AN INVESTIGATION INTO CONSTRAINTS IMPACTING ON SMALL MICRO AND MEDIUM ENTERPRISES (SMMEs) ACCESS TO FINANCE IN BUFFALO CITY METROPOLITAN MUNICIPALITY

BY

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INTEGRATIVE SUMMARY

Internationally, in both developed and developing countries, it has been accepted that SMMEs are the backbone and the driving force of economic growth and job creation. In South Africa, SMMEs account for approximately 60 per cent of all employment in the economy and more than 35 per cent of South Africa's Gross Domestic Product (GDP) (Ntsika, 1999:38; Gumede, 2000:67 and Berry *et al*, 2002 in Kongolo, 2010:235). SMMEs are often the vehicle by which the lowest income people in our society gain access to economic opportunities. The sector represents 97.5 per cent of the total number of business firms in South Africa and that it contributes 42 per cent of total remuneration. SMMEs account for some 3.5 million jobs and have between 500 000 and 700 000 businesses (Abor and Quartey, 2010:2337).

Due to the above-mentioned contribution, the South African government initiated a number of SMME support programmes aimed at promoting, growing and developing the SMME sector. As a result, a number of national government agencies such as the National Youth Development Agency (NYDA), Khula Finance Limited, the National Development Agency (NDA), the Small Enterprise Development Agency (SEDA) and many other national, provincial and local government organizations were established post 1994.

However, despite the concerted efforts by government to develop the sector, SMMEs are, after 17 years of democracy, still faced with enormous challenges such as access to markets, information, appropriate technology, finance, to mention but a few. Of the above-mentioned challenges, access to finance is on top of the list of these.

This study, therefore, is aimed at investigating external, institutional and internal constraints impacting on SMME access to finance in the Buffalo City Metropolitan Municipal area. The study is also aimed at ascertaining which of the above-mentioned constraints have the greatest influence to SMME access to finance.

In developing the framework of the study, recent empirical research conducted around the country and internationally on constraints influencing SMME access to finance (Bbenkele, 2007:18; Ganbold, 2008:45; Mahadea and Pillay, 2008:99; Chenesai, 2009:135; Zindiye, 2009:78; Fatoki and Garwe, 2010:2765; Pandula, 2011:257) was drawn upon.

In order to meet the objectives of the study, a simple random sample survey of 50 SMMEs in the Buffalo City Metropolitan Municipality (BCMM) jurisdiction was conducted. The profile of the SMMEs was very similar to that of other studies that focused on constraints to SMME access to finance. A structured questionnaire was used to collect data from SMME owner-managers and a response rate of 60 percent was achieved.

The results of the study indicated that the high cost of credit and interest rates and Value Added Tax (VAT) registration were the key external factors that impacted on SMME access to finance. Generally, SMMEs are viewed by lending institutions as high risk category. Therefore, even though interest rates have come down significantly, the cost of credit and interest rates still remain a constraint. The study also found that even though the South African Revenue Services (SARS) has increased the VAT threshold to R1 million (South African Revenue Service, 2007: 29), SMMEs still struggled to register for VAT.

With regards to the institutional factors, the study revealed that ineffective support services provided by private and public SMME support agencies, the lack of communication of these services (access to information) and the lack of the subsequent follow-up services were the key constraints to SMME access to finance.

The results of the study indicate that those firms with good track record, high annual turnover, sophistication and diverse skills, good credit record, good cash flow, proper financial records, bankable and viable business plans, collateral and registered for VAT were more likely to have access to finance than their counterparts.

The main conclusion of the study is that the internal factors turned to have the greatest influence to SMME access to finance. However, there is more to be done by private and public SMME support agencies and lending institutions to address the above-mentioned institutional constraints which have a negative influence to SMME access to finance.

It is recommended that more in-depth empirical research be conducted on the support services provided by private and public SMME support agencies in terms of the services that they offer the effectiveness of the services and how these are communicated to potential customers. It is also recommended that training workshops aimed at addressing the internal constraints identified be conducted. Also recommended is the development and implementation of sector-specific mentoring programmes for the owner-managers.

Strategies to improve the awareness of support services provided by SMME support agencies need to be developed. This would ensure the effective use of these services by SMMEs. It is also recommended that SMME support agencies and lending institutions staff be trained in order to better understand and be more responsive to the owner managers' needs. Linkages with tertiary institutions in planning and conducting the training needs to be made.

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ACRONYMS

BCMM	- Buffalo City Metropolitan Municipality
SMMEs	- Small Micro and Medium Enterprises
SAMAF	- South African Microfinance Apex Fund
GDP	- Gross Domestic Product
SEDA	- Small Enterprise Development Agency
IDC	- Industrial Development Corporation
NYDA	-National Youth Development Agency
NDA	- National Development Agency
DTI	- Department of Trade and Industry
AsgiSA	- Accelerated Shared Growth Initiative of South Africa
VAT	- Value Added Tax
UIF	- Unemployment Insurance Fund
USAID	- United States Agency for International Development
NGO	- Non Governmental Organization
GEM	- Global Entrepreneurship Monitor
FNB	- First National Bank
Absa	- Amalgamated Bank of South Africa

SECTION 1: THE ACADEMIC PAPER

1.1. ABSTRACT AND INTRODUCTION

1.1.1 Abstract

The study investigates external, institutional and internal constraints influencing SMME access to finance in Buffalo City Metropolitan Municipality (BCMM). The study is also aimed at investigating which of the above-mentioned factors has the greatest influence on SMME access to finance. The literature review revealed that SMME access to finance is most often cited as the main challenge facing SMME growth and development. To realize the above-mentioned objective, a 57-item structured questionnaire was developed and administered to 30 SMMEs within the BCMM area. The descriptive statistics and cross tabulation were used to analyze the collected data.

The results of the study indicated that the high cost of credit and interest rates and Value Added Tax (VAT) registration were key external factors that influenced SMME access to finance. Regarding institutional factors, the study revealed that the ineffective support services provided by private and public SMME support agencies, lack of communication of these services and lack of subsequent follow-up services were the key constraints to SMME access to finance. On the internal factors the results of the study indicated that firms with men as owner-managers, a good track record, more than one owner, high level sophistication and skills, audited financial statements, bankable proposals or business plans and good credit record were more likely to access finance than their counterparts. The main conclusion of the study is that the internal factors tended to have the greatest influence to SMME access to finance.

Key words: SMMEs, external, institutional and internal constraints, access to finance

1.1.2 Introduction

The SMME sector is, in both developed and developing countries, regarded as the driving force behind economic growth, job creation and poverty reduction (Ferreira, 2007:275; Ganbold, 2008:14; Herrington *et al*, 2010:14; Fatoki and Smit, 2011:2766; Pandula, 2011: 255). Many governments have, as a result of this contribution by SMMEs, paid more attention to the sector.

Since 1994, the South African government introduced and implemented a number of policy initiatives and programmes aimed at economic reform and in particular those that give effect to the vision and objectives of addressing the economic imbalances and uneven development within and between South Africa's regions (Ferreira, 2007:275). The above-mentioned policy initiatives and programmes were aimed at addressing the economic disparities and inequalities attributed to the past apartheid regime.

In addition, government also established national and provincial SMME financing agencies such as Khula Finance Limited, Small Enterprise Development Agency (SEDA), South African Microfinance Apex Fund (SAMAF), National Youth Development Agency (NYDA), Eastern Cape Development Corporation (ECDC) and many others to provide finance to SMMEs. However, despite the above-mentioned government endevour, empirical evidence proves that SMME access to finance still remains a challenge (Pandula, 2011:255).

The study, therefore, is aimed at investigating external, institutional and internal constraints influencing SMME access to finance in BCMM. The study is also aimed at investigating which of the above-mentioned constraints have the greatest influence on SMME access to finance.

It is believed that the study will provide policy makers, finance institutions and SMME support and development organizations with valuable information regarding constraints influencing SMME access to finance and which of these have the greatest influence. The following sub-section presents the reviewed literature on the external, institutional and internal factors influencing SMME access to finance.

1.2 LITERATURE REVIEW – FACTORS AFFECTING SMME ACCESS TO FINANCE

External, institutional and internal factors have, in a number of studies (Bbenkele, 2007:14; Ganbold, 2008:18; USAID, 2010:57; Fatoki and Smit, 2011:2764; Pandula, 2011:270), been identified as key factors influencing SMME access to finance. Beck (2007) pointed out that the external or systemic factors (also known as state variables) are outside the reach of lenders' actions and policy makers cannot change them in the short-run. The internal (borrower-specific) factors, on the other hand, include variables largely controllable by a firm (Barbosa and Moraes (2004:17) in Fatoki and Smit (2011: 1415). The last category (institutional factors) is those that are largely controllable by the lender (Pandula, 2011:257). These categories of factors are presented in the table below.

Table 1.2 Factors influencing SMME access to finance

External factors	Institutional factors	Internal factors
• High cost of credit and interest rates • Taxation • Cost of doing business • Availability of funds for lending • The risk profile of a firm • Policy issues	• Bureaucracy and red tape • Loan application forms • Lack of understanding of the loan application procedure • Lack of understanding of the lending criteria • Lack of access to information	• The age of the entrepreneur • The size of the firm • The age of the firm • The ownership type • The Industry sector • The firm location • The entrepreneurial experience • Networking • Lack of appropriate skills to run and manage a business • Bad credit record • Poor quality business plans • Lack of audited financial statements

1.2.1 External factors

As mentioned above, the external or macro factors include, but are not limited to, the high cost of credit and interest rates, VAT registration and the National Credit Act. The high cost of credit and interest rates were identified by Ganbold (2008:14) as key variables that negatively influenced SMME access to finance. This means that the higher the interest rates, the higher the cost of credit for SMMEs as they are considered by lending institutions as having a high risk profile.

Rogerson (2008:28) argued that the complexity of VAT registration and administration and the time it takes for SMMEs to register for VAT have a negative influence on SMME access to finance. Also, a study by the USAID (2008:18) revealed that the debt check by lending institutions prior to granting loans thereby uncovering the extent of borrowing was considered a hindrance to accessing finance.

Beck (2007:39) argued that the stronger the negative influence of the above-mentioned external factors, the less maneuvering room for credit supply optimization. However, interest rates have, since 2009 fallen significantly and it is hoped that this has a lesser influence to SMME access to finance. Also, SARS has increased the VAT threshold to R1 million. It is therefore argued that the external factors have a less impact to SMME access to finance.

1.2.2 Institutional factors

For the purpose of the study, loan application forms, lack of understanding of the loan application procedure and criteria and lack of access to information were identified as the major variables influencing SMME access to finance. Herrington *et al* (2010:41) observed that although numerous small business incentives are becoming available, excessive bureaucracy and cumbersome application processes and the protracted inefficient decision-making, amongst others, have limited the impact of these and such incentives.

Mahadea and Pillay (2008:54) argued that SMMEs are required to complete bulky and complex loan application forms written in English and not translated to the applicant's first language. This results in incomplete and inaccurate applications because the applicants struggle to understand the contents of the form. At the same time the lack of understanding of the loan application procedure and criteria frustrates SMMEs and this creates a negative perception against lending institutions (Bbenkele, 2007:20; Ganbold, 2008:33). This sets SMMEs up for failure as completing the form not having been taken through and understood the above-mentioned procedures and criteria excluded them from being considered for finance.

The Khula Retail Finance Intermediary Programme study by the World Bank (2006:29) and Mazanai and Fatoki (2011:212) identified access to information as one of the major influences to SMME access to finance. The study identified low levels of SMME awareness and knowledge of government and some private sector lending institutions and what they offer as a major challenge. Herrington *et al* (2010:41) also observed that many of the government and private sector finance initiatives are poorly marketed to their targets. This deprives SMMEs of valuable information which in turn limits their chances of accessing finance.

1.2.3 Internal factors

A number of borrower-specific and firm related variables have been identified by various researchers (Mahadea and Pillay, 2008:39; Chenesai, 2009:190; Fatoki and Garwe, 2010:2767; Abor and Quartey, 2010:2456; USAID, 2010:37; Pandula, 2011:259) as having a great influence on SMME access to finance. These factors include gender, the level of education, the level of experience, lack of appropriate skills to run and manage a business, the size and age of the firm, the ownership type, industry sector, firm location, the risk profile of a firm, networking, bad credit record and lack of audited financial statements and the poor quality of business plans.

A study conducted by Zindiye (2007: 197) found that compared to male counterparts, female managed firms are less likely to obtain a bank loan. However, this was disputed by the USAID (2010:46) which argued that finance institutions seem less concerned about the gender of the entrepreneur when looking at loan applications. The study pointed out that a number of government and private sector finance institutions, instead, prioritise women, youth and the disabled when lending credit to SMMEs.

Various studies on SMME access to finance found a correlation between the entrepreneur's level of education and SMME access to finance. For example, a recent study by Pandula (2011:259) revealed that graduates had the least difficulties raising finance from lending institutions compared to their less educated counterparts. The study argued that more educated entrepreneurs have the ability to present positive financial information, strong business plans and are able to maintain a better relationship with finance institutions compared to their less educated counterparts. Fatoki and Smit (2010:1422) also shared the same views.

In relation to the entrepreneur's experience and lack of appropriate skills to run and manage a business, Abor and Quartey (2010:1254) and Fatoki and Garwe (2010:2765) pointed out that owner-managers with previous experience and appropriate business management skills are more likely to avoid costly mistakes than those with no prior experience.

The size and age of the firm were identified by researchers as one of the important variables to SMME access to finance. Pandula (2011:263) argued that smaller firms are not legally required to submit annual financial statements which are required by finance institutions for loan consideration. Also, smaller and/or younger firms have fewer assets to offer as collateral and the smaller the firm, the higher the risk as smaller firms have a high failure rate compared to large firms. Chenesai (2009:150) argued that because businesses require a range of skills, chances are that businesses with more than one owner are more likely to access finance due to their management structure.

The industry sector of a firm also determines SMME access to finance. Rogerson (2008:67) and Pandula (2011:259) observed that lending institutions favoured industry sectors that are competitive, innovative and growing. For example, Rogerson observed that metal and wood furniture have significantly less potential to access finance than the food processing sector.

Talavera *et al* (2010:70) in their study on the impact of social capital on financial obstacles faced by entrepreneurs using a pooled data of about 270 small companies, found that membership in business associations increases the probability of loan access by 14.8 percent. The challenge for SMMEs though, is the absence of small business associations under which they can affiliate.

A thorough review of the literature on SMME finance identified external, institutional and internal factors influencing SMME access to finance. However, no study has investigated which of the above-mentioned factors have the greatest impact or influence in SMME access to finance from the demand side hence this study. The sub-section below provides details on the research methodology followed in conducting the research.

1.3 RESEARCH METHOD

The research methodology employed in this research involved an extensive review and analysis of relevant literature, studies and surveys on SMME access to finance. This provided a theoretical framework for the research followed by the empirical study. The target population for the study was owner-managers of SMMEs trading in the BCMM area. These had to comply with the definition of an SMME as outlined in the National Small Business Act (102 of 1996) attached as Appendix A of the study.

The overall objective of the research was to investigate the constraints negatively affecting BCMM SMME access to finance and the following goals have been identified:

1. To identify the prevailing external, institutional and internal factors which impact on SMME access to finance.
2. To identify which of these factors show the greatest impact.
3. To make recommendations on how these constraints can be overcome.

A database composed of a total of 390 SMMEs and cooperatives was obtained from BCMM's Economic Development and Agencies Department. BCMM, as part of its legislative mandate of growing, supporting and developing SMMEs within its area of jurisdiction, developed the above-mentioned database so as to understand the profile of SMMEs trading within the city for effective and efficient service delivery.

Fifty SMMEs from the manufacturing, construction, services, agriculture, mining, wholesale and textile sectors were randomly selected from the above-mentioned population. A 57- item structured questionnaire was designed based on the literature review. The questionnaire consisted of eight sections and contained questions on external, institutional and internal factors influencing SMME access to finance.

The self-administered questionnaire was, after it was pre-tested amongst five SMMEs to improve the content, phrasing, sequence and layout e-mailed/faxed/hand delivered to the above-mentioned fifty SMMEs. Thirty completed questionnaires, translating to a response rate of 60 percent, were returned. Data was collected between June and July 2011. A descriptive analysis of the data collected including a cross tabulation frequency analysis was done and the results of the study are presented in the sub-section below.

1. 4 RESULTS

1.4.1 Firm characteristics

The table below presents the firm characteristics influencing SMME access to finance.

Table 1.4.1 Firm characteristics

FIRM CHARACTERISTICS	FREQUENCY (30)	PERCENTAGE (100)
Legal Form		
Sole proprietor	13	43.3
Close corporation	8	26.7
Partnership	5	16.7
Company	4	13.3
Business Premises		
Rented	20	66.7
Owned	9	30
Home	1	3.3
Age of the firm		
< 1 year	2	6.6
1-2 years	8	26.7
3-5 years	13	43.4
5-10 years	5	16.7
> 10 years	2	6.6
Economic sector		
Construction	10	33.4
Services	7	23.4
Manufacturing	6	20
Agriculture	2	6.6
Wholesale	2	6.6
Textile	2	6.6
Mining	1	3.4
Number of people employed		
None	5	16.7
< 5 people	12	40
6-10 people	6	20
11-20 people	2	6.6
21-50 people	5	16.7
Business Membership		
Yes	13	43.3
No	17	56.7
Firms annual turnover		
Between R2.5 and R5 million	3	10
Between R500k and R2.5 million	7	23.3
< R500 000	13	43.3
Start-up	7	23.3
VAT REGISTRATION		
Yes	17	56.7
No	13	43.3

As can be seen from the table above, sole proprietors formed the majority of the businesses interviewed followed by close corporations, partnerships and companies. A significant proportion of firms traded in rented premises, nine in owned while only one traded at home. The majority of firms were between the ages of three to five years in operation, followed by those that were one to two years in operation and very few were more than ten years in operation. Construction topped the list of sectors followed by services and manufacturing while the rest formed the minority.

A large proportion of firms employed less than five people on a permanent basis while only 16.7 percent employed between 21 and 50 people and none respectively. More than half of the firms did not belong to any business organization. A significant proportion (43.3%) of the firms had an average annual turnover of less than R500 000 over the last three years, while few recorded annual turnovers of between R2.5 and R5 million over the said period. A significant proportion (56.7%) of the firms was registered for VAT while the rest (43.3%) were not registered.

1.4.2 Entrepreneurship characteristics

Table 1.4.2 below shows entrepreneur characteristics influencing SMME access to finance.

Table 1.4.2 Entrepreneur characteristics

ENTREPRENEUR CHARACTERISTICS	FREQUENCY (30)	PERCENTAGE (100)
Gender distribution		
Male	19	63.3
Female	11	36.7
Age		
18-35	9	30
35-60	19	63.4
> 60	2	6.6
Population group		
African	19	63.3
Coloured	7	23.3
Indian/Asian	3	10
White	1	3.3
Education level		
Some high school	7	23.3
Matric/grade 12	9	33.3
Certificate/diploma	5	16.7
University degree	9	26.7

For firms owned by more than one person (partnerships, close corporations and private companies), the most senior person with more authority and responsibility (e.g. managing director) was interviewed. The majority of owner-managers interviewed were males while the rest were females.

A large proportion of owner-managers were between the ages of 35 to 60 years followed by those between 18 to 35 years while only 6.6 percent were above the age of 60 years. The majority of owner-managers were Africans followed by Coloureds, Indians and Whites. More than half of owner-managers had some high school and matric/grade 12 qualifications, while 43.4 percent had tertiary qualifications.

1.4.3 Firm readiness

Firm readiness is presented in the table below.

Table 1.4.3 Firm readiness

FIRM READINESS	FREQUENCY	PERCENTAGE
Business plan (BP)	**Frequency (30)**	**Percentage (100)**
Yes	17	56.6
No	13	43.4
Year of (BP)	**Frequency (17)**	**Percentage (100)**
2005	3	17.6
2006	4	23.5
2007	3	17.6
2008	2	11.9
2009	3	17.6
2010	2	11.8
Outside assistance received in BP preparation	**Frequency (17)**	**Percentage (100)**
Yes	5	29.4
No	12	70.6
Training received in BP preparation	**Frequency (17)**	**Percentage (100)**
Yes	8	47.1
No	9	52.9

More than half (56.6%) of firms had business plans while 43.4 percent did not have. A large proportion (58.7%) of firms' business plans were prepared between the years 2005 and 2007 while the rest (41.3%) were prepared between the years 2008 and 2010. Only 29.4 percent of firms received assistance from business development institutions such as SEDA and NYDA in the preparation of their firm's business plans compared to those (70.6%) that did not receive any assistance whatsoever. A large proportion (52.9%) of the owner-managers did not receive any training in the preparation of their firms' business plans compared to those (47.1%) who received it.

1.4.4 Funding applied for/obtained

1.4.4.1 Sources of start-up capital

The table below presents the sources of start-up capital used by firms in descending order.

Table 1.4.4 Sources of capital

Start-up capital	Frequency	Percentage
Own savings	16	53.3
Family and friends	8	26.7
Commercial bank (s)	4	13.3
Development finance	2	6.7
Total	**30**	**100**

Own savings (53.3%) topped the list of the sources of capital used by owner-managers in starting their businesses followed by family and friends (26.7%). Only 20 percent of firms used loans from commercial banks and development finance institutions (DFIs) to start their businesses.

1.4.4.2 Financial Institutions approached for finance

Table 1.4.5 provides a distribution of owner-managers in terms of financial institutions approached for finance and whether their applications were successful or not.

Table 1.4.5 Financial institutions approached for finance

Finance institutions approached	Frequency	Successful applications
Khula Finance Limited	9	0
ECDC	**13**	**5**
Business Partners	3	0
Standard Bank	7	1
FNB	5	2
Absa	6	3
Nedbank	4	0
IDC	2	0
Total	**49**	**11**

Twenty one firms approached finance institutions for finance whilst the rest (9) did not approach any finance institution. The majority (13) of the firms approached ECDC whilst 9 approached Khula Finance Limited for finance. However, it can be noted that few (11) loan applications were approved by finance institutions approached.

1.4.4.3 Reasons for not having approached any of the financial institutions for finance

The table below shows reasons in descending order presented by owner-managers for not having approached any of the financial institutions for finance.

Table 1.4.6 Reasons for not having approached any financial institution for finance

Reason	Frequency
High cost of credit and interest rates	9
Lack of information about financing institutions	7
My earnings change from month to month	5
Don't need to	4
Industry too risky	3
I don't qualify	2
Total	**30**

High cost of credit and interest rate appeared to be on top of the list of reasons all owner- managers mentioned for not approaching finance institutions followed by lack of information about financing institutions.

1.4.4.4 Reasons that led to applications for finance being rejected

The table below presents reasons (in descending order) that led to some of the firms' applications for finance being rejected by lending institutions.

Table 1.4.7 Reasons that led to firm applications for finance being rejected

Reasons	Frequency
Lack of collateral	20
Poor cash flow	15
Bad credit record	13
Lack of financial records	11
Poor business plan	11
Lack of understanding of SMMEs by lending institutions	10
Total	**80**

It can be noted that the total frequency is more than the total number of owner-managers interviewed. This is due to the fact that some owner-managers ticked more than one reason. Lack of collateral topped the list of reasons that led to the rejection of firms' loan applications by lending institutions followed by poor cash flow and bad credit record.

1.4.4.5 Tenders won from government, the private sector or the NGO sector in the last two years

The distribution of firms according to tenders won from government, the private sector or the NGO sector in the last two years is presented in figure 1.4.1 below.

Figure 1.4.1 Tenders won from government, the private sector or the NGO sector in the last two years.

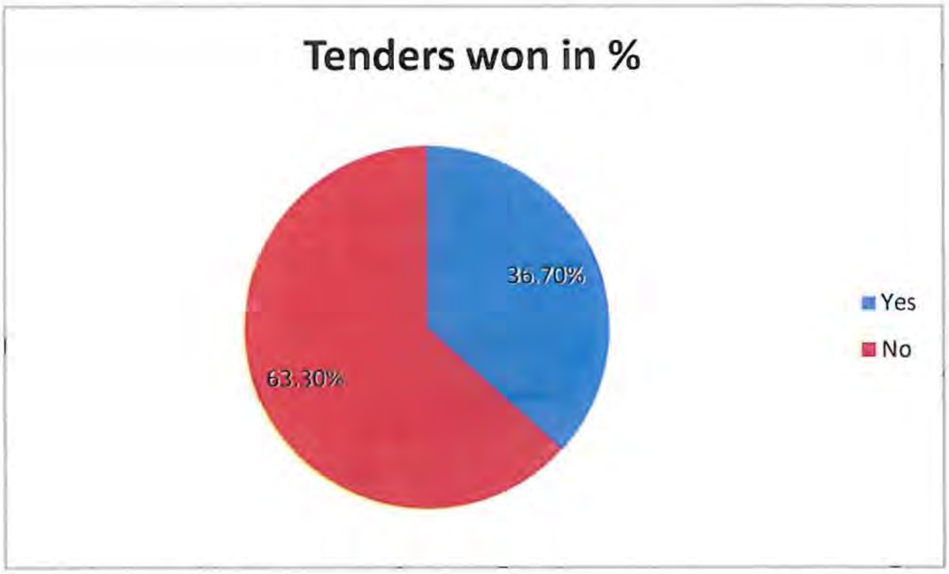

Figure 1.4.1 shows that 36.7 percent of firms won tenders either from government, the private or the NGO sector in the last two years compared to 63.7 percent that did not win any tender whatsoever.

1.4.5 The loan application form

1.4.5.1 The number of pages of the application form for finance

Table 1.4.8 presents the distribution of owner-managers in terms of the number of pages of their loan application forms for finance.

Table 1.4.8 The number of pages of the application form

Number of pages	Frequency	Percentage
1-2 pages	2	9.5
3-4 pages	1	4.8
5-6 pages	4	19.1
More than 6 pages	14	66.6
Total	**21**	**100**

Of the 30 owner-managers interviewed, 21 had applied for finance. The above table shows that 66.6 percent of owner-managers indicated that application forms they filled were more than 6 pages, with only few (9.5%) that were 1-2 pages long. The great majority confirmed that the more the number of pages of the application form, the more onerous the form.

1.4.5.2 Assistance received in putting loan application forms forward

Table 1.4.9 shows the distribution of owner-managers in terms of assistance received in putting loan application forms forward.

Table 1.4.9 Assistance received in putting loan application forms forward

Assistance received	Frequency	Percentage
Yes	5	23.8
No	16	76.2
Total	**21**	**100**

A large proportion (53.3%) of owner-managers indicated that they did not receive any assistance in completing their loan application forms compared to their counterparts (16.7%). The majority of the latter indicated that they received support from SEDA, the NYDA and Buffalo City Metropolitan Municipality's Economic Development and Agencies department.

1.4.6 The loan application process

1.4.6.1 The explanation of the criteria for obtaining finance

The distribution of owner-managers in terms of whether the criteria for obtaining finance were explained to them is presented in the table 1.4.10 below.

Table 1.4.10 The explanation of the criteria for obtaining finance

Criteria for obtaining finance	Frequency	Percentage
Yes	11	52.4
No	10	47.6
Total	**21**	**100**

Table 1.4.10 above shows that 52.4 percent of owner-managers who applied for finance indicated that they were satisfied with the explanation that was given to them while 47.6 percent indicated that they were not satisfied with the explanation given.

1.4.6.2 Obstacles experienced during the loan application process

Table 1.4.11 provides details of obstacles (in descending order) experienced by owner-managers during the loan application process.

Table 1.4.11 Obstacles experienced during the loan application process

Obstacles	**Frequency**
Complexity of application forms	19
Too much information required (too many pages to fill)	15
No assistance given in filling in the application form	14
Others	9
Being sent from this office to another	7
Communication problems – no forms in local language	3
Total	**67**

It can be noted that the total frequency is more than the total number of owner-managers interviewed. This is due to the fact that some owner-managers ticked more ticked more than one obstacle. The complexity of application forms, too much information required and no assistance given in filling in the application form were on top of the list of obstacles experienced by owner-managers during the application process. Few indicated communication problems as a challenge.

1.4.7 Access to information

1.4.7.1 Development finance institutions

Table 1.4.12 shows the distribution of owner-managers in terms of DFIs they were aware of.

Table 1.4.12 Development finance institutions

Development finance institutions	**Frequency**
Khula Finance Limited	7
SEDA	17
Business Partners	5
ECDC	**27**
NYDA	21
SAMAF	3
Total	**80**

ECDC appeared to be the most well-known institution followed by NYDA and SEDA. Business Partners and SAMAF, on the other hand, appeared to be the least well-known of the institutions.

1.4.8 Customer care

Owner-managers who applied for finance were asked to indicate if they received reasons for the rejection of their applications. Sixty percent received feedback from the lending institutions while the remaining percentage did not receive feedback whatsoever.

Asked about how long it took for the financial institutions to respond to their applications, three owner-managers indicated one to two weeks, sixteen indicated three to four weeks and the rest five to six weeks.

1.4.9 Attributes of successful loan applications

Table 1.4.13 shows the list of attributes of successful loan applications in descending order.

Table 1.4.13 Attributes of successful loan applications

Attributes to success of applications	Frequency
Cash flow	10
Good business plan	9
Collateral	7
Won a contract and needed cession	4

As shown above, a good cash flow, good business plan, collateral and having won a contract were attributes indicated by owner- managers as attributes of successful loan applications.

1.4.10 The relationship between firm and entrepreneur characteristics and loan application success

1.4.10.1 Legal forms of firms and loan application success

The relationship between the legal forms of firms and the number of loan applications approved for finance is presented in the table below.

Table 1.4.14 Legal forms of businesses and loan applications success

Legal form of firm	Number of loan applications submitted to finance institutions	Number of loan applications approved for finance	Percentage
Sole proprietor	17	0	0
Partnership	8	2	18.2
Close corporation	10	8	72.8
Company	2	1	9.0
Total	**37**	**11**	**100**

The above table shows that eight (72.8%) of the eleven successful loan applications were from close corporations followed by two (18.2) from partnerships while only one (9.0) from companies. It can be noted that no application from sole proprietors was successful. It can be noted that the total number of loan applications submitted to finance institutions exceed the total number of businesses interviewed. This is because some businesses submitted more than one loan application to different finance institutions.

1.4.10.2 Age of the firm

The relationship between the age of the firm and the number of successful loan applications is presented in the table below.

Table 1.4.15 The age of the firms and the number of successful loan application

Age of the firm	Number of loan applications made and submitted	Number of loan applications approved for finance	Percentage
< 1 year	5	0	0
1-3 years	16	0	0
3-5 years	9	6	54.6
5-10 years	5	4	36.4
> 10 years	2	1	9.0
Total	**37**	**11**	**100**

Table 1.4.15 above shows that of the eleven successful loan applications, six (54.6%) were from firms that were between 3-5 years in existence, four (36.4%) from those 5-10 years in existence while one (9.0) from those that existed for more than ten years. No loan application from firms that were in existence for less than 3 years was approved.

1.4.10.3 The firms' economic sectors and loan application success

The relationship between firms' economic sectors and loan application success is presented in the table below.

Table 1.4.16 The firms' economic sectors and the number of successful loan applications

SMME economic sectors	**Number of loan applications made and submitted**	**Number of loan applications approved for finance**	**Percentage**
Agriculture	5	1	9.1
Manufacturing	**9**	3	27.3
Construction	7	**6**	**54.5**
Mining	1	1	9.1
Wholesale	6	0	0
Textile	4	0	0
Services	5	0	0
Total	**37**	**11**	**100**

The majority of loan applications approved for finance were from the construction (54.5%) followed by the manufacturing sector (27.3%). Only one loan application was approved from the agricultural and mining sectors respectively. It can be noted that no loan applications were approved from the wholesale, textile and the services sectors.

1.4.10.4 The firms' annual turnover and the number of loan applications approved for finance

The relationship between the firms' annual turnover and the number of applications approved for finance is presented in the table below.

Table 1.4.17 The firms' annual turnover and the number of loan applications approved

The firms' annual turnover	**Number of loan applications made and submitted**	**Number of loan applications approved**	**Percentage**
Start-up	2	0	0
< 500 000	15	3	27.3
Between R500k and R2.5 million	13	3	27.3
Between R2.5 and R5 million	7	5	45.4
Total	**37**	**11**	**100**

Of the eleven applications approved for finance, five (45.4%) were from firms with a turnover between R2.5 and R5 million, three (27.3) with a turnover between R500 000 and less than R500 000 respectively and none from start-ups.

1.4.10.5 The gender of owner-managers and number of loan applications approved for finance

The relationship between the gender of owner-managers and the number of loan applications approved for finance is presented in Table 1.4.18 below.

Table 1.4.18 Gender of owner-managers and the number of loan applications approved for finance.

The gender of respondents	Number of loan applications made and submitted	Number of loan applications approved for finance	Percentage
Male	24	8	72.7
Female	13	3	27.3
Total	**37**	**11**	**100**

The gender breakdown of the sample comprised of 63.3 percent male and 36.7 percent female, a ratio of about 2:1. If one looks at the number of applications made, it is more or less consistent with the gender split of 2:1. When looking at the number of loans granted to both males and females, it is evident that males are more likely to be granted finance than females, but not significantly.

1.4.10.6 The relationship between the age of owner-managers and loan applications approved for finance

The relationship between the age of owner-managers and loan applications approved for finance is presented in the table below.

Table 1.4.19 The age of owner-managers and loan applications approved for finance

The age of the respondents	Number of loan applications made and submitted	Number of loan applications approved for finance	Percentage
18-35 years	11	3	27.3
35-60 years	23	8	72.7
> 60 years	3	0	0
Total	**37**	**11**	**100**

When one considers the number of loans approved for owner-managers between the ages 18-35 years and 35-60 years, the ratio is about 2:1 which suggests that owner-managers between the ages of 35-60 years were more likely to be granted finance than those between the ages of 18-35 but not significantly.

1.4.10.7 The level of education and the number of loan applications approved for finance.

Table 1.4.20 below presents the relationship between the level of education of owner-managers and the number of loan applications approved for finance.

Table 1.4.20 The education level and the number of loan applications approved for finance.

The level of education of respondents	**Number of loan applications made and submitted**	**Number of loan applications approved for finance**	**Percentage**
Some high school	9	0	0
Matric/grade 12	10	2	18.2
Certificate/diploma	8	4	36.4
University degree	10	5	45.4
Total	**37**	**11**	**100**

It appears that a large proportion (81.8%) of owner-managers whose loan applications were approved had tertiary qualifications and few (18.2%) with matric/grade 12.

1.5 DISCUSSION AND CONCLUSION

1.5.1External factors

The results of the study indicate that external factors such as high cost of credit and interest rates and VAT registration had an influence to SMME access to finance. All owner-managers who did not approach any lending institutions identified the high cost of credit and interest rates as one of the obstacles negatively influencing SMME access to finance. This is despite interest rates having come down significantly since 2008. This is attributed to private and public lending institutions being reluctant to finance SMMEs due to perceived risk and lack of collateral.

The study recommends that government must ensure that such schemes as the SMME loan guarantee are well publicized and available to SMMEs. However, it is also necessary for SMME owner-managers to have either business or personal assets to be used as collateral when applying for finance.

The study also revealed that firms that were registered for VAT were more likely to access finance than their counterparts. The former firms demonstrated a higher level of sophistication than the latter firms. Lack of understanding of the importance of registering for VAT and the perception that when a firm registers for VAT it will be required to pay VAT were identified as key reasons for the latter firms' refusal to register for VAT. However, from the policy point of view, government has increased the VAT threshold to R1 million and thus VAT has a lesser impact on SMME access to finance. It is recommended that SARS, in collaboration with private and public SMME support and development agencies educate SMMEs on what VAT is and the importance of SMME registering for VAT.

1.5.3 Institutional factors

The results of the study shows that bureaucracy and red tape (being sent from one office to another, too much information required, complexity of application forms), lack of SMME assistance in putting in the loan application form and the lack of explanation of the loan application procedure and criteria were key institutional constraints to SMME access to finance. It is therefore recommended that more in-depth research on the support services provided by private and public lending institutions and business support agencies in terms of what they offer, the effectiveness of these services in improving SMME access to finance and how these services are marketed to potential customers needs to be conducted.

Training workshops in order to address the needs of SMMEs must be conducted. Cognisance of the concerns of SMMEs in terms of time that they have available and the limited financial resources they have to pay for them must be taken. It is also recommended that the development and implementation of effective and efficient sector-specific mentoring programmes for SMMEs be investigated.

The study also pointed out that those firms with good and bankable business plans were more likely to have success in their applications for finance compared to those that did not have. However, the current system where government agencies such as SEDA use consultants to develop business plans on behalf of entrepreneurs who struggle to articulate their plans constrains SMME access to finance. Therefore, it is recommended that entrepreneurs must personally be involved in the gathering of the relevant information as well as in the writing up of their business plans. There is also a clear need for private and public SMME support staff to be trained in being more responsive to the needs of small business owners so as to improve SMME access to finance.

The results of the study indicate that although some of the private and government finance and supporting agencies have been in existence for years, they are still not known by some owner-managers. It is also evident that even those agencies that are known to some owner-managers, their services are not utilized.

There is a need for the above-mentioned institutions to vigorously advertise themselves through the media and workshops to inform SMMEs about the services they offer, how SMMEs can access these and how they can benefit from these services. Simple information products, possibly in the form of booklets or pamphlets should be provided on the services offered by various SMME support institutions. Communication with SMMEs must be the key area of focus.

The study also revealed that finance institutions often take too long to respond to loan applications submitted by owner-managers and when they responded, reasons for the rejection of loan applications are not given. Finance institutions need to make follow-ups on loan applications submitted and give feedback on time. Also, capacity building of financial institutions in streamlining credit processing, standardizing product offering, segmenting the SMME market, training staff and management and introducing management information system is a significant component of their SMME finance assistance strategy.

Finance institutions, banks in particular, could consider setting up an SMME division or department to provide specialized services to SMMEs. This must be staffed by specially trained credit officers. For large financial institutions that already have such divisions, they are usually perceived to be less important compared to corporate lending divisions. Elevating the importance or status of SMME divisions would encourage greater interest and focus on the SMME sector. Government could encourage this by providing certain banking privileges to such banks.

The feedback from some owner-managers is that bank credit officers lack understanding of SMMEs and do not have the requisite skills to evaluate SMMEs. Many financial institutions apply the same techniques of evaluating large companies to smaller ones without any adjustment for the inherent differences. SMMEs have unique characteristics that differentiate them from large established corporations. Therefore, credit officers must realize this. Financial institutions must adjust their evaluation techniques accordingly and apply relevant ones to suit each group of borrowers.

The promotion of greater linkages and dialogues between financial institutions and SMME/Trade Associations/SMME centres is recommended. This would promote better understanding and facilitate SMME access to finance. In this regard, finance institutions could organize road shows to various SMME associations to introduce their services. Also, seminars or trade exhibitions held by industry associations could include financial institutions.

Lastly, to promote greater SMME lending, government could consider granting certain incentives to financial institutions that actively promote SMME financing and have achieved a sizeable SMME loan book. Such incentives could be for a certain period of time and in non-financial form e.g. branching privileges, tax deductions or certain expenses.

1.5.4 Internal factors

The results of the study indicate that those firms with good track record, high annual turnover, sophistication and diverse skills, good credit record, good cash flow, proper financial records, bankable and viable business plans, collateral and registered for VAT were more likely to have access to finance than those that did not meet the above criteria. These factors were identified to have a greater influence to SMME access to finance followed by the institutional factors.

The above factors are within the control of owner-managers and as such, it is important for SMMEs to understand that they are responsible for their own success or failure. The capacity building of SMMEs in improving their access to finance is important. This includes providing technical and business support services such as training, business development services, assistance in formalizing financial statements and loan application forms. It is important for SMMEs to always maintain a good credit history and agreements such as repayment of credit extended should always be met.

Academic institutions should build the capacity of SMMEs through the involvement of academics and students through research and community engagement projects focused on educating SMMEs on business planning and financial management. It is also recommended that entrepreneurship should form part of the school curriculum. When learners are oriented into entrepreneurship from an early age, it becomes easy to develop successful business ventures.

Business support institutions should provide SMMEs with the necessary business skills in order to articulate a business model that is competitive. SMMEs should be encouraged to join business associations for networking and access to information. It is also recommended that a knowledge portal that will enable the sharing of knowledge and learning among SMMEs in Buffalo City be established. The portal should provide a single repository for information and handbooks on policies and regulations, SMME practices, tax and registration, access to finance and financial business development services. The portal could also be a platform where training events, workshops and business expos could be advertised.

1.5.5 Conclusion

There is a consensus among all researchers that the contribution made by SMMEs cannot be overemphasized. The literature review clearly outlined the role played by government in creating an enabling and a conducive environment for SMME access to finance. However, despite all the initiatives by government to help SMMEs access finance, SMMEs access to finance still remains a challenge.

External, institutional and internal factors have been identified as key factors impacting on SMME access to finance. The study has revealed that the high cost of credit and interest rate and VAT registration were amongst the key external factors that influenced SMME access to finance. Bureaucracy and red tape, too much information required complexity of application forms and lack of explanation of the loan application procedure and criteria were key institutional factors influencing SMME access to finance. However, the external and institutional factors' impact to SMME access to finance was minimal.

The internal factors were identified as having the greatest contribution to the challenge of SMME access to finance. The study revealed that firms that met the lending institutions criteria were more likely to access finance than those that did not meet the criteria. A concerted effort by policy makers, the private sector and the NGO sector is required for the latter firms to meet the lending institutions criteria so that they can access finance. Short, medium and long-term interventions by the above-mentioned stakeholders to bridge the gap between the two groups of firms need to be implemented.

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SECTION 2: LITERATURE REVIEW

2.1 INTRODUCTION

This section entails a comprehensive literature study on aspects relating to SMME access to finance and is composed of seven sub-sections. The first sub-section outlines the global role of SMMEs in economic development paying special reference to South Africa.

The second sub-section briefly looks at empirical lessons and experiences of some selected developing countries' SMME access to finance. The third sub-section outlines some of the legislative initiatives and frameworks by the South African government in its endeavor to promote the growth and development of SMMEs in the country.

Sub-section four takes a closer look at the external, institutional and internal obstacles negatively impacting on SMME access to finance. The fifth sub-section focuses on public and private sector financial institutions (role players) providing finance to SMMEs. The last sub-section that precedes the conclusion presents the different sources of finance available to SMMEs.

2.2 THE CONTRIBUTION OF THE SMME SECTOR TO ECONOMIC DEVELOPMENT

There is a general consensus amongst researchers that SMMEs contribute significantly to both the developing and the developed countries. Kongolo (2010:24) argued that one of the significant characteristics of a flourishing and growing economy is a booming SMME sector. Kongolo (2010:24) further argued that SMMEs contribute to economic development in various ways: by creating employment for rural and urban growing labour force and providing desirable sustainability and innovation in the economy as a whole. Makgoe (2008:72) argued that SMMEs employ more than half the workforce in the private sector, generate about ¾ of net new jobs each year and produce more than half of the private sector's output. Emphasizing the same contribution, Fida (2008:67) stated that large number of people directly or indirectly relies on the SMME sector.

Abor and Quartey (2010:234) noted that due to the above-mentioned contribution, SMMEs have been noted to be one of the major areas of concern to many policy makers in an attempt to accelerate the rate of growth in low-income countries including South Africa. Researchers have come to a common agreement that SMMEs, from a socio-economic point of view, provide a variety of benefits.

Firstly, Abor and Quartey (2010:234) argue that SMMEs seem to have advantages over their large-scale competitors in that they are able to adapt more easily to market conditions, given their size and flexibility. They are able to withstand adverse economic conditions because of their flexible nature (Kongolo, 2010:24).

Secondly, SMMEs are more labour intensive than larger firms and they have lower capital costs associated with job creation (Herrington *et al*, 2010:129; Kongolo, 2010:24). Since SMMEs are labour intensive, they are more likely to succeed in smaller urban centres and rural areas where they can contribute to a more even distribution of economic activity in a region and can help to slow the flow of migration to large cities. Kayanula and Quartey (2000:76) in Abor and Quartey (2010:289) observed that SMMEs improve the efficiency of domestic markets and make productive use of scarce resources, thus facilitating long-term economic growth.

In South Africa, SMMEs account for about 91 percent of the formal business entities and they contribute between 52 and 57 percent of Gross Domestic Product (GDP) and provide about 61 percent of employment (Ntsika, 1999:38; Gumede, 2000:68 and Berry *et al*, 2002:14 in Kongolo, 2010:268).

However, despite the above-mentioned commendable contribution, SMMEs are bound to various challenges affecting their ability for expansion (Fida, 2008:45). The most general challenges affecting SMMEs include lack of management skills, finance, access to bank credit, access to markets, appropriate technology, low production capacity, recognition by big companies, lack of interest, long bureaucracy processes and support for the roles that SMMEs can play in economic development (Absa, 2005:13, Fida, 2008:45, Kongolo, 2010:268, Abor and Quartey, 2010:289). The following section presents empirical lessons and experiences in some developing countries.

2.3 SMME ACCESS TO FINANCE – EMPIRICAL LESSONS AND EXPERIENCES IN SOME DEVELOPING COUNTRIES

SMME access to finance has generally been identified as topping the list of SMME challenges throughout the developed and developing economies. Abor and Quartey (2010:289), in a study on issues in SME development in Ghana and South Africa, argued that lack of adequate financial resources places significant constraints on SMME development. Abor and Quartey (2010:289) indicated a World Bank study found that about 90% of small enterprises surveyed stated that credit was a major constraint to new investment.

Pandey and Shivesh (2007:15) found that in India, many of the small manufacturing enterprises do not access bank finance and only about 16% of total bank credit finds its way to the sector. A global perspective on challenges facing small businesses found that SMME access to finance was common in all the developing countries (Kenya, India, China and the entire Africa). However, even in the developed countries such as Australia, Singapore and Canada, SMME access to finance was identified as one of the crucial "hindrances" to the development of the SMME sector (Rogerson, 2008:23). Isern and Pellegrini (2009:35), in their diagnostic study on access to finance in Nigeria, observed that only 5% of the total number of firms interviewed acquired loans.

Many researchers (The Dorrian Consulting, 2005:6; Ram Consulting Services, 2005:14; Isern and Pellegrini, 2009:39; Bowen, Morara and Mureithi, 2009:70) have attributed the SMME access to finance constraint in developing countries to a number of factors. These factors are categorized into three factors namely: external, institutional and internal. These are shown in the table below.

Table 2.3 Factors influencing SMME access to finance

External factors	**Institutional factors**	**Internal factors**
• High cost of credit and interest rates • Taxation • Cost of doing business • Availability of funds for lending • The risk profile of a firm • Policy issues	• Bureaucracy and red tape • Loan application forms • Lack of understanding of the loan application procedure • Lack of understanding of the lending criteria • Lack of access to information	• The age of the entrepreneur • The age and size of the firm • The ownership type • The Industry sector • The firm location • The entrepreneurial experience • Networking • Lack of appropriate business skills Bad credit record • Poor quality business plans • Lack of audited financial statements

Government in developed and developing countries introduced a number of initiatives to address the external constraints negatively affecting SMME access to finance. For example, in South Africa, government has established a number of financial institutions (SEDA, IDC, NYDA, Khula Finance and NDA) to address the lack of finance available to SMMEs. However, the extent to which these institutions address lack of access to finance remains to be seen.

In 2007, government introduced the Tax Amnesty for SMMEs. Also, credit guarantee schemes such as Khula Finance have been established to address the lack of collateral from SMMEs. In 2009, the South African government has lowered the interest rate and thus has lowered the high cost of credit. However, despite all the above-mentioned initiatives by government to create an enabling and conducive environment for SMMEs, their access to finance still remains a challenge. The section below provides a review of some of the endevours by government to promote and develop SMMEs.

2.4 SMME SUPPORT AND DEVELOPMENT FRAMEWORK IN SOUTH AFRICA

The promotion of entrepreneurship and small business remains an important priority of the South African Government (Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprise, 2008). In March 1995, the Government released a *White Paper on National Strategy for the Development and Promotion of Small business in South Africa*, in which an elaborate policy and strategy framework on small business development was delineated.

Following the release of the White Paper in 1995, the National Small Business Act 102 of 1996 was enacted. The act outlined the support institutions and initiatives needed to achieve policy objectives for SMMEs namely: poverty alleviation, job creation and income redistribution and economic growth through competitiveness (Rogerson, 2004b:39).

Following the above-mentioned act, government introduced the Preferential Procurement Policy Framework Act (PPPFA) 5 of 2000 which was aimed at creating room for the procurement of goods and services from SMMEs. This act was followed by the ushering in of the Broad-based Black Economic Empowerment (BBBEE) Act 53 of 2003 which sought to economically empower the historically disadvantaged groups in the country.

The Department of Trade and Industry (DTI) at national level established the Centre for Small Business Promotion which became responsible for SMME policy-related matter and support programmes (Van Vuuren and Groenewald, 2007:378). The centre then gave birth to the then Ntsika Enterprise Promotion Agency, now the Small Enterprise Development Agency (SEDA), and Khula Enterprise Finance Limited. These were the main institutional pillars that were created to implement the National SMME Strategy (Jackson, 2004:33). Subsequent to these initiatives, a number of other government agencies such as the Independent Development Corporation (IDC), the National Development Agency (NDA), the National Youth Development Agency (NYDA) and many other provincial agencies aimed at creating an enabling and conducive environment for SMME access to finance were also established.

In 2006, the then Deputy President, Ms Phumzile Mlambo-Ngcuka launched the Accelerated and Shared Growth Initiative for South Africa (AsgiSA). The programme resulted from government's commitment to halve unemployment and poverty by 2014. AsgiSA identified six binding constraints which prevent South Africa from achieving the desired growth. Amongst the constraints identified were the regulatory environment and the burden on SMMEs.

In 2010, President Jacob Zuma launched the New Growth Path Framework aimed at creating decent work, reducing inequality and defeating poverty (New Growth Path Framework, 2010:23). The framework also acknowledged the importance of the SMME sector in creating jobs and contributing positively to economic growth.

However, despite all the above-mentioned government initiatives aimed at growing and developing the SMME sector, SMMEs are to date faced with many challenges and access to finance is topping the list of these (Rogerson, 2008; Abor and Quartey, 2010:279; Fatoki and Smit, 2011:1422; Pandula, 2011:260). The following section takes a closer look at the constraints negatively affecting SMME access to finance.

2.5 FACTORS NEGATIVELY AFFECTING SMME ACCESS TO FINANCE

2.5.1 External factors

2.5.1.1 High cost of credit and interest rates

The high cost of credit and interest rates has generally been identified by literature as having an influence in SMME access to finance. This, according to Rungani and Chimucheka (2011:5515) is attributed to the fact that finance institutions consider SMMEs as being high risk borrowers. Due to their low capitalization and limited assets, SMMEs are vulnerable to market fluctuations and have high mortality rates (Ganbold, 2008:35). Based on this, finance institutions charge SMMEs higher interest rates than what they would charge larger businesses. They do this to compensate for higher costs of information collection, the smaller volume of external financing and the greater risk of failure.

2.5.1.2 Taxation

Income tax and VAT form part of the list of prerequisites by finance institutions for the consideration of loan applications. However, the majority of SMMEs do not register for the above-mentioned taxes. Mahadea and Pillay (2008:39) attributed this to a number of factors such as the SMMEs' understanding that once they register for tax, they will automatically be required to pay tax, the complexity of VAT registration and administration and the inconvenience of SMMEs having to stand in long queues to register for tax. The above-mentioned factors prohibit SMMEs from registering for tax which in turn excludes them from being considered for finance by finance institutions. However, government has since the study was undertaken, increased the VAT threshold to R1 million (South African Revenue Services, 2007:29).

2.5.1.3 The National Credit Act

The National Credit Act has been identified by some researchers as one of the constraints to SMME access to finance. For example, a study conducted by the USAID (2008:29) revealed that one participant stated that the national credit act was there to protect the borrower if too many loans are granted. However, the debt check by financial institutions prior to granting a loan thereby uncovering the extent of borrowing was considered a hindrance to access to finance. The above-mentioned study argued that the debt check could force borrowers to the informal market.

2.5.2 Institutional factors

2.5.2.1 Bureaucracy and red tape

Bureaucracy and red tape especially in government have been identified as one of the reasons for SMMEs inability to access finance from public and private financial institutions (Ncokazi, 2007:69; Madahea and Pillay, 2008:47). SMMEs have to undergo an unnecessary lengthy and costly process before their applications for funding are approved. Herrington *et al* (2010:49) also argued that although numerous small business incentives are becoming available, excessive bureaucracy and cumbersome application processes, offices that are open only on weekdays and the protracted, inefficient decision-making has limited the positive impact of these incentives.

2.5.2.2 Loan application forms

Empirical research conducted by a number of authors attested to the fact that SMMEs are required to complete bulky application forms written in English and not translated to the applicant's home language (Mahadea and Pillay, 2008:50, Herrington, 2010:133, Pandula, 2011:263). This results in incomplete applications because the applicants struggle to understand the language in which the applications have been prepared.

2.5.2.3 Lack of understanding of the loan application procedure and criteria

Clover and Darroch (2005:245) mentioned that difficulties in accessing investment capital may also arise from SMME owner's lack of understanding of loan application procedures or lending institutions bias against SMMEs due to the relatively high costs of administering relatively small loans. A study conducted by Ganbold (2008:56) on improving access to finance in Mongolia, complexity of loan application procedure was raised as one of the constraints to access to finance by SMMEs in Mongolia. Bbenkele (2007:21) also identified the low levels of sophistication and understanding of bank loan procedures as stumbling blocks to SMME access to finance from lending institutions. He further stated that this made SMMEs to have a negative perception against the lending institutions, especially banks, and did not regard them as useful.

2.5.2.4 Lack of access to information

It has been highlighted that a number of government and private sector initiatives aimed at assisting with funding of entrepreneurial ventures. However, the problem identified by Herrington *et al* (2010:37) is that many of these initiatives are poorly marketed with respect to their targets. The United States Agency for International Development (USAID) (2008:23) and Herrington *et al* (2010:120) noted that these initiatives tend to be concentrated in the urban areas and particularly in Gauteng. The Western Cape Youth Report also noted that all programmes have a significantly higher recognition factor in Gauteng and queries whether the other provinces are being sidelined in this respect.

The Khula Retail Finance Intermediary Programme review study by the World Bank (2006) was critical of some aspects of the supply-side financing through government programmes. In the study, firms expressed concern about accessibility and bureaucracy around SMME support. The study revealed a low level of SMMEs awareness and knowledge of government support programmes. Also, interactions between firms and staff running programmes were unsatisfactory. DTI's promotion of programmes was rated as poor or very poor (Mazanai and Fatoki, 2011:212).

2.5.3 Internal factors

The internal environment, according to Fatoki and Garwe (2010:2766) refers to the characteristics or resources of the firm over which the entrepreneur has some measure of control, as well as his inherent entrepreneurial and managerial qualities. The internal environment includes factors such as the risk profile of the firm, lack of collateral, lack of business skills, credit history, lack of information and poor quality business plans. These are individually discussed below.

2.5.3.1 The gender status

Some researchers argued that there is a correlation between the gender of an entrepreneur and SMME access to finance. Zindiye (2007:187) found that compared to male managed counterparts, female managed firms are less likely to obtain a bank loan. In addition, they suggest that female entrepreneurs are charged higher interest rates when loan applications are approved. However, a report on the international exposure programme in Thailand and Vietnam on financing SMMEs by the Reserve Bank of India, 2008 found that the gender of an entrepreneur does not play an important role in the loan application decision making process. The USAID (2010:27) concurred with the above-mentioned report stating that financial institutions seem less concerned about the gender of the entrepreneur when looking at loan applications.

2.5.3.2 Education background

Empirical research found a positive correlation between higher educational qualifications and business growth (Albert, 200435; Mutezo, 2005:173; Ferreira, 2007:230; Mahadea and Pillay, 2008:14; Fatoki and Garwe, 2010:2767; Pandula, 2011:262). A recent study done by Pandula (2011:262) using a telephone survey of 400 SMMEs in the UK found that graduates had the least difficulties raising finance from financial institutions. Researchers argued that educated entrepreneurs have the ability to present positive financial information and strong business plans and they have the ability to maintain a better relationship with financial institutions compared to less educated entrepreneurs.

Secondly, the educated managers/owners have the skills to manage the other functions of the business such as finance, marketing, human resources and these skills results to high performance of the business which helps those firms to access finance without any difficulty. Thirdly, financial institutions attach value to the higher education level of the owner/manager in the loan approval process.

2.5.3.3 Entrepreneur's experience

The entrepreneur's previous management experience was identified by many researchers as key to small business growth (Alberts, 2004:36; Abor and Quartey, 2010:2379; USAID, 2010:23). Pandula (2011:263) stressed the positive effect of past experience on small business growth by arguing that owner managers with previous experience are more likely to avoid costly mistakes than those with no prior experience.

2.5.3.4 Lack of appropriate skills to run and manage the business

Many researchers (Jackson, 2004:54; Mutezo, 2005: 160; Ferreira, 2007:234; Fatoki and Garwe, 2010:2769) have concurred with the notion of the importance of small businesses possessing the necessary business management skills for the effective and efficient running of a business. Fatoki and Garwe (2010:2769) explained managerial competencies as sets of knowledge, skills, behaviours and attitudes that contribute to personal effectiveness. He further stated that managerial competencies are very important to the survival and growth of new SMMEs.

2.5.1.5 The size and age of the firm

The size and age of the firm were identified as some of the most important variables in literature influencing SMME access to finance. Smaller and younger firms face difficulties in accessing finance from finance institutions than their large counterparts. This can be attributed to the fact that when a firm is small, most of the time it is owned and operated by an entrepreneur himself and there are no legal requirements to regularly report financial information and many firms do not maintain audited financial accounts (USAID, 2010:29). Secondly small and younger firms generally do not have audited financial statements which are a requirement by finance institutions.

Pandula (2011:257) pointed out that smaller and older firms have fewer assets to offer as collateral. Financial institutions use collateral as one of the instruments to reduce the anticipated risk and moral hazard associated with lending. The collateral is an assurance to financial institutions in case of default and it also ensures the borrowers commitment to the loan repayment. The last reason is that the smaller the firm, the higher the risks as small firms have a high failure rate compared to large firms.

2.5.3.6 Ownership type

A firm's ownership structure is one of the variables influencing a firm's access to finance. For example, research conducted by Pandula (2011:259) found that listed firms and foreign owned firms face lesser financial constraints compared to their counterparts. These findings confirm those of Chenesai (2009:149) who suggested that because businesses require a range of skills, chances are that businesses with more than one owner were more likely to succeed because of the management structure.

2.5.3.7 Industry sector

The type of industry a firm is trading under influences the firm's access to finance. Financial institutions tend to favour industry sectors that are competitive, innovative and growing (Pandula, 2011:259). Research done by Rogerson (2008:37) using data from Mozambican manufacturing firms also found that sector seems important for having credit access. The results of their study indicated that both metal and wood furniture sectors have significantly lower credit access than the food processing sector. Their interpretation for this was that banks attach a lower risk premium to food processing sector compared to other two sectors.

2.5.3.8 Location

Numerous researchers (Keeble, 1990:47; Kumar and Francisco, 2005:99; Bbenkele, 2007:19 and Pandula, 2011:260) concurred with the fact that spatial variations exist in both the cost and availability of finance especially for SMMEs. Pandula (2011:260) identified three factors which contribute to spatial variations in the availability of finance for SMMEs in rural areas. Firstly, he argues that there may be an absence of financial institutions in these rural areas. He further states that there may be a single bank branch available to the location, which may enjoy a monopoly power in the area and small firms may not have much financing alternatives available.

The second factor that Pandula (2011:260) identified, which Bbenkele (2007:20) also supported is that bank branch managers assigned in these rural bank branches may have limited delegation of authority. This may result in delays in approving loans requested by rural firms or high amount of loan rejections as the bank loans are processed and approved by the head office officials who have no personal knowledge of customers or projects based in rural locations. The third factor is that the assets offered as collateral by SMMEs in rural areas may have less market value and in case of default they may find it difficult to realize these assets.

However, Rand (2007:79) presented a different view to Pandula's factors. According to him, the probability of accessing finance is higher in rural than in urban areas. Rand argued that most of government finance is allocated towards rural areas confirming that local governments often are distinctly protective of firms in rural areas.

2.5.3.9 Networking

Networks have been proven to be of much help to SMMEs in overcoming problems of access to limited resources and markets. Curran *et al* (1993:33) in Pandula (2011:263) argued that networks help to provide advice, information and capital to small firms. Talavera, Xiong and Xiong (2010:65) conducted an investigation into the impact of social capital on financial obstacles faced by entrepreneurs using a pooled data of about 270 small companies. The researchers concluded that membership in business associations increase the probability of having a loan by 14.8 percent.

However, the challenge facing SMMEs is the absence of small business associations under which they can belong. This is contrary to large organizations which are members of organized business organizations.

2.5.3.10 Bad credit record

Poor credit history was identified as one of the obstacles negatively affecting SMME access to finance (Berry *et al*, 2002:29). Bad credit record was identified as one of the reasons identified by Mutezo (2005:144) for the rejection of SMME applications by financing institutions. The USAID (2008:36) report also identified poor or no credit history was one of the major reasons given by SMMEs interviewed for not being able to get loans from lending institutions.

2.5.3.11 Poor quality business plans

A sound and viable business plan is one of the documents required by financing institutions from businesses applying for finance. A business plans contain socio-economic information about the business and is used as a criterion by lending institutions in offering finance. Herrington *et al* (2010:90) stated that it is critical that business plans are easy to read, understandable, economically viable and above all, realistic.

Poor quality business plans was identified by the USAID (2010:56) as one of the barriers to SMME access to finance. Herrington *et al* (2010:91) observed that entrepreneurs and owner/managers of SMMEs are often not able to prepare business plans that are acceptable to institutions providing finance.

Entrepreneurs often use the services of small business advisors to prepare their business plans. As noted by Herington *et al* (2010:91), many of these advisors have little or no business experience and simply use a generic template to produce poor standardized plans. The inability for SMMEs to understand and articulate their business plans prepared by service providers results in lending institutions losing confidence in them and reject their loan applications.

2.6 SMME FINANCING

2.6.1 Government programmes on SMME financing

2.6.1.1 Khula Enterprise Finance Limited

Khula Enterprise Finance is an agency of the Department of Trade and Industry (DTI) and became operational with its first guarantee in 1996. The agency was established to facilitate access to finance for SMMEs and was funded by a commitment of approximately R1 billion (Herrington *et al*, 2010:125).

Khula is a wholesale finance institution which operates across the public and private sectors through a network of channels to supply funding to small businesses (Diale, 2009:78). However, entrepreneurs do not get assistance directly from Khula but through institutions which include leading commercial banks, retail financial institutions, specialist funds and joint ventures of which Khula is a participant.

Khula's mandate has three key focus areas namely:

- Maximization of access to finance for SMEs
- Maximization of development impact
- Financial sustainability

Khula offers non-financial services in the form of a mentorship programme but also assists SMMEs through a variety of other programmes which include:

- **The Khula Land Reform Empowerment Facility** – this offers financial assistance to emerging black farmers and entrepreneurs who wish to invest in agriculture or agro-processing projects, thereby enabling black South Africans to control and manage their own land-based income generating assets (Herrington *et al*, 2010)
- **Khula Credit Indemnity Scheme** – the aim of this fund is to share the financial risks with the commercial banks, thus enabling SMEs to access funding from participating banks. The funds can be used for establishing, expanding or buying out an existing business as well as for the purchase of business assets and working capital.
- **Joint Venture Funds** – Khula has a number of joint venture funds which include the Business Partners-Khula Start-up Fund, Anglo-Khula Mining Fund, Regent Factors Reverse Factoring Fund, Enablis-Khula Loan Fund and Khula-Enablis SMME Acceleration Fund.

A study on the impact of Khula in lending finance to SMMEs has not been undertaken. However, Makinana and Malobola (2004:267) in Rogerson (2008:47) argue that the geographical patterns of the impact of Khula financing are uneven with lower income communities in rural areas benefiting far less than the not-so-poor counterparts in urban areas.

2.6.1.2 Small Enterprise Development Agency (SEDA)

SEDA was established in December 2004 as an agency under the Department of Trade and Industry (DTI). The establishment was done by merging three organizations; Ntsika Enterprise Promotion Agency, National Manufacturing Advisory Centre (NAMAC) and the Community Public Private Partnership Programme (CPPP). The GODISA Trust and the Technology Programmes were integrated into SEDA in April 2006, becoming SEDA Technology Programme (STP).

SEDA is responsible for non-financial support services such as marketing, capacity building and training programmes, procurement advice, technology assistance and business mentoring (Van Vuuren and Groenewald, 2007). The bulk of the above-mentioned services are rendered through service providers or consultants contracted by SEDA. According to Herrington *et al* (2010:137), these service providers were rendering poor services to SMMEs.

2.6.1.3 Industrial Development Corporation (IDC)

The IDC is a self-financing national development finance institution. The institution was established in 1940 to promote economic growth and industrial development in South Africa. Its primary objectives are to contribute to the generation of a balanced, sustainable economic growth in Africa and to the economic empowerment of the South African population, thereby promoting economic prosperity of all citizens (Herrington *et al*, 2010:135). The IDC has increasingly supported SMMEs over the past years.

Through its financing activities since 1996, over the past years, the IDC created a number of direct jobs and generated R10 billion export earnings through the SMME funding. A number of financial products are available from the IDC and these products are structured to meet the entrepreneurs' needs. These include equity investments, quasi-equity investments and commercial loans (Bbenkele, 2007:19). IDC focuses more on larger enterprises that are established.

2.6.1.4 The National Youth Development Agency (NYDA)

The National Youth Development Agency was established by an Act of Parliament at the end of 2008. The agency was formally launched by President Zuma on Youth Day, 16^{th} June 2009. The agency was formed through a merger of the Umsobomvu Youth Fund and the National Youth Commission, with the primary aim of taking youth development to scale and integrating it across all government and private initiatives.

The objective is that of encouraging youth (14-35 years) development through economic participation, skills development and training, social cohesion and support (Bbenkele, 2007:19). The fund reports to the Presidency and is accessible through 13 youth advisory centres across the country as well as 121 youth advisory points. In the Buffalo City Municipal Area, the organization has one youth advisory centre situated in the central business district and three youth advisory points situated in Mdantsane, Duncan Village and King William's Town.

The NYDA provides financing from R1000 to R5 million to start, expand, buy into or buy out existing businesses which confer significant economic benefits to youth. This financing can be for franchises, contracts and tenders, assets and working capital and targets micro enterprises and cooperatives as well as small and medium enterprises (Herrington *et al*, 2010:134). NYDA provides finance directly through intermediaries.

2.6.2 Private sector financing

2.6.2.1 Own savings, family and friends

According to a survey carried out by Foxcroft *et al* (2002:34), the most important source of funding in all countries included in the Global Entrepreneurship Monitor (GEM) report was the entrepreneurs themselves. Many researchers (Albert, 2004:36; Rogerson, 2008:47; Herrington *et al*, 2010:134; Mahadea and Pillay, 2008:27) attest to the fact that many entrepreneurs raise the start-up capital from their own or family savings rather than approaching formal institutions or agencies. This is because financial institutions generally require collateral and formal business records as criteria for considering a loan. Also friends and family are less likely to attach onerous terms to the repayment of the loan.

However, many entrepreneurs with a good track record, leadership skills and business plans experience no problem in accessing loans for business formation or expansion from financial institutions (Mahadea and Pillay, 2008:72).

2.6.2.2 The South African Banking Sector

Commercial banks are by and large the most frequently used source of short-term finance by the entrepreneur when collateral is available (Mutezo, 2005:168). The four major banks in South Africa include Standard Bank, Amalgamated Banks of South Africa (Absa), First National Bank (FNB) and Nedbank. Funds provided by the above-mentioned banks are in the form of debt financing and as such require, amongst others, some tangible guarantee or collateral – some asset with value. Also, banks consider SMMEs as high risk something which makes it difficult for SMMEs to access finance from banks.

Many researchers in the area of SMME access to finance (Bbenkele, 2007:134; Rogerson, 2008:16; USAID, 2010:54; Pandula, 2011:257) identified that banks were reluctant to offer credit to SMMEs. Reasons raised by the above-mentioned authors were that generally, banks considered SMMEs as high risk and unprofitable. Other reasons raised were that there is a high risk of default when banks grant credit, high cost of screening, low returns and the particular issues of dealing with informal sector entrepreneurs due to language and cultural barriers.

2.6.2.3 Micro finance lenders

Micro financing provides an important source of funding for those entrepreneurs excluded from formal financing institutions (Herrington, 2010:156). Sources of micro finance included the Matshonisa, private institutions and Non Governmental Organizations (NGOs).

a) Matshonisa (loan sharks)

Informal money lenders in townships of South Africa are known as Matshonisa. The term "matshonisa" loosely translated "making you poorer" and is a reference to the interest payments attached to the loans, or to the trap into which the borrowers often fall (Rwigema and Venter, 2004: 394). Loans up to a maximum of about R5 000 are made available to individuals. As soon as borrowers receive their monthly income, they are expected to repay their loans and the interest amount.

Siyongwana (2004:56) in Rogerson (2008:34) argued that the "informal or unregistered" lending sector is an important segment of the "unbanked" sector of the South African population and provides a valuable financial service to a section of the population that is unable to utilize the formal banking system. However, the interest charged by this informal sector is exorbitant.

b) Micro lenders

Micro lenders provide small loans averaging R1 600 which do not require any form of collateral, over a period of one month. These suppliers concentrate on personal, relatively short-term to regular salary earners, with good security (in the form of an Identity Document and salary printout showing the potential for a garnishing value and a reasonable credit record checked through an efficient industry-wide referral system (Herrington *et al*, 2010:134). This limits availability of loans only to those who are gainfully employed. The bulk of the loans are for household needs and the balancing of income fluctuations. An insignificant share of five to ten percent of these funds is utilized for business purposes.

c) Non-governmental organizations (NGOs)

In South Africa, there are many NGOs, Section 21 and small companies that support enterprise development. This section will discuss only a few of these.

A. Zimele Investments (Pty) Ltd

Zimele Investments (Pty) Ltd is the enterprise development and empowerment initiative of Anglo American. In line with Anglo American's commitment to South Africa's socio-economic growth, Zimele concentrates on the establishment and promotion of small and medium enterprises.

Zimele provides a fund to the SME sector, driven by sound commercial principles. The organization strives to empower its entrepreneurs, both financially and managerially, so that they operate independently. It provides both loan and equity finance to support start-up or expansion businesses. Businesses must have a significant black empowerment shareholding and management. There must be a transfer of both technical and business skills to the entrepreneurs to enable them to participate in the mainstream activities of the economy.

Anglo Zimele oversees three funds:

1. **Anglo Zimele Supply Chain Fund** – assists the group's procurement departments in identifying BEE suppliers and ensuring the channeling of business opportunities to black-empowered SMEs. It gives support through equity and loan finance and provides hands-on support and guidance.

2. **Small Business Start-up Fund** – This fund was established specifically to provide loans to start-up and also provides support. It is in the process of establishing eleven small business hubs in designated areas.
3. **Anglo Khula Mining Fund** - Launched in 2003 as a joint initiative with Khula Enterprise Finance to assist small scale, black owned mining companies with funding and technical support during the typically high risk and exploration phases of mining projects.

B. Masakhisane

Masakhisane, meaning "come let's build each other together" in Zulu, was established by AngloGold Ashanti to provide venture capital to projects located in areas surrounding their operations. It enters into partnerships primarily with people from a historically disadvantaged South African background, to provide education, capacity-building and funding with the long-term aim of creating self-sustaining businesses.

2.7 TYPES OF SMME FINANCE

According to Smith and Smith (2004:508), there are various sources of business financing where providers have different objectives, capabilities and constraints. Some, like banks, seek low-involvement, low-risk investments, usually of short duration while others, like business angels, seek high risk, high involvement investments of moderate to long duration. Different financing sources protect the value of their investments. Others, like factoring companies and most lenders rely heavily on collateral.

2.7.1 Internal or external

There are a variety of possible sources of finance available to the SMME sector in South Africa. These can be classified as internal and external. Internal sources of finance include the personal equity of the entrepreneur, usually in the form of savings re-mortgages, or perhaps money rose from family and friends. After the initial start-up, retained profits and earnings provide internal capital. The principal sources of external sources include bank loans, equity capital from venture capitalists and short-term credits (Pandula, 2011:263).

For many businesses in South Africa, certain sources of finance are not available due to barriers of entry. For example, most SMMEs are automatically excluded from certain financial sources such as public sources like the Johannesburg Securities Exchange (JSE). They also face difficulties raising certain types of finance such as long-term loans because of the automatically higher risk associated with businesses which have equity in the form of share capital (Bbenkele, 2007:18).

2.7.2 Debt or equity

Start-up capital for SMMEs can be in the form of debt financing or equity financing (Herrington *et al*, 2010:156; Rogerson, 2008:48; Ganbold, 2008:57). Debt financing is a method that involves a loan, the payment of which is only directly related to the sales and profits of the venture. Typically, debt financing requires that some asset (such as a car, house, plant machine or land) be used as collateral. Equity financing, on the other hand, does not require collateral and offers the investor some form of ownership position in the venture. Therefore, choosing between debt and equity involves trade-offs for owners with regard to potential profitability, financial risk and voting control (Kongolo, 2010:244).

Debt increases the potential for higher rates of return to the owner and allows the owner to retain voting control of the business. On the other hand, equity financing limits the potential rate of return and the owner has to give up some voting control. While equity funds have been seen as a way to stimulate the growth and development of SMMEs, particularly owned by previously disadvantaged, the preferred investment ranges are too high to significantly reach these enterprise sectors.

2.7.3 Venture capitalists

Venture capitalists, according to Herrington *et al* (2010:145), are "independent companies or organizations which are an extremely valuable and powerful source of equity funding for new or existing ventures". Herrington *et al* (2010:145) further points out that the very nature of the word "venture" suggests that this type of capital certainly involves some sort of risk or even gamble. Venture capitalists all over the world differ in what they offer: some are generalists, others specialists while others may concentrate on specific geographical areas (Ganbold, 2008:56).

Herrington *et al* (2010:145) stated that most funds run for a period of ten years at which stage the venture capitalists requires its initial sum back plus a substantial returns. Herington *et al* (2010:145) further states that the venture capitalist companies are generally run by experienced professionals who provide a full range of services which include:

- Capital for start-ups and expansion
- Business administration and financial advice assistance
- Assistance in negotiating technical agreements
- Help and guidance in recruiting suitable employees and developing employee contracts

- Assistance in areas such as risk management, insurance planning and counseling

For SMMEs, access to venture capitalists could be a huge challenge due to lack of access to information and that because there are few venture capitalists; they are normally in high demand and can therefore be extremely selective.

2.8 CONCLUSION

There is a common understanding among researchers that SMMEs contribute significantly to the economy of both the developing and the developed countries through the creation of employment and the innovation of the economy as a whole. In South Africa, the SMME sector's contribution to the country's GDP cannot be overemphasized. The role played by government in creating an enabling and conducive environment for SMME access to finance has also been acknowledged. However, despite the above-mentioned commendable contribution made by SMME, they are still faced with various challenges chief amongst them is access to finance. These have been categorized as external, institutional and internal factors.

Several studies on SMME access to finance have been conducted but very little research, if any, has been conducted on which of the above-mentioned factors have the greatest influence on SMME access to finance hence the study.

The following section entails the description of the research methodology employed in the study.

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SECTION 3: DESCRIPTION OF RESEARCH METHODOLOGY

3.1 INTRODUCTION

A methodology provides the user with a framework for selecting the means to analyze, order and exchange information about an issue (Hofstee, 2006:74). It defines what can be known or exchanged, how that should be presented and by and for whom this is done.

This section, which is composed of three sub-sections, outlines the methodology used to investigate the constraints negatively affecting SMME access to finance in Buffalo City Metropolitan Municipality (BCMM). The first sub-section of this chapter outlines the objectives of and the rationale for undertaking the study. The second sub-section deals with the research design which outlines the paradigm and the ontology under which the study is based.

The third sub-section outlines the methodology used in conducting the study. The sub-section details the identification of the research population, the sampling, the research instrument used in data collection, the pre-testing and administration of the questionnaire, data capturing and analysis. The sub-section also outlines the validity and reliability of the data, ethical considerations and the limitations of the survey.

3.2 RESEARCH OBJECTIVES

Section one outlined that despite initiatives by government to create an enabling and conducive environment for SMME access to finance, SMMEs still find it difficult to access finance from government and private sector finance institutions. In section two, relevant issues regarding SMME access to finance as well as external, institutional and internal factors negatively affecting SMME access to finance have been discussed.

The overall objective of the research is to investigate the constraints negatively affecting BCMM SMME access to finance and the following goals have been identified:

4. To identify the prevailing external, institutional and internal factors which impact on SMME access to finance.
5. To identify which of these factors show the greatest impact.
6. To make recommendations on how these constraints can be overcome.

3.3 RESEARCH DESIGN

Due to the fact that the study is investigative, a critical theory *et al* paradigm with historical realism ontology was adopted. According to Riege (2003:33), critical theory assumes apprehendable social, political, cultural or economic realities incorporating a number of virtual or historical structures of these realities that are taken as real. Riege further states that researchers and their investigated subjects are linked interactively, with the belief system of the researcher influencing the inquiry, which requires a dialogue between researcher and subject. Therefore, the study will be based on the transactional or subjectivist epistemology (Guba and Lincoln, 1994:110).

According to Guba and Lincoln (1994:110), transactional or subjectivist epistemology assumes that the researcher cannot separate himself/herself from what he/she knows. The investigator and the object of investigation are linked such that who the investigator is and how he/she understands the world is a central part of how he/she understands himself/herself, others and the world.

The exploratory study adopted the inductive and qualitative approach/reasoning where no theoretical proposition was made prior to the commencement of the fieldwork. According to Babbie (2008:270), deductive reasoning works from the more general to the more specific. Sometimes this is called a "top-down" approach and is theory testing. Qualitative research is about exploring issues, understanding phenomena and answering questions (Guba and Lincoln, 1994:110). It is used to gain insight into people's attitudes, behaviours, value systems, concerns, motivations, aspirations, culture or lifestyle.

Data collection and analysis were premised on the model (external, institutional and internal factors) derived from the literature. The model was tested so as to identify which of the above-mentioned factors are the most prevalent and make recommendations.

3.4 RESEARCH METHOD

A survey of a selected sample from a population of SMMEs within the Buffalo City Metropolitan Municipality was conducted. According to Babbie (2008:270), a survey research is the best method available to the social researcher interested in collecting original data for describing, exploring and explaining a population too large to observe directly.

3.4.1 Secondary data

The research methodology employed in this research involved an extensive review and analysis of relevant literature, studies and surveys that have been conducted by different researchers that reflected and discussed various aspects related to SMME access to finance.

Firstly, literature review regarding the contribution of SMMEs to economic development was undertaken. In this regard, studies by Absa (2005:12), Pandey, and Shivesh (2007:39), Fida (2008:140), Chenesai (2009:230) Kongolo (2010:55, Abor and Quartey (2010:2769) Fatoki and Garwe (2010:2370), Pandula (2011:263) amongst others were drawn upon. Also, the review of some empirical experiences in some developing countries regarding SMME access to finance was conducted. This exercise involved the review of a number of studies by Ram Consulting Services (2005), Rogerson (2008:37), Isern and Pellegrini (2009:24) and Bowen, Morara and Mureithi (2009:278).

A review of the South African government's legislative framework on the promotion of SMMEs and the creation of an enabling and conducive environment for SMME access to finance was done. Some of the legislation reviewed includes the Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprise (2008:4), the National Small Business Act 102 of 1996, the Broad Based Black Economic Empowerment Act 53 of 2003, Accelerated Shared Growth Initiative of South Africa (AsgiSA) and the New Growth Path Framework.

In designing the part of the questionnaire that dealt with the external, institutional and internal constraints, literature by Mahadea and Pillay (2008:34), Fatoki and Garwe (2010:2765), Ganbold (2008:47), the USAID (2008:16), Bbenkele (2007:23), Herrington *et al* (2010:178), Pandula (2011:257) to mention but a few was drawn upon.

3.4.2 Primary data

The above-mentioned literature review exercise provided the theoretical foundation for the research followed by the empirical study. Results obtained from personal interviews with SMME owner-managers formed the primary data.

3.4.3 Research population

According to Babbie (2008:270), the population for a study is that group (usually people) about whom conclusions are drawn. Babbie further states that, due to cost and time, we are almost never able to study all the members of the population that interests us and neither can we make every possible observation of them. Therefore, data will usually be gathered in terms of sample which is selected to represent the population. The choice of the population to be sampled is greatly influenced by the available database.

The target population for the study were owner-managers of small, micro and medium enterprises (SMMEs) trading in the Buffalo City Metropolitan Municipal area. To be classified as an SMME, the target business had to comply with the definition of an SMME as outlined in chapter four (page 13) of the National Small Business Act (102 of 1996) attached as Appendix A of the study.

A database composed of a total of 390 SMMEs (20 companies, 130 close corporations, 35 sole proprietors, 15 partnerships and 190 cooperatives) was obtained from Buffalo City Metropolitan Municipality's Economic Development and Agencies department. The municipality, as part of its legislative mandate of growing, supporting and developing SMMEs within its area of jurisdiction, developed the above-mentioned database so as to understand the profile of SMMEs trading within the city for effective and efficient service delivery.

The database is administered by the department's three SMME support centres situated in Mdantsane, Duncan Village and King William's Town. SMMEs are, though quarterly SMME information seminars, workshops, IDP hearings, the Daily Dispatch and posters in all municipal buildings annually invited by the municipality to register their businesses in the municipality's database. Only those SMMEs registered with the municipality's database are eligible for services related to SMME development.

The database is categorized into legal form, physical address, business registration number, ward number, contact person, contact number, sectors namely: manufacturing, construction, services, textiles, agriculture, mining and wholesale. These are businesses whose annual turnover ranges from R0 to R5 million and employ not more than 200 people. They also range from start-up to the well established businesses.

The target population of the study was all the 200 SMMEs excluding the 190 cooperatives. A spreadsheet composed of the database of the 200 SMMEs categorized as mentioned above was obtained from the Economic Development and Agencies department.

3.4.4 The sample size

A sample of 50 SMMEs from the manufacturing, construction, services, agriculture, mining, wholesale and textile sectors was randomly selected from the population of 200 SMMEs. Every SMME in the fourth position had a chance to be chosen as part of the sample. A simple random sampling technique was used to select the sample size. According to Keller (2005:56), a simple random sample is a sample selected in such a way that every possible sample with the same number of observations is equally likely to be chosen.

3.4.5 The research instrument

A structured questionnaire instrument was used for collecting data from respondents. Fifty questionnaires accompanied by a covering letter explaining the purpose of the study and requesting the participation of the target businesses were either e-mailed, faxed and/or hand-delivered to the selected sample.

The questionnaire, prepared in English, consisted of forty closed-ended and seventeen open-ended questions which translated to four and half pages. Babbie (2008:270) describes closed-ended questions as survey questions in which the respondent is asked to select an answer from among a list provided by the researcher. These are popular in survey research because they provide a greater uniformity of responses and are more easily processed than open-ended questions.

Open-ended questions, on the other hand, are questions for which the respondent is asked to provide his or her own answers and in-depth, qualitative interviewing relies almost exclusively on open-ended questions.

3.4.6 The structure of the questionnaire

The questionnaire was aimed at investigating the external, institutional and internal factors negatively affecting SMME access to finance in the Buffalo City Metropolitan Municipality. Section A, B and C dealt specifically with the internal (firm) factors whilst sections D to H looked at the combination of external and institutional factors.

Section A: Firm characteristics

The section, composed of ten questions (four open and six closed), was aimed at gathering data on the firm characteristics that influence SMME access to finance. These included the firm's legal form, its physical address, whether the premises were rented or owned as well as how these premises were financed if owned. The section also looked at how long the firm has been in operation, the sector under which it was operating, the services offered, the number of people employed and whether the business was a member of any business organization.

The overall purpose of the questions was to establish the impact of the above variables on SMME access to finance. The USAID (2010:59) observed that smaller firms have fewer assets to offer as collateral as a result they find it difficult to access finance from finance institutions. On the other hand, Pandula (2011:258) noted that the information required by lenders at the time of granting finance may be limited to younger firms due to lack of established track record. It is also expected that businesses with more than one owner will have more chances of obtaining finance from lenders due to their management structure.

Section B: Entrepreneurial characteristics

Section B, composed of only four questions, was concerned with the firm owner's gender status, age, the level of education and the previous job held by the owner before becoming self-employed. The questions were aimed at ascertaining if there was a correlation between the above-mentioned variables and SMME access to finance. They were aimed at determining if the above variables played a significant role in the approval or rejection of finance applications by financial institutions.

According to Chenesai (2007:178), female managed firms are less likely to obtain finance that their male counterparts. Pandula (2011:263), Fatoki and Garwe (2010:2764) and Mahadea and Pillay (2008:25) also observed that there is a positive correlation between higher educational qualifications and firm access to finance and between previous management experience and firm access to finance.

Section C: Firm readiness

The section took a closer look at the firm's readiness prior to the process of applying for finance. The questions were based on whether the firm has a business plan and when (the year) it was prepared and whether it had the general requirements such as cash flow forecast, budget, products and services, the marketing plan and other relevant requirements, if any.

The section was also aimed at ascertaining whether the firm received outside assistance in the preparation of the business plan; the firm owner received any training in the preparation of the business plan and the aspects of the training the owner found most useful.

The purpose of the questions was to find out if SMME owners who received training on business plan development or have put together business plans were able to access finance than their counterparts. Given the fact that a sound and viable business plan is one of the document s required by financing institutions from businesses applying for finance (Herrington *et al*, 2010:160), it is expected that firms that have sound business plans are more likely to access finance than their counterparts.

Section D: Funding applied for/obtained

The section which was the longest of all sections was concerned with funding that was applied for by the entrepreneur and had seventeen questions (eleven closed-ended and six open-ended). The open-ended questions were constructed to allow for the respondent to give a narrative explanation on the issues articulated.

The section was aimed at ascertaining how the firm raised its start-up capital; finance institutions approached for financial assistance and the reasons for not having approached any financial institution. The section also ascertained the reasons that led to the firm's application for finance being rejected by the financial institutions; the most difficult and easiest parts the firm owner found during the application process.

The purpose of the questions was to investigate the constraints faced by SMMEs in their endevour to apply for finance from financial institutions. Section two outlined the high cost of credit and interest rate, bad credit record, lack of

financial records, lack of collateral, poor cash flow and poor business plan as some of the constraints negatively affecting SMME access to finance.
Section D was also aimed at ascertaining the firm's average annual turnover over the last three years; whether the firm was able to pay the owner contribution required by the financial institutions, as well as the percentage contribution of the loan the firm paid, if applicable.

The section also ascertained if the firm was registered for VAT and whether it had won any tender from government, the private sector or the NGO sector in the last two years and the reasons for not winning any tender if no tender was won. The purpose of these questions was to determine if those SMMEs that registered for VAT were successful in winning tenders and therefore were able to access finance from financial institutions. It is expected that the firms that had a high turnover per annum were likely to access finance from finance institutions.

Section E: The loan application form

The section looked closely at the loan application form and consisted of four questions. It looked at the language in which the application form was prepared; the number of pages of the application form and whether the firm owner received any assistance in putting the application form forward. Mahadea and Pillay (2008:25) argued that SMMEs are required to complete bulky application forms prepared in English and not translated to the applicant's home language.

The questions were aimed at investigating the correlation between the language in which the application form was prepared and the ability of the applicant to comprehend the contents of the said application. The questions on the number of pages of the application form were based on the understanding that the longer the application form, the more onerous the requirements. It is also expected that the firm owners who received assistance in putting their application forms forward will be more likely to access finance than their counterparts.

Section F: The loan application process

Section F dealt with the loan application process and consisted of eight questions. The section looked at whether the criteria for obtaining finance as well as loan requirements were explained to the firm owner who applied for finance and how the above were explained if applicable. Furthermore, the section took an in-depth look at whether the firm owner understood the explanation on both the criteria and the loan requirements for obtaining finance. Lastly, the section looked at the obstacles experienced by the firm owners during the application process.

Section G: Access to information

The section was aimed at ascertaining which development finance institutions were firm owners aware of and how they knew about them. For example, a study by the World Bank (2006:34) observed that a low level of SMME awareness of government support programmes constrained SMME access to finance. It is expected that the firms that are aware of some government programmes were able to access SMME support from these programmes.

Section H: Customer care

The section was aimed at finding out if firms whose applications were rejected received reasons from financial institutions for the rejection and how long it took for the above-mentioned institutions to respond to their loan applications. The section also ascertained the attributes of a successful application. The purpose of the above questions was to determine if financial institutions had the courtesy to respond to firms that applied for funding and were rejected.

3.4.7 Piloting of the questionnaire

The questionnaire was piloted by the interviewer on five SMMEs to improve content, phrasing, sequence, layout and instructions of a questionnaire and to determine the time required by the respondent to complete the questionnaire. This exercise resulted in the rephrasing of five questions as they were not clear to the respondents. For example the question on whether the business belonged to any networking group was rephrased to ask as to whether the business belonged to any business organization. The questionnaire took a minimum of twenty and a maximum of thirty minutes to complete. This time also allowed for an opportunity to discuss the open-ended questions and ask probing questions.

3.4.8 Administering of the questionnaire

Subsequent to the piloting of the questionnaire, the self-administered questionnaire was refined and e-mailed, faxed and hand delivered to the fifty selected sample. Participants in the survey were assured strict confidentiality in order to obtain the necessary information. Telephone calls and e-mails to respondents reminding them of filling in and sending back questionnaires were made. Of the fifty questionnaires sent to SMME owner-managers, thirty were returned translating to a response rate of 60 percent. Data was collected between June and July 2011.

3.4.9 Data analysis

Primary data obtained from owner managers who were sent was edited, carefully coded, captured and then analyzed using a process of cross-tabulation. A descriptive analysis of the data collected including cross tabulation was done. Also, frequency tables were carried out as part of descriptive data analysis.

3.4.10 Validity and reliability

Patton (2001:23) states that validity and reliability are two factors which any qualitative researcher should be concerned about while designing a study, analyzing results and judging the quality of the study. According to Patton, validity determines whether the research truly measures that which it was intended to measure or how truthful the research results are. On the other hand, reliability is the extent to which results are consistent over time and an accurate representation of the total population under study. Reliability and validity were ensured through the following measures:

- Pre-testing the research instrument in a pilot study
- Using the simple random sampling method

3.4.11 Ethical considerations

Babbie (2008:67) states that anyone involved in social scientific research needs to be aware of the general agreements shared by researchers about what is proper and improper in the conduct of scientific inquiry. Taking this into account, owner-managers were interviewed on a voluntary basis. The study required that owner-managers reveal personal information about themselves and their businesses – information that may be unknown to their friends and associates. This required that anonymity and confidentiality be maintained throughout the study.

3.4.12 Limitations of the survey

The research has been subject to certain limitations. Firstly, the research study has been restricted to Buffalo City Metropolitan Municipality due to time and financial constraints. Secondly, entrepreneurs interviewed for the study were not representative of all industry categories and sectors. Another limitation was dealing with the entrepreneurs own cognitive biases in relation to them articulating their own capabilities in relation to raising finance. Entrepreneurs tend to blame the lenders as opposed to looking at the quality of their own application forms and the required documents that accompany them.

3.5 CONCLUSION

The section outlined the research methodology that provided the framework for collecting and analyzing data. The objectives of the study, the research design, the analysis of data and the limitations to the study were comprehensively discussed.

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APPENDIX A: THE NATIONAL SMALL BUSINESS ACT (102 OF 1996) DEFINITION OF AN SMME

Enterprise Size	**Number of employees**	**Annual turnover**	**Gross assets (excluding fixed property)**
Medium	Fewer than 100 to 200 depending on industry	Less than R4 million to R50 million depending on industry	Less than R2 million to R18 million depending on industry
Small	Fewer than 50	Less than R2 million to R25 million depending on industry	Less than R2 million to R4.4 million depending on industry
Very small	Fewer than 10 to 20 depending on industry	Less than R200 000 to R500 000 depending on industry	Less than R150 000 to R500 000 depending on industry
Micro	Fewer than 5	Less than R150 000	Less than R100 000

APPENDIX B: THE RESEARCH QUESTIONNAIRE

AN INVESTIGATION INTO CONSTRAINTS AFFECTING BUFFALO CITY MUNICIPALITY (BCM) SMALL MICRO AND MEDIUM ENTERPRISES (SMMEs) ACCESS TO FINANCE

SMME Name	
Ref. No	
Date	

Please answer each question by filling an X in the appropriate box provided or write your answer in the space provided (open questions)

1.1 Firm characteristics

1. Legal Form

1.	Sole proprietor	
2.	Partnership	
3.	Closed Corporation	
4.	Company	

2. What is your business' physical address?

....

....

3. Is the business premises rented or owned?

1.	Rented	
2.	Owned	

4. If owned, how was the business premises financed?

....

5. For how long has your business been in operation?

1.	< 1 year	
2.	1-2 years	
3.	3-5 years	
4.	5-10 years	

5.	> 10 years	

6. In which economic sector would you classify your business?

1.	Agriculture	
2.	Manufacturing	
3.	Construction	
4.	Mining	
5.	Wholesale/retail	
6.	Textile	
7.	Services	
8.	Other (please specify)	

7. Which services does your business offer?

....

8. How many people does your business employ?

1.	None	
2.	< 5	
3.	6-10	
4.	11-20	
5.	21-50	
6.	51-200	

9. Is your business a member of any business organization?

1.	Yes	
2.	No	

10. What is your BBBEE status?

....

1.2 Entrepreneur characteristics

11. What is your gender?

1.	Male	
2.	Female	

12. Under which age category do you belong?

1.	<18	
2.	18-35	
3.	35-60	
4.	>60	

13. What is your level of educational?

1.	No schooling	
2.	Some primary school	
3.	Primary school completed	
4.	Some high school	
5.	Matric/grade 12	
6.	Certificate/Diploma	
7.	University degree	
8.	Apprenticeship	

14. Previous job held before becoming self employed if any (e.g. Accountant, Salesperson, etc.)

....

1.2 Firm readiness

15. Does your business have a business plan?

1.	Yes	
2.	No	

16. If yes, when was it prepared?

....

17. If your business has a business plan, does it have the following (please tick where appropriate)

1.	Cash flow forecast	
2.	Budget	
3.	Products and services identified	
4.	Marketing plan	
5.	Other	

18. Did you receive outside assistance in the preparation of your business plan?

1.	Yes	
2.	No	

19. If yes, please explain

....

20. Have you ever received training in the preparation of a business plan?

1.	Yes	
2.	No	

21. If yes, who provided the training?

....

22. Please identify which aspects of the training you found most useful.

....

1.3 Funding applied for/obtained

23. How did you raise your start-up capital?

1.	Family and friends	
2.	Own savings	
3.	Commercial bank (s)	
4.	Development Finance Institution (s)	
5.	Other (please specify)	

24. Which of the following financial institutions did you approach for financial assistance? (Indicate one or more)

	Financial institutions	Institution approached	Tick if successful
1.	Standard Bank		
2.	First National Bank		
3.	Absa		
4.	Nedcor Bank		
5.	Capitec bank		
6.	Khula Finance Limited		
7.	SEDA		

8.	Business Partners		
9.	ECDC		
10.	IDC		
11.	Micro Lenders		
12.	Stokvel		
13.	Other (please specify)		

25. If you have not approached any of the above financial institutions for financial assistance, what was the reason for you not to?

1.	Don't need to	
2.	Lack of information about financing institutions	
3.	High cost of credit and interest rate	
4.	I don't believe in borrowing money	
5.	I'm scared of borrowing money	
6.	My earnings change from month to month	
7.	Industry too risky	
8.	I don't qualify (please state reason below)	
9.	Other (please specify)	

26. According to the financial institution (s) where you applied for finance, which of the following reasons led to your application being rejected?

1.	Bad credit record	
2.	Lack of financial records	
3.	Lack of collateral	
4.	Poor cash flow	
5.	Poor business plan	
6.	Other (please specify)	

27. Did you agree with the reasons indicated above?

1.	Yes	
2.	No	

28. If you answered no to the above question, why do you not agree with the above-mentioned reasons?

....
....
....

29. Now that you have gone through the process of applying for finance, what would you have done differently and why?

....
....
....

30. Would you re-submit the application form for finance?

1.	Yes	
2.	No	

31. If no, why would you not re-submit the form?

....
....

32. What was the most difficult part you found of the application process?

....
....

33. What was the easiest part you found of the application process?

....
....

34. What is your business' average annual turnover over the last three years?

1.	Start up	
2.	< R500k	
3.	Between R500k and R2,5 million	
4.	Between R2,5 million and R5 million	

35. Were you able to pay the owner contribution required by the financial institutions?

1.	Yes	
2.	No	

36. If yes, what percentage contribution of the loan amount did you pay?

....

37. Is your business registered for VAT?

1.	Yes	
2.	No	

38. Has your business won any tender from government, the private sector or the NGO sector in the last two years?

1.	Yes	
2.	No	

39. If not, what would you say is the reason for your business not to have been successful in winning tenders?

....

2.1 The loan application form

40. In which language was the application form prepared?

1.	English	
2.	Afrikaans	
3.	Xhosa	
4.	Other (please specify)	

41. How many pages was the application form?

1.	1-2 pages	
2.	3-4 pages	
3.	5-6 pages	
4.	More than 6 pages	

42. Did anybody assist you in putting your loan application forward?

1.	Yes	
2.	No	

43. If yes, who assisted you?

1.	Friend/relative	
2.	Loan consultant	
3.	Government official	

4.	Other (please specify)	

2.2 The loan application process

44. Was the criteria for obtaining finance explained to you?

1.	Yes	
2.	No	

45. If yes, how was the criteria explained?

....

46. Did you understand the explanation?

1.	Yes	
2.	No	

47. Prior to making the loan application, are you of the opinion that the lending institution took adequate steps to inform you about the loan requirements e.g. business plan, budget, cash flow statement, collateral, etc?

1.	Yes	
2.	No	

48. If yes, what aspects were most useful?

....

....

49. Did the loan advisor explain the above-mentioned loan requirements to you?

1.	Yes	
2.	No	

50. If yes, how was the process explained?

....

51. Did you understand the explanation?

1.	Yes	
2.	No	

52. Which of the following obstacles have you experienced during the application process?

1.	Communication problems – no forms in local language	
2.	Too much information required (too many pages to fill)	
3.	Complexity of application forms	
4.	No assistance given in filling in the application form	
5.	Being sent from this office to another	
6.	Other (please specify)	

2.3. Access to information

53. Which of the following development finance institutions are you aware of?

No.	Finance institution	Aware (please tick)	Why have you approached them?
1.	Khula Finance Limited		
2.	Small Enterprise Development Agency		
3.	Business Partners		
4.	Eastern Cape Development Corporation		
5.	National Youth Development Agency		
6.	SAMAF		

54. If yes, how did you know of the financial institutions where SMMEs can access finance?

1.	Referral by friends and relatives	
2.	Over the radio	
3.	Television advertisement	
4.	SMME Information Seminars, workshops and conferences	
5.	Other (please specify)	

2.4 Customer Care

55. If your application was declined, did you receive a reason for the rejection?

1.	Yes	
2.	No	

56. If you answered yes to the above question, how long (in weeks) did it take for the financial institution to respond to your loan application?

1.	One to two weeks	
2.	Three to four weeks	
3.	Five to six weeks	
4.	Seven to eight weeks	
5.	Longer	

57. If your application was successful, what did you attribute to its success?

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Your participation in this research is much appreciated and valued – thank you.