SASFA

South African SME Finance Association

Code of conduct

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Code of Conduct – SME Finance Industry

“SASFA”

South African SME Finance Association

Introduction

In any economy, a vibrant and active SME (Small Medium Enterprise) business community depends on access to working capital. But that access is the greatest challenge small businesses face in South Africa, threatening the vibrancy of the South African economy and social stability.

As per the Banking Association of South Africa, some researchers have estimated that, in South Africa, small and medium-sized enterprises make up 91% of formalized businesses, provide employment to about 60% of the labour force, and total economic output accounts for roughly 34% of GDP.

SME’s are considered an important contributor to the economy and a key driver for reducing unemployment.

Given the restricted access to traditional funding faced by SME’s, the SME Finance products provide a convenient, flexible and accessible alternative.

Any merchant contemplating an SME Finance Product should review the best practice principles as set out by SASFA.

SME Finance Products are generally broken into subcategories, depending on the Collection mechanism and the structure of the product:

- The Merchant Cash Advance (MCA) is a buy/sell agreement and not a standard loan product. The Merchant Cash Advance (MCA) is a funding product currently being offered to businesses that accept credit and debit cards as a payment method;
- The Unsecured SME loan is based on standard loan features. This product is offered to businesses that accept a variety of income types. Furthermore, these are based on the overall ability of the merchant to repay the loan within a defined repayment period and at an agreed interest rate or fee.

Reason for SASFA

The rapid growth of the SME Funding marketplace in South Africa has provided many merchants with an alternative source of funds for business development, and has also provided Independent Sales Organizations (ISOs) with an alternative revenue stream, given pricing pressures in the hyper-competitive card processing industry.

This growth has led to the need to create industry standards, which SME Finance providers should adhere to, to ensure the reputation and sustainability of the SME Finance industry in South Africa is maintained.

SASFA has established a set of "best practices" that set forth a framework for acquirers/ISOs and merchants to assess the business practices of companies they wish to do business with.

Following these practices will foster ethical behavior and lead to further industry success and continued growth.

Objective of SASFA

The members of SASFA provide critical financial products to SMEs in South Africa, supporting growth and expansion opportunities as well as emergency or seasonal cash flow requirements. It is in the interests of these SME Finance providers to ensure that the SME business community benefits from fair and transparent financial products.

The SME business community faces numerous challenges and takes on significant risks to succeed with their businesses. The objective of each member of SASFA is to assist in overcoming any challenges in securing working capital by providing financial solutions that are transparent and fair.

SASFA encourages businesses that require financing solutions to verify SASFA providers and ensure they follow the principles outlined below. These principles will assist the business community in obtaining fair and transparent terms for the capital they require.

The Merchant

SASFA encourages each business to clearly understand the following in the context of applying for an SME Finance Product;

- Clearly understand what the SME Finance product is
- Clearly understand the typical product features and the mechanics of repayment for the product
- Clearly understand what the benefits are to the merchant's business for taking a Product
- Clearly understand what type of businesses are best suited for the product

The Merchant Cash Advance

1. What is a Merchant Cash Advance

1.1. The MCA product is a purchase of future merchant receivables (i.e. future debit & credit card transactions that the merchant will process) at a discounted price.
1.2. The MCA is a discounted sale and purchase agreement, and not a loan.
1.3. A percentage of future receivables are paid to the MCA provider as the card transactions occur, until the purchase price has been fully repaid. This percentage is agreed with the merchant as part of the MCA contact.

2. Features and Benefits of the Merchant Cash Advance

2.1. The MCA product is unsecured and generally does not require any form of collateral, unless specifically requested from time to time, and agreed to by both parties. A personal surety may be required to protect the MCA provider from certain acts of bad faith by the merchant to intentionally avoid payment of the purchase price to the MCA provider.
2.2. The MCA product takes less time to process than traditional bank finance, and MCA providers are able to finance SMEs that banks typically would not.
2.3. The MCA product has higher funding approval rates.
2.4. The payment of the purchase price to the MCA provider fluctuates with the card turnover of the merchant, matching the cash flow cycles of the business. The time taken to pay the purchase price will depend on the percentage of payment agreed with the merchant, as well as the card transaction volumes of the merchant. No minimum payments are required, unless specifically agreed to by both parties. There is no set period of payment of the purchase price.
2.5. No daily or monthly interest charges are levied. All fees are agreed with the merchant in the contract, and no additional fees are levied. No late payment penalties will apply to the payment of the receivables to the MCA provider.
2.6. Most MCA providers will be able to purchase additional future receivables before the original purchase has been fully recovered from the merchant. This can provide the merchant with ongoing funding should their business require it.

3. Merchants best suited to the Merchant Cash Advance

3.1. The MCA product is suited to all SME's wishing to obtain funding and benefit from the product's key features not offered by traditional banks.
3.2. It does not work well for SMEs that are experiencing severe financial distress, as the payments of the purchase price may compromise the business's cash flow.
3.3. The MCA is suitable for all businesses that accept debit and credit card transactions, however, an affordability assessment is recommended for businesses with low profit margins to ensure the MCA does not result in high level of indebtedness of the merchant.

The Unsecured SME Loan

1. What is an Unsecured SME Loan

1.1. The Unsecured SME loan product is based on standard loan principals.
1.2. Depending on the merchant's needs, an Unsecured SME loan product is repaid in daily, weekly or monthly installments.
1.3. The interest rate or fixed fee charged on capital is defined upfront.
1.4. The loan amount is determined based on the merchant's overall affordability and ability to repay.

2. Features and Benefits of the Unsecured SME Loan

2.1. An Unsecured SME Loan does not require any form of collateral, unless specifically requested from time to time, and agreed to by both parties. A personal surety may be required to protect the provider from certain acts of bad faith where a merchant intentionally tries to avoid payment of the balance outstanding.
2.2. An Unsecured SME Loan typically takes less time to process than traditional bank finance.
2.3. The product typically offers a simple application process and higher approval rate.
2.4. The repayment period is defined upfront for the capital and interest and / or cost to be repaid. Flexible repayment periods are offered and will naturally govern the size of the loan awarded.
2.5. All fees are agreed with the merchant in the contract, and no additional fees are levied. Late payment penalties may be incurred upon non-payment; however, these will be disclosed upfront before entering into any agreement.
2.6. In the same manner as most MCA providers, the merchant may make an application for further finance once an acceptable percentage of the loan has been repaid to the lender. This can provide the merchant with ongoing funding should their business require it.

3. Merchants best suited to an Unsecured SME Loan

3.1. The Unsecured SME Loan product is suited to all SME's wishing to obtain funding and benefit from the product's key features not offered by traditional banks.
3.2. The Unsecured SME Loan product favours merchant's that receive EFT receipts as well as debit & credit card transactional income.
3.3. It does not work well for SMEs that are experiencing severe financial distress, as the repayments may compromise the business's cash flow.
3.4. An Unsecured SME Loan is suitable for all businesses; however, an affordability assessment is recommended for businesses with low profit margins to ensure the loan does not result in high level of indebtedness of the merchant.

Best Practice Principles

1. Disclosure

The SME Finance provider should provide transparent information to a prospective applicant / merchant to allow the merchant to make an educated and informed financial decision:

1.1. The SME Finance provider should clearly explain to the merchant the nature of the product(s) and its key features.

1.2. SME Finance providers should disclose all fees, the amount of funds provided to the merchant, and the total amount to be repaid. MCA Providers in particular should disclose the discounted cost of receivables purchased associated with the purchase transaction.

1.3. These costs should be disclosed in a clear and transparent format in the agreement or any other relevant documentation that is to be signed by the merchant.

1.4. The funding process of disbursing funds to the merchant should be clearly explained as well as the date of commencement of first payment.

1.5. The mechanism for the collection of funds / repayment process and how it works, the frequency of payments, and the amount of each payment should be clearly explained.

1.6. Should any additional finance be required or an additional purchase of receivables be considered, the merchant needs to clearly understand the additional fee(s) being levied.

1.7. SME Finance providers should also clearly disclose any policies around any prepayment amounts and whether any prepayment penalties apply.

1.8. SME Finance providers should provide clear disclosure of recourse. In particular, an MCA is a purchase of future card receivables and not a loan. That means the merchant may not have to repay the amount specified if the business fails in the normal cause of operation. However, MCA providers could hold merchants responsible if they intentionally avoid paying the purchase price to the provider. An MCA provider must list any conditions in this regard which need to be clearly understood by the merchant and should primarily revolve around bad faith conditions.

1.9. SME Finance providers may require the merchant to sign a personal surety or non-financial guarantee, which should only relate to these bad faith conditions.

1.10. The merchant should be provided with direct access to customer service representatives that should make it easy for the merchant to obtain detailed, accurate and timely information about their accounts (i.e. statements etc.), the application process, or any other processes once a merchant becomes a customer.

1.11. Inappropriate terminology can create confusion in the terms of the advance agreement. Merchants should be aware of this and make sure they understand the terms used in any agreement.

1.12. Explain the role of the SASFA

2. Risk Assessment

SME Finance providers should ensure their respective products are provided to merchants that can reasonably afford the product without unnecessarily causing undue repayment pressure on the business.

2.1. The SME Finance provider should implement well-developed underwriting policies and procedures to ensure appropriate credit risk and affordability criteria are met.

2.2. The underwriting policies should continually be reviewed and refined to maintain their appropriateness and relevance.

2.3. The risk assessment should encompass the business, principal(s) / merchant and financial review.

2.4. The SME Finance provider should analyze the merchant's cash flow position in accordance with their respective risk policy levels during the underwriting process to determine whether the business can service the advance/loan without putting undue pressure on the finances or operations of the merchant's business.

2.5. The SME Finance provider must be sensitive to a merchant's cash flow and/or cash and card split percentages, as well as business margins to ensure the business remains profitable.

2.6. Should the merchant's business have any outstanding finance obligations with other SME Finance providers (i.e. an Unsecured loan or a MCA), then at the point of providing funding / disbursement, the other SME Finance obligations are to be settled. This is to avoid the merchant having to repay multiple obligations, commonly referred to in the industry as stacking. Should the merchant represent a large business with sufficient available cash flow – stacking may be undertaken from time to time provided it's done responsibly after adequate risk assessment.

2.7. The SME Finance provider should not alter any term of the agreement without mutual consent by all parties. In particular, the provider must avoid any rate hikes in the agreement;

2.7.1. MCA providers should not change split percentages at will. A reputable MCA provider will clearly identify the split percentage in the agreement and will not change it during the duration of the agreement. Changing that percentage requires written consent from both the merchant and the MCA provider.

2.7.2. Unsecured loan providers should not change the agreed interest rate and/or repayment period. Any change or variation should require written consent from both parties.

2.8. The SME Finance provider should treat every merchant and his or her business fairly, determining creditworthiness based on the business case. No financing decision should be influenced by race, religion, ethnicity, gender or sexual orientation.

2.9. If a merchant is declined for funding, the SME Finance provider must provide reasons for the decline, to enable the merchant to understand what is required to position itself for financing in the future.

3. Collection Practices

SME Finance providers should treat the customer with fairness throughout the collection process.

3.1. The SME Finance provider must adhere to the rules of the Payments Association of South Africa (PASA) regarding the processing of debit orders.

3.2. In the instance when an account is in default, the SME Finance provider must treat the merchant fairly and make every effort in good faith to resolve the issue in a manner that is professional and respectful.

3.3. The SME Finance provider must adhere to the terms of the agreement with the merchant. The provider should not under any circumstances unilaterally change payment amounts or dates.

4. General Practices

SME Finance providers should always be truthful and fair in all dealings with the business.

4.1. The SME Finance provider should monitor marketing and sales practices to ensure a transparent, truthful, and fair process.

4.2. The SME Finance provider needs to ensure compliance with all applicable laws within the South African regulatory framework, including but not limited to privacy, marketing and direct marketing.

4.3. All brokers who refer business to the SME Finance provider must be aligned with the principles contained in this document and equally comply where applicable with South African laws.

4.4. The SME Finance provider must ensure that merchants have a channel available to them to file complaints that will be promptly addressed.

4.5. The funding that has been provided to the business should be intended to add value and not cause the business to be stuck in a cycle of debt.

Conclusion

Merchants searching for business funding can vet potential partners based on their adherence to industry best practices. Clear communication between the merchant and provider is in both parties' best interest, ensuring a long and mutually beneficial financial relationship.

Should you have any questions, please contact SASFA on email info@SASFA.net