

Factors Influencing SMEs' Access to Finance in South Africa

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MOLOBENG SERAME

SRMMOL001

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Supervisor: Abdul Latif Alhassan (PhD)



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ABSTRACT

Policymakers and scholars universally accept and recognise the influence of small, medium, and large enterprises (SMMEs) on stimulating economic growth and job creation. South Africa in particular, has the challenge of a high unemployment rate, particularly among the youth, coupled with high inequality levels and stagnant economic growth over the recent years. These challenges have made the role of SMMEs even more important in South Africa. Despite the known importance of the influence of SMMEs on the economy and the government initiatives to grow SMMEs, SMMEs continue to face challenges of access to finance and high failure rates in their start-up phases. Against this background, this study examined the key reasons SMMEs struggle to gain access to banking finance with the aim of understanding the root causes of those reasons. This study aimed to provide solutions to addressing the root causes of SMMEs inaccessibility to finance to narrowing the finance gap in this segment. The study employed the parallel convergent mixed methods approach that combined both qualitative and quantitative approaches in data collection and analysis. Convenient sampling was used to identify the SMMEs for quantitative research. The empirical evidence was collected using survey data. The survey was distributed among the SMMEs sampled. For qualitative research, purposeful sampling was used to identify the research participants. Four bank managers working specifically with SMME finance were selected and approached for the research. Qualitative data was collected using semi-structured interviews. The study found that most SMMEs struggle to get access to finance with the majority citing a poor credit record as the main reason for being declined for credit. Most SMMEs are deterred from applying for banking finance and find the processes long and complicated. The study also found that the root cause of SMMEs low access to banking finance is a lack of education and understanding of bank processes and factors influencing their creditworthiness. These include poor governance by SMMEs and lack of proper bookkeeping. It is recommended that SMMEs upskill themselves with financial literacy and basic business management skills. Banks should find innovative ways of assessing creditworthiness for SMMEs and should consider other data sources. A collaboration between banks, government agents, and DFIs is advised.

Keywords: SMME financing, Access to credit, Credit supply

GLOSSARY OF TERMS

BBSDP	Black Business Supplier Development Programme
BEE	Black Economic Empowerment
CIPC	Companies and Intellectual Property Commission
DBSA	Development Bank of Southern Africa
DFIs	Development Finance Institutions
DTI	Department of Trade and Industry
FNB	First National Bank
GDP	Gross Domestic Product
GEM	Global Entrepreneurship Monitor
GEP	Gauteng Enterprise Propeller
GVA	Gross Value Added
ICT	Information and Communications Technology
IDC	Industrial Development Corporation
IFC	International Finance Corporation
NCR	National Credit Regulator
NDP	National Development Plan
NEF	National Empowerment Fund
NSB Act	National Small Business Act of 1996 as amended by the National Small Business Amendment Act of 2003 and 2004
NYDA	National Youth Development Agency
OECD	Organisation for Economic Cooperation and Development

ROE	Return on Equity
SEDA	Small Enterprise Development Agency
SEFA	Small Enterprise Finance Agency
SMEs	Small and Medium Enterprises
SMMEs	Small, Medium and Micro Enterprises
TEA	Total early-stage entrepreneurial activity
VAT	Value-Added Tax

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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

South Africa is characterised by extremely high unemployment at a level that has the potential to derail its future political stability (Bischoff & Wood, 2013). This high unemployment rate coupled with high poverty and inequality levels continues to threaten the economic sustainability of South Africa. There is a consensus among academics, researchers, and policymakers about the contribution of small, medium and micro enterprises (SMMEs) to a country's economy. This is no different in South Africa.

The unemployment rate in South Africa's was 26.7% in Q1 of 2018. This rate is the same as that observed in the previous period. There has also been an increase in the number of employed persons. The total number of unemployed persons increased by 100 000 to 5.98 million while the total employed increased by 207 000 to 16.38 million. According to trading economics, the average rate of unemployment for the years 2000 to 2018 was 25.54% with record highs (31.2%) observed in Q1 of 2013 and the lowest being Q4 of 2008 with 21.5%.

According to Stats SA (2018), there were 9.6 million unemployed persons in South Africa in 2018. This equated to a 27.2% unemployment rate in Q2 of 2018, a deterioration from 26.7% in Q1 of 2018, with the highest unemployment rate being 27.7% over the past decade. Furthermore, there was 6.1 million unemployed youth (those aged between 15 and 34) at the end of Q2 of 2018. This brings the youth unemployment rate to 38.8%.

Given the triple challenge of unemployment, inequality, and poverty, small, medium and medium enterprises (SMMEs) have been identified as productive drivers of inclusive economic growth and development in South Africa and around the world. Some researchers have estimated that, in South Africa, small and medium-sized enterprises comprise 91% of formalised businesses, provide employment to about 60% of the labour force, and its total economic output accounts for approximately 34% of the gross domestic product (GDP) (Brown, 2019). Given the high unemployment rate in South Africa and big corporates being unable to absorb the excess labour supply, the government's focus has been on growing small and medium enterprises to create employment.

The labour market in South Africa effectively excludes the youth from employment opportunities (Essay UK, 2014). Essay UK (2014) argued that the opportunity to decrease youth unemployment is influenced by the extent of the need for labour and the degree to which the youth can participate in the economic processes. Consequently, when the overall need for labour increases, they can benefit from the increased demand. Unless the demand for labour increases, any interventions to decrease youth unemployment, therefore, will most likely be ineffective.

The South African government has recognised the role and importance of SMEs in their economy. The Department of Trade and Industry (DTI) and the Small Enterprise Development Agency (SEDA) have taken various measures to provide adequate and appropriate finance for these emerging enterprises (Caga, 2012). Despite the South African government's initiatives to grow and support SMEs, there is still a high business failure rate on these SMEs. According to Friedrich (2016), 70–80% of small businesses fail within the first five years.

Post the global financial crisis, job creation and economic stimulation through the development of the private sector have become the main areas of focus for policymakers around the world. Recent evidence points to the importance of SMEs in providing employment opportunities across countries. In addition to being employers, SMEs also create the most, new jobs (Ayyagari, Demirgüç-Kunt, & Maksimovic, 2011). SMMEs also face many challenges in their daily operations that can often hinder growth. Access to finance is frequently cited as one of the primary obstacles that affect SMMEs disproportionately to other segments (Ayyagari, Demirgüç-Kunt, & Maksimovic, 2012; The World Bank, 2006).

Access to finance is crucial for the ongoing and sustainable growth and profitability of the small and medium enterprise sector through its role in facilitating the creation of new businesses, nurturing the innovation process and promoting both the growth and development of existing businesses that, in turn, boost national economic growth (Abdulsaleh & Worthington, 2013). This study explores the reasons SMMEs continue to struggle to gain access to banking finance in South Africa.

1.2 Problem Statement

With high unemployment rates and inequalities in South Africa, the role of SMEs in driving economic growth through job creation and innovation has become increasingly important. To

reduce both unemployment and poverty levels, an environment that is supportive of the needs of SMMEs is required to stimulate the survival and growth of SMMEs and to ensure the sustainability of the jobs created. It is generally accepted that SMMEs across the world, in both developed and developing countries, are key contributors to economic development, increase employment, and create jobs. They also increase competitiveness and create new markets. This is no different in South Africa.

According to Stats SA (2018), in 2018 there were 9.6 million unemployed persons in South Africa. This equates to an unemployment rate of 27.2% in Q2 of 2018, a deterioration from 26.7% in Q1 of 2018 with the highest unemployment rate being 27.7% over the past decade. Furthermore, there were 6.1 million unemployed youth (those aged between 15 and 34) at the end of Q2 of 2018. This brings the youth unemployment rate to 38.8% (Stats SA, 2018).

According to Finfind (2018), funding SMMEs is crucial to the growth of SMMEs. In addition, Finfind (2018) found that SMMEs, including start-ups, were struggling to access finance and that this needed to be addressed urgently, as it affects SMMEs potential to growth. Despite the known importance of SMMEs in the economy and the government initiatives to grow SMMEs, SMMEs continue to face challenges of financial access and high failure rates in their start-up phases. SMMEs lack of financial access is rated one of the top contributors to the low growth of SMEs. Without finance, SMMEs cannot compete with large corporates who have the financial means to expand. According to Finfind (2018), the SMME credit gap is estimated between R86 billion and R346 billion.

According to FinMark Trust (2015), South African SMEs constitute almost 91% of formal businesses, contribute to nearly 57% of GDP, and create close to 60% of employment (Kongolo, 2010). The South African government has put together programmes to support SMMEs. These programmes include supporting SMMEs with finance and include support that is not financial in nature. For example, SEDA was established to oversee the development of small businesses in South Africa. Other entities, such as Khula Enterprise Finance, were established with the primary objective of extending credit to SMMEs.

As disclosed in the National Development Plan (NDP), it is envisaged that by 2030, 90% of new employment will be generated by SMMEs. The FinMark Trust (2015) survey found that only 3% of SMEs in South Africa can access formal credit, while 93% have never accessed

credit with the majority stating “not needing finance” and “not believing in borrowing” as key contributors. According to The World Bank (2006), SMEs play a significant role in most economies, particularly in developing countries. Formal SMEs contribute up to 60% of the total employment and up to 40% of the national income (GDP) in emerging economies. These numbers are significantly higher when informal SMEs are included. The World Bank (2006) estimated that 600 million jobs would be needed in the next 15 years to absorb the growing global workforce, mainly in Asia and sub-Saharan Africa. In developing markets, SMEs generate the most formal employment opportunities, which create four (4) out of five (5) new positions. Access to finance remains a key limitation to the growth of SMEs. Without access to capital, many SMEs fail.

Finfind (2018) are of the view that the SMME credit gap in South Africa is estimated between R86 billion and R346 billion with start-ups and microbusinesses being the least served. There is a high demand for credit by SMMEs, but they are perceived to be a high-risk market segment to serve.

Access to finance is not the only challenge faced by SMMEs (Rogerson, 2008). In a study conducted in the Free State province, the following were identified as attributes to the SME failure rate: access to finance, inadequate premises, lack of equipment and tools, inadequate markets and marketing, theft, registering, and transport challenges. Chimucheka (2012) further asserted that the effect of most of these challenges can be reduced if the challenge of inaccessibility of finance is addressed.

1.3 Research Questions and Objectives

The main research questions this study seeks to answer are:

1.3.1 What factors are influencing SMMEs’ access to bank credit in South Africa?

1.3.2 What banks’ policies influence SMMEs ability to gain access to credit in South Africa?

The research objectives stemming from the research questions are:

- to examine why SMMEs cannot gain access to credit in South Africa; and
- to explore banks’ policy-specific factors influencing SMMEs’ access to bank credit in South Africa.

1.4 Justification of the Study

Abor and Quartey (2010) argued that SMEs in South Africa constitute 91% of formal businesses, absorb 61% of the labour force, and contribute up to 57% to the GDP. They further noted that despite the significant contribution of SMEs to the economy, they continue to be constrained by several factors ranging from access to markets, strict laws, inadequate training, and finance.

Quartey, Turkson, Abor, and Iddrisu (2017) argued that for sub-Saharan Africa to compete in the global economy, SMEs should grow, be efficient, and compete globally. They further highlight that SMEs in sub-Saharan Africa are the “missing middle” when referring to issues of access to financial services and financial inclusion. Osano and Languitane (2016) agreed with the importance of finance for SMEs in enabling them to grow and be competitive on the international stage.

An abundance of literature focuses on the difficulties SMEs face regarding accessing finance. Despite the vast literature on SMEs’ financial access, the problem continues to exist, requiring further research given the consensus in general on the role SMEs play in the economy.

The SMME credit gap in South Africa is estimated between R86 billion to R346 billion (Finfind, 2018). The SMME sector in South Africa offers a convincing, mostly untapped market opportunity for innovative financiers who can develop more innovative methods and tools of lending to SMMEs. Most research shows that one of the factors influencing business failure and lack of growth is financial access. The FinMark Trust survey (2010) found that only 13% of small formal sector businesses had accessed credit. Global Entrepreneurship Monitor (GEM) (2016) also found that in 2016, 28% of businesses closing was due to financial issues.

This study’s objective is to outline the current landscape of providers of funding and those seeking funding, particularly SMMEs. In addition to identifying the landscape, this study seeks to identify why SMMEs struggle to accessing finance, identify the possible root causes and highlight the potential opportunities available to financiers. This study further aims to provide solutions to increase financing to SMMEs and narrow the financing gap in the SMME sector.

This study aims to contribute to the development of the SMME sector and enable a better understanding of the barriers SMMEs experience to access banking credit. Once these barriers are identified, solutions can be put in place to eliminate some of these barriers and improve

SMEs' financial access and reduce the number of SME failures due to the inaccessibility of funding.

1.5 Organisation of the Study

This study is structured into five chapters. Chapter 1 is the introduction to the research. Background to the study is provided with the problem statement and research questions articulated. The remainder of the paper is as follows:

Chapter 2 provides an overview of the literature review, which includes the definition of concepts and terms related to SMEs. It gives an overview of SMEs in South Africa, an overview of the financial services landscape for SMEs in South Africa, and the theoretical framework for demand and supply factors for financial access. The chapter concludes by providing empirical literature on SMEs' financial access.

Chapter 3 provides a brief overview of the research methodology. This chapter outlines the research methods used to collect and analyse data. It justifies using the research methods and introduces the research hypothesis. Chapter 3 further provides the research limitations and concludes with a summary.

Chapter 4 outlines the research findings and analysis thereof. The findings are broken down into quantitative and qualitative findings. Research findings are discussed within the context of what other similar studies highlighted in the literature review.

Chapter 5 discusses the research findings and concludes by offering recommendations for SMMEs, government and banks.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter provides an overview of the SMME finance landscape in South Africa. The chapter also provides an overview of the financial services landscape for SMMEs in South Africa. Section one of the chapter provides various definitions and concepts of SMME finance. The chapter further provides a theoretical framework on demand and supply factors for SMME access to finance. The literature on factors influencing SMME access to finance is also discussed. The chapter concludes by providing a summary.

2.2 Definitions of Concepts and Terms

There is no universal definition of an SMME. According to Berisha and Pula (2015), academics and policymakers' application of the definition of an SMME generally contradicts what is universally accepted and the general regulation of a definition that is distinctive and is sector-specific. They further noted that as much it is easy to separate SMMEs from large businesses using qualitative variables, mostly, quantitative variables are used. They further noted that SMEs are usually identified by their characteristics that are indicative of their size. As such, SMEs are classed, in general, according to quantitative criteria that can be measured. The most used indicator to distinguish SMEs from large businesses is the number of employees, which varies across countries and industries.

Table 1: Distribution of Firms by Number of Employees in Different Countries

	Micro	Small	Medium	SME	Large
EU Countries, Iceland, Norway, Switzerland	1-9	10-49	50-249	1-249	250+
Australia	0-9	10-49	50-199	0-199	200+
Canada	0-9	10-49	50-499	0-499	500+
Japan	4-9	10-49	50-249	1-249	250+
Korea	5-9	10-49	50-199	5-199	200+
Mexico	0-10	11-50	51-250	1-250	251+
New Zealand	1-9	10-49	50-99	0-99	100+
Turkey	1-19	20-49	50-249	1-249	250+
United States	1-9	10-99	100-499	1-499	500+

Source: OECD Studies on SMEs and Entrepreneurship SMEs, Entrepreneurship, and Innovation

The definition of SMMEs covers a broad range of companies. The definition includes companies that are formally registered on CIPC, informal organisations, and organisations not registered for VAT (DTI, 2008). Small businesses range from informal microenterprises to medium-sized enterprises, such as matured traditional family businesses hiring more than 100 employees. Microenterprises include survivalist self-employed people from the poorest segment of the population.

In South Africa, a vast majority of SMMEs are concentrated on the lowest end of the spectrum where one would, in general, find survivalist businesses (Berry et al., 2002). These businesses can take the form of garage manufacturing and services, street vendors, and various home-based businesses established to create additional income sources. The informal sector comprises mostly SMMEs. Those categorised as survivalist businesses have muted growth potential and are less likely to hire employees (The DTI, 2008).

The OECD (2005) defined SMEs as non-subsiary, independent firms that employ less than a given number of employees. This number varies across countries. The most frequent upper limit designating an SMME is 250 employees, as in the European Union. Some countries, however, set the limit at 200 employees, while the United States considers SMMEs to include firms with fewer than 500 employees. In South Africa, SMMEs are defined by several categories, namely the number of employees, annual turnover, and total assets.

According to the National Credit Regulator (NCR) (2011), the definition of an SMME can be broadly categorised into two, namely economic and statistical definitions. Under the economic definition, a firm is regarded as small if it meets the following three criteria: (1) it has a relatively small share of their market place; (2) it is managed by owners, or part owners, in a personalised way and not through the medium of a formalised management structure; and (3) it is independent as it is not part of a larger enterprise.

The statistical definition, on the other hand, is used in three main areas: (1) quantifying the size of the small firm sector and its contribution to the GDP, employment, and exports; (2) comparing the extent to which the small firm sector's economic contribution has changed over time; and (3) in a cross-country comparison of the small firms' economic contribution.

The National Small Business Act (102 of 1996) has four categories for small businesses, which are micro, very small, small, and medium. The total number of employees, turnover, and gross

assets by category of enterprise varies by industry. Below are the definitions according to the National Small Business (NSB) Act.

Microenterprise: The turnover is less than the value-added tax (VAT) registration limit (R150 000 per year). These enterprises usually lack formality regarding registration. They include, for example, *spaza* shops, minibus taxis and household industries. They employ no more than five people.

Very small enterprise: These enterprises employ fewer than 10 paid employees, except for the 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, in general, 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 characterised by the decentralisation of power to an additional management layer.

There, therefore, is no universal definition of an SMME. For this study, an SMME is defined as any business, formal or informal, employing less than 100 employees with an annual turnover of less than R50 million.

Falkena et al. (2001) broadly summarised the small business definition as per the NSB Act as shown in Table 2.

Table 2: Definitions of SMMEs

Enterprise Size	Number of Employees	Annual Turnover (S A. Rand)	Gross Assets, Excluding Fixed Property
Medium	Fewer than 100 to 200, depending on industry	Less than R4m to R50m, depending on industry	Less than R2m to R18m, depending on industry
Small	Fewer than 50	Less than R2m to R25m, depending on industry	Less than R2m to R4.5m, 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

Source: Falkena et al. (2001)

2.3 Overview of Small and Medium Enterprises in South Africa

According to a survey by FinScope in 2010, there were an estimated 5.6 million SMMEs in South Africa of which only 17.3% were registered with the Companies and Intellectual Property Commission (CIPC) and had a bank account. According to Odendaal (2017), of the 5.6 million SMMEs, 3.3 million were survivalist businesses, 1.7 million microenterprises and 554 000 small enterprises. Based on the study commissioned by SEDA in 2016, there was an enormous difference between the formal and informal sectors. The formal sector appeared more educated, white, situated in Gauteng and the Western Cape, and with a higher turnover. It, however, was found that most SMMEs are black-owned and operate in the informal sector. Table 3 summarises the key indicators of SMEs in South Africa.

Table 3: Key SMME Indicators

Key Indicators	2015Q2
Number of SMMEs	2 251 821
Number of formal SMMEs	667 433
Number of informal SMMEs	1 497 860
SMME owners as % of total employment	14%
% operating in trade & accommodation	43%
% operating in community services	14%
% operating in construction	13%
% operating in fin. & business services	12%
% contribution to GVA*	21%
% black-owned formal SMMEs	34%
% operated by income group < R30k pa	7%

Source: BER, StatsSA *GDP before taxes and subsidies

According to SME South Africa (2018), 56% of SMEs are in Gauteng, 11% in Western Cape, and 9% in KwaZulu-Natal with the balance spread across the remaining provinces. Furthermore, the SME South Africa (2018) found that the majority of SMME owners are male (52%) and the majority of SMME owners are African blacks. Forty-seven per cent (47%) of SMMEs employ 2–5 persons while only 13% employ more than five (5) persons. The balance is where the entrepreneur is the only employee. Compared to other sub-Saharan countries, SME

South Africa (2018) found that South Africa’s rate of established businesses is extremely low with young businesses (60%) having reported being in existence for less than three years.

In the Global Entrepreneurship Monitor South Africa 2016-2017, Herrington, Kew, and Mwanga (2017) noted that entrepreneurial activity in the 25–34 year age cohort is less than a third of the African average and considerably lower than the average for efficiency-driven economies (17%). South Africa is ranked 58th out of 65 economies regarding entrepreneurial participation by 25–34-year olds. A disappointing score that is a likely strong contributor to South Africa’s decline in the overall total early-stage entrepreneurial activity (TEA) and is a cause for concern in its implications for future entrepreneurial activity in the country. Table 4 summarises the findings.

Table 4: SMMEs by Age Bands

	2001	2005	2009	2013	2014	2015	2016	Africa Region 2016 Average
18–24 years	3.4*	3.1	4.7	7.8	4.8	6.3	6.7	16.3
25–34 years	5.3	6.1	7.4	14.1	9	10.9	6.3	20.8
35–44 years	9.1	7.2	7.7	11.5	7.5	12.3	8.4	18.9
45–54 years	4.3	4.5	5.9	10.9	7.4	8	9.6	15.6
55–64 years	1.9	5.4	2.2	6	4.9	4.4	3.1	11.4

**Read as 3.4% of 18–24-year olds in 2001 were engaged in early-stage entrepreneurial activity*

Source: Global Entrepreneurship Monitor South Africa (2016–2017)

In 2006, The FinScope Small Business Survey Gauteng found that the majority of businesses in South Africa are informal. Table 5 summarises the findings by province.

Table 5: SMMEs by Geographical Location

	Formal Business	Informal Business	Population	Informal business/total business	Informal Businesses per capita	Formal Business per capita
Western Cape	78 000	111 000	4 760 000	58.70%	2.30%	1.60%
Eastern Cape	22 000	209 000	6 500 000	90.50%	3.20%	0.30%
Northern Cape	5 000	17 000	818 000	77.30%	2.10%	0.60%
Free State	13 000	126 000	2 740 000	90.60%	4.60%	0.50%
KZN	54 000	580 000	9 770 000	91.50%	5.90%	0.60%
North West	11 000	175 000	3 800 000	94.10%	4.60%	0.30%
Gauteng	199 000	616 000	9 450 000	75.60%	6.50%	2.10%
Mpumalanga	15 000	191 000	3 250 000	92.70%	5.90%	0.50%
Limpopo	10 000	266 000	5 410 000	96.40%	4.90%	0.20%
Total	407 000	2 291 000	46 498 000	84.90%	4.90%	0.90%

Source: FinScope Small Business Survey Gauteng (2006, p. 10)

2.4 Financial Services Landscape for Small and Medium Enterprises in South Africa

Various sources of financing are available to SMEs in South Africa that can be divided into debt and equity. There are also several programmes and schemes aimed at improving SMEs’ access to funding, usually provided by development finance institutions (DFIs) in the form of guarantees and grants. According to Finfind (2018), there are an estimated 148 finance providers with an estimated 328 different finance products on offer. These finance providers are divided between the private and public sector (government funders) with different operating and business models and different strategic objectives. The objectives of the government funders are to stimulate economic growth, especially in current environments of low or negative economic growth. As such, these sources of funding are limited to specific industries and have developmental objectives. On the other hand, most of the private sector funders have a profit motive and do not necessarily have developmental objectives. Finfind (2018) further summarised some of the types of finance products as follows:

Table 6: Types of Financing Products

Definitions of Finance Product Types	
Cost-sharing grant	Funds made available to new SMMEs or cooperatives to encourage entrepreneurship and economic inclusivity; hence, there is a black economic empowerment (BEE) requirement to access these funds. These are once-off grants that can only be accessed once in the lifetime of the business. The grant only covers a portion of the full costs required by the SMME/cooperative, and in many cases, the money is not given directly to the applicant, but rather, is paid to the suppliers of the required goods or services.
Cost-sharing incentive	Funds made available to SMMEs operating in key priority sectors. These are project specific, and the government provides a portion of qualifying project costs. The applicant pays these costs and the costs are refunded upon completion of designated milestones; therefore, it is not suitable for start-ups, unless they have good cash flow.

Definitions of Finance Product Types	
Cost-sharing loan	Loan provided by government funding agencies to qualifying SMMEs where the SMME must make an own contribution as part of the terms of receiving the loan.
Enterprise development funding	This is funding made available by the private sector in return for points on their BEE score-card; hence, they only fund BEE entrepreneurs.
Equity investments	Funds given in return for shares in the company.
Grant	Funds provided to SMMEs that do not have to be repaid.
Guarantee fund (government fund known as the Collateral Guarantee Scheme)	Funds that secure up to 90% of the collateral required to obtain a loan. This is typically a three-way arrangement between the guarantee fund, the funder, and the applicant.
Impact funding	Also known as Social Enterprise funding. Funding only provided to commercial businesses that can show their work has a positive social impact.
Incentive	Funds provided to incentivise SMMEs to develop and grow a specific sector, e.g. export incentives and manufacturing incentives.
Long-term loan	Loan is provided for a period of five (5) years or longer.
Medium-term loan	Loan is provided for a period of 2–5 years.
Private lender loans	Funds provided by private sector finance organisations.

Definitions of Finance Product Types	
Revolving loan	Once a certain percentage of the loan has been repaid, the SMME may borrow again from the same fund without submitting another loan application, e.g. access bonds on houses and credit cards.
Seasonal	Fund only accepts applications at specific times of the year. Many governments and Enterprise Development funds operate on this basis.
Short-term loan	Loan is provided for a period of up to two (2) years.
Tax incentives	These types of funds are provided by the government as an incentive for companies to fulfil specific mandates.
Term loan	A loan granted for a set period.

2.4.1 Commercial banks

Based on the research conducted by the NCR in 2011, it was established that there were 17 commercial banks operating in South Africa with an additional 13 branches of foreign banks present. Over and above this, the research found that there were two mutual banks and 41 representative offices of foreign banks. The NCR (2011) also found that 84.6% of the total banking assets were held by the four largest banks, namely First National Bank (FNB), Standard Bank, ABSA, and Nedbank. It also found that of the total SME loan book of these four major banks, Standard Bank's market share of the SME loan book was 35% with FNB lagging at 12%. Table 7 summarises the SME loan books of the four largest banks in South Africa in 2010.

Table 7: SMMEs Lending Book for the Four Largest Banks in South Africa

	Standard Bank	Nedbank	ABSA	FNB	Total
SME clients	367 500	346 500	210 000	126 000	1 050 000
Total book			R2.6bn		R13bn
Average size of loan	39 000		47 000		
Market share	35%	33%	20%	12%	100%

Source: Split of market share and average size of loan, based on SME Report (Falkena et al., 2001)

According to Fuchs et al. (2011), large commercial banks are by far the biggest suppliers of SMME finance and remain committed to supporting this sector, as they perceive SMMEs as an important segment for the growth of the business in future. The big four commercial banks in South Africa contributed a substantial proportion of the market for financing SMMEs while the public sector only contributed 2.5% of the SMME lending in 2009. The research further revealed that SMME business models for commercial banks in South Africa were vastly different and tended to have a more deposit-and-transaction service focus than providing credit to SMMEs.

It was also found that the ratio of deposits from SMEs was higher than the level of lending, which further suggests that commercial banks were less focused on lending but rather, on deposits. This was evident in the level of income generated by large commercial banks being from non-credit products and services. For example, 73% of the revenues generated from SMMEs in 2009 were from deposits and other fee-based services. On the lending side, a substantial portion of the SMME loan books consisted of traditional asset-backed lending with a small proportion being other products such as leasing, factoring, and trade finance.

Most SMMEs fail at obtaining access to finance. According to the statistics revealed by Foxcroft, Wood, Kew, Herrington, and Segal (2002), it is apparent that SMMEs prefer bank

loans over other sources of finance with a significantly high rejection rate from the banks. Table 8 demonstrates the approval and take-up rates by the type of source of finance for SMMEs.

Table 8: SMMEs Credit Applications by Type of Product

Applications for Finance and Outcomes in 2002				
	Entrepreneurs applying for finance	Applicants who were successful (%)	Applicants who accepted the offer (%)	Applicants who received finance (%)
Bank loan	84.4	25	85.2	18
Bank overdraft	18.2	62.5	76.7	9
Bank credit card	2.3	83.3	60	1.2
Microlenders	3.1	0	-	0
Stokvel	1.2	33.3	100	0.4
Mortgage	0.8	100	100	0.8
Venture capital 0.4 0 - 0.0	0.4	0	-	0
Average		33.2	82.4	27.3

Source: Foxcroft et al. (2002)

2.4.2 Development finance institutions

There is a range of DFIs operating in South Africa, some with a specific focus on certain industries. Below are a few DFIs operating in South Africa as cited by Business Partners (2016).

Development Bank of Southern Africa (DBSA)

The DBSA is a state-owned entity aiming to accelerate sustainable socio-economic development and improve the quality of life by driving financial and non-financial investments in the social and economic infrastructure sectors. Water, energy, transport, and information and communications technology (ICT) are its key focus areas.

Industrial Development Corporation (IDC)

The IDC is a national development finance institution belonging to the government, designed to promote economic and industrial development. The IDC provides finance for industrial projects and promotes partnerships between and across industries in South Africa and beyond its borders. Its investment products include Equity Funds, BEE financing of equities, and private funding.

The National Empowerment Fund

Established by the National Empowerment Fund Act No 105 of 1998 (NEF Act), the National Empowerment Fund (NEF) is a driver and thought-leader in promoting and facilitating black economic participation by providing financial and non-financial support to black empowered businesses. They also promote a culture of savings and investment among black people.

The Gauteng Enterprise Propeller

The Gauteng Enterprise Propeller (GEP) is a provincial government agency established in 2005 under the auspices of the Department of Economic Development. It provides non-financial support, financial support, and coordinates stakeholders for the benefit of Small, Medium and Micro Entrepreneurs in Gauteng. The GEP is working towards enabling full SMME participation in the economy and ensuring their contribution to the creation of employment opportunities.

Small Enterprise Finance Agency (SEFA)

The Small Enterprise Finance Agency (SOC) Ltd, also known as SEFA, was established in April 2012 because of the merger of the South African Micro Apex Fund, Khula Enterprise Finance Ltd, and the small business activities of IDC. With a footprint of nine offices around the country, SEFAs mandate is to contribute towards the alleviation of poverty by fostering the survival and growth of SMMEs.

2.4.3 Government grants and incentives

In some instances, a grant or incentive is offered to SMMEs to help grow their businesses and stimulate their growth. For example, The Department of Trade and Industry (DTI) offers a range of incentives and grants geared towards SMMEs.

Black Business Supplier Development Programme (BBSDP)

The BBSDP is a cost-sharing grant for black-owned small enterprises to assist them to improve their competitiveness and sustainability. The programme provides grants to a maximum of R1 million. This grant is broken up into R800 000 for tools, machinery and equipment on a 50:50 cost-sharing basis and R200 000 for business development and training interventions to improve corporate governance, management, marketing, productivity, and using modern technology on an 80:20 cost-sharing basis.

2.4.4 Private investors and fund managers

Unlike banks and other financial institutions with strict lending criteria and low-risk appetites when it comes to lending to SMMEs, angel investors often have a higher appetite for risk and are usually more willing to lend to the SMME sector, which is generally perceived a high risk by traditional lenders. This high risk taken by angel investors is usually rewarded by the prospects of high returns. Below are some of the angel investors operating in South Africa.

Angel Investment Network

Angel Investment Network is a web-based matching service for angel investors seeking investment opportunities and entrepreneurs seeking capital. According to Business Partners (2015), there are 30 networks worldwide covering over 80 countries in Europe, North America, South America, Africa, Asia, and Australasia. Angel Investment Network brings the investment

world much closer together by enabling entrepreneurs to contact investors locally, nationally, and internationally (and vice versa). The network, in 2015, had over 500 000 members worldwide, making it the largest angel investment community in the world. Since it is an internet company, overheads are low, and the contact process is streamlined. For this reason, the rates are extremely competitive compared to many other angel groups.

2.5 Theoretical Framework: Demand and Supply Factors for Access to Finance

According to SME South Africa (2018), SMMEs in South Africa have limited access to markets, and this is coupled with high competition and slow economic growth. These are some of the key factors influencing the demand for finance. Furthermore, SME South Africa (2018) found that the regulatory environment in South Africa affects SMMEs. Based on a survey conducted, 53% of the survey respondents cited government laws and regulations being restrictive on SMMEs in South Africa regarding taxes and requirements for licences or permits.

Di Noia, D’Onofrio, and Giovannini (2015) noted that the business conditions for SMMEs were significantly affected by the 2008 global fiscal crisis. The fiscal crisis has aggravated their financial limitations. As a result, shortages in funding have developed, together with low investment and growth. Given the low investment and slow economic growth coupled with the fiscal crisis, financial resources available for SMMEs were squeezed even for the most resilient entities. It is still uncertain what the root cause of this problem is. Does it lie on issues with demand or is supply a root cause?

Barbosa and Moraes (2004) highlighted borrower-specific factors affecting SMEs’ access to finance. These are factors within SMEs’ control and include the quality of business information, availability of collateral, and managerial competencies. Other factors include, particularly in South Africa, financial literacy.

The financing gap, which is usually defined as the difference between SMEs demand for funds and the supply of funds, can occur due to a variety of reasons. These reasons can be from a demand side or from a supply side. Others argue that the main reason for this gap lies in the characteristics of SMMEs. Others argue that the main reason for the financing gap could be market imperfections on the supply side (Park, Lim, & Koo, 2008). Finfind (2018) estimated the SMME credit gap between R86 billion and R346 billion in South Africa, which represents a huge opportunity for innovative lenders to enter the SME market.

2.5.1 Demand factors

Agency Theory

Agency theory in the context of SMMEs refers to a situation involving the business owners and other interested parties such as employees, financiers, and others who might have a vested interest in the business. Under the agency theory, it is assumed that the small business owner is not involved in the everyday running of the business, as this is the primary responsibility of the business manager as an agent of the small business owner. The theory focuses on the view of “two-sided transactions” that assumes that any transaction of a financial nature will have two parties participating in the transaction and both parties serving their own self-interest. Given the risks arising from the agency theory, most researchers argue that the agency theory might not necessarily hold in the context of small businesses regarding the financial management of the small business since small business owners are usually the managers of their businesses.

The Pecking Order Theory

According to Mole and Namusonge (2016), the pecking order theory is another theory that is considered in the context of how SMMEs manage their finances and make decisions regarding sources of finance. Under this theory, it is suggested that small business owners have a preference of which sources of finance to use to fund their businesses. It is assumed that small business owners’ first finance comes from profits in the form of retained income followed by debt then by hybrid instruments. Under this theory, equity is usually the last option for finance.

Other factors

Based on the analysis by Motsa and Associates (2004), SMMEs have several challenges affecting their ability to gain financial access, specifically from banks. These include inadequate collateral, the owner’s contribution is insufficient, blacklisting, failure to produce attractive financial records and/or business plans, and SMME-specific characteristics.

Foxcroft et al. (2002) also assessed factors affecting SMMEs’ ability to borrow money successfully. It also found that a lack of collateral was the main reason SMEs were unsuccessful in securing external finance. The findings are summarised in Table 9.

Table 9: Factors Influencing SMMEs' Access to Funding

Problem	Proportion of applicants who indicated the problem (%)
Blacklisted	12.9
Do not keep adequate financial records	11.7
Lack of collateral	45
Seeking working capital	28.1
One or more of the above	74.9
High risk: (1 or 2 or 3 and 4)	32.7

Source: Foxcroft et al. (2002)

According to OECD (2005) SMMEs are often disadvantaged when compared to large, well-established firms when it comes to accessing debt. The OECD also found that SMMEs usually do not have enough collateral, have a thin credit history, and might often lack the expertise and skills required to produce a set of financial statements (OECD, 2005).

Mole and Namusonge (2016) identified education and training, particularly among women, as one of the factors influencing demand. According to them, women have a limited understanding of their rights regarding laws and regulations, which affects their demand for credit. Furthermore, the high illiteracy rates among SMMEs result in SMMEs being unable to differentiate the different products offered by banks, which is further exacerbated by banking jargon that most SMMEs do not understand.

Makina, Fanta, Mutsonziwa, Khumalo, and Maposa (2015) further asserted that studies across different countries share a common view that SMMEs across different economies have similar

characteristics. One of the first characteristics relates to size. By being smaller than large corporates in size, they tend to be less capital-intensive and, in general, have lower investments in assets that could otherwise be used as collateral should the lenders require collateral. Added to this, they have small balance sheets that are not always attractive to lenders. Makina et al. (2015) further alluded to the structure of SMEs being sole proprietors who are not keen on inviting outsiders to invest in their businesses. This further constrains their ability to raise external funding and, therefore, leaves them even more reliant on banking finance than on equity capital. Added to that, the absence of financial transparency caused by the absence of formal bookkeeping records serves as an added factor to their limitations in securing finance.

SMMEs have a significant amount of their finance tied in working capital and as such, typically have little fixed assets to be used as collateral. Liquidity is dominant in the SMME sector. This restricts SMMEs' ability to gain access to credit, particularly from banks where there is a heavy reliance on tangible collateral to secure a loan.

The SMME aversion to the dilution of control, or rather, their preference to control, often restricts their ability to raise finance and as a result, hinders their growth. Makina et al. (2015) further argued that this need for control and independence are often regarded as the main reason for the differences in how SMMEs behave financially compared to large publicly listed companies.

Rogerson (2008) further noted, that according to several studies, access to finance has been identified as a barrier to the development of SMEs. He further refers to The World Bank survey done in Durban and Johannesburg where a lack of credit was found a key constraint to SMMEs. The survey found that SMMEs relied on personal savings or borrowings from friends and family to start financing their businesses in the start-up phase. The World Bank (2006) further found that high interest rates and inadequate access to finance together with inadequate collateral, thin credit history, and complicated application processes were the main drivers to the low usage of bank loans. According to the NCR (2011), it is possible that there is sufficient credit being made available, but the terms and conditions under which it can be accessed are unfavourable for the SMME sector it is intended to serve.

Fatoki (2014) stated that macroeconomic variables such as inflation, interest rates, and foreign exchange rates influence the supply and demand for credit. In an economic downturn, banks

tend to tighten their risk appetite and lend less to reduce their credit losses and maintain or increase profits. Furthermore, Finfind (2018) found that many SMMEs do not necessarily have financial literacy and, therefore, are unable to do proper financial planning and management. Similarly, regarding information to obtain funding, most SMMEs do not have the knowledge on the finance options and types or sources of funding available to them.

Most do not know who the funders are or what types are suitable for their business needs. Over and above this, they also found that SMMEs do not necessarily have the knowledge on the funding they qualify for. Significant amounts of time are spent approaching the wrong types of funders and applying for the type of funding that does not match their needs or for which they do not necessarily qualify.

Finfind (2018) further found that a key challenge for SMMEs is the attraction of the right skills that many start-ups require to grow their businesses, be better managed, and maintain adequate financial records. Consequently, they cannot manage their cash flow and are unable to clearly articulate their financial needs. Finfind (2018) also found that SMMEs lack financial readiness. The qualitative research revealed that most SMMEs who qualify for funding continue to be unsuccessful in securing funding due to their inability to provide the required documents to assess creditworthiness and eligibility.

2.5.2 Supply factors

The credit rationing theory by Stiglitz and Weiss (1981) is one of the main theories that focus on the financing gap. They argued that a conflict of interest arises between shareholders and those managing the business on behalf of the shareholders. This is called the agency problem. They further argued that only SMMEs truly knew their financial positions, ability to repay debt, and investment profitability. They argued that the agency problem, coupled with information asymmetry, were the main drivers of moral hazard and adverse selection risk.

Stiglitz and Weiss (1981) further explained the options among different financing types under conditions of asymmetric information and credit rationing. Information asymmetry could result in credit rationing conditions by changing the risk-return distribution. Because of this, banks are encouraged to decline applications for finance and thus, it results in discrepancies between divergence demand and supply (Alfo & Trovato, 2006). Green (2003) argued that SMMEs had limited access to formal credit in developing and emerging economies due to the relatively

underdeveloped nature of the financial system, the lack of liquidity, and inexperience in small-scale lending in many of these countries.

According to Mazanai and Fatoki (2012), there are four main reasons for banks' unwillingness to extend credit to SMMEs. The reasons are the administrative costs of lending on a small scale are too high, the issue of information asymmetry, the perceived high risk of SMMEs, and the lack of collateral. These reasons apply to both developed and developing economies. These factors, however, are more significant in developing countries. The costs of processing SMME loans are often fixed and given the small nature of the amounts requested by SMMEs, these costs are often inefficient and it, therefore, is too costly for the banks. Banks lack the means of reducing administrative costs.

Green (2003) further asserted that banks' costs of administering SMME loans tend to be even higher where there is a requirement to visit the SMME's premises to gather information, analyse information, and monitor the loans. SMMEs are not necessarily located near urban areas, often lack the necessary accounting skills, and do not keep adequate financial records. Added to this, Green (2003) further noted that banks do not have the required skills to service SMMEs.

Mole and Namusonge (2016) are of the view that banks, in general, charge high interest rates when lending to SMMEs. This is the perceived high risk of this segment and the high costs of serving SMMEs, which require relationship-based banking. They, however, believe that the high interest rates charged by banks are sometimes beyond banks' control and are driven by several factors that the banks cannot control such as the prime lending rate.

Finfind (2018) found that high transaction costs have been a challenge to both SMMEs and financiers. The costs associated with assessing the creditworthiness of SMMEs are extremely high. In addition, banks struggle to serve SMMEs. Banks apply the same treatment to SMMEs as they do to large commercial businesses. This results in traditional lending methods such as calling for collateral and credit scorecards being used. Finfind (2018) found these traditional lending strategies a hindrance to SMMEs securing funding.

2.6 Empirical Literature on SMEs' Access to Finance

According to Beck (2007), SMMEs constitute a substantial portion of enterprises and a large share and contribute the most to the creation of overall employment in the private sector of

most economies with 60% of total manufacturing in many countries being by SMMEs. Beck (2007) further argued that the evidence from cross-country reveal that SMMEs have more limitations to their growth due to limited access to financial services. According to Beck (2007), access to finance coupled with the cost thereof appeared to be among the top factors affecting the SMME business environment. Cost of finance was rated at 35% by 71 SMME participants as a top constraint. Thirty per cent (30%) of the SMME participants rated access to finance as an additional constraint to their business environment.

According to the GEM South Africa 2014 report by Herrington, Kew, and Kew (2014), the main reasons cited for business failure in South Africa were poor profitability and lack of access to finance. The report noted thin credit history, inadequate collateral, and business plans not produced to acceptable standards being the common factors affecting SMMEs' ability to access finance.

When looking at factors influencing SMMEs' access to finance, gender must be considered. According to Makina et al. (2015), gender affects the performance of SMMEs' business (Robb & Watson, 2012). This is indicative of the slow growth observed in female SMMEs when compared to male-owned SMMEs. The performance also lags those of their male counterparts (McPherson, 1996). Mead and Liedholm (1998) also established that women-owned businesses were concentrated in activities with low returns and prospects for growth being low.

Sabarwal and Terrell (2008) agreed that women-owned businesses were smaller relative to male-owned businesses and thus, male-owned businesses were more efficient. The relative size of the women-owned businesses was attributed to have a stronger effect on financial access.

Some of the factors identified by Makina et al. (2015) as affecting women SMMEs having access to finance include financial literacy, lack of understanding financial jargon, lack of awareness of services and products offered by financial services providers, and the lack of understanding the credit processes and the attitude of banks towards women. They further identified the lack of adequate programmes aimed at increasing SMMEs' access to banks, particularly for women, limited awareness of finance options by development finance institutions, and how to access those products and services as factors influencing women SMMEs' financial access.

They further assert that confidence in women tends to be lower than that of men when it comes to matters of finance. There are also inappropriate lending requirements such as the requirement for collateral that affects most women SMEs in developing countries due to women, in general, not having any asset ownership. Thus, most women are disqualified. Based on a survey conducted by The World Bank (2006), only 7 out of the 170 women SMEs across four provinces were familiar with the DFI offerings in their regions. This is indicative of insufficient marketing to women SMMEs.

The above factors, however, are not unique to women in the South African context. The lack of collateral affects most SMMEs. Furthermore, financial literacy is an ongoing challenge for these SMMEs together with the complicated credit application process. The NCR (2011) further noted other factors influencing SMMEs' access to finance to include the lack of business managerial experience and skills, insufficient information on available products, relatively low levels of financial literacy, poor business plans, and other external factors.

Financial literacy is necessary for understanding banks' requirements and how to conduct the business profitably. According to Reynolds, Camp, Bygrave, Autio, and Hay (2001), the lack of business skills and experience make it difficult for many potential entrepreneurs to access financial resources in South Africa.

Furthermore, according to the NCR (2011), it is possible that there is enough credit being made available, but the terms and conditions under which it can be accessed are unfavourable for the SMME sector it is intended to serve. The NCR (2011) further noted that there are SME-specific characteristics that influence their access to banking finance. These are (1) the lack of information available regarding the business, or where there is information available, the information is of poor quality; (2) the lack of collateral; (3) the failure to access financial services, including credit, due to various perceptions small business owners have of the requirements needed for access; (4) the poor level of managerial competence and skills of the small business owner; (5) the age of the enterprise; and (6) the legal status of the enterprise.

Lack of collateral (especially lack of tangible assets and equity contribution) is one of the most important reasons why credit is not available to new SMMEs from commercial banks (Fatoki, 2014). The World Bank (2006) further noted that SMMEs are deterred from applying for bank credit by complex application procedures, lack of collateral and credit history, and high costs.

Abdulsaleh and Worthington (2013) further agreed that the provision of collateral plays an indispensable role in easing SMMEs' access to debt finance. Motsa and Associates (2004) highlighted the importance of collateral and the lack of easily available collateral replacements to commercial finance institutions. Banks use collateral to mitigate customers' risk of default. In the South African context with the South African history of apartheid, however, few business owners will have tangible security to provide the banks. They are running their businesses to build wealth and to acquire assets that they can in future provide as security.

In contrast to financial access as a major challenge for SMMEs, The World Bank (2006) further found that the South African firms, in general, seem to have little demand for external credit. Most firms that did not have loans reported that they did not want or need a loan and few firms had been rejected for a loan. Black-owned firms, however, were more concerned about access to credit and cost of financing than others, regardless of their size, sector, or age. Black-owned firms were also less likely to have applied for or to hold a loan or overdraft facility, were more likely to have been rejected for a loan and tended to pay higher interest rates.

Finfind (2018) found numerous factors identified as affecting SMMEs' accessing formal funding. These factors include thin credit history, adverse credit record, inadequate collateral, poor financial literacy, business plans, and business skills. Nigrini and Schoombie (2002) are of the view that banks are reluctant to deal with SMMEs for three main reasons, namely SMEs are perceived as too risky, the costs involved are seen as too high, and the returns from SME loans are seen as too low. Nigrini and Schoombie (2002) further suggested that to mitigate the high risk perceived by banks, banks tend to create repayment incentives and enforce repayment by attaching collateral requirements to loans. SMMEs, however, seldom have adequate collateral, and this results in high interest rates being charged by banks to compensate for the high risk involved.

Motsa and Associates (2004), however, suggested that banks "are not geared to financing entrepreneurs since they developed in an economy dominated by large companies" and thus, "do not have the skills set for assessing start-ups and small enterprises". In addition to the lack of skills, banks "were not able to interact effectively with entrepreneurs" because of, once again, "the quality of communication and the level of understanding of their businesses by bank officials".

This could be because of the cost to serve SMMEs being too high and banks relying heavily on credit-scoring models to identify the risk of SMEs' default. Nigrini and Schoombie (2002) disagree and assert that the lack of skills is not an issue to banks. Bank employees are highly skilled.

According to The World Bank survey of 2007, there were three main barriers to SMMEs accessing finance. These were classified as physical access (the location to submit the loan applications), affordability, and eligibility. The NCR (2011) found that, based on The World Bank survey 2007, it takes up to twice as long to process the SMME loan application compared to a business loan application. The NCR (2011) attributed this to the quality of information submitted by the applicants. This could result in reworks and more information requested by the banks. This is indicative of SMMEs being unaware of banks' processes for originating a loan.

The NCR also identified additional SME-specific factors influencing SMEs' ability to access funding. These include the variability that SMMEs experience in their earnings that can fluctuate significantly annually, the low survival rate of SMEs, and the difficulty of separating small business owners' personal finances from that of the business. It is clear there are several factors influencing SMEs' accessibility to finance. These factors are both self-imposed by SMEs, some are inherent to SMEs, and some are supply factors.

Finfind (2018) found that start-ups and microbusinesses are the least served segments and represent the biggest financing gap. The challenge funders face in servicing this segment is that the demand for funding is high in SMMEs that are at an early stage and do not meet the lenders' criteria for offering credit. Lenders, therefore, decline this segment's applications for credit despite the high returns they could potentially make from this segment.

2.7 Summary

While SMMEs are still considered drivers of economic growth, the perceived high risk and costs to serve, continue to influence SMEs' accessibility to funding and deter funders from this sector. SMMEs in South Africa continue to be severely affected by issues of finance and access to financial products. This inadequate access influences the development and growth prospects of these SMEs.

Lack of collateral, inadequate financial records coupled with financial literacy and lack of understanding of the credit process have been common themes in the understanding of barriers to accessing finance. Banks, on the other hand, have high costs to serve SMMEs. In addition to this, the cost to serve coupled with the perceived high risk of SMEs result in higher interest charges that SMMEs cannot afford.

CHAPTER THREE: METHODOLOGY

3.1 Introduction

This chapter describes activities undertaken to explore the research problem statement and further explains the rationale behind the selection of certain methods used to identify, select, and analyse data collected. The purpose of this section is to answer two main questions: What method was used to collect or produce the data? And, how was the data collected analysed (Kallet, 2004)?

In this chapter, a brief outline of the research design and the deductive approach used to answer the research questions is provided. Then, the criteria used to select the research participants are discussed. Following the discussion on the population and the sampling method is a discussion on the instruments used to collect data and the related methods of data analysis.

3.2 Research Approach

For this research, a combination of quantitative and qualitative research methods was used to increase the reliability of the study. Triangulation was used to gather more insights using multiple data sources. Given the low response rate observed in the online survey, triangulation was used to increase the reliability of the study. The combination of findings from more than one source provides a clearer picture of the research. Furthermore, triangulation is usually used in research to describe a situation where a researcher used more than one research method, known as mixed methods.

According to Creswell et al. (2003), there are six generic types of mixed methods design. For this research, the concurrent triangulation strategy was used. In the concurrent triangulation approach, both quantitative and qualitative data are collected and analysed simultaneously. The two are then compared to identify any similarities, differences, or convergence. This model is useful when the researcher wants to offset the shortcomings of either method against the strengths of another due to its simplistic and straightforward nature.

Both qualitative and quantitative analysis are given equal priority. The concurrent triangulation is selected due to its simplistic nature and its ability to provide well-balanced findings. The benefit of using this method is the short period to collect the data due to the two methods being

deployed simultaneously. The concurrent triangulation method was used to offset the low response rate in the online survey and to increase the reliability of the study by using data from SMMEs and banking professionals. The other reason for using the concurrent triangulation was to gain different perspectives and increase the understanding of the phenomenon being investigated. Creswell (2013) summarised the concurrent triangulation, as seen in Figure 1.

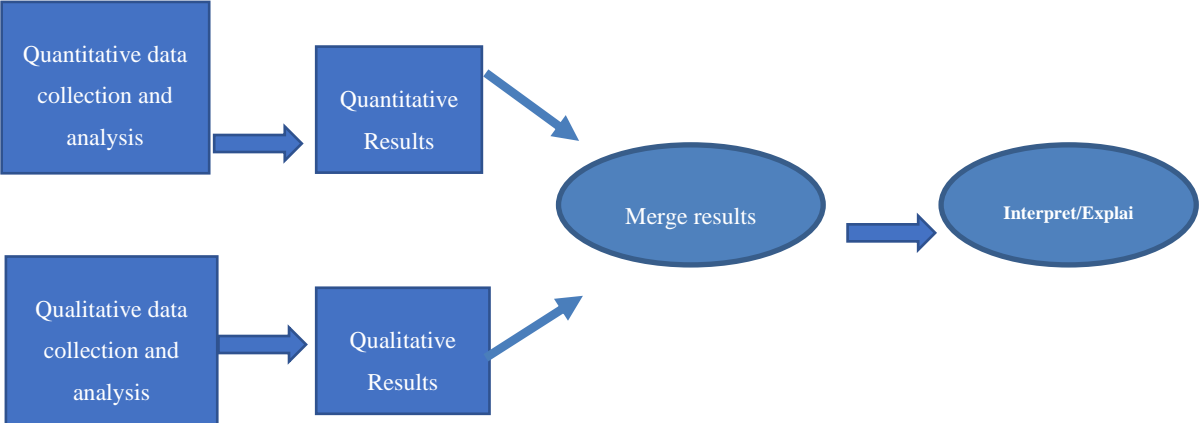


Figure 1: Concurrent Triangulation

According to Yilmaz (2013), one of the benefits of quantitative research is that it permits the researcher to measure the responses of several partakers to a limited set of questions thus, allowing for comparison and combination of data collected. The quantitative component, therefore, was used to identify the main reasons why SMMEs were successful or unsuccessful in obtaining banking finance. Furthermore, to increase the reliability of the quantitative study, qualitative research was done. According to Creswell (2003), qualitative research is appropriate to use when a research problem needs to be explored. The exploration is required due to the requirement to study a group or population. Characteristics that can be measured are identified.

3.3 Research Design

According to De Vaus (2001), research design refers to the whole plan that the researcher selects to combine the various aspects of the research rationally and logically, thus, making sure that the research effectively addresses the research objective. It creates a plan for how data will be measured, collected, and analysed. The research problem drove the type of design the researcher used. The objective of a research design is to verify that the evidence collected

addresses the research objective in reasonably. The design adopted for this study was in line with the concurrent mixed methods research approach explained earlier.

3.3.1 Population

According to Blair and Blair (2015), the first step in defining a research population is to define the units. Is the population households, behaviours, institutions, or other units? The definition of a research population depends on the research topic and objective. For this research, the heterogeneous population was defined as all SMMEs in South Africa regardless of age, gender, level of education, social status, and residence and bank employees who have worked with SMMEs. The SMMEs were identified for quantitative research. For qualitative research, bank managers working or having worked specifically with SMMEs were identified.

3.3.2 Sampling

Etikan, Musa, and Alkassim (2016) noted that convenience sampling is a form of non-probability sampling where the researcher identified research participants who meet a certain criterion to that of the research population. This is done due to practicality, time accessibility of the sample, and willingness to participate in the research. Convenient sampling method was used for both qualitative and quantitative research.

For quantitative research, SMMEs were selected using their LinkedIn profiles where they indicated that they were entrepreneurs and based in South Africa. The SMMEs were of different races, ages, and social statuses. The SMMEs were defined as either sole proprietors or formally registered businesses with CIPC, with a turnover less than R30 million per annum regardless of the development stage. A total of 100 SMEs were identified for this study.

According to Palinkas et al. (2015), purposeful sampling is an often-used sampling method. This method is used in qualitative research where the researcher identifies and selects research participants based on their experience in their subject matter and their availability, accessibility, and willingness to participate in the study. For qualitative research, purposeful sampling was used to select the research participants. Four bank managers working specifically with SME finance were selected and approached for the research. For this research, non-probability sampling was used. Convenient sampling was used for the quantitative study while purposeful sampling was used for qualitative sampling.

3.3.3 Data collection instruments

According to Muijs (2004), there are several types of quantitative research, namely experimental, quasi-experimental, and non-experimental. Experimental research differs from non-experimental research because the objective of the experimental research is to experiment. The basis on which can be defined as an experiment performed under controlled conditions that are designed to prove a known fact, or to test the validity of a hypothesis. The key factor with experimental research is control.

According to Hox, and Boeije (2005), for a researcher to collect data, several instruments are available for use. They noted experiments and quasi-experiments being the first option for data collection, as they allow the researcher to make reliable inferences. A survey is noted as another tool the researcher can use to collect data because surveys can collect large amounts of data from a large sample of respondents. They further noted interviews as a data collection tool for qualitative data where the sample is small. Hox and Boeije (2005) defined primary data as data collected for the specific research objective and research problem the researcher wishes to address. For this research, primary data were collected using surveys for quantitative research and face-to-face interviews for qualitative research.

Surveys

Muijs (2004) is of the view that surveys are the most popular research design in quantitative research because they are flexible and can be adapted to a variety of forms. Online surveys have the advantage of allowing the respondents to respond at their convenience. They are usually cheap to conduct and is a familiar tool for respondents. The shortcoming with surveys is the low response rate often associated with online surveys.

Wright (2005) has identified the cost-effectiveness of online web-based surveys as a primary advantage of using web-based surveys for research purposes. Paper surveys are expensive, even with a small sample; the cost of mailing and collecting responses can be high. This is also coupled with the fact that more people now have access to the Internet, which makes it easier for the researcher to access a large sample group due to different communities being formed online. This also saves time for the researcher.

Wright (2005) further noted sampling issues as a disadvantage to online surveys since the characteristics of the sample might be unknown. This, however, is not unique to online surveys.

This challenge is inherent in any form of survey. The other disadvantage noted by Wright is the issue of familiarity where participants might ignore the request to complete the online survey out of fear of being spammed.

According to Hox and Boeije (2005), in a survey, a big sample that is representative of a clearly defined population is surveyed. They noted one of the key characteristics of a survey is that a survey contains many standardised questions where responses are coded in standardised answer questions. Below are some of the examples of primary data provided by Hox and Boeije (2005).

Table 10: Examples of Primary Data in Social Research

Examples of Primary Data in Social Research		
Quantitative	Solicited	Spontaneous
	Experiment	(Passive) Observation
	Interview Survey	Monitoring
	Mail Survey	Administrative records (e.g. statistical records, databases, internet archives)
	Structured Diary	
	Web Survey	
Qualitative	Open Interview	(Participant) Observation
	Focus Group	Existing records (e.g. ego-documents, images, sounds, news archives)
	Unstructured Diary	

Source: Hox & Boeije (2005)

An online survey using Survey Monkey was used to collect data from SMMEs because it is cost effective and free to run and administer a survey on Survey Monkey. The survey was designed to ensure that the respondents do not spend too much time responding to the questions. The survey was designed to not take more than three minutes and to address the research questions.

Interviews

According to Gill et al. (2008), there are three fundamental types of research interviews, namely structured, semi-structured, and unstructured. Structured interviews are, in general, questionnaires carried out verbally where pre-set questions are asked, and there is very little room for variation or further elaboration. As a result, they are usually simple and fast to administer. The limitation with structured interviews is that they do not allow for in-depth use. Unstructured interviews, on the other hand, are not reflective of any preconceived ideas and are unorganised. Unstructured interviews are time-consuming due to their unstructured nature and the ability to ask the respondent to elaborate.

Semi-structured interviews have characteristics of both structured and unstructured interviews. Semi-structured interviews contain a few key questions that direct the interviewer to the areas they would like to explore but also allow for elaboration. Semi-structured interviews were used in this study to incorporate flexibility and because they are less time-consuming than unstructured interviews. Face-to-face interviews were conducted because they allow the researcher to gain rapport with the research participants and can increase the level of cooperation. Interviews also provide a high rate of response and allow the researcher the opportunity to clarify any answers that might appear ambiguous and to ask follow-up questions.

3.4 Analytical Framework

3.4.1 Quantitative analysis

According to Muijs (2010), it is necessary for the researcher to first analyse how the respondents have responded to the survey questions before analysing the responses. The responses were first analysed to determine whether there was any misinterpretation of the questions asked.

According to Freeman and Julious (2005), using figures or graphs to represent results from quantitative research is useful as a primary step to analysing data, as one can identify outliers with relative ease. They further note the importance of understanding the type of data being analysed to ascertain the appropriate method of displaying the data. They distinguish data between categorical or quantitative. For this study, the data collected are quantitative and discrete, as it is grouped into the number of observations per variable.

Frequency distributions were used to get a distribution of the respondents' responses because of their simplicity and understandability. The analysis of data into frequency distributions started with the number of respondents who applied for funding. The next step was to get a frequency distribution for the various types of responses to the different questions asked in the survey. Two segments were created; the segment that obtained bank funding approval, and the segment whose applications were declined. The reasons for approval or decline are presented in a frequency distribution.

3.4.2 Qualitative analysis

According to Thorne (2000), qualitative research is usually interpretive in nature. Data collection and analysis usually run in parallel. It, therefore, is important for the researcher to recognise that the data collection and analysis of qualitative research are not necessarily separable. Furthermore, Thorne (2000) pointed out that most qualitative data analysis approaches rely on "constant comparative analysis". In the case of an interview, this process involves comparing each new interview with the previous ones. This approach, however, is not the only approach to qualitative research data analysis.

Sutton and Austin (2015) also noted qualitative data analysis involving the comparison of one new interview with the previous ones and then to identify a trend. They term this interpretative phenomenological analysis. This form of analysis has its foundation in phenomenology and involves the researcher's interpretation of the output to the research objective. For interviews conducted, once transcribed, trends and themes were identified. The trends and themes were captured in Excel and analysed as lived experiences.

According to Watling and James (2012), qualitative data analysis involves six major steps. The first step involves defining and identifying data. It, therefore, is necessary for the researcher to have clarity on the data required to meet the research objective. Once the researcher has

identified the data needed to conduct the research, the data collection process begins. The qualitative data for this study were collected using a recorder and supported by written notes. The data were saved on Google Drive as back up.

The following step is data reduction. This step involves identifying which data are irrelevant to this study. Once irrelevant data are identified and reduced to saturation, similarities, keywords, and themes are identified from the respective interviews. Once themes and trends are identified, the data are coded and clustered into themes and theory is built on the outcomes and is tested. In building theory, the views and responses of the participants are analysed to ensure that they match or to see whether there are any deviations.

For this qualitative analysis, the data collected were coded using the variables used in the quantitative study. As progress was made and more data were collected through more interviews, additional themes or sub-themes were identified and named.

In summary, the qualitative data consisted of interview responses that were formally recorded. The responses were analysed and broken down into controllable themes, trends, and categories. In line with the research objective, the purpose of the qualitative analysis of this study was to identify the different variables of the collected and captured data to clarify perceptions and to identify trends, themes, and relationships. This is done by arranging, reducing, and clustering data. Based on the reduction and clustering of this data, the researcher made an effort to make sense of these trends and patterns in relation to the reasons SMMEs struggle to access banking finance and the results of the quantitative analysis.

3.5 Reliability of Instruments

To test the validity of the survey questionnaire used to collect quantitative data, an independent SME specialist was consulted to review the contents of the survey and make recommendations. The results were further compared to the literature review. Maxwell (1992) argued that qualitative research, by its nature, cannot account for all the possibilities in the research study and, therefore, the researcher cannot generalise. The validity of the research, therefore, lies upon the researcher to prove.

Hammarberg, Kirkman, and de Lacey (2015) cited trustworthiness, credibility, applicability, and consistency to prove reliability and validity of qualitative results. To prove trustworthiness,

the steps taken to collect data have been clearly outlined, and it is easy for an independent reviewer to follow and justify the methods used.

Regarding credibility, Hammarberg et al. (2015) deemed results to be credible when experiences are relatable to others who share that experience. The qualitative results were compared to the literature review to test for credibility. Verbatim quotation marks were used to give credibility to the research results. Hammarberg et al. (2015) further noted applicability as a test for the validity of qualitative results. According to them, the applicability criterion is met when a study can be related outside the situation in which it was conducted. Lastly, a test for consistency in testing the reliability of the results is suggested. To test for this, the qualitative results were compared to the literature review.

3.6 Research Limitations

One limitation of this study is the small sample sizes used for the interviews and survey questionnaire. This was due to challenges in getting survey respondents to respond to the online survey and due to SMME practitioners being busy and unable to be available for the interviews. A larger sample, especially for the survey questionnaire, would be more representative and could enhance the quality of the findings in investigating the factors influencing SMMEs' access to banking finance. Only 52 SMMEs were successfully reached via email and WhatsApp. The intended target was 100 SMMEs. The remainder of the emails bounced, and WhatsApp messages were not delivered. Another limitation of this study is the unavailability of the SMME database with valid contact records. The Small Business Directory was used to sample SMMEs, but some of the contact details were outdated, and telephone numbers were no longer in use.

3.7 Summary

A mixed methods research approach was selected for this study, as combining qualitative and quantitative research methods gives the research more reliability as opposed to performing only one of the methods. In addition, this chapter outlined the type of mixed methods approach taken, and justified the concurrent triangulation method used as a choice of mixed methods research. The data collection instruments and analysis methods used are also explained in this chapter with the research limitations being outlined.

CHAPTER FOUR: RESEARCH FINDINGS AND ANALYSIS

4.1 Introduction

As highlighted in the literature review, the improvement of SMMEs' access to finance will enable the meaningful contribution of SMMEs to economic growth, narrow the inequality gap, reduce unemployment, and alleviate poverty. The objective of this study was to identify the reasons SMMEs in South Africa struggle to access banking finance and the bank policy-specific factors influencing SMMEs' access to banking finance. This chapter presents the findings of the study from the quantitative data obtained through an online survey questionnaire with SMMEs and qualitative data obtained by interviews conducted with banking professionals.

The quantitative results were collected using a structured questionnaire administered online via Survey Monkey, and the qualitative results were obtained by structured interviews with banking professionals. The survey and interviews focused on factors influencing SMMEs' access to banking finance. This chapter forms the foundation on which Chapter 5 was based. This chapter consists of four main sections. The first section is a quantitative analysis of the survey questionnaire, followed by the analysis of the qualitative analysis of the semi-structured interviews. The third section links the findings of the quantitative and qualitative analysis. A conclusion is then drawn based on the findings, and finally, a summary of the chapter is provided.

4.2 Quantitative Analysis

In total, 25 SMMEs participated in the research. The intended target was to obtain at least 100 responses to the online survey questionnaire. In total, 100 SMMEs were sampled, and the online survey was sent via email and WhatsApp. Some of the emails sent bounced back due to invalid email addresses, and others were not opened and could have been perceived as spam. Fifty-two (52) messages were successfully delivered. Based on this, the response rate was calculated using the 52 as a base. This brings the survey response rate to 48%. According to Leedy and Ormrod (2010), the survey questionnaire response rate can often be low, sometimes below 50%.

4.2.1 Results of the survey questionnaire

Of the 25 survey respondents, all 25 gave consent to participate in the study. As depicted in Figure 2, 22 out of 25 were small businesses as defined by the NSB Act. A total of 88% of respondents were small businesses as defined by the Act.

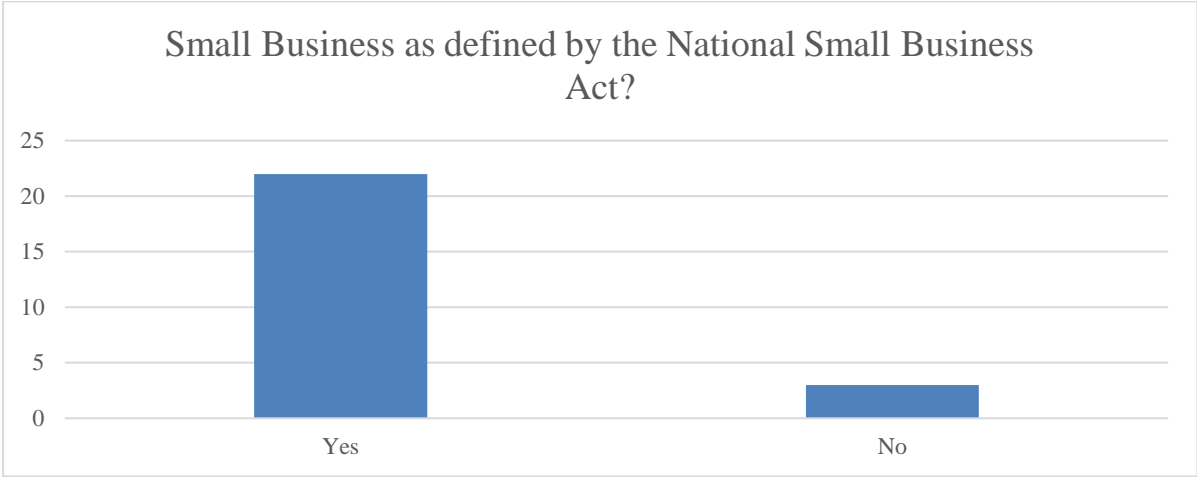


Figure 2: Number of Respondents Defined as Small Businesses

The number of respondents that applied for a bank loan in the last five years was eight (8). This represents 32% of the respondents that applied for a loan and the rest, 68%, did not apply for a loan. Majority of the respondents had not applied for a loan and cited the following reasons for not borrowing from the bank. Of the respondents, 33% who did not borrow from the bank cited banks' processes being too long and thus, a hindrance in applying for a loan. This could be indicative of banks' requirements being too complicated and a hindrance to SMMEs who urgently needs funds. It could also be indicative of SMMEs not being fully aware of banks' requirements and, therefore, not producing sufficient documentation required to make the application processes easier. This can result in a lot of back and forth between the banks and the SMMEs. Nineteen (19%) of those who did not borrow from the bank had poor credit records while the balance found it easier to borrow from friends and family or had no financial need.

The results are depicted in Figures 3 and 4. It can be inferred that SMMEs have no confidence in applying for banking finance due to the fear of being rejected or the perception of banks regarding lending to SMMEs. According to The World Bank (2006), high interest rates with inadequate collateral, thin credit history, and complicated application processes were the main drivers for the low usage of bank loans.

The FinMark Trust (2015) survey found that only 3% of SMEs in South Africa can access formal credit while 93% have never accessed credit with the majority stating not needing finance and not believing in borrowing.

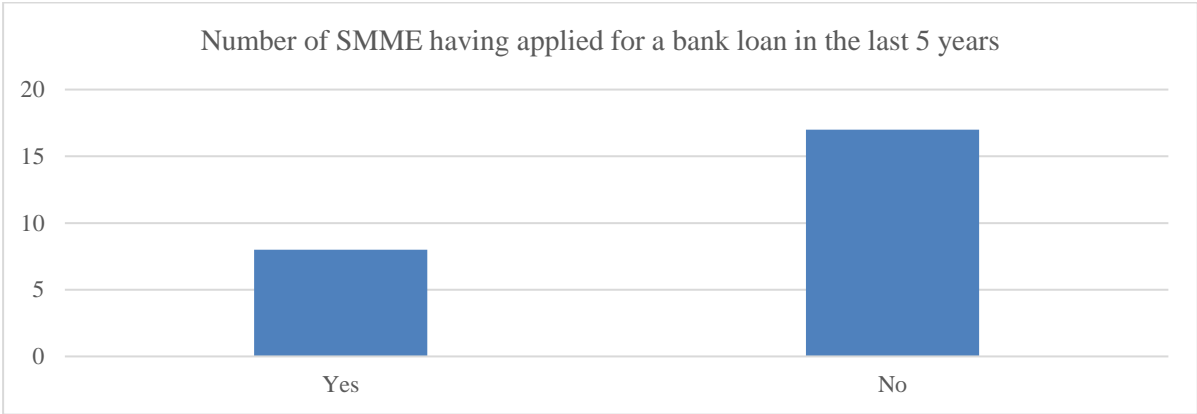


Figure 3: Number of SMMEs Having Applied for a Bank Loan in the Last Five Years

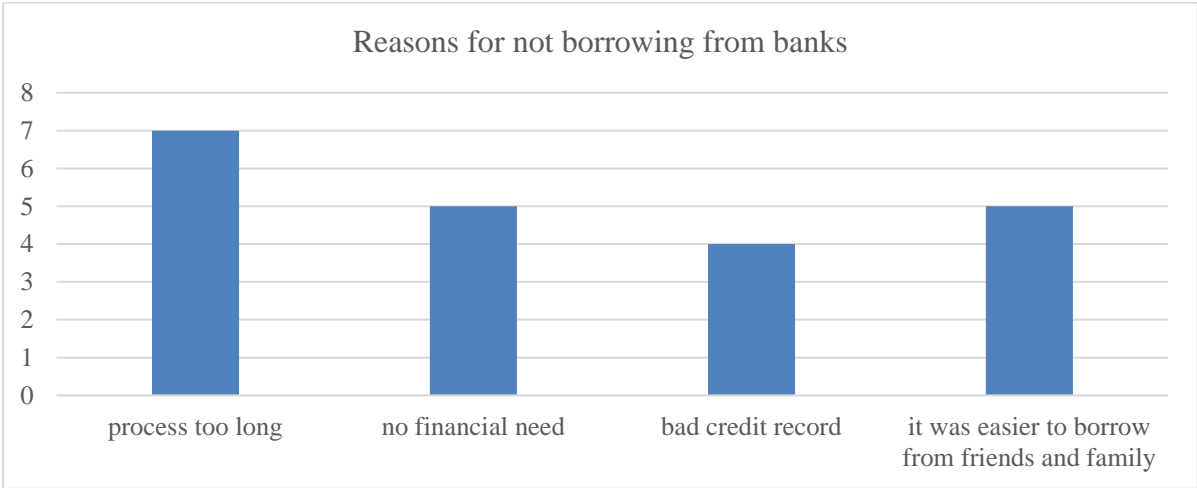


Figure 4: Reasons for Not Borrowing from a Bank

Of the respondents, 6 out of 10 (38%) had been successful in obtaining a bank loan in the past. The successful applicants cited a good credit record and a good business plan as the key factors to obtaining banking finance. Those who were unsuccessful cited a lack of collateral as the main reason for being declined, as shown in Figures 5, 6, and 7. Even SMMEs who cited not having applied for a loan in the last 5 years responded to the success factors. These responses are considered, as they represent the perceptions of the SMMEs.

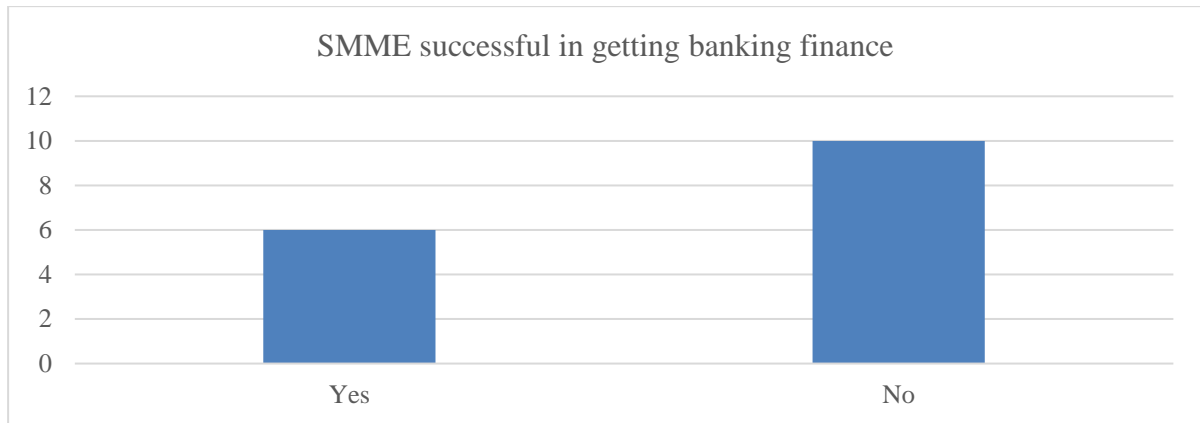


Figure 5: SMMEs' Success in Obtaining Banking Finance

It can be inferred that, in general, SMMEs in South Africa struggle to obtain banking finance.

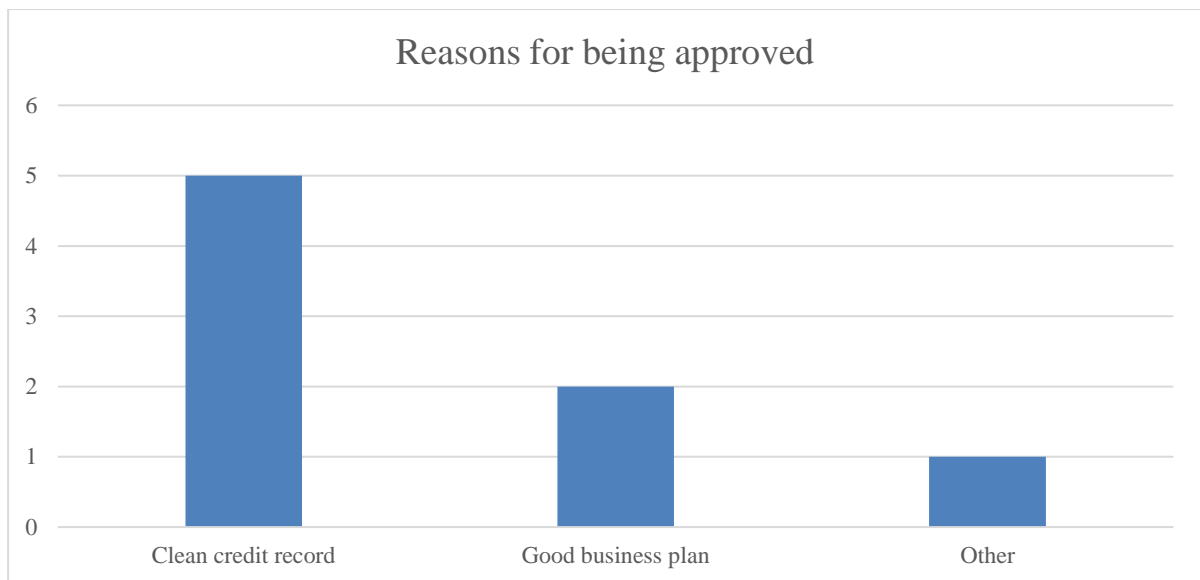


Figure 6: Reasons for Being Approved for Banking Finance

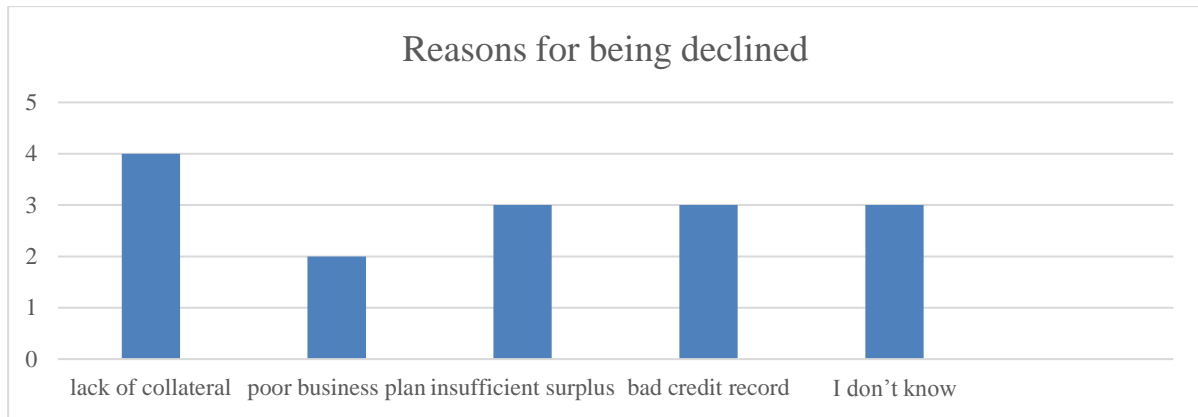


Figure 7: Reasons for Being Declined Banking Finance

The above figures indicate that access to finance for SMMEs continues to be a challenge due to SMMEs not having adequate collateral coupled with affordability. Affordability is indicated by the insufficient funds to service loans as another reason for SMMEs being declined banking finance. There is also a need for banks to be transparent with the reasons for declining SMMEs' finance, as 20% of the respondents cited not knowing the reasons for being declined finance. This highlights the need to educate SMMEs on banks' criteria for lending and how they can improve their chances of gaining access to banking finance.

According to Barbosa and Moraes (2004), the quality of business information, availability of collateral, and management competencies are the main factors affecting SMEs' access to finance. The above reasons given by respondents is indicative of this. Foxcroft et al. (2002) also found that a lack of collateral was the main reason SMEs struggled to gain access to finance.

4.3 Qualitative Analysis

The objectives of the qualitative analysis in the form of semi-structured interviews was twofold; first, to offset the weaknesses of the quantitative method used, and second, to get the supply-side perspectives of the reasons SMMEs continue to struggle to access banking finance. Four bank employees in managerial positions were interviewed. Consent was obtained from the interview participants, and it was further mentioned that the anonymity of the interviewees would be maintained. The participants consented to take part in the research.

The participants interviewed had an average of 5 years' experience in the SMME lending field at large listed banks in South Africa. The interviewees' roles ranged from credit managers, SMME strategy executives to SMME product managers. From the thematic analysis, banks' risk appetite, banks' lending strategies, and the education of SMMEs as the supply-side constraints to access to credit.

4.3.1 Banks' risk appetite for SMMEs

The respondents were asked whether they believed that small businesses struggle to gain access to banking finance. Four out of four indicated that they believed this statement is true. Three of the four research participants attributed this to the banks' risk appetite for SMMEs being set to be exclusive by design. Respondent 2 said, *“Due to the perceived high risk of SMMEs, banks tend to price for the risk, and this makes bank loans unaffordable to SMMEs”*.

The high cost of servicing this segment was highlighted by two of the four respondents. It was noted that due to the high costs that banks carry in servicing this segment, the segment is, in general, less profitable compared to other segments. As a result, banks tend to price too high to cover the costs of servicing this segment, and that, coupled with the high default rates observed, further exacerbates the challenge.

One of the respondents stated, *“Banks don't understand entrepreneurs and want to treat them like the personal consumer customer. You cannot look to make such high Return on Equity (ROE) on lending to this segment. Banks need to consider the returns made from other products. Banks need to have a customer level ROE and not product level ROE. Our current risk appetite excludes majority of the entrepreneurs”*. Another respondent observed, *“This segment needs to be cross-subsidised and we as banks need to recognise the developmental need in this segment and consider accepting lower returns.”*

All four respondents believe that banks are willing to support this segment and need to find innovative ways of assessing risk on these customers and not rely on traditional credit risk methods. All four respondents attested to their bank having a separate SMME unit. This is indicative of most banks being willing to support this segment and view this segment as a strategic sector. One respondent noted, *“We are committed to supporting small businesses, but we cannot rely on old methods of assessment. This is doing a disservice to the customers”*.

According to Green (2003), banks' costs of servicing and administering SMME loans are higher and are further increased by the need to gather and analyse information and monitor the loans. This, in general, requires a visit to SMMEs' premises. Mazanai and Fatoki (2012) further agreed that banks are unwilling to lend to SMMEs due to the high administrative costs of servicing this segment and the perceived high risk of SMMEs. Mazanai and Fatoki (2012) also cited the issue of information asymmetry as a factor.

Mole and Namusonge (2016) asserted that the cost of credit is, in general, high for SMMEs, as banks perceive SMMEs to be high risk and due to the relationship-banking nature of servicing this segment. According to Nigrini and Schoombie (2002), banks do not have an appetite for SMMEs due to their perceived high risk, high costs of serving this market, and low returns. Consequently, banks require SMMEs to produce collateral to mitigate against their high risk. SMMEs, however, seldom have collateral and, as a result, banks charge high interest rates to compensate for the risk taken.

It is evident that banks' perception of risk associated with lending to SMMEs plays a significant role in the SMMEs' ability to access funding. This risk, therefore, is mitigated by the requirement for collateral, which SMMEs in South Africa, in general, cannot produce.

4.3.2 Banks' lending strategies for SMMEs

Three of the four respondents believe that banks' SMME lending strategies need to be improved and customised to this specific sector. They indicated that personal consumer strategies that are used to lend to SMMEs' need to be customised to this specific segment using the unique characteristics of an SMME. Banks need to better understand SMMEs and develop strategies unique to SMMEs. Banks need to see the SMMEs for what they could become and not only look at history. Banks need to have a futuristic lense on how they perceive SMMEs.

According to Motsa and Associates (2004), banks "*are not geared to financing entrepreneurs because they developed in an economy dominated by large companies*" and thus, "*do not have the skills set for assessing start-ups and small enterprises*". In addition, banks need to be more innovative in how they assess affordability for credit. A request for financial statements is not effective, as this segment does not keep proper financial records in general. Four out of the four respondents indicated complicated product designs by the banks as one of the factors SMMEs

struggle with to qualify for finance. They cited banks' processes and requirements being complicated and not understandable even by some of the bank employees.

One respondent noted, *"Small businesses don't have financials. Why do we ask small businesses for financials? Besides, financials are historical. We run a centralised credit evaluations process. Those people don't know much about the entrepreneur. We need to be where the entrepreneur is and see the business for its potential, not its past"*.

Green (2003) argued that SMMEs often lack the necessary accounting skills and do not keep adequate financial records. Green (2003) further argued that banks do not have the necessary skills to service SMMEs.

4.3.3 Education of SMMEs

All four respondents cited poor credit records and lack of affordability as symptoms of a lack of understanding and lack of knowledge. The need to educate SMMEs on the benefits of proper maintenance of financial records and understanding of banks' lending criteria was also highlighted as an opportunity in this segment.

As the literature suggests (Mole & Namusonge, 2016), education and training, particularly among women, is one of the factors influencing demand. Furthermore, the high illiteracy rates among SMMEs result in SMMEs being unable to differentiate the various products offered by banks and this is further exacerbated by banking jargon that most SMMEs do not understand.

On the demand side, four out of four respondents cited lack of proper financial record keeping by SMMEs being the key factor to accessibility to finance. They indicated that SMMEs do not separate personal and business expenses, and these are often seen as one. This is also coupled with the understanding of banks' lending processes. Three out of four respondents identified the need for banks to be more transparent in their lending criteria so that SMMEs can be more informed in the processes. All four respondents cited a lack of financial education as one of the key factors influencing SMMEs' success in gaining finance.

Respondent 3 noted, *"It all comes down to education. The rest are just outcomes of a lack of education"*. Respondent 4 said, *"There is a big opportunity to train and educate in this segment. They need basic fundamentals of understanding financials and understanding what affects their creditworthiness"*.

Makina et al. (2015) noted financial literacy and a lack of understanding of financial jargon as some of the factors affecting SMMEs' access to finance. Mole and Namusonge (2016) further highlighted the need for education and training, particularly among women, as one of the factors influencing demand. They further note that women have a limited understanding of their rights regarding laws and regulations, and this affects their demand for credit. Mole and Namusonge (2016) further noted the high illiteracy rates among SMMEs resulting in SMMEs being unable to differentiate the various products offered by banks. They also noted that this lack of understanding is aggravated by banking jargon that most SMMEs do not understand.

4.4 Summary

This chapter analysed the responses obtained by quantitative research in the form of an online survey questionnaire. From the responses received, it is indicative that SMMEs continue to struggle to gain access to banking finance with 17 out of 25 respondents not having applied for a loan at a bank. This is indicative of the perception SMMEs have of accessing banking finance. The respondents, however, indicated having applied for finance at one point in their business existence, not necessarily in the last five years.

From the quantitative results, there is no one single factor that influences SMMEs' access to finance. Having a clean credit record, however, appears to be a key driver in accessing banking finance, as indicated by respondents who were approved for and those who were declined finance. The qualitative analysis further indicated the need to educate SMMEs on financial literacy as critical in ensuring the increase in chances of gaining finance. Education was cited as the root cause of low approval rates. The poor credit record and other decline reasons are due to SMMEs not understanding banks' lending criteria and not understanding the consequences of poor account conduct and poor governance.

CHAPTER 5: RESEARCH CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter summarises the study findings, conclusion and provides suggestions to policymakers, financiers, and SMMEs. This chapter further provides recommendations to researchers who wish to study the factors influencing SMMEs' access to banking finance.

5.2 Research Conclusions

The main objective of this study was to identify the reasons SMMEs struggle to gain access to banking finance. This stemmed from the back of high unemployment rates, particularly youth unemployment, and stagnant economic growth. SMMEs are identified as the key drivers of economic growth and job creation, but there is a high failure rate. According to Herrington et al. (2014), the main reasons cited for business failure in South Africa were poor profitability and lack of access to finance. It, therefore, is important to increase SMMEs' access to finance to increase their chances of survival. The secondary objective of this study was to understand the root causes underlying the factors influencing SMMEs' access to finance.

Non-probability sampling method was used to identify SMMEs for a survey questionnaire and bank managers for semi-structured interviews. The SMMEs were anonymously surveyed, and 25 responses were received. A further total of four banking managers were interviewed in a semi-structured interview. The data collected in the study were analysed and presented using graphs, charts, and detailed explanations.

Based on the study conducted, it is undeniable that SMMEs are an important sector in driving economic growth and closing the inequality gap. Despite the importance of SMMEs, from the literature review and analysis conducted, they continue to struggle to gain access to finance. The reasons for the low access to finance are multi-dimensional and range from banks' risk appetites being too strict, resulting in banking finance being too expensive for this segment. The main factor or underlying root cause is SMMEs' lack of understanding of banking processes and the lack of financial literacy and proper bookkeeping and governance.

There is a consensus on the importance of SMMEs in the economic growth of a country. There is also a general view of the positive relationship between SMMEs' business success and access

to finance. According to Rogerson (2008), access to finance has been identified as a barrier to the development of SMMEs. The study found that banks are open to supporting this sector and view this sector as a strategic sector. There, however, are several factors hampering on banks' intentions to grow and support this sector. These factors include the high risk associated with SMMEs, high interest rates, and high costs to serve.

This study highlighted the nature of SMMEs' credit record, good or bad, coupled with banks' complicated origination process as key factors in influencing SMMEs' access to finance. Linked to banks' complicated processes is the request for financial statements to assess SMMEs' capacity to service the debt. This requirement discourages SMMEs from applying for finance due to their inadequate accounting records.

This study highlighted a poor credit record as a symptom of a different root cause being education and lack of understanding. The study found a high need for SMMEs to be educated on banking processes and trained in financial literacy and business management. This can reduce the adverse credit bureau statuses affecting SMMEs' credit records. When SMMEs understand what makes a good or poor credit record, they can put measures in place to ensure a good credit record. The lack of understanding of the complex banking products can also be addressed by banks being transparent on how their products work and what the best uses are for those products. The study highlighted the need for financiers to develop innovative ways of assessing creditworthiness and not rely on traditional methods. Banks must consider alternative non-financial data in assessing risk.

Solving access to finance is the first step to resolving SMMEs' challenge. Access to markets also becomes critical if SMMEs are to succeed and contribute meaningfully to the economic development of South Africa.

5.3 Recommendations

5.3.1 SMME education

SMMEs need to upskill themselves regarding basic financial management and increase their financial literacy. This will enable them to better understand their credit affordability, business profitability, interpret financial statements, and put in place measures and actions to increase their chances of gaining access to finance and increase their returns on investments.

Furthermore, SMMEs should separate personal expenses from business expenses to accurately determine the profitability of the business. Free credit reports and scores are provided by major credit bureaus in South Africa, and SMMEs should use service to better understand the factors influencing their creditworthiness.

SMMEs should leverage government development agencies such as SEDA and National Youth Development Agency (NYDA) that offer free basic business management training. SMMEs can also leverage the incubation programmes offered by big corporates as part of their skills development programmes. Banks also have a role to play in educating SMMEs on their requirements for lending and how SMMEs can improve their creditworthiness. Banks have a social responsibility to teach SMMEs about financial wellness and its benefits. An increase in SMME knowledge and understanding will help SMMEs improve their financial conduct and avoid adverse statuses on their credit records or account conduct. This will lead to improved access to banking finance by SMMEs.

There is a need for SMMEs to further educate themselves on the various sources of finance available to them and not only rely on banking finance. There are also various financial products in the market that SMMEs can leverage, but due to the number of products, it can be difficult for SMMEs to know which product best suits their needs. Financiers need to simplify products and disclose the uses of each product together with the pros and cons. Banks should provide simple and straightforward financial product information that SMMEs can easily access and understand.

5.3.2 SMME governance

It is important that SMMEs run their businesses as separate legal entities and not mix their personal finance with those of the business. Proper bookkeeping and maintenance of financial records help SMMEs to increase their chances of getting finance and enable SMMEs to better understand their financial position and identify areas of the business that need improvement. It is often easier for banks to lend to someone who can demonstrate their ability to efficiently run their business.

5.3.3 Innovative credit risk assessment by banks

As highlighted earlier, it is a challenge for SMMEs to obtain credit. According to Finfind (2018), SMMEs that are less than three years old find it even more difficult to qualify for

funding. This is due to banks relying on customer history to make a credit decision. Financial data such as annual financial statements, bank statements, and credit records are a basic requirement. SMMEs, in general, do not keep a set of financial statements. Alternative data sources for assessing SMMEs' creditworthiness should be used instead of the traditional scoring methods. Banks should develop strategies that are futuristic and can assess SMMEs not for what they are but for what they could become.

Many of the traditional credit assessment methods prove to predict default. In the case of SMMEs, banks can combine these methods with other sources of data that is not necessarily of a financial nature. This can include social media ratings, compliance with legislation, and credibility of the main customer.

5.3.4 Use of credit guarantees

To de-risk SMMEs' lending portfolio, financiers can use the credit guarantee schemes that offer a loss-share at a predetermined premium. Credit guarantee schemes offer insurance on the credit losses incurred by financiers. Banks can consider schemes such as Khula Credit Indemnity Scheme and the International Finance Corporation's (IFC's) risk share facility to share the risk on this segment. These credit guarantees can be used for SMMEs that are declined based on collateral or the ability to service debt but who have a high potential of success. According to Finfind (2018), there has been a low take-up on the guarantee schemes. As further noted by Finfind (2018), the government guarantee schemes in place account for 0.03% of the GDP, but when compared with other countries, the impact is negligible.

5.3.5 Collaboration with government agencies and DFIs

Given the current situation of high unemployment, low economic growth, poverty, and inequality, the role of SMMEs in South Africa has become increasingly important in addressing those issues. Should these issues not be addressed with urgency, the economic and political stability of South Africa will be threatened. The SMME finance challenge, therefore, is not only the government's problem to solve but requires the government, private sector, and non-governmental organisations (NGOs) to collaborate to make this sector a success given its contribution to the GDP. Policymakers should revise some of the regulatory conditions under which SMMEs operate and the regulatory environment specific to lending to SMMEs. There is an opportunity for banks to view a sub-segment of SMMEs, particularly microenterprises, as

developmental credit. The government, NGOs, and the private sector have a significant role to play in the skills development of SMMEs and educating and training SMMEs on matters of business and financial management. The government should consider introducing entrepreneurship as a subject in the high school curriculum.

5.4 Suggestions for Further Study

This study investigated the reasons SMMEs struggle to access banking finance in South Africa. The findings indicate the need to educate SMMEs on banks' credit assessment methods. The findings also suggest the need to upskill and train SMMEs on financial and business management. This study could be further extended to other types of financiers such as venture capitalists. The political environment under which SMMEs operate can also be investigated.

As much as this study addressed some of the factors influencing SMMEs' access to banking finance, there is an opportunity to study the banking models for lending to SMMEs. This could be done by comparing different banks' credit assessment tools, application approvals, take-ups, and the performance of those customers over time, given the different methods.

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APPENDIX A: RESEARCH QUESTIONS

Surveys of 100 randomly selected SMMEs operating in South Africa. The surveys were created using an application called “Survey Monkey” and sent via email and WhatsApp to the selected SMMEs. Survey Monkey tool was used to collect the survey responses. Consent to participate in the research was obtained from the respondents.

The survey will cover the following question:

1. Are you a small business as defined by the National Small Business Act? **Yes/No**
2. Have they applied for a bank loan in the last 5 years? **Yes/No**
 - 2.1.If “No”, what are your reasons for not applying?
 - a. The process was too long and complicated
 - b. I have never needed finance for my business
 - c. I had a poor credit record
 - d. It was easier to borrow from friends and family
 - e. Other- please specify
 - 2.2. If your answer to question 2 above is “Yes”, were you successful in getting approval for the loan? **Yes/No**
 - 2.2.1. If “Yes” to question 2.2 above, which of the following factors do you think contributed to your success?
 - a. Long time with the bank
 - b. Clean credit record
 - c. Adequate collateral
 - d. Good business plan
 - e. Other
 - 2.2.2. If “No” to question 2.2 above, which of the following factors do you think contributed to your application being declined?
 - a. Lack of collateral
 - b. Poor business plan
 - c. Insufficient surplus to service the loan
 - d. Poor credit record
 - e. I don’t know
 - f. Other, please specify

Interviews with bank managers dealing specifically with Quality of information submitted by SMEs

The interview questions were as follows.

1. Why do SMEs continue to struggle to gain access to finance?
2. What are the main factors influencing SMME access to banking finance and how can these be addressed?

Please state from a bank/SMME perspective