FINANCIAL CHALLENGES FACED BY SMMES IN GAUTENG SOUTH AFRICA

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ABSTRACT

Small, medium and micro enterprises (SMMEs) are not spared from the global economic and financial turmoil which periodically occurs worldwide and therefore they must adjust their financial needs to accommodate such dynamic phenomena. This is particularly relevant in developing countries such as South Africa. It is important to note that SMMEs are major contributors to the economy, as they provide employment opportunities and create economic wealth resulting in the reduction in poverty and increased employment. In order to succeed and prosper, SMMEs need to establish a sound financial management function, and therefore it is vital to investigate the financial challenges these firms are experiencing. This paper reveals a better and deeper understanding of the issues surrounding the financial difficulties encountered by SMMEs in the Gauteng Metropolitan area. The data used in the study was gathered by administering structured questionnaires to businesses within Gauteng, selected randomly through a probability sampling method. The analysis of the results was based on descriptive statistics arrived at through SPSS tools. The results indicated that most SMMEs in the Gauteng Metropolitan are not supported adequately especially in the areas of financial management skills and expertise. Recommendations were made for firm owners to have workshops and proper training on the financial matters. A one stop shop centre for SMMEs to have access to financial information and support as well as remedial action on policy matters was also recommended.

Key words: SMMEs Financial Challenge Enterprise and Economic Benefits.

INTRODUCTION

The study is centred on identifying the problem areas experienced by small and medium enterprises in the financing of their businesses. For small and medium scale enterprises to succeed in their current economic environment and improve their level of competitiveness, they must form networks and build alliances with international partners. This gives rise to the idea of clusters of SMMEs which can reinforce each other through the networking and the sharing of skills and financial expertise. Developing small, medium and micro enterprises (SMMEs) is a key driver of government's economic development, poverty alleviation and job creation strategy (SA DTI, 2008). Small businesses offer a great redistribution effect and help to restructure society (Njiro, Mazwai and Urban, 2010).

Despite the country's economic growth in recent years, the unemployment rate has not fallen substantially. By the second quarter of 2014, the official unemployment rate of South Africa was estimated to be 25.5% (Statistics SA, 2014). SMMEs contribute to socio-economic development of a nation by creating employment and thus can play a vital role in achieving the vision 2030 of the National Development Plan (NDP) to reduce the employment to 6% through the creation of about 90% jobs in small and expanding firms (NPC, 2011). The current trend in South Africa is that credit is being tightened everywhere as banks tend to take precautionary measures against financial transactions. Businesses therefore find it very hard to survive. This results in increased layoffs and closures which affect the anticipated growth rate considerably. In an attempt to dampen these challenges the National government has introduced a favourable tax regulation for this sector which is still viewed as the country's solution to the unemployment rate. Through these measures the National government intends to particularly encourage youth, women and people with disabilities to start and sustain their own businesses.

Objective of the Study

The primary objective of this study was to investigate the major challenges faced by SMMEs in Gauteng province in financing their businesses and to identify opportunities available to enhance and sustain their Financial Management skills. The second objective was to sample important government policies on the financials of SMMEs and to recommend areas of improvement.

LITERATURE REVIEW

SMMEs in South Africa are facing numerous challenges including lack of funding, lack of access to finance (Rogerson, 2008; Booyens, 2011). These also include weak entrepreneurial culture, poor management skills, and high barriers to market entry, thus resulting in high rates of business failures (NCR, 2011). However, the 2010 Small Business Survey ranked lack of access to finance (8.7%) third after competition (12.6%) and lack of space to operate (16.2%) as key obstacles for the growth of SMMEs (FinScope, 2010). Credit access for SMMEs in South Africa is relatively difficult for the informal sector (second economy) compared to the formal sector (first economy). However, information solutions can help mitigate the gap between these two economies and ease the transition of informal businesses to the formal sector (Turner, Varghese and Walker, 2008). Information solutions can provide sufficient credit information and reduce risk for credit thus helping large lenders to lend money to SMMEs.

The nature of support and funding required for SMMEs depends on their size and development phase. This would encompass personal savings, friends and families for the start-up phase with bank loans for stable businesses (NCR, 2011). Equity finance, which is important for young, high growth and potentially high risk SMMEs, has been limited in South African businesses. (SA National Treasury, undated). Access to bank credit is mostly limited to enterprises with acceptable credit histories and sufficient collateral. For small and micro enterprises, however, non-bank financial intermediaries (NBFIs, such as retailers and micro-lenders) can play an important role. Interest rate control, access to capital, lack of sufficient competitive environment, collection preferences, control over access to payment streams and lack of access to information on credit exposures and collateral are the major factors hindering financing of SMMEs by NBFIs. Access of SMMEs in South Africa to capital markets is still underdeveloped (SA National Treasury, undated).

There are nevertheless, a variety of support and funding programmes available to South African SMMEs by both the public and private sector. The government institutions, such as SEDA, Khula Enterprise Finance and Ntsika Enterprises Promotions Agency mainly support existing, medium sized ventures (Booyens, 2011). Ntskia Enterprise Promotion Agency and Khula Enterprise Finance were created under the Department of Trade and Industry to provide financial and non-financial support to SMMEs (Mago and Toro, 2013). Ntskia is responsible for business development services, and Khula is responsible for financial support. Ntsika also supports survivalist, micro sized and very small enterprises. The other government support programmes include the Centre for Small Business Development (CSBD), the Small Enterprise Development Agency, the Industrial Development Corporation (IDC), the National Empowerment Fund, the National Development Agency (NDA), the Umsobomvu Youth Fund (UYF) and the South African Microfinance Apex Fund.

Despite the government's commitment in supporting SMMEs, the awareness and uptake of supports has been very low (NCR, 2011; Mago and Toro, 2013). According to the 2010 Small Business Survey, the majority of the owners (75%) were not aware of support organizations (FinScope, 2010). The upper BSM segments, however, were more aware of support organizations compared to lower segments - the awareness level for BSM 7 was 70%, BSM 6 was 57% and BSM 5 was 38%. Higher awareness was observed in the Free State (64%), Gauteng (62%), Western Cape (61%) and Northern Cape (58%). Out of those SMMEs which are aware of the support programmes, the majority do not know how the programmes operate which indicates the poor marketing of these programmes (Mago and Toro, 2013). It was also observed that the requirements and selection criteria for the financial applications are not made sufficiently clear to the clients resulting in the higher failure rate of applications. Hence, SMMEs are still struggling to access financial and non-financial services and their performance have not improved much.

The lack of provincial offices, uneven distribution, high cost of searching for support services, lack of well-trained accredited service providers, cumbersome administrative requirements and insufficient knowledge transfer between consultants and small businesses are also identified as challenges towards easy access of finance to SMMEs (NCR, 2011; Mago and Toro, 2013). The rejection rate for bank loans is high with only 25% likely to be successful (out of 84.4% applied) and out of 25% successful applications, 85% of applicants accepted the loan but only 18% finally got the loan (NCR, 2011). The reasons for failure in South African SMME loan applications include: collateral, lack of financial deposit, poor business plans and non-viable business ideas (Chimucheka and Rungani, 2011). A large number of SMMEs are completely excluded from the financial support due to their informality. Since banks are not set up to deal with small loans, this may add further complications to the formal SMMEs. For instance, only 59% of SMEs had any credit products as compared to 82% for large firms. The SMME banking revenue was only US$ 5 billion (3.3% of the global) in 2010 (Chironga et al., 2012). Microfinance (MFI) provides solutions for smaller loans, but the interest rates might be too high for small businesses to be able to afford.

Several provincial support programmes have also been established to support SMMEs (NCR, 2011), such as the Mpumalanga Economic Growth Agency (MEGA), Gauteng Economic Development Agency (GEDA), Gauteng Enterprise Propeller (GEP), Western Cape Department of Economic Development and Tourism, Limpopo Business Support Agency (Libsa), Limpopo Economic Development Enterprise (LimpDev), The Northern Cape Economic Development Agency (NCEDA), Ithala Development Finance Corporation – KZN, Trade and Investment Kwazulu-Natal, and The Free State Development Corporation (FDC).

According to the 2010 Small Business Survey, the largest proportion of small business owners resided in Gauteng province (23%) compared to 9.8% in Limpopo province. The majority of small businesses in Gauteng were service providers (34.2%), while the majority in Limpopo were retail services (78.2%). Small businesses in Gauteng were larger than those in other provinces which contributed significantly in job creation, while small businesses in Limpopo were smaller than those in other provinces. Thus, greater credit demand for investment purposes is expected in Gauteng compared to Limpopo (NCR, 2011). In Gauteng, the probability for BSM 6 and 7 type small businesses was highest (11.8% and 9.0% respectively), while BSM 1 and 2 type small businesses (29.2% and 31.4% respectively) was highest in Limpopo. Thus, small business owners in Gauteng are more likely to be able to access credit easily compared to those in Limpopo. Hence, a higher level of financing is expected to be made available in Gauteng as compared to Limpopo.

It appears that financial institutions are not reaching out to SMMEs in Gauteng province, because most of the contributions are coming from owners (56.5%) and friends or relatives (14%) compared to 20.5% by bank loans, 3.3% by the government, 2.8% by ventures and 2.2% by grants (Njiro et al., 2010). Instead of seeking help from the formal financial sector, young businesses in the province are particularly using personal savings or money borrowed from friends and relatives to start-up the business. Young businesses in Gauteng are using personal savings or money borrowed from friends and relatives for the start-up, rather than borrowing from the formal financial sector. A high segment of unbanked SMMEs in Gauteng indicates the need for further development by banks of this market (Rogerson, 2008).

With the exception of a few institutions providing financial support, South African SMMEs lack financial resources for R&D, funding and guarantees from most banks, and venture capital and seed funding for innovations (Booyens, 2011). SMMEs experience high barriers to entering markets in industries controlled by large companies due to the rigid market structure and unfavourable regulatory environment. South Africa's early-stage entrepreneurship activity (TEA) rate and the prevalence rate for new business were only 7.8% and 2.1%, respectively, which are lower than the average rate.

RESEARCH METHDOLOGY

The aim of this survey was to establish the challenges faced by SMMEs, and what needed to be done to address these. The main methodologies used in the study were desktop research and a document review; 334 SMMEs in different sectors and locations were selected, and questionnaire surveys were administered to them; quantitative statistical analyses were conducted. The research activities included development of a research design; the development and piloting of questionnaires; conducting the field survey; data collection, collation, uploading and analysis; reporting on findings, results and general discussions. Conclusions were drawn about financial challenges faced by a sample of SMMEs and cooperatives across sectors and in different municipalities, and recommendations were made to deal with challenges. The study applied the probability random sampling method to access 334 SMMEs of all types in the different parts of Gauteng which included Johannesburg, Ekurhuleni, Tshwane, Metsweding, Sedibeng and the West Rand. The following Table 1 illustrates the number of questionnaires that were completed in the specific regions to date. Table 2 shows the specific areas visited in the province.

Table 1: Questionnaires administered per region

Regions	Ekurhuleni	Johannesburg	Metsweding	Sedibeng	Tshwane	West Rand	Total
Total Questionnaires administered	100	81	5	45	33	70	334

Table 2: The research areas of the first 334 respondents

Areas in Gauteng Province where the respondents Operate Businesses			
Alberton	Grasmere	Mzimihlophe	Sedibeng
Attridgeville	Irene	Naturena	Roodepoort Royal Place
Bagit	Jabulani	Olwese	Sebokeng
Bara Mall	Johannesburg CBD	Orange Farm	Southgate
Boksburg	Katlehong	Orlando West	Soweto
Brackenhurst	Kenilworth	Orlando	Trade Route Mall
Centurion	Lenasia	Palm Ridge	Vaal
Carletonville	Lesotho	Palm Springs	Vereeniging
De-Deur	Malvern	Palm Springs Mall	Vosloorus
Denneboom	Maponya Mall	Pretoria CBD	Wadeville
East Rand Mall	Meredale Midvaal	Rietfontein	West Gate
Evaton	Mntanami Mofolo	Rondebult	Westgate Mall

FINDINGS AND DISCUSSIONS.

The data obtained was analysed using SPSS. The analysis is descriptive through the use of frequency tables.

The discussion begins by looking at the initiation of SMMEs and where most of the funding is sourced during the establishment of the new businesses. The businesses were divided into 7 BSM (business sophistication levels as was used in the Fin Scope study). The Figure below shows that the source of funding used by the entrepreneurs in starting up their businesses originated from their personal savings. It is evident that most businesses especially BSM 2, 3 and 4 had over 50% of their funding from personal savings and a further 30% from other family members. The Figure 1 below shows that the bulk of the money used in setting up business in Gauteng does not come from the formal financial institutions. Some of the sources for funding considered were from stokvels, retirement and retrenchment packages, government agency grants and salary, with less than 4% being borrowed from the banking institutions. These results are confirmed by the study carried out by the South African National Treasury and that of Mago and Toro (2013), although their study was carried out nationally.

The possible explanation for this is that most of the business owners are not aware of these opportunities to borrow from financial institutions and find it very difficult to approach the banks, as the majority of them may not meet the minimum requirements set by these banks. In most cases they end up selling their personal assets which is more common in the BSMs 5; 6 and 7. In some cases most of the businesses in this category would have other branches or businesses where they would also borrow money on a temporarily basis.

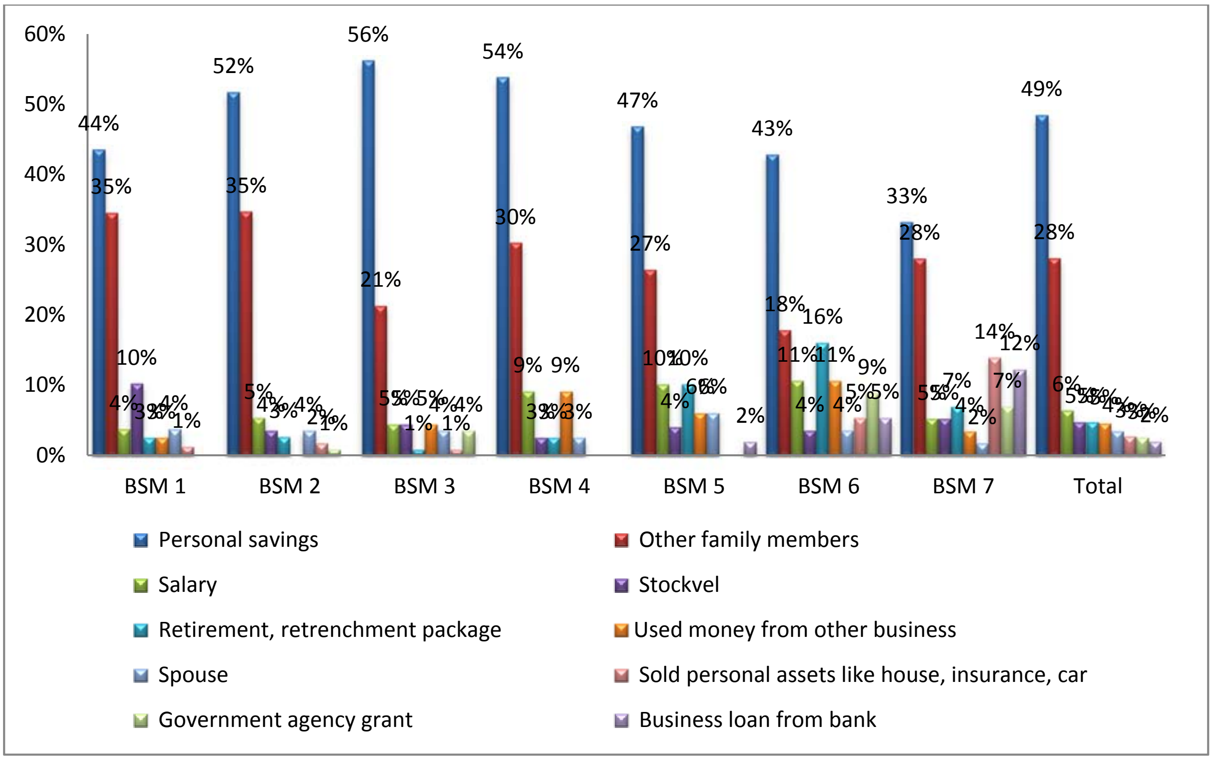

Figure 1: Source of funding for starting up the businesses

Figure 2 tends to agree with the previous findings that most of the small business owners are struggling to borrow money or deal with the banking institutions. Instead they believe that these banks apply stringent conditions which tend to reduce their opportunity of growth. This belief was recorded by over 40% of BSM 1 and 6 while BSM 3,4,5,6 and 7.indicated that they were not sure of banking activities. The possible explanation of the above result could be that most of these entrepreneurs are ignorant of the banks' functions. They are not willing to learn from the banks, and as a result they remain uninformed of what they would need from the banks. .

These groups have a negative impression of banks as may be explained by Figure 2 and Figure 3 below. The response was to the question asked whether financial institutions exploit small business owners when they apply to loans. Over 40% indicated they agree to the question in all categories of BSM from BSM 1 to 6. Again the number of owners who were not sure of this answer remained very high up to 57% in BSM 3 followed by BSM 6 at 55%. The possible explanation could be lack of awareness of the functions of banks by these entrepreneurs as explained earlier.

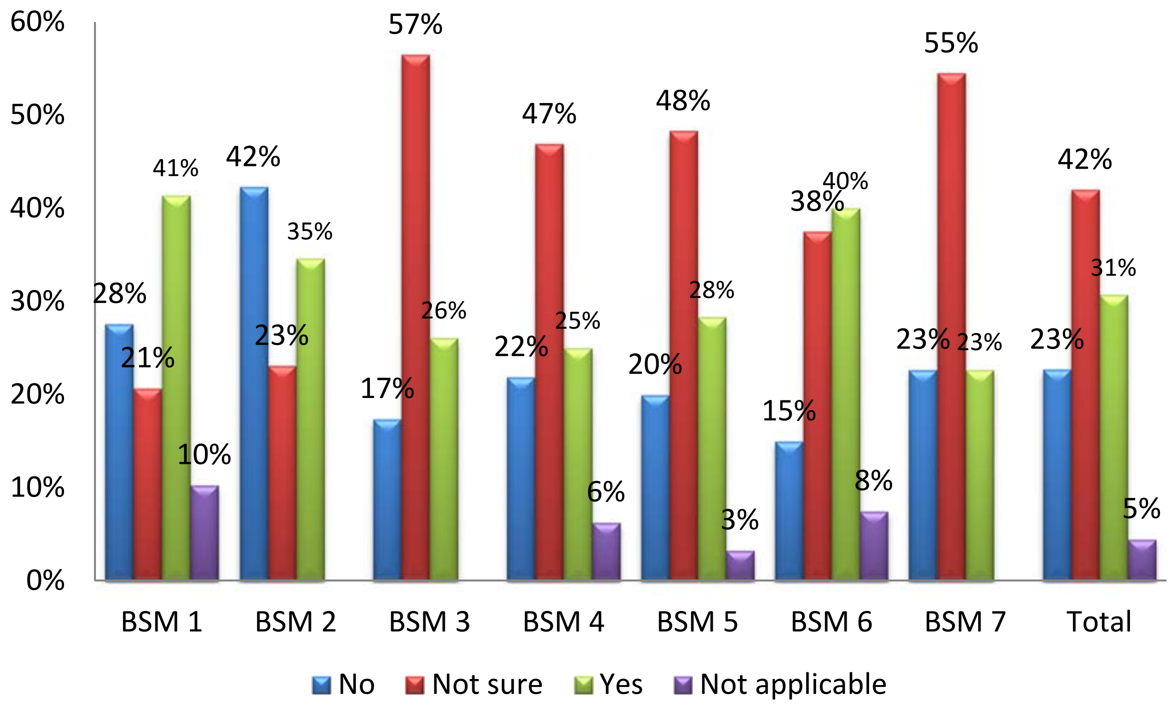

Figure 2: The conditions imposed by financial sources are reducing the business growth.

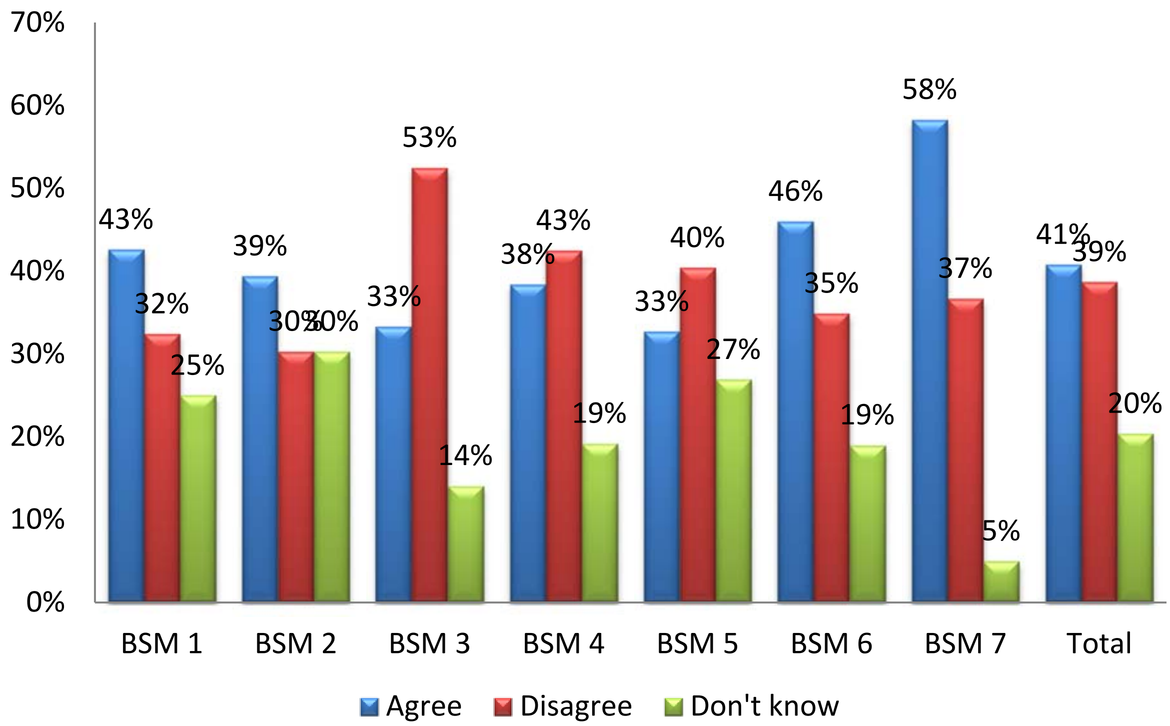

Figure 3: Financial insitutions exploit small business owners

The Figure 4 below again indicates the lack of knowledge about formal financial institutions. The indication is that most SMMEs do not have a dedicated business bank account, therefore the business activities are either carried out through the owner's personal account that of his spouse or do not have any business bank account at all. This situation is clearly reflected by businesses in BSM 1 up to BSM 4. The result shows that only 23% overall have a bank account dedicated for their business in the sample analysed. The majority of the business owners use their personal bank accounts recorded at up to 44% overall.

This is another indication of limited knowledge and lack of trust of these business owners in the banking sector. The result of this is very complicated financial management and accuracy in the financial records, as it becomes so difficult to separate the owner from the business itself.

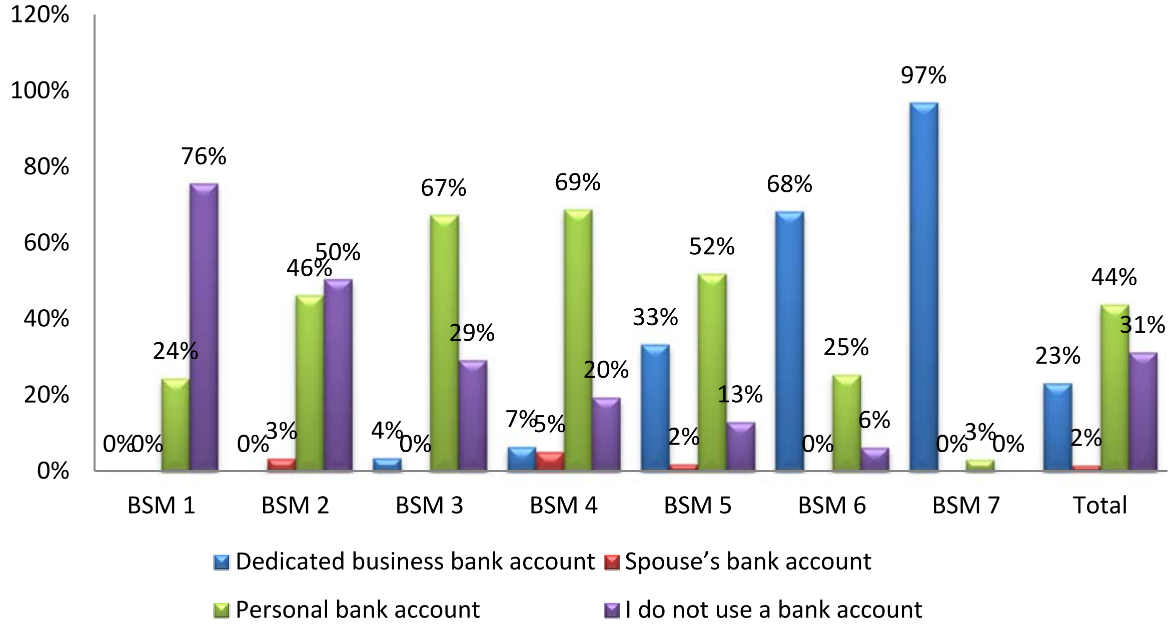

Figure 4: The facilities used for dedicated banking by SMMEs in Gauteng

As mentioned above, without a dedicated financial business bank the day to day transactions of the business become very difficult to manage. Cash flow problems are one of the major challenges experienced by these owners. Figure 5 below indicates the cash flow problems experienced. There seems to be some similarity in the percentages in Figures 4 and 5 meaning that most of the businesses without bank accounts or using their owners' accounts seem more likely to have cash flow problems. The figure shows BSM 1, 3, 4, 6 and BSM 7 showing a very high cash problem recorded. The overall total for all the surveyed businesses is reflected as 38%.

The possible explanation for this high indication could be due to difficulties in financial management and record keeping of the accounting books. A business without a bank account or where the owner has access to funds as and when he feels like is most likely to run into financial problems, as the opportunity to predict possible cash flow problems would be very much compromised.

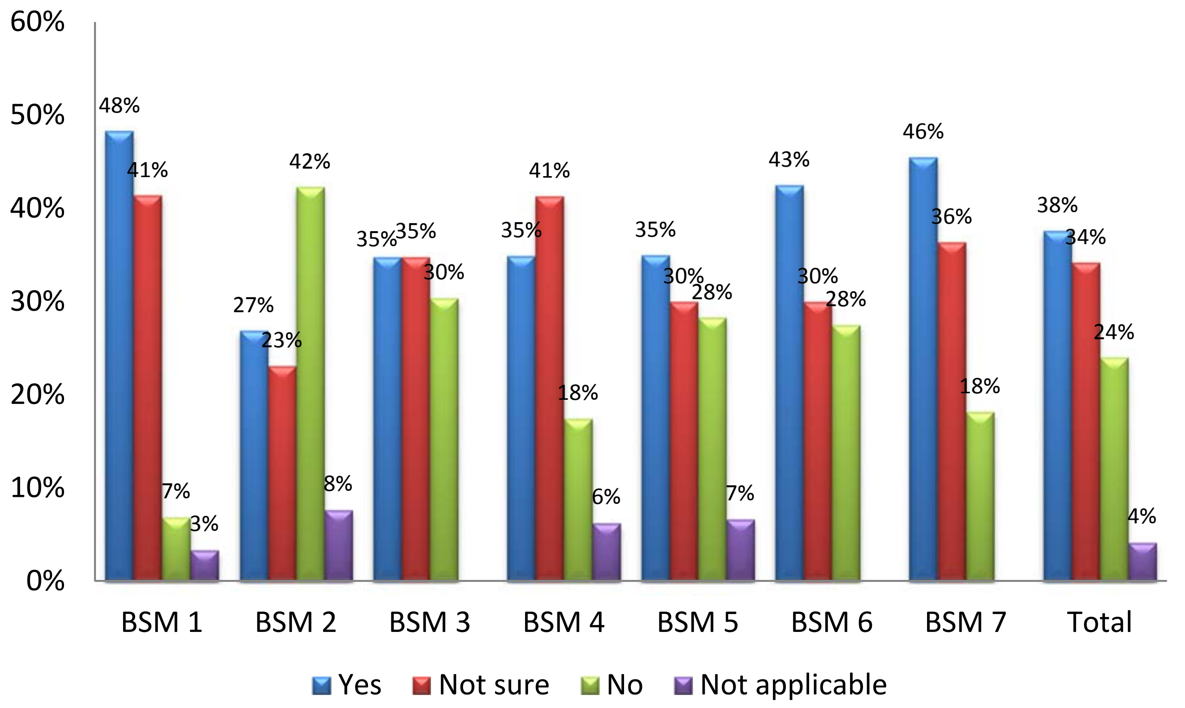

Figure 5: Does your business expericnce any cash flow problems.

Figure 6 and Figure 7 discuss some positive aspects of financial management such as the way information technology and communication has improved the sourcing of finances for SMMEs. The second part continues to explain the financial risk normally covered by insurance companies who seem to be better known to business owners than the banks.

In Figure 6 the improvement of financial sourcing is reported to have increase steadily from BSM 1 up to BSM 7 with the highest response being in BSM 5 with 65%. The highest level of respondence not sure was in BSM 7 with a 27% cases reported. The percentage of businesses that reported that information and communication technology does not improve financial sourcing is indicated as highest in BSM 1 at 31%. The overall total response in support of information and communications technology is well above average at 57%.

In Figure 7 an indication of financial risks covered through insurance is revealed. Again most of the BSM agreed with the need to insure their businesses. The lowest level of agreement stated for BSM 1 at 62% and rose steadily to well over 90% in BSM 7. The total percentage of businesses who agree to the need for insurance stood at 73%. This is an indication that most of the businesses in Gauteng have at one time thought of insuring his businesses against financial risks.

The possible explanation for this agreement on insurance could be because of difficulties in obtaining financial support together with the high rate of unemployment and crime in Gauteng. As Gauteng is the hub of business activities most business owners seemed scared of losing their business and might not be able to recover in the future. Insurance therefore is seen as a vital part of their survival.

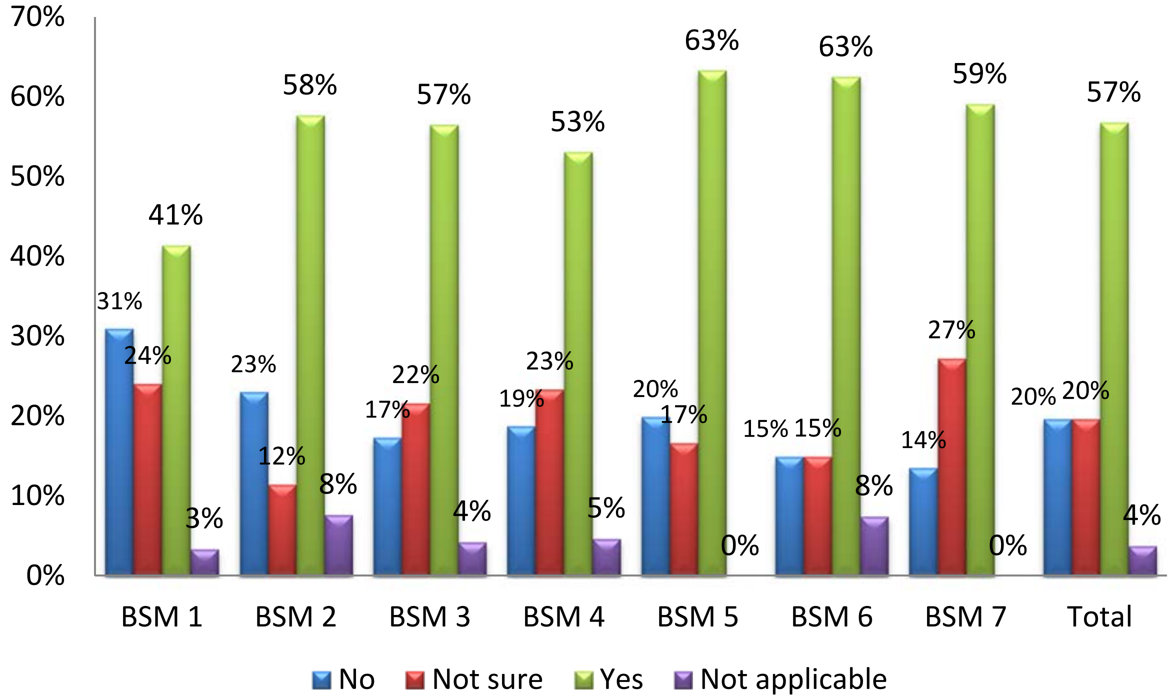

Figure 6: Information and Communication technology has improved the sourcing of finances

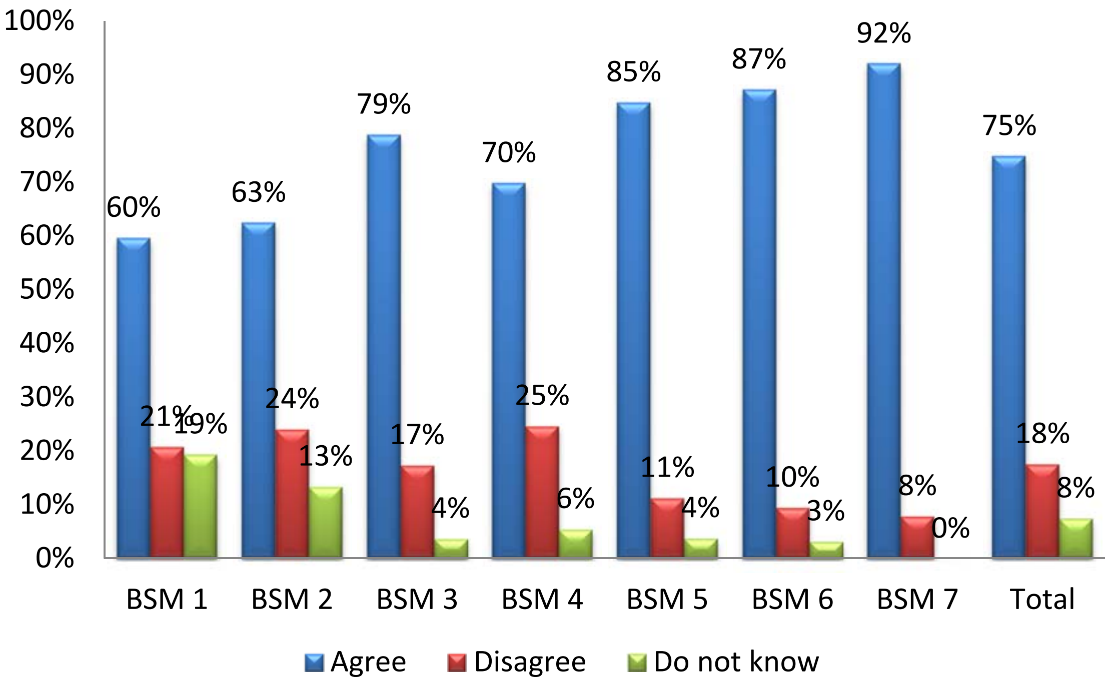

Figure 7: The importence of Insurance to business

CONCLUSION

The results show that there is a need to educate and bring about awareness to the business owners in various financial management skills and record keeping. Most of these entrepreneurs do not understand the functions of the financial institution and are therefore not geared to approach the financial institutions even if there are huge opportunities available for them. Most business owners have acknowledged that they do not have a dedicated business account and are therefore unable to report accurately on their business financial status. There should be a policy that could assist in bridging this gap through the government support mechanism and financial support systems.

It is clear that the Gauteng government can have a positive impact in promoting financial services to the business owners through skills training and workshops as well as seminars, since most of these SMMEs have similar business transactions and could have common issues and solutions. Lastly information and communication technology was reported as the agreed tool for the promotion of sourcing funds. It would therefore be a sustainable opportunity to use in educating the entrepreneurs.

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