SMALL, MICRO AND MEDIUM ENTERPRISES ACCESS TO CREDIT IN THE EASTERN CAPE, SOUTH AFRICA

BY

MZWANELE ROADWELL DLOVA

STUDENT NUMBER: 880322

DISSERTATION SUBMITTED TO THE UNIVERSITY OF WITWATERSRAND FOR THE FULLFILMENT OF THE DEGREE OF DOCTOR OF PHILOSOPHY

JUNE 2017

SUPERVISOR: PROFESSOR MUNACINGA SIMATELE

DEDICATION

I, the undersigned, declare that this is my original work and has not been submitted for a degree in this or any other university for examination.

Mzwanele Roadwell Dlova

Signed:___________________________________

Date:____________________________________

ABSTRACT

The study is aimed at empirically investigating the dynamic interaction between the demand and supply factors affecting SMME access to credit in the Eastern Cape. The study is also aimed at conducting a comparative evaluation of lending criteria used by development finance institutions (DFIs) and commercial banks in evaluating SMME funding applications. The study is geared towards proposing a funding framework aligned to the characteristics of SMMEs which can be used by both DFIs and commercial banks to assess applications for SMME funding.

In order to meet the objectives of the study, a sample of 80 SMMEs from the manufacturing, construction, services, agriculture, automotive, mining, security, merchandising and retail sectors was, through proportionate stratified sampling, selected from the population of all the SMMEs from the eight metropolitan and district municipalities (Nelson Mandela, Buffalo City, Joe Gqabi, Chris Hani, OR Tambo, Cacadu, Alfred Nzo and Amathole) constituting the Eastern Cape Province. Three separate structured open and closed-ended questionnaires were used to collect data from the 80 SMMEs owner/managers, 8 DFIs' regional/branch managers and 5 major commercial banks branch managers in the province. The design of both questionnaires was underpinned by the credit rationing theoretical framework as well as the 5C's of credit (capacity, collateral, capital, condition and character). A response rate of 100% was achieved. Content analysis and Relative Importance Index (RII) were used to analyse data.

The results of the dynamic interaction between the supply and demand factors affecting SMME access to credit show that generally, there is an alignment between the SMME and the funding institutions survey results. This shows that the lending criteria of funding institutions are transparent. On the other hand, it is evident that there is poor awareness of the funding institutions criteria by SMMEs. SMMEs seem not to know what funding institutions are looking for when they evaluate funding applications. The results also pointed out that the characteristics of SMMEs in the study are representative of those of SMMEs countrywide. SMMEs in the study are characterised by poor/no business plans, lack of financial statements, lack of collateral, tax clearance certificates, poor cash flow, lack of owners' contribution and lack of previous industry experience. The results also indicate that funding institutions' lending criteria do not take into account the unique characteristics of SMMEs in the Eastern Cape.

The results of the comparative evaluation of the lending criteria of DFIs and commercial banks show that there are no substantive differences between how commercial banks and DFIs evaluate the credit applications made by SMMEs. Both groups of lenders place significance on the business plans, financial statements, cash flows, owners' contribution, collateral and experience of owner/managers. Moreover, the study also found that there is significant discrepancy between what the lending documentation of DFIs and commercial banks indicates as key requirements and what the survey results indicate. This means that what funding institutions practice is not congruent with what is enshrined in their lending criteria/policy.

If we proxy lend in practice with what the key informants indicated as critical variables, the results show that both groups are more stringent in practice in key areas of their lending criteria. The review of the characteristics of SMMEs in South Africa showed that they lack collateral, are low on savings and experience. Furthermore, they have little capacity for

writing business plans and cash flow management. The results here indicate that these are the very same areas which the financial institutions place significant importance on.

The findings indicate that the lending criteria used by both groups tend to favour large and well established firms which have the required capacities. Based on the above findings, it is evident that in order to address the SMME access to credit constraint, a new framework that can be used by DFIs to lend to SMMEs needs to be developed. The framework must take into account the peculiar nature of SMME characteristics. Without such an approach, the funding gap for SMMEs in SA will continue.

In response to the above findings, the study proposes that government must incentivise funding institutions to innovatively provide capacity building and training programmes targeted at improving the skills and expertise of their staff. It is proposed that DFIs should simplify their loan application forms to cater for the historically low literacy levels of SMMEs in the Eastern Cape. In addition, DFIs should adopt a more streamlined loan application process as well as a shared due diligence process. Credit application forms as well as key lending documents should be standardised. DFIs should conduct road shows to take their potential SMME customers through their application form, how they must be completed and the documents to accompany the form.

SMMEs must be personally involved in the gathering of the relevant business plan information as well as in the writing up of their business plans. DFIs must organise quarterly workshops aimed at taking their potential clients through their lending criteria. The SEFA Credit Guarantee Scheme must be reviewed. Government must provide support to its venture capital industry by creating a good investment climate. The study proposes that a knowledge portal that will enable the sharing of knowledge and learning among SMMEs in the Eastern Cape be established. DFIs must set up SMME divisions or units to provide specialised credit services to their SMME customers. DFIs should evaluate SMME credit applications based on alternative risk evaluation methodologies such as the psychometric screening developed by the Harvard University's Entrepreneurial Finance Laboratory. DFIs should explore alternative means of financing that do not require collateral. To increase SMME access to credit, government should establish specialised banks that can exclusively cater for the needs of the SMME sector. Government could consider granting certain incentives to funding institutions that actively promote SMME financing and have achieved a sizeable SMME loan book.

ACKNOWLEDGEMENTS

First and foremost, I wish to express my sincere gratitude to the Lord Almighty, without whose unfailing love, favour, benevolence and divine grace, this study would not have been possible.

My word of thanks and appreciation extend to the following people who have contributed enormously to the completion of this study:

- My wife, Pumla for her love, relentless support, understanding and being my pillar of strength during my three years of study.
- My children Bulumko, Kwazi and Ilungile for their understanding.
- Professor Munacinga Simatele, my supervisor for her unwavering guidance and advice throughout the study.
- My PhD colleagues for the courage and strength they provided me during the three year period of my study.
- The Eastern Cape SMMEs interviewed for their patience, understanding and willingness to contribute to the study.
- All the Eastern Cape Development Finance Institutions and commercial banks interviewed for the invaluable information they provided during the duration of the study.
- The field workers from all the eight metro and district municipalities who assisted with data collection.
- Wits University Business School staff for their support during my three years of study at the university.
- Irene Mazhawidza for editing the document

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

ACRONYMS AND ABBREVIATIONS

Absa:	Amalgamated Bank of South Africa
AsgiSA:	Accelerated Shared Growth Initiative of South Africa
BCMM:	Buffalo City Metropolitan Municipality
DFIs:	Development Funding Institutions
DTI:	Department of Trade and Industry
EC:	European Commission
FNB:	First National Bank
GDP:	Gross Domestic Product
GEM:	Global Entrepreneurship Monitor
IDC:	Industrial Development Corporation
NDA:	National Development Agency
NGO:	Non-Governmental Organization
NYDA:	National Youth Development Agency
SAMAF:	South African Microfinance Apex Fund
SEDA:	Small Enterprise Development Agency
SMMEs:	Small Micro and Medium Enterprises
UIF:	Unemployment Insurance Fund
UNIDO:	United Nations Industrial Development Organisation
USAID:	United States Agency for International Development
VAT:	Value Added Tax

CHAPTER 1: INTRODUCTION

1.1 Background

The importance and contribution of small micro and medium enterprises (SMMEs) in promoting economic growth, employment creation and poverty alleviation in developed and emerging economies is widely documented (Amra *et al*, 2013; Fatoki and Asah, 2011; Musamali and Tarus, 2013; Gangata and Matavire, 2013; Islam *et al*, 2011; Richard and Mori, 2012). The above-mentioned studies concur with the fact that worldwide, SMMEs are pivotal in stimulating private ownership and entrepreneurial skills, are flexible and can adapt quickly to volatile market demand and supply situations, help diversify economic activity and make an important contribution to exports and trade. As a result of this contribution, countries across the globe have prioritised the creation of a conducive and enabling environment for SMME growth and development.

In South Africa, SMMEs account for approximately 60% of all employment in the economy and more than 35% of South Africa's Gross Domestic Product (GDP) (Kongolo, 2010). In addition, SMMEs are often seen as the vehicle by which the lowest income people in society gain access to economic opportunities. The sector represents 97.5% of the total number of business firms in South Africa and that it contributes 42% of total remuneration. SMMEs estimated at more than 2.5 million, account for some 3.5 million jobs in the South African economy (Bureau for Economic Research, 2016).

However, despite the significant positive impact by SMMEs to economic growth highlighted above, there is considerable evidence that their failure rate is high, especially in South Africa where unemployment rate is also high (25.6%) (Statistics South Africa, 2014). For example, according to Fatoki and Asah (2011), 75% of newly established SMMEs in South Africa close down after having operated for approximately two years. The above-mentioned scenario can be attributed to a number of constraints faced by SMMEs such as access to markets, technology, business infrastructure and information amongst others. However, scholarly research conducted over the years revealed that SMME access to credit is one of the critical challenges negatively impacting on SMME growth and development (Rogerson, 2008; Irwin and Scott, 2010; USAID, 2010; Kira and He, 2012). The SBP's SME Growth Index (2015) features SMME access to credit as one of the top five factors discouraging SMME growth and development. SMMEs require finance to start and expand their operations, develop new products and invest in new staff or production facilities. A 2010 Finmark Trust survey of small businesses in South Africa revealed that 93% of firms in the survey never had access to formal or informal credit.

The South African government has, since the dawn of democracy in 1994, realised the enormous contribution made by SMMEs in the country's economy and as a result it prioritised their promotion and growth. The country's first economic policy, the Reconstruction and Development Programme (RDP) (1994), advocated for the support of SMMEs for employment creation, income distribution and growth.

In 1995, the White Paper on National Strategy for the Development and Promotion of Small Business in South Africa was developed. The White Paper put emphasis on government to facilitate an enabling environment for SMME access to information, procurement opportunities, markets, business infrastructure and finance. The White Paper culminated in the National Small Business Act No. 106 of 1996. The act was subsequently followed by the establishment of Khula Enterprise Finance Limited that focused on promoting SMME access to credit. Following the establishment of Khula, Ntsika, aimed at providing non-financial support to SMMEs was also formed. In addition, the Centre for Small Business Promotion (CSBP), charged with the operationalization of the National Small Business Strategy was also established.

The promotion of SMMEs continued to feature in the subsequent government economic policies such as the Growth, Employment and Redistribution Plan (GEAR) (1998). GEAR encapsulated the promotion of SMMEs as one of the key elements in the government's strategy for employment creation and income generation. In 2001, the Umsobomvu Youth Fund (now the National Youth Development Agency) was established to, amongst other things, provide finance to youth-owned and run SMMEs. In 2004, the Small Enterprise Development Agency (SEDA) -- an amalgamation of Ntsika and CSBP -- was formed. SEDA's directive was to execute the National Small Business Strategy and to provide non-financial support to SMMEs.

In 2006, GEAR was replaced by the Accelerated Shared Growth Initiative for South Africa (ASGISA) (2006). One of ASGISA's strategies was to eliminate the second economy. Small business promotion and broad-based empowerment were some of the vehicles to achieve the above-mentioned strategy. Access to credit and preferential procurement were therefore prioritised. In 2010, government revealed the New Growth Path (2010) economic strategy. The New Growth Path listed the strengthening of SMME access to credit as one of its core strategic components aimed at bringing the country's citizens, in particular the previously disadvantaged, into the economic mainstream. This endeavour also featured prominently in the subsequent government's economic blueprint, the National Development Plan (NDP) (2012) which aims to reduce unemployment by 6% and create 11 million jobs by 2030. The policy document calls for the examination of the state's role in promoting SMME access to credit.

In 2012, an amalgamation of Khula, the South African Micro Finance Apex Fund (SAMAF) and the Industrial Development Corporation (IDC)'s small business wing led to the establishment of the Small Enterprise Finance Agency (SEFA). The organisation is mandated to provide credit to SMMEs. In addition to the above-mentioned initiatives by government to promote and develop SMMEs, a number of other initiatives by provincial and local government including the private sector and civil society geared towards SMME development were introduced. Realising the contribution by SMMEs to the country's economy, the South African government has established a stand-alone Ministry for Small Business Development. The Ministry is mandated to create a conducive environment for the growth and development of SMMEs and cooperatives through the provision of enhanced financial and nonfinancial support services and leveraging on public and private partnerships.

However, despite all the endeavours by the above-mentioned spheres of government, the private sector and the civil society to create an enabling environment for SMME access to credit, access to credit continues to be a challenge for SMMEs. The National Council of Provinces summoned all commercial banks and DFIs to its Select Committee on Trade and International Relations to make presentations on their SMME services in particular regarding SMME access to credit and the progress they made during the 2012/2013 financial year (NCOP, 2012). In the meeting, all the above-mentioned entities were asked to explain why so few credit applications were successful in obtaining credit. An example of this situation was the Development Bank of Southern Africa (DBSA) where it received more than 2000 funding applications during the above-mentioned financial year but only 26 were approved for credit.

It became clear that there were challenges experienced by SMMEs in accessing funding meant for them in all the government entities. A recent study by Finmark Trust (2015) on financial access and SMME size in South Africa revealed that only 7% of the 5667 SMMEs surveyed had access to credit.

The question that needs to be answered here is "why, despite so many government and private sector initiatives aimed at facilitating SMME access to credit, do SMMEs still fail to access the same credit from DFIs meant for them and how can this challenge be addressed?"

1.2 Problem statement

The South African government has identified SMMEs as critical in bolstering economic growth and employment in the country (OECD, 2006). This is enshrined in the government's National Development Plan (NDP) economic policy. The policy has a target of 11 million jobs to be created by 2030. The Endeavour jobs calculator stated that to meet the above-mentioned jobs target, South Africa needs over 49 000 SMMEs growing at a rate of 20% per annum. This means that the country would need no less than 8.2 million SMMEs to create the same number of jobs.

However, compared to other developing countries, South Africa has a high failure rate of new SMMEs. Van Scheers (2011) and Cant and Wiid (2013) observed that 40% of new businesses in South Africa fail in their first year, 60% in their second year and 90% in their first ten years of existence. Adeniran and Johnston (2011) assert that the failure rate of SMMEs in South Africa is estimated between 70 and 80%. Meanwhile, Adcorp (2012) observed that about 440 000 small businesses have closed down in the last five years in South Africa. A recent study by the Bureau for Economic research (2016) revealed that over the last seven years, the number of SMMEs in South Africa increased by only 3% from 2.18 million in 2008 to 2.25 million in 2015. Among the nine provinces, Limpopo had the highest growth rate of SMMEs (34%) during this period followed by Gauteng (14%) and the Western Cape (2%) (Statistics South Africa, 2013).

Contrary to the above-mentioned growth realised by Limpopo, Gauteng and the Western Cape, the Eastern Cape, characterised by high levels of poverty, unemployment and inequality, was among provinces which saw a 10% reduction in its number of SMMEs from 218 865 to 197 366 during the above-mentioned period (Bureau for Economic Research, 2016). Given this situation, it is evident that there are slim chances for the realisation of the above-mentioned government objective of bolstering economic growth and employment through SMMEs if no radical strategies are devised to counteract the situation. Fatoki (2014) pointed out that the high failure rate paints a bleak picture of the SMME sector's potential to contribute meaningfully to job creation, economic growth and poverty reduction. The significant contribution made by SMMEs cannot be sustained without the creation of new SMMEs (Maas and Herrington, 2006).

The high attrition rate can be attributed to, among others, the lack of funding generally experienced by SMMEs in South Africa (Fatoki, 2014). Numerous studies on SMME access to credit in South Africa (USAID, 2010; Finmark Trust, 2010; Herrington *et al*, 2010; Rogerson, 2008; Mago and Toro, 2013) have been conducted. The studies were aimed at investigating a number of internal, external and institutional factors impacting on SMME access to credit in the country. The majority of the above-mentioned studies investigated SMME access to credit from the demand (SMME perspective) side while few focused on the supply (funding institutions perspective) side. The above-mentioned studies corroborated on the fact that firm and entrepreneurship demand factors such as poor business plans, lack of collateral, poor cash flow, lack of own contribution, the character of the firm and its owner/manager as well as compliance factors have an impact to SMME access to credit. On the other hand, DFIs and commercial banks have been observed to prioritise collateral, cash flow, own contribution and experience as key supply factors to be met by credit applicants to be eligible for credit (USAID, 2010; Pandula, 2011; Agyapong *et al*, 2011).

The reviewed literature revealed that no study was undertaken to empirically investigate the dynamic interaction between the above-mentioned demand and supply factors that affect SMME access to credit. An understanding of whether there is an alignment between the characteristics of SMMEs and the lending criteria of DFIs and commercial banks is invaluable. Deakins *et al* (2008) pointed out that supply and demand side studies on SMME access to credit are rare.

Section 1.2 above outlined a number of DFIs established by the South African government to create a conducive and an enabling environment for SMME access to credit. Their establishment was in response to the challenges experienced by SMMEs in accessing credit from commercial banks (Mago and Toro, 2013). Their role is to improve SMME access to credit. However, as pointed out in the above section, it appears that despite the existence of the above-mentioned institutions, SMMEs still continue to experience challenges accessing credit from DFIs (Fatoki, 2014). The question that needs to be answered is whether DFIs are addressing the financing gap or not.

A comparative evaluation of lending criteria used by DFIs and commercial banks in evaluating SMME credit applications is critical in responding to the above question. According to their mandate, DFIs are expected to be lenient and take the unique characteristics of SMMEs into account when they evaluate SMME funding applications (USAID, 2010). As a result, their lending criteria have to be totally different to that of commercial banks. No study was undertaken to conduct the above-mentioned investigation. The aim of the comparative evaluation will be to outline the lending criteria used by DFIs and commercial banks in evaluating SMME credit applications. It will also determine whether there are differences between how commercial banks and DFIs evaluate the credit applications made by SMMEs. The reviewed literature revealed that compared to their larger counterparts, SMMEs have unique characteristics that negatively impact on their access to credit. Therefore, a funding framework aligned to the characteristics of SMMEs which can be used by funding institutions to assess SMME credit applications is necessary.

Section 1.1 presented the importance and contribution of SMMEs in promoting economic growth, employment creation and poverty alleviation in developed and emerging economies. The review of literature revealed that globally, SMMEs are the engine of economic growth and generators of employment. However, despite the significant positive impact by SMMEs to economic growth highlighted above, there is considerable evidence that their failure rate is high especially in South Africa where unemployment rate is also high. The failure rate can be attributed to the number of constraints that SMMEs face chief amongst them is SMME access to credit. This is despite a number of initiatives by government, the private sector and the civil society to create an enabling environment for SMME access to credit. The question that needs to be answered is why after more than 20 years of democracy SMMEs still find it difficult to access credit from DFIs as well as commercial banks.

1.3 The objective of the research

The objectives of the research are as follows:

1. To empirically investigate the dynamic interaction between the demand and supply factors that affect SMME access to credit in the Eastern Cape.
2. To conduct a comparative evaluation of lending criteria used by DFIs and commercial banks to evaluate SMME funding applications.
3. To propose a funding framework aligned to the characteristics of SMMEs which can be used by DFIs to assess SMME credit applications.

1.4 The significance of the study

As mentioned under the problem statement, studies that assessed industry (firm) and entrepreneurship attributes on SMME access to credit approached their studies from the demand (perception of SMMEs) perspective and not from the supply side (perspective of funding institutions) or both. Given the fact that a combination of demand and supply-side studies are very rare, the study first seeks to investigate the dynamic interaction between the demand and supply factors that affect SMME access to credit in the Eastern Cape. The investigation seeks to attain a comprehensive picture of the impact of these factors on SMME access to credit. The results of this investigation will make an invaluable contribution to literature, in that they will outline whether there is an alignment between SMME characteristics and funding institutions lending criteria. The investigation will also point out as to whether funding institutions lending criteria take into account the unique characteristics of SMMEs or not.

The results of this study will bring new and valuable insights to the SMME access to credit discourse thereby closing the above-mentioned gap and enriching literature in this subject. Moreover, the results of the study will serve as a catalyst towards an endeavour to find possible solutions to the challenge of SMME access to credit which is one of the factors negatively impacting on SMME growth and development.

Secondly, the above-mentioned studies paid more attention on debt finance from commercial banks and not from DFIs. The study, therefore, will pay attention to SMME access from both commercial banks and DFIs. The rationale for this approach is to get a complete perspective and magnitude of the dynamic interaction between the demand and supply factors that affect SMME access to credit, thereby closing this gap. It is hoped that this complete perspective will influence local, provincial and national policy on the creation of an enabling and conducive environment for SMME access to credit. This is aimed at reducing the high attrition rate of SMMEs in the country.

Thirdly, a comparative evaluation of lending criteria used by DFIs and commercial banks to evaluate SMME credit applications is yet to be undertaken. This study is therefore aimed at making a significant contribution to literature by closing this gap.

Fourthly, an investigation on the differences between the commercial banks and DFIs' criteria in evaluating SMME credit applications is yet to be undertaken. The study is therefore aimed at closing this gap in the literature by ascertaining if there are any differences between the criteria of the above-mentioned funding institutions. It is hoped that the results of this investigation will have a significant influence on SMME access to credit.

Lastly, an investigation on an appropriate framework that can be used by commercial banks and DFIs to lend to SMMEs is yet to be undertaken. This study, therefore, is aimed at proposing this framework that could be used by the above-mentioned funding institutions to assess SMME credit applications. It is believed that this framework will have a positive impact towards SMME access to credit. This will result in SMME longevity and increase the number of SMMEs in the Eastern Cape. The increase in the number of SMMEs in the province will in turn result in the creation of jobs and the improvement of the province's economy.

1.5 The scope of the survey

The research will be subject to certain scope limitations. Firstly, the research study is only restricted to SMMEs in the Eastern Cape metropolitan and district municipalities' Supply Chain Management database due to time and financial limitations. Secondly, the study is only focusing on SMMEs trading under the following sectors; manufacturing, construction, automotive, service, merchandize and retail, agriculture, security and mining. According to the Eastern Cape Development Indicators (2012), these are sectors driving the economy of the Eastern Cape. The research only concentrates on firm and entrepreneurship characteristics (internal factors) impacting on SMME access to credit.

1.6 Organisation of the study

The study is organised into seven chapters. The first chapter provides a brief background to the study, the problem statement, objectives of the study, its significance and its scope. The second chapter gives an overview of SMMEs in the South African context. The chapter outlines the overview of the South African profile, the picture of the nature of SMMEs in the country, the background to the Eastern Cape Province, the contribution of SMMEs to economic development as well as challenges they face. The third chapter provides a comprehensive discussion of the theoretical and empirical review of literature on SMME access to credit. The theoretical literature analysis entails the review of the capital structure theories of the firm, debt and equity financing and the credit rationing theoretical framework amongst others. The empirical literature details the firm and entrepreneurship characteristics impacting on SMME access to credit.

The fourth chapter outlines comprehensive details on the research methodology employed in the study. The chapter discusses the research paradigm adopted as well as the research design followed by the study. The research design is composed of the secondary data analysis, the research population, sampling, the research instrument, the piloting of the questionnaire and the analysis of the collected data. The fifth chapter presents the results of the study in accordance with the themes adopted by the study. The sixth chapter presents the analysis of the above-mentioned results in line with the 5C's of credit. The seventh chapter outlines the funding framework aligned to the characteristics of SMMEs which can be used by DFIs to assess SMME credit applications. The last chapter concludes the entire study.

CHAPTER 2: AN OVERVIEW OF SMMES IN THE SOUTH AFRICAN CONTEXT

2.1 Introduction

The chapter is composed of six sections. The first section outlines the general overview of the South African economic profile. The section provides highlights on the economic challenges facing the country and identifies SMME development as one of the key potential catalysts to economic growth and employment creation. The second section provides a picture of the context of SMMEs in South Africa. The country's SMME statistics as well as its Total Entrepreneurial Activity (TEA) are also discussed in this section. The third section gives a brief background to the Eastern Cape Province, highlighting the province's population, GDP, its natural resources, Gini co-efficient and unemployment. The fourth section details the global and South African contribution of SMMEs to economic development. The fifth section gives an overview of some key challenges facing SMMEs in South Africa whilst the last section provides a summary of the entire chapter.

2.2 An overview of South Africa's economic profile

South Africa, home to about 51.7 million (Statistics South Africa, 2011), is made up of nine provinces namely Gauteng, KwaZulu-Natal, Eastern Cape, Western Cape, Limpopo, Mpumalanga, North West, Free State and the Northern Cape. According to the 2011 National Census, the provincial populations are shown in the table below.

Table 2.1 Population of South Africa by provinces

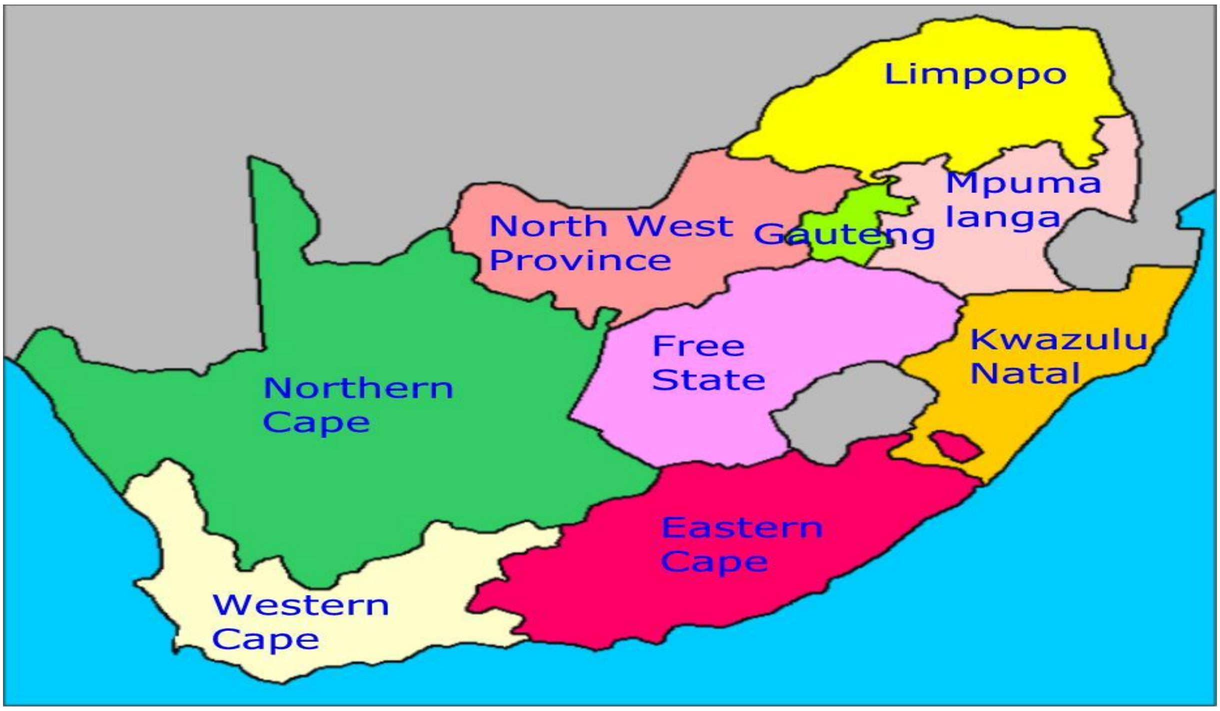
RANK	PROVINCE	2011 CENSUS		2014 MID-YEAR ESTIMATE	
		Population	**Percentage**	**Population**	**Percentage**
1	Gauteng	12,272,263	23.7	12,914,800	23.9
2	KwaZulu-Natal	10,267,300	19.8	10,694,400	19.8
3	Eastern Cape	6,562,053	12.7	6,786,900	12.6
4	Western Cape	5,822,734	11.2	6,116,300	11.3
5	Limpopo	5,404,868	10.4	5,630,500	10.4
6	Mpumalanga	4,039,939	7.8	4,229,300	7.8
7	North West	3,509,953	6.8	3,676,300	6.8
8	Free State	2,745,590	5.3	2,786,800	5.2
9	Northern Cape	1,145,861	2.2	1,166,700	2.2
South Africa		**51,770,561**	**100.0**	**54,002,000**	**100.0**

Source: Statistics South Africa, 2011

As can be seen in the table above, Gauteng, which is regarded as the economic powerhouse of the country, has the highest population followed by KwaZulu-Natal and the Eastern Cape. The Northern Cape has the lowest population. The majority (66%) of the population of the country is young people (people below the age of 35 years) (Statistics South Africa, 2014).

This puts a challenge on the country as it has to ensure that this group of the population is absorbed into the mainstream economy.

Figure 2.1 South African Provinces



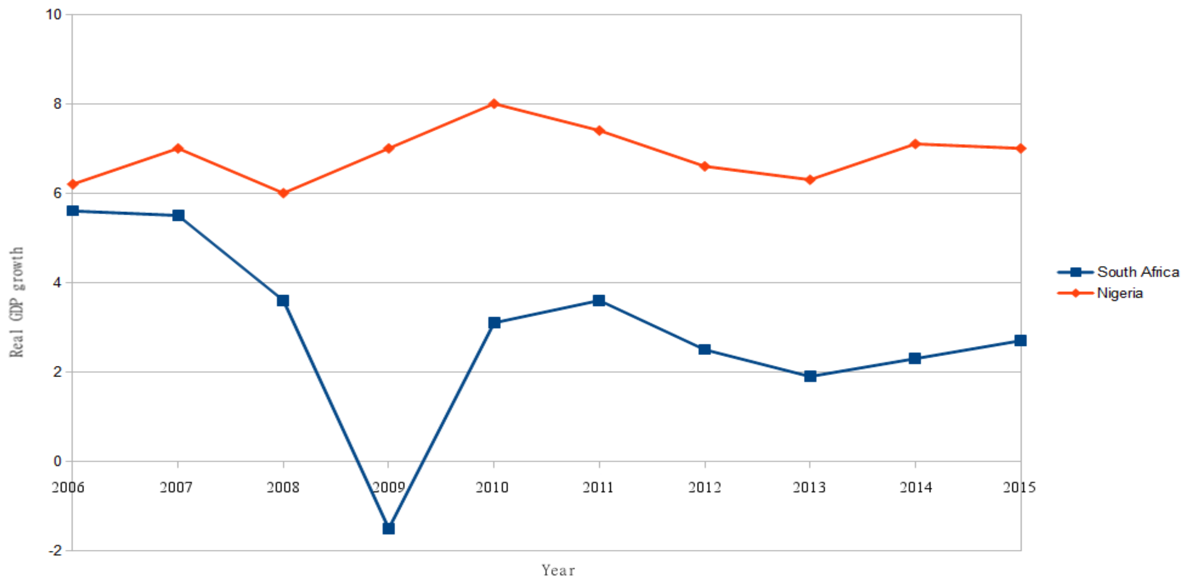
Source: Statistics South Africa (2014)

The country, which celebrated its 20th year of democracy in 2014, has recorded tremendous development achievements since the advent of democracy in 1994. For example, the country's constitution is regarded as one of the best in the world; more than 2.8 million new houses have been built since 1994; access to water has increased from 59% of the population in 1994 to more than 85% in 2013; access to sanitation increased from 50% in 1994 to more than 70% in 2013 and 4.2 million homes were electrified between 1994 and 2006 and 80% in 2013 (Statistics South Africa, 2014).

The country recorded an average economic growth rate of 3.3% per annum in real terms over the period 1994 to 2012 (Statistics South Africa, 2014). This is a remarkable improvement on the 1.4% average annual growth realised during the period 1980 to 1993. However, the pace of growth fell short of the 3.6% average recorded by the world economy during the same period (UNDP, 2014). The country was the first African nation to host the successful Soccer World Cup in 2010 which contributed positively to how the entire world views the country. However, notwithstanding the above-mentioned achievements realised since 1994, South Africa, like other developing countries in Africa, is faced with a number of development challenges key amongst which is poverty, unemployment and inequality (triple challenge).

South Africa is the second largest economy in Africa after Nigeria. The country has a strong and diversified industrial base, a world class infrastructure and a highly sophisticated financial sector dominated by banking, insurance, the mortgage industry and the stock market. South Africa is ranked 53rd out of 148 countries in the World Economic Forum's Global Competitiveness Index for 2013-2014 (UNDP, 2014). The country's economy was hard hit by the 2008-2009 global recession. After growing at an average of 3.6% per year between 1994 and 2008, the economy contracted by 1.5% in 2009, representing its first recession since the end of apartheid (UNDP, 2014). Since the recession, growth has been uneven, slipping from 3.5% in 2011 to 2.5% in 2012 and 1.9% in 2013 (Statistics South Africa, 2014).

Figure 2.2 Real GDP growth – South Africa vs. Nigeria

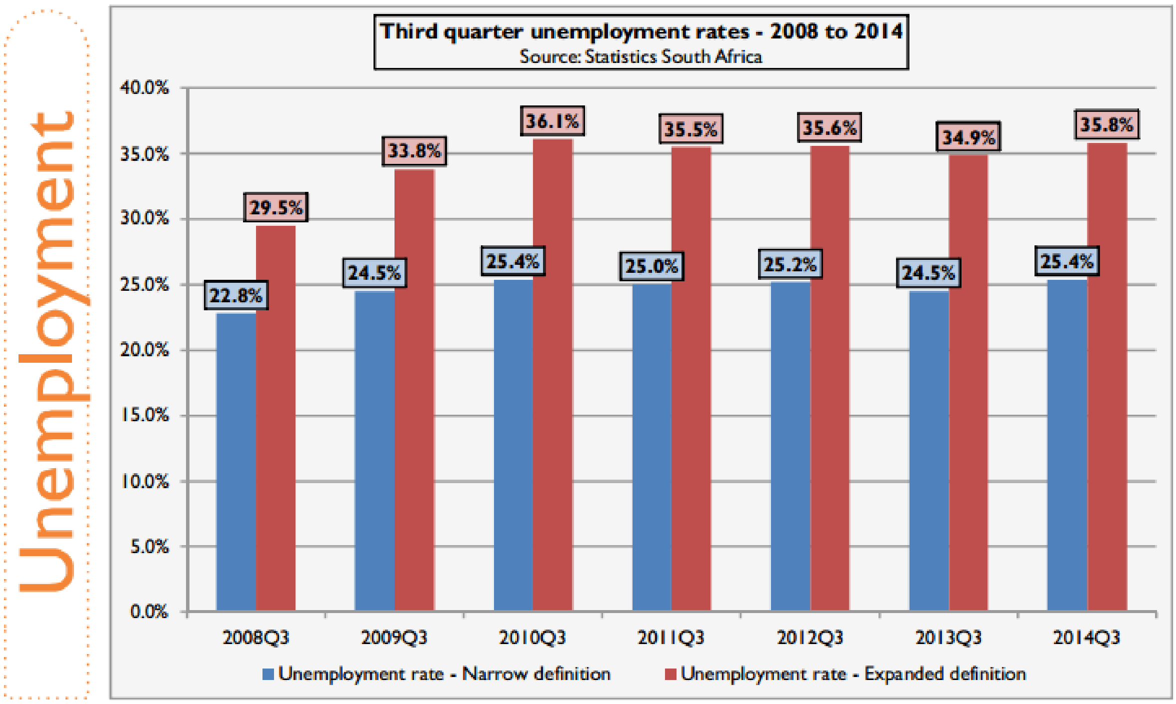


Source: Statistics South Africa (2014)

As can be seen in the above graph, the country's economy grew by 0.4% to 2.3% in 2014 and is projected to grow by 2.7% in 2015. However, the country's counterpart, Nigeria, has maintained a real GDP growth rate of over 6.0% year on year and has taken over South Africa as Africa's largest economy. The significant growth in the economy of Nigeria is attributed to the growth and development of the country's SMME sector (Ilegbinosa and Jumbo, 2015). According to Tom *et al* (2016), Nigeria had 17 284 671 SMMEs in 2010 and they created 32 414 884 jobs and contributed 46.56% to the country's GDP. The above study also points out that 98% of the country's 1.8 million jobs created annually are from SMMEs. This shows that SMMEs are pivotal in improving economic growth and job creation.

The rate of high unemployment is one of the major challenges facing South Africa. The rate of unemployment in South Africa decreased from 25.4% in the third quarter of 2014 to 24.3% in the fourth quarter of the same year. Unemployment rate in South Africa averaged 25.2% from 2000 until 2014, reaching an all-time high of 31.2% in the first quarter of 2003 and a record low of 21.5% in the fourth quarter of 2008. The South African youth unemployment rate of more than 50% is the third highest in the world after Greece and Spain. This means that the country has to devise strategies to counteract the situation as it does not auger well for any country. The country's unemployment rate from 2008 to 2014 is presented in Figure 2.3 below.

Figure 2.3 South Africa Unemployment Rate (2003Q3 – 2014Q3)



Source: Statistics South Africa (2014)

The country's economy has for many years not been able to generate sufficient employment to absorb a growing labour force the majority of which are youth. This has been attributed to numerous factors amongst which are: increased capital intensity in numerous sectors of economic activity; skills mismatch between what employers require and the available skills profile; labour market rigidities and regulatory aspects as well as wage cost increases versus productivity growth (World Bank, 2015). Table 2.2 below presents the unemployment rate in BRICS countries and Nigeria in 2012.

Table 2.2 Unemployment rate in BRICS countries and Nigeria in 2012

Country	**Unemployment rate (%)**
India	3.4
China	4.5
Russia	6.9
Brazil	6.9
Nigeria	7.2
South Africa	24.3

Adapted from World Bank (2015)

As can be noted in the table above, South Africa has the highest unemployment rate compared to all the countries listed above. The South African government's newly launched employment tax incentive, among other government initiatives, is aimed at addressing the above-mentioned challenge by encouraging the private sector to absorb youth through subsidizing the newly recruited workers aged between 18 and 29. However, despite the aforesaid strategies by government to create an enabling environment for youth employment, the overall job market remains hamstrung and the private sector continues to shed jobs (Fatoki, 2014). In addition, labour unrests especially in the agricultural and manufacturing sectors; continue to have a negative effect on the country's overall output. Furthermore, the country's output capability is constrained by the skills shortage and calls are being made for further investment and reform of the poor performing education system.

The poverty level, which is the second biggest challenge facing South Africa, has declined since 2006 (Statistics South Africa, 2014). According to Statistics South Africa (2014), people living below poverty line have dropped from 27% to 20.2% of the population. This improvement is attributed to collaborative and concerted efforts by government, the private sector and the civil society to push back the frontiers of poverty in the country. However, despite these efforts and the fact that the number of people living below the poverty line has declined, the poverty level is still stubbornly high (Fatoki, 2014).

The high levels of employment and poverty and other socio-economic factors give rise to high inequality. According to Statistics South Africa (2014), the country's Gini coefficient is approximately 0.65 based on expenditure data and 0.69 based on income data during the last quarter of 2014. This makes the country one of the most unequal countries in the world after Lesotho. In addition, literature attests to the fact that South Africa is faced with high levels of crime and corruption. According to the United Nations Office on Drugs and Crime (2013), crime is one of the important issues the country is grappling with. The report further notes that though the country's murder rate has decreased by half, South Africa still remains one of the most violent countries in the world for homicide.

Given the above-mentioned economic profile of South Africa, and the fact that the country has a 40% labour absorption rate (UNDP, 2014), it is evident that the country needs radical strategies to grow the economy, drastically reduce unemployment, poverty and inequality. SMME development remains one of the key potential catalysts to create employment, reduce poverty and inequality in the country (UNDP, 2014). Cant and Wiid (2013) observed that SMMEs play an essential role in the development of the country's economy and have become the primary source of job creation. SMMEs have been instrumental in the growth of countries' economies such as China, Nigeria, Kenya, Brazil, Uganda and many more. South Africa can learn from such countries. The South African government has launched the National Development Plan which aims to:

- Reduce the high unemployment rate to 6% by 2030
- Create 11 million more jobs by 2030
- Grow the economy by 5.4% year on year by 2030
- Reduce inequality – the Gini coefficient should fall from 0.69 to 0.6 by 2030

In agreement with the above-mentioned statement, the plan outlines the promotion, growth and development of SMMEs as pivotal in the achievement of the above-mentioned targets. The plan envisages that by 2030, 90% of new employment will be generated by SMMEs and expanded firms. The Endeavour jobs calculator stated that to meet the 11 million jobs target by 2030, South Africa needs over 49 000 SMMEs growing at a rate of 20% per annum. This means that the country would need no less than 8.2 million SMMEs to create the same number of jobs. South African SMMEs are constrained by a number of internal, external and institutional factors key among them is access to credit. For the NDP jobs target to be realised, the country has to devise proactive and radical strategies aimed at creating an enabling environment for SMME access to credit.

2.3 SMMEs in the South African context

A recent study by the Bureau for Economic research (2016) revealed that over the last seven years, the number of SMMEs in South Africa increased by only 3% from 2.18 million in 2008 to 2.25 million in 2015. This growth, according to the above-mentioned study, is significantly less than the 14% growth in the country's GDP over the same period. A breakdown of the number of SMMEs in the country by province from 2008-2015 is provided in the table below.

Table 2.3 Number of SMMEs by province from 2008-2015

Province	**Number of SMMEs in 2008 (Quarter 1)**	**Number of SMMEs in 2015 (Quarter 2)**	**Percentage difference**
Western Cape	223 933	230 324	2.77
Eastern Cape	218 865	197 366	-10.89
Northern Cape	29 894	20 611	-31.05
Free State	114 949	96 864	-15.73
KwaZulu-Natal	418 406	373 434	-10.75
North West	109 860	112 856	2.65
Gauteng	687 556	785 321	14.22
Mpumalanga	193 259	185 399	-4.07
Limpopo	186 101	249 663	34.15
Total	**2 182 823**	**2 251 821**	**3.06**

Adapted from Statistics South Africa (2015)

As shown in the table above, among the nine provinces, Limpopo had the highest growth rate of SMMEs (34%) during this period followed by Gauteng (14%). Contrary to the above-mentioned growth realised by Limpopo (34%) and Gauteng (14%), the Eastern Cape, characterised by high levels of poverty, unemployment and inequality, was among provinces which saw a 11% reduction in its number of SMMEs from 218 865 to 197 366 during the above-mentioned period (Bureau for Economic Research, 2016). The Northern Cape lost the largest portion (-31%) followed by the Free State (-16%). Statistics South Africa's 2013 Survey of Employers and the Self-Employed also noted a decline in the number of SMMEs in South Africa from 2.3 million in 2001 to 1.1 million in 2009 before increasing to 1.5 million in 2013.

The creation rate of new SMMEs in South Africa is one of the lowest in the world. According to the Global Entrepreneurship Monitor (2015), South Africa's Total Entrepreneurial Activity (TEA) rate dropped by 34% since 2013. According to the report, the percentage of adults in

South Africa involved in business that are less than three and half years old (TEA) fell to 6.97% in 2014 from a 13 year high of 10.6% in 2013. According to the Global Entrepreneurship Monitor (2014), the country's TEA rate is significantly below that of other Sub-Saharan countries such as Nigeria (39.9%), Uganda (25.2%) and Brazil (17.3%). This does not bode well with the country's economy characterised by high unemployment, poverty and inequality.

However, there has been some improvement in the country's TEA from a low 4.3% in 2003 to 10.6% in 2013. In 2003, the country's position in TEA ranking was 35th out of 68 countries with one position above the median (Herrington and Kew, 2014). In order to meet its target of 11 million jobs by 2030 as outlined in the NDP, the country needs an increasing TEA rate of 14 to 16% (Global Entrepreneurship Monitor, 2014). The table below provides a comparison of the levels of perceived opportunity, capability, TEA, established and discontinuance business rates in South Africa, Nigeria, Uganda and other BRICS countries in 2013.

Table 2.4 Perceived opportunity, capability, TEA, established business rate and discontinuance in South Africa, Nigeria, Uganda and other BRICS countries in 2013

Country	**Perceived opportunity (%)**	**Perceived capability (%)**	**TEA (%)**	**Established business rate (%)**	**Discontinuation of business rate (%)**
Brazil	50.9	52.6	17.3	15.4	4.7
China	33.0	36.2	14	11	2.7
India	41.4	55.7	9.9	10.5	1.5
Russia	18.2	28.2	5.8	3.4	1.6
South Africa	37.9	42.7	10.6	2.9	4.9
Nigeria	84.7	87.0	39.9	17.5	7.9
Uganda	81.1	83.8	25.2	36.1	20.1

Source: Global Entrepreneurship Monitor (2014)

As can be noted in the above table, the TEA rate of South Africa is lower than that of Brazil and China but higher than that of Russia and India. In addition, the country's established business rate is 2.9% compared to its discontinuance rate of 4.9%. This indicates that there is a 2% net loss of small businesses in the country. South Africa also has the highest rate of discontinuance compared to other BRICS countries. Combined, the low rate of business establishment and the high rate of discontinuance paint a bleak picture of the potential of SMMEs to contribute meaningfully to job creation, economic growth and more equal income distribution in the country (Fatoki, 2014).

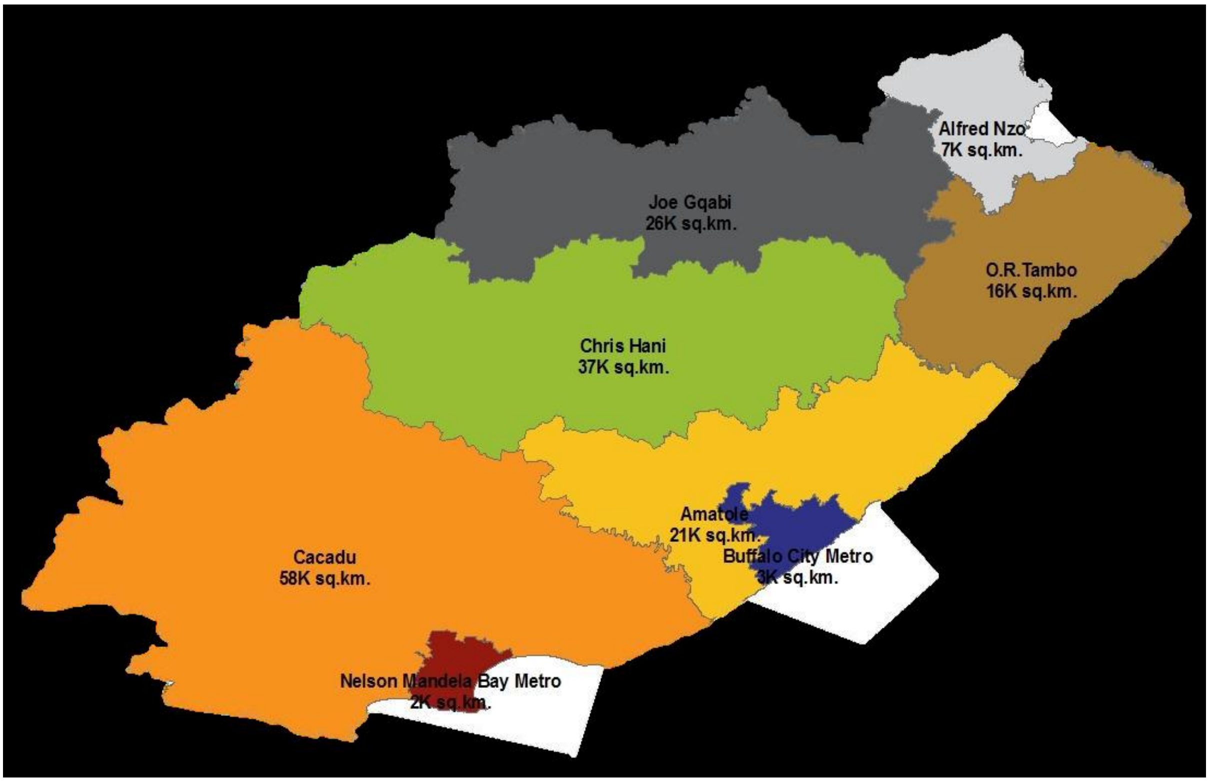
Secondly, the above situation is worsened by the fact that South Africa has a high failure rate of new SMMEs. Van Scheers (2011) and Cant and Wiid (2013) observed that 40% of new business ventures in the country fail in their first year, 60% in their second year and 90% in their first ten years of existence. This high attrition rate is attributed to a number of challenges faced by SMMEs in the country with access to credit being amongst some of these key challenges. The increase in the number of SMMEs operating in the country and their longevity will improve the economy of the country and will solve the challenges of unemployment, poverty and inequality.

Endeavour jobs calculator, which is a global tool developed by the International Labour Organisation, National Statistics Agencies and Endeavour Insights, stated that to meet the NDP's 11 million jobs target, South Africa needs over 49 000 SMMEs growing at a rate of 20% per annum. In comparison, the country would need no less than 8.2 million SMMEs to create the same number of jobs. Success in countries such as Brazil, India and China can be attributed to their concerted efforts in promoting, growing and developing SMMEs and South Africa can learn from these countries. It is acceptable worldwide that SMMEs lay a significant contribution in economic growth, employment creation and poverty alleviation.

2.4 Background to the Eastern Cape Province

The Eastern Cape Province, located in the south-eastern side of South Africa, is home to about 6.6 million people, a number that translates to about 13% of the country's population (The Eastern Cape Socio-Economic Review and Outlook, 2014). The province has a relatively young population with 70% of its population under the age of 35 years. This has implications on the ability of the provincial economy to generate jobs at a rate higher than that of population growth, as this age group represents new entrants into the labour force. The province, with its largest part being rural, is made up of two metropolitan municipalities (Buffalo City and Nelson Mandela) and six district municipalities (Alfred Nzo, Amatole, Cacadu, Chris Hani, OR Tambo and Joe Gqabi) situated in the erstwhile Transkei and Ciskei homelands. The above-mentioned municipalities are depicted in the provincial map below.

Figure 2.4 Map of the Eastern Cape



Source: Eastern Cape Socio-Economic Review and Outlook, 2014

As can be seen in figure 2.4 above, Cacadu is the biggest municipality followed by Chris Hani and Joe Gqabi. The Nelson Mandela Bay Metro is the smallest of all municipalities. The province is rich in natural resources such as grazing and arable land for livestock and crop production respectively, abundant water from numerous rivers and streams that run from the mountains to the sea, a long coastline for fishing and fish farming to mention but a few. However, despite its possession of the above-mentioned resources, the province is characterised by a number of developmental challenges such as widespread and abject poverty, income inequality (Gini coefficient of 0.656 in 2013), food insecurity (about 78% of the province's households are food insecure) and high unemployment among others (Eastern Cape Socio-Economic Profile, 2014).

The province, like the rest of South Africa is composed of a dual economy with both developed and undeveloped regions. The two industrial manufacturing centres (Nelson Mandela Bay and Buffalo City) have first world components while the rural hinterland, particularly in the former homeland areas of the then Transkei and Ciskei, is characterised by poverty and is generally undeveloped. In 2013, the province accounted for 7.8% of the country's GDP. The province's GVA and GDP growth rates are presented in the table below.

Table 2.5 Eastern Cape Province's GVA and GDP Growth Rate

Year	GVA (Rm)	% Change (Year on Year)	GDP Growth Rate (%)	GVA as % of South Africa (%)
2009	125 699	0.77	1.12	7.87
2010	128 695	2.38	2.41	7.81
2011	133 221	3.52	3.56	7.82
2012	136 763	2.66	2.62	7.84
2013	138 874	1.54	1.82	7.81

Source: Eastern Cape Socio-Economic Review and Outlook (2014)

The province's economy is structurally different from that of the country in that it has a significantly larger tertiary sector accounted for mainly by the public sector. In terms of the Eastern Cape Provincial Growth and Development Plan (PGDP) (1996), there are seven economic sectors with high potential in the province namely: agriculture, mining and energy, construction, manufacturing, tourism, the social economy and the knowledge based services. However, the top five sectors in the province, as outlined in the Eastern Cape Socio-Economic Review and Outlook (2014), are as follows:

- Finance, insurance, real estate and business services (30.1%)
- Wholesale and retail trade, catering and accommodation (17%)
- Community, social and personal services (8.5%)
- Transport and storage communication (12.3%)
- Manufacturing (18.3%)

One of the developmental challenges facing the province is extreme poverty. Of the 21 million people living in poverty in South Africa, nearly 3.8 million live in the Eastern Cape (Eastern Cape Socio-Economic Review and Outlook, 2014). This means that 40.5% of South Africa's population and 54.8% of the province's population live in poverty. However, the number of people living in poverty in both South Africa and the Eastern Cape is declining. In

2004 there were over 4 million Eastern Cape people living in poverty. This has dropped by an average annual rate of -0.7 % since 2005. This is, nevertheless, slower than the corresponding rate for South Africa, which was -1.4%. Table 2.6 below presents the level of poverty in the Eastern Cape from 2009 to 2013.

Table 2.6 Level of poverty in the Eastern Cape Province

Year	No. of people living in poverty	% change (y/y)	Poverty Rate	Population
2009	3 894 334	0.80	57.51	6 771 185
2010	3 856 462	0.97	56.70	6 801 229
2011	3 831 122	0.66	56.09	6 829 959
2012	3 806 023	0.66	55.44	6 865 428
2013	3 780 924	0.66	54.79	6 901 350

Source: Adapted from the Eastern Cape Socio-Economic Review and Outlook (2014)

The province's Human Development Index (HDI), which is a comparative measure of life expectancy, the level of education and Gross Domestic Product (GDP) per capita, has since 1995 been lower than that of the country. In 2014, the province's HDI, as presented in the table below, was 0.656 compared to the country's 0.654 (Eastern Cape Socio-Economic Profile, 2014).

Table 2.7 Eastern Cape Gini coefficient from 2009 to 2013

Year	Gini coefficient
2009	0.642
2010	0.646
2011	0.649
2012	0.653
2013	0.656

Source: Statistics South Africa, 2014

The above table shows that inequality in the province is increasing yearly, something which does not auger well for the socio-economic wellbeing of the province. Unemployment is one of the greatest challenges facing the Eastern Cape. In 2011, more than 60% of youths between 15 and 19 years and more than 50% of youths between the ages 20 to 24 years in the province were unemployed (Eastern Cape Socio-Economic Profile, 2014) and these people were not studying. This high unemployment among youth is attributed to the following:

- Employers look for skill and experience - unskilled and inexperienced job seekers are risky;
- Low-quality education feeds into poor workplace learning capacity;
- Lack of networks among black African youth makes it difficult for job seekers to be absorbed into the working environment; and
- Mismatch between type of workers demanded by companies and those supplied by the labour market.

The table below presents unemployment in the province compared to the rest of the country.

Table 2.8 Unemployment rate in South Africa by province

Province	**Q4 2013**	**Q1 2014**	**Q2 2014**	**Q3 2014**	**Q4 2014**
Western Cape	21.0	20.9	23.5	23.6	22.9
Eastern Cape	27.8	29.4	30.4	29.5	29.1
Northern Cape	24.9	29.0	32.3	29.7	28.7
Free State	33.0	34.7	35.0	34.6	32.2
KwaZulu-Natal	19.9	20.7	23.7	24.1	20.8
North West	27.3	27.7	26.0	26.8	25.2
Gauteng	25.2	25.8	24.6	24.6	24.6
Mpumalanga	27.2	30.4	29.5	29.3	26.6
Limpopo	16.9	18.4	15.9	15.2	15.9
South Africa	24.1	25.2	25.5	25.4	24.3

Source: Statistics South Africa (2014)

As can be noted in table 2.8 above, the Eastern Cape is the second province after the Free State with the highest unemployment (29.1%) and its unemployment rate is higher than the national average of 24.3% in the fourth quarter of 2014. According to the Eastern Cape Socio-Economic Review and Outlook (2014), of the total number of unemployed in the province, 28% were job losers. SMMEs are expected to be an important vehicle through which to address the challenge of unemployment, poverty, inequality and general economic growth in the province (FinMark Trust, 2010).

However, as pointed out in the section above, the number of SMMEs in the province over the past seven years (2008-2015) has dropped by 11% (Bureau for Economic Research, 2016). The study revealed that in 2008, the Eastern Cape Province was the fourth province with the high number of SMMEs following Gauteng, KwaZulu-Natal and the Western Cape. The reduction in SMMEs led to the province taking the fifth position in 2015. This does not auger well for the province as it has been accepted worldwide that SMMEs make a significant contribution to economic growth and employment creation.

The table below gives an overview of the geographical distribution of small business owners in South Africa.

Table 2.9 Geographic distribution of business owners in South Africa

Province	% of business owners
Western Cape	8.1
Eastern Cape	14.9
Northern Cape	2.8
Free State	8.0
KwaZulu-Natal	13.8
North West	12.9
Gauteng	22.9
Mpumalanga	6.9
Limpopo	9.8
Total	100

Source: FinMark Trust (2010)

The study also found that 89.5% of the total number of small businesses in the province was service providers whereas the remainder (10.5%) were retailers. During 2010, the small businesses in the province generated 1 315 million employment opportunities and was the third employment creator after Gauteng and North West provinces as shown in the table below.

Table 2.10 Business size and employment opportunities per province

Business size	EC	FS	G	KZN	L	M	NC	NW	WC
0 employees	76.0%	76.8%	52.9%	76.4%	77.2%	64.1%	79.6%	65.4%	57.9%
1 employee	13.6%	7.7%	19.0%	13.3%	15.0%	15.5%	4.9%	6.0%	16.5%
2 employees	4.6%	3.2%	13.0%	3.4%	4.2%	13.2%	5.25	12.5%	12.4%
3-4 employees	3.3%	8.3%	7.9%	3.1%	2.6%	4.0%	3.8%	3.6%	7.4%
5-10 employees	1.7%	3.5%	5.1%	3.6%	0.6%	2.7%	3.3%	11.9%	4.5%
> 10 employees	0.8%	0.5%	2.1%	0.2%	0.4%	0.6%	3.2%	0.6%	1.2%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Employment opportunities	1315 million	773 million	3.691 million	1235 million	877 million	735 million	388 million	1631 million	962 million

Source: FinMark Trust (2010)

As evidenced by the above table, the province has a potential to create more employment opportunities through small business if more effort can be put in promoting, growing and supporting this group. The development of SMMEs especially in rural areas where the majority of the province's population resides is of paramount importance. This will improve the economy of the province as well as create employment for the benefit of the citizens. In 2010, the majority (67.0%) of the small business owners in the province had a secondary/apprenticeship education while 29.0% had some primary education and only 4.0% had post matric education (FinMark, 2010).

The SMME sector has been accepted as the engine of economic growth and poverty eradication worldwide (Katua, 2014). Given the nature of the Eastern Cape Province characterised by high unemployment especially amongst youth, poverty, inequality, large rural population and many more challenges, the promotion, growth and development of SMMEs is of paramount importance. However, as in the entire country, SMMEs in the province are faced with numerous challenges with access to credit as chief amongst these (Fatoki, 2014).

2.5 The contribution of SMMEs to economic development

The section discusses the global and South African SMME contribution to the economy. It articulates SMME contribution to GDP, employment creation, poverty eradication, inequality, urbanisation reduction as well as social cohesion.

2.5.1 The global perspective of SMME contribution to the economy

There is a general consensus among researchers that SMMEs contribute significantly to the economy of both the developing and the developed countries. Kongolo (2010), for example, observed that one of the significant characteristics of a burgeoning and growing economy is a buoyant SMME sector. An empirical study conducted by Tadesse (2009) on the perspective of SMME financing in sub-Saharan Africa revealed that SMMEs account for over 90% of all enterprises of which 70 to 80% are micro and very small businesses.

Globally, there is an agreement that SMMEs have the ability to propel economic growth because they create new jobs, increase the tax base of a country and are drivers of innovation (Abor and Quartey, 2010). For example, a recent study conducted by Katua (2014) on the role of SMEs in employment creation and economic growth in selected countries revealed that SMMEs play a significant role in economic growth of countries such as the Netherlands, Australia, Italy, Malaysia, Thailand, Indonesia, Japan, Korea and Taiwan.

In Netherlands, SMMEs account for 98.8% of all private sector companies, contribute 31.6% to GDP and employ 55% of total workforce (Inarti and Langenberg, 2004). In Australia, small business account for approximately 97% of all private sector businesses and 51% of private sector employment (Australian Bureau of Statistics, 1996). In Italy, SMMEs contribute \$ 35 million in exports and absorb \$ 2.2 million of national labours (Patrianila, 2003). In Malaysia, SMMEs contribute 32% to the country's GDP, 56.4% to employment and 19% to export (Ormar *et al*, 2009). In Thailand, SMMEs are increasingly seen as creators of new jobs (Swierczek and Ha, 2003). They contribute 55.3% and 50.0% of Japan and Korea's GDP respectively, and economic growth in Taiwan was significantly generated by SMME activities. In addition, the contribution of SMMEs to the GDP of China and Germany is 60.0% and 57.0% respectively (Katua, 2014).

Literature has also noted that SMMEs play a pivotal role in the economic development of China. In 2014, there were more than 10 million SMMEs comprising 99% of the total number of enterprises in China (Katua, 2014). They contribute 60% of industrial output volume and 40% of the total taxes realised by enterprises in China. SMMEs generate more than half of USA's national GDP. The growth of economies of countries such as Nigeria and Uganda is attributed to the development of SMMEs. The above review of literature regarding the role of SMMEs in economic growth internationally reinforces the notion that SMMEs are the backbone of the economy. Therefore, their promotion, growth and development are paramount in propelling the above-mentioned growth.

SMMEs are seen as drivers of innovation and competition across the globe. Empirical research conducted worldwide indicate that SMMEs play a significant role in employment creation (Garikai, 2011; Babtista *et al*, 2005), innovation (Fritsch and Mueller, 2005), growth and reduction of unemployment (Garikai, 2011). Katua (2014) observed that there is a significant correlation between the degree of poverty, unemployment, economic wellbeing/standard of living of countries and the degree of vibrancy of the respective countries' SMMEs. In most developed and developing economies, SMMEs constitute over 90% of total enterprises and are credited with generating the highest rates of employment growth. They also account for a major share of industrial production and exports countrywide. For example, in European Union (EU), SMMEs constitute about 99% of all businesses, account for 65% of business turnover and employ about 65 million people (Katua, 2014).

In China, SMMEs account for 75% of the country's total township and urban employment and as a result they contribute significantly in releasing employment pressure and maintaining social stability in the country. In addition, SMMEs comprise approximately 97% of all enterprises in Nigeria and account for an average of 50% employment and 50% of the country's industrial output. In USA, SMMEs employ more than 50% of the country's private workforce and are respected for their role in creating new jobs, providing competition to existing businesses, improving product quality, reducing prices and introducing new goods and services through innovation and technology advancement (Muragia, 2008).

In UK, SMMEs account for 99% of all businesses in the country and account for more than 50% of the country's employment whereas in India, they play a central role in the overall industrial economy of the country (Katua, 2014). In 2003, India's SMME sector comprised more than 12.8 million enterprises and employed about 31 million people. During the same year, the country's labour intensity in the SMME sector was estimated to be almost four times higher than that of their larger counterparts (Katua, 2014). In 2014, the country's SMME sector, through its 26.1 million enterprises, employed about 59.7 million people.

In Pakistan, SMMEs provide employment to approximately 65% of the country's workforce in the industrial sector. In Italy and Greece, the sector accounts for 48% and 57% of the countries' employment respectively. In 2003, SMMEs in Kenya provided employment to 3.2 people. Currently, the sector, which represents 90% of the country's total businesses, employs more than 60% of the country's population. In Zimbabwe, SMMEs provided 15% of the country's formal employment.

The significant contribution of SMMEs to economic growth and employment creation has in most cases been temporary due to the fact that most of them die before their fifth birthday thus further contributing to unemployment (Katua, 2014). Moreover, SMMEs have been criticised for their high rate of bankruptcy. These challenges can be attributed to a number of factors with access to credit being amongst the top of these challenges.

There is a common agreement that SMMEs, from a socio-economic point of view, provide a variety of benefits compared to their larger counterparts. Firstly, empirical evidence points out that SMMEs have advantages over their large-scale counterparts in that they are able to adapt more easily to adverse market and economic conditions due to their size and flexibility (Kayanula and Quartey, 2000; Cullen *et al*, 2014). Secondly, SMMEs are more labour intensive than their larger counterparts and that they have lower capital costs related to job creation. Consequently, SMMEs have been a solution to the problem of unemployment in many developed and developing countries (Herrington *et al*, 2010; Kongolo, 2010). Because of this advantage, SMMEs are more likely to thrive in relatively peri-urban and rural areas where they can contribute to a more even distribution of economic activity in a region.

Secondly, SMMEs also have the ability to slow the flow of migration of people from rural to urban areas and therefore are instrumental in curbing urbanisation. Kayanula and Quartey (2000) observed that SMMEs enhance the effectiveness and efficiency of local markets and make productive utilisation of scarce resources, thereby easing long-term economic growth and development.

Thirdly, according to Tadesse (2009), SMMEs are more likely to utilise local available resources. This helps curtail the use of transport something which auger well for environmental sustainability. In addition, most SMME output serves as intermediate or semi-processed goods for larger scale firms. Through this, they generate mutual industrial backward and forward linkages between local producers of raw materials and larger industrial concerns (Oduntan, 2014). Tadesse (2009) further asserts that their business profits are not reliant on long production runs and that SMMEs can as a result produce smaller quantities to serve small domestic markets.

Fourthly, the SMME sector serves as a “nursery” and has been proven to be a coaching and training terrain for higher level entrepreneurship and innovation (Oduntan, 2014). In addition, SMMEs not only satisfy local needs by making differentiated varieties of products, by being spread all over the country, they also help ensure some form of equal distribution of income earning opportunities. SMEs are also normally owned and controlled locally. Therefore, this means that they can strengthen the extended family as well as other social systems and cultural traditions.

Another advantage of SMMEs is that compared to their larger and established counterparts, they are likely to be more able to withstand or recover quickly from depression (Brusco, 1992). For example, SMMEs worldwide were less affected by the 2008 recession and those affected were able to recover quickly than their larger counterparts. However, SMMEs generally have a short lifespan in that the majority of them die before their fifth birthday (Fatoki, 2014). This is attributed to a number of challenges they face. SMMEs also offer a stable and balanced level of employment; their activities and locations are diverse, they depend on diverse sources and kinds of raw material, and their owners have a high probability of staying in business and maintain at least some activity and employment in conditions where foreign investors would have closed their businesses.

SMMEs play a critical and pivotal role in alleviating the triple challanges of unemployment, poverty and inequality, contributing positively to economic growth. This is linked to the economical and relatively low capital requirement for their establishment compared to their larger counterparts. SMMEs also employ both skilled and unskilled workforce thus creating a means of livelihood. This is an important role in any economic development process (Oduntum, 2014). Most, if not all, of SMEs products serve as intermediate or semi-processed goods of large scale firms. By this, they generate mutual industrial linkages between local producers of raw materials and large industrial concerns.

SMEs have short-term maturation period and have a predisposition for high potentials for quick yield on investment. SMMEs have a short-term gestation period and high potential for quick yield on investment (Oduntan, 2014). They also provide promising alternatives for countries that desire the fast and quick alternative of industrial development. This is made possible by the fact that in most instances, the technology used by SMMEs is less complicated and can be controlled and operated by the entrepreneurs themselves.

Given the above benefits, it makes economic sense for governments worldwide to enhance the development of the SMME sector. This means that strategies aimed at reducing their challenges must be devised.

2.5.2 SMME contribution to the South African economy

It must be pointed out that very little systematic data on SMMEs in South Africa is available and as such reliance had to be placed on ad hoc studies and/or surveys. In 1999, there were 906 700 businesses operating in South Africa (Ntsika, 1999). Of this total number of businesses, only 6000 (0.7%) were large businesses and the rest were SMMEs including survivalists and micro enterprises. The recent Bureau for Economic Research (2016) study revealed that there are 2.25 million SMMEs in South Africa and the majority of them are in Gauteng. Research on the contribution of SMMEs to the country's economy found that the sector accounts for about 91% of all formal business entities and that they contribute between 52 and 57% of the Gross Domestic Product (GDP) and provide about 61% of employment (Kongolo, 2010; GCIS, 2011). A study by World Wide Worx (2012) noted that SMMEs in South Africa create approximately 7.8 million jobs and play a critical role in reducing wealth inequalities and improving economic growth.

The South African government has identified SMMEs as an important vehicle to address the challenges of job creation, sustainable economic growth, equitable distribution of income and the overall stimulation of economic development in the country. However, despite the positive impact by SMMEs to economic growth highlighted above, the creation rate of new SMMEs in South Africa is one of the lowest in the world. According to the Global Entrepreneurship Monitor (2014), South Africa's Total Entrepreneurial Activity (TEA) rate was 10.6 in 2013 and remains significantly below that of other Sub-Saharan countries such as Nigeria (39.9%), Uganda (25.2%) and Brazil (17.3%). However, there has been some improvement in the country's TEA from a low 4.3% in 2003 to 10.6% in 2013. This, coupled with the high failure rate of new SMMEs in the country, is a great concern especially in light of the developmental challenges facing the country.

Van Scheers (2011) and Cant and Wiid (2013) observed that 40% of new business ventures fail in their first year, 60% in their second year and 90% in their first ten years of existence. The above-mentioned undesirable scenario can be attributed to a number of constraints facing the SMME sector, such as: access to markets, appropriate technology, access to credit, crime and corruption, the business regulatory environment, and access to information to mention but a few. However, scholarly research conducted revealed that SMME access to credit, which is the topic of this study, is one of the key challenges negatively impacting on SMME growth and development (Rogerson, 2008; Irwin and Scott, 2010; USAID, 2010; Kira and He, 2012). The following section examines the challenges facing SMME in South Africa.

2.6 Challenges facing SMMEs in South Africa

2.6.1 Lack of management skills

There seems to be an agreement among researchers that the success or failure of SMMEs is a function of factors which include managerial competencies among others. Studies on the challenges facing SMMEs in South Africa converge on the fact that lack of appropriate management skills is the primary cause of SMME failure. Hellriegel *et al* (2008) described managerial competencies as sets of knowledge, skills, behaviours and attitudes that contribute to personal effectiveness.

A research study by Smallbone and Welter (2001) identified managerial competencies, measured by experience, training and knowledge of the industry, as having a positive impact on the performance of new SMEs in South Africa. On the other hand, Oyelana and Fiseha (2014) in their study of the effect of SMMEs on the socio-economic development of Alice in the Eastern Cape observed that managerial skills such as financial, marketing and human resource management were lacking in many SMMEs. These findings were also echoed by Musara and Gwaindepi (2014) in their study of factors affecting entrepreneurial activity in South Africa. Abor and Quartey (2010) argue that even though SMMEs tend to attract motivated managers, they can hardly compete with larger firms. This is despite numerous government and private sector institutions providing a variety of capacity building and training programmes as well as advisory services to these SMMEs.

2.6.2 Lack of access to credit

Lack of access to credit by SMMEs is widely documented. For example, Foxcroft, *et al* (2002) observed that 75% of applications for bank credit by new SMEs in South Africa were rejected. This observation was confirmed by Naude and Havenga (2004) who indicated that most entrepreneurs, most importantly small businesses, struggle with accessing credit from finance institutions due to a number of external, institutional and internal factors.

The FinMark Trust study conducted in 2006 found that only 2% of new SMMEs in South Africa were able to access bank loans and that this lack of access to bank credit is one of the major challenges that South African SMMEs face. According to Olawale and Garwe (2010), lack of access to credit in South Africa is the second most reported contributor to low firm creation and failure, after education and training. Recent studies by Oyelana and Fiseha (2014) and Musara and Gwaindepi (2014) revealed that SMMEs is South Africa still struggle to access credit from finance institutions despite so many endeavours by government and the private sector to create a conducive environment for SMME access to credit. The Survey of Employers and the Self Employed (SESE) study by Statistics South Africa (2013) pointed out that 73.4% of the surveyed SMMEs borrowed money from friends and relatives to start their businesses.

2.6.3 Access to markets

Businesses need to secure local, national and international markets in order to sell their goods and services. However, access to markets is one of the major constraints negatively affecting the growth and development of SMMEs in South Africa (Van Scheers, 2011; Musara and Gwandepi, 2014). Nieman (2006) discovered that marketing skills enable business owners and or managers to attract customers and provide them with expertise on how to present a product or service in a manner that is attractive and interesting to the customer. There have been a number of reasons listed on why SMMEs find it difficult to access markets. Some of these reasons include products and services that do not meet the required industry regulations and standards. This also includes lack of access to credit and equipment to improve product quality and make products more competitive in the market and lack of demand or market opportunities for their products (SEDA, 2012). In addition, competition from big and well established businesses was also noted as one of the reasons negatively impacting on SMME access to markets.

2.6.4 Lack of access to appropriate technology

Businesses operate under a volatile and an ever-changing environment. This requires them to be current and keep up with this environment. For example, information and communication technology is indispensable in today's business as it enhances business growth and development. Many SMMEs is South Africa lack appropriate technology as a result they find it difficult to compete with their larger counterparts. Olawale and Garwe (2010) pointed out that technology not only helps in evolving a multi-pronged strategy but also in maximising business opportunities. Information technology is also seen as a significant catalyst in sales generation. The purchase and installation of information technology equipment involves cost. The majority of SMMEs may not have access to credit, the above-mentioned cost and the capability and expertise to operate this equipment.

2.6.5 Crime and corruption

The World Bank Investment Climate Report – South Africa (2005) identified crime as one of the four major constraints impeding SMME growth and development in the country. In 2008, the South African Presidency commissioned SBP to conduct a national study on the impact of crime on small businesses in South Africa. The study found that the majority of the 446 SMMEs surveyed listed crime as one of the major hindrances to the growth of their businesses. A study by the United Nations Office on Drugs and Crime (2013) revealed that South Africa was amongst the world's five most dangerous nations and that crime is an important issue the country must deal with head on. Crime has a negative effect on businesses in general as it discourages their endeavour to grow and develop (Anga, 2014; Fatoki, 2014). This effect becomes more acute in SMMEs as some may not have insurance to cover their loss due to criminality.

Another constraint negatively affecting SMMEs is corruption. Transparency International Global Corruption Report (2008) describes corruption as "the abuse of entrusted power for private gain". The above-mentioned study argues that corruption both in the public and private establishments is growing in South Africa. A study by Fatoki (2014) argued that the reason why SMMEs engage in corruption is often linked to problems with regulatory compliance and bureaucracy. Fatoki (2014) observed that corruption raises operational costs, lowers competitiveness and ultimately lowers sales. Secondly, corruption prevents firms from entering profitable business, limits the opportunities for growth and lowers sales, investment and employment. Finally, corruption may cause firms to lose valuable human and financial resources, likewise lowering competitiveness.

2.6.6 Business regulatory environment

Several studies (Maas and Herrington, 2006; Simrie *et al*, 2011; SEDA, 2012; Musara and Gwaindepi, 2014 and Oyelana and Fiseha, 2014) pointed out that the business regulatory environment is one of the key factors which had a negative impact on the growth and development of SMMEs. Ferreira (2007) asserts that SMMEs in South Africa are unable to reach their set goals and objectives due to a number of impediments such as bureaucracy and red tape, cumbersome regulations and tax.

A recent study by Musara and Gwaindepi (2014) on the business regulatory environment affecting entrepreneurship in South Africa revealed that 81% of new business owners singled out bureaucracy and corruption as one of the factors with the greatest negative impact on starting a business. On the other hand, Zwane (2009) pointed out that the cost of doing business in South Africa is arguably the highest in the world. This, coupled with the high start-up costs for firms as well as licensing and registration requirements, can impose excessive and unnecessary burden on SMMEs (Abor and Quartey, 2010). Compared to other developing countries in the Sub-Saharan Africa, it takes too many days (about 176 days) to licence an enterprise in South Africa. The Company Intellectual Property Commission (CIPC) is currently experiencing backlogs in registering companies and this does not auger well for SMME promotion.

2.6.7 Access to information

The Department of Trade and Industry (DTI)'s Review of Ten Years of Small Business Support in South Africa (1994-2004) assert that easy access to relevant and appropriately packaged information, advice, guidance, referrals and contact networks is the most important need of every emerging, expanding or transforming small enterprise. However, research has proven that SMME access to information, advice and support networks is one of the challenges impacting on SMME development (Oyelana and Fiseha, 2014).

The South African government has, since the dawn of democracy, introduced a number of programmes and initiatives geared towards promoting, supporting and developing SMMEs. However, literature has revealed that the majority of SMMEs are not aware of such programmes and as a result they don't benefit from them. Secondly, it has been argued that most of the offices for the organisations meant to assist SMMEs are situated in urban areas thus disadvantaging the rural SMMEs.

2.7 Summary

The chapter discussed the vital contribution of SMMEs to global and local economic growth. Worldwide, SMMEs have been observed to contribute significantly to poverty eradication, employment creation and GDP growth. SMMEs have also made an invaluable contribution to the South African economy. There is therefore a need to ramp up their development through addressing their challenges especially access to credit. The following chapter presents the review of the theoretical and empirical literature upon which the study is underpinned.

CHAPTER 3: THEORETICAL AND EMPIRICAL LITERATURE REVIEW

3.1 Introduction

This chapter, which consists of seven sections, reviews the theoretical and empirical literature on SMME access to credit in general. The first section of the chapter discusses the various definitions of SMMEs worldwide. The second section provides the definition of SMME access to credit and the importance of credit in bolstering SMME growth and development. The third section of the chapter details the credit rationing theoretical framework which underpins the entire study as well as the determinants of credit rationing by finance institutions.

The fourth section outlines the firm and entrepreneurship factors influencing credit rationing by finance institutions. This is followed by the discussion of the key capital structure theories of the firm such as the Modigliani and Miller theory, the Trade-off theory, the Agency theory, the Perking Order theory as well as the Market Timing theory. A brief discussion of the sources of SMME credit such as equity, debt, government, the private sector and non-governmental organisations financing is also articulated. The last section, followed by the summary, outlines the criteria used by lending institutions to evaluate SMME loan applications.

3.2 The definition of SMMEs

While the importance and significant contribution of the SMMEs is acknowledged in both developed and developing economies, there is no common and uniform definition of an SMME (Storey, 1994; Cullen *et al*, 2014). Countries across the globe use different terminology to address the category of businesses that do not form part of the large enterprises. For example, some countries refer to them as "small businesses", others such as the European Union, the World Bank, the United Nations and the World Trade Organisation use the concept "small and medium enterprises" (SMEs) while others (including South Africa), refer to them as "small micro and medium enterprises" (SMMEs). However, these concepts are used interchangeable though they differ significantly.

The OECD (2004) points out that the definition of SMMEs is important and is useful in:

- The preparation of statistics and the monitoring of the sector over time
- Benchmarking against other economies and between regions within an economy
- Providing arbitrary thresholds in imposition of tax and other regulations
- Determining eligibility for particular forms of support.

There is a common agreement among researchers that businesses vary with respect to their level of capitalisation, sales and employment (Abor, 2007). Because of this reason, definitions which utilise measures of size, for example the number of employees, gross revenue, profitability and assets when employed to only one sector may result to all firms being categorised as small. Whereas the same size definition when employed to a totally different sector may yield totally different results (Kayanula and Quartey, 2000).

The Bolton Committee (1971) which came up with the first definition of a small firm defined it according to two distinct concepts namely: "economic" and "statistical" definitions. The economic definition regards a firm as small if it satisfies the following three criteria: (1) a firm has a comparatively insignificant share of their market place; (2) a firm is run and operated by owners or partners in a personalised way and not through an official management structure; and (3) a firm is autonomous in the sense that it is not a constituent of a larger enterprise.

On the other hand, the "statistical" definition is employed in three main areas: (1) quantifying the size of the small firm sector and its contribution to GDP, employment and exports; (2) comparing the extent to which the small firm sector's economic contribution has changed over time; and (3) in a cross-country comparison of the small firms' economic contribution. The Bolton Committee definition of an SMME is presented in the table below.

Table 3.1 Bolton Committee Definitions of an SMME

Sector	**Definition**
Manufacturing	200 employees or less
Construction	25 employees or less
Mining and Quarrying	25 employees or less
Retailing	Turnover of 50 000 pounds or less
Miscellaneous	Turnover of 50 000 pounds or less
Services	Turnover of 50 000 pounds or less
Motor Trades	Turnover of 100 000 pounds or less
Wholesale Trades	Turnover of 200 000 pounds or less
Road Transport	5 vehicles or less
Catering	All excluding multiples and brewery – managed houses

Source: Bolton Committee (1971)

However, a number of flaws and shortcomings were identified in the above-mentioned Bolton definitions. Firstly, no standard definition or criteria was utilised for "smallness". Instead, the definition used the number of employees, turnover, ownership and assets as determinants of the small business. Secondly, three different upper limits were identified for number of employees made, the definition complicated to allow for cross-country comparison. Thirdly, comparing monetary units over time requires construction of index numbers to take account of price changes. In addition, currency fluctuations make international comparison more difficult. Lastly, the definition considered the small firm sector to be homogenous. However, firms may grow from small to medium and in some cases to large.

It was against this background that the European Commission (EC) introduced the term "Small and Medium Enterprise" (SME) which is constituted of three components as shown in Table 3.2 below.

Table 3.2 Definition of SMEs by the European Commission

Type of enterprise	Number of employees
Micro	0-9
Small	10-99
Medium	100-499

Adapted from the European Commission, 2003

Based on the definition in table 3.2 above, an SME consists of enterprises which employ less than 500 workers. In essence, the EC definitions are solely based on employment rather than a number of criteria. Secondly, the use of 100 employees as the small firm's upper limit was seen as more appropriate given the increase in productivity over the past decades (Storey, 1994). Lastly, the EC definition did not assume the SME group is homogeneous. In other words, the definition makes a distinction between micro, small and medium-sized enterprises.

However, this definition too was not spared from criticism. For example, researchers felt that the EC definition is too "all-embracing" to apply to many countries. This meant that researchers would have to use definitions for small firms which are more appropriate to their particular target group.

The United Nations Industrial Development Organisation (UNIDO) coined its own definition of SMEs in terms of the number of employees by assigning varying classifications for industrialised and developing countries as shown in the table below.

Table 3.3 Definition of the SME by UNIDO

Type of enterprise	No. of employees	No. of employees
Small	99 or less	5-19
Micro	Not applicable	<5
Medium	100-499	20-99
Large	500 or more	100 or more

Adapted from Elaian, 1996

The definition of an SME was taken further by a number of multilateral institutions such as the World Bank, the Multilateral Investment Fund (MIF), the African Development Bank, the Asia Development Bank and the United Nations Development Programme (UNDP). Their definitions are presented in the table below.

Table 3.4 SME definitions used by some selected multilateral institutions

Institution	Maximum number of employees	Maximum Revenues or turnover ($)	Maximum assets
World Bank	300	15 000 000	15 000 000
Multilateral Investment Fund	100	3 000 000	None
African Development Bank	50	None	None
Asian Development Bank*	None	None	None
UNDP	200	None	None

Source: Gibson and Van der Vaart (2008)

As can be noted in table 3.4 above, there are disparities among these definitions. For example, the World Bank 's definition includes businesses three times larger by employees and five times larger by turnover or assets than the largest SME under the MIF definition. In addition, none of these institutions set a minimum definition for SMEs. Gibson and Van der Vaart (2008), in their study of finding a less imperfect way of defining SMEs in developing countries, argued against the use of employment and assets as standard size determinants of SMEs. Their argument is based on the fact that defining SMEs by the number of employees suggests that the larger an enterprise, the more employees it will have and that for an SME to grow it must have more employees. In addition, they pointed out that policies that utilise the number of employees to define SMEs run the risk of classifying businesses by their inefficiency or their lack of value addition.

On defining SMEs by the size of their assets, Gibson and Van der Vaart (2008) pointed out the following deficiencies pertaining to this definition:

- SMEs rarely have a precise estimate of the value of their fixed assets and generally minimise them in environments where substantial asset taxes are imposed
- Governments are inconsistent with regard to what they count as assets when defining business size. Many use fixed assets and land while others use only fixed assets, thereby complicating cross-country comparisons
- Where there is inflation, local currency values for various fixed assets are likely to be understating the true value of the assets, as a regular restatement of such assets is generally not required.
- As outsourcing-based SMEs become more prevalent and important in developing countries, the asset base of an increasing share of growth-oriented companies will be defined by rapidly depreciating personal computers and mainframe-terminal networks. In these situations, the value of fixed assets can decline even as revenues and employment increase.
- Just as employment-based definitions tend to recognise labour efficiency, asset-based definitions tend not to recognise capital efficiency.

Instead of the above-mentioned definitions, Gibson and Van der Vaart (2008) advocated for the use of the turnover definition based on the fact that it is realistically measurable and meaningful. In addition, they argued that the measurement of business by turnover most closely reflects functional and behavioural attributes. Their argument was based on the fact that revenues in a given country can be converted to any country's currency thus making the turnover definition universal and convenient. However, they acknowledged that their argument was not immune from criticism. The EC has also revised their definition of an SME and as a result it has recently introduced a guide for the definition of an SME. However, all these initiatives have not culminated into a common definition of an SMME.

The definition of an SMME is a subject of debate not only internationally but in South Africa as well (Abor and Quartey, 2010). Researchers, despite the fact that there is an official definition of an SMME in South Africa, have defined this sector in a number of different ways. However, a relatively standard definition of an SMME incorporates two aspects namely the number of employees and the turnover of a firm excluding fixed property. In terms of the National Small Business Act 102 of 1996 (as amended), the two aspects vary according to industry sectors. The definition of SMEs by size is necessary, but it is not sufficient for an understanding of a sector where the realities are not only composite, but also dynamic. In South Africa, a 'small business' is officially defined in Section 1 of the National Small Business (NSB) Act of 1996 (as amended) as:

"… a separate and distinct business entity, including co-operative enterprises and nongovernmental organisations, managed by one owner or more which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or sub sector of the economy mentioned in Column I of the Schedule14… ".

The NSB Act further categorises small businesses in SA into distinct groups, namely; survivalist, micro, very small, small and medium, hence the use of the term "SMME" for small, medium and micro-enterprises. However, the terms 'SMME' and 'SME' are used interchangeably in SA. The SMME definition uses the number of employees (the most common mode of definition) per enterprise size category combined with the annual turnover categories, the gross assets excluding fixed property; as summarised in Table 3.5 below.

Table 3.5 National Small Business Act definition of an SMME

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 R18 million depending on industry
Small	Fewer than 50	Less than R2 million to R25 million depending on industry	Less than R2 million to R4.4 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: The National Small Business Act 102 of 1996 (as amended)

i. **Survivalist enterprise:** The income generated is less than the minimum income standard or the poverty line. This category is considered pre-entrepreneurial, and includes hawkers, vendors and subsistence farmers. In practice, survivalist enterprises are often categorised as part of the micro-enterprise sector.

ii. **Micro-enterprise:** The turnover is less than the value added tax (VAT) registration limit (that is, R150, 000 per year). These enterprises usually lack formality in terms of registration. They include, for example, *spaza* shops, minibus taxis and household industries. They employ no more than 5 people.

iii. **Very small enterprise:** These are enterprises employing fewer than 10 paid employees, except for the mining, electricity, manufacturing and construction sectors, in which the figure is 20 employees. These enterprises operate in the formal market and have access to technology.

iv. **Small enterprise:** The upper limit is 50 employees. Small enterprises are generally more established than very small enterprises and exhibit more complex business practices.

v. **Medium enterprise:** The maximum number of employees is 100 or 200 for the mining, electricity, manufacturing and construction sectors. These enterprises are often characterised by the decentralisation of power to an additional management layer.

It is important to note that the South African definition incorporates survivalist and micro-enterprises which form the majority of the SMME category and play a significant role in the economy of the country. These groups do not feature in the definitions of many developed countries. In addition, many businesses categorised as SMEs by the EU, World Bank, UN and other international organisations are regarded as large enterprises in South Africa. Therefore, any common definition of SMMEs must take into account the uniqueness of all countries' economic environments.

As can be seen from the above definitions, there is no standard or common definition of what an SME is. However, it is important to note that the issue of SME definitions comes down to eligibility for special support (Gibson and Van der Vaart, 2008). Therefore, the importance of having a universal definition of an SME is pivotal in that SME policy must provide assistance to enterprises that need them most and are able to use the assistance in order to help them grow further under adverse conditions.

3.3 SMME access to credit defined

The subject of SMME access to credit has for decades been of great interest to researchers in developing and developed countries across the globe. However, there seems to be no one size fits all definition of access to credit as many researchers have different interpretations of this subject. For example, Claessens and Tzioumis (2006) defined access to credit in terms of three aspects namely availability (are finances available in particular to SMMEs, and if so in what quantity), cost (at what total cost are financial services available), range, type and quality of credit offered by finance institutions.

Morduch (1999), on the other hand, identified access dimensions as being related to reliability (whether credit is available when needed), continuity (can credit be accessed on a continuous basis) and flexibility (are products customised to individual needs). Meanwhile, Nkuah *et al* (2013) took a different angle and he defined access to credit as the "absence of both price and non-price barriers in the use of financial services".

However, what can be noted from the above-mentioned definitions is that SMME access to credit, no matter how it is defined, is pivotal in the growth and development of SMMEs countrywide. The Investment Climate Survey study undertaken by IBRD/World Bank (2008) revealed that one of the cardinal challenges limiting the growth and development of SMMEs is inadequate access to financial services which would bolster economic growth and job creation. This will push back the frontiers of poverty in many developing countries. In support of this notion, Mazanai and Fatoki (2012) postulate that the ability of SMMEs to grow and develop is a function of their ability to put money into reconstitution and revolution of their firms. However, it goes without saying that this investment requires capital and therefore access to credit.

There is evidence that SMMEs in both developed and developing countries (South Africa included) face a number of challenges that impede them on accessing credit from financial institutions. Challenges facing SMMEs in accessing credit is a priority of concern and various studies conducted on this issue concurred with the fact that if these challenges are not properly dealt with and addressed, they can negatively impact the growth and survival of the SMME sector which is the backbone of the economy of any country (USAID, 2010; Fatoki and Asah, 2011). Therefore, finding possible solutions to the above-mentioned challenges will enhance access to credit by SMMEs.

3.4 The credit rationing theoretical framework

The study is underpinned by the credit rationing theoretical framework pioneered by Stiglitz and Weiss (1981). The framework, which is used to analyse financial market inefficiencies, fits well with the current South African situation. In South Africa, SMMEs find it difficult to access credit from funding institutions in particular state owned DFIs due to lack of information. These were established to create a conducive environment for SMME access to credit.

The challenge of SMME access to credit has been seen through the credit rationing conduct by funding institutions which, based on theoretical and empirical evidence, have an unfavourable effect on the formerly depressed groups who have inadequate access to credit (Stiglitz and Weiss, 1981; OECD, 2006). Stiglitz and Weiss (1981) defined credit rationing as a condition in which at current interest rate in a credit deal, the loan applicant would like to borrow more credit but is not permitted by the lender. This situation militates against SMME access to credit even when they are prepared to pay higher interest rates (Maziku, 2012). This results in the high attrition rate of these SMMEs as for them to survive they need credit.

Storey (1994) identified two types of rationing imposed by lenders to borrowers, in particular SMMEs. The first type is where lending institutions agree to give smaller loan amounts to firms than those they applied for. The second is where a large number of borrowers are denied credit completely. The study by Maziku (2012) on credit rationing for SMMEs in the commercial bank loan market observed that funding institutions pay attention to two features of the loan during their credit decision process namely; the interest rate and the credit risk of the loan. Empirical and theoretical research on the aspect of credit rationing identified information asymmetry, fixed transaction costs, the risk profile of a firm, lack of collateral and firm and entrepreneurship characteristics as some of key factors determining credit rationing by funding institutions world-wide. These are individually discussed in the sub-sections below.

3.4.1 Information asymmetry

There is evidence that SMMEs face difficulties accessing credit from funding institutions in order to finance fixed assets and working capital for their operations (Tucker and Lean, 2003). The presence and nature of a "financing gap" for SMMEs has been the subject of debate for decades since the Macmillan Report (1931). Generally, SMMEs have been observed to be frequently under-capitalised. This means that the term structure of loans offered to SMMEs does not suit their needs (Blanton and Dorman, 1994).

There is consensus among researchers that when SMMEs are granted credit by funding institutions, they are often given short-term loans thus leaving them with no alternative but to depend on short term and informal credits in financing their long-term needs such as acquiring new equipment (Riding and Short, 1987; Blanton and Dorman, 1994) . The "financing gap", described as the distinction between the demand for credit by SMMEs and the provision of the same credit by funding institutions (OECD, 2006), has been attributed to a number of theories, one of which is information asymmetry.

Stiglitz and Weiss (1981), in their analysis of the funding gap through their credit rationing theory, argue that information asymmetry is one of the major reasons why SMMEs generally have constraints accessing credit. This emanates from the fact that the availability of information, which is a determining factor of the lending decision by funding institutions, is of crucial importance to the financing transaction (Harvie, 2011). This information enables the funding institution to assess the risk-return profile of the loan application and hence set the level and terms and conditions of credit to be extended to the borrower (Maziku, 2012). The absence of this information means that the creditworthiness of a borrower cannot be established and thus the ability of the borrower to pay back the loan cannot be determined. This results in credit rationing by funding institutions which impacts negatively on SMME access to credit.

Information asymmetry takes place when one side to the lending deal has more and/or better detailed information than the other side (Stiglitz and Weiss, 1981). This is manifested in the lack of the ability of most of SMMEs to furnish the prospective lender with accurate, up to date and reliable information. This information is contained in audited financial statements, bankable business plans and feasibility studies, to mention but a few. For example, the Survey of Employers and the Self Employed by Statistics South Africa (2013) revealed that 75.7% of all SMMEs surveyed did not keep financial records of their businesses. The reasons for not keeping these records varied from business too small, no need of records, no skill to not enough time. This is compounded by the fact that in smaller enterprises, the line of demarcation between the finances of the owner(s) and those of the business is usually blurred. In addition, SMMEs in South Africa are not legally required to have audited financial statements.

A study by USAID (2010) on the financial institutions hurdles to SMME access to credit in South Africa, observed that the information provided by SMMEs to funding institutions is often deficient of facts and meticulousness. Moreover, there is evidence suggesting that SMMEs fail to thoroughly articulate their firms' business plans when engaged to do so by funding institutions. This is generally common when the business owner/manager was not involved in the preparation of the business plan. For example, the Small Enterprise

Development Agency (SEDA) appoints consultants to develop business plans for its SMME clients. The failure by SMMEs to articulate their business plans is compounded by inadequate levels of schooling of SMMEs who sometimes may not be in a state of sufficiency to plead their case to funding institutions. This situation makes it difficult for funding institutions to assess the creditworthiness of individual borrowers and as a result, SMMEs are credit rationed.

Foxcroft *et al* (2002) observed that 75% of SMME applications for bank credit are rejected and this was attributed amongst others to information asymmetry. Their findings were supported by the FinMark Trust (2006) study which revealed that only 2% of SMMEs in South Africa have access to bank loans. Stiglitz and Weiss (1981) mentioned that only SMMEs know their actual financial structure, the actual intensity of the investment project and the essential intent to pay back the debt. This means that businesses have higher-ranking exclusive information (asymmetric information). Therefore, the finance manager makes decisions under imperfect and lopsided details and functions under a moral hazard and adverse selection risk.

Moral hazard refers to the lack of the ability of the lender to adequately enforce the agreed-upon credit agreement after credit has been landed to the borrower (Stiglitz and Weiss, 1981). It happens when the parties involved have separate and different interests and the measures taken by the agent cannot be observed precisely and accurately by the principal. Adverse selection, on the other hand, refers to difficulties of choosing credit risk before credit is offered. Although such risk can be recompensed by raising the interest rate, such increase would in turn swell adverse selection and moral hazard. This gives rise to credit rationing by funding institutions.

As the interest rate increases, this will draw riskier borrowers to the pool and will lure borrowers to take on riskier projects with a higher prospect of failing to fulfil the debt obligation (Beck, 2007). The difficulty in using interest rates as an assessment tool forces the financiers to employ non-interest assessment measures such as collateral, warrants or assessments based on screened information (Maziku, 2012). Financiers will limit credit rather than letting the interest rate increase to the market-clearing level, as articulated by Stiglitz and Weiss (1981). The next section briefly looks at fixed transaction costs as one of the determinants of credit rationing.

3.4.2 Fixed Transaction Costs

Credit rationing by financial institutions has also been attributed to the fixed transaction costs charged by funding institutions during the lending transaction. These costs include, but not limited to, costs associated with collecting information about the borrower, for example paying visits to borrowers, assessing their applications and closely observing their loans (Maziku, 2012; Okurut *et al*, 2010 and Ghosh *et al*, 1999).

Fixed transaction costs in credit evaluation, processing and monitoring result in decreasing unit costs as the size of the loan increases (Ramlee and Berma, 2013). Assessing one single loan request involves costs that are fixed and independent of the size of the loan administered. This means that the costs of evaluating and dealing with loan applicants are similar for large and smaller loans and SMMEs need comparatively smaller loans than larger businesses (Fatoki and Asah, 2011). Mazanai and Fatoki, (2012) observed that funding institutions frequently realise that dealing with small scale loans is not commensurate with the effort as the process is ineffective and inefficient. Moreover, small enterprises are often located away from the main urban centres, their accounting skills are usually lower and banks lack experience in servicing them. This therefore results in funding institutions, especially commercial banks, rationing credit to SMMEs.

Beck (2007) pointed out that fixed transaction costs cause a negative relationship between credit costs of financiers and the lending rate they impose on borrowers. Excessive transaction costs, moreover, can limit access to outside credit (credit rationing) for some borrower groups. Fixed transaction costs, though they are a constraint for all borrowers, pose as a hurdle more so for SMMEs than larger enterprises. SMMEs' peculiar firm and entrepreneurship qualities and their lack of transparency elevate evaluation and overseeing costs (Okurut *et al*, 2010). This is coupled with the fact that SMME lending is till to date generally seen as a high-cost lending commodity by funding institutions.

3.4.3 The risk profile of a firm

Literature on credit rationing points out that the level of risk of a business has a direct impact on SMME access to credit by funding institutions. For example, Okurut *et al* (2010) observed that firms whose probability for the repayment of loans was very low were considered risky by funding institutions and were thus credit rationed. Funding institutions are exposed to a default risk which means that the business cannot fulfil its responsibility to the financier. The risk profile of the business can be determined by the credit history of the borrower, the anticipated yield of the project and the expertise of the business (Okurut *et al,* 2010).

Finance institutions consider SMMEs as risky because of several reasons. Firstly, SMMEs face a somewhat dubious territory than large enterprises (Herrington *et al*, 2010). In addition, they are prone to more changing rates of return and excessive rates of failure (Fatoki and Asah, 2011). Secondly, SMMEs are relatively less prepared in terms of both human and capital resources to bear up against economic adversity (Maziku, 2012). Thirdly, there is a challenge of insufficient accounting systems which compromise the accessibility of information in relation to profitability and pay back capacity (Beck, 2007).

Empirical evidence has revealed that in developing countries, there is the additional challenge of a more unpredictable operating terrain which has a negative effect on the security of transactions. There is a potential risk that a financier will not be paid back or that the estate will not be adequately registered. Guido (2008) in Okurut *et al* (2010) argued that one of the attributes of credit rationing is the inability of the lenders to rank loan applicants in proper risk classes.

Ramlee and Berma (2013) pointed out that SMMEs are credit rationed because they have either no or inadequate experience as a result of a short business history. This situation worsens adverse selection problems among borrowers as determining profitable business plans is not easy. Lack of business plans and audited financial statements further worsens the negative risks perception of SMMEs by funding institutions, as profitability and growth of borrowers are not easy to ascertain (Hwarire, 2012). This leads to an unconvincingly financial prediction and subsequently onerous repayment performance (Ghimire and Abo, 2013) which give rise to credit rationing by funding institutions.

3.4.4 Lack of collateral

The value of collateral provided by a business also determines the credit rationing behaviour of funding institutions (Badulescu, 2011). Funding institutions request for collateral from borrowers so as to lessen the risk linked with moral hazard. The absence of collateral is arguably the most quoted hurdle experienced by SMMEs in accessing credit from funding institutions. Okurut *et al* (2010) observed that collateral serves as the last resort for recovery of the loan in case of default, where the funding institution can trade the collateral acquired to recoup the outstanding amount of the loan.

Collateral decreases information asymmetry between the SMME and the financier. The amount of collateral needed in reference to the size of the loan is a measure often adopted to evaluate the gravity of the funding gap (Badulescu, 2011). In some instances, the business may not be in a position to furnish adequate collateral as it is still new while in some, the lender may consider collateral inadequate commensurate with the size of the loan requested. It is generally accepted that in emerging economies, the challenge of collateral is greatly acute (Kimutai and Ambrose, 2013). The absence of collateral means that a firm may be credit rationed. In South Africa, collateral is one of the key requirements by funding institutions when evaluating funding applications (Fatoki, 2014). However, empirical and theoretical evidence shows that collateral is one of the key reasons why SMMEs fail to access credit from the above-mentioned institutions.

3.4.5 SMME characteristics

Empirical studies conducted on the subject of SMME access to credit worldwide revealed that credit rationing by funding institutions may also be influenced by firm and entrepreneurship characteristics (Fatoki and Asah, 2011; Pandula, 2011). Lapar and Graham (1988) in Okurut *et al* (2010) mentioned that funding institutions' credit rationing behaviour with reference to the business' loan requirement can be grouped into three phases; the screening phase, the evaluation phase and the quantity rationing phase. They pointed out that at the screening phase; the finance manager interrogates the prospective borrower to ascertain whether they qualify for credit in relation to their solvency, loan requirements and terms aspired. The manager thereafter determines whether the applicant is adequately eligible to make a loan application or not. During this process, funding institutions look closely at firm and entrepreneurship characteristics.

Fatoki and Asah (2011) defined firm characteristics as traits or features specific to the firm that can positively or negatively affect the performance of the firm. These characteristics include a firm's age, size, industry sector, audited financial statements, business plan, collateral, etc. Entrepreneurship characteristics, on the other hand, are traits or attributes specific to the owner/manager of the firm which can also positively or negatively affect the performance of the firm. These include the owner/manager's age, gender, education level, experience, etc.

At the evaluation phase, the financier commits himself/herself to a comprehensive evaluation of the profitability of proposed investment projects and the above-mentioned firm and entrepreneurship characteristics are taken into account. Based on this information, the loan officer decides as to whether it will be viable for the funding institution to afford the applicant a loan or not. Borrowers considered not credit worthy will have their loan applications rejected completely or credit rationed.

At the quantity rationing phase, the financier decides the excellent loan size for a borrower at a given interest rate (Okurut, 2010). Quantity rationing deals with a situation where some borrowers are given credit that is less than what they requested (Kira and He, 2012). An in-depth analysis of the firm and entrepreneurship characteristic factors influencing SMME access to credit is discussed in the sub-sections below.

3.4.5.1 The gender status

The gender of an entrepreneur is one of the factors impacting on SMME access to credit. However, there are different opinions on whether there is correlation between the gender of an SMME owner/manager and access to credit. Zindiye and Mwangolela (2007) in their demand side study, for example, observed that, compared to male managed counterparts, female managed businesses are less likely to obtain credit from funding institutions. Another demand side study by Nkuah *et al* (2013) concurred with the above-mentioned observations. Contrary to these findings, Irwin and Scott (2010) in their study of barriers faced by SMMEs in raising credit found that women were favoured by funding institutions than men.

However, a supply side research undertaken by the USAID (2010) on the funding institutions' hurdles to SMME credit in South Africa had a different opinion to the above-mentioned findings. The study, instead, found that credit institutions are less worried about the gender status of the business owner when considering credit applications. These findings are supported by Fatoki and Asah (2011) who in their study of the effect of industry or business and entrepreneurship qualities on access to bank credit in King William's Town, also found no correlation between the gender of the business owner and access to credit.

3.4.5.2 Education background

Statistics South Africa's 2013 Survey of Employed and Self Employed study pointed out that the majority of SMMEs in South Africa had below matric qualifications. Empirical research conducted on the education background of entrepreneurs discovered that there is a positive relationship between higher educational qualifications and business growth (Albert, 2004; Mutezo, 2005; Ferreira, 2007; Mahadea and Pillay, 2008; Olawale and Garwe, 2010; Pandula, 2011). Also, a supply-side study done by Pandula (2011) on SMME access to bank credit in Sri Lanka concurred with the above-mentioned findings. The study's findings revealed that graduates had the least difficulties obtaining credit from funding institutions. Research scholars converged on the fact that well-schooled business owners have the potential to put forward positive financial information and strong business plans and they have the potential to maintain a better relationship with funding institutions in comparison to less educated business owners.

The second proposition is that well-schooled business owners possess the necessary experience and expertise to operate the other functions of the business such as finance, marketing, human resources to mention but a few. The above-mentioned experience and expertise yield to better performance of the business something which assists those businesses to access credit relatively easy. Thirdly, researchers observed that funding institutions put more value to the higher education level of the business owner/manager in the loan approval exercise.

Notwithstanding the above-mentioned education effect, a supply-side study by the USAID (2010) found that funding institutions are less concerned about education qualifications when assessing credit applications. These findings were supported by Agyapong *et al* (2011) who found that the curriculum vitae of an entrepreneur is ranked the lowest on the criteria used by banks in assessing loan applications from SMMEs.

Given the above-mentioned findings, there appears to be contradicting views from the demand and supply perspectives on the effect of education on SMME access to credit. SMMEs consider the level of education as an important criterion used by funding institutions to evaluate their funding applications. Contrary to this notion by SMMEs, it appears that the level of education is not a critical factor in the lending criteria of funding institutions. This is a literature gap that needs to be closed as there appears to be a disjuncture by SMMEs and funding institutions on the education level and SMME access to credit.

3.4.5.3 Managerial competency

A large number of research scholars agree with the idea of the importance of SMMEs that have the required business management experience and expertise for the viability and profitability of any firm (Jackson, 2004; Mutezo, 2005; Ferreira, 2007; Olawale and Garwe, 2010). According to Olawale and Garwe (2010), managerial competencies measured by education, managerial experience, start-up experience and knowledge of the business, skills, behaviours and attitudes have an impact on the performance of the business. In their study of the importance of management competencies in the success of SMMEs, Martin and Staines (2008) found that lack of managerial experience, skills and personal qualities of SMME owner/managers were the main reasons for SMME failure. In addition, Zarook *et al* (2013), in their study of management skills and access to finance by SMMEs in Libya, found that management skills and education were important factors determining SMME access to credit. They further argued that managerial competencies are crucial and pivotal to the survival and development of new SMMEs. Fatoki and Asah (2011) also found a positive relationship between managerial competency and SMME access to credit. Nkuah *et al* (2013) also pointed out that managerial competency is one of the criteria funding institutions use to evaluate SMME loan applications.

However, supply-side studies reviewed (USAID, 2010; Pandula, 2011; Agyapong *et al*, 2011; Fatoki, 2014) found that entrepreneurship characteristics including managerial competency were not critical factors in the lending criteria of funding institutions. Instead, the studies listed cash flow, owner equity, a good business plan, reputation and trustworthiness, a good track record as key in the loan application assessment process. Again, there appears to be contradicting views on this variable, a literature gap that needs to be closed. The literature is also silent about appropriate skills being part of the criteria for lending to SMMEs by state owned funding institutions.

3.4.5.4 The size and age of the firm

Empirical evidence points out that the size and age of the firm have an influence on SMME access to credit. This evidence is based on the fact that the longer a firm exists and the bigger it is, the more it signals that it can weather tough economic conditions (Chandler, 2009). This suggests that the opposite is true for younger firms. Secondly evidence postulates that information asymmetry is more severe in younger and smaller firms that their larger counterparts. Thirdly, there is consensus among researchers that when a business is small and young, more often than not it is owned and run by the business owner himself/herself and that there are no legal requirements to report financial information on a regular basis (Musamali, 2013; Nkuah *et al*, 2013; Fatoki, 2014). Moreover, there is a general observation that younger and smaller firms are more prone to failure than their larger counterparts. These are attributed to the failure of younger firms to access credit from funding institutions than their larger counterparts.

However, a supply-side study by Pandula (2011) found no correlation between firm size and age and SMME access to credit. These results were supported by the USAID (2010) who also disputed the notion of the smaller and younger the firm, the more likely it is to be credit constrained. Does the size of the firm matter when funding institutions assess SMME credit applications? This is a question that needs to be answered.

3.4.5.5 Ownership type / legal form

The manner in which a business is structured or its ownership type/legal form has an impact in a business' potential to access credit from funding institutions. For example, an empirical study undertaken by Pandula (2011) concluded that listed businesses and foreign owned ones are exposed to less credit constraints in comparison to the non-listed and locally owned businesses. The above-mentioned conclusions are in line with those of Chenesai (2009) and El Said *et al* (2013) who observed that due to a whole range of skills required by businesses, there is a huge probability that firms with more than one owner were more likely to thrive because of their management structure. However, as reported in the section above, literature on the criteria used by funding institutions to lend to SMMEs is silent about the legal form variable. A supply-side investigation on the impact and significance of the legal form of a firm on SMME access to credit would be interesting.

3.4.5.6 Industry sector

It is widely documented that the type of industry a firm is trading under has a huge impact on the business's access to credit. It has been observed that funding institutions have a tendency of favouring industry sectors that have a competitive edge, innovative and expanding (Pandula, 2011). Research conducted by Rogerson (2008) utilising information from Mozambican manufacturing businesses also discovered that the industry sector appears to be a vital variable considered by funding institutions when assessing loan applications. The results of his research pointed out that both metal and wood furniture industry sectors considerable had lower credit access than the food processing sector. They attributed this to the fact that commercial banks put a lower risk premium to food processing sector in comparison to the other two sectors. In a recent study by Zairani and Zaimah (2013) on variables linked to accessing loans from banks in Malaysia, industry/business under which a firm belongs is listed as one of the criteria. However, it remains to be seen whether the above-mentioned situation also applies to South Africa.

3.4.5.7 Firm location

A number of researchers (Keeble, 1990; Kumar and Francisco, 2005; Bbenkele, 2007 and Pandula, 2011) coincide on the reality that spatial variations exist in both the cost and availability of credit especially for SMMEs. Pandula (2011) observed three aspects which have an impact on spatial variations in the availability of credit for SMMEs in rural areas. Pandula asserts that firstly, funding institutions may not exist in rural areas. He further states that where they exist, there may be only one bank branch available to the location, which may enjoy a monopoly power in the area and small firms may not have much credit alternatives available.

The second aspect that Pandula (2011) noted, which Bbenkele (2007) also concurred with, is that bank branch managers mandated to operate and run these rural bank branches may have restricted delegation of authority. This, they reckoned, may lead to delays in the approval of loan applications from rural firms. Alternatively, there might be a huge amount of loan rejections because of the bank loans that are processed and approved by the head office officials who have no personal knowledge of customers or projects based in rural locations. The third factor is that the assets offered as collateral by SMMEs in rural areas may have less market value and in case of default they may find it difficult to realize these assets.

However, Rand (2007) submitted a contrasting notion to Pandula's findings. Rand discovered that the probability of SMMEs accessing credit is higher in rural than in urban areas. He contended that the bulk of government credit is set aside for rural areas thereby confirming that local governments often are decisively protective of businesses in rural areas. Location does not feature in the criteria used by funding institutions to lend to SMMEs. Funding institutions put a premium on other factors that are much important to them than location.

3.4.5.8 Networking and relationship with bank

Several authors on the subject of networking have corroborated on the fact that networks are of much assistance to SMMEs in conquering challenges of access to few resources and markets. Curan and Storey (1993) in Pandula (2011) pointed out that networks add value in providing advice, information and capital to SMMEs. Talavera *et al* (2010) in their study on the impact of social capital on credit hurdles faced by entrepreneurs using a pooled data of about 270 small companies discovered that that membership in business associations increase the probability of having a loan by 14.8%.

However, the challenge facing SMMEs is the absence of small business associations under which they can belong. This is contrary to large organizations which are members of organized business organizations. Studies conducted on the criteria used by funding institutions to lend to SMMEs are silent about the impact of networking in SMME access to credit. Instead, funding institutions emphasise the relationship with the lender as one of the factors considered by the above-mentioned funding institutions when lending to SMMEs. A closer look at the importance of this factor in determining SMME access to credit would be interesting.

3.5 The capital structure theories

The relationship between capital structure and the firm's performance has been the subject of debate for numerous development finance studies (Cekrezi, 2013). This debate consist of whether there is an optimal capital structure for a firm or whether the use of debt is irrelevant to the firm's performance or value (Modigliani and Miller, 1958).

The capital structure is defined as the mix of debt and equity that a firm uses to finance its operations (Gitman, 2003). According to literature, there are two main sources of firms' financing namely internal and external financing. Internal financing is related to retained earnings while external financing could be in the form of borrowing or issue of equity. Firms constantly invest in their businesses to achieve sustainability and growth and as such financing decisions are significantly critical (Mostafa and Boregowda, 2014). The capital structure theory determines what the source of money supply is and what strategy should be adopted to acquire the above-mentioned source for purchasing the firm's assets or investing in projects. Choosing between debt and equity is generally a huge challenge for firms.

The subject of capital structure has been of much interest to development finance researchers for decades. This section discusses the five major capital structure theories namely the

Modigliani and Miller theory, the trade-off theory, agency cost theory, the perking order theory and the market timing theory.

3.5.1 The Modigliani and Miller theory

The fundamental principles underpinning the capital structure can be traced back from Modigliani and Miller (1958) and there is consensus on the fact that before them there was no generally accepted theory of capital structure. The Modigliani and Miller (MM) theory argue that capital structure has irrelevance proposition (Iqbal *et al*, 2012; Mostafa and Boregowda, 2014). The theory is based on four assumptions namely: that the firm has a distinct set of expected cash flows; that it divides the cash flows among investors when it chooses a certain mixture of debt and equity for acquiring assets; that firms and investors have the same opportunity to access the financial markets and that the investors can create any leverage according to their own choice.

The MM theory argues that firms can reduce their costs of capital and increase shareholders' wealth by employing debt. The theory advocates that because interest on debt is tax-deductible, firms can exploit the opportunity and save on tax. The theory further argues that the tax advantage of debt makes debt finance cheaper than equity finance. Kira and He (2012) and Fatoki and Asah (2011) argue that the usage of both cheap debt with relatively expensive equity reduces a firm's cost of capital which is a hurdle rate for investment acceptance or rejection decisions.

The MM theory points out that, in order to take advantage of the tax shield benefit, a firm should have 100% debt in its capital structure. However, Scott (1972) and Kraus and Litzenberger (1973) pointed out that practically, because of distress costs, the 100% tax shield notion does not exist. Their argument is based on the fact that debt comes with a price tag (legal obligation) of a firm having to pay interest and principal. This is also coupled with the fact that SMMEs struggle to get credit from funding institutions. Kira and He (2012) indicated that breaching the above-mentioned arrangement results in a firm being liquidated and incurring the associated costs.

The MM theory introduced two types of capital irrelevance propositions. The first (classic arbitrage-based irrelevance proposition) is based on the fact that arbitrage by investors keeps the value of the firm distinct of its leverage. The second irrelevance proposition states that given a firm's investment policy, the dividend it chooses to follow will affect neither the current price of its shares nor the total return to its shareholders (Modigliani and Miller, 1963). Put differently, neither capital structure choices nor dividend policy decision matter.

The Modigliani and Miller theory stimulated enormous interest by researchers aimed at disproving the irrelevance theory as a theoretical or as an empirical matter. The research found that the MM theory fails under a variety of circumstances and the most common elements involved consideration for taxes, transaction costs, bankruptcy costs, agency conflicts, adverse selection, lack of distinction between financing and operations, time-varying financial market opportunities and investor clientele effects. This realisation led to the ushering in of the trade-off theory and the perking order theory discussed in the subsections below.

3.5.2 The Trade-Off Theory

The term "trade-off" theory is used by various researchers to outline a household of associated theories (Frank and Goyal, 2005). In all of these theories, a decision maker running a firm assesses the various costs and benefits of alternative leverage plans. Generally, it is presupposed that an internal resolution is obtained so that marginal costs and marginal benefits are balanced. The original account of the trade-off theory emerged from the discourse on the Modigliani-Miller theorem mentioned in the subsection above. This came about when corporate income tax was factored into the Modigliani and Miller's irrelevance proposition. The incorporation of corporate income tax generated an advantage for debt because it shielded the firm's income from tax. Since the firm's objective function is linear, and there is no offsetting cost of debt, this implied 100% debt financing. To circumvent this utmost forecast, an offsetting cost of debt is required. According to Frank and Goyal (2005), this might lead to bankruptcy.

Kraus and Litzenberger (1973) argue that optimal leverage mirror a trade-off between the tax benefits of debt and the costs of bankruptcy. Myers (1984) postulates that a firm that observes the trade-off theory allocates a target debt-to-value ratio and then slowly moves towards the target. According to Myers (1984), the target is established by equating debt tax shields against costs of bankruptcy. A number of aspects of Myers' definition were critically discussed by Frank and Goyal (2005). In their discussion, for example, they realised that the target is not directly observable. Secondly, they concluded that the tax code is much more complicated than that assumed by the theory. Thirdly, they argue that bankruptcy costs must be deadweight costs rather than transfers from one claimant to another. Lastly, they maintained that transaction costs must take a particular configuration for the analysis to work. The trade-off theory is further divided into two components namely the static trade off theory and the dynamic trade off theory and these are individually discussed below.

3.5.2.1 Static trade-off theory

The first prototype of static trade-off theory of capital structure was first conceptualised and introduced by Brennan and Schwartz (1978) and Leland (1994).The theory suggests that firms create a balance between the marginal present values of interest tax shields and the costs of financial difficulty (Shyam-Sunder and Myers, 1999). According to the theory, the optimal level is achieved when the marginal value of the benefits associated with debt issues exactly offsets the increase in the present value of the costs associated with issuing more debt (Myers, 2001). The benefits of debt are the tax deductibility of interest payments which favours the utilisation of debt but the positive effect can be complicated by the existence of personal taxes (Miller, 1977) and non-debt tax shields (De Angelo and Masulis, 1980).

De Angelo and Masulis (1980) study suggested a theoretical optimum level of debt for a firm, where the present value of tax savings due to further borrowing is just offset by increases in the present value of costs of distress. Also this theory assumes that there are no transaction costs to issuing or repurchasing securities (Dudley, 2007). This theory also suggests that higher profitable firms have higher target debt ratio, because they would ensure higher tax savings from debt; lower probability of bankruptcy and higher over-investment and these require a higher target debt ratio.

3.5.2.2 The dynamic trade-off theory

The static trade off theory postulates that firms create a balance between the tax benefits of debt and the risks of insolvency (Cekrezi, 2013). However, the dynamic trade off theory, on the other hand, argue that it is costly to issue and repurchase debt in so as to achieve the target debt ratio that would achieve the maximization of firm value (Goyal and Frank, 2005; Iqbal *et al*, 2012). Therefore, firms whose leverage ratios is not exactly as their target one, will adapt their capital structure when the benefits of doing so outweigh the costs of adjustment (Dudley, 2007).

The dynamic trade off theory suggests that firms let their leverage ratios differ within an optimal range (Dudley, 2007). Hovakimian *et al* (2001) found that more profitable firms are more likely to issue debt over equity. Empirical evidence of a study by Dudley (2007) supports the predictions of dynamic trade off theory, concluding that volatility increases the optimal leverage range and profitability and interest rates reduce the leverage range.

3.5.3 The Agency Cost theory

In 1976, following the MM theory, Jensen and Meckling (1976) introduced the agency theory which was founded on the conflicts between the shareholders and managers of the firm and the equity holders and debt holders. The theory advocates that conflicts between shareholders and managers arise because managers do not hold total residual claim and thus they cannot capture the entire gain from their value maximisation activities. Furthermore, conflicts arise between lenders and shareholders because debt contracts grant shareholders an incentive to invest sub-optimally (Iqbal *et al*, 2012).

Iqbal *et al* (2012) observed that in capital structure decisions; there are three ways that give rise to agency cost namely; free cash flow, the assets substitution effect and the problem of debt overhang. Regarding the free cash flow, he stated that the manager destroys the firm value by investing profit into unessential projects instead of giving back the free cash flow to investors. On the asset substitution effect, Jensen and Meckling (1976) observed that managers take a risk by investing in very risky projects. Lastly, in relation to the debt overhang problem, he stated that debt has a cost price tag and all the profit from projects will be for the account of the debt holder rather than the shareholder. The mainstay of the agency cost theory is that investment decisions are associated and have a powerful influence on capital structure decisions (Jensen and Meckling, 1976).

3.5.4 The Perking Order Theory

In 1984, Myers (1984) brought about the pecking order theory which argued that the idea of a well-defined optimal capital structure is non-existent. He instead argued that the debt ratio is a function of hierarchical financing overtime. Myers indicated that management has the prerogative to opt for internal than external financing. He pointed out that when a firm is forced to utilise external financing sources, managers select the less risky and demanding source first. Thus the pecking order theory advocates for the utilisation of external debt before external equity. The perking order theory postulates that the capital structure decisions of a firm are determined by the firm's age (Myers, 1984). In terms of this theory, internal sources of funding are prioritised while the use of external resources is delayed until the internal resources are exhausted (Abdulsaleh and Worthington, 2013). In other words, the theory postulates that when seeking finance, a firm prefers internal equity to external debt, short-term debt to long-term debt and external debt to external equity (Cassar and Holmes, 2003).

Meyer's theory received support from Gregory *et al* (2005) who argued that older firms should be less reliant on external financing sources than younger firms. Their argument is based on the fact that due to older firms having more opportunities to accumulate retained earnings than younger firms, more internal funds are available to finance their operations. The study by Sanchez-Vidal and Martin-Ugedo (2005) also supported the pecking order theory.

However, a study conducted by Helwege and Liang (1996) who investigated the financial decisions of a group of young small businesses between the period 1984 and 1992 contradicted Meyer's theory. Their findings revealed that the patterns followed by their respondents did not match the pattern suggested by the perking order theory. In addition, Helwe and Liang found no evidence of a significant relationship between the raising of finance externally and a deficit in internal resources.

The financial growth cycle paradigm proposed by Berger and Udell (1998) also contrasts with the perking order theory. According to Berger and Udell, financing options available for SMMEs change throughout the various phases of a firm's life cycle. This means that at different stages of the firm's growth cycle, different financing strategies are required. For example, the life cycle paradigm postulates that due to their unique characteristics such as information opacity, lack of credit history and the high risk of failure, start-up firms depend heavily on internal funding sources. As a firm proceeds through their business life cycle, it starts to slowly adapt their capital structure (La Rocca *et al*, 2011).

The life cycle paradigm further states that as SMMEs mature, they start to establish a good track record in addition to their ability to provide collateral. Collateral demonstrates the creditworthiness of the firm and helps to attract the attention of investors to willingly inject money into the business. As a consequence, a firm begins to substitute internal with external financing sources including venture capitalists, trade credit and bank loans to mention but a few. In the more advanced stages of their growth cycle, when SMMEs become more informationally transparent, they may develop access to securitised debt and publicly listed equity markets (Berger and Udell, 1998). The life cycle paradigm received some support from a number of studies including Wu *et al* (2008) and La Rocca *et al* (2011) which found that the financial behaviour of SMMEs by and large can be attributed to the lifecycle paradigm.

However, as with the pecking order theory, the life cycle paradigm also received some criticism from some studies which claimed that the paradigm does not offer a comprehensive picture of SMME financial decisions and behaviour. For example, Berger and Udell (1998) themselves acknowledge that the lifecycle paradigm is not relevant to all SMMEs operating in different industries. Even Gregory *et al* (2005) partially agreed with the paradigm stating that SMME financing cannot be standardised.

3.5.5 The Market Timing Theory

The market timing theory of capital structure, pioneered by Baker and Wurgler (2002) is founded on the fact that the firm issues new stock when its share price is overvalued and it purchases back its shares when its share price is undervalued (Iqbal *et al*, 2012; Mostafa and Boregowda, 2014). The continuous variation in the prices of stocks of the firm have an impact in the firm's financing decisions and eventually its capital structure (Iqbal *et al*, 2012). Equity market timing theory has two versions of capital structure dynamics. The first version is that managers and investors (economic agents) must be logical. To avoid asymmetric problem, the firm may issue the shares directly to the prospective investor after the release of positive information about the firm. This can minimise the information chasm between the management of a firm and its stakeholders. It may improve the price of share when there is regular sharing of information between the above two (Mostafa and Boregowda, 2014).

The second version is that managers and investors must be illogical (Baker and Wurgler, 2002). Due to this illogical behaviour, the prices of stock differ and are mispriced. The manager issues the securities illogical when prices are low and purchase irrationally when prices are up. The second version also proposes that information is not correct. The main point is that managers think that they have complete and comprehensive information about the time of the market. Graham and Harvey (2001) showed that managers conceded that while issuing or buying back of the firm's stock, time to market it is an important consideration for them. In addition, there is support by the study that managers believe that they can time the market but they cannot differentiate between mispricing and asymmetric information about a firm.

There is evidence from Baker and Wurgler (2002) that market timing of equity securities has persistent consequences on the firm's capital structure. They argue by defining the market timing measure as external capital weighted average needs in past few years, where the weights used are market to book values of the firms. They showed that changes in the leverage of the firm are related positively and strongly to the measure of market timing and their conclusion was that capital structure of the firm is the result of previous collective attempts to time the equity market.

3.6 Sources of SMME finance

Demirguc-Kunt *et al* (2006) ascertain that the two primary sources of external credit for SMEs are equity and debt. These are discussed in the subsections below.

3.6.1 Equity Financing

Equity financing is defined as capital invested in the firm without a specific date where the supplier of the equity capital is effectively investing in the business (Ou and Haynes, 2006). According to Abdulsaleh and Worthington (2013), equity capital can be raised either internally or externally. Internal equity is defined as funds obtained from the current owner-manager(s) of a firm, family and friends or from the retained earnings within a firm. External equity, on the other hand, is capital acquired from external channels other than the existing partners and their relatives.

Equity financing is favoured over debt as a means of financing by new and young SMMEs. This is because during their early stages, new and young SMMEs are faced with severe moral hazard, information opacity and collateral problems to mention but a few. As a result they rely solely on internal equity in the form of owner-manager personal savings (Abdulsaleh and Worthington (2013). As these SMMEs grow and develop, they tend to reduce their dependence on internal equity and begin to look for alternative sources of equity such as retained earnings and venture capital (Berger and Udell, 1998).

Ou and Haynes (2006) identified two advantages of equity financing. The first advantage is that equity, as opposed to debt, offers long-term financing with minimum cash flow in the form of interest. Secondly, equity capital enhances the new/young firm's creditability by indicating that the firm has the approval of sophisticated financial professionals. According to Ou and Haynes (2006), there are two circumstances where SMMEs pursue financing from equity capital sources in order to meet their expansion needs. The first scenario is when SMMEs are faced with credit difficulties coupled with a lack of alternative sources of credit. The second scenario is when cash outflows exceed the cash inflows generated from regular sources. The above-mentioned scenarios can be attributed to the fact that funding institutions are reluctant to offer credit to new/young firms due to their reservations about the firm's future growth opportunities. Thus, these firms are normally categorised as high risk.

However, Reid (1996) pointed out that some SMME owner-managers opt not to utilise equity as a source of financing as they do not want any undesirable changes in the ownership of the firm. Contrary to Reid's observation, Abdulsaleh and Worthington (2013) noted that other entrepreneurs may choose to source funding from external equity in order to share the risk with less risk-averse investors. In addition there is evidence that internal equity is often limited or inadequate. This therefore leads SMMEs to look for external equity or debt finance. There are a number of equity finance sources available to entrepreneurs. However, the study only focuses on venture capital and angel investors. These are discussed in the subsections below.

3.6.1.1 Venture Capital

Porter and Porto (2007) define venture capital as that category of financing in which funds are raised from investors and redeployed by investing in high-risk informationally opaque firms which by and large are young or start-up firms. Venture capitalists determine the timing and type of investment in addition to their role in monitoring, screening and contracting (Gorman and Sahlman, 1989). In addition, venture capitalists also engage in strategic planning and decision making in the firm so as to ensure the sustainability and good performance of the firm. There are a number of venture capital organisations providing venture capital to firms. These include, but not limited to, public corporations, small business investment corporations and private limited partnerships.

Compared to other more conventional financing sources, venture capital exhibits some distinct features. The first feature is that investments using venture capital frequently include high levels of asymmetry information and uncertainty as well as higher intangible assets (Gompers, 1995). In addition, Hellmann (1998) explained that the situation in which a firm has adequate large incentive for active monitoring takes place only when the venture capitalist has a concentrated stake invested in that firm. Hellman further states that monitoring in such instances may involve spending more time in the firm and frequent meetings with the managers. Lastly, venture capitalists can help the firm with strategic access to new suppliers and clients as well as strategic partners (Bygrave and Timmons, 1992).

Venture capital is generally associated with high risk and uncertainty. For example, when providing external finance to firms, venture capitalists experience a remarkable adverse selection problem and moral hazard (Smolarski and Kut, 2011). Another problem that may arise is the agency problem (Berger and Udell, 1998). This occurs in the relationship between the venture capitalist and the entrepreneur when the latter lacks sufficient information or skills to make optimal production decisions. This problem might also be combined as information about the project is imperfect and revealed over time (Bergemann and Hege, 1998). In order to alleviate these problems and reduce uncertainty, particular mechanisms can be implemented. In this instance, Gompers (1995) emphasised three control strategies namely; the utilisation of convertible securities, the syndication of investment and the staging of capital infusion.

Cumming (2006) observed that most venture capital transactions involve convertible securities. Bascha and Walz (2001) pointed out that convertible securities have the potential to alleviate the agency challenge impacts by leaving the owner-manager with some control during the investment period. In addition, as the price of conversion is a function of performance, the venture capitalist has a better chance to recover the investment if the venture is not successful.

Syndication is a common type of venture capital risk alleviation and refers to two or more venture capitalists sharing in a single financing ground. The syndication mechanism is used to reduce challenges related with adverse selection through the engagement of a co-investor sharing the investment risk (Smolarski and Kut, 2011). Concurring with this notion, Cumming (2006) also realised that venture capital syndication significantly alleviates adverse selection challenges.

Venture capital staging refers to that category of financing in which venture capitalists invest in stages so as to keep the project under control (OECD, 2004). This was noted by Gompers (1995) when he stated that staged investment enables venture capitalists to collect more information thus allowing him/her to monitor the firm before refinancing decisions are made. Wang and Zhou (2004) also concurred with Gomper's statement adding that the staging financing plays an important and pivotal role in controlling moral hazard.

Venture capital financing has some advantages. Firstly, venture capital has no repayment commitment during the term of the loan and requires no payment of dividends/personal guarantees/collateral from the SMME owner/manager (Tedesco, 2014). Secondly, the capital provided by the firm also increases the capital base of the start-up firm resulting in the improvement of the start-up firm's net asset value. This makes the firm more attractive to debt financing or future investors. Thirdly, start-up firms that receive venture capital also receive many other intangible benefits. Because venture capital firms have reputations for being highly selective, their receipt of venture capital funding usually enhances a start-up firm's reputation to its customers, other investors, and suppliers.

In addition, venture capital firm resources, such as access to technical specialists, accounting, taxation, and legal experts, industrial contacts, strategic partnerships and access to new technologies accompany the investment (Bygrave and Timmons, 1992). This may assist start-ups in defraying the expensive legal and marketing costs associated with growing a start-up firm. In many occasions, at least one of the members of the venture capital firm will sit on the start-up's board of directors (or in a similar position of control). This helps provide structure and management to the emerging firm/start-up. Moreover, venture capital investors, through their own experiences, contribute intuition and stability to start-up firms. This helps save start-ups firms from making catastrophic financial or managerial mistakes.

While there are many advantages to venture capital funding, it is not always suitable for every start-up endeavour. Firstly, because the venture capital firm usually have investors sit on the board of directors of the start-up firm, the entrepreneur will likely encounter ownership dilution. Secondly, venture capital is fundamentally more costly than debt financing because the firm typically takes an ownership stake in the start-up firm, often referred to as an "equity position". This, in essence, means that the venture capital firm is a co-owner of the start-up firm.

Thirdly, the amount of time and resources spent during the process of seeking and acquiring a firm's support is another drawback (Kortum and Lerner, 2000). For example, evidence indicates that it may take between six to nine months for the start-up firm to secure funding. During this time, the start-up firm must collate and put together numerous documents, spend time with hired legal and financial advisors, and spend numerous hours in negotiations with the firm. Shane (2012) asserts that as only 1 in 100 firms secure venture capital funding, many firms are reluctant to waste their resources (time and money) on the process.

In South Africa, there are 65 venture capital funds controlling a total of R29 billion with an average investment size of R15.4 million (South African Venture Capital Association, 2008). However, according to Fatoki (2014), new venture investment focusing on SMEs is about R1.1 billion which is only a fraction (3.8%) of the funds. This implies that venture capital's availability to start-up and emerging SMMEs is limited to both developed and developing countries. The lack of venture capital and other sources of equity leaves SMMEs with no option but to depend on debt finance in the form of bank loans, overdrafts and credit financing for start-up financing (Blumberg and Letterie, 2008). However, evidence has proven that debt finance is limited to start-up SMMEs especially in developing countries. This is due to information asymmetry, fixed transaction costs, the level of risk of a firm, absence of collateral and firm and entrepreneurial characteristics among others.

3.6.1.2 Business Angels or Informal Investors

The term "angels", according to Herrington *et al* (2010) was originally employed on Broadway where it was used to describe wealthy backers of high-risk productions. Angels are highly-selective wealthy individuals with long business experience who invest directly in high growth SMMEs with which they have had no previous relationship (Madill *et al*, 2005; Herrington *et al*, 2010). This form of investment is usually founded on an equity contract, typically common stock. Whilst angels by definition are individuals, they sometimes synchronise their investment in small investment groups.

According to Harrison and Mason, there are three features that make angel financing an appropriate option for SMMEs. Firstly, angels are more dynamic in the early stages of enterprises (seed and start-up) closing the so-called "equity gap" by establishing a "bridge" between internal financing sources and outside investors. Secondly, by having lower rates of rejection and being a more patient form of capital with longer exit horizons, angel financiers tend to be more accommodative to the needs of SMME owner-managers. Lastly, unlike venture capitalists, angel investors prefer to invest in their local economies where the majority of SMMEs operate.

Abdulsaleh and Worthington (2013) argue that angel investors are an important source of financing for many SMMEs especially start-ups. Morrissette (2007) observed that the amount of capital that angels provide is estimated to be eleven times that provided by venture capitalists. However, Wall (2007) noted two main limitations that business angels have. Firstly, few angels are prepared to inject additional money into a firm to enable it to grow and be a real competitor in its market. Secondly, most angel investors do not have the skills nor the interest in investing in a firm after it has access to other external sources of finance including public equity markets.

In South Africa, despite the many sources of external equity available to SMMEs, access to external equity remains a huge constraint for SMMEs. External equity finance in the form of venture capital and business angels is generally not available to SMMEs (Fatoki, 2014). In addition, access to external equity through public listing on the Johannesburg Stock Exchange (JSE) is also unavailable until a firm is relatively large and is able to meet the minimum size requirements for listing. The unavailability of external equity leaves SMMEs with no option but to rely on debt finance (Fatoki, 2014).

3.6.2 Debt Financing

Debt financing is a method of financing in which a firm borrows money from finance institutions to finance its operations. According to literature, debt financing has two advantages. The first advantage is that the firm owner/manager retains his/her maximum control over the firm. Secondly, the interest on debt financing is tax deductible. Literature evidence (Fatoki, 2014; Abdulsaleh and Worthington, 2013) corroborate on the fact that SMME owner-managers prefer debt financing over equity financing so as to keep full ownership and control of their businesses. In addition, Wu *et al* (2008) identified three significant differences between debt financing for SMMEs and that of large and established firms.

Firstly, he postulates that unlike managers of large firms who generally have the option to choose from a wide variety of debt financing sources, SMMEs tend to favour commercial lenders (banks), especially institutional lenders as a source of short-term financing that can be renewed for long-term debt. Secondly, as information asymmetry challenges are more severe in SMMEs than in large firms, long-term lending relationships are more important for SMMEs in order to deal with the resultant agency problems along with other three conventional mechanisms; signalling, monitoring and bonding. Thirdly, in concentrated owner-manager SMMEs, and contrary to what the agency theory suggests, it is not clear whether debt can lower the agency costs that result from information asymmetry arising due to different motives of owners and managers.

In South Africa, there are four types of debt financing available to SMMEs namely trade credit, non-bank financial institutions debt, bank finance and government assistance and initiatives. These are individually discussed in the subsections below.

3.6.2.1 Trade Credit

Huyghebaert *et al* (2007) and Garcia-Teruel and Martinez-Solano (2010) define trade credit as a delay in the payment for goods or services after they have been delivered or provided as a result of an agreement between the supplier and the firm. It is generally extended for an intermediary period of thirty to sixty days and if payment has not been made during this period, this credit attracts interest.

Trade credit is a source of financing that reflects in the balance sheet of a firm under current liabilities whereas for the supplier it is an investment that is reflected in accounts receivable. It is one of the most important sources of external financing for SMMEs. For example, Berger and Udell (2006) estimated that one third of the total debt of SMMEs in the United States in 1998 was represented by trade credit.

The reasoning behind the widespread use of trade credit by SMMEs is widely documented. For example, Ellihausen and Wolken (1993) identified the transaction motive and the financing motive as behind the rationale for the above-mentioned use. The transaction motive argues that both the firm and the supplier have a better ability to forecast their cash requirements in the short-term and as a result management costs can be economised. The financing motive, on the other hand, suggests that SMMEs resort to trade credit when alternative sources of finance are unavailable or expensive. In support of the above notion, Fatoki and Odeyemi (2010) observed that trade credit financing is more favoured by emerging SMMEs during their early stages of their life cycle when the risk default is high.

Abdulsaleh and Worthington (2013) discovered that trade credit is more essential in countries with less developed banking and financial systems and acute asymmetric information challenges. For example, Allen *et al* (2005) ascribed the booming economy of the country to, among others, different sources of financing principal among them is trade credit. Berger and Udell (2006) pointed out that trade credit provides the necessary cushion during credit crunches, contractions of monetary policy or other shocks that lead to finance institutions' reluctance to lend to SMMEs.

However, Wilson and Summer (2002) cautioned that trade credit can be costly for SMMEs if the firm (buyer) does not honour the trade credit agreement and settles payment beyond the agreed-upon payment date. In South Africa, despite the fact that the country's banking and financial system is very well developed, SMMEs struggle to access trade credit debt from trade creditors. This is caused by suppliers seeing SMMEs as high risk and informationally opaque and thus may not be paid for the goods taken on credit. In addition, Fatoki and Odeyemi (2010), in their study of the determinants of trade credit by new SMMEs in South Africa found that managerial competency, business plan, relationship with banks and the location of the business were important determinants of trade credit to new SMMEs in South Africa. So, it can be concluded that even in countries with very well developed banking and financial systems like South Africa, access to trade credit may be a hurdle for SMMEs.

3.6.2.2 Government SMME financing initiatives

The South African government has realised the enormous contribution made by SMMEs to the country's economy and therefore prioritised their promotion, growth and development. The country's first economic policy, the Reconstruction and Development Programme (RDP) of 1994, advocated for the support of SMMEs for employment creation, income distribution and growth. Later initiatives included the Growth, Employment and Redistribution Plan (GEAR) of 1998, the Accelerated Shared Growth Initiative for South Africa (ASGISA) of 2006, the New Growth Path (NGP) of 2010 and the National Development Plan (NDP) of 2012, among others. The NGP, for example, has the strengthening of SMME access to credit as one of its core strategic pillars. The latest policy, the NDP features SMME development as one of its vehicles to reduce unemployment by 6% in 2030, poverty and inequality.

In 1995, the White Paper on the promotion of SMMEs was developed. It emphasised government's need to create a conducive environment for SMME access to information, procurement opportunities, markets, business infrastructure and credit. However, Berry *et al* (2002) and Phillips (2002) in their analysis of the effectiveness of the Paper criticised the paper stating that it seldom addressed the needs of SMMEs and this resulted in rising high employment and poor economic growth. The White Paper culminated in the National Small Business Act No. 106 of 1996. This was subsequently followed by the establishment of Khula Enterprise Finance Limited and Ntsika.

The agencies' mandate was to promote SMME access to credit through its Credit Guarantee Scheme. However, an evaluation of the effectiveness of Khula Enterprise Finance from 1996 to 2012 by Mthimkulu and Aziakpono (2012) revealed that the organisation failed to meet its mandate as the scheme largely benefited white owned large businesses than its intended black SMME clientele. Their findings confirmed those of Thurlow and Wobst (2004) and Rogerson (2007) who in their evaluation of the services provided by Khula Enterprise Finance and Ntsika observed that the organisations' services were supply driven and did not take into account the unique nature of SMMEs in South Africa.

A recent evaluation by Mago and Toro (2013) of the support provided by the South African government to SMMEs focusing on Khula and Ntsika revealed that the agencies failed to meet their objectives of providing financial and non-financial support to SMMEs. Their study points out that Ntsika mentors were inexperienced and unskilled something which resulted in poor dissemination of information to SMMEs. On Khula, the study indicated that the agency failed to encourage commercial banks that were beneficiaries of its credit guarantee scheme to lend to SMMEs. Instead, the majority of the beneficiaries of the scheme were white-owned established businesses. The level of utilisation of the credit guarantee scheme was also observed to be far below expectations.

In 2000, there was an increasing pressure for government to rethink its SMME policy and this process culminated into the ushering in of the Integrated Small Enterprise Development Strategy of 2005. The strategy was aimed at providing a framework for the promotion, support and development of SMMEs including facilitating SMME access to credit.

Following the establishment of Khula and Ntsika, the Centre for Small Business Promotion (CSBP), charged with the operationalization of the Integrated Small Enterprise Development Strategy was also established. In 2001, the Umsobomvu Youth Fund (now the National Youth Development Agency) was established to, amongst others, provide finance to youth-owned and run SMMEs. However, the effectiveness of the services this organisation provides still remains to be seen. In 2004, the Small Enterprise Development Agency (SEDA), aimed at executing the National Small Business Strategy was formed. In 2012, the Small Enterprise Finance Agency (SEFA) charged with the provision of finance to SMMEs was established.

However, literature attests to the fact that the above initiatives by government aimed at creating an enabling environment for SMME access to credit have not been effective in achieving their intended results. The question that needs to be answered is "why, despite so many government and private sector initiatives aimed at facilitating SMME access to credit, do SMMEs still fail to access the same credit from DFIs meant for them and how can this challenge be addressed?"

3.6.2.3 Private sector financing

a) Own savings, family and friends

According to a survey carried out by Foxcroft *et al* (2002), the most important source of funding in all countries included in the Global Entrepreneurship Monitor (GEM) report was entrepreneurs themselves. Many researchers (Albert, 2004; Rogerson, 2008; Herrington *et al*, 2010; Mahadea and Pillay, 2008) attest to the fact that many entrepreneurs raise the start-up capital from their own or family savings rather than approaching formal institutions or agencies. This is because funding institutions generally require collateral and formal business records as criteria for considering a loan. In addition, funding institutions find new SMMEs to be informationally opaque and risky. Also friends and family are less likely to attach onerous terms to the repayment of the loan. However, many entrepreneurs with a good track record, leadership skills and business plans experience no problem in accessing loans for business formation or expansion from funding institutions (Mahadea and Pillay, 2008).

b) The South African Banking Sector

Traditional funding institutions (commercial banks) are by and large the most frequently used source of short-term finance by the entrepreneur when collateral is available (Mutezo, 2005). The South African Financial Sector is comprised of five major banks that provide financial services to the SMME sector. These four major banks include Standard Bank, Amalgamated Banks of South Africa (Absa), First National Bank (FNB), Capitec and Nedbank. As mentioned before, the lack of external equity in the form of venture capital and angel investors result in SMMEs depending on bank loans, overdrafts and trade credit for their early stage financing.

Paradoxically, access to debt finance from commercial banks in developing countries (including South Africa) is very limited for SMMEs. Commercial banks are reluctant to lend credit to this sector. A study conducted by Foxcroft *et al* (2002) indicated that 75% of SMME bank loan applications were rejected by commercial banks. Their findings were confirmed by a study by FinMark Trust (2006) which pointed out that only 2% of SMMEs in South Africa are able to access bank loans. Information asymmetry, high administrative costs of small-scale lending, high risk perception, lack of collateral and firm and entrepreneurial characteristics were identified as the main reasons why commercial banks are reluctant to extend credit to SMMEs.

c) Micro finance lenders

Micro financing provides an important source of funding for those entrepreneurs excluded from formal financing institutions (Herrington *et al*, 2010). Sources of micro finance included the Matshonisa, private institutions and Non-Governmental Organizations (NGOs).

Matshonisa (loan sharks)

Informal money lenders in townships of South Africa are known as Matshonisa. The term "matshonisa" loosely translated "making you poorer" is a reference to the interest payments attached to the loans, or to the trap into which the borrowers often fall (Rwigema and Venter, 2004). Loans up to a maximum of about R5 000 are made available to individuals. As soon as borrowers receive their monthly income, they are expected to repay their loans and the interest amount.

Siyongwana (2004) in Rogerson (2008) argued that the "informal or unregistered" lending sector is an important segment of the "unbanked" sector of the South African population and provides a valuable financial service to a section of the population that is unable to utilize the formal banking system. However, interest charged by this informal sector is exorbitant.

Micro lenders

Micro lenders provide small loans averaging R1 600 which do not require any form of collateral, over a period of one month. These suppliers concentrate on personal, relatively short-term to regular salary earners, with good security (in the form of an Identity Document and salary printout showing the potential for a garnishing value and a reasonable credit record checked through an efficient industry-wide referral system (Herrington *et al*, 2010). This limits availability of loans only to those who are gainfully employed. The bulk of the loans are for household needs and the balancing of income fluctuations. An insignificant share of 5 to 10% of these funds is utilized for business purposes. However, as is the case with Matshonisas, interest charged by micro lenders is often exorbitant.

Non-governmental organizations (NGOs)

In South Africa, there are many NGOs, Section 21 and small companies that support enterprise development such as Zimele Investments (Pty) Ltd and the Old Mutual's Masisizane Fund to mention but a few. Their funding instruments usually cater for certain designated groups and legal entities.

3.7 Lending technologies

Different variants of credit scoring systems are used by banks. Most of these build on the multiple discriminant credit scoring analysis pioneered by Altman (1968). Such models identify financial variables that discriminate between defaulting and non-defaulting firms. This section discusses the different lending technologies funding institutions use to evaluate credit applications. The section outlines the transactions lending technologies (financial statement lending, credit scoring, asset based lending, factoring and trade credit lending) as well as the relationship lending technology. In addition, the section discusses the 5C's of credit namely capacity, capital, condition, collateral and character.

3.7.1 Transactions lending technologies

3.7.1.1 Financial statement lending

Financial statement lending is defined as a transactions technology based fundamentally on the strength of a borrower's financial statements (Berger and Udell, 2006). According to Berger and Udell (2006), this technology requires that the borrower have informative financial statements such as audited financial statements prepared by creditable and reputable accounting firms according to generally accepted accounting standards. In addition, financial statement technology requires that the borrower must have a strong financial position determined by the financial ratios (e.g. current assets over current liabilities, gross profit over gross sales, net income over total assets and net income over net worth) calculated from the statements. Under the financial statement lending, the lender views the expected future cash flow of the firm as the primary source of repayment. Berger and Udell (2006) observed that financial statement lending is by and large tailor made for large and well established firms that are informationally transparent. This puts SMMEs in an awkward situation as they are informationally opaque. Moreover, the costs associated with compliance under transactional lending often imply that the SMMEs may not be able to meet to these requirements. Pretorius and Shaw (2004) shows that bank lending to SMEs in South Africa is still very much reliant on business plans and therefore tends to be more transactional in its approach. Business plans tend to require a lot of hard information which is typical of transactional lending.

Financial statement lending provides a clear-cut advantage for large and well established firms in that the comprehensive information enshrined in the financial statements addresses the information problem in a very low-cost way. This is because financial statement lending underwriting and monitoring is based on hard information. As a result, this type of lending can be effectively and efficiently provided by large and more sophisticated financial institutions without them exposing themselves to organisational diseconomies (Stein, 2002). Berger and Udell (2006) pointed out that the efficacy of financial statement lending critically on the lending infrastructure. This means that it is dependent on existing strong information environment especially in relation to generally accepted accounting standards and reputable auditors. Given the above requirement and based on the characteristics of SMMEs, it is evident that this type of lending is not suitable for SMMEs.

3.7.1.2 Small business credit scoring

The small business credit scoring is a transactions technology based essentially on hard information about the SMME and its owner/manager. The firm owner/manager's information is fundamentally personal consumer data (for example personal income, debt, financial assets, home ownership) acquired from consumer credit bureaus. This data is incorporated with the information on the SMME obtained by the funding institution and from commercial credit bureaus (Feldman, 1997). The data are fed into a loan performance prediction model which generates a score or summary statistic upon which a decision of issuing or not issuing the loan is based. In some instances, funding institutions make underwriting decisions based on rules and the SMME loan application is automatically accepted or rejected based on a score determined by the technology. In other instances, the score generated by the above-mentioned process is utilised in collaboration with data gathered using other lending technologies.

The small business credit scoring technology, as with the financial statement technology, is a transactions technology based on hard information. Literature generally points out that SMMEs are characterised by information asymmetry, lack of collateral in the form of property assets, insufficient track record, poor credit record of the SMME owner/manager and over-indebtedness (USAID, 2010). It is evident that though the small business scoring technology was designed for informationally very opaque SMME, it fails to address the personal history of SMME owner/managers.

3.7.1.3 Asset-based lending

Asset-based lending is a transactions lending technology in which financial institutions address the opacity problem of a firm by focusing on a subset of the firm's assets which are contributed as collateral as the primary source of repayment. Under this technology, funding institutions (in particular commercial banks) utilise short-term assets such as accounts receivable and inventory for working capital financing. They in turn use equipment for long-term financing. The fact that asset-based lending requires funding applicants to pledge their collateral does not differentiate it from other lending technologies. This is because collateral in the form of accounts receivable, inventory and/or equipment feature in financial statement lending, relationship lending as well as credit scoring. In all these lending technologies, collateral serves as a secondary source of payment.

With asset-based lending, the amount of credit issued is linked on a formula basis using hard data to a dynamically-managed estimation of the liquidation value of the assets used as collateral. Therefore, asset-based technology lending is a transactions-based technology grounded on hard information about the value of the underlying collateral (Berger and Udell, 2006). SMMEs in South Africa are characterised by information asymmetry and lack of collateral. Therefore, asset-based lending is inappropriate for this group of businesses.

3.7.1.4 Factoring

Factoring refers to the purchase of accounts receivable by the funding institution/lender. The funding institution or lender is known as the factor. Similar to asset-based lending, underwriting for factoring centres on the value of an underlying asset than the total value/risk of a business (Berger and Udell, 2006). However, it is different from asset-based lending in three respects. Firstly, factoring only encompasses the financing of accounts receivable and not inventory and equipment. Secondly, with factoring, the underlying asset (accounts receivable) is sold to the funding institution/lender. This implies that the ownership of the asset is transferred from the borrower to the lender. Thirdly, factoring is fundamentally a package of three financial services namely; a financing component, a credit component as well as the collections component (Berger and Udell, 2006).

Berger and Udell (2006) noted that under most factoring transactions; the borrower outsources its credit and collections activities in addition to obtaining financing. Like the previously discussed lending technologies, factoring is a transactions technology using underwriting based on hard data. The hard data about accounts receivable is found in the firm's financial statements. In informationally opaque firms, this data is not available and the transaction between the lender and the borrower cannot occur. This result in the firm being credit rationed due to lack of the required information.

3.7.1.5 Relationship lending

Relationship lending is a lending technology where the financial institution depends predominantly on soft information collected through contact over time with the SMME, its owner and the local community to address the opacity problem (Rajan, 1992). This information is acquired in large parts by the loan officer through direct contact with the borrower and through observing the SMME's performance on all dimensions of its banking relationship (Degryse and van Cayseele, 2000). The collection of the above-mentioned information goes beyond that which can be obtained from the firm's financial statements as well as information readily available to the public. This soft information may also include an assessment of the future prospects of the SMME collected from past communications with SMME suppliers, customers or neighbouring businesses (Berger and Udell, 2006).

Lending to SMMEs tends to be relationship based. This decision is influenced by the structural nature of SMMEs. Firstly, SMMEs borrowing is often in small amounts and is therefore more expensive per unit of lending due to fixed costs of lending. Secondly, the distinction between the manager and owner in the majority of SMMEs is very unclear. Generally, the labour intensive nature of relationship lending makes it costly. These costs may be passed on to the borrower in the form of higher fees and/or higher interest rate.

3.7.2 The 5C's of credit

The 5C's of credit are five elements (capacity, capital, collateral, conditions and character) used by funding institutions to conduct a borrower's credit analysis (Golam *et al*, 2010). Capacity represents the firm's ability to repay issued debt. Lending institutions review the historical and projected financial performance to evaluate whether or not the firm can repay the requested debt (Golam *et al*, 2010). During the evaluation process, business plans are reviewed. The strength of the borrower's financial statements (e.g. audited financial statements) are also analysed to determine among others, the expected future cash flows of the firm as these serve as the primary source of repayment (Brown and Moles, 2014). In addition, variables such as the business plan, average annual turnover, tax clearance and VAT registration certificate, among others are also taken into account. According to literature, SMMEs are informationally opaque, lack financial statements and have low average annual turnovers to determine their capacity to repay loans. This results in them being credit-rationed by funding institutions in particular commercial banks.

Capital represents the equity invested in the firm by its owners. It provides a cushion for a firm to rely on during periods when cash flow is tight. Lending institutions want to ensure that the owners have sufficient personal investment to remain committed to the business should unfavourable circumstances arise (Brown and Moles, 2014). Lenders normally want a minimum of 30% owners' contribution from the borrower to be eligible for funding. Empirical studies conducted worldwide on SMME access to finance corroborated on the fact that SMMEs lack owners' contribution.

Collateral refers to the security for the loan as a secondary source of repayment (Golam *et al*, 2010). Generally, collateral is composed of the firm's assets acquired with the requested loan. The problem is that many SMMEs often do not own assets that can be used as collateral. Conditions refer to the macroeconomic environment within which the firm operates. In particular, the lending decision is affected by the macroeconomic environment for the business, the nature of the industry including trends in the global economy.

The character of the entrepreneur or applicant is determined by the educational background and relevant business experience of the owner/manager of a firm (Golam *et al*, 2010). The education background, credit history, work and industry experience of borrower are considered. Moreover, the quality of the borrower's references and the background experience of firm employees are also reviewed. Generally, SMMEs have a bad credit history and this militates against them accessing credit from lenders.

3.8 Summary

It is evident that while the importance and significant contribution of the SMMEs is acknowledged in both developed and developing economies, there is no common and uniform definition of an SMME. Countries use different terminology to address the category of businesses that do not form part of the large enterprises. The definition of an SMME is a subject of debate not only internationally but in South Africa as well. Researchers, despite the fact that there is an official definition of an SMME in South Africa, have defined this sector in a number of different ways. However, it is important to note that the issue of SME definitions comes down to eligibility for special support. The importance of having a universal definition of an SME is pivotal in that SME policy must provide assistance to enterprises that need them most and are able to use the assistance in order to help them grow further under adverse conditions.

The subject of SMME access to credit has since decades been of particular interest to development finance economists, academics and researchers in general. However, though there is no one size fits all definition of the above-mentioned subject, there is a common agreement among researchers that SMME access to credit is pivotal in the growth and development of SMMEs in both the developing and developed countries. SMME access to credit is underpinned by the credit rationing theoretical framework which is determined by information asymmetry, fixed transaction costs, the risk profile of a firm, lack of collateral and firm and entrepreneurship characteristics. The chapter has discussed the various internal firm and entrepreneurial factors influencing credit rationing by lending institutions. There appears to be no consensus among researchers as to which of the above-mentioned factors have an influence on credit rationing by lending institutions.

The chapter reviewed and discussed the five major capital structure theories of the firm which include the Modigliani and Miller theory, the Trade-off theory, the Agency theory, the Perking Order theory and the Market Timing theory. The capital structure theory determines what the source of money supply is and what strategy should be adopted to acquire the above-mentioned source for purchasing the firm's assets or investing in projects. However, it is acknowledged that choosing between debt and equity is a huge challenge. The chapter also discussed the two sources of external finance available to SMMEs namely equity and debt. The review has revealed that equity in the form of venture capital and business angels/informal investors is not available to SMMEs. Given this situation, SMMEs opt for debt financing from commercial banks and development finance institutions. However, evidence has proven that due to information asymmetry, high administrative costs of small-scale lending, lack of collateral, firm and entrepreneurship characteristics, access to debt finance from commercial banks is very limited for SMMEs.

Lastly, the chapter reviewed the criteria used by lending finance institutions to evaluate SMME loan applications. The review revealed that the evaluation criteria of SMME loan applications vary from institution to institution. However, collateral was found to be a common element in all the factors considered by funding institutions in lending to SMMEs. The review also found that there is a lack of literature on the criteria used by development finance institutions to evaluate SMME loan applications as well as the differences between the criteria used by banks and DFIs, a gap that this study seeks to fill.

Generally, the chapter has revealed that despite all the efforts by DFIs and the private sector in the form of commercial banks, access to credit by SMMEs is still a hurdle. The following chapter discusses the research methodology followed in carrying out the study.

CHAPTER 4: RESEARCH METHODOLOGY

4.1 Introduction

A methodology provides the user with a framework for selecting the means to analyse, order and exchange information about an issue (Hofstee, 2006). It defines what can be known or exchanged, how that should be presented and by and for whom this is done.

This chapter is composed of three sections namely the research paradigm, the research design and the summary. The research paradigm outlines the major four research paradigms identified by literature as well as their ontology, epistemology and methodology. The section also points out the type of paradigm underpinning the study. The research design outlines the identification of the research population, the sampling, the research instrument used in data collection, the pre-testing of the questionnaire, data capturing and analysis. The section also outlines the validity and reliability of the data and ethical considerations of the study. The last section provides a summary of the entire chapter.

4.2 Research paradigm

The term paradigm originates from the Greek word "*paradeigma*" which means pattern. According to literature, this word means a conceptual framework commonly shared by researchers and scientists worldwide. The framework is a model used by the above researchers and scientists to examine problems and finding solutions (Antwi and Hamza, 2015). Paradigm, according to Guba and Lincoln (1994), refers to "a research culture composed of a set of beliefs, values and assumptions that a community of researchers has in common pertaining to the nature and conduct of research". On the other hand, Fossey *et al* (2002) defined paradigm as a system of ideas or world view used by a community of researchers to generate knowledge. According to Lincoln (1994), a research paradigm is composed of three components namely ontology, epistemology and methodology.

The term "ontology" is derived from two Greek words *onto* (meaning "being") and *logia* (meaning scientific study or discipline). According to Scotland (2012), ontology refers to a philosophical discipline related to the expression of the nature and structure of the world. It outlines the nature and form of reality and what can be known about it (Guba and Lincoln, 1994). Bhattacherjee (2012) defined ontology as referring to our assumptions about how we see the world. The three concepts provide a framework that serves as a blueprint for the entire research process (Antwi and Hamza, 2015).

Guba and Lincoln (1994) define epistemology as the nature of the relationship between the researcher and what can be known. It is concerned with the nature and forms of knowledge. Scotland (2012) pointed out that epistemological assumptions are concerned with how knowledge can be generated, obtained and communicated. Methodology is a research strategy that translates ontological and epistemological principles into guidelines that show how research is to be conducted (Bhattacherjee, 2012). Based on Guba and Lincoln (1994), methodology asks the question "how can the researcher find out what he/she believes can be known.

There are four popular paradigms used by researchers and these are positivism, post positivism, critical reality and constructivism paradigms. The positivist paradigm is founded on the ideas of the French philosopher August Comte. The paradigm is based on the idea that science or knowledge should be restricted to what can be observed or measured. Positivists by and large rely purely on theories that can be directly tested. They maintain that reality is objectively given and is measurable using methods that are objective, quantifiable and independent of the researcher (Antwi and Hamza, 2015). Positivists are based on realism ontology which is premised on the idea that reality exists independently of the researcher (Pring, 2000). Positivism is based on objectivist epistemology which is grounded on the idea of the researcher and the object researched are assumed to be independent and the researcher to be capable of studying the object without influencing it or being influenced by the object (Guba and Lincoln, 1994). The positivist research paradigm is underpinned by quantitative, experimental and manipulative methodology (Antwi and Hamza, 2015). In a quantitative methodology, questions or hypothesis are stated in propositional form and subjected to empirical test to verify them. Confounding propositions must be carefully manipulated to prevent outcomes from improperly influenced (Guba and Lincoln, 1994).

The post-positivism paradigm, which emerged from the positivism paradigm during the 20th century, has more or less similar ontological, epistemological and methodological beliefs as those of positivism. The difference is that post-positivism is principled on critical realism ontology. With critical realism, reality is assumed to exist but to be only imperfectly apprehendable because of basically flawed human intellectual mechanism and the fundamentally intractable nature of phenomena (Guba and Lincoln, 1994). Scotland (2012) assert that post-positivism claims that post-positivistic knowledge is more certain and objective than knowledge which originated from other paradigms.

The critical theory paradigm, upon which this study is based, is founded on the belief that reality is composed of researchers' subjective view of the external world and as such reality is socially constructed (Bhattacherjee, 2012). The paradigm is underpinned by the historic realism ontology which states that reality is assumed to be apprehendable. The reality was once plastic and was overtime shaped by a congeries of social, political, cultural, economic, ethnic and gender factors (Guba and Lincoln, 1994). The critical theory paradigm is underpinned by the transactional and subjectivist epistemology which states that the researcher and the object researched are assumed to be interactively linked with the values of the researcher inevitably influencing the inquiry (Scotland, 2012). The methodology adopted by the critical theory paradigm is dialogic and dialectical (qualitative) in the sense that the nature of inquiry requires a dialogue between the researcher and the subjects of the enquiry (Antwi and Hamza, 2015). Guba and Lincoln pointed out that the dialogue between the researcher and the subjects of the inquiry must be dialectical in nature to transform ignorance and misapprehensions into more informed consciousness.

The constructivism paradigm is based on relativist ontology. Relativist ontology is founded on the belief that realities are apprehendable in the form of multiple, intangible mental constructions, socially and experientially based, local and specific in nature (Guba and Lincoln, 1994). Realities are dependant for their form and content on individuals or groups holding the constructions. Scotland (2012) points out that reality is constructed through the interaction between language and aspects of an independent world. Constructivism, like the critical theory paradigm, is premised on transactional and subjectivist epistemology and the methodology is hermeneutical and dialectical. The methodology is directed at understanding phenomenon from an individual perspective. This involves investigating interaction among individuals as well as the historical and cultural contexts which people inhabit (Creswell, 2009).

4.3 Research design

A survey of a selected sample from a population of SMMEs within the Eastern Cape Province was conducted. According to Battacherjee (2012), a survey is a research method involving the use of standardized questionnaires or interviews to collect data about people and their preferences, thoughts and behaviours in a systematic manner. A survey study is the ideal method obtainable to the social researcher keen in collecting original information for outlining, examining and describing a population too large to perceive instantly (Babbie, 2008). Bhattacherjee (2012) points out that, in a survey research, all respondents are given questions worded the same and demonstrated in the self-same order. The response alternatives (scales) are the same too. Moreover, interviewers read the questions to respondents and file their responses fast and without any difficulty. In some instances, the respondents complete the questionnaires on their own.

In a survey research, it is feasible to ask apt questions about people's intentions, situations, a set of events and mental considerations (Mathiyazhagan and Nandan, 2010). Big sample sizes and computer processing permit fast scores, cross tabulations and other statistical analyses. Respondents can be grouped into components or subgroups for differentiation in the search for meaningful differences.

4.3.1 Secondary data analysis

The research methodology employed in this research involved an extensive review and analysis of relevant theoretical and empirical literature on various aspects related to SMME access to credit**.**

Firstly, an extensive literature review regarding the background to the Eastern Cape Province was conducted. Pertaining to this subject, a number of studies such as the Eastern Cape Socio-Economic Review and Outlook (2014), Statistics South Africa (2014), FinMark Trust (2010), Fatoki (2014) and many more were drawn upon. Literature on the overview of the economic profile of South Africa was also reviewed. This included, but not limited to, the World Bank (2015), the Global Entrepreneurship Monitor (2015) and Statistics SA (2014). In addition, a review of a number of studies on the international and local contribution of SMMEs to economic development was undertaken. In this regard, studies by Kongolo (2010), Kayanula and Quartey (2000), Herrington *et al* (2010), USAID (2010), Abor and Quartey (2010) Olawale and Garwe (2010), Fatoki (2014), Pandula (2011) amongst others were drawn upon. Also, the review of some empirical experiences on challenges facing SMMEs in South Africa was conducted. This exercise involved the review of a number of studies by Oyelana and Fiseha (2014), Rogerson (2008) and Musara and Gwaindepi (2014).

A review of the South African government's legislative framework on the promotion of SMMEs and the creation of an enabling and conducive environment for SMME access to finance was done. Some of the legislation reviewed includes the Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprise (2008), the National Small Business Act 102 of 1996, the Broad Based Black Economic Empowerment Act 53 of 2003, Accelerated Shared Growth Initiative of South Africa (AsgiSA) (2006), the New Growth Path Framework of 2010 and the recent National Development Plan of 2012.

A comprehensive literature on the credit rationing theory underpinning the study was undertaken. This exercise involved the reviewal of studies by Stiglitz and Weiss (1981), OECD (2006), Maziku (2012), Beck (2007), Okurut *et al* (2010), Ramlee and Berma (2013) to mention but a few. Moreover, theoretical literature on capital structure theories by Modigliani and Miller (1958), Myers (1984), Jensen and Meckling (1976), Berger and Udell (1998), Baker and Wurgler (2002) and Cekrezi (2013) was reviewed.

In designing the part of the questionnaire that dealt with the firm and entrepreneurship characteristics as well as the finance institutions lending criteria, literature by Mahadea and Pillay (2008), Olawale and Garwe (2010), Ganbold (2008), the USAID (2008), Bbenkele (2007), Herrington *et al* (2010), FinMark Trust (2010) Pandula (2011), Berger and Udell (2006) and Arthur (2009) to mention but a few was drawn upon.

4.3.2 Research population

The population for a research is that category (usually people) about whom conclusions are made (Babbie, 2008). Babbie further states that, because of cost and time, we are practically never able to research all the members of the population that fascinate us and neither can we make every possible observation of them. As a result, information will more often be collected in terms of sample which is chosen to represent the population. The choice of the population to be sampled is greatly affected by the accessible database.

The target population (sampling frame) for the study was small, micro and medium enterprises (SMMEs) from the eight metropolitan and district municipalities (Nelson Mandela, Buffalo City, Joe Gqabi, Chris Hani, OR Tambo, Cacadu, Alfred Nzo and Amathole) constituting the Eastern Cape. A database of SMMEs from each of the above-mentioned metropolitan and district municipalities composed of companies, close corporations, sole proprietors, partnerships and cooperatives was obtained from the respective municipalities' Local Economic Development office.

The metropolitan and district municipalities, as part of their legislative mandate of growing, supporting and developing SMMEs within their areas of jurisdiction, developed the above-mentioned database so as to understand the profile of SMMEs trading within their areas for effective and efficient service delivery. The database was categorized into legal form, physical address, business registration number, contact person, contact number and the sector. The following sectors namely: manufacturing, construction, services, agriculture, forestry and fishing, mining and quarrying and wholesale and retail. These are businesses whose annual turnover ranges from R0 to R5 million and employ not more than 200 people. They also range from start-up to relatively well established businesses. The category also included those businesses making losses. The above-mentioned sectors are the main economic sectors driving the economy of the Eastern Cape (Eastern Cape Development Indicators, 2012).

The second population of the study was all DFIs operating from the province. A list of these institutions was obtained from the provincial Department of Economic Development Environmental Affairs and Tourism. The third population was all the major five commercial banks having offices in the province.

4.3.3 The sample size

A sample is a subgroup of a population chosen to partake in the research; it is a fragment of the entire, chosen to be involved in the study project (Lenth, 2001). A sample of 80 SMMEs (10 SMMEs from each metro/district municipality) from the manufacturing, construction, services, agriculture, automotive, mining, security, merchandising and retail sectors was, through proportional stratified sampling, selected from the population of all the SMMEs from the metropolitan and district municipalities' Supply Chain Management database. Fox *et al* (2009) define stratified sampling as a way of making sure that particular class or groups of people are represented in the sampling exercise.

Each stratum/sector was relatively represented in correspondence to its size in the population from which the sample was taken. Keller (2005) argues that a proportionate stratified sampling is more systematic than drawing a simple random sample because it ensures appropriate representation of elements across classes. Also, this method completely removes any prospect of sampling error in the sample's distribution of ethnicity (Yount, 2006). Every SMME in the fourth position had a chance to be selected as part of the sample.

All the eight DFIs and all five major commercial banks operating in the Eastern Cape Province were interviewed.

4.3.4 The research instrument

The credit rationing theoretical framework identified information asymmetry, fixed transaction costs, the risk profile of the firm, lack of collateral and the firm and entrepreneurial characteristics as key determinants of credit rationing by finance institutions. The design of the research instrument (questionnaire), therefore, was underpinned by the credit rationing theoretical framework as well as the 5C's of credit (capacity, capital, condition, collateral and character). A questionnaire is a research instrument composed of a set of questions aimed at intended to capture responses from respondents in a standardized manner (Bhattacherjee, 2012). The questionnaire was aimed at eliciting information that would respond to the study questions in the context of the credit rationing theoretical framework. Variables on each of the above-mentioned determinants featured prominently in the questionnaire as discussed in the section below.

Table 4.1 List of actual variables collected

Variables predicted by the theoretical framework	**Variables collected through the study**
Information asymmetry,	<u>Firm Characteristics</u>
Fixed transaction costs,	Form of legal entity
The risk profile of a firm,	Age of firm
Lack of collateral	Industry sector
Firm characteristics	Services offered
Entrepreneurship characteristics	Size of firm
Lending criteria	Networking
	Business Plan
	Vat registration
	BBBEE Status
	Business information
	<u>Entrepreneurial characteristics</u>

	Gender status Age of entrepreneur Education level Skills to run a business <u>Funding applied for</u> Start-up capital Nature of finance applied for The loan application process Challenges encountered during the application process Constraints to accessing credit

Three types of structured open and closed-ended questionnaires (one for collecting data from SMMEs and the remaining two from DFIs and commercial banks were prepared. Babbie (2008) describes closed-ended questions as survey questions in which the respondent is asked to select an answer from among a list provided by the researcher. These are popular in survey research because they provide a greater uniformity of responses and are more easily processed than open-ended questions. Open-ended questions, on the other hand, are questions for which the respondent is asked to provide his or her own answers and in-depth, qualitative interviewing relies almost exclusively on open-ended questions. The three questionnaires are discussed in the sections below.

4.3.4.1 The SMME questionnaire

A structured open and closed-ended questionnaire instrument (Annex A) consisting of 52 questions was used to collect data from respondents. Data collected through the questionnaire responded to the first research question on dynamic interaction between the demand and supply factors that affect SMME access to credit in the Eastern Cape. The questionnaire entailed firm and entrepreneurship questions aimed at eliciting information on SMME access to credit in general. The questionnaire consisted of three sections.

The first section of the questionnaire, which consisted of 23 open and closed-ended questions, was aimed at collecting information on firm characteristics such as the firm's incorporation (legal form), business premises where the firm operated, firm size (measured by number of employees and annual turnover) and age (measured by the number of years the firm has been in operation), firm's economic sector, firm's business network/association membership, firm information (e.g. audited financial statements, business plan, VAT and tax clearance registration and BBBEE status) and collateral. The rationale behind the section was to get an understanding of the firm characteristics impacting on SMME access to credit.

The second section of the questionnaire, composed of 10 questions, was geared towards collecting data pertaining to the entrepreneur (firm owner/manager) characteristics and these included the owner/manager's age and gender status, education background, employment status before starting the business, whether the owner/manager(s) attended training related to the business as well as details on the person responsible for the day-to-day running of the business. The purpose of this section was to establish the impact of the above-mentioned variables on SMME access to credit.

The third section of the questionnaire, composed of 18 questions, was in relation to credit applied for by the firm. The section had questions pertaining to the source of start-up credit, whether a firm ever applied for funding or not, reasons for not applying for credit if firm never applied for credit, funding institutions where credit was applied for, nature of credit applied for, problems encountered in making credit application, whether credit application was successful or not, attributes of credit application success, problems in meeting payments and reasons for credit application rejection. The section was geared towards ascertaining from the SMME perspective, the funding institutions' lending criteria and the challenges they faced in applying for credit from the said institutions.

4.3.4.2 The DFIs and commercial banks questionnaire

Two sets of questionnaires were developed for the DFIs and the commercial banks. The first set of the DFIs and commercial banks questionnaire (Annex B), composed of 32 open and closed-ended questions, was aimed at eliciting information on the funding institutions' lending criteria. The questionnaire entailed questions related to the entrepreneurial and firm characteristics of the SMMEs in relation to the funding institutions' lending criteria. Information gathered through this questionnaire responded to the first research question on the dynamic interaction between the supply and demand factors impacting on SMME access to credit in the Eastern Cape. The information was also used in the development of a framework to be used by funding institutions when evaluating SMME credit applications.

The questionnaire was composed of three sections. The first section was aimed at collecting information on the criteria used by DFIs and commercial banks. The section captured information pertaining to capacity (business plan, VAT registration, tax clearance, audited financial statements, average annual turnover and BBBEE status), capital (cash flow statement and owners contribution), condition (form of business, industry sector, member of business association and business location) and collateral which form part of the 5C's of credit. The second section collected information pertaining to the last C of credit which is character. Variables under character were the age of owner/manager, education level, experience, the age of business and the gender of the owner/manager.

The last section of the questionnaire was geared towards collecting data relating to credit applied for by SMMEs. The section collected information on the reasons why SMMEs fail to obtain credit from funding institutions as well as the criteria SMMEs had to satisfy in order to be successful in their credit applications.

The comparative evaluation of lending criteria used by DFIs and commercial banks in providing credit to SMMEs in the study was done in two phases. The first phase involved the use of two identical questionnaires (Annex C). The first questionnaire was prepared for the eight DFIs operating in the Eastern Cape Province whilst the second was prepared for the five major commercial banks also operating in the province. Both questionnaires had 18 questions each. The reviewed literature on SMME access to credit in South Africa identified among others eighteen key criteria used by both the DFIs and commercial banks to assess SMME credit applications. The 18 questions, classified according to the 5Cs of credit (capacity, capital, collateral, condition and character) were prepared in line with the above criteria. The questionnaires were based on a four-point likert scale which ranged from 1 (not important) to

4 (very important). Respondents from both groups of funding institutions were asked to indicate the importance of each of the 18 lending criterion in their assessment of SMME funding applications based on the above-mentioned likert scale.

The second phase encompassed the review of the lending documents and protocols of the two groups of funding institutions based on the same 18 lending criteria mentioned above. The document review was also based on the four-point likert scale which also ranged from 1 (not important) and 4 (very important).

4.3.5 Piloting of the questionnaire

Pilot testing is an extremely important part of the research process. It helps detect potential problems in the research design and/or instrumentation as well as ensuring that the measurement instruments used in the study are reliable and valid measures of the constructs of interest (Battacherjee, 2012). Both the SMME and funding institutions' questionnaires were piloted by the interviewer on twenty four (24) SMMEs, one commercial bank and one DFI. Three SMMEs from each of the eight sectors (manufacturing, construction, services, agriculture, mining, security, merchandising and retail) were randomly selected to participate in the pilot study. This was aimed at ensuring that the outcomes of the pilot research were representative of all sectors. The purpose of the pilot was to ensure that:

- Each question assesses what it is supposed to assess
- All the words are comprehended
- All respondents interpret the question in the same way
- All response choices are appropriate
- The range of response choices actually used
- Respondents correctly follow directions
- The questionnaire creates a positive impression that motivates people to respond
- The questions flow in a conversational manner
- The questionnaire collects the required information

The pilot for both questionnaires conducted in January 2015, was also aimed at determining the time required by the respondent to complete the questionnaires. The SMME questionnaire took a minimum of 20 and a maximum of 30 minutes to complete. This time also allowed for an opportunity to discuss the open-ended questions and ask probing questions. The interview exercise resulted in the addition of some variables to the SMME questionnaire and the rephrasing of some questions. For example, question 2 on whether the firm was operating on rented or owned premises presupposed that these were the only two options firm owners/managers were to choose from. However, it became apparent that some firms operated their businesses from home. This option was then added to the question. In addition, question 20 on whether the firm was registered for VAT revealed that some firms were not registered for VAT but for tax clearance. This revelation led to the incorporation of the tax clearance question to the questionnaire.

The DFIs and commercial banks questionnaire took a minimum of 15 and a maximum of 20 minutes to complete. The interview also brought about some additions to the questionnaire. The missing tax clearance question mentioned above was also incorporated into the DFIs and commercial banks questionnaire. Also, a "not applicable" option was added to some of the questions which were irrelevant for some funding institutions. For example, the question on whether is it necessary for the applicant to hold an account with the funding institution to be eligible for credit was only relevant to commercial banks not to DFIs.

4.3.6 Data analysis

Primary data obtained from SMME owner/managers, DFIs and commercial banks was cleaned, edited and coded. The coded data was entered into a SPSS statistical programme. Content analysis was used to analyse demand and supply factors impacting on SMME access to credit as well as the criteria used by funding institutions to lend to SMMEs in the Eastern Cape. This analysis responded to the first research question of the study which was aimed at investigating the dynamic interaction between the supply and demand factors affecting SMME access to credit in the Eastern Cape.

The likert-scale responses obtained from the likert-scale questionnaires as well as the document reviews were transformed into the Relative Importance Index (RII). This exercise was done in order to determine the importance of each of the 18 lending criterion identified.

The RII is a powerful technique used to calculate the relative importance of predictors (independent variables) when independent variables are correlated to each other (Megha and Rajiv, 2013). It is an alternative to the multiple regression technique and it addresses the multicollinearity problem in research. It also helps to calculate the importance rank of variables. The RII was invented by Hoffman (1960) in the early 1960's. Over the years, the method gained its popularity and has been used by a number of prominent researchers to analyse likert-scale data. For example, Megha and Rajiv (2013) used it to determine the causes and effects of delays for residential construction projects in India. Muhwezi *et al* (2014) on the other hand used it to assess the factors causing delays on building construction projects in Uganda while Somiah *et al* (2015) employed it to analyse factors influencing unauthorised sitting of residential buildings in Ghana. Recently, the method has been used by Aziz *et al* (2016) in ranking the procrastination factors among university students in Malaysia.

The RII for each of the lending criterion was calculated using the following formula:

$$\mathbf{RII} = \frac{\boldsymbol{\Sigma\, W}}{\mathbf{A * N}}$$

Where:

W = the weighting given to each criterion by the respondents and ranges from 1 to 4 (where 1 = not important, 2 = somewhat important, 3 = important and 4 = very important),

A = is the highest weight (i.e. 4 in this case) and

N = is the total number of respondents (i.e. in this case 8 for DFIs and 5 for commercial banks).

The higher the value of RII, the more important is the lending criterion

The above-mentioned analytical exercise gave rise to the proposed framework by which DFIs and commercial banks could assess SMME credit applications. The framework responded to the third research question of the study.

4.3.7 Validity and reliability

Validity and reliability are two factors which any qualitative researcher should be worried about while putting together a study, analysing the outcomes and determining the standard of the research (Patton, 2002; Zorhabi, 2013). According to Bashir *et al* (2008), validity ascertains whether the study really measures that which it was aimed to measure or how authentic the study results are. On the other hand, reliability is the degree to which results are constant over time and a precise representation of the total population under study (Battacherjee, 2012; Zorhabi, 2013).

For the study, reliability and validity was ensured through pre-testing the research instrument in a pilot study, using the stratified random sampling method and distilling the sampling and data collection techniques throughout the data collection exercise. The researcher also spent enough time in the field. The study also employed multiple data collection strategies to corroborate the findings. For example, the researcher obtained some funding institutions' lending criteria from their respective offices as well as from their websites for triangulation purposes. In order to strengthen the validity of evaluation data and findings, collection of data was done through questionnaires, interviews and observations (Battacherjee, 2012).

Multiple methods such as observation, interviews and recordings were engaged upon. In addition, the study made use of a team of experienced and trained researchers. Lastly, the results and interpretations of interviews will be handed over to the interviewees in order to confirm the content of what they have stated during the interview encounter. In this way, the plausibility and truthfulness of the information was recognised and supported.

Subsequent to the piloting of the questionnaire, face-to-face and telephone interviews were conducted to the 80 sampled SMME owners/managers, the 8 DFIs and 5 commercial banks business advisors and/or loan consultants. The interviews were conducted by a team of 8 experienced researchers who were on many occasions engaged by government on similar research. Each researcher was responsible for each metropolitan/district municipal area. Before they undertook the survey, the team was trained to:

- Obtain informed consent from respondents before interview
- Stay neutral throughout the interview
- Know the study thoroughly
- Read each question verbatim and in order
- Record responses accurately
- Deal with inconsistencies politely
- Be courteous and professional at all times
- Probe for answers
- Maintain confidentiality

The administration of all questionnaires took place between February and June 2015.

4.3.8 Ethical considerations

Bhattacherjee (2012) states that any researcher engaged in social scientific research must be conscious of the general agreements shared by researchers about what is perfect and imperfect in the conduct of scientific investigation. Taking this into account, the sampled SMMEs and financial institutions business advisors and/or loan officers were interviewed on a voluntary basis. The study required that interviewees reveal personal information about themselves and their businesses – information that may be classified to their peers and compatriots. Given this situation, anonymity and confidentiality was maintained throughout the research exercise. Also, an opt-out clause was included in all questionnaires in case any respondent wanted to voluntarily opt out of the interview at any time.

Lastly, the respondents were given consent forms (Annex D and E) to sign. The form stated that the respondent's participation in the research was voluntary; that his/her personal details would remain anonymous throughout the research study as well as in the research dissertation and that he/she could refuse to answer any questions which he/she felt uncomfortable with. The respondents were also given participant information sheets (Annex F and G) that explained the purpose of the research and requested the respondent's participation in the research.

4.4 Summary

The chapter discussed the research paradigm underpinning the study. The study is based on the critical theory paradigm, historical realism ontology, transactional/subjective epistemology and dialogic and dialectical (qualitative) methodology. The chapter also outlined the research design used to carry out the study which spelt out the secondary data analysis, the research population, sample size, research instrument, the pre-testing of the questionnaire, the analysis of data, the validity and reliability as well as ethical considerations. The next chapter presents the results of the study.

CHAPTER 5: PRESENTATION OF RESULTS

5.1 Introduction

The chapter composed of three sections, presents the descriptive statistics results of the data analysis conducted in the previous chapter. The first section of the chapter outlines the firm and entrepreneurship characteristics results such as the gender, age, education levels as well as the managerial experience of the business owner/managers, the number of employees of the businesses, their annual turnover, the industry sector, ownership/legal status, types of premises businesses were operating from and how these were financed, the age of business, audited financial statements, VAT registration, Tax clearance registration, business plan status, the owners contribution status, network membership as well as the firms BBBEE status. The second section presents results on details pertaining to credit applied for. The last section provides the summary of the chapter.

5.2 Firm and entrepreneurship characteristics

5.2.1 Gender of the business owner/manager

The gender of a business owner/manager is one of the important variables influencing SMME access to credit. South African SMMEs tend to be run by men. The sample shows that 65% of all businesses are either owned by or where there are multiple owners are run by men and 35% by women. The findings confirm those of Fatoki (2014) who also found that most businesses are run and operated by men. The gender of business owner/manager and credit application success is presented in Table 5.1 below.

Table 5.1 Gender of business owner/manager and credit application success

Gender of business owner	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
Male	17	58.6	14	66.7
Female	12	41.4	7	33.3
Total	**29**	**100**	**21**	**100**

An overwhelming majority (91.7%) of funding institutions indicated that gender is not an important factor in their lending decisions. This is confirmed by the firm results reflected in Table 5.1 above which indicate that of the 29 business owners whose SMME applications were successful in obtaining credit, 58.6% were males and 41.4% females. The findings are consistent with those of studies undertaken by Pandula (2011), Irwin and Scott (2010) and USAID (2010) which found that there is no correlation between gender of a business owner/manager and access to credit. It must be noted that the sample size takes into account only those 50 business owner/managers who applied for funding and not the remaining 30.

5.2.2 The age of the business owner/manager

A large proportion (63.7%) of the business owner/managers were between the ages of 36 to 60, followed by those between 18 to 36 years (21.3%) while only 15% were over the age of 60 years. The cross tabulation of the age of the business owner/manager and credit application success is presented in Table 5.2 below.

Table 5.2 Age of the business owner/manager and credit application success

Age of business owner/manager	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
18-36	4	13.8	6	28.6
36-60	21	72.4	13	61.9
>60	4	13.8	2	9.5
Total	**29**	**100**	**21**	**100**

The SMME survey, as shown in Table 5.2 above, indicates that the majority (72.4%) of credit applications approved by funding institutions were those of owner/managers between the ages of 36-60. Contrary to these findings, the majority (91.7%) of the funding institutions indicated that the age of a business owner/manager is not an important factor in their lending decisions. The results are in line with those of Pandula (2011), the USAID (2010) and Fatoki (2014) who also observed that funding institutions are less concerned about the age of the business owner when evaluating SMME funding applications.

5.2.3 Education levels of the business owner/manager

The level of education of a business owner/manager has an impact in the overall performance of a business. Education helps to enhance the exploratory skills and improves communication abilities and foresight (Pandula, 2011). It also helps owner/managers to present positive financial information and strong business plans to funding institutions (Olawale and Garwe, 2010).

The SMME survey results indicate that almost half (48.8%) of the owner/managers had tertiary education; 26.3% matric/Grade 12 while the remainder (16.3%) had some high school education, primary school (7.5%) and no schooling at all (1.3%). A cross tabulation of education levels of the business owner/manager and credit application success is presented in Table 5.3 below.

Table 5.3 Education levels of the business owner/manager and credit application success

Level of education of business owner/manager	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
Primary school	1	3.5	1	4.8
Some high school	3	10.3	5	23.8
Matric/Grade 12	7	24.1	5	23.8
Tertiary education	18	62.1	10	47.6
Total	**29**	**100**	**21**	**100**

The SMME survey results reflected in Table 5.3 bove reveals that 62.1% of the applications approved for credit were those of business owners/managers with tertiary education. However, the funding institutions survey results indicate that a large percentage (97.1%) of funding institutions was less concerned about the education levels of their credit applicants. The results are in line with those of Pandula (2011) and USAID (2010) who found that there is no correlation between education levels and SMME access to credit.

5.2.4 Employment status and the age of business

Relevant industry experience and expertise are pivotal in the viability and profitability of a firm. The SMME survey shows that 48 (60%) of the owner/managers were employed before starting their businesses while the rest (40%) were not. The SMME survey data indicates that a large percentage (79.3%) of credit applications approved by funding institutions were those of owners/managers who were employed before starting their businesses.

The funding institutions survey, on the other hand, indicates that 58.3% of funding institutions require SMME owners/managers to have relevant industry experience to qualify for funding. The findings from both the SMME and the funding institutions surveys point to the fact that relevant industry experience is a critical factor in obtaining credit from funding institutions. This can be attributed to the fact that owner/managers with previous relevant work experience are more likely to avoid costly mistakes than those with prior experience. The findings confirm those of Fatoki and Asah (2011) who also found that there is a positive correlation between SMME owner/manager experience and access to credit.

Table 5.4 Employment status of business owners/managers and credit application success

Employment status before starting business	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
Employed	23	79.3	4	19.0

Not employed	6	20.7	17	81.0
Total	**29**	**100**	**21**	**100**

The age of a business has an influence on SMME access to credit. The businesses in the sample have generally been in existence for more than 3 years. Over 90% of the businesses have been in existence for at least 3 years while just over 60% have been in existence for more than 5 years. The funding institutions survey results show that 83.3% of funding institutions indicated that the age of the business is not critical in their lending decisions. The SMME survey results however indicates to the contrary with more than 90.0% of successful applicant businesses being at least 3 years old while 69% were at least 5 years old. This also emphasises that experience is a critical factor in obtaining credit from funding institutions. This is based on the fact that the longer a firm exists and the bigger it is, the more it signals that it can weather tough economic conditions. In addition, funding institutions perceive older and larger businesses as having overcome the challenge of information asymmetry which tends to be more severe in younger firms. The findings are contrary to those of Pandula (2011) who found that there was no correlation between the age of the business and SMME access to credit.

Table 5.5 Age of businesses and credit application success

Age of businesses	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
<1 year	1	3.45	0	0.00
1-2 years	1	3.45	2	9.52
3-5 years	7	24.14	9	42.86
5-10 years	10	34.48	7	33.33
>10 years	10	34.48	3	14.29
Total	**29**	**100**	**21**	**100**

5.2.5 Training related to business

Managerial competencies as measured by among others the training related to business attended by the SMME owner/manager has an impact in SMME access to credit. The SMME survey results indicate that 65% of the total number of respondents attended training related to their businesses while the remaining 35% did not attend any training related to their businesses. The table below shows that of the 29 business owners/managers whose credit applications were approved, 27 (93.1%) attended training related to their businesses while the remaining 2 (6.9%) did not.

The SMME survey findings reveal that experience as measured by training related to business undertaken by the SMME owner/manager is an important factor in obtaining credit from funding institutions. However, the funding institutions survey indicates that the training status is not an important factor in their funding institutions lending criteria. There appears to be a mismatch between this SMME characteristic and funding institutions criterion. This could be attributed to the limited understanding of SMME characteristics by funding institutions as well as the limited understanding of the funding institutions lending criteria by SMME credit applicants.

Table 5.6 Training related to business and credit application success

Training related to business status	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
Attended training	27	93.1	13	61.9
Never attended training	2	6.9	8	38.1
Total	**29**	**100**	**21**	**100**

5.2.6 Day-to-day running of the business

An overwhelming majority (97.5) of SMME owners/managers were responsible for the day-to-day running of their businesses while a very small percentage (2.5%) employed managers to run their businesses on their behalf as they were employed. The SMME survey results in the table below show that 96.6% of successful credit applications were those from owners/managers responsible for the day-to-day running of their businesses.

The funding institutions results also indicate that the majority (83.3%) of funding institutions require credit applicants to be responsible for the day-to-day running of their businesses to qualify for credit. The findings point out that being responsible for the day-to-day running of the business is a critical factor in obtaining credit from funding institutions. This implies that funding institutions want funding applicants to be accountable, responsible and have a sense of ownership for their day-to-day business operations. This also shows commitment and dedication which funding institutions put a premium to.

Table 5.7 Day-to-day running of the business and credit application success

Day-to-day running of business status	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
Responsible	28	96.6	20	95.2
Not responsible	1	3.4	1	4.8
Total	**29**	**100**	**21**	**100**

5.2.7 Number of employees

Firm size as measured by the number of employees a business employs has an impact on SMME access to credit. More than half (52.5%) of the SMMEs employed between 5-20 people followed by those which employed less than 5 people. This means that according to the National Small Business Act (102 of 1996) definition of an SMME according to the number of employees, the majority of SMMEs in the survey are very small. Very small SMMEs are defined as those between 10 to 20 employees depending on industry. These SMMEs operate in the formal market and have technology. Only one SMME employed between 51-200 people. According to the above-mentioned definition, this SMME falls under the medium enterprises. Medium enterprises are those which employ between 100 to 200 people depending on industry.

The funding institutions survey indicates that 83.3% of funding institutions stated that the number of employees a business has is not a critical factor in their lending criteria. Contrary to this finding, the SMME survey results, as shown in the table below, indicate that businesses which employed between 5-20 people were 65.5% successful in their credit applications. This can be attributed to the fact that funding institutions consider firms with a large number of employees as sustainable, viable and profitable and thus have the ability to pay back the loan if granted.

Table 5.8 Size of workforce and credit application success

Size of workforce	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
None (business run by owner)	1	3.5	1	4.8
<5	5	17.2	10	47.6
5-20	19	65.5	10	47.6
21-50	3	10.3	0	0.0
51-200	1	3.5	0	0.0
Total	**29**	**100**	**21**	**100**

5.2.8 Businesses average annual turnover

The turnover of a business is used to check the importance of capacity in lending decisions. The SMMEs were categorised according to the South African National Small Business Act 102 of 1996 definition of SMMEs. According to the above act, a total of 33 firms (41.3%) were very small enterprises. These SMMEs had an average turnover of between R150 001 and R500 000. Twenty four (30%) of the firms were small enterprises and had an annual turnover of between R5001 001 and R25 million. The remaining 12 (15%) were micro enterprises and had an annual turnover of less than R150 000. The table below presents the breakdown of the sample in accordance with the National Small Business Act 102 of 1996.

Table 5.9 Firms business annual turnover

Business average turnover	**No. of SMMEs**	**Percentage**
Micro enterprises (<R150 000)	23	28.7
Very small enterprises (R150 001 – R 500 000)	33	41.3
Small enterprises (R500 001 – R25m)	24	30.0
Total	**80**	**100**

The SMME survey indicates that for a firm to get credit, it has to have a minimum turnover of more than R150 000. The results in the table below show that about 90% of the firms whose credit applications were successful had an annual turnover of more than R150 000. This indicates that successful financing is greater amongst SMMEs with higher annual turnovers than their counterparts. The results are consistent with those of the USAID (2010) which found that funding institutions prioritise businesses with higher annual turnovers when considering credit applications. Contrary to the above findings, an overwhelming majority (83.3%) of funding institutions indicated that a business' annual turnover is not an important factor in their lending criteria. This implies that what funding institutions reflect in their criteria is not what they practice on the ground.

Table 5.10 Business average annual turnover and credit application success

Business average turnover	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
<R150 000	3	10.34	6	28.6
R150 001 – R 500 000	14	48.28	12	57.13
R500 001 – R25m	12	41.38	3	14.29
Total	**29**	**100**	**21**	**100**

5.2.9 Business legal form and industry sector

The manner in which a business is structured or its ownership type/legal form has an impact in a business' potential to access credit from funding institutions. More than half (53.8%) of the firms interviewed were close corporations followed by private companies (22.5%), cooperatives (15%) and sole proprietors (8.8%). The survey results, as shown in the table below, indicate that more than half (51.7%) of the businesses whose credit applications were successful were close corporations followed by cooperatives (34.5%). This indicates that firms with more than one owner have more potential to obtain credit from funding institutions than their counterparts. These firms are more likely to thrive in business because of their management structure.

However, contrary to the above findings, the majority (83.3%) of funding institutions indicated that the legal form of business is not an important factor in their lending criteria. The findings are contrary to those of Rogerson (2008) and Zairani and Zaimah (2013) who found some correlation between the industry sector and SMME access to credit. SMME owners/managers indicated that commercial banks were reluctant to fund cooperatives. This is supported by the fact that none of the cooperatives' successful applications were funded by commercial banks. Commercial banks view cooperatives as high risk and lack collateral and as such do not have potential to pay back the loan.

Table 5.11 Legal form of business and credit application success

Legal form of business	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
Sole proprietor	2	6.9	1	4.8
Close corporation	15	51.7	12	57.1
PTY (Ltd)	2	6.9	7	33.3
Cooperatives	10	34.5	1	4.8
Total	**29**	**100**	**21**	**100**

The type of industry a firm is trading under has a huge impact on the business's access to credit. Firms in the SMME survey were spread through all the nine sectors. However, a significant proportion (32.5%) of the firms fell under the services sector followed by the construction (21.3%), manufacturing (16.3%) and agricultural (12.5%) sectors. Only one (1.3%) of the firms traded under the mining sector. The SMME survey results, as shown in the table below, do not show any strong bias towards specific sectors. The services sector was the least successful where the odds of success are lower with a 57% failure rate. The financial institutions survey indicates that 75% of funding institutions favoured no economic sector. The results confirm those of Pandula (2011) which found that there is no significant correlation between the business economic sector and SMME access to credit.

Table 5.12 Economic sector and credit application success

Economic sector	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
Agriculture	6	20.7	1	4.8
Construction	8	27.6	3	14.3
Manufacturing	5	17.2	4	19.0
Mining	0	0.0	1	4.8
Wholesale	1	3.4	0	0.0

Services	7	24.1	9	42.9
Automotive	2	6.9	1	4.8
ICT	0	0.0	2	9.5
Total	**29**	**100**	**21**	**100**

5.2.10 Types of premises businesses were operating from

Premises businesses operate from are used as proxy for collateral by funding institutions. The survey results revealed that 42.5% of all businesses operated from rented premises followed by those which operated from home (38.8%) while the remainder (18.8%) operated from owned premises. A large majority of businesses which operated from owned premises were trading under the hospitality industry. The survey results in the table below indicate that 48.3% of credit applications approved by funding institutions were those from businesses operating from rented premises. The results surprisingly suggest that premises businesses were operating from were not an important factor in the funding institutions lending criteria.

Table 5.13 Types of premises businesses were operating from and credit application success

Types of premises businesses were operating from	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
Rented	14	48.3	8	38.1
Owned	8	27.6	2	9.5
Home	7	24.1	11	52.4
Total	**29**	**100**	21	100

Based on Table 5.13 above, there are 10 owner/managers whose businesses operated from owned premises. The business owner/managers were asked to indicate how these premises were financed. The majority (66.6%) of the owned premises were financed through mortgage loan while 20.0% were donated. A cross tabulation of the financing model of owned businesses and credit application success is presented in Table 5.14 below.

Table 5.14 Financing model of owned businesses and credit application success

Financing model of owned businesses	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
Grant funding	2	25.0	0	0.0
Premises donated	2	25.0	0	0.0
Mortgage loan	4	50.0	2	100.0
Total	**8**	**100**	**2**	**100**

The SMME survey results in Table 5.14 above indicate that of the 8 businesses that operated from owned premises and their funding applications were approved, 50% were those whose premises were financed through mortgage loan. This can be attributed to the fact that because the above businesses were financed by banks, funding institutions consider them as low risk with good credit history and thus have potential to pay back the loan. This therefore made them preferred clients by funding institutions. Secondly, their premises would serve as collateral in case of loan default or non-payment.

5.2.11 Business network membership

Networks are of much assistance to SMMEs in conquering challenges of access to few resources and markets. Networks also add value in providing advice, information and capital to SMMEs. A large majority of the firms (73.0%) were not affiliated to any business network, forum or association compared to their affiliated (27.0%) counterpart. The majority (64%) of firms which were affiliated to associations were members of their respective municipal

SMME forums followed by those (27%) which were members of the Eastern Cape Chamber of Commerce. The remainder (9%) were members of the Border Kei Chamber of Business.

The funding institutions survey results show that all funding institutions indicated that business network/association is not an important factor in their funding institutions' lending criteria. The results are confirmed by those of the SMME survey which indicates that the majority (62.1%) of credit applications approved for credit were those from businesses that were not members of any business network/association. The results are consistent with those of Fatoki (2014) who found that there is no correlation between business network membership and SMME access to credit.

Table 5.15 Business network/association and credit application success

Business network/association	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
Member of business network/association	11	37.9	5	23.8
Not a member of any business network/association	18	62.1	16	76.2
Total	**29**	**100**	**21**	**100**

5.2.12 Business plan, audited financial statements, VAT and Tax Clearance registration

The business plan is an important instrument in deciding the viability of a business as a borrower. It is one of the determining factors of the lending decisions by funding institutions. The majority (64.0%) of businesses had business plans while 36.0% had none. Of the 51 businesses which had business plans, 28 stated that their business plans were prepared before the year 2010 while the rest were prepared between the years 2010 and 2014. A significant percentage (75%) of funding institutions requires a firm to have a business plan to qualify for credit. This means that a business plan is an important factor in the funding institutions' lending criteria. It enables funding institutions to assess the risk-return profile of the loan application and hence set the level and terms and conditions of credit to be extended to the borrower.

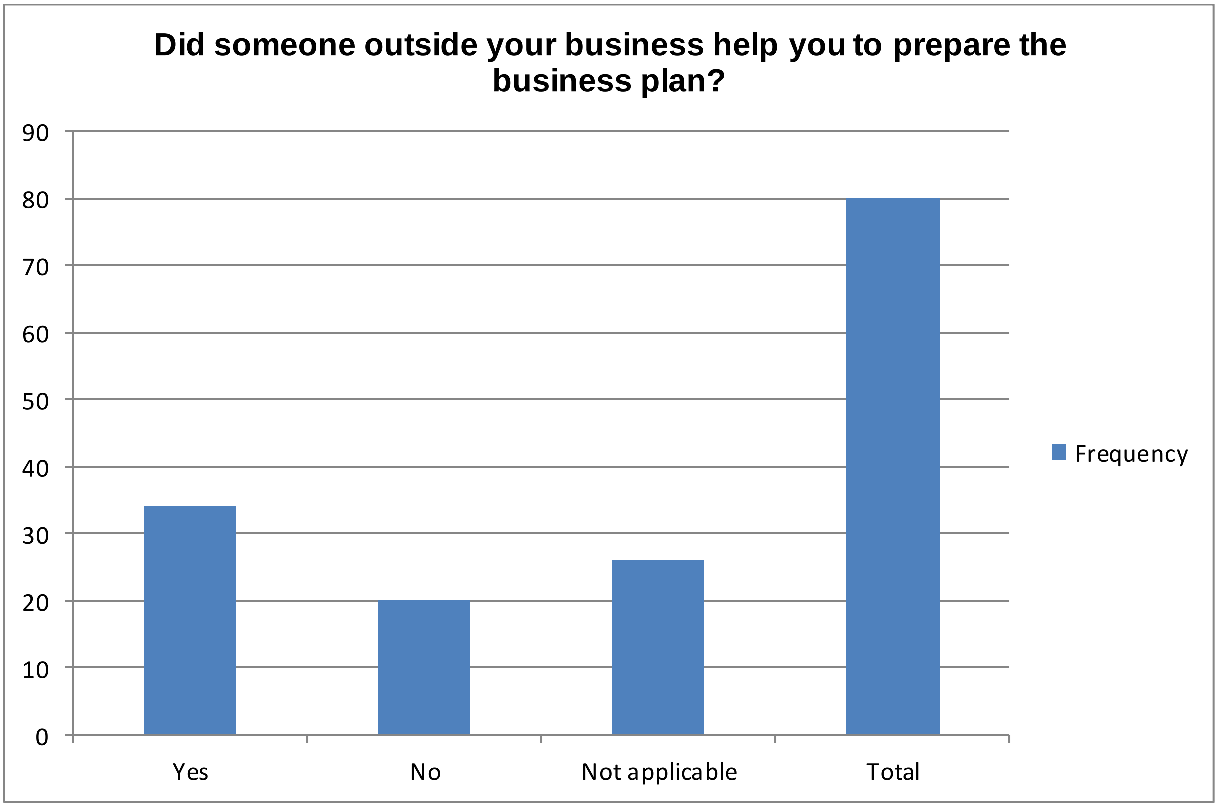
The remaining 25% have application forms that require credit applicants to provide all the information required in a business plan. This finding is supported by the SMME survey which shows that 93.1% of successful applications were those of firms with business plans. The findings are in line with those of Pretorius and Shaw (2004) who found that funding institutions require bankable business plans from applicants to be eligible for credit.

Table 5.16 Business plan and credit application success

Firms business plan status	No. of applications approved for credit	Percentage	No. of applications rejected for credit	Percentage
Have a business plan	27	93.1	9	42.9
Does not have a business plan	2	6.9	12	57.1
Total	**29**	**100**	**21**	**100**

Owner/managers were asked if someone outside their businesses helped them to prepare their business plans. Their responses are presented in Figure 5.1 below.

Figure 5.1 Assistance received in the preparation of the business plan



The above results show that 34 (42.5%) of the owner/managers got outside help from the Small Enterprise Development Agency (SEDA), DFIs, private consultants and family and friends for their preparation of their firms' business plans. The remaining 20 (25.0%) prepared their business plans themselves without any external help while the rest (26) did not have business plans at all. The cross tabulation of the assistance given in the preparation of the business plan and credit application success is presented in the table below.

Table 5.17 Outside help provided in the preparation of business plans and credit application success

Outside help provided in the preparation of business plans	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
Help provided	23	79.3	7	33.3
No help provided	6	20.7	14	66.7
Total	**29**	**100**	**21**	**100**

Table 5.17 shows that 79.3% of credit applications approved for credit were those from firms which were provided outside help in the preparation of their business plans. This means that funding institutions put a premium on quality business plans in their lending decisions.

Firms which got outside help in the preparation of their business plans were asked to indicate which organisations helped them in this regard. The table below presents a breakdown of their responses.

Table 5.18 A breakdown of organisations that helped owner/managers prepare their business plans

Organisation	**No. of owner/managers helped**	**Percentage**
Friends and family	4	11.8
DFIs	10	29.4
Private consultants	5	14.7
SEDA	15	44.1
Total	**34**	**100**

Table 5.18 above reveals that a large percentage (44.1%) of owner/managers received assistance from SEDA in their preparation of business plans followed by DFIs (29.4%). It can be noted that no assistance was provided by commercial banks in the preparation of owner/managers business plans. However, when asked if they help funding applicants to draw up business plans, 66.7% of funding institutions indicated that they do help applicants to develop their business plans.

Owner/managers were asked if they received any training in the preparation of their business plans. Their responses are presented in Figure 5.2 below.

Figure 5.2 Training received in the preparation of a business plan

Figure 5.2 above shows that an overwhelming majority (86.3%) of the owner/managers did not receive any training in the preparation of their business plans while only 13.8% received training from SEDA, DFIs or private consultants in the preparation of their business plans. It can also be noted that no training was provided by commercial banks to owner/managers in preparing business plans.

Audited accounts help to show how well firms are doing with assets and cash flow. They, together with other relevant information, enable funding institutions to assess the risk-return profile of the loan application and hence set the level and terms and conditions of credit to be extended to the borrower. The absence of this information means that the creditworthiness of a borrower cannot be established and thus the ability of the borrower to pay back the loan cannot be determined.

The SMME survey results indicate that only 40% of the businesses had audited financial statements. When asked to state the reasons why their businesses did not have audited financial statements, the majority (83%) of the 48 indicated that their businesses were not required by law to have audited financial statements. Meanwhile, the remainder (16.7) indicated that audited financial statements were too expensive to prepare and thus they could not afford them. The majority (83.3%) of the funding institutions indicated that they do not require credit applicants to have audited financial statements to qualify for credit. This is confirmed by the SMME survey results which show that 44.8% of successful applicants had no audited accounts.

Table 5.19 Audited financial statements and credit application success

Firms audited financial statements status	No. of applications approved for credit	Percentage	No. of applications rejected for credit	Percentage
Have audited financial statements	16	55.2	5	23.8
Do not have audited financial statements	13	44.8	16	76.2
Total	**29**	**100**	**21**	**100**

VAT is an indirect system of taxation (which means it's not directly deducted from the business' income) that is currently levied at 14% on the value of all goods and services supplied by vendors. VAT is levied on the value of the goods or services – whether by sale, rental agreement, instalment credit agreement or any other forms of supply. Where supply between unconnected parties is done at no cost, no VAT is charged. Businesses with a turnover (or a forecasted turnover) of more than R1 million per year are obliged to register as VAT vendors. A business can also register voluntarily if its turnover in a 12 month period has exceeded R50 000.

The majority (68.8%) of firms were not registered for VAT in the study. The funding institutions survey indicates that 50% of funding institutions require firm applicants to be registered for VAT to qualify for credit. This is confirmed by the results of the firms' survey which indicate that of the 29 SMME whose credit applications were successful, 55.2% were not registered for VAT.

Table 5.20 VAT registration and credit application success

Firms VAT registration status	No. of applications approved for credit	Percentage	No. of applications rejected for credit	Percentage
Registered for VAT	13	44.8	4	19.0
Not registered for VAT	16	55.2	17	81.0
Total	**29**	**100**	**21**	**100**

A tax clearance certificate confirms that a business is a tax payer registered with the South African Revenue Services (SARS) and that its tax affairs are in order. This means that it has no outstanding tax returns or outstanding debt. The certificate may be required by funding institutions (in particular DFIs) to accompany the credit application. It is issued free of charge by SARS.

The analysis of firm data indicates that the majority (63.7%) of businesses were registered for tax clearance. All funding institutions indicated that they require a firm to have a valid tax clearance to qualify for credit. This is confirmed by the firms' survey results which show that of the 29 SMMEs whose funding applications were successful, 22 (75.9%) were registered for tax clearance as shown in the table below. This shows that funding institutions are aware of the importance of abiding by SARS regulations and requirements.

Table 5.21 Tax clearance registration and credit application success

Firms Tax Clearance registration status	No. of applications approved for credit	Percentage	No. of applications rejected for credit	Percentage
Registered for Tax Clearance	22	75.9	14	66.7
Not registered for Tax Clearance	7	24.1	7	33.3
Total	**29**	**100**	**21**	**100**

5.2.13 Firms' understanding of Broad Based Black Economic Empowerment (BBBEE)

Broad-Based Black Economic Empowerment (BBBEE) is a form of economic empowerment initiated by the South African government in response to criticism against narrow-based Black Economic Empowerment (BEE) instituted in the country during 2003/2004. While narrow-based black economic empowerment led to the enrichment of a few previously disadvantaged individuals (Black African, Coloured or Indian), the goal of broad-based empowerment is to distribute wealth across as broad a spectrum of previously disadvantaged South African society as possible (as long as they are black). In contrast, narrow-based empowerment measures only equity ownership and management representation. BBBEE is measured using seven pillars, each with relative weighting as shown in the table below:

Table 5.22 The seven pillars of BBBEE

Pillar	Percentage
Equity ownership	20
Management	10
Employment equity	15
Skills development	15
Preferential procurement	20
Enterprise development	15
Socio-economic development	5
Total	**100**

The South African National Accreditation System (SANAS) and the Independent Regulatory Body for Auditor (IRBA) have been mandated with accrediting verification agencies. This accreditation has been put in place to ensure the consistency of the independent verification of BBBEE contributions. Companies are required to have BBBEE certificates showing the company's BBBEE level in order to score points especially when tendering for work from government.

Owner/managers were asked to state their level of understanding of BBBEE and their responses are presented in Table 6.6 below.

Table 5.23 Firms' understanding of BBBEE

Firms' understanding of BBBEE	**Frequency**	**Per cent**
No understanding	35	43.8
Limited understanding	24	30.0
Some understanding	17	21.3
Adequate understanding	4	5.0
Total	**80**	**100.0**

Table 5.23 above reveals that 43.8% of the owner/managers did not have any understanding of BBBEE whatsoever while 30% had a limited understanding of the legislation. Only 5.0% of the owner/managers had adequate understanding of BBBEE.A significant proportion (43.8%) of the firms had BBBEE level 3 status followed by those which had no status at all (35.0%). Only one firm had BBBEE level 4 status. The SMME survey reveals that funding applications from businesses with BBBEE level 3 and above were more successful (62%) in getting credit than those with BBBEE levels below. It can also be noted that credit applications from businesses with no status at all had lesser chances of success. Meanwhile, a large percentage (75.0%) of DFIs indicated that BBBEE status was not a critical factor in their lending criteria. It is interesting to note that all commercial banks and 25% of DFIs required businesses to have BBBEE level 4 to qualify for credit.

Table 5.24 Firms BBBEE status and credit application success

Firms BBBEE status	**No. of applications approved for credit**	**Percentage**	**No. of applications rejected for credit**	**Percentage**
No status	6	20.8	10	47.6
Level 1	4	13.8	5	23.8
Level 2	1	3.4	0	0.0
Level 3	17	58.6	6	28.6
Level 4	1	3.4	0	0.0
Total	**29**	**100**	**21**	**100**

5.2.14 The owner's contribution

Owner/managers whose funding applications were successful were asked to indicate if they were required to pay the owner's contribution to qualify for credit. The results of the SMME survey show that 79.3% of the 29 SMMEs whose funding applications were approved were required to pay an average of 30% owner's contribution. In support of these results, the funding institutions survey also revealed that all commercial banks and 75% of the DFIs required SMMEs to pay owner's contribution to qualify for credit.

5.3 Credit applied for

The section presents the results of credit applied for by the 50 SMMEs in the study. The section is composed of two sectors outlining the reasons the 26 firm did not apply for credit as well as the capital finance applied for by those which applied for credit.

5.3.1 Reasons for not applying for credit

Owner/managers who never applied for credit were asked to indicate reasons they never applied for credit. The following table presents their responses to this question.

Table 5.25 Reasons for not applying for credit

Reasons for not applying for credit	**Frequency**	**Per cent**
Failure to meet requirements	22	19.5%
SMME characteristics	18	15.9%
Lack of understanding of business plans and/or financials	2	1.8%
Entrepreneurship characteristics	21	18.6%
Not applicable	50	44.2%
Total	113	100.0%

Of the 30 owner/managers who never applied for credit, 22 (19.5%) indicated failure to meet requirements (.g. collateral, owner contribution, financial statements, a good business plan, VAT and tax clearance registration, compliance with FICA) as one of the reasons why they never applied for credit while 18.6% mentioned entrepreneurship characteristics (sex, age, education, business experience, etc.) as key in their apathy to apply for credit. Those that indicated SMME characteristics (such as poor track record of loan repayment, poor or weak cash flow to repay the loan, industry too risky, firm, age, sector, low annual turnover, over indebtedness, number of people employed, etc.) made 15.9% of the total number of 30 who never applied for credit. It can be noted that the total frequency is more than the total number of owner/managers interviewed. This is due to the fact that some owner-managers ticked more than one reason.

Respondents were asked to indicate if they encountered any problems in making the credit application. Their responses are presented in Table 5.26 below.

Table 5.26 Problems encountered in making the credit application

Problems encountered	**Frequency**	**Per cent**
Yes	29	58.8
No	21	41.2
Total	50	100.0%

Table 5.26 above shows that more than half (58.8%) of the 50 who applied for credit stated that they encountered problems in their endeavour to apply for credit compared with their counterpart. The table below presents the nature of problems encountered by owner/managers who applied for credit from funding institutions.

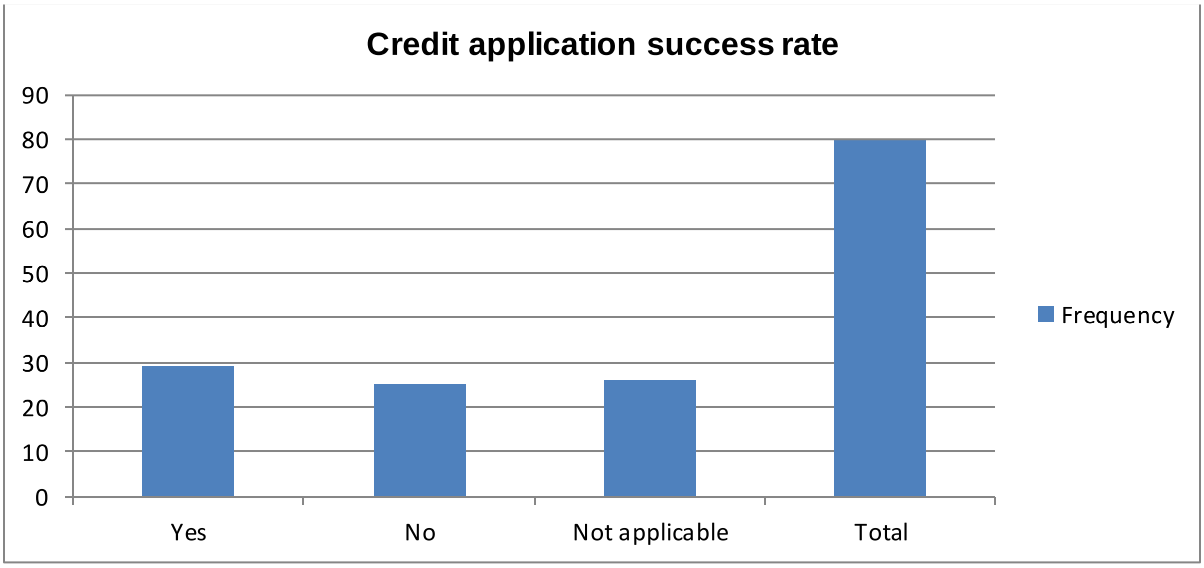
Table 5.27 Nature of problems encountered in making the credit application

Problems encountered	**Frequency**	**Per cent**
Communication and unfriendly staff	3	10.4
Application forms complicated	13	44.8
Too much information required and no assistance offered	13	44.8
Total	29	100.0

The majority (89.6) of the owner/managers who encountered problems in making credit applications listed too much information required and complicated application forms as key problems they encountered during their credit application process. A few (10.4%) mentioned communication and unfriendly staff as some of the problems they encountered.

Owner/managers who applied for credit were asked to indicate if their credit applications were successful or not. Their responses are captured in Figure 5.3 below.

Figure 5.3 Credit application success rate



It can be noted that of the 50 owner/managers who applied for credit from funding institutions, 29 (58.0%) were successful and 21 (42.0%) not successful. Owner/managers whose funding applications were successful were asked to indicate attributes to their credit application success. These are presented in the table below.

Table 5.28 Attributes of credit application success

Attributes of credit application success	**Frequency**	**Per cent**
Coaching and mentoring	15	51.7
Assistance from family and friends	1	3.4
Accurate completion of forms and submission of all required documents	1	3.4
Meeting the requirements and awarded a contract	12	41.5
Total	**29**	**100.0**

The majority (93.2%) of owner/managers whose credit applications were successful attributed their success to coaching and mentoring as well as meeting the funding institutions' requirements and cession (using a contract awarded as collateral). The 21 owner/managers whose credit applications were rejected by funding institutions were asked to indicate the reasons for their application rejection. Their responses are showed in the table below.

Table 5.29 Reasons for application rejection

Problems encountered	**Frequency**	**Per cent**
Failure to meet requirements	13	61.9
SMME characteristics	9	38.1
Total	**21**	**100.0**

As reflected in Table 5.29 above, failure to meet requirements (61.9%) (.g. collateral, owner contribution, financial statements, a good business plan, VAT and tax clearance registration, compliance with FICA) and SMME characteristics (38.1%) (sex, age, education, business experience, etc.) were identified as the main reasons why firms' credit applications were rejected by funding institutions. Owner/managers whose credit applications were rejected were asked if they would re-submit their credit applications to the funding institutions. Their responses are presented in the table below.

Table 5.30 Re-submission of credit applications

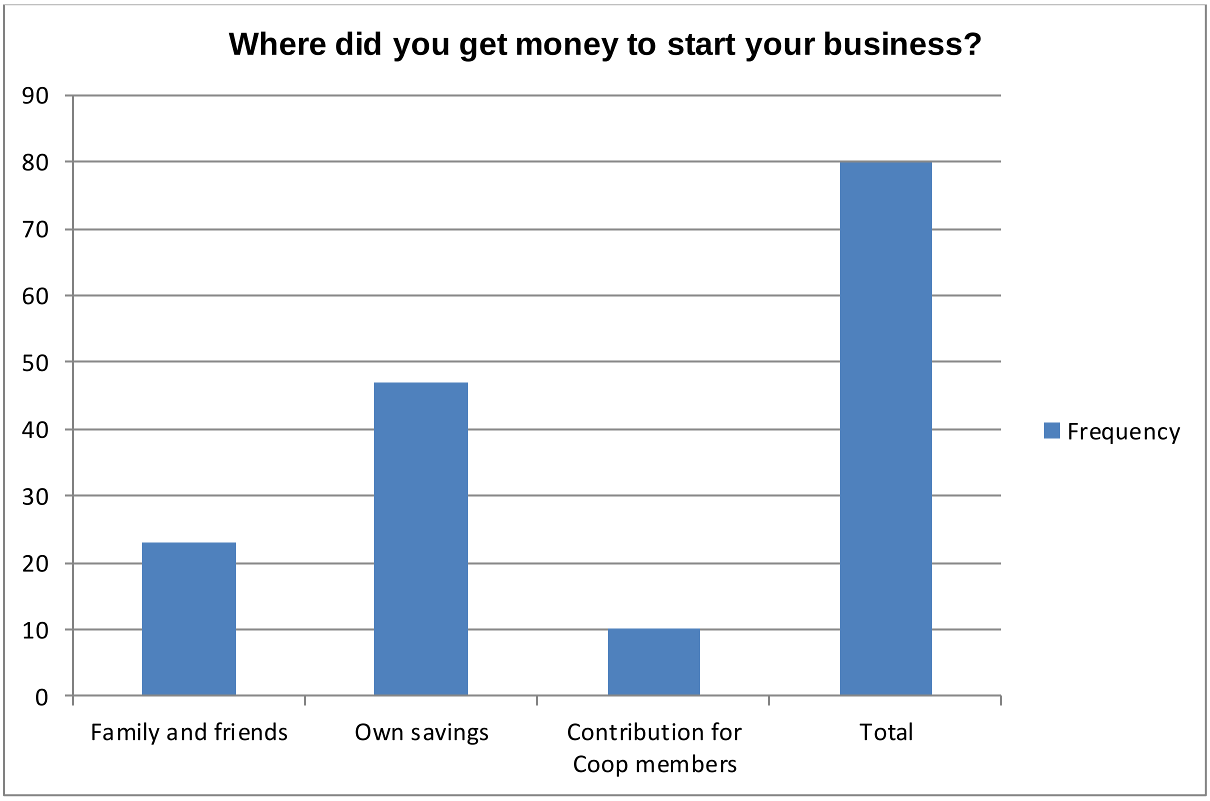
Would you re-submit your credit application(s)?	**Frequency**	**Per cent**
Yes	10	47.6
No	11	52.4
Total	**21**	**100.0**

Table 5.30 above reveals that 47.6% of the 21 owner/managers whose applications were rejected stated that they would re-submit their credit applications for credit while the rest (52.4) stated otherwise. The latter group was asked to indicate reasons why they would not re-submit the credit applications. Thirteen of them stated that applying for credit was a waste of time and resources while the rest (9) stated that their businesses were sustainable and therefore saw no reason to apply for credit again.

5.3.2 Capital and credit applied for

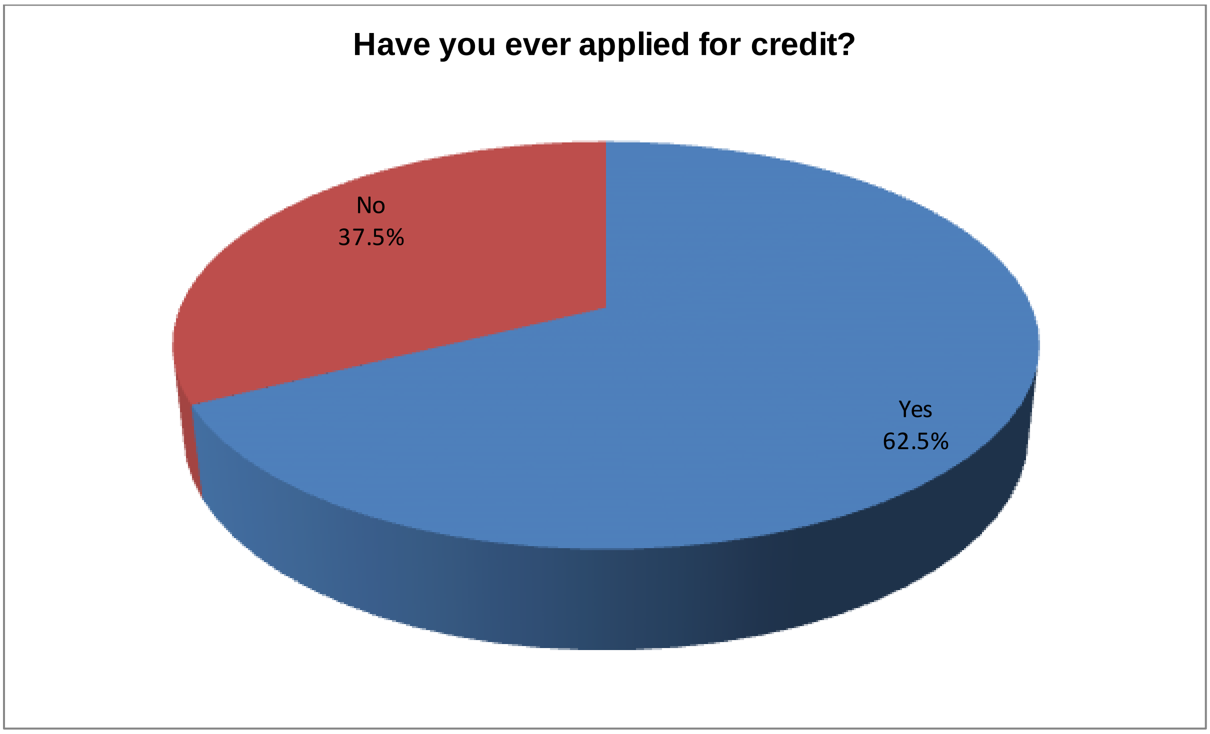
Owner/managers were asked to indicate where they got money to start their businesses. Their responses are presented in Figure 5.4 below.

Figure 5.4 Start-up capital



According to Figure 5.4 above, more than half of the owner/managers used their own savings to start their businesses followed by those who got their start-up capital from their family and friends while 12.5% started their businesses through contributions from their cooperative members. These findings are consistent with literature. Owner/managers were asked if they ever applied for credit from funding institutions. Their responses are reflected in Figure 5.5 below.

Figure 5.5 Credit applied for



As reflected in Figure 5.5 above, of the total of 80 owner/managers interviewed, 50 (62.5%) applied for credit from a variety of funding institutions while 30 (37.5%) never applied for credit whatsoever. Owner/managers who applied for credit were asked to choose from the list in the table below which funding institutions they applied for credit from. Their responses are presented in table 5.31 below.

Table 5.31 Funding institutions firms applied for credit from

Funding institutions	**No. of credit applications**	**No. of approved credit applications**
Traditional funding institutions	32	5
Development funding institutions (DFIs)	50	24
Total	**82**	**29**

As can be seen from Table 5.31 above, the majority of the 50 owner/managers who applied for credit approached DFIs followed by those 32 who applied for credit from commercial banks. Again, it can be noted that the total frequency is more than the total number of owner/managers interviewed. This is due to the fact that some owner-managers ticked more than one reason.

From Table 5.31 above, it can be noted that of the 32 credit applications submitted to commercial banks, only 5 were approved. On the other hand, of the 50 credit applications submitted by businesses to DFIs, almost half (24) were approved for credit. From the above table, it can be noted that commercial banks are reluctant to offer credit to SMMEs. Commercial banks perceive SMMEs as high risk, with high transaction costs and severe information asymmetry. The 50 owner/managers who applied for credit were asked to indicate the nature of credit they applied for. Their responses are presented in Figure 5.6 below.

Figure 5.6 What is the nature of finance facility you applied for?

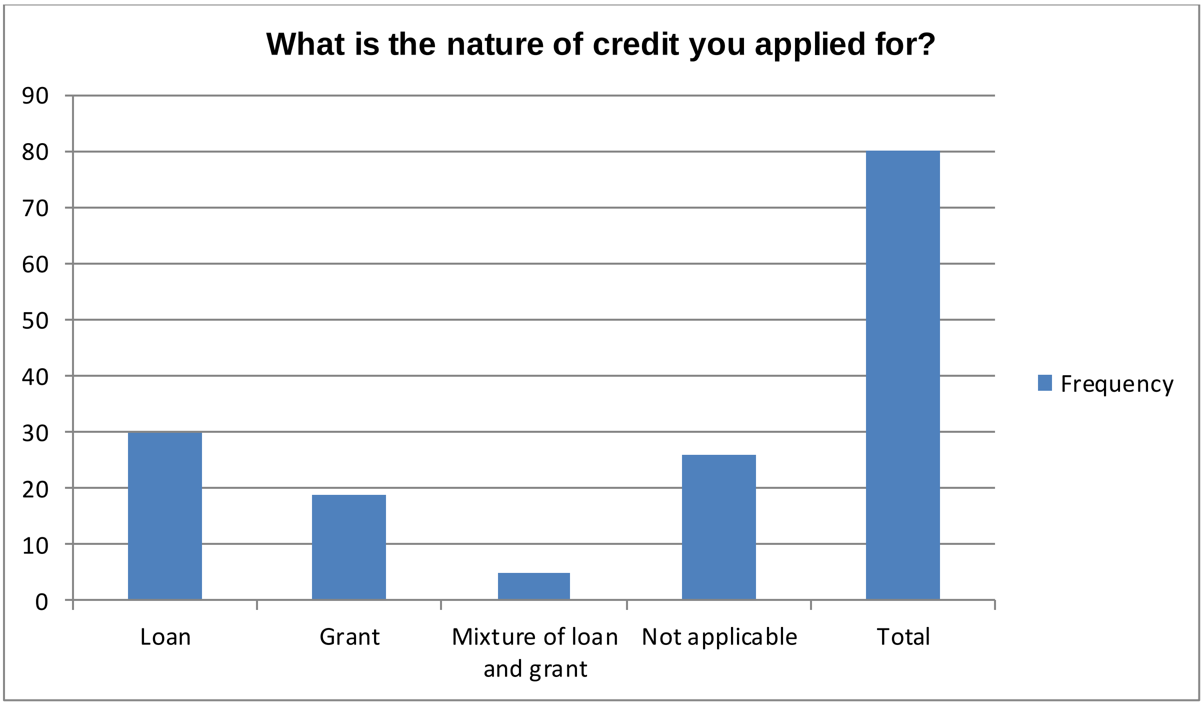


Figure 5.6 above shows that a significant proportion (37.5%) of owner/managers applied for loan credit from commercial banks followed by those who applied for grant funding from DFIs only. A small proportion (6.25%) applied for a mixture of both loan and grant funding from DFIs.

Table 5.32 Nature of credit applied for and credit application success

Nature of credit applied for	No. of applications approved for credit	Percentage	No. of applications rejected for credit	Percentage
Loans	23	79.3	17	80.9
Grants	6	20.7	4	19.1
Mixture of loan and grant	0	0	0	0
Total	**29**	**100**	**21**	**100**

Table 5.32 above reveals that the majority (79.3%) of firms whose credit applications were approved applied for loans. Only 20.7% of grant funding was approved by development funding institutions and the beneficiaries of these grants were cooperatives. No mixture of loan and grant funding was approved.

5.4 Summary

The chapter presented the firm and entrepreneurial characteristics of SMMEs in the study area. In terms of the results presented in the chapter, the majority of SMMEs had business plans, were registered for tax clearance, were close corporations, were spread across all sectors, had BBBEE certificates, were urban and existed for more than 3 years. On the other hand, the majority of SMMEs were not registered for VAT, had no audited financial statements, had no cash flow, owners' contribution and collateral and were not affiliated to any business association. The majority of SMME owner/managers were men, were between the ages of 36-60 years old, had tertiary education and had previous experience.

In terms of the criteria used by funding institutions to lend to SMMEs, the results of the SMME and funding institutions surveys revealed that both DFIs and commercial banks require credit applicants to have business plans, valid tax clearance certificates, BBBEE level 4 status, cash flow statement, owners' contribution, collateral and experience. On the other hand, both surveys confirmed that VAT registration certificate, financial statements, form of business, industry sector, location of business, business association affiliation, the age of the SMME owner/manager, education level as well as the gender are not important in the lending decision of DFIs and commercial banks.

There were differences between the SMME survey and the funding institutions survey regarding the average annual turnover and the age of business in relation to their importance in the funding institutions lending decision. SMME owner/managers stated that the firm's average annual turnover and its age are important in the lending decisions of funding institutions. However, the funding institutions survey indicated contrary to these findings. Generally, the findings indicate that there is an alignment between the SMME and funding institutions results.

CHAPTER 6: ANALYSIS OF RESULTS

6.1 Introduction

Chapter 5 gave a comprehensive description of the SMME and funding institutions results. The chapter outlined the demographics of the SMMEs and their characteristics in relation to them accessing credit from both DFIs and commercial banks. The chapter also provided an overview of the factors funding institutions look for when evaluating SMME funding applications. This chapter is aimed at presenting an analysis of the study results presented in the above-mentioned chapter thereby responding to the first and second objectives of the study.

The first section of the chapter presents an analysis of the dynamic interaction between the demand and supply factors that affect SMME access to credit in the Eastern Cape Province. The section starts by giving a brief explanation of the demand and supply factors from the literature followed by the identification of the above-mentioned factors. In addition, the section also provides a summary of the comparison between the demand and supply findings of factors affecting SMME access to credit. This exercise is followed by a detailed discussion of the comparison and a summary thereof.

The second section of the chapter presents a comparative evaluation of lending criteria used by DFIs and commercial banks in providing credit to SMMEs. The section outlines the methodology used in conducting the comparative evaluation as well as the literature identification of the criteria used by funding institutions to lend to SMMEs. The section also presents the calculation of the Relevant Importance Index (RII) for each of the above criteria as well as the discussion and summary of the method results. The evaluation is based on the 5C's of credit which are capacity, capital, condition, collateral and character.

6.2 The dynamic interaction between the demand and supply factors affecting SMME access to credit

A number of demand-side studies conducted on SMME access to credit corroborate on the fact that SMME characteristics (both firm and entrepreneurial) have an impact on SMME access to credit. For example, Fatoki (2014), Gangata and Matavire (2013), Irwin and Scott (2010) and Islam *et al* (2011) observed that demand factors such as collateral, business information (business plan, financial statements, compliance documents, etc.), firm average annual turnover, cash flow, own contribution, age, size and location, experience, education, form of business, industry sector, gender and business association membership have an impact on SMME access to credit. Demand factors are defined as factors which SMMEs perceive as key requirements by funding institutions when assessing their credit applications (Irwin and Scott, 2010).

Demand-side studies noted that SMMEs are credit rationed due to information asymmetry. SMMEs often fail to provide funding institutions with accurate and credible information in the form of bankable business plans, financial statements, compliance documents to mention but a few. This information is used by funding institutions to determine the creditworthiness of a firm. Poor cash flow and lack of owners' contribution, which is generally 30% of the loan value, are amongst some of the challenges faced by SMMEs when applying for credit from funding institutions. Moreover, there is a general observation that SMMEs fail to obtain credit from funding institutions because they cannot provide collateral in the form of assets, properties registered in the owner's name, stock, vehicles, shares, etc.

On the other hand, funding institutions have their own requirements that SMMEs applying for funding have to meet in order for their applications to be successful. Studies by Pandula (2011), Agyapong *et al* (2011) and USAID (2010) noted that funding institutions put a premium on good business plan, financials, collateral, cash flow, owners' contribution as well as experience. The above factors are referred to as supply factors and are used by funding institutions to determine the ability of the applicant to pay back the loan. A breakdown of the list of the demand and supply factors identified in the study is provided in the table below.

Table 6.1 Demand and supply factors affecting SMME access to credit

Demand factors	**Supply factors**
Bankable business plan	Good business plan
Compliance documents (BBBEE status, VAT and tax registration)	Financial statements
Financial statements	Cash flow statement
Average annual turnover	Own contribution
Cash flow statement	Collateral
Own contribution	Experience
Collateral	
Form of business	
Industry sector	
Location of business	
Member of business association	
Age of owner/manager	
Education level	
Experience	
Age of business	
Gender of owner/manager	

In order to determine the dynamic interaction between the demand and supply factors affecting SMME access to credit, a comparative analysis between the findings of the SMME survey against those of the funding institutions was done. This exercise involved ascertaining if there is an alignment between what SMMEs identified as impacting on their access to credit (demand factors) and what funding institutions require from SMMEs to qualify for funding (supply factors). The dynamic interaction was determined by assessing if the SMME survey findings for each of the demand factors match the funding institutions findings of their criteria. The exercise was done in conjunction with the determination of the firm attributes. The findings of the dynamic interaction are presented in Table 6.2 below.

Table 6.2 Summary of the comparison between the demand and supply findings of factors affecting SMME access to credit

Lending criteria	SMME Survey findings	Funding institutions findings	Firm attribute
Business plan	required	required	36% with no business plan
VAT registration	not required	not required	69% not registered for VAT
Tax clearance	required	required	36% not registered for tax
Financial statements	not required	not required	60% with no audited financial statements
Average annual turnover	required	not required	70% with annual turnover of more than R150 000
BBBEE status	required	required	35% with no status
Cash flow statement	required	required	Majority with no cash flow
Own contribution	required	required	Majority with no owners contribution
Collateral	required	required	Majority with no collateral
Form of business	not required	not required	Majority were close corporations
Industry sector	not required	not required	Spread across all sectors
Location of business	not required	required	Majority urban
Member of business association	not required	not required	Majority not affiliated
Age of owner/manager	not required	not required	36-60
Education level	not required	not required	Typically tertiary
Experience	required	required	40% with no previous experience
Age of business	required	not required	Existence for more than 3 years
Gender of owner/manager	not required	not required	Majority men

A bankable business plan is an important document used by funding institutions when evaluating the borrower's credit application (Pretorius and Shaw, 2004). It is an essential document used in setting codes and relationships between the borrower and the funding institution. A business plan enables the funding institution to assess the risk-return profile of the loan application and hence set the level and terms and conditions of credit to be extended to the borrower (Maziku, 2012).

The above table results show that both the SMME survey and the funding institutions survey agree that a bankable business plan understood by the firm owner/manager is a non-negotiable requirement in the lending criteria of funding institutions. This indicates that there is an alignment between SMMEs and funding institutions in relation to the business plan as a key lending requirement. Interestingly, 36% of firms in the survey had no business plans and 57% of those whose credit applications were rejected had no business plans. The results confirm those of Maziku (2012) who observed that SMMEs are characterised by information asymmetry. Information asymmetry in this case is manifested by the inability of more than half of SMMEs who applied for credit to provide lenders with bankable business plans. The absence of this information means that the creditworthiness of these borrowers cannot be established and thus the ability of them to pay back the loan cannot be determined. This has resulted in them being credit rationed by funding institutions something which impacts negatively on them accessing credit. The results clearly indicate that without a business plan, SMMEs cannot access credit from funding institutions.

The SMME survey revealed that an overwhelming majority (86%) of SMME owner/managers did not receive any training in the preparation of business plans. This result in some who can afford appointing consultants to develop business plans for them while the rest submit poor quality plans. This has a negative effect in their endeavour to access credit from funding institutions. Without training provided to SMMEs in developing their business plans, it is evident that their credit applications will continue to be rejected by funding institutions.

All funding institutions require credit applicants to have a comprehensive understanding of the business plan and financials. A thorough understanding of a business plan by the firm applicant indicates that the borrower has an insight in the running and management of his/her business. Funding institutions observed with concern that the majority of SMME owner/managers applying for credit failed to articulate their firm business plans when required to do so. This failure can be attributed to the fact that government agencies such as SEDA, NYDA, etc. appoint consultants to develop business plans on behalf of SMMEs and they fail to educate them on these plans. The failure then results in funding institutions rejecting credit applications from the above-mentioned firms as the business plan is one of the key determining factors of the lending decision by funding institutions.

The above findings reveal that there is a mismatch between the characteristics of SMMEs in the study and the lending criteria of funding institutions in as far as the business plan factor is concerned. This implies that those SMMEs without business plans and those who have them but cannot articulate them will find it difficult to access credit from funding institutions if no strategies are devised to counteract this situation. The findings also reveal that generally, there is poor awareness by SMMEs in the study about the lending criteria of funding institutions. This is shown by the fact that more than half of SMMEs applied for credit without providing business plans. On the other hand, funding institutions seem not to understand the characteristics of SMMEs.

There is a consensus among SMMEs and funding institutions that VAT registration is not an important factor in the lending decisions of funding institutions. This implies that there is an alignment between the SMMEs in the study area and the funding institutions in relation to VAT registration. The findings from both surveys confirm those of the USAID (2010) and Richard and Mori (2012) which found that funding institutions are quite tolerant of compliance aspects that can be fixed or addressed.

Both the SMME and funding institutions surveys agree that a valid tax clearance certificate is an important factor in the lending criteria of funding institutions. The findings are also confirmed by the DFIs and commercial banks document review results which indicate that a tax clearance certificate is a key requirement by funding institutions. This shows that there is an alignment between the two findings. A significant percentage (36%) of all SMMEs in the study was not registered for tax clearance. This can be attributed to the general view SMME owner/managers have of thinking that when they register for tax clearance they will be required to pay tax. It appears that this group lack understanding of how tax clearance registration entails and how the process works. In addition, and of utmost importance, the group does not know the importance of a tax clearance certificate in the lending decisions of funding institutions.

The absence of valid tax clearance certificates lowers the chances of these SMMEs success to access to credit. The findings of the study reveal that there is a disjuncture between the characteristics of SMMEs in South Africa and the lending requirements of funding institutions pertaining to tax clearance. This shows that funding institutions do not understand the characteristics of SMMEs. If the situation persists, only SMMEs with valid tax clearance certificates will be eligible for credit and the rest will be credit rationed.

Table 6.2 above reveals that both the SMME and funding institutions surveys point out that audited financial statements are not a requirement in the lending criteria of funding institutions. The findings are contrary to those of Pandula (2011), USAID (2010) and Agyapong (2011) and Johnson *et al* (2014) who found that financial statements are of paramount importance in the lending decisions of funding institutions. The findings are also contrary to those of the document review which found that audited financial statements are very important in the lending decisions of both DFIs and commercial banks. This implies that what is enshrined in the funding institutions lending documents and protocols is not necessarily what these institutions practice. This may lead to confusion as SMMEs would not know what funding institutions' lending criteria really are.

Research (Kira and He, 2012; Calice *et al*, 2012; Fatoki, 2014; Johnson *et al*, 2014) on SMME access to credit pointed out that SMMEs in South Africa lack financial statements. The majority (60%) of SMMEs in the study do not have audited financial statements. This again proves the fact that what funding institutions look for in terms of their lending criteria is not in line with the characteristics of SMMEs in the study. It is evident that if this misalignment continues unabated, SMMEs in the study area and in the country as a whole will continue to be credit rationed by funding institutions.

The SMME and funding institutions surveys differ when it comes to the average annual turnover. The SMME survey point out that funding institutions are willing to fund firms with an average annual turnover of more than R150 000. This is confirmed by the fact that the majority of credit applications approved for credit were from those SMMEs with an annual turnover of more than R150 000. The findings support those of USAID (2010) study which found that the higher the turnover, the more successful the credit application. This implies that SMMEs whose turnover is less that R150 000 have slim chances of accessing credit from funding institutions. Contrary to these findings, the funding institutions survey state that funding institutions do not consider the firm's average annual turnover when evaluating SMME credit applications. The findings are supported by those of Kira and He (2012), Fatoki (2011) and Pandula (2011) who found no correlation between average annual turnover and access to credit. Moreover, the findings are also supported by the document review of both funding institution groups. The conflicting findings confirm that there is no alignment between the funding institutions' practice and what is enshrined in their lending documents and protocols. Moreover, the findings reveal that there is a mismatch between the SMME characteristics and the funding institutions lending criteria pertaining to average annual turnover.

Both the SMME and the funding institutions surveys agree that the BBBEE status is an important requirement in the funding institutions' lending decisions. However, 35% of SMMEs in the study area were not registered for BBBEE at all while the majority of those that were registered had BBBEE level 1. It is interesting to note that this requirement does not feature in any of the funding institutions lending documents and protocols. This implies that there are criteria funding institutions consider important though they do not appear in their documents. This might confuse funding applicants as they are guided by the lending documents obtainable from funding institutions offices and websites.

Capital refers to the money personally invested in the business by the shareholder borrower and is an indicator of how much the shareholder has at risk should the business fail (Johnson *et al*, 2014). Funding institutions measure capital by the sufficient amount of own equity contribution as well as cash flow sufficient to repay the loan. The SMME and funding institutions survey show that funding institutions require credit applicants to have owners' contribution of 30% and above (depending on the applicant's risk) to qualify for credit. There is consensus among SMMEs and funding institutions that cash flow and owners' contribution are indispensable in the lending decisions of funding institutions. The findings were confirmed by the DFIs and commercial banks document review analysis. The findings also support those of Fatoki (2014) and the USAID (2010) who also found that cash flow sufficient to repay the loan and sufficient amount of own equity contribution are pivotal in the lending criteria of funding institutions. In essence, SMME access to credit comes down to creditworthiness and how much an applicant is able to finance from own sources. No matter how bankable a business plan may look, what counts is how much the applicant is willing to put down as own contribution so as to limit the financial risk to the funding institution. The business plan therefore becomes secondary after the creditworthiness test has been passed by the credit applicant.

The SMME survey revealed that 42% of SMMEs whose credit applications were rejected had no sufficient cash flow to repay the loan. They also had no or insufficient owners' contribution to qualify for credit. In addition, more than 70% of SMMEs which never applied for credit listed lack of owners' contribution and cash flow as one of the reasons for not doing so. The study on financial institutions hurdles to SME financing by USAID (2010) revealed that cash flow and own contribution top the list of lending criteria of funding institutions. This implies that without cash flow and owners' contribution, SMMEs will find it difficult to obtain credit from funding institutions. This means that what funding institutions are looking for does not match-up with the unique characteristics of SMMEs in the study. It is generally accepted that SMMEs countrywide are credit rationed due to lack of cash flow and owners' contribution. This brings the question of the effectiveness of the Small Enterprise Finance Agency (SEFA) as one of their mandates is to cushion firms with no or poor owners' contribution. Given the fact that the majority of SMMEs in the Eastern Cape as per the results of the survey and generally in South Africa have no owners' contribution, access to credit will continuously be a challenge.

Collateral in the form of assets such as fixed property registered in business owner's name, mortgage bond, stock, vehicles, shares and movable property is security the funding applicant has to provide the lender when the loan has been approved. This serves as a repayment source in case the loan is not repaid. As with capital, both the SMME and funding institutions survey agree that collateral together with owners' contribution is of paramount importance in the lending decisions of funding institutions. The findings are also confirmed by the DFIs and commercial banks document review which revealed that collateral ranks high in the lending documents and protocols of funding institutions. A large majority of firms in the survey did not have collateral and as a result they never applied for credit. Moreover, the majority of those that applied had their credit applications rejected for failure to provide collateral.

It is evident that for credit applicants to qualify for credit, they need to have collateral in the form of personal or business assets. SEFA was established to among other things cushion SMMEs on this requirement by funding institutions. However, the effectiveness of this organisation in fulfilling this mandate still remains to be seen. A large majority (81%) of SMMEs in the study operated from rented premises and at home. This makes them unable to provide fixed property to funding institutions as collateral.

A study conducted by Kira and He (2012) on the impact of firm characteristics in accessing credit from funding institutions in Tanzania found that there is correlation between collateral and access to credit. The USAID (2010) study also pointed out that collateral ranked third in the list of funding institutions lending criteria. The above findings also concur with those of Agyapong (2011) who also ranked collateral among the top five lending rending requirements by funding institutions. Moreover, literature on the characteristics of SMMEs in South Africa revealed that SMMEs generally lack collateral and as a result they are credit rationed. Given the above SMME and funding institutions findings, it is clear that the collateral requirement by both DFIs and commercial banks does not take into account the unique characteristics of SMMEs in the study. The findings also spell out that SMMEs are not aware of the lending requirements of funding institutions. This means that if this situation does not change, credit will only be available to those SMMEs who can provide collateral and the rest will be credit rationed.

Condition describes the intended purpose of the loan and the conditions under which the credit is being granted. Condition in the study was measured by the legal form of business, the industry sector under which a firm trades, firm location as well as firm membership in a business association/forum. Both the SMME and funding institutions survey agree that the legal form of business, the industry sector, firm location and firm membership in a business association are not critical in the lending criteria of funding institutions. The findings are further confirmed by the funding institutions document review study which found that all the above factors do not feature in the lending criteria of funding institutions. A study conducted by Pandula (2011) on SMME access to bank credit in Australia also found that there was no correlation between the above-mentioned factors and access to credit.

Character is the general impression the credit applicant makes on the prospective lender (Gangata and Matavire, 2013). Based on this impression, the lender subsequently forms an opinion as to whether the applicant is sufficiently trustworthy to repay the loan offered or not. Character in the study was measured by the age, gender, education level and the experience of the SMME owner/manager as well as the age of the firm. The SMME and funding institutions surveys converge on the fact that all the above factors except the experience of the SMME owner/manager are not important in the lending criteria of funding institutions. The findings are in line with those of the funding institutions document review study. The findings also confirm those of the USAID (2010) study which found that criteria pertaining to the individual were least important in the lending decisions of funding institutions. Despite the importance of experience, the SMME survey pointed out that 40% of owner/managers in the study did not have any previous experience related to their businesses. This implies that there are slim chances of this group's success in obtaining credit from funding institutions. A review of the characteristics of SMMEs in South Africa point out that SMMEs lack previous industry experience. The findings therefore point out that the experience required by funding institutions is not aligned with the general unique characteristics of SMMEs in South Africa.

In summary, the results of the dynamic interaction between the supply and demand factors affecting SMME access to credit show that generally, there is an alignment between the

SMME and the funding institutions survey results. Only three of the criteria namely the average annual turnover, the location of the business and the age of the business were not aligned. This shows that the lending criteria of funding institutions are transparent.

The results also point out that the characteristics of SMMEs in the study are representative of those of SMMEs countrywide. SMMEs in the study are characterised by poor/no business plans, lack of financial statements, lack of collateral, poor cash flow, lack of owners' contribution and lack of previous industry experience to mention but a few. This implies that the funding institutions' lending requirements do not match-up with the above-mentioned peculiar characteristics of SMMEs in the study area. It appears that the lending requirements of both groups of funding institutions are tailor-made for the large and well established firms which have the required capacity. This may explain the reason behind the lack of SMME access to credit in South Africa.

The results also indicate that funding institutions lending criteria do not take into account the unique characteristics of SMMEs in the Eastern Cape. It appears that funding institutions lack the understanding of this category of businesses in particular their profile. On the other hand, it is evident that there is poor awareness of the funding institutions criteria by SMMEs. SMMEs seem not to know what funding institutions are looking for when they evaluate credit applications. The effectiveness and efficiency of the services provided by SEFA with respect to its credit guarantee scheme leaves much to be desired. In addition, the findings challenge business development services provided by government agencies such as the South African Revenue Services (SARS), the NYDA, SEDA and many more as part of their mandate is to disseminate business information to SMMEs. Given the above findings, it is clear that SMMEs will continue to struggle accessing credit from funding institutions if no strategies to address this situation are put together.

Lastly, the results also pointed out that what funding institutions practice is sometimes not in line with their lending documents and protocols. For example, the survey findings of both groups indicate that tax clearance is important in their lending decisions. However, the document review of both groups indicates contrary to these findings. The document review point out that it is not important. Also, the survey of both groups indicate that financial statements are not important in their lending decisions but the document review points out that they are very important in the lending process. This brings confusion to credit applicants as they go with the lending requirements as enshrined in the above-mentioned documents not realising that funding institutions may not go according to the book. This, coupled with the poor awareness of lending criteria by SMMEs militates against SMME access to credit.

6.3 A comparative evaluation of lending criteria used by DFIs and commercial banks in providing funding to SMMEs

The comparative evaluation of lending criteria used by DFIs and commercial banks in providing funding to SMMEs in the study was done in two phases. The first phase involved the use of two identical questionnaires. The first questionnaire was prepared for the eight DFIs operating in the Eastern Cape Province whilst the second was prepared for the five major commercial banks also operating in the province. Both questionnaires had 18 questions each. The reviewed literature on SMME access to credit in South Africa identified among others eighteen key criteria used by both the DFIs and commercial banks to assess SMME credit applications. The 18 questions, classified according to the 5Cs of credit (capacity, capital, collateral, condition and character) were prepared in line with the above criteria. The questionnaires were based on a four-point likert scale which ranged from 1 (not important) to

4 (very important). Respondents from both groups of funding institutions were asked to indicate the importance of each of the 18 lending criterion in their assessment of SMME funding applications based on the above-mentioned likert scale.

The second phase encompassed the review of the lending documents and protocols of the two groups of funding institutions based on the same 18 lending criteria mentioned above. The document review was also based on the four-point likert scale which also ranged from 1 (not important) and 4 (very important). The likert-scale responses obtained from the questionnaires as well as the document reviews were transformed into the Relative Importance Index (RII). This exercise was done in order to determine the importance of each of the 18 lending criterion identified.

The RII is a powerful technique used to calculate the relative importance of predictors (independent variables) when independent variables are correlated to each other (Megha and Rajiv, 2013). The index helps to calculate the importance rank of variables. The RII was invented by Hoffman (1960) in the early 1960's. Over the years, the method gained its popularity and has been used by a number of prominent researchers to analyse likert-scale data. For example, Megha and Rajiv (2013) used it to determine the causes and effects of delays for residential construction projects in India. Muhwezi *et al* (2014) on the other hand used it to assess the factors causing delays on building construction projects in Uganda while Somiah *et al* (2015) employed it to analyse factors influencing unauthorised sitting of residential buildings in Ghana. Recently, the method has been used by Aziz *et al* (2016) in ranking the procrastination factors among university students in Malaysia.

The RII for each of the lending criterion was calculated using the following formula:

$$\mathbf{RII} = \frac{\boldsymbol{\Sigma W}}{\mathbf{A * N}}$$

Where:

W = the weighting given to each criterion by the respondents and ranges from 1 to 4 (where 1 = not important, 2 = somewhat important, 3 = important and 4 = very important),

A = is the highest weight (i.e. 4 in this case) and

N = is the total number of respondents (i.e. in this case 8 for DFIs and 5 for commercial banks).

The higher the value of RII, the more important is the lending criterion. In this case, the highest RII was 1.000 and the lowest 0.250). The RII results for each criterion were ranked in order of importance. The results of the RII analysis for both DFIs and commercial banks are presented in Table 6.3 and 6.4 respectively. The results of the document review for both DFIs and commercial banks are also provided in Table 6.5 and 6.6 respectively.

Table 6.3 The DFI survey and document review RII results

Criterion number	Lending criteria	Survey Results		Doc Rev Results	
		RII	Rank	RII	Rank
1	Business plan	1.000	1	1.000	1
2	Own contribution	0.750	2	0.812	2
3	Tax clearance	0.750	2	0.781	3
4	Collateral	0.750	2	0.750	4
5	Experience	0.730	3	0.500	5
6	Location of business	0.718	4	0.500	5
7	Cash flow statement	0.625	5	0.500	5
8	VAT registration	0.531	6	0.350	6
9	Financial statements	0.375	7	0.250	7
10	Education level	0.375	7	0.250	7
11	Age of business	0.375	7	0.250	7
12	BBBEE status	0.343	8	0.250	7
13	Age of owner/manager	0.343	8	0.250	7
14	Gender of owner/manager	0.281	9	0.250	7
15	Industry sector	0.281	9	0.250	7
16	Form of business	0.281	9	0.250	7
17	Average annual turnover	0.250	10	0.250	7
18	Member of business association	0.250	10	0.250	7

Table 6.4 Commercial banks survey and document review RII results

Criterion number	Lending criteria	Survey Results		Doc Rev Results	
		RII	Rank	RII	Rank
1	Business plan	1.000	1	1.000	1
2	Cash flow statement	1.000	1	1.000	1
3	Owners' contribution	1.000	1	1.000	1
4	Collateral	1.000	1	1.000	1
5	Tax clearance	0.900	2	1.000	1
6	Experience	0.850	3	1.000	1
7	BBBEE status	0.750	4	0.800	2
8	Location of business	0.700	5	0.750	3
9	VAT registration	0.550	6	0.600	4
10	Education level	0.437	7	0.550	5
11	Age of business	0.400	8	0.350	6
12	Form of business	0.350	9	0.281	7
13	Industry sector	0.350	9	0.250	8
14	Member of business association	0.281	10	0.250	8
15	Age of owner/manager	0.250	11	0.250	8
16	Average annual turnover	0.250	11	0.250	8
17	Gender of owner/manager	0.250	11	0.250	8
18	Financial statements	0.250	11	0.250	8

The RII results of the DFIs survey, as shown in Table 6.3 above, indicate that a bankable business plan was ranked as the top criterion (RII = 1.000) used to assess SMME credit applications by DFIs in the study. The results are confirmed by those of the commercial banks survey and those of the document review of both DFIs and commercial banks (RII = 1.000 respectively) which ranked the business plan as number 1 of the lending criteria used to assess SMME credit applications. Both DFIs and commercial banks' respondents as well as the document review of both groups of funding institutions ascribed a scale of 4 (very important) to the business plan criterion. This implies that funding institutions place business plans at the centre of their lending criteria.

The above findings on the importance of a business plan are in line with those of Pretorius and Shaw (2004), Agyapong (2011) and Fatoki (2014) who all indicated that a bankable business plan is non-negotiable and indispensable in the assessment of credit applications by funding institutions. A study by the USAID (2010) on the financial institutions' hurdles to SME financing in South Africa also found that a good and bankable business plan was ranked among the top criteria by funding institutions. This is not surprising as a business plan is an important instrument in deciding the viability of a business as a borrower.

It can be observed that own contribution, tax clearance and collateral were ranked second (RII = 0.750) by the DFIs survey. This means that 63% (or five) of the DFI respondents gave a weight of 3 (important) or 4 (very important) to the above-mentioned criteria. The results for the above criteria (except tax clearance which was ranked as not important – RII = 0.500) were confirmed by the DFIs document review RII results (Table 6.5) which ranked own contribution and collateral second (RII = 0.750 respectively) on the list of their lending criteria. This means that the same number of DFI respondent percentage (63%) as with the DFI survey allocated a weight of 3 or 4 to these criteria.

The DFIs survey and document review RII results on own contribution confirm those of Fatoki (2014), Johnson *et al* (2014) and Richard and Mori (2012) who also found that sufficient amount of owner equity contribution and collateral are indispensable in the lending criteria of funding institutions. Own contribution is an indicator of how much the borrower has at risk should the business fail whereas collateral serves as a repayment source in case the loan is not repaid by the borrower. The above results by DFIs imply that they put significance on the above criteria. The findings are interesting because DFIs are expected to be lenient with SMMEs on these factors since they should understand the SMME profiles better than commercial banks.

Own contribution, collateral and the cash flow were ranked the same (number 1) as the business plan (RII = 1.000) by commercial banks' RII results. This means that all commercial banks, like DFIs, allocated a scale of 4 (very important) to all the above criteria. These results were confirmed by those of the commercial banks document review (Table 6.6) which also indicated that all the above, including financial statements, were top of the list (RII = 1.000) of their lending criteria. That commercial banks ranked the above factors at the very top of their list of lending requirements indicates that they perceive SMMEs as high risk and informationally opaque. They therefore do not want to leave anything to chance.

Table 6.3 indicates that experience, location of business and cash flow statement (RII = 0.730, 0.718 and 0.625 respectively) were some of the important factors (ranked 3, 4 and 5 respectively) indicated by the DFIs' RII results. This means that more than 50% of the DFIs' respondents allocated a scale of either 3 or 4 to the above-mentioned criteria. However, the DFIs' document review RII results in Table 6.5 were contrary to the DFI survey results.

According to the former results, experience, location of business and cash flow (RII = 0.250, 0.250 and 0.500 respectively) were not important (ranked 7, 7 and 5 respectively) in the lending criteria of DFIs. This implies that there is a discrepancy between the two results.

The USAID (2010) study ranked experience of the owner/manager as one of the important criteria in the lending decisions of funding institutions. Moreover, an empirical study by Zarook *et al* (2013) on experience and accessing credit in Libya found that there was a positive correlation between experience and SMME access to credit. They argued that experience influences the management capability of the firm to run a business sustainably. The DFIs RII results on the location of the business are contrary to those of the above-mentioned studies, Fatoki (2014) and Pandula (2011) who all observed that there was no correlation between the location of the business and SMME access to credit. The results on cash flow are consistent with those of USAID (2010) which ranked cash flow sufficient to repay the loan amongst the five key criteria used by funding institutions to evaluate credit applications from SMMEs.

The results of the commercial banks' RII survey revealed that experience (RII = 0.850), BBBEE status (RII = 0.750) and location of the business (RII = 0.700) were also some of the important factors (ranked 3, 4 and 5 respectively) used by banks in their lending criteria. However, the banks document review RII results elevated experience (RII = 1.000) to the top factors required by banks to lend to SMMEs. Moreover, the BBBEE status ranked as important by the banks survey was found not to be important (RII – 0.250; ranked 8) by the banks document review. This means that BBBEE status does not feature in any of the commercial banks' lending documents and protocols. With regards to the location of the business, there seems to be alignment between the commercial banks survey results and the document review results (RII = 0.750; ranked 3).

The DFIs and commercial banks survey as well as the document review RII results concur on the fact that VAT registration, educational level, age and gender of the owner/manager, the age of business, industry sector, form of business, average annual turnover and the firm's membership of business association are not important in the lending decisions of funding institutions. The above factors' RII results were each less than 0.599 hence this finding. The results confirm those of Fatoki (2014), USAID (2010), Pandula (2011) and Agyapong (2011) who all found that all the above factors (except the education level) were not important in the lending decisions of funding institutions. The above studies had differing views on the education level.

In summary, the results of the comparative evaluation of the lending criteria of DFIs and commercial banks show that there are no substantive differences between how commercial banks and DFIs evaluate credit applications made by SMMEs. This is interesting because DFIs were established to create an enabling environment for SMME access to funding by providing credit specifically to SMMEs. This was in response to the credit rationing of SMMEs by commercial banks which perceived them as high risk and informationally opaque. Therefore, if the criteria they use to evaluate SMME credit applications are the same as that of commercial banks, it means that they are no longer operating in accordance to the above mandate. If this status quo continues, it means that access to SMME credit in South Africa will continue to be an insurmountable challenge.

The survey and document review RII results of both groups of lenders place significance on the business plan, own contribution, collateral, cash flow statement, financial statements, experience, tax clearance, location of business, and BBBEE status. Moreover, there is significant discrepancy between what the RII lending documentation results of both groups indicate as key requirements and what the RII survey results of both groups indicate. For example, the RII survey findings of both groups indicate that tax clearance is important in their lending decisions. However, the RII document review findings of both groups indicate contrary to these findings. Also, the RII survey findings of both groups indicate that financial statements are not important in their lending decisions but the document review findings point out that they are very important in the lending process. Lastly, the RII survey results of commercial banks show that industry sector and education level are not important in their lending decisions but the document review results point to the contrary. This implies that what funding institutions practice is not congruent with what is enshrined in their lending criteria/policy. This further complicates the environment that SMMEs find themselves in with regards to them accessing credit from these funding institutions. The discrepancy may be one of the factors negatively affecting SMME access to credit in the Eastern Cape and in South Africa in general.

If we proxy lending in practice with what the key informants indicated as the critical variables, the results of the comparative evaluation of the funding institutions lending criteria show that both groups are more stringent in practice in key areas. A review of the characteristics of SMMEs in South Africa showed that they lack collateral, are low on savings and experience, have little capacity for writing business plans, are information opaque, have poor access to information, and cash flow management. The results here indicate that these are the very same areas which both groups of funding institutions place significant importance on. The findings indicate that the lending criteria used by both groups tend to favour the large and well established firms which have the required capacities.

Based on the above summary, it is evident that in order to address the SMME access to credit constraint, a new framework that can be used by both DFIs and commercial banks to lend to SMMEs needs to be developed. The framework must take into account the peculiar nature of SMME firm and entrepreneurship characteristics as outlined above. Without such a lending framework, the funding gap for SMMEs in SA will continue. The following section presents the recommended framework that can be used by both groups of funding institutions to evaluate funding applications from SMMEs.

CHAPTER 7: A FRAMEWORK FOR LENDING TO SMMES: CONCLUSIONS AND RECOMMENDATIONS

7.1 Introduction

The South African government created several DFIs to increase SMME access to credit in the country. However, data shows that access to credit for this group of firms remains very low. Moreover, given this background, the thesis investigated the criteria used by DFIs to evaluate SMME credit applications using commercial banks as a benchmark. The first objective of the study was to investigate the characteristics of SMMES in the Eastern Cape. The results of the study indicate that SMMEs in the study are characterised by poor/no business plans, lack of financial statements, lack of collateral, poor cash flow, lack of owners' contribution and lack of previous industry experience. Secondly, the interaction between demand and supply determinants and factors affecting access to credit was explored. The demand side factors identified included collateral, business information (business plan, financial statements, compliance documents, etc.), firm average annual turnover, cash flow, own contribution, age, size and location, experience, owner/manager education, form of business, industry sector, owner/manager gender and business association membership while the supply-side factors included good business plan, financials, collateral, cash flow, own contribution as well as experience.

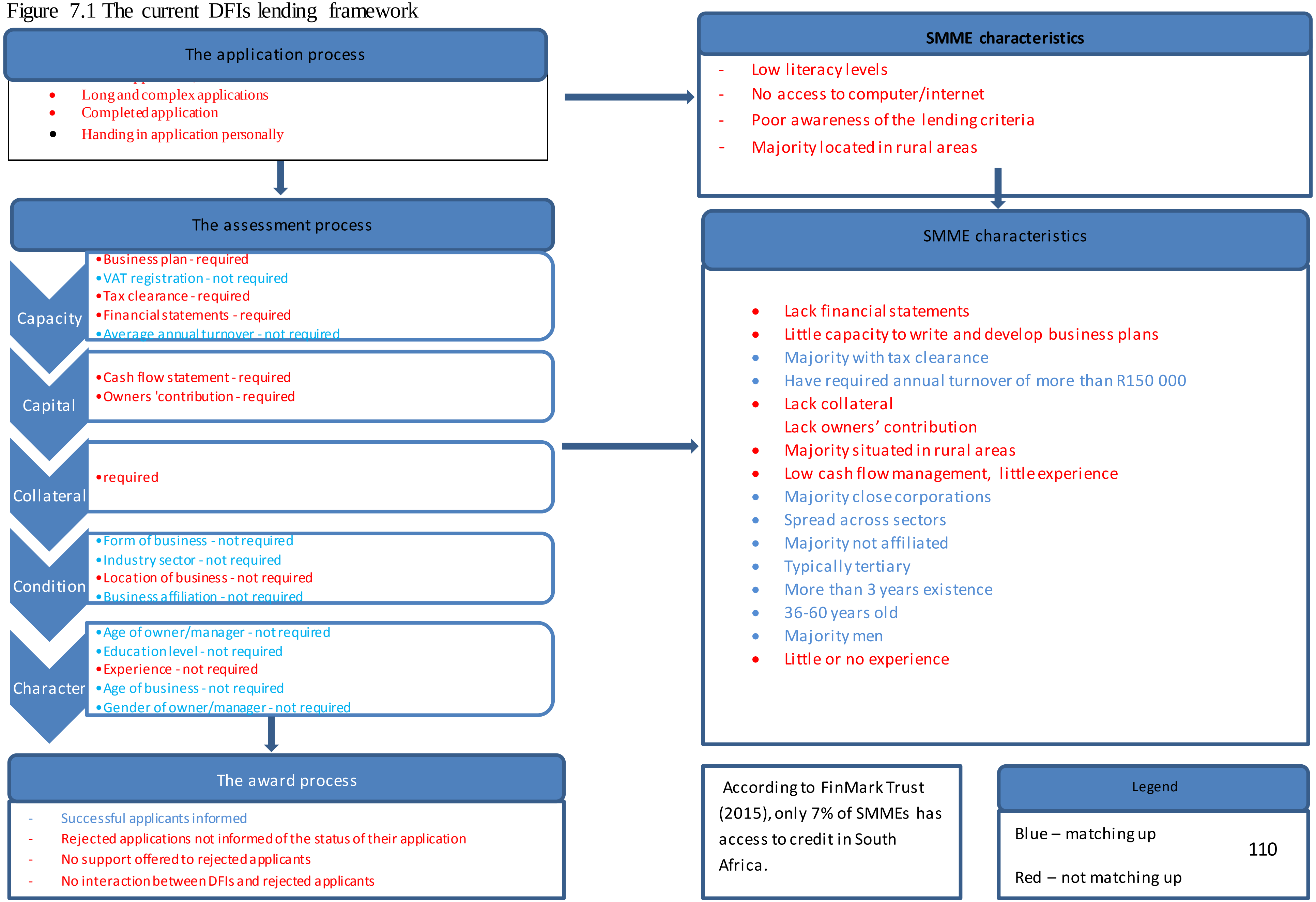
The study has found that generally, there is an alignment between the SMME and the funding institutions survey results. Only three of the criteria namely the average annual turnover, the location of the business and the age of the business were not aligned. This shows that the lending criteria of funding institutions are transparent. The study also pointed out that the characteristics of SMMEs in the Eastern Cape are representative of those of SMMEs countrywide. SMMEs in the province are characterised by poor/no business plans, lack of financial statements, lack of collateral, poor cash flow, lack of owners' contribution and lack of previous industry experience to mention but a few. These are the very same areas which both groups of funding institutions place significant importance on. This implies that the funding institutions lending requirements do not match-up with the above-mentioned peculiar characteristics of SMMEs in the province. It appears that the lending requirements of both groups of funding institutions are tailor-made for the large and well established firms which have the required capacity. Aligned with that, it was important to establish whether the criteria these institutions use to evaluate applications take account of the characteristics of the SMMEs. To underline the lending principles, the criteria used by DFIs were compared to that used by commercial banks. The results show that the criteria are very similar and both groups of financial institutions do not pay much attention to the unique characteristics of SMMEs.

Based on the above findings, the purpose of this chapter is to review the existing DFI model and in light of the findings of this study propose an alternative framework that can be used by DFIs in evaluating SMME credit applications. The framework that takes into account the unique characteristics of SMMEs is aimed at responding to the above-mentioned challenges faced by SMMEs in the province. The chapter consists of two sections. The first section outlines the model currently used by DFIs to lend to SMMEs. The lending framework details the credit application form, process as well as the criteria used by funding institutions for lending. The second section provides the proposed lending framework that can be used by DFIs to lend to SMMEs.

7.2 The current lending framework

The current lending framework currently used by DFIs is depicted in the Figure 7.1 below.

Figure 7.1 The current DFIs lending framework



7.2.1 The application process

By and large, the credit application process for DFIs and commercial banks is the same. The credit applicant obtains the hard copy credit application form from the funding institution's loan consultant (in the case of commercial banks) or business development advisor (in the case of DFIs). Some funding institutions in particular commercial banks have their application forms available on line. These institutions encourage credit applicants who have access to internet to make online applications. However, though this arrangement is convenient to those SMME credit applicants with access to computers and internet, the general feeling was that it disadvantages those who do not have these facilities. The latter applicants have no alternative but to visit the funding institutions' offices to obtain application forms. Some of these institutions offices are located far away from where applicants reside. This means that applicants have to spend money on transport and have to stand on long queues before they are served. In certain instances, credit applicants would be told to come back the following day as someone who ought to provide them with application forms is on leave. This has financial implications for SMMEs as the majority of them are based in rural areas.

The credit application forms for both the DFIs and commercial banks ranged between 4 and 20 pages long. The majority (58%) of both DFIs and commercial banks credit application forms were more than 10 pages long while 25% had 7. These findings reveal that the funding institutions application forms are long and are thus discouraging to SMMEs applying for credit. Given the fact that generally, SMMEs are characterised by low literacy levels, long application forms dampen SMMEs' appetite to make loan applications. The findings are in line with those of Pretorius and Shaw (2004) who in their analysis of the major banks application forms found that their application forms were extensive and posed as a hurdle to SMME endeavours to access credit.

Secondly, the application forms were found to be complex, and not easy to understand. The findings confirm those of the SMME survey which pointed out that complicated application forms was one of the major reasons why 42% of SMMEs' credit applications were rejected. This can be attributed to the complexity of the application forms and the lack of assistance in completing them thereof. This was also raised as one of the major challenges experienced by the credit applicants. The findings are supported by those of Pretorius and Shaw (2004) who also observed that credit application forms were too complicated and difficult to understand thus impacting negatively to SMME access to credit.

Thirdly, application forms from all funding institutions were prepared in English. This was noted by Mahadea and Pillay (2008) who pointed out that SMMEs are required to complete bulky and complex loan application forms written in English and not translated to the applicant's first language. This results in incomplete and inaccurate applications because the applicants struggle to understand the contents of the form. At the same time, the lack of understanding of the loan application procedure and criteria frustrates SMMEs and this creates a negative perception against lending institutions (Bbenkele, 2007; Ganbold, 2008). This sets SMMEs up for failure as completing the form not having been taken through and understood the above-mentioned procedures and criteria excluded them from being considered for credit.

The application forms are designed in such a manner that they capture all the relevant information pertaining to the funding applicant's personal details, business entity details, projects to be implemented, management, finance as well as a checklist of documents to accompany the application form. Some funding institutions also use the form to capture information contained in the credit applicant's business plan.

Once the form has been obtained, the applicant completes it and submits it to the funding institution. The findings of the analysis of assistance provided to credit applicants by funding institutions revealed that 58% of the funding institutions do not provide any assistance in the completion of application forms while only 25% provides assistance. The remaining funding institution conducts public road shows on how to complete the application form. In addition, the findings indicate that there is no interaction between the funding institutions and the SMME credit applicants during the funding application process. These findings concur with those of the SMME survey where owner/managers whose credit applications were not approved listed non-assistance in the completion of application forms by funding institutions as one of the reasons for their application rejection. The findings are also supported by the USAID (2010) study which found that poor/incomplete paperwork was among key reasons why SMMEs failed to obtain credit from funding institutions.

When asked why they did not provide any assistance to applicants in the completion of their credit application forms, funding institutions stated that they did not have enough staff to provide the said assistance. The non-availability of assistance results in some credit applications being submitted incomplete or not submitted at all. Based on their funding criteria, incomplete credit applications are not considered by funding institutions. This impact negatively on SMME access to credit.

Once the form is completed and required documents attached, the applicant submits the form back to the loan consultant or business development advisor who in turn checks if all the sections have been completed and required documents attached. If the form has not been fully completed and there are missing documents, the funding applicant is turned back to complete the form and to provide the missing documents. This process is done at a branch/regional level.

DFIs have funding window periods and applicants have to meet deadlines for submission. The window periods are in line with the government departments' financial year calendar. If a credit applicant misses the closing date by which completed funding applications must be returned, the application is not accepted. Commercial banks, on the other hand, do not have the above arrangement and credit applications are received all year round. Twenty per cent (20%) of all funding institutions indicated that when the credit application has been submitted, it goes through the preliminary credit assessment at the branch/regional level while the remaining 80% stated that credit applications are sent directly to their respective head offices for evaluation.

Due to the opacity of SMMEs, the latter arrangement by the majority of funding institutions limits the potential of qualifying SMMEs to access credit. This is because when credit applications are assessed at branch/regional level, it becomes easier for a funding institution to request any outstanding information from the potential funding applicant. The applicant can in turn provide the information with ease due to his/her proximity to the branch/regional office. In addition, because the loan officer/business advisor has forged a relationship with the applicant, acquiring the outstanding information becomes easier. However, the opposite is true when credit applications are assessed at head office. This impacts negatively to SMME access to credit as the applications are assessed by someone who might not have any background about the credit applicants whatsoever.

7.2.2 The assessment process

The submitted application forms are then assessed based on the respective funding institutions lending criteria. The previous chapter outlined that the funding institutions lending criteria are fundamentally the same. SMME credit applications are assessed based on the creditworthiness of the applicant as well as the ability of the applicant to repay the loan. In this process, a bankable business plan, availability of credible and up to date financial information, a cash flow statement, own contribution, tax clearance certificate, location of the business, experience and collateral are considered by funding institutions.

The investigation of the criteria used by funding institutions revealed that tax clearance, average annual turnover, the form of business, industry sector, business membership, education level, age of business and the gender of owner/manager are not important in the lending decisions of funding institutions. The analysis of the results of the study pointed out that SMMEs in the study have little capacity to write and produce business plans, have low levels of experience, are information opaque, are low on savings and lack collateral and own contribution. This implies that what funding institutions look for doe s not match up with the characteristics of SMMEs in the province. It is therefore evident that SMMEs will continue to struggle accessing credit from funding institutions if the current arrangement is not addressed.

7.2.3 The award process

Successful applicants are sent correspondence informing them of the approval of their applications. Those that fail the evaluation process are returned back to the loan consultants/business development advisors for additional information and any other detail that may improve the credit status of the applicant. Commercial banks forward weak approved credit applications together with the business plans to the Small Enterprise Finance Agency (SEFA) for the issuing of the Credit Guarantee Scheme. However, strong applications are funded by banks. Alternatively, the applicant is rejected altogether.

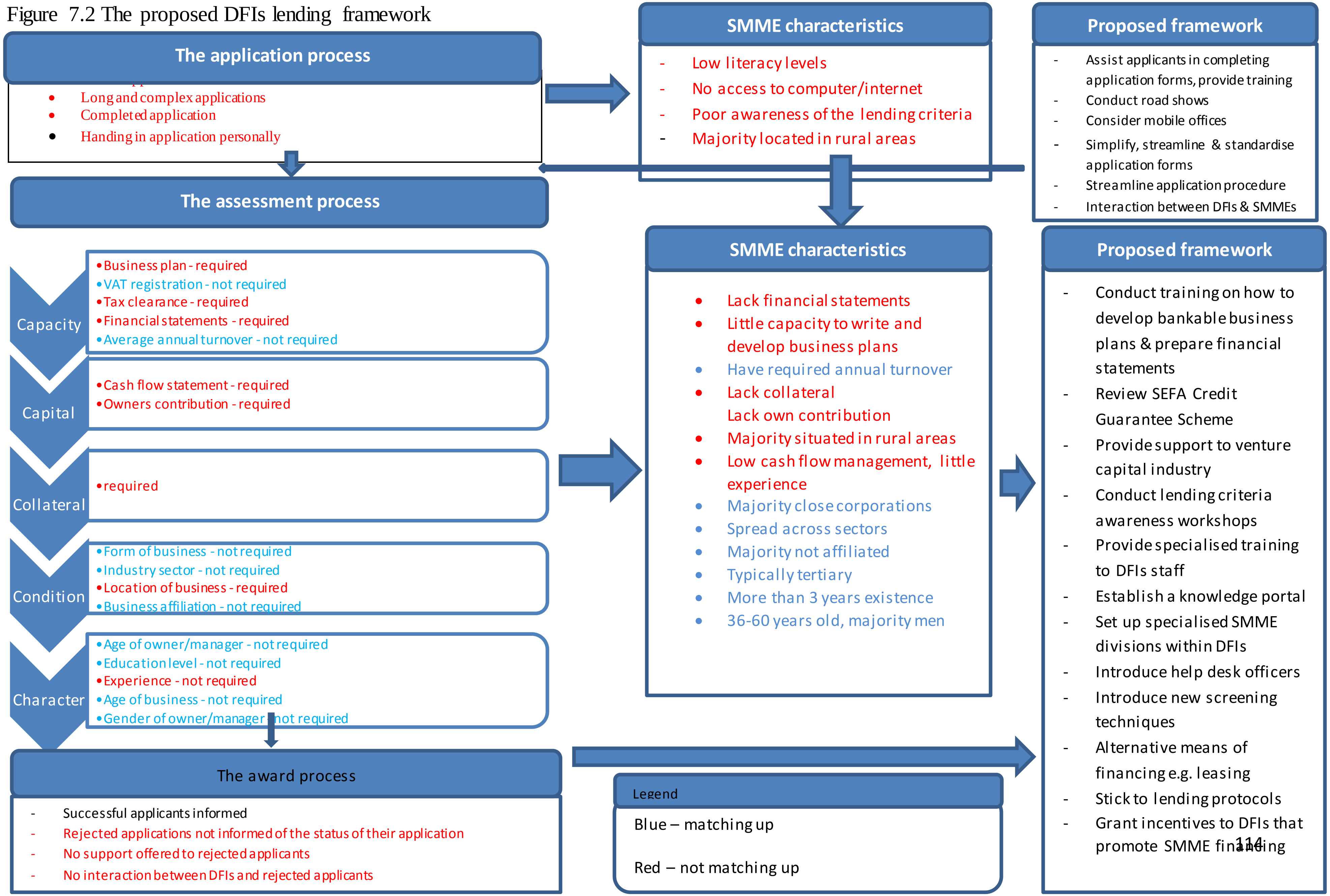
It is important to note that SMME owner/managers whose credit applications are totally rejected are not responded to and given reasons why their applications are rejected. As a consequence, they are left in the dark in relation to what they need to improve upon. This discourages the applicants and they end up not applying for credit again. There is also no support provided to those whose applications are successful to ensure that their businesses thrive so that they can in turn pay back the loan.

Based on the above current lending model, it is evident that in order to increase SMME access to credit and reduce their attrition rate in the Eastern Cape, a lending framework that takes into account the peculiar characteristics of SMMEs in the province. It is hoped that the framework will change the lending landscape of the DFIs in the province. The following section presents the proposed framework.

7.3 The proposed DFIs lending framework

The proposed DFIs lending framework is presented in Figure 7.2 below.

Figure 7.2 The proposed DFIs lending framework



The current lending framework revealed that unfriendly staff, complicated application forms, too much information required and no assistance offered by funding institutions in the completion of the application forms were major constraints faced by SMMEs in their endeavour to apply for funding. In response to the above constraints, it is proposed that government must incentivise funding institutions to innovatively provide capacity building and training programmes targeted at improving the skills and expertise of their staff. In addition, funding institutions can also support the development of new products as well as developing new risk assessment tools that can be used when evaluating SMME credit applications.

With regard to the complicated application forms and too much information required, it is proposed that funding institutions should simplify their loan application forms to cater for the historically low literacy levels of SMMEs in the Eastern Cape and in the country as a whole. The loan application forms must be user-friendly. In addition, funding institutions must adopt a more streamlined loan application process as well as a shared due diligence process. This initiative can significantly make the SMME credit applications evaluation process easy as noted in Kenya (Calice *et al*, 2012). Moreover, the streamlined application process can significantly reduce the loan approval time and will make it easier for SMMEs to submit loan applications to a number of funding institutions. It is also proposed that in consultation with other funding institutions, application forms as well as key lending documents are standardised. The standard documents together with relevant information on financing schemes could be made available to SMMEs via an internet portal. The above initiatives have been observed to transform the lending landscape of funding institutions in Kenya, Tanzania and Uganda (Calice *et al*, 2012) and South Africa can learn from these countries.

Moreover, it is recommended that funding institutions must conduct road shows and workshops and to take their potential SMME customers through their application forms, how they must be completed and the documents to accompany the form as well as create a platform for the above-mentioned customers to ask questions regarding the form. In addition, funding institutions should provide consultancy services to help SMMEs with their loan requests. The current lending framework indicates that there is no interaction between DFIs and their potential customers during the funding application stage. It is therefore proposed that DFIs should open room for interacting with SMME credit applicants from the application stage till the loan has been repaid. DFIs should also provide business development support to the successful applicants to ensure the sustainability of their businesses so that they can repay the loan offered.

The study pointed out that a bankable business plan is non-negotiable in the lending decisions of both DFIs and commercial banks. In addition, the findings of the study revealed that firms with good and bankable business plans were more likely to have success in their applications for credit compared to those that did not have. However, the current system where government agencies such as SEDA use consultants to develop business plans on behalf of entrepreneurs who struggle to articulate their plans constrains SMME access to credit. Therefore, it is proposed that entrepreneurs must personally be involved in the gathering of the relevant information as well as in the writing up of their business plans. There is also a clear need for private and public SMME support staff to be trained in being more responsive to the needs of small business owners so as to improve SMME access to credit. For those SMMEs with no business plans, it is proposed that government agencies in collaboration with the respective municipal local economic development units must organise training sessions on how to develop bankable business plans.

The findings of the study also revealed that SMMEs in the study area lack awareness of the services provided by funding institutions as well as the criteria DFIs use to evaluate funding applications. This was evidenced by the fact that the majority of SMMEs did not have the documentation required by funding institutions. It is therefore proposed that both DFIs and commercial banks must organise quarterly workshops/seminars or awareness campaigns aimed at informing their potential clientele on the services each funding institution offers as well as their lending criteria. These workshops must thoroughly articulate the importance of such requirements as financial statements, the availability of collateral, cash flow, owner’s contribution as well as relevant experience.

There is also a need for SEFA to review its Credit Guarantee Scheme. South Africa can learn a number of lessons from Chile’s Fogape and Malaysia’s Credit Guarantee Corporation (CGC). All three countries have similar emerging economies and similar per capita GDPs. Chile and South Africa are both characterised by income inequality, poor level of primary education and ailing infrastructure (Trade and Industrial Policy Strategies, 2012). According to Trade and Industrial Policy Strategies (2012), the two organisations have since their establishment lent millions of rands in loans through their respective schemes to thousands of SMMEs. South Africa’s Kula Guarantee Scheme (which is now under the custodianship of SEFA), nearly closed down during the 2009/2010 financial year.

The scheme saw a slight recovery during the 2010/2011 financial year when it loaned out 81 new loans amounting to R36.5 million to SMMEs (Hansen *et al*, 2012). Since its establishment in 1996, the scheme’s credit guarantees never exceeded 800. In 2009 the scheme lent out 53 guarantees compared to Fogape’s over 52 510 and CGC’s 14 073. Between 2006 and 2010, the SEFA Guarantee Scheme recorded an average default rate of 42.15% (Trade and Industrial Policy Strategies, 2012). This means that more than four in every ten loans lent out by banks through the scheme were defaulted upon. Fogape and the CGC, on the other hand, recorded default rates of 4% respectively during the same period. Chile and Malaysia have driven lending through innovative measures such as the reduction of red tape and bureaucracy in the claims process, using systems to reduce risk when lending as well as maintaining trust between banks and the credit guarantee schemes.

Timeous and speedy settlement of claims by a credit guarantee scheme to member banks is extremely important if a credit guarantee scheme is to gain confidence from its participating banks. This practice is especially pivotal for the Kula Guarantee Scheme, where over two in five loans were defaulted upon by businesses between 2006 and 2010 (Trade and Industrial Policy Strategies, 2012). The scheme requires a participating bank to first acquire a default judgment against the firm owner before it can lodge a claim. It could take a minimum period of between one to three months and a maximum of five years to obtain the above-mentioned default judgement (Calice *et al,* 2012). When the bank has ultimately obtained the default judgement, it can take Kula a year to settle a claim with banks. As a result of this, banks have lost confidence in Kula and are reluctant to rely on this scheme. This does not auger well for SMMEs who depend upon the scheme to bail them out should things no go well for them. Compared to SEFA, Chile’s Fogape (where banks only need proof that legal proceedings are under way in court) takes less than one month to settle a bank’s claim. Meanwhile, Malaysia’s CGC takes a maximum of three months to settle a claim claims after an application for claim settlement has been lodged with a court.

In South Africa, SEFA can do well to increase communication between bankers and the scheme’s officials. In 2011, South African banks observed that the number of meetings between its staff and Khula’s had dwindled in recent years. On the other hand, Chile’s

Fogape sponsors an advisory committee with representation from the four major banks, the nation's largest three employers' associations of small and micro enterprises, the Ministry of Economy as well as the Supervisor Fund. This committee meets on a quarterly basis. If SEFA is to win back the banks, it has to adopt the two countries' strategy.

Lastly, the use of credit-risk systems by CGC can also help Kula to mitigate risks. The CGC makes use of three important systems to mitigate risks (Trade and Industrial Policy Strategies, 2012). This makes it easier for credit providers to make a quick decision as to whether to grant SMMEs loans or not. The three systems are as follows:

- The Central Credit Reference Information System (CCRIS): banks must supply the central bank with data on loans in order for the system to calculate the risk of lending to SME clients.
- The Credit Tip-off System (CTOS): reports on any legal proceedings lodged against businesses or individuals in Malaysia.
- SME Credit Bureau: provides SME lenders with accurate credit ratings which will help in accessing finance from CGC.

The findings of the study revealed that one of the factors negatively impacting on SMME access to credit is information asymmetry. Venture Capital finance is one of the strategies to counteract the above-mentioned challenge. Venture capitalists are organised providers of financing for winning but risky business proposals by SMMEs that have a promising but yet unproven idea (Ambrose, 2012). As outlined in chapter 3 of the study, venture capital financing has some advantages. Firstly, venture capital has no repayment commitment during the term of the loan and requires no payment/dividends/personal guarantees/collateral from the SMME owner/manager. Secondly, the capital provided by the firm increases the capital base of the start-up firm resulting in the improvement of the start-up's net asset value. This makes the firm more attractive to debt financing or future investors. Thirdly, start-up firms that receive venture capital also receive many other intangible benefits. Because venture capital firms have reputations for being highly selective, their receipt of venture capital funding usually enhances a start-up firm's reputation to its customers, other investors, and suppliers.

Venture capital finance is a common source of credit used by a number of countries such as Ireland, America, Macedonia and Philippines (Global Entrepreneurship Monitor, 2015). America pioneered the use of Venture Capital and is still the leader in terms of money invested and number of deals but other countries are now developing their own venture capital funds. Other African countries such as Ghana, Uganda, Nigeria, Zambia and Kenya have realised the importance this source of finance has on increasing SMME access to credit. As a result, these countries are mobilising their governments to create a conducive environment for the promotion and growth of this industry (Boadau *et al*, 2012; Poku and Frimpong, 2009; Ambrose, 2012). In South Africa, the Venture Capital asset class is a very small component of the overall market for equity investments compared to other similar sized countries (Tuomi and Neto, 2013). In 2008, the country only had 65 venture capital funds controlling a total of R29 billion with an average investment size of R15.4 million (South African Venture Capital Association, 2008). During this period, new venture investment focusing on SMMEs was about R1.1 billion which was only a fraction (3.8%) of the funds. This implies that venture capital's availability to start-up and emerging SMMEs is limited in the country.

Compared to South Africa, Brazil, the country's BRICS counterpart, has grown its VC fund managing companies from 8 to 180 between 1994 and 2004 (Tuomi and Neto, 2013). According to the sector's Brazilian association, ABVCAP, the country's VC investment grew from $5.6 billion to $38 billion between the period 2004 to 2010 (Tuomi and Neto, 2013). According to Tuomi and Neto (2013) Brazil's VC industry invested on 204 start-ups and 100 established enterprises in 2004. Brazil's VC growth can be attributed among others to the country's macroeconomic environment which has been stable since the mid 1990's. The country has maintained low inflation rates and steady economic growth. The growth can also be attributed to the country's legislative changes that allowed for greater public-private partnerships. In 2006, Brazil reduced taxes on income made with VC by foreign investors to zero provided that they were taxed at least by 20% in their home countries. Moreover, the Brazilian equivalent to Securities and Exchanges Commission, the CVM, set new ownership mechanisms that allowed limited partnership and holding companies to be set up.

The above are lessons South Africa can learn from Brazil. It can provide support to its venture capital industry along the Brazilian lines. The first step is to create a good investment climate. Some of the strategies could include the removal of the capital gains tax on such funds by either residents or non-residents. In addition, the country could speed up and simplify the patent process. This could help foster innovation among SMMEs. Moreover, SMMEs must be educated about VC including their requirements so that they are better prepared to make use of VC opportunities when they come their way. Academic-business linkages are also important in increasing VC in the country.

In addition, funding institutions must prepare funding criteria information brochures to be distributed to each local municipal LED unit and other relevant local information centres. These must be prepared in simple local languages spoken by SMME owner/managers in the Eastern Cape. The brochures must contain information on the services provided by each funding institution as well as the lending criteria used to evaluate funding applications. Funding institutions could also partner with SMME associations to host regular meetings with business owners in a bid to better understand their needs and build relationships with potential profitable clients.

Funding institutions staff dealing with SMMEs requires a sound knowledge about SMME owner/managers and their firms in order to develop an affinity with their clients and offer them solutions adapted to their needs. In addition, funding institutions should recruit account managers with adequate background and experience in small business development who can be flexible and sensitive to SMME issues. Funding institutions must provide specialised and quality training programmes on SMME credit analysis and portfolio management.

Business support institutions such as SEDA, NYDA and government departments should provide SMMEs with the necessary business skills in order to articulate a business model that is competitive. SMMEs should be encouraged to join business associations for networking and access to information. It is also proposed that a knowledge portal that will enable the sharing of knowledge and learning among SMMEs in the Eastern Cape be established. The portal should provide a single repository for information and handbooks on policies and regulations, SMME practices, tax and registration, access to finance and financial business development services. The portal could also be a platform where training events, workshops and business expos could be advertised.

The results of the study indicate that although some of the private and government finance and supporting agencies have been in existence for years, they are still not known by some owner-managers. It is also evident that even those agencies that are known to some owner-managers, their services are not utilized. There is a need for the above-mentioned institutions to vigorously advertise themselves through the media and workshops to inform SMMEs about the services they offer, how SMMEs can access these and how they can benefit from these services. Simple information products, possibly in the form of booklets or pamphlets should be provided on the services offered by various SMME support institutions. Communication with SMMEs must be the key area of focus.

Funding institutions in particular banks in Africa are beginning to realise the importance of setting up SMME divisions or units to provide specialized credit services to SMMEs. For example, in Kenya, Tanzania, Zambia funding institutions have established separate units so as to be responsible to the needs of SMME clients (Calice *et al*, 2012). This is in recognition of the inherent differences between SMMEs and consumer and corporate clients. Some of these funding institutions have gone as far as allocating resources in order to provide capacity building training to their SMME clientele so as to improve their management skills and financial reporting. Therefore, it is proposed that South African funding institutions can learn from these countries and establish such divisions/units within their corporate structures. The divisions/units must be staffed by specially trained credit officers. For financial institutions that already have such divisions, they are usually perceived to be less important compared to corporate lending divisions. Elevating the importance or status of SMME divisions would encourage greater interest and focus on the SMME sector. Also, funding institutions could consider introducing help desk officers who can assist SMMEs in the completion of loan application forms as well as providing them with the necessary advice in obtaining funding.

The findings of the study indicate that funding institutions evaluate SMME credit applications based on the credit history of the applicant owner/manager. It is proposed that funding institutions should evaluate SMMEs credit applications based on a variety of factors such as their personality, intelligence, business potential, deposit history and character rather than their past track record. SMME loan applications must be approved at branch/regional level. Funding institutions could offer interest rates commensurate with new risk profiles of their SMME clientele. Moreover, funding institutions could also employ the test innovation risk evaluation methodologies such as the psychometric screening developed by the Harvard University’s Entrepreneurial Finance Laboratory. The psychometric screening technique evaluates personal attributes such as honesty, ethics, drive, motivation, optimism, intelligence and business skills. With this valuable information, funding institutions can lend to those SMMEs that do not have a good credit record, borrowing history or collateral. This technique has been proven successful in some initial pilots conducted in other African countries such as Malaysia, Nigeria and Uganda (Beck and Cull, 2014). Funding institutions can also explore considering financing as a package that includes loans as well as extension type services such as business development or entrepreneurial training. They also need to adapt their commercial operational models to accommodate the peculiar needs of SMMEs.

The study has revealed that lack of collateral and own contribution is some of the pivotal impediments impacting negatively on SMME access to credit. Therefore, it is proposed that alternative means of financing that do not require collateral be introduced. This could reduce access to credit constraints for SMMEs. Alternative means of financing could be achieved through the use of specific transaction and asset-based lending techniques. These could take care of the informationally opaque SMMEs. One example of such alternatives used in Ethiopia is leasing (Nega and Hussein, 2016). With leasing, credit applications are assessed based on the project’s capacity to service lease payments. The Ethiopian government introduced the machine leasing programme for SMMEs lacking collateral in securing loans for their projects (World Bank, 2015). The programme is run by the country's Commercial Bank of Ethiopia (CBE). The country's Metal Engineering Corporation, the biggest producers of machinery and metal products in the country and other private organisations partake in this programme as key suppliers.

The promotion of greater linkages and dialogues between financial institutions and SMME/Trade Associations/SMME centres is proposed. This would promote better understanding and facilitate SMME access to credit. In this regard, funding institutions could organize road shows to various SMME associations to introduce their services. Also, seminars or trade exhibitions held by industry associations could include funding institutions.

The findings of the study indicate that there is a discrepancy between what the lending documentation indicates as key requirements and what the survey results indicate. It is therefore proposed that funding institutions must reconcile the two so that they can have one lending criteria they communicate to their clientele. This will ensure that there is no confusion on the SMME side. Funding institutions must stick to their documented lending protocols.

Another possible strategy to increase SMME access to credit is to set up special banks for SMMEs that can exclusively cater for the needs of this sector. These could be based on the structures of the current cooperatives banks. These are found in some Asia-Pacific countries such as Malaysia, Pakistan and Thailand (United Nations Economic and Social Commission for Asia and the Pacific, 2015). SMME banks should provide consultancy services to help SMMEs with their loan requests.

Lastly, to promote greater SMME lending, government could consider what countries such as Nigeria have done - granting certain incentives to financial institutions that actively promote SMME financing and have achieved a sizeable SMME loan book. Such incentives could be for a certain period of time and in non-financial form e.g. branching privileges, tax deductions or certain expenses.

7.4 Areas for further research

The study investigated SMME access to credit from the SMME characteristics point of view. It would be interesting to find out how external and institutional factors affect SMME access to credit. Moreover, an investigation into the effectiveness of the SEFA Credit Guarantee Scheme in promoting SMME access to credit would be invaluable.

REFERENCES

Abdulsaleh, A.M. and Worthington, A.C. (2013). Small and Medium-Sized Enterprises Financing. *International Journal of Business and Management, 8 (14): 36-44.*

Abor, J. (2007). Capital Structure and Financing of SMEs: Empirical Evidence from Ghana and South Africa. Unpublished PhD Dissertation. University of Stellenbosch, South Africa.

Abor, J. and Quartey, P. (2010). Issues in SME Development in Ghana and South Africa. *International Research Journal of Finance and Economics, Issue* 39:2456.

Accelerated Shared Growth Initiative of South Africa (AsgiSA). (2006). The Presidency, Republic of South Africa, Pretoria.

Adcorp. (2012). New Business Start-ups Slump to All time Low. [Online] Available: www.adcorp.co.za/News/ Pages/ New Business Start-ups (March 22, 2012).

Adeniran, T, and Johnston, K. (2011). Investigating the Level of Internet Capabilities of South African Small and Medium Enterprises in Changing Environments. [Online] Available: www.zaw3.co.za/index.php/ZAWWW/ 2011/paper/view/450> (May 5,2014).

Agyapong, D., Agyapong, G.K.Q. and Darfor, K.N. (2011). Criteria for Assessing Small and Medium Enterprises' Borrowers in Ghana. *International Business Research, 4 (4): 132-135.*

Albert, S.C. (2004). Funding SMEs in the Natal Midlands Region. Unpublished Master of Business Administration thesis. The School of Business, University of KwaZulu-Natal.

Allen, F., Qian, M. and Qian, J. (2005). Law, Finance and Economic Growth in China. *Journal of Financial Economics, 77 (1): 57-116.*

Altman, E.I. (1968). Financial Ratios, Discriminant Analysis and the Prediction of Corporate Bankruptcy. *The Journal of Finance, 23 (4): 1-21.*

Ambrose, J. (2012). Venture Capital (VC): The All Important MSMEs Financing Strategy Under Neglect in Kenya, International Journal of Business and Social Science, 3 (21): 234-237.

Amra, R., Hlatshwayo, A. and Mc Millan, L. (2013). SMME Employment in South Africa. Biennial Conference of the Economic Society of South Africa. Bloemfontein, 25-27 September 2013.

Anga, R.M. (2014). Determinants of Small and Medium Scale Enterprises in Nigeria. *JORIND, 12 (1): 140-146.*

Antwi, S.K. and Hamza, K. (2015). Qualitative and Quantitative Research Paradigms in Business Research: A Philosophical Reflection. *European Journal of Business and Management, 7 (3): 217.*

Arthur, R. (2009). Understanding Credit 5C's to Make your Banker a Friend. [online]. Available: http://www. Advantage bizmag.com/archives [July 16, 2015].

Australian Bureau of Statistics (1996). Australian Small Business: Key Statistics and Analysis. Commonwealth of Australia.

Aziz, N., Zain, Z., Mafuzi, R.M.Z., Mustapa, A.M., Najib, N.H.M. and Lah, N.F.N. (2016). Relative Importance Index in Ranking of Procrastination Factors Among University Students. Proceedings of the International Conference on Applied Science and Technology 2016. AIP Publishing.

Babbie, E. (2008). The Basics of Social Research (Fourth Edition). Belmont, CA: Thomson Wadsworth. United States of America.

Babtista, R., Escaria, V. and Madruga, P. (2005). Entrepreneurship, Regional Development and Job Creation: Case for Portugal. Discussion Papers on Entrepreneurship, Growth and Public Policy No 0605, Max Planck Institute for Research into Economic Systems, Group Entrepreneurship, Growth and Public Policy.

Badulescu, D. (2011). Collateral in SMEs' Lending: Banks Requirements vs. Customers Expectation. The Annals of the Stefan cel Mare. University of Suceava. Faculty of Economics and Public Administration, 11 (1).

Baker, M. and Wurgler, J. (2002). Market Timing and Capital Structure. *The Journal of Finance, 57 (1): 1-32.*

Bascha, A. and Walz, U. (2001). Convertible Securities and Optimal Exit Decisions in Venture Capital Finance. *Journal of Corporate Finance, 7 (3): 285-306.*

Bashir, M., Afzal, M.T. and Azeen, M. (2008). Reliability and Validity of Qualitative and Operational Research Paradigms. *Pak.j.stat.oper.res*, 4(1): 35-45.

Battacherjee, A. (2012). Social Science Research: Principles, Methods and Practices. Textbook Collection. Book 3. http://scholarcommons.usf.edu/oa_textbooks/3

Bbenkele, E.K. (2007). An investigation of small and medium enterprises perceptions towards services offered by commercial banks in South Africa. *African Journal of Accounting, Economics, Finance and Banking Research*, 1 (1):13-25.

Beck, T. (2007). Financing constraints of SMEs in developing countries: Evidence, determinants and solutions. *Journal of International Money Finance, 31 (12):401-441.*

Beck, T. and Cull, R. (2014). Small and Medium Sized Enterprise Finance in Africa. World Bank Policy Research Working Paper 7018.

Bergemann, D. and Hege, U. (1998). Venture Capital Financing, Moral Hazard and Learning. *Journal of Banking and Finance, 22 (6): 703-735.*

Berger, A.N. and Udell, G.F. (1998). The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle. *Journal of Banking and Finance, 22: 613-673.*

Berger, A.N. and Udell, G.F. (2002). Small Business Credit Availability and Relationship Lending: The Importance of Bank Organisational Structure. *The Economic Journal, 112: 32-53.*

Berger, A.N. and Udell, G.F. (2006). A More Complete Conceptual Framework for SME Finance. *Journal of Banking and Finance, 30 (11): 2945-2966.*

Berry, A., Von Blottnitz, M., Cassim, R., Kesper, A., Rajaratnum, B. and Van Seventer, D.E. (2002). The Economics of SMMEs in South Africa. Trade and Industrial Policy Strategies.

Blanton, W.R. and Dorman, T.L. (1994). Small Business Spotlight SBA… Loans for Community Banks. *Journal of Commercial Lending*, 76.

Blumberg, B.F. and Letterie, W.A. (2008). Business Starters and Credit Rationing in Small Business. *Small Bus Econ*, 3(1): 187-200.

Boadau, F., Dwomoh, G., Appiah, S. and Dwomo-Fokuo, E. (2014). Venture Capital Financing: An Opportunity for Small and Medium Scale Enterprises in Ghana. *Journal of Entrepreneurship and Business Innovation, 1 (1): 1-11.*

Bolton, J.E. (1971). Report of the Committee of Inquiry of Small Firms. HMSO, London.

Brennan, M. and Schwartz, E. (1978). Corporate Income Taxes, Valuation, and the Problem of Optimal Capital Structure. *Journal of Business, 51: 103-114.*

Broad Based Black Economic Empowerment Act 53 (2003). The Presidency. Republic of South Africa.

Brown, K. and Moles, P. (2014). Credit Risk Management. Edinburgh Business School. Scotland. United Kingdom.

Brusco, S. (1992). Small Firms and the Provision of Real Services, Dans Pyke, F. et Sengenberger, W. (éd.) Industrial Districts and Local Economic Regeneration, International Institute for Labour Studies, BIT, Genève.

Bureau for Economic Research (2016). University of Stellenbosch. South Africa.

Bygrave, W.D. and Timmons, J.A. (1992). Venture Capital at the Crossroads. Harvard Business Press.

Calice, P., Chando, V.M. and Sekioua, S. (2012). Bank Financing to Small and Medium Enterprises in East Africa: Findings of a Survey in Kenya, Tanzania, Uganda and Zambia. African Development Bank Group Working Paper.

Cant, M. and Wiid, J. (2013). Establishing the Challenges Affecting South African SMEs. *International Journal of Business and Economic Research, 12 (6): 401-441.*

Cassar, G. and Holmes, S. (2003). Capital Structure and Financing of SMEs: Australian Evidence. *Journal of Accounting and Finance, 43 (2): 123-147.*

Cekrezi, A. (2013). A Review of the Trade-off Theory of Capital Structure. *Iliria International Review, 1: 126-132.*

Chandler, J.G. (2009). Marketing Tactics of Selected Small Firms in the East London CBD Area, South Africa. University of South Africa.

Chenesai, R.E. (2009). Determinants of Capital Structure of Small and Medium Enterprises in the Buffalo City Municipality. Unpublished Master of Commerce Thesis. University of Fort Hare. Eastern Cape Province, South Africa.

Claessens, S. and Tzioumis, K. (2006). Measuring Firm's Access to Finance. World Bank, Washington DC.

Creswell, J.W. (2007). Research Design: Quantitative, Qualitative and Mixed Methods Approaches. 3rd Edition. Upper Saddle River, N.J. Pearson Education.

Creswell, J.W. (2009). Research Design: Qualitative and Mixed Methods Approaches. London: Sage.

Cullen, M.D.M, Calitz, A.P. and Gaga, S. (2014). SMME Access to Finance in South Africa. *Journal of Emerging Issues in Economics, Finance and Banking (JEIEFB), 3 (6): 1255-1257.*

Cumming, D. (2006). Adverse Selection and Capital Structure: Evidence from Venture Capital. *Entrepreneurship Theory and Practice, 30 (2): 155-183.*

Curan, J. and Storey, D.J. (1993). The location of Small and Medium Enterprises: Are there urban/rural differences? in Curran and D.J. Storey (eds), Small Firms in Urban and Rural Locations, London, Routledge.

Deakins, D., North, D., Baldock, R. and Whittam, G. (2008). SMEs Access to Finance: Is There Still a Debt Finance Gap? Institute for Small Business and Entrepreneurship.

DeAngelo, H. and Masulis, R.W. (1980). Optimal Capital Structure under Corporate and Personal Taxation. *Journal of Financial Economics, 8 (1): 3-29.*

Degryse, H. and Cayseele, P.V. (2000). Relationship Lending within a Bank-based System: Evidence from European Small Business Data. *Journal of Financial Intermediation, 9: 90-109.*

Demirguc-Kunt, A., Maksimovic, V., Beck, T., & Laeven, L. (2006). The Determinant of Financing Obstacles. *International Journal of Money and Finance, 25, 932-952.*

Dudley, E. (2007). Testing Models of Dynamic Trade-off Theory. Graduate School of Business Administration, University of Rochester, Rochester, New York.

Eastern Cape Development Indicators. (2012). Eastern Cape Socio-Economic Consultative Council. Bhisho, Eastern Cape.

Eastern Cape Provincial Growth and Development Plan. (1996). The Premier's Office, Bhisho, Eastern Cape, South Africa.

Eastern Cape Socio-Economic Profile. (2014). Department of Economic Development Environmental Affairs and Tourism. Bhisho, Eastern Cape.

Eastern Cape Socio-Economic Review and Outlook. (2014). Department of Economic Development Environmental Affairs and Tourism. Bhisho, Eastern Cape.

Elaian, K. (1996). Employment Implications of Small Scale Industries in Developing Countries: Evidence from Jordan. *Science, Technology and Development 14 (1): 80-101.*

Elliehausen, G.E. and Wolken, J.D. (1993). The Demand for Trade Credit: An Investigation of Motives for Trade Credit Use by Small Businesses. *Federal Reserve Bulletin, 79 (10): 929.*

El-Said, H., Al-Said, M. and Zaki, C. (2013). What Determines the Access to Finance of SMEs? Evidence from the Egyptian Case. Working Paper Series, Economic Research Forum.

European Commission (EC) (2003). The New SME Definition User Guide and Model Declaration.

Fatoki, O. (2014). External Environmental Factors Impacting on Access to Debt Finance by Small and Medium Enterprises in South Africa. *Mediterranean Journal of Social Sciences, 5 (20): 1013-1017.*

Fatoki, O. (2014). Factors Influencing the Financing of Business Start-ups by Commercial banks in South Africa. *Mediterranean Journal of Social Sciences, 5 (20): 94-98.*

Fatoki, O. (2014). The Role of Small and Medium Enterprises in Alleviating the Development Challenges Facing South Africa. *Mediterranean Journal of Social Sciences, 5 (23): 270-274.*

Fatoki, O. and Asah, F. (2011). The Impact of Firm and Entrepreneurial Characteristics on Access to Debt Finance by SMEs in King William's Town, South Africa. *International Journal of Business Management, 6 (8): 171 – 175.*

Fatoki, O. and Odeyemi, A. (2010). The Determinants of Trade Credit by New SMEs in South Africa. *African Journal of Business Management, 4 (13): 2763-2770.*

Feldman, R. (1997). Banks and a Big Change in Technology Called Credit Scoring. The Region, Federal Reserve Bank of Minneapolis.

Ferreira, E.J. (2007). An Analysis of Business Interventions and Their Effect on the Perceived Success of South African Small and Medium Enterprises. Unpublished Doctor of Commerce in Business management Dissertation. University of South Africa.

FinMark Trust. (2006). FinMark Trust Small Business Survey Report. [Online] Available:http://www.finmarktrust.org.za (July 15, 2015).

FinMark Trust. (2010). Finscope South Africa Small Business Survey.

FinMark Trust. (2015). Financial Access and SME Size in South Africa. Occasional Research Paper.

Fossey, E., Harvey, C., McDermott, F. and Davidson, L. (2002). Understanding and Evaluating Qualitative Research. *Australian and New Zealand Journal of Psychiatry, 36: 717-732.*

Fox, N., Hunn, A. and Mathers, N. (2009). Sampling and Sample Size Calculation. The National Institute for Health Research (NIHR) for the East Midlands/Yorkshire and the Humber.

Foxcroft, M.L., Wood, E., Kew, J., Herrington, M. and Segal, N. (2002). Global Entrepreneurship Monitor. South African Executive Report. Graduate School of Business. University of Cape Town.

Frank, M.Z. and Goyal, V.K. (2005). Trade-off and Perking Order Theories of Debt. Sauder School of Business, University of British Columbia BC, Canada.

Fritsch, M. and Mueller, P. (2005). The Persistence of Regional New Business Formation – Activity over Time – Assessing the Potential of Policy Promotion Programs. Discussion

Papers on Entrepreneurship, Growth and Public Policy. Max Planck Institute for Research into Economic Systems Group Entrepreneurship, Growth Public Policy.

Ganbold, B. (2008). Improving Access to Finance for SME: International Good Experiences and Lessons for Mongolia. Ide-Jetro.

Gangata, K. and Matavire, E.H.M. (2013). Challenges Facing SMEs in Accessing Finance from Financial Institutions: The Case of Bulawayo, Zimbabwe. *International Journal of Applied Research and Studies, 2 (7):1.*

Garcia-Teruel, P.J. and Martinez-Solano, P. (2010). Determinants of Trade Credit: A Comparative Study of European SMEs. *International Small Business Journal, 28 (3): 215-233.*

Garikai, B.W. (2011). Growth of SMEs in Developing Nations: Special Reference to AGOA.

GCIS. (2011). Pocket Guide to South African Economy 2011.

Ghimire, B. and Abo. R. (2013). An Empirical Investigation of Ivorian SME Access to bank Finance: Constraining Factors at Demand Level. *Journal of Finance and Investment Analysis, 2 (4):29-55.*

Ghosh, P., Mookhererjee, D, and Ray, D. (1999). Credit Rationing in Developing Countries: An Overview of the Theory. A Reader in Development Economics, London: Blackwell.

Gibson, T. and Van der Vaart, H.J. (2008). Defining SMEs: A Less Imperfect Way of Defining Small and Medium Enterprises in Developing Countries. Brookings Global Economy and Development.

Gitman, L.J. (2003). The Principles of Managerial Finance. New York, Pearson Education Inc.

Global Entrepreneurship Monitor. (2015). Special Topic Report 2015-2016: Entrepreneurial Finance. University of Cape Town, South Africa.

Golam, K., Jahan, I., Chisty, H. and Akhtar, H. (2010). Credit Risk Assessment and Evaluation Systems for Industrial Project. *International Journal of Trade, Economics and Finance, 1 (4): 331.*

Gompers, P.A. (1995). Optimal Investment, Monitoring and the Staging of Venture Capital. *The Journal of Finance. 50 (5): 1461-1489.*

Gorman, M. and Sahlman, W.A. (1989). What do Venture Capitalists Do? *Journal of Business Venturing, 4 (4): 231-248.*

Goyal, K.V. and Frank, M.Z. (2005). Trade-off and Perking Order Theories of Debt. Department of Finance. Hong Kong University of Science and Technology.

Graham, J.R. and Harvey, C. (2001). The Theory and Practice of Corporate Finance: Evidence From the Field. *Journal of Financial Economics, 60: 187-243.*

Gregory, B.T., Rutherford, M.W, Oswald, S. and Gardiner, L. (2005). An Empirical Investigation of the Growth Cycle Theory of Small Firm Financing. *Journal of Small Business Management, 43 (4): 382-392.*

Growth, Employment and Redistribution (GEAR). (1998). A Macroeconomic Strategy. Department of Finance, Republic of South Africa.

Guba, E.G. and Lincoln, Y.S. (1994). Competing Paradigms in Research.

Guido, F. (2008). Credit Rationing with Symmetric Information. MPRA Paper No. 8201.

Hansen, A., Kimeria, C., Ndirangu, B., Oshry, N. and Wendle, J. (2012). Assessing Credit Guarantee Schemes for SME Finance in Africa: Evidence from Ghana, Kenya, South Africa and Tanzania. Working Paper.

Harvie, C. (2011), 'Framework Chapter: SME Access to Finance in Selected East Asian Economies', in Harvie, C., Oum, S. and Narjoko, D. (eds.), Small and Medium Enterprises (SMEs) Access to Finance in Selected East Asian Economies. ERIA Research Project Report 2010-14, Jakarta: ERIA.

Hellmann, T. (1998). The Allocation of Control Rights in Venture Capital Contracts. *The RAND Journal of Economics, 29 (1): 57-76.*

Hellriegel, D., Jackson, S.E., Slocum, J., Staude, G., Amos, T., Klopper, H.P, Louw, L. and Oosthuizen, T. (2008). Management. 2nd South Africa Edition. Oxford University Press. Oxford.

Helwege, J. and Liang, N. (1996). Is There a Perking Order? Evidence from a Panel of IPO Firms. *Journal of Financial Economics, 29 (1): 57-76.*

Herrington, M. & Kew, J. (2014). *GEM South Africa 2013 Report*. [Online] Available at: http://www.gemconsortium.org/docs/3336/gemsouth-africa-2013-report (30 April 2014).

Herrington, M., Kew, J. and Kew, P. (2010). Tracking Entrepreneurship in South Africa: The GEM Perspective. Centre for Innovation and Entrepreneurship, University of Cape Town, South Africa.

Hoffman, P.J. (1960). The Paramorphic Representation of Clinical Judgement. *Psychological Bulletin, 59: 77-80.*

Hofstee, E. 2006. *Constructing a good dissertation: A practical guide to finishing a Masters, MBA or PHD on schedule*. EPE, Sandton, Johannesburg, South Africa.

Hovakimian, A., Opler, T. and Titman, S. (2001). The Debt-Equity Choice. *The Journal of Financial and Quantitative Analysis, 36 (1): 1-24.*

Huyghebaert, N. and Van de Gucht, L.M. (2007). The Determinants of Financial Structure: New Insights from Business Start-ups. *European Financial Management, 13 (1): 101-133.*

Hwarire, C. (2012). Loan Repayment and Credit Management of Small Businesses: A Case Study of a South African Bank. A Paper Presented at the African Development Finance Workshop, Cape Town, South Africa.

IBRD/World Bank. (2008). Finance for all? Challenges and Pitfalls in Expanding Access. World Bank, Washington DC.

Ilegbinosa, I.A. and Jumbo, E. (2015). Small and Medium Scale Enterprises and Economic Growth in Nigeria: 1975-2012. *International Journal of Business Management, 10 (3): 203.*

Inarti, N. and Langenberg, M. (2004). Factors Affecting Business Success Among SMEs: Empirical Evidences From Indonesia.

Integrated Small Enterprise Development Strategy. (2005). Department of Trade and Industry. Republic of South Africa.

Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprises. (2005). Department of Trade and Industry. Republic of South Africa.

Iqbal, S.M.J., Muneer, S., Jahanzeb, A. and Rehman, S. (2012). A Critical Review of Capital Structure Theories. *Information Management and Business Review, 4 (11): 553-557.*

Irwin, D. and Scott, J.M. (2010). Barriers Faced by SME's in Raising Bank Finance. *International Journal of Entrepreneurial Behaviour and Research, 16 (3): 245-259.*

Islam, A., Khan, M.A., Obaidullah, A.Z.M. and Syed Alam, M. (2011). Effects of Entrepreneur and Firm Characteristics on the Business Success of SMMEs in Bangladesh. *International Journal of Business Management, 6 (3):289.*

Jackson, P.L.M. (2004). Entrepreneurial Support in South Africa: A Case Study of a Small Enterprise Support Centre in Johannesburg. Unpublished Master of Science in Urban Governance Development Dissertation. International Development Department. School of Public Policy. University of Birmingham.

Jensen, M.C. and Meckling, W.H. (1976). Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure. *Journal of Financial Economics, 3: 305-360.*

Johnson, Y., Asifiri, E.K. and Adigbo, E.D. (2014). The Role of Banks in Financing Small and Medium Scale Enterprises in Ghana – A Case Study of Universal banks in Sekondi-Takoradi. *Journal of Education Practice*, 5 (11): 161.

Katua, N.T. (2014). The Role of SMEs in Employment Creation and Economic Growth in Selected Countries. *International Journal of Education and Research, 2 (12): 461-468.*

Kayanula, D. and Quartey, P. (2000). The Policy Environment for Promoting Small and Medium-Sized Enterprises in Ghana and Malawi. Finance and Development Research Programme, Working Paper Series, Paper No. 15, IDPM, University of Manchester.

Keeble, D. (1990). Small Firms, New Firms and Uneven Development in the United Kingdom. Area, 22, 234-245.

Keller, G. (2005). Statistics for Management and Economics (7th edition). Thompson Brooks/Cole. United States of America.

Kimutai, C. and Ambrose, J. (2013). Factors Influencing Credit Rationing by Commercial Banks in Kenya. *International Journal of Humanities and Social Science, 3 (20): 246.*

Kira, A.R. and He, Z. (2012). The Impact of Firm Characteristics in Access of Financing by Small and Medium-sized Enterprises in Tanzania. *International Journal of Business Management, 7 (24):109.*

Kongolo, M. (2010). Job creation versus job shedding and the role of SMEs in economic development. *African Journal of Business Management, 4 (11): 2288-2295.*

Kortum, S. and Lerner, J. (2000). Assessing the Contribution of Venture Capital to Innovation. *The RAND Journal of Economics, 31 (4): 674-692.*

Kraus, A. and Litzenberger, R.H. (1973). A State Preference Model of Optimal Finance Leverage. *Journal of Finance, 9 (1): 911 – 922.*

Kumar, A., and Francisco, M. (2005). Enterprise size, financing patterns and credit constraints in Brazil: analysis of data from the Investment Climate Assessment Survey. World Bank Working Paper No. 49.

La Rocca, M., La Rocca, T. and Cariole, A. (2011). Capital Structure Decisions During a Firm's Life Cycle. *Small Business Economics, 37 (1): 107-130.*

Lapar, M.L.A. and Graham, D.H. (1988). Credit Rationing Under a Deregulated Financial System. Working Paper Series No. 88.

Leland, H. (1994). Corporate Debt Value, Bond Covenants, and Optimal Capital Structure. *Journal of Finance XLIX, 1213-1252.*

Lenth, V. (2001). Some Practical Guidelines for Effective Sample Size Determination. *The American Statistician*, 55 (3): 187

Maas, G. and Herrington, M. (2006). Global Entrepreneurship Monitor: South African Report.

Macmillan, H. (1931). Report of the Committee on Finance and Industry. CMD 3897,HMSO, London.

Madill, J., Haines, G. and Riding, A. (2005). The Role of Angels in Technology SMEs: A Link to Venture Capital. *An International Journal of Entrepreneurial Finance, 7 (2): 107-129.*

Mago, S. and Toro, B. (2013). South African Government's Support to Small, Medium Micro Enterprises (SMMEs): The Case of King William's Town Area. *Journal of Economics, 4 (1): 19-28.*

Mahadea, D. and Pillay, M.K. (2008). Environmental conditions for SMME Development in a South African Province. *SAJEMS NS 11 (4).*

Martin, G. and Staines, H. (2008). Managerial Competencies in Small Firm. From <http://www. emraldinsight.com/insight/ viewcontentitem.do? content type> (Retrieved March 22, 2014).

Mathiyazhagan, T. and Nandan, D. (2010). Survey Research Method. Media Mimarisa. New Delhi.

Mazanai, M. and Fatoki, O. (2012). The Effectiveness of Business Development Services Providers in Improving Access to Debt Finance by Start-up SMEs in South Africa. *International Journal of Economics and Finance, 3 (4): 208-212.*

Maziku, M. (2012). Credit Rationing for Small and Medium Scale Enterprises in Commercial Bank Loan Market. Research on Poverty Alleviation's 17th Annual Research Workshop. White sands Hotel, Dar as Salam, Tanzania.

Megha, D. and Rajiv, B. (2013). A Methodology for Ranking of Causes of Delay for Residential Construction Projects in Indian Context. *International Journal of Emerging Technology and Advanced Engineering, 3 (3): 396-398.*

Miller, E.M. (1977). Risk, Uncertainty and Divergence of Opinion. *The Journal of Finance, 32 (4): 1151-1168.*

Modigliani, F. and Miller, M.H. (1958). The Cost of Capital, Corporate Finance and the Theory of Investment. *American Economic Review, 48: 261-297.*

Modigliani, F. and Miller, M.H. (1963). Corporate Income Taxes and Cost of Capital: A Correction. *American Economic Review, 53: 433-443.*

Morrissette, S.G. (2007). A Profile of Angel Investors. *The Journal of Private Equity, 10 (3): 52-66.*

Mostafa, H.T. and Boregowda, S. (2014). A Brief Review of Capital Structure Theories. *Research Journal of Recent Sciences, 3 (10): 113-118.*

Mthimkhulu, A.M. and Aziakpono, M.J. (2012). Do Credit Guarantee Schemes Address Credit Market Failures for Small Business? Preliminary Evidence from South Africa. University of Stellenbosch Business School, South Africa.

Muhwezi, L., Acai, J. and Otim, G. (2014). An Assessment of the Factors Causing Delays on Building Construction Projects in Uganda. *International Journal of Construction Engineering and Management, 3 (1): 13-23.*

Muragia, I. (2008). Factors that Determine Entrepreneurial Behaviour in Micro and Small Enterprises (MSEs) in Kenya, Nairobi. Scangraphics LTD.

Morduch, J. (1999). The Microfinance Promise. *Journal of Economic Literature, 37 (4): 1569-1614.*

Musamali, M.M. and Tarus, D.K. (2013). Does Firm profile Influence Financial Access Among SMEs in Kenya? *Asia Economic and Financial Review, 3 (6): 714-723.*

Musara, M. and Gwaindepi, C. (2014). Factors within the Business Regulatory Environment Affecting Entrepreneurial Activity in South Africa. *Mediterranean Journal of Social Sciences, 5 (6): 109-112.*

Mutezo, A.T. (2005). Obstacles in the access to SMME finance: an empirical perspective on Tshwane. Unpublished Master of Commerce. University of South Africa. Pretoria. South Africa.

Myers, S.C. (1984). The Capital Structure Puzzle. *The Journal of Finance, 39 (3): 574-592.*

Myers, S.C. (2001). Capital Structure. *The Journal of Economic Perspectives, 15 (2): 81-102.*

National Council of Provinces. (2012). Committee for Trade and International Relations. The South African Parliament. Republic of South Africa. Cape Town.

National Development Plan 2030. (2012). National Planning Commission. The Presidency, Republic of South Africa, Pretoria.

National Small Business Act 102 (1996). Parliament of the Republic of South Africa. Pretoria, South Africa.

Naude, W.A. and Havenga, J.D. (2004). An Overview of African Entrepreneurship and Small Business Research. *Journal of Small Business and Entrepreneurship, 18 (1): 101-112.*

Nega, F. and Hussein, E. (2016). Small and Medium Enterprise Access to Finance in Ethiopia: Syntheis of Demand and Supply. The Horn Economic and Social Policy Institute (HESPI). Working Paper.

Nieman, G. (2006). Small Business Management. Pretoria: Van Schalk.

Nkuah, J.K., Tanyeh, J.P. and Gaeten, K. (2013). Financing SMEs in Ghana. Challenges and Determinants in Accessing bank Credit. *International Journal of Research in Social Sciences, 2 (3):14.*

Ntsika. (1999). State of Small Business in South Africa. Annual Review. Ntsika Enterprise Promotion Agency. Pretoria.

Oduntum, K.O. (2014). The Role of Small and Medium Enterprises in Economic Development: The Nigerian Experience. International Conference on Arts, Economics and Management (ICAEM'14), Dubai (UAE).

OECD. (2004). Promoting Entrepreneurial and Innovative SMEs in a Global Economy. Paper Presented at the 2nd OECD Conference of Ministers Responsible for Small and Medium Enterprises (SMEs), Istanbul, Turkey.

OECD. (2006). The SME Financing Gap. Volume 1. Theory and Evidence.

Okurut, F.N, Olalekan, Y. and Mangadi, K. (2010). Credit Rationing and SME Development in Botswana: Implications for Economic Diversification. Botswana.

Olawale, F. and Garwe, D. (2010). Obstacles to the Growth of New SMEs in South Africa: A Principal Component Analysis Approach. African Journal of Business Management, 4 (5): 729 - 738.

Omar, S., Arokiasamy, L. and Ismael, M. (2009). The Background and Challenges Faced by the Small Medium Enterprises . A Human Resource Development Perspective. *International Journal of Business and Management, 4 (10).*

Ou, C. and Haynes, G.W. (2006). Acquisition of Additional Equity capital by Small Firms – Findings from the National Survey of Small Business Finances. *Small Business Economics, 27 (2): 157-168.*

Oyelana, A.A. and Fiseha, G.G. (2014). An Investigation into the Effect of Small and Medium Enterprises (SMEs) on the Socio-Economic Development of Alice in Eastern Cape province, South Africa. *Mediterranean Journal of Social Sciences, 5 (23): 674-677.*

Pandula, G. (2011). An Empirical Investigation of Small and Medium Enterprises' Access to Bank Finance: The Case of an Emerging Economy. ASBBS Annual Conference: Las Vegas.

Patrianila, V. N. (2003). Italia Besarkan UKM Dengan ... *Pengusaha* (32): 70-71.

Patton, M.Q. (2002). Qualitative Evaluation and Research Methods (3rd edition). Thousand Oaks, CA: Sage Publications, Inc.

Phillips, D.A. (2002) The Market-based Approach to Enterprise Assistance: An Evaluation of the World Bank's Market Development Grant Funds. Mapping the Shift in Business Development Services: Making Markets Work for the Poor, Warwickshire: ITDG Pub.

Poku, K. and Frimpong, F.A. (2009). The Assessment of the Prospects of Venture Capital Finance in Ghana: The Views and Perception of Some Selected SMEs in Ghana. Ninth Annual IBER and TLC Conference Proceedings, Las Vegas, NV, USA.

Porter, J. and Porto, A. (2007). Promoting Entrepreneurship in South East Europe: Policies and Tools. OECD Papers, 6 (12).

Pretorius, M., and Shaw, G. (2004). Business Plan in Bank Decision-Making when Financing New Ventures in South Africa. *South African Journal of Economics and Management Science, 7: 221-242.*

Pring, R. (2000). Philosophy of Education Research. London: Continuum.

Rajan, R. (1992). Insiders and Outsiders: The Choice Between Informed and Arm's Length Debt. *Journal of Finance,* 47: 1367-1400.

Ramjee, S. and Berma, B. (2013). Financing Gap in Malaysian Small-Medium Enterprises: A Supply-side Perspective. *SAJEMS Special Issue, 16:115-126.*

Rand, J. (2007). Credit constraints and determinants of the cost of capital in Vietnamese manufacturing. *Small Business Economics, 29, 1-13.*

Reconstruction and Development Programme. (1994). The President. Republic of South Africa, Pretoria.

Reid, G.C. (1996). Mature Micro-Firms and Their Experience of Funding Shortages. *Small Business Economics, 8 (1): 27-37.*

Review of Ten Years of Small Business Support in South Africa 1994-2004. (2004). Department of Trade and Industry. Republic of South Africa, Pretoria.

Richard, E.M. and Mori, N.G. (2012). SME's Access to Financial Services: Banker's Eye. *Chinese Business Review, 11 (2): 217-223.*

Riding, A.L. and Short, D.M. (1987). Some Investor and Entrepreneur Perspectives on the Informal Market for Risk Capital. *Journal of Small Business and Entrepreneurship,* 4:19-30.

Rogerson, C.M. (2007) Supporting Small Firm Development in Tourism: South Africa's Tourism Enterprise Programme. *The* Intern*ational Journal of Entrepreneurship and Innovation,* 8(9): 6-14.

Rogerson, C.M. (2008). Tracking SMME Development in South Africa: Issues of Finance, Training and Regulatory Environment. School of Geography, Archaeology and Environmental Studies, University of Witwatersrand, Johannesburg, South Africa.

Rwigema, H. and Venter, R. (2004). Advanced Entrepreneurship. Oxford University Press Southern Africa. Cape Town.

Sanchez-Vidal, J. and Martin-Ugedo, J.F. (2005). Financing Preferences of Spanish Firms: Evidence on the Pecking Order Theory. *Review of Quantitative Finance and Accounting, 25 (4): 341-355.*

SBP's SME Growth Index. (2015). SMME Sustainability and Growth Should be an Obsession for Job Creation in South Africa. Bulletin 1, an SBP Occasional Paper.

Scotland, J. (2012). Exploring the philosophical Underpinnings of Research: Relating Ontology and Epistemology to the Methodology and Methods of the Scientific, Interpretive and Critical Research Paradigms. *English Language Teaching, 5 (9): 9*.

Scott, D.F. (1972). Evidence on the Importance of Financial Structure. *Journal on Financial Management, 1(3):45-60.*

Shane, S. (2012). The Importance of Angel Investing in Financing the Growth of Entrepreneurial Ventures. *The Quarterly Journal of Finance, 2 (2).*

Shyam-Sunder, L. and Myers, S.C. (1999). Testing Static Trade-off Against Pecking Order Models of Capital Structure. *Journal of Financial Economics, 51 (2): 219-244.*

Simrie, S., Herrington, M., Kew, J. and Turton, N. (2011). Global Entrepreneurship Monitor 2011, South Africa.

Siyongwana, P.Q. (2004). Informal money lenders in Limpopo, Gauteng and Eastern Cape provinces of South Africa. *Development Southern Africa, 21, 851-866.*

Small Enterprise Development Agency (2012). Analysis of the Needs, State and Performance of Small and Medium Businesses in the Agriculture, manufacturing, ICT and Tourism Sectors in South Africa. Pretoria, South Africa.

Smallbone, D. & Welter, F. (2001). The Distinctiveness of Entrepreneurship in Transition Economies. *Small Business Economics, 16(4): 249-262.*

Smolarski, J. and Kut, C. (2011). The Impact of Venture Capital method on SME Performance and Internationalization. *International Entrepreneurship and Management Journal, 7 (1): 39-55.*

Stein, C. (2002). Information Production and Capital Allocation: Decentralized vs. Hierarchical Firms. *Journal of Finance,* 57:1891-1921.

Somiah, M.K., Osei-Poku, G. and Aidoo, I. (2015). Relative Importance Analysis of Factors Influencing Unauthorised Sitting of Residential Buildings in the Sekondi-Takoradi Metropolis of Ghana. *Journal of Building Construction and Planning Research, 3: 117-126.*

South African Venture Capital Association. (2008).Venture Capital Funding. [Online] Available: http://www.savca.co.za/kpmgsurvey/default.aspn [July 16, 2015].

Statistics South Africa. (2011). Provinces at a Glance.

Statistics South Africa. (2013). Survey of Employers and the Self-Employed (SESE). Pretoria. South Africa.

Stats SA (2014). Statistics South Africa: Quarterly Labour Force Survey. Quarter 4. Statistical Release P0211, Pretoria.

Statistics South Africa. (2015). Quarterly Labour Force Survey. Pretoria.

Stiglitz, J. and Weiss, A. (1981). Credit Rationing in Markets with Imperfect Information. *American Economic Review, 71: 393-410.*

Storey, D.J. (1994). Understanding the Small Business Sector. Thomson Learning Emea.

Swierczek, F. W. & Ha, T. T. (2003), Entrepreneurial orientation, uncertainty avoidance and firm performance: An analysis of Thai and Vietnamese SMEs. *International Journal of Entrepreneurship and Innovation*, 4(1): 46-58.

Tadesse (2009). SME Financing in Sub-Saharan Africa. Development Bank of Southern Africa.

Talavera, O., Xiong, L. and Xiong, X. (2010). Social Capital and Access to Bank Financing: The case of Chinese entrepreneurs. School of Economics, University of East Anglia, Norwich, UK.

Tedesco, D. (2014). An Overview of the Venture Capital Process for Entrepreneurs. Albany law School, Government Law Centre.

The New Growth Path. (2010). Department of Economic Development. Republic of South Africa, Pretoria.

The South African Presidency (2008). The Impact of Crime on Small Businesses in South Africa. The Republic of South Africa, Pretoria.

Thurlow, J. & Wobst, P. (2004). The Road to Pro-Poor Growth in Zambia: Past Lessons and Future Challenges. Washington DC: International Food Policy Research Institute.

Tom, E.E.T, Glory, B. and Alfred, U.J. (2016). An Appraisal of Nigeria's Micro, Small and Medium Enterprises (MSMES): Growth, Challenges and Prospects. *International Journal of Small Business and Entrepreneurship Research, 4 (4): 1-15.*

Trade and Industrial Policy Strategies. (2012). How the State and Private Sector can Partner to Boost Support to SMEs: Lessons from Chile & Malaysia. Department of Trade and Industry. Republic of South Africa, Pretoria.

Transparency International Global Corruption Report (2008).

Tucker, J. and Lean, J. (2003). Small Firm Finance and Public Policy. *Journal of Small Business and Enterprise Development, 10(1): 50-61.*

Tuomi, K. and Neto, L.D. (2013). Innovation and Venture Capital Policy in Brazil and South Africa. *Journal of Technology Management and Innovation, 8 (2): 39-43.*

United Nations Development Programme (2014). Human Development Report. Sustaining Human Progress: Reducing Vulnerabilities and Building Resilience.

United Nations Economic and Social Commission for Asia and Pacific. (2015). Financing Small and Medium Sized Enterprises for Sustainable Development: A View from the Asia-Pacific Region. Third International Conference on Financing for Development. Addis Ababa, Ethiopia.

United Nations Office on Drugs and Crime (2013). Global Study on Homicide.

United States Agency for International Development. (2008). SME Finance needs assessment: Qualitative and Quantitative Study in Gauteng Province. United States of America.

United States Agency for International Development. (2010). Financing Institutions' Hurdles to SME Financing. United States of America.

Van Scheers, L. (2011). SMEs' marketing skills challenges in South Africa. *African Journal of Business Management, 5 (13): 5048-5056.*

Wall, L.D. (2007). On Investing in the Equity of Small Firms. *Journal of Small Business Management, 45 (1): 89-93.*

Wang, S. and Zhou, H. (2004). Staged Financing in Venture Capital: Moral Hazard and Risks. *Journal of Corporate Finance, 10 (1): 131-155.*

White Paper on National Strategy for the Development and Promotion of Small Business in South Africa. Department of Trade and Industry. Republic of South Africa.

Wilson, N. and Summer, B. (2002). Trade Credit Terms Offered by Small Firms: Survey Evidence and Empirical Analysis. *Journal of Business Finance and Accounting, 29 (3): 317-351.*

World Bank. (2015). SME Finance in Ethiopia: Addressing the Missing Middle Challenge. Washington, D.C: World Bank Group.

World Bank Investment Climate Report (2005). A Better Investment Climate for Everyone. Washington DC.

World Wide Worx. (2012). SMME Survey. Pretoria. South Africa.

Wu, J., Song, J. and Zeng, C. (2008). An Empirical Evidence of Small Business Financing in China. *Management Research News, 31 (12): 959-975.*

Yount, R. (2006). Research Design and Statistical Analysis for Christian Ministry. 4th Edition.

Zairani, Z. and Zaimah, Z.A. (2013). Difficulties in Securing Funding from banks: Success Factors for Small and Medium Enterprises. *Journal of Advanced management Science, 1 (4): 355-356.*

Zarook, T, Rahman, M.M. and Khanan, R. (2013). Management Skills and Access to Finance: Evidence from Libya's SMMEs. *International Journal of Business and Social Science, 4 (7): 106-111.*

Zindiye, S. and Mwangolela, T.F. (2007). Entrepreneurship a Key to Poverty Reduction and Socio-Economic Development. Department of Business Economics. Nelson Mandela Institute for Education and Rural Development. University of Fort Hare. South Africa.

Zorhabi, M. (2013). Mixed Methods in Research: Instruments, Validity, Reliability and Reporting Findings. *Theory and Practice in Language Studies,* 3 (2): 254

Zwane, T.T. (2009). The Impact of Regulation on Small Business in the Republic of South Africa. University of Johannesburg, South Africa.

ANNEX A: SMME RESEARCH QUESTIONNAIRE

DETERMINANTS OF SMALL MICRO AND MEDIUM ENTERPRISES (SMMEs) ACCESS TO FINANCE

SMME NAME	
REFERENCE NUMBER	
DATE	

Please answer each question by filling an X in the appropriate box provided or write your answer in the space provided.

<u>A. FIRM CHARACTERISTICS</u>

1. What form of legal entity is your business?

1.	Sole proprietor	
2.	Partnership	
3.	Close corporation	
4.	PTY (LTD)	
5.	Cooperative	

2. Is your business operating from rented or owned premises?

1.	Rented	
2.	Owned	
3.	Home	

3. If business premises are owned, how was the premises financed?

1.	Not Applicable	
2.	Grant funding	
3.	Premises donated	
4.	Mortgage bond	

4. For how long has your business been in operation?

1.	< 1 year	

2.	1 - 2 years	
3.	3 - 5 years	
4.	5 - 10 years	
5.	> 10 years	

5. In which economic sector would you classify your business?

1.	Agriculture		6.	Textile	
2.	Construction		7.	Services	
3.	Manufacturing		8.	Automotive	
4.	Mining		9.	ICT	
5.	Wholesale				

6. How many people does your business employ?

1.	None	
2.	< 5	
3.	5 – 20	
4.	21 – 50	
5.	51 – 200	

7. What is your business' average annual turnover over the last three years?

1.	Start-up	
2.	< R150 000	
3.	R150 000 to R500 000	
4.	R501 000 to R25m	
5.	R26m to R50m	

8. Is your business a member of any business network/forum/association?

1.	Yes	
2.	No	

9. If you answered yes to the above question, please specify the name of the organisation

1.	Not applicable	
2.	Eastern Cape Chamber of Commerce and Industry	
3.	Border Kei Chamber of Business	

4.	SMME Forum	

10. Does your business have a business plan?

1.	Yes	
2.	No	

11. If yes, when was it prepared?

1.	Not applicable	
2.	Before 2010	
3.	Between 2010 and 2014	

12. If your business has a business plan, please indicate what it typically includes (please tick where appropriate)

1.	Budget and cash flow forecast	
2.	Products and services	
3.	Marketing Plan	
4.	All of above	
5.	Not applicable	

13. Did someone outside your organisation help you to prepare the business plan?

1.	Yes	
2.	No	
3.	Not applicable	

14. If yes, what kind of help did you get?

1.	Not applicable	
2.	Friends and family	
3.	Government department/agent	
4.	Contracted a consultant	
5.	SEDA	

15. Have you ever received training in the preparation of a business plan?

1.	Yes	
2.	No	

16. If yes, who provided the training?

1.	Not applicable	
2.	Independent Consultant	
3.	Government department/entity	
4.	SEDA	
5.	COEGA	

17. Please identify which parts of the training you found most useful?

1.	Not applicable	
2.	Hospitality management	
3.	Financials and marketing	
4.	Cash flow	
5.	Budgeting	

18. Does your business have audited financial statements?

1.	Yes	
2.	No	

19. If the answer to the above question is no, please specify the reason (s)

1.	Not applicable	
2.	Can't afford then (too expensive)	
3.	Don't need to have them	
4.	Small business	
5.	Not a requirement	

20. Is your business registered for VAT?

1.	Yes	
2.	No	

21. Is your business registered for Tax Clearance?

1.	Yes	
2.	No	

22. What is your understanding of Broad Based Black Economic Empowerment?

1.	No understanding	

2.	Limited understanding	
3.	Some understanding	
4.	Adequate understanding	

23. What is your BBBEE status?

1.	No status	
2.	Level 1	
3.	Level 2	
4.	Level 3	
5.	Level 4	

B. ENTREPRENEURIAL CHARACTERISTICS

24. Please tick the appropriate box.

1.	Male	
2.	Female	

25. Please indicate which age category you fall into.

1.	<18	
2.	18-35	
3.	36-60	
4.	>60	

26. Please tick the appropriate box in relation to your education level.

1.	No schooling	
2.	Primary school	
3.	Some high school	
4.	Matric/Grade 12	
5.	Tertiary education	

27. Were you employed before starting your business?

1.	Yes	
2.	No	

28. If you were employed, please state previous job held (e.g. Accountant, Salesperson, etc.)

1.	Not applicable	
2.	Public sector related job	
3.	Public sector non related job	
4.	Private sector related job	
5.	Private sector non related job	

29. Did you attend any training related to your business?

1.	Yes	
2.	No	

30. If yes, please specify training attended.

1.	Not applicable	
2.	Business management training	
3.	Sector specific technical training	
4.	Business and sector specific technical training	

31. Are you responsible for the day-to-day running of your business?

1.	Yes	
2.	No	

32. If no, who is responsible for the day-to-day running of your business?

1.	Not applicable	
2.	Manager	

33. If no, why are you not running the business yourself?

1.	Not applicable	
2.	Employed	

C. FUNDING APPLIED FOR

34. Where did you get the money to start your business?

1.	Family and friends	
2.	Own savings	
3.	Commercial bank	

4.	Development Finance Institution	
5.	Contribution from cooperative members	

35. Have you ever applied for finance?

1.	Yes	
2.	No	

36. If you have never applied for finance, which of the following reasons made you not to apply for finance (Please tick one or more)

1.	Not applicable	
2.	Failure to meet requirements e.g. collateral, owner contribution, financial statements, a good business plan, VAT and tax clearance registration, compliance with FICA	
3.	SMME characteristics such as poor track record of loan repayment, poor or weak cash flow to repay the loan, industry too risky, firm, age, sector, low annual turnover, over indebtedness, number of people employed, etc.	
4.	Lack of understanding of the business plan or financials	
5.	Entrepreneurship characteristics such as sex, age, education, business experience, etc.	

37. If you applied for finance, which of the following finance institutions did you apply for finance from (Please tick one or more)

1.	Not applicable	
2.	Commercial banks	
3.	Development finance institution	
4.	Micro lenders	
5.	Other	

38. If your funding application was approved by a commercial bank, do you bank with it?

1.	Yes	
2.	No	
3.	Not applicable	

39. If you applied for finance, what was the nature of finance applied for?

1.	Loan	
2.	Grant	
3.	Mixture of loan and grant	

4.	Not applicable	

40. Did you encounter any problems in making the application?

1.	Yes	
2.	No	
3.	Not applicable	

41. If you answered yes to the above question, please state below what problems you encountered.

1.	Not applicable	
2.	Communication and unfriendly staff	
3.	Application forms complicated	
4.	Too much information required and no assistance offered	
5.	All of above	

42. Was your application successful?

1.	Yes	
2.	No	
3.	N/A	

43. If your application was successful, what did you attribute to its success?

1.	Not applicable	
2.	Coaching and mentoring	
3.	Assistance from family and friends	
4.	Accurate completion of form and submission of all required documents	
5.	Meeting the requirements and awarded contract	

44. Did you encounter any problems in meeting payments?

1.	Yes	
2.	No	
3.	N/A	

45. If your application was unsuccessful, which of the following reasons resulted in your application being rejected (Please tick one or more)?

1.	Not applicable	

2.	Failure to meet requirements e.g. collateral, owner contribution, financial statements, a good business plan, VAT and tax clearance registration, compliance with FICA, incomplete information on the application form	
3.	SMME characteristics such as poor track record of loan repayment, poor or weak cash flow to repay the loan, industry too risky, firm, age, sector, low annual turnover, over indebtedness, number of people employed, etc.	
4.	Applicant's lack of understanding of the business plan or financials	
5.	Entrepreneurship characteristics such as sex, age, education, business experience, etc.	
6.	Don't know	

46. Did you agree with the reason(s) indicated above?

1.	Yes	
2.	No	
3.	N/A	

47. If no, why do you not agree with the above-mentioned reason(s)?

1.	Not applicable	
2.	I met all the requirements	

48. If yes, please specify the problems encountered (Please tick one or more)

1.	Not applicable	
2.	Failure to meet requirements e.g. collateral, owner contribution, financial statements, a good business plan, VAT and tax clearance registration, compliance with FICA, incomplete information on application form	
3.	SMME characteristics such as poor track record of loan repayment, poor or weak cash flow to repay the loan, industry too risky, firm, age, sector, low annual turnover, over indebtedness, number of people employed, etc.	
4.	Lack of understanding of the business plan or financials	
5.	Entrepreneurship characteristics such as sex, age, education, business experience, etc.	
6.	Don't know	

49. Now that you have gone through the process of applying for finance, what would you have done differently and why?

1.	Not applicable	
2.	Nothing	
3.	Get help to complete application form	

4.	Apply to other finance institutions	

50. Would you re-submit the application form for finance?

1.	Yes	
2.	No	
3.	N/A	

51. If no, why would you not re-submit the form?

1.	Not applicable	
2.	Waste of time and resources	
3.	No need as business sustainable	
4.	Banks do not fund cooperatives	
5.	Response rate is long, poor administration	

52. What was the easiest part you found of the application process?

1.	Not applicable	
2.	None	
3.	Business background and executive summary	
4.	Detailing how much I wanted	
5.	I don't know	

Your participation in this research is much appreciated and valued – thank you.

ANNEX B: RESEARCH QUESTIONNAIRE (FUNDING INSTITUTIONS)

DETERMINANTS OF SMALL MICRO AND MEDIUM ENTERPRISES (SMMEs) ACCESS TO FINANCE

NAME OF FINANCIAL INSTITUTION	
REFERENCE NUMBER	
DATE	

Please answer each question by filling an X in the appropriate box provided or write your answer in the space provided.

1. Does your organisation provide finance to SMMEs?

1.	Yes	
2.	No	

2. Does your lending criteria make a distinction between an SMME and a large firm?

1.	Yes	
2.	No	

3. Is the size of a firm an important factor in your lending criteria?

1.	Yes	
2.	No	

4. If you answered yes to the above question, how does your criteria define firm size?

1.	Not applicable	
2.	More than R1m	
3.	Start-up, survivalist and growth	
4.	Small Business Act criteria	

A. FIRM CHARACTERISTICS

5. Does the type/form of a business (e.g. sole proprietor, partnership, close corporation, PTY (LTD), cooperative) an important factor in your lending criteria?

1.	Yes	

2.	No	

6. Is location (i.e. where a business is located e.g. city, township, village, farm, etc.) an important factor in your lending criteria?

1.	Yes	
2.	No	

7. If you answered yes to the above question, how does your criteria define location?

1.	N/A	
2.	Market availability	
3.	Rural bias	

8. For how long must a business be in operation to be eligible for funding?

1.	< 1 year	
2.	1 - 2 years	
3.	3 - 5 years	
4.	5 - 10 years	
5.	> 10 years	
6.	Not a requirement	

9. Does your lending criteria favour certain sectors of the economy e.g. manufacturing, construction, etc.?

1.	Yes	
2.	No	

10. If your answer to the above question is yes, please state the sectors.

1.	Not applicable	
2.	Construction	
3.	Manufacturing	

11. How many people must a business employ to be considered for funding?

1.	None	
2.	< 5	
3.	5 – 20	
4.	21 – 50	

5.	51 – 200	
6.	Not a requirement	

12. What average annual turnover must a business realise to be eligible for funding?

1.	Start-up	
2.	< R150 000	
3.	R150 000 to R500 000	
4.	R501 000 to R25m	
5.	R26m to R50m	
6.	Any turnover	

13. Must a business be a member of a business organization or association to be eligible for funding?

1.	Yes	
2.	No	

14. Do you require a business to have a business plan to be eligible for funding?

1.	Yes	
2.	No	

15. Do you help the applicants to draw up or prepare a business plan?

1.	Yes	
2.	No	

16. Which of the following must a business plan have for a business to be eligible for funding? (Please tick where appropriate)

1.	Cash flow forecast	
2.	Budget	
3.	Products and services	
4.	Marketing Plan	
5.	All of the above	

17. Do you require a business to have audited financial statements to be eligible for funding?

1.	Yes	
2.	No	

18. Must a business be registered for VAT to be eligible for funding?

1.	Yes	
2.	No	

19. Must a business have tax clearance to be eligible for funding?

1.	Yes	
2.	No	

20. Is BBBEE an important factor in your lending criteria?

1.	Yes	
2.	No	

21. What BBBEE status must a business have to be eligible for funding?

1.	Not a requirement	
2.	Level 1	
3.	Level 2	
4.	Level 3	
5.	Any level	

B. ENTREPRENEURIAL CHARACTERISTICS

22. Is the gender of the owner/manager of the enterprise an important factor in your lending criteria?

1.	Yes	
2.	No	

23. Which age category must an applicant be under to be eligible for funding?

1.	<18	
2.	18-35	
3.	36-60	
4.	>60	
5.	Any age	

24. Is the level of education of the applicant an important factor in your lending criteria?

1.	Yes	

2.	No	

25. If the answer to the above question is yes, how important is the level of education in your lending criteria?

1.	Not applicable	
2.	Knowledge and experience determinant	

26. Do you require an applicant to have industry experience or skills relevant to his/her business/industry sector to be eligible for funding?

1.	Yes	
2.	No	

27. Do you require an applicant to be responsible for the day-to-day running of his/her business to be eligible for funding?

1.	Yes	
2.	No	

C. FUNDING APPLIED FOR

28. Do you require an applicant to have the owner's contribution to be eligible for funding?

1.	Yes	
2.	No	
3.	Not required	

29. If yes, what percentage contribution of the loan amount do you require?

1.	Not applicable	
2.	30%	
3.	A reasonable contribution	

30. Is it necessary for an applicant to hold an account with you to be eligible for funding?

1.	Yes	
2.	No	
3.	Not applicable	

31. According to your assessment, what are the main reasons why SMMEs fail to obtain finance from your institution (Please tick one or more)

1.	Failure to meet requirements e.g. collateral, owner contribution, financial statements, a good business plan, VAT and tax clearance registration, compliance with FICA	
2.	SMME characteristics such as poor track record of loan repayment, poor or weak cash flow to repay the loan, industry too risky, firm, age, sector, low annual turnover, over indebtedness, number of people employed, etc.	
3.	Applicant's lack of understanding of the business plan or financials	
4.	Entrepreneurship characteristics such as sex, age, education, business experience, etc.	
5.	Incomplete information on the application form	

32. What criteria does an SMME have to satisfy to be successful in their application for finance (Please tick one or more)

1.	Meeting requirements e.g. collateral, owner contribution, financial statements, a good business plan, VAT and tax clearance registration, compliance with FICA	
2.	SMME characteristics such as good track record of loan repayment, sufficient cash flow to repay the loan, industry, firm, age, sector, annual turnover, number of people employed, etc.	
3.	Applicant's understanding of the business plan or financials	
4.	Entrepreneurship characteristics such as sex, age, education, business experience, etc.	
5.	Complete information on the application form	

Your participation in this research is much appreciated and valued – thank you.

ANNEX C: FUNDING CRITERIA QUESTIONNAIRE

		LEVEL OF IMPORTANCE			
No.	**CRITERIA**	**Not important**	**Somewhat important**	**Important**	**Very important**
1	Business plan				
2	Own contribution				
3	Tax clearance				
4	Collateral				
5	Experience				
6	Location of business				
7	Cash flow statement				
8	VAT registration				
9	Financial statements				
10	Education level				
11	Age of business				
12	BBBEE status				
13	Age of owner/manager				
14	Gender of owner/manager				
15	Industry sector				
16	Form of business				
17	Average annual turnover				
18	Member of business association				

Your participation in this research is much appreciated and valued – thank you.

ANNEX D: CONSENT FORM FOR THE SMME OWNER/MANAGER

I, ____, acknowledge that I understand the research and that the research has been fully explained to me. I also understand that the information which I give to the researcher will be used in the research report.

I further acknowledge that the researcher has promised me the following:

- That my participation in this research is voluntary
- That my personal details will remain anonymous throughout the research study as well as in the research dissertation
- That I can refuse to answer any questions which I feel uncomfortable with

I hereby consent to being interviewed for the research study

"Small micro and medium enterprises (SMMEs) access to finance in the Eastern Cape, South Africa"

I agree / **I do not agree** to the interview being audio- recorded

________________________________ ________________________________

Participant Researcher

________________________________ ________________________________

Date Signed Date Signed

ANNEX E: CONSENT FORM FOR THE FINANCE INSTITUTION MANAGER/OFFICIAL

I, ______________________________________, acknowledge that I understand the research and that the research has been fully explained to me. I also understand that the information which I give to the researcher will be used in the research report.

I further acknowledge that the researcher has promised me the following:

- That my participation in this research is voluntary
- That my personal details will remain anonymous throughout the research study as well as in the research dissertation
- That I can refuse to answer any questions which I feel uncomfortable with

I hereby consent to being interviewed for the research study

"Small micro and medium enterprises (SMMEs) access to finance in the Eastern Cape, South Africa"

I agree / **I do not agree** to the interview being audio- recorded

______________________________ ______________________________

Participant Researcher

______________________________ ______________________________

Date Signed Date Signed

ANNEX F: PARTICIPANT INFORMATION SHEET FOR THE SMME OWNER/MANAGER

Good day,

My name is Mzwanele Dlova and I am currently completing my PhD in Management at the University of the Witwatersrand, Johannesburg. My current research is entitled "Small, micro and medium enterprises (SMMEs) access to finance in the Eastern Cape, South Africa". Through my research, I aim to explore the firm and entrepreneurship characteristics impacting on SMME access to finance.

I am inviting you to be a participant in my current research study. Your selection into this research was based on the fact that you are a member of the National Federated Chamber of Commerce (NAFCOC) based in the Eastern Cape and that you are an SMME entrepreneur. By being a participant in this research study I would request an interview session to be conducted either in your office/via telephone or on line whichever option is convenient for you. With your permission, I ask that this interview be recorded through the use of an audio-recorder (if applicable). This will allow for accurate results and analysis to be done. This interview session will be approximately 45 minutes in length.

Your participation in this research is voluntary and I can guarantee that your personal details will remain anonymous throughout this research study as well as in the final research dissertation. You as the participant may refuse to answer any questions which you feel uncomfortable with and may also feel free to withdraw from this study at any time. By being a participant in this research you will not receive payment of any form and the information you disclose will be used in the research report.

This research will be written into a PhD Dissertation and will be available through the University's website. Should you require a summary of the research, I can make this available to you. Should you have any further questions or queries you are welcome to contact myself or my Supervisor, Dr Munacinga Simatele at any time at contact details provided below.

Researcher

Mr Mzwanele Dlova

Mzwaneler1@gmail.com

Supervisor

Professor Munacinga Simatele

Munacinga.Simatele@wits.ac.za

ANNEX G: PARTICIPANT INFORMATION SHEET FOR THE FINANCE INSTITUTION

Good day,

My name is Mzwanele Dlova and I am currently completing my PhD in Management at the University of the Witwatersrand, Johannesburg. My current research is entitled "Small, micro and medium enterprises (SMMEs) access to finance in the Eastern Cape, South Africa". Through my research, I aim to explore the firm and entrepreneurship characteristics impacting on SMME access to finance.

I am inviting you to be a participant in my current research study. Your selection into this research was based on the fact that you are an employee of a developmental finance institution (DFI) offering credit to SMMEs. By being a participant in this research study I would request an interview session to be conducted either in your office/via telephone or on line whichever option is convenient for you. With your permission, I ask that this interview be recorded through the use of an audio-recorder (if applicable). This will allow for accurate results and analysis to be done. This interview session will be approximately 45 minutes in length.

Your participation in this research is voluntary and I can guarantee that your personal details will remain anonymous throughout this research study as well as in the final research dissertation. You as the participant may refuse to answer any questions which you feel uncomfortable with and may also feel free to withdraw from this study at any time. By being a participant in this research you will not receive payment of any form and the information you disclose will be used in the research report.

This research will be written into a PhD Dissertation and will be available through the University's website. Should you require a summary of the research, I can make this available to you. Should you have any further questions or queries you are welcome to contact myself or my Supervisor, Professor Munacinga Simatele at any time at contact details provided below.

<u>Researcher</u>

Mr Mzwanele Dlova

Mzwaneler1@gmail.com

<u>Supervisor</u>

Professor Munacinga Simatele

Munacinga.Simatele@wits.ac.za