The role of commercial banks in financing small, medium and microenterprises in the Greater Soweto

by

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Supervisor: Prof. A.E Loots

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Title of the Dissertation : The role of commercial banks in financing small, medium and microenterprises in the Greater Soweto

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Degree : M. Com

Department : Economics

The growth and development of the small, medium and microenterprise (SMME) sector is acknowledged by most interest groups and policy makers as being of critical importance to South Africa's ability to address the serious problems of unemployment. However research that has been conducted recently shows that the major factor that impedes the establishment and success of businesses is the lack of capital, which is ascribed to a lack of own funds and a lack of assets, especially fixed assets, which could serve as security to obtain loans and bank overdrafts. Further, current levels of investments in SMMEs are inadequate for achieving the growth levels anticipated in the GEAR strategy. This problem is even more prevalent mainly in the areas of the previously disadvantaged.

The purpose of this dissertation is therefore to identify the role of commercial banks in financing SMMEs in the Greater Soweto. This purpose stems from the fact that SMMEs have a major role to play in the South African economy in terms of employment creation, income generation and output growth. SMMEs are also often a vehicle through which the lowest-income people in our society gain access to economic opportunities at a time that distribution of income and wealth in South Africa is amongst the most unequal in the world.

Commercial banks are profit-seeking and risk-averse institutions. They need to satisfy
themselves in respect of the financial stability of the SMMEs that seek funds from them. To this effect, management procedures of the SMMEs that seek funds have to be acceptable and recognised by the commercial banks from which funds are sought. In light of this, practices of planning, organising, directing and controlling of the SMMEs are some of the key features over which SMMEs have control. It can also indicate their risk profiles to the commercial banks.

Over and above the management procedures, SMMEs have to keep proper financial statements that clearly reveal the SMMEs’ financial position, financial performances, growth plans and resources required to achieve those plans. This information is also important not only to commercial banks but also to other non-banking institutions that help SMMEs financially to evaluate their risk profiles. These other non-banking institutions could be less concerned about the risk profiles of the SMMEs but rather be more concerned about their development.

The findings of this study reveal that while most SMMEs use the services of the commercial banks in one or other respect, they still have difficulty in obtaining finance. The main reason for the lack of finance is considered to be discrimination on the part of the commercial banks. However, other factors contribute to the difficulty in obtaining finance. These are a lack of understanding by banks and the fact that other than banks, there are not many other alternative sources of finance available to SMMEs in Soweto. The fact that most SMMEs have had low past net profits and low owner’s contribution is another reason.

It is recommended that managements of the SMMEs improve their managerial skills on aspects of financing, financial information preparation, calculation of capital requirements and related matters. It is also recommended that commercial banks study the reasons offered by the respondents as to why they perceive them to be discriminatory in allocating funds to the previously disadvantaged SMMEs. It is therefore recommended that commercial banks seek to eliminate this perception by means of a substantial public relations campaign that will bring together the commercial banks and the SMMEs concerned to discuss possible solutions to the problems at hand.
CHAPTER 1
PROBLEM STATEMENT AND METHODS OF INVESTIGATION

1.1 PROBLEM STATEMENT

The growth and development of the small, medium and microenterprise sector is acknowledged by most interest groups and policy makers as being of critical importance to South Africa's ability to address the serious problems of unemployment, low income, inequality, economic concentration, lack of international competitiveness and low economic growth which currently confront the country. The Small Business Development Corporation considers the following to be the most important role of small businesses in the South African economy (World Bank, 1998a:1):

- In a developing country there is a strong demand for basic consumer goods and the small business sector is a natural supplier of such goods.
- Small businesses are an important source of competition and challenge to larger companies and may spur them on to more innovative marketing and/or supply.
- Small businesses are important in the promotion of free enterprise and self-sufficiency by generating additional wealth and income in the economy and spreading prosperity more widely.
- Small businesses are valuable sources of innovation and creativity.
- A small business is regarded as an effective means by which one can integrate the informal or semi-formal sector of the economy into the more formal or modern economy.
- Once people are given the opportunity to generate their own wealth and success, and to become more self-sufficient and gain a stake in the future of the country, this promotes stability.

Dhlamini (1994:26) investigated the external or environmental factors that influence the establishment and success or failure of black entrepreneurs in the Greater Soweto. The results of the study show that the major factor that impedes the establishment and success of businesses in this
region is the lack of capital, which is ascribed to lack of own funds and a lack of assets, especially fixed assets, which could serve as security to obtain loans and bank overdrafts. Other factors are a lack of business tradition, experience and exposure, educational qualifications and the poor location of business and inadequate business premises.

Current levels of investments in Small Medium and Micro Enterprises (SMMEs) are inadequate for achieving the growth levels anticipated in the GEAR strategy. SMMEs receive approximately 2.6 per cent of investment capital flows, through both formal and informal agents (RSA, 1997:3). According to the Council of South African Banks (COSAB), there are an estimated 375 000 loans on the books of two major commercial banks that can be considered micro-enterprise credit (a total of R4 billion, averaging R11 700 per loan). In order to benefit from the dynamism and the labour absorption capacity of SMMEs, South Africa has to redirect public and private investment flows to this sector of the economy substantially.

1.2. PURPOSE OF STUDY

The main reason for the study stems from the importance of the small business sector both in the formal and in the informal sectors in creating employment. This tends to be confirmed by the comparison of the Department of Trade and Industry’s Tax Holiday and Small and Medium Manufacturing Development Programmes. These programmes indicate that the average capital cost per job created under the latter programme is roughly one fifth of that required for the larger scale projects utilising the Tax Holiday schemes (RSA, 1997:2-3 & SACOB, 1993:5).

In view of the fact that the employment rate in South Africa is officially estimated to decline at a rate of approximately four percent of the economically active population (South African Reserve Bank, 2000:s152 & Statistics South Africa, 2000:p0271), makes small business development an obvious priority for policy-makers. In the current macroeconomic context, it is imperative that significant investment is made in SMMEs, in order to create both short-term and long-term capacity for labour absorption and output growth, as well as improve income generation and redistribution.
The aim of this study is to identify the role of commercial banks in financing SMMEs in the greater Soweto area. The attainment of this aim is constituted by the following objectives:

- Providing an overview on the small business sector.
- Explaining the role of SMMEs in the South African economy.
- Analysing the planning of the capital requirements of SMMEs.
- Identifying the sources of finance available to SMMEs.
- Running an empirical research on the SMMEs in the greater Soweto and their financing sources.
- Suggesting possible alternative means of financing SMMEs by the commercial banks in this region.

1.3. METHOD OF INVESTIGATION

Information for this study has been obtained through both primary and secondary research.

1.3.1 Primary research

To obtain information and data for this study, it was necessary to gather information from small businesses in the formal and the informal sector of the Greater Soweto. The collection of information and data has been obtained from both the businesses themselves and from the existing published material. Random control checks have been carried out to verify information obtained by means of questionnaires.

1.3.2 Secondary research

A literature study has been done to explain the role of SMMEs in the South African economy, and
to analyse the lack of finance to SMMEs in the Greater Soweto. to determine the factors that influence commercial banks' lending to SMMEs and to identify the extent of the role that commercial banks play in sustaining the financial viability of SMMEs in this region. For the purpose of this dissertation, the Greater Soweto comprises all the townships that are located in the South Western area of Johannesburg.

The theoretical basis of the study an extensive number of literature references has been consulted. These include textbooks, dissertations, theses, research reports, journals and other financial publications on the subject of small businesses.

The study shall concentrate on small, medium and microenterprises in the Greater Soweto. The SMMEs studied shall mainly be those in the formal sector since a list of all the businesses in the formal sector is readily obtainable from the Soweto Metropolitan Council. Few details are known about the size of the informal sector in urban areas or in South Africa as a whole (Beavon. 1989:13).

Scott-Wilson and Mailoane (1990: 52) also found that the estimates of the size of the informal sector in the Greater Soweto are influenced by the vested interest of the person making the estimates. It follows therefore that it might be difficult to draw up a representative sample from the business population in the informal sector.

The layout of the chapters is as follows: Chapter 2 discusses the South African business sector and the role of SMMEs in the South African economy. Chapter 3 identifies the sources of finance available to SMMEs and chapter 4 analyses the results of the empirical research. Chapter 5 provides the main conclusions and summaries of the dissertation.
CHAPTER TWO
THE SMALL BUSINESS SECTOR: A LITERATURE REVIEW

2.1 INTRODUCTION

The aim of this chapter is to provide an insight into the nature and outlook of the small, medium and microenterprises (SMMEs) in South Africa. Since the main aim of this dissertation is to identify the role that commercial banks play in helping to establish and sustain SMMEs in the Greater Soweto, it is necessary to have an understanding of what is considered to be an SMME, what their capital requirements are, how they are being managed and the role that they play in the South African economy. These issues will be dealt with during the course of this chapter.

However, before an attempt can be made to deal with the problem of the commercial banks' role in financing SMMEs in the Greater Soweto, it is necessary to provide a definition of a small business. On studying the different definitions of the concept small business, no universally accepted description was found. This chapter focuses on the different definitions emanating from the United States of America, the United Kingdom and South Africa.

This chapter also provides a rendition of the role of SMMEs in the South African economy, the managing of SMME's, and planning the capital requirements of SMMEs.

2.2 DESCRIPTION OF A SMALL BUSINESS

As has been stated earlier, there is no universally accepted definition of a small business. However, to find an acceptable definition of SMMEs for the purpose of this dissertation, a number of definitions of SMMEs are reviewed in the following sections. It is easier to describe than to define an SMME (Dhlamini, 1994:7). Furthermore, according to Vosloo (1995:3), the definition of what a small business is differs from country to country and even from organisation to organisation within the same country.
2.2.1 Definition in the United States

In the USA, a small business is defined according to economic standards and statistical guidelines (Otero & Rhyne, 1994:16). The economic standards are based on the following: independent ownership/management, the non-dominance of the business in its field of operation and the fact that capital is owner-supplied. The statistical guidelines are based on the number of employees in the business and the annual turnover of the business. While the economic standards are static, the statistical guidelines can be adjusted as circumstances change (Otero & Rhyne, 1994:16 & Farbman, 1998:26).

In the US the Small Business Administration, created in terms of the Small Business Act of 1953, specifies a small business in terms of section 3 of the Act, as follows (Farbman, 1998:35): A small business concern shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation.

In addition to the foregoing criteria, the administrator, in making a detailed definition, may use the following criteria: number of employees and dollar volumes of business. Where the number of employees is used as one of the criteria in making such a definition for the purposes of this act, the maximum number of employees which a small business concern may have under the definition shall—vary from industry to industry to the extent necessary to reflect differing characteristics of such industries and to take proper account of the other relevant factors.

Leistner (1992:10) states that the measure used by the Small Business Administration in the US to evaluate small firms for eligibility for financial assistance, managerial assistance or assistance in procuring government contracts are based on total sales or total employment of a firm. The criteria are as follows:

- In the case of retailers, a firm is considered small if its annual sales do not exceed $3.5 million.
In the case of service firms, a firm is considered small if its annual sales do not exceed $3.5 million. However, in certain cases this figure may go up to $13.5 million.

In the case of wholesalers, a firm is considered small if it does not employ more than 500 employees.

In the case of manufacturers, a firm is considered small if it does not have more than 500 employees, however in certain cases some industries may have up to 1500 employees and still be considered small.

In the case of transportation and warehousing companies, a firm is considered small if its annual sales do not exceed $1 million.

In the case of construction firms, a firm is considered small if its annual sales do not exceed $17.5 million for the three years immediately prior to the evaluation.

In the case of agricultural firms, a firm is considered small if its annual sales do not exceed $100,000, however, in some cases, depending on the nature of the operation, this figure may be as high as $3.5 million.

From the abovementioned, it is clear that a wide range of definitions exists on small businesses in the US depending on the sector in which the business operates, the size of its annual sales and in some cases the number of employees employed by the business. Therefore, there is no all-embracing single definition of a small business in the USA.

2.2.2 Definition in the United Kingdom

According to the Brundtland Commission (1997:26), the Committee of Inquiry into Small Firms in 1971 defined a small business in the UK as follows:

- In economic terms, a small business is one that has a relatively small share of its market.
- A small firm is managed by its owner or part owners in a personalised way, and not through the medium of a formalised management structure.
- A small firm is independent in the sense that it does not form part of a larger enterprise and that the owner(s)/manager(s) are free from outside control when making principal decisions.
The statistical definition of a small business in the UK is set out in table 2.1. From this table it is clear that the definition also depends on the sector in which the business operates, on the number of employees it employs and the annual turnover of the business. In the case of a road transport business, a small business is considered a small business if it utilises a maximum of five vehicles. Table 2.1 also shows that all catering firms are considered small excluding multiples and brewery-managed public houses.

The Brundtland Commission (1997:26) further states that the committee of Inquiry of Small Business, the Bolton Committee, recognises that no single statistical definition of a small business would cover industries as divergent as the manufacturing and service industries, and that a definition with a measure of size expressed in financial terms would suffer an inherent disadvantage in times of inflation.

<table>
<thead>
<tr>
<th>Business sector</th>
<th>Statistical measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>200 employees or less</td>
</tr>
<tr>
<td>Construction</td>
<td>25 employees or less</td>
</tr>
<tr>
<td>Mining/Quarrying</td>
<td>25 employees or less</td>
</tr>
<tr>
<td>Retailing</td>
<td>Annual turnover of up to £50 000</td>
</tr>
<tr>
<td>Wholesalers</td>
<td>Annual turnover of up to £200 000</td>
</tr>
<tr>
<td>Motor traders</td>
<td>Annual turnover of up to £100 000</td>
</tr>
<tr>
<td>Miscellaneous services</td>
<td>Annual turnover of up to £50 000</td>
</tr>
<tr>
<td>Road transport</td>
<td>Five Vehicles</td>
</tr>
<tr>
<td>Catering</td>
<td>All excluding multiples and brewery-</td>
</tr>
<tr>
<td></td>
<td>managed public houses</td>
</tr>
</tbody>
</table>

Source: Brundtland Commission (1997:26)

In conclusion, a small business is one which commands a relatively small share of its market.
managed by its owner or part-owners and one that is independent in that it does not form part of a larger enterprise and that the owner(s)/manager(s) are free from outside control when making principal decisions in the UK. Furthermore, as in the US, a small business is considered small in the UK on the basis of the sector in which the business operates and the statistical measures in relation to the number of employees and annual turnover.

2.2.3 Definition of the small businesses and their financing sources in South Africa

A general perception of a small business in South Africa relates to the size of the business, the size of its annual turnover, the number of employees it employs, the size of its market share and whether it is managed and owned by its owners. A small business is also understood to be independent in that it is not a subsidiary of any larger business and that its managers are free to determine their own strategic market position and calibrate their own financial, marketing and public relations policies. However, what is discussed next is the official definition of a small business according to the National Small Business Act, Act No. 106 of 1996.

The National Small Business Act classifies SMMEs according to five size categories, namely survivalist enterprises, microenterprises, very small enterprises, small enterprises and medium-sized enterprises. Each has particular financing requirements.

2.2.3.1 Survivalist enterprises

Survivalist enterprises are enterprises with no paid employees and minimal asset value. These enterprises generate income below the minimum income standard or the poverty line, and their main aim is to provide minimal subsistence means for the unemployed and their families. Most entrepreneurs in this category are involved in hawking, vending, subsistence farming, etc. In the National Small Business Act, the survivalist enterprise is considered to be part of microenterprises (RSA, 1996 :Section 23 (1)).
It is estimated that the survivalist sector constitutes 23.3% of all enterprises recorded in South Africa and absorbs approximately 3% of total employment. This category has great potential for the absorption of unskilled labour, as has been confirmed by the correlation between the unemployment rate and the amount of self-employment in unregistered, mainly survivalist, enterprises that prevail in informal settlements and rural areas. The largest number of South Africa’s survivalist enterprises are located in KwaZulu-Natal, Gauteng, the Eastern Cape and the Northern Province (where approximately 23%, 21%, 17% and 11% respectively, are located) (RSA, 1996: Section 26(1)).

The main sources of finance for the survivalist sector are family and friends, informal money lenders, NGO’s, and credits obtained from suppliers. Most survivalists have never had access to formal financial institutions. The greatest need faced by enterprises operating in the survivalist sector is for working capital to purchase supplies and inputs, often for periods of less than a week. Very little capital accumulation takes place in these enterprises, as most income is consumed by the family. As a result, survivalist enterprises have continual borrowing needs and run the risk of excessive dependence upon sources of capital outside the business.

Entrepreneurs operating in the survivalist sector generally have very little or no collateral. Alternative lending approaches, such as group lending, are sometimes successful in overcoming the collateral constraints faced by the sector, but the character of the programme is important (RSA, 1996: Section 26(1)).

2.2.3.2 Microenterprises

Microenterprises have a turnover below the VAT registration limit (presently R150 000 per annum) and have less than five paid employees (RSA, 1996: Section 23(1)). According to SACOB (1999: 10) these enterprises tend to lack formality in terms of registration for tax purposes, labour legislation, business premises and accounting procedure.

Examples of microenterprises are spaza shops, mini-taxis and household industries.
Microenterprises without employees constitute approximately 31% of all enterprises and are estimated to contribute 3.9% of total private sector employment, while microenterprises with one to four employees constitute approximately 16.4% of all enterprises and absorb about 6.8% of employment (RSA, 1996:Section 26(1)).

The largest numbers of microenterprises are located in Gauteng, KwaZulu-Natal, the Western Cape and the Eastern Cape (where approximately 34%, 18%, 14% and 10% respectively, are located) (RSA, 1996:Section 26(1)).

Microenterprises are more likely to have access to formal financial institutions than survivalist enterprises, but often for purposes other than their own businesses, since such businesses are usually too small to interest commercial lenders. Common sources of enterprise finance include family and friends, money lenders and NGO's.

According to SACOB, (1999:12) the financing needs of microenterprises are more complex than survivalist enterprises. Generally microenterprises require small fixed asset loans for equipment. Loan requirements are for longer periods, ranging from 3 months to 3 years (longer periods are required for mini-taxis), and for larger amounts ranging from R1 000 to R30 000.

While some microenterprises may have access to collateral such as a house, they are generally unwilling to risk their property. Furthermore, few microenterprises have the type of collateral required by the formal financial institutions. According to Booysen (1997:9), these entrepreneurs are more likely to benefit from the revision of regulation around collateral.

2.2.3.3 Very small enterprises and their sources of financing

Very small enterprises employ fewer than ten paid employees, but in the mining, electricity, manufacturing and construction sectors, fewer than twenty. They operate on the formal market and usually have access to modern technology. The smallest of these enterprises are self-employed
owners with no employees, such as artisans and professionals. Very small enterprises make up an estimated 19.7% of all enterprises recorded and account for 13.3% of employment. The largest concentrations of very small enterprises are found in Gauteng (42%), the Western Cape (16%) and KwaZulu-Natal (15%) (Booysen. 1997:9 & RSA. 1996:Section 26(1)).

Very small enterprises sometimes have access to formal financial institutions and are often considered to be formal microenterprises by institutions such as the commercial banks. Very small enterprises could benefit from the combination of debt and equity, but their equity requirements are generally too small for the equity financiers. The only equity in the business is, therefore, the owner’s contribution. Often, very small enterprises are established as a result of an entrepreneur’s retrenchment package from their previous employer.

The debt financing needs of very small enterprises are usually for fixed asset investment, capital outlay for enterprise establishment such as office equipment and working capital, especially bridging finance or revolving credit. Leasing finance is, therefore, important for very small enterprises. Factoring could potentially be a source of capital for this sector, but is not available due to a small number of debtors. Very small enterprises may have established relationships with their suppliers, but generally do not buy in adequate volumes to obtain credit. The average credit requirements of very small enterprises range from R10 000 to R20 000 (RSA.1997:20).

Very small enterprises are often constrained by collateral requirements imposed by formal financial institutions. While some entrepreneurs may have some life insurance policies or pension funds and are often home owners, they usually are overly leveraged (RSA.1997:20). Most business failures occur in this sector.

2.2.3.4 Small enterprises

Small enterprises have fewer than 50 paid employees and are more established, with more complex business practices. Usually, the owner does not manage the enterprise directly, and secondary
coordinating mechanisms have been put in place. Growth from a small to a medium sized enterprise requires an accumulation of resources as well as a set of appropriate incentives for enterprise expansion. Small enterprises constitute an estimated 7.6% of all enterprises and contribute 19.9% of employment RSA, 1997:21). Almost 50% of small enterprises are located in Gauteng. A further 16% and 12% are located in KwaZulu-Natal and the Western Cape, respectively.

Small enterprises are more established than very small enterprises and have greater capital needs, especially for equipment and working capital. They rely more upon leasing capital and factoring. However, long-term outlays for machinery and equipment are often required, as well as overdraft facilities and suppliers credit for working capital.

According to the Department of Trade and Industry (RSA, 1997:21) businesses in this sector also require equity injections, but as with very small enterprises, the equity amounts required are often too small for equity financiers to consider (below R5 million). Loan finance requirements of small enterprises range from R20 000 to R5 million.

Entrepreneurs in the small enterprise sector often have some form of collateral that would be acceptable to formal financial institutions, but it is usually not sufficient to meet their requirements. Collateral therefore remains a constraint.

2.2.3.5 Medium-sized enterprises

Medium-sized enterprises are enterprises with up to 100 paid employees, although in the mining, electricity and manufacturing sectors up to 200 employees are included. Although usually still controlled by an owner-manager, the ownership and management structure is more complex. Often the decentralisation of power to an additional management layer and a greater division of labour are the main differences between the small and the medium-sized enterprises.

A more complete separation of ownership and management is often the natural barrier between the
medium and large enterprises. Medium-sized enterprises make up to 1.4% of enterprises recorded and account for approximately 13.8% of employment. According to the Department of Trade and Industry (RSA, 1997:21) medium-sized enterprises are mostly concentrated in Gauteng, KwaZulu-Natal and in the Western Cape.

Medium-sized firms generally have established relationships with their bankers, and those with growth potential are also targeted by equity fanciers. A wide range of institutions serve their financing needs (RSA, 1997:21). Medium-sized enterprises are also more complex in that the owner may not manage the business directly and may require secondary coordinating mechanisms to ensure the smooth operation of the business.

In conclusion Table 2.2 provides a summery of the definition of SMMEs by sector, size, number of employees, turnover and assets in South Africa.

Table 2.2  Definition of SMMEs by sector, size, number of employees, turnover and assets

<table>
<thead>
<tr>
<th>Sector or Sub-sector in accordance with the Standard Industrial Classification</th>
<th>Size or class</th>
<th>Total full-time equivalent of paid employees Less Than</th>
<th>Total annual turnover (R million) Less Than</th>
<th>Total asset value (Fixed assets excluded) (R million) Less Than</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>Medium</td>
<td>200</td>
<td>R4</td>
<td>R4</td>
</tr>
<tr>
<td></td>
<td>Small</td>
<td>50</td>
<td>R2</td>
<td>R2</td>
</tr>
<tr>
<td></td>
<td>Very small</td>
<td>20</td>
<td>R0.40</td>
<td>R0.40</td>
</tr>
<tr>
<td></td>
<td>Micro</td>
<td>5</td>
<td>R0.15</td>
<td>R0.1</td>
</tr>
<tr>
<td>Mining/Quarry</td>
<td>Medium</td>
<td>20</td>
<td>R30</td>
<td>R18</td>
</tr>
<tr>
<td></td>
<td>Small</td>
<td>50</td>
<td>R7.5</td>
<td>R4.5</td>
</tr>
<tr>
<td></td>
<td>Very small</td>
<td>20</td>
<td>R3</td>
<td>R1.8</td>
</tr>
<tr>
<td></td>
<td>Micro</td>
<td>5</td>
<td>R0.15</td>
<td>R0.1</td>
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<tr>
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<td>Medium</td>
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<td>R10</td>
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Of all definitions discussed above, the most exhaustive appears to be the South African version. Not only does it specify a sector and industry in which the small business is expected to be operating, but also a detailed statistical prescription of the total number of full-time paid employees, total annual
turnover and total assets value. Furthermore, it classifies businesses into the sub-categories of very small, small, micro and medium enterprises. Therefore, a business has a clear identity in relation to its size or class depending on the sector or sub-sector in which it is being classified in South Africa. For the purposes of research and policy, this makes it easier to conduct studies and calibrate policy in relation to the small business sector in South Africa.

2.3 THE ROLE OF SMMEs IN THE SOUTH AFRICAN ECONOMY

According to the Department of Trade and Industry (RSA, 1997:22) small businesses have a major role to play in the South African economy in terms of employment creation, income generation and output growth. SMMEs account for approximately 60% of all employment in the economy and 40% of output (RSA, 1997: Section 76(h)). They are also often a vehicle through which the lowest-income people in our society gain access to economic opportunities at a time that distribution of income and wealth in South Africa is amongst the most unequal in the world.

According to Business Partners, the former Small Business Development Corporation (SBDC), the following are the most important factors determining the role of SMMEs in the South African economy (Business Partners, 1999:14):

- SMMEs are by far the most cost effective and efficient job creator in the free enterprise economy. The number of jobs created per unit of capital invested is generally far higher than in larger firms (RSA, 1997:2-3 & SACOB, 1995:5), which produce output growth without necessarily producing more employment. Small businesses are therefore considered to be especially suitable in an economy such as the South African economy where unemployment is widespread.
- In a developing economy there is basic consumer goods and the small business sector is the natural supplier of such goods. Small businesses ensure continuity of products and services in areas such as rural areas that are often out of reach of larger enterprises or in markets that they do not care to enter (Kirsten, Van Niekerk & Du Plooy, 1997:282). Small businesses also add flexibility to the market place, satisfying specialised or micro-needs in certain
markets.

- SMMEs are an important source of competition and challenge the larger companies and may spur them on to more innovative marketing and/or supply. Small businesses promote healthier competition and contribute to the dispersal of economic activity. In this way, the alleged evils of concentration of business size, of industry and of population is countered.

- SMMEs are important in the promotion of free enterprise and self-sufficiency by generating additional wealth and income in the economy and spreading prosperity more widely, especially in lesser developed areas. Clarke (1995:26) further states that small business contribute to the achievement of self-sufficiency and human dignity.

- SMMEs are valuable sources of innovation and creativity. Small businesses often are not price competitive but compete through service and technology (NAFCOC, 1996:15). They are important partners to larger enterprises and often reinforce and supplement the initiatives of such enterprises rather than replace them.

- SMMEs are regarded as an effective means by which one can integrate the informal or semi-formal sector of the economy into the formal or modern economy. SMMEs encourage grassroots development in that it is a logical starting point for the black entrepreneur who has been denied free and equal access to participation in the South African economy.

- Once people are being given the opportunity to generate their own wealth and success, and to become self-sufficient and obtain a stake in the future of the country, this promotes stability. Increased market share and buying power enables individuals to have more influence on their socioeconomic environment (Business Partners, 1999:14).

From the discussion above it can be concluded that the important role of SMMEs in the South African economy cannot be overemphasised. Its importance is highlighted in its job creation capacity, ability to efficiently produce basic consumer goods, potential to encourage competition, promotion of free enterprise and self-sufficiency, innovation and creativity and the promotion of socio-economic stability and the possible reduction of poverty.

2.4 MANAGING SMALL BUSINESSES
In large companies, the managerial activities are distinct from doing activities of employees. Whereas in small firms the distinction is less clear because the owner/manager works side-by-side with employees (Pickle & Abrahmson, 1990:210). The responsibilities of the owner/manager in a small firm involve coordinating the firm’s total resources. The owner/manager completes these responsibilities by performing the functions of management, namely, planning, organising, directing and controlling (Pickle & Abrahmson, 1990:210).

Van Niekerk (1998:280) points out that initially, when the business is still small, the owner controls all aspects of the organisation personally, but as the firm grows, the decisions regarding routine activities ought to be delegated to responsible persons. This liberates the owner to concentrate on all-embracing activities such as planning, organising, directing and controlling. A brief discussion of the four managerial activities follows.

2.4.1 Planning

According to Van Niekerk (1998:30), planning is the group of activities that must be performed to prepare the organisation for future development and to ensure that decisions affecting the use of the available human and capital resources will lead to the accomplishment of the organisation’s planned objectives. Szilagyi (1998:171) points out that planning is the process that begins with the analysis of the external environment and internal resources, concerns the development of goals and strategies to achieve goals, formulates detailed plans to make sure that strategies are carried out, and deals with the future impact of current decisions.

In a small business, planning is probably the most difficult management function to perform because managers are too involved in day-to-day operations and do not see the immediate result of their efforts. Most managers in SMMEs spend the greater portion of their time and energy on short range, day-to-day planning (Pickle & Abrahmson, 1990:211). Planning, particularly long range planning, tends to be neglected mainly because of the following factors that discourage owners/managers and act as barriers to planning (Megginson, 1992:226):

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• Fear, or believing that careful thoughts about their firm’s future will reveal new troubles or problems.
• Unpredictability, or believing that planning is not worth it because things do not work out according to plan.
• Uncertainty, or feeling that plans and circumstances change too rapidly to make planning worthwhile.
• Lack of planning knowledge and finding it too difficult to state objectives and courses of action on paper.
• Lack of proper time and place, concentrating on favourite jobs, delaying disagreeable ones and/or not delegating.

Megginsion (1992:234) discusses the need for long-term and short-term planning as follows:
• Long-term planning is needed for activities such as market development, machine purchase and product and personnel development. Trends in income levels, industrial development, growth of population, mobility of people, market size and a few other factors that should be studied when striving to form valid long range forecasts. The manager of SMME, for example, should forecast whether the volume of sales seems adequate to justify the high initial cost of a product.
• Short-term planning, on the other extreme, is more immediate in nature. It covers a period of a day, a week, a month, six months or at most a year. This type of planning gives the manager and employees some form of direction for the day-to-day operations of the business. Short-term plans should contribute to and be consistent with long-term plans. Also, an SMME should excel in short-term planning because their strength lies in being flexible.

2.4.2 Organising

Organising is one function of an SMME that a manager/owner must perform. Scarborough (1998:52) states that managers of SMMEs will normally discover that the growth of a business brings with it the need to reorganise and the basic concepts of organising apply to all enterprises.
Pickle & Abrahamson (1990:220) define organising as the management function of coordinating the human, financial and physical resources of the business so that they follow the course needed to attain the objectives of the business as specified in the planning phase. Such coordinated effort is achieved through the design of a structure of tasks, authority, people and communication. Szilagyi (1998:253) draws a further three points with regards to organising:

- Firstly, the meaning of the word 'design', implies that this is a rational and conscious process on the part of the manager to develop the most effective interactions and interrelationships within the organisation.
- Secondly, the result of the design effort is a structure or framework within the organisation.
- Thirdly, this structure includes grouping similar jobs, placing the most capable people in these jobs, and developing the most effective means of communication between jobs and job-holders.

Tootelian & Goedeke (1995:364) are of the opinion that one of the most common difficulties found among owners of SMMEs with respect to organising is their uncertainty about how to group jobs and tasks. There is no right answer to the question: On what basis should job activities be joined? This depends on the type of the business or industry and the personal preferences of the entrepreneur. Many sole proprietors view organising as the wasted exercise. A typical comment among them is: "Why should I develop an organisational chart? There are only a few people here! We know what we are supposed to do and I'm the Boss." According to (Tootelian & Goedeke, 1995:355) such a perspective simplifies or ignores the value of sound management. A proper organisational structure will help a business survive by ensuring that the tasks are completed and that a foundation is laid for future growth.

2.4.3 Directing

Directing is the leadership function of a manager. Through daily interactions with employees, the owner of an SMME provides leadership that is needed to guide the business. The quality of
leadership is a major influence in determining the success of the firm (Pickle & Abrahamson, 1990:216). Marx and Churr (1995:177) define leadership as the process by means of which one person can influence the others in such a way that they will willingly strive to achieve the objectives that he/she sets for them.

Marx and Churr (1995:227) summarise the most important reasons for directing as follows:

- Directing is responsible for the actual execution of the activities of the enterprise.
- Without directing, the planning and organising done earlier would be of no use, since no activities would be taking place.
- Proper direction can ensure that the execution of work will take place as effectively and as efficiently as possible. In order to survive in today's demanding and difficult circumstances, an enterprise must necessarily function as efficiently as possible.
- Directing has the most important influence on the relationship between the owner/manager and his subordinates and on the willingness of the subordinates to work efficiently.

Pickle & Abrahamson (1990:219) refers to the relationship between a manager and subordinates, mentioned by Marx and Churr above, as the employee relations. Of the many issues that confront the SMMEs manager, employee relations is the most challenging.

2.4.4 Controlling

The last area of managerial concern is the controlling function. The plans of the businesses become the standards against which the behaviour of the business is compared (Scabourough, 1998:64). Control of activities is found in all types of organisations (Szilagy, 1998:253). Du Toit (1990:85) points out that, just as planning determines the course of future events, control is likewise aimed at determining whether the planned course becomes a reality and whether any adaptations are needed.

Marx and Churr (1995:231) differentiates between directing and controlling. With directing, the emphasis falls on the initiation and continuation of work and correctly leading subordinates. With
controlling, on the other hand. the work is already in progress and the emphasis falls on controlling the quality of the work and the corrections needed if the work is not satisfactory.

The steps involved in the controlling process are the setting of standards. measuring actual performance against planned performance and taking corrective steps if there are deviations (Megginsion. 1998:226).

Scabourough (1998:59) briefly elaborates on the control steps as follows:

- Control must be timely in that feedback from the control system must reach the decision maker in time to modify the plan of action or take corrective action.
- Control should be cost effective. It should not cost more to operate than the savings produced. The manager must try to reduce the time and paper work needed to collect information.
- Control should be accurate. The basic trend of any control system is to use the accurate data and the system must be reliable.
- Control should be quantifiable and measurable, although at times quality has to be judged subjectively. It is much easier to measure and control phenomena that can be expressed in quantitative terms.
- Control should cause rather than indicate actual situations.
- Control should be assigned to one individual because often, owners of SMMEs do not have the time to control all activities themselves. They should delegate authority for some actions to subordinates (Scabourough, 1998:59).

In conclusion, managing SMMEs involves planning, organising, directing and controlling. Planning is the analysis of the external environment and internal resources, in order to develop goals and strategies to achieve those goals. To effectively implement and execute the businesses' plans it is necessary to coordinate the human, financial and physical resources of the business so that they follow the course needed to attain the objectives of the business as specified in the planning phase (Megginsion. 1998:226). As has been discussed above this is referred to as organising.
While directing involves the actual execution of the activities of the enterprise, controlling ensures that the quality of the work is up to standard and executes the corrections needed if the work is not satisfactory. In order to ensure the businesses’ success it is imperative that the manager considers the use of the management functions as discussed above.

2.5 PLANNING THE CAPITAL REQUIREMENTS OF SMMEs

Before moving to the next chapter, it is necessary to identify factors that influence the capital requirements of SMMEs. According to Dhlamini (1994:22) a small business can plan its capital requirements by using the following procedure:

- firstly. quantify the factors that influence the determination of the capital requirements;
- secondly. draft a budget to determine capital requirements; and
- thirdly. formulate a business plan that summarises the total capital requirements.

The economic factors identified by Dhlamini (1994:22) in determining the capital requirements of SMMEs are: maximising of returns to investment and owner’s equity, financial leverage, liquidity, solvency, management skills and retention of independence. He contends that the maximising of profits is not a good yardstick to measure the performance of SMMEs. This, he argues, does not facilitate the determination of the capital requirements because profits must be maximised irrespective of the capital requirements.

The discussion below will concentrate on return on investment, and on owner’s equity, financial leverage, liquidity, solvency, management skills and retention of independence. A brief discussion on budgets and business plans are also included.

2.5.1 Return on investments and return on owner’s equity

The return on investments, which is often called the return on total assets, measures the overall effectiveness of management in generating profits with its available assets (Gitman, 1993:206).
The primary objective of the enterprise is not necessarily to strive to make profits, but rather profitability (Cronje, *et al.*, 1997:134), in which case the cost and investment made in assets are taken into account. The return on investments is calculated by dividing earnings (income) by total assets (Correira *et al.*, 1993:155).

According to Dhlamini (1994:23), there is a difference of opinion as to what constitute earnings or income or realised profits. Correira *et al.* (1993:155), state three possible definitions of earnings or income, namely earnings before interest and tax, earnings before interest but after tax and earnings after interest and tax, that is net profit. Which definition to choose will depend on the objective of the analyses as shown below:

- using earnings before interest and tax is useful in comparing firms in different tax situations and with different degrees of financial leverage;
- using earnings before interest but after tax is conceptually the most correct approach. The reason being that it excludes interest which is a cost of financing but includes taxation which is an operating cost; and
- using earnings after interest and tax tends to understate the return as the after-tax cost of debt finance has not been removed. In this case the degree of financial leverage will have an impact on the return on total assets.

Another difficulty associated with returns on total assets is that since a large part of a firm’s total assets are fixed, and since book and market values of fixed assets may be widely divergent, the return on total assets may differ simply because of the degree to which the assets are depreciated (Moyer, 1993:32).

Correira *et al.* (1993:156) define return on owner’s equity as the rate of net profit after interest and tax to owner’s equity. Dhlamini (1994:24) points out that profit after tax is used in the calculation of return on owner’s equity, as this is the profit retained by the entrepreneur and can be used to expand the business or can be withdrawn for personal use. Further, the ratio is influenced by the effective utilisation of borrowed capital and can, together with the return on total assets, highlight
• It can result in cost saving, since illiquidity may force the business to pay higher interest and the business may lose the advantage of discounts for payments made on time.
• It provides the enterprise with greater freedom in its operations.
• It creates an impression of solidness to outsiders and may improve the creditworthiness of a business.
• Without liquidity problems, management can work with greater peace of mind and carry out more creative tasks.
• Finally, if illiquidity occurs more frequently, it begins to affect solvency and may result in bankruptcy.

According to Gitman (1993:195), the following three basic measures of liquidity are used:
• Net working capital is calculated by subtracting current liabilities from current assets. A firm’s creditors may require that a minimum net working capital be maintained in cases where long-term debt has been given.
• A current ratio is one of the most cited financial ratios. It is the ratio of current assets to current liabilities. A ratio of 2:1 is occasionally cited as acceptable, but this will depend on the industry in which the business operates.
• An acid-test ratio is similar to the current ratio except for the fact that it excludes inventory from current assets. The basic assumption is that inventory is the least liquid current asset and should therefore be ignored. It is calculated as the ratio of current assets less inventory to current liability. A ratio of 1:0 or greater is occasionally cited although again this will depend on the industry.

Entrepreneurs can increase liquidity by ensuring that a positive leverage factor is maintained when borrowed capital is used. In SMMEs, liquidity is important because only one liquidity setback can lead to insolvency (Dhlamini, 1994:25).

2.5.4 Solvency
Solvency refers to liquidity in the long-term, that is, a firm’s ability to pay its long-term debt. Lambrechts (1998:119) describes solvency as the ability of an enterprise, even when ceasing its activities and selling all its assets, to settle all its debts.

Dhlamini (1994:26) highlights the relationship between solvency and liquidity by pointing out the following different situations:

- A business is solvent and liquid if it will be able to meet its short-term and long-term commitments.
- A business is not solvent, but liquid, and could, with the right product and management, survive and become solvent.
- A business is solvent, but not liquid in that total assets exceeds total liabilities. The business has difficulty in meeting its short-term liabilities, and in certain instances its long-term obligations. This situation is referred to as technical insolvency or cash insolvency. It could lead to the forced disposal of assets with the effect that a lower return on total assets will be realised and this could lead to total bankruptcy.

The following solvency ratios (Dhlamini, 1994:26) also known as leverage ratios (Moyer, 1993:32) or debt management ratios (Correira et al., 1993:152) should be calculated:

- **Debt ratio** is the ratio of total debt to total assets and measures the percentage of total funds provided by creditors. Total debts includes current liabilities (Correira et al., 1993:153). The higher the ratio, the greater the amount of other peoples’ money that is being used to generate profits (Gitman, 1993:201).

- **Debt:equity ratio** indicates the relationship between the long-term funds provided by creditors and those that are provided by the firm’s owner(s). It is defined as the ratio of long-term debt to owner’s equity and is commonly used to measure the degree of financial leverage (Gitman, 1993:201).

- **Interest-earned ratio**, which is also called a firm’s ‘total interest coverage ratio’, measures the firm’s ability to meet its interest obligations (Lambrechts, 1998:123). The higher the value of this ratio, the better able the firm will be to meet its interest obligations. It is the
ratio of earnings before interest and tax on interest (Gitman, 1993:202).

Lambrechts (1998:120) makes the following remarks about the problems encountered in calculating solvency ratio’s:

• The value of fixed assets shown in the balance sheet is often unrealistic. The basis of depreciation of durable means of production is determined at the discretion of management and the correct amount cannot easily be arrived at.
• The amounts attributed to goodwill, patents and trademarks should preferably be ignored, since they do not realise any value on liquidation.
• The valuations of current assets, particularly stock, presents many problems.

2.5.5 Management abilities and the retention of independence

In South Africa, many existing and aspirant entrepreneurs do not have the necessary management knowledge and experience to be successful entrepreneurs. Ignoring sound financial management principles reduces the chances of attaining the economic objectives of maximising the return on investments, a positive financial leverage, solvency and liquidity.

One reason that entrepreneurs give for starting a business is that of being one’s own boss and controlling oneself (Kirsten et al., 1997:276). Independence can be maintained by using own capital, but it is often restricted and the entrepreneur has to rely on external finance. This could result in a loss of independence. According to Dhlamini (1994:27), by not utilising borrowed capital, the entrepreneur can lose the opportunity to increase the return on owner’s equity, because the benefit of a financial leverage cannot be utilised.

2.5.6 Drafting a budget and utilising a business plan

Van Niekerk (1998:31) states the following regarding the planning of the capital requirements of SMMEs: Firstly, the factors that influence the determination of capital requirements must be
quantified. and secondly, budgets must be drafted to determine capital requirements, and finally, a business plan must be formulated to summarise the capital requirements.

To determine the extent of the capital requirements, the following budgets are drafted (Dhlamini, 1994:27):

- The sales budget, which is the most important as it has an effect on all other budgets. Like all other budgets, the sales budget should be drawn up for the ensuing year, the medium term and the long-term. It is drafted first because of the long-term relation between turnover and fixed assets and the short-term relation between turnover and the working capital needs. This budget must distinguish between cash and credit sales.

- The cost of sales budgets, which reflects the direct cost incurred in respect of sales. The cost per product or range of products must be calculated from the sales volumes obtained from the sales budget. Gross percentages help in the calculations of this budget provided a constant mark-up is used.

- The expense budget, which is not always influenced by the sales budget as other expenses such as salaries, electricity consumed, and other administration expenses, are not directly influenced by the level of sales. Historical data and the present objectives of business should be used as guidelines in drafting the expense budget.

- The current asset budget, which uses the current asset ratio, in its drafting. Current assets, such as stock and debtors are directly influenced by sales. Stock on hand should be taken into account when determining stock requirements. The debtors are determined by credit sales and the collection period.

- The fixed asset budget, which is used to determine fixed asset requirements so as to prevent over-capitalisation which can cause fixed assets to be underutilised and much needed capital being tied up in unproductive assets.

The cash budget reflects all receipts from cash sales, debtors receipts, finance introduced and proceeds from the sale of assets.

Once all budgets discussed above have been drafted, a projected income statement, balance sheet
and a business plan summarising the capital requirements of a business are drafted. Every business, new or established, must have a written document setting out its capital requirements, and the manner in which these are to be financed. The business plan assists the SMMEs in obtaining finance (RSA. 1996:Section 26(1)), and is also a powerful tool in attracting venture capital (Business Partners. 1999:19).

In conclusion, it is clear that planning the capital requirements of SMMEs is an involved process. First it was noted that to plan for the capital requirements it is paramount for the business to quantify all the factors that influence the determination of these requirements. Then the business has to draft a budget to determine these capital requirements and, lastly it has to formulate a business plan to summarise all the requirements.

A number of criteria can be used to determine these financial statements. Discussed in this section were the following: the return on investments and owner’s equity, financial leverage, liquidity, solvency and management abilities and the retention of independence. It can be concluded that using these criteria can provide management of a business with sufficient information tools to determine what volume of capital the business needs to either expand or maintain its strategic position in the market.

2.6 CONCLUSION

This chapter provided an insight into the nature and outlook of the SMMEs in South Africa. To this end, a study was conducted on the definition of a small business in South Africa as well as in the USA and in the UK. In the USA a small business is defined according to economic standards and statistical guidelines. The economic standards are based on independent ownership/management, the non-dominance of the business in its field of operation and the fact that capital is owner-supplied. The statistical guidelines are based on the number of employees in the business and the annual turnover of the business. While the economic standards are static, the statistical guidelines can be adjusted as circumstances change.
In the UK, the following criteria is used for the purpose of defining the small businesses. These include, in economic terms, a small business is one that has a relatively small share of its market; a small firm must be managed by its owner or part owners in a personalised way, and not through the medium of a formalised management structure; and a small firm has to be independent in the sense that it should not form part of a larger enterprise and that the owner(s)/manager(s) should be free from outside control when making principal decisions.

In South Africa, a general perception of a small business relates to the size of the business, the size of its annual turnover, the number of employees it employs, the size of its market share and whether it is managed and owned by its owners. A small business is also understood to be independent in that it is not a subsidiary of any larger business and that its managers are free to determine their own strategic market position and calibrate their own financial, marketing and public relations policies.

The National Small Business Act classifies SMMEs according to five size categories, namely survivalist enterprises, microenterprises, very small enterprises, small enterprises and medium-sized enterprises. Survivalist enterprises are enterprises which have no paid employees and have minimal asset value. These enterprises normally generate income below the minimum income standard or the poverty line, and their main aim is to provide minimal subsistence means for the unemployed and their families. Most entrepreneurs in this category are involved in hawking, vending and subsistence farming to name a few.

The main sources of finance for the survivalist sector are family and friends, informal money lenders, NGO's, and credits obtained from suppliers. Most survivalists have never had access to formal financial institutions and the reason for this is that these entrepreneurs generally have very little or no collateral at all.

Microenterprises have a turnover below the VAT registration limit of R150 000 per annum and have less than five paid employees. These enterprises tend to lack formality in terms of registration for tax purposes, labour legislation, business premises and accounting procedure. Examples of
microenterprises are spaza shops, mini-taxis and household industries.

Microenterprises are more likely to have access to formal financial institutions than survivalist enterprises, but this is often the case only for purposes other than their own businesses, since such businesses are usually too small to appeal to commercial lenders. Common sources of enterprise finance include family and friends, money lenders and NGO's.

Very small enterprises employ fewer than ten paid employees, but in the mining, electricity and manufacturing and construction sectors, fewer than twenty. They operate on the formal market and usually have access to modern technology. The smallest of these enterprises are self-employed owners with no employees, such as artisans and professionals. Very small enterprises make up an estimated 19.7% of all enterprises recorded and account for 13.3% of employment. The largest concentrations of very small enterprises are found in Gauteng (42%), the Western Cape (16%) and KwaZulu-Natal (15%).

Very small enterprises sometimes have access to formal financial institutions, and are often considered to be formal microenterprises by institutions such as the commercial banks. Very small enterprises could benefit from the combination of debt and equity, but their equity requirements are generally too small for the equity financiers. The only equity in the business is, therefore, the owner's contribution. Often, very small enterprises are established as a result of an entrepreneur's retrenchment package from their previous employer. Very small enterprises are often constrained by collateral requirements imposed by formal financial institutions. While some entrepreneurs may have some life insurance policies or pension funds and are often home owners, they usually are overly leveraged. Most business failures occur in this sector.

Small enterprises have fewer than 50 paid employees and are more established, with more complex business practices. Normally, the owner does not manage the enterprise directly, and secondary coordinating mechanisms have been put in place. Growth from a small to a medium sized enterprise requires an accumulation of resources as well as a set of appropriate incentives for enterprise
expansion. Small enterprises constitute an estimated 7.6% of all enterprise and contribute 19.9% of employment.

Small enterprises are more established than very small enterprises and have greater capital needs. Their main sources of capital are capital leasing and factoring. However, long-term outlays for machinery and equipment are often required, as well as overdraft facilities and suppliers credits for working capital.

Medium-sized enterprises are enterprises with up to 100 paid employees, albeit in the mining, electricity and manufacturing sectors up to 200 employees are found. Many medium-sized enterprises are still controlled by an owner/manager, but the ownership and management structure is more complex. Often the decentralisation of power to an additional management layer and a greater division of labour are the main differences between the small and the medium-sized enterprises. Medium-sized firms generally have established relationships with their bankers, and those with growth potential are also targeted by equity financiers.

This chapter also discusses the role of SMMEs in the South African economy. It was found that small businesses have a major role to play in the South African economy in terms of employment creation, income generation and output growth. It was further concluded that SMMEs account for approximately 60% of all employment in the economy and 40% of output. They are also often a vehicle through which the lowest-income people in our society gain access to economic opportunities at a time that distribution of income and wealth in South Africa is amongst the most unequal in the world.

Managing SMMEs was also a subject of discussion in this chapter where it was noted that the responsibilities of the owner/manager in a small firm involve coordinating the firm's total resources. The management process involves the activities of planning, organising, directing and controlling. Planning is said to be the group of activities that must be performed to prepare the organisation for future development and to ensure that decisions affecting the use of the available human and capital
resources will lead to the accomplishment of the organisation's objectives. Organising is defined as the management function of coordinating the human, financial and physical resources of the business so that they follow the course needed to attain the objectives of the business as specified in the planning phase. Directing is said to be the leadership function of a manager whereby through daily interactions with employees, the owner of an SMME provide leadership that is needed to guide the business. Lastly, controlling is aimed at determining whether the planned course had become a reality and whether any adaptations are needed.

The last discussion was on planning the capital requirements of SMMEs. It was learnt that a small business can plan its capital requirements firstly by quantifying the factors that influence the determination of the capital requirements, secondly by drafting a budget to determine capital requirements and thirdly by formulating a business plan that summarises the total capital requirements.

The following were discussed as major influences of the capital requirements of SMMEs. Return on investments which measures the overall effectiveness of management in generating profits with its available assets and return on owner's equity which measures the rate of net profit after interest and tax to owner's equity, financial leverage which provides a measure to indicate to what extent management has succeeded in utilising debt capital to increase return on owners equity, liquidity which measures the ability of a business to satisfy its short-term obligations as they come due, solvency refers to liquidity in the long-term, that is, a firm's ability to pay its long-term debt, management abilities and the retention of independence and drafting a budget and utilising a business plan.

In the next chapter, the various sources of finance available to small business are discussed in detail.
CHAPTER 3
SOURCES OF FINANCE AVAILABLE TO SMMEs

3.1 INTRODUCTION

Chapter 2 discussed the role of SMMEs in the South African economy, the management of SMMEs and the capital requirements of SMMEs. Dhlamini (1994:36) points out that total capital requirements of SMMEs consist of the following:

- Permanent capital requirements, which consist of fixed assets and the minimum working capital for a desired level of productivity.
- Varying capital requirements, which are the additional working capital required when the production level of the permanent capital requirement is exceeded.

Once the total requirements of the business have been determined, by means of budgets and business plans, the entrepreneur determines how these requirements are to be financed to achieve the objectives of maximum returns on investments, a positive financial leverage, liquidity and solvency.

Lambrechts (1998:524) points out that it is best from the liquidity point of view to finance permanent capital requirements with long-term funds, except in circumstances where there are reasonable certainty that short-term credit can continually be replaced. Lambrechts (1998:526) further mentions that variable capital requirements may, from a liquidity point of view, be financed by short- and long-term funds.

The reason why short-term funds are usually used to finance varying capital is that long-term capital can become idle with loss of income as a possible result. According to Collier (1998:237), entrepreneurs consider their own aspirations, how much control they are willing to sacrifice, the rate of interest the business is willing to pay and the risk element involved when deciding upon the nature of finance.
Bateson (1995:21) states that there is no single ideal way of financing an SMME because the circumstances that determine the capital requirements of each individual business are unique. There are number of occasions in the life of an SMME when the need for finance may arise.

- The first is the need for start-up capital to help in the establishment of a new business.
- The second is the need for funds to finance an expansion of a business.
- The third is the need for capital to finance an innovation.
- The fourth is the need to adjust the financial structure of the business.

In this chapter, a discussion on the financial needs of SMMEs is undertaken. This is done firstly by looking at the various sources of short-term, medium-term and long-term sources of finance provided by commercial banks to SMMEs in South Africa. Secondly, other non-banking sector institutions that help provide finance to SMMEs are discussed, namely NTSIKA enterprises, Business Partners and the informal money markets.

3.2 SOURCES OF SMME FINANCING

After a small business has determined its total capital requirements, it determines how to finance these requirements. In order to achieve the objective of maximum return on investments, financial leverage, liquidity and solvency, it is necessary for the business to determine when capital is needed and for what period (Dhlamini 1994:29). Before finance can be obtained, the nature of capital requirements of the business has to be determined.

Dhlamini (1994:29) stipulates that the capital requirements of an SMME consists of the following: Firstly, permanent capital requirements. For an SMME, this consists of all fixed assets and the minimum working capital (including stock, debtors, cash and other current assets) necessary for the desired activity or production level. Secondly, varying capital requirements. This is the additional working capital required when the activity or production level of the permanent capital requirement is exceeded.
A number of sources of finance for the total capital requirements (i.e. permanent and varying) have been determined. Dhlamini (1994:29) categorises financial sources that are available for SMMEs into the following:

- Short-term finance is finance obtained for a period not exceeding 12 months. It consists of trade credit, bank overdrafts, short-term loans, revolving credit and factoring.
- Medium-term finance is finance obtained for a period of one to five years. It consists of medium-term loans, instalment sales and leasing.
- Long-term finance is finance obtained for a period in excess of five years. It consists of own capital, long-term loans and sale-and-lease back.

Various sources of finance provided by commercial banks are discussed below. The nature of the source, the security requirements and the cost of the finance are also discussed.

3.2.1 Financing sources through commercial banks

3.2.1.1 Short-term sources of finance

The short-term sources of finance available to SMMEs are given as trade credit, bank overdrafts, revolving credits and factoring. The suppliers of short-term finance evaluate the liquidity of a business to determine the ability to service the debt. Correira et al (1993:505) raises the point that if a business chooses to use the short-term finance, it exposes itself to higher risk because short-term finance needs to be paid sooner, or alternatively, it needs to be renegotiated more frequently.

Trade credit

Brigham & Gapenski (1999:636) regard trade credit as the largest category of the spontaneous short-term debt representing about 40 per cent of the current liabilities of the average non-financial firms. Trade credit is spontaneous in that it arises almost automatically and does not require much formal arrangement by the business (Collier, 1998:238). Trade credit is a form of finance that arises when
a firm obtains goods and services in exchange for its promise of future payment (Clarke. 1995:26).

Trade credit is regarded as the most important source of finance for SMMEs in that they are less able to obtain funds from money and capital markets (Brigham & Gapenski. 1999:636; Collier. 1998:239 & Vosloo. 1995:12). The most common type of trade credit is the open account credit which derives its name from the fact that the business doesn't sign a formal debt instrument evidencing the amount owed to the supplier of goods (Van Horne. 1995:487).

Trade credit has no visible or explicit cost if the business pays its supplier exactly on time, taking all discount on the discount date. The supplier may pass the cost of credit associated with credit granting to the business in the form of higher prices. How much of these costs will be passed on by the supplier to the business is determined by the degree of competitiveness of the industry in which the firm operates (Van Horne. 1995:492).

Bank overdraft

According to Lambrechts (1998:479) bank overdrafts are the most important sources of finance in South Africa and are provided by the commercial banks. Technically, an overdraft is not the provision of funds but rather the provision of a facility by the bank for a potential follower to obtain funds (Reekie et al. 1996:42). An overdraft facility is an arrangement where the bank permits the business to borrow funds up to a specified maximum amount on its current account (De Cronje et al. 2000:230).

Lambrechts (1998:479) states that bank overdrafts are generally unsecured loans but the recent trend is for banks to demand security in different forms. Bank overdrafts also display the following characteristics:

- A bank overdraft is a flexible form of financing as funds are drawn only when needed, usually to provide fluctuating capital requirements in the business (De Cronje et al. 2000:230 & Lambrechts. 1998:480)
The facility is reviewed periodically on presentation of annual financial statements to the bank (De Cronje et al. 2000:230 & Dhlamini, 1994:33)

According to Correira et al (1993:426), the cost of a bank overdraft is based on the size of the loan. The interest rate for more of the risky borrowers and small businesses is higher. The lowest interest rate is the prime rate, which is the rate that commercial banks charge to their best clients. The interest can fluctuate on the basis of the security and the credit-worthiness of the borrower (Lambrechts, 1998:479).

**Revolving credit**

A revolving credit agreement is defined by both Neveu (1989:426) and Van Horne (1995:498) as the legal commitment on the par value of the commercial bank to extend credit to a business up to a maximum over a specified period of time. The most important distinguishing feature is that a bank is legally obliged to honour a revolving credit agreement (for which commitment it charges fees), whereas no such commitment exists in the case of a bank overdraft (Weston & Brigham, 1993:524).

In view of this obligation, Weston & Brigham (1993:524) contend that even during periods of tight money, commercial banks may be forced to borrow funds in order to satisfy revolving credit lending obligations. The revolving credit arrangement is particularly useful at times when the business is uncertain about its funding requirements. In this way a business has flexible access to funds during a period of uncertainty (Van Horne, 1995:518).

The calculation of the cost of funds borrowed according to a revolving credit agreement is more complex than for a bank overdraft, in that, in addition to the interest and commitment fee, the cost is also influenced by the amount borrowed and the credit limit of the credit agreement (McGuigan, 1992:204). The interest rate on the agreement may be tied to the prime rate on a floating basis and thus the cost of the loan varies over time as interest rates change (Brigham & Gapenski, 1999:643).
Factoring

According to Dhlamini (1994:34) credit factoring has only recently become known in South Africa although it was initially introduced in 1961. Correira et al (1993:424) point out that because accounts receivable constitute a major part of working capital and their settlement terms frequently strain the liquidity requirements of a business, factoring is a means of using accounts receivable to generate cash flow.

Lambrachts (1998:482) describes factoring as the sale of an enterprise's debtors to a factor or a factoring enterprise which usually accepts the credit risk and the responsibility for collecting the debts. According to Cole (1992:309) it is the only arrangement whereby the factor completely assumes the entire credit and collection function for its clients.

The use of a factoring facility provides additional working capital and hence enables a business to undertake sales expansion and to negotiate more favourable purchasing terms from suppliers and to take advantage of discounts (McGuigan, 1992:321). Although there are different ways in which factoring can be effected, Cole (1992:309) lists the following steps in the factoring procedure:

- Before the business delivers goods to consumers, it submits the list of customers, amounts of the orders, terms of sale, and any other information to the factor for approval.
- After the delivery of goods on approved orders, the business sells the accounts to the factor by signing and sending to the factor an assignment schedule together with the copy of each invoice.
- The factor credits the business' accounts for accounts receivable purchased. The method of payment to the business is normally geared to business' working capital needs.
- A statement is sent to the business each month stating the exact financial standing of the business with the factor. This statement consists of the records of the accounts receivable purchased, charges for returns and allowances, commission, interest charges, and other items that may affect the account.
Cole (1992:309) states that the cost of factoring consists of the factor's fees for servicing and collecting the receivables and bearing the risks of the bad debts losses, and the interest charged on advances. Mc Guigan (1992:326) mentions that the factor's fees vary according to the number of invoices handled, the number of debtors’ accounts, the average invoice value and the turnover of the business. Advancing payment is, according to van Horne (1995:511), a lending function of the factor in addition to risk bearing and servicing receivables and the business must therefore pay interest.

Mc Guigan (1992:324) also contends that a factor's interest on advances may be more than the cost of a bank overdraft, but less than comparable rates charged by many finance houses for alternative forms of finance.

3.2.1.2 Medium-term sources of finance

The medium-term sources of finance that should be available to SMMEs are medium-term loans, leasing and instalment sales agreements. Medium-term financing agreements last longer than one year but less than five years. According to Van Horne (1995:516), medium-term financing can also be used to meet the permanent funding requirements of a business and are a temporary measure until such time that long-term financing can be obtained on favourable terms. It also helps when a business is uncertain about the size and nature of its future funding requirements.

**Term-loans**

Moyer (1993:250) defines a term-loan as a debt instrument that has an original maturity longer than one year, provides a specified amount of financing, and contains a repayment schedule that requires the borrower to make regular principal and interest payments. Van Horne (1995:516) mentions that the payment schedule of term-loans is usually geared to the borrower's ability to service the loan. Term-loans are, according to Lambrechts (1998:484), usually granted for the financing of current assets, the purchase of new machinery and the refunding of existing debt.
The limitations of existing loans are that the assets pledged as collateral cannot be used to secure other financing instruments and the period payment may represent a large cash drain because both the principal and the interest must be paid (Moyer, 1993:251). Another limitation of the term-loan is the restrictions placed on the borrower by the lender that are intended to maintain the borrower's financial standing and decrease the likelihood of loss on the loan (Correira et al., 1993:425).

The cost of a term-loan is generally slightly higher than that of long-term finance and is paid over the period of the loan (Lambrecht, 1998:485). In addition to the interest cost, the borrower is also expected to pay legal expenses incurred in drawing up the loan agreement and may also be charged a commitment fee for the period during the period in which the loan is not taken (Van Home, 1995:517).

**Leasing**

Van Home (1995:533) describes a lease as a contact whereby the owner of an asset (the lessor) grants to another party (the lessee) the exclusive right to use the asset, usually for an agreed period of time, in return for the payment of rent. Most leases do not involve maturities of more than ten years and as a result lease financing is regarded as a source of medium-term financing (Correira et al., 1993:429).

The basic characteristic of a lease is that ownership is vested in the lessor and while the lessee has unlimited use of the item with the option, at the end of the lease period, to either purchase the property or to negotiate a secondary rental contract (Lambrecht, 1998:474). Two basic types of lease agreements are available to businesses, namely operating leases and financial leases (Gitman, 1993:592):

- An operating lease agreement is a lease agreement in which property is leased for a much shorter period than the life of the property and the agreement often makes provision for cancellation by either the lessee or the lessor (Lambrecht, 1998:475). By their very nature, operating leases are sources of short-term finance (Van Home, 1995:533). Correira et al
give the avoidance of indirect taxation such as VAT as the reason why the operating lease has become attractive as an alternative to buying in recent years. If an article is bought or financed through the financial lease, taxation is paid on the full purchase price, whereas in an operating lease tax it is paid on the rental (which is less than the purchase price) and hence a lower tax paid.

Unlike operating leases, financial leases cannot be cancelled and are fully amortised over the life of the leased article. That is, the lessor receives rental payments equal to the full price of the leased article plus interest (Brigham & Gapenski, 1999:548). When the lease expires, the lessee is given the option to renew it. A further distinguishing feature of the financial lease is that the lessee is usually responsible for maintaining and insuring the leased item (Lambrechts, 1998:475). The lease payments, that is the rental, becomes a tax-deductible expenditure which the lessee must pay at predetermined dates over a definite period (Gitman, 1993:593). According to Correira et al, (1993:562), the interest rate on financial leases can either be fixed or variable. If it is fixed, however, the instalment will also be fixed, whereas if the interest rate is variable, the instalment will change to incorporate the movement in the interest rate.

Instalment sales agreements

Dhlamini (1994:37) defines an instalment sale agreement as a contract whereby a business obtains an asset and a financial institution finances the cost of the asset either partially or in full. In terms of the Credit Agreement Act, No 75 of 1980 (as amended), the Minister of Finance is empowered to prescribe by Government Notice the maximum period within which the full price of the purchase under a sales agreement is to be made, the portion of the cash price required as the down payment or a deposit, and classes of goods to be purchased under a sale agreement (Fourie et al. 1998:78). The Credit Agreement Act describes an instalment sale transaction as the following:
• An instalment sales transaction is a transaction in terms of which:
  (a) goods are sold by the seller to the purchaser against payment of a stated or
determinable sum of money at a future date in whole or in part instalments over a
period in the future: and

(b) the purchaser does not become the owner of those goods merely by virtue of the
delivery to or the use, possession or enjoyment by him thereof: or

(c) the seller is entitled to the return of those goods if the purchaser fails to comply with
any term of that transaction.

Cole (1992:44) sets the following principles for an instalment sale agreement which will best serve
the purchaser and the seller:

• The instalment sale should be confined to durable goods that are consumed over a relatively
long period. Long-standing obligations on goods that are immediately consumed will place
the seller in a more difficult position from the collection standpoint.

• The down payment or deposit should be sufficient to create a sense of ownership on the part
of the purchaser so that he/she can take good care of the goods purchased. The asset
obtained serves as security for the goods advanced.

• The amount and instalment payments must be relative to the income and other outstanding
obligations of the purchaser.

• The finance charges should be sufficient to cover the cost of the instalment transaction and
should be clearly communicated to the purchaser to avoid misunderstanding.

3.2.1.3 Long-term sources of finance

The long-term sources of finance available to SMMEs are own capital, long-term loans and sale-and-
leaseback. Suppliers of long-term finance not only take into account the long-term liquidity, the
return on investment and owner's equity and the financial leverage of the business, but will also
incorporate certain provisions into the loan agreement that are intended to protect the money
advanced. In this regard, the provisions of a positive nature that outline the actions that the borrower
agrees to take during the term of the loan are the following (Moyer, 1993:487):

• The borrower agrees to furnish the provider of finance with periodic financial statements.
• The borrower agrees to take out insurance to cover insurable business risk.
• The borrower agrees to maintain a minimum amount of working capital.
• The borrower agrees to retain management personnel who are acceptable to the supplier of funds.

The provisions that outline actions that the borrower agrees not to take without the consent of the lender are the following (Moyer, 1993:487):
• The borrower may not pledge any of its assets as security for other loans nor to sell its account receivables.
• The borrower is prohibited from selling or leasing any of its assets.
• The borrower is prohibited from giving the loans to others that would impair the lender’s security.

Default provisions permit the lender to insist on immediate repayment of the entire loan under the following conditions (Moyer, 1993:488):
• The borrower fails to pay interest or principal or both in terms of the agreement.
• The borrower materially misrepresents any information required by the lender.
• The borrower fails to observe any of the provisions mentioned above.

Owner’s capital

Owner’s capital is the finance that may come from the personal savings of the entrepreneur and from contributions by partners, shareholders, members or other participants. The general rule, according to Pickle & Abrahamson (1990:133) is that a small business must provide 50 per cent of the starting funds. Steinhoff (1993:120) mentions that potential creditors and other outsiders who are invited to provide financial assistance to a business will first consider the amount contributed by the owners so that risk should also be borne by the owners.

According to Megginson (1997:179) the economic function of the owner’s capital is to serve as a
buffer that protects creditors from losses in the event of a difficulty, because the creditors have a legally enforceable claim on the assets of a business in the event of default. Steinhoff (1993:120) states that profit is a source of internal funding that may be the easiest and cheapest to find and that retained profits increase the capital of a business. Owner’s capital may be in the form of capital contributions for a sole proprietorship and partnership, loans advanced by the owners of the business, shares in a private company, or as member’s interest in a close corporation (Dhlamini, 1994:39).

Long-term loans

Long-term loans are loans that are given for periods of ten years and longer and can be classified according to whether they have a fixed or variable interest rate and whether they are secured or unsecured (Correira et al. 1993:502). Suppliers of long-term loans are not only interested in long-term liquidity, return on investments and financial leverage but also incorporate certain provisions into the loan agreement to protect the money advanced.

The providers of long-term loans generally do not exercise control over the business and do not participate in the residual income of the business, but instead receive a fixed return (Van Horne, 1995:609). The general characteristics of long-term loans that contrast with the characteristics of owner’s capital are the following:

• There is an interest liability which is repayable over certain periods and in a certain manner.
• The provider of a long-term loan is legally a creditor and not an owner of the business.
• Long-term loans are secured by the assets that are financed.

Sale-and-leaseback

Moyer (1993:489) describes a sale-and-leaseback as an arrangement made when a company sells an asset it currently owns to a purchaser and simultaneously executes a lease agreement with the same firm, which now becomes a purchaser-lessee. The selling company receives cash for the assets sold, retains the use of the assets for the duration of the lease and make periodic lease payments to the
purchaser-lessor. In South Africa firms that own certain assets and wish to raise funds, commonly use sale-and-leaseback arrangements (Correira et al, 1993:563).

The sale-and-leaseback increases the firm’s liquidity by transforming its assets into cash in exchange for an obligation to make a series of fixed future payments to the purchaser-lessor (Moyer, 1993:501). The providers of capital in a lease agreement could be an insurance company, a commercial bank, a specialised leasing company, the finance arm of an industrial firm or an individual investor (Brigham & Gapenski, 1999: 547). According to Megginson (1997:180) a number of companies that have stores in the central business districts have engaged in sale-and-leaseback agreements, and there are usually ready buyers among financial institutions who are keen to add to their property portfolios.

3.2.2 Financing sources through the non-banking sector

3.2.2.1 NTSIKA Enterprise Promotion Agency

Ntsika Enterprise Promotion Agency (Ntsika) was established in 1996 as a juristic person by an Act of Parliament, the National Small Business Act, Act No. 102 of 1996. Although Ntsika's main aim is to expand, coordinate and monitor the provision of training, advice, counselling and any other non-financial services to small businesses in accordance with the National Small Business Strategy, it does provide financial support to service providers that provide the services contemplated above (RSA, 1996:6).

Ntsika enterprises was established alongside the National Small Business Council (the Council), in 1996 also as a Juristic person. The Council, however, is mainly responsible for representing and promoting the interest of small businesses, with the emphasis on those entities defined in the Act as SMMEs. According to the Department of Trade and Industry (RSA, 1996:7) the Council is also responsible for advising the national, provincial and local governments on social and economic policy that promotes the development of small businesses in South Africa.
The Council does not provide direct financial assistance to the SMMEs. Therefore, the council simply acts as the political arm of the government to help implement specific aspects of the broader economic policies of the government. For the purpose of this dissertation, therefore, the council will only be made mention of and shall not be dealt with in greater detail, since it does not contribute to the value of the topic being researched.

Ntsika enterprises is managed and controlled by a board of directors of between seven and fifteen persons appointed by the Minister of Trade and Industry (RSA. 1996:7). The chief executive officer thereof is also appointed by the Minister, on recommendation of the board. The board members are mainly South African citizens with experience in business. and/or knowledgeable in trade. industry and the economy.

The finances of Ntsika are managed through the fund, also known as the fund of the Agency. This fund consists of:

- the money appropriated by parliament;
- grants. donations and bequests granted to the agency: and
- money lawfully obtained by the agency from any other source (however. loans raised by the Agency are subject to approval by both the Ministers of Trade and Industry and of Finance.

This money is then made available to all state agents and other non-profit organisations and institutes whose aim is to promote the development of small businesses by way of finance, training, research or any other valuable means.

3.2.2.2 Business partners

Business Partners Limited is a company that was established in 1980 as a joint venture between the private sector and the government with the aim of promoting small businesses in South Africa. This company was operating under the name Small Business Development Corporation (SBDC). The idea of establishing the SBDC emerged during the Carlton deliberations between the government

According to Business Partners (1999:6), changing the company's name from SBDC to Business Partners Limited came as an intensive repositioning process which commenced in 1996. This process included moving into a niche market i.e., investing between R150 000 to R15 million in formal SMMEs. This process also included the introduction of financing and investment products for SMMEs by way of equity related funding. It also included the enhancement of systems to become a professional organisation and restructuring the property portfolio to ensure that business premises are made available to SMMEs at market related rentals.

Business Partners invest capital which is provided by way of equity, quasi-equity and term debt structured to the individual needs of each client. The current and potential clients of Business Partners have characteristics analogous to those prescribed by the National Small Business Act as discussed in section 2.2.3 table 2.1. Business Partners (1999:7) list these clients as those that:

- are independently owned and managed;
- have gross assets below R50 million;
- employ fewer than 500 employees;
- have a turnover below R200 million per annum;
- are controlled by persons with relevant knowledge, expertise, experience, managerial ability and entrepreneurial skills;
- have a sound financial structure or are prepared to let the Business Partners share in the equity; and
- are prepared to share the risk and reward of investments fairly.

Business Partners provide five types of investment products which are being used as financial assistance schemes for the SMMEs. These investment products are separated by province/region (at times referred to as funds). There are four of these funds throughout South Africa which are the South Fund, Cape Town; the West Fund, in Port Elizabeth; the Central Fund, in Johannesburg; and the East Fund, in Durban. Although Business Partners (1999:6) considers the centralisation of the
Struwig (1992:1) a number of informal lending mechanisms, such as professional money lenders, informal credit arrangements, voluntary credit societies and informal savings associations play an important role in providing for the financial needs of the businesses and individuals from the disadvantaged communities.

Informal financial institutions differ from formal financial institutions both in size and in that they avoid taxes and official regulations. Informal financial lending is found not only in South Africa but also in other developing countries. In Niger, informal credit accounts for 84 per cent of total loans (World Bank, 1998a:113) and in Cameroon about 70 per cent of the adult population participates in informal financial associations (Struwig, 1992:1). In Thailand the informal credit sector continues to thrive despite the fact that the interest rates charged are many times higher than in the formal sector and despite increased access to government credit (Siamwalla et al., 1996:271). Stokvels are informal money lenders and they are discussed below as institutions operating in the informal money market.

The stokvel

A stokvel is a type of credit union in which people enter into an agreement to contribute a fixed amount of money to a common pool weekly, fortnightly or monthly (Lukhele, 1990:1). The money contributed to a stokvel is available to members either on a rotational basis or in time of need. The main purpose of a stokvel is to provide mutual financial assistance to its members (Struwig, 1992:3). Rotating savings and credit associations resembling a stokvel are a popular form of informal finance in other countries and are referred to as Tanda in Mexico, Pasianaku in Bolivia, Sun in Dominican Republic, Syndicate in Belize, Gamaivah in Egypt, Isusu in Nigeria, Susu in Ghana, Tontins in Niger, Chit fund in India, Hui in China and Ko in Japan (World Bank, 1998a:114). A rotating savings and credit association is typically formed by a small number of individuals who elect a leader to collect a given amount from each person. The money collected (the funds) is then given to each member of the group on a rotational basis.
Lukhele (1990:25) lists the following as the possible advantages of a stokvel:

- It provides the means to purchase goods in bulk.
- It provides the means to acquire a business.
- It helps pay funeral expenses.
- It is a means of saving.

Burial societies (Makgotlas), umgalelo clubs, youth stokvels and investment syndicates or clubs are the various types of stokvel that operate in South Africa (Lukhele, 1990:16). As far as the financing of small businesses is concerned, the investment syndicates or clubs are the most important. Lukhele (1990:19) describes an investment syndicate or club as a type of stokvel aimed at establishing a joint undertaking. Members subscribe funds to start-up a joint business or to invest as a group in a business.

The Southern African Black Taxi Association Foundation is, according to Lukhele (1990:26), the most successful financing scheme and is similar to a stokvel in that members contribute to a fund and can, in turn, borrow well above the amount that they contribute or have contributed to purchase taxis. Lukhele (1990:35) further points out that default on loan repayments is generally rare because stokvels rely for their survival on trust, and most members are carefully selected. A form of social credit rating is at risk for a member who does not fulfill his/her commitments to the stokvel.

Informal money-lenders

Money-lenders (Mashonisas), referred to by Lukhele (1990:21), extend short-term loans to clients of long standing. Such loans are rarely tied to any collateral. Interest rates are normally high and most money-lenders use their own funds for lending. In order to meet the demand for timely and convenient loans, money-lenders maintain adequate liquidity. This means that much of their funds may lie idle during a slack period (World Bank 1998a:114).

World Bank (1998b:312) states that money-lenders solve the problem of adverse selection by confining their lending to known clients although they also make the relevant investment in building
up a clientele and adding to it when the occasion looks promising. It is costly for borrowers to
switch from one lender to another because of the fact that money-lenders prefer to deal with known
clients and take on new ones reluctantly. Anderson (1994:7) also mentions that money-lenders
prefer their clients to have the security of fixed employment. Collection is on pay-day. Many
borrowers with access to formal credit may borrow from money-lenders if formal lenders take too
long to process an application. When the funds from formal lenders or institutions finally arrive
these are used to repay the informal money-lender (World Bank 1998a:114).

Money-lenders reduce transaction costs and risk in ways denied to formal institutions, because they
can operate out of their own homes or on the street, maintain only the simplest accounts, and mix
finance with other business. Also, the services they provide are outside the review and control of
the monetary authorities and this allows informal money-lenders greater flexibility (World

The World Bank (1998b:321) identifies the following factors as limiting arbitration between formal
institutional lenders and money-lenders who charge high interest rates:
• Access by individuals to loanable funds from formal institutions is limited.
• Re-lending requires inside knowledge of the borrowers and the cost of acquiring such
  information is reflected in the interest rates charged by formal institutions.

The importance of money-lenders in providing finance is illustrated by the fact that for the past 40
years government intervention in rural credit markets in developing countries has failed to drive
money-lenders out of business (Hoff & Stiglitz 1998:235). Money-lenders continue to charge high
interest rates.

3.3 CONCLUSION

This chapter provides a discussion on the financial needs of SMMEs. This was carried out by
analysing the various sources of short-term, medium-term and long-term sources of finance provided
by commercial banks and other non-banking sector institutions, namely NTSIKA enterprises, Business Partners and the informal money markets. Short-term finance is finance obtained for a period not exceeding 12 months. It consists of trade credit, bank overdrafts, short-term loans, revolving credit and factoring.

Trade credit, which is the largest category of the spontaneous short-term debt, is spontaneous in that it arises almost automatically and does not require much formal arrangement by the business. It is a form of finance that arises when a firm obtains goods and services in exchange for its promise of future payment. Trade credit is regarded as the most important source of finance for SMMEs in that they are less able to obtain funds from money and capital markets.

A second source of short-term finance discussed was a bank overdraft which was defined as an arrangement where the bank permits the business to borrow funds up to a specified maximum amount on its current account. Bank overdrafts, being the most important sources of finance in South Africa, are provided by the commercial banks. They are not the provision of funds but the provision of a facility by the bank for a potential client to obtain funds.

Thirdly, a revolving credit agreement is defined as the legal commitment on the par value of the commercial bank to extend credit to a business up to a maximum over a specified period of time. The most important distinguishing feature is that a bank is legally obliged to honour a revolving credit agreement, whereas no such commitment exists in the case of a bank overdraft.

Lastly, factoring is known as the sale of an enterprise’s debtors to a factor or a factoring enterprise which usually accepts the credit risk and the responsibility for collecting the debts. It is the only arrangement whereby the factor completely assumes the entire credit and collection function for its clients. Because accounts receivable constitute a major part of working capital and their settlement terms frequently strain the liquidity requirements of a business, factoring is a means of using accounts receivable to generate cash flows.
The first source of medium-term finance discussed was term-loans which were defined as debt instruments that have an original maturity longer than one year. Provides a specified amount of financing, and contains a repayment schedule that requires the borrower to make regular principal and interest payments. It was mentioned that the payment schedule of term-loans is usually geared to the borrower's ability to service the loan. These loans are usually granted for the financing of current assets, the purchase of new machinery and the refunding of existing debt.

The limitations of existing loans are that the assets pledged as collateral cannot be used to secure other financing instruments and the period payment may represent a large cash drain because both the principal and the interest must be paid. The cost of a term-loan is usually slightly higher than that of long-term finance and is paid over the period of the loan.

The second source of medium-term loans is leasing. A lease is described as a contract whereby the owner of an asset (the lessor) grants to another party (the lessee) the exclusive right to use the asset, usually for an agreed period of time, in return for the payment of rent. Most leases do not involve maturities of more than ten years and as a result lease financing is regarded as a source of medium-term financing.

The basic characteristic of a lease is that ownership is vested on the lessor and while the lessee has unlimited use of the item with the option to either purchase the property or to negotiate a secondary rental contract at the end of the lease period.

Lastly, instalment sale agreements are defined as a contract whereby a business obtains an asset and a financial institution finances the cost of the asset either partially or in full. The Minister of Finance is empowered to prescribe by government notice the maximum period within which the full price of the purchase under the sales agreement is to be made, the portion of the cash price required as the down payment or a deposit, and classes of goods to be purchased under a sale agreement.

In case of the long-term sources of finance, the following were discussed: Owner's capital, long-
term loans and sale-and-lease back. Owner's capital is the finance that may come from the personal savings of the entrepreneur and from contributions by partners, shareholders, members or other participants. The general rule is that a small business must provide 50 per cent of the starting funds. The economic function of the owner's capital is to serve as a buffer that protects creditors from loss in the event of a difficulty, because the creditors have a legally enforceable claim on the assets of a business in the event of default. Another source of long-term sources of finance are long-term loans which are loans that are given for periods of ten years and longer and can be classified according to whether they have a fixed or variable interest rate and whether they are secured or unsecured.

Suppliers of long-term loans are not only interested in long-term liquidity, return on investments and financial leverage, but also incorporate certain provisions into the loan agreement to protect the money advanced. The providers of long-term loans generally do not exercise control over the business and do not participate in the residual income of the business, but instead receive a fixed return.

Lastly, a sale-and-leaseback was described as an arrangement made when a company sells an asset it currently owns to a purchaser and simultaneously executes a lease agreement with the same firm, which now becomes a purchaser-lessee. The selling company receives cash for the assets sold, retains the use of the assets for the duration of the lease and makes periodic lease payments to the purchaser or lessor. The sale-and-leaseback increases the firm's liquidity by transforming its assets into cash in exchange for an obligation to make a series of fixed future payments to the purchaser or lessor.

Ntsika Enterprise Promotion Agency (Ntsika) is the first financing source through the non-banking sector that was discussed. Ntsika's main aim is to expand, coordinate and monitor the provision of training, advice, counselling and any other non-financial services to small businesses in accordance with the National Small Business Strategy. Ntsika also provides financial support to service providers that provide the services relating to financing SMMEs in South Africa. The finances of
Ntsika are managed through the fund, also known as the fund of the Agency. This money is made available to all state agents and other non-profit organisations and institutes whose aim is to promote the development of small businesses by way of finance, training, research or any other valuable means.

The second non-banking sector institution to be discussed was Business Partners Limited which is a company that was established in 1980 as a joint venture between the private sector and the government with the aim of promoting small businesses in South Africa. Business Partners, formerly, the Small Business Development Corporation, invest capital which is provided by way of equity, quasi-equity and term debt structured to the individual needs of each client. The current and potential clients of Business Partners must have characteristics analogous to those prescribed by the National Small Business Act.

Business Partners provide five types of investment products which are being used as financial assistance schemes for the SMMEs. These investment products are separated by province/region. There are four of these funds throughout South Africa which are the South Fund, in Cape Town; the West Fund, in Port Elizabeth; the Central Fund, in Johannesburg; and the East Fund, in Durban. Although Business Partners consider the centralisation of the accounting function of these funds paramount, they have, however, as part of their strategy, always seen the four regions/funds as an ideal structure of the company. The investment schemes of Business Partners have five dimensions, namely the equity partner, risk and property partner, loan partner, incentive partner and venture capital partner.

This chapter also discussed the stokvel and the informal money-lenders under the auspices of the informal money market. A stokvel is said to be a type of credit union in which people enter into an agreement to contribute a fixed amount of money to a common pool weekly, fortnightly or monthly. The money contributed to a stokvel is available to members either on a rotational basis or in time of need. The main purpose of a stokvel is to provide mutual financial assistance to its members.
Money-lenders (Mashonisas), provide short-term loans to clients with which they have a long business history. Such loans are rarely tied to any collateral. Interest rates are normally high and most money-lenders use their own funds for lending. In order to meet the demand for timely and convenient loans, money-lenders maintain adequate liquidity. The importance of money-lenders in providing finance is illustrated by the fact that for the past 40 years government intervention in rural credit markets in developing countries has failed to drive money-lenders out of business.

The following chapter will provide an insight into the empirical results of the research conducted in Soweto whose aim is to identify the role that commercial banks play in maintaining and sustaining SMMEs in the greater Soweto.
CHAPTER 4
SMMEs IN THE GREATER SOWETO AND THEIR FINANCING SOURCES

4.1 INTRODUCTION

The aim of this chapter is to identify the sources of finance that SMMEs in Soweto currently use. This chapter also looks at the degree to which SMMEs in this area use sources of finance provided by commercial banks in Soweto. A questionnaire was designed to solicit information regarding the use of financial assistance that commercial banks offer in the greater Soweto. This questionnaire was designed in a manner that influences the answers of the respondents to build a general picture as to whether commercial banks play a role in financing SMMEs in the greater Soweto. A copy of this questionnaire is included in the appendix.

For this purpose one hundred respondents were asked to answer the questions on the questionnaire. Some of the respondents had difficulty understanding what they described as technical business language of the questions. However the author took note of their concerns and explained every single concept or question that they did not understand in their respective languages.

The results of the 100 questionnaires are discussed below. Section A of the questionnaire was included to record the details of the respondents. Personal details of the respondents were made to be optional. This was done in order to maintain anonymity and confidentiality.

Section B of the questionnaire was included in order to determine whether a business could be regarded as an SMME according to the discussion in Chapter 2. The quantitative definition is stated in Table 2.2. The economic definition of an SMME is that it must be independently owned and managed by the owners, have a relatively simple organisational structure and a small influence on the market.

Furthermore, some capital must be provided by the owner(s), the number of the people employed...
must be less than 200. Total assets must not exceed R18 million and annual turnover must not exceed R40 million (see section 2.2.3 and table 2.2). The discussion of the responses relate to sections B and C of the questionnaire and shall be done in the following order:

- Firstly, an analyses of the data is made to prove that all the respondents' businesses are in fact SMMEs as defined above:
- Secondly, an analyses of the data in descriptive form is presented to give an overall picture of the results.

4.2 ANALYSES OF RESULTS

This discussion will start with the analyses of the business size of the respondents. An analyses of the size of the business of the respondents was done and the results are tabulated in Table 4.1. From Table 4.1 shows that all the businesses of the respondents meet the criteria for SMMEs. It would therefore be in order to include the data for all the respondents in further analyses.

As indicated in Table 4.1, the maximum number of employees employed by the respondents is 44, while the minimum number of employees is one. Statistical analysis of the number of employees shows that the mean number of employees is 7.1. This means that a sample of the population does satisfy the requirements of the Small Business Act in terms of the number of employees that an SMME must employ. It is however important to note that the highest number of employees is 44, which is only 22% of the maximum prescribed by the Act. This indicates the job creating capacity of SMMEs in the Soweto area.

For the purpose of analysing the size of the businesses in respect of the assets employed by the businesses, the scores were converted to midpoints of the size categories so that the resultant figures have a monetary meaning. From Table 4.1 it shows that the mean assets are R321,310 with the lowest of between R0 and R100,000 worth of assets and the highest of above R1.5 million still within the maximum limit.
Table 4.1  Classification of businesses according to the criteria for a business to be regarded as an SMME

<table>
<thead>
<tr>
<th>ITEM</th>
<th>CRITERIA</th>
<th>OBSERVATION</th>
<th>SMME yes / no</th>
</tr>
</thead>
<tbody>
<tr>
<td>Privately Owned</td>
<td>Must be</td>
<td>100 % respondents</td>
<td>yes</td>
</tr>
<tr>
<td>Managed by owners</td>
<td>Must be</td>
<td>100 % respondents</td>
<td>yes</td>
</tr>
<tr>
<td>Some capital supplied by owners</td>
<td>Must be</td>
<td>100 % respondents</td>
<td>yes</td>
</tr>
<tr>
<td>Percentage of capital supplied by owners</td>
<td>&gt;50 %</td>
<td>100 % respondents</td>
<td>yes</td>
</tr>
<tr>
<td>No. of employees</td>
<td>&lt; 200</td>
<td>Average 7.1</td>
<td>yes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Lowest 1</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Highest 44</td>
<td></td>
</tr>
<tr>
<td>Amount of assets</td>
<td>&lt; R 18 million</td>
<td>Average R321 310</td>
<td>yes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Lowest R0-R100 000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Highest &gt; R1.5 m</td>
<td></td>
</tr>
<tr>
<td>Amount of turnover</td>
<td>&lt; R40 million</td>
<td>Average R258 300</td>
<td>yes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Lowest R0-R100 000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Highest &gt; R1.5 m</td>
<td></td>
</tr>
</tbody>
</table>

Table 4.1 shows that the mean turnover is R258 300 with the lowest between R0-R100 000 and the highest over R 1.5 million. The average turnover to assets ratio is 0.8 which is rather high. This ratio gives a rough indication of the efficient use the SMMEs invested capital. In other words capital productivity is rather high. This is even true in the case of service industries where most of the capital is fixed. For any other industries, it implies a good cash flow management by the business (Scarborough, 1998:99).

Table 4.2 details the results on how often SMMEs calculate their total capital requirements.
Most SMMEs (46%) calculate their capital requirements only once a year, while 16 per cent calculate their total capital requirements twice a year and 6 per cent never do so at all. Twenty-four per cent of the SMMEs do so quarterly. Only a small percentage (8%) calculate capital requirements sometimes.

The responses indicate that the majority or 86% of SMMEs calculate their capital requirements once yearly or more frequently. The above does not indicate division between permanent capital requirements (which includes all fixed assets and the minimum working capital for the desired level of activity) and varying capital (which is the additional working capital required when the activity or level of production of the permanent capital requirement is exceeded).

Table 4.2 The frequency of the calculation of capital requirements

<table>
<thead>
<tr>
<th></th>
<th>Quarterly</th>
<th>Half-yearly</th>
<th>Yearly</th>
<th>Never</th>
<th>Sometimes</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number</td>
<td>24</td>
<td>16</td>
<td>46</td>
<td>6</td>
<td>8</td>
<td>100</td>
</tr>
<tr>
<td>Percentage</td>
<td>24%</td>
<td>16%</td>
<td>46%</td>
<td>6%</td>
<td>8%</td>
<td>100%</td>
</tr>
</tbody>
</table>

According to Steinhoff & Burgess (1996:188), financing a small business is a critical element of its success, since many potentially successful firms have failed because of undercapitalisation or a lack of sufficient funds to pay for needed assets or operating expenses. It is discouraging to accept the liquidation of a business due to insufficient capital. It follows then that every business should be planned with a clear and positive understanding of how much funds will be needed to begin the operation, what additional funds will keep it going once it is operating and just where the money can be found.

Schal & Haley (1994:194) suggest that planning capital requirements should be done as often as possible to accommodate changes and adjustments of the capital needs and capital structure of a business that occur as the business grows or the demand patterns facing the business change. All too often, entrepreneurs have trouble acquiring needed money because they are poor managers and
are not prepared for the questions they will be asked by the officers of financial institutions or by investors (Steinhoff & Burgess, 1996:189). They often do not take the time to forecast their capital and operating cash needs. As a result they lack an understanding of the use of the funds requested, payback arrangements and future plans for the business. As seen in Chapter 3, funds can be obtained from several sources, but few institutions or individuals are interested in investing in or loaning money to poor entrepreneurs who cannot demonstrate an adequate plan for the use of funds.

No firm should try to operate without adequate cash on hand for emergencies, adequate inventory or products to sell, or adequate operating equipments. Firms that start life in a state of inadequacy will surely have difficulty acquiring tremendous funds (if needed) in the future. Table 4.3 details the responses with regard to the factors considered by SMMEs in calculating the level of total capital investment.

Most respondents (66%) indicate that they sometimes or always take the maximisation of returns on investments into account when calculating their capital requirements. Siropolis (1997:385) argues that the best yardstick for estimating the return is called return on investment and is computed by dividing net profit by investment. The return on investments tells an entrepreneur how many cents he earns in a year for every rand of investment, in the same way that an interest rate tells savers how much they earn for each rand of savings at the bank.

Table 4.3 Criteria used to decide on the total capital investments

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Max Returns</th>
<th>Liquidity</th>
<th>Solvency</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>%</td>
<td>No.</td>
<td>%</td>
</tr>
<tr>
<td>Never</td>
<td>4</td>
<td>14</td>
<td>18</td>
<td>18</td>
</tr>
<tr>
<td>Sometimes</td>
<td>20</td>
<td>20</td>
<td>38</td>
<td>38</td>
</tr>
<tr>
<td>Always</td>
<td>46</td>
<td>46</td>
<td>44</td>
<td>44</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>
Because investments may be defined in three different ways - as either total assets, owners equity, or permanent capital - entrepreneurs may compute their return on investments in three different ways (Steinhoff & Burgess, 1996:191). Which of these could be the best way? The answer to this question depends on what the entrepreneur wants to measure, as explained below:

- **Return on total assets**: This yardstick measures how well entrepreneurs have invested all the money entrusted to their care, regardless of where it came from. In addition to own capital, sources of capital may also include short-term creditors, medium-term creditors and long-term creditors. Computing the return on assets can be done by making use of the following formula:

\[
\text{Return on assets} = \frac{\text{net profits} + [\text{interest} - (1 - \text{tax rate}) \times 100]}{\text{total assets}}
\]

- **Return on owners’ equity**: This yardstick measures how wisely entrepreneurs have invested money from their own capital only, thus purposely ignoring money from creditors and other sources. This method is highly popular because of its simplicity. Siropolis (1997:390) argues that this yardstick appeals strongly to small businesses, mostly because the owner’s thereof chose to put their money in their own businesses rather than elsewhere - in the belief that they would earn a higher return. So naturally they would want to know if they had made the right choice. Computing the return on assets can be done by making use of the following formula:

\[
\text{Return on owners’ equity} = \frac{\text{net profit}}{\text{owners’ equity}} \times 100
\]

- **Return on permanent capital**: This yardstick measures how well entrepreneurs have invested all the long-term finance entrusted in their businesses. It takes into account not only the investment made by the owners of the business but also any long-term loans made by the
banks, thus omitting money from short-term creditors. The sum of owners' equity and long-term debt is called permanent capital (Sharpe & Alexander 1993:455). It reflects the total amount needed to finance fixed assets, such as machinery and buildings, and the fraction of current assets such as cash and inventory, not otherwise financed by short-term creditors. Computing the return on assets can be done by making use of the following formula:

\[
\text{Return on permanent capital} = \frac{\text{net profit} + [\text{interest} \times (1 - \text{tax rate})]}{\text{owners' equity} - \text{long-term liabilities}} \times 100
\]

Of the 100 respondents, 82% sometimes and always use liquidity and 78% use solvency when calculating their capital requirements. These results comply with the objective stated in Chapter 2 that in order for a business to achieve a positive financial leverage, liquidity and solvency must be considered. No respondents indicated that his/her business use any other criteria for this purpose.

As has been discussed in Chapter 2 the liquidity of a business is measured by its ability to satisfy its short-term obligations as they come due. This implies that a liquid firm is one that is able to raise cash when it is needed. Money market securities are an excellent source of asset liquidity. Potential liabilities (e.g., unused available credit as in bank overdraft or revolving credit discussed in Section 3.2) also provide liquidity. For example, if a firm has a revolving credit of R200 000 and is currently borrowing only R50 000, it has R150 000 of liquidity from this borrowing source. It follows that a firm with a credit of R200 000 that is borrowing R50 000 has more liquidity than a firm with the same amount of credit but borrowing the full R200 000. To the extent that a firm has large investments in assets that are readily convertible into cash and has a large potential for borrowing, it is liquid.

Steinhoff & Burgess (1996:256) argue that there are two aspects of liquidity - planned liquidity and protective liquidity. Planned liquidity involves planning. An entrepreneur has to forecast cash needs and plan how those needs are to be met - through reductions in assets or the issuance of stock (as in venture capital). Protective liquidity is the ability to meet unexpected cash demands. Unexpected
cash demands are net cash outflows greater than those forecast. Unexpected cash demands can arise for many reasons. In some cases cash can be needed to undertake unexpected investment opportunities. The inability to raise sufficient cash to undertake these investments result in the forgone profits.

In other cases cash may be needed because of unexpected outflows - for example a sudden increase in the price of factor inputs such as production material (Steinhoff & Burgess, 1996:257). Cash may be needed because cash inflows are less than anticipated - for example. a strike that stops production, a slowdown in collections due to a recession in the economy. a breakdown in a critical manufacturing step that cannot be fixed quickly or a technological breakdown that causes prices to drop dramatically.

Given the general uncertainty regarding cash flows entrepreneurs should maintain conceivable amount of liquidity. Entrepreneurs should commit credit well above the amount they expect to be needed.

The following liquidity ratios can be used to compute liquidity:

\[
\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}
\]

\[
\text{Quick ratio} = \frac{\text{Current assets} - \text{inventories}}{\text{Current liabilities}}
\]

\[
\text{Cash position ratio} = \frac{\text{Cash + marketable securities}}{\text{Current liabilities}}
\]

1If calculated for a number of consecutive years, a decline in this ratio implies a weakening of a firm's liquidity.
Inventory turnover = \( \frac{\text{Cost of goods sold}}{\text{Average inventory}} \)

Receivables turnover = \( \frac{\text{Net credit sales}}{\text{Average accounts receivables}} \)

As mentioned in Chapter 2, solvency refers to liquidity in the long-term, that is, a firm's ability to pay its long-term debt. The more solvent a firm, the better protected its owner is from losing his investments. To measure this protection, entrepreneurs should use as a yardstick the debt ratio, debt equity ratio and times interest earned ratio's as discussed in chapter 2 above. These ratio's are as follows:

Debt ratio\(^1\) = \( \frac{\text{Total liabilities}}{\text{Total assets}} \)

Debt equity ratio\(^2\) = \( \frac{\text{Long-term liabilities}}{\text{owner's equity - long-term liabilities}} \)

Times interest earned\(^3\) = \( \frac{\text{Operating profit before interest}}{\text{Interest expense}} \)

\(^1\)The debt ratio measures the degree to which a firm's assets are financed by creditors. Generally a debt ratio of less than 50 percent is considered favourable by bankers.

\(^2\)The debt equity ratio measures the degree to which a firm's equity and long-term debts are financed by long-term liabilities.

\(^3\)The times interest earned ratio measures how low profits can drop without straining the firm's ability to pay interest when due.
Table 4.4 details the responses with regard to plans and statements prepared by SMMEs to determine total capital requirements. The table below shows that budgets are the most prepared statements by the respondents in that 84% prepare budgets falling either in the *sometimes* (40%) or the *always* (44%) category. Sixteen percent (16%) or the respondents do not prepare budgets at all.

<table>
<thead>
<tr>
<th>Plans and statements prepared to determine total capital requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image" alt="Table" /></td>
</tr>
</tbody>
</table>

Dlamini (1994:62) found that in 1994, 75.6 per cent of black SMMEs made use of budgets, whilst Holmes and Nicholls (1998:63) in their study of 938 Australian SMMEs found that 48 per cent of the respondents never made use of written budgets in planning capital requirements. The figure of 84 per cent of SMMEs that make use of budgets, as indicated by the findings of this research, would therefore appear to be high.

The next frequently used financial statement is the business plans and the projected balance sheet (78% and 44% respectively). Holmes and Nicholls (1998:63) have found that in Australia only 14.5 per cent of the respondents prepare balance sheets and income statements internally, but that 69.3% seek outside help from accountants from the preparation of these statements.

This result in Soweto is in strong contrast to the findings of Business Partners (1998:24) that only 20 per cent of SMMEs give attention to the business plan. It can therefore be concluded that from...
the information above most SMMEs in the Soweto area draft budgets and business plans to determine their capital requirements and other statements to summarise all other sorts of requirements.

Reekie et al. (1996:256) assert that entrepreneurs should have a plan of action to guide them as they chart the direction of the company and strive to make the best possible decisions to increase the likelihood of success for the proposed new business venture or the contribution and growth of the ongoing firm. This plan of action is called the business plan, a comprehensive, well-thought-out, written document which establishes the necessary guidelines for entrepreneurs. In the course of the soliciting information from the respondents, the most verbally cited complaint by the entrepreneurs is that they do not have time to sit down and write out a business plan or a budget. However, despite this complaint, the results prove that the respondents do appreciate the importance of planning and budgeting and therefore make the means of finding time for this purpose.

The importance of the pro forma financial statements lies in enabling the management of a business to forecast the future financial position of a business and therefore help adjust operations to influence the position that the management seeks for its business. Management can consider a change in their operating policy, such as changing the price of its products, developing additional markets or selling some of its plant or assets and buying the items produced by them from subcontractors. The development of operating forecasts and pro forma financial statements that indicate the expected effects of such changes may provide valuable insights.

Table 4.5 indicates the types of short-term finance used by SMMEs in the Greater Soweto area. SMMEs in Soweto make use of short-term finance as follows: Trade credit - 74 per cent (sometimes 32% and always 42%); Bank overdraft - 44 per cent (sometimes 28% and always 16%); Revolving credit - 44 per cent (sometimes 28% and always 16%); Factoring - 18 per cent (sometimes 14% and always 4%).

As has been discussed in Chapter 3, trade credit is a form of finance that arises when a firm obtains
goods and services in exchange for its promise of future payment. This implies that a trade credit for a firm is like a charge account for a consumer.

<table>
<thead>
<tr>
<th>Table 4.5</th>
<th>Type of short-term finance used</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Trade Credit</td>
</tr>
<tr>
<td></td>
<td>No.</td>
</tr>
<tr>
<td>Never</td>
<td>26</td>
</tr>
<tr>
<td>Sometimes</td>
<td>32</td>
</tr>
<tr>
<td>Always</td>
<td>42</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>

An attractive feature of a trade credit as a financing source is that it responds readily to an increase in the firm's purchases such as might occur during a seasonal build up of inventory. This might also explain the popularity of trade credit (74%) as a short-term financing source for SMMEs in Soweto.

It can therefore be concluded that trade credit is the most frequently used source of short-term finance in the Greater Soweto area. This is followed by bank overdraft and revolving credit both at 44 per cent and factoring at 18 per cent. Both the bank overdraft and the revolving credit are the only short-term finance sources offered by the commercial banks in the Soweto region. Results show that less than half (44%) of the respondents use commercial banks for their short-term finance sources. This may suggest that most SMMEs do not know about revolving credit and factoring. When they are better informed this may become better used forms of financing.

This situation of using only some forms of finances sources could bear three implications. Firstly, it could prove that trade credit is more efficient as a short-term financial source for SMMEs in the Soweto region than the rest of the other short-term finance sources. Secondly, it could also imply the lack of interest of the commercial banks to finance short-term needs of SMMEs in consideration of the risk factor. Firms with short-term financial needs often suffer from liquidity and cash flow
problems. A risk-averse commercial bank would naturally avoid risking its money on such kind of firms. Thirdly, it could imply that SMMEs in the greater Soweto have a good cash flow and a liquidity profile. This is more likely a reason for SMMEs in the Soweto region since results show that the most considered element of planning capital requirements (82%) for SMMEs in this region is liquidity hence there is no need to use bank overdrafts and revolving credit offered by commercial banks. It may also indicate that many are ignorant of some forms of finance.

However, the use of revolving credit and bank overdrafts at 44 percent indicate that SMMEs in the Greater Soweto make use of services provided by commercial banks. Factoring cannot be regarded as a source of finance in this area because of the small percentage of businesses using it.

Table 4.6 lists the types of medium-term finance used by SMMEs in the Greater Soweto. Medium-term loans are used by 54 per cent of the SMMEs (sometimes 38% and always 16%); leasing by 35 per cent (sometimes 13% and always 22%); and the most frequently used source of medium-term finance used is instalment sales with 80 per cent use (sometimes 30% and always 50%).

<table>
<thead>
<tr>
<th>Medium-term loans</th>
<th>Leasing</th>
<th>Instalment sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>No.</td>
<td>%</td>
<td>No.</td>
</tr>
<tr>
<td>Never</td>
<td>46</td>
<td>46</td>
</tr>
<tr>
<td>Sometimes</td>
<td>38</td>
<td>38</td>
</tr>
<tr>
<td>Always</td>
<td>16</td>
<td>16</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Table 4.6 shows that most SMMEs (80%) finance their medium-term requirements by means of instalment sales. This result concurs with Kolb & De Mongs's (1998:485) finding that during the past two decades leasing and instalment sales have become much more prevalent especially with SMMEs and their use has broadened to include almost any type of capital equipment as well as real
estate. Today a firm can lease almost anything from light machinery to supertankers, from industrial plants to potted plants. The results show that leasing is considered a practical and useful alternative to buying and financing assets in the Soweto region. Results also show that a considerable number (54%) of SMMEs also finance their medium-term requirements by means of medium-term loans. This situation of commercial banks financing medium-term loans is a growing trend worldwide. This is confirmed by Siropolis (1997:189) arguing that medium-term loans are an important and rapidly growing area of commercial banks' services internationally. He mentions that these loans are used by firms to finance machinery or equipment purchases where the commercial banks hold the title until the loan is paid off.

Table 4.7 tabulates the types of long-term finance used by SMMEs in the Greater Soweto (Schwenke, 1998:3). Venture capital is also included in the long-term loans because, according to, venture capital is a long-term investment that often requires a period of five to ten years before any significant returns are realised.

<table>
<thead>
<tr>
<th></th>
<th>Own capital</th>
<th>Long-term loans</th>
<th>Sale and leaseback</th>
<th>Venture capital</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>%</td>
<td>No.</td>
<td>%</td>
</tr>
<tr>
<td>Never</td>
<td>8</td>
<td>8</td>
<td>52</td>
<td>56</td>
</tr>
<tr>
<td>Sometimes</td>
<td>30</td>
<td>30</td>
<td>26</td>
<td>26</td>
</tr>
<tr>
<td>Always</td>
<td>62</td>
<td>62</td>
<td>22</td>
<td>22</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Own capital is utilised by 92 per cent of the SMMEs (sometimes 30% and always 62%) followed by long-term loans at 48 per cent (sometimes 26% and always 22%). This followed by sale-and-lease back at 26 per cent (sometimes 20% and always 6%) and finally venture capital at 20 per cent (sometimes 16% and always 4%). This may again indicate that many SMMEs are ignorant of some
forms of finance.

Table 4.7 also indicates that although SMMEs rely on their own capital to finance their long-term requirements, they also use long-term loans as sources of finance. However, less than half (46%) of the respondents use long-term loans offered by commercial banks. This could be the result of stringent security demands by the commercial banks on SMMEs before a loan can be granted.

The sale-and-leaseback and venture capital are seldom made use of by the SMMEs in the Soweto region. This indicates a lack of interest and/or knowledge of the two sources of finance. During the interviewing most of the respondents asked that sale-and-leaseback and venture capital be explained. The impression that is created is therefore that the lack of use of these financing sources could be due to the lack of knowledge thereof by the SMMEs in the Soweto Region.

It was mentioned in the introduction of this paper that the major factor influencing the establishment and sustenance of SMMEs in the Greater Soweto is the difficulty of obtaining finance.

Table 4.8 indicates the number of SMMEs which have difficulty in obtaining finance. The responses above show that 90 per cent (sometimes 38% and always 42%) of SMMEs in this region have problems obtaining finance from the commercial banks. The results support Holmes & Nicholls' investigation of external or environmental factors that influence SMMEs in the Greater Soweto and confirm problems identified by Dhlamini (1994:67). The reasons behind their difficulties obtaining finance are listed below.

Table 4.8  SMMEs that have difficulty obtaining finance

<table>
<thead>
<tr>
<th></th>
<th>NEVER</th>
<th>SOMETIMES</th>
<th>ALWAYS</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>No.</td>
<td>20</td>
<td>38</td>
<td>42</td>
<td>100</td>
</tr>
<tr>
<td>%</td>
<td>20</td>
<td>38</td>
<td>42</td>
<td>100</td>
</tr>
</tbody>
</table>
Table 4.9 reflects some reasons why finance is difficult to obtain from commercial banks. These are from the perspective of the respondents and not that of the commercial banks. Different reasons could be have been obtained had the answers been from the perspective of the commercial banks.

Discrimination by banks (82%) is regarded as the main reason why finance is not obtained from commercial banks. This is followed by the lack of understanding by banks (80%) and the fact that businesses could be regarded as too risky (74%). This is clearly in contrast to the findings that 54 per cent of the SMMEs use medium-term loans and that 44 per cent use bank overdrafts.

Table 4.9  Reasons why finance is difficult to obtain from commercial banks

<table>
<thead>
<tr>
<th>Reasons</th>
<th>Yes</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discrimination by banks</td>
<td>82</td>
<td>18</td>
<td>100</td>
</tr>
<tr>
<td>Lack of understanding by banks</td>
<td>80</td>
<td>20</td>
<td>100</td>
</tr>
<tr>
<td>Business regarded as too risky</td>
<td>74</td>
<td>26</td>
<td>100</td>
</tr>
<tr>
<td>Sources of finance not available</td>
<td>70</td>
<td>30</td>
<td>100</td>
</tr>
<tr>
<td>Owner's capital contribution low</td>
<td>70</td>
<td>30</td>
<td>100</td>
</tr>
<tr>
<td>Past net profits too low</td>
<td>70</td>
<td>30</td>
<td>100</td>
</tr>
<tr>
<td>Difficulty in supplying information</td>
<td>68</td>
<td>32</td>
<td>100</td>
</tr>
<tr>
<td>Not aware of existing sources of finance</td>
<td>66</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Other borrowed capital too high</td>
<td>56</td>
<td>44</td>
<td>100</td>
</tr>
<tr>
<td>Lack of managerial skills</td>
<td>52</td>
<td>48</td>
<td>100</td>
</tr>
</tbody>
</table>

The reason of too low owner's capital contribution (since 70% of the respondents have low capital contribution) can also be regarded as an impediment for SMMEs in obtaining funds, although it was shown that 100 per cent of the respondents use their own capital in Section 4.2. The fact that most SMMEs have had too low past net profits (70%) is also a reason why it had been difficult to obtain finance. Seventy percent of the respondents indicated that financing sources were not available.
while 66% indicated that they were not aware of existing sources of finance.

Difficulty in supplying information by SMMEs (68%) is another reason for not obtaining finance from commercial banks. This implies that SMMEs have no problem in identifying existing sources of finance. Of the 100 respondents, 56 per cent presume that their other borrowed capital may be too high, while 52 per cent reckon that a lack of managerial skills is the reason for not obtaining finance.

4.3 CONCLUSIONS

The aim of this chapter was to identify the sources of finance that SMMEs in Soweto currently use. This chapter also looked at the degree to which SMMEs in this area use sources of finance provided by commercial banks in Soweto. To this end a questionnaire was drafted and administered to 100 respondents for the purpose of soliciting information regarding the extent of the role of commercial banks in the financial development of the SMMEs in the Soweto region.

The questionnaire was sub-divided into two portions in the following manner: Section A of the questionnaire recorded the details of the respondents, while section B of the questionnaire was meant to determine whether the business of the respondent satisfied the legal requirements as set out for SMMEs according to the discussion in Chapter 2 and whether that business did make use of the services provided by commercial banks and to what degree. A copy of this questionnaire is included in the Appendix. Further, the analyses of the results of the empirical research that was conducted in the Greater Soweto followed.

The results show that all respondents satisfy the criteria set by the government for the requirements of a small business. The results show that the average number of employees employed by the respondents is 7.1 and that the businesses own an average of R152,084 worth of assets and command an average of R101,320 of annual turnover. The average annual turnover and the average assets are R258,300 and R321,310 respectively.
The average turnover to asset ratio of 1:8 gives an indication of the efficient use the SMMEs invested capital. This also implies that capital productivity of these SMMEs is rather high. It was discovered that this is even true in the case of service industries and that for the rest of the other industries it meant a good cash flow management.

Sixty six percent of the respondents indicate that they sometimes or always take the maximisation of returns on investments into account when calculating their capital requirements, while 82% sometimes and always use liquidity and 78% use solvency when calculating their capital requirements. From the discussion in Chapter 2, this may imply that most SMMEs in the greater Soweto are relatively successful in achieving a positive financial leverage. No respondents indicated that his/her business use any other criteria for this purpose.

It was further discovered that budgets are the most prepared statements since the results reveal that 84% of the respondents prepare budgets. This is followed by the business plans and the projected balance sheet whereby 78% and 74% of the respondents respectively agreed to using business plans and the projected balance sheet.

With respect to short-term finance used, 74 per cent of the respondents make use of trade credit; 44 per cent use bank overdrafts; 44 per cent use revolving credit and 18 per cent use factoring. The use of revolving credit and bank overdrafts indicate that SMMEs in the Greater Soweto make use of services provided by commercial banks.

In the case of medium-term finance the results show that the most frequently used source of medium-term finance is instalment sales with 80 per cent, followed by medium-term loans used by 54 per cent of the SMMEs and leasing used by 35 per cent. In as far as the long-term sources of finance is concerned, the following was discovered: Own capital is utilised by 92 per cent of the SMMEs, followed by long-term loans at 48 per cent, sale-and-leaseback at 26 per cent and finally venture capital at 20 per cent. It is clear that although SMMEs rely on their own capital to finance their long-term requirements, they do use long-term loans as sources of finance.
The results also show that 90 per cent of SMMEs in the Soweto region have problems obtaining finance from commercial banks. Most of these respondents (82%) feel that discrimination by banks is regarded as the main reason why finance is not obtained from commercial banks. This is followed by the lack of understanding by banks (80%) and the fact that businesses could be regarded as too risky (74%). Seventy percent of the respondents feel that the unavailability of financial sources, low owner’s capital contribution and low past net profits are equally important reasons for commercial banks’ reluctance to finance SMMEs in Soweto. Difficulty in supplying information by SMMEs (68%) is another reasons for not obtaining finance from commercial banks. Lastly, 56 per cent presume that their other borrowed capital may be too high, while 52 per cent reckon that a lack of managerial skills could be a reason for the difficulty in obtaining finance from commercial banks.
CHAPTER 5
SUMMARY AND CONCLUSIONS

The aim of this study was to identify the role of commercial banks in financing SMMEs in the Greater Soweto area. The purpose for the study emanates from the importance of SMMEs in both the formal and informal sectors in creating employment, especially in areas of dense population concentration like the Greater Soweto. The interest in SMME research can be attributed to the fact that SMMEs serve as an economic underpinning and as an important source of employment.

In Chapter 2, different definitions of SMMEs from different countries such as the United States, United Kingdom and South Africa are reviewed. It was mentioned that there is no universally acceptable definition of an SMME. The definition of an SMME in South Africa is provided by the National Small Business Act which, in summary is a classification of SMMEs according to five size categories ranging from survivalist to medium-sized enterprises. The economic and quantitative definition of an SMME, as applicable to this study, is indicated in Table 2.1.

Chapter 2 also discusses the role of SMMEs in the South African economy. In this regard, SMMEs have been found to play a significant role in the South African economy in respect of employment creation, income generation and output growth. Managing SMMEs was a discussion that emphasised planning, organising, directing and controlling as the main ingredients to effective management. Lastly, planning capital requirements and factors influencing capital requirements was also discussed, as this was considered an important aspect of the study of SMMEs. It was concluded that to establish the extent of the capital requirements, the budget, business plan, projected income statement, balance sheet, and capital requirement schedule had to be used.

In Chapter 3, the various sources of finance to SMMEs are discussed and elaborated on. The short-term sources of finance available to SMMEs include: trade credit, bank overdrafts, revolving credit and factoring.
On the other hand, medium-term sources of finance discussed are, firstly, term loans which are defined as debt instruments that have an original maturity longer than one year. The second one is leasing, which is described as a contract whereby the owner of an asset grants another party the exclusive rights to use the asset for an agreed period in return for a payment of rent. Lastly, the instalment sale agreement is one medium-term finance source whereby a business obtains an asset and a financial institution finances the cost of the asset and the business repays the stated amount in instalments over the stated period.

Sources of long-term finance discussed in Chapter 2 include own capital, long-term loans and sale-and-leaseback. While own capital was considered the finance that comes mainly from the personal savings of the entrepreneur long-term loans are financed by financial institutions for periods up to five years and longer. A sale-and-leaseback is an arrangement made when a company sells an asset it currently owns to a purchaser and simultaneously executes a lease agreement with the same firm.

The Ntsika enterprise promotion agency was discussed as an institution that aims to expand, coordinate and monitor the provision of training, advice, counselling and any other non-financial services to SMMEs. It was also mentioned that Ntsika was established alongside the National Small Business Council, which was not dealt with in detail in this study because of its lack of direct value to the topic being researched in this study.

The different financial schemes, which are available from the Business Partners and which have different characteristics were also discussed in Chapter 3. Those discussed were the equity partner, risk partner, property partner, loan partner, incentive partner and venture capital. Lastly, informal money market financing which consists of individuals obtaining short-term finance from informal institutions is discussed. The informal money lenders and stokvels are identified as institutions operating in the informal money market.

Chapter 4 set out to discuss the SMMEs in the Greater Soweto and their financing sources. This chapter also looked at the degree to which SMMEs in this area use sources of finance provided by
commercial banks in this region.

For this purpose data for the empirical research was collected by means of a survey of a randomly selected sample of SMMEs in the Greater Soweto area in order to achieve the objectives of this study. The empirical research was conducted with an understanding that it is a survey of a fact-finding process according to which data is collected in a planned manner in order to discover the distribution of and interrelationships between certain variables, in this case commercial banks and the capital financing of SMMEs.

To implement the survey research, the technique used for collecting data was by means of personal interviews using a questionnaire. The discussion and evaluation of the findings resulting from the survey was done in the following sequence: Firstly, an analyses of the data was made to prove that all businesses of the respondents are SMMEs; secondly, an analyses of the data in descriptive form was presented to give an overall picture of the results; and thirdly, a conclusion on the overall results was provided.

The findings of the empirical research confirm the theoretical hypothesis about the need for the financing of SMMEs in Soweto. The research points that all respondents satisfy the criteria set by the government for the requirements of a small business. The findings also reveal that while most SMMEs use the services of the commercial banks in one or other respect, they still have difficulty obtaining finance. The main reason for the lack of finance is considered to be discrimination on the part of the commercial banks. However, other factors contribute to the difficulty to obtain finance. These are a lack of understanding by banks and the fact that other than banks, there are not many other alternative sources of finance available to SMMEs in Soweto. The fact that most SMMEs have had low past net profits and low owner’s contributions also make matters worse.

The following recommendations are made. Regarding what SMMEs in the greater Soweto can do to secure financial success and improve their credibility with commercial banks. A number of actions can taken by SMMEs to secure financial success and improve their credibility with
commercial banks. These actions include the following: Managements of SMMEs should study the reasons as listed in Table 4.9 and determine in which way each of these reasons is applicable to their businesses. This may provide them with the basis for analysing their strengths and weaknesses in respect of their credibility with the financial institutions. Subsequently, the necessary actions can be taken to eliminate the weaknesses identified.

With reference to the major conclusions stated above, it is recommended that the managements of SMMEs should do a feasibility study before a business venture is started. They should also prepare a business plan on a continuous basis and ensure that a well-structured and appropriate accounting system is instituted in their businesses. This will provide them with up to date information for decision-making. It is also important that these managements prepare a presentable presentation before rushing into an application for financial assistance and seek the help of a qualified accountant or professional to assist them in preparing an application for financial assistance.

Managements of SMMEs have to pay special attention to asset management in order to achieve an acceptable turnover to assets ratio. It is often the case that better asset management set free some of the funds tied up in a business for creating greater turnover, better discounts or expansion. It is also imperative that these managements improve their managerial skills on aspects of financing, financial information preparation, calculation of capital requirements and related matters.

The following are the recommendations regarding what the commercial banks can do to alleviate the plight of SMMEs in respect of financing their businesses. Commercial banks should study the reasons offered by the respondents as to why they perceive it to be difficult for their businesses to obtain funds. Commercial institutions should plan a strategy for assisting SMMEs in overcoming the reasons as listed in Table 4.9. The vast majority of respondents felt that the commercial banks discriminate against their businesses. Whether the discrimination is on the basis of their race or the size of their businesses is not determined, but this does not negate the perception that commercial banks adopt discriminatory practices in their criteria for approving finance. It is therefore recommended that commercial banks seek to eliminate this perception by means of a substantial
public relations campaign. This will help to eliminate the perception and to increase awareness on the criteria that the commercial banks sets for the financing of private enterprises and SMMEs.

Respondents also felt that there is a lack of understanding by commercial banks of the circumstances of SMMEs and their problems regarding the acquisition of loans. The recommendation in this regard is that the commercial banks undertake a rigorous research on the circumstances befalling SMMEs and aim to adjust their criteria to accommodate the SMMEs.

The majority of respondents felt that they have difficulty in supplying information to commercial banks. Commercial banks can make a substantial contribution in the training of the management of SMMEs. The recommendation here is that commercial banks set up clear, simple and accurate training programmes to assist aspiring and established SMMEs in preparing sound financial statements.
APPENDIX

Questionnaire regarding the role of commercial banks in sustaining SMMEs in the greater Soweto

This questionnaire is strictly confidential and you and or the business will not be identified to any third party

SECTION A

Kindly provide the following information (Strictly not compulsory)*

5. Name of business:_________________________________________________________

6. Address:________________________________________________________________

7. Telephone number:________________________________________________________

SECTION B

Kindly answer the following questions:

1. Is the business privately owned? YES/NO

2. Is the business managed by the owner(s)? YES/NO

3. Is part of the capital supplied by the owner(s)? YES/NO

4. If the answer to 3. is yes, what percentage of the capital is supplied by the owners?

<table>
<thead>
<tr>
<th>Percentage</th>
<th>5%</th>
<th>10%</th>
<th>20%</th>
<th>30%</th>
<th>40%</th>
<th>50%</th>
<th>&gt;50%</th>
</tr>
</thead>
</table>

5. How many people are employed by the business?_________________________________

6. Depending on the nature of the business, i.e. whether it is a wholesaler, general dealer, etc. indicate the order of your assets and turnover below.

ASSETS

Wholesaler
<table>
<thead>
<tr>
<th>Segment</th>
<th>RO to</th>
<th>R101 000 to</th>
<th>R201 000 to</th>
<th>R501 000 to</th>
<th>&gt;R1.5 m</th>
<th>Do not know</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retailer</td>
<td>R0 to</td>
<td>R101 000 to</td>
<td>R201 000 to</td>
<td>R501 000 to</td>
<td>&gt;R1.5 m</td>
<td>Do not know</td>
</tr>
<tr>
<td></td>
<td>R100 000</td>
<td>R200 000</td>
<td>R200 000</td>
<td>R500 000</td>
<td>R1.5 m</td>
<td></td>
</tr>
<tr>
<td>General dealer</td>
<td>R0 to</td>
<td>R101 000 to</td>
<td>R201 000 to</td>
<td>R501 000 to</td>
<td>&gt;R1.5 m</td>
<td>Do not know</td>
</tr>
<tr>
<td></td>
<td>R100 000</td>
<td>R200 000</td>
<td>R200 000</td>
<td>R500 000</td>
<td>R1.5 m</td>
<td></td>
</tr>
<tr>
<td>Service</td>
<td>R0 to</td>
<td>R101 000 to</td>
<td>R201 000 to</td>
<td>R501 000 to</td>
<td>&gt;R1.5 m</td>
<td>Do not know</td>
</tr>
<tr>
<td></td>
<td>R100 000</td>
<td>R200 000</td>
<td>R200 000</td>
<td>R500 000</td>
<td>R1.5 m</td>
<td></td>
</tr>
<tr>
<td>Hair salon</td>
<td>R0 to</td>
<td>R101 000 to</td>
<td>R201 000 to</td>
<td>R501 000 to</td>
<td>&gt;R1.5 m</td>
<td>Do not know</td>
</tr>
<tr>
<td></td>
<td>R100 000</td>
<td>R200 000</td>
<td>R200 000</td>
<td>R500 000</td>
<td>R1.5 m</td>
<td></td>
</tr>
<tr>
<td>Shoe maker</td>
<td>R0 to</td>
<td>R101 000 to</td>
<td>R201 000 to</td>
<td>R501 000 to</td>
<td>&gt;R1.5 m</td>
<td>Do not know</td>
</tr>
<tr>
<td></td>
<td>R100 000</td>
<td>R200 000</td>
<td>R200 000</td>
<td>R500 000</td>
<td>R1.5 m</td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turnover</td>
<td>Wholesaler</td>
<td>Retailer</td>
<td>General dealer</td>
<td>Service</td>
<td>Hair salon</td>
<td></td>
</tr>
<tr>
<td>----------</td>
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<td>----------</td>
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<td>---------</td>
<td>------------</td>
<td></td>
</tr>
<tr>
<td></td>
<td>R0 to R100 000</td>
<td>R101 000 to R200 000</td>
<td>R101 000 to R200 000</td>
<td>R101 000 to R200 000</td>
<td>R101 000 to R200 000</td>
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</tr>
<tr>
<td></td>
<td>R100 000</td>
<td>R201 000 to R500 000</td>
<td>R201 000 to R500 000</td>
<td>R201 000 to R500 000</td>
<td>R201 000 to R500 000</td>
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</tr>
<tr>
<td></td>
<td>R501 000</td>
<td>&gt;R1.5 m</td>
<td>&gt;R1.5 m</td>
<td>&gt;R1.5 m</td>
<td>&gt;R1.5 m</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Do not know</td>
<td>Do not know</td>
<td>Do not know</td>
<td>Do not know</td>
<td>Do not know</td>
<td></td>
</tr>
</tbody>
</table>

Other, please specify

<table>
<thead>
<tr>
<th>Turnover</th>
<th>Wholesaler</th>
<th>Retailer</th>
<th>General dealer</th>
<th>Service</th>
<th>Hair salon</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>R0 to R100 000</td>
<td>R101 000 to R200 000</td>
<td>R101 000 to R200 000</td>
<td>R101 000 to R200 000</td>
<td>R101 000 to R200 000</td>
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<tr>
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<td>R201 000 to R500 000</td>
<td>R201 000 to R500 000</td>
<td>R201 000 to R500 000</td>
</tr>
<tr>
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<td>R501 000</td>
<td>&gt;R1.5 m</td>
<td>&gt;R1.5 m</td>
<td>&gt;R1.5 m</td>
<td>&gt;R1.5 m</td>
</tr>
<tr>
<td></td>
<td>Do not know</td>
<td>Do not know</td>
<td>Do not know</td>
<td>Do not know</td>
<td>Do not know</td>
</tr>
</tbody>
</table>

87
<table>
<thead>
<tr>
<th>R0 to</th>
<th>R101 000 to</th>
<th>R201 000 to</th>
<th>R501 000 to</th>
<th>&gt;R1.5 m</th>
<th>Do not know</th>
</tr>
</thead>
<tbody>
<tr>
<td>R100 000</td>
<td>R200 000</td>
<td>R500 000</td>
<td>R1.5 m</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Shoe maker

<table>
<thead>
<tr>
<th>R0 to</th>
<th>R101 000 to</th>
<th>R201 000 to</th>
<th>R501 000 to</th>
<th>&gt;R1.5 m</th>
<th>Do not know</th>
</tr>
</thead>
<tbody>
<tr>
<td>R100 000</td>
<td>R200 000</td>
<td>R500 000</td>
<td>R1.5 m</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Manufacturing

<table>
<thead>
<tr>
<th>R0 to</th>
<th>R101 000 to</th>
<th>R201 000 to</th>
<th>R501 000 to</th>
<th>&gt;R1.5 m</th>
<th>Do not know</th>
</tr>
</thead>
<tbody>
<tr>
<td>R100 000</td>
<td>R200 000</td>
<td>R500 000</td>
<td>R1.5 m</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Other. please specify

<table>
<thead>
<tr>
<th>R0 to</th>
<th>R101 000 to</th>
<th>R201 000 to</th>
<th>R501 000 to</th>
<th>&gt;R1.5 m</th>
<th>Do not know</th>
</tr>
</thead>
<tbody>
<tr>
<td>R100 000</td>
<td>R200 000</td>
<td>R500 000</td>
<td>R1.5 m</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

SECTION C

Please cross the applicable on all the questions.

1. How often do you calculate the total capital requirements for your business?

<table>
<thead>
<tr>
<th>Quarterly</th>
<th>Half yearly</th>
<th>Yearly</th>
<th>Other, specify</th>
</tr>
</thead>
</table>

2. To what extent do you consider the following criteria in deciding on the level of total capital investment in your business?
3. Are the following plans and statements prepared to determine capital requirements?

<table>
<thead>
<tr>
<th>Plans/Statements</th>
<th>Never</th>
<th>Sometimes</th>
<th>Always</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business plan</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Budgets</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Projected income statements</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Projected balance sheets</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Projected capital requirements schedule</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Other, specify</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
</tbody>
</table>

4. To what extent are the following short-term finances used by business?

<table>
<thead>
<tr>
<th>Finances</th>
<th>Never</th>
<th>Sometimes</th>
<th>Always</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade credit</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Bank overdraft</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Revolving credit</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Factoring</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Other, specify</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
</tbody>
</table>

5. To what extent are the following medium-term financing sources used by your business?
<table>
<thead>
<tr>
<th>Financing Source</th>
<th>Never</th>
<th>Sometimes</th>
<th>Always</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medium-term loans</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Leasing</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Instalment sales</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Other, specify</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
</tbody>
</table>

6. To what extent are the following long-term financing sources used by your business?

<table>
<thead>
<tr>
<th>Financing Source</th>
<th>Never</th>
<th>Sometimes</th>
<th>Always</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own capital</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Long-term loans</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Sale-and-leaseback</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Venture capital</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
<tr>
<td>Other, specify</td>
<td>never</td>
<td>sometimes</td>
<td>always</td>
</tr>
</tbody>
</table>

7. Do you have difficulty in obtaining finance?

<table>
<thead>
<tr>
<th>Difficulty Level</th>
<th>Never</th>
<th>Sometimes</th>
<th>Always</th>
</tr>
</thead>
</table>

If your answer to question nine sometimes or always, then please answer the following question.

8. Why, in your opinion is finance not available or financial assistance refused by the financial institutions?
<table>
<thead>
<tr>
<th>Sources of finance not available</th>
<th>yes</th>
<th>no</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of understanding by banks</td>
<td>yes</td>
<td>no</td>
</tr>
<tr>
<td>Difficulty in supplying information</td>
<td>yes</td>
<td>no</td>
</tr>
<tr>
<td>Discrimination by banks</td>
<td>yes</td>
<td>no</td>
</tr>
<tr>
<td>Owner's capital contribution is low</td>
<td>yes</td>
<td>no</td>
</tr>
<tr>
<td>Past net profits were low</td>
<td>yes</td>
<td>no</td>
</tr>
<tr>
<td>Other borrowed capital were too high</td>
<td>yes</td>
<td>no</td>
</tr>
<tr>
<td>Business regarded as too risky</td>
<td>yes</td>
<td>no</td>
</tr>
<tr>
<td>Not aware of existing sources of finance</td>
<td>yes</td>
<td>no</td>
</tr>
<tr>
<td>Lack of managerial skills</td>
<td>yes</td>
<td>no</td>
</tr>
<tr>
<td>Other, specify</td>
<td>yes</td>
<td>no</td>
</tr>
</tbody>
</table>
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Rousseau.


Kirsten, JF. Van Niekerk, JT & Du Plooy, JB. 1997. The demand for financial services by the microenterprise sector in selected areas of the Northern Province. South Africa. 10th Annual conference of SEASBA. Zimbabwe.


