SMME Access to Finance in South Africa

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Abstract

Small, Medium and Micro Enterprises (SMMEs) are vital components in the economies of developing countries. In South Africa, SMMEs contribute in excess of 52% towards the GDP. As a result of their importance to the economy, the South African government has taken various steps to encourage SMME growth and to improve the access to finance by SMME entrepreneurs. This process has however been slow and the S.A. government has faced numerous barriers in creating a suitable mutual relationship between the commercial banks and the SMME management. SMMEs have unique finance requirements and commercial banks have faced numerous barriers catering for these specific requirements. Commercial banks have also been reluctant to finance new high-risk SMME ventures. SMME entrepreneurs, as a result, favour informal sources of finance such as personal savings, retained earnings or financial assistance from relatives rather than restrictive and costly bank loans. The research objective of the study was to conduct exploratory research through a survey of 20 SMMEs operating in the manufacturing sector of Pretoria, South Africa to determine their preferred method of finance. The findings of this study indicated that the SMME owners did not choose bank loans as a source of finance nor government funding initiatives at the time of start-up or at the time of expansion. The results indicate that SMME owners did not rely on commercial banks as source of finance. The results further indicated that SMME owners and to a limited extent, commercial banks lack the specific knowledge related to SMME financial requirements regarding commercial loans to SMMEs. The recommendations from the study are that both parties must be educated and provided with a platform where they can exchange requirements and reach a mutual agreement where the needs of both sides are met.

Key Words: SMME’s, start-ups, financial access.
JEL Classification: M130.
1. Introduction

Small, Medium and Micro Enterprises (SMMEs) have gained considerable importance in the economies of developing countries. They are recognised as boosters of Gross Domestic Product (GDP) and economic development. It is also believed that SMMEs may be the solution to the unemployment problem faced by all economies of the world (Fisher & Reuber, 2000). Due to this enhanced role in the economy, governments of a number of countries have started focusing on SMME development in order to promote growth in the economy (Olawale & Garwe, 2010). SMMEs can be gateways to economic prosperity for developing economies, especially South Africa. The South African government has recognised the role and importance of SMMEs in their economy and the Department of Trade and Industry (DTI) and the Small Enterprise Development Agency (SEDA) have taken various measures to provide adequate and appropriate finance for these emerging enterprises.

The main issue faced when defining SMMEs is the lack of a standard definition. Existing definitions of SMMEs vary greatly from country to country (Ardic, Mylenko & Saltane, 2011). Fisher and Reuber (2000:2) outlined the characteristics of SMMEs in developing countries; these were Labour Force Characteristics, Sectors of Activity, Gender of the owner and Efficiency. Single-proprietor businesses are the most commonly found in SMMEs and constitute a large percentage of the workforce in most developing countries. The majority of SMMEs operate in retailing, manufacturing or trading sectors. The proportions of these sectors vary from country to country.

The role of SMMEs in South Africa is further regulated by the government. The National Small Business Act 102 (1992) defines five business categories in South Africa in terms of number of employees combined with annual turnover and gross assets sans fixed property. These categories are described as follows (Abor & Quartey, 2010; National Small Business Act, 1992):

- **Survivalist Enterprise:** The income generated under this enterprise is below the poverty line and the minimum income standard. This category includes vendors, hawkers and farmers.

- **Micro Enterprise:** Micro enterprises have an annual turnover of less than R150,000 per year and generally do not register with the Receiver of Revenue. Micro enterprises employ less than 5 people. The gross assets of these enterprises are generally less than R100,000. Small taxis and home-based businesses are some examples of these enterprises.

- **Very Small Enterprise:** The number of employees in this category is less than 10 with the exceptions of the mining, manufacturing, construction and electricity sectors which may employ 20 workers. These enterprises have access to technology and function in the
formal market. They may have an annual turnover of R200,000 to R500,000. The gross assets of this enterprise may vary between R150,000 and R500,000.

- **Small Enterprise**: Small enterprises may not employ more than 50 employees. These are more established than very small enterprises and have more complex business operations. They have an annual turnover of between R2 million and R25 million and the gross assets range from R2 million to R4.5 million.

- **Medium Enterprises**: Medium enterprises may not employ more than 100 employees, however the limit is increased for electrical, manufacturing, mining and construction enterprises to 200 employees. Medium enterprises differ from the other aforementioned enterprises in the manner of their business structure. These have an upper-management layer and decentralisation of authority which does not exist for the previously mentioned enterprises. Their turnover ranges between R4 million and R50 million with gross assets between R2 million and R18 million (Abor & Quartey, 2010; National Small Business Act, 1992).

Manufacturing forms part of Very Small Enterprises, Small Enterprises and Medium Enterprises. SMMEs operating in the manufacturing sector are encouraged by the S.A. government as this limits the export of raw materials and reduces the importation of manufactured products. The growth of the manufacturing sector further improves the Balance of Payments of a country. In order to grow the number of SMME’s in S.A., SMME’s require access to finance, specifically at start-up and during expansion. This exploratory study investigates where SMME’s in the manufacturing sector obtain access to finance. The paper is structured as follows: the research problem and objectives are discussed in Section 2, followed by a comprehensive literature review (Section 3). The research methodology (Section 4) and results (Section 5) are presented, followed by conclusions, limitations and future research (Section 6).

### 2. Problem investigated and research objectives

Governments of a number of countries have started focusing on SMME growth and development in order to promote the economy and reduce unemployment (Olawale & Garwe, 2010). SMME’s require funding at start-up and during expansions. Governments and the banking industry are sources of such funding. This exploratory study investigates where SMMEs in the manufacturing sector in South Africa obtain financial assistance. Large organisations such as the World Bank and the IMF have taken an interest in the global promotion of SMMEs and the South African government has taken major steps to boost SMME development, yet there are core problems which have not been resolved. The following research problem is investigated in this paper:
SMMEs in the manufacturing sector in South Africa are not utilising governmental and formal sources of finance.

This problem is addressed in this study through the following research objectives:

- To identify the conventional sources of finance for the start-up of SMMEs in the manufacturing sector in South Africa;
- To identify the conventional sources of finance for the expansion of SMMEs in the manufacturing sector in South Africa; and
- To determine the common barriers to formal finance for SMMEs in the manufacturing sector in South Africa which result in forms of informal finance.

A comprehensive literature review is provided in the following section to provide the theoretical basis of the paper and indicate the sources of finance available to SMME’s. The paper will conclude with suggestions for the improvement of formal sources of finance for SMMEs in the manufacturing sector of South Africa.

3. Literature Review

Finance is the lifeblood of any business and access to finance can determine the establishment of a business, specifically SMMEs. It is impossible for a business to function without access to finance (Kunt, Beck & Honohan, 2008). Policy makers and practitioners have thus started paying more attention to the regulation and allocation of finance in such a way that it can be efficient, boost economic growth, reduce poverty and evenly distribute national income. However, such a utopian concept is not obtainable due to the limited range of available financial services. Financial services that do cater for the general population have such strict policies that many fail to meet the eligibility criteria and are thus left without access to finance opportunities (Kunt, Beck & Honohan, 2008).

3.1 Contributions of SMMEs to the S.A. Economy and Government Measures

SMMEs have become vital sectors of national economies due to their contributions to employment, GDP (Gross Domestic Product) and capital formation (IFC, 2010a). Policy makers in developing countries have made SMMEs their primary concern when it comes to the acceleration of the growth-rate. Advani (1997) indicates that SMMEs are potential sources of income and employment, especially in developing countries.

In 2011, SMMEs contributed between 52% and 57% of the South African GDP. An estimate of 61% of employment in South Africa is due to SMMEs (GCIS, 2011). With these benefits in mind, the SA government has taken various measures to boost and encourage SMMEs. Female entrepreneurs are one of the main foci of the SA government. The Small Enterprise Development Agency (SEDA) was created by merging the Ntsika Enterprise Promotion Agency and the National Manufacturing Centre. The Department of Trade and
Industry (DTI) took various measures to establish a framework for the promotion of SMMEs in South Africa. This included the Integrated Small Business Strategy and other agencies which would provide financial services to SMMEs. These institutions were:

- **Khula Enterprise Finance Ltd.**: KEFL provided financial support to SMMEs between R10,000 and R250,000;
- **Small Enterprise Development Agency**: SEDA provided non-financial aid to SMMEs;
- **South African Micro-Finance Apex Fund**: This institution provided micro-finance up to R10,000; and
- **National Empowerment Fund**: This aimed to finance Black Economic Empowerment to increase employment and provide equal opportunities for the black population.

Job creation, as explained above, is one of the major economic benefits derived from SMME development. SMMEs have a comparative advantage over larger enterprises due to their flexible nature as they can adjust to market conditions easily. The low capital cost of SMMEs allows them to succeed in both rural and urban areas. This helps prevent migration to larger cities and can help maintain a stable population density. It also raises the level of the domestic market and makes use of scarce resources. SMMEs also make use of locally available resources and have low production costs which allow the facilitation of long-term economic growth (Advani, 1997). The economic importance of SMMEs can be confirmed by their contributions to the GDP. Some high-income and middle-income countries note SMME contribution as over half of the domestic product. SMMEs also account for a substantial amount of the GDP in low-income countries (IFC, 2010a).

SMMEs are essential parts of a nation that can help them achieve economic and social cohesion as they can be key agents of structural change. Leutkenhorst (2004) claimed that the turbulence created by SMMEs constantly restructured the economy. Since there is freedom of entry and exit of firms, SMMEs are constantly being created. New small enterprises enhance competition, bring innovation and challenge old methods used by enterprises. This motivates older enterprises to refresh their approach and potential SMMEs are encouraged by their success. SMMEs are not only economically beneficial to a nation but also serve social purposes. SMMEs lead to a more equitable income distribution. An equitable income distribution in turn contributes to ensure long-term social stability. SMMEs also help eliminate regional disparities and control rural to urban migration. SMMEs form the majority of the businesses in the private sector and can help boost and encourage the private sector, especially in developing countries (Leutkenhorst, 2004). SMMEs help countries achieve higher income levels and boost employment. These two factors may indicate that not only are SMMEs important components of the economy but also drivers of economic growth (IFC, 2010a).
3.2 SMME Finance

The important role that SMMEs play in an economy has been explained above. However, the many benefits of SMMEs cannot be fully enjoyed until appropriate finance is provided to them and they are allowed to flourish to their full potential. SMMEs require finance to set up or expand operations, develop new products or invest within the enterprise to maintain quality (OECD, 2006). SMMEs start off with one or two owners who either invest their own money or borrow from close relatives or friends. There comes a point for such businesses, where such a mode of finance cannot meet the growing demands of the enterprise and they turn to other sources of finance to service these demands (OECD, 2006). Berger and Udell (2004) recognised six modes of finance for SMMEs:

- **Financial Statement Lending:** In this mode of finance, finance is provided on the basis of the strength of the financial statements of the SMME owner. Two requirements of financial statement lending are detailed audited financial statements, which are informative of the company’s financial practices and a strong financial history, which will be reflected in the financial ratios mentioned in the statements. These conditions aim to ensure transparency and to provide guarantee to the lending institution that the owner will be able to return the amount;

- **Small Business Credit Scoring:** This is a credit facility based on hard information about the owner and the SMME. The owner’s data are mostly personal data like the annual income, financial assets, fixed assets and other outstanding debts. Information about the SMME mainly regards the current and fixed assets, turnover and profit and other liabilities of the SMME. The data are entered into a loan performance prediction model which generates a summary statistic or score for the loan. Financial institutions base the acceptance or rejection of a loan application based on the score generated;

- **Asset-Based Lending:** in asset-based lending, an underlying asset(s) of the firm is taken as collateral. The amount of the loan depends upon the value of the asset. In case of a short-term loan, current assets such as inventory or receivables are taken as collateral whereas for long-term financing, equipment is used. The benefit of asset-based lending is that the financial and personal information of the owner and the SMME does not come under much scrutiny;

- **Factoring:** A lender also known as a factor, purchases the accounts receivable of the SMME. It is similar to asset-based lending as it takes place based on an underlying asset and not the value or financial situation of the SMME and its owner;

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

- **Relationship lending**: Relationship lending tries to go beyond the informational requirements of other modes of finance. The lender gains proprietary data about the borrower over a period of time regarding provision of loan and other products. This information, which cannot be observed from financial statements and other public information, includes data regarding the borrower’s community, business environment and the interaction of the SMME with that environment. This mode of finance however, is labour-intensive and costly (Berger & Udell, 2004).

The IFC (2010b) divided the types of SMME finance into two categories, namely informal sources of finance and formal sources of finance. Informal sources of finance are money borrowed from friends or family or supplier finance. Formal sources of finance may be debt or equity finance. Apart from the aforementioned sources of finance, the IFC (2010b) also recognised two other sources of SMME finance namely **Leasing** and **Private Equity Investors**:

- **Leasing** is an important source of finance for SMMEs as it depends mostly on the SMMEs ability to generate timely cash-flow, rather than on the owner’s personal finances or the SMMEs financial performance. An asset is leased (i.e. possession of the asset is handed over) to the SMME owner, who pays a fixed amount, similar to rent, to the owner of the asset. In case of non-payment, the asset on lease is simply repossessed;

- **Private Equity Investors** are common in small or start-up companies and are known as Venture capital finance. Returns on these equity finances are received through initial public offerings, sale of controlled companies or management buy-backs (IFC, 2010b). The larger companies inject cash and expertise into the smaller controlled companies. Some countries encourage angel investment which is a mode of finance where an Angel Investor invests his personal finance and expertise into an SMME in order to assist and aid in its development. Angel Investors search for SMMEs with high potential and help them grow. Angel investment is an informal source of finance.

### 3.3 Access to Finance definitions

The World Bank used two different definitions in their “Access to finance survey” (World Bank, 2008). These definitions, taken from two sources, will also be used in this paper and will stand true for any further references to “Access to Finance” in this study.
Definition 1:
“An individual or a business is said to have finance when they either have a bank account; use it as their primary financial institution; use mainly non-bank institutions or can reach their financial institution by foot” (Kumar, 2005).

Definition 2:
“Two indicators for access to finance are supply side indicators and demand side indicators. Supply side indicators include the area coverage of the bank, credit distribution, and deposit and branch distribution. Demand side indicators include credit access without a formal loan” (Basu, 2006).

3.4 Indicators of Access to Finance

The World Bank (2005:3) outlined four core indicators of access to finance. These were classified into two dimensions: the institutional dimension and the functional dimension. The institutional dimension includes the following:

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

The functional dimension includes: transactions, savings, loan and insurance (World Bank, 2005).

According to Beck, Kunt and Peria (2007), access to finance relies on three important factors:

- Physical access: This is the access point where financial services are obtained by customers in various convenient ways. An individual has access to finance if he can physically visit the financial institution conveniently.
- Affordability: This is the minimum payment or any other costs incurred by the debtors in return for the services offered by the bank. An individual has access to finance if he has the financial capacity to pay these costs.
- Eligibility: If an individual fulfils the criteria set by the bank in terms of financial status, documents and other personal information then he has access to finance. These criterion need to be made more flexible with better use of risk assessment techniques in order to provide better access to finance.
3.5 Measuring Access to Finance

There are various barriers faced by practitioners when it comes to measuring access to finance. The problems they are faced with are the lack of empirical or unreliable data. The difference further lies between the need and the demand for finance. What needs to be determined is whether the demand for access to finance arises out of a need for financing opportunities or a want (Beck, 2006). Providing access to finance in an area where there is no immediate need would lead to an ineffective financial system and would cause uneven distribution of wealth. Beck, Kunt and Peria (2007) classified access to finance into two ways. Finance can either be in the form of cash or credit and therefore needs to be measured separately using different units of measure. The indicators of the measurement of access to finance as presented by Beck, Kunt and Peria (2007) are indicated in Table 1.

Table 1: Indicators to measure Access to Finance

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

Source: (Beck, Kunt and Peria, 2007)

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

3.6 Formal and Informal sources of finance

Finance can be obtained from two sources in the economy: the formal and the informal sector. The formal sector includes organisations which have been officially registered with the government and have a license giving them permission to carry out business in their respective field (Suchada, Trankler, Cholada & Scholl, 2003). The informal sector on the other hand, can be defined as “that part of the economy that reflects the efforts of people without formal jobs to engage in some form of monetary economic activity” (European Commission, International Monetary Fund, Organisation for Economic Co-operation and Development, United Nations & World Bank, 2008: 529). There is a need for further development of the formal sector of finance in order to facilitate SMME growth and development.
3.7 SMME Banking industry

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

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

The SMME banking industry is in the state of a global transition as it tries to understand this vast and emerging sector of the economy. Commercial banks so far avoided financing SMMEs because they believed that it was “too difficult to serve.” Now that they have started to understand the unique needs of SMMEs they are able to provide customised services for them. In fact, SMMEs have become more valued customers for banks than larger corporations. This is because of the attitude of SMME owners towards banks. SMMEs prefer to be treated as valued customers and are more willing to pay back any credit or loan to the bank on time (IFC, 2010a).

Banks are further faced with various challenges when it comes to SMME finance (IFC, 2010a). First, SMMEs prefer a more personalised form of service and require more attentive services. It is because of this that relationship-lending with banks has become a common trend among SMMEs. These personalised demands need to be met with personalised services which may be costly and unconventional for banks; especially those which have only recently begun to cater to the SMME sector. Banks need to overcome these challenges by keeping costs down and focussing on the most immediate needs. An efficient risk evaluation strategy needs to be developed in order to ascertain which SMMEs require more immediate and justified financing. The International Finance Corporation (IFC) made the following suggestions to banks which were either engaged in or were about to engage in SMME finance. The IFC suggests that banks focus on five core areas:
1. Strategy, SMME focus and execution capabilities;
2. Market segmentation, products and services;
3. Sales culture and delivery channels;
4. Credit risk management; and
5. IT (Information Technology) and MIS (Management Information Systems) (IFC, 2010b:6).
The above suggestions will aide in the financing and development of SMMEs, especially in developing countries. A thorough understanding of the SMME market, effective risk evaluation criteria and better financing opportunities for SMMEs can help speed up the development process of developing countries and contribute substantially to their annual GDP.

3.8 Barriers to SMME Finance

SMMEs have generally lacked appropriate access to finance, especially in developing countries. This is because of the reluctance of banks to take risks when it comes to financing SMMEs (IFC, 2010a). Some issues faced by banks when providing finance to SMMEs are as follows:

- **Information Asymmetry**: Banks rely on accurate information when it comes to financing SMMEs. Information Asymmetry is a situation where the SMME owner knows more information regarding the chances of risk and loss than the bank does. This results in the lending of an amount that may be excessive of the amount primarily required;

- **Granularity**: This is a situation where the banks’ risk assessment systems are incapable of distinguishing between good and bad risks. This results in various measures taken by banks to diminish the probability of risk and loss by tightening the credit terms or increasing prices. This leads to a situation where SMME owners feel that high-risk businesses are being under-priced and low-risk businesses are being overpriced;

- **Pecking Order Theory**: This theory stems from the above two. SMMEs that face lending costs above true-risk adjusted costs would rather opt for other sources of finance that would not cause that much expense;

- **Moral Hazard**: The moral hazard is a situation where the bank accepts a loan application for an SMME. In such a case, the SMME owner might take risks with the money or use it in a manner that the owner would not originally have done. If these risks fail, then the ultimate loss-bearer is the bank; and

- **Switching Costs**: SMMEs may not be willing to switch banks in order to follow the one providing the loan. The costs incurred due to switching of the bank would be more significantly felt when it comes to smaller enterprises (Srinivas, 2005).

3.9 The Missing Middle

The financial demands of SMMEs are of an exclusive nature. Their requirements are too large to be facilitated by micro-finance but too small for long-term corporate loans. This dilemma has created a financing gap for SMMEs which has been termed as the ‘Missing Middle’ (IFC, 2010a). The World Economic Forum started a ‘Missing Middle Initiative’ which explained the characteristics which were missing from financing opportunities for SMMEs. Small and Medium Capital Finance (SMC) was suggested to meet the demands of the SMME sector.
The missing middle has been identified as a new opportunity for the banking sector (Fernandes, Naidoo & Wanjohi, 2010). Several banks worldwide have already identified the opportunities in this new un-ventured territory and the missing middle has already started to shrink. The fastest development in SMME banking has been observed in developing countries where the gap was observed to be the widest.

**4. Research Methodology**

The research objective of this paper was to determine why SMMEs in the manufacturing sector in South Africa are not utilising governmental and formal sources of finance. A questionnaire was developed from literature and comprised of five sections. Section one related to the business, the business owner, the sector, years in operation and number of employees. Sections two to five related to finance: sources for start-up capital, expansion capital, barriers to finance access and lastly suggestions for commercial banks. The questionnaire consisted of open and close ended questions. Descriptive statistics were obtained.

The target population for this study was SMME owners in South Africa. A convenience sample was utilised and comprised of 20 SMME owners who operate in the manufacturing sector. The more established businesses allowed for investigation as to whether the more recent developments in SMME financing by the South African Government had helped finance or create any new financing trends for SMMEs and whether any barriers to finance had been removed by their activities. The data for this paper were collected from SMME owners located in Pretoria at the National Industrial Chamber (NIC) offices during a meeting of SMME owners with their regional manager. The SMME owners were members of the NIC. The data from the open ended questions were thematically analysed.

Personal interviews were conducted with 20 SMMEs operating in the manufacturing sector. The SMMEs operated on average for 6 to 7 years (Min=1; Max=22) and employed an average of 8 people (Min=1; Max =21). Twelve owners were Male and 8 Female. The details of the SMMEs are provided in Table 2.
Table 2: Details of SMMEs used in the Survey

<table>
<thead>
<tr>
<th>Name of Company</th>
<th>Years in operation</th>
<th>No of Employees</th>
<th>Gender of owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 B.L.W</td>
<td>12</td>
<td>5</td>
<td>Male</td>
</tr>
<tr>
<td>2 T.Y.T</td>
<td>5</td>
<td>2</td>
<td>Male</td>
</tr>
<tr>
<td>3 D.T.Co</td>
<td>2</td>
<td>5</td>
<td>Male</td>
</tr>
<tr>
<td>4 D.Co</td>
<td>2</td>
<td>15</td>
<td>Male</td>
</tr>
<tr>
<td>5 G.B.</td>
<td>6</td>
<td>2</td>
<td>Female</td>
</tr>
<tr>
<td>6 B.R.B.Co</td>
<td>2</td>
<td>5</td>
<td>Female</td>
</tr>
<tr>
<td>7 I.B</td>
<td>5</td>
<td>7</td>
<td>Female</td>
</tr>
<tr>
<td>8 C.M.B</td>
<td>11</td>
<td>2</td>
<td>Male</td>
</tr>
<tr>
<td>9 O.T.P</td>
<td>1</td>
<td>2</td>
<td>Female</td>
</tr>
<tr>
<td>10 Di.Co</td>
<td>2</td>
<td>21</td>
<td>Male</td>
</tr>
<tr>
<td>11 E.D.S</td>
<td>6</td>
<td>15</td>
<td>Female</td>
</tr>
<tr>
<td>12 M.P.C</td>
<td>1</td>
<td>1</td>
<td>Male</td>
</tr>
<tr>
<td>13 L.C.P</td>
<td>11</td>
<td>14</td>
<td>Male</td>
</tr>
<tr>
<td>14 A.B.F.C</td>
<td>4</td>
<td>15</td>
<td>Female</td>
</tr>
<tr>
<td>15 T.C.P</td>
<td>5</td>
<td>10</td>
<td>Female</td>
</tr>
<tr>
<td>16 S.G.M</td>
<td>20</td>
<td>7</td>
<td>Male</td>
</tr>
<tr>
<td>17 M.T</td>
<td>12</td>
<td>16</td>
<td>Male</td>
</tr>
<tr>
<td>18 S.F</td>
<td>22</td>
<td>7</td>
<td>Male</td>
</tr>
<tr>
<td>19 M.G.T</td>
<td>1</td>
<td>2</td>
<td>Female</td>
</tr>
<tr>
<td>20 S.S.S.</td>
<td>3</td>
<td>3</td>
<td>Male</td>
</tr>
</tbody>
</table>

5. Research Findings

The results for the barriers to finance showed that the barrier most faced by SMME owners was Difficult Eligibility Criteria of Bank. This was followed by Unfair evaluation of risk and profitability by the bank. Lack of Incentives for SMMEs also showed substantial results whereas the least faced barrier was Inappropriate Amount Allocation. The respondents when asked for suggestions for improvement of SMME finance, the majority indicated Flexible Eligibility Criteria followed by Easier Loan Repayment Options. These results showed that even though newer methods have been introduced for SMME financing in South Africa and that banks are now more aware of the needs of SMMEs with regard to finance, there is still a gap when it comes to the implementation of these ideas and techniques. Better Risk and profitability Evaluation Methods were also suggested by respondents which reinforced the point that there was a lack of implementation of new SMME financing methods. The least observed suggestion was for Proper Amount Allocation.

The research further compared access to start-up and expansion finance. The sources of finance available at the time of start-up and those at the time of expansion were observed to compare the consistency of their use and to see whether any diverse sources of finance were
introduced or differed from each other. Table 3 indicates the percentages occupied by various sources of finance at the time of start-up and at the time of expansion. It was observed that finance obtained from Friends or Family was 10% at the time of start-up but increased to 16% at the time of expansion. This was an unusual observation since it was assumed that at the time of expansion SMME owners would be self-sufficient to expand their businesses or be eligible to apply for a bank loan. Finance from Personal Savings was 75% at the time of start-up but went down to 15% at the time of expansion. This was probably due to the introduction of the new option Retained Earnings which was not available as a source of finance at the time of start-up. Bank loans were very scarcely used being 10% at the time of start-up and then 0% at the time of expansion. Other Sources of finance were 5% at the time of start-up and increased to 15% at the time of expansion.

Table 3: Percentage Comparison of finance at the time of start-up and expansion

<table>
<thead>
<tr>
<th>Source of Finance</th>
<th>Start-up (%)</th>
<th>Expansion (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Friends and/or family</td>
<td>10%</td>
<td>16%</td>
</tr>
<tr>
<td>Personal Savings</td>
<td>75%</td>
<td>15%</td>
</tr>
<tr>
<td>Bank Loan</td>
<td>10%</td>
<td>0%</td>
</tr>
<tr>
<td>Other</td>
<td>5%</td>
<td>15%</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>0%</td>
<td>54%</td>
</tr>
<tr>
<td>Cumulative Percentage</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Table 3 above indicates that the finance obtained from friends and/or family actually increased rather than decreased, which was an unexpected result. The reason for this occurrence could be the collective nature of the South African culture. Collectivism relates to groups or families who are identified as a whole; as opposed to individualism which treats every person as a singular entity. Collectivism and individualism are important cultural traits which affect the way people do business (Murithi & Crawford, 2003).

The respondents were also asked about the barriers to finance that they had faced when they had applied or tried to obtain a loan from a bank or any reason that might have prevented them from utilising the bank as a source of finance. They were then asked to provide suggestions for the improvement of SMME financing. These two were compared to see whether the respondent’s suggestions were in line with the actual barriers they had faced when attempting to obtain finance from banks. This was done in order to see whether SMME owners themselves understood the troubles that they were facing or whether they had any current knowledge of what they actually required from banks regarding finance.
Table 4: Percentage Comparison of Barriers to Finance and Suggestions for Improvement.

<table>
<thead>
<tr>
<th></th>
<th>Barriers (%)</th>
<th>Suggestions (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eligibility Criteria of Bank</td>
<td>40%</td>
<td>35%</td>
</tr>
<tr>
<td>Evaluations of Risk &amp; Profitability by Bank</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>Amount Allocation</td>
<td>5%</td>
<td>15%</td>
</tr>
</tbody>
</table>

Table 4 indicates the barriers faced and the suggestions provided by the respondents. It was observed that 40% of the respondents were faced with the inflexibility of the eligibility criteria as a barrier when attempting to obtain finance from banks. However the suggestions showed that the number went down by 5%. A similar phenomenon was observed in Evaluation of risk & Profitability. 30% of the respondents listed it as a barrier which they faced but the number went down to 20% in suggestions. Proper Amount Allocation was listed as a barrier by only 5% of the respondents. However 15% suggested it as an aspect that needed improvement.

The above results show that even if respondents were faced with a barrier during the time of applying for a bank loan, they would probably not recognise it as an issue that needs improvement. Respondents also faced the issue of prioritising i.e. they did not know which issues were more important than the others or whether the barriers that were faced by them were the ones that needed attention. Instead of opting for the barrier that they had actually faced, some respondents answered with options which may have been conventionally chosen. This shows that there is a lack of know-how regarding SMME financing on the part of SMME owners. Banks have faced problems in catering to them due to a lack of knowledge of their needs and SMMEs are unaware of the facilities that banks actually are able to provide or where the missing links lie.

Most SMME owners did not avail the new incentives provided by the government. Those that did also received finance from an external source (i.e. USAID). It seemed that there was a lack of knowledge regarding the new incentives introduced by the South African Government. The results further showed that there was very little know-how or utilisation of government incentives by SMME owners. Along with this observation it was also observed that SMME owners did not even approach private banks for finance. The surprising aspect of this was reinforced when it was observed that SMME owners did not even obtain loans at the time of expansion when they were eligible for them. This observation proved the findings of previous literature. Banks initially did not provide SMME financing because they were “too difficult to serve” (IFC, 2010). Another indication of the results is that there is also a lack of trust and faith on the part of the SMME owners regarding finance from commercial banks.
The incentives introduced by the South African Government e.g. Black Business Supplier Development Programme, Co-operative Incentive Scheme, Enterprise Investment Programme, SEDA Technology Programme and Support Programme for Industrial Innovation; have good frameworks which are designed specifically to provide finance to SMME owners in a way in which they will benefit the most and can develop their businesses further (DTI, n.d.). The missing link however exists at the point where the SMME owners do not know how to utilise the finances provided by these institutions. Another issue with these financing institutions and government incentives is that the approaches of these governing bodies have been more financial rather than informational, even though Information Asymmetry has been recognised as a barrier to finance in previous literature.

Slow development of SMME financing in South Africa is compounded by the fact that there are no proper scales of measurement to see the demographic distribution of SMMEs in South Africa (Fisher & Reuber, 2000). This lack of demographic data and statistics make policy creation problematic. Developing countries such as South Africa focus more on the development of SMMEs because of their substantial contributions to the economy and the GDP (IFC, 2010a). This development however becomes stunted because estimates cannot facilitate policy creation.

6. Conclusions

The results showed that out of the provided options (Personal Savings, Friends or Family, Bank Loan and Other) the most common source of finance at the time of start-up was Personal Savings which occupied 75% of the results whereas Friends or Family, Bank Loan and Other occupied the remaining 25%. Other was the least common observed source. It was found that 65% of the respondents had expanded their business whereas 35% had not. At the time of expansion it was found that out of the provided options (i.e. Bank Loan, Family or Friends, Personal Savings, Retained Earnings and Other) the most common source of finance was Retained Earnings which occupied 54% of the results. The remaining 45% were equally divided among Family or Friends, Personal Savings and Other, however Bank loan showed no (null) responses.

The respondents were then asked about the barriers they faced when applying for a bank loan at a commercial bank. The results showed that the most common barrier to obtaining finance at the time of expansion was Difficult Eligibility Criteria of the Bank which occupied 40% of the results. Another barrier which took up a substantial amount of the results (i.e. 30%) was Unfair Evaluation of Risk and Profitability by Bank. Lack of Incentives for SMMEs was the third barrier which took up 25% whereas Inappropriate Amount allocation occupied the remaining 5%. Regarding suggestions for improvement of SMME financing facilities by banks, 35% of the respondents suggested Flexible Eligibility Criteria (35%) followed by
Easier Loan Repayment Options (30%). The remaining 35% were occupied by Better Risk & Profitability Evaluation Methods and Proper Amount Allocation.

6.1 Limitations and recommendations for future research

The sample size is a limitation of this research study. However as the nature of this research was exploratory, the findings create a base for future research with a more representative sample. Future research must be done in order to further identify and provide enlightenment on the indication of this research study that SMME owners do not possess the knowledge regarding the banking services provided to them.

6.2 Managerial Implications

The implications of this research paper are that there is a lack of knowledge regarding SMME finance. This lack of knowledge is not only on the part of commercial banks but also that of SMME owners. There was a lack of finance obtained from commercial banks at the time of start-up. This could have been due to various reasons such as ineligibility for a loan or the inability to or unwillingness to pay high interest. At the time of expansion not even one respondent had obtained finance from a commercial bank. This again indicates that there is a lack of knowledge on the part of SMME owners regarding obtaining finance from commercial banks. Lefilleur (2009) and IFC (2010a) described this phenomenon as Information Asymmetry. Information Asymmetry exists on both sides of the argument. On the part of the banks it causes ineffective risk evaluation techniques which were also reflected in the results of this research study. Unfair Evaluation of Risk and Profitability by Bank was observed to be the second-most common barrier to obtaining finance.

The indications of this study are that SMME owners as well as commercial banks lack the appropriate knowledge to receive or provide finance. This has caused a problem in reaching mutual ground where the needs and wants of both sides are identified and satisfied. It is recommended that conferences and meetings are organised where the two sides can discuss their respective issues and reach mutual understanding. This is especially important because the implemented ideas must be based on African culture, techniques and practices. Even though an institute for educating SMMEs was started (The Small Enterprise Development Agency for SMME support), it is not sufficient to meet the needs of all SMMEs all over the country. The South African government will have to set up further institutions or workshops where SMME owners and/or bankers may be educated. There is also a need for a nation-wide infusion rather than focussing only on the larger more developed cities. The South African government will also have to obtain recent and accurate demographic and statistical information regarding SMMEs which can help facilitate policy creation in the future.

The other indication of this research study was that SMME owners have lost faith and trust in commercial banks as a result of past practices and treatments. This was observed from
the results at the time of start-up and at the time of expansion. The South African government or commercial banks should aim to reconstruct the faith of SMME owners in commercial banks. Banks would be required to implement new financing strategies aimed exclusively towards SMMEs in order to help provide them with finance with ease. Commercial banks should also adopt new marketing strategies.

References


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