

The Dichotomy between Small, Medium and Micro Enterprises and Financial Institutions in Thohoyandou

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ABSTRACT Small, Medium and Micro Enterprises (SMMEs) as vehicles of growth, innovation and social transformation, are important new businesses catalysts, which should be nurtured and harnessed by the South African authorities. The importance of SMMEs to the South African economy has been acknowledged by the government. Yet, extensive research reveals that access to financing is one of several important factors that are critical for business survival and growth. This study examined SMMEs' access to financial management services in the Thohoyandou Business Centre. It is found that the SMMEs do not possess financial management skills, nor do they have access to financial management services although most acknowledge the need for such skills for the success of their businesses. Management capability strengthens the financial capacity of SMMEs. Financial institutions are prone to be favorably disposed to SMMEs who can demonstrate skills in financial management, marketing and technology upgrading.

INTRODUCTION

Small, Medium and Micro Enterprises (SMMEs) have a major role to play in the South African economy in terms of employment creation, income generation and poverty alleviation. According to Statistics SA, small businesses account for more than sixty percent of all employment for the population (Limpopo Economic Development Agency 2014). Worldwide, SMMEs contribute significantly to job creation, social stability and economic welfare (Limpopo Economic Development Agency 2014; Gartner and Schon 2016). The South African government has prioritized SMME development to address high levels of unemployment. The national unemployment rate, currently estimated at 28.4 percent (Statistics South Africa 2015), is increasing at an alarming rate. SMMEs generate 34.8 percent of Gross Domestic Product (GDP), contribute 42.7 percent of the total value of salaries and wages paid in South Africa, and employ 54.5 percent of all formal private sector employees (Limpopo Economic Development Agency 2014). The gap between the high and low-income groups is increasing with time. Small busi-

nesses and entrepreneurship development can bridge this gap. Given South Africa's legacy of big business and constrained competition, the small business sector is seen as an important force to facilitate more equitable income distribution, activate completion, exploit niche markets, and enhance productivity and technological change, thereby stimulating economic development (De Waal and Chipeta 2015). Following South Africa's democratization in 1994, the government has increasingly sought to include SMMEs in national economic development strategies (Lam et al. 2015). Although the initial strategic framework for these policies has undergone several revisions since the early 1990s, the government's perception of the role of SMMEs remains essentially unchanged. SMMEs are seen as important role players in three areas, that is, increasing international economic competitiveness, creating employment, and facilitating wealth redistribution (Chauhan 2015).

Purpose of the Study

SMMEs in the Thohoyandou Business Centre do not have access to financial management services that would enable them to effectively and efficiently run their businesses (Limpopo Economic Development Agency 2014; Masson 2015). The study aimed to investigate, identify and describe the challenges impeding access to financial management support services for SMMEs in the Thohoyandou Business Centre. Despite the growth in venture capital funding,

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access to funding remains a problem for small enterprises, particularly empowerment groups in South Africa. Most surveys of small enterprises have found that concessionary finance is the most urgent need. On the other hand, access to financing is one of several important factors that are critical for business survival and growth, the others being market access and financial management skills (Zhong and Zhang 2015). South Africa's financial sector has always been reluctant to provide comprehensive services to the fragmented, risk-prone and geographically dispersed small enterprises sector (He 2015). SMMEs are a major feature of the economic landscape in all developing countries today (Gong et al. 2015). They contribute more than ninety percent of employment opportunities in many countries, are responsible for revenue creation and poverty alleviation, and are a source of creativity and innovation.

This study addressed two main issues relating to the growth and development of SMMEs in South Africa, that is, the lack of financial management skills and lack of access to finance. The lack of financial management skills is one of the obstacles affecting the growth of local SMMEs (Eric and Chong 2015). The study assessed access to financial management services by SMMEs in Thohoyandou Business Centre, as this has a bearing on their economic development and sustainability. It sought to determine if the SMMEs in Thohoyandou had access to financial management services support, and if they have, whether or not they are ready to receive these financial management services (Zendler et al. 2015).

Problem Investigated

The problem investigated in this study was the inability of SMMEs in Thohoyandou Business Centre to access financial management support services that would enable them to effectively and efficiently run their businesses (Netshandama 2015). Given the proven relationship between sound financial management practices and a business' likelihood of obtaining financing, those that procure some form of external financial management services are more likely to obtain loan finance. The study recommends that relevant financial management practices be implemented by SMMEs in order to be able run their businesses properly.

- Arising from the above, the article aims to,
- ♦ Establish and describe SMMEs' state of readiness to receive financial management support services.
 - ♦ Identify and describe the challenges faced by SMMEs in the Thohoyandou Business Centre in accessing financial management services.
 - ♦ Recommend relevant financial management services for SMMEs.

Literature Review

In African as well as in other less developed countries, SMMEs have been subject to increased attention because of their labor absorptive capacity in times of both a shrinking public sector and private formal economy, and the increase in new labor entrants. The promotion and development of entrepreneurship in South Africa is currently the focus of much attention in a wide variety of fields because it is regarded as a major key to economic development and wealth creation, thereby contributing to social prosperity and upward mobility. The demand for an entrepreneurial-driven economy in South Africa is increasing, particularly because of the employment creation benefits it offers. The SMME sector is globally regarded as the driving force in economic growth and job creation (Chung Fun 2015; Netshandama 2014). The South African economy has declined over the past 20 years. The year-on-year change in the value of real Gross Domestic Product (GDP) determines the real growth rate of a country (Eric and Chong 2015). In the 1960s, South Africa's GDP averaged 6 per year. During the 1980s, it decreased to 2.2 percent, with no growth in the 1990s. This has led to a high unemployment rate of around thirty percent. Small businesses in South Africa contribute approximately forty-two percent of the country's GDP (He 2015; Netshandama 2014). In 2006, the World Bank issued an assessment of the overall investment climate in South Africa. The report identified the major obstacles to business, including Black business' lack of access to finance. Masson (2015) notes that, "Black owned businesses report significantly higher difficulty in accessing finance. African owned firms were far more concerned about access to credit and the cost of financing than European owned firms. There is still lack of evidence on whether this higher mortality is a cause

or a consequence of the higher credit rejections, and whether the higher risks of these segments can be made up for on an accordingly higher return". Numerous studies have shown that SMMEs are financially more constrained than large firms and are less likely to have access to formal finance. Edwards (2015) surveyed the financial management practices of 224 Black-owned SMMEs in South Africa. The study posed the following questions:

- ♦ What aspects of financial administration, if any, are deficient?
- ♦ How widespread are these deficiencies?
- ♦ What impact do these deficiencies have on the financial health of a business?
- ♦ Do these deficiencies influence an entrepreneur's ability to secure external finance?

The report suggests a worrying trend amongst the previously disadvantaged SMME community (De Salas and Huxley 2014). "Overall, the financial state of a significant majority of businesses in this sample shows signs of being precarious. Forty-five percent of those businesses that have an overdraft facility had exhausted this facility in the last six months" (Netshandama 2014). In order to understand the effect of good financial management practices, the study surveyed entrepreneurs' financial procedures across a range of business activities. The report concludes that, "a few relatively simple changes to the administration practices of owner-managed firms have the potential to improve significantly their cash position and reduce the probability of their overdraft being exhausted (Gartner and Schon 2016). Over sixty percent of these entrepreneurs could potentially benefit from training in these practices". Most importantly, "the results demonstrate that nearly three quarters of entrepreneurs who proactively manage cash flows are successful in applications for bank loan finance. This implies that banks channel finance to the majority of firms that adopt good management practices" (Netshandama 2014).

One of the major hurdles confronting entrepreneurship endeavors is a lack of financial management skills. South Africa has a severe skills gap. SMMEs are particularly hard hit, as they compete with the broader commercial sector for these skills. Many small enterprises have developed their employees, only to lose them to bigger firms that offer superior incentives. As a case in point, SMMEs in South Africa's expanding

construction sector are losing the fight in the battle for scarce skills (Muthusamy 2014). Sound financial management is an essential business trait as it ensures proper cash flow administration, and balancing costs and turnover versus business growth. Although the majority of SMME operations are not complex, a basic level of education is required for their successful management (Choi and Nazareth 2014).

In South Africa, not even short-term funds are easily available to the small entrepreneur. The social, economic, financial, legislative, political and banking systems characteristic of the previous dispensation combined to create financial problems for the SMME sector. The government needs to promote alternative financial institutions that serve as vehicles for savings and loans to low and middle income individuals, as well as the self-employed. Among the constraints that hinder SMMEs from growing and developing in many countries, access to business support and advice is one of the most critical. Lack of awareness of the value of business support amongst entrepreneurs, or problems arising from the accessibility of providers, with many located in urban areas, can be attributed to reduced support for SMMEs in rural areas (Chauhan 2015). Such support encompasses a wide range of services, including business advice and information, training, financial assistance, and business networks and mentoring schemes. Business advice and information incorporates generic business startup advice and support, business planning advice, development support, and consultancy and advice on business plans and business promotion (De Salas and Huxley 2014). Training ranges from generic training to business planning courses and financial management training, whereas financial assistance can consist of advice on raising finance, the provision of grants and funding, financial planning and management (Gartner and Schon 2016).

RESEARCH METHODOLOGY

The aim of this study was to describe the financial management skills difficulties experienced by small businesses. Therefore, the research is classified as a non-experimental, descriptive research. The study adopted a qualitative approach as it aimed to describe the state of access to financial management services by SMMEs in Thohoyandou Business Centre (Guercini 2014).

Population and Sampling

The study targeted SMMEs. The population was defined as the entrepreneurs in the Thohoyandou Business Centre. Hair (2014) describes the target population as the complete group of specific population elements relevant to the research project. For the purposes of this research, the target population comprised entrepreneurs and managers from small, medium and micro enterprises. The geographical location is Thulamela Municipality. Due to the fact that no complete list exists of all SMMEs in South Africa, SEDA's (Limpopo Economic Development Agency 2014) was used to draw a sample. This consisted of approximately 993 SMMEs, which were registered for the purpose of the services rendered to them. It should, however, be acknowledged that SEDA's Database, as with other lists of businesses, would include more formalized businesses, that is, licensed businesses registered for tax purposes. This shortcoming was addressed by also distributing questionnaires to informal businesses operating in the Thohoyandou Business Area. A total of 150 questionnaires were distributed to SMMEs in Thohoyandou Business Centre (Erikson 2015).

Research Instrument

The study made use of one instrument, a questionnaire specifically designed for the targeted entrepreneurs. The questionnaires were delivered by hand to each respondent and collected later, due to the fact that the sample was large. It had a moderately high response rate of fifty percent. The questionnaire contained mainly closed-ended questions, which were suitable for the purpose of this study (Lee 2014).

Data Collection

The questionnaires were distributed to SMMEs in Thohoyandou Business Area in Thulamela Municipality in Limpopo Province. The section on demographic information consisted of closed-ended questions to gather information such as gender, age, home language and education. In the section on the profile of business activities, closed- and open-ended questions were used to gather information such as the respondents' number of years' experience as an entrepreneur, their position or role in the

business and the size of the business (Parker 2014). Entrepreneurs were asked how they raised start-up capital, what problems they encountered in raising the necessary capital, and whether or not there is a need for further or improved support in the area of financial management amongst SMMEs. Registered Business Management students from the University of Venda were approached to distribute the questionnaires. Seventy-five of the 150 questionnaires were returned. This is a response rate of fifty percent. Of the 75 questionnaires returned only 72 were used, as the remaining three were not complete (Guercini 2014).

DATA ANALYSIS AND INTERPRETATION

Descriptive statistics were used to analyze the data collected by means of the questionnaire. These included frequency counts, mean scores, standard deviations and cross tabulations. In other words, the numerical data collected were mathematically manipulated and statistically analyzed as opposed to the inductive reasoning approach, which was used to analyze the data collected through the field observations. The following inferential techniques were used, namely, the *squiestest* and the *t-test* for independent measures. All statistical analyses were computed using the SPSS statistical package (Lee 2014).

DISCUSSION

The growth of SMMEs in South Africa is still a work in progress as the country rebuilds its economy (Netshandama 2014). The SMME sector is making an important contribution to the South African economy. Financial institutions and other institutions that provide support to SMMEs are starting to consider all types of SMMEs and are also realizing the importance of training entrepreneurs to manage their finances (Gartner and Schon 2016). The government is also aware that SMMEs are the backbone of the economy. This encourages the government to fund institutions to train emerging entrepreneurs in financial management in order to ease the burdens carried by SMMEs and hence promote their growth (De Waal and Chipeta 2015). However, despite government initiatives, the study found that a lack of financial management skills and access to finance are among the most chal-

lenging factors that affect SMMEs' growth and development in South Africa. Furthermore, the study also noted that mismanagement and a lack of marketing skills among owners-managers cannot be underestimated (Lam et al. 2015). Other non-financial impediments identified include the unfavorable legal environment, lack of adequate infrastructure, lack of proper operating premises, lack of proper education among owner-managers, and a lack of the adequate business information and support necessary for informed business decisions, or counseling services (Masson 2015). The findings confirmed the general perception that the SMME owners' lack of management skills and access to finance are the main factors that negatively impact the growth and development of this sector in South Africa (Zong and Zhang 2015). Consequently, entrepreneurs find it difficult to manage their businesses in order to grow and they eventually fail.

CONCLUSION

SMMEs are one of the primary catalysts of innovation and social transformation. They are thus important assets that should be nurtured and harnessed in South Africa to enable the economy to quickly and effectively adapt to the challenges of globalization and reap its benefits. However, government's efforts to support the SMME sector have so far been dismal. While the government has acknowledged SMMEs' economic importance, the government alone cannot make firms grow and employ staff. It has to make the environment more conducive for entrepreneurship by implementing a favorable institutional and regulatory environment. What is needed is a new approach. Although the government has put policies and institutions in place with the aim of improving small business owners' access to finance, their success has been minimal. It is therefore imperative that management capability and financial management acumen be regarded as the key to easy access to funding by both the entrepreneurs themselves, and those supporting and promoting them.

RECOMMENDATIONS

Risk capital investment is urgently required to enhance the rapid development of SMMEs. For financial institutions to develop an appetite to fund SMMEs and better manage the risks,

the sector should address the following credit analysis issues, that is, a viable business model in a profitable and growing industry, sound and focused management, a clear succession plan, demonstrable financial management capabilities, a focused cost structure, and financial planning. To enable SMMEs to move up the value chain in order to remain competitive, the government should adopt a more comprehensive approach to SMME development to improve their operations and productive capabilities through increasing access to finance through loan guarantee schemes, creating enabling business infrastructure, enhancing human capital development, and exposing more SMMEs to and encouraging them to adopt ICT. The practice of financing SMMEs through grants, which are not repayable, should be reviewed, as it underestimates their ability to achieve self-sufficiency. SMMEs should be encouraged to form cooperative societies, SACCOS, investments clubs and merry-go-round schemes in order to develop critical mass to leverage group capacity building opportunities and financial resources from members, MFI, banks and DFI. Supportive legislation could be passed to enable financing at subsidized rates.

Measures should be taken to support and counsel prospective entrepreneurs when they decide to start a business. These include increasing the amount of information available to people thinking of starting a business to ensure that they are able to make rational decisions. There is also a need for more government and private sector partnerships to find innovative strategies to increase SMMEs' access to finance, training in financial management and marketing skills. Owners and managers of SMMEs should be encouraged to participate in policymaking decisions on the development of SMMEs to ensure that all policies favor all types of small businesses. Management capability strengthens SMMEs' financial capacity. Financial institutions are prone to be favorably disposed to SMMEs that can demonstrate capabilities in areas such as financial management (including basic bookkeeping), marketing and technology upgrading. It is recommended that the government and other service providers incorporate additional simplified components of their training packages to cover areas such as bookkeeping and formulating business plans.

Entrepreneurs' educational background also has direct bearing on how they respond to training. This study found that most of the entrepreneurs (42%) viewed financial management skills as vital for the development of their businesses. Financial institutions should fund non-financial support services such as the provision of financial management skills and mentoring. Access to information on SMMEs should be increased to ensure that all providers and potential providers of finance have sufficient knowledge to assess the risk of SMME applications for finance. Any intervention that improves the ability of financial providers to accurately assess risk would increase their willingness to extend credit and other services to SMMEs. Funding institutions should advertise their services so that entrepreneurs are aware of where to go when they need capital to start-up or grow their businesses. The study found that most entrepreneurs (71%) used their personal savings to start their businesses. Therefore, improved regulation of credit bureaux is recommended in order to enhance their credibility and the integrity of the information distributed by the bureaux.

LIMITATIONS OF THE STUDY

- ♦ Time as well as financial constraints prevented a wider study. It would have been ideal if SMMEs in South Africa's other eight provinces could have been included.
- ♦ The sample was relatively small, due to a lack of financial resources and the difficulties experienced in getting the entrepreneurs to participate.
- ♦ Only 75 of the 150 questionnaires that were distributed were returned. Three were not complete, which further reduced the sample to 72.
- ♦ There is a paucity of research on SMMEs' problems in accessing financial management services in South African an entrepreneurship context. Further research on the topic on a national scale is required.

FURTHER RESEARCH

Further research could include certain skills as a pre-requisite for a successful application for finance such as bookkeeping, cash flow management and drafting a comprehensive business plan, how financial institutions and the govern-

ment could impart financial management skills to existing and potential entrepreneurs, obstacles faced by SMMEs to access financial management services, the provision of financial management services to SMMEs by financial institutions, and an examination of financial institutions' policies on assisting SMMEs to access finance.

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