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By

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Abstract

Venture capital as a source of finance and non-financial services has gained popularity among start-up and existing businesses worldwide in recent years. Venture capital has been synonymous with high technology start-ups in the United States and of late has emerged as a recognizable source of finance in South Africa.

South Africa has a healthy VC industry and growing number of SMEs. The SMEs in the country however have a challenge when it comes to accessing financial resources for starting businesses and for expansion purposes despite the existence of VC companies. It would have been the popular belief that the emergence of VC companies in the country would have increased the alternatives to the financing sources for SMEs but this seems to not have been the case. The VC companies are still not popular among the small business sector and their services are still not accessible as well. The aim of the study was to explore the state of venture capital market in South Africa and find out how it can accelerate entrepreneurial development. The researcher selected VC companies who are associated to the South Africa Venture Capital and Private Equity Association (SAVCA) and SMEs based Johannesburg area to take part in the study. The target sample was 70 venture capital firms and 200 SMEs from the Johannesburg area. The response rate from the VC companies was 53% and it was 67% from SMEs.

The results obtained from the study indicated that there was a need for VC companies to impart more information concerning their services to SMEs. The SMEs generally did not have much knowledge of venture capital, how and where ton access it hence the low accessibility of this finance source to South African SMEs. The empirical study revealed that only 17% of SMEs in the study had knowledge of VC financing and only 6% of the SMEs had approached VC companies in the past. It was also discovered that 85% of the VC companies believed that the conveyance of information relating to their services contributed to the challenges SMEs faced in accessing VC sector. Of the SMEs taking part in the study 45% strongly believed that the development of the VC sector will drive SME growth and survival in South Africa.

Table of Contents

Acknowledgements 3

Abstract 4

Table of Contents i

List of figures iv

List of acronyms v

Chapter 1 Introduction 6

1.1 Introduction 6

1.2 Research Context: Background 7

1.4 Purpose of study 9

1.5 Objectives of study 9

1.6 Research questions 9

1.7 Significance of study 10

1.8 Research scope 10

Chapter 2 Literature Review 11

2.1 Introduction 11

2.2 Sources of finance 12

2.3 Venture capital defined 14

2.4 Nature of Venture Capital funds 15

2.5 Common characteristics of VC firms 20

2.5.1 Venture Capital funds expectations 20

2.5.2 VC firms preference and stage of development 21

2.5.3 Technology and business planning 22

2.6 VC process 23

2.6.1 Deal generation 24

2.6.2 Screening 24

2.6.3 Due diligence 24

2.6.4 Deal completion 25

2.6.5 Monitoring 25

2.6.6 Exit 26

2.7 State of entrepreneurship in South Africa 27
2.8 State of Venture Capital Funds in South Africa 28
2.9 VC funds preferences 30
2.10 Conclusion 32

Chapter 3 Research Methodology 33
3.1 Introduction 33
3.2 Rationale for Research Methodology 33
3.3 Research design 34
3.3.1 Types of Research 34
3.3.1.1 Basic research 34
3.3.1.2 Applied research 34
3.3.2 Distinction between quantitative and qualitative research 35
3.3.2.1 Quantitative research 35
3.3.2.2 Qualitative research 35
3.4 Target population 36
3.5 Data collection 37
3.5.1 Questionnaire construction 39
3.5.2 Pilot Study 39
3.6 Questionnaire administration 40
3.7 Data collection and analysis 40
3.8 Validity and reliability 40
3.9 Limitations of study 41
3.10 Ethical considerations 41
3.10.1 Informed consent 41
3.10.2 Confidentiality and anonymity 42
3.11 Conclusion 42

Chapter 4 Results, Discussion and Interpretation of Findings 43
4.1 Introduction 43
4.2 The Sample 43
4.3 Results of study 43
4.4 Conclusion 49

Chapter 5 Conclusions and Recommendations 50
5.1 Introduction 50
5.2 Summary and Conclusion 50
5.3 Recommendations 51

References 53

Appendix A: Venture Capital questionnaire 71
Appendix B: Questionnaire to SMEs 76
Appendix C: Results from VC questionnaire (Question 12 – 19) 78
Appendix D: Reliability tests 93

List of figures

Figure 2.1: VC investments by industry... 17
Figure 2.2: Percentage of deals exited and still invested in 26
Figure 2.3: Venture Capital transactions in S.A. per annum from 2000 - 2012..................... 29
Figure 2.4: VC funds by sector in South Africa 30
Figure 2.5: VC firm preferences 31
Figure 3.1: Target Population 36
Figure 3.2: Data Collection Methods 38

List of acronyms

SME	Small to Medium size Enterprises
VC	Venture Capital
SA	South Africa
OECD	Organization of Economic Cooperation and Development
GEM	Global Entrepreneurship Monitor
GDP	Gross Domestic Product
ICT	Information and Communication Technology
IDC	Industrial Development Corporation
SEDA	Small Enterprise Development Agency
SAVCA	South Africa Venture Capital and Private Equity Association
URL	Uniform Resource Locator
UK	United Kingdom
US	United States
R&D	Research and Development
TEA	Total Entrepreneurship Activity
IBM	International Business Machines
SPSS	Statistical Programme for the Social Sciences

Chapter 1 Introduction

1.1 Introduction

South Africa is a vast country geographically and in terms of its population. The country boasts the biggest and strongest economy on the African continent. It has a diverse population, and it has been dubbed a rainbow nation because of its rich mix of races and ethnicities who flock into it to enjoy the endless possibilities that abound. It is a land of so many contrasts as well; the gap between the rich and the poor is very wide and increasing by the day. The townships of Reiger Park and Alexandra exhibit dire poverty whilst the suburbs of Bassonia and Meyersdale are havens for the rich. The poverty and the high unemployment rates should act as an impetus for government to promote SME development.

The country is one of the youngest democracies on the continent having just emerged from the apartheid rule. It is also riddled by high levels of violent crime and top level government corruption. The country's unemployment rate is hovering somewhere around 25.5% and this is a cause for concern for the current government (Stats SA, 2012).

Looking at the number of challenges facing the country one wonders whether the country has what it takes to get to the next level of economic development. It has to grapple with all these challenges in order to achieve the status of being a developed nation and high on its priority list is the reduction of high unemployment levels. The key to the reduction of poverty and high unemployment levels lie in the Small to Medium sized enterprises (SMEs) sector. The SME sector provided jobs to approximately 7 million South Africans in 1996. SMEs are the backbone of all economies and are a key source of economic growth, dynamism and flexibility in advanced industrialised countries, as well as in emerging and developing economies (OECD, 2006).

In order for the SMEs to develop and create adequate jobs that can result in significant reduction in the country's unemployment levels increased levels of government support are sought. The growth of the SME sector and entrepreneurial development in South Africa is being hampered by a rigid regulatory environment and limited access to capital (Van Eeden, 2004). A business cannot start and run without funding and this reason makes access to capital a key factor in the development of the SME sector.

Commercial bank policies in South Africa expect individuals or companies applying for business loans to meet certain requirements, which include collateral security. It is these huddles that prevent some of the brightest and creative business ideas from seeing the light of day. The banking system remains the main source of capital to start and grow businesses, whereas in other emerging countries, different financial structures play this support role (Gore and Fal, 2010). Having a creative business idea alone will not aid entrepreneurs as access to debt capital remains out of reach because of the myriad of requirements set by financial institutions but venture capital could fill that financing gap if it gets adequate government support. The study is aimed at shedding light on how venture capital could boost entrepreneurial development and the growth of the SME sector.

1.2 Research Context: Background

The research project is directed at exploring how venture capital firms can act as a catalyst in entrepreneurial development. There is a large number of SMEs who cannot access finance either through the traditional financial institutions which include commercial banks or through the government agencies which have been established to solely to focus on SME development. According to a GEM report South African entrepreneurial environment is mediocre and the report further stated that access to finance remains a perennial problem for all SMEs (Herrington, Kew and Kew, 2008).

SMEs face challenges in accessing finance because they largely lack the collateral which banks ask for. Most entrepreneurs struggle to raise finance for their businesses and use alternative fund raising avenues like borrowing from shylocks which is expensive and available only at unsustainably exorbitant rates such as 10% per month (Mulupi, 2012). The SMEs despite being the biggest employer in the South African economy are not able to stand up to the challenges of globalization due to limited access to finance. The development of the nation’s SME base requires the increase in supply of venture capital which is one of the only sources of finance that supports risky business ventures. In 2007, the contribution of venture capital-backed companies to the Canadian GDP was $14.5 billion which was 0.94% of total GDP (Durufle', 2009).

Without adequate finance, SMEs cannot acquire or absorb new technologies nor can they expand to compete in global markets or even strike business linkages with larger firms (Srinivas, 2005).

1.3 Problem statement

A financing option that is available to entrepreneurs is venture capital. However, venture capitalists in South Africa reject 88 per cent of all new applications for venture capital in the initial screening phase (Eeden, 2004). VC firms bring capital, skills and expertise, and in a long run they take over the business, should its owners be found incapable. According to Klonowski (2010) the problems of accessing finance and the provision of know how are closely related. Therefore access to finance is necessary to address operational challenges, and effective managerial skills assure proper utilization of capital. The provision of capital without proper managerial assistance is likely to result in a lack of development for companies (lack of know-how often leads to limited investment, which, in turn, leads to the limited growth of the business), more sensitivity to external factors, and a business potential that is unlikely to be captured. The researcher will find out the issue of capacity building whether the skills transferred to the recipient company have left the company, capacitated enough to stand on its own and still be successful. VC mostly finance fast growing businesses, which is not the case in SA, where SME’s are dominated by service sector, which is not fast growing. Paucity of data on why there is a low contribution of venture capitalist finance to SA SME’s.

Mostly literature on VC comes from the US, where it is seen as having had a resounding success. We do not have substantial literature addressing problems of VC in an emerging economy like SA. There are a number of reasons why VC companies might not have been successful in South Africa over the years have something to do with history and their accessibility of these firms. Most VC firms are owned and operated by people who come from the historically advantaged groups yet most SMEs who need financing are owned by the historically disadvantaged groups thus there is an element of distrust among these two groups. VC firms are spatially distributed in South Africa and they are to be found mostly in major metropolitan areas. The other reason for the low levels of success in VC firms could be their low accessibility to South African small business sector.

This study is expected to bring to light problem of the shortage of adequate information pertaining to venture capital as a source of finance. The study will further agitate for the integration of venture capital as a major component of business courses in higher learning institutions in South Africa. Once venture capital firms as well as local business figures become aware of this study, the researcher expects interest in venture capital to be further ignited. The interest of both the business sector and venture capitalists will likely lead to interventions such as business conferences and forums aimed at expanding knowledge and increasing accessibility of venture capital to entrepreneurs.

1.4 Purpose of study

The study is aimed at exploring the state of venture capital market in the South African economy and finding out how it could be leveraged to accelerate entrepreneurial development given that the existing sources of SME finance which include the government and banks have not achieved significant strides in the past.

1.5 Objectives of study

The objectives of this study are:

i) to find out how VC can function in a society where there is a wide inequality, and emerging from conflict;
ii) to investigate factors that contribute to low accessibility of venture capital in SA;
iii) to find out why VC is not widely known among SME operators, and
iv) to find out why few businesses pursue the VC finance alternative even among those who know it.

1.6 Research questions

The research questions of this study are:

i) How VC can function in a society where there is a wide inequality, and emerging from conflict?
ii) Which factors contribute to low accessibility of venture capital in SA?
iii) Why VC is not widely known among SME operators?
iv) Why few businesses pursue VC finance alternative even among those who know it?

1.7 Significance of study

This research is aimed at building a body of knowledge that will create a base for future research work on venture capital and SME development. There is little information in the form of books and business publications, which talk about venture capital and how it can be a catalyst for entrepreneurial development and this research project provides that answer. The study will also aid potential entrepreneurs and SMEs through the provision of information pertaining to venture capital financing.

1.8 Research scope

The study is limited to venture capitalists who are both governmental and private that operate from the Gauteng province. The research also includes SMEs that operate in Johannesburg that have approached VC firms in the past seeking funding. The research will focus on the VC funds that have helped develop entrepreneurship in Gauteng and in other provinces with any form of financing ranging from seed capital to growth capital.

1.9 Conclusion

The first chapter introduced the topic and discussed the research background, the problem statement, the purpose of study, objectives of study, significance of study, research questions and the research scope. The first chapter generally provided the reasons for the research study and an overview of what the reader can expect to find in more detail in the succeeding chapters. The next chapter is Chapter 2 which discusses literature review relevant to the study.

Chapter 2 Literature Review

2.1 Introduction

The development of the SME sector in the South African economy hinges on the sector being able to effortlessly access a wide variety of financing options. Presently the SME sector can access start-up finance from commercial banks and from such governmental organizations as Khula, Industrial Development Corporation (IDC), Small Enterprise Development Agency (SEDA) and from the private sector organizations such as Business Partners. Private equity which includes VC funds was responsible for 5% employment of South African formal sector employees which equates to around 427 000 jobs (Mulupi, 2012). The VC industry has recorded significant growth over the past few years. This goes to support the notion that if more VC investors would pour their funds into SMEs, which meet their requirements the country, would record notable reductions in the unemployment rates. The South Korean and Malaysian economies rely on small enterprises as a foundation of economic growth (Kerimova, 2007).

According to Abor (2007) a World Bank study discovered that 90% of small enterprises surveyed stated that accessing credit was a major constraint to new investment and this had substantial consequences on their growth and development. SMEs financing has attracted considerable attention over recent years and this can be attributed to the fact that most large companies usually start as small enterprises, so the ability of SMEs to develop and invest becomes crucial to any economy wishing to prosper (de la Torre, Peria and Schmukler, 2008). Due to the importance of SMEs in a developing economy more financing alternatives are needed.

For many entrepreneurs who are trying to break into the business world with their bright business ideas, accessing finance remains a chief challenge. Someone with an idea or new technology often has nowhere to turn to for financing and this is where venture capitalists chip in (Zider, 1998). The term venture capital is synonymous with the success stories of technology companies such as Google, Yahoo!, Netscape and Sun Microsystems. Venture capitalists invested $40 million in Netscape in 1994 and in just a year the internet giant's stocks were worth $2.1 billion (Quinden, 2000). It was a company founded by students using knowledge from university project and it appeared too risky. Despite the revered success stories authored by venture capital funds it must be noted that they do not form a large portion of SME funding worldwide.

Commercial banks and the government due to their inflexible policies do not want to expose themselves to unprecedented levels of risk through investing in ideas that might seem somewhat wild, they require tried and tested ideas and collateral security which most entrepreneurs do not have. Many SMEs also lack awareness of the different financing alternatives and with equity financing they are often unwilling to accept an outside ownership stake hence the high failure rates induced by among other reasons the lack of funding (Malan, 2007).

According to MacKaskill (2009) venture capital refers to the form of private equity most often raised by emerging enterprises, that is, those seeking funds from business Angels or Venture Capital Funds to develop their business concept or to support the initial growth phase. Venture capital financing unlike banks is a form of short-term funding for SMEs. MacKaskill (2009) asserts that venture capital funds are a catalyst to entrepreneurial development because of the fact that they provide business finance in relatively high risk situations where other forms of finance, such as bank loans or lines of credit are not available. The development of this unique type of financing in the South African SME sector would breathe much needed fresh air and accelerate the pace of SME growth hence a reduction of the country's unemployment rate. The literature review will begin with discussing the sources of finance, and then define venture capital, discuss the state of entrepreneurship in South Africa and also discuss the venture capital processes of identifying firms in which they invest. The chapter will be end with a summary of the discussions covered in this chapter.

2.2 Sources of finance

Attracting finance is one of the difficulties experienced by new ventures; investors usually want to invest their money in proven ventures, which have a proven track record in profitability (Sayed, 2010). This is validated by a research conducted by two Ghanaian professors who argued that the lackof funds may be the immediate reason for a business failing to start or to progress, even when the more fundamental reason lies elsewhere (Abor and Quartey, 2010). The 2012 GEM Report stated that the lack of venture capital funding and angel investors in South Africa, as well as limited availability of affordable funds remain critical issues that require dedicated attention (Simrie, Herrington, Kew and Turton, 2011). The capacity of a business to expand is usually thought in terms of available finance and the ability to expand the markets. It is therefore crystal clear that finance despite not being the only ingredient of success for entrepreneurial ventures it is a critical factor.

The lack of funds for SMEs in South Africa has been cited as a major hindrance towards the development of entrepreneurship. The bulk of the capital that entrepreneurs utilize to start their ventures will be from their savings or invested by friends and relatives. Due to the fact that these sources of finance are most usually inadequate to support small businesses' expansion, entrepreneurs will turn to a variety of financing mechanisms, which include debt and equity options (Sayed, 2010).

Obtaining debt capital is often viewed as difficult by most entrepreneurs due to the requirements that are set by providers of debt capital and again debt is also known to be a risky source of funds. Many financial institutions are not accustomed to dealing with small loans that lack conventional collateral (Newland and Tanaka, 2010). Research in the field of small business financing has also discovered that the high interest rates, collateral requirements and the cumbersome processes are some of the main impediments to entrepreneurs accessing bank loans (Abor and Biekpe, 2006). Financial institutions generally require formal business records as criteria for considering a loan and most of the newer SMEs do not have formal business records. The issue of poor record keeping worsens their chances of having any success with obtaining loans from banks (Herrington, Kew and Kew, 2008). The finances that are available from lending banks and financial institutions tend to be much more restricted than for big companies. Banks usually charger higher interest rates and the sums that they give to smaller business are usually smaller (Butler, 2001). This problem is coupled with the fact that smaller entrances into the business sector do not have any negotiating power when it comes to interest rates and the terms of borrowing.

Entrepreneurial firms that are characterized by significant intangible assets usually expect years of negative earnings and have uncertain prospects and their chances of receiving funds from banks or any other form of debt financing are also quiet slim (Lerner, 2009). Banks are not prepared to risk their funds in small firms because of the high levels of risk that is involved. According to Lerner (2009) the difficulties which are associated with accessing debt finance imply that the equity instruments such as venture capital which is described as independently managed, dedicated pools of capital that focus on equity or equity-linked investments in privately held, high-growth companies represent an answer to the issue of source of finance.

2.3 Venture capital defined

There are many different definitions of venture capital, which include the following.

Definition 1: A form of private equity most often raised by emerging enterprises, that is, those seeking funds from business Angels or Venture Capital Funds to develop their business concept or to support the initial growth phase (MacKaskill, 2009, p. 21).

Definition 2: According to the Southern African Venture Capital and Private Equity Association (2012) venture capital is a subset of the private equity asset class which deals with predominantly equity funding of high tech, high growth-potential businesses, whose growth is typically achieved through radical global scaling.

Definition 3: Venture Capital is equity funding provided by outside investors into early stage ventures in return for above-average returns (Frontier Market Network, 2012).

Definition 4: Venture capital is the name given to equity finance provided to support new, expanding and entrepreneurial businesses (McLaney, 2009, p. 461).

The following features differentiate venture capital funds from traditional sources of finance:

- The common feature of VC investments is that they provide business finance in relatively high risk situations where other forms of finance, such as bank loans or lines of credit are not available.
- Venture capital is equity funding provided by external investors during the early stages of a business start-up in return for above average returns (Frontier Market Network, 2012). Venture capital funds are exchanged for shares in the target business as opposed to loans. The difference that can be identified is that it is equity funding whilst the banks provide loans, which are debt finance.
- Due to the fact that in these high-risk finance arrangements there is a high reward element, there are both significant failures as well as spectacular success stories. Venture capital funds are provided by firms or individuals, who are prepared to take the risks of investing in ventures that are high risk, innovative and have a promise of high returns. According to Fairchild (2011) venture capitalists and angels investors provide important alternative sources of funding for entrepreneurs seeking start-up finance for innovative projects. Banks and government affiliated SME funders are not there to invest in business ventures that are somewhat emanating from wild imaginations but prefer low risk proven models.

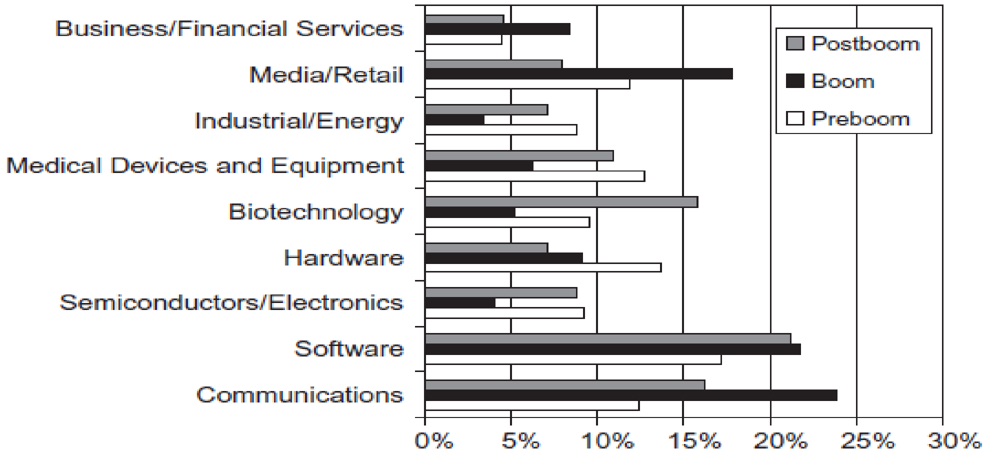
2.4 Nature of Venture Capital funds

Venture capitalists raise predetermined amounts of money, which are usually called funds. They do not primarily invest their own capital, but rather raise the bulk of their funds from institutions and individuals (Lerner, 2009). Investors in venture capital usually include large institutional investors, such as pension funds and university funds who desire investments in their portfolios that have great potential to generate high yields. McLaney (2009) further elaborates that a bulk of the venture capital is also contributed by a number of smaller investors, in many cases taking advantage of the tax incentives available to providers of equity finance through such funds. These types of investors also do not mind placing substantial amounts of capital in investments that cannot be liquidated for long periods of time (Lerner, 2009). It must also be noted that venture capitalists are attracted by fast expanding, often high-tech businesses. According to Mclaney (2009) venture capitalists are usually expecting returns that range from 25 to 35 per cent per annum on a relatively short-term basis running up to five years.

Once the investment has been committed by the investors, the venture capitalist screens and evaluates investment alternatives in high-potential start-ups and existing firms (Moore, Petty, and Longenecker, 2008). The screening phase is used to select the best investment alternative, which is expected to shield the investors from extremely high risk and at the same time offer them very high returns. Most VC funds tend to invest in businesses that they are familiar or that are closely related to the other portfolios they hold (Lerner, 2009). Venture capitalists have therefore been known to be highly selective in their choice of firms that obtain their funding and this has meant a few of the firms that apply for this kind of funding actually obtains it. According to Klonowski (2010) traditionally VC firms give finance to approximately one out of five hundred business plans that they review. This highlights that despite receiving significant coverage in business media; very few start-ups ever receive VC funds. In the United Kingdom only a small minority of small business use this form of financing even though venture capital actually plays a valuable role in the provision of finance (McLaney, 2009).. This could be attributed to the fact that it is only available to outstanding innovative businesses, that is it does not fund coffee shops or fashion design businesses. Corporate venture capital programs are interested in new technologies and the development of potential new products (Cumming, 2010). VC funds have also been known for their avoidance of firms requiring significant capital resources preferring to invest in small firms with commoditized products (Klonowski, 2010). The selection process is therefore very stringent and this leads to only a few lucky firms from a large pool actually obtaining the financing from a VC firm. Venture capitalists conduct due diligence checks on the investee firm, which may takes to months and this is aimed at addressing the risks associated with the business (Davila, Foster and Gupta, 2002). VC firms are not looking for long-term investments but rather opt for those short-term investments, which will allow them to get their returns and exit quickly and search for other options. Venture capitalists, on average, hold their investment for an average of three to five years following which they dispose of their shareholdings in the investee firms. According to Polonsky and Waller (2005) the VC fund managers and the investee firm sign an incubation contract which binds the venture capitalists to nurture the business until such a stage when the firm is generating adequate revenues. This means that VC firms are prevented from premature exits. The fund managers are therefore forced to ensure the success of an investee firm also considering that most of their returns will come from the growth in the value of an investee business rather than dividends (Polonsky and Waller, 2005). A firm in its early stages will not pay dividends because a bulky of their capital goes towards ensuring the firm's early stage developments which include extensive research and development initiatives. According to Metrick and Yasuda (2011) dividends are not normally paid out through the holding period and all profits are reinvested into the development of new products or services, the building of new production facilities, the acquisition of other businesses, or the strengthening of distribution capabilities.

VC firms are without doubt searching for investments that are highly innovative, with potential to yield very high returns and they are definitely not searching for an ordinary business idea. A report which detailed the launch of a R350 million VC fund made it clear that its objective was to identify companies that had the potential to succeed on an international level and provide access to an international network of leading companies, venture capital firms and institutions in the technology arena (S.A Good News, 2008). VC funds seek to invest mostly in high growth industries and have a bias towards the information technology sector (ICT). Figure 1.2 below shows the industries that have traditionally benefited from VC funds.

Figure 2.2-1: VC investments by industry



Source: Metrick and Yasuda (2011)

The graph shows that VC firms have a bias towards businesses in the communication and software industry and business financial services receive the smallest attention. The communication and software sectors are high growth industries and they have enjoyed high growth rates hence the interest from venture capital firms. The investment by VC firms in technology is a worldwide trend which indicates that the development of new technology actually is fuelling the growth of the VC industry. A global upsurge of investor interest in technology investing, both from the retail and the institutional sector has helped fuel the creation of a wave of new private equity and venture capital firms (Small Business Service, 2005). Venture capital is generally well suited to the requirements of new technology based firms hence the attraction to fund technology based start-ups (Christofidis and Debande, 2001).

Venture capital funds are usually divided into the following types of financing options, which include:

a. Types of VC funds

Seed capital: According to SAVCA (2012) this is financing typically used to pay for preliminary operations as market research and product development. Put in other words it is invested in research and development before the business can start investing. Seed capital is put into a firm, which is at seed stage. This in when a business' investment is an idea that has not yet become a company. Seed funding is not popular with South African fund managers.

Start-up funding: Start-up financing is provided by venture capitalists to companies that are in the process of being set up or may have been in business for a short time but have not sold their product commercially (Bender, 2011). These funds will be utilized in establishing a business venture. It is also used to fund the hiring of staff, renting of office space, equipping the production system among other things.

Development Capital: This is finance, which is used to further launch the business and grow market share in order to become profitable. Development capital is also known as expansion capital. In order to fund the expansion the VC fund managers check the expansion trend of the demand and the sustainability of the required investment (Caselli, 2010).

Growth Capital: These are equity type investments used to assist established but still high-risk ventures in expanding activity such as launching into foreign markets, creating new product/ technology lines, accelerating production and/or acquiring competitors. Development and growth capital are collectively called early stage capital as they are used to fund companies that are established but are ready for further development and aggressive expansion (Frontier Market Network, 2012).

b. Benefits of VC funds to SMEs

Venture capital funds provide strategic direction to ultimately grow investments to a profitable exit whilst banks and government funders will mostly provide loans and ensure the business pays back their loans on time. According to Quinden (2000) venture capital managers bring a wealth of experience and insights into international expansion, legal requirements regarding exchange control and intellectual property protection and an international contact base to open doors for entrepreneurs. Many venture capitalists also use their knowledge, management expertise, and network to support their investments and thus to enhance the development of their portfolio companies (Bender, 2011). Venture capitalists have also developed tools that are very well suited to the challenging task of nurturing high-risk but promising new ideas (Lerner, 2009). This tends to increase the chances of success of the funded firm. When comparing VC funds with angel financing, venture capital funds emerge as the financing of choice. Fairchild (2011) contends that this may be attributed the higher value-creating abilities associated with VC funds than angel financing.

Venture capital funds possess more cash on hand for entrepreneurs for growth and they do not have a fixed repayment period (Frontier Market Network, 2012). VC funds therefore will offer SMEs adequate time period to find their feet and strengthen before they exit. Furthermore VCs participate fully in the opportunities and risks and, in contrast to the banks, do not consider the issue of collateral and instead undertake an in-depth analysis of the projects (Bilau and Couto, 2012). Bank loans have a fixed repayment terms and failure to meet the repayment terms might result in legal action towards the business in question.

Investors in venture capital funds only realize returns when the business they have invested in start making returns. According to Bender (2011) venture capitalists usually do not receive interest payments or dividends throughout the holing period. On the other hand banks will require their interest payments and repayment of principal whether the business has started making profits or not. This advantage makes VC funds attractive for entrepreneurs than bank financing.

If the business that the VC managers have invested in fails there is usually no obligation for them to pay back the money. Banks will try to recoup every cent invested in the failed business venture either through selling the assets of the business or any other means possible.

Venture capital funds do not require any form of security from the business entity they are investing in. In effect this means investors in VC funds expose themselves to high levels of risk in the promise of high returns. SAVCA (2010) argues that the supply of risk funds enables the formation and growth of businesses that would not have been able to raise other forms of finance due to the risk profile of such investments. VC firms have developed their own ways of minimizing risk. According to Bender (2011) in order to manage the high risks and improve inherent incentive structures, VC investments are mostly done in multiple financing rounds (staging) and portfolio companies have to achieve predefined milestones in order to receive further funding. If portfolio companies fail to meet those milestones the VC firms are able to abandon the investment in order to reduce their losses. On the other hand banking institutions always require collateral security from recipients of business loans as a way to mitigate risk.

Venture capital investors usually play an active part in the business in which they have invested in. This view is supported by Wang, Wang and Lu (2003) who argue that extant VC studies generally agree that VC firms not only contribute funding but also provide value-added services to their portfolio companies. Another factor is that from a governance perspective, VC firms take an active role in the board and in monitoring the evolution of the firm as well as in the structuring top management compensation (Davila, Foster and Gupta, 2002). VC also provides a mentoring or monitoring role to the firm, they achieve this by sitting on the board of directors, and may have the right to appoint or fire managers (Cochrane, 2004). The active involvement of the equity partners can increase growth and returns for all stakeholders as the investor has a vested interest in the business success. SMEs can also benefit from the experience and contacts of the VC fund managers (De Waal, 2007). Banks on the other hand do maintain a relationship with the business but do not play an active interest in the running of the business. The active involvement of VC firm in the affairs of the investee firm also helps to reduce the amount of risk they are exposed to.

2.5 Common characteristics of VC firms

Generally VC funds are categorized into seed capital, start-up and expansion capital (Bender, 2011). Early stage or seed financing is at ideation stage, initial production and marketing, whilst expansion funding which is done during commercial production, marketing and growth. Expansion funding is usually called development finance. Different VC funds focus on different types of funding and sectors. All these different types of VC funds have unifying characteristics (Finance Train, 2012).

2.5.1 Venture Capital funds expectations

VC capital funds generally require very high rates of return for early stage financing due to the very high levels of risk involved (Bilau and Couto, 2012). According to McLaney (2009) in the UK VC require rates rates ranging from 25 to 35% annually from start-up ventures. The typical ventture capital investment is expected to return about 22% but venture capital firms can demands as much as 30% and usually these demands are based on their extraordinary track records (Finkel and Greising, 2010). The expectations of high rates by VC has been attributed as one of the main factors that make the source of finance unpopopular with many smal businessess. According to Bilau and Cauto (2012) Belgian entrepreneurs have cited the VCs' high expectations in terms of returns as the second greatest cause in their failure to attract this source of funding.

VCs despite expecting very high rates of return do not stay longer than five years in the firms which they invest in. On average they remain with the investee firm for an average of three to five years (Klonowski, The Venture Capital Investment Process, 2010). During the short time the venture capital firms are with the investee firms they will be seeking the best exit strategy. The nature of investors who invest in VC funds are what prompts VC firms to invest for a limited amount of time. Bilau and Couto (2012) state that larger investors larger investors are more willing to avail funds to VC firms if they can later recoup their investment. The fact that VC firms seek a quick exit has also been cited by technology start-ups as the main reason compounding the difficulties of obtaining early stage financing from VC funds (Bozkaya and Van Pottelsberghe De la Potterie, 2008). Despite an early exit as being one of the chief characteristics of a VC investment, a contractual agreement for the sake of protecting the investee exists. This contact is for the assuranac that an appropriate incubation period for the business will be provided and the illiquidity acts as a detterent as well against the VC firm leaving too early (Klonowski, The Venture Capital Investment Process, 2010). Illiquidity refers to the fact that the VC cannot sell their shares in the investee company during the incubation period.

Following the incubation period the VC must have an exit strategy which will the firm to leave the investee and continue to another investment. One of the most common exit strategy is an Initial Public Offer (Cumming, 2010). The other form of exit strategy involves a trade sale. According to Kabrit (2011) venture capital firms make money by selling their equity stake in private (non-listed) companies at a higher price than the entry price. Private equity investors have traditionally been interested in putting their money in ventures with high growth prospects, enjoy barriers to entry from competitors, have experienced and ambitious management teams and have exit opportunities which commensurate with the risk that has been taken (Irish Venture Capital Association, 2005). A viable exit strategy is therefore one of the essential considerations made by the VC firm when investing in a company. The primary goal of a VC company is to maximize its financial return through exiting its investments, this achieved either through a trade sale or an IPO (Metrick and Yasuda, 2011). An IPO released in a poor market can stall possibilities of cashing out for the VC. In countries with undervalued IPO markets VC firms are most likely to cite that as a a challenge and limit their investments only to those firms they believe have potentially desirable exit mechanisms and this in turn presents a signifcant amount of difficulty for firms who require VC funds (Bilau and Couto, 2012).

2.5.2 VC firms preference and stage of development

Venture capital firms seem to have more preference to provided expansion capital as compared to other forms to early stage financing. US and UK VC firms are not constrained by geographical location, they invest wherever they cite potential but most of these firms have revealed a trend of shying away from getting involved in early stage financing and this has been associated with transaction costs and the high levels of investment risk involved (Cumming, 2010). Several studies conducted in the United States although indicating that more than a third of investments occur when investee firms have not posted any profits, however a signfiicant number of studies have also shown that VC firms are somewhat reluctant to finance early stage firms (Bilau and Couto, 2012). VC firms are usually expected to fund early stage firms because this is the stage where you find most of the innovative firms which do not have access to funding but the findings actually reveal that VC firms prefer companies requiring expansion capital. According to research conducted in German it was also revealed that regarding the number of companies financed an estimated 37% were in early investment stages (seed stage) whilst the remainder of the companies financed where at later stages (expansion stage). The studies indicated an underrepresentation of early stage companies in terms of financing (Bender, 2011). Venture capitalists generally avoid being involved in early stage financing, when technologies are uncertain and markets are uncertain and market needs are unknown and also the later stages when competitive shakeouts and consolidations are unavoidable and growth rates have dropped drastically (Zider, 1998). VC firms accept sufficient returns at acceptable risk, they do not take extremely high risks being the saviors of start-up firms.

The amounts of funding required by investee companies seem to another point of consideration for VC firms and it seems this also hinders the procurement of funds by those who need them as well. VC firms prefer to invest their money in companies which need high amounts. According to Dorf and Byers (2005) US venture capitalists prefer investing in companies that require $US1 million and above. The reason cited for the lack of interes in smaller investments is the fixed costs involved in due diligence that is conducted to protect the interests of the VCs and their shareholders (Bilau and Couto, 2012). Surveys conducted in Europe and especially among Belgian entrepreneurs concluded that the difficulties experienced in obtaining finance where also related to the small size of the required funding (Bozkaya and Van Pottelsberghe De la Potterie, 2008). The size of the required funds is an important concern for VC firms which is likely to hinder entrepreneurs requiring funding.

2.5.3 Technology and business planning

VC firms seem to have an inclination towards investee companies that possess some sort of intellectual capital in the form of patents and exclusivity licenses to protect innovative technologies. Established literature has also indicated a relationship between the existence of patents and future increase in the value of firms and this has tended to attract VC firms to invest (Bilau and Couto, 2012). According to Zider (1998) issued patents which are enforceable indicate a high probability of success for the investee firm hence the interest in companies with such considerable intellectual capital by VC firms. Companies with no innovative new technology are not likely to have any needs for intellectual capital such as patents and this usually presents a challenge in them accessing VC funds. The link between growth and intellectual capital (intangible assets) is confirmed by Sherman (2000), who states that a typical growing company's value to an investor depends on intangible assets, such as patents, trade secrets, or goodwill and projected earnings. This explains the higher empathy by VC firms for companies with patents, trademarks and goodwill as opposed to those with none. VC firms also indicate a higher bias towards investing in companies that have a higher number of employees committed to R&D, patents and high human capital endowment (Cumming, 2010).

The quality of business plans of a potential investee firm also comes under immense scruitiny by the VC firm before they can commit any funding. According to Klonowski (2010) a venture capital deal can take between six to nine months to conclude and during this time venture capitalists place a lot of importance on a variety of documents which need to be prepared which include business plans with multiple revisions of financial forecasts. Numerous meetings are usually convened to discuss these documents as well. A well articulated business plan enables nascent entrepreneurs to translate great business ideas into reality.

2.6 VC process

VC deals go through a series of stages before funding can be approved. The process basically begins with the venture capitalists educating the entrepreneur about the nature of VC funding, distinguishing it from other traditional forms of funding such as bank finance (Klonowski, 2010). The stages of VC process include; deal generation, initial screening, due diligence and phase 1 and internal feedback, preapproval completions, due diligence phase II and internal approvals, deal completion, monitoring and then finally exiting (Klonowski, 2010). VC firms are generally very choosy investors hence they demand that a very thorough process be followed before funding can be approved. PaxCapital.com (2013) has shortened the processes involved into idea generation, start-up, ramp up and exit. For the purposes of this study the following stages will be discussed in detail; deal generation, screening, due diligence, deal completion and exit.

2.6.1 Deal generation

Deal generation is argued to be the most important stage in venture capital process. Deal generation is commonly known as deal flow. It is defined as the number of potential investments that a VC fund analyzes during a given time period (Caselli, 2010). A VC fund usually has a network where it generates opportunities, which are where it obtains potential businesses which are worth funding. The VC firms require a strong flow of high quality deals which have a high probability of returning superior financial returns for the VC firm (Klonowski , 2010). VC firms generate hundreds of investment opportunities annually but will most likely invest in just a very small number. The average reported deal flow in by South African VC managers was 274 per manager in 2012; this figure had not changed significantly since the previous year (SAVCA, 2012). Deal generation is followed by the screening of the hundreds of opportunities identified.

2.6.2 Screening

Screening is the preliminary analysis of the identified opportunities which is conducted by management and supported by a technical committee (Caselli, 2010). The initial screening is generally related to the assessment of two primary areas which are: commercial attractiveness of the venture and whether the idea is realistic and can be done (Klonowski, 2010). In assessing the attractiveness of a potential investee firm, the VC firm analyses the entrepreneur and the management team, market size and growth prospects. The second assessment still within the initial screening phase is related to checking the probability of the project being completed. It is reported that at the screening phase 88% of the entrepreneurs requiring finance are rejected by South African VC firms (Van Eeden, 2004). In the US an average of 80% of ventures are rejected at screening phase. Every VC firm follows its own rejection criteria and has got different preferences in terms of the type of business to invest in. According to Van Eeden (2004) South African VC firms use the following aspects at screening phase: investment size, industry preference, industry exclusions, economic cycle of business and geographic preferences.

2.6.3 Due diligence

Due diligence is conducted by an investor as part of initial evaluation of investment opportunity (MacKaskill, 2009). Due diligence in VC deals involves checking the legal, economic and financial valuation of the company (Caselli, 2010). It is executed to analyze and valuate the desirability, value as well as the potential of an opportunity. The process of due diligence only proceeds if the VC feels the investment has potential so it is usually a crucial stage as well as it will uncover in weaknesses in the investee. In 2012 only 0.1% of the deal flow to South African VC firms actually went through due diligence phase (SAVCA, 2012).

Due diligence usually involves product/market evaluation to identify if the business environment can support the projections of the investee firm. In the event that the due diligence process does not uncover any major issues of concern, the VC managers proceed to negotiate a deal with the investee firm (Klonowski, 2010). The next phase involves deal completion.

2.6.4 Deal completion

Deal completion refers to the conclusion of the negotiation of detailed legal documents in a transaction between venture capitalists and entrepreneurs (Thomas et al, 2011). If the VC managers are satisfied with the outcomes from the due diligence process they proceed to negotiate the final set of terms to be included in the formal set of contracts (Metrick and Yasuda, 2011). Most VC deals are usually are approved in about eight weeks, with deal completion occurring in ten weeks (Klonowski, 2010). Deal completion involves protracted negotiations with the entrepreneur. These negotiations have a number of unique characteristics. They tend to be comprehensive, encompassing many functional areas of the business as well as personal behaviours of the entrepreneurs involved. These negotiations are also future oriented. They focus as well on how future market success can be achieved, profitability can be generated and how market share can be expanded (Klonowski, 2010).

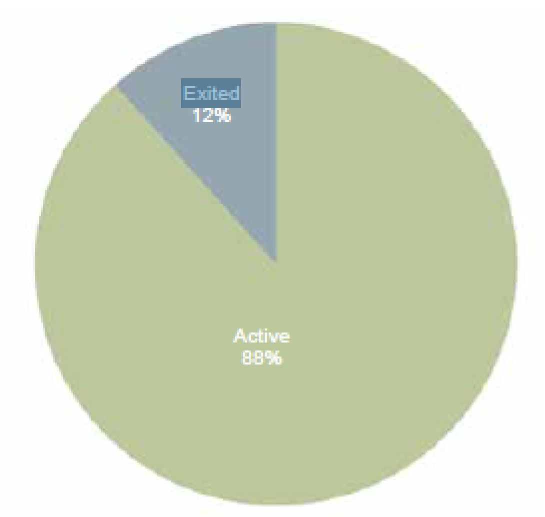
2.6.5 Monitoring

Once the deal has been completed the VC firm will now focus on maintaining the investee firm operational efficiency, development of the business according to a pre-agreed business plan and the achievement of the operational and financial milestone as well as performing operational reviews and audits (MacKaskill, 2009). The monitoring is done to ensure the investee firm does not fail and it gets all the support it needs to survive until the VC exits. The main purpose of this phase is therefore to ensure that the competitive position of the investee firm is strong and there is a good match between the firm's core competencies and the market opportunities and the target customers are well served (Klonowski, 2010). The monitoring phase is often referred to as mentoring as well because of the role the VC firm plays at this stage. The VC managers sit at the board of directors and may also have the right to appoint and fire managers all in a bid to increase the probability of investee firm survival (Cochrane, 2004).

2.6.6 Exit

This is the final phase in the venture capital process; it represents a coordinated way of cashing out a VC investment in a portfolio company. It is also referred to as the monetization of cash committed to the done and is usually executed through a trade sale; an Initial Public Offer (IPO) or other means available (Klonowski, The Venture Capital Investment Process, 2010). Among the different exit alternatives available the IPO of shares in the portfolio firms is often regarded as the most essential one in terms of its contribution to a venture capitalist's return (Neus and Walz, 2005). The diagram below indicates the percentage of active and exited deals in the South African VC market.

Figure 2-2.2: Percentage of deals exited and still invested in



Source: SAVCA (2012)

The overall amount involved in exits in South Africa was R1 billion over the 2012 period surveyed by SAVCA (SAVCA, 2012). The most notable exit deal recorded by SAVCA being the purchase of Fundamo by VISA, a transaction worth $US110 million.

2.7 State of entrepreneurship in South Africa

Entrepreneurship is vitally important to the economic and social development of this country. It is through innovation, entrepreneurs create new, competitive markets and businesses which lead to job creation and the growth of a country's economy. An entrepreneur is defined as a person who sets up an enterprise or business and takes financial risks in the expectation of profit; that is, he or she takes a chance on profit or loss (Butler, 2001). Entrepreneurship plays a crucial role in job creation and therefore in economic growth and development of various geographic entities from villages to regions and even to entire countries. Entrepreneurship has been defined as the process of identifying opportunities for which marketable needs exist and assuming the risk of creating an organization to satisfy them (Hatten, 2012). The process of entrepreneurship is credited with the creation of employment in South Africa.

The state of South African entrepreneurship is not a beautiful one; most entrepreneurial ventures do not last long enough to grow into big business. According to Zambonini (2013) South Africa now sits alongside the Gaza Strip and Romania when it comes to getting new businesses past the 3½ year mark, the latest Global Entrepreneurship Monitor (GEM) survey has found. This statistic speaks to the desperate need for enterprise development in the country. Zambonini (2013) argues that entrepreneurship does not impact an economy simply through higher numbers of entrepreneurs. It is imperative that quality measures, such as growth, innovation and internationalization be part of entrepreneurship.

Small businesses are also making an important contribution to the development of technological innovation within industries at regional levels. The European Union (EU) actually strongly believes that this sector holds the key to the future renewal and growth of Europe (Thomas, Miller and Murphy, 2011). The Global Entrepreneurship Monitor (GEM) carried out a survey on the state of entrepreneurship in 59 geographically and economically diverse economies, which together covered over 52% of the world's population and 84% of the world's GDP (Herrington, Kew and Kew, 2008). Among those analyzed in the survey it was revealed that some 110 million people between 18 and 64 years old were actively engaged in starting a business, while another 140 million were running new businesses which they had started less than 3½ years earlier. It was also discovered that out of these 250 million early stage entrepreneurs an estimated 63 million expected to hire at least five employees over the next five years, and 27 million anticipated hiring 20 or more employees in the same time frame (Herrington, Kew and Kew, 2008). The research into the contribution to the EU economy from entrepreneurship just highlights it importance.

A widely used measure of entrepreneurship known as TEA (Total Entrepreneurship Activity) was used to gauge the level of entrepreneurship South Africa. The country's TEA stood at 7.8% in 2008 (Gore and Fal, 2012). This statistic means that there are approximately 7. 8% people actively engaged in entrepreneurship between the ages of 25 and 64. South Africa's TEA in 2008 had increased from its 2006 level of 5% but it was lower than that of Columbia (24.5%) and that of Mexico of 13.1%. The global economic crisis in 2009 caused a drop of the TEA to 5% (Gore and Fal, 2012).

South African entrepreneurs have limited sources of finance to fund their ventures. However, the 2003 GEM Report showed that South Africa's financial system was no more reluctant in support of entrepreneurs than for other developing countries participating in GEM (Herrington, Kew and Kew, 2008). The bulk of the finance for most start-up businesses is traditionally savings, and investments from family and friends.

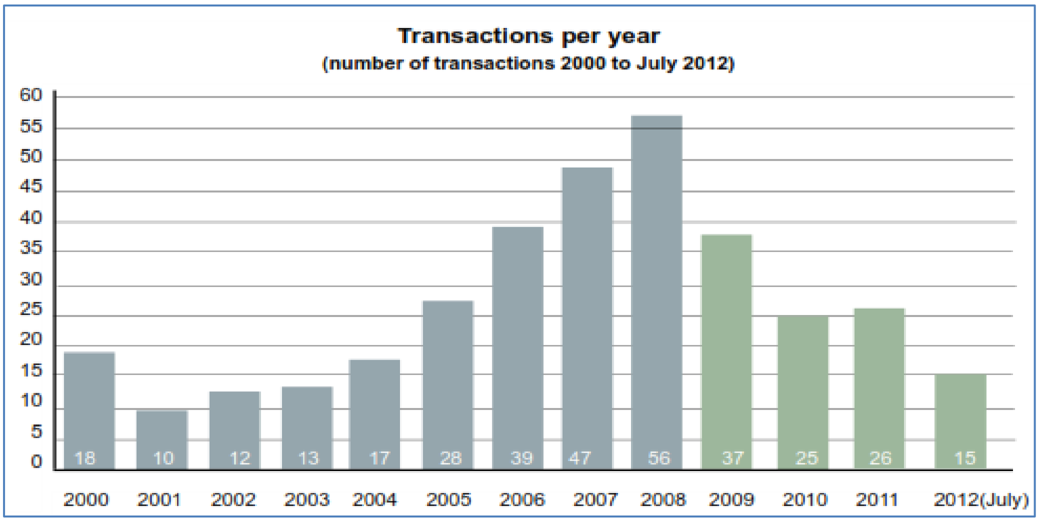
2.8 State of Venture Capital Funds in South Africa

The venture capital market in South Africa is still at infancy stage and it forms a very small part of the broader private equity industry therefore it is not yet popular with many investors as well as with SMEs. Despite the fact that VC funds are not a popular form of finance in South Africa, it is however quite prevalent in developed countries and it has played a big role in enhancing growth of SMEs by providing equity capital (Memba, Gakure and Karanja, 2012). Despite the VC industry being currently small, the country is said to be home to one of the most sophisticated private equity industries among emerging and developed markets, with different funds at all stages of business development, from start-up venture capital funds through to late-stage and buy-out funds (KPMG; SAVCA, 2012). The unpopularity of VC funds with small enterprises could be explained by the results of a study conducted in Ghana in which a low awareness and usage levels of financing initiatives among SMEs was discovered. Most SMEs in which took part in the study were also found to perceive that other sources of finance which include debt capital and VC funds were difficult to access (Abor and Biekpe, 2006).

The venture capital asset class is a subset of the R120 billion private-equity class in the country (De Waal, 2007). Currently the majority of investors in these firms are usually high-net individuals or institutional investors. Since this form of financing is new to the country there are just a handful of companies providing type of finance and they are mostly captive funds, meaning that there is only one funder or corporate parent. One author contended that seed capital is extremely rare and this makes the role of government initiatives in the VC industry crucial in order to revitalize the sector (Sayed, 2010). A large number of SMEs are seeking to attract funds from VC firms but unfortunately there aren't enough investors who are looking for these types of investments (De Waal, 2007).

According to SAVCA (2012) venture capital deals with an estimated value of R2billion took place between 2000 and 2009. This figure surged to R3 billion from 2009 to 2012. This represented a 50% expansion in the number of VC transactions over the above mentioned period. The graph in Figure 1 below shows the number of venture capital deals concluded over the period from 2000 to 2012.

Figure 2-3.3: Venture Capital transactions in S.A. per annum from 2000 - 2012

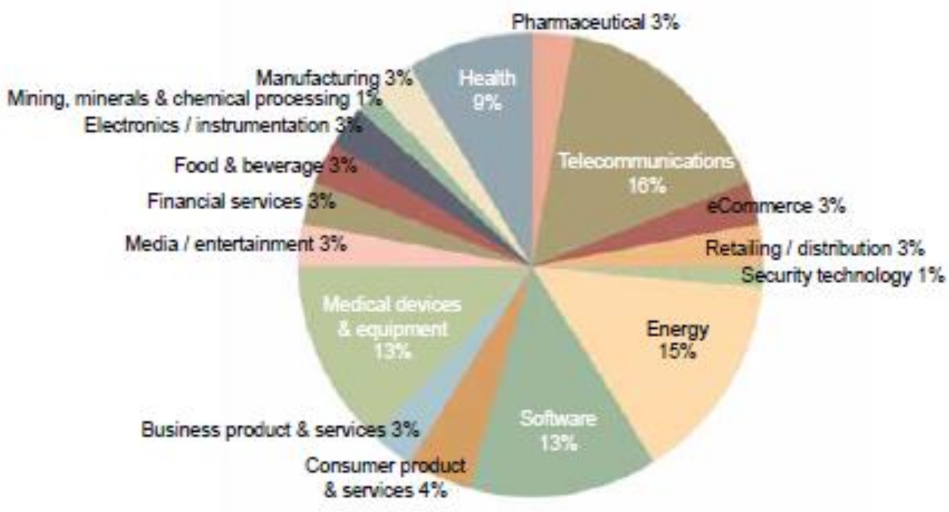


Source: The Southern African Venture Capital and Private Equity Association (2012)

The graph above indicates the number of venture capital transactions per year as per the survey concluded by SAVCA over the 12-year period. It can be observed from the graph in

Figure 2.2 that VC deals experienced firm growth from 2001 and reached an all-time high in 2008 but due to the global financial crisis which began in 2009 the number of transactions dropped gradually. Fourie and Lamprecht (2010) discovered that Gauteng was the largest base for VC transactions but Cape Town received more VC money than Johannesburg or Pretoria. A bulk of the VC transactions amounting to 41% involved life sciences (biotechnology, medical devices, health technology) and only 27% of deals involved ICT and electronics. Figure 1.3 below shows the sectors that have benefited from VC funds.

Figure 2-4.4: VC funds by sector in South Africa



The sectors that have been the biggest recipients of VC funds are telecommunications, energy, software and medical devices and equipment.

The activity in the venture capital asset class market over the years under review was an indication that good ideas in South Africa can get risky money for translation into successful ventures (SAVCA, 2010).

South Africa and the rest of the world are coming out of the global financial crisis and business sentiment is experiencing a positive turn. According to Frontier Market Network (2012) this bodes well for further maturation of the venture capital industry in the country. The further development of this industry is more likely to witness an increase in the availability of VC funds to SMEs in the country.

2.9 VC funds preferences

According to Hargadon and Kenney (2012:137) VCs have not remained continuing sources of capital for driving innovation in the airline package delivery, airlines, microbreweries, or cookie producers. The authors argue that entrepreneurship is possible in these and other industries not mentioned but VCs seek those opportunities that are transformative and have high returns. This sets apart VC funds from other sources of finance that are available to businesses. Venture capital funds are not biased against particular sectors but they invest in firms that have potential to generate significant returns on their investments. VC firms also have different preferences with regards to stage of financing. The table below shows the preferences of a selected list of South African VC firms.

Figure 2-5.5: VC firm preferences

Company	Financial cycle investment stage preference	VC firm?
Kagiso Ventures	All, except sow, start-up and early stage	Yes
Khula Holdings (Pty) Ltd	All	Yes
Lireas Holdings (Pty) Ltd	Start-up	Yes
MCI Fund Managers (Pty) Ltd	All, except start-up	Yes
National Empowerment Fund	All, except sow capital	Yes
Nedbank Corporate Private Equity	All, except start-up	Yes
New Farmers Development Co. Ltd	All	Yes
NIB-MDM Fund Managers (Pty) Ltd	All, except sow and start-up	Yes
Sabvest Ltd	All, except start-up	Yes
Triumph Venture Capital (Pty) Ltd	All, preference for early stage	Yes
Vantage Capital Fund Managers (Pty) Ltd	All	Yes
Wipprivate Equity (Pvt) Ltd	All, except start-up and growth	Yes

Source: Van Eeden (2004)

The above table indicates that a majority of the South African firms invest in at least one financial stage. A majority of the VC firms seem to avoid investing in start-ups as well.

Despite the preferences of the different VC firms, VC funding of early stage high growth ventures is an important feature of any developing economy such as South Africa.

2.10 Conclusion

The above discussion shows that SMEs meet difficulties in accessing sources of finance such loans from financial institutions. It can therefore be argued that VC funds provide the alternative, which can help spur the development of SMEs in South Africa. The VC funds aid entrepreneurial development because:

They can avail a lot of funds to SMEs as compared to loans;

- The chances of business failure are little because of the VC fund managers play an active role in the SME they have invested in
- VC funds are risk funds and the investors do not want SMEs that have failed to pay them back.

It is these advantages that have seen the VC industry in the country enjoy a steady growth of the past few years.

Chapter 3 Research Methodology

3.1 Introduction

This chapter discusses the research design and research methodology that was followed in the study of venture capital and SME development in Johannesburg. Research methodology is defined by White (2002) as an approach the researcher employs in investigating a subject and the techniques used to collect data and information as the research methods. Kumar (2005) defines research as a process of collecting and interpreting information to answer questions and he further argues that the process followed will only qualify as research if it is controlled, rigorous, systematic, valid and verifiable, empirical and critical.

In conducting research a researcher has a number of alternative methodologies to select from depending on the intended objectives of the study and some of those will be deliberated in this study. This chapter focuses on the steps followed in conducting this study, and includes a discussion of the research philosophy and strategies, purpose of the study, target population and sampling methods. The data analysis methods, validity and reliability as well as the limitations of this study will also be discussed. The ethical considerations taken into account in conducting this research and the limitations of the study were also discussed.

3.2 Rationale for Research Methodology

A quantitative research methodology was used for the purposes of this study. It was found to be appropriate because of the following reasoning:

- A researcher in quantitative research is able to maintain objectivity especially pertaining to the data that is acquired from research respondents. Quantitative data are more objective than qualitative data (Gill and Johnson, 2004);
- According to Cozby and Bates (2012) the conclusions in quantitative research approach are based on statistical analysis of data which can be done using statistical software whilst qualitative approach does not use any software but is dependent on a researcher's objectivity; and
- The size of the sample which was chosen was big and a quantitative approach was hence more appropriate.

The differences between quantitative and qualitative research methodologies will be explored in the section that follows. The differences will discussed will further cement the reasons why a quantitative approach was utilized.

3.3 Research design

Zikmund (2011) describes a research design as a master plan that specifies the methods and procedures for collecting and analysing the needed information. A research design can therefore be likened to a framework or blue print that will guide a researcher throughout the research process. Brewerton and Milward (2001) define research design as the strategy or schedule used to collect evidence, to analyze the findings and from which to draw conclusions in a study. The definitions that have been given above both reflect that a research design is a systematic way of gathering and analyzing data. The absence of an appropriate research design can make achievement of the intended research objectives a challenge.

3.3.1 Types of Research

According to Stangor (2011) there are two basic types of research, which are namely basic and applied research.

3.3.1.1 Basic research

Stangor (2011) and Cozby and Bates (2012) stated that basic research answers fundamental questions about behaviour. Examples of basic research include studies that are aimed at addressing theoretical issues concerning phenomena such as emotion, motivation and social behaviour.

3.3.1.2 Applied research

Applied research is described as research designed to investigate issues that have implications for everyday life and to provide solutions to real-world problems (Stangor, 2011). Applied research has been conducted in studies which seek to discover the most effective ways of reducing depression, what type of advertising campaigns can reduce drug and alcohol abuse and in the prediction of how well particular individuals are likely to perform in managerial positions (Cozby and Bates, 2012).

3.3.2 Distinction between quantitative and qualitative research

Quantitative and qualitative research will be discussed below and the major differences between the two approaches will be outlined.

3.3.2.1 Quantitative research

Locke, Silverman and Spirduso (1998) and Bryman and Bell (2007) concur that quantitative research most usually seeks for structured and quantifiable responses or numbers or figures or percentages to describe the nature of the phenomenon under investigation in an organisation or society. Quantitative research is descriptive research that uses more formal measures of behaviour, including questionnaires and systematic observation of behaviour, which are designed to be subjected to statistical analysis (Stangor, 2011). The study conducted was aimed at identifying the accessibility of venture capital firms in Johannesburg and how they could catapult the SME development in the country.

A quantitative research approach was used because according to Cohen, Manion and Morrison (2007) it possesses a measure of standard error which is inbuilt. It is however impossible for research to have 100% validity but quantitative research strives to achieve greater levels of reduction in bias. Quantitative research also allows for replication especially if the same methods are used with the same sample then the results to be obtained are more likely to be the same. Collection of data under quantitative research usually uses questionnaires and they do not take a long time to complete. The population involved in the study included venture capitalists and SME business owners who are busy people and thus quantitative research was best suited for this study as the questionnaire was designed concisely and it would take 5 -10 minutes on average to complete. According to Saunders, Lewis and Thornhill (2007) responses that are collected through the use of questionnaires in quantitative research are easier to analyse especially when compared to responses in qualitative research. Quantitative research methodology was chosen because of the advantages that have been mentioned above.

3.3.2.2 Qualitative research

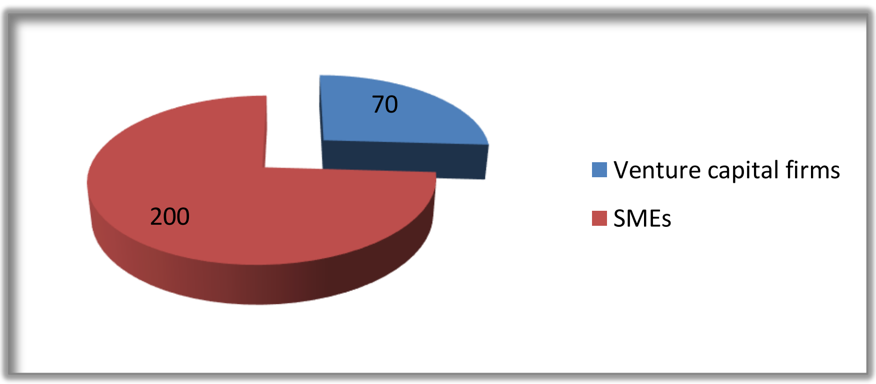
Qualitative research on the other hand is described by Strydom, Jooste and Cant (2003) as a research process which is mainly concerned with the testing of ideas, opinions and attitudes.

A qualitative approach to research often seeks to measure the behaviours, attitudes or thoughts of individuals in an organisation or society. This approach to research uses interviews as a data collection method and interviews on average take lengthy periods to conduct when compared to the usage of questionnaires under quantitative research. Trochim (2009) contends that a qualitative research approach is adopted when a researcher desires to generate new theories and hypothesis, needs to achieve a deeper understanding of the underlying issues, is willing to trade details for generalizability and has a large budget set aside for the study. A quantitative approach was used because through the use of questionnaires in data collection, costs were limited and generalizability under this approach is also higher.

3.4 Target population

According Gill and Johnson (2002) a population is defined as a group of individuals that share one or more characteristics from which data can be gathered and analysed. The population is the total number of all the people that a researcher will concentrate their research on. The target population for this research was venture capital firms that are either privately or government owned and SMEs businesses operating within the Johannesburg area. A total of 70 venture capital firms and 200 SMEs from the Johannesburg area were targeted for the research. The list of venture capital firms who are full members of SAVCA was accessed from the SAVCA website (SAVCA, 2013).

Figure 2-6.1: Target Population



The population of small businesses in Johannesburg is very large and attempting to involve the entire population in the study would be impossible and very costly. That is why only those SMEs from the Johannesburg area that have approached VC firms for funding in the past 12 months were used in the investigation. The SMEs that have accessed VC firms for financial assistance were obtained from VC firms, which took part in the study.

3.4.1 Population Sampling

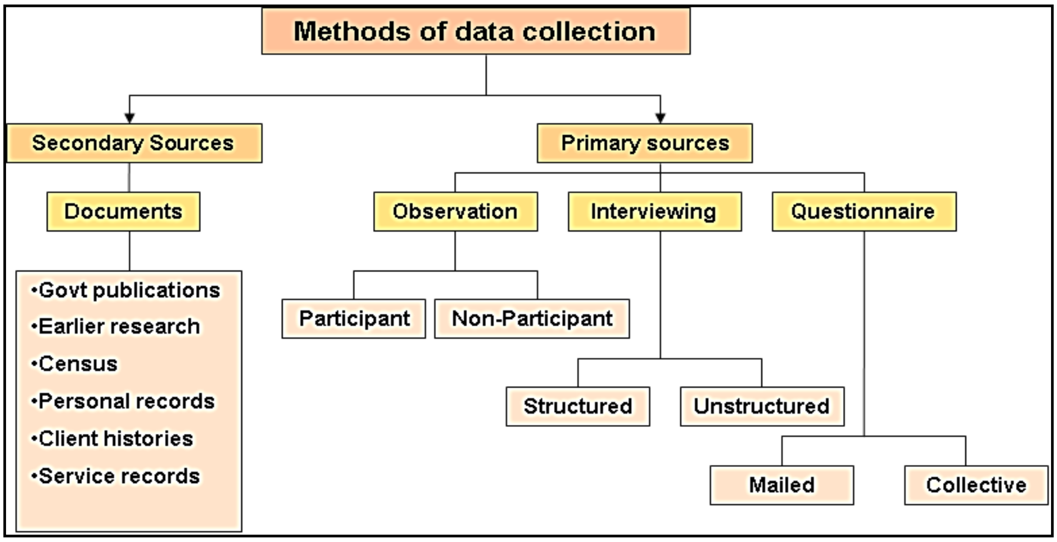
Cohen, Manion and Morrison (2007) define a sample as a subset of the total population which is considered representative. On the other hand sampling involves any procedure that uses a small number of items or a portion of a population to make a conclusion regarding the whole population (Zikmund, 2006). In sampling a researcher is attempting to use a portion representative of the population because is often impractical to work with an entire population. The use of large samples will usually give the most accurate results but if probability sampling is implemented a small proportion of the total population will give a reliable measure of the whole.

There are two broad types of sampling namely probability and non-probability sampling. According to Zikmund (2011) probability samples are based on random selection whilst non-probability samples are based on researcher's subjective judgement. For the purposes of this investigation non-probability purposive sampling was used. Purposive sampling is a non-probability sampling technique in which a knowledgeable individual selects the sample based upon some appropriate characteristic of the target population (Zikmund, 2011). In order to get the expected results it was deemed appropriate to select a sample which best satisfied the requirements of the study. A purposive sample constituting of SMEs who had approached VC firms for funding and VC firms that are involved with funding businesses in the Johannesburg area.

3.5 Data collection

In order to complete an investigation or study data must be collected from the selected sample. The two commonly used primary data collection methods are the questionnaire and the interview methods. A structured questionnaire designed using Survey Monkey was used for the purposes of data collection. Internet-based surveys such as those designed Survey Monkey have moved from being in the form of emails to emails-plus-attachments of the questionnaire itself, to emails directing potential respondents to a web site, or simply to web sites (Cohen, Manion and Morrison, 2007). A questionnaire is defined as an ordered list of questions (Waters, 2011). The questionnaire was chosen because it has got several advantages which include the fact that it's easy to design, it's cost effective and it's well suited to a when a researcher wants to collect a lot of information from a large sample. The table below indicates data collection methods.

Figure 2-7.2: Data Collection Methods



Source: Kumar (2005:15)

The use of an online questionnaire saved time and costs, it was easy to design as well and the fact that it does not take more than 10 minutes to complete made it convenient for the respondents to complete. Using the Internet for the conduct of surveys is becoming commonplace in many branches of social science (Cohen, Manion and Morrison, 2007). The anonymity of the respondents, which gave them a greater degree of freedom, was also a reason why a questionnaire was selected for the purposes of data collection. Respondents are also more likely to give more honest responses to questions when they access the questions electronically in the absence of a researcher. Structured questionnaires however are limited in the amount of information they can collect from respondents because they do not provide room for respondents to express their thoughts and feelings. However another problem that is found in questionnaires which is not found with interviews is that people may not answer the questions in the order they are written, and the researcher does not know whether or not they have (Stangor, 2011).

3.5.1 Questionnaire construction

A self-constructed questionnaire was used in the survey. The questions in the questionnaire were selected in such a way that they addressed the research questions and the research objectives. Every effort was taken to ensure that the questionnaire guaranteed anonymity and confidentiality of respondents. The language that was used in the questions was kept simple, easily comprehensible and not offensive to the respondents. The questions were kept brief, straightforward and free from technical jargon. Care was also taken to ensure that the questions were not too many as the target population was considered to be very busy and it was thought it would bore the participants and result in a low response rate. In terms of page layout for internet based questionnaires Cohen et al (2007) warns that researchers should keep the designs simple as utilizing advanced page layout features does not translate into higher completion rates, indeed more advanced page layout reduce completion rates. The questions in the research instrument were divided into various segments with guide headings to ensure easy data classification for interpretation and analysis.

3.5.2 Pilot Study

After the questionnaire had been constructed it was tested to ensure that it was fit for purpose in a pilot study. Zikmund (2011) states that pilot studies are conducted in order to collect data from a few of the actual subjects of the study, in order to serve as a guide for the larger study. The questionnaire was sent to 10 SME business owners and 5 VC firms. A response rate of 60% was achieved from the respondents but however some of the questions had not been responded to. As a result of carrying out a pilot study the researcher realised that some of the questions were complex and too many and this was adjusted accordingly. The researcher decided to write the questions on the research instrument in simple language and the number was reduced by removing a few questions. Thus the pilot study enabled the necessary rephrasing and changes of the structuring of the wordings of the questions to ensure that they could easily be comprehended by the respondents.

3.6 Questionnaire administration

In administering the questionnaire a URL (uniform resource locator) was sent to the sample population via email. The URL is the link on which the questionnaire is available. The responses will be linked to an email which means all the responses will be collected via a researcher's email. According to Taylor, Sinha and Ghoshal (2011) in designing any type of questionnaire it is essential to consider how you are going to track returns and remind non-responders. Delivering the questionnaires directly to respondents' email address ensured that they received the questionnaires in short space of time as compared to mailing. This form of questionnaire administration also ensured that no questionnaires were lost. The usage of internet based surveys was found to be most appropriate because all the businesses in the target population had internet connection.

3.7 Data collection and analysis

The completed questionnaires were received electronically into the email inbox. An electronic folder was created on a computer for the proper management and filing of the collected responses. The received questionnaires were checked for completeness and were subsequently codded and captured into an Excel spread sheet and readied for quantitative data analysis. Quantitative data analysis was done using IBM (Statistical Programme for the Social Sciences) SPSS version 19. According to De Vos, Strydom and Delport (2002), data analysis in the quantitative paradigm entails that the analyst breaks down data into constituent parts to obtain answers to research questions and to test research hypothesis. Descriptive statistics were calculated for data relationship analysis while inferential statistics were used to reach conclusions and make generalisations about the characteristics of the population based on data collected from the sample. Data obtained from the analysis was presented in the form of tables, graphs and charts well.

3.8 Validity and reliability

According to Rubbin and Babbie (2011) validity is defined as the extent of systematic error in measurement. Validity therefore addresses the issue of whether the researcher is actually measuring what was set out to be done, and that the instrument measured what it was intended to measure. The method of questionnaire administration which sent a link directly into the inbox of the respondent enhanced the validity of the survey as it ensured that multiple responses from the same person were eliminated.

Zikmund (2011) defines reliability as the degree to which measures are free from error and therefore yield consistent results. Reliability is therefore concerned with the ability of the research instrument to measure what it is supposed to measure in a consistent pattern. Reliability was improved by designing the instrument around already established concepts and theories. The Survey Monkey which was used to design the online questionnaire is common with business people hence this boosted its reliability as well.

3.9 Limitations of study

The following limitations were identified during the study:

- Some of the respondents were unwilling to participate due to a lack of time. The researcher made numerous calls, contacted respondents via email in order to try and emphasise the importance of their participation. The respondents were persuaded to complete the questionnaire by being told that it was not going to take a long time to complete.
- Due to the small number of the population of venture capital companies operating from Johannesburg area the research results might not be generalizable to the extent envisaged.

3.10 Ethical considerations

Cohen et al (2007) states that the ethical dilemmas in research are many and the consequences can be dire to those researchers who do not cautiously plan through the aspect of ethical considerations. This study took the ethical considerations of the research in terms of informed consent, confidentiality and anonymity in conducting the research.

3.10.1 Informed consent

The respondents were contacted both telephonically and by email to ensure that they agreed to take part in the study. A cover letter for the questionnaire which contained the objectives of the study was emailed to the respondents so that they understood what they were taking part in before the questionnaire link could be emailed to them. Cohen et al (2007) argues that it should be made easy for respondents to withdraw from the study at any time as well. This was cited as one of the rights the respondents had in the cover letter that was emailed to the respondents.

3.10.2 Confidentiality and anonymity

The cover letter that was emailed to respondents made a commitment to respecting the confidentiality of all who participated. Information relating to their names or deemed confidential and any information that would result in them being personally identified was not solicited. Private contact numbers and names were not required on the questionnaires administered to respondents. Hence the confidentiality and anonymity of respondents was highly regarded.

3.11 Conclusion

This chapter discussed the research methodology which was used in conducting the research. The study used a quantitative research approach because of its simplicity when it comes to data collection and data analysis. The population was adequately defined and the sampling strategy used was discussed as well. The two broad types of research approaches that are quantitative and qualitative were discussed and the rationale for selecting a quantitative approach was discussed as well. The population involved in the study was made up of 70 VC firms and 200 SMEs from the Johannesburg area. The research instrument used was an online questionnaire designed by Survey Monkey. A pilot study was conducted to test whether the research instrument was fit for the purpose it was designed for. The chapter discussed issues relating to validity and reliability, limitations of the study and ethical considerations of the research. The following chapter will discuss the results and findings of the research.

Chapter 4 Results, Discussion and Interpretation of Findings

4.1 Introduction

A quantitative study was conducted in the Johannesburg area and a total of 40 Venture Capital firms and 70 SMEs took part in the research study. The research participants were drawn from Johannesburg area. Questionnaires were issued to the respondents in the month of September 2013 as from the second day of the month. The data collected from the respondents was analysed using a software package, SPSS. The chapter presents and discusses the results of the study.

4.2 The Sample

The first sample to be dealt with is for the Venture Capital firms, it comprised of companies that are in the business of funding start-ups through venture capital and private equity in Johannesburg. The second sample comprised of SMEs operating in the Johannesburg area. A total of 75 questionnaires were issued to Venture Capital firms and responses were received from 40 representing a response rate of 53% and out of the 105 questionnaires that were issued to SMEs, 70 responses were received representing a 67% response rate.

4.3 Results of study

a. How VC can function in a society where there is a wide inequality and emerging from conflict?

Venture capital companies in a country such as South Africa which is emerging from apartheid and wide inequalities need to concentrate on increasing the knowledge of SMEs about their services and giving SMEs a wide range of services which may include financial and non-financial services.

The majority of the SMEs represented by 87% stated that given an opportunity they would approach VC firms mostly for non-financial services whilst 16% disagreed. The results indicate that a majority of SMEs if given a chance would want to access both financial and non-financial services from the VC firms. The SMEs sector basically needs requires more information on the VC financing option in order for them to start using this source of finance. VC financing has the capacity to increase the financing options to SMEs in South Africa.

Out of the 70 SMEs sampled, 51% revealed that there the other reasons besides lack of financing that contributed to their failure. A majority of the research respondents also indicated that they would be better off if they could access both financial and non-financial services from VC firms. A majority of the respondents neither agreed nor disagreed to the statement and this response was from 68% of the 70 respondents. 12% of the respondents indicated that they strongly agreed, 7% agreed whilst 10% disagreed and 3% strongly agreed. The results indicate that SMEs have known that only unique and innovative ideas will be funded by SMEs. Of the 70 respondents 12% of the respondents strongly agreed that VC firms have increase financing alternatives available to SMEs. 15% of the respondents agreed, whilst 27% neither agreed nor disagreed and another 38% disagreed and 8% strongly disagreed. The SME sector indicated that they did not feel that the VC firms had so far increased financing options to their businesses. Of the 70 SMEs in the study 45% of the SMEs strongly agreed that the development of the VC sector will drive SME growth and survival. 31% of the respondents agreed to the above statement, 18% of respondents neither agreed nor disagreed. Of the 70 respondents involved in the study 3% disagreed. The results presented indicate that a majority of SMEs feel that the development of the VC sector will help boost SME growth.

The results obtained from the primary study conducted with Venture Capital firms indicated that only 35% of the respondents believed that VC industry is developed in South African whilst 65% indicated that they did not believe the industry was developed. The results indicated that a majority of the Venture Capital firms believe that the VC industry is not yet fully developed in South Africa, generally inaccessible and this may explain the challenges met by businesses who try to access these organizations. The primary study further revealed that 73% of VC firms felt that their services were not accessible to the vast majority of SMEs in the country whilst a paltry 27% believed they were accessible. The conveyance of information pertaining VC services to SMEs was discovered to be a major contributing factor to low accessibility of venture capital to SMEs in South Africa. The empirical study reflected that 85% of VC businesses taking part in the study believed that conveying information necessary to SME needs was a major challenge facing the VC industry but on the other hand 15% of the respondents disagreed with that notion. On a more positive note, 65% of the VC companies believed that the South African economy was more receptive to VC financing whilst by 35% indicated that the local economy was not conducive for this type of financing. This result indicated that the local economy is generally receptive to this type of financing. The results also revealed that 80% of the VC firms stated that businesses are actually fighting to obtain VC funding from the few such companies available in the country whilst 20% of the respondents disagreed. The results obtained from VC firms indicated that VC financing is considered cheaper than bank finance and this could explain why most businesses who know about this financing alternative fight to access it. This result actually indicated that the South African economy was receptive to VC finance and it was actually growing. The emergence of the VC sector has increased financing options for businesses; this notion is shared by 75% of the respondents whilst 25% disagrees. This generally indicated that VC fund providers believe they have increased financing alternatives available to entrepreneurs when it comes to finance.

The South African VC industry unlike in the US is not synonymous with technology businesses. Of the VC companies who took part in the primary study 88% indicated that VC firms are not primarily concentrated in technology start-ups whilst 12% disagreed. The chart on Figure 4.1 indicates the VC areas of concentration.

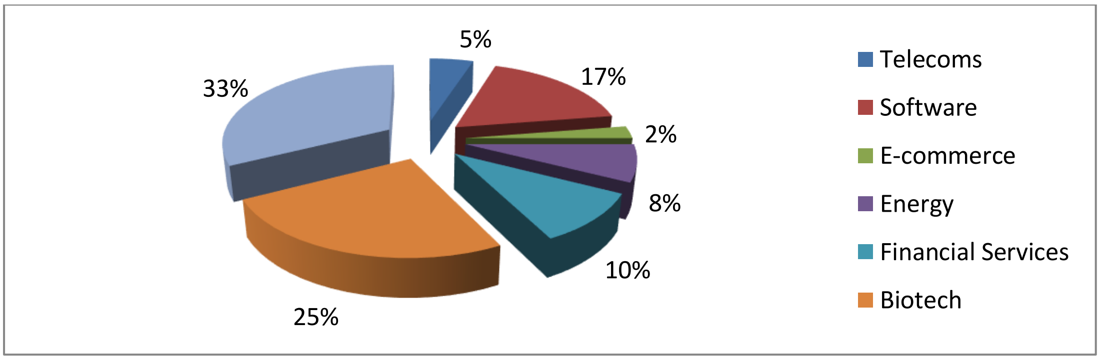


Figure 8.1: VC companies area of concentration

The results indicated that 25% of VC firms invested in Biotech firms, 17% in software ventures, 10% in financial service ventures, 8% in energy firms, 5% in telecommunication ventures and whilst only 2% are funded e-commerce ventures. The results showed that VC firms are not only concentrated in technology but there are a lot of other sectors which they provide funds to. VC firms also concentrate on different stages of financing which are primarily divided into start-up, development capital, growth capital and seed capital. The majority of the VC firms in South Africa represented by 50% provided start-up capital, 35% of the VC companies provided development capital, a further 12% provided growth capital and finally 3% provided seed capital. Figure 4.2 below presents the percentage of firms providing funds at every stage of financing:

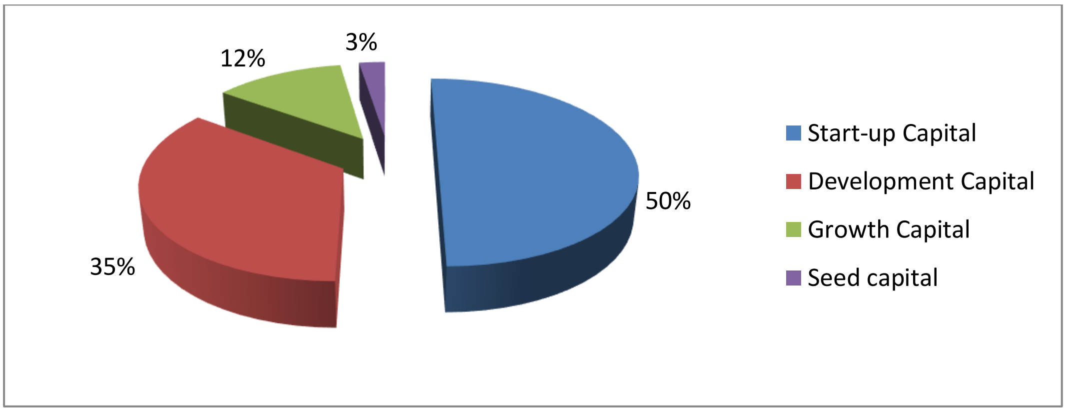


Figure 9.2: Stage of financing which most VC firms are concentrated

The VC companies in South Africa do not just extend financial services to those firms seeking funding, they also provide non-financial services. According to the research findings 90% of the VC companies indicated that they provided an array of non-financial services whilst only 10% indicated that they majored mostly in provision of finance. The non-financial services VC firms provided are indicated in the chart in Figure 4.1 below.

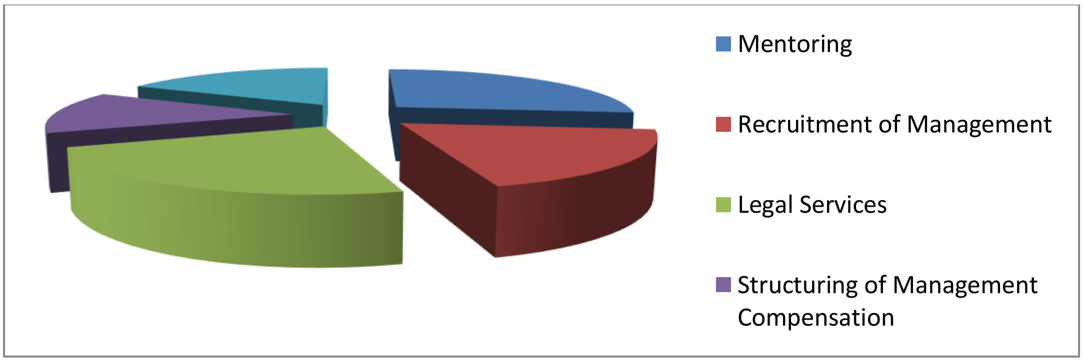


Figure 10.3: Non-financial services

Figure 4.3 indicated that the non-financial services that are provided by VC firms in South Africa. It is indicated that all the 40 VC firms provided mentoring, 28 helped with the recruitment of top management, 35 provided legal services as well, 20 helped in the structuring of management compensation and 26 of the VC firms helped with management. It has also been discussed above that SMEs indicated that their failure is not only caused by lack of financing hence the non-financial services of VC companies are also very useful for SMEs in addition to accessing the funding from VCs.

b. Why VC is not poor popular among SMEs and why its accessibility is low?

One of the factors that contribute to the unpopularity of VC companies among SMEs is the stringent VC vetting process. The empirical study revealed that 68% of the VC companies taking part in the study believed that the VC vetting process is very stringent whilst 32% disagreed with that view. The VC companies however indicated that the leading reasons which led to the failure of South African SMEs was actually related poor business model, failure to seek professional advice, lack of focus, poor knowledge of business they are involved in and inexperienced management.

Of the VC fund providers involved in the study 85% indicated that it was important that entrepreneurs seeking finance must possess the ability to articulate their venture, 80% indicated that they must be passionate about their ideas, 85% stated that they must be able to evaluate and react to risk whilst 78% indicated that they must be hardworking and consistent and to a lesser extent be attentive to detail. Entrepreneurs seeking finance from VC firms are also expected to have a high level of familiarity with the target market and have demonstrable leadership capabilities as this can up their chances of the accessing capital they require. With regards to the product / service, 85% of VC companies expected outstanding levels of innovativeness, 75% stated that the product/service must be accepted in the market whilst 68% indicated that they expected the product / service to be in high technology. The availability of a market for the firm's seeking finance's product/service is also of great importance during the vetting process. The results indicated that 85% of VC firms' familiarity with target market is very essential whilst 75% indicated that a growing target market was of immense importance in the vetting process. The majority of the VC firms taking part in the study indicated that innovativeness of product/service, financial investment; an entrepreneur's experience and a strong management team were the most essential factors in the success of SMEs seeking VC financing.

c. Why few businesses pursue the VC finance alternative even among those who know it?

The results obtained from SMEs respondents during the study indicated that VC financing was still an unpopular financing option among the SME sector. Of the 70 respondents in the study only 17% indicated that they had any knowledge of VC firms, whilst 44% had never heard of these firms. Only 6% of the SMEs indicated that they had approached VC firms seeking financing, whilst 56% had never approached VC firms with the intention to seek finance.

The results chart below indicates the percentage of SMEs that stated that they were aware of the existence of VC firms:

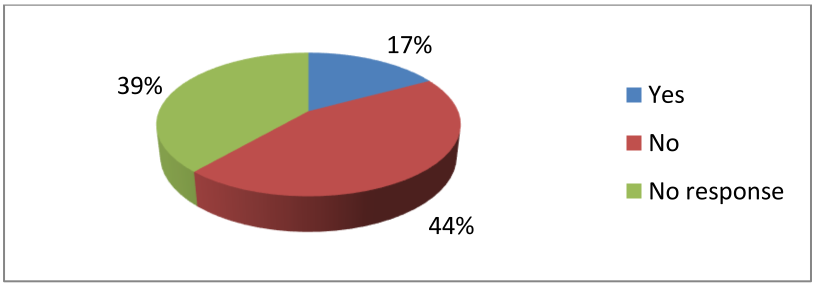


Figure 11.4: Knowledge of VC firms

The majority of SMEs generally indicated that they faced challenges in accessing funding for their businesses. This generally meant that most SMEs with knowledge of VCs were not likely to use this source of finance because the difficulties of accessing information related to this source of finance. The results revealed that 59% of SMEs were more likely to approach banks for financing, 11% stated that they would opt for VC financing, 20% stated they would use any other financing alternatives besides bank loans and VC. The results also indicated that 77% of SMEs stated that there was lack of adequate of information with regards to VC finance. The results generally point to the fact that there is no adequate information available on VC financing.

Of the SMEs involved in the study, only 17% had ever considered using equity financing whilst 48% stated that they had never made such a consideration. The results reflect that the majority of the respondents have not considered using equity financing to fund their businesses. Given the fact that a majority of SMEs stated that they were had little or no knowledge of VC, a majority also indicated that they believed that the VC market was not well developed in South Africa. Due to the little knowledge of VC, 55% of the SMEs in the study indicated that they did know which financing method was cheaper between VC finance and bank loans. On the other hand of the 70 respondents 5% strongly agreed that VC finance was cheaper than bank loans, 2% agreed whilst on the other hand 23% disagreed and 15% strongly disagreed. The results generally indicate that most of those who took part in the survey did not have knowledge of the cost of VC financing hence very few SMEs also dared to try this source of finance. The lack of information pertaining to VC financing also contributed to low usage of this source of finance by a number of SMEs as well.

4.4 Conclusion

The chapter presented the results obtained from the questionnaires which were issued to Venture Capital companies as well as SMEs. The results indicated that very few SMEs are aware of the existence of VC companies and what they offer. The VC industry in South Africa is still in its infancy and this explains the reason why very few SMEs know about the VC services. SMEs in the country also cited the inaccessibility of VC services owing to the companies' stringent vetting process. The research results also revealed that among the SME businesses who have heard about VC companies, very few were likely to opt for this finance because of lack of adequate information. Most SMEs were more likely to approach banks for finance instead of VC companies. The lack of information contributes to the low usage of VC services among South African SMEs. The next chapter discusses the findings, conclusions and recommendations.

Chapter 5 Conclusions and Recommendations

5.1 Introduction

The conclusions and recommendations for the study are presented in this chapter. The findings of the study from literature review and primary study will be discussed in this chapter. The conclusions as well as the recommendations are also discussed in this chapter.

5.2 Summary and Conclusion

The findings from empirical study revealed the following:

The empirical findings revealed that a majority of VC firms in South Africa believed that the VC industry is still at the infancy stage and this explained why most of the SMEs faced difficulty in accessing this type of funding. Furthermore the study discovered that VC firms are not yet very accessible to SMEs in the country and this actually meant that their existence was not increasing the number of sources of finance accessible to the small business community. The results generally indicated that VC funding is not yet easily accessible in South Africa.

Empirical findings discovered that most of the SMEs in the country did not have any knowledge of the existence of venture capital firms hence they also were not aware of the fact that this was another rich source of finance to fund their ventures. The accessibility of information pertaining to VC funding to SMEs was another huge challenge to the growth of VC funding in South Africa. Information relating to VC funding is not yet readily available to SME owners and as result unavailability of information regarding how they can access this form of funding is one of the biggest challenges lessening the impact of VC firms on the SME sector.

Despite the unavailability of information regarding VC industry to SMEs most of the VC companies believe their presence in the South African economy has increased financing options to businesses seeking funding. SMEs on the other hand actually believed that the existence of VC firms had not reduced the challenges they faced as far as satisfying their funding needs are concerned. SMEs therefore do not believe that VC firms have made any impact in terms of increasing financing options in the country.

The VC firms are usually known to fund technology start-ups. The empirical study revealed that most of the South African VC firms instead of putting a bulk of their funds into software ventures they are investing most of the funds into Biotechnology ventures. The trend in the US has seen most VC firms investing in technology start-ups but the research findings have actually indicated that in South Africa it's a different case.

The growth of the VC sector cannot be achieved without the help of the national government. The research study revealed that the poor accessibility of VC firms to SMEs is also to be blamed on the South African government not playing a part in aiding SMEs to have adequate information on VC firms. The SME sector actually indicated that they expected the government through the chamber of commerce to play a more crucial role in facilitating the accessibility of the VC sector and its growth.

The findings reveal that VC finance sector in South Africa still has a long way to go before it can actually be counted as a major alternative for businesses which include SMEs. The SMEs in South Africa indicate that VC funds are generally not accessible to them. The major problem is that despite the growth of VC finance in the country information is not easily accessible to the ones who need the finance the most which is SMEs. The government on the other hand through its chamber of commerce is accused of not doing enough to promote the easy access of SMEs to the formal finance sector.

5.3 Recommendations

The following recommendations can be made based on the findings made in this study: Realizing that SMEs actually have little or no knowledge on the existence of VC firms on average, the government needs to step in and facilitate workshops and seminars where they attempt to educate SMEs on the available financing options but make an emphasis on Venture Capital firms. Such workshops should be run in the country's major cities which include Johannesburg, Cape Town and Durban in because this is where you finding a large number of SMEs engaged in employment creation which has an impact on the country's unemployment rate.

Venture Capital firms also need to sell themselves to the SME sector through creating partnerships with organizations which represent SMEs in the country. Such partnerships will fast-track the spread of the use of VC finance by SMEs. VC firms can also make publications which are made available to the public which entrepreneurs can access especially from university libraries or other platforms which can be accessed by all entities requiring finance.

The South African government can adopt regulations on Venture Capital Funds which can facilitate the increased supply and accessibility of this type of funding to SMEs. Since a very small number of small businesses can access VC financing, the government can also guarantee loans from the banks and venture capital facilities up to certain amount. These guarantees can help those businesses who do not have sufficient collateral to be able to access either loans or venture capital funds.

There needs to be improvements with regards to access to information from the SMEs' perspective and the providers of financial services such as VCs and banks. The SMEs require more information in order to be on a better position to identify potential suppliers of financial services. The SMEs also require this information in order to evaluate the costs of the varying sources of finance that are being offered. A task force needs to be instituted by the Department Trade and Industry with a view to addressing the issue of information deficiencies to both the financial services providers and to the SMEs.

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Appendix A: Venture Capital questionnaire

QUESTIONS TO VENTURE CAPITALISTS

1. Can one safely state that the Venture Capital market is now well developed in the South African economy?

Yes ☐ N☐

If your answer to the first question was No can you give a reason or two for the status quo?

2. Does your VC firm also provide any other services besides financial to businesses requiring financing?

Yes ☐ N☐

3. Which of the following non-financial services do you offer your clients?

Services (non-financial)	
Mentoring	
Recruitment of top management personnel	
Legal services	
Structuring of management compensation	
Management	

Others:

In your experience do non-financial services carry the same level of importance as the financial services in the success of the businesses you help?

Yes ☐ No ☐

4. Is VC financing easily accessible to SMEs in the South Africa?

Yes ☐ N☐

Briefly explain your answer.

5. Is information on VC financing easily available to SMEs and other businesses in South Africa?

Yes ☐ No ☐

6. As Venture Capitalists do you find the South African economy receptive or conducive or developed enough for this type of business financing?

Yes ☐ No ☐

Why do you say so?

7. Will it be correct to state that businesses are actually fighting to get funding from you or it is the other way round?

Yes ☐ No ☐

Comments

8. Comparing VC funding with other traditional sources of funding such as banks, can it be safely stated that VC funding has breathed a new lease of life into SME financing?

Yes ☐ No ☐

What are you doing differently from traditional banks?

9. Is VC funding cheaper than business loans offered by banks?

Yes ☐ No ☐

10. VC funds in the US became synonymous with funding technology start-ups and other businesses that are related to ICT, is this also the case in South Africa as well?

☐ ☐

Yes No

11. The VC vetting process is said to be very stringent and only a few businesses are able to obtain VC funding? Is this true and if so, doesn't this reduce its significance on the SME sector at the end of the day?

Yes No

12. What is the biggest cause of SME failure besides mismanagement of financial resources in your experience?

Factors	**1**	**2**	**3**	**4**	**5**
Poor business model					
Inexperienced management team					
Lack of focus					
Poor knowledge of competitors					
Dwindling market					
Not seeking professional advice					

Venture Capital Process Related Questions

In evaluating businesses to invest in please indicate the degree of importance in the factors related to the entrepreneur's personality listed below.

13. Entrepreneur personality

Factor	**1**	**2**	**3**	**4**	**5**
Entrepreneur's ability to articulate venture					
Attentiveness to detail					
Ability to evaluate and react to risk					
Traits of hardworking and consistence					
Passionate about their ideas					

14. Entrepreneur's experience

Factor	1	2	3	4	5
Entrepreneur's work experience in industry					
Leadership capabilities demonstrated in the past					
Familiarity with target market					
Familiarity with person who referred entrepreneur					
Position held by entrepreneur when they worked					

15. Entrepreneur's product / service

Factor	1	2	3	4	5
Product/service can be protected through patents					
Product/service's innovativeness					
Product/service is high technology					
Product/service has been accepted in market					

16. Market related factors

Factor	1	2	3	4	5
The product has a very large demonstrable market					
Target market is growing significantly					
Little threat of from competitors in first 3 years					
The VC firm's familiarity with target market					

17. What do you consider to be essential for a venture to succeed? With regards to the following factors can you indicate their degree of importance in venture success?

Factor	1	2	3	4	5
Academic achievements of entrepreneur					
Entrepreneur's experience in business					
The entrepreneur's management team					
Venture been initiated by an individual or group					

with relevant ideas to the business.					
Innovativeness of product / service					
Financial investment					

18. Can you please indicate the in which sector your investments are concentrated in? Please indicate with a tick.

Telecommunications	**5%**
Software	**18%**
Ecommerce	
Energy	**5%**
Financial services	**9%**
Biotechnology	**25%**
Other (please indicate in writing)___________________________________	

19. In which stage of financing are you most concentrated on? Please indicate with a tick in the boxes provided below.

Seed Capital	
Start-up funding	
Development Capital	
Growth Capital	

Appendix B: Questionnaire to SMEs

Instructions

i. *Please respond to the questions below by putting an (X) in the appropriate box*
ii. *Respond to all questions honestly*
iii. *There is no right answer, it is your opinion that counts*

<u>Section A</u>

1. Have you ever heard of venture capital firms?

Yes ☐ No ☐

2. Have you approached ever approached a Venture Capital firm in the past?

Yes ☐ No ☐

3. Do you face challenges in accessing business funding?

Yes ☐ No ☐

4. Would you take a bank loan or Venture Capital financing instead?

Bank Loan ☐ Venture Capital finance ☐ other sources ☐

5. Is there adequate information pertaining to Venture Capital finance available?

Yes ☐ No ☐

<u>Section B</u>

S.A: Strongly Agree

A: Agree

N: Neutral

D: Disagree

S.D: Strongly Disagree

	S.A	A	N	D	S.D
6. I have considered utilizing equity financing before					
7. The Venture Capital market is well developed in South Africa					
8. Venture Capital is cheaper than bank loans					
9. I would approach Venture Capital firms for financial as well as non-financial services					
10. Lack of financing is not the only reason why SMEs fail to succeed; there are other reasons which include poor product or inexperienced management among others.					
11. SMEs would actually do better if they could access both the financial and non-financial services offered by Venture Capital firms					
12. I have heard that Venture Capital firms only fund SMEs with unique and innovative ideas					
13. The presence of Venture Capital firms in South Africa has increased the financing options for SMEs					
14. The development of Venture Capital firms in South Africa will facilitate faster growth in the small business sector and ensure survival of SMEs through their unique services					
15. Chambers of industry in South Africa are helpful in promoting SMEs' access to formal finance such as Venture Capital finance					

Thank you for your participation in the survey

Appendix C: Results from VC questionnaire (Question 12 – 19)

20. Question 12: *What is the biggest cause of SME failure besides mismanagement of financial resources in your experience?*

Figure 12.12: Biggest cause of SME failure besides mismanagement finances

Poor business model

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	19	47.5	47.5	47.5
	AGREE	14	35	35	82.5
	NEUTRAL	4	10	10	92.5
	DISAGREE	2	5	5	97.5
	STRONG DISAGREE	1	2.5	2.5	100.0
	Total	40	100	100.0	
Total		40	100.0		

Inexperienced Management

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	2	5	5	5
	AGREE	5	12.5	12.5	17.5
	NEUTRAL	6	15	15	32.5
	DISAGREE	12	30	30	62.5

	STRONG DISAGREE	15	37.5	37.5	100.0
	Total	40	100.0	100.0	

Lack of focus

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	9	22.5	22.5	22.5
	AGREE	4	10	10	32.5
	NEUTRAL	2	5	5	37.5
	DISAGREE	8	20	20	57.5
	STRONG DISAGREE	17	43.5	43.5	100.0
	Total	40	100	100.0	
Total		40	100.0		

Poor Knowledge

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	6	15	15	15
	AGREE	5	12.5	12.5	27.5
	NEUTRAL	9	22.5	22.5	50
	DISAGREE	11	27.5	27.5	77.5

	STRONG DISAGREE	9	22.5	22.5	100.0
	Total	40	100.0	100.0	

Dwindling Market

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	0	0	0	0
	AGREE	2	5	5	5
	NEUTRAL	5	12.5	12.5	17.5
	DISAGREE	12	30	30	47.5
	STRONG DISAGREE	21	52.5	52.5	100.0
	Total	40	100	100.0	

Not Seeking Professional Advice

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	27	67.5	67.5	67.5
	AGREE	10	25	25	92.5
	NEUTRAL	2	5	5	97.5
	DISAGREE	0	0	0	97.5
	STRONG DISAGREE	1	2.5	2.5	100.0

	Total	40	40	100.0	

21. Question 13: *Entrepreneur personality*

Figure 13.13: Entrepreneur personality

Entrepreneur's ability to articulate venture

		Frequency	Per cent	Valid Per cent	Cumulative Per cent
Valid	STRONG AGREE	25	62.5	62.5	62.5
	AGREE	9	22.5	22.5	85
	NEUTRAL	6	15	15	100
	DISAGREE	0	0	0	100
	STRONG DISAGREE	0	0	0	100
	Total	40	100	100.0	
Total		40	100.0		

Attentiveness to detail

		Frequency	Percent	Valid Percent	Cumulative Percent

Valid	STRONG AGREE	12	30	30	30
	AGREE	6	15	15	45
	NEUTRAL	18	45	45	90
	DISAGREE	1	2.5	2.5	92.5
	STRONG DISAGREE	3	7.5	7.5	100.0
	Total	40	100.0	100.0	

Ability to evaluate and react to risk

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	23	57.5	57.5	57.5
	AGREE	11	27.5	27.5	85
	NEUTRAL	6	15	15	100
	DISAGREE	0	0	0	100
	STRONG DISAGREE	0	0	0	100
	Total	40	100.0	100.0	

Traits of hardworking and consistency

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	17	42.5	42.5	42.5
	AGREE	14	35	35	87.5
	NEUTRAL	6	12.5	12.5	100
	DISAGREE	0	0	0	100
	STRONG DISAGREE	0	0	0	100

	Total	40	100	100.0	
Total		40	100.0		

Passionate about their ideas

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	11	27.5	27.5	27.5
	AGREE	21	52.5	52.5	52.5
	NEUTRAL	4	10	10	10
	DISAGREE	4	10	10	10
	STRONG DISAGREE	0	0	0	0
	Total	40	100	100.0	100
Total		40	100.0		

22. Question 14: *Entrepreneur's experience*

Figure 14.14: Entrepreneur's experience

Entrepreneur's work experience in industry

	Frequency	Percent	Valid Percent	Cumulative Percent

Valid	STRONG AGREE	7	17.5	17.5	17.5
	AGREE	14	35	35	52.5
	NEUTRAL	5	12.5	12.5	65
	DISAGREE	3	7.5	7.5	72.5
	STRONG DISAGREE	11	27.5	27.5	100.0
	Total	40	100	100.0	
Total		40	100.0		

Leadership capabilities demonstrated in the past

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	29	72.5	72.5	72.5
	AGREE	4	10	10	82.5
	NEUTRAL	1	2.5	2.5	85.0
	DISAGREE	2	5	5	90
	STRONG DISAGREE	4	10	10	100.0
	Total	40	100	100.0	
Total		40	100.0		

Familiarity with target market

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	26	65	65	65
	AGREE	4	10	10	75
	NEUTRAL	5	12.5	12.5	87.5
	DISAGREE	3	7.5	7.5	95
	STRONG DISAGREE	2	5	5	100.0
	Total	40	100	100.0	
Total		40	100.0		

Familiarity with person who referred entrepreneur

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	4	10	10	10
	AGREE	12	30	30	40
	NEUTRAL	3	7.5	7.5	47.5
	DISAGREE	2	5	5	52.5
	STRONG DISAGREE	19	47.5	47.5	100.0
	Total	40	95.9	100.0	
Total		40	100.0		

Position held by entrepreneur when they worked

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	8	20	20	20
	AGREE	3	7.5	7.5	27.5
	NEUTRAL	5	12.5	12.5	40
	DISAGREE	9	22.5	22.5	62.5
	STRONG DISAGREE	15	37.5	37.5	100.0
	Total	40	100	100.0	
Total		40	100.0		

Question 15: *Entrepreneur's product / service*

Figure 15.15: Entrepreneur's product / service

Product/service can be protected through patents

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	8	20	20	20
	AGREE	1	2.5	2.5	22.5
	NEUTRAL	5	12.5	12.5	35
	DISAGREE	6	15	15	50
	STRONG DISAGREE	20	50	50	100.0

	Total	40	100	100.0	
Total		40	100.0		

Product/service's innovativeness

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	28	70	70	70
	AGREE	6	15	15	85
	NEUTRAL	5	12.5	12.5	97.5
	DISAGREE	0	0	0	97.5
	STRONG DISAGREE	1	2.5	2.5	100.0
	Total	40	100	100.0	
Total		40	100.0		

Product/service is high technology

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	18	45	45	45
	AGREE	9	22.5	22.5	67.5
	NEUTRAL	4	10	10	77.5
	DISAGREE	5	12.5	12.5	90
	STRONG DISAGREE	4	10	10	100.0

	Total	40	100.0	100.0	

Product/service has been accepted in market

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	18	45	45	45
	AGREE	12	30	30	75
	NEUTRAL	7	17.5	17.5	92.5
	DISAGREE	3	7.5	7.5	100
	STRONG DISAGREE	0	0	0	100.0
	Total	40	100.0	100.0	

Question 16: *Market related factors*

Figure 16.16: Market related factors

The product has a very large demonstrable market

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	5	12.5	12.5	12.5
	AGREE	12	30	30	42.5
	NEUTRAL	18	45	45	87.5

	DISAGREE	3	7.5	7.5	95
	STRONG DISAGREE	2	5	5	100.0
	Total	40	100.0	100.0	

Target market is growing significantly

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	24	60	60	60
	AGREE	6	15	15	75
	NEUTRAL	4	10	10	85
	DISAGREE	4	10	10	95
	STRONG DISAGREE	2	5	5	100.0
	Total	40	100.0	100.0	

Little threat of from competitors in first 3 years

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	7	17.5	17.5	17.5
	AGREE	9	22.5	22.5	40
	NEUTRAL	13	32.5	32.5	72.5
	DISAGREE	8	20	20	92.5

	STRONG DISAGREE	3	7.5	7.5	100.0
	Total	40	100.0	100.0	

The VC firm's familiarity with target market

		Frequency	Per cent	Valid Per cent	Cumulative Per cent
Valid	STRONG AGREE	21	52.5	52.5	17.5
	AGREE	13	32.5	32.5	85
	NEUTRAL	1	2.5	2.5	87.5
	DISAGREE	2	5	5	92.5
	STRONG DISAGREE	3	7.5	7.5	100.0
	Total	40	100.0	100.0	

Question 17: *Factors essential for entrepreneurial venture success*

Figure 17.17: Factors essential for entrepreneurial venture success

Academic achievements of entrepreneur

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	4	10	10	10
	AGREE	9	22.5	22.5	32.5
	NEUTRAL	17	42.5	42.5	75
	DISAGREE	2	5	5	80
	STRONG DISAGREE	8	20	20	100.0
	Total	40	100.0	100.0	

Entrepreneur’s experience in business

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	27	67.5	67.5	67.5
	AGREE	6	15	15	82.5
	NEUTRAL	5	12.5	12.5	95
	DISAGREE	1	2.5	2.5	97.5
	STRONG DISAGREE	1	2.5	2.5	100.0
	Total	40	100.0	100.0	

The entrepreneur’s management team

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	19	47.5	47.5	47.5
	AGREE	8	20	20	67.5
	NEUTRAL	7	17.5	17.5	85
	DISAGREE	4	10	10	95
	STRONG DISAGREE	2	5	5	100.0
	Total	40	100.0	100.0	

Venture been initiated by an individual or group with relevant ideas to the business.

		Frequency	Per cent	Valid Per cent	Cumulative Per cent
Valid	STRONG AGREE	4	10	10	10
	AGREE	5	12.5	12.5	22.5
	NEUTRAL	9	22.5	22.5	45
	DISAGREE	8	20	20	65
	STRONG DISAGREE	14	35	35	100.0
	Total	40	100.0	100.0	

Innovativeness of product/service

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	29	72.5	72.5	72.5
	AGREE	4	10	10	82.5
	NEUTRAL	2	5	5	87.5
	DISAGREE	1	2.5	2.5	90
	STRONG DISAGREE	4	10	10	100.0

	Total	40	100.0	100.0	

Financial Investments.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	STRONG AGREE	22	55	55	55
	AGREE	14	35	35	90
	NEUTRAL	2	5	5	95
	DISAGREE	2	5	5	100
	STRONG DISAGREE	0	0	0	100.0
	Total	40	100.0	100.0	

Appendix D: Reliability tests

Case Processing Summary for VC results

		N	%
Cases	Valid	40	100.0
	Excluded[a]	0	0.0
	Total	40	

Case Processing Summary for SME results

		N	%
Cases	Valid	43	61.4%

	Excluded[a]	27	38.6
	Total	70	100.0