

# 1 INTRODUCTION

## 1.1 Purpose of study

The purpose of this research ~~paper is was~~ to determine whether or not formal sector debt financing ~~has a role to play~~ plays a role in funding the capital requirements of informal market traders in South Africa.

## 1.2 Context of study

Unemployment is one of ~~South Africa's the~~ most pressing challenges ~~facing South Africa~~. According to the Labour Force Survey of September 2005, the unemployment rate in South Africa was an alarming 26.7%<sup>1</sup> (Statistics South Africa 2005). Kingdon and Knight (2005) contend that ~~if this challenge is not addressed, it~~ has the potential to threaten the social and political stability of South Africa ~~if not addressed~~. The importance of this challenge is further highlighted by the attention that this issue has received in the government's Accelerated and Shared Growth Initiative for South Africa (South African Government Information 2006).

One of the reasons for South Africa's alarming unemployment rate can be attributed to the dramatic decline in the labour absorption capacity of the formal economy (Ligthelm 2006).

The informal sector, of which informal markets and street trading ~~are is~~ a constituent, ~~plays has~~ an important ~~role to play~~ role in alleviating the high levels of unemployment due to the potential for increased employment creation that it has exhibited (Ligthelm and Van Wyk 2004). Although informal market and street trading activities account for upward of half a million jobs in South Africa (International Labour Organisation 2003), considerably more can and should be

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<sup>1</sup> According to the official definition of unemployment.

done to stimulate growth in these areas. Further credence is lent to the importance of informal sector development when it is considered that South Africa is viewed as an international outlier in terms of the small size of its informal sector (Kingdon and Knight 2005).

~~It is therefore,~~ it is important that tangible steps be taken to encourage the growth of informal markets and the informal sector in general. An important aspect of promoting this growth is the removal of those barriers which impede ~~this-its~~ development.

One of the obstacles facing informal market traders is the difficulty ~~that~~ they encounter in accessing capital to fund their businesses. According to Cichello (2005), the respondents ~~of~~ a self-employment survey conducted in Khayelitsha/Mithchell's Plain stated that the primary barrier to their participation was a lack of money/capital. This is further ~~borne-out~~ evidenced by the results of a survey conducted by the Wits Business School and Progressus Social Research (2006) in the Natalspruit Trading area. One of the findings generated from the survey related to the difficulty that informal market traders experienced in accessing capital. The findings of a survey conducted by African Response for FinMark Trust and Gauteng Enterprise Propeller (2006) into the state of small businesses in Gauteng provide further collaboration<sup>2</sup>. According to this survey, access to finance still constitutes a significant hindrance to the development and growth of the informal sector. ~~However, t~~his problem is ~~however~~ not uniquely South African. Kauffman (2006) provides a broader African perspective, stating that small and medium African ~~small and medium~~ enterprises (SME's) have little access to finance, which has had a negative impact on the emergence and growth of these SME's.

~~One of the~~ A reasons for the existence of this obstacle is the almost non-existent use of formal sector debt financing to fund the capital requirements of informal

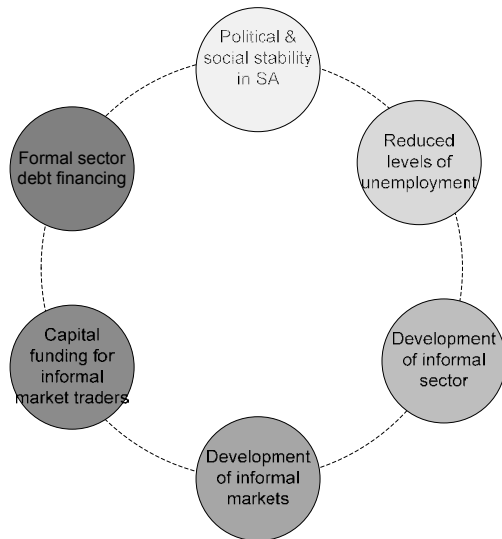
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<sup>2</sup> The findings of the survey conducted by African Response for FinMark Trust and Gauteng Enterprise Propeller are referenced on numerous occasions in this study. ~~Therefore, m~~More information regarding this survey has ~~therefore~~ been provided in Appendix J.

market trading businesses (and businesses of their type)<sup>3</sup>. The reasons for the almost non-existent use of formal sector debt financing are essentially two-fold. On the one hand, is the reluctance of formal sector financial institutions to make such funding available, while and on the other hand is the reluctance of informal market traders to apply for such financing (although this could be considered ~~to be~~ a function of the former). The reasons most often forwarded by formal sector financial institutions for their reluctance to extend credit to informal market trading businesses include poor guarantees (if any), the absence of reliable information regarding the ability of such businesses to repay the loans, the high costs of managing such facilities and the risks associated with this market segment (Schoombee 1998; Kauffmann 2006). According to Skinner (2005), the reasons ~~put forward~~presented by the respondents in a survey conducted for not applying for formal sector debt financing included ~~the fact that the costs were too high~~high costs (34.4%), lack of required guarantees (26.5%) and ~~that the procedures were too complicated~~complicated procedures (21%).

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<sup>3</sup> A related point arising from a study conducted ~~into~~ microenterprises in Mexico ~~is~~was that those microenterprises that have been funded through bank loans and other forms of formal sector credit were technically more efficient than those funded through friends and families (Hernandez-Trillo *et al* 2002).



It is against this background that the role of formal sector debt financing as an option in funding the capital requirements of informal market traders in South Africa is examined

**Figure 1: Context for the study**

### **1.3 Problem statement**

#### **1.3.1 Main problem**

Is the use of formal sector debt financing a viable option for funding the capital requirements of South African informal market traders in terms of the nature of their capital funding requirements, their ability to pay the associated finance costs and whether or not ~~informal market traders~~they are willing to utilise this form of financing?

#### **1.3.2 Sub-problems**

The first sub-problem was to establish whether the capital requirements of informal market traders are large enough to justify the use of formal sector debt financing.

The second sub-problem was to assess whether or not informal market traders generate sufficient operating profits to pay for the financing costs associated with the use of formal sector debt financing.

The third sub-problem was to assess whether or not informal market traders are willing to utilise formal sector debt financing.

#### 1.4 Significance of study

This study will provide guidance as to whether or not formal sector debt financing has a role to play in funding the capital requirements of informal market traders in South Africa. The results of this research can be drawn ~~on-from~~ by all the relevant stakeholders, namely:

- Informal market traders. The results of this research paper will provide guidance to informal market traders ~~as-with regards~~ to whether or not the formal sector provides a viable option in funding their capital requirements.
- Government. The results of this research paper will provide guidance to the South African government in terms of what additional support they may be required to provide to informal market traders in order to encourage the development of the informal sector.
- Financial institutions. The results of this research paper will provide guidance to South African financial institutions about the appropriateness of their lending behaviour to informal market traders.

The results of this research paper will also provide valuable information regarding ~~the-generated~~ revenues ~~generated~~, costs incurred and profits earned by informal market trading businesses. ~~This area was highlighted by~~ Cichello highlighted this area (2005) as requiring further research. Although this suggestion was specifically based on obtaining a better understanding of the hindrances to self-employment, it is believed that this is also relevant to this area of study.

## 1.5 Delimitations and limitations

### 1.5.1 Delimitations

The research was delimited by the following:

- The research was limited to those informal market traders who participated in the initial survey conducted by the Wits Business School and Progressus Social Research (2006) in the Natalspruit Trading Area.
- The research was only concerned ~~itself~~ with formal sector debt financing. Therefore, it did ~~therefore~~ not consider the role of other forms of financing, such as the sale of equity, or funding obtainable from friends or family and the like.

### 1.5.2 Limitations

The following limitation applied to this study:

- The research was limited by the ability of the selected informal market traders to accurately record all revenue generated and costs incurred in the period under review.

## 1.6 Assumptions

The following assumptions were made:

- The informal market traders in the Natalspruit Trading Area are representative of the broader South African informal market trading community.
- Operating profits are an appropriate indicator of the ability of informal market traders to pay for the costs of utilising debt financing.

- The ability to pay for the costs of utilising debt financing is an important consideration in assessing the role of formal sector debt financing in funding the capital requirements of informal market traders.

## 2 LITERATURE REVIEW

### 2.1 Introduction

This chapter presents a review of the important literature related to understanding and analysing the role of formal sector debt financing in funding the capital requirements of informal market traders in South Africa. The purpose of this review ~~is was~~ to identify and present the important work that ~~has~~ been previously been performed in each of the areas that constituted this study. In turn, ~~t~~The findings of the work performed in each of these areas ~~in turn~~ allowed for the formulation of appropriate research questions related to the three sub-problems presented in the previous chapter.

The review commences with a presentation of the literature related to the definition of the key terms used in the problem statement. These include “formal sector debt financing”, “capital” and “informal market traders”. The review of literature related to the definition of informal market traders was extended to include street traders, which ~~reflected~~ ing the similar nature of informal market trading and street trading.

The remainder of the review has been structured ~~along the lines of~~ according to the three sub-problems previously presented. As such, a review of the important literature related to the nature of the capital requirements of informal market traders is presented. Understanding these requirements (and specifically the magnitude thereof) is important in formulating research questions about whether or not these requirements make the use of formal sector debt financing appropriate.

This is ~~then~~ followed by a review of important literature relating to the profitability of informal market businesses. The purpose of this review ~~was~~ is to be able to formulate research questions about the ability of informal market traders to generate sufficient operating profits to pay for the financing costs related to formal sector debt financing.