STRATEGIC PLANNING AS A TOOL FOR INVESTMENT DECISION-MAKING FOR SMEs IN NELSON MANDELA METROPOLE

BY

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DECLARATION

I, **Bereng Nimrode Kikine**, ID No 810509 5356 084, hereby declare that:

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ABSTRACT

All around the world, SMEs are perceived as the engine room of economic growth, job creation and poverty alleviation, due to their flexibility and quick adaptability to change. It is believed that, for developing countries to address their social and economic challenges, it would be beneficial if they leverage the potential that the SME sector potentially possess. However, despite the government focus on supporting and encouraging the establishment of SMEs through the small business development programmes in order to address these social challenges, SME sector has experienced a high degree of business mortality, which impacts negatively on the ability to create sustainable employment opportunities in the long term. This view is supported by the work of (Ligthelm and Cant 2003). According to the global economic monitor (GEM), the small business mortality in South Africa is among the highest in the world. It is said that that most newly established SMEs will not survive beyond 48 months Von Broembsen, as cited in Olawale and Garwe (2010: 730).

One of the reasons that lead to the high failure rate of SMEs is the lack of strategic planning and the poor allocation of resources. The literature review suggests that SMEs that embark on strategic planning are the ones that are most likely to experience sales growth, personnel growth and asset value growth, as opposed those that do not do any strategic planning at all.

The primary objective of this research was to establish how a strategic planning process can be used as an investment decision-making tool for manufacturing SMEs in the Nelson Mandela Metropole. In order to address this research problem, the following sub-problems had to be solved:

- What strategic planning processes do current SME managers use?
- What strategic performance measurement systems do SME owner-managers currently use?
- What capital budgeting techniques are currently being used by SME’s in the region?
- How do SME owner-managers evaluate the risk of the projects at hand?

The research design was methodological triangulation in nature, that is, using both qualitative and quantitative methodologies, though a quantitative paradigm was more dominant that the qualitative paradigm. A questionnaire was designed as a primary source of data collection from a selected sample group.

The empirical study revealed that there is some level of strategic planning amongst SMEs, however, it is mostly informal and unstructured. It also emerged that strategic planning can be used as more than just a performance measurement tool, it can contribute more effectively to strategic alignment, organisational learning and diffusion of knowledge throughout the organisation. The empirical study also suggests that SMEs understand that capital budgeting is critical for the success of the organisations. However, very few SMEs have a formal capital budgeting process. It also became evident that most SMEs are still relying on the traditional capital budgeting techniques; that is, 'gut feel' and the payback methods of evaluating projects. The empirical study suggests that the largest group of SMEs rely on break-even analysis and scenario planning as the major indicators of the impact the projects will or may have on the organisation.

The recommendations have thus been made to address the challenges facing SMEs with regard to strategic planning, strategic performance measurement, capital budgeting and project risk evaluation.

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CHAPTER ONE

BACKGROUND AND INTRODUCTION TO RESEARCH STUDY

1.1 BACKGROUND OF THE STUDY

Since 1994, South Africa has been faced with the challenges of re-integration into world markets as a global economy, while at the same time positioning itself to realise the high expectations of its population regarding a successful transition towards a more democratic order (Berry, von Blottnitz, Cassim, Kesper, Rajaratnam, and Ernst van Seventer, 2002). In order to address the challenges of economic growth, poverty alleviation, and unemployment, since 1995 the South African government has been actively promoting the SME sectors. According to Olawale and Garwe (2010) one of the best ways to address the challenges that are facing most developing countries like South Africa is through the leveraging and promotion of the SMEs sector.

This is the notion that is shared by Liigthelm and Cant (2003: 41) when stating that the important contribution that SMEs can make to employment and income generation is increasingly being recognised around the world. In South Africa, this contribution is even more significant, because the non-agricultural formal sectors shed more than a million employment opportunities between 1990 and 2001. Despite government's efforts to increase support to the small business sector, the SMME Business Confidence Index, a survey of SMME perceptions, has suggested that these initiatives have not had the intended impact (FinScope South Africa, 2010).

In order to develop effective interventions, it is important to first have a comprehensive understanding of the small business sector, the specific challenges small business owners face and the capacity they have to deal with these challenges. Any intervention strategy should take into account that a 'one size fits all' approach will not be effective (FinScope South Africa, 2010)

According to FinScope South Africa (2010), 39% of small business owners cite money-related matters as the main obstacles they faced when starting up their businesses; 34% cite business strategy issues as their main obstacles (determining and finding what to sell, finding their target market, dealing with competitors, etcetera.)

1.2 PROBLEM STATEMENT

One of the possible factors that could lead to the failure of small business is the inability of small business managers to plan or to forecast for the future of their businesses and to properly allocate its resources. Many of these factors that result in business failure could possibly be avoided or managed with strategies and financial decisions that drive growth and the organisational objectives. While it is important for SMEs to grow, with growth comes a lot of challenges; with growth comes the issue of financing this growth. There also arises the question of return on investment (Salazar, Soto, and Mosqueda, 2012).

The literature reveals that SMEs that engage in strategic planning are the ones that are most likely to realise higher sales growth, higher returns on investment, as well as the increase in the number of their employees. All this factors could, incidentally be used as the measures of growth in an organisation (Wang, Walker, and Redmond, 2006).

1.2.1 **Main Research Objective**

In light of the above, the following reasearch objective will be addressed:

To establish how to improve the performance of manufacturing SMEs within the Nelson Mandela Metro by investigating how strategic planning can be used as a tool for investment decision-making.

1.2.2 **Sub-Problems**

In order to answer the main research problem, the following research sub-problems will be addressed.

i. What strategic planning processes do current SME managers use?
ii. What strategic performance measurement systems do SME owner-managers currently use?
iii. What capital budgeting techniques are currently being used by SME's in the region?
iv. How do SME owner-managers evaluate the risk of the projects at hand?

1.3 DELIMITATION OF THE RESEARCH

The study will be confined to the Manufacturing SMEs within the Nelson Mandela Metropole (Port Elizabeth, Uitenhage and Dispatch).

1.4 THE SIGNIFICANCE OF THE STUDY

The most pressing problem facing South Africa today is the absence of sustained economic growth, which is essential to reduce poverty and improve living conditions (Lewis, 2002). All around the world, the critical role that SMEs play with regard to alleviation of poverty, job creation and the cotribution to the economic growth is increasingly being recognised. The SME sector is perceived as the engine room of economic growth, particularly for the developing countries like South Africa, where the the agricultural and the mining sectors have been the main contibutors of employment. This is due to their quick adaptability during the ever changing economic times (Olawale and Garwe, 2010; Abor and Quartey, 2010).

Whilst there are many factors that contribute to the failure of SMEs ranging from the perceived difficulty in accessing finance to the lack of government support, many studies have identified the pitfalls of SMEs. However, very little research has been done regarding the importance of strategic planning as a tool that can assist SME owner-managers to make an informed investment in order to maximise the return on investment and to ensure optimal allocation of resources for manufacturing SMEs.

According to Rajaram (2008), in order to successfully establish and grow any business entity, especially the small business entity, there are many crucial financial decisions that must be made. Many of these decisions relate to sourcing of capital and ensuring that such capital is utilised in a manner that results in the optimal growth and profitability of the entity. In order to achieve this objective, there is a necessity for the entity to possess financial management and accounting skills.

This notion is shared by Longenecker, Moore, Petty, and Palich (2006: 404), when they state that most small business manager(s) plan to some degree. However, the amount of planning they do is less than ideal. Whilst they acknowledge that various circumstances affect the degree to which formal planning is needed, they also state that most businesses could function profitably by increasing the amount of planning done by managers and making it more systematic.

1.5 THE PREVIOUS RESEARCH PAPERS

Many previous research papers have focused on identification of factors hindering or contributing to the growth or success of SMEs. However, very few focussed on the solutions that will ensure that fewer SMEs find themselves in a similar situation. For example, one of the main reasons appearing in most research papers as increasing the failure rate of SMEs is the lack of access to finance or financial resources. The study of Krog (2007), had the objective to determine what factors financial institutions assess when deciding on providing finance to small, micro and medium enterprises. This is an important study and has highlighted the factors that SMEs have to consider when applying for funding.

However, Okpara and Kabango (2009: 10) state that the degree to which limited financial resources alone are a major obstacle to business development is still controversial. Kollon (1990) cited in Okpara and Kabango (2009: 10), found that the amount of capital needed to start a business is significantly negative when related to the rate of growth for the business. He also found that access to commercial credit did not contribute to entrepreneurial success in any significant way, and if it did, the relationship would be negative.

The approach that the researcher is planning to explore is to prove to the small business managers that the success of the organisation is not always dependant on external factors only, such as the availability of finance. However, that properly planning their operations better and adhering to their plan when allocating the limited resources, are most likely to influence the success or failure of their organisations (Salazar, Soto, and Mosqueda, 2012).

1.6 DEFINITION OF KEY CONCEPTS

The dollowing important key concepts in this study

1.6.1 Strategic planning

is concerned with the setting of long-term organisational goals, the development and implementation of plans to achieve these goals, and the allocation or diversion of resources necessary for realising these goals. In a practical sense, strategic planning is about competitive advantage (Wang, Walker and Redmond, 2006: 3).

1.6.2 **Investment Decision**

According to Salazar, Soto, and Mosqueda (2012: 95) investment decisions relate to the allocation of capital to carry out investment opportunities that are valuable or bring value to the organisation, taking into account the magnitude, opportunity and risk of the future cash flows of investment.

1.6.3 **Capital Budgeting**

It refers to the process of planning significant investments that may or will have the long term implications for the organisation such the purchasing new equipment or acquiring land and building (Garrison, Noreen and Brewer, 2008).

1.6.4 **Competitive Advantage**

Zimmerer and Scarborough (2002: 69), state that the goal of developing a strategic plan is to create for the small company a competitive advantage – the aggregating factor that sets a small business apart from its competitors and give it a unique position in the market. Zimmerer and Scarborough (2002: 69) further state that every small business must establish a plan for creating a unique image in the minds of its potential customers. Zimmerer and Scarborough also acknowledge that no business can be everything to everyone.

However, one of the biggest pitfalls of small businesses is not differentiating their company from the crowd. Small businesses have the opportunity to exploit this avenue in their development of a strategic plan, as they ussually have fewer product lines compared to their larger competitors. Small businesses also have a better defined customer base which makes it easier to establish good customer relations and serves their customer needs better.

1.6.5 **Financial planning**

This is an important aspect of the firms operations because it provides road maps for guiding, coordinating, and controlling the firm's actions to achieve its objective Gitman, (2009: 117). For small businesses, planning is crucial. However, because of their preoccupation with daily problems, many small businesses fail to give adequate attention to their financial future until a severe problem develops (Abdelsama, DeGenaro, and Wood, 2001).

1.6.6 **Cash Management**

Zimmerer and Scarborough (2002: 69) describe cash management as a process that involves forecasting, collecting, disbursing, investing and planning for the cash a company needs to operate smoothly.

1.6.7 Risk

This implies the likelihood of an undesirable result or event occuring. It is the chance or probability that an undesirable event will or may occur, which could influene the outcomes of the investment (Warszawski, Asce, and Sacks, 2004).

1.7 RESEARCH METHODOLOGY

The perception, the philosophy and the nature of knowledge that people have about how they should conduct research, is referred to as the research paradigm. A paradigm is a universally acceptable way of providing solutions to the problems that people seek to resolve (Collis and Hussey, 2003).

Collis and Hussey (2003: 78) state that the use of different research approaches, methods and techniques in the same study is referred to as triangulation. They further state that this can overcome the potential bias and sterility of a single-method approach for the purpose of this research, the researcher used both qualitative and quantitative approaches of research (Methodological triangulation).

1.7.1 Sample Group and Data Collection

The sample group consisting of 40 manufacturing SMEs from the Nelson Mandela Metropole was selected. Only the SMEs that met the definition of the small business act were considered. The contact details of the businesses were obtained via the Chamber of Commerce website and other small business agencies and financial institutions' small business units.

The selected participants were then contacted telephonically and by electronic mail to inform them about the survey and its purpose and to request thei participation. Once they accepted the questionnaire was sent via eletronic mail for their complition and others were delivered by hand.

1.8 OUTLINE OF THE STUDY

The research was planned to include the following chapters:

Chapter 1: Background and introduction to the research study
Chapter 2: Literature review on strategic planning and strategic performance measurement.

Chapter 3: Literature review on capital budgeting process and risk evaluation of capital projects.
Chapter 4: Research methodology
Chapter 5: Discussion of the research findings
Chapter 6: Summary, conclusion and recommendations.

1.9 CONCLUSION

This chapter outlined the backgound of the study, by highlighting the importance of strategic planning as a tool for investment decision-making for SMEs in the Nelson Mandela Metropole. The main research objective as well as the sub-problems were discussed. The key concepts were clarified and the delimitation of the study was also outlined.

The following chapter will illustrate the literature review focusing on the overview of the SMEs, strategic planning and the strategic performance measurement.

CHAPTER TWO

SME OVERVIEW, STRATEGIC PLANNING AND STRATEGIC PERFORMANCE MEASUREMENT

2.1 INTRODUCTION

According to Okpara and Kabango (2009: 7), all around the world small and medium sized enterprises (SMEs) are recognised as key to economic development due their recognised role to wealth and job creation. Okpara and Kabango (2009) further state that SMEs are perceived to be instruments capable of dealing with globalisation and poverty alleviation because of their flexibility and quick adaptability. It is acknowledged that the SME sector is labour intensive and has a great potential for job creation; thus, the recognition of SMEs and their contribution is even more important in developing countries like South Africa where the rate of unemployment is very high, with the agricultural sector having shed more than a million employment opportunities between 1990 and 2000 (Ligthelm and Cant, 2003).

Kongolo (2010: 2288) states that one of the significant characteristics of a flourishing and growing economy is a booming and blooming small and medium enterprise sector. Since 1994 SMEs have also been promoted as one of the cornerstones of the South African government's economic development policies in an attempt to address the imbalances of the past. However, this sector has experienced a high degree of business mortality, which impacts negatively on the ability to create sustainable employment opportunities in the long term. This view is supported by the work of (Ligthelm and Cant 2003).

There is evidence that suggests that companies which implement strategic plans have proven to be more successful as opposed to those that do not do any strategic planning at all (Bhattacharya, 2009: 1). This chapter focuses on strategic planning for SMEs as a management tool for investment-decision. Firstly, the study will establish what SMEs are and the role or the contribution they make in our economy and secondly, the study will define what strategic planning is and its significance to the SME sector and how it can be used as a tool for investment decision-making for SMEs.

2.2 THE ROLE OF THE SME SECTOR IN SOUTH AFRICA

According to Olawale and Garwe (2010: 729) one of the alternatives to address to social ills facing South Africa such as; the high rate of unemployment, poverty alliviation and economic growth, is to leverage the potential of the SME sector. Olawale and Garwe further point out that for South Africa to avoid economic stagnation, it is imperative for the South African government to support the creation of new SMEs. This should in turn bring about new product development, new technology and exert competitive pressures on already established firms; thus generally fostering a healthy competitve business environment.

In South Africa SMEs contribute 56% of private sector employment and 36% of the gross domestic product (GDP). However, despite all the commendable contributions that SMEs can potentially bring to developed and developing nations, The failure rate of SMEs in South Africa is one of the highest in the world, with about 75% of newly formed SMEs not becoming fully established firms (Olawale and Garwe, 2010).

In the past the focus of the South African government was split between first and second economy enterprises. The objective, or the hope thereof, was to encourage and assist the so-called second economy entities (micro enterprises), with the hope that they will eventually graduate into the mainstream economy (first economy), in order to bridge the gap between these two perceived economies. However, most of these micro enterprises are just survivalists enterprises with no intention of graduating into the mainstream or first economy. Most of them are established as a strategy for coping with poverty and unemployment; thus they hardly ever survive for a period longer than a year (Small business environment, 2009).

In light of these factors stated above, South Africa lags behind other developing countries when it comes to the sustainability and the promotion of SMEs. Amongst other reasons, the small enterprise development agency (seda) (2011: 8), points out that small business owners in South Africa face rather strict governance and statutory circumnstances, plus the challenges of expensive human, communication and other resources. To start and grow your own business in South Africa is challenging on all levels, and 80% of small business traditionally fail within the first year. This notion seems to be seconded by Von Broembsen, as cited in Olawale and Garwe (2010: 730) who points out that the probability of a new SME surviving beyond 42 months is less likely in South Africa than in any other country in global enterprise monitor (GEM) survey.

According to Toomey (1998: 84) the South African emergent entrepreneurs and SMEs sector are characterised by the following:

- Half of all SMEs are less than three years old;
- Employment growth is inversely related to the age of the firm;
- The vast majority of newly established SMEs were begun as strategies to cope with unemployment;
- Women operate 62% of all micro enterprises and their businesses tend to be in sectors with the lowest levels of profitability and growth in employment;
- Net monthly income from such micro enterprises is on average below the established subsistence level of R650.00 per month.

2.2.1 Definition of the SME sector

All around the world it appears to be a problem to encapsulate the small business sector in one definition, with most countries describing it based on counry specific characteristics. In South Africa the SME sector is refered to as the SMME sector which incorporates the micro enterprises. In the quest to define this sector the small business act classifies five categories; namely:

2.2.1.1 Survivalist Enterprises

These are entities that were establised as a means of coping with poverty and unemployment by people who were unable to find a paid job or get into an economic sector of their choice. Toomey (1998) and Figg (2002) point out that most survivalist entities are characterised by the flollowing aspects:

- The income generated by these entities is generally less that the minimum income standard or poverty line;
- There is very little capital invested;
- There is virtually no skills training in the particular field required and only limited opportunities for growth into a viable business;
- There are no paid employees and the business asset value is minimal; and
- The economic activity of the business is mainly directed at providing the minimal means to keep the business owner alive.

2.2.1.2 Micro enterprises

These are entities that generate an annual turnover that is less than the Value Added Tax (VAT) registration limit of hundred and fifty thousand per annum. Micro enterprises are usually characterised by the lack of compliance with other government regulations such as:

- The formal tax registration;
- Non adherence to labour legislation, and standard accounting procedures, business licences, operating permits, and
- These entities usually have less than five employees.

There is a very blurred defining line between the micro enterprises and the survivalist enterprises. Micro enterprises often include homebased businesses such as: spaza shops, cafés, mini-taxis and small-scale construction and textile manufacturing. However, many micro-enterprises advance into viable small businesses. Also, earning levels of micro-enterprises differ widely, depending on the particular sector, the growth phase of the business and access to relevant support (Toomey, 1998; Figg, 2002).

2.2.1.3 Very Small Enterprises

This a category unique to South Africa and refers to businesses employing less than ten employees depending on the industry. Some industries like mining, electricity, manufacturing and construction sectors are an exception with the Very Small Enterprise limit being twenty employees. Though very small, these enterprises operate in the formal economy, and do comply with government requirements such as being VAT-registered. They also have access to limited technology in business operations (Toomey, 1998; Figg, 2002).

2.2.1.4 Small Enterprises

These are entities that have more established business practices compared to the very small enterprises. One of the major distinguishing aspects from very small enterprises is the upper limit on employee size of fifty and increasingly complex supervision and management structures. They are likely to operate from business or industrial premises, be tax registered and are compliant with all the other formal registration requirements or regulations. Small enterprises have usually passed the stage of direct supervision by the entrepreneur and have developed secondary management systems. However, it is rather difficult to classify them by means of turnover due to the variety of sectors within this category. The challenge of growing the business into a small enterprise usually requires an accumulation of resources over time and access to credit (Toomey, 1998; Figg, 2002).

2.2.1.5 Medium Enterprises

These are formal entities with more complex divisions of labour and management structures employing up to one hundred employees (two hundred in the mining, electricity manufacturing and construction sectors) (Government of South Africa, 1996b).

Table 1 below is a schedule of small business “definitions” categorised by; industry, size or class, number of employees, total annual turnover and the total gross asset value. The table seeks to quantify the factors or categories that are used to differentiate the various business etities according to their industries. The manufacturing SME sector is reflected seperately to as it the main focuss of the study and it is the category that was used to stratify the sample.

Table 1: Schedule of definition of "small business" in section 1 of the small business act

Sector or sub-sectors in accordance with the Standard Industrial Classification	Size or class	Total full-time equivalent of paid employees Less than	Total annual turnover Less than	Total gross asset value (fixed property excluded) Less than
All sectors	Medium	100 to 200 depending on the Industry	Less than R4m to less than R50m depending on industry	Less than R2m to less than R18m depending on industry
	Small	50 or less	Less than R2m to less than R25m depending on industry	Less than R2m to less than R4.5m depending on industry
	Very small	More that 10 but less than 20	Less than R0.2m to less than R0.5m depending on industry	Less than R0.15m to less than R0.5m depending on industry
	Micro	Not more than 5	Not more than R0.15m	Less than R0.1m
Manufacturing	Medium Small Very small Micro	200 50 20 5	R40m R10m R4.4m R0.15m	R15m R3.75m R1.5m R0.1m

Source: Small Busness Act (1996)

2.2.2 SME Sector and Job Creation

SMEs play an important role when it comes to job creation, particularly in the developing countries. This is mainly due to its high labour intensity and the quick adapdability to change in these turbulant economic times. In order for developing and developed countries to improve the living conditions of its people, their respective governments should leverage the benefits that can be achieved through SMEs (Kongolo, 2010). Fida (2008), as cited in Kongolo (2010: 2288), contends that SMEs contribute to economic development in many ways:

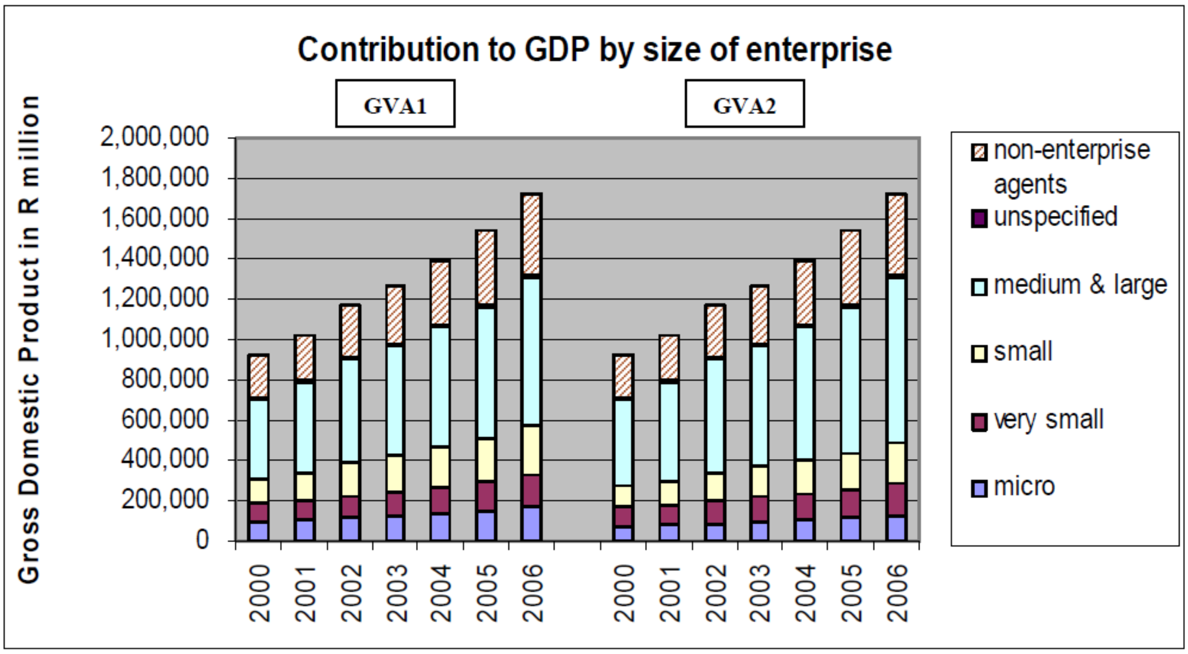
- By creating employment for rural and urban growing labour forces;
- Providing desirable sustainability and innovation in the economy as a whole.

In addition to that, a large number of people relys on the small and medium enterprises directly. Despite the important role that SMEs play with regard to job creation in both developed and developing countries, they still face major challenges when it comes to access to credit and or financing, which creates a stumbling block to the potential growth of this sector and the benefits that come with it.

2.2.3 SME Sector and Gross Domestic Product (GDP)

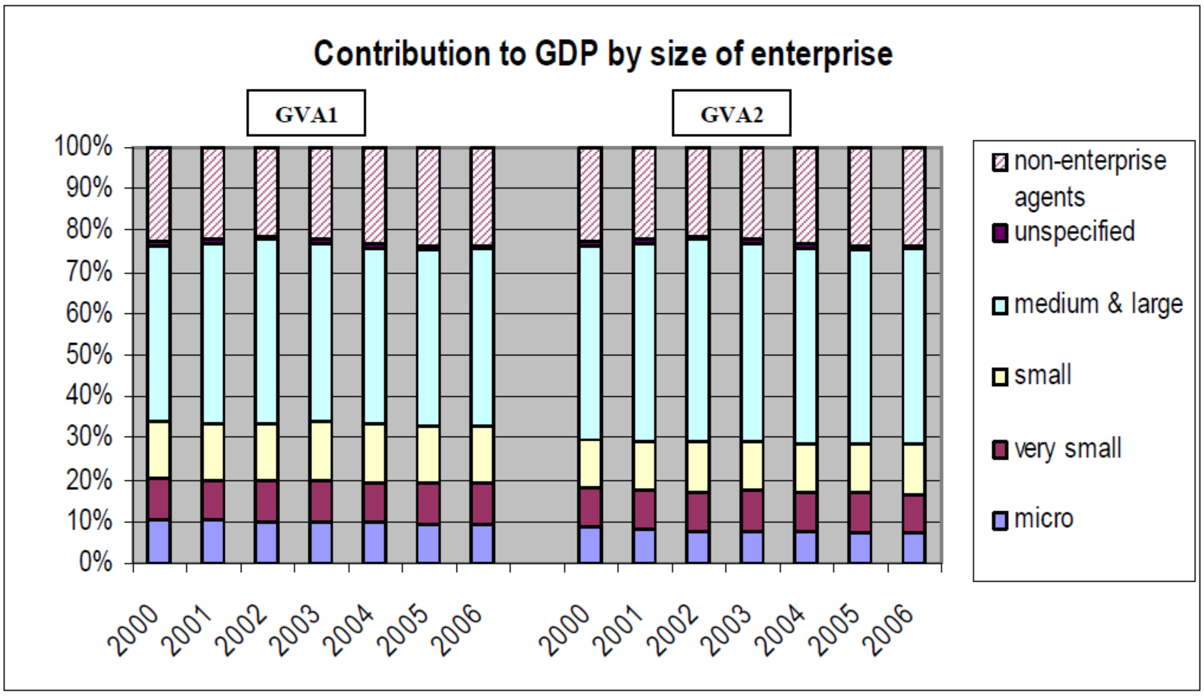
SMEs make a substantial contribution to GDP and an even greater contribution to employment. However, most SMEs are micro and survival enterprises, with little potential for growth. To illustrate this significance the consideration of the economy as a whole, under the model presented in the SEDA report (SEDA, 2007: 49) as cited in the DTI (2008: 94), for example, the gross value added generated by micro, very small and small enterprises amounted to R572 billion (assumption GVA1) or to R493 billion (assumption GVA2) in 2006, which was up from R313 billion or R274 billion in 2000. The breakdown is illustrated in Figure 1 below. Figure 2 also illustrates the percentage contribution made by the micro, very small, small and medium/large firms to GDP, from 2001-2006 in South Africa. Table 2 summarises this contribution which amounts from 27% to 34% of the countrys GDP.

Figure 1: Contribution to GDP by size of enterprise, aggregated across all industries



Source: SEDA (2007: 49) cited in the DTI (2008: 94)

Figure 2: Percentage contribution of micro, very small, small and medium/large firms to GDP, 2001-2006



Source: SEDA (2007: 49) cited in the DTI (2008: 95)

Table 2 : Percentage contribution of micro, very small, small and medium/large firms to GDP, 2006

	Enterprise size category	% of total GDP in 2006
Enterprise Sectors	Micro (A)	8 - 10 %
	Very Small (B)	9 - 11 %
	Small (C)	10 - 13 %
	Total (A/B/C)	27 - 34 %
	Medium or Large	40 - 50 %
Non enterprise sectors		21 - 24 %

Source: SEDA (2007: 12) cited in the DTI (2008: 95)

2.2.4 SME Sector and Economic Growth

Kongolo (2010: 2289) states that SMEs make a significant contribution in the transition of agriculture-led economies to industrial ones, providing opportunities for processing activities which can generate sustainable sources of revenue and enhance the development process. SMEs shore up the expansion of systematic productive capability. They help to absorb the productive resources at all levels of the economy and add to the formation of flexible economic systems in which small and large firms are interlinked. Such linkages are crucial for foreign direct investment (FDI).

SMEs are also perceived to have some socio economic benefits in comparison to their larger organisations because they can or should adapt easily to market conditions, and they can also withstand adverse economic conditions due to their flexibility in nature. They are also more labour intensive and lower costs are associated with job creation (Kongolo, 2010: 2290).

From the sections above, it can be seen that SME’s are major role players in the South African economy regarding employment and economic growth and their contribution to GDP. It is thus important for the government to ensure that it creates an enabling environment for the public to start small businesses and for the existing ones to survive, not only as survivalist businesses but rather established business ventures.

2.3 STRATEGIC PLANNING

According to Wang, Walker, and Redmond (2007: 3) strategic planning is concerned with the setting of long-term organisational goals, the development of and implementation of plans to achieve these goals, and the allocation or diversion of resources necessary for realising these goals. Bhattacharya (2009: 2) states that a basic requirement for sound strategic planning is to formulate an action plan to achieve long-term objectives of an organisation, which are derived from its mission and vision. The essence of strategic planning is to ensure that a business can gain, as efficiently as possible, a sustainable competitive advantage (Wang, Walker, and Redmond, 2007: 3).

Almond and Barlow (nd; 2) encapsulate strategic planning by referring to it simply as a management tool. Almond and Barlow further state that, as with any management tool, it is used for one purpose only: to help an organisation do a better job - to focus its energy, to ensure that members of the organisation are working toward the same goals and to assess and adjust the organization's direction in response to a changing environment. In short, strategic planning is a disciplined effort to produce fundamental decisions and actions that shape and guide what an organisation is, what it does, and why it does it, with a focus on the future.

Rhodes (nd: 1) proclaims that strategic planning is a change oriented process that allows businesses to perform a periodic reassessment of where they are and where they are going with respect to their business operations. Almani and Esfaghansary, (2011: 139) concur with Rhodes when they state that strategic planning determines the end outcomes to be achieved and strategies for accessing, allocating, and managing resources to achieve predetermined goals. it is essential to remember that strategic planning is process, not a product. Strategic planning is generally pursued as a rational undertaking to reduce the firms' performance uncertainty through trade-off decisions from controversial choices (Almani and Esfaghansary, 2011: 139).

O'Regan and Ghobadian (2002: 664) maintain that strategic planning thus implies an attempt to alter a company's strength relative to that of its competitors, in the most efficient and effective way. Strategic planning focuses on the direction of the organisation and actions necessary to improve its performance.

In general, strategic management is regarded as long-term oriented (greater than three years), directed towards future growth potentials, substantial, holistic, and predominantly associated with the highest management level which determines the vision, mission, and culture of the enterprise (Kraus, Reiche, and Reschke, 2007: 3).

2.3.1 Benefits of the Strategic Planning Process

Strategic planning plays a crucial role in any business organistion. It can make the difference between the success or failure of your business. It is important for SME owner-managers to plan carefully before investing their time and money in any business venture. Rhodes (nd: 1) together with Almani and Esfaghansary (2011: 140) further identified the following as some of the benefits of embarking on a strategic planning process:

- Think strategically and develop effective strategies;
- Action plan to respond to changes in business environment;
- Create a plan which will also provide a formal forward direction for the organisation;
- Such a plan will Aid in the decision-making process;
- Anticipate future problems and opportunitise;
- Buid teamwork and experties;
- Provide employees with clear objectives and directions for the future of the organisation and increase employee motivation and satisfaction; and
- Provide for an improvement in the overall business performance.

Even though the literature reveals that most SMEs that engage in strategic planning (compared to those that do not) are more likely to be those that succeed or achieve higher sales growth, higher returns on assets, higher margins on profit and higher employee growth, it is well recognised that strategic planning is rare or non-existent in the majority of SMEs. In practice, SMEs tend to orientate towards short-term operational rather than long-term strategic issues, and decision-making tends to be reactive rather than proactive (Wang, Walker, and Redmond, 2007).

2.3.2 Steps of the Srategic Planning Process

Many businesses that embark on strategic planning do not reap the full benefit of their robust strategic planning process. Planning is an essential part of doing business, so for those managers who claim that they do not have time for strategic planning, they will be constantly problem solving, without the support of their staff because they have not provided clear strategic direction and accountability (Parke, 2012: 44). Heather (2010: 235) states that breaking down strategic intentions into actionable components and allocating responsibility for each of the components is considered an important part of successful implementation.

Figure 3: Steps of the strategic planning process

Source: Razaian (2008) as cited by Almani and Esfaghansary (2011: 142)

2.3.2.1 Vision and Mission

According to Van der Walt, Kroon, and Fourie (2004: 206) vision and mission are two important elements in providing a strategic direction. Vision indicates the ideal direction or guiding philosophy and future position, while the mission is a vehicle to maintain the direction and achieve this position. They further state that it is important for managers to distinguish and understand the difference between these two phenomena as they imply different aspects of strategic management but complement each other.

It is important for all businesses to have a clear vision serving as a pilot to steer the business in a chosen direction. Such a vision can spawn fierce employee loyalty, high productivity, and motivation. A vision focuses a business's strategy and is the root for continued success (Shrivastavea, 1994: 1 as cited by Van der Walt, Kroon, and Fourie, 2004: 207).

According to Pearce and Robinson (2009) as cited by Almani and Esfaghansary (2011: 142) the mission of an organisation determines the future objectives and executive activities of that organisation. Therefore, the mission is a unique fundamental object which distinguishes the organisation from other similar organisations and determines its operation range in terms of product, technology, and market. Formulation of such a mission should be done in a way that the values and strategic decision makers' priorities should be reflected in it. Van der Walt, Kroon, and Fourie (2004: 207) state that the mission should stimulate individuals inside the business to act on a continuous basis. It will only have meaning if it serves as a driving force for strategic decisions.

2.3.2.2 Goal Setting (main and specific)

According to Almani and Esfaghansary (2011: 143), after formulating the mission of the organisation, the next problem is how to achieve it. At this stage, a set of clear and given goals for specific time periods must be defined in a way that achieving those goals, will result in realising the organisation's mission. Rezaian (2008), as cited by Almani and Esfaghansary (2011), further states that it is important to note that these goals are used as the basis for planning, policy making and setting performance standards and they play a vital role in the success of the organisation.

Coetsee (2003: 111) state that it is not only about setting goals, but rather how you set these goals that will have a major influence on the outcomes. Coetsee further states that effective goals depict the following preconditions:

- They must be results orientated (tie in and support the overall vision of the organisation;
- They must be understood and accepted (participation in the formation of goals);
- They must be challenging and specific (goal commitment), and
- There must be regular feedback (feedback on the achievement of goals).

2.3.2.3 Evaluating of organisational resources and environmental opportunities and threats

SMEs focus on allocation of resources to achieve their maximum short-term advantage, which often leaves them to respond to external influences as they occur rather than taking a proactive approach. Analysis of the external environment is a crucial step in strategic planning, regardless of the tools (critical success factors, what if analysis, SWOT analysis or stakeholder analysis) being utilised to analyse the the environment. The analysis of the external environment is considered an essential part of planning (Heather, 2010: 235).

Parke (2012: 45), on the other hand, states that, prior to developing a strategic plan, every organisation must take an external and internal audit or inventory of its current and future operating environment. Externally, a review of economic conditions and the competitve environment is needed to develop a meaningful plan. At the same time, internally, the organisation must be brutally honest when evaluating its strengths and weaknesses, as the inaccuracy or overstating your organisations current performance will influence the strategic plan base, thus changing your goals into “stretch goals”. The author further states that the leadership of the organisation should be wary of employees who may want to use the strategic planning process as an opportunity to rail about everything that is wrong with the organisation in their quest to fulfill their personal agendas. Hodges and Kent (2007), as cited in Heather

(2010: 235), are clear in their direction to small business owners, when stating that "if you want to be more successful, then obtain knowledge of the strategic planning process."

In Table 3 below are some of the change drivers, grouped into five categories, that the SME owner-managers should consider. It shows present and emerging issues that will have an impact on their operations. In fact, these forces also relate to the external opportunities and threats in a broad business environment that are normally considered as part of the swot analysis frequently forming a preliminary step in the strategic planning process (heather, 2010: 236).

Table 3: SME change drivers

External Opportunities and Threats:	
Technological Advances	- availability of new technology - affordability of new technology
Customer Expectations	- customer expectations of price - customer expectations for quality - changing products or services
Suppliers Requirements	- major supplier requirements
Regulatory Changes	- free trade agreement - exchange rate fluctuation - change in government regulation
Increasing Competition	- erosion of profits - increased competition in market place - export market opportunity - desire to compete globally

Source: Banham, (2005) as cited in Heather (2010: 236)

2.3.2.4 Strategy formulation

Gimbert, Bibse and Mendoza (2010: 479) describe strategy formulation as a process through which a firm defines its overall long-term direction and scope. It involves establishing the way a a company creates value through the configuration of its activities and resources in the markets in which it operates.

According to Almani and Esfaghansary (2011: 143) a fundamental principle of strategic management is that an effective organisation should attempt to align its characteristics with the challenges posed by its external environment. Parke (2012: 45-46) concurs with the above when he states that in order to maixmise the impact of strategic planning, every level of the organisation must be aligned in its priorities. In fact, vertically mapping strategic priorities across organisational levels is crucial to achieve organisational performance.

Herter (1995) as cited in French, Kelly, and Harrison (2004: 766) believes that every organisation, regardless of its size, should have a comprehensive plan because in the process of developing this plan it forces the SME owner-managers to think about the harsh realities of the business world than the more common dream world. The Herter (1995) further states that this comprehensive plan should be able to answer the old age questions such as:

- Where are you now?
- Where do you want to go? and
- How are you going to get there?

2.3.2.5 Strategy implementation

Strategy implementation refers to the process of turning strategy into action and monitoring and assessing the results (Gimbert, Bibse, and Mendoza, 2010: 479).
Strategy is more than the content of a written document, it also encompasses the processes required in the formulation and deployment of the strategic plan. Strategic planning is not just a matter of formulation and deployment, it also includes how people interpret and deploy the strategic plan. It is clear from the above that strategic planning cannot be separated from the implementation thereof. It is thus important to ensure that the strategic plan is well communicated with all relevant

stakeholders and that it is understood and accepted (O'Regan and Ghobadian, 2002: 664). Parke (2012: 47) states that lack of governance leads to a static plan and lack of accountability in terms of the actions required to execute the plan. It is also important to develop a solid communication strategy to ensure that all stakeholders understand the strategic direction of the organisation and how their individual roles fit into the bigger picture (Parke, 2012).

According to Rezaian (2008), as cited in Almani and Esfaghansary (2011: 145), the following implementation tools should be utilised:

- Organistional structure appropriate to strategies;
- Coordination of organisation's skills, resources and capabilities at the executive level;
- Creation of an organisational culture appropriate to the organisation's new strategy; and
- Cooperation and sympathy among managers and employees of all sections and units of the organisation.

2.3.2.6 Strategy evaluation

This is the stage at which the owner-managers get to evaluate the organisation's performance in comparison to the set objectives as described in stage two. This is the opportunity to review the results in comparison to the expected results. It also grants the owner-managers the opportunity to take corrective action to ensure the accuracy of performance and the operating based on plans, should there be discrepencies in comparison to the expected results (Almani and Esfaghansary, 2011).

Littler, Aisthorpe, Hudson, and Keasey (2000: 412) argue that success is very little when the strategic planning is divorced from the reality of implementation. Broady-Preston and Heyward (1998), as cited in Littler et al. (2000), further argue that the solution to bridging the gap between strategy formulation and implementation is the intergration of the conceptualisation and communication of strategy with the information systems for monitoring its achievements. It is this integration that will partially remove the distinction between top-down strategic approach and facilitate the flow of bottom up information.

In light of the above, it is therefore clear that all the strategy planning steps are critical and interdependent of one another for the strategic planning/implementation to be a success. The strategic planning process serves as a platform to facilitate communication amongst relevant stakeholders within the organisations, ensuring that all the business units are vertically aligned towards the common objective of the organisation. The planning steps also highlight the importance of evaluating the internal and external factors prior to strategy formulation, which allows managers to think about issues such as competence, capability, and resources to make the planned strategy a success.

2.3.3 Strategic Performance Measurement

Performance measurement systems (PMSs) are defined as a concise set of financial and/or non-financial matrices that support the decision-making processes of an organisation by gathering, processing and analysing quantified information about its performance and presenting it in the form of a succinct overview (Gimbert, Bibse and Mendoza, 2010).

According to Micheli and Manzoni (2010: 467), strategic planning has for a long time been a subject of several studies; however, the majority of the researchers have looked mainly at strategic performance measurement system (SPMS) as a means of strategy implementation, thus raising a fundemental question of wherther performance measurement systems (PMSs) are mere tools of implementing strategy or can they play a role in strategic reviews? They further state that SPMS is not the same as PMSs. SPMS is the subset of the PMS, which is characterised by four main attributes:

- Intergration of long term strategy and operational goals;
- Presence of multi-perspective indicators;
- Inclusion of cause-effect linkages, and
- Presence of a sequence of goals-targets-action plans.

Dossi and Patelli as cited in Micheli and Manzoni (2010), state that it is important for organisations to have a more diverse set of performance indicators that can assist the organisation to understand better the cause of poor performance and identify appropriate course of action, while not focusing soley on short-term results. The authors further point out that by having a more advanced set of non-financial indicators, PMSs could contribute more effectively to strategic alignment, organisational learning and diffusion of knowledge throughout the organisation.

Micheli and Manzoni (2010: 465), further state that strategic performance measurement (SPM) can be both functional and disfunctional for organisations. SPM can help organisations define and achieve their strategic objective, align behaviours and attitudes and, ultimately, have a positive impact on organisational performance. In a survey conducted by Gimbert, Bibse, and Mendoza (2010: 478) completed by 349 chief executive officers (CEOs) of medium and large Spanish companies, the study revealed that the SPMS are not confined to the alignment with pre-defined strategy or implementation issues, but that they also extend strategy (re)formulation issues. Ittner and Larcker (2003), as cited in Tapinos, Dyson, and Meadows (2005: 371), suggest that performance measurement is used to:

- Help direct the allocation of resources;
- Access and communicate progress towards strategic objective;
- Evaluate managerial performance;
- Helps managers to identify good performance;
- Provides means of introducing individual strategies strech targets; and
- Ensures that corporate management knows when to intervene if the business is not performing.

In addition to the above, Micheli and Manzoni (2010: 466) also suggest that the appropriate measurement and management of performance, can benefit the organisation in the following areas:

- Formulation, implementation and review of organisational strategy,
- Communiction of results achieved to stakeholders, thus strengthening culture, and reputation, and
- Motivation of employees at all levels, promotion of a performance improvement culture, and fostering of organisational learning.

In summary, strategic performance measurement allows organisations to review the implemented strategic objectives against the actual results achieved. It serves as a platform to clarify expectations and it also fosters accountability and commitment amongst business unit managers. Strategic performance measurement also forces business unit managers to formulate a business unit strategy that is aligned and in support of the overall business strategy of the organisation.

However, Micheli and Manzoni (2010: 471) criticised SPM by stating that it can promote organisational inertia and create 'ossification', that is, organisation paralysis caused by an extremely rigid SPMS. Particularly when a system is pervasive and consists of large number of indicators, organisational inertia or ossification may arise.

2.3.4 Strategic Implementation Barriers

O'Regan and Ghobadian (2002: 665) sugget that strategic deployment often fails as a result of SMEs' inability to overcome potential implementation barriers. The study of O'Regan and Ghobadian (2002) identified the following as some of the barriers or pitfalls to strategic planning:

2.3.4.1 Internal

- Communication was in adequate;
- Implementation took longer than anticipated;
- A shortfall in employee capabilities occurred;
- Overall goals of strategy not well enough understood by staff, and
- Co-ordination of of implementation not effective enough.

2.3.4.2 External

- Crises distracted attention from implementation;
- Unanticipated external problems arose;
- External factors impacted on implementation

it is vital to recognise that the motivation of the SME owner-managers are fundamental to the basic operation of their business. As a result, this motivation influences the managerial style, organisational structure, decision-making, pattern development and the level of strategic activity within the enterprise. O'Regan and Ghobadian (2002) further state that the motivation of the owner-managers for being in business will influence whether or not the business does embark on strategic planning (Wang, Walker and Redmond, 2007).

2.4 CONCLUSION

In this chapter an overview of the role that SMEs play was discussed, focusing mostly on the contributions they make with regard to employment creation, gross domestic product, as well as the contribution to economic growth in general. Secondly, strategic planning was discussed in order to get an understanding of what strategic planning is, in addition, the benefits of embarking in strategic planning were also outlined. The strategic planning process that should be followed by the SME owner-mangers in order to reap these benefits, was also discussed.

The following chapter will discuss the various capital budgeting techniques that the SME owner-managers may use to decide on which project to select for investment. The capital budgeting process will also be discussed, highlighting the link between stategic planning and the capital budgeting process.

The following chapter will discuss the the various capital budgeting techniques that can be used by SMEs to select capital projects. It will also discuss the types of potential risks, and how SMEs should evaluate the riskiness of capital projects at hand.

CHAPTER THREE

INVESTMENT DECISION-MAKING AND RISK EVALUATION FOR SMEs

3.1 INTRODUCTION

The role of a finance manager is to safeguard the shareholder's investment by ensuring that their wealth is maiximised at all times. It is part of his or her duties to decide what projects to invest in, how these projects are going to be financed and where will this funding be sourced (debt or equity)? The shareholders' wealth maximisation goal states that management should endeavour to maximise the net present value of the expected future cash flows to the shareholders of the firm (Dayananda, Richard, Harrison, Herbohn, and Rowland, 2002). According to Prather, Benco, Topuz and Romer (2008: 2) sound capital budgeting decisions are imperative for organisation's financial well-being and are among the most important decisions the SME owner-managers will have to make.

The optimal allocation of resources is part of every organisation's strategic planning. Capital budgeting is one of the tools that the SME owner-managers can utilise to ensure this optimal allocation of resources. Brigham (2003: 1) points out that the allocation of capital is as important in small firms as it is in large ones. Brigham further reiterates that, in fact, this allocation could be even more important in smaller organisations than it is in big businesses due to the small businesse's lack of access to capital markets. Big businesses on the other hand, can allocate capital to numerous projects, which allows them to offset the mistakes of one project by the success of another project. Small businesses do not have this luxury due to their limited financial resources. It is thus imperative for SME owner-mangers to ensure that they allocate resources to projects that will yield the required return on investment at the right time.

SMEs are usually cash strapped and as a result, the SME owner-managers are not keen on long-term analysis or project evaluation techniques. As a result most SMEs rely on the use of the payback method which assures the owner-managers that the money invested in a specified project will be recouped within a short space of time therefore allowing them to invest in other opportunities or projects (Brigham, 2003).

This chapter will review the literature, which covers the question, ‘How can capital budgeting improve the perfromance of smes?’ by firstly, establishing the history/background of capital budgeting, secondly, establishing whether capital budgeting is relevant to smes, and, thirdly, what the appropriate capital budgeting techniques for the smes are.

3.2 CAPITAL BUDGETING

Garrison, Noreen and Brewer (2008: 652) refer to capital budgeting as the process of planning significant investment in projects that have long-term implications, such as the purchase of new equipment or the introduction of a new product.

Gitman (2009:380) defines capital budgeting as the process of evaluating and selecting long-term investments that are consistent with the firm’s goal of maximising shareholder’s wealth.

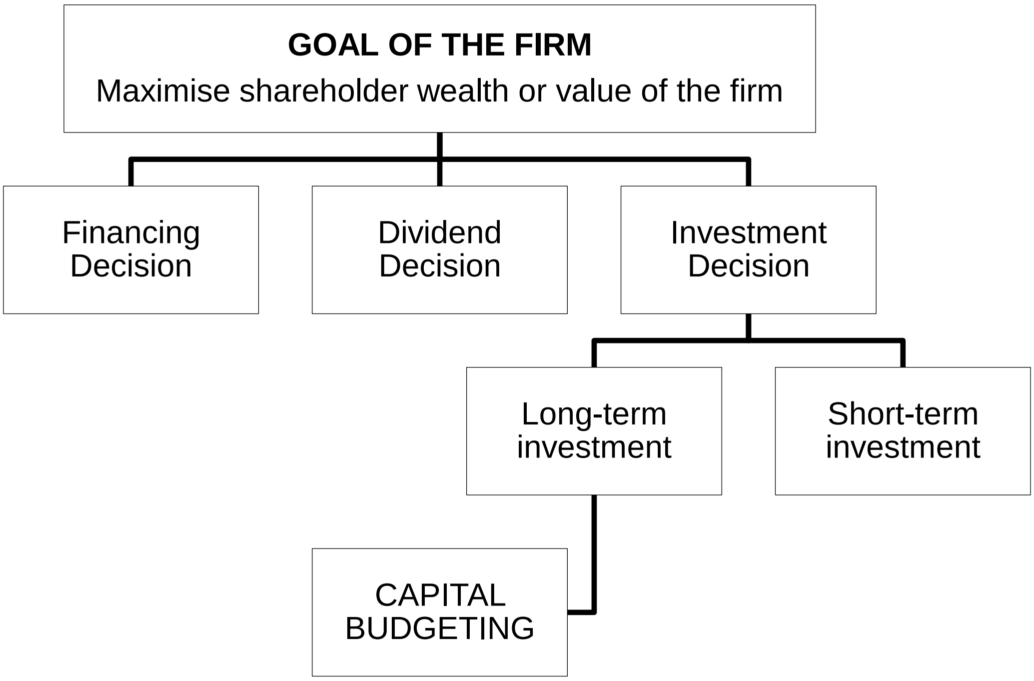
It is clear from the definitions that capital budgeting is not only about the optimal allocation of funds to any projects with positive net present values, but rather to those projects that will enhance the overall business strategy of the organisation in the future.

Garrison, Noreen and Brewer (2008: 626) further point out that how well the mangers make these investment decisions will be critical for the long-term profitability of the organisation. The following are some of the typical capital budgeting decisions that the managers will have to make:

- *Cost reduction decision*: these are decision that interrogate whether should new equipment should be purchased to reduce costs;
- *Expansion decision*: these are the decisions that have to be made in order to increase capacity; for example should a new plant/production be acquired in order to increase sales?
- *Equipment selection decision*: these are decisions that involve choosing one project that has a positive net present value;

- *Lease or buy decision*: these are decisions that are pertaining to whether should the machinery be purchased or leased, and
- *Equipment replacement decision*: Should the equipment be replaced now or later?

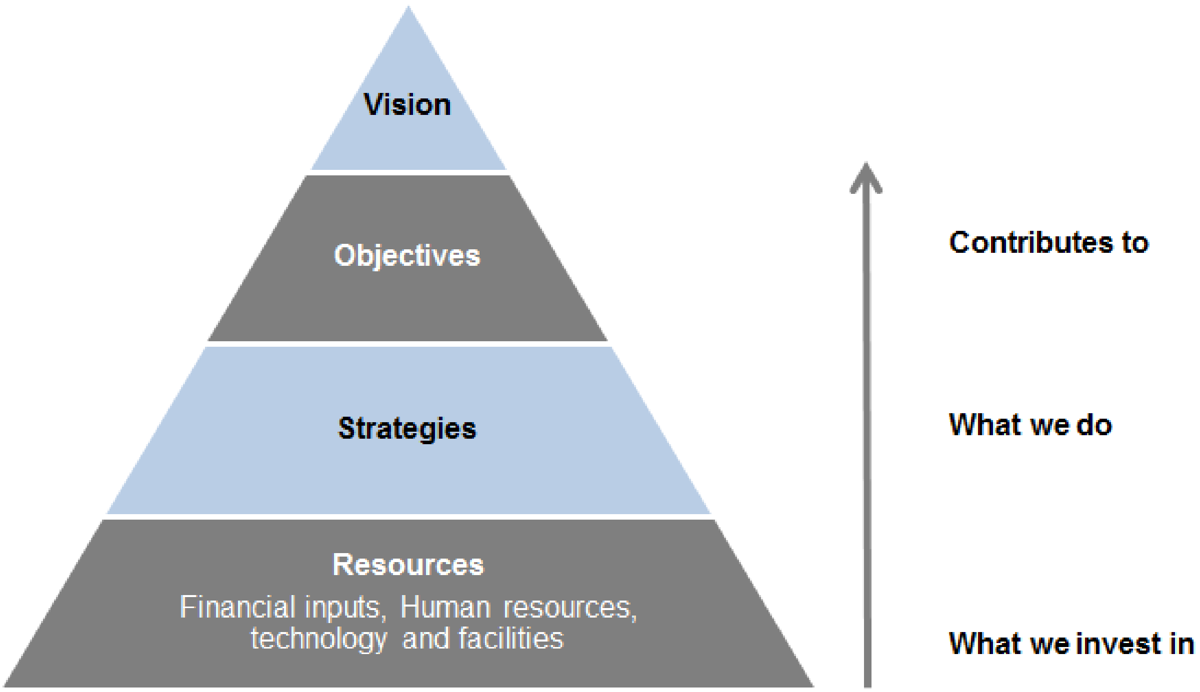
Figure 4: Corporate goal, financial management and capital budgeting



Source: Dayananda et al. (2002: 2)

Figure 4 above illustrates how capital budgeting fits with the overall strategic objective of the organisation. It clearly shows that the firm's decision to invest today will influence it strategic positioning tomorrow. Hence, these investments have a considerable impact on the organisation's future cash flows and the risk associated with those cash flows. It is therefore clear that for any organisation to succeed or to achieve its strategic objectives, it has to invest in projects that assist or support the overall strategic objective of the organisation. Capital budgeting decisions thus, have a long-range impact on the firm's performance and they are critical to the firms success or failure (Dayananda et al., 2010).

Figure 5: Results-based budgeting

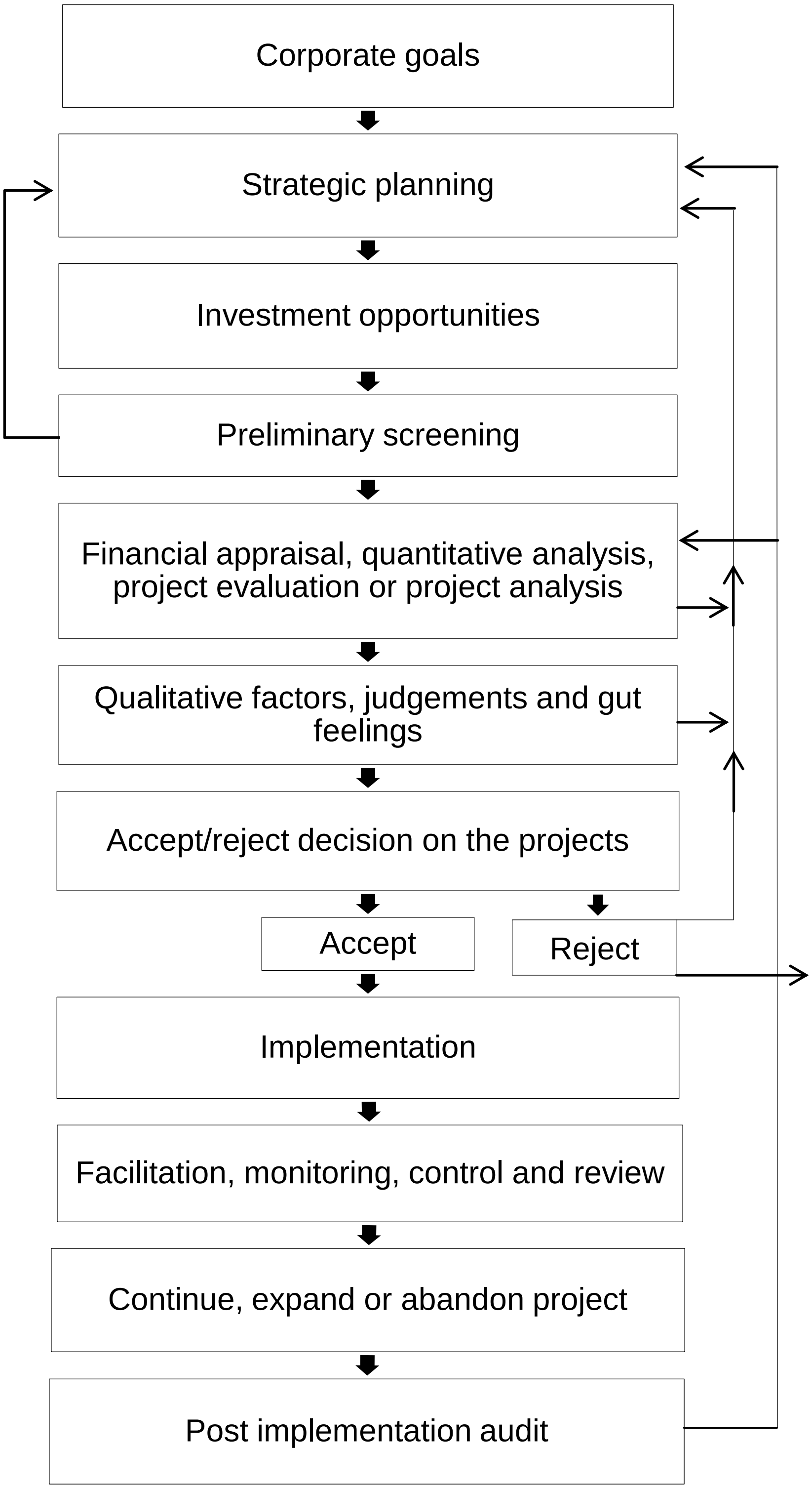


Source: KPMG (2011: 5)

This notion of investing in projects that are vertically aligned or that are in support of the overall business strategy is well incorporated by KPMG's results-based budgeting diagram in Figure 5. The diagram illustrates that for any business to succeed, the allocation of resources should be linked to objectives that are aligned or in support of the vision of the organisation. It further points out that the key performance indicators should also be linked to the set objectives in order to stimulate the performance of the orgnanisation (KPMG, 2011).

3.3 CAPITAL BUDGETING PROCESS

Figure 6: The Capital Budgeting Process



Source: Dayananda et al., (2002: 2)

According to Uddin and Zakir (2009: 113), the capital budgeting of a small business is likely to be different from that of a large organisation. Uddin and Zakir further point out that the following are some of the reasons that result in these differences;

- Size and the availability of capital;
- Investment opportunities, and
- The nature of decision makers being different for small businesses may partially explain this difference.

Figure 6 above illustrate a typical capital planning process of a large organisation; however, it is possible that this process may not applicable or used by most SMEs. It is meant to clarify the process and the factors that should be considered by SME owner-managers when evaluating a project.

Danielson and Scott (2006: 46) state that several reasons could lead to small firms using different criteria to evaluate projects compared to the large organisations. The following are some of the reasons highlighted:

- The shareholder's wealth maximisation theory, presumes capital budgeting could be the objective of every organisation could be offset by the owner-manager's objectives, such as maintaining the independence of the organisation
- The lack of expertise and personnel resources as compared to larger organisations could also be contributing to the non usage of capital budgeting process or techniques
- Small business owner-managers are more concerned with the liquidity of the organisation than long-term investmet due to the capital constraints.

Below are the capital budgeting process steps, as suggested by Dayananda et al.

3.3.1 Strategic Planning

According Peel and Bridge (1998: 852), a key aspect of strategic (long-range) planning, as opposed to operational (short-term) planning, relates to capital investments. After the SME corporate objectives have already been set, the second step would be strategic planning. In chapter two, strategic planning was described as a roadmap that seeks to address the following questions; where the organisation is, where it wants to go, and how it will or intends to get there? Strategic planning translates the firm's corporate goal into specific policies and directions, sets priorities, specifies the structural, strategic and tactical areas of business development, and guides the planning process in the pursuit of solid objectives. A firm's vision and mission is encapsulated in its strategic planning framework. This is the step which the organisation keeps on revisiting should there be some loops at the different stages of the project and communication is very critical in order to ensure that the business project becomes a success. It is also meant to evaluating if there is a need to change the strategic direction of the business if or when the need arises (Dayananda et al., 2002).

3.3.2 Identification of Investment Opportunities

Peel and Bridge (1998: 852) emphasise the importance of the analysis of investment opportunities, together with the use of financial models, in the strategic planning process. This notion is also shared by Dayananda et al. (2002) when they point out that the identification of investment opportunities and generation of investment project proposals is an important step in the capital budgeting process. This step may be even more critical for SMEs as they normally have capital constraints which means they have to identify projects that are aligned to the vision, mission and overall strategic plan of the organisation. This therefore suggests that project proposals can not be divorced from the strategic planning of the organisation. However, if an excellent investment opportunity presents itself the corporate vision and strategy may be altered to accommodate it. Consequently, these two stateges of the capital budgeting process have to talk to one another to ensure that this synergy is realised by the organisation (Dayananda et al., 2002).

Dayananda et al. (2002: 2) also point out that It is important to realise that some investments are *mandatory* – for instance, those investments required to satisfy particular regulatory, health and safety requirements – and they are vital for the firm to remain in business, which means that these are the types of projects that the organisation has to invest in for compliance. Such investments do not necessarily have to be in support of the the strategic objective of the organisation. Other investments are *discretionary* and are generated by growth opportunities, competition, cost reduction opportunities and so on. Unlike the mandatory projects, discretionery projects normally represent the strategic plan of the business firm and, in turn, these investments can set new directions for the firm's strategic plan. These discretionary investments form the basis of the business of the corporation and, therefore, the capital budgeting process above is viewed mainly with these discretionary investments in mind.

3.3.3 Preliminary Screening of Projects

This is the step that is most likely not happening in the SME sector, mainly because the SME owner-managers most likely to use a 'gut feel' when selecting their projects. However, this could be a very critical stage of the capital budgeting process as it is the stage at which the projects that may be financially unsound, should be isolated. In larger organisations the identified investment opportunities have to be subjected to a preliminary screening process by management to isolate the marginal and unsound proposals, because it is not worth spending resources to thoroughly evaluate such proposals. The preliminary screening may involve some preliminary quantitative analysis and judgements based on intuitive feelings and experience of the project coordinators or managers (Dayananda et al., 2002).

3.3.4 Financial Appraisal of Projects

This is the step at which the project proposal is put through a rigorous financial appraisal process to ascertain that it will be value adding to the organisation, in line with the shareholder's wealth maximisation theory. This stage is also called quantitative analysis, economic and financial appraisal, project evaluation, or simply project analysis.

At this stage the project's expected future cash flows are put under scrutiny to evaluate the risk associated with such cash flows. Different scenarios may also be drawn to simulate the sensitivity of such cash flows to factors such as micro and macro economic indicators. This would then assist the project coordinator or manager to check how resistant the project would be under stressfull economic conditions.

Dayananda et al. (2002) further point out that as a result, the project analysis can involve various techniques such as; the application of forecasting techniques, project evaluation techniques, risk analysis and mathematical programming techniques such as linear programming. Dayananda et al., (2002) also suggest that while the basic concepts, principles and techniques of project evaluation are the same for different projects, their application to particular types of projects requires special knowledge and expertise depending on the capital budgeting decision that has been taken. For example, asset expansion projects, asset replacement projects, and the industry specific projects such as water and forestry have their own special features and uniqueness.

This is the stage at which the estimated value addition of the project to the firms is provided through the discounted cash flow or the net present value of the project at hand. Thus, it is critical to open the channel of communication between the financial appraisal stage and the strategic planning to ensure that the identified projects for the strategic positioning of the organisation are not yielding negative net present values as this may suggest that the organisation will have to revisit or alter its strategic plan (Dayananda et al., 2002).

3.3.5 Qualitative Factors in Project Evaluation

Dayananda et al., (2002) state that when a project passes through the quantitative analysis test, it has to be further evaluated taking into consideration qualitative factors. Qualitative factors are those that do not have a direct impact on the project, but are still very important to consider before giving the project a green light . The authors further point out that these factors are fundamentally difficult to measure accurately in monetary terms. The following are some of the factors to consider:

- The societal impact of an increase or decrease in employee numbers;
- The environmental impact of the project;
- Possible positive or negative governmental political attitudes towards the project;
- The strategic consequences of consumption of scarce raw materials;

- Positive or negative relationships with labour unions about the project;
- Possible legal difficulties with respect to the use of patents, copyrights and trade or brand names,and
- Impact on the firm's image if the project is socially questionable.

It is important for SME owner-managers to note that not all the factors listed above do have a direct effect on the value of the firm, while some do. However, some of the factors are matters that relate to the corporate social responsibility of the organisation and being a good corporate citizen. These are factors that can be addressed at the project analysis stage, However, these processes could be lengthy, and their outcomes unpredictable. It is thus important to consult all the relevant stakeholders to address all issues that might be of concern to them regarding the project at hand. For example, the project could be perceived to be threatning some jobs if it is believed to be too capital intensive.

Some of the factors could be relating to the impact the project may have on nature conservation and as a result the environmentalists could be concerned about the different indegenous species that could possibly be only found on the site where the project would be built. In some cases, however, those qualitative factors which affect the project benefits may have such a negative bearing on the project that an otherwise viable project will have to be abandoned. As a result the consultation with different stakeholders such as trade unions and environmentalists could be a solution, or could metigate the potential strikes and other challenges (Dayananda et al., 2002).

3.3.6 The Accept/Reject Decision

At this stage the SME owner-managers or the project coordinator would have consider the vaibility of the project(s) based on their net present value results from the quantitative analysis combined with qualitative factors as the basis of their decision support information. It is based on this information that management will make a major decision of whether to accept or reject the proposed investment project (Dayananda, et al., 2002).

3.3.7 Project Implementation and Monitoring

At this stage, once SME owner-managers accept the project proposal, the next step would be implementation and monitoring. This is the stage at which various departments of the organisation will have to work together to ensure the smooth implementation of the project. An integral part of project implementation is the constant monitoring of project progress with a view to identifying potential bottlenecks, thus allowing early intervention (Dayananda et al., 2002).

According to the Internationa federation of Red Cross Crescent Societies (2011) this is the step that deals with the collection and analysis of information to track progress of project against the set plans and check complaince to established standards. There are various forms of monitoring; results monitoring, process monitoring, compliance monitoring, context monitoring, beneficiary monitoring, financial monitoring and organisational monitoring. In the context of SMEs compliance and financial monitoring are most likely to be the most important due to limited access to financing and to monitor deviations from the estimated cash flows and to take corrective action.

3.3.8 Post-implementation Audit

Unlike the project monitoring that pursues to address problems as and when they occur during the implementation stage of the process, the post-implementation audit deals with a post-mortem of the performance of already implemented projects. It evaluates the performance of past decisions, it seeks to improve the current investment decision-making of SMEs by analysing the past ‘rights’ and ‘wrongs’ (Dayananda, et al., 2002). The post-implementation audit can also assist the SMEs by providing the following:

- It helps improve the forecasting accuracy by highlighting the deficiencies of the previous cash flow forecast;
- It helps in the establishment a new strategic plan, and
- It provides seful feedback to project appraisal or strategy formulation.

3.4 CAPITAL BUDGETING TECHNIQUES

Prathe et al. (2008: 2) acknowledge that it is important for small business owner-managers and or decision makers to understand how to evaluate projects correctly in order to establish which projects to accept and which ones to reject. The section below will discuss the various capital budgeting techniques that can assist SME owner-managers to decide which project(s) will add more value to the organisation, Each technique will be scrutinised to evaluate the benefits and shortcomings of utilising such a technique.

According to Peel and Bridge (1998: 852), there are various standard capital budgeting techniques available to assist SME owner-managers reach investment decisions. These techniques can be categorised as follows; traditional budgeting techniques such as, the payback method and the average accounting rate of return method, the other techniques are categorised under a more sophisticated capital budgeting techniques that take into account the time value of money through the discounted cash flows (DFC). These techniques include; net present value, and internal rate of return. In terms of maximising the value of the firm (or owners' wealth), which is the assumed objective of the firm in the finance literature, DCF techniques have been demonstrated to be superior to the less technical traditional methods

Based on the above, capital budgeting evaluation techniques can,then, be categorised into two groups, namely sophisticated techniques and unsophisticated techniques. Both techniques use cash flows as their starting point in order to get to the result from which a final decision can be taken.

3.4.1 Payback Period

According to Steven (2012: 1), the payback method is the simplest appraisal method. It focuses on the length of time it will take the project to recoup its initial investment from the cash inflows it receives, but does not take into account the cash inflow occuring after that period. Garrison, Noreen, and Brewer (2008: 643) point out that payback method is not the true mesure of the profitability of an investment. Rather, it simply tells the SME owner-managers how many years are required to recover the original investment. They further point out that, unfortunately a shorter payback period does not necessarily mean that one investment is more desirable than the other.

Garrison, Noreen, and Brewer (2008: 642) further state that when the annual cash inflow of a project is the same every year, the following formula can be used to compute the payback period:

Equation 1: Payback Period

$$\text{Payback period} = \frac{\text{Investment required}}{\text{Net annual cash inflow}}$$

There are various reasons why the payback method is the mostly prefered and most frequently used capital budgeting technique. The following are some of the advantages and disadvantages of using this technique:

<u>Advantages</u>

- Small business owners rely on payback period for their capital budgeting decisions because the principles underlying it are easily understood;
- The payback period shows the small business owner how long it will take him to payback his/her investment in the project;
- This concept is more meaningful to a small business owner than the other methods, particularly because of the interest in the liquidity of the firm, rather than the return on investment, and
- Because cash flows in the distant future are inherently risky, a shorter payback period implies that a project is less risky.

<u>Disadvantages</u>

- The payback method ignores those cashflows beyond the payback period, and ignores the time value of money;
- The payback period cannot evaluate mutually exclusive products;
- The payback method is short-term in nature, and may be tied to the compensation of the managers. Small businesses typically do not engage in

long-term planning, and as such are not as concerned with long-range capital budgeting techniques, and

- The payback method ignores the time value of money.

3.4.2 Accounting Rate of Return

Drury (2000: 474) points out that the accounting rate of return is also referd to as return on investment (ROI) and return of capital employed. Unlike the other capital budgeting techniques, the average accounting rate of return is calculated using profits rather than cash flows.

Advantages

Drury (2000: 475) further points out that the average accounting rate of return is more superior than the pay back method as it allows for the differences of the projects being compared.

Disadvantage

- Like the payback method, one of the shortcomings of the accounting rate of return is that it ignores the time value of money, and
- In instances where the method is used to evaluate projects where the cash inflows do not occur until the near end of its life time, it will show the same rate of return as it would for the project with the cash inflows that occur early in its project life, provided that the average cash inflows are the same.

Equation 2: Accounting rate of return

$$\text{Accounting Rate of return} = \frac{\text{Average Annual profits}}{\text{Average Investment}}$$

Decision Rule

Accept the project with a higher accounting rate of return or a higher return on investment.

3.4.3 Net Present Value

According to Garrison, Noreen, and Brewer (2008: 627) and Gitman (2009), under the net present value (NPV), the project's cash inflows are discounted and compared to the present value of the project's cash out flows using the required rate of return. The difference between these cash flows is refered to as the NPV. The project with the highest positive NPV should be accepted or chosen over the other projects.

<u>Decision Rule</u>

The principle of NPV is that you accept projects that are yielding positive NPV and reject those that are have a negative NPV. The NPV also assumes that whenever the project's NPV is positive, the project will most likely be able to recoup its initial investment.

The formula below illustrates how the net present value formula is computed; it also futher describes all the elements of the formula for clarity.

Equation 3: Net present value

$$\mathrm{NPV} = \sum_{t=0}^{N} \frac{C_t}{(1+r)^t}$$

t = the time of the cash flow

N = the total time of the project

r = the discount rate (the rate of return that could be earned on an investment in the financial markets with similar risk)

Ct = the net cash flow (the amount of cash) at the time

*C*0 is commonly placed to the left of the sum to emphasise its role as the initial investment.

3.4.4 Profitability Index (PI)

According Drury (2000: 470), the profitability index (PI) is the third capital budgeting technique that takes into account the time value of money. This method is consistent with the net present value method since the PI can only be accepted when it is greater than one which is inline with the requirements of a net present value of a positive net present value for a project to be accepted. Inversely if the PI is less than one, then that project has to be rejected which is also in line with the requirements of the NPV which state that all projects with a negative present value, should be rejected.

Equation 4: Profitability Index

$$\text{Profitability Index} = \frac{\text{PV of future cash flows}}{\text{PV of initial investment}}$$

<u>Decision Rule</u>

According to Drury (2000: 470), the principle of profitability index is that, if the profitability index is less than one, the investment should be rejected. On the other hand, if the profitability index is greater than one, the investment should be accepted:

- If projects are independent, accept if the project PI > 1;
- If projects are mutually exclusive, accept projects with the highest PI greater than 1 - those that add the most value.

However, Drury (2000: 470) further points out that the PI is deemed week as a measure of mutually exclusive investment projects because the decision is based on the absulute number, for example; table 4 illustrates that, according to PI, project C is to be preferred; however, given that only one project can be chosen, project D would be chosen because it offers the highest absulute NPV.

Table 4: Profitability index and mutually exclusive projects

	PV of Cash flow R	Initial Investment Outlay R	Profitability Index
Project C	100 000.00	50 000.00	2.0
Project D	180 000.00	100 000.00	1.8

3.4.5 Internal Rate of Return (IRR)

Garrison, Noreen, and Brewer (2008: 633) refer to the internal rate of return as the rate of return promised by an investment project over its useful life. It is the rate at which the present value of the net cash inflows, including the initial investment, are equal to zero. The internal rate of return represents the interest rate that the project will yield over its useful life. Gitman (2009: 431) states that although the internal rate of return is more complicated and difficult to calculate than the net present value, it is still the most widely used sophisticated capital budgeting technique. Howver, this technique could prove to be too complicated for small business owner-mangers without any accounting or financial background.

Equation 5: Internal Rate of Return

$$NPV = CF_0 + \frac{\hat{CF_1}}{(1+IRR)^1} + \frac{\hat{CF_2}}{(1+IRR)^2} + \cdots + \frac{\hat{CF_n}}{(1+IRR)^n} = 0$$

$$CF_0 = \frac{\hat{CF_1}}{(1+IRR)^1} + \frac{\hat{CF_2}}{(1+IRR)^2} + \cdots + \frac{\hat{CF_n}}{(1+IRR)^n}$$

<u>Decision Rule</u>

- Drury (2000: 463) states that the decision rule of the IRR is that, if the IRR is greater than the opportunity cost of capital, the investment is profitable and will yield a positive NPV. If the IRR is less that the cost of capital, the investment is unprofitable and will result in a negative NPV.

Advantages

- It takes into account the time value of money, and
- It is easy to understand, in a sense that it promises a straight forward rate over the useful life of a project.

Disadvantages

- It often provides unrealistic rates and assumes that the money earned from a potential investment will be reinvested at the project's IRR. However, this assumption is often not the case in reality, particularly if a project has a high potential return;
- It is possible to calculate multiple rates of return for a project if it has irregular or unusual cash flows, which is an element that raises doubt about the validity of the rates, and it creates confusion about which rate to choose;
- IRR produces a different recommendation from that of other discounted cash flow techniques; for example the project that could be rejected through the NPV could be the project that is accepted through the IRR. This is an element that creates confusion about which should be accepted or trusted;
- IRR does not always evaluate mutually exclusive projects correctly, as it calculates a reletive return and not an absolute return, and
- The internal rate of return can be very difficult to calculate, which requires trial and error by using multiple discount rates until the NPV equals zero.

3.4.6 Why SMEs are not using Capital Budgeting Techniques

Though it is clear that capital budgeting is critical to helping SME owner-mangers to make informed investment decisions, many SME owner-mangers do seem to be utilising this technique. Brigham (2003: 1) points out that the following could be the reasons why SMEs do not utilise the developed techniques to assist them in the investment decisions:

- *Lack of training:* is cited as one of the main reasons that leads to SME owner-managers opting to use the back of an envelope instead of the sophisticated capital budgeting techniques. This argument suggest that SME owner-managers would use more sophisticated capital budgeting techniques if they undersntood them better;

- *Management talent is a scarce resource in SMEs*: this means that even if the SME owner-mangers were exceptionally sophisticated, perhaps demands on them are such that they simply would not have the time to use the elaborative techniques to analyse the proposed projects. This argument suggests that SME owner-mangers could be capable of doing the full discounted cashflow analysis. However, it would be irrational for them to allocate the time required for such analysis, and
- *A third argument relates to the costs of analysing the capital projects:* to some extent the costs are fixed, which means that sometimes the cost of analysis could be larger than the cost of the project itself. It thus may not be economical if this costs are indeed fixed to incur them if the project itself is smaller.

Brigham (2003: 1) further points out that in large organisations the capital budgeting process involves lower level analysts marshalling facts needed by higher level decision makers. On the other hand the small businesses may appear to be utilising a snap judgement; however, if the snap judgement is done by someone with a total knowledge of the firm and its markets, it could yield better decisions than those based on the analysis of a lower employee. This argument suggests that SME owner-managers are in a better position to evaluate the projects at hand due to their hands-on approach and the better understanding of the industry and the market.

3.5 RISK

According to Warszawski, Asce, and Sacks (2004: 357), risk implies the occurrence of an undesirable result (that may lead to a loss). It is the chance or probability that an adverse event occurs during a stated period of time.

3.5.1 Types of Risks

Market Risk

This is the risk that entails the possibility that the value of an investment will decrease due to movement of the market risk factors. These are factors such as interest rates, stock indices, commodity prices, foreign exchange rates, real estate indices, and son. This type of risk could affect the SMEs particularly, if the investment is financed with debt, as this would mean that the interest portion of the loan would fluctuate depending on the interest rate (Embrechts, Furrer and Roger, 2006).

Project/Industry Specific Risk

This is a type of risk that could be attributable solely to the project at hand, whilst the industry specific risk is an idustry related type of risk (Peterson and Fabozzi, 2002).

Competitive Risk

This is the type of risk that is concerned with the probability of loss due to the firms decline in competitiveness.

Stand-Alone Risk

This is the type of risk that relates to the variability of the SME’s assets.

Corporate Risk

The corporate project risk within a firm would be influenced by the firms desire to diversify its assets. In other words in an instance where the organisation is or will be looking to invest in projects that may lead to new markets, this could trigger some level of corporate risk (Peterson and Fabozzi, 2002).

International Risk

This is the risk that is related to the international market expansion. However, in the context of SMEs, if this capital investment is done locally solely to serve the international market, it will expose the organisation to this type of risk as the economic and political influences of those markets will have an influence on the cash inflows of the projects (Peterson and Fabozzi, 2002).

3.5.2 How to evaluate the Project Risk

It is important for businesses to be able to identify any foreseeable risk and mitigate it rather than being reactive. This notion is shared by Garrison, Noreen, and Brewer (2008: 27). In the context of investment decisions, evaluating the project risk is even more important for SMEs in order to minimise any possibilities that could hinder the proposed project from achieving its forecasted cash inflows. Drury (2000: 419) points out that the perception and the course of action to be taken with regard to whether company should be engaged in risky projects, depends on the decision maker's attitude towards risk. The following are some of the various attitudes that will or may influence the decision maker's behaviour towards desicion making;

- Risk seeker: there are people who prefer the riskier alternatives;
- Risk averter: these are the people who are a bit more cautious towards risk, and
- Neutral: These are people would choose either/or.

Warszawski, Asce and Sacks (2004) point out that, the larger the scale and the complexity of the project, the greater the impact of risk, as the degree of uncertainity and severity are harder to assess.

The issue with risk management is that there is no 'one size fits all' to the possible problems that may arise. The risk factor is usually associated with the project at hand, the macro and micro economic indicators at the time. The sources and the consequences of risk keep on evolving and changing over the project development life cycle. However, monitoring, assessing and controlling the risk would always be better than not having any plan at all, particularly for the SMEs that are normaly cash strapped (Kujawski and Angelis, 2010). It is thus important that the SME owner-managers ask and answer at least the following three questions when assessing the riskiness of the project:

- What can go wrong?
- What are the associated likelihoods?
- What are the consequences?

These question will or should help the SME owner-manager to address and control the following three questions;

- What can be done and what are the options?
- What are the tradeoffs in terms of cost, benefits and risk?
- What are the impacts of future decisions on future options?

The following analysis could assist in answering the above questions:

Sensitivity Analysis:

It is a measure that is used to evaluate the riskiness of the project at hand by assessing the impact of the different variables on the return on investment. This is done by analysing the impact of the changes in the critical variables such as the selling prices, forecasted sales volumes and/or the expected material cost, on the profitability or the expected net cash inflows of the project (Online degree support, 2012).

Scenario Analysis:

It is a measure which is used to analyse and evalute the combined effect of different scenarios on the potential returns of the investment project. It takes into account the interrelation of the different variables as a basis of each scenario. Thus, the scenario analysis assists the decision makers in analysing the risk associated with different scenarios and therefore considers the different scenarios and their significance when making an investment decision (Online degree support, 2012).

Simulation Analysis:

The more the factors that are uncertain about the product, the more difficult or unmanageable it is for the project managers. Thus a simulations method would be recommended. A simulation method is a method that will allow the SME owner-managers to develop possible outcomes taking into account the the probability of each variable (Peterson and Fabozzi, 2002).

Break-even Analysis:

These are is the units of production that the company should produce in order for cost to equal income. It is the point at which the company is neither making profit nor loss (Drury, (2000); Garrison, Noreen and Brewer (2008); Gitman (2009)).

In the context of investment decision or risk evaluation, break-even can be used as a form of evaluting the riskiness of making investments in the sense that, it will reflect how the plant plant increase its production in order to cover the costs of this investment. This will, of course, be influenced by the other factors such as the financing structure of the organisation. If the company is financing its assets more by debt than equity, it would be required to increase its break-even units in order to cover the interest portion of the loan.

3.6 CONCLUSION

In this chapter, an overview of the literature was given on investment decisions of SMEs. The general investment decision process was also provided:

The capital budgeting process that the SME owner-mangers should follow when undertaking the capital expenditure or investment project(s) was discussed. The various steps of the capital budgeting process were also discussed with the clear expected outcome at each step or level.

Secondly, the various capital budgeting techniques that can assist the SME owner-managers when deciding on which investment decision to prefer, were also discussed.

The risk factors or element of the capital budgeting process were also discussed to ensure that SME owner-mangers are aware of the risk associated with each respective project they embark on and thus take the necessary steps to mitigate such possible risks.

The following chapter discusses the methodology used to carryout this research paper.

CHAPTER FOUR

RESEARCH METHODOLOGY

4.1 INTRODUCTION

The primary objective of this research is to establish how a strategic planning process can be used as an investment decision-making tool for manufacturing smes in the Nelson Mandela Metropole. In order to address this research problem, the following sub-problems will need to be solved:

i. What strategic planning processes do current SME managers use?
ii. What strategic performance measurement systems do SME owner-managers currently use?
iii. What capital budgeting techniques are currently being used by SME's in the region?
iv. How do SME owner-managers evaluate the risk of the projects at hand?

In chapter two the literature was presented in order to ensure a better understanding of the strategic planning process, the current state of SMEs in the country, the contributions they make and or the role they play in order to emphasise the importance of this sector. Following on chapter two, in chapter three the capital budgeting process was discussed and the various capital budgeting techniques that could be used to assist SME owner-managers when deciding on which projects to invest in as well as the factors to consider when evaluating the riskiness of the projects.

This chapter will focus on the following: firstly, an explanation of the research paradigm that was used in order to conduct this research is given, and secondly, the research methodology and the structure of the research instrument used are discussed.

4.2 RESEARCH PARADIGMS

The perception, the philosophy and the nature of knowledge that people have about how they should conduct research is referred to as the research paradigm. A paradigm is a universally acceptable way of providing solutions to the problems that people seek to resolve (Collis and Hussey, 2003).

The concept of a paradigm is one of the most misused terms and it means different things to different people; for example:

- At the Philosophical level, it is used to reflect basic beliefs about the world view;
- At the Social level, is used to provide guidance as to how the researcher should go about conducting his or her endeavours, and
- At the Technical level, it is used to describe a method that should be used when conducting research.

4.2.1 **Positivistic Paradigm**

This paradigm argues that there is a reality "out there" in the world that exists irrespective of people. This paradigm is founded on the basis that it is possible for the researcher to separate themselves from the research project (Collis and Hussey, 2003). This is the notion that is supported by Cheng (2010) who states that, to positivists, reality is objective, and people can accurately describe or explain this objective reality by conducting value-free research. It is furthermore indicated that if strict methodological protocol is followed, research will be free of subjective bias and objectivity will be achieved. As a result, true knowledge gained from data can be verified between independent observers.

This paradigm argues that the facts about reality exist regardless of the human existence and therefore if the "cause and effects" are well understood, they can be manipulated and controlled by influencing the variables that lead to the desired outcomes (Collis and Hussey, 2003). Alvesson and Skoldberg, (2009) explains that for positivism, all knowledge comes to us in single-sense data, and theories are just human-made linkages between these single data bundles. Leong (2008: 343) concurs with Collis and Hussey when stating that the positivist paradigm asserts that real events can be observed empirically and explained with logical analysis. The criterion for evaluating the validity of a scientific theory is whether our knowledge claims (that is, theory-based predictions) are consistent with the information we are able to obtain using our senses.

It can therefore be summarised that this approach relies heavily on experimental and manipulative methods that enforces a gap to exist between the bias perception of the researcher and the true reality of the study. The paradigm is normally associated with quantitative methods which generally involve hypothesis generation and testing.

4.2.2 **Phenomenological Paradigm**

The phenomenological paradigm argues that it is impossible to separate the interrelationship of the researcher from the research project. It further states that there is no reality that is independent from the mind (Collis and Hussey 2003). Some of the criticisms of the positivistic paradigm by those who are in favour of the phenomenological paradigm are follows:

- It is impossible to separate people or researcher(s) from the research project, as researchers are not objective but part of the research project;
- A highly structured paradigm may ignore certain relevant information due to the constraints it imposes, and
- Capturing a complex phenomenon in a single value can be very misleading.

The phenomenological paradigm is otherwise known as qualitative research. It is concerned with the understanding of the human behaviour base of the researcher's point of view or frame of mind. It can be described as: qualitative, subjectivist, humanistic and interpretivist. The outcomes of this approach are normally based on the meaning, rather than the frequency of the outcomes, thus making them prone to bias (Collis and Hussey, 2003).

Phenomenological paradigms include the following methodologies:

- Action Research is an approach which assumes that the social world is constantly changing and the researcher and research itself are part of the change;
- Case Studies are an extensive examination of a single instance of a phenomenon of interest;
- Ethnography stems from anthropology which is a study of people especially of their society and customs;
- Feminist perspective is about change for women and parity with men in society;
- Grounded Theory is used to describe the world of the person/s under study;
- Hermeneutics involves paying particular attention to the historical and social context surrounding an action when interpreting a text, and
- Participative Enquiry – this methodology is about research with people rather than on people (Collis and Hussey, 2003).

4.2.3 **Paradigm of study**

Collis and Hussey (2003: 78) state that the use of different research approaches, methods and techniques in the same study is referred to as triangulation. They further state that this can overcome the potential bias and sterility of a single-method approach. Leedy, (1997: 169), describes triangulation as the process of using multiple data collection methods, data sources, analysts, or theories to check the validity of the findings.

Eastorby - Smith, Thorpe and Lowe (1991) as cited by Collis and Hussey (2003: 78), identify four types of triangulation:

- *Data triangulation*; where data is collected at different times or from different sources;
- *Investigator triangulation*; where different researchers independently collect data on the same phenomenon and then compare the results;
- *Methodological triangulation*; where both quantitative and qualitative methods of data collection are used, and

- *Triangulation of theories*; where theory is taken from one discipline (for example, marketing) and used to explain a phenomenon in another discipline for example, accounting).

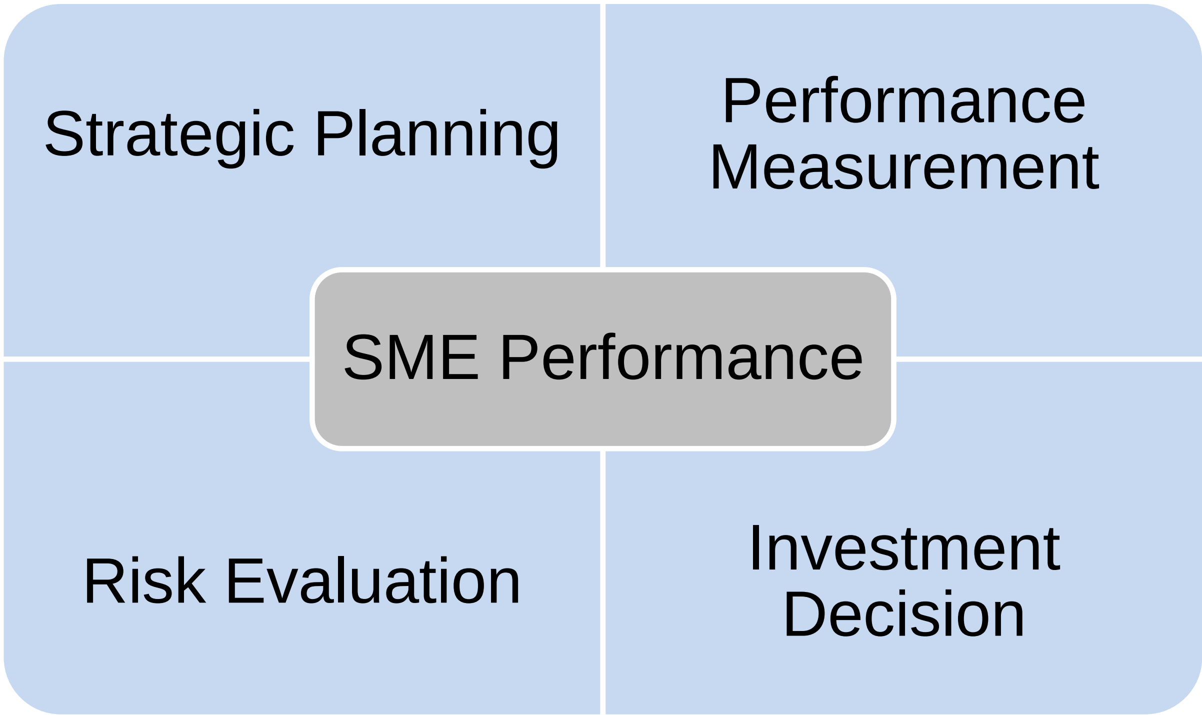
The investigator triangulation is rather difficult to embark on unless one is part of the research team (Collis and Hussey, 2003). Jick (1979), as cited by Collis and Hussey (2003: 78), argues that triangulation has vital strengths, encourages productive research, enhances qualitative methods and allows the complementary use of quantitative methods.

For the purpose of this research, the researcher used both qualitative and quantitative approaches of research (methodological triangulation). It was quantitative when the researcher wanted to understand whether the SMEs being investigated did have any form of strategic planning and to what extent their strategic plan processes influenced the company's investment decision-making processes. On the other hand, it was qualitative when the researcher relied on his own experience as a Management Accountant and previously having worked as a business advisor for a major financial institution financing SMEs, to understand the problem or subject matter, in order to make an informed decision from some of the comments received through the measuring instrument.

The next section outlines the conceptual framework.

4.2.4 **Conceptual framework**

Figure 7: The integration of strategic planning and investment decision-making



Source: Researcher's own construction

The conceptual framework above illustrates the importance of the four elements, namely; strategic planning, performance measurement, investment decision and risk evaluation on the performance of the SMEs. The researcher is fully aware that there could be many factors that may lead to the success of failure of the SMEs. However, for the purpose of this research the focus will be only on strategic planning as an investment decision-making tool. The framework suggests that strategic planning should be the guide to where the business wants to go and that there should some form of measurement to keep on checking whether or not the business is still on the right track. The investments that the organisation embarks on should be informed by the strategy of the organisation taking into account the risk associated with such investment(s).

4.3 ENVISAGED SAMPLE

The envisaged sample is the manufacturing SMEs within the Nelson Mandela Metropole (Port Elizabeth, Uitenhage and Dispatch). The researcher downloaded the list of manufacturing SMEs from the service providers' of this sector such as the Eastern cape dvelopment coporation (ECDC), Business Partners, Port Elizabeth regional chnmber of commerce and industry (PERCCI) and Khula enterprise development websites to get an idea of the population of Manufacturing SMEs in the region in order to get a sample that would be representative of the population of Manufacturing SMEs in the region.

4.4 SAMPLING DESIGN

According to Collis and Hussey (2003),selecting a sample is a fundamental element of a quantitative study. There are various forms of sampling methods, and for the purpose of this study, the researcher opted for a stratified sampling method. There are three ways by which the SMEs can be stratified. they can either be stratified by means of total turnover, number of employees and or the net book value of the company's assets. Random sampling was used to select the sample group using the following criteria:

- Manufacturing SMEs;
- Located within the Nelson Mandela Metropole; that is, Port Elizabeth, Uitenhage and Dispatch;
- Who are currently operational, and,
- Meet the requirements of the small business definition as outlined by the small business act (see chapter two).

4.5 CONSTRUCTION OF MEASURING INSTRUMENT

Collis and Hussey (2003: 162) explain that collecting data in a quantitative study is an attempt to measure variables or count occurrences of a phenomenon. One of the main advantages of a quantitative approach of data collection is the relative ease and speed at which data can be collected. A positivistic approach suggests that closed ended questions are more suitable for this approach. In the case of this survey, a self constructed questionnaire (see Annexure B) was used as a means of collecting data for this study from a selected sample group. The nature of the questions mainly used the two to six Likert scale type questions and the close questions or the selection of the appropriate answer. The measuring instrument was designed taking into account the following key issues as stated by Leedy (1997: 197);

- Use simple and concise language;
- Do not make unrealistic demands of those who fill in the questionnaire;
- Each question should ask about only one topic;
- Each question should have no escape route; that is, don't know, no comment;
- Each question should be polite;
- Be straight forward and guard against double meanings;
- Get the question order right;
- Make the layout easy to follow;
- Give clear instructions, and
- Test the questionnaire first.

The questions on the measuring instrument were grouped into the following categories;

- *Biographical details of the respondents*: this section sought to establish the experience and the education level of the respondents;
- *General company details*: to establish the general company information;
- *The strategic planning process of the organisation*: to solicit respondents about the strategic planning process of the organisation;
- *Performance measurement process*: to establish the performance measurement systems used within the organisation;
- *Investment or capital budgeting process*: to establish what capital budgeting techniques are used by the organisations, and

- *Risk evaluation of the investment projects*: to establish what forms or risk evaluation measures SMEs used to evaluate the riskiness of their investment projects.

The distribution of the questionnaire was done both electronically by means of an email, as well as manually by hand delivering the questionnaires to some manufacturing SMEs whose emails auto reply stated “undelivered”. The cover letter explaining the objective of the survey as well as assuring the respondents of the anonymity of the study was sent together with the questionnaire.These were also stapled to the questionnaires that were delivered manually.

4.6 RELIABILITY AND VALIDITY

The reliability of the research is concerned with the consistency of the research findings. In other words, if the research was to be performed by another person following a similar or the same procedure, he or she will be able to replicate your findings. On the other hand, the validity of the research is concerned with whether the research measures accurately what it is intended to measure (Collis and Hussey, 2003).

In order to ensure both the validity and the reliability of the study, the correlation between the responses of various business entities and the findings will confirm the reliability. The analysis of the survey will validate the information received from the questionnaire. The questionnaire was also endorsed by the experts in the small business development agencies as suitable for gathering or measuring what it is intended to measure. However, prior to conducting the study, the questionnaire was checked by a senior lecturer at the Nelson Mandela Metropolitan University, as well as a statistician (Dr Jacques Pietersen) from the Nelson Mandela Metropolitan University and the amendments were made where necessary.

4.7 DATA ANALYSIS PROCEDURE

Both the descriptive and inferential statistics were used to analyse the data collected and the results were presented in the form of graphs and charts. These results were also used to draw conclusion and to formulate recommendations.

4.8 CONCLUSION

In this chapter the methodology was discussed by referring to research design, research strategy, and data analysis. The study analysed theory to determine which methods would be appropriate for the type of research being conducted and the outcomes envisaged. Chapter five will focus on the results of the empirical study which will be summarized and analysed.

The following chapter discusses the results of the empirical study.

CHAPTER FIVE

RESULTS AND DISCUSSIONS

5.1 INTRODUCTION

In this chapter, the data obtained from the measuring instrument that was sent to the various business entities were analysed and interpreted to establish how strategic planning was being used as an investment decision-making tool by manufacturing SMEs in the Nelson Mandela Metropole.

The objective of this study was to establish how strategic planning could be used as an investment decision-making tool for SMEs in the Nelson Mandela Metropole by establishing the current strategic planning process for SMEs, establishing the current strategic performance evaluation system, the capital budgeting process as well as understanding how SME owner-managers evaluate the level of risk of the prospective capital projects.

The section below will outline the findings in detail as per the sample responses obtained from the survey.

5.2 SAMPLE AND THE EXTENT OF RESPONSE

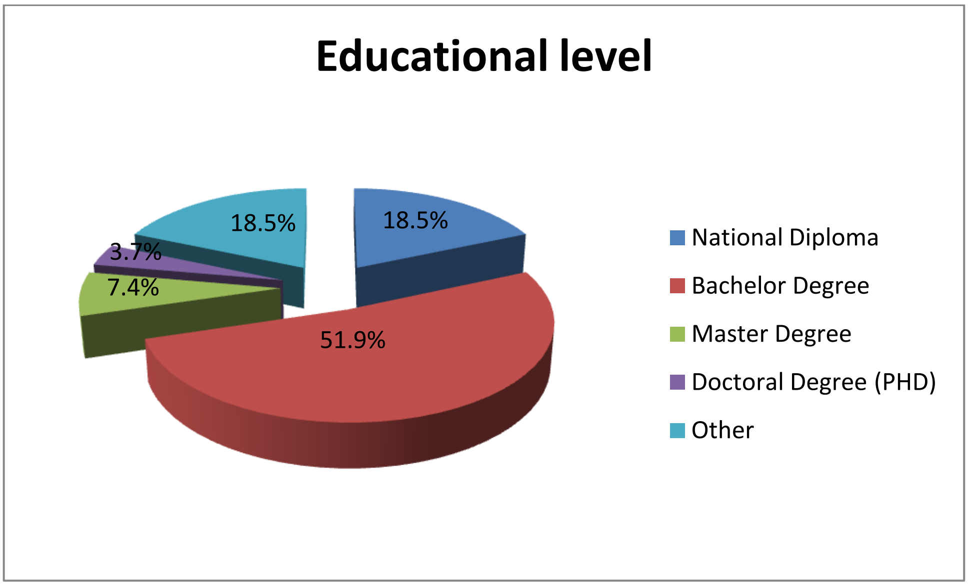
In a quest to understand the level of strategic planning, the use of strategic performance measurement systems, use of capital budgeting techniques as well as the extent to which SMEs evaluate the riskiness of the prospective capital projects, an empirical survey was conducted by means of questionnaires.

A sample group of fourty manufacturing SMEs within the Nelson Mandela Metropolitan Municipality was selected. These questionnaires were sent electronically via email and some were delivered by hand to the respective envisaged respondents. Of the fourty that were sent out only twenty seven responses came back, making a response rate of 68%.

5.3 GENERAL CHARACTERISTICS OF THE RESPONDENTS

This section shows an analysis of biographical and general company statistics

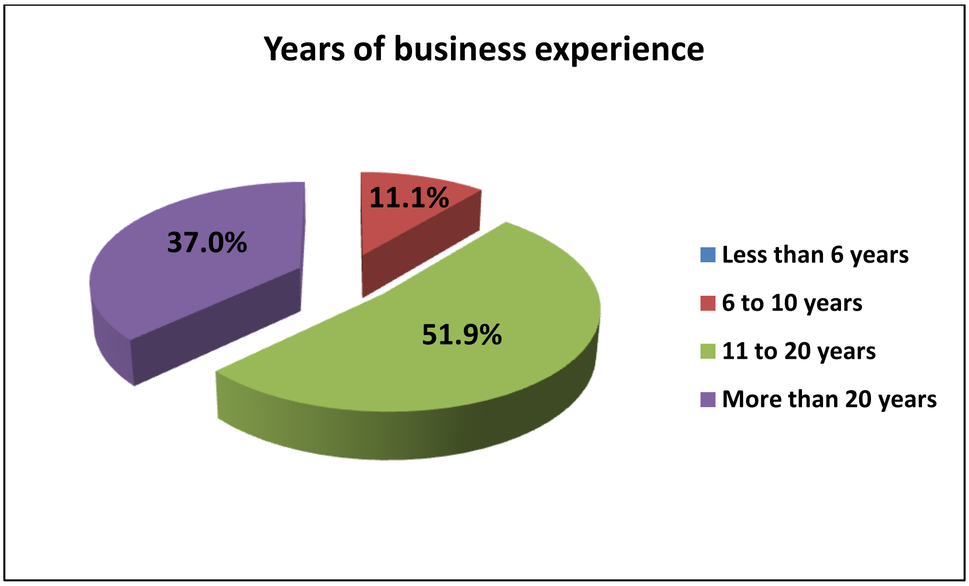
Graph 1: Education level of the respondents



Source: Author's computation based on the data obtained from the survey

Graph 1 above illustrates the education level of the respondents of the survey. It shows that almost 52% of the respondents had a bachelor's degree, whilst only 3.7% percent had a PHD, and 18.5% indicated that they had other technical qualfications such as the N5 and N6. It does, however, reflect that, most of the respondents had a formal tertiary qualification which could be key for the success of the organisation.

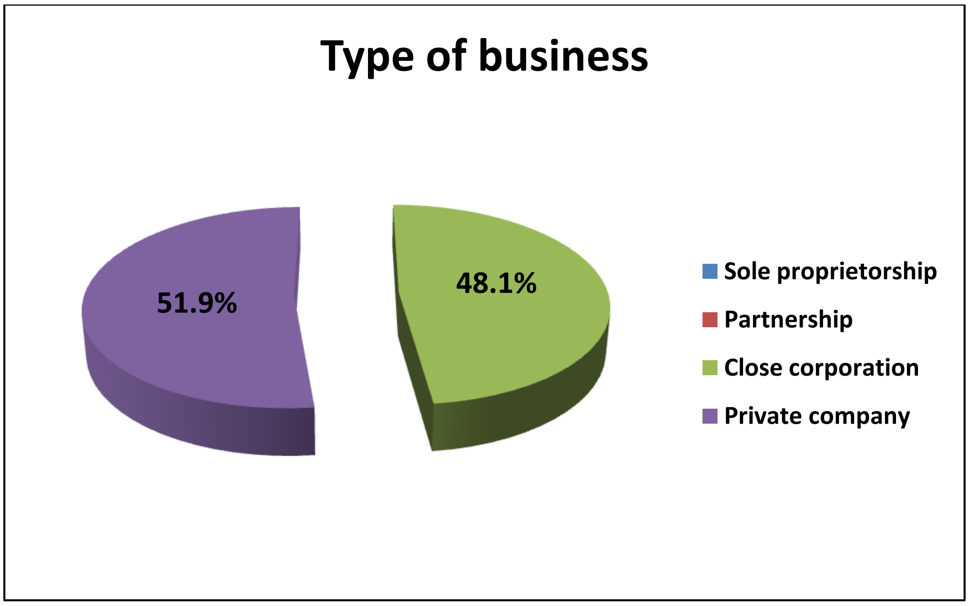
Graph 2: Respondents' years of business experience



Source: Author's computation based on the data obtained from the survey

Graph 2 above illustrates that almost 52% of the respondents had eleven to twenty years of business experience, whilst only 11% had six to ten years of business experience and 37% of the respondents had more than twenty years of business experience.

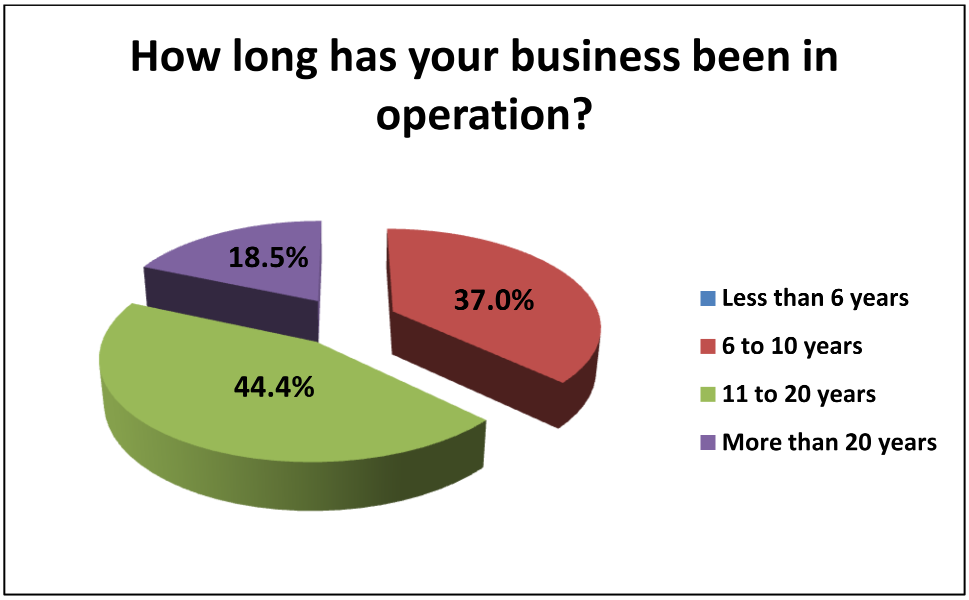
Graph 3: Types of Businesses that participated



Source: Author's computation based on the data obtained from the survey

Graph 3 above illustrates that 48% of the participants were close corporations whilst 52 % were private companies.

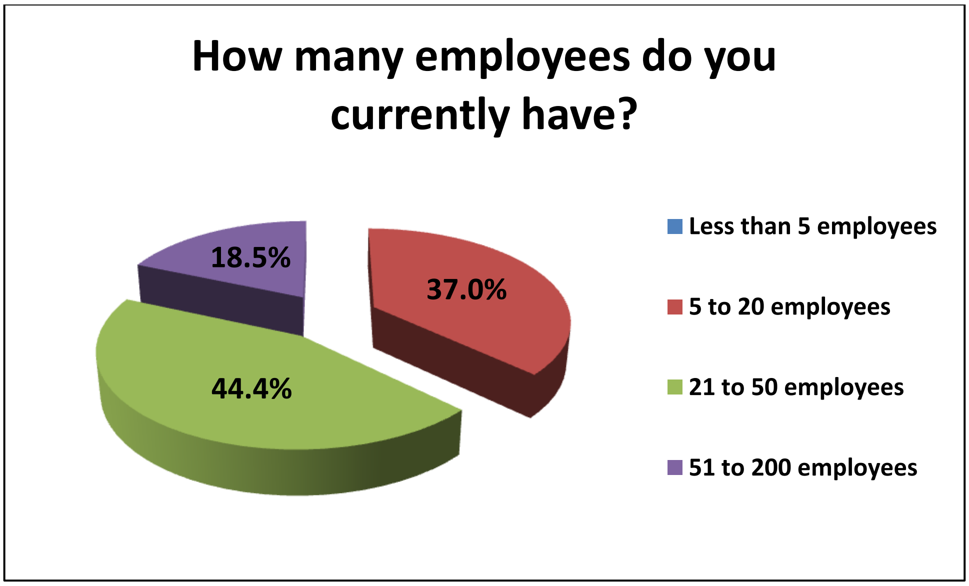
Graph 4: Number of years in operation



Source: Author's computation based on the data obtained from the survey

Graph 4 above illustrates that 44.4% of the companies that were part of the survey had eleven to twenty years in operation, 37% percent had been operating for six to ten years whilst 18.5% had been operating for more than twenty years.

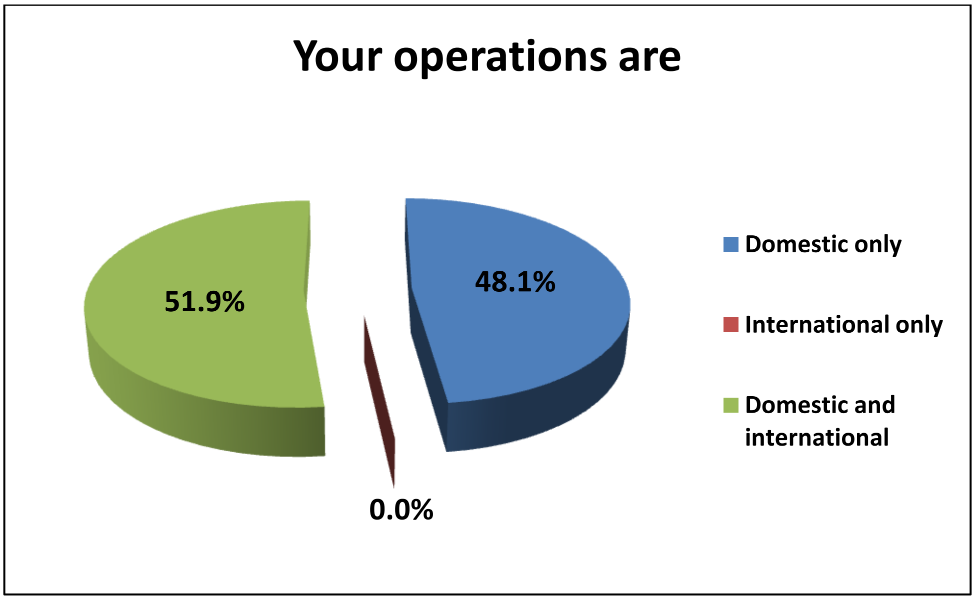
Graph 5: Number of employees



Source: Author's computation based on the data obtained from the survey

Graph 5 reflects that 37% of the participants employed five to 20 employees, 18.5 % had less than five employees on thier payroll, whilst 44.4% of the companies employed 21 to 50 employees. This means that 44.4 % of the participants were small enterprises, 37% were very small enterprises and 18.5% could be regarded as medium enterprises based on the definition of the small business act of 1996 (see table 1).

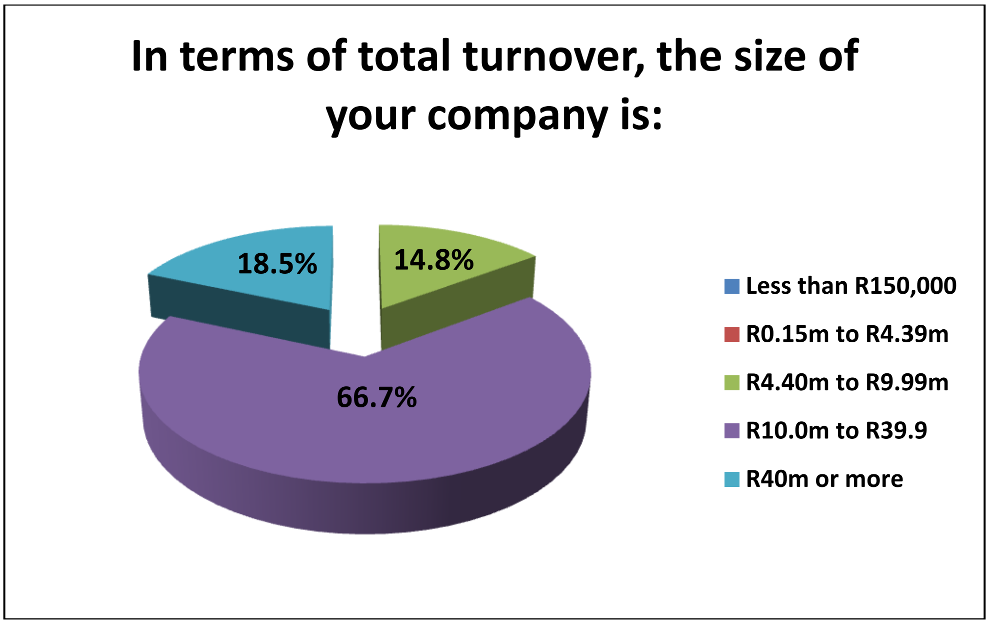
Graph 6: Scope of Business operations



Source: Author's computation based on the data obtained from the survey

Almost 52 % of the participants operate their business both domestically and internationally whilst 48% were only operating domestically, as illustrated by means of Graph 6 above.

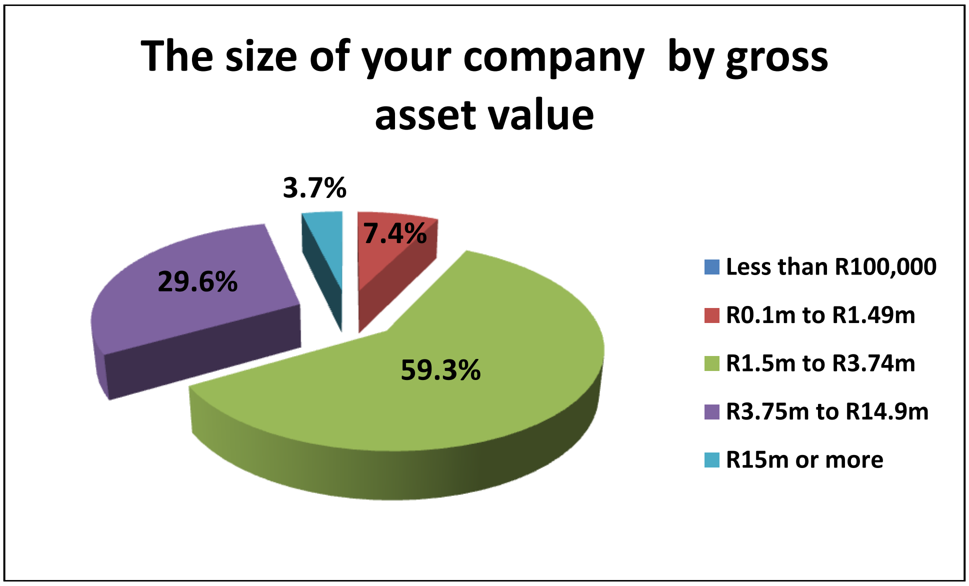
Graph 7: Company size in terms of total annual turover



Source: Author's computation based on the data obtained from the survey

Graph 7 shows that 66.7 % of the respondents stated that their organisation had an annual total turnover between ten million rands and thirty nine million rands, 14.8 % had an annual total turnover of less than ten million but more than four million rands, whilst 18.5% of the respondents had an annual total turnover of more than fourty million rands.

Graph 8: Company size in terms of gross asset value



Source: Author's computation based on the data obtained from the survey

Almost 60% of the respondents' organisations had a gross asset value of between R1,5 million rands and R3,74 million, 29.6% were between R3.75 million and R14.9 million rands, 7.4% had gross asset value between R100 000 and R149 000, whislt only 3.7% had gross asset value of R15 million or more, as illustrated in graph 8 above.

5.4 STRATEGIC PLANNING

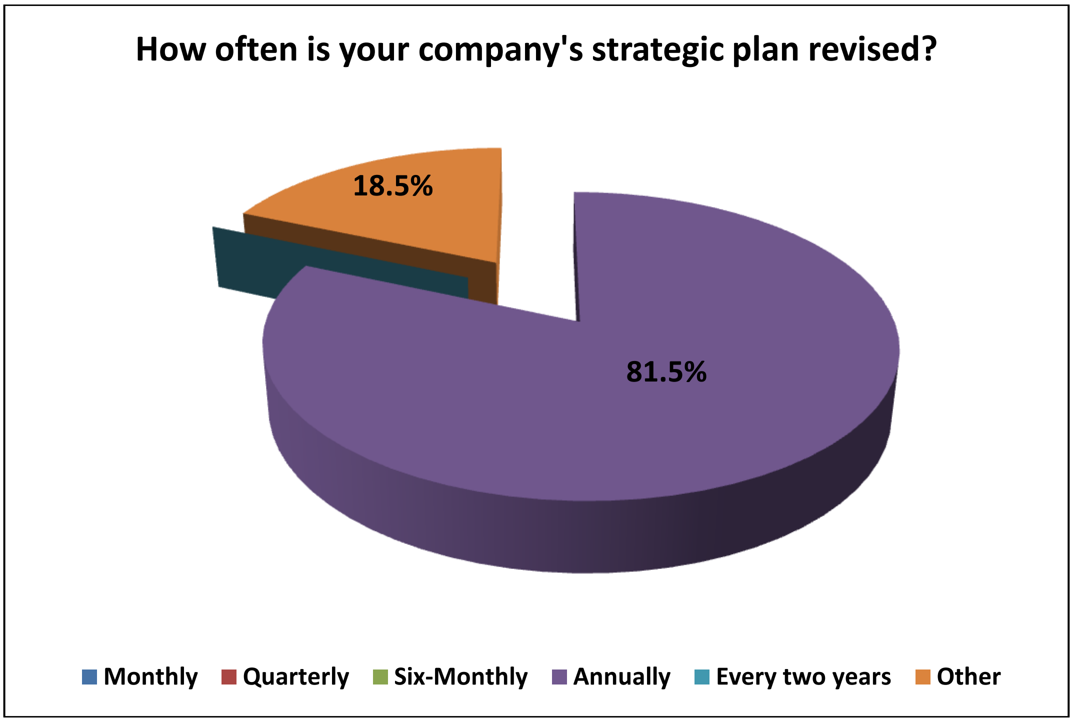
This section shows an analysis of the strategic planning process of the SMEs. It also evaluates how often is the strategic plan is being revised. It seeks to establish how well is the vision and mission statements of the organisation communicated throughout the organisation. This section also seeks to establish what are possible hindrances to successful implementation of the strategic plan?

Graph 9: Strategic planning is important for the success of my organisation

Source: Author's computation based on the data obtained from the survey

Graph 9 above illustrates that 85.2% of the respondents believe that strategic planning is significant for the success of their organisations, whilst 7.4% were (strongly agree and agree). On the other hand 14.8% of the respondents were not convinced that strategic planning was that significant for their organisation's success.

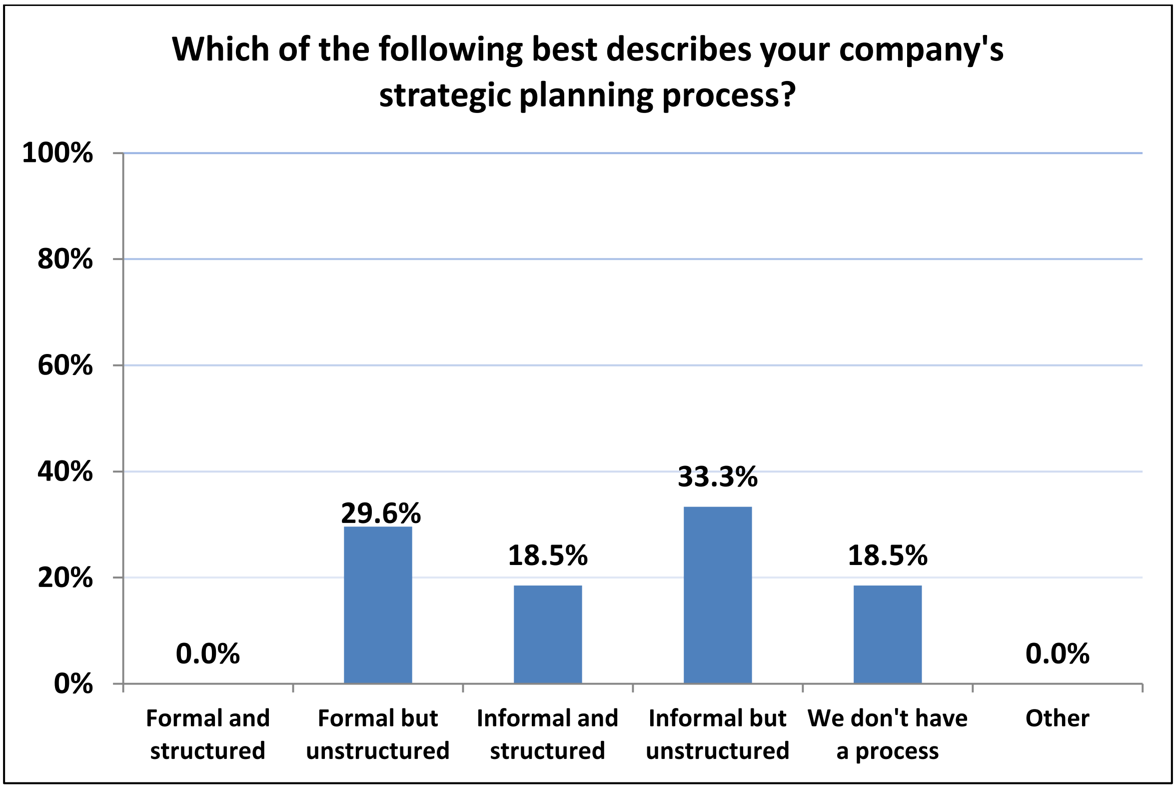
Graph 10: How often is your company's strategic plan revised?



Source: Author's computation based on the data obtained from the survey

Though Graph 9 above showed as many as 85% believe in strategic planning as playing an important role in their organisation's potential success, Graph 10 above reflects that strategic planning is still an annual event, with 81.5% of respondents attesting that strategic planning is revised annually. However, 18.5% opted for 'other' as the number of times their company's strategic plan is revised. This may suggest that as many as 18.5% of the respondents either do not embark on strategic planning at all, or do it eratically.

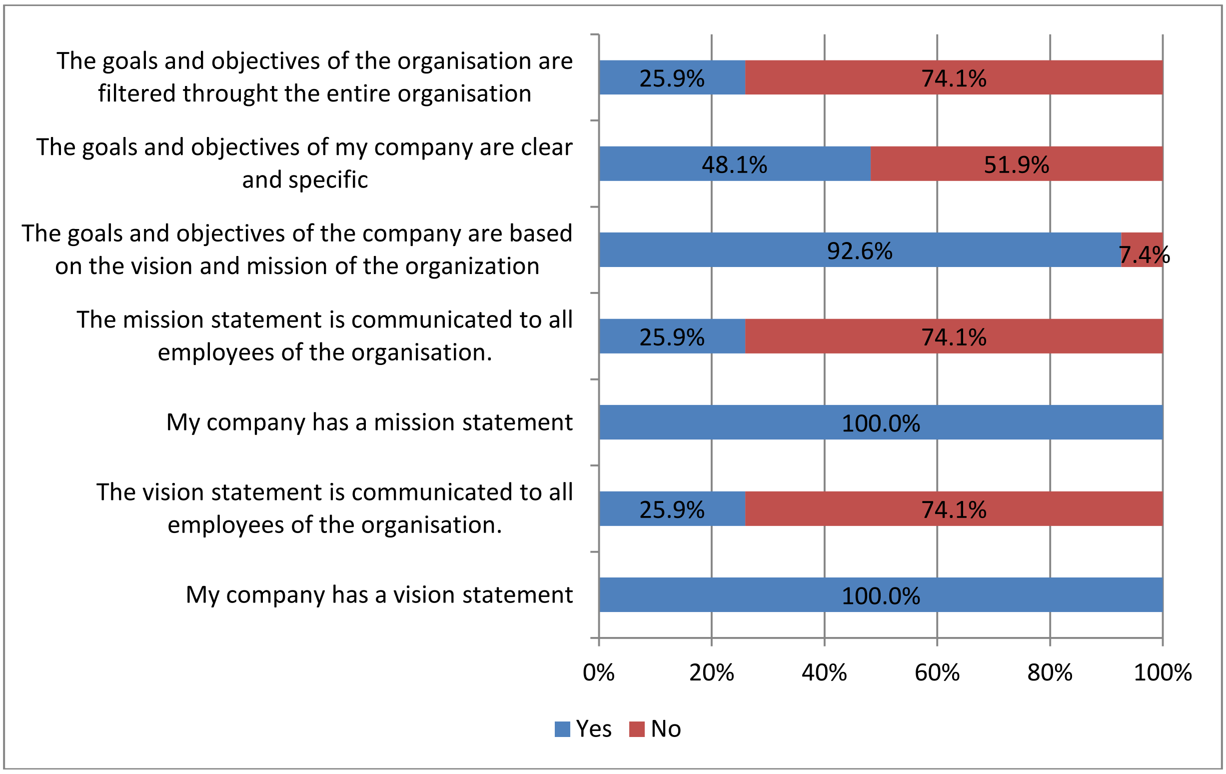
Graph 11: Company's strategic planning process?



Source: Author's computation based on the data obtained from the survey

Graph 11 above illustrates that 33.3% of the respondents' organisations had an informal and unstructured strategic planning process, 29.6% of the respondents had a formal but unstructured strategic planning process, whilst 18.5% stated that their organisations had informal and structured planning. Those who claimed not to have any strategic planning process in place amounted to 18.5% of the respondents. This means almost a fifth of the respondents did no planning at all.

Graph 12: Which of the following statements is relevant to your organisation?



Source: Author's computation based on the data obtained from the survey

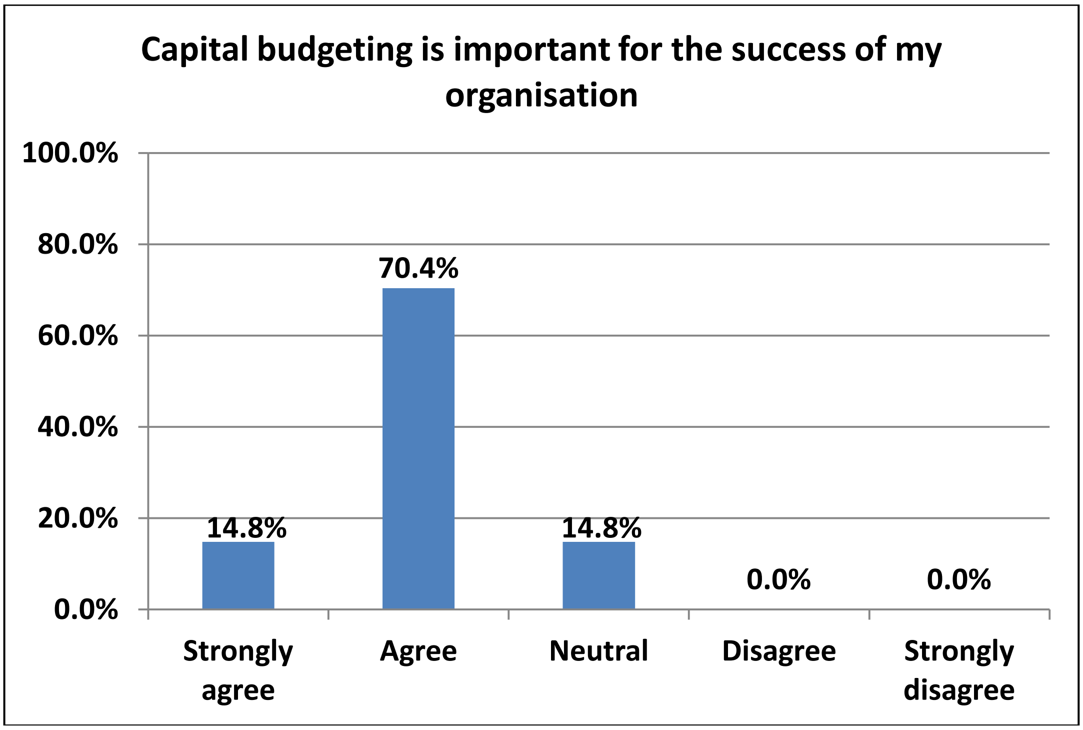
Graph 12 above shows that all the respondents' organisations do have vision and a mission statements; however, not all of them seem to be filtering or communicating these statements to the entire work force. Only 25.9% of the respondents stated that their vision and mission statements are communicated through out the entire organisation. Almost half (48.1%) of the respondents stated the goals and objectives of their organisations are clear and specific, whilst only 25.9% of the respondents suggested that the goals and objective of their organisations are filtered through their organisation.

This seems to suggest that only a handful of SMEs understand the significance of ensuring that all employees are informed of the vision and mission of their organisations and also ensuring that employees understand how their roles or functions are contributing towards the achievement of the said objectives.

5.5 CAPITAL BUDGETING PROCESS

This section analyses the capital budgeting process, it seeks to establish whether capital budgeting is perceived to be important for the success of SMEs. It is also meant to establish what capital budgeting techniques that are considered to be important by the respondents.

Graph 13: Capital budgeting is important to the success of my organisation?

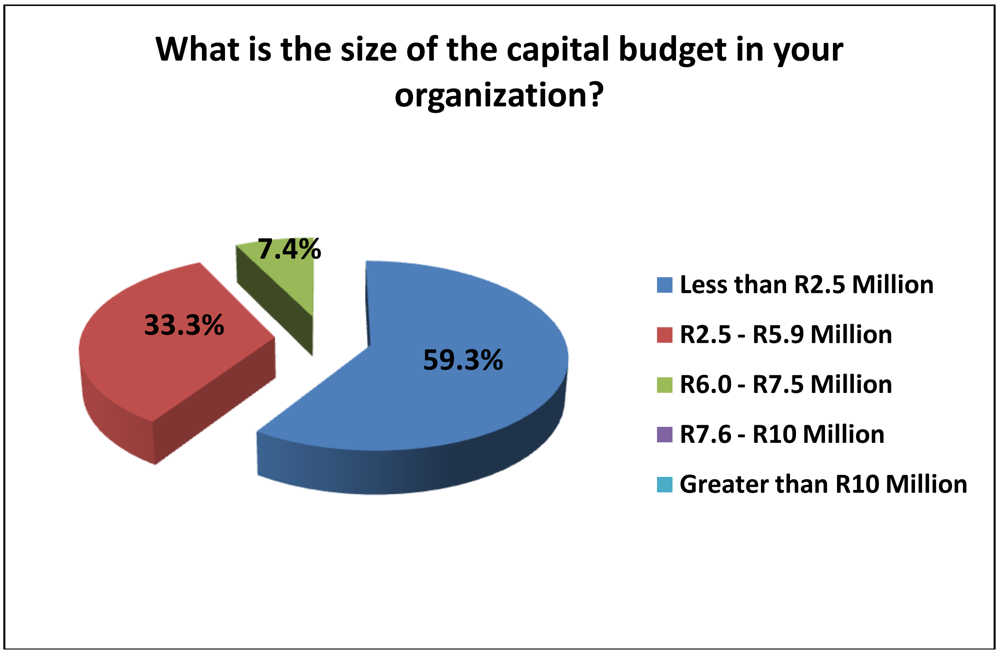


Source: Author's computation based on the data obtained from the survey

Graph 13 above illustrates that 70.4% of the respondents agree that capital budgeting is critical for the success of their organisations, whilst 14.8% strongly agree with this statement. However, the other 14.8% remained neutral, as neither agreeing nor disagreeing.

This finding is important as it suggests that, there should be some form of capital budgeting amongst the selected sample group.

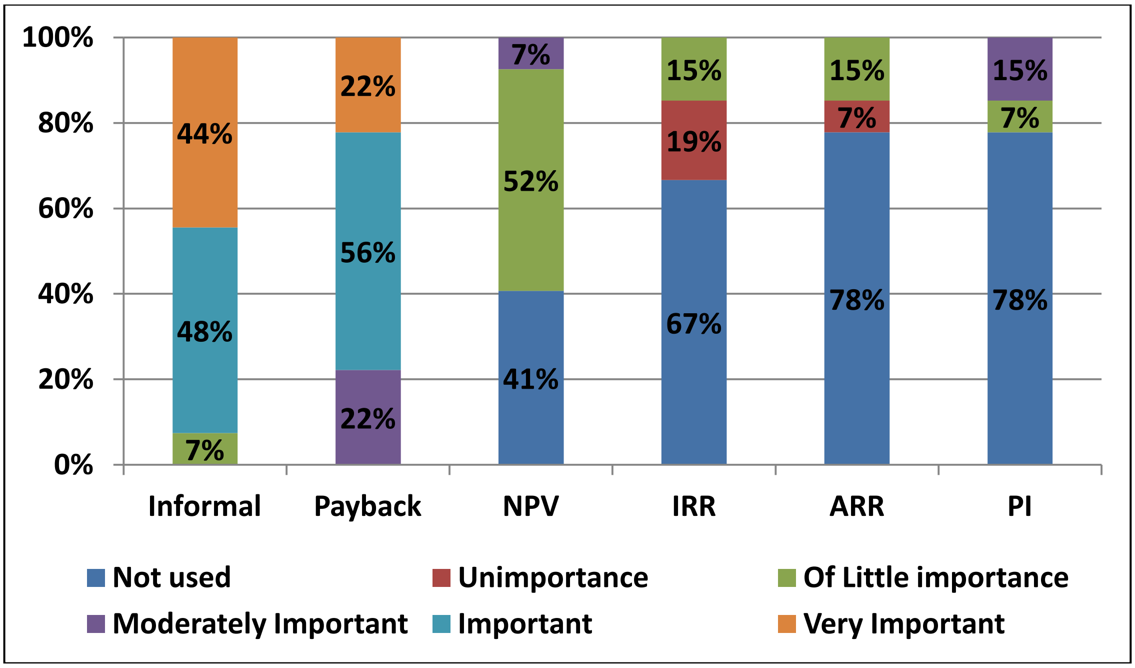
Graph 14: What is the size of the capital budget in your organisation?



Source: Author's computation based on the data obtained from the survey

Almost 60 % of the respondents had a capital budget of less than R2.5 million rands per annum, 33.3% reflected a budget between R2.5 million rands and R5.9 million rands and only 7.4% reflected a budget between R6 million rands and R7.5 million rands. This is illustrated in Graph 14 above.

Graph 15: Relative to its importance, which of the following Capital Budgeting Techniques are used in your firm?

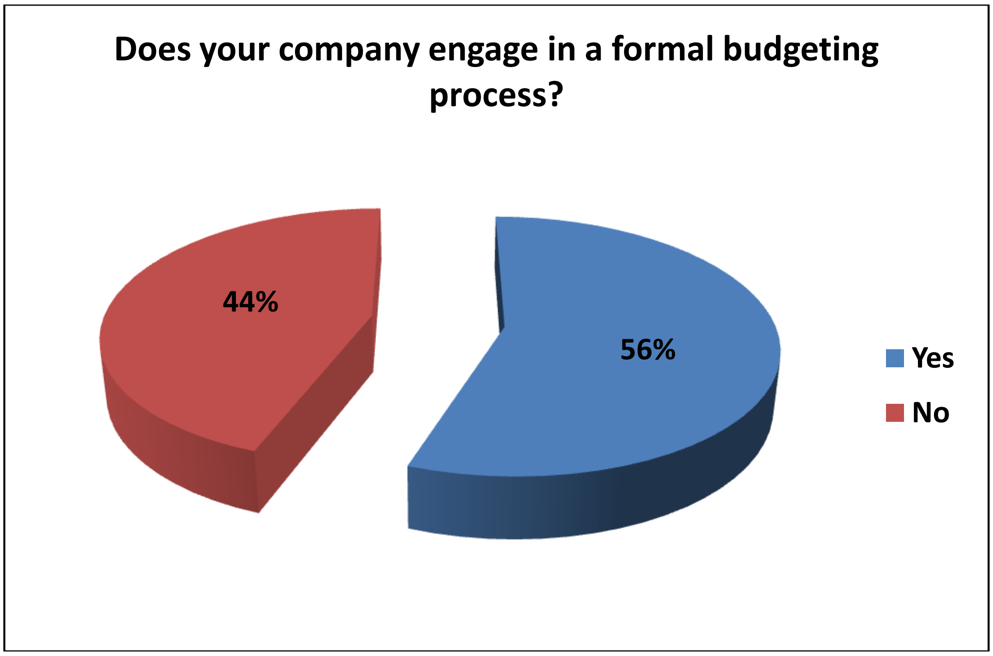


Source: Author's computation based on the data obtained from the survey

Graph 15 above illustrates the usage of the various capital budgeting techniques. The findings suggest that most SMEs still rely on the informal method of evaluating projects as well as the payback methods with 44% and 22% of respondents repectively rating them as very important methods of evaluating projects. Another 48% and 56% also agree that these are important methods of evaluating projects. Overhalf, 52 % of the respondents rated the NPV as of little importance. The sophisticated methods such as Internal rate of return (IRR), accounting rate of returnv(ARR) and the profitability index (PI) are rated as not being used at all by the majority of the respondents; that is, 67%, 78% and 78% respectively.

This may suggest that SMEs are still relying on simpler methods such as payback method of evaluating projects, due to the shortage of skills and/or simply being concerned about the short term obligations of the organisation (liquidity). However, as the literatures suggested, this technique of evaluating projects does not take into account the time value of money as compared to the other forms of evaluting projects such as the NPV and the IRR.

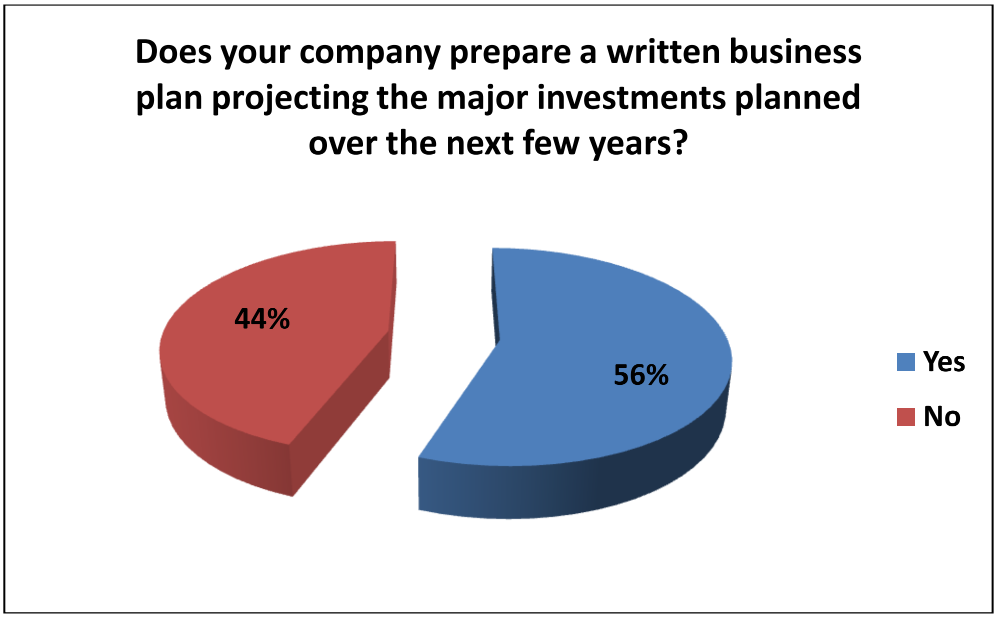
Graph 16: Does your company engage in a formal budgeting process?



Source: Author's computation based on the data obtained from the survey

Graph 16 above illustrates that 56% of the respondents engage in a formal capital budgeting process, while the other 44% stated that their organisations do not have any form of capital budgeting process. This means that almost half or the respondents either do not deem it necessary or simply do not have the personnel to plan for their capital expenditure. This could mean that these SMEs, which do not plan for capital expenditure, only operate by 'extinguishing fires' as and when they happen with regard to the availability to finance for any unforeseen projects.

Graph 17: Does your company prepare a written business plan projecting the major investments planned over the next few years?



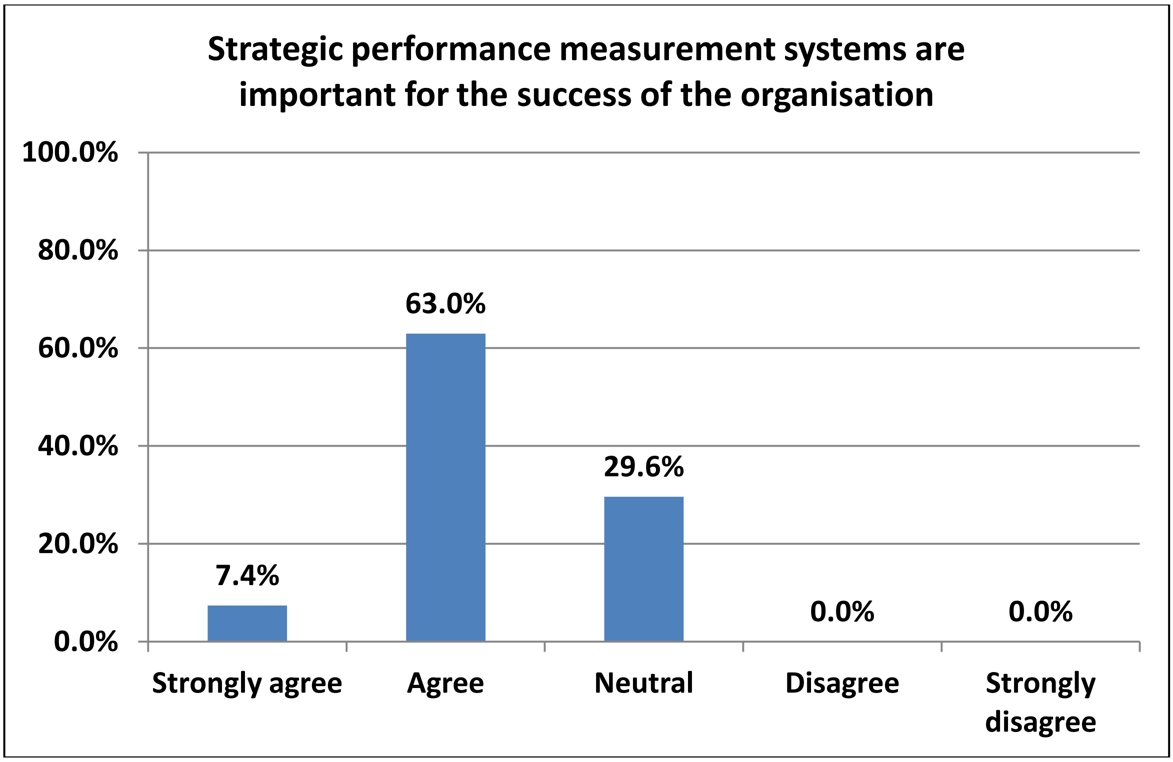
Source: Author's computation based on the data obtained from the survey

Graph 17 concurs with graph 16 by reflecting that 56% of sample respondents do prepare a written business plan for their envisaged projects whilst the other 44% do not prepare any business plan. This was expected as those that do engage in a formal capital budgeting process, as stated in Graph 16 above, would be expected to prepare a written business plan for their projects.

5.6 STRATEGIC PERFORMANCE MEASUREMENT

This section seeked to establish if there are any strategic performance measurement systems in place. It is also to establish, what are the possible hindrances to successful implementation of the strategic performance measurement systems.

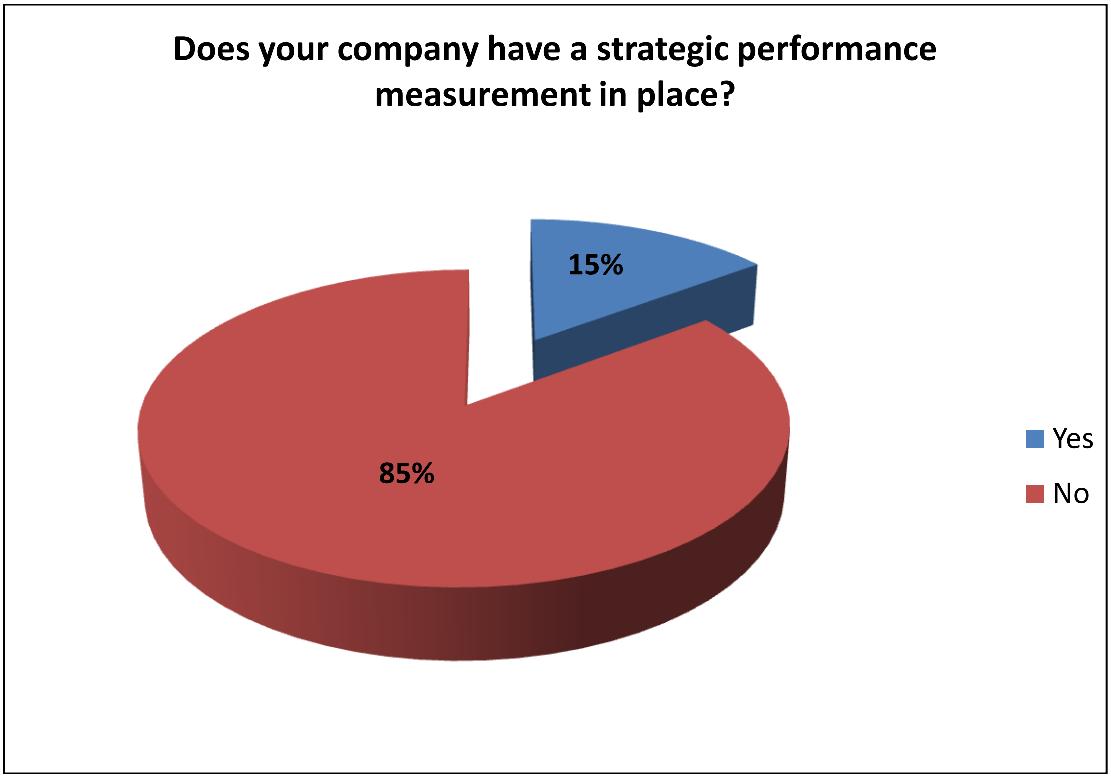
Graph 18: Strategic performance measurement systems are important for the success of the organisation



Source: Author’s computation based on the data obtained from the survey

Graph 18 above reflects that 63% of the respondents agree that strategic planning is important for the success of their organisation and 7.4% strongly agree whereas 29.6 of the respondents remain neutral. This may mean that 29.6% of the SMEs do not believe performance measurement systems are important for the success of their organisations, or they simply do not know what they entails.

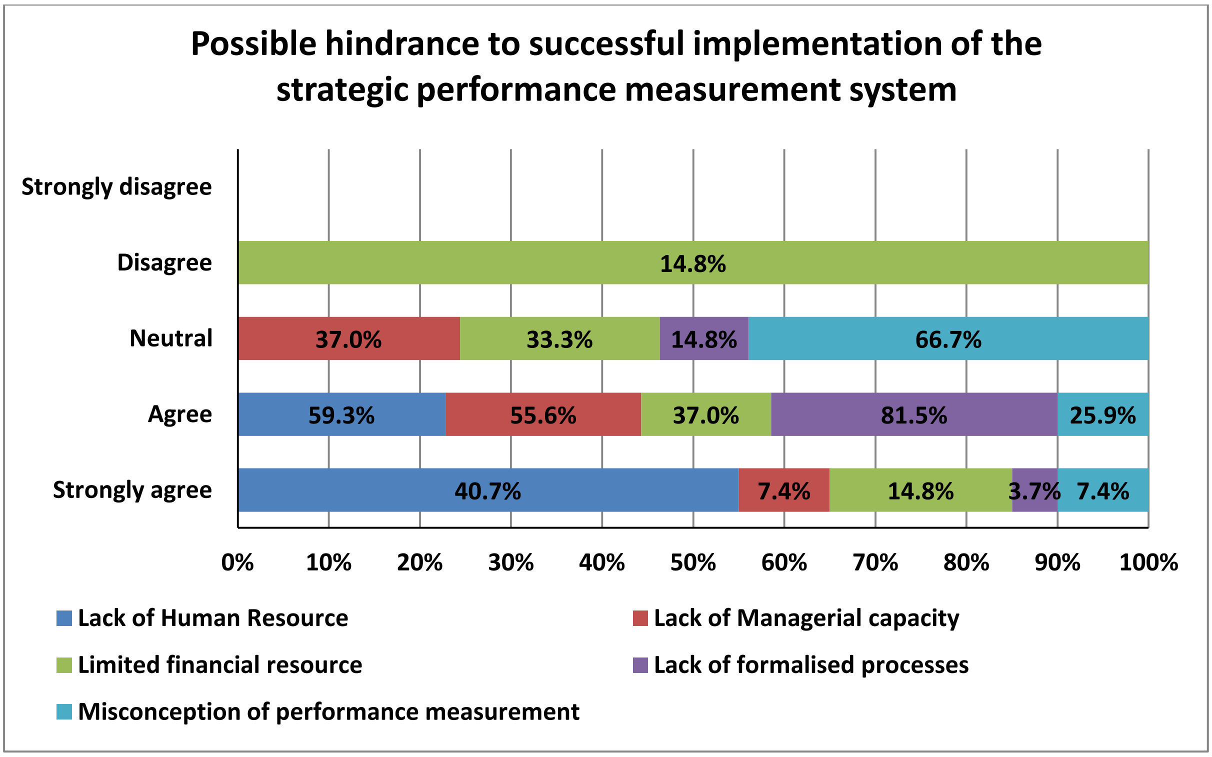
Graph 19: Does your company have a strategic performance measurement in place?



Source: Author's computation based on the data obtained from the survey

Graph 19 suggest that, while many respondents in graph 18 highlighted the importance of having a performance measurement for the success of their organisations, only 15% of the respondents actually do have a performance measurement in place. An overwhelming 85% do not have any strategic performance measuremnt in place, which may result in many SMEs not realising their strategic objectives, as they do not have any form of measurement system that ensures that they do not deviate from their set objectives.

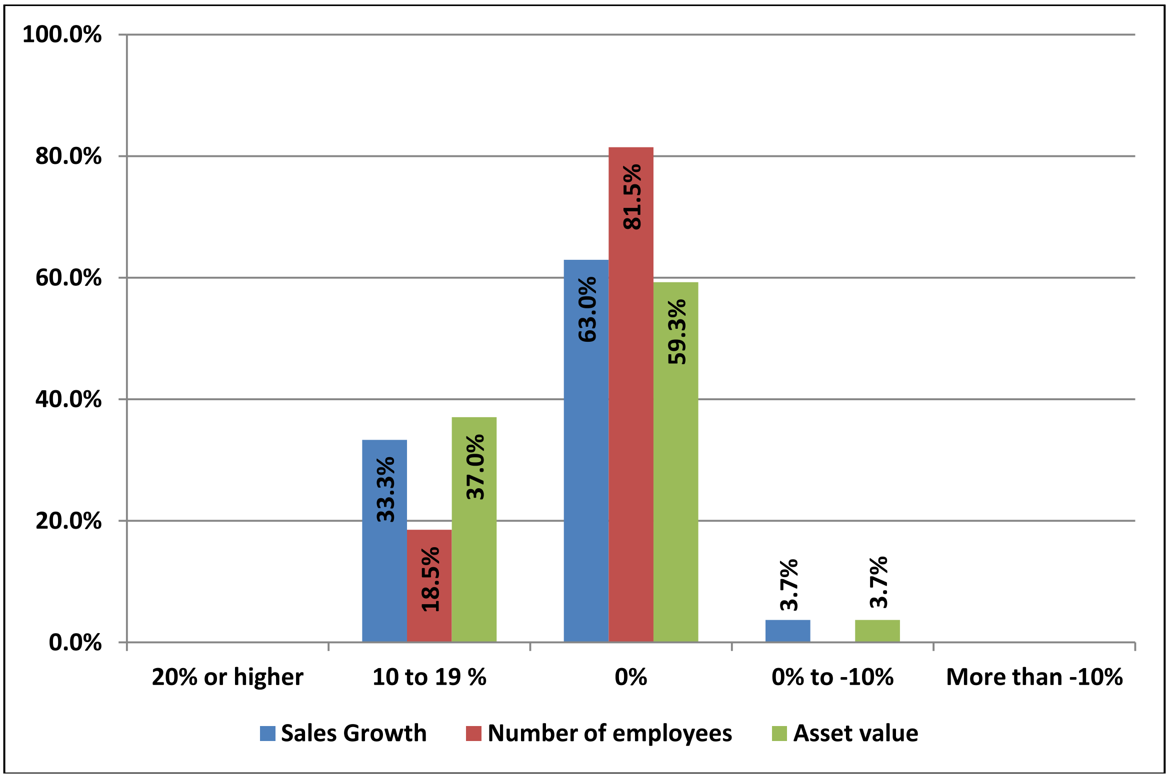
Graph 20: Possible hindrance to successful implementation of the strategic performance measurement system



Source: Author's computation based on the data obtained from the survey

Graph 20 above highlights which of the listed factors were perceived to be a possible hindrance to the successful implementation of the the strategic plan. 'Lack of human resource personnel' and 'lack of managerial capacity' were cited as major stumbling blocks, with 59.3% and 55.6% respectively choosing these. All respondents referred to limited financial resources as not a hindrabce.

Graph 21: Annual Company Growth 2011



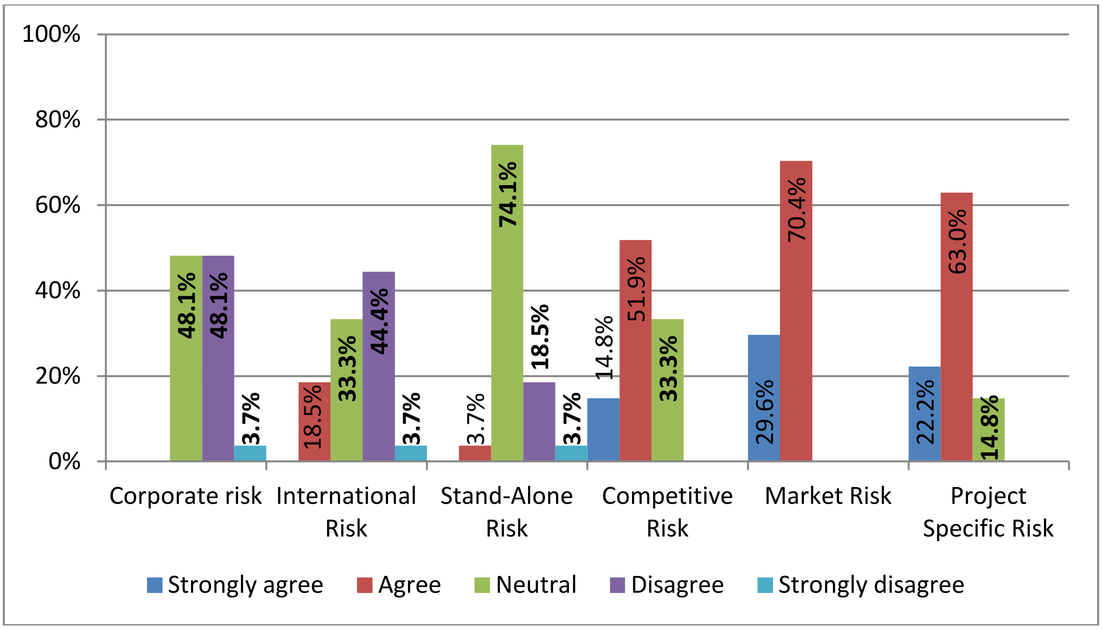
Source: Author's computation based on the data obtained from the survey

Graph 21 above illustrates the growth of the respondents' organisations in terms of the sales, number of employees and the asset value. A third, 33.3% of the respondents illustrated that their organisation had a sales growth of between 10% and 19%, whilst 37% reflected an asset value improvement of between 10% and 19%. Only 18.5% stated that their number of employees grew with a similar margin. Only 3.7% of the respondents illustrated that they had experrienced a reduction of less than 10% in their asset value and sales volumes in the previous year. Close to 60% of the respondents stated that there was no change in both their sales volumes and asset values, whilst almost 82% stated that there was no change in the number of their employees.

5.7 RISK

This section analyses how SMEs evaluate the riskiness of the projects; and what types of risks that are experienced by the SMEs when embarking on capital projects.

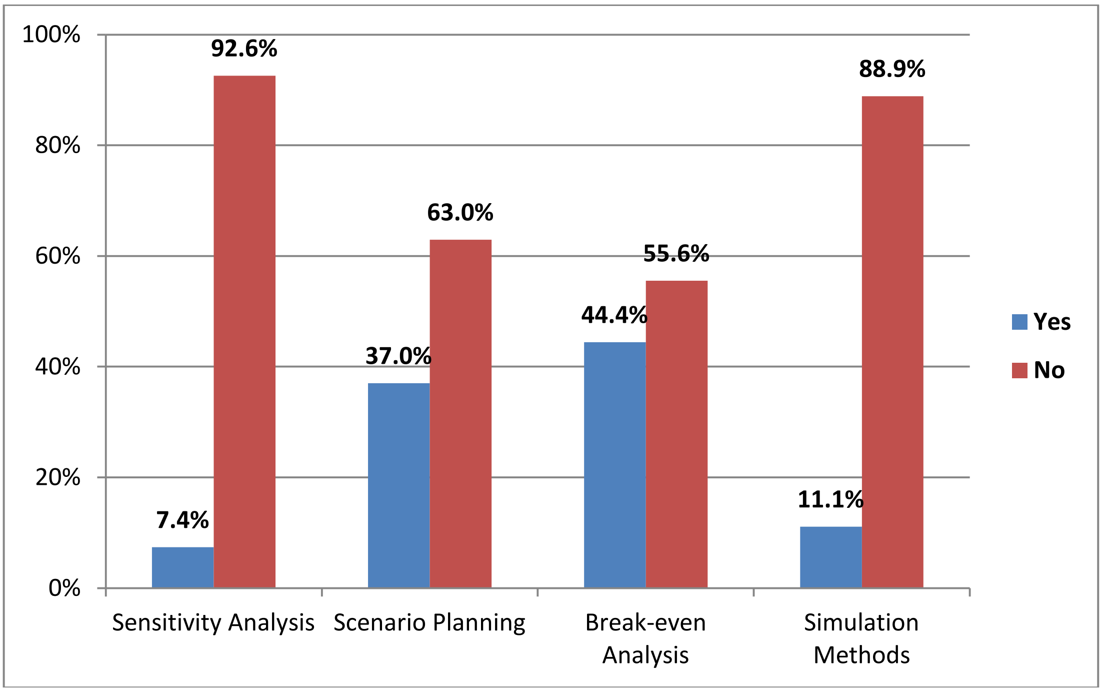
Graph 22: Types risks to be considered when making an investment decision



Source: Author’s computation based on the data obtained from the survey

Graph 22 illustrates that most respondents agreed that market risk, project specific risk, and the competitive risk are the type of risks that are worth considering before making an investment decision, with 70.4%, 63% and 51.9% respectively choosing these. Corporate risk, international and the stand alone risks are also cited as the least forms of risks to consider before making an investment decision.

Graph 23: Methods of evaluting project risk



Source: Author's computation based on the data obtained from the survey

Graph 23 above reflects that the biggest group of respondents of are using break-even analysis and scenario planning as methods of evaluating the project risk, whilst sensitivity analysis and simulation methods are the least used forms of evaluating project risk, with the response rate of 7.4% and 11.1% respectively.

5.8 CONCLUSIONS

In this chapter the interpretation of the findings was presented. It emerged that, even though many SMEs believe that strategic planning is important for the success of their organisations, very few had a formal strategic planning process and the strategic performance measurement system in place. Many respondents highlighted lack of personnel, lack of formalised process and lack of managerial capacity as some of the factors that hindered their organisations from the successful implementation of a strategic plan.

All the respondents stated that their organisations do have visions and mission statements. However, it also emerged that these vision and the mission statements are not communicated through the entire organisation. This, therefore, means that not all employees understand how their respective roles contribute towards the acheivement of the organistional objectives or goals.

It also emerged that, though most respondents believed that capital budgeting was important for the success of their organisations, most SMEs still do not engage in a formal capital budgeting process, and those that do engage in some form of capital budgeting, are still relying heavily on the traditional capital budgeting techniques such as the payback method and the ‘gut feel’ of management. This suggest that SMEs are still concerned with short term obligations; hence the use of the payback method, which focuses on how long it will take the SMEs to get their investment capital. However, this means that the SMEs are exposed to the shortcommings of these methods, such as their inability to take into account the tme value of money as compared to other sophisticated methods like the NPV and IRR etcetera.

The empirical study also revealed that SMEs do not have a link between capital projects at hand and the strategic plan of the organisation, which means that the allocation of resources is not done in a manner that is in line with where the organisation intends to go or what it wants to acheive. Break-even analysis and scenario planning appeared to be the most popular forms of evaluating the possible risk associated with the project investment with, 44.4% and 37% respectively choosing these.

The following chapter discusses the summary, recommendations, and conclusion.

CHAPTER SIX

SUMMARY, RECOMMENDATIONS AND CONCLUSION

6.1 INTRODUCTION

This chapter summarises the literature study that was conducted and the analysis of the survey that was sent to the participants.

6.2 RESEARCH SUMMARY

The main objective of this study was to establish how to improve the performance of manufacturing SMEs within the Nelson Mandela Metro, by investigating how strategic planning can be used as a tool for investment decisions for these SMEs. To do this, the researcher had to first understand the strategic planning process amongst SMEs, the performance measurement or evaluation within the SMEs, the capital budgeting techniques currently being used, as well as how SMEs evaluate project risks before deciding to invest in such projects.

The literature study conducted was twofold in nature; firstly the literature study was conducted to establish the role or the significance of the smes in our economy by establshing their contribution to the GDP as well as their contribution to employment creation. The literature also sought to establish if there is any form of strategic planning process that should be adhered to in order to improve the perfomance of SMEs, as well as how their performance should be evaluated in order to ensure that SME owner-managers do not deviate from the set strategy, thus not realising the full potential of the strategic planning process.

The second part of the literature study was conducted to establish to what extent SME owner-managers used various capital budgeting techniques in order to evalute prospective capital projects. This part of the literature study also incorporated or sought to establish how these SME owner-mangers also went about evaluting the riskiness of the said projects.

It emerged that SMEs are still critical in addressing the social challenges facing developing countries like South Africa. The SME sector is still the main contributor to the GDP, it still acts as an engine room of our economy and a significant number of people are employed in this sector. It also emerged that strategic planning is critical for the success of the SMEs, as it serves as a road map of where the company is heading. It should also be used a guide or tool for the allocation of resources.

However, it also emerged that there were very few SMEs that had any form of strategic planning process in place. Those that did have some form of strategic planning, did it informally and there was never any link between the strategy and the performance evaluation of the units within the organisation. It also emerged that strategic planning in most SMEs is mostly done annually. Having said that, it was good to note that most SMEs did have a company vision statement that is communicated to all employees, though the goals or objectives of employees in most SMEs were not linked to the overall strategic objectives of the organisation.

6.3 PROBLEMS ENCOUNTERED

One of the major problems that were encountered were; the lack of willingness by business entities to participate in the survey. This was mainly due to the nature of the study and the questions posed particularly in section B (company details section). Some respondents were of the opinion that questions pertaining to turnover could be used for other purpose beyond the survey. The researcher thus had to explain that the questions were purely for stratifying the responses according to their small business act categories based on turnover, the number of employees and/or the asset value. However, after obtaining the responses, it was clear that the respondents answered the questions truthfully and honestly.

6.4 RECOMMENDATIONS

It is important that SMEs do not look at the investment decision in isolation from the strategic plan of the organisation. In other words, strategic planning should be used as one of the tools that will assist SME owner-managers when deciding on the projects to invest in. For example, capital budgeting techniques will assist SMEs to decide on which projects to invest in, taking into account the estimated cash inflows and the time value of money; however, the project that could seem profitable might not necessarily be the project that is in line with the strategic objectives of the organisation. Based on the empirical study conducted, the following is recommended:

6.4.1 Strategic Planning

Strategic planning serves as a road map which the company can or should follow in order to realise its objectives. It is thus advisable that SME owner-managers consider adopting the following suggestions with regard to their strategic planning:

- Ensure that the strategic plan of the organisation is aligned to the vision and mission of the organisation,
- SME owner-managers should adopt a formal strategic planning process with clear outcomes and time frames,
- The process should incorporate all the various stakeholders or business units managers and the goal setting process of this process should be understood and accepted by all parties involved,
- Each business unit managers should ensure that their departmental objectives are aligned to the vision and mission of the organisation. This will ensure that each department is aware of how their departments contributes to the overall strategic objective of the organisation.

6.4.2 Performance measurement

The following is recommended with regard to the performance measurement as part of the conceptual framework to assist SME owner-managers

- It is recommended that the SME owner-managers adopt a strategic performance measurement tool. This tool will ensure that all the various business units do not lose sight of their strategic objectives.
- Whilst it is important for SME owner-managers to track the performance of their staff, the performance measurement tool should not be perceived as a tool for determinating annual remuneration increase, but rather as a strategy implementation tool.

- It is also recommended that the SME owner-managers align the organisation’s strategic plan to the employee’s individual goals. However, these goals must be set and agreed upon by both the employees and the respective business unit mangers. This should help employees understand how their individual roles contribute towards the company’s strategic objects.

6.4.3 Capital budgeting

As was expected, most SMEs, particularly the small businesses, are relying ‘gut feel’ when making or choosing which projects to invest in. The other popular option with regard to the capital budgeting techniques is the pay back method of evaluating the projects. This suggest that the SMEs are more concerned with the short term obligations of their investment; that is, how quickly will the money invested be recovered. It should, however, be highlighted that the the preferred method in this case, which appears to be the pay back method, has its own short comings. This method does not take into account the time value of money and it also ignores the cash inflow or outflows that may or will occur beyond the payback period.

It is acknowledged that one of the reasons for choosing the technique(s) stated above, was due to its simplicity and the lack of capacity with regard to skilled personnel.

- However, SME owner-managers should consider using the more sophisticated capital budgeting techniques such as the net present value method and the internal rate of return which do take into account the time value of money amongst other things.

- Training and development in field of finance and management accounting may be a solution to address the shortage of skills and to increase the capacity of the SMEs in order to adopt the more sophisticated capital budgeting techniques.

- Alternertively, the outsourcing of such calculationg to accounting or consulting firms may be a cheaper option as these may be the once off costs during the capital budgeting process.

6.4.4 Risk evaluation

Risk evaluation is about an undesirable incident occuring and analysing how it could affect the envisaged outcomes of the project should it occur. For example, a project that seemed to be profitable could be too sensitive if certain variables, that it strongly depends on, do happen. The objective is thus to evalute the sensitivity of the project's expected cash flows if such unwanted activities do occur, and how could they be mitigated to avoid them or how should the SME owner-managers be prepared to work around them.

- It is therefore recommended that risk evaluation be incorporated as part of the project appraisal or evaluation so as to ensure that all the undesirable factors have been considered and prepared for.
- Break even may be an easier tool as it will help the SME owner managers to understand how many additional units the company will have to produce to cover the increased fixed costs as a result of the projects.
- A sensitivity analysis may also be used in conjunction with various risk evaluation methods to evaluate the sensitivity of the projects when some factors that have a effect to the project potentially change such as the exchange rate if the project material is sourced from abroad and the interest rate if the project is financed by debth.

6.4.5 Recommendations for future research

This research paper only focused on the manufacturing SMEs within the Nelson Mandela Metropole. It is thus recommended that a similar study be conducted across the various sectors of SMEs, to establish the status of strategic planning within the SME sector in general. This will establish whether the industry or sector has an influence on how strategic planning is perceived. It will also increase the pool of SMEs from which the population can be drawn, thus allowing conclusions that are representative of the entire SME sector.

6.5 LIMITATIONS OF THE STUDY

One of the limtations of this study was the inability to attribute the success or the failure of the SMEs solely to strategic planning or the lack thereof. The good performance, as suggested by some SMEs, could be as a result of many other factors that were outside the scope of this study.

6.6 CONCLUSIONS

SMEs still have an inportant role to play in the economy. Literature reveals that SMEs are still the major contributors towards GDP. SMEs are also perceived to be critical in addressing the inequalities of the past. The literature also revealed that in order for the South African government to address some of the social challenges facing our country, such as the high rate of unemployment and the low rate of econmic growth, it would be best if the government could leverage the potential that the SME sector potentially has in addressing these challenges. However, though the role that SME play is unquestionable, the failure rate of businesses in this sector in South Africa is one of the highest in the world. Some of the factors that previous researchers highlighted as factors contributing to this high failure rate, were poor planning and improper allocation of resources.

The objective of this research was to establish how strategic planning could be used as an investment decision-making tool by SMEs in the Nelson Mandela Metropole. In order to achieve this objective the following subproblems had to be addressed:

The first sub-problem, strategic planning process was discussed in chapter two. The literature revealed that strategic planning is a road map which SMEs may use in order to acheive their objectives. The literature suggests that SMEs, that perform strategic planning, are the ones that are most likely to succeed. It also emerged that strategic planning can also assist the SME ownner-managers with the allocation of resources. The strategic planning process steps that must be followed by the SMEs in order to realise these objectives were also outlined. The barriers to the successful implementation of the strategic planning process were also outlined. The literature also highlighted some of the benefits of embarking on a strategic planning process.

According the analysis of the data collected by means of the questionnaire, SMEs acknowledged their awareness of the significant role that strategic planning can play towards the success of their organisations. it is also clear that there is some level of strategic planning done by some SMEs. However, there is no formal strategic planning process in place. The empirical study also revealed that all SMEs do have vision and mission statements; however, these vision and mission statements are not communicated throughout the organisation. This means that SMEs still do not reap the full benefit of a formal strategic planning process that can be relied upon and be used as a guideline for decision-making and goal setting.

The second sub-problem, what strategic performance measurement systems do SME owner-managers currently use, was addressed in chapter two. The literature revealed that strategic planning can be used as more than just a performance measurement tool, it can contribute more effectively to strategic alignment, organisational learning and diffusion of knowledge throughout the organisation. Strategic performance measurement can help organisations define and achieve their strategic objective, align behaviours and attitudes and, ultimately, have a positive impact on organisational performance.

The literature revealed that most respondents believe that strategic planning has a significant role to play with regard to the success of their organisation. However, 85% of the respondents stated that their organisations do not have a strategic performance measurement in place. The lack of personnel, lack of managerial capacity and limited financial resources were cited as major contributors towards the non implementation of strategic performance measurement processes.

The third sub-problem, what capital budgeting techniques are currently being used by SME’s in the region, was discussed in chapter three. The literature highlighted various capital budgeting techniques that the SME owner-managers may use when deciding on the capital projects to invest in. The capital budgeting process steps were also outlined. It emerged that second step of the of the capital budgeting process is strategic planning. This reiterates the significance and the link of strategic planning as two concepts that should not be looked at in isolation.

The empirical study revealed that SMEs understand that capital budgeting is critical for the success of the organisations. However, very few SMEs have a formal capital budgeting process. It also became evident that most SMEs are still relying on the traditional capital budgeting techniques; that is, ‘gut feel’ and the payback methods of evaluating projects, with most of them stating that they are not using the sophisticated methods like IRR and the NPV due to the lack of human capacity. This suggests that SMEs are exposed to the risk associated with the short comings of the traditional capital budgeting methods, such as not considering the time value of money when calculating the project cash inflows.

The fourth sub-problem, how do SME managers evaluate the risk of the projects and hand, was discussed in chapter three. The various possible forms of risk were outlined. A discussion on how to evaluate project risks was also outlined.

The empirical study suggests that the largest group of SMEs rely on the break-even analysis and the scenario planning as the major indicators of the impact the projects will or may have on the organisation. This also reiterates that SMEs are aware that just because a project seems viable in terms of the capital budgeting techniques, there may still be some unforeseen circumstance that may result in a project not achieving the forecasted cash inflows. Thus the break-even and the scenario planning serve as more of a margin of safety to ensure that the organisation will still be able to meet its short-term obligations, should the unwanted circumstance occur.

There has been a positive correlation between the companies that embark on a formal strategic planning process and growth of the organisation in terms of sales growth, number of employees as well as the net asset value. However, it is must be reiterated that the sample was not big enough to warrant that such is the case.

Finally, the results of this study are not representative of the entire population of SMEs, they are just indicative of the role that strategic planning has on the investment decision if used properly.

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ANNEXURE A: QUESTIONNAIRE COVER LETTER

Dear Respondent

My name is Bereng Kikine and I am studying towards my MBA (Masters in Business Administration) degree at the Nelson Mandela Metropolitan University Business School. I am conducting research on how to improve the performance of manufacturing SMEs within the Nelson Mandela Metro by investigating how strategic planning can improve the investment decision of SMEs.

You are part of the selected sample of respondents whose views I seek on the above-mentioned matter. I would appreciate it if you could answer a few questions. It should only take about 10 to 20 minutes of your time and I want to thank you in advance for your co-operation.

Your completion of the questionnaire is important for the accuracy of my study and the understanding of the strategic planning process and investment decision in manufacturing SMEs. Please answer the questions as accurately as possible, bearing in mind that there are no correct or incorrect answers.

Please note that this study is part of my academic curriculum and the information obtained will remain confidential and will not be used for any other reason other for the reason stated above.

Thank you, in anticipation
Bereng Kikine

Tel no: 041 978 7017
Cell no: 073 374 3158
Email: **bereng.kikine@rehau.com**

ANNEXURE B: MEASURING INSTRUMENT

Section A: Respondents' Biographical Details

The following questions relate to your background and experience. Kindly complete this section by circling the bullet applicable to you.

1) What is your gender?

- Male
- Female

2) What is your age?

- Younger than 36 years
- 36 to 45 years
- 46 to 55 years
- Older than 55 years

3) What is your current Job title?

- Financial Manager
- Financial Accountant
- Management Accountant
- Other (please specify)…………………………………………….

4) What is your education level?

- National Diploma
- Bachelor Degree
- Master Degree
- Doctoral Degree
- Other (please specify)…………………………………………….

5) How many years of business experience do you have?

- Less than 6 years
- 6 to 10 years
- 11 to 20 years
- More than 20 year

Section B: General Company Details

6) What is your Company name: ....

7) Your firm, business or organization is a:

- Sole proprietorship
- Partnership
- Close corporation
- Private company

8) How long has your business been in operation?

- Less than 6 years
- 6 to 10 years
- 11 to 20 years
- More than 20 years

9) How many employees do you currently have?

- Less than 5 employees
- 5 to 20 employees
- 21 to 50 employees
- 51 to 200 employees
- More than 200 employees

10) Your operations are

- Domestic only
- International only
- Domestic and international

11) In terms of total annual turnover, the size of your company is;

Less than R150,000	**R0.15m to R4.39m**	**R4.40m to R9.99m**	**R10.0m to R39.9m**	**R40m or more**

12) In terms of total gross asset value (fixed property Excluded) thse size of your company is;

Less than R100,000	**R0.1m to R1.49m**	**R1.5m to R3.74m**	**R3.75 to R14.9m**	**R15m or more**

Section C: Strategic Planning

13) Strategic planning is important for the success of my organisation

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree

14) Which of the following best describes your company's strategic planning process?

Formal and Structured	Formal but Unstructured	Informal and Structured	Informal but Unstructured	We don't have a process	Other

15) How often is your company's strategic plan revised?

Monthly	Quarterly	Six-Monthly	Annually (once a year)	Every two years	Other

16) Please indicate by selecting **YES/NO** which of the following statements is relevent to your organisation

STATEMENT	YES	NO
My company has a vision statement		
The vision statement is communicated to all employees in the organisation		
My company has a mission statement		
The mission statement is communicated to all employees in the organisation		
The goals and objectives of my company are clear and specific		
The goals and objectives of the company are based on the vision and mission of the organisations		
The goals and objective of the organisation are filtered throught the entire organisation		

17) Please rate which of the following reasons or statements are possible hindrances to successful implementation of strategy in your organisation ?

STATEMENT	**Strongly Agree**	**Agree**	**Neutral**	**Disagree**	**Strongly Disagree**
Communication was in adequate					
Implementation took longer than anticpated					
A shortfall in employee capabilities					
Overall goals of strategy not well enough understood by staff					
Co-ordintionof of implementation not effective enough					
Crises distracted attention from implementation					
Unanticipated external problems arose					
External factors impacted on implementation					
Other, please specify:					

18) The Capital investments or projects currently underway are informed by the strategy of our organisation

Strongly Agree	**Agree**	**Neutral**	**Disagree**	**Strongly Disagree**

Section D: Capital Budgeting Techniques

19) Does your company engage in a formal budgeting process?

- Yes
- No

20) Capital budgeting is important for the success of my organisation

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree

21) Does your company prepare a written business plan projecting the major investments planned over the next few years?

- Yes
- No

22) What is the size of the capital budget in your organisation?

- Less than R2.5 Million
- R2.5 – R5.9 Million
- R6.0 – R7.5 Million
- R7.6 – R10 Million
- Greater than R10 Million

23) Please circle the relative importance of each of the following techniques USED in your firm to evaluate projects.

Capital Budgeting Techniques	Not used	Unimportant	Of Little Importance	Moderately Important	Important	Very Important
Managerial Judgment (informal)						
Payback						
Net Present Value						
Internal Rate of Return						
Accounting Rate of Return						
Profitability Index						
Other please Specify						

Section E: Performance Measurement system

24) Does your company have a strategic performance measurement in place?

- Yes
- No

25) Strategic performance measurement systems are important for the success of the organisation

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree

26) Please rate which of the following statements are possible hindrances to successful implementation of strategic performance measurement in your organisation

STATEMENT	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Lack of Human Resource					
Lack of Managerial capacity					
Limited financial resource					
Lack of formalised processes					
Misconception of performance measurement					
Other, please specify					

27) In the past 2 years, how has your company grown or declined with regard to:

STATEMENT	20 % or Higher	10 to 19 %		0% to minus 10%	More than minus 10%
Sales Growth					
Number of Employees					
Asset Value					

Section F: Risk Management

28) To what extent do you agree/disagree that the following are major risks that your company face when it comes to investment decision?

Types of Risk	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Corporate Risk					
International Risk					
Stand-Alone Risk					
Competitive Risk					
Market Risk					
Project Specific Risk					
Other, please specify					

29) Please indicate by selecting **YES/NO** which of the following method(s) is used as a measure of risk in your organisation?

Methods of evaluating risk	YES	NO
Sesitivity Analysis		
Scenario Analysis		
Break-even Analysis		
Simulation Methods		
Other, please specify		