FULL COLOUR THINKING

GRADUATE SCHOOL OF BUSINESS
UNIVERSITY OF CAPE TOWN

Investigating the factors that constrain growth of funded SMMEs in KwaZulu Natal Province: "A Case Study of Ithala Development Finance Corporation"

A Dissertation

presented to

Graduate School of Business
University of Cape Town

In partial fulfilment
of the requirements for the
Master of Commerce in Development Finance Degree

By

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June 2014

DECLARATION

I, Joseph Mubonderi, do hereby declare that this dissertation is the result of my own investigation and research, except to the extent indicated in the Acknowledgements, References and by comments included in the body of the report, and that it has not been submitted in part or in full for any other degree to any other university.

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Signature Date

ACKNOWLEDGEMENTS

For providing valuable guidance and support throughout this research, I want to thank my study leader Prof. Enrico Uliana. The experience was invaluable. Special and heartfelt thanks go to my parents and family for having given me a strong and solid foundation. I will forever cherish the support you all gave me.

ABSTRACT

This research investigates the factors that affect the performance of funded Small, Medium and Micro Enterprises (SMMEs) in the KwaZulu Natal (KZN) province of South Africa. Many studies have shown that access to financing is the major challenge facing small enterprises in Africa due to a number of factors which include information opacity and lack of collateral. Other researches however noted that many of the SMMEs in South Africa that had received funding from agencies set by the government or other private sources of funding struggled to attain sustainable growth and many of them failed, something which is puzzling to authorities and academics alike. This study sought to investigate possible causes of such failures through investigating a sample of 300 SMMEs that had received agency funding and operating in the KZN province.

The study reveals that there are poor management practices within the funded SMMEs, with weak financial management and control systems in place. The study also reveals the lack of use of technology to leverage business growth. In addition the study reveals that there are no additional support structures put in place for funded enterprises which adversely affect their growth prospects. The study also raises important questions about the affordability and the structuring of the terms of financial support facilities made available to the SMMEs. Finally the study proffers policy recommendations to support the growth of SMMEs and ultimately to see them grow into large corporations.

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CHAPTER 1

INTRODUCTION

1.1 INTRODUCTION AND BACKGROUND

With increasing levels of abject poverty in most developing countries, Governments have recently focused attention to the development of SMMEs to tackle the problems of unemployment. In South Africa where the economy is characterised by low growth, high rate of unemployment at 24,5%, skewed income distribution and inequality, the SMMEs sector is playing a major role in addressing the problems by creating jobs and wealth in the economy. In South Africa, SMMEs employed half of the working population and contributed 50% of the economy's Gross Domestic Product (Gumende, 2004 and Rogerson, 2008).

According to Mars and Harrington (2006) a new SMME can be described as an SMME that has being in existence for less than 42 months. However, the quantitative definition of SMEs differs from country to country. In South Africa qualitative and quantitative definitions as prescribed by the National Small Business Act. The National Business Act of South Africa of 1996 as amended in 2003 quantitatively defines an SMME as a business that employs between 1-200 employees with a turnover of less than R51m per year. (Government Gazette of the Republic of South Africa, 2003).

However, despite the noted contributions of SMMEs, their failures rate in South Africa is a point of no contention. Research findings by Von Broembsenetali, (2005) estimates that about 75% of new SMMEs in South Africa did not become established firms. This high failure rate of SMMEs in South Africa attracted a lot of researchers to investigate the obstacles to the growth of new SMMEs. The prominent obstacle that emerged from the research findings is the lack of access to financial resources (Fatoki and Garwe, 2010; Fatoki and Smit, 2011).

In as much as the findings are true, little empirical research has been done in South Africa to explain the causes of high rate of failure for SMMEs that manage to acquire /access financial aid from financial institutions in the form of loans. This study therefore focused on investigating the factors that constrained growth of SMMEs in KwaZulu Natal (KZN) province of South Africa despite receiving financial assistance in form of loans.

1.2 PROBLEM STATEMENT

The problem identified by the current study was the high rate of failure among SMMEs in South Africa. Various studies (Fatoki and Garwe, 2010; Fatoki and Smit, 2011: Olufunso et al, 2010; Cassar, 2004; Stilglitz and Weiss,1981) and researchers and business experts argue that access to external finance is crucial for the success of SMMEs. However reports from Financial Institutions confirm that most SMMEs that received loans did not grow into sustainable entities, which was puzzling. The SMMEs also did not register significant improvement in performance and a number of them still failed to come out of the infancy stage resulting in losses for organisations that provided funding to these enterprises.

The Government of South Africa has implemented a number of initiatives to assist new SMMEs to access financial resources for growth. Government Agencies such as Small Enterprises Development Agency (SEDA), Small Enterprise Finance Agency (SEFA), Provincial Developmental Finance Institutions etc. were set up to assist new SMEs with financial resources.

Poor financial performance of SMME borrowers however resulted in such enterprises struggling to meet their obligations on their borrowings. Due to the high rate of loan default among SMMEs, commercial banks have tightened their screening process to try and minimise the risk of non-repayment. As a result many SMMEs were finding it difficult to qualify for credit schemes from commercial banks thus limiting the prospects of growth for the sector. It was important therefore to establish the causes of the poor performances by funded SMMEs apart from access to financing.

1.3 RESEARCH PROPOSITION

Management issues affect the performances of funded SMMEs in the KwaZulu Natal province in South Africa.

1.4 OBJECTIVES OF THE STUDY

The objectives of this study were to:

- Critically investigate economic factors that constrain growth of SMMEs in South Africa particularly in the KwaZulu Natal province apart from access to financing.
- Establish the role of poor management skills in the perceived poor performance by the funded SMMEs in the KwaZulu Natal Province, South Africa.
- Establish whether initiatives and policies by the government and other economic authorities had an effect on the performance of funded SMMEs in KwaZulu Natal province.
- Provide recommendations to Policy Makers and Financial institutions on how to further improve the framework for assisting SMME growth.

1.5 SIGNIFICANCE OF THE STUDY

This study was timely and significant in view of the high failure rate of SMMEs in South Africa. Since, new empirical information was urgently needed to guide policy makers, credit providers and receivers (SMMEs) on how best to assist each other. This study was therefore worth pursuing because it added new information on credit risk management within the SMMEs lending space.

SMMEs play a critical role in providing employment to the economy as already indicated. The South African Government was putting much trust in the SMMEs as one of the major solution to poverty eradication and in particular addressing the problem of high unemployment in the economy. Higher employment directly impacts consumption which in turn affects economic growth. More attention therefore needs to be paid to the promotion of SMME growth as they are the drivers of economic growth. While the government and other players have made efforts to provide funding to SMMEs, the high failure rate among funded SMMEs is a cause for concern and suggests that there is need to focus on other issues that affect performances of the funded SMMEs which may not be apparent at first sight. Such information is of practical significance to organisations that fund SMMEs and adds to the literature on SMME growth in South Africa. This study also aids in coming up with a new framework for promoting SMME growth in the country.

1.6 METHODOLOGY

The methodology which was adopted in this study was based on the positivist approach. The research was based on collecting data from the sample from which conclusions and inferences about the population could be made. The research was also based on obtaining statistical characteristics from the population from which objective conclusions could be made about SMMEs in the KZN province. The researcher carried out a survey of a number of SMMEs operating in the KwaZulu Natal province that had been funded by Ithala Development Finance Cooperation. A questionnaire was developed after a thorough review of relevant literature on SMME development and credit risk management among SMMEs. Questionnaires were then sent out to a sample of 300 of the funded SMMEs.

1.6.1 Population

For this study the population consisted of all SMMES operating in the KwaZulu Natal province that have accessed financing from the Ithala Development Finance Corporation over the past ten years. The population numbered 3000 in size and is drawn from various sectors of the economy.

1.6.2 Sampling

The sample used in this study consisted of SMMEs that had accessed finance from the Ithala Development Finance Cooperation in the past 10 years. The Raosofty sample size calculator was used to determine the sample size taking into consideration the population size, margin of error and confidence levels. The study focused on SMMEs in all sectors that were financed by Ithala. This financial institution was chosen mainly because it's the main credit provider solely focusing on SMMEs in KZN province. There are other SMMEs funded by other agencies or financial institutions in the KZN province but this study focuses on those funded by Ithala.

1.6.3 Secondary Research

Secondary data was obtained from the KwaZulu Natal provincial government on SMMEs in the province. This data included the population of SMMEs in the province and the industries in which they operate. Most of that data was readily available from the internet and provincial offices. Data was also collected on SMMEs in the whole of South Africa and other jurisdictions in developed and developing country. Some of the secondary data collected was not necessarily related to the objectives of this study but it was useful to put primary data collected pursuant to this study into perspective.

1.6.4 Primary Research

In this study primary raw data was collected directly from study units through a questionnaire as the primary research instrument. Questionnaires were distributed to the identified research units and the responses collated and analysed so that conclusions could be made in order to achieve the objectives of the study. No previous similar study was identified as having been conducted in the KZN area so all the data had to be collected from the respondents.

1.6.5 Research Instruments

The following data collection techniques were used in the research:

(a) Personal interviews – one on one and telephone interviews were conducted; these interviews were flexible as they gave the researcher the opportunity to probe further into the discussion. Personal interviews were conducted with professionals in the SMME industry including key people from SMME lending departments of the banks and Ithala Finance Corporation. These interviews were primarily for the purpose of gaining deeper insight into the SMME sector in KZN, the lending environment and the challenges that the sector faced. Personal interviews were also conducted with some of the respondents to the questionnaires for the purpose of gaining insight into the operations of some of the SMMEs and assistance with completing the questionnaire; which was the primary research instrument.

(b) Desk research - Desk research was conducted prior to the study being carried out. This included a review of available literature from South Africa and globally on the subject of SMME. Desk research was used to identify the research gap. In addition empirical findings from researches in other economies were used to make comparisons with the reality in South Africa, thus helping to shape this study.

(c) Observations – observations were made on visits to some SMMEs that were included in the sample and some that did were not included in the sample. The observations were important especially in areas of infrastructure, information systems and location of SMMEs. Observations were important in informing the structure of the questionnaire and some of the areas to be investigated.

(d) Questionnaires – the primary research instrument for this study was the questionnaire. Questionnaires were distributed to a sample of SMMEs that had previously accessed financing from Ithala Finance Corporation. The questionnaire was chosen as the primary research instrument because it was simple and quick as they gave the respondent ample time to give information. Responses from the questionnaires were then summarized and analysed; thus allowing conclusions to be made regarding the objectives of this study.

1.6.6 Data Collection Procedures

Data for the study was collected using the following data collection procedures:

- From the random sample chosen, initial contact was made to ascertain if the potential participants would be interested in taking part in the survey. The contact details were obtained from the Ithala database. From the initial list the researcher came up with a list of 300 participants for the study.

- The questionnaires were distributed by hand and email to the respondents that were identified from the database of Ithala Development Finance Corporation.

The researcher physically visited some of the participants to administer the questionnaires.

- The researcher conducted a number of personal interviews with a few of the respondents to get a deeper insight into the operations of the SMMEs. Personal interviews were also held with professionals with an understanding of the SMME landscape in South Africa.
- Research instruments were collected from some of the respondents; especially those in the vicinity of Durban Municipal area. Some of the respondents sent the completed questionnaires through email and some sent them via the provided return stamped envelopes that were included with the questionnaires.

1.6.7 Data Analysis & presentation

Data obtained from the questionnaire was systematically organised in order to draw conclusions. The data was collated, summarised and manipulated using spreadsheets. Given the volume of the data and the complexity of the data analysis, spreadsheets were considered adequate in the data analysis. The data was presented by way of charts, graphs, averages, percentages and summarised. The data from the study is presented in Chapter 4.

1.7 STRUCTURE OF THE RESEARCH

The study is structured as follows

CHAPTER ONE

This chapter gives an outline of the problem on which the study is based. It also discusses the significance of the study. In addition the research objectives will be discussed in detail in this chapter. A brief review of the available literature on SMME is also included.

CHAPTER TWO

This chapter will focus and dwell at great length on available literature on SMMEs both in South Africa and in other developed and developing economy. The chapter will discuss issues like management of SMMEs, entrepreneurship, access to finance and the role of SMMEs in economic development

CHAPTER THREE

This chapter focused on the study at hand in terms of the study area, the study unit and the population. It will also cover the methodology applied during the study. Justification of the methods and instruments used will also be discussed.

CHAPTER FOUR

This chapter will present the data in a variety of ways for effective analysis so that conclusions can be derived from the study.

CHAPTER FIVE

The chapter incorporates the conclusions on the findings of the study. Recommendations to improve the performance of SMEs were discussed in the chapter. The limitations of the study were highlighted in the chapter. Finally, areas for further research in relation to SMEs were highlighted.

CHAPTER 2
LITERATURE REVIEW

2.1 INTRODUCTION

This chapter locates the SMME sector on the development agenda. The chapter reviews literature on the role of SMMEs in the development of, in particular, developing economies. There has been a heightened awareness by Government Authorities on the role that SMMEs play in economic development with various studies pointing out the big role these enterprises play in job creation, new product development and the elimination of poverty as outlined below. However the growth of this sector has been hampered by a myriad of challenges. Selected literature on the factors affecting the growth of the SMME sector is also reviewed in this chapter.

2.2 THE ROLE OF SMMEs IN NATIONAL DEVELOPMENT

SMMEs have now come to occupy a privileged place in international development literature. Castel-Branco (2003) says that arguments for the role of SME sector in economic development come from almost all corners of development literature and economic programmes, particularly in the case of Least Developed Countries (LDCs). Many authors have shown that developed countries that encouraged and supported entrepreneurship and SMMEs have higher growth (e.g. Schimitz (1989), Acs (1992), Calderon and Nickel (1998) and Audretsch and Thurik (2000)). Enterprises including small and medium-sized enterprises, supported by venture capital are vital in bringing economic growth and sustainable development to African economies (AVCA: 12). Kovacs (2000) provides some interesting data about the role of SMEs in Europe. He claims that SMEs account for a large portion of Europe's economic and professional activity and in practice 99% of all businesses in Europe are SMEs and they provide two thirds of all private sector jobs in the European Union (EU).

Urban and Naidoo (2012), quoting Naude (1998), state that small and medium enterprises (SMEs) are seen by policymakers as an ideal way to increase sustainable development and were a pivotal to the growth and development of the South African economy (Butcher, 1999) and the government was pinning its hopes on the sector for economic empowerment, job creation and employment within the disadvantaged communities (Davies, 2001). Urban and Naidoo (2012) further state that the SME sector has a valid claim to increasing relevance and the developed world was crafting strategies to ensure that the sector expand and is integrated into the mainstream economy (Luiz, 2002). A large part of the economic system in many countries, whether developing or developed, is formed by SMMEs (Fumo and Jabba, 2011). Selbourne and Rogut (2005) posit that small enterprises represent not less than 95% of the firms in the EU member countries.

In 2007, van Praag and Verslot reviewed available literature from 57 studies on the relationship between small enterprises and development and concluded that SMME entrepreneurs played a very important role in the economic development of all the economies as these enterprises generated employment opportunities, economic growth and produced commercial innovations of high quality. For example Longenecker et al (1997) point out that many scientific advances, including the photocopier and helicopter where originated by small enterprises. SMMEs also complement the work of larger enterprises, providing materials and valuable support services to the bigger enterprises (van Praag and Verslot, 2007).

Writing in the Milken Institute Review (second Quarter 2005), Patricof and Julie Saunderland (quoted in AVCA, 2000), explain that “Like their counterparts in wealthy nations, SMEs in poor countries are responsible for a disproportionate amount of innovation, growth and employment compared to the resources they consume. Yet they have little access to the long term capital they need to grow.”

2.3 THE PROBLEM OF SMME GROWTH

According to Boysana and Ladzana (2011) small businesses are the backbone of many economies worldwide. The major challenge is how to overcome the many factors hindering their growth (Buckley, 1998). 2005). Fumo and Jabba (2011) note that despite the fact that SMMEs play a crucial role in many economies, these organizations generally encounter various weaknesses and barriers, such as a high failure rate (Smallbone and Rogut, 2005); internal barriers which include, inter alia, management and contracting of less qualified labor (Smith and Smith, 2007); funding (Pissarides, 1999; Joubert, 2004); and external barriers such as the availability of access to prime materials, delays in payments of invoices by customers (Smith and Smith, 2007); and by way of regulatory barriers (Bartlett and Bukvic, 2001) among others.

There is a huge body of literature written on the barriers faced by SMMEs but the focus has mostly been on the small enterprise sector in developing economies and little written on the least developed economies like Mozambique and other African countries (Fumo and Jabour, 2011). As such, little is known about factors affecting the growth of African SMMEs (Irwin, 2011).

Fumo and Jabour (2011) in their review of literature available of barriers faced by SMMEs classified the barriers into six broad barriers namely; management, awareness, human resources, funding, institutional and infrastructural. Management barriers refer to the ability of owner managers to administer their businesses (Fumo and Jabour, 2011). The human resources barrier refers to the quality and quantity of personnel hired to work for the SMME (Smith and Smith, 2007). Baron and Shane (2007) refer to awareness as the competitive force that the enterprise can have. Funding barriers are prevalent in most SMMEs and these barriers manifest in for example difficulty in accessing credit (Pissarides, 1999), and collateral or guarantees, inter alia. Baron and Shane (2006) define institutional barriers as regulations and policies that could affect the activities of small enterprises. Infrastructure refers to transport networks, telecommunication networks and electricity supply. The lack of reliable infrastructure, especially in developing countries, can be a significant barrier to the development of small enterprises (Olawale and Garwe, 2010).

2.4 BARRIERS TO THE GROWTH OF SMMEs IN SOUTH AFRICA

Research literature has shown the importance of SMMEs in the development of the South African economy (Olwale and Garwe, 2010). Maas and Herrington (2006) point out that new SMMEs are seen as significant component of the solution to South Africa's development issues. Herrington et al (2009) also point out the failure of the formal and public sector to create enough jobs with the result that increased focus has to be shifted to entrepreneurship and the creation of new enterprises. Berry et al (2002) however were not sure whether the SMME sector could be a panacea for the problems that the South African economy faces because of several factors that limited the growth of new enterprises, especially small enterprises. The following broad factors have been identified as suffocating the growth of the SMME sector in South Africa (Olwale and Garwe, 2010). The business environment has a significant impact, positive or negative, on the operations of small enterprises (The Word Bank, 2006). Delmar and Wiklund, 2008 also concurred with this assertion and pointed out that the business environment has an impact on the growth or failure of small enterprises in Africa. The business environment could be divided into two distinct factors namely; internal environment (access to finance, management skills, location and networking, information technology) and the external environment (economic variables and markets, crime and corruption and labour, infrastructure and regulations).

2.4.1 Access to Finance

All businesses require financing for start up and to fund growth (Olwale and Garwe, 2010). The lack of access to financing is a big impediment to entrepreneurship (Cassar, 2004). The lack of finance has been defined by Stilglitz and Weiss (1981) as a finance gap which affect the growth of small businesses. Herrington et al (2009) point out that lack of access to finance is a major problem for entrepreneurs in South Africa and was the second most mentioned contributor to business failure after lack of training. Access to finance is a major constraint to business growth; this is discussed in detail in subsequent sections (sections 2.14 to 2.18).

2.4.2 Management Skills

The skills of the entrepreneur or owner-managers are critical for the success of the small enterprise. These skills also include the knowledge, experience and education of the owner managers (Ahmed et al (2010). Lack of managerial experience and skills was cited by Martin and Staines (2008) as one of the major reason why new enterprises fail. The management skills of owner-managers are further reviewed in detail in a subsequent section (section 2.20).

2.4.3 Location and Networking

According to Olawale and Garwe (2010) location impacts market potential and growth opportunities of small enterprises, especially new firms. Proximity to key markets or suppliers allows the small enterprise to be more prominent and visible and exploit growth opportunities on the market (Dahl and Sorenson, 2007). Networking is important for small firms and can especially be helpful to the small enterprise to access finance (Olawale and Garwe, 2010). Networks also help the small firm to obtain the needed support from key stakeholders, thus networking can positively impact on the growth of the new SME (Olawale and Garwe, 2010)

2.4.4 Investment in Information Technology

Information technology is key to production of reliable financial information. Most SMEs in South Africa could not obtain bank financing due to their inability to provide reliable financial statements. Investment in technology and keeping up with information technology is increasingly becoming important to all firms (Olawale and Garwe, 2010). Mathews (2006) point out that ICTs are playing an important role in the growth of enterprises by contributing directly to profitability and providing foundation for the evolution of the small firm to a medium enterprise. The adoption and assimilation of information and communication technology (ICT) is recognised as one factor in the growth equation, both for enabling growth (through strategic exploitation of ICT as a tool) and inhibiting it (through poor access or adoption) (Matthew 2006). Lock (2004) however points out that it can be difficult to separate the effect of ICTs on the growth of SMMEs from other factors contributing to the same growth. Some studies have attempted to quantify the effects of ICT usage on the growth of small enterprises. For example Quany, Clarke and Halewood (2006) found that firms using email for customer communication grew 3.4% faster in terms of sales than those that did not. Another study in Canada found out that SMEs in Canada that used e-business methods grew 4% and 5% more in sales and exports respectively than those that did not (Raymond, Bergeron and Bill, 2005). In a survey of South African small enterprises Southwood (2004) revealed that the biggest perceived impact of ICT investment on profitability and growth was due to cost saving.

According to Mathews (2006), ICT infrastructure in small enterprises often contribute to growth in the areas of marketing, communications and resource planning. Growing SMEs can clearly see potential for enlarging their market footprint by making the use of internet communications. The findings from Chowdry and Wolf (2003) in a survey they did in Kenya however show that ICT usage had no significant impact on profitability and growth of small enterprises. Esselaar et al (2005), reporting on a survey of ICT usage and impact on profitability of SMEs in some 13 African countries found out that ICTs are significant input factors for both formal and informal SMEs and contribute positively to revenue generation. They also concluded that ICT use increases labor productivity.

Small enterprises are usually reluctant to embrace new technologies, preferring instead to stick with older technologies that they are familiar with (Ismail et al, 2011). This is despite the fact that new technologies often result in increased growth and profitability. In South Africa little research has been carried out on the use of ICT and value addition for small enterprises (Modimogale and Kroeze, 2009, Ismail et al, 2011). Ramsey et al (2003) report that not all small and micro enterprises in South Africa have taken up or intended to take up new technologies in the near future although they stood to gain huge advantages through use of new technologies (Bolocco, Mogre and Tolleti, 2009). Vosloo et al (2005) also reported the same result of low adoption of new technologies by small enterprises in South Africa. Ismail et al (2011) report that the low level of ICT adoption among small enterprises was partly due to the belief that ICT cost more than they are worth in terms of benefits from their use. They also report that those small enterprises that were investing in ICT were largely investing in general applications and not advanced systems that they could use to aid business growth.

2.4.5 Economic Variables and Markets

Economic factors have a direct impact on operations of all enterprises but these factors have a different impact on various types of enterprises (Oluwale and Garwe, 2010). Economic factors include fiscal and monetary policies, inflation, interest rates and foreign exchange reserves. These factors influence demand of goods and hence have an effect on the growth prospects of small enterprises (Ehlers and Lazenby, 2007). The factors in South Africa which include high inflation and an unstable exchange rate have a serious negative impact on growth of small enterprises. Small enterprises, unlike the bigger enterprises, have a limited ability to respond to these factors (Zahra et al, 2002). The ability of small enterprises to respond to the chances in the market dynamics is a huge barrier to their prospects of growth as such competencies are not well developed at this stage among the small enterprises. The unpredictable nature of the economic variables only serve to make the task of the owner manager more difficult (Oluwale and Garwe, 2010).

2.4.6 Crime and Corruption

South Africa has the distinction of being among the world’s top 5 countries with the highest murder rates according to the United Nations Office of Drugs and Crime (2007). Organized business is usually the biggest victim of violence and crime (Brown, 2001). Oluwale and Garwe also point out that the effects of crime on South Africa are also growing. They also note that business related crime is on the increase in south Africa. Crime and violence affect business profitability through an increase in costs associated with crime. Transparency International notes that corruption is on the increase in South Africa. The effect of corruption is to increase the cost of doing business in South Africa. The World Bank (2005) report that 70% of South African small enterprises perceived corruption as an impediment to their business compared to 60% of bigger businesses.

2.4.7 Labour Infrastructure and Regulations

Small enterprises require access to a pool of qualified and skilled labour in order to sustain growth. It is however expensive and difficult for small enterprises to hire skilled labour in South Africa (Mahadea, 2008). Labour regulations, including employment and minimum wage regulations, mean that acquiring the relevant labour will be expensive for small enterprises thus making it difficult for small enterprises to achieve sustainable growth (Oluwale and Garwe, 2010). In many developing countries the transport infrastructure, especially road networks, is in deplorable state. Electricity supplies are also not reliable and this can affect demand and turnover at small enterprises (Kalra, 2009). Regulations usually exert additional burden on small enterprises which can ultimately affect growth of these enterprises (Oluwale and Garwe, 2010).

2.5 SMALL ENTERPRISE GROWTH IN OTHER ECONOMIES

Several factors have been identified as constraining the growth of small enterprises as discussed in the foregoing literature review. The constrains faced by small enterprises are similar in most economies. Keyser et all (2000) found that in Zambia lack of starting capital was a common problem for entrepreneurs as only a small percentage received loans from banks for startup capital. Orser et al (2000) found similar results from the survey of nearly 1000 Canadian small enterprises. In Nigeria Okpara and Wynn (2007) identified the following as responsible for small business failure: lack of financial support, lack of management experience, corruption, lack of adequate infrastructure, lack of training and inadequate bookkeeping and record keeping

A. AN OVERVIEW OF THE SMME SECTOR IN SOUTH AFRICA

2.6 INTRODUCTION

This section gives an overview of the SMME sector in South Africa. The section starts by discussing the definitions assigned to small enterprises in South Africa and in other economies. Definitions of small enterprises vary from economy to economy. Next the section discusses the nature of the small enterprise sector in South Africa and this is followed by a review of the role played by small enterprises in South Africa. The support measures for the SMME sector are then discussed before the chapter closes with a brief discussion of institutions that have been put in place to support the small enterprise sector in South Africa.

2.7 DEFINITIONS

The definition of small enterprises varies from country to country. According to Mars and Harrington (2006) a new SMME can be described as an SMME that has being in existence for less than 42 months. Zindiye (2008) also notes that different jurisdictions emphasise different aspects in their definitions of a small enterprise. Table 2.1 below, adapted from Zindiye (2008), illustrates some of the definitions found in literature of small enterprises.

Reference	**Definition**
Ayyagari, Beck & Demirguc-Kunt (2003:4 -5)	*SMEs are formal enterprises which have a cut-off range of 0 to 250 employees*
Cronje et al. (2001: 495)	*An SME in South Africa is any business with fewer than 200 employees, an annual turnover of less that R5 million, capital assets of less than R2 million, and the owners are directly involved in the management of the business*
Quartey (2001:5)	*In developing countries a small firm employs between five and nine people, while a medium firm employs between 20 and 90 employees.*
United States Small Business Administration (2004)	*An SME is an entity that is independently owned and operated, and is not dominant in its field of operation.*
European Union (2004)	*A small firm employs fewer than 50 employees and a medium firm has fewer than 250 employees.*

Table 2.1: Definitions of Small Enterprises

As illustrated in the above table, the quantitative definition of SMEs differs from country to country. There is no generally agreed or universally applicable definition of SMEs. Numerous factors, related to a given socio-economic environment, influence the definition of SMEs. However all the definitions are based on thresholds for the following key factors: (i) number of employees (ii) value of assets held by the enterprise (iii) capital base of the enterprise, and (iv) registration of the enterprise.

The most widely used framework in South Africa is the definition of the National Small Business Act, which defines five categories of business as follows:

Survivalist enterprise: The income generated is less than the minimum income standard or the poverty line. This category is considered pre-entrepreneurial, and includes hawkers, vendors and subsistence farmers. (In practice, survivalist enterprises are often categorised as part of the micro-enterprise sector.)

Micro enterprise: The turnover is less than the VAT registration limit (that is, R150 000 per year). These enterprises usually lack formality in terms of registration. They include, for example, *spaza* shops, minibus taxis and household industries. They employ no more than five people.

Very small enterprise: These are enterprises employing fewer than 10 paid employees, except mining, electricity, manufacturing and construction sectors, in which the figure is 20 employees. These enterprises operate in the formal market and have access to technology.

Small enterprise: The upper limit is 50 employees. Small enterprises are generally more established than very small enterprises and exhibit more complex business practices.

Medium enterprise: The maximum number of employees is 100, or 200 for the mining, electricity, manufacturing and construction sectors. These enterprises are often characterized by the decentralization of power to an additional management layer.

The above definitions can be depicted easily in a tabular format as shown below:

Enterprise Size	Number of employees	Annual turnover	Gross assets, excluding fixed property
Medium	Fewer than 100 to 200, depending on industry	Less than R4 million to R50 million, depending upon industry	Less than R2 million to R18 million, depending on industry
Small	Fewer than 50	Less than R2 million to R25 million, depending on industry	Less than R2 million to R4,5 million, depending on industry
Very small	Fewer than 10 to 20, depending on industry	Less than R200 000 to R500 000, depending on industry	Less than R150 000 to R500 000, depending on industry
Micro	Fewer than 5	Less than R150 000	Less than R100 000

Table 2.2: South African Definition of Small Enterprises

In this study, the definition of Small, Micro and Medium Enterprise (SMME) encompasses all the above categories as defined in the National Small Business Act. The term SME may also be used but the meaning will be interchangeable with SMME.

2.8 THE NATURE OF SMME IN SOUTH AFRICA

The nature of SMMEs refers to generally observed characteristics of these kinds of enterprises (Zindiye, 2008). Although as already observed, definitions of SMMEs vary between economic jurisdictions and countries some important characteristics of SMEs can be distinguished. In developing countries, with a shortage of capital and growing labour surpluses, the following characteristics of SMEs are observed (Cronje, Du Toit & Motlatla, 2001:492):

- SMEs are generally more labour intensive than larger businesses;
- On average, SMEs generate more direct, and possibly also more indirect, employment opportunities per unit of invested capital. In service industries the capital invested per employment opportunity is even less;
- SMEs are an instrument for utilizing the talents, energy and entrepreneurship of individuals who cannot reach their full potential in large organisations;
- Smaller businesses often flourish by rendering services to a small or restricted market which larger businesses do not find attractive;
- SMEs are a breeding ground for entrepreneurial talent and a testing ground for new industries;
- SMEs make a contribution to the competitiveness of the economy; and
- SMEs create social stability since they cause less damage to the physical environment than larger factories, stimulate personal savings, increase prosperity in rural areas and enhance the population’s general level of economic participation.

Small enterprises are a manifestation of the entrepreneurial spirit of the country’s population. These enterprises, by promoting competition are an important element of the free market economy. This competition eliminates monopolies and encourages free trade which results in quality products and services being offered to customers (Longenecker *et al.*, 2006:14). The Banking Association of South Africa note that while contributing significantly to the economy, SMEs foster diversification through their development of new and unsaturated sectors of the economy. In addition, innovative and technology-based small and medium enterprises can provide a platform for local, regional and international growth, especially in BRICS economies.

The small business is a partner to big business and provides products and services that normally cannot be provided by the latter. Longenecker *et al.*, 2006:15 also note that at times a small business is the only provider of necessary products and services in thinly populated and small markets. SMEs are important worldwide and their contributions are being recognised globally.

The influence of SMEs on the economy is of major importance. In addition to their key role as providers of employment, they initiate technological innovation, play a role in the production of new products and the establishment of new businesses, and support large businesses as suppliers and subcontractors. Against this background, the role of SMMEs in the social and economic development of South Africa is discussed below.

2.9 THE ROLE OF SMMEs IN SOUTH AFRICA

According to Fatoki (2011) the SMME sector in South Africa plays a vital role in creating jobs and wealth. In addition they are an essential ingredient for fostering competitiveness, entrepreneurial spirit and innovation (Temtime and Pansri (2004). In South Africa the SMME sector employs half the working population and contributes 50% of the Gross Domestic Product (GDP) of South Africa (Gumede 2004, Mutezo 2005; Rodgerson 2008). In South Africa, the total economic output of small and medium enterprises (SMEs) is some 50 per cent of gross domestic product (GDP), and this sector employs in excess of 60 per cent of the total labour force. According to Olufunso et al (2010), SMMEs are very important to South Africa as the country suffers from high unemployment with official estimates putting unemployment at 22.5% of the economy's economically active population. They argue that SMMEs are therefore expected to be a vehicle to reduce this problem of unemployment, equitable distribution of wealth and overall stimulation of the economy. They are also expected to be a source of innovation in the South African economy through new products, services and technologies (Olufunso et al, 2010). The table below (Table 2.3) summarises the number of enterprises in South Africa at the end of 2009 and gives a good indication of the role of small enterprises in the South African economy.

Sector	Survivalist	Micro O employee	Micro 1-4 empl.	Very small	Small	Medium	Large	Total
Agriculture	14 700	13 600	26 200	17 900	20 900	3 240	1 520	98 100
	15%	**14%**	**27%**	**18%**	**21%**	**3%**	**1%**	**100%**
Mining	1 100	300	2 200	500	131	112	137	4 500
	25%	**7%**	**49%**	**11%**	**3%**	**2%**	**3%**	**100%**
Manufacturing	19 600	30 900	14 800	30 600	4 800	3 840	1 479	106 000
	19%	**29%**	**14%**	**29%**	**5%**	**4%**	**1%**	**100%**
Construction	19 900	27 600	24 100	13 300	2 300	996	320	88 500
	23%	**31%**	**27%**	**15%**	**3%**	**1%**	**40%**	**100%**
Wholesale trade	900	3 200	3 300	8 900	3 270	660	577	20 800
	4%	**15%**	**16%**	**43%**	**16%**	**3%**	**3%**	**100%**
Retail trade	91 700	120 300	53 200	43 300	13 100	970	744	323 300
	28%	**37%**	**17%**	**13%**	**4%**	**0,3%**	**0,2%**	**100%**
Catering & Accommodation	2 300	3 300	5 700	660	3 450	385	124	21 900
	11%	**15%**	**26%**	**30%**	**15%**	**1%**	**60%**	**100%**
Transport	7 600	28 400	14 600	6 200	1 400	293	303	58 800
	13%	**48%**	**25%**	**11%**	**2%**	**0,5%**	**0,5%**	**100%**
Finance & Business services	7 700	25 400	15 100	24 300	4 600	301	425	77 800
	10%	**33%**	**19%**	**31%**	**6%**	**0,4%**	**0,5%**	**100%**
Community, social & personal services	18 900	30 300	23 600	28 400	4 900	525	388	107 000
	18%	**28%**	**22%**	**27%**	**5%**	**0,5%**	**0,4%**	**100.00%**
Total	184 400	283 300	182 800	180 000	58 900	11 322	6 017	906 700
	20%	**32%**	**20%**	**20%**	**7%**	**1%**	**1%**	**100.00%**
Source: Ntsika, *State of Small Business in South Africa*, 1999, p. 50.								

Table 2.3: Summary of Enterprises in South Africa

The table shows that only about 1% of the number of firms in South Africa at the time the report was done were large corporations. The small enterprises sector therefore plays an important role in the South African economy (Gumede, 2002).

2.10 SUPPORT MEASURES FOR SMMES IN SOUTH AFRICA

According the Banking Association of South Africa (www.banking.org.za) the SME sector of the economy is actively promoted by a number of government initiatives, including:

- The National Small Business Act of 1996, which defines SMEs and provides for the establishment of the National Small Business Council and the Ntsika Enterprise Promotion Agency (Ntsika).
- Khula Enterprise Finance is charged with helping small and medium sized enterprises secure finance, primarily through the provision of security on behalf of

small businesses to commercial banks, retail financial institutions, specialist funds and joint ventures, as well as offering loans through partner intermediaries.

The important role that SMMEs play in South Africa has largely been recognized, what remains therefore is the establishment of support mechanisms to ensure that the sector can realize its potential (Butcher 1999, Davies 2001). According to The Banking Association South Africa and member banks are committed to SME development and support through stakeholder engagement, and involvement or ownership of several initiatives. Initiatives of the Banking Association in SME Development include the following:

- Financial Sector Charter and BBBEE.
- Finance and Investment Committee – Credit Extension to distressed SMEs (a response to the global crisis) – NEDLAC.
- Financial Sector Program (FSP) – USAID.
- SME Financial Literacy - BANKSETA and FSP.
- Risk Capital Facility (RCF) - EU fund admin by the Industrial Development Corporation.
- Stakeholder engagement - Gauteng Dept. of Economic Development, Industrial Development Corporation, Khula, Small Enterprise Development Agency, South African Micro-Finance Apex Fund, Development Finance Institutions, Department of Trade and Industry, and donors etc.
- Research and Knowledge Management.
- Downstream banking and Financial Inclusion - Micro-Finance, Co-ops & Co-op banks.

Urban and Naidoo (2012) recommended that the government of South Africa set up institutions to help SMME owners acquire specialized skills in operations management of their enterprises.

2.11 SMME INSTITUTIONS IN SOUTH AFRICA

Various institutions have been set up in South Africa specifically to assist SMMEs in various areas. Some institutions, although not focusing specifically on the SMME sector provide support to the growth of the SMME sector in South Africa.

2.11.1 National Small Business Act

The National Small Business Act is the major piece of legislations providing a framework for the support of small enterprises in South Africa. The National Small Business Act of 1996, which defines SMEs and provides for the establishment of the National Small Business Council and the Ntsika Enterprise Promotion Agency (Ntsika).

2.11.2 National Small Business Council

The Small Business Council was responsible for policy advice to national, provincial and local government.

2.11.3 Small Enterprise Development Agency

The Small Enterprise Development Agency (SEDA) was established in December 2004 as an agency under the Department of Trade and Industry **(**the DTI**).** The establishment was done by merging three organisations, namely the Ntsika Enterprise Promotion Agency, National Manufacturing Advisory Centre (NAMAC), and Community Public Private Partnership Programme (CPPP). The GODISA Trust and National Technology Transfer Centre were integrated into SEDA in April 2006, becoming the SEDA Technology Programme (STP).

SEDA provides business development and support services for small enterprises through its national network, in partnership with other role players in the small enterprise support. SEDA also implements programmes targeted at business development in areas prioritised by the government.

2.11.4 Small Enterprise Finance Agency

Small Enterprise Finance Agency commonly known as SEFA was established in the year 2012 as a result of the merger of South African Micro Apex Fund, Khula Enterprise Finance Ltd and the small business activities of Industrial Development Corporation. Khula Finance had the mandate of improving the SME sector's access to finance, primarily through the provision of 'wholesale finance' or guarantees to retail financial intermediaries, which, in turn, finance the SME sector. SEFA'S mandate is to foster the establishment, survival and growth of SMMEs and contribute towards poverty alleviation and job creation in South Africa. The mission of SEFA is to be the leading catalyst for the development of sustainable Survivalist, Micro, Small and Medium enterprises through the provision of finance. SEFA has nine regional offices around the country. SEFA provides direct lending products to small enterprises which include bridging loans, term loans and structured finance products in addition to wholesale lending products which include lending to microfinance intermediaries, retail finance intermediaries and specialized funds.

2.11.5 Banks

Commercial banks in South Africa provide lending to SMMEs through various facilities. However the banks have often been criticized for not providing enough financing to SMMEs (Beck, et al 2008). Non-Bank Financial Institutions (NBFIs) like microfinance institutions (MFI) also have a role to play in providing finance to SMMEs. Bank lending to the SMME sector has however not always been adequate (Mutezo 2005). Berry et al, 2002 states that the SMMEs may be to blame for failing to access bank loans because they do not always present full accounting records which makes it difficult for the financial institutions to evaluate creditworthiness of the SMMEs. Berger and Udel (2006) cite the problem of information opacity for SMMEs making it hard for banks to assess credit applications by these enterprises. Despite these challenges, bank financing remains very important as a source of finance for South African enterprises (Mutezo 2005).

B. SMME FINANCING AND FINANCING THEORIES

2.12 INTRODUCTION

This section focuses on financing for the SMME sector in general. The section reviews literature on SMME financing from across the world. In addition the chapter will also review the role of SMMEs in national economic development. Many studies have identified lack of access to finance as the key constraint to development of the SMME sector in most developing economies. The chapter also reviews literature on the methods of financing SMMEs across the world, with particular emphasis on South Africa. While governments have in most instances made arrangements for small enterprises to access finance, most of the funded small enterprises still fail to grow. This chapter also reviews literature on this topic.

2.13 THE ROLE OF SMMEs IN NATIONAL DEVELOPMENT

SMEs have now come to occupy a privileged place in international development literature. Castel-Branco (2003) says that arguments for the role of SME sector in economic development come from almost all corners of development literature and economic programmes, particularly in the case of Least Developed Countries (LDCs). Many authors have shown that developed countries that encouraged and supported entrepreneurship and SMEs have higher growth (e.g. Schimitz (1989), Acs (1992), Calderon and Nickel (1998) and Audretsch and Thurik (2000)). Enterprises including small and medium-sized enterprises, supported by venture capital are vital in bringing economic growth and sustainable development to African economies (AVCA: 12). Kovacs (2000) provides some interesting data about the role of SMEs in Europe. He claims that SMEs account for a large portion of Europe’s economic and professional activity and in practice 99% of all businesses in Europe are SMEs and they provide two thirds of all private sector jobs in the EU.

Urban and Naidoo (2012), quoting Naude (1998) state that small and medium enterprises (SMEs) are seen by policymakers as an ideal way to increase sustainable development and were a pivotal to the growth and development of the South African economy (Butcher, 1999) and the government was pinning its hopes on the sector for economic empowerment, job creation and employment within the disadvantaged communities (Davies, 2001). Urban and Naidoo (2012) further state that the SME sector has a valid claim to increasing relevance and the developed world was crafting strategies to ensure that the sector expand and is integrated into the mainstream economy (Luiz, 2002).

Writing in the Milken Institute Review (second Quarter 2005), Patricof and Julie Saunderland (quoted in AVCA, 2000), explain that “Like their counterparts in wealthy nations, SMEs in poor countries are responsible for a disproportionate amount of innovation, growth and employment compared to the resources they consume. Yet… they have little access to the long term capital they need to grow."

2.14 THE PROBLEM OF SME FINANCING

Financial literature has discussed reasons why it is harder for SMEs to access debt financing. For example, Berger and Udell (1995) found that small and young firms – with generally shorter banking relationships – pay higher interest rates and are more likely to be required to pledge collateral. Since the seminal work by Jaffee and Russell (1976) and Stiglitz and Weiss (1981), the argument that there are frictions in capital markets that make it difficult for firms to obtain external financing and constrain their investment decisions has increasingly been gaining ground in the economic and financial literature (see Fazzari *et al.* 1988 and the studies mentioned by Hubbard 1998).

The finance gap hypothesis suggests that small and medium sized enterprises (SMEs) suffer from a shortage of finance and that informational asymmetry is the likely cause of this problem (Ang, 1992; Avery, Bostic, and Samolyk, 1998; Berger and Udell, 1998; Gregory, Rutherford, Oswald, and Gardiner, 2005). That there are financial differences between the SME form of business and the publicly listed forms of business have long been agreed. Vos (1992) simply states that the two forms of business are not financial clones of each other.

Vos *et al* (2005) however argue that SMEs are financially contented. They say that literature points toward SME financial contentment and control by suggesting that most SMEs do not opt for rapid growth (Curran, 1986; Hakim, 1989) and that most SME owners prefer to retain control by not applying for external capital (Curran, 1986; Jarvis, 2000). Internal equity, as opposed to external equity, is the main source of finance for SMEs (Ou and Haynes, 2003). Yet, the conventional wisdom suggests that informational opacity hinders SMEs' access to external funds (Ang, 1992; Berger and Udell, 1998, Gregory et al, 2005).

SMEs, it seems, live in a world where growth is the normative expectation but they are unable to grow due to informational asymmetry which results in a finance gap contributing to the inability to grow (Vos *et al*, 2005). In the absence of transparent disclosure, SMEs are less able to send credible signals to venture capitalists, banks, or trade creditors. This lack of transparency implies that SMEs have limited access to external funds due to informational asymmetries.

Storey's (1994) overview of bank lending to SMEs highlights a number of assumptions that underpin the research literature: asymmetric information; agency issues; higher objective risk in lending to small firms; costly monitoring; competing banks; the variability of entrepreneurs with regard to their ability, honesty and motivation; and the view that entrepreneurs gain from increased project valuation while banks gain only from repayment. Cole (1998) shows that potential lenders are more likely to extend credit to SMEs in the presence of pre-existing transactions. Further, if the finance-gap hypothesis holds true, growth-oriented SMEs are less likely to acquire loan approval to fund growth opportunities (Vos *et al*, 2005).

Independence and control are oft-given reasons for the differences in SME financial behaviour (Curran, 1986; Jarvis, 2000) compared to what might be expected of the publicly listed firm. Financial analysis of SMEs, therefore, traditionally begins with the presumption that growth is expected (Berger and Udell, 1998, Gregory et. al., 2005), but market failures (Stiglitz and Weiss, 1981) or credit rationing (Storey, 1994) restrict growth. Further, SMEs 'over' or 'under' invest (Ang, 1992) and suffer from agency costs (Ang, Cole, and Lin, 2000). It seems that SMEs are financially frustrated.

Satio and Villanueva (1981) and Peel and Wilson (1996) showed that in general SMEs have higher costs and reduced access to financing because of the information asymmetries associated with newer, smaller firms. Furthermore, Levy (1993) concluded that restricted access to financial services slows the growth of SMEs. Great part of the literature acknowledges that entrepreneurship is the fundament of the economic growth and productivity performance (OECD, 2004) and, as such, it triggers creating innovative small firms, which in turn add huge "blocks" in building the national competitiveness (Pandey et al, 2003). But, on the other hand, because of the high start-up risk and informational inconsistency, small firms are often highly vulnerable (Berger and Udell,

2002) and face with a harsh financing issues due to the investors' refusal to "feed" the early stage business (Gans and Stern, 2003). In the words of Reynolds (2000, p.52), "the problem is that once you have bled your friends and family dry of cash, sold the cat and remortgaged the house, where do you go in order to get the wad of cash needed to progress your get-rich idea further?"

2.15 METHODS OF FINANCING SMEs

2.15.1 Equity Capital

The commonly held view is that firms at start-up have difficulty accessing external finance due to informational opacity. In this regard, the personal wealth of the owner is an important factor in entrepreneurship, as outlined by Evans and Jovanovich (1989) and Rosen (1998). The personal resources of the firms' owner are most important at the "start-up" stage. This includes not only funding from friends and family, but also the provision of personal assets to secure funding for the business.

Start-up and early stage firms may face particular difficulty in sourcing finance for investment for a number of reasons. Firstly, internal equity is limited as sufficient profits may not be generated, and the personal resources of the firm owner and his family are limited. Secondly, a combination of information asymmetries and agency problems related to the lack of a trading history restricts access to external debt, which may be exacerbated by the lack of collateralisable assets. For these reasons, start-up and early stage firms may resort to external equity, particularly private investors and business angels (Berger and Udell, 1998, p.624). According to Bhaird and Lucey (2005) SME owners willing to cede control may attract funding from venture capitalists, especially firms with high-growth potential. Government grant schemes and tax incentive equity schemes may also be important sources of external equity financing for fledgling firms, especially in strategically targeted sectors e.g. high-tech (Bhaird and Lucey, 2005).

If the firm is successful as it grows, retained profits are reinvested in current and capital projects, augmenting personal sources of funding. A continued preference for internal equity increasingly relies on accumulated retained profits as the firm ages and accumulates profits. Consistent with Myers' (1984) Pecking Order Theory, Bhaird and

Lucey (2005) proposed and tested the hypothesis: Retained profits become a proportionately more important source of funding as the firm ages. The results they got from the sample of Irish SME were positive thus supporting their hypothesis.

Small companies in some developed and developing companies are able to raise finance by listing on SME exchanges or through Initial Public Offerings (IPOs) on the main exchanges in their countries, for example in the UK there is the Alternative Investment Market (AIM) for small companies to list their securities. Those companies still choosing to list on the increasingly mature Alternative Investment Market (AIM) have sought to benefit from the opportunity to raise significant funding without debt and a heightened corporate profile, with the credibility which quoted status brings. AIM allows smaller, fast-growing companies to access its pool of investors without the demanding trading history and regulatory requirements of the main market. However, a company joining either market will certainly be struck by the reporting obligations and higher level of visibility in addition to the costs and planning needed to even to get to market, so it is not a step to be taken lightly (http://www.officefile.co.uk/sme-raising-capital.htm)

2.15.2 Bank Loans

Previous research identified the lack of collateral as "one of the most important hindrances in small enterprise development" (Tacis 2002). Hubert and Matthey (2003) also report that high interest rates are often stated by firms and entrepreneurs as impeding access to finance. Other issues are equally important and explain why agencies with excess funds may not be willing to lend such funds do deficit economic units. For example, Brush and Chaganti (1998) found that ownership structure and creditors' rights protection have significant positive influence on the size and performance of SMEs. Furthermore, Beck Demirguc-Kunt, and Maksivmovic (2002) showed that small firms are most credit constrained as a result of underdeveloped financial and legal systems and higher corruption.

Young, small firms and high growth firms are often associated with asymmetric information thus banks are less willing to lend long term to these firms. Banks therefore prefer to issue loans using tangible assets as collateral, also due to asymmetric information, they are less likely to issue loans to more opaque firms such as small and high growth firms.

Berger and Udell (2005) suggested a new framework for the analysis of credit availability to SMEs. In this framework, lending technologies are the key conduit through which government policies and national financial structures affect credit availability. They define a lending technology as a unique combination of primary information source, screening and underwriting policies/procedures, loan contract structure, and monitoring strategies/mechanisms. Lending technologies have been categorized into transaction lending technologies and relationship lending technologies. Under this categorization, transactions lending is generally viewed as being focused on informationally transparent borrowers, while relationship lending is seen as used for opaque borrowers.

Bank loans however may not always be the right kind of capital for SME entrepreneurs with positive NPV projects. According to the UNIDO paper (2001) the loan does not always provide the right type of capital to entrepreneurs. The highly leveraged entrepreneur will have only a very limited capacity left to obtain additional capital or short-term loans that are often required in a start-up or expansion phase, and usually interest payments start immediately, depriving the enterprise of funds in a stage where it needs all the funds it can get. All too often this problem of the "structure" of capital is overlooked, as the focus is on the absolute need for and availability of "finance".

Contrary to the conventional wisdom some researches show a positive and statistically significant impact between growth opportunities and firm leverage. However, this positive relationship is consistent with the Michaelas et al. (1999) argument, based on the idea that in SMEs the tradeoff between independence and financing availability is more pronounced and the major part of debt financing is short term. In this way, the application to the SMEs of Myers´ (1977) underinvestment problem, which could be resolved by shortening debt maturity, implies that growth perspectives may be positively related to leverage.

2.15.3 Trade Credit

According to a research by Berger and Udell (1998) a sizable 15.78% of total small business assets in the USA are funded by trade credit, as measured by accounts payable at the end of the prior year. They conclude from this study that clearly, trade credit is extremely important to small business finance, but has received much less research interest than commercial bank lending, which provides only slightly more credit to small business. The basic idea is that firms with direct access to financial markets, in general large well known firms, issue trade credits to small financially constrained firms (Bernanke and Blinder, 1988). Although relatively expensive, a small amount of trade credit may be optimal from the viewpoint of transactions costs, liquidity, and cash management and may help give the borrowing firm and supplier information that helps predict cash flows. Since small firms, in general, have no reputation then these firms are forced to use trade credits to signal the quality of their products. (Bartholdy and Matteus, 2008)

2.15.4 Other Debt

Bartholdy and Matteus (2008) define other debt as composed of credit card debt, car loans etc. that are more expensive than bank loans as they carry higher interest rates. The variables determining this type of debt are financial health and performance, just like for bank loans. These kinds of debt are very little researched and there is little empirical data on the subject.

2.16 SMME FINANCING AND GROWTH

In 2008 Hussein and Aldy investigated the magnitude of the financing barrier in Egypt and found out that the lack of suitable financing was a major barrier to small business growth. Similar results emerged from Robson and Obeng (2000), in a survey they carried out among entrepreneurs from Ghana. External financing is needed not only at the start up stage but also for the development of new products and business expansion (Atieno, 2009). Clarke et al (2010) provide evidence that availability of finance positively impacts on firm performance and hence enterprise growth. Financing structure is however also important as Martinovic (2008) proves that high debt levels can be harmful to business growth.

2.17 CAPITAL STRUCTURE AND SMME GROWTH

Olufunso, Herbst and Roberts-Lombard (2010) investigated the impact of capital structure on performance and growth of small enterprises in the Buffalo City Municipality in South Africa and found that the usage of debt has a negative impact on performance of small enterprises in the area. Previously studies on capital structure, in particular debt usage, had focused on larger enterprises and ignored smaller enterprises (Eriotis et al, 2002). These studies established a positive relationship between debt usage and enterprise performance. Olufunso et al (2010) argued that these studies may not be portable across business sizes and hence debt usage could yield different relationship to firm performance for small enterprises. Capital structure theory has its roots in the seminal paper by Miller and Modigliani of 1958 and 1963, which established the advantages of debt due to its tax deductibility of debt costs (interest). Olufunso et al (2010) argue that in looking at SME financing and growth it is important to not only look at availability of financing but there is also need to look at types of capital and capital adequacy. It is therefore important to look and the link between debt usage and profitability and growth of small enterprises given the role that this sector was expected to play in economic development and wealth distribution.

Previous studies done in South Africa on debt usage (Negash, 2001 and Negash, 2002) established that there was a positive link between performance and debt usage in line with Miller and Modigliani (1963) and also in line with studies carried out in developed countries. However these studies looked at debt usage by firms listed on the Johannesburg Stock Exchange and hence the results may not be applicable to smaller enterprises. The use of debt in a small enterprise can be positive or negative depending on whether the return on assets is higher than the cost of debt (Corriera et al, 2003). The use of debt can be problematic for small enterprises in South Africa especially with the high cost of debt, and more than half of them have been adversely affected by the cost of debt (Falkena, et al, 2002).

2.18 SMME BUSINESS FAILURE

Literature reviewed so far has shown how financing is one of the major cited barriers to the growth and development of small firms. Robson (2001) indicate that in Canada small enterprise failure remains very high at 68%. A number of studies (Gumede 2004, Mutezo 2005 and Rodgerson 2008) note that despite the important role that the small enterprise sector play in South Africa, the failure rate of small enterprises remains very high in South Africa. Brink et al 2003 report the failure rate of new enterprises to be as high as 70% to 80%. The result is that the regions in which the SMME operate will lose jobs and wealth. It is important therefore that the root cause of the business failure is researched (Sha, 2006).

C. INTERNAL BARRIERS TO SMMES GROWTH

2.19 INTRODUCTION

This section focuses on internal barriers to SMME growth. Internal barriers are barriers that arise due to circumstances within the firm and include factors such as the people in the firm and how the firm’s finances are managed. It also includes internal control systems. Previous sections looked at external barriers to SMME growth, in particular financing barriers. This section reviews literature on internal barriers to SMME growth. It looks at human capital barriers and also financial management, with emphasis towards accounting information which is important for enterprise control.

2.20 HUMAN CAPITAL AND ENTERPRISE GROWTH

Oluwale and Garwe (2010) stated that for small enterprises, the human capital base was one of the major determinants of growth. Human capital is the stock of competencies, knowledge and personality attributes embodied in the ability to perform labour so as to produce economic value (Sullivan and Shefrin (2003), quoted in Fatoki, 2011). The most critical human capital resources are likely to be held by owner-managers (Ahmed et al, 2010). The stock of human capital an enterprise possesses therefore is the most important determinant of growth. The skills and experience of the owner managers are therefore the key determinants of business failure (Fatoki, 2011). Lack of knowledge and skills for the owner managers often times is the root cause of problems encountered by small enterprises (Marshal and Oliver, 2005).

New enterprises in South Africa often fail due to lack of education and training among owner managers in South Africa (Herrington, et al 2009). This is supported by findings from Gumede and Ramussen (2002) which show that small enterprise owners lack in networking skills. These results are however in contrast to those found by Rowley et al (2000) where no firm relationship was found between firm performance and social capital of owner managers. Although some studies fail to establish the link between human capital and performance (e.g. Letao and Franco, 2008) the majority of the studies have established a positive relationship between human capital and firm performance (Van Praag and Cramer, 2001, Bosma et al, 2004, Fatoki 2012). Given the link between human capital and small enterprise growth, it is therefore important to ensure that employees in an organization is well trained and possesses relevant experience to ensure value creation (Fatoki (2012), Schultz (1961). Investing in human capital leads to increase in human productivity and consequently leading to a positive return and sustainable growth for the small enterprise (Schultz, 1961).

Human capital refers to both employees and entrepreneurs although researchers have tended to focus on employees (Fatoki, 2012). Firms with higher levels of human capital are expected to show better growth and value creation as compared to those with lower levels. Entrepreneurial human capital refers to the owner manager's knowledge, skills and education related to entrepreneurial activity (Terjesen, 2008). Entrepreneurial human capital is very important to business growth because even where capital is made available, without good human capital the enterprise will still fail. Several studies have shown that human capital is the most cited barrier to business growth (Clarke et al, 2010, Atieno, 2009, Gumede and Ramussen, 2002).

2.21 HUMAN CAPITAL AND SMME GROWTH IN SOUTH AFRICA

The empirical findings of Fatoki (2012) established that there was significant positive relationship between firm performance and the stock of human capital that it possessed. The findings also show that an investment in human capital lead to increased small enterprise performance and chances of survival in an environment where failure rate of small enterprises was high. These findings were consistent with human capital theories by Schultz (1961) and Becker (1964). The research findings also show that external networks were important for business growth. To improve human capital and aid the growth of small enterprises Fatoki (2012) called for owner managers to invest in the areas of business and financial management. There is also need to improve on entrepreneurial education at South African universities and include entrepreneurship courses in all courses as opposed to the current situation whereby entrepreneurship was being taught only to business management students. The study also recommended the appointment of non-executive directors to complement the skills of the owner managers.

Shah (2006) noted that most small enterprises were owner managed and therefore the owner managers were responsible for the direction and success of the firm. The development of entrepreneurial human capital was therefore very important. The high failure rate of small enterprises was therefore an indication of low entrepreneurial human capital at most South African small enterprises.

2.22 ACCOUNTING INFORMATION IN SMALL ENTERPRISES

Accounting information is very useful as a tool for enterprise control and is very important as a driver of growth in small enterprises (Maseko and Manyani, 2011). However small enterprises do not always keep accounting information and usually only do so because of regulatory requirements (Lalin and Sabir, 2010). A number of operating factors determine the extent to which small enterprises keep information and these include the size of the business, nature of its operations and the age of the business (Holmes and Nicholls, 1998). The extent to which a small enterprise keeps information is usually dependent on the level of accounting knowledge of the owner manager of the small enterprise (Ismail and King, 2007). Maseko and Manyani (2011), in a study in the Bindura area of Zimbabwe found that although small enterprises kept accounting records, information kept was usually limited to sales and cost of sales and often ignored other transactions with the result that the information obtained was not always sufficient to enable proper control of the business. The study results also supported the results reported by Wahlstedt (1996) which showed that small enterprises preferred to use cash accounting as it was simple.

Small enterprises do not always prepare a full set of financial statements with most not preparing any at all (McMahon, 1999). Even where a small enterprise keeps a full set of accounting records it does not always follow that they would prepare financial statements (Maseko and Manyani, 2011). In most instances owner managers prepare the information although they may not be well versed in accounting principles. They usually do so to avoid the cost of hiring professional accountants.

2.23 FINANCIAL MANAGEMENT AND ENTERPRISE GROWTH

Financial management at small enterprises is very important. However Temtime and Pansri (2004) reveal that not all small enterprises kept books of accounts or prepared financial statements. According to Osteryoung et al (1997) ”..*while financial management is a critical element of the management of a business as a whole, within this function the management of its assets is perhaps the most important. In the long term, the purchase of assets directs the course that the business will take during the life of these assets, but the business will never see the long term if it cannot plan an appropriate policy to effectively manage its working capital".* This suggests that the poor financial management of owner-managers at small enterprises or lack of financial management altogether is the main cause underlying the problems in SME financial management.

The reason for failure among small enterprises that were subject to involuntary liquidation in the UK was found to be financial in nature among 49.8% firms in a study by Hall and Young (1991). Peacock (1995) states that studies have established the positive relationship between financial management and business failure in many developed countries. Olufunso et al, 2012 also point out that small enterprises suffer from the problem of information asymmetry between the owners and potential lenders. They argue that due to the small size SMMEs rarely kept adequate accounting records of prepared financial statements. Bose and Cotheren (1997) this lack of adequate financial information worked against the small enterprises as they were not able to supply required financial information hence they face problems with accessing debt from financial institutions.

Olufunso et al (2012) state that most SMME owners do not have basic business skills such as financial and marketing management and as such they have problems in preparing documents like budgets and business plans. They recommend that owner managers should make an effort to attend courses on financial management and the government through SEDA to provide training to small firms. To ensure that financial management in small firms is improved from the current weak financial management by requiring that small firms submit financial statements annually to the Small Business Development Agency or Statistics South Africa (Olufunso et al, 2012). In many instances owner managers have training in other functional areas and not in financial management or accounting, the result is that the financial management function is often overlooked, which explains the poor financial management practices in most of the small enterprises (Collis and Jarvis, 2000). The other problem is that the owner managers even were financial statements may be prepared they may not be able to interpret the accounts as they have no background in financial management (McChey, 1986)

Small businesses do not always apply accounting standards to the letter (Schutte and Buys, 2011). Levin and Travis (1987: 30) advocated that the financial statements of SMEs tell only half the story about private companies. As owner managers are closely involved in the day to day running of their enterprises financial statements may not always include all information. Disclosure requirements and practices for small enterprises are not closely monitored as compared to listed companies on the Johannesburg Stock Exchange (Schutte and Buys, 2011). As such the financial statements of small enterprises in South Africa may not always be available, and where they are available they may not be up to date (Schutte and Buys, 2011).

Osteryoung et al (1997) also addressed another issue that has not been taken into account in corporate finance. They argue that modern finance theory assumes that the objectives of a firm are always to maximize shareholder value. However they argue that for small enterprises which are owner managed the objective may be different. The objective may be that of providing an income for the owners, it may not necessarily be growth. Fatoki (2012) content with this assertion and state that survivalist enterprises in South Africa do not always look to growth but instead focus on providing an income. Osteryoung et al (1997) also assert that owner managers may be more interested in enjoying a particular life style associated with getting into a particular business and the objective may be divorced from the traditional goal of corporate finance of wealth maximization and growth.

2.23.1 Financial Planning in SMES

Financial planning is a plan to ensure that enough funding is available at the right time to meet the needs of the organisation for short, medium or long-term capital. For example how much money is needed to smooth out changes in debtors, creditors and other cash requirements, should a new asset be bought or leased? Osteryoung et al (1997) state that financial planning in small enterprises is very important in their quest to attain sustainable growth. Working capital management is one of the most important aspects of financial management for small enterprises, especially inventory management and debtors management. Mathuva (2009) examined the working capital management of 30 small enterprises in Nairobi, Kenya and found out that the working capital management was poor with the result that enterprise growth was subdued. The same study also showed that owner managers were not strong at financial analysis and in many cases were not able to make use of available financial information for financial planning purposes.

2.23.2 Financial Forecasting in SMEs

Financial planning also includes forecasting and hence owner managers need to have access to forecasting skills like forecasting demand, forecasting sales, forecasting debtors and credit, it is important to ensure that financial resources are available to finance any anticipated growth (Osteryoung et al, 1997). Meyer and De Wits also concur with the need for forecasting skills as forecasting is usually the basis of financial planning. Copeland et al (2000) indicate that sound historical information provides a basis for making realistic forecasts.

2.24 COMPUTER BASED ACCOUNTING SYSTEMS (CBAS)

Many organisations are deploying Computer Based Accounting Systems (CBAS) in order to gain competitive advantages. The pattern however does not seem to hold for most small enterprises, especially those in developing countries (Tijani and Mahommed, 2013). Development on the IT front is fast converting computer resources that had previously been regarded as luxuries into must have business enabling tools that support business processes (Runge and Lee, 2002). This has created many strategic opportunities for business owners (Tijani and Mahommed, 2013). Accounting information systems are required in order to capture business transactions and generate information useful for improved business decision making (Brecht and Martin, 1996). Tijani and Mahommed, 2013 note that SMEs in Nigeria played a very special role as a development tool and they argue that the fusion of CBAS in the strategic success of SMEs in contemporary economies therefore becomes inevitable if the SMEs will survive. Further, SMEs needed to build accounting information systems (AIS) and integrate them with planning, control and decision making systems. Through business performance enhancement small enterprises will be able to increase their chances of survival in the cut throat that is the business environment today. They could do this by leveraging AIS and utitlise other technologies to ensure that they reduce costs and increase competitiveness (El Louadi, 1999 and Ismail et al, 2003).

Although various stakeholders continue to engage in activities aimed at ensuring survival of SMEs, research has shown that the effective adoption of computerized systems by these firms is relatively low in most developing countries as compared to developed environments, for example, Adewoye and Akambi (2012) reported that generalized IT adoption by small and medium scale industries in Oyo State, Nigeria recorded 56.7%. Sam et al, (2012) report that among Malaysian SMEs the adoption of CBAS was as high as 80% among the surveyed small enterprises. While most of the studies have reported a positive relationship between firm performance and survival and deployment of CBAS, a study by Grande et al (2011) in Spain failed to establish a link between SME productivity and the use of CBAS.

The deployment of CBAS for small enterprises has now become easier with the proliferation of turnkey AIS suitable for small businesses like Pastel sage, Turbocash, QuickBooks and others (Tijani and Mahommed, 2013). However other small enterprises invested in general application systems like spreadsheets that were however not able to fully support the information needs of decision making, planning and control (Ismail et al, 2003). The adoption of CBAS among small enterprises in Africa therefore remained low despite the fact that these had the potential to give these kinds of enterprises competitive advantages.

2.25 CHAPTER SUMMARY

This chapter examined in broad terms barriers affecting the growth of small enterprises in general and those in South Africa in particular. Literature from across the world on barriers to small business growth was reviewed and applied to the South African context. Barriers to small business growth can be broadly categorized into internal barriers and external barriers. Internal barriers include access to finance, management skills, deployment of information and communication technologies and location and networking. External barriers include crime and corruption, economic variables and markets and labour, infrastructure and regulations.

This chapter also reviewed the definition of small enterprises. It looked at the different definitions of small enterprises from various economic jurisdictions. The definitions of small enterprises in the South African context were discussed and the various types of small enterprises as defined by the National Small Business Act were noted. The chapter further discussed the nature of SMMEs and the common characteristics of SMMEs from different countries before reviewing the role of SMMEs in the South African economy. The various institutions that have been set up to support the growth of the SMME sector in South Africa were also discussed. The chapter also reviewed internal barriers to the growth of small enterprises. In particular literature of barriers to SMME growth was reviewed with particular attention being paid to issues to do with human capital and financial management in small enterprises. The majority of literature reviewed support the assertion that growth and profitability in small enterprises is positively related to human capital and financial management in small organisations.

CHAPTER 3

RESEARCH METHODOLOGY

3.1 INTRODUCTION

This chapter mainly focuses on the research design and research instruments used to collect data. The chapter is arranged in ten (10) sections as follows: section 3.1 discusses and justifies the research philosophy adopted for this study while section 3.2 justifies the research design for the study. The research method adopted for the study is the subject of section 3.3 while section 3.4 identifies the population for the study and justification for sampling method used. Data collection process and procedures are discussed in section 3.5 and 3.6 respectively including the justification thereof. Section 3.7 discusses data processing, analysis and presentation while section 3.8 discusses measures taken to ensure validity and reliability of the research data collected using the research instruments. Ethical issues that arise from this study and how they were addressed are addressed in section 3.9. A brief summary of the chapter is presented under section 3.10.

3.2 RESEARCH PHILOSOPHY

This study was based on the positivism research philosophy. Positivism is a philosophy of science based on the view that in the social as well as natural sciences, data derived from sensory experience, and logical and mathematical treatments of such data, are together the exclusive source of all authoritative knowledge. Obtaining and *verifying* data that can be received from the senses is known as empirical evidence (Macionis and Gerber, 2003). The basic principle of Positivism is that all factual knowledge is based on the "positive" information gained from observable experience,

The study used a qualitative research design method since it wanted to solicit responses from a large number of respondents. Using a qualitative method of research the study came up with responses from the sample. The responses from the sample varied and some responses were grouped together in order to come up with percentages and figures as the statistics. Such statistics were analysed to develop conclusions in terms of barriers faced by funded SMMEs in the KwaZulu Natal (KZN) region.

The basic starting point of this study was that information was available to enable the researcher to make conclusions based on the research objectives. The study was also based on interrogation of the views of participants in the SMME sector in KwaZulu Natal (KZN), such data could be expressed mathematically thus the Positivist philosophy was considered appropriate for this study.

3.3 SCOPE OF THE STUDY

3.3.1 Survey Area

The study covered SMMEs in the KwaZulu Natal (KZN) province of South Africa. The definition of SMME is as specified in Chapter 2. The SMMEs covered where from all the sectors of the economy, including manufacturing, agriculture, retailing and transportation. KwaZulu Natal is one of the major economic provinces in South Africa with the administrative capital of Pietermaritzburg. With a population of just under 10 million as of 2011, KZN has about 20% of the South African population. There are various industries in the KZN area with agriculture forming the back bone of the province's economy as a result of fertile soils and good rainfalls. Richards Bay is the centre of operations for South Africa's aluminum industry. The vehicle-manufacturing industry has created a considerable multiplier effect in component- and service-providers. The automotive leather industry has grown rapidly, with exports significantly increasing foreign exchange earnings. As a result of abundant water resources and cheap labour, the province has recently undergone rapid industrialization with several industries found at the major industrial centres of the province. Durban remains the major commercial centre of the province and is, by many measures, rated the busiest sea port in Africa.

3.3.2 Study Units

The study covered SMMEs in all sectors from the KZN region. These SMMEs have previously or were currently being funded by the Ithala Development Finance Corporation. The entities that access financing from Ithala Finance are engaged in various business sectors although Ithala focuses on the agriculture, agri-processing, services, trade, manufacturing, construction and tourism with specific geographic areas of the province that will best realize developmental impact. SMMEs in all the sectors were included in study and candidates for the sample were chosen in a random manner through a computerized random number system.

3.3.3 Survey Population

For this study the survey population was obtained from the database of SMMEs that had previously or were currently accessing finance from Ithala Development Finance Corporation (Ithala Finance). A survey population is the list of elements from which the sample elements will be derived. Weather and Cook (2000:201) note that it is difficult in practice to find complete lists or records of elements making up a population with the result that survey populations rarely include all the elements of the population. The Ithala Finance system keeps record of all entities that have accessed financing from the corporation. The records include a lot of data which range from loan sizes, repayment history, default history and other information related to the borrower. A sample was derived from the survey population as described below.

3.4 RESEARCH DESIGN

According to Barbie (1979) a research design addresses the planning of scientific enquiry and designing a strategy for finding out something. A research design is a plan that provides a researcher with a framework to collect data (Leedy, 1980). This study is descriptive as it is concerned with finding out the factors affecting the performance of funded SMMEs in the KZN province. This study was a statistical study which attempted to capture a population's characteristics by making inferences from responses and other financial and non-financial data from SMME borrowers in the KZN province. Data were collected from a sample of SMMEs drawn from the Ithala Finance database.

3.5 PRIMARY RESEARCH METHOD

This study used the survey research method. The survey is a non-experimental, descriptive research method. Surveys can be useful when a researcher wants to collect data on phenomena that cannot be directly observed, as in the case of the present study. Data are usually collected through the use of questionnaires, although sometimes researchers directly interview subjects. Surveys can use qualitative (e.g. ask openended questions) or quantitative (e.g. use forced-choice questions) measures. This study used both questionnaires and interviews but the questionnaire was the primary research instrument. The survey method was chosen for the following reasons;

- Surveys are relatively inexpensive (especially self-administered surveys). This minimized the cost of carrying out this research as data was collected from respondents scattered across the KZN province. This allowed the study to be completed cost effectively without incurring excessive transport cost and time.
- It was possible to administer the research to remote locations using mail, email or telephone. The researcher was stationed in Durban but could effectively administer the research to respondents in Pietermaritzburg, Newcastle, Ladysmith and other areas in the KZN Province
- Many questions could be asked about a given topic giving considerable flexibility to the analysis.
- Standardized questions made measurement more precise by enforcing uniform definitions upon the participants.
- It was possible to achieve a high reliability by presenting all subjects with a standardized stimulus; observer subjectivity was therefore greatly eliminated.

The survey method allowed this study to be carried out cost effectively and with minimum time. Further the respondents were considered to be of sufficient knowledge levels to easily understand the research instruments being used.

3.6 THE SAMPLING STRATEGY

3.6.1 POPULATION

The population for this study consists of all SMMEs with operations in the KZN province. The SMMEs operate in diverse industries including agro-industrial, manufacturing, tourism, textiles, steel fabrication, timber etc. The SMMEs are derived from the eleven various administrative districts of the KZN province. This was the primary population for this study. Other information was obtained from individuals with knowledge of the KZN SMME landscape.

3.6.2 SURVEY POPULATION

The population for the purpose of this survey consists of all SMMEs that had previously or were currently accessing financing from the Ithala Development Finance Corporation over the past 10 years. The data for the population was accessible from the database kept by the Ithala Development Finance Corporation.

3.6.3 SAMPLING

A sample is a portion of the population, selected so as to represent the whole population (Mann, 1992). Cooper and Schindler (2003) describe sampling as a process by which elements of a given population are selected as representative of the entire population. By selecting some elements of the populations it was possible to draw conclusions about the SMMEs that had accessed financing from the Ithala Corporation. The following sections elaborate more on the sampling procedures used in this study.

3.6.3.1 Probability Sampling

This research used the probability sampling method. In probability sampling selection all members of the sample are selected through a random process. All the elements in the population have the same chance of being chosen into the sample. Probability sampling removed researcher bias because elements of the sample were not chosen at the discretion of the researcher (non probability sampling). With non probability sampling the probability of selection of elements would not be know and the researcher would not be sure if the sample selected was representative of the survey population.

The researcher used simple random sampling for the study. Simple random sampling is a probability sampling technique in which every population element has an equal and known probability of being included in the sample. The survey population consisted of SMMEs in the database of Ithala Development Finance Corporation. With simple random sampling each SMME had a chance of being selected into the final sample.

3.6.3.2 Sample Size

The sample size usually depends on the nature of the population to be sampled and the survey to be carried out. Where statistical analysis is to be applied there are formulae to be applied (Roberts-Lombard, 2006). There are however other considerations to be made in the choice of sample size; these include time constrains and the data collection procedures to be applied. For the purpose of this study a randomly selected sample of 300 SMMEs were selected from the Ithala Development Finance Corporation database of funded SMMEs. In choosing the sample size the following factors were taken into consideration:

- The time in which the survey must be carried out; a larger sample would not allow for data collection and analysis within the proposed timeframe for the study,
- Budget considerations were also taken into account given the available budget and the cost of travel to several economic centres of the KZN province where the SMMEs operate from,
- The sample size had to be large enough to ensure that credible conclusions could be made from the study

The chosen sample size was considered sufficient within the available time and budget to ensure that the objectives of the study were met and conclusions of the study were credible.

3.7 DATA COLLECTION PROCESS

According to Wegner (1991), research instruments are tools used in data collection to find solutions to the problems under investigation. The tools that the researcher used for collecting information were questionnaires and interviews. The following sections set out the justification and motivation for the data collection procedures that were employed during the study.

3.7.1 QUESTIONNAIRES

Questionnaires are used extensively in SME financing research (Norton, 1991; Michaelas et al., 1998), the use of questionnaire surveys has recently come back into vogue in corporate finance as witnessed by seminal studies (e.g. Graham and Harvey, 2001) and also a special issue of The International Journal of Managerial Finance (Vol.3, no. 1, 2007). In this study questionnaires were administered both in hard copy and online via email.

A total of 300 questionnaires were administered to respondents in the randomly selected sample. Interviews were also carried out with professionals in the SMME in addition to the interviews carried out with some officials from UNDP, SEDA, Ntsika, UNESCO, World Bank, IMF and Afrexim Bank. The interviews also included bank managers and the heads of SMME departments of these banks. These interviews were carried out to give a broader understanding of the SMME landscape, including challenges that the sector was currently facing. They were not used as data collection methods for the study.

Questionnaires for SMMEs were sent for the attention of owner managers or other senior managers within such firms. All this information was available from the Ithala Finance database which kept detailed contact details of borrowers. The questions in the questionnaires required such information as age of owners, amount of capital raised, sales, number of employees etc. Ang (1991) stated that SME owner-manager's personal income is interrelated with the income of the firm, and so they were reluctant to disclose detailed financial information about their business. Due to the well-documented reticence in disclosing this data, sources of financing used by SMEs at start-up and at present were requested in percentage form rather than absolute amounts.

The use of questionnaires in this study was justified for the following reasons:

- It was possible to administer and send them to a large number of people at the same time.
- The method was cost effective and convenient in collecting data.
- Questionnaires were easy to monitor and follow up.
- Use of questionnaires saved time as compared to interviews and minimised the need for physical presence by the researcher during data collection.
- Online questionnaire management is very effective but this was not used for this study due to lack of access to internet by some of the respondents in the sample. With modern trend towards paperless working environment, online questionnaire administration lent well to today's networked environments.

However, despite the above mentioned advantages questionnaires had the following drawbacks:

- Not many people may be keen to go through the printed questionnaire; hence the response rate could be lower than expected. To ensure a higher response rate follow up were made both through telephone and e-mails.
- Some of the respondents could have given incorrect and false answers wanting to shed off the hassle of filling in questionnaires. However this was not prevalent as the quality of the questionnaires returned was considered to be of high quality.
- Some of the respondents could have misinterpreted the questions and ended up giving wrong information. Questions were made as clear as possible and easy to understand. In addition the researcher made follow ups on some of the questions so as to ensure that they were clearly understood.
- Response rate could have lowered where some of the selected respondents did not have access to internet. Further some of the respondents were concerned with data usage cost. To ensure higher response rate the online form was made very simple to use and hence did not use too much data.

To counter the effect of the above weakness the researcher took the following precautions in designing the questionnaire:

- The questionnaires were made user friendly by use of clear, simple and straight forward English, in particular the use of jargon was minimised.
- Careful attention was given to the designing and analysis of the questionnaire.
- The participants were given reasonable time to respond to the questionnaires. The researcher collected completed forms from the premises of respondents and in cases where this was not possible, a return envelope was supplied.
- Email reminders about the questionnaires were sent to respondents regularly without being overly bearing

Pre-testing

Pre-testing refers to the testing of the questionnaire on a small sample of respondents to identify and eliminate potential questions (Zindiye, 2008). Elements that were tested included wording of the questions and questionnaire structure. The respondents in the pre-test should be similar to those who will be included in the actual survey (Roberts-Lombard, 2002:132). Pre-testing was necessary as it helped in identifying potential problems with the questionnaire during the actual data gathering process. These can occur for both respondents and interviewers regarding question content, "skip patterns," or formatting.

Some problems that were identified during pretesting include issues with question content include confusion with the overall meaning of the question, as well as misinterpretation of individual terms or concepts. Questionnaire formatting concerns are particularly relevant to self-administered questionnaires, and if unaddressed may lead to the loss of vital information (Snijkers, 2002:97). The questionnaire was pre-tested in a pilot study involving SMMEs in the manufacturing sector in Durban. A pilot study is described as the using of a questionnaire on a trial basis. Pre-testing is essential if the researcher is satisfied that the questionnaire being developed will perform its various functions in the interview situation. Furthermore, the data collected will be relevant and as accurate as possible, the target respondents will participate and co-operate as fully as possible and the collection and analysis of data will proceed smoothly (Cooper & Schindler, 2003:320).

The pretest revealed a few questions regarding comprehension of certain questions in the original questionnaire. However the overall response from the pretesting was satisfactory as it revealed that despite the potential of some respondents unwilling to provide data that may be deemed personal, most of the respondents were will to provide all the data requested. The performance of a questionnaire can be enhanced by the data gathering technique that was applied to the research process.

3.7.2 INTERVIEWS

An interview is a method of eliciting primary data responses through direct questioning. The interviews can be through personal telephonic conversation (Wegner, 1999). The main advantage of using an interview was that respondents were able to expand on areas of interest and use of nonverbal clues such as facial expression to emphasize their responses. The interviews were conducted in the following manner. An initial contact was made with the chosen organisation and from an informal meeting with any of the managers available during the first contact the name and rank of the person with knowledge on SMME operations was identified and an appointment made for an interview. An interview guide was left with the identified interviewee to enable advance preparations to be made for interview.

Some other advantages for interviews are that answers are provided immediately and there is room for further explanations, which made it easier for the researcher to seek clarification where there was need. The main disadvantage of interviews is that they can be time consuming and expensive to conduct. The researcher used interviews to gain more insight in the area of research from professional in the SMME operations sector and from the various development institutions with offices in Durban (where the researcher was based) and the relevant ministries. Five interviews were scheduled with professionals in Durban and of these four were successfully conducted. The interviews were all unstructured and covered a range of issues about SMME operations in KZN and other territories and were designed to gain an overview of the industry in KZN and its role in economic development.

3.8 DATA COLLECTION PROCEDURES

A number of procedures were used in collecting the data from respondents. A part time assistant was engaged at a nominal fee to assist with data collection. The procedure used for questionnaires was as follows:

3.9 DATA PROCESSING, ANALYSIS AND PRESENTATION

To prepare for data entry, questionnaires were given unique codes for all responses from respondents and a data entry template was designed in Excel. The data was entered using the same package. After entry, the data was cleaned to remove inconsistent responses by running frequency tables in the Excel. The data was then analyzed using the same package. In data analysis and interpretation, statistical principles like frequencies, percentages and mean were mainly used. Tables, graphs and charts were used in presentation of research findings and are laid out in chapter 4.

3.10 ENSURING VALIDITY AND RELIABILITY

The research literature agrees that content validation is a judgmental process that can be done in many ways. According to Cooper and Schindler (2001), a researcher may choose to use a panel of experts to judge how well the instrument meets standards or use his own judgment. This is further supported by Dzansi (2004) that a researcher can use own judgment to judge if the instrument meets the standards. In this study, the decision was made to rely on own judgment and also to solicit the views of colleagues and some experts in the SMME and development field to assess the validity of research instruments. The researcher also relied on literature (books, journals, dissertations, theses) to determine how well the research instrument met standards.

The major types of errors in research of the current nature are response and non-response errors (Loubser, 1999). These errors are discussed in more detail below. Response errors were minimised by carefully constructing and pre-testing the questionnaires. The use of self-administered questionnaires, also, assisted in reducing response errors, because unclear questions were clarified by the researcher to the respondents. However, data for the study at hand was only obtained from the firms who were willing to complete the questionnaire. This might have created a bias relative to those firms that did not participate in the survey. The number of firms that did not respond to the questionnaire relative to the total population was small hence ensuring higher reliability for the data gathered.

Loubser (1999) describes a non-response error as an error caused by failure to contact all members of a sample and/or the failure of some contacted members of the sample to respond to all or a specific part of the questionnaire. The non-response error occurs because people who respond to the survey might not have characteristics similar to those who do not. Non-response errors were reduced to the absolute minimum in the research study by repeated telephone calls and visits to the respondents to check on the status of completion of the questionnaires.

3.11 ETHICAL CONSIDERATIONS

There are several reasons why it is important to adhere to ethical norms in research. One of the most important of these norms is to promote the aims of research, such as knowledge, truth, and avoidance of error. The researcher subscribed to the common norms in academic research. These include keeping all information gathered from this study confidential. The researcher also maintained openness in dealings with the respondents in this study. The researcher also strove to maintain objectivity in analyzing the data gathered from this study. Respect for intellectual property gathered from the study was maintained and where relevant, appropriate acknowledgements have been made for information used in this study.

CHAPTER 4

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1 INTRODUCTION

This chapter presents and discusses the study findings. The chapter is arranged in thirteen main sections as follows. The first section is an introduction to the chapter. The second section and third section present the response rate and demographic data of respondents respectively. Subsequent sections present the main data from the study as follows: Funding information (section 4.4), management functions affecting business growth (section 4.5), economic factors affecting business growth (section 4.6), information technology issues (section 4.7), financial management issues (section 4.8), loan management issues (section 4.9), human capital issues (section 4.20), infrastructure and crime (section 4.11), Other issues raised by respondents (section 4.12). Last section 4.13 presents a summary of the chapter.

4.2 RESPONSE RATE

Three hundred (300) questionnaires were sent the identified SMMEs in the KZN region. Of these questionnaires sent two hundred and forty seven (247) were returned, but six (6) questionnaires were rejected implying a response rate of 82% of which 80% were valid and the data considered in data analysis. The six questionnaires rejected were due to the fact that the responses were poorly presented as to invalidate the whole questionnaire. Five interviews were scheduled with professionals in the SMME industry in the KZN region, of these, four were conducted successfully. Another interview was scheduled with the responsible manager at Ithala Development Finance and this was conducted successfully. The researcher also scheduled seven interviews with some of the SMME owners within the Durban Municipal region, of which five were conducted successfully The overall success rate for both questionnaires and interviews was 82%, enough to give valid results which could be used to make conclusions.

4.3 DEMOGRAPHICS

4.1.1 GENDER AND QUALIFICATIONS OF RESPONDENTS

The respondents were either the SMME owners or the managers of such firms. The gender distribution of the respondents was as shown in the chart below (Figure 4.1).

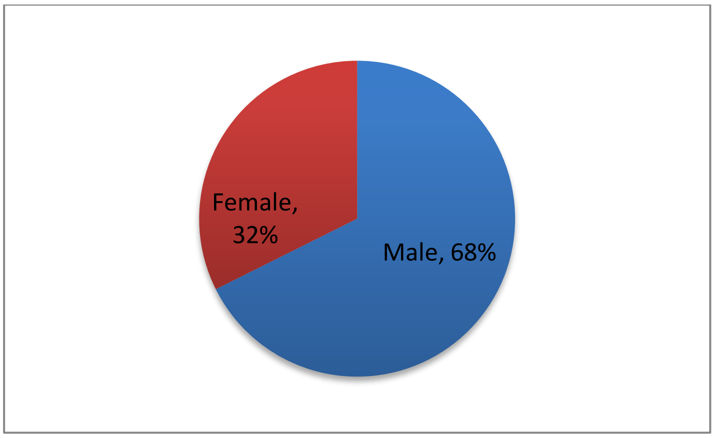

Figure 4.1: Gender of Respondents

The majority of the respondents (68%) were male with only 32% females. The results indicate that most of the decision making roles at SMMEs in the KZN region is dominated by males. Most of the respondents were the owners of the enterprise (201 or 83%) with the remainder representing the managers (17%) (Figure 4.2). The results suggest that most owners of the SMMEs are involved in the day to day management of their firms.

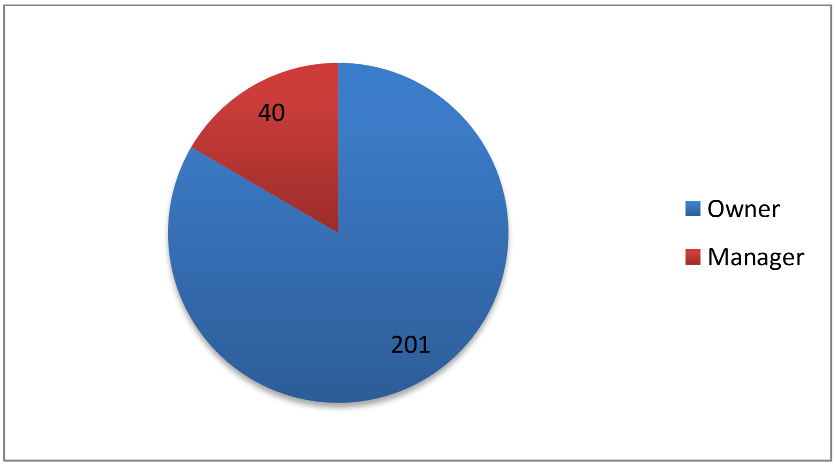

Figure 4.2: Role of Respondents

The figure below is the diagrammatic representation of the ages of the respondents

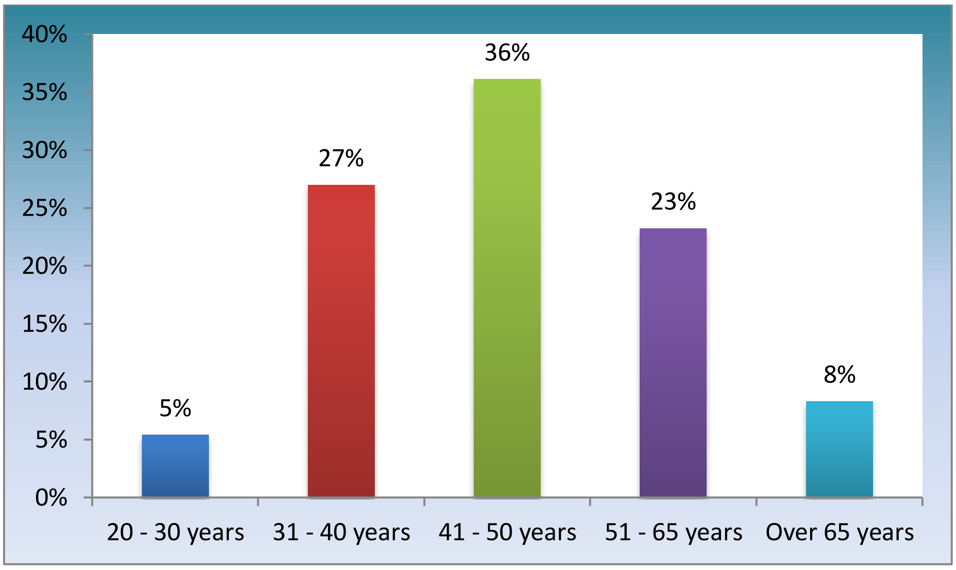

Figure 4.3: Age of Respondents

The majority of the respondents (208 out of 241 or 87%) were in the 31 to 65 years age group. The largest number of respondents was in the 41 to 50 years age group. The age distribution reflects the pattern of economic participation across the South African economy in terms of ownership of the means of production. A very small percentage (5%) of the respondents was below the age of 30 at the time of filling in the questionnaires.

The figure (Figure 4.4) below shows the educational qualifications of the respondents. The majority of the respondents had a matric qualification (40%). A number of respondents had diplomas (24%) and 15% had no formal qualification while 14% had an undergraduate degree qualification and 7% had a postgraduate qualification.

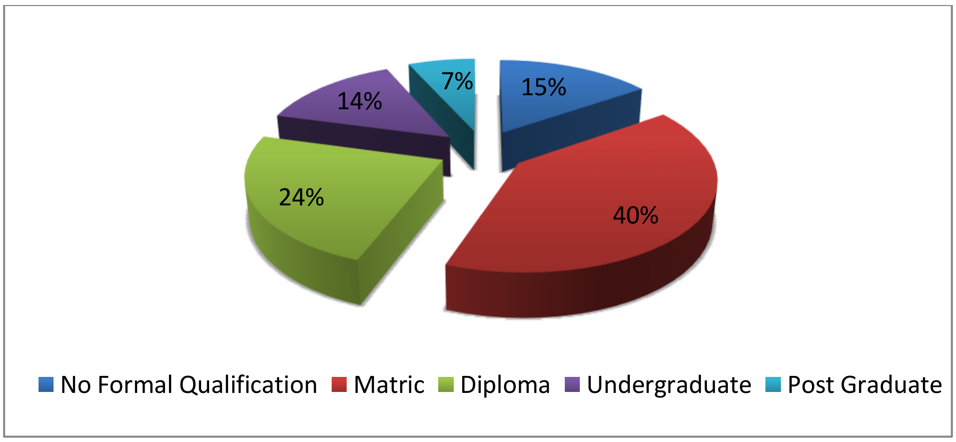

Figure 4.4: Educational Qualifications of Respondents

The results, however, do not indicate the relevance of the qualifications to the industry in which the SMME operates. The researcher also sought to understand the demographics of the owners as the respondents were not necessarily the owners of the enterprises on whose behalf they provided answers. Research results indicate that most of the SMMEs are owned by males (71%), with the remainder owned by females (29%). The results indicated the level of participation of women in the economy at the enterprise ownership level. The level of education of the owners is as shown in Figure 4.5 below.

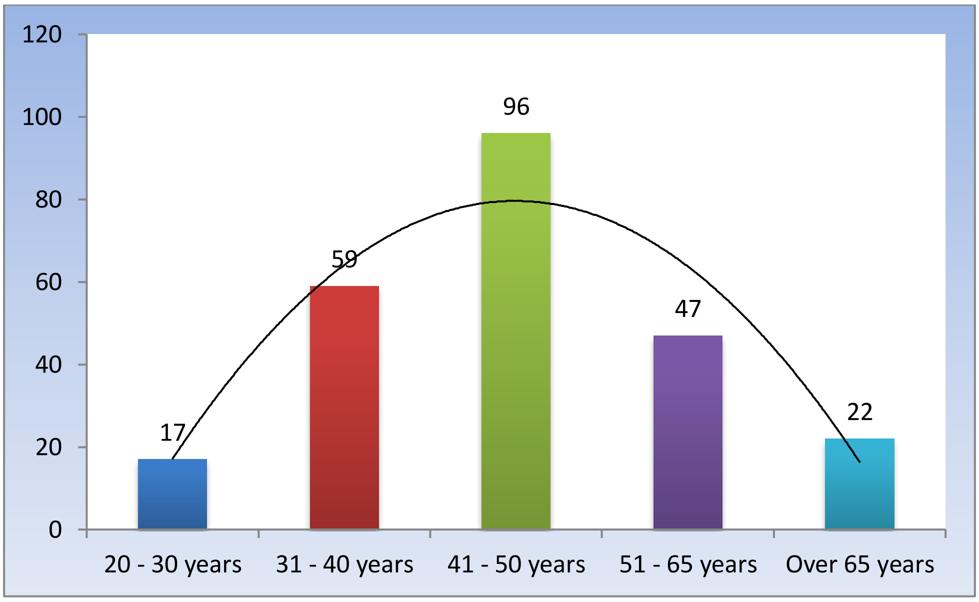

Figure 4.5: Age of SMME Owners

The above figure shows that most of the SMME owners are within the 41 to 50 years age group (40%) followed by the 31 to 40 years age group (59 of the respondents or 25%). The level of participation of the youth in the SMME sector is very low with just 7% of the owners below the age of 30. However this may be indicative of the difficulty by the youth and young firms to access finance from the development finance providers.

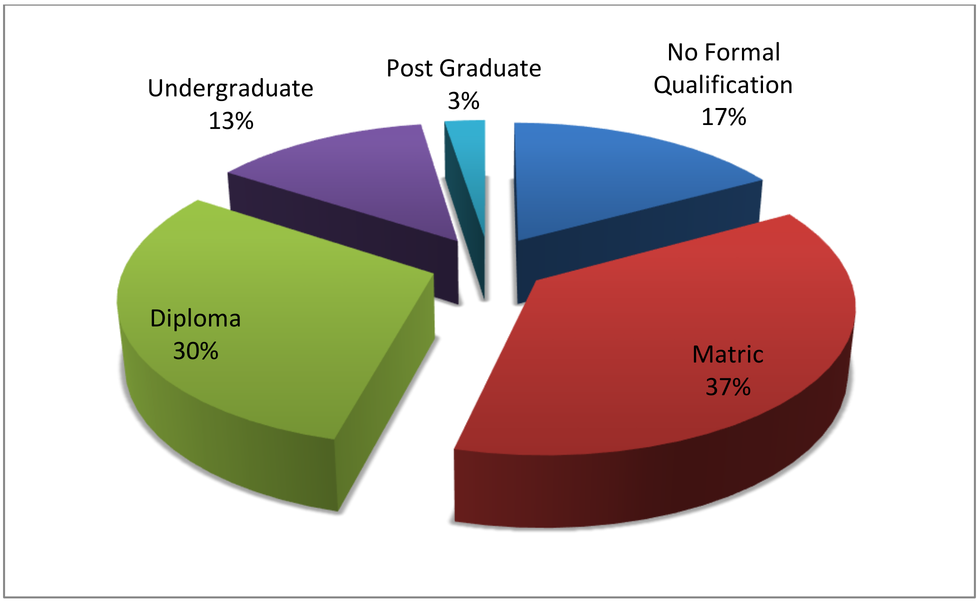

Figure 4.6: Educational Qualifications of SMME Owners

In line with the fact that most of the respondents were the owners of the enterprises on behalf of which they were completing the questionnaires, the educational profile of the owners closely those of the respondents. 7% of the owners had a post graduate qualification while 17% had no formal qualification. The other categories were undergraduates (13%), matric (37%) and diploma holders (30%). Most of the owners had at least a matric qualification.

INFORMATION ON RESPONDENT SMMEs

4.1.2 ENTERPRISE STATUS

Figure 4.7 shows the number of years each of the respondent firms has been operating

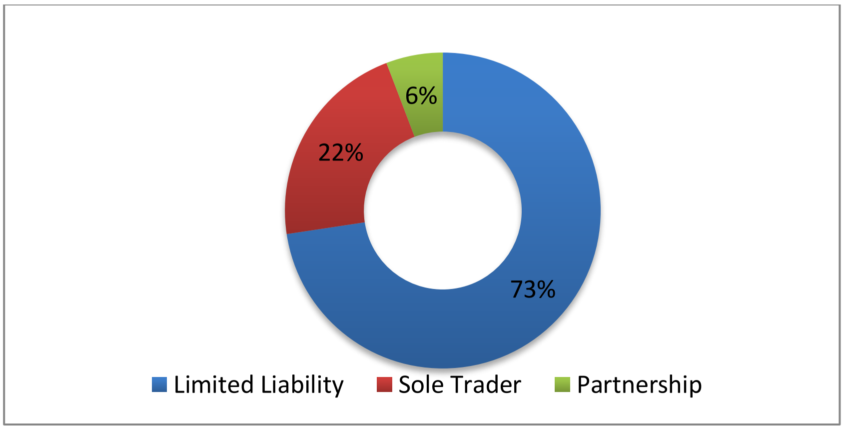

Figure 4.7: Form of the Enterprise

The majority of the firms (73%) were registered as limited liability companies, reflecting the popularity of this form of organisation and the benefits that it brings to the organisation. 22% of the firms were sole traders while the remainder (6%) were registered partnerships. While the data may show that most of the firms in the survey were properly registered this does not necessarily reflect the position of SMMEs as it can be assumed that financial institutions would insist on proper registration of the firms before they can extend development finance.

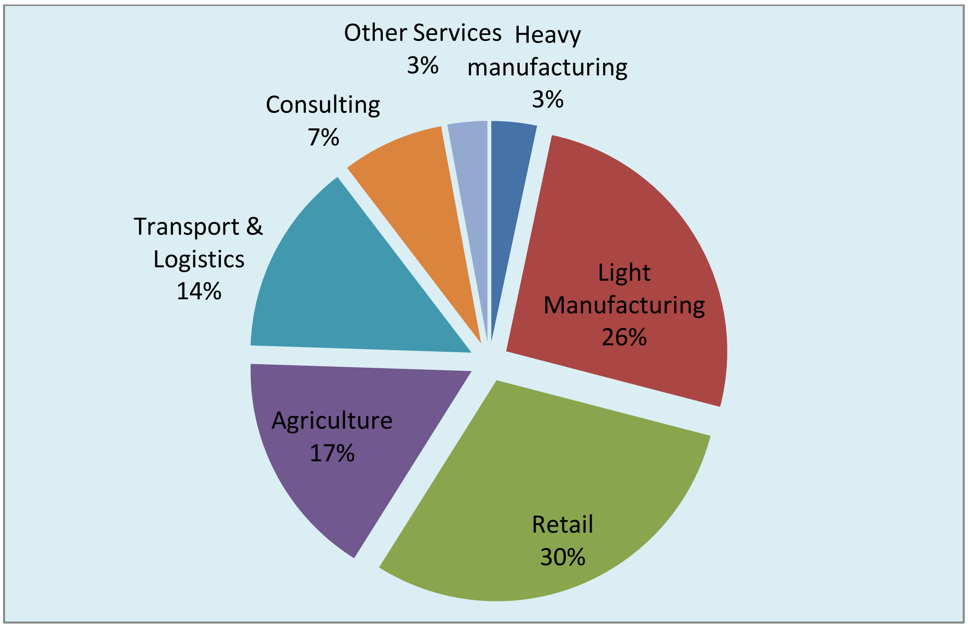

Figure 4.8: Sectorial Analysis of SMMEs

The above figure represents the sectorial distribution of the firms in the survey. Just over one quarter (26%) were in the light manufacturing sector while only 3% were involved in the heavy manufacturing and other services respectively. A significant number 30% of the respondent firms were from the retail sector, while agricultural and transport & logistics sectors weighed in with 17% and 14% respectively of the total. The consulting sector contributed 7% to the total. The sample selected was therefore diverse, roughly mirroring the distribution of SMMEs in the KZN province.

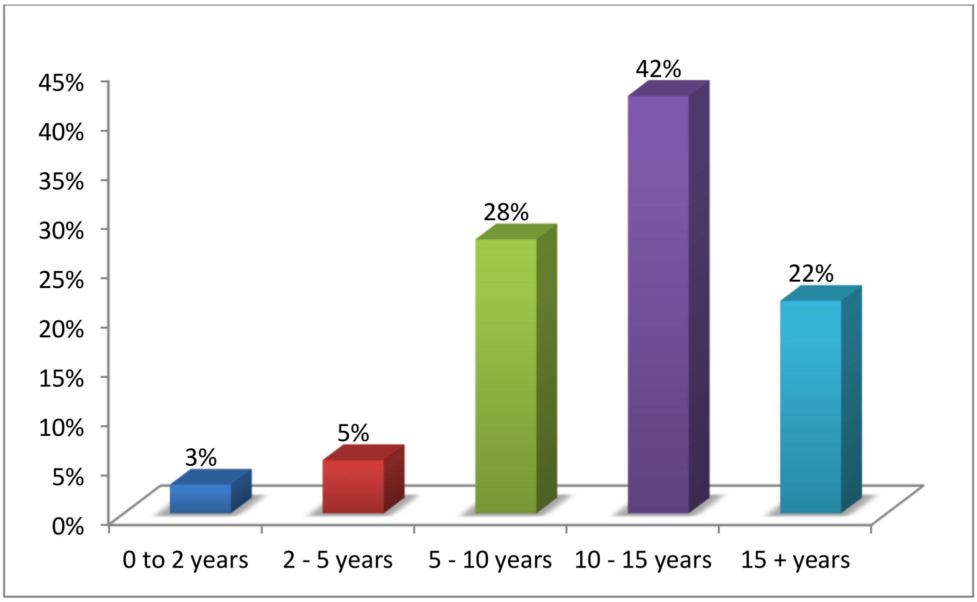

Figure 4.9: Number of Years in Operation

The above table shows that the proportion of firms that had been in operation for less than 5 years was only 8% (5% for 2 to 5 years in operation and 3% for less than 2 years). Most of the firms 70% have been in operation for between 5 and 15 years. 22% of the firms had been in operation for more than 15 years. The data shows that a number of the firms had failed to graduate from the SMME category.

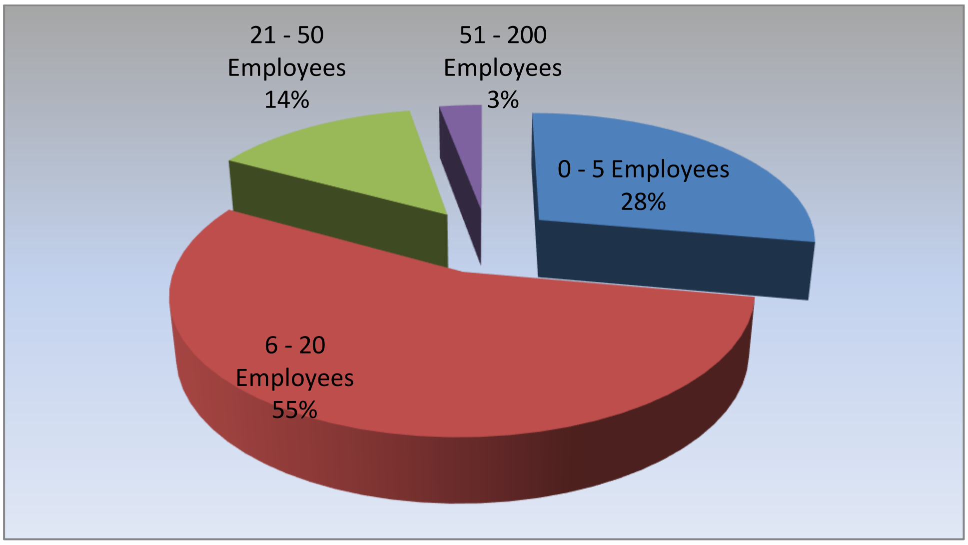

Figure 4.10: Number of Employees at the Firms

A large percentage of the firms in the study (55%) had between 5 and 20 employees. In terms of the National Small Business Act these are classified as very small enterprises (provided they meet other criteria like annual turnover and amount of assets). Small enterprises (those with between 20 and 50 employees) accounted for 14% of the respondent firms. Medium sized firms (51 to 200 employees) and micro enterprises (less than 5 employees) accounted for 3% and 28% respectively.

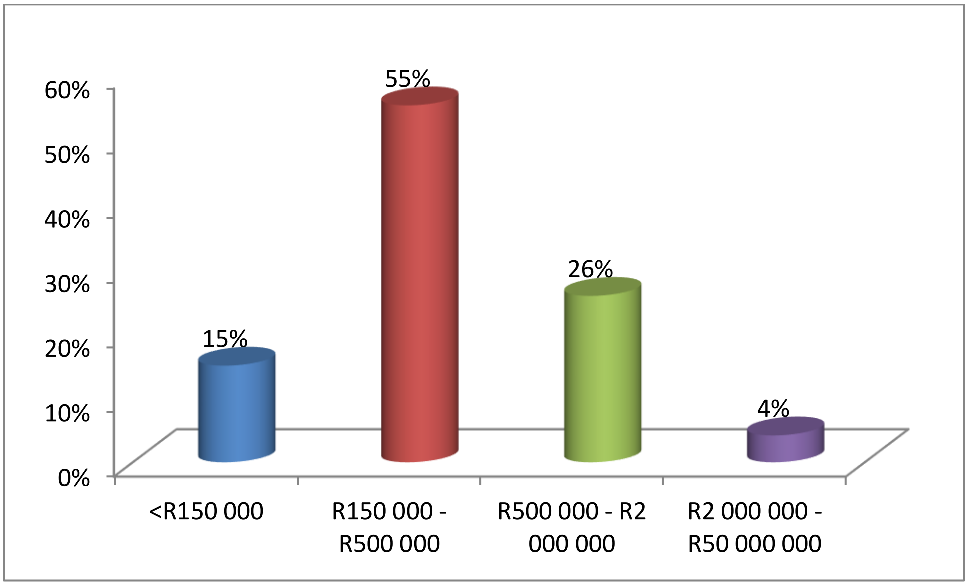

Figure 4.11: Annual Turnover

The table shows the turnover profile of the respondent firms. The majority of the firms (55%) had turnover between R150 000 and R500 000. Only 4% had turnover between R2 million and R50 million (the official definition of a medium enterprise). Microenterprises (less than R150 000 annual turnover) constituted only 15% of the respondent enterprises.

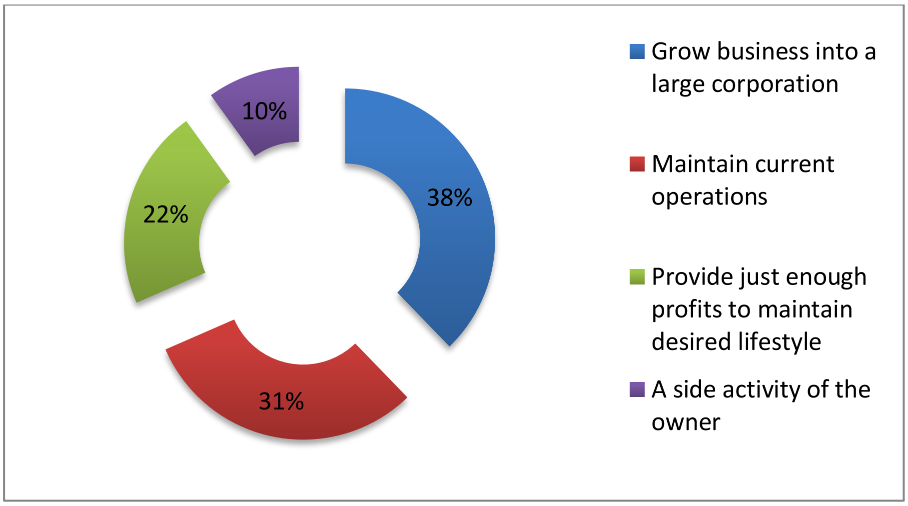

Figure 4.12: Owner Motivation

The researcher sought to understand the motivation of the owners as this would inform their views towards business growth. The results indicated that 38% of the owners/managers had the growth of the firm into a large corporation as the primary focus. Slightly less (31%) stated that the maintenance of current operations was the primary focus of management. 10% of respondents indicated that the business was a side activity of the owner and hence less focus was paid to the growth of the firm. 22% of the respondents indicated that the owners required just enough income from the business to maintain their current lifestyles.

4.4 FUNDING INFORMATION

4.4.1 Raising Startup Financing

Source of funding	***%***
Own savings	99%
Bank borrowings	10%
Government support	22%
Business angels	5%
Family/Friends	63%

Table 4.1: Funding Sources for Business Startup

Funding for start up comes from a variety of sources; however the chief source of financing start up is the use of owners' savings (Evans and Javonovich, 1989), Rosen

(1998)). Table 4.1 above shows that about 99% of the respondents cite own savings as source of financing start up. The second most important source cited is family or friend circles. These results are in line with the findings by Rosen (1998) which shows the importance of family and friends to raising start up financing. Government support was cited by 22% of the respondents while only 10% cited bank borrowings as a source of start up capital. Tacis (2002) and Bhaird and Lucey (2005) allude to the fact that lack of collateral by SME often acts as a barrier to their obtaining bank financing. These results indicate the level of reluctance by financial institutions to fund Greenfield projects or start up. The level of activity of private equity, and in particular business angels is very low as only 5% of the respondents cited this as source of start up funding. These results are in agreement with the finding of Berger and Udell (1996) who cite the fear of losing control as a possible reason why entrepreneurs are often reluctant to approach private equity firms for financing.

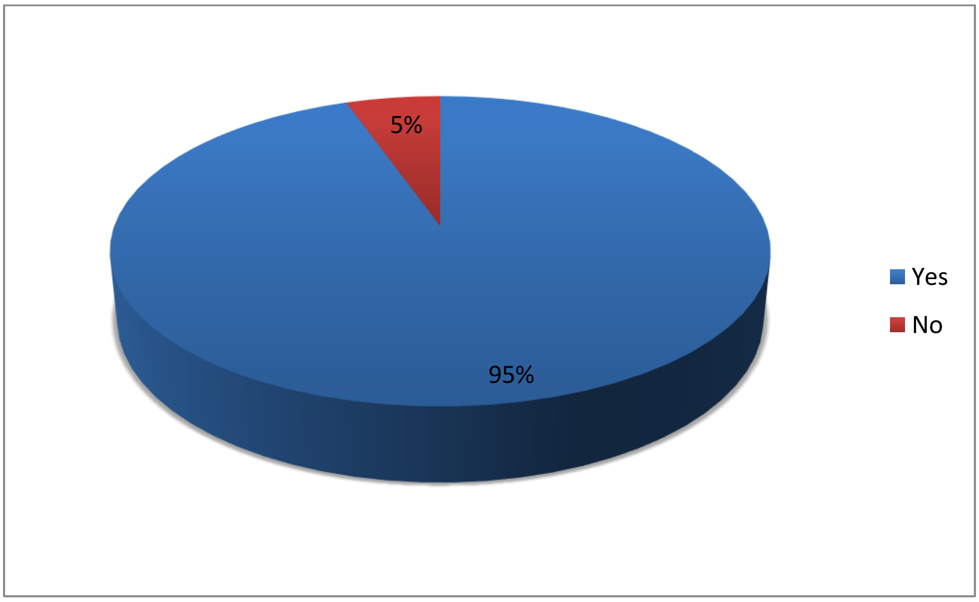

Figure 4.13: Difficulty in raising start-up financing

Respondents were asked for their opinion on the difficulty of raising startup financing. The figure above shows that 95% of the respondents had experienced difficulties in raising financing. The difficulty of raising financing by small and medium sized enterprises has been well documented in several studies (for example Fazzari et al (1998), Fummo and Jabba (2011), Olwale and Garwe (2010), Fatoki (2011)). Only 5%

of the respondents had not experienced difficulties in raising startup financing. These results indicate that raising financing still remains a challenge for SMMEs in South Africa.

Respondents were further asked to elaborate on how difficulty it had been for them to raise financing for start up. The results are presented in figure 4.14 below.

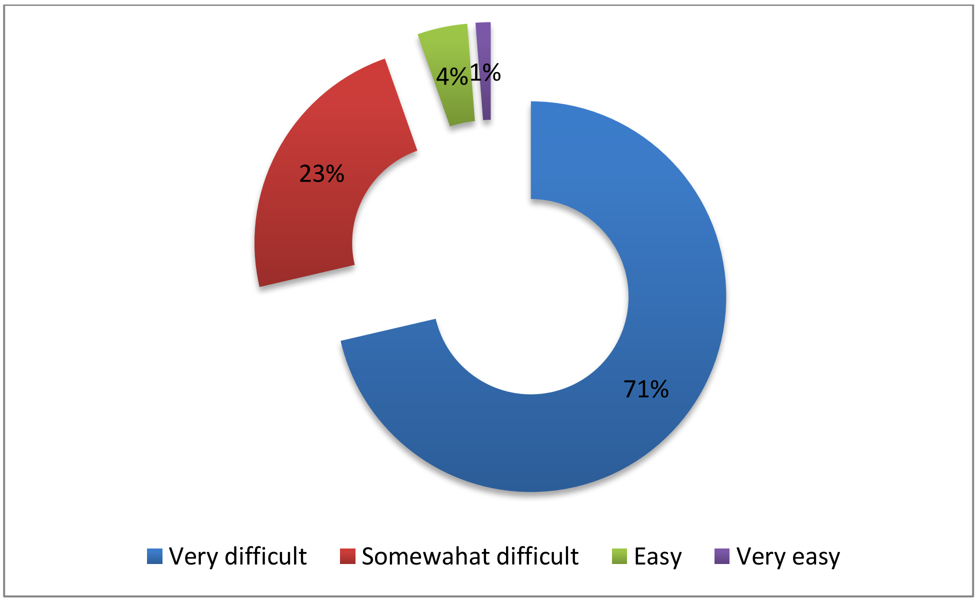

Figure 4.14: Level of Difficulty in Raising Financing

71% of the respondents indicated that raising start up financing was very difficult while only 1% found it very easy to raise start up capital. Overall 95% of the respondents indicated that it was difficult to raise finance for start up to varying degrees.

4.4.2 Raising Expansion Capital

Once a business has taken off, many business owners aspire for it to grow. While usually retained earnings may be enough, for a fast growing business in infancy stage growth often requires external financing otherwise business growth would stall. Just like raising financing for startup, raising financing to fund growth for an SMME can be challenging (Berger and Udell, 1998). The researcher sought to find out whether the firms in the sample had experienced difficulties in raising funding for expansion.

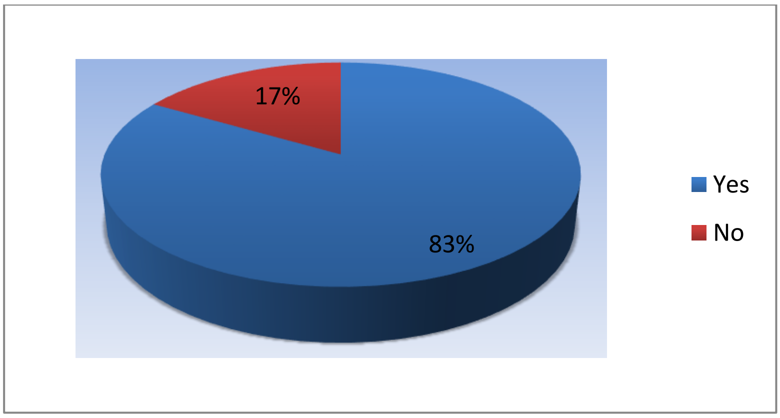

Figure 4.15: Difficulty in raising expansion capital

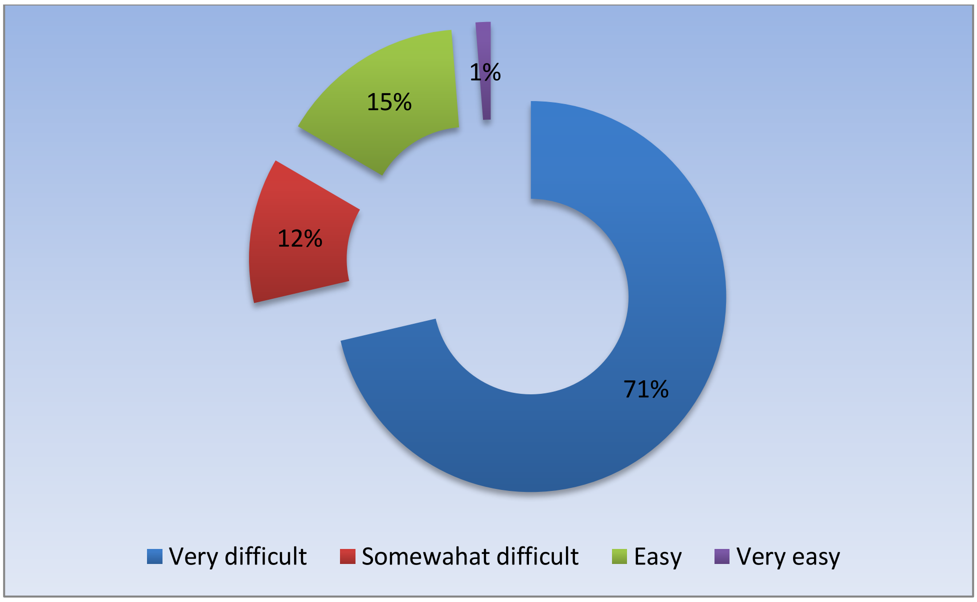

Figure 4.16: Level of Difficulty in raising expansion capital

The above figures present similar results. Figure 4.17 shows that 83% of the firms had experienced challenges in raising financing to expand operations with the remainder indicating that they had not experienced difficulties with raising expansion capital. A little less than three quarters or 71% of the respondents said it was very difficult to raise growth capital while only 1% felt it was very easy to raise growth capital. In a study of SMMEs in South Africa, Herrington et al (2009) pointed out that difficulty in raising capital was the second most cited contributor to business failure. These results also confirm several studies that highlighted the difficulties in raising expansion capital (Berger and Udell (1998), Rosen (1998) and UNIDO (2011))

Comparisons between figures 4.17 and 4.18 on difficulty in raising start up capital and growth capital shows that there is a noticeable (though slight) improvement in ease to raise capital for start up and expansion. A possible explanation could be that growth capital is needed after the firm has established itself and some of the problems of information opacity have reduced significantly. Bartholdy and Matheus (2008) point out that the problem of information opacity gets better as an enterprise trades for some years and in the process establishes a track record. Bhaird and Lucy (2005) cited the importance of retained capital in financing further business growth after the start up stage.

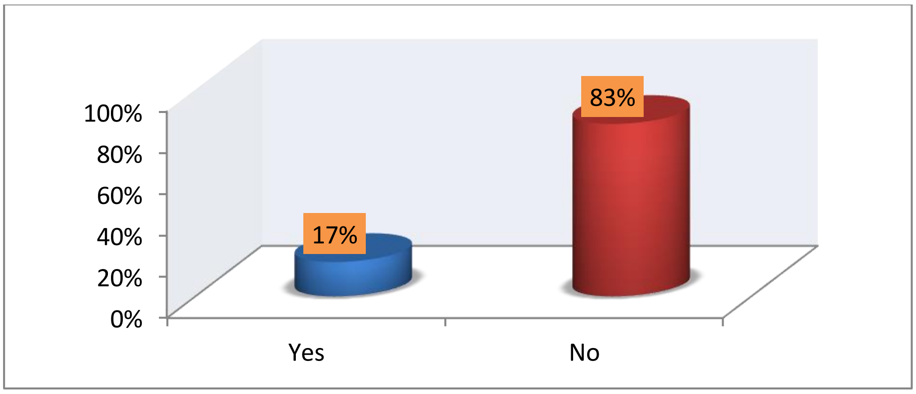

Figure 4.17: Borrowings from Multiple Sources

Enterprises usually obtain financing from multiple sources. However the difficulty of small enterprises obtaining bank borrowings is well documented (for example Tacis, 2002 and Hubert and Mattthey, 2003, Beck-Demirguc-Kunt and Maksivmovic, 2002). It would therefore be very difficult for a small or medium enterprise to get funding from another financial institution while at the same time carrying debt from another financial institution. The above results partly reflect this situation where 83% of the respondents indicated that they didn't have additional borrowings apart from the financing from Ithala Development Finance. The study did not attempt to find out the reason for this but a possible reason could be the covenants that are build into the contracts forbidding additional debt exposure while existing arrangements were current (Michaelas et al, 1999).

The study confirmed that firms obtain primary expansion capital from a variety of sources. The table below indicates these sources for the sample studied. Note the study did not include sources that did not directly affect capital structure like trade credit and order financing.

Source of Funding	***%***	***Number***
Retained Profits	92%	221
Owner additional contribution	82%	197
Bank borrowings	97%	233
Government support	27%	64
Business angels	3%	7
Family/Friends	46%	112

Table 4.2: Sources of Expansion Capital

Business angels still account for only 3% as source of expansion capital. As in the case of start up capital, business angles participation in funding SMME growth remains low (Bhaird and Lucey, 2005). This does not necessarily reflect their level of participation in the SMME growth financing sector as the sample represent enterprises that had already obtained financing elsewhere. Retained profits represent a key source of primary expansion capital (92%) as does bank borrowings (97%). These results on retained earning support the finding of Holmes and Kent (1991) and Reid (1996). However no studies have shown higher level of bank financing among SMMEs. The current study yields high results because the sample was chosen from borrowed firms. Once again it is important to put the results into context. Bank borrowings have a high incidence in the results as the sample from which the data was derived consisted of companies that already carried borrowings from Ithala. Additional capital contribution from the owners still remains important as a source of expansion although the role of family and friends is diminished slightly to 46% from 63%. This is supported by Evans and Javonovich (1989) who noted that owner’s additional contribution and that of friend and relatives remained a key source of expansion capital and start up capital.

4.5 Managerial Functions Affecting Business Performance

This research sought to find out management practice and the awareness of management functions which was hoped would shed some light as to how different management functions were being prioritized in the SMMEs. Respondents were asked to rate each of the functions on the following scale. 1 = Most Important, 2 = Important, 3 = Neutral, 4 = Less Important, 5 = Least Important. These results yielded information as to how much each function received management attention and how much time and resources were devoted to it. A higher percentage in the lower scores indicates more focus being paid towards that particular factor. The factors listed are all considered to be of importance in ensuring business growth, and as such should be prioritized by the SMMEs seeking growth.

	1	**2**	**3**	**4**	**5**
Skilled personnel	55%	21%	11%	10%	3%
Financial Management Skills	26%	19%	11%	17%	27%
Customer Care	30%	22%	14%	20%	15%
Marketing and Sales	27%	22%	22%	11%	19%
Human Resource Management	23%	28%	13%	18%	18%
Operations management	13%	15%	29%	28%	15%
Planning and forecasting	12%	11%	14%	27%	36%

Table 4.3: Managerial Functions Affecting SMME Growth

Management felt that skilled personnel were very important for business performance with more than half of the respondents (55%) indicating that SMMEs are focused with ensuring that business has adequate human resources for their needs. The distribution of the responses regarding financial management suggests that SMMEs are generally neutral as regards the importance of financial management in achieving business growth. These results are also consistent with responses regarding financial planning and forecasting where 36% of the respondents regarded these functions as least important and only 12% regarded the functions as most important. These results indicate that the financial management function, including planning and forecasting, is not considered priority in the management of the business despite the fact that they provide a basis for measuring growth.

Customer care and marketing skills are considered very important by 30% and 27% of the respondents respectively and are some of the functions that are prioritized more by the SMMEs. Only 13% of the respondents thought operations management was a very important function. These results in general indicate that SMMEs do not prioritise many of the functions that would ensure better control of their enterprises, and therefore sustainable growth. Enterprise control and management is as important as the actual business transactions that sustain the business of the enterprise.

4.6 Economic Factors Affecting Business Performance

Respondents were asked about factors that had a direct influence on the performance of your business and were required to rate the impact to the performance of their business. These factors were considered by the researcher to potentially have a negative effect on growth of the enterprises. The following scale was used in the rating of the extend to which external factors impacted on the business: 1 = Most Important, 2 = Important, 3 = Neutral, 4 = Less Important, 5 = Least Important

	1	2	3	4	5
Inflation	10%	9%	15%	26%	40%
Interest Rates	30%	25%	13%	18%	13%
Crime	27%	22%	22%	11%	19%
Infrastructure	13%	15%	29%	28%	15%
Exchange rates	17%	28%	13%	14%	28%
Regulations	32%	16%	11%	23%	18%

Table 4.4: Economic Factors Affecting SMME Growth

Most of the respondents (40%) were of the opinion that inflation was least important in its effect on the performance on the SMMEs. This is as a result of the relatively low rate of inflation in the South African economy. Interest rates were however considered to be of a significant effect on enterprise growth with 30% reporting that their effect was very important and 25% reporting that it was important. These results suggest that the funded enterprises still had issues with the cost of money; either on what they are paying on their borrowings or the effect on the general economy, which directly affect them through for example affecting customer spend. Exchange rates were however considered not to be of much impact, perhaps due to the relative stability of the Rand and the fact that most of the respondents only operated domestically with limited exports or imports.

Regulations were also considered to have an important, and negative, effect on enterprise performance. 32% of the respondents felt that the effect was very important. These results may suggest that as it currently small enterprises in South Africa are over regulated to the extent of stifling their growth

4.7 INFORMATION TECHNOLOGY

Information Technology (IT) is increasingly becoming an important tool in business management and growth (Olwale and Garwe (2010), Mathews (2006). Those enterprises that are adopting IT are gaining competitive advantages over those that are not adopting IT in their business operations.

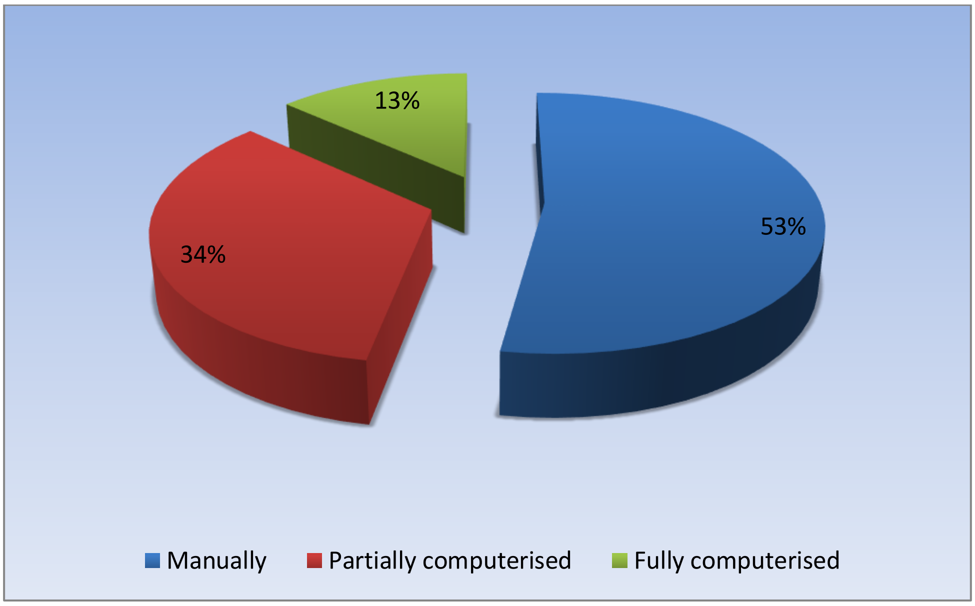

Figure 4.18: Accounting Information System

The level of adoption of IT in accounting systems at SMMEs in the study is still very low as shown in the results above. The above results indicate that only 13% of the firms in the study had fully computerised their accounting systems. More than half of the respondents (53%) had fully manual accounting systems and 34% had partially computerised their accounting information systems. Ismail et al (2011) pointed out that most small enterprises are reluctant to adopt ICTs. Vosloo et al (2005), in a study of South African small enterprises, concluded that the adoption of ICTs by SMMEs in South Africa was low. The results above are consistent with these empirical findings.

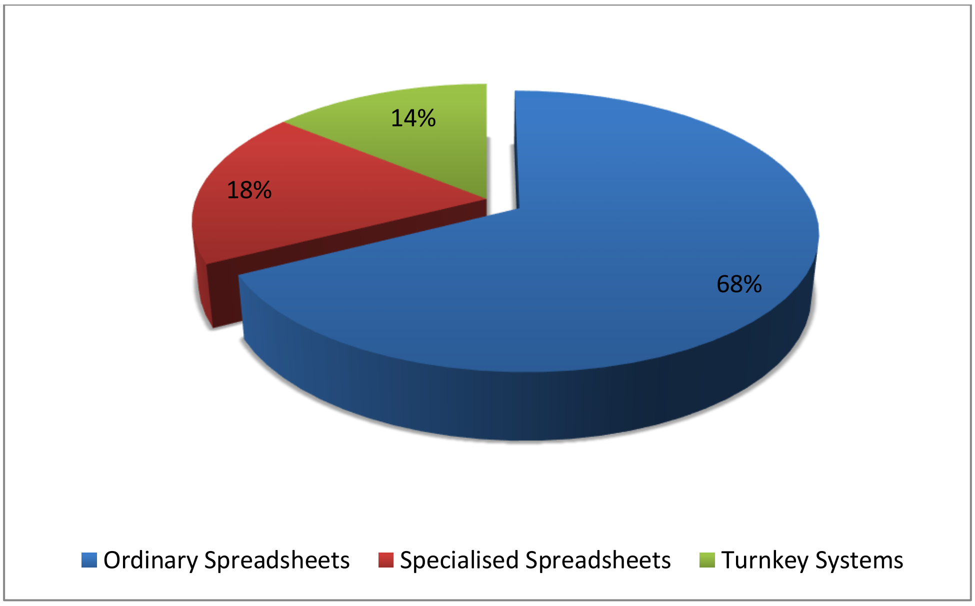

Figure 4.19: Computerised Accounting Systems

The researcher further probed the use of computerised system in the SMMEs. Those respondents who indicated that they had computerised to an extent their systems were asked to provide the type of computerised systems that they employed and the result were as shown in the figure above. Most of the respondents (68%) used ordinary spreadsheets to keep track of accounting information. These results are consistent with the findings of Ismail et al (2003) who found out that most SMMEs that had adopted computer systems only used specialized spreadsheets. Tijani and Mahomed, 2013, also found similar results. Just under a fifth of the respondents (18%) used specialised spreadsheets to keep track of accounting information and the remainder (14%) had turnkey systems installed. These results are in contrast to the finding of Sam, et al (2012) who found that 80% of small enterprises in Malaysia had adopted fully computerized accounting systems

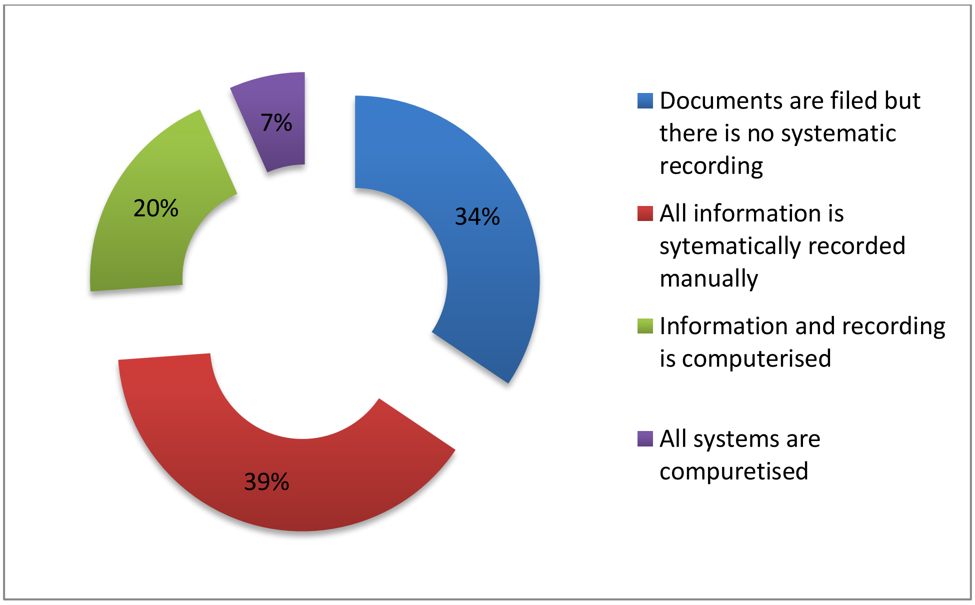

Figure 4.20: Use of Computer Systems

Enterprises use computer systems to manage their businesses to varying degrees as represented in the above figure. Most of the respondents (39%) indicated that their information is systematically filed manually, while an almost equal number of respondents (34%) indicated that they filed documents but not systematically. A small percentage of the respondents (7%) indicated that their systems were all computerised while 20 % indicated the information was computerised but not necessarily all the other systems. Adewoye and Akambi (2012) in a study of small enterprises in Nigeria also found low level of integration of computer systems with the enterprises' operations.

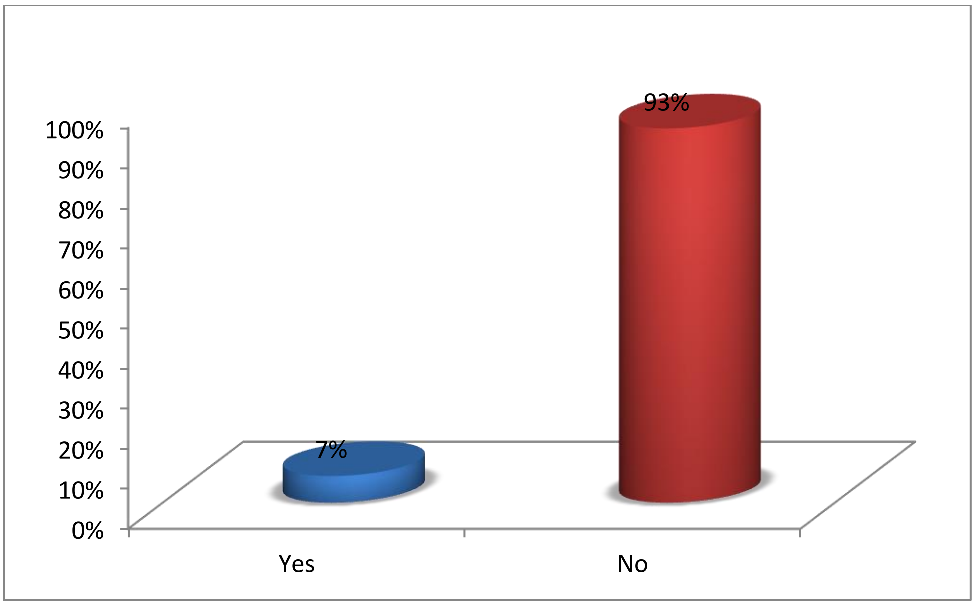

Figure 4.21: Systems Integration

While accounting systems are key in driving enterprise growth there are other systems that are equally important. To derive maximum value, enterprises need to integrate these systems. The researcher sought to find out the extent to which systems were integrated. Figure 4.21 above shows that only 7% of the respondents indicated that they had integrated systems and the remainder (93%) did not have integrated systems. These results are consistent with the findings of Maseko and Manyani (2011), in a study of small enterprises in Bindura, Zimbabwe; they found out that systems were not integrated, especially to the accounting system. Runge and Lee (2002) also obtained similar results in their study.

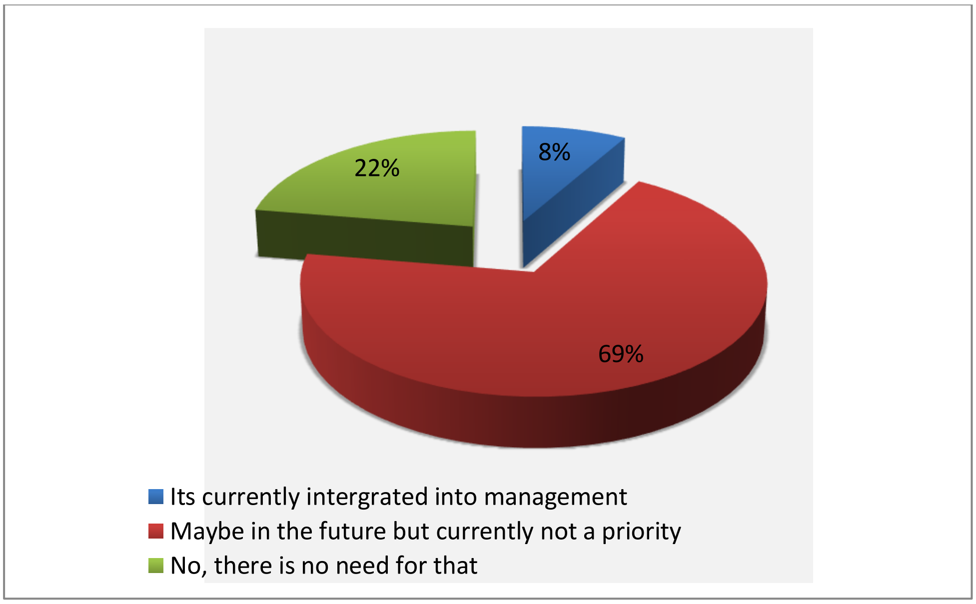

Figure 4.22: IT Systems and business growth

It was important to get the views of respondents regarding their views on IT systems and enterprise growth. Only 8% of the respondents indicated that IT was already integrated into management while 69% recognized the importance of adopting IT to business growth but indicated that it was currently not a priority but would be considered in the future. 22% of the respondents SMMEs did not consider IT systems to be of importance in enterprise growth. Tijani and Mahommed (2013) reported similar results regarding priority of IT systems in business growth within small enterprises. These results indicate that the perceived role of IT systems in business growth in South African SMMEs is low.

4.8 FINANCIAL MANAGEMENT

Financial management is very important in enterprise control and ultimately growth. The results in Figure 4.23 below however indicate that three quarters (76%) of the SMMEs in the survey did not have a formal financial management system in place. Only 24% of the respondent firms had the financial management system in place.

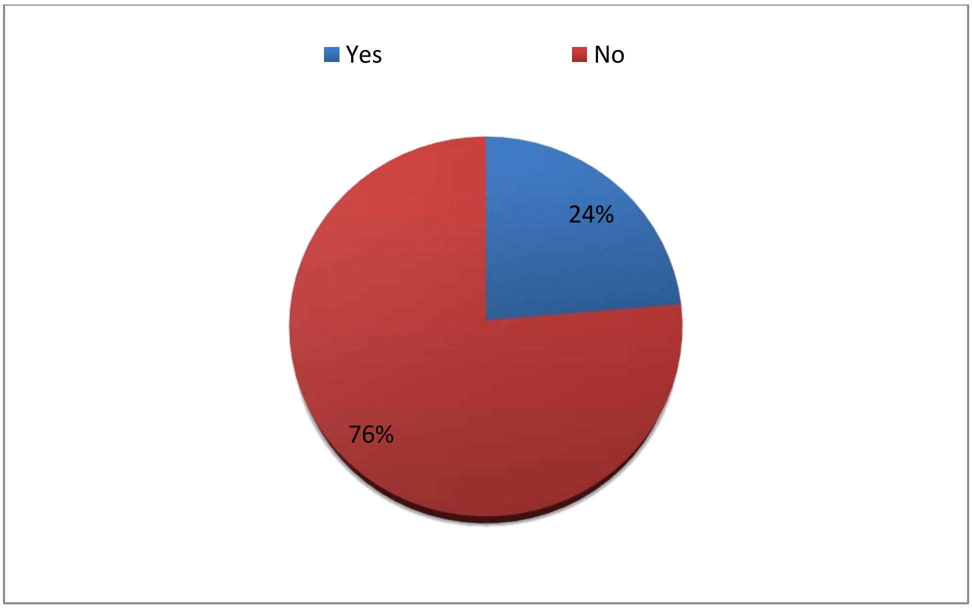

Figure 4.23: Formal Financial Management System

Temtime and Pansri (2004) reported that formalization of financial management systems within small enterprises was very low; results which agree with this study's finding above. Financial management systems are however important to support business growth and in the long-term to ensure business survival. These results indicate that there are issues with financial management systems and practices among SMMEs in South Africa. Hall and Young (1991) reported that 50% of business failures among small enterprises in the UK were due to poor financial management.

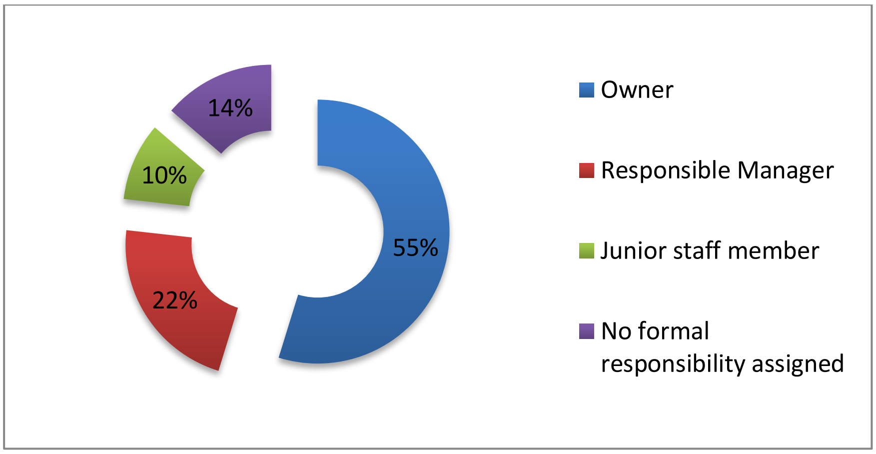

Figure 4.24: Financial Management Responsibility

Several studies have shown that owner/managers in most cases assume financial management responsibilities in their organisations (for example Maseko and Manyani, 2010, Mathuva, 2009). The results from this study are in agreement with these previous results with 55% of the respondents showing that owner/managers assumed the financial management responsibility in their enterprises. About one fifth of the respondents (22%) had a responsible manager overseeing the financial management function. However one tenth (10%) of the respondents relegated the responsibility to a junior member of staff and the remainder 14% did not assign financial management responsibility at all to anyone in the organisation.

The above results indicate that most owners have the financial management responsibilities in their organisation. It is therefore important that owners have a background in financial management. The researcher sought to find out if the owners had background in financial management. The result showed that the majority of the owners (83%) did not have financial management background and only 17% had a financial management background. Mathuva (2009) reports similar results regarding financial management background in a study of Kenyan small enterprises owner. In a 2012 study in South Africa by Olufunso et al, they found out that most owners of SMMEs did not have training in business management, including financial management. Collins and Jarvis (2010) say that financial management literacy among small business owners was important given the roles they assume in their organisations.

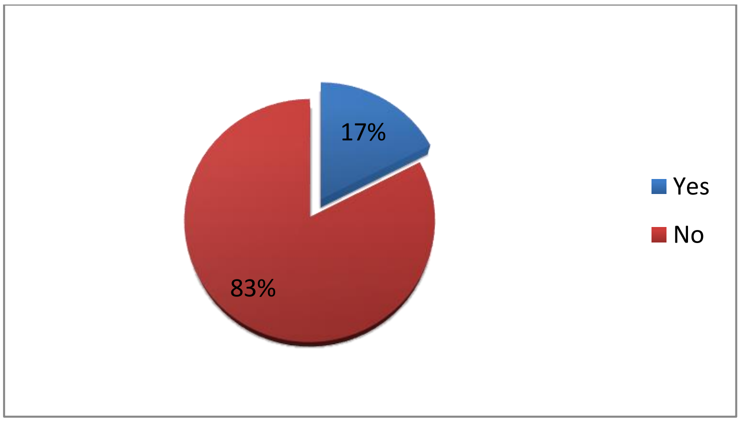

Figure 4.25: Owners Financial Management Background

Planning and forecasting is an integral part of the financial management system and is important in ensuring growth of the small enterprises into big corporations. For this reason the researcher sought to find out if the SMMEs in the survey had in place a formal planning and forecasting framework. The results are presented in Figure 4.26 below. Four fifth (79%) of the respondent enterprises did not have a formal planning and forecasting framework in place. Only 21% of the respondent firms had the framework in place. Osteryoung et al, 1997, emphasized the importance of planning and forecasting for small enterprises to ensure that the required resources are available to finance the anticipated growth. They also pointed out that such skills were generally missing among small enterprises; which constrained their ability to grow. These results are consistent with the findings of this research.

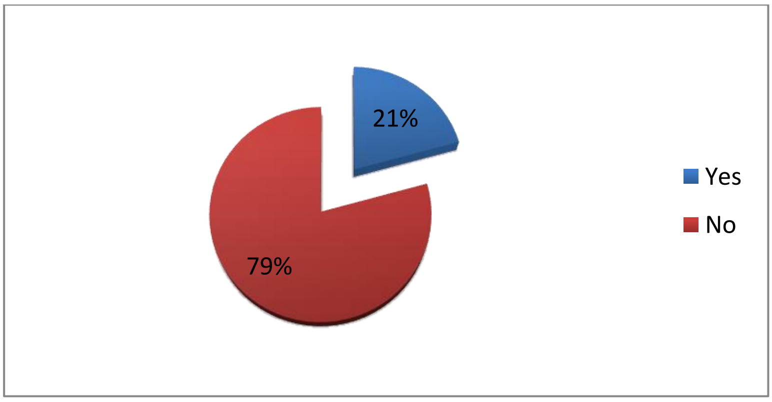

Figure 4.26: Planning and Forecasting Framework

Financial statements are an important aspect of financial management and they are important in that they help management to monitor growth of their enterprises. Financial statement can therefore help to ensure enterprise growth (Manyani and Maseko, 2010). It is against this background that the researcher sought to find out the level to which firms in the survey prepared financial statements. The study revealed that only a handful of the respondents (17%) prepared annual financial statements and the rest (83%) did not prepare annual financial statements. McMahon (1999) obtained similar results where only a few of the small enterprises prepared financial statement. Lalin and Sabir (2010) suggested that usually small enterprises prepared financial statements because regulatory authorities required them. Wahlstedt (1996) pointed out that most small enterprises preferred to use cash accounting, which was simple and did not require elaborate financial statements. Ismail and King (2007) also suggest that because of the limited users of the accounting statements (which are usually just the owners) small enterprises avoided preparing a full set of financial statements.

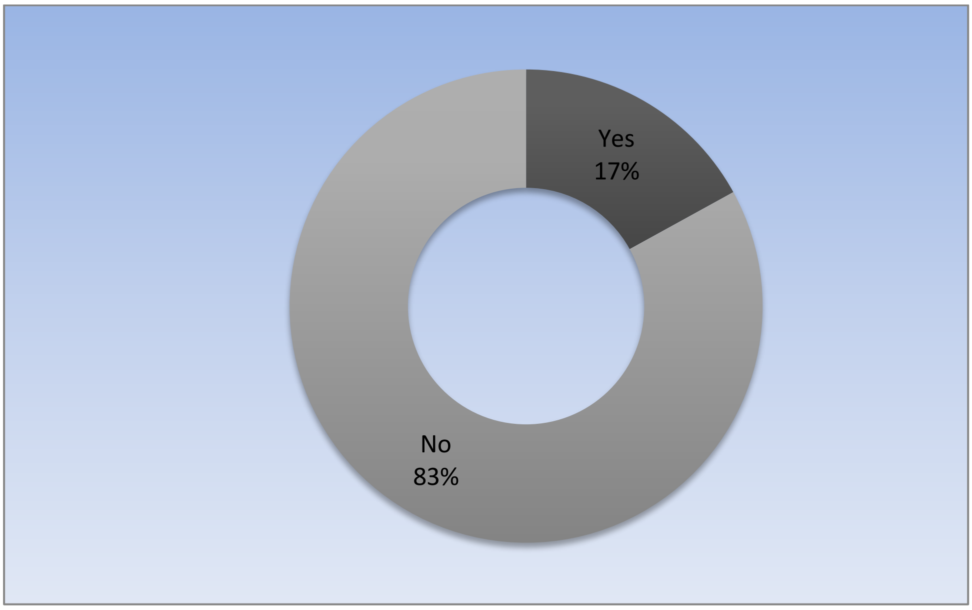

Figure 4.27: Preparation of Annual Financial Statements

4.9 LOAN MANAGEMENT SYSTEM

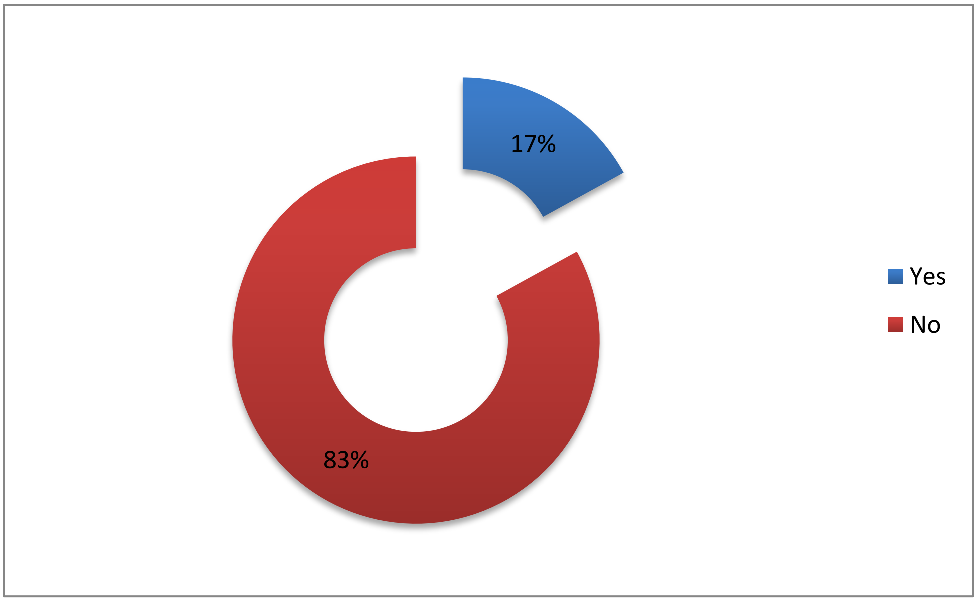

Figure 4.28: Multiple Borrowings

Enterprises often receive borrowings from multiple sources. However small enterprises often have challenges raising financing from banks, let alone have multiple borrowing relationships with multiple lenders (Ang (1992), Jaffee and Russel (1976) and Stiglitz and Wess (1981), Berger and Udell, 1998). This is confirmed by the results from this study where 83% of the respondents did not have additional credit relationships with financial institutions apart from Ithala Development Finance Corporation.

An important issue that needed exploring was whether recipients of development finance felt that the financing they received was helpful or not. Financial discourse on SMMEs has often focused on the need of SMMEs to access financing. The research study sought to find out the extent to which respondent firms thought the financing they received to be helpful. Figure 4.29 below presents the results from this study

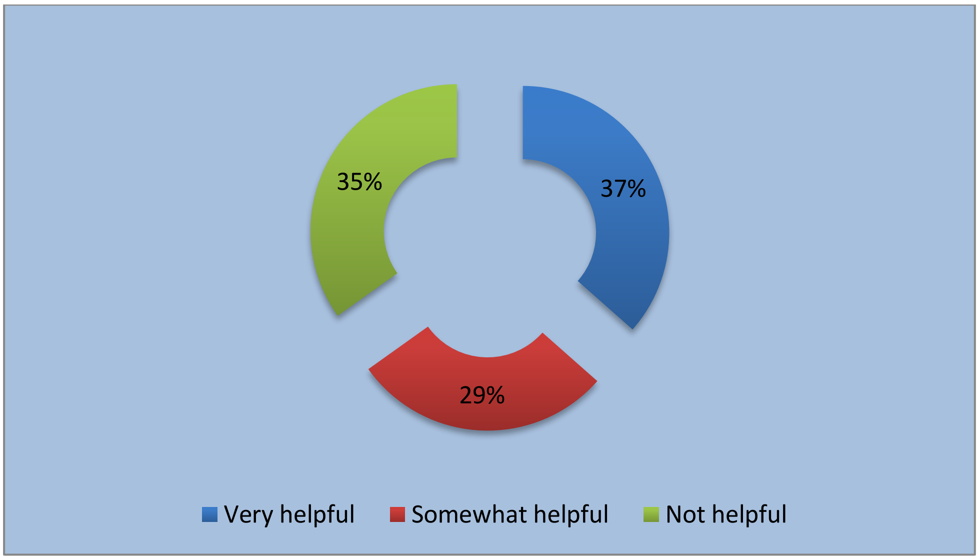

Figure 4.29: Value of Borrowings

The study found out that 35% of the respondents felt that the financing they had received had not been helpful. The remainder (65%) however largely felt that the financing had largely been helpful. However 29% of these could not give a definitive answer on whether it had been helpful in terms of the objectives on accessing borrowings. The results could also be interpreted as that 69% of the respondents felt that the financing that they had received had not fully allowed their enterprises to meet their goals. These results indicate the importance of accessing financing by small enterprises. However they also point to the need to ensure that financing is appropriately packaged so as to be able to meet the objectives of the borrowers

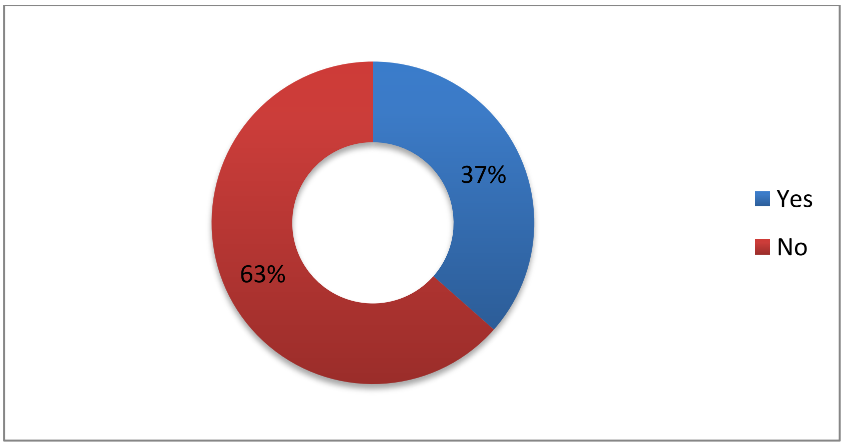

Figure 4.30: Affordability of Interest rate

The issue of the cost of financing as measured by the rate of interest was also felt by the researcher to be of key importance. Against this scenario respondents were asked about their views on the rate of interest they paid on their borrowings. As shown above, 63% of the respondents felt that the interest rate was not affordable. The concern of the owners was that the interest rate charged was burdensome on their enterprises. However 37% felt that the interest rate was affordable. It is important therefore to ensure that development facilities made available to SMMEs are priced at levels that allow them to thrive. Hubert and Matthey (2003) and Tacis (2002) previously reported on the challenges of affordability of interest rates and this study confirms the results in the South African context. It is important to ensure that interest rates offered are affordable for the SMME borrowers by structuring the terms of the financing to suit the situations of each borrower.

This research also sought to find out concerns of SMME owners regarding the financing that they had received. The researcher felt that this could shed light on why the funded SMMEs could fail to achieve growth even though they had received funding. The assumption was that there were some issues inherent in the financing structure that could restrict business growth and prevented enterprises from achieving the anticipated growth. Curran (1986) and Haskin (1989) assert that SMMEs do not always opt for growth. The results are summarized in the table below

Concern by SMME owners	**%**	**Number**
Amount advanced not enough for business needs	65%	156
Interest rate too high	63%	153
Tenure of loan too short	40%	97
Restrictions on use of loans	20%	49
Loans not tailor-made for needs of my business	55%	133

Table 4.5: Concerns of SMME owners with financing

The researcher felt that the adequacy of the funding availed to SMMEs needed to be investigated. It is not enough to only ensure access to financing but measures should be taken to ensure that the funding is adequate for the recipients' needs. Two thirds (65%) of the respondents felt that the funding was not enough for their business needs.

Enterprises require adequate funding in order to ensure that they realize their full growth potential. An almost equal number of respondents (63%) had concerns with the interest rate obtaining on their loans was too high and therefore stifled their growth. Berger and Udell (1995) assert that SMMEs generally pay higher interest rates and have shorter banking relationships. Hubert and Matthey (2003) report similar results. 40% of the respondents had issues with the tenure of the loan, which they considered to be too short and 55% felt that loans were not tailor made for their needs as SMME. It could be that the respondents felt that the credit providers bunched the SMMEs together without considering the unique needs of each borrower. The research also found out that 20% of the SMMEs felt that the restrictions that came with the financing which include issues like additional credit facilities, ring fencing of sales proceeds and restrictions on use of the funds which gave the borrowers less flexibility in pursuing growth opportunities. Generally it can be concluded that SMMEs have issues with their current financing structure. This is in agreement with the assertion by Vos et al (1995) who say that small enterprises are not financially contented (also Storey, 1994).

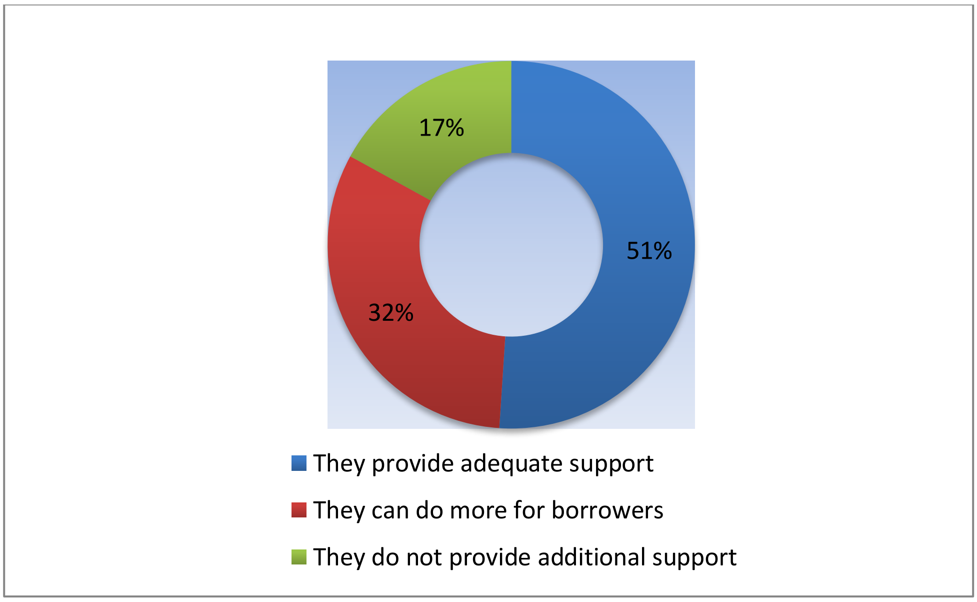

Figure 4.31: Support by Lenders

4.10 HUMAN CAPITAL

Human capital is very important in enterprise growth and several researches have been carried out to investigate the access of SMMEs to qualified labour. This research also sought to find out the SMME human capital landscape in the KZN region. Figure 4.34 below presents the responses regarding difficulties faced by the SMMEs in the sample in obtaining qualified workers for their operations. 65% of the respondents indicated that it was very difficult to obtain qualified workers for their operations while 20% indicated that it was somewhat difficult to obtain qualified workers for their operations. Overall 85% of the respondents indicated that it was difficult to obtain workers for their operations. A total of 15% thought it was easy to get the required workers. Similar results were obtained is studies by Herrington, et al (2009), Shah (2006) and Gumede and Ramussen (2002) and this indicates that SMMEs in South Africa have challenges obtaining adequate skills to grow their enterprises into bigger firms.

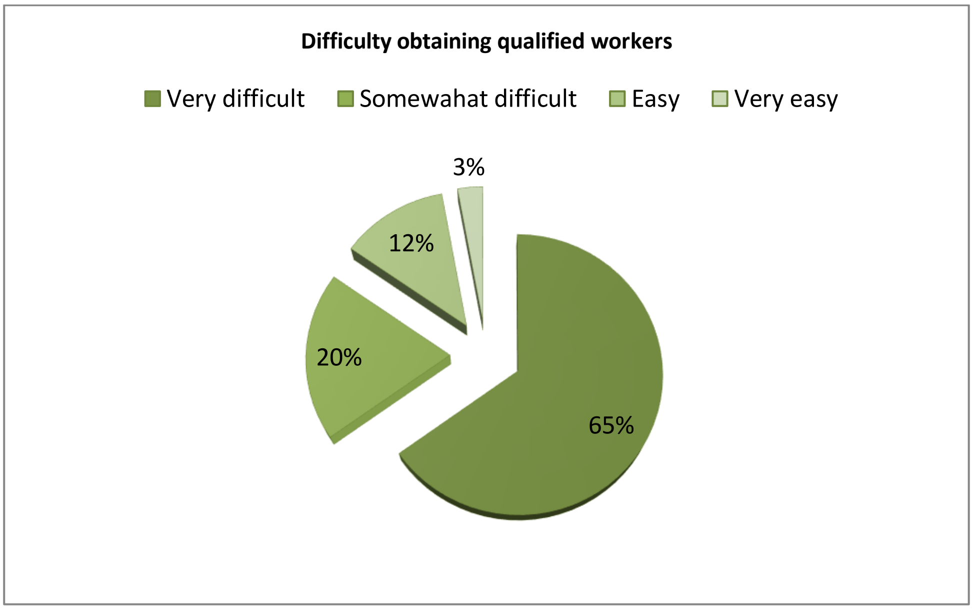

Figure 4.32: Difficulty in Obtaining Qualified Workers

In a related question respondents were asked if their enterprises were currently staffed with all the adequate skills required for growth and 63% (about two thirds) of the respondents answered in the negative. 37% were content with the level of skills they had in their enterprises. This is reported in Figure 4.33 below. Marshall and Oliver (2005) report that lack of adequate skill was the root cause of failure of SMMEs. Fatoki (2011) reports similar results in South Africa. These results suggest that the absence of adequate skills could be restricting potential growth of funded and unfunded SMMEs in the KZN region in South Africa. These results also support the claim by Mahadea (2008) who says that it is very expensive for small enterprises to hire qualified labour in South Africa.

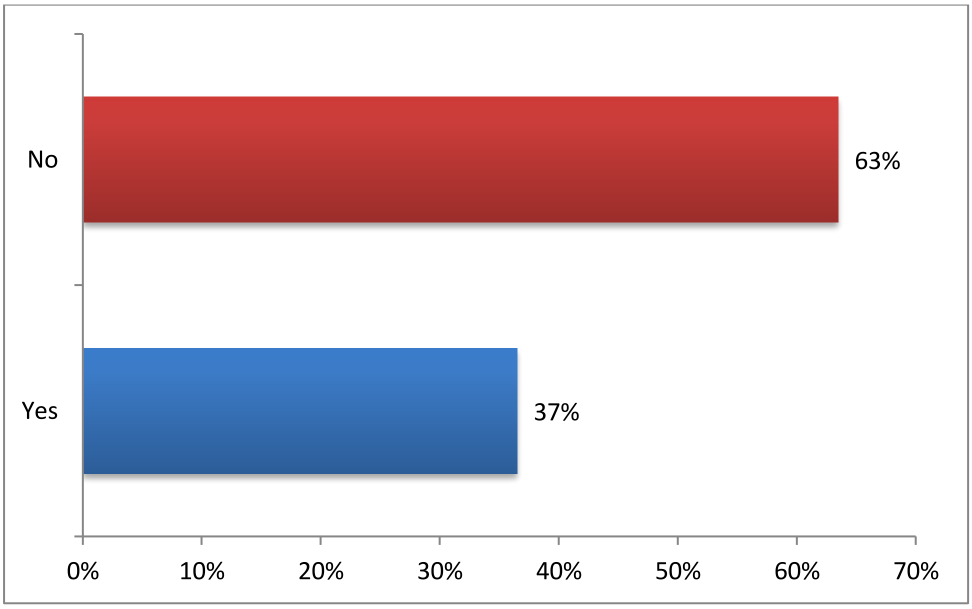

Figure 4.33: Skills Adequacy

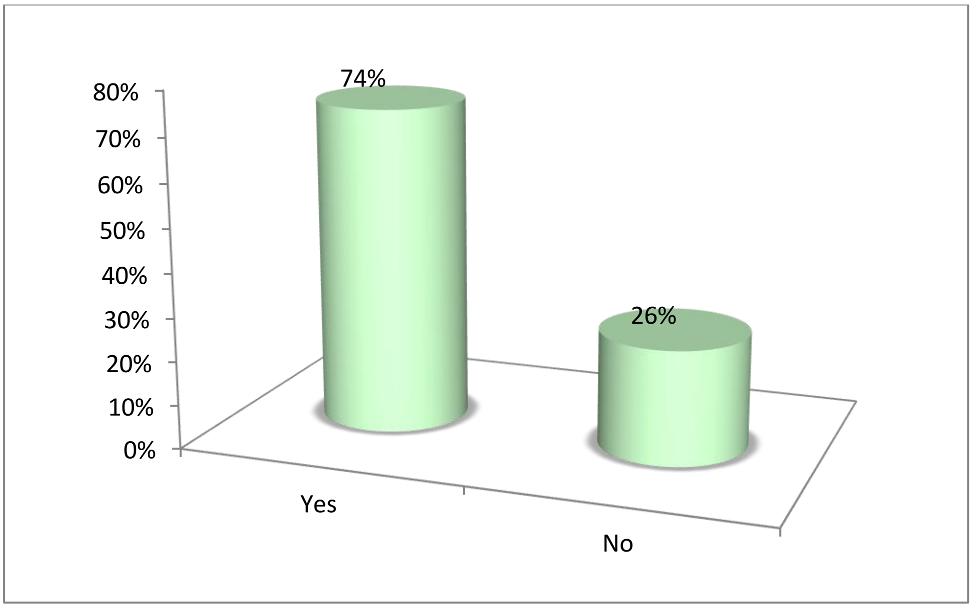

Figure 4.34: Specialised Skills by Owners

Owners play an important role in their enterprises and are often involved in all functions in their organisations, including day to day operations. It is therefore very important that they posses the specialised technical skills in their areas of operations. The results from the survey showed that three quarters of the owners had specialised technical skills in their area of operations (Ahmed et al, 2010). Only 26% of the owners did not have specialised skills in their area of operation. Marshal and Oliver (2005) assert that lack of specialized skills by the owner managers is the root cause of problems encountered by

SMMEs, including lack of growth. The highly specialised skills of the owners can be attributed to the fact that owners usually start businesses in areas that they are familiar with, usually areas or sectors in which they have previously worked.

In a bid to increase business skills and competence among small business owners, the South African government has, through SEDA, been offering training courses for small business owners and managers to increase their competence levels in business management. Slightly more than half of the respondents (55%) had attended small business courses offered by the government. Fatoki (2012) called upon small business managers to invest in additional training. Similarly he called upon universities and colleges to introduce courses on entrepreneurship to assist in business growth of small enterprises.

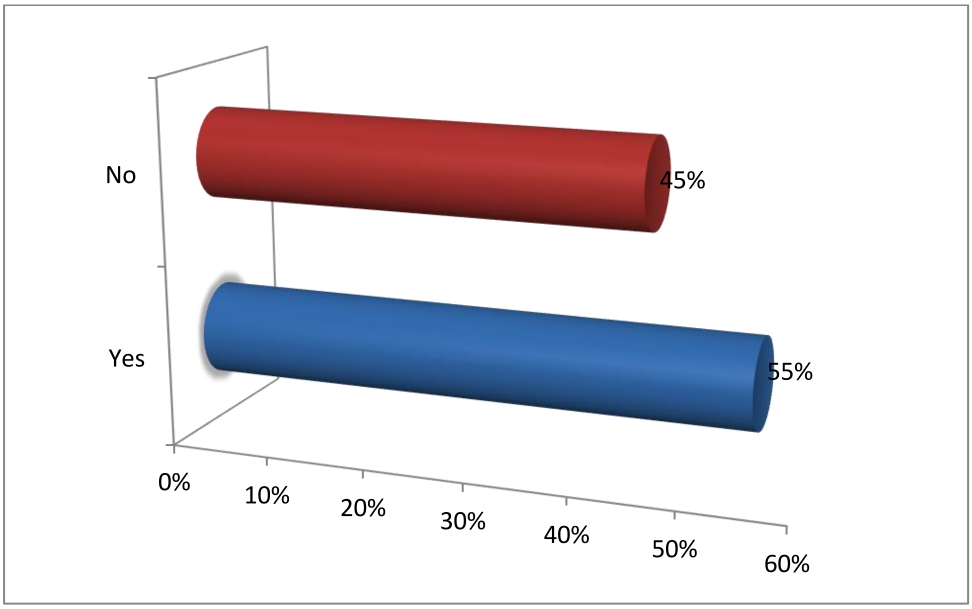

Figure 4.35: Business Skills Course Attendance

It is also important to ensure that workers are provided with regular training so as to ensure that they keep abreast of the ever changing business environment. This was important to ensure sustainable business growth. It is therefore important to ensure that SMMEs provide training to their workers. This research sought to find out the practice regarding training of worker. Half of the respondents (50%) indicated that they did not offer regular training to their workers while 28% indicated that such training was offered regularly. The remainder of the respondents sometimes offered the training.

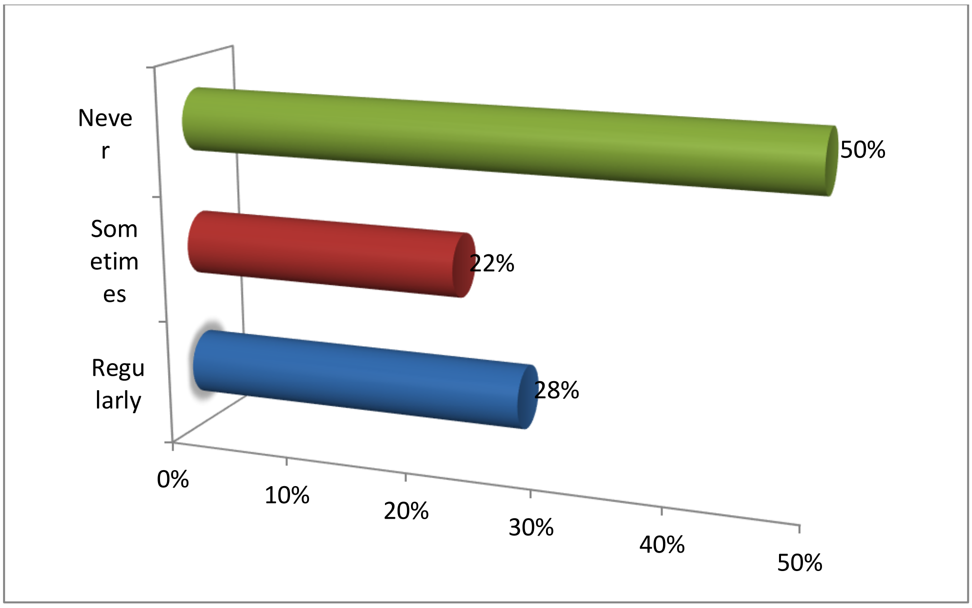

Figure 4.36: Training for workers

Opinion was almost divided among the respondents on whether they thought the South African education system was producing adequate and appropriately qualified people for the economy from which the SMME sector could tap its human resource base. 60% of the respondents did not think that the RSA education system was producing adequate skills for industry and commerce while 40% were content with the skills that were being produced by the education system in the country.

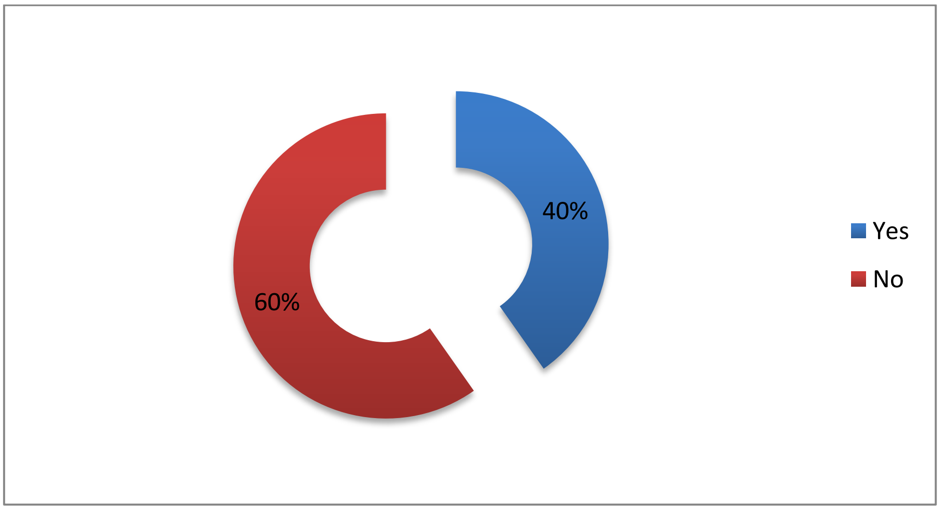

Figure 4.37: Adequacy of education system

SMMEs face a number of challenges in attracting and retaining qualified people in their businesses. Table 4.6 summarises the challenges that SMMEs face in terms of obtaining human resource skills to ensure sustainable business growth.

HR Challenges	%	Number
Can not match remuneration offered by bigger companies	65%	157
Workers are averse to working for smaller companies	41%	99
Competition for available labour skills	68%	164
Not enough qualified people in our business line	65%	157
Can not identify skills gap in the company	32%	76

Table 4.6: Human Capital Challenges

The most common cited challenge by the respondents was competition for available labour skills (68%). Slightly less (65%) cited the inability of the smaller enterprise to compete with the remuneration offered by larger enterprises. The result is that SMME are unable to attract adequate skills that they require even in the face of high unemployment. An equal number of respondents (65%) cite the fact that it was difficult to find enough qualified people in their line of business and also that workers were averse to working in smaller enterprises (41%). These results show that there are several factors restricting small enterprises from acquiring adequate skilled labour. Mahadea (2008) cite minimum wage and labour regulations which make labour too expensive for smaller enterprises. Oluwale and Garwe (2010) also echo similar sentiments.

4.11 INFRASTRUCTURE AND CRIME

The high crime rate in South Africa has been well documented in the media and other studies. Its effect on the business sector has not been fully investigated. Focus has been placed on the social implications of crime and not the economic implications. The state of infrastructure also has an impact on the business environment and growth prospects of all enterprises. This study sought to investigate this phenomenon and how it was affecting SMMEs in South Africa.

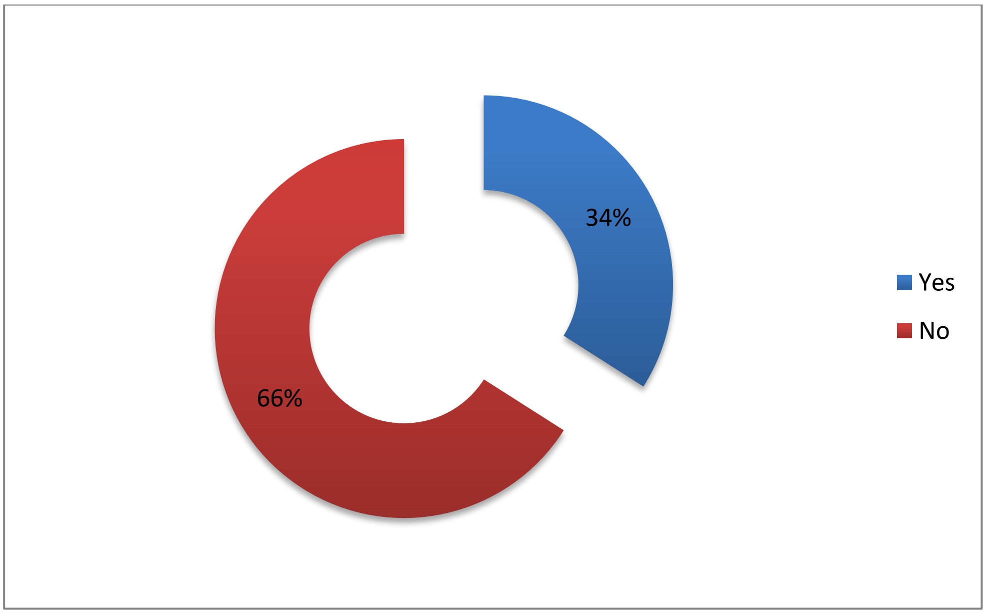

Figure 4.38: Adequate infrastructure

In terms of infrastructure like roads, electricity, telecoms and other social amenities, 66% of the respondents thought the available infrastructure were not adequate to support sustained business growth while the remainder were content with available infrastructure. Kalra (2009) obtained similar results when he found out that most SMMEs complained of inadequate electricity supplies which adversely affected turnover of small enterprises. Oluwale and Garwe (2010) also report similar results in terms of road access and other utilities in the areas of operation of many SMMEs. These results show that inadequate infrastructure is stifling the growth of SMMEs in most areas of KZN.

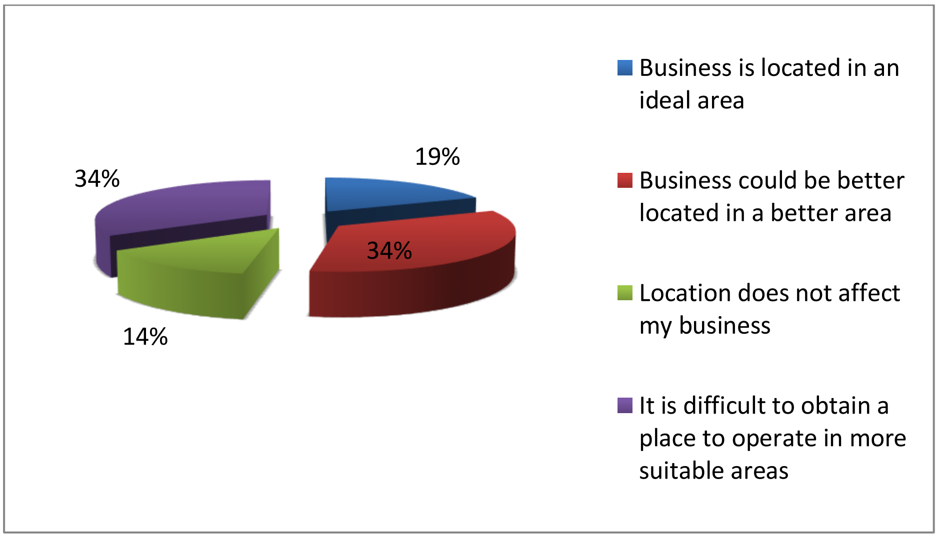

Figure 4.39: Business Location

An issue that has not been fully investigated is that of the link between business location and the potential for enterprise growth. The location of a business can determine its fortunes. This research sought to investigate the issue. A third of the respondents or 34% indicated that business could be better located in another area. An equal number (34%) of respondents indicated that it was difficult to get an ideal place from which to operate, suitable for their line of business. Overall 68% of the businesses were not located in ideal areas, potentially impacting on their growth potential. Slightly below a fifth of the respondents (19%) reported that they were located in and ideal location for their business while 14% would not care either way as location was not important in their business. Kalra (2009) reports that the state of roads and other infrastructure in most developing countries is deplorable and the location of many SMMEs is not ideal. The current study shows that most SMMEs are not located in areas that are ideal for their operations. This directly impacts on the growth prospects of these enterprises especially in an environment of intense competition.

The impact of crime on SMME was generally considered to be high with the effects being multifaceted. The predominant concern among the sample was increased security costs (71%) followed by the theft of business assets. The effect of crime on employee performance was also cited by 59% of the respondents as was the difficulty in attracting employees to the business due to concerns with crime (45%). Options that were cited less as concerns were increased cost of insurance (27%) and suspicion from potential customers and associates.

Theft of business assets	67%	162
Increased cost of insurance	27%	66
Increased cost of security	71%	171
Affects employee performance	59%	142
Difficult to attract employees to this area	45%	109
Suspicion from potential customers and associates	24%	59

Table 4.7: Cost associated with high crime rate

These results show that crime is putting a lot of burden on the operations of SMMEs in KZN province. The results are in agreement with the findings of Brown (2001) which show that organized business is victims of crime. The World Bank (2005) also reported that up to 60% of small enterprises resulted in increased cost of doing business in South Africa; the current study confirms these results.

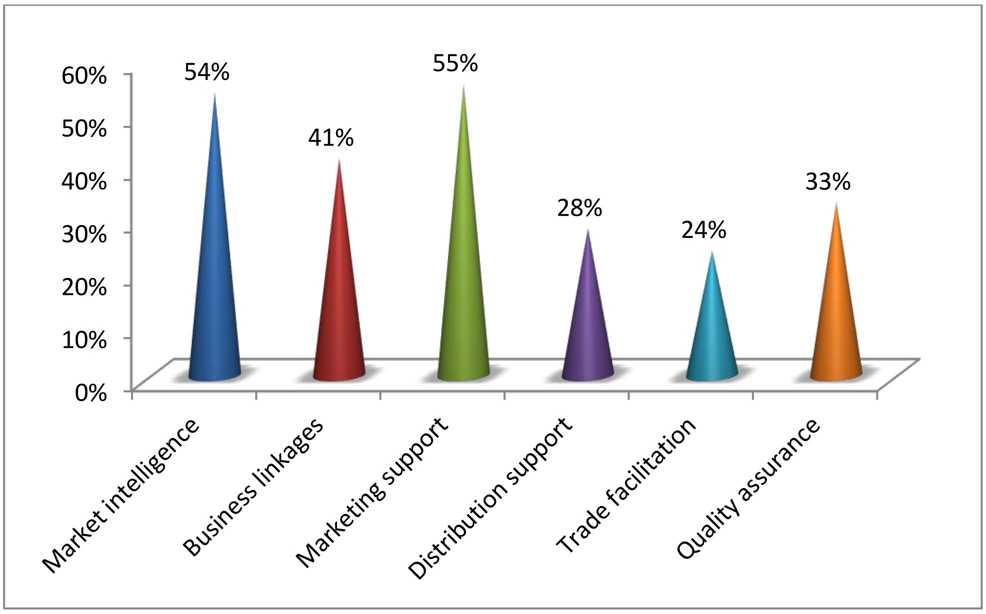

Figure 4.40: Government Support Measures

The role of the government in supporting the growth of SMME has been widely noted and acknowledged. Respondents from the survey noted that marketing support (55%) was of major importance to ensure sustainable growth of the business sector. The same number of respondents cited that support measure for SNNEs regarding marketing intelligence would go a long way to support. Some of the respondents (41%) felt that government should provide opportunities for business linkages among SMMEs and larger established corporations. Aspects of government support that were considered to be of lesser importance to enterprise growth include quality assurance (33%) trade facilitation and distribution support.

4.12 OTHER ISSUES

Respondents were asked to list any other issues that they felt had an impact on their performance. Responses were varied but included the following. Some respondents felt that government support initiatives for SMMEs were not enough and some of the initiatives were not accessible to all SMMEs. Some respondents lamented the issue of corruption which they felt exerted additional burden on small enterprises. Some cases cited include officials requesting bribes before the SMME could access cheap government funded financial support funds and other non funding support measures. A number of respondents felt that government support was not enough and they felt there is need for the government to craft measures that deliberately favour SMMEs for example in the allocation of government tenders which some felt there was a lot of corruption as the tenders were not fairly distributed.

4.13 CHAPTER SUMMARY

The chapter presented data from the study in the form of graphs and charts. Results from the study indicate that SMMEs in the study face a number of challenges that is restricting their growth despite having received funding from Ithala Development Finance Corporation. The results also expose deficiencies in management systems, especially the use of Information technology and inadequate financial systems which hamper business growth. Results also highlight the feeling among respondents that the government and funders needs to do more than just provide finance to those enterprises who receive the funding. The next chapter gives the summary of the study, conclusions and recommendations.

CHAPTER 5

DISCUSSION OF FINDINGS

5.1 INTRODUCTION

This chapter presents the summary of the entire study, the research conclusions and the recommendations. The rest of the chapter is arranged as follows: Section 5.2 gives a summary of the research and section 5.3 lists the conclusions drawn from the study in light of the research objectives. Section 5.4 discusses the recommendations that arise from the study while the last section proffers suggestions for further study in the area of small enterprise development in South Africa.

5.2 SUMMARY

This study sought to investigate the challenges constraining growth of funded small micro and medium sized enterprises (SMMEs) in South Africa. The research was carried out as a case study of SMMEs operating in the KwaZulu Natal province, in particular those enterprises that had received funding from the Ithala Development Finance Corporation. Financing challenges faced by SMMEs have been well documented in both the South African environment and the developed economies. Financing has also been shown to be a major factor constraining the growth of SMMEs. The focus of the South African government has been to provide access to financing for SMMEs in order to drive the economy and to provide adequate employment opportunities for the economy. However despite the fact that a number of SMMEs have been availed financing from agencies set up by the government to promote the development and growth of the SMME sector, a number of such funded enterprises continue to struggle and have not graduated into large enterprises as expected. This study sought to understand the factors constraining the growth of funded SMMEs in the KZN province.

Three hundred questionnaires were administered to a sample drawn from the database of Ithala Development Finance. Invaluable findings and observations were made during the study, and the following conclusions were drawn.

5.3 CONCLUSIONS OF THE STUDY

The following conclusions have been drawn from the research findings. The research finding are discussed in line with the three major objectives of the study as stated in Chapter 1, namely

a) Factors constraining the growth of the SMME sector

b) Role of poor management skills in the perceived poor performance of funded SMMEs; and

c) The success of initiatives of the government to promote the growth of SMMEs

5.3.1 FACTORS CONSTRAINING THE GROWTH OF SMMES SECTOR

i. Lack of Growth

The results show the lack of growth of most of the SMMEs as indicated by the number of years in operation of most of the SMMEs in the study. A number of the SMMEs have been in operation for a number of years without graduating into being larger corporations. The study shows that only 8% of the enterprises had been in operation for less than 5 years.

ii. Funding

The results of this study confirm findings from many previous researches that SMMEs have difficulties in raising funding for both start up and expansion. The results from the study also prove the importance of owners' savings as both start up and expansion capital. The funding climate was considered to be very difficult for SMMEs for a number of reasons. Since the SMMEs in the sample had already accessed financing from Ithala, this study sought to investigate the financing problem from a different angle from that of availability. The following issues arose from the study:

a) In a number of cases the financing was considered not to be adequate for the business needs and hence not enough to finance the growth needs of the enterprises,

b) The development finance received was considered to be too expensive in terms of interest rate charged. The challenge was also compounded by other covenants that may be added to the loans thus constraining the ability of the funded enterprises to pursue growth opportunities.

c) Providers of finance are not always offering adequate assistance to borrowers. The funded SMMEs expected support beyond financing from development finance lenders however such support was limited. Borrowers required additional support like financial management, marketing support and operations management.

iii. Enterprise Management

The study unearthed deficiencies in enterprise management systems as shown by the level to which various management functions were understood and prioritised within the enterprise. Several aspects and functions of management were routinely ignored or were not considered to be of importance in as far as enterprise growth is concerned.

iv. Financial Management

It is widely agreed that financial management in enterprises is very important as it allows for effective enterprise control. Financial management is also important as it allows for the enterprise to be able to measure and quantify growth. Without proper financial management resources will be wasted and an enterprise will not be able to achieve its potential growth.

a. The study revealed that the majority of SMMEs (76%) did not have formal financial management systems in place. Weak financial controls could lead to inefficiencies in resource deployment and also inability to monitor growth and other business aspects.

b. In most instances (55%) owner managers are responsible for financial management within their organisation. However the study also reveals that most (83%) of the owner managers do not have financial management backgrounds. This result may also explain why most of the SMMEs did not have formal financial management systems in place since the owners did not have a full appreciation of the value of financial management to the growth of their enterprises.

c. The planning and forecasting functions are also neglected within SMMEs despite their importance, especially in projecting growth and planning for business growth.

The small enterprises lack growth because they do not have the capacity's plan and prepare for it. Almost four fifth of (79%) of SMMEs do not have in place a formal planning and forecasting framework.

d. Financial statements are an important tool for business control and are used by management to measure and as a basis for planning for growth. Small enterprises rarely prepare adequate financial statements. The study affirms this claim as only 21% of the SMMEs were shown to prepare a full set of financial statements with the rest not preparing any at all or preparing only basic financial statements required by the bank

v. Information Technology

Information Technology (IT) is increasingly being deployed in businesses to gain competitive advantage and also ensuring effective control of businesses processes and operations. SMMEs can use IT to drive their growth through lowering costs and streamlining business processes. The use of IT however remains very low among SMMEs in the study. The following results were observed from the study

a. Most of the SMMEs have not computerised their operations with only 13% of the respondents having fully computerised their operations against 53% who had fully manual systems. The other 34% had basic computer systems in some of their operations or processes. The results show that the deployment of IT to support business growth remains low among SMMEs in South Africa.

b. The use of turnkey computer systems for management remains very low even among those few enterprises that report some level of IT deployment. Most of those enterprises that have deployed IT in their business processes use rudimentary spreadsheets especially in managing their accounting information. The study found out that only 14% of the enterprises that have deployed IT resources use turnkey systems.

c. Information systems are not integrated into the whole business management system; with only 7% of the respondents in the study indicating that information systems were integrated into the management systems.

vi. Human Capital

Human resources are critical for enterprise growth and the study shows that small enterprises have challenges in adequately resourcing their teams due to a number of reasons. The key issue is that SMMEs are finding it difficult to attract the skills that they require for their operations, chiefly because of the inability to compete with large established enterprises competing for the same skills. The South African labour market does not provide enough skills for the needs of the business community. Further some owners of SMMEs are not taking advantage of courses offered by government agencies.

vii. Infrastructure.

Inadequate infrastructure restricts business growth of small enterprises. This study finds out a number or pertinent issues regarding the operations of SMMEs as far as infrastructure issues are concerned

a. More than half (66%) of the respondents indicate that infrastructure in their areas of operation was not adequate, a situation that is external to the business and out of control of business owners. Infrastructure refers to road networks, telecommunication networks, electricity and water resources.

b. An important issue that the study also highlighted was that of location. Most of the SMMEs (68%) are not located in ideal areas for their forms of business, in terms of customer traffic or accessibility. This adversely affected the growth potential of the enterprises.

c. While the social costs of crime on the South African society have been discussed in various forums, this study also found out that crime exerted additional costs on small enterprises which adversely affected enterprise growth. Issues that arise from high crime rate include the theft of assets (67%), increased cost of security (71%), effect on employee performance (59%) and loss of potential customers or business contacts (24%).

CHAPTER 6

CONCLUSION

6.1 Objectives of Study

The objectives of this study were to:

- Critically investigate economic factors that constrain growth of SMMEs in South Africa particularly in the KwaZulu Natal province apart from access to financing.
- Establish the role of poor management skills in the perceived poor performance by the funded SMMEs in the KwaZulu Natal Province, South Africa.
- Establish whether initiatives and policies by the government and other economic authorities had an effect on the performance of funded SMMEs in KwaZulu Natal province.
- Provide recommendations to Policy Makers and Financial institutions on how to further improve the framework for assisting SMME growth.

Findings

6.2 The study has identified a number of challenges at funded SMMEs in South Africa that are restricting their growth despite having been availed financing. The study speculated that management issues could be the contributing factor. The study results show that a number of factors are contributing to the poor growth patterns identified. There are management issues at play, especially management's lack of appreciation of the importance of certain management functions within their organsisation. Further the study revealed that there are poor financial controls within funded enterprises with most of the SMMEs failing to set up proper financial management systems. The study also revealed poor understanding of the role of IT in supporting enterprise growth as shown by low level of deployment of IT resources and tools within the operations of SMMEs

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APPENDIX 1 : QUESTIONAIRE

FULL COLOUR THINKING

GRADUATE SCHOOL OF BUSINESS
UNIVERSITY OF CAPE TOWN

The Owner/ Manager

SMME

KZN, RSA

Questionnaire for MCom in Development Finance Research Study

While a lot of research has so far been done in identifying the factors constraining the growth of SMMEs in South Africa, the emphasis has always been on financing. Other factors have not been fully investigated. This research is being conducted under the auspices of the University of Cape Town to establish factors that constrain the growth of SMMEs that have received funding from agencies established for the purpose of funding such enterprises.

Your assistance will be invaluable to ensure that the study is successfully completed. Could you kindly provide information by completing this questionnaire to the best of your knowledge? Your responses will be treated as confidential and will not be used for purposes other than those intended for this research.

For any further information, do not hesitate to contact the researcher on the above contact details.

Thank you in anticipation

Joseph Mubonderi

Student Number

WRWJOS001

1. INFORMATION ON RESPONDENTS

This section solicits for information about the person completing this questionnaire.

Gender of Respondent	
Age of Respondent	
State whether business owner or manager	
State educational qualification attained	
Highest professional Qualification	

2. BIOGRAPHICAL INFORMATION

The purpose of this section is to give general background on the business owner

State whether owner is male or female	
Educational Qualification of Owner	
Number of years of experience in the business of the owner	
Age of the owner	
Motivation for starting the business	

3. BASIC BUSINESS INFORMATION

Years business has been in existence	
Industry in Which Business Operates	
Products manufactured/service offered	
Number of employees	
Annual turnover of business	
Is the business legally registered	

4. BUSINESS MOTIVATION

How best can you describe the focus of managers in as far as the business is concerned

Grow the business	
Maintain current operations	
Just provide enough profits to maintain desired lifestyle	
A side activity for the owner	

5. FUNDING INFORMATION

The purpose of this section is to obtain information about the funding of your business.

(i) How did you raise funding required to start your business? Tick all applicable options.

Own Savings	Bank Borrowing	Government Support	Business Angel	Family/Friends	Other

(ii) How difficult was it to raise the funding to start your business? Tick the applicable box below. Tick the applicable option.

Very Difficult	Somewhat Difficult	Easy	Very Easy

(iii) How difficult was it to raise further funding to expand your business? Tick the applicable box below.

Very Difficult	Somewhat Difficult	Easy	Very Easy

(iv) Apart from the funding you may have obtained from Ithala Development Finance Corporation, have you raised funding from other sources?

YES ☐ NO ☐

(v) What other sources have you used to fund your business growth?

Own Savings	Bank Borrowing	Government Support	Business Angel	Family/Friends	Other

6. BUSINESS MANAGEMENT FUNCTIONS AFFECTING PERFORMANCE OF BUSINESS

Which of the following functions do you believe contribute to business performance and growth? Rate each of the functions on the following scale. 1 = Most Important, 2 = Important, 3 = Neutral, 4 = Less Important, 5 = Least Important and tick the appropriate box .

	1	2	3	4	5
Financial Management					
Customer Care					
Marketing and Sales					
Human Resource Management					
Operations Management					
Planning and forecasting					

What other functions do you believe are important to the performance of business?

………
………
………
………
………………………………………………………………………………

7. FACTORS AFFECTING PERFORMANCE OF BUSINESS

Which of the factors have significant influence on the performance of your business and how do you rate the impact to the performance of your business? Rate each of the functions on the following scale. 1 = Most Important, 2 = Important, 3 = Neutral, 4 = Less Important, 5 = Least Important and tick the appropriate box

	1	2	3	4	5
Inflation					
Interest rates					
Crime					
Infrastructure					
Exchange rates					
Regulations					

8. INFORMATION TECHNOLOGY & ACCOUNTING SYSTEM

a) How do you keep your accounting information?

Manually		Partly computerized		All computerized	

b) If you have computerized accounting, what system do you use?

Ordinary Spreadsheet		Specialized Spreadsheets		Turnkey Systems	

c) To what extent do you use computer systems in managing your business?

Documents are filed but no systematic recording	
All information systematically recorded manually	
Information and recording is computerized	
All systems are computerized	

d) Do you have a system that integrates accounting and other functions like sales and production?

YES ☐ NO ☐

e) Do you regard computerized systems as an integral part of your business growth?

Its currently integrated into our management now	
Maybe in the future but currently its not a priority	
No, there is no need for that. That is not important.	

9. FINANCIAL MANAGEMENT

a) Who is responsible for financial management in your company?

The owner	
Responsible Manager	
No formal responsibility for financial management assigned	
A junior staff member	

b) Does the business owner have a background in financial management?

YES ☐ NO ☐

c) If YES what financial management qualifications does the owner have?

……………………………………………………………………………………………………

d) Does your company have in place a formal planning and forecasting framework?

YES ☐ NO ☐

e) Does your company prepare annual financial statements?

YES ☐ NO ☐

f) Which of the following financial management skills are important for the growth of your business? Rate each of the functions on the following scale. 1 = Most Important, 2 = Important, 3 = Neutral, 4 = Less Important, 5 = Least Important and tick the appropriate box

	1	**2**	**3**	**4**	**5**
Book keeping skills					
Financial statements preparation					
Debtors and creditors control					
Budgeting skills					
Tax calculations					
Working Capital Management					

g) How do you rate the importance of financial management in attaining the growth objectives of your organisation?

Very Important	Somewhat Important	Not Important

10. LOAN MANAGEMENT

a. Has the funding helped you to expand your business?

Very Much Helpful	Somewhat helpful	No effect

b. Do you think the interest rate you are charged is affordable?

YES ☐ NO ☐

c. What challenges do you face with managing your loan? Please tick all the options applicable from the table below.

Amount advanced is not enough for business needs	
Interest rate is too high for us	
The tenure of the loan is too short	
Restrictions on the use of the loan	
Loan is not tailor made to the needs of my business	

d. Do you think lenders provide adequate support apart from providing finance? Choose the best applicable option.

They provide adequate support		They can do more for the borrowers		They do not provide additional support	

11. HUMAN CAPITAL & MANAGEMENT

a. How hard is it to obtain all the qualified workers that you require in the business?

Very Difficult	Somewhat Difficult	Easy	Very Easy

b. Do you think your business has all the skills that it requires for it to grow?

YES ☐ NO ☐

c. Do the owners or managers have the specialized skills and qualifications to be successful in your line of business?

YES ☐ NO ☐

d. Has the owner/manager attended any training offered by the government for small enterprises?

YES ☐ NO ☐

e. How often do you provide your workers with training to keep in touch with new skills in their areas of work?

Regularly	Sometimes	Never

f. What challenges do you face when you try to attract skilled workers for your business? Tick all the applicable option below.

Can not match the remuneration offered by bigger companies	
Workers are averse to working for small enterprises	
Competition for available labour skills	
Not enough qualified people in our business line	
Can not identify skills gap in the company	

12. INFRASTRUCTURE & CRIME

a. Do you think there is adequate infrastructure like roads, telephones etc to support your business growth?

YES ☐ NO ☐

b. Do you think local municipalities are doing enough in terms of providing infrastructure to ensure your business grows?

YES ☐ NO ☐

c. Do you think the location of your business in any way affect your business prospects? Choose the applicable from the table below

Business is located in an ideal area	
Business could be better if located in a better place	
Location does not affect my business	
It is difficult to obtain place to operate in more suitable areas	

h) In what ways does crime affect growth of your business? Rank in order of importance.1 = Most Important, 2 = Important, 3 = Neutral, 4 = Less Important, 5 = Least Important

Tick the appropriate box

	1	2	3	4	5
Theft of business assets					
Increased cost of insurance					
Increased cost of security					
Affect employee performances					
Difficulty in attracting skills to your area of business					
Suspicion from potential customers or associates					

i) Which of the following measures do you think will best help the growth of small enterprises? Rank in order of importance.1 = Most Important, 2 = Important, 3 = Neutral, 4 = Less Important, 5 = Least Important

Tick the appropriate box

Market intelligence	1	2	2	4	5
Business Linkages					
Marketing Support					
Distribution Support					
Trade Facilitation					
Quality assurance					

13. OTHER ISSUES

a. In your own words what do you think is holding back the growth of small enterprises like yours?

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What do you thing the government must do to assist small enterprises to grow into large corporations?

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YOU FOR COMPLETING THE QUESTIONAIRE