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The role played by Business Development Services Providers (BDSs) in improving access to finance by start-up SMEs in the Buffalo City Municipality

By

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i

ABSTRACT

Small and medium enterprises (SMEs) are very important to employment creation, poverty alleviation and the sustainable economic development of a nation. Encouraging SMEs, especially start-ups is crucial for sustainable economic growth. However, the failure rate of start-up SMEs in South Africa is one of the highest in the world. In reviewing the literature of the causes of the failure of start-up SMEs, access to finance emerged as a prime challenge.

Start-up SMEs find it very difficult to obtain external finance from commercial banks and venture capitalists. The national and provincial governments in South Africa have realised that access to finance is a major constraint to the growth and survival of start-up SMEs and have put in place certain measures to improve access to finance by start-up SMEs. One of the primary measures put in place by government to improve access to finance by start-up SMEs is the provision of Business Development Service by some government agencies. This research investigates the role of Business Development Services Providers (BDSs) in improving access to finance for start-up SMEs. Questions arise as to why the failure rate of start-up SMEs is high in South Africa despite all these government measures aimed at assisting start-ups to access finance.

Empirical research was conducted to investigate the role of BDS in improving access to finance by start-up SMEs. The instrument used for data collection was the self-administered questionnaire. The statistical analyses included descriptive statistics, T-test, ANOVA, correlation and regression analysis. The Cronbach's alpha was used as a measure of reliability.

The results of the study revealed that:

- Access to finance is still a major problem hindering the survival of start-up SMEs.

- There is a lack of awareness of BDS providers and their services by the majority of start-up SMEs.

- There is a significant positive relationship between the use of BDS by start-up SMEs and success in accessing finance.

- Start-up SMEs that are aware of BDS do make use of the services.

The results suggest that BDS are important to improving access to finance by start-up SMEs. However, there is a need to build awareness and encourage the use of BDS by start-up SMEs to improve their access to finance and ultimately increase their chances of survival.

DECLARATION

I, the undersigned, Musara Mazanai, hereby declare that this thesis is my own original work and that it has not been submitted, and will not be presented at any other University for a similar or any other degree award.

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Signature

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Date

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My sincere gratitude to:

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

CHAPTER 1: INTRODUCTION AND BACKGROUND TO THE STUDY

1.1   Introduction

This chapter introduces a study that was undertaken to investigate the role played by Business Development Services Providers (BDSs) in improving access to finance for start-up small and medium enterprises (SMEs). The study is based on the premise that, despite various institutional frameworks aimed at helping SMEs in addressing challenges that lead to their failure, the failure rate of SMEs (particularly during the start-up phase) in South Africa remains high. The study focuses on access to finance as one of the major challenges impeding the growth of start-up SMEs in South Africa. A detailed investigation of the role of BDSs in improving access to finance, and the gaps and problems encountered in services provision can lead to insights into developing an effective framework of BDSs services provision. This chapter presents a broad overview of the study. Specifically, the following areas are outlined: the background of the problem, the problem statement, the research objectives, the research hypotheses and the significance of the research. This chapter, in addition describes the research methodology, the limitations of the study and the layout of the study.

1.2   Background to the Study

Small and medium enterprises (SMEs) play a significant role in the economic development of every nation, particularly in developing countries such as South Africa. The development of SMEs is seen globally, as a key strategy for economic growth, job creation and poverty reduction. The contribution of SMEs to economic growth of a country is enormous. SMEs create new jobs, introduce innovative products and services, open up foreign markets, and act as agents of economic and social development in rural areas (Berry, Blottnitz, Cassim, Kesper, Rajaratnam & Seventer, 2002:4). The South African Department of Trade and Industry (DTI) estimates that small businesses employ almost half of employees in the formal sector, and contribute to 42% of the country's gross domestic product (Makgoe, 2008:4).

Start-up SMEs are a key driver of sustainable economic development of the country. Start-ups for the purpose of this research are defined as new businesses that have been in operation for a period of less than 3.5 years (Maas & Herrington, 2006). In addition, Maas and Herrington (2006:4) suggest that if the government of South Africa wants to sustain economic growth that will create wealth for all, efforts should be made to increase new business start-ups. Furthermore, Herrington, Kew and Kew (2009:153) point out that given the failure of the formal and public sector to absorb the growing number of job seekers in South Africa, increasing attention has focused on entrepreneurship and new firm creation and its potential for contributing to economic growth and job creation.

Maas and Herrington (2006:12) and Herrington *et al.* (2009:15) posit that access to finance is a major problem for the South African entrepreneur. The failure rate of start-up SMEs in South Africa is about 80%. A lack of financial support is the second most reported contributor in South Africa to low new firm creation and high failure rate, after education and training . Many entrepreneurs raise their start-up capital from their own or family savings, which is often inadequate, rather than approaching formal institutions or agencies for external finance.

According to the Umsobomvu Youth Fund (2008) only about two out of every ten applications for credit by start-up SMEs are approved in South Africa. Von Broembsen, Wood and Herrington (2005) also point out that 75% of credit applications by start-up SMEs to banks in South Africa are rejected. In developed countries, the situation is markedly different. According to Statistics Canada (2004) in Riding and Orser (2007:5), there is approximately 82% approval rate for credit applications by start-up SMEs in Canada. In 2000, 23% of start-up SMEs made requests for debt financing and 82% were approved. Of the loans approved, 75% were not covered by a federal loan guarantee. In England, 71% of applications for credit by start-up SMEs from financial institutions between 2004 and 2007 were approved. Twenty six percent (26%) were wholly or partially rejected. A ninety three percent (93%) success rate was achieved in asset based lending and factoring, 75%

for overdrafts, a 70% success rate for credit cards and 88% for leasing and hire purchase. This suggests a weak access to finance by start-up SMEs in South Africa which must be addressed if their high failure rate is to be reduced.

Ensuring access to finance has been an important pillar of public support for small business in the United States for more than half a century (Craig, Jackson & Thomson, 2007:4). In South Africa, public sector support to SMEs is also very notable. Concerns that small firms face problems in getting access to funding may be valid. Since a large share of small firms are relatively young and have little or no credit history, lenders may be reluctant to fund small firms, especially those with new and innovative products, which are likely to be difficult to evaluate. Because small businesses face severe credit rationing, they may become credit constrained and miss out on projects that are profitable because they cannot raise the external capital necessary to fund them (Craig *et al.*, 2007:4).

Promoting start-ups is the key to enhancing competition and entrepreneurship. This has spill-over effects on innovation, efficiency and the growth of productivity. More importantly, the expansion of SMEs could boost employment more effectively than large firms can do because they tend to be more labour intensive (Alweendo, 2004). From this perspective, government intervention to improve access to finance by SMEs especially start-ups could help to create employment and alleviate poverty.

A controversial issue in the access to finance by start-up SMEs is the failure of the private sector financial services providers to address the financial problems facing SMEs. Rogerson (2008:66) points out that the role of private banks in addressing the credit needs of SMEs is a major area for concern. Schoombee (2000:751) and Daniels (2004:840) address the failure of commercial banks to serve the low-income market and of the potential policy options available to government to stimulate involvement. Initiatives made by banks to enter the small business market have centred largely on the formally employed and/or delivering products to established rather than emerging SMEs. Schoombee (2000:752) refers to this phenomenon as market failure and argues that the reasons for market failure are explained in terms

of the high risk of default when banks grant credit to start-up SMEs, the high cost of screening and the low returns on income from small business lending.

These arguments are also supported by Stiglitz and Weiss' (1981: 393-410) credit rationing theory. Stiglitz and Weiss (1981: 393-410) argue that in a market in equilibrium but with problems that are commonly found in financial markets, it would be rational for banks to engage in "credit rationing". Due to problems of asymmetric information and agency problems, banks have difficulty distinguishing good risks from bad risks and in monitoring borrowers once funds have been advanced (Organisation of Economic Cooperation and Development, (herein after OECD) (2006). In the Stiglitz-Weiss' formulation, credit rationing is said to occur if

i) among loan applicants who appear to be identical, some receive credit while others do not

ii) there are identifiable groups in the population that are unable to obtain credit at any price.

The argument put forward by Stiglitz and Weiss (1981:393-410) suggests that there is market failure in access to external finance by start-up SMEs. Therefore, government intervention to address access to finance challenges facing start-up SMEs is deemed necessary. According to the CEO of the South African Chamber of Commerce and Industry (Sacci), Neren Rau, the failure to help SMEs out with their crippling cash-flow problems could lead to structural problems in the economy (Doneva, 2009).

The role of the government of South Africa is of critical importance in shaping the present and future of the SME sector. The government of South Africa, through the Department of Trade and Industries (DTI) has established a number of public sector institutions that cater for the needs of SMEs. Among them are Khula Enterprise Finance Ltd, Small Enterprises Development Agency (SEDA), Industrial Development Cooperation (IDC), Umsobomvu Youth Fund (UYF), South African Micro-Finance Apex Fund (SAMAF), National Empowerment Fund (NEF), South African Women Entrepreneurs' Network (SAWEN) and Technology for Women in Business (TWIB) (Department of Trade and Industries, 2005).

Provincial government agencies such as the Eastern Cape Development Corporation (ECDC) in the Eastern Cape, Gauteng Enterprise Propeller (GEP) in Gauteng, Limpopo Business Support Agency (LIBSA) in Limpopo, and the Western Cape's Red Door also provide a range of business development services to SMMEs at provincial level and have strengthened partnerships with SEDA. These, in this dissertation are termed Business Development Services providers (BDSs).

The government has invested considerable resources in supporting small enterprises. However, the effectiveness of these programmes is highly contentious. Small enterprises are largely unimpressed with the direct support offered by government (Orford, Herrington & Wood, 2004:4). Despite a wide range of BDSs in the South African business landscape, start-up SMEs still experience daunting challenges, specifically in access to finance, which hampers entrepreneurial development. It is therefore important to assess the role being played by these BDSs in addressing access to finance challenges facing start-up SMEs. The question is "Are BDSs effective in addressing access to finance challenges facing start-up SMEs?" This is the focus of this study.

The following section describes the research problem for this research study.

1.3   Statement of the Research Problem

Many SMEs fail in the infancy stage and some fail a few years after start-up as a result of a number of challenges. Herrington *et al.* (2009:62) argue that the prevalence rate for established business, run by owner-managers in South Africa is very unsatisfactory. South Africa ranked 41st out of the 43 countries, with an established business rate of 2.3% indicating a high failure rate for South African start-up SMEs. Furthermore, Van Eeden, Viviers and Venter (2003:13) deduce that the estimated failure rate of start-up SMEs is between 70% and 80% and millions of rands are being lost on business ventures because of avoidable mistakes and problems. In South Africa, various authors (Nigrini and Schoombee (2002), Maas

and Herrington (2006), Rogerson (2008), Herrington *et al.* (2009), among others, revealed that access to finance is a major problem hindering the survival of start-up SMEs. According to Nigrini and Schoombee (2002:737), in a survey of SMEs worldwide, access to finance emerged as one of the most urgently felt needs. In another study, Rogerson (2008:62) also supported the view that the lack of access to finance is one of the major problems facing SMEs in the South African business environment. Financing constraints have implications for investment, financial system stability and economic development.

Start-up SMEs are the most affected by financing constraints. This is mainly because smaller firms tend to be subject to high risk, being less likely to have developed a good reputation with investors, as small firms are typically start-ups with little or no credit history (Craig *et al.,* 2007:4). This leads to market failure. This is why programmes of financial assistance are one of the principal ways by which governments, international development agencies and donors support the SME sector.

The purpose of this study was to investigate if government intervention efforts in the form of BDS are helping to improve access to finance by start-up SMEs. The effectiveness of the intervention efforts by government were measured by investigating if start-up SMEs that use BDS had improved access to external finance. In addition, the study investigated whether start-up SMEs were aware of BDS and whether start-up SMEs that were aware of BDS were making attempts to use their services.

Given such a scenario, the primary research problem for this study was:

- Does the use of government intervention efforts through Business Development Service (BDSs) help to improve access to external finance by start-up SMEs?

The other research problems investigated by this study were:

- Are start-up SMEs aware of BDSs?
- Do start-up SMEs that are aware of BDSs utilise their services?

To address these problems, the following objectives were set for this research study.

1.4 Research Objectives

The research sought to achieve the following objectives:

1.4.1 Primary objective

- To investigate empirically whether start-up SMEs that use BDSs have improved access to external finance

1.4.2 Secondary objectives

- To review the literature on the contribution of start-up SMEs, their creation rate, their failure rate and the causes of failure in South Africa
- To review the literature on the challenges hindering access to finance for start-up SMEs (i.e. the causes of market failure)
- To review the literature on government intervention efforts that can assist in improving access to finance by start-up SMEs
- To investigate empirically whether start-up SMEs are aware of BDSs
- To investigate empirically whether start up SMEs that are aware of BDSs use their services
- To develop a more efficient model of government intervention effort through BDSs in improving access to finance by start-up SMEs

In pursuit of the above mentioned objectives, the following hypothesis statements were formulated.

1.5 Research Hypotheses

1.5.1 Primary Hypothesis

- $H1_0$ There is no relationship between the use of BDSs and improved access to finance by start-up SMEs.
  $H1_A$ There is a relationship between the use of BDSs and improved access to finance by start-up SMEs.

1.5.2 Secondary Hypotheses

- $H2_0$ Start-up SMEs are not aware of BDS providers in their localities.

  $H2_A$ Start-up SMEs are aware of BDS providers in their localities.

- $H3_0$ Start-up SMEs that are aware of BDS are not using their services.

  $H3_A$ Start-up SMEs that are aware of BDS are using their services

Having formulated the research hypotheses, addressing the significance of the research became vital.

1.6 Significance of the Research

The contributions of start-up SMEs to the economic and social development of the country are enormous. In their endeavour to grow and survive, start-up SMEs face a number of challenges. One of the prime challenges hampering the growth of start-up SMEs is the lack of access to finance (Maas & Herrington, 2006:12). The research at hand sought to address the role played by Business Development Services (BDSs) in addressing the challenges facing start-up SMEs in accessing finance. Once the challenges hindering access to finance by SMEs are identified, policy recommendations can be made, and if implemented, can go a long way in fostering entrepreneurial survival and growth for the benefit of entrepreneurs, their communities and the nation at large.

With a sub-standard Total Early Stage Entrepreneurial Activity rate of 5.29 in 2006, and a failure rate of start-up SMEs in the order of 70-80%, there is a greater need to facilitate survival of start-up SMEs in South Africa for sustainable economic growth. An in-depth understanding of challenges facing start-up SMEs is crucial in developing strategic and sound interventions to improve access to finance by SMEs.

The following section provides details of the research methodology that was followed in this study.

1.7   Research Methodology and Design

The study comprises two phases which are phase 1: Literature review and phase 2: Empirical study.

1.7.1   Phase 1: Literature review

The literature review examined the role of start-up SMEs in sustainable socio-economic growth, the access to finance challenges facing start-up SMEs and the need for government intervention (in the form of BDSs) to address these access to finance challenges.. The contribution of SMEs to poverty reduction, income redistribution and employment was reviewed. In addition, the definitions of a start-up SME as well as the creation and failure rates of start-up SMEs were examined. The review also examined the theories of capital structure and determined whether there is sufficient debt funding for start-up SMEs in South Africa. The last part of the literature review focused on the need for BDSs, an examination of BDSs and justification for the need for government support to start-up SMEs. Sources that were consulted for the literature study included the following:

- Local and international peer-reviewed journals such as Small Business Economics, International Small Business Journal, Journal of Finance, Journal of Banking and Finance, Journal of Money, Credit and Banking and South African journal of Accounting Research.
- Books on finance, entrepreneurship and research methodology such as Financial Management by Correia, Flynn, Uliana and Wormald (2008), Timmons and Spinelli (2007) and Business Research Methods by Cooper and Schindler (2003, 2008).
- Unpublished Masters and Doctorate dissertations such as Fatoki (2010).
- Internet sources through the websites of Statistics South Africa, Global Entrepreneurship Monitor, Organisation for Economic Co-operation and Development (OECD), World Bank, African Development Bank, Department of Trade and Industries (DTI) and the New Partnership for Africa's Development.

The literature review phase identified gaps that needed to be addressed empirically and this led to the empirical study.

1.7.2 Phase 2: Empirical study

The empirical study was approached from the perspective of a formal research design through the definition of the study population, the incorporation of a suitable measuring instrument and reliable techniques for data analysis as stipulated in Cooper and Schindler (2008:82). The empirical research for the study was conducted in two ways; a pilot study and the main survey. The measuring instrument was designed to measure the role played by BDSs in improving access to finance by start-up SMEs. Following the design of the initial questionnaire, a pilot study was conducted on 20 respondents.. The result of the pilot study and a discussion with a panel of experts led to the initial questionnaire being revised accordingly, taking into consideration all the flaws identified in the process. The questionnaire was later administered to 315 respondents (owners, managers and owner-managers of businesses that had been in operation for less than 3.5 years). Following rigorous follow-ups on respondents a response rate of 65.7% was achieved.

- **Research type**

According to Zikmund (2003:68) there are two basic types of research design: qualitative and quantitative and a hybrid of the two. The choice of research design centres on the nature of the research, the setting, the possible limitations and the underlying paradigm that informs the research project. This study used a quantitative research design. Quantitative research involves the collection of primary data from large numbers of individuals/respondents with the intention of projecting the results to the research population. The aim is to generalise about a specific population, based on the results of a representative sample of that population. The research findings will then be subjected to mathematical or statistical manipulation to produce broadly representative data of the total population and forecast future events under different conditions (Tustin, Martins, Ligthelm, & Wyk, 2005:89).

- **Data collection method**

Gerber-Nel, Nel and Kotze (2005:88) identify three primary data collection methods, namely, observation, experiment and survey. Observation is a process through which primary data is obtained by observers (humans or machines) about the behavioural pattern of people, objects or occurrences. With the experiment method of data collecting, the researcher manipulates an independent variable and then measures the effect. The experimental setting can be in a laboratory or in the field. In a laboratory, experiments are conducted in an artificial or laboratory setting. In survey research, the researcher selects a sample of respondents from a population and administers a standardized questionnaire to them. This study used the survey research. Surveys can be divided into four major types: personal interviews, telephone surveys, mail surveys and self- administered surveys as pointed out by Gerber-Nel *et al.* (2005:94). The data for this study was gathered through self-administered questionnaires.

- **Targeted Study population**

Hair, Wolfinbarger, Ortinau and Bush (2008:129) define a targeted population as consisting of the complete group of elements (people or objects) that are identified for investigation based on the objectives of the research. Thus the defined target population of this research study includes all start-up SMEs in the Buffalo City Municipality. The Buffalo City Municipality consists of East London (including Mdantsane), King William's Town and Bisho. The study population in this study was obtained from information provided by the Small Businesses Development Agency (SEDA), the Black Enterprises register and the Yellow Pages of the telephone directory. According to these sources, 407 SMEs suited the definition of start-up SMEs in the area of focus for this study (that is, SMEs that had been in operation for a period of less than 42 months). SEDA is one of the government's small business development agents, born out of the DTI's strategy to promote SMEs in South Africa. It offers a range of business development services to SMEs. It provides non-financial services through integrated support agencies across the nation with more than 284 Enterprise Information Centres in municipalities across the nation

- **Sampling method**

The research study made use of the simple random sampling method which is the probability sampling method. The probability sampling method is a sampling method in which every element in the population has an equal chance of being included in the sample (Tustin *et al.,* 2005:344).

- **Sample size**

The sample size was calculated using the Raosoft sample size calculator with a margin of error of 5%, 95 confidence levels and a 50% response distribution. The sample size calculator gave a minimum recommended sample size of 198 SMEs. However, 315 questionnaires were distributed to provide for non-responses. The sample was small enough to allow for the feasibility of the study and yet large enough to be truly representative of the targeted population.

- **Statistical analysis**

Data collection and analysis was carried out with the assistance of a firm of professional statisticians called Stat Analysis limited. Data analysis was done using the Statistical Package for Social Sciences (SPSS) version 12.0 for Windows. The statistical analysis included descriptive statistics, T-test, ANOVA, Pearson correlation and regression analysis. Reliability was tested using Cronbach's Alpha. Validity was ensured by using a statistician and a panel of experts to evaluate the research instrument for conceptual clarity and by pre-testing the research instrument in a pilot study.

- **Referencing style**

The referencing style used for the study was the Harvard method.

1.8   Limitations of the Study

It is important to recognise the inherent limitations of the scope and approach of the study. Addressing challenges facing SMEs can be approached from different

perspectives. Despite numerous challenges impeding the survival and growth of start-up SMEs, the study focused mainly on access to finance. Only BDSs were investigated as an intervention to address access to finance challenges facing start-up SMEs. Furthermore, BDS provision is in the form of public sector and private sector services provision. The study concentrated only on public sector services provision. This is mainly because the focus was to investigate the effectiveness of government intervention through BDSs in addressing the financial challenges facing start-up SMEs. Government intervention has a more socio-economic development focus rather than the capitalistic focus of the private sector which is usually market driven. Therefore, the study did not investigate private sector BDS provision. In addition, the study was limited to the opinions of start-up owners, owner-managers and managers in the Buffalo City Municipality in the Eastern Cape Province. Because of the limitations pointed out, care should be exercised in the interpretation and application of the results of this study and the generalisation of the findings to the whole of South Africa.

1.9   Layout of the Study

Chapter 1: Introduction and background of the study

This chapter provides the background of the study. The statement of the research problem, research objectives and hypotheses are discussed in this chapter. In addition, the significance of the study, the research methodology and the limitations of the study are explored.

Chapter 2: Start-up SMEs: A South African Perspective

The chapter provides a comprehensive literature study of SMEs and specifically, start-up SMEs in the South African context. The definition, contribution and failure rates of start-up SMEs, particularly in South Africa are discussed in this chapter. Literature review on challenges facing start-up SMEs is also presented in this chapter.

Chapter 3: Access to Finance in the SMEs sector

The chapter addresses the financial needs of SMEs, theories of capital structure as well as access to finance issues facing start-up SMEs in South Africa.

Chapter 4: Business Development Services (BDSs) in South Africa

Chapter four provides a comprehensive background literature on BDSs in both the global and South African economies. This includes a definition, the challenges, successes and contributions in addressing challenges facing start-up SMEs.

Chapter 5: Research Methodology and Design

Chapter 5 describes the research methodology applied in the study. The research methods, techniques and sampling procedures followed are discussed in this chapter.

Chapter 6: Data Analysis and Research Results

Chapter 6 focuses on the interpretation and a quantitative analysis of the research results. Tables and graphs are used to illustrate the research results.

Chapter 7: Conclusions and Policy Recommendations

Chapter 7 provides conclusions and policy recommendations drawn from the research results. The limitations of the study and recommendations for further studies are also provided in this chapter.

1.10 Summary

The chapter gave an insight into the contribution of start-up SMEs to sustainable socio-economic development of the country. Furthermore, it revealed the need to

address access to finance challenges facing start-up SMEs through the use of BDS. However, the question of contention is whether BDSs are really helping start-up SMEs in improving their access to finance and, if they are helping, to what extent. This chapter set out the research problems. In addition, the chapter examined the research objectives, the research hypotheses and the significance of the research. Furthermore, the chapter highlighted the research methodology, the limitations of the study and the layout of the study.

The next chapter focuses on the role of SMEs (with a special emphasis on start-up SMEs) in development, and especially the impact of SMEs on employment, poverty alleviation, income equality and economic growth.

CHAPTER 2- SMEs: A SOUTH AFRICAN PERSPECTIVE

2.1 Introduction

Start-up SMEs are a pillar of a sustainable growth in every thriving economy. The importance of start-up SMEs to job creation, poverty alleviation, and economic growth of a nation cannot be underestimated. With an increasing number of school leavers and a continuously growing population growing in South Africa, there is need to create new jobs, increase wealth and avoid economic stagnation. This can be achieved if the creation of new businesses is encouraged and supported (Maas & Herrington, 2006)

This chapter examines the definition of SMEs and the contribution that SMEs make to poverty alleviation, income equality, employment creation and the economic growth of South Africa. In addition, the definition and the importance of start-up SMEs are discussed. In their endeavour to grow, start-up SMEs face a number of challenges which impede their continued survival. The literature on the challenges facing start-up SMEs in South Africa is also the focus of this chapter.

The following section is a review of the literature on the definition of a SME from international and South African perspectives.

2.2 Definition of SME

SMEs are the cornerstone of the success and growth of the South African economy. The SME sector constitutes about 97% of the absolute number of enterprises in South Africa. Large enterprises constitute only 3% of all registered enterprises in 2007 (Statistics South Africa, 2007). However, the statistical determination of the number of SMEs varies with the definition of SMEs adopted.

Selai (2008) suggests two main rationales for defining the SME sector. These are: to generate reliable statistics (statistical definitions) which will facilitate the monitoring and evaluation of development in the SME sector and for direct support for SMEs as well as administrative definitions used by the government and its agencies to reinforce a wide range of SME support services and strategies. Furthermore, clearly

defining the SME sector is a major step in strengthening small business support and a way to develop objective driven policy instruments. According to Angela Motsa and Associates (2004:1) the categorisation of SMEs was used as a basis for defining the policy stance taken in the White Paper on SMEs development by the Department of Trade and Industries in 2005. Furthermore, as articulated in the White paper, since publicly funded support for small enterprises should only be granted to those really needing it, the objective definition and classification of different types of small enterprises is essential. Moreover, adopting guidelines for defining SMEs eliminates confusion among policy makers, academics and researchers (Selai, 2008).

Worldwide, there is not only one clearly stated definition of an SME. Different definitions are adopted in different countries and regions. Beck, Levine and Demirguc-Kunt (2005:200) point out that there is no universally agreed upon definition of the term small and medium enterprises (SMEs). Numerous factors related to a country's social-economic environment influence the definition of an SME. However, these definitions follow either quantitative or qualitative parameters. Qualitative definitions consider aspects of management structure and decision making, control and independence of ownership, financial practice and trading style. Quantitative parameters include market share, turnover, and number of people employed, size of capital invested, net worth, value added and volume of production.

The National Small Business Act of South Africa of 1996, as amended in 2003, describes an SME as,

> *"…a separate and distinct entity including cooperative enterprises and non-governmental organisations managed by one owner or more, including its branches or subsidiaries if any predominantly carried out in any sector or sub-sector of the economy mentioned in the schedule of size standards, and can be classified as an SME by satisfying the criteria mentioned in the schedule of size standards" (Government Gazette of the Republic of South Africa, 2003).*

The quantitative definition of an SME in South Africa is as follows:

- **Small enterprise**: Employs between 5 and 50 employees, generates a maximum of R13 million turnover per annum and has a maximum balance sheet total of R5 million.

- **Medium-sized enterprise**: Employs a maximum of 200 employees, generates a maximum of R51 million turnover per annum and has a maximum balance sheet total of R19 million.

Excluded from the SME sector definition in South Africa are micro-enterprises. These are very small businesses, often involving only the owner, family members and, at the most, one or two paid employees. These enterprises usually lack formality in terms of licences, tax registration, formal business premises, operating permits and accounting procedures.

The following sub-section discusses the contribution of SMEs to the South African economy.

2.2.1 The contribution of SMEs

International and local literature support the contention that SMEs are critical to the success of every economy (Berry *et al.,* 2002; Neck, Zacharakis, Byrave and Reynolds, 2003; European Union 2005; Department of Trade and Industry, 2005). According to the European Union (2005), SMEs are the engine of the European economy. They are an essential source of jobs, create entrepreneurial spirit and innovation in the European Union and are thus crucial for fostering competitiveness and employment. Literature from other developed countries also supports the fact that SMEs are a tool for employment creation, economic growth, poverty alleviation and solve income inequalities.

a) Contribution of SMEs to employment

The job creation potential of SMEs is recognised in both international and local literature. Stevenson and Lundström (2001) opine that government attention to the SME policy agenda was intensified considerably following the breakthrough research of Birch (1979) in which it was discovered that over 80% of new jobs were being

generated by small rather than large firms in the United States of America and that, in fact, new, young firms were the engine of growth of the American economy. Studies in other developed countries also confirm the job creation potential of SMEs. During the period between 1997 and 1998, 45% of gross new jobs in Australia were created by SMEs; between 1994 and1998, SMEs generated more than 80% of new jobs in the Netherlands (Baljé & Waasdorp, 2001:4).

The European Union (2009:3) concedes that in the enlarged European Union of 25 countries, some 23 million SMEs provide around 75 million jobs and represent 99% of all enterprises. 99% of firms in the European Union are SMEs and they provide two-thirds of all private sector jobs. Therefore, SMEs are in fact the real giants of the European economy. SMEs are one of the primary reasons why unemployment is low in Europe. Large firms in Europe have been shedding jobs while employment in the SME sector has increased.

Several studies from developing countries also acknowledge the contribution of SMEs (Kesper, 2001; Hamwele, 2005:5; Department of Trade and Industry, 2005). According to Hamwele (2005:5), in Namibia the SME sector employs approximately 20% of the Namibian labour force. This is a strong indicator that the SME sector is a major tool for creating socio-economic stability.

SMEs also play a significant role in absorbing most of the unskilled labour force in South Africa. Kesper (2001:173) suggests that SMEs are seen as the vehicle to address unemployment problems in South Africa. In South Africa, and are therefore regarded as the engine of employment creation. Manuel (2007) states that,

> "*SMEs remain a vital ingredient for job creation in our economy*". FinMark Trust (2006) also argues that "*…one of the best ways to address unemployment is to leverage the employment creation potential of SMEs and to promote SME development*".

In their study, Falkena, Abedian, von Blottnitz, Coovadia, Davel, Madungandaba, Masilela and Rees (2001:25) argue that as a result of the lack of reliable data,

estimation of the value added by SMEs to employment creation and economic growth is a hazardous process. However, despite the problems of estimation, Falkena *et al.* (2001:15) point out that the estimate data show the material significance of SMEs to employment in South Africa. Falkena *et al.* (2001:15) estimated that the share of SMEs in national job creation is 62 %. Due to structural changes in the economy affecting bigger firms, the job creation capacity of SMEs is expected to be more significant and increasingly to generate jobs that are skill intensive and well remunerated.

Despite the various arguments in favour of SMEs as the major employment creators, authors such as Kesper (2001:173) have reservations about the job creation potential of SMEs. Kesper (2001:173) points out that there is a mismatch between the reality and the model of the SME sector used by South African policy makers. Only a few dynamic SMEs show a potential to contribute to rapid employment creation. While some SMEs have been able to increase their sales (and to a lesser extent their profits), this turnover growth is not accompanied by employment growth. Nissanke (2001:345) opines that in Sub-Saharan Africa, large firms were the dominant source of net job creation. While gross rates of job creation and destruction are higher in SMEs, there is no systematic relationship between net job creation and firm size. In terms of job quality, microeconomic evidence does not support the pro-SME view that small firms create better quality jobs than large firms.
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 Nigrini and Schoombee (2002:735) point out that despite some literature that challenged the job creation potential the fact that employment opportunities in large enterprises are shrinking have placed the hope of job creation on SMEs. In addition, Finlayson (2003:1) points out that two decades of academic research had not settled the question of the extent to which SMEs are a source of job creation, poverty reduction and income equality. According to the author, despite a few studies challenging the notion that SMEs create more than a disproportionate share of new jobs, Birch's (1979) original study has had considerable staying power. Birch's research was revolutionary and sparked controversy because it stood in sharp contrast to the traditional belief that large firms were the backbone of the American

economy. Finlayson (2003:1) further argues that even if SMEs do not create the most new jobs, researchers should not be distracted from or minimise the economic benefits that flow from them. SMEs are a critical part of the economy and provide millions of jobs. They are more flexible than large firms. They are also a source of innovative products, processes and business methods. Although the assumption that the large firms create more stable jobs might be true, it should always be remembered that, most of these large firms today began as SMEs. Therefore, SMEs should be encouraged and supported in order to realise their job creation potential.

b) Contribution of SMEs to poverty alleviation and income distribution

South Africa suffers from high levels of poverty and income inequality and it is vital that strategies be developed to alleviate the problems. Aguero, Carter and May (2007:785) revealed that approximately 57% of individuals in South Africa live below the poverty income line of two United States Dollars per day. Despite economic growth in South Africa in the past ten years, the rate of poverty has not declined. Evidence seems to indicate that poverty is proving to be much more perverse than initially hoped.

In many developing countries (South Africa included) poverty levels are significantly higher than those in developing countries. Table 2.1 shows the poverty levels in selected developing and developed countries.

Table 2.1: Poverty levels in selected African and developed countries

African countries	Poverty level (%)	Developed countries	Poverty level (%)
South Africa	57	France	6
Cameroon	48	UK	14
Senegal	54	USA	12
Zambia	86	Australia	8

Source: World Bank (2008).

It is therefore important to probe the reasons why there are such marked differences in poverty levels between developing and developed countries. According to the Parliament of the Republic of South Africa (2005), the government of South Africa identifies SMEs as a key to poverty alleviation, income equality, employment and sustainable economic growth.

"*The stimulation of SMEs must be seen as part of an integrated strategy to take this economy onto a higher road - one in which our economy is diversified, poverty is reduced, productivity is enhanced, investment is stimulated and entrepreneurship flourishes*".

In addition, The New Partnership for Africa's Development (NEPAD) agrees that,

"*SMEs offer significant prospect for increased employment, poverty alleviation, increased utilisation of Africa's productive and intellectual resources, improved tax base for government revenues and low-cost accessible investment opportunities for local populations*" (New Economic Partnership for Africa's Development, 2008).

Beyene (2002:132) also reveals that Africa's ability to break out of its current non-impressive economic performance would, to a large extent, depend on its ability to harness the entrepreneurial potential visible on its streets, market places and in small and medium enterprises.

The World Bank (2003) and International Labour Organisation (2008) further assert that a vibrant SME sector improves productivity, promotes economic growth and increases opportunities for the poor. SMEs are the most important driver of local economic development. This is one of the reasons why all over the world, governments are stimulating and supporting a healthy small firm sector. The pro-SME policy of the World Bank is based on three core arguments. First, SMEs enhance competition and entrepreneurship and hence have external benefits for economy-wide efficiency, innovation, and aggregate productivity growth. Second, SMEs are more productive than large firms, but the financial market and other institutional failures impede SME development. Third, SME expansion boosts employment more than large firm growth because SMEs are more labour intensive. Therefore, SMEs can be used to alleviate poverty and unemployment.

In contrast, a few empirical studies disagree that SMEs are a key driver of poverty reduction and income equality. Beck, Demirguc-Kunt and Levine (2003:4) suggest that cross-country analyses do not provide strong support for the view that SMEs exert a causal impact on growth and poverty alleviation. Beck *et al.* (2003:4) conducted a study to determine the role of SMEs in poverty reduction using:

(i)   the level of income of the poorest quintile *(A quintile refers to each of the five classes that were created),* of the population in the 1990s,

(ii) the growth rate of income of the poorest quintile of the population during the 1990s,

(iii) the percentage of the population living below the national poverty line, and

(iv) the "poverty gap," which is a weighted average of the fraction of the population living on less than a dollar a day and extent to which incomes fall per day.

In their study, Beck *et al.* (2003) did not find a significant relationship between SMEs and poverty alleviation. Specifically, the size of the SME sector is not significantly associated with the income of the poorest quintile of society, the percentage of the population living below the poverty line, or the poverty gap when controlling for the level of GDP per capita. Also, the size of the SME sector is not linked with the growth rate of the incomes of the society. Beck *et al.* (2003:4*)* conclude that SMEs do not exert a differential impact on the poor and thus on poverty alleviation. Mukras (2003:58) disagrees with Beck *et al* (2003) and argues that the choice of SMEs as a strategy for poverty reduction would not have any significant difficulty in meeting the approval of policy makers and development economists today.

The government of South Africa through the Department of Trade and Industries (DTI) recognises the importance of the SME economy as a tool to alleviate poverty. The government has therefore targeted the SME sector as an economic empowerment vehicle for previously disadvantaged people. Moreover, SMEs are used by the government as the gateway to Black Economic Empowerment (BEE) in South Africa, an attempt to redress income inequalities, a product of the past political imbalances (Amatole, 2007).

Fatoki, Okubena and Herbst, (2010:1275) pointed out that income and wealth distribution in South Africa is amongst the most unequal in the world. SMEs are therefore the vehicle by which the lowest income earners in the South African society gain access to economic opportunities. This argument leads to the conclusion that SMEs serve as a tool for solving income inequalities and thereby closing the huge gap between the rich and the poor, thus resulting in poverty alleviation.

c) Contribution of SMEs to Economic Growth

The contribution of SMEs towards economic growth has received a lot of attention in both the international and local literature. Tambunan (2008:148) posits that, in Indonesia, SMEs have been an important engine for the development of local economies and communities. Despite his recognition of the importance of SMEs on economic growth, Tambunan (2008:148), points out that, compared with many other more developed Asia Pacific Economic Cooperation economies, Indonesian SMEs are not yet contributing significant value added to the national economy.

There are a number of ways through which SMEs affect economic growth. These include new market and product development; innovations in product or management processes; stimulating competition; and knowledge spill-over. Furthermore, SMEs make a significant contribution to South Africa's gross domestic product (Berry *et al.*, 2002). According to Berry *et al.* (2002) the SME sector contributes between 12 and 14.5% of South Africa's GDP. In their cross country study, Beck *et al.* (2003:4) revealed a statistically significant and economically large relationship between economic growth and the size of the SME sector.

Another way through which SMEs contribute to the economy is through new investments. Hamwele (2005) suggests that SMEs play a significant role in net fixed capital formation, an indicator that reflects on internal investment into the economy. Berry *et al.* (2002) also posit that SMEs contributed about 25.5% of South Africa's nominal gross fixed capital formation in the year 2000. Furthermore, SMEs play a significant role in opening up new markets through their introduction of new

innovative products. Economically, the increase in the numbers of SMEs is seen as opening up new markets for industrial goods, which are provided by large enterprises, therefore, they act as very important customers to large enterprises. For this reason,, SMEs are not only beneficial to the entrepreneurs or their communities only, but also to large established enterprises.

As pointed out by the literature such as Berry *et al.* (2002) SMEs make a unique contribution to any economy. However, if the contribution of SMEs is to be sustained, new ones should be created. Without start-ups a country risks economic stagnation and puting a strain on existing businesses. With the growth in population and an increasing number of school leavers there is need to create more new firms to create more jobs (Maas & Herrington, 2006).

Based on the benefits derived from start-up SMEs the following sections provide the literature on start-up SMEs. These include the definition adopted for this study and their contribution to the economy. Furthermore, the problems and the failure of start-up SMEs are discussed..

2.2.2 Start-up SMEs Defined

Maas and Herrington (2006) point out that the creation of a business is a process which develops in stages. The ***start-up phase*** is the phase in which the business is less than 42 months old. It covers a period during which (one or more) individuals identify the products or services that the business will trade in, access resources (such as finance) and put in place the necessary infrastructure, which would include staff. Also at this stage, following the gathering of the necessary resources, the business begins to trade and compete with other firms in the market place. When the business is in this phase of development, it is referred to as a start-up firm. The definition of a start-up is a business that has paid salaries or wages for a period of 42 months or less. Once a business has established itself and is more than 42 months old, it is referred to as an ***established firm***.

According to Maas and Herrington (2006) if the individual is starting the business because he/she has no other way of earning a living, then this business is referred to

as one motivated by necessity. If on the other hand, the individual is starting a business in response to an opportunity (whether an opportunity in the market place, or an opportunity to lead a different lifestyle or to earn more money), this business is referred to as one motivated by opportunity.

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In the opinion of Deakins and Freel (2003:224), the business start-up process can be divided into a number of stages. These stages include; idea formulation, opportunity recognition, pre-start planning and preparation, entry and launch, and post-entry development. Each stage is affected by a number of factors that impinge on the process. Some factors may encourage further development, while others have a negative influence, perhaps causing the individual start-up entrepreneur to terminate the process. These factors include the nature of the local government, culture, access to finance, local support networks, role models and enterprise support and encouragement.

Grunhagen and Mittelstaedt (2002:190) define start-up SMEs using a five-stage growth model.

- *Stage I: Existence.* At the beginning, owners of start-up SMEs are most concerned about finding and signing up customers and being able to deliver their products and services. They grapple with the question of whether they will get enough customers and deliver enough products/services to become a viable business; and whether they have the financial resources, cash, to meet all start-up requirements.

- *Stage II: Survival.* The focal point at this stage is the relationship between revenues and expenses. Owners evaluate whether (1) they can generate enough cash to break even and cover the repair/replacement of basic assets; (2) they are able to finance growth in order to earn an economic return on assets and labour.

- *Stage III: Success.* This is a pivotal point for owners in that the firm has reached economic health.

- *Stage IV: Take-off.* What owners face at this juncture is how to grow quickly and how to finance their growth.

26

- *Stage V: Resource Maturity.* At this point, the company has the staff and financial resources to engage in detailed operational and strategic planning. It has a decentralised management structure with experienced, senior staff and all necessary systems are in place.

A venture is considered a start-up if it has not yet reached a phase in its development where it could be considered a mature business. The precise moment in time in which a new venture becomes a mature business has not yet been determined. However, the idea of business maturation could be equated with a firm that has fully completed the transition to a Stage II as explained above (Grunhagen & Mittelstaedt, 2002:190). For the purpose of the study at hand start-up SMEs are defined as SMEs that have been in operation for a period of less than 42 months.

2.2.2.1　The Importance of Start-Up SMEs

Over and above the contributions of the SMEs in general, start-up SMEs specifically, play an outstanding role in the economic growth of a country. With a high population growth rate, a characteristic of many developing countries, there is a need to expand the means of production using innovative ways. This can be achieved to a greater extent through the emergence of new businesses in the form of start-ups.

Wong, Ho and Autio (2005:335) point out that, in 1934, Schumpeter was one of the earliest economists to argue for the importance of start-ups. According to him, start-up SMEs are the vital force behind the progress of capitalism. The innovative activity of entrepreneurs feeds a creative *"destruction process"* by causing constant disturbances to an economic system in equilibrium and creating opportunities for economic rent. In adjusting to equilibrium, other innovations are spun-off and more entrepreneurs enter the economic system. In this way, Schumpeter's theory predicts that an increase in the number of start-up SMEs leads to an increase in economic growth.

In the United States of America, start-ups are believed to be the most viable source of sustainable employment creation. According to the Global Entrepreneurship Monitor (GEM) survey in the USA in 2003, more than 70 percent of people currently

involved in a start-up or in managing a new business employ at least one person. More than 80 percent of them plan to employ at least one person within the next five years. Finally, more than 20 percent of those currently involved in entrepreneurial activity plan to employ at least 19 people in the next five years. These estimates suggest that the increase in TEA rates from 2002 to 2003 may have a positive impact on employment statistics in the near future (Minniti & Bygrave, 2004:6). Therefore, such information indicates that start-ups are a key to sustainable employment creation.

Maas and Herrington (2006) endorse the argument that start-up SMEs make a significant difference to economic prosperity and that South Africa risks economic stagnation without a high new SME creation rate. Countries that are able to replenish the stock of businesses and jobs and have the capacity to accommodate volatility and turbulence in the entrepreneurial sector are best placed to compete effectively. In countries ranking high in the GEM analysis, entrepreneurship and new SME creation is an integral and accepted feature of economic and personal life. There is a clear tendency for countries with below-average future growth projections to be clustered on the top half of the GEM graph where new SME rates are low and those with above average-growth projections to be clustered on the bottom half where new SME rates are high.

Beck, Levine and Demirguc-Kunt (2005:188) stipulate that promoting start-up SMEs enhances competition and entrepreneurship and hence has external benefits for economy-wide efficiency, innovation, and aggregate productivity growth. Benedicte and Guinet (2000) also advocate that SMEs, especially young firms (Start-ups) contribute greatly and increasingly to the innovation system by introducing new products and adapting existing products to the needs of customers. Furthermore, many advances in technology rely on a myriad of detailed inventions involving individual components, materials, and fabrication techniques. The sales possibilities of making such narrow, detailed advances are often too modest to capture the interest of giant corporations. An individual entrepreneur (a characteristic of many start-up SMEs) can tolerate sales flow over a new product or process with sales prospects in the millions of Rands per year, whereas few large corporations cannot

work up much excitement over such small investment, nor can they accommodate small ventures easily into their organisational structures. In some industries, the bulk of innovations are introduced by new entrants, start-ups who challenge the incumbents' market share (Benedicte & Guinet, 2000).

Furthermore, Puhakka (2007:30) provides evidence that,

 "…research on business organisations has started to show signs of shifting the focus from the management of existing firms to the creation of new firms. This new line of enquiry criticizes the view that businesses are to be best developed and renewed by planning and controlling existing firms and hoping that they would continue to grow. The renewal capacity through the creation of new firms is crucial in today's knowledge based economy. Organising new businesses is more important than managing the present. Creativity, motivation and discovery come to the fore instead of adaptation to existing situations. The speed of change in a competitive environment is changing and the best way to handle this is to develop readiness for new businesses".

This argument advocates for the support of start-up SMEs.

Reynolds, Bygrave, Antio and Hay (2003) agree that while SMEs have always mattered to policy makers, the way in which they matter has drastically changed. Confronted with rising concerns about unemployment, job creation, economic growth and international competitiveness in global markets, policy makers have responded to this new evidence with a new mandate to promote the creation of start-up SMEs.

Gree and Thurnik (2003:244) note that start-up SMEs play a key role in the evolution of an industry. Entrants introduce new products and develop new technologies. As an important source of innovation, they bring competitive pressure to bear on established firms. These pressures arise as the new firms pursue customisation and niche market strategies as a means of gaining market share. However, for many start-up SMEs life is short and uncertain. Start-up SMEs suffer the highest failure rate compared to other types of firms. However, those that do survive often grow and bring in substantial benefits to the economy at large.

Hong and Daly (2005:52) point out that the contributions of start-up SMEs to economic development include; triggering competition; stirring research and development and innovation, pushing old firms to improve their efficiency, injecting new blood into the veins of the economy, resulting in economic growth, technological upgrading, job creation and welfare improvement, thus increasing the stock of SMEs.

Hiscocks (2005) argues that start-up SMEs need to be successful in order to contribute to a country's economy. Successful start-up SMEs are likely to add significant benefits to regional and national economies. The benefits are likely to be in the form of new products, new jobs, greater exports, taxation revenues (both corporate and personal) etc. All these contribute significantly to the wealth of the regional and national economy.

Davis and Haltiwanger (2000:2715) and Bruce, Deskins, Hill and Rork (2007) propound that the number of births of SMEs adds significantly to a country's gross domestic product. In a study done in the United States of America, the researchers found that increasing the birth of start-up SMEs by 5% results in 4.65% growth in the economy of the USA. Deaths of start-up SMEs detract from GDP growth to a similar degree. This suggests that, when the net birth rate of SMEs is positive (i.e. when the birth rate exceeds the death rate), GDP grows at a faster rate and personal income and employment increase. Therefore, start-up SMEs provide long-term benefits to the local economy. The situation is also applicable in many developing countries, South Africa included, hence there is a need to support the growth of start-up SMEs.

2.2.2.2   Creation rate of start-up SMEs in South Africa

The literature has shown that the creation rate of start-up SMEs is significantly lower in South Africa, than in developed and other developing countries. Using the total early-stage entrepreneurial activities (TEA) rate, South Africa's TEA is markedly low. The TEA index measures the percentage of individuals between the ages of 18 and 64 that are involved in starting a new business (Maas & Herrington, 2006). The year on year changes in the TEA can be used to depict the growth of entrepreneurship in a country. Since 2001, when South Africa began participation in the Global Entrepreneurship Monitor (GEM) surveys, South Africa's TEA rate has continued to fluctuate significantly below average. Furthermore, compared to other countries

classified under efficient driven economies, South Africa's TEA rates are unsatisfactory.

Herrington *et al.* (2009) indicate that;

> "…*countries participating in GEM are classified as factor-driven economies, efficiency-driven economies or innovation-driven economies, in line with the categories used in the Global Competitiveness Report 2009-2010. This classification into phases of economic development is based on the level of GDP per capita and the extent to which the countries are factor-driven in terms of the shares of exports of primary goods in total exports. Although all three types of economic activity are present in all national economies, their relative prevalence and contribution to economic development varies".*

Based on this categorisation, South Africa is classified under efficiency driven economies.

Table 2.2 shows that for the period South Africa participated in the GEM surveys, its TEA rates continued to fluctuate below yearly averages. Furthermore, compared to other countries in the efficiency driven economies category, such as the Dominican Republic, Ecuador, Mexico, Peru, Thailand and Uruguay, South Africa's TEA rates are significantly lower. Table 2.2 indicates the TEA rate of countries classified under efficiency driven economies.

The TEA rates in Table 2.2 indicate that, over the years 2001-2009 South Africa's TEA rates continued to fluctuate below average and have significantly dropped from 7.8 in 2008 to 5.9 in 2009. This is an indication of the low rate of new firm creation in South Africa. In terms of new firm activity in 2008, South Africa ranked 38th out of the 43 countries with a new business prevalence rate of only 2.1%. This is significantly lower than the average of 4.6% for all GEM countries. The prevalence rate for established businesses follows a similar trend; South Africa ranked 41st out of the 43 countries, with an established business rate of 2.3% indicating a high failure rate for South African start-ups (Herrington *et al.*, 2009). These results indicate low levels of start-up business as well as lower levels of small businesses which graduate into established businesses.

Table 1.2: TEA rates of efficiency driven economies 2001-2009

Countries	2001	2002	2003	2004	2005	2006	2007	2008	2009
Croatia		3.6	2.6	3.7	6.1	8.6	7.3	7.6	5.6
Dominican Republic							16.4	20.4	17.5
Ecuador				27.2				17.2	15.8
Hungary	11.4	6.6		4.3	1.9	6.0	6.9	6.6	9.1
Indonesia						19.3			
Iran								9.2	12.0
Jordan				18.3					10.2
Latvia					6.6	6.6	4.5	6.5	10.5
Macedonia								14.5	
Mexico	20.7	12.4			5.9	5.3		13.1	
Malaysia						11.1			4.4
Panama									9.6
Peru				40.3		40.2	25.9	25.6	20.9
Poland	10.0	4.4		8.8					
Romania							4.0	4.0	5.0
Russia	6.9	2.5				4.9	2.7	3.5	3.9
Serbia							8.6	7.6	4.9
South Africa	9.4	6.5	4.3	5.4	5.1	5.3		7.8	5.9
Taiwan		4.3							
Thailand		18.9			20.7	15.2	26.9		
Tunisia									9.4
Turkey						6.1	5.6	6.0	
Uruguay						12.6	12.2	11.9	12.2
Average	**11.7**	**8.3**	**11.3**	**14.9**	**9.1**	**12.6**	**12.3**	**11.8**	**11.2**

Source: Adapted from Herrington *et al.* (2009:35)

The low levels of entrepreneurial activities are attributed to a number of factors which significantly contribute towards the failure of start-up SMEs in South Africa. There are a number of barriers that inhibit the growth of start-ups in South Africa. Despite

efforts by South African government, more significantly through the Department of Trade and Industries, in eliminating the barriers to the growth of start-ups, South Africa's TEA is below the international average (Maas & Herrington, 2006).

Hamilton and Rivera (2003) provide evidence that the difficulties faced by start-up SMEs centre around raising capital, elevated costs of establishing location and infrastructure to establish their businesses and the groundwork for preparing objective and effective business plans. Another problem is their lack of experience. These challenges often lead to the failure of the start-up SMEs.

There is a wide contention amongst authors in entrepreneurship literature about the causes of failure of start-up SMEs. The following subsection discusses failure and the causes of failure by start-up SMEs.

2.2.2.3   Failure of start-up SMEs

Both international and local literature alluded to high failure rates of SMEs, particularly during their early stages of development. There are significantly large differences in business failure rates between developed and developing economies. Failure rates are higher in developing countries than in developed countries. Poor management, lack of planning, improper financing and a shortage of funds were identified as the main causes of start-up deaths globally (Longenecker, Petty, Moore & Palich, 2006). Maas and Herrington (2006) indicate significant differences between failure rates of start-up SMEs in developing countries and developed countries. Table 2.3 shows the failure rates from selected developing and developed countries.

Table 2.3: Failure rates of start-up SMEs in some selected developing and developed countries

Developing countries	Failure rate of new small SMEs (%)	Developed countries	Failure rate of new SMEs (%)
South Africa	75	Australia	30
Mexico	68	New Zealand	28
Chile	66	UK	28
Venezuela	48	Japan	24

Sources: Adapted from Maas and Herrington (2006), OECD (2006).

Table 2.3 indicates that South Africa has the highest failure rate of start-up SMEs amongst the selected developing countries. The failure rates are significantly lower in developed countries. It is therefore crucial to examine the possible causes of failure of start-up SMEs. Watson (2003) states that;

> "…*although failures cannot be completely avoided in a free enterprise system, the failure rate could be reduced if some of its causes are recognised and preventive action is taken*".

Understanding the causes of failure of SMEs is therefore a key to developing successful interventions. Therefore, a reliable analysis of the causes of start-up SMEs failure should be comprehensive and take into consideration not only the causes as reported by entrepreneurs but also those reported by other stakeholders , such as commercial banks, venture capitalists and government.

According to Holland (2008:21) about 90% of all start-up SME failures are due to management mistakes. Some of the leading management mistakes that result in business failures are: going into business for the wrong reasons; the entrepreneur getting worn-out and/or underestimating time requirements; family pressure on time and funds; pride; lack of market awareness; lack of financial responsibility and awareness; lack of a clear focus.

Temtime and Pansiri (2004:20) argue that factors related to marketing such as a lack of market research, ineffective demand forecasting and analysis, bad customer service, and a lack of training for sales staff are the most significant factors leading to the failure of start-up SMEs. The investment analysis and working capital management factor is rated second and includes the lack of financial record keeping and documentation, insufficient provision for contingencies, high investment in fixed assets particularly during the start-up stage, inadequately estimated capital requirements, inability or failure to analyse financial statements, misperception of turnover as profit, and under-utilisation of company assets.

Customer relationship was also rated high by the respondents in its impact on the performance of firms. Service and merchandising firms spend much time and resources to retain their customers. Customer loyalty and retention have been the main strategy for these firms to achieve competitiveness. Managerial action and external environmental factors are rated fourth. Small business owners/managers need to develop basic managerial skills and knowledge if they are to succeed. Managers need to have adequate skills in the area of planning, organising, directing and controlling organisational resources.

Similar findings also emerged from a study by Boeker and Wiltbank (2005:127). Their study affirms that, to entrepreneurs, the four most important factors causing failure are poor market conditions, poor capitalisation, a poor management strategy and key people incompetence. On the other hand, fund providers reveal the lack of management skills, poor product design, the lack of technical skills and lastly inadequate capitalisation, as the four primary causes of new SME failure.

In South Africa, Phaladi and Thwala (2008) also suggest that a lack of effective management, of financial management; of entrepreneurial skills; of proper training; of resources; of technical skills and of contractual and managerial skills; as well as late payment for work done which is common with government contracts; and the inability to get credit from suppliers are seen as critical failure factors for small and medium sized contractors in the North West Province.

Maas and Herrington (2006:26) revealed some reasons why start-up SMEs go out of business in South Africa. The results are shown in Table 2.4.

Table 2.4: Reason for exit from business by start-up SMEs

Reason	Frequency	Valid Percent
Too much competition	6	11.5
Lack of customers	6	11.5
Financial reasons	17	32.1
Found another job	2	4.3
Retirement	1	2.7
Personal reasons	12	23.1
Other reasons	8	14.7
Total	52	100

Source: Maas and Herrington (2006:26).

Table 2.4 shows that financial constraints scored highest with a frequency of 17 out of 52 and a valid percentage of 32.1%. This suggests that financial constraints (32.1%) and personal reasons (23.1%) are primary causes of small business failure in South Africa. Herrington *et al.* (2009) also confirm that the lack of financial support had been widely reported as the main problem facing entrepreneurs in South Africa.

Despite many reasons given for the failure of start-up SMEs from both the entrepreneurs and the providers of funds, it can be concluded that most failures occur because of bad management, a lack of capital and a weak external environment. It appears that the financial reason is one of the primary causes of the failure of start-up SMEs. It must be pointed out however that there is a significant difference in the way the financial reason is perceived by entrepreneurs and credit providers. Entrepreneurs claim that finance is a first order problem, whereas credit providers argue that management skill is the major problem and could in fact be the

cause of the financial problem. Without access to financial resources start-up SMEs find it the difficult to cope with the challenges of newness and this result in high failure rates.

This accentuates the importance of improving the availability of finance to start-up SMEs which is the primary objective of this study. Therefore, strategies and policies to ensure access to financial resources by start-up SMEs should be sought. The primary focus of this study is to evaluate the impact of government intervention in the form of Business Development Service institutions in improving access to finance by start-up SMEs.

2.3   Summary

This chapter reviewed the literature on the definition of SMEs including start-ups. The literature review shows that it is impossible to measure the role of SMEs and also to provide support to them without defining them clearly. In addition, the importance of start-up SMEs was examined. It was found that start-up SMEs are very important to the sustainable development of South Africa. The creation and the failure rates of start-up SMEs were also investigated. The findings revealed that South Africa suffers from a low TEA rate and a high failure rate of start-ups.

Critical failure factors of start-up SMEs were also examined. The literature revealed that there are many reasons for small business failure. Access to finance appears to be one of the most consistent reasons. Entrepreneurs argued that it is a major problem, whereas fund providers suggested that the lack of management skills (which could also perpetuate the lack of access to finance) is the major contributor to the failure of start-up SMEs. It seems reasonable to conclude, though, that for some reason, funds are not getting to start-up SMEs. The conclusion that can be derived from the review of the literature is that South Africa has one of the lowest creation rates of start-up SMEs. In addition, the country has one of the highest failure rates of start-up SMEs. There are many causes of new SME failure in South Africa. The lack of finance is one of the major causes of failure. Maas and Herrington (2006) note that, "*without appropriate financing, start-up SMEs simply, cannot grow, compete and create jobs. The issue of finance must be addressed if an environment*

promoting entrepreneurship and SME development is to be encouraged in South Africa".

Therefore, the next chapter examines the importance of finance to the survival of start-up SMEs. Issues such as the need for capital and the capital structure of start-up SMEs are discussed. Furthermore, issues of access to finance gaps are discussed.

CHAPTER 3- FINANCING OF START-UP SMEs

3.1   Introduction

Chapter two concluded that the failure rate of start-up SMEs in South Africa is significantly high. The lack of finance is one of the prime factors hindering the survival and growth of start-up SMEs. According to Maas and Herrington (2006:12), quite a significant number of entrepreneurs are of the opinion that, although there seems to be sufficient funds available, access to these funds remains difficult, especially for start-up SMEs. Access to finance is therefore a priority issue for SME development.

The ability of start-up SMEs to grow depends strongly on their potential to have fixed assets and working capital for operations. This chapter examines the financial needs of start-up SMEs as well as the available financing options to meet these needs. Theories of capital structure are also discussed in this chapter. In addition, the equity and debt gaps and the causes of the equity and debt gaps for start-up SMEs are examined with reference to both international and local literature.

3.2   Financial Needs of Start-up SMEs

According to the Organisation of Economic Cooperation and Development (2006:12), providing adequate financing to start-up SMEs is vital in helping them set up and expand their operations, develop new products, and invest in new staff or production facilities. SMEs need finance to undertake productive investment in order to develop and expand their businesses, to introduce new products, and to market these products. However, start-up SMEs encounter great difficulties in raising fixed and working capital because of the reluctance of banks to provide loans. Heidrick and Nicol (2002:2) reveal that, a new venture requires "*seed money*" to initiate operations; *"start-up money"* to purchase basic equipment and assets; *"working capital"* to ensure sufficient cash flow for on-going operations; and "*expansion capital*" to acquire additional resources and make investments in new technology and business opportunities as the company grows and prospers. Such financing requirements require effective and sound planning.

Many small businesses start out as an idea from one or two people, who invest their own money and probably turn to family and friends for financial help in return for a share in the business. These financial sources may not be adequate to me*et* all the financial needs to keep the business running. Even when SMEs become successful during the initial stages, there comes a time for all developing SMEs when external funds will be needed for new investment (Organisation of Economic Cooperation and Development, 2006:13).

According to the International Trade Centre (2009:5), there are several components of financial needs that SMEs should consider to estimate when starting and operating a new business. These include; **fixed *assets*** (land, building, equipment, etc.); **working *capital*** (day-to-day operating costs); ***marketing costs*** (advertising, promotional programmes, etc.), and ***financial cushion or contingency*** (some reserved amount for changes in business circumstances). These are discussed in the subsections below.

3.2.1 Fixed Assets

According to Barringer and Ireland (2006:23), fixed assets can be tangible, such as real property, plant and equipment; or intangible, such as copyrights, patents, trademarks and goodwill. These assets are usually important for the long-term operations of a business. Therefore, decisions regarding investing in fixed assets should be evaluated with a long-term investment focus in mind. The International Trade Centre (2009) emphasises that, before investing in a fixed asset, it is essential for the enterprise to have a capacity plan. This means an estimate of how much the asset will be utilised in, for example, a production or manufacturing process. If the amount of capacity required is far below the capacity created through acquisition of the new asset, the fixed asset will be underutilised and will not generate the amount of profit desired (International Trade Centre, 2009:14).

The International Trade Centre (2009:12) further affirms that a new asset that does not provide the level of capacity required perpetuates a situation where the company is producing at lower levels than it profitably should. Revenues are lost in this situation. Any exercise requiring projection into the future, including estimates of

capacity, involves risk of inaccuracy. This is an inescapable reality of longer-term evaluations. This can however be minimised by combining both qualitative and quantitative forecasting methods to calculate sales projections. Alternatively, instead of a large, once-off investment, the business can consider investing in phases, shortening the period over which projections must be made, and reducing the amount of capital at risk. The acquisition of fixed assets, particularly, expensive capital equipment, is a major commitment for many start-up SMEs. It is therefore, important that start-up SMEs do a thorough planning and evaluation to assess their fixed assets requirements.

Falkena *et al.* (2002:22) reveal that SMEs' investment in fixed assets (fixed capital) is low in South Africa. Their study explicates that SMEs are estimated at 25 per cent of the national fixed capital formation in 2000. The results showed that SMEs have a rather low propensity to invest. Barringer and Ireland (2006:231) point out that while it may be possible for the founders of a new SME to fund its initial activities, it becomes increasingly difficult for them to do so when it comes to buying property, constructing buildings, purchasing equipment, or investing in other capital projects.

However, the challenge of investing in fixed assets comes at a price. Fixed assets, once established, can be used as collateral security in obtaining further financing. Furthermore, the value of a fixed asset is relatively more stable compared to current assets such as inventories and accounts receivable, which can fluctuate greatly as they are being consumed in the normal operation of the firm. For this reason, lenders prefer fixed assets rather than current assets as collateral. The choice and decisions of how much to invest in fixed assets therefore contributes a lot towards the long-term success of start-up SMEs.

3.2.2 Working Capital

Working capital is the difference between current assets and current liabilities. Current assets consist of cash and other assets that are expected to convert into cash within a year. Important current assets are cash, marketable securities, accounts receivables and inventories. Current liabilities are short-term debts and

obligations that must be paid in cash within that operating year. Current liabilities include accounts payable, payable expenses such as accumulated wages and taxes, and notes payables (Barringer & Ireland, 2006:23).

Failure to access and manage adequate working capital is one of the major causes of failure of start-up SMEs. Garcial-Teruel and Martinez-Solano (2007:166) point out that non-availability of working capital is a major constraint to the survival and growth of start-up SMEs. The International trade centre (2009:12) further asserts that businesses must manage their working capital efficiently to ensure that they are able to continue operations and satisfy both maturing short-term debt and upcoming operational expenses. Managing working capital means being able to meet day-to-day cash flow needs, pay wages and salaries when they are due, pay suppliers, pay taxes and pay providers of capital. This involves managing inventories, accounts receivable and accounts payable, and cash. Padachi, Howorth, Narasimhan and Durbarry (2010) argue that working capital is regarded as the lifeblood of the business and its effective provision and management can do much to ensure the success of the business, while its inefficient management or lack of attention to it may lead to the downfall of the enterprise.

3.2.3 Marketing Costs and Financial Cushion/Contingency

Garcial-Teruel and Martinez-Solano (2007:167) point out that the marketing of the firm and the firm's products is an important aspect to the successful growth of start-up SMEs. Since the business will be new in the market, probably with new products, creating customer awareness of the firm and its products is the key to the successful growth in sales and gaining a considerable market share. The International Trade Centre (2009) however argues that marketing costs such as advertising and promotional programmes are discretionary costs. These costs are not absolute necessities for on-going operation. They can be curtailed or eliminated during hard times without materially affecting the company's short-term performance or survival. The importance of marketing especially for start-up SMEs should, however, not be underestimated.

The financial cushion, or contingency, is a reserve to take care of possible discrepancies between plan and reality. Financial reserves are there so that some emergency situations can be handled with relative ease (International Trade Centre, 2009:14). There are various other financial needs of start-up SMEs; these include among others human capital development, such as training and technology. It can, therefore, be deduced that possessing adequate financial resources to purchase fixed assets and managing working capital is an integral ingredient in the success of start-up SMEs.

In order to invest in fixed assets, meet working capital requirements and marketing needs and provide for contingencies, start-up SMEs need to develop a suitable financing mix (debt and equity) that minimises the cost of financing. This is referred to as the capital structure. The following section explores the various capital structures and theories of capital that start-up SMEs may adopt in their attempts to meet and manage their financing and financial needs.

3.3   Capital Structure and Theories of Capital Structure

3.3.1   Capital Structure

Correia, Flynn, Uliana and Wormald (2008:14-1) reveal that a great deal of academic research has focused on the relationship between a firm's cost of capital, its value and its capital structure. According to Vigario (2004:41) capital structure refers to the long term financing of a business. It is further argued that all businesses are financed by the owners' equity or by the owners' equity plus debt. Correia *et al.* (2008:14-1) explains that "*a business can be viewed as a portfolio of all its assets and the financing of these assets can be considered as a separate issue. The way in which the financing is arranged is a strategic financial decision, the result of which is the capital structure*". Therefore, management should make strategic decisions on how much of the firm's assets should be financed using debt or equity.

Bhaird and Lucey (2009) posit that many studies on the capital structure of SMEs have tested hypotheses derived from the capital structure theory developed in corporate finance, particularly the static trade-off theory, the agency theory and the

pecking order hypothesis. The following subsection is a review of these theories of capital structure and their relation to start-up SMEs.

3.3.2 Theories of Capital Structure

3.3.2.1 The Modigliani and Miller (1958 and 1963) Theories

Bhaird and Lucey (2009) point out that the theoretical discourse on the capital structure of the firm originated from the irrelevance propositions of Modigliani and Miller (1958), which stated that the capital structure of the firm was independent of its cost of capital, and therefore of firm value. Vigario (2004:51) explains that Modigliani's and Miller's1958 proposition argues that there is no optimal capital structure because the advantage of debt will be exactly counteracted by the increase in the cost of equity such that the firm's weighted average cost of capital (WACC) will always be equal to its business risk. As debt financing increases, the initial effect would be to lower the WACC and this increases the value of the firm.

The theory was based on the assumptions that; there are no taxes, a perfect capital market, no bankruptcy costs, and all relevant information is freely available among others. It was proved that in equilibrium, the market value of a firm must be independent of its capital structure. The model however contends that increased gearing (the use of debt financing) results in equity holders requiring an increased return to equate the increased risk, and the change in required equity return will offset any possible saving or loss on the interest change. Therefore, as gearing increases the average cost of capital remain constant and so there is no optimal level of capital gearing (Vigario, 2004:51).

The initial perfect market assumptions, on which the 1958 theory of Modigliani and Miller were based, were later reviewed in 1963 with the introduction of the tax benefits of debt. Because interest on debt is tax-deductible, thereby creating tax savings for the borrowers, it becomes possible for firms to minimise their costs of capital and maximise shareholders' wealth by using debt (Modigliani & Miller, 1963).

3.3.2.2   The Trade-off theory

According to Frank and Goyal (2007:12), the term static trade-off theory is used by several authors to describe a family of related theories.   Frydenberg (2004:1) explains that the trade-off theory claims that a firm's optimal debt ratio is determined by a trade-off between the losses and gains of borrowing, holding the firm's assets and investment plans constant. The gain of debt is primarily the tax-shield effect, which arises when paid interest on debt is deductible on the profit and loss account.

The costs of debt are mainly direct and indirect bankruptcy costs. The static trade theory has implications for start-up SMEs. Daniel, Masli, Rahman and Selvarajah (2006:210) point out that for start-up SMEs, the expected costs of bankruptcy are quite high and the expected costs of financial distress may outweigh any potential benefits from the tax shield. Start-up SMEs rarely generate profit in the early stages of operations, and the potential benefit of tax shields of interest payments remains doubtful. Frelinghaus, Mostert and Firer (2005:9) point out that start-up SMEs have limited access to external equity. In addition, internal equity is often inadequate for growing start-ups. Therefore, start-up SMEs have to depend on external debt to survive and grow.

3.3.2.3   The agency theory

Jensen and Meckling (1976:306) identify two types of agency conflicts. The first focuses on the conflict between shareholders and managers and the second on the conflict between equity holders and debt holders. The agency theory has important implications for the relationship between stockholders and debt-holders. Stockholders are interested in the return over and above that amount which is required to repay debt. Debt-holders are only interested in the debt payment specified in the contract.

Ahmed and Hisham (2009:61) point out that the agency theory predicts that growth firms should have less debt. Firms that are expected to make profitable investments should have less need for the discipline that debt provides. This would seem to be a serious omission for two reasons. First, debt and equity represent different

constituencies with their own competing, and often mutually exclusive goals. Second, as the level of debt increases, the corporate governance structure can change from one of internal control to one of external control. For firms that adopt debt as a control mechanism, lenders become the key constituents in the corporate governance structure. This can have a significant impact on both managerial discretion, and on the ability of an organisation to deal effectively with its competitive environment.

Falkena *et al.* (2002:22) note that the agency theory gives vital insights into the problems of ownership, management interrelationships and credit rationing. Issues around information asymmetry, moral hazard and adverse selection are likely to arise in contractual arrangements between firms and external providers of finance. These problems may well be more severe, and the associated costs much higher for SMEs than for large businesses. SMEs are also subject to the risk of asset substitution which, in practice, means a change in the firm's asset structure. For SMEs, asset substitution may well take place between the enterprise and the owner's household. Thus, the proximity to the household, the lack of legal formalisation, weak financial disclosure and the owner-managed nature of SMEs make it hard for lenders to track ongoing changes to the asset base of the SME. The presence of these problems in SMEs may explain the greater use of collateral lending to SMEs as a way of dealing with these agency problems.

Lenders' strategies for dealing with these problems also add significantly to the cost of dealing with this sector. For a large enterprise the evaluation of an application for finance may be limited to the assessment of an (audited) set of financial statements (information asymmetry) and supporting documentation provided by the applicant. For SMEs the assessment frequently has to go far beyond this, implying a substantially higher transaction cost.

According to Stiglitz and Weiss (1981:394) agency problems such as asymmetric information and moral hazards can impact on the availability of credit and hence the capital structure of start-up SMEs. Stiglitz and Weiss termed this phenomenon credit rationing. In the Stiglitz & Weiss formulation, credit rationing is said to occur if (1)

among loan applicants who appear to be identical - some receive credit while others do not; or (2) there are identifiable groups in the population that are unable to obtain credit or can only obtain credit at much higher prices. The core of the argument is that suppliers of finance may choose (due to asymmetric information, adverse credit selection and monitoring problems) to offer an array of interest rates that would leave a significant number of potential borrowers without access to credit. The Stiglitz and Weiss' theory therefore suggests that there are significant numbers of SMEs that could use funds productively if they were available, but cannot obtain finance from the formal financial system.

It can be concluded that due to the agency problem, asymmetric information problems and credit rationing behaviours of financial institutions, SMEs, particularly start-up SMEs are significantly denied access to external financing. Therefore, the capital structure decisions for start-up SMEs are greatly influenced by factors beyond their control.

3.3.2.4 Pecking Order Hypothesis (POH)

According to the pecking order hypothesis by Myers and Majluf (1984:188) and Myers (1984:576), firms seeking to finance new investments prefer to use funds according to a hierarchy; first internal funds, then debt financing, and finally equity financing. This pecking order arises because managers, not wanting to dilute existing shareholders claim, will issue only overvalued securities. Furthermore, Myers and Majluf (1984:219) show that because adverse selection costs are always larger for equity issues than for debt issues, by issuing equity, an optimal capital structure will not be achieved.

Hogan and Hutson (2004:11) explain that the pecking order hypothesis is highly applicable to privately held SMEs. The POH suggests that costs associated with information asymmetries between stockholders and company management have a significant impact on the firm's choice of funding. Managers are privy to inside information that is not available to actual and potential investors. Investors understand this asymmetry, and they assume that managers will issue stock only

when they perceive it to be overvalued. The POH predicts that in order to avoid this adverse signalling problem, firms prefer to finance projects from retained earnings. When the internal sources are exhausted, managers will opt for safer securities, which Myers (1984: 584) defines as *"securities whose future value changes least when the manager's inside information is revealed to the market".* Thus, debt will be preferred to outside equity, and new equity will be issued only as a last resort.

Despite emphasis from capital structure theories on the importance and relevance of debt financing or external financing in general, studies from the South African literature review claim that access to debt financing is limited for start-up SMEs (Foxcroft, Wood, Kew, Herrington, & Segal, 2002; Angela Motsa and Associates, 2004; Herrington *et al.,* 2009). These studies reveal that approximately 75% of credit applications by start-up SMEs to banks are rejected. Therefore, there is need for policy reforms to ensure improved accessibility of external finance for SMEs in South Africa.

Policy reforms to improve access to finance to SMEs should be in line with different requirements at each stage of growth in the SME sector. Angela Motsa and Associates (2004:21) imply that, at each stage, from start-up to exit, SMEs have different financial requirements and will source their financial needs from different sources. Therefore, both theoretically and practically, a problem of access to finance occurs due to the gaps that exist between the suppliers of external financing and the demand for financial resources.

The following section discusses the financial gaps in access to finance, particularly for start-up SMEs.

3.4   Gaps in Access to Finance for start-up SMEs

According to the Organisation of Economic Cooperation and Development (2006) the financing gap, often defined as the difference between the demand for funds by SMEs and the supply of funds, occurs for various reasons. A clear distinction must, however, be made between 'actual gaps' and 'perceived gaps'. The fact that some

enterprises experience difficulties in accessing financing is not necessarily an indication of the existence of an 'actual gap'. The Organisation of Economic Cooperation and Development (2006:50) points out that, although there is no generally accepted definition of the financing gap, it is generally acknowledged that quiet a sizeable share of economically significant SMEs cannot easily get financing from banks, capital markets or other suppliers of finance. In other words, an actual financing gap is said to exist if firms that merit financing cannot obtain it due to the existence of market imperfections. Park, Lim and Koo (2008:1) mention that some authors in both the international and local literature argue that the fundamental reasons behind SMEs' lack of access to funds can be found in their peculiar characteristics, while others such as Rogerson (2008:66) argue that SMEs suffer from financing gaps because of market imperfections on the supply side.

There is a markedly huge difference between sources of finance and access to finance by start-up SMEs in developing and in developed countries. Table 3.1 shows the different sources of finance for start-up SMEs in South Africa and Ghana (developing countries) while Figure 3.1 shows the different sources of finance for start-up SMEs in Canada (developed country).

Table 3.5: Sources of finance for start-up SMEs in South Africa and Ghana

Sources of finance	South Africa (%)	Ghana (%)
Internal equity	78	82
Banks	5	6
Trade credit	1	4
Government	1	1
Other sources	17	7

Source: Abor (2004:65).

Figure 3.1: Sources of finance for start-up SMEs in Canada
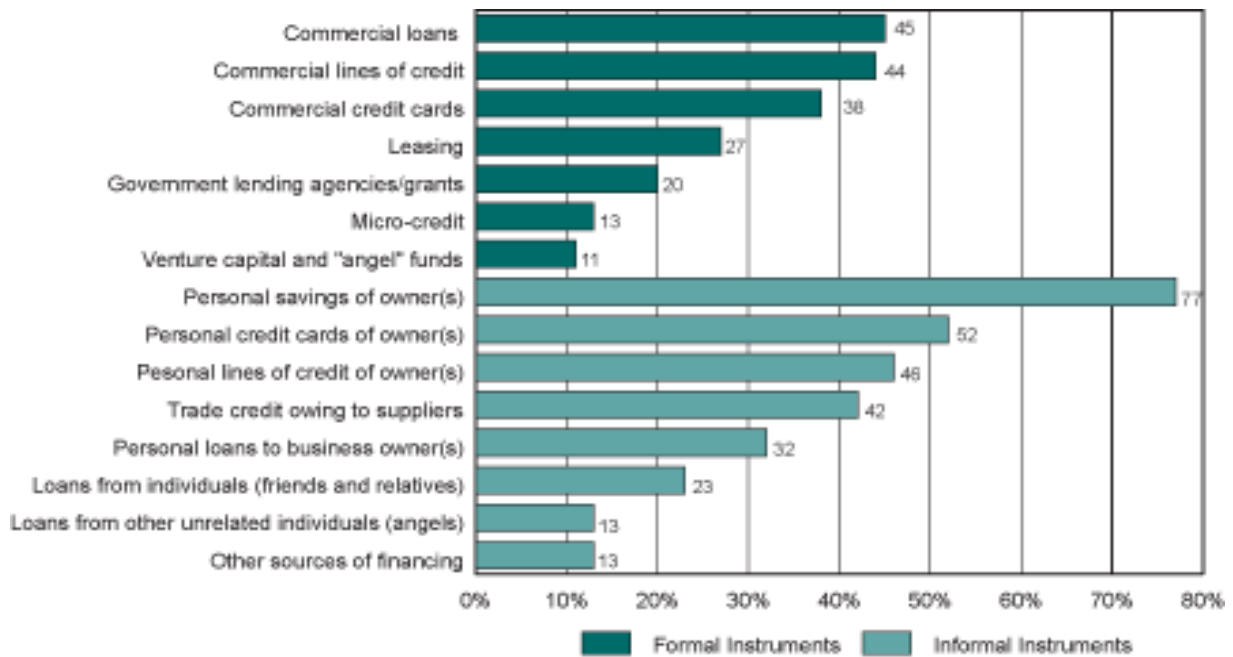
Source: Statistics Canada (2007).

One noticeable finding from the table and figure is that internal equity, especially owners' contribution, is the major source of finance for start-up SMEs as suggested by the static trade-off theory, the agency theory and the pecking order theory of capital structure. The empirical literature confirms, however, that internal equity is usually insufficient to ensure the survival and growth of start-up SMEs. Furthermore, as revealed in Table 3.1 and Figure 3.1 above, it can be noted that the use of venture capital and other sources of external equity by start-up SMEs is extremely limited in both developed and developing countries. Debt finance is relatively more available in developed countries than in developing countries. This reinforces the fact that external equity, especially from private investors or the stock market is not an available source of finance for start-up SMEs. Therefore, improving the availability of debt finance seems to be one of the options to reduce the high failure rate of start-up SMEs in South Africa as well as in other developing countries.

Park *et al.* (2008:12) further argue that SMEs face financing gaps probably because of a combination of reasons originating from both the supply and demand sides. The

supply side refers to providers of finance (financial institutions and investors), while the demand side is composed of SMEs who require financing from financial institutions and other providers of finance. The financing gap for SMEs is most prominent in capital market financing. Most countries, including the developed ones, have problems in SME financing through capital markets.

Park *et al.* (2008:12) found that substantial financial gaps exist in a large numbers of both Organisation of Economic Cooperation and Development (OECD) and non-OECD countries. The results of their studies are summarised in Figure 3.2.

Figure 3.2: Financing Gaps in OECD and Non-OECD countries
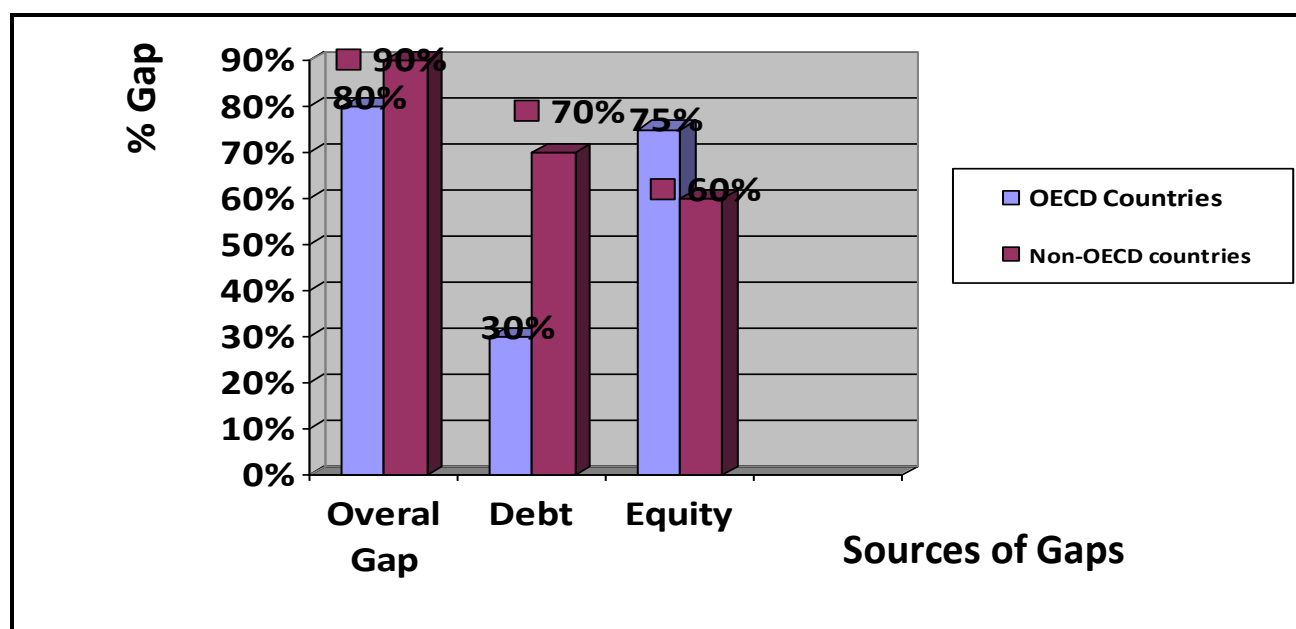
Adopted from: Park *et al.* (2008)

The results above indicate an 80% financial gap in OECD countries and a 90% financial gap in non-OECD countries such as South Africa. Furthermore, a break-down of debt and equity also indicates significant gaps except for debt in OECD countries.

Significantly large numbers of entrepreneurs fail to gain access to finance. Foxcroft *et al.* (2002) illustrate the rates at which entrepreneurs who have applied for

financing get the required finance. The results of their study are shown in the Table 3.6.

Table3.6: Applications for Finance and Outcomes

	% entrepreneurs applying for finance	% applicants who were successful	% of applicants who accepted the offer	% of applicants who received finance
Bank loan	84.4	25.0	85.2	18.0
Bank Overdraft	18.2	62.5	76.7	9.0
Bank Credit Card	2.3	83.3	60.0	1.2
Micro Lenders	3.1	0.0	-	0
Stokvel	1.2	33.3	100.0	0.4
Mortgage	0.8	100.0	100.0	0.8
Venture Capital	0.4	0	-	0
Average	-	33.2	82.4	27.3

Source: Foxcroft *et al.* (2002)

From an analysis of the above figures it is apparent that bank loans are the most preferred sources of external finance by entrepreneurs and a significant proportion of applicants to banks failed to get the finance. Although a proportionally large amount of entrepreneurs had made an effort to access finance, on average a small proportion (27.3%) succeeded in getting financed.

3.4.1 Bases for credit rationing behaviour by commercial banks

Green (2003:1) attempted to draw conclusions on various issues relating to credit rationing behaviours of financial institutions. Green (2003:1) argues that limited access of small enterprises to formal credit in developing and emerging economies is largely due to the relatively underdeveloped nature of the financial system, the lack of liquidity, and inexperience in small-scale lending in many of these countries. Bank branches outside the capital cities frequently provide only cash and do not have the authority to make loans, leaving small enterprises in rural areas disproportionally disadvantaged. If commercial banks do extend credit to small firms,

it may take up to several months to process applications. The following are the reasons put forward by Green (2003:12) as the argument for the credit rationing behaviours of financial institutions.

(a) Disincentives to Small-Scale Lending

Banks advance four main reasons for their reluctance to extend credit to small enterprises:

- High administrative costs of small-scale lending,
- Asymmetric information,
- High risk perception,
- Lack of collateral.

Although the reasons apply to developed as well as developing economies, they tend to be more significant in the latter.

➤ High administrative costs of small-scale lending

SMEs typically require relatively small loans as compared to large firms. The transaction costs associated with processing and administering loans are however fixed and banks often find that processing small SME loans is inefficient. Furthermore, administrative costs also include information gathering costs such as visiting borrowers, analysing their applications and monitoring their loans. For a number of reasons, these costs tend to be higher for small than for large firms. Small enterprises are often located away from the main urban centres, their accounting skills and standards are usually lower, and banks lack experience in servicing them (Green, 2003:12).

➤ Asymmetric Information

Green (2003:16) posits that it is a prerequisite for the efficient allocation of resources by market forces, that all participants share the same relevant information. This is not the case in financial markets. Borrowers will always know more about the viability of their projects and their ability and willingness to repay than lenders. The lenders

are thus faced with uncertainty about both the expected rates of return of the project they are financing and the integrity of the borrower. This uncertainty increases with the length of the loan. Borrowers face difficulties in transmitting information about their projects to lenders, as lenders will suspect them of underestimating the risks of failure. The problem of asymmetric information is more acute for small businesses than for larger ones because of lower information standards and the greater variability of risk. Small, privately owned firms face no legal reporting requirements and are more vulnerable than large firms.

Asymmetric information makes it impossible to distinguish accurately between "good" and "bad" borrowers. The two main problems associated with asymmetric information are adverse selection and moral hazard, both of which may affect the quality of the loan. Adverse selection refers to the fact that the probability of default increases with the interest rate, the quality of the borrower pool worsens as the cost of borrowing rises. Small firms are more likely to be rationed because they are seen as particularly risky. Although they might be willing to pay more to compensate for this additional risk, the banks refuse to raise the interest rate sufficiently to equate supply with demand (Green, 2003:11).

Moral hazard and adverse selection also make significant contributions in widening the financing gap. Moral hazard refers to a situation in which an agent (the borrower) takes an action that adversely affects the return to the principal (the lender). It occurs if the parties involved have diverging interests and the action taken by the agent cannot be monitored accurately by the principal. A borrower may, for example, be tempted to exert less effort or to secretly switch to riskier projects in order to increase his return. Because of a higher probability of default, the return to the bank will be reduced.

Banks can resort to two methods to reduce moral hazard which are: making it profitable to tell the truth, for example through the promise of renewed credit in the future and/or including penalties for low effort levels, for example, collateral which is lost if the firm becomes insolvent. Due to information imperfections and costly control

mechanisms, the superior selection criteria based on cash-flow projections is thus often abandoned in favour of loan selection according to firm-size and collateral (Green, 2003:16).

> **Lack of Collateral**

Financial institutions are more likely to approve loans to firms that are able to provide collateral and to those firms that have established long term relationships with lenders. Due to the existence of asymmetric information, banks base their lending decisions on the amount of collateral available. Collateral acts as a screening device and reduces the risk of lending for commercial banks. By pledging his assets, a borrower signals the quality of his project and his intention to repay. In the case of a default, the collateral serves to put the lender in a privileged position with regard to other creditors (Green, 2003:14). Small firms are disadvantaged in this regard, because they lack collateral security and also a proved credit track record. Therefore, start-up firms with innovative products may be constrained by the lack of access to finance because they may not have collateral security. Furthermore, information asymmetries may prevent financial institutions from seeing the profitability of the proposals.

> **Growth**

Growth may be another dimension that forms a basis for a gap based on capital rationing for which a gap may be claimed. There is great controversy about the growth of SMEs in South Africa, as the survival rate of SMEs is significantly low, less than 20% (Herrington *et al.*, 2009:34). As a result of doubts about the growth possibilities in SMEs, financial institutions are inclined to tighten their requirement s for loan approvals and may require a lot more information about the investment. This information may not have been furnished clearly and thus potentially successful business ideas may fall into the credit rationing trap. High growth firms may be more informational opaque and may face a greater degree of difficulty in obtaining financing.

➢ **Risk**

Brierley (2001:71) argues that the willingness of financial institutions to provide finance to venture capital firms that invest in small firms (SMEs) will depend ultimately on the risk-reward relationship, that is, the extent to which such investments are likely to provide returns commensurate with the risks involved. Moreover, it can be argued that the role of the banks is, in fact, to discriminate based on risk.

Green (2003:10) observes that commercial banks tend to impute a high risk to small enterprises and are therefore reluctant to extend credit to them. Due to their small size and inherent vulnerability to market fluctuations, the mortality rates of small enterprises are relatively high. These firms are, by their very nature, often relatively young and consequently lack a financial history and a track-record of profitable projects. In addition, organisational and administrative deficiencies, lower the quality of management, and a lack of appropriate accounting systems may compromise the accessibility and reliability of information from small firms on their repayment capacity.

In South Africa the risk perception of SMEs is attributed to the high failure rates. Therefore, it is reasonable for financial institutions to ration finance to SMEs, particularly start-up SMEs who have little or even no credit history. Tightening collateral security requirements is one of the ways through which financial institutions attempt to protect themselves against such risks. The need for collateral militates against potentially viable small, emerging enterprises getting finance (Maas & Herrington, 2006:50).

Malhotra *et al.* (2007:2) contend that, experience from the microfinance industry shows that one way to successfully bridge the gap between the demand for and supply of credit is through innovative lending methodologies. Such methodologies according to Holtman, Rühle, and Winkler, (2000) include the following:

- A loan analysis that focuses on the prospective client's ability to pay (cash flow). Less emphasis should be placed on collateral. The analysis should be highly standardised, and loan processing times kept to the minimum;
- Entitle repeat borrowers to increasingly larger loans;
- Loan officers should bear full responsibility for the loan throughout its entire life and should be paid performance based salaries. If payment problems occur, there should be a powerful incentive structure in place for immediate follow-up;
- Appropriate decision-making and control mechanisms should be in place and supported by a strong management information system (MIS) and information technology (IT) to assist in the management and administration of the loan portfolio.

In another study, Park *et al.* (2008:1) argue that many banks have developed tools, such as credit scoring models and other sophisticated techniques, to discriminate between high-risk and low-risk borrowers, thus reducing the risk of lending to SMEs.

Despite the potential for the above mentioned methodologies to be effective in addressing the access to finance challenge for SMEs, applying these approaches has failed to provide a clear path to closing the information asymmetry gap, a major reason why SMEs cannot adequately access financial resources. Therefore, there is a need to find more effective ways to ensure that the information gap between financial institutions and SMEs is closed.

In South Africa, policy debates in the past have failed to close the financial gap between SMEs and providers of financial resources. Various authors have revealed that access to finance challenges are the main reasons for low entrepreneurial growth and SME survival in the country (Maas & Herrington, 2006; Herrington *et al.,* 2009).

Several policy reforms have been suggested and efforts have been made to implement them, however the challenges remain unsolved. The findings reveal that

the dearth of finance is a key problem facing entrepreneurs in South Africa (Herrington *et al.*, 2009). Furthermore, it can be concluded that there have been several incidence of the market failing to address effectively the financial challenges facing start-up SMEs; hence there is a need for government intervention. The next chapter discusses government intervention with a special focus on Business Development services (BDSs).

3.5   Summary

The chapter focused on the financial needs of start-up SMEs. The need for fixed assets, working capital, marketing and contingencies was discussed. In addition, the capital structure theories and their implications for start-up SMEs were explored. The chapter found that start-up SMEs have inadequate access to external finance, both debt and equity. External equity is generally unavailable for start-up SMEs throughout the world. However, external debt is more readily available to start-up SMEs in developed countries than in developing countries. The failure of the market to serve the SMEs sector effectively led to the need for government intervention. One such notable attempt is in the form of both private and public institutional arrangements supported by the government in South Africa in the form of BDSs. The effectiveness of these BDSs is a controversial issue and has been debated by various authors. Therefore, the following chapter provides a review of the literature relating to BDSs considering both international and local literature.

CHAPTER 4: BUSINESS DEVELOPMENT SERVICES IN SOUTH AFRICA

4.1   Introduction

Chapter three showed that there is a market failure in the financing of start-up SMEs. This necessitates government intervention. For the past one and half decades, the government of South Africa together with the private sector have engaged in various initiatives aimed at poverty reduction, employment creation and economic growth at large. Central to these initiatives is the provision of support to SMEs. One such initiative worth noting is the growth in numbers of institutional arrangements aimed at addressing the needs of the SMEs sector. These arrangements are termed Business Development Services (BDSs). Quite a substantial amount of resources have been channelled towards building institutions that are intended to build the entrepreneurial spirit, support emerging and existing entrepreneurs as well as improve the general business environment for SMEs (Department of Trade and Industries, 2005)

Given the situation in South Africa, especially the high failure rates among start-up SMEs and the low new firm creation rate, the question is, "are government measures to assist start-up SMEs to access finance working?".   An understanding of these business support networks and advisory services (herein included in BDSs) can paint a clear picture of their function and effectiveness.

This chapter provides a discussion of market imperfections as the reason for public sector intervention through business development services provision, the effectiveness of BDSs, the background to BDSs, the definitions of BDSs, the need for BDSs, challenges facing BDSs, and the international experiences and literature on BDSs.

4.2   The Need for Government Intervention

4.2.1 Theoretical framework
Stiglitz and Weiss (1981:393-410.) developed the main theoretical foundation for government intervention in SME financing through their credit rationing theory. Stiglitz and Weiss (1981:395) argue that it is rational for credit providers to engage in

credit rationing based on asymmetric information and agency problems. Asymmetric information is prevalent if a firm knows the expected risk and return of iits project, while the credit provider only knows the average expected return and risk of an average project in the economy. The agency problem implies that bank managers are agents of shareholders, and granting of credit should always ensure that interests of shareholders are not compromised. Credit markets also diverge from an idealised market because information is imperfect. A lender's willingness to lend money to a particular borrower may hinge on having enough information about the borrower's reliability and on being sure that the borrower will use the borrowed funds effectively. The absence of good information may explain why lenders choose not to serve certain borrowers, such start-up SMEs.

The fact that credit providers have little or no access to convincing information on small firms implies that credit rationing is most likely to affect SMEs the most. This possibility suggests that to the extent that credit rationing significantly affects small business credit markets, a rationale exists for supporting small enterprises through government programs aimed at improving their access to credit (Craig *et al.,* 2007). Stiglitz and Weiss (1981: 396) argue for government intervention to improve access to finance for SMEs on the grounds of an explicit account of market failure.

4.2.2 Empirical review of government intervention

Following the recognition that entrepreneurial activities and SMEs are key issues in economic growth, many local and national governments are enacting policies that promote entrepreneurship. There is a significantly large number of government initiated programmes that are aimed at promoting the development of the SME sector. Governments of both developed and developing countries recognise the importance of SMEs as tools for sustainable employment creation, poverty alleviation and local economic growth. For several years, governments have intervened in BDS markets at the level of the BDS transaction, directly providing services to SMEs through public BDS providers or permanently subsidising services delivered by other BDS providers (The Committee of Donor Agencies for Small Enterprise Development, 2001). However, government support should not be thought of in terms of direct interventions only.

Although direct intervention has been advocated, it does not mean that direct interventions (for instance, specially designed SME credit schemes) are more important than indirect ones (such as training and mentoring) for the growth of SMEs. In many cases, subsidised credit accompanied by appropriate public policies, which make it easier for SMEs to distribute and market their output and to buy their raw materials, is much more effective than introducing too many special supporting schemes for SMEs within a distorted market (Tambunan, 2008:166). In South Africa, various authors have emphasised direct government support for SMEs (Department of Trade and Industries, 2005). It is further argued that direct SME support provision at local government level is a reflection of the national government's policy focus and interventions since 1995. More precisely, upgrading of the role of SMEs in the national economy has been a central focus of new development policies that have been implemented in South Africa since the democratic transition (Rogerson, 2006:54).

Furthermore, the issues of demand-side and supply-side service provision have been alluded to by the Committee of Donor Agencies for Small Enterprise Development, (2001). It was argued that the choice of demand-side and supply-side interventions to develop BDS markets should correspond to the market development constraints and opportunities. Examples of demand-side interventions include information to raise SME awareness of the potential benefits of BDS and incentives to try them such as vouchers and matching grants. Supply-side intervention options include introducing new models of doing business and developing new products and services, as well as technical assistance, training and other capacity-building for BDS providers. Some interventions can work on both sides, for example, strengthening business-to-business linkages and quality assurance that build client confidence in services being offered (Committee of Donor Agencies for Small Enterprise Development, 2001). The government of South Africa has over the years initiated both supply-side and demand side interventions. However, the success in effectively serving the SME market is in dispute..

Rogerson (2006:56) points out that there has been a paradigm shift in government support provision to SMEs in South Africa away from the past. A trend which involves the shift away from government-led support provision towards a greater role for the private sector in the delivery of BDS to the SME economy has been introduced. It was proposed to be noted that the BDS market development initiatives are part of broad development initiatives rather than stand-alone programmes and should focus on long-term sustainable change in markets, institutions and social structures rather than just short-term results.

Rogerson (2006:59) reflects that there are significant improvements in the old approach to SME support provision by the government. The new approach sees support provision as being provided through both private and publicly supported services providers. The old approach served as a complete substitution and worked in competition with private sector services provision. The following are illustrations of both the old and new approaches to support provisions to SMEs.

Fig 4.1 reflects the structures of old and new approaches support provisions to SMEs.

Figure 4.1: Approaches to Market Development
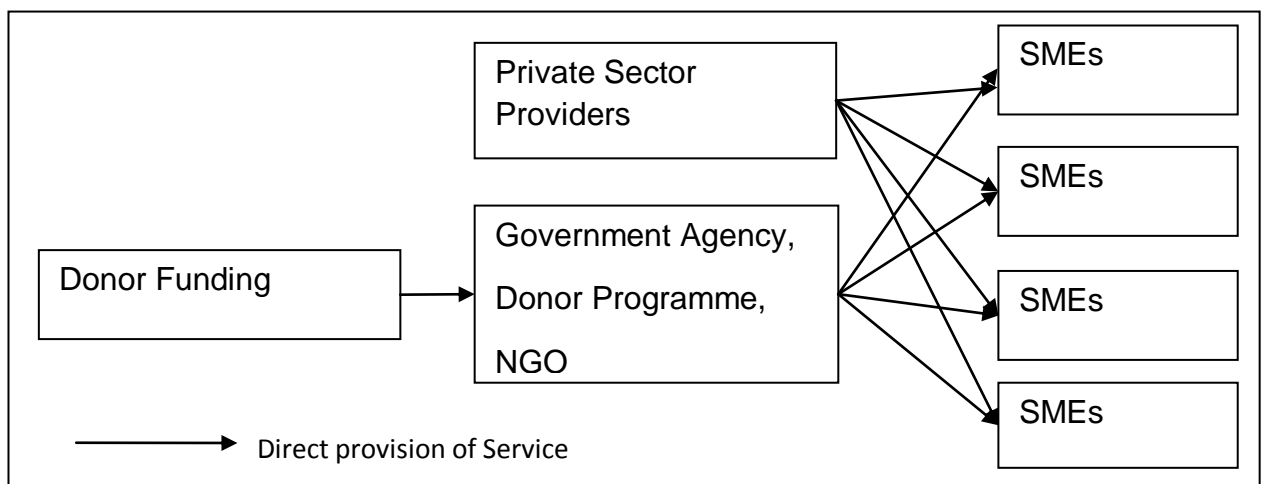
a) New Approach: Facilitate Market Development
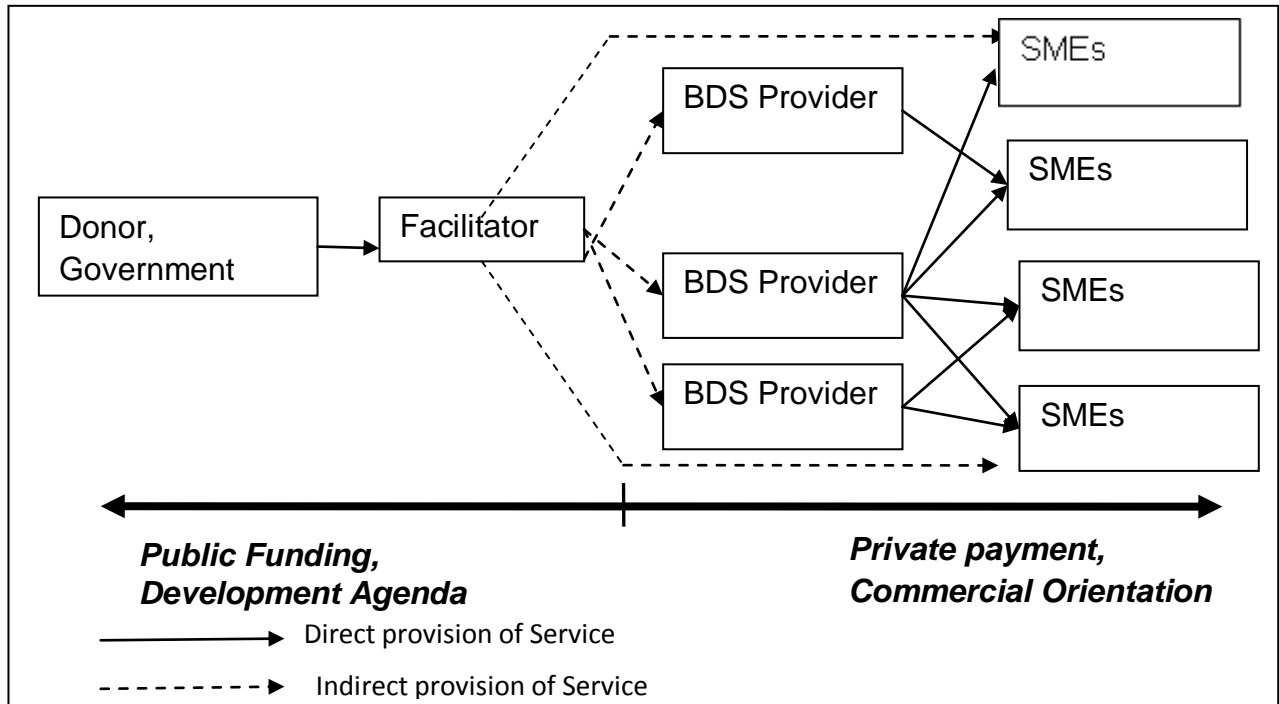
Adopted From: Rogerson (2006:59)

Comparing the two approaches, it can be noted that the new approach provides an incorporation of the private sector into government initiated support programmes. Unlike the traditional approach where government directly supports the SMEs through the use of donor funding and other public funds, the new approach advocates for an indirect support to private sector service providers who then, directly provide services to SMEs. The new approach furthermore, incorporates a developmental agenda by government into the commercially driven service provision of the private sector hence allowing market forces to be at play. Such an arrangement could be the most appropriate if efficiency and effective service delivery are to be considered.

However, the new approach, if not closely monitored, can bring us back to market imperfections which disadvantage SMEs because they lack resources. A market imperfection, which several authors alluded to as the reason why government intervention is necessary, refers to any deviation from the assumptions of perfect competition. DeGennaro (2005) defines a market imperfection as anything that

interferes with trade. This operates on two dimensions. Firstly, imperfections cause a rational market participant to deviate from holding the market portfolio. Secondly, imperfections cause a rational market participant to deviate from his preferred risk level. Green (2003) argued that market imperfections are forces that deprive SMEs of the financial resources they need to survive competition with large enterprises and to grow. Carefully applying the new approach which, to some extent, allows market forces (demand and supply) to be at play as well as having a developmental agenda can be an effective means to foster sustainable entrepreneurial development initiatives.

There has been a considerable debate on the need and appropriateness of various government interventions in attempting to address challenges facing SMEs and specifically start-up SMEs. In a study by Green (2003) it was argued that credit guarantee schemes are a failure, as there is not sufficient reason for government intervention by means of publicly-funded schemes. The cost-effectiveness of such schemes was also questioned.. Green (2003) points out that, the main argument advanced by government officials in favour of guarantees is the assertion that small businesses are faced with a systematic lack of finance and that the economy in general would benefit from increased small-firm access to credit. It was argued that there is no clear justification of the underlying reasons for government intervention. Instead, to address the problem of asymmetric information and to reduce transaction costs as well as the uncertainty surrounding repeat lending, credit bureaus are seen as superior to credit guarantee schemes.

Hitchins (2002) presents a rigorous critic of government intervention in markets. It was argued that an assessment of governments' role in East Asian economic development indicated that government intervention has often been ineffective because:

- It has not been based on a sound analysis of market failures;
- It does not address specific market failures;
- It ignores market signals in trying to achieve objectives;
- It underestimates the information needed for effective interventions;

- It overlooks the limited capacities, competencies and capabilities of the government;
- It overestimates the human and other resources available;
- It disregards efficiency, scale and other considerations.

Hitchins (2002) further reveals that these historical weaknesses are reflected more specifically in government interventions in BDS. This experience accentuates the importance of developing a clear framework to determine government's role in BDS markets, which takes into account both government's capacity and the operation of market mechanisms.

Park *et al.* (2008) point out however that market imperfections are a strong justification for the need to provide government support to the SME sector, which, despite its significant contribution to socio-economic growth finds it difficult to survive competition with large and established enterprises. Leaving the SME sector without government or donor support can increasingly jeopardise their growth and survival, therefore there is need for government intervention.

It should be noted however that government intervention in the form of public sector intervention alone is not sufficient. There is need to include the more efficient private sector in the loop, thus creating a mix of a market driven as well as a socially oriented sustainable support provision to the SME sector (Green, 2003). Despite, several arguments against government intervention in BDS, a mix of private sector and public sector services provision is of critical importance. However, their effectiveness and efficiency, collectively needs to be investigated. More importantly, addressing access to finance challenges facing start-up SMEs requires collective effort by the government and the private sector. This is mainly because this may have a sustainable socio-economic impact. In which the social impact requires citizenry and public sector support.

Hitchins (2002) reveals that incidents of government intervention are notable through BDS provision. Therefore, the role in markets and the effectiveness of BDS in

addressing problems faced by start-up SMEs need to be investigated. This suggests that there is a need to integrate government interventions with market forces and the provision of BDS should be strategically rethought to ensure effective service delivery. It can be suggested that, with problems in the market and high failure rate of start-up SMEs in South Africa, government intervention in the form of BDS is a good step towards improving the success rate of start-up SMEs. Furthermore in accordance with international best practice government intervention is necessary to improve the availability of financial resources to start-up SMEs. The following section provides background literature on the development of BDS.

4.3 Background to Business Development Services (BDS)

The contribution of SMEs in the economy called for the channelling of resources to support the sector. In both developed and developing countries, sustainable socio-economic development can be achieved through providing support and resources to the SME sector. In the United States of America (USA), provision of support to small businesses dates back to the early 1950s with the establishment of the Small Business Administration (SBA), a federal agency to provide training and help small enterprises secure financing, land contracts with government agencies, as well as raise equity capital (Conte, 2006). The SBA was established in 1953, by the United States Congress with the passage of the Small Business Act. Its function was to "*aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns.*"

In Italy, business development service centres became popular as policy tools to improve SMEs' innovation and competitiveness since the beginning of the 1980s. The propagation of BDS centres, generally established with public or jointly public/private initiatives, was induced by the increasing awareness among policy markers, economists and representatives of the industrial sector of the need to support and encourage the modernisation of the Italian manufacturing system, characterised by a predominance of SMEs specialising in traditional sectors. The underlying principle was the existence of a market failure to explain under-investments in product and process innovations among SMEs. Therefore, there was a need to support them both through financial subsidies and the supply of services

such as information, training, technological assistance as well as the development of innovative projects (Pietrobelli & Rabelloti, 2002).

In South Africa, the provision of support to SMEs was enacted in 1996 through the passage of the National Small Business Act, 1996 (Act 102 of 1996), amended in 2004. The act stipulates the establishment of the Small Businesses Development Agency whose major mandate is to develop and implement the national government's policy for small enterprises development. The Integrated Strategy for the Promotion of SMEs propounded the importance of small businesses support services as a solution to the crippling challenges they face in their attempt to grow and survive (Department of Trade and Industries, 2005). Since 1994, in order to attain the objectives of economic growth, employment generation, income redistribution and sustainable development, policy attention has increasingly focused on the promotion of SMEs.

Both private and public sector initiatives for the promotion of SMEs visibly date back to early 1994 just after the country's first democratic elections. This was clearly articulated in the White Paper for the Promotion of SMEs in 1995 followed by the Presidential Conference on SMEs held in Durban the same year. The Integrated Strategy for the Promotion of SMEs (Department of Trade and Industries, 2005), stressed the urgent need to promote SMEs as vehicles for sustainable economic growth. The idea was to integrate the SME sector into the heart of the socio-economic development of the country.

In reviewing the literature on challenges facing start-up SMEs, access to finance emerged as a critical challenge impeding the growth of SMEs in South Africa. As an attempt to address that challenge, the government of South Africa established development financial institutions such as Khula Finance Ltd, the Industrial Development Corporation (IDC), National Empowerment Fund, National Development Agency (NDA), and National Youth Development Agency (NYDA). Apart from the IDC which caters for the upper end of the SME market, many SMEs still have difficulty iaccessing finance in South Africa (Bbekhele, 2007:14).

An analysis of the above mentioned government initiatives shows that all of them are aimed at financial intermediation between the state and the SME sector and also between the SME sector and private sector financial institutions. As an institutional framework to support the financial intermediation efforts, business development support was instituted through the creation of government agencies such as the Small Enterprise Development Agency (SEDA) in 2004. SEDA was formed in terms of the National Small Businesses Act. It merged the Ntiska Enterprise Promotion Agency, National Manufacturing Advisory Centres and the Community Public Private Partnerships. The mandate of SEDA is to strengthen support for Small, Medium and Micro Enterprise (SMME) access to finance, provide an enabling policy environment and the expansion of market opportunities for certain types of enterprises, localise small business support through a grid of SEDA-coordinated information and advice access points, initiate a national entrepreneurship drive and expand education and training for small business and co-fund minimum business infrastructure facilities in local authority areas across the country (Small Enterprise Development Agency, 2007).

The past decade has seen some public agencies restructuring and some totally collapsing as a result of underperformance, as well as claims of abuse of public funds by management. Recently, the Umsobomvu Youth Fund (UYF) was merged with the National Youth Commission to form the National Youth Development Agency (NYDA). The success of SEDA or even of the then UYF, now NYDA, has not yet been noted and the entrepreneurs' views of SEDA as a government agent to help them have not yet been researched.

It is necessary to articulate clearly the activities, functions and operations of these institutional frameworks (BDS) designed to assist entrepreneurs in running their businesses successfully. This will assist in developing an effectively structured policy for the development of the current and future BDS institutions. Thus, the section below includes the definition of the BDS sector.

4.4 Defining the Business Development Services (BDS) Sector

A clear understanding of the Business Development Sector (BDS) requires clearly stated definitions that list all the activities, functions and probably the structure of the sector. Although there is no clear and internationally recognised definition of the BDS sector, several authors and researchers have attempted to define the sector. The International Finance Corporation (hereafter IFC) (2006) defines Business Development Services as "…*those non-financial services and products offered to entrepreneurs at various stages of their business needs".* Goldmark (1996) in Brijlal (2008:49) points out that, traditionally, the sector had been referred to as "*non-financial services*". However, these services are offered in conjunction with credit and other financial services, hence financial services can be included in the BDS services provision. The International Finance Corporation (2006), also argues that Business Development Services (BDS) are important because they can assist entrepreneurs to run their businesses more effectively and, if appropriately applied, can act as an enhancer of access to finance and also as an alternative form of "collateral" in circumstances where tangible collateral may be an impediment to meeting traditional security requirements.

In another study Pietrobelli and Robellotii (2002) note that several expressions are frequently found in the English-language literature to designate a concept similar to the BDS, with sometimes varying nuance, including industrial extension services, support services, advisory services, or business services. Among all these labels, the notion that most vividly portrays the actual nature and function of such services is that of "real services", indicating their impact on the structural features of the business, and notably on their competitiveness. Thus, "real" should not be interpreted as the opposite of "financial" since the latter services may also be real, to the extent that they have a structural impact. Ideally, the provision of these services may transfer knowledge and technology, and facilitate learning, thereby modifying in a structural non-transitory way, the business's production and the relations with the market.

The Committee of Donor Agencies for Small Enterprise Development, (2001:11) defines BDS as services that improve the performance of an enterprise, its access to markets, and its ability to compete..

> *"… includes an array of business services (such as training, consultancy, marketing, information, technology development and transfer, business linkage promotion, etc.), both strategic (medium to long term issues that improve performance] and operational [day-to-day issues)".*

BDS are designed to serve individual businesses, as opposed to the larger business community.

A distinction can be made between "operational" and "strategic" business development services. Operational services are those needed for day-to-day operations, such as information and communications, management of accounts and tax records, and compliance with labour laws and other regulations. Strategic services, on the other hand, are used by the enterprise to address medium- and long-term issues in order to improve the performance of the enterprise, its access to markets, and its ability to compete. For example, strategic services can help the enterprise to identify and service markets, design products, set up facilities, and seek financing. The market for operational services may already exist, since there is often an articulated demand and willingness to pay for these services. In contrast, markets for strategic services for SMEs have largely failed to develop, and they are the focus of most donor interventions in BDS (The Committee of Donor Agencies for Small Enterprise Development, 2001:11).

Pietrobelli and Rabellotii (2002:9) in addition, propound that in a developing country context the emphasis of BDS on new knowledge and innovation should be somehow moderated. Notwithstanding the central role of learning at all levels of industrial development, BDS in developing countries may target the promotion of a wide range of business skills and capabilities, even of a simpler and routine kind, with varying degrees of innovativeness.

The primary focus of BDS services provision is to facilitate skills transfer and provide business advice. This skills transfer and provision of business advice is important in helping small business or emerging entrepreneurs to develop their business ideas into viable business enterprises (Pietrobelli and Rabellotii, 2002:9). Internationally, the field of business support has been growing alongside the SME development process (IFC, 2006). In South Africa the Business Development Services are also closely aligned to government's initiatives to support the SME Sector. This is evident in the clearly stated SME policy stance defined in the White Paper (Department of Trade and Industries, 2005).

The effectiveness of these BDS services in promoting or addressing challenges facing the SME sector is subject to debate. The IFC (2006) pointed out that, while the South African government, through the Department of Trade and Industries (DTI), has offered strategic direction in terms of SME development from time to time, there is as yet no coherent and focused delivery of such support available throughout the country. Although some programmes, such as the Red Door in the Western Cape, the Eastern Cape Development Corporation, Gauteng Enterprise Propeller, among others, have been supported by provincial governments and are working on offering a range of services in terms of local businesses needs, there is a range of obstacles facing entrepreneurs needing support. Rural areas, for example, are very under-resourced and serviced (International Finance Corporation, 2006).

A range of business support options have been developed and can be applied to develop small businesses. In South Africa such support options include mentorship programmes; the Voucher Programmes (for example, the one offered by the former Umsobomvu Youth Fund (UYF), now National Youth Development Agency (NYDA), and credit guarantee schemes, among others). However, key benchmarks need to be applied in order for such support services to be effective (International Finance Corporation, 2006).

Quite a substantial number of services are offered under the banner of Business Development Services. However, most of them fall into one of the following categories:

- Financial Services
- Non-Financial Services

These are discussed in the following subsections.

4.4.2 Financial Services

Financial services refer to a wide range of services that are intended to improve or facilitate access to finance. Henry (2006) refers to financial services as services that facilitate access to credit. Churchill and Frankiewicz (2006:18) argue that to facilitate access to credit to the poor *(low income market)* and start-up SMEs, the provision of microfinance services is paramount. Microfinance is the provision of financial services to the poor on a sustainable basis. It embodies, like other developmental strategies, a viable combination of equality and efficiency because access to financial services should both protect and empower the poor by giving them choices. It has however been noted that most financial institutions do not have a poverty orientation (*they do not have a social mission)*. Thus, microfinance provision is distinguished from conventional financing in that it aims to serve the poor and generally people outside the reach of the formal financial market (Churchill & Frankiewicz, 2006:18).

Despite emphasis by several authors on facilitating access to credit, Churchill and Frankiewicz (2006:18) argue that credit is not sufficient as a developmental tool. They pointed out that not everyone in a poor community is an entrepreneur and even the entrepreneurs do not want to be in perpetual debt. Providing loans to people who do not have the means to repay them makes them worse off, not better off.

Low income people have similar financial needs to everyone else, but they need them to be redesigned and delivered in a way that meets their particular characteristics, such as a sporadic or unpredictable income, long periods with negative cash flows, and vulnerability to risk and probably located in difficult to reach

locations with limited infrastructure (Churchill & Frankiewicz, 2006:20). To ensure this, financial services tailored to serve small businesses, as they are characterised by low levels of income, should be sought and provided. The Business Development Services (BDS) sector, as defined in this study, should indirectly and directly attempt to provide services that enable access to financial services to SMEs. In South Africa, government funded institutions attempt to provide financing to start-up SMEs. However, such attempts are not satisfactory since quite a significant number of SMEs have no access to finance (Maas & Herrington, 2006). Although a distinction can be drawn between financial and non-financial services, it is evident that these services complement each other.

4.4.3 Non-Financial Services

Traditionally the BDS sector had been referred to as providing non-financial services only (International Finance Corporation, 2006). The non-financial services function of BDS includes providing training, mentorships, consultancy, technology development and transfer, business linkages promotion, marketing assistance, and other related functions. These functions are intended to enable business skills transfer as well as acting as supporting services to small firms (SMEs) who, in most circumstances, do not have the capacity to incorporate these services into their organisational functions. The following is a discussion of some of the non-financial services offered by the BDS sector.

a) Training

Providing training services in the SME sector is one of the urgently felt needs in order to impart entrepreneurs with the necessary skills to effectively and successfully run their businesses. Training for SMEs includes business plan preparation and marketing research. Huang (2001:439) provides a comprehensive definition of training and the training process. According to him,, training consists of organized learning activities capable of improving individual performance through changes in knowledge, skills, or attitudes. The training process includes such activities as identifying employee-training needs, designing annual training plans, devising

training objectives, choosing delivery methods, implementing training programs, evaluating training results, and documenting training records. As an organizational subsystem, training must be closely coordinated with overall business strategy and the activities of line departments. Therefore, setting up a specific department within a firm to organise and implement employee training and development may result in more effective training (Huang, 2001:441).

Devins, Johnson and Sutherland (2004:449) revealed that training interventions lead to positive outcomes for the majority of SME employees, particularly those working in organisations with relatively formalised training practices. Furthermore, it was argued that there is a considerable body of evidence to support the view that there are significant differences between the training and associated human resource development activities undertaken by businesses of different sizes.

Several studies such as Huang (2001:438) and Brijlal (2008:51) have alluded to the importance of training aimed at organisational success. However, little attention has been given to training needs and support for SMEs. Among the authors who attempted to relate training to SMEs, Huang (2001:439) points out that owners and managers of smaller firms tend to demand less training than those of larger ones do. He argued that the explanation for this tendency is that time-related pressures and the high direct cost of training may make SMEs reluctant to invest in training or to allow their employees to attend training courses. If top management does not provide support for or undertake a commitment to employee training, a firm may focus little attention on training activities. Therefore, a strong correlation exists between the degrees of management support for training and training effectiveness.

The arguments put forward by Huang (2001:441) suggest that SMEs have no capacity to provide training services within their enterprises because they lack resources. Therefore, training interventions from outside bodies are necessary in the SME sector. In South Africa, quite a substantial number of institutions (both private and public sector), including universities and colleges have programmes to provide training to SMEs. Despite a wide range of entrepreneurial training service providers,

the lack of skills remains among the critical challenges that hamper the success of SMEs in South Africa (Olawale & Garwe, 2010:735). Thus, SME sector focused training is of great value to the South African entrepreneurs. Such, SME sector focused training can be provided by BDSs, of course making use of government subsidies. Herrington, *et al.* (2009) argue that providing finance to poorly skilled entrepreneurs is an ineffective use of scarce resources, particularly if these individuals do not have the correct skills set to make effective use of the finance provided. Therefore training is important to the success of start-up SMEs.

Quite a substantial number of BDS service providers have access to subsidised training provision packages (Department of Trade and Industries, 2005). For example provincial BDS service providers such as the Eastern Cape Development Corporation (ECDC) in the Eastern Cape, provide government subsidised entrepreneurship training programmes that are done through private sector service providers (ECDC, 2010). Brijlal, (2008:49) argues that management training should greatly improve SME survival and performance. Although the importance of training to improve business performance has been stressed, this area has received little attention in the literature. A study by the Organisation of Economic Cooperation and Development (2002) reveals that there is a positive correlation between the degree of management training and the bottom-line performance of an SME. Rogerson (2000:711) also points out that training has a positive impact on the success of SMEs in South Africa. Therefore it can be concluded that provision of training services to start-up SMEs can positively contributed towards their success and enhance their access to debt finance

b) Mentoring

Another service that is offered by BDS is mentoring. Mentoring services, like training are aimed at providing skills transfer. Various authors attempted to define mentorship and their definitions vary with the varying contexts in which the definitions are provided. Bozeman and Feeney, (2007:731) define mentorship as:

"..*a process for the informal transmission of knowledge, social capital, and psychosocial support perceived by the recipient as relevant to work, career, or*

professional development. It entails informal communication, usually face-to-face and during a sustained period of time, between a person who is perceived to have greater relevant knowledge, wisdom, or experience (the mentor) and a person who is perceived to have less (the protégé)".

A mentor is generally defined as a higher-ranking, influential individual in a work or business environment who has advanced experience and knowledge and is committed to providing upward mobility and support to the career of another (Ragins, Cotton & Miller, 2000: 1182). A protégé is an individual or an organisation which is being mentored.

Although there are slight variations in definitions provided for mentorship, they all emphasise skills transfer as the ultimate goal. As already noted, the lack of skills is a common feature in the SME sector in South Africa. The situation is even worse for start-up SMEs who in many instances, although they may have sound business proposition may lack the skill to effectively nurture their business proposition into viable and successful business ventures. Von Broembsen *et al.* (2005) found that in South Africa, only 35% of young men and women between the ages of 25 and 44 believe that they have the skills to start a business. These results suggest that there is a need for skills transfer to start-up SMEs and mentorship programmes can be instrumental in this regard.

For many start-up businesses, some form of mentoring is needed to varying degrees to grow business skills and expertise. One to one mentoring is effective but expensive. Unless economies of scale can be achieved, providing these support services to small enterprises is difficult to sustain. Therefore, it is vital to have programmes in place to ensure that SMEs get access to mentoring services. The BDS sector attempts to provide such services.

In South Africa, one of such notable programmes is the Khula Mentorship Programme. The primary aim of this mentorship programme is to act as a risk mitigator and facilitator of access to finance for SMEs. It offers two services, namely;

pre-loan and post loan mentorship services. During the pre-loan stage entrepreneurs are assisted by experienced mentors with advice, counselling and the development of viable business plans. In order to access funding in the post-loan stage, clients are assisted with various aspects of managing a successful business as identified by the client, mentor, bank and Khula. Such a programme is of great help to SMEs, particularly start-ups who do not have experience and knowledge of developing and running a successful business venture despite having innovative business ideas.

Despite the widely noted importance of mentorship, specifically for start-up SME owners, Tepper and Taylor, 2003 as cited in Boozen and Feeney, (2007:725), made important contributions with respect to negative implications of certain mentoring approaches. Boozen and Feeney (2007:725) investigate the conditions under which protégés are most likely to report negative mentoring experiences, such as abuse, neglect, intentional exclusion, tyranny, deception, incompetence, or sexual harassment and found that having a mentor who is one's supervisor, as compared to a nonsupervisory mentor, is not related to reporting negative mentoring experiences. Burke, *et al.* (1991) as cited in Boozen and Feeney (2007:725) tested whether mentoring relationships are "special" compared to regular supervisor–subordinate relationships and found that there were no significant differences between mentored subordinates and other subordinates, except that those mentored reported higher levels of psychosocial functions such as friendship.

However, mentorship is important to start-up SMEs. Ragins *et al.* (2000:1182) indicate that mentors are viewed as knowledgeable and trusted counsellors, who are willing to share their business knowledge, skills, experience, and most importantly, serve as respected role models. Due to lack of skills, experience and probably knowledge, start-up SMEs should seek mentorship services to see them through the successful running of their businesses. It is can be concluded that mentorship is necessary to guide start-up SMEs through the challenges they face in their attempts to survive and grow. Herrington *et al.* (2009) emphasise that mentorship, guidance and small business training support are an essential component of entrepreneurial

development. This suggests that mentorship can positively impact on the performance of start-up SMEs and lead to improved access to external finance.

c) Consultancy and Advisory Services

BDSs also provide consultancy services to SMEs. These consultancy services again are aimed at providing business advice to SMEs as well as providing some ancillary services to small businesses. BDSs through the use of expertise in various specialised fields of business development provide consultant services to SMEs to help them through a successful and effective growth path (Boozen & Feeney, 2007:725).

d) Technological development and transfer

With increasing advances in technology in the 21st century economy, surviving competition requires an enterprise that copes with technological changes. Such coping is quite a difficult task for SMEs due to lack of resources and skilled staff. BDS help in providing technological advice as well as supporting innovation in the SME sector. In South Africa, programmes such as SEDA technology programmes, in conjunction with SA Business Technology and Incubation Association (Sabtia), are intended to facilitate technology development and transfer to SMEs (Department of Trade and Industries, 2005). Due to challenges such as lack of information on available and mature technologies, and difficulties in financing the acquisition of new technology, it is critical to provide assistance to SMEs to help them to overcome these challenges (Boozen & Feeney, 2007:725).

e) Marketing assistance

Marketing of a firm's product is essential to the success of enterprises, particularly in start-ups with innovative products. Lack of enough marketing resources and skills may lead to the collapse of a new otherwise successful innovative product. Some of the major challenges facing SMEs in trying to market their products include lack of up-to-date market information, lack of familiarity with export procedures and

weaknesses in product design, packaging, pricing and servicing. BDSs through their use of experts and a wide array of specialized resources are able to provide market assistance to SMEs (Boozen & Feeney, 2007:726).

f) Business Linkages

Promoting and supporting business linkages is also an important BDS function. Through linkages with large and established enterprises, emerging entrepreneurs and small business have a great chance of survival and growth. In South Africa some large enterprises such as Anglo American, DeBeers, Xerox, South African Breweries (SAB), Barlows Limited, among others, have initiatives that enable linkages with the SME sector (Department of Trade and Industries, 2005).

Jenkins, Akhalkatsi, Roberts and Gardiner, (2007) emphasise the role of business linkages in developing countries. They proposed that business linkages with local SMEs, including procurement, distribution and sales offer large firms an avenue through which they can reduce input costs while increasing specialisation and flexibility. It is further propounded that business linkages increase local integration and "rooting", providing access to local knowledge by spurring growth and development in the local SMEs. This will bring about social and economic impacts in the wider community (Jenkins *et al.,* 2007).

Furthermore, the role of business linkages in the value chain of large firms found expression in the literature. Large firms can forge linkages with local SMEs in many different areas of their own value chain. These include procurement, agricultural out growers' schemes, manufacturing subcontracting, outsourcing of non-core functions and services, distribution and retail, franchising and leasing, sale of financial services, information and communication technologies and other productive inputs and tools. The key to these programmes is developing the capacity of SMEs to meet the needs of large firms (Jenkins *et al.*, 2007).

Several authors (Stiglitz and Weiss, 1981; Hitchins, 2002; Department of Trade and Industries, 2005; Rogerson; 2006; Herrington *et al.,* 2009) advocate for the role of

the public sector (government) in helping SMEs overcome the growth and survival challenges they face. Central to the discussions on the reason why the government should intervene, is the issue of market imperfections that work to the detriment of emerging and young entrepreneurs or start-up SMEs that lack enough resources to effectively compete or gain access to market information.

Despite government intervention to help SMEs in South Africa, the lack of access to adequate financing of start-up SMEs, of business and managerial skills, of access to markets, among other problems facing start-up SMEs are still major issues that need to be addressed if the success rate of start-up SMEs is to be improved. South Africa still has high start-up SME failure rates of more than 75% and incidences of inadequate financing of SMEs are still a major problem leading to high failure rates of SMEs. Herrington *et al.* (2009) point out that access to finance has remained one of the top three constraints mentioned by the national expert panel as a reason for South Africa's still high failure rate among start-up SMEs.

The literature review in chapters two, three and four has indicated that start-up SMEs in South Africa have the highest failure rates, adequate access to finance is still a major problem and the effectiveness of government intervention (BDS) in addressing access to finance challenges facing start-up SMEs needs to be investigated. With such disturbing trends and problems in mind this study attempts to investigate the role of BDS in improving access to finance by start-up SMEs. IIt is obvious then that empirical research is essential at this stage to find effective solutions to access to finance challenges facing start-up SMEs. This study focuses primarily on the non-financial services provided BDS and how these can impact on access to finance. The following chapter describes the research methodology that was followed in collecting empirical data and their analysis.

4.5 Summary

The chapter laid a foundation for the literature on the need for government intervention to address access to finance challenges facing start-up SMEs. Government intervention has been reviewed with special reference to BDS provision.

Furthermore, the financial and non-financial services components of the BDS sector have been discussed. It has further been clarified that, traditionally, BDS were regarded in terms of non-financial services only however, in the contemporary literature the BDS sector has been thought of as incorporating financial services. Furthermore, the role of the government in BDS services provisions was discussed. This included a discussion of the old and new approaches to BDS provision.

Despite the richness of the literature on BDS, their effectiveness in delivering services that help SMEs address challenges that impede their growth and survival has remained controversial. Despite a wide array of BDS, the failure rate of start-up SMEs in South Africa is still one of the highest in the world and access to finance is still a problem. Empirical studies such as Rogerson (2006) investigated how to improve access to finance from private market providers; no study has investigated empirically whether government support in the form of BDS is actually working to alleviate the problem of finance for start-up SMEs. The central focus of this study was to explore the role of BDS in addressing access to finance challenges facing start-up SMEs. The following chapter is an outline of the research methodology for the empirical research for this study.

CHAPTER 5: RESEARCH METHODOLOGY AND DESIGN

5.1 Introduction

The objective of this chapter is to explain the research methodology followed in the empirical part of the study. According to Leedy and Ormrod (2001:4), "a research is a systematic process of collecting data in order to measure and have an understanding of the phenomenon with which we are concerned or interested in." Research methodology outlines the details of the study; the design of the research, the decisions regarding population and sampling procedures followed, methods employed to collect data and the procedures used to analyse the data.

A scientific research follows systematic, empirically based procedures for generating replicable research (Cooper & Schindler, 2008:22). The primary focus of this study was to produce empirically tested results and conclusions on the role played by Business Development Services Providers (BDS) in improving access to finance for start-up SMEs. Such empirical data can be obtained by following a properly designed research methodology and data collection instruments. A properly planned and conducted research produces reliable results which are important in making informed decisions about future courses of action.

This study adopted a formal business research process as outlined by Zikmund (2003:61). The business research process offers a description of how research is designed and implemented. Figure 5.1 depicts the phases of the business research process followed in this study.

Figure 5.1: Steps in the business research process
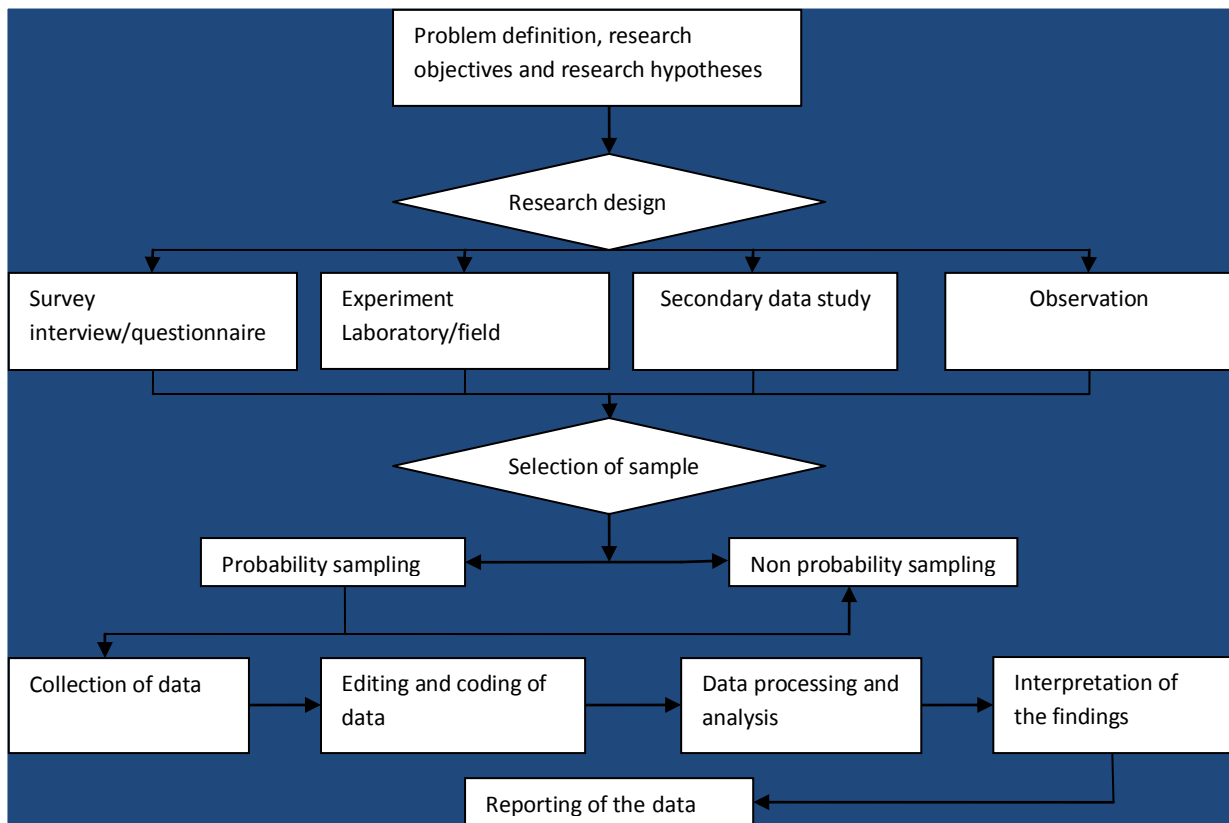
Source: Adapted from Zikmund (2003:61).

This chapter begins with a statement of the research problem and research objectives, followed by a discussion of the scope of the study, the research methods and techniques used, the sampling methodology, the data analysis procedures and finally the limitations within the study. The chapter finally provides a chapter summary.

5.2 The Research Problem

Many SMEs fail in the infancy stage and some fail a few years after start-up due to a number of challenges. According to Herrington *et al*. (2009) the prevalence rate for established business owner-managers is very unsatisfactory. South Africa ranked 41st out of 43 countries, with an established business rate of 2.3% indicating a high failure rate for South African start-up SMEs. Furthermore, Van Eeden *et al.* (2003:13) deduce that the estimated failure rate of start-up SMEs is between 70% and 80%.

According to Nigrini and Schoombee (2002:737), in surveys of SMEs worldwide access to finance emerged as one of the most urgently felt needs. This is why programmes of financial assistance are one of the principal ways in which governments, international development agencies and donors support this sector. Start-up SMEs in particular face a number of challenges that affect their survival and growth. Attempts to address challenges facing SMEs have not be very successful for the past decade or more when both government and private initiatives were put in place. The effectiveness of such initiatives in helping the SME sector remains controversial. Thus this research investigates the role played by Business Development Services providers (BDSs) in improving access to finance for start-up SMEs. The primary research problem was:

- Does the use of government intervention efforts through Business Development Service (BDSs) help to improve access to external finance by start-up SMEs?

The other research problems investigated by this study were:

- Are start-up SMEs aware of BDSs?
- Do start-up SMEs that are aware of BDSs utilise the service?

In an attempt to provide solutions to the above mentioned research problem, the following research objectives were formulated.

5.3 Research Objectives

5.3.1 Primary objective

- To investigate empirically whether start-up SMEs that use BDSs have improved access to external finance

5.3.2 Secondary objectives

- To review the literature on the contribution of start-up SMEs to the economy, their creation rate, their failure rate and the causes of failure in South Africa

- To review the literature on the challenges hindering access to finance for start-up SMEs (i.e. the causes of market failure)

- To review the literature on government intervention efforts that can assist in improving access to finance by start-up SMEs

- To investigate empirically if start-up SMEs are aware of BDSs

- To investigate empirically if start up SMEs that are aware of BDSs use the service

- To develop a more efficient model of government intervention effort through BDSs in improving access to finance by start-up SMEs

5.4 Research Hypotheses

According to Cooper and Schindler (2003:151) a hypothesis is a preliminary or tentative explanation or postulate by the researcher of what the researcher considers the outcome of an investigation will be. It is an informed or intelligent guess of the solution to a problem. It indicates the expectations of the researcher regarding certain variables. Hypotheses play important roles in a research study. They offer explanations for the relationships between variables that can be tested empirically. It furnishes proof that the researcher has sufficient background knowledge to enable him/her make suggestions in order to extend existing knowledge. More importantly, hypotheses give direction to an investigation since they structure the next phase in the investigation and therefore provide continuity in the examination of the problem.

Hypotheses are stated as the null and the alternative hypotheses. When a hypothesis is stated negatively, it is called the null hypothesis. It is a 'no difference', 'no relationship' hypothesis. It states that, no difference exists between the parameters and statistics being compared or no relationship exists between the variables being compared. It is usually represented as H_O or H_0. An alternative is the hypothesis that describes the researcher's prediction that, there exists a relationship between two variables or it is the opposite of the null hypothesis. It is represented as H_A or H_1 (Cooper & Schindler, 2003:151). Following the comprehensive literature

review in the previous chapters, the following hypothesis statements were formulated.

5.4.1 Primary Hypothesis

- $H1_0$ There is no relationship between the use of BDSs and improved access to finance by start-up SMEs.
  $H1_A$ There is a relationship between the use of BDSs and improved access to finance by start-up SMEs.

5.4.2 Secondary Hypotheses

- $H2_0$ Start-up SMEs are not aware of BDS providers in their localities.
  $H2_A$ Start-up SMEs are aware of BDS providers in their localities.
- $H3_0$ Start-up SMEs are aware of BDS are not using the services.
  $H3_A$ Start-up SMEs are aware of BDS are using the services.

5.5 Scope of the Study

This section includes aspects such as where the study was conducted, what was researched, and who was studied. A proper demarcation of the geographical area, the population and the study units to be interviewed is necessary in order to reduce the time frame, the costs and effort needed to complete the study. Furthermore reliable results can be obtained from a clearly defined targeted population from which the results can then be projected to a larger population.

5.5.1 The Survey Area

The study was carried out in the Eastern Cape Province of South Africa. The Buffalo City Municipality was chosen because it is the central municipality of the Eastern Cape, with many business activities taking place in the municipality. The Buffalo City Municipality consists of East London (including Mdantsane), King William's Town and Bhisho. Issues of convenience and availability of the research units in the area played a significant role in choosing the survey area. Furthermore, the Buffalo City Local Economic Strategy (2008) presents some disturbing trends which make the area a priority focal point for policy reforms to improve the socio-economic conditions

of the area. According to the Buffalo City Local Economic Strategy (2008) the study area is characterised by the following trends:

- Declining population numbers related to migration of the youth in search of economic opportunities elsewhere;
- Declining rural population, although still significant at about 25% of the population;
- Declining formal sector jobs (by about 13,000 jobs net between 1995 – 2004) and the need to create about 50000 jobs per annum on average in order to halve unemployment by 2014;
- The only areas where formal jobs have been created are in the wholesale and retail trade, and finance and business service sectors and this is largely a result of increasing domestic demand linked to improved access to welfare grants, as opposed to increased domestic or foreign productive investment.
- Geographically, East London is the only area within the study area that has seen a growth in formal sector employment (of about 10,000 jobs over the past 10 years), with King William's Town, Mdantsane, and the rural areas all losing formal sector jobs.
- High levels of unemployment, at around 30% associated with much reliance on survival in the second informal economy. This is related to high levels of poverty (60% of all households earned less than R1600/ month in 2001).

With such disturbing trends, the job creation potential and socio-economic impact of start-up SMEs is crucial to achieve positive socio-economic reform in the area, which is the centre of commerce in the Eastern Cape Province.

5.5.2 The Target Population

A target population is a specified group of people or objects for which questions can be asked or observation made to obtain information (Hair, Wolfinbarger, Ortinau & Bush 2008:33). The target population for this study included all start-up SMEs (small businesses that had been in operation for a period of less than three and a half years).

Information obtained from the Black Enterprises directory, the Yellow Pages of the telephone directory and the Small Business Development Agency (SEDA) indicated that there are 407 start-up SMEs in the area of focus for this study. SEDA is one of the government's small business development agents, born out of the DTI's strategy to promote SMEs in South Africa. It offers a range of business development services to SMEs. It provides non-financial services through integrated support agencies across the nation with more than 284 Enterprise Information Centres in municipalities across the nation.

5.6 Research Design

According to Babbie and Mouton (2002:74), a research design is a plan or blueprint of how the researcher intends to conduct the study. It focuses on the end product, namely the kind of study that is being planned and what results are aimed at.

5.6.1 Research Method

Research methods are classified into qualitative and quantitative research methods. In quantitative research, the information obtained from the participants is expressed in numerical form. In qualitative research, on the other hand, the information obtained from participants is not expressed in numerical form. The emphasis is on the stated experiences of the participants and on the stated meanings they attach to themselves, to other people, and to their environment. Those carrying out qualitative research sometimes make use of direct quotations from their participants, arguing that such quotations are often very revealing (Eysenck, 2004:2). The following table is a comparison of qualitative and quantitative research.

Table 5.1: Qualitative Versus Quantitative Research

Evaluation Variable	Qualitative	Quantitative
Objective	To gain an qualitative understanding of the underlying reasons and motivations, insights of a phenomenon through an intensive collection of narrative data	To quantify the data and generalise the result to the population of interest, explain, predict or control phenomena through a focused collection of numerical data.
Sample	Small numbers of non-representative cases. Purposive: intent to select small, not necessarily a representative sample to acquire in-depth understanding.	Large numbers of representative cases. Random: intent to select large representative samples to generalise results to a population
Data collection	Unstructured	Structured
Data analysis	Non statistical, raw data are words; Non-standardised, narrative; Essentially on-going, involves synthesis	Statistical, raw data are numbers; Standardised, numerical, at the end Performed at the end of the study, involves statistics
Outcome	Develop and initial understanding; Conclusions tentative, reviewed on an on-going basis; Generalisations are speculative or non-existent	Recommend on final course of action; Conclusions and generalisations formulated at the end of the study; Stated with predetermined degree of certainty

Source: Adopted from Malhotra, Hall, Shaw and Oppenheim (2002:192)

This study used the quantitative research method. Cooper and Schindler (2003:125) state that quantitative research generally involves the collection of primary data from large numbers of individuals, frequently with the intention of projecting the results to a wider population. In quantitative research the aim is to determine the relationship between one thing (an independent variable) and another (a dependent or outcome variable) in a population. Quantitative research designs are either descriptive (subjects usually measured once) or experimental (subjects measured before and after a treatment). A descriptive study establishes only associations between variables. An experiment establishes causality.

A descriptive research design was followed in this study. A descriptive research design provides answers to questions of who, what, where and how of the phenomenon of interest (Gerbel-Nel *et al.*, 2005:33). The descriptive research in this study established the perceptions of start-up SMEs on the role played by BDS in improving their access to finance. In order to gather data for analysis primary data collection methods were used.

5.6.2 Primary data collection methods

Gerber-Nel *et al.* (2005:88) identify three primary data collection methods namely observation, experiment and survey.

- **Observation**

Cooper and Schindler (2003:114) describe observation as a process through which primary data is obtained by observers (humans or machines) about the behavioural pattern of people, objects or occurrences. Observation is an effective method when specific behaviours can be observed, the behaviour is repetitive, predictable and frequent, and the behaviour is relatively short-lived. Observation was inapplicable for this kind of result study because the researcher wanted to obtain critical information from the respondents and not observe their behaviour.

- **Experiment**

Cooper and Schindler (2003:115) point out that under the experiment method of data collection, the researcher manipulates an independent variable and then measures

the effect. The experimental setting can be in a laboratory or in the field. In a laboratory, experiments are conducted in an artificial or laboratory setting. The research is isolated from the natural setting or routine of respondents. Laboratory experiments allow the researcher to have direct control over most of the crucial factors that may have an effect on the experiment. Field research is done in the natural setting of the respondents. This study however was not about the manipulation of variables. Therefore, experiment was not used as a method of data collection. This study used the survey as the research method because other methods of data collection such as observation and experiment were inapplicable to collecting data to investigate the research problems.

- **Survey**

Wheather and Cook (2000:195) note that the broad area of survey research encompasses any measurement procedures that involve asking respondents questions. A survey asks a series of questions that require answers from these groups which are then analysed at the end of the survey when the participant level has been reached. In survey research, the researcher selects a sample of respondents from a population and administers a standardised questionnaire to them. The study used survey research for the following reasons as pointed out by Cooper and Schindler (2003:663):

- ➢ Surveys are relatively inexpensive (especially self-administered surveys).

- ➢ Surveys are useful in describing the characteristics of a large population. No other method of data collection can provide this general capability.

- ➢ Surveys can be administered from remote locations using mail, email or telephone. Consequently, very large samples are feasible, making the results statistically significant even when analyzing multiple variables.

This study followed the survey research process as outlined by Gerber-Nel *et al.* (2005:94). Following this process:

- ➢ The population to be studied was defined.

- A representative sample was selected.

- Data were collected through the use of self-administered questionnaires.

- SPSS (Statistical Package for Social Sciences) was used to tabulate and analyse the sample to produce various sample statistics.

- Inferences were made from sample statistics to population parameters of interest.

- **Methods of conducting survey research**

Gerber-Nel *et al.* (2005:94) point out that surveys can be divided into four major types: personal interviews, telephone surveys, mail surveys and self-administered surveys. Gerber-Nel *et al.* (2005:94) further define a personal interview (i.e. face-to-face communication) as a two-way conversation initiated by an interviewer to obtain information from a participant. This implies that the people selected to be part of the sample are interviewed in person by the researcher. The researcher used the personal interview at the exploratory stage to refine the questionnaire. The personal interview was not used during data collection because it is a costly method of data collection. The researcher would have needed to personally visit the respondents a couple of times. This would have resulted in a longer period for data collection.

According to Gerber-Nel *et al.* (2005:94) telephone interviews take place when respondents are telephoned in order to gather primary data about a specific research problem. The researcher decided not to use telephone interviews because its response rate is lower than for personal interview or self-administered questionnaires, responses to the questions may be less than complete and many of the phone numbers may not be working making directory listings unreliable. Cooper and Schindler (2003:430) describe a mail survey as a survey that takes place when the researcher selects a sample of names and addresses and send questionnaires to these respondents with the aim of collecting data. The researcher decided not to use mail survey because of the following reasons: the respondents may not return the questionnaires and mail surveys are a very slow method of data collection.

Because of the limitations associated with the other methods of conducting surveys, data for the research study were gathered through self-administered questionnaires. Self-administered questionnaires are research questionnaires personally delivered to the respondent by the interviewer but completed by a respondent with no interviewer involvement (Cooper & Schindler, 2003:326). The researcher used self-administered questionnaires for the following reasons:

➢ Self-administered questionnaires ensure anonymity and privacy of the respondents, thereby encouraging more candid and honest responses.

➢ Self-administered questionnaires have proved to have a higher response rate than other data gathering techniques such as mail surveys.

➢ Self-administered questionnaires are less expensive than other data gathering methods such as personal interviews where the researcher must be present with respondents at all times (Cooper & Schindler, 2003:369).

The researcher was also able to obtain the names and telephone numbers of the respondents when the questionnaires were distributed. Repeated call backs and follow-ups were made to the respondents to ensure they completed the questionnaires.

5.6.3 Research Instruments

A structured questionnaire was used as an instrument for collecting primary data from SMEs. The structured questionnaire combines open-ended and close-ended questions and constituted the main source of obtaining primary data in this study. The majority of questions were presented in the form of a five point Likert scale. The questionnaire was divided into three sections which were organised in order to address the objective of this study.

- **Section A –** addressed issues and challenges facing SMEs on access to finance.

- **Section B –** addressed issues on awareness, the use and the role played by business development services providers (BDSs) in improving access to finance for start-up SMEs.
- **Section C –** attempted to find business characteristics and demographic information of the respondents.

The questions in the questionnaire were carefully selected to ensure that only questions that make meaningful contributions to the focus of the study are included. Careful considerations were done to avoid "*nice to have*" questions without any relevance to achieving the objectives of this study. Each of the questions was checked for the following:

- whether they should be asked,
- if the question is of proper scope and coverage,
- if the respondents can adequately answer the questions,
- if there is no ambiguous wording or wording that means different things to different respondents,
- whether the respondents can be willing to answer the questions, and
- If there were no double meanings of the questions, bias and that the respondent would not mistake the meaning of the questions.

In designing the questionnaire, the research took consideration of the theoretical constructs that were identified during literature review as well as gaps in literature which need to be filled with new knowledge and insights.

Following the design of the questionnaire, a pilot testing was conducted. In the pilot testing, twenty (20) questionnaires were distributed to respondents as well as some experts. This was followed by a discussion with experts to strengthen the validity of the questionnaire and to identify unclear or ambiguously formulated items, to detect flaws in measurement procedures as well as to investigate the reliability of the selected instrument (the questionnaire). This helped to check on whether the planned data collection instrument and measurement questions met the data needs to achieve the research objectives. The questionnaire was then revised accordingly, taking particular attention on the flaws and problems identified in the pilot testing.

The revised questionnaires were then sent out to the respondents to complete and the collected data was captured into Ms. excel application.

5.7 Sampling Design

Sampling involves the selection of a relatively small number of elements from a larger defined group of elements (target population). It is expected that the information to be gathered from the small group will enable accurate judgement about the larger group (Hair *et al.,* 2008:128). The following subsections provide details on the sampling method, sampling technique and sample size used in this study.

5.7.1 Sampling Method

Sampling methods are divided into probability and non-probability sampling methods. In probability sampling, every element in the population has a known non-zero probability of being included in the sample. In survey sampling, the sample is selected from a countable population of individuals. In non-probability sampling, every element in the population does not have a non-zero probability of being included in the sample. The following table provides a comparison of probability and non-probability sampling methods:

Table 5.2: Comparison of Probability and Non-probability Sampling Methods

Probability Sampling Designs			
Sampling Type	**Description**	**Advantages**	**Disadvantages**
Simple Random	Each population element have an equal known non-zero chance of being selected	Easy to implement, Highly representative if all subjects participate	Uses large sample sizes, Requires listing of all population elements, can be expensive
Systematic sampling	Select an element at the start randomly and thereafter selects the Kth element	Simple to design, Easy to determine sampling distributions of means or proportions	Periodicity with the population may skew the sample and the results.
Stratified Sampling	Divides the population into subpopulations or strata and then apply simple random sampling on each	Researcher controls sample size in strata; increases statistical efficiency; provides data to represent and analyse subgroups	Increased error if subgroups are selected at different rates; Is expensive.
Cluster	Population is divided into internally heterogeneous groups	Provides an unbiased estimate of population parameters if properly applied; Easy to do without a population list	Often lower statistical efficiency due to subgroups being more homogeneous than heterogeneous
Double sampling	Process includes collecting data using a previously defined technique, then select a subsample based on information found.	May reduce cost if first stage results in enough data to stratify or cluster the population	Increased costs if indiscriminately used.

Non-Probability Sampling Designs			
Sampling type	**Description**	**Advantages**	**Disadvantages**
Convenience	Researchers or fieldworkers choose whoever they find.	Normally the cheapest and easiest to conduct, Useful in the early stages of exploratory research	Considered the least reliable design; Researchers has no control to ensure precision
Judgemental Sampling	Sample conforms to certain criteria; Research selects respondents based on a certain criterion.	This method is less costly and is useful at exploratory stages.	Samples are not easily defensible as being representative of populations due to potential subjectivity of researcher
Quota	Select individuals as they come to fill a quota by characteristics proportional to populations	Ensures selection of adequate numbers of subjects with appropriate characteristics	Not possible to prove that the sample is representative of designated population
Snowball	Subjects with desired traits or characteristics give names of further appropriate subjects	Possible to include members of groups where no lists or identifiable clusters even exist (e.g., drug abusers, criminals)	No way of knowing whether the sample is representative of the population

Source: Adapted from Cooper and Schindler (2003:199)

The research study made use of simple random sampling method which is a probability sampling method. Probability sampling method is a sampling method in

which every element in the population has an equal chance of being included in the sample (Tustin *et al.*, 2005:344).

A simple random sampling method was chosen due to its simplicity in application as well its ability to produce a representative sample with limited selection biases. Applying this sampling method in this study, all start-up SMEs in the Buffalo City Municipality had an equal probability (chance) of being selected for inclusion into the sample which is 1/N, where N is the targeted population size.

5.7.2 Sample Size

The sample size was calculated using the Raosoft sample size calculator. Raosoft takes into consideration four factors in determining sample size. These factors include the margin of error, the confidence level, the population and the response distribution.

- *The margin of error:* The margin of error (also known as the confidence interval) measures the precision with which an estimate from a single sample approximates the population value. The margin of error ranges from 3% to 7% in business research, with 5% being the most commonly accepted.
- *Confidence level:* The confidence level is the estimated probability that a population estimate lies within a given margin of error. It is the amount of uncertainty that the researcher can tolerate. The confidence interval in business research varies from 90% to 100% with 95% being the most commonly accepted.
- *The population:* This population to be used for the study.
- *Response distribution:* This answers the question, "for each question in the questionnaire, what does the researcher expects the answer to be". If the answer is skewed highly one way or the other, the population is probably skewed too. 50% is usually used as the response distribution as it gives the largest sample size (Raosoft, 2009).

Using the Raosoft sample size calculator at 5% margin of error and 95% confidence interval a minimum recommended sample size of 198 start-up SMEs was obtained. However, 315 questionnaires were distributed to start-up SMEs in order to provide for non-responses.

5.7.3 Gathering the data

This section will describe the actual data collection and the treatment of missing values. The researcher and one paid fieldworker distributed questionnaires to the respondents between June and October of 2010. The questionnaires were distributed to respondents within the Buffalo City Municipality in the Eastern Cape province of South Africa. The researcher was also able to obtain the names and telephone numbers of the respondents when the questionnaires were distributed. Repeated call backs were made to the respondents to ensure they completed the questionnaires.

5.7.3.1 Missing values

Allison (2001:172) points out that a missing value may represent or is a product of an unknown value. In surveys, respondents may not answer certain questions. It is very important for the researcher to manage missing values efficiently. If the researcher does not handle the missing values properly, then he/she may end up drawing an inaccurate inference about the data. Due to improper handling of missing values, the result obtained by the researcher will differ from those where the missing values are present. Graham (2009:550) in addition, points out that a researcher must fully understand the concept of missing values. Item non-response occurs when the respondent does not respond to certain questions due to stress, fatigue or lack of knowledge. Sometimes the respondent does not respond because some questions are sensitive. This leads to missing values. There is no fixed rule about the proper handling of missing values. The researcher may leave the data or do data imputation to replace the missing values. It entirely depends upon the researcher's experience in dealing with missing values.

Graham (2009:551) further notes that there are three basic options when dealing with missing values. The first option is to do nothing. Leave the data as it is, with the missing values in place. This is the most frequent approach, for a few reasons. First, the number of missing values is typically small. Second, missing values are typically non-random. However, if a researcher chooses the first option, he must keep in mind how SPSS will treat the missing values. SPSS will either use listwise deletion or

pairwise deletion of the missing values. The researcher can elect either one when conducting each test in SPSS.

- **Listwise deletion**

According to Graham (2009:551) under listwise deletion, SPSS will not include cases (subjects) that have missing values on the variable(s) under analysis. If only one variable is been analysed, listwise deletion simply analyses the existing data. If multiple variables are being analysed, listwise deletion removes cases (subjects) if there is a missing value on any of the variables. The disadvantage is a loss of data because you are removing all data from subjects who may have answered some of the questions, but not others (e.g., the missing data).

- **Pairwise deletion**

Graham (2009:551) notes that with pairwise deletion, SPSS will include all available data. Unlike listwise deletion, which removes cases (subjects) that have missing values on any of the variables under analysis, pairwise deletion only removes the specific missing values from the analysis (not the entire case). In other words, all available data is included. Pairwise deletion is useful when the sample size is small. The second option is to delete cases with missing values. For every missing value in the dataset, the researcher can delete the subjects with those missing values. This means that the researcher is left with complete data for all subjects. The disadvantage to this approach is that the sample size is reduced. The third option to replace missing values is imputation. This could be done by mean substitution or regression substitution. Mean substitution replaces the missing value with the mean of the variable. Regression substitution uses regression analysis to replace the missing value. Regression analysis is designed to predict one variable based upon another variable, so it can be used to predict the missing value based upon the subject's answer to another variable. Missing values presented a problem that had to be addressed in this research before evaluation could proceed. The three cases of missing values and pairwise deletion method under SPSS was used.

5.8 Data Analysis

In a quantitative research, data analysis refers to the process of breaking down the collected data into constituent parts in order to answer the research questions (Terre Blanche & Durrheim, 2002:105). It involves reducing the accumulated data into manageable sizes, developing summaries, looking for patterns and applying statistical techniques.

Gerber-Nel *et al.* (2005:204) point out that the purpose of analytic methods is to convert data into information needed to make decisions. The choice of the methods of statistical analysis depends on the type of question to be answered, the number of variables, and the scale of measurement. The type of question the researcher is attempting to answer is a consideration in the choice of the statistical technique. Based on this factor, the researcher may be concerned about the central tendency of a variable or the distribution of that variable. The number of variables is also considered to determine whether the statistical techniques applied should be the univariate data analysis, the bivariate data analysis or the multivariate data analysis. The scale of measurement on which the data are based or the type of measurement reflected in the data determines the permissible statistical technique and whether the appropriate empirical operation may be performed. Data analysis process for the study at hand included descriptive statistics, T-test, ANOVA, Pearson correlation and regression analysis.

5.8.1 Descriptive Statistics

Descriptive statistics is the method used to describe characteristics of a population or a sample. It is therefore aimed at describing the data by investigating the distribution of scores for each variable and by determining whether the scores on different variables are related to each other (Terre Blanche & Durrheim, 2002:101). Descriptive analysis allows the researcher to present data in a manner that is easily interpretable, in this study frequency table as well as graphs were used.

Cooper and Schindler (2008:436) assert that descriptive statistics are used to point out the measures of central tendency (mean, median and mode), measures of dispersion (variance, standard deviation, range, interquartile range) as well as shape

(skewness and kurtosis). In this study two important measures were considered, the mean and standard deviations. The arithmetic average or mean (X) comprises a point which coincides with the sum of the scores divided by the number of scores. The standard deviation shows the variations about the average of the data. Calculating the standard deviation of the theoretical distribution of the sample reflect how far the sample means could be from the population mean.

5.8.2 Inferential Statistics

Inferential statistics is the method used to draw conclusions about the population itself. While descriptive analysis allows the researcher to generalise from the sample of the population, inferential analysis allows the researcher to draw conclusions about the population on the basis of data obtained from samples (Terre Blanche & Durrheim, 2002:117).

Based on the distribution of the descriptive statistics obtained from the study, analytical techniques were used to perform inferential analysis. These included analysis of variance (ANOVA), T-tests, correlation and regression analysis. The T-test and ANOVA were used to test the differences in the results and the Pearson correlation and regression analysis were used to test the associations and relationships.

5.9 Ethical Issues

Barbie and Mouton (2002:522) point out that conducting research requires good ethical considerations. In carrying out the study the researcher abided by the following ethical research principles:

a) The managers / owners of the targeted SMEs were informed of the objective of the research project.

b) A covering letter was obtained from the Department of Business Management. The covering letter contained information about the investigation, the objectives of the measuring instrument, the voluntary participation of the respondents, assurance regarding confidentiality and

anonymity, the intention to reveal the findings upon completion of the study and the contact details of the researcher.

5.10 Validity, Reliability and Errors

A researcher has to ensure that the evidence and conclusions from a research can stand up to scrutiny. This depends on how scientifically sound the measuring instrument is. Validity and reliability are two important characteristics of a sound measurement instrument (Cooper & Schindler, 2003:156). To ensure the credibility of the findings and conclusions of this study, steps were taken to ensure both the reliability and validity of the instrument and reduce the errors.

- **Validity**

According to Cooper and Schindler (2008:289) validity refers to the degree to which a study succeeds in measuring the intended values and the extent to which differences found reflects the true differences among respondents.

Babbie and Mouton (2002:15) reveal that validity determines whether the research truly measures that which it was intended to measure or how truthful the research results are. Validity refers to whether an instrument actually measures what it is supposed to measure given the context in which it is applied. Babbie and Mouton, (2002:15) identify four major types of validity. These are face (content) validity, criterion related validity, content validity and construct validity.

According to Babbie and Mouton (2002:15) face (content) validity refers to the fact that the concept being measured is done so appropriately. Face validity of a measuring instrument is the extent to which the instrument provides adequate coverage of the concept. Face validation is a judgmental process that can be done in many ways. The researcher may choose to do it alone or may use a panel of experts or senior researchers in the field of study to judge how well the instrument meets the standard. Cooper and Schindler (2003:214) note that criterion related validity, also referred to as instrumental validity, is used to demonstrate the accuracy of a measure or procedure by comparing it with another measure or procedure, which

has been demonstrated to be valid. Gerber-Nel *et al.* (2005:30) point out that content validity refers to the use of measures that will incorporate all of the meanings associated with a specific concept. Cooper and Schindler (2003:214) refer to construct validity as how adequately a scale or a test measures what it proposes to measure. The researcher used the following steps to ensure the validity of the study as pointed out by Cooper and Schindler (2003:214).

> ➤ Using a statistician and a panel of experts to evaluate the research instrument for conceptual clarity.

> ➤ Pre-testing the research instrument in a pilot study.

> ➤ Sampling was carried out using probability methods ensuring external population validity.

> ➤ Using self-administered questionnaires, which generally have a high response rate.

> ➤ Using a big sample size with a margin of error of not more than 5% and a confidence level of 95%.

> ➤ Comprehensively reviewing the literature for theoretical constructs and empirical conclusions.

- **Reliability**

Babbie and Mouton (2002:81) point out that the extent to which results are consistent over time and an accurate representation of the total population under study is referred to as reliability. If the results of a study can be reproduced under a similar methodology, then the research instrument is considered to be reliable. Reliability is concerned with consistency of measures. The level of an instrument's reliability is dependent on its ability to produce the same result when used repeatedly. According to Babbie and Mouton (2002:81) the Cronbach's alpha can be used to measure reliability. The Cronbach's alpha is a test for a survey's internal consistency. It is also called the scale reliability test. The Cronbach's alpha is a measure of how well each individual items in a scale correlates with the remaining

items. Reliability also shows the extent to which the measurements of a test remain consistent over repeated tests on the same subject. The alpha coefficient ranges in value from 0 to1. The higher the score, the more reliable the generated scale is. Cooper and Schindler (2003:417) note that a score of 0.7 is the acceptable reliability coefficient but lower thresholds are sometimes used in the literature. Reliability for the following steps as also enhanced this study pointed out by Babbie and Mouton (2002:81):

- ➢ Pre-testing the research instrument in the survey development stage through a pilot study.

- ➢ Discussions were held with senior researchers who had had previous experience in similar studies.

- ➢ Keeping open-ended questions to the minimum; devising response scales that are likely to increase the variability of responses thereby ensuring higher statistical value from the data by using a large sample size.

- ➢ Performing a thorough review of the literature in the field of interest review of literature.

- ➢ Having the questionnaire thoroughly reviewed by the promoter and other experienced researchers.

- **Errors**

According to Cooper and Schindler (2003:332) errors, especially the response and non-response errors, can also pose a serious threat to the reliability of data and must be minimised by the researcher. Response errors are the estimated inaccuracies that can be introduced by the researcher, the interviewer or the respondents. The researcher may make the error in the design of the measurement instrument or may not properly define the problem and the related information required. Response errors can also occur when the respondent deliberately or mistakenly provide incorrect answers to the survey questions.

Gerber-Nel *et al.* (2005:231) describe a non-response error as an error caused by failure to contact all members of a sample and/or the failure of some contacted members of the sample to respond to all or a specific part of the questionnaire. The non-response error occurs because people who respond to the survey might not have characteristics similar to those who do not. The following steps were used to reduce non-response errors as pointed out by Babbie and Mouton (2002:81):

> ➢ Using self-administered questionnaires, which involved a direct meeting between the researcher and the respondents.

> ➢ Repeated telephone calls and visits to the respondents.

> ➢ Removing sensitive questions from the questionnaire.

> ➢ Carefully constructing and pre-testing the questionnaires.

5.11 Reporting of Research Findings

The reporting of research findings and its analysis is the focus of the following chapter (chapter 6). The interpretation of findings, conclusions and recommendations are detailed in chapter 7. From the analysis and interpretation of the results, the study was able to make predictions and recommendations on the role played by Business Development Services providers (BDSs) in improving access to finance for start-up SMEs.

5.12 Summary

The chapter provided a description of the research methodology used in this study. Details of the scope of the study, the research method and research instrument and the sampling methodology applied for this study were outlined in this chapter. Furthermore, the chapter provided a detailed description of the data analysis process followed for this study as well as the test for validity and reliability. A discussion of the limitations in this study as well as how the research results and findings are to be reported was also discussed in this chapter. The research results and findings are presented in chapter 6 which follows.

CHAPTER 6: RESEARCH FINDINGS AND DISCUSSIONS

6.1   Introduction

Chapter five has presented the research methodology that was followed in the empirical data collection process and analysis. It also alluded to the actual data collection process and the data analysis procedures. Once the data was collected from the respondents and coded, statistical tests were performed on the data. The statistical analyses conducted illustrated the extent to which BDS are helping start-up SMEs in improving their access to finance. The findings of this study are discussed in this chapter. A huge volume of data was obtained, therefore only the summary of the results is presented. Statistical analyses that were performed included descriptive statistics, T-test, ANOVA, regression analysis and Pearson correlation.

The first section of this chapter focuses on the empirical findings of this study. This section is divided subsections. Subsection 6.2.1 presents the response rate, subsection 6.2.2 presents the normality of data, and this is followed by the questionnaire analysis in subsection 6.2.3 using the Cronbach's alpha tests and variable and cluster analysis. The business characteristics and demographics are presented in subsection 6.2.4. Subsection 6.2.5 presents results on access to finance challenges facing start-up SMEs. This is followed by awareness of BDS (section 6.2.6), and then use of BDS (section 6.2.7). Finally the summary of the chapter is presented in section 6.3. The following section presents the empirical findings.

6.2   Empirical Findings

6.2.1 Response Rate

The population for this study was all start-up SMEs (SMEs that had been in operation for a period of less than 42 months) within the Buffalo City Municipality, Eastern Cape Province of South Africa. The questionnaire was distributed to 315 respondents. Respondents were required to fill in the questionnaire on the spot and

return it to the researcher. However, some respondents requested to submit the questionnaire at a later time or date and this affected the response rate. Ultimately a response rate of 65.7% was achieved and this means that 207 out of 315 questionnaires were returned. Table 6.1 shows the response rate in this study.

Table 6.1: Response rate

Distributed questionnaires	No. of questionnaires returned	Response rate
315	207	65.7%

6.2.2 The normality of the data

According to Coakes (2005:35) the normality of the data can be determined by using the Kolmogorov-Smirnov test (if the sample size is above 100) and the Shapiro-Wilks test (if the sample size is below 100). If the significance level is greater than 0.05 using either of the two tests, then normality is assumed. This study used the Kolmogorov-Smirnov test to determine the normality of the data because the sample size was more than 100. The significance of the Kolmogorov-Smirnov test was greater than 0.05 in all the tests. This implies that the normality of the data can be assumed.

6.2.3 Reliability of the questionnaire

The questionnaire was divided into three sections. The three sections represented access to finance challenges (section A), use and role of Business Development Services providers (BDS) (Section B) and the business characteristics and demographic information (Section C). The Cronbach's alpha coefficient was used for assessing the internal consistency of the questionnaire with coefficients of 0.70 considered high enough to denote adequate consistency and reliability.

Reliability was tested for the access to finance and the role of BDS (sections A and B) of the questionnaire. The questionnaire was generally found to be reliable with a Cronbach's alpha coefficient of 0.84. The Cronbach's alpha coefficients for sections A and B were 0.82 and 0.79 respectively. Table 6.2 illustrates the alpha coefficients

on access to finance challenges and use and role of BDS providers in improving access to finance.

Table 6.2: Reliability tests on access to finance challenges and use and role of BDS variables

Variable	Number of items	α coefficient
Access to finance challenges	7	0.823
Use and role of BDS	14	0.791
Overall	21	0.842

6.2.4 Business Characteristics and Demographics

The business characteristics and demographic information were obtained through section C of the questionnaire (see Appendix 1). The information include the age of the business, the size of the business (number of employees), the legal status of the business, number of active owners/partners, the position of the respondent, the gender of the respondent, age of the respondent and the educational qualification of the respondent. These are presented using table, charts and graphs in the following subsections.

- **Age of businesses**

Business ages were divided into four categories (less than 12 months, 13-24 months, 25-36 months and 37-42 months). Of the 207 respondents 15% of the businesses were less than 12 months old, another 15% were between the ages of 13 to 24 months, 25% were between the ages 26 to 36 months and 44% were between the ages 36 to 42 months. The results are illustrated in the Table 6.3 below:

Table 6.3: Age of the Business

Age (months)	Frequency	Percentage	Cumulative Frequency	Cumulative Percentage
>12	31	15.0	31	15.0
13-24	31	15.0	62	30.0
25-36	53	25.6	115	55.6
37-42	92	44.4	207	100.0

The results indicated the majority (44.4) of businesses that participated in this study were between the ages of 37-42 months.

- **Size of the Business**

The size of business was measured in terms of number of employees in the business. Four categories were used to find the business of the participants in this study. Table 6.4 illustrates the business sizes and their frequencies in this study.

Table 6.4: Size of the Business

Number of employees	Frequency	Percentage (%)	Cumulative Frequency	Cumulative Percentage (%)
>50	151	73.0	151	73.0
51-100	34	16.4	185	89.4
101-150	17	8.2	202	97.6
151-250	5	2.4	207	100.0

The results presented in Table 6.4 above indicated that the majority (73%) of start-up SMEs that participated in this study employed less than 50 employees and the number of businesses decreases as the number of employees increases. Thus it can be deduced that the majority of start-up SMEs are small businesses based on the number of employees.

- **Forms of ownership**

Figure 6.1 below illustrates the forms of business ownerships of the respondents in this study.

Figure 6.1: Forms of Ownership
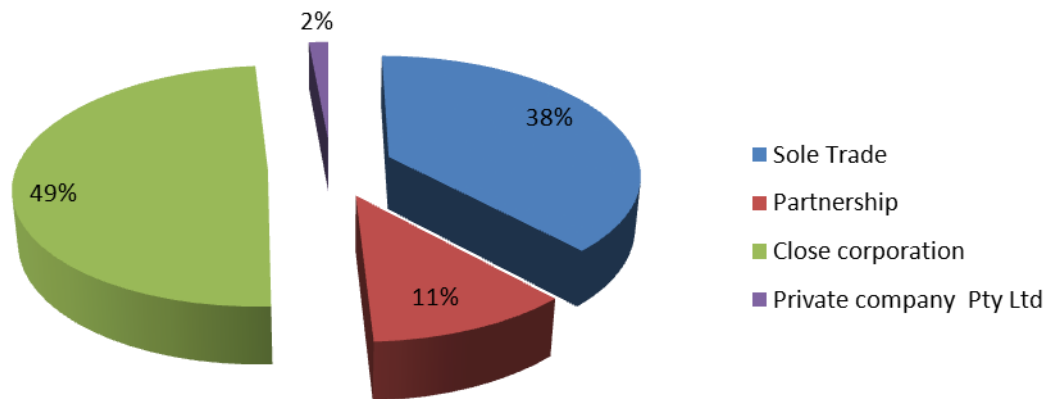
The results indicated that 49% of the respondents were close corporations, 38% were sole traders, 11% were partnerships and only 2% were private companies (Pvt Ltd). These indicates that the most common form of business ownership in the Buffalo City municipality are close corporations followed by sole traders, then partnerships and the least common are Private companies.

- **Number of active owners**

Table 6.5 below shows that 71% of the respondent business had less than five owners who are actively engaged in the day to day running of the business. 18.8% had 6-10 active member, 7.2% had 11-15 members while on 2.9% had more than 15 active members.

Table 6.5: Number of Active owners

Number of active members	Frequency	Percentage	Cumulative Frequency	Cumulative Percentage
<5	147	71.0	147	71.0
6-10	39	18.8	186	89.8
11-15	15	7.2	201	97.1
16-20	6	2.9	207	100.0

- **Position of the respondents**

Figure 6.2 show that 79% of the respondents were owners of the business while only 21% were managers appointed to run the business. The results indicate that the majority of the respondents were owners of the business and this indicates that most owners of start-up SMEs are usually present in their business to see through all the activities.
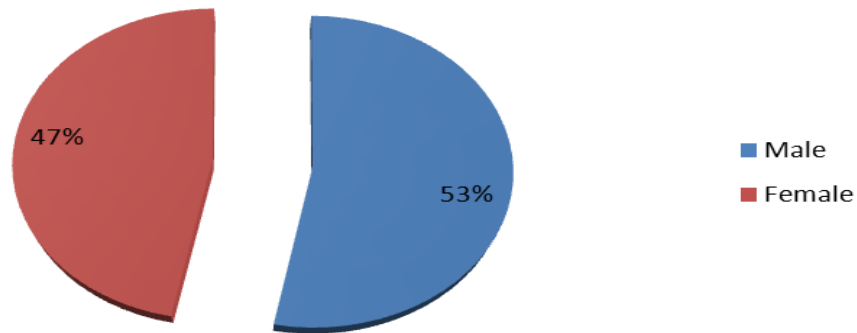
Figure 6.2: Position of the respondents
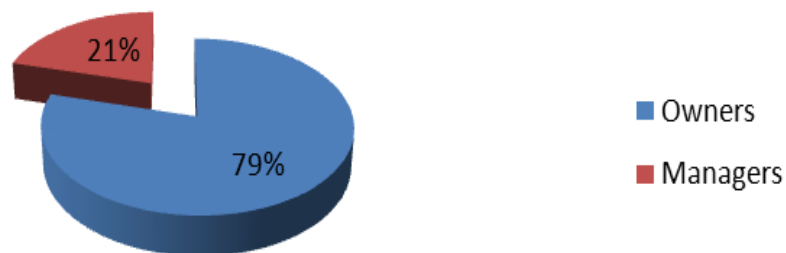
- **Gender**

Figure 6.3 below indicate that an almost equal proportion of male and female respondents participated in this study. 53% were males and 47% were females.

Figure 6.3: Gender of the respondents

- **Age of the Respondents**

Figure 6.4 shows that 11.6% of the respondents were 25 or fewer years old, 28% were between the ages of 26-35, 36.2% were between 36 and 25 years old, 17.4% were between 46 and 55 years old, 5.8% were between 55 and 65 years while only 1% was above the 65 years old. The results indicate that the majority of the respondents were between the age of 26 and 45 years.

Figure 6.4: Age of the respondents
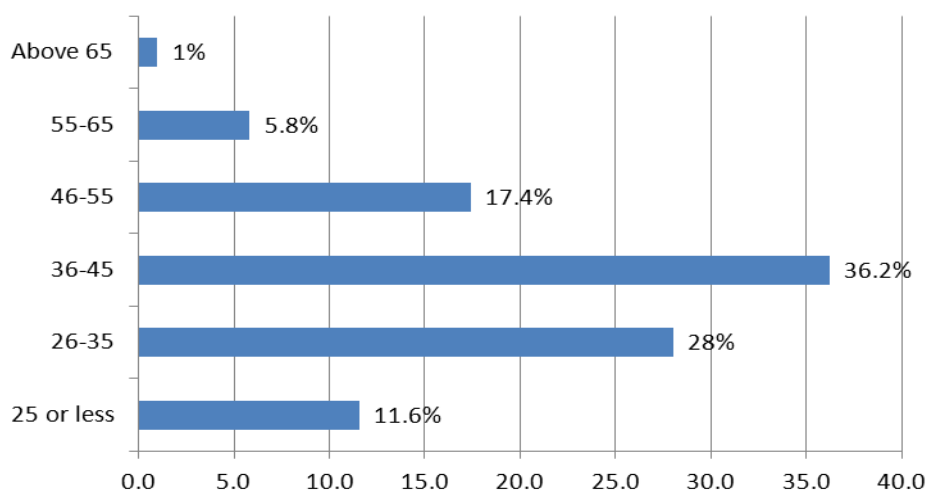
- **Educational level of the respondents**

Figure 6.5: Educational level

Figure 6.5 shows that 55% had matric, 35% had a certificate or a diploma while only 10% had at least a degree. These results indicate that the majority of the respondents had low educational qualifications.
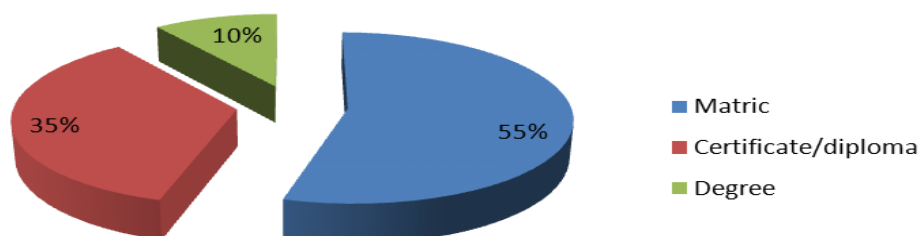
- **Summary of Demographics**

From the analysis of demographic the following stand out:

- 44% of the businesses were between the ages of 26 and 42 years old.
- 73% of the businesses that participated in this study employed 50 or less employees. And this indicates that the majority of the businesses were small enterprises.
- 49% of the businesses were legally registered as close corporations.
- 71% of the businesses had 5 or less owners who are actively involved in the day to day running of the business.
- 79% of the people who completed the questionnaire of behalf of the business were the owners while 21% were the appointed managers.
- A higher number of respondents were male (53%).
- The majority of the respondents were between the ages of 26 and 45 years.
- In term of qualification levels 55% of the respondents had matric qualification.

6.2.5 Access to finance challenges

The purpose of section A of the questionnaire (see Appendix 1) was to solicit responses on the perceptions of start-up SMEs about challenges they face in attempting to access financial resources and the reasons for lack of access to finance. The first question of section A in the questionnaire measures the perception of the owners of start-up SMEs about access to finance.

Table 6.6: Perception of access to finance challenges

	Frequency	Percentage	Cumulative Frequency	Cumulative Percentage
Strongly disagree	8	3.9	8	3.9
Disagree	6	2.9	14	6.8
Neutral	8	3.9	22	10.7
Agree	106	51.2	128	61.9
Strongly agree	79	38.2	207	100.0

Table 6.6 shows that 89.4% of the respondents agree that access to finance is a major challenge facing start-up SMEs. The results are consistent with other empirical studies on access to finance by start-up SMEs in South Africa such as Maas and Herrington (2006) and Herrington *et al.* (2009).

In examining the reason why start-up SMEs face access to finance challenges (questions 2 to 7 of section A in the questionnaire) about 82.6% of the respondents at least agreed that start-up SMEs provide insufficient information, 88% agreed that start-up SMEs face access to finance challenges due to lack of sufficient collateral security, 73% agreed that bad credit records lead to access to finance challenges, 67% believed that the perception of default risk by financial services providers is the reason for lack of access to finance, 15% believed legal restrictions prevent them from gaining access to finance while 69.2% agreed that their educational levels

affect their ability to access external financing. Table 6.7 below shows the reasons for access to finance challenges facing start-up SMEs.

Table 6.7: Reasons for access to finance challenges facing start-up SMEs

Reason.	Percentage (%) Respondents (agree and strongly agree)
Insufficient business Information	82.6%
Lack of collateral security	88.0%
Bad credit records	73.0%
Risk	67.0%
Legal restrictions	15.0%
Educational levels	69.2%

The results indicated that lack of collateral security is viewed by many start-up SMEs as the reason for their lack of access to finance. Blumberg and Letterie (2008:188) argue that collateral helps to reduce informational asymmetries and moral hazard problems that arise between banks and entrepreneurs. In addition, lack of business information is another very important reason for weak access to finance by start-ups. BDS can help in this regard. BDS can help with the provision of business information such as the preparation of business plan. In addition, BDS can help provide information on how start-ups can be assisted with collateral through government agencies such as Khula Enterprise.

Table 6.8: Means and Standard Errors on reasons for access to finance challenges

Variable	N	Mean	Std Error
Insufficient Information	207	4.46	0.04
Collateral Security	207	4.79	0.06
Bad credit records	207	3.79	0.06
Risk	207	3.96	0.05
Legal restrictions	207	2.45	0.07
Educational levels	207	3.99	0.05

The results of access to finance challenges confirm that start-up SMEs still have challenges hindering their adequate access to financing. Therefore, it can be concluded that the belief that access to finance is challenge facing start-up SMEs is valid.

The study at hand focused on the effectiveness or role of BDS in improving access to finance by start-up SMEs, the results of which are presented in the following section. The following section presents the results on the awareness, the use and the role of BDS in providing access to finance to start-up SMEs.

6.2.6 Awareness, Use and Access to finance

- **Awareness of BDS (Section B, Question 1)**

Question 1 in Section B of the questionnaire as restated, "Are you aware of the existence BDSs in your localities?" sought to find out if start-up SMEs where aware of BDS providers operating in their localities. The results on awareness indicate that 68% of the respondents answered "No" when they were asked if they were aware of the existence of BDS providers in their localities. Only 32% showed that they are of BDS providers in their localities. Figure 6.6 below shows the results of awareness of BDS.

Figure 6.6: Awareness of BDS
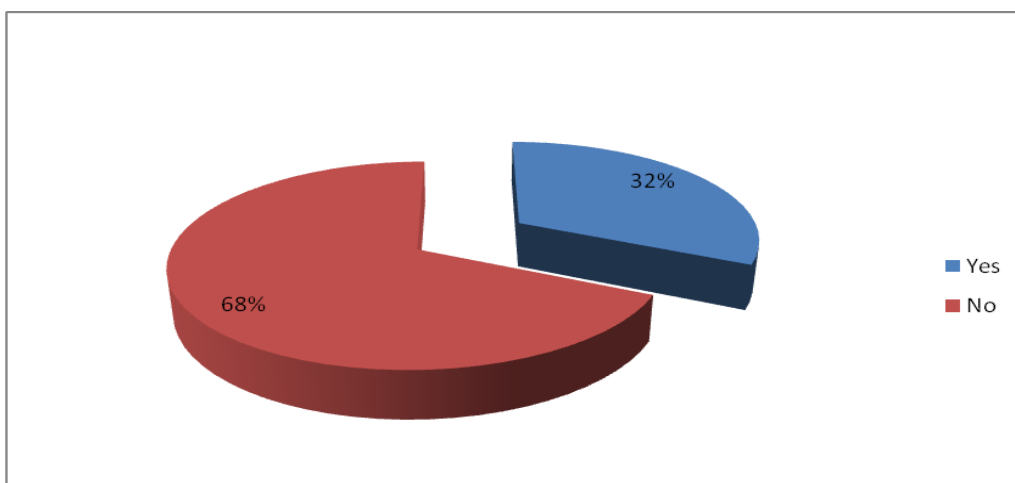
The results presented in Table 6.6 above indicate that the majority of the respondents lack awareness of BDS providers operating in the localities. This suggests that there is a need to build awareness amongst SMEs of the existence and services of provided by BDS.

- **Application for external funding by non-aware respondents (Section B, question 2)**

When asked, "Have you applied for external funding for your business?" in question 2 of section B in the questionnaire (see Appendix 1 for the questionnaire), 89% of the respondents indicated they have applied for external funding. Only 11% indicated they have not applied for external funding. These results suggest that the majority of the respondents are keen to get external financing.

- **Results of the application for external financing by non-aware respondents (Section B, Question 3)**

Of the 89% of the respondents who indicated they have applied for external funding, when asked, "Has your application been successful?", only 22% indicated that their applications were successful. These results suggest that most of the applications for credit by start-up SMEs is rejected further confirming the existence of credit rationing.

- **Demographic factors and awareness of BDS**

ANOVA and T-test were conducted to determine if there were significant differences on awareness of BDS by demographic variables presented in the questionnaire. The results are presented below.

  ➢ **Awareness and length of operation**

ANOVA results in Table 6.9 indicates that there is no significant differences in responses to awareness of BDS when grouped by length of operations (F=0.414, p=0.6532).

Table 6.9: ANOVA on awareness of BDS by Length of operation

Length of operation	Mean	Mean Square	F	Sig.
>12	2.3345	0.134	0.414	0.6532
13-24	2.4342	0.433		
25-36	2.5321			
37-42	2.5443			

The highest mean of awareness of BDS is between the ages of 37-42 months (2.5441) and the lowest mean is on the ages less than 12 months (2.3345). However, all the means are relatively the same and are below neutral indicating a lack of awareness across different length of operation of the business.

> **Awareness and Size of the Business**

ANOVA results in Table 6.10 indicates that there is no significant differences in responses to awareness of BDS when grouped by size of the business (F=0.426, p=0.7424).

Table 6.10: ANOVA on awareness of BDS by size of the business

Size of the business (No. of employees)	Mean	Mean square	F	Sig.
>50	2.1743	0.143	0.426	0.7424
51-100	2.0142	0.543		
101-150	2.1452			
151-250	2.4314			

The highest mean of awareness of BDS was among businesses with between 151-250 employees (2.4314) and the lowest mean was on the businesses with 50-100 employees (2.0142). However, all the means are relatively the same and are below neutral indicating a lack of awareness across different sizes of the businesses.

➢ **Awareness of BDS and Form of Ownership**

ANOVA results in Table 6.11 indicates that there is no significant differences in responses to awareness of BDS when grouped by form of ownership (F=0.326, p=0.7534).

The highest mean of awareness of BDS was among private companies (2.0041) and the lowest mean was among sole traders (1.9143). However, all the means are relatively the same and are below neutral indicating a lack of awareness across different forms of ownership. The ANOVA results indicate that there are no statistically significant differences on awareness of BDS among the respondents when grouped by form of ownership.

Table 6.11: ANOVA on Awareness of BDS by Form of ownership

Form of ownership	Mean	Mean square	F	Sig.
Sole trader	1.9143	0.241	0.326	0.7534
Private Co. (Pty Ltd)	2.0041	0.562		
Partnership	1.9873			
Close corporation	1.9732			

➢ **Awareness of BDS by number of active owners**

Table 6.12 presents the results of ANOVA on Awareness of BDS by number of active owners in the business.

Table 6.12: ANOVA on awareness of BDS by number of active owners

Number of Active owners	Mean	Mean square	F	Sig.
<5	2.3562	0.324	0.354	0.7342
6-10	2.8764	0.472		
11-20	2.9143			
>20	3.0124			

The ANOVA results on awareness of BDS among the respondents when grouped according to the number of active owner found no statistically significant differences (F=0.354, p=0.7342). The highest mean was on business with more than 20 active owners (3.0124) and the lowest mean was amongst respondents with less than 5 active owners (2.3562).

➤ **T-test on position of the respondent by awareness of BDS**

The result of the independent samples t-test shows that there are no significant differences (t=1.193, p=0.341) between the responses from the owners and managers about awareness of BDS. The mean score of owners (3.335) is rather higher compared to that of managers (3.287). Table 6.13 reflects the results of the t-test on the positions of the respondent.

Table 6.13: T-test on the position of the respondent by awareness of BDS

	Mean	T	Df	Sig.(2-tailed)
Owner	3.335	1.193	186.476	0.341
Manager	3.287			

> ## Awareness of BDS and Age of the respondent

The ANOVA results found no statistically significant differences in responses among different age groups (F=0.743, p=0.2361). The results are presented in Table 6.14.

Table 6.14: ANOVA on Awareness of BDS by Age of the respondent

Age of the respondent	Mean	Mean square	F	Sig.
25 or less	2.3256	0.327	0.743	0.2361
26-35	2.3342	0.473		
36-45	2.4346			
46-55	2.1672			
55-65	2.1924			
Above 65	2.2356			

The highest mean was in the age group of 36-45 years (2.4346) while the lowest mean was in the age group of 46-55 years. However the means across different age groups are relatively the same. Thus there are no statistically significant different differences in responses.

> ## T-test on Awareness of BDS by gender

The T-test on gender on both showed no statistically significant differences on all the three factor namely Awareness of BDS (t=1.345, p=0.346). This indicates that there are no statistically significant differences between responses from males and females about their awareness of BDS. The mean score of male (3.6455) is however higher compared to that of managers (3.6142). The results of t-test on awareness of BDS by gender are shown in Table 6.15.

Table 6.15: T-test on awareness of BDS by gender

	Mean	T	Df	Sig.(2-tailed)
Male	3.6455	1.193	186.476	0.341
Female	3.6142			

> ➢ **Awareness of BDS and Educational level of the respondent**

The analysis of variance on awareness of BDS by educational level indicated that there is no statistically significant difference in responses across different educational level. The highest mean (2.9241) was on respondents with a degree and the lowest (2.3256) was on respondents with have matriculated only. The results of ANOVA on awareness of BDS by educational levels are indicated in Table 6.16 below.

Table 6.16: Awareness of BDS by educational level

Age of the respondent	Mean	Mean square	F	Sig.
Matric	2.3256	0.327	0.743	0.2361
Certificate/Diploma	2.3342	0.473		
Degree	2.9241			

The results of the ANOVA and T-test indicated that there are no statistically significant differences in responses to awareness of BDS across all the selected demographic variables. Furthermore, the means on awareness of BDS when grouped according to all the selected demographic variables fluctuated below neutral (3.000) and this indicate that there is generally a lack of awareness of BDS among the respondents.

> **Correlation of Awareness and Access to finance**

The Pearson correlation was used to test the correlations between awareness of BDS and access to finance. The Pearson correlation, is used when the normality of data can be assumed. The significance of the Kolmogorov-Smirnov test was greater than 0.05 in all the tests. This implies that the normality of the data can be assumed.

According to Coakes (2005:18) the main result of a correlation is called the correlation coefficient (or "r"). It ranges from -1.0 to +1.0. The closer r is to +1 or -1, the more closely the two variables are related. If r is close to 0, it means there is no relationship between the variables. The P-value measures the significance. 5% level of significance was used for this study.

A correlation analysis was done between non-awareness of BDS and success in getting access to finance and Awareness of BDS and success in getting access to finance. The results of the correlation analysis are shown in Table 6.17.

Table 6.17: Correlation of awareness of BDS and success in getting financing.

Variable	Awareness of BDS		Non-awareness of BDS	
	R	p-value	R	p-value
Access to finance-outcome	0.946	0.0321	-0.546	0.0024

Sig. 0.05 (2-tailed)

The results showed a statistically significant negative correlation between non-awareness of BDS and success in getting financing (r= -0.546, p=0.0024). This indicates that non-awareness of BDS is negatively correlated with success in getting access to finance. Furthermore, a correlation analysis between awareness of BDS and success in getting access to finance showed a statistically significant strong positive correlation between awareness of BDS and success in getting access to finance (r=0.946, p=>0.0321).

The results of the correlation suggest that lack of awareness of BDS and their services shows a statistically significant negative correlation (r=-0.862, p-value>0.0013) and this will negatively impact on the chances of accessing financing

which also shows a negative correlation. It can be suggested that there is a need to build awareness of BDS amongst the start-up SMEs.

Furthermore a simple linear regression was done on access to finance outcome and awareness of BDS. The regression results are presented in Table 6.18.

Table 6.18: Regression results of Awareness of BDS and access to finance outcome

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.946	0.963	0.951	0.426

ANOVA

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	0.344	3	0.344	0.426	0.000
Residual	7.275	40	0.182		
Total	7.619	43			

Coefficients

Model	Unstandardised Coefficients		Standardised Coefficients		
	B	Std. Error	Beta	t	Sig.
1 (Constant)	1.388	0.280		4.954	0.000
Awareness of BDS	0.921	0.155	0.946	1.375	0.177

Dependent Variable: Access to finance outcome.

The result of the regression model showed a 95% variations in responses (adjusted R-square=0.9503). The F-test (F=0.426, p<0.0001) is significant indicating that the model as a whole accounts for significant variations on awareness of BDS. Awareness of BDS has significant effects on the responses to success in access to finance. This is shown by the beta coefficient (0.921) that is significantly different from zero. This indicates that with every unit increase in awareness of BDS, the chances of getting access to finance increase by 0.921. These effects have p-values that are less than 0.05, which suggests high statistical significance.

The results of ANOVA and T-test revealed that there is a general lack of awareness of BDS among the respondents. Furthermore, the results of the correlation analysis showed a negative correlation between non-awareness of BDS and success in access to finance.

Based on the results of the descriptive statistics as evidenced by figure 6.6, the null (H2$_0$) hypothesis that start-up SMEs are not aware of BDS providers in their localities is not rejected.

In addition, the results of the correlation and regression indicate that there is a positive relationship between non-awareness of BDS and failure to obtain credit.

Therefore, it can be concluded that there is a lack of awareness of BDS by the majority of the respondents. Lack of awareness of BDS will lead to non-use of the services of BDS and subsequently affect the chances of gaining access to financing by start-up SMEs. The use of BDS was also investigated in the empirical survey. The results of use of BDS are presented in the section below.

- **Use of BDS by start-up SMEs (Section B, Question 4)**

The empirical results of this study indicated that out of the respondents who indicated awareness of BDS when asked "Have you used the services of BDS? In question 4 of the questionnaire (refer to Appendix 1 for the questionnaire), 87.9% indicated that they have used the services of BDS providers. Only 12.1% of the respondents who showed awareness of BDS have not used the services of BDS. Figure 6.7 shows the results of use of BDS amongst the respondents in this study.

Figure 6.7: Use of BDS by the respondents
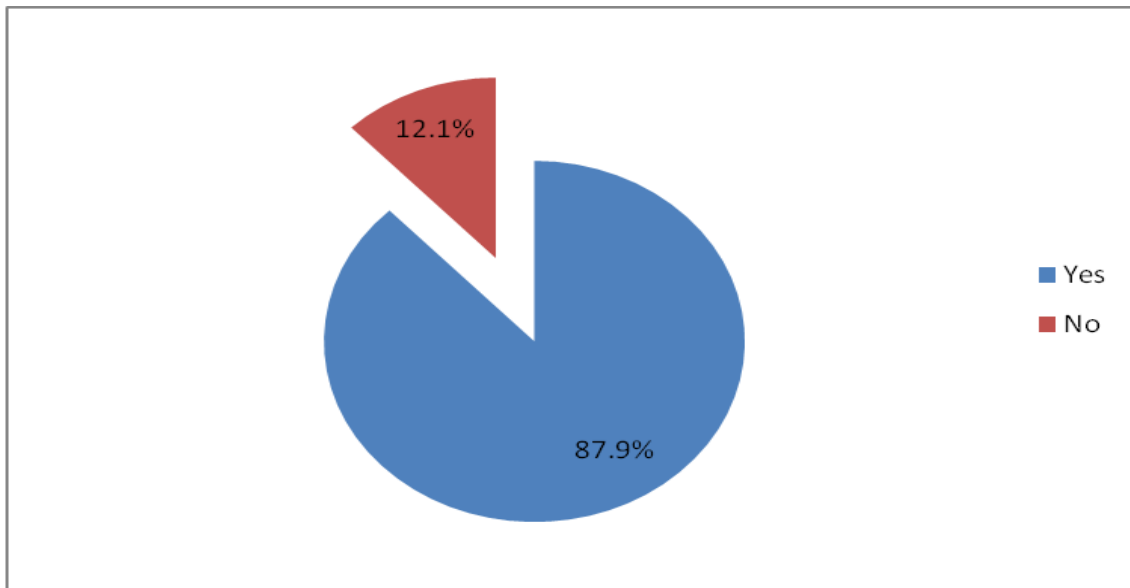
It can be deduced that the majority of the respondents who showed awareness of BDS have used the services of BDS.

Therefore, the null hypothesis that start-up SMEs that are aware of BDS are not using the service is rejected

- **Service Providers Used (Section B, Question 5)**

The respondents who indicated that they have used the services of BDS were also asked in question 5 of the questionnaire, "Which of the following BDS providers have you made use of?" (See Appendix 1 for the questionnaire). The results revealed that some respondents have used more than one BDS providers. The majority of the respondents (87%) indicated that they have used the services of Small Enterprises Development Agency (SEDA) followed by National Youth Development Agency (NYDA) (87%), Eastern Cape Development Corporation (ECDC) (56%) and Buffalo City Municipality (BCM) (12%). The results of BDS providers used are presented in Figure 6.8.

Figure 6.8: BDS providers Used
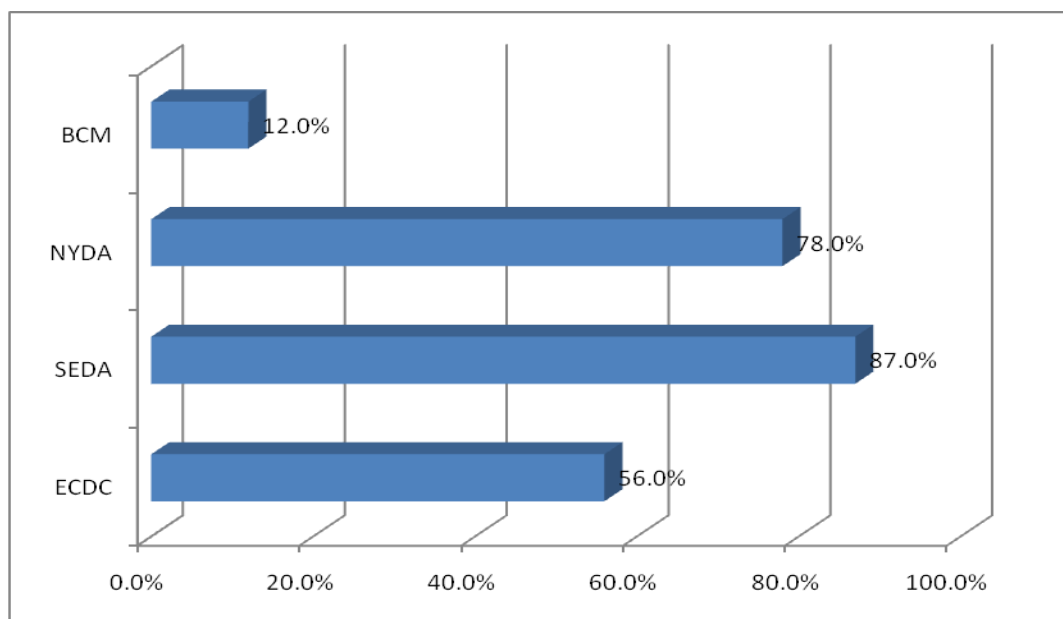
- **Services of BDS providers Used (Section B, Question 6)**

Question 6 in Section B of the questionnaire is restated, *"If your answer to question 4 is yes, which of the following services have you made use of from BDS providers?"* Amongst the respondents who indicated that they have used the services of BDS, when asked about which services of BDS they have used, multiple answers were obtained. However, business planning (79%) and business registration (63%) stand out as the mostly used services of BDS by the respondents. The other services were information sharing and networking (61%), feasibility assessments (12%), business and financial administration (12.2%), mentorship services (23%), training services (61%) and marketing and marketing planning (32%). The results OF BDS services used are presented in Figure 6.9.

Figure 6.9: BDS services used
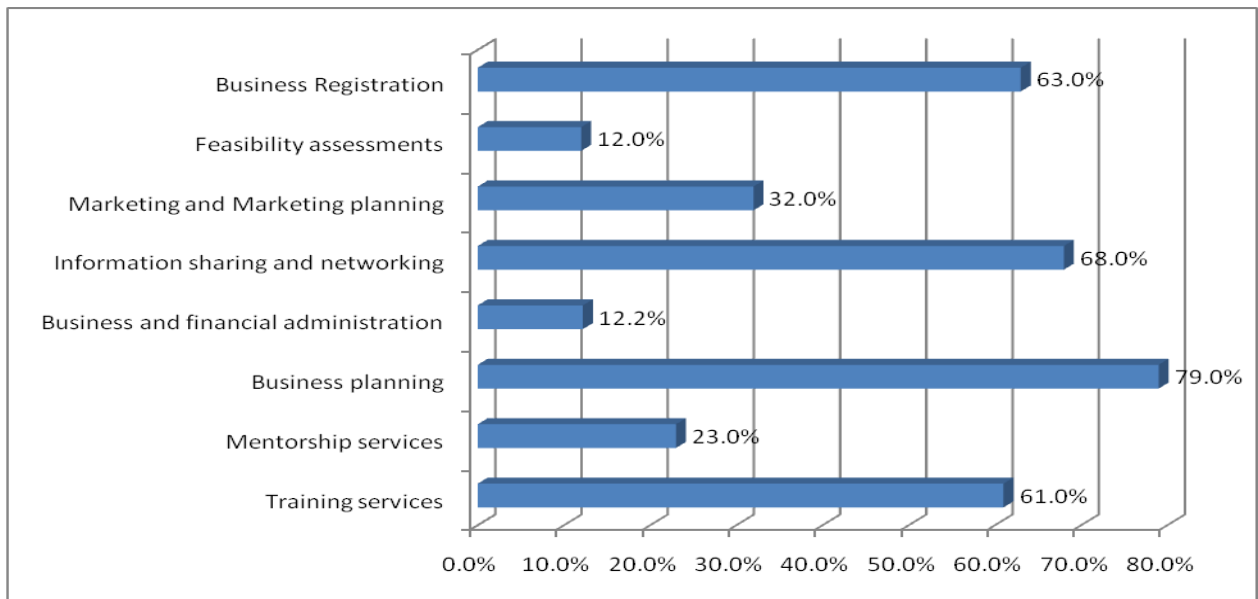
- **Application for external funding by aware respondents (Section B, Question 7)**

Question 7 in Section B of the questionnaire (see Appendix 1) asked, "*Have you applied for external funding following your use of the above BDS services?"* The results revealed that only 2% of the respondents had not applied for external funding following their use of BDS while 98% of the respondents who indicated that they had used the services of BDS had applied for external funding. This suggests that the majority of respondents who had used the services of BDS had applied for external funding.

- **Results of the application for external financing by aware respondents (Section B, Question 8)**

Question 8 as stated here, "*If your answer to 6 above is yes, has application been successful?"* sought to reveal the results of application for external funding following the use of BDS services. The results of the studied showed that 87.4% of the respondents who had used the services of BDS and applied for external funding were successful in their applications. This is an indication that the use of BDS has a positive impact in terms of improving access to finance by start-up SMEs.

- **Opinions about BDS providers by Respondents (Section B, question 9-14)**

Questions 9-14 in Section B of the questionnaire (see Appendix 1 for the questionnaire) sought to reveal the opinions of the respondents on the availability of information about BDS (question 9), their use of BDS (question 10), comfortability in using BDS (question 11), whether BDS have programmes designed to improve access to finance (question 12), whether the use of BDS is a waste of resources and whether using the services of BDS is costly.

The results of the study indicated that only 24% of the respondents agreed that information about BDS is readily available. This suggests that there is lack of information about BDS providers and their services. Thirty seven percent (37%) of the respondents agreed that they have used the services of BDS while only 23.2% of the respondents agreed that they feel comfortable using the services of BDS provider. Only 11.6% of the respondents felt that using the services of is a waste of resources that should otherwise have been used for growing the business while only 16.2% of the respondents felt that the use of BDS is costly.

- **Demographic variables and use of BDS**

ANOVA and T-test were done to find out if there were significant differences in responses among the selected business and demographic variables presented in the questionnaire (see Appendix 1). The results of ANOVA and T-test on the use of BDS by the respondents are presented below.

- ➢ **Use of BDS and length of operation**

The results of the ANOVA showed that there are statistically significant differences in responses to use of BDS when grouped according to length of operations. The results of the ANOVA are shown in Table 6.19.

Table 6.19: ANOVA on use of BDS by length of operation

Length of operation	Mean	Mean Square	F	Sig.
>12	3.1423	0.143	0.409	0.023
13-24	3.3451	0.334		
25-36	3.3461			
37-42	4.4321			

The highest mean on use of BDS is between the ages of 37-42 months (4.4321) and the lowest mean is on the ages less than 12 months (3.1423). The results show statistically significant differences in responses (F=0.409, p-value=0.023). If a significant result is obtained in an ANOVA, the researcher needs to go further and determine, using a Tukey HSD test, where the significance lies. The results of the Tukey HSD test are presented in Table 6.20.

Table 6.20: Tukey HSD test for the differences in use of BDS by length of operation

Length of operation	Sig.
>12	0.467
13-24	0.325
25-36	0.154
37-42	**0.035**

Sig at 0.05 (2-tailed)

The results of the Tukey HSD test show that the significant difference is between businesses that have been in operation for a period between 37-42 months.

> **Use of BDS and Size of the Business**

ANOVA results in Table 6.21 indicate that there are significant differences in responses to the use of BDS when grouped according to size of the business (F=0.416, p=0.0442).

Table 6.21: ANOVA on use of BDS by size of the business

Size of the business (No. of employees)	Mean	Mean square	F	Sig.
>50	2.4413	0.143	0.416	0.0442
51-100	2.2142	0.543		
101-150	2.1432			
151-250	2.4314			

The highest mean on use of BDS was among business with less than 50 employees (2.4413) and the lowest mean was on the businesses with between 101-150 employees (2.1743). The Tukey HSD test was conducted to find out where the significant differences lie. The results of the Tukey HSD test are shown in Table 6.22.

Table 6.22: Tukey HSD test for the differences in use of BDS by size of business

Size of the business (No. of employees)	Sig.
>50	0.267
51-100	0.223
101-150	0.176
151-250	**0.013**

Sig at 0.05 (2-tailed)

The results of the Tukey HSD test show that the significant difference is with the 201 and above number of employees at 0.013.

> ➤ **Use of BDS and Form of Ownership**

ANOVA results in Table 6.23 below indicates that there is no significant differences in use of BDS responses when grouped by form of ownership (F=0.266, p=0.87144). The highest mean on use of BDS was among private companies (2.0041) and the lowest mean was among sole traders (1.9143). However, all the means are relatively the same and are below neutral (3.000), indicating a lack of use of across different forms of ownership.

Table 6.23: ANOVA on use of BDS by Form of ownership

Form of ownership	Mean	Mean square	F	Sig.
Sole trader	1.9143	0.241	0.266	0.8714
Private Co. (Pty Ltd)	2.0041	0.562		
Partnership	1.9873			
Close corporation	1.9732			

The ANOVA results indicate that there are no statistically significant differences on awareness of BDS among the respondents when grouped by form of ownership.

> ➢ **Use of BDS by number of active owners**

The ANOVA results on use of BDS among the respondents when grouped according to the number of active owner found no statistically significant differences (F=0.354, p=0.7342). The highest mean was on business with more than 20 active owners (3.0124) and the lowest mean was amongst respondents with less than 5 active owners (2.3562). Table 6.24 presents the results of ANOVA on use of BDS by number of active owners in the business.

Table 6.24: ANOVA on use of BDS by number of active owners

Number of Active owners	Mean	Mean square	F	Sig.
>5	2.3562	0.324	0.354	0.7342
6-10	2.8764	0.472		
11-20	2.9143			
<20	3.0124			

> ## T-test on position of the respondent by use of BDS

The result of the two independent samples t-test shows that there are no significant differences (t=1.093, p=0.431) between the responses from the owners and managers on the use of BDS. The mean score of owners (3.335) is rather higher compared to that of managers (3.287). Table 6.25 reflects the results of the T-test on the positions of the respondent.

Table 6.25: T-test on the position of the respondent by use of BDS

	Mean	T	Df	Sig.(2-tailed)
Owner	3.335	1.093	186.476	0.431
Manager	3.287			

> ## Use of BDS and Age of the respondent

The ANOVA results found no statistically significant differences in responses to use of BDS among different age groups (F=0.743, p=0.2361). The results are presented in Table 6.26.

Table 6.26: ANOVA on Use of BDS by Age of the respondent

Age of the respondent	Mean	Mean square	F	Sig.
25 or less	2.3256	0.327	0.743	0.2361
26-35	2.3342	0.473		
36-45	2.4346			
46-55	2.1672			
55-65	2.1924			
Above 65	2.2356			

The highest mean was in the age group of 36-45 years (2.4346) while the lowest mean was in the age group of 46-55 years. However the means across different age groups are relatively the same.

> ➤ **T-test on Use of BDS by gender**

The t-test on gender showed no statistically significant differences on use of BDS (t=1.425, p=0.436). This indicates that there are no statistically significant differences between responses from males and females on their use of BDS. The mean score of male (3.6455) is however higher compared to that of managers (3.6142). The results of t-test on awareness of BDS by gender are shown in Table 6.27.

Table 6.27: T-test on awareness of BDS by gender

	Mean	T	Df	Sig.(2-tailed)
Male	3.6455	1.193	186.476	0.341
Female	3.6142			

> ➤ **Use of BDS and Educational level of the respondent**

The analysis of variance on use of BDS by educational level indicated that there is no statistically significant difference in responses across different educational level. The highest mean (2.4117) was on respondents with a degree and the lowest (2.3656) was on respondents who have matriculated only. The results of ANOVA on use of BDS by educational levels are indicated in Table 6.28.

Table 6.28: Use of BDS by Educational level

Age of the respondent	Mean	Mean square	F	Sig.
Matric	2.3656	0.327	0.743	0.2361
Certificate/Diploma	2.3342	0.473		
Degree	2.4117			

- **Correlation between the use of BDS and success in obtaining finance**

A correlation analysis was used to investigate the relationship between use of BDS and success in getting access to finance and non-use of BDS and success in getting access to finance. The results showed a statistically significant negative correlation between non-use of BDS and success in getting financing (r= -0.346, p=0.0124). This indicates that non-use of BDS is negatively correlated with success in getting access to finance. In contrast, a correlation analysis between use of BDS and success in getting access to finance showed a statistically significant strong correlation between awareness of BDS and success in getting access to finance (r=0.841, p=>0.0021). The results of the correlation analysis are shown in Table 6.29

Table 6.29: Correlation of use of BDS and success in getting financing

Variable	Use of BDS		Non-use of BDS	
	R	p-value	R	p-value
Access to finance-outcome	0.841	0.0021	-0.034	0.0124

Sig. 0.05 (2-tailed)

Based on the results of the correlation analysis it can be concluded that non-use of BDS reduce the chances of getting access to financing.

A regression analysis was also done on use of BDS and access to finance outcome. The result of the regression model showed an 83% variations in responses to access to finance outcome (adjusted R-square=0.830) are explained by use of BDS. The F-test (F=0.356, p<0.000) is significant indicating that the model as a whole accounts for significant variations on the use of BDS and access to finance Table 6.30 presents the results of the regression analysis.

Table 6.30: Regression results of Use of BDS and access to finance outcome

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.841	0.839	0.830	0.426

ANOVA

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	0.344	6	0.344	0.356	0.000
Residual	7.275	60	0.182		
Total	7.619	66			

Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	T	P-value
	B	Std. Error	Beta		
1 (Constant)	1.388	0.280		4.957	0.000
Use of BDS	0.973	0.155	0.841	1.375	0.001

Dependent Variable: Access to finance

Use of BDS has a significant positive effect on the responses to success in access to finance. These are shown by the beta coefficient of 0.973. The results are interpreted to mean that with a unit increase in use of BDS chances of succeeding in getting financing increases by 0.973. These effects have p-values that are less than 0.05 (p-value=0.001), which suggests high statistical significance.

Furthermore, the correlation analysis between use of BDS and access to finance showed a statistically significant strong positive correlation (r=0.756, p-value>0.0021). **Therefore based on the correlation analysis, and the results of the regression analysis, the null hypothesis (H1$_0$) that there is no relationship between the use of BDS and improvement in access to finance by start-up SMEs is rejected. This leads to the conclusion that there is a strong**

statistically significant positive relationship between use of BDS and improvement in access to finance.

The results confirm the importance of BDS in improving access to finance by start-up SMEs. Therefore, it can be argued that the use of BDS services by start-up SMEs improves their chances of gaining access to the financial resources they need to successfully run their businesses. The reason being that start-up SMEs that use the services BDS providers enhance their knowledge and skills of making effective applications for external funding, have good information and networking opportunities (including information about government agencies that can assist with collateral and guarantees) and most importantly gain knowledge of running their businesses effectively.

The results of the study also revealed that there is a general lack of awareness of BDS providers amongst the respondents of this study. This significantly affects their use of the services provided by BDS. Therefore, it can be concluded that lack of awareness of BDS is the root cause of lack of use of BDS. Thus lack of awareness of BDS impacts on the ability of start-up SMEs to obtain debt finance. Therefore, creating awareness of BDS amongst start-up SMEs, effectively conveying information about the service packages and their benefits to the start-up SMEs and effectively designing service packages tailored to the needs to start-up SMEs are instrumental to improving access to finance to start-up SMEs.

6.2 Summary

The chapter presented the results of the empirical data collection of this study. The results revealed that access to finance is a major problem facing start-up SMEs. In light of that fact, start-up SMEs acknowledges the weaknesses on their part in terms of their failure to provide adequate information to financial institutions, lack of sufficient collateral security, bad credit records, risk perception, and educational levels as impediments to their access to finance. The results of this study revealed that there is a lack of awareness of BDS amongst the majority of the respondents and this affect their use of the services BDS of providers. An analysis of data using ANOVA, T-test, Pearson correlation and regression analysis showed that there are

statistically significant relationships between lack of awareness of BDS and weak access to finance by start-up SMEs. A statistically significant positive correlation between the use of BDS and success in getting financing was revealed by the results of this study. The results further revealed that amongst the respondents who showed awareness of BDS, the majority of them have used the services of BDS. This suggests that the use of services of BDS results in increased chances of gaining access to finance. It is therefore important to create awareness of BDS among start-up SMEs and encourage the use of BDS in order for them to be able to effectively access finance. Access to finance may lead to a reduction in the high failure rates of start-up SMEs.

The following chapter provides conclusions, discussions and recommendations of the study.

CHAPTER 7: CONCLUSIONS, DISCUSSIONS AND RECOMMENDATIONS

7.1 Introduction

The previous chapter presented the findings of the empirical research for this study. This chapter presents discussions and conclusions of the study that was undertaken to investigate the role of Business Development Services (BDS) in improving access to finance by start-up SMEs in the Buffalo City Municipality. English and van Tonder (2009:194) state that discussions must comment on and interpret the findings, relate and compare these findings with literature review, put the results of the study into perspective, show whether the results reflect or solve a problem and if problems were identified prioritise them. Therefore, the focus of this chapter is to present conclusions drawn from the findings and suggest recommendations.

7.2 Summary

The conclusions from this study were drawn from the results of the two phases of research methodology of this study, which are the literature review phase and the empirical survey. The study consists of seven chapters.

7.2.1 Introduction to the study (Chapter 1)

Chapter one presented the background to the research problem. As pointed out by Maas and Herrington (2006) start-up SME are engines of development and innovation, put pressure on old firms to improve their efficiency, inject new blood into the veins of the economy, result in economic growth, with positive impact on poverty alleviation, income inequality and most importantly are a source of sustainable employment creation. This points out to the importance of start-up SMEs for a thriving economy.

Start-up SMEs face significant challenges in their attempt to survive and grow. The creation of start-up SMEs is very low in South Africa. According to Herrington *et al*.

(2009) South Africa was ranked 23rd out of 43 countries surveyed by Global Entrepreneurship Monitor (GEM) in 2008. In 2008, South Africa's TEA was 7.8% which was below the average rate of 10.6% surveyed by GEM. Herrington *et al.* (2009) also reveal that 75% of start-up SMEs created in South Africa fail within the first three years of operation. South Africa's low start-up SMEs creation rates and high failure rates negatively impact on the SMEs sector's full potential to contribute meaningfully to job creation, economic growth and more equal income distribution. Therefore, it is paramount to explore strategies to improve the survival of start-up SMEs in order to enjoy the full benefits derived thereof.

Authors such as Nigrini and Schoombee (2002), Maas and Herrington (2006), Rogerson (2008) and Herrington *et al.* (2009) revealed that that access to finance is a major challenge hindering the survival of start-up SMEs in South Africa. Most start-up SMEs have difficulties obtaining finance from credit providers. This leads to market failure. This is why programmes of financial assistance are one of the principal ways in which governments, international development agencies and donors can support the SME sector. The purpose of this study was to investigate if government intervention efforts in the form of BDS are helping to improve access to finance by start-up SMEs

7.2.2 SMEs: A South African perspective (Chapter 2)

A review of both international and local literature confirmed that SMEs, especially start-up SMEs are important to sustainable economic growth, employment creation, poverty alleviation and income distribution (Herrington *et al.,* 2009). Furthermore, the creation rate of start-up SMEs in South Africa as measured by the TEA is one of the lowest in the world. In addition, the failure rate of start-up SMEs in South Africa is one of the highest in the world. Weak access to external finance is a major challenge to the survival and growth of start-up SMEs.

7.2.3 Financing of start-up SMEs (Chapter 3)
Studies from both international and local literature pointed out that financing is paramount to the continued survival and growth of start-up SMEs. The literature

review concluded that access to external equity is a major problem for start-up SMEs in both developed and developing countries. However, start-up SMEs in developed countries have better access to debt compared to those in developing countries. There seems to be a market failure in the provision of debt to start-up SMEs in South Africa and other developing countries. Therefore, policy interventions to effectively address access to finance challenges facing start-up SMEs are very important.

7.2.4 The role of Business Development Services (BDS) (Chapter 4)

Several studies such as the Committee of Donor Agencies for Small Enterprise Development (2001) and Rogerson (2006) pointed out to the need for government intervention in the form of BDS to improve access to finance by start-up SMEs. However, there is a gap in the literature about the effectiveness of BDS in improving access to finance by start-up SMEs. This gap in the literature stimulated this study.

7.2.5 Research methodology (Chapter 5)

Chapter five of this study presented the research methodology. This chapter examined aspects of the study, including the research design, the data collection methods and data analysis. Data was collected through the use of self-administered questionnaires. Data collected was transformed into more suitable format for analysis by utilising Excel software. After data processing, the Statistic Package for Social Science (SPSS) was utilised for data analysis. Statistical techniques used in this study included descriptive statistics, correlation, regression analysis, T-tests and ANOVA.

7.2.6 Results of the empirical survey (Chapter 6)

Following an intense literature review and conclusions drawn from the results of the literature review chapters, the necessity of an empirical survey emerged, the findings of which were presented in chapter 6. The results of this study revealed that start-up SMEs acknowledges weaknesses on their part, such as lack of collateral security, failure to provide sufficient information to financial institutions and financial services providers and this result in their failure to adequately access the finances they need to develop and keep their businesses running. Moreover, they are aware of the fact

that financial institutions and other financial services providers regard them as risky investments and this point to incidences of market failure, hence they need the services of BDS.

As Hofstee (2006:157) states, "conclusions must always link back clearly to your thesis statements". The conclusions drawn from the empirical study as discussed above are therefore discussed in relation to hypothesis formulated for this study.

a) Primary Hypothesis

- $H1_0$ There is no relationship between the use of BDS and improvement in access to finance by start-up SMEs.

  $H1_A$ There is a significant relationship between the use of BDS and improvements in access to finance by start-up SMEs.

In examining the primary hypothesis as stated above, the results of this study revealed a statistically significant positive correlation between use of BDS and success in getting access to finance. The results of Pearson correlation analysis revealed a statistically significant strong positive correlation (r=0.756, p >0.0021) between the use of BDS and the access to finance-outcome. A regression analysis also confirmed the relationship.

Thus, the null hypothesis ($H1_o$) that there is no relationship between the use of BDS and improvement in access to finance by start-up SMEs is rejected leading to the conclusion that there is a statistically significant positive correlation between the use of BDS and success in getting financing. Therefore it can be deduced that BDS are helping start-up SMEs in improving access to finance.

Secondary Hypotheses

- $H2_0$ Start-up SMEs are not aware of BDS providers in their localities.

  $H2_A$ Start-up SMEs are aware of BDS providers in their localities.

The results revealed that there is a general lack of awareness of BDS among the respondents. Furthermore, the results of the correlation and regression analysis

showed a negative correlation between non-awareness of BDS and success in access to finance.

Thus, the null (H3₀) hypothesis that start-up SMEs are not aware of BDS providers in their localities is not rejected.

> H3$_0$: Start-up SMEs that are aware of BDS are not using the services.
> H3$_A$: Start-up SMEs are aware of BDS are using the services.

The results revealed that start-up SMEs that are aware of BDS utilise the services. The results of the correlation and regression analysis indicated a positive relationship between the use of BDS and success of credit applications.

Thus, the null hypothesis (H3₀) that start-up SMEs that are aware of BDS are not using the services is rejected.

7.3 Recommendations

It should be acknowledged that start-up SMEs are the lifeblood of any thriving economy. They are the engines that drive the economy towards sustainable employment creation, poverty alleviation and solving income inequalities. To cater for the demands of increasing population, increasing numbers of job seekers and increasing ever-changing business environment, new businesses should be encouraged and fully supported to ensure that sustainable economic growth is achieved. Literature review and the empirical results of this study revealed that start-up SMEs face severe challenges in their attempts to access the financing they need to run their businesses more effectively and survive. Some of the challenges facing start-up SMEs are a result of their inherent characteristics and also perceptions of the financial services providers about the SME sector.

Start-up SMEs are perceived as risky investments, they lack sufficient skills and knowledge of effectively running their business, they lack adequate collateral security, and they fail to furnish sufficient information about their business propositions, among other challenges. These challenges mean that start-up SMEs

are credit rationed and face difficulties in getting financing. Stiglitz and Weiss (1981:393-410) developed the main theoretical contributions about credit rationing and suggest that the problems of information asymmetry, moral hazard and adverse selection have the greatest limitations on productive credit granting. The arguments put forward by Stiglitz and Weis (1981:393-410) prompted the need for government intervention to help the SME sector overcome the challenges they face due to the inherent characteristics which lead to credit rationing.

Thus it is recommended that the government (national, provincial and local) should work hand in hand with private sector institutions to ensure effective and adequate access to finance by start-up SMEs. This can be done through efficient and effective provision of BDS. The BDS provision should be restructured in such a way that provision of access to finance dedicated services is intensified and effectively supported to benefit start-up SMEs. Furthermore, the initiatives to support emerging businesses should be intensified in order to achieve sustainable socio-economic growth.

Such initiatives as BDS provision can be intensified through intensive awareness campaigns, encouraging the use of BDS by start-up SMEs and incentives or subsidies provided to BDS institutions. National and local media should be used more aggressively by government agencies to create the awareness for BDS. In addition, government agencies such as SEDA should organise seminars, training and road show to create awareness of BDS. Commercial banks can also help create awareness of BDS by informing credit applicants about the existence of BDS. There is also the need for government agencies such as SEDA to link up effectively with the chambers of commerce to aggressively market the existence of BDS. Educational institutions (especially the Department of Business Management or Entrepreneurship) can also help to create awareness about BDS especially during community engagements with start-up SMEs. Emanating from the relevance of BDS in helping solve challenges facing start-up SMEs, these institutions should be closely monitored and evaluated on a regular basis to ensure sustainability in their services provision.

The legal frameworks relating to access to finance should also be fundamentally restructured to ensure that they are favourable to start-up SMEs who in many cases despite having good and viable business proposition fail to access adequate financing to sustain their businesses. The "Competency-as-Collateral" scheme as practiced in India can also be introduced amongst the financial services providers here in South Africa. The scheme integrates measures of management competency with the conventional credit risk assessment criteria. Customised evaluation systems built on the basis of this platform help SMEs that would not have been eligible for a loan under the conventional criteria to become eligible by allowing them to show their management competence as part of their collateral. Such a scheme can entrepreneurs are encouraged to upgrade their managerial competencies by going for training services some of which are provided by BDS providers.

Furthermore, a strong bond between BDS providers, financial services providers and entrepreneurs should be created to ensure that benefits derived at one service level becomes effective at another service to achieve a desirable subsequent outcome. Thus BDS provision should directly link to the subsequent access to financing.

However, the government cannot alone create awareness about BDS. Start-up SMEs should be encouraged to take full responsibility of the success of their businesses and make use of the services of BDS providers. Owners of start-up SMEs have to take greater responsibility for their own learning by creating a positive attitude towards entrepreneurship and training and by attending seminars. In addition, the owners should clearly understand that government intervention efforts alone will not work to improve access to finance. Therefore, to get the required funding from commercial banks, it is first about the owners of start-up SMEs getting investment ready by understanding the demands of credit providers.

As reflected by the results of this study that that there is a lack of awareness and subsequently lack of adequate use of BDS by start-up SMEs, intensive efforts should be made to build awareness and encourage the use of BDS by start-up SMEs in order to enjoy the benefits of BDS that are set up to help them run their businesses

effectively. In light of the recommendations provided herein, the following model of supporting start-up SMEs through BDS can be adopted.

Figure 7.1: Model for supporting SMEs through BDS
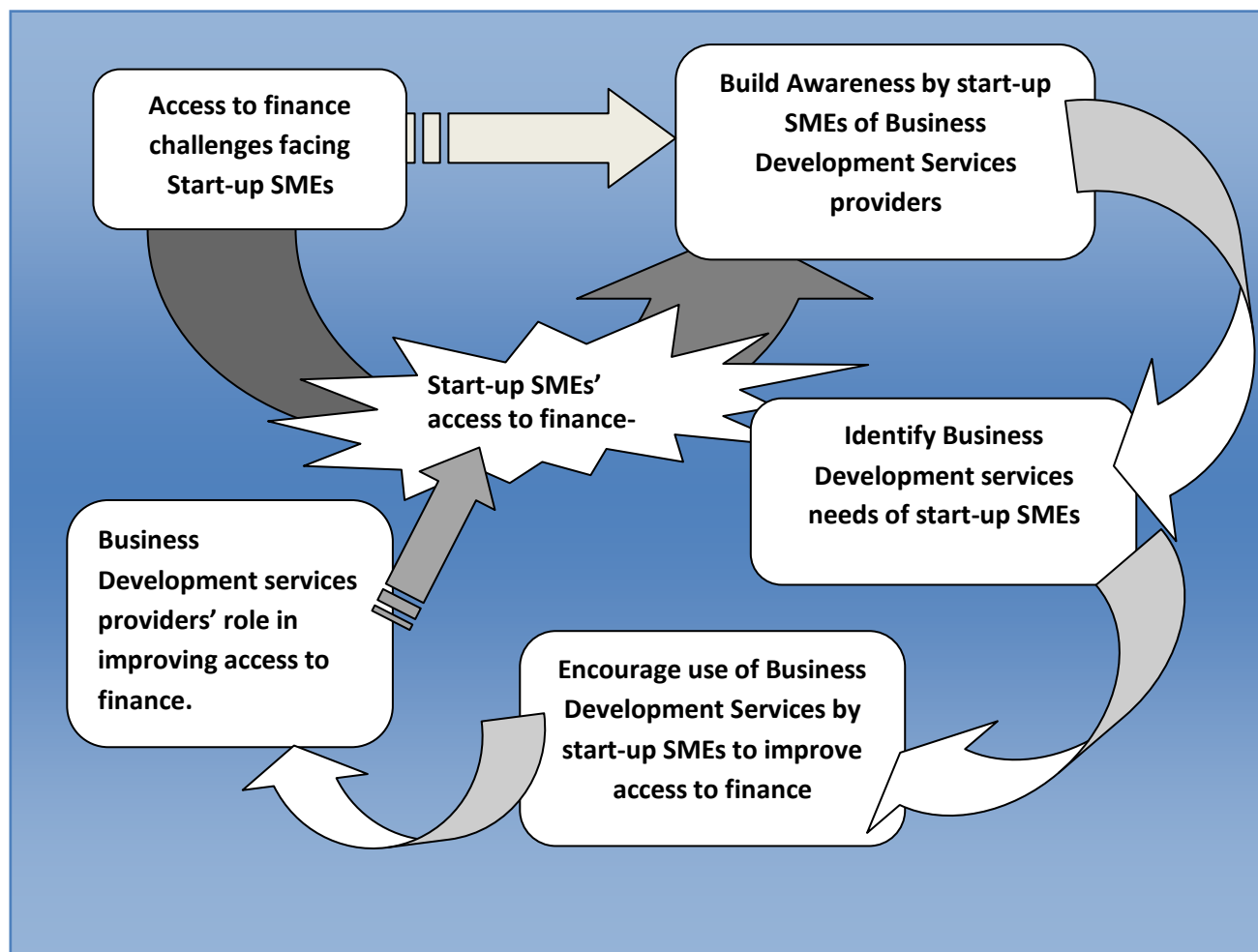
The model developed above show the links between access to finance challenges facing start-up SMEs, building awareness and encouraging the use of BDS in improving access to finance by start-up SMEs, the BDS needs of start-up SMEs as well as the role of government in BDS provision. The model calls for acknowledging the inherent challenges facing start-up SMEs, create awareness of the existence and service provided by BDS institutions, identify and develop BDS packages that critically address the challenges facing start-up SMEs, encourage the use of BDS by start-up SMEs and clearly exhibit the role and benefits derived from the use of BDS

providers, probably through success stories on access to financing following the use of BDS.

In addition to efforts through both private and public sector initiatives to address challenges facing start-up SMEs, the start-up entrepreneurs themselves should take initiative and fully take advantage of the business development services provided to them and ensure that they gain skills, knowledge and competency of successfully nurturing their business through a sustainable growth path. Furthermore, emanating from the harsh realities of getting external financing and market failures, start-up SMEs should do a thorough groundwork to ensure self-sustainability of their business until they reach establishment stages. Also, cognisance of the fact that access to finance is a major challenge, start-up SMEs owner should do their financial planning such that the business will survive a perpetual debt trap.

The following section describes the achievement of the objectives of this study.

7.4   Achievement of Objectives

This section measures the success of the study against the research objectives formulated in section 1.3.2.

The research sought to achieve the following objectives:
- To review the literature on the contribution of start-up SMEs, their creation rate, their failure rate and the causes of failure in South Africa
- To review the literature on the challenges hindering access to finance for start-up SMEs (i.e. the causes of market failure)
- To review the literature on government intervention efforts that can assist in improving access to finance by start-up SMEs
- To investigate empirically whether start-up SMEs that use BDSs have improved access to external finance
- To investigate empirically if start-up SMEs are aware of BDSs
- To investigate empirically if start up SMEs that are aware of BDSs use the service

- To develop a more efficient model of government intervention effort through BDSs in improving access to finance by start-up SMEs

The first objective was to review the literature on the contribution of start-up SMEs, their creation rate, their failure rate and the causes of failure in South Africa. This was achieved in chapter two of the study. The chapter examined the role of SMEs in the socio-economic activities of the nation in terms of employment creation, poverty alleviation and income equality and economic growth at large. The chapter defined start-up SMEs and examined the contribution of start-up SMEs. The review of the literature reviewed that South Africa has significantly low new firm creation as measured by the TEA amongst all the developing countries surveyed by Global Entrepreneurship Monitor. It is also reviewed that more 75% of new SMEs in South Africa fail within the first two years of operations. This is the highest failure rate amongst all the countries surveyed by Global Entrepreneurship Monitor. The literature revealed that there are many reasons for the failure of start-up SMEs. Lack of finance stood out to be one of the prime challenge hindering the survival and growth of start-up SMEs.

The second objective was to review the literature on the challenges hindering access to finance by start-up SMEs (i.e. the causes of market failure). The second objective was achieved by reviewing the literature in chapter three. It was discovered that start-up SMEs in South Africa suffer from both debt and equity gaps. The use of external funding by start-up SMEs is extremely limited. This is not limited to South Africa alone. In developed countries such as Canada, Norway, the use of external equity is also severely limited for new SMEs. The debt gap is however more severe in developing countries (South Africa included) than in developed countries. The lack of equity and debt indicates that start-up SMEs are face severe financial constraints and credit rationing.

The third objective was to review the literature on government intervention efforts that can assist in improving access to finance by start-up SMEs. This was achieved in chapter four of the study. The literature revealed that there are quite a number of

government intervention efforts to assist SMEs in achieving growth and success. It was reviewed that despite these efforts the failure rate of start-up SMEs remains high and the creation rate of start-up SMEs is low. From the literature review, the contentious issue is the effectiveness of BDSs in delivering services that can help SMEs address the challenges of access to finance. This prompted the need for an empirical survey, the methodology of which was presented in chapter five of this study and the results were presented in chapter six.

Empirical study was carried out to achieve the fourth, five and sixth objectives which were "to investigate empirically whether start-up SMEs that use BDSs have improved access to external finance", "to investigate empirically if start-up SMEs are aware of BDSs" and "to investigate empirically if start up SMEs that are aware of BDSs use the service".

To achieve the objectives, the research methodology was explained in chapter five. In addition, the results of the empirical study were discussed in chapter six.

The last objective was to develop a more efficient model of government intervention effort through BDS in improving access to finance by start-up SMEs. This was achieved in chapter seven of the study in which recommendations to improve the use of BDS were suggested and a model to improve the effectiveness of BDS was developed. The model encourages recognising the access to finance challenges facing start-up SMEs, followed by building awareness of BDS among start-up SMEs as intervention to address their problems, identifying the BDS needs of start-up SMEs, encouraging the use of BDS by start-up SMEs and clearly establishing an understanding of the role of BDS in improving access to finance with the ultimate outcome of improving access to finance by start-up SMEs. Therefore, it can be concluded that the objectives of the study were achieved.

7.5   Limitations of the study

The present study has certain limitations that need to be taken into account when considering the study and its contributions. This study focused on access to finance

by start-up SMEs which is a very extensive and complex. Addressing challenges facing SMEs can be approached from different perspectives. Despite numerous challenges impeding the survival and growth of start-up SMEs, the study focused only on access to finance. Only BDSs were investigated as an intervention to address access to finance challenges facing start-up SMEs.

In addition, the study was limited to the opinions of start-up owners, owner-managers and managers in the Buffalo City Municipality in the Eastern Cape Province. Because of the limitations pointed out, care should be exercised in the interpretation and the application of the results of this study and the generalisation of the findings to the whole of South Africa.

Although the study has some inherent limitations, it however provides a foundation upon which the direction of effective BDS provision to start-up SMEs can be built. It also enlightens future researchers about BDS and their effectiveness in helping start-up SMEs to access finance. The following section describes possible directions in future research.

7.6   Suggestions for future research

The issue of access to financing or financing of SMEs in general is quite a broad topic and a great deal of research can be done to find effective solutions to solving the problem. A survey to examine the effectiveness of BDS from the supply side (i.e. the BDS providers) and the problems faced by BDS providers in achieving their mandate can be undertaken. Further studies could also investigate whether start-up SMEs understand the criteria employed by commercial banks to determine whether to grant a loan or not.

7.7   Summary

This chapter focused on the conclusions, the discussions and the recommendations of the study. The findings of the study revealed that BDS plays a significant role in improving access to finance by start-up SMEs. Furthermore, cognisance of the importance of start-up SMEs, policy directions should be such that this segment receives the best attention to ensure sustainable socio-economic development.

Because of the inherent challenges encountered by start-up SMEs, specially designed service packages to ensure access to finance should be developed and delivered to start-up SMEs. As the results of this study revealed, the focus of BDS provision should begin with creating awareness by government agencies and commercial banks.

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APPENDICES

Appendix 1: Questionnaire

Department of Business Management

Dear Respondent,

The following questionnaire is part of research dissertation conducted in fulfilment of the requirements for a Master of Commerce degree. The research focuses mainly on the role played by Business Development Services Providers in improving access to finance for start-up SMEs. It would be appreciated if you would complete the questionnaire and answer the questions as thoroughly as possible.

All information provided will be treated confidentially and will only be used for academic purposes. Your participation in this research will go a long way in improving access to finance for start-up SMEs and is highly appreciated.

Please answer the questions as objectively and honestly as possible according to the instructions contained in the body of the questionnaire. If you have queries concerning the questionnaire, please contact the researcher and/or the supervisor, whose details are set out below:

Researcher: Mazanai Musara   Supervisor: Dr. O. Fatoki

Cell: 083 861 1039   Tel: 040 602 2248

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        Or jilgram@yahoo.com

Section A: Access to Finance Challenges

The following set of statements relates to the perceptions on the major challenges encountered in accessing finance. Statement number 1 refers to opinion on whether start-up SMEs face challenges in accessing finance, while statements 2-7 refers to reasons for the challenges in accessing finance. *Using the following scale, please indicate the extent to which you either agree or disagree with the statements by marking the appropriate number with an X in each row:1 =Strongly disagree, 2=Disagree; 3=Neither agree nor disagree (neutral); 4= Agree; 5 = Strongly agree.*

		Strongly disagree	Neutral			Strongly agree
1	Start-up SMEs face challenges in accessing finance	1	2	3	4	5
2	Start-up SMEs fail to provide the necessary business information to gain access to finance.	1	2	3	4	5
3	Start-up SMEs are denied access to finance due to failure to provide sufficient collateral security.	1	2	3	4	5
4	The majority of start-up SMEs is denied access to finance due to bad credit records.	1	2	3	4	5
5	Legal restrictions such as the Credit Control Act impede access to finance for start-up SMEs.	1	2	3	4	5
6	Poor educational backgrounds are a reason why start-up SMEs is denied access to finance.	1	2	3	4	5
7	The start-up SMEs presents a high risk profile that is why financial institutions are less willing to provide financing.	1	2	3	4	5

Section B: The use and role of Business Development Services Providers (BDSs)

Answer the following questions by placing an X on the most appropriate answer.

1. Are you aware of the existence BDSs in your locality?

Yes	
No	

If your answer to 1 above is "Yes" proceed directly to question 4, if "No" continue question 2 and 3.

2. Have you applied for external funding for your business?

Yes	
No	

3. If your answer to 2 above is yes, has your application been successful?

Yes	
No	

4. Have you used the services of BDS

Yes	
No	

5. Which of the following BDS providers have you made use of?

Eastern Cape Development Corporation	
National Youth Development Agency	
Small Enterprise Development Agency	
Buffalo City Municipality …………………………………	

6. If your answer to 4 above is yes, which of the following services have you made use of from BDS providers?

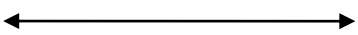|	
Training services	
Mentorship services	
Business Planning	
Business and Financial Administration	
Information sharing and networking including information about how to obtain government assistance with collateral	
Marketing and Marketing planning	
Feasibility assessments	
Business registrations	

7. Have you applied for external financing following your use of the above BDS services?

Yes	
No	

8. If your answer to 6 above is yes, has your application been successful?

Yes	
No	

The following statements relates to the use and role of these BDSs in improving access to finance for Start-ups. Please indicate to what extent you agree or disagree with each of the following statements about BDSs by marking the appropriate number in each row: 1=strongly disagree, 2=Disagree; 3=neither agree nor disagree (neutral); 4=Agree; 5 = Strongly agree.

		Strongly disagree	Neutral			Strongly agree
9	Information about the services of BDS is readily available.	1	2	3	4	5
10	My business has used the services of BDSs in attempting to gain access to financial resources.	1	2	3	4	5
11	My business feel comfortable using the services of BDSs.	1	2	3	4	5
12	BDSs have programmes designed to improve access to finance for start-ups.	1	2	3	4	5
13	Using the services of BDS is a waste of resources that should have been otherwise used for the growing the business.	1	2	3	4	5
14	Using the services of BDS is costly	1	2	3	4	5

Section C: Business Characteristics and Demographic Information

The questions in this section pertain to characteristics of your business. This information will help the researcher to get acquainted with the profile of the respondent and his/her business.

1. For how long have your business been in operation?

0-12 Months	13-24 Months	25-36 Months	37-42months

2. How many employees does the business have?

>50	51-100	101-150	151-200	201-250

3. What is the legal status of your business?

Sole Trade	
Partnership	
Close corporation	
Private company Pty Ltd	

4. How many partners/owners/members are actively involved in the running of the business?

1-5	6-10	11-20	21+

5. What is your position in the business?

Owner	
Manager	

6. What is your gender?

Male	
Female	

7. What is your age?

25 or less	26-35	36-45	46-55	55-65	Above 65

8. What is your highest qualification?

Matric	
Certicate/Diploma	
Degree	

Thank you for your time and co-operation.