

## Small and Medium Enterprises (SMEs) as a Means of Creating Employment and Poverty Reduction in Fort Beaufort, Eastern Cape Province of South Africa

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**ABSTRACT** The establishment and contributions of various SMEs in improving socio-economic development in the developed countries include creation of employment, improving the standard of living and increasing household incomes. Hence, this study establishes a base level of understanding of the operational core values of SMEs in creating employment and poverty reduction in Fort Beaufort in the Eastern Cape Province of South Africa. Simple random sampling techniques were used to select the participants. Data was collected through self-administered questionnaires. It was analyzed using descriptive statistics of frequency and percentage. The findings revealed, among others, that SMEs plays a major role in creating employment and reducing poverty. It was also revealed that there are constraints and challenges such as lack of finance and lack of managerial skills as well as training faced in the operations of SMEs in most of African countries. The study concludes that unless the limitations are resolved, SMEs in the developing nations will continue to experience those challenges.

### INTRODUCTION

SMEs play a significant role in South Africa in dealing with the challenges of poverty and job creation in rural areas. The Department of Trade and Industry (DTI) (2005) reveals that SMEs are the key for achieving economic growth and development goals such as job creation and poverty reduction. Thus, the development and establishment of SMEs are means of employment creation, poverty reduction and income generation, as a result, job creation by the SME sector serves to benefit the economic development in remote areas and ensure a healthy balance of economic growth in rural areas. According to DTI (2005), the promotion of SMEs in rural areas remains an important priority of the government of South Africa during the post-apartheid period. A well-structured program was put in place by the government to ensure that rural SMEs increase their contribution to employment creation, income distribution and poverty alleviation. A strategic approach to SME development in South Africa was adapted by the 1995 White Paper on national strategy on

the development and promotion of SME in South Africa. The paper sought to help facilitating access to information and advice, facilitating access to finance, creating an enabling environment and facilitating access to affordable physical infrastructure.

Generally speaking, the policymakers from both developed and developing countries of the world now accept that SMEs at the local, regional and national level are becoming increasingly important in terms of employment, wealth creation and the development of modernism (Johnson and Lundvall 2000). However, the Statistics South Africa (2012) reveals that the establishments of various SMEs in South Africa are very important because over seventy-five percent of the population derive their livelihoods from SMEs, while approximately seventy percent of the rural people are poor because of the inability of the rural economies to provide them with remunerative jobs or self-employment opportunities. The problem becomes more complex with poor infrastructures.

SMEs contribute extensively to the nation's socio-economic growth and development. In addition to this, through the establishment and creation of SMEs, several job opportunities have been created globally. Nwigwe et al. (2012) reveals that in 2008 and 2009, SMEs created several employment opportunities for a large number of employees in Nigeria and as a result, dras-

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tically and extensively enhanced the socio-economic growth and development of the country by eighty percent.

### Research Objective

The establishment and contributions of various SMEs in improving socio-economic development in the developed countries include creation of employment, improving the standard of living and increasing household incomes. Hence, this study establishes a base level of understanding of the operational core values of SMEs in creating employment and poverty reduction as well as exploring the obstacles confronting SMEs in the rural social and economic development in Fort Beaufort, Eastern Cape Province of South Africa.

### Research Questions

1. What are the sources of business finance?
2. What is the nature and type of the business organization?
3. What are the impacts of SMEs on improving the economic growth and development as well as poverty reduction in South Africa?
4. What are the obstacles confronting SMEs in the Rural Social and Economic Development in South Africa?

### Literature Review

This section focused on the contributions of SMEs to the socio-economic growth and development of South Africa. From the discussion below, it is believed that SMEs make a great contribution in reducing the high unemployment rate and poverty as well as income inequality in South Africa.

#### *Contributions of SMEs to National Economic, Growth and Development of South Africa*

Lighthelm and Cant (2002) observed that in South Africa, one million jobs have been lost since 1990 bringing the joblessness rate by 2002, to twenty-eight percent. In many developing countries, in which South Africa is not excluded, the creation or establishment of more Small

and Medium Enterprises brings about expansion, growth, development and increase in employment opportunities, income generation as well as reducing the rate of poverty in the economy. According to Sunter (2000), Small Medium Enterprise sectors are the driving force in employment generation, poverty reduction and stabilizing the economy globally. In South African economy, SMEs contribute to fifty-six percent of private sector employment and thirty-six percent to the Gross Domestic Product (GDP) (Ntsika 2002). Hence, this is an indication for a huge labor absorption competence and emphasizes the job establishment potentials of this sector as well as its importance of decrease in the unemployment rate in South Africa (Ntsika 2002). Furthermore, Small and Medium Enterprises still remained the backbone of virtually all economies of the world (Zingales 2000) cited in Oyelana (2011).

The establishment and development of SMEs in the rural areas could bring about reduction in unemployment and poverty, which would sooner or later improve the standard of living. The problems of inequality, unemployment and poverty in the rural areas could be overcome by the development of vibrant SMEs (United Nations Industrial Development Organization/UNIDO 2007). Therefore, Small and Medium Enterprises play an important role in people's endeavor to meet their basic needs and assist female heads of households, disabled people and rural families. Jiabao (2011) states clearly that the growth, expansion, progress and advancement of Small and Medium Enterprises are unified towards local economic development. In order to address the challenges of poverty and employment creation in the rural areas, more attention and focus should be directed to establishment of more Small and Medium Enterprises, which are an engine or driving force in the rural areas development. In the European countries, more than ninety percent of businesses are Small and Medium Enterprises, and they contribute more than fifty-three percent to the employment sector (European Commission 2013). It is often believed that in the sub-Saharan African countries, SMEs contribute ninety percent to employment sector (United Nations Educational Scientific and Cultural Organization/UNESCO 2012). Hence, the development of Small Medium Enterprises has received great attention from different governments across the globe as an im-

portant tool for employment generation, poverty and crime reduction as well as income generation.

Small and Medium Enterprises also generate employment by creating job opportunities, they also serve as a training ground for employees, because they provide a more comprehensive learning experience (Megginson et al.1997). Megginson et al. (1997) believe that seventy-one percent of future employment in the fastest-growing industries such as medical care, business services, and the environment will emerge from the Small and Medium Enterprises. SMEs take in a great portion of the labor force, especially in remote areas where circumstances are not conducive to establish large enterprises (Kroon 2000). SMEs play a significant role in creating employment opportunities, and therefore contribute to a large extent to poverty reduction (Sinxoto 2007). SMEs are self-motivated, elastic, innovative, creative and have more self-esteem than big businesses. Consequently, SMEs are an important component of socio-economic growth and development strategy. In South Africa, the government has seen SMEs as a key to address the challenges of job creation, economic growth and equity in the country. Furthermore, from the South African perspective, SMEs are playing a great role in employment creation, poverty reduction, wealth creation, penetrating and expanding new markets as well as improving the economy. Unemployment is one of the most crucial socio-economic problems facing South Africa. A survey carried out showed that forty percent to fifty percent, which represents about 7 million of the economically active population are presently unemployed (Knight 2006). Hence, SMEs are expected to play a crucial role to address the challenges of poverty, employment creation, economic growth stability, and equitable distribution of income. Small and Medium Enterprises provide employees with different learning skills that would not be open to individuals holding more specialized jobs in larger ventures. Performing a better diversity of functions, Small Medium Enterprise employees have more freedom to make decisions. Finally, according to Megginson et al. (1997), Small and Medium Enterprises usually ensured that their employees undergo training to become better leaders and managers as

well as to develop their talents more effectively and efficiently.

## **RESEARCH METHODOLOGY**

### **Research Design**

The study adopted a descriptive research design to investigate how SMEs can create employment and reduce poverty in Fort Beaufort.

### **Population**

The population consists of all the SME owners in Fort Beaufort, Eastern Cape Province of South Africa.

### **Sample and Sampling Techniques**

A purposive sampling technique was used to select fifty (50) SME owners in Fort Beaufort, Eastern Cape Province of South Africa.

### **Research Instrument**

Self-administered questionnaires were used to elicit information from the respondent. The questions were related to SMEs as a means of employment creation and poverty. The questionnaire consist of open-ended questions, which enabled the respondents to respond in their own words as well as close-ended questions that provided the respondents with different options. The questions were brief and clear. Sensitive questions were avoided because it may be difficult for respondents to attempt and to avoid false information. Therefore, the questionnaire contained information like age, sex, as well as the educational status, which forms a part of the demographic information. Information in the questionnaire has socio-economic impact activities of SMEs and the challenges that the SME owners are facing as well as the expected supports that can improve their small business activities.

### **Validity and Reliability of Research Instrument**

A structured questionnaire was used to elicit information from the respondents. Experts in the same field validated the instrument and the Cronbach alpha was used to measure its reliability. The reliability coefficient is  $r=0.76$ .

### Data Administration and Analyses

The instrument was administered to the respondents with the support of research assistants. The data collected was analyzed using descriptive statistics of frequency and percentage.

## RESULTS AND DISCUSSION

This study has shown that through the establishment of more Small and Medium Enterprises in their communities, small business owners would meet their essential needs and be able to save enough money as well as acquire properties. Therefore, the establishment of Small and Medium Enterprises goes beyond a mere survival strategy for households. It is also a poverty reduction strategy. Small and Medium Enterprises have helped people as well as entire communities to elevate their status regardless of gender especially in the midst of the socio-economic crises they found themselves in. Evidences include the improvement in health security, food security, incomes, property as well as education for children among the households' participants.

The majority of the respondents agreed that Small and Medium Enterprises serve as a strategy for poverty reduction. The study has recognized that if adequate support and proper management is given to Small and Medium Enterprise owners, it will serve as a better approach to poverty reduction. Hence, the study revealed that those who have engaged themselves in hawking as a form of small business see it as a survival strategy because they have not been able to achieve more as those who have established businesses for many years.

This study also established that Small and Medium Enterprises do not benefit the owners only, but the majority of Fort Beaufort residents. It has enabled those who are not financially buoyant to buy their needed commodities at cheaper prices as compared to the big stores' prices. Small and Medium Enterprises have uplifted the status of the unemployed youths as they were able to secure a work space with the existing Small and Medium Enterprises, some as a part of sales assistance while others work as apprentice yet they earn stipends.

Most participants emphasized that there has been a great improvement in their household security, food security, health security, and shelter as well as property ownership. Thus, none of

the participants expressed any regret in their engagement with Small and Medium Enterprises because it is their main source of income, which has enabled them to come out of the poverty predicament. Some of the participants who engage in other professions argued that it could have been difficult for them to achieve success if they only relented on their profession without engaged in small businesses.

This section presents the information from the data analyzed using descriptive statistics as a statistical tool. Data is interpreted and stated with the responses below.

### Characteristics of Sampled SMEs

The study covered demographic information regarding both the managers or owners and the enterprises. The managers or owners' information comprises of gender, age and educational level, while the enterprises' information comprised of the business size, age, and insight of the enterprises systems.

**Table 1: Gender distribution according to the respondents**

<i>Variables</i>	<i>Measuring group</i>	<i>Frequency</i>	<i>%</i>
<i>Gender</i>	Male	25	50
	Female	25	50
	Total	50	100

*Source:* Field work 2014

From the Table 1, it was observed that fifty percent of the respondents were males while fifty percent were females. The gender distribution is the same irrespective of the SME owners' or managers' status. McGregor (2008) stated that the gender of a SME manager or owner has an impact or influence on the enterprises. These results also show that men and women are actively and equally engaged in the entrepreneurial ventures in the survey area.

Table 2 indicated that 30.6 percent of the respondents were SMEs owners while 61.2 per-

**Table 2: the position of respondents at work**

<i>Positions occupied</i>	<i>Number of respondents</i>	<i>Percentage</i>
Owner	15	30.6
Manager	30	61.2
Both (Manager and Owner)	5	8.2

*Source:* Field work 2014

cent were SMEs Managers and 8.2 percent were both SME managers as well as owners.

In terms of the age distribution of the respondents, Table 3 shows that most of the respondents who participated were between 20 and 30 years old (40%), two percent were above 60 years old, forty-six percent between 31 and 45 years old, and twelve percent between 46 and 59 years old. As observed above, the majority of SMEs owners or managers are within the age limit of 31-45 years while the category of 60 years has the lowest count. This is a natural situation, but SMEs owners or managers below the age of 30 years are also increasing gradually, which may be due to more business exposure, or the fact that owners or managers tend to retire as they get older.

**Table 3: Age distribution according to respondents**

Age distribution	Number of respondents	Percentage
20-30years	20	40
31-45years	23	46
46-59years	6	12
60-above	1	2

Source: Field work, 2014

In terms of the education qualification, from Table 4, the result indicates that most people who participated hold a secondary certificate (32%), twenty-eight percent have a degree, diploma holder comprise thirty percent, four percent have a primary certificate and six percent have no formal education, which shows that SME owners or managers do have a certain degree of qualification.

**Table 4: Educational level of the respondents**

Measuring group	Frequency	Percent
Primary certificate	2	4.0
Secondary certificate	16	32.0
Diploma certificate	15	30.0
Degree holder	14	28.0
No formal education	3	6.0
Total	50	100.0

Source: Field work, 2014

In terms of the duration of the business, Table 5 shows that majority, that is, eighteen percent of the respondents said their businesses have been operating for one year, ten percent

for two years, fourteen percent for three years, six percent for four years while fifty-two percent for five years and more, showing that the majority of SMEs were older than five years.

**Table 5: Years of business operations according to the respondents**

Years of business operation	Frequency	Percent
One year	9	18.0
Two years	5	10.0
Three years	7	14.0
Four years	3	6.0
Above five yrs.	26	52.0
Total	50	100.0

Source: Field work, 2014

**Research Question 1:** What are the sources of business finance?

Table 6 shows that two percent of the respondents obtained a loan from the government, twenty percent obtained a loan from family, twelve percent obtained a loan from a bank, fifty-eight percent financed their businesses through their personal savings and eight percent financed their businesses with external support.

**Table 6: The source of business finance**

Measuring group	Frequency	Percent
Loan from government	1	2.0
Loan from family / friends	10	20.0
Loan from bank	6	12.0
Personal savings	29	58.0
External support	4	8.0
Total	50	100.0

Source: Field work, 2014

**Research Question 2:** What is the nature and type of the business organization?

In terms of the type of business, Table 7 shows that most people who participated are sole traders who owned the businesses of cash builds and hardware with sixty-six percent, twenty-four percent respondents were in partnership owned printing and clothing store businesses and ten percent respondents in joint venture owned construction businesses.

**Research Question 3:** What are the impacts of SMEs on economic growth and development as well as poverty reduction in South Africa?

**Table 7: Nature and type of business organization according to respondents**

<i>Measuring group</i>	<i>Frequency Percent</i>	
Sole trader	33	66.0
Partnership	12	24.0
Joint venture	5	10.0
Total	50	100.0

Source: Field work, 2014

### ***SMEs Contribution to Employment Creation***

Concerning the employment opportunity, the majority of the SMEs play an important role in the economic development of South Africa. At least twenty percent of respondents had employees between 2 and 10 people. Approximately 13.3 percent respondents employed 6 people and 6.7 percent respondents employed more than 10 people. The respondents also appointed workers by the hour to give work to more people.

### ***Effect of Crime Rate on SMEs***

SMEs also play an important role in reduction of crime. The respondents were asked to rate the crime level in the study area. The result shows that eighty-three percent of people who participated said that the rate of crime is low and only seventeen percent of participants said the crime rate is high. This indicates that establishing more SMEs in this study area would bring about more job opportunities, more income generation and poverty reduction, which will eventually improve the standard of living of the people.

### ***SMEs Contribution to Tax and Value Added Tax (VAT)***

Taxation as one of the government instruments used to improve the socio-economic growth and development in South Africa plays an important role in assisting the government to reduce the rate of poverty and to improve the standard of living in the economy. The majority, that is, seventy-three percent of respondents were not registered for Value Added Tax (VAT), while thirty-three percent registered for VAT. Hence, it is very important to note that taxation will play a crucial role in revenue generation in

order to reduce the rate of poverty in any economy. SMEs in South Africa are prospectively main taxpayers. There is a need for equitable development in order to increase revenues generation in the economy. In particular, poverty improvement in rural areas needs considerable public investment in health, education and infrastructure. This investment has to be solely financed by the government since the public revenues are one of the major sources that the government used to improve and promote the standard of living of the people in the economy. The establishment of more SMEs in the rural areas will contribute positively to the social, economic and development of South Africa to raise revenues required for financing the services demanded by the people and infrastructure that will enable them to flight poverty.

**Research Question 4:** What are the obstacles confronting SMEs in the Rural Social and Economic Development in South Africa?

The following are the obstacles confronting SMEs in the rural social and economic development in South Africa.

### **Access to Finance**

The results indicated that eighty percent of the respondents lack credit access and this places a heavy burden on their businesses. Nieman (2006) reveals that lack of access to finance is often a major problem to the development of SMEs in rural areas. An ample portion of the SME sector may not have the adequate security required for collateral. Thus, majority of SMEs in rural areas rely on the owners' personal resources. Respondents also indicated that rising transport and logistics costs, poor service delivery from the local government, high rent and poor access to market were the major constraints that they face in operating their businesses.

### **Regulations and Rules**

As regards the government's regulations and rules, the finding reveals that thirty-five percent of the respondents indicated that tax and regulations are among the main obstacles in the development of SMEs and an increase in tax will have a negative impact on the people. As a result, this could also increase the rate of poverty.

Some respondents indicated that the majority of SME owners in this area face several difficulties in establishing and developing their businesses as a result of tax regulations. In addition, Kim (2011) viewed these issues as the major obstacles facing the SME owners in the rural areas. He argued further that there are many issues and hindrances confronting the SME owners in establishing their businesses and some of these could be associated to policy, regulatory, and governance environment at the local level, which include unnecessary procedures and regulations, red tape in business licensing and registration. An increase in tax could have an adverse effect on the cost of running businesses and goods produced, and as a result it has the ability to impose large costs on society as a whole. The respondents specify that the regulation is too rigid in the study area and it is too difficult to obtain a license. Moreover, some respondents also specified that some of the obstacles they are facing in this study area include proof of premises and requirements for a large amount of capital. SMEs are also heavily taxed. The finding then shows that SME owners find it difficult to establish their small businesses conveniently.

#### *Lack of Entrepreneurial Skills and Experience*

The study shows that thirty-five percent of the respondents lack business skills, such as business management, financial accounting, cash flow, management skill, and financial knowledge, which are the major obstacles facing the survival rate and operation of small businesses in this area. According to Nieman (2006), most of the SMEs in rural areas lack business skills. He further stressed that these are commonly found among the households, the young as well as the previous disadvantaged people. He therefore said further that better skills could be a way of increasing income for SMEs. Luiz (2002) stated that inadequate management skills therefore have a negative effect on the development and growth of SMEs. Hence, to ensure success for a SME, training alone may not be the most considerable factor, but other factors, such as lack of access to markets, lack of support services, lack of financial resources and others should as well be considered to be restricted issues (Ladzini and Van Vuuren 2002). The acquirement of important scientific and business skills is the most essential factor for the success of SMEs' establishment in order to create a sustainable envi-

ronment or opportunity and to reduce the poverty level in rural areas. It is believed that the contribution by SMEs to create employment opportunities and to reduce the poverty level in this area can be much higher if SMEs have better business skills. Hence, to improve the role of SMEs in this area, it is the responsibility of both, the government and private sectors to provide effective entrepreneurial business skills and relevant training as well as good managerial skills.

#### **CONCLUSION**

This study has contributed immensely to the impact of Small and Medium Enterprises (SMEs) in improving and promoting the rural economic, growth and development in developing countries and shown findings and recommendations. The literature review presented various ground rules within the field of SME finance, marketing, training, managerial skills, business skills, market access, and operating space among others. The main findings of this study showed that lack of proper training, lack of finance, lack of business skills, poor to market access, and lack of operating space are the main obstacles faced by SME owners or managers in order to provide a sustainable and viable businesses as well as conducive business environment. These and others are the main obstacles facing SME owners or managers to increase their contribution in creating more employment opportunities thereby reducing the poverty level to the minimal in South Africa.

A good understanding of the impact of SMEs in creating more employment and to reduce the poverty level in the rural economic development as well as the obstacles faced by the SME owners or managers in South Africa has been clearly identified and discussed in details, and recommendations or suggestions to these impacts and obstacles have also been discussed.

#### **RECOMMENDATIONS**

SMEs are regarded as a medium to address the obstacles in creation of employment and poverty in rural areas of South Africa. They are mostly concerned with absorbing labor, penetrating new markets and expanding economies in creative and innovative ways. The government should increase its efforts in creating a legal environment, which provides SME to flourish. An environment should be made conducive and should attempt to provide sufficient oppor-

tunities to attract investors as well as entrepreneurs including school leavers, matured men and women to be motivated enough to opt to be employers instead of looking for paid jobs.

In order to ensure a smooth operating system of SMEs as a means of creating employment and to reduce poverty in the economy of South Africa, there should be proper harmonization between the local government, provincial government and national government. The government and all its agencies as well as the policy-makers should be involved in the establishment and sustained support to SMEs. This is to ensure that all policies and strategies as well as support programs developed to support SMEs are maintained. The obstacles confronted by the SME owners or managers to create employment opportunities in order to reduce the level of poverty highlighted in the previous section suggest that the government as alone may not have the capacity to promote SMEs without support from others.

The majority of the respondents also recommended that the government should provide financial support in order to expand their businesses and make it easier for them to obtain loans from a bank with an affordable collateral security. Most of the respondents in the business indicated that it is very difficult to get financial support at the beginning of the business, as this could be one of the poverty determinant factors in the economy. Most of the respondents also suggested that the government should organize entrepreneurship workshops, seminars and training, which could improve their business operating skills.

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