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**THE CHALLENGES FACED BY SMALL AND MEDIUM ENTERPRISES IN  
ACCESSING CREDIT IN NAMIBIA**

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by

**Beatus Amadhila**

Amdbea001

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*Supervisor:* Abdul Latif Alhassan, Ph.D.



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## **Abstract**

This study sets out to explore the challenges associated with small and medium enterprises (SME) in obtaining funds from financial institutions. Specifically, it seeks to identify the types of credit facilities used by SMEs in Namibia, examine the factors that limit SME access to credit from banks and to understand the challenges associated with SMEs in accessing credit facilities. This study employs the logistic technique to correlate survey data from 120 small and medium firms in Namibia, to examine the likelihood of access to credit from a financial institution.

The study has found that the type of credit used by SMEs is either short-term loans, medium-term loans or long-term loans. The conclusion reached is that the majority of SME business owners preferred short-term loans to finance their business activities. This leads to another question: whether financial institutions' products, designed for the SME sector, are well aligned with this finding or if this is another challenge to SMEs in accessing funds. The study revealed factors in accessing credit by small and medium-sized enterprises, including: requests by the financial institutions for collateral and audited financial statements of account; length of operation, and details of competent management, capable of giving the banks confidence and assuring them that the loans will be repaid; rates of interest which determine the loan costs. These are some of the factors that determine SME access to finance.

The study strongly recommends that SME businesses keep up-to-date business financial records for various reasons, such as to keep track of their operations, and to provide this information to financial institutions in the event of their making applications for funding. Also, SME firms should build strong balance sheets, displaying their profits, so as to ensure that they are able to meet the collateral requirements of the financial institutions.

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## **List of abbreviations**

Agri-Bank	Agricultural Bank of Namibia
APR	Annual Percentage Rate
ATM	Automatic teller machine
BIPA	Business Intellectual Property Authority
BoN	Bank of Namibia
DBN	Development Bank of Namibia
DFIs	Development finance institutions
DGDA	Dalberg Global Development Advisors
DTI	Department of Trade & Industry
EEZ	Exclusive Economic Zone
SEZ	Special Economic Zone
GDP	Gross domestic product
ICEG	International Congress on Environmental Geotechnics
IFC	International Finance Corporation
LaRRI	Labour Resources and Research Institute
MENA	Middle East and North Africa region
MFI	Microfinance institutions
MITSD	Ministry of Industrialisation, Trade and SME Development
MSME	Micro, small and medium enterprises
MTI	Ministry of Trade and Industry
NCCI	Namibia Chamber of Commerce and Industry
NCR	National Credit Regulator
NDP	National Development Plan
NEPRU	National Economic Policy Research Unit
NGO	Non-governmental organisations
NGP	New growth path
NHE	National Housing Enterprise
OECD	Organisation for Economic Cooperation and Development
POT	Pecking order theory
SBCGT	Small Business Credit Guarantee Trust
SDF	Special Development Fund
SME	Small and medium-sized enterprises

[treated in this text as both adjective and noun, singular and plural noun: —

SMME, SMMEs, SMME's]

SMME	Small medium and micro enterprises
UEAPME	European Association of Art, Small and Medium Enterprises
UNCTAD	United Nations Conference on Trade and Development
UNIDO	The Industrial Development Organization of the United Nations
VAT	Value Added Tax

# CHAPTER 1

## Introduction

### 1.1 Background to the study

The Bolton Committee (1971) applied different definitions of SME and among others it defined small and medium-sized enterprises (SMEs) as companies with relatively small shares (in terms of sales turnover, number of employees, and assets) of their markets, which are managed by the owners and not through a formalised management structure, and are independent in the sense of forming a large company. This definition has, however, evolved over time and many countries adopt a definition of SME that covers all firms with less than 250 employees, thereby including micro firms (OECD, 2006).

The definition issue gets further complicated by the fact that individual banks in each country use different definitions of an SME, for their own strategic and risk-management purposes, for instance, among banks in the International Finance Corporation's (IFC) Middle East and North Africa region (MENA), the cut-off between small and medium firms ranges from five to fifty employees, and the cut-off between medium and large firms ranges from fifteen to one hundred employees (Beck, Demirguc-Kunt & Peria, 2008).

According to (Labour Resources and Research Institute (LaRRI) and National Economic Policy Research Unit (NEPRU), (2002) in Namibia, there are several names and definitions given to the SME sector which overlaps, to a significant extent, the informal sector. The multitude of definitions should not be regarded as a problem in itself, but an indication of the challenges regarding the lack of clarity and consistency faced by all those dealing with the sector (LaRRI and NEPRU), 2002.

**Table 1. MTI small enterprise definition**

Sector	Employment	Turnover (N\$)	Capital Employed (N\$)
Manufacturing	Fewer than 10 persons	1 000 000	500 000
Service	Fewer than 5 persons	250 000	100 000

*Source: LaRRI and NEPRU, 2002*

According to Hisrich (2005) Small and medium-sized enterprises and micro-enterprises (SME & SMME) play a very important role in the economy of any country, both at development and at individual levels as SMEs offer jobs and improve the standard of living for both employers and employees and Entrepreneurship is recognised as a vital engine for growth, creativity, productivity and careers, and is generally recognised as a key area of economic dynamism but turning ideas directly into economic opportunities can be the ultimate difficulty in terms of entrepreneurship.

According to OECD report (2017) SMEs are key players in the economy and wider eco-system of firms, and that enabling them to adapt and thrive in a more open environment and participate more actively in the digital transformation is essential for boosting economic and delivering a more inclusive globalisation. According to National Credit Regulator (2011) the dynamic role of SMEs in developing countries as economic engines, ensures the achievement of growth targets in those countries. The Industrial Development Organization of the United Nations (UNIDO) estimates that SMEs account for more than 90 per cent of private enterprises, and contribute to over 50 per cent of employment and gross domestic product (GDP) in most African countries (UNIDO, 1999).

According to the data released in August, 2014 by Namibia's Ministry of Trade and Industry, 78 per cent of the companies registered in the country belong to the small and medium enterprise sector of the Namibian economy (Ajax Industry, 2012, p.67). Based on this information, it can be concluded that the Namibian economy depends to a large extent on the SME sector creating jobs for hundreds of thousands of Namibians. (Cofie, 2012; Ahiawodzi & Adade, 2014), state that the SME sector can improve its current contribution to GDP growth, and undoubtedly, this sector can grow faster and contribute to employment growth in Namibia. However these arguments indirectly say that the sector does not fully use its logical potential, as a result of limiting the methods and Ackah and Vuvor (2011) are among to the authors who recognise that some of these limitations are the challenges SMEs face when accessing credit from financial institutions (banks, microfinance institutions, companies, savings-and-loans, etc.), who are financiers in this sector.

In the literature on microfinance and small and medium-sized enterprises, a number of challenges have been identified that hinder access to credit lines by SME firms and some of these challenges are: SMEs having no collateral; keeping bad records; having poor creditworthiness stemming from bad savings history; and rigorous credit criteria applied by

financiers (Ackah & Vuvor, 2011; Cofie, 2012). These and other challenges are consistently discovered by research conducted in context, in both developed and developing countries.

## **1.2 Statement of the problem**

According to the Research Department of the Bank of Namibia, 2010, p. 9 the Namibian government has recognised and acknowledged the importance of the SME sector within the economy. The paper further states that as one of the ways of achieving the ideals of National Vision, Namibia aspires to have a flourishing SME sector by the year 2030, and that the importance placed on this sector, therefore, is evidenced by the special attention and efforts directed to this sector.

Initiatives by the private sector, as well as non-governmental organisations (NGOs), aimed at assisting SMEs, are also acknowledged (Research Department of the Bank of Namibia, 2010). The Research Department of the Bank of Namibia, 2010, p. 9 further states that despite these efforts, there is still room to further develop the SME sector, for it to contribute meaningfully to the economy. The paper further states that there are several challenges, which are currently hampering this sector's flourishing, amongst of them being access to finance which has been identified as one of the key obstacles. Additionally, limited business support services and poor entrepreneurial skills also pose challenges. The paper further states that these challenges indicate that, as a country, Namibia still need to do more, or perhaps more players need to be involved in the development of SMEs and equally, Namibia needs to identify the appropriate financing model for SMEs. For a country with widespread poverty and a high level of unemployment, we are compelled to seek solutions to these challenges. It is believed that finding solutions will not only broaden our economic activity base, but also address the issues of poverty, unemployment and income inequality (The Research Department of the Bank of Namibia, 2010).

The National Bureau of Statistics Namibia (2014) indicated that three out of five companies in Namibia failed in the first months of operation and, of those that remained, 80 per cent do not make it to their fifth year. The National Bureau Statistics Namibia (2014) further states that despite the efforts of several stakeholders, the lack of access to credit is almost universally recognised as a key problem facing SMEs, however these credit restrictions operate differently in Namibia to elsewhere, where the undeveloped capital market forces entrepreneurs to rely on self-financing or on the willingness to lend of friends or relatives which has also forced them to depend on high-cost short-term finances.

### **1.3 Statement of research objectives**

The objective of this study is to explore the challenges associated with SMEs in getting funds from financial institutions. The specific objectives are;

- a) To identify type of credit facilities used by SMEs in Namibia.
- b) To examine the factors that limit SMEs' access to credit from banks.

### **1.4 Justification of the study**

This research was motivated by the increasing role of SMEs in the Namibian economy, and the continuing constraints they face in their activities. SMEs have been identified by the Namibian Government as one of the development strategies for promoting industrialisation, creating employment, catalysing innovation and eradicating poverty in Namibia. The findings of the study will be of importance to small and medium entrepreneurs as they outline the major factors that influence access to credit by small and medium enterprise operators in Namibia. Information in this study may be used to provide useful insights for the Government of Namibia, and subsequently other countries, when formulating policies on planning. This will also aid in building an inclusive policy for all traders, including SMEs.

Educational institutions and non-governmental organisations will also be able to focus on the needs of small and medium entrepreneurs, to educate in practical aspects of business, and for NGOs to be aware of key areas in which to offer grants or donations for training the less fortunate. It is hoped that the recommendations and measures will help in checking whether the government is on track in the realisation of Namibia's Vision 2030.

To academicians and researchers, the study should be useful as a reference for future research into factors influencing the access to credit by small and medium entrepreneurs.

### **1.5 Organisation of the study**

The dissertation consists of five chapters or sections. The first chapter contains general information on SMEs; the meaning of the study; a description of the research problem; the objectives of the research, as well as the limitations of the research.

The second chapter presents the theoretical framework of the investigation. This chapter describes the definitions of an SME, the existing literature and the current structure of SMEs in Namibia.

The third chapter explains in detail the methodology used in the study. This includes several data sources, methods used in the collection of research data and their reliability and credibility. It describes the questionnaires.

Then, in the fourth chapter, an empirical study is introduced. It includes the analysis and presentation of the data collected from the respondents.

Finally, the fifth chapter concludes the investigation with a summary of the various findings and appropriate recommendations.

## **CHAPTER 2**

### **Literature Review**

#### **2.1 Introduction**

This chapter reviews existing literature relevant to this research in order to draw on the findings of other researchers. There is much research based on factors that hinder the growth of small businesses in Namibia as well as elsewhere. The chapter discusses the theoretical basis of the challenges SMEs face in accessing finance, specifically Schumpeterian theory, the refugee effect, the theory of social capital, and capital structure theories such as pecking order and credit rationing. This is followed by empirical review of literature related to challenges of SMEs in accessing finance.

#### **2.2 Overview and profile of SME development in Namibia**

Nakusera, Kadhikwa and Mushendami (2008) emphasise that SMEs are the backbone of most economies and are a primary source of economic development, dynamism and mobility. SMEs in Namibia contributed about 12 per cent of the gross domestic product (GDP) and employed about 20 per cent of the workforce in 2004 (Nakusera, Kadhikwa & Mushendami, 2008). Many SMEs do not have the collateral that banks require to secure loans. Any country's economic growth can be achieved through appropriate policies, programmes and strategies focusing on business activities, promoting high potential for integration into the main economic stream, promoting job creation and sustainable development (Hansohm & Mastaert, 2013).

Promoting SME development is high on the Namibian government's agenda and is seen as a tool to promote economic growth and jobs, alleviate poverty, reduce inequalities, and empower previously disadvantaged groups (Rosendahl, 2010). Through the adoption of a National Small and Medium Enterprises (SME) Policy and Programme, in 1997, the Namibian Government recognised this role as a framework for creating an enabling regulatory environment, in which SMEs could be developed and promoted by the public and private sectors (Ministry of Industrialisation Trade & SME Development [MITSD], 2015). The 1997 SME policy sought to tackle the problems that SMEs were facing in the areas of finance, marketing, technology, infrastructure, skills development and institutional support (MITSD, 2015).

For the purpose of this study, SMEs refer to those who have registered and have SME Certificates from the Ministry of Commerce and Industry (now the Ministry of Industrialisation, Trade and SME Development), (MITSD, 2015). SME certification provides eligibility for funding from a variety of areas, including preferential government procurement programmes, financial support, capacity building, mentoring and other institutional support for SMEs (Jauch, 2010). The MITSD certification process requires SMEs to have a Certificate of Incorporation, a Social Security Commission Good Standing Certificate not older than three months, a Value Added Tax (VAT) Good Standing Certificate, not older than three months, and approved copies of identity documents for all SME members and owners (MITSD, 2015). These requirements have resulted in a phenomenal increase in the number of small and medium-sized enterprises registering with the MITSD, to more than 40 000 (Ogbokor & Ngeendepi, 2011).

Not all registered SMEs are actually operational, as most of these registered SMEs have become briefcase companies, targeting favoured SMEs. These types of SME are referred to as 'tenderpreneurs' in some circles. These briefcase SMEs exist to target government tenders and move from project to project. In addition, they do not work in any specific field, often have no business premises and function solely from tenders, posing a threat to SME support structures in Namibia (Grossmann, Mwatotele, Stork, & Tobias, 2010).

Dieci, Foresi, Hansohm, Ricover and Tonin (1998) noted that Namibia's small and medium-sized enterprises worked informally, before and after independence, but only in 1997/98 did the sector gain popularity and formal recognition, when the Republic of Namibia government launched its first Small Business policy. Five key constraints have been established for SME growth and development in the White Paper on Small Business Development: financing, markets, procurement, technology and training. Access to finance in both formal and informal sectors is seen as the main limitation (Dieci et al., 1998).

Amiss (2012) notes that the Namibian government's identification of lack of access to finance as a major obstacle to SME growth, laid the foundation for SME development, in partnership with Namibian commercial banks, to provide financing to small enterprises, who were unable to obtain loans from commercial banks due to lack of collateral. According to Amiss (2012) this was done in a form of the formation of the Small Business Credit Guarantee Trust (SBCGT) in June 1999, with the trust's purpose being to provide the necessary security to small business enterprises, in the form of a guarantee, to allow them to receive loans from

commercial banks. Amiss (2012) further states that the SBCGT was focused on cooperation between the Namibian and German governments, however, having realised the important role played by the SME sector in addressing socio-economic problems, the government created a number of institutions to improve access to financial services for SMEs. However as a result of administrative inefficiencies, many of the organisations created, collapsed and only The Namibia Development Bank (DBN), Agricultural Bank of Namibia (Agri-Bank) and the National Housing Enterprise (NHE) are the remaining entities (Amiss, 2012).

Dieci et al. (1998) argued that the Namibian government's goal was to provide financial assistance to SMEs in the short to medium term, hoping that commercial banks would assume the role of financial provider for SMEs in the longer term. However, due to the fact that commercial banks are either unable or unwilling to provide financial assistance to SMEs, this concept did not deliver the expected results. Dahlberg (2011), who outlined many obstacles to debt financing for SMEs by banks that hamper SME access to finance, supported this view. Dalberg Global Development Advisors (DGDA, 2011) notes in its study that banks in developing countries are not adequately providing capital to SMEs, although Banks earn high returns from their core markets, giving them no reason to take additional risks on the SME market, incurring higher administrative costs through loans to SMEs, still they have difficulty in supplying long-term capital and have limited information, expertise and regulatory support in lending to SMEs, and the characteristics of the banking system (formal loan criteria) create unfavourable leverage. Dalberg Global Development Advisors further states that in the past, for various reasons, commercial banks were either reluctant or unable to provide SMEs with access to finance. In support of this, Levitsky (1996) outlined many SME-related elements that make funding for SMEs difficult for commercial banks, among other items, which include SME lending being perceived as risky because of:

- a) the high failure rate of SMEs;
- b) reluctance on the part of SMEs to borrow from formal banks because of administrative and costly formalities;
- c) banks maintaining an institutional bias towards lending to the large corporate sector due to close links between them;
- d) the administrative costs of SME lending being high;

- e) SMEs being either unable or unwilling to present the full accounting records demanded by banks;
- f) SMEs usually being unable to provide collateral security.

Namibia's banking sector came under intense scrutiny at the Bank of Namibia's (BoN) 12th Annual Symposium in 2010, where the main focus was on the Namibian SME market. The symposium highlighted the recognition of the importance of the SME sector in Namibia by the Namibian government and the aim of the government to have a thriving SME sector, in line with the national vision for the country, by 2030. It suggested the need to develop a suitable financial model for SMEs, with commercial banks highlighted as stakeholders, to ensure that this comes to the forefront (Amiss, 2012).

In order to fulfil the government's goal of providing access to finance for SMEs, many banks have launched efforts to help address the lack of access to finance, by setting up specialised branches dedicated to SME lending and also introduced mentoring programmes to assist SMEs (Bank of Namibia [BoN], (2011).

## 2.3 Definition of terms and concepts

### 2.3.1 Comparing SME definitions in South Africa, Kenya and Namibia

SME definitions vary from country to country and with the type of industry involved. In Namibia, SME is defined by the Ministry of Trade and Industry (MTI) as shown in Table 4.

**Table 2: Broad definitions of SMEs in the National Small Business Act of South Africa.**

Enterprise Size	Number of Employees	Annual Turnover (SA Rands)	Gross Assets, Excluding Fixed Property
Medium	Fewer than 100 to 200 depending on industry	Less than R4m to R50m, depending on industry	Less than R2m to R18m depending on industry
Small	Fewer than 50	Less than R2m to R25m, depending on industry	Less than R2m to R4.5m depending on industry
Very Small	Fewer than 10 to 20	Less than R200 000 to R500 000, depending on industry	Less than R150 000 to R500 000, depending on industry
Micro	Fewer than five	Less than R150 000	Less than R100 000

*Source: Falkena et al. (2001)*

**Table 3: Classification of SMEs by MSE Act, 2012 of Republic of Kenya.**

Entity	Number of Employees	Annual Turnover Limit	Investment in Plant and Machinery and Registered Capital	Equipment Investment and Registered Capital
<b>Micro Enterprise</b>	Less than 10 people	Not exceeding KES 500 000	Not exceeding KES 10m	Not exceeding KES 5m
<b>Small Enterprise</b>	More than 10 but less than 50 people	Between KES 500 000 and KES 5m	More than 10m but less than KES 50m	More than KES 5m but less than KES 20m

*Source: Ong'olo & Awino, (2013)*

**Table 4: Definition of Small Business in Namibia**

Sector	Employment	Turnover (N\$000)	Capital
			Employed (N\$000)
<b>Manufacturing</b>	Less than 10 persons	N\$ 1 000	N\$ 500
<b>Other businesses</b>	Less than 5 persons	N\$ 250	N\$ 100

*Source: MTI (1997) and LaRRI (2002)*

### 2.3.2 Access to credit

Access to credit refers to the possibility for individuals and companies to obtain external financing to help them solve problems related to cash flow (Osoro & Muturi, 2013). Osoro and Muturi (2013) further states that the loan can be short- or long-term, depending on the lender's assessment of borrowers' ability to pay, and that the ability of companies to access credit is a key factor in the growth of the private sector, especially SMEs, which often do not have enough capital, which they need for development.

Smaller companies tend to have limited access to non-bank lenders, due to the lack of credit information in their applications (Monteiro, 2013). The main focus of this study is external loans available to SMEs. At the international level, in countries in development like Vietnam it was found that the characteristics of the company were not the main factor in the financing of an SME (Minh, 2012). But the more influence the company had, the greater the probability of it getting a bank loan. Elsewhere, research in Malaysia on the determinants of access to credit has shown that the presence of security plays an important role in the evaluation of the loan, and gives a better chance of approval of the loan (Haron, Said, Jayaraman & Ismail, 2013). Another study conducted in Ghana revealed that the lack of collateral, high borrowing costs and the lack of audited financial statements, make access to bank loans difficult (Ackah

& Vuvor, 2011). In Ghana, 75 per cent of small and medium enterprises urgently needed loans for expansion, but the lack of collateral was the cause of rejection of a loan to most small businesses (Aryeetey et al. 1993).

A study conducted in Nigeria, on the availability of credit in the Niger Delta, showed that social capital, age and the sex of owners of companies had a significant impact on access to credit (Essien & Arene, 2014). Where the lenders are not supervised, they are accused of demanding high rates of interest by borrowers' associations, etc., while enterprise age, size, collateral and education had a significant impact on access to formal loans, according to (Essien & Arene, 2014).

In recent years, the Namibian government has introduced various funding schemes, such as grants administered through regional councils, to expand access to finance and promote the well-being of young people, women and people with disabilities. Literacy level had a positive impact on the awareness by borrowers of how and where to obtain a loan in order to improve business activity; and that the number of credit institutions has had a positive impact on the availability of funding, as more institutions will meet specific service needs in a quest for credit absorption by the entrepreneur (Wangai & Omboi, 2011). The level of education gave an additional benefit to those who had a good knowledge of accounting, better management skills and the use of technology, when applying for loans. Wealthy people who have collateral were more likely to get a loan (Wangai & Omboi, 2011).

### **2.3.2.1 Collateral requirements**

The historical development and culture of the associated banking system underlies the problem of emphasising the provision of collateral as the basic condition for granting loans. Banks have always adopted an unfavourable attitude towards small businesses with the inability to focus on the potential to generate income for the company, analysing the probability of repayment of the loan (Gichuki, Njeru & Tirimba, 2014). Credit restrictions can occur when banks increase the collateral for the loan. As a result, the borrowers, including SMEs, may be removed from the list of potential clients and banks can skip these clients (Stiglitz & Weiss, 1981). With the high cost of credit, through high interest rates, it is very difficult to access bank loans (Vuvor & Ackah, 2011). Better borrowers receive higher loans and lower interest rates, to cover reserves and reduce the interest rate of the loan, it has been shown that the bank uses both qualitative and quantitative methods in structuring loan agreements for small businesses (Toivanen & Cressy, 2001). The result can be as simple as banks approaching the loan process to avoid risks (to protect the funds of savers) (Toivanen & Cressy, 2001). They therefore reject

many proposals that they perceive as ‘risky’ and there is also clear ‘discrimination’, for example, against women and ethnic minorities.

### **2.3.2.2 Cost of credit**

The cost of borrowing refers to the amount of money that entrepreneurs pay when they borrow money from financial institutions. The key cost indicators in this sense are the calculation of negotiation fees, interest rates, personal insurance, legal fees and travel costs that entrepreneurs spend in the process of obtaining a loan. Hallberg, (2002) distinguished the high risk associated with lending to SMEs and the fixed costs associated with obtaining reliable information about the borrower from financial institutions, as the main driver of high loan costs. High transaction fees not only increase the cost of loans, but may also limit access to external financing for certain groups of borrowers. Although transaction costs are applied to all borrowers, there are arguments that they are even more restrictive for small and micro enterprises. The varied characteristics and relative opacity increase the costs of evaluation and monitoring. Unlike other credit categories, such as consumer loans or mortgages, loans for SMEs are still considered high-cost credit products. Specifically, unlike other credit products that can be reduced to simple transactions, loans to SMEs often depend heavily on the relationship between borrowers and lenders (Berger & Udell, 2006).

Every company needs finance, although at first glance it may seem that financing is not necessary. It is important that funding be as effective as possible (Stutely, 2003). He firmly states that the borrower should be able to cover the costs of all financing on the same basis, compare them and discover the cheapest financing option (Stutely, 2003). Banks have often been criticised for high interest rates on loans. The rate of interest on loans depends on the interest rates charged to the bank, which depend on the basic credit interest rate established by the Bank of Namibia (BoN). The interest rate sometimes depends on the value of the collateral provided and the purpose for which it will be used or the type of business. This means that the safest loans carry low interest rates due to their low risk. This leads SMEs to microfinance institutions (MFIs) to apply for short-term loans with temporary interest rates.

A study conducted by Mwangiego and Bwise (2013) on the challenges that entrepreneurs face in accessing credit included the case of young Makuyu entrepreneurs in Namibia. It has shown that most young entrepreneurs face challenges related to access to credit (Mwangiego & Bwise, 2013). This is because of the high cost of credit—confirmed high loan handling rates, high court fees, high interest rates, high credit insurance costs and high expenses incurred

during the process of searching for a loan. The study recommends that financial institutions look for ways to develop credit products that attract young people (Mwangiego & Bwise, 2013). Lenders and other interested parties should consider reducing the interest rates on credit products for young clients. Another study was also carried out on access to financial credit in relation to the development of small retail businesses belonging to women in Uasin Gishu—the Kapseret Constituency case (Cheluget, 2013). The study showed that interest rates affect access to credit for women entrepreneurs with small businesses in the district of Kapseret (Cheluget, 2013).

### **2.3.2.3 Availability of information on finance**

Tucker and Lean (2003) pointed out that access to information is important, both from the perspective of SMEs and from the perspective of suppliers and financial services providers, and that SMEs require information to identify potential suppliers of financial products, whereby they require this information to evaluate the costs of financial services and the products offered. Tucker and Lean further state that financial service providers require information that can be used to assess the risk associated with the SME requesting finance, and to evaluate the SME prospects in a given market segment but One of the problems that small businesses face when trying to obtain financing is information asymmetry, because they cannot prove the quality of their investment projects for the financial institutions (usually banks) (Tucker & Lean, 2003). Small business managers often suffer from a lack of financial sophistication, because they are often specialists in products or services, rather than finances, therefore, the problem of information asymmetry is related in part to difficulties in the sphere of communication and credibility (Tucker & Lean, 2003). This is compounded by the fact that new or recent companies may not be able to provide evidence of good financial results. Banks in particular rely on past financial results as indicators of the future profitability of projects (Tucker & Lean, 2003).

Access to information is, therefore, a basic condition for granting loans to companies. The problem of insufficient information is often mentioned as one of the main aspects that limit bank financing for SMEs (European SMEs Observatory, 2003; Udell, 2004). Most of the information that banks obtain from SMEs come from the same borrowers' investment plans, working capital requirements and balance sheets (European SMEs Observatory, 2003; Udell, 2004). The required information is analysed in terms of internal consistency and compared with other information available to the bank, however, interaction with the borrower is another possible source of information for the bank of SME borrowers (European SMEs Observatory,

2003; Udell, 2004). Serving the borrower's accounts, the bank knows the size of transactions and trends in its operations and as a result, borrowers are more likely to obtain loans and overdrafts from a bank they have been using for years (European SMEs Observatory, 2003; Udell, 2004).

According to the Observatory of European SMEs (2003: 23), 60 per cent of SMEs in Europe regularly provide this type of information. The report also indicates that there is a positive correlation between the size of the company and the information provided to the banks, it also notes that 70 per cent of SMEs without credit lines do not share financial information with the bank (European SMEs Observatory, 2003:23). According to the report, the situation is even worse in the less developed countries, where the level of literacy is very low. However, it may be necessary to provide information to a bank to create a rating culture among the member states in order to obtain access to external financing.

Small business owners generally have more information about the potential of their own companies, but in some situations, business owners may have difficulty expressing and providing the detailed information about the company, that their financiers want (Winborg & Landstrom, 2000). In addition, some small business managers appear to be restrictive when it comes to providing external financiers with detailed information about the essence of the business, because they believe, in one way or another, that information about their activities can be accessed by the competition (Winborg & Landstrom, 2000). The importance of maintaining appropriate accounts, to promote the development of small businesses, has been confirmed in previous research on the growth and development of a small business (Abor & Biekpe, 2006; Kinyanjui, 2006), who note that some entrepreneurs considered it difficult to obtain loans because they had to show credit cards and did not fully understand the requirements to obtain and pay loans.

#### **2.3.2.4 Business risks**

The risk factor is another aspect that explains access to credit by SMEs. The total risk (both business and financial) can be a dimension in which there can be a financial gap. The company's commercial risk (focusing on the company's operations) means the uncertainty of the return on assets (Correia, Flynn & Wormald, 2008). Financial risk occurs when the company uses debt (financial leverage). In such cases, the company assumes the additional responsibility of financing the debt, which means paying interest on time as the inability of

the company to pay interest or return the capital will result in insolvency, which will lead to bankruptcy (Correia, Flynn & Wormald, 2008). As the amount of debt used by the company increases, the possibility of default will also increase, due to the limitations of cash flow as a result of interest payments. SMEs rely more on external financing, so it is likely that the financial risk in the SME sector is very high (Correia, Flynn & Wormald, 2008).

Green (2003) argued that commercial banks often attribute a high risk to small businesses, and therefore, are reluctant to lend to them. Due to their small size and inherent susceptibility to market fluctuations, the mortality rate of small businesses is relatively high. These firms, due to their nature, are often young and, therefore, their owners have no financial background or results of profitable projects to show (Green, 2003). In addition, organisational and administrative deficiencies, lower quality of management and the lack of adequate accounting systems, can jeopardize the availability and reliability of information for small businesses with respect to their ability to repay (Green, 2003).

Van Aardt and Fatoki, (2012) states that the difficulties faced by SMEs in accessing credit lines are attributed to their profile of higher perceived risk. Credit institutions treat SMEs as riskier companies for many reasons, including: uncertain competitive environments; insufficient accounting systems; an unpredictable operating environment in emerging economies; the assets not being recorded correctly; delayed payments for products and services completed; being less well equipped in terms of human and financial resources to support economic activities (Van Aardt & Fatoki, 2012).

### **2.3.2.5 Access to loans**

Access to financing helps all companies grow and prosper. However, the lack of access to credit is the main obstacle that hinders the development of microenterprises (GOK, 2005). In addition, companies with greater access to capital can take better advantage of development and investment opportunities (Beck, Demirgüç-Kunt, Laeven & Maksimovic, 2006). In Kenya, there is no structured institutional mechanism that facilitates the flow of financial resources from the formal sector to microfinance enterprises (Atieno, 2001). In general, these companies operate with tight budgets, often financed by the owner's own contribution, loans from friends and family and some bank loans. Often they cannot obtain adequate financial resources for the purchase of machinery, equipment and raw materials, as well as to cover daily expenses (Atieno, 2001). This is due to the low value of the company and the small fixed investments, and that they find it difficult to obtain loans at reasonable interest rates. As a

result, they have to rely heavily on internal resources and the problem remains serious in rural areas, where bank branches are widely separated or do not exist (Atieno, 2001).

As underlined by Haṭega (2007), Kauffmann (2005) and the IFC report (2006), ‘Realization and financing for Africa’, it is quite obvious that the malfunctioning of financial markets is the most important obstacle to entry of SMEs, with growth investments. Ntakobajira, (2013), in his study, stated that access to financing had a great impact on the performance of SMEs, since it limited the ability of entrepreneurs to take advantage of opportunities in their infancy. Nalwelishe (2003) cited in Ondieki, Nashappi and Moraa (2013), conducted a survey of the sources of finance available for small businesses in Nairobi. Its purpose was to identify what types of loan were readily available for Special Economic Zone (SEZ) and evaluate the credit policy of the Exclusive economic Zone (EEZ). The survey found that in the case of access to credit, most entrepreneurs rely on limited own and family savings for start-up and additional capital and they hardly ever have external sources of financing, therefore, these companies have poor access to credit, however urban located companies had a higher success rate than the rural ones.

Ondieki, Nashappi and Moraa (2013) further found that the interest in accessing financing has increased significantly in recent years, as growing data suggest that lack of access prevents low-income households and small businesses from investing in high-yield projects, which has had a negative impact on the economic growth and poverty reduction. They analysed the literature on the causal link between access to financial services and its impact on agricultural production. In the literature, most observations from several case studies reveal that access to financial services by rural residents (or segments with low incomes) can improve their incomes and, therefore, their well-being. According to de la Torre (2008), who is cited in Njeru, Namusonge and Kihoro (2012), financial institutions consider it expensive to supervise small businesses, although technological advances (including the arrival of scanning techniques) suggest that the banking sector is in a better position to provide corporate financing than in the past.

### **2.3.3 Empirical review of SMEs benefits from**

According to the study of financial services for SMEs in Namibia by Dieci, Foresi, Hansohm & Tonin (1998), it was found that the granting of loans to SMEs has a strong impact on the development and growth of SMEs. The loan was defined as the transfer by the lender of the

capital to the borrower, with a contract for the reimbursement of a specified amount in a given period. Dieci et al (1998) also pointed out that the poor can obtain loans reliably when they have the opportunity to start or improve profitability and economic activity, however, due to the lack of additional security, access to loans by small entrepreneurs is seriously impeded.

Kuntchev, Ramalho, Rodriguez-Meza and Yang (2012) state that SMEs are more limited than large companies and, therefore, are more likely to use commercial credit and informal sources of financing to finance their investments, and as working capital, than large companies.

Njeru (2014) states that it is widely believed that SMEs in Kenya have only limited access to lines of credit and other financial support services offered by financial institutions, because most SMEs cannot provide the collateral required but at the same time, rigorous conditions are imposed by the financial institutions on loans, which deter the SMEs. According to Mwewa (2013) formal financial institutions generally perceive SMEs as high risk and unprofitable from a commercial point of view, therefore only a few SMEs have access to credit from formal financial institutions.

#### **2.3.4 Credit access and SME growth**

The availability of external financing positively influenced the growth and performance of each company (Osoro & Muturi, 2013). Financial institutions have different loan packages for various activities and these loan packages products, offered to SMEs, help them to improve and increase their productivity; improve returns on investments and increase revenues (Njeri, 2012). According to Andoh and Ejembi (2007) the training that some financial institutions offer their clients helps entrepreneurs to understand basic issues, such as record keeping, which in turn helps them to better understand their activities, and furthermore; training increases the skills of entrepreneurs, changes their attitudes and abilities to perceive and direct a business. The result is an increased capacity of their companies to achieve better results. An entrepreneur with financial skills can make better decisions regarding the use of other financial services, such as savings, the full use of credit lines and the reduction of risks through the use of insurance services (Andoh & Nunoo, 2011).

SMEs still face several restrictions in access to credit. There was still insufficient knowledge about financial management on the part of managers and owners of SMEs, despite the great importance it has in making rational decisions (Ogiji & Ejembi, 2007). Cohen and Klepper

(1996), however, noted that small businesses had smaller asset bases with which to secure loans to finance their investments, compared to larger companies. Banks for example in most African countries have not made great efforts to reach SMEs, due to the challenges associated with processes and procedures related for the administration of loans, high administration costs of small loans and high risk. This limited access to financing by SMEs translates, therefore, into slow growth (Muñoz, 2010).

## **2.4 Theoretical framework**

This section looks at the various theories that relate to access to credit by SMEs, including financial inclusion theory, imperfect information theory and theory of financial intermediation.

### **2.4.1 Financial inclusion theory**

This theory points out that there is a process required to ensure access to adequate financial services and products by all groups in society, including especially vulnerable groups such as weaker sections and low-income groups. This is needed at an affordable price, in a transparent, fair and affordable way, through the main providers of financial services (Chakrabarty, 2011). An inclusive financial sector provides access to credit to all natural and legal persons; insurance companies provide insurance services to all persons and companies, savings and payment services for all (UN, 2006). Inclusive financing does not necessarily require that all those who qualify will use each of the services, but should be able to choose them if necessary (UN, 2006).

Kempson, Atkinson and Pilley (2004) report that financial exclusion is most frequent among low-income people. The unemployed, who use social security payments provided by the state, are more vulnerable, as well as low-income households from minority communities that may have a relatively low level of interaction with the financial services industry. Data from the family resource survey in 2002–2005 confirmed the Kempson et al. (2004) report that the absorption of financial products and services is the lowest among households in Africa, Montenegro, Pakistan, Bangladesh and the United Kingdom. However, for some members of these groups, religious beliefs play a partial role for this obvious exclusion. The World Bank (2008) classified the barriers to financial access to four major categories;

- barriers to documentation
- physical barriers
- lack of adequate availability of products and services

- bank branches were traditional places of access to the financial network, so the geographic distance to the nearest branch may indicate the lack of physical access (Beck, Demirguc-Kunt & Martínez, 2007).

#### **2.4.2 Imperfect information theory**

According to Lofgren, Persson, & Weibull (2002), information asymmetry is a common feature of all market interactions, whereby for example, the seller of goods often knows more about their quality than the potential buyer, but the borrower knows more than the lender about its own solvency. Among the pioneers of this theory was George Akerlof who demonstrated how imperfect information can cause a negative selection in markets (Lofgren et al., 2002).

Robinson (2011) pointed out that this theory assumes that banks cannot effectively distinguish between high-risk and low-risk applicants. This theory also argues that major financial institutions cannot compete effectively with informal lenders, since such lenders have access to better information about loan applicants than formal institutions and the theory suggests that banks would have difficulty generating returns in the credit markets of developing countries (Lofgren et al., 2002). According to the imperfect information theory, it would be difficult for economists, policy makers, bankers, donors, financial analysts and government decision-makers to defend access to commercial banks in microcredit markets (Lofgren et al., 2002).

#### **2.4.3 Theory of financial intermediation**

Financial intermediation describes a process in which excess units (savers) provide funds, e.g. by deposits. Intermediaries, who includes financial institutions such as banks, credit unions, investment funds and insurance companies, in turn are means of reversing deficits from individuals (borrowers) (Saunders & Cornett, 2011). Financial intermediation refers to the transfer of funds from entities with a surplus to entities with a deficit, through financial intermediaries (Andries, 2009). Therefore, financial intermediaries can be defined as financial institutions specialising in the purchase and sale of financial capital. According to Gorton and Winton (2003); financial intermediaries borrow loans from entities with surpluses and grant loans to entities in deficit. The loans and lending groups are large, which increases the diversification on both sides of the balance sheet, and the loans granted to borrowers have different conditions of payment (Gorton & Winton, 2003).

According to Andries (2009), the theory of financial intermediation can be linked to the works of Gurley and Shaw, and is based on the theory of information asymmetry and the theory of

agency. Allen and Santomero (1998) argue that theories are based on models of resource allocation, in turn based on excellent markets, and that transaction costs and asymmetric information are important for understanding financial intermediation. Andries (2009) states that the theory emphasises the functions of financial intermediaries, such as reducing liquidity, reducing transaction costs, providing information and renegotiating debt. Financial intermediaries connect depositors and borrowers by matching their transaction needs and providing other services, which in turn reduce transaction costs and eliminate information costs (Winton, 2002). Financial intermediaries also act as delegated observers (on behalf of depositors) and therefore help to reduce monitoring costs, thus eliminating agency costs, lowering liquidity costs and lowering price risk (Winton, 2002). Depositors entrust their funds to intermediaries who, in turn, invest them in loans and other investment projects, while depositors can recover their savings (through payments) at any time (Andries, 2009).

Therefore, the participation of SMEs in financial institutions can be summarised on the basis of the role played by financial institutions as financial intermediaries. SMEs can be depositors or borrowers and are able to receive services from financial institutions, including transactional services, providing liquidity, financial advice, the analysis and valuation of assets, the issue of assets, loans, service surveillance, financial services for risk management, insurance and other services (Andries, 2009; Diamond & Dybvig, 1986; Allen & Santomero, 1998).

#### **2.4.4 Pecking order theory**

Myers & Majluf (1984) developed the pecking order theory (POT) based on the assumption that 'internal' management is better informed about the true value of a company than 'outside' investors. These IT asymmetries cause different costs from additional external funding sources, since potential investors perceive capital as riskier than debt (Myers & Majluf, 1984). They propose that companies try to overcome the problems of undervaluation that results from the asymmetry of information, preferring the financing of investment projects first with internal funds (Myers & Majluf, 1984). When equity is exhausted, companies use debt-financing before obtaining external capital. The authors state that POT is even more important for the SME sector, because information asymmetries are relatively larger and external capital costs are higher for SMEs (Ibbotson, Sindelar & Ritter, 2001). In addition, the general trend in the sector is the willingness of the owners of the company to maintain control over the company and maintain managerial independence (Jordan, Lowe & Taylor, 1998).

These factors suggest that the owners of SMEs obtain capital in a balanced order: first with 'own' money (personal savings and retained earnings); second, short-term loans; third, long-term debt; and last, the most advantageous, the introduction of new capital investors (Bhaird, & Lucey, 2010). The empirical evidence confirms the suitability of POT to provide MSE finance (Ou & Haynes, 2006). These studies emphasise that small businesses rely on both internal financing and external loans, to finance operations and growth, while only a small number of companies use external capital finance (Ou & Haynes, 2006). Many studies indicate that companies operate in a restricted hierarchical order and do not even consider increasing external capital (Howorth, 2001).

Compliance with the POT depends not only on demand preferences, but also on the availability of the preferred funding source and the supply of finance depends on many factors, in particular the stage of development of the company finance (Ou & Haynes, 2006). The most important sources of funding for emerging and small companies are the personal resources of the business owners and the funds of friends and family (Geoff & Jim, 2020). Howorth (2001) studied the hierarchical order, although the theory appeared in other literature: entrepreneurs generally seek financing first from their own resources, then from friends and family, and then from other sources such as banks. In fact, money from family and friends is often necessary (and often considered quasi-capital by banks) to unlock the support of commercial institutions (Geoff & Jim, 2020).

## **2.6 Empirical literature on SME access to finance and growth**

Access to external sources of financing can increase development opportunities because it facilitates the development and improvement of the company's products and services, or the hiring of new employees. In economies in transition, the evolution of financial markets can pose obstacles to access to finance (Brown, Earlem & Lup, 2005). Therefore, scientific research recognises financial limitations as a major obstacle to entrepreneurship and dynamic development (Brown, Earlem & Lup, 2005). Empirical evidence confirming the importance of access to external sources of financing for business development can be found in Brown et al, (2005), who examine the determinants of the company's development. In contrast, Johnson, McMillan and Woodruff (2000) evaluate institutional reforms in five eastern European countries (including Romania) and conclude that access to bank financing does not stop business development.

The lack of access to credit is almost universally recognised as a key problem for small and micro enterprises and in most cases, even if credit is available mainly through banks, entrepreneurs may lack the freedom to choose, because bank credit conditions may call for the purchase of heavy and immovable equipment that can serve as collateral for the bank (Brown et al, 2005). Credit restrictions operate in various ways in Namibia, where the undeveloped capital market forces entrepreneurs to depend on self-financing or indebtedness to friends and relatives (LaRRI & NEPRU, 2002). The lack of access to long-term loans for micro, small and medium enterprises forces them to use high-cost short-term finances (Wanjohi & Mugure, 2008).

In the Bulawayo case, Zimbabwe found that SMEs were not able to obtain loans due to the strict requirements of financial institutions, among which the most important was additional security and among its recommendations was that the government should play a role that allows SMEs to obtain financing from financial institutions. Makena, Kubaison & Nyati (2014), in their research on the challenges faced by women entrepreneurs in accessing business finance in Kenya, noted that lack of security was the case in Ruiru Township, Kiambu County. The survey also showed that lack of security was a major obstacle to women's access to credit. This is due to the lack of fixed assets, such as land, which were used to secure loans and among its recommendations was that the government should play a role that allowed SMEs to obtain finance from financial institutions.

Gitari (2012), in her research on the factors affecting the financial performance of women entrepreneurs in Kenya, commented on the Ngara Market case, which showed that the lack of information about who offers, and the cost of obtaining such services, limits them, and that the high Inventory costs, are some of the main obstacles to success in female entrepreneurship, while the high costs of active entrepreneurs pose a big problem for the development of women, due to the lack of adequate capital, and on the other hand, the lack of information about how to access funds to increase business is also a serious threat. Ntakobajira, (2013) investigated the factors that affect the performance of SME merchants in the street market of Windhoek City, Namibia, and the study found that lack of access to finance greatly affected the results of SMEs, as it limited the ability of entrepreneurs to take advantage of opportunities at the time of their creation.

In general terms, these results confirm the literature, which emphasises the primacy of business factors over the operating environment, to facilitate access to bank loans to small

businesses (Wagama, 2006). Nalyanya, (2012) in his research on the factors that affect the performance of small businesses in the areas of AsalHOLA Town in the RíO Tana district, recommended that the government consider granting cheap loans to small and medium enterprises without guarantees.

### **2.6.1 Critique of existing literature relevant to the study**

Although most of the research indicated that there were problems related to the cost of credit, the availability of financial information, safety requirements and commercial risk, there were few studies that affected all of them in combination. For example, Gitari (2012) found in the study, factors that influenced the financial situation of women entrepreneurs in Namibia. The case of the Ngara market showed the lack of information about who has what, the cost of obtaining such services, and these high inventory costs, are among the main discouragers of success in women's entrepreneurship (Gichuki, Njeru & Tirimba, 2014). However, it did not analyse the impact of loan and guarantee costs on the availability of loans.

Ogollah (2013), in her research on the problems related to the availability of loans to women's companies in Namibia business centres, found that the lack of available information, skills and knowledge, inability to provide guarantees and the role of strong, negative socio-cultural factors, affected the availability of financing, however, she did not analyse the impact of loan costs on loan availability. The objective of this research was to verify how security requirements, loan costs and the availability of information on financial and commercial risks, affected the availability of loans to SMEs in Namibia.

### **2.7 The role and value of small and medium-sized enterprises in different economies**

Liu (2008) states that the position of small and medium-sized enterprises is significant in many countries around the world, because small and medium-sized enterprises provide the only feasible prospects for creating additional jobs and economic growth, thus reducing poverty and improving the quality of life, for example, the development of small and medium-sized enterprises has increasingly contributed to the economic development and growth of China, making up more than 99 per cent of all enterprises in China. Liu (2008) also points out that SME output value accounts for at least 60 per cent of China's GDP, producing more than 82 per cent of China's job opportunities and that China's SMEs play an increasingly important role in job creation. Large firms employ 20 877.8 or 18.11 per cent of total employment;

medium-sized firms employ 35 464.3 or 30.76 per cent; and small firms employ 58 947.8 or 51.13 per cent, according to Liu.

Arokiasamy, Ismail and Omar (2009) stressed that, as in any country, small and medium-sized enterprises play a vital role in the growth of the Malaysian economy and their contributions have had a significant impact on the economy as a whole and that SMEs are also significant primary industry traders and service providers. A large number of SMEs are also manufacturers of finished goods and services, according to Arokiasamy et al. (2009) where they go on to state that small and medium-sized businesses deliver job opportunities, promote change, stimulate competitiveness and support big business. Evidence shows that SMEs contribute 32 per cent of gross domestic product, 56.4 per cent of job opportunities, and 19 per cent of the Malaysian economy's exports (SMIDEC, 2008).

Maina (2006) states that in the case of Kenya, SMEs employ about 5.1 million people, accounting for 74 per cent of total national jobs and contributing about 88 per cent of total job creation and they also contribute to the country's Gross Domestic Product, contributing about 24.5 per cent of GDP. Atieno (2009) pointed out, in another study, that SME growth has been described as one of Kenya's strategies for generating industrialisation, job creation, and poverty reduction.

On the other hand Kira (2013) states that SMEs in Tanzania are estimated to provide about one-third of its GDP, and further states that around 20 per cent of Tanzania's population, which is approximately three-million people, is working in small businesses.

Kaunouwewa and Chao (2011) states that over the past few years, SMEs have played an increasingly important role in developing countries and that they are not only critical for the business sector's sustainability, they also create new jobs. Kaunouwewa and Chao (2011) also allude to the need to use approaches explicitly designed to work with small businesses, in order to achieve maximum efficiency in industrial development methods.

## **2.8 Policy system for small and medium-sized enterprises in different countries**

According to the United Nations Conference on Trade and Development (UNCTAD) (2005), experience has shown that, in the absence of a coherent policy setting, the globalisation of production and the opening up of domestic markets have adversely affected the structure of enterprises and, in particular, the small and medium-sized enterprises of many developing co-operation sectors. The study further pointed out that these effects have resulted in a situation

where small and medium-sized companies have often been destroyed or are significantly and constantly losing ground in terms of their profitability, resulting in a missing or diminishing centre in these countries' business structures (The United Nations Conference on Trade and Development (UNCTAD), 2005).

Furthermore according to UNCTAD, (2005) SME support agencies and services need to be developed alongside efforts to improve the policy, legal and regulatory climate in which SMEs work, as this would include, among other things, eliminating subsidies and other policy initiatives in favour of large companies and discriminating against SMEs, simplifying regulations and administrative processes for start-ups and enacting new legislation to fix deficiencies or contradictions in business law.

In response to the triple challenge of poverty, unemployment and inequality, the South African government has made significant commitments to helping small, medium and micro Enterprises (SMMEs) as a crucial policy tool for sustainable economic growth, job creation and poverty alleviation (DTI, 2006; Rogerson, 2013). It is critical that the New Growth Path (NGP) of the national government and the National Development Plan (NDP), the blueprint for future development for South Africa, both recognise the SMME sector as key to the realisation of South Africa's Vision 2030 (Masutha & Rogerson, 2014).

According to the National Planning Commission (NCP), (2011), South Africa's National Development Plan, Vision 2030 sets a goal to generate eleven million jobs by 2030, 90 per cent of which are expected to come from SMEs. According to Rogerson, (2014) SME promotion and growth is one of the cornerstones of the productive achievement of South Africa's local economic development programmes and the SME sector's growth can be traced back to the 1996 National Small Business Act, No. 102, which was revised in 2004.

According to Ong'lo and Awino (2013) the SME Act, which defines the main organisational linkages for successful cooperation, governs the overall regulatory framework for SMEs in India. Ong'lo and Awino further state that the 2006 Micro, Small and Medium Enterprise Development Act No. 27 is the overall SME policy that has played a key role in revitalising the performance of the Indian SME sub-sector. Generally speaking, the Act aims to improve and encourage the productivity of micro, small and medium-sized enterprises and that it sets up the structure needed to oversee and regulate the growth of SMEs in India.

## **2.9 SME policy in Namibia.**

The Ministry of Trade (MTI) report (2013) states that through the Ministry of Trade and Industry (MTI), the Government of Namibia continues to fulfill its mandate to provide a sound business climate through the growth of SME business and industrial infrastructure, and that according to 2015 World Bank report in terms of doing business in Namibia, places the overall business climate of Namibia at 88 out of 189 economies, higher than the 142 sub-Saharan average ranking, but a downturn in economic and structural changes, however, has seen the Doing Business performance of the country fall behind the economies of similar countries, but the study found that starting a business in Namibia requires ten procedures and 66 days at a price of 14.7 per cent of per capita income, putting the country below the sub-Saharan average of 129 and well behind the continental leaders Mauritius (29th) and South Africa (61st) as the 156th of the 189 economies.

The 1997 SME Strategy and System Report is under review, according to the renamed Ministry of Industrialisation, Trade and SME Development (MITSD) (2015). The government aims to make the legal framework more flexible for micro, small and medium-sized enterprises (MSMEs), to reduce administrative costs and encourage the growth of MSMEs (MTI, 2015). Kakwambi (2012) found, in his study, that 60 per cent were aware of SME policy, while Ipinge (2010) concluded in her study that 94 per cent of SMEs were unaware of the policy. Due to the time lapse between the two reports, this data is inconsistent.

According to MITSD (2015) Namibia's updated National Policy on Micro, Small and Medium Enterprises is related to the national goals set out in Vision 2030 and the National Development Plans (NDPs), as well as the Industrial Policy and its recently adopted Growth at Home implementation structure and strategy, plus Namibia has different legal frameworks and regulations to support and promote the growth of small and medium-sized enterprises, such as: the Constitution of the Republic of Namibia; Namibia Vision 2030; National Development Policies; Decentralisation Policy; Namibia Industrialisation Policy, 2012; Local Authority Act 23 of 1992; Namibia Small Business Development Policy, 1997 and Namibia Competition Act. therefore Considering the policies and guidelines that support the development of small and medium-sized enterprises, Namibia needs to have a solid SME strategy with foundations from various government agencies and institutions.

## **2.10 Access to financing**

This has been identified by many as one of the main obstacles to the development and growth of small businesses in Namibia. Arnold, Grossman, Mwatotele, Stork and Tobias (2005) believed that one of the Namibian economy's backbones is SMEs. They also reported that SMEs contributed about 12 per cent of GDP and employed about 20 per cent of the workforce in 2004, rising at an average annual rate of two per cent.

In general, formal financial institutions, according to Nakusera, Kadhikwa and Mushendami (2008), were reluctant to provide credit and finance facilities to SMEs until the early 2000s, in spite of their important role in the economy, due to the lack of collateral and the high transaction costs involved in small transactions, among other issues. In response to the SMEs' plight, a number of institutions were founded by the Government of Namibia. Some of these organisations dissolved or combined to form new companies due to the organisational inefficiencies that defined most of the Development Finance Institutions (DFIs). Furthermore, banks have begun to realise the importance of SMEs in the domestic economy. As a result, Bank Windhoek and First National Bank set up branches designed to meet the needs of SMEs. Likewise, the establishment of venture capital or private equity firms in Namibia, namely the Stimulus and Oshipe Development Funds, may improve access to working capital for SMEs.

### **2.10.1 Development finance institutions**

According to Nakusera et al (2008) the Development Bank of Namibia (DBN) and the Small Business Credit Guarantee Trust (SBCGT) are the major development finance institutions that provide SMEs with access to financial services, whereby DBN's aim is to fill the current gap in funding the major private and public sector medium- and long-term development projects. The DBN provides support to larger firms and larger ventures, but also focuses on SMEs through its Special Development Fund (SDF), thus promoting important sustainable development initiatives and programmes (Nakusera et al., 2008).

Nakusera et al (2008) further state that the support provided by DBN may take the form of loan lines, operated by low-interest account banks that are extended at lower (subsidised) rates, direct loans and working capital provision, whereby direct loans provide bridging funding in the form of working capital to SMEs that are awarded tenders or contracts to supply goods and services by well-established institutions. Direct loans have a minimum of N\$250 000 and

a limit of N\$3 million and they can be repaid for up to 18 months but Customers must provide appropriate collateral, and interesting DBN loans also include education, mentoring, supervision and assessment of SMEs, with borrowers paying two per cent of the overall cost of training (Nakusera et al., 2008).

Nakusera et al (2008) state that in addition, the DBN offers medium-term financing with the same minimum and maximum sums, as well as collateral to be given by banking institutions. Nevertheless, the repayment varies since the medium-term lending has a fixed repayment period of five years. The DBN created 319 new jobs in 2006, and 290 jobs in 2007 through its SME operations. The portfolio of SME loans in 2006 and 2007 respectively amounted to N\$34.1 million and N\$34 million and is currently stable, paving the way for further expansion (Nakusera et al. 2008).

The SBCGT was set up to assist small-business owners with the protection required to access commercial bank loans and it offers guarantees of up to 80 per cent of loans by participating lending institutions, the limit of which is N\$250 000 (Nakusera et al., 2008). The borrowing company must have less than two employees, less than N\$1million in annual turnover and less than N\$500 000 in equity, to meet the qualifying criteria. Until 2007, the trust supported some 762 companies, with guarantees to a tune of N\$69 million and the average loan guarantees range from N\$1 500 to N\$200 000, with a three-year repayment period, and prime plus five per cent caps interest rates, and banks are required to charge less if the borrower's risk profile permits this (IMF & World Bank, 2006). The trust has also had a positive impact on 4 630 workers, through these assurances but the problems faced by the SBCGT, however, include poor credit assessments and monitoring of their funded loans, on the part of the banking institutions (Nakusera et al., 2008).

### **2.10.2 Banking institutions**

The existing Namibian banking system includes Bank of Namibia (regulator), Bank Windhoek Limited, EBank Limited, First National Bank Namibia Limited, Nedbank Namibia Limited, Standard Bank Namibia Limited, SME Bank Limited, Trustco Bank Namibia Limited, Bank BIC Namibia Limited, Letshego Bank Namibia Limited (BoN, 2019).

### **2.10.3 Private equity firms**

Two private equity firms, namely Stimulus and Oshipe Development Fund, are operating in the region. Investments from Stimulus are based on well-established and profitable Namibian businesses, typically in the form of growth capital and management buy-out or empowerment buy-ins funding (Nakusera et al., 2008). The scale of the investments Stimulus undertakes varies from N\$5 million to N\$30 million, but sometimes they are influenced by the complexity of the transactions, as they also made investments within the ranges of N\$1–2 million. Stimulus has invested in various types of projects including transportation, office automation, hospitality, media, and retail (Nakusera et al., 2008).

By investing in commercially viable business ventures in Namibia, the Oshipe Development Fund supports entrepreneurship and SME development. Oshipe has invested in about seven SMEs, with a combined value of about N\$5 million since its establishment in 2006, creating jobs for over 70 Namibians (Nakusera et al., 2008). Most of the companies in which Oshipe has invested so far are in the manufacturing sector, but its scope is not limited to the manufacturing sector alone as the investment target range varies from N\$500 000 to N\$1 million (Nakusera et al., 2008). Oshipe's shareholding in any company ranges from 26 per cent to 49 per cent, with a representative on each board. Loans can be repaid over three to five years. Nonetheless, owners will contribute 25 per cent to the business capital. Oshipe finishes its participation in the sector with self-sustainability and sufficient transmission of expertise, selling its shares at fair value to the business owners (Nakusera et al., 2008).

#### **2.10.4 Micro lenders**

Namibia has two types of specialised micro lending institutions: term lenders and money lenders. Term lenders provide term loans, up to a maximum of 36 months, while cash lenders extend credit for a period of just 30 days, with some offering creditworthy customers 60 days (Nakusera et al., 2008). No collateral from borrowers is needed by micro lenders. Nevertheless, term lenders use payroll deduction and the retention of automatic teller machine (ATM) cards and pin numbers, as protection for loans (Nakusera et al., 2008). The total loans provided by term lenders are N\$20 000, while cash borrowers are permitted to provide up to 50 per cent of their take-home salary after deductions, to lenders. Term lenders are allowed to charge up to a usury limit of twice the prevailing prime rate, reflecting the risks associated with their lending. Nonetheless, money lenders charge 25–30 per cent per month, in order to remain financially sustainable (Nakusera et al., 2008).

## **2.11 Challenges faced by small and medium-sized enterprises in obtaining credit**

Kongolo (2010) argues that small and medium-sized enterprises have played a vital role in contributing to the economic development of many countries around the world, but have faced several challenges that hamper the country's development. These challenges include, but are not limited to, lack of management skills, financing, access to credit, market access, sufficient technology, low production efficiency, long cycles of bureaucracy and support for SME's position in economic development.

Based on Kongolo's (2010) view, SMEs in countries around the world face many challenges, with challenges that vary from country to country. Nevertheless, for the purpose of the study, the emphasis is specifically on one of the main challenges facing SMEs worldwide, that is financing and access to credit. This view was reinforced by Levitsky (1996), who highlighted in particular the lack of access to finance as one of the most prevalent issues faced by SMEs in both developed and developing nations. He argues that the lack of access to finance affects the ability of the company to develop, update its technology, expand its markets, strengthen its ability to manage, increase productivity, or simply survive (Levitsky, 1996).

### **2.11.1 Factors impacting access to finance for small and medium-sized enterprises**

According to a study conducted in South Africa by the National Credit Regulator (NCR), many internal and external factors impede SMEs' access to finance. According to Mahembe, (2011) a comprehensive understanding of these variables is very important because it essentially affects the conceptual system model used to support this study, and such considerations include, but are not limited to, internal factors (SME-specific characteristics) and external factors, as described below:

#### **A) Internal factors:**

##### *i. The size of the firm*

This view was supported by Beck (2007) who claimed to have evidence indicating that small and medium enterprises (SMEs) are more constrained by financing and other institutional obstacles than larger enterprises, exacerbated by the weaknesses in the financial systems of many developing countries. The author argues that obstacles such as collateral requirements, bank paperwork, interest rate payments, as well as lack of access to specific forms of financing such as export, leasing and long-term finance are significantly more constraining for small firms' growth than for large firms.

##### *ii. Demand for loans*

SMEs tend to not apply for financing from financial institutions mainly due to the high perception of possible rejection. Several reasons however have also been highlighted as to why SMEs never applied for bank loans. One is because of the procedures for applying for a loan were unknown; lack of knowledge about the available funding options from banks; Interest rates too high and SMEs don't need funding as they have their own capital to start and run their businesses (Mahembe, 2011).

iii. *Loan application rejections*

With reference to loan applications, Mahembe (2011) suggested that of all SMEs that apply for an unsecured bank loan, only 25 per cent succeed, and of those that are successful, only 85 per cent accept the loan. In the end, only 18 per cent finally get the loan, as the stringent terms and conditions make it impossible for applicants to comply. In addition to the above, Mahembe (2011) believes that other reasons for applications being rejected include: 1) lack of collateral, 2) lack of a financial deposit, 3) poor business plan or non-viable business ideas. Bad credit histories were also cited as a main reason for applications being rejected. SMEs with poor credit histories are listed by the Credit Bureau, with the information accessible to everyone linked to the bureau.

iv. *Experience and ownership of small business owner*

Banks are perceived to place reliance on businesses with more experienced owners who display effective managerial competencies, and consequently are more likely to obtain finance from a financial institution (Nakusera, K. & Mushendami, 2008).

v. *Availability of information*

SMEs in general are struggling to provide good quality information and this leads to information asymmetry, resulting in banks declining applications out of hand. Kitindi, Magembe and Sethibe (2007), as referred to by Mahembe (2011), concluded that creditors, banks and other lenders use business information provided by firms to analyse their present performance and predict future performance.

vi. *Registration and legal formality*

The registration of firms appears to have a significant impact on their ability to access finance. Formal registration of firms enables business owners to separate business finances from personal finances. A study by the National Credit Regulator in South Africa (Mahembe, 2011) revealed that formally registered SMEs have a higher success rate in obtaining finance, compared to those not formally registered.

vii *The age of the SMEs*

Young SMEs, without a proper track record, face more problems accessing credit, as these firms are less transparent and less information about their credit history is available to banks. These firms are, therefore, regarded as more risky and are more likely to be refused credit (Mahembe, 2011).

**B) External Factors:**

*i) The phenomenon of 'informality'*

The phenomenon of informality refers to SMEs operating outside the formal system mostly to benefit from not being regulated or having to pay tax etc. (Mahembe, 2011).

*ii) Inefficient legal systems*

Market imperfections such as those caused by inefficient legal systems can constrain the ability of firms to access external funds. The reason for this is because in cases of default by SMEs, the providers of finance are not able to recover their funds in a timely manner, if at all, making them more reluctant to deal with those sectors where default rate is perceived as very high (Mahembe, 2011).

*iii) Sources of finance available to SMEs*

The success of small and medium enterprises depends largely on their ability to obtain finance to enable them to grow and compete to an extent where they are able to sustain themselves. They can obtain financing from two sources, internal financing and external financing (Mahembe, 2011).

*iv) Internal financing*

According to Ahlberg and Anderson (2012), internal financing refers to capital generated within the firm, with profit achieved as the main source. Internal funds are normally funds such as capital generated from owners' family and friends, business associates and other personal contacts, due to the relatively low issuing- and information costs.

*v) External financing*

Ayyagari, Demirguc-Kunt and Maskimovic (2006), as referred to by Mahembe (2011), indicated that there were two primary sources of external finance for new SMEs, namely equity and debt. They argue that external equity in the form of venture capital or the stock exchange, is usually not available for new SMEs, primarily due to relatively small amounts of financing required by a new SME. Ahlberg and Anderson (2012) also support this view by arguing that equity financing is limited for small firms,

compared to larger firms, when most firms are privately held and cannot issue shares on the public market. They also have difficulty meeting the criteria for venture capitalist, as their projects are often small in scale. This results in SMEs having to turn to debt financing and in particular bank financing (Jauch, 2010).

## **2.12 Recent trends on SME development and financing in Namibia**

According to Bank of Namibia (BoN) (2012) report, the importance of the small and medium-sized enterprises sector in Namibia was highlighted with the launch of the new Namibia Financial Sector Strategy 2011–2021, a ten year strategy by the Namibian Government to allow the financial sector of the country to transform and contribute more meaningfully to socio-economic objectives, including poverty reduction and the creation of wealth. The following approaches are required for SMEs to have greater access to financial services, according to BoN's Monetary Policy Statement as stated in Bank of Namibia Report, (2012):

- a) Consideration to be given to whether there is a need to revise the 1997 SME Development Policy, so as to strengthen implementation and enforcement, and to ensure improvement in SMEs access to finance.
- b) A study to be undertaken to determine the viability of a credit guarantee scheme in Namibia.
- c) Legislation to be created to enable the establishment of a credit bureau.
- d) A specialised SMEs bank to be created to cater for the financial needs of viable SME projects/businesses.
- e) Investigation to be launched as to how best the various existing initiatives (such as the existence of funding programmes, which are housed under several ministries and aimed at assisting small entrepreneurs (micro, small and medium enterprises (MSMEs), can be coordinated to yield optimum results.
- f) All credit-providing entities, such as DBN and commercial banks, as well as other financial institutions, to be encouraged to provide SME advisory services (BoN, 2012).

### **2.12.1 Financial services offered**

The rise in financial services offered by traditional financial institutions, it is argued, helps to mitigate the suffering of savers and borrowers in deprived areas. Most studies that concentrate on small and medium-sized companies continue to report that access to financial services is a constraint on their creation or growth (International Congress on Environmental Geotechnics [ICEG], 1999). This has contributed to efforts to address the disparity between supply and

demand, in most developing countries, by funding small and medium-sized enterprises. The perceived imbalance in this sector's financing may be due to problems on either the supply or demand side.

Thomas (2005) in his study state that on the demand side, some argue that SMEs are not financially mature enough to be active in the formal financial sector, or are unable to afford market interest rates and therefore need credit subsidies funded by government or donor, and on the supply side, some claim that competitive provision is not feasible due to high transaction costs and structural risks, arising from asymmetric information between borrowers and lenders; SME clientele's inability to generate sufficient market volume to attract formal financial institutions; sparsely dispersed populations or insufficient infrastructure in rural areas. These are some of the reasons why there is still a void in the provision of finance to SMEs, whether legitimate or false (Thomas, 2005).

In Africa, small and medium-sized businesses are weak, due to small local markets, low regional development, and very difficult business conditions, including rigid official processes, poor infrastructure, questionable legal systems, insufficient financial systems, and unattractive tax regimes, and according to Katswara (2005), some of the main reasons why financial institutions were reluctant to invest in small and medium-sized enterprises were SMEs' inadequate operational and managerial abilities and project investment costs.

Harvie and Lee (2005) states that flexibility, as well as low start-up and operating costs, have allowed small and medium-sized businesses to spring up, rapidly positioning themselves and responding to business and economic changes, and in a short time, they easily expand or contract. Not only have SMEs survived the effects of the law of big business and economies of scale, they have also built niches for themselves that allow them to coexist with big business (Harvie and Lee, 2005). The most common problems for SMEs, however, are low quality of human resources available, and lack of access to information and technology, markets, and capital (Paliwal, 2008).

According to a study by Ayyagari, Demirguc-Kunt & Maksimovic (2006), in a sample of 71 mostly developing countries, the cost of financing is classified by more than 35 per cent of SMEs as a major growth constraint. Beck, Demirguc-Kunt and Levine (2005) found, in their analysis, that there is empirical evidence that funding constraints and access to external financing are inversely associated with firm size, and that fixed transaction costs and

knowledge asymmetries with resulting company issues, are the basis for financial market frictions.

Financing small and medium enterprises is a major function of the general financial market, in which equity is supplied and priced for types of companies. Money is supplied through the business finance sector in the forms of bank loans and overdrafts, lending and hiring agreements, equity and corporate bond issues, venture capital or private equity and asset-based financing, such as factoring and invoice discounting (Namibia Economic Policy Research Unit [NEPRU], 2005). OECD (2006b) agrees that these players may be in the economy. This has contributed to substantial discussion of the best ways to serve the sector. Funding is needed to help small and medium-sized enterprises set up and expand their operations, develop new products and invest in new employees and production facilities. But many small and medium-sized enterprises find it much more difficult than it is for large entities, to obtain funding from banks, capital markets or other credit providers (OECD, 2006b). There are, however, a variety of distinctive recurrent SME finance strategies (Berger & Udell, 2005). Collateral-based loans, provided by traditional banks and finance companies, usually consist of a combination of asset-based financing, contribution-based financing, and factoring-based financing, using reputable debtors or contracts.

Lending, based on information, usually includes loans calculated upon financial statements, credit scoring and loans from relationships. Viability-based loans are synonymous with venture capital in particular.

Despite efforts by financial institutions and public sector bodies to close the funding gap, small and medium-sized businesses continue to find it difficult to obtain risk capital. The difficulties faced by SMEs in trying to access financing can be attributed to (a) an inadequate array of financial products and services on offer and (b) regulatory rigidity or deficiencies in the legal framework, lack of information on both banks and SMEs (OECD, 2006).

A significant portion of the SME sector may not have the protection needed for traditional collateral-based bank loans, nor may it have adequate returns to attract formal venture capitalists and other risk investors. In addition, deficient information can characterize markets, limiting the efficacy of lending and credit scoring based on financial statements. This has resulted in claims of a gap in SME finance, particularly in emerging economies (Newberry, 2006).

There are two distinctive solutions to closing the so-called SME finance divide, according to Kamanyi (2003). The first is to expand the collateral-based service by allowing bank lenders to fund small and medium-sized businesses with inadequate collateral. This could be achieved by supplying the collateral or assurances by an external party. The second is to extend the viability-based approach. Since the company itself is concerned with the viability-based approach, the aim is to provide better general business development assistance, to reduce risk and maximise returns.

According to Hoffman, Kurt, Jarvis & Westley (2005), the main goal or function of the viability-based approach is to provide adequate funding, tailored to the SME's cash flow. Hoffman, Kurt, Jarvis and Westley further state that while western venture capitalists may never be comparable to the returns generated by this strategy in less developed countries, they may be substantially better than conventional collateral-based borrowing, while at the same time being less risky than the standard capitalist plan (Hoffman, Kurt, Jarvis & Westley, 2005).

### **2.13 The Namibia Chamber of Commerce and Industry and the SME**

Namibia chamber of commerce and Industry (NCCI) (2015) s' mission is to be a force representing the business community of Namibia and working for private sector interests. Table 5 shows some of the advocacy services offered by the NCCI including its roles for SMEs in particular.

**Table 5: Other services rendered by NCCI**

1. Networking opportunities through NCCI events.
2. Listing in the NCCI membership directories.
3. Providing regular information on trade and investment opportunities.
4. Providing opportunities to participate in business missions organised or received by NCCI and partners.
5. Providing opportunities to make useful business contacts.
6. Providing opportunities to participate in NCCI demand-driven training programmes.
7. Receive trade enquiries through NCCI.
8. Providing the opportunity to participate in NCCI umbrella pension and medical aid schemes.
9. Receiving referrals for services by other service providers.

*Source: [www.ncci.org.na](http://www.ncci.org.na)*

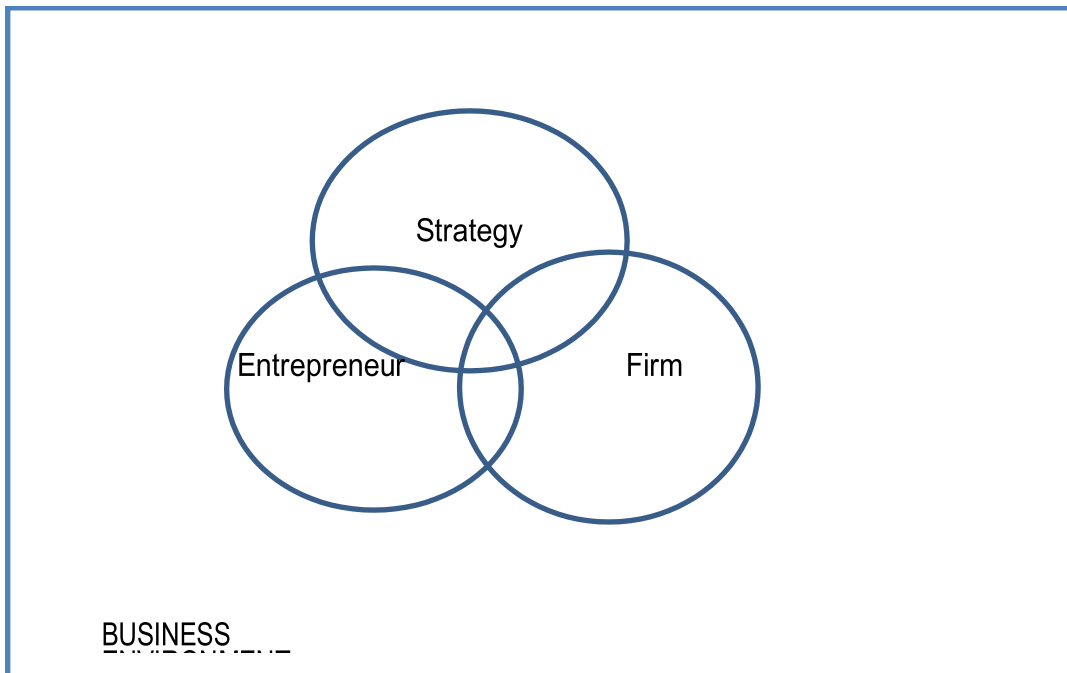
Looking at Tables 5 and 6, it is obvious that NCCI is an organ vital to businesses, but only if it is performing its job well, as expected by members. The question is: are these services reaching the end user (SMEs) as they are supposed to?

#### **2.14 Business environment and the growth of SME sector**

The relationship between the business environment and small and medium-sized businesses is considered to be a focal point for its continued existence on the market. As shown in Figure 2.1, the SME background takes the form of an internal environment and an external environment. The business person manages the internal environment while the external environment is beyond the entrepreneur's influence (Storey, 1994). The relationship between

the SME and its environment will decide its failure or success and the key factors affecting the SME's problems will be extracted from both the business person and the internal and external environments (Storey, 1994).

**Figure 1: Factors affecting business growth (Storey, 1994).**



*Source: (Storey, 1994).*

In Figure 1, it is evident that the business environment (governmental, global, international, local and sectoral) is greater than any other variable. This is where every country's government and any other stakeholder can participate as a means of encouraging SMEs to promote a healthy business environment. Rwigema and Venter (2004) note that the business owner must take the business as a whole into account and be fully aware of its position in the sector in which it operates. I agree that seeing the entire business will provide a long-term outlook of future growth and prosperity to the entrepreneur.

Greiner (1972), Churchill & Lewis (1983), Scott & Bruce (1987) and Burns in Burns and Dewhurst, (1996) are the four most common growth models, but this study does not choose to give more attention to growth theories. Dobbs & Hamilton (2007) concluded that it is not only currently impossible to have a unified theory of small firm growth; it is likely to remain outside the scope of scholars. No single explanation can adequately describe small business growth

patterns (Carter & Jones-Evans, 2006). Gupta et al. (2013) indicate that small business organisations and entrepreneurs will always be seen as essential to developed economies' development. Therefore, it is critical to pay attention to this sector's overall growth.

## **2.15 Conclusion**

This chapter focuses on the challenges faced by small and medium-sized businesses, with access to finance listed as the main challenge in many developing countries. The researcher looked at the funding sources available to SMEs, with a focus on debt financing and bank financing in particular. The chapter also highlights the fundamental factors that affect access to finance for SMEs. The section also looked at Namibia's banking sector. Furthermore the section offers an insight into current trends in funding for SMEs. Finally the section also discusses the facets of the financing gap for SMEs, from demand and supply perspectives and proposes ways to reduce the funding gap.

## **CHAPTER 3**

### **Methodology**

#### **3.1 Introduction**

This chapter presents the methodology to be used in the present study. The chapter starts with the applied research methods that will be used for conducting the research to answer the research questions which triggered this research. This includes the research design, target population, data collection tools and techniques used, data analysis method and presentation. This research methodology aims at enabling the researcher to obtain the data, process and interpret it.

#### **3.2 Research approach**

There are three possible research approaches that can be employed in any study, namely quantitative, qualitative and mixed methods. The last is the combination or integration of qualitative and quantitative techniques (Creswell, 2003). For the purpose of this study, a quantitative research method was adopted, to explore the problem. The design is appropriate for the current study since it seeks to examine the factors influencing credit access among SMEs, as well as gaining first-hand experience of the challenges associated with SMEs credit access in Namibia.

#### **3.3 Research design**

##### **3.3.1 Population and sample**

The population was a group of entrepreneurs, totaling around 2 500 of the registered SMEs in Namibia who have some common characteristics; 120 questionnaires were administered to the participants who volunteered to take part in the survey. The sample was randomly selected.

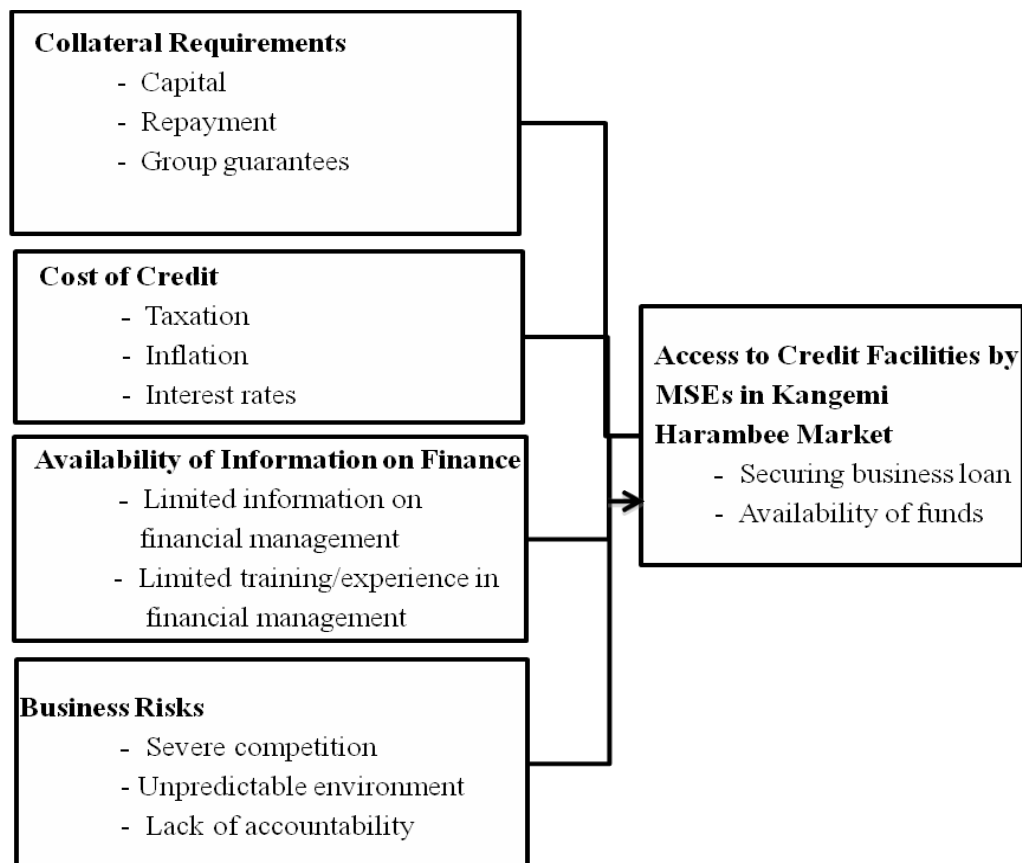
##### **3.3.2 Data collection**

The Questionnaire was designed with demographic section; a section of close ended questions and open-ended section were administered to participants who had volunteered to be part of the survey. The advantage of using a questionnaire for this survey was that those of this nature are free from interviewer's biases, and can be administered to a large number of respondents (Kothari, 2004). The questionnaire used to collect the data is attached as Appendix A.

## 2.5 Conceptual framework

According to Jabareen (2009) the conceptual framework is the product of a qualitative theoretical process that combines a concept that provides a comprehensive understanding of a phenomenon, whereby concepts that form the conceptual framework, support each other, express their respective phenomena and establish a framework philosophy that defines relationships. The conceptual framework of this study refers to independent variables; security requirements, loan costs, availability of financial information, commercial risk and dependent variables; access to micro and small business loans in Namibia as set out in Figure 2.

**Figure 2: Conceptual Framework**



**Independent variables**

**Dependent variable**

*Source: (MIT 2010)*

### **3.4 Analytical framework**

#### **3.4.1 Regression model**

A multivariate regression model has been used to link the independent variables to the dependent variable as follows;

$$Y_i = \beta_0 + \beta_1 Size_i + \beta_2 Age_i + \beta_3 TO_i + \beta_4 EL_i + \beta_5 EBX_i + \beta_6 FR_i + \beta_7 CC_i + \beta_8 CC_i + \beta_9 TA_i + \beta_{10} CR_i + \beta_{11} EG_i + \mu_i$$

Where  $Y_i$  represents Access to Credit by SMEs; Size denotes the number of employees; Age is the number of years of SMEs existence; TO is SME turnover; EL is literacy level of entrepreneur; EBX refers to the experience of business owner; FR is financial record keeping; CC refers to credit cost; TA is turnaround of credit application; CR denotes credit requirement and EG refers to the gender of entrepreneur.

### **3.5 Definition and measurements of variables**

#### **3.5.1 Access to credit**

Credit access by SMEs can be in the forms of working capital loans, fixed assets facilities and trade financing facilities. Those SMEs who involuntarily have no or only limited access to financial services are referred to as the unbanked or under banked, respectively. The depth of credit information index measures rules and practices affecting the coverage, scope and accessibility of credit information available through either a public credit registry or a private credit bureau.

#### **3.5.2 Number of employees**

Number of employees refers to the total number of persons who work in the observed unit (employees receiving remuneration, working proprietors and unpaid family workers), as well as outside working persons who belong to a unit and are paid by it (OECD, 2001). However, in this instance the variable referred to is the number of employees within the SME respondent.

#### **3.5.3 Number of years the business is in operations.**

The number of years the business has been in operation can range between one year until the business ceases to exist, due to various factors. The business can survive on capital generated from business operations or from funds borrowed from financial institutions or a mix of

owner's capital and borrowed funds. In order for the business to be able to borrow funds, for whatever purpose, it should be in a position to satisfy the lender's requirements.

#### **3.5.4 Turnover of business in N\$**

Lenders would normally take comfort from the amount of revenue the business is able to generate, in order to determine affordability. The business should thus be able to demonstrate that it can generate adequate revenue which it will use to service its debts.

#### **3.5.5 Cost of credit**

Interest refers to the premium paid to the lender for the risk of lending money. Interest is usually stated as annual percentage rate (APR). Interest can also represent the percentage ownership a stockholder has in a company. For this study interest refers to the premium paid for the risk of borrowing money. It is measured as the amount of interest due per period, as a proportion of the amount borrowed (called the principal sum). The total interest on an amount borrowed depends on the principal sum, the rate of interest paid, the compounding frequency, and the length of time over which it is borrowed.

#### **3.5.6 Credit requirements: Collateral required or not.**

Collateral refers to a security in the form of an asset given in addition to the direct security, and subordinate to it, intended to guarantee its validity or convertibility or insure its performance; if the direct security fails, the creditor may call upon the collateral security to recover debt owed. Collateral refers to assets that SMEs are willing to put up to secure credit. Collateral is an asset or property that an SME offers to the bank whenever credit is required. It is used as a way to obtain a loan and, at the same time, acts as protection for the bank should the business default on the payments. In such an event, the collateral becomes the property of the bank to compensate for the unreturned borrowed money.

#### **3.5.7 Financial record**

Most SMEs do not keep proper financial records and accounts, and this has often created problems when applying for loans from financial lending institutions such as banks, where financial statements are required. Most financial lending institutions require financial statements in order to evaluate the credit-worthiness of applicants. It is therefore imperative to note that having adequate financial information is the key to accessing loans from lending institutions by SMEs.

### **3.5.8 Entrepreneurial literacy**

It is the knowledge, skills and training acquired by entrepreneurs to encourage entrepreneurial success in a variety of settings. It is the development of skills or attributes that enable the realization of opportunity. It is a key factor for increasing the level of knowledge and competence of an entrepreneur.

### **3.5.9 Turnaround processing of credit application in number of weeks**

The funding institutions internal processes and time frame will indicate how long it takes for an application to be processed. This includes the submission stage, the assessment stage and the approval stage, as well as loan pay-out to the business or individual who applied for the loan facility.

### **3.5.10 Gender of SME owner / manager / entrepreneur**

From the perspective of the lender, it could be a decisive factor whether to approve or decline funding to a business, based on who the owner of the business is in terms of gender. This could be due to stereotyping or other reasons.

### **3.5.11 Number of years of entrepreneur's business experience**

The number of year's experience is a determining factor in many business deals, due to various factors. In the SME funding application scenario it could be a determining factor.

### **3.5.12 Registration status.**

This refers to the legal status of the business, in terms of registration with BIPA (Business Intellectual Property Authority), a body responsible for company registrations in Namibia. Either the Business is a registered entity with BIPA or it is not a registered entity.

**Table 6: Specification of variables included in regression model for access to credit by SMEs in Namibia.**

<b>Symbol</b>	<b>Measurement</b>
Y	Binary dependent variable that registers “1” for access to credit and “0” for no access to Credit
Size	Number of employees
RS	Registration status of the SME
Age	Number of years the business has been in operation
TO	Turnover of business (in N\$)
EL	Literacy level of the SME manager / owner / entrepreneur, based on qualification possessed.
EBX	Number of entrepreneur’s business experience in years
FR	“1” if a financial record is kept, “0” if no financial record kept
CC	Cost of credit in percentage
TA	Turnaround process of credit application in number. of weeks.
CR	Credit requirement (collateral required or not)
EG	Gender of SME owner / manager / entrepreneur, “1” if male “0” if female.

*Source: Author estimates from research data, 2019*

### **3.6 Estimation approach**

According to Statistical Solutions (2020) logistic regression is an extension of simple linear regression, where the dependent variable is dichotomous or binary in nature, simple linear regression cannot be used, and furthermore it is the statistical technique used to predict the relationship between predictors (our independent variables) and a predicted variable (the dependent variable) where the dependent variable is binary (e.g. sex [male vs. female], response [yes vs. no], score [high vs. low] etc.). There must be two or more independent variables, or predictors, for a logistic regression (Statistical Solutions, 2020). The IVs, or predictors, can be continuous (interval/ratio) or categorical (ordinal/nominal), and all predictor variables are tested in one block to assess their predictive ability while controlling for the effects of other predictors in the model (Statistical Solutions, 2020).

Logistic regression does not require independent variables to be linearly related, nor does it require equal variance within each group, which makes it a less stringent procedure for statistical analysis (Starkweather & Moske, 2011). Logistic regression is a statistical model which uses a logistic function to model a binary, dependent variable (Statistical Solutions, 2020). It is the appropriate regression analysis to conduct when the dependent variable is dichotomous (binary) (Statistical Solutions, 2020).

The Logistic Regression was used to link the independent variable to dependent variable. As given by the equation below:

$$\ln \left( \frac{P}{1-P} \right) = \ln \left( \frac{p}{1-p} \right) + B_1 X_1 + B_2 X_2 + \dots + B_{pg} X$$

Here,  $p_g$  is the probability that an individual with values  $X_1, X_2, X_p \dots$  is in outcome  $g$  and  $p$  is the probability that the event  $Y$  occurs,  $p(Y=1)$ ;  
 $p/(1-p)$  is the "odds ratio";  
 $\ln[p/(1-p)]$  is the log odds ratio, or "logit";  
all other components of the model are the same.

## **CHAPTER 4**

### **Discussion of results**

#### **4.1 Introduction**

This chapter presents the findings of the study from the data collected. Findings are presented under each of the objectives sets, using frequency distribution tables. The researcher analysed the demographic characteristics of respondents involved in the study, using descriptive statistics. Areas investigated included respondents' gender, age, educational level and number of years spent in current employment. Analysis of these variables was meant to provide any evidence of association between these variables and the various responses. The various findings are presented under the respective headings.

#### **4.2 Descriptive statistics**

##### **4.2.1 Demographic characteristic and profile of SME responded**

The first part of the questionnaire covered and captured the characteristics of SME owners. It covered the individual characteristics, such as gender, age, level of education, number of years of experience in operating the SME. The result is presented in Table 7. Out of 120 respondents, 68 or 57 per cent of respondents were male, while 52 or 43 per cent of respondents were female. Forty-eight per cent of the respondents were between the ages of 25 and 35 years, followed by age range 36 to 45 years at 19 per cent, and over 45 years at 19 per cent. The least number of respondents were younger than 25 years, at 14 per cent. The majority of respondents indicated that they were single, representing around 57 per cent of the respondents, while 52 respondents or 43 per cent, indicated that they were married. It can be observed that 13 per cent of the respondents have less than one year's experience in their designated jobs, while 58 per cent have one to three years' experience, six per cent have four to five years' experience, and 33 per cent have experience of more than five years.

**Table 7: Demographic Profile**

	Category	Frequency	Percentage
Gender	Male	68	57
	Female	52	43
Age	Less than 25 years	17	14
	25–35 years	57	48
	36–45 years	23	19
	More than 45 years	23	19
Marital status	Single	68	57
	Married	52	43
Role in business	Owners	96	80
	Employees Manager	24	20
Years of experience in operating an SME business	Below 1 year	13	13
	1–3 years	58	48
	4–5 years	6	6
	More than 5 years	33	33
Years as SME owner	1–3 years	15	13
	4–6 years	46	38
	7–9 years	31	26
	10–12 years	20	16
	13–15 years	8	7
Educational qualification	Below secondary	23	33
	Grade 12	12	17
	Post-secondary	6	8
	Diploma	12	17
	Undergraduate	6	8
	Postgraduate	12	17

*Source: Author estimates from research data, 2019*

Most of the respondents indicated that they had spent four to nine years in their company. The trend in the responses looks like a business cycle, with an initial success of SMEs in infancy stages between year-one to year-three, followed by a peak during year-four to year- six, followed further by a slight decline in years seven to nine. It then decreases to less than ten per cent of the companies that appear to be surviving as successful SMEs, having been in operation for around 13 to 15 years. Only a few SMEs exceed ten years of being in operation.

It can be observed that 20 per cent of the respondents were in managerial/employee roles, while 80 per cent were in the position of owner or co-owner. Approximately 40 respondents

have been in operation for about four to six years. Furthermore, 29 respondents indicated that they had been in operation for seven to nine years. The least experienced category was in the thirteen to fifteen-year-old company.

It is debatable whether educational level is critical to successfully managing a business. At least 50 per cent of the sample had post-secondary qualifications. The statistics thus show that the sample was 50/50 in terms of education level. While Babajide (2012) states that the level of education is a relevant condition for sources of capital for start-ups, as well as capacity to access more capital, in their studies, Bowen, Morara and Mureithi (2009) discovered that more (75.4 per cent) of those respondents who had received technical or professional training, said their business performance had deteriorated. This may suggest that formal education is not a critical factor in the company's success.

#### 4.2.2 Characteristic of SME Business

In the next section, the following relevant information has been covered: registration status, loan preference, nature or industry the SME is operating in, the number of employees in the SME, and registered SME category.

**Table 8: Business profile**

	<b>Category</b>	<b>Frequency</b>	<b>Percentage</b>
Registration status	Registered	108	90
	Non-registered	12	10
Loan preferences	Yes	114	95
	No	6	5
Nature of business	Manufacturing	25	21
	Retail trade and others	32	27
	Tourism	21	17
	Construction	42	35
Number of employees	Less than five	42	35
	Five to ten	40	33
	More than ten	38	32

*Source: Author estimates from research data, 2019*

The majority of the respondents in the sample were legally registered, amounting to 90 per cent, and also preferred accessing finance, amounted to 95 per cent of the respondents. The majority of the respondents are in the construction industry, followed by retail and others at 27 per cent, and manufacturing at 21 per cent. Lastly, in tourism at 17 per cent, 35 participants,

said they hired fewer than five employees, 33 per cent hired between five and ten employees and 32 percent hired more than ten employees.

**Table 9: SMEs Registration type profile**

<b>Enterprise ownership type</b>	<b>Frequency</b>	<b>Percentages</b>
Private	20	17
Partnership	10	8
Close corporation	50	42
Sole proprietorship	40	33

*Source: Author estimates from research data, 2019*

As per table 9, the majority of SMEs surveyed were registered as close corporations, which accounted for 42 per cent of the total sample who responded. Furthermore, 40 respondents or 33 per cent were operating as sole proprietorships and 10 respondents or 8 per cent were partnerships. The SMEs registered or operating as private companies made up the remaining 20 or 17 pe cent of participants. Public Limited Companies have been excluded from this study.

### 4.3 Type of credit facilities used by SMEs in Namibia

#### 4.3.1 Nature of loans accessed by SMEs

In order to determine adequacy of the loans preferred by SMEs and to determine structural suitability of the loans, to suite the operations of the SMEs, the following questions were put to the SME respondents: What was the nature of the loans applied for in the past, duration and period of repayment.

**Number      Percentages**

**Table 10: Type of characteristics**

Nature of the loan preferred	Short term	72	60
	Medium term	36	30
	Long term	12	10
	Above 25%	6	5
	Research and development	12	10
	Others	6	5
Duration of loan repayment	3 months or less	60	50
	4 – 8 months	30	25
	9 – 12 months	24	20
	Over 12 months	6	5
Waiting period to receive loan	Less than 1 week	6	5
	Between 1 week and 3 weeks	18	15
	Between 3 weeks and 4 weeks	36	30
	More than 4 weeks	60	50

*Source: Author estimates from research data, 2019*

From Table 10 above, it can be observed that 60 per cent of the respondents preferred to apply for short-term loans, while 30 per cent of respondents preferred medium-term loans and ten percent preferred long-term loans. Thus it can be concluded that a majority of SME business owners prefer short-term finance for their business activities. This leads to another question: whether financial institution products for SMEs are well aligned with this finding, or is this another challenge to SMEs in accessing funds.

Because small and medium-sized enterprises are considered a high-risk sector, short-term lending is the preferred form of lending extended to them (Cofie, 2012; Ahiawodzi & Adade, 2014). The researcher asked the SME respondents how long it took them to pay back their

loan because of this. At least 60 percent of the SMEs surveyed were required to repay their loans within three months or less, according to Table 10. This confirms the fear of financial institutions when it comes to dealing with SME financing. A quarter (25%) of the sample indicated that it took them four to eight months to pay back their loans. A fifth (20%) of the respondents indicated that it took them nine to twelve months to settle their loans. Only five per cent of the sampled SMEs took more than one year to settle the loans granted to their businesses.

Access to loan services from financial institutions is beneficial for small businesses, but the speed with which these facilities are granted by financial institutions to SMEs is a significant issue (Njeru, 2014). The researcher asks the small and medium-sized enterprise owners how long it had taken for them to receive the funds after the loan facility had been granted.

Table 10 above shows that most loans were approved after more than four weeks, by financial institutions. This shows that for 50 per cent of the sample, 30 percent of approvals were received within three or four weeks of implementation. The table shows 15 per cent of facilities took between one and three weeks to be awarded. Finally, five per cent of financial facilities took less than one week to be awarded. The difference in the length of the delay in credit authorisation may be affected by the type of client SME, the type of financial institution as well as the amount and type of loan that had been requested.

#### **4.3.2 Frequency distribution: Interest rates on SME loans charged by banks**

SME respondents were asked to indicate the interest rate charged on their loans, to determine whether it is in favour of SME operational environment, when it comes to affordability. The results are presented below.

**Table 11: Interest rate range charged on SME loans**

	<b>Frequency</b>	<b>Percentage</b>
Less than 10%	15	15
Between 10% and 15%	50	50
Between 16% and 20%	10	10
Between 21% and 25%	20	20
Above 25%	5	5

*Source: Author estimates from research data, 2019*

Based on the interest charged on loans as one of the factors that have influence on credit accessibility, a study to probe the impact of interest rates was conducted as per table 11 above. Half (50 per cent) of respondents indicated that they were charged an interest rate between 10 and 15 per cent. Around ten per cent of respondents indicated that they were charged interest rates ranging between 15 and 20 per cent. Around 20 per cent of respondents indicated that they were charged interest rates in the range of 20 to 25 per cent. Respondents who indicated that they were charged less than ten per cent interest made up 15 per cent of the group, and respondents who indicated that they were charged more than 25 per cent interest amounted to five per cent of the sample. Respondents indicated that the interest charged on SME loans appeared too high and could lead many SMEs being unable to service their loans, which in turn could make it difficult for institutions to agree to fund more SMEs. Only 100 out of 120 respondents answered this part of the questionnaire.

## 4.4 Examining of possible factors that limits SMEs access to Credit from Banks:

### 4.4.1 Descriptive statistics

This section shows descriptive statistics, (mean, standard deviation), in order to confirm the consistency of the data collected for generic details across SME respondents' reasons for seeking financial assistance. It includes number of employees, number of years in operation, turnover of business (in N\$), literacy level of the SME manager/owner/entrepreneur based on qualification achieved, entrepreneur's business experience in years, cost of credit, turnaround processing of credit application in number of weeks, credit requirement (collateral required or not). Therefore, 120 questionnaires were administered for the pilot study to ensure that participants chosen had similar characteristics to the main study respondents within the target population (this would detect any problems in the questionnaire design).

**Table 12: Descriptive statistics**

	No.	Max	Min	Mean	Std. Dev.
Age	120	1	0	.52	.503
Number of employees	120	1	0	.44	.501
Years of operation/experience	120	5	0	.48	.503
Business annual turnover	120	2	0	.48	.535
Literacy level	120	5	0	2.68	1.424
SME support	120	6	0	3.59	2.021
Growth of your business	120	4	0	.60	.493
Years as an SME business entrepreneur	120	4	0	1.52	1.318
Financial record	120	3	0	1.51	1.148
Application interest rate charged	120	6	0	2.43	2.146
Credit requirement	120	4	0	2.08	1.371
SME manager gender	120	3	0	1.41	1.087

*Source: Author estimates from research data, 2019*

Table 12 indicates the descriptive statistics of all variables used. On average, the mean number of employees is 0.44 and the variation is 0.501. The analysis further shows that on average the mean number of years that the business has been in existence is (M= 0.48, SD = 0.503). This variation is small but positive, which shows that the data possess the positive skewed distribution.

### 4.4.2 Correlation results

Results from Table 13 show the linear strength between variables. It can be seen in the table that a weak positive linear strength existed between gender and the following variables: age, business turnover, financial record keeping, credit application turnaround time, credit collateral requirement, number of employees and registration status, which ranges between 0.03 and 0.3. Additionally, variables such as literacy level, experience of the entrepreneur and cost of credit, also indicated a weak negative linear strength with gender.

**Table 13: Correlation matrix**

	Gender	Age	TO	EL	EBX	FR	CC	TA	CR	EG	Size	RS
Gender	1											
Age	0.077	1										
TO	0.135	-0.16	1									
EL	-0.226	-0.48	-0.14	1								
EBX	-0.046	0.069	0.153	-0.1	1							
FR	0.037	0.041	-0.14	-0.18	-0.45	1						
CC	-0.138	0.02	-0.23	-0.05	-0.13	0.175	1					
TA	-0.028	0.238	-0.27	0.089	-0.15	0.275	0.072	1				
CR	0.055	0.147	-0.01	-0.01	-0.09	0.292	-0.18	0.523	1			
EG	0.042	0	0.178	0.046	-0.34	-0.33	0.009	-0.13	-0.1	1		
Size	0.304	0.137	0.134	-0.22	-0.14	-0.12	0.039	-0.03	0.071	0.016	1	
RS	0.111	0.191	0.01	0.086	-0.07	0.154	-0.05	0.026	-0.01	-0.18	0.035	1

*Source: Author estimates from research data, 2019*

The results further indicated that age had a weak linear strength with experience of the SME financial records, cost of credit, turnaround time, credit requirement, number of employees and registration status that ranges between 0.02 and 0.2, respectively. A weak negative linear strength was also observed between age and turnover time, while a moderate negative strength was record with literacy level and a neutral strength was reported between age and gender. The table further show that there was a weak positive linear strength between financial records and the following variables: cost of credit, turnaround time, collateral, registration status. Equally important, a weak negative linear strength was observed between financial records and gender of the SME manager and number of employees.

#### **4.4.3 Logistic regression model results and discussions.**

Table 14 illustrates the logistic regressions model that was applied using the IBM SPSS system (Statistical Package for Social Sciences), for data analysis. The dependent variable (Y) is applied/access to credit funding from the bank or financial institution. Table 14 shows the logistic model results. Indicator binary variable codes the dependent variable with 1 (access to credit funding) and 0 (no excess to credit funding). The logistic regression model is a good overall fit in the challenges faced by SME enterprises in accessing credit. The method identifies eleven variables as important predictors of failure; 0.7 of this variable significance at one per cent and significant at 0.5 per cent. A good model fit is indicated by insignificant chi-square value. The reduction in-2 Log likelihood is highly significant and smaller values of the 2LL measure indicate better model fit. High R<sup>2</sup> values for Nagelgerke and Cox and Snell test also support the above findings and reveal that the logistic regression model is a good fit.

**Table 14: Logistic regression model results**

<b>Dependent variable: Access Credit</b>					
Variable	B	S.E.	Wald	P	OR
Constant	-1.602**	1.611	0.989	0.020	0.201
Registration status	0.255	0.659	0.149	0.699	1.29
Age	0.864**	0.813	1.13	0.018	2.372
Number of employees	-.500	0.709	0.497	0.481	0.607
Year of operation	-1.259	0.808	2.427	0.119	0.284
Business turnover	-.232	0.321	0.519	0.471	0.793
Literacy level	0.336	0.237	2.011	0.156	1.399
SMEs support	-.081***	0.67	0.015	0.004	0.922
Growth of your business	0.59*	0.317	3.469	0.063	1.803
Years as an SME business entrepreneur	0.38	0.333	1.299	0.254	1.462
Financial record	-.368*	0.206	3.196	0.074	0.692
Application interest rate	0.342	0.326	1.105	0.293	1.408
Credit requirement	0.258	0.268	0.933	0.334	1.295
SMEs manager gender	0.208***	0.59	0.933	0.000	1.231

**Note:  $\beta$  - Standardised coefficients; OR = Odds ratio; \*\*\*, \*\* and \* denotes significance at 1%, 5% and 10% respectively.**

The findings indicated that registration status (OR = 0.201, p = 0.699), literacy level (OR = 1.399, p = 0.156), years of experience as an SME business entrepreneur (OR = 1.462, p = 0.254), application interest rate (OR = 1.408, p = 0.293), collateral credit requirement

(OR = 1.295,  $p = 0.334$ ) show a positive association with access to credit. On the other hand, age (OR = 2.372,  $p = 0.018$ ), growth of business (OR = 1.803,  $p = 0.063$ ) and SME manager gender (OR = 1.231,  $p = 0.00$ ) show a significant and positive effect on access to credit. Specifically, older firms, growth of business and male ownership of SME firms increases the odds of SME access to credit by approximately 130 per cent, 77 per cent and 23 per cent, respectively.

According to these findings, registration status (OR = 1.29,  $p = 0.699$ ), although not significant, the OR is less than 1. According to Grossmann, Mwatotele, Stork and Tobias (2010), not all registered SMEs are actually operational, as most of them have become briefcase companies, targeting favourite SMEs. These types of SME are referred to as 'tenderpreneurs' in some circles. They just target government tenders and move from project to project. The registration of firms appears to have a significant impact on their ability to access finance. Formal registration of firms enables business owners to separate business finances from personal finances, and a study by the National Credit Regulator in South Africa (Mahembe, 2011) revealed that SMEs that are formally registered have a higher success rate in obtaining finance, compared to those not formally registered. This finding was contrary to the above author's findings.

The results also indicate that years of operation (OR = 0.284,  $p = 0.119$ ), business turnover (OR = 0.793,  $p = 0.471$ ), SME support (OR = 0.922,  $p = 0.004$ ) and financial record maintenance (OR = 0.692,  $p = 0.074$ ) have a negative effect on access to credit by the sampled SMEs. However, significance was only observed for SME support and financial records. Specifically, it reduces the odds of accessing credit by approximately eight per cent.

Furthermore, the view of interest rates (OR = 1.408,  $p = 0.293$ ) and collateral requirements (OR = 1.295,  $p = 0.334$ ), was supported by Beck (2007), who claimed to have evidence indicating that small and medium enterprises (SMEs) are more constrained by financing and other institutional obstacles than larger enterprises, exacerbated by the weaknesses in the financial systems of many developing countries. The author argues that obstacles such as collateral requirements, bank paperwork, interest rate payments, and lack of access to specific forms of financing, such as export, leasing and long-term finance, are significantly more constraining for small firms' growth than for large firms.

Mahembe (2011) suggested that of all SMEs that apply for an unsecured loan at a bank, only 25 per cent succeed, and of those that are successful, only 85 per cent accept the loan, so that in the end, only 18 per cent finally receive a loan, as the stringent terms and conditions make it impossible for the other applicants to comply. In addition to the above, Mahembe (2011) believes that other reasons for applications to be rejected include 1) lack of collateral, 2) lack of a financial deposit, 3) poor business plans or non-viable business ideas. Bad credit histories were also cited as a main reason for applications being rejected. SMEs with poor credit histories are listed by credit bureaus with the information accessible to everyone linked to the bureau.

Equally important variables, such as number of employees (OR = 0.607,  $p = 0.481$ ), years of operation (OR = 0.284,  $p = 0.119$ ), business turnover (OR = 0.793,  $p = 0.471$ ) and financial records (OR = 0.692,  $p = 0.074$ ), show a decreased association that was also not significant. According to Mahembe (2011), young SMEs, without proper track records, face more problems accessing credit, as these firms are less transparent and there is less information about their credit history available to the banks. These firms are, therefore, regarded as more risky and are more likely to be refused credit. Banks are perceived to place more reliance on businesses with experienced owners, who display effective managerial competencies. Consequently, they are more likely to obtain finance from a financial institution (Nakusera, K., & Mushendami, 2008).

## **CHAPTER 5**

### **Conclusion and recommendations**

#### **5.1 Introduction**

This chapter summarises the study's major findings and conclusions. The author then sets out the recommendations of the study, as well as the change in policy and practice. The theme of this study, the challenges faced by small and medium enterprises in accessing credit in Namibia, sought to highlight the difficulties faced by these SME firms in accessing credit from financial institutions to operate and grow their businesses. In achieving this, the study addressed the objectives associated with SMEs getting funds from financial institutions, which are;

- a) To identify the types of credit facilities used by SMEs in Namibia;
- b) To examine the factors that limit SME access to credit from banks.

#### **5.2 Summary of findings**

The research focused on the challenges faced in accessing credit in Namibia by small and medium-sized enterprises. To achieve the study's objectives, a quantitative method was used. The research used a number of theories relating to financing problems and difficulties in accessing finance for SMEs, including the Schumpeterian theory, the refugee effect, the theory of social capital and the theories of capital structure, such as the theory of pecking order and the theory of creation. A total of 120 questionnaires were issued and 120 questionnaires were returned from the sample that reflected a response rate to the questions of 100 per cent in most cases. The questionnaires included questions that addressed research questions.

It became evident from the responses received to the questionnaire, that SMEs in Namibia, like most SMEs in other countries, face major challenges in accessing credit. The study revealed that these challenges included the inability of small and medium-sized enterprises to provide collateral and information demanded by banks, such as audited financial accounts, which coupled with high interest rates on loans, make access to bank loans extremely difficult. The above also supports the outcome of research by Aryeetey (1993) in Sectoral Credit Allocation Policy and Credit Flow to Small Enterprises in Ghana (1993), which concluded that the banks' main reason for refusal of loans was lack of adequate collateral. Seventy-five

per cent of sampled firms in this study, that needed loans, were among those whose applications had been rejected.

Because of these constraints relating to access to bank loans and the difficulties faced by SMEs in managing their receivables, mainly due to delays in receiving payment for goods and services rendered, SMEs in Namibia are unable to raise cash as quickly as they are expected to which can enable SMEs growth and expansion.

The time taken for the approval of credit ranges from less than a month, to over three months, most often between one and three months, for 60 per cent of the of the results. Half (50%) of the credit facilities taken up had to be repaid within three months. Within eight months, 25 per cent had to be paid back, while the remaining 25 per cent had from nine months to more than a year to do so. This incidence reinforces the fact that financial institutions see the SME sector as a risky business field.

All the financial institutions emphatically stated that in the past they had denied or rejected a small business credit application (Aryeetey, 1993). Reasons for rejection included business credibility, unrealistic proposals, general economic conditions, weak turnover and balance sheet. Turnover, bank balance and entrepreneurial credibility were frequently among the reasons why credit applications were rejected.

While dealing with small businesses, the various financial institutions face challenges. These include inaccurate bookkeeping, asymmetry of data, liquidity issues, poor internal controls and credit allocation. The most common challenges faced by financial institutions are inadequate bookkeeping and data asymmetry (Aryeetey, 1993).

Given the country's alphabetic rate, the education level of managers and owners of the various SMEs is very encouraging. Only five out of 20 had no sound education meaning they only had grade 12 or less, representing 25 per cent of the owners and managers. Ten per cent had tertiary education and the other 70 per cent had primary and secondary education. This means that the issue of inadequate bookkeeping is not caused by a total lack of education but by a lack of managerial skills.

### **5.3 Conclusions**

The study sought to investigate the challenges that SMEs face in Namibia in access to credit. From the findings of the study, this researcher concludes that the factors affecting Namibian

SMEs' access to finance are related to human, social and financial capital, where technical and management skills determine the amount of social and financial capital generated for SMEs. Furthermore, the generated social and financial capital is needed to jump-start business expansion activities for SMEs, and increase their monthly turnover beyond the N\$5 million limit.

Challenges faced by Namibian SMEs in their access to credit are, among other things, related to length of operation, major constraints, and the information required by financial institutions. This might have led to most SMEs being unable to remain in operation beyond five years. The major constraints faced by SMEs were the lack of competent management capable of giving their banks confidence and assurance that their loans would be repaid, and lack of collateral. This leads to prohibitively high interest rates and a general lack of finance accessible from banks. Because financial institutions see SMEs as high risk, they require them to pledge security in the form of collateral before they can be funded.

The study concludes that the overall performance of SMEs in Namibia is affected by this lack of access to finance. This results in SMEs' inability to meet customer demand on time, because of the lack of financial resources needed for expansion and efficiency. In addition, SMEs do not raise awareness of their products and services to customers, which in turn affects their market access and monthly turnover.

#### **5.4 Recommendations**

In view of the challenges and implications related to access to finance by SMEs in Namibia, the study findings yielded the following recommendations. The study recommends that SMEs keep up-to-date business financial records for various reasons, such as to keep track of their operations, and to provide them to financial institutions in the event of funding application from the financial institutions. The study further recommends, SMEs to build strong balance sheets with their profits to ensure that they are able to meet the collateral requirements of the financial institutions. Moreover, the SME will benefit from good financial record-keeping as this will enhance their chances of accessing credit facilities easily.

The study recommends the adoption of a SME accounting and bookkeeping program by Namibian SMEs. It is recommended that the program should involve partnerships with SMEs with renowned accounting software. This will assist with the management of all their accounting records. Using an accounting software program simplifies the process involved in

the preparation of financial statements. Given the reduced risk of misinformation from unaudited financial records, potential lending institutions may also be able to offer lower interest rates to SMEs. In other words, audited financial records enhance the credibility of the borrower and thus reduce the risk to lenders. Hitchins (2002) agrees that intervention by the government has often been ineffective because it did not address the underlying reasons for market failures. When attempting to achieve goals, government intervention frequently lacks market signals and underestimates the data needed to effectively intervene. Government intervention in access to finance for SMEs should, therefore, take into account the value of affordable microfinance, as well as family and friends' capital.

It is important that government look for new ways to reduce some burdens, such as taxation and levies, in favour of small and medium-sized businesses. It is recommended that preferential treatment should be given to SMEs in certain areas to promote their growth and development. Secondly, the government should establish pecking-order levels of support in the development of support structures for SMEs. This can be achieved by designing cluster-based incubation centres for instance, to ensure that SMEs collaboratively complement each other by capitalising on SME owners' technical and management skills for example. Small and medium-sized companies that lack certain skilled human resources may benefit from an SME that specialises in advertising, financial planning or good business strategies for example. Government intervention in access to finance for SMEs should therefore take into account SMEs' limited capacities, competencies and capabilities in order to be effective and provide appropriate means of intervention. Finally, in order to enhance their knowledge and skills, SME owners should invest in themselves by attending education and training courses tailored to their specific needs.

### **5.5 Areas for further research**

The study recommends further research on the same or a similar topic that covers all Namibia's business incubators—on the effect that access to credit has on performance of SMEs.

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## **APPENDIX 1**

### **SEMI-STRUCTURED INTERVIEW GUIDE**

The semi-structured interview is divided into four sections

#### **SECTION A: Participant information and procedure of the interview explained**

Section A is off record. Here the researcher introduces himself. This section is to build rapport, which is very important for any face-to-face interview. The potential participants will be given insight into why the research is being done and why they are the targeted participants for the study. The participants will be given a chance to decide if they want to participate in the study or not. Here a recording device is also pointed out. The interviewer asks the participant if they give their permission for us to record the interview on a tape recorder.

#### **SECTION B: Signing of consent forms**

- The interview is to be recorded with your permission as the information is part of the data to be collected in order for the study to be conclusive.
- With your permission given, please sign the consent form.

#### **SECTION C: Demographic questions**

- Is your enterprise registered? Yes or no
- Did you seek financial assistance to start your business? Yes or No
- How many years has your enterprise been in existence now?
- Which towns or city in Namibia is your enterprise operating from?

#### **SECTION D: Closed ended questions**

Circle the appropriate choice(s)

- Have you ever applied for a credit funding form a bank or financial institution? Yes / No.
- If not, please choose the reason(s) below:
- Do you keep financial records? Yes / No.
- If yes, what kind of financial records do you keep?
- Where do you access credit from in Namibia? (Please circle appropriate choice)
- Has your company ever been refused/declined credit funding by a bank or financial institution? Yes /No

- If yes, what was the reason for the bank or financial institution gave for declining your application for credit (Please circle appropriate choice).

## **APPENDIX 2 CONSENT FORM**

By signing this form, I, \_\_\_\_\_ agree to participate in the study. I declare that the following has been explained to me by the researcher and that I fully understand and accept the conditions of participation in this study:

1. Participating in this study is voluntary and I can choose to withdraw from the research anytime.
2. I understand that the focus of the study is on the challenges faced by small and medium enterprises in accessing credit in Namibia.
3. A semi- structured interview will be conducted, should clarity of information given be required, a follow-up session can be scheduled.
4. I have the right to ask questions during and after the research, pertaining to the research and to abstain in response to a question should I experience any distress in disclosing information.
5. No identifying details will be requested in relation to the information given, to ensure anonymity.
6. The research results will be made available to me should I request them in writing from the researcher.

Signature Participant: \_\_\_\_\_ Date:

Signature Researcher: \_\_\_\_\_ Date:

**APPENDIX 3  
PERMISSION AND RELEASE FOR RECORDING**

I,.....(Recorded person’s full name), do hereby consent to the use by.....(researcher’s full name) of my voice recording to extract the interview data for analysis and coding. I understand that this audio recording will be destroyed once the data has been transcribed.

I understand that this material will be used in a legitimate manner, both internally and externally. UCT does not intend to cause any harm or undue embarrassment to the parties involved.

Signature: .....

Date: ...../...../.....

**APPENDIX 4  
QUESTIONNAIRE**

Dear Sir/Madam

I, Mr Beatus T Amadhila 0811277094, a master student in the Development Finance Centre (DEFIC), Graduate School of Business, University of Cape Town, pursuing a master’s thesis with the title “The challenges faced by small and medium enterprises in accessing credit in Namibia. I humbly request you to take some time in order to fill and complete this questionnaire and return it to me, in accordance with the partial fulfilment of the aforesaid degree. Thanking you in advance as your support in investing time with us to respond and answer the questionnaire is a great contribution to completing this part of the research. Your effort is highly appreciated. Feel free to ask questions for clarity.

This questionnaire is divided in two sections.

**SECTION A: Demographic questions**

Are you male or female?

---

1. Have you registered your enterprise? Circle one of the below;  
(Yes or no)
  2. Did you ever seek financial assistance in form of a loan to start your business? Circle one of the below; (Yes or No)
  3. How many years has your enterprise been in existence now? Circle the category your business is under;
    - A. 2 Years and less
    - B. 3 years – 5 years
    - C. 6 years to 10 years
    - D. 11 years and more
  4. Which industry most closely describes your business? Circle one of the below;
    - A. Manufacturing
    - B. Retail Trading
    - C. Tourism
    - D. Others (please specify).....
  5. Name of the product or service offered by your enterprise
- 
-

6. Which best describes the ownership of your enterprise? Circle the appropriate one;

- A. Sole proprietorship
- B. Cooperative
- C. Partnership
- D. Public
- E. Private
- F. Rural
- G. Others, name-----

7. What is your role in relation to the main business?

- A. Owner/Co-Owner
- B. Manager/Employee

8. How long have you been operating as an entrepreneur and SME owner?

- A. Less than 1 year.
- B. Between 1 and 3 years.
- C. Between 3 and 6 years.
- D. Between 6 and 9 years.
- E. More than 9 years.

9. The number of full time workers in your enterprise?

- A. Less than 5
- B. Less than 10
- C. 10 or above

10. As SME owner, what is your highest level of education?

- A. Below secondary
- B. Grade 12 certificate
- C. Post-secondary certificate
- D. Diploma
- E. Undergraduate degree
- F. Post graduate MBA
- G. Postgraduate PHD

**SECTION B: Closed-ended questions**

Circle the appropriate choice(s)

1. Have you ever applied for a credit funding from a Bank / Financial institution?
2. Yes / No.
  
3. If no, please choose the reason(s) below:
  - a) I do not like Bank loans
  - b) Interest rates are too high
  - c) I am not able to provide collateral
  - d) I am not able to provide financial statements as requested by banks
  - e) Others (please specify) .....
  
4. What is the average monthly turnover of your business?
  - a) Less than N\$1,000,000.00
  - b) N\$1,000,000.00 to 5,000,000.00
  - c) N\$5,000,000.00 to N\$10,000,000.00
  - d) Above N\$10,000,000.00
  
5. Do you keep financial records? Yes / No.
  
6. If yes, what kind of financial records do you keep?
  - a) Audited financial statements.
  - b) Unaudited financial statements.
  - c) Informal financial records
  - d) Others (specify).....
  
7. Where do you access credit from in Namibia? (Please answer yes or no where applicable).
  - a) Commercial Banks
  - b) SME's Bank
  - c) Agricultural Bank
  - d) Micro Finance Institutions
  - e) Family and friends
  - f) Namibia Postal Services

g) Others (please specify) .....

8. Has your company ever been refused/declined credit funding by a bank or financial institution? Yes /No

9. If yes, what was the reason for the bank/ financial institution declining your application for credit

10.

a) Lack of collateral

b) Affordability issues due to high repayment instalments

c) Lack of proper qualified management

d) Credit score issues

e) Others (please specify) .....

What information did the bank request you to provide when you applied for the credit facility?

a) Collateral

b) Audited financial statements

c) Business Plan

d) Management accounts (Cashflow statements, Income statements, Balance sheet)

e) Others (please specify) .....

11. What is the nature of the loan you applied for?

a) Short term loan repayable within 12 months

b) Medium term loan repayable between 1 year and 5 years

c) Long term loan repayable over 10 years or more.

12. If you received a loan how long did it take to receive the loan?

a) Less than one week

b) Between one week and three weeks

c) Between three weeks and 4 weeks

d) More than 4 weeks

13. If you received a loan what was the interest rate charged?

a) Less than 10%

- b) Between 10% and 15%
- c) Between 15% and 20%
- d) Between 20% and 25%
- e) More than 25%

14. What do you consider is the most critical obstacle faced by SMEs, imposed by Banks / financial institutions when considering credit applications for SMEs?

- a) Collateral
- b) Audited Financial Statements
- c) Management structure
- d) High interest rates
- e) Short repayment terms
- f) Others (please specify).....

15. Have you ever had a problem repaying your business loan? Yes / No

16. If yes, what made it difficult to repay?

- a) Short repayment term
- b) High interest rates.
- c) Poor financial management
- d) Others (please specify).....

What are the most critical constraints to the growth of your business?

- a) Lack of finance
- b) Stiff competition from domestic firms
- c) Access to adequate funding
- d) Lack of proper bookkeeping
- e) High interest rates charged by banks
- f) Government taxes
- g) Others (please specify) .....

17. How do you keep informed regarding SME support?

- a) Via membership of trade association
- b) Personal business contact

- c) Mass media communication
- d) Via financial institutions stakeholders engagement
- e) Via government support programmes
- f) Others (please specify).....

18. What would you prefer financial assistance for, should the it become available??

- a) Working capital
- b) Expansion/growth
- c) New product development
- d) Research and development
- e) Others (please specify).....

Thank you very much