

Improving SME access to finance in the North West Province of South Africa

IMRAAN GH BAKHAS
ND-ABM, AMP

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Supervisor: Professor T.E. du Plessis

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ABSTRACT

The purpose of this study is to provide empirical, qualitative evidence concerning the factors within the supply, demand and institutional support environments that hinder SME access to finance as well as the interventions necessary to improve access to finance for SMEs in the North West Province (NWP) of South Africa.

The semi-structured interview technique was used to collect data from a sample of 25 organisations. A response rate of 56% comprising two financial institutions and 12 SME support and development organisations currently operating in or providing financial and/or non-financial services to SMEs in the NWP, participated in the study. Descriptive statistics in the form of frequency counts and percentages and a qualitative data analysis software package (Weft QDA) were used to analyse the data and interpret the results.

The findings of this study are consistent with and support the findings of previous studies investigating SME access to finance. The findings indicate that the SME sector is characterized by a dearth of entrepreneurs, highly risk averse financial institutions and a poorly functional support and development environment. The findings of this study further indicate that formal and structured collaboration initiatives between financial institutions and SME support organisations are vital to improving SME access to finance in the NWP.

The study will be of interest to policy makers, financial institutions and SME support and development organisations interested in SME financing and economic development. The results of the study contribute to the understanding of the current financing challenges facing SMEs and will assist financial institutions, SME support organisations and SMEs to better understand the role and importance of effective stakeholder collaboration in improving SME access to finance.

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LIST OF KEY TERMS

- Small and Medium Enterprises (SMEs)
- SME access to finance
- SME constraints and challenges
- SME development
- Stakeholder collaboration

LIST OF ABBREVIATIONS

BDS	Business Development Services
DTI	Department of Trade and Industry
EU	European Union
GEM	Global Entrepreneurship Monitor
LED	Local Economic Development
MoU	Memorandum of Understanding
NW-DEDT	NW Department of Economic Development and Tourism
NWP	North West Province
OECD	Organization for Economic Cooperation and Development
PDI	Previously Disadvantaged Individual
SA	South Africa
SEDA	Small Enterprise Development Agency
SME	Small and Medium Enterprise
SMEDP	Small Medium Enterprise Development Programme
SMEs	Small and Medium Enterprises
SMMEs	Small, Micro and Medium Enterprises
UNIDO	United Nations Industrial Development Organization

CHAPTER ONE

INTRODUCTION AND PROBLEM STATEMENT

1.1 INTRODUCTION

This study is aimed at determining how financial institutions and Small Medium Enterprise (SME) support organisations can effectively collaborate to improve access to finance for SMEs in the North West Province (NWP) of South Africa (SA). Chapter one provides an overview of the research study. It presents the background to the study and details the problem statement as well as the research objectives and research methodology. This chapter concludes by providing an overview of the remaining chapters of the study.

1.2 BACKGROUND TO THE STUDY

Small and Medium Enterprises (SMEs) are universally acknowledged as the driving force of economies in both developed and developing nations (Wattanaputtipaisan, 2003:66). For developing countries, integration into the global economy through economic liberalization, deregulation and democratization is seen as the best way to overcome poverty and inequality (Raynard & Forstater, 2002:2). Crucial to this process is the development of a vibrant and an enabling environment for private sector development in which SMEs play a central role.

Globally, SMEs make up over 90% of enterprises and account for between 50% and 60% of employment opportunities (Raynard & Forstater, 2002:2). In the European Union (EU), SMEs make up 98% of an estimated 19.3 million enterprises and account for approximately 65 million (66%) of all employment opportunities created (Lukács, 2005:3-4). In China and Russia, SMEs account for 99.9% and 90% of the total number of firms and provide 84% and 45% of total employment respectively (Fan, 2003:8).

In South Africa (SA), Small and Medium Enterprises (SMEs) are a heterogeneous group of firms aggregated into micro enterprises, very small enterprises, small enterprises and medium-sized enterprises. Taking micro enterprises into account, the SA National Small Business Act, No 102 of 1996 classifies Small, Micro and Medium-sized Enterprises (SMMEs) into eleven sectors ranging from agriculture to mining and quarrying and uses quantitative

criteria (number of full-time paid employees, total annual turnover and total gross asset value) to classify SMMEs into four categories. Using employment only, SMMEs in SA are classified as follows:

Table 1: Definition of SMMEs in South Africa

SECTOR	SIZE (EMPLOYMENT)			
	Micro	Very Small	Small	Medium
Agriculture	5	10	50	100
Retail, Motor trade & Repair services	5	10	50	100
Wholesale Trade, Commercial Agents & Allied services	5	10	50	100
Catering, Accommodation & Other Trade	5	10	50	100
Transport ,Storage & Communication	5	10	50	100
Finance and Business Services	5	10	50	100
Community, Social & Personal Services	5	10	50	100
Electricity, Gas & Water	5	20	50	200
Construction	5	20	50	200
Manufacturing	5	20	50	200
Mining & Quarrying	5	20	50	200

Source: Adapted from the SA National Small Business Act 1996, No. 102 of 1996:17

This study focuses only on Small and Medium-sized Enterprises (SMEs) which, in SA, account for 28.6% of all businesses and provide approximately 41.7% of all employment opportunities in the private sector. As these figures do not take micro enterprises into account, the contribution of SMEs to the SA economy is very significant given that the vast majority of SA businesses are micro-enterprises operating in the informal sector of the SA economy (Turner *et al.*, 2008:17).

It is within the context of this contribution to aggregate economy that SMEs are regarded, globally, as the engine for economic growth and development and a strategic catalyst for socio-economic transformation. Given the strategic importance of SMEs in an economy, the ability of SMEs; to access credit and raise finance is not only crucial to its own sustainability and growth but also for a country's economic growth, employment creation and asset formation (Turner *et al.*, 2008:11).

Torre *et al.* (2008:1) assert that numerous studies support the perception among academics and policymakers that SMEs lack appropriate financing and need to receive special assistance such as government programmes that broaden lending or make lending more

accessible. Using data from 10 000 firms in 80 countries, Beck *et al.* (in Torre *et al.*, 2008:1) reveal that the probability that a firm rates financing as a major obstacle is 39% for small firms, 38% for medium-sized firms and 29% for large firms.

Despite the strategic contribution and the role that SMEs play in developing a vibrant economy, the challenges that they encounter in accessing finance remains a universal problem (Wu *et al.*, 2008:959). It has therefore been proposed that further research focusing on the immediate obstacles that have to be overcome in order to improve access to entrepreneurial finance is necessary (Maas & Herrington, 2006:60).

1.3 PROBLEM STATEMENT

It is an established fact that SMEs are the backbone of both developed and developing economies (Wu *et al.*, 2008:959). Improving access to finance, providing skills and business training and promoting a more flexible business and regulatory environment for SMEs is crucial in fostering an environment of entrepreneurship, innovation and growth (Rogerson, 2008:62).

Access to finance for SMEs in SA is particularly acute. It has been and is still one of the major problems contributing to the slow development and high mortality rate of SMEs in the country (Hannig & Joubert, 2003:32). Investigating access to finance for SMEs in SA indicates that the challenges in accessing entrepreneurial finance are both supply and demand orientated.

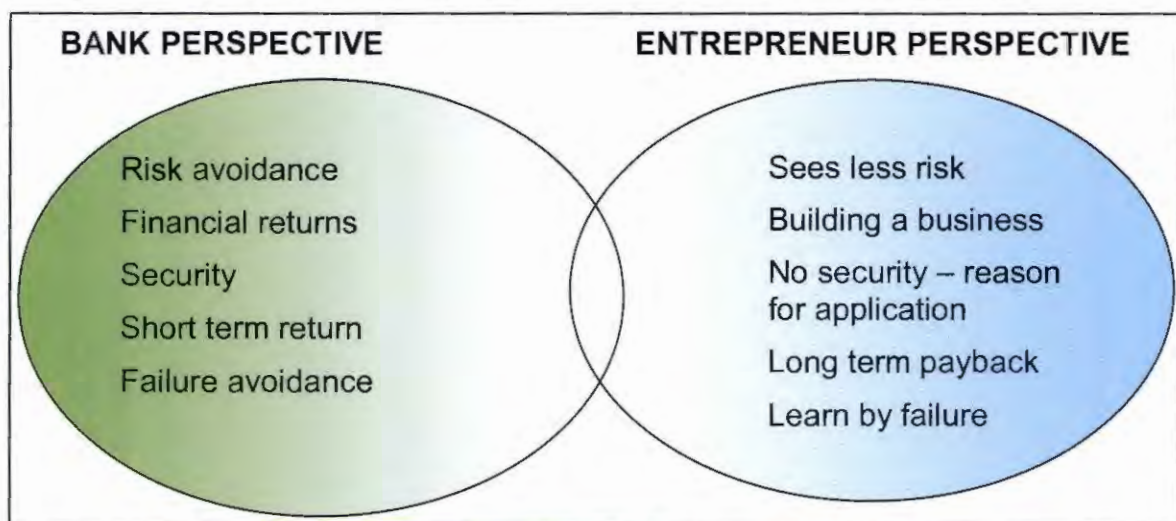
SA banks are typically accused of lending only to older, larger and mostly White owned companies while requiring collateral that is unaffordable from the small business person, particularly Previously Disadvantaged Individual (PDI) entrepreneurs (Berry *et al.*, 2002:74). Angela Motsa & Associates (2004: 42) similarly argue that commercial banks are "not geared towards financing entrepreneurs due to the fact that they (bank:s) developed in an economy dominated by large companies and thus do not have the skills set for assessing start-ups and small enterprises".

Banks on the other hand comment that financing SMEs is not a problem. The real problem is a dearth of commercially viable business projects and entrepreneurs (Pretorius & Shaw, 2004:222). SMEs further lack the necessary management skills, business experience and entrepreneurial attributes required to successfully access external finance (OECD, 2006:13).

Investigating the SME financing gap, the OECD study (2006:16) states that many researchers and policy analysts acknowledge that a financing gap exists between the supply of and demand for entrepreneurial finance. While there is no commonly agreed definition of the term financing gap, the term is basically used to imply that a sizeable portion of economically significant SMEs cannot obtain financing from banks, capital markets and other suppliers of finance (OECD, 2006:16).

It is found that there are underlying disparities between what entrepreneurs need and what banks or financial institutions are able to offer them (Foxcroft *et al.*, 2002:39-44). Pretorius and Shaw (2004:240) illustrate this gap by highlighting the differences in the perception of needs of banks to that of entrepreneurs as depicted in the figure below:

Figure 1: Differences in the perception of needs of banks and entrepreneurs



Source: Pretorius and Shaw (2004:240)

With financial institutions required by the Financial Sector Charter Council (Nedlac, 2002:9) to broaden SME access to finance on the one hand and the Department of Trade and Industry (DTI) placing strategic emphasis on improving access to finance through its Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprises (2005:7) on the other hand, the fundamental research question of this study is: How can financial institutions and SME support organisations (also referred to as business development service providers in this study) collaborate to improve SME access to finance in the North West Province (NWP) of South Africa?

1.4 RESEARCH OBJECTIVES

1.4.1 Primary objective

The primary objective of this study is to identify the obstacles that impede SME access to finance as well as establish how financial institutions and SME support organisations can effectively collaborate in order to improve access to finance for SMEs in the North West Province of South Africa.

1.4.2 Secondary objectives

The secondary objectives of this study are as follows:

- To determine the level (current and desired) of collaboration between financial institutions and SME support organisations in the NWP.
- To establish how financial institutions and SME support organisations can jointly intervene to improve the sharing of and availability of relevant information.
- To ascertain what interventions are necessary in order to improve the factors that inhibit SME access to finance.

1.5 RESEARCH METHOD

This research, pertaining to the above-mentioned objectives, consists of a literature review and an empirical study.

1.5.1 Literature review

The literature review is based on the fundamental research question of the study and forms the foundation of the study. The salient themes emanating from the literature review will recognize previously established research on the topic as well as provide the reader with background information pertaining to the research question and objectives.

To determine the factors that hinder SME access to finance, the author consulted relevant journal articles, government publications, reports, lectures, papers and research studies.

1.5.2 Empirical study

1.5.2.1 Research design

This study adopts a qualitative research paradigm and is exploratory in nature.

1.5.2.2 Participants

A target population is defined as the entire set of individuals or elements that meet the sampling criteria (Wegner, 2003:168). The target population for this explorative study is made up of financial institutions and SME support organisations either located in or servicing SMEs within the NWP of SA.

A sample is defined as a subset of the target population (Wegner, 2003:4). Sampling criteria refer to the characteristics that lead to the selection of the informant in the sample. The sampling criteria for this study is as follows:

- Organisations operating in or providing business development and support services to SMEs in the NWP;
- Organisations operating in or providing finance (debt and equity) to SMEs in the NWP;
- Participants should have the autonomy to take or influence decisions within their respective organisations; and
- Participants should have a minimum of one year of working experience as this would ensure that they are familiar with the dynamics pertaining to SME financing/lending or support/development.

Convenience sampling will be used in this study. Convenience sampling represents a sample drawn to suit the convenience of the researcher (Wegner, 2003:171). A sample of $n = 25$ was drawn from the following study population:

- Financial institutions
 - Loan/Debt Financing – Commercial Banks
 - Debt/Equity Financing – Development and Venture Finance Institutions
 - Debt/Equity Financing – Mining Houses

- SME support organisations
 - The Department of Trade and Industry and its relevant agencies such as the Small Enterprise Development Agency (SEDA) and Productivity-SA.
 - SME Development unit at the NW Department of Economic Development and Tourism (NW-DED&T) and its relevant agencies
 - Local Economic Development (LED) departments within local government structures
 - Mining houses providing SME support

1.5.2.3 Research instrument

The researcher has chosen the semi-structured interview technique as it allows the interviewer to pose a series of open ended questions pertinent to the topic. The questions on a semi-structured interview guide are pre-formulated, but the answers to those questions are open-ended. As a result, answers, at the discretion of the interviewer and interviewee, may be fully expanded upon and can be enhanced by probes (Hancock, 2002:10).

1.5.2.4 Data analysis

The semi-structured interviews sought to obtain qualitative data pertinent to the primary and secondary objectives of the study. Interviews were voice-recorded as recording ensures that the whole interview is captured and provides complete data for systematic analysis.

The study employed a six-step process for analysing qualitative data as prescribed by Creswell (2009:185). The rationale behind the six-step process is that it allows the researcher to identify, from the transcripts, the extracts of data that are informative and to sort out the important messages hidden in the mass of each interview.

1.6 CHAPTER DIVISION

The structure for the dissertation is as follows:

Chapter 1:

This chapter provides a comprehensive background to the study, the problem statement, fundamental research question and primary and secondary research objectives. This chapter also provides an overview of the research methodology that was used to determine how financial institutions and SME support organisations can collaborate in order to improve access to finance for SMEs in the NWP. This chapter concludes with a brief overview of the remaining chapters of the study.

Chapter 2:

This chapter is an article format. The literature review investigates previous research pertaining to SME finance with specific emphasis on the factors that impede SME access to finance as well as interventions that improve SME access to finance. An in-depth semi-structured interview technique was used in the empirical study to gather data pertinent to the primary and secondary objectives of the study. This chapter concludes by presenting the findings of the empirical study followed by recommendations.

Chapter 3:

In chapter 3, the primary and secondary objectives of the study are reviewed and the conclusions arrived at are discussed. Chapter 3 further presents the study limitations and recommendations for future research.

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CHAPTER 2

IMPROVING SME ACCESS TO FINANCE IN THE NORTH WEST PROVINCE OF SOUTH AFRICA

ABSTRACT

This study is aimed at providing empirical, qualitative evidence, concerning the factors within the supply, demand and institutional support environments that constrain SME access to finance as well as the interventions necessary to improve access to finance for SMEs in the North West Province (NWP) of South Africa.

The semi-structured interview technique was used to collect data from a sample of 25 organisations currently operating in or providing financial and/or non-financial services to SMEs in the NWP. A response rate of 56%, comprising two financial institutions and twelve SME support and development organisations participated in the study. Descriptive statistics in the form of frequency counts and percentages, together with a qualitative data analysis software package (Weft QDA) was used to analyse the data and interpret the results.

The findings of this study are consistent with and support the findings of previous local and international research exploring SME access to finance. The findings indicate that the SME sector in South Africa (SA) and more specifically, the North West Province (NWP) is characterised by a dearth of entrepreneurs, highly risk averse financial institutions, and a poorly functional support and development environment. The findings of the study indicate that any initiative aimed at improving SME access to finance needs to be holistic in approach and collaborative in nature.

The study will be of interest to policy makers, financial institutions and SME support and development organisations interested in SME financing and economic development. The results of the study contribute to the understanding of the current financing challenges facing SMEs and will assist financial institutions, SME support organisations and SMEs to better understand the role and importance of effective stakeholder collaboration in improving SME access to finance.

2.1 INTRODUCTION AND PROBLEM STATEMENT

The importance of the SME sector and the factors inhibiting the survival, development and growth of the sector continues to be at the forefront of policy debates in both developed and developing economies. Synonymous with this subject is the lack of access to finance for SMEs, which has received widespread attention and is well documented (Torre *et al.*, 2008:1).

Access to finance for SMEs has been identified in many business surveys and empirical studies (Maas & Herrington, 2006:13; Beck, 2007:3; Rogerson, 2008:63) as one of the most important factors influencing the development, survival and growth of the SME sector in both developed and developing economies. As a result, the financing of SMEs has received extensive attention in recent years and has become an important topic for economists and policy makers interested in financial and economic development (Torre *et al.*, 2008:1).

When financial institutions show little interest in lending to SMEs or when SMEs perceive a lack of willingness on the part of financial institutions to lend to them, they have little motivation and incentive to produce credible business accounts and operate transparently. Furthermore, entrepreneurs (specifically micro and small) conclude that their interests are better served by remaining in the informal sector owing to the excessive taxation and bureaucratic rigidity of the formal sector (OECD, 2006:42). Therefore, failing to improve access to finance and the conduciveness of the SME business environment, irrespective of whether the constraints are supply or demand related, will be detrimental to the growth and development of any country's SME sector.

Relating to the findings of the OECD study (2006:42), SA SMEs have a very negative perception of financial institutions and SME support organisations, including the SME business and regulatory environment (Maas & Herrington, 2006:18). In view of this, the study seeks to identify how financial institutions and Business Development Service (BDS) providers/SME support organisations can collaborate to improve access to finance for SMEs in the NWP of SA.

The study commences with a literature review, prior to discussing and presenting the findings of the empirical study. This chapter concludes by providing recommendations pertaining to improving SME access to finance in the NWP as per the outcomes of the empirical study.

In an effort to improve access to SME finance in the NWP, the literature study investigates the key factors that inhibit SME access to finance. As a result, the literature review forms the basis of the study.

2.2 LITERATURE REVIEW

2.2.1 Factors hindering SME access to finance

Studies investigating SME access to finance in both developed and developing economies by Van Eeden *et al.* (2004:3); Mutezo (2005:79) and Torre *et al.* (2006:8) have identified a range of factors (stringent lending criteria of financial institutions, lack of entrepreneurial and micro-finance skills within financial institutions, information asymmetry, excessive transactional costs, discrimination, SME lack of collateral and own capital contribution, SME lack of management and business skills, SME lack of investment readiness and poorly developed business plans, SME lack of access to and awareness of business information, lack of mentoring and assistance and lack of government support) within the supply, demand and institutional support environments that constrain SME access to finance.

Six factors consistently appear as the dominant factors that hinder access to finance for SMEs across these studies. Any intervention aimed at improving access to SME finance therefore requires a detail understanding of the cause-effect relationship of these factors

2.2.1.1 Information asymmetry

Nigrini and Schoombee (2002:737) define information asymmetry as a situation whereby prospective financiers and business partners are only partially informed or aware of the prospects of a business venture or opportunity. This situation leads to imperfections in the debt and equity markets, making it difficult for lenders and financiers to assess the quality of business and investment propositions. As a result, providers of finance are unable to quantify the level of risk involved in a particular business or investment opportunity and therefore experience difficulties in offering a discount or interest rate that accurately reflects the level of risk involved (HM Treasury, 2003:15-17).

Studies by Abereijo and Fayomi (2005:219); Malhotra *et al.* (2006:12); Beck, (2007:23); Ganbold (2008:11) and Torre *et al.* (2008:2) all found that information asymmetry, which is primarily caused by poor accounting records, lack of audited financial statements and inadequate access to SME information from credit bureaus, seriously constrain SME access to finance. Information asymmetry is regarded as the primary factor hindering SME access to finance as it raises the level of reluctance and risk aversion of debt and equity financiers.

Information asymmetry gives rise to factors such as high transaction costs (due to information gathering, screening and monitoring), excessive collateral requirements and higher risk premiums, all of which exacerbate SME access to finance (Beck & Demirgüç-Kunt, 2006:2936). This finding reveals, very clearly, that information asymmetry discourages financiers and investors from transacting with SMEs (due to perceived risk and exorbitant transactional costs) and prevents SMEs from seeking debt or equity financing (due to excessive collateral requirements and high discount rates).

The findings of studies investigating SME development and challenges in SA are not only consistent with the findings of the above-mentioned studies but also highlight information asymmetry as a major SME financing obstacle. Berry *et al.* (2002:68) found that accurately determining credit risks leads to disproportional transaction costs. While there is evidence of commitment to sharing of information on SME performance with reputable credit bureaus and authorities, credit providers identify the lack of credible and easily available information as a major constraint in providing credit to SMEs (Porteous, in Angela Motsa & Associates, 2004:45).

The credit reporting system in SA, although well developed and advanced is restricted to the first economy (Turner *et al.*, 2008:46). This is a particularly interesting finding as it serves to imply that, given the arguments and findings pertaining to issues of information asymmetries and the related impact thereof, the vast majority of SA SMEs will continue to experience challenges in accessing finance.

A rapidly expanding literature on SME finance (Beck & Demirgüç-Kunt, 2006:2940; OECD, 2006:28; Beck, 2007:20; Abereijo & Fayomi, 2005:222; Turner *et al.*, 2008:11) indicates that a well-developed credit information-sharing infrastructure and an extensive practice of credit reporting greatly improves access to finance, especially for SMEs.

Investigating the information asymmetry environment in SA, Turner *et al.* (2008:12-13) postulate that information sharing can contribute to the expansion of financial credit for SMEs. Without providing any specific information, this study mentions that although SME lending may face several hurdles, many projects and innovations in information sharing are underway, which promise to lower the costs and speed of risk assessments and improve lending.

2.2.1.2 Lack of collateral and own capital contribution

Most financial institutions make lending or financing decisions on the basis of criteria such as credit history, past bank account management, entrepreneurial track record, willingness to invest own money and evidence of re-payment capability based on the merits of the business or investment proposition (HM Treasury, 2003:15). However, due to information asymmetries, SMEs often encounter significant shortcomings in these criteria, which increase the risks and transaction costs of SME lending. This in turn results in financiers and lenders placing significant emphasis on the borrower's ability to provide sufficient collateral in order to secure the loan (Tagoe *et al.*, 2005:332).

The willingness and ability to provide collateral is not only an indication of a borrower's creditworthiness or confidence in the viability of the business/investment proposition, but also serves as a risk mitigating tool from a lenders perspective (OECD, 2006:52). The provision of collateral ensures that the borrower bears some risk of loss and that the lender is provided with an alternative source of repayment should the borrower not be able to meet its financial obligations or go insolvent (Nigrini & Schoombee, 2002:737).

While the provision of collateral enables many businesses to secure debt finance, this approach to SME lending creates difficulties for entrepreneurs who lack suitable assets to offer. In this regard, the primary reason given for rejecting SME loan applications is lack of collateral and own capital contribution (OECD, 2006:46). The findings of similar studies conducted by Beck (2007:5); Tagoe *et al.* (2005:332) and Abereijo and Fayomi (2005:222) indicate that lack of collateral is a universal phenomenon restricting SME access to finance

Investigating the challenges and obstacles facing the SME sector in SA, the findings of studies conducted by Angela Motsa and Associates (2004:17); Van Eeden *et al.* (2004:10) and Clover and Darroch (2005:256) reveal that the lack of collateral and own capital

contribution is one of the greatest factors hindering SME access to finance. Investigating the role and importance of the business plan in the decision-making process of banks, Pretorius and Shaw (2004:237) found that while SA commercial banks place significant emphasis on the importance of a bankable business plan, the decision to provide a loan is based entirely on the borrower's creditworthiness and ability to provide collateral.

The findings of more recent studies (A-Cubed Consulting, 2006:44-45; Rogerson, 2008:66) are not only consistent with the findings of the above-mentioned studies but also indicate that SA commercial banks lack an appetite for risk and are not forward looking or orientated. To this end, loan applications are rejected on the basis of insufficient collateral, regardless of the viability or potential of the prospective borrower's venture (Pretorius & Shaw, 2004:237).

The typical SME lending environment favours borrowers with collateral rather than those with viable business projects. This obviously poses a serious problem, particularly for start-ups and other relatively young enterprises (OECD, 2006:61). In response to this constraint, governments around the world have resorted to providing credit guarantees in order to facilitate and enhance SME access to finance (Wattanaputtipaisan, 2003:80).

While differences of opinions exist as far as the operational effectiveness of credit guarantee schemes are concerned, a number of studies (Nigrini & Schoombee, 2002:749; Wattanaputtipaisan, 2003:80; OECD, 2006:61) reveal that government credit guarantee schemes is an important policy measure as it improves access to finance for SMEs.

2.2.1.3 Lack of investment readiness and poor quality of business plans

The importance of a bankable business plan is vital to successfully securing debt or equity financing for any business. The business plan is therefore perceived as the most essential document to be prepared by the entrepreneur throughout the business and academic world (Pretorius & Shaw, 2004:224).

The purpose of a business plan is to carefully articulate the realisation of a potential opportunity as well as its merits, requirements, risks and potential rewards. Although financiers and lenders place greater emphasis on creditworthiness and the ability to provide collateral, the business plan serves as the point of departure for prospective financiers and

lenders to begin their due diligence in order to ascertain the potential as well as the various risks of a business (Timmons & Spinelli, 2007:223-224).

Studies by the HM Treasury (2003:15-18); OECD (2006:28); Torre *et al.* (2008:43) and Abereijo and Fayomi (2005:225) found that there is often a contrast between SMEs that complain of a lack of availability of finance, and financiers and lenders who simultaneously complain of a dearth of bankable/investment-ready projects and the inability of entrepreneurs to present a business plan that meets their requirements.

The situation in SA with regard to a lack of investment readiness and poor quality of business plans is no different. The findings of studies by Berry *et al.* (2002:68); Angela Motsa and Associates (2004:17); Van Eeden *et al.* (2004:7-12); Clover and Darroch, (2005:243); A-Cubed Consulting (2006:45) and Maas and Herrington (2007:38) indicate that the lack of access to finance for most SMEs is exacerbated by the inability to provide a business plan that meets the requirements of financiers and lenders. An equally important factor that prevents SMEs from securing finance is the submission of business plans that have been entirely developed by business consultants. This weighs negatively on the application as most banks, for obvious reasons, disapprove of this practice (Pretorius & Shaw, 2004:234)

2.2.1.4 Lack of entrepreneurial and management skills

Entrepreneurship is defined as a way of thinking, reasoning and acting that is opportunity obsessed, holistic in approach and leadership balanced. Successful entrepreneurs further possess excellent business management skills, experience and know-how (Timmons & Spinelli, 2007:79).

Access to finance is undoubtedly linked to entrepreneurial skills and business management competencies. Pretorius and Shaw (2004:224) found that when appraising a business plan, financiers and lenders always consider risk as a prime factor, together with the management skills and expertise of the applicant. This finding substantiates the argument that a lack of entrepreneurial and management skills hinders SME access to finance in SA and is consistent with the findings of studies conducted by Berry *et al.* (2002:96); Angela Motsa and Associates (2004:57); Van Eeden *et al.* (2004:11); Clover and Darroch (2005:255); Maas and Herrington (2006:19) and Rogerson (2008:70).

The above-mentioned studies all found that SA SMEs lack sufficient entrepreneurial skills, business acumen and appropriate management experience. This increases the risk perception of lenders and financiers and thus hinders SME access to finance. Although there is evidence indicating that SMEs are constrained by a lack of access to finance, the supply of finance is actually constrained by management weaknesses and poorly presented business plans that do not meet the requirements and standards of financiers (Malhotra *et al.*, 2006:14; Orford & Wood, 2005:32).

2.2.1.5 Lack of access to and awareness of business information

Business information is defined as the conversion and packaging of raw data into a format that easily enables the user to make a decision pertaining to a business need (Thomas & Ballard, in Chiware, 2008:25). Access to and awareness of business information has been identified as an impediment to SME growth and development (Chiware, 2008:1).

SMEs, particularly in developing economies, are not only unaware of the existence of national business information but are also discouraged from using it due to the cumbersome procedures involved in accessing the information (UNIDO, 2003:3). A study investigating the SME financing gap reported that SME surveys in all countries indicate that poor information about the different financing options constitutes a barrier to finance (OECD, 2006:27).

Lack of access to and awareness of business related information is an important factor hindering access to finance for SMEs in SA. Studies undertaken in SA reveal that both emerging and established SMEs are generally unaware of the existence of SME support initiatives, especially the Khula credit guarantee scheme (Berry *et al.*, 2002:39). Women entrepreneurs have a poor understanding of financial terminology and lack awareness of different financial products and credit processes (Rogerson, 2008:65) and SMEs in the agri-business sector in Kwazulu-Natal lack an understanding of loan application procedures (Clover & Darroch, 2005:242).

SMEs therefore might not be constrained by a lack of access to finance but rather by issues of knowing where to access it, how to access it and how to use it once it has been accessed (Chiware, 2008:136).

2.2.1.6 Inefficient institutional support environment

The challenges experienced by SA SMEs have been appropriately acknowledged by government through its SME development and intervention policies. In this regard, the Department of Trade and Industry's (DTI) strategy on the promotion of entrepreneurship and small enterprises (2005:4) is based on three strategic pillars (increase the supply of financial and non-financial support services, creating demand for small enterprise products and services, and reducing small enterprise regulatory constraints) and underpinned by efforts to improve the availability of quality business information and knowledge through expanded research and communication outreach.

The impact of these strategies and related interventions have, however, been questioned by researchers, policy analysts and stakeholders alike (Angela Motsa & Associates, 2004:37; Clover & Darroch, 2005:256). Berry *et al.* (2002:45) argue that in addressing the challenges faced by SA SMEs, originally well-intended and supportive policy measures suffer from sub-optimal implementation. Substantiating this argument, Berry *et al.* (2002:39-40) found that the SME institutional support network in SA is characterised by poor information dissemination and outreach, interventions that are not informed by or targeted to the actual needs and requirements of SMEs, high information search costs and high levels of bureaucracy and red tape.

The 2004 Global Entrepreneurship Monitor (GEM) reported that a national survey of small enterprises conducted in 2004 provides, for the first time, overwhelming confirmation that the SA government is failing to reach most small enterprises. According to the survey, small enterprises are either unaware of or do not use the services offered by government. Where they do use government support, small enterprises are sceptical about the quality of the support received (Orford, Herrington & Wood, 2004:45-49). The 2006 GEM once again revealed that government support for entrepreneurs is perceived as underdeveloped (Maas & Herrington, 2006:18).

The findings of the 2004 and 2006 GEM are consistent with that of a 2006 World Bank report prepared for the DTI. The report was critical of government programmes such as the Khula credit guarantee scheme and Small Medium Enterprise Development Programme (SMEDP) incentive, and revealed that businesses expressed concern about accessibility and bureaucracy pertaining to entrepreneurial support (World Bank, in Rogerson, 2008:70).

The deficiencies inherent within the institutional support environment can therefore be regarded as an important factor exacerbating SME access to finance. SMEs are clearly not receiving the necessary developmental support and assistance required to improve its circumstances and enhance its ability to easily access finance.

2.2.2 Importance of partnerships and collaboration

Although the business environments in developing countries differ in many aspects from that of developed countries, the problems of servicing SMEs are similar namely, high perceived risk, information asymmetries and high administrative costs (Abereijo & Fayomi, 2005:222). Successful and recent innovations in developed countries aimed at improving SME access to finance, can however provide valuable insights for financial and support organisations in developing economies to become more SME-oriented and to increase the volume of financing and quality of their services to this sector (Abereijo & Fayomi, 2005:222).

It is noted from the experiences of financial institutions in developed countries that the provision of SME finance is closely linked to the delivery of business development services so as to improve the sustainability of SME businesses and its ability to repay loans (Abereijo & Fayomi, 2005:226). Initiatives undertaken by banks to better serve the SME sector include cooperating with SME support organisations in order to reduce the risks and costs associated with the financing of SMEs (Ganbold, 2008:13).

Research undertaken by Sievers and Vandenberg (2007:1350) indicate that SMEs that have received business development services (BDS) such as skills development, management training and marketing support achieved better business results, which in turn allowed them to access finance more easily and with longer maturities. As a result, linkages between financiers and BDS providers lead to mutually beneficial relationships for both parties and greatly benefits SMEs

Improving SME access to finance requires commercial banks, micro-credit institutions, organised business associations and BDS providers to work closely together (OECD, 2006:119). This recommendation is consistent with the findings and recommendations of studies (Angela Motsa & Associates, 2004:58; Rogerson, 2008:68; Beck & Demirgüç-Kunt, 2006:18; Wattanapruttipaisan, 2003:85) investigating SME access to finance and the

challenges constraining the SME sector. Accordingly, the former Deputy Minister of the Department of Trade and Industry (DTI), Lindiwe Hendricks (2002), in a speech made at an SME road show stated that “with proper referral systems and information dissemination we will find that businesses end up in the right place for the support that they need”.

2.3 RESEARCH METHODOLOGY

The research in support of the study consists of a literature review and an empirical study.

2.3.1 Literature review

The literature review conducted in this study is based on the fundamental research question of the study and forms the foundation of the investigation. The salient themes emanating from the literature review recognizes previously established research on the topic and provides the reader with background information pertaining to the research question and objectives. In order to determine the factors that hinder SME access to finance as well as the interventions that improve SME access to finance, the author consulted relevant journal articles, various government publications and reports, and research reports related to the topic.

2.3.2 Empirical study

2.3.2.1 Research design

This study adopts a qualitative research paradigm and is exploratory in nature.

- **Qualitative:** Qualitative research methods mainly use open-ended techniques such as interviews to collect data and non-statistical techniques to analyse it (Marczyk *et al.*, 2005:17). As such, qualitative research is concerned with the opinions, experiences and feelings of individuals and produces subjective data. Qualitative research can thus expand our knowledge about the variations in human behaviour (Hancock, 2002:2). This empirical study lends itself well to a qualitative paradigm as it aims to identify the factors that constrain SME access to finance as well as determine the current and desired level of collaboration between financial institutions and SME support organisations with a view to improving access to SME finance in the NWP.

- **Explorative:** One of the characteristics of a qualitative research design is that it is explorative. Exploratory research is designed to explore ideas and gain insights in order to obtain a proper definition of problems at hand and is therefore appropriate to any problem about which very little is known (Creswell, 2009:18). This empirical study will adopt an exploratory approach in order to gain insight into how finance for SMEs in the NWP can be improved.

2.3.2.2 Population and sampling frame

Two distinct populations were targeted in the current study, namely financial institutions (commercial banks, development finance institutions and venture capital companies) and SME support and development organisations from both the private and public sectors.

The convenience sampling method was used in this study. According to Wegner (2003:171), convenience sampling represents a sample that is drawn to suit the convenience of the researcher. Given the nature of the study population, a sample of twenty five (25) organisations (as depicted in Table 2) operating in the NWP was drawn. The characteristics that lead to the selection of the informant in the sample was based on the respondent having a minimum of one year of working experience as this would ensure that the respondent is fairly familiar with the dynamics pertaining to SME financing or support. Respondents were further required to have the autonomy to take or influence decisions within their respective organisations.

Table 2: Study sample size

TYPE OF ORGANISATION	NO
Commercial banks	4
Development finance institutions	4
Venture capital organisations	4
SME development and support (Public sector – 6) (Private sector – 7)	13
TOTAL n	25

2.3.2.3 Data collection and research instrument

In order to determine the factors that hinder SME access to finance and the interventions necessary to improve SME access to finance as perceived and experienced by financial institutions and SME support organisations in the NWP, the researcher developed a research instrument in the form of a structured questionnaire. The researcher chose the semi-structured interview technique to gather qualitative data as it allows the interviewer to pose a series of open-ended questions which may be fully expanded upon and enhanced by probes (Hancock, 2002:10).

In order to ensure the reliability and validity of the data, a pilot study preceded the actual semi-structured interviews. The pilot study was conducted with a Senior Investment Associate from a development finance institution and a Chief Director from a Provincial government department responsible for Enterprise Development. Only minor modifications were made to the research instrument after the pilot phase of the study.

Respondents for the actual study were identified via the Invest North West (INW) strategic alliance database and contacted telephonically. In order to solicit participation in the study the researcher explained the relevance and objectives of the study and ensured potential respondents of anonymity and confidentiality. The questionnaire contained open-ended questions as well as questions that required Likert scale responses. The semi-structured interviews were conducted at the respondents' place of employment and took approximately 25 to 30 minutes to complete.

The questionnaire consisted of three sections and was structured as follows:

Section 1: Biographic information

This section used close-ended questions to gather specific information of respondents such as designation, highest qualification, number of years of experience in SME financing/lending and or development/support, type of organisation represented and the types of services provided to SMEs in the NWP.

Section 2: Obstacles hindering SME access to finance

Section two of the questionnaire used both open and closed-ended questions to gather information pertaining to the perceptions of respondents with regard to the importance of a vibrant SME sector and the conduciveness of the SA SME business and regulatory environment. This section of the questionnaire also gathered data relating to the factors within the supply, demand and institutional support environments that constrain SME access to finance.

Section 3: Improving SME access to finance

The last section of the questionnaire consisted of both open and close-ended questions and aimed to identify the existence of any collaboration or partnership initiatives between financial institutions and SME support organisations in the NWP. This section of the questionnaire further focused on ascertaining the opinions of respondents pertaining to how financial institutions and SME support organisations in the NWP can collaborate to address the factors that constrain SME access to finance and the extent to which these interventions will improve SME access to finance.

2.3.2.4 Responses

The final data representation consisted of 14 responses indicating a 56% response rate. Twelve (86%) of the semi-structured interviews were face-to-face interviews while two (14%) were telephonic interviews.

2.3.2.5 Data analysis

Data analysis with respect to the Likert scale questions in the study is limited to descriptive statistics in the form of frequency counts and percentages.

A six-step process for analysing qualitative data as prescribed by Creswell (2009:186) was employed to analyse the data gathered from the semi-structured interviews. The rationale behind this process of analysing qualitative data is that it allows the researcher to identify,

from the transcripts, the extracts of data that are informative and to sort out the important messages hidden in the mass of each interview (Creswell, 2009:185).

The semi-structured interviews were voice recorded and the data was first manually analysed in order to identify emerging patterns and recurring themes. Thereafter, the data was analysed using the Weft QDA software package. Weft QDA is a software tool for the analysis of textual data such as interview transcripts, documents and field notes and is available free under a public domain licence.

Because the data obtained is primarily qualitative and due to the exploratory nature of the study, in-depth statistical analysis of the data collected at this stage will not have any significant value.

2.4 RESEARCH FINDINGS

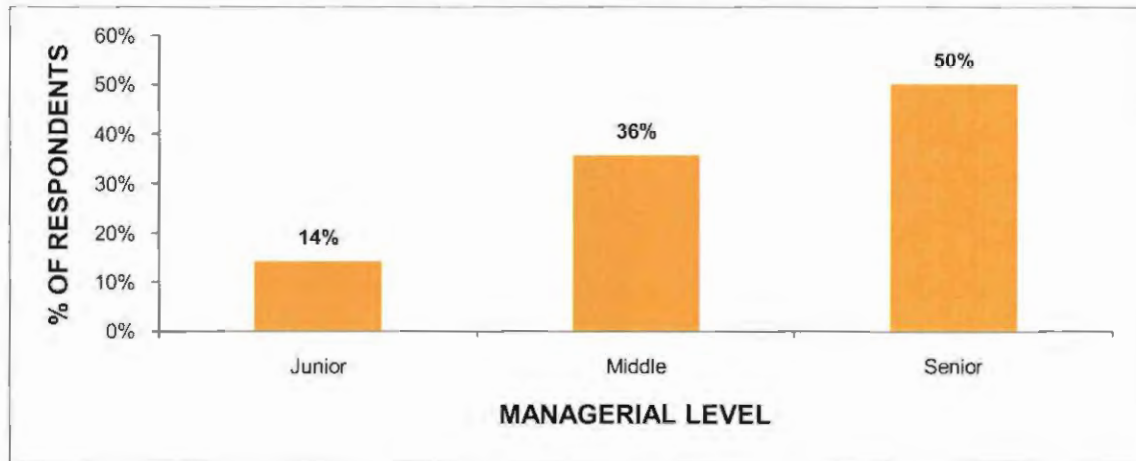
The primary objective of this study was to identify the obstacles that hinder SME access to finance as well as determine how financial institutions and SME support and development organisations can effectively collaborate to improve access to finance for SMEs in the NWP of SA. This section reports on the findings of the semi-structured interviews conducted and provides an analysis of the data gathered.

2.4.1 Section 1: Biographic profile of respondents

2.4.1.1 Designation

The designations of respondents in the study varied from Regional Managers to Business Analysts to SME Coordinators. Given this wide range of designations, the researcher asked respondents to also indicate their respective managerial levels. Two respondents in the study (14%) represent junior management, five (36%) represent middle management and seven (50%) represent senior management

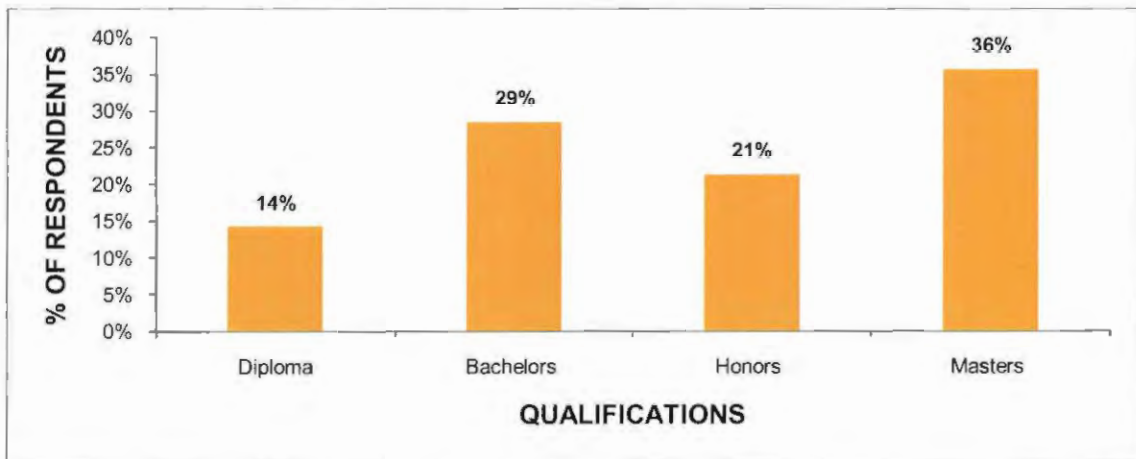
Figure 2: Managerial levels of respondents



2.4.1.2 Qualifications

The majority of respondents in the study hold either a graduate or a post-graduate qualification. In this regard, five respondents (36%) hold a Masters Degree, three (21%) hold an Honours Degree and four (29%) hold a Bachelors Degree. Only two respondents (14%) indicated a Diploma as the highest level of qualification obtained

Figure 3: Qualification levels of respondents



2.4.1.3 Number of years in current post

Table 3: Number of years in current post

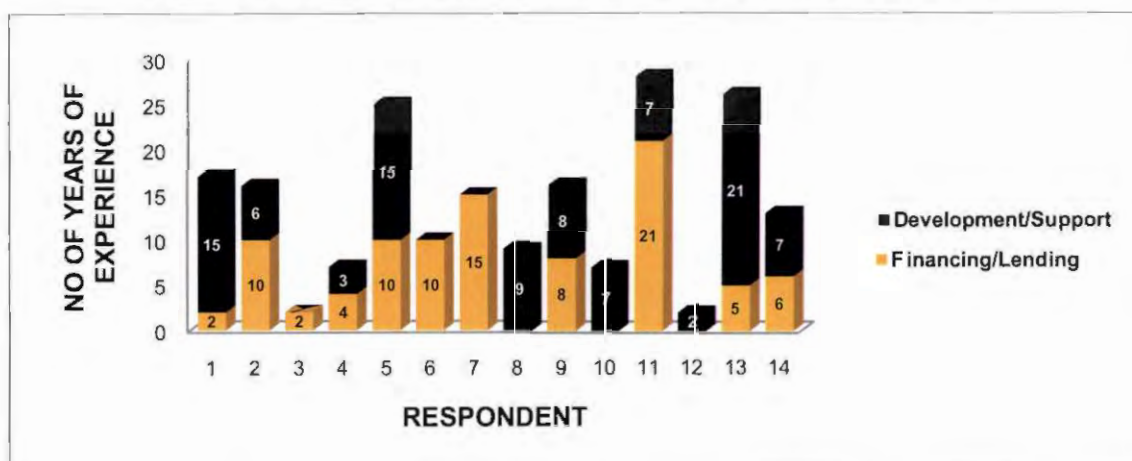
No of Years in Current Post	Absolute Frequency	Relative Frequency (%)
1 < 3	5	36%
3 < 6	4	29%
6 < 9	3	21%
9 < 12	2	14%
Total	14	100%

Table three (Appendix 1, Question 1.1) indicates that the profile of respondents with respect to the number of years of experience in SME financing/lending or development/support conforms to the sampling criteria of the study. The majority of respondents (64%) were in their current posts for longer than three years.

2.4.1.4 Number of years of experience

Eight respondents (57%) indicated that their careers (which varied from seven to twenty-eight years with an average of eighteen years) had exposed them to both SME financing/lending and SME development/support. As a result, they were fully conversant with the challenges experienced by SMEs from both a finance and support/development perspective. Three respondents (21%) indicated that they had two, ten and fifteen years of SME financing/lending experience only, while the remaining three respondents (21%) indicated that they had two, seven and nine years of SME development and support experience only. The following figure illustrates the number of years of experience in SME financing/lending and development/support per respondent.

Figure 4: Number of years of experience working with SMEs



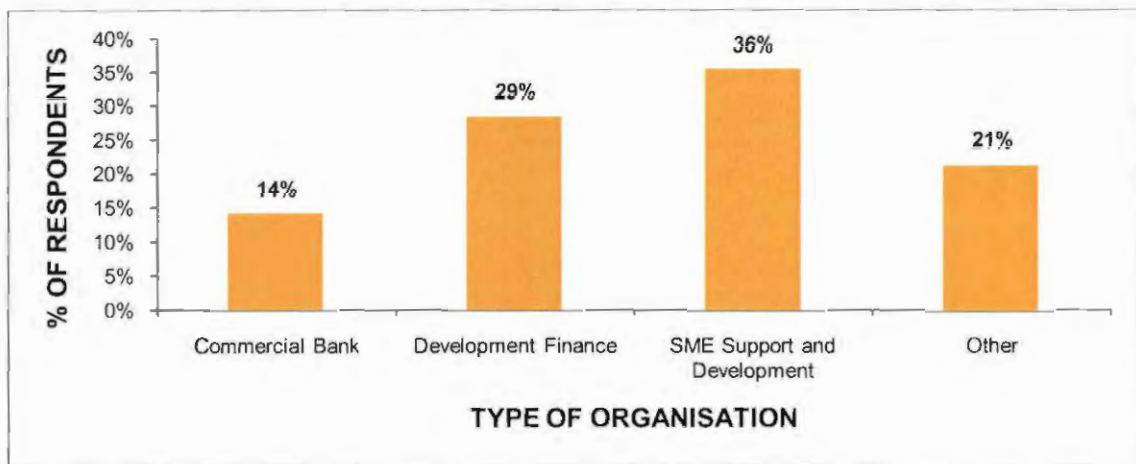
2.4.1.5 Type of organisation represented

Table 4: Organisation representation

Type of Organisation	Number of Respondents	Percentage of Total
Commercial bank	2	14%
Development finance	4	29%
SME support and development	5	36%
Other	3	21%
Total	14	100%

Three respondents (21%) depicted as 'other' in Table 4 (Appendix 1, Question 1.2) represent organisations such as mining houses and local and district municipalities that have dedicated departments focusing on SME development and support.

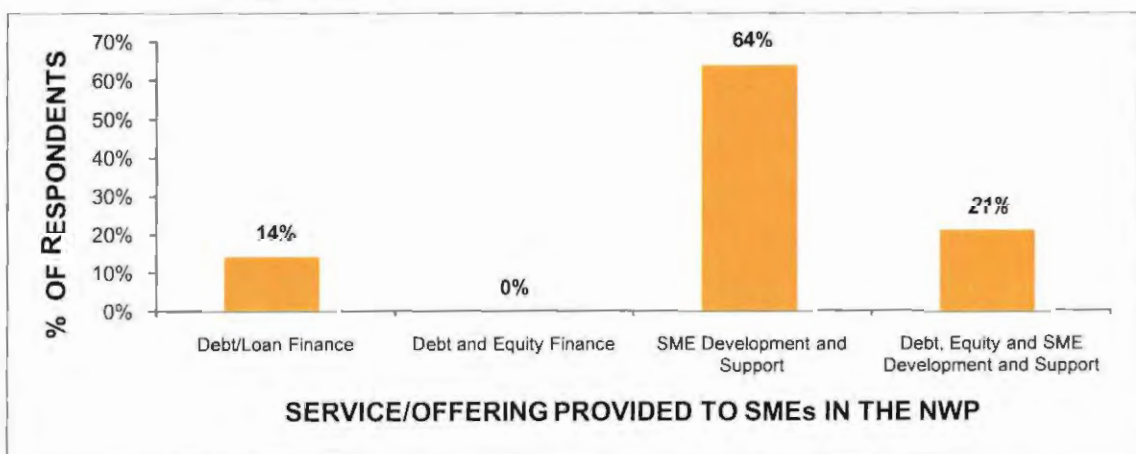
Figure 5: Organisation representation



2.4.1.6 Type of service/offering provided to SMEs in the NWP

Two respondents (14%) indicated that the key function of their departments within their respective organisations is to provide SMEs with debt finance only. Nine respondents (64%) indicated that services provided by their respective organisations is limited to SME support and development while the remaining three respondents (21%) indicated that they were mandated to provide SMEs with both debt and equity finance as well as support and development

Figure 6: Services provided to SMEs in the NWP



It is interesting to note that that the organisations providing both debt and equity finance, namely three of the four development finance institutions, are involved in all aspects of the SME financing and development value chain.

2.4.2 Section 2: Obstacles hindering SME access to finance

2.4.2.1 Importance of the SME sector

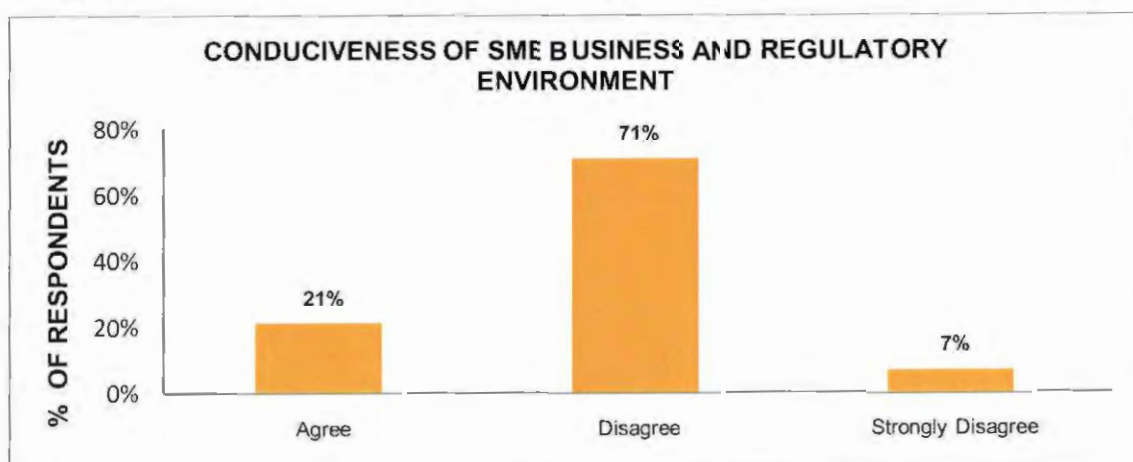
A 100% of the respondents strongly agreed with the statement “A vibrant SME sector is crucial for SA's economic growth, industrial development and job creation”. This response is consistent with the literature review and indicative of the fact that the opinions concerning the importance of the SME sector is uniform across both developed and developing economies.

2.4.2.2 Conduciveness of the SME business and regulatory environment

The majority of respondents (71%) disagreed while 7% strongly disagreed with the statement pertaining to the conduciveness of the SA business and regulatory environment for SME growth and development. Respondents characterised the SA SME business and regulatory environment as highly bureaucratic, inflexible and rigid with regard to its labour laws, tax regime and business registration procedures. The recently introduced National Credit Act (NCA) also featured prominently among the list of factors rendering the SA SME business and regulatory environment as unfavourable.

Only three respondents (22%) found the SA business and regulatory environment conducive for SME development and growth.

Figure 7: Conduciveness of the SME business and regulatory environment



2.4.2.3 SME access to appropriate finance

Two respondents (14%) agreed with the statement “SMEs in SA have easy access to affordable and appropriate finance, which enables them to operate efficiently and grow”. The remaining twelve respondents (86%) either disagreed or highly disagreed with this statement.

This response is consistent with the literature reviewed and indicates that finance for SMEs in SA is not easily accessible (they don’t get it when they need it), is not appropriately priced (very high risk premium) and is not aimed at the actual needs and requirements of SMEs (long term vs. short term).

2.4.2.4 Demand-side factors constraining SME access to finance

A. Information asymmetry

As much as 79% of respondents indicated that information asymmetry, arising from poor accounting records, lack of audited financial statements and inadequate access to SME information from credit bureaus is a major constraint while 14% regarded this factor as a medium constraint. Only 7% considered this factor to be a low constraint.

B. SME lending/financing risks

More than half, 57% of respondents indicated that the perceived high risk profile of SMEs served as a major financing constraint while 36% regarded this factor as a medium constraint. Only 7% of respondents considered this factor to be a low constraint.

C. SME lending/financing transactional costs

Similarly, 57% of respondents indicated that the costs associated with lending to or financing SMEs, relative to the size of loan or value of investment, served as a medium constraint while 36% of respondents regarded this factor as a low constraint. A mere 7% of respondents indicated that the costs associated with administering SME transactions are excessively high and therefore regarded this factor as a major constraint.

D. Investment-ready projects and bankable business plans

As much as 70% of respondents indicated that the inability of SMEs to produce business plans that meet standard requirements as well as the poor availability of investment-ready projects is a major constraint hindering SME access to finance. The remaining 30% of respondents considered this factor to be a medium constraint.

E. SME skills, management competencies and business experience

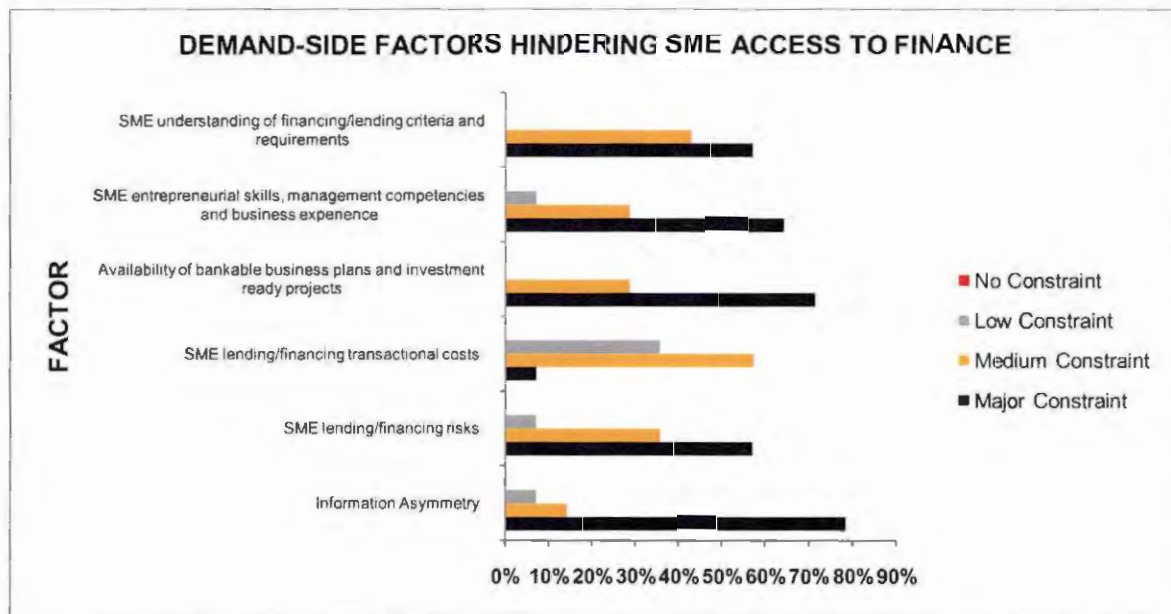
Some 64% of respondents indicated that SMEs lacked the necessary skills, management competencies and business experience required to access finance or attract investment into their businesses. As such, they regarded this factor as a major constraint; 29% of respondents considered this factor as a medium constraint while 7% deemed this factor to be a low constraint.

F. SME understanding of financing/lending criteria and requirements

Some 57% of respondents considered the lack of SME understanding of financing/lending criteria and requirements as a major factor hindering SME access to finance, and 43% of respondents regarded this factor as a medium constraint.

Figure 8 illustrates the demand-side factors hindering SME access to finance.

Figure 8: Demand-side factors hindering SME access to finance



2.4.2.5 Supply-side factors constraining SME access to finance

A. Lending criteria and level of risk averseness of financial institutions

The majority of respondents (93%) indicated that the stringent lending criteria and high level of risk averseness of financial institutions are major constraints hindering SME access to finance. The remaining 7% of respondents regarded this factor as a medium constraint.

B. Entrepreneurial and micro-finance skills within financial institutions

Some 43% of respondents regarded the entrepreneurial and micro-finance skills of staff within commercial banks and development finance institutions as a medium constraint. Only 29% felt this factor was a major constraint while the remaining 29% considered this factor to be a low constraint.

C. Loan application processes and procedures of financial institutions

Half of the respondents (50%) felt that the loan and finance application processes and procedures of financial institutions are moderately cumbersome. As a result, they rated this

factor as a medium constraint. However, 29% considered this factor to be a major constraint while 21% regarded this factor as a low constraint.

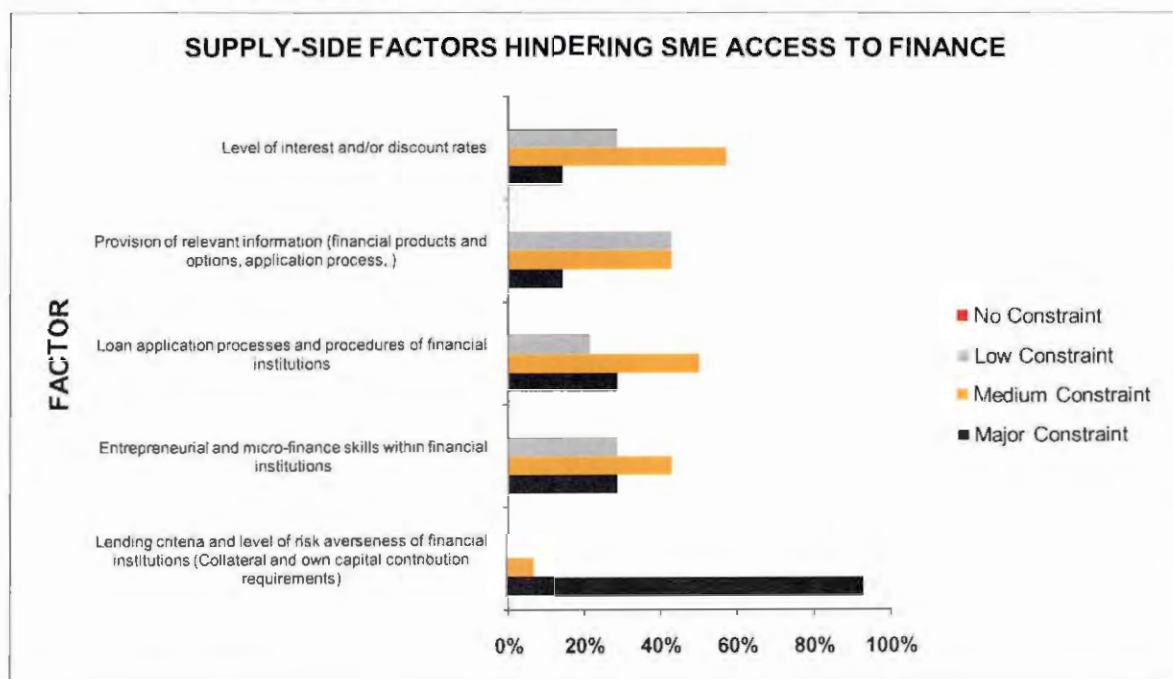
D. Provision of relevant information (products, options, application processes)

Some 43% of respondents indicated that there was a concerted effort by commercial banks and development finance institutions to provide its clientele with relevant information pertaining to respective services and product offerings. They therefore regarded this factor as a low constraint inhibiting SME finance. Another 43% of respondents regarded this factor as a medium constraint while only 14% considered this factor to be a major constraint.

E. Level of interest and/or discount rates

The majority of respondents (57%) indicated that the pricing structure (interest and discount rates) of financial institutions was a medium constraint hindering SME access to finance. Another 29% of respondents regarded this factor as a low constraint while the remaining 14% deemed this factor as a serious deterrent and rated it as a major constraint.

Figure 9: Supply-side factors hindering SME access to finance



2.4.2.6 SME support environment factors constraining access to finance

A. Functioning of risk and collateral mitigating interventions

Some 50% of respondents indicated that this factor was a major constraint as the functioning of schemes aimed at addressing SME financing/lending risks and collateral requirements were highly ineffective. Another 29% of respondents regarded this factor as a medium constraint while 7% considered this factor to be a low constraint.

It is interesting to note that 14% of respondents indicated that their organisations placed absolutely no emphasis on collateral and therefore did not consider this factor as a constraint. These respondents, however, indicated that their respective organisations embark on a very comprehensive due diligence process in order to minimise its risk exposure and validate the business concept or investment opportunity.

B. Provision and availability of relevant business information

The majority of respondents (57%) indicated that while some SME support and development organisations were improving on their information dissemination mandate, a few organisations remain inefficient in this regard. They therefore regarded this factor as a medium constraint. Another 36% of respondents, however, regarded this factor as a major constraint while the remaining 7% considered this factor to be a low constraint.

C. Effectiveness of SME outreach programmes

Some 50% of respondents indicated that the level of effectiveness of SME outreach programmes served as a major constraint inhibiting SME access to finance while 43% regarded this factor as a medium constraint. The remaining 7% of respondents deemed this factor to be a low constraint.

D. Provision of targeted SME support and development interventions

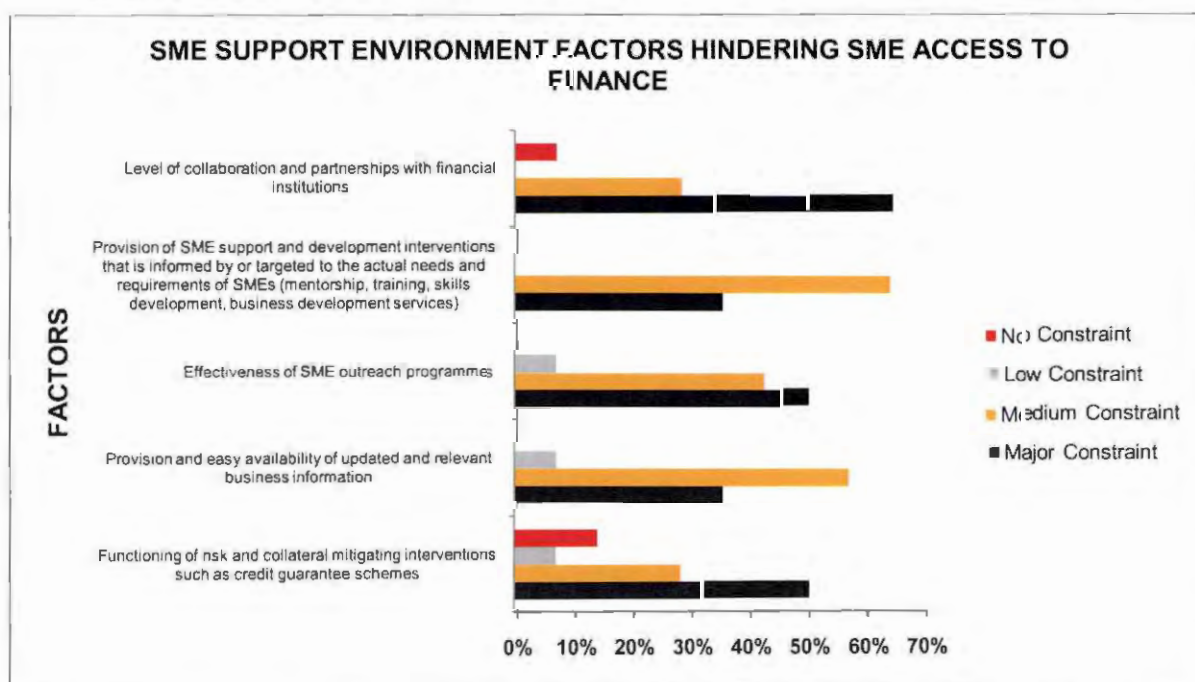
As much as 64% of respondents positively acknowledged SME development interventions such as skills development programmes, mentorship initiatives and business development

services. They however indicated that these interventions adopted a one size fits all approach and therefore regarded this factor as a medium constraint. The remaining 36% regarded this factor as a major constraint indicating that current SME support and development interventions do not address the actual needs and requirements of SMEs.

E. Level of collaboration and partnerships with financial institutions

The majority of respondents (64%) consider the current level of collaboration and partnerships between SME support organisations and financial institutions as a major constraint negatively impacting upon SME access to finance. Another 29% of respondents regarded this factor as a medium constraint while only 7% deemed this factor to be of no constraint. Figure 10 illustrates the supply-side factors hindering SME access to finance.

Figure 10: Support environment factors hindering SME access to finance



2.4.3 Section 3: Improving SME access to finance

2.4.3.1 Importance of collaboration in improving SME access to finance

The majority of respondents (79%) strongly agreed while the remaining 21% agreed with the statement “collaboration between financial institutions and SME support organisations is imperative to improving access to finance for SMEs in the NWP”. In substantiating their

answers, respondents indicated that collaboration between financial institutions and SME support organisations will result in the following benefits and advantages:

- Collaboration will ensure that the SME receives complete advice and assistance from respective organisations thus avoiding the need to move to and fro between different organisations.
- Collaboration will enable both financial institutions and SME support organisations to synchronise its SME financing, development and support efforts.
- Collaboration will enhance product development within respective organisations by ensuring that new product development will be mutually beneficial and supported by respective stakeholders.
- Collaboration will improve the likelihood of syndication and will lead to organisations jointly embarking on SME initiatives resulting in more efficient utilisation of resources.
- Collaboration will result in all stakeholders sharing the same vision pertaining to SME growth and development.

2.4.3.2 Existence of collaboration and partnership initiatives in the NWP

Table 5: Existence of stakeholder collaboration initiatives

Availability of Current Collaboration Initiatives	Absolute Frequency	Relative Frequency (%)
Yes	4	29%
No	3	21%
Not Sure	7	50%
Total	14	100%

Table 5 (Appendix 1, question 3.2) indicates that 50% of respondents were not sure of the existence of any collaboration or partnership initiatives between financial institutions and SME support organisations in the NWP while 21% indicated that no such initiatives currently existed.

Altogether 29% of respondents indicated that they were aware of collaboration and partnership initiatives between commercial banks and state funded SME support organisations in the NWP. Another 14% of these respondents, however, indicated that these

initiatives are ineffective while the remaining 15% indicated that they were doubtful of the impact of these initiatives

2.4.3.3 Current effective referral systems in the NWP

The majority of respondents (57%) indicated that there is currently no referral systems between financial institutions and SME support organisations while 36% indicated that they were not sure if any such referral system existed. Only one respondent (7%) indicated that his organisation continuously refers but there was no reciprocation on the part of financial institutions.

2.4.3.4 Collaborating to improve the functioning of credit guarantee schemes

All of the respondents indicated that collaboration is vital to improving the general state of SME access to finance. The interventions in respect of question 3.4 therefore also applies to the questions posed in 3.5 (2.4.3.5) to 3.7 (2.4.3.7) of the questionnaire.

The most consistent and recurring theme emanating from the discussion indicated that there should be a formal system (in the form of a bilateral agreement or Memorandum of Understanding) linking financial institutions and SME support organisations. The primary objective of such an agreement should be to obtain broad based support for advancing the cause of SME growth and development. In order to improve SME access to finance, the Memorandum of Understanding (MoU) should culminate in and focus on the following:

- Establishment of a forum that is SME led and fully representative of all other stakeholders;
- A forum that meets regularly to discuss all issues affecting SMEs as well as the organisations responsible for financing, supporting and developing them.
- Coordinated planning between different organisations;
- Development of a database that will allow all stakeholders to easily identify the roles and responsibilities of respective organisations; and
- Enhanced support for the development of intermediary service providers with an emphasis on post-loan support.

Another interesting argument emanating from the discussions is the fact that credit guarantees are currently used in a bankable environment for clients who are generally not bankable. Hence the functioning of credit guarantees is ineffective and not tailor-made to benefit SMEs. To improve guarantee schemes, it is imperative to partner with development finance institutions as they focus on non-bankable clients.

2.4.3.5 Collaborating to improve access to and awareness of information

Responses pertaining to improving the lack of SME access to and awareness of business information are linked to the formation of a formal system linking financial institutions and SME support organisations. The following themes with specific references to information awareness were most common:

- Jointly establish and operate SME business excellence centres within local business chambers, local economic development (LED) departments and other easily accessible locations;
- Joint marketing, advertising and SME outreach programmes;
- Provision of relevant and updated information in all major languages; and
- Empower employees (across all organisations) through appropriate training in order to enable them to disseminate correct and current information.

2.4.3.6 Collaborating to improve SME management and business skills

The following most common and recurring themes emerged with regard to improving the management competencies and business skills of SMEs:

- Support and strengthen the capacity of intermediaries in order to enable them to transfer business skills to SMEs;
- Jointly fund and embark on SME training, business coaching and mentorship programmes;
- Ensure that training and development initiatives are targeted at the actual needs and requirements of SMEs; and
- Place greater emphasis on skills based/outcome based training.

2.4.3.7 Collaborating to improve information sharing and reduce opaqueness

The following themes with regard to improving information sharing and reducing SME opaqueness were identified as most common:

- Financial institutions and SME support organisations need to establish fruitful working relationships with credit bureaus.
- Stakeholders should jointly embark on a campaign to educate SMEs about the importance of information sharing, keeping credible accounting records, maintaining a good credit history, and the benefits of using computerised systems.

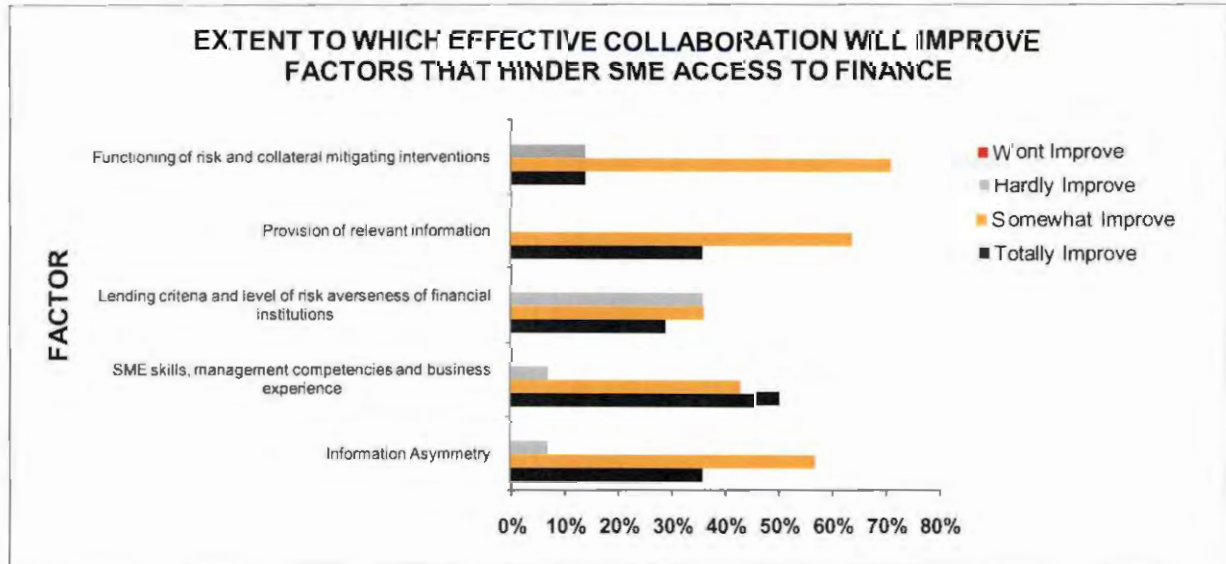
2.4.3.8 The extent to which interventions will improve the factors that hinder SME access to finance

Table 6: Level of Agreement (%) on the impact of collaboration

Factor	Totally Improve	Somewhat Improve	Hardly Improve	Won't Improve
Information asymmetry	36%	57%	7%	0
SME skills, management competencies and business experience	50%	43%	7%	0
Lending criteria and level of risk averseness of financial institutions	28%	36%	36%	0
Provision of relevant information	36%	64%	0	0
Functioning of risk and collateral mitigating interventions	14%	72%	14%	

Table 6 (Appendix 1, question 3.8) indicates that the majority of respondents view effective collaboration between financial institutions and SME support organisations optimistically. As a result, most respondents indicated that collaboration between stakeholders will somewhat improve most of the factors that currently constrain SME access to finance. Most notable in this regard is the functioning of risk and collateral mitigating interventions such as the Khula credit guarantee scheme, the provision of relevant information and information asymmetry. Figure 11 below illustrates the extent to which stakeholder collaboration interventions will improve SME access to finance.

Figure 11: Impact of effective collaboration



2.4.3.9 Impact of business development services on SME access to finance

In response to the statement “SMEs who receive business development services are better positioned to access finance more easily and on better terms”, 43% of respondents strongly agreed while 50% of the respondents agreed. The remaining 7% disagreed with the statement. This is indicative of the importance of an efficiently functioning SME support and development environment.

2.4.3.10 Importance of capacity building for SME financing and development

All of the respondents (100%) are of the opinion that capacity building initiatives for financial institutions and SME support organisations are vital to improving access to finance for SMEs. In this regard, the majority of respondents indicated that their respective organisations should place greater emphasis on training programmes that will enable them to better understand the SME sector in terms of the nature and characteristics of SMEs and the environment within which they operate. Small business management, entrepreneurship and financial management emerged as the most common training themes.

2.4.3.11 Improving SME access to finance – requirements and method

When asked what their respective organisations required to improve access to finance for SMEs (Question 3.9), stakeholder collaboration and dedicated personnel emerged as the

most common theme. One particular response of note was the development of a provincial SME database consisting of individual SME profiles that will include, amongst other pertinent information, their respective needs and requirements.

2.4.3.12 Best way to improve SME access to finance

When asked what in their opinion was the best way to improve SME access to finance, industry collaboration and training and development (within the supply, demand and support environment) emerged as the most common themes.

2.5 SUMMARY OF RESEARCH FINDINGS

Based on the primary and secondary research objectives of the study, the empirical study adopted an exploratory and qualitative approach. A total of 14 semi-structured interviews, guided by a structured questionnaire, were used to gather the necessary data. Given the exploratory and qualitative nature of the study, data analysis is limited to descriptive statistics in the form of frequency counts and percentages.

2.5.1 Biographic profile

50% of respondents interviewed held senior managerial posts while 36% occupied middle management positions. Another 14% of respondents occupied junior managerial positions within their respective organisations. All respondents were suitably qualified with only 14% of respondents holding a Diploma as the highest level of qualification. Qualification levels of the remaining respondents (86%) ranged from Bachelors to Masters Degrees. Similarly, all respondents were appropriately experienced with the majority of respondents (57%) indicating that their careers, averaging 18 years, had exposed them to both SME financing/lending and SME development/support.

The biographic profiles of respondents fully conformed to the sampling criteria of the study. As a result, it can be concluded that the data gathered accurately reflects the state of SME financing in the NWP across the supply, demand and institutional support environments.

2.5.2 Obstacles hindering SME access to finance

The findings of the empirical study in respect of the factors hindering SME access to finance are totally consistent with the literature review. This clearly indicates that the factors hindering SME access to finance in developing economies is no different to the factors hindering SME access to finance in developed economies. The responses obtained further imply that very little progress has been achieved with regard to addressing the factors that constrain SME access to finance.

The empirical study reveals that information asymmetry, the availability of investment-ready projects and appropriately developed business plans and SME skills, management competencies and business experience, respectively, are the greatest demand-side factors inhibiting SME access to finance. The remaining three demand-side factors were subsequently regarded by the majority of respondents as medium constraints inhibiting SME access to finance.

The lending criteria and high level of risk averseness of financial institutions were considered to be the greatest supply-side factors hindering SME access to finance. This is a very surprising finding given that 29% of the study participants represented development finance institutions (DFIs) that are supposed to be, technically speaking, less risk averse. This phenomenon can, however, be attributed to information asymmetries, making it onerous for potential financiers to quantify the level of risk inherent in a business proposition.

The lack of collaboration and partnerships between SME support organisations and financial institutions emerged as the greatest factor within the SME institutional support environment inhibiting SME access to finance. This finding substantiates the comments of respondents that organisations across the industry are not aware of one another's roles, responsibilities and service/product offerings. The majority of respondents simultaneously regarded the functioning of risk and collateral mitigating interventions and the ineffectiveness of SME outreach programmes as the second greatest factors constraining SME access to finance.

2.5.3 Improving SME access to finance

The research findings pertaining to improving SME access to finance is once again consistent with and supports that of the literature review. The findings of the study reveal that formal and

structured collaboration between financial institutions and SME support organisations is vital to improving SME access to finance in the NWP.

Targeted and specific training, development and capacity building within a collaborative framework and across the industry (SMEs, financial institutions and SME support organisations) emerged as the key intervention required to improving the state of SME access to finance in the NWP.

2.6 RECOMMENDATIONS

2.6.1 Introduction

Given the importance and contribution of the SME sector, the proliferation and development of SMEs have been strategically emphasized via government policies throughout the world (Torre *et al.*, 2008:1). SMEs in SA and more specifically the NWP are no different and play an important role in contributing to processes of local economic development.

SMEs are however faced with various challenges and impediments, which prevent them from developing to or reaching their full potential. Studies (Van Eeden *et al.*, 2004:3; Tagoe *et al.*, 2005:332; Maas & Herrington, 2007:38 and Torre *et al.*, 2008:2) investigating these challenges and impediments have identified a number of factors of which access to finance appears to be the most severe.

The findings of this study indicate that SME access to finance should not be regarded as a single factor but rather as a product of a number of different factors as it is so determined. In this regard, an SME's ability to successfully acquire finance is based on, amongst other factors, his/her ability to prove creditworthiness, clearly articulate the merits of a business proposition and display the necessary skills, management competencies and business experience. Financial institutions, on the other hand, should relax its lending criteria, lower its level of risk averseness and pay specific attention to the opportunity rather than the security (collateral). Finally, SME support organisations need to support and develop SMEs by ensuring that the products and services (credit guarantees, mentorship programmes) developed to advance the cause of SME growth and development are easily accessible and optimally functional.

Given the above, any effort or intervention aimed at improving SME access to finance needs to adopt a holistic approach, taking into consideration the challenges, roles and responsibilities of all stakeholders within the industry. Based on the findings of the empirical study, industry-wide collaboration and training and development are the most important interventions required to improve SME access to finance in the NWP.

2.6.2 The formation of a NW “Access to Finance” forum

The findings of this study clearly indicate that effective collaboration between respective stakeholders is vital to improving SME access to finance in the NWP. Stakeholders in this context refer to financial institutions (commercial banks, venture capitalists and development finance institutions), SME support organisations (private and public sector) and organisations that fully represent the interests of SMEs in the NWP.

Collaboration between stakeholders has the potential to improve access to finance for SMEs (Abereijo & Fayomi, 2005:222) as SME support organisations and BDS providers within their structures have a comparative advantage in:

- Pre-screening potential SME clients;
- Helping to provide clear business plans;
- Improving financial information generated by SMEs; and
- Providing risk assessment and monitoring services for financial institutions.

It is recommended that a collaboration initiative between respective stakeholders be implemented through the formation of a NW SME “Access to Finance” forum.

The formation of an “Access to Finance” forum will result in stakeholders sharing a common vision and mission with regard to SME growth and development and the provision of a platform for stakeholders to deliberate over and identify workable solutions in respect of the issues within the supply, demand and support environments that constrain SME access to finance. Strategic emphasis in respect of the factors that were considered to be major constraints should be emphasized by the forum. Table three provides an indication of the extent to which such a collaboration initiative between respect stakeholders will improve the factors that hinder SME access to finance.

In order to address the major demand-side factors inhibiting SME access to finance (information asymmetry, lack of investment readiness, poorly developed business plans and limited skills, management competencies and business experience), the NW “Access to Finance” forum should identify initiatives that will enhance and stimulate credit-information sharing and reporting. The forum should also embark on regular SME outreach programmes that will not only disseminate appropriate and relevant business information but also educate SMEs about the benefits of maintaining proper accounting records and encourage them to do so by providing specific training and tools. Lastly, the forum should focus on training and development initiatives that are aimed at assisting SMEs to overcome problems related to investment readiness, poorly developed business plans and limited skills, management competencies and business experience.

The lending criteria and high level of risk averseness of financial institutions were identified as the major constraining factors within the supply environment. The literature review and empirical study indicate that this factor is as a result of information asymmetries and other factors that characterise SMEs. Although successfully addressing these factors will not entirely reduce the stringent lending criteria and high level of risk averseness of financial institutions, it will surely improve SME access to finance. By participating in the forum, financial institutions will become more responsive to the challenges, needs and requirements of SMEs.

The lack of collaboration and partnerships between SME support organisations and financial institutions emerged as the greatest factor within the SME institutional support environment inhibiting SME access to finance. As such, the formation of a NW “Access to Finance” forum specifically addresses this constraint.

2.6.3 Training, development and institutional capacity building

The findings of the empirical study indicate that apart from stakeholder collaboration, training, development and institutional capacity building is crucial to improving SME access to finance. It is therefore recommended that the NW “Access to Finance” forum focuses on the training, development and capacity building needs of respective stakeholders.

The training and development needs of SMEs have already been alluded to in 2.6.2 above. In addition to the training needs alluded to in 2.6.2 and with specific reference to finance, the forum should focus on empowering SMEs to understand the following:

- Importance and use of credit;
- Different sources of funding;
- Creditworthiness and affordability;
- The role of credit bureaus and credit reports; and
- The impact of unfavourable credit reports on access to finance.

In order to improve SME access to finance and enable stakeholders to better deliver on their respective mandates, the forum will also need to address the specific capacity building needs of personnel within financial institutions and SME support organisations. Based on the findings of the empirical study, the forum should focus on training related to pre and post loan mentoring, small business management, entrepreneurship and financial management.

It has further been established that SME support organisations and BDS providers within its respective structures need to be more familiar with and better understand credit risk mitigation. In this regard, the forum should facilitate for capacity building initiatives that will enable relevant personnel to understand the principles of risk management, the features and components of a good credit proposal, the process of credit approvals and the lending criteria and policies of different financial institutions.

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CHAPTER THREE

CONCLUSION, LIMITATIONS AND RECOMMENDATIONS

3.1 INTRODUCTION

This study has established that effective collaboration between financial institutions and SME support organisations is vital to improving the state of SME access to finance in the NWP of SA. Research focusing on stakeholder collaboration as well as the impact thereof with respect to improving SME access to finance is, however, very limited, especially within the South African context.

In light of the above, this study endeavoured to create a platform from which further research on this topic can be conducted. The factors constraining SME access to finance within the supply, demand and institutional support environments were identified and the interventions necessary to improve these factors were explored. The researcher is of the opinion that the study will assist financial institutions, SME support organisations and SMEs to better understand the role and importance of effective stakeholder collaboration in improving SME access to finance.

This chapter discusses the findings of the study in relation to the primary and secondary research objectives. The limitations of the study are highlighted and related research opportunities are identified.

3.2 CONCLUSION

The primary objective of this study was to investigate the obstacles that impede SME access to finance as well as investigate how financial institutions and SME support organisations can effectively collaborate to improve access to finance for SMEs in the North West Province of South Africa.

The secondary objectives of this study, closely related to the primary objective, were aimed at determining the following:

- The level (current and desired) of collaboration between financial institutions and SME support organisations in the NWP;

- How financial institutions and state-funded SME support organisations can jointly intervene to improve the sharing of and availability of relevant information; and
- What are the kind of interventions necessary in order to improve the factors that inhibit SME access to finance.

The literature study identified the key factors within the supply, demand and institutional support environments that play a significant role in inhibiting SME access to finance. The literature study further provided some insight into the role and importance of stakeholder collaboration in improving SME access to finance. As such, the literature study formed the basis of the empirical study. The study sample, although small, was made up of well experienced managers that provided meaningful insights into the current state of SME financing as well as the interventions required to improve SME financing in SA/NWP.

Based on the findings of the empirical study, which is fairly consistent with that of the literature review, the following conclusions have been reached:

Obstacles hindering SME access to finance

- Although a vibrant SME sector is crucial for SA's economic growth, industrial development and job creation, the SA business and regulatory environment is not conducive for SME growth and development.
- SMEs in SA do not have easy access to affordable and appropriate finance, which negatively impacts on their operations and growth potential.
- Information asymmetry, lack of investment readiness, poorly developed business plans and limited skills, management competencies and business experience are the greatest demand-side factors hindering SME access to finance.
- The stringent lending criteria and high level of risk averseness of financial institutions are the greatest supply-side factors hindering SME access to finance; and
- The low level of collaboration between financial institutions and SME support organisations as well as the ineffectiveness of SME outreach programmes are the key factors within the SME institutional support environment that exacerbate SME access to finance.

Improving SME access to finance

- Effective collaboration between financial institutions and SME support organisations is imperative to improving access to finance for SMEs in the NWP. However, existing stakeholder collaboration initiatives and effective referrals between financial institutions and SME support organisations are virtually non-existent.
- A MoU (resulting in the formation a NW “Access to Finance” forum) linking financial institutions and SME support organisations is imperative to ensuring effective stakeholder collaboration.
- Effective stakeholder collaboration has the potential to appropriately address the myriad of factors that inhibit SME access to finance, especially the functioning of risk and collateral mitigating interventions, the provision of relevant business information and information asymmetry.
- SMEs who receive business development services are better positioned to access finance more easily and on better terms, which is indicative of the importance of a well functioning SME support environment.
- Effective industry collaboration as well as broad-based training, development and capacity building is the best way to improve SME access to finance in the NWP.

Access to debt and equity finance will assist SMEs to achieve its full growth potential. However, access to debt and equity finance is influenced or determined by a number of factors, which has already been comprehensively outlined and discussed in this study. This study indicates that SMEs, financial institutions and SME support organisations are jointly responsible for improving the factors that determine access to finance.

This study therefore recommends that SMEs, financial institutions and SME support organisations enter into a MoU that will lead to the formation of a NW “Access to Finance” forum. This forum will provide respective stakeholders with a platform to engage one another with a view to addressing the issues that constrain SME access to finance. To this extent, coordinated linkages and on-going collaboration between financial institutions and BDS providers will improve SME access to finance in the NWP.

3.3 LIMITATIONS

Several shortcomings were identified during the study. Research investigating stakeholder collaboration in the context of improving SME access to finance is very limited. As a result, documented research in respect of stakeholder collaboration fails to explicitly convey empirical findings indicating the challenges and impact of collaboration as an intervention aimed at improving SME access to finance.

The study focused only on financial institutions and SME support organisations operating in or providing finance and support/development services to SMEs in the NWP. This, together with the fact that no venture capital organisations participated in the study is a limitation in the sense that the findings of the study cannot be regarded as fully representative of the state of SME access to finance in SA.

The biased nature of participants' responses to questions may be regarded as another limitation to the study. To this extent, respondents may not have accurately commented on, or may have disguised sensitive issues, although assurance in respect of confidentiality of responses and anonymity of participants was provided.

3.4 RECOMMENDATIONS

In order to make a meaningful contribution to local and national economic development and prosper, SMEs require a favourable business and regulatory environment, access to appropriate business development services and support, and easy access to finance at reasonable rates.

SMEs, however, are typically opaque and suffer from weak entrepreneurial skills while financial institutions generally display very stringent lending criteria and a low risk appetite. This situation is further exacerbated by SME support and development organisations, especially government funded organisations, whose strategies and interventions have not yielded the intended results. So, while SMEs normally complain of a lack of access to finance, financial institutions complain of a dearth of entrepreneurs. Both arguments are equally valid. It can therefore be concluded that improving SME access to finance is dependent on sustainable SME development which requires a concerted and joint effort from all stakeholders.

In light of the above, further research on stakeholder collaboration (within the framework of improving SME access to finance) is proposed. As such, further research should be directed at investigating the impact of stakeholder collaboration initiatives, different stakeholder collaboration models and approaches, and the participatory experiences of various stakeholders involved in these initiatives.

Appendix 1: Research Instrument

IMPROVING SME ACCESS TO FINANCE IN THE NORTH WEST PROVINCE OF SOUTH AFRICA

SEMI-STRUCTURED INTERVIEW SCHEDULE

Section 1: Biographic Information

1.1 Details of Interviewee

Organisation (Optional)								
Designation								
Please select your highest qualification	Other	Doctorate	M Degree	H Degree	B Degree	Diploma	Certificate	Grade 12 or less
No of years in current post								
No of years of experience in SME	Financing/Lending				Development/Support			
Date, time and place of interview	Date		Time		Place			

1.2 Please select your organisation.

Commercial bank	
Development finance institution	
Venture capital	
SME development and support	
Other (Please specify)

1.3 Please indicate the types of services provided to SMEs in the NWP.

Debt financing	
Debt and equity financing	
Business development and support	
Please list any other services and/ or assistance provided to SMEs:	
.....	
.....	
.....	
.....	
.....	

Section 2: Obstacles hindering SME access to finance

2.1 A vibrant SME sector is crucial for SA's economic growth, industrial development and job creation.

Strongly agree	
Agree	
Disagree	
Strongly disagree	

2.2 The SA SME business and regulatory environment is conducive for SME growth and development.

Strongly agree	
Agree	
Disagree	
Strongly disagree	
Please substantiate your answer:	
.....	
.....	
.....	

- 2.3 SMEs in SA have easy access to affordable and appropriate finance, which enables them to operate efficiently and grow.

Strongly agree	
Agree	
Disagree	
Strongly disagree	

- 2.4 Please indicate the extent to which the following demand-side factors constrain SME access to finance in SANWP.

Factor	Major Constraint	Medium Constraint	Low Constraint	No Constraint
Information asymmetry (poor accounting records, lack of audited financial statements and inadequate access to SME information from credit bureaus)				
SME lending/financing risks				
SME lending/financing transactional costs				
Availability of bankable/investment-ready projects and ability of SMEs to produce business plans that meet standard requirements				
SME entrepreneurial skills, management competencies and business experience				
SME understanding of financing/lending criteria and requirements				

- 2.5 Please indicate the extent to which the following supply-side factors constrain SME access to finance in SANWP.

Factor	Major Constraint	Medium Constraint	Low Constraint	No Constraint
Lending criteria and level of risk averseness of financial institutions (collateral and own capital contribution requirements)				
Entrepreneurial and micro-finance skills within financial institutions				
Loan application processes and procedures of financial institutions				
Provision of relevant information (financial products and options, application process)				
Level of interest and/or discount rates				

- 2.6 Please indicate the extent to which factors within the SME institutional support environment constrain SME access to finance in SA/NWP.

Factor	Major Constraint	Medium Constraint	Low Constraint	No Constraint
Functioning of risk and collateral mitigating interventions such as credit guarantee schemes				
Provision and easy availability of updated and relevant business information				
Effectiveness of SME outreach programmes				
Provision of SME support and development interventions that is informed by or targeted to the actual needs and requirements of SMEs (mentorship, training, skills development, business development services)				
Level of collaboration and partnerships with financial institutions				

Section 3: Improving SME access to finance

- 3.1 Collaboration between financial institutions and SME support organisations is imperative to improving access to finance for SMEs in the NWP.

Strongly agree	
Agree	
Disagree	
Strongly disagree	

Please substantiate your answer:

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.....

- 3.2 Are there currently any collaboration or partnership initiatives between financial institutions and SME support organisations in the NWP?

Yes	
No	
Not sure	

If you selected Yes, please state with which institutions as well the structure, nature and effectiveness of this relationship.

.....

.....

- 3.3 Is there currently an effective referral system between financial institutions and SME support organisations in the NWP?

Yes	
No	
Not sure	

If you selected Yes, please state with which institutions as well the structure, nature and effectiveness of this system.

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.....

- 3.4 How can financial institutions and SME support organisations collaborate to improve the functioning of any credit guarantee schemes?

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- 3.5 How can financial institutions and SME support organisations collaborate to improve the lack of access to and awareness of business information?

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- 3.6 How can financial institutions and SME support organisations collaborate to improve the management competencies and business skills of SMEs in the NWP?

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3.7 How can financial institutions and SME support organisations in the NWP collaborate to improve information sharing and reduce SME opaqueness?

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3.8 To what extent will the interventions in 3.4 to 3.7 above improve the following factors that hinder access to finance for SMEs in SANWP?

Factor	Totally Improve	Somewhat Improve	Hardly Improve	Won't Improve
Information asymmetry (poor accounting records, lack of audited financial statements and inadequate access to SME information from credit bureaus)				
SME entrepreneurial skills, management competencies and business experience				
Lending criteria and level of risk averseness of financial institutions (Collateral and own capital contribution requirements)				
Provision of relevant information (financial products and options, application process)				
Functioning of risk and collateral mitigating interventions such as credit guarantee schemes				

3.9 SMEs that receive business development services are better positioned to access finance more easily and on better terms.

Strongly agree	
Agree	
Disagree	
Strongly disagree	

3.10 Do you believe that capacity building initiatives for financial institutions and SME support organisations is vital to improving access to finance for SMEs?

Yes	
No	

If you selected Yes, please specify the type of capacity building initiatives.

.....

.....

- 3.11 What does your organisation require in order to improve access to finance for SMEs in the NWP?
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- 3.12 What in your opinion is the best way to improve access to finance for SMEs in the NWP?
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.....
- 3.13 Are there any other comments and/or remarks, pertinent to the research that you wish to add?
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.....
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THANK YOU FOR YOUR COOPERATION