, 2015). Another approach is to identify the marketing decisions (regarding product, distribution, price and marketing communication) to reach the integrated processes of the marketing system (Cronje et al., 2004, p. 359). Both these approaches are problematised by the question whether marketing (in particular distribution) of services can be analysed and planned according to the same rules as marketing of products – an issue already raised in 1976 by Donelly (p. 55).

The value proposition, or market position, as described in section 5.3 implies a certain understanding of the marketplace and customer needs, wants and demands. Among a wide variety of credit needs, a well-defined niche in the marketplace was identified. This is the customer with valuable fixed assets, who nevertheless experiences a liquidity shortage and unwillingness from banks to meet this need.

A customer-driven marketing strategy is a product of understanding the marketplace. A firm which understands that it cannot meet all demands, in this case for credit provisioning, continues towards market segmentation and targeting, in order to differentiate and position itself in the market (Armstrong et al., 2015, p. 172). In the case of asset-backed short-term finance, the market has by definition been segmented to include only high net-worth customers with an urgent need for liquidity. These

potential customers must therefore be targeted by the promotional channels and content being selected, which automatically differentiate a firm and position it in the market.

Constructing an integrated marketing programme means to launch and maintain a coherent message across multiple media channels, as customers continuously and almost seamlessly use different media to be entertained and to find information (Marketing Schools, 2012). Bearing the highly targeted market for asset-backed short-term finance in mind, it is doubtful that mass advertising, printed or electronic, will be efficient. However, it is reported that more than 97% of all purchases, locally or globally, are preceded by an Internet search of the firm involved (Rampton, 2015). Donelly (1976) suggests identifying characteristics of a service which may allow for intermediaries, identifying functions that intermediaries can perform, and classifying intermediaries according to the functions that they can perform. In the case of asset-backed short-term finance, accountants and lawyers (professionals who are likely to be confronted with business persons' financial challenges) may be appropriate intermediaries, backed by Internet presence.

Customer delight revolves around exceeding customers' expectations (Business Dictionary, 2017; Ehrlichman, 2014). Asset-backed short-term finance was described in section 2.3.4 as a service shop, in other words, a business which has the capacity to focus on tailor-made solutions for a customer's specific needs. This industry excels in evaluating collateral and effecting payment within a short time span. These should be the areas in which a provider should aim to delight customers.

The essence of capturing value from customers to create profit is self-evident in a market economy. Providers of asset-backed short-term finance do so by collecting payment of their loans, or seizing assets, when necessary, which may conceivably dilute customer delight.

It can be concluded that an industry which targets high net-worth individuals with a (possibly embarrassing) liquidity shortage, will be reached by narrowly targeted promotion, most likely through direct contact or intermediaries. It is essential to have an Internet presence, which facilitates access to the firm. The firm should excel in quality of service (loan-specific attention as well as prompt payment) but should be equally careful to collect its payments.

In 5.4.2, the operational system is discussed.

5.4.2 System for managing the loan life cycle

The system for managing the loan life cycle consists of the processes for loan applications, screening of applications, evaluation of collateral, acquiring collateral, formalising the agreement, payment to customer, voluntary collection of repayment, and forced collection of repayment. The discussion commences with outlining the aim the system has for management of the loan life cycle.

5.4.2.1 Aim of system for managing the loan life cycle

The aim for managing the loan life cycle is to ensure that both the value proposition and the profit proposition are realised. The value proposition is realised by ensuring that the application receives focused attention and prompt payment. The profit proposition is realised by ensuring that repayment is collected and that collateral can be liquidised when payment does not materialise.

5.4.2.2 Application process

The application process commences with a customer enquiry by telephone or email, followed by an invitation for a personal visit. The purpose of the loan and the nature of the collateral must be ascertained, while the terms of repayment must be explained. When both parties are in agreement, the procedure of filling out an application form follows.

5.4.2.3 Screening process

Prudent judgement in assessing, approving and managing credit risks is essential in credit provisioning (Shirveishyn & Vannin, 2016, p. 7), which highlights the importance of a credit screening process. Information is central in the screening process and the responsibility cannot be delegated to third parties (Shirveishyn & Vannin, 2016, p. 6). As indicated in section 4.4, screening by providers of asset-backed short-term finance focuses primarily on the collateral offered, but the ability to predict a propensity on the potential customer’s side to evade payment is also valuable. As will be indicated in section 5.4.2.9.2, forced collection of repayment can be time-consuming, creating liquidity risk for the credit provider.

5.4.2.4 Evaluation of collateral process

While screening of an applicant investigates an applicant's willingness to repay the loan, evaluation of collateral evaluates the credit provider's ability to recover the capital in case of delinquency (section 4.4).

The most important consideration is whether the collateral on offer has sufficient value, as the loan must be in the order of 60% of the realisable collateral value, both as a guarantee and an incentive to repay the loan fully (section 4.9). Valuation is a formal process executed by registered valuers, and should take fluctuations of the collateral's value into account (Shirveishyn & Vannin, 2016, p. 17).

5.4.2.5 Formalising of the agreement process

The purpose of collateralisation is to secure a lender by gaining the right to liquidate collateral provided by the borrower in the event that the borrower becomes insolvent or defaults in another way. In order to ensure that courts will enforce a lender's right to collateral, it is usually mandatory, or at least prudent, to provide a written agreement as evidence of the intentions of the parties to give the lender the right to liquidate the collateral. In the case of repossession of security, the evidence provided by a written agreement should help to ensure that a court will not invalidate the transfer of title to the collateral (International Capital Market Association [ICMA], 2017).

5.4.2.6 Payment process

Once the contract is finalised and signed and collateral is secured, the loan is granted and payment to the customer's account can be effected. A source document is generated with a follow-up number and detail of the relevant bank. The process is concluded with an electronic payment, and proof of payment is supplied to the customer by email, fax or text message.

5.4.2.7 Voluntary collection process

Payment according to contractual agreement is the ideal outcome of a credit agreement. In other cases, there should be a clear definition of what is considered to be non-performing, and how different categories of problem loans should be treated and analysed for impairment. It is expected that at least all loans that are 90 days in arrears (past due) are automatically subject to default procedures and action to be

taken in respect of these must be contained within the arrears policy. However there may be exceptions or circumstances where certain types of lending require a more conservative approach, and procedures in respect of these should be documented (Shirveishyn & Vannin, 2016, p. 17).

5.4.2.8 Forced collection process

Failure to repay a loan compels a credit provider to take steps to recover its capital and costs. The procedures for litigation and execution of a court order are discussed next.

5.4.2.8.1 Litigation

Failure to reach a repayment agreement regarding a defaulting loan, compels a credit provider to call on the courts for an enforcement of rights, with a process is known as litigation (West's Encyclopaedia, 2008). In a situation where a debtor is in default in terms of a written loan agreement, the financier's legal team could instigate legal proceedings by way of:

- Application procedures application (Chief Justice, 2009, rule 6): To be used when the legal team foresees no factual dispute. No oral evidence is provided in court as the matter is supposed to be decided on only the written affidavits attached to the application. It is undesirable to endeavour to decide an application upon an affidavit where the material facts are in dispute (*Frank v. Ohlsson's Cape Brewers Ltd*, 1924).
- Action procedures (Chief Justice, 2009, Rule 17): Either a simple or combined summons may initiate an action. A so-called 'simple summons' must be used if the claim is in respect of a debt or liquidated demand (Chief Justice, 2009, Rule 17(2)). The object of a summons is not only to bring the defendant before the court but also to inform him or her of the nature of the claim or demand. It is consequently insufficient to state what the claim is without the cause of action and on what the claim is based (Harms, 2003). Because the possibility of an unfounded defence by the debtor exists, a factual dispute may arise that needs to be settled by the court and read together with the rules of the court (Chief Justice, 2009, Rule 17(2)), action procedures is the more fitting process to follow (*Frank v. Ohlsson's Cape Brewers Ltd*, 1924).

- Application for provisional sentence (Chief Justice, 2009, Rule 8): This procedure provides a creditor who is in possession of a liquid document with a summary remedy (Harms, 2003, p. 120). It is essential to the financier to realise collateral as soon as possible once a loan has become delinquent. The financier has two liquid documents at his disposal to launch an application for provisional sentence, namely an acknowledgement of debt as well as a mortgage bond. It is not the type of transaction that determines whether a document is liquid or not but the terms as they appear on the document itself (*Rich v. Lagervey*, 1974). A liquid document is defined as: "A written instrument signed by the defendant or his agent, evidencing an acknowledgement of indebtedness, which is unconditional of a fixed amount of money" (Harms, 2003, p. 129). The procedure comprises a speedy procedure which enables a financier to obtain a judgement against a debtor (Rich v. Lagervey 1974), leaving the defendant effectively with only the defence that the signature of the defendant or his or her agent is not authentic, that the agent was not authorised to sign the documents (*Sonfred (Pty) Ltd v. Papert,* 1962) or a 'simple' condition was not fulfilled (*Union Share Rand Agency and Investment Ltd v. Spain* n.d.). In a situation where a creditor is in possession of a liquid document such as an acknowledgement of debt as well as a mortgage bond, the preferential route to follow to obtain judgement will be an application for provisional sentence.

5.4.2.8.2 Execution

Execution (Chief Justice, 2009, Rule 45) is the process by which practical effect is given to the terms of a court order (*Brandtner v. Brandtner 1999 1 SA 866*, 1999). Once a successful litigant has obtained a judgement for payment and or execution he or she needs to be able to enf ((orce his or her rights in terms thereof. Judgement ultimately only has any value beyond the theoretical if the plaintiff is able to enforce his or her rights therein (Harms, 2003, p. 274).

The party in whose favour any judgement of the court has been pronounced may, at own risk, sue out of the office of the registrar one or more writs for execution (Chief Justice, 2009, Rule 45(1)). The sheriff as an officer of the court is ordered to levy and raise any sum of money upon the goods of any person (Chief Justice, 2009, Rule 45(3)). 'Sheriff' shall mean a person appointed in terms of section 2 of the Sheriff's

Act, no. 90 of 1986 (RSA, 1986), and shall include a person appointed in terms of sections 5 and 6 of the Act as an acting sheriff and a deputy sheriff, respectively (Chief Justice, 2009, Rule 1(15)).

A judgement creditor (the winning plaintiff in a lawsuit to whom the court decides the defendant owes money ('judgement creditor', 2017)) may not issue a writ against immovable property of the debtor until a writ has been issued against movable property and the return indicates that there is insufficient movable property to satisfy the writ, except where judgement has specifically declared the immovable property executable (*Tobacco Exporters & Manufacturers Ltd v. Bradbury Road Properties (Pty) Ltd 1992 4 SA 600 (C)*, 1992). Such an order is usually granted when the plaintiff holds a mortgage bond over the immovable property concerned (Harms, 2003, p. 282).

Once the sheriff has attached the immovable property, which has been declared specifically executable by the court, the sheriff in accordance with the rules of court (Chief Justice, 2009, Rule 46 (8) – (16)) can, on instruction of the plaintiff's attorneys, proceed to sell the attached property on public auction (*Syfrets Bank Ltd v. Sheriff of the Supreme Court, Durban Central* 1977). After deduction from the proceeds of the costs and charges of execution, the claims of creditors – ranking in priority in their legal order of preference – are paid from the proceeds of the sale (Chief Justice, 2009, Rule 14(c)).

5.4.3 Managing the financial management system

Financial management is important in every business, but in the financial sector it is the essence of a firm's business activities. In this section, this system will be approached from the perspectives of its aim and processes regarding debtors, creditors and liquidity.

5.4.3.1 Aim of financial management system

The aim of the financial management system is to ensure:

- sufficient availability of capital;
- efficient use of capital;
- use of capital budgeting methods, namely:
    - payback period;
    - the internal rate of return (IRR); and

- net present value (Gitman, 2010, pp. 380–397)

The processes for managing debtors, creditors and liquidity are discussed next, as successful management of these processes will ensure reaching the aim of the financial management system.

5.4.3.2 Process for managing debtors

A credit provider should have a clear definition of what are considered to be non-performing exposures. It is expected that at least all loans that are 90 days in arrears (past due) are automatically subject to default procedures, although there may be exceptions or circumstances, which may require a more conservative approach. The process for managing debtors must also outline the procedures in respect of accounts where security has deteriorated in value and has become in breach of the original terms of approval (Shirveishyn & Vannin, 2016).

5.4.3.3 Creditor management

A business which provides supplies or services to a company or an individual and which does not demand payment immediately is considered a creditor, based on the fact that the client owes the business money for services already rendered (Investopedia, 2017). The importance of creditor management for a financial services firm is that professional services is a recurring need, and a positive and mutually advantageous relationship ensures willingness to provide the recurring services (Law Donut, 2017).

This view is in contrast to that of Page (2017), who regards an extended payment period as advantageous, and advises on ways to achieve it. Due to the unpredictable occurrence of the need for professional services in the financial sector (section 5.4.2), the opposite opinion, that prompt payments of all creditors is advisable, can be endorsed by this study.

5.4.3.4 Liquidity management process

Liquidity is the ability of a credit provider to meet obligations as they become due, without incurring unacceptable losses. Effective liquidity risk management helps ensuring the ability to meet cash-flow obligations, which are uncertain as they are

affected by external events and other agents (BCBS, 2008, p.1). Borrowers, who may fail to make scheduled payments, are such ‘other agents’.

The absence of deposits implies that there is no systemic risk when an independent credit provider fails, which means that central banks do not act as a lender of last resort (section 4.7). An independent credit provider, who suffers from a liquidity shortage, due to excessive costs, or who fails to collect payment from borrowers, puts its equity capital at risk. Liquidity management is therefore equally important to banks and independent credit providers

As mentioned in section 4.7.5, private credit providers’ main instrument to contain liquidity risk is meticulous collection of payments. Sufficient funds should always be available to meet all obligations, even when payments are not received on schedule. No indication could be found in literature of the appropriate level of reserve funds as it is determined by fixed costs.

5.4.4 Management of the corporative communication system

‘Corporate communication’ refers to the management function which has also been termed ‘public relations’ and ‘external relations’, highlighting the integral nature of all communicative actions of an organisation.

5.4.4.1 Aim of the corporative communication system

According to Cornelissen (2014, p. 5), corporative communication is “a management function that offers a framework for the effective co-ordination of all internal and external communication with the overall purpose of establishing and maintaining favourable reputations with stakeholder groups upon which the organisation is dependent”.

This definition emphasises the long-term nature of an organisation’s reputation and the importance of all communication in the nature of this reputation. The aim of this system can be summarised as a long-term positive reputation among stakeholders.

In the next sections, the processes of payment of service providers and liaison with debtors will be discussed as the most crucial corporate communication processes for independent credit providers.

5.4.4.2 Payment of service providers process

The payment of service providers has been discussed in section 5.4.3.3, under the heading “creditor management” as part of the financial management system. It was pointed out that creditors of independent credit providers are normally providers of professional services, an unpredictable and recurring need. It was therefore concluded that these creditors should be paid as soon as possible.

Professional service providers can arguably be described as the most important stakeholders with whom a long-term relationship (reputation) must be maintained. The process for payment of service providers is therefore also important as part of the corporate communication system.

5.4.4.3 Liaison with debtors process

Debt collection is a process which is notoriously associated with unethical practices and communication (lawyers.co.za, 2017). In section 133 of the National Credit Act (no. 34 of 2005) (RSA, 2005), it is therefore declared an offence to use or permit any other person to use documentation when collecting on or enforcing a credit agreement, which is in contravention of section 90 of the same Act, the section which prohibits false declarations in marketing of loans.

Additional to this Act, is the Debt Collectors Act, no. 114 of 1998 (RSA, 1998) and the Code of Conduct for debt collectors (RSA, 2003). These statutes (an Act and a regulation) rule the conduct of debt collectors, which are defined as third parties appointed to collect debt or who acquired the debt with the aim of collecting it for own benefit (RSA, 1998). Debt collectors are required to respect the dignity of debtors and to communicate truthfully with debtors. Creditors are not included in this definition, but it is inferred that the same rules of dignified and truthful communication can be expected from independent credit providers conducting their own collections.

In the next section, the management of the purchasing system is discussed.

5.4.5 Management of purchasing system

The purchasing system is a method used by businesses to buy products and/or services (Investopedia, 2017). The ‘product’ of credit providers is loans, and from this perspective, capital available for lending can be regarded as ‘stock’. The system for acquiring capital can therefore be discussed as the ‘purchasing system’, distinct from

the financial management system (section 5.4.3) which refers to managing for efficient expenditure of capital, debtors and creditors.

5.4.5.1 Aim of purchasing system

The aim of the purchasing system is to ensure that the purchases of a business are good value for money, which is determined by strategic objectives (Markgraf, 2017). As indicated in section 2.2.3.1, three sources of capital are available: equity capital, loan capital and reinvestment of profits. The aim of the purchasing system is to balance these three sources of capital in order to meet strategic objectives efficiently.

The strategic positioning of asset-backed short-term finance was explained in section 1.4 as structuralist – to differentiate within the existing market structure, and to differentiate on service by promptly deciding and acting on loan decisions. This must be attained while avoiding the risk categories described in section 4.7.

5.4.5.2 Financing process

In the financing process, the decision is whether own (equity) or borrowed capital will be used. These are the only options, as only banks may take deposits from the public (section 3.2.2.3). When equity funding is used, the expectations of equity holders must be analysed. If they require unabated growth, the business may approve doubtful loans, in order to reach targets. Expectations of equity growth must therefore be realistic. Imprudent lending exacerbates credit risk (section 4.7.1) and liquidity risk (section 4.7.5). Since independent credit providers pose no systemic risk (section 2.3.2.1.6) and therefore do not have access to the SARB as a lender of last resort (section 3.2.3), credit and liquidity risk occurrences may terminate a credit provider's operations.

The last system, discussed in 5.4.6, is the administrative system.

5.4.6 Management of administrative system

Administrative management refers to processes within an organisation whereby information is stored, analysed and distributed among its members to ensure smooth business operation (Reference.com, 2017). This system is discussed in the subsections below in terms of the aim of the system, the processes for creating contracts and source documents, the filing and the audit processes, and lastly, regulatory reporting.

5.4.6.1 Aim of administrative system

The aim of the administrative system is to provide accurate and accessible information about the assets, obligations and profitability of a firm. This aim is reached by keeping meticulous records, as indicated below.

5.4.6.2 Contract process

Administration of a loan begins with the process of drafting and signing a contract, which reinforces the rights of the credit provider and sets the procedures to be followed in the event of a default (ICMA, 2017). Therefore, provided that all regulatory requirements are met, the contract sets the legal basis for the life cycle of the loan.

5.4.6.3 Creation of a source document

Source documents are a critical part of an audit trail for establishing the authenticity, and tracing the history of a transaction (Business Dictionary, 2017). As a functional document, source documents should reflect information on the contract which is of direct value, such as invoice number, amount, account number of the receiver and basic terms of repayment. A source document for each payment creates a complete audit trail.

5.4.6.4 Filing process

The audit trail referred to in the previous section, implies the necessity of a well-ordered filing process. The purpose of filing is to store documents safely but securely. When the life cycle of a loan has been completed, the file can be closed and stored for later reference (Education and Training Unit [etu], 2017).

5.4.6.4 Financial reporting process

Financial reporting by way of an income statement, balance statement and funds flow statement enables an enterprise to analyse its financial performance and to plan accordingly for the future (Cronje et al., 2004, p. 435). As such, the reporting process requires records of all transactions, as documentary proof. The purpose is to supply dependable information to stakeholders and to analyse results according to profitability, liquidity, debt and efficiency ratios (Maverick, 2015). This process must be executed in close co-operation with a chartered accountant (South African Institute of Chartered Accountants [SAICA], 2017).

This concludes the profit proposition. In the next section, the people proposition will be discussed.

5.5 People proposition

The people proposition determines the relationship between different people as role players in an organisation. In planning the people proposition, three steps are taken: identification of the work to be done in the enterprise, identification of the type of people necessary to do the work, and identification of the number of workers required in future (Cronje et al., 2004, p. 205).

5.5.1 Roles within the independent credit provisioning enterprise

The following roles are identified in an enterprise providing asset-backed short-term finance:

5.5.1.1 Liaison with public

Liaison with the public involves a wide range of responsibilities. All enquiries need to be responded to either by direct answers or by referring to the most appropriate person (Prospects, 2017).

5.5.1.2 Liaison with authorities

The authorities envisaged here are the NCR, the FIC, and the South African Revenue Service (SARS). The person liaising with these authorities needs detailed knowledge of the total business proposition in order to adhere to the regulatory requirements and to manage regulatory risk exposures.

5.5.1.3 Liaison with banks

Independent credit providers need to use the NPS, operated by the major banks of South Africa (SARB, 2008, pp. 39–43). It is therefore necessary to keep deposits with the main commercial banks, in order to make payments on short notice. As providers of asset-backed short-term finance specialise in providing loans on short notice, a bank with an adequate system is essential. As large amounts need to be available at short notice, the possibility of internal fraud exists. It is therefore recommended that liaison with banks is a role to be fulfilled only by a senior responsible and knowledgeable employee.

5.5.1.4 Deciding on loan applications

Deciding on which loans to approve and which to decline, is the basis upon which a credit provisioning enterprise is built. This role should be fulfilled by a highly skilled and experienced employee.

5.5.1.5 Drafting of legal documents

The contract process (section 5.4.6.2) requires a person with the capacity to draft contracts that are fair to both parties, but should ensure that the loan provider will be able to recover the loan, even if the borrower defaults. When fulfilling this role, it is necessary to consider that some customers may be malevolent and borrow without any intention to fulfil the obligations. Contracts should protect credit providers to such an extent that even a skilled legal representative will not be able to assist a customer in dishonouring its payment obligations. Although the abilities of the person fulfilling this role will not be tested with every loan, the consequences when it is indeed tested are serious. This highlights the recommendation that a specialised lawyer must fulfil this role.

5.5.1.6 Registering of mortgages

Mortgages must be registered on the title deed of the relevant property. This can only be done by a registered conveyancer.

5.5.1.7 Keeping track of payments

Keeping track of payments is a highly responsible task, even if it needs no sophisticated skills. The relevant information must be channelled towards the person who liaises with nonpayers.

5.5.1.8 Liaison with non-payers

Liaison with nonpayers requires firmness and unequivocal communication regarding the consequences if payment does not resume. It is this person's responsibility to decide when to take action. This role requires sound and unsentimental judgement.

5.5.1.9 Liquidation of forfeited collateral

When it has been decided that a customer will or cannot repay the loan, the collateral must be liquidated. A judgement needs to be obtained from a court of law, after which

the local sheriff is instructed to sell it (section 5.4.2.8). It is also possible to directly dispose of the asset, which may realise a higher price. The person who fulfils this role (apart from the sheriff) must decide when and how to perform this task.

5.5.1.10 Litigation in case of contested agreements

Litigation is a 'worst case scenario' for credit providers. It means that the customer contests the credit provider's right to claim the collateral. A lawyer and sometimes senior counsel need to be employed for such cases. This is discussed in section 5.4.2.8.

5.5.2 Evaluate own capacity to run systems

The CEO of a credit provisioning business should evaluate his or her own ability to run the different systems. It is clear that there is such a variety of knowledge and skills involved in credit provisioning, that several people have to co-operate. While the final responsibility cannot be delegated, the owner must decide which of the tasks will be performed by him- or herself, for which permanent staff will be appointed, and which tasks will be outsourced. To this end, the systems will be revisited from the perspective of the different roles to be fulfilled. These roles can be assigned to the CEO, specific employees, or be earmarked for outsourcing.

Recruitment involves advertising vacancies and screening of applications. Interviews, psychometric evaluation, and job simulations are complementary methods to reach decisions on appointments (Cronje et al., 2004, p. 205).

In the next section, a flow diagram for the life cycle of a loan will be provided as summary of this chapter,.

5.6 Flow diagram for the life cycle of a loan: summary of Chapter 5

Figure 5.1: The life cycle of a loan

Figure devised by the author

5.7 Conclusion

To operate an asset-backed short-term finance enterprise implies a strategic decision to be in the credit market for a short term only with each loan. Due to global developments in regulation of the banking industry, an opportunity for asset-backed short-term finance arose. To operate such a business implies that a structuralist approach was taken, which means utilising an opportunity the market structure allows rather than restructuring the market.

A framework for implementing an independent provider of asset-backed short-term finance was presented, which focused on the value proposition (the business from customers' point of view), the profit proposition (systems which must be managed correctly to ensure profitability), and the people proposition (appointment and outsourcing for different roles in the business). The chapter ended with a flow diagram (devised by the author) on page 180 which represented the life cycle of a loan graphically.

This concludes the literature review regarding a structured approach to strategic positioning of an independent provider of asset-backed short-term finance. In the next chapters the empirical surveys aimed at reaching the research goals are dealt with.

PART C EMPIRICAL RESEARCH

CHAPTER 6

RESEARCH METHODOLOGY

6.1 INTRODUCTION

This study was construed around the research aim and objectives, presented in Chapter 1, section 1.3.3.

Based on the research question, the study aimed to develop a structured approach for the strategic positioning of a private credit-providing enterprise, specialising in asset-backed short-term finance, which could assist in ensuring success in the credit provisioning market.

The objectives in support of the aim of this study were:

- to determine why some business people prefer private asset-backed short-term loans to credit from commercial banks;
- to identify the most relevant risks to providers of asset-backed short-term finance; and
- to develop a framework for asset-backed short-term finance as a structured approach that could assist the existing and potential market players to ensure a successful enterprise.

Chapters 2, 3, 4 and 5 dealt with the literature and subsequent deductions and conclusions regarding the concept of credit, internationally and locally, as well as asset-backed short-term finance as a credit industry. These conclusions, based on the literature, pointed towards areas where existing knowledge could be augmented by empirical research. The aim of this section is to link this chapter to the literature review by way of an empirical analysis and by outlining the systematic research process. The process consists of a summary of literature findings, which require further investigation in terms of the research aim, synthesising a hypothesis from the consulted literature, outlining the methodological foundations, and explaining the methodology employed in the empirical research. Results and analysis are reflected in Chapter 7.

6.2 RESEARCH DESIGN

The empirical research consisted of two surveys: one among customers and potential customers of asset-backed short-term finance to collect views on the reasons for using

this financial industry; and the other among providers of asset-backed short-term finance to gain insight into the handling of risk. Both served to develop a structured approach to this industry. The complete investigation was conducted according to a quantitative survey research design. To explain this, philosophical position and methodology are discussed in this section.

6.2.1 Philosophical position

The philosophical position is considered from the perspective of two basic divisions of philosophy, ontology and epistemology. Ontology deals with the nature of being, and epistemology deals with the question what is (or should be) regarded as acceptable knowledge (Bell & Bryman, 2011, pp. 15–23).

- Ontological tension exists between:
    - objectivism, which holds that even cultural phenomena, such as organisations, are entities in themselves, which can be studied from the outside; and
    - constructionism, which holds that reality is not fixed, but continuously transformed by different actions, including those of the researcher.
- Epistemological tension exists between:
    - Positivism, which applies the approach and methodologies of natural sciences to social sciences. This includes sensory observation as ultimate test for validity and the belief that science can and must be conducted value-free; and
    - interpretivism, which regards social reality as fundamentally different from nature in the sense that an inevitable interaction between researcher and reality exists. The researcher should ‘bracket out’ own preferences, but will inevitably be influenced by it (Bell & Bryman, 2011, pp. 15–23).

If judged by its first appearance, this study was done in the positivist tradition as, according to Denzin and Lincoln (2005, p. 1), quantitative research is, by definition, positivist. This judgement is problematised by Hair, Celsi, Money, Samouel, and Page (2011, p. 277), who state:

Postpositivism is a modern revision of positivism. Postpositivists believe that there is an objective reality, but acknowledge that it is difficult to describe or analyse that reality

without socio-cultural and psychological lenses filtering interpretation. However, postpositivists continue to try to interpret research findings in a bias-free fashion under the assumption that there is an objective reality to describe.

The reconciliation of objectivism with constructionism; and positivism with interpretivism, as articulated by post-positivism, was the philosophical foundation of this study, although it is difficult to conceive how a complex subject, such as the reasons for using a specific form of credit, can be investigated according to the exact premises and categories of the natural sciences. However, it was regarded possible to determine, in an unbiased way, the relative importance of certain factors, as envisaged by post-positivism. In the present study, the application of post-positivism, therefore, did not lie in the method of enquiry, but in the interpretation of results, as presented in Chapter 7.

6.2.2 Methodology

'Methodology' refers to a body of methods, rules and postulates employed by a discipline, a particular procedure or set of procedures, and the analysis of the principles or procedures of inquiry in a particular field (Merriam-Webster Dictionary, 2017). This is described in the next section.

6.2.2.1 Methodological options

Bell and Bryman (2011, p. 5) convincingly argue that "evidence" in business settings are not "there to be discovered" in a technical, value-free scientific pursuit, but is always informed by the preferences of the observer. For the present study, a fundamental choice between quantitative and qualitative methods or a combination thereof, was necessary, as indicated in section 6.4.

Hill and McGowan (1999) suggest that smaller firms (such as private providers of asset-backed finance) should be studied qualitatively for a comprehensive analysis. However, the literature review revealed information on customers' preferences which need to be verified, which could be accomplished with Best-Worst Scaling (section 6.2.5.1). Therefore this study is exclusively quantitative in nature.

Myers (2013, p. 8) identifies a **survey research design** as an accepted method to find the opinions of a specific target group on well-defined questions. Williams (2003) mentions that surveys are conducted by means of a questionnaire, which is a

specialist research tool, and must be designed consciously to ensure valid and reliable results. Stone (1993) opines that a questionnaire should, from the respondent's[20] perspective, be appropriate, intelligible, unambiguous, unbiased and capable of coping with all possible responses. From the researcher's perspective, a questionnaire should be satisfactorily coded, piloted with a limited number of informed respondents, and ethical. Stone (1993) proceeds to identify the key steps in designing a questionnaire as:

- deciding which data is needed;
- selecting items for inclusion;
- designing individual questions;
- composing the wording;
- designing layout and presentation;
- thinking about coding;
- preparing and pretesting the first draft;
- submitting the questionnaire to a knowledgeable pilot group;
- evaluating the form.

Surveys can be conducted by way of personal interviews, mailing of questionnaires and online surveys (Sue & Ritter, 2012, p. 11). According to these authors, the highest response rate can be expected from personal interviews, but these are time-consuming. Mailing of questionnaires demands few resources, but a low response rate can be expected. Online surveys can be conducted by email, where anonymity cannot be guaranteed, or by providing a link to a website, where anonymity can indeed be guaranteed (Survey Monkey, 2014). Setup costs of online surveys are high, but can be justified by the number of geographically dispersed respondents, or when a high number of respondents have to be reached (Sue & Ritter, 2012, pp 10–11). Commercial services for online surveys are available, but may need customisation (Survey Monkey, 2014).

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[20] In quantitative research, people answering questionnaires are called **respondents**. In qualitative research, people engaged with are called **participants**, or in observation-based research designs, they are called **informants** (Saunders et al., 2012, p. 340).

The questionnaire to be used for a survey needs to be compiled by the researcher, or selected, if an appropriate questionnaire already exists. Aldlaigan and Buttle (2005), for example, identified a large number of phrases relevant to their topic through qualitative research (focus groups and individual interviews). These were reduced to 17 statements, which were presented to respondents, to evaluate according to a 7-point Likert-type scale (Aldlaigan & Buttle, 2005, p. 351–355). Whichever option, or combination of options, is followed, the reliability and validity of the research instrument must be ensured.

The methodological choices for this study are presented in section 6.4.

6.2.2.2 Reliability and validity of a research instrument

Reliability of a research instrument is determined by consistency and **validity** by accuracy, as explained in the paragraphs below.

6.2.2.2.1 Reliability

Reliability is established if repeated application of a research instrument results in consistent scores (Hair et al., 2011, p. 233). Reliability is created by interaction among the instrument, the specific group of people taking the test, and the situation – therefore the results can be declared reliable, not the instrument (Streiner, Norman, & Cairney, 2015, p. 163). As such, reliability indicates whether a the results of a test are consistent, not whether it is a true reflection of reality. For instance, a person may (for the sake of acceptability) present the same answers repeatedly, without it being his or her real opinion (Streiner et al., 2015, p. 164).

As reliability depends on consistent results, it can be measured by presenting the same test to a respondent at different times – the so-called **test–retest method** (Hair et al., 2011, p. 233), or the **test for temporal stability** (Pallant, 2013, p. 6). This is problematic, however, as the first test may prejudice respondents towards the following test, a prejudice which can be overcome by the second test, named **alternative-form reliability**, which means that the same construct is presented in an equivalent form. The third way to determine reliability is **internal consistency reliability**. With this method, different questions dealing with the same concepts are divided – if responses correlate, the instrument can be regarded as reliable. When the average coefficients of all possible combinations are calculated, the answer is the

coefficient alpha or the **Cronbach alpha** (see (Hair, Celsi, Money, Samouel, & Page, 2011). This ranges from 0 to 1, where, 0.7 is regarded as the lowest acceptable value (Hair et al., 2011, pp. 233–235). When there are fewer than 10 items in the scale, Cronbach alpha values can be quite small, and then it is better to calculate the mean inter-item correlation for the items. Optimal inter-item correlation values range from 0.2 to 0.4 (Pallant, 2013, p. 6). Other tests which can be applied are the weighted Kappa (see Williams, 2003) or categorical data (see Williams, 2003) and Spearman's rank correlation coefficient (see Williams, 2003, or its non-parametric equivalent, the Wilcoxon rank sum test (Williams, 2003, p. 249).

In order to be able to run the above-mentioned statistical tests, each concept has to be measured by at least three items. If these are not positively correlated, one could be reverse coded, for example, Likert-type scale level 4 in one statement is 2 in another. An item with a Cronbach alpha coefficient below 0.3 should be omitted completely (Hair et al., 2011, p. 237).

Validity, the topic of the next subsection, is related to reliability in the sense that reliability places an upper limit to validity – the more reliable a scale is, the more valid it can be (Streiner et al., 2015, p. 232).

6.2.2.2.2 Validity

'Validity' refers to the extent to which a construct measures what it is supposed to measure. If disposable income is investigated, then the research instrument should not measure total income (Hair et al., 2011, p. 238).

Hair et al. (2011, pp. 238–240), supported by Pallant (2013, p. 7) present the conventional description of validity, as assessed by measuring content validity, construct validity and criterion validity. **Content validity** is found where constructs in the research instrument are in cohesion with prevailing theory. This has to be augmented by either construct validity or criterion validity. **Construct validity** refers to comparison of the results of an instrument to that of another instrument measuring the same or opposite concept(s), called either **convergent** or **discriminant validity**. **Criterion validity** presents the forms of concurrent and predictive validity. **Concurrent validity** is found where two or more related concepts affirm each other, for instance when satisfied customers of a restaurant are also frequent customers. **Predictive validity** is found where the expectation created by one concept is

confirmed by something which happens afterwards, for instance when the score obtained in an admission test correlates with success rate in the relevant course.

Streiner et al. (2015, p. 231) respond to the view on validity as expressed by Hair et. al. (2011) above by emphasising that validity is a single concept, existing on a continuum between valid and not valid (not as either of the two). As validity is a whole and integrated concept, there is not content, criterion or any other kind of validity, but such forms of validating a research instrument. In these terms, **content validation** is an indication of the measure to which an instrument is coherent to what certain experts think; **criterion validation** means to compare the relevant instrument with a 'gold standard' (which is for some reason in need of improvement) (i.e. concurrent validation) or to compare results with another, future result which is the actual proof of validity (i.e. predictive validation). **Construct validation** is done by hypothesis testing using the specific scales. Validation can therefore not be done at once, but as an ongoing process. While many tests may confirm construct validity, it takes only one disproving test to disprove it. In reality, different, even conflicting, sources inform the process of validation; therefore, no final and unquestionable decision can be reached (Streiner et al., 2015, pp. 233–238).

In the next section, the possibility of a 'gold standard' for surveys (either to be used in this study or for validating purposes) is investigated.

6.2.2.3 SERVQUAL as a possible 'gold standard' for surveys

Williams (2003, p. 249) states that if a 'gold standard' questionnaire exists, the composition of a new questionnaire has limited value. In order to create a 'gold standard', the concept of a SERVQUAL questionnaire was first presented in 1985 by Parasuraman et al. As a result of the subjective and intangible nature of service, these authors suggest five dimensions to assess service quality, and correspondently, five gaps between expected service levels and perceived service levels (Parasuraman et al., 1985). The 'five dimensions in predicting overall quality' are tangibles, reliability, responsiveness, assurance and empathy. The SERVQUAL questionnaire first determines customer expectations in these dimensions, and then perceptions on how a specific enterprise reaches these expectations (Parasuraman et al., 1988), the so-called 'gap theory' (Parasuraman, Berry, & Zeithaml, 1991) referring to the gap between expectations and experience (Parasuraman et al., 1991, pp. 138). In 1991,

these authors published a follow-up study on the refinement of SERVQUAL. The authors suggest that, to retain validity and reliability, the instrument should be employed as a complete unit. Rewording for specific contexts may add value, but not the inclusion of untested questions, nor the exclusion of certain questions (Parasuraman et. al., 1991, pp. 424–442).

The five dimensions, by which quality of service can be measured according to the SERVQUAL instrument, encompass tangible items, reliability of service delivery, responsiveness to customers' needs, and assurance as perceived by customers (Parasuraman et al., 1991, pp. 135–138).

In the course of time, many scholars expressed their opinions on the usefulness of the SERVQUAL questionnaire. Cronin and Taylor (1992) disregarded the gap between expectation and performance, and suggest an alternative, named SERVPERF, for 'service performance'. Buttle (1996) recognised the effect of SERVQUAL in industry as well as academic circles, but questions the ability of the tool to retain its dominant position. Caruana agreed that the dual test of expectation and performance is superfluous, although he accepted the gap theory (Caruana, 2000). Bahia and Nantel (2000) developed the Bank Service Quality (BSQ) investigation tool by adapting SERVQUAL, as they contend that the generic nature of SERVQUAL makes it too broad to measure service quality in a specific industry.

Nyeck, Morales, Ladharri, and Pons (2002) evaluated SERVQUAL by investigating 40 academic articles using SERVQUAL to evaluate service quality, in order to evaluate this model. They mention statistical tests for reliability, which can add value if included, and recommend that researchers explore alternatives to conceptualise service quality.

Brown, Churchill and Peter (1993, pp. 137–139) contend that SERVQUAL is a flawed tool to measure service quality across a variety of industries. The measurement of expectation against perception was outperformed by non-difference score measures, which asked respondents to compare expectations with perceptions in a single item, on psychometric and statistical considerations. Brown et al. (1993) regard the assertion of universal application of the SERVQUAL instrument in service industries as even more problematic, as the changed wording for different industries in some instances undermined the integrity of the instrument. It appears from this discussion

that the SERVQUAL instrument is regarded as only a useful starting point for necessary modifications.

The following are examples of research projects on service quality which reflect the reasons for using adapted versions of SERVQUAL:

- electronic service quality (abbreviated as E ServQual) for web-based service companies (Herington & Weaven, 2009);
- SERVQUAL with an extra dimension for convenience (Kumar, Tat, & Charles 2010);
- Siddiqi (2011) doubts the universal applicability of SERVQUAL in its original form; and
- Toorawa and Naiko (2012) conclude that SERVQUAL contributes to bridging the gap between expected and perceived service levels, and enables comparisons between the scores of competitors in the same industry.

If a 'gold standard' survey tool is presented and has been widely used in academic and commercial research, a decision not to use it should be carefully considered. For this study, SERVQUAL was not regarded suitable, for the following reasons:

- This study focuses narrowly on reasons why a specified group of customers preferred this financial service in specified circumstances. SERVQUAL, with its generic approach to service, would have to have been modified beyond recognition to render such specific results.
- Identifying key risk indicators as part of risk management by providers of asset-backed short-term finance was an important aspect of this study, and is in no way covered by a survey, which exclusively investigates service.

In the next section, the questionnaire formulated specifically for this study is theoretically argued, presented and discussed.

6.2.4 Conceptual imperfections of simple choice questionnaires – including SERVQUAL

Research on people's opinions is generally conducted by using rating scales, for instance Likert-type scales (Hair et al., 2011, pp. 221–222), as is also the case with the SERVQUAL research tool. However, empirical evidence reveals that under certain circumstances (discussed below) this kind of research fails to predict customer

behaviour (Adamsen, Rundle-Thiele, & Whitty, 2013, p. 11). Although this observation is recent in terms of market research, it has been known in personality tests for several decades; respondents tend to ‘fake good or bad’. This phenomenon is corrected in analysis by the well-known Cronbach alpha, although important information can be lost in this ‘correction’ (Crowne & Marlowe, 1960, p. 394).

The psychological processes in responding to personality tests and market research are rooted in the human psyche, and similarities should be expected. Related to socially desirable responding is acquiescence response bias (the tendency rather to agree than to disagree with a statement, (see Adamsen et. al., 2013). Hypothetical bias is especially prevalent in Willing to Pay (WTP) research, in which people indicate that they are willing to pay more for an item than it actually is worth. Furthermore, a labelled Likert-type scale questionnaire tends to attract an acquiescence bias, while the way in which a statement is expressed, also influences responses to it (Adamsen et al., 2013, p. 11).

The inability of rating scales to predict customer decisions can be blamed on the fact that respondents are not forced to choose between items, as has to be done in real-market circumstances (Flynn & Marley, 2014, p. 179), or when multiple values, in their relative importance, guide action (Schwartz, 2012, pp. 3–4). To determine the relative order of values is indeed problematic. When asked, respondents tend to view all problems as highly important. However, given limited resources, all cannot be dealt with equally. One way to deal with this ‘method bias’ is called ipsatising (see Lee, Soutar, & Louviere, 2008), or centring responses around an individual’s overall mean, or alternatively using this mean as a covariate to reduce such effects. However, this method is criticised for removing true differences from the data (Lee, Soutar, & Louviere, 2008, p. 335).

With all the literature on the limitations of simple rating scales, such as the Likert-type scale, it is surprising that they are still so widely used in market research (Adamsen et al., 2013, p. 11). As will be indicated in section 6.5, however, the Likert-type scale is still useful in the collection of opinions, and was used in the second survey of this study (see section 6.2.2).

The imperfections of rating scales for market research led to the development of conjoint analysis. This includes discrete choice experiments and the Schwartz Value Scale (see Schwartz, 2003), which will be discussed in the next section.

6.2.5 Conjoint analysis as an alternative to simple choice

Conjoint analysis is based on the assumption that decisions are not made on a single factor but are based on several factors or attributes, which are considered conjointly. Preferences are revealed through a series of rating, ranking and trade-off decisions, which are reported to have superior prediction abilities to simple rating techniques. It is assumed that consumer behaviour and subsequent choice are based on utility maximisation and any product is basically a bundle of attributes from which consumers gain value (Adamsen et al., 2013, pp.11–12).

Conjoint analysis has its origin with Thurstone (1927) who explained that judgement on qualitative issues are not absolute and that the same observer may regard one object as darker/heavier/more excellent than another, depending on when it is compared with another object (Thurstone, 1927, p. 285).

Thurstone is also credited for the random utility theory (RUT) (Louviere & Woodworth, 1983), which holds that some choices can be predicted as they are based on clear utilities, while others are randomly selected and only probability can be indicated. The randomness of RUT dictates that some errors will occur. A way to deal with these errors was suggested in 1974 by McFadden and is called ‘paired comparison’, which requires the respondent to repeatedly select one of two options (Louviere & Woodsworth, 1983). Similarly, Schwartz (2012, pp. 3–10) developed the Schwartz Value Scale (SVS), according to which a list of 56 items describing desirable ways of acting or desirable end states is presented to respondents. The importance of each ‘as a guiding principle in MY life’ is rated on a 9-point scale. The shortcomings of a rating scale was discussed in the previous section, but Swait and Marley (2013, pp. 1–4) add the effort required to read through more than 50 items in order to rank them.

Discrete choice experiments (DCE) evolved from paired comparison, by measuring how often one choice is made over another. Subsequent preference is revealed by using sophisticated regression methods such as multinomial logit (MNL), which explains why this technique is not used often (Adamsen et al., 2013, p. 12).

In the next section, best–worst scaling (BWS) as a distinct and advanced form of DCE is discussed.

6.2.5.1 Best–worst scaling as an advanced form of conjoint analysis

One shortcoming of DCE is the difficulty to arrange more than ten items. For this reason, BWS was developed, which requires respondents to indicate only the most and least favoured of a set of items. Some of these items are repeated, in order to reach a preferential order. This provides an ordinal ranking of the items for each individual and an interval scaling of the items for the sample of respondents (Lee et al., 2008, p. 13). The transition from DCE to BWS is easy, as it requires simply asking respondents (who have already, in terms of discrete choice, selected the best possibility) to select the worst possibility also. The human mind is skilled at identifying extremes (Flynn & Marley, 2014, p. 179).

Although BWS only refers explicitly to best and worst possibilities, a respondent in fact selects the most distinct pair out of a set of items, for example also the largest and the smallest. The particular combinations that appear in each set are determined by an experimental design to ensure balanced appearance and co-appearance across the sets. This reduces response style effects, as it is impossible to choose the middle points or one end of the scale consistently. In addition, this method forces a respondent to evaluate a certain item in relation to others, for example: “How concerned are you with the safety of your food supply?” is only really answered within the context of “relative to what?” (Lee et al., 2008, p. 336).

In order to compare accuracy of results of BWS with an established methodology, two studies were conducted with BWS and with SVS. It was found that BWS can equally well (or even better) be analysed than SVS, but the biggest advantage of BWS is that it is easier to administer than SVS and that respondents are more likely to complete the surveys than with SVS (Lee et al., 2008, p. 344). A disadvantage of BWS in comparison to DCE, according to Zhang, Johnson, Mohamed, and Hauber (2015, pp. 1–3), is that BWS is unable to measure different levels of a specific attribute. (This perceived disadvantage is discussed in the next section on types of BWS.) It was nevertheless found that results from BWS and DCE were consistent with each other (Zhang et al., 2015, p. 9).

Flynn, Louviere, Peters, and Coast (2007, p. 172) contend that BWS is particularly applicable to health care, where the services within an institute are not always subject to market choices. When a patient indicates that short waiting time before seeing a doctor is more important than the continuity of always seeing a particular doctor, there is no indication of different degrees of waiting time or continuity. In BWS, several scenarios are repeatedly presented, but in different combinations, resulting in a hierarchy of choices. Similarly, Adamsen et al. (2013, p. 11) conclude that BWS is superior in predicting customer behaviour and is therefore appropriate for market research.

The present study can be conceived of as backward market research (see Andreasen, 1985; Bothwell, 2007). Asset-backed short-term finance had already emerged as a financial industry, and creating a structured approach to the industry involved determining why customers select this specific form of finance. Therefore indications (which are confirmed in the next section) are that BWS was in this case an appropriate methodology. In the next section, the different types of BWS studies are discussed.

6.2.5.2 Types of best–worst scaling

Three types of BWS techniques have evolved, which are called the **object case** (case 1), the **profile case** (case 2) and the **multi-profile case** (case 3). Cases 1 and 3 are associated with market research, while case 2 has been used in valuation studies concerned with general population preferences for quality of life attributes and is most appropriate when respondents have no experience with making choices in the particular area of investigation – profiles are presented one at a time, contrary to choice sets of two or more (Adamsen et al., 2013, p. 13).

Case 1 (object case) is the simplest type of BWS, and requires respondents to choose between different items or utilities. This might be brands or attributes of specific items (Flynn & Marley, 2014, p. 182). Respondents are required to choose the best/most and worst/least between (for example) the production method, price, packaging and appearance of apples. Case 3 (multi-profile case) is similar to Case 1, but it confronts the respondent with the different attributes of the item, for instance the best choice between three apples:

- Apple 1 would be organic, costs AU$8.99, is packaged and B-grade.

- Apple 2 would be conventionally cultivated, costs AU$6.99, is packaged and A-grade.
- Apple 3 would be organic, costs AU$7.99, is sold in loose weight and is A-grade.

The major strength of Case 3 is that it closely resembles real-market choices (Adamsen et al., 2013, p. 13). For its similarity to market realities, Case 3 is most often used in market research (Flynn & Marley, 2014, pp. 184–186).

Case 2 (profile case) is a test in which different attributes (utilities) within a specific profile are played off against one another (Flynn & Marley, 2014, p. 183–184). Participants are presented with a series of different scenarios. For each scenario, participants are asked to select which attribute they consider to be the best and which the worst within the scenario. In effect, participants are asked to evaluate and compare their preferences (utilities of the profile) towards the different attribute levels within the scenario and select the pair of attribute levels that they consider to be furthest apart. The attribute impact (see Molassiotis et al., 2012) is a measure of the average propensity to choose an attribute as best more often than worst. Levels of these attributes are also formulated (Molassiotis et al., 2012, p. 2).

Typical size of BWS surveys is indicated by reporting that in eight different BWS studies from 2009–2011 of all cases, the number of attributes ranged from 2 to 5, profiles from 6 to 12, choice tasks from 10 to 14 and pictorial representation was used in all (Adamsen et al., 2013, p. 15). As all attributes need to be compared with all others, it means that BWS has a distinct repetitive nature – which has been reported as an irritation for respondents (Adamsen et al., 2013, p. 14).

A BWS survey has the necessary attributes to determine why customers make a specific choice out of several presented to them, as in the case of asset-backed finance in opposition to any of many other forms of finance.

6.2.6 Analysis of data

The primary purpose of analysing data is to convert data into knowledge, which means to examine the data in order to identify and confirm relationships (Hair et al., 2011, p. 294). To this end, descriptive statistics and parametric analyses is discussed briefly below.

Descriptive statistics summarise the samples and measures employed. Data is presented in tables and graphic presentations, which render the possibly high volume of data accessible, and provide the inputs for subsequent (Trochin, 2006). Data can also be categorised as **nominal** (labelling a series of values), **ordinal** (providing information about the order of choices), **interval** (quantifying the difference between choices of different orders), and **ratio** (adding the ability to calculate ratios, because a 'true zero' can be defined) (Market Research Man LLC, 2015). As such, nominal scales are analysed without representing data numerically, while interval and ratio data lend itself particularly to numerical presentation. Ordinal data is problematic, as researchers tend to analyse it like interval and ratio data. In fact, such an analysis of ordinal data may lead to unreliable results, as the distance between categories is not constant (Allen & Seaman, 2007).

Parametric analysis (Rashidi, Ali, Freidoonimehr, & Nazari, 2013) assumes a normal distribution of data, based on mean and standard deviation, which is appropriate for interval and ratio scales. For data on ordinal scales, however, nonparametric procedures based on rank, median, mode and range are appropriate, using the chi-square (see Hair et al., 2011) as statistical procedure. The chi-square assesses how near observed values are to those theoretically expected. Data is presented in contingency tables, which provide the inputs needed for hypothesis testing (Allen & Seaman, 2007; Hair et al., 2011, pp. 326–327).

Due to the small sample realised in the simple Likert scale survey (section 7.4), these statistical instruments were not employed.

6.3 SYSTEMATIC RESEARCH PROCESS

Bell and Bryman (2011, p. 151) identify the following steps in the research process:

- elaborate on theory;
- devise hypothesis;
- select research design;
- devise measures of concepts;
- select research site(s);
- select research respondents;
- administer research instruments and collect data;

- process data;
- analyse data;
- develop findings and conclusions; and
- consolidate findings and conclusions.

This set of 11 steps will be recognised in section 6.2.1.

6.3.1 Investigate existing theoretical background

The background to asset-backed short-term finance as an industry involves the concept of credit, globally as well as in South Africa. The literature review reflected on this concept, with special attention to developments which have an effect on asset-backed short-term finance. In this section, the most important findings based on the literature review are summarised.

Chapter 2 dealt with the concept of credit in the modern monetary economy. It is indicated that commercial banks do not generally supply a prompt answer to non-standard applications, mainly due to four reasons:

- **Mechanism of collecting adequate information**. Commercial banks increasingly collect borrowers' information from powerful electronic databases, run by credit bureaux. These computerised information systems do not have the capacity to investigate non-standard applications, especially the applications of high net-worth customers, who do not regularly use credit facilities or receive regular monthly salaries. In case of cash-flow challenges, such customers' applications require individual and knowledgeable evaluation.
- **Risk management**. It is imperative to identify and assess the risks of any enterprise. Only when key risk indicators are identified and appropriate measures taken and communicated, can risk be mitigated.
- **Bank regulation**. Systemic and operational risk lead to ever-increasing regulatory requirements for commercial banks at both macro and micro level, eliminating the power of individuals to make important financial decisions without consultation. Regulatory requirements decrease banks' lending appetite due to increased reserves and equity levels required from banks, as discussed in sections 2.3.3 and 4.5.
- **Customer relations**. Private providers of asset-backed short-term finance may be less attractive to customers due to their relative obscurity, as discussed in

section 2.3.4. The empirical investigation determined whether this obscurity decreases in importance as customers' dependence on credit providers who are prepared to attend to the specific circumstances and security of the customer, increases.

In reference to the abovementioned, it can be verified by means of an empirical analysis whether the period between a customer's application for a loan and the approval or rejection by a commercial bank is a factor in the emergence and growth of asset-backed-short-term finance as a financial industry.

Chapter 3, dealing with the South African perspective on credit provisioning, confirmed the global description in Chapter 2 regarding the period between loan application and decision as a reality. An important conclusion in this regard is that, even in academic circles, a perception exists that South African banks are unresponsive to customers' needs, despite attempts by banks to bridge this gap with private banking. This perception might arise from the prudency of this sector, means of collecting adequate information, and regulatory requirements. An uncertainty has also been identified in section 2.3.3.3, namely whether the target market for asset-backed short-term finance finds increasing fees (or a perception thereof) to be a factor in investigating alternatives to traditional banking.

The following aspects were investigated:

- whether South African commercial banks are perceived to empower employees with sufficient service orientation to interact responsively with customers and reach decisions within a satisfactory time frame; and
- whether banking fees encourage South African customers and potential customers of asset-backed finance to investigate non-bank financial service providers.

Chapter 4 deals with asset-backed short-term finance as a financial industry. From a customer's view, probably the most important positive feature of asset-backed short-term finance is identified as the promptness with which loan applications are processed and executed, while the most negative feature is identified as the above average interest rate. In addition, an inventory of requirements and items to consider in loan provisioning is also considered an important attribute of such an industry. From the point of view of providers of asset-backed short-term finance, the issue of risk is

of critical importance. The risks most pertinent to asset-backed short-term finance are credit, legal, reputation, liquidity, operational and strategic risk. Furthermore, the macro-economic environment favours the strategic positioning of asset-backed short-term finance, due to the following reasons:

- Technological advances in processing standard loan applications and calculating repayment ability meant that banks did not continue to train employees with the skills to evaluate collateral.
- International regulation forced banks to be more conservative in making loan decisions.

This created a need for loan providers who respond to business persons' need for loans guaranteed by assets, which outlines the strategic positioning of asset-backed short-term finance. In this regard, positive as well as negative features of asset-backed short-term finance can be determined from customers' perspectives' by an empirical analysis.

From providers' perspectives, the relative importance of different types of risk in evaluating loan applications was investigated.

Chapter 5 deals with the processes and systems used in operating asset-backed short-term finance as a business, by investigating the value, profit and people propositions of this industry The value proposition was analysed by describing the market position, while the profit proposition was analysed with reference to management of the systems for marketing, operation, financial management, external relations, purchasing and administration. The people proposition was analysed with reference to the roles to be played within a firm in the industry. Some of these roles can be unified in one person, or can be outsourced. This forms the basis of the human resources (HR) approach of a relevant credit provider.

With this review of the existing theoretical background completed, a review of the research aim and research questions follows.

6.3.2 Review of research aim and research questions

In section 1.4.3, the research aim was presented as the development of a structured approach for the strategic positioning of a private credit-providing enterprise, specialising in asset-backed short-term finance, which could assist in ensuring

success in the credit provisioning market. The objectives in support of the aim of this study were indicated as follows:

- to determine why some business people prefer private asset-backed short-term loans to credit from commercial banks; and
- to develop a framework for asset-backed short-term finance as a structured approach that could assist the existing and potential market players to ensure a successful enterprise.

To achieve the first objective, it was imperative to determine whether customers of asset-backed short-term finance perceive this industry as filling a void in the credit market, while the other aspects of the structured approach (risks incurred and steps to be taken in conducting the enterprise) were conclusively dealt with in sections 4.7 and 4.9 respectively. To this end, a hypothesis was tested (discussed in section 6.2.3), the result of which were combined with the findings of section 4.8 to present a structured approach for the strategic positioning of a private credit-providing enterprise specialising in asset-backed short-term finance, which could assist in ensuring success in the credit provisioning market.

6.3.3 Hypothesis

The hypothesis, deducted from the literature review and tested by empirical investigation, was as follows:

Ho: Asset-backed short-term finance does not fill a necessary niche in the financial sector, because high net-worth business persons with urgent, short-term liquidity challenges, do not experience commercial banks as unable or unwilling to consider their assets, rather than regular income, as loan guarantee, and to assist such persons within the required time frame, therefore, such a business cannot be operated as a profitable enterprise when the most relevant risks are attended to.

Ha: Asset-backed short-term finance fills a necessary niche in the financial sector, because high net-worth business persons with urgent, short-term liquidity challenges, experience commercial banks as unable or unwilling to consider their assets, rather than regular income, as loan guarantee, and to assist such persons within the required time frame, therefore, such a business can be operated as a profitable enterprise when the most relevant risks are attended to.

In order to select the null hypothesis (H0) or the alternative hypothesis (Ha), answers to the following questions need to be reached by conducting a survey:

Is the period between a customer's application for a loan and approval or rejection by a commercial bank a factor in the emergence and growth of asset-backed-short-term finance as a financial industry?

Do South African commercial banks empower employees with sufficient service orientation to interact responsively with customers and reach decisions within a satisfactory time frame?

Do increasing banking fees encourage customers to investigate alternatives to traditional banking.

Is the less prominent branding of private credit providers a meaningful discouragement to customers who may need asset-backed short-term finance?

What are the positive features of asset-backed short-term finance from the customer's perspective?

What are the negative features of asset-backed short-term finance from the customer's perspective?

What is the relevance of different risks pertaining to asset-backed short-term finance?

6.4 METHODOLOGIES EMPLOYED IN THIS STUDY

Empirical evidence for this study was gathered by two surveys: one among customers of asset-backed short-term finance, and the other among independent providers of asset-backed short-term finance, using quantitative methodologies, as explained below. The methodological options exercised in each survey are discussed in the next sections.

6.4.1 Survey among customers: best–worst scaling

One research aim of the present study, as indicated in section 1.5.3, was to determine why some business people prefer asset-backed short-term loans to credit from commercial banks. To attain this research aim, a survey using BWS was conducted among existing customers of asset-backed short-term finance. The distinct nature of this type of survey is discussed in 6.4.1.1, motivating the reason for using this specific type of survey.

6.4.1.1 Nature and purpose of the survey

Market research tends to focus on competitors and their appeal to the market (British Library, 2017). As such, the choices people make and the reasons for those decisions are important. This study investigated a specific industry and the reasons why it was selected. The most important advantage of BWS (discussed in section 6.3.5) is that it simulates real-life balancing of choices between options, which have some preferred and some disfavoured features. The 'best' features are those sufficiently important that other, less preferred features may be overlooked, while the 'worst' features are those which are so unattractive that they override favoured features. As customers who have already decided to use asset-backed short-term finance were surveyed, the purpose was to find the 'best' features of asset-backed short-term finance, as well as the 'worst' features of alternative forms of credit.

6.4.1.2 Data collection

Data collection is the process of finding facts that will be analysed in order to create information (Hair et al., 2011, p. 294). The following paragraphs will indicate how data was collected for this study.

6.4.1.3 Administering the survey

To execute the fieldwork for this study, a professionally managed project was conducted amongst high-value business persons who made use of finance and loan providers, by an independent academic and market research company. This company has strong academic ties, as well as international affiliations, to ensure rigour and keeping abreast of international best practices. It has developed a stratified proprietary panel of respondents (Schreuder, 2017). A profile supplied by the company is included in this chapter as Appendix 3.

Two groups of respondents were identified by using a non-probability quota sampling approach (Moser, 1952): The sample of established users of asset-backed short-term finance was selected from the database of an independent credit provider, who was willing to provide his database.

The sample of potential customers of asset-backed short-term finance (persons with similar financial profiles as customers) was realised by utilising the sample framework of the Consulta Community. With the advent of the Consumer Protection Act (RSA,

2008), the Electronic Communication Act (RSA, 2014) and the Protection of Personal Information Act in South Africa (RSA, 2013), companies wanting to conduct research amongst consumers needed to become more sophisticated in the handling of consumer information. With these requirements, Consulta (Pty) Ltd established the Consulta Community. Using the best in class international technology platform Verint, Consulta started building a database of South Africans who gave their permission to be contacted for participation in research. In addition, these respondents provided personal and demographic information that can be used for profiling and selection in participation in particular research studies. This demographic information includes LSM-type (lifestyle measure) information, such as personal and household income estimates, employment, businesses ownership and position in business.

The Consulta Community is made up of more than 250 000 South Africans who represent this multi-cultural nation with people from every age group, background, ethnicity and income level (Schreuder, 2017). The Consulta Community is continuously refreshed with consumers who continuously sign up to take part in a variety of survey research initiatives. Advanced features for the Consulta Community are:

- extension of customer understanding by, e.g. interest- and psychographics-based questioning;
- use of Consulta's panel research community representing customers from a variety of backgrounds regarding, e.g. geography, ethnicity, income and age; and
- database management using intelligent storage allowing the use of profiles.

It is from this Consulta Community that customers were selected with a comparable income, lifestyle and business ownership as customers who are known to have made use of asset backed short-term financing. The one thousand Consulta Community members whose profiles matched those of known users of asset-backed short-term finance closest were used for this study. Every member was invited to take part in this study, but only 120 responded. In total, therefore a sample of 120 interviews were realised.

6.4.1.4 Loan profiles used in the survey

As indicated in section 1.2.1, asset-backed short-term finance is needed under the specific circumstances of a cash-flow constraint perceived to be temporary, but urgent. To outline the different needs of customers applying for 'normal' credit and asset-backed short-term credit, two basic loan profiles were formulated:

Profile 1: Fixed-asset finance: A bank loan of R200 000 to several millions of rand to acquire property of any kind for private or business use, to be repaid within 20 to 25 years out of regular income or selling after value had been added (actively or passively).

Profile 2: Bridging finance: A loan of any amount (very rarely less than R50 000) to acquire anything of value for business ends, to be repaid within six months either by reselling or refinancing, guaranteed by other assets.

The loan attributes (utilities in terms of BWS) considered, were:

- interest rate;
- initiation fee;
- waiting period between loan application and granting or rejection thereof;
- facilities of provider (institution) (such as ambience, building and furniture);
- contact person with finance provider who can and may (or cannot and may not); reach a conclusion on your loan application;
- loan decision based on repayment ability, without security; and
- loan decision on security, without considering repayment ability.

Following the discussion in Chapter 4, asset-backed short-term finance can be expected to be known for higher interest rates, lower initiation fees, short waiting period, and contact persons with the authority to reach a conclusion, based on security. Facilities may vary, but cannot compete with commercial banks due to a smaller scale of operations, compared to banks. This survey aimed to determine the relative importance of the loan attributes associated with different credit needs.

6.4.1.5 The research instrument

The research instrument (Appendix 1) requested respondents to rank the following loan attributes in order of preference for the two different sets of circumstances outlined in section 6.4.1.4:

- interest rate (section 2.2.3);
- fees (sections 2.2.3.4 and 3.2.3.3);
- waiting period between loan application and decision (section 4.3);
- brand prominence (or a lack of brand prominence) of the credit provider (section 2.3.4.2);
- impressive facilities (or a lack of impressive facilities) (section 2.3.4.3);
- contact person who can and may reach a conclusion on your loan application (2.2.3.4);
- loan decision based on repayment ability, without security (2.2.3.3); and
- loan decision on security, without considering repayment ability (section 2.3.2.2)

A measure of repetition was encountered, as each attribute had to be compared with every other attribute in sets of three.

Additional information was requested from respondents with the following purposes:

- **Primary bank**, in order to determine whether a pattern existed according to which customers of a certain banks were more inclined to need asset-backed short-term finance than customers of other banks.
- **Primary reasons** for taking out loans from independent credit providers, in order to enhance the structured approach to asset-backed short-term finance by designing it according to customer needs.
- **Type of ownership**, to determine whether a pattern existed according to which certain types of owners were more inclined to need asset-backed short-term finance than other types of owners.
- **Industry in which firm operates**, to determine whether a pattern existed according to which firms in certain industries were more inclined to need asset-backed short-term finance than firms in other industries.

- **Annual revenue**, to determine whether a pattern exists according to which firms in certain revenue categories were more inclined to need asset-backed short-term finance firms in other revenue categories.

In the next section, validation of the research instrument is discussed.

6.4.1.6 Validation of the research instrument

Unlike traditional scale questionnaires, BWS does not ask respondents directly which attributes are important or which attributes they prefer based on a rating scale. Instead, BWS compels respondents to choose between the attributes, statements or items. Preferences are then revealed through a series of scoring calculations, ranking (implied from the score) or trade-off decisions. It was found that by doing so, BWS overcomes the problem of respondent bias. It was thus concluded that BWS thereby provides results with higher validity and reliability as well as being more useful for practitioners overall than other methods of enquiry (Walley, Parsons, & Bland, 1999). The following aspects of validity were considered:

6.4.1.6.1 External validity

It is important to control for ambiguity effects in the establishment of importance of statements using BWS (Louviere & Islam, 2006). The method to ensure this is referred to as **external validity** whereby validation is done against actual respondent behaviour in a meaningful behavioural context. This is done by asking whether importance measures as established through the BWS are consistent with measures revealed by actual choices made by respondents.

6.4.1.6.2 Face validity

The objectives of selecting BWS for the use in this study were:

- to determine how customers of credit providers make their decisions;
- to obtaining a substantive measure of the value or importance that customers attach to the factors or dimensions that enter into the decision-making process; and
- to predict the outcomes, preferences and choices implied by those decisions.

It is in this light that (MacLachlan, Mulhern, & Shocker, 1998) emphasise the importance of the selection of attributes or statements selected for respondents to

trade off. Since this attribute selection is not a typical research measurement instrument with convergent and discriminant validity requirements, (MacLachlan et al., 1998) places significant importance on ensuring the validity of the selected statements or items through face validity. This is confirmed by Muhlbacher, Kaczinsky, Zweifel, & Johnson (2016).

While face validity alone is often not regarded sufficient, the nature of BWS requires that the attributes included need to reflect the important choices with which consumers are faced. Through the subjective agreement of experts on the items and statements being tested and thorough literature review reflected in the chapters above, proper face validity could be proved. These items, as presented in 6.2.4.3.2, were:

- loan decision based on repayment ability, without considering security;
- waiting period between loan application and decision;
- fees (such as initiation fee and transaction costs);
- access to contact person who can and may reach a conclusion on your loan application;
- brand prominence of the credit provider;
- impressive facilities – buildings, furniture etc., of the credit provider;
- loan decision based on security, without considering repayment ability; and
- interest rate.

Subsequently, it was concluded that face validity was adequately shown (see Green & Srinivasan, 1978; MacLachlan, 1988; (Muhlbacher, Kaczinsky, Zweifel, & Johnson, 2016).

6.4.1.6.3 Prediction validity

Prediction validity looks at the extent to which a score on a scale or outcome predicts scores on some criterion measure. While this is often used in cases where the criterion measure that is predicted by the score or outcome is collected at a later stage, in the case of BWS, this takes place simultaneously. As described in section 7.2.3, the fit statistic identified how accurately the hierarchical Bayes score estimation algorithm (see Wolfgang, 2016) can predict individual respondent choices. The hierarchical Bayes fit statistic score (see Author, date) was determined with 1/c, where c is the

number of items displayed per set. For this study, three items were displayed per set, thus random choices could be predicted with a 37.1% chance.[21]

Since the study conducted two BWS scenarios, a set of respondent-level fit statistic scores was generated for each scenario. In scenario 1, the fit statistic across 120 respondents was 68.4%. This mean score was higher than the minimum requirement of 37.1% indicating a strong ability to make respondent-level choice predictions. From all respondents, 1 respondent out of the 120 had a fit statistic of 33.8%, which was lower than the minimum requirement of 37.1%. This also indicated that the ability to predict respondent-level choices spanned across the majority of the respondents. The fit statistic mean score for scenario 2 was 72.9%. This was also higher than the minimum requirement of 37.1%, also indicating a strong ability to predict respondent-level choices accurately. In scenario 2, there was again a single respondent with a fit statistic of below 37.1%. Since the respondent with a fit statistic of below 37.1% was a different respondent than the one in scenario 2, and because it was only the single respondent in each scenario, it was decided to keep both of the responses.

It was concluded that the BWS in scenario 1 and scenario 2 had predictive validity in line with the objectives set out using BWS methodology.

6.4.1.6.4 Construct validity

Construct validity is not a requirement, as the BWS does not use a construct that requires convergent or discriminant validity. Construct validity instead comprises a set of statements or attributes that are tested to identify how customers of financing and loans make their decisions. Construct validity determine a substantive measure of the value or importance that customers attach to the factors or dimensions that enter into the decision-making process, and is a way of predicting the outcomes.

According to the above-mentioned forms of validation, valid conclusions could be expected from the research instrument discussed and used in section 7.2.

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[21] Although 1/c is 33.3%, the score estimation algorithm used in MaxDiff (Hierarchical Bayes) (see Author, date) attempts to fit the respondent's choices, even if they are just random. Thus, the actual fit observed, even from random data, is mostly above the chance rate, resulting in the 37.1% indicated (Sawtooth Software, 2016).

6.4.1.7 Measurement of results

The scenarios presented to respondents (discussed in section 6.4.1.5) represented a change from the traditional long-term loan in scenario 1 to an urgent cash-flow constraint perceived to be of short duration in scenario 2. Respondents were then requested to choose the “Most important” as well as the “Least important” statement from each set of 3 statements in the 11 sets for the two scenarios.

Rounds, Miller, and Dawis (1978) explain the decision to evaluate statements in pairs of 3 statements for 11 sets. They identify the following optimal experiment design requirements:

- frequency balance: each statement appeared at least 4 times;
- orthogonality: all statements were randomly mixed to ensure they were paired optimally with all of the other statements;
- connectivity: all statements were randomly interconnected with all the other statements; and
- positional balance: all the items appeared equally on the left as on the right.

The hierarchical Bayes application of multinomial logit (MNL) analysis (see Laerd Statistics, 2017) was used to estimate respondent-level scores for the best–worst rating of the business strategy items. Sawtooth Software SSI Web 8.3.8 was used to calculate hierarchical Bayes individual-level scores. Raw parameters were zero centred to ratio-scaled probabilities ranging from 0 to 100 on an individual score level for easy interpretation. Various methods exist to compute individual-level scores, including **count analysis** (simply counting and scoring the number of times an item is rated best or worst), **mixed logit** (Orme & Combs-Orme, 2009) or **latent class**(Orme & Combs-Orme, 2009). Currently, the best practice for estimating individual-level scores for BWS remains hierarchical Bayes employing the MNL model (Orme & Combs-Orme, 2009, p. 3). Once the individual scores had been calculated, the hierarchical Bayes respondent-level output was used to conduct further analysis for this study. An important output of the BWS is an individualised fit statistic that estimates the internal consistency of the choices made for each respondent. The fit statistic identifies how accurately the hierarchical Bayes score estimation algorithm can predict individual respondent choices. This fit statistic is primarily based on the consistency with which the respondent makes his or her selections. The hierarchical

Bayes fit statistic score was determined with 1/c, where c is the number of items displayed per set. For this study 3 items were displayed per set, thus random choices could be predicted with a 37.1% chance (as discussed in section 6.4.1.6.3, referring to 37.1% and not 33.3%). Therefore, a higher fit statistic is an indication of a higher than random predictability and rating and subsequently an individual level consistency on choice selection. Similarly, a lower fit statistic is an indication of lower consistency and a lower level of predictability (Sawtooth Software, 2016). Thus, the fit statistic is an indication of the consistency or inconsistency with which a particular respondent selected the strategic choices offered to him or her. For example, if a respondent's hierarchical Bayes fit statistic score (based on MNL) in this study was equal to or less than 37.1%, it could have been that the questionnaires were filled in without real consideration of the choices required and the response was useless for the purpose of this study.

6.4.1.8 Statistical framework of best–worst scaling

Choice frequency is used as the metric to generate the probability of each item to be selected as the best or the worst (Flynn & Marley, 2014). The underlying statistical theory is that the relative choice probability of a given best–worst pair of options is proportional to the distance between the two options on the latent utility scale (Marley & Louviere, 2005). Based on the random utility theory, the statistical function of BWS is $U_{ij} = V_{ij} + \varepsilon_{ij}$,

where

- **U_{ij}** represents the utility for a specific individual i in choice set j;
- **V_{ij}** represents the explainable components included in the choice experiment; and
- the expression **ε_{ij}** represents the number of random components due to variability among individuals and random error within an individual (Flynn et al., 2007).

It is assumed that the relative choice probability of a given best worst pair is represented by the proportional distance between them on a latent utility scale (Flynn et al., 2007). Another assumption is that an individual has an underlying utility function

which is linearly additive (Flynn et al., 2007). The value of hypothetical options is captured in $V_{ij} = X_{ij}\beta + Z_i\gamma$

where

- $X_{ij}$is = the vector of attributes of the choice set j as viewed by the individual i;
- whereas $Z_i$is = the vector of individual characteristics of individual i; and
- both β and γ represent the coefficients of vectors which need to be estimated.

With the use of systematic variation to include loans with competing attributes into choice questions, preference of respondents can be elicited effectively without bias. Each of the best–worst pair selected by respondents is conceptualised as one maximum difference between the two options on an underlying utility scale (Flynn et al., 2007). By aggregating individual best–worst pairs by a series of choice questions, the difference in utility between every best–worst pair can be estimated. The choice models of individuals can be estimated and individual choice models can be pooled into an average choice model which represents the population (Flynn et al., 2007).

Hierarchical Bayes application (see Author, date) was used as input for cluster analysis by means of K-means clustering (see (Orme & Combs-Orme, 2009) applying Statistics 11. The objective of the study, namely to determine why some business persons use asset-backed short-term finance, was facilitated by identifying a group for whom asset-backed short-term was more important than for others, and by implication a group for whom it was not important. This provided the basis for the most meaningful number of clusters (Jain, 2010, p. 654). After initial analysis and examination of a two-, three- and four-cluster solution, the choice of the four-cluster solution was considered as the most acceptable, based on maximum external isolation and internal cohesion, and parsimony of the four-cluster solution (Klastorin, 1983; Sarstedt & Mooi, 2014, pp. 273-324).

6.4.1.9 Analysis of data

Analysis of best–worst data can be done on two levels. The first is simply by counting the number of times certain items were selected as best/most preferred or as worst/least preferred. The times a certain item (utility) is rated as worst, is subtracted from the times it was rated as best. A zero value might either indicate that the utility was rated as best as many times as it was rated worst, or that it has never been rated

as best or worst (Jaeger, Jorgenses, Aaslyng, & Bredie, 2008, p. 579–580; University of Aberdeen, 2015, pp. 12–13). The second level is to utilise all the responses in statistical analysis. Subsequent preference is revealed by using regression methods such as MNL (Adamsen et al., 2013, p. 12).

Flynn and Marley (2014, p. 180) contend that BWS can be approached as a method of data collection or as a theory explaining the processes that individuals might follow in providing best and worst data. Sequential and MaxDiff (see Sawtooth Software, 2016) are two different models of best–worst choices. The **sequential model** assumes that the individual provides best and worst in a particular order whilst **MaxDiff** is a well-established model that assumes a simultaneous choice of the pair of items that maximises the difference between them on a latent (usually utility) scale.

Molassiotis et al. (2012, p. 2) explain that frequency counts are determined across scenarios to provide summary estimates of the best and worst selections for participants. A marginal level analysis follows, estimated by weighted least squares (WLS) (see Molassiotis et al., 2012), which uses the log of the adjusted frequency of best–worst counts for each attribute level as the outcome. In order to avoid a saturated model, one attribute is used as a reference case. This is the attribute which is found to have the least utility. This marginal analysis, using WLS, is an approximation to an individual level analysis using conditional logit regression (see Molassiotis et al., 2012).

The results of this survey are discussed in Chapter 7. In the next section, methodology for the second survey, that among credit providers, will be discussed.

6.4.2 Survey among credit providers: Simple choice questionnaire

The second survey of this study involved independent providers of asset-backed short-term finance. As indicated in section 1.2.2, it is an emerging industry, regulated like all other credit providers without any specific regulations for the industry. This leads to a paucity of information, and possibly to hesitance by the credit providers to supply information.

6.4.2.1 Nature and purpose of the survey

In order to construe a framework for asset-backed short-term finance, it was necessary to augment the literature-based description of the industry (Chapter 4) with an empirical survey. Aspects to be covered below are the following:

- strategic considerations for operating in the industry;
- credit strategy of the firm;
- governance structures;
- credit underwriting policy;
- capital management;
- operational risk; and
- regulatory risk.

A rating scale with a five-point Likert-type scale was used, as the survey simply asked the extent to which each statement was true for the specific firm – no trade-offs or choices needed to be simulated.

6.4.2.2 Data collection

Finding a universe of independent providers of asset-backed short-term finance was the problematic part of this survey. As indicated, the industry as such is not regulated, and a voluntary association is the only available universe.

The Bridging Finance Association of South Africa (BFASA) deals collectively with matters important to this industry. Due to its voluntary nature, it can be assumed that some providers will not be members. Through their membership it was possible to identify 17 providers, who were approached to contribute to the study.

6.4.2.3 The research instrument

The research instrument (Appendix 2) requested information on the turnover of the firm, the period it has been in operation and the town or city where it was based. These questions were asked to determine whether a pattern existed between each of these variables and the responses on other items. The main part of the questionnaire requested a minimum of four and a maximum of 13 responses on each of the following aspects of the operations of the respective firms:

- strategic considerations for operating in the industry (sections 4.10.2.8 and 5.2);

- credit strategy of the firm (section 4.4);
- governance structures (sections 4.5 and 4.9);
- credit underwriting policy (section 4.9);
- capital management (section 5.4.3);
- operational risk (section 4.7.3); and
- legal risk (section 4.7.2).

Each response was requested by means of a statement where the respondent had to mark its importance on a five-point Likert-type scale. The questionnaire concluded with a list of 8 types of risk, which had to be ranked according to its importance for the firm (section 4.7).

6.4.2.4 Validation of the research instrument

The purpose of this questionnaire was to determine the importance of aspects of the operations of asset-backed short-term finance, which were identified in the literature study, according to the perceptions of providers of this type of credit. As all of these aspects had been identified in the literature review as essential to the success of such a firm, the validity of this research instrument can be accepted.

6.4.2.5 Population and sampling

A population of short-term financing providers in South Africa was determined through a thorough in-depth investigation by the researcher. A total of 17 organisations were identified. Within these organisations, 17 senior managers were identified. In most cases, the senior manager identified was the chief executive or the managing director. In order to perform statistical analysis on this population, a census (response by all possible respondents) was required. For each respondent less than a census, the margin of error will increase by approximately 4%. For example, if only 14 of the possible 17 respondents were to participate, the margin of error would jump to above 11% (using a 95% confidence interval). Even with what would be considered a high response rate, a margin of error that makes meaningful interpretation difficult, would be yielded (Anderson, Sweeney, Williams, Camm, & Cochran, 2013, pp. 318-320).

Subsequently, a number of measures were put in place in order to achieve a census, or at least get as close as possible to a census. Firstly, a highly professional interview team was selected to conduct the interviews. The selected interviewers all had more

than 10 years of experience conducting interviews with high-profile respondents. The interviewers were also accompanied by regional supervisors who performed quality control over the entire process. The project was further overseen by the professional survey company mentioned in section 6.4.1.2. All attempts to reach the respondents were recorded and all interaction with respondents was also captured. To make the interview as convenient as possible for the respondents, they were given a choice of doing the interview on the Internet, in the convenience of their own office, to conduct the interview telephonically in a time that suited them or for the interviewer to visit them and conduct a face-to-face interview. Furthermore, interviewers and their supervisors were trained in depth on the interview, the context of the study, the importance of the research and how best to convince respondents to participate. Standard practice of reminding respondents that all feedback will remain anonymous and confidential was also covered.

The outcome of the fieldwork project is provided in Table 7..5. A total of only 6 respondents completed a full interview. Other potential respondents were either unavailable (even with as many as six attempts to reach potential respondents), or unwilling to participate. According to ethical conduct standards of the research industry, the interviewers had to respect these respondent's unwillingness to participate.

6.4.2.6 Analysis of data

Analysis of a Likert-type scale survey involves the tasks of collapsing items into scales, checking the reliability of scales, and conducting descriptive analysis. In addition, inferential statistics can be run to answer the research questions or assess practical implications of the results (Creswell, 2014, p. 157). Descriptive statistics involve frequency description, which indicates how many valid responses there were for each question in a survey, according to each option. Percentages of all responses are given, as well as percentages of valid responses. This information can be presented by way of histograms, bar charts and pie charts (Hair et al., 2011, pp. 299–308). Allen and Seaman (2007) regard this process as unproblematic and transparent.

6.7 CONCLUSION

This chapter investigated different forms of enquiry to reach the research aims discussed in section 1.5.3. Simple choice questionnaires (with SERVQUAL as a possible ‘gold standard survey instrument’), as well as BWS as an advanced form of conjoint analysis, were investigated. Chapter 7 will indicate in which way each of the Likert-type scale questionnaire and the BWS methodologies was appropriate and how it was employed.

CHAPTER 7

EMPIRICAL RESULTS

7.1 INTRODUCTION

Chapter 6 described the methodologies followed in two separate surveys conducted in order to reach the research aim outlined in Chapter 1. This chapter deals with the results and analyses of the surveys.

7.2 RESULTS OF THE SURVEY AMONG CUSTOMERS AND POTENTIAL CUSTOMERS OF ASSET-BACKED SHORT-TERM FINANCE

The results of the survey among customers and potential customers of asset-backed short-term finance are presented below. All responses on each of the eight utilities for scenarios 1 and 2 are presented. These led to the identification of four clusters of respondents, according to their different preferences. The results of each cluster are presented in respective tables, each followed by a discussion. Then the eight utilities are collapsed into five competing features, which keep each other in balance, in order to present the different needs of the different clusters graphically, as met by asset-backed short-term finance. As only scenario 2 met the description for an asset-backed short-term loan, the results for scenario 1 are not used in these charts. The five collapsed features were:

- Evaluation of loan application based on repayment ability;
- Evaluation of loan application based on collateral;
- Functionality (access to decision maker and period between application and result);
- Favourable cost (fees and interest); and
- Image (brand prominence and facilities).

The results of the first survey (among customers and potential customers of asset-backed short-term finance) are presented and discussed in the following sections.

7.2.1 Respondent-level scores and resulting clusters of respondents

The survey was statistically analysed by the firm mentioned in section 6.4.1, which administered the surveys with academic rigour (Schreuder, 2017). However, conclusions are those of the author, who accepts full responsibility for it.

Using the output from the hierarchical Bayes application of MNL analysis to estimate respondent-level scores for the best–worst rating for scenario 1 and scenario 2, the following importance scores emerged:

Table 7.1: Respondent-level importance scores of attributes for scenarios 1 and 2 – Compiled by the author

Statement	Scenario 1 Overall importance	Scenario 2 Overall importance
Loan decision based on repayment ability, without considering security	16	16
Period between loan application and decision	14	17
Fees (such as initiation fee and transaction costs)	14	12
Access to contact person who can and may reach a conclusion on your loan application	16	15
Brand prominence of the credit provider	2	1
Impressive facilities – buildings, furniture etc. – of the credit provider	1	1
Loan decision based on security, without considering repayment ability	13	13
Interest rate	24	25

An important step in reaching the objectives of this study was the identification of a group or groups of business persons for whom the benefits and importance of asset-backed short-term finance were more important than others. For this purpose, the output of the BWS survey rendered the necessary information.

From the analysis, four clusters emerged. To assure the meaningfulness and usefulness of these four clusters, a one-way ANOVA relating the cluster membership to the eight statements between scenario 1 and scenario 2 proved to be a strong

validator of the homogeneity within and difference between criteria with $p \leq 0.05$ for 7 of the 8 statements. Furthermore, discriminant analysis was conducted with cluster membership as the grouping variable and the eight statements between scenario 1 and scenario 2 as the independent variable. The discriminant analysis revealed that 98.8% of the respondents were correctly classified, providing further confidence in the cluster solution (Klastorin, 1983).

The study tested the importance of the factors that influence a business person's decision in financing when presented with two loan profiles. The first profile was dominated by a long-term perspective, while urgency and a short loan term perspective dominated the second. These loan profiles were identified as scenario 1 and scenario 2. According to the analysis, there was no general increase in importance between scenario 1 and scenario 2 for any of the critical statements on which a loan decision was based. The changes between scenario 1 and scenario 2 as urgency increased only emerged within specific clusters.

7.2.2 Results Cluster 1

An independent samples t-test was conducted between scenario 1 and scenario 2 for Cluster 1. Table 7.2 provides the output of the t-test of the independent samples indicating the mean for the two different groups, the SD, F and *p*-values as well as effect size.

Table 7.2: Cluster 1: Differences between scenario 1 and scenario 2 – Compiled by the author

Cluster 1	Mean		Std. Deviation		F	*p*-value[a]	Effect Size	Effect Size
	Scenario 1	Scenario 2	Scenario 1	Scenario 2			Eta squared	Cohen's *d*
Loan decision based on repayment ability, without considering security	14.0	18.4	7.1	5.5	6.61	*0.00*	0.110	0.7
Time lapse between loan application and decision	15.9	18.1	7.0	8.2	1.02	0.22	0.021	0.3
Fees (such as initiation fee and transaction costs)	12.3	12.3	5.4	5.7	0.07	0.97	0.000	0.0
Access to contact person who can and may reach a conclusion on your loan application	16.5	11.7	7.3	7.5	0.02	*0.01*	0.098	0.7
Brand prominence of the credit provider	1.4	2.0	3.7	5.3	1.07	0.58	0.004	0.1
Impressive facilities – buildings, furniture etc., of the credit provider	1.1	0.9	2.9	4.2	0.03	0.76	0.001	0.1
Loan decision based on security, without considering repayment ability	16.9	13.3	8.5	8.8	0.04	0.08	0.043	0.4
Interest rate	21.8	23.3	6.1	5.4	1.09	0.28	0.017	0.3

Notes: [a]Significance level (*p*-value) is based on independent samples t-test; SD = standard deviation

Table 7.2 above shows that for Cluster 1, there was a significant difference between scenario 1 and scenario 2 for the statements "Loan decision based on repayment

ability, without considering security" and "Access to the contact person who can and may reach a conclusion on your loan application". It is clear that there was an increase in importance for the statement "Loan decision based on repayment ability, without considering security" while the statement "Access to the contact person who can and may reach a conclusion on your loan application" declined in importance for this cluster. The effect size for both these statements was moderate.

For Cluster 1, there was no increase in importance that aligned to the criteria for asset-backed short-term finance. Rather, the increase in importance was for the loan decision to be based on the ability of the business person to repay the loan. Also, there was a decrease in importance for access to a contact person who could and might have reached a conclusion on a loan application. This cluster identified a group of customers that would remain with typical banking services provided by the large banks despite an increase in urgency and a short loan term perspective.

The results for Cluster 1 are represented on the radar chart introduced in section 1.5., as figure 7.1.

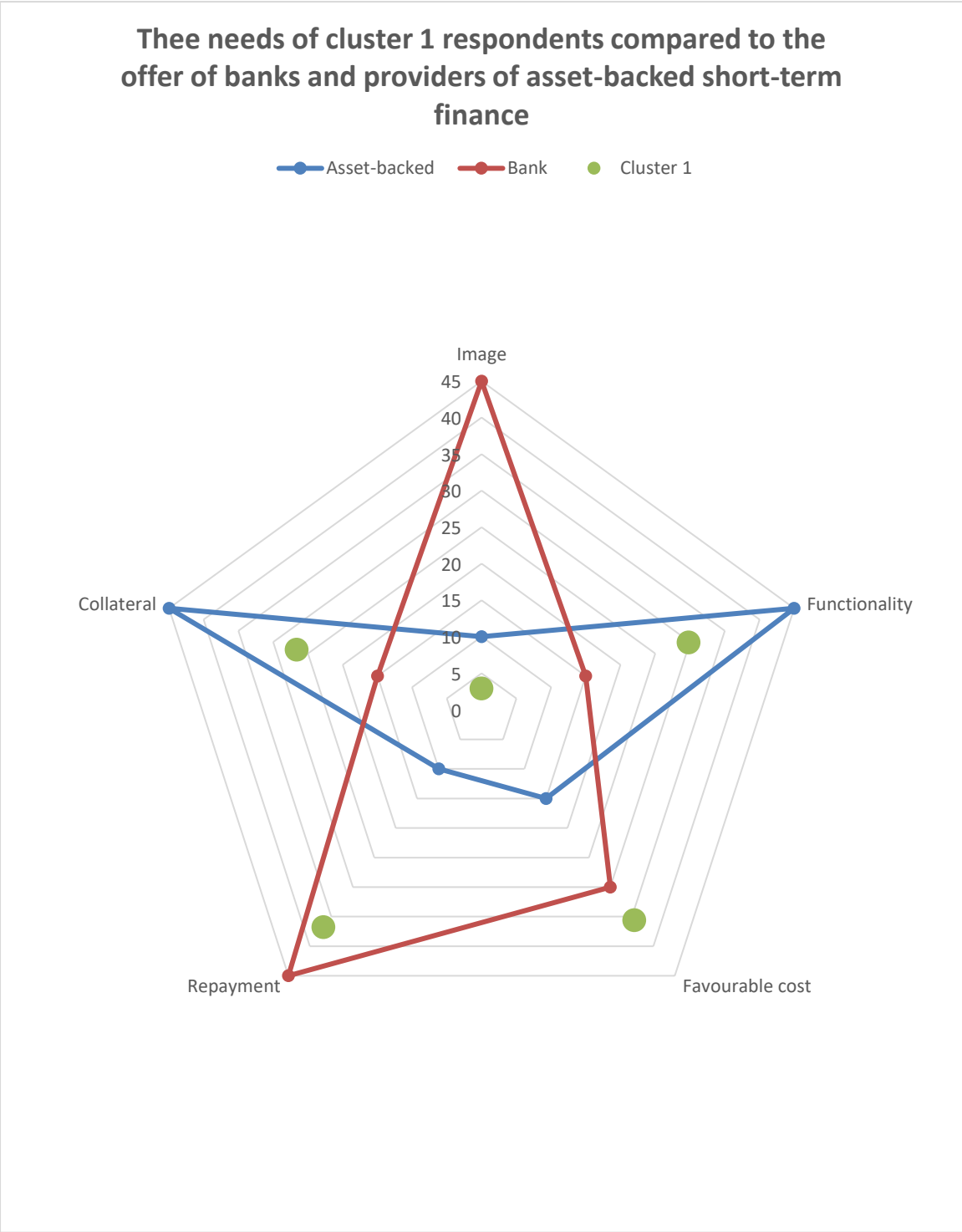

Figure 7.1: The needs of Cluster 1 respondents compare to the offer by banks and providers of asset-backed short-term finance – Drawn by the author

The extent to which banks meet the needs of this cluster of customers is visible in this chart. Although they might have appreciated a higher level of functionality and evaluation of collateral than received from banks, these needs were superseded by

their need for evaluation on repayment ability, and the superior (even if still adequate) favourable cost structure of banks.

7.2.3 Results Cluster 2

Another independent samples t-test was conducted between scenario 1 and scenario 2 for Cluster 2. Table 7.3 provides the output of the independent samples t-test indicating the mean for the two different groups, the SD, F and *p*-value's as well as Effect Size. Compiled by the author

Table 7.3: Cluster 2: Difference between scenario 1 and scenario 2 – Compiled by the author

Cluster 2	Mean		Std. Deviation		F	*p*-value[a]	Effect Size	Effect Size
	Scenario 1	Scenario 2	Scenario 1	Scenario 2			Eta squared	Cohen's *d*
Loan decision based on repayment ability, without considering security	15.5	11.1	7.8	4.8	8.20	*0.03*	0.108	0.7
Time lapse between loan application and decision	16.8	22.6	6.2	5.2	1.89	*0.00*	0.212	1.0
Fees (such as initiation fee and transaction costs)	14.1	8.9	6.4	5.3	0.97	*0.00*	0.173	0.9
Access to contact person who can and may reach a conclusion on your loan application	15.5	21.5	6.2	4.9	4.05	*0.00*	0.236	1.1
Brand prominence of the credit provider	1.1	1.2	2.6	2.3	0.14	0.86	0.001	0.1
Impressive facilities – buildings, furniture etc., of the credit provider	0.2	0.0	0.4	0.1	11.75	*0.02*	0.117	0.7
Loan decision based on security, without considering repayment ability	11.6	9.2	7.5	6.9	1.66	0.27	0.028	0.3
Interest rate	25.2	25.5	3.6	2.7	0.07	0.77	0.002	0.1

Notes: [a]Significance level (*p*-value) is based on independent samples t-test; SD = standard deviation

The results showed that there were significant differences between scenario 1 and scenario 2 for the following statements:

- Loan decision based on repayment ability, without considering security
- The waiting period between loan application and decision
- Fees (such as initiation fee and transaction costs)
- Access to contact person who can and may reach a conclusion on your loan application
- Impressive facilities – buildings, furniture etc. – of the credit provider

It can also be seen that for Cluster 2 "Loan decision based on repayment ability, without considering security", "Fees" and "Impressive facilities – buildings, furniture etc. – of the credit provider" decreased in importance, while "Waiting period between loan application and decision" and "Access to contact person who can and may reach a conclusion on your loan application" increased in importance between scenario 1

and scenario 2. The effect size for the statements with a statistically significant difference was large. Cluster 2 identified a group of customers for whom there is meaningful relationship between an urgent cash-flow constraint perceived to be of short duration and a business person's need for a service-oriented contact person at a credit provider.

This cluster showed a combined increase in importance for the period between loan application and decision as well as access to a contact person who can and may reach a conclusion on the loan application. This group expected a general increase in service orientation as the urgency and short loan term perspective of a loan increases.

The results for Cluster 2 are represented on the radar chart introduced in section 1.5, and shown here as Figure 7.2:

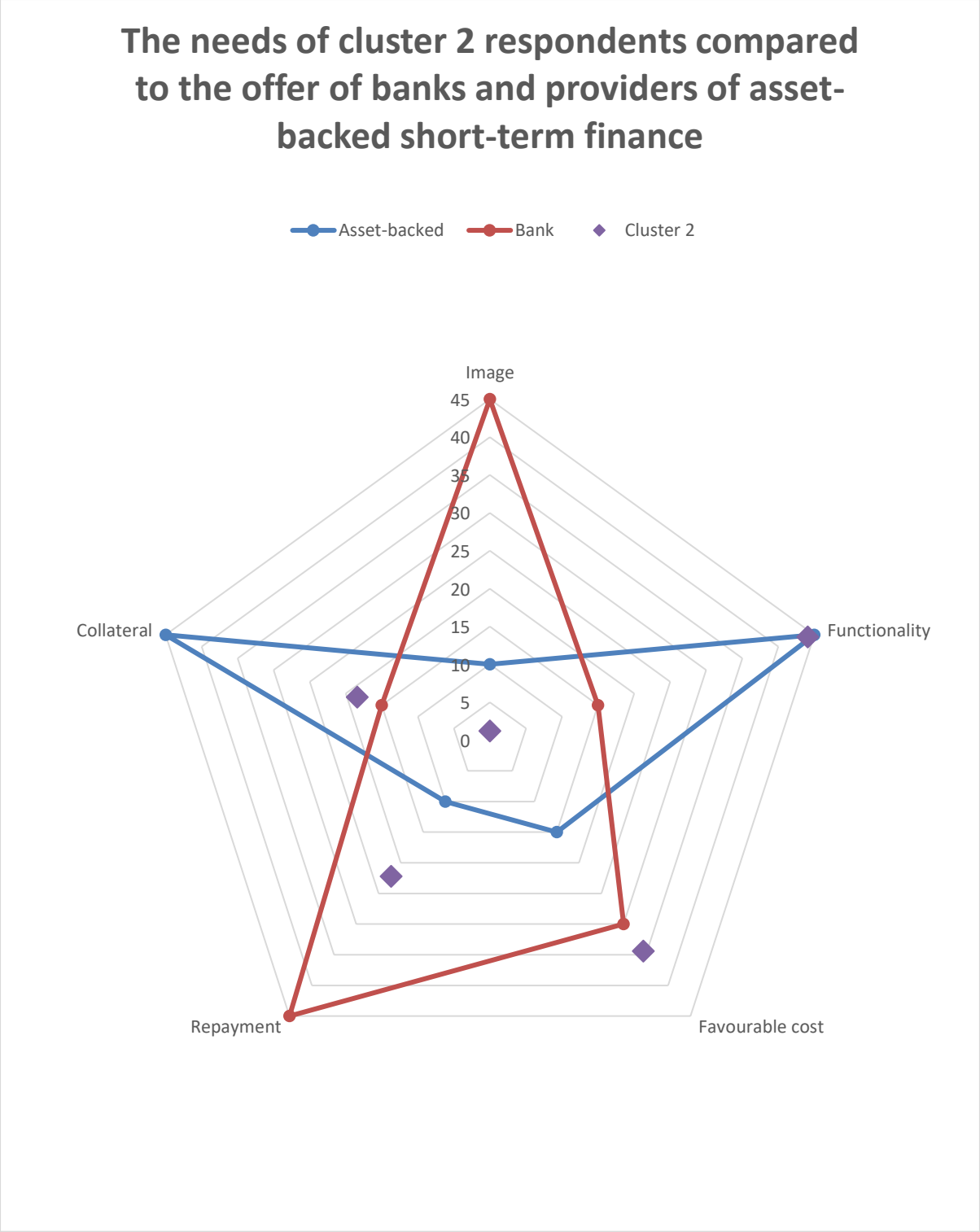

Figure 7.2: The needs of Cluster 2 respondents compared to the offer by banks and providers of asset-backed short-term finance – Drawn by the author

It is visible in this chart that, although banks met the requirements of this cluster regarding the evaluation of repayment ability, and nearly meet their needs for favourable cost and evaluation of collateral, their need for functionality (access and

response time) overrode these considerations to the extent that they may need to use asset-backed short-term finance under the circumstances described as scenario 2.

7.2.4 Results Cluster 3

Subsequently, an independent samples t-test was conducted between scenario 1 and scenario 2 for Cluster 3. Table 7.4 provides the output of the independent samples t-test indicating the mean for the two different groups, the SD, F and *p*-values as well as effect size.

Table 7.4: Cluster 3: Difference between scenario 1 and scenario 2 – Compiled by the author

Cluster 3	Mean		Std. Deviation		F	*p*-value[a]	Effect Size	Effect Size
	Scenario 1	Scenario 2	Scenario 1	Scenario 2			Eta squared	Cohen's *d*
Loan decision based on repayment ability, without considering security	16.5	18.2	5.9	5.8	0.03	0.21	0.021	0.3
Time lapse between loan application and decision	13.2	7.1	6.7	7.7	0.15	*0.00*	0.155	0.9
Fees (such as initiation fee and transaction costs)	14.4	13.0	6.4	6.1	0.27	0.34	0.012	0.2
Access to contact person who can and may reach a conclusion on your loan application	15.6	15.4	8.3	8.5	0.26	0.91	0.000	0.0
Brand prominence of the credit provider	1.4	2.2	3.0	3.5	2.43	0.27	0.016	0.3
Impressive facilities – buildings, furniture etc., of the credit provider	0.4	0.2	1.0	0.7	1.79	0.37	0.011	0.2
Loan decision based on security, without considering repayment ability	13.5	19.9	8.1	7.4	0.53	*0.00*	0.150	0.8
Interest rate	25.1	24.0	3.5	5.1	2.65	0.28	0.015	0.2

Notes: [a]Significance level (*p*-value) is based on independent samples t-test; SD = standard deviation

It is clear that, for Cluster 3, between scenario 1 and scenario 2, there was a significant difference between "Waiting period between loan application and decision" and "Loan decision based on security, without considering repayment ability". Whereas "Waiting period between loan application and decision" was also significantly different for Cluster 2, in the case of Cluster 2, the importance of this statement increased in importance. In the case of Cluster 3, the importance of "Waiting period between loan application and decision" declined. "Loan decision based on security, without considering repayment ability" increased in importance for Cluster 3. The effect size for the two statements with a statistically significant difference was notable.

Cluster 3 identified a group of customers for whom there is a meaningful relation between an urgent cash-flow constraint perceived to be of short duration and a business person's need for a loan decision to be based on his or her security, instead of his or her repayment ability. The third cluster identified, showed a simple increase in importance of the loan decision based on security, without considering repayment

ability. This could typically identify a group of business persons with business interests that hold some capital, but with inconsistent cash flow or monthly income. This is an important group of customers for whom asset-backed short-term finance provides a service which commercial banks do not provide. It is also clear that this group will wait longer for a decision on the approval of a loan, as long as this decision is then based on their security rather than their repayment ability.

The results for Cluster 3 are represented in the radar chart introduced in section 1.5 and repeated here as Figure 7.4:

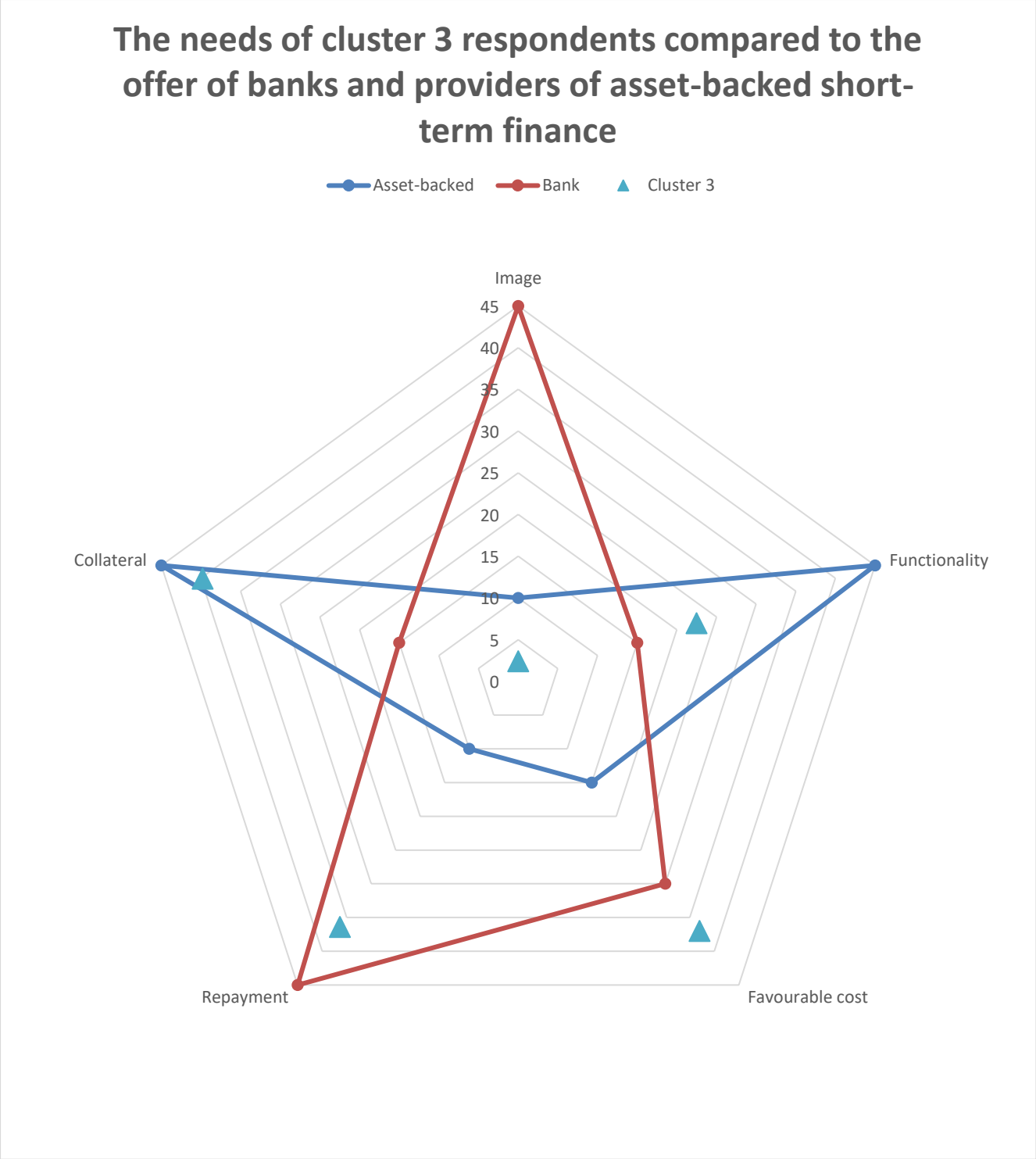

Figure 7.3: The needs of Cluster 3 respondents compared to the offer by banks and providers of asset-backed short-term finance – Drawn by the author

This cluster was differentiated from other clusters in terms of their need for collateral being evaluated and a higher level of functionality than associated with banks under the relevant circumstances. Although this cluster preferred more favourable costs than providers of asset-backed short-term finance could offer, the other two features

mentioned may override the preference for favourable costs under specific circumstances (as described under scenario 2).

7.2.5 Results Cluster 4

Lastly, an independent samples t-test was conducted between scenario 1 and scenario 2 for Cluster 4. Table 7.5 provides the output of the independent samples t-test indicating the mean for the two different groups, the SD, F and *p*-values as well as Effect Size.

Table 7.5: Cluster 4: Difference between scenario 1 and scenario 2 – Compiled by the author

Cluster 4	Mean		Std. Deviation		F	*p*-value[a]	Effect Size	Effect Size
	Scenario 1	Scenario 1	Scenario 1	Scenario 1			Eta squared	Cohen's *d*
Loan decision based on repayment ability, without considering security	17.6	13.6	5.6	7.2	6.33	*0.04*	0.091	0.6
Time lapse between loan application and decision	6.9	22.9	6.0	5.8	0.00	*0.00*	0.656	2.8
Fees (such as initiation fee and transaction costs)	18.2	11.4	5.8	6.1	0.20	*0.00*	0.254	1.2
Access to contact person who can and may reach a conclusion on your loan application	18.4	15.5	6.8	7.8	0.89	0.18	0.040	0.4
Brand prominence of the credit provider	6.7	2.3	7.8	4.1	6.54	*0.02*	0.117	0.7
Impressive facilities – buildings, furniture etc., of the credit provider	0.2	0.4	0.3	1.3	2.91	0.45	0.013	0.2
Loan decision based on security, without considering repayment ability	9.1	7.1	7.8	7.5	0.03	0.37	0.018	0.3
Interest rate	22.9	26.9	5.5	3.3	1.95	*0.00*	0.166	0.9

Notes: [a]Significance level (*p*-value) is based on independent samples t-test; SD = standard deviation

Cluster 4 had 5 statements that differed significantly between scenario 1 and scenario 2, namely:

- Loan decision based on repayment ability, without considering security
- Waiting period between loan application and decision
- Fees (such as initiation fee and transaction costs)
- Brand prominence of the credit provider
- Interest rate

Out of these, the statements that decreased in importance were “Loan decision based on repayment ability, without considering security”, “Fees” and “Brand prominence of the credit provider”. “Interest rate” showed a slight increase in importance from scenario 1 to scenario 2 for Cluster 4. This cluster featured a very large effect size for the increase in importance for the statement “Waiting period between loan application and decision”.

Cluster 4 identified a group of customers for whom there is a meaningful relation between an urgent cash-flow constraint perceived to be of short duration and a business person's need for a short period between loan application and decision.

Cluster 4 also identifies a group of customers for whom there is a meaningful relation between long-term loans and a business person's sensitivity for a favourable interest rate. For this cluster, there was an increase in importance for the single statement, waiting period between loan application and decision. This group was clearly very sensitive about the time of getting approval as the urgency and short loan term perspective of a loan increased.

The results for Cluster 3 are represented in the radar chart introduced in section 1.5 and repeated here as Figure 7.5:

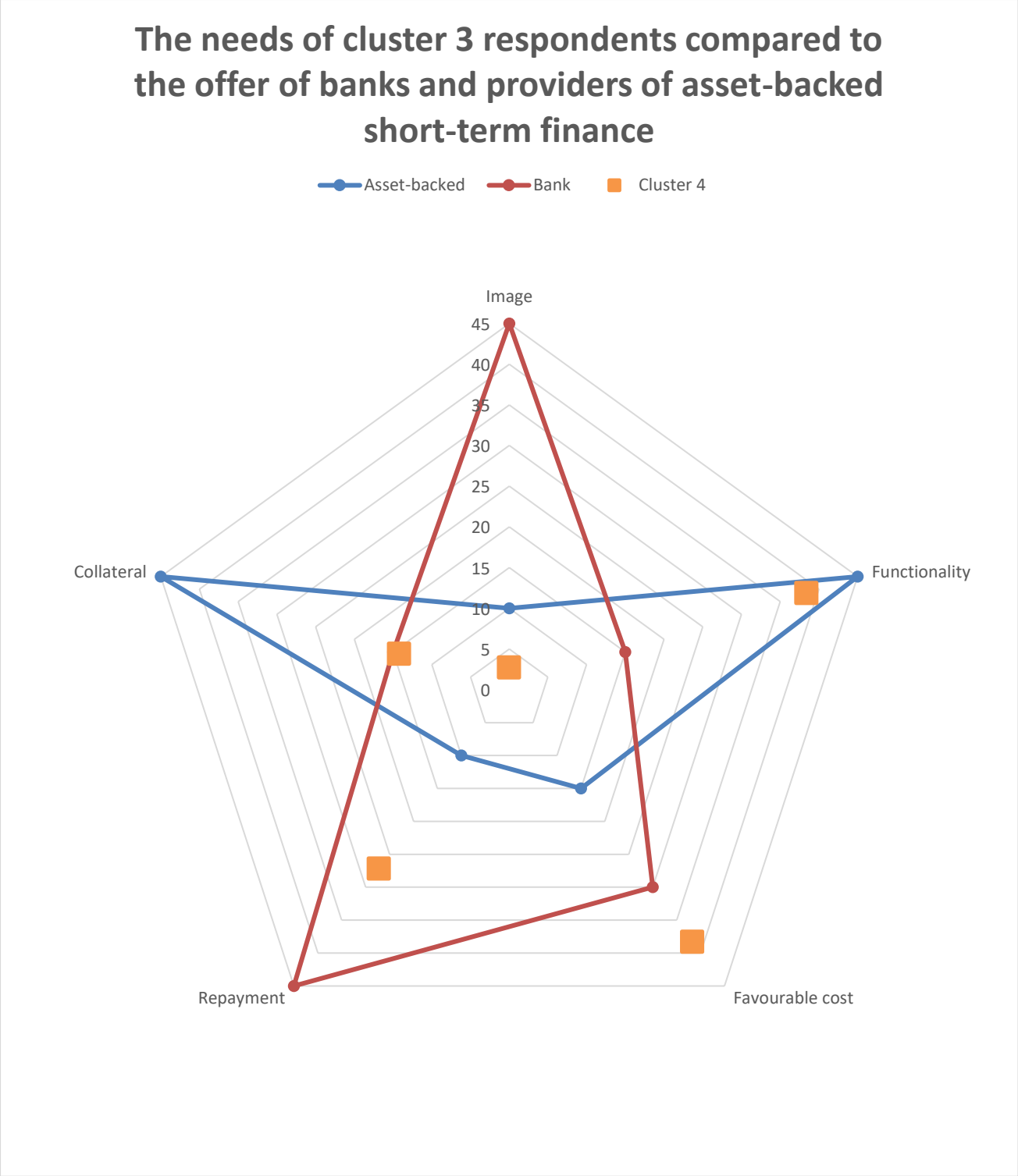

Figure 7.4: The needs of Cluster 3 respondents compared to the offer by banks and providers of asset-backed short-term finance – Drawn by the author

Although banks met most of the requirements of this cluster of customers, the circumstances described in scenario 2 elevated functionality to a level of importance which banks could not meet. This is the circumstances under which asset-backed short-term finance is a viable option.

7.2.6 Strategic positioning of banks versus asset-backed short-term finance

It became clear from the results of this survey, that different clusters of customers have different reasons for using asset-backed short-term finance (or not doing so). However, the needs of customers (the value proposition) are not the only determinants of the nature of a loan; the need of the credit provider to protect its revenue (the profit proposition) is also important. Therefore, although none of the clusters preferred the level of costs offered by banks or providers of asset-backed short-term credit, and only one cluster indicated a preference for security being evaluated rather than repayment ability, these features are essential for the income and risk management of the providers of asset-backed short-term credit.

Figure 7.5 depicts the preferences of all the clusters combined with the positions of banks and providers of asset-backed short-term finance provides the strategic position of asset-backed short-term finance in relation to banks and market preferences.

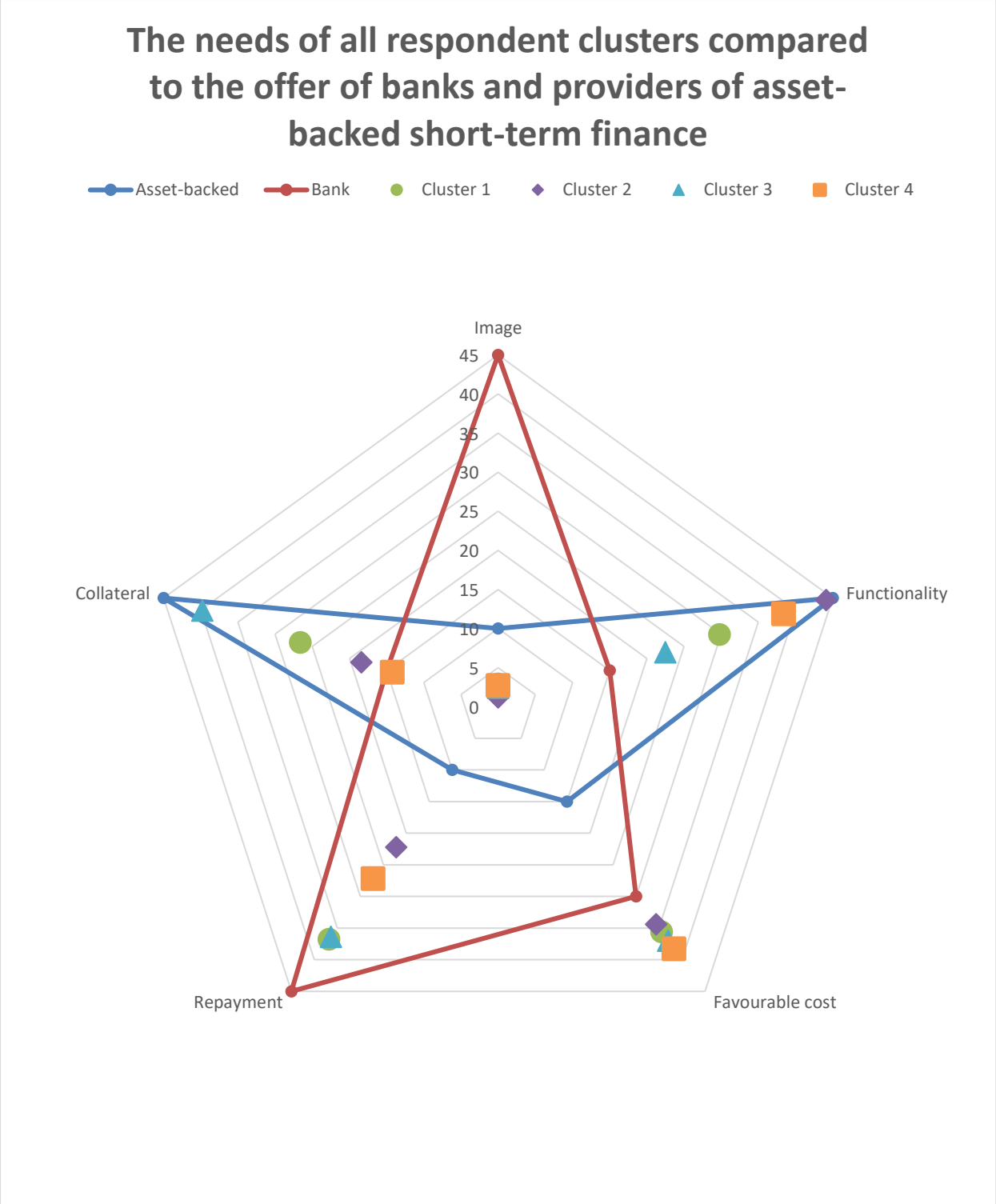

Figure 7.5: The needs of all respondent clusters compared to the offer by banks and providers of asset-backed short-term finance – Drawn by the author

It is clear from this chart that all clusters of respondents preferred lower costs, that all clusters claimed to disregard the image of a service provider, and that the functionalities of swift response and direct access to decision-makers are probably the most important factors drawing customers to asset-backed short-term finance.

Nevertheless, there is also a cluster of customers who prefer to have their loan applications evaluated according to security and not repayment ability, as is the case with asset-backed short-term credit providers. The strategic position of providers of asset-backed short-term finance can be summarised as follows:

Customers are mainly drawn to asset-backed short-term finance due to these financiers' ability to process applications quickly, which may be the result of direct access to a decision-maker. Although some customers prefer their security to be evaluated rather than their regular income as proof of repayment ability, security is more important as a risk-mitigating measure for providers. Loans are not provided at low cost, because independent credit providers can only use own capital or bank loans to finance their operations. Independent credit providers do not need to aspire to the facilities and brand prominence of banks, as customers claim to disregard this feature. Initiative should rather be channelled towards features that meet customers' proven demands or providers' need to secure their income and mitigate risks.

7.2.7 Biographical information of respondents

It was indicated in section 6.4.1.5 that biographical information is part of the questionnaire in order to identify possible patterns. Respondents identified their primary bank as follows:

- FNB, 38%
- Standard Bank, 24%
- Barclays, 20%
- Nedbank, 12.5%
- Capitec, RMB and Investec made up a further 4%
- Other smaller banks made up the remaining 2%

This compares to the portion of assets held by the different banks (section 3.2.3.2), where the First Rand Group (including FNB) holds 23%, Standard Bank 31%, Barclays (Absa) 26% and Nedbank 20%. These figures seem to indicate that a disproportionately high number of FNB, and a disproportionally low number of Standard Bank and Nedbank customers, use asset-backed short-term finance. This observation warrants closer investigation.

The majority of respondents held a limited liability company (44%), followed by a large proportion that held a closed corporation (38%). A number of respondents also held a sole proprietorship (8%) and a sole corporation (4%). The remaining respondents (7%) either held a partnership, franchise or other. This observation could be expected, as it was noted in section 4.3 that providers of asset-backed short-term finance only deal with juristic persons.

Respondents also indicated the primary reasons why they take out business loans. The main reason identified was to finance business operations (48%), followed by the purchase of real estate and to expand operations (26%) as well as to purchase equipment (14%). Other reasons were research and development and the purchase of inventory (9%). These considerations were in accordance with the literature (as noted in section 4.3) that this industry finances operations for which time is important, and it was found that banks take longer to evaluate applications.

The turnover of the businesses of the respondents was indicated as follows:

- Prefer not to disclose, 13%
- R0–10 000 000, 55%
- R10 000 001–40 000 000, 23%
- R40 000 001–100 000 000, 5%
- R100 000 001 +, 4%

The observation that more than half of the customers had a turnover of between R0 and 10 million and another 23% between R10 and R40 million may indicate that banks tend to deal more efficiently with the needs of customers with a turnover beyond R40 million. It may also be expected that a smaller number of businesses with a turnover beyond R40 million accounts for a smaller number of customers for asset-backed short-term finance. This also warrants further investigation.

7.2.8 Discussion of results of empirical survey among customers

In summary, this survey found that there were groups of customers with a need for asset-backed short-term financing for whom traditional banks did not provide the required service. It was found that there was a group of customers who will always prefer traditional banking services where a loan approval is based on payment ability. Yet, three additional groups were identified for whom personal attention, waiting time

between application and approval as well as approval based on security and not payment ability were critical decision factors.

The researcher expected to identify two groups, namely a group where the statements relevant to short-term, asset-backed finance increased as the urgency and short loan term perspective of a loan increased, and a group where the statements relevant to asset-backed short-term finance did not increase. In fact, four different groups were identified, with the different groups showing how different statements increased in importance as the urgency and short loan term perspective of a loan increased.

7.3 INSIGHTS GAINED FROM THE SURVEY AMONG CUSTOMERS

The investigation among customers of asset-backed short-term finance disproves the null hypothesis presented in section 6.3.3, that asset-backed short-term finance does not fill a necessary niche in the financial sector. In contrast, it proves the alternative hypothesis, that asset-backed short-term finance fills a necessary niche in the financial sector, because high net-worth business persons with urgent, short-term liquidity challenges, experience commercial banks as unable or unwilling to consider their assets, rather than regular income, as loan guarantee, and to assist such persons within the required time frame, therefore, such a business can be operated as a profitable enterprise when the most relevant risks are attended to. The investigation provides nuance to the hypothesis by identifying three clusters of customers or potential customers (rather than a single group), as well as a cluster of persons with similar profiles, who are not potential customers, because of their different requirements.

The survey among customers and potential customers of asset-backed short-term finance revealed that there were business persons with no identifiable inclination towards any of the unique features of asset-backed short-term finance. These business persons cannot be expected to use the service of such independent credit provider, as commercial banks meet all their requirements.

In contrast to this group, among those business persons who did indeed find the industry under consideration as meeting crucial needs, were three distinct groups, or clusters:

- there was a cluster of persons for whom the combined effect of contact with the final decision-maker as well as prompt decision-making was crucial;
- another cluster focused only on promptness of decision-making; and
- for yet another cluster, it was crucial that their loan applications were evaluated upon their assets, rather than regular income.

None of the respondents found the appearance of facilities crucial, while all respondents found the interest rates of the industry higher than they would have preferred.

Two possible topics for future investigations were also identified. These are –

- the reasons why customers of FNB seem to be disproportionately inclined to use asset-backed short-term finance (as opposed to customers of Standard Bank and Nedbank of whom the opposite seemed true); and
- the reasons why fewer business entities with a turnover beyond R40 million seemed to need asset-backed short-term finance.

The significance of these findings is the following: The market position of asset-backed short-term finance (section 4.3) is indicated as follows: Customers with a high net-worth, but irregular income, find that commercial banks do not serve all their needs. These customers especially need prompt decision making, service orientation and demand to be evaluated for loans based on collateral, rather than regular income (repayment ability). The results in the previous section show that there is not a single typical profile, but three separate profiles of customers for asset-backed short-term finance; as well as persons whose profiles overlap with those of customers, but who has no interest in this type of finance. This information will enable credit providers to focus their marketing efforts efficiently.

7.4 RESULTS OF THE SURVEY AMONG PROVIDERS

The tables in the following sections show the responses for each question, as well as for the sections covered. The average across the six respondents is also provided as well as the minimum and maximum rating. It is clear that the section covering credit strategy received the highest score, namely 4.5 out of 5, while the section about governance structures received the lowest rating with an average score of 3.1 out of 5. Each table is discussed separately.

7.4.1 Demographic information of respondents

This section reflects the demographic information, as supplied by respondents.

Table 7.6: Demographic information of respondents – Compiled by the author

Respondent Number	Respondent 1	Respondent 2	Respondent 3	Respondent 4	Respondent 5	Respondent 6
Size of the company you are involved with, in terms of gross advances	Medium R0m - R1bn	Medium R0m - R1bn	Medium R0m - R1bn	Medium R0m - R1bn	Medium R0m - R1bn	Medium R0m - R1bn
Tenure	2 – 5 years	≥ 5 years	≥ 5 years	2 – 5 years	≥5 years	2 – 5 years
Region	Pretoria	Pretoria	Killarney, JHB	Johannesburg	Alberton	Cape Town
Date of interview	22/02/2017	23/02/2017	22/02/2017	21/02/2017	21/02/2017	24/02/2017

It can be inferred from Table 7.6 that, at the time of this research, independent providers of asset-backed short-term finance were predominantly situated in large metropolitan areas (in these cases, Tshwane [Pretoria], Johannesburg, Ekurhuleni [Germiston] and Cape Town). It seemed that these firms are relatively young, as the tenure of respondents were 2 to 5 years in three cases and longer than 5 years in three cases. It must be taken into account that only senior managers were approached (section 6.4.2.5). In terms of the financial sector, all responding firms were regarded as of medium size.

7.4.2 Strategic considerations

The perceptions of respondents on strategic considerations for the industry of asset-backed short-term finance as a whole, is the topic of this section.

Table7.7: Strategic considerations (refers to the industry) – Compiled by the author

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.
(Strongly Disagree = 1, Disagree = 2, No opinion = 3, Agree = 4, Strongly Agree = 5)

Respondent Number	1	2	3	4	5	6	**Average Rating**	Minimum	Maximum
Strategic considerations (Refers to the industry)	**4.0**	**3.4**	**3.5**	**3.6**	**3.6**	**3.6**	**3.6**	**3**	**4**
1. The opportunities for asset-backed short-term credit providers are increasing in South Africa.	5	4	4	3	4	4	4.0	3	5
2. The asset-backed short-term finance industry is highly profitable.	4	4	3	3	3	3	3.3	3	4
3. My organisation do not grant loans for longer than a year, in order not to be exposed to the prevalent economic environment for an extended period	5	5	3	5	5	5	4.7	3	5
4. The use of online marketing for asset-backed short-term finance is becoming more prevalent.	4	4	4	3	3	4	3.7	3	4
5. Asset-backed short-term finance is concentrated among a small number of firms.	4	4	4	3	3	4	3.7	3	4
6. The characteristics of asset-backed short-term finance products are very similar.	4	2	3	5	3	2	3.2	2	5
7. Users of asset-backed short-term finance can be described as "loyal customers".	4	3	2	2	4	2	2.8	2	4
8. The image of a specific provider of asset-backed short-term finance is important for potential customers.	2	1	5	5	4	5	3.7	1	5

Table 7.7 indicates a wide variety of opinions between providers of asset-backed short-term finance on the strategic considerations for the industry. While five respondents agreed that opportunities for this industry are increasing in South Africa, the other respondents had no opinion on the matter. The high levels of risk for these loan providers may be reflected by four respondents having no opinion on the statement that the industry is highly profitable, while the other two agreed – there were no respondents who strongly agreed. Only one respondent did not strongly agree on limiting loan periods to less than a year, and this was the same respondent who indicated in Table 7.8 that it had no opinion on granting only collaterised loans. Four respondents agreed, while two had no opinion, on the statement that this industry is concentrated among a small number of companies. The similarity of products in this industry is highly disputed, as one respondent strongly agreed, one agreed, two had no opinion and two disagreed on the statement that the products in the industry are very similar. A wide variety of opinions on the loyalty of customers and the importance of the image of providers also existed at the time of this research. While two respondents agreed that customers were loyal, one had no opinion and the other three disagreed. On the importance of image, four respondents agreed or strongly agreed that it was important to customers, while the other two disagreed or strongly disagreed.

The low level of agreement on strategic considerations for asset-backed short-term finance may be an indication of the 'invisibility' of the industry (or low levels of information available) pointed out in section 1.5.1 in the research statement.

7.4.3 Credit strategy

Credit strategy can be unique to each firm. It can be expected that the less standardisation there is in an industry, the more unique each firm's credit strategy will be.

Table 7.8: Credit strategy (Refers to your organisation) – Compiled by the author

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.
(Strongly Disagree = 1, Disagree = 2, No opinion = 3, Agree = 4, Strongly Agree = 5)

Respondent Number	1	2	3	4	5	6	Average Rating	Minimum	Maximum
Credit strategy (Refers to your organisation)	**4.8**	**4.8**	**4.2**	**4.4**	**4.0**	**4.8**	**4.5**	**4**	**5**
9. The organisation has a clearly defined target market.	5	5	4	5	5	4	4.7	4	5
10. The organisation has set minimum and maximum loan values	4	4	4	5	1	5	3.8	1	5
11. The organisation only grants loans in South African Rand.	5	5	5	5	5	5	5.0	5	5
12. The term of loans is for a specific period only?	5	5	5	3	5	5	4.7	3	5
13. Only fully collateralised loans are granted	5	5	3	4	4	5	4.3	3	5

The responses in Table 7.8 show a level of agreement regarding credit strategy. All respondents agreed or strongly agreed that their specific organisations had a clearly defined target market, while five agreed or strongly agreed that the organisation had set minimum and maximum loan values; the other respondent strongly disagreed, which indicated an unique approach in this regard. All respondents strongly agreed that loans were only granted in South African rand, which indicated the domestic nature of this industry. While five respondents strongly agreed that loans were for a specific term only, one respondent had no opinion on the matter. Five respondents agreed or strongly agreed that only fully collaterised loans were granted, while no opinion was given by the respondent who indicated in Table 7.7 that loans were granted for longer than a year. This may indicate higher availability of lending capital, relative to other respondents.

7.4.4 Governance structures

It can be expected that governance structures will adhere to legal as well as practical requirements. This section investigates the governance structures independent providers of asset-backed short-term finance who responded to the survey, find appropriate.

Table 7.9: Governance structures (Refers to your organisation) – Compiled by the author

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.
(Strongly Disagree = 1, Disagree = 2, No opinion = 3, Agree = 4, Strongly Agree = 5)

Respondent Number	1	2	3	4	5	6	Average Rating	Minimum	Maximum
Governance structures (Refers to your organisation)	**2.8**	**3.1**	**3.2**	**2.2**	**3.5**	**4.1**	**3.1**	**2**	**4**
14. The organisation has a credit committee.	1	5	5	1	5	5	3.7	1	5
15. The credit requirements of the credit committee have been approved by the board of directors.	3	5	5	1	5	5	4.0	1	5
16. The majority of members of the credit committee consist of non-executive directors.	3	1	4	1	5	5	3.2	1	5
17. The credit committee meets once a month.	3	2	1	1	1	2	1.7	1	3
18. The decisions of the credit committee are reported monthly to the board of directors.	3	1	3	1	1	5	2.3	1	5
19. The credit policy has been approved by the credit committee.	3	5	5	1	5	5	4.0	1	5
20. The organisation has a separate board committee that oversee the other risks that are relevant to the business.	3	4	3	1	1	5	2.8	1	5
21. The audit committee oversees the other risks that are relevant to the organisation.	4	5	3	3	1	4	3.3	1	5
22. The terms of reference of the risk/audit committee have been approved by the board of directors	4	3	5	3	5	4	4.0	3	5
23. The majority of members of the risk/audit committee consist of non-executive directors	3	1	4	3	5	3	3.2	1	5
24. The risk/audit committee meets once a month	1	2	1	4	1	2	1.8	1	4
25. The decisions of the risk/audit committee are reported monthly to the board of directors.	2	2	1	4	5	4	3.0	1	5
26. The risk management policy has been approved by the risk/audit committee.	3	4	1	4	5	4	3.5	1	5

The individualistic nature of the industry under consideration was highlighted by the lack of agreement and strong opinions on governance structures, shown by Table 7.9. For most statements, responses varied from strong disagreement to strong agreement. While four respondents strongly agreed on the existence of a credit committee, two strongly disagreed. The same four respondents, who strongly agreed on its existence, strongly agreed that credit requirements had been approved by the committee. The other two either had no opinion or strongly disagreed. Three respondents agreed or strongly agreed that the majority of members of this committee were non-executive directors, while two strongly disagreed and one had no opinion. Five respondents disagreed or strongly disagreed that this committee met once a month, while the other had no opinion. However, one respondent strongly agreed that the decisions of the credit committee were reported to the board of directors once a month, while three disagreed and two had no opinions. Four respondents strongly agreed that the credit policy was approved by the credit committee, while one strongly disagreed and one had no opinion. On the question of a specific board committee to oversee risks, two respondents agreed and strongly agreed on its existence, while two strongly disagreed and two had no opinion. The related statement, that the audit committee oversaw other relevant risks, was strongly agreed and agreed upon by

three respondents, strongly disagreed upon by one, with two having no opinion. Four respondents strongly agreed or agreed that the terms of reference of the risk/audit committee were approved by the board of directors, while two indicated no opinion. Two respondents strongly agreed or agreed that the majority of the risk/audit committee members were non-executive directors, while one strongly disagreed and three had no opinions. Only one respondent agreed that at the time of this study, this committee met at least once a month, while five either disagreed or strongly disagreed. However, three respondents strongly agreed or agreed that decisions of the risk/audit committee were reported to the board of directors on a monthly basis, while three disagreed or strongly disagreed. On the statement that the risk management policy had been approved by the risk/audit committee, four respondents strongly agreed or agreed, with one strong disagreement and one who had no opinion.

The responses on governance structures were not only characterised by a wide variety but also by a lack of consistency with some respondents. Three respondents disagreed or had no opinion on the existence of a risk and/or audit committee, but still offered opinions on the activities of such committees. This may point towards a lack of clarity on the relevant concepts, response bias towards providing the ‘right’ answers, or even a lack of commitment to respond accurately to the statements.

7.4.5 Credit underwriting policy

‘Credit underwriting policy’ refers to the measures each firm takes to reach decisions on credit applications.

Table 7 10: Credit underwriting policy (Refers to your organisation) – Compiled by the author

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.
(Strongly Disagree = 1, Disagree = 2, No opinion = 3, Agree = 4, Strongly Agree = 5)

Respondent Number	1	2	3	4	5	6	Average Rating	Minimum	Maximum
Credit underwriting policy (Refers to your organisation)	**3.6**	**3.4**	**4.7**	**4.6**	**3.5**	**4.2**	**4.0**	**3**	**5**
27. The levels of authorisation are clearly stated in the credit policy.	2	4	5	5	4	5	4.2	2	5
28. Each person in the decision making process has an approved delegated authority.	4	4	5	5	4	4	4.3	4	5
29. The approval process is clearly defined.	4	2	5	5	5	5	4.3	2	5
30. The policy clearly states the background information required for the underwriting decision.	5	4	5	5	4	5	4.7	4	5
31. The policy clearly states the minimum acceptable requirements underwriting loans.	5	4	5	5	4	5	4.7	4	5
32. The policy clearly states the level of required collateral.	2	4	5	5	4	4	4.0	2	5
33. The policy clearly states the quality of acceptable collateral.	2	4	5	5	4	4	4.0	2	5
34. Actions to be taken when the value of collateral falls below the minimum threshold (due to a revaluation of collateral) is clearly stated.	1	2	5	4	1	5	3.0	1	5
35. Collateral denominated in foreign currency must include a margin to provide for foreign exchange volatility.	4	3	1	1	1	2	2.0	1	4
36. The business has a system to follow up on loans in arrears	5	5	5	5	5	5	5.0	5	5
37. Actions to be taken for the different categories of arrears are clearly stated.	4	4	5	5	3	5	4.3	3	5
38. The policy for the provisioning for bad debt is clearly stated.	4	2	5	5	3	5	4.0	2	5
39. The policy for writing off bad debt is clearly stated.	5	2	5	5	3	1	3.5	1	5

Responses on credit underwriting policy showed a higher level of agreement and consistency than encountered in the previous section:

- 5 respondents agreed or strongly agreed that levels of authorisation were clearly stated in the credit policy (one disagreed);
- 6 respondents agreed or strongly agreed that each person in the decision-making process had an approved delegated authority;
- 5 agreed or strongly agreed that the approval process was clearly defined (one disagreed);
- 5 agreed or strongly agreed that the policy clearly stated the level of required collateral and the quality of acceptable collateral (one disagreed in each case);
- 3 respondents agreed or strongly agreed, while 3 disagreed or strongly disagreed that there was clearly stated action when the value of collateral fell below a minimum threshold, although 6 respondents strongly agreed that the business has a system to follow up on loans in arrears;
- 5 agreed or strongly agreed that these actions were clearly stated, while one had no opinion;

- the policy for provisioning for bad debt was clearly stated according to 4 respondents who agreed or strongly agreed, while one disagreed and one had no opinion; and
- the policy for writing off bad debt was clearly stated according to 3 respondents who strongly agreed, while 2 disagreed or strongly disagreed and one had no opinion.

This section indicated that respondents had a high level of clarity on their credit underwriting policies, which can be regarded as the core of an independent credit provider's operations.

7.4.6 Capital management

A credit provider's 'stock' is the capital available for lending; therefore, capital management is of crucial importance. This section enquired into respondents' approaches to this function.

Table 7.11: Capital management (Refers to your organisation) – Compiled by the author

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.
(Strongly Disagree = 1, Disagree = 2, No opinion = 3, Agree = 4, Strongly Agree = 5)

Respondent Number	1	2	3	4	5	6	Average Rating	Minimum	Maximum
Capital management (Refers to your organisation)	**4.0**	**3.0**	**5.0**	**3.8**	**3.0**	**4.3**	**3.9**	**3**	**5**
40. Credit is extended at a variable rate. (Interest is not fixed and can change with market or agreement conditions)	1	1	5	4	5	4	3.3	1	5
41. Credit is extended only at fixed rates.	5	5	5	3	1	4	3.8	1	5
42. The cost of capital is considered with each loan granted.	5	1	5	3	ot Answere	5	3.8	1	5
43. Do you at all times have sufficient capital, or access to sufficient capital, to provide your loan applications.	5	5	5	5	ot Answere	4	4.8	4	5

Capital management is another core function of a credit provider. Responses in this category might indicate that all respondents did not clearly understand the first two statements. The statements that credit is extended at a variable rate, and that credit is extended only at fixed rate, should have drawn opposite responses. However –

- only 3 respondents responded according to this expectation;
- while 2 agreed or strongly agreed with both statements and one agreed with the first and had no opinion on the third;
- 3 respondents strongly agreed that cost of capital was considered with each loan granted, while one strongly disagreed and one did not respond;

- on the statement that sufficient capital or access to sufficient capital is always available to provide loan applications, 5 respondents agreed or strongly agreed, while one did not respond to the statement.

It can be inferred that responding providers of asset-backed finance closely attended to capital management.

7.4.7 Operational risk

'Operational' risk refers to the risk of failures of people and systems within the organisation. It is regarded as a risk relatively within control of the organisation.

Table 7.12: Operational risk (Refers to your organisation) – Compiled by the author

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.
(Strongly Disagree = 1, Disagree = 2, No opinion = 3, Agree = 4, Strongly Agree = 5)

Respondent Number	1	2	3	4	5	6	**Average Rating**	Minimum	Maximum
Operational risk (Refers to your organisation)	**3.1**	**3.7**	**4.7**	**5.0**	**4.9**	**3.1**	**4.1**	**3**	**5**
44. The sales consultants receive commission immediately after the credit (loan was established) was granted.	5	4	3	5	ot Answere	1	3.6	1	5
45. Key positions have been identified for the organisation.	4	4	5	5	5	4	4.5	4	5
46. A realistic succession plan is in place if a key person is unable to resume duties.	1	2	4	5	5	2	3.2	1	5
47. The organisation will be able to recover customer data in the event that the production servers malfunction.	5	5	5	5	5	5	5.0	5	5
48. Customer data can be restored in the same day.	5	5	5	5	5	4	4.8	4	5
49. The system has the ability to give a detailed age analysis of assets (loans).	1	5	5	5	5	4	4.2	1	5
50. Key business information is obtained directly from systems without manual intervention on spreadsheets such as Excel.	1	2	5	5	4	2	3.2	1	5
51. Where Excel spreadsheets are used for key business information, all cells containing formulae are protected.	1	2	5	5	5	2	3.3	1	5
52. Key business information is available when needed.	5	4	5	5	5	4	4.7	4	5

Respondents' attention to operational risk varied across different aspects.

- while 3 respondents agreed or strongly agreed that sales consultants received commission immediately after credit was granted, one strongly disagreed, one had no opinion and one did not answer;
- all respondents agreed or strongly agreed that key positions had been identified for the organisation, although a realistic succession plan was in place with only 3 respondents who agreed or strongly agreed with that statement and 3 who disagreed or strongly disagreed.

Regarding information systems, all respondents strongly agreed with the statement that their respective organisations would be able to recover customer data in the event of their servers malfunctioning.

- 5 respondents strongly agreed, and one agreed that this can be done the same day;
- while 5 respondents agreed or strongly agreed that their respective systems had the ability to give detailed age analyses of loans, one strongly disagreed.

On the statement that key business information was obtained directly from systems without manual intervention on spreadsheets –

- 3 respondents agreed or strongly agreed, while 3 disagreed or strongly disagreed
- 3 respondents strongly agreed that all spreadsheet cells containing formulae were protected, while 3 disagreed or strongly disagreed;
- all respondents agreed or strongly agreed that key business information was available when needed.

The result on operational risk indicated that each of these independent firms dealt with operational risk in a way which probably corresponded to their experience of risk occurrences. It seemed that no standardised practices, regulatory requirements or industry software existed which facilitated uniform handling of operational risk. This affirms what has been found in section 4.7.3.

7.4.8 Regulatory risk

‘Regulatory risk’ refers to risks caused by the regulatory environment imposed on the individual credit provider.

Table 7.13: Regulatory risk (Refers to your organisation) – Compiled by the author

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.
(Strongly Disagree = 1, Disagree = 2, No opinion = 3, Agree = 4, Strongly Agree = 5)

Respondent Number	1	2	3	4	5	6	**Average Rating**	Minimum	Maximum
Regulatory risk (Refers to your organisation)	**3.8**	**4.1**	**4.4**	**4.4**	**4.4**	**4.2**	**3.9**	**4**	**4**
53. The organisation is registered with the National Credit Regulator.	5	2	1	1	1	1	1.8	1	5
54. All the consultants are trained to provide potential clients with advice.	4	4	5	5	5	5	4.7	4	5
55. The organisation is a responsible institution in terms of the Financial Intelligence Centre Act.	1	5	5	4	5	5	4.2	1	5
56. The consultants are trained to identify potential money laundering transactions.	1	2	5	5	5	4	3.7	1	5
57. My organisation has an established mechanism to report suspicious transactions.	1	5	5	5	5	4	4.2	1	5
58. The processes to protect the personal information of customers are established in the organisation.	5	4	5	5	5	4	4.7	4	5

Responses to statements pertaining to regulatory risk indicated what respondents perceived to be regulatory requirements and risks, but these perceptions might have been inaccurate.

- only one respondent strongly agreed that its firm was registered with the NCR, while the other 5 strongly disagreed or disagreed;
- on the other hand, 5 respondents strongly agreed or agreed that their firms were responsible institutions in terms of the FICA, while one (the only one registered with the NCR) strongly disagreed.

According to section 4.5, providers of asset-backed short-term finance are subject to both these regulatory institutions.

- 6 respondents agreed or strongly agreed that all consultants were trained to provide potential customers with advice;
- 4 agreed or strongly agreed that consultants were trained to identify potential money laundering practices, while 2 respondents disagreed or strongly disagreed;
- 5 respondents agreed or strongly agreed that their respective organisations had mechanisms to report suspicious transaction, while one strongly disagreed.
- all respondents agreed or strongly agreed that their respective organisations has processes to protect personal information of customers.

As mentioned in section 4.5, the regulatory environment for independent providers of asset-backed short-term finance is more relaxed than that of banks or microlenders.

It seems that each firm therefore develops its own approach to regulatory risk, based on its perceptions on legal requirements and practical expediency.

7.4.9 Importance of various risks

The importance of each type of risk involves subjective judgement by each respondent, based on own knowledge and experience.

Table 7.14: Importance of various risks – Compiled by the author

Indicate the importance of the following risks for an asset-backed short-term business in South Africa in order of priority according to your experience. 1 = Most important; 8 = Least important

Respondent Number	1	2	3	4	5	6	Average Rating	Minimum	Maximum
Credit risk	5	1	2	5	1	1	2.5	1	5
Market risk	7	6	6	7	6	8	6.7	6	8
Operational risk	2	2	4	8	8	5	4.8	2	8
Regulatory risk (Compliance)	4	4	3	3	4	6	4.0	3	6
Legal risk	1	5	5	4	7	7	4.8	1	7
Reputational risk	6	7	1	1	5	3	3.8	1	7
Liquidity risk	3	3	8	2	3	2	3.5	2	8
Strategic risk	8	8	7	6	2	4	5.8	2	8

Table 7.13 indicates that, on average, independent providers of asset-backed short-term credit regard market risk as their most important risk, followed by strategic risk, operational and legal risk (equally), regulatory risk, reputational risk, liquidity risk, and lastly credit risk. The low rating of credit risk can be expected to be the result of the central role of collateral in this credit industry.

7.5 INSIGHTS GAINED FROM THE SURVEY AMONG PROVIDERS

The survey among providers of asset-backed short-term finance should be regarded with caution, due to the low response rate by an already small universe of potential respondents. However, certain insights were gained. Due to the emerging nature of asset-backed short-term finance as an industry, views on relative importance of different aspects of conducting this business, vary widely.

This survey should have contributed to identifying the most relevant risks to providers of asset-backed short-term finance; and assist in developing a framework for asset-

backed short-term finance as a structured approach that could assist the existing and potential market players to ensure a successful enterprise. However, there is a low level of agreement on strategic considerations in the industry, governance structures, operational risk and regulatory risk, as well as on the relative importance of each type of risk. This may be due to the fact that little is published on this industry and each respondent can only take personal experience into account.

In contrast, a high level of agreement existed regarding credit strategy, credit underwriting policy and capital management. As this industry is defined by its approach to credit, this insight was not unexpected.

7.6 CONTRIBUTION TO A STRUCTURED APPROACH AND STRATEGIC POSITIONING

It was mentioned in section 1.2 that there is a general lack of academic literature on asset-backed short-term finance and that it is to a certain extent an unknown financial industry. This led to the research focus of this study. The problem statement and the research aim and objectives will be revisited in Chapter 8, by taking into account what could be gleaned from literature as well as from the empirical investigation. In this section, it suffices to state that the first survey, among customers and potential customers of asset-backed finance, contributed by identifying market segments, even within this limited market. The second survey involving providers of asset-backed short-term finance, revealed a low level of agreement on how this type of business should be conducted. This may be natural among independent operators in an industry, but it may also be indicative of a need for a theoretical basis for the industry. These are some of the questions to be discussed in Chapter 8.

7.7 CONCLUSION

This chapter gave a complete account of the two surveys, which together formed the empirical part of this research project. Important insights were gained regarding the different needs in the market for asset-backed short-term finance, as well as considerations on the supply side of this industry. It was concluded that ample information was gained to reach the research aim and to point towards possible subsequent research. This is the topic of the next chapter.

PART D FINDINGS AND CONCLUSIONS

CHAPTER 8

CONCLUSIONS AND RECOMMENDATIONS

8.1 INTRODUCTION

This study was a response to the emergence of asset-backed short-term finance as a credit industry unaccounted for in theoretical literature. In order to create a South African perspective on a structured approach to asset-backed short-term finance, a literature review was conducted, followed by two investigations. The reasons for customers using this type of credit as well as important considerations from the view of providers, were investigated.

This chapter provides a summary of literature and empirical findings. This is followed by a suggested structured approach to asset-backed short-term finance taking literature and empirical findings into account, as the main conclusion of the study. The final section identifies possible limitations in the study and suggests areas for further investigation.

8.2 RESEARCH AIM, OBJECTIVES AND HYPOTHESIS

The rationale for this study was identified in section 1.5.1 to fill the perceived knowledge gap due to a general lack of supporting literature, which could serve as a guideline for a successful enterprise in asset-backed short-term finance. In support of this rationale, the research question as also stated in 1.5.2 was:

Can a structured approach to ensure the strategic positioning of an independent credit-providing enterprise, specialising in asset-backed short-term finance, ensure the success of such an initiative?

Based on the research question, this study aimed to develop a structured approach for the strategic positioning of an independent credit-providing enterprise, specialising in asset-backed short-term finance, which could assist in ensuring success in the credit provisioning market.

The objectives in support of the aim of this study were:

- to develop a framework for asset-backed short-term finance as a structured approach that could assist the existing and potential market players to ensure a successful enterprise;

- to determine why some business people prefer private asset-backed short-term loans to credit from commercial banks; and
- to identify the most relevant risks to providers of asset-backed short-term finance.

This was accentuated by the hypothesis as presented in section 3.3:

The hypothesis, deducted from the literature review and tested by empirical investigation, was as follows:

Ho: Asset-backed short-term finance does not fill a necessary niche in the financial sector, because high net-worth business persons with urgent, short-term liquidity challenges, do not experience commercial banks as unable or unwilling to consider their assets, rather than regular income, as loan guarantee, and to assist such persons within the required time frame, therefore, such a business cannot be operated as a profitable enterprise when the most relevant risks are attended to.

Ha: Asset-backed short-term finance fills a necessary niche in the financial sector, because high net-worth business persons with urgent, short-term liquidity challenges, experience commercial banks as unable or unwilling to consider their assets, rather than regular income, as loan guarantee, and to assist such persons within the required time frame, therefore, such a business can be operated as a profitable enterprise when the most relevant risks are attended to.

In order to select the null hypothesis (H0) or the alternative hypothesis (Ha), answers to the following questions need to be reached by conducting a survey:

Is the period between a customer's application for a loan and approval or rejection by a commercial bank a factor in the emergence and growth of asset-backed-short-term finance as a financial industry?

Do South African commercial banks empower employees with sufficient service orientation to interact responsively with customers and reach decisions within a satisfactory time frame?

Do increasing banking fees encourage customers to investigate alternatives to traditional banking.

Is the less prominent branding of private credit providers a meaningful discouragement to customers who may need asset-backed short-term finance?

What are the positive features of asset-backed short-term finance from the customer's perspective?

What are the negative features of asset-backed short-term finance from the customer's perspective?

What is the relevance of different risks pertaining to asset-backed short-term finance?

8.3 LITERATURE FINDINGS REGARDING RESEARCH OBJECTIVES

The first four chapters of this study were devoted to a report on the available knowledge regarding the following:

- the concept of credit in the modern monetary economy (Chapter 2);
- a South African perspective on credit provisioning (Chapter 3);
- asset-backed short-term finance as a financial industry (Chapter 4); and
- a framework for the implementation of asset-backed short-term finance (Chapter 5). These conclusions will be presented in the following sections.

8.3.1 The concepts 'structured approach' and 'strategic positioning'

Chapter 1 focused on the basic concepts and points of departure of the study. Accordingly, definitions of the word 'structure' were found to refer to "the arrangement of and relations between the parts or elements of something complex" (Oxford Dictionary, 2016) and "the aggregate of elements of an entity in their relationships to each other" (Merriam-Webster, 2016). A structured approach to asset-backed short-term finance as presented in this study, aims to provide background to the industry in order to identify the different elements of and risks relevant to the industry, which results in orderly guidelines for use by current enterprises and prospective entrants.

Strategic positioning, according to the Institute for Strategy and Competitiveness of the Harvard Business School (2016) –[R]eflects choices a company makes about the kind of value it will create and how that value will be created differently than rivals. Strategic positioning should translate into one of two things: a premium price or lower costs for the company.

Kim and Mauborgne (2009) regard this definition as the definition for a structuralist approach to strategic positioning – an approach which accepts the market structure and the requirement to compete either in terms of cost or differentiation. In addition, the authors identify the reconstructionist approach. This is constituted when a role player successfully competes both on cost and differentiation and in the process reconstructs the industry. Asset-backed short-term finance follows a structuralist approach, competing on differentiation. The possible positions and selected choices are graphically compared in Figure 8.1, as presented below.

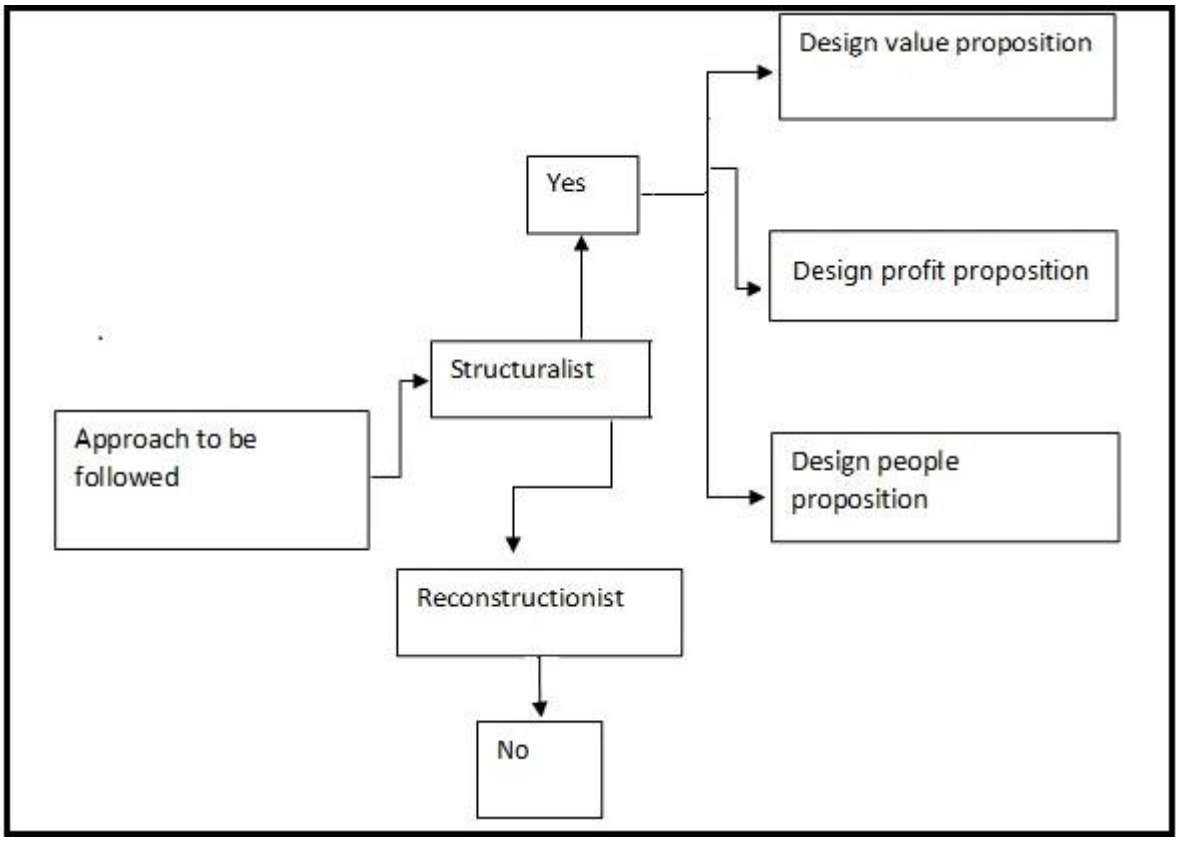

Figure 8.1: Strategic positioning of asset-backed short-term finance (Compiled by author)

Asset-backed short-term finance is a financial industry exploiting a niche which was formed in the credit market as a result of macroeconomic developments. Therefore it follows a structuralist approach, competing in terms of differentiation. A summary of the structured approach to conducting business in this industry is presented in section 8.3.5. The strategic positioning and resulting propositions were discussed in Chapter 5.

8.3.2 The concept of credit in the modern monetary economy

It was concluded in Chapter 2 that, in contrast to traditional economies where credit provisioning was a benevolent activity, in the modern monetary economy, credit is driven by the profit motive. It is a mainstay of modern economy and is comprehensively studied as part of the scientific field of finance. Loans are classified according to different criteria, of which ‘asset-backed’ and ‘short-term’ were relevant to this study.

Two basic principles for all credit agreements are adequate information and risk reduction. Due to the nature of computerised information systems, large commercial banks tend to focus on unsecured loans. Credit bureaux are consulted electronically for the credit histories and remuneration of prospective customers, leading to a prompt response. These computerised systems cannot process information on non-standard applications or high net-worth customers with cash-flow constraints. The information gathered by a knowledgeable owner/manager can put a private credit provider at an advantage. Risk is multi-faceted and adequate information on all these facets is imperative. Collateral is an effective tool to reduce lender’s risk. The lender normally does not wish to own the collateral, but losing it, is an incentive for the borrower to honour the loan agreement.

Bank regulation is a topic of much discussion in financial and academic circles, and also a principle for credit provision. Due to the danger of system-wide financial crises, which result from the interconnectedness of banks, regulation is essential. The dilemma is, however, that regulation does not always have the intended effect. Indications are that some crises are even regulation-induced. It is important for regulation to aim at system-wide prudency (macro prudency) and not only prudency in specific institutions (micro prudency). There is still difference of opinion over the appropriateness of ‘light touch’ or strict regulation. It is agreed, however, that regulation should be counter-cyclical. The Basel Accords, on which the most important national regulators base their policies, are continuously revised towards this end.

In terms of customer relations, banks do not expend equal time and effort on all customers. A distinction is made between building customer relations through mass communication and personal communication. Personal communication is reserved for customers with whom it may be conducted profitably. Regarding competition, direct contest is contrasted to a more complex scenario of coopetition, according to which

co-operation and competition between firms are interspersed in an ecological model of the economy.

Asset-backed short-term finance is presented as part of a ‘credit provisioning ecology’. As Pitman (2012) points out, high-quality firms with sufficient assets may also encounter liquidity shortages which banks are unable to meet on short notice due to considerations of risk reduction and regulation. This creates a niche market, which private providers of asset-backed finance can serve in a superior way.

The concept of a ‘service shop’, in contrast to a ‘service factory’, created by Schmenner in 1986, is introduced in chapter 2. The concept of a ‘service factory’ takes all factors mentioned above into account, which induce service providers to offer mass delivery of services based on standardised information which can be processed by ICT. In the context of credit provisioning, this means that banks only take information into account which can be processed electronically without human judgement, reaching high levels of efficiency and quick response to applications. The opposite is a ‘service shop’, which focuses on services which cannot be standardised to be evaluated by ICT, in other words, where human judgement is indispensable.

In contrast with credit provisioning by banks, which can be labelled ‘service factories’, independent providers of asset-backed short-term finance are ‘service shops’.

The relevance of chapter 2 can be summarised as identifying ICT and regulation as the two main drivers for banks to become service factories, which created a niche in the market for service shops, of which independent provisioning of asset-backed short-term finance is an example. The specific features of this industry are summarised in section 8.3.3.

8.3.3 Credit provisioning: A South African perspective

Chapter 3 comprised an overview of the history of banking in South Africa, as a historical understanding was indispensable in creating a South African perspective on credit provisioning. The most pertinent conclusions of this chapter are not historically, however, but regarding the regulatory environment of credit provisioning in South Africa. It must be noted that:

- Independent credit providers may not take deposits from the public. Therefore:

    - independent credit providers may only lend out equity funds, or capital loaned from banks; and
    - as no deposits are taken, systemic risk is significantly reduced, leading to a more lenient regulating environment than for banks.
- Private credit providers are subject to the National Credit Act (no. XX of 2005. Therefore:
    - all credit providers are obliged to register with the NCR; and
    - credit providers must abstain from reckless lending and unethical collection methods, as indicated in section 3.2.2.4.
- Providers of asset-backed short-term credit are exempt from most provisions of the National Credit Act, as their customers are usually juristic persons with a high net value, and not vulnerable consumers.
- The strict regulatory environment for banks, especially in terms of prudence and operational risk, leads to time-consuming processes for non-standard loan applications, which may be perceived by customers as a lack of service orientation. This may contribute to the existence of a market for asset-backed short-term finance.

A description of the role players in South African credit provisioning, identifies commercial banks as the dominant providers of credit. Independent credit providers operate within the spaces left open by commercial banks. It was found that credit management should be based on sufficient knowledge, high levels of professionalism and continuous awareness of the business environment.

In conclusion, this section indicates that private providers of asset-backed short-term finance have a necessary role to play in the credit market, due to regulatory intervention in the banking sector, and factors of internal organisation congruent with international trends discussed in section 8.3.1.

8.3.4 Asset-backed short-term finance as a financial industry

Chapter 4 reported on the operation of a provider of asset-backed short-term finance, by using information obtained from mainly promotional material published by providers of asset-backed short-term finance.

The most important risks to which an independent provider of asset-backed short-term finance is exposed were identified, and mitigating measures for each were discussed.

This was followed by an inventory of requirements and steps to follow in the provisioning of asset-backed short-term finance. Regarding strategic positioning, it was found that this industry is favoured by the present macro environment, on condition that executive persons have high levels of knowledge, skills and experience, and that the target market of customers with sufficient assets to cover their loans is strictly adhered to.

The information presented in Chapter 4 directly led to Chapter 5, which provided a framework for the implementation of asset-backed short-term finance.

8.3.5 Framework for the implementation of asset-backed short-term finance

The first four chapters culminated in Chapter 5 to conclude that the decision to operate an asset-backed short-term finance enterprise means that a strategic decision has been made to be in the credit market only for a short term with each loan. Due to global developments in regulation of the banking industry, an opportunity for asset-backed short-term finance arose. To operate such a business implies that a structuralist approach was taken, which means to utilise an opportunity the market structure allows, rather than restructuring the market. This presents a framework for implementing an independent provider of asset-backed short-term finance which focuses on the value proposition (the business from customers' point of view), the profit proposition (systems which must be managed appropriately to ensure profitability), and the people proposition (appointment and outsourcing for different roles in the business).

This section concludes the summary of the literature review regarding a structured approach to strategic positioning of an independent provider of asset-backed short-term finance. In the following sections, the empirical surveys aimed at reaching the research goals are summarised.

8.4 EMPIRICAL FINDINGS REGARDING RESEARCH OBJECTIVES

The empirical component of this study investigated the relevant financial industry from the perspectives of customers and providers. With customers, the focus was on their reasons for using asset-backed short-term finance, and with providers, on the risks they find most relevant. The next section presents a discussion on the methodologies employed in this study (Chapter 6) and findings of the empirical survey (Chapter 7).

8.4.1 Methodologies employed in this study

Chapter 6 reported on different possible methodologies for this study. The nature of the two different investigations had to be taken into account. Customers of asset-backed short-term finance had made a choice for this type of credit and the purpose of the investigation was to determine why the choice was made. In the case of providers, the purpose was to determine their perceptions on the relative importance of different types of risk. Due to these differences, different types of research instruments were employed: a BWS questionnaire for customers, and a questionnaire using a simple Likert-type rating scale for providers, as indicated below.

8.4.1.1 Best–worst scaling for customers

Although rating scales, for instance the Likert-type scale, is generally used when canvassing people's opinions, in market research, it often fails to predict customer behaviour. Socially desirable responding is customary, while acquiescence response bias is the tendency to agree rather than disagree with a statement). Hypothetical bias is especially prevalent in WTP research, where people indicate that they will be willing to pay more for an item than it actually is worth. Respondents also tend to view all problems as highly important. However, given limited resources, all cannot be dealt with equally.

These imperfections of rating scales for market research, led to the development of, amongst other methods, BWS. BWS requires respondents to indicate only the most and least favoured of a set of items. Some of these items are repeated in order to reach a preferential order. This provides an ordinal ranking of the items for each individual and an interval scaling of the items for the sample of consumers.

The present study can be conceived of as reverse market research: asset-backed short-term finance had already emerged as a financial industry, and creating a structured approach to the industry involved determining why customers selected the specific form of finance. Therefore it was concluded that BWS had the necessary attributes to determine why customers made a specific choice out of several presented to them, as in the case of asset-backed finance in opposition to any of many other forms of finance. The opinions of customers and potential customers of asset-backed finance were therefore canvassed, using BWS methodology.

8.4.1.2 Ranking scale questionnaire for providers

Despite the weaknesses of ranking scales discussed in section 8.4.1.1, under certain circumstances, it is still the most appropriate form of investigation. For the purpose of the investigation among providers of asset-backed short-term finance, the literature-based description of the industry (Chapter 4) had to be augmented with an empirical survey. Aspects that were covered were the following:

- strategic considerations for operating in the industry;
- the credit strategy of the firm;
- governance structures;
- credit underwriting policy;
- capital management;
- operational risk; and
- regulatory risk.

The survey simply asked the extent to which each statement was true for the specific firm – no trade-offs or choices needed to be simulated. Therefore a five-point Likert-type scale was used.

8.4.2 Insight gained by the empirical investigation among customers

The central insight gained by the empirical investigation among customer is to disprove the null hypothesis, that asset-backed short-term finance does not fill a necessary niche in the financial sector. Instead, the alternative hypothesis, that asset-backed short-term finance fills a necessary niche in the financial sector, is accepted. The different reasons given in the alternative hypothesis for the necessity of the industry (unresponsiveness of banks; evaluation of security rather than regular income; and assistance within the required time frame) are represented by the different clusters identified in the survey. These can be summarised as follows:

For Cluster 1, there was no increase in importance that aligned to the criteria for asset-backed short-term finance. For these customers, evaluation of the ability to repay the loan from regular income was most important, while neither the time, nor the access to a contact person who can and may reach a conclusion on a loan application was important. This cluster would remain with typical banking services provided by the large banks despite an increase in urgency and a short loan term perspective.

For Cluster 2, there was meaningful relationship between an urgent cash-flow constraint perceived to be of short duration and a business person's need for a service-oriented contact person at a credit provider. This cluster showed a combined increase in importance for the waiting period between loan application and decision as well as access to a contact person who can and may reach a conclusion on their loan application. This group expected a general increase in service orientation as the urgency and short loan term perspective of a loan increased.

For Cluster 3, there was a meaningful relationship between an urgent cash-flow constraint perceived to be of short duration and a business person's need for a loan decision to be based on his or her security, instead of repayment ability. This could typically identify a group of business persons with business interests that hold some capital, but with inconsistent cash flow or monthly income. This is an important group of customers for whom asset-backed short-term finance provides a service which commercial banks do not provide. It was also clear that this group would wait longer for a decision on the approval of a loan, as long as this decision was then based on their security rather than repayment ability.

For Cluster 4, there was a meaningful relationship between an urgent cash-flow constraint perceived to be of short duration and a business person's need for a short waiting period between loan application and decision, but for whom a favourable interest rate is also highly important. This group is clearly very sensitive to the time of getting approval as the urgency and short loan term perspective of loan increases, while the associated high interest rate is a highly unfavourable price to pay.

Customers are mainly drawn to asset-backed short-term finance due to their ability to process applications quickly, which may be the result of direct access to a decision-maker. Although some customers prefer that their security be evaluated rather than their regular income as proof of repayment ability, this is more important as a risk-mitigating measure for providers. Loans are not provided at low cost, because independent credit providers can only use own capital or bank loans to finance their operations. Independent credit providers do not need to aspire to the facilities and brand prominence of banks, as customers claim to disregard this feature. Initiative should rather be channelled towards features which meet customers' proven demands or providers' need to secure their income and mitigate risk.

Two possible topics for future investigations were also identified. These are the reasons why customers of FNB seemed to be disproportionately inclined to turn to asset-backed short-term finance (as opposed to customers of Standard Bank and Nedbank of whom the opposite seemed true); and the reasons why fewer business entities with a turnover beyond R40 million seemed to need asset-backed short-term finance.

8.4.3 Insights gained by the empirical investigation among providers

The survey among providers of asset-backed short-term finance was limited by the small number of providers, which formed a universe of around 20 possible respondents. However, only six responded, leading to very cautious analysis of results. The low response rate may point to an attitude of unwillingness to share business information in an emerging industry – respondents may perceive a risk to impart the knowledge which gives them a comparative advantage.

All the respondents were from metropolitan areas. This may point to a certain scale which the surrounding economy must probably reach before such an enterprise will be feasible.

Among the small number of respondents, there was a low level of agreement on strategic considerations in the industry, governance structures, operational risk and regulatory risk, as well as on the relative importance of each type of risk. This may be due to the fact that little is published on this industry and each respondent can only take personal experience into account.

A level of agreement was found regarding credit strategy, credit underwriting policy and capital management. As this industry is defined by its approach to credit, this finding was not unexpected.

8.5 A FRAMEWORK FOR ASSET-BACKED SHORT-TERM FINANCE

A framework for asset-backed finance comprises three critical factors, which should be the aim of processes and people within an independent credit provisioning firm. These are the waiting period between application and decision, access to a person who can and may reach a decision on a loan application, and the ability to evaluate collateral in order to base loan decisions on its value. In addition, the providers must be able to contain their own risks.

For a short waiting period, the following persons must be available at short notice:

- the CEO or another person with the ability and authority to decide on loan decisions, and who may also effect payment, if the loan is approved;
- a valuer who can evaluate collateral;
- a lawyer to draft a contract which formulates each party's rights and responsibilities in a way sufficiently clear that it would prevent future disputes; and
- a conveyancer who can register a bond at the deeds office.

If these persons are available at short notice to limit the time, the other critical factors (access to a person with the necessary authority, evaluation of collateral, and containment of risk) will also be met.

8.6 SWOT ANALYSIS FOR ASSET-BACKED SHORT-TERM FINANCE AS AN INDUSTRY

An analysis of strengths, weaknesses, opportunities and threats (SWOT analysis) is a basic tool often used to guide discussions on strategy within a business or organisation (Investopedia, 2017). Due to its prevalence in discussions on strategy, a SWOT analysis was utilised in this study to summarise the most important findings. The findings may also serve as a benchmark list for participators and prospective entrants to the industry.

8.6.1 Strengths

Providers of asset-backed short-term finance should have the following strengths:

- the ability to evaluate and reach a decision on a loan applications within a short time frame;
- the ability to evaluate collateral offered as security for value and legitimacy;
- the ability to dispose of collateral efficiently;
- access to a lawyer to draft contracts, which are individualised and complete;
- an administrative system, which enables management to determine the position of each loan at any given time, as well as available funds;
- an administrative system, which enables the business to comply with all regulatory requirements;

- sufficient funds to buffer temporal losses due to defaulting loans, completion of the execution, and expenditure on associated legal costs; and
- access to a law team, which can take the necessary steps to redeem delinquent loans.

8.6.2 Weaknesses

- deposits may not be taken, which limits available funds to own capital and bank advances;
- no protection or aid in liquidity crises from the SARB;
- being a relatively unknown financial industry, possibly leading to misunderstandings with customers and banks; and
- small scale of operations in a sector dominated by large banks.

8.6.3 Opportunities

- international regulation will probably not relax in the foreseeable future, limiting the ability of banks to deal with non-standard loan applications within a short time frame;
- increased use of information technology by banks to reach loan decisions decreases their ability to process non-standard loan applications; and
- perceived lack of service orientation with banks may induce customers to investigate alternatives.

8.6.4 Threats

- enforcement of loan agreements may be expensive and must be financed by the credit provider itself;
- banks may establish specialised units to deal with asset-backed short-term finance;
- the South African economy may deteriorate to such an extent that there is no demand for credit;
- the regulatory environment may harm asset-backed short-term finance, either expressly or as an unintended consequence of, for example, the protection of vulnerable consumers; and
- the firm’s own people or systems may fail.

This SWOT analysis should be revisited annually, to determine the extent to which strengths were utilised and weaknesses strengthened or managed, while the ability to utilise opportunities and the imminence of threats should also be considered.

8.7 THE STRATEGIC POSITIONING OF ASSET-BACKED SHORT-TERM FINANCE

A structured approach for the strategic positioning of an independent credit provisioning enterprise, specialising in asset-backed short-term finance, which could assist in ensuring success in the credit provisioning market, can be formulated as follows:

Asset-backed short-term finance follows a structuralist approach by –

- positioning itself as a service shop, distinguished from banks (service factories) by superior service, especially regarding the short period between application and response;
- individualised valuation of collateral; and
- access to a person with the ability and authority to reach a conclusion.

To be able to deliver this service, the associated persons (CEO, lawyer, valuator and conveyancer) must be available at short notice. To ensure viability of the enterprise, the lawyer must be involved with minimising risk, and the interest rate must reflect the risk taken.

Thus, the research aim was met by reaching the research objective of developing a framework for asset-backed short-term finance as a structured approach that could –

- assist the existing and potential market players to ensure a successful enterprise;
- determine why some business people prefer private asset-backed short-term loans to credit from commercial banks; and
- identify the most relevant risks to providers of asset-backed short-term finance.

The next section will summarise literature findings regarding these research objectives.

8.8 CONTRIBUTION TO THE BODY OF KNOWLEDGE REGARDING ASSET-BACKED SHORT-TERM FINANCE

As indicated in section 1.1 and 1.2, asset-backed short-term finance as a financial industry is largely absent from academic literature. Information on this industry could mainly be obtained from the publications of providers of asset-backed short-term finance, which indicates what best can be described as providers' perceptions of the reasons for customers turning to their industry.

The first contribution of this study to the body of commercial scientific knowledge is the systematic description of asset-backed short-term finance as an industry in chapters 4 and 5. It is important to note that this type of finance is not new: It had been a function of banks, depending on the judgement of the local manager on character and security. However, due to reasons identified in the literature review, banks do not play that role anymore. This led to the emergence of a distinct financial industry, which this study describes and positions strategically.

The second contribution is to determine the stratified reasons why customers use asset-backed short-term finance from independent credit providers, despite the relatively high interest rate identified in the literature review. Before conducting this study, the only available information on the topic were the perceptions of credit providers as reflected on their websites. Best-Worst Scaling (a form of conjoint analysis) was used to confront customers and potential customers of asset-backed short-term finance with situations resembling real-life choices where loan attributes had to be played off against another. These choices were presented with the hypothetical background of a liquidity shortage perceived to be of short duration. Attributes where providers of asset-backed short term-finance does not compare favourably with banks (interest rate; brand prominence; impressive facilities) were presented with attributes where these providers do compare favourably (fees; period between loan application and decision; access to decision maker) as well as the binary pair of defining attributes (loan decision based on repayment ability, or based on security). Analysis of the results identified four clusters of respondents:

- Cluster 1 shows no interest in the attributes that characterise asset-backed short-term finance

- Cluster 2 shows an interest increased service orientation (waiting period and access to decision maker)
- Cluster 3 needs security to be evaluated, even if it takes longer to do so
- Cluster 4 is sensitive for period between loan application and decision
- In addition, none of the clusters regards impressive facilities or brand identity as important under the given circumstances, but all of the clusters are sensitive for interest rate.

The second contribution can be summarised by stating that there are persons with similar profiles to customers of asset-backed short-term finance who will probably never become actual customers, but that those who are or may become customers have distinct needs and form three different clusters. Furthermore, all customers are indeed sensitive to high interest rates.

The investigation among providers of asset-backed short-term finance did not contribute to the body of academic knowledge on this topic.

8.9 RECOMMENDATIONS RESULTING FROM THIS STUDY

In section 1.6, the importance of this study was approached from a South African and an academic perspective, and its importance to direct and indirect stakeholders was considered. From the South African perspective, it is recommended that the industry of asset-backed short-term finance be awarded a higher level of recognition by policymakers and regulators. This should lead to these institutions being recognised as a legitimate and even essential industry in the financial sector as well as higher visibility in the market. In recognising the role of asset-backed short-term finance, the differences between independent providers of unsecured short-term credit on the one hand, and deposit-taking institutions (banks) on the other should be outlined. These distinctions should lead to expressed clarity on lenient regulatory requirements, as neither the interests of vulnerable consumers nor the public's deposits will be at stake.

A result should be that direct stakeholders (providers and customers of asset-backed short-term finance) will gain more confidence in conducting business, as each will have clarity on its rights and obligations. Indirect stakeholders (commercial banks) are advised to advance funds to independent providers of asset-backed short-term finance who can prove their ability to manage industry-related risks effectively, as these credit

providers provide a service which commercial banks do not. This should be beneficial to banks, independent credit providers and customers alike.

Increased recognition of asset-backed short-term finance as an industry can be extended to a recommendation that a limited banking license be issued in South Africa to an institution to advance loans for shorter than a year, backed by collateral and subject to all regulatory requirements for banks. It emerged from this study that the institutional inability of banks to conduct this type of business within a short time frame prevents business persons from realising certain business opportunities. Independent credit providers, on the other hand, operate on a scale which may be regarded as too small to realise the potential of this industry to contribute to economic growth. In the post-2008 business environment of slow economic growth, the South African economy needs the transition from being innovation-poor to being innovation-rich, as indicated by Schwab (2016) and cited in section 1.6.1.

8.10 POSSIBILITIES FOR FURTHER STUDY

This study pioneered the academic description of asset-backed short-term finance. There is still an open field of possible topics to investigate.

The emerging nature of the financial industry studied here, led to limited access to potential respondents. Especially providers of asset-backed short-term finance were not keen on sharing information. Customers of the industry were sourced from only one provider who was prepared to supply customer information for academic study. In addition, only a small number of the (already small) universe of providers were prepared to contribute to this study in any way. It is asserted that this will only be overcome with increased recognition and visibility of the industry. This may be a possibility for future research.

Regulatory and technological developments in banking were described as the main drivers for opening a niche for asset-backed short-term finance. This has been discussed from the perspective of the relevant emerging financial industry, but not from the viewpoint of banks. A future investigation among commercial banks in South Africa may reveal important information on the following:

- What is the importance and nature of personnel training?

- To which extent do banks regard repayment ability as more important than collateral?
- What does each commercial bank regard as its own competitive advantage?
- It was identified in section 7.2.7 that a disproportionate number of asset-backed short-term credit customers bank with First National Bank. Is this co-incidental, or can it in some way be linked to the strategy of the bank?

The market for asset-backed short-term finance has been investigated in the South African context. This comprised the types of business persons who find it difficult to secure bank credit, such as property developers with a high asset value but without regular income. Investigating the relationships of similar business persons with commercial banks in First World economies (especially those with a similar banking tradition, like the United Kingdom and Australia) may shed light on the South African reality, and may contribute to credit provisioning in those countries.

Investigating future developments in global banking practices may point to influences on asset-backed short-term finance. In addition, the possible effect of new entrants to South African banking may be investigated fruitfully, especially in terms of risk management which is becoming an imperative part of all organisations and their business strategies.

8.11 CONCLUSION

This chapter provided an overview of the literature review and empirical findings of the study. During the literature review, the concept of credit in the modern monetary economy, a South African perspective on credit provisioning, and asset-backed short-term finance as a financial industry were investigated. In the chapters of this thesis, the strategic positioning of asset-backed short-term finance was identified by referring to a value proposition based on functionality (short period between loan application and decision paired with direct access to decision-makers) and a profit proposition based on an above average interest rate. At the time of this research, risk is managed by requiring collateral to guarantee loans, while in specific circumstances, this is part of the value proposition. Strategic considerations were summarised in a SWOT analysis, which could serve as a benchmark for providers of asset-backed short-term finance. The literature review culminated in a framework for the implementation of asset-backed short-term finance, which analysed the environment in which it operates

and described the value, profit and people propositions as put into operation in the relevant industry.

The empirical investigation consisted of two surveys. A survey among customers and potential customers of asset-backed short-term finance indicated that the industry meets a real need in the credit market, although there is a cluster of potential customers with no need for its services. Another three clusters need the industry either for its focus on functionality or on evaluating collateral rather than a repayment ability, or on a combination of the two. The results were reached by employing a BWS survey, which is a form of conjoint analysis. A survey among providers of asset-backed short-term finance resulted in a low response rate, indicating that providers may be hesitant to share information on what they may regard as the embodiment of their competitive advantage.

It can be asserted that this study did pioneering work by investigating an emergent financial industry, showing its strategic position relative to banks (which dominate credit provisioning). In addition, the subsequent dissertation contributes to the body of knowledge by providing a framework, which current and prospective operators in the industry could utilise to optimise their performance, not only from a South African perspective, but also internationally. It identifies four clusters of business persons with profiles similar to customers of asset-backed short-term finance, of which one cluster will probably not be interested in this industry. Those who indicated that the attributes of asset-backed short-term finance are important to them, form the other three clusters, according to which attributes appeal to each cluster. This proves that customers of this industry have stratified needs.

APPENDIX 1: SURVEY AMONG CUSTOMERS AND POTENTIAL CUSTOMERS OF ASSET-BACKED SHORT TERM FINANCE

Section A: Trade-offs

We want you to think of the last time you made use of short-term asset backed finance and consider how important each of the following statements are in that situation.

You will now be asked to rate the different statements in 10 trade-off scenarios. In each scenario, we'll show you three aspects of generic business strategies, decisions and focus areas. We'll ask which aspect (among a set of three) is the Most Important priority for the business you are thinking about and which is Least Important to the business you are thinking about. You will be asked repeated trade-off scenarios (involving different priorities) so that we can learn what is truly important to your company.

Scenario 1:

Imagine that you need loan of R200 000 to several millions of rands to acquire property of any kind for private or business use, to be repaid within 20 to 25 years out of regular income or selling after value has been added (actively or passively).

Trade-off 1

	Least Important	Most important
Time lapse between loan application and decision	☹	☺
Brand prominence (or lack of brand prominence) of the credit provider	☹	☺
Loan decision based on repayment ability, without security	☹	☺

Trade-off 2

	Least Important	Most important
Brand prominence (or lack of brand prominence) of the credit provider	☐	☐
Loan decision based on repayment ability, without security	☐	☐
Contact person who can and may reach a conclusion on your loan application	☐	☐

Trade-off 3

	Least Important	Most important
Impressive facilities (or lack of impressive facilities)	☐	☐
Loan decision on security, without considering repayment ability	☐	☐
Brand prominence (or lack of brand prominence) of the credit provider	☐	☐

Trade-off 4

	Least Important	Most important
Contact person who can and may reach a conclusion on your loan application	☐	☐
Time lapse between loan application and decision	☐	☐
Fees	☐	☐

Trade-off 5

	Least Important	Most important
Fees	☐	☐
Impressive facilities (or lack of impressive facilities)	☐	☐
Interest rate	☐	☐

Trade-off 6

	Least Important	Most important
Time lapse between loan application and decision	☐	☐
Contact person who can and may reach a conclusion on your loan application	☐	☐
Impressive facilities (or lack of impressive facilities)	☐	☐

Trade-off 7

	Least Important	Most important
Loan decision based on repayment ability, without security	☐	☐
Interest rate	☐	☐
Brand prominence (or lack of brand prominence) of the credit provider	☐	☐

Trade-off 8

	Least Important	Most important
Loan decision on security, without considering repayment ability	☐	☐
Fees	☐	☐
Loan decision based on repayment ability, without security	☐	☐

Trade-off 9

	Least Important	Most important
Interest rate	☐	☐
Contact person who can and may reach a conclusion on your loan application	☐	☐
Loan decision on security, without considering repayment ability	☐	☐

Trade-off 10

	Least Important	Most important
Fees	☐	☐
Interest rate	☐	☐
Time lapse between loan application and decision	☐	☐

Scenario 2:

Imagine you need a loan R100 000 or more to bridge a cash flow crises in business operations. You are confident that you will be able to repay the loan within the required 6 months.

Trade-off 1

	Least Important	Most important
Impressive facilities (or lack of impressive facilities)	☐	☐
Fees	☐	☐
Time lapse between loan application and decision	☐	☐

Trade-off 2

	Least Important	Most important
Loan decision based on repayment ability, without security	☐	☐
Impressive facilities (or lack of impressive facilities)	☐	☐
Loan decision on security, without considering repayment ability	☐	☐

Trade-off 3

	Least Important	Most important
Brand prominence (or lack of brand prominence) of the credit provider	☐	☐
Time lapse between loan application and decision	☐	☐
Interest rate	☐	☐

Trade-off 4

	Least Important	Most important
Loan decision on security, without considering repayment ability	☐	☐
Time lapse between loan application and decision	☐	☐
Contact person who can and may reach a conclusion on your loan application	☐	☐

Trade-off 5

	Least Important	Most important
Loan decision on security, without considering repayment ability	☐	☐
Brand prominence (or lack of brand prominence) of the credit provider	☐	☐
Loan decision based on repayment ability, without security	☐	☐

Trade-off 6

	Least Important	Most important
Interest rate	☐	☐
Contact person who can and may reach a conclusion on your loan application	☐	☐
Impressive facilities (or lack of impressive facilities)	☐	☐

Trade-off 7

	Least Important	Most important
Time lapse between loan application and decision	☐	☐
Contact person who can and may reach a conclusion on your loan application	☐	☐
Loan decision based on repayment ability, without security	☐	☐

Trade-off 8

	Least Important	Most important
Contact person who can and may reach a conclusion on your loan application	☐	☐
Interest rate	☐	☐
Brand prominence (or lack of brand prominence) of the credit provider	☐	☐

Trade-off 9

	Least Important	Most important
Brand prominence (or lack of brand prominence) of the credit provider	☐	☐
Loan decision on security, without considering repayment ability	☐	☐
Fees	☐	☐

Trade-off 10

	Least Important	Most important
Loan decision based on repayment ability, without security	☐	☐
Fees	☐	☐
Interest rate	☐	☐

Section B: Open-ended verbatim

In your own words, please describe the greatest problem or difficulty that your business is facing in order to gain Short-term asset backed finance.

You can write as much or as little as you would like to.

Section C: Demographics

1. Which of the following banks do you consider your primary bank?

Barclays Bank	☐
Capitec Bank	☐
FNB	☐
Investec Bank	☐
Nedbank	☐
Old Mutual	☐
RMB Private Bank	☐
Standard Bank	☐
Other, please specify	☐

2. What are the primary reasons for taking out private business loans?

Please select all options that apply.

Research and Development	☐
Used to finance business operations (managing your day-to-day operations)	☐
To Purchase Real Estate and Expand Operations	☐
To Purchase Equipment	☐
To Purchase Inventory	☐
Other, please specify	

3. What type of business do you have?

Sole Proprietorship	☐
Limited Liability Company	☐

Cooperative	☐
Closed Corporation	☐
Sole Corporation	☐
Partnership	☐
Franchise	☐
Other, please specify	☐

4. In which industry is your company?

	Main Category	
1	Agriculture, Forestry and Fisheries	☐
2	Defence and Security" (Botswana Defence Force, Botswana Police)	☐
3	Education	☐
4	Health and social work	☐
5	Recreational, cultural and sporting activities	☐
6	Construction: Residential construction i.e. houses, townhouses, apartments, condominiums, cottages, single unit dwellings and subdivisions	☐
7	Construction: Institutional and commercial construction i.e. hospitals and clinics, schools and universities, sports facilities and stadiums, large shopping centres and retail chain stores etc.	☐
8	Construction: Industrial construction i.e. manufacturing, power generation, petroleum, roads, etc.	☐
9	Electricity, gas, steam and hot water supply	☐
10	Collection, purification and distribution of water	☐

11	Financial intermediation (except insurance and pension funding)	☐
12	Insurance and pension funding (except compulsory social security)	☐
13	Real estate activities	☐
14	Renting of machinery and equipment, without operator, and of personal and household goods	☐
15	Computer and related activities	☐
16	Research and development (except market research and public-opinion research)	☐
17	Manufacturing: Manufacture of food products, beverages and tobacco products	☐
18	Manufacturing: Manufacture of textiles, clothing and leather goods	☐
19	Manufacturing: Manufacture of wood, mineral and other non-metallic products	☐
20	Manufacturing: Manufacture of metallic, electrical, electronic or transport products	☐
21	Mining: Mining of precious or semi-precious stones	☐
22	Mining: Extraction of crude petroleum and natural gas; service activities incidental to oil and gas extraction, excluding surveying	☐
23	Mining: Mining of other compounds (such as coal, gold, silver, uranium, etc.)	☐
24	Mining: Service activities incidental to the mining of minerals	☐
25	Retail trade (except of motor vehicles and motor cycles; repair of personal household goods)	☐
26	Sale, maintenance and repair of motor vehicles and motor cycles; retail trade in automotive fuel	☐

27	Wholesale and commission trade (except of motor vehicles and motor cycles)	☐
28	Hotels, restaurants and catering services	☐
29	Transport activities (land-based, water-based or aerial) and auxiliary transport activities (such as travel agencies)	☐
31	Post and telecommunications	☐
32	Arts and performing arts	☐
33	Other Industries	☐

5. Please indicate the annual revenue for your company:

R0 - 10 million	☐
R10 - 40 million	☐
R40 - 100 million	☐
R100 million +	☐
Prefer not to disclose	☐

Thank you for your willingness to participate in this research and provide us with valuable information.

APPENDIX 2: SURVEY QUESTIONNAIRE AMONG INDEPENDENT CREDIT PROVIDERS

You are kindly requested to take part in an academic survey on asset-backed short-term finance, which is part of a doctorate study with the University of South Africa (Unisa). The short-term financing industry is well-established, but there is a general shortfall in theoretical knowledge specific to the business concept, which is to bridge short term liquidity gaps, guaranteed by assets. The aim of the questionnaire is to collate data which could assist in developing a business framework for conducting this type of business within the context of current risk exposures for the South African industry.

CONFIDENTIAL AND ANONYMOUS

Participation in the survey is totally voluntary and your input will be treated **as strictly confidential.** The questionnaire is **anonymous** and neither the names of any respondent nor organisations/institutions will be disclosed at any stage. A copy of the final report will be available on request.

STRUCTURE AND TIME

The questionnaire consists close-ended questions, which will take approximately 10 minutes to complete.

GENERAL INFORMATION

Kindly indicate your answer in the appropriate block with an X

1. Please indicate the size of the company you are involved with, in terms of gross advances.	Small <Rm	Medium R0m - R1bn	Large >R1bn	Not Applicable

2. How long have you been involved in the industry as indicated?	0 – 2 years	2 – 5 years	≥ 5 years
3. Please write down the city/ town in which you are based.			

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.	Strongly Disagree	Disagree	No opinion	Agree	Strongly Agree
Strategic considerations (Refers to the industry)					

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.	Strongly Disagree	Disagree	No opinion	Agree	Strongly Agree
1. The opportunities for asset-backed short-term credit providers are increasing in South Africa.	1	2	3	4	5
2. The asset-backed short-term finance industry is highly profitable.	1	2	3	4	5
3. My organisation do not grant loans for longer than a year, in order not to be exposed to the prevalent economic environment for an extended period	1	2	3	4	5
4. The use of online marketing for asset-backed short-term finance is becoming more prevalent.	1	2	3	4	5
5. Asset-backed short-term finance is concentrated among a small number of firms.	1	2	3	4	5
6. The characteristics of asset-backed short-term finance products are very similar.	1	2	3	4	5
7. Users of asset-backed short-term finance can be described as “loyal customers”.	1	2	3	4	5
8. The image of a specific provider of	1	2	3	4	5

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.	Strongly Disagree	Disagree	No opinion	Agree	Strongly Agree
asset-backed short-term finance is important for potential customers.					
Credit strategy (Refers to your organisation)					
9. The organisation has a clearly defined target market.	1	2	3	4	5
10. The organisation has set minimum and maximum loan values.	1	2	3	4	5
11. The organisation only grants loans in South African Rand.	1	2	3	4	5
12. The tenure of loans is for a specific period only.	1	2	3	4	5
13. Only fully collateralised loans are granted.	1	2	3	4	5
Governance structures (Refers to your organisation)			/		
14. The organisation has a credit committee.	1	2	3	4	5
15. The terms of reference of the credit committee have been approved by	1	2	3	4	5

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.

	Strongly Disagree	Disagree	No opinion	Agree	Strongly Agree
the board of directors.					
16. The majority of members of the credit committee consist of non-executive directors.	1	2	3	4	5
17. The credit committee meets once a month.	1	2	3	4	5
18. The decisions of the credit committee are reported monthly to the board of directors.	1	2	3	4	5
19. The credit policy has been approved by the credit committee.	1	2	3	4	5
20. The organisation has a separate board committee that oversee the other risks that are relevant to the business.	1	2	3	4	5
21. The audit committee oversees the other risks that are relevant to the organisation.	1	2	3	4	5
22. The terms of reference of the risk/audit committee have been approved by the board of directors.	1	2	3	4	5
23. The majority of members of the	1	2	3	4	5

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.	Strongly Disagree	Disagree	No opinion	Agree	Strongly Agree
risk/audit committee consist of non-executive directors.					
24. The risk/audit committee meets once a month.	1	2	3	4	5
25. The decisions of the risk/audit committee are reported monthly to the board of directors.	1	2	3	4	5
26. The risk management policy has been approved by the risk/audit committee.	1	2	3	4	5

Credit underwriting policy (Refers to your organisation)					
27. The levels of authorisation are clearly stated in the credit policy.	1	2	3	4	5
28. Each person in the decision making process has an approved delegated authority.	1	2	3	4	5
29. The approval process is clearly defined.	1	2	3	4	5
30. The policy clearly states the background information required for	1	2	3	4	5

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.

	Strongly Disagree	Disagree	No opinion	Agree	Strongly Agree
the underwriting decision.					
31. The policy clearly states the minimum acceptable requirements underwriting loans.	1	2	3	4	5
32. The policy clearly states the level of required collateral.	1	2	3	4	5
33. The policy clearly states the quality of acceptable collateral.	1	2	3	4	5
34. Actions to be taken when the value of collateral falls below the minimum threshold (due to a revaluation of collateral) is clearly stated.	1	2	3	4	5
35. Collateral denominated in foreign currency must include a margin to provide for foreign exchange volatility.	1	2	3	4	5
36. The business has a system to follow up on loans in arrears	1	2	3	4	5
37. Actions to be taken for the different categories of arrears are clearly stated.	1	2	3	4	5
38. The policy for the provisioning for bad	1	2	3	4	5

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.	Strongly Disagree	Disagree	No opinion	Agree	Strongly Agree
debt is clearly stated.					
39. The policy for writing off bad debt is clearly stated.	1	2	3	4	5

Capital management (Refers to your organisation)					
40. Credit is extended at a variable rate.	1	2	3	4	5
41. Credit is extended only at fixed rates.	1	2	3	4	5
42. The cost of all loan capital is covered with each loan granted.	1	2	3	4	5
43. Do you at all times have sufficient capital, or access to sufficient capital, to provide your loan applications.	1	2	3	4	5
Operational risk (Refers to your organisation)					
44. The sales consultants receive commission immediately after the	1	2	3	4	5

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.	Strongly Disagree	Disagree	No opinion	Agree	Strongly Agree
credit (loan was established) was granted.					
45. Key positions have been identified for the organisation.	1	2	3	4	5
46. A realistic succession plan is in place if a key person is unable to resume duties.	1	2	3	4	5
47. The organisation will be able to recover customer data in the event that the production servers malfunction.	1	2	3	4	5
48. Customer data can be restored in the same day.	1	2	3	4	5
49. The system has the ability to give a detailed age analysis of assets (loans).	1	2	3	4	5
50. Key business information is obtained directly from systems without manual intervention on spreadsheets such as Excel.	1	2	3	4	5
51. Where Excel spreadsheets are used for key business information, all cells	1	2	3	4	5

Kindly mark your answer with an X in the appropriate box, which represents your opinion whether the following framework can assist potential asset-backed short-term finance entrants to identify possible risks.	Strongly Disagree	Disagree	No opinion	Agree	Strongly Agree
containing formulae are protected.					
52. Key business information is available when needed.	1	2	3	4	5
Regulatory risk (Refers to your organisation)					
53. The organisation is registered with the National Credit Regulator.	1	2	3	4	5
54. All the consultants are trained to provide potential clients with advice.	1	2	3	4	5
55. The organisation is a responsible institution in terms of the Financial Intelligence Centre Act.	1	2	3	4	5
56. The consultants are trained to identify potential money laundering transactions.	1	2	3	4	5
57. My organisation has an established mechanism to report suspicious transactions.	1	2	3	4	5
58. The processes to protect the personal information of customers are established in the organisation.	1	2	3	4	5

59. Indicate the importance of the following risks for an asset-backed short-term business in South Africa in order of priority according to your experience. 1 = Most important; 8 = Least important

Risk type	**Rank**
Credit risk	
Market risk	
Operational risk	
Regulatory risk (compliance)	
Legal risk	
Reputational risk	
Liquidity risk	
Strategic risk	

END OF SURVEY KINDLY EMAIL YOUR FEEDBACK TO: …….

APPENDIX 3: BACKGROUND TO SERVICE PROVIDER FOR SURVEY – SUPPLIED BY THE PROVIDER

RESEARCH APPROACH

This company does not believe in offering off-the-shelf solutions. We approach every project with a standard methodology – this approach easily accommodates our clients where non-standard research is required.

With our positioning as a research supplier that specialises in customised research, good robust scientific methodology is essential and has proven to be very successful. Our affiliation with academy is further proof of our commitment to scientifically reliable market research.

Customised Model Development

We are primarily known in the market for our specialised scientific knowledge and expertise in model development. This is particularly well illustrated in the amount of new instrument development that we are commissioned for in a year (estimated to be more than 40% of our non-tracking research work in a year) as well as the amount of conjoint analysis work that we do for clients (new product development, segmentation studies, pricing studies). Our link with a leading university provides us with the scientific background and knowledge base to develop truly reliable and valid measurement models.

APPENDIX 4: CERTIFICATE OF ETHICS APPROVAL

A copy of the relevant certificate supplied by the *Finance management & banking research ethics review committee* of the University of South Africa, dated 2 March 2016 is presented on the following page.

UNISA university of south africa

FINANCE, RISK MANAGEMENT & BANKING RESEARCH ETHICS REVIEW COMMITTEE

02 March 2016

Ref #: 2016/CEMS/DFRB/004
Name of applicant: Mr Andre Laas
Student #: 4968050
Supervisor: Prof J Young
Staff #: 90074904

Dear Mr A Laas,

Decision: Ethics Approval

Name: Mr A Laas, andre@bridging.co.za, 082 450 2250

Supervisor: Prof J Young, youngj@unisa.ac.za, 012 429 3010

Proposal: A structured approach to the strategic positioning of private credit providers: A South African perspective
Qualification: PHD

Thank you for the application for research ethics clearance by the Department of Finance, Risk management and Banking Research Ethics Review Committee for the above mentioned research. Final approval is granted for the duration of the project.

For full approval: The application was reviewed in compliance with the Unisa Policy on Research Ethics by the DFRB RERC 02 March 2016.

The proposed research may now commence with the proviso that:

1) The researcher/s will ensure that the research project adheres to the values and principles expressed in the UNISA Policy on Research Ethics.
2) Any adverse circumstance arising in the undertaking of the research project that is relevant to the ethicality of the study, as well as changes in the methodology, should be communicated in writing to the department of Finance, Risk Management and Banking Ethics Review Committee. An amended application could be requested if there are substantial changes from the existing proposal, especially if those changes affect any of the study-related risks for the research participants.

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3) The researcher will ensure that the research project adheres to any applicable national legislation, professional codes of conduct, institutional guidelines and scientific standards relevant to the specific field of study.

Note:

The reference number 2016/CEMS/DFRB/004 should be clearly indicated on all forms of communication [e.g. Webmail, E-mail messages, letters] with the intended research participants, as well as with the [DFRB] RERC.

Kind regards,

Mutezo

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