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*Managing tomorrow*

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Complexities of Accessing Finance from Government Institutions and Its Agencies

**Abstract**

**Purpose:** with the recent establishment of Small Business Development department, the ministry is tasked and will be responsible for ensuring that the business environment is enabling for new Small to Medium businesses. The real issue and the point of interest in researching this particular dissertation is the available literature around the issue of the SME sector which indicates that new SMEs in South Africa do not move from the first stage (existence) to other stages such as survival, success, take off and resource maturity. The study seeks to inaugurate two specific challenges

(difficulties in accessing finance and to examine if there is sufficient non-financial SME incubators and mentorship programs post funding allocation). The area of study focused on SMEs that are concentrated in highly populated areas of Gauteng.

**Methodology:** The study was conducted using qualitative research and a questionnaire was used as a data collection tool. The researcher was able to get valuable information on stakeholders in the SMME sector. This was done through the use of questionnaires to businesses, government funders and incubators.

**Results:** when posed with a question of the start-up capital, a mere 17% responded to having obtained financial assistance from government institutions, 20% from friends and family while a massive 60% indicated they have used own capital to start businesses. When the researcher posed the question of the reasons that often leads to failure, approximately 23% of businesses mentioned lack of working equipment as the core reasons for the business failure while 17% indicated that lack of business opportunities or rather contracts of supply from government departments as the main impeding factor which resulted to failure. In terms of the availability of incubators, approximately 67% of respondents indicated that there were no business incubators available in their areas of business. Approximately 57% of businesses mentioned the inability to obtain loans from government funding institutions was the major business constraint that often leads to failure.

The researcher posed a question to business incubators personnel that participated in the study to gain perspective as to why do they think SMEs fail within the first year of operation. Approximately 40% of respondents alluded that, barriers to entry by big corporates in South Africa force Small and Medium Enterprises out of businesses. Other participants added that the South African government procurement system does not provide opportunities to small businesses due to lack of experience.

All government funding institutions participants mentioned that in most cases SMEs finance applications are rejected due to the fact that businesses fail to present viable business proposals that show the ability for business to remain operating for a long time

**Implications:** The above analysed study findings indicate that there is a huge gap between small businesses and government funding institutions in terms of the awareness of the available financial support to SMEs. From the government perspective, it was indicated that businesses submit business plans that are not viable. There needs to be the middle ground where business plans compilation support currently provided by SEDA awareness should be spread across SMEs operating in the highly populated areas of Gauteng.

**Recommendations:** Access to finance is a major constraint hindering the growth and success of small enterprises. The South African government has established a number of financial support programmes aimed to assist SMEs. With these financial support programmes, most of the SMEs are unsuccessful due to the fact that they cannot easily access those funds and as a result they remain stagnant for a very long time or end up shutting down.

**Conclusion:** The effect of credit rationing is the potential loss of opportunity and or reduction in the scale of a business, neither of which is a desirable outcome. At the most fundamental level, there are lost opportunities for the borrower and the lender. There are implications for the wider economy also. SMEs are a key source of innovation, competition and choice.

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### **List of Acronyms**

GDP: Gross Domestic Product

NDP: National Development Plan

SME: Small Medium Enterprises

SMMEs: Small, Micro and Medium Enterprises

### **Government Institutions**

DED: Department of Economic Development

DSBD: Department of Small Business Development

SEDA: Small Enterprise Development Agency

SEFA: Small Enterprise Financing Agency

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# Chapter 1

## 1.1 Introduction

There is unanimity among business experts, policy makers and development economists that small and medium enterprises (SMEs) are the drivers of economic growth. The significant role of SMEs in developing countries assures their existence as engines through which the growth objectives of developing countries can be achieved. Thus, it is consistently acknowledged that a healthy SME sector contributes prominently to the economy through creating some wide range employment opportunities in different sectors, generating higher production volumes, increasing exports and entrepreneurship skills (Mahembe; 2011). Small to medium enterprises (SMEs) are increasingly seen as playing the significant role in the economies of many countries. Thus, governments throughout the world focus on the development of the SME sector to promote economic growth.

The National Development Plan (NDP) sets out several ambitious goals for the small to medium enterprise (SME) sector, including a target for 90% of employment opportunities to be created by this sector by 2030. Furthermore, the NDP envisages the South African economy growing by at least 5.4% growth per year over the next 15 years (SBP Alert, 2014). The aforementioned economic growth prospects then triggered an interest of finding ways through which the country is to attain the proposed growth aspirations. The potential of the small firms as an engine for growth in developing countries has been extensively acknowledged by global institutions such as the World Bank.

The White Study on National Strategy for the Development and Promotion of Small Business in South Africa (1995) highlighted the fact that “Small, medium and micro enterprises represent an important vehicle to address socio-economic challenges.

The rate of failure amongst small business initiatives in South Africa is remarkable, and much is needed to untangle the causes contributing to such failures. Small businesses play a vital part in the economy and in particular in terms of job creation and poverty eradication in communities they operate in.

It has been observed that small businesses are by nature vulnerable. Although the Small Medium Enterprises (SME) sector creates employment which is good for South Africa, the high failure rate casts doubt on this sector's ability to create sustainable employment in the long term.

There can be no "one size fits all" approach to addressing challenges faced by SMEs. Thus, this study follows a focused approach towards examining the efficiency and availability of South Africa's SME support mechanisms, and will investigate critical obstacles that prohibit Gauteng's high populated areas, focusing specifically on evaluating the effectiveness of early stage support (in the form of access to finance) and availability of SME incubators and support programmes.

Therefore, factors that negatively impact the growth of SMEs need to be reduced. Given this background, it is then important for the researcher to tackle two particular obstacles that are perceived as one of the contributing factors towards the high failure rate of SMEs within the first year of operation.

This study seeks to examine the challenges that the average small and medium scale enterprise faces. The question and the specific focus are to establish possible factors that lead to the failure predominantly in the first year of business. This will take a multi-sector perspective to develop a comparative view of conditions and/or common factors across the selected sectors.

Thus, this study follows a focused approach towards examining the efficiency and availability of South Africa's SME support mechanisms, and will investigate critical obstacles that prohibit Gauteng's high populated areas, focusing specifically on evaluating the effectiveness of early stage support (in the form of access to finance) and availability of SME incubators and support programmes.

Given all the relevant information, the researcher looked at the status quo, role and the capability of the SMEs that they can play in stimulating fundamental socio-economic issues. The researcher therefore, also wishes to capture the SME policy makers and strategists within the public sector, responsible to turn around the SME

GDP contribution to the national economy. The expected outcome is for the decision makers to approach the sector's revitalisation efforts with a different perception of only 'availing funds' but rather also ensuring the necessary support post funding allocation stage. This is expected to serve as the necessary support for the inexperienced SMEs to have access to resources, gain access to markets, improve on product or service quality and possibly lower overhead cost within the initial phases of business operations.

The key in addressing non-sustainability of SMEs is to approach various sectors with specific tools suitable for particular industries. This implies that there are other key significant contributing sectors' factors such as share of employment, output or any other aggregate variables. Thus, the sector's improvement approach should also look at how much difference can make to overall economic performance? It is generally acknowledged that at any level of a country's development, some needed activities involve few or no economies of scale while others involve considerable higher economies of some sort. The size of this distribution is greatly influenced by SMEs. That distribution can also be influenced by international trade.

## **1.2 Research Background**

As Olawale and Garwe (2010) points out, there are many different definitions of business growth and ways of measuring this growth. Business growth is typically defined and measured, using absolute or relative changes inter-alia in employment and productivity. According to Churchill and Lewis (1983) as a new small firm starts and develops, it moves through some growth stages, each with its own distinctive characteristics. Churchill and Lewis (1983) identified five stages of growth: existence, survival, success, and take-off and resource maturity. The Churchill Lewis model gives an acumen into the dynamics of SME growth, including the distinguishing characteristics, problems and requirements of growing SMEs and explains business growth processes amongst SMEs.

Despite the SME sector's significant importance and its contribution to economic growth, SMEs in South Africa (SA), are still faced with numerous challenges that inhibit entrepreneurial growth. Apart from challenges experienced by SMEs in the early

phases of operation in accessing funding (which is the focus of this study) in the public sector finance institutions (government institution, its agencies). The Global Entrepreneurship Monitor (GEM) Reports (2001-2010) noted that SA SMEs also suffer from poor management skills which could be as a result of lack of the availability of SME incubators and adequate support programmes post funding allocation (which is a sub-problem that will be examined in this study). This inter-alia results in high rates of business failure (SA has been according to comparative various studies described as one of the countries that have the lowest SMEs survival rates in the world).

Part of the problem as indicated by SBP (2014) has been the insufficiency of empirical information about South Africa's SMEs. Therefore, the aforementioned challenges mentioned above have made the understanding of this sector. Amid the lack of available empirical information, this has led to policy decisions that are aimed at growing the SMMEs sector to rely on general assumptions in justifying the reasons behind SA's SMEs failure to survive in the first year of operation.

### **1.3 Research Problem**

The fundamental research issues that will be tackled in this study are:

1. Why do average SME fail within the first year of operation within high population areas of Gauteng?
2. How effective are the existing early stage SME support, specifically, the complexities of accessing finance from government institutions and its agencies?
3. Does South Africa have adequate SME incubators and mentorship programmes available within reach for SMEs?
4. What can be done in addition to the government funds allocated to SMME's in order to create an enabling environment that will improve the sector's Gross Domestic Product (GDP) contribution to Gauteng province?

## 1.4 Rationale of the Study

With the recent establishment of Small Business Development department, the ministry is tasked and will be responsible for ensuring that the business environment is enabling for new Small to Medium businesses. The real issue and the point of interest in researching this particular dissertation is the available literature around the issue of the SME sector which indicates that new SMEs in South Africa do not move from the first stage (existence) to other stages such as survival, success, take off and resource maturity. The study seeks to inaugurate two specific challenges (difficulties in accessing finance and to examine if there is sufficient non-financial SME incubators and mentorship programs post funding allocation). The research will be specifically conducted in highly populated areas of Gauteng.

The researcher took into cognisance the importance of establishment and sustainability of new SMEs as vital for economic prosperity of South Africa. Without the creation of new SMEs, South Africa risks economic stagnation. The evident challenges of the formal and public sector to absorb the growing number of job seekers in South Africa, call for an increasing attention to be shifted towards entrepreneurship and new firm creation and its potential for contributing to economic growth and job creation. The study aims to examine various challenges faced by the SME's operating in high population areas in the Gauteng province. The focus will be on:

1. To identify the causes of failure within the first year of business: availability of finance and effectiveness and reach of support institutions closer to SMEs.
2. To reflect on the impact of the SME's difficulties regarding access to funding through government entities and its agencies
3. To highlight the efficiency of the existing early stage support post funding.
4. To develop a perspective in which we can learn from the stated causes.
5. To recommend possible interventions that will suggest how best the existing SME's support mechanisms can be improved to avert first year failure, in order for them to meaningfully contribute to the national economy in the form of job creation and output growth.



## **1.5 Definitions and Scope of Research Focus**

It is important to point out that the Small, Micro and Medium Enterprises (SMMEs) sector comprises of a wide range of enterprises. There are major differences between very small or micro-enterprises and medium-sized enterprises on the other side.

The primary focus of this research study has been on small and medium-enterprises rather than on the micro-sector, and the acronym 'SME' is thus used throughout.

According to Falkena et al. (2001), the very often unstated, yet powerful assumption that is often made is that small and medium enterprises are affiliated to micro/survivalist enterprises. This is inaccurate and misleading, particularly regarding the financial products related to debt, equity, and financial services. In practise, SMEs have different financial needs depending on the nature of the company, whether the firm is retail oriented or production oriented, the margins on the products, the inventory turnover, and whether they are truly seeking to be growth oriented enterprises. Additionally, SMEs also have great many other needs, which in some cases outweigh their need of finance.

The researcher, acknowledges that there is no generally agreed or universally applicable definition of SMEs. Numerous factors, related to a given socio-economic environment, influence the definition of SME. Therefore, it is critical to define the precise meaning of the terms used.

### **1.5.1 Small, Micro and Medium Enterprises Definition**

The most widely used framework in South Africa is the definition of the National Small Business Act, which defines five categories of business, however for the purpose of this research study, three categories will be defined and each category is depicted as follows:

- Survivalist enterprise: The income generated is less than the minimum income standard or the poverty line. This category is reflected as pre-entrepreneurial,

and includes hawkers, vendors and subsistence farmers. In practice, survivalist enterprises are often categorised as part of the micro-enterprise sector.

- Small enterprise: The upper limit is 50 employees. Small enterprises are generally more established than very small enterprises and exhibit more complex business practices.
- Medium enterprise: The maximum number of employees is 100, or 200 for the mining, electricity, manufacturing and construction sectors. These enterprises are often characterised by the decentralisation of power to an additional management layer.

Therefore, the National Small Business Act's definitions of the different categories of business may be summarised as set out in Table 1 indicated below;

**Table 1.1: Definitions of SMMEs as provided in the South Africa's National Business Act**

Number of Employees	Enterprise Size	Annual Turnover	Gross Assets, excluding fixed property
Fewer than 5	Micro/survivalist	Less than R150 000	Less than R100 000
Fewer than 50	Small	Less than R2 million up to R25 million, depending on the industry.	Less than R2 million up to R4,5 million depending on industry
Fewer than 100 to 200 depending on the industry	Medium	Less than R4 million up to R50 million, depending upon industry.	Less than R2 million to R18 million, depending upon industry.

Source: National Business Act, 1995, p.65

### 1.5.2 Business Incubators Defined

As mentioned by Tambudze (2012), a business incubator is defined as a programme designed to assist a business in its development and growth phase. Throughout the programme the business owner(s) or entrepreneurs usually receive support in the form

of equipped working space, coaching, mentoring, and guidance, access to networks, finance and education, depending on the specific programme.

### **1.5.3 Definition of a Financial Institution**

Financial institution is defined as an enterprise specialising in the handling and investment of funds (as a bank, trust company, insurance company, savings and loan association, or investment company). Given these definitions and scope of the research focus, it is important to provide a brief preliminary literature review expanding the research problem.

### **1.6 An Overview of Preliminary Research: Context**

The SBP's Growth and Competitiveness report (2014), cites that growing firms generate employment and support the expansion of a country's economy as a whole. Growing the number of SMEs in the economy, and fundamentally growing the size of existing SMEs, are both vital intentions for South Africa's future prosperity.

The article titled 'The importance of SMEs in the economy' dated 2012, found on the villager's website reiterates the role SMEs play in contributing to output by partaking in the mainstream economy and to the creation of some "decent" jobs especially to the few that runs the SMEs in highly populated areas.

According to Department of Trade and Industry estimates indicated that approximately 80% of new job opportunities created in South Africa are in the SME sector, accentuating the importance of small enterprises to the country's future prosperity. Conversely, it is estimated that up to 35% of these jobs are lost again within two years. Timm (2011) cites that "SMEs in South Africa have a disreputably low survival rate. Even those that survive often end up hanging onto the lowest rung of the cash-based economy rather than developing into businesses that can compete successfully in a globalised economy."

What this intends on a broader scale is that SMEs in South Africa are faced with a number of challenges including increasing competition from global companies and a shortage of management capacity and technical skills. This then push local SMEs to compete on the basis of low cost rather than on quality and efficiency because they don't have the management or technical skills they need to cross over into higher-end markets (Makatiani, 2010). The aforementioned multi-faced challenges are as a result of SMEs obstacles in accessing the money and support they need for growth, leading to few of them expanding into self-sustainable businesses that have the potential to export surplus goods or services outside the South African markets.

The small businesses policy comparison study between South Africa, India and Brazil conducted by Timm (2011) states that all three countries have specific policies aimed at small businesses. It is cited that South African small business policy is mostly guided by the white study strategy while the other countries passed legislations which were specially targeted at boosting small business sectors.

Despite the country's similarities of available institutions and agencies at the government level, Timm (2011) points out that in comparison to India and Brazilian financial and business support systems, South Africa has an extremely rigid support system matrix. In the SA's case funds are distributed across various departments and agencies while in Brazil, for instance, funds are dispersed through one agency. The multi-dimensional funding institutions milieu creates an ineffective support system when it comes to strategic coordination and therefore, results in insignificant growth of the small business sector.

### **1.6.1 Small Business Support in South Africa**

The South African government has established various small business support initiatives aimed at boosting the performance of the sector. However, the SBP (2009) small businesses support system research findings indicate that, both the high end enterprise development and the encouragement of the existing SMEs to grow support given shows "less success than intended" performance. The "less than" expected effect in growing the sector then necessitates the need to change the

approach of creating the enabling environment for small business to thrive at a much higher rate than it currently does.

## **1.7 Synthesis**

The study only focuses on the complexities of accessing funding in government entities and its agencies and examining the existence or shortage of SME incubators and mentorship programmes available to small businesses past the allocation of funding. Further, the study focuses on the SME's operating in highly operated areas of Johannesburg. The study will therefore be confined to this particular topic and SME sector.

The remainder of the remaining chapters will cover the following areas;

### **Chapter 2: Literature Review**

The Literature Review will be detailed in a deeper context to bring to the fore related information specific to SME sector of my research interest.

### **Chapter 3: Research Design and Methodology**

Research Methodology: this chapter will detail steps and processes of getting to the desired objective of the study, by reflecting approach, design, and target research participants. The chapter will outline the limitations encountered and provide a brief methodology summary or conclusion.

### **Chapter 4: Research Findings and Analysis**

Provide statement of data findings, analysis, and discussion of these findings. Findings will be discussed in more detail. Comparison and linkages of the research finding will be done.

### **Chapter 5: Policy recommendations and conclusions**

This chapter will mark the final closure of my thesis and will take the opportunity to present my policy recommendations and conclusions on my problem statement

## **Chapter 2**

### **2.1 Literature Review**

The analysis that will be provided in this chapter involves the analysis of available SMEs related policies/strategies both at national and at provincial level. These policies/strategies provide the SME blueprint for the country and will particularly provide the vision that the South African government has with regard to continuously improving the performance of the sector.

### **2.2 Importance of SMEs in the Economy**

As noted by Ramukumba (2014), given that SME are given financial injections in order to expand, such entities have the potential to have an immense potential to expand into large enterprises that would improve various sectors of the economy, thus, contributing to the broader economy in the context of inter-alia, job creation and the Gross Domestic Product (GDP) at large.

According to (Rao, Metts and Monge, 2003: 13) SMEs are the pioneers of creating jobs rather than those growing by larger businesses. Thus far, SMEs have been predicted to having contributed 37% to employment in South Africa (Soontiens, 2002: 712; Barry & Milner, 2002: 316). From a developmental perspective, Moodley (2002: 37), stipulates that the presence of SMEs lead to multiplier effects on the socio-economic activities of a country which in turn generate developmental activities of a country.

The roles played by the visibility of SMEs in developing economies, as described by (Lloyd, 2002; Chaston, 2000 and Barry and Milner, 2002) consist of the following contributing factors:

- Equitable distribution of income.
- Testing ground for new products.
- Widely facilitates innovation.
- Encourages competition within various national economies.

Ramukumba (2014), emphasises that SMEs, in the context of African economies, promote job creation, mitigation of poverty and economic growth.

### **2.3 Gauteng's SMEs Landscape**

The Gauteng Department of Economic Development compiled a policy framework that aimed to address major business constraints facing small businesses in the province. Within the policy framework, the critical factors affecting business operations and to be precise, prohibiting growth factors on the SMEs operating environment in the province.

A survey was conducted on small businesses and the most prominent challenges that most of the businesses indicated as limiting to growth was lack of capital. The second most common problem faced by businesses in Gauteng province, is the issue of crime. Approximately 39% of the businesses who participated indicated that they would like to expand their profits and margins. The major issue which then arises is, is the environment conducive for that?

The later sections of this study, will further detail main challenges facing Gauteng SMEs and for those that have closed down, focus on those factors that might have led to the failure of businesses.

### **2.4 An Overview of SMEs Related Policies**

#### **2.4.1 National Development Plan 2030**

The National Development Plan (2011), acknowledges that the State's efforts of assisting the sector have had limited success. The plan mentions various prohibiting factors limiting significant growth of the sector which includes, inter alia, policy environment that traditionally favours concentration on large corporations and the support structure that focuses on creating global trade environment which, at that level, encourages and rewards economies of scale and scope in both production and distribution.

This creates gaps and unfavourable environment for small business that cannot compete on that level. This could then be one of the problems which phases out SMEs as they might not have all the resources that will promote business to grow into that level. Thus, the NDP (2011) explains that large companies are already established and recognised, they have supply chains across the country, and they are therefore able to sell their products at lower prices smaller businesses cannot match.

Moreover, the NDP (2011) suggests that understanding issues facing SMEs and recognising the diversity of the sectors that these entities operate in is essential. An insightful knowledge of such challenging factors that lead to the inability of SMEs to grow will determine the kind of assistance needed by the sector and the interventions required.

More importantly and fitting to this study, the NDP (2011) also suggests that the focus falls on SMEs that have failed and propose that the policy makers and other relevant stakeholders create the mechanism that will address this challenge.

Key proposals made by the NDP included but not limited to the following;

- Access to debt and equity finance: this proposal suggested that the state and its agencies re-examine its role in easing access to finance to start-ups and emerging businesses. Additionally, the plan points out the necessity to consider measures to reform mandates and operations of development finance institutions in line with the existing initiatives that have already been undertaken.
- Small business support services: The suggested improvement approach is to consolidate and strengthen the existing structures.

Subsequently, the identified challenges and proposals are intended for the envisaged potential of the sector to generate the majority of 11 million jobs needed by the economy by 2030. In practical terminology, South Africa needs 49 000 scalable SMEs



growing at a rate of 20% per annum to meet the set job creation target (SME South Africa, 2015).

#### **2.4.2 White Study on National Strategy for the Development and Promotion of Small Businesses in South Africa**

According to Krog (2007: 19) government formulated the White Study on national strategy for the development and promotion of small business in South Africa in March 1995 to foster an environment in which small and medium enterprises could operate.

According to the Department of Trade and Industry (Integrated, 2005: 4), the strategy includes but not limited to:

- Facilitating access to information and advice;
- Facilitating access to affordable physical infrastructure;
- Facilitating access to appropriate technology;
- Capacity building and institutional strengthening; and
- Facilitating access to finance.

#### **2.4.3 Gauteng SMME Policy Framework (2010-2014)**

The main objective of the Gauteng SMME Policy Framework was to develop an economic strategy towards accelerated and sustainable shared growth for Gauteng using entrepreneurship as a pathway.

The SMME Policy Framework as outlined in a document proposed a six-pillar framework in order to address challenges faced by SMMEs, these are:

- Research on specific sectors and the role of SMMEs in building partnerships;
- Capacity building initiatives;
- Financial entrepreneurial support initiatives;
- Nonfinancial entrepreneurial support initiatives with a particular focus on entrepreneurial training;

- Regulatory reform and supporting the informal economy SMME sub-sector; and
- Employment retention and linking with the National Training Layoff Scheme.

## **2.5 The State of South African SMEs at a Glance**

Entrepreneurial activity is a significant indicator of the future of SMEs, since the small business owners of tomorrow are today's entrepreneurs. The occasional study of Parliamentary Liaison Office (2014) states that although South Africa has made many efforts to assist SMMEs, the current atmosphere is one in which running a small business is difficult and risky, and the failure rate is high. Trade and Industry Minister Rob Davies has acknowledged that five out of every seven small businesses in South Africa fail within one year.

In its 2014 report on growth and competitiveness for small business in South Africa, private sector development and research company SBP conducted a study of 500 small and medium enterprises from various industries. The research findings indicated that owners strongly believed that the business environment is unfavourable to their operations, with 71% of respondents saying that it became harder to operate a business in South Africa in 2013, while only 9% said it became easier. They identified the chief impediment to growth as lack of finance.

For the purpose of this research, the focus is on identifying specific challenges that SMEs face and thus contribute to the current high failure rate in the first year of operation. The section to follow will provide a brief overview of what is holding South Africa from thriving beyond the first year, as in comparison to the United States 70% of small businesses survive at least two years, according to the U.S. Small Business Administration.

## **2.6 What Could Be Holding South Africa's SMME Sector?**

There are several dynamics working against SMME success in South Africa and if the country hopes to embolden small business growth, it will have to make momentous

changes. With the newly established Department of Small Business, some of the wide-ranging challenges will fall within the' domain and some will not. The most pressing challenges relevant to the research topic are briefly discussed below.

### **2.6.1 Early stage Support in the form of SME incubators**

Simple support measures that currently lack in South Africa's SME's include, pertinent non-financial provision such as mentorship. Therefore, limited number of business incubators in South Africa limit options for early-stage businesses. The existence of SME incubators can offer mentorship, tax advice, and business guidance. Incubators can help nurture emerging business ideas into successful start-ups. The current incubation programme is according to Willis (2004) a step in the right direction, but it is being operated on a small scale.

The department should look to expand the existing programme with substantially more investment. It should also make it more accessible and able to better reach potential business owners by expanding its geographical reach and having a bigger presence in townships.

### **2.6.2 Difficulties in Accessing Finance**

According to Naudé (2013), complexities encountered by SMEs in accessing finance is one of the major contributing factors contributing to the failure of SME's in the first year of operation.

According to Maye (2014), current government assistance to small business is multifaceted and difficult to navigate. The 2012 establishment of the Small Enterprise Financing Agency (SEFA) was a step toward simplification, but more is needed. SEFA is housed under the Department of Economic Development (DED), while Small Enterprise Development Agency (SEDA) is part of the Department of Trade and Industry (DTI). The creation of the Department of Small Business Development (DSM) could potentially further provide clear guidance on which government institutions must the SME's approach in order to get appropriate assistanc

### **2.6.2.1 Incubation Support Programme (ISP)**

According to the DTI, this grant is aimed at initiating entities to enable them to develop incubator programmes and thereby create employment within communities and in turn strengthen the economy. Moreover, the programme is intended at encouraging partnerships between the private sector, SMEs and Government in order to create sustainable growth within the economy by creating these incubator programmes.

The DTI further explains that the ISP is available on a 50:50 cost-sharing basis between the government and the private sector. One of the conditions outlined in this incubator programme also cites that the ISP must offer the SME a cost-sharing ratio of 60:40. This is capped at R10 million a year for three years. The ISP also provides mentorship to develop the necessary services and **grow** the entity. The ISP lasts for two to three years in which time the incubator should become self-sustainable.

According to the DTI, benefits of the incubator include covering costs that the ISP incur which include the business development services, market access, machinery, equipment as well as tools, the infrastructure of the entity have to do with the creation of the incubators, feasibility studies, product or service development, as well as operational costs.

## **2.7 The role of Business Incubators in the Context of SMEs**

As noted by Musewe (2012), government is a significant role player in creating a conducive environment for SMEs as previously alluded to. Moreover, Musewe (2012), also points out the African governmental structures often become obstructive due to, inter alia, unfavourable national policies which end up relegating SMEs while creating market opportunities that big business exploit with ease.

Collectively, such factors transcend into struggling SMEs which fail to grow to the point of becoming competitive on a global scale. Similar to the worldwide approach, South Africa also used various approaches along the spectrum of private-sector to government reforms and improvements that have been advocated to rectify these

difficulties. Musewe (2012) argues that while some of these approaches have been supportive, there is a current model that is enabling thriving SMEs to realise their dreams of building healthy start-ups: the business incubator.

According to Zasiadly (2010; 3), a business incubator model includes the provision of the following;

- management guidance;
- technical assistance and consulting tailored to young growing companies;
- access to appropriate rental space and flexible leases;
- shared basic business services and equipment;
- technology support services; and
- assistance in obtaining the financing necessary for company growth.

Liming (2009) cites that business incubators are especially active in particular sectors which are relatively but not limited to, technology-intensive operations. Enterprises targeted under such schemes are typically small start-up companies which require support in terms of finance, technology and marketing in order to survive and grow their businesses.

To be more precise, the core rationale of establishing business incubators is to increase the chances of an incubate firm surviving its formative years and to “nurture the development of entrepreneurial companies, helping them survive and grow during the start-up period, when they are most vulnerable (Liming, 2009; 152).

### **2.7.1 The Business Incubator Model**

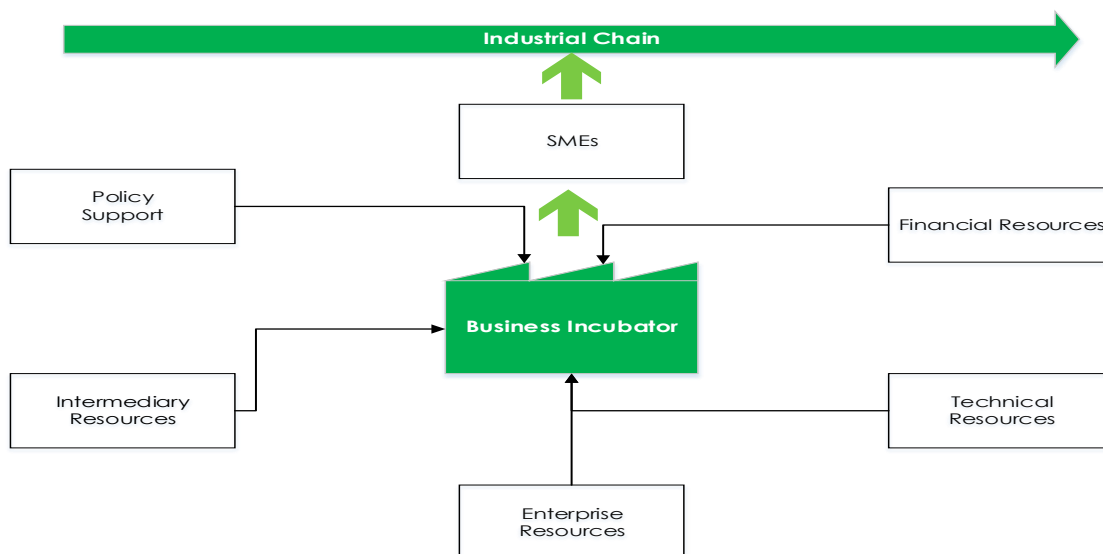
According to Soni (2005), the business incubator model has been in existence for several decades, however, it has gained significant momentum in recent years. During the course of its history, it has been applied to a variety of industries, along the way compelling constant adaptation. It is estimated that there are currently 7,000 incubators across the world (Musewe, 2012).

The identified primary role of business incubator is described by Forrest (2014) as the process of drawing from businesses' physiological counterparts, an incubator nurtures a business through its "childhood" stage. Musewe (2012) states that incubators tend to offer support services and resources, such as networks, finance, office space and mentorship to local start-up businesses. Musewe (2012) further elaborate that business incubator's core objective in offering support services to SMEs usually geared towards developing entrepreneurship, growing particular industries, creating jobs, retaining business and economic diversification, all within a particular locale or community.

### 2.7.2 Core Functions of Business Incubators

As noted by Liming (2009), the core function of business incubators is to upscale businesses that are in the early stages of operation and to show the importance of cooperation between institutions and organisations to support SMEs. Liming (2009) also cited the example of China where the presence of business incubators has resulted in commercialisation rate of, specifically, the fruit sub-sector which as a result dramatically increased, from national average of 30% to over 80%. The survival rate of technology enterprises also increased considerably, after the incubation and nurturing in incubators, thereby resulting to the survival rate of small start-ups that generally exceeded 80%.

**Diagram 2.1: Core Functions of Business Incubators**



Source: Liming, 2009, Pg.15

As can be noted in Diagram 2.1, it takes collaborative strategy to have an optimal functioning incubators that are available within. They equip it enables the ability to tackle difficulties facing the SMEs during the first year of operation. It takes various factors such as policy support, financial resources, enterprise resources, etc. to support multi-sectorial SMEs. Each factor plays a significant role in assisting SMEs to reach maximum potential that will fundamentally transform SMEs into becoming large entities.

### **2.7.3 Significant Business Incubators Success Stories: African Cases**

Establishment of business incubator is a collective strategic initiative that is usually steered by governments in the form of providing funds and initiating growth enhancing programmes that are sector development specific. On a broader African context, significant recognition of the importance of adopting business incubator models as one of the support mechanisms for SMEs is making a difference to businesses still in early phases of operation. According to Kelley (2012), various forums initiated by governments across the continent, contribute significantly to the incubation processes.

The examples of such initiatives include, the Economic Community of West African States (ECOWAS) and New Partnership for Africa's Development (NEPAD) which committed EUR 1,000,000 (US\$ 1,250,860) to the Business Incubator for African Women Entrepreneurs (BIAWE) project (Musewe, 2012). This project provides business support structures, promotes entrepreneurship and secures funding for women entrepreneurs from rural areas who work primarily in agriculture.

Given the aforementioned overview of business incubators across Africa, it is important to bring the study focus back to the South African progress that has been made with regard to business incubators.

## 2.7.4 Availability of Business Incubators in South Africa

Based on the South Africa's SME performance indicators and Africa's economic scenarios in general which mention that lack of conduciveness in business environment pose serious challenges to the establishment and growth of SMEs (Humala, 2013). Business incubators have the potential to be used as one of the tools that can be used to meet the needs of SMEs and so present a viable means of rectifying growth challenges. According to Musewe (2012), business incubators offer adaptable models that can be employed by government.

Even though, business incubators are yet to be fully exploited by government and the private sector alike for their full economic growth, cognisance of their connotation as interventions for SME growth is progressively growing. For the purpose of this study, a closer look at the spectrum of available business incubators as the support system for South African SMEs is given.

**Table 2.3: List of Business Incubators in South Africa**

Incubator Name	Focus	Information Details	Location
1. Aurik	Start-ups	<a href="http://www.aurik.co.za">www.aurik.co.za</a>	Johannesburg
2. African Rose	Emerging essential oil farmers and agro-processing	<a href="http://www.africanrose.co.za">www.africanrose.co.za</a>	Pretoria
3. Chemin	Start-ups in the chemical industry in Port Elizabeth, Kwa-Zulu Natal, East London and Midrand.	<a href="http://www.chemin.co.za">www.chemin.co.za</a>	Port Elizabeth, East London, Kwa-Zulu Natal, Midrand
4. The Downstream Aluminium Centre for Technology	Small enterprises in the aluminium casting industry in Richards Bay	<a href="http://www.dact.co.za">www.dact.co.za</a>	Richards Bay
5. Egoli Bio	Start-ups involved in life sciences and biotechnology ventures	<a href="http://www.egolibio.co.za">www.egolibio.co.za</a>	Johannesburg



<b>Incubator Name</b>	<b>Focus</b>	<b>Information Details</b>	<b>Location</b>
6. Furntech	Small enterprises in the furniture manufacturing sector	<a href="http://www.furntech.org.za">www.furntech.org.za</a>	Cape Town and George, Durban, White River, Umzimkhulu, Johannesburg, Mthatha
7. The Innovation Hub	Start-ups in the knowledge-intensive, green economy information, sustainable development, communications technology, bioscience, electronics and advanced manufacturing	<a href="http://www.theinnovationhub.com">www.theinnovationhub.com</a>	Pretoria
8. Shanduka Black Umbrellas Small black businesses	Small black businesses	<a href="http://www.shandukablackumbrellas">www.shandukablackumbrellas</a>	Cape Town, Johannesburg, Pretoria, Durban, Mooinooi, Port Elizabeth, Lephale, Richards Bay
9. Mpumalanga Stainless Initiative	Small enterprises in the manufacturing sector	<a href="http://www.mpstainless.co.za">www.mpstainless.co.za</a>	Mpumalanga
10. Mobile agri-skills incubator	Small agricultural enterprises in Mpumalanga	<a href="http://www.masdt.co.za">www.masdt.co.za</a>	Mpumalanga
11. The Seda Nelson Mandela Bay incubator	Small Information, Communications and Technology enterprises in the Eastern Cape.	<a href="http://www.snii.co.za">www.snii.co.za</a>	Port Elizabeth
12. Raizcorp business incubator	Provides full business support to drive entrepreneurs to profitability.	<a href="http://www.raizcorp.com">www.raizcorp.com</a>	Johannesburg, Witbank, Uitenhage, Rustenburg, Richards Bay, Durban
13. Lepharo	Copper, Zinc and Base Metals.	<a href="http://www.lepharo.co.za">www.lepharo.co.za</a>	Johannesburg

Incubator Name	Focus	Information Details	Location
14. Mapfura Makhura Incubator (MMI)	Bio-fuels plant production & processing.		Mpumalanga

Source: Small Business Connect, 2015, Pg.2

Table 2.3 shows that there is a significant number of business incubators in South Africa, offering support to different sectors in the form of both financial and non-financial support system. The effectiveness, awareness and the impact these available resources for SMEs operating in the province of Gauteng will be thoroughly examined in chapter 3.

## 2.8 SMEs Demand for Finance

To grow, SMEs need the proper entrepreneurial business environment (EBE) that allows them to access financing, human capital, networks, innovation and international markets.

For a country like South Africa where the SME sector plays a substantial role in addressing socio-economic challenges, identifying SME prohibiting growth factors have become crucial for identifying intervention areas. This has become a priority objective for governments of industrialised and developing countries alike.

Due to such, the South African government has benchmarked the performance of this sector against the global economy and understands the importance of providing fertile ground for all types of SMEs to spawn and grow.

To clearly show this, Table 2.2 indicates typical SME growth phases and financial requirements in the chosen first world country, the United Kingdom (UK).

**Table 2.2: SME Growth Phases**

Type of SME	Start-up Phase	Growth Phase	Stable/consolidation	Exit
High potential, possibly exporting business	Team's equity, venture capital, etc.	Venture capital, private equities, asset backed	Often none, but debt if required	Either exit via Capital markets, direct access to

Type of SME	Start-up Phase	Growth Phase	Stable/consolidation	Exit
		finance structure, etc.		competitive markets
High-technology, information, life sciences and intellectual property	Team's equity, venture capital, etc.	Venture capital, private equities, asset backed finance structure, etc.	Venture capital; high-yield debt market, bank debt	Exit typically via trade sale
Traditional small businesses.	Friends, family, loans, equity in property equity.	Asset backed finance, factoring, bank debt, trade credit, government backed financial and non-financial support.		n/a

Source: Felkana et al., (2001), Pg.30

As indicated in Table 2.2 above, the nature of funding required by an SME depends on its development phase. Businesses in the start-up phase generally rely on personal savings, friends and families, while those businesses which are much more stable rely on bank loans for financing.

## 2.9 Examining SMEs finance gap in South Africa

According to Mahembe (2011), the term “financing gap” refers to a situation where a sizeable proportion of economically significant SMEs cannot obtain financing from development finance institutions, banks, capital markets or other suppliers of finance. It is often alleged that due to structural characteristics, the formal financial system does not provide finance to such entities. To adequately address the question of whether there is difficulty in accessing SME finance or not. Table 2.1 will indicate trends of SME financial applications and the funds that were actually approved for the period of 2010.

In alluding to the aforementioned finance gap definition provided above, only formally registered SMEs can apply to finance institutions, leaving informal SMEs being

excluded from receiving any sort of financial assistance from all finance institutions. Table below indicates the National Credit Regulator supply side versus demand side SME financing gaps survey that was done in 2010.

**Table 2.1: Financing Gap-Formal and Informal SMEs: 2010**

Description	Loan Application Survey
Registered SMEs (Formal)	1034 455
Average SME loan applicants	873 080
Average loan application success rate	343 439
Average funds allocation after successful application	93 759
Total Formal SMEs	5 979 510
<b>Financing Gap</b>	<b>779 321</b>
Total informal	2 334 439
Less: unaccounted informal served SMEs	357 169
Total financially excluded informal SMEs	1 977 270
<b>Total Estimated Financing Gap: Formal and Informal SMEs</b>	<b>2 756 591</b>

Source, National Credit Regulator, 2011, Pg.9

As can be noted from Table 2.1, in 2010 approximately 873 080 of SMEs apply for finance in financing institution, however, only 93 759 SMEs were successfully allocated funds.

What can be deduced from Table 2, 1 is the fact that various surveys of SME financing “strongly suggest that business owners in South Africa view access to financing as a significant problem for business activity” (Turner et al, 2008: 15), this is despite various public and private sector initiatives to facilitate access to financing.

Furthermore, FinScope survey (2010) cited that small business respondents from the survey mentioned lack of access to finance as a reason for lack of growth in their businesses.

## **2.10 Supply Side: Government Funds Available to SMEs in South Africa**

Khan (2014) explains that the South African government has attempted to provide such support via a few mechanisms, namely provision of grant funding and soft loans, tax incentives for entrepreneurs and big business who work with entrepreneurs, etc.

For the purpose of this study, the point of focus will be on the available financial support that government provides to SMEs.

### **2.10.1 Department of Trade and Industry**

The Department of Trade and Industry (DTI) is one of the pioneering government departments that support SMEs in the country. In this sub-section, its numerous financial support initiatives in various sectors will be explained.

Several grants are available to SMEs in different sectors. The DTI has various programmes and grants in place to encourage new SMEs and to create employment in the country. These are summarised below.

#### **2.10.1.1 The Black Business Supplier Development Programme (BBSDP)**

Khan (2014) explains that this is a grant that encourages black businesses to grow by acquiring assets and operational capacity. The BBSDP allows for a maximum of R1 million investment to a 51% black-owned entity of which 50% of management must be black, Blacks in South Africa are defined as a “generic terms which mean Africans, coloureds and Indians who are South African citizens by birth or who have obtained citizenship prior 27 April 1994” (South African Government, 2005). The R1 million is divided as follows:

- R800 000 is given to entities, of which R400 000 is funded by the DTI and the remaining amount is to be contributed by the entity and is used for machinery and equipment.
- The remaining R200 000 is to be used to develop the business contributed in the ratio 80:20 between DTI and the recipient.

### **2.10.1.2 Technology and Human Resources for Industry Programme (THRIP)**

This scheme was specifically introduced and implemented to increase the high level of technical skills for the industry and enhance South Africa's competitive edge through the development of technology. THRIP is a project between DTI and the NRF (National Research Foundation).

THRIP aims to develop these SMEs into large companies, expanding the networks and allowing these SMEs access to scientific expertise, equipment and facilities at partner research entities.

### **2.10.1.3 Clothing and Textile Competitiveness Improvement Programme (CTCIP)**

According to the DTI, this is a grant designed for the clothing and textile manufacturing industry. The DTI explains the programme that is intended to build capacity among manufacturers and in other areas of the apparel value chain in South Africa. The goal is to enable the entities to effectively supply its clientele and to compete on a global scale. Such competitiveness incorporates issues of cost, eminence, tractability, reliability, adaptability and the capability to innovate. The allocation of this grant is divided as follows:

- *Year 1: 100% Investment grant*
- *Year 2: 95% Investment grant*
- *Year 3: 90% Investment grant*
- *Year 4: 80% Investment grant*
- *Year 5: 70% Investment grant*

### **2.10.1.4 Enterprise Investment Programme (EIP)**

According to the DTI (2008), this programme was launched to support the manufacturing sector. The allocated investment grant is between 15% and 30% towards machinery, equipment, plant, and customised vehicles. The incentive is surpassed at R200 million per application.

For less than R5 million of investment, the DTI suggests that the benefit is up to 30% payable over three years. If the investment is between R5 million to R200 million, the benefit given to the entity is 15% and is distributed for over a period of two years. Additional benefits of this programme for SMEs incorporate foreign investment projects and providing financial support for transporting the qualifying machinery and equipment to RSA as part of the grant.

In particular, the qualifying expenditure includes machinery and equipment, land and buildings acquired as part of the investment projects and commercial vehicles.

This programme has two parts to it, namely:

- Manufacturing investment programme (MIP): This grant is for the promotion of manufacturing in metal fabrication, chemicals, plastic fabrication, pharmaceuticals, furniture, automotive and components.
- Tourism support programme (TSP): This is for the creation of jobs outside the main tourism destinations. The TSP offers grants of +30% of qualifying capital investment to enterprises investing less than R200 million.

#### **2.10.1.5 Small Enterprise Finance Agency**

According to Small Enterprise Finance Agency (SEFA), its mandate is to foster the establishment, survival and growth of SMMEs and contribute towards poverty alleviation and job creation.

The funding amount allocated to SMEs is in the form of a loan and it starts at R500 000 and is capped at R5 million. The fund will contribute 90% and the remaining 10% must be funded by the entity. The entity must be owner-managed and the loan must be repaid within five years.

#### **2.10.1.6 Franchise Fund**

Launched by Business Partners in collaboration with the Development Bank of Southern Africa (DBSA) in 2014, the total Franchise Fund amounts to R107.03 million

and comprises of R48.65m from National Treasury's Jobs Fund (R38.92m for financing and R9.73m for technical assistance), as well as R58.38m from Business Partners Limited.

The franchise Fund intentions is to create jobs through entrepreneurship via franchised businesses. According to Botes (2014) the Franchise Fund is merely open to franchisors who have been accredited by South Africa's Franchise Warehouse and Business Partners and comply with certain minimum requirements, such as proper founding documents, full Franchise Association South Africa (FASA) membership and accreditation, successful track record and subscribing to jointly support the new franchisees.

Botes (2014) further explains that a key outcome is to offer funding, training and mentorship to approximately 125 viable and long term sustainable franchises, with most applications for finance ranging between R600 000 and R2 000 000, and in the process to also facilitate the creation of more than 700 jobs.

- The screening process for this funding mechanism involves the training programme which is facilitated by SA Franchise Warehouse.
- The next phase involves a five-day training course which allows the entrepreneur to become acquainted with what managing a franchise outlet entails. This phase includes an analysis of the entrepreneur and a tough psychological interview to ensure the entrepreneur is committed to the project.
- The subsequent phase then starts with application processes that are followed by tight control through monitoring the business during its set-up and growth stages.



## Chapter 3: Research Design and Methodology

### 3.1 Research Methodology

In this chapter, the comprehensive overview of the type of research methodology used is given. The chosen methodology will explain the identified research problem. Thus, techniques, methods and procedures applied in conducting this will be discussed. Additional critical underlying issues of acceptable ethical conduct in executing research studies will also be explained.

The objective of conducting this research is to examine factors contributing to the current high failure rate of the average Small and Medium Enterprises (SMEs) in the first year of operation with specific reference to highly populated areas of Gauteng. The broader intention of conducting this study is to recommend intervention instruments that will add value to the Small and Medium Enterprises sector. Moreover, the newly established Small Business Development Department is tasked with reviewing numerous strategies which currently exist.

It is looking for cross-cutting research evidence from the SMEs perspectives, existing business incubators and particular government institutions and its agencies that provide financial assistance to SMEs in the form of loans and grants this will assist all the stakeholders operating within this sector to collaboratively work together in upscaling the SME sector performance. Therefore, the magnitude of the importance of this study cannot be over emphasised as the country is faced with an enormous task of addressing various socio-economic challenges.

The study was conducted using qualitative research and a questionnaire was used as a data collection tool. The researcher was able to get valuable information on stakeholders in the SMME sector. This was done through the use of questionnaires to businesses, government funders and incubators.

### **3.2 Research Objectives**

The overall objective of this study is to examine factors as to why the average Small and Medium Businesses (SMEs) fail within the first year of operation, particularly, focusing on two factors. Firstly, the research focuses on challenges encountered by SMEs when accessing financial assistance from public sector funding institutions and its agencies. Secondly, the focus is on assessing the availability of business incubators, post funding allocation to SMEs as a support structure. The nature of the research is qualitative as it is an insightful 'investigation' for the purpose of searching out factors that lead to the high failure of SMEs within the early stages of operating.

The research methodology combined qualitative methods as well as desktop research of secondary data and can be explained as follows:

1. First, relevant policies relevant to this study were chosen, namely the NDP, White study strategy of SMMES and Gauteng SMMES policy framework (literature review).
2. Secondly, through qualitative data gathered in the form of questionnaires from SMEs, public institutions funders and business incubators.

### **3.3 Specific Procedures**

The research method is based questionnaire data collection method and was sent to SMEs functioning in various sectors and operating in highly populated areas of Gauteng, with government department financing institutions and its agencies as well as business incubators. For all three stakeholders, the researcher developed questionnaires. The type of questions asked mixed the set of questions and focused more on descriptive questions, especially for funders and business incubators.

A questionnaire was sent out to SMEs, business incubators and funders within the Gauteng province. The questionnaires were distributed with a detailed covering letter (Appendix attached). The components of the letter details to the respondent:

- the study objective.
- instructions how to fill in the questionnaire.
- confidentiality assurance.
- contact details for clarities and questions when encountering problems.

### **3.4 Data Collection Techniques**

As noted by McClure (2002), the qualitative approach is also known as phenomenology and is applied when the sample size is anticipated to be small. Gerber (2015), describes phenomenological research method as a qualitative research method that attempts to understand participants' perspectives and views of social realities. For the purpose of this research, questionnaires were developed for all three stakeholders that consist of open and closed-ended questions.

For the purpose of this study, inductive approach has been applied, in order to avoid using preconceived classifications, instead to allow new insights to emerge from the sector research participants. The data collection for this study will be gathered through the use of primary and secondary data sources. In conducting the primary data source for this study, the researcher designed questionnaires.

The questionnaires were distributed to SME operators and/or owners for first-hand information so as to gain perceptions about the financial institutions. It also intends evaluate the effectiveness of the business incubators as the support structure to SMEs. For sections where, the researcher wanted to gain full insight, open ended questions were asked where respondents expressed their views. A different questionnaire was sent to business incubators. The questions asked were more open ended as the researcher was interested in the research participant's SMEs selection processes and overall sub-sectors role in supporting SMEs. For funders, questionnaire was sent to government financing institutions which includes its agencies.

### **3.5 The questionnaire for SMEs was divided into three sections**

#### **Section A: Background information**

Section A of the questions asked concentrated on the business information data such as:

- The number of years the firm has been in existence.
- The sector in which each business is operating in.
- Number of employees.

#### **Section B: Business characteristics**

In this section, the questions were open ended, the researcher focused on the performance of business, financial questions and growth plans of the businesses.

The researcher intends to extract information from SMEs regarding the challenges they face when applying for funding from government financing institutions. This will be done using a qualitative approach, where the researcher makes use of field workers to distribute questionnaires to the SMEs. A set of specific questions has been developed. Section A, questions are closed question and subsequent questions are open ended questions.

#### **Section C: Non-financial support**

This sub-section of the researcher wanted to evaluate the effectiveness of the available business incubators as support structures for SMEs. Questions asked included the following:

- The availability of business incubators.
- SMEs awareness about business incubators.
- Support offered in such incubators.
- The impact of such structures (incubators) to SMEs.

The rationale behind this is to have a full insight of SMEs and the sectors they operate in. This section also seeks to assist in identifying the employment contribution that these SMEs have in societies they operate in. Section B of the questionnaire consisted of various questions geared towards answering the objective of the study. Questions looked at the restraints faced by SMEs when accessing funds from government financing institutions.

### **Questions for public financial institutions and business incubators**

The questions asked for financiers and business incubators were also open ended. The researcher tried to be specific and precise to avoid losing the interest of the informants in partaking in this study. Questionnaires were developed and emailed to the identified financial institutions and business incubators.

### **3.6 Target Population**

The research target population was consolidated into three main stakeholders. The questionnaires were distributed among funders (government), SMEs and business incubators

Approximately 50 questionnaires were sent to SMEs and 10 to funders and 10 to business incubators. The figures are detailed in table 3.1 below.

**Table 3.1: Population sample**

<b>Research stakeholder</b>	<b>Questionnaires distributed</b>
SMEs	50
Funders	10
Business Incubators	10
<b>TOTAL</b>	<b>70</b>

Source: June, 2015

### **3.7 Instrumentation for collecting primary research**

The researcher developed a set of questions and emailed it together with a covering letter from the university and a signed ethics form to funding institutions. The researcher, used guided semi-structured questions in getting insights from the expert's insights about the performance of the sector.

In conducting surveys, the researcher made use of field workers in collecting data from SMEs respondents. For both, instrumentations, a written consent was emailed to experts and SMEs.

### **3.8 Qualitative Data Analysis**

Data analysis is explained by (Matthews, 2005) as process where “reactive process that requires spending a great deal of time with the data, reading and re-reading, coding and recoding, writing memos and rewriting memos and then making connections among them, until an argument emerges that is grounded in the data”.

According to qualitative research principles, all the views or opinions given by each participant reflects his or her consciousness. For this study, the cognition of participants will be jotted down and expressed in participant's own words as transparent as possible so as to fully reflect the authenticity of their views.

### **3.9 Ethical Considerations**

In distributing questionnaires to all research participants, the signed ethical form was attached and clear assurance to respondents was explained that the research findings will be kept strictly confidential and in accordance with the ethical research guidelines and standards. The following details were adhered to:

- protecting the identity and fundamental interests of research participants, and
- keeping the responses of the target population with the utmost confidentiality.

The participants have been given a questionnaire with a covering letter from the university which detailed the research purpose, objectives and their role in the whole research process.

### 3.10 Research Limitations

The most prominent limitations that were encountered in conducting the study is lack of the willingness from government institution to correspond with the researcher and provide detailed processes that they use when assessing financial applications. This have limited the funders contribution in detailing potential challenges that can improve the sector’s performance at large.

## Chapter 4: Findings

### 4.1 Introduction

The objective of this study was to identify some of the major challenges possibly confining growth of Small and Medium Enterprises (SMEs) operating in highly populated areas of Gauteng. This chapter will therefore report on the findings of the surveys conducted and will provide analysis of all stakeholders that participated in the study. Research findings to be tabulated in this chapter comprise of three groups of stakeholders involved in this study namely SMEs, government funding institutions and its agencies, and business incubators within the parameters of Gauteng. As such, findings will be divided into three sections.

Prior to the results findings analysis, Table 4.1 illustrates the number of questionnaires sent to SMEs, government financing institutions and business incubators and the response rate of each of the stakeholders.

Table 4.1: Questionnaire distribution among research participants

Research stakeholder	Questionnaires distributed	Response rate percentage average
SMEs	50	70%

Research stakeholder	Questionnaires distributed	Response rate percentage average
Funders	10	40%
Business Incubators	10	69%
<b>TOTAL</b>	<b>70</b>	<b>60%</b>

Source: June, 2015

## 4.2 Small and Medium Enterprises Findings

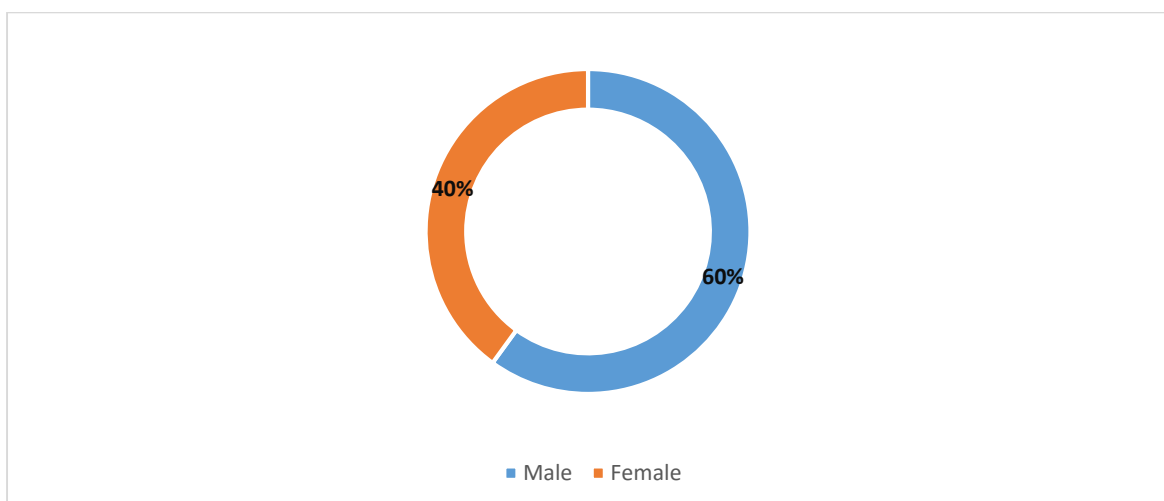
The questionnaire for SMEs was divided into five sections. Each section's results were analysed and presented. Section A provides business background information such as demographics of research participants, the municipality the business falls under, the number of years the business has been in existence and the sector that these SMEs operated in.

### 4.2.1 Section A: Background Information

#### 4.2.1.1 Gender

In terms of demographics of the research participants, approximately 60% of the respondents were males while 40% of SMEs owners and managers were females.

Figure 4.1: Gender representation of SMEs Respondents



Source: June, 2015

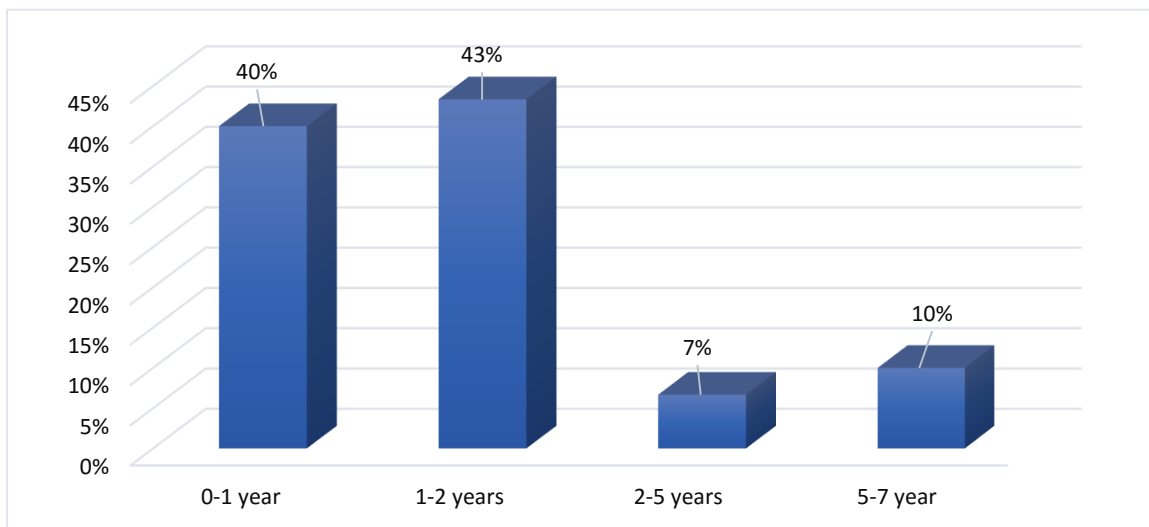
Figure 4.1 shows that most of the Gauteng's SMEs participants are males.



### 4.2.1.2 Number of Years in Operation

This sub-section provides the number of years that the participating businesses have been in existence for. Moreover, the objective of this sub-section was to identify if research participants had been existence for more than a year, had failed and or were struggling and planning to close down. The purpose of this question was to assess if they had survived the early stages of being in business. Figure 4.2 indicates the number of years SMEs have been in existence for.

**Figure 4.2: Number of Years in Business**



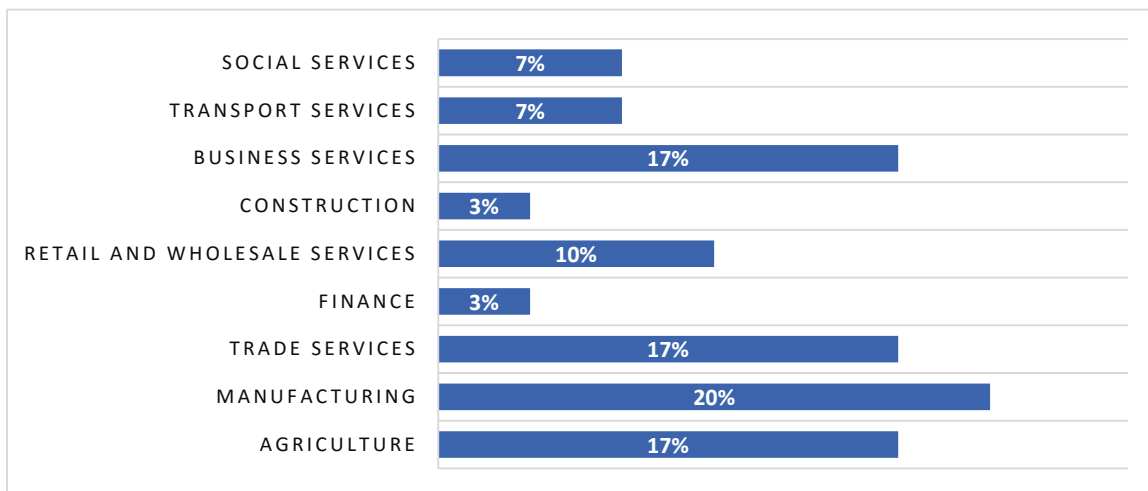
Source: June, 2015

As can be noted in Figure 4.2, approximately 43% of businesses had been operating for two years, while 40% were in business for a year. It is also noted that only 7% remained in business for five years while a mere 10% survived through up to seven years.

### 4.2.1.3 Economic Sector Categorisation

In this sub-section, Figure 4.3 provide the sectors in which the research participants operated in. Based on the responses provided by respondents, Figure 4.3 portrays the sectorial outline of SMEs responses.

**Figure 4.3: SMEs Sector Classifications**



Source: June, 2015

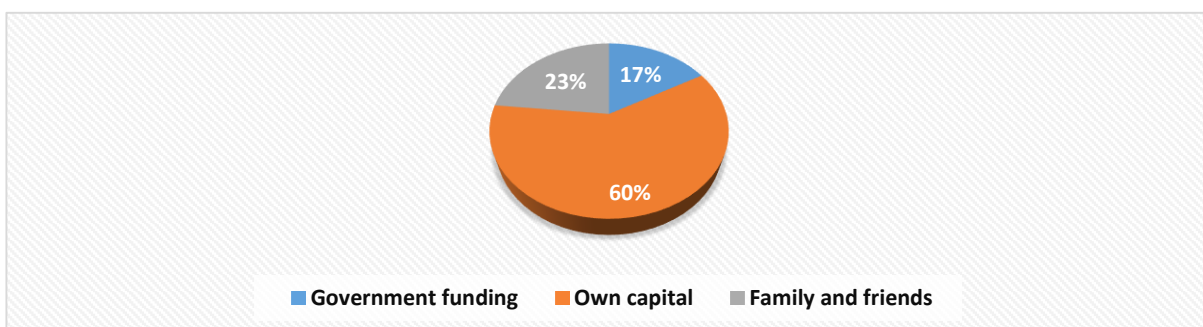
From Figure 4.3, it can be deduced that most SMEs that participated in this study were in the manufacturing sector, approximately 20% were involved in manufacturing activities. Approximately 17% of businesses were in agriculture, trade services, and business services.

## 4.2.2 Section B: Business Characteristics

### 4.2.2.1 Start-up Financial Assistance

In this sub-section, the researcher was interested in identifying the awareness of available different funding programmes, loans and or grants among SMEs. Figure 4.4 depicts responses regarding start-up financial assistance from research respondents.

**Figure 4.4: Source of Financial Assistance**



Source: June, 2015

From Figure 4.4, it can be deduced that most of research participants used own financing for start-up financing. The findings indicate that approximately 60% of

respondents used own savings for starting out, 17% of participants indicated that they had received some of their financial assistance from family and friends, while 17% of some of the research participants indicated that they obtained financial assistance from either government departments or its agencies. Some of respondents indicated that the form of financial assistance obtained from government was either in the form of grants, loans or incentives.

Figure 4.4 depicts the statistical distribution of sources of finances that was used by SMEs in start-up financing.

#### 4.2.2.2 Awareness of Government Financial Schemes

In posing this question, the researcher wanted to determine if SMEs were aware of the available government department funds, grants, incentives, etc. Most of the SMEs indicated that they were aware, however, they indicated that such funds were not accessible to everyone. One participant said “I am aware, but it depends on who you are, it seems impossible”.

#### 4.2.2.3 Question 1: SMEs Business Records

The following table was developed by the researcher in order to establish if the study participants had drafted business plans prior starting out, if they were keeping financial records, etc. Table 4.2 portrays respondents’ results regarding business records.

Table 4.2: Business Records Management

	No	Yes
Have you developed business plan	13%	7%
Have you developed financial forecast for your business	13%	7%
Cash flow management	20%	7%
Do you monitor performance and and keep costs to minimum	7%	27%
Late payments strategy	7%	20%
Do you have a system of budgeting sales and expenses, and do you compare this with reported performance	0%	7%
Does the business have enough finance to meet its needs	33%	0%
Is accessing finance a problem	7%	27%

Source: June, 2015

As can be noted in Table 4.2, approximately 13% of the surveyed businesses indicated that they did not have a business plan, while a about 33% of research participating SMEs indicated that their businesses did not have enough finance to meet the current needs of the business. In addition to the major challenges facing SMEs business operations include the cash flow management inadequacies. Approximately 20% of research participants indicated that they did not manage their cash flow effeciently. This phenomenon, might have resulted in the high number of businesses that have indicated that their businesses do not have enough finances to meet their needs.

A positive trend noticed from businesses that participated in this study, shows that approximately 27% of businesses mentioned that they monitor the performance of their businesses and keep costs to the minimum. The concerning response regarding access to finance was the fact that, most businesses indicated that accessing financing was a problem. When asked to elaborate, how exactly was this a problem. One of the respondents indicated that;

*“ banks and government financial institutions have long processes”* Participant A

#### **4.2.2.4 Question 2: Do You Foresee Any Major Challenges to Your Business in the Next Five Years?**

Table 4.3 illustrates some of the responses research participants to the question regarding the envisaged future changes in their prospective businesses.

Table 4.3: Perpectives of SME owners regarding Future Prospects of the Business

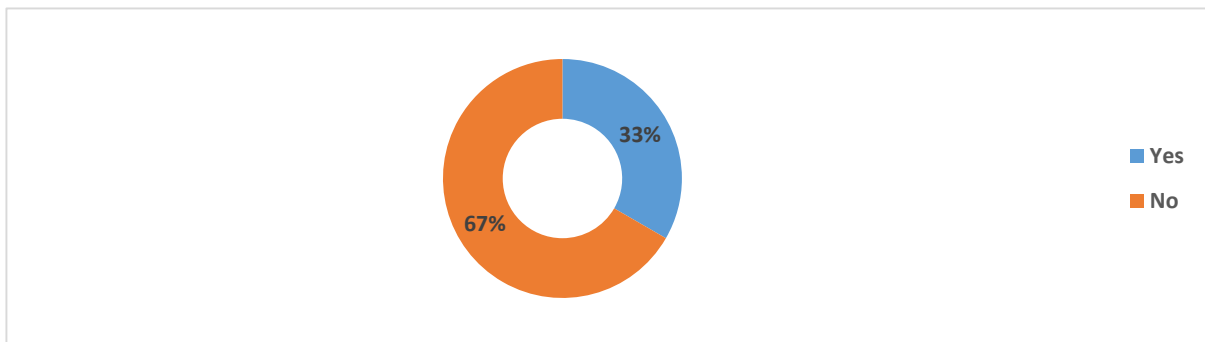
<b>Respondent</b>	<b>Answer</b>
One	“yes expand and create more jobs”
Two	“positive changes,looking at finding premises where the business can expand”
Three	“business management and cash flow managemen”
Four	“challenges of rental premises”
Five	“need more money”

Source: June, 2015

### 4.3 Section C: Non-financial Support

In this sub-section, the researcher was interested in the non-financial support resources available within reach to SMEs operating in research areas. Figure 4.5 indicates respondents' results to the availability of business incubators.

**Figure 4.5: Is there a business incubator in your local area?**

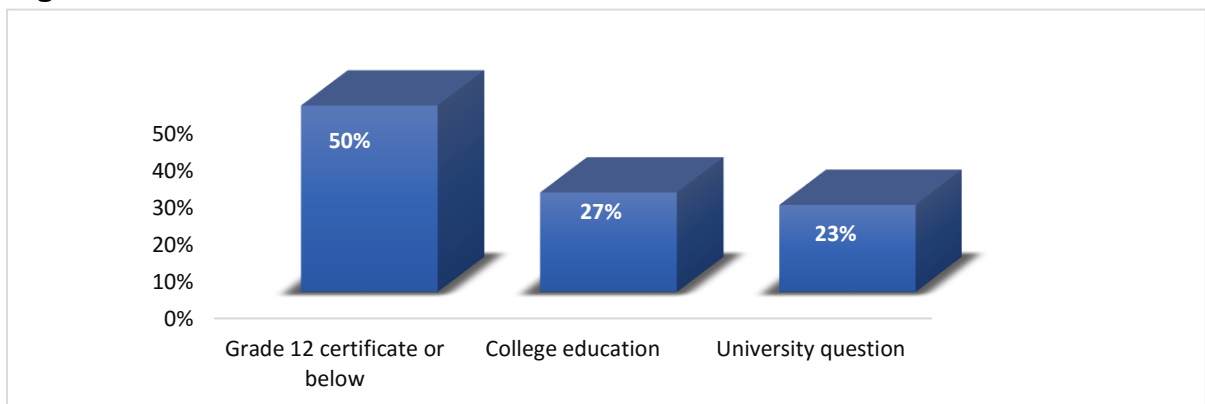


Source: June, 2015

Approximately 67% of respondents indicated that there were no business incubators available in their areas of business. However, businesses operating in the communities of Diepsloot indicated that they were making use of the available business incubators.

#### 4.3.1 Question 1: What is the Average Education Level?

**Figure 4.6: Qualifications**



Source: June, 2015

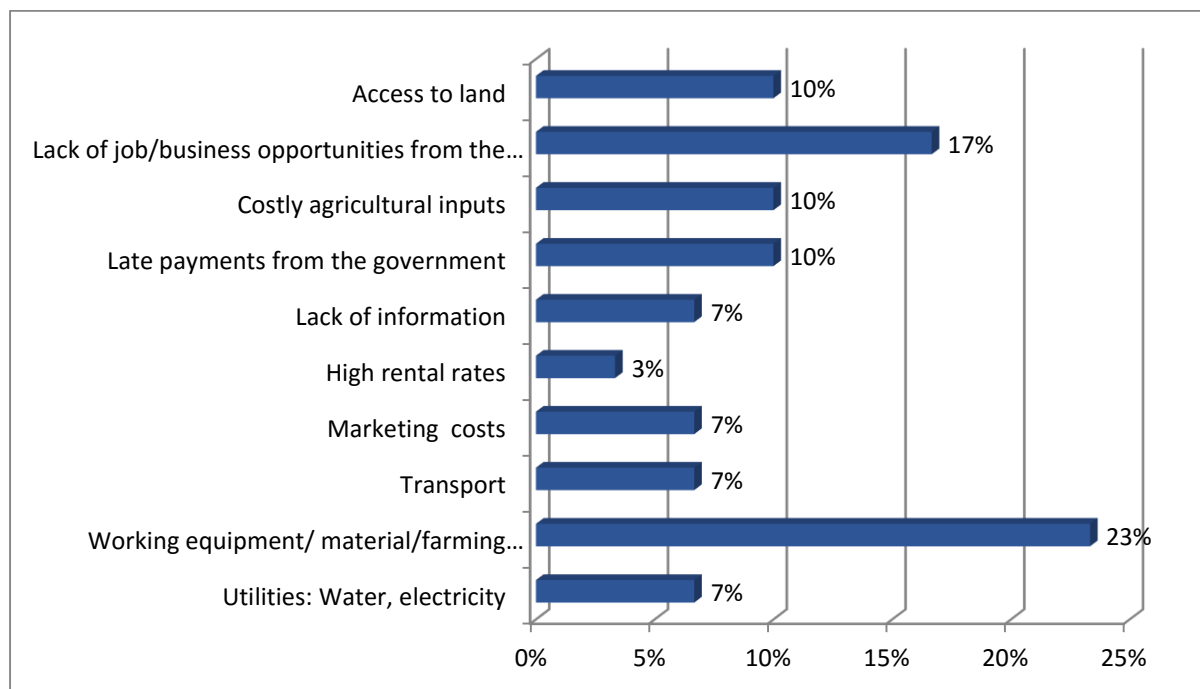
The majority of SMEs managers and or owner indicated that they have grade 12 certificate, while approximately 27% indicated that they had obtained college certificates. Approximately 23% of the research participants indicated that they had obtained bachelor's degree.

#### 4.3.2 Section D: Major Challenges Which Frequently Result in Failure

The findings portrayed in Figure 4.7 were gathered from businesses that have already failed as well those that are still in business, but are struggling. Most of the businesses are facing challenges such as lack of job or business opportunities from the government, shortage of equipment and late payments from the government.

This indicates that most of the small businesses have relied on the government for business opportunities, which then raises a need for the private sector to recognise the small businesses and provide them with business opportunities. Figure 4.7 illustrates the business challenges faced by SMEs in Gauteng.

**Figure 4.7: Business challenges**



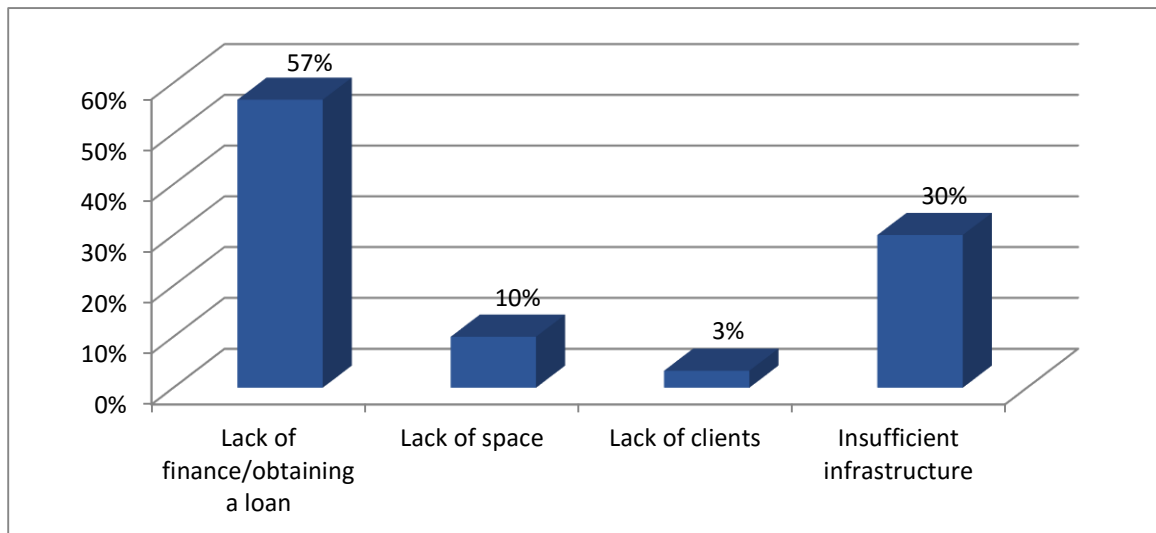
Source: June, 2015

Lack of finance or access to funds was the major constraint hindering the growth of these businesses which was then followed by insufficient infrastructure. These constraints are in a way associated with the lack of funds which will affect the availability of infrastructure.

One of the respondents stated that the reason for them to battle with accessing funds is because the requirements from the financial institutions are too high, therefore, small businesses are automatically disqualified by those requirements.

Figure 4.8 illustrates the business constraints.

**Figure 4.8: Business Constraints facing Gauteng SMEs**



Source: June, 2015

In figure 4.8, lack of funding seems to be the main business constraint among businesses operating in the region of Gauteng. In the second ranking, inadequate infrastructure is the consecutive major constraint facing SMEs of the regions.

#### **4.4 SME's Results Synthesis**

Based on the number of years in operation, only 7% of businesses remained in business for five years while a mere 10% survived through up to seven years. The majority of businesses that participated in this study, approximately 20% were involved in manufacturing activities while 17% of businesses were in agriculture, trade services,

and business services. When posed with a question of the start-up capital, a mere 17% responded to having obtained financial assistance from government institutions, 20% from friends and family while a massive 60% indicated they have used own capital to start businesses.

When the researcher posed the question of the reasons that often leads to failure, approximately 23% of businesses mentioned lack of working equipment as the core reasons for the business failure while 17% indicated that lack of business opportunities or rather contracts of supply from government departments as the main impeding factor which resulted to failure. Approximately 67% of respondents indicated that there were no business incubators available in their areas of business.

#### **4.5 Role of Business Incubators as the Supportive Mechanisms to SMEs**

##### **Question 1: The role of Incubators as the Post-Financial Support Mechanism for SMEs Operating in Gauteng**

###### **4.5.1 Overview of Participants**

Most of the participants were experts of business incubators and their work involved an aspect of generating leads for funding, facilitating the linkages between SMEs and markets and ensuring sustainability of small businesses within early stages of operations.

Approximately five experts on business incubators in Gauteng were interviewed. One of the participating research participant works for the government agency that specifically deals with non-financial support of SMEs across South Africa. The other four representatives work for various business incubators that were established by the government departments. Some participants work for incubators that have been established by large private sector organisations. These incubators have significant contributions to small business developments in Gauteng and selective provinces across the country. The positions of the participants varied from general managers to marketing and sales executives. The gender profile of respondents were skewed



towards females, with 99.9% being mixed race females. For a profile of all respondents, please see attached Appendix (A).

#### **4.5.2 Data Analysis**

Data analysis emerged as soon as all responses from those who participated were gathered. The researcher noted that the manner in which participants framed responses was solely based on the nature and experience of various SMEs they have dealt with and the number of years and or months such business incubators have been existence. Therefore, as such, seven major themes emerged from the interviews.

#### **4.5.3 Theme 1: SMEs Assessment Criteria**

When discussing the issue of criteria used on selecting SMEs, many participants indicated that each absorbed SME is judged against six major factors, prior to being accepted into operation under the guardianship of the incubators. The following factors are some of the basic selection criteria that is specifically used by the participating incubators that the researcher interviewed:

1. Viability and potential for growth;
2. Economic opportunity created for surrounding area;
3. Entrepreneurial characteristics and capacity to execute;
4. Fit to that *particular* Incubation Hub available resources or sectorial speciality;
5. Ratio of cost and risk to benefit; and
6. Majority black-owned business.

#### **4.5.4 Theme 2: Fee Structure**

One representative from one of the incubators alluded that SMEs on the programme are required to pay subsidised rent for their units and cover their electricity and water expenses. The other participant also indicated that the SMEs participating on the programme were required to pay a small fee that would cover for expenses incurred for marketing activities and specific training providers that are brought into the incubators.

#### **4.5.5 Theme 3: SMEs Graduation Policy in Incubators**

The respondents' opinions differed with regard to this question, one participant cited that the full incubation programme runs for a period of three years. All business coaching activities are geared towards the exit. The other respondents mentioned that, their incubation programmes run for a period of two years, where businesses receive business coaching specifically focused on providing basic business skills, financial management, product quality and access to markets skills. Once the businesses are well equipped to stand on their own, they graduate from the incubation programme and sustainably operate outside the programme.

#### **Question 3: Why do average SME Fail Within the First year of Operation Within High Population areas of Gauteng?**

#### **4.5.6 Theme 4: Barriers to Entry**

When asked about the sentiments as to why SMEs fail within the first year of operation, approximately 40% of respondents alluded that, barriers to entry by big corporates in South Africa force Small and Medium Enterprises out of businesses. The respondent explained that this is done by ensuring that the SMME's do not meet their criteria e.g.

*“Engineer who worked for more than 20yrs in the company leaves to open his business he will be told his company does not have experience irrespective of his personal experience, He will be asked about capacity.”* Participant A

Other participants added that the South African government procurement system does not provide opportunities to small businesses due to lack of experience.

#### **4.5.7 Theme 5: Corruption in the Government System**

Approximately 80% of the interviewed officials from incubators emphasised that corruption in the public sector as one of the major downfalls for Small and Medium

Enterprises (SME) as it reduces the profit margins of the SME because they have to bribe officials who are not contributing to the productivity of the business.

#### **4.5.8 Theme 6: Lack of Enforcement by Government**

One participant raised lack of enforcement by the government in terms of procurement spent that favours SMEs across sectors as one of the leading contributing factors that lead to failure of the SMEs. The other participant added that, as the incubator, one of the mandates is to ensure that when SMMEs graduate from the programme, they would have channels through to the markets and be able to do business with government. It was also mentioned that transformation is not a vocabulary of the private sector or not embraced, so private sector makes provisions for fines if they do not meet BBBEE codes.

#### **4.5.9 Theme 7: Poor Financial Acumen from the SMEs**

All business incubator participants confirmed that one of the major problems that SMEs lack in is financial management skills and cash flow problems. One participant explained that,

*“lets say for instance, an SME gets a big tender from government, he does not do the work properly but is quick to buy a flashy car to show off”*. Participant D

This then leads to the company being unable to deliver on time due to financial problems and lack of resources. Approximately 75% of participants indicated this problem as probably one of the main challenges that leads to the failure of SMEs.

### **4.6 Government Funding Institutions Findings**

#### **4.6.1 Overview of Participants**

As per the targeted research participants of this study, ten funding institutions were targeted and approximately five responded. Most of the respondents were experts in assessing SMEs financial applications, either for start-up capital, commercial debt-

revolving loans, bridging finance, term loans, asset finance, and short-term trade finance.

Additionally, the participants complement consisted of various managers who are responsible for assessing financial applications from government financing departments and its agencies based in Pretoria and in Johannesburg. One of the participating institutions specifically focuses on funding Small, Micro and Medium Enterprises (SMMEs).

The age profile of participants was between the ages of 25 up to 50 years of age. The participants have experience of five years up to twenty years. In terms of gender, all respondents were males. Refer to Annexure 3 for brief profiles of respondents that participated.

#### **4.6.2 Data Analysis**

In this sub-section, research findings from government financing institutions and their agencies will be analysed. The researcher designed the standardised set of questions for all participants and will provide research results. The data collected will be analysed both qualitatively and quantitatively. The questions set for government funders were divided into two and it was categorised as follows:

- Section A: Participants background information
- Section B: Funding criteria information

Section A part of the research has been analysed in the “overview of participants” sections while Section B will be analysed shortly. In section B, text-based data have been analysed in a quantitative manner while the other sections have been analysed through themes.

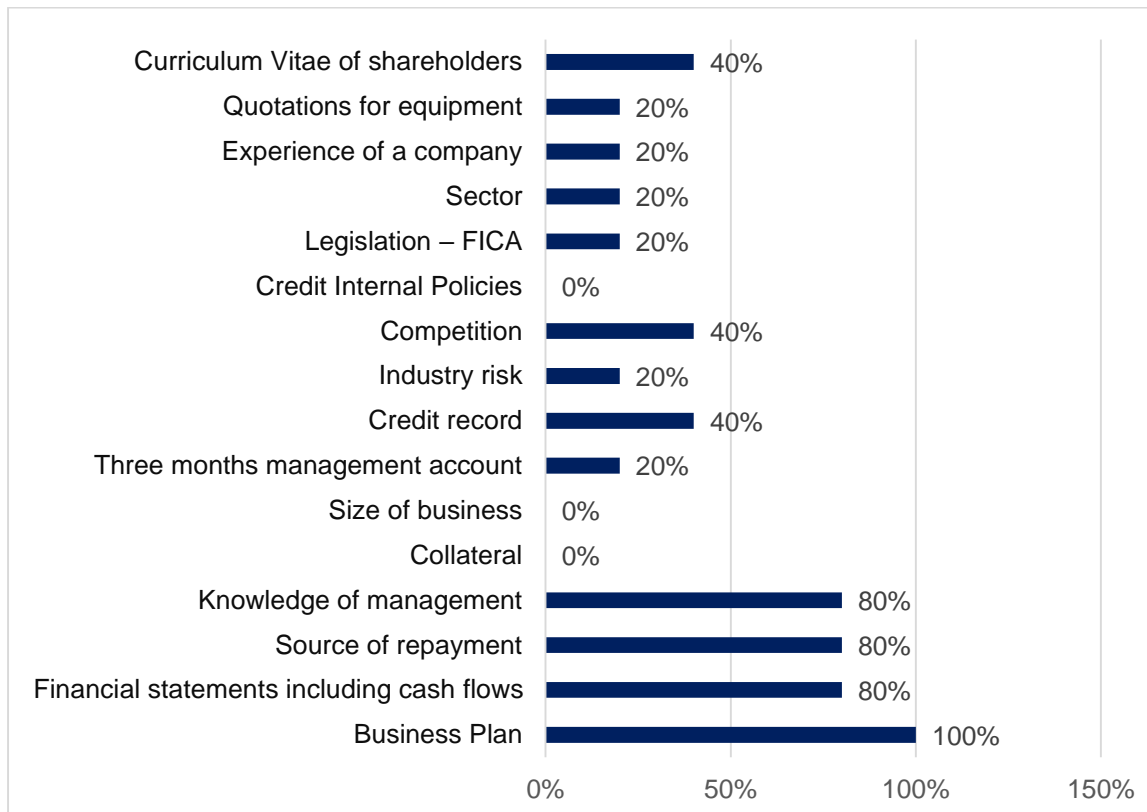
### 4.6.3 Section B: Government Funding Criteria Processes

**Question 1: What are the most important factors you consider when you are assessing financial applications?**

In this sub-section, the basic financial application assessment factors that the funding institutions usually require from businesses applying for financial assistance in government department and its agencies is analysed.

Figure 4.7 depicts government institutions financial application assessment criteria for SMMEs.

**Figure 4.7: Funding Institutions Financial Applications Assessment Criteria**



Source: June, 2015

From figure 4.7, it can be deduced that the top three important required documentation from government institutions comprise of the business plan, past financial statements for existing businesses or financial forecasts for start-up business and source of repayment capability.

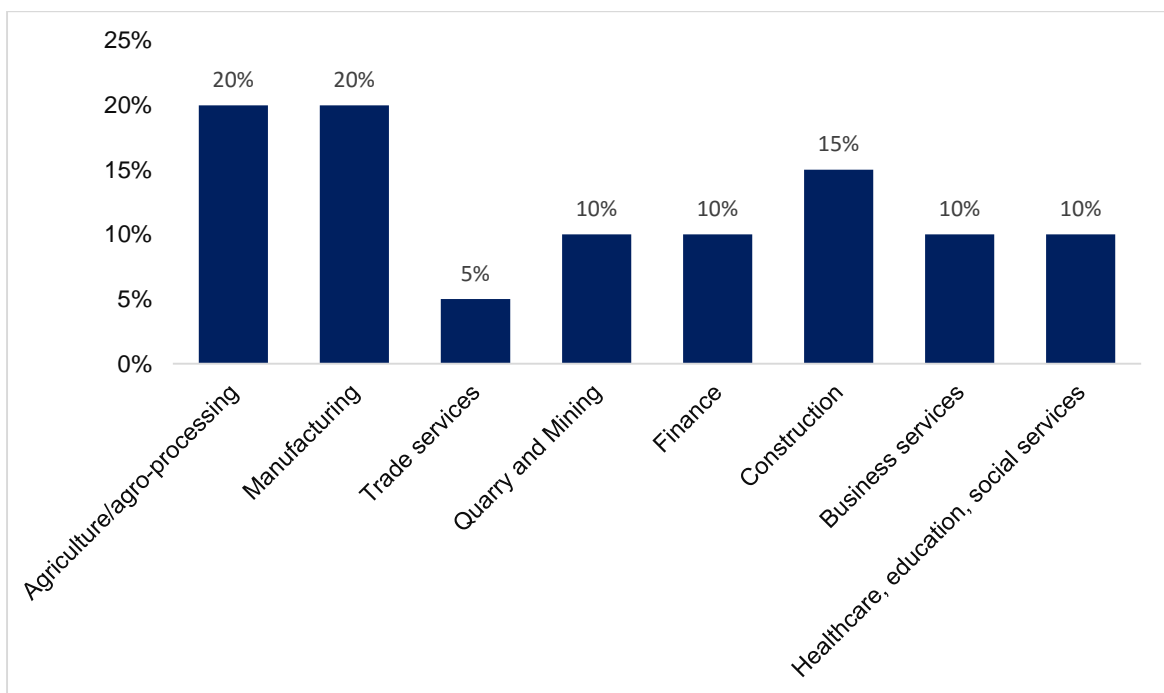
**Question 2: What is the Institution's Financial Application Turnaround Time?**

The general response from all research participants indicated that it takes approximately one to three months (for most institution, they take a month), while other institutions indicated that it takes about six months to a year.

**Question 3: Sectors Funded by Government Institutions?**

Figure 4.8 illustrates economic sectors that government institutions invest in. The list includes sectors such as agriculture activities including agroprocessing, manufacturing, construction, etc.

**Figure 4.8: Economic sectors**



Source: June, 2015

From Figure 4.8, it can be inferred that manufacturing, agroprocessing and construction are the leading sectors that have been allocated funding to date. Following in this lead are mining, business services, finance and other sectors.

#### **Question 4: Who has the department/institution mostly dispersed funds to?**

##### **4.6.4 Theme 1: Black empowered businesses**

Most of the participants indicated that funds have been mostly allocated to black empowered business. Participants alluded that that this was done as per the overall government mandate which encourages economic empowerment of the previously disadvantaged businesses. The other participant, indicated that in his institution, the racial implications of black ownership structure was not the main priority in assessing businesses having the potential to be sustainable.

##### **4.6.5 Theme 2: Specific Sectorial Funding**

Approximately three funding institutions that responded indicated specific sectorial funding was not the priority. The institutions emphasised that the assessment and approval of financial application outcomes was solely based on the bankable business plans, industry dynamics and the potential to be a sustainable business that will grow into a big entity.

However, one institution representative whose mandate is purely based on specific sectors, indicated that it is within the institution priority to only target sectors that need to supported to be global competitors. The representative also alluded that these are efforts by the department of moving toward imports substitution.

##### **4.6.6 Theme 3: Finance Application Rejections**

All participants mentioned that in most cases SMEs finance applications are rejected due to the fact that businesses fail to present viable business proposals that show the ability for business to remain operating for a long time. One responded indicated that:

*“Many businesses fail to provide all the necessary documentation that is required. Businesses also provide business plans that are theoretical, thus increasing risks that may lead to failure of businesses”.* Participant C

Most of the participants, indicated that they provided explanations as to why finance applications were rejected.

#### **4.6.7 Theme 4: Type of Funds**

Approximately 75% of government funding institutions mentioned that they provided various types of funding, which include, start-up capital, expansion and equity acquisition.commercial debt-revolving loans, bridging finance, term loans, asset finance, and short-term trade finance.

#### **4.6.8 Theme 5: Lack of Skills**

The total number of participants have mixed responses regarding this question. Some, believed that the majority of SMEs applications that have been rejected are often characterised by lack of accurate and reliable information, lack of business-planning skills and management depth, etc. Other participants, explained that this phenomenon was not always the case, as most businesses failed due to inadequate access to markets, poor product quality, etc.

#### **4.6.9 Section C: SMEs Failure Rate**

##### ***Question 1: Why Do You Think Many SMEs Fail Within the First Year?***

When this question was posed, all participants provided a list of the possibilities towards high failure rate of SMEs in Gauteng during the fearly stages of operation and they are as follows:

1. Lack of market and inability to secure markets share for products / services.
2. Lack of proper mentoring / hand holding products to assist entrepreneurs and senior management if the business;
3. Lack of technical / management abilities of the owners of the business.
4. Lack of focus on the business by the entrepreneurs to meet its planned objectives.
5. Lack of business management skills.
6. Cash flow management.



7. Overtraded markets.
8. SMME fails because their businesses lack innovation and compete in same markets.
9. Lack of basic business knowledge and training.
10. Require more mentoring.

## **Chapter 5: Conclusions**

### **5.1 Introduction**

The main aim of the study was to delineate principal factors which lead to the high failure rate of the average SMEs in the first year of operation within the highly populated areas of Gauteng.

The outcomes of the literature review indicated that potential various challenges can be attributed to South Africa (SA)'s high failure rate of SMEs during the first year of operation. These challenges include, inter alia, access to finance and the non-financial support structure of the allocation of funds (Govender, 2014).

Furthermore, the literature review revealed that various South African government institutions have funding grants and loans set aside in order to offer both the financial and non-financial support for the SMEs to meet SMEs business needs. This has been dealt with in more detail in chapter two. In efforts of gaining broader understanding of addressing the primary research questions, the researcher's primary research involved three perceived critical role players of the sector namely, the SMEs, government department funding institutions and its agencies and business incubators based in Gauteng region.

Based on the existing available literature, South Africa has a relative sufficient financial government funding institutions. However, the availability of business incubators which serve as support mechanisms as stated in the literature review is still restricted in elite locations of the province. Thus, even though the Gauteng economic development department has initiated few pilot business incubators that are located in close proximities to the highly populated areas of Gauteng. There is still an existing gap that will have to be spread across the province in order to improve the visibilities of business support mechanisms, especially in terms of infrastructure and resource sharing among businesses in the early years of operation.

The focus of this study aimed to determine as to why small businesses fail within the first year of operation with the view to indicate whether there is a need from

government funding institutions including the newly created Department of Small Businesses to change the existing strategies pertaining to communicating these resources to SMEs on the ground level, placing business incubators in areas that are in close proximity to where businesses are operating. Collectively, the broader aim of conducting this study was to recommend some solutions to the posed research problem based on the findings of the research.

In chapter 3, the researcher had indicated that the research will focus on epistemology which refers to the “theory of knowledge, including the theory of knowledge acquisition”. Epistemology was anticipated to be subjective to the research due to the fact that the researcher opted for phenomenological exemplar. The researcher’s interpretation was subjective and subjectivity relates both to the multiple realities which the researcher has recognised, as well as to how it will impact on the reliability of the study

## **5.2 Research question 1: Why Do Average SME Fail Within the First Year of Operation Within High Population Areas of Gauteng?**

The literature review identified five stages of growth: existence, survival, success, and take-off and resource maturity (Churchill and Lewis, 1983). The Churchill Lewis model gives an acumen into the dynamics of SME growth, including the distinguishing characteristics, problems and requirements of growing SMEs and explains business growth processes amongst SMEs.

The researcher conducted a primary research and in this section, summary, recommendations and conclusion will be drawn based on the main findings of the studies.

## **5.3 Highlights of the Primary Research**

In this sub-section, the researcher will conclude on a three-fold research approach that was embarked on when clarifying the core research problem that prompted the research question.

The first section of the research focused on SMEs challenges. Issues such as the number of years, economic sectors that the SMEs are operating in, source of financing they used in starting their businesses, awareness of government finance schemes and business records. The secondary set of questions focused on issues such as major challenges that resulted in failure of some of the businesses and business constraints that are currently facing Gauteng businesses.

The researcher designed a different questionnaire for business incubators that are also based in Gauteng. The questionnaire addressed issues such as the assessment and the availability of business incubators within the areas of business operations. This sub-section, focused on the assessment criteria used in selecting SMEs that can be part of mostly three year programmes within the incubator. The posed questions such as the fee structure, and SMEs graduation policies.

The third part of the research dealt with government funding institutions which provide financial assistance to SMEs either on start-up basis, funding for infrastructure purpose or as financial assistance on the go.

Questions asked included the funding criteria used in assessing financial applications from SMEs, turn-around time, prioritised sectors, frequent financial applications reasons for rejection, etc.

- I. Most of the businesses indicated that they had used own financing when starting up. When asked to elaborate, on whether they were aware of available various funding schemes for SMEs they answered that they either failed or are struggling to survive and indicated that it was very difficult to get funding if they do not know someone from these departments.
- II. This, raises an area of concern as it hinders many businesses from applying for funds that would assist the sectors they are operating in to contribute significantly in communities they are operating in.
- III. In terms of business records and other critical elements which sustain the business, approximately 13% of the businesses that participated in this

research indicated that they never drafted business plans for their businesses while 20% indicated that they lacked cash flow management skills and have indicated that it was one of the major contributing factors that have led to the failure of businesses.

- IV. Based on the aforementioned business management weaknesses, approximately 33% indicated that their businesses did not have enough finance to meet business needs that would keep businesses afloat and ensure continuity beyond the first two years of operating.
- V. Accessing finance from the designated public development financial institutions is clearly a major challenge facing businesses and that has led to the inability to seek financial assistance from funding government institutions.
- VI. Working equipment or rather necessary resources (infrastructure) seemed to be one of the major prohibiting growth factors facing businesses.
- VII. The nature of the South African SMEs is seemingly dependent on government departments to “create” tenders for them, approximately 17% indicated that lack of work from government departments is one of the major business challenges that prohibits business growth.
- VIII. The other business challenges mentioned by the businesses were late payments from government department, high rental costs, marketing costs and transport costs.
- IX. The major business constraints that seemed to be mostly prominent in this study was lack of obtaining finance to either start or expand. Approximately, 57% indicated that as the major constraints, insufficient infrastructure to deliver on specifications of some of the projects available on the market.
- X. Amongst some of the major reasons that was been mentioned by funders was inadequate business proposals that SMEs supply to funding government departments when applying for financial assistance.

The following main findings from the study can be articulated;

***SMEs operating in high populated areas of Gauteng faces the following issues;***

- I. Lack of business records such as the cash flow statements, business plans and practical business management skills.
- II. Some of the business fail due to inadequate financial availability to keep businesses afloat, about 33% of businesses highlighted as the major challenge.
- III. Working equipment for businesses seems to be one of the main impeding challenge for businesses.
- IV. The main challenge, however, that the majority of this study's mentioned as the core reason that has led to the failure is the inability to access funding from government financing institutions.
- V. With regard to availability of business incubators as the non-financial support structures for SMEs, Gauteng has quite a number of incubators that specialise in various industries. Many businesses indicated high rental costs, electricity and water bills and access to appropriate technology resources (marketing costs) as some of the challenges facing everyday activities of businesses in general.

***Key business incubator findings conclusion consist of the following;***

- I. There is inadequate availability of incubators in particular in the high populated areas of Gauteng where some of the research participants are located.
- II. There should be a roll-out of non-financial support structures especially in townships where some of the businesses are located. The business incubators should provide subsidising rental premises, ICT access, etc., in order to curb some of the major challenges that are highlighted in this study.
- III. Business incubators need to support and improve the quality of products manufactured in the incubators.

***Key funders findings conclusion consist of the following;***

- I. From the findings, from both the SMEs perspectives and business incubators, the government funding institutions need to simplify application's documentation requirements.
- II. There is a need to reduce application turnaround time
- III. There is also a need to roll-out satellite offices to remote/township areas where some of the SMEs are based. These satellite offices can be situated in business incubators. In this way, one stop useful resources can be created and can improve the performance of the sector.

The next sub-sections highlights some of the research key findings.

**5.3.1 Barriers to entry: Large corporation domination**

The National Development Plan (NDP) mentions various prohibiting factors limiting significant growth of the sector which includes, inter alia, policy environment that traditionally favours concentration on large corporations and the support structure that focuses on creating global trade environment which, at that level, encourages and rewards economies of scale and scope in both production and distribution. This has been concurred by the business incubator research participant under a theme "barriers to entry". The research participant mentioned a scenario where the experienced engineer resigns from a corporate environment, starts a new business but is faced with the rejection of procurement system from the government departments citing lack of experience as the possibility not having the capacity to execute the available job.

**5.3.2 Finance Gap**

Literature review indicated that in 2010 approximately 873 080 of SMEs apply for finance in financing institution, however, only 93 759 SMEs were successfully allocated funds.

Various surveys of SME financing “strongly suggest that business owners in South Africa view access to financing as a significant problem for business activity” (Turner et al, 2008: 15), this is despite various public and private sector initiatives to facilitate access to financing. The primary research also emphasised the same phenomenon.

#### **5.4 Recommendations**

The literature review provided various findings, in particular the strategy on SMMEs indicated some of the following priorities as the areas of concern that would improve the sectorial performance:

- Facilitating access to information and advice;
- Facilitating access to affordable physical infrastructure;
- Facilitating access to appropriate technology;
- Capacity building and institutional strengthening; and
- Facilitating access to finance.

However, the business constraints that SMEs which participated in the study highlighted as the main business operation concerns, indicated the aforementioned “strategy priorities” as the main challenges that prohibit business growth beyond the early stages of operating. This indicates a gap within the sector despite government’s efforts for programmes that are meant to improve the performance of the sector.

As mentioned in NDP and now in main primary research findings, there is a major need to offer small businesses support services that would consolidate and strengthen the existing structures. By addressing this major defect, the alarming rate of high business failure in the early stages of operation would be somehow reduced.

- I. The existing financial institutions and just in general the perception about the personnel in these institution is bad. While conducting the research, officials kept on referring to various departments without a tangible straight forward guidance on the appropriate personnel that would offer assistance regarding financial assistance quires.



- II. There is no clear indication as to where exactly to go for various available funds in the province, in particular, available grants or loans that they can get in order to grow businesses and offer more job opportunities. This is noticeable in particular from research findings where ordinary business owners operating in various sectors did not know which government institution would be appropriate for each sector. This indicate lack of proper marketing or awareness done through the following communication liaison mechanisms that can get through to a significant number of SMEs such as:
- community bill boards,
  - local radio stations and or
  - local news study that an ordinary SME would be able to contact when in need of any form of business assistance.
- III. In the researcher's perspective, these SMEs resource constraints can be reduced through availing business incubators that can drastically reduce overheads cost of running businesses. Business incubators offer these service at a reduced cost and they facilitate some access to markets services that would actually ensure sustainability of some of the struggling SMEs.
- IV. With that said, many SMEs that participated in this study mentioned that they were aware of the benefits that incubators offer but indicated that these incubators are not within reach of where businesses were based. The Riversands business incubators centre is one of the first resource centres that can assist SMEs to be sustainable. The creation of similar incubators on the "ground" would significantly improve the performance of SMEs operating in Gauteng.
- V. The existing institutions are there but they are not in touch and accessible to the ordinary SMEs. Thus, the major problem is not the inadequacy of funding schemes available to SMEs, however, the main predicament lies in ensuring that the higher officials completely eliminate the perception that SMEs have regarding these institutions. The turn-around times, road shows or any other promotional programmes need to be planned to ensure that the existing

institutions meet their objectives, which is to ensure that the SMME significantly contribute to the economy of the country and create the much needed jobs that many South African are in need of.

- VI. Besides the financial “burden” as well as lack of jobs from government departments that most SMEs indicated that they were facing as the major challenges, the innovative industries lack means of to self-sustain their entities.
- VII. This prompts for an intensive limited relevant support structure for industries that will not be necessarily be dependent on government to sustain their business, but create platforms that would for example, focus on offering the economy business services that would be consistently be on demand.
- VIII. The country has many redundant resources that are no longer used to benefit the economy, thus there have to be ways that innovation and skills development programmes that would address lack of business management, cash flow management courses and or marketing courses need to be revitalised and made relevant to SMEs across Gauteng region.
- IX. This would stimulate ideas to businesses to shift focus and assist the South African economy from being government expenditure driven.

The Gauteng financing departments, financing agencies and others need to create central offices or mobile offices that would serve as the information gateways for SMEs to approach and be directed in the appropriate institutions that would assist SMEs in financial needs and business incubator services that can reduce the existing high failure rate of SMEs.

Moreover, the following strategic programmes have been identified as the possible key interventions that can curb the existing high failure rate of SMEs within the early of operation.

### 5.4.1 Recommended Strategic Programmes

The following strategies are recommended as they can potentially improve the performance of the sector:

#### a. Improving Access to Finance

Key interventions includes:

- Improve the facilitation process for SMEs to easily access funds from relevant financial institutions.
- **Proper business planning** - SMEs should be assisted with proper business planning in order to speed up the funding process as some SMMEs cannot access funds on time due to business plans failure.
- **Feasibility Study** - SEDA, MICC and other supporting institutions should assist prospective SMEs with some form of feasibility study to advise businesses pertaining to available resources and possible available infrastructure and other business alternatives before venturing into a business that is subject to failure
- Improving the payment process to companies providing goods and services to the government.
- **Clear and detailed database** - Clear and detailed database with funding institutions and other funding programmes should be developed and disseminated to SMEs and prospective SMEs across the province including businesses that are operating in highly populated areas.

#### b. Improving Infrastructural and Technological Support Programmes

Most recently, technology and infrastructure improve small enterprises development. The Seda Technology Programme (STP) is aimed at improving small enterprise performance and productivity through facilitation and transfer of technology to small enterprises through Incubation Support Programmes (ISP).

Key interventions include:

- Improving the facilitation of business incubators- This will improve enterprise development, skills and technology transfer, supplier development and access to market opportunities. This should be done through the Seda Technology Programme and with other relevant institutions.
- The provision of provincial and district operational infrastructure.
- The establishment of district wide networking, communication and any other technology centres.

### **c. Improving access to skills development**

Lack of business skills and general skills is one of the major constraints in business development and growth. Education and training are integral in any institution and will play a very important role in strengthening the capabilities of SMEs for growth and sustainability.

Key interventions include:

- **Human resource development-** Human resource development is a very important factor to be taken into consideration in the SMMEs sector. Other external institutions should also be consulted pertaining to skills development in this sector
- **Financial skills, business skills, record keeping computer related skills and technical skills-** These types of skills limit the growth of SMMEs, collaboration with business colleges and FET colleges will do justice in terms of addressing these kind of skills
- **Mentorship should be enforced in small businesses more especially to the new entrants-** New entrants struggle to survive because they don't have the knowledge and business skills. Mentorship should be aligned with the supporting institutions in order to identify the relevant mentors.
- **Interpersonal skills such as conflict management-** Workshops on team building, communication skills and conflict management should be meticulously provided as conflicts pose a serious threat and lead to business failure.

- **Addressing sector specific skills shortages will benefit the SMMEs sector-** These include trainings and workshops that are tailor made to specific sectors which can be held in a form of trainings or workshops per local municipality.
- **Linking SMMEs with well-developed or established companies** - Business Linkage should be strengthened between SMMEs and established companies through the Business Linkage Centres and other supporting institutions. This will also contribute to the mentorship programme and skills transfer.

#### **d. Improving Access to Market and Market Orientation**

Access to markets is one of the major challenges in business development and survival in Gauteng province and South Africa as a whole. Most of the respondents from the survey indicated that lack of formal markets is one of the key challenges they are facing.

Key interventions include:

- **Adequate access to market information-** Businesses should be oriented with regard to a market information system where information is gathered, analysed and disseminated about prices and other information relevant to farmers, processors and manufacturers.
- **Improve the quality of small enterprise goods and services**—Quality of goods produced and services offered by small companies should be improved through skills development, business linkages, mentorship from experienced businesses to improve their trustworthiness so that they can be in a position to compete with bigger companies in future
- **Assist SMMEs to understand and interpret market trends** -Understanding the market trends such as information on products that are on demand, product prices and input prices, fashion trends (for manufacturers) will assist businesses with planning and making viable economic decisions.

- **Organising market fairs-** This will assist SMEs to better advertise their products and network with bigger companies within and outside the district in order to take advantage of new opportunities.

#### **e. Improving Access to Information and Advisory Services**

Lack of access to adequate and timely information is one of the challenges faced by the SMMEs sector in Gauteng province. Most of them indicated that they don't get information on time or hear about other programmes or workshops after they have been delivered.

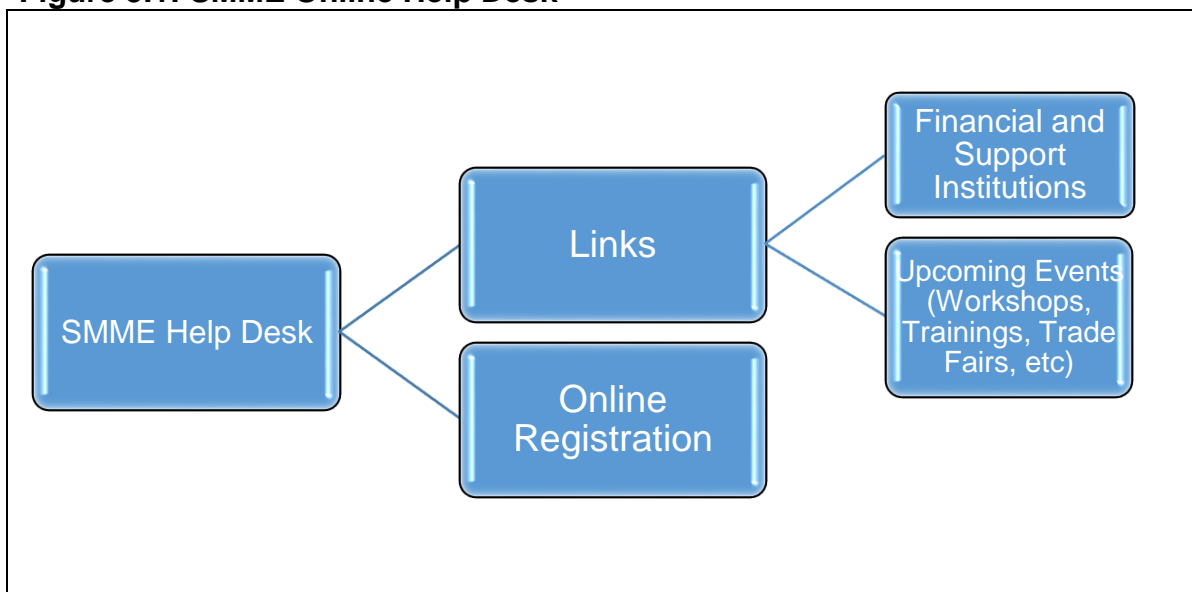
This is a major challenge to businesses in townships since SEDA and other business support institutions are located in more affluent areas of the province. Information pertaining to business opportunities from the government sector is not transparent to the majority of the SMEs and they indicated that business opportunities rotate around the same group of people. As far as the tendering process is concerned, majority of the SMEs indicated that it is only those who are connected to the officials within local municipalities who access this information and the opportunities thereof.

Key Interventions include:

- **Support Programmes/Institutions Database-** Clear database with relevant support programmes and institutions should be available within LED units and disseminated to SMMEs and Co-operatives according to their needs.
- **Transparency-** Information about opportunities and the tendering process should be transparent, fair and accessible to all.
- **Feedback Mechanism-** Companies who apply for tenders and do not succeed should at least be provided with feedback as to why they were disqualified so that they can address issues that need to be addressed for them to stand a better chance in future.

- Self–Help registration – Due to the fact that some of the SMMEs do not appear in Municipalities databases, a self-help registration method is suggested. The Self-Help registration method will also assist in reducing transaction costs associated with transport, printing, etc. An SMME help desk in the municipalities website is suggested.
- These help desks should contain an online registration form which is easy and quick to fill, with space to upload all the company’s documents and submit electronically. Furthermore, it should also have links and guides to SMME funding and support institutions and adverts on upcoming events, workshops and trainings. The Self-Help SMME desk should incorporate the following as described in Figure 5.1.

**Figure 5.1: SMME Online Help Desk**



Source: August, 2015

#### **f. Create an Enabling Environment**

In rectifying the challenges facing the sector, the following pointers can be taken into cognisance:

- The provincial and national public institutions responsible for SMMEs sector financial assistance, is seemingly sufficient, however, what it lacks is integration and the ability to scale up some of these initiatives.
- In as much as entrepreneurship culture is needed in the South Africa economy, policy makers, public institution and other sectorial stakeholders need to be careful of the SME sector that has too many “me too” entrepreneurs that start business with little to differentiate themselves from their competition. Such a trend, results in the failure of these businesses.
- Thus, instead of trying to get more people to run their own business, the government should make it easier for entrepreneurs to flourish, by creating a more enabling business environment.

#### **5.4.2 Monitoring and Evaluation of the Recommended Strategic Programmes**

Monitoring and evaluation play a significant role in any organisation. Government can continuously disperse its funds to various sectors of the province. For as long as such funds are allocated to various SMEs without the continuous assessment of how such funds are managed in order to the sector’s sustainability into significantly contributing to the economy of Gauteng.

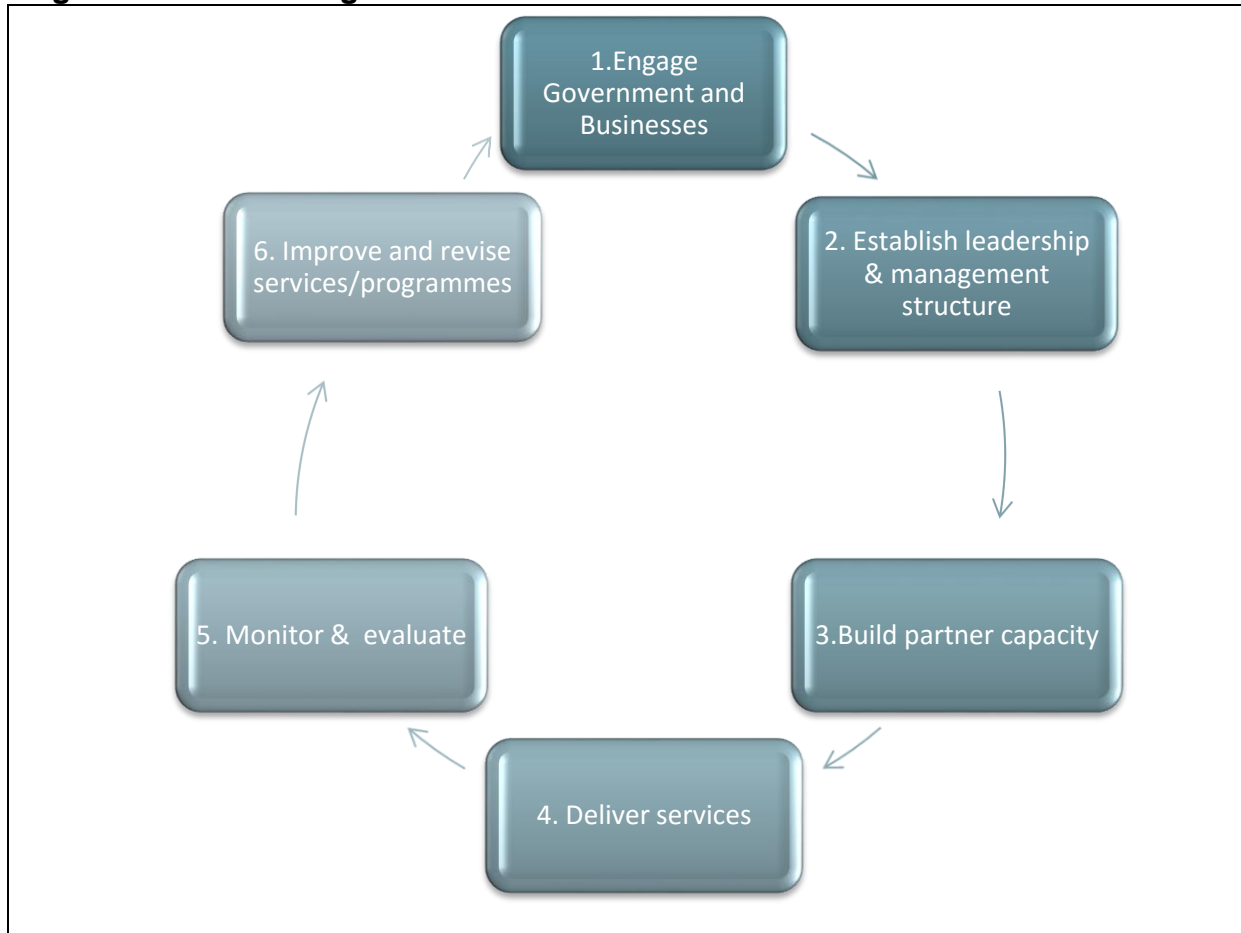
Then the existing perception and the indicated major business constraints that lead to the failure of businesses will persistently impede growth of this sector. Thus, monitoring and evaluation are meant to monitor and evaluate the sector’s progress to ensure that the programmes outcomes and goals are being achieved.

An effective monitoring and evaluation plan is required to determine how well the collective sectors’ comprehensive programmes (funds within government departments and its agencies and business incubators as the post-funding support structures) meet their objectives.



Figure 5.2 illustrates the monitoring and evaluation process that can be adopted by various funding institutions and other sectorial stakeholders.

**Figure 5.2: Monitoring and Evaluation Process**



Source: Bristol-Myers Squibb, 2011, Pg. 19

Although monitoring and evaluation are often used together as one term, these are actually two different organisational activities. Definitions for the two terms are provided below:

**Monitoring:**

Monitoring is defined as the routine collection and use of data to assess progress in achieving objectives.

**Evaluation:**

Evaluation involves the collection of special data on a specific period or when required to address issues that cannot be examined using routinely collected data such as project's cost effectiveness or overall impact.

- **Management tool** - Monitoring inputs and outputs can help determine whether programmes and services are reaching their target audiences. Monitoring also helps in formulation of annual plans of action by detailing what has or has not been accomplished by previous ones.
- **Accountability to beneficiaries** - Information from monitoring systems provides feedback of all project levels to beneficiaries (SMEs).
- **Advocacy** -Monitoring provides credible information about progress, problems and potential solutions to business challenges encountered.
- **Reporting requirements** - When projects or programmes are funded by different donors, reports are often required according to donor's specifications. The same should be applied by the government funding institutions and its agencies.

## 5.5 Conclusion

As with many studies such as this study, Gauteng government funding departments need to reduce the barriers in terms of the “white studys” and the execution of the identified stepping factors in meeting the objectives of multi-sectorial performance improvement areas.

This implies that as it is always the case, there are good policies, plans and or strategies as have been alluded to in the literature review chapter. The main challenges now lie within ensuring progressive sector that supports the sustainability of SMEs operating in highly populated areas of Gauteng.

The study revealed that SMEs do not only fail due to lack of financing but also due to lack of proper business management skills especially in the areas of cash flow management systems and lack of being innovative in ensuring that they continuously meet with the ever changing demands of economy.

The study also reveals that there is a wide gap in the availability of non-financial support services in the country's business incubators systems. There is also lack of clarity, in terms of the government financing institution which can be of assistance to the SMEs in need of various business support services.

The difficulty of accessing finance from government financing institutions impact extends to limited innovation capabilities by SMEs. Thus, limited financial access by SMEs. A rejected financial application leads to the following;

- access to finance is also the most common barrier to innovation. Lack of innovation implies that the business cannot offer cross-cutting products or services that are able to keep businesses in operation for long.
- It is a barrier to general business operations leading to business closures.
- lack of finance constrain cash flow and hamper businesses' survival prospects

### **Implications of reduced access to capital**

The effect of credit rationing is the potential loss of opportunity and or reduction in the scale of a business, neither of which is a desirable outcome. At the most fundamental level, there are lost opportunities for the borrower and the lender. There are implications for the wider economy also. SMEs are a key source of innovation, competition and choice.

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## **ANNEXURES**

**Annexure 1**

**Covering Letter**



Dear valued Respondent

The attached questionnaire represents a survey amongst government financing institutions and its agencies in Gauteng, that aims to identify possible contributing factors of high Small and Medium Enterprises (SMEs) in the early years of operation.

It is expected that survey will produce information that could be used by the policy makers to improve the success rate of SMEs to survive the early years of business operation (sustainability).

The survey is part of a research project towards the completion of a Masters study (MA-Development Studies) which will be submitted to the Nelson Mandela Metropolitan University. Your agreement to complete the questionnaire is voluntary, and you are assured that all information shall be treated confidentially. Anonymity is guaranteed. Instructions are provided on each section of the questionnaire. Instructions to complete the questionnaire:

The questionnaire answers can be emailed to: [mfuza@webmail.co.za](mailto:mfuza@webmail.co.za) or [nomfuneko@urban-econ.com](mailto:nomfuneko@urban-econ.com)

Email Instructions:

- |   |
|---|
| <ol style="list-style-type: none"><li>1. Once you have completed the questionnaire save the alterations. Please return the document to me using the email: <a href="mailto:mfuza@webmail.co.za">mfuza@webmail.co.za</a> by 14 August 2015</li></ol> |
|---|

Ideally, the questionnaire should take about 20 minutes of your time.

Thank you for your co-operation.

Yours sincerely,

Nomfuneko Mbundwini

0844627217

## **Annexure 2**

### **Questionnaires**

**Questionnaire for SMEs:**

Name of the interviewer	

**INTRODUCTION:** I am doing Masters in Development Studies through Nelson Mandela Metropolitan University (PE) and I am conducting a research on why do average Small and Medium Enterprises (SMEs) fail within the 1<sup>st</sup> year of operation. My main areas of focus seek to examine challenges SMEs come across with regards to accessing funding from Government institutions and its agencies as well as the assessing the availability of business incubators. I would like to ask you some questions about your business operations to assist me with this research study.

**Your individual answers will be kept confidential.**

---

## SECTION A: BACKGROUND INFORMATION

This information will be kept strictly confidential and will only be used if clarification is needed.

Name of respondent	
Name of Business	
Location	
Contact details	
Email	

How long has your business been in existence? Please place x where appropriate

Years of operation	X	Sector	X
0-1		Agriculture	
1-2		Manufacturing	
2-5		Trade services	
5-7		Finance	
		Wholesale, motor services and repairs	
		Construction	
		Healthcare, education, social services	
		Business services	
		Other	

## SECTION B: BUSINESS CHARACTERISTICS

**2.1 Can you please briefly describe main activities of your business?**

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**2.2 To start your business, who assisted you with start-up funds? Please elaborate**

**2.3 Are you aware of the available financial government assistance? If yes, please specify which one?**

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**2.4 If you have applied for financial assistance from government agencies, did you find the process easy or complicated? Please elaborate by first stating an institution you approached for funding**

**2.5 If your answer to finance criteria was “difficult” what would you recommend to the panel setting finance approval criterion to consider with regards to the nature of SMEs?**

--

**2.6 Does your business have the following financial management records? Please indicate and explain**

Have you developed a business plan?		
Have you developed financial forecasts for your business?		
Have you approached a professional business or finance advisor to assist in business and financial forecasts?		
How do you manage your day-to-day cash flow?		
Do you monitor performance and keep business costs to a minimum		
Do you have a person responsible personnel for chasing customer payment?		
Have you established a procedure for dealing with late payments from customers?		
Do you have a system of budgeting sales and expenses, and do you compare this with reported performance?		
Does the business have enough finance to meet its needs?		
Is accessing finance a problem?		
If so, what are you doing to address this?		
Do you produce regular management accounts which are made available to credit agencies?		

**2.4 What is the total number of employees working for this business?**

*Please write numbers in box*

Permanent or full time worker(s)	1
Part time worker(s)	2
Total <i>(Must Add Up)</i>	3

**2.5 How has the number of employees changed ?:**

Over the past 1-5 years.....

**2.6 What do you foresee for your business over the next five years?**

*In terms of revenue?*

<b>Decrease</b>	1
<b>Stay the same</b>	2
<b>Increase</b>	3

*In terms of employment?*

<b>Decrease</b>	1
<b>Stay the same</b>	2
<b>Increase</b>	3

*In terms of growth?*

Item	Please tick where applicable	Why?
<b>Growing</b>		
<b>Staying the same</b>		

Closing down		
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2.7 Do you foresee any other major changes to your business in the next five years? Explain

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### SECTION C: Non-Financial Support

3.1 Is there a business incubator in your local area?

*Tick One*

Yes	1	No	2
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If YES, what kind of support does it offer, if NO, would your business benefit from it if it what was available? How so?

3.2 What is the average education level of (non-management) employees? Hint : Grade 12/Higher education

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3.3 What specific skills are demanded by your company? E.g carpentry, plumbing, mechanic, hairdresser etc.

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### SECTION D: OPPORTUNITIES AND CHALLENGES

4.1 What are the greatest challenges to the business in terms of limiting growth and employment creation?

*le: Infrastructure, service delivery, taxes/rates, skills shortages, available technology, lack of customers*

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**4.3 What type of assistance do you require in order to be successful and expand?**

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## **SECTION 5: BUSINESS REVENUE**

**5.1 Please estimate the businesses annual revenue? Your response will be kept confidential.**

*Tick only one*

Less than R150,000	1
R150,000 to R5million	2
R5 million to R10 million	3
R10 million to R 20 million	4
R20 million to R40 million	5
R40 million to R100 million	6
Over R100 million	7

**5.2 How has the businesses revenue changed?**

**Over the 1-5 years?** \_\_\_\_\_

**Since the recession?** \_\_\_\_\_

**Thank You for completing this questionnaire!!!**

## Questionnaire for Business Incubator Hubs

This information will be kept strictly confidential and will only be used if clarification is needed.

Name of respondent	
Name of Institution	
Location	
Contact details	
Email	

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### Question 1

Can you please briefly explain your role in the incubator hub?

### Question 7

How long has the program been operating?

### Question 2

Will you please explain how does your hub work?

### Question 3

How do you decide who can join your business incubator?

### Question 4



What services are available via partners of the incubator?

**Question 5**

How many ventures can you take on? What are your anticipated returns (e.g. how many do you expect to graduate from the hub, or averaged across the portfolio)?

**Question 6**

How has the incubator progressed since inception? I.e. track record?

**Question 7**

What is the program's graduation policy, i.e. what are the incubator's exit criteria?

**Question 8**

Do you have SMEs that have graduated from the incubator system and if so, how many and how long have they been independent from the incubator?

**Question 9**

What fees are involved?

**Question 10**

Any other pointers regarding presence of incubator hubs in Gauteng you may want to share/add?

**Thank You for participating in my research!!!**

### **Annexure 3**

## **Profile of Research Participants (Funding institutions and Business Incubators)**

Participant A	Incentives Programmes Manager: Government Department that is responsible for providing funds and also finances most of its agencies. Experience: 11-19 years
Participant B	Executive Manager: One of government's parastatal that is responsible for financing industrial projects Experience: 10 years
Participant C	Head of Marketing and Sales: Organisation is one of the newly established business incubators and is located close to township businesses. Experience: 6 years
Participant D	Assistant Manager: Organisation is responsible for advising sector specific businesses Experience: 9 years
Participant E	General Manager-Inland Operations: One of the private sector business incubators that assist black small businesses. Experience: 12 years
Participant E	Manager: Organisation is one of the DTIs funding agencies that is responsible for providing funds to black businesses Experience: 8 years
Participant F	General Manager: Organisation is one of the specific government agency that is solely responsible for funding SMMEs

	Experience: 11 years
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