SASFA

South African SME Finance Association

Code of conduct

Contents

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 SME to repay the loan within a defined repayment period and at an agreed interest rate or fee.

- Invoice Discounting is a short to medium term financing solution, whereby an upfront cash advance is made against outstanding receivable invoice/s. These receivables represent a form of collateral to the discounter and allow the SME to draw down on future invoices as and when issued.

- Asset Finance is a short to medium term financing solution for businesses to acquire assets without making the full capital outlay upfront.

Reason for SASFA

The rapid growth of the SME Funding marketplace in South Africa has provided many businesses 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 SMEs 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 SME

SASFA encourages each SME 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 SME's business for taking a such 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 SME'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 SME'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 SME 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 SME may make an application for further finance once an acceptable percentage of the loan has been repaid to the lender. This can provide the SME with ongoing funding should their business require it.

3. SMEs 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.

Invoice Discounting

1. What is invoice discounting

1.1. Invoice discounting is the purchase of an SME's outstanding receivable invoice/s at a discounted price.

1.2. An upfront cash advance is made on invoices typically less than 90 days old.

1.3. Once the invoice is paid, the full amount goes to the Invoice Discounter with the balance after fees and interest being paid to the SME.

1.4. The funding rate is the percentage that the Invoice Discounter will payout.

2. Feature and Benefits of Invoice Discounting

2.1. Invoice discounting provides SME's that sell on credit with an alternative funding solution to typical overdrafts or revolving credit facilities.

2.2. It provides immediate cash flow for working capital tied up in invoices that would usually be paid in 30 – 90 days.

2.3. Invoice discounting provides access to at least 70 – 75% of receivables outstanding whereas typical overdraft facilities offer 30% of the debtor's book.

2.4. Once the SME has been approved by the Invoice Discounter – the SME is given the opportunity to draw down on further invoices as and when issued.

2.5. This product typically offers a fixed fee that is negotiated upfront with the Invoice Discounter. Structuring and admin fees should also be taken into consideration which may vary from lender to lender.

2.6. Finance typically takes less time to process and gives the SME peace of mind when cash flow is tight.

3. Merchants best suited to Invoice Discounting

3.1. Invoice discounting is most suited to SME's that sell on credit, and in particular where working capital is tied up in accounts receivable beyond standard 30-day payment terms.
3.2. The SME should be in business for at least 12 months and demonstrate a healthy margin of 20% plus.
3.3. Invoice discounting is suited to SME's with consistent turnover of +/- R6million per annum and with reliable systems in place for collecting payments from good standing credit relationships.
3.4. Invoice discounting favours SME's looking for quick turnaround times and access to a greater percentage of funding compared to traditional banks.

Asset Finance

1. What is asset finance

1.1. Asset finance is the financing and use of equipment over a fixed period of time.
1.2. Asset finance can take the form of a finance lease, operating lease or hire purchase depending on business asset requirements at the end of the lease term.

2. Features and Benefits of Asset Finance

2.1. Asset finance gives SME's access to new assets without the cash flow burden of having to buy the asset outright.
2.2. Asset finance agreements are typically tailored around the SME's needs and use of the asset.
2.3. SME Finance providers often specialize in the financing of certain assets and can provide the SME with industry expertise.
2.4. The repayment period is defined upfront for capital and interest to be repaid. A repayment schedule will in most cases accompany the agreement with fixed annual escalation clauses denoted where applicable.
2.5. The SME will make monthly payments spread over a defined period of time.
2.6. All fees are agreed with the SME in the agreement, 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.
2.7. Asset finance is typically more expensive than buying an asset outright.

3. Merchants best suited to Asset Finance

3.1. Asset finance is suited to all SME's wishing to finance assets, and in particular SME's overlooked by traditional banks.

Best Practice Principles

1. Disclosure

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

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

1.2. SME Finance providers should disclose all fees, the amount of funds provided, 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 SME.

1.4. The funding process of disbursing funds to the SME 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 SME 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 SME to sign a personal surety or non-financial guarantee, which should only relate to these bad faith conditions.

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

1.11. Inappropriate terminology can create confusion in the terms of the advance agreement. SME's 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 SMEs 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. 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) and financial review.
2.4. The SME Finance provider should analyze the SME's cash flow position in accordance with their respective risk policy levels during the underwriting process to determine whether the business can service the finance product without putting undue pressure on the finances or operations of the SME's business.
2.5. The SME Finance provider must be sensitive to a SME's cash flow and/or cash and card split percentages (i.e. an MCA), as well as business margins to ensure the business remains profitable.
2.6. SME Finance Providers cannot have multiple exposures or security to the same asset provided by the SME. This is commonly referred to as 'stacking' within the MCA industry. Any outstanding finance obligations (in relation to such asset) with other SME Finance providers must be settled (or security released) at the point of providing funding / disbursement, to avoid the SME having to repay multiple obligations. The exiting SME Finance provider must ensure SME's are fairly treated at the point of settlement.
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 and Asset finance providers should not change the agreed interest rate and/or repayment period. Any change or variation should require written consent from both parties.
    2.7.3. Invoice Discounting providers should not change the agreed fee and interest structure, unless the variation is linked to repo rate changes by the

South African Reserve Bank, as provided for in the facility agreement. Any other change or variation should require written consent from both parties.

2.8. The SME Finance provider should treat every SME 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 SME 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 SME 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. 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

SME' searching for business funding can vet potential partners based on their adherence to industry best practices. Clear communication between the SME 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

SASFA Members

Due professional care must be exercised by all SASFA Members (including their respective sales teams) in their interactions and dealings with SME's and fellow SASFA Members. In particular, SASFA Members must;

- Abide by the Code of Conduct.
- Demonstrate ethical and professional behaviour at all times.
- Understand the SME's finance requirements and ensure unscrupulous sales tactics are prohibited, including the badmouthing of fellow SASFA Members and SME Finance providers.

SASFA has taken a 'no stacking policy'. Any member found to be intentionally stacking will be subject to a disciplinary hearing in accordance with the SASFA Constitution.

Each SASFA Member is required to sign an annual declaration that they continue to adhere to the principles outlined within the SASFA Code of Conduct.

SASFA Associate Membership

Aggregators and/or Brokers must act with due professional care in the promotion of SME Finance providers. Associate membership is conditional upon adhering to the Code of Conduct.