BARRIERS FACED BY SMMEs IN ACCESSING FINANCE

BY

SIYABONGA MACPHERSON CAGA

9536968

PROMOTER: DR. MARGARET CULLEN

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DECLARATION

I, Siyabonga MacPherson Caga student number 9536968, hereby declare the following:

- The research paper for “Masters in Business Administration” has not previously been submitted for assessment to another University or for another qualification;

- The work contained in this research paper is my own original work; and

- All sources used or referenced have been documented and recognised.

____________________________                            ____________________
SIYABONGA MACPHERSON CAGA                                      DATE
ACKNOWLEDGEMENTS

Upon the completion of this dissertation, I would like to pay my regards to all the people that helped me with this research, those who supported and encouraged me to work towards its completion and provided valuable guidance for making it better. I particularly wish to thank my supervisor for the advice, help and constructive criticism provided by her during the course of the study. I would also like to express my gratitude for all the respondents of the study who gave their valuable time and permitted me to use their opinions and views in the research. It would have been impossible to find answers to the research questions without their valued opinions. I would like to present a final word of thanks to my family in particular my wife Tabisa, who was a constant pillar of support and encouraged me to produce good quality research work.
SMMEs have been cited as major players in economic development in South Africa and in other developing countries. In South Africa SMMEs contribute more than 52 percent towards the GDP. Subsequently, the South African government has taken various steps to encourage their growth and to improve access to finance for SMMEs. Despite this, securing finance remains a challenge in this group of enterprises. Since SMMEs have unique financial needs, commercial banks and other funders are faced with difficulties in catering for them. Banks in particular have been reluctant in financing these high-risk ventures. SMME owners as a result still prefer informal sources of finance such as personal savings, retained earnings or friends or family rather than bank loans.

The study purpose was to examine the barriers that are faced by SMMEs in accessing finance. To do this a survey was conducted on 40 SMMEs operating in the manufacturing sector in Tshwane Metropolitan Municipality.

The research findings indicated various barriers that are faced by SMMEs in accessing finance. Dominating among the barriers are those that are related to perceived risks of SMMEs by funders, including lack of collateral or business assets, lack of financial statements, excessive red tape by funders, administrative burden associated with applications as well as unfair evaluation of risks and profitability of SMMEs by funders. Other factors that were identified as barriers were those that are associated with poor business plan development, poor business training and development and source of funding. The majority of the respondents recommended that there must be better risk and profitability evaluation, easy loan repayment methods, more government support for SMMEs, flexible eligibility criteria for SMME loans and proper loan amount allocations.
LIST OF ACRONYMS AND ABBREVIATIONS

BBBEE      Broad Based Black Economic Empowerment
BBSDP      Black Business Supplier Development Programme
BDS        Business Development Services
BEE        Black Economic Empowerment
BSM        Business Sophistication Measure (FinScope)
CDE        Centre for Development of Enterprise
CIPC       Companies and Intellectual Property Commission
CIPRO      Companies and Intellectual Property Registration Office
CIS        Co-operative Incentive Scheme
EC         Eastern Cape
EC         European Commission
EIP        Enterprise Investment Programme
FSCs       Financial Services Cooperatives
GCIS       Government Communication and Information System
GDP        Gross Domestic Product
GEM        Global Entrepreneurship Monitor
IDC        Industrial Development Corporation
IFC        International Finance Corporation
IMF        International Monetary Fund
IT         Information Technology
Khula      Khula Enterprise Development Fund
LTD        Limited Company
MIP        Manufacturing Investment Programme
MIS        Management Information Systems
Namac      National Manufacturing Advisory Centre
NCA        National Credit Act
NCR        National Credit Regulator
NEF        National Empowerment Fund
NIC  National Industrial Chamber
NSMED  Micro, Small and Medium Enterprises Development
Ntsika  Ntsika Enterprise Promotion Agency
NGOs  Non Governmental Organisations
NSB Act  National Small Business Act of 1996 as amended by the National Small Business Amendment Act of 2003 and 2004
NSBAC  National Small Business Advisory Council
OECD  Organisation of Economic Co-operation and Development
PPD  Product Process Development
SA  South Africa
SEDA  Small Enterprise Development Agency
SPII  Support Programme for Industrial Innovation
STP  Seda Technology Project
SETAs  Sector Education and Training Authorities
SMBs  Small and Medium Businesses
SMMEs  Small, Medium and Micro-Enterprises
The dti/DTI  Department of Trade and Industry
TSP  Tourism Support Programme
UN  United Nations
USA  United States of America
USAID  United state Agency for International Development
WB  World Bank
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>DECLARATION</td>
<td>i</td>
</tr>
<tr>
<td>ACKNOWLEDGEMENTS</td>
<td>ii</td>
</tr>
<tr>
<td>ABSTRACT</td>
<td>iii</td>
</tr>
<tr>
<td>LIST OF ACRONYMS AND ABBREVIATIONS</td>
<td>iv</td>
</tr>
<tr>
<td>TABLE OF CONTENTS</td>
<td>vi</td>
</tr>
<tr>
<td>LIST OF TABLES</td>
<td>xiv</td>
</tr>
<tr>
<td>LIST OF FIGURES</td>
<td>xv</td>
</tr>
</tbody>
</table>

## CHAPTER 1

### PROBLEM STATEMENT AND THE OUTLINE OF THE STUDY

1.1 INTRODUCTION  
1.2 ACCESS TO FINANCE  
1.2.1 What is Access to Finance?  
1.2.2 Indicators of Access to Finance  
1.2.3 Measuring Access to Finance  
1.2.4 Formal and Informal sectors of Finance  
1.3 SMME BANKING  
1.4 PURPOSE OF THE STUDY  
1.5 PROBLEM STATEMENT
1.6 RESEARCH OBJECTIVES 8
1.7 RESEARCH QUESTIONS 8
1.8 RESEARCH DESIGN AND METHODOLOGY 9
  1.8.1 Research Sample 9
  1.8.2 Data Analysis 9
  1.8.3 Ethical Considerations 10
1.9 HYPOTHESIS 10
1.10 OUTLINE OF THE STUDY 10
1.11 SUMMARY 11

CHAPTER 2
AN OVERVIEW OF SMMEs

2.1 INTRODUCTION 13

2.2 DEFINITION OF SMALL, MEDIUM AND MICRO ENTERPRISES (SMMEs) 13
  2.2.1 International Definitions 13
    2.2.1.1 Micro Enterprise 14
    2.2.1.2 Small Enterprise 14
    2.2.1.3 Medium Enterprise 15
  2.2.2 Definitions in Developing Countries 15
    2.2.2.1 Micro Enterprise 16
3.3.1 Access to Finance 33
3.3.2 Barriers to Funding for SMMEs 35
   3.3.2.1 Perceived Risk of SMMEs by Creditors 35
   3.3.2.2 Lack of Education and Business Skills 37
   3.3.2.3 Poor Business Plan Development 39
   3.3.2.4 High Number of Informal SMMEs 40
3.4 SUMMARY 42

CHAPTER 4
METHODOLOGY

4.1 INTRODUCTION 43
4.2 RESEARCH PARADIGM 43
4.3 RESEARCH METHOD 44
   4.3.1 Quantitative Research 45
   4.3.2 Qualitative Research 45
4.4 RESEARCH APPROACH 46
4.5 POPULATION AND SAMPLING 46
   4.5.1 Location of the Study 47
4.6 DATA COLLECTION 48
4.7 THE MEASURING INSTRUMENT 48
CHAPTER 5
DATA ANALYSIS AND FINDINGS

5.1 INTRODUCTION

5.2 DEMOGRAPHICS OF RESPONDENTS

5.2.1 Source of Start-up Capital

5.3 BARRIERS FACED BY SMMEs IN ACCESSING FINANCE

5.3.1 Perceived Risks of SMMEs by Funders

5.3.2 Poor Business Plan Development

5.3.3 Poor Business Training and Development

5.3.4 Source of Funding

5.4 SUGGESTIONS FOR IMPROVEMENT
5.4.1 Better risks and profitability evaluation as well as easy loan repayment methods
5.4.2 More Government support for SMMEs
5.4.3 Flexible eligibility criteria for SMME loans and proper amount Allocations
5.4.4 Business management skills should be taught as early as primary school
5.4.5 SMMEs need to learn to write business plans for themselves

5.5 SUMMARY

CHAPTER 6
CONCLUSION AND RECOMMENDATIONS

6.1 INTRODUCTION
6.2 OVERVIEW OF THE RESEARCH
6.3 RESEARCH OBJECTIVES REVISITED
6.4 CONTRIBUTION OF THE STUDY
6.5 STUDY LIMITATIONS
6.6 KEY RESULTS OF THE STUDY
6.7 SUGGESTIONS PUT FORWARD BY THE RESPONDENTS
6.8 RECOMMENDATIONS
6.8.1 Improve the levels of managerial competencies and skills of SMMEs 82
6.8.2 Improve financial support to structures that support SMME growth and development 83
6.8.3 Flexible SMME eligibility criteria 83
6.8.4 Increasing the levels of formality of SMMEs 83
6.8.5 Increase awareness of the SMME related products including credit access 84
6.9 SUGGESTION FOR FUTURE RESEARCH AREAS 84
6.10 CONCLUSION 85

REFERENCES 86

ANNEXURES

CONSENT FORM 105

RESEARCH QUESTIONNAIRE 106
LIST OF TABLES

Table 1.1     Indicators to measure Access to Finance                               5
Table 5.1     Type of business                                                  57
Table 5.2     Source of start-up Capital                                        60
Table 5.3     Source of Capital for business expansion                          61
Table 5.4     Question statements                                               62
Table 5.5     Recommendations made by respondents                               72
LIST OF FIGURES

Figure 5.1  Gender Composition (≈40)  54
Figure 5.2  Race Distribution  55
Figure 5.3  Level of Education  56
Figure 5.4  Number of Years in operation  59
CHAPTER 1

PROBLEM STATEMENT AND THE OUTLINE OF THE STUDY

1.1 INTRODUCTION
Small, Medium and Micro Enterprises (SMMEs) have recently been recognised as boosters of GDP and economic development (Myciin, 2012). It is also believed by some that SMMEs may even be the solution to the unemployment problem faced by all economies of the world (Fisher & Reuber, 2000). SMMEs can be gateways to economic prosperity for developing economies, especially in South Africa.

The South African government has recognised the role and importance of SMMEs in their economy and the Department of Trade and Industry (DTI) and the Small Enterprise Development Agency (SEDA) have taken various measures to provide adequate and appropriate finance for these emerging enterprises. This chapter explains access to finance and its importance to SMMEs and their owners. It also discusses the attitudes of commercial banks towards SMMEs. The purpose, problem statement, objectives, research questions, research design and methodology as well as the hypothesis are also briefly discussed followed by the outline of the entire project.

1.2 ACCESS TO FINANCE
Finance is the lifeblood of a business and exists at its very core. It is impossible for a business to function without it (Kunt, Beck & Honohan, 2008). This is why policy makers and practitioners have started paying more attention to the regulation and allocation of finance in such a way that can be efficient, boost economic growth, reduce poverty and evenly distribute national income. However, such a utopian concept is a little further away than preferred. This is due to the limited range of available financial services. Those financial services that do cater for the population have such strict policies that
many fail to meet the eligibility criteria and are left without financing opportunities (Kunt, Beck & Honohan, 2008).

South Africa has between 2.4 and 6 million SMMEs (National Credit Regulator, 2011). About 20 percent of these SMMEs are registered with Companies and Intellectual Property Commission (CIPC) and they own a bank account. Of the formal SMMEs, less than 100,000 (27.3 percent) successfully apply for and receive funds from the formal financial sector. Half of the SMMEs are not registered and they are operating informally. About 84.7 percent of the informal SMMEs are financially excluded, that is they do not have access to the formal financial markets. Thus, the total financing gap, both formal and informal SMMEs is estimated at around 45-48 percent of all SMMEs in South Africa (National Credit Regulator, 2011).

1.2.1 What is Access to Finance?

The World Bank used two different definitions in their Access to Finance survey (World Bank, 2008). These definitions, which are taken from two sources, will also be used in this study and will stand true for any further references to “Access to Finance” in this research study.

Definition 1:

An individual or a business is said to have access to finance when they either have a bank account; use it as their primary financial institution; use mainly non-bank institutions or can reach their financial institution by foot (Kumar, 2005).

Definition 2:

Two indicators for access to finance are supply side indicators and demand side indicators. Supply side indicators include the area coverage of the bank, credit distribution, and deposit and branch distribution. Demand side indicators include credit access without a formal loan (Basu, 2006).
1.2.2 Indicators of Access to Finance

The World Bank (2005) outlined four core indicators of access to finance. These were classified into two dimensions; the institutional dimension and the functional dimension. The institutional dimension included the following:

- The proportion of the adult population that uses a bank or bank-like institution;
- The proportion of the adult population which uses services from non-bank or other formal financial institutions, but does not use bank services;
- The proportion of the adult population which only uses informal financial service providers;
- The proportion of the adult population which uses no financial services at all.

The functional dimension included transactions, savings, loan and insurance (World Bank, 2005). According to Beck, Kunt and Peria (2007), access to finance relies on three important factors. These are physical access, affordability and eligibility.

Physical access:

This is the access point where financial services are obtained by customers in various convenient ways. An individual has physical access to finance if he can physically visit the financial institution conveniently.

Affordability:

This is the minimum payment or any other costs incurred by the debtors in return for the services offered by the bank. An individual has access to finance if he has the financial capacity to pay these costs.
Eligibility:

If an individual fulfils the criteria set by the bank in terms of financial status, documents and other personal information then he has access to finance. This criteria needs to be made more flexible with better use of risk assessment techniques in order to provide better access to finance (Beck, Kunt and Peria, 2007).

1.2.3 Measuring Access to Finance

There are various difficulties faced by practitioners when it comes to measuring access to finance. The problems they are faced with include the lack of empirical or unreliable data. The difference lies between the need and the demand for finance. What needs to be checked is whether the demand for access to finance arises out of a need for financing opportunities or a want (Beck, 2006). Providing access to finance in an area where there is no immediate need would lead to an ineffective financial system and would cause uneven distribution of wealth. Beck, Kunt and Peria (2007) classified access to finance in two ways. Finance could either be in the form of cash or credit and needs to be measured separately using different units of measure. The indicators of measurement of access to finance as presented by Beck, Kunt and Peria (2007) are as follows:
Table 1.1: Indicators to measure access to finance

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<tr>
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<th>Cash deposit</th>
<th>Credit Services</th>
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<tr>
<td><strong>Physical Access</strong></td>
<td>Number of locations where account can be opened</td>
<td>Locations to submit a loan application</td>
</tr>
<tr>
<td><strong>Affordability</strong></td>
<td>Minimum balance required to open a savings account to GDP per capita</td>
<td>Fee on consumer loans expressed as a percentage of GDP per capita</td>
</tr>
<tr>
<td><strong>Eligibility</strong></td>
<td>Number of documents required to open a checking account</td>
<td>Number of days it takes to process a loan application</td>
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</table>

Source: Beck, Kunt and Peria (2007)

The creation of an effective and efficient financial system is now a crucial requirement of all economies; developed or developing. Providing adequate and reliable access to finance is the gateway to economic prosperity as it provides small business owners with the opportunity to work to their full potential (Kunt, Beck & Honohan, 2008).

1.2.4 Formal and Informal sectors of finance

Finance can be obtained from two sectors in the economy; the formal and the informal sector. The formal sector includes organisations which have been officially registered with the government and have a license giving them permission to carry out business in their respective field (Suchada, Trankler, Cholada and Scholl, 2003).

The informal sector on the other hand, can be defined as the part of the economy that reflects the efforts of people without formal jobs to engage in some form of monetary economic activity (European Commission, 2008). There is a need for further
development of the formal sector of finance in order to facilitate SMME growth and development.

Many SMMEs rely on informal sources in order to start or expand their businesses. An efficient financial system with a strong formal sector and minimum reliance on the informal sector needs to be developed. This is due to the unreliable nature of informal sources and the fact that informal finance cannot be accurately measured empirically (McKernan, Pitt & Moskowitz, 2005).

1.3 SMME BANKING
The SMME banking industry is a recent and emerging industry still in the development stages. Providing finance to SMMEs was a challenge for commercial banks as they did not fully understand the needs and requirements of SMMEs (International Financial Corporation, 2010). Finance could not be provided in the same manner as to large organisations, as it had different evaluation techniques, criteria and difficult payment options which SMME owners could not have borne.

Micro-finance, on the other hand, is often too small an amount for the start-up or expansion of an SMME. These hardships not only make it difficult for SMMEs to obtain finance but were also a challenge for commercial banks when it came to providing finance. In developed countries, the SMME banking industry has reached a more established stage where banks provide exclusive finance to SMMEs and cater especially to their needs.

In developing countries, however, the SMME banking industry is still in the pre-mature stage.

The difference is not too much as the SMME banking industry is in the state of a global transition as it tries to understand this vast and emerging sector of the economy. Commercial banks have so far avoided financing SMMEs because they believe that they were too difficult to serve. Now that they have started to understand the unique needs of SMMEs they are able to provide customised services to them. In fact, SMMEs
have become more valued customers for banks than larger corporations. This is because of the attitude of SMME owners towards banks. SMMEs prefer to be treated as valued customers and are more willing to pay back any credit or loan to the bank on time (International Financial Corporation, 2010).

Banks are faced with various challenges when it comes to SMME finance (International Financial Corporation, 2010). First, SMMEs prefer a more personalised form of service and require more attentive services. It is due to this reason that relationship-lending with banks has become a common trend among SMMEs. These personalised demands need to be met with personalised services which may be costly and unconventional for banks; especially those which have only recently begun to cater to the SMME sector.

Banks need to overcome these challenges by keeping costs down and focussing on the most immediate needs. An efficient risk evaluation strategy needs to be developed in order to ascertain which SMMEs require more immediate and justified financing. The International Finance Corporation, (2010) made the following suggestions to banks which were either engaged in or were about to engage in SMME finance and the corporation suggested banks to focus on five core areas:

- Strategy, SMME focus and execution capabilities;
- Market segmentation, products and services;
- Sales culture and delivery channels;
- Credit risk management; and
- IT (Information Technology) and MIS (Management Information Systems).

The above suggestions will aid in the financing and development of SMMEs, especially in developing countries. A thorough understanding of the SMME market, effective risk evaluation criteria and better financing opportunities for SMMEs can help speed up the development process of developing countries and contribute substantially to their annual GDP.
1.4 PURPOSE OF THE STUDY
The purpose of the study is to determine why SMMEs in Tshwane Metropolitan Municipality face difficulties in obtaining financial assistance from financial institutions. A host of literature on this issue exists. Even though large organisations such as the World Bank and the International Monetary Fund (IMF) have taken an interest in the global promotion of SMMEs and the South African government has taken major steps to boost SMME development, still there are core problems which have not been resolved. This served as motivation for the researcher to understand why barriers to SMME finance existed despite all these global and local efforts.

1.5 PROBLEM STATEMENT
SMMEs are gateways to economic prosperity and can boost the GDP and contribute to it substantially. Finance for SMMEs, however, is hard to obtain due to various financial and non-financial barriers in particular the commercial.

1.6 RESEARCH OBJECTIVES
The objectives of this study are as follows;
- To identify the conventional sources of finance for start-up of SMMEs in the manufacturing sector in Tshwane Metropolitan Municipality;
- To identify the conventional sources of finance for expansion of SMMEs in the manufacturing sector in Tshwane Metropolitan Municipality;
- To determine the common barriers to finance for SMMEs in the manufacturing sector in Tshwane Metropolitan Municipality;
- To make suggestions for the improvement of access to finance for SMMEs.

1.7 RESEARCH QUESTIONS
The questions that this study aims to answer are the following.
- What is the source of start-up capital for SMMEs in the manufacturing sector in Tshwane Metropolitan Municipality?
What is the source of finance for expansion for SMMEs in the manufacturing sector in Tshwane Metropolitan Municipality?

What barriers are faced by SMMEs in the manufacturing sector in obtaining finance in Tshwane Metropolitan Municipality?

What measures can be taken to improve access to finance for SMMEs?

1.8 RESEARCH DESIGN AND METHODOLOGY

Blanche, Durrheim, and Painter (2006) describe research design as a strategic framework for action that serves as a bridge between the research question and the implementation of the research. There are two recognised approaches to research, namely the qualitative and quantitative paradigms. The study employed a quantitative research design utilising survey as a data collection technique. Blanche et al (2006) pointed out that the two main primary strengths of the quantitative research design are that the findings are generalisable and that the data is objective.

1.8.1 Research Sample

Maree (2010) explains that purposive sampling is used when the researcher has a specific purpose in mind and with the aim of making the sample reflect key characteristics of the targeted population. In this study the purposive research sample was used as it was convenient to obtain SMME owners at the National Industrial Chamber offices (NIC) during their regional meeting. The sample taken comprised of 40 SMME owners who have been operating in the manufacturing sector for the past two years or more.

1.8.2 Data Analysis

The data collected for the research study was graphically analysed in order to observe the frequencies of occurrence. The results were then discussed and compared with the literature.
1.8.3 Ethical Considerations
The researcher gave the participants adequate information about the study and they were also given an option to opt out, should they wish to. Approval was obtained from the management of the National Industrial Chamber to conduct the study. Participants signed a written consent before participation. The researcher also ensured that the information provided by the research participants cannot be linked to the individual participants.

1.9 HYPOTHESIS
The hypothesis for this study is that even though various measures have been taken to improve access to finance to SMMEs in the manufacturing sector of South Africa, SMMEs are still faced with difficulties in obtaining finance.

1.10 OUTLINE OF THE STUDY
The study will be divided into chapters which will deal with each aspect separately. Following are the details that outline the issues that will be dealt with in the coming chapters.

Chapter 2: This chapter includes the literature review. Previous studies on this topic will be reviewed and analysed in order to see what similarities or differences exist between the approach of the researcher and the views of previous researchers.

Chapter 3: This chapter will review the appropriate literature regarding SMME policies and institutional framework in South Africa, common causes for SMME failure in South Africa and will give a hypothesis regarding barriers to funding for SMMEs.

Chapter 4: This chapter will outline the methodology to be used in this study. This will include the research paradigm, the research method, the research approach, sampling methods, data collection and the questionnaire will be discussed. The pilot study, ethical
considerations, validity and reliability and data analysis will also be explained in this chapter.

Chapter 5: This chapter includes a discussion on the results found from the survey. Detailed analysis of the finding will be given and the findings will be compared to the literature.

Chapter 6: This chapter includes the conclusion of the findings of the research study and shows how the objectives were fulfilled. It also provides recommendations for future research and practice.

1.11 SUMMARY
Access to finance refers to the ability of a customer to obtain finance. This ability relies on three factors; physical access, affordability and eligibility. A person is said to have access to finance if he can physically access the branch of a commercial bank by foot or any other means of transport, can afford the interest rates and repay the amount applied for and fulfils the required criteria of the commercial bank. Commercial banks are faced with many difficulties when it comes to financing SMMEs. These problems arise due to their lack of knowledge regarding the unique needs and requirements of SMMEs.

Banks have taken many steps to improve access to finance for SMMEs but the transition has been slow, especially in developing countries. The purpose of this research study is to determine why SMMEs in South Africa face difficulties in obtaining finance from commercial banks. The researcher aims to achieve that purpose by finding out the common sources of finance for SMMEs in South Africa at the time of start-up and expansion and to identify the barriers faced by them and to provide solutions for these barriers.
The following chapter will look at literature regarding SMMEs in an attempt to give a deeper understanding of SMMEs both globally and in South Africa.
CHAPTER 2

AN OVERVIEW OF SMMEs

2.1 INTRODUCTION
In this chapter the literature regarding SMME development and its role in economic growth is reviewed. Global definitions of SMMEs are given, as well as some definitions used in developing countries. A definition of SMMEs in South Africa is explained according to the National Small Business Amendment Act No. 29 of 2004. The chapter also includes a discussion on the contribution of SMMEs to the South African Economy, the various modes of finance available to SMMEs and various measures taken by the South African government to facilitate SMME growth.

2.2 DEFINITION OF SMALL, MEDIUM AND MICRO ENTERPRISES (SMMEs):
The acronym SME stands for Small and Medium Enterprise. In some countries the definition has been extended to SMME, Small Medium and Micro Enterprise. In this study the later definition will be used.

The main issue faced when defining SMMEs is the lack of a common definition. Existing definitions of SMMEs vary greatly from country to country. Creating a common global definition is thus difficult and complex (Ardic, Mylenko and Saltane, 2011). Consequently, many authors have tried to create an all-encompassing definition, but not without criticism.

2.2.1 International Definitions
SMME definitions can be broadly classified into two categories namely, the statistical definition and the economic definition. The National Credit Regulator (2011) noted that under the economic definition, for a business to be regarded as small it must be have a relatively small share of the market, it must be managed by its owners and its has to be
independent and should not be part of the larger enterprise. In contrast the statistical
definition quantifies the size of the SMME and its contribution to Gross Domestic
Product (GDP), employment and exports. It compares the extent to which the SMME
sector contribution has changed over time and across countries (National Credit
Regulator, 2011).

Fisher and Reuber (2000) argued that SMMEs are usually defined in terms of the
number of employees. The World Bank (2008) defines SMMEs in terms of three
categories, namely: employees, assets and annual sales. Other definitions may also
focus on total net assets, sales and investment level (Ayyagari, Beck and Kunt, 2005).
Ayyagari et al. (2005) further state that any private sector business employing 0-250
workers is said to be an SMME. This definition in general has gained considerable
importance in the economies of many countries in the world.

The definition of SMME by the European Commission (EC) takes into account three
different indicators, namely staff headcounts, annual sales and assets.

2. 2.1.1 Micro Enterprise:
A micro enterprise is described as a business employing less than 10 people. These
businesses have total net assets that are less than or worth US$ 100,000 (R 800,000)
and annual sales up to US$ 1 million (R 8 million) (International Financial Corporation,
2010).

The European Commission (2003) extends the annual sales or total assets to qualify
as a micro enterprise to US$ 2 million.

2. 2.1.2 Small Enterprise:
A business is regarded a small enterprise if it fulfils any of the following three criteria: (1)
it has less than 50 employees, (2) its net assets are less than or worth US$ 3 million (3)
it has annual sales up to US$ 3 million (International Financial Corporation, 2010).
The European Commission (2003) defined small enterprises as those enterprises employing less than 50 persons and with annual sales or total assets that do not exceed US$10 million (R 80 million).

2.2.1.3 Medium Enterprise:
A business is regarded as a medium enterprise if it has less than 300 employees, the total net assets are worth less than US$ 15 million (R 120 million) and with annual sales up to US$ 15 million (R 120 million), (International Financial Corporation, 2010).

The European Commission (2003) suggests that medium enterprises are those enterprises that employ less than 250 people and have annual sales not exceeding US$ 50 million (R 400 million) and/or total assets not exceeding US$ 43 million (R 344 million).

2.2 Definitions in Developing Countries
The term SMME covers a heterogeneous group of businesses in the developing economy which range from single artisan work in a small shop making handicrafts for a village market to sophisticated engineering companies selling in overseas markets (Reuber and Fisher, 2003). Kayanula and Quartey (2000) propound that SMMEs have been variously defined in developing countries but the most underlining criterion used is the staff complement of the enterprise. Ganbold (2008) concurs with the above view and further added that the size of the turnover also defines SMMEs and within developing countries this tends to be small compared to the developed countries.

According to Fisher and Reuber (2000) the characteristics of SMMEs in developing countries are labour force characteristics, sectors of activity, sex of owner and efficiency. SMMEs make up a large part of the workforce in most developing countries. The majority of SMMEs operate in retailing, manufacturing or trading sectors. The proportions of these sectors vary country by country. Retailing is found predominately in
the urban areas whereas manufacturing tends to be located in the rural areas (Kayanula and Quartey, 2000).

The dominant gender, when it comes to SMME proprietorship, is female. Businesses run by females are mostly found to be run from their own homes. Efficiency of labour depends mostly upon the size of the organisation. Single-owner SMMEs often generate the least net-returns. In developing countries, small enterprises are found to be inefficient as compared to medium-enterprises (Fisher & Reuber, 2000).

2.2.1 Micro Enterprise

The Government of India has enacted the Micro, Small and Medium Enterprises Development (MSMED) Act No 27 of 2006. The MSMED Act (2006) has modified the definition of micro, small and medium enterprises engaged in manufacturing or production industries. The MSMED Act (2006) described a micro enterprise as a business where investment in plant and machinery does not exceed Rs. 25 lakh.

2.2.2 Small Enterprise

The MSMED Act (2006) proposed that a small enterprise is where the investment in plant and machinery is more than Rs. 25 lakh but does not exceed Rs. 5 crore.

In the case of Malawi, the official definition of enterprise sizes is based on three criteria, namely: the level of capital investment, number of employees and turnover. An enterprise is defined as small scale if it satisfies a capital investment of US$ 2,000 (R 16, 000) -US$ 55,000 (R 440, 000) and if it employs 5 - 20 people and/or it has a turnover of up to US$ 110,000 (R 880, 000), (Kayanula and Quartey, 2000). According to the (Ghana Statistical Service, 2008) companies with less than 10 employees are regarded as small scale enterprises.
2. 2.2.3 Medium Enterprise

In India an enterprise where the investment in plant and machinery is more than Rs.5 crore but does not exceed Rs.10 crore is regarded as a medium enterprise (MSMED Act 2006). Companies with more than 10 employees are regarded as medium and large-sized enterprises (Ghana Statistical Service, 2008).

2. 2.3 SMME Definitions in South Africa

The National Small Business Amendment Act No 29 of 2004 defines five business categories in South Africa. It defines the categories in terms of number of employees, combined with annual turnover and gross assets of fixed property. These categories are described in more detail by (Abor and Quartey, 2010). For the purpose of this study, the focus will be on Micro, Small and Medium enterprises.

2. 2.3.1 Micro Enterprise

These enterprises have an annual turnover of less than R 150,000 per year. There is a lack of registration of these enterprises. Micro enterprises generally employ less than five people. The upper limit of gross assets of these enterprises is set at less than R 100,000. Private taxis and home-based businesses are some examples of these businesses.

2. 2.3.2 Small Enterprise

For small enterprises, the cut-off for number of maximum employees is 50. These are better established than the micro enterprises and have more complex business operations. They have an annual turnover between R2 million and R25 million and a gross assets range of between R2 million and R4.5 million.
2. 2.3.3 Medium Enterprises

The cut-off for maximum employees is 100 but the limit is increased for electrical, manufacturing, mining and construction enterprises to 200 employees. These differ from aforementioned enterprises in the manner of their business structure. These have an upper-management layer and decentralisation of authority which does not exist for previously mentioned enterprises. Their turnover ranges between R4 million and R50 million with gross assets between R2 million and R18 million (Abor and Quartey, 2010).

2. 3 IMPORTANCE OF SMMEs IN SOCIO-ECONOMIC DEVELOPMENT

SMMEs have become vital sectors of national economies due to their contributions to employment, GDP and capital formation (International Financial Corporation, 2010). Policy makers in developing countries have made SMMEs their primary concern when it comes to acceleration of growth-rate.

Job creation is one of the major economic benefits derived from SMME development. SMMEs have a comparative advantage over larger enterprises due to their flexible nature and can adjust to market conditions easily (Kayanula and Quartey, 2000). The comparatively low capital cost of SMMEs allows them to succeed in both rural and urban areas. This helps prevent migration to larger cities and can help to maintain a stable local community population density. It also raises the level of the domestic market and makes use of scarce resources.

The economic importance of SMMEs can be confirmed by their contributions to the GDP. Some high-income and middle-income countries note SMME contribution to be over half of the domestic product. SMMEs also account for a substantial amount of the GDP in low-income countries (International Financial Corporation, 2010).

Leutkenhorst (2004) explained the economic importance of SMMEs in a comprehensive manner. He classified them into two operational levels: the Enterprise Level and the Industrial System Level. The importance of SMMEs in each level is further described below:
2. 3.1 Enterprise Level
The economic importance at the enterprise level includes three factors; employment, productivity and innovation. According to the Organisation of Economic Co-operation and Development (2011), SMMEs play an important role in all OECD economies. They make up over 95 percent of enterprises and account for 60 to 70 percent of jobs in most OECD countries. The Organisation of Economic Co-operation and Development (2011) further proposes that SMMEs contribute between 25 and 35 percent of world manufactured direct exports and most of the growth of exports seems to be taking place in smaller SMMEs.

Statistics show that the majority of employment is facilitated by SMMEs. In a study by the Shandong University of Technology in China, it was observed that 60-80 percent of job creation relied solely on the SMMEs sector in USA. In Europe, it was observed that SMMEs accounted for 75 percent of the labour-force, whereas in Organisation of Islamic Corporation countries, SMMEs contribution to employment was 33 percent (Byrne, 2010). The success of SMMEs in developed countries paved the way for their acceptance in developing countries.

2. 3.2 Industrial System Level
At the Industrial system level, Leutkenhorst (2004) explained that SMMEs are important tools for the development and structure of systemic productive capacities. This is the creation of a resilient, flexible and interlinked industrial system.

Secondly, he pointed out the capabilities of SMMEs to attract foreign investment. By nature, the scale of operation and level of risk involved in doing business at this level would hardly encourage international business allowances or partnership. SMMEs can help in the creation of such an environment. Lastly, he labelled SMMEs as key agents of structural change.

Further, Leutkenhorst (2004) claimed that the turbulence created by SMMEs constantly restructured the economy. Since there is freedom of entry and exit of firms, SMMEs are
constantly being created. New small enterprises enhance competition, bring innovation and challenge old methods used by more established enterprises. This motivates established enterprises to refresh their approach. Potential SMMEs are thus encouraged by their relative competitive success in the existing market place.

Successful SMMEs help countries achieve higher income levels over time and boost employment. These two factors may indicate that not only are SMMEs important components of the economy but that they are also drivers of economic growth (International Financial Corporation, 2010).

2.4 SMMEs IN SOUTH AFRICA

2.4.1 SMME Composition in South Africa
The vast majority of SMMEs owners are females, they have not completed the secondary educational level, one in two of them started their business either because they could not find jobs or because they lost their jobs. Small business owners from Gauteng are significantly more likely to be financed, more formal, have access to banking services than small business owners from other provinces (FinMark Trust, 2010).

FinMark Trust (2010) further argued that 41.8 percent of small business owners do not use formal or informal products for business purposes, but rely solely on family and friends for borrowing and saving money at home.

2.4.2 Contribution of SMMEs to the South African Economy
In 2011, Small, Medium and Micro Enterprises contributed between 52 percent and 57 percent to the South African GDP. An estimate of 61 percent of employment in South Africa is attributed to SMME’s (Government Statistics and Information System, 2011). FinMark Trust (2006) argued that one of the best ways to address unemployment is to leverage the employment creation potential of small businesses and promote SMME
development. Small businesses have been identified as key in driving South Africa’s economic growth and the South African government’s strategy is to curb unemployment through job creation, alleviate poverty and redistribute wealth (FinMark Trust, 2010).

Maas and Herrington (2006) supported the above views and further indicated that SMMEs are seen as an important solution to South Africa’s developmental issues. The large and diverse manufacturing sector of South Africa is a major contributor to the achievement of its macro-economic objectives (SEDA, 2012). The manufacturing sector is a large contributor towards foreign direct investment, job creation and retention and it also improved balance of trade in South Africa.

In terms of the size of total registered SMMEs operating in South Africa, 90 percent of SMMEs are doing business in the manufacturing sector. In foreign trade, the manufacturing sector in South Africa accounts for 20 percent of export goods. In March 2007, 107 724 manufacturing companies were functional, out of which 42 percent were economically active (DTI, 2008). Out of these, only four percent were large enterprises whereas very small enterprises accounted for 53 percent and micro enterprises accounted for 25 percent of the economically active part of the manufacturing sector.

In the SMME sector of manufacturing, there were 60 154 active enterprises. Out of these, 73.1 percent were close corporations and 25.6 percent were private businesses (SEDA, 2007).

2.5 SMME FINANCE

The important role that SMMEs play in an economy has been explained above. However, the many benefits of SMMEs cannot be fully appreciated until appropriate funding has been provided for them, whereby they are allowed to reach their full potential. SMMEs require finance to set up or expand operations, develop new products or invest into quality of products and services rendered (OECD, 2006).
Most SMMEs start off with one or two owners who either invest their own money or borrow from close relatives or friends. The business then grows to such a point where such a mode of finance cannot meet the demand of the enterprise and thus they have to turn to other sources of finance to solve these problems (OECD, 2006).


### 2.5.1 Financial Statement Lending
Berger and Udell, (2004) stated that in financial statement lending funding is provided on the basis of the strength of the financial statements of the SMME owner. Two requirements of financial statement lending are detailed audited financial statements, which are informative of the company’s financial practices and a strong financial history, which will be reflected in the financial ratios mentioned in the statements. These conditions aim to ensure transparency and to provide guarantee to the lending institution that the owner will be able to repay the loan.

### 2.5.2 Small Business Credit Scoring
This is a credit facility based on hard information about the owner and the SMME. The owner’s data is mostly personal data like annual income, financial assets, fixed assets and other outstanding debts owing to the owner. Information of the SMMEs mainly comprises the current and fixed assets, turnover and profit and other liabilities of the SMMEs. The data is entered into a loan performance prediction model which generates a summary statistic or score for the loan. Financial institutions base the acceptance or rejection of a loan application on the score generated (Berger and Udell, 2004). Frame, Padhi and Woosley (2004) proposed that this model of finance is associated with credits that are rated as relatively risky, have high interest rates and are often located outside of the banks.
2.5.3 Asset-Based Lending

Stock (2010) pointed out that asset-based lending was once considered a last-resort finance option but has become a popular choice for companies that do not have the credit ratings, track record or patience to pursue more traditional capital sources. In asset-based lending, underlying assets of the business are taken as collateral. The amount of the loan depends upon the value of the asset. In case of a short-term loan, current assets such as inventory or receivables are taken as collateral for the qualifying loan whereas for long-term financing, equipment is used. The benefit of asset-based lending is that the financial and personal information of the owner and the SMME does not come under much scrutiny (Berger and Udell, 2004).

Stock (2010) argued that because asset-based lenders focus on collateral, rather than credit-worthiness, they do deals that traditional lenders will decline. Stock (2010) further highlighted that there are drawbacks of asset-based lending which include relatively high interest rates, and the ability of lenders to legally seize assets if the borrower misses payments.

2.5.4 Factoring

Klapper (2006) mentioned that in factoring a lender, who is also known as a factor, purchases the accounts receivable of the SMME. Factorisation is similar to asset-based lending as it takes place based on an underlying asset and not the value or financial situation of the SMME and its owner (Berger and Udell, 2004). Factoring is used in both developed and developing countries and it can provide important export services to local SMMEs.

Klapper (2006) concluded that factoring may be hampered by weak contract enforcement institutions and other tax, legal, and regulatory impediments. Fraud also represents a big problem in this industry, for example bogus receivables and nonexistent customers. Klapper (2006) however highlighted that the solution to these
barriers to factoring is the technology often referred to as reverse factoring where a lender purchases accounts receivables only from specific high-quality buyers and the factor only needs to collect credit information and calculate the credit risk for selected buyers.

2.5.5 Trade Credit
Trade credit is the purchase of product or other assets without the need to make immediate payment. Most other modes of finance have an underlying trade credit factor. Trade creditors, however, enjoy a comparative advantage when it comes to repayment. Since trade creditors hold possession of the product, they can stop supply in case of non-payment or accrued payment. Trade creditors also have the option of repossessing goods that have not been paid for (Berger and Udell, 2004).

Burkart and Ellingsen (2004) focused their attention on the moral hazard aspect in trade credit. Their main argument is that trade credit is costlier to divert than bank loans, so it diminishes the risk of the moral hazard problem. Consequently, they are of the view that trade credit can alleviate financing problems associated with moral hazard. Using this framework, Burkart and Ellingsen (2004) also argued that bank credit will be used instead of trade credit because it is cheaper. They further argued that business owners will seek trade credit only if the loan by the bank is insufficient to fund the project.

2.5.6 Relationship Lending
Relationship lending tries to go beyond the informational requirements of other modes of finance. The lender gains proprietary data about the borrower over a period of time regarding provision of loan and other products. This information, which cannot be observed from financial statements and other public information, includes data regarding the borrower’s community, business environment and the interaction of the SMME with that environment. Longer or more concentrated relationships reduce the firm’s flexibility to change banks and provide the lender with monopoly power to extract rents via higher interest rates (Ca´novas and Solano, 2008). Ca´novas and Solano,
(2008) additionally argued that this raises the question of whether there is a better way of establishing relationship lending for firms in creditor-oriented economies. Berger and Udell (2004) are of the opinion that this mode of finance is labour-intensive and costly.

2.6 SMME FINANCING IN SOUTH AFRICA
Business Partners (2011), one of the leading financiers of SMMEs in South Africa, classified SMME sources of finance in their SME tool kit into the following categories:

2.6.1 Private Loans
These are loans that are acquired by close friends or family members. The amount available through this source is unreliable and often limited and could most likely not help in the expansion of a business (Business Partners, 2011). On the other hand, Go 4 Funding (2010) highlighted that the advantage of private loans is that many of these loans can be made available quickly because family and associates know the entrepreneur personally and enjoy the excitement of the new business venture. Additionally, the writers indicated that borrowing money from friends and family can work both for and against the new business owner. Family members and friends may feel that they should have a say in company decisions or may desire a large stake in the new business since they had lent money to the entrepreneur (Go 4 Funding, 2010).

2.6.2 Bank Loans and Term Financing
Bank loans and term financing are determined against the security that the borrower is able to give. These may be asset based or product based. The commercial banking sector is still the main source of external finance for SMMEs. It is therefore important that the commercial banking sector develops viable and sustainable means of extending credit to SMMEs (National Credit Regulator, 2011).
2. 6.3  **Equity Investments**

Equity Investments is money that is invested in a business by its owners or members through common stock which is not returned in the normal course of the business. Investors recover it only when they sell their shareholdings to other investors, or when the assets of the business are liquidated and proceeds distributed among them after satisfying the firm’s obligations. Equity investments are made on the basis of two criteria namely: the enterprise’s potential for future success and the skills and the entrepreneurial abilities of the proprietor (Business Partners, 2011).

2. 7  **GOVERNMENT FINANCING AND SUPPORT FOR SMMES IN SOUTH AFRICA**

The South African government has taken various measures to encourage SMME development in order to create and maintain economic stability and boost employment (GCIS, 2011). Some of the measures taken by the South African government were to establish various bodies that were aimed to give financial and other support to SMMEs.

These include the following:

2. 7.1  **Black Business Supplier Development Programme (BBSDP)**

BBSDP is a cost-sharing grant offered to small black-owned businesses to assist them to improve their competitiveness and sustainability in order to become part of the mainstream economy and to create employment. BBSDP provides a grant to a maximum of R1 million (R800 000 maximum for tools, machinery and equipment and R200 000 maximum for eligible enterprises to improve their corporate governance, management, marketing, productivity and use of modern technology (South African Government Services, 2012).
2. 7.2 Co-operative Incentive Scheme (CIS)
CIS is a cost-sharing grant which is aimed to encourage the establishment of co-operatives in the emerging economy and the transfer of business development skills. The maximum amount granted by the CIS is R350 000 (DTI, 2012).

2. 7.3 Enterprise Investment Programme (EIP)
The EIP consists of two sub-programmes; the Manufacturing Investment Programme (MIP) and the Tourism Support Programme (TSP).

MIP provides financial assistance to local and foreign-owned enterprises. It offers 30 percent of the value of the machinery, land and buildings and vehicles in the form of an investment grant. This can be used for a new SMME expansion of an older SMME or the upgrading of production (DTI, 2012).

The tourism support programme (TSP) provides a grant of 30 percent of the value of business establishment and expansion costs for existing enterprises. The grant is available to both local and foreign owned enterprises for the investment cost of furniture, equipment, vehicles and property. The maximum amount provided by the grant is R200 000 (DTI, 2012).

2. 7.4 Industrial Development Corporation (IDC)
IDC was established in 1940 and it falls under the Economic Development Department. It is a national development finance institution set up to promote economic growth and industrial development. IDC primary objectives are to contribute to the creation of balanced, sustainable economic growth in South Africa and on the rest of the continent (IDC, 2012).
2. 7.5 Khula Enterprise Finance Ltd.

Khula was set up by the South African Government in 1996 as a mechanism to supply funding to small businesses. Khula operates through a network of financial intermediaries across the country. These include commercial banks, retail financial institution, specialist funds and joint ventures in which Khula participates. It provides financial support to SMMEs between R10 000 and R250 000 (Khula Enterprise Finance, 2012).

2. 7.6 National Empowerment Fund (NEF)

The National Empowerment Fund is established through the National Empowerment Fund Act No 105 of 1998. The NEF is a driver in promoting and facilitating black economic participation through the provision of financial and non-financial support to black empowered businesses, as well as by promoting a culture of savings and investment among black people (NEF, 2012).

2. 7.7 Small Enterprise Development Agency (SEDA)

The Small Enterprise Development Agency (Seda) is an agency of the South African Department of Trade and Industry (DTI). Seda was established in December 2004, through the National Small Business Amendment Act, Act 29 of 2004. SEDA was created by merging the Ntsika Enterprise Promotion Agency and the National Manufacturing Centre. SEDA provides non-financial support to SMMEs.

The aim of SEDA is to:

- Improve geographic outreach;
- Achieve the desired impact on small enterprises;
- Provide a single access point for small enterprises;
- Be inclusive of all relevant stakeholders;
- Leverage resources in service delivery;
- Optimise resource usage; and
- Align government’s service-delivery strategy coherently (GCIS, 2011).

The Seda Technology Project (STP) is a branch of SEDA which focuses on Technology Business Incubation, Quality and Standards, and Technology Transfer Services and support to small enterprises. The aim of the STP is to encourage economic growth and development via technological innovation and the improvement of the sustainability and the global competitiveness of SMMEs. The STP provides financial and non-financial aid to SMMEs. Two areas funded by the STP are Technology Transfer Division and Technology Business Incubation (Seda, 2012).

2.7.8 Support Programme for Industrial Innovation (SPII)

The SPII is an initiative of DTI. It is a programme which aims to promote technology implementation and development in South Africa’s industry. SPII only focuses on the development phase where basic research has been done and continues until the creation of a prototype. There are three schemes offered by SPII. These are SPII Product Process Development (PPD) scheme, SPII matching scheme and the SPII Partnership Scheme (SPII, 2012).

2.8 SUMMARY

This chapter provided a brief overview of SMMEs in order to provide a better insight to the reader with regards to the selected research project. There is a general lack of a common definition with regards to SMMEs.

However, Small, Medium and Micro Enterprises (SMMEs) can be generally defined in terms of three characteristics, namely: the number of employees, assets and annual sales. SMMEs are a very important sector of the economy and play a large role in the development of a country and substantially contribute to its GDP. SMMEs are crucial factors for the progression of economies in developing countries as well as in South Africa.
Chapter three will focus on barriers faced by SMMEs with regards to finance and suggested mitigation strategies as highlighted in the literature reviewed.
CHAPTER 3

BARRIERS TO SMME FINANCE IN SOUTH AFRICA

3.1 INTRODUCTION

Despite the contributions of SMMEs and the strategies taken by South African government to support them as discussed in Chapter two, the failure rate of SMMEs in South Africa remains to be one of the highest in the world (Olawale and Garwe, 2010). Failure of SMMEs in South Africa is estimated between 70 percent and 80 percent (Brink, Cant and Lighthelm, 2003). Olawale and Garwe (2010) argue that about 75 percent of new SMMEs in South Africa do not become established firms. Von Broembsen, Wood and Herrington (2005) are of the view that the chances of SMMEs surviving more than 42 months are unlikely in South Africa. This chapter briefly looks at the SMME policies that the South African government has put in place to mitigate SMME failure rate, the common causes of SMME failure and the barriers to funding.

3.2 SMME POLICIES AND INSTITUTIONAL FRAMEWORK IN SOUTH AFRICA

The opening up of domestic markets to world trade has resulted in many countries resorting to promoting and supporting their respective SMME sector to ensure local businesses are able to compete against the added competition that is caused by global trade. A number of developing countries, including South Africa, have passed SMME policies in an attempt to forge more equitable economic growth in their respective countries (Bignews, 2007).

The White Paper on the National Strategy for the Development and Promotion of Small Business in South Africa (1995) is aimed at creating an enabling legal framework for SMMEs, to facilitate access to information and advice, to boost procurement from SMMEs and to improve access to finance and affordable physical infrastructure. The
drafting of the white paper led to the 1996 National Small Business Act which was later amended in 2004.

Khula Enterprise Finance Limited, a government agency to finance SMMEs, and Ntsika Enterprise Promotion Agency which was responsible for dispensing non-financial support to SMMEs were also launched in 1996. In 2003 the government realised a need to create a one-stop body where SMMEs could get assistance from reputable sources. The government decided to merge Ntsika with the Community Private Partnership Programme to form the Small Enterprise Development Agency (SEDA) in 2004. The main function of SEDA was to dispense market support and business advice to business owners. During the past several years more agencies that support and fund SMMEs in South Africa were also established, mainly under five different departments namely: the Department of Trade and Industry; the Department of Economic Development, the Department of Science and Technology; the Presidency and the Department of Agriculture (National Credit Regulator, 2011).

The South African government’s key focus with regards to SMMEs has been on supporting black entrepreneurs, which the 1995 White Paper pointed out were the most marginalised group during apartheid. Two main policies that aimed at helping more black people to become active in the economy and to aid black SMME owners, are The Preferential Procurement Policy Framework Act of No.97 of 2000 and The Broad-Based Black Economic Empowerment Act No. 53 of 2003. The Department of Treasury also promulgated regulations for the Preferential Procurement Policy Framework Act in 2011. In summary the act and the regulations are aimed at ensuring that the government procurement system is fair, equitable, transparent, competitive and cost effective. They also give preference in the allocation of contracts to previously disadvantaged SMMEs for example black owners, women and people with disabilities by the introduction of a tender allocation system that awards more points to these groups (Department of National Treasury, 2011).
The BEE codes were also drafted under the Broad-Based Black Economic Empowerment Act No. 53 of 2003. The codes came into effect in 2008 and they award points to businesses based on seven elements, namely: the percentages of black ownership, black management, black staff, and black staff trained by black suppliers, business or financial assistance to black small businesses, and corporate social investment. Businesses with an annual turnover of above R35 million can score 15 points on the BEE scorecard if they spend three percent of their net profit on SMME development. For those businesses with an annual turnover of R35 million and below, the target is two percent of net profit (Department of National Treasury, 2011).

Bignews (2007) argued that the South African government is hoping that large businesses will step in to assist SMMEs by adopting business development as a means of scoring BEE points. Mbeki (2009) believes that while this would go some way to expanding support and finance for SMMEs, the BEE codes’ strong emphasis on black ownership has inadvertently created a rent-seeking behaviour among wealthy or skilled black business people, in effect curbing entrepreneurship among this group. Mbeki (2009) further mentioned that instead of using their skills or capital to start their own businesses, many of these businesses have instead chosen to buy into existing large, often listed, companies. Black ownership is often perceived by companies to be the quickest and most visible way to transform and companies with high BEE scores can win business with government (Bignews, 2007).

3.3 COMMON CAUSES FOR SMME FAILURE IN SOUTH AFRICA

3.3.1 Access to Finance

Access to finance remains a major problem for SMMEs in South Africa despite the above legislation and the government agencies that have been put in place. There is research that has been done in South Africa in which finance or the lack thereof emerges as one of the biggest barriers with regard to starting and growing SMMEs. This includes a SMME survey done by FinMark Trust which reflects that sourcing finance
was cited as the main problem faced by small business owners, while access to finance was one of the major obstacles for business growth (FinMark Trust, 2010). Tlomola (2010) supported this view and mentioned that one of the factors leading to failure of SMMEs is lack of access to finance. Herrington et al. (2009) argue that access to finance is a problem for the South African SMMEs. Olawale and Garwe (2010) investigated obstacles to the growth of new SMEs in South Africa by conducting a research of 187 business owners in the Eastern Cape. They discovered that the first obstacle that was cited by most of the respondents were lack of access to finance, followed by lack of collateral, crime and lack of owners’ equity contribution.

In a survey conducted by Orford, Wood, Fischer, Herrington and Segal (2003), selected financial experts in South Africa and other participating countries identified the financial support as the number one limiting factor for SMME growth. The survey findings has also concluded that in all developing countries, financial support is the number one limiting factor, with the primary problem being access to finance.

Nieuwenhuizen and Groenewald (2004) concluded that the lack of sufficient financing is a serious constraint during the formation of new firms as well as at later stages, as business requires additional inflows of capital to support expansion and growth. Furthermore, Naude and Havenga (2004) also highlighted that SMMEs have problems in raising both short- and long-term finance. Small businesses have little security to offer banks in exchange for loans and this makes obtaining finance much more difficult than for larger firms.

Access to bank debt is frequently cited as the challenge for SMMEs especially in developing countries. According to Smorfitt (2009) SMMEs in South Africa struggle to raise finance from banks. This is because of the reluctance of banks in taking risks when it comes to financing SMMEs (International Financial Corporation, 2010). FinMark Trust (2006) discovered that only two percent of new SMMEs in South Africa are able to gain financial support from the bank.
Foxcroft, Wood, Kew, Herrington and Segal (2002) further revealed that 75 percent of SMMEs’ applications for bank credit by new SMMEs in South Africa are rejected. Srinivas (2005) is of the view that this is due to the fact that banks rely on accurate information when it comes to financing SMMEs.

3.3.2 Barriers to Funding for SMMEs

Access to finance refers to the availability of financial services in the form of deposits, credit, payments, or insurance to enterprises. The availability of such services can be constrained for instance by physical access, affordability or eligibility as discussed in Chapter one.

In Africa, on average, less than 20 percent of households have access to formal financial services, with low population densities, poor transport and limited communications infrastructure contributing to a lack of supply in extensive regions of the continent. Even where such services are available, SMMEs may have difficulty in meeting eligibility criteria such as strict documentation requirements or the ability to provide collateral (Making Finance Work for Africa, 2012).

Those that are able to meet such demands may find that they are still excluded from formal financial services by cost barriers, in the form of high transaction fees or substantial minimum requirements for savings balances or loan amounts (Making Finance Work for Africa, 2012).

3.3.2.1 Perceived Risk of SMMEs by Creditors

Risk perception is the subjective judgement that people make about characteristics and severity of risk. The risk perception about SMMEs, especially the new ones in South Africa, is high because of their high failure rate. This is one of the reasons for low access to debt finance (Tagoe, Nyarko and Anuna-Amarh, 2005). The criteria for lending by trade creditors or banks usually require information such as financial statements, credit rating agency reports and accessible bank together with trade
references (Burkart and Ellingsen, 2004). Financial markets are characterised by a number of market imperfections, including information asymmetry. In order to analyse financial ratios and do credit scoring to access risk, hard information is needed. This implies that financial statements need to be made available and the profitability and solvency ratios of the business are good (Wiedenhofer, 2006).

Timmons and Spinelli (2009) also concurred with the above statements and indicated that the relationship between creditors and new SMME owners is usually established under conditions of uncertainty and information asymmetry. In the absence of a credit history or assets to serve as collateral, it is difficult to secure loans from financial institutions. Collateral refers to assets pledged by a borrower to a lender as security for payment of debt. Collateral helps reduce information asymmetries and moral hazard problems that could arise between banks and business owners (Coco, 2000). Collateral as security is attractive to banks as it shows the confidence of the business owner in his/her abilities and in the likely success of the business. Collateral thus positively impacts on the risk perception of the business by credit institutions (Van Aadt Smit and Fatoki, 2011).

According to Berger and Udell (2006) new SMMEs lack crucial information as they have no track record. Cassar (2004) argues that asset structure should also be related to capital structure, particularly for new SMMEs. The more tangible and generic the business assets are, the greater the business’ liquidation value, thereby reducing the financial loss incurred by financiers should the company default and the business’ assets be realized. Businesses can also reduce adverse selection and moral hazard costs by pledging their assets as collateral. This will result in business with assets of greater liquidation value having easier access to finance, and lower costs of financing, leading in turn to these businesses acquiring a higher level of debt in their capital structure (Van Aadt Smit and Fatoki, 2011). In addition, potential investors are more likely to invest in a project if the owner is investing his/her own capital. This will improve the credibility of the project (Bollingtoft, Ulhoi, Madsen, and Neergaard, 2003).
Hawkins (2002) and the World Bank (2005) reiterate that owners of new SMMEs often lack collateral, specifically in developing countries. Umsobomvu Youth Fund (2008) also reports that most new SMMEs in South Africa start business without any acceptable collateral. In addition, their personal contribution is often very low and inadequate.

Research conducted by Naude and Havenga (2004) indicated that most SMMEs struggle with accessing finance from banks due to excessive red tape and administrative burden. They argue that financial institutions rarely finance start-up businesses, they are bureaucratic, they lack knowledge and understanding of the SMMEs owners as well as they are reluctant to provide finance to people who do not have a business record.

Rungani (2009) argued that SMMEs in South Africa do not succeed in attracting enough loans as they are regarded as high-risk due to a weak financial base. Nieuwenhuizen and Kroon (2002) agreed with this notion and further highlighted that because of high transactional costs involved and inability of SMMEs to provide the collateral that the banks require, SMMEs find themselves starved for funds at all stages of their development, ranging from start-up to expansion and growth. This is also a common problem which is also highlighted by GEM (2010) which suggest that SMMEs across the globe find it difficult to secure formal financing for new venture unless they have collateral or some form of credit listing which serves to mitigate the inherent risk in starting a new business.

3.3.2 Lack of Education and Business Skills

The majority of SMME operations are not complex, but a basic level of education is prerequisite for the successful management of small business units (Antonites and Van Vuuren, 2004). This basic educational level is not usually found amongst the small and medium entrepreneurs. FinMark Trust (2010) reflected that an SMME survey in South Africa revealed that two-thirds of SMME owners have not completed their secondary education. This is the factor that contributes to their failure according to the GEM report.
of 2010. Rungani (2009) pointed out that many SMMEs in South Africa have failed to operate successfully because they do not have sufficient information and intelligence on market opportunities and market trends.

Rogerson (2008) argues that research contributions on education, training and skill development linked to the SMME economy in South Africa is substantial as a whole but the field lacks a generally accepted paradigm or theory regarding the content of SMMEs education and training. Vesper (2010) elaborates on the issue when he states that current literature on SMMEs education and training only touches the surface as far as the content is concerned.

Business Dictionary (2012) describes business skills and training as an ability and capacity acquired through deliberate, systematic and sustained effort to smoothly and adaptively carry out complex activities or job functions involving ideas, technical skills and interpersonal skills. Robertson (2003) reported that SMMEs in developing countries are not well positioned to make the right decisions regarding training and skill acquisition for managers and employees.

Ligthelm and Cant (2002) supported the above statement and further argued that the deficiencies in the internal environment are the major cause of SMME failures and these revolve around management skills, financial knowledge, lack of expertise in functional areas such as marketing, human resource management. Ligthelm and Cant (2002) also added that some of the problems emanating from these factors include specific management issues such as a lack of business management training and skills as well as a limited family business culture in South Africa.

Alasadi and Abdelrahim (2007) mentioned that one of the most significant causes for the failure of SMMEs in South Africa is their inadequate application of essential business and management practices. Van Aardt, Van Aardt, Bezuidenhout and Mumba (2008) postulate that 80 percent of the problems that business experiences are caused by management.
Chimucheka and Rungani (2011) reported that financial illiteracy is the real challenge faced by SMMEs in South Africa. The impact of these challenges needs to be assessed so as to come up with useful and relevant solutions that can contribute to the success of South African SMMEs. A financially literate SMME owner is defined as someone who knows what are the most suitable financing and financial management options for his/her business at the various growth stages of his/her business, who knows where to obtain the most suitable products and services and who interacts with confidence with the suppliers of these products and services. He/she is familiar with the legal and regulatory framework and his/her rights and recourse options (USAID, 2009).

Financial literacy is viewed primarily as a challenge among South African SMME. USAID (2009) identified major information and training needs in South African SMME and such needs include a need for access to computers and computer literacy.

Much of the business support and financial literacy information are found on the internet. Lack of computer literacy and access prevents the SMMEs in accessing significant information regarding their expansion.

### 3.3.2.3 Poor Business Plan Development

A business plan is a business game plan, it puts together the dreams and hopes that encourage a business owner to take the start-up plunge. This plan should state clearly where the business is, where is it going and how the owner intends to make the business grow (Longenecker, Moore, Petty and Palich, 2006). Small Business Notes (2012) cited that an advantage to preparing an effectively organised loan application, including a well thought out business plan, is that it will significantly decrease the time spent waiting for an answer from a bank or lending institution.

According to Van Aardt, Van Aardt, Bezuidenhout and Mumba (2008) before SMME owners start a business it is important that they should plan and such a plan should take the form of a business plan. Business plans are used for various purposes such as to
determine the chances of business success, to raise capital and as a schedule for business start-up and growth. Van Aardt et al. (2008) stated that the financial institutions would generally not even consider providing financing for SMMEs who do not have a well-reasoned business plan and no institution will be willing to fund a business that does not have a sound business plan. A business plan is not only important at start-up or when sourcing funds. Even after the business has been started, the business plan plays an important role as a managerial tool (Van Aardt et al., 2008). Nieman and Nieuwenhuizen (2009) proposed that the reasons for compiling a business plan include obtaining funding. It serves as an internal purpose and is also used as a tool for reducing risk.

Chimucheka (2012) investigated the usefulness of business plans for SMMEs in the Eastern Cape Province. The objective of the study was to determine the usefulness of a business plan. The researcher used questionnaires to gather data from the respondents and conducted interviews with representatives from financial banks. Chimucheka (2012) discovered that some of the SMME respondents did not even know what a business plan is and how the business plans were prepared, while others used experts to prepare them only when they need to apply for finance and never referred to them.

Chimucheka (2012) suggested that SMMEs need to learn to write business plans for themselves and they should not only rely on experts or consultants as this makes it difficult for a business plan to contain all details and facts. In cases where owners are illiterate and cannot prepare this important document for themselves, they must at least be there when the document is prepared. SMMEs should also use their business plans effectively to monitor performance and growth of their ventures. This will help them attain success in business.

3.3.2.4 High Number of Informal SMMEs

The vast majority of SMMEs in South Africa are informal. It is estimated that SMMEs in the informal sector contribute between five percent and ten percent to gross domestic product (GDP) (Steward, 2012). Ligthelm (2007) cited that the informal trade sector
constitutes an important part of the South African economy, with estimated sales of R32 billion in 2002. Hope (2004) is of the view that by 2020 the informal sector in South Africa will significantly increase while the formal sector will become stagnant. The emergence and increase of the informal sector in South Africa is largely attributed to the divergence between the growth in population, especially the urban population and employment growth in the formal economy. Growth of informal enterprises, especially in the retail sector, is also thriving on the demand of less affluent households, whose household needs for unsophisticated and affordable products are supplied by the informal sector (Ligthelm, 2007).

The National Credit Regulator (2011) discovered that almost half of the SMMEs are not registered, hence they are operating informally. The 84.7 percent of SMMEs are financially excluded as they do not have access to the formal financial markets. This makes the total financing gap for both formal and informal SMMEs to be estimated at around 45-48 percent (The National Credit Regulator, 2011).

There is a widespread and well-informed perception that improved access to finance for SMMEs in the informal sector can improve their financial health and through them, alleviate poverty, unequal distributions of wealth or income and unemployment (Turner, Varghese and Walker, 2008).

SMMEs, especially those in rural areas or in the informal sector, face many barriers to financial access. This is due amongst other things to the distance from services, the inability to produce formal documents when needed and prohibitive costs (The World Bank Group, 2012). Among the SMMEs in developing countries, only 15 percent of new investments are financed externally, compared with 30 percent among larger firms. Without financial access, small and new firms face obstacles to both entry and prospective growth.
3.4 SUMMARY

In this chapter the most common causes of SMME failure are highlighted, with access to finance evidently among the significant factor that causes high SMME failure rate in South Africa. It is also hypothesized that perceived risk of SMMEs by creditors, insufficient collateral, lack of education and business skills, poor business plan developments and high number of informal SMMEs are significant barriers to access to finance for new businesses as well as for expansion of existing businesses.

The next chapter, Chapter four, will discuss in detail the methods which the researcher used in gathering and analysing data.
CHAPTER 4

METHODOLOGY

4.1 INTRODUCTION

This chapter explains the methodology used in the research study. According to Panneerselvam (2004) methodology can be defined as a system of models, procedures and techniques used to find the results of the research problem.

This chapter includes descriptions and details of the models, procedures and techniques implemented in the research study to examine the barriers faced by SMMEs in accessing finance in Tshwane Metropolitan Municipality. The chapter provides details and justification of the research paradigm used, research method and research approach. The design of the primary research including the population, the sample, data collection procedure, the measuring instrument, the pilot study as well as details regarding the analysis of the collected data have been provided. The chapter also provides explanations on validity and reliability as well as ethical considerations taken into account when conducting this research study.

4.2 RESEARCH PARADIGM

The research paradigm is the way in which the world and environment around us are viewed. Individuals differ in the way that they perceive the world. This difference becomes more apparent when it comes to research. Two popular paradigms in research are positivism and phenomenology (Collins, 2010).

The choice of research paradigm relies on the natural instinct of the researcher (Saunders, Lewis and Thornhill, 2009). The positivist view is empirical in nature and claims that social happenings and interactions are subject to particular laws which are observable elements that can be generalised (Collins, 2010). The role of the researcher...
in positivism is that of an independent observer who analyses data in a quantitative manner from an objective viewpoint (Nueman, 2007). Positivism aims to understand social situations and draw generalisable assumptions from them in a value-free, unbiased manner. Nueman (2007) defined the positivist approach as an organised method for combining deductive logic with precise empirical observations of individual behaviour in order to discover and confirm a set of probabilistic casual laws that can be used to predict general patterns of human activity.

Phenomenology, on the other hand, deals with understanding human behaviour from the respondent’s perspective and it stresses the subjective aspects of human activity by focusing on the meaning rather than the measurement of the social phenomena (Collis and Hussey, 2003).

This research study used positivism as the philosophy of research. The aim of this study is to determine why SMMEs in the Tshwane Metropolitan Municipality have difficulty in obtaining financial assistance from financial institutions. Positivist philosophy will help to measure the factors responsible for this issue and try to troubleshoot the main problems that create barriers to access finance.

The researcher also adopted an exploratory design, which is a particular type of descriptive study. The purpose of exploratory research is to gain insight into a situation, phenomenon, community or person (Bless and Higson-Smith, 2000). The need for such a study could arise from a lack of basic information on a new field of interest (Bless and Higson-Smith, 2000). Through exploration, researchers develop concepts more clearly, establish priorities, develop operational definitions and improve the final research design (Blumberg, Cooper and Schindler, 2008).

4.3 RESEARCH METHOD

Two most popular methods of research are qualitative and quantitative. In the quantitative method, data undergoes numerical analysis and observation. Natural phenomena or events are associated with, or represented by, numbers. Responses or opinions of individuals may be numerically coded. This is based on the assumption that
all human facts can be numerically represented and thus analysed. These numerically represented human facts can then be used to obtain social facts (Amaratunga, Baldry, Sarshar and Newton, 2002).

Quantitative research is often associated with positivism while qualitative research with phenomenology.

4. 3.1 Quantitative Research

Collis and Hussey (2003) state that quantitative research is an objective approach that focuses on measuring phenomena by collecting and analysing numerical data by applying statistical tests. It is also known as a positivist paradigm which is viewed to be high on reliability and low on validity. It sometimes generalises from sample to population.

The researcher has chosen to adopt a quantitative research design for this study. Quantitative research design is an excellent way of finalising results and proving or disproving a hypothesis and it also filters out external factors and so the results gained can be seen as real and unbiased (Shuttleworth, 2008).

4. 3.2 Qualitative Research

According to Maree (2010) qualitative research is a subjective approach that is concerned with understanding the processes and the social and cultural context which underline various behavioural patterns and is mainly concerned with exploring the why questions of research.
4.4 RESEARCH APPROACH

The process by which the researcher undertakes the research and arrives at conclusions is the research approach. The research approach may either be inductive or deductive. In an inductive approach, the research process begins with the observation of specific events leading to ideas which may be generalised (Skinner, 2010). Inductive reasoning is the observation of data which is analysed to determine why such a phenomenon exists while moving towards a generalisable theory (Neuman, 2007). On the other hand, the deductive approach begins with a hypothesis which forms the basis of the research. A general idea is studied in order to derive numerical evidence (Neuman, 2007).

Skinner (2010) explained the distinctions between the two approaches, in which he described deductive reasoning as the top-down approach and inductive reasoning as the bottom-up approach.

This research study employed the deductive approach. It aims to test a pre-established theory that even though various measures have been taken to improve access to finance to SMMEs in the manufacturing sector in South Africa, SMMEs are still faced with difficulties in obtaining finance. This approach also supports the positivist philosophy as the two are complementary to one another (Amaratunga et al., 2002).

4.5 POPULATION AND SAMPLING

Research population is defined by Castillo (2009) as a large collection of individuals that are the main focus of a scientific study. It is for the benefit of the population that research studies are done and individuals within a certain population usually have a common, binding characteristic or trait (Castillo, 2009).

For the purpose of this study the target population is comprised of existing SMMEs in the Tshwane Metropolitan Municipality within the manufacturing sector.
The study utilised a purposive sampling method, which is described by Maree (2010) as the method which is used in situations where the sampling is done with the specific purpose in mind. Nieuwenhuis (2010) mentioned that in purposive sampling respondents are selected because of some defining characteristic that makes them the holders of the data needed for the study. The researcher selected a purposive sampling method because it is the most convenient form of sampling to the proposed research study, it is less costly and less time consuming.

The sample taken comprised 40 SMME owners who have been operating in the manufacturing sector for at least two years. The sample criteria needed a minimal time frame of at least two years in order to evaluate whether the more recent developments in SMME support by the South African Government had harnessed any finance opportunities or created any new financing trends for SMMEs or whether there are still barriers to finance despite these activities.

The researcher had access to the respondents by collecting data from SMME owners that are members of NIC during their regional meeting.

4.5.1 Location of the Study

Tshwane Metropolitan Municipality, where the study was conducted, lies in the Gauteng province and covers an area of 2 198 square kilometers. It includes Pretoria, Centurion, Laudium, Eersterust, Akasia, Soshanguve, Atteridgeville, Crocodile River, Ga-Rankuwa, Mabopane, Winterveld, Hammanskraal, Temba and Mamelodi. The population of the municipality is about two million people. It also has the highest level of education in the country. Sepedi is the most frequently spoken language followed by English, Tsonga, Zulu and Afrikaans (City of Tshwane, 2009).
4.6 DATA COLLECTION

The data collected for this research study were secondary and primary. The secondary data used in this research included publications from journals and books. The data used was taken from reliable sources and is presented in Chapter two and Chapter three.

The primary data is the data that was collected from 40 SMME owners who started operating in the manufacturing industry at least two years ago. The data were collected from SMME owners that were members of the NIC during their regional meeting. A group administration of the questionnaires was done. The researcher waited while the respondents completed the questionnaires. Maree (2010) indicated that in a group administration many respondents can complete the questionnaire in a short space of time, the questionnaires can be checked for accuracy and the interviewer can immediately assist with issues in the questionnaires which are not clear to the respondents.

4.7 THE MEASURING INSTRUMENT

A survey design provides a quantitative description of trends, attitudes or opinions of a population by studying a sample of that population. The researcher then generalises or makes claims about the population based on the results of the survey (Creswell, 2003). Some of the advantages of a survey as a research method are that it collects a large amount of data in a relatively short period of time, it is less expensive than many other data collection techniques and is created quickly and administered easily (Cherry, 2012).

A self administered questionnaire was developed to gather information for the study from SMME owners. According to Collis and Hussey (2003) the questionnaire is a list of carefully structured questions chosen after considerable testing with a view to elicit reliable responses from the research participants.
The questionnaire consisted of three sections, which are as follows:

4. 7.1 **Section A: Biographic Information of the respondents and their businesses**
This section contains closed questions on gender, race, highest level of education, type of business, number of years in operation and source capital for starting-up and for business expansion.

4. 7.2 **Section B: Barriers faced by SMMEs in accessing finance**
In section B there are question statements that evaluate the respondent’s views on barriers that are faced by SMMEs in accessing finance. A five point Likert scale is used, whereby the respondents were required to state the extent to which they agreed or disagreed with the statements on the questionnaire. The question statements are drafted under the following headings:

- Perceived Risks of SMMEs by funders;
- Poor Business Plan Development;
- Poor Business Training and development;
- Source of funding;
- Recommendations.

4. 8 **THE PILOT STUDY**
The researcher conducted a pilot study by administering the questionnaire to a group of five respondents who are specialists in the field of study to test the comprehension, the clarity and appropriateness of the questionnaire. Mitchell and Jolley (2001) are of the view that the pilot study helps the researcher to fine-tune the study for the main enquiry. Bless and Higson-Smith (2000) concurred with the above statement and further stated that a pilot is a small study conducted prior to a large piece of research to determine whether the methodology, sampling, instruments and analysis are adequate and appropriate.
Following the pilot study attention was given to the recommendations presented by the pilot group and relevant adjustment made to the questionnaire.

4.9 ETHICAL CONSIDERATION

The researcher adhered to the following to ensure sound ethical consideration:

**Permission to conduct the study:** The researcher was granted permission to conduct the study by the NIC managers. A letter highlighting the objectives of the study and its contribution, as well as giving assurance in ensuring the confidentiality and anonymity of the respondents and their response, was written and forwarded to the NIC management.

**Voluntary Participation:** The respondents participated following adequate information about the study and they were given a consent form to sign and grant permission to participate in the study.

**Confidentiality and anonymity:** According to Walter (2009) confidentiality ensures that the information provided by the research respondents cannot be linked to them. Respondents' anonymity and confidentiality was provided by excluding respondents' identities on the biographic data questionnaire and when documenting the research findings.

4.10 VALIDITY AND RELIABILITY

Validity can be defined as the determinant of instrument quality (Golafshani, 2003). It measures the truthfulness of the instrument (Saks and Allsop, 2007). The questionnaire was administered over a sample of 40 SMME owners. This number provides for a certain amount of validity.

Results and data are said to be reliable if a scenario similar to the one used in a particular research is reproduced in the same environment and yields the same results.
at a later date (Saks and Allsop, 2007). The data collected was taken from reliable scholarly journals and provides reliability. Since the data is quantitative in nature, it provides a certain degree of reliability in itself and can be reproduced at a later date if the same scenarios are taken into consideration.

4.11 DATA ANALYSIS

Data analysis refers to the process of breaking down the collected data into constituent parts in order to obtain answers to the research questions (Tlhomola, 2010). De Vos, Strydom, Fouche and Delport (2005) mentioned that data analysis involves a process of reducing data into intelligible and interpretable form so that the relations of the research problems can be studied, tested and conclusions drawn.

Data can be presented as descriptive statistics and inferential statistics. The data collected by the researcher for the research study were analysed quantitatively by making use of the descriptive and inferential statistics. Descriptive statistics is used to describe the basic features of the data in a study. It provides simple summaries about the sample, the measures and together with simple graphics analysis, they form the basis of virtually every quantitative analysis of data (Trochim, 2006). On the other hand by using inferential statistics, the researcher will try to reach conclusions that extend beyond the immediate data alone.

The results are presented in the form of percentages and graphs that are analysed in order to observe the frequencies of occurrence. The researcher constructed graphs and tables in order to reflect which barriers faced by SMMEs in accessing finance were more prevalently reported by the respondents. The biographic information given by respondents was also analysed and compared to the results.
4.12 SUMMARY

The main purpose of this chapter was to outline and address the research paradigm, the research method and research approach adopted by the study. The researcher has covered the following subsections in this chapter: the quantitative and qualitative research methods; population and sampling; data collection; measuring instrument; the pilot study; ethical considerations; validity and reliability; and data analysis.

The quantitative research method was selected and utilised as the appropriate approach for the study. The survey was used as the research technique, using a structured questionnaire for data gathering. Descriptive and inferential statistics methods were used to analyse the research data.

In the next chapter the researcher will analyse and discuss the findings of the collected data.
CHAPTER 5

DATA ANALYSIS AND FINDINGS

5.1 INTRODUCTION
This chapter presents the research findings and discussion of barriers faced by SMMEs in accessing finance. A presentation of results and the findings obtained from the questionnaires as well as a thorough examination of observations derived from these findings is done. The analysis is based on responses from 40 questionnaires that were completed by SMME owners within the manufacturing industry in Tshwane Metropolitan Municipality.

The researcher initially presents the demographics of the research sample. This is followed by the perceptions of the respondents with regards to barriers faced by SMMEs in accessing finance and later in the chapter suggestions for improvements recommended by the respondents are discussed.

5.2 DEMOGRAPHICS OF RESPONDENTS
The sample is analysed and described in terms of gender, race and educational level. The SMMEs owners' demographics are as follows:
The sample consisted of 57.5 percent females and 42.5 percent males, as shown in Figure 5.1 above. The statistical representation of the respondents indicates that the sample consisted of more females than males. This is in line with the findings of FinMark Trust (2010) that concluded that in South Africa, females are more likely to be SMMEs owners than males. OECD (2011) supports the above statement and mentioned that women-owned SMMEs are growing at a faster rate than the economy at a whole in several countries, especially in developing countries.
Ninety percent of the respondents were black. Coloured and Asian represented a small percentage, 7.5 percent and 2.5 percent respectively.
The figure above illustrates that the majority (45 percent) of the respondents had a grade 12 level of education. Thirty-five percent of the respondents have some high school level of education but did not complete grade 12. Only 12.5 percent of the respondents completed a post matric certificate, while there was only one respondent who had a National Diploma. There were no respondents that held a university degree or a qualification above such level.

It is evident from the figure above that there is generally a low level of education among the SMME owners who participated in the study. FinMark Trust (2010) did a national
SMME survey and found that the majority of SMME owners in South Africa have some high school level of education but did not complete grade 12. According to the survey findings by FinMark Trust (2010), 43 percent of SMME owners in South Africa have some high school level of education, 25 percent had grade 12, 23 percent had primary level of education and less while a small percentage of seven percent and two percent had a diploma and university degree respectively.

According to GEM (2010), research shows that a low level of overall education and training is still the biggest challenge facing South Africa.

**TABLE 5.1 Type of Business**

<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Frequency</th>
<th>Percentages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sole Propriety</td>
<td>25</td>
<td>62.5%</td>
</tr>
<tr>
<td>Partnership</td>
<td>5</td>
<td>12.5%</td>
</tr>
<tr>
<td>Close Corporation</td>
<td>10</td>
<td>25%</td>
</tr>
<tr>
<td>(PTY) LTD</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>LTD</td>
<td>0</td>
<td>0%</td>
</tr>
</tbody>
</table>

Table 5.1 gives a brief description of different type of business that respondents were engaged in. The survey findings reveal that the majority of the business owners were sole proprietors, with 62.5 percent of the sample respondents classifying their businesses in this sector. Close corporation also had a relatively large representation in the sample at 25 percent while 12.5 percent of the respondents were in a partnership.
The findings of table 5.1 illustrate that the majority of the respondents were running unregistered informal businesses and they were sole proprietors. This finding correlates with the view of the National Credit Regulator (2011) that cited that almost half of the South African businesses are informal. The results of the national SMME survey by FinMark Trust (2010) concurred with this notion and illustrated that a vast majority of business in South Africa are informal. De la Torre, Pería and Schmukler (2008) cited that relative to large firms, SMMEs are more likely to be informal, particularly in developing countries. This not only makes opaqueness worse, but it also poses additional obstacles and risks to SMME lending.

The National Credit Regulator (2011) indicated that one of the internal factors that affect an SMME’s ability to access finance is whether it is registered or not. In non-registered businesses, it is often difficult to separate SMME owners’ personal finances from that of the business and this factor often negatively impacts on an SMME’s ability to access finance (OECD, 2011).

According to the Word Bank (2008) only 59% of SMME enterprises had any credit products compared to 82% large businesses. Micro enterprises are more likely to report access to finance as one of the top three obstacles to growth, are less likely to have a bank account and less likely to have access to any of the credit products such as loans, overdrafts or any lines of credit.
As seen from the figure above, 45 percent of the SMMEs were in operation for two to four years, 25 percent of the respondents ran their businesses for four to six years and 20 percent for 10-12 years. A very small percentage of SMMEs, 5 percent, were in operation for six to eight years and for over 14 years respectively. This indicates that most of the SMME businesses were relatively new.

Younger businesses without a track record face more problems accessing credit. These firms are less transparent as there is less information available about them to the credit institutions and they are more likely to fail and are therefore more risky (OECD, 2011). The World Bank (2008) reported that only four percent of firms under five years old had any credit products, compared to 55 percent of firms who were six to ten years old and 73 percent for firms older than ten years. Furthermore, the National Credit Regulator
(2001) showed that loan applications for businesses in the middle age category are more likely to be rejected and younger firms are more likely to pay higher interest rates.

5. 2.1 Source of Start-up Capital
The respondents were asked where they obtained start-up capital for their business. The start-up capital refers to the initial investments made by the owners of the SMME’s when starting their business for the first time. They were provided with the options personal savings, friends or family, loan from bank or other funders.

TABLE 5.2 Source of Start-up Capital

<table>
<thead>
<tr>
<th>Source of start-up capital</th>
<th>Frequency</th>
<th>Percentages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal savings</td>
<td>30</td>
<td>75%</td>
</tr>
<tr>
<td>Friends or family</td>
<td>5</td>
<td>12.5%</td>
</tr>
<tr>
<td>Loans from banks or other funders</td>
<td>4</td>
<td>10%</td>
</tr>
<tr>
<td>Other (Grant from Tshwane Entrepreneurial Competition)</td>
<td>1</td>
<td>2.5%</td>
</tr>
</tbody>
</table>

Seventy five percent of the respondents generated the capital to start their businesses from personal savings, 12.5 percent from friends and family, 10 percent from loans from the banks and other funders and one of the respondents received a grant from Tshwane Entrepreneurial Competition and used the grant to start the business. The findings are in line with the research findings of Irwin (2006) who explored the barriers faced by entrepreneurs in raising bank finance by conducting telephonic surveys to 400 Barclays SMMEs in the United Kingdom. Irwin (2006) discovered that in 70 percent of all SMMEs interviewed, personal savings were the primary source of finance followed by family and friends. Bank loans were a source of finance only to 13 percent of the respondents.
The National Credit Regulator (2011) is of the view that the nature of funding required by SMMEs depends on its development phase. Businesses in the start-up phase generally rely on personal savings, friends and families, while those businesses which are stable rely on bank loans for financing. OECD (2011) stated that a specific disadvantage of new SMMEs is that they cannot refer credit histories which provide important signals and help facilitate access to debt financing.

TABLE 5.3 Source of capital for business expansion

<table>
<thead>
<tr>
<th>Source of capital for business expansion</th>
<th>Frequency</th>
<th>Percentages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans from banks and other funders</td>
<td>2</td>
<td>5%</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>14</td>
<td>35%</td>
</tr>
<tr>
<td>Friends or family</td>
<td>4</td>
<td>10%</td>
</tr>
<tr>
<td>Personal savings</td>
<td>4</td>
<td>10%</td>
</tr>
<tr>
<td>Other- Not expanded</td>
<td>16</td>
<td>40%</td>
</tr>
</tbody>
</table>

The majority of the respondents, 40 percent, did not expand their business, 35 percent of the respondents expanded their business through retailed earnings, 10 percent received a capital for expansion from friends or family and 10 percent financed expansion from personal savings. Only two of the respondents, five percent, expanded their business by using loans from banks and other funders.
5.3 BARRIERS FACED BY SMMEs IN ACCESSING FINANCE

Table 5.3 provides the question statements as well as percentages of respondents' responses per question. The five point Likert Scale was used and this enabled the respondents to indicate their opinions on various factors of business environment that impact on SMMEs in terms of accessing finance. The following table reflects the respondents' responses on each level of the scale.

Table 5.4 Question statements

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of collateral or business assets</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of financial statements</td>
<td>80%</td>
<td>20%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excessive red tape by funders</td>
<td>90%</td>
<td>10%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administrative burden associated with applications</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unfair evaluation of risks and profitability of SMMEs by funders</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>-------------------------------------------------------</td>
<td>------------------</td>
<td>---------</td>
<td>-------------</td>
<td>------------</td>
<td>--------------------</td>
</tr>
<tr>
<td>Business plans are valuable in accessing finance</td>
<td></td>
<td>67.5%</td>
<td>32.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business plans are difficult to put together</td>
<td></td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business plans are costly</td>
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<td>100%</td>
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<tr>
<td>Business are easy to understand</td>
<td></td>
<td></td>
<td></td>
<td>25%</td>
<td>75%</td>
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<tr>
<td>Business plans are easy to implement</td>
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<td></td>
<td></td>
<td>10%</td>
<td>90%</td>
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<tr>
<td>I have been trained in general management of the business</td>
<td>5%</td>
<td></td>
<td></td>
<td></td>
<td>95%</td>
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<tr>
<td>I have been trained in financial management</td>
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<td>100%</td>
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<tr>
<td>I have been trained in human resource management</td>
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<td>100%</td>
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<tr>
<td>I have technical experts in manufacturing</td>
<td>10%</td>
<td>55%</td>
<td></td>
<td>35%</td>
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<tr>
<td>Business training programmes by the government are not</td>
<td>72.5%</td>
<td>27.5%</td>
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<tr>
<td>enough</td>
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</tr>
<tr>
<td>It is easy to acquire finance from the government financial institutions</td>
<td></td>
<td></td>
<td></td>
<td>2.5%</td>
<td>97.5%</td>
</tr>
<tr>
<td>Many of SMMEs know about government financial institutions</td>
<td>45%</td>
<td>55%</td>
<td></td>
<td></td>
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<tr>
<td>Lack of financial support from the government institutions impact on the success of SMMEs</td>
<td>100%</td>
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<tr>
<td>The commercial banks are willing to finance SMMEs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>100%</td>
</tr>
<tr>
<td>Lack of financial support from the banks impact on the success of SMMEs</td>
<td>100%</td>
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Each category of the question statements will be discussed below in more detail:

5.3.1 Perceived Risks of SMMEs by Funders

The findings of the research revealed that the majority of the respondents viewed lack of collateral or business assets, lack of financial statements, excessive red tape by funders, administrative burden associated with applications as well as unfair evaluation of risks and profitability of SMMEs by funders as the barriers that are faced by SMMEs in accessing finance.

All respondents strongly agreed that lack of collateral or business assets, the administrative burden associated with applications as well unfair evaluation of risks and profitability of SMMEs hinders the success of SMMEs in accessing finance.

On the other hand a majority, 80 percent strongly agreed that lack of financial statements and 90 percent of the respondents highlighted excessive red tapes by funders as barriers that limit SMMEs in assessing finance.

These factors are also highlighted in by a number of researchers and other experts in the fields of SMMEs. Business Town (2003) highlighted that banks are reluctant to loan to businesses that cannot show at least two years of profitable operation, as they want to see that the owner of the business is heavily invested in the enterprise. Samitos and Kenourgios (2005) supported this and indicated that banks look for a positive track record and collateral, which generally SMMEs do not have.

Olawale and Garwe (2010) investigated the obstacles to growth of the new SMMEs in South Africa by administering questionnaires in 187 SMMEs in the Eastern Cape. Their findings revealed that lack of collateral was the second highest factor perceived as an obstacle in growth of SMMEs in South Africa, while insufficient owner’s equity contribution was viewed as the third highest factor.

Tlhomola (2010) investigated failure of SMMEs in the Tshwane Metropolitan Municipality and revealed that 82.9 percent of the respondents were of the opinion that
the funder’s policies are discriminatory and they need to be properly addressed to accommodate a fragmented group of society which was historically sanctioned.

Many South Africans do not have money to invest in start-up businesses, due to high levels of poverty and unemployment (Rwigema and Venter, 2004). Nieuwenhuizen and Kroon (2003) argued that existing criteria for evaluation loan applications discriminate against SMMEs and limit the funders to identify potentially successful owners of SMMEs; instead they focus on potentially successful businesses.

5.3.2 Poor Business Plan Development

67.5 percent of the respondents agreed that business plans are valuable in accessing finance, however of interest was that 32.5 percent of the respondents were uncertain with regard to the statement. Despite the fact that more than half of the respondents indicated there is a value to business plan, they also all strongly agreed that the business plans are difficult to put together and they are costly. Ninety percent of the respondents indicated that they strongly disagreed with the statement that indicates that business plans are easy to understand and 80 percent disagreed that the business plans are easy to implement.

According to Van Aardt et al. (2008) before SMMEs start a business it is vital that they should plan and such a plan should take the form of a business plan. Business plans are used for various purposes such as to determine the chances of business success, to raise capital, and as a schedule for business start up and growth (Van Aardt et al., 2008).

Chimucheka (2012) investigated the usefulness of business plans to SMMEs in the Eastern Cape Province and documented 28 percent (30 out of 109) of the research respondents confirmed that they had business plans. Chimucheka (2012) was concerned that most, 64 percent, of the businesses that had business plans were not using them at all and some had only submitted them to banks and could not even remember what was in the document.
5.3.3 Poor Business Training and Development

The results were strongly conclusive that the majority of the respondents were not trained regarding relevant business skills. Over seventy-five (75.5) percent of the respondents were of the view that business training programmes by the government are not enough. Ninety-five percent of them strongly disagreed that they have been trained in general management of business. All the respondents indicated that they have not been trained in financial or in human resource management. Additionally as indicated earlier, most of the respondents had a grade 12 level of education with no post matric certificate or training.

Tlhomola (2010) revealed in his research that education is a key success factor for business survival and he also pointed out that education increases the operational term of businesses. He highlighted that it is important that SMME owners be equipped with basic education to enhance the effective operation of the business. It is also concluded by Rogerson (2008) that education, training and experience are key elements in successful business creation. This correlates with the GEM (2010) report that indicates that dramatic improvements in the quality of education are needed and appropriate business management skill needs to be offered at schools at all levels. Lussiers and Pfeifer (2001) conducted a study and found that business owners with higher education levels, managerial experience and business exposure have a greater chance of succeeding than people without tertiary education and managerial experience.

Most credit institutions are interested in the skills and experience of the SMME business owner. Studies by Shane and Stuart (2002) and Rudez and Mihalic (2007) associate managerial competencies with good business performance. The higher the level of managerial competency exhibited by the owners of a business, the greater the viability and survival of the SMME and the more successful they are likely to be in accessing credit.

Alasadi and Abdelrahim (2007) highlighted that one of the most significant reasons for the failure of SMMEs is their inadequate application of essential business and
management practices. Van Aardt et al. (2008) indicated that about 80 percent of the business challenges are caused by management.

Knowledge of interpreting financial statements is also imperative, as well as preparing cash budgets and maintaining cash flow projections (Tlhomola, 2010). A strong capital base should be built before huge drawings can be made from the business (Van Aardt et al., 2008). Likewise Nieman et al. (2009) pointed out that a further sign of a continuum of failure is a problem with irregular cash flow, which indicates underperformance.

According to Tlhomola (2010) it is a common practice in businesses for managers or owners to reward themselves with huge amounts of money before realizing the prospects of the business. This aspect is associated with poor business skills and is prevalent especially in young businesses. It is the responsibility of business owners and managers to avoid using assets of the business for personal use at the expense of the business (Van Aardt et al., 2008).

5.3.4 Source of Funding
Fifty five percent of the respondents were of the view that most of the SMMEs know about government financial institutions. However despite this perception a significant percentage of respondents, 97.5 percent, disagree with the statement that stated that it is easy to acquire finance from the government financial institutions. All of the respondents strongly agreed that lack of financial support from the government institutions and from the banks impact negatively on the success of SMMEs.

The DTI (2012) cited that despite the fact that there are a number of government funding programmes and financing schemes in South Africa, awareness and the uptake of these schemes, however, has been very low. Schussler (2009) suggested that the DTI and its subsidiaries need to understand SMMEs, as their efforts to support SMMEs so far have been unsuccessful. According to Schussler (2009), DTI has not focused enough and have not been successful in helping SMMEs.
The National Credit Regulator (2011) revealed a number of reasons for the failure of Government support to SMMEs which include: lack of awareness; uneven distribution; the high cost of searching for support services which has not been mitigated by effective information on how and where to access support; and cumbersome administrative requirements of government programmes resulting in user fatigue and high levels of disappointment. The GEM (2010) also suggests that, in addition to the factors mentioned above, an important reason for the failure of government support programmes to SMMEs in South Africa is due to poor service delivery, specifically the incompetence of the people delivering the government support.

The commercial banking sector is still the main source of external finance for SMMEs. It is important, therefore, for the commercial banking sector to develop viable and sustainable means of extending credit to the SMME sector (National Credit Regulator, 2011). In most OECD countries, banks perceive SMMEs as an attractive line of business and have developed effective monitoring systems. These include investing in credit scoring models and other sophisticated techniques to discriminate between high and low risk borrowers in overcoming the information asymmetry problem. It is worth noting that in most cases funds supplied under official government programmes are modest compared to that supplied by banks at their own risk (OECD, 2006).

Despite the above mentioned views, the results of this research revealed that all of the respondents strongly disagreed with the statement that indicated that the commercial banks are willing to finance SMMEs. These findings are related to fact that only five percent of the respondents expanded their business by using loans from banks and other funders.

Chimucheka and Rungani (2011) found similar results and mentioned that 28 percent of SMMEs surveyed by them had never applied for financing from a bank. The main reasons given were not knowing the procedures for applying for a loan (53 percent), not knowing about the sources of finance available from the banks (23 percent) and the high interest rates (seven percent). Seventeen percent indicated that they had enough capital to start and run their own businesses.
FinMark Trust (2006) found that only two percent of new SMMEs in South Africa are able to access bank loans. Foxcroft et al (2002) on the other hand documented that 75 percent of the applications for bank credit by SMMEs in South Africa are rejected.

FinMark Trust (2010) explored the barriers to financial inclusion and found that the most significant barriers to entry were neither regulatory nor supply related, but mainly attitudinal or perceptual in nature, similar to those stated above. Most business owners felt that the irregularity and the size of their income did not justify having a bank account. Secondary to income-related reasons were reasons that are associated with that there was a majority of unregistered SMMEs, high bank charges and the minimum bank requirements being too stringent. These findings point to the significant need for financial education amongst SMMEs.

5.4 SUGGESTIONS FOR IMPROVEMENT
The respondents were finally asked for suggestions regarding improvement in providing finance to SMMEs. The table below shows the summary of the responses by the respondents and such responses are further briefly discussed in the next sections.
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<tbody>
<tr>
<td>Better risks and profitability evaluation methods</td>
<td>100%</td>
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<tr>
<td>Easy loan repayment options</td>
<td>100%</td>
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<td></td>
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<tr>
<td>Flexible eligibility criteria</td>
<td>90%</td>
<td>10%</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Proper amount allocation for loans</td>
<td>40%</td>
<td>50%</td>
<td>10%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business management skills should be taught as early as primary school</td>
<td>35%</td>
<td>35%</td>
<td>30%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SMMEs need to learn to write business plans for themselves and not to only rely on experts or consultants</td>
<td>15%</td>
<td>20%</td>
<td>30%</td>
<td>35%</td>
<td></td>
</tr>
<tr>
<td>There is a need for the government to monitor activities of the banks with regards to SMME funding</td>
<td>85%</td>
<td>15%</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Government should offer more business training programmes for SMMEs</td>
<td>100%</td>
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</table>
5. 4.1 Better risks and profitability evaluation as well as easy loan repayment methods

All of the respondents were of the view that better risks and profitability evaluation methods as well as easy loan repayment option should be offered. Hwarire (2012) analysed loan advances made by South African banks to 169 SMMEs in 2008/09 financial year and suggested several methods to the banks to do this. He recommended that banks can create an innovative fund to cater for SMMEs where write-offs are not regarded as losses but as part of corporate social investment. He also suggested that banks must increase overdraft lending base, increase awareness in regard to cash flow and general business management. Hwarire (2012) also mentioned that the government may also give tax breaks to those SMMEs that pay their loan debts on time to encourage a culture of loan repayment.

5. 4.2 More Government support for SMMEs

All respondents were of the opinion that government should offer more business training programmes for SMMEs. Eighty-five percent of the respondents strongly agreed that there is a need for the government to monitor activities of the banks with regard to SMME funding while 15 percent agreed with the statement.

These findings also support the argument by Storey (2003) who suggested that SMMEs need training, because their owners are invariably less educated and therefore less able to be formally trained compared to managers in large businesses. In addition, failed businesses are normally poorly managed, implying that management training will improve the situation (Tlhomola, 2010). Ongoing training is needed to assist SMME owners to manage the constantly changing environment and be able to respond to it with initiative and innovation (Tlhomola, 2010).
The National Credit Regulator (2011) encourages the government to continue building on current programmes and establishing new ones if warranted, to improve the levels of managerial competence and skills of the SMME owners or managers.

5. 4.3  **Flexible eligibility criteria for SMME loans and proper amount allocations**

One of the suggestions put forward by the respondents is that there must be flexible eligibility criteria for SMME loans. The majority, 90 percent of the respondents, strongly agreed with the statement while 10 percent agreed. Forty percent of the respondents strongly agreed that there must be proper amount allocation for loans while 50 percent agreed with the statement.

Timm (2012) proposed that the government and the private sector must partner together when it comes to financing SMMEs. One of the most effective ways to do this is for the state to set up more and effective credit guarantee schemes. Banks and lending organisations that are members of the scheme then advance loans to SMMEs, but the state provides a guarantee to these organisations that should the loan go bad the banks will be compensated by the state (Timm, 2012).

5. 4.4  **Business management skills should be taught as early as primary school**

The findings indicated that the respondents were divided regarding their views with regard to the statement that suggested that business management skills should be taught as early as primary school. Thirty-five percent of them strongly agreed with the statement while 35 percent agreed and 30 percent were uncertain.

5. 4.5  **SMMEs need to learn to write business plans for themselves**

A small number of the respondents, 15 percent, strongly agreed with the notion that SMMEs need to learn to write business plans for themselves and not to only rely on experts or consultants, while 20 percent of the respondents agreed with the statement.
Of interest was that 30 percent of the respondents were uncertain regarding the issue and 35 percent disagreed with the statement.

5.5 SUMMARY

The main purpose of Chapter five was to present research findings and support the findings with appropriate literature. The data obtained from the SMME owners who participated in the study was analysed. Based on the respondents’ responses, it is evident that factors regarding perceived risks of SMMEs by funders, poor business plan development, poor business training and development and source of funding are perceived barriers faced by SMMEs in accessing finance.

A majority of the respondents recommended that there must be better risk and profitability evaluation, easy loan repayment methods, more government support for SMMEs, flexible eligibility criteria for SMME loans and proper loan amount allocations.

The next chapter, Chapter six, provides the conclusion and recommendations.
CHAPTER 6

CONCLUSION AND RECOMMENDATIONS

6.1 INTRODUCTION

The aim of this research study was to determine the barriers faced by SMMEs in accessing finance. For this purpose, the researcher conducted a survey on 40 SMME owners who are members of the National Industrial Chamber offices (NIC) in Tshwane Metropolitan Municipality. The SMMEs were in operation for at least two years. The respondents were asked questions regarding the sources of finance for start-up and business expansion, the type of businesses they are running as well as their opinions regarding barriers faced by SMMEs in accessing finance and suggestions that they would give to the creditors for improvement.

The results of these responses were graphically analysed and discussed in the preceding chapter. The researcher compared the results with previous literature to search for similarities or contradictions and also compared the results within themselves to compare respondent’s behaviours.

This chapter presents the conclusion drawn from the results of the analysis. It shows how the analysis fulfilled the objectives of this research study and also provides suggestions for future research and for practice.

6.2 OVERVIEW OF THE RESEARCH

Chapter 1: Problem statement and outline of the study

A background to the study was offered in Chapter one. The following was addressed: access to finance, SMME banking, purpose of the study, problem statement, research objectives, research design and methodology and hypotheses.
Chapter 2: An overview of SMMEs

The chapter provided a comprehensive literature review with regards to SMME sector and SMME financing. Definitions of SMMEs were given focusing on international definitions, definitions in developing countries as well as in South Africa. The importance of SMMEs in socio-economic development and their contribution in the South African economy was also included in this chapter.

Chapter 3: Barriers to SMME finance in South Africa

This chapter reviewed the appropriate literature regarding SMME policies and institutional framework in South Africa, common causes for SMME failure in South Africa and gave a hypothesis regarding barriers to funding for SMMEs.

Chapter 4: Methodology

This chapter provided a detail explanation of the research methodology used to conduct the study. The research paradigm, the research method, the research approach, sampling methods, data collection and the questionnaire were discussed. The pilot study, ethical considerations, validity and reliability and data analysis were also explained in the chapter.

Chapter 5: Data analysis and Findings

Chapter 5 discussed the results obtained from the survey. A detailed analysis of the findings was given. Various statistical methods were used to analyse the data and the findings were compared to the literature.
Chapter 6: Conclusions and Recommendations

This is the final chapter of the research study, which is aimed at drawing conclusions and making recommendations that could provide solutions with regards to barriers faced by SMMEs in accessing finance.

6.3 RESEARCH OBJECTIVES REVISITED

The study sought to achieve the following objectives:

- to identify the conventional sources of finance for start-up of SMMEs in the manufacturing sector in South Africa;
- to identify the conventional sources of finance for expansion of SMMEs in the manufacturing sector in South Africa;
- to determine the common barriers to finance for SMMEs in the manufacturing sector in South Africa; and
- to make suggestions for the improvement of access to finance for SMMEs in the manufacturing sector of South Africa.

The above objectives of the study have been met. The study has illustrated the sources of finance for start-up and for business expansion. Common barriers faced by SMMEs to access finance have been discussed and suggestions for the improvement are also pointed out in the study.

6.4 CONTRIBUTION OF THE STUDY

This study will act as a source of reference to role players that are involved in drafting policies that govern SMME financing. It highlights the common barriers faced by SMME in accessing finance. The study of this nature is crucial as the barriers are given by the SMME owners themselves rather than the creditors or government support structures as in other similar research studies.
6.5 STUDY LIMITATIONS

The study was limited to manufacturing SMMEs in the Tshwane Metropolitan Municipality. Therefore, care should be exercised in the interpretation and application of the results of this study and the generalisation of the findings.

6.6 KEY RESULTS OF THE STUDY

The research findings that were analysed in Chapter five are briefly summarised below and the key barriers faced by SMMEs in accessing finance are highlighted.

- Education and training are viewed as the key success factor for business survival and growth. Despite this, the research findings indicate that there is generally low level of education among the SMME owners. The majority of SMMEs are also not trained regarding relevant business skills such as general management of business, financial management and/or human resource management. This results in limitation in understanding requirements of finance, formulating and following business plans as well with regards to general management of the businesses, especially cash flow management. Financial and other management skills need to be enhanced to enable SMMEs to respond to the financial and management difficulties that threaten their businesses. This could help the SMME owners to make informed decisions between personal and business commitments. This will help to prevent the use of business assets for personal commitments. It can thus be concluded that SMMEs need financial and management skills for running a structured and sustainable business.

- The majority of the SMME owners are trading informally. The researcher associates this with the lack of management skills. It is evident that the SMME owners would ideally run away from the structured management as they are not educated and resort to informal businesses where there can rely only on their skills.
The majority of SMMEs owners have difficulty in expanding their businesses. Those who manage to expand still source finance for expansion from personal savings, friends and family and retailed business earnings. Banks and other government credit institutions are still financing a negligible number of SMME despite the general improvement made by these institutions with regards to SMME finance policies. The study also highlights that lack of financial support from the government institutions and from the banks impacts negatively on the success of SMMEs. The results of this research revealed that the commercial banks are not willing to finance SMMEs. An overwhelming majority of respondents felt that the banks and other financial institutions are not doing enough to assist them.

- The findings revealed that lack of collateral or business assets, lack of financial statements, excessive red tape by funders, administrative burden associated with applications as well as unfair evaluation of risks and profitability of SMMEs by funders are the main barriers that are faced by SMMEs in accessing finance.

- Business plans are one of the key prerequisites to access finance. However SMME owners still have problems in formulating and following proper business plans. Most of SMME owners rely on other experts to prepare the business plans. Most of them have no idea about what the business plan entails and do not follow the business plans.

- It is evident from the study that most SMME owners know about government financial institutions, but despite this perception most of the SMMEs have a difficulty in sourcing finance from these institutions. The government, through its subsidiaries, has the obligation to create a conducive environment for SMMEs and improve financial support for SMMEs. Lack of government interventions are significant causes for the collapse in SMMEs.

### 6.7 SUGGESTIONS PUT FORWARD BY THE RESPONDENTS

The respondents were finally asked for suggestions regarding improvement in providing finance to SMMEs.
In response to the question, the respondents were of the view that better risks and profitability evaluation as well as easy loan repayment methods should be applied. SMME owners are required to put down collateral before being financed. It is a well-known fact that most SMMEs, especially those who come from previously disadvantaged backgrounds, do not have sufficient track record or assets to provide such collateral. Hence, better risk and profitability evaluation as well as easy loan repayment methods were suggested by all the respondents.

The issue of more government support for SMMEs was suggested by the majority of the respondents. They recommended that government should offer more business training programmes for SMMEs and it must monitor activities of the banks with regards to SMME funding. The findings reveal that the credit available for SMMEs is insufficient to meet their demands. In this case, then government would have to put in place programmes that will increase the availability of funding for SMMEs. The National Credit Regulator (2011) encourages the government to continue building on current programmes and establishing new ones if warranted in order to improve the levels of managerial competence and skills of the SMME owners or managers.

The respondents also suggested that flexible eligibility criteria for SMME loans and proper amount allocations should be offered. Timm (2012) proposed that the government and the private sector must partner together when it comes to financing SMMEs. More and effective credit guarantee schemes must be established and the state should provide guarantees to the lending organisations to provide more loans.

6.8 RECOMMENDATIONS

Based on the findings of this research it is clear that there are still significant barriers to SMMEs in accessing finance. The following recommendations are made in view to improve access to finance for SMMEs
6.8.1 Improve the levels of managerial competencies and skills of SMMEs

Government support structures such as SEDA must offer structured training programmes aimed at building strong financial and other management skills for SMMEs. Such programmes may include drafting and understanding business plans, understanding financial statements, cash flow management as well as managing staff. The government is therefore encouraged to continue building on current programmes and establishing new ones if needed, to improve the levels of managerial competence and skills of the SMME owner. As the majority of training programmes are implemented through SEDA, to improve the effectiveness of the current programmes SEDA needs to be capacitated by improving staffing levels with individuals with the appropriate skills and experience, and making better/more use of consultants.

Tertiary institutions should encourage and prioritise that SMME programmes be taught in all academic disciplines. This can be done by adding a business skill course in the final year of study. It is a reality that a significant number of the graduates that finalise their programmes sit without employment. By doing this, they can be encouraged to also think about options of running their businesses. Additionally, short courses that deal with specific business management competencies must be made available to aspiring SMME or existing SMME owners and these courses must not necessarily require any level of education except the basic ability to comprehend the course material.

SMMEs need to learn to write business plans for themselves and not to only rely on experts or consultants. For a business plan to contain all details and facts, it needs to be prepared by the owners of the business, those who came up with the idea, not the consultants. In cases where owners are illiterate they must at least be there when the document is prepared (Chimucheka, 2012).
6.8.2 Improve financial support to structures that support SMME growth and development

Social responsibility contributions by financial institutions should prioritise NGOs and other structures that support SMME development and growth. This will also be a positive step towards preventing failures of SMME and also increase future potential customers for the financial institutions.

6.8.3 Flexible SMME eligibility criteria

Banks continue to finance a small number of SMMEs despite the support that has been offered by the government in an attempt to improve this. The loan applications assessments by the creditors must be flexible and done on metric. The loan assessments must be based more on the viability of the business and there must less or no collateral required.

It is also recommended that structures such as Khula Enterprise Finance Ltd consider offering loans direct to SMMEs rather than function as a guarantor for the business owners who do not have collateral.

6.8.4 Increasing the levels of formality of SMMEs

As discussed earlier in the study, registered SMMEs are more likely to have a bank account and also make use of available credit products. In order to encourage more SMMEs to formalise their business, several strategies should be implemented. This should include strategies by government to reduce the regulatory burden on SMME’s. This should address high interest rates, high inflation and allow lenient tax deductions for SMMEs. This will encourage SMMEs to formalise their business, to be able to apply for loans and will make loans more affordable for SMMEs.

Government should encourage registration of SMMEs and this must be sponsored and done with minimal or no cost to the SMME. SMMEs can be incentivised by highlighting the benefits to registration such as access to finance from the various government or
private schemes and access to other support programs such as business development services.

Government should also derive and enforce policies that require private sector to only trade with businesses that are formally registered.

6.8.5 Increase awareness of the SMME related products including credit access
The study revealed that although most respondents indicated that they are aware of the various government products related to SMME finance, most of them they have not used them. The National Credit Regulator (2011) is of the view that there is a generally low uptake on available products, especially on government schemes. There is a need to increase awareness among SMME owners’ about the government and private products and services available, including the eligibility criteria of such products.

There is also a need to publicise the various schemes and programmes through a wide variety of media on an on-going basis and ensuring that the targeted market is reached.

6.9 SUGGESTION FOR FUTURE RESEARCH AREAS
Based on the findings of the research, underneath are possible future research areas:

- Strategies to grow small businesses to medium and large enterprises;
- Barriers that hinder SMMEs to be formalised;
- Effectiveness of current government policies on SMME growth and sustainability.
6.10 CONCLUSION

It can be concluded that the purpose of the study, which was to identify the barriers that are faced by SMMEs in accessing finance, has been achieved. The study revealed various barriers faced by SMMEs in accessing finance. These include those barriers that are related to perceived risks of SMMEs by funders, poor business plan development, poor business training and development among SMME owners and source of funding.

The researcher hopes that the findings of the study will be used as a source of reference to role players that are involved in SMME financing and also stipulate further research in the area of SMME.
REFERENCES


The Micro, Small and Medium Enterprise Development Act, 2006. Mumbai: India


ANNEXURE 1: CONSENT FORM

ASSENT BY THE PARTICIPANTS

I, the undersigned

(Name of the Applicant)

Of ____________________________________________ (Home Address)

HEREBY CONFIRM AS FOLLOWS:

1. I was invited to participate in a research project titled “Barriers Faced by SMMEs in Accessing Finance” which was being undertaken by Siyabonga Caga as part of the requirements of Masters in Business Administration done through the Nelson Mandela Metropolitan University.

2. The research study aims to investigate barriers that affect SMME’s in accessing finance.

3. The results of the research findings may be published in professional conferences and publications.

4. I understand that I will complete the consent form and forward it to the researcher before I participate in the research and I will complete the research questionnaire.

5. My identity will not be revealed in any discussion, description or publication by the researcher.

6. My participation is voluntary and I can pull out at any time during the research should I want to.

7. Participation in this study will not cost me.

I consent voluntarily to participate in the above-mentioned research study.

Signed at ______________________________________ on ______________________

Signature of the Participant
ANNEXURE 2

RESEARCH QUESTIONNAIRE

SECTION A: BIOGRAPHIC INFORMATION OF THE PARTICIPANTS

The information provided under this section will allow the researcher to compare the responses given by the respondents. Your response will remain anonymous.

Please answer all questions by marking X on the appropriate box

<table>
<thead>
<tr>
<th>Gender</th>
<th>Female</th>
<th>Male</th>
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<td>2</td>
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<table>
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<tr>
<td>White</td>
<td>2</td>
</tr>
<tr>
<td>Coloured</td>
<td>3</td>
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<tr>
<td>Asian</td>
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<table>
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<th>Highest Level of Education</th>
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<tbody>
<tr>
<td>Primary</td>
<td>1</td>
<td>National Diploma</td>
</tr>
<tr>
<td>High School/ did not pass grade 12</td>
<td>2</td>
<td>Honour’s Degree</td>
</tr>
<tr>
<td>Grade 12</td>
<td>3</td>
<td>Master’s Degree</td>
</tr>
<tr>
<td>Post Matric Certificate</td>
<td>4</td>
<td>Doctorate</td>
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<tr>
<td>Other</td>
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### Type of Business

<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Number</th>
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</thead>
<tbody>
<tr>
<td>Sole propriety</td>
<td>1</td>
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<tr>
<td>Partnership</td>
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</tr>
<tr>
<td>Close Corporation</td>
<td>3</td>
</tr>
<tr>
<td>(Pty) LTD</td>
<td>4</td>
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<tr>
<td>Ltd</td>
<td>5</td>
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</tbody>
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### Numbers of Years in Operation

<table>
<thead>
<tr>
<th>Years in Operation</th>
<th>Number</th>
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<tbody>
<tr>
<td>2-4 years</td>
<td>1</td>
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<tr>
<td>10-12 years</td>
<td>5</td>
</tr>
<tr>
<td>4-6 years</td>
<td>2</td>
</tr>
<tr>
<td>12-14 years</td>
<td>6</td>
</tr>
<tr>
<td>6-8 years</td>
<td>3</td>
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<tr>
<td>Over 14 years</td>
<td>7</td>
</tr>
<tr>
<td>8-10 years</td>
<td>4</td>
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</table>

### Source of a start-up capital vs. Source of capital for business expansion

<table>
<thead>
<tr>
<th>Source of a start-up capital</th>
<th>Source of capital for business expansion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal savings</td>
<td>Loans from banks and other funders</td>
</tr>
<tr>
<td>Friends or family</td>
<td>Retained earnings</td>
</tr>
<tr>
<td>Loans from banks or other funders</td>
<td>Friends or family</td>
</tr>
<tr>
<td>Other, specify</td>
<td>Personal savings</td>
</tr>
<tr>
<td></td>
<td>Other, specify</td>
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</tbody>
</table>


## SECTION B: BARRIERS FACED BY SMMEs IN ACCESSING FINANCE

### Perceived Risks of SMMEs by funders

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Lack of collateral or business assets</td>
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<tr>
<td>Lack of financial statements</td>
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<tr>
<td>Excessive red tape by funders</td>
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<tr>
<td>Administrative burden associated with applications</td>
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<tr>
<td>Unfair evaluation of risks and profitability of SMMEs by funders</td>
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</tbody>
</table>

### Poor Business Plan Development

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<tbody>
<tr>
<td>Business plans are valuable in accessing finance</td>
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<tr>
<td>Business plans are difficult to put together</td>
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<tr>
<td>Business plans are costly</td>
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<tr>
<td>Business plans are easy to understand</td>
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<tr>
<td>Business plans are easy to implement</td>
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</table>
### Poor business training and development

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<tbody>
<tr>
<td>I have been trained in general management of the business</td>
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<tr>
<td>I have been trained in financial management</td>
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<tr>
<td>I have been trained in human resource management</td>
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<td>I have technical experts in manufacturing</td>
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<tr>
<td>Business training programmes by the government are not enough</td>
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### Source of funding

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<tbody>
<tr>
<td>It is easy to acquire finance from the government financial institutions</td>
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<tr>
<td>Many of SMMEs know about government financial institutions</td>
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<td>Lack of financial support from the government institutions impact on the success of SMMEs</td>
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<tr>
<td>The commercial banks are willing to finance SMMEs</td>
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<td>------------------------------------------------------------------------------------</td>
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<tr>
<td>Lack of financial support from the banks impact on the success of SMMEs</td>
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<td>SECTION C: RECOMMENDATIONS</td>
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<td>Recommendations</td>
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Better risks and profitability evaluation methods

Easy loan repayment options

Flexible eligibility criteria

Proper amount allocation for loans

Business management skills should be taught as early as primary school

SMMEs need to learn to write business plans for themselves and not to only rely on experts or consultants

There is a need for the government to monitor activities of the banks with regards to SMME funding

Government should offer more business training programmes for SMMEs
Other specify

Any other comments

____________________________________________________________________________________

____________________________________________________________________________________

____________________________________________________________________________________

____________________________________________________________________________________

____________________________________________________________________________________

____________________________________________________________________________________

Thank you for participating in this research