

ANGEL NETWORKS AS A BUSINESS START-UP FINANCING OPTION IN SOUTH AFRICA

Thesis

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Zenzo Sibanda

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ABSTRACT

The following study is about business angels financing small business start-ups. It explores the aspect of starting up an entrepreneurial venture in which the entrepreneur seeks to secure start-up finance from lenders, raising the various issues that are known to characterise this engagement between the entrepreneur and the lender. Using the phenomenological paradigm, the study seeks to determine the awareness of small scale financing by entrepreneurs in South Africa, to determine the most commonly used source of start-up business funding in South Africa, to assess the extent to which business angel financing could be used to finance businesses in South Africa and to determine the factors impacting the use of business angel financing in South Africa. From these objectives, the study will also seek to determine the extent to which business angel networks could facilitate the financing of business start-ups.

Small businesses invariably come up in different policy spheres as the main avenues to social and economic construction across national and regional lines. The importance of a successful business start up to a growing economy should not be underestimated. In line with this is the particular factor of gaining access to start up capital, which continues to emerge as a leading contributor to the success or failure of business start ups. Studies continue to verify that the most common challenge faced by most emerging entrepreneurs is start-up capital, either in the lack of this capital, the unfavourable conditions surrounding its availability, the lack of assets to serve as collateral for its use or the ambiguous flow of crucial information between lenders and providers of finance in the funding relationship (Abor and Biekpe, 2006: 69; Hernandez-Trillo, Pagan and Paxton, 2005: 435, ISPESE, 2005: 7, CDE, 2004: 5; Musengi, 2003: 11).

Roger Sorheim (2005: 179) refers to business angels as private individuals who offer risk capital to unlisted companies that are struggling to obtain start up capital to finance their business ideas. Business angels are further defined as high net-worth bearers of substantial private capital who predominantly invest in the early stage of high risk high potential return business ventures with a positive further growth potential. Business angel finance is typically a 'once-off' early stage form of small firm financing compared to the more frequent later stage venture capitalist funding. Studies show that business angels represent an underutilised wealth creation mechanism when it comes to small firm start-ups as most business angels contribute expertise in addition to finance to the start-ups they get involved in. This brings

valuable business insight to the commercialisation of a good business idea. The business angel network exposes a range of potentially viable business prospects to willing investors by facilitating the flow of information about entrepreneurs and their businesses, thereby eliminating ambiguity, information asymmetry and transaction costs (Aernoudt and Erikson, 2002: 178; Van Osnabrugge and Robinson, 2000:374; Macht, 2006:1; Ehlich, De Noble, Moore and Weaver, 1994:70; Sorheim, 2005:179).

To achieve a holistic approach to a phenomenon which appears to be relatively new in South African business circles, the study will follow a qualitative approach in which two categories of populations will be used, one of small business operators and the other of business angels in South Africa. In the study, 20 small business operators and five business angels in Grahamstown will be approached using the convenience and snowballing sampling methods respectively. Face-to-face semi-structured interviews will be used as a data collection method and content analysis will be used as a data analysis tool (Collis and Hussey, 2003:156, Driver, Wood, Segal and Herrington, 2001:32, National Small Business Act).

There has been very limited research on business angels in the South African context, therefore the study would significantly contribute in entrepreneurship, government and small business development circles as it brings about attention to what the researcher predicts is an underutilised business start-up financing option.

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I dedicate this page to the people who have shown me support from day one and who have always believed in me even in the roughest of academic and personal times. This page belongs to my mother, Enet Kunyelele Sibanda nee Mnkandla who sacrificed everything to see me through my academic career. Ngidumisa uNkulunkulu ngalokho ongenzela khona mihla ngemihla. UNkulunkulu akwandisele maKhabo. Ngokungapheliyo.

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CHAPTER 1
BACKGROUND TO THE STUDY

1.1 CONTEXT OF RESEARCH

Entrepreneurship and the small business sector development have increasingly gained significance in developing and in third world economies due to their potential to facilitate economic development (Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprise: Unlocking the Potential of South African Entrepreneurs, 2005:7). The South African government recognises this and has, especially since 1994, increased efforts to facilitate an environment favourable to entrepreneurship and small business development as evidenced by the pronouncements of the White Paper of 1995 on national strategy on the development and promotion of small business in South Africa (Center for Development and Enterprise, 2004:5). The small business sector is seen as part of the national agenda to promote national economic development, job creation and wealth redistribution (CDE, 2004:5; Musengi, 2003:11). This has led to various government initiatives such as the Ntsika Enterprise Promotion Agency (Ntsika) and Khula Enterprise Financial Limited (Khula) through the Department of Trade and Industry (DTI). These structures are aimed at promoting entrepreneurship and small businesses by providing technical and financial support.

A stumbling block faced by many fledgling entrepreneurs is start up capital (Abor and Biekpe, 2006:69; Hernandez-Trillo, Pagan and Paxton, 2005:435). Some reasons advanced for this finance gap include lack of access to funding, a high degree of information asymmetry between providers of finance and borrowers, the perceived higher risk of small business, the term structure of finance available to such businesses, lack of assets that can be used as collateral and the high transaction costs. (Abor and Biekpe, 2006:69; Brewer, 2007:43; Amit, Glosten, and Muller, 1990:107; Hernandez-Trillo *et al.*, 2005:435; Timmons and Sander, 1989:72; Tucker and Lean, 2003:51). Conventional funders such as banks have also tended to grant fewer loans although there are good credit risks in the market (Tucker and Lean, 2003:51, Van Osnabrugge and Robinson, 2000:23).

Related to information asymmetry are adverse selection and moral hazard. With adverse selection, potential investors have difficulty distinguishing between a good and bad entrepreneurial idea. Moral hazard contributes to high financing costs due to the monitoring needed to ensure that funds provided are used for the intended purpose (Abor and Biekpe, 2006:71; Brewer, 2007:42; Tucker and Lean, 2003:51).

In South Africa research shows that in spite of government efforts to promote entrepreneurship and the small business sector the results have been disappointing (CDE, 2004:6). It has been acknowledged that “Khula, the DTI’s small business finance agency has never managed to help more than a few hundred businesses per year with bank-loan guarantees...” (Terblanche, 2009:2). The reasons advanced for this failure are varied and include a misplaced focus on access to debt finance and misconception of government initiatives as poverty relief as well as the need for government to play a more facilitating and supporting role (CDE, 2004:28).

The banking sector does not seem to have fared well in promoting the small business sector either. In 2000, the then Minister of Trade and Industry Alec Erwin stated that “If we got something wrong in the last five years, it was to overestimate the capacity of the banking sector to advance the national imperative of promoting SMMEs” (CDE, 2004:41). Riley (in CDE, 2004:28) found that less than two percent of the world’s micro and small entrepreneurs have access to financial services from the formal financial sector. Indeed research on small enterprise financing in South Africa shows a very poor investment record by the major banks forcing more and more entrepreneurs to look to informal private investment for their entrepreneurial initiatives (Schoombee, 2000:752).

A source of start up capital that has not traditionally enjoyed much attention is that of business angel finance. Business angels are individuals with an entrepreneurial interest, and/or experience and excess funds which they are willing to invest in feasible business ideas at the start up phase. In the United States of America (USA) business angel investment is a significant source of entrepreneurial funding. In 2005 business angel investment was said to stand at \$25 billion a year whilst in the United Kingdom, business angel networks were estimated to provide at least one billion pounds sterling of investment annually. However, it is a practice that is relatively unknown in South Africa and the term is sometimes used interchangeably with venture capital (Aernoudt and Erikson, 2002:178; Clarke, 2005:319; Van Osnabrugge and Robinson, 2000:5, 374; Macht, 2006: 1; Ehlich, De Noble, Moore and Weaver, 1994:70; Sorheim, 2005:179).

In comparison to venture capitalists business angels are frequent business start-up stage investors whereas venture capitalists are normally once off later stage investors. Unlike

venture capitalists business angels do not normally make equity investments and prefer to invest in local projects to which they can have easy access as they usually provide not only financial assistance but both managerial expertise and valuable business networks (Ehlich *et al.*, 1994:70; Sorheim, 2005:179).

Angel finance is normally available in relatively smaller amounts and is therefore more suitable as a source of seed capital whereas venture capital funding is more characteristic of later stage financing seemingly due to its risk averse nature and the increasing amount of funding required as the business grows. Some business angels may just be looking for financial return, leaving the running of the business to the entrepreneur (Aernoudt, 2005:370; Freear and Wetzel, 1990:86, 87; Ehlich *et al.*, 1994:70; Sorheim, 2005:179).

Business angels represent an underutilised wealth creation mechanism as some angels may have some degree of expertise in the ventures they choose to invest in. However, business angels are also willing to venture beyond their areas of expertise and previous investment to support good business ideas. A common trend in the United Kingdom and the United States of America has been the formulation of business angel networks that link individual business angels and entrepreneurs. Business angel networks are groupings of individual potential investors that expose a wide range of potentially viable business ideas to investors. They facilitate information flow about entrepreneurs and their businesses thereby eliminating information asymmetry and transaction costs. Angel networks are however, largely informal and may be difficult to identify and/or distinguish from investment companies. Existing literature shows that business angel networks have and continue to play a significant role in promoting entrepreneurial development in the USA and UK (Aernoudt and Erikson, 2002:178-180; Macht, 2007:13).

1.2 AIMS AND OBJECTIVES

The aim of this research is to determine the extent to which business angels and angel networks could facilitate the financing of entrepreneurial ideas in South Africa.

The specific goals will be to:

- determine the awareness of sources of small scale financing by entrepreneurs in South Africa;

- determine the most commonly used source of start-up business financing South Africa;
- assess the extent to which business angel financing could be used for small businesses in South Africa;
- determine the factors impacting the use of business angel financing in South Africa;

1.3 RESEARCH METHODOLOGY

The study is based on the phenomenological paradigm and is therefore qualitative in nature. The qualitative design facilitates a holistic approach and flexibility which allows exploration of a given phenomenon in order to understand the key variables and human behaviour from the frame of reference of the participants in the study (Collis and Hussey, 2003:47).

1.3.1 POPULATION AND SAMPLE

Two categories of the population will be used in this study, one comprising small business operators and the other made up of business angels in South Africa. For the purpose of this study the use of the term small business will be based on the National Small Business Act No. 102. 27 November 1996. The Act defines a small business as a separate business entity having not more than 50 full time employees, a total turnover of between R3m and R32m annually or gross asset value of between R1m and R6m. (National Small Business Act, 1996). To collect in-depth data a sample of 20 small business operators will be used. This sample will be drawn from Grahamstown. The random sampling method will be used to identify the small business operators (Collis and Hussey, 2003:158). Sampling frames will be obtained from organisations that work with small businesses such as the Small Enterprise Development Agency and Local Development and Tourism. This sampling method will allow for an unbiased sample in order to obtain data in a balanced way (Collis and Hussey, 2003:156). Due to the difficulty in identifying business angels, especially in a town as small as Grahamstown, a sample of five business angels will be selected using the snowball sampling method. This involves the researcher relying on respondents to provide information about business angels whom they know of (Collis and Hussey, 2003:158). It is relevant due to the potential difficulty in identifying business angels.

1.3.2 Data Collection and Analysis

Content analysis will be the research technique used with data analysis (Collis and Hussey, 2003:255). Semi structured interviews will be used to collect data from the two groups of respondents. The interview questions will be adapted from the Global Entrepreneurship Monitor (GEM) 2001 Adult Interview Schedule (ADSPLR04) (Driver, Wood, Segal and Herrington, 2001:32). The adapted questions will focus on the aims and objectives of this research. The interviews will either be face-to-face or telephonic depending on the proximity of the researcher to the respondent. The researcher will seek to promote credibility, transferability, dependability and confirmability by reflecting the views of the respondents (Collis and Hussey, 2003:278). Validity will also be assured by the fact that the research instrument is based on one that has been successfully used by GEM.

1.4 SIGNIFICANCE OF THE STUDY

The nature of small business research usually requires in-depth data collection which the researcher will achieve by conducting multiple interviews that include small business owners and business angel networks. This exploratory study will provide insights on the financing of small business start-ups and the usage of business angels as an option to fund start-ups. The study will also reveal entrepreneurs' experience with securing start-up capital from banks and small-scale funding institutions, indicating what entrepreneurs and providers of start-up finance should know about each other.

Not much research has been undertaken on business angels although the significance of their contribution to economic development has been acknowledged internationally. Literature relating to the South African context is extremely limited. The study would therefore make a significant contribution on a topic which is relevant to a growing economy like South Africa. The results of this research will be of interest to emergent entrepreneurs seeking information about sources of start-up capital as well as relevant government agencies charged with the task of creating an enabling environment for small businesses. It will also be of interest to existing and potential business angels.

1.5 ETHICAL CONSIDERATIONS

The researcher will explain the objectives of the study to the respondents and seek their informed consent to participate. The anonymity of the respondents will be assured by use of a declaration which will be signed by both the researcher and the respondent and will be binding on the part of the researcher. The information collected from the respondents will be anonymous and will only be used by the researcher for academic and other purposes. The respondents will have the option to request general feedback on the findings of the research. The researcher will obtain the approval of the Department of Management Research Ethics Committee before approaching any respondents.

The following chapter will be a perspective on entrepreneurship and its various aspects. It will discuss the definition of entrepreneurship, the generic elements of entrepreneurship, the key features of entrepreneurship, the importance of entrepreneurship to the developing world and the different myths that have surrounded an understanding of entrepreneurship.

CHAPTER 2
DEFINING ENTREPRENEURSHIP

2.1 INTRODUCTION

Entrepreneurship is more than just the creation of business from existing opportunities. The characteristics of looking for opportunities, taking risks beyond security, and having the persistence to push an idea through a real economic and social environment combine into a perspective that permeates entrepreneurs. An entrepreneurial perspective can be developed in individuals depending on the approach used to define and understand entrepreneurship. This perspective can be exhibited inside or outside an organisation, in profit or not-for-profit enterprises, and in business or non-business activities for the purpose of bringing forth creative ideas. Thus, entrepreneurship can be understood as an integrated concept that permeates an individual's business in an innovative manner. It is this perspective that has revolutionized the way business is conducted at every level and in every country (Kuratko & Hodgetts, 2004:3).

This chapter seeks to discuss what is arguably the symbol of business tenacity and achievement; entrepreneurship. Entrepreneurs were the pioneers of today's business successes. Their sense of opportunity, the drive they possess to innovate, and the capacities they have for accomplishment have become the standard by which free enterprise is now measured. This standard is popularly held throughout the entire world. Entrepreneurs will continue to be critical contributors to economic growth through their leadership, management, innovation, research and development effectiveness, job creation, competitiveness, productivity, and the formation of new industries (Kuratko & Hodgetts, 2004:3; Sexton & Kasarda, 1992:48-54).

Research shows that some of the most rapidly prospering nations in the world emphasise entrepreneurship as a leading highlight to local economic development in terms of manufacturing, job creation and service delivery (Kesper, 2000:1). With the re-entry of South Africa into the global free market environment at the turn of independence in 1994, surviving competitively on the international economic scene was of utmost importance to the new government as democracy opened the country to outside trade and global market forces. Learning from other nations became very crucial and replicating tested and popular economic development strategies in a way unique to the South African experience became very important to the new government. Entrepreneurship has risen to the top of many development

agendas in South Africa and perhaps the most appropriate way to go about achieving an understanding of this is first defining entrepreneurship as a concept in itself.

2.2 DEFINING ENTREPRENEURSHIP

In defining entrepreneurship, a clear understanding of the entrepreneurial firm has proved to be important in order to be able to identify which businesses fit the definition and description of entrepreneurship and which ones do not. Popular definitions of the entrepreneurial firm have coined it to be represented by the following conditions: (i) They employ fewer than 100 employees; (ii) They are younger than seven years old; and (iii) They are new entrants into the market (Van Praag and Versloot, 2007:353). The entrepreneur is commonly defined as the individual who started up or owns a business. Despite such efforts however, a universally accepted definition of the ‘entrepreneur’ and entrepreneurship continues to be a point of disagreement amongst researchers who all offer different views on how to identify entrepreneurship. The following table brings together some of the main proponents and propositions that have attempted to come up with a definition of entrepreneurship. These definitions tend to vary yet a generic theme can be found that runs through them to form a definitive emergence of conceptual characteristics.

Table 2.1: Definitions of entrepreneurship

Definition	Reference	Description
A	van Aardt, van Aardt & Bezuidenhout (2002:4)	<i>Entrepreneurship is the act of initiating, creating, building and expanding an enterprise or organisation, building an entrepreneurial team and gathering other resources to exploit an opportunity in the marketplace for long-term gain.</i>
B	Cronje, du Toit, Marais & Motlatla (2004:40)	<i>Entrepreneurship is the process of mobilising and risking resources (land, capital, human resources) to utilise a business opportunity or introduce an innovation in such a way that the needs of society for products and services are satisfied, jobs are created, and the owner of the venture profits from it. This process includes new as well as existing ventures, but the</i>

		<i>emphasis is usually on new products or services, and new businesses.</i>
C	Kuratiko & Hodgetts (2004:30)	<i>Entrepreneurship is a dynamic process of vision, change, and creation. It requires an application of energy and passion towards the creation and implementation of new ideas and creative solutions. Essential ingredients include the willingness to take calculated risks in terms of time, equity or career, the ability to formulate an effective venture team, the creative skill to marshal needed resources, the fundamental skill of building a solid business plan and finally the vision to recognise an opportunity where others sees chaos, contradiction and confusion.</i>
D	Rwigema & Venter (2004:6)	<i>Entrepreneurship is the process of conceptualising, organising, launching and through innovation nurturing a business opportunity into a potentially high growth venture in a complex, unstable environment.</i>
E	Nieman & Bennett (2006:49)	<i>Entrepreneurship is the emergence and growth of new businesses.</i>

(Adapted from Zindiye, 2007)

From the definitions provided in the table above, it is possible to identify an underlying theme of defining characteristics that make up an understanding of entrepreneurship. Morris and Kuratko (2002:23) put together a table that highlights and individually explains the elements that highlight this underlying theme in a way that creates a rounded understanding of entrepreneurship and what it involves. The table is presented below.

Table 2.2: Themes of Entrepreneurship

Creation of wealth	Entrepreneurship involves assuming the risk associated with the facilitation of production in exchange for profit
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Creation of enterprise	Entrepreneurship involves the founding of a new venture where none existed before.
Creation of innovation	Entrepreneurship is concerned with the unique combinations of resources which make existing methods obsolete
Creation of change	Entrepreneurship involves change, adjusting, adapting and modifying one's personal repertoire, approaches, and skills to meet different opportunities in the environment
Creation of employment	Entrepreneurship is concerned with employing, managing and developing the factors of production, including the labour force
Creation of value	Entrepreneurship is a process of creating value for customers by exploiting untapped opportunities
Creation of growth	Entrepreneurship is defined as a strong and positive orientation towards growth in sales, income, assets and employment

(Source: Morris and Kuratko, 2002:23).

From the table above, it can be seen that attempts to understand entrepreneurship tend to bring out underlying characteristics or points of definition of entrepreneurship, ranging from the creation of wealth, enterprise, and innovation creation, to the creation of growth, value, employment, and change creation. What stands out from the table is the fact that entrepreneurship involves some form of creation, an initiation of a certain kind from a point of opportunity to a point of delivery.

Various approaches have however been proposed in the numerous attempts to come to a definition of entrepreneurship. In earlier studies for example Kuratko and Hodgetts (2001:35) have attempted the definition of entrepreneurship from a schools of thought point of view, an approach that puts entrepreneurship into two frames of reference: the macro viewpoint and

the micro viewpoint. In the macro viewpoint, the entrepreneur is faced with economic forces beyond his control such as financial markets and the business environment, whereas in the micro viewpoint, the entrepreneur is faced with factors to which he has a capacity to control; these are, for example, structural venture orientation and the strategic orientation of the firm (Kuratko and Hodgetts, 2001:35).

Bygrave (1989, cited in Kuratko and Hodgetts, 2001:36) proposed that entrepreneurship can also be understood in terms of entrepreneurial processes which consist of the events approach, the entrepreneurial assessment approach and the multidimensional approach. The entrepreneurial events approach involves individuals planning, implementing and controlling their entrepreneurial activities by focusing on initiative, organisation, administration, relative autonomy, risk taking, and the environment. According to Ronstadt (1984, cited in Kuratko and Hodgetts, 2001:41), the entrepreneurial assessment approach focuses on making assessments in a qualitative, strategic, quantitative and ethical manner in consideration of the entrepreneur, the venture and the environment. Johnson (1990, cited in Kuratko and Hodgetts, 2001:41) presents the multidimensional approach as a multifaceted framework that focuses on the individual, the environment, the firm and the venture process.

As mentioned earlier, however, all these attempts at defining entrepreneurship tend to show an existence of generic characteristics which have been identified by Morris and Kuratko (2002). These are further discussed in the following section which focuses on the generic elements to the definitions of entrepreneurship.

2.3 GENERIC ELEMENTS TO THE DEFINITIONS OF ENTREPRENEURSHIP

2.3.1 Entrepreneurs are risk takers

Risk in entrepreneurial terms can be understood as the solid likelihood of loss or the turnout of less than expected returns from an investment. It is the possibility of one suffering harm, loss or danger from any entrepreneurial engagement. Risk can also be described as the variability of returns from an investment. Very few if any entrepreneurs have managed to fend off failure and, apart from risking money, they also risk their reputation and standing in society. The motivation to take calculated risks is one of the defining characteristics of an entrepreneur. The successful entrepreneurs only take calculated risks and are therefore not gamblers who will risk everything for the possibility of success. They are willing to take

risks, but calculate the risk carefully and thoroughly, and are willing to do everything possible to avoid failure and tip the odds in their favour. The risks inherent in entrepreneurship are both financial and personal. In getting together an entrepreneurial team of co-founders and shareholders, entrepreneurs persuade others to share inherent financial and business risks with them. Creditors and customers are also included, since they might advance credit and payments (van Aardt, van Aardt and Bezuidenhout, 2002:8; Hellriegel *et al.*, 2004:146).

The following four critical risk areas in respect of the entrepreneur are identified (van Aardt, van Aardt and Bezuidenhout, 2002:8-9):

- financial risks;
- career risks;
- family and social risks; and
- emotional risks.

Apart from the financial and personal risks, entrepreneurs also risk resources in the form of capital, land and human resources. In the event of a successful calculation of risk and positive return on investments, risk takers are greatly rewarded or compensated. When pursuing an opportunity, an entrepreneur will risk his or her family, in that less time will be spent with the family due to the demanding nature of the career. Financial risk means the entrepreneur could lose all of his or her money and personal assets should the business venture fail. Failure can also mean that the entrepreneur loses his status in society, especially if the venture goes bankrupt and the personal estate of the entrepreneur is sequestered. Socially the entrepreneur will suffer in that he or she may be excluded in the community due to the myth of entrepreneurship. In the event of failure an entrepreneur's career will be at risk. The entrepreneur may also suffer emotionally in that he or she will be operating in a turbulent and stressful business environment which is full of uncertainties (Nieman & Bennett, 2002:58).

2.3.2 Business opportunity

An opportunity can be described as a situation or condition favourable for the attainment of a goal. It can also be described as a possibility due to a favourable combination of circumstances that bring it to the fore and an occasion offering a possibility or chance. It is a

favourable position, opening, or prospect for advancement or success. An opportunity is also a gap in the market which presents the possibility of new value being created. Opportunities are pursued with innovations, that is, a better way of doing business for a customer. Entrepreneurs are accustomed to new opportunities and are motivated to pursue them (Wickham, 2004:197).

An entrepreneur must be able to identify opportunities in the business environment. Business opportunities are created by the unlimited needs of people and trends that appear in the business environment. A successful entrepreneur is one who has the ability to recognise business opportunities and envision a plan of how to take advantage of it. The identified opportunity must be a real business opportunity in the sense that pursuing it should lead to the realisation of profits on the part of the entrepreneur. Resources are committed to exploit the recognised opportunity according to what demands are identified by the entrepreneur upon assessment of the opportunity. These resources are committed for personal gain. An identified business opportunity must be exploited effectively and timeously as the business environment is ever changing and there are also competitors. Entrepreneurs tend to be people who recognise business opportunities and marshal the necessary resources to exploit the opportunity for personal gain (Wickham, 2004:182).

What is common about most entrepreneurs is that they are constantly searching for new opportunities since they are hardly ever satisfied with their current status. Their strong focus on seeking opportunity means that they become familiar with their industries, customers, competition, and the demands of what it takes to survive and hopefully lead. This implies that entrepreneurs have an intimate knowledge of customers' needs, are market driven and are focused on value creation and enhancement. The most popular pattern has shown that an entrepreneur who has gone through the stages of business growth will seek new opportunities and challenges (Nieman & Bennett, 2002:58).

A common agreement amongst most researchers is that entrepreneurship behaviour involves the taking of tasks in one way or another. In the business world there are variables such as interest rates and currency fluctuations, and new laws which are beyond production and control. The successful entrepreneur is an individual who correctly interprets the risk situation and then determines actions that will minimise the risk. Individuals in the community accept risks in providing products and services for society. Entrepreneurs are

rewarded with profits for the risks they take and the initiative they show, but they suffer losses for errors in judgment (Cronje *et al.*, 2005:43).

2.3.3 A complex and unstable environment

The business environment is unpredictable and hosts a number of variables that each affect the pursuit of entrepreneurial opportunities in one way or the other. The environment that entrepreneurs operate in is very hard to predict. This is due to variables such as continuous changes in government legislations on the operations of businesses and the ever changing customer needs. The entrance of new competitors as a result of globalisation also makes the business environment unpredictable. A successful entrepreneur is the one who is able to understand the environment and exploit the available opportunities. The complexity of the business environment calls for fast and effective decision making and pro-activeness all the time (Hellriegel *et al.*, 2004:102-103).

The effect caused by new entrants in an industry is an example of how complex and unstable the business environment can be for entrepreneurs. Entrepreneurial firms that make an entry into a market usually have the effect of leading to new business development mostly to the extent that some known market competitors would be forced to dissolve due to the increased competition brought by the new firms. As a more indirect effect, the entry of new business into a market and the removal of the older maybe less efficient businesses could lead to better levels of competitiveness and economic growth. It is however difficult to estimate how long it takes, with sufficiently reliable assumption, for these effects to arise. Another known effect of entrepreneurship is that high start-up rates lead to immediate high levels of employment in the new firms. As the years go by however this relationship with employment becomes a negative one as competitive pressure leads some firms to shed labour or even to exit the market. However, with continuous competition and new entry, the net effect is a positive one due to increased competitiveness (van Praag and Versloot, 2007:358).

Organisations find themselves in an environment made up of various macroeconomic features, stakeholders and competitors. This business environment offers resources, but also challenges their availability. The available opportunities offer new possibilities such as new product development and growth in market share whereas threats present the danger that current opportunities may be lost to competition in the future if they are not taken advantage

of in good enough time. The environment is defined by a number of factors such as how complex it is (i.e., how fast it is the environment developing or changing, and how predictable those changes are). As with strategy, the influence of the environment on structure impacts through the way in which decision making is shaped. A known, slow-changing, predictable environment encourages centralised decision making. A new or fast-changing and unpredictable environment encourages decision making to be passed down to those in the organisation who are in contact with the environment (Wickham, 2004:197).

2.3.4 Innovation and creativity

Innovation can be described as a means of exploiting business opportunities. It encompasses the successful exploitation of new ideas or change that creates a new dimension of performance. The term innovation may refer to either radical or incremental changes to products, processes or services. The often unspoken goal of innovation is to solve a problem and it is a major driver of the economy (Wickham, 2004:183).

The business environment demands that a new product or service must be substantially different from what already exists in the market and not just show a mere change. The change in the new product must increase value to customers in a desirable way and produce value in a way that results in positive returns. Innovations are intended to make entrepreneurs more financially secure through the profits they make when they are able to meet customer needs through being innovative and offering products that satisfy customer needs. The succession of many innovations grows the economy. In relation to organisations, innovation may be linked to performance and growth through competitive improvements in efficiency, productivity, quality, competitive positioning, and market share. The more innovative organisations tend to outperform and eventually destroy the organisations that fail to innovate. This is due to the fact that innovative organisations respond to changes in customer needs and wants. The ability to respond to changes in customer needs and wants enhances an organisation's competitive advantage (Nieman and Bennett, 2002:58).

Entrepreneurs have innovative ideas, because business involves new products, new processes, new markets, new materials and new ways of product development. Successful entrepreneurs and small business owners are innovative and creative. Innovation results from the ability to

see, conceive, and create new and unique products, processes or services. Entrepreneurs see opportunities in the marketplace and visualise creative new techniques to take advantage of the identified opportunities. Innovation or the production of new or original ideas and products is usually included in any definition of creativity (Cronje *et al.*, 2005:43).

2.3.5 Vision

Vision describes a desired future position which is usually outlined in the form of a vision statement. A vision statement focuses on tomorrow, it is inspirational, it provides clear decision-making criteria and it is timeless and indicates the ideal direction or guiding philosophy of the firm as well as its future position. The competitiveness of the business environment due to globalisation requires comprehensive forecasting and an insight into the future. Successful entrepreneurs are able to anticipate and properly plan for the future. This requires the entrepreneur to be pro-active all the time. An entrepreneur's expectations mobilises or results in entrepreneurial activity. If the entrepreneurial spirit is absent, the factors of production will not be fully exploited (Cronje *et al.*, 2005:40; van der Walt, Kroon & Fourie, 2004:26).

The entrepreneur's vision is a picture of the new world he or she wishes to create. Vision exists in the tension between what is and what might be. A vision includes an understanding of the rewards that are to be earned by creating the new world and why people will be attracted to it. Vision specifies a destination rather than a route and it is created out of possibilities, not certainties. Vision is an important tool for an entrepreneur as it defines where the entrepreneur wants to go, illuminates why he or she wants to be there and provides direction for how they might get there. It gives shape and direction to the venture (Wickham, 2004:267-269).

2.3.6 Change

Change is a transformation process and organisational change refers to any transformation in the design or functioning of an organisation (Hellriegel *et al.*, 2004:383). Entrepreneurship brings about change, growth and wealth in the economy. Successful nations have entrepreneur-driven economies. An entrepreneur must be flexible and adapt to change in

order to keep in line with the changing trends. The business environment is continuously changing due to globalisation, hence the ability to change is an essential characteristic of a successful entrepreneur. These changes encompass a change in products, change in production methods and change in management styles (Cronje *et al.*, 2005:40).

Entrepreneurs are managers and they manage more than just an organisation, they manage the creation of a new world. This new world offers the possibility of value being generated and made available to the ventures' stakeholders. This value can only be created through change. This change is the way operations are done, change in organisations and change in relationships. It is usually a reward to entrepreneurs for directing their actions in an appropriate way towards an opportunity (Wickham, 2004:267).

2.3.7 Energy and passion

It has been widely noted that people with entrepreneurial talents and skills are able to achieve more than others in mobilising productive resources by starting enterprises that will grow. Entrepreneurship can be described as the initiation that brings the other factors of production such as labour, capital and raw materials into motion. Starting a business venture requires dedication which implies that an entrepreneur must be committed. Successful entrepreneurs are passionate about entrepreneurship and they are energised to put more effort into their business ventures in order to be competitive and ensure its future survival (Cronje *et al.*, 2005:40).

Entrepreneurs strive to achieve goals and measure success in terms of what their efforts have accomplished. Entrepreneurs learn to set challenging but achievable goals for themselves and for their businesses and, when they achieve them, to set new goals. They are driven by the need for achievement. This need energises them and they tend to work hard to achieve their goals. This energy is enhanced through passion. Entrepreneurs are passionate about what they do (Hellriegel *et al.*, 2004:32).

For entrepreneurship to occur there are certain features that must be present. Without these features there will be no entrepreneurship. Section 2.3 below discusses these elements in detail and clearly outlines the extent to which they are important in entrepreneurial activities.

2.4 THE KEY FEATURES OF ENTREPRENEURSHIP

In the study of entrepreneurship, it has been noted that there are certain key elements that are very important for there to be a definition and understanding of entrepreneurial activity. Without these key elements, the possibility of success for an entrepreneur is greatly reduced. Entrepreneurs need to prioritise these elements if they are to record any measure of success in their operations. These elements can be defined as follows:

- the pursuit of opportunities;
- innovation; and
- growth

For entrepreneurship to exist there needs to be the pursuit of opportunities. The business engagements that entrepreneurs pursue exist as opportunities for business before entrepreneurs take them on. The pursuit of these opportunities is made possible by the creativity and innovation that entrepreneurs display in their objectives. Innovation will result in entrepreneurs coming up with new products and services or new and improved production methods. Through the entrepreneur's commitment and determination an entrepreneurial venture will grow. The pursuit of growth in the business venture is one of the defining characteristics of an entrepreneur (Nieman and Bennett, 2002:58). Entrepreneurs are pursuing opportunities to grow a business by changing, revolutionising, transforming, or introducing new products or services. To ensure the growth and development of their business ventures entrepreneurs must be innovative (Wickham, 2004:183).

In order for entrepreneurship to take place there are certain conditions that need to be in place. These conditions are interdependent meaning that they cannot operate independently. First of all, for there to be a direction taken for the exploitation of and later success from an identified business opportunity, there is need for a business plan. The business plan communicates the manner in which the resources, opportunity, and the entrepreneurial team will be harnessed. The exploitation of an opportunity requires resources such as capital and labour. An appropriate structure and a motivated team must be set up in order for an entrepreneurial venture to function effectively and also to be successful. All these aspects are dependent on a founder or lead entrepreneur. While most ventures are started in various ways, they share common features such as (Rwigema & Venter, 2004:25):

- an opportunity focus;
- a business plan;
- resource acquisition and deployment;
- an appropriate structure and a motivated team; and
- a founder or lead entrepreneur.

2.4.1 Opportunity and resources

The survival and success of business ventures rests on the availability of opportunities. One of the defining characteristics of entrepreneurs is the ability to identify opportunities. Entrepreneurs identify opportunities, make an assessment and gather the needed resources which they commit to exploit the identified opportunities. The required resources are determined by the opportunity. It is the norm that the larger the opportunity, the greater the required investment in cash, staff, raw materials, buildings, technical and information technology infrastructure. However, the quality and quantum of resources also determine the degree of opportunity realisation (Rwigema & Venter, 2004:25; Longenecker *et al.*, 2006:55).

What the above argument illustrates is the importance of a strong resource base for the success of any business venture. It also points to adequate funding as a necessity for an individual to start a business. The discovery of an opportunity also entails calculated risk taking as a large number of resources are required to convert the opportunity into an operating business. Opportunity and resources are intertwined, i.e. they work together to ensure the success of an entrepreneur. This is due to the fact that without both an opportunity and the required resources, the business venture will fail. The availability of resources such as human resources, financial resources, buildings and equipment without an opportunity to exploit will not result in entrepreneurship.

2.4.2 Opportunity and the team

As mentioned above, the link between opportunity and the implementing team is similar. Diversified talent is required for large and dynamic opportunities. A balanced team must be

established, that is, the educational background and experience of individuals involved in the business will determine the success of the business venture. Where skills are absent or insufficient, opportunities may be forgone, under-exploited or delayed. The education background and skills possessed should be in line with the demands of the entrepreneurial venture. Furthermore, a proactive entrepreneurial team is likely to achieve more than a timid, bureaucratic team. This implies that a team work approach is important for the success of an entrepreneurial venture, as the team complement each other in terms of skills and expertise such as financial management, selling and marketing management skills (Rwigema & Venter, 2004:25-26; Longenecker *et al.*, 2006:11, 55).

It can be noted from the above paragraph that the success of any venture highly depends on the entrepreneurial team's ability and knowledge levels. Therefore, it is of great importance for an entrepreneur to ensure the establishment of a balanced team in terms of expertise before committing the resources to ensure the long term success and survival of the enterprise.

2.4.3 Resources and the team

It is important that a positive relationship exists between resources and the team, which itself is a resource. There needs to be a complementary relationship between the team and the resources. The other factors of production such as capital and raw materials are utilised by the team and the team cannot function where there are no other resources. The management team determines the relevance and necessity of other resources in the entrepreneurial process. It is the responsibility of the team to manage available resources in a professional and efficient manner. It is for reasons such as this why members of a team should possess sound managerial skills such as financial management, marketing management, human resources management, technical and people skills. These skills are required for the survival, growth and development, and success of an entrepreneurial venture. Moreover, a motivated and skilled team can compensate for inadequate financial and physical resources through their level of commitment. However, limited resources inhibit (in the short term at least) the efficacy of even an ambitious team. Limited resources can also impair the ability of a management team to be efficient and successful. A lack of resources will result in the entrepreneurial team not implementing specific effective strategies which can result in the

limited success of a business venture (Rwigema & Venter, 2004:26; Longenecker *et al.*, 2006:11-55).

Planning and organising are some key success factors for any entrepreneur. The available resources may be fully utilised through effective planning to achieve the goals of the enterprise. A proper plan of action to be followed must be drafted and implemented efficiently. It should be in the form of a business plan. The objectives and goals to be achieved must be set and control mechanisms must be established. Controlling is important as it ensures the achievement of the set objectives and to take corrective action if the need arises (Griffin, 2005:652-653).

Against this background it is important for an entrepreneur to put in place a good management team to ensure the success of his or her business venture. This management must be in a position to always strive to keep the whole team motivated. A motivated team will increase the productivity of the enterprise which in turn will lead to the growth and development of the business venture.

2.4.4 The entrepreneur as the anchor of all the elements

Bridge, O'Neill and Cromie (1998:26) describe the entrepreneur as a person with "unique values, attitudes and needs that drive them". His or her behaviour is said to be influenced by risk, a need for achievement, and personal values which thrive in the start-up phase of an entrepreneurial venture. In addition, the entrepreneur when described in this way thrives in the start-up phase of the business because of their strengths in self esteem and intuition (Bridge, *et al.*, 1998:26). The entrepreneur is seen as the galvanising force behind the business venture and is responsible for the blending of an opportunity, resources, and the entrepreneurial team to produce a new or distinctive product or service in the marketplace, to add value in the face of dynamic competition and a volatile environment. In a highly competitive world continuous innovation is required in order to maintain a competitive edge. Entrepreneurs are adept networkers and readers who keep themselves abreast of developments. Building a sustainable, high growth venture that meets market needs demands alertness and continual innovation. Products, processes and skills must keep up with market

tastes and economical, cultural, technological and other changes (Rwigema & Venter, 2004:26).

Entrepreneurs also act as agents of change. According to Bridge, *et al.*, (1998:26), the 'management' school of thought suggests that "entrepreneurs are organisers of an economic venture" who also assume a level of risk to manage it. The management school of thought proposes that the entrepreneur can perform at a high level in the start-up or early growth phase of a business venture. Managing change as the business grows implies anticipating, executing, and monitoring it. This requires proactive engagement with the external environment from which opportunities, resources, and the entrepreneurial team emanate. The entrepreneur must also exercise leadership in raising capital and needs a business plan for this. The business plan is necessary as it clearly articulates the marketing strategy to be adopted and describes the product (Bridge, *et al.*, 1998:26, Hellriegel *et al.*, 2004:35, Rwigema & Venter, 2004:26).

A successful entrepreneur is one who can identify opportunities and come up with effective plans on how to go about taking advantage of them. Timmons (1999:45) describes this type of entrepreneur as one who demonstrates high levels of creativity and innovation on the one hand and good management skills, business knowledge and networks on the other. The identified opportunities must be weighed to determine how feasible they are and a plan to exploit the opportunity must be put in place. This plan must be supported by adequate resources such as capital and human resources. The effective entrepreneur makes an 'opportunity-organization' fit assessment once the opportunity is identified. This defines the organizational structure, processes and culture, thereby leading the organization to form its shape to fit the identified opportunity (Wickham, 1998:28). As entrepreneurs act as agents of change, they turn threats into opportunities. This is only possible if an entrepreneur is able to adapt to change by being flexible. Flexibility implies the ability to adapt to change be it change in products or change in production methods. Due to the competitive nature of the business environment and the complexity which characterizes it, fast decision making and quick implementation of decisions will result in the success of the entrepreneur.

Entrepreneurship is important worldwide. It is a vehicle for economic growth and development. Unemployment levels can be reduced through entrepreneurship. Hence entrepreneurs are important as they aid in poverty alleviation and improvement in standards

of living. The importance of entrepreneurship in the developing world is discussed in the section below.

The following two sections are a direct extract from the work done by Stan Zindiye (2008) on the topic in his study on entrepreneurship. They will discuss the importance of entrepreneurship in the developing world and the myths that have in the past and continue to surround entrepreneurship.

2.5 THE IMPORTANCE OF ENTREPRENEURSHIP IN THE DEVELOPING WORLD

Some of the main challenges being faced by most of the developing countries are the high rate of unemployment, closure of big companies which results in job losses and decreased standards of living. Most of the developing world is poverty stricken and people do not have enough disposable income to purchase the basic necessities. One of the more prominently proposed solutions to all these challenges is the pursuit of entrepreneurship. Entrepreneurship allows for more employment opportunities to be created which results in improved standards of living. This is due to the fact that through employment from entrepreneurial ventures, individuals will have disposable income and will be able to purchase goods and services. The poverty levels will also be reduced as a result of entrepreneurship (Steinhoff & Burgoss, 1993:4, 11; Rwigema & Venter, 2004:9-12).

Entrepreneurship is one of the most important drivers of local economic development. New firm formation and the activities of SMEs help drive job creation and economic growth through accelerating innovation and promoting the full use of human, financial and other resources. The vitality of the new and small firm sector is therefore a major determinant of local competitiveness, whilst low local economic performance, in this respect, influences national economic performance. Local economic performance refers to a country's economic activities at societal level. National economic activities are the total activities in the whole country which enables it to compete on a global level (OECD, 2005:1). A discussion of the importance and role of entrepreneurship in economic development follows below.

2.5.1 Entrepreneurship and economic development

The majority of the world's booming economies are the result of a vibrant entrepreneurial sector. The economic prosperity of the United States of America is mainly due to the embracing of the concept of entrepreneurship. Entrepreneurs take advantage of new wealth-creating opportunities that arise daily from constant change. The spirit of entrepreneurship transforms most countries' businesses and society through economic growth, improved standards of living and poverty reduction.

2.5.2 Entrepreneurs create new employment opportunities

The rapid development of the entrepreneurial economy has helped soften the pain of disappearing jobs by creating new jobs to replace those that are lost. Since 1980, the US has added 34 million new jobs. When entrepreneurs are able to create even more jobs than are eliminated due to the closure of big companies, they cut unemployment rates, ensure that less people depend on welfare since they are employed, and help to drive up wages (Anon, 2004:4). SMEs represent about 98% of domestic business activity in Brazil. This implies that 60% of the urban population and 45% of the formal labour force is employed in entrepreneurial firms (Best, 2005:1).

Small businesses play an important role in economic development in both developed and developing countries. Not all small-scale businesses are entrepreneurial, but collectively they make a significant economic contribution. It is among the larger but still small-scale ventures that employment prospects are more promising. In South Africa, 338 000 enterprises employed 734 000 people in 2001, an average of 2.2 employees per enterprise. Based on these figures and the current trend it can be stated that over three million employees (including the self-employed) are working in the small and micro enterprise sector in South Africa. This amounts to nearly 30% of the 10.8 million people employed in South Africa in 2001 (Statistics SA, 2001:1).

The above paragraph clearly highlights the role of entrepreneurship with specific reference to small businesses in employment creation. Small businesses must therefore be fully supported by the government and other entrepreneurial agencies as they have the potential to ease the

unemployment problems being faced by developing countries such as South Africa. Failures to support small businesses and without a continuous supply of entrepreneurs the developing countries are likely to stagnate and decline economically.

The problem of high unemployment rates can therefore only be addressed through entrepreneurship. The role of entrepreneurship in employment creation is clearly illustrated by the case of America. In America unemployment is not a major economic challenge as the culture of entrepreneurship has been embraced and is thriving. The backbone of Thailand's economy is entrepreneurship as it currently has 32 000 registered new enterprises (Best, 2005:2).

2.5.3 Entrepreneurs create economic growth and new wealth for reinvestment in the country

Experience in many countries has shown that successful entrepreneurial activity is very important for a healthy market economy and can, specifically, be a major source of job creation. In third world countries and in under developed economic societies, job creation is a high priority. This is true of many countries in Sub-Saharan Africa. Entrepreneurship and the encouragement of this kind of activity are therefore important in these countries. Schumpeter (1934) described entrepreneurship as the driving force behind the economy. Shapero (1985) referred to entrepreneurship as a means of creating diversity, innovation, development and independence by individuals in society (Bester, Boshoff & van Wyk, 2003:1).

One country that can be used as a reference is Thailand. Entrepreneurship has long been the main vehicle of Thailand's economic growth. The Thailand government and other related agencies have initiated several projects and activities to help strengthen and promote entrepreneurship. This has been necessitated by the realisation that economic growth can be achieved through entrepreneurship. Thailand has one of the highest rates of women entrepreneurship activity among Global Entrepreneurship Monitor (GEM) countries, which stood at 18.5% in 2002 (Best, 2007:2). This is a clear indicator that a large percentage of the population is employed by entrepreneurial firms and economic growth is as a result of these firms.

The economic growth generated by entrepreneurial companies is the core engine of a “virtuous cycle.” A virtuous cycle is a condition in which a favourable circumstance or result gives rise to another that subsequently supports the first. Successful entrepreneurs, through their breakthrough technologies and rapidly growing businesses, create new wealth that can generate even greater economic growth. For successful entrepreneurs to reinvest some of their wealth, in other new entrepreneurial ventures, they invest with friends or family members (informal investments), through local investment networks (“angel” investments), and through organized venture capital firms. Angel investors are investment managers who provide high yield investment advice (Anon, 2004:5).

Entrepreneurs are goal driven and they are achievement oriented. Reinvestment is important in the economy and on the part of an entrepreneur. Through continual investments small business owners will move from being survivalists into large companies which are globally competitive. Reinvestment should be encouraged as it results in more job opportunities for people.

2.5.4 Entrepreneurs improve a country’s global economic competitiveness

Finding opportunities in change, entrepreneurs have pushed US companies into dominating positions in critical global industries such as the internet, biotechnology and pharmaceuticals. The most successful economies will be those where established industries rapidly adjust to changes in the global environment. By their very nature, entrepreneurs see ways to make the economy more adaptable. They do not do business “the way it has always been done” but rather make changes and introduce intense levels of competition into even established industrial sectors (Acs, 2006:101).

Due to globalisation the world has become a global village. Intense competition is now being witnessed in terms of business activities as a result of trade liberalisation (free trade). The economies which are able to survive this level of competition are the ones that are entrepreneurial driven. This is due to the fact that entrepreneurs are creative and innovative and they are able to offer customers the right products to suit their needs. Being in a position to compete will help to improve the standards of living of people in a specific country since quality products are offered at affordable prices.

Entrepreneurs have helped shape American companies into formidable international competitors. This is due to the fact that they have formed new companies and industries to take advantage of global change. As many entrepreneurs build their companies on new technologies and communications systems, they feel as comfortable selling their products and services internationally as they do in the USA. Small firms are becoming America's most successful exporters, showing the fast growth rates in terms of export value and the number of exporting companies (Anon, 2004:5).

According to Qiangui (2002) the number of SMEs in China had exceeded eight million, which results in a larger percentage of the population being employed in entrepreneurial ventures. The industrial output and export volume of these SMEs make up 60% of China's total Gross Domestic Product (GDP). SMEs which make up 99% of all enterprises in China are a vital force for the sustainable development of the Chinese economy.

Small businesses with fewer than 500 employees make up nearly 97% of all US exporting firms, and their importance is growing. Between 1987 and 1997, the number of these small company exporters tripled. Between 1992 and 1997 the value of small company export dollars also tripled to \$171, 9 billion. Companies with fewer than 20 employees have been the most successful exporters. They are the fastest growing both in numbers of exporters and in numbers of export dollars (Anon, 2004:5).

Entrepreneurship brings foreign currency through exports. This is important in that parts and raw materials which require foreign currency can be easily acquired. A favourable balance of payment and balance of trade will be maintained through exports because the country will have more exports as compared to imports and this is a healthy economic situation. This clearly shows the importance of entrepreneurs and the economic role which is played by entrepreneurship. The section below discusses the societal contributions and significance of entrepreneurship.

2.5.5 Entrepreneurship and society

Entrepreneurship is an important aspect of the society as it brings societal development and helps in the alleviation of poverty within the society. Although they face risks, entrepreneurs discover innovations to exploit opportunities. This results in the building and growth of entrepreneurial ventures. A discussion of the role of entrepreneurship in society follows below.

2.5.6 Entrepreneurs use innovation to improve the quality of life of citizens

Entrepreneurs use innovations to improve the quality of life of a society's citizens. They create new technologies, new products, and new services that multiply the choices and enrich the lives of individuals. People's lives are enriched in that it is made easier, innovation makes individuals more productive at work, and they are entertained in new ways, improving their health, helping people to communicate better with one another and in other countless ways through technological changes. As a result of the established entrepreneurial ventures the quality of life of the entrepreneur is enhanced. Entrepreneurial ventures provide an enhanced quality of life to employees, customers, and the community (Marcketti, Niehm & Fuloria, 2006:241-259).

Through innovation efficient and effective methods of performing tasks in the work place can be adopted. These will in-turn result in increased productivity. An increase in productivity will lead to increased chances of survival, growth and competitiveness of companies. The advent of the internet has also made communication simple and easy. The emergence of computers and the internet is mainly as a result of the innovativeness of entrepreneurs.

Small entrepreneurs lead the way in developing ideas. They are responsible for more than half of all innovations. In America 67% of inventions and 95% of radical innovations since world war two are attributed to the innovativeness of entrepreneurs. In addition to bringing particular inventions to the market, entrepreneurs have created whole new industries that are integral parts of people's daily lives. New industries that did not exist a generation ago include personal computing, voice mail, cellular phones, fast oil changes, internet shopping, convenience foods, superstores, and digital entertainment. Entrepreneurs often bring new

products and services when larger companies lack the vision or interest to bring innovations to the market (Anon, 2004:3-4). The importance of innovation in entrepreneurship is clearly outlined above. Entrepreneurs highly depend on innovation to succeed and be competitive in a turbulent and globalised business environment.

2.5.7 Entrepreneurs are involved in socio-economic programs

Entrepreneurs require the support of society to ensure the success of its entrepreneurial activities. To obtain such support, entrepreneurs are involved in activities where they sponsor community development projects. For example, they can carry out clean-up campaigns or they can donate medication for the needy in society. Entrepreneurs may also sponsor youth activities through sports so that they can cultivate a culture of responsibility among the youth. Social responsibility will lead to a closer relationship between the entrepreneur and the communities in which they operate. This cordial relationship is helpful in that the entrepreneur will receive the necessary support that he or she requires for the success of their business ventures and loyalty can also be achieved. Entrepreneurship plays a significant role in the educational system and the section below outlines the relationship between entrepreneurship and education.

2.5.8 Entrepreneurship and education

In industrialised countries, entire schools exist for entrepreneurship. Entrepreneurship is increasingly being taught as a stand-alone module or as a major subject. As a result of the spread of capitalism and globalization, entrepreneurship continues to gain importance. Due to globalisation entrepreneurs are being exposed to competition worldwide. As tariffs reduce and trading spills national borders, survival will depend upon the creativity of a country's entrepreneurs (Rwigema & Venter, 2004:10).

Globalisation has resulted in intense and fierce competition in the world market. The world is slowly becoming a global village and as a result of this it is now difficult for people to secure employment. This is due to the fact that employment in the formal sector declines and companies are increasingly outsourcing work to countries with cheap labour. Therefore it

becomes imperative to teach entrepreneurship in schools in order to prepare people for the future. The entrepreneurial spirit can be instilled into people at an early age thereby encouraging them to be innovative and creative. Through innovation and creativity more jobs can be created which will help in improving the standard of living of people as they will be having disposable income. Innovation and creativity will also lead to economic development and growth, since more business ventures will be established through entrepreneurship.

2.5.9 Entrepreneurship and the political environment

The impact of change and the need for entrepreneurship is pertinent in education, sport, charity work and in virtually every aspect of life, including politics. Coping with change, although stressful, is potentially rewarding. Those who analyse the situation accurately and reposition strategically, change the odds in their favour. Opportunities are present in all spheres even where there are threats. For example, in the United States and other industrialised western nations, parties are run on business principles, parlaying their leaders as marketable 'products' (Rwigema & Venter, 2004:12).

Those organisations and politicians who continually apply entrepreneurial skills will have a competitive edge as compared to those who cling to the status quo. This therefore means that there is a need for change in the way different entities operate because in today's business world there is no room for inertia. Entrepreneurial leadership therefore remains relevant in the political arena, non-profit organisations and social and cultural ventures. In short, entrepreneurship is pertinent to every endeavour. Its principles apply wherever people aspire to manage change.

The above discussion is aimed at highlighting the role played by entrepreneurship in economic development and the significance of entrepreneurship. For organisations, both profit making and non-profit making, to survive, grow and develop they need to embrace entrepreneurship. Entrepreneurship enhances the competitiveness of businesses as they operate according to international standards due to the global nature of the business environment. It is universally relevant to all business and must be fully integrated into their operations as it is the cornerstone of the growth and survival of organisations. Without entrepreneurship the lifespan of many businesses will be shortened.

2.6 A MYTHICAL FOCUS ON ENTREPRENEURSHIP

Entrepreneurship is a very important aspect for economic growth and development. The challenge of unemployment can be solved through engaging in entrepreneurial activities. Although entrepreneurship is important there seems to be a lack of knowledge with regard to it. People do not understand entrepreneurship which has given rise to the different myths surrounding entrepreneurship as discussed below.

The different myths surrounding entrepreneurship portray people's ignorance of entrepreneurship. The myths stifle the emergence of entrepreneurs as they are discouraged from undertaking entrepreneurial activities. When talking about entrepreneurs, people tend to stereotype them, and entrepreneurship is often referred to as a characteristic that leads to underhandedness, for example, a student who sells his or her tasks or test papers to others to generate income. An analysis of the following authors' work on entrepreneurship, Van Aardt *et al.*, (2000:10:12); Kuratiko & Hodgetts (2004: 30-33); Cronje *et al.*, (2005:40) and Nieman & Bennett (2002:58), identifies popular myths about entrepreneurs, namely:

2.6.1 Entrepreneurs are doers, not thinkers

Although it is true that entrepreneurs tend towards action, they are also thinkers. Indeed, they are often methodical people who plan their activities carefully. The emphasis is today on the creation of clear and complete business plans which is an indication that "thinking" entrepreneurs are as important as "doing" entrepreneurs.

The ability to think is a requirement for an individual to be a successful entrepreneur. This is being necessitated with the emergence of competition which has resulted in products being similar. For an entrepreneur to be successful under competitive conditions innovation is therefore essential since it is a product of creative thinking (Van Aardt *et al.*, 2000: 10:12, Kuratiko & Hodgetts, 2004: 30-33, Cronje *et al.*, 2005:40, and Nieman & Bennett, 2002:58).

2.6.2 Entrepreneurs are born, not made

The idea that the characteristics of entrepreneurs cannot be taught or learned, that they are innate traits an entrepreneur must be born with, has been prevalent for a long time. These traits include aggressiveness, initiative, drive, a willingness to take risks, analytical ability, and skill in human relations. Today, however, the recognition of entrepreneurship as a discipline is helping to dispel this myth. There exist models, processes and case studies in entrepreneurship to be studied and knowledge to be acquired. These are available so that the concept of entrepreneurship can be better understood.

While entrepreneurs are born with certain native intelligence, a flair for creating, and energy for innovation, these talents in themselves are like unmoulded clay or an unpainted canvas. The making of an entrepreneur takes place by accumulating the relevant skills, know-how, experience and contacts over a period of years and includes large doses of self-development. The creative and capacity to envisage and then pursue an opportunity is a direct descendant of ten or more years of experience that have led to pattern recognition (Van Aardt *et al.*, 2000: 10:12, Kuratiko & Hodgetts, 2004: 30-33, Cronje *et al.*, 2005:40, and Nieman & Bennett, 2002:58).

2.6.3 Entrepreneurs are always inventors

The idea that entrepreneurs are inventors is a result of misunderstanding by people. Although many inventors are also entrepreneurs, numerous entrepreneurs encompass all sorts of innovative activity. Entrepreneurship encompasses innovation and creativity. It requires a complete understanding of innovative behaviour in all forms. For entrepreneurs to survive they must be innovative; this may be by introducing new products or services or improved efficient and effective methods of production.

Due to the competitive nature of the business environment innovative entrepreneurs have a competitive advantage. This is the result of products that are becoming similar in nature hence there is a need for innovation and creativity in order to differentiate the products of a business from those of its competitors (Van Aardt *et al.*, 2000: 10:12, Kuratiko & Hodgetts, 2004: 30-33, Cronje *et al.*, 2005:40, and Nieman & Bennett, 2002:58).

2.6.4 Entrepreneurs are academic and social misfits

The belief that entrepreneurs are academically and socially ineffective is a result of some business owners having started successful enterprises after dropping out of school or quitting a job. This, however, is not always the case, as entrepreneurship is a skill which must be acquired and it is also one of the factors of production. Entrepreneurship is that spark that brings the other factors of production into motion.

The availability of labour, capital and raw materials without the entrepreneurial spirit will not result in entrepreneurship. An entrepreneur utilises all other factors of production and the success of a business venture depends on how entrepreneurial an individual is. This being the case, an entrepreneur complements and completes the factors of production (Van Aardt *et al.*, 2000: 10:12, Kuratiko & Hodgetts, 2004: 30-33, Cronje *et al.*, 2005:40, and Nieman & Bennett, 2002:58).

2.6.5 Entrepreneurs must fit the profile

Many books and articles have presented checklists of characteristics of the successful entrepreneur. These lists were based on case studies and on research findings among achievement-oriented people. This means that studies about entrepreneurs were carried out and they tend to exhibit the same characteristics such as energy, passion and an achievement orientation. Today it has been realised that a standard entrepreneurial profile is hard to compile. The environment, the venture itself and the entrepreneur have interactive effects, which result in many different types of profiles.

Due to the ever changing trends in the business environment, it is currently difficult to develop unique characteristics that define an entrepreneur. It depends on how well an entrepreneur exploits the opportunities in a complex and unstable environment. This is due to the fact that the survival of an entrepreneurial venture now depends on the flexibility of the entrepreneur, i.e. the ability to adapt to change and meet customer needs and expectations (Van Aardt *et al.*, 2000: 10:12, Kuratiko & Hodgetts, 2004: 30-33, Cronje *et al.*, 2005:40, and Nieman & Bennett, 2002:58).

2.6.6 All an entrepreneur needs is money

It is true that a venture needs capital to survive, it is also true that a large number of business failures occur as a result of a lack of adequate financing. However, having money is not the only hedge against failure. Failure due to a lack of proper financing is often an indicator of other problems. These problems include managerial incompetence, a lack of financial understanding, poor investments, and poor planning. Many successful entrepreneurs have overcome the lack of money while establishing their ventures. To those entrepreneurs, money is a resource, but never an end in itself. Proper planning, management and organising are essential elements in the survival of an entrepreneurial venture and must be combined with proper financing (Van Aardt *et al.*, 2000: 10:12, Kuratiko & Hodgetts, 2004: 30-33, Cronje *et al.*, 2005:40, and Nieman & Bennett, 2002:58).

2.6.7 All an entrepreneur needs is luck

In the business environment the concept of “luck” is not applicable, since the success of an entrepreneur depends on his or her preparedness to exploit any opportunity that might arise. Prepared entrepreneurs who seize an opportunity when it arises will always have a competitive edge over the others. This is due to the fact that they take the initiatives ahead of competitors and they establish the new product first. They are in fact simply better prepared to deal with situations and turn them into a success. Successful entrepreneurs are quick to realise an opportunity and exploit it before competitors. What appears to be “luck” is preparation, determination, desire, knowledge and innovativeness.

Entrepreneurship is not built on “luck”, but it is a characteristic that is possessed by a few individuals. It depends on an individual’s ability to exploit the other factors of production such as capital, labour and raw materials. These factors are utilised to exploit an identified business opportunity which is one of the key determinant characteristics of successful entrepreneurs (Van Aardt *et al.*, 2000: 10:12, Kuratiko & Hodgetts, 2004: 30-33, Cronje *et al.*, 2005:40, and Nieman & Bennett, 2002:58).

2.6.8 Ignorance is bliss for entrepreneurs

The myth that too much planning and evaluation lead to constant problems, that over-analysis leads to paralysis does not hold up in today's competitive markets, which demand detailed planning and preparation. Identifying a venture's strengths and weaknesses, setting up clear timetables with contingencies for handling problems and minimising these problems through careful strategy formulation are all key factors for successful entrepreneurship. Thus careful planning is the mark of an accomplished entrepreneur (Van Aardt *et al.*, 2000: 10:12, Kuratiko & Hodgetts, 2004: 30-33, Cronje *et al.*, 2005:40, and Nieman & Bennett, 2002:58).

2.6.9 Entrepreneurs seek success, but experience high failure rate

It is true that many entrepreneurs suffer a number of failures before they are successful. In fact, failure can teach many lessons to those willing to learn and often leads to future successes. Due to the energy, passion and commitment of entrepreneurs they are able to turn failures into success. Entrepreneurs are not easily discouraged and they are achievement oriented and always motivated to succeed. A belief in themselves (i.e. self-belief) is necessary to succeed, but that failure can lead to success in the future (Van Aardt *et al.*, 2000: 10:12, Kuratiko & Hodgetts, 2004: 30-33, Cronje *et al.*, 2005:40, and Nieman & Bennett, 2002:58).

2.6.10 Entrepreneurs are extreme risk takers (gamblers)

Risk is a major element in the entrepreneurial process. However, the public's perception of the risk most entrepreneurs assume is distorted. Although it may appear that an entrepreneur is taking risks, the fact is the entrepreneur is usually working on a moderate or "calculated" risk. Entrepreneurs usually commit resources after calculating their chances of success. Most successful entrepreneurs work hard through planning and preparation to minimise the risk involved in order to better control the destiny of their vision.

Successful entrepreneurs take very careful, calculated risks. They attempt to influence their chances of success positively by getting others to share their risk with them and by avoiding or minimising risks if they have the choice. Often they slice up the risk into smaller pieces and only then do they commit the time or resources to determine whether that piece will

work. They do not deliberately seek to take more risks or take unnecessary risk, nor do they shy away from unavoidable risks.

These ten myths have been presented to provide a background for today's current thinking on entrepreneurship. By sidestepping these myths, a foundation can be built for critically researching the contemporary theories and processes of entrepreneurship. Entrepreneurship is important world wide as a vehicle for economic growth and development. Unemployment levels can be reduced through entrepreneurship and entrepreneurs are important as they aid in poverty alleviation and contribute to improvements in the standards of living (Van Aardt *et al.*, 2000: 10:12, Kuratiko & Hodgetts, 2004: 30-33, Cronje *et al.*, 2005:40, and Nieman & Bennett, 2002:58).

2.7 SUMMARY

There is no single definition of entrepreneurship due to the fact that there are a lot of factors that constitute what goes into defining an entrepreneur. This chapter has shown that some of the main characteristics that define entrepreneurship are creativity, risk taking, vision, change and passion. It has been shown that the combination of these characteristics defines an entrepreneur whereas the elements of entrepreneurship were mentioned to be the pursuit of happiness, innovation and growth. These aspects gave a rounded understanding of what an entrepreneur was before the contributions of entrepreneurs to the developing world were highlighted. A mythical interpretation of entrepreneurship was then shared to identify the common mistakes that people make when attempting to understand entrepreneurship.

The following chapter will explore the various issues that come with securing start-up capital for entrepreneurs and the aspect of entrepreneurship. The chapter will discuss collateral and personal commitment, information asymmetry and credit rationing, bank-small firm interaction and the various lending decision criteria used by banks before exploring the importance of entrepreneurship and the small business sector to South Africa.

CHAPTER 3
START-UP CAPITAL AND
ENTREPRENEURSHIP

3.1 INTRODUCTION

A stumbling block faced by many emerging entrepreneurs is start up capital (Abor and Biekpe, 2006:69; Hernandez-Trillo, Pagan and Paxton, 2005:435). Some reasons advanced for this finance gap include:

- a lack of access to funding or unfavourable funding conditions;
- a high degree of information asymmetry between providers of finance and borrowers;
- the perceived higher risk of small business;
- the term structure of finance available to such businesses;
- lack of assets that can be used as collateral; and
- the high transaction costs. (Abor and Biekpe, 2006:69; Brewer, 2007:43; Amit, Glosten, and Muller, 1990: 107; Hernandez-Trillo *et al.* 2005: 435; Timmons and Sander, 1989: 72; Tucker and Lean, 2003: 51).

Conventional funders such as banks have also tended to grant fewer loans although there are good credit risks in the market (Tucker and Lean, 2003:51, van Osnabrugge and Robinson, 2000:23). The following chapter will expand further on the start up capital issues highlighted above, giving a more in depth insight into the factors that affect a funding decision and/or the process of securing funding for a small business in the start up phase. It will start off by focusing on the case of collateral and personal commitment and how it affects the possibility of securing funding or not and how it determines the kind of funding that an entrepreneur may be able to attain. It will then further go on to speak of the problem of information asymmetry, highlighting adverse selection and moral hazard as borrower side issues of information asymmetry surrounding the funding relationship and finally, discussing credit rationing as an investor side hindrance to the funding relationship. The following section describes the area of focus of the chapter.

3.2 AREA OF FOCUS

The start-up phase of a business is the stage in which a business idea first becomes a commercial product or service made available to a group of customers by an entrepreneur who has been driven far enough to turn his or her dream into a business reality. It is the stage in which a business idea becomes a business offering wherein customers give the first response to the market research and marketing done in order to commercialise the business

idea. This is normally the first two years of a business idea being offered to a market, the stage in which an actual company is built from this idea provided the necessary financial and other resource support is sought after and provided in the desired amounts (Gillis, 1997: 13). The two used forms of start-up funding are discussed in the following section, which are debt and equity finance.

3.3 DEBT AND EQUITY FINANCE

The two main sources of finance available for uses by entrepreneurs are debt and equity finance. The main difference between these types of finance is the role of the financier. With regard to debt financing, the financier maintains an inactive role where the management of the business is concerned whereas with equity financing, the financier takes up an active management role and becomes part of the control of the business. When using debt finance, the entrepreneur assumes continued control over the business even though he or she is restricted to raising funds that are linked to the amount of security available. Although the costs of debt finance are lower and the repayments remain fixed, the business remains exposed to liquidity problems due to the high gearing structure and the profitability is reduced because of servicing high debt costs. In addition to this, the enterprise risks an increased exposure to financial risks because of movements in the interest rates (Victoria Government, 1998, in Musengi, 2003:61).

Equity financing provides the small firm flexibility in raising funds in excess of security available but this comes at the expense of 100 per cent control and autonomy in decision-making with greater management reporting needed and the possibility of increased conflicts between the owner and the financier. Where the entrepreneur opts out of debt finance, the enterprise reduces exposure to interest rates increases and improves purchasing power because of increased liquidity. However, additional costs for acquiring equity exist and there may be a delay in raising the equity resulting in lost business opportunities. Although the advantages and disadvantages of each form of finance discussed here are not exhaustive, however, they provide insight into the dilemma the entrepreneur faces in making finance decisions (Victoria Government, 1998, in Musengi, 2003:61).

A 2002 GEM study revealed, from interviews with 360 disadvantaged entrepreneurs in the provinces of Gauteng and KwaZulu Natal and the cities of Port Elizabeth and Cape Town,

that a significant number of applicants for external finance had been successful in obtaining this. The following table presents firstly the source of finance sought by the entrepreneurs and secondly, the success rate of obtaining finance.

Table 3.1 Successful applicants for start-up finance.

Source of finance	Percentage of entrepreneurs applying for finance	Percentage of applicants who were successful	Percentage of successful applicants who accepted the offer	Percentage of all entrepreneurs who received finance
Bank Loan	84.4	25.0	85.2	18.0
Bank Overdraft	18.8	62.5	76.7	9.0
Credit Card	2.3	83.3	60.0	1.2
Micro-Lender	3.1	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: 40 in Musengi, 2003: 62).

From the above table it can be seen that the most common source of external finance used by entrepreneurs was in the form of a bank loan followed by an overdraft. What is of significance is that of the 84.4 per cent who applied for bank loans only 25 per cent were successful compared to 62.5 per cent of entrepreneurs who successfully obtained bank overdraft facilities. In terms of the way small business funding is structured it would be safe to suggest that banks offer overdraft facilities more readily because of the minimized exposure to risk for the bank. As can be seen from the table above, this risk avoiding tendency reduces the number of loans given out and presumably the number of loans applied for by entrepreneurs with time. Since the bank loan is the more ideal option for entrepreneurs, most of whom may not hold accounts with the banks in question to take out overdrafts, the bank becomes less of an option when seeking start up finance. This means that business

angels exist as the more viable option for finance in the start up phase as they are more willing to give loans to entrepreneurs than banks (Fletcher, 1995 in Musengi, 2003:62).

The following section will discuss of the case of collateral and personal commitment with regard entrepreneurs putting forward security for the funds they require.

3.4 THE CASE OF COLLATERAL AND PERSONAL COMMITMENT

Raising capital for a start up is considered to be one of the most demanding tasks of getting a business to become active. It is considered to take up the most time and creative energy that business founders can commit to starting up their businesses (Timmons and Sander, 1989:70). In addition to all the strain involved in securing funding, the process itself is said to have a high disappointment rate after months of dedication, draining most entrepreneurs to a point where they have very little or any energy left to run the business efficiently as money keeps going out rather than coming into the business (Timmons and Sander, 1989:71). The performance of the entrepreneur is said to suffer in one way or the other, resulting in customers sensing some form of neglect, even if this is not the intention, sales flatten or drop, and profits are low as a result of all of this and various other out-of-pocket costs such as printing important and other business related documents and getting a lawyer or an accountant for the business (Timmons and Sander, 1989:71).

The first check that lenders tend to make when considering a funding opportunity is that of the personal wealth that the entrepreneur is either prepared or capable of committing, and the collateral the borrower is prepared to tie to the investment as security for the investor (Avery, Bostic, Samolyk, 1998:1026). The collateral serves as a security and the personal wealth serves a form of guarantee. When dealing with risky borrowers, lenders are said to generally prefer borrowers who can offer an agreed upon level or form of personal commitment in order to secure their claims. Such lenders are also said to require guarantees especially when the value of the personal assets committed and/or collateral is uncertain (Avery *et al.*, 1998: 1026). Where possible however, it has been noted that the more attractive borrowers have been those who have been able to offer both personal and collateral commitments in a complementary way to lenders (Avery *et al.*, 1998: 1059).

In an investment environment where collateral commitments are considered to be of high importance in obtaining credit, the personal wealth of firm owners tends to play a role in the allocation of credit to small firms and their chances of future survival (Avery *et al.*, 1998: 1020). Due to lending cost pressures, lenders are viewed to be increasingly basing their underwriting decisions on the creditworthiness of small business owners rather than on the businesses or business ideas themselves. This means that an increased use of personal commitments becomes a necessary consequence for small business owners (Avery *et al.*, 1998: 1020). This is especially the case when dealing with commercial banks.

Avery *et al.*, (1998: 1024) state that there are three firm characteristics that most lenders take into consideration when looking into possible small business investment opportunities with regard personal or collateral commitment. These are firm industry, firm age and firm size. Firstly, they state that due to the type of industry some firms operate in, there might be very few tangible assets to commit as collateral when engaging in investment negotiations, a situation which is mostly the case with service based industries. This makes them less popular amongst potential lenders. They also state that older small businesses are more likely to be better known and have more established and strong relationships with lenders, making them easier to evaluate and offer investment proposals (Avery *et al.*, 1998: 1025).

When it comes to firm size however, the relationship is held to be a negative one because larger small businesses tend to have sufficient assets to serve as collateral, thereby making the use of personal commitment less prevalent for larger small businesses compared to smaller ones (Avery *et al.*, 1998: 1025). It is hence safe to conclude that with regard to these considerations; lenders are more likely to fund older small businesses of sufficiently large size, operating in industries that allow them to present a considerable amount of value in tangible assets as collateral. These are the investment options that would appear to be of a more positive risk when compared to others that do not possess either or all of these characteristics. The next section discusses information asymmetry and credit rationing as common characteristics of the funding relationship between small businesses and lenders.

3.5 INFORMATION ASYMMETRY AND CREDIT RATIONING

Literature on the subject of start up capital and information asymmetry states that with all things being equal in a 'perfect markets' setting, the principal-agent relationship does not

suffer the usual costs of collecting and processing the crucial funding relationship information and financing decisions are reached with relative ease. All information important to the funding relationship is assumed to be available and well prepared for use by both principal and agent and the funding decision making process goes off unaffected by missing information or ambiguously presented details. In this relationship the firm is taken to be the agent and the finance provider is seen as the principal (Tucker and Lean, 2003:51).

This 'perfect markets' setting is however not the case. What this means is that the funding relationship characteristics of risk and uncertainty remain a feature of the principal-agent relationship with an asymmetric distribution of information between conventional financial institutions and entrepreneurs (Abor and Biekpe, 2006:71, Tucker and Lean, 2003:51). As inherent components of information asymmetry, the most prominent concerns that have been constantly identified are adverse selection and moral hazard. With adverse selection, potential investors have difficulty distinguishing between a good and bad entrepreneurial idea. The entrepreneur either has private knowledge about the success probability of a project that he or she does not share with the finance provider or does not make a good enough effort to make all of the necessary information known to the principal (Abor and Biekpe, 2006:71; Brewer, 2007:42; Tucker and Lean, 2003:51).

Moral hazard contributes to high financing costs due to the monitoring needed to ensure that funds provided are used for the intended purpose. The finance provider is unable to fully control and ensure that the entrepreneur uses the funds provided strictly for the purpose for which they were acquired and so runs the risk of losing out on returns due to bad funds administration by the entrepreneur (Abor and Biekpe, 2006:71; Brewer, 2007:42; Tucker and Lean, 2003:51).

The difficulty faced by a lot of emerging entrepreneurs in securing start up capital which has also been attributed to the lack of reputation (track record), a requirement that predominantly comes out as one of the top priorities when fund providers are making funding considerations. In a 2005 study conducted by Abor and Biekpe (2006:75) on the experience of small and medium enterprises in securing start up financing, results showed that 26.4% of the businesses in the study experienced the lack of securable assets as well as the lack of knowledge by finance providers about their business as problems when attempting to secure funding from finance providers. It was also found that finance providers such as venture

capitalists and business angels tend to offer lower bids to entrepreneurs who seek funding without developing a prototype of their product or service, especially when they believe that developing a prototype in that particular case is possible and would better serve the drive to secure financing (Abor and Biekpe, 2006:75).

A prototype is a record or presentation of the business idea in action, showing how it operates or would best operate under particular optimal conditions and would be best served by additional funding. This could be a presentation of business records, such as sales and other financial statements over a given period, a display of current versus possible future production capacity for a manufacturing business or results of a market survey on consumer perception of the performance of a particular product or service in relation to what or how they think there could be a desirable improvement. Finance providers tend to interpret the lack of such presentation as an adverse selection problem as the investor, being the provider of the needed finance, has the right to believe that there is some positive or negative information about the project that the entrepreneur is not sharing with him or her which could be well expressed through the presentation of a prototype (Abor and Biekpe, 2006:75).

Credit denial usually characterises instances in which an entrepreneur shows a lack of collateral and reputation. In addition to this, the appraisal of emerging entrepreneurs' asset-backed collateral is usually valued at 'carcass value' in case of default. Carcass valuing basically positions the valuation of an asset at its most basic minimum due to the possibility of project failure, a scenario which is a regular feature of emerging entrepreneurial ventures (Abor and Biekpe, 2006:72). This implies that the already collateral strained emerging small and medium enterprises (SMEs) might require proportionately more collateral than do large firms seeing that they are already operating at a disadvantage when taking into account the particular considerations made by financial institutions and potential investors about a potential investment opportunity (Abor and Biekpe, 2006:71-75).

According to studies conducted by Altman (1968 in Tucker and Lean, 2003:52) the problem with information asymmetry is not only in the fact that it may result in the rejection of good lending business prospects, but also in the approval of poor lending prospects by fund providers. Altman laid out these possibilities into categories of possible funding errors on the part of fund providers and named them Type II and Type I errors respectively (Altman, 1968 in Tucker and Lean, 2003:52). An illustrating table representation of Altman's categorisation

of these possible errors of information asymmetry is presented by Tucker and Lean (2003:52) in the following format:

Figure 3.1: Altman’s (1968) risk categories.

		PROVIDER THINKS	
		Good Prospect	Bad Prospect
FIRM	Good Prospect		X Type 2 Error
KNOWS	Bad Prospect	X Type 1 Error	

Tucker and Lean (2003:52) state that of Altman’s Type I and Type II errors, the Type II error is the most common, that is, a situation in which good investment projects are, incorrectly, rejected by the lender, contributing significantly to the finance gap. Bright-minded emerging entrepreneurs with potentially high return business ideas fail to secure the needed funding from finance providers either due to the inability to communicate the current and projected future value of the entrepreneurial idea, i.e borrower fault, or an inability to sufficiently evaluate the information provided by the entrepreneur in the process of deciding whether or not to fund, i.e provider fault (Tucker and Lean, 2003:52). This is the adverse selection problem of information asymmetry.

Further illustration of the adverse selection problem of information asymmetry is provided by Amit, Glosten, and Muller (1990:107) who explain the adverse selection problem in terms of the venture capitalists approach to financing the start up phase of businesses and the risk affiliation of entrepreneurs. They state that in instances where venture capitalists make average ability based funding propositions to entrepreneurs, the risk neutral entrepreneurs may not feel that they need to make use of the funding; leaving an opportunity for an entrepreneur whose ability is below average to attract venture capital funding (Amit *et al.*, 1990:107).

This leads to a situation that is very similar to the scenario represented by Altman’s (1968) Type I error in which the firm knows the business is a bad investment prospect yet the investor is either unaware of this or thinks otherwise. The criteria used for presenting funding

opportunities would have automatically pushed a certain type of entrepreneur away from the funding option and drew a different type closer. In both cases described by Altman (1968) and Amit *et al.* (1990) the adverse selection problem is a result of an entrepreneur holding certain knowledge about the potential of the investment that he or she does not share with the investor, leading to poor investment deals being made.

In order to understand the role of informal financing and to appreciate the existence of the funding gap, Tucker and Lean (2003:52) assert that it is important to understand how informal financing works in the wider setting by looking at how banks operate as finance providers and the main providers of external finance to small firms. They state that the problem of asymmetry is increased further, first of all, by competition in the banking sector which leads to greater market concentration resulting in an inability of the larger banks to establish close relationships with small firm customers compared to the smaller banks. Another problem has been identified as the tendency by the larger banks to centralise business lending decisions within rigid policy structures, thereby distancing the ultimate funding decision maker further and further away from the reality of the entrepreneurs' situation (Tucker and Lean, 2003:52).

Furthermore, the intended efficiency of computerised knowledge-based lending decision processes has tended to lead to increased unwillingness to lend to firms with non-standard projects whereas the reality of most bright minded entrepreneurs is the lack of needed technology to see through the commercialisation of their ideas (Tucker and Lean, 2003:52). In other words, the competitive environment that the major potential funders operate in, that is the large banks and the banking industry, and the rigid policies they put in place for their survival and efficiency in this environment is reducing the desired contact between them and entrepreneurs. Together with the preference given to technology based small businesses, the process of securing funding from these sources is really difficult.

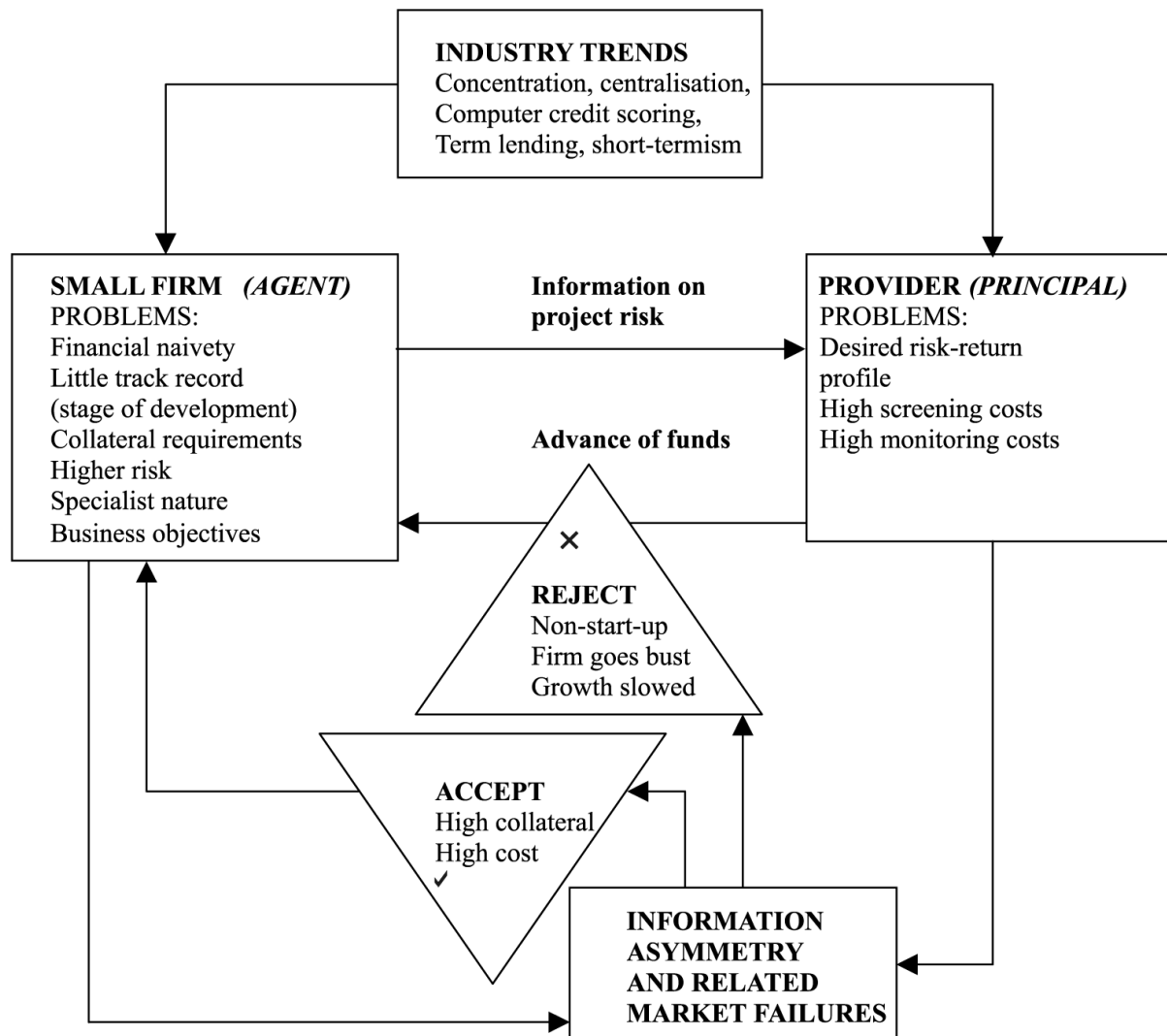
There has also been noted a trend in which most businesses decline bank overdraft facilities and opt for term-loan lending. This forces banks to be more cautious as such loans are not easily repayable as they tend to demand a greater collateral commitment, which most entrepreneurs may not necessarily be able to deliver upon (Tucker and Lean, 2003:53). Banks tend to adopt a collateral-gearred approach as compared to an income-gearred approach, focusing more on what they can hold on to in the event of the business failing rather than on

how well the business can go about generating continuous income flow (Tucker and Lean, 2003:53).

On a more entrepreneur and firm based level, looking at the objectives and attitudes of the small firm owner-manager, a few hindrances to securing funding can be noted. Some owner-managers have a very strong tendency to hold back from committing their own personal assets to their entrepreneurial ventures, causing most providers of start up capital to be reluctant towards issuing out funds to ventures in which the risk is not shared by the entrepreneur (Tucker and Lean, 2003:53). In other instances, investors are reluctant to commit where the entrepreneur shows other objectives from pure business for engaging in the entrepreneurial venture, such as lifestyle motivated businesses for example. (Tucker and Lean, 2003:53). Most entrepreneurs are motivated into starting their own businesses by the need to hold greater control over the work process and are hence normally reluctant to make use of equity financing from business angels and venture capitalists. This is indicative of how the attitudes of small firm owner-managers can be a hindrance to securing early stage financing (Tucker and Lean, 2003:53).

This process of interaction between the principal and agent can further be understood in terms of the figure given below:

Figure 3.2: Information asymmetry in small firm lending



(Tucker and Lean, 2003:54).

When it comes to banks and credit rationing, Simon Parker (2002:163) defines credit rationing as “... the situation where some loan applicants are denied a loan altogether, despite (i) being willing to pay more than the banks’ quoted interest rates in order to obtain one, (ii) being observationally indistinguishable borrowers from borrowers who do receive one”. In his paper, he proposes a various number of economic models that explain credit rationing in a number of ways operating in different lending environments (Parker, 2002:178). Those models will not be discussed in this study as they deter from the object of this research. He however explains the situation described above as a Type II Error whereby the lender, given sufficient and relevant information by the borrower, fails to make a positive lending decision when the borrower would have otherwise qualified for lending (Parker, 2002:163). In

addition to the rigid policy structures and the competitive environment that distances the large banks from emerging entrepreneurs, Parker (2002:163) holds that just as is the case with other finance providers, the funding decision of the bank in this scenario is characterised by adverse selection. This leads to credit rationing. The following section explores and discusses bank-small firm interaction in the lending context in more detail, highlighting the differences in the objectives of small businesses and banks in this context and evaluating the lending criterion used by banks in relation to small businesses.

3.6 BANKS AND THE SMALL FIRM

Entrepreneurs have generally been noted to rely predominantly on banks as a source of financing for their enterprises. However, banks are faced with several problems the first of which is the inadequate development of risk assessment skills and secondly that lending decisions are made under conditions of uncertainty and information asymmetry (Musengi, 2003:65). The decision making is often delegated to bank managers with respect to providing finance to small and medium-sized enterprises. The rules set by head offices influence the decisions and the lending decision itself is an interaction between these rules and the manager's experience (Musengi, 2003: 65). Lange, Warhus and Levie (1999) suggest that bankers faced with a lending decision are often surrounded by uncertainty because of incomplete information. This leads to the decision being either a strict interpretation of rules or decisions made on complete use of the manager's own experience and attitude (Musengi, 2003: 65). There are several variables in commercial lending according to Musengi (2003: 65), for example, "heterogeneity of loan applicants, quality of information, presentation of the proposal and the influence of the decision". The following section presents three examples of approaches to lending decision-making used by banks.

One of the benefits that a close SME-Bank relationship provides is that banks are in a better position to understand the environment in which small firms operate in. This also allows for a better understanding of the small firm owner's attributes and a more precise overview of the business's viability (Ennew and Binks, 1997). In addition, Lange, *et al.*, (1999) suggest that close bank relationships are "associated with greater availability of capital, lower credit lines, less frequent pledging of collateral and lower monitoring". In quite a similar fashion to the South African situation, few large banks in the UK provide products and services to the SME sector and the banks have recognized the importance of servicing the SME sector because of

its profit and revenue potential. As is the case in South Africa, “the range and variety of products available to the small business sector have expanded, while the management of the banking relationship continues to be an area of concern (Ennew and Binks, 1997 in Musengi, 2003:70). The following table gives a presentation of some differences between bank and SME objectives.

Table 3.2: Differences in bank and SME objectives

Objectives of Banks	Objectives of SMEs
Managing risk on loans provided in order to avoid losses	Getting funding without constraints to allow flexibility in all business activities
Giving high priority to shareholder/member value by focusing the bank’s strategic objectives on raising productivity, efficiency and profitability	Acquiring the necessary funding and support to start a business, develop, prosper and provide a satisfactory return to the owners and employees
Segregating the organisation into autonomous business units and channels in order to maximize productivity, efficiency and individual profit contribution	Requiring single sources for customised and comprehensive packages of products and services to improve business performance
Reorganizing the branch network and reducing low margin services to cut costs and improve short-term profitability	Having maximum access to loans and services
Job rotation of the banks’ staff, because of career planning and the necessity for flexibility	Intensifying personalised interaction with Account Managers to mitigate the information gap and create mutual trust
Key positioning of IT systems in many aspects of banking, e.g. establishing clients’ profit contribution, risk assessment and product distribution (virtual banking)	Creating and maintaining a personal relationship with the bank staff to ensure that loan decisions take the entrepreneur’s skills and attributes into account

(Source: Third Round Table of Bankers and SMEs, 2000:15 in Musengi, 2003:71).

Mismatches between banks and small firms result in liquidity constraints that combined with moral hazard and adverse selection contribute to finance gaps (Fletcher, 1995:36). This is because the objectives of banks and small businesses, as highlighted above, differ on several issues. According to Musengi (2003:72) in the first instance, banks seek to manage loan risks to avoid losses, while small businesses want easy access to finance which enables them the business to operate. Small business owners/managers need to obtain finance to provide a suitable return to the owners and employees. However, banks need to ensure shareholder/member value, which forces banks to focus on the bank's strategic goals such as improving productivity, efficiency, and profitability.

Musengi (2003:72) goes on to state that the final difference focuses on the relationship between banks and small businesses. Small businesses strive to create and maintain strong relationships with bank staff in an attempt to influence loan decisions, which would take into consideration the entrepreneur's skills and characteristics. Banks, on the otherhand, strive to use information technology systems in many areas of banking, for example, calculating the client's profit contribution to the bank and risk assessment. These systems would not encourage the close personal relationship the small business owner/manager seeks (Third Round Table Report, 2000 in Musengi, 2003:72).

3.6.1 Lending decisions based on meeting certain criterion

Fletcher (1995:38) investigated how Scottish bank managers make lending decisions to small firms and the importance of the criteria used to evaluate lending propositions. He interviewed a representative sample of bank managers to determine their process of decision-making by the answers they supplied to the questions asked about their funding decisions. This enabled him to analyse the importance of different criteria actually used in the decision making (Fletcher, 1995:38). The following table is a presentation of the criteria that was used or sought by Scottish bank managers in making their lending decisions.

Table 3.3: Criteria used by Scottish bank managers to make lending decisions

Criterion	Percentage
Management Capabilities	76
Location	58
Forecast balance sheet and profit and loss	47
Gearing	45
Employing a chartered accountant	42
Motivation of directors	32
Role of IT consultant	24
Industry sector	29
Small business experience	21
Qualifications	16
Sources of finance/grants	53
Connection with bank	29

(Source: Fletcher, 1995:46).

From the table above, management capabilities emerged as the most important criterion used by bank managers on evaluating applications followed by location and source of finance and grants available to the small firm. Financial issues including financial statements (47 per cent), gearing (45 per cent) and the use of a chartered accountant (42 per cent) ranked as the next important factors considered by bank managers. Only 16 per cent of the managers considered the qualifications of the individual as important, which is interesting, given the high status given to the role of education in entrepreneurship development.

A South African study by Nieuwenhuizen and Kroon (2002 in Musengi, 2003:66) presented interview data from nine financial institutions in South Africa that revealed the finance criteria followed in evaluating loan applications. The study conducted a survey to identify success factors associated with small firm success. The study analysed the relation of the success factors with their use by financiers in accessing applications (Musengi, 2003:66). The following table presents the research findings.

Table 3.4: Number of success criteria corresponding with the success factors

Type of Success Factor	Success Factor	Number of corresponding financing criteria (n=9)
Success Factors Relating to Personal Characteristics	1. Creativity and innovation	1
Success Factors Relating to Management Skills	2. Commitment to enterprise	5
	3. Involvement in enterprise	1
	4. Planning of enterprise	9
	5. Knowledge of competitors	2
	6. Mainly market focused	2
	7. Quality work enjoys priority	1
	8. Client service	1
	9. Financial understanding	4
	10. Financial management	9
	11. Knowledge and skills	4

	12. The use of experts	4
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(Source: Nieuwenhuizen and Kroon, 2002:25).

This table shows that planning of the enterprise and financial management emerged as the most important factors used in evaluating applications with the commitment to enterprise (a personal success factor) being regarded as the next important factor (Musengi, 2003:67). The findings from this study highlight management success factors as more important than personal success factors. In addition to this, the study identified the following key success factors- “perseverance, willingness to take risks, sound human relations, positive attitude and approach, and bookkeeping for own advantage” that do not feature in financing criteria followed by financial institutions in their study (Musengi, 2003:67). These factors demonstrate the individual’s entrepreneurial skills, which Nieuwenhuizen and Kroon (2002, in Musengi, 2003:67) argue as the key for enterprise success.

3.6.2 Lending decisions based on credit scoring systems

According to Frame, Padhi and Woosley (2001), credit scoring is the “process of assigning a single quantitative measure, or score, to a potential borrower representing an estimate of the borrower’s future loan performance”. Feldman (1997, cited in Frame, *et al.*, 2001) holds that credit scoring enables lenders to underwrite and monitor loans without meeting potential borrowers. He also suggests that credit scoring should potentially reduce costs because small firms have access to more finance lenders. One more advantage of using credit scoring in the lending decision is the potential increase in credit availability because the lender will have more information regarding the business and base decisions on expected risk (Feldman, 1997, cited in Frame, *et al.*, 2001). According to a survey by Falkena, *et al.*, (2001), commercial banks in the Western Cape province in South Africa strongly rely on collateral existence and use automatic or semi-automatic credit scoring systems to assess small firm risk. However, they also suggest that there is little evidence supporting credit scoring as an effective method for risk assessment in South Africa. Landstrom and Winborg (1995) add that financiers have underdeveloped competence and financial tools to handle small firm investment (Musengi, 2003:68).

3.6.3 Lending decisions based on assessing the business plan

Musengi (2003: 68) noted that in South Africa, NedEnterprises “uses the business plan to assess character, capacity, content, contribution and collateral aspects of owners who require debt finance as part of their lending decision-making process”. She holds that character assesses the owner’s honesty, integrity, and creditworthiness as well as the owner’s ability to operate the business on a day-to-day basis as well as their strategic long-term planning. NedEnterprises also takes into account the owners’ qualifications and relevant experience to operate the business. It also analyses the financial forecasts in terms of profitability, attainability and consideration of economic changes such as inflation, taxation and set-up cost for example. NedEnterprises also performs a sensitivity analysis to assess the sustainability of the business and more importantly the business’s ability to accommodate debt in its capital structure (Musengi, 2003:68).

Musengi (2003:69) also notes that NedEnterprises “expects the owner to contribute 20 per cent and 30 per cent into the business in the form of assets” and will accept “non-interest-bearing loans from third parties (repaid after debt finance has been repaid), cash withdrawals from home loans, personal assets used solely in the business and cash savings as own contributions”. NedEnterprises also emphasises collateral and security from small firm owners, of which security can be in the form of personal assets such as fixed property, deposits or business assets such as bonds over equipment. The level of security required by NedEnterprises depends on the perceived level of risk in the business (NedEnterprises, 2001). The following section seeks to understand the South African small business in its definition and nature.

3.7 UNDERSTANDING THE SOUTH AFRICAN SMALL BUSINESS

Research has shown that there is no one single definition of the small business but a number of contextual variations that have all been coined to describe particular observations. For example when looking at the small business definition at sector level, objective measures such as number of employees, sales turnover, profitability and net worth suggest that in some sectors “ all firms may be regarded as small, while in other sectors there are possibly no firms that are small” (Storey, 2000:9). The definition of small businesses in South Africa is provided by the National Small Business Act of 1996 which emphasises number of

employees, annual turnover, and gross assets as measures of size. The South African Small Business sector is also distinguished in terms of size and the main size categories are the micro, very small, small and medium sized enterprises; referred to commonly as ‘SMMEs’ (small, medium and micro enterprises). The researcher will use the terms ‘small firm’, ‘enterprise’ and ‘venture’ when referring individual businesses while ‘small business sector’ and ‘small, medium and micro enterprises’ (SMMEs) embody all forms of small firms in the economic sector. The terms ‘small and medium enterprises’ (SMEs) omits the micro sized enterprise. The following table presents the National Small Business Act 1996 definitions of the small business sector.

Table 3.5: Definitions of small businesses given in the National Small Business Act

Enterprise Size	Number of Employees	Annual turnover	Gross assets, excluding fixed property
Medium	Fewer than 100 to 200, depending on industry	Less than R4 million to R50 million, depending on industry	Less than R2 million to R4.5 million, depending on industry
Small	Fewer than 50	Less than R2 million to R25 million, depending on industry	Less than R2 million to R4.5 million, depending on industry
Very small	Fewer than 10 to 20, depending on industry	Less than R200 000 to R500 000, depending on industry	Less than R150 000 to R500 000, depending on industry
Micro	Fewer than 5	Less than R150 000	Less than R100 000

(Source: National Small Business Act 1996).

Micro enterprises include businesses that yield a turnover below the VAT registration limit (R150 000) and employ less than five people. Some examples of people in micro enterprises include owners of *spaza* shops and minibus taxi operations. Micro enterprises are predominantly considered to be informal, as these enterprises are not registered for tax purposes, do not have formal accounting and operating procedures, and do not comply with the labour legislation. The micro enterprises that have employees on a payroll constitute at least 31.0 per cent of the small business sector and contribute 3.9 per cent of the total private sector employment. Micro enterprises with between one paid employee and five paid employees constitute in the region of 16.4 per cent of the small business sector and contribute about 6.8 per cent of private sector employment. The breakdown according to province from a study conducted in 2000 shows that Gauteng province has the greatest number with 34.0 per cent followed by KwaZulu-Natal province with 18.0 per cent, then the Western Cape province with 14.0 per cent and finally the Eastern Cape province with 10.0 per cent (DTI, 1998; Forgey, Dimant, Corrigan, Mophuthing, Spratt, Pienaar and Peter, 2000). There have been no recent publications of more up to date statistics.

Following the micro enterprise is the very small enterprise which has a higher limit in employment, including the self-employed, such as professionals, and less than ten paid employees. Enterprises in the mining, electricity, construction and manufacturing sectors allow for the number of employees to increase to less than twenty paid employees. These are formal market enterprises that have access to technology and constitute 19.7 per cent of all enterprises recorded and account for 13.3 per cent employment in the private sector. A study conducted in 2000 showed that Gauteng province has the greatest number of very small enterprises with 42.0 per cent, followed by the Western Cape province with 16 per cent and finally the KwaZulu-Natal province with 15.0 per cent (DTI, 1998; Forgey, *et al.*, 2000).

The small enterprise on the other hand has less than fifty paid employees and has more complex business practices, as it is more established. In order for a small enterprise to grow to a medium-sized enterprise, resource accumulations as well as incentives for enterprise expansion are pre-requisites. Small enterprises constitute an estimated 7.6 per cent of enterprises in the small business sector and small enterprises contribute 19.9 per cent of employment in the private sector. The largest concentration of small enterprises is in the Gauteng province with 46.0 per cent, KwaZulu-Natal province has 16.0 per cent and the Western Cape Province 12.0 per cent (DTI, 1998; Forgey, *et al.*, 2000).

Medium sized enterprises have at least one hundred people on the payroll, although in mining, electricity, and manufacturing the number increases to two hundred paid employees. When it comes to ownership and management, the structures involved are more complex and a greater division of labour stands as the main difference between small and medium-sized enterprises. Medium-sized enterprises constitute 1.4 per cent of enterprises recorded and are responsible for about 13.8 per cent employment in the private sector. Medium-sized enterprises are concentrated in Gauteng, KwaZulu-Natal, and the Western Cape provinces (DTI, 1998; Forgey, *et al.*, 2000).

3.7.1 South Africa and the value of entrepreneurship

Entrepreneurship and the small business sector development have increasingly gained significance in developing third world economies due to their potential to facilitate economic development (Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprise, 2005: 7). The South African government recognises this and has, especially since 1994, increased efforts to facilitate an environment favourable to entrepreneurship and small business development as evidenced by the pronouncements of the White Paper of 1995 on national strategy on the development and promotion of small business in South Africa (Centre for Development and Enterprise, 2004:5). The small business sector is seen as part of the national agenda to promote national economic development, job creation and wealth redistribution (CDE, 2004: 5; Musengi, 2003:11). This has led to various government initiatives such as the Ntsika Enterprise Promotion Agency (Ntsika) and Khula Enterprise Financial Limited (Khula) through the Department of Trade and Industry (DTI). These structures are aimed at promoting entrepreneurship and small businesses by providing technical and financial support.

In South Africa research shows that in spite of government efforts to promote entrepreneurship and the small business sector the results have been disappointing (CDE, 2004:6). It has been acknowledged that “Khula, the DTI’s small business finance agency has never managed to help more than a few hundred businesses per year with bank-loan guarantees...” (Terblanche, 2009:2). The reasons advanced for this failure are varied and include a misplaced focus on access to debt finance and misconception of government initiatives as poverty relief as well as the need for government to play a more facilitating and

supporting role (CDE, 2004:28). Claims were made by Ahwireng-Obey and Piaray (1999:78) that the South African government had not, in the previous years, been successful in minimising institutional uncertainty in its efforts to promote productive entrepreneurship on a large scale.

3.7.2 How many entrepreneurs exist in South Africa?

Ntsika (2001) has a measure that is used for showing enterprise density- that is the number of entrepreneurs for every 100 people in a country or province. The following table presents the enterprise density for each of the provinces in South Africa for 1999.

Table 3.6: Number of entrepreneurs per province population and enterprise density

Province	Number of entrepreneurs	Population	Enterprise density%
Eastern Cape	200 410	6 769 000	2.9
Free State	87 022	2 813 000	3.1
Gauteng	382 021	7 778 000	4.9
KwaZulu Natal	382 021	9 003 000	4.2
Mpumalanga	124 242	3 000 000	4.1
Northern Cape	27 764	890 000	2.8
Northern Province	151 601	5 310 000	2.7
North West	97 583	3 592 000	2.7
Western Cape	179 992	4 171 000	4.3
Total	1 628 797	43 325 000	3.7

(Source: Ntsika, 2001:32)

The above table shows that Gauteng has the highest density with 4.9 per cent of its population involved in entrepreneurship or entrepreneurial activity. The North West, Northern Cape and the Northern Province have the lowest density with 2.7, 2.7 and 2.8 respectively. The Eastern Cape has an enterprise density of 2.9 per cent. The number of economically active people in a province and the total population in a province will have

some bearing on the number of entrepreneurs that a province will have. Economic participation rates will differ strongly between provinces because of the unequal distribution of enterprises (Ntsika, 2000:32). Higher urbanization rates in provinces such as Gauteng and the Western Cape allows for high economic participation rates. It is however important to also note that the large rural population in the Eastern Cape affects enterprise distribution towards the lower end of the spectrum even though the province has large metropolitan areas.

3.7.3 The importance of the small business sector to South Africa

The main contribution that has been noted to be made by South African SMMEs is that of employment creation (Ntsika, 2000:24). The small business sector employs an average of 54.5 per cent of all people in the formal private sector. In the micro enterprises, trade, transport, business services, and other services sectors employ the majority of the people, while the same holds for the small enterprises but with the addition of the construction sector. The medium enterprise main contributors to employment include agriculture, manufacturing, transport, construction and trade.

According to Pitt (1996) the second reason why the small business sector is considered important to the South African economy is that it is crucial to achieving the objective of empowering communities that have previously been disadvantaged. The third reason is the sector's potential to improve the economic competitiveness of local industry. The final reason, regional economic development, can be facilitated through the adoption of a 'self-help', locally driven approach with emphasis on the importance of establishing cooperative networks between key stakeholders (Rogerson, 1997; Morris and Brennan, 2000). In order to be supportive to entrepreneurial activity, more start-up business activity and regional economic activity, there is a need to establish an enabling culture through local government policies, procedures, and practices with the small businesses (Morris and Brennan, 2000). In light of this, a number of organizations, agencies and government departments have instituted a range of initiatives to bring out the potential of the small business sector and to assist with its development (SACOB, 1999). For this to occur, it is important that small businesses grow; in addition, Petty and Martin (1997) suggest that firms should "exhibit the capacity to create economic value for the investors which goes beyond merely providing a comfortable lifestyle for the founders".

However, in light of all the positive arguments on the South African small business sector that have been put forward by various researchers, there have been arguments proposed on the contrary suggesting a different outcome to the strategies and initiatives proposed and implemented. Theodosiou (1996) is one researcher who offers a different perspective to that proposed on the South African government's White Paper on national strategy for development and the promotion of small businesses. He proposes that the White Paper was formulated on the assumption that "all small businesses are entrepreneurial and therefore play a vital role in job creation" (Theodosiou, 1996:19). The document however makes no explicit reference as to whether the strategy focuses on the start-up or growth stage; a critical distinction according to Morris and Pitt (cited in Theodosiou, 1996:19). Morris and Pitt (1995, cited in Theodosiou, 1996:19) make reference to a finding that "about 10 per cent of small businesses are responsible for creating virtually all the new jobs generated by the small business group as a whole".

For this to be the case, there is a need for the small businesses to be entrepreneurial, which is not always the case. Karungu, Marabwa and Stettler (2000:13) on the other hand question the employment capability of the SMME sector. They concluded that the SMME sector created eight of the ten jobs created in South Africa per year but expressed concerns over omissions from governmental reports that of the eight new jobs created, five or six jobs are lost within the year. Karungu, *et al.*, (2000:13) hold that ascertaining the precise contribution of the SMME sector in terms of employment is difficult "by virtue of the very characteristics of micro and very small enterprises". Karungu, *et al.*, (2000) support Manning (1996, cited in Rogerson, 1997:5) in challenging that SMME promotion equates to employment creation and Manning (1996, cited in Rogerson, 1997:5) argues, "evidence in support of the perceptions of SMEs as important sources of employment is somewhat weak".

The third insight is the role of SMMEs in redressing racial income inequalities. Manning (1996, cited in Rogerson, 1997:6) warns of the danger "for policy-makers to rely on SMMEs as the main agent for economic redistribution on South Africa" and offers three reasons for his argument. The initial reason is that a reliance on SMMEs to redistribute wealth does not address the core economic power of South Africa, which is concentrated in the hands of the large white-owned corporations. In addition to this, the majority of black owned businesses are small and it cannot be expected that these will significantly shift the patterns of wealth distribution. The final reason offered is that although SMMEs can be a useful channel of

wealth creation for black entrepreneurs, this does not necessarily mean that the entire black population will become wealthier (Manning, 1996, cited in Rogerson, 1997).

The final insight offered by literature highlights in the study by Karungu, *et al.*, (2000:6) show several concerns by provincial and local governments who “have not yet been effectively integrated into SMME development”. Karungu, *et al.*, (2000) suggest that for the SMME sector to develop, the DTI needs to make an impact at local levels and this includes establishing an enabling culture through local government policies, procedures, and practices to be supportive for entrepreneurial activity (Morris and Brennan, 2000). The promotion of such a culture allows for increased rates of business start ups and subsequently the use of business angels in financing such start ups will increase as they emerge as the more readily accessible and available financing option.

However, according to Musengi (2003:34), “despite such criticism, the small business sector does have the potential to transform the South African economy and invaluable lessons from other countries can assist policy makers, institutions such as banks, and the entrepreneurs to develop appropriate strategies to promote entrepreneurial activity in the country”.

3.7.4 The importance of institutional factors in promoting entrepreneurship

Entrepreneurship is an aspect of economic and social development that is affected as much by other factors as it is by institutional influences, referring specifically to the structuring and functioning of institutions that deal directly with or somehow affect entrepreneurship (Ahwireng-Obey and Piaray 1999:78). Examples of such institutions in South Africa are the Ntsika Enterprise Promotion Agency (Ntsika) and Khula Enterprise Financial Limited (Khula) which are run through the government’s Department of Trade and Industry (DTI). These institutions, for example Khula, are committed to developing and sustaining small business enterprises in South Africa by providing structural and financial support through various channels such as leading commercial banks, retail financial institutions, specialist funds and joint ventures. Their objective is to “... bridge the funding gap in the SME market not addressed by commercial financial institutions” (Anon, 2004).

The uncertainty of laws and policies as a variable affects entrepreneurship in terms of the decision that an investor has to make on a potential investment opportunity. The laws and

policies on business set by government will influence a potential investor's expectation of profits in potential investments in that economy, resulting in higher or lower levels of small business investments (Ahwireng-Obey and Piaray 1999:78). This is worsened especially by the irreversibility of certain losses in an investment relationship in an economy that constantly adjusts its policies in order to cater for a diverse range of socio-economic conditions. Countries such as South Africa are a case in point where previously repressed populations are emerging and making various business and economic demands of the government to address their previous conditions. The policy review and adjustment demands made by this situation tend toward a perception of instability mostly by foreign investors and consequently a lower expectation of high returns in such economic conditions (Ahwireng-Obey and Piaray 1999:79).

Depending on the level of creative brilliance and the skill that an entrepreneur and his or her entrepreneurial team possess, some entrepreneurs tend to adopt risk minimising business strategies which allow for limited control of productive resources. Such entrepreneurs will, for example, look to rent, lease or borrow essential productive resources such as buildings and equipment. Increasing institutional uncertainties limit such risk minimising options, thereby frustrating the implementation of business plans and the creation of value to stakeholders (Ahwireng-Obey and Piaray 1999:79).

In a study on the importance of institutional factors to entrepreneurship in South Africa, Ahwireng-Obey and Piaray (1999:79) found that most businesses they investigated indicated crime and security problems as an institutional variable that led to the highest cost in doing business. These entrepreneurs felt that their assets were not protected well enough by the government, including their physical safety. Following this variable in descending order was the perception on tax laws and labour legislation and how these affected business and the existence of corruption, and bureaucratic red tape as costly obstacles to entrepreneurship (Ahwireng-Obey and Piaray 1999:81). The majority of the responding firms in this study were small-sized firms (20-200 employees) characterised by less than 10 years' business experience, with a 60% service sector to 40% manufacturing sector distribution.

The small business owners also indicated foreign currency regulations, inadequate infrastructure, financing and regulations of foreign trade as frequent problems to entrepreneurship in South Africa. Government was perceived to have failed to address the

concerns voiced by entrepreneurs and also to have made very small efforts to keep the entrepreneurs informed of the laws and policies that affected their businesses (Ahwireng-Obey and Piaray 1999:81). The reliability of the judiciary was also seen as another institutional obstacle to entrepreneurship as most indicated a perceived lack of independence, limited power to enforce rulings and a general inefficiency as an institution in itself. The indication was that a judiciary that failed to set and decide on rulings and policy on business and economic policy did not provide for a business environment in which entrepreneurship could be successful (Ahwireng-Obey and Piaray 1999:81).

3.8 SUMMARY

This chapter focused on start up capital. The discussion above has shown that information asymmetry and moral hazard are the main issues of concern that surround the decision to finance a venture and the funding relationship. These eventually lead to fewer business ideas getting the financial support they need from financial institutions and the credit rationing of business ideas by banks. What this means to this study is that there is a place in small business financing for an option that allows for closer and more regular interaction between the entrepreneur and the lender in order to eliminate the occurrence of information asymmetry and moral hazard. These are inefficiently structured entrepreneurship institutions, uncertainty of laws and policies, business and personal safety and security, foreign currency regulations and the reliability of the judiciary. These were highlighted as issues of importance that played an important role in determining whether or not South Africa's business and economic environment were conducive enough and consequently the possibility of emerging entrepreneurs securing start up capital.

The following issues are however very significant to this study:

- Information asymmetry and moral hazard are two of the most important aspects of the funding relationship that affect the possibility of entrepreneurs securing the funding they need from potential investors and an investment being beneficial to an investor
- The efficient structuring and service package design of entrepreneurship institutions such as the Ntsika Enterprise Promotion Agency (Ntsika) and Khula Enterprise Financial Limited (Khula) are important to provide the needed service and support to facilitate the emergence of entrepreneurial ventures.

- It is important that institutions such as the judiciary, economic policy regulators and the government are seen to function in a way that is perceived to promote the emergence of successful entrepreneurs and that creates a business and economic environment conducive for sustainable entrepreneurship.

The next chapter will focus on business angels and business angel networks. The chapter will define the term business angel and explain how business angel networks operate in facilitating the financing of small business start-ups before it shows how business angels benefit their investee companies past the investment stage.

CHAPTER 4
BUSINESS ANGELS AND ANGEL NETWORKS

4.1 INTRODUCTION

Business angels are aware of the economic significance of the entrepreneur and they also have an understanding of how difficult it is for entrepreneurs to secure equity or loan capital to fund their ventures. Due to this and the fact that institutional sources of capital such as banks and venture capital firms have largely turned their backs on funding seed or small business start-ups, business angels have emerged as the more viable source of financing for business start ups (Freear, Sohl and Wetzel, 1994:109, Mansson and Landstrom, 2005:2).

The following chapter is about business angels. The initial section focuses on the definition and profiling of business angels as they are known in the countries in which they are most predominantly operational. The definitions and profiles are taken from studies on business angels that were undertaken mostly in Europe, the United States of America and Canada. This is where business angel activity is most well researched and recorded. The chapter will also focus on business angel syndication, which is the formation of business angel networks, as a way in which business angel funding is made more identifiable and easily accessible to emerging entrepreneurs. The final section will focus on the value of an experienced business angel on an entrepreneurial venture an experienced business angel with a good track record and reputation compared to the more institutionalised sources of further finance such as banks and venture capitalists.

4.2 THE BUSINESS ANGEL

A source of start up capital that has not traditionally enjoyed much attention is that of business angel finance. Roger Sorheim (2005:179) refers to business angels as private individuals who offer risk capital to unlisted companies that are struggling to obtain start up capital to finance their business ideas. Business angels are further defined as high net-worth bearers of substantial private capital who predominantly invest in the early stage of high risk high potential return business ventures with a positive further growth potential. They contribute a wide range of benefits to these enterprises, ranging from financial capital and managerial know-how to networking, involvement in operations and strategic development (Aernoudt and Erikson, 2000:178, Freear *et al.*, 1994:109 and Reitan and Sorheim, 2000:131, Ehrlich, De Noble, Moore and Weaver, 1994:69).

Business angels offer their managerial assistance in a consultancy or board membership form and are usually people who have had previous success in starting and running small enterprises who are now in the market to invest in potentially high growth enterprises. For purposes of active and regular participation within the investment of choice, most business angels are said to predominantly prefer investing in businesses of close geographic proximity to where they live and work (Freear *et al.*, 1994:111, Harrison and Mason, 1992:463; van Osnabrugge and Robinson, 2000:23; Duxbury, Haines and Riding, 1996:46; Reitan and Sorheim, 2000:131).

Available profiles of the 'typical' business angel, obtained from studies held in Canada, the United Kingdom and the United States, present a description of a well educated middle aged man whose education is mostly affiliated to the business or commerce profession (Reitan and Sorheim, 2000:131; Duxbury *et al.*, 1996:46; Harrison and Mason, 1992:463). UK studies hold the business angel to be an infrequent but experienced investor who invests across various business sectors but with a preferential interest on service sector businesses, whilst the American East Coast counterpart in a 1988 study showed a tendency to direct investments more towards high technology manufacturing businesses and construction/real estate businesses. Business angels are said to rely on friends, family and business associates for business information regarding potential investments. It is the aim of this study to establish whether South African small businesses are utilising business angels as an alternative source of financing their operations (Harrison and Mason, 1992:463; van Osnabrugge and Robinson, 2000:109; Haar, Starr and Macmillan, 1988:13).

Research has also shown that business angels tend to follow a certain criteria in terms of how they make the decision to finance or not to finance. The decision making criteria noted by most authors on the subject showed four distinct phases, which are:

- first impressions;
- the initial assessment;
- analysis; and
- negotiation (Manson and Landstrom, 2001:6).

Business angels use the above criteria to determine whether or not to consider making an investment. Some businesses fail at the first impressions stage as some business angels use their past experience with similar businesses on deciding first hand whether or not a

particular option will make a good investment (Manson and Landstrom, 2001:6). This shows that the business angel's experience within a particular industry and past investment experience does to some extent influence the decision to invest or not to invest.

4.3 THE BUSINESS ANGEL NETWORK

Aernoudt and Erikson (2000:178) believe that the challenges and problems of matching entrepreneurs with business angels and insufficient information regarding the flow of new deals can be addressed through the formation of business angel networks which facilitate the matching process between investors and entrepreneurs. They define the business angel network as public or private network organisations acting as intermediaries between individual business angels and entrepreneurs (Aernoudt and Erikson, 2000:178). Existing mostly on a national and regional basis, business angel networks function by matching business angels to entrepreneurs in a cost-effective manner (Aernoudt and Erikson 2000:178). These networks are most identifiable when business angels syndicate and form an investment company. They are otherwise not easily identifiable (Aernoudt and Erikson, 2000:178).

Aernoudt and Erikson (2000:178) also showed that the few initial business angel networks to have been created in the United Kingdom were a result of private initiative, but public partnerships have also supported their formation. In 2001, there were more than 130 business angel networks operating across Europe (Aernoudt and Erikson, 2000:182). Most were said to have received government support in terms of financing their operating costs in the launch stage, and more networks began to emerge across Europe in countries such as Spain, Greece, Norway and Portugal (Aernoudt and Erikson, 2000:178).

Such countries have also set up national and regional associations of business angels, such as the European Business Angel Network. Its aims include the exchange of experience, acting as a representative organisation in relation to national and regional business angel administrations and promoting the development of business angel investments in Europe. These networks have also drafted codes of conduct for administrative regulation in countries where the legal frameworks have not yet recognised their operation to provide legal support and regulation. The services provided by business angel networks will always vary and most networks will take several years before they become self-sustaining (Aernoudt and Erikson, 2000:183).

There has also been some public support provided for business angel networks in Europe, such as the European Business Regional Development Fund which was used to support networks in the UK and Belgium. Public sector support is normally used to cover costs associated with efforts to enhance an entrepreneurial culture and efforts to identify and recruit new business angels. Other costs are involved in seeking and identifying entrepreneurs willing to work with a business angel and matching business angels with entrepreneurs. Providing a supportive framework for the existence of business angel networks would involve emphasising a highly entrepreneurial culture within a country's economy, reducing the number of authorities involved in the registration of a business and the amount of time this takes. This eliminates any apparent difficulties to be faced in this process thereby making the idea of entrepreneurship an attractive one within a country's economy (Aernoudt and Erikson, 2000:186).

Haar *et al.*, (1988:13) make reference to a study conducted by Wetzel in 1983 that showed that informal networking is a good strategy to assemble sufficient funds to support ventures, wherein the funding of 60% of the ventures included in the study was said to have been a group or network effort in which individual investors joined other investors in order to provide access to funding for entrepreneurs. These networks were found to be usually made up of friends and business associates (Haar *et al.*, 1988:4). Shapero's study also found that in Columbus, Ohio, Louisville and Kentucky, business angels would not invest as individual investors, but would look to investing with other interested investors (Shapero, 1983 in Haar *et al.*, 1988:14). This was found to be the same with at least 78% of the San Francisco Bay area investors (Krasner and Tymes, 1983 in Haar *et al.*, 1988:14).

As a continuation from the studies referred to above, Haar *et al.*, (1988) conducted a study, sampled from MBA alumni from a New York university, medical professionals and venture capital club members, that followed a similar line of thought which sought to test the effect of closeness and trust as aspects affecting the investment decision within the context of a referral network relationship in the New York Metropolitan area (Haar *et al.*, 1988:14-15). In this study, a set of at least eight propositions were tested, all of which centred on informal risk capital/business angel investment and referral and trust within the context of referral (Haar *et al.*, 1988:14-15).

Initial findings revealed a high informal risk business investment tendency within the New York Metropolitan area, attracted mainly by a high rate of return, for at least 44% of the respondents, the opportunity for capital appreciation, for at least 39% of the respondents and a high profitability outcome which was experienced by at least 42% of the respondents. This gave informal risk-capital investments a high approval rate with 90% of the respondents stating that they would invest in an informal risk-capital investment again, including 68% of those who had failed in their investments (Haar *et al.*, 1988:19).

Further investigations that focused more on testing hypotheses and propositions structured around the before mentioned objective revealed that a significant proportion of the business angels, that is 52%, refer their investments to a referral network while close to 75% of these referees also invested in these ventures (Haar *et al.*, 1988:22). This result supported findings in other studies which proposed that extensive syndication of business angels takes place in the informal risk capital market (Haar *et al.*, 1988:23).

It was also revealed that the more preferred referral investors were friends and business associates (Haar *et al.*, 1988:23). It is from such evidence that Haar *et al.*, (1988:14) propose that it is advisable for an angel to avoid investments in which he or she cannot persuade others to join firstly because of the value of shared risk and also on the importance placed on the opinions of referees. Ventures not supported by the opinion of a referee can easily be regarded as potentially low return ventures and hence tend to experience more difficulty in attracting outside investors (Haar *et al.*, 1988:14).

Interesting findings were made when results proved the proposition that the closer the referee to the referrer, in terms of personal familiarity, the more likely that they would invest. It was found that personal colleagues invested in 85% of the investments referred to them, while professional contacts only invested in 60%, a significant statistical difference of Chi square, $p < .005$ (Haar *et al.*, 1988:23). It was also found that professionals have a better successful venture selection capacity as compared to personal colleagues, a finding with a statistical significance of $p < .05$ (Haar *et al.*, 1988:23). This shows that although familiarity plays an important role when it comes to the decision to invest or not to invest, attracting a professional investor could mean that the venture has a positive potential for success.

Testing the proposition that the more trusting the decision behaviour of the referee the less likely that the investment will be successful, proved fruitless as a cross tabulation of trusting and formal evaluation styles against the outcomes was not significant (Haar *et al.*, 1988:24). From these results, it is proven that there are benefits to be derived from networking regardless of whether the networks created are with business angels personally familiar to the entrepreneur or with professionals that take up an interest in the business. This falls in line with the proposition that a mixed approach is adopted in which several trusting referees are approached to ensure full capitalisation, and a limited number of professionals are approached to screen the business proposal put forward by an entrepreneur. This ensures that such a proposal receives objective scrutiny from a reputable professional and still has a success potential as both investors of personal familiarity and professionals are approached for investment (Haar *et al.*, 1988:28). The research at hand seeks to establish whether entrepreneurs in South Africa make use of such business angel networks. It seeks to investigate the existence and understanding of the business angel practice in South Africa and to determine the awareness of business angel networks and their benefits in South Africa.

4.4 BEST PRACTICES IN BUSINESS ANGEL NETWORKS

In the United Kingdom, research has shown that the best practices for business angel networks can be identified as those that involve the formation of introductory agencies whose main purpose is to bring together entrepreneur candidates for possible investment and a group of potential investors (Carriere, 2005:1). From here, investor-investee relationships would be initiated and the necessary due diligence carried out before investment terms and conditions are agreed upon. Contrary to the specific function described above, another predominant tendency in the United Kingdom was to formulate structures known as angel funds (Carriere, 2005:1). These are business angel groups that basically handle the due diligence process and invite other business angels as members to join them in the investment. What these structures essentially point to is the fact that business angel syndicates function better when there are measures put in place to handle the more administrative side of syndication before the entrepreneur meets the investor (Carriere, 2005:1).

Establishing networks and good relationships with venture capitalists has also been highlighted as a positive practice that business angels and business angel groups can get involved in. This is due to the important role that both types of fund providers play in driving

the innovation of a nation's economic and entrepreneurial objective (Carriere, 2005:2). Both types of fund providers facilitate the possible success of entrepreneurial ventures by providing finance at the start-up and growth stages of a business. These stages are crucial if a business idea is going to get commercialised and realise its full potential. Networking and investor business conferences, partnerships among national associations and even venture capital membership in the angel groups have been noted as the best places in which the relationship between business angel syndicates and venture capital firms or groupings can be forged (Carriere, 2005:1).

Where business angel groups experience the poor quality of a business deal as one of the challenges to funding entrepreneurial ideas, it has been proposed that business angel groups take the time to educate entrepreneurs on what they stand to benefit from equity financing in order to increase the demand for additional capital in financing (Carriere, 2005:14). It is also important that the business owners understand the needs of the investors before making presentations to them in order to avoid poor first impressions from presentations lacking essential information. In the same respect, effective presentation skills are of importance if the entrepreneur is to fully communicate the business idea in a way that interests the business angel into considering investing. This is also a way of encouraging investors to work with promising companies that appear 'investor ready', in terms of all the information that is needed on their part to make the potential relationship work by taking time to look into promising ideas (Carriere, 2005:14).

Business angel networks that have assumed a credible reputation in Europe and North America have been seen to be those that have within them a leading entrepreneurial figure as a leader figure. It was found that the charisma and entrepreneurial spirit of the leading figure of a business angel network exists as a strongpoint for setting the tone and the spirit of the group. Where investors experienced limited time as a constraint to monitoring additional and potential investments in Europe, it was suggested that business angels join a reputable angel fund that would provide the opportunity to invest in a large number of investment opportunities which would already have been evaluated by experienced business investors. The other option suggested was to develop syndicates with introductory agencies which would allow them to assume active roles in some investments and to be passive in others "therefore increasing the breadth of investments and better managing the risks" (Carriere, 2005:17).

Business angels that have in the past experienced difficulty in sourcing good investment deals have found that relying on other business angels in some form of a network of referral for word on good investment has been a positive approach to eliminating this difficulty. Most business angels experience this difficulty as they go about striking a balance between their desire for anonymity and the need to keep a constant flow of good investment deals going. Relying on other business angels and being associated to a referral network to which other business angels belong has been proven to be a way of achieving this balance and of ensuring that one is always aware of the good business opportunities out there (Carriere, 2005:18).

Other business angels were noted as stating that one of the barriers they faced with investment was the inability to negotiate a deal with entrepreneurs that was beneficial to both sides. Research showed that the most prominent discrepancy was in the price offered or the amount to be purchased in equity. The solution to this was, as presented earlier in the study, also based on the emphasis that entrepreneurs should make an effort to understand the investment expectations of investors before proposing term agreements. It was also proposed that introductory agencies should make efforts to educate business angels on how to come up with appropriate terms sheets and how to negotiate effective investment deals (Carriere, 2005:19).

Carriere (2005:20) also noted that “success in any angel group will depend on the commitment of key individuals and their ability to identify and nurture high potential investment opportunities”. He goes on to mention that the importance of a champion individual or small group of people to champion an enterprise should not be underestimated in the formation of an angel group. This emphasis highlights the value placed on the qualities and potential contributions that angels could bring into an angel syndicate in order for it to provide the necessary assistance to entrepreneurs. This is so because some small businesses are found in generally worse off states and would need the involvement of a highly skilled angel syndicate team in order to function effectively. The following table highlights some of the kind of challenges and best practice recommendations that Carriere makes in his research.

Table 4.1: Challenges and best practices for angel networks

Challenges:	Best Practice
Leveraging champion angels	<ul style="list-style-type: none"> • Organise angels around nodes of expertise
Developing less experienced angels	<ul style="list-style-type: none"> • Partner less experienced angels with more experienced ones in a syndicate • Offer business angel training programmes, particularly focused on negotiating and structuring the deal • Conduct deal post mortems- what went right and what went wrong • Keep members involved in the operation of the angel group. Be knowledgeable about their skills and make sure to take advantage of their expertise
Angel membership turnover	<ul style="list-style-type: none"> • Angel groups should maintain a critical mass of angels with a variety of backgrounds

(Source: Carriere, 2005:18).

One of the most emphasised strategies with regard to ensuring effective business angel syndicates has been the pairing of inexperienced business angels with effective ones who are referred to as nodes of expertises. Mixing business angels on the basis of experience and expertise allows the more experienced business angels to play a mentoring role to the less experienced ones, for example in due diligence teams, allowing the less experienced business angels to learn from the more experienced ones. Some angel syndicates have been noted to run their groups in terms of apprentice programmes in which they ask the more experienced business angels to help them in completing investment work. This is believed to help upgrade the quality of such syndicates' selection and due diligence processes and to "increase(d) members' willingness to be more significantly involved in the operation of the angel group. It also provides value to the members as they learn new skills and have new

experiences themselves” (Carriere, 2005:20). To achieve the same objective, some organisations such as the London Business Angels have been noted as having created business angel training programs in which they make angels out of interested wealthy individuals and increase the supply of champion angels. The challenge, as noted by Carriere (2005:20) is “to get potential angels that are interested, but have not yet made investments, and inactive angels, who might already have some experience in investing, to start investing actively”.

4.5 THE BENEFIT OF BUSINESS ANGELS TO INVESTEE COMPANIES

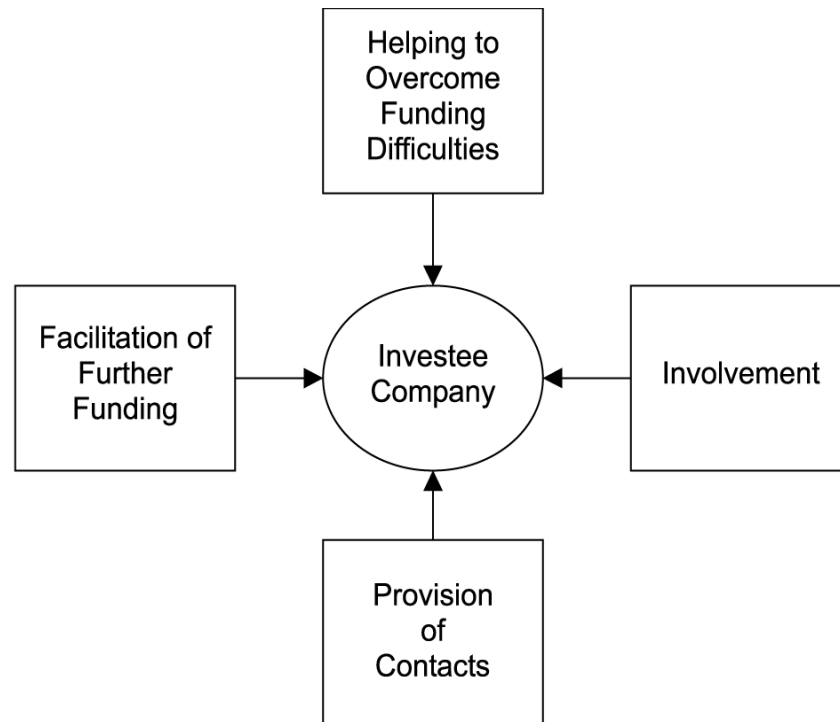
Researchers on small businesses appear to have a common understanding of small high growth enterprises when it comes to the kind of contribution they make to growing economies. It is understood that the contribution made by these enterprises is highly valuable and should not be underestimated as they provide vital employment, goods and services. Valuable as this contribution may be, however, there seems also to be a trend in the general problems encountered by these businesses from as early as the launch stage going through to the growth stage (De Clerq and Sapienza, 2006 in Macht and Robinson, 2008:187).

Most enterprises are found to experience problems such as accessing finance and the lack of human capital in terms of experience, knowledge and/or skills in managerial and other business issues (Macht and Robinson, 2008:187). Entrepreneurs who start high growth enterprises have mostly been noted as having the technical skills needed to start and run a high growth enterprise in its early stages but lack the management and business skills needed to steer it towards further success (De Clerq and Sapienza, 2006 in Macht and Robinson, 2008:187).

In addition to a variety of public sector grants, specialised early-stage equity funds and other non-financial supports, business angels exist as a vital contribution to a business effort as they provide not only financial assistance but business acumen too. Most business angels tend to contribute their skills and expertise to further the returns on the commitments made by their investee companies. As a third and fourth contribution made by business angels to small enterprises, providing access to a network of valuable business contacts and the facilitation of further finance have both been seen as added benefits brought by business angels (Aernoudt

and Erikson, 2000:178, Freear *et al.* 1994:109 and Reitan and Sorheim, 2000: 131, Macht and Robinson, 2008: 187). This is illustrated below:

Figure 4.1: Benefits of business angel networks



Framework of BA benefits (Macht and Robinson, 2008:187).

On providing benefits through involvement, business angels can be categorised as either passive or active, depending on the extent of their involvement (Macht and Robinson, 2008:190). Passive business angels are basically taken to provide only financial support to the investee company and little or nothing else in terms of actual involvement in the running of the enterprise after that (Macht and Robinson, 2008:190).

Their active counterparts on the other hand are seen to use their knowledge and skills to help monitor, manage and control the business in a very involved manner such as taking seats in the Board of Directors where they are able to access management information and participate in management decisions (Mason 2002 in Macht and Robinson, 2008:190). The level of involvement is also sometimes determined by the business angel's knowledge and expertise regarding business start-ups although the general trend has been a rather strategic

contribution to the start-up (Van Osnabrugge and Robinson, 2000 in Macht and Robinson, 2008:190).

Business angels may also provide the investee company with valuable business contacts which help the investee company in different aspects of the business. Management and recruitment contacts are introduced, whose use depends on the business background of the business angel (Macht and Robinson, 2008:191). Some business angels facilitate relations with potential customers; provide valuable business alliances and provide contacts in the investment community introduce the investee company to other business angels and recommend the investee company to other sources of finance (Macht and Robinson, 2008:191).

4.6 THE PROCESS OF FACILITATING FOR FURTHER FINANCE

Roger Sorheim conducted an exploratory study on the value-added contribution of business angels to small businesses in 2000, in which he sought to determine the extent to which business angels act as facilitators of further finance (Sorheim, 2000:179). Using a loosely structured interview guide which focused on the investment process, Sorheim conducted in-depth case studies of five experienced business angels.

He revealed how the reputation of educated and experienced business angels, with regard to their investment behaviour and success in the past, helps secure further financing from sources within their region of operation such as the bank and other sources for entrepreneurs who would have otherwise not been able to secure this (Sorheim, 2000:184). Most of the business angels he used in the study seemed very conscious of the important role they played as facilitators of further finance and referred to themselves as ‘door openers’ to further investment as it sometimes only took the mere mention of their names as referees in financing negotiations to get the financiers interested in the venture (Sorheim, 2000:185). Being associated with business angels who had developed good reputation of being involved with successful projects was found to be a positive aspect when engaging in financing negotiations with the more institutionalised sources of funding such as banks.

These investors consider themselves as very important to securing further finance for such businesses as they already have good reputations with banks and other financial institutions.

Roger Sorheim quotes a particular investor who was able to secure further finance for a venture he had taken interest in merely because he had a reputation with banks and other financial institutions with regards his past investment success (Sorheim, 2000:184). Not only did this business angel secure the required further finance for the venture, but he did so, as he claimed to normally be the case with other such investments, on favourable interest terms to the entrepreneur (Sorheim, 2000:184). A close relationship between the facilitator and the potential investor, the reputation of the facilitator and a strict regional focus were seen to be important determinants of success in obtaining debt financing (Sorheim, 2000:185).

Another important contribution made by these business angels was the business networks they were a part of and which were now exposed to the use of the venture. Most angels interviewed described having regional networks which the venture could benefit from, but more importantly they could also bring in people with national and international networks and experience even though this was usually difficult (Sorheim, 2000:183). The most important aspect about these networks was maintaining credibility either as a leading investor or as a referrer to good investment opportunities.

The study revealed that the ability of business angels in securing further finance rested on their investment in good business ventures because this in turn attracted the business angel's network to the venture. This developed a reputation for the business angel which worked in his/her favour when attracting further potential investors to the venture (Sorheim, 2000:185). Potential partners usually base their judgements on their own or other past dealings with the investor (Sorheim, 2000:187). However, the business angels also showed great care in the type of investor they brought into a portfolio firm, making sure that the investor was a long term investor, and not one looking for immediate short term returns. This was considered vital for the growth of the firm (Sorheim, 2000:186).

Industry specific investors were seen to perform a role as 'boundary spanner' for ventures looking to attract venture capital funding at a later growth stage (Sorheim, 2000:187). The role of 'boundary spanner' involves the investor bridging structural holes within ventures, in terms of finance and administration, in ways that attract venture capital funding at a later growth stage. The investors make commitments to a venture in ways that are in line with venture capital expectations such that the firm has no problem in securing this type of financing when the need for it arises (Sorheim, 2000:187).

It is also interesting to note that as these investors facilitate easier access to such later stage finance, they are not usually involved in the actual or direct facilitation of debt finance. Their role is mostly to create conditions that allow for further finance as would be rendered the case when venture capitalists make considerations of possible investment opportunities (Sorheim, 2000:187). In other words, their involvement enhances the credibility of such entrepreneurial firms, making them more attractive to further financing from sources such as venture capital firms and banks.

Boundary spanners are investors with a good track record in developing entrepreneurial firms and their involvement may increase the credibility of the entrepreneurial firm and ease access to debt finance. Their involvement with an entrepreneurial venture tends to attract institutionalised venture capital firms to the investment as strategic partners, thereby leading to the securing of further growth finance (Sorheim, 2000:187). In understanding how business angels facilitate further finance, it is important to realise that experienced business angels play a vital role (Sorheim, 2000:189).

4.7 SUMMARY

Business angels ease the familiar difficulty in obtaining business start-up finance. They predominantly allow for more favourable terms in investment negotiations with entrepreneurs, which make them an attractive option for entrepreneurs seeking funding in the start up phase of their businesses. They are however not easily identifiable to such entrepreneurs and have been shown to decrease this difficulty where they form part of an identifiable local or regional network. One of the most important realisations that entrepreneurs or entrepreneurial teams need to take note of when seeking further finance is the value of being involved with a business angel with a proven and reputable track record of investment and referrals. Such business angels add value to an entrepreneurial firm by making the process of securing further finance easier because they already have a reputation and track record of being involved with worthwhile investments and referring investment opportunities with a high return potential.

This credibility brings the needed attention to the entrepreneurial venture from potential investors, thereby increasing the possibility of such firms securing the needed further

financing. Of particular importance is the likelihood of attracting venture capitalists to an entrepreneurial firm as it has been noted that reputable business angels make an entrepreneurial firm attractive as an investment option to venture capitalists. Reputable and experienced business angels also contribute exposure to valuable networks that entrepreneurs can come to make use of in the ongoing process of growing their businesses as the need arises.

The following chapter will focus on the methodology of the study, highlighting the techniques and approaches used to obtain results and draw conclusions.

CHAPTER 5
RESEARCH METHODOLOGY

5.1 INTRODUCTION

The methodology aspect of a research refers to the overall approach that the research process will be adapting, from the theoretical underpinning to the collection and analysis of the data. This process cannot be rendered true or false but rather it can be considered more or less useful in terms of achieving the set goals or objectives of the research. It is mainly concerned with issues regarding to why certain data was collected, what data was collected and from where it was collected. It also focuses on when the data was collected, how it was collected and how it will be analysed (Collis and Hussey, 2003: 55, Silverman, 1994:2).

5.2 IMPORTANCE AND PURPOSE OF RESEARCH

The purpose of this research is to explore the field of small business finance in the start-up phase, focusing particularly on business angel finance. The researcher seeks to expose current and emerging entrepreneurs to a form of early stage financing that may not currently be considered as one of the popular forms of small business financing in South Africa but one that may ease the burden of acquiring start-up financing if it is adopted. This research also aims to create fresh interest in the potential of pooled/networked private capital as a viable alternative form of financing for creative and potentially high return entrepreneurial ideas. The results of this research will be of interest to emergent entrepreneurs seeking information about sources of start-up capital as well as relevant government agencies charged with the task of creating an enabling environment for small businesses. This is because studies have shown that finance is one of the major challenges facing start-up businesses (Abor and Biekpe, 2006:69; Hernandez-Trillo *et. al*, 2005:435).

To achieve this purpose, this research followed the exploratory research approach. Exploratory research is very useful for familiarisation with a topic of interest to a researcher that he or she believes may be of value to the targeted audience of the research. It is usually conducted for two other purposes, other than the researcher's interests, which are to test the feasibility of conducting more extensive study and to develop the methods to be employed in a subsequent study. Exploratory studies are also very important for breaking new grounds. The main shortcomings with this form of study are that exploratory studies rarely provide satisfactory answers to research questions even though they usually hint at the answer and suggest which research methods can provide definitive ones. The reason for this shortcoming

is that the people studied in this form of research may not be typical of the larger population that interests the researcher (Babbie, 2007:88).

5.3 PARADIGMS AND RESEARCH METHODOLOGY

5.3.1 Paradigms Overview

The research paradigm refers to how research should be conducted in terms of providing a framework of theories and methods of defining data. It is the frame of reference we use to organise our observations and reasoning which helps us understand different views and learn to accommodate them. (Collis and Hussey, 2003: 46, Babbie, 2007:31). The term can be used and understood on three different levels, which are philosophical, social and technical (Morgan, 1979:137). At the philosophical level, paradigm is used to reflect basic beliefs about the world, whereas at the social level, it provides guidelines as to how the researcher should go about conducting the research.

At the technical level, the term specifies the methods and techniques recommended when conducting the research (Morgan, 1979:137). As the researcher goes about conducting the research, the paradigm pursued will be reflected by the way in which the research is conducted, the kind of questions asked and how the responses to these questions are analysed and interpreted. The two main paradigms often used by researchers are the positivist and phenomenological research paradigms (Collis and Hussey, 2003:48).

There are various assumptions that are used by researchers to help draw the distinction between the phenomenological and positivist paradigms, referred to by some researchers as qualitative and quantitative approaches respectively. These assumptions shape the research process in itself in terms of what direction is followed and how the required information is obtained from the field. The following table helps make this distinction:

Table 5.1: Assumptions of the two main paradigms

ASSUMPTION	QUESTION	QUANTITATIVE	QUALITATIVE
Ontological	What is the nature of reality?	Reality is objective and singular, apart from the researcher	Reality is subjective and multiple as seen by participants in a study
Epistemological	What is the relationship of the researcher to that researched?	Researcher is independent from that being researched	Researcher interacts with that being researched
Axiological	What is the role of values?	Value-free and unbiased	Value-laden and biased
Rhetorical	What is the language of research?	Formal. Based on set of definitions. Impersonal Voice. Use of accepted quantitative words.	Informal. Evolving decisions. Personal voice. Use of accepted qualitative words.
Methodological	What is the process of research?	Deductive process. Cause and effect. Static design-categories isolated before study. Context-free generalisations leading to prediction, explanation and understanding. Accurate and reliable through validity and reliability	Inductive process. Mutual simultaneous shaping of factors. Emerging design-categories identified during research process. Context-bound patterns, theories developed for understanding. Accurate and reliable through verification

Adapted from Creswell (1994:5).

5.3.2 The Positivistic Paradigm

The positivistic paradigm on the other hand is based primarily on facts or causes and logical reasoning. It follows a very precise method of inquiry and emphasises objectivity as a key aspect of the process of the research. The underlying belief is that inquiries into social phenomena should be conducted in the same fashion as are inquiries into the natural sciences (Collis and Hussey, 2003:53). It also proposes that social reality exists independent of us and that it continues to exist regardless of whether we are aware of it or not. It then follows on by stipulating that the act of investigating reality has no effect on that reality. Further propositions of the paradigm state that laws provide the basis of explanation, permit the anticipation of phenomena, predict their occurrence and therefore allow them to be controlled. (Collis and Hussey, 2003:53).

Table 5.2: Features of the two main paradigms

POSITIVISTIC PARADIGM	PHENOMENOLOGICAL PARADIGM
Tends to produce quantitative data	Tends to produce qualitative data
Uses large samples	Uses small samples
Concerned with hypothesis testing	Concerned with generating theories
Data is highly specific and precise	Data is rich and subjective
The location is artificial	The location is natural
Reliability is high	Reliability* is low
Validity is low	Validity* is high
Generalises from sample to population	Generalises from one setting to another

Source: (Collis and Hussey, 2003:55).

Key

- * The terms reliability and validity have a star on them in the phenomenological paradigm column due to the fact that their usage and definition in phenomenological research is contested and uniquely defined by qualitative researchers. Sections 5.7 and 5.8 have been set aside in this chapter to understand the propositions and motivations put forward by the qualitative researchers in their defence of this position.

5.3.3 The Phenomenological Paradigm

The phenomenological or qualitative paradigm attempts to understand human behaviour from the frame of reference of the participants in the study. The researcher locates him or herself in the research field and attempts to make sense of the subject in a natural setting. The researcher pays attention to the subject in the field and how the subject experiences his or her reality as interpreted by the researcher. Often the researcher seeks to remain anonymous within the field of research and to the participants in order to avoid behaviour modification through what is known as reactivity but the assumption is that the social reality is within the research and therefore the act of research in itself has an effect on that reality (Denzin and Lincoln, 2000:3; Babbie, 2007:290; Collis and Hussey, 2003:53; Van Maanen, 1983:9).

The subjective state of the individual within the research is held in high regard and the focus is directed more on the meaning rather than the measurement of social phenomena. It is believed in this paradigm that there is no reality independent of the mind and that what is researched cannot be unaffected by the actual process of the research (Denzin and Lincoln, 2000:3; Babbie, 2007:290; Collis and Hussey, 2003:53; Van Maanen, 1983:9).

What the information above basically points to about qualitative research is that it makes use of a naturalistic approach whose aim is to understand phenomena in context-specific settings, such as “real world setting [where] the researcher does not attempt to manipulate the phenomenon of interest” (Patton, 2001:39) even though the very presence of the researcher in the field already affects the research outcome. However, the main point with phenomenological research is that research findings are reached upon without the usage of statistical procedures or quantification because the aim is to allow the research interest to unfold as would be expected without the usage of formulae and mathematical processes. The researcher observes and extracts what is in the field and analyses this without the usage of statistical methods and processes as would be the case in quantitative research (Patton, 2009:39; Strauss and Corbin, 1990:17).

A researcher conducting an ethnographic study within a community for example will affect the process of the research through both action and inaction as long as he or she has become known to the community, regardless of whether or not he or she discloses the reason for his or her presence in the field. This is true in the sense that contributing to the ‘normal’ life of

the community will influence the course of that community from the point of contribution just as much as having no contribution when one is asked for might create uncertainty within the community from the point of not contributing. The techniques used in conducting studies using this paradigm are hence interpretive in nature and seek to describe and translate meaning (Golafshani, 2003:600; Babbie, 2007:292; Collis and Hussey, 2003:53; Van Maanen, 1983:9).

5.4 METHODOLOGY

The researcher pursued this study using the phenomenological paradigm making use of the semi-structured interview research technique. This is mainly due to the novelty of the research topic in South Africa and hence the researcher felt that a qualitative approach would be appropriate to test for detailed levels of understanding, an approach which would make way for other strategies to the study. The phenomenological approach was also chosen due to the interconnectedness of the key elements of the qualitative technique which enables the progression from one stage of the study to another to be pursued in a whole and flexible manner in a way that other techniques would not enable. The researcher also chose the phenomenological methodology because this paradigm seeks to describe and translate the meaning of phenomena, an objective that the researcher values especially with an exploratory study of this nature (Collis and Hussey, 2003:47; Maxwell, 1996:6, van Maanen, 1983:9).

The researcher drew from a study that was conducted by the Global Entrepreneurship Monitor on South Africa in 2001 by assuming a more in-depth investigation to the practice of business angels in order to capture the constructs used as a basis for its usage. To draw up a research problem, the researcher used the deductive reasoning technique to theory construction and testing. This method of reasoning entails a procession from a general claim to fact and knowledge, toward verification through specific observation (Collis and Hussey, 2003:168, Connole, 1998:11).

5.5 RESEARCH POPULATION AND SAMPLE

The research population refers to that group of people from whom findings and conclusions about the research will be drawn (Creswell, 1994:114). The population of this research came from small business owners and business angels in a chosen location in the Eastern Cape

province of South Africa. It covered the area of Grahamstown, Eastern Cape, South Africa. The business owners were taken to be all those business owners that fell under the definition of the National Small Business Act of 1996 across different sectors, ranging from micro, very small, small to medium. Local small business agencies from each location together with the Yellow Pages Business Directory were used to draw a list of potential respondent for the research.

Creswell (1994:114) holds that “the idea of qualitative sampling is to purposefully select informants” from whom the best responses on the phenomena under research may be obtained. The researcher made use of the natural sampling method to contact the business operators and relied on the snowball effect to contact the business angels. These approaches involve using a respondent from the sample where you find one, and relying on one respondent to tell you where to find the next respectively. These approaches have been chosen due to the limited research on business angels in South Africa, the potential difficulty in identifying business angels and the possibility of sample error in such a situation (Babie and Mouton, 2001:100, Collis and Hussey, 2003:158, Seaberg, 1988:254 in de Vos, Strydom, Fouche, Delpont, 2005:195).

5.6 RESEARCH METHOD

This study made use of the phenomenological and critical ethnography research methods in achieving its objectives. The phenomenological perspective on ethnography is a predominantly interpretive approach concerned primarily with meanings. In this perspective, human behaviour is viewed as a product of how people interpret the world. The researcher adopts an empathetic approach to understanding the processes behind people’s actions, an approach that requires the researcher to see things from the point of view of those people. The researcher seeks to get acquainted with the meanings people have for phenomena that makes up their reality either by co-existing with the group, that is, participating in one way or another and gradually assimilating their perspective, or it might be ‘short-circuited’ to some extent by asking questions (Bogdan and Taylor, 1975:13-14, in Harvey and MacDonald, 1993:183). The researcher will seek to understand the objectives of this research from the point of view and understanding of the respondents by asking questions on the meanings of key research terms such as entrepreneurship, business angels, and small business owner.

To achieve this purpose of the research, the researcher adopted the ethnomethodology technique which focuses on taken-for-granted aspects of the social world by examining routine, everyday activities and understandings of the social world and how meanings about these are generated to relate to common sense. Ethnomethodology approaches all meanings as being unclear, ambiguous and problematic for people in particular situations. This approach “ ..examine(s) the ways in which people apply abstract rules and common-sense understandings in situations so as to make actions appear routine, explicable and unambiguous” (Harvey and MacDonald, 1993:184).

The critical ethnography methodology also focuses on meaning but attempts to locate these within a broader setting. Meanings are seen as either cultural or structural, that is belonging to a broader cultural or structural setting to which people are a part. They are seen to depend on broader social issues and processes that affect the interpretive process. Meanings are situated not only to make sense but also to reflect how social structures and existing power relationships shape them. The social structure is examined rather than taken for granted. Attempting to interpret or understand meaning on its own is therefore not enough as there is a need to critically understand the society or setting to which people are a part (Harvey and MacDonald, 1993:184-185).

In addition to attempting to interpret and understand the objectives of the research from the point of view of the respondents, the researcher sought to examine these understandings in relation to the broader social context to which the respondents belong or are exposed to. By this the researcher sought to understand aspects such as the business environment in which the small businesses operate, the level and accessibility of government activity in promoting entrepreneurship in Grahamstown, Eastern Cape, South Africa and the events and processes that led to the engagement in entrepreneurship, just to mention a few. The objective was to examine the taken for granted social structures and how these affect the understanding or interpretation of particular meanings that the researcher is studying.

5.7 DATA COLLECTION METHOD AND CAPTURING

This section presents the data collection method that the researcher used. The research collection method refers to the various means by which data can be collected and/or analysed. For the purposes of this research, the researcher will make use of the interview data collection

method. Interviews are a method of data collection that involves the asking of a set of questions with the intention of acquiring qualitative information from a respondent. They can take the form of face-to-face verbal interchange, mailed or self-administered questionnaires, and telephone surveys. They can be structured, semi-structured or unstructured. The length of an interview can vary from a five minute telephone to multiple lengthy sessions, spanning over days in some instances (Collis and Hussey, 2003:55).

The researcher used semi-structured face-to-face interviews for data collection. The researcher contacted the sample populations to schedule interviews and held the interviews with those respondents who agreed to participate in the study. Interviews however come with their advantages and disadvantages. Some of the advantages are that qualitative in-depth interviews allow the researcher to conduct a study with a specific purpose, exploring general topics in order to reveal the interviewee's perspective whilst paying attention to how the interviewee frames and structures these responses (Kahn and Cannell, 1957:16). This supports the view that the "participant's perspective on the phenomenon of interest should unfold as the participant views it, not as the researcher views it" (Marshall and Rossman, 1999:109).

They also offer an opportunity for the data being understood in a faster manner, allow for urgent follow-up and clarification of the information given by the interviewees, whilst giving the interviewer the line of control over the questions (Marshall and Rossman, 1999:110). One of the disadvantages of interviews is that some respondents might not be willing to divulge certain information to the researcher whilst not all respondents may be equally articulate and perceptive in divulging the information required (Creswell, 1994:150).

5.8 RELIABILITY AND VALIDITY AS SEEN BY QUALITATIVE RESEARCHERS

5.8.1 Reliability

According to Golafshani (2003:601), when seeking to understand the meaning of the terms validity and reliability in qualitative research it is important to read on how the two terms have been defined by quantitative researchers. Researchers such as Eisner (1991:58) have emphasised that the true test of a quantitative research is its quality, in terms of the manner in which the research is conducted and the richness of the information that it draws from its data collection. The motivation behind this emphasis goes along with a similar idea on the quality

of a qualitative research which states, however, that a good quality qualitative research is one that achieves the main objective, which is to generate understanding of the phenomenon being studied.

Hence, due to the difference in emphasis where qualitative and quantitative research are concerned, some qualitative researchers state that to even mention reliability in a qualitative research context would render that study “no good” (Stenbacka, 2001:552). This is further supported by researchers such as Lincoln and Gubba (1985:300) who use the terms dependability and confirmability in their study, terms which have a close meaning to reliability but not the word reliability itself as would be done in quantitative research. In the same line of thought, Seale (1999:266) holds that the examination of trustworthiness is quite crucial to ensure reliability in qualitative research, further adding to the pool of qualitative researchers who believe that a separation of terms is important when dealing with qualitative and quantitative paradigms. Reliability in the positivistic sense is not as important.

5.8.2 Validity

Issues of validity in qualitative studies have been approached differently by qualitative researchers but they have all nonetheless shown a similar thread of separation from quantitative meanings and understandings. A number of qualitative researchers have for example suggested that the validity of a qualitative research is affected by the researcher’s own perception of validity in the study, leading to a generation of various terms to refer to validity some of which are rigour, quality and trustworthiness. Redefinition of terms or the decision to use different terminology for phenomenon specific research purposes continues to be a leading issue for qualitative researchers. For example Golafshani (2001:602) notes that the researchers Davies and Dodd (2002) propose that the term rigor (sometimes used to refer to validity in quantitative research, an apparent quantitative bias according to the authors) in qualitative studies should differ from that in quantitative studies by adopting a bias toward subjectivity, reflexivity and social interaction.

For the purposes of this research, the researcher will seek to generate an understanding of the usage of business angels, business angel networks and the knowledge of business angel finance by asking qualitative interview questions that carefully seek this understanding from the respondents. From the data collection and analysis stages, the researcher will seek to

show that the results reflect what is actually happening on the ground and to approach the data in the eyes of the respondents and not the researcher's own perceptions (Stenbacka, 2001:551 in Golafshani, 2003:601; Collis and Hussey, 2003:58). The researcher will also base the authenticity of the data collected on the fact that research instrument used is an adaptation from one successfully used by the Global Entrepreneurship Monitor in conjunction with University of Cape Town in a similar study in 2001.

5.9 QUALITATIVE TERMINOLOGY AND APPROACHES TO ENSURING 'VALIDITY' AND 'RELIABILITY'

Patton (2002:14 in Golafshani 2003:600) states that whereas instrument construction stands out as being important for data credibility purposes, in qualitative research the researcher is the main instrument. What this means is that when quantitative researchers speak of research validity and reliability they normally refer to research that is credible whereas qualitative researchers believe that "the credibility of a qualitative research depends on the ability and effort of the researcher" (Golafshani 2003:600). In this sense, reliability and validity in qualitative research are not treated separately but are rather considered to fall in the definitions of dependability, credibility, transferability and confirmability.

In qualitative research, dependability can be viewed as the comparable notion to what would be referred to as reliability in quantitative studies (Riege, 2003:81). According to Collis and Hussey (2003:58), qualitative measures are not concerned with reliability as would be the case with quantitative studies, but rather with whether or not similar observations and interpretations cannot be made on different occasions and/or by different observers. The aim behind dependability is to ensure that stability and consistency are ensured throughout the process of inquiry by ways of the researcher avoiding a personal theoretical position or bias on the process of research.

Credibility is taken to be "the approval of research findings by either interviewees or peers" (Riege, 2003:81). It is referred to as "the parallel construct to internal validity [which] seeks to ensure that the inquiry was carried out in a way which ensures credibility" (Riege, 2003:81). This can be achieved by giving and getting feedback from the respondents to ensure that the respondents' views are accurately captured (Creswell, 1994:158). In this research, the researcher will ask the questions in a conversational manner, allowing the

interviewees to respond freely and elaborate further on their responses in a way that they feel satisfied with what they would have said. This allows the respondents to re-affirm their own responses and to feel sure that what they said in response was what they intended to express.

Closely linked to the concept of credibility is that of trustworthiness. This is important to qualitative studies especially when questions lined towards or related to validity are asked of the research findings. Trustworthy findings are considered credible and therefore defensible (Golafshani, 2003:603; Johnson, 1997:283). According to Norman (1970, in Collis and Hussey, 2003:58) “it is possible to generalise from a very few cases, or even a single case, if your analysis has captured the interactions and characteristics of the phenomena you are studying. Thus, you will be concerned with whether the patterns, concepts and theories which have been generated in a particular environment can be applied in other environments. To do this, you must have a comprehensive understanding of the activities and behaviour you have been studying”.

Linked to the concept of validity is that of transferability which comes to effect “when the researcher shows similar or different findings of a phenomenon amongst similar or different respondents” (Riege, 2003:81). Transferability was ensured through the analysis each one of all the respondents who represented different industries in running their businesses in Grahamstown, Eastern Cape, South Africa. This allowed the researcher to determine whether the findings were similar or different about the same phenomenon from similar respondents who are small business owners in different industries.

Also aligned with the concept of construct validity, neutrality and objectivity in positivist research is that of confirmability. Confirmability “assesses whether the interpretation of data is drawn in a logical and unprejudiced manner” (Riege, 2003:81). The confirmability of this research will be achieved through the retention of all transcriptions on a laptop computer, a flash drive and a compact disc (CD) for reanalysis purposes.

Mathison (1988 in Golafshani 2003:603) believes that triangulation methods are also appropriate when making checks for validity in qualitative studies. Mathison states that triangulation is a very important methodological research issue in qualitative studies where the objective is to control for bias and establish valid propositions “because traditional scientific techniques are incompatible with this alternate epistemology” (Mathison, 1988:13

in Golafshani 2003:603). The combination of methods brought about by triangulation strengthens a study according to Patton but Barbour believes that triangulation should be defined in qualitative terms when it is used in a qualitative context. After a consideration of constructivist and realist propositions on perceptions of reality, Golafshani (2003:604) concludes that “triangulation may include multiple methods of data collection and data analysis, but does not suggest a fixed method for all the researches. The methods chosen in triangulation to test the validity and reliability of a study depend on the criterion of the research”. The following section shows how the researcher will achieve this objective in the data analysis stage of this particular research.

5.10 DATA ANALYSIS

Qualitative data analysis refers to the non-numerical examination and interpretation of observations, for the purpose of discovering underlying meanings and patterns of relationships. The collected data is brought together in an orderly manner, to be structured and interpreted by the researcher. It is a thorough back and forth process which involves the researcher repeatedly going through the collected data and breaking down the data into themes and categories before “...building it up again in novel ways (elaborating and interpreting)” (Terre Blanche, Durheim and Painter, 2006:322; Babbie, 2007:378; Marshall and Rossman, 1999:150).

According to Lofland and Lofland (1995:127-45) and Marshall and Rossman (1999:150), qualitative data analysis is best done by way of discovering patterns as one goes about the research process. They state that the process of discovering a pattern in data analysis involves the researcher asking certain questions from six proposed themes, which are: frequencies, magnitudes, structures, processes, causes and consequences. The questions ask how much a certain phenomenon occurs in a field, at what level(s), with what differences, with or without an order, from what cause and with what outcome (Lofland and Lofland, 1995:127-45).

The following research will make use of the content analysis research method of the transcribed interview material obtained from the respondents. This research method uses a system in which text is converted into numerical variables for quantitative data analysis. The material analysed can be in document form, audio cassette recording or video material. It allows the classification of analysed material into coding units which the researcher normally

constructs beforehand. The process involves extracting and justifying the usage of a sample to analyse from the data being analysed, depending on how substantial the material being analysed is. In cases whereby the material is less substantial, the researcher analyses all of it. From here, the researcher decides on coding units which could be words, characters, items or themes that can be found in the material. This leads to the construction of a coding frame in which the coding units are listed vertically to allow the analysis of particular communications to be added to a horizontal axis. Analysis is then conducted on frequency or the placing of certain items or words. (Collis and Hussey, 2003:255-256).

Content analysis allows for a range of advantages as a research method in qualitative data analysis. One of these advantages is that the handling of public documents with this method eliminates the problem of access and is generally inexpensive to utilise. Where a sample has been constructed, it exists as a permanent record to be visited and re-visited such that the pressures of time linked to interviews and observations is not an issue in the research. Some of the criticisms of content analysis have however been that choosing to use this method initiates the reduction of data at a very early stage of the research process. The core of this criticism is that selecting particular words and themes for usage in the method increases the incident where large amounts of data are discarded which could have assisted in understanding the phenomenon being studied at a more thorough and deeper level. Public documents may also have omissions such that the researcher's sample becomes incomplete. Some documents may have been created for purposes other than that which the researcher intends to use them for, "or they may be worded for public audience" (Collis and Hussey, 2003:256).

The researcher conducted the research analysis by comparing the responses obtained from the field interviews with the propositions made by the different researchers in the literature review. From this comparison, patterns were highlighted, inconsistencies pointed out and possible meaning deduced in order to reach some form of conclusion from the data under analysis. The data analysis included the 5 steps mentioned by Terre Blanche, Durheim and Kelly (2006:322, cited in Terre Blanche *et al.*, 2006) which are:

- familiarisation and immersion;
- including themes;
- coding;
- elaboration; and
- interpretation and checking.

This means that the researcher will dedicate a thorough effort to going through all research material and working with text such as field notes and interview transcripts, making notes throughout the process, drawing diagrams and brainstorming to get a full experience of the data that will be collected. The researcher then drew up themes from the data but also with a bearing on the research question and objectives. In this process, the researcher paid attention to the language and terms used by the respondents to describe certain phenomena and to respond to certain questions. An effort was made to avoid summarising but to think in terms of processes, functions, tensions and contradictions within the research (Terre Blanche, *et al*, 2006:326).

The next stage involved coding the data by breaking it up in analytically relevant ways. Key words and phrases were drawn as codes by the researcher for this particular process. After breaking up the data in this manner, the researcher then looked at the re-arranged data more closely and with a fresh perspective before putting together a written account of the phenomenon just studied using the thematic categories from the analysis as sub-headings (Terre Blanche, *et al*, 2006: 326; Collis and Hussey, 2003:255).

5.11 ETHICAL CONSIDERATION

One of the main issues with regard to ethics in conducting research is that of voluntary participation. The general rule with both social and experimental research is that all participation must be voluntary and not forced. Although the aspect of voluntary participation has been argued to be very important, it takes criticism on the basis of generalizability because if the participants who take part in a study are generally the kind to volunteer, the results of the research cannot be generalised to an entire population because the character of the participants may not be reflective of the rest of a population. A researcher cannot generalize sample findings to an entire population unless both willing and the somewhat unwilling are included as participants in the study (Babbie, 2007:63).

It is also important that the process of the research never injures the people being studied, regardless of whether they volunteer for the study. For example, the researcher should ensure that the research does not reveal information that could embarrass subjects or endanger their home lives, friendships, jobs, livelihoods and so forth. It is the responsibility of the researcher to look for the most subtle dangers and guard against them, such as research on ethical

conduct which may cause participants to look into their own moral conduct, which may last long after the research, thereby injuring fragile self-esteem. The best way to avoid whatever possible harm that may arise after all efforts to avoid such is to implement the concept of informed consent (Babbie, 2007:64). This means that subjects must base their voluntary participation in a study with a full understanding of the risks involved.

A researcher should also make considerable efforts to ensure the protection of the subjects' interest and well being by protecting their identity. One way to achieve this is by ensuring anonymity, which means that in the process of the research, both the researcher and the targeted audience cannot match a particular response to a given respondent. Although, in a survey research, this makes keeping track of who has returned and who has not returned a survey very difficult, it is often better to ensure this than to let respondents feel uneasy about their participation. Tied to this is the concept of confidentiality, wherein the researcher can identify a given person's responses but commits to not make this public. It is always the researcher's responsibility to disclose to the subjects that the material of the research will be treated as confidential. Training on ethical conduct and responsibilities is one way of ensuring that such important guarantees are properly effected (Babbie, 2007:64).

In the research process, it is sometimes important for the researcher to identify him or herself in the field because, generally, deception is considered as unethical. In order not to heavily influence the direction of the research once this revelation is made, it is sometimes important not to reveal the real purpose of the researcher's presence in the field in terms of the actual area or aspect being studied. It is also important to hold a debriefing session after a study has been conducted in order to find out what experience the subjects had of the research and what possible damage it might have caused that may need to be addressed. Disclosing the real purpose of the study after it has been completed may make up for not disclosing this information at the outset. (Babbie, 2007:68).

For the purposes of this research, the researcher will sought to be open to the respondents and to declare the researcher's position with regard to the reason for conducting the research. The researcher was sure to respect the respondents' wishes for anonymity by drawing up a comprehensive declaration signed by both the researcher and the respondent which was binding on the part of the researcher. The researcher was also sure to respect the confidentiality requirements of the data that was collected and was sure to treat is as delicately

as possible by including a clause in the before mentioned document to bind the researcher to the researcher's word (Remenyi, 1998:4-6).

5.12 Research Process

In the data collection stage of the research, the researcher initiated the process by drafting and circulating a research participation invitation letter which was sent to various purposively sampled small business owners in Grahamstown, Eastern Cape, South Africa, in an effort to obtain possible respondents for the study in question. The letter was drafted in line with the research ethics objective of transparency and voluntary participation, stating the aims and objectives of the study without running the risk of leading the possible respondents in terms of giving away the core of the research before the data collection interviews began. The letter basically invited the targeted small business owners to participate in a study on small businesses in Grahamstown as part of a Management Masters research conducted by a student at Rhodes University. Together with the main objectives, the letter also stated a preferred response date by which the researcher would like to have heard from the respondents in order to know which small business owners were interested in being respondents and which were not willing to participate. Setting this time frame allowed the respondent to schedule the research progression in line with existing deadlines so as to ensure that the desired research stages were passed in a productive and consistent manner. The possible respondents had the option of responding and confirming their interest in participating by either of the following avenues: e-mail, mobile phone message or through a telephone call. See Appendix (A).

The researcher aimed to obtain at least fifteen (15) small business owner respondents for this study from the wider population of small business owners in Grahamstown. In an attempt to achieve this objective, a total of twenty (20) letters were sent out to the same number of small business owners across all industries from which a total of eleven (11) small business owner respondents with an interest to participate in the time frame, specified in the letter by the researcher. From the initial target population of small business owners in Grahamstown, these eleven respondents made up the research population and were used as the small business owner respondents to the study. From this response, the researcher then set up meeting dates with each respondent in order to conduct the research interviews. The interviews were conducted and completed within four weeks of the respondents expressing interest in

participating in the study as they each had to fit in the interview time with their busy end of year business schedules. The researcher did not experience this as a setback due to the fact that a timeline had already been set in order to cater for busy schedules as these were small business owners after all, who would in any case be very 'hands on' in the day-to-day running of the business.

The actual process of conducting the interviews reflected this level of involvement in the day-to-day running of the small businesses as most respondents would ask to pause the interview half-way into the process in-order to attend to an important phone call or to assist an employee or shop assistant with some area that needed their hands on attention. One respondent even mentioned that he was individually responsible for handling all entries from any sale made by his employees and for that reason he warned the researcher that he might have to leave the interview at any moment in order to attend to this. Other respondents tried to commit their time fully to the researcher during the process of the interview but the researcher could sense a tense urge on the part of these respondents for the interview to be over so that they could go on with their work which appeared to demand their undivided attention all the time. The researcher played his part in attempting to ease this pressure by mentioning before the interview commenced that the respondents should feel free to ask the process to be put on hold for a while if they needed to attend to something urgently. In this way the researcher allowed the respondents to feel like they were in control of the research process and hence did not have to feel tense or tied down by the interview process. The research objective was to obtain the best possible responses in an enabling and open manner and one good way of ensuring this was allowing the respondents to feel a sense of control over the interview and freedom within the process itself.

As mentioned in section 5.5. p.81, the researcher aimed to use the snowball sampling method to identify a target population of business angels from which a research population could be drawn. Due to the difficulty in identifying business angels as shown by literature on business angels, the researcher decided that at least five (5) business angels from Grahamstown would be an acceptable and reasonable number of respondents. This was also coupled with the fact that business angel phenomenon is a pre-dominantly western concept that is very poorly researched on in Africa and the third world, hence the researcher safely assumed that knowledge of this term would be inexistent or very minimal where it occurs, let alone the identification of business angels where they may exist. With this, the researcher only

managed to identify two (2) business angels who also happened to be small business owners participating in the study. When at the end of the interview they were asked if they knew of any others who were involved in the funding of small business start-ups in the way that the researcher had identified, the respondents mentioned that they did not know of any others in Grahamstown but believed that they do actually exist. The trouble was just identifying them or knowing how to get hold of them. However, due to the time schedule that had already been set added to the already mentioned inherent difficulty in identifying business angels, the researcher could not commit an extended effort at attempting to identify more business angels in Grahamstown. The research process had to continue.

The following chapter will be the presentation of the research findings in line with the aims and objectives of the study mentioned in section 1.9 of the research. An overview of the research process followed will be discussed before a detailed analysis is made.

CHAPTER 6
RESULTS FINDINGS AND ANALYSIS

6.1 OVERVIEW

The following chapter is an analysis and discussion of the research findings and results. The opening section of the chapter will describe the data collection process in order to give light on the experiences of the researcher in going about the data collection. From this point onward, the early sections of the chapter will be an overview of the significant findings of the research in terms of the data that stood out in the data collection stage. These and other findings will be considered in light of existing literature and research studies in order to obtain a rounded understanding of the data obtained. This process will also highlight the implications of the study for current theory on small businesses finance, entrepreneurship and business angels. Towards the end of the chapter, separate sections will be reserved to discuss any limitations that may affect the transferability of the results and recommendations for future research (Rudestam and Newton, 1992:121).

To guide and direct this process, it is important for the researcher to restate the purpose and objectives of the research (Collis and Hussey, 2003:297). The aim of this research was to determine the extent to which business angels and angel networks could facilitate the financing of entrepreneurial ideas in South Africa.

The specific goals were to:

- determine the awareness of sources of small scale financing by entrepreneurs in South Africa;
- determine the most commonly used source of start-up business financing South Africa;
- assess the extent to which business angel financing could be used for small businesses in South Africa; and
- determine the factors impacting the use of business angel financing in South Africa.

Section 6.2 below is a discussion of the key findings of the research.

6.2 FINDINGS AND ANALYSIS

6.2.1 Awareness of sources of small scale funding

As mentioned earlier, one of the main objectives of the study was to determine the awareness of the sources of start up-funding by the entrepreneurs. The researcher sought to find out what the entrepreneurs in Grahamstown knew about the various ways of funding a small business start-up and to find out how detailed this knowledge was. The following excerpts indicate the responses given by the entrepreneurs to the question:

“Are you aware of any other sources of small-business start-up funding?”

E¹ “There was one I approached once, I had a B&B and it was the Small Business Association the government had and I found it so tied up with red tape and get this and do that and certified copies of this that it took me about a week and I said no thanks, I will do it by myself. I understand why they do it to safe guard themselves but the small business thing I think is too regulated, it should be a bit freer. Any other start up funding is friends and family.”

E7 “Government has a whole system. One is gender specific, ones for certain types of industry. The banks not that much, venture capitalist are not looking at somebody that wants to open a fruit & veg store so yes these things are available but I don’t know how accessible they are.”

E2 “I don’t know of any institutions that would give small businesses funding other than your concept that you are putting together. SEDA like I said wasn’t the start up capital it was more the intangible side of getting yourself started up. Look the value was about thirty thousand Rand to do all the marketing because they paid the suppliers so it was very worthwhile but that is the only other institution I know for small business development.”

E3 “The institutions have more funds readily and easily available to the general population because they are in your face and you know where they are and you can

¹ E represents entrepreneur

go there. Their interest in investments are often lower because they know it will take longer to get their funds back, whereas start up venture capitalists have shorter terms that they want their money back so their interest on the investment is also higher but they are generally easy to get money from if you can prove you have a good business proposal.”

E4 “There is this Small Business Corporation that helps small businesses. We are trying to get the management to come to us for one of our small businesses for the staff. The problem with the Small Business Corporation is that they now want the business only if you are selling the business to gain surety. I am not going to sell my business to someone that I do not know and then sign surety for it; I mean why would I bother selling it then? However if I as a small business decided that I was a risk and I get paid out my money but in return I sign a contract and mentor your business for x amount of time, that is a different story. However if you choose not to go with the guidance I cannot be held liable if you have chosen not to go with my advice. I think if the Small Business Corporation do make people sign surety I am never going to sign surety. The other thing is as a business owner if it’s a successful business, stay with the new owner and mentor them through the process. You are not going to tell them what to do all you will advise them is in your experience and they choose what to do.”

E5 “Well going back I’ve actually come across one, its not quite an angel investing thing because its more commercial but the same principle is something called The Business Partners. They have got branches all around South Africa and basically you take an idea to them and they want unique ideas and they will come up with a deal. Either they will play a role as a business partner or they will finance the money and they take a calculated risk and they measure it on different things than a bank would and I think they are fine actually.”

E6 “Small Business Development Corporation.”

E8 “The only thing I have heard of is the Small Business Corporation and of about a hundred people that I know one of the guys got help and started up a butchery and it

was going well and then he messed it up about four years later but this is the only success story that I know that they helped to start up a business.”

E9 “When I started my business which was eleven years ago we had The Small Business Development Corporation or Business Partners and real financial institutions. I think there are one or two state sponsored programmes I may be wrong. By the time I got my business there were Industrial Corporation for example, that were an option but I am not aware of any other option.”

From the excerpts above, it can be seen that the respondents are aware of mostly the following sources of financing:

- Small Enterprise Development Agency (SEDA)
- The Small Business Development Corporation and
- Business Partners

There was no mention of other sources of small business funding such as Ntsika Enterprise Promotion Agency (Ntsika), Khula Enterprise Financial Limited (Khula), the Isivande Women’s Fund (IWF), the Industrial Development Corporation (IDC) and the National Empowerment Fund (NEF) which have been created by the South African government through the Department of Trade and Industry (DTI). Although the respondents were knowledgeable about the different sources of start-up funding, they did not show any great depth in knowledge about alternative sources of funding.

On analysing these responses, the researcher was led to question what exactly could have been the reason for knowledge of only two entrepreneurial agencies provided by the government when clearly there are quite a number that the government provides. The researcher was led to conclude that this might be as a result of either poor promotional efforts of these institutions in small towns by the South African government or simple ignorance on the part of the entrepreneurs to the available facilities catering for their financial needs. An investigation into this would clearly make an interesting research for the researcher if further studies on the topic of small business finance is considered.

6.2.2 The most commonly used source of start-up funding

The researcher also sought to find out which source of start-up funding was the most commonly used by the respondents in the research. The researcher asked the following question to which the excerpts that follow were the responses:

R² “Please describe your particular experience with securing start-up capital.”

E9 “Without the finance we wouldn’t have been able to start the business and it was difficult to get finance because I didn’t have security in property which the bank could use as security so basically I had to pay a competitive interest rate. It wasn’t like banks were lining up to give me finance because I had no security so I had to take the only offer I had. It wasn’t the bank it was The Small Business Development Corporation which is now called Business Partners but we have had overdraft facilities from time to time and we have had access financing through banks for motor vehicles etc but the majority of finance came from Business Partners and we did have some overdraft facilities and vehicle financing from the bank.”

E8 “Fortunately for me I had a family farm and I was in two minds about keeping the farm and having no income from the farm side and then after six months I sold the farm and I funded this business. It actually belonged to my wife and her family and I bought it from them and I think we have grown about nine hundred percent since I have had it. Fortunately for me I was in a good position and I didn’t buy this business and owe anybody any money for this business so I had a bit of money to start off and do what I wanted to do and to stretch and open up. Before we didn’t have flowers, we didn’t have bouquets, we only had the candle side so basically that is how we started off.”

E5 “We got a loan from the family and from a financial institution at Standard Bank and at the time we didn’t know the content of the surety. We kind of figured that at some point we would settle the loan but when you actually have to its quite tough.

² R refers to the researcher from this point on

We had to get a credit contact who was willing to help us out and I think a rule of thumb for our industry is to aim to pay off your start up loan quite ahead of time and I think we are well on track to that.”

E4 “Well when I started the business I couldn’t get finance because I was a woman because only Afrikaans men got the finance. Then we got going and I didn’t get it because I was a white woman because only black woman got finance. When they had the PDI (Previously Disadvantaged Individual) they asked me what my PDI number was and I said do them ‘do you want my previously disadvantaged woman in an Afrikaner men’s world or the present white woman in a black woman’s world, you tell me which you would like it to be?’ they were all apologetic and also being a woman they thought you were stupid, they think you are stupid and you don’t know what is happening. You overcome it by learning all you need to know and proving the people wrong by building a history but its still a downside and it will always be.” (Respondent E4 later mentioned that she had to sell her property to get her start-up capital)

E3 “This particular business started as a very small business with three people running from one room and it grew from there and that is just from knowing people, good service and carrying on from that and then obviously bringing in a bit of stock and going with it as it goes. Not with capital but with small growth and when there is big growth then I will use overdraft, which is from a financial institution.”

E2 “I think we had the same problems as everyone else. In order to get start up capital I had to have existing records, business records which there wasn’t with a start up business and my status wasn’t clean at all and that’s why I ended up using my pension fund. Then I thought I would bank with the bank, I would invest the balance of my pension fund with the bank and start getting everything together and if I can survive the first five years, then the bank at five years would see. So I think it’s the same with everything else, if that’s the rule you are not going to beat the rule and there can be as much theology about it but the bottom line is that you are not going to get the loan. So somehow you have got to walk around and climb the mountain at the same time. Luckily I had a pension fund I could pass on and then my next plan was to build a ‘hetchie’, let me build a ‘hetchie’ with this bank and in five

years time when I want to upgrade or expand then maybe I will have the capital available.”

E1 “One I just explained to you about the helicopter and the money, the other I haven’t borrowed too much and the others I have had a bond on my house. Over the years I have managed to buy a house and I have managed to buy a bigger house so they become more valuable, this is how life works. You get bigger and bigger and wealthier and wealthier and you are able to borrow money against your increasingly valuable assets so that is what I have done on the few occasions that I have had to. I have paid off my house and I have used the same mortgage again. That is quite important nowadays because it’s quite difficult to get a mortgage now and I have always had one lurking in the back in case I need it.”

The responses above show that the majority of the entrepreneurs started their businesses with funding from personal investments and capital from family, whilst a few mentioned using banks and other financial institutions. The entrepreneurs expressed difficulty in securing this start-up funding because of the extent of the commitments they had to make to secure the funds and also because of the “red-tape” they mentioned to be associated with securing funding from financing institutions such as banks and other small business loans providers. The red tape referred to in this instance are the various regulations and requirements that form a part of the process of securing funding from loan institutions which the respondents stated that it slows down the process of getting started.

The mention of red-tape gives rise to an interesting topic on the nature of the business loans environment because there seems to be dissatisfaction with the process of securing loans from these institutions. Investigating the perception versus the reality of this red-tape when securing start-up and or growth loans would make for a good research topic as it would benefit both entrepreneurs and policy makers to know what research on the process of securing start-up funds has to say. It would lead to an evaluation of past, current and future policies with regards loans, a development that would hopefully allow a more conducive business loans environment in South Africa.

6.2.3 Knowledge of business angels and occurrences of their use

The researcher conducted a total of eleven (11) interviews of small business owners and in the course of those interviews, only two (2) respondents had any sort of knowledge of the term ‘business angel’ either in explanation of what the term meant or in showing an idea of what it means. All the other respondents had never heard of the term before it was mentioned to them by the researcher. Of the two respondents who said they had knowledge of business angels and how they worked, respondent E7 appeared to have detailed knowledge of how they operate as he had used a business angel in starting up one of his businesses. The respondent showed a positive experience of the funding relationship he had with the business angel and also showed how part of the control he had of his business had been lost to the business angel due to his use of this form of start-up funding. The respondent mentions this in the following excerpt:

“I have had the fortune of being set up by a business angel yes ... No conditions it was pay me when you want to ... that has helped me and they make suggestions and they kind of expect you to implement those suggestions so you tend to lose the control of your business a little bit depending on how strong your personality is. It’s certainly an option for those needing great attention to set up a business but I am not too sure what influence they want to exert and what their motives are for loaning you money.”

The above excerpt details a first hand account of a business owner who started his business with the assistance of a business angel and highlights the two-sided nature of the relationship. What the researcher will conveniently refer to as the first side of business angel funding is the instance in which the business angel provides the desired funds to start up the business and provides other benefits such as exposing the entrepreneur to a network of investors and helping to manage the start-up by providing valuable managerial expertise. The researcher will refer to the second side as the instance in which the entrepreneur experiences a loss of control of the start-up due to the participation of the business angel.

In the first instance, as shown by the excerpt above, the respondent uses the word ‘fortune’ in mentioning that he has used business angel finance, a word that, in this context suggests a successful funding relationship experience between him and the business angel and also

suggests some level of relief at obtaining this form of funding from a mentioned difficulty in securing funding from other sources. The interpretation of the usage of this word and what follows in the rest of the excerpt suggests that this is the first side of the funding relationship. Where the respondent mentions the fact that there were no conditions for the funding he obtained and that he could pay back the loan when he wanted to, a very important aspect of business angel funding is highlighted and that is the specialized early-stage funding that is provided by business angels to entrepreneurs (Sorheim, 2005:179). This statement highlights how the funding agreements between business angels and entrepreneurs are tailored for particular funding engagements and especially how the funding agreement is influenced by the informal relationship the entrepreneur develops with the business angel.

The terms of this particular funding agreement show the existence of a high level of trust in the character and ability of the entrepreneur by the business angel. The kind of trust implied in these terms goes above what one would expect of a typical business relationship as it is hard to imagine an instance where a funds provider allows the funds seeker to 'pay when you want' or to even have a funding agreement that appears to be as open-ended as the one described above. This is possible when the business angel is aware and sure of both business and non-business related characteristics the entrepreneur has when going into the agreement.

The second side of the funding relationship represents the instance in which the entrepreneur experiences a loss of control of the enterprise due to what is referred to as the active participation of the business angel. This is an instance in which the business angel gets involved in the running of the business by performing executive services and functions depending on his or her level of knowledge in the actual business of the enterprise (Macht and Robinson, 2008:190). The entrepreneur tends to experience a loss of control of the direction of the entrepreneurial venture as a result of this involvement. Respondent E7 showed a response consistent with this where he mentioned that the business angel expects you to implement the suggestions he or she makes thereby resulting in a loss of control of the venture.

The respondent however gives light to a different aspect of the angel-entrepreneur funding relationship that may have perhaps been omitted in the literature review part of the research and that is the social dynamics at play in this relationship due to the informal nature in which it exists. The respondent mentions how the involvement of the business angel and the

subsequent expectation that suggestions made to the entrepreneur are implemented may result in a loss of control of the business “...depending on how strong your personality is”.

This suggests interplay of personality power relations between the business angel and the entrepreneur when it comes to the decision on what direction should be taken by the enterprise based on dominant personalities versus agreeable tendencies. Where a close relationship of the nature suggested by respondent E7 exists between a business angel and an entrepreneur it is no surprise that factors such as personality interplay influence the nature of the on-going relationship as the relationship is already an informal one from the beginning, allowing for non-business aspects such as this into the agreement.

The mentioned benefits of using a business angel to finance a business start-up as mentioned in the literature and affirmed by respondent E7 are however not outweighed by the disadvantages also mentioned and affirmed in the research. The respondent emphasized the success he had experienced as a result of using a business angel to finance his start-up and only mentioned the downside as a non-major part of the relationship. He mentions how the business angels were always there to function as sounding boards for the decisions he wanted to implement and how everything was always left to him as far as final decisions go. This may not be representative of what all entrepreneurs in business angel funding relationships experience but it is quite suggestive of a general positive nature of this relationship.

When it came to knowledge about business angel networks, respondent E7 also showed that he knew of their existence. He mentions this in the excerpt below:

“I am not too sure about the networks I have never looked into the networks but I am sure they exist. I know within certain communities they exist but they only help their own and I am not sure about commercial business angels where you can go to and get loans, I know of a close knit within communities.”

When the researcher asked if there was a problem of identifying business angel networks from what the respondent had just mentioned, the response was:

“Yes. Only if you are part of it (close knit community) will you know they exist or if you are part of the culture they live in will you know they exist even though you may not be part of the culture.”

Respondent E6 was also asked a similar question surrounding the possible prevalence of business angel activity in the country and his response was captured in the following excerpt:

R “From your perception what would you think is the potential of what you did in the rest of the country? How active is this kind of engagement in the country beyond what you have done, are there other people doing it?”

E6 “I am sure there are plenty people helping others to get up off the ground especially if they themselves battled in the early days to give some help to these young businesses and I think the input from established businesses is most important...”

These responses indicated a possible key characteristic of business angel networks that might need to be highlighted when further studies on the topic in South Africa are undertaken. The respondent mentioned that business angel networks are found in closely knit communities, suggesting the presence of a strong identity based selection process when it comes to the funding of entrepreneurial ventures. What the researcher means by ‘identity based selection process’ is that not only are these networks accessible to members of tightly knit communities but the networks themselves will prefer and possibly only consider appeals for finance from within the community and not from outsiders. In adopting this characteristic, these business angel networks can be understood as what Aernoudt and Erikson (2000:178) refer to as private networks.

Whereas the majority of the business angel networks covered by literature in the United Kingdom and the United States are public networks willing to accept any referrals from trusted sources (Aernoudt and Erikson, 2000:178), the case in South Africa might be in favor of the private network due to the strong emphasis on culture and identity in the culturally diverse South Africa. This would also fall in line with the study by Haar *et al* (1988:23) which showed that personal familiarity is an important and strong influence to the funding of referred investment opportunities. Although a single case is not enough to make far reaching general assumptions, the instance is enough to spark interest in a possible investment pattern considering the nature of the country and the pride taken in uplifting one’s community and culture. These emphases might be discovered to translate into decision making with regard to

investment in entrepreneurial ventures and referral of ideas within and across community business angel networks.

Respondent E5 on the other hand appeared to have a rather basic understanding of the term business angel in terms of the fact that business angels will invest and expect returns from their investment. He however mentioned an outstanding entrepreneur/investor in Richard Branson who since his success with the Virgin brand has taken great interest in entrepreneurial ideas, either by way of engaging in them himself or promoting them from other entrepreneurs. Respondent E5 did not provide as detailed an account of business angels as was provided by Respondent E7 but mentioned an important detail to the business angel-entrepreneur relationship when he stated that it is important for the entrepreneur to know where the business angel is “coming from” in terms of his or her involvement and expectation from the enterprise. This encourages a good relationship to be built between the entrepreneur and the business angel so that the terms of the relationship are clear to both parties and that the progress of that relationship grows with minimal conflict.

6.2.4 Instances where the Type I and Type II errors occurred

As mentioned earlier in the research, the problem with information asymmetry is not only in the fact that it may result in the rejection of good lending prospects, but also in the approval of poor funding prospects by funds providers. Altman (Tucker and Lean, 2003:52) laid out these possibilities into categories of possible funding errors on the part of the fund providers and named them Type I and Type II errors. The Type I error occurs when an entrepreneur knows that he or she may not be well equipped to engage in a particular entrepreneurial venture, keeps this knowledge from the funds provider, leading to a misinformed decision to provide funds. The Type II error occurs when the entrepreneur knows that he or she is well equipped and is presenting a good entrepreneurial idea and the funds provider fails to see this and thinks that it is a bad funding option, resulting in no funds being provided.

- **Type I error**

The following excerpt of the interview of respondent E11 shows the occurrence of the Type I error. It shows a situation where the ability of the entrepreneur was not fully disclosed to the

business angel such that the business had no knowledge besides the fact that the entrepreneur was interested in the business when the following crucial decision was made:

R “Please describe if you have ever funded a business idea that turned out to be a bad one or a bad option?”

E11 “A similar bottle store that I was running by myself I gave to my manager and he destroyed it in exactly six months. Now we have been rebuilding that same business and it starts with the lady on the till, the lady on the counter, running and chasing stock, packing the shelf. They are making it a success because I think they realize that any business can go down in one day and it doesn’t take one day to rebuild it, it will take maybe five years to rebuild it.”

Respondent E6 also shared similar experiences when it came to funding business ideas that turned out not to be as ideal as they first sounded:

R “From this experience has there been a situation where the business hasn’t turned out to be as successful as you predicted?”

E6³ “I think maybe of the seven people that I did assist over my time in the business I would probably think of two that maybe didn’t make it and I can be proud that the others did make it and they are established in our company.”

In the above excerpts, the business angels gave a potential entrepreneur an existing business to run on the assumption that the entrepreneur would do a good job with the business but as it turned out, the simple assumption that a good job was going to be done by the entrepreneur was not enough to guarantee success in the venture. The entrepreneurs, as expressed in the first excerpt, failed to run the business due to an apparent lack of entrepreneurial skills for the trade as opposed to managerial skills. The entrepreneurs may have misrepresented his managerial experience to represent an apparent entrepreneurial skill, leading to a typical Type I error.

³ Respondent E6 was both an entrepreneur and a Business Angel

In the following excerpt, the business angel indicates a high value placed on the entrepreneur showing his or her skill as an entrepreneur before a funding decision is made. The subsequent failure to make a thorough follow up on the potential entrepreneur's actual skill as compared to managerial ability is what appears to have led to the bottle store business failing:

R "When you made the decision to fund the other businesses that you have, how important was the ability of the entrepreneur in your consideration?"

E11⁴ "For me everybody in this life must prove themselves and all the people that I am helping are people that came through our system and they are actually qualified to run a business. I won't allow any of my staff to just come here and go and collect his pay on a Friday. He must be involved in the business because if you are not involved in my business, I don't want you here."

According to E11 it can be seen that it was also the job of the business angel to make a thorough check of the entrepreneurial skill with the entrepreneur for the safety of his investment. The business angel could have asked for a detailed plan of what the manager was going to do differently once he had ownership of the bottle store in order to be more successful. That would have been the expected order of things so to speak but from the interview with the business angel, this does not seem to have been the case. The business angel appears to have based the decision to give the bottle store to his manager primarily on the trust he had for the potential entrepreneur to translate his managerial ability into entrepreneurial skill, a decision which proved to be costly.

The active participation of the business angel after the occurrence of this failure seems to have led the business on the path to steady recovery as the respondent mentions that, together with the staff at the bottle store, he has been rebuilding the store and putting the right people in the right positions to do a better job. This shows how invaluable the active participation of the business angel can be to an entrepreneurial venture especially in times of adversity. The business angel has vested interests in the business and so will act to save the business and his investment in tough times. This is perhaps the positive side to active participation of business angels, a side that has incidents in which the control of business angels over the

⁴ Respondent E11 was both an entrepreneur and a Business Angel

entrepreneurial venture is needed to ensure that the venture survives in its initial and subsequent stages.

This excerpt also shows the added contribution that the business angel brings to the protection of investments. Where institutions such as the bank would rather focus on the security and collateral attached to their investment in times of such adversity, the business angel maintains focus on the actual investment, the entrepreneurial venture. The business angel focuses on the actual risk taken in the initial decision to invest and works on ensuring that this risk delivers on the intended returns even during the least promising of times. The bank on the other hand when faced with a similar situation would pay no attention to getting the business back on track or providing managerial assistance. Focus would swiftly shift to the sale of what was held as security in order to earn back the investment with interest.

Entrepreneurs, especially those engaging in business for the first time, need a more supportive investor when it comes to dealing with tough times in the business. Entrepreneurs need an investor who is willing to see the bigger picture of the entrepreneurial venture when the entrepreneur is facing adversity and be patient enough to see the entrepreneur through that stage and onto a more positive situation. What respondent E11 showed in actively assisting an entrepreneur who had basically run the business into the ground is a positive and broad-minded interest in the investment. Entrepreneurs need investors who are interested in seeing the business becoming a success just as much as they are interested in getting their investments back with the desired interest. Entrepreneurs need investors who will want to see the return on their investment coming through the business in which they invested and not through the sale of what has been attached as security.

The following excerpt shows how committed respondent E6 was to delivering this support:

R “Did you provide any finance to these people as they started up and did you provide any form of management beyond what you have described?”

E6 “I helped them find material and when they finished the job they paid me back for the material and gave space in my own premises to start up.”

Respondent E6 also appeared to have the same sentiments as respondent E11 when it came to entrepreneurs having a particular ability level before they were considered for assistance. The

respondent showed that he valued entrepreneurs who showed that they were able to do the job before he supported their ventures or referred them to specific customers. This is also because the respondent's reputation was attached to the referrals he made to customers and he did not want to lose customers as a result of bad referrals. This is shown in the following excerpt from the interview:

R "How important is the ability of the entrepreneur or the person who asks for your assistance when you decide whether or not to assist them?"

E6 "It's very important that I know they will be able to deliver if I start a project with them. I have learned from past experience with them that when I give them work, they are able to deliver. So now they have to be on their own feet and I wouldn't be that involved with them if I knew they were not capable because it is a risk. You could harm your own business by getting an easy loss."

It can be seen that the sharing of a vision of growth by the entrepreneur and the business angel is important to such investment relationships. The investor needs to share the vision that the entrepreneur has for growth of the enterprise. This allows for a more interested take on the experiences of the business by the investor especially in times of adversity such as that described by respondent E11, section 6.2.4. p.115. When an investor sees an entrepreneur experiencing such a situation, a positive interpretation would be that the entrepreneur is experiencing a hiccup on the path to growth which can be attended to with the help of an active attendance to the issues of adversity. This is the benefit to entrepreneurial ventures that is provided by business angels and would not be expected of other sources of funding. It is a benefit that the researcher believes is crucial to the success of entrepreneurial ventures, especially those started by first time entrepreneurs in need of early stage support as they commercialise their ideas.

Respondent E11 indicated a strong presence of this kind of interest when he made the following response to the question in the following excerpt:

R "How would you describe your own involvement in the business you are involved in now, how are you involved in financing it?"

E11 "The chap who will be running now all the management and my son he needs to learn, he still has a long way to go. I am doing all the management, servicing the

vehicles. That's why I have got one guy that I am training on that side; my son gets trained on the other side and another girl in the office that is getting trained by the day."

- **Type II error**

The business angels however did not appear to have experienced the Type II error in their engagements with funds seekers. This is shown in the excerpts below:

R "Do you think there has been a situation where you have maybe foregone or maybe decided not to help someone start up an idea that someone has come to you with that maybe later on turned out to be a good idea when you thought about it or when it grew elsewhere?"

E6 "Do you mean a missed opportunity?"

R "Yes"

E6 "Not to my knowledge, they probably moved on and took their business elsewhere not getting our support, investment and time so yes we may have lost them it is possible but not that I can recall specifically."

A similar response was obtained from respondent E10:

R "Do you think you have ever refused to fund an idea that later on turned out to be a good option that you could have taken?"

E10 "I don't think I have ever had one of those luckily."

6.2.5 Provision of contacts

Another important contribution made by business angels to the success of an entrepreneurial venture is the exposure to a wider network of potential investors to the business. The researcher mentioned this contribution in chapter four, section 4.6. p.78, when it was stated that business angels provide access to networks of valuable business contact that the entrepreneur may use to profit (Macht and Robinson, 2008:171). Respondent E6 indicated making this sort of contribution to an entrepreneurial venture he had funded when he made the following response to the question presented in the excerpt below:

R “How would you describe the nature of your involvement past the phase where you helped them start up? What else did you provide in terms of assistance and how involved were you?”

E6 “In the past I recommended them to all my customers which was quite important and then they just got on to their feet and carried on, so I think that was my most important input by recommending them to my customers and it was easy competition for them to get into the stream of the type of business that we are in the building industry.”

R “So they basically assisted in the building up of a client base?”

E6 “Yes that was probably my best input.”

Although the literature on the provision of contacts past the investment stage shows business angels providing contacts of other investors who might be interested in investing in the enterprise, the provision of contacts of potential clients is just as much an invaluable contribution. Entrepreneurs are assisted in starting themselves up by being recommended and attached to clients, thereby setting the entrepreneurial venture on a positive growth path from an early stage. This is a welcome contribution to a start-up especially when some of the entrepreneurs in the study mentioned marketing and getting your product to the consumer as one of the most important challenges of financing the start-up. The recommendation to clients serves as a valued contribution to the marketing drive and allows the entrepreneur to focus on delivery from the moment the business is ready to operate.

6.2.6 Proximity to place of residence

The business angels in this study both showed investment behaviour that was predominantly consistent with literature in terms of the preference of investing in businesses that were close to their place of residence. Reitan and Sorheim (2000:131) stated that most business angels predominantly invest in businesses of close geographic proximity to where they live and work. The following excerpts hold testimony to this:

R “Have you ever funded a business that is beyond your residence, lets say outside Grahamstown?”

E11 “No.”

R “How far away from your place of business have you supported this kind of thing. Let’s say if someone has come up and asked for assistance how far from this place of work have you done this?”

E6 “Mostly in Grahamstown. One or two was financial help out of town but that was just financial, no other expertise or assistance in my field but mostly all local in business.”

This shows that the business angels in Grahamstown have an interest in being closely involved with the starting up of businesses that they have invested in. It also shows that the business angels are interested in being active investors and assisting with the investment as much as they can and hence they tend to invest locally. This may be linked to reputation, familiarity and trust issues as one of the business angels mentions in an extract highlighted earlier in the chapter. This reputation is attached to the success of the investment and referrals he makes hence he would prefer to keep a close eye on these businesses. This suggests that the business angels prefer investing in entrepreneurs they are familiar with and can trust and these are mostly the people who they either work with or live in close geographic proximity to. This manages the risk of the investment and allows the business angel to make informed investment decisions and to play an active role in monitoring their investments.

6.2.7 Entrepreneurs’ own definition of entrepreneurship

The researcher asked the respondents to share their understanding of what an entrepreneur is. The aim was to observe what the different understandings of entrepreneurship would be and to identify the key terms or concepts that inform the entrepreneurs’ understanding of the term. The respondents shared a wide range of definitions which are described in the excerpts that follow:

E1 “An entrepreneur is a person who puts up his own money, at his own risk to make a profit for himself. He doesn’t rely on anyone else; he relies on his own skills and entrepreneurship. In other words, he is not a leach on society such as lawyers and people like that. He is the man that actually creates the risk and creates the job.”

E2 “Well I think it’s a self starter who is not employed, who is prepared to take the risk to start up a business enterprise, or an idea that develops into a money making

entity with a unique idea, a unique concept and starts with a sole owner or a partnership with the potential to grow. Am I right? [laughs].”

E3 “I think having an idea and turning it into a profitable business.”

E4 “If you are trying to go into business yourself and you use your initiative to start up a business.”

E5 “An entrepreneur is someone with an idea that is more than just a job. With an entrepreneur a business is just a vehicle but more than a profit margin, it’s an idea that can be taken anywhere. It really is like a canvas and you can make it anything you want, you can involve a charity, you can give back to the community, you can go after your profit, you can create jobs and so forth and there is a lot of creation being an entrepreneur and it’s only a small way of life than anything.”

E6 “Somebody who can make a profit from any enterprise and create employment and be formal. I think that’s quite important that we can be formal and be of service to people like the government and states and municipalities so its not really like a home based thing, that would probably be the early stages but I think at the end I would expect people to be standing a certain distance and that would be my interpretation.”

E7 “An entrepreneur is somebody who can spot an opportunity before anyone else does and does it smartly, that’s what they do. It doesn’t have to be anything innovative, it doesn’t have to be anything new, they just do things smartly and I think that to me encompasses an entrepreneur. The biggest thing is to spot an opportunity and do something about it whether it’s successful is immaterial. By their nature they are resilient they try things, they fail, they try again and they carry on.”

E8 “From what I understand it means to start up something or make a successful living from the idea you created.”

E9 “Someone who started by himself, self driven, basically someone who sees an opportunity in the market place and tries his best to achieve his goal.”

E10 “I would describe your own business, with your own money, without help. You are not getting help so the only way to do it is by starting up with capital.”

E11 “An entrepreneur I think is somebody who is involved in business, who is in business.”

Respondent E1 described entrepreneurship in terms of risk, creativity and personal investment, while respondent E2 described entrepreneurship in terms of novelty and self employment. Both respondents described entrepreneurship in terms of the risk taken by the entrepreneur and the fact that he or she is usually solely responsible for the enterprise. Respondent E3 and E5 described an entrepreneur as someone who commercialises ideas whilst E5 went on to mention that profit is not the only objective of entrepreneurship as there is also a social responsibility objective included.

Respondent E6 describes the term in terms of employment creation and service provision, whilst respondent E7 gives a thorough definition of the term, emphasising that identifying an opportunity and doing something about it whether unique or simply different, regardless of success or failure, defines an entrepreneur. Respondent E9 described entrepreneurship in terms of the motivation and drive that entrepreneurs have in starting their venture whilst E10 focused more on the personal financial investment aspect of entrepreneurship. The above definitions showed a diversity that focused on different aspects of the definition of an entrepreneur with inherent aspects such as talent, community development, opportunity identification, financial objectives, employment creation and providing services to people.

6.2.8 Entrepreneur versus the small business owner

One of the questions asked by the researcher was with regard the difference between an entrepreneur and a small business owner. Below were the responses given by the respondents:

E1 “No, they are both entrepreneurs. An entrepreneur is a man who is normally a business owner, whether he is small or big.”

E2 “I think you start off as an entrepreneur and you develop a small business. I think you could be both, you are an entrepreneur that develops a small business and then you become the business owner of that business. The entrepreneur I think is the intangible aspect the conceptualization of what you want to start and then the small business becomes the tangible thing that you can actually develop. You can be an entrepreneur and have six small businesses.”

E3 “They certainly could be both. A small business owner could have just bought it or taken it over whereas an entrepreneur would have thought up the idea, got it going and was running it as a possible business.”

E4 “No it depends; sometimes a small business owner can be an entrepreneur. Sometimes a small business owner inherits the business from someone else so I think there is a divide between someone who starts up a small business, he is the entrepreneur and someone who owns a small business that he inherited, he is a small business owner.”

E5 “I think an entrepreneur is someone that has a basic idea and just goes after it whereas the small business owner he at some stage is or was an entrepreneur, he submitted himself to an idea and he made it happen. So a small business owner is probably an entrepreneur just one level up.”

E6 “I think small business or small businesses probably have all the same principles it’s just that they differ in their turnover but I think they would probably be described as the same unless they become players on the stock market or shareholders. But I think it’s more a group of people or partners who progress than having shareholders or people invested in the business.”

E7 “Essentially they are the same thing but your small business owner might take over the existing business and people might not see that as an entrepreneurial but they might do things smarter than the previous owner by turning things around. Entrepreneur people perceive it to be innovative, new, radical stuff, revolutionary but it doesn’t have to be. Within your business you can be entrepreneurial by operating smartly. So there is a distinction, a small business owner might just go

with the flow; run of the mill stuff and you don't do anything different if you came from the industry. If you are selling fruit and veg, well fruit and veg are fruit and veg, if you are a hawker that is more of a survivalist, more so than an entrepreneur. It's a difficult distinction but you can kind of distinguish here and there it's not that clear cut."

E8 "I don't think an entrepreneur needs to own a business, it can be side line thing and occasionally do something for himself while having permanent work. I think there is a slight difference between the two."

E9 "Yes I would say so. An entrepreneur is someone who comes with original ideas and a small business owner is someone who buys into a small business and doesn't do anything to change or modify it. It is kind of blurred, an entrepreneur is someone who has to have more vision and he sees new opportunities and new ways of doing things."

The majority of the respondents responded to this question either by saying that an entrepreneur and a small business owner are the same thing or that there is no significant difference between the two. There seemed to be an understanding that a person could be both an entrepreneur and a small business owner although a small business owner could just be a person who takes over an existing business and does nothing entrepreneurial. In such a case there appeared to be an understanding that there could be a difference between an entrepreneur and a small business owner although essentially they can be the same. Respondent E8 even mentioned that entrepreneurs do not need to own a business to be entrepreneurs; he or she can be a permanently employed person whilst doing something entrepreneurial on the side. It can hence be said, from these responses, that perhaps the main difference between a small business owner and an entrepreneur is the entrepreneurial behaviour. A small business owner who makes entrepreneurial decisions and actions can be referred to as both a small business owner and an entrepreneur. It all depends on the presence of an entrepreneurial action.

6.2.9 Understanding the contribution of entrepreneurship to the economy

Perhaps one of the most interesting findings of any research on entrepreneurship is that which is based on the entrepreneurs' understanding of the 'bigger picture' to their activity as entrepreneurs. What this means is that it is interesting to find out how well the entrepreneurs understand their contribution to the economy in general. The understanding of this contribution is essential in showing that entrepreneurs have a full perspective of their entrepreneurial activity and how their activities serve not only to further their own individual interests but also those of the economy in general.

A section on the value of this contribution was set aside in the chapter on entrepreneurship in this study where various positive contributions made by entrepreneurship to a country's economy were mentioned. Refer to section 2.5.3. p.24. Amongst these were job creation through small firm creation and the promotion of the full use of human resources, the acceleration of innovation and the promotion of other activities and services that support entrepreneurship in what is known as a virtuous cycle (Anon, 2004:5; Rwigema & Venter, 2004:9-12). The researcher was interested in finding out what the entrepreneurs in his study had to say on this contribution in general. The researcher was interested in highlighting these responses to compare and contrast what the literature had to say with what the entrepreneurs on the ground had to say. The following excerpts indicate what these responses were:

E7 “ ... the economic data and the historical data will show you in developing countries the contribution that small businesses make to job creation far outweighs the big corporates. Big corporates are more likely to shed jobs during bad times and not so likely to give jobs during good times where small businesses are merely job creators because of the numbers that they can employ ...”

E2 “ ... I think it brings in new skills number one, number two I think it brings in a will to work as opposed to protected employment which I think this country has gone totally. All the employees that are employed by big companies are protected with more emphasis on the comfort factor within the workplace than there is in actually getting the work done; and I think this is what is destroying our economy ... I think self employed people are hard workers and much more conscientious in quality control because its your product that is going out there and if it looks bad,

you look bad. Whereas if you work for a company, if the stuff looks bad its not you that looks bad its that company that looks bad, so you have got this protection going on and no responsibility ...”

E3 “Most customers are going away from the big business walk in to the shelf, take what you want and walk out. Most people actually prefer speaking to somebody and finding out what they do really need and having that personal contact that was lacking before...”

E4 “In a large business the staff have the attitude that they don’t care possibly because their jobs are all guaranteed or they think they are guaranteed and they don’t have to deliver a service. Whereas in a small business if you don’t deliver that service you are going to be out, finished and out of business...”

E6 “...I think its important because not everybody can afford to go to big businesses for certain things...”

E8 “...Small business and private sector I think are very important to South Africa this is where behind the scenes before you go corporate where you teach yourself business skills etc. Nobody can take away the experience I have in the last ten years. The type of things we thought of doing we couldn’t do because of financial constraints so rather start small and I’ve got the term in my business to get to the top of the ladder rather start at the bottom. I think we are not even half way yet and we are eleven years old already.”

E11 “I think it’s important because there are no jobs. So those people who are involved in the small business sector make some sort of a living from that and they can provide one or two jobs for other people.”

From the above responses, five (5) different areas of emphasis can be detected when considering the views of the entrepreneurs on their contribution to the economy. These read as follows:

- job creation;

- greater quality control;
- human touch on service delivery;
- affordable cost saving alternatives; and
- localized skills development.

Entrepreneurs in Grahamstown considered these to be the main contributions of entrepreneurship to the South African economy. They showed quite a diverse perspective of their contribution as entrepreneurs to the South African economy as their responses ranged from the mere creation of jobs to the development of skills at a local level which is something that is of great importance to any growing economy like that of South Africa. The point on quality control also falls in line with the human touch on service delivery because the entrepreneurs expressed a feeling of personal responsibility on the service and products they delivered and would hence make a determined effort to make sure that the perception of this remains positive.

It was interesting to find responses that were this diverse because this showed the researcher that the respondents were taking time to consider their contributions from a broad perspective and were conscious of the fact that they were not just making profits for themselves with their businesses. The differences in responses showed how the respondents perceived themselves in the greater perspective of their engagement in entrepreneurship and how they saw their activities as entrepreneurs serving the economic objective of South Africa.

6.2.10 What entrepreneurs need to know about financing a business start-up

One of the questions that were asked by the researcher to the entrepreneurs was about what they felt other entrepreneurs should know about the financing of a business start-up. The researcher aimed to draw on the knowledge of the entrepreneurs of their experience in financing their start-ups and especially what lessons they had learnt from this experience. It was interesting to find what these lessons were and how the respondents communicated them to the researcher because most of these responses were communicated from what seemed to be an advisory effort by the entrepreneurs to other potential entrepreneurs that would find themselves in a similar situation rather than from a textbook definition.

Most of the respondents seemed to make a strong emphasis on cash-flow management and general discipline with handling the finances of a business start-up. What also appeared to be important from the responses given was a good knowledge of the product/service and marketing in addition to understanding cash-flow and knowing what sources to get funding from. The following excerpts are an indication of the general tone that appeared to dominate the responses to this question:

E6 “Financially they don’t have to be a graduate they just need discipline which is most important but they also need to know exactly what the cost of the job is and exactly what they expect from the job. One of the pitfalls is under quoting and to try and settle it you cut corners and then you harm your business. So if I can just say two words it would be financial discipline and not doing your homework when you are quoting a job ...”

E1 “How to manage money. If you get a bunch of money don’t spend it on fancy cars, fast living in restaurants to impress your customers because it doesn’t work, it doesn’t impress anybody. So you don’t have to have a sexy office with marble and chrome and steel and stuff like that, you have to have your front room. So manage your money, plough it back in, don’t spend it ...”

E5 “Well I think it’s very easy to under budget. The first thing you need to do is have your idea and then budget it and work out the best way you can achieve something and make room for a contingency plan because stuff will come up and when you need money its good to have it on hand. If you budget it at fifteen percent and its budgeted for I think that is a good way to go.”

E2 “The biggest lesson I have learnt is factoring in your failures because nothing ever runs a hundred percent smoothly all the time. There are plenty of jobs out there and if you can get fifty percent of those jobs depending on the opposition, then you need to look at those fifty percent that you didn’t get as a loss. If you can do that then you are covering your bases. Cash flow is the killer, if you don’t understand cash flow then you are never going to make it. You need to be focused, you need to know how much money you need to make every month to survive and once you

have that in place, you can say ok now I don't only want to survive I want to start making a profit and then you budget accordingly and the other thing is to give back, that from you is the biggest thing ...”

E11 “If you can go to the end of the month without going short then you can run a business ...”

The responses of respondents E7 and E8 appeared to have a more market focused emphasis in addition to the financial emphasis as opposed to the predominantly financial management focused emphasis that was made by the other respondents. This is shown in the excerpts below:

E7 “You have to demonstrate your understanding of the market and if the market exists and if you are able to plug back into the market you have to identify it and you must be able to convince somebody to do that and that your idea is doable. Then you have to demonstrate that from this gap there is going to be revenue generated and how you are going to do that looking at cash flows for instance. I am not too big on pro-forma, profit and loss and balance sheet and all that. You need to know how much you need to make this thing work and how much money you need to sustain it for at least two years and you must also understand how much revenue you are going to generate from day one and manage that carefully. If you can do those things its good. Yes you need to sell the idea but to understand the advertising and understand the financial implications of what you want to do and if you can do this you are well on your way. Those two you need to know upfront and the others you can learn along the way.”

E8 “I think he must know what he wants to do and see what its going to cost and go from there and I think there are a couple of categories when you want to start up a business you must look at what you use and what you do and where you want to be in the next six months. So he must know all the aspects of what he wants to do before starting.”

From these responses it can be seen that discipline and knowledge of financial processes stand out as the most valued knowledge that entrepreneurs are advised to have when looking to finance a business start-up. These entrepreneurs value the understanding of finances as the

most important aspect of financing a business start-up as they mention that this is the key to survival and growth for any small business start-up. Closely linked to this is an understanding of the market and the identification of a gap in the market that can be filled by your entrepreneurial idea. Once this is in place it is believed that an entrepreneur is in a position to convince potential investors of the business idea and secure the desired funding as he or she is fully versed on the financial management side of the engagement and the market side of the business.

6.2.11 What should providers of finance know about entrepreneurs

From understanding what entrepreneurs needed to know about financing an entrepreneurial venture, the researcher wanted to find out what the entrepreneurs felt the providers of finance needed to know about entrepreneurs seeking funding for their ventures. The following excerpts show these opinions:

E2 “I think they should buy into the business plan. If someone has done something bad in their life I think everyone deserves a chance, everyone makes mistakes, we are human beings we are not machines and I don’t think lifelong decisions about whether you are going to get finance or not should be based upon the one mistake you have made in your life compared to all the good things that you have done in your life. Everybody is a human being and if we don’t make mistakes we don’t learn. So I think they need to buy into the business plan and I think if they cant buy into it fair enough but if they can buy into it and if they want a success, in other words they want to get a return back on their loan then they need to put a lot more effort into making sure that they get a return back on that loan. I think there has to be a lot more working together and if the bank or financial institutions could have a small business sector available to give advice, like an advice centre to say listen lets just have a look where you’ve gone wrong. Oh gosh this is it, look what you have done here, you not making a profit you’re pricing is wrong. You have forgotten to factor in transport or this or that and although it looks like a profit on paper, once you add up all the little bits its not a profit and this is where you are going wrong. I think that is the problem, that there is not enough working together, a lot of people are left on their own.”

E3 “Pick out the old fart and put in young guys that know what they are doing! That’s actually the bottom line, the old guys who hang on to traditions actually have no idea of the potential of the young generation with the tools that they have available to them and they are still thinking of old school methodology and its clashing.”

E4 “They do have their check points but what they need to do is an assessment on the person or entrepreneur, see what are his personality traits etc. If the bank just does financials not everyone has financials but see how he manages his life around him, see what people think of him and see how he pays his little accounts that he has. Don’t go on the big picture and then see his business, is he a cash business and if it is work on the situation that he can use his cash business as backing for the finance and then maybe monthly management and keep an eye on his finances to guarantee their money. That way they can lend out and have the control and in that way take away the power from the entrepreneur to start off with. Not the power to buy but the power to allow people to extend their credit.”

E5 “The entrepreneur in South Africa is trying to make it, they are not going anywhere and they are what should be promoted in this country right now because they are playing a part in educating some skills and getting the people to a better lifestyle and that is the quickest way to do it, through entrepreneurs.”

E6 “They have to know if they can deliver. That means if they are given the money can they deliver the goods to the customer. The quality is also important because if you get the best material and you haven’t got the quality workmanship on it you won’t get the orders. So I think the financier needs to know if the small business can deliver on quality and if he will last the duration of the contract. So many small businesses fall down because they falter along the way and they don’t finish the job and then that’s end of it. The most important is that they need to deliver and give quality.”

E7 “These emerging businesses need an opportunity and banks should provide you with an opportunity to kick start a business and take some risk. Banks should also be able to advise the small business and they train the employees but they still don’t

have the expertise to advise someone the particular track of businesses such as right of industry but they need to be bold enough to take risks and take losses. They shouldn't lose sight of trying to support these guys because the one thing about an entrepreneur is that if you give an entrepreneur a break they become pretty loyal to you, that's been my experience. I have seen them stick it out with a bank through tough times and good times as long as the bank was standing by them.”

E8 “Well I think it should be easier for them to come by the opportunity to start. They must lift the finger a bit to help the guy and I am not saying that he must help anybody off the street but you can see in a guy when he believes in what he is going to do and its going to work. I think they must make it easier to help people and I know it's not the money of the people that are employed by the financial institution, it's just another day, another client, another paperwork and I don't think the people get to the personal feelings of the clients. It's just another application so we don't have that personal touch and people that really believe and care if somebody makes it or doesn't make it. They just employ people and whether it's approved or not approved it's not for them to decide.”

E9 “I think banks and financial institutions do their homework, I think they do their track record etc but I think they need to take a little bit more account of good track records especially when it comes to young entrepreneurs who don't have track records and who don't have finance. Also to look at the idea and also to look at the feasibility of the idea.”

E10 “That's a good one. I think if the finance people go out and do a study on the type of business of the small entrepreneurs; surely they can see which one can provide and which one can't provide. I think they don't do any surveys so that they can get the real statements etc, that type of thing, they just don't do that

E11 “I think he should know that this person has never been in business before and should try to provide mentorship so that the business does not fall.”

Respondent E2 gave a response that proposed more attention to be given to the business plan presented to providers of finance and not just the credit record of the entrepreneur. E2

mentioned that the success or failure of an appeal to obtain business funds should focus on the business plan and not on the mistakes that an entrepreneur has made in the past because “we all make mistakes and we learn from them”. Together with E11 there was also an emphasis on the services provided by the government to entrepreneurs that should include management consultancy in order to help the entrepreneurs realise where they are going wrong in the business. Respondent E3 proposed that the providers of finance focus more on the younger generation and the potential they have for innovation and ideas instead of focusing on the older generation whose ways of entrepreneurship are apparently no longer relevant.

E4 proposed that the providers of finance, such as banks, should value relationships and getting to know the entrepreneur instead of just focusing on financials. E5 and E7 mentioned that the entrepreneurs are trying to make a success of themselves and hence the providers of finance should actively support them. E5 also emphasised that these entrepreneurs are not going anywhere and that their contribution is important to the growth of the economy. E7 went on to mention that entrepreneurs remain loyal to banks that assist them professionally and give them opportunities even when the banks are going through their toughest times. E9 suggested that banks revise their strict policies and give entrepreneurs who show potential a chance to be successful with their idea.

These responses seemed to show an emphasis on providers of finance paying attention to the situation that the entrepreneurs were going through and not just to consider them as mere numbers on a system. A suggested relationship based approach seemed to be called for by the entrepreneurs who felt that the strict approach that was custom to providers of finance was resulting in good business ideas going unattended to. The underlying message seemed to call for greater participation and commitment on the part of the providers of finance to the objective of entrepreneurship and the provision of an opportunity to succeed with business ideas.

6.2.12 Difficulty of securing start-up finance from banks

One of the questions that the researcher asked the respondents was if they thought that a lack of collateral by entrepreneurs led to a difficulty of securing finance from banks. The researcher wanted to determine what the respondents felt was the effect of collateral demands

by banks on the possibility of entrepreneurs securing the start-up funding they desired. The following were the responses given:

E3 “I would say financial institutions are a lot wearier because they have also got to work within the constraints of their bank policies. Whereas someone who is going to loan out money on their own accord, has got their own worry of do I have enough money, will I get my investment back, does it look like a good investment proposal, so there is a lot less red tape to go through. There is just one man or two people making decisions whereas some board members deciding around a table deciding against it. It’s a lot easier if it’s just two people making a decision who have money, whereas a bank is theoretically a business and they will work their best to make money as well.”

E4 “It is a problem but I think the biggest problem for new entrepreneurs and potential businesses is the new credit act because they brought out all these new laws and regulations without thinking through it. So most people think with the new credit act I don’t need to pay my account, which doesn’t work like that. If you are a new business and you cannot get solid finance and generally you need account facilities, so if you cannot have a solid financial backing to get your money back and per the law that says if you buy it you pay, those people go under because they cannot be guaranteed to pay their suppliers. So with the new credit act people can just buy on account and never pay and it just doesn’t work like that but it is happening like that. If people are going to get reconciliation and they hear these wonderful ads to come and get reconciliation and they can’t do a thing to you. Yes they can’t do anything to you because as you get reconciliation because twenty, ten, five, four people are unemployed and out of jobs and your business will close. If you cannot pay your account, the business cannot employ the staff and those staff in turn don’t pay it and it’s a vicious circle All banks, world wide if you don’t have credit history you are not going to get the finance but one of the reasons the banks are even stricter is because of the new credit act. So I would say that predominantly unless you are going to get a hand out, the new credit act is going to stop many businesses I mean this business is considered to be high risk. So if the bank wants to lend me ten thousand Rands, I have to have collateral of a hundred thousand Rands, which means all my customers are high risk and why are they high risk? Because of

the credit act and they won't pay me and they will go under and so they don't give me finance. I have got finance but that is only because of seventeen years of trading. I mean I wouldn't lend myself money, even new accounts we don't do. You would have to have a lot of money to open an account here because we just cannot risk it at the moment."

E5 "Yes it is very difficult, as I said it's matching literally one man's every Rand of his money for surety and you find unlimited surety as well. So let's say that you take out a hundred thousand Rand loan, you have got to have a hundred thousand Rand that you can show the bank and on top of that you have to sign something that says if you lose that hundred thousand Rand to give back, they can take more than that hundred thousand Rand, they can take up to any debt that they incur so it is quite difficult to get a loan but that shouldn't stop anyone from trying."

E6 "I don't think that would be a big issue because you can grow from your first job. If you go to a supplier and he trusts you for thirty days and you deliver the job and you get paid and you pay the business back for the materials and so on and so on; and I am confident that in six months you could do a project that is maybe four times the size of your first project so it's a growth in collateral. I don't think it is a big issue unless you are going for projects that are over a million Rand but then you are not really a small business anyway, so I don't think that is the right way to grow. If you are a small business you should just manage your finances."

E8 "Yes I do. It's tough for a small business at this stage because we do functions and flowers and catering and we have our season. So if the bank looks at our financial statements it's up and down, up and down. If we had to ask the bank for a sum of money to do something big it's still a hell of a story to get it and they will look and sniff and the chances are we still won't get it. So it's a big problem and I think it needs to be addressed to help entrepreneurs get started and there are certain ways and means to look at what the guy is planning and what are his future plans but I think there are no opportunities for us as small business owners. Good money or borrowed money, I always use the term OPM (other peoples money) you have to get other peoples money to make a start and these days it's very hard to come by."

E9 “Of course yes. I was young when I started the business I was twenty nine and the five years since I left Varsity were teaching and teachers don’t get paid very much so I wasn’t able to accumulate any savings or anything so I was very much reliant on borrowed funds.”

Respondent E3, E8 and E9 believe that there is a lot of red-tape with securing finance from banks because banks have a thorough checklist to ensure that they make a positive investment. A failure to match these demands leads to a failure to secure funding from the bank. E4 also believes that the problem is policy based as there is mention in the response of how the new Credit Act has resulted in bad credit records due to unsettled accounts from customers who leave businesses in a cycle of debt with their suppliers. This together with surety demands means that entrepreneurs and small businesses are unable to access loans from banks. E5 also mentions the difficulty of securing start-up funds as a result of surety demands whereas E6 believes that collateral is more of an issue when an entrepreneur seeks funds in million rand figures.

These responses all seem to point to one common factor which is that there is considerable difficulty in securing start-up funding from banks. They show that the entrepreneur faces a tough task when seeking to secure funding from banks due to the various demands and checks that the banking institution emphasises upon its funds seekers. Surety demands, for example, when described by respondent E5 make the process of securing this funding close to impossible to first time fund seekers who may not have the resources to match the bank’s apparent rand-to-rand matching requirement. Entrepreneurs who experience such a situation find the process of securing funds from banks extremely difficult and may risk failing to secure the necessary funds to commercialise their business ideas.

6.2.13 Entrepreneurs’ understanding of why ventures fail at start-up stage

Another objective of the study was to find out what in the opinions of the entrepreneurs themselves were the reasons why most entrepreneurship ventures fail at the start-up stage. This was important in order to see the kind of survival lessons that the entrepreneurs had learnt in running their ventures. The following excerpts are the responses given by the respondents:

E1 “I think a lot of them fail in this country because people are too concerned about image. They don’t do a hands on approach, they don’t do things themselves, they get somebody else to manage their business. This is a big mistake, you have to manage your own business, even for the first ten years and at that stage you can get a family member or a trusty friend to carry on but you have to be hands on. I think a lot of entrepreneurs who start up start thinking of a fancy car, a fancy office, a fancy location, which is the wrong thing. You start off in your garage, in the back of your house with a scooter and you start with some hands on dirt under your nails and you build it from there and you plough back your profits.”

E2 “Lack of information, lack of education, lack of reality and the background that you need before you go in. I am a BCom and a Marketing graduate and I must tell you there were things that I had never dreamed that would happen and it’s a lot of work for one person and a lot of it is the government requirements. I mean the administration just growing a little company! You don’t make money filling in your books, you only make money doing the work and so you have got this crucial tug between ‘do I make money or do I please the government by getting all my admin up to date?’ and it’s a crucial, terrible tug because you have got to make money to survive and so much of your money goes to the government on all your taxes and administrations and submissions to this and that. That is the problem with small businesses, there is too much administration.”

E3 “A lot of the time its lack of finance, lack of capital when starting your new venture especially when you push your ideas the more you see the capability of it and then you need to expand the idea and then you need more money to do that. So your initial plan or proposal is actually a percentage of what you are going to achieve if you have enough money to keep going.”

E4 “Rules and regulations, government control, hidden challenges and hidden things and poor accounting systems. I think most of them fail because there is no proper financial advise from banks, they advise ambiguously and external accountants don’t do their job properly and only advise the entrepreneur in business when its too late to rectify something. So there are no financial guidelines for new businesses.”

E5 “It comes down to what we were talking about earlier is cash flow. More businesses are growing statistically and more businesses are failing from a cash flow problem whereas versus not having a good idea. If the cash flow is not managed correctly you find yourself in dry money or in slow debt with no money, where you could very easily have had money if you had actually loosened himself into actually making. That’s why its cash flow more than anything.”

E6 “I see the biggest mistake with young businesses is that they overexert their expansion and not really feel the business. They seem to want to be on a level with businesses that have been there for thirty or forty years. In other words they want to have the same type of house or the same type of car and I think that is where they falter because then they can’t meet payments.”

E7 “Research will tell you its lack of management. You will find entrepreneurs and small business owners have the technical skills in that they can capture shares and produce all sorts of things well but skills to manage the business are what will determine whether the business will be a success. Then finance and marketing follow. The ability to manage your finances and market your business in terms of finding market or finding customers or finding gaps in the market and understanding the needs of your customers those are the top two that will create success in your business.”

E8 “People are not positive if the first step you do something and it doesn’t work they lie down and they don’t go on. With business from the outside it’s very hard to go on. I think you must be prepared to take a knock, you must be prepared to learn every day and you are never too good. You must be positive and whenever you lie down and you stand up, be able to stand up from where you are lying.”

E9 “The last statistics I saw was that eighty percent of small businesses fail within the first five years. I am not sure if the statistics are relevant or accurate but I would think that financing, lack of planning and people are not necessarily aware of what is involved in starting a business successfully. Maybe lack of market research as well which would fall into the whole planning phase also poor financial management, poor cash flow management, I think those are contributing factors as well.”

E10 “Because they are using the cash money.”

Respondent E1 believes that the reasons why most entrepreneurship ventures fail at the start-up stage is that most entrepreneurs are more concerned with the image of success than with actually making the business a success. E1 states that too many entrepreneurs leave the running of their businesses to other people in the early stages and use whatever initial profits that are obtained to purchase a lifestyle instead of ploughing these profits back into the business to ensure continued growth and success. This together with the overheads that entrepreneurs end up having to pay leads the business towards bankruptcy at an early stage.

Respondent E2 believes that the reason for this failure is the lack of education and the lack of important information on entrepreneurship and small business management that most entrepreneurs experience. E2 mentions that even with a commercial tertiary degree there are things that are still challenging to her, the message being that people with no academic background potentially have a far worse experience. E2 mentions that all together the main problem becomes too much administration and the required documentation that small businesses have to keep living up to. The bureaucratic red-tape is the issue.

Respondents E3 and E4 believe that a lack of finance and adequate financial advice are the reasons why most entrepreneurship ventures fail at the start-up stage. E3 believes that capital is the main determinant of success when it comes to business ideas. E4 states that there is a lack of ‘proper’ financial advice from banks and that external accountants do their jobs poorly and when it is too late to rectify particular problems. E5 and E9 believe that the reason for failure is cash-flow based as most entrepreneurs fail to plan and to manage their finances adequately, whereas E6 believes that most entrepreneurs try to grow too fast before they have the actual capacity to grow. This situation results in major miscalculations and overexertion such that the business as a whole is strained and eventually fails.

E7 responds in a way that is in line with E5’s response in that the main reason given for start-up failure is poor management by the entrepreneur. E7 states that most entrepreneurs are skilled enough to bring up an idea and present it for commercialisation but they fail in the actual management of this commercialisation in terms of finding and securing a market and managing the financial side of the business. E8 believes that most ventures fail because

entrepreneurs lack resilience and they give up on their enterprises at the first sight of difficulty.

From these responses it can be seen that entrepreneurs consider a wide range of factors to be the reasons why most ventures fail at the start-up stage which are not always financially based. The main theme from these responses appears to be the belief that most entrepreneurship ventures fail at the start-up stage mainly due to a lack of knowledge on the important approaches and aspects of entrepreneurship by the entrepreneurs amongst other reasons. The responses showed how important it is for entrepreneurs to have a full understanding of the demands and challenges of entrepreneurship if they are to see any success in their ventures.

6.2.14 SUMMARY

This chapter has shown amongst other things that entrepreneurs in Grahamstown, Eastern Cape, South Africa believe in the importance of understanding financial processes and other business related information if one is to be a successful entrepreneur. It has also shown that these entrepreneurs believe in the value of strong lender-borrower relationships between entrepreneurs and funds providers, especially when banks interact with entrepreneurs. This does not however offset the main emphasis of knowledge of entrepreneurship by entrepreneurs, a point which was strongly emphasised by the entrepreneurs in Grahamstown. The chapter also showed the difficulty in identifying and accessing business angels whilst revealing that business angel networks are likely to have a strong community emphasis where they do exist in South Africa.

CHAPTER 7
CONCLUSIONS AND RECOMMENDATIONS

7.1 INTRODUCTION

The following chapter is a presentation of the study's conclusions and recommendations. To make this presentation, it is important to make a recap of the study's main objectives in order to remain mindful of what the study intended to achieve when summing up what was actually achieved. The study intended to determine the extent to which business angels and angel networks could facilitate the financing of entrepreneurial ideas in South Africa.

The specific goals were to:

- determine the awareness of sources of small scale financing by entrepreneurs in South Africa;
- determine the most commonly used source of start-up business financing South Africa;
- assess the extent to which business angel financing could be used for small businesses South Africa; and
- determine the factors impacting the use of business angel financing South Africa.

7.2 CONCLUSIONS OF THE STUDY

The findings suggest that, although access and identification may be an issue, there is great potential for the usage of business angels and business angel networks to facilitate the financing of entrepreneurial ideas in South Africa. When they can be accessed, business angels provide a viable alternative to the more conventional sources of small-scale funding. The study has shown that, consistent with literature, business angels invest in ventures of close geographic proximity to their places of residence. It was also shown that business angels expose the entrepreneur to a network of important contacts, which in this case were clients for the entrepreneur to get started with the business.

What was also discovered from the research is that business angels and business angel networks in South Africa are likely to be accessible to members of communities rather than the general public. It was shown that trust, familiarity and belonging may rank high in relation to the entrepreneur within business angel networks in South Africa which can be considered as characteristic of engagements with a community emphasis. This is in order to eliminate information asymmetry, and subsequently the Type I and Type II errors, and to

reduce the likely moral hazard associated with funding entrepreneurial ventures. These networks may be hard to identify to the public eye, but not to members of communities where they exist. Referral in this instance may mean acceptance into a particular community. The funding agreement and nature of business angel involvement in the venture may reflect the values of that community and the entrepreneur may have to live up to those values.

From these findings, it can be concluded that some of the main factors impacting the use of business angels in South Africa include a lack of knowledge of business angel finance by South African entrepreneurs, a subsequent difficulty in identifying and accessing business angels and a likely restrictive access point to business angel networks where they exist. These are factors, however, that can be addressed through further research into the field of business angel finance and through the promotion of business angel activity and visible networking in order to increase accessibility of funding to entrepreneurs. Educational websites and programmes could also be produced through various media to educate the entrepreneur on what business angels are and how they can be accessed.

The findings also suggest that although there was some mention of sources of small-scale funding, there is limited overall knowledge of sources of small-scale funding Grahamstown, Eastern Cape, South Africa. Only three sources were mentioned by the respondents, which is not sufficient considering the fact that the government has at least eight sources of small-scale funding provided through the department of trade and industry. This lack of knowledge points to either a general ignorance to these facilities by entrepreneurs in Grahamstown or a poor promotion effort by these institutions in small towns.

Most entrepreneurs in Grahamstown make use of personal finance and other forms of informal capital such as funds from family to start up their entrepreneurial ventures. Some entrepreneurs use their pensions to invest in entrepreneurial ventures when they cannot access other forms of funding. The study suggests that the entrepreneurs who use banks and other financial institutions experience problems of “red-tape”, that is strict bureaucratic funding regulations and requirements that slow down the process of starting-up a business. This was cited as one of the main difficulties in securing start-up capital.

To be successful as an entrepreneur, entrepreneurs in Grahamstown have shown that it is important for one to focus on the success of the enterprise and not the image of success by

adopting a 'hands on' approach to entrepreneurship. They believe that financial institutions addressing the lack of start-up finance and adequate financial advice is what is needed to solve the problem of entrepreneurship ventures failing in the start-up stage. It is believed that an entrepreneur who has been educated on how to manage all the aspects of an entrepreneurial venture will take the venture through the start-up stage and see it to its growth.

It is from this information that the researcher will state that all the objectives of the study were achieved.

7.3 RECOMMENDATIONS

- The South African government should play an active role in promoting business angel finance as a viable option for the financing of entrepreneurial ventures in South Africa. This will increase the sources of small-scale funding and the amount of capital available to start-up small businesses and hopefully translate into higher entrepreneurial activity.
- The South African government should set aside a fund for identifiable and formally registered business angel networks to increase business angel activity in the country and to attract potential entrepreneurs and later stage investors such as venture capitalists to entrepreneurial activity
- Business angels that are familiar to each other should syndicate and form identifiable networks to increase access and visibility to entrepreneurs, even if this is done at first at a community level
- Potential entrepreneurs seeking start-up funding should commit dedicated efforts to accessing business angels in order to widen the options they have to financing their start-ups
- Entrepreneurs need to take the responsibility of educating themselves on key areas of small venture management such as cash-flow management and marketing
- Banks and small-scale funding institutions should make greater efforts at educating themselves about the South African entrepreneur and the small business sector

- Entrepreneurs in South Africa should demand detailed, far reaching and consistent education drives by banks and small-scale funding institutions on the process of securing start-up capital and the nature of the relationship thereafter.

7.4 AREAS FOR FURTHER RESEARCH

An area for potential further study that stood out the most from the research was with regard the performance and accessibility of entrepreneur finance institutions in promoting and supporting entrepreneurship in small towns. As the researcher conducted the research, there seemed to be a feeling from the respondents that the various finance institutions such as Ntsika Enterprise Promotion Agency (Ntsika), Khula Enterprise Financial Limited (Khula), the Isivande Women's Fund (IWF), the Industrial Development Corporation (IDC) and the National Empowerment Fund (NEF) were more active and accessible in the larger cities in provinces such as Gauteng and the Western Cape whereas in the Eastern Cape they were only actively engaged in the larger cities of East London and Port Elizabeth. There is great potential for study in this area and it would be interesting to find what the results on a study of this nature have to say.

Another similar and equally interesting area of study that can be suggested would be a study on the role of banks and micro-finance institutions in small firm start-up and growth. This study would seek to determine what facilitation these institutions provide to small firms and to measure what effect this has on the successful start-up and growth of small enterprises. A study of this nature would be of great value to entrepreneurs, banks, micro finance firms and governments as it would cover some core economical growth areas when it looks at the promotion and financing of small enterprises. A detailed look into the policies of these institutions with regard small-firm finance would also reveal interesting patterns when policy is compared to practice and it would be interesting to see what strategies these institutions adopt from the findings of this study.

Further study could also be undertaken into community based angel networks and the importance of familiarity, trust and culture in allowing access to these networks. This would be interesting because it would lead to a revelation of tailored informal investment practices,

an area the government might find important in promoting investment in entrepreneurship and small businesses. The promotion and support of formal and informal private networks might lead to an increase in entrepreneurship and small business growth as more potential entrepreneurs within different communities would be exposed to potential fund providers. Minimal regulation and the 'reduction of red tape' in promoting these networks would be an even greater advantage that would attract more potential entrepreneurs to come up with business ideas to commercialise.

It would also be interesting if a study was conducted on the activity of business angels in promoting technology based start-up ventures as compared to a non-industry focused study such as this one. The interest in studying this activity especially with a technology based focus comes in the fact that the majority of the literature on business angels shows business angels investing in technology based businesses and less so in other non-technology based businesses. It would be interesting to find out what support the technology industry in South Africa is receiving from informal private investors when compared to government initiatives to promote the same. This information would greatly serve the technology and development industry and attract potential investors to that industry for possible future investment. Lastly, the study could be carried out in a comparative manner between the different provinces in South Africa.

7.6 LIMITATIONS OF THE STUDY

One of the main limitations of the study is that it was conducted in one small town in the Eastern Cape of South Africa. This means that the findings from the research may not be transferrable to bigger provinces with larger and more economically active cities because the level and experience of entrepreneurship may widely differ. The results may only hold true to an experience of entrepreneurship in Grahamstown and hence may only be relevant to the town and the entrepreneurial activity taking place there. A study that included Port Elizabeth and East London would have given a richer and more transferrable set of results.

The number of business angels that the study managed to cover is also not sufficient enough to portray considerable business angel activity and hence may represent a very limited insight into an interesting topic to small business start-up funding. Two business angels do not make a sufficient enough response rate. A study with a greater time allocation to the research data

collection process may have obtained more business angel respondents and hence added greater value to the content and quality of responses from business angels. The greatest challenge was to identify the business angels.

The study could also have benefitted from a section that showed an investigation into the lending policies and practices of small business funding agencies and banks to have a well rounded perspective on these practices in comparison to just the perspectives of the entrepreneurs. This would have led to interesting revelations with regards the study and may also have charted valuable themes and approaches with which to conduct future study on the phenomenon. A table showing the differences between the entrepreneurs' perspectives and the actual bank and financial institution practices would have been an interesting presentation of how disparities exist between policy claims, actual practice and the experience or perspectives of entrepreneurs.

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APPENDIX A: Research Participation Invitation Letter

Zenzo Sibanda
Department of Management
Rhodes University
6139

To

Owner of in Grahamstown, Eastern Cape, South Africa.

RE: INVITATION TO PARTICIPATE IN A STUDY OF SMALL BUSINESSES

Dear Sir/Madam

You are cordially invited to participate in a study of small businesses in Grahamstown, conducted by a Masters in Management student at Rhodes University. The study is based on entrepreneurship and the starting up small businesses and should be of great interest to you as an entrepreneur and small business owner in the South African economy.

The study will consist of an interview conducted and recorded by the student doing the research and will have questions focused specifically on entrepreneurship and small business ownership. The research will ensure that your responses remain anonymous and that and are used for purposes that are sanctioned by the Rhodes University Management Department and the Rhodes University Research Ethics Committee. This is a genuine academic study.

Should you wish to participate, please contact the student conducting the research via the following avenues:-

- E-mail: g05s3577@campus.ru.ac.za
- Cell Phone: 073 794 3510
- Telephone: 046 603 8021

BY NO LATER THAN 2010.

Your interest and participation in this study will be greatly appreciated as a contribution to greater knowledge of small businesses in South Africa and a well researched business sector.

Yours Sincerely

Zenzo Sibanda.

APPENDIX B: Research Interview Schedule

BUSINESS ANGEL FINANCE INTERVIEW SCHEDULE

Before we go on, I'd like to tell you the object of my research so that you have an idea of what I'm trying to achieve. My research is on the usage of people called business angels to finance the starting up of small businesses. Business angels are people who help the start up of small businesses by providing finance and helping to manage a small business in its start up phase. They can be anybody with the financial potential and interest in small business investment and entrepreneurship. They are also known to be more accessible to entrepreneurs than other forms of small business finance, such as financial institutions and banks and they are said to be less strict in handing out business loans when compared to these institutions.

NB Before today, had you ever heard of the term business angel? **

IF YES [<i>BUSINESS OWNERS</i>] ...	IF NO ..
<ul style="list-style-type: none"> • Have you used or considered using business angel financing? • How did you (or are you planning to) get in contact with the business angel? • What are/were the conditions of financing? • How much money was or will be provided by the business angel? • Are you aware of business angel networks? What role do you think they play in relation to entrepreneurs and business angels? • Would you recommend business angel financing to other business operators? Please give reasons for your answer. 	<ul style="list-style-type: none"> • From the way I explained the term, do you know of any other term used to describe the same thing <ul style="list-style-type: none"> • if yes ... • Please explain further:

- | | |
|--|--|
| <ul style="list-style-type: none">• How would you describe the business angel's level of involvement in your business? | |
|--|--|

GENERAL QUESTIONS

- 1) Please describe what you understand by the term entrepreneur?
- 2) In your opinion, is there a difference between a small business owner and an entrepreneur?
- 3) Please describe what you believe to be the main activities and focus areas of entrepreneurship
- 4) Are there any entrepreneurs in Grahamstown/East London/Port Elizabeth? How can they be identified?
- 5) Have you ever taken any risks in your business and what has been the outcome?
- 6) On a day-to-day basis, how do you go about taking up a business risk? How successful have you been with this approach?
- 7) Please describe your firm's past and current employment situation dating from when you started the business. This is in terms of number of employees and the types of employees employed.
- 8) Why do you think the small business sector is important to the South African economy?
- 9) Why do you think most entrepreneurship ventures fail at the start up stage?
- 10) The main barrier to small business start ups is finance. What is your opinion?
- 11) One of the reasons emerging entrepreneurs fail to access finance from banks is their lack of financial records. Do you agree with this? Why?

12) In your opinion, what do you think emerging entrepreneurs should know about financing a business start up?

13) In your opinion, what should the providers of finance know about emerging entrepreneurs?

Business Operators

- In your opinion, what are the biggest challenges of starting a business venture?
- Please describe your particular experience with securing start up capital. What has been the effect of this experience on your businesses success
- Are you aware of any sources of small business start-up funding? If yes, describe what you understand by each of them
- How easily available to emerging entrepreneurs do you think these sources are? Please explain fully
- Which of these sources do you think is the most commonly used in South Africa and why?
- Business start ups tend to rely on more than one source of funding, please explain your particular experience?

Business Angels

- Please describe your experience of funding small business start ups in South Africa
- What do you consider when making funding decisions? How important is the ability of the entrepreneur in your consideration
- How long does it take you to decide on whether to invest or not to invest? What challenges do you face in making this decision?
- How important is a business prototype or track record to you as a funds provider? Motivate your answer
- Please describe and explain if you have ever funded what turned out to be a bad option?
- Please describe and explain if you have ever refused to fund what later turned out to be a good funding option
- How would you describe the general nature of your engagement beyond finance in a small business start up in South Africa?
- From your own perception, what is the extent of business angel use in South

	<p>Africa?</p> <ul style="list-style-type: none">• Which factors do you think impact the use of business angel financing in South Africa?• What can be done to improve the extent of business angel use in South Africa?• How far away from your place of residence have you funded a business in South Africa?
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