REASONS FOR FAILURE OF SMEs IN THE FREE STATE

by

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Declaration

I, **Lefa Kalane**, declare that this research is my own work and that it has not been submitted before for any degree or examination at any other university.

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Signed   **Date**

Abstract

Small and medium enterprises (SMEs) are important tools to address the challenges of job creation, sustainable economic growth, equitable distribution of income and the overall simulation of economic development. The failure rate of SMEs in South Africa is very high and it is of great importance to investigate the reasons for failure of SMEs which impacts on their performance. The high failure rate of SMEs paints a bleak picture of the SME sector's potential to contribute meaningfully to job creation, economic growth and poverty reduction.

This study investigates the reasons for failure of SMEs in the Free State, for the reason that there are many risks involved in managing them due to the challenges experienced by the owners across all the different business industries. The study focused on reasons involved in common business failures which are managerial, financial and the economic environmental reasons.

The objectives of this research were achieved by means of questionnaires that were distributed to 50 SMEs in the Free State Province. Fifty (50) questionnaires were received back from the respondents, which means that the return rate of the questionnaires received was 100%. The quantitative data analysis method was used and the gathered data included three major aspects of the study which are the financial, managerial and the economic environment.

Managerial and financial reasons were found to be among the leading causes of SMEs failures, where the respondents indicated that there is a lack of business, financial management and the marketing skills. Lack of business and management skills was also amongst the major causes of SMEs failure because the respondents indicated that without these skills, their businesses are bound to fail. In addition, using the company's resources for you own personal benefit or financial mismanagement has also contributed to failure because these companies have not been previously audited and it was therefore easier for them to recklessly use the funds.

It has also been established that the educational qualifications as well as managerial skills also plays a critical role in the failure or success of the SMEs. The study also made some recommendations from the research findings and it is clear that the government and the other role players needs to address the challenges and problems faced by the SMEs.

Keywords: failure, causes, SMEs, Free State

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- National Development Plan (NDP)

- National Economic Development and Labour Council (NEDLAC)

- National Research Foundation (NRF)

- National Youth Development Agency (NYDA)

- Organization for Economic Co-operation and Development (OECD)

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- Technology and Human Resources for Industry Programme (THRIP)

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- Total Early-Stage Entrepreneurial Activity (TEA)

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- Value Added Tax (VAT)

CHAPTER 1: INTRODUCTION

1.1 Introduction

There is an agreement between economists, business experts and policy makers that Small Medium Enterprises are economic growth drivers. The SME sector that is healthy, contributes highly to the country's economy by generating higher production capacities, creating more job opportunities, introducing entrepreneurship and innovative skills and increasing exports. SMEs' active role in developing countries, identifies them as the vehicles through which the government policies of the developing countries, namely to grow and prosper, can be achieved.

It is projected that in developing countries, SMEs employ on average 22% of the adult population in developing countries. It is also estimated that SMEs contribute to over 50% of employment, the gross domestic product (GDP) and also represent over 90% of private businesses in most African countries (National Credit Regulator, 2011). A recent study undertaken by Abor and Quartey (2010), has estimated that SMEs constitute to 91% of formal business entities in South Africa, that their contribution to GDP is between 52% to 57%, and their job creation opportunities are about 61% (National Credit Regulator, 2011).

The importance of SMEs to the economy was realized by the democratically elected Government of South Africa (SA), as early as 1995. It has also been highlighted by the White Paper on National Strategy for the Development and Promotion of Small Businesses in South Africa (1995), that "SMEs represent a significant vehicle to address the challenges of economic growth, job creation and equity in our country".

The SME sector in South Africa is critical to the Government's initiatives of improving the creation of jobs in the country. It has been estimated by the Task Group of the Policy Board for Financial Services and Regulation (2014) that the total economic output of SMEs in South Africa, is 50% of the GDP. It has further been estimated that they provide employment to about 60% of the labour force. SMEs are therefore a vital contributor to the country's economy and are considered as a vehicle for unemployment reduction, given that the formal sector continues to shed jobs (Bankseta, 2011).

There are initiatives in South Africa that actively promote the SME sector of the economy, including:

- ✓ The 1996 National Small Business Act, which describes SMEs and makes provision for the formation of the Ntsika Enterprise Promotion Agency (Ntsika) and the National Small Business Council.
- ✓ An order to advance the SME sector's finance access has been given to Khula Enterprise Finance. This is mainly done through the comprehensive finance guarantees or provisions to retail financial institutions, which should finance wholesale finance guarantees or provide to retail financial institutions, which should in turn finance the SME sector.
- ✓ The Skills Development Programme is another initiative which was launched in 1998 by the Government. SMEs are able to get aid through this initiative, to assist with the two major challenges that they face in the management of their businesses, namely the lack of management skills, as well as customer relationship development. Skills improvements result in enhanced productivity and efficacy and as a result should lead to an organisation that is stable and maximizes profits.
- ✓ BEE codes and preferential procurement;
- ✓ Tax incentives for both big businesses that work with entrepreneurs as well as for entrepreneurs; and
- ✓ Provision of soft loans and grant funding.

This initiatives has contributed significantly to the success of some of the SMEs in South Africa in that they became aware of opportunities, both financial as well as non-financial and they made good use of them. Access to financial support became easy and training opportunities offered by the Skills Development Programme assisted in empowering the SMEs to effectively run their businesses.

Subsequent to South Africa achieving democracy in 1994, the development of SMEs has been identified by the Government as the most important consideration for the creation of jobs and the alleviation of unemployment (Nieman, 2001). Abor and Quartey (2010) highlights that it is estimated that 91% of the formal business entities

in South Africa are SMEs, which contributes between 52 to 57% to GDP and provide about 61% to employment.

Thus, SMEs play a critical role in the South African economy, because of the amount of people it employs as well as the high number of firms in the country (SBP Alert, 2013). This study examines reasons for failure of SMEs' in the Free State Province because this contributes negatively to the economy of the Province as SMEs are seen as one of the main contributors to the Gross Domestic Product as well as the job creation. The study will further pursue reasons from the SMEs in the Free State to further establish if the already existing reasons are genuine or whether there are more reasons that have not yet been provided or covered by the previous studies. To put the study in context, the next section provides information, such as the role of SMEs in the economy, and the way they operate.

1.2 Background

In accordance with the Global Entrepreneurship Monitor Report (2013), South Africa is behind the other less developed countries (LDC) when it comes to entrepreneurial activities. This can partly be blamed on the legacy of apartheid, due to the fact that the apartheid Government never supported the development of SMEs. The entrepreneurial activity rate is very low for a nation that is still developing, but a mere quarter of this is noticed in other sub-Saharan African states. The rate of unemployment for the adult population is about 40%. South Africa's early-stage entrepreneurial activity Total Early-Stage Entrepreneurial Activity is very low (6%-10%), especially when compared to other developing countries such as those in South America (Global Entrepreneurship Report, 2014). The GEM Report 2014 further stipulates that South Africa had the lowest youth entrepreneurial propensity of only 23.3% and the lowest youth entrepreneurship participation of only 12.8%.

Irrespective of the economic value of the sector, laws in the past prevented the growth of this sector, specifically between the non-white population groups. This led to the low level of activities relating to entrepreneurship activities in South Africa. After 20 years of democracy, the entrepreneurial problems in our country have not yet been solved. To dwell on apartheid and the injustices of the past will not change anything

though. It will also not benefit this study to keep focusing on this. The failure of SMEs today has nothing to do with what happened in the past, they all have equal opportunities now.

The people of colour were prohibited by the Group Areas Act in the 1950's, from running a business outside their residential areas. They were forcefully stopped form trading near white populated areas. After apartheid, the Government rectified the situation by passing the White Paper, relating to the National Strategy for the Development and Promotion of Small Businesses. The development of SMEs was recognised as one of the priorities for creating jobs and alleviating the high unemployment rate, with the aim of redistributing the wealth through the country (Department of Trade and Industry [DTI], 1995). According to Statistics SA (2014), the unemployment rate in South Africa has been estimated at 25.5% during the second quarter and 25.4% during the third quarter of 2014. SMEs are seen as a solution to address the high unemployment rate in South Africa because the high number of SMEs creation will result in more the job opportunities. It is therefore imperative for the government to ensure that it supports the SMEs by creating a conducive environment where they can be able to operate with minimal challenges.

The Government has benchmarked against the global economy and fully understands the significance of the provision of fertile ground for all SME types to breed and grow. There are also different programmes available at the DTI, as well as grants to motivate SMEs and to promote employment in the country, as listed below:

i. **The Black Business Supplier Development Programme (BBSDP)**

    This grant inspires black owned businesses to grow in operational capacity and by acquiring assets.

ii. **Co-operative Incentive Scheme (CIS)**

    This is a scheme for co-operatives that are formed with five (5) or more black members. It aims to support co-operatives on a 90:10 cash basis grant by helping them to meet their start-up requirements.

iii.   **Technology and Human Resources for Industry Programmes (THRIP)**

THRIP is a project between the National Research Foundation (NRF) and the DTI. The scheme's objective is to develop SMEs into large corporations, growing their networks, allowing them access to equipment, facilities and scientific expertise at partner research entities.

iv.   **Incubation Support Programme (ISP)**

The aim of the grant is to initiate entities to allow them to develop incubator programmes, thus creating jobs within the societies, and in turn reinforcing the economy. It is aimed at inspiring partnerships between the Government, private sector, and SMEs in order to build sustainable growth inside the economy by producing these incubator programmes.

v.   **Capital Projects Feasibility Programme (CPFP)**

This project is intended for South African enterprises which operate in the capital goods sector, that have the potential of boosting the employment and expansion in the country, by drawing international investment.

vi.   **Clothing and Textile Competitiveness Improvement Programme (CTCIP)**

This grant is designed for the textile and clothing manufacturing industry. The grant is directed at the international market for affordable and quality clothing. It is meant for individual companies.

vii.   **Manufacturing Competitiveness Enhancement Programme (MCEP)**

This grant is aimed at advancing manufacturing competitiveness in the support and services market in South Africa.

viii. **Investment Programme (EIP)**

This programme is aimed at the manufacturing sector. This investment grant covers between 15% and 30% towards equipment, machinery, customised vehicles and plants.

ix. **Foreign Investment Grant (FIG)**

The grant is aimed at providing support for the actual transport cost of qualifying new equipment and machinery. This is targeted at attracting the foreign direct investors to start operations in South Africa.

x. **Product Incentive (PI)**

This grant is likewise for the footwear, textiles, clothing, leather, and goods industries.

xi. **Sector Specific Assistance Scheme (SASS)**

This is a reimbursable grant that is reimbursed at a 80:20 ratio.

xii. **Seda Technology Programme (STP)**

This programme offers a maximum grant of R1 million. Out of this R1 million, R800k is to be used for machinery, equipment and tools, of which 35% is funded by the DTI. The R200k balance is to be used via a 50:50 distribution in the business development programme.

xiii. **Bavumile**

This grant is aimed at empowering the women of South Africa in the crafts and arts sector. This fund is to ensure the quality production of commercially viable products by women with the relevant skills.

xiv. **Isivande Women's Fund**

The DTI manages this fund with the sole purpose of promoting women's economic empowerment. It is allocated to women, who owns 60% and manages it. This fund has been in existence for two years with a loan amount from R30 000 up to R2 million.

xv. **Critical Infrastructure Programme (CIP)**

This grant covers the costs of development, with grants from 10% to a maximum of 30% towards critical infrastructure improvement.

xvi. **Export Marketing and Investment Assistance (EMIA)**

This fund provides assistance for exporters in South Africa. It aids them by arranging events during which locally produced products can be showcased for the international traders.

xvii. **Film and television incentives**

Incentives are offered by the South African Government to promote this industry.

xviii. **SIZWE/FABCOS**

This loan funding is made available to the BEE SMEs that are incorporated and working within South Africa.

xix. **Business Partners**

Equity investments and loans are made available to the public for products that are researched and tested.

xx. **Red Door Funds**
   ✓ **Nedbank/Khula**

These SMEs' loans are offered by Khula in conjunction with Nedbank.

✓ **Khula-Akwandze Fund**

This is a crop establishment and re-plantation agricultural loan for crops. A cane delivery agreement needs to be in place for this loan. Authority is needed by the entity to occupy the land. This loan starts from R1 300 and goes up to as high as R15 500 per hectare.

✓ **Anglo Khula Mining Fund**

The stake of equity taken must not surpass 49% of the share capital issued. The offered amount is between R1 million and R20 million.

xxi. **Small Business Development Fund**

✓ **Godisa Supplier Development Fund**

The emphasis of this fund is on BEE-owned companies (SMEs) in Transnet's procurement chain, with the attention on port and rail businesses. The fund amounts to approximately R165 million, of which an average of R5 million can be granted per project.

✓ **SEFA**

The funding amount starts at R500k and is capped at R5 million. Only 90% will be subsidized by the fund; the outstanding 10% must be subsidized by the entity. The requirement is that the entity must be owner-managed and the loan has to be repaid within five years.

xxii. **Umsobomvu Youth Fund**
✓ **Franchise Fund**

This business partners manage this fund which avails R150k to R3 million for the purchase of a new or existing franchise that is viable or has the potential to be viable. A black South African youth who must be operationally involved must hold 30% shares.

✓ **Micro Finance**

This fund is run by the Micro Enterprises and the Nations Trust. The loan is accessible to a South African black youth aged between 18 and 35 years requiring a loan capped at R20k. The business must operate in the Limpopo, Eastern Cape, Mpumalanga or Free State. The black youth of South African origin must be operationally involved in the entity.

✓ **Youth co-operative finance**

This funding is for a business with at least a shareholding of 50% black youth with a stable and credible management team, requiring a loan of not more than R500 000. The business must be owned by the registered co-operative. All the members of the co-operative must be operationally involved. The funds have to be used to start up a business or to expand an existing one.

The role of job creation by SMEs is highlighted by Statistics South Africa's quarterly labour force survey, quarter 2, 2014, which estimates that 2 400 000 people who are older than fifteen years, are managing large and small enterprises in South Africa in March 2007(Statistics South Africa, 2014). This shows the critical impact made by the SMEs in the economy of South Africa, more especially on job creation. SMEs must be looked after by the Government and all the stakeholders, as they are fast becoming one of the biggest employers in the country.

These programmes were also established by the DTI to complement the initiatives that were already in place to address the lack of awareness of some governmental sources of soft capital for SMEs. It is also to encourage new SMEs and to create employment in the country.

1.3 Current state of affairs of SMEs in South Africa

The SME failure rate is as high as 63% in the first two years of trading (South Africa.info, 2010). Also, according to the Forum SA, 71% of SMEs are out of business by year 5. This is a problem for South Africa as a whole.

There are no statistics which compares the SMEs' failure per province in South Africa. The statistics only shows the failure rate for the country as a whole. There is however substantial information in the form of reports, both locally and internationally, which highlight the failure of SMEs in the country, including the Free State province. This information also indicates the reasons for the failure of SMEs and the remedial actions.

Generally, this is attributed to a lack of financial access by the owner-managers, as well as a lack of education. The Government has introduced support programmes for SMEs in order to ensure that they have advice and assistance on hand for any problems they may be encountering.

A survey of 100 firms conducted indicated that the majority of owners of these SMEs used their own money as start-up capital. At least 53 % of business owners in the Free State have used their own savings; 16% were granted loans by banking institutions; and 14% obtained micro-finance from the National Youth Development Agency. (Fongwa, 2011).

Many business owners are running informal, survivalist businesses, which decreased the desirability of entrepreneurship as a career choice (Turton et al., 2012). Some already known reasons for the SMEs failure is that most of the people in the Free State only pursue entrepreneurship because of unemployment and as a result, they are forced to seek the other means of generating revenue by opening small businesses.

They do this without conducting a proper research in terms of the market needs and dynamics. They also lack the information and skills necessary to run a business. They do not possess the essential skills and education nor do they receive proper training before embarking on the road of running a business. They purely enter into a business for survival. This is one of the many reasons why most of the SMEs in the Free State do not survive.

A recent study conducted by the Global Entrepreneurship Monitor (GEM) 2014 has shown that the SMEs in South Africa have generally been performing very poorly. While there is evidence that South African firms are failing less than in previous years (with the discontinuance rate fell falling from 4.9% to 3.89%) an analysis by Small

Business Insight of Gem data for 2014 shows that South Africa still has one of the high failure rates (those running established companies as a ratio of the sum of both established and early-stage entrepreneurial activity). Of a group of eight emerging economies (Brazil, Chile, Colombia, Malaysia, India, Russia, Georgia and South Africa) South Africa, with the exception of Chile and Colombia, has the highest business failure rate (GEM, 2014).

According to the 2014 GEM Report, the percentage of adult South Africans involved in entrepreneurial activity has dropped by 34% since 2013. The percentage of adults in South Africa involved in a business that are less than three-and-a-half years old (also known as early-stage entrepreneurs) fell to 6.97% last year from a 13-year high of 10.6% in 2013.

The 2014 GEM report further shows that the rating of South Africa's entrepreneurial eco-system - the conditions that enhance (or hinder) new business creation - have slipped. The biggest reasons for the decline are the country's poor ratings on government programmes, primary education, restricted and inhibiting regulatory environment and restrictive labour laws.

According to Mike Herrington, the executive director of GEM, when compared with the entrepreneurial activity rates of different countries, South Africa should have an increasing rate in the region of 14%, which if achieved would go a long way towards reducing unemployment and alleviating the poverty experienced by much of its population.

Further studies showed that education plays a major role in entrepreneurial activity in that the more educated the person, the more likely that person is to start a business and that the business continues to be sustainable (GEM, 2014).

It is not a secret that the youth are the future leaders and the entrepreneurs of the country. They should be encouraged to vigorously be involved in entrepreneurial activities and also be trained on how to run these businesses. Table 1.1 below clearly depicts the picture in the Free State of the youth involvement in entrepreneurship.

The table shows that the Gauteng Province has the highest percentage of early-stage entrepreneurs (29%), whilst the Free State Province has the fifth highest percentage of early-stage entrepreneurs (GEM, 2012). This is a clear indication that entrepreneurship is not encouraged in the Province and in situations where it is encouraged, there are no follow ups made by the authorities to assess whether the business have survived and if not, what are the major reasons for failure.

The table clearly paints a blur picture on the youth interest in entrepreneurship. It can be clearly observed that the lower number of youth entering into the business space in the Free State is as a result of uncertainty or reluctance to take risks. That is the reason why even though that risk is taken, businesses still fails because of lack of confidence by the youth of the Province.

Table 1.1: Involvement in entrepreneurial activity by province, 2012

Province	Percentage of early-stage entrepreneurs (TEA)	Percentage of Provincial population to national population	Ration of entrepreneurs to overall Provincial group
Gauteng	29%	24%	1.2
KwaZulu-Natal	23%	20%	1.2
Eastern Cape	18%	13%	1.4
Mpumalanga	10%	8%	1.3
Free State	7%	5%	1.4
Western Cape	6%	11%	0.5
Limpopo	4%	10%	0.4
North West	4%	7%	0.5
Northern Cape	0%	2%	0

Source: Global Entrepreneurship Monitor (2012)

A joint ILO/GEM survey in the Free State Province, conducted in 2012, highlights that 40% of young entrepreneurs had not made use of a support programme because they were not aware of any (Turton et al., 2012).

According to Bankseta (2011), small and medium enterprises in SA face numerous challenges, including:

- finance and securing credit;
- appalling skills shortages in SA, which makes it impossible to retain and attract skilled talent;
- compliance with all the requirements relating to the legislation of the country;
- lack of managerial skills;
- access to markets; and
- suitable technology and low production capacity.

This challenges can also result as the reasons for the small business failure because once the business is established and one of the above challenges faces the SME, the business can easily closed down.

The Government of South Africa is fully aware of the importance of the SMEs and thus a framework for SME support and development has been developed. Bankseta (2011) further mentions challenges that also affect the SMEs in the Free State Province, which can also turn out to be the reasons for their failure:

- SMEs in the Free State Province require advance payments before they can provide goods and services, because of a lack of finances;
- Difficulties in communicating with the SMEs because of technological constraints;
- Lack of knowledge in terms of costing of projects/goods and services; and
- Lack of understanding of how to quote and invoice for goods and services.

1.4 Problem Statement

The business environment of an SME can substantially affect the growth and success of the business, while several reasons may contribute to the lack of growth in an SME.

This stagnation can be the result of unwillingness among owners to pursue new innovations and markets, or it might be the result of barriers that exist in the overall business environment.

These barriers may be either external or internal to the business. According to Global Entrepreneurship Monitors (GEM) 2012, start-up enterprises in South Africa have shown poor sustainability compared to equivalent businesses in other countries. Reasons which impacts on the failure of SMEs may have a negative impact on the creation of employment, contribution to the economy, alleviation of poverty and the standard of living.

SMEs are growing at a slower rate in the Free State Province, both in terms of value and numbers. This is as a result of the external and internal reasons that contribute towards this slow growth, which includes the lack of business management skills, lack of financial support as well as non-payment after the delivery of goods and services. Some of these reasons can be avoided by the SMEs but some cannot, as they depend entirely on outside stakeholders.

Government and private sector interventions are failing to control the high failure rate of the SMEs in South Africa. Various control mechanisms have been put in place by the Government to mitigate these reasons, but with minimal success. This study explores the various reasons for the failure of SMEs in the province since the Government only provide an overall failure of SMEs in South Africa. The study will further provide recommendations on how SMEs can be assisted in order to avoid such a high failure rate.

1.5 Aim and Objectives

This study looking into the reasons contributing to the failure of SMEs in the Free State Province was conducted based on the quantitative research method. The research commenced by conducting grounded theory (GT) research in order to identify variables that might be contributing towards the failure of SMEs in the Free State Province.

The general aim of this study was to explore the reasons that contribute to the failure of SMEs in the Free State Province.

1.5.1 Research Objectives

The specific focus for the research problem is provided by the objectives below.

1.5.2 Primary objectives

To identify the reasons which contribute to the failure of SMEs in the Free State Province.

1.5.3 Secondary objectives

To reach the primary objective, the following are the secondary objectives of the study:

- To determine the current state of SMEs in South Africa;
- To identify the consequences of the failure of SMEs in the FS Province;
- To highlight reasons that lead to the failure of SMEs in the FS Province;
- To suggest remedial actions to avoid the failure of SMEs in the FS Province; and
- To develop an action step plan on how to avoid failure of SMEs in the Free State Province.

1.6 Literature Review

1.6.1 Introduction

The way a business is conducted and participates in the marketplace, has been changed by globalization and digitalization. The driving forces behind these changes are communication and information. This has resulted in a brand new economy, referred to as the knowledge economy.

The most critical asset in the economy is knowledge. It is what we buy and sell in the market. Luchetti and Sterlacchini (2004) indicated that the high growth rate in the US economy during the 1990's, which led to the rise in employment and productivity, was because of the early and fast adoption of the Information and Communication Technology (ICT).

"Presently, the organisational performance is led by the organisations which recognised that information, knowledge and their intelligent application are the important and critical factors of success in the new economy".

Definitions and interpretations outlined by the National Small Business Act no. 102 of 1996, became generally utilized as a framework for theory and disclosure in SA. Five classes of business are defined by the act (Abor and Quartey, 2010), with a number of employees being used as the main basis.

With almost two million smaller businesses in South Africa, which employ over 50% of the country's total labour force, the SME market is of importance to the increasing growth of the local economy, especially in the current economic environment (International Business Report, 2011).

Gross assets and annual turnover figures, which do not include fixed property, are also used to define these categories as per Table 1.2 below:

Table 1.2: Broad definitions of SME's in the National Small Business Act

Enterprise size	Number of employees	Annual turnover (SA Rand)	Gross assets, excluding fixed assets
Medium	Fewer than 100 to 200 depending on industry	Less than 4m to 50 m depending on industry	Less than 2m to 18m depending on industry
Small	Fewer than 50	Less than 2m to 25m depending on industry	Less than 2m to 4.5 m depending on industry
Very small	Fewer than 10 to 20 depending on industry	Less than 200 000 to 500 000 depending on industry	Less than 150 000 to 500 000 depending on industry
Micro	Fewer than 5	Less than 150 000	Less than 100 000

Source: Falkena et al., (2001)

The National Small Business Act defines the types of businesses as follows:

1.6.1.1 Survivalist enterprise

They produce an income lower than the minimum poverty line or income standard. This is defined as pre-entrepreneurial and it includes subsistence farmers, hawkers and vendors.

1.6.1.2 Micro but formal enterprise

The turnover for these enterprises is lower than the Value Added Tax (Vat) registration threshold; currently at R1 million per annum. These categories of businesses are not usually registered formally. Examples include minibus taxi operations, home industries and spaza shops. The micro but formal enterprise employs up to five people.

1.6.1.3 Very small enterprise

This kind of company employs up to ten people, except if they fall within the following sectors: electricity, construction, manufacturing and mining, where they can employ up to twenty people.

1.6.1.4 Small enterprise

These businesses employ not more than fifty employees. This category of business is generally more established when compared to very small enterprises. They embark on more difficult business practices.

1.6.1.5 Medium enterprise

Medium enterprises employ a maximum of hundred employees, except when they operate in the construction, manufacturing, electricity or mining sectors, where they can employ up to two hundred employees. These enterprises have a tendency of showing decentralization of power and use additional management layers.

1.6.2 Reasons for the failure of SMEs in the Free State Province

Different reasons like the lack of managerial planning skills, the inability to effectively manage competitive environments, as well as over expansion and ineffective working

capital management, are some of the reasons why SMEs fail. The critical reasons that contribute to the failure of SMEs are as follows:

1.6.2.1 Fraud and corruption

Fraud and corruption have a huge impact on the growth and sustainability of SMEs. The impact of these reasons on the sector should be thoroughly examined. High costs relating to fraud and corruption results in the SMEs being vulnerable in the corporate sector, irrespective of their contribution to the economic progress of South Africa

1.6.2.2 High crime rate

The impact of crime remains the top concern for SMEs in South Africa. According to a 2011 international business report, half of the businesses surveyed cited financial losses due to crime as a critical negative element affecting their businesses, whereas 48% indicated that the increasing costs of security affected their business operations. According to the World Economic Forum (2010–2011), SA is poorly ranked in numerous areas due to the extreme levels of corruption and crime (Herrington et al., 2010). Corruption and crime are ranked fifth and third respectively as the most serious problems facing South African businesses.

1.6.2.3 Lack of financial support from the Government and financial institutions

A key stumbling block for the prosperity of SMEs globally, is the challenge of accessing capital for the business. The lack of financing for SMEs, not just in South Africa (Herrington et al., 2010), but in many parts of the world as well, is much talked about.

Most of the goals of the Finscope Survey (2010) were to determine the levels of access for the small business sector and to identify and describe the drivers of and the barriers to the usage of financial services and products for the small business sector in South Africa which depends on the developmental phase of the SMEs as shown in Table 1.3 below:

Table 1.3: Growth phases and funding requirements of SMEs

Type of SME	Start-up Phase	Growth Phase	Stable/Consolidation	Exit
	Source of Finance			
Traditional small business. Provides employment for individual, family and friends.	Family, friends, savings, equity in residential property, loans underwritten by Government.	Asset-backed finance, bank debt, factoring, trade credit.	Bank debt if required.	N/A
High potential. Possibly export business.	Angel finance, teams' equity, some venture capital.	Venture capital, private equity, asset backed finance, some bank debt.	Venture capital-high yield debt market, bank debt.	Exit via capital markets or direct access to stock market.
High-tech, information and life sciences, intellectual property.	Angel finance, venture capital, corporates.	Venture capital, corporates, asset backed finance.	Corporates, bank debt.	Exit typically through trade sales.

Source: Felkana et al., (2001)

As illustrated by Table 1.3 above, the nature of funding required by an SME depends on its development phase. Businesses in the start-up phase generally rely on personal savings, friends and families, while those businesses which are stable, rely on bank loans for financing.

The unfortunate reality is that there are many constraints facing small business owners who need finance. The main problem is that as talented as you might be in a particular field, you might not have all of the competencies needed to ensure the viability of a small business. There is greater potential for such a business to fail, which is why banks are often reluctant to approve a loan application (Standard Bank, 2005).

This is exacerbated when:

- ✓ The application shows a lack of feasibility or pre-screening;
- ✓ The business plan is poor – possibly as a result of being drawn up by a consultant, with little input from the owner; and
- ✓ The proposed business plan is based on unsustainable margins.

Many businessmen who intend to form SMEs do not have good track records or the means to give security; as a result of this, they are in most cases declined access to financing. The majority of South Africans do not own assets that can be pledged as security to banks, mostly because of the consequence of unemployment, poverty and the disparities of the past.

1.6.2.4 Lack of entrepreneurial training and education

The need for entrepreneurship education and training facilities for entrepreneurial activities, with the stimulation of entrepreneurial activities and performance as the main focus, definitely exists. Education is an important factor in advancing long-term employment and economic growth from an economic perspective (Sweeney, 1998).

1.6.2.5 Access to appropriate information and communication technology

Information and communication technology (ICT) includes technologies like telephone, stand-alone computers, financial systems, Internet and social media. Ritchie and Brindley (2005) defines ICT as "the array of primarily digital technologies designed to collect, organize, store, process and communicate information within and external to an organisation and, in our case, SMEs" (Ritchie & Brindley 2005).

"ICT offer enterprises a wide range of possibilities for improving their competitiveness: they provide mechanisms for getting access to new market opportunities and specialized information services such as distance consulting, continuous training, new advisory modes, etc" (Fulantelli & Allegra 2003).

The possibilities for potential new business activities are limited for the people who do not have easy access to electricity (Herrington et al., 2010). In some areas of the country, small businesses depend heavily on information and communication

technology (ICT). The owners are sceptical to use ICT as the larger companies do. As a result, they do not take advantage of the potential benefits of ICT.

The major explanation for this unwillingness includes lack of funds, no awareness of computers and a lack of identifying the nature of their companies' information needs (Baard and Van der Berg, 2004).

1.6.2.6 Full access to markets

Full access to the markets has a significant impact on the survival of the SMEs. Since the SMEs are the critical components of the economy, the Government needs to play a significant role in ensuring that a conducive, regulatory environment exists for SMEs.

The long-term survival, growth and success of the SMEs depend largely on two reasons:

- ✓ Delivery of quality services and products; and
- ✓ Marketing and selling power of services and products.

Access to markets is the determining factor of the ability of SMEs to survive and compete. The difficulty of penetration into the markets also suggests that the competition is fierce between SMEs and other large companies, for the provision of goods and services. The result of not marketing the products and services of the SMEs is poor performance, which could lead to the closure of the business.

SMEs have to come up with the new innovative ideas that will lure customers to buy their products. SMEs are peripheral in the manufacturing sector due to the high number of food-value chains which the supermarkets have a dominating influence over (Mather 2005).

1.6.2.7 Mismanagement of resources

When a business starts to be profitable, owners reward themselves by buying big cars and living expensive lives, rather than ploughing the profits back into the business for expansion. They also do not take into consideration the operating costs, tax implications, as well as the liabilities of the business.

This is common among enterprises and entrepreneurs who are still in their infancy stage. Business managers and owners must be advised to not use assets belonging to the business for private purposes, at the expense of the enterprise. Employees should also be encouraged not to abuse the resources of the business. Stringent control measures should be enforced in order to prevent employees from misusing the resources of the business.

1.6.2.8 Lack of tax knowledge

According to the South African Revenue Services (SARS), small firms classed as small business corporations as depicted by Table 1.4 below:

Table 1.4: Tax rates: Small business corporations

Taxable income	Rate of tax
R0 – R67 711	0%
R67 112 – R365 000	7%
R365 001 – R550 000	21%
R550 001 +	28%

Source: www.sars.gov.za

According to table 1.4 above, small business corporations with a taxable income of less than R67 111, are not subject to any tax. Those with a taxable income of between R67 112 and R365 000 are taxed at 7%, while those between R365 001 and R550 000 are taxed at 21%. From the threshold of R550 001 upwards, they are taxed at 28%.

Due to the lack of information and capacity by the SMEs, the information provided above is not known to them. This might be the reason why the SMEs use the money on other things without taking into consideration their tax obligations if they fall within a bracket where they are eligible to pay tax. That could be why most of them are not in good standing relating to their tax matters, because once they submit their tax returns, in most of the cases, they are liable to pay tax. This is where the problem comes in, because at this stage, they have used all the money.

This is a major challenge facing South African businesses. SME owners are not familiar with figures. Dealing with finances can be very strenuous and costly. This is because of the fact that they do not keep proper records that will serve as supporting evidence when they submit tax returns. This is as a result of the lack of tax knowledge. SARS should exempt small businesses from having to pay punitive taxes because of this lack of knowledge and give them a grace period where they can submit the tax returns. They should also be provided with tax education. Also as recourse, entrepreneurs must pay their taxes timeously to avoid interests and penalties.

Failure of SMEs can result in the following consequences:

Financial consequences

- huge sums of unrecovered money mismanaged by owners of small businesses can impact negatively on both the state and civil society.

Employment loss consequences

- high number of employees can lose their jobs as a result of the business failure

Psychological consequences

- societies can develop a "psychology of failure" stigma as a result of business failure

1.7 Research Methodology and Design

1.7.1 Introduction

The chapter outlines the sample selection, research design and methodology. The sample consists of 50 SMEs that are registered on the FSGSD database of suppliers.

1.7.2 Research design

The study will be a quantitative, exploratory study and it will be conducted as a first phase of the study. The case study will indicate, if any, the type of support the SMEs of the Free State province are receiving and the problems that they are encountering in an attempt to survive, thus further identifying questions and types of measurement before commencement of the second phase of the study.

This research will partly explore the existing reasons for SMEs failure in South Africa in order to prove that small businesses are struggling and also explore further reasons for business failure. The case study will be conducted in all five districts of the Free State province, namely, Motheo, Thabo Mofutsanyana, Lejweleputswa, Fezile Dabi and Xhariep districts.

The researcher will focus on interviewing a total of 50 SMEs that trades in goods and provision of services. The study will also highlight the existence of the SMEs in different communities and will provide a comprehensive understanding of their challenges and reasons leading to their failure.

The results of the study will then be compared in order to identify similar and different characteristics and carefully studied in an attempt to get a brief overview of the reasons for SME failure. The second phase of the study will entail a review of the information already existing regarding the reasons for the SMEs failure. This will provide guidance during the development of questionnaires to be issued to the SMEs.

The third phase of the study will be to issue the questionnaires to the SMEs that have been selected in the Free State province in an attempt to investigate the reasons for their failure. The questions posed will be based on the findings of the first and second phase of the study and will be asked in an unbiased manner.

The three phases will be concluded by the compilation of the recommendations for SMEs within the Free State province to become viable in their business activities.

1.7.3 Target population and sample

The study sample consisted of 50 SMEs registered on the Free State Government's database of suppliers. This was critical to the study because the sample covered different districts of the Province as well as having enough representation of all SMEs in the Free State.

These SMEs provided goods and services valued between R50 000 and R2 000 000. The researcher identified 50 SMEs who specialized in supplying different goods and services. All 50 of the SMEs were contacted to find out whether they would be willing

to participate in the study. All the SMEs were selected as a sample, in order to obtain a variety of viewpoints. The total sample therefore consisted of 50 SMEs which meant that 50 individual owner–managers were interviewed during the study.

The sample was a non-probability and purposive sample, which supplied the primary data. This method was selected due to the research problem's nature; seeing that all the participants was already involved in this field of study. The reasons for people deciding not to take part in the research was not investigated, and no attempt was made by the researcher to establish whether important demographic differences existed between the people who chose not to take part and those who did. The same applied to the ones who agreed to take part in the semi-structured interviews.

1.7.4 Data collection and analysis

Quantitative techniques were used to collect the data, as are shown in the next sections. Semi-structured interviews were conducted with every participant. Thereafter, results were typewritten and inspected for similar themes. The data collection consisted of semi-structured face-to-face interviews administered by the researcher to the owner-managers, in order to allow fresh ideas to emerge during the interview process, based on what the interviewee's answers were.

The schedule of interviews was temporarily pre-planned but finalised once the questionnaires were collected and examined. The interviews provided the researcher with an understanding of the "how and what" of the participants' reaction and appreciation relating to the research problem. The format of the interviews included between 9 and 14 open-ended questions. The aptness of the questions was tested by means of a pilot study. The quantitative data was collected by the researcher through the questionnaires that were distributed to the SME owners.

For the identification of common trends and patterns, microsoft word and excel software's were used for quantitative data analysis to draft the questionnaire and interpret the results respectively. The outcomes therefore provided an in-depth understanding of the problems, unhappiness, and different strengths amongst SME

owners. The researcher's overall recommendations as well as conclusions were informed by the findings.

The steps in the quantitative analysis in this study were as follows:

- Formulation of the hypothesis and selection of variables;
- Sample determination;
- Collection of data;
- Preparation of data;
- Sample description;
- Exploration of the differences within the data;
- Exploration of the relationship between data;
- Exploration of models built on relevant variables;
- Organisation and presentation of data; and
- Validation and discussion with key stakeholders.

1.7.5 Demarcation of field study

The focus of the study was to identify the reasons that contribute towards the failure of the SMEs in the Free State Province. The field of study was based solely on financial as well as non-financial support to the SMEs by the Government. The study was conducted in Bloemfontein, as this was where most of the service providers were based.

1.7.6 Ethical Considerations

Ethical considerations included protecting the anonymity of the participants, in order to allow them to speak their minds with honesty and without any fear of consequences during the research. The researcher had to ensure participants during the interaction that they would not be exposed to any risk, or extreme influence, and should not develop expectations because of their participation in the study. The researcher should be guided by moral values.

All the participants were informed about the purpose and nature of the study, and they voluntarily gave their permission to participate. Participants did not receive any rewards or penalties, financial or social, for electing to participate or not. The

researcher thanked those who agreed to participate and the research results were made available to them.

The confidential information of participants was only known by the researcher and the research assistant, where deemed necessary. The obtained data was used only for the present study and will not be used illegally or distributed on any platform that was not agreed to by the participants. The data was analysed collectively for the entire population group instead of a single participant. The process of collecting and analysing the data was handled in a professional manner at all times. The researcher scrutinized and interpreted the findings objectively and neutrally.

The researcher supplied a brief explanation of his own personal interest on the research topic.

1.8 Chapter Outlay

Chapter one: Introduction and problem statement

This chapter highlighted the problem that was investigated, and the way it was investigated. This clarified the manner in which the research was done. In this chapter, the study background as well as the problem statement was presented.

Chapter two: Literature review

This chapter provided background to the proposed study, investigating work that had been published by other scholars and researchers in South Africa. The intention was to express knowledge and ideas to the reader about what had been said on the topic. It also showed possible strengths and weaknesses from different provinces, as well as past studies and historical background on the different causes of small and medium enterprise failures.

Chapter three: Research methodology

This chapter focused on the methodology that was applied in conducting the research. The chapter observed the design of the research, research type used, total population, design of the sample, data collection, as well as the analysis methods.

Chapter four: Results and discussion

This chapter concentrated on the research results, analysis and interpretation. The research results and the exploration of data from the analysis were tabulated and the findings discussed.

Chapter five: Conclusion and recommendations

The research problems and objectives were revisited in this chapter. The presentation of the summary and conclusions on "Reasons for failure of SMEs in the Free State", based on the previous chapters, were also discussed. The limitations of the research were highlighted and areas for further research suggested.

1.8.1 Limitations

This study was carried out on fully black owned small and medium businesses in the Free State Province. These businesses were randomly selected from the Free State Government's supplier database. Due to time and logistical constraints, this method required less time than having to visit each and every town in the Free State Province, in search of relevant businesses.

1.8.2 References

A complete list of references used for this study was presented in this section.

1.8.3 Appendices

This section included copies of the research instruments used to gather the information.

1.9 Conclusion

The reasons contributing to the failure of SMEs in the Free State Province are a result of issues both internal as well as external to the businesses. Some of these reasons entirely depend on the conduct, discipline and behaviour of the SMEs, as outlined in the literature review of the research.

Some of the reasons are beyond the control of the SMEs, as shown in the literature review. The economy of the Free State Province depends on the growth of SMEs as businesses, as well as the growing numbers of SMEs.

The growth of SMEs means sustainability and job security to ensure that the economy of the Province flourishes. The growing numbers of SMEs in the Province indicate more job creation and growth of the Free State economy.

The Government must put measures and plans in place to address these reasons that contribute towards the failure of the SMEs, including among others, training for SMEs in all business aspects, as well as financial support. This will have a positive impact on the Government's policies of alleviating poverty and job creation.

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

This chapter comprises of the literature review on the failure of SMEs and the causes thereof, in order to get insight into why there is such an appalling rate of failure of SMEs. Literature from South Africa and other parts of the world was studied for interpretations and tendencies. This study was meant to plug the gap that was left by earlier researchers on the topic, to further explore the reasons that contribute to the SMEs' failure, as well as the solutions. Although the research was based on the Free State Province, all the reasons were explored nationally, as they might still affect the Province.

The literature review was also thoroughly studied with the intent of theorizing the problem statement, as well as the objectives of the study. In particular, the literature review included mentioning of the past studies and the historical background on the different causes of small and medium enterprise failures, in the Free State Province.

There are numerous possible causes of failure of SMEs, but yet the Government seems to be dragging their feet to set up the programmes in order to address these. This study focused on the general reasons for SME failure in South Africa, with the research conducted in the Free State Province.

2.2 Definition of small and medium businesses in South Africa

SMEs must be regulated to avoid such a high failure rate. In accordance with the 1996 National Small Business Act, small businesses are grouped as small and medium enterprises (SME), as well as small, medium and micro enterprises (SMME). SMEs are defined by the 1996 Act on National Small Business as "a distinct and different entity which includes non-governmental organisations and cooperative enterprises managed by a single or many owners, that includes subsidiaries or branches if one of them is mainly carried out in any economic segment or sub segment as outlined in the size standards schedule and can be categorised as SME by substantiating the criteria stated in the size standards schedule" (Government Gazette of the Republic of South Africa, 2008).

Small businesses can be categorised as small, medium, very small or micro enterprises, by following a difficult set of thresholds that classifies them. The National Small Business Act, which has been reviewed by the 2003 and 2004 National Small Business Amendment Act, describes each sector's thresholds as well as sub-sectors, as depicted in Table 2.1 below.

Table 2.1: Thresholds for the classification for micro, very small, small and medium enterprises

Sectors or sub-sectors in accordance with the Standard Industrial Classification (SIC)	Site or class	Total full-time equivalent of paid employees (Less than)	Total annual turnover(Rm) (Less than)	Total gross asset value (fixed property excluded) (Rm) (Less than)
Agriculture	Medium	100	5.00	5.00
	Small	50	3.00	3.00
	Very small	10	0.50	0.50
	Micro	5	0.20	0.10
Mining and Quarrying	Medium	200	39.00	23.00
	Small	50	10.00	6.00
	Very small	20	4.00	2.00
	Micro	5	0.20	0.10
Manufacturing	Medium	200	51.00	19.00
	Small	50	13.00	5.00
	Very small	20	52.00	2.00
	Micro	5	0.20	0.10
Electricity, Gas and Water	Medium	200	51.00	19.00
	Small	50	13.00	5.00
	Very small	20	5.10	1.90
	Micro	5	0.20	0.10
Construction	Medium	200	26.00	5.00
	Small	50	6.00	1.00
	Very small	20	3.00	0.50
	Micro	5	0.20	0.10
Retail, Motor Trade and Repair Services	Medium	200	39.00	6.00
	Small	50	19.00	3.00
	Very small	20	4.00	0.60
	Micro	5	0.20	0.10
Wholesale Trade, Commercial Agents and Allied Services	Medium	200	64.00	10.00
	Small	50	32.00	5.00
	Very small	20	6.00	0.60
	Micro	5	0.20	0.10

Sectors or sub-sectors in accordance with the Standard Industrial Classification (SIC)	Site or class	Total full-time equivalent of paid employees (Less than)	Total annual turnover(Rm) (Less than)	Total gross asset value (fixed property excluded) (Rm) (Less than)
Catering, Accommodation and Other Trade	Medium	200	13.00	3.00
	Small	50	6.00	1.00
	Very small	20	5.10	1.90
	Micro	5	0.20	0.10
Transport, Storage and Communications	Medium	200	26.00	6.00
	Small	50	13.00	3.00
	Very small	20	3.00	0.60
	Micro	5	0.20	0.10
Finance and Business Services	Medium	200	26.00	5.00
	Small	50	13.00	3.00
	Very small	20	3.00	0.50
	Micro	5	0.20	0.10
Community, Social and Personal Services	Medium	200	13.00	6.00
	Small	50	6.00	3.00
	Very small	20	1.00	0.60
	Micro	5	0.20	0.10

Source: Schedule 1 of the National Small Business Act of 1996, as revised by the National Small Business Act, as amended in 2003 and 2004

South Africa's thresholds are low when compared to developed-country standards. Businesses that are regarded as small or medium enterprises by the Americans or Europeans are classified as big enterprises in South Africa (Department of Trade and Industry, 2008).

2.2.1 The International perspective

There are various legal and policy definitions for SMEs. According to the United States' International Trade Commission (2010) and the United States of America's Small Business Administration, founded by the United States Government in 1953, for the purpose of providing intermediary to long-term financing for SMEs that could not obtain finance on reasonable terms elsewhere, the definition of a SME which embraces almost 90% of full-time businesses, is shown in Table 2.2:

Table 2.2 United States of America's Small Business Administration standard for SMEs

Size of enterprise	Number of employees	Annual turnover	Balance sheet total
Medium	Less than 500, depending on industry.	$10m-$50m, depending on industry.	Less than $25m, depending on industry.
Small	Less than 250, depending on industry.	Less than $10m, depending on industry.	Less than $7m, depending on industry.

Source: Adapted from the United States International Trade Commission 2010.

According to the DTI of the United Kingdom (2004), the 1971 Bolton Report went to the extent of providing a statistical definition for SMEs. The Department of Trade and Industry further states that the UK Companies Act of 1985, which includes special less severe requirements on the reporting for SMEs, uses the following definitions, as shown in Table 2.3:

Table 2.3 Requirements of UK Companies Act for SMEs

Criterion	Small business	Medium business
Maximum number of employees	50	250
Maximum annual turnover	2.8 million	11.2 million
Maximum annual balance sheet total	1.4 million	5.6 million

Source: Department of Trade and Industries of the United Kingdom 2004

2.2.2 South African perspective

According to Abor and Quartey (2010), the definition of SMEs in the National Small Business Act 102 of 1996, as modified in 2003, is the most generally used framework in South Africa. A SME is defined by its act as an unconnected and separate entity, which includes non-governmental and cooperative enterprises, managed by a single

or more owners, which includes its own divisions or branches if any, is operated in any economic sector or sub-sector mentioned in the size standards schedule, and could be categorised as small by satisfying the mentioned criteria in the size standards schedule.

The following criteria are also important for defining SMEs in South Africa. These criteria are as follows: SMEs should operate in a formal market; SMEs are registered for tax and therefore have to meet other correct registration requirements. As highlighted in the explanation above, the National Small Business Act indicates the size standards schedule for SMEs for all the segments of the economy in South Africa, as pointed out in Table 1.1 of the previous chapter.

However, looking at the different definitions from different countries, it can be stated without a doubt that adopting the American definition for SMEs in Europe and South Africa would mean no medium enterprises, as all the medium enterprises will become small enterprises. As a result, research suggests that a globally uniform definition of SMEs is crucial for the successful development of the SME sector. According to Senderovitz and Philipsen (2008), without a uniform definition for SMEs, it will be difficult to have a cross country comparison of the performance of SMEs. It will also be difficult for global organisations like the International Monetary Fund and the World Bank to put in place uniform support systems for SMEs. Nonetheless, this study used the meaning of SMEs as defined by the South African National Small Business Act 102 of 1996, as amended in 2003.

2.3 History of business in South Africa

Developed economies realize the importance of the roles that SMEs play, and back the point that the importance of SMEs cannot be overstated, particularly amongst developing countries, or rather less developed countries. SMEs have been mentioned as the "engine of growth" in order to emphasize the importance of SMEs, relative to the growth and development of a given economy, (Nguyen, Alam, Perry and Prajogo, 2009).

As a result of the historic inequality and discrimination visited upon South Africa's black population by the apartheid Government relating to the business, the new democratic

Government inherited the highly unequal distribution of the benefits of growth from the apartheid Government, when it assumed power after the 1994 elections. The apartheid Government channelled all the resources to the white minority and as a result, the black people, who are the majority in South Africa, were disadvantaged.

Inequality was thus decidedly radicalized in that the apartheid Government had ensured that the white South African population were highly skilled and given opportunities, which resulted in them accumulating wealth. Many black South Africans were deprived of skills, never given opportunities and as a result remained poverty stricken. The apartheid regime shaped the business industry openly through entities in railway, electricity, iron, steel, air transport and telecommunications.

This was to ensure that the white population in the country was employed in these areas, where they earned high salaries, while the black population were only used as hard labour with low salaries. The new democratic Government installed measures and strategies to ensure that the black people also have access to the formal economy. These strategies were aimed at broadening the economic base of the country by ensuring that small and medium business enterprises are promoted through Reconstruction and Development Programmes (RDP).

The Government expanded over the years with objectives of empowering businesses by training, implementing affirmative action as well as affirmative procurement and equity ownership. Black Economic Empowerment (BEE), which was introduced in 1994 and enhanced during the early 2000's was specifically aimed at addressing these disparities relating to the control and ownership of economic resources, by growing black involvement at all the levels of the economy (Van der Nest, 2004). This encouraged the black population to participate in the economy of the country and therefore resulted in a high number of formations of SMEs and SMMEs in South Africa.

However, BEE has its own disadvantages, which are detrimental to the South African economy, as well as disadvantaging the white SMEs as follows:

- ✓ It benefits only a small number of black elites;
- ✓ It increases the gap between the poor and the rich in South Africa;

- ✓ It creates a generation of people who just want the benefits of finance without contributing positively towards business;
- ✓ The emphasis of BEE is placed too heavily on management and ownership characteristics which lead to minimal efforts being made towards the development of skills;
- ✓ It leads to unsound business decisions made by unskilled empowering partners;
- ✓ It results in the businesses losing focus on business activities; and
- ✓ It contributes towards the unemployment crisis in South Africa.

2.4 South African Literature on SMEs

The National Development Plan (NDP) (2030) indicates that minor and growing firms will turn out to be more prominent, and therefore generate the bulk of new jobs. These businesses should furthermore add to changing the apartheid legacy forms of business ownership. They should also be stimulated through private and public procurement, a simplified regulatory environment, equity finance and improved access to debt (Davis Tax Committee, 2014). The NDP has accepted the role of small and medium-sized businesses as representative of a vital sector that promotes employment, mostly in labour-absorbing industries. It is suggested by the NDP that a great percentage of jobs will be generated in the services sector and through domestic-orientated activities. Small and expanding firms will create 90% of jobs (Davis Tax Committee, 2014).

In other words, the business entry and expansion should be enabled by the economy, with the aim of crediting and marketing access. This portion of small and medium-sized firms should have substantially grown by 2030. Mass entrepreneurship should be boosted by regulatory reform and support. With SMEs being the major job creators, employment and growth could be boosted by growth in exports, with suitable connections to the domestic economy (Davis Tax Committee, 2014).

For instance, SMEs have been placed at the centre of South Africa's future by the succession of official plans, starting with the Reconstruction and Development Programme (RDP), specifically concerning employment creation. Political figures

across all political spectrums have voiced their agreement in this regard (SBP Alert, 2013).

According to the GEM report 2014, South Africa is the second lowest sub-Saharan country when it comes to the early-stage entrepreneurial activity (TEA) as shown by Table 2.4 below:

Table 2.4 Motivation for early-stage entrepreneurial activity in the GEM economies during 2014, by region

Region and economies	Early-stage entrepreneurial activity (TEA) (% of adult population)	Necessity driven (% of TEA)	Opportunity driven (% of TEA)	Improvement driven opportunity (% of TEA)	Motivational index*
Angola	21.5	24.5	72.1	43.4	1.8
Botswana	32.8	30.3	67.2	54.7	1.8
Burkina Faso	21.7	22.3	75.3	52.8	2.4
Cameroon	37.4	33.5	59.2	40.5	1.2
South Africa	7.0	28.2	71.3	35.5	1.3
Uganda	35.5	18.9	80.8	54.3	2.9
Average (unweighted)	**26.0**	**26.3**	**71.0**	**46.9**	**1.8**

Source: Global Entrepreneurship Monitor Report 2014

The table depicts the motivational variances in entrepreneurial early-stage activity in 2014 by economic development phases and regions. However, the landscape of SMEs is often poorly understood in South Africa, and the information about it is often incomplete, subjective or simply non-existent. This is remedied by the SBP's SME Growth Index, as depicted in Figure 2.1 below (SBP Alert, 2013). The data suggests a connection between employment growth and turnover. About 50% of the firms that generated growth in their turnover, reported a rise in their employment base.

Figure 2.1: Employment vs Growth by SMEs
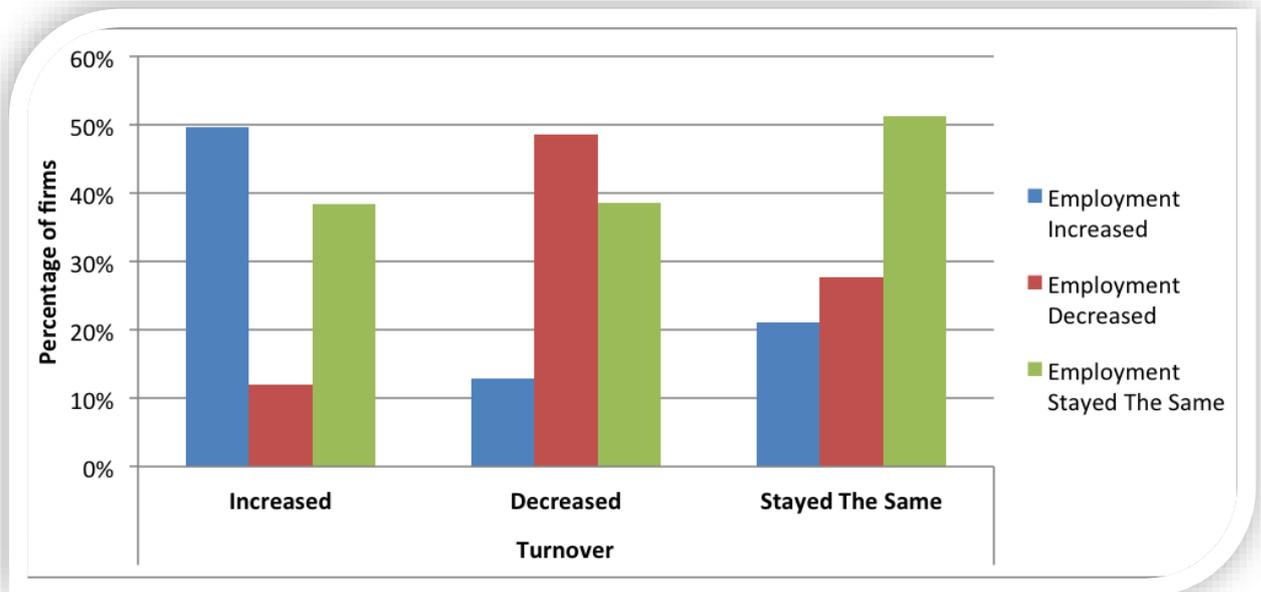
Source: SBP Alert 2013

For example, as turnover rises, it is possible that employment will do likewise. Business growth is one of the most commonly mentioned reasons for the increasing number of employees. In general, wealth-producing and a healthy SME growth in South Africa are very good for job creation (SBP Alert, 2013).

According to the SBP Alert (2013), SMEs are with good reason viewed as lynchpins of strategies for success. They are mostly viewed to be labour, as opposed to capital, intensive. The social impact of SMEs' employment creation is underappreciated in the South African context.

Furthermore, Statistics South Africa, quarter 4 of 2014, indicates that the unemployment rate in South Africa is currently 24.3%. This might indicate why there is a positive relationship between the turnover increase and employment. The higher the SMEs' output, the more likely that more and more jobs will be created which will result in positive spinoffs for the country's economy. This will assist the country in offsetting the high levels of poverty and income inequality. Therefore, SMEs are anticipated to be essential tools for solving the sustainable economic growth

challenges, overall stimulation of economic development and equitable distribution of income (Fatoki, 2014).

Above all, almost 70% of entrepreneurs who start informal businesses, do so as a result of them being unemployed and not having a different source of income. They are therefore also self-funded. Amongst those who run informal businesses and did not use their own money to start, most borrowed the money from friends and relatives (Stats SA, 2013).

SMEs supplied approximately 75 000 jobs to the annual gross employment creation during the period between 2005 and 2011. They also contributed 110 000 employment opportunities to the annual gross employment annihilation, which resulted in a 35 000 net loss (Mail & Guardian 2013). About 60 000 jobs on average per annum were contributed by the largest firms, however, only 37 000 was contributed to the employment annihilation (Mail & Guardian, 2013).

Despite SMEs being recognised as important engines for employment creation by the Government, South Africa's strict policy framework and legislations are demonstrating to be more difficult for them to grow in. This is in accordance with the SBP survey findings titled 'Counting the cost of red tape for business in South Africa' which was conducted in 2012 (Mahlaka, 2014).

2.5 The role of SMEs in the economy

The country's economy is faced with difficult times as it is pounded by both domestic and global challenges. This feeling embodies extensive worries for the fortunes of the economy of South Africa. It has been shown by the economic headwinds of the previous few years that the world is both uncertain and changing. The pre-crisis years are over and the cash-flows of the commodities have boomed. South Africa needs to trim its sails and alter course accordingly (SBP Alert, 2013).

In other words, this calls for creative and bold actions relating to the country's options for the development of our economy. These kinds of action may not even require such a great leap at the end of the day. The staple part of official economic thinking in the country has long been small and medium enterprises (SBP Alert, 2013).

Again, the verdict on SMEs is unanimous in that they play a critically vital role in the world's economies. It has been demonstrated by a number of studies that SMEs are the key propellers of employment creation. It has been validated that the contributions that have been made by SMEs are more prominent in developing as opposed to the developed countries. Under the correct situations, a strong SME community has the ability to be a transformational and dynamic force. When compared to larger firms, SMEs increase entrepreneurship, competition, job growth, and encourages economy-wide efficiency, growth, innovation and poverty alleviation (SBP Alert, 2013).

The Banking Association of South Africa (2014), states that SMEs have been recognised both in South Africa and around the world as the productive drivers of inclusive economic development and growth. It has been estimated by some researchers that SMEs' contribution to formalized businesses is 91% and provide jobs to approximately 60% of the labour force in South Africa. The SMEs' total output to the economy accounts for approximately 34% of the Gross Domestic Product (Banking Association of South Africa, 2014).

2.6 The current state of affairs of SMEs

The current state of affairs of SMEs appears to be that as much as they are striving to contribute to the economy of the country by creating jobs and alleviating poverty, it seems that red tape has a negative impact on their success. For instance, SMEs have to comply with the regulations of the country that governs business. In order to for the SMEs to fully comply with these regulations, they also have to pay the compliance costs. Because compliance costs tend to be "fixed" costs, it is felt more by smaller firms than by larger ones. This red tape is questioned at different points in the SME Growth Index. The following are the top five red tape aspects that SMEs find most costly and frustrating (SBP Alert, 2013) :

- ✓ Firstly, the South African Revenue Services' (SARS) inefficiencies;
- ✓ Secondly, the regulations that are mandatory;
- ✓ Thirdly, the regulations and labour laws;
- ✓ Fourthly, Broad-Based Black Economic Empowerment (BBBEE); aand
- ✓ Finally, municipal issues.

The red tape aspects mentioned above are now depicted in Figure 2.2 below, with the inefficiencies within SARS as the highest frustrating red tape issue during 2012.

Figure 2.2: SMEs' red tape issues
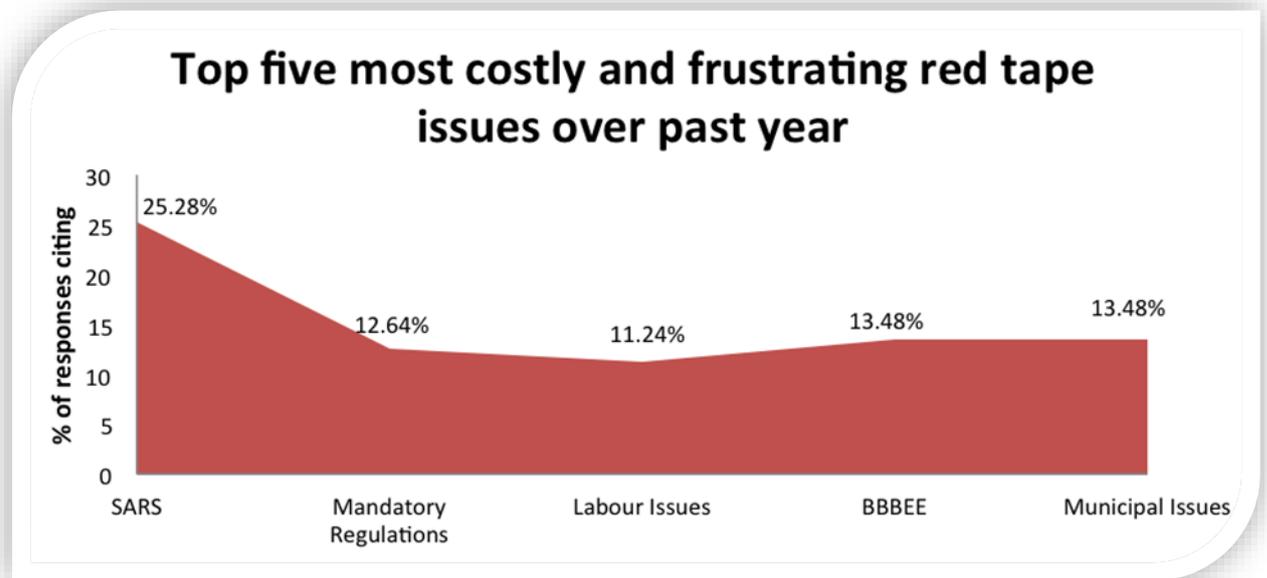
Source: SBP Alert 2013

For example, inefficiencies within SARS range from the inability by the SMEs to obtain tax clearance certificates to not being able to obtain them timeously. This has extreme knock-on effects. SMEs see SARS as abiding to an ethic of punishment rather than of facilitation, by penalising enterprises for its own failures (SBP Alert, 2013).

The SBP Survey (2012) added that SMEs use eight working days per month taking care of red tape, which comprises of regular modifications in the lack of access to information, regulatory environments and the inefficiencies of SARS. On an analysis of the top hurdles of the development for SMEs as well as the percentages of displeasure amongst entrepreneurs, the lack of finance, burdensome regulations, a lack of skills at 15% and the cost of labour, were identified by the survey (SBP Survey, 2012).

2.7 Reasons for failure of SMEs

2.7.1 Definition of SME failure

There is no exact definition for SME failure, although some schools of thought have tried to define it in order to give it better context. Nevertheless, Peacock (2004) observes that there are two important features of SMEs which separate them from large firms. The first feature is how small they are and the second one is their turnover and failure rates.

Peacock (2004) further notes: "The new comer's chances of becoming an established member of the business community are sadly slight. The SME owner carries on until his funds are exhausted and then disappear from the scene. Subsequently, his place is occupied by another hopeful, who is certain that he possesses the abilities which will allow him to prosper where his predecessor has failed." "Prospective proprietors marched solidly to the ambush unaware of the odds against them and largely ignorant of the weapons of trade".

Peacock (2004) agrees that there are numerous diverse definitions that are credited to the word "failure" when applied to an SME. From the perspective of the economist, this will be a company which received an investment rate return that was inadequate to cover its opportunity cost. This is however, for most purposes, not a useful approach, because data is not often available to make the necessary calculations about the profitability of small firms. The easiest way to understand "failure" is by understanding legal failure.

For instance, this occurs when a small firm is officially liquidated, or in the case of an independent enterprise, for business reasons, the owner becomes bankrupt. Another approach is relating failure to the rate of exit by the owners, as well as firms, from the small business sector. The experiential studies on business failure have therefore had a habit of relying on some recorded events as surrogates to measure failure.

In addition, there are two events for which data have been most readily available, seen as the formal bankruptcy proceedings and the discontinuance of a business for any reason. Amongst these two extremes, two further definitions have been proposed,

namely termination to prevent further losses and failure to make a go of it. In South Africa, one of the primary measures of business failure is the Statistics of Liquidations and Insolvencies published by Statistics South Africa (Fatoki, 2014).

Furthermore, Watson (2003) expands the definition of SME failure to include the following reasons:

- ✓ Bankruptcy, which is a discontinued operation with the resulting losses to its creditors;
- ✓ Discontinuance, which is defined as the prevention from more losses; and
- ✓ Retirement due to bad health.

Titus (2008) points out that failure arises when a firm fails to meet its duties to the stakeholders of the company, which include suppliers, employees, owners and customers. From this viewpoint, a failure of business is the end of an entrepreneurial inventiveness, since it fell short of its goals. In addition, failure happens when there are significant losses in the capital of the business that ultimately lead to business discontinuance. Honjo (2000) observes that a number of firms continue to trade whilst earning low rates of return.

However, when observed from the return rate viewpoint, a business is believed to have "failed" if it fits any of the following criteria:

- ✓ Earnings Criterion: if it has a significant and consistent return on capital lower than that obtainable on similar investments.
- ✓ Solvency Criterion: if the owner, in order to avoid loss to creditors or bankruptcy after actions such as foreclosure, attachment, or execution, willingly withdraws, leaving behind unpaid obligations.
- ✓ Bankruptcy Criterion: if believed to be legally bankrupt. Bankruptcy usually goes along with liquidation and/or insolvency.
- ✓ Loss Cutting Criterion: if the owner sells the firm or its assets with losses, with the aim of avoiding further losses.

Pretorius (2009) claims that understanding business failure presents a huge theoretical test and that no one universal definition exists.

2.7.2 Reasons for the failure of SMEs

There are numerous reasons that contribute to the failure of SMEs. Some are internal reasons and others are the external. Mudavanhu et al. (2011), point out that there are various reasons why small businesses fail. Pratten (2004) argues that one research line developed by Stinchcombe (1965), proposes that the important reason for the new SME failure is the liability of newness. This point of view proposes that new organisations fail from a combination of external and internal reasons.

Pinhold (2008) maintains that the liability of newness is substantial for a new SME. It is more costly to enter and win a new market than it is to maintain an existing one. Additionally, it takes time and effort to build up sales, while running expenses are incurred from the first day. Hiatt and Sine (2012) assert that the external and institutional environments impact on organisational outcomes. Political organisations play an important role in establishing the environment in which the new firms are born. Therefore, the main role of a political organisation is to offer a stable and reliable atmosphere, essential for the growth of economic activities (Fatoki, 2014).

Again, this is accomplished through the protection of private property, the enforcement of contracts, enactment of laws, provision of social welfare and education, organised armed protection against outside attacks and the protection of personal safety and public order. Environments characterised by weak organisations and high levels of civil and political violence, directly affects the survival of a new venture (Fatoki, 2014).

For example, this proposes that new SMEs' failure may be affected by reasons such as corruption, weak property rights, crime and a system that does not promote entrepreneurship and contract enforcements. Another stream of research on new SME failure, as pointed out by Ahmad and Seet (2009) focuses on management skills, as the new small firm transits from the founding entrepreneurial stage to higher growth rate stages.

In addition, one of the critical reasons in the success of a new SME, is the ability of its original leadership to carry on meeting new tests as the business progresses. New SMEs are often started by an entrepreneur with a very specific marketable idea or product, who then gets together the other founders and funding to form a new

business. Start-up firms need to supplement their managerial competences as they grow (Fatoki, 2014). The expansion of the venture offers changing leadership requirements and a necessity for diverse managerial capabilities. Entrepreneurs reach an "executive limit" at which their incapability to manage the firm becomes damaging. In such instances, ventures that do not replace the entrepreneur with a professional manager are more inclined to fail (Fatoki, 2014).

Fatoki (2014) maintains that this "executive limit" concept is consistent with the internal causes of failure. Valdiserri and Wilson (2010) agree that management or leadership mistakes are one of the causes of SMEs' failure. Most of the primary leadership blunders that result in the failure of businesses are:

- ✓ Embarking on the business for the wrong reasons;
- ✓ Underestimating business time requirements;
- ✓ Family burden on funds and time;
- ✓ Absence of market awareness;
- ✓ Absence of financial responsibility; and
- ✓ No clear focus.

Van Scheers (2010) highlighted some of the marketing skill challenges relating to the SMEs as follows:

- ✓ Gain an understanding of the market and potential for growth
- ✓ Market Segmentation
- ✓ Market Needs Analysis
- ✓ Access to finance
- ✓ Education and training
- ✓ Competitiveness; and
- ✓ Marketing of products and services

Phaladi and Thwala (2008) conclude that a lack of financial and effective management, resources, entrepreneurial skills, contractual and managerial skills, technical skills, proper training and a lack of credit from suppliers and banks, are serious reasons that lead to the failure of SMEs.

Maas and Herrington (2006) show that the main reasons for the closure of SMEs are personal and financial, namely a lack of customers, too much competition, found another job, retirement, as well as other causes. Mbonyane (2006) observes that the most common reasons for the failure of businesses in South Africa are the absence of knowledge about legal matters, a general lack of business acumen, and funding.

Pinhold (2008) argues that one of the primary reasons why SMEs fail is their abnormal rate of creation. SMEs are established at a rate which is far higher than is acceptable by the economy. Individuals who have complicated drives for starting a business and achieving a financial return is but one of them. Over-optimism usually drives the process, causing business founders to overrate the returns and underrate the risks involved.

Although most entrepreneurs claim that finance is a key cause of failure, banks contend that they are willing to lend to new firms that are investment ready. Temtime and Pansiri (2004) also argue that a lack of financial resources may be a direct cause for business failure, but the indirect cause, which is often more important but seldom recognised by entrepreneurs, is the lack of management skills. Banks and other lending bodies have approved a set of criteria that they use to assess new business applications. Robb and Fairlie (2008) also disagree with entrepreneurs that a lack of finance is the major cause of small firm failure. Boeker and Wiltbank (2005) find that, to the business owners, the most critical reasons causing business failure are: (1) poor capitalization, (2) poor conditions in the market, (3) key people incompetence and (4) a poor management strategy.

On the other hand, to the providers of funds, the four primary causes of new SME failures are: (1) the poor design of products, (2) a lack of technical skills, (3) inadequate capitalization and (4) a lack of management skills (Fatoki, 2014). The South African Banking Association (2014) confirms that there are a number of challenges the SMEs face in South Africa, such as:

- ✓ Corruption and crime;
- ✓ Low production capacity and appropriate technology;
- ✓ Inadequate skilled labour and lack of management skills;

- ✓ Obtaining credit and finance;
- ✓ Developing relationships with customers and access to markets;
- ✓ Government bureaucracy and recognition by large companies; and
- ✓ Compliance with regulations.

According to Business Magazine (2014), there are entrepreneurs who have business passion and have more capital available, but still struggle to build sustainable enterprises.

Business Magazine (2014) highlights that the reason why people start businesses is to make money, but they are not properly armed with the knowledge required to manage the cash flowing inside and outside the business. Failure to plan correctly as well as to manage budgets, simply results in mistakes and business failure (Business Magazine, 2014).

2.8 Remedial actions to avoid the failure of SMEs

2.8.1 Government policy on SMEs

According to Timm (2011), the 1995 SA White Paper defined, amongst others things, the necessity for administration to produce an allowing legal structure, enabling access to advice and information, enhancing procurement from small businesses as well as improving access to finance and reasonable infrastructure. He also indicated that the White Paper development resulted in the National Small Business Act of 1996 and the subsequent launching of Khula Enterprise Finance Limited in the same year. This was a Government entity established to provide financial assistance to small businesses, while Ntsika Enterprise Promotion Agency had to provide non-financial support.

This was as a result of the appeals to build a "one-stop" organisation where SMEs could obtain support from trustworthy sources. The administration took the decision to close Ntsika and merged it with the successful Manufacturing Advice Centre (MAC) Programme and the Community Private Partnership Programmes to establish the Small Enterprise Development Agency (Seda) in 2004, in order to distribute market support as well as business advice to business owners (Timm, 2011).

For instance, SMEs are weighed down by the same heavy regulatory burdens as their bigger counterparts. As a result, an environment promoting SMEs will be one where regulations are sensible, easily understood, and relates to their influence on business performance, within which they are managed competently. The regulatory environment of South Africa has been an issue of concern over the years (SBP Alert, 2013).

On the other hand, in 1994 the RDP White Paper pledged positive adjustments to the regulatory and legislative conditions for SME growth. This has not yet happened, as a couple of years ago, Minister Gordhan labelled South Africa's initiatives to support SMEs as "pathetic". It is shown by the SME Growth Index that SMEs are spending 4% of their turnover on compliance costs (SBP Alert, 2013).

Therefore, the key focus of the Government, in relation to small businesses has been on assisting black entrepreneurs, as pointed out by the White Paper of 1995, since they were the most ostracised group during the apartheid era. Two policies were developed by the Government, which were intended to assist many black people to become involved in the economy and to assist small business owners, as per the Black Economic Empowerment (BEE) codes of good conduct and the 2000 Preferential Procurement Policy Framework Act (PPPFA) (Timm, 2011).

The new codes have since been issued by the DTI in October 2013. Table 2.5 below shows the comparisons between the 2007 and 2013 BEE point requirements for every eight (8) levels of BEE status, and how much can be claimed on the BEE card.

Table 2.5 Comparison of the old and the new BEE codes

2007 BEE Codes	2013 BEE Codes	BEE Status (Level)	Procurement Recognition
100+	100+	1	135%
85-100	95-100	2	125%
75-85	85-90	3	110%
65-75	80-85	4	100%
55-65	75-80	5	80%
45-55	70-75	6	60%
40-45	55-70	7	50%
30-40	40-55	8	10%

Source: http://www.bee.co.za/content/Information.aspx 2013

The codes that were revised extracted the elements of the scorecard from 7-5 by merging employment equity and management control into one element, as well as merging enterprise development and preferential procurement into one element. The variance between the BEE scorecards of 2007 and 2013 is depicted by table 2.6 below:

Table 2.6: Comparison of the difference between the old and the new BEE codes

Criteria	2007 BEE Codes		2013 BEE Codes	
	Weighting	Bonus	Weighting	Bonus
Ownership	20	3	25	0
Management control	10	1	15	4
Employment equity	15	3	0	0
Skills development	15	0	20	5
Preferential procurement	20	0	0	0
Enterprise and supplier development	15	0	40	4
Socio-economic development	5	0	5	0
TOTAL	100	7	100	13

Source: http://www.bee.co.za

According to Timm (2011), no study has been conducted to date on the influence that preferential procurement or BEE has had on the promotion of small businesses. Currently, the Government anticipates that medium and large firms will intervene in assisting small businesses by accepting the development of enterprises as criteria to score BEE points.

Though this will go some way towards increasing finance and support for small businesses, tough emphasis by the BEE codes on black ownership has accidentally generated a conduct of rent-seeking between the skilled or wealthy black business people, in effect restricting entrepreneurship in this group. As an alternative to using their capital or skills to form their own businesses, many have instead selected to buy into the existing big, often listed, companies (Timm, 2011).

Moneyweb (2013) points out that all the Government measures that have been put into place to support SMEs in South Africa are deemed as completely ineffective and that they have so far changed nothing. The agencies which support the SMEs must be managed by business experts, and diverse structures of support are required for the diverse small business life stages. Too much money, focus and effort are currently expended on micro enterprises that do not generate huge revenues and employment prospects (Moneyweb, 2013). Mahlaka (2014) adds that SMEs experienced a better year in 2013 and employment is promising. This is the reason why SMEs hire people; in order to facilitate growth.

In summary, nothing is significantly changing in the small business landscape of South Africa. It does not have enough start-ups or enough start-ups that are growing and surviving. It is of grave concern that 63% of start-up entrepreneurs have indicated that their ideas for business turned into good opportunities but there are many reasons for these businesses not to survive. People see something and get enthusiastic about the opportunities. They do not however always possess the necessary skills to run a business. They do not do the necessary research and eventually they run out of cash and cannot freely access the markets. In some circumstances SMEs do not even know what their turnover is (Moneyweb, 2012).

2.8.2 Finance and investment for SMEs

Financial and investment opportunities need to be provided to the SMEs by banks. Even though it is difficult for SMEs to obtain finance, there is good news for those that are blossoming; contact for investment and finance is no longer a problem. A total of 18% of all firms that submitted applications for bank loans and 16% for credit facilities and bank overdrafts, were successful. Well over two thirds of credit and overdraft applications have been fully granted. Mahlaka (2014) further highlighted that 13% of overdraft or credit applications, as well as 10% of bank loan applications were rejected.

Table 2.7 below shows the statistics of SME applications and registration for finance assistance from the banks.

Table 2.7: Financing gap in terms of SME numbers

Description	Number of SMEs		
	FinScore Survey (2010)	**Stats SA LFS (2007)**	**Label**
Total SMEs 5	979 510	2 432 000	A
Registered SMEs (Formal): 17.3%	1 034 455	4 20 736	B
Average applying for a loan: 84.4%	873 080	3 55 101	C
Average loan application success rate (Formal): 33.2%	3 43 439	1 39 684	D
Those who received funds after successful appl: 27.3%	93 759	38 134	E
Financing gap (C-E)	779 321	3 16 967	F
Total informal: 41.8%	2 334 439	1 016 576	G
Less: Informal served (15.3%)	357 169	155 536	H
Total financially excluded (G-H)	1 977 270	861 040	I
Total financing gap (Formal and Informal): F+I	2 756 591	1 178 007	J

Source: National Credit Regulator 2011

As shown by the table above, South Africa has between 2.4M-6M SMEs. About 20% of these SMEs are listed with the Companies and Intellectual Property Commission (CIPC) and do own a bank account. Of all the formal SMEs, fewer than 100,000 (27.3%) positively apply and obtain funds from the formal financial sector. Nearly half of the SMEs are not listed; hence they are operating informally (National Credit Regulator, 2011).

As a result of this, most (84.7%) of the SMEs are financially disqualified. That is to say, they do not have access to formal financial markets. Consequently, the overall total financing gap for both formal and informal SMEs, is projected at around 45-48% of all SMEs in South Africa (National Credit Regulator, 2011).

2.8.3 Opportunities for SMEs in South Africa

Both the public and the private sectors need to enhance opportunities for SMEs in South Africa. One of the main reasons why there is not a stronger small business sector in South Africa is the concentrated nature of the South African economy. The economy is controlled by big corporations which makes it difficult for entrepreneurs to enter into the business sector of their choice and contributing to the small number of supposed business opportunities among South Africans, as revealed in the GEM report of 2012 (Mail & Guardian, 2013).

According to the Mail & Guardian (2013), only 35% of the people of South Africa are certain that business opportunities exist in the country, when compared with the 82%, 65% and 52% in Nigeria, Chile and Brazil respectively. A protection from less expensive imports, in the form of subsidies for local corporations and tariff hurdles, often look after big corporations. As a result, these firms change their focus to competing with small businesses, who are then repeatedly the victim of such competition (Mail &Guardian, 2013).

In other words, what is required is a mixture of tough anti-competitive policies and resilient supply-chain connections to support an economy that is more open. South Africa does not provide the appropriate incentives for its people to view entrepreneurship as a viable career choice (Mail & Guardian, 2013).

It is pointed out by the Mail & Guardian (2013) that almost 80% of the people of South Africa discovered that it is hard to find a person who is able to run a small business. The Government often introduces regulations that could be easier for large corporations to adhere to, than for small businesses. These however, compound the volume of red tape that is already facing smaller firms, even though it has the best intentions to assist small businesses (Mail & Guardian, 2013).

In addition to this, regulatory exemptions were often targeted more at micro firms than small businesses. It remains very difficult to obtain finance, everything from venture capital to bank loans, mainly as a result of many entrepreneurs not understanding how to access it (Mail & Guardian, 2013).

2.8.4 SME support by the Government

Support from the Government for small businesses is critical in ensuring that the owner-managers of the businesses are properly trained, in order to equip and skill them on regulations as well as the requirements of the business environment. However, the Government is not able to come up with real targets in support of the sector. Malaysia, for instance, released, in their SME master plan in 2012, the percentage exports by the small firms and the finance percentage which banks are lending to small businesses (Mail & Guardian, 2013). The DTI has been occupied with the idea of whether to have a longitudinal study as is done in India and Malaysia or a regular small business census. It is not clear when the first of such census or study will be conducted (Mail & Guardian, 2013).

In contrast with all the challenges that are faced by the sector, one would assume that small businesses must be lobbying the policymakers and the Government for support; instead their voices are hardly heard. Carl Lotter, who started the South African Small and Medium Enterprise Federation (Sasmef) in 2011, to encourage and lobby for more small business support from the corporate environment and Government, specified that small business representation is broken and that at policy level, there is no voice from the sector (Mail & Guardian, 2013).

Mail & Guardian (2013) suggested that the majority of business chambers represent the voice and the interests of large businesses. The few which still exists are either

the small local business chambers, with a very small influence on policy decisions, or they turn out to be more like marketing associations. In addition to this, in 2006, a backroom advisors council called the National Small Business Advisory Council was set up to consult the Minister of Trade and Industry on small businesses (Mail & Guardian, 2013).

2.8.5 The viability of creating new SMEs with the current challenges

Although the creation of new SMEs has its own challenges, it is viable to start a new SME with the current challenges in the country. According to Maas and Herrington (2006), the country cannot continue to enjoy the influence of this sector without the formation of new SMEs. New SMEs are understood to be a vital piece of the solution to the development issues of South Africa.

New SME formation is a process that happens in two-stages. The initial phase is the start-up phase, which is generally a period of three months during which people identify the services or products that the company will trade in, gain access to resources and put the necessary infrastructure, such as staff, in place. The second phase is a 3-42 month period, during which the SME starts to trade and contest with other firms in the market place. A new SME can therefore be described as a SME that has been in existence for less than forty-two months (Fatoki, 2014).

In other words, a firm becomes established once it has existed successfully for a period exceeding 42 months. Additionally, in South Africa, a new SME must meet all the qualitative and quantitative descriptions of a SME, as prescribed by the National Small Business Act (Government Gazette of the Republic of South Africa, 2003).

Turton and Herrington (2013) point out that, as measured by the Total Early-Stage Entrepreneurial (TEA), the South African activity rate of new SMEs is one of the lowest in the world. The TEA rate of South Africa has decreased from 9.1% to 7.3% from 2011 to 2012, which is considerably underneath the average of 14.3% for efficiency-driven countries. In addition, it is also projected that SMEs' failure rate in South Africa ranges between 70% and 80% (Adeniran and Johnston, 2011).

Over the previous five years, about 440,000 small businesses ceased operations in South Africa (Adcorp, 2012). Adding to this, the total new business start-up numbers were at an all-time low. Also, over the past decade, the number of small businesses in South Africa has stagnated. The only genuine prospect of large-scale employment creation in South Africa is offered by the small businesses (Adcorp, 2012).

Still, this is an opposing feature of South Africa's entrepreneurial segment. The new SME creation to the high failure rate in South Africa paints a miserable picture of the SME segment's ability to contribute extensively to economic growth, poverty reduction, and employment creation (Fatoki, 2014).

Titus (2008) asserts that the significant role of SMEs in countries' economies worldwide indicates that an understanding of why SMEs fail or are successful is critical to the steadiness and health of the economy of the world. The policymakers of the Governments in most states have been urged on by what they perceive as the job generation prospective of SMEs. The high occurrence of failure is a severe waste of resources (Titus, 2008).

Besides, there are both economic and human costs associated with the failure of new SMEs. In the light of this, it is vital to understand the causes of failure of new SMEs. Bowen et al. (2009), remark that given the high failure rate of SMEs, it becomes vital to research the reasons that are needed to enable SMEs to survive and improve their performance.

2.9 Internal and external reasons contributing to SME failure

In accordance with Delmar and Wiklund (2008), the environment from which the business operates has an important influence on new small enterprises' development. The business environment is defined by Smit et al. (2007), as all those variables or reasons, both outside and inside the business that may impact on the continuous and fruitful existence of the business. Beck and Demirguc-Kunt (2006) contended that for SMEs to flourish, it is significant to reinforce both the internal and external business environments. Changes relating to the business environment either have a positive or negative result on the SMEs' progress or failure in most of Africa (World Bank, 2010). This setting could therefore be divided into external and internal environments.

2.9.1 Internal environment

2.9.1.1 Access to finance

All businesses need financial resources so that they can start trading, as well as fund growth. A lack of financial access or availability could result in the restriction on business growth.

2.9.1.2 Skills of management

Managerial skills are knowledge sets, behaviours and conducts which contribute to personal effectiveness.

2.9.1.3 Networking and location

Location impacts directly on market potential, as well as the growth prospects of new businesses. Geographical closeness to either critical suppliers or buyers creates a form of improved scanning of the environment, which allows new market entrants to identify and exploit opportunities of growth in the market more easily.

2.9.1.4 Cost of production and investment in information technology

Investing in technology as well as being up to date with information technology, is gradually important to all businesses. Technology plays a critical part in the expansion of new SMEs.

2.9.2 External environment

Beck (2007) argues that the performance of SMEs can be influenced by both external and internal reasons. The external reasons comprise of social reasons, such as crime, corruption, ethics, informational and contractual frameworks, macroeconomic and regulatory environments, and technology. These Government variables are usually uncontrollable by new SMEs.

2.9.2.1 Markets and economic variables

Economic elements have an influence on the possible appeal of different strategies and the consumption trends in the economy. It also has important and imbalanced effects on businesses in various industries and in various locations.

2.9.2.2 Corruption and crime

The UN Office of Drugs and Crime highlights that South Africa has the doubtful distinction of being one of the world's five most-murderous nations. Brown (2001) indicates that business is the biggest planned group, suffering from violence and crime.

2.9.2.3 Infrastructure, regulations and labour

In sustaining growth, SMEs need access to a pool of motivated and suitably skilled labour. It has been found by Mahadea (2008) that it is expensive and difficult for SMEs to employ skilled labour.

2.10 Micro environment

Micro environment issues that resulted in being huge causes of SMEs' failure, are insufficient management skills, minimal expertise in areas of function, such as human resources and marketing and financial knowledge (Brink & Cant, 2003). The most pertinent issues facing most SMEs are the problems relating to marketing. Marketing is an important yet overwhelming concept for the majority of SMEs, because most of them are struggling to effectively employ it (Van Scheers, 2012).

Also, reasons of marketing, such as a products' low demand, lack of knowledge, wrong pricing strategies, competition, the disability to meet the needs of customers, product branding and variety, and poor location, all have an impact on SMEs. SMEs start small marketing activities as they have problems managing the different marketing challenges mentioned above. Secondary research specify that SME owners' opinions on marketing related tests are that they lack funds or time to invest in research to establish their customer trends, target markets and marketing in general (Van Scheers, 2012).

2.11 Consequences of failure of SMEs

Hart and Knott (2005) point out that failure has critical consequences for a number of the stakeholders involved in the start-up process. Unincorporated SMEs do not enjoy limited liability. Failure can therefore lead to the loss of the business and personal assets. Unincorporated SMEs are often collateralised by the personal assets of the founder.

In addition, incorporation should help limit the personal losses to entrepreneurs in the case of failure. Maas and Herrington (2006) point out that there are also emotional costs involved in new SME failure. South Africa has a harsh attitude towards failure, which inhibits many potential entrepreneurs. Hart and Knott (2005) further note that the impact of failure may also have bearing on Government policy. New SMEs are lauded as the engines of economies around the world.

Again, business failures have a high cost in terms of employment, lost productivity, purchasing power (unpaid wages), finance (unpaid debts), poverty reduction and income equality. Business failures can also lead to social problems such as crime, drunkenness and prostitution. Business failure can further lead to a reduced income for the Government in the form of lower taxes and increased expenditures on crime prevention (Fatoki, 2014).

Mitchell et al. (2008) argue that the effect of new SME failure can be portrayed both negatively and positively. Whilst the negative effects of failure manifest in monetary and emotional costs, its positive effects are not very visible, but associated with experience, learning, and other cognitive constructs.

Furthermore, the majority of the lenders as well as venture capitalists consider a past failure to be a virtue of entrepreneurs who are seeking finance. The meaning of new SME failure must at least be interpreted within the context of start-up experience. Failure can actually facilitate experience and a new beginning, leading to success. This is consistent with the view of Markman et al. (2007), that personal perseverance is related to a person's capability to persist in the face of difficulties, risks, and failure.

In addition, as much as these challenges can be resolved, enterprises continue to struggle. The problems with SMEs highlighted here, are not something new, these are the specific conditions of South Africa that can be amended. There is a need for SMEs to contribute positively towards the economy. The Government should play its role in ensuring that their skills are enhanced and regulatory reforms are simplified (Mahlaka, 2014).

According to the Mail & Guardian (2013), this high rate of failure can also clarify why South Africa has not been that successful in encouraging small businesses to drive the creation of jobs. Big firms generate more net jobs in South Africa than small firms do, mainly because of the high attrition rate of small businesses (Mail & Guardian, 2013).

Furthermore, small businesses in South Africa are disadvantaged by three primary challenges, namely access to a workforce that is skilled, business regulations and access to finance. Small businesses in South Africa did worse in these particular areas when compared to other African countries. Small businesses often struggle to scale up due to the restricted amount of gifted and skilful employees in South Africa (Mail & Guardian, 2013).

2.12 Remedial actions on how to avoid the failure of SMEs

According to the European Federation of Accountants (2004), there must be action plans in place for the SMEs to avoid this high failure rate. The action plans should include:

2.12.1 Pre-Emptive Actions

SMEs must always be prepared to take all the required possible actions to avoid failure of the business. Businesses rarely suddenly fail; failing is a slow process which typically includes a descending spiral.

2.12.2 External Advice

SMEs should always pursue assistance from professionally qualified financial accountants on a regular basis, commencing at the start-up phase, and continuing through all the stages of the business' life.

2.12.3 Planning, Budgeting and Forecasting

A business that is well-run will have the controls in place to observe business plans and an information system which regularly updates the management on progress towards its objectives.

2.12.4 Strategic Plans

Preparing a strategic business plan is an important step in developing a long-term view of where the business is going and how it plans to get there.

2.12.5 Business Plans for finance providers

When a business considers raising finance, the benefits of having a strategic plan becomes apparent, as the key marketing aspects of the business will be well established.

2.13 Conclusion

As a strategic contributor to tackling South Africa's social and economic challenges, a flourishing community of SMEs has rare equals. The general tendency of SMEs to create labour opportunities to the lesser skilled, highlights that priority should be given to their development and growth. Presently, the leading story is mainly about what is failing to occur: the economy of SMEs is mainly stagnant, and there is still a very long road ahead if we want to arrive at the wealth-and-job-creating, purposive growth that South Africa so badly needs. In the meantime SMEs are coping with a situation ill-suited to their requirements.

They are faced with a number of demands they need to comply with, just to find out that they are often treated indifferently by the responsible officials. Appropriate costs and beneficial regulations are needed. Regulations are necessary, but they must occur

with a clear eye on its implications to competitiveness. Another requirement is to intensify any firm's productivity potential.

Handling this includes an extensive range of likely activities: innovation, investment in capital and up-skilling, to mention but three. The skills shortage in South Africa is a major problem and it cannot be addressed solely inside the workforce. The origin of the problem lies within the difficult social and education system, and thus needs to be addressed at that level.

There is a high failure rate of SMEs in South Africa, which negative impacts on the ability of SMEs to meaningfully contribute to economic growth, job creation and a more equal income distribution in South Africa.

Finweek (2014) has revealed the numerous reasons why SMEs' fail; both external and internal.

External reasons are those that can largely not be controlled by the organisation and include:

- ✓ Logistics chain non-availability;
- ✓ High distribution costs;
- ✓ Increasing costs of running a business;
- ✓ Competition;
- ✓ Lack of finance; and
- ✓ Crime.

Internal reasons are largely controllable by the organisation and include:

- ✓ Lack of experience by management;
- ✓ Lack of functional skills;
- ✓ Poor development of staff and training; and
- ✓ A negative attitude towards customers.

SME owners need to be personally developed, more specifically in the business management skills area through training. They have to take more responsibility for

their own development and create a positive attitude towards training and entrepreneurship.

Government entities such as SEDA should arrange training for the owners of SMEs on business management as well as how to prepare business plans. Training programmes' arrangements should be made known through adverts in both national and local media. Furthermore, the Government entities could institute a mentorship or learning from peers approach to help SMEs.

CHAPTER 3: RESEARCH METHODOLOGY

3.1 Introduction

The study covered SMEs in different sectors in the Free State Province. This Province was chosen by the researcher as a study area because the University is in the Free State, as well as the fact that it has a comparatively large number of SMEs, as deduced from observation.

Research methodology is the technique by which data is collected for a research project. It is the design for the measurement, collection and analysis of information in order to attain the purposes of a research project (Cooper & Schindler, 2006). The research methodology is critical in the research as it stipulates the sampling design.

Research methodology clearly describes the target population as well as the method of sampling used. The motivation for choosing the specific method of sampling for the research as well as the identification of the data collection method used, are clearly provided in the research methodology. This can be in the form of interviews, postal surveys or self-administered questionnaires and constitutes the basis for selecting a specific data gathering method.

Additionally, research methodology also identifies the data analysis methods, defines statistical tests, data handling, computer programmes as well as other technical data. This also forms the basis for using a certain method. Lastly, the research methodology detects important methodologies or implementation difficulties such as response and non-response errors, sampling errors, and the constraints of time and cost (Cooper & Schindler, 2006).

The aim of this chapter is to outline the research techniques and methods applied to attain the findings which are presented in the next chapter. Characteristics of the research method outlined in this chapter include the elementary research design type, population definition, the information collection tools used in the research as well as the management of the tools, their validity and reliability, the methods of data gathering utilized and the statistical techniques that were applied to analyse the data.

This chapter delivered a summary of the research design, sample selection, and methodology. The sample consisted of fifty (50) SMEs that supply a variety of goods and services across the Free State Province. The decision to select the sample was based on the research objective as well as the cost and time constraints. The data used in the research was obtained from the Free State Government's centralized database of suppliers.

The target population will be the SMEs rendering services within the five districts of the Free State province as listed in the centralized database. The study will focus on different types of SMEs in the Free State province.

A non-probability method of sampling will be used, as there is no sampling frame. Heterogeneity sampling method (sampling for diversity) will be utilised. According to Trochim (2006), heterogeneity sampling is used when the researcher wants to include all opinions or views without worrying about representing them proportionately. The aim is to get a broad spectrum of ideas, not worrying about average or modal instance ideas. This type of sampling will include a broad and diverse range of participants (Trochim, 2006)

3.2 The research process

This is a series of steps in the organised gathering and scrutiny of data. This includes the use of numerous techniques and methods in order to generate scientifically acquired knowledge, by making use of objective research procedures and methods. It therefore defines the way in which the research process was designed and affected (Williams, 2007).

3.2.1 Step 1: Problem statement, research questions, objectives and hypotheses

3.2.1.1 Problem statement

The research problem is the most vital and the first step in the process of research due to the fact that without the research problem, there will not be any research and there will not be a research subject. The beginning of the research process is marked in this step. A research problem that is well defined provides a sense of direction to

the researcher in order to come up with likely research objectives. These research objectives assist the researcher to discover possible solutions (Cant, et al., 2008).

It was indicated in Chapter 1 that irrespective of the huge contribution by the SMEs to the South African economy, their failure rate still remains very high. The failure rate, according to South Africa.info (2010), of SMEs in South Africa is as high as 63% in the first two years of trading.

"What are the reasons for the high failure rate of SMEs in South Africa?" This is the question most researchers are struggling to answer. As indicated in the first chapter, this research investigated the reasons for failure of SMEs in the Free State Province. Therefore the research question for this study is:

"What are the reasons for the failure of SMEs in the Free State Province"?

3.2.1.2 Research objectives

It is necessary to stipulate what it is that needs to be researched, in order to describe the kind of data that must be gathered, and to offer a framework for the study scope which is displayed in the form of research objectives. According to Cooper and Schindler (2003), a research objective is the vision of the researcher's business problem. Every research objective explains and defines the research purpose in quantifiable terms and also defines the standards that the research must accomplish.

This study's objectives were:

- ✓ To identify the reasons for the failure of SMEs;
- ✓ To provide the definition of SMEs and their role in the economy;
- ✓ To discuss the current state of affairs of SMEs;
- ✓ To highlight reasons that lead to the failure of SMEs in the FS Province;
- ✓ To discuss the consequences of the failure of SMEs;
- ✓ To provide remedial actions to avoid SME failure; and
- ✓ To develop an action step plan for how to avoid failure of SMEs in the Free State Province.

These objectives were achieved through the following means:

- ✓ By identifying the reasons that contribute to the failure of SMEs in the Free State Province;
- ✓ By defining SMEs and their roles in the economy of the Free State Province;
- ✓ By highlighting the current state of affairs of the SMEs in the FS Province;
- ✓ By identifying the consequences of the failure of SMEs in the FS Province;
- ✓ By providing the remedial actions to avoid failures of SMEs in the FS Province; and
- ✓ By developing an action step plan of how to avoid failure of SMEs in the Free State Province.

3.2.1.3 Research hypotheses

According to Cooper and Schindler (2006), the research hypotheses are likely answers to indicated research questions. They express a hypothesis as an unverified declaration or suggestion about an aspect or occurrence that is of the researcher's interest. A hypothesis is therefore an empirically testable preposition.

Cooper and Schindler (2006) further state that hypotheses are educated predictions about a problem's solution, conveyed in an empirically testable form. In order to address research objectives, guesses about the problem's solutions are made in the form of hypotheses which can be empirically tested. They must first be translated into hypotheses in order for them to achieve research objectives. Additionally, the questions first needed to be decoded into hypotheses (alternative or null), so that the research questions can be answered.

H0 signifies the null hypotheses. It is a statement which falsifies the relationship between measured variables. H1 signifies the alternative and indicates that there is a connection between measured variables. The following hypotheses were used in the study:

H0: The reasons for failure of SMEs is not as a result of the lack of government interventions.

H1: The reasons for failure of SMEs is as a result of the lack of government interventions.

H0: The reasons for failure of SMEs is not as a result of the lack of management skills.

H2: The reasons for failure of SMEs is as a result of the lack of management skills.

H0: The reasons for failure of SMEs is not as a result of the lack of financial support by the financial institutions.

H3: The reasons for failure of SMEs is as a result of the lack of financial support by the financial institutions.

H0: The reason for failure of SMEs is not as a result of poor planning.

H4: The reason for failure of SMEs is as a result of poor planning.

3.2.2 Step 2: Research design

According to Hair, Wolfinbarger, Bush and Ortinau (2008), a research design is a general plan indicating the approaches to be used to gather and analyse the information for a research study. This offers the glue that holds the research together. For that reason, a research design is the strategy, structure and plan of a study, considered to find answers to research questions and control variables.

There are three elementary kinds of research designs used in conducting primary research: qualitative, quantitative and a combination of the two (Zikmund 2003). It has been noted that the research design choice centres on the research nature, the possible limitations, the setting, and the underlying pattern that enlightens the research project. The nature of the information will therefore differ in accordance with the research method followed. The research design has been fully described in Chapter 1 under section 1.7.

3.2.2.1 A quantitative research design

A quantitative research commonly includes statistic or primary data generated from comprehensive surveys, with the purpose of projecting the outcomes to a broader

population. It applies to a form of statistical analysis by quantifying data. The purpose is to simplify the outcomes to a broader setting, centred on the outcomes of a sample of the population which is representative.

According to Cant (2010), the research results are exposed to difficult statistical and mathematical manipulation to create generally representative data that can be widely applied to the entire population and used as a foundation to estimate future actions and tendencies under different conditions.

As already explained in Chapter 1, the study will be a quantitative, exploratory study and it will be conducted as a first phase of the study. The case study will indicate, if any, the type of support the SMEs of the Free State province are receiving and the problems that they are encountering in an attempt to survive, thus further identifying questions and types of measurement before commencement of the second phase of the study.

This research will partly explore the existing reasons for SMEs failure in South Africa in order to prove that small businesses are struggling and also explore further reasons for business failure. The case study will be conducted in all five districts of the Free State province, namely, Motheo, Thabo Mofutsanyana, Lejweleputswa, Fezile Dabi and Xhariep districts.

The researcher will focus on interviewing a total of 50 SMEs that trades in goods and provision of services. The study will also highlight the existence of the SMEs in different communities and will provide a comprehensive understanding of their challenges and reasons leading to their failure.

The results of the study will then be compared in order to identify similar and different characteristics and carefully studied in an attempt to get a brief overview of the reasons for SME failure. The second phase of the study will entail a review of the information already existing regarding the reasons for the SMEs failure. This will provide guidance during the development of questionnaires to be issued to the SMEs.

The third phase of the study will be to issue the questionnaires to the SMEs that have been selected in the Free State province in an attempt to investigate the reasons for

their failure. The questions posed will be based on the findings of the first and second phase of the study and will be asked in an unbiased manner.

The three phases will be concluded by the compilation of the recommendations for SMEs within the Free State province to become viable in their business activities.

3.2.3 Step 3: Selecting the primary research data collection method

The different methods of data, as well as the questionnaire design, are discussed in this section.

3.2.3.1 Basic primary data collection methods

According to Gerber-Nel et al. (2005), there are three primary data collection methods that have been identified, namely observation, experimentation and survey.

3.2.3.1.1 Observation

Observation can be explained as the process by which primary data is acquired by observers on the behavioural patterns of objects, people, or occurrences, without questioning or communicating with them (Cant et al. 2008). The method of observation in gathering primary data concerning human behaviour depends on observation by humans or recording devices of applicable facts or consumer behaviour. Observation is a substitute for straight questioning and is completed by strategically placed humans or machines.

3.2.3.1.2 Experimental research

Cant et al. (2008) also point out that experimental research is centred on the idea that one independent variable is influenced in a way that might have a certain effect on another dependent variable. The researcher influences the independent variable and then measures the effect. If all the other reasons is kept under control, it can be assumed that the independent variable has a causal effect on the dependent variable. The experiment's setting can be in a laboratory or in the field. This study used a survey as the research method because other methods of data collection such as experimental and observational were not suitable for collecting data to investigate the research problem.

3.2.3.1.3 Survey

The data collection method used in this study, was the survey method, as the other methods such as the experimental and observation methods were not suitable for gathering data to scrutinize the research problems. The researcher used a research technique in which information is collected from a sample of respondents by using a standardized questionnaire for survey research.

The study used survey research because it supplies an accurate, quick, efficient and inexpensive means of assessing information about the population. Surveys are extremely valuable if conducted properly, as they post questions to the respondents to find out what people think about a situation. Surveys are quantitative research data collecting techniques which use questionnaires as a data gathering instrument (Cant et al. 2008).

Data is gathered from different respondents via telephone, mail, or in person. Abstract information of different types can be collected by interrogating others (Zikmund, 2003). Accordingly, the self-administered type of survey techniques used in the form of questionnaires, were delivered in person to the respondents by the researcher, and therefore completed by the respondents without any interviews conducted.

According to Cooper and Schindler (2006), this self-administered survey data collection method is used by researchers because it has the following advantages:

- ✓ Expansion of geographic coverage without cost increase;
- ✓ Perceived to be more anonymous;
- ✓ Allows interaction with participants who are otherwise not accessible;
- ✓ Allows participants enough time to ponder about questions;
- ✓ Incentives can be used in order to increase the rate of response;
- ✓ Often the option that is the lowest in cost;
- ✓ Involves minimal staff; and
- ✓ Is proven to have a higher reply rate than any other data collection techniques.

Repeated call backs were made to the respondents to ensure that they complete the questionnaires.

3.2.3.2 Questionnaire design and content

3.2.3.2.1 Questionnaire

The primary instrument in this study was a questionnaire. A questionnaire can be defined as a set of questions delivered to the participants via personal (phone, intercept) or non-personal (mail delivered, computer delivered) means that has to be completed by the participant. Questionnaires were used in this study because it gave enough time to the respondents to ponder about the answers to the questions as contained in the document. It also offered the likelihood of normalizing and relating scales, as well as enabling the secrecy of the data source to be preserved. Furthermore, a huge number of respondents dispersed over a large geographical area could be reached (Brynard and Hanekom, 2006).

The questions in the questionnaire were mostly closed-ended questions. The closed-ended questions were used by the researcher because they are easier to record, code, and analyse when compared to the opened-ended questions. Closed-ended questions are also favoured by researchers over opened-ended questions for their efficiency and specificity. In addition, the response rate is much higher with surveys that use closed-ended questions than with those that use open-ended questions (Cooper and Schindler, 2006). Three open-ended questions were used by the researcher for this study.

3.2.4 Step 4: Sample design

A sample is quite a small subset of a population, according to Hair et al. (2008). It can be selected by using either non-probability or probability procedures. A sample should be representative of the population from which it is selected. In proper perspective, it should reflect features of the population. For that reason, a population is the total of all the elements that share some common sets of characteristics.

A method which is employed to select a sample with a view to determine the characteristics of a population is called sampling. If it is chosen sensibly, the sample should show the same features or properties as the big group (Brynard and Hanekom, 2006).

It is acknowledged by Brynard and Hanekom (2006), that a sample of a population is frequently used for the following reasons:

- ✓ Research simplification: it is less complex to study a sample of a population that is representative than to study the population as a whole;
- ✓ Time saving: studying the population as a whole can consume time, particularly if there is a large population or if it is dispersed over a big geographical area;
- ✓ Costs cutting: interviewing, observing or using questionnaires to gather data from each component of a population can be very expensive if the population is big and geographically dispersed over a big area; and
- ✓ Determination of the specific properties of the whole population.

The key reasons for sampling in this study were:

- ✓ Lowering of costs;
- ✓ Greater precision of results;
- ✓ Quicker data gathering; and
- ✓ Availability of the elements of the population.

The next section identifies different kinds of sampling design.

3.2.4.1 Types of sampling design

The sampling method applied to select the representative sample for the study is an important part of this research and is explained in the section below. According to Cant (2010), there are two major types of sampling design. These are probability and non-probability sampling. This study used the probability sampling method.

3.2.4.1.1 Probability sampling

Probability sampling includes selection methods in which all the components of a sample are selected through a haphazard process. The reason why probability sampling was selected was because of the fact that each of the components had a known, non-zero chance of being included in the sample.

3.2.4.1.2 Non-probability sampling

With non-probability sampling, the probability of the selection of the elements is not known and therefore the researcher cannot be sure that the sample is representative of the population.

Convenience sampling was used for the research because the sample selected is accessible to the researcher. Subjects are chosen simply because they are easy to recruit. This technique is considered easiest, cheapest and least time consuming.

3.2.4.2 The population

Cooper and Schindler (2003) define the word "survey population" as the population element list from which the sample will be selected. Though in practice, it is problematic to find comprehensive records of all of the components in the survey population, the survey population for this study was obtained from the Free State Government's database of suppliers. This resulted in a sample drawn from lists which do not necessarily contain all of the elements.

In this study, the research population was black owned SMEs in the Free State Province of South Africa. The population size of SMEs in the Free State Province was unknown, as the database does not really provide the total number of SMEs registered.

3.2.4.3 Sample size

According to Tustin et al. (2005), a sample is a population sub-group which is chosen to partake in the research. It must therefore be noted that the right sample size in a study will be dependent on the population's nature and the study's purpose. The size of the sample typically hinges on the population that is to be sampled, even though there are no general rules.

Sample sizes larger than 30 and less than 500 are generally best suitable for most research (Unite for sight, 2016). However, in a critical study, the size of the sample must be numerous times as big as the sum of variables in the study, so as to achieve decent outcomes. The sample size for this study is fifty (50) because it will be very

cost effective to distribute the questionnaire to the few respondents representing the population as opposed to the higher sample size which will be very expensive. Therefore, 50 questionnaires were dispersed because of the restrictions related to the self-administered data gathering method, such as non-response. The questionnaire were dispersed personally by the researcher to the respondents.

3.2.4.4 The margin of error

The margin of error is the quantity of errors that can be accepted, and is chosen by the researcher based on the accuracy required to make population approximations for a given sample. The margin of error varies from 3% to 7% in business research, by which a 5% margin of error is the most appropriate. In calculating the sample size, a 5% margin of error was used for this research (Cant, 2010).

3.2.4.5 Confidence level

The quantity of doubt that the researcher can accept, is the confidence level. It is the estimated probability that a population's estimate lies within a given margin of error. The confidence interval in business research varies from 90% to 100% with 95% being the most commonly accepted. The higher the confidence level, the larger the sample size should be. The confidence level used for this study was 95%.

3.2.4.6 Response distribution

The response distribution answers the question, "for each question in the questionnaire, what does the researcher expect the results to be". If the sample response is highly skewed, one way or the other, the population will probably be skewed too. However, 50 questionnaires were distributed because there were no limitations expected that are associated with the self-administered data collection method, such as non-responses.

3.2.4.7 The survey area

The study covered SMEs in the Free State Province as registered on the Government's database, adhering to the meaning of a SME, as stated in Chapter 2.

SMEs provide formal employment in the Province and as a result contribute to the economy of the Province.

3.2.5 Step 5: Data collection

This section defines the actual gathering of data and the treatment of missing values as well as coding. Data collection was done by the researcher, who issued the questionnaires to the respondents and followed up on the completion of the questionnaires. The questionnaires were distributed to the respondents between the months of June and August 2015. These questionnaires were distributed personally by the researcher to SMEs across the Free State (FS) Province. The researcher had to wait for almost a month and a half before the questionnaire were returned.

3.2.6 Step 6: Data analysis

Data analysis is one of the steps that need to be followed when conducting a research study. During this step, data collected using various methods is evaluated by using both analytical and logical methods in order to make sense of it.

The main aim of this section was to outline the researcher's analysis of the data collected. This process usually includes the reduction of gathered data to a controllable size, development of summaries, observation of patterns and the application of statistical techniques. It is a process of assembling, transforming and modelling data with the objective of emphasizing useful information, proposing conclusions, as well as supporting decision making. Data analysis has many aspects and methods, including different techniques under a range of names, in different business, science, and social domains (Cooper & Schindler, 2003).

An interpretation of the research findings is also included by the process in the light of the research questions, as well as the determination of whether the results are consistent with the research hypotheses and theories.

In order to make sense of the data collected, it was first coded in order to facilitate its analysis. In this study, SPSS (statistical package for the social sciences) program was used to analyse the coded data. SPSS is a Windows-based program that can handle

large data. It can further use the coded data to provide analysed data in the form of tables and graphs.

Various tests were run during data analysis. These tests include:

- Correlation tests. These provide a measure of the degree of the linear relationship between two variables that are both measured on the same group of people.
- Analysis of variance (ANOVA). It is used to compare differences among more than two means.
- Chi-Square tests. They are useful for analysing whether a frequency distribution for a categorical or nominal variable is consistent with expectations or whether two categorical variables are related or associated with each other.
- T-test. It is used for testing differences between two means.

3.2.7 Step 7: Reporting the results

As depicted in the research process, the final stage is the explanation of the outcomes and the drawing of conclusions related to the failure of SMEs. It is in this step that the researcher reports on the research findings, the research conclusions and makes recommendations (Gerber-Nel et al., 2005). The results of the research are presented in the next chapter. After the data analysis, the results are reported by the researcher. The research report therefore involves the findings, analysis of the findings, interpretation of the results, conclusions, as well as the recommendations. This research report was presented in Chapter four.

3.3 Summary

This chapter scrutinized the research methodology relating to the study. The research methodology was explained and the research process described. The researcher identified and followed the steps in the research process. The problem statement, the research objectives and the research hypothesis were identified as highlighted in the research process. Cooper and Schindler (2006) point out that the formulation of the research problem is of utmost importance in the research.

The two main kinds of research design, namely quantitative and qualitative research, were clarified. The reason for using quantitative research for this study was discussed. In addition, the three types of quantitative and qualitative research, namely exploratory, descriptive and causal research, were also discussed. Furthermore it was mentioned that Gerber-Nel et al. (2005) identified three primary data collection methods, namely observation, experimental and survey. The reasons for using the survey method were given. This study used self-administered questionnaires in the survey, thus the motivation behind using self-administered questionnaires was discussed.

3.4 Conclusion

This chapter provided a short overview of the research design for the main research aspect of the paper. The design was predominantly quantitatively orientated and through the literature research and the Helbok and Wagner (2006) research methodology, the quantitative method was identified as the most applicable, comprehensive and easiest method to apply to the survey.

CHAPTER 4: RESULTS AND DISCUSSION

4.1 Introduction

The previous chapter of this study, Chapter three, discussed parts of the research methodology, comprising of the sampling method design plus the data collection and analysis methods used.

Chapter 4 looks at the empirical findings of this study. In explanation, the instant results were converted into combined and expressive statistics and findings. Neely and Cortes (2009) stress the fact that research findings should be related to the objectives of the research. Thus, the success of the study cannot be assured if both the data analysis and interpretation are not carried out properly. Accordingly, the aim of this chapter was:

- ✓ To systematically present the findings of the research study; and
- ✓ To interpret the findings of the research study.

Data for this study was analysed using descriptive statistics, principal component analysis, as well as means and multiple regression analysis. A summary of findings in line with the hypotheses was also done. As a result of the huge volume of data analysis, only the summary results were presented in this chapter.

4.2 Empirical findings

4.2.1 Response rate

Response rate, also known as completion rate or return rate in survey research refers to the total number of people who responded to the survey, divided by the total number of people in the sample. The response rate for the study is depicted in Table 4.1 below.

Table 4.1: Response rate

No. of questionnaires issued	No. of questionnaires returned	Rate of response
50	50	100%

4.2.2 Reliability of the questionnaires

The questionnaires consisted of five main sections. Section A focused on demographic information, Section B on the measurement of motivations, Section C on the measurement of personal values, Section D on the measurement of managerial skills and Section E measured the performance of the business. The reliability of the variables in four of the five sections, namely motivations, personal values, managerial skills and performance, was tested by using Cronbach's coefficient alpha. The variables were tested for reliability after the questionnaires were returned by the respondents. The reliability for each variable is indicated in Table 4.2.

Table 4.2: Reliability test of the variables

Variables	Cronbach's Alpha	No. of Items
Performance	0.907	4

The variable "performance" had four items with an alpha of .907. Cooper and Schindler (2006) note that a score of 0.7 is an acceptable reliability coefficient. The results indicate that the scales are reliable.

4.3 Research results

The research results refer to the outcomes of a study. In this section, outcomes of this research were discussed by analysing every section of the questionnaire.

4.3.1 Section A: Demographic information

This section recognises and deliberates on the demographic factors related to the SMEs and the research participants' responses. The study used the basic demographic analysis for two reasons:

- ✓ For the identification of population features, in order to determine the respondents' basic information; and
- ✓ For the identification material provision about the respondents, such as their age, level of education, gender, level of business experience, number of full time employees and the legal status of the business.

These questions were also important as other studies, such as Fatoki and Garwe (2010) as well as Gorgievski, *et al.* (2011), argue that these factors contribute to the high failure rate of SMEs. Ages of the managers was specifically asked to ensure that no one outside the age range would be included in the survey.

4.3.1.1 Question 1: Ages of the respondents

Figure 4.1: The age of the respondents
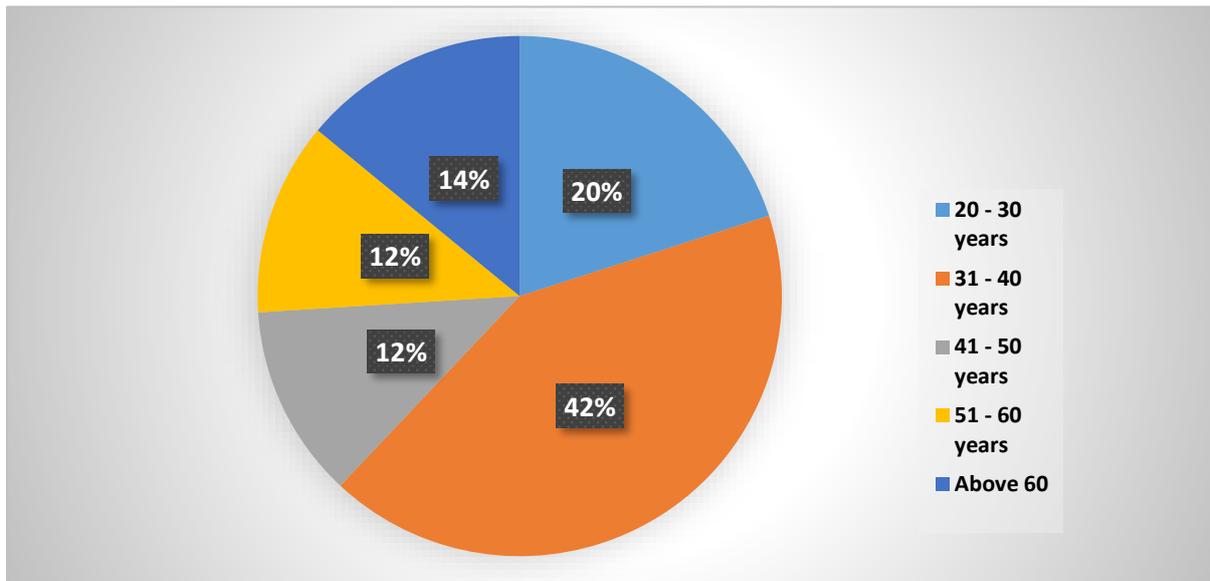
Age is distributed into five main categories, namely 20-30, 31-40, 41-50, 51-60 and above 60. The distribution according to figure 4.1 shows that the majority of respondents in the study were between the ages of 31-40. This implies that the level of entrepreneurial activity is the highest within the 31-40 age range. The 51-60 and 41-50 age ranges had the least representation. This means that the entrepreneurial activity is very low in those age ranges. This result shows that SME owners are generally active between the ages of 20-40. It is also consistent with the findings by Kuratiko and Audretsch (2009), who maintain that there are two natural age peaks correlated to entrepreneurship, namely the late twenties and mid-forties.

4.3.1.2 Question 2: Gender of the respondents

Figure 4.2: The gender of the respondents
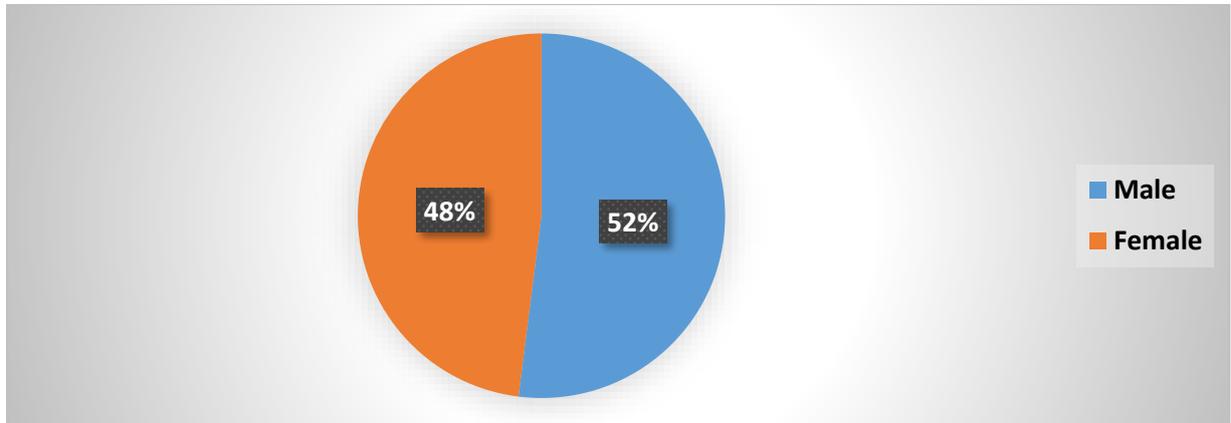
The results according to figure 4.2 indicates that there is a relatively low participation rate of women in small businesses as managers. The results are consistent with the study by Delmar and Wiklund (2008). The authors point out that very few women hold managerial positions in organisations because of their house-hold responsibilities and other family commitments.

4.3.1.3 Question 3: Educational qualifications

Figure 4.3: The educational qualifications of the respondents
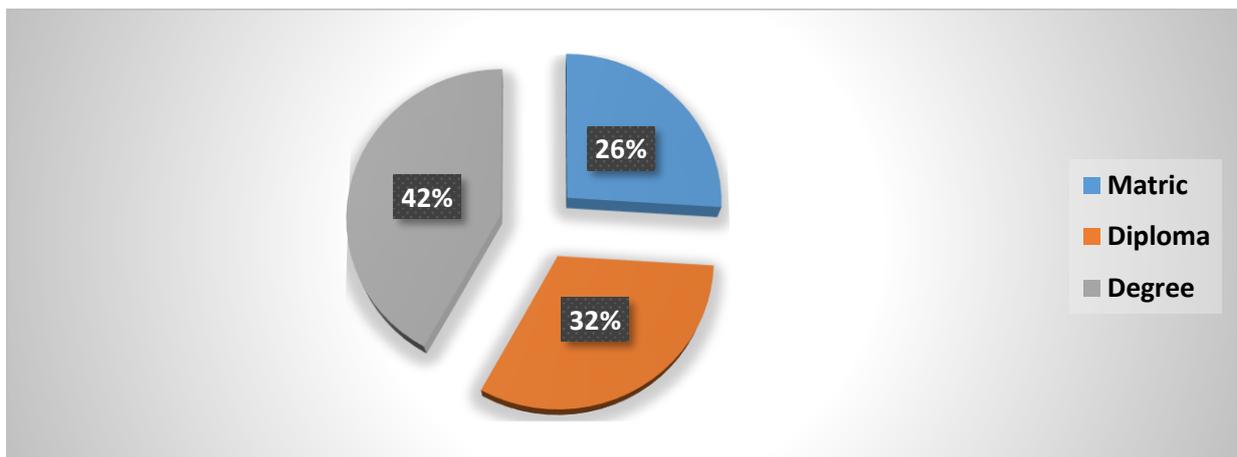
The results according to figure 4.3 indicates that the majority of respondents have degree qualifications. This is consistent with the study done by Ahmad, *et al.* (2009),

which concluded that the level of education increases the likelihood of identifying good business opportunities and the chance of the success of the business.

4.3.1.4 Question 4: Current business

Figure 4.4: Current business
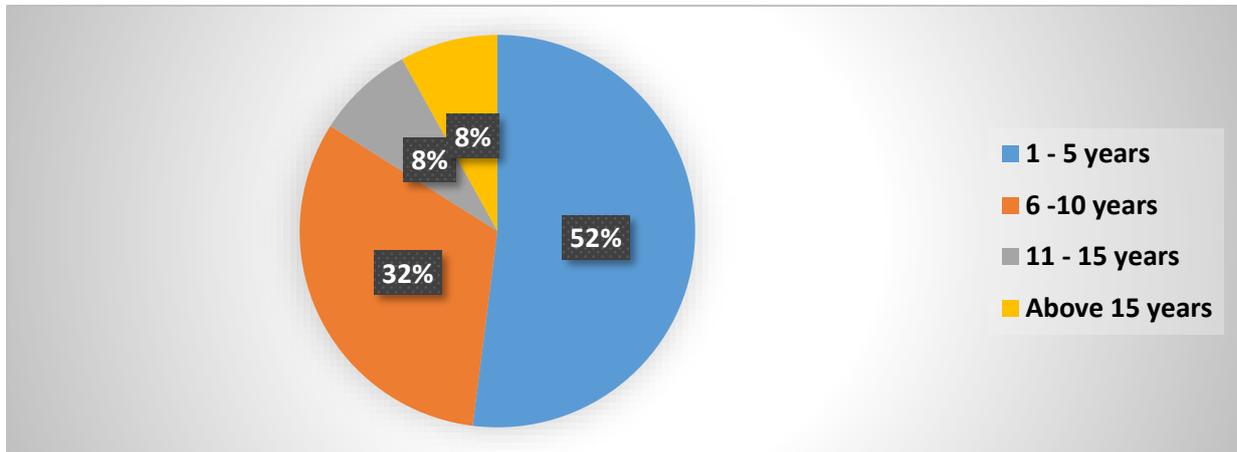
The results according to figure 4.4 indicates that the majority of respondents have been in business for a period of between 1-10 years. This means that more people are embarking on opening the new businesses.

Figure 4.5: Current business sector
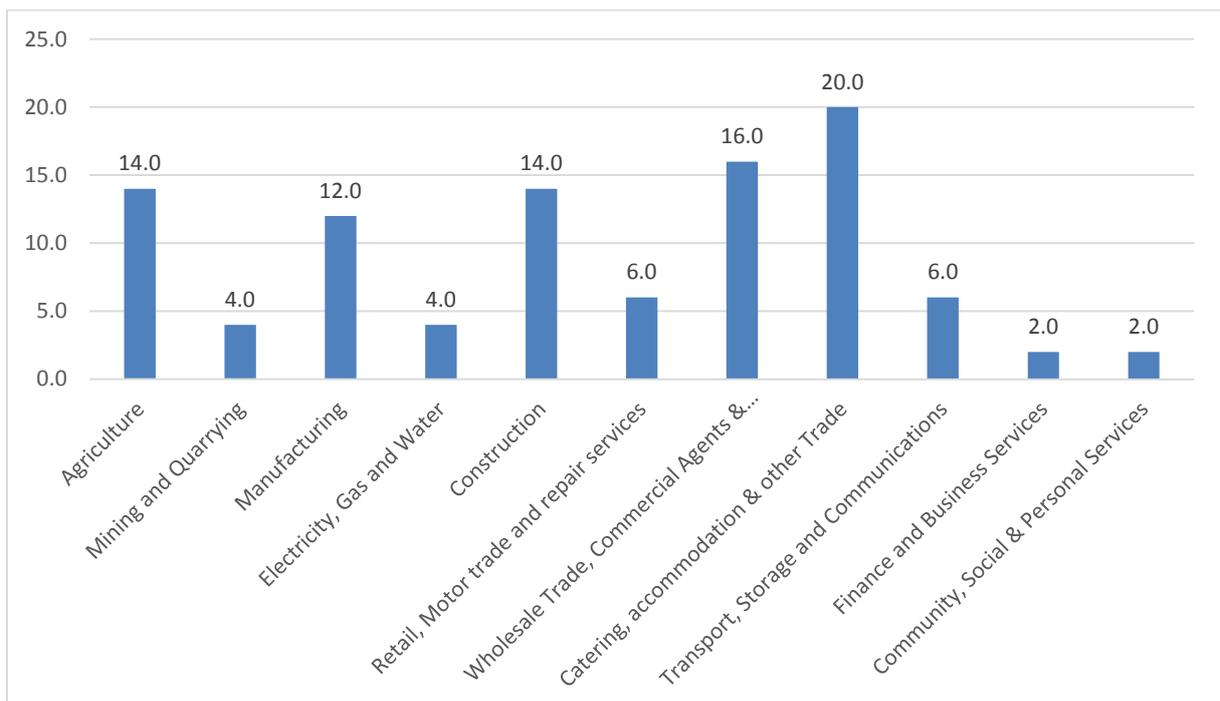
The results according to figure 4.5 indicates that the majority of the respondents are operating in the catering, accommodation & other trades sector. This is normal for the new business entrants as anyone can participate in this sector without necessarily acquiring many operating skills. There are also no complex restrictions or requirements when compared to the other sectors.

4.3.1.5 Previous business experience

Figure 4.6: Previous business
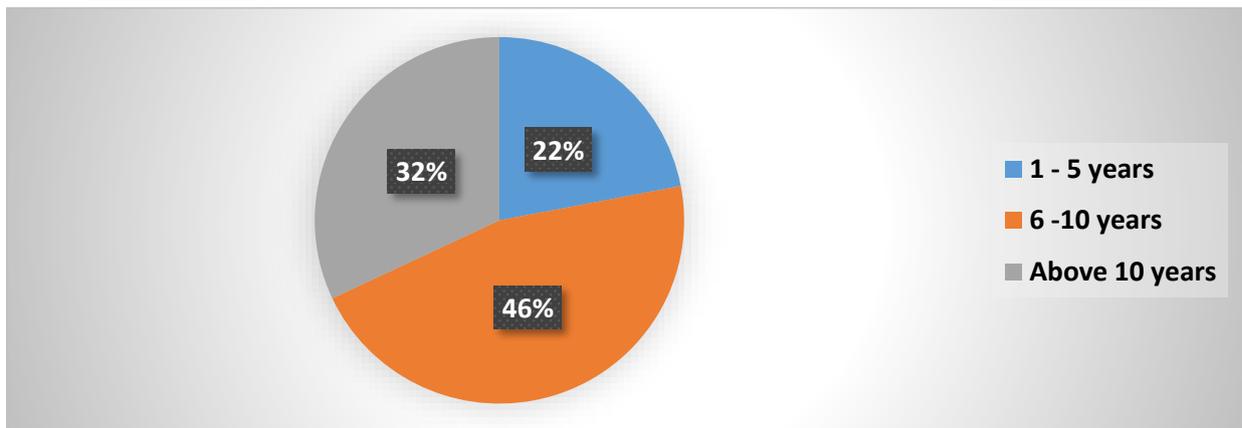
The results according to figure 4.6 indicates that the majority of entrepreneurs have been previously operating businesses in the other sectors over the past 1-10 years before opening new ones in the current sectors.

Figure 4.7: Previous business experience sector
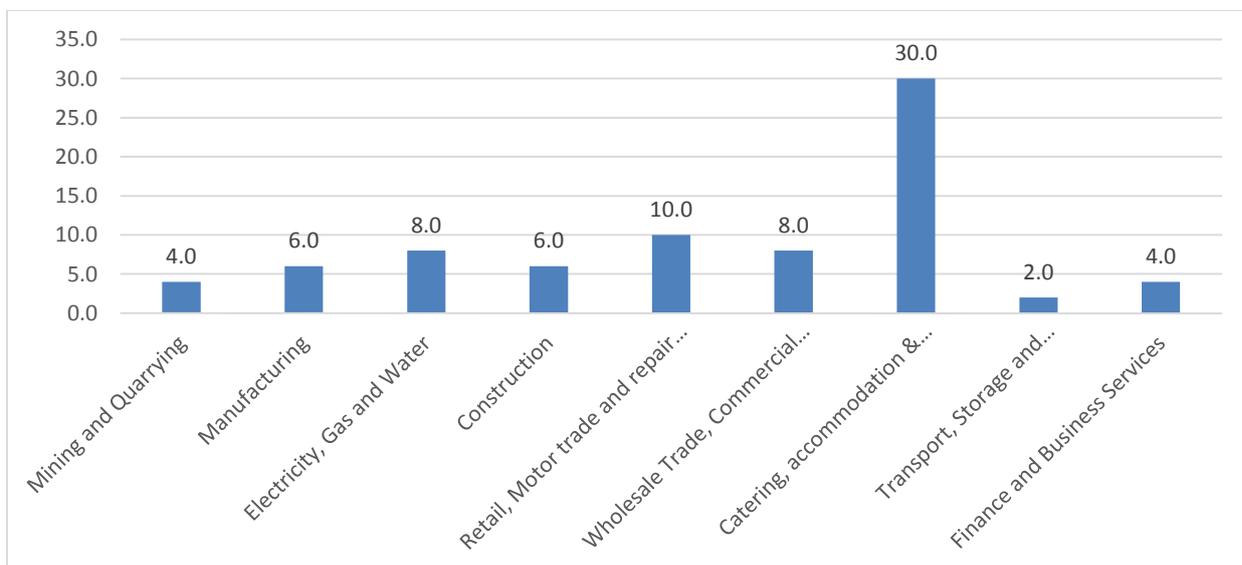
The results according to figure 4.7 indicates that the majority of entrepreneurs were previously operating in the catering, accommodation & other trades sector. This means that most of the entrepreneurs have been operating in the same sectors for the past 10 years.

4.3.1.6 Question 6: Legal status of the business

Figure 4.8: Legal status of the business
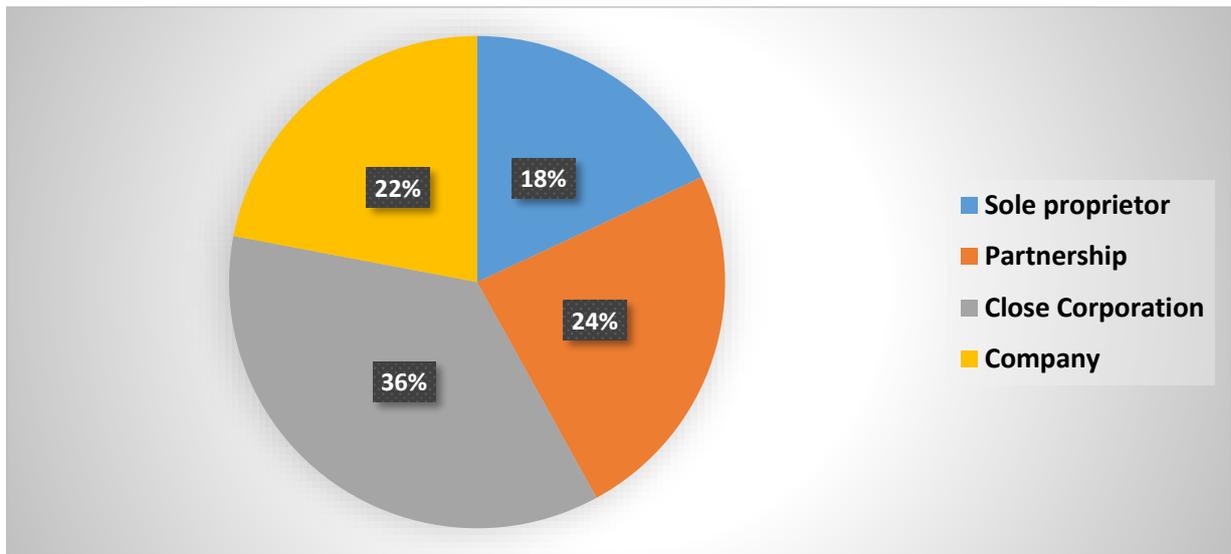
The results according to figure 4.8 indicates that close corporations are the most dominant business status for the respondents, with a percentage of 36%. The results are consistent with the study done by Delmar and Wiklund (2008) that found that close corporations are the dominant business status in South Africa. The second dominant form of business is partnerships, at 24%. It is also interesting to mention here that 60% of the businesses were made up of sole proprietors and close corporations. These results are consistent with the study done by van Vuuren and Groenewald (2007), which states that more than 50% of all businesses in South Africa are close corporations and sole proprietors.

4.3.1.7 Length of operation of the business

Figure 4.9: Length of operation of the business
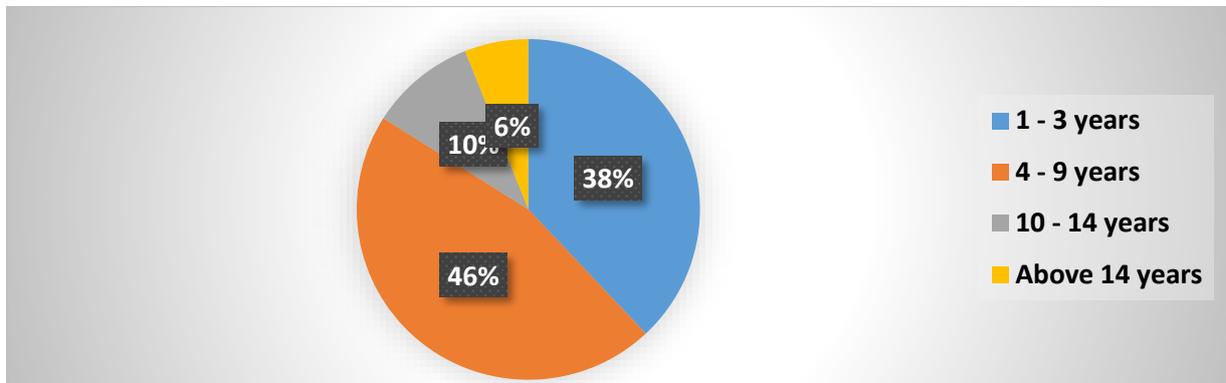
The results according to figure 4.9 indicates that most of the SMEs are young and approximately 84% of them have not been operating for more than fourteen years. However, 6% of the SMEs have been in operation for more than fifteen years. The World Bank's (2010) report on SMEs in South Africa also reveals that the majority of SMEs in the country are post-apartheid firms, established after 1995.

4.3.1.8 Number of full time employees

According to Table 4.3 below, SMEs employ an average number of 5 employees. This confirms Abor Industrial Development Organization's (UNIDO) estimation that SMEs represent over 90% of private businesses and contribute to more than 50% of employment and the Gross Domestic Product (GDP) in most African countries (National Credit Regulator, 2011).

Table 4.3 Average number of employees employed by SMEs

Number of respondents	Total number of employees	Average number of employees
50	272	5.44

4.3.2 Measures of motivations

The objective of this section of the questionnaire (refer to questions 8 to 12 of the questionnaire) was to measure the motivations of SMEs in South Africa. Malik, Ghafoor and Naseer (2011) define motivation as that psychological process that gives

behaviour purpose and direction, the tendency to behave in a purposive manner in order to achieve specific unmet needs. In addition, it is that internal drive in a person to satisfy an unsatisfied need and the will to achieve. The authors used the same scale to measure the motivations of employees. Block and Wagner (2007) also used a similar scale. Figure 4.10 shows the results of the measures of motivations of SMEs.

Figure 4.10: Motivation for managers
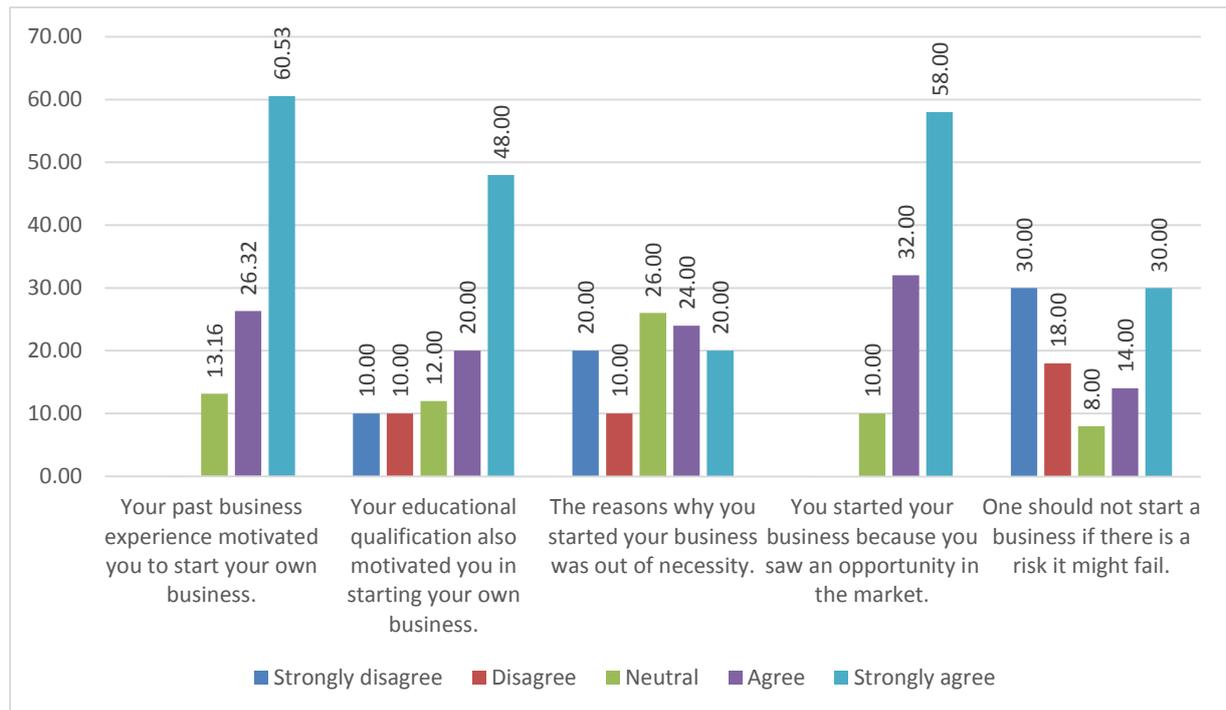
It can be noted from Figure 4.10, that 60.53% of the respondents responded positively that their past business experience motivated them to go into business, while 48% of the respondents indicated that their level of education acted as a motivating factor.

A total of 26% of the respondents were neutral concerning the fact that they started their business out of necessity and 58% of the respondents stated that they went into business because of the business opportunity they saw in the market.

In addition, 30% of the respondents were in accordance with the point that one should not start a business if there is a risk that it might fail, whereas 30% of the respondents did not agree with the same point. This also means that next to the "pure" opportunity and "necessity" motivated individuals there are potential entrepreneurs who are

motivated by a combination of opportunity and necessity factors. Other studies that highlight the possibility that opportunity and necessity factors are simultaneously present in an individual include Giacomin et al. (2007) and Block & Sandner (2009).

It could be concluded from the above results that the level of education and past business experience both play very important roles in managers' motivation. According to Malik, Ghafoor and Naseer (2011), self-motivation is much better than simple motivation (for instance financial incentive) in the managers of the organisations.

According to Martin and Staines (2008), a study on the success of small businesses in Canada, found that the level of education and business experience of the owner/manager, is positively related to the success of the business. Small businesses operated by people with a minimum of secondary education, had their revenues growing more than twice as fast compared to enterprises managed by individuals with less than a high school education.

Driver, Wood, Segal and Herrington (2001) argue that in South Africa, individuals with a matric or those with tertiary educations are significantly more likely to own a small business than those without matric. In addition, Baron (2007) states that personal qualities, such as the level of education and level of business experience, help entrepreneurs to identify better opportunities and assess risk better than other entrepreneurs.

In addition, the author further states that risk tolerance reduces the likelihood of failure for those who start their business out of opportunity and mixed motivations, but not for those who start their business out of necessity motivations. Entrepreneurs are not only motivated by either opportunity or necessity exclusively, both opportunity and necessity motivations are rather present in some entrepreneurs, as stated by Block and Sandner (2009).

4.3.3 Section C: Measure of management skills

The objective of this section of the questionnaire (refer to Question 10 of the questionnaire), was to measure the management skills of SMEs in South Africa.

Questions in this section contributed comprehensively to the understanding of the managerial skills that have an effect on the performance of SMEs. DuBrin (2012) explains managerial skills as a set of behaviours that lead to job performance. The author stresses that managerial skills are acquiring and learning abilities. These skills include financial management skills, strategic planning skills, marketing skills, human resource management skills, networking skills and organizing skills. Due to the nature of the questions in the questionnaire, a principal component analysis was used.

Figure 4.11: Managerial skills I
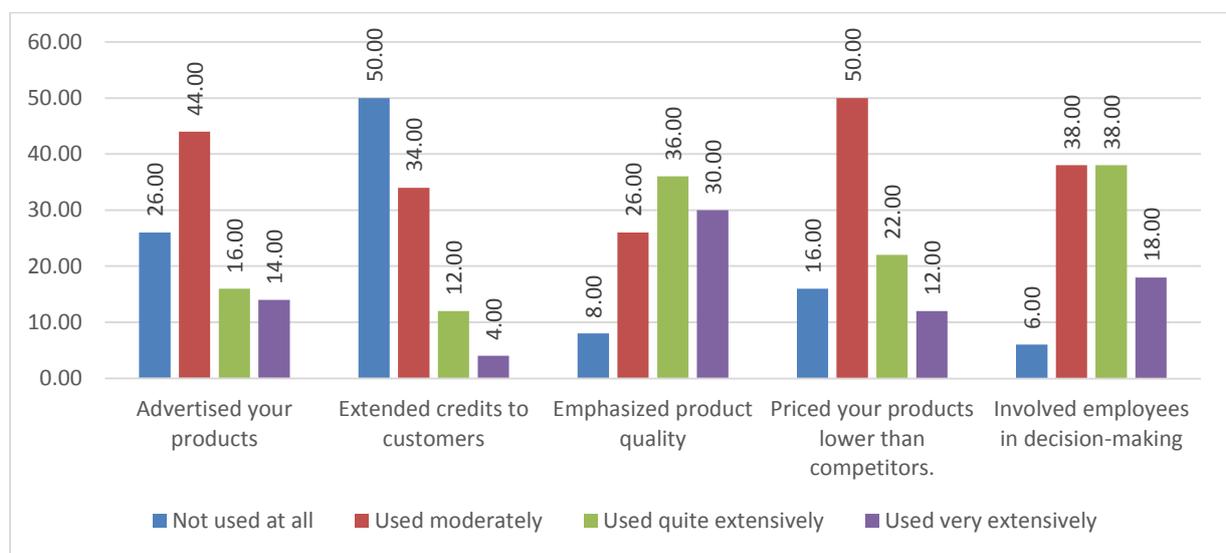
It can be noted from Figure 4.11, that 44% of the respondents moderately advertise their products to maximize their profits and that 50% do not extend credit to their customers. A total of 36% of the respondents extensively emphasizes product quality, while 50% moderately prices their products lower than that of their competitors. In addition, 38% moderately to quite extensively involve their employees in decision making.

FIGURE 4.12: Managerial skills II
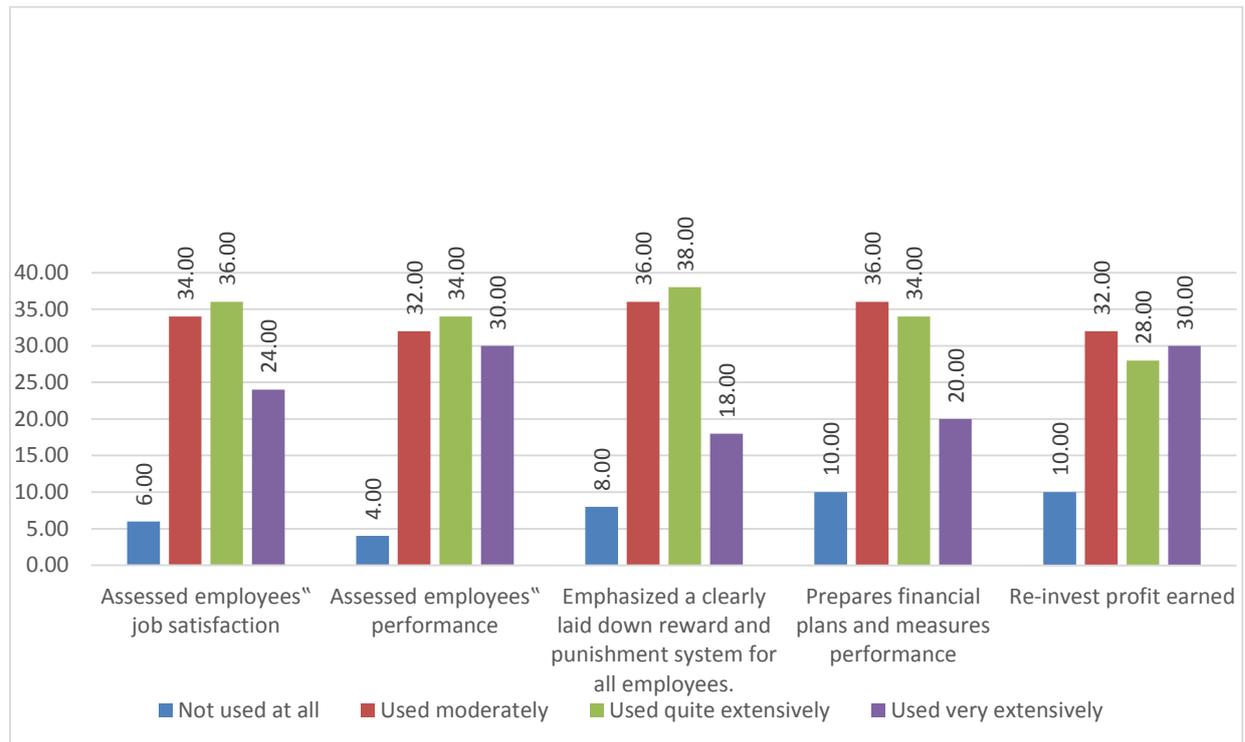
It can be noted from Figure 4.12 that 36% and 34% of the respondents quite extensively assess their employees' job satisfaction and performance respectively.

A total of 38% of the respondents quite extensively emphasizes a clearly laid down reward and punishment system for all employees, while 36% moderately prepares the financial plans and measure performance. In addition, 32% moderately re-invests their profits earned.

FIGURE 4.13: Managerial skills III
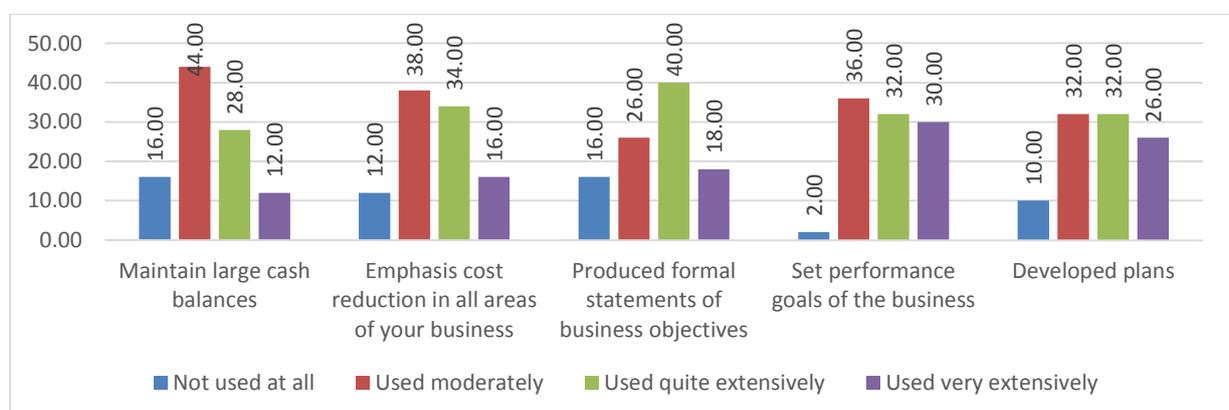
It can be noted from Figure 4.13 that 44% of the respondents moderately maintains large cash balances and that 38% moderately emphasizes cost reduction in all areas of their business.

A total of 40% of the respondents quite extensively produces formal statements of business objectives and 36% moderately sets performance goals for the business. In addition, 32% moderately and quite extensively develops plans.

FIGURE 4.14: Managerial skills IV
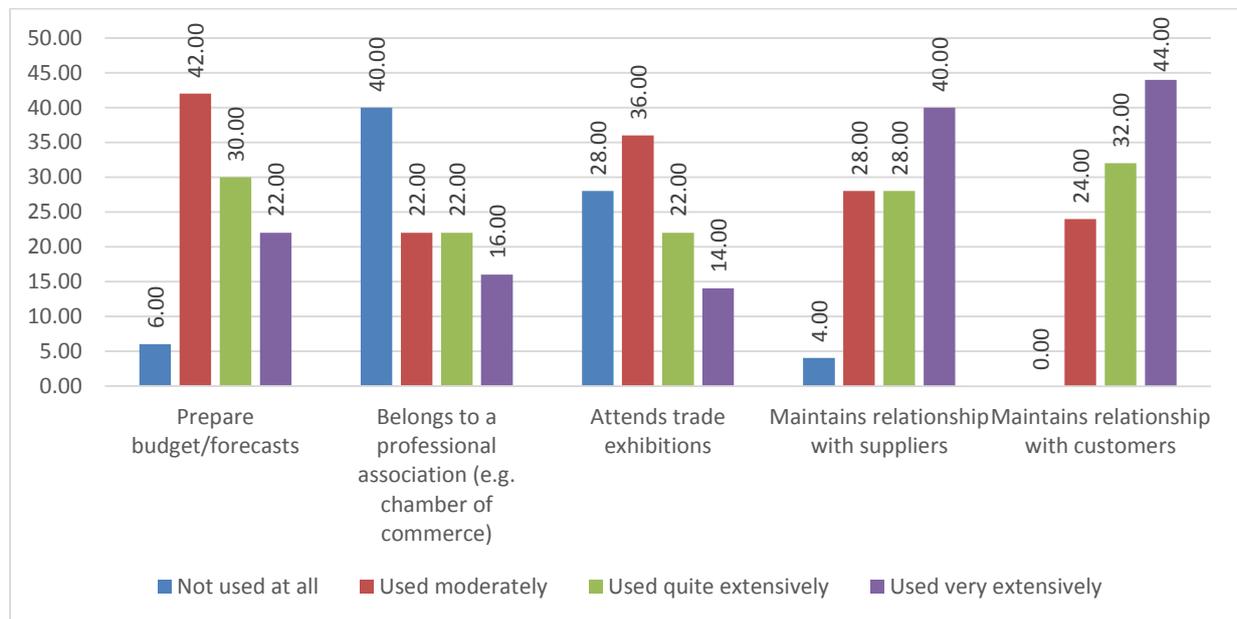
It can be noted from Figure 4.14, that 42% of the respondents moderately prepares budgets/forecasts and that 40% does not belong to any professional associations.

A total of 36% of the respondents moderately attends trade exhibitions and 40% very extensively maintains relationships with suppliers. In addition, 44% very extensively maintains relationships with customers.

FIGURE 4.15: Managerial skills V
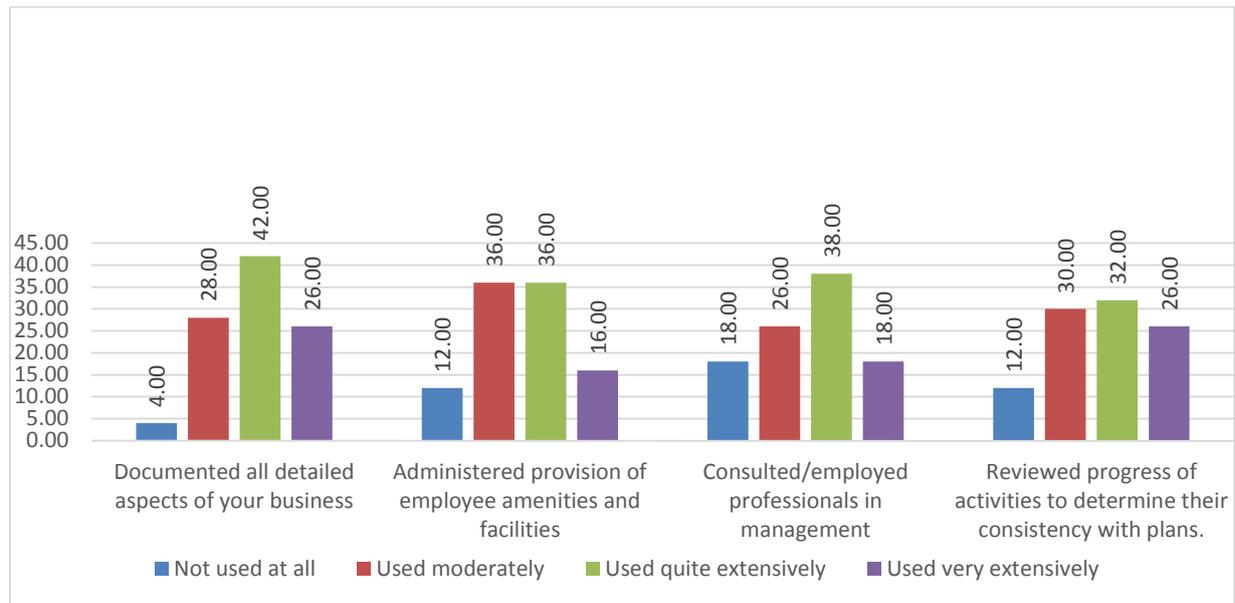
It can be noted from Figure 4.15 that 42% of the respondents quite extensively documents all detailed aspects of their business and that 36% moderately and quite extensively administers provisions of employee amenities and facilities.

A total of 38% of the respondents quite extensively consult/employs professionals in management and 32% quite extensively reviews the progress of activities to determine their consistency with plans.

4.3.4 Section D: Personal values

The objective of this section of the questionnaire (refer to Question 11 of the questionnaire), was to measure the personal values of SMEs in South Africa. Questions in this section contributed comprehensively to the understanding of personal values of SMEs that could impact the organisational values and thus, have an effect on the performance of the business. Cervone and Pervin, (2007) define personal values as qualities that contribute to an individual's enduring and distinctive patterns of feeling, thinking, and behaving. The authors state that personal values have been recognised as the most influential manager characteristics, and firm performance is explained by the fit between values and strategic choices.

FIGURE 4.16: Personal values I
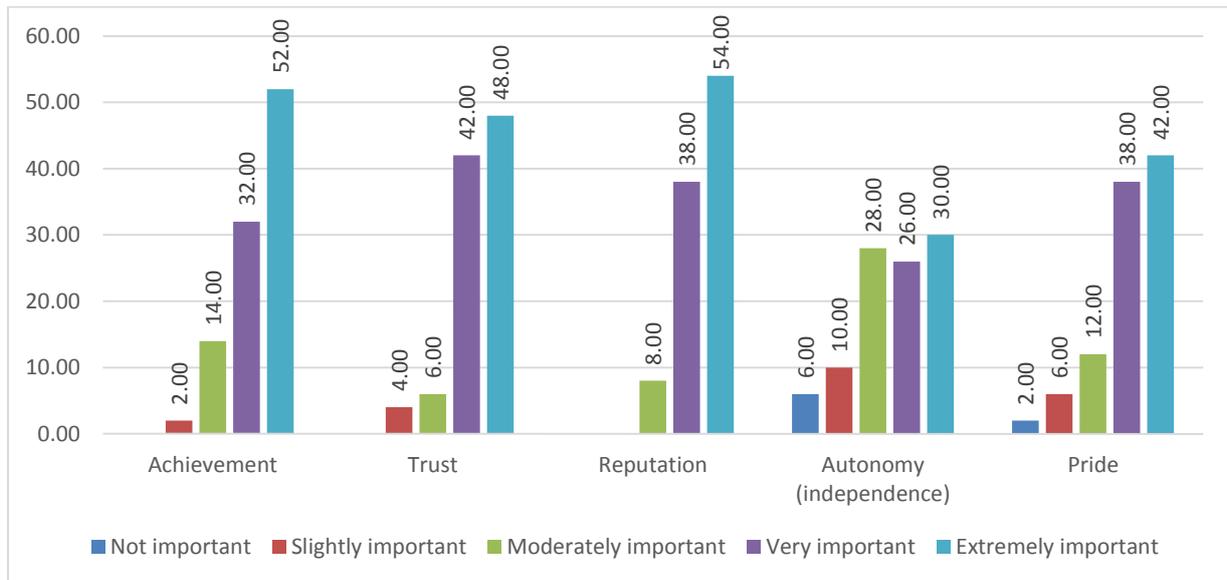
It can be noted from Figure 4.16 that 52% of the SMEs views the value of achievement in the business as extremely important and that 48% perceives trust as an extremely important pillar for the business to succeed. A total of 54% of the SMEs feels that it is extremely important to build a good business reputation and 30% feels that it is very important for the business to be autonomous. Furthermore, 42% of SMEs feels that it is extremely important for the business to pride itself in terms of good services as well as good business practices.

FIGRE 4.17: Personal values II
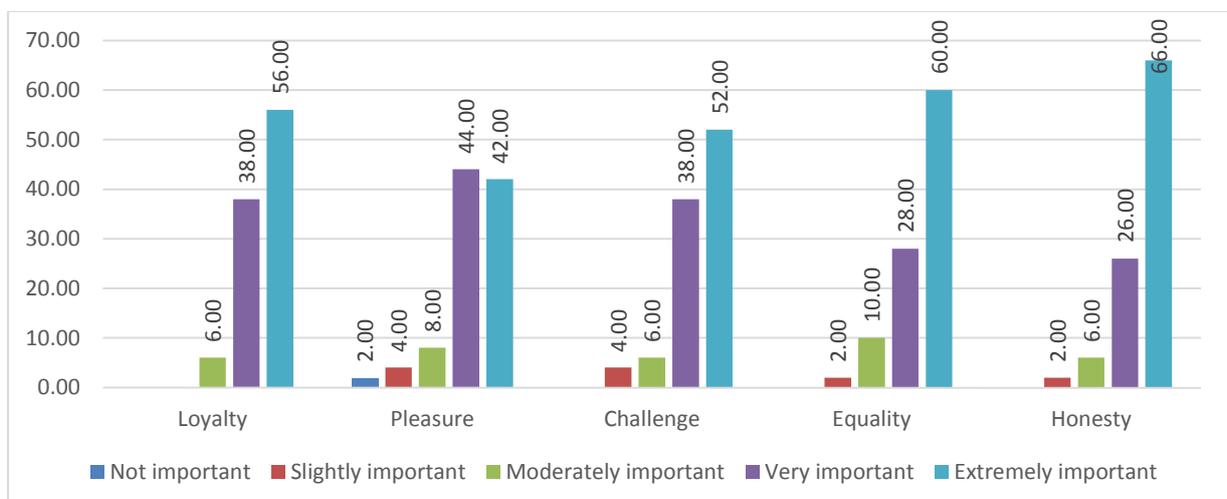
It can be noted from Figure 4.17 that 56% of SMEs deems it extremely important to be devoted to the customers and that 44% deems it very important to derive pleasure from all the business activities. A total of 52% of SMEs feels that it is extremely important to enjoy the challenges that are brought by operating a business and 60% feels that it is extremely important to have equality, as it plays a vital role within a business to ensure efficient and effective operations. Furthermore, 66% of SMEs feels that it is extremely important for the business to operate honestly, relating to its internal and external stakeholders.

FIGURE 4.18: Personal values III
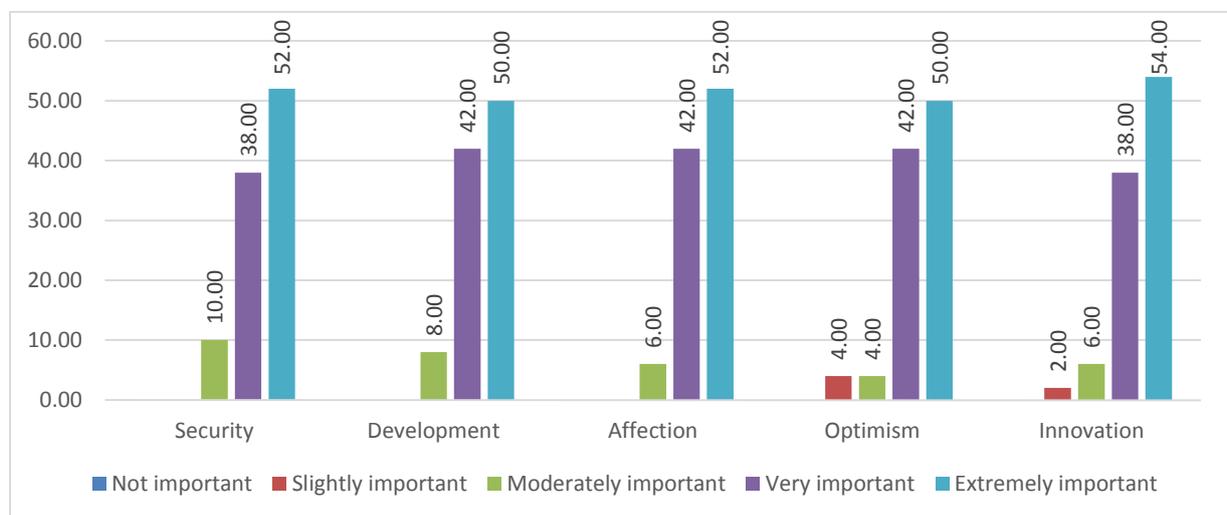
FIGURE 4.19: Personal values IV
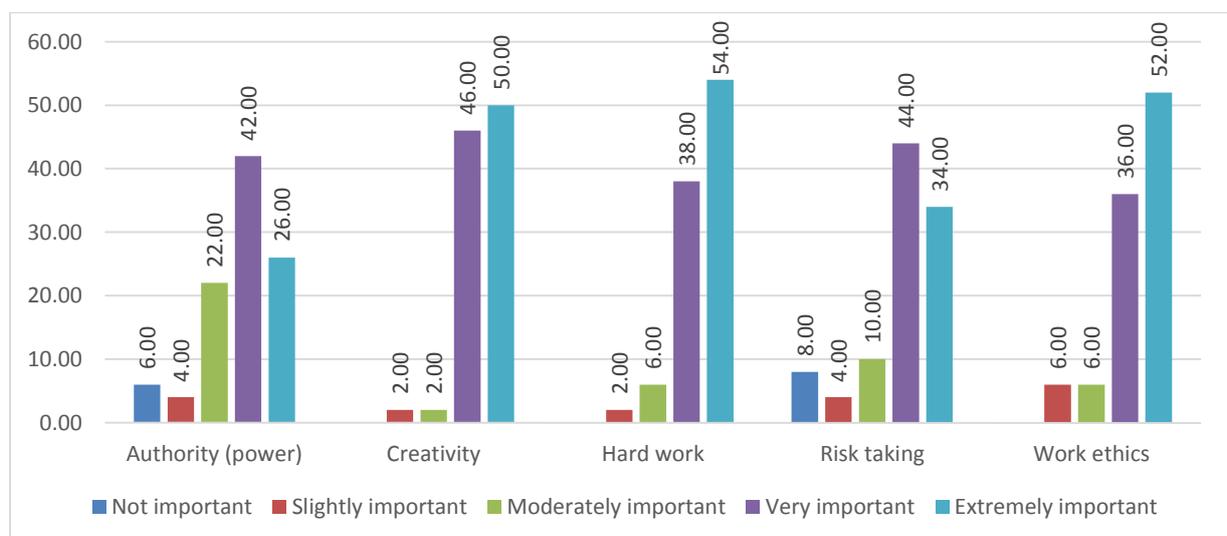
As shown in Figures 4.18 and 4.19 above, 54% of SMEs indicated "honesty", "hard work" and "innovation" as extremely important values. Security, affection and work ethics comes second with 52% of the SMEs. Development, optimism and creativity are third with 50% of the respondents. On the other hand, autonomy is the least important value within the business. The least important level of the six values for managers within their businesses, namely autonomy, authority, risk taking, pride, reputation and challenge, scored below 50%.

The data analysed above revealed that the important finding is consistent with the literature. That is that the most important personal values of managers of SMEs are entrepreneurial values, such as honesty, loyalty, trust, hard work, work ethics and achievement. Therefore, it can be said that having such a high level of entrepreneurial values is a good characteristic of a successful enterprise, which is consistent with the study by Blackman (2003).

4.3.5 Section E: SMEs' performance

The objective of this section of the questionnaire (refer to Questions 15 to 18 of the questionnaire) was to measure the performance of SMEs in South Africa. Questions in this section contributed comprehensively to the understanding of the performance of SMEs. Performance as the results of activities of a business or investment over a given period. Responses to the questions related to measure performance of SMEs, are indicated in Figure 4.20.

Figure 4.20: Performance of SME
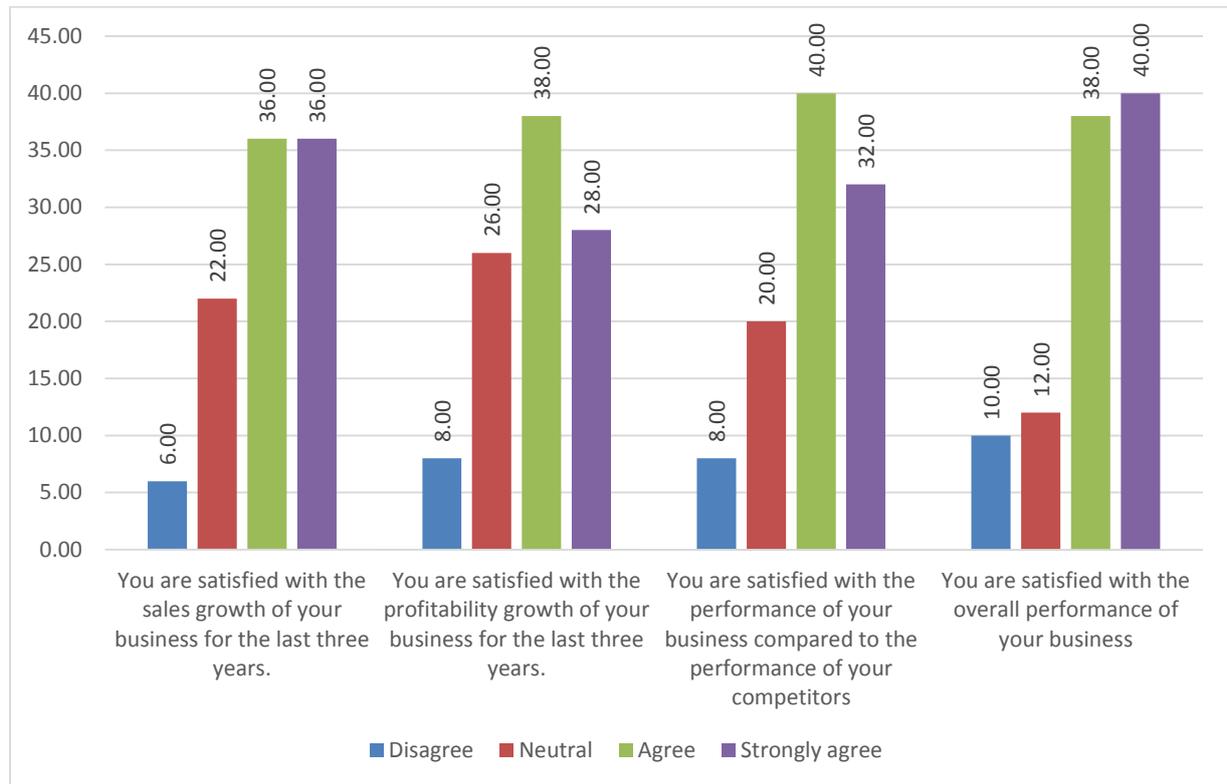
Based on the results in figure 4.20 above, 36% of SMEs indicated that they are satisfied with the sales growth of their business over the past three years, whereas 38% of the managers indicated that they are satisfied with the profitability of their business over the past three years. About 40% of the responses from managers indicated that they are satisfied with their business performance compared to competitors' performance and finally, 74% of SMEs indicated that they are satisfied with the overall performance of their businesses.

4.4 Conclusion

This chapter analysed the research results from the questionnaire distributed to the respondents. The age of the respondents were analysed and majority are between the age of 31 – 40 years. It can also be seen from the responses that the majority of the respondents were males and the majority of them have the degree qualifications. Most of the respondents have been into their current business for a period of between 1 – 5 years.

Majority of the respondents are in the catering accommodation and other trade business sector. They have been in their previous business for a period of 6 – 10 years also in the catering, accommodation and other trade business sector. The majority of the respondents' legal status of their current business are in the close corporations and have been operating in the business for a period of 4 – 9 years. Their past business experience highly motivates them and they started their business because they saw a gap in the market to sell their products.

They moderately advertise their products and do not extend credits to their customers. The respondents also emphasize the product quality and they do not always price their products below their competitors. It can also be concluded that they lack in terms of the managerial skills to effectively and efficiently manage their businesses. It can further be emphasized that SMEs views loyalty and honesty as an extremely important element in the survival of the business.

Innovation is also viewed as an important aspect in the survival of the business as the introduction of new products and the improvement in the existing ones is very vital to the sustainability of the business.

It can therefore be concluded from the results that most of the owners have not been in the business for a long time and even though the majority of them are educated, they are still lacking in terms of the managerial skills. It can also be concluded from the results that some of the SMEs enter the business for the wrong reasons.

The next chapter presents the conclusions and recommendations of the study. In addition the achievement of the objectives of the study is presented. Furthermore, the limitations of the study and areas for further study are highlighted.

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provides a conclusion to the study that was carried out to determine the reasons for the high failure rate of SMEs in the Free State Province.

The high failure rate of SMEs which has resulted in the high unemployment rate, is a problem currently faced by South Africa as supported by the literature. As a result, it is of great importance to understand the influence of factors such as motivations, personal values, and managerial skills of managers of SMEs, on their firms' performance. A discussion of the findings, recommendations and limitations of the study and areas for further study are presented in this chapter.

The section below presents a brief summary of all the chapters in this study as well as the findings. Furthermore, recommendations and the achievement of the research objectives as well as the limitations of the study and areas for further research are discussed. The final section gives the conclusion of the study.

5.2 Summary of the study

This study consists of five chapters. The following section presents the summary of the chapters.

5.2.1 Introduction and problem statement (Chapter one)

The current study was aimed at investigating the reasons for the high failure rate of SMEs in the Free State Province. The primary focus of this study was to determine if funding, motivations, personal values, and managerial skills had an impact on business performance, by using SMEs as the case study. According to Brink, Cant and Ligthelm (2003), it is estimated that the failure rate of SMEs in South Africa is between 70% and 80%.

Accordingly, many SMEs do not reach their full potential and fail to grow, resulting in the loss of jobs and wealth. In addition, this has led to the high unemployment rate of the economically active population. The research problem for this study was to identify the reasons that contribute to the failure of SMEs in the Free State Province.

To obtain solutions to this problem, a review of the literature and development of the hypotheses, was important. The research hypotheses for this study were:

H0 signifies the null hypotheses. It is a statement which falsifies the relationship between measured variables. H1 signifies the alternative and indicates that there is a connection between measured variables. The following hypotheses were used in the study:

H0: The reasons for failure of SMEs is not as a result of the lack of government interventions.

H1: The reasons for failure of SMEs is as a result of the lack of government interventions.

H0: The reasons for failure of SMEs is not as a result of the lack of management skills.

H2: The reasons for failure of SMEs is as a result of the lack of management skills.

H0: The reasons for failure of SMEs is not as a result of the lack of financial support by the financial institutions.

H3: The reasons for failure of SMEs is as a result of the lack of financial support by the financial institutions.

H0: The reason for failure of SMEs is not as a result of poor planning.

H4: The reason for failure of SMEs is as a result of poor planning.

5.2.2 Literature review (Chapter two)

Chapter two of this study focused on small and medium enterprises in South Africa. The chapter started by defining entrepreneurship and concluded that many definitions of entrepreneurship exist and no definition can be singled out as totally defining entrepreneurship.

Nonetheless, it was brought to light that entrepreneurship and SMEs are synonymous and are used interchangeably in literature. In addition, the definition of SMEs from both

national and international perspectives was also brought to the fore. The chapter proved that the definition of SMEs also differs from country to country. Furthermore, literature with respect to the importance of SMEs in the South African economy was examined.

SMEs create new employment, eradicate poverty and contribute significantly to economic growth. Finally, the challenges faced by SMEs were examined. Chapter two examined the literature in respect to the relationship between funding, motivations, personal values, managerial skills and firm performance. The literature review revealed that motivations include the level of education, previous business experience, opportunity recognition, necessity, and the desire to take risks in business.

Performance was measured under two separate categories, namely financial measures, which included growth in profit, and growth in sales, and non-financial measures, that included managers' satisfaction with overall performance and managers' satisfaction with the way the business is progressing compared to competitors. Motivations were measured by the level of education, previous business experience, started business because of opportunity, started business out of necessity and the risk of business failure.

Personal values were measured by hard work, honesty, equality, accomplishment, risk taking, optimism, growth, national security, loyalty, compassion, trust, responsibility, creativity, innovation, autonomy, social security, religion, affection, competence, security, ambition, prestige, energy and work ethics. Managerial skill was measured by financial management skills, strategic planning skills, administration skills, marketing skills, human resource management skills and networking.

5.2.3 Research methodology (Chapter three)

Chapter three of the study dealt with the research methodology. This chapter examined aspects of the study that included the research design, definitions, measurements, data collection methods, and data analysis. The study was based on descriptive and causal research, in which a simple random sampling technique was used to draw a sample.

The research instrument used to collect data was self-administered questionnaires. The data collected was converted into a more suitable format for analyses by using Excel software. After data processing, the Statistical Package for Social Science (SPSS) was used for data analysis. Statistical techniques used in this study included descriptive statistics, central tendency (mean), principal component analysis, Pearson's correlation and multiple regression analysis. Reliability was tested using Cronbach's alpha.

5.2.4 Results and discussion (Chapter four)

The research findings were presented following the questionnaire's structure which presented the questions in a serial order.

5.2.4.1 Response rate

In this study, out of the 50 questionnaires that were distributed to managers of SMEs, 50 questionnaires were returned. The response rate for this study was therefore 100%. Reliability was tested using Cronbach's alpha.

5.2.4.2 Demographics

The majority of the respondents for this study were male managers and were in the 31–40 age range. Most of the respondents also had at least a matric qualification with 6–10 years of previous business experience. In addition, the results also indicated that most of the businesses were younger than fourteen years and close corporations were the dominant form of business registration.

5.2.4.3 Measures of reasons for failure of SMEs in the Free State Province

The questions were necessitated by the need to identify the motivations, personal values and the managerial skills of SMEs that could positively impact on the performance of their businesses. It can be concluded from the results that the majority of SME managers were aged between 31–40 years and most of them were males.

The majority of SME managers have Bachelor's Degrees and have been in their current business for 1-5 years. Most of them are in the catering, accommodation and other trades industry. Also, the majority have been in previous businesses for 6-10

years, in the industries mentioned above. The legal status of the most SMEs is close corporation.

The following issues have been identified from the questionnaire as the major reasons for the failure of SMEs in the Free State Province:

- ✓ Lack of business and financial management and no control over cash flow – the respondents indicated that it is difficult to manage the business without financial and business management skills as these also affects the cash flow management of the business.
- ✓ Economic meltdown and closure of big business to supply – the economic meltdown has led to the restructuring by the large business corporates and this has resulted in them exercising cost containment measures which resulted in them not procuring from the small businesses.
- ✓ Failure to get paid on time and a lack of training – small businesses are not paid on time upon the delivery of goods and services and this negatively affects the cash flow of the business.
- ✓ High market concentration – most of the small business sells the same goods and services and this has resulted in high market concentration.
- ✓ Infighting amongst partners – the fighting amongst partners can also lead to the failure of the business.
- ✓ Insufficient funds, lack of knowledge, non-investment of profits and poor management and planning – entering into the business without necessarily conducting a market research, lack of financial resource resources, not investing the profits made by the business and poor management and planning can contribute to the failure of the small businesses.
- ✓ Lack of business and management skills.
- ✓ Lack of business ethics, mismanagement of funds and a lack of direction – issuing of bribes and kickbacks, misappropriation of the business funds and lack of vision can lead to a business failure.
- ✓ Lack of business management skills and bribes.
- ✓ Lack of business opportunities, especially if you don't have connections – opening a business without researching what product are you going to sell,

where are you going to buy the product and to whom are you going to sell the product also contributes to the business failure.

- ✓ Lack of consistency and stability.
- ✓ Lack of experience and too lazy to go and look for business.
- ✓ Overexpansion and location of business – expanding the business without properly studying the market as well as carefully evaluating the market of which the business is going to supply can result in the failure of the business.
- ✓ Lack of financial management skills.
- ✓ Lack of planning.
- ✓ Lack of proper research of the market and marketing of products and services.
- ✓ Lack of proper training and financial support from Government and other institutions – lack of training as well as the financial support from the government as well as the other stakeholders can result in the failure and subsequent closure of the business. Training is very critical for the survival of small business. Financial support from the financial institutions is also critical for the survival of the small business.
- ✓ Lack of research and commitment.
- ✓ Mismanagement of business cash flow, not hands on and losing track of the business activities and funds.
- ✓ High dependency on Government assistance – over dependence on government tenders can also result on the business failure because there won't be any business if the government decides to procure from someone else.
- ✓ Late payments and lack of proper training.
- ✓ Location of the business operations – location is critical for any small business to survive. Location in the remote areas can result in the business not being easily accessed and the customers will search for alternatives.
- ✓ Mismanagement and no re-investment of profits back into the business. Concentrating on outsmarting competition.
- ✓ No website for marketing products – lack of marketing of the products also contributes to the business failure.
- ✓ Poor management skills and an inability to attract more customers and market the business, as well as failure to meet customer needs.
- ✓ Poor planning and late payments from clients, especially Government.

✓ Reckless use of business funds.

✓ Starting business for the wrong reasons, without doing necessary research.

From the results obtained from this study, it can be concluded that a lack of skills and knowledge is a major factor that leads to the failure of SMEs. SMEs do not embark on thorough research to test the market before starting a business they just start a business and hope for the best.

It could also be clearly seen from the results that SMEs are too reliant on the Government to provide then with business. They are not innovative and as a result, most of them are involved in one business industry, resulting in that the market becomes too concentrated. Lack of marketing of their products and services had also been identified as one of the reasons that lead to the failure of SMEs. There is no clear marketing strategy by SMEs, which results in their products and service offerings not being known by their customers.

Late payments by customers, especially the Government, had also been identified as one of the reasons that lead to the failure of SMEs. SMEs use their own capital to provide goods and services and if they are not paid in time, their businesses suffer. A lack of financial skills also contributes to the failure of SMEs, which results in the reckless usage of funds and non-investment of profits back into the business.

The economic meltdown has also contributed to the high failure rate of SMEs. As a result of many big businesses that usually trade with SMEs closing down, it also results in the SMEs closing down, because they are no longer getting this business.

5.3 Recommendations

SMEs have a very important role to play in the economy of South Africa. They are a key source of economic growth and poverty alleviation. SMEs also help diversify economic activity, make a significant contribution to exports and trade and contribute to employment. From the research findings, it is clear that the South African business industry as a whole critically needs to address the problems and challenges that are faced by the SMEs.

The findings of this study revealed that a lack of funding, a lack of knowledge, the economic meltdown, a lack of motivation, a lack of personal values, and a lack of managerial skills of SMEs negatively influence SMEs' performance in South Africa.

The review of the literature revealed that personal values of SMEs greatly influence their behaviour, which in turn influences their decisions and their management style. The empirical findings of this research show that SME managers' personal values are an important factor, which positively influence the performance of SMEs. This is evident from the fact that a manager in an organisation will agree on a vision and mission, but lapse into conflict, because different people have different values about how to put it into action.

In addition, Schwartz's theory (2005) stresses the fact that values form the bedrock of any corporate culture. As the essence of a company's philosophy for achieving its goals, values provide a sense of common direction for all employees and guidelines for their day-to-day behaviour.

The author reiterates the fact that if managers and employees know what their business stands for, if they know what standards they have to uphold, they are much more likely to make decisions that will support those standards. Managers are also more likely to feel as if they are an important part of the organisation. They are motivated because life in the company has meaning to them.

According to Herrington et al. (2009), entrepreneurship education should be seen as a key prerequisite for raising the levels of managerial skills in South Africa. This is also supported by Shariff and Peou (2008), namely that apart from the educational impact of the home, academic institutions can be regarded as the place where the most profound impact can be brought about in the development of managers and would-be managers of businesses. Therefore, entrepreneurship education is one of the initiatives that can be designed to enhance skills and knowledge in SMEs.

Another means by which managers of SMEs can acquire and improve on their managerial skills, is through training. Government agencies such as the Small Enterprise Development Agency (SEDA) and Development Corporations can organize

practical training for managers. The present system where the Government agencies such as SEDA use consultants who write business plans for managers which they cannot articulate does make sense, but could potentially be counterproductive.

Additionally, the study also highlights the lack of business management skills as well as the cash flow and financial management as being the constraints and challenges relating to the management of the SMEs.

It is further recommended that the following interventions be made:

i. The Government and the private institutions must set aside more funds to ensure that people are encouraged to open new businesses and the assurances should be made that they will be supported financially as well as being properly trained to manage their business.

ii. The private sector and the government should focus their energies on the advancement of the SMEs by being more prominent in distributing the information to the SMEs that can assist in the management of their business.

iii. The SMEs must robustly market themselves in order to ensure that their products are known.

iv. The SMEs must be innovative and should continuously introduce new products in the market.

v. The SMEs must not rely on the tenders from the government. They should also look for opportunities in the private sector.

vi. The government must introduce very strict regulations to manage the companies that does not pay the SMEs in time.

vii. The South African Revenue Services should provide more tax incentives for the SMEs and also train them on tax matters.

viii. SMEs must be allowed access to the financial resources by the financial institutions as well as training on how to service their loans.

ix. There should be no regulatory bias towards the allocation of credit to the SMEs by discouraging high risk or high cost credit provision.

5.4 Achievement of objectives

This section measures the study's success against the objectives of the research, as formulated in Section 1.5.3. The objectives of this study were:

- ✓ To find the reasons that contribute to the failure of SMEs in the Free State Province;
- ✓ To describe SMEs and their role in the Free State Province's economy;
- ✓ To outline the present SME state of affairs in the Free State Province;
- ✓ To find consequences of SME failure to the Free State Province;
- ✓ To offer corrective actions in order to avoid SME failure in the Free State Province;
- ✓ To mention reasons that result in the SME failure in the Free State Province; and
- ✓ To develop an action step plan of how to avoid failure of SMEs in the Free State Province.

The first objective of this study was to identify the reasons that contribute to the failure of SMEs. The second objective was to define the SMEs and their role in the economy. The third objective was to identify the consequences of the failure of SMEs. The fourth objective was to provide remedial actions. The fifth objective was to highlight the reasons that lead to failure. Finally, the sixth objective was to develop an action step plan on how to avoid failure.

In order to achieve these objectives, two approaches were employed. One was through the review of literature and the other through empirical evidence. The first approach was achieved through the review of literature, in Chapter two, and the second approach was achieved through the presentation of empirical findings in Chapter four. All six objectives were achieved by using the first approach in Chapter two and the second approach in Chapter four.

5.5 Limitations of the study

The main limitation of this study was the measure of motivations, values, performance and management skills. Values of an individual can be measured in terms of security,

vitality, energy and pleasure. On the other hand, performance can be measured by the profits that the business generates.

For the purpose of this study, the measure of values, motivations, management skills and performance, were limited to the measures listed in Section 5.2.2. In addition, the study was limited to SMEs in the Free State Province, specifically Bloemfontein and Welkom. As a result of the limitations, as pointed out above, caution should be applied in interpreting and applying the outcomes of this research, and generalizing the findings to South Africa as a whole.

5.6 Areas for further research

One of the main causes of SME failure in South Africa is the non-accessibility of trade creditors and debt finance from commercial banks. Further research studies can investigate the processes that SMEs needs to follow, as well as the information they need to get to be able to access debt finance from commercial banks and trade creditors. Another study could compare the impact of motivations, personal values and managerial skills on a firm's performance between immigrant entrepreneurs and South African entrepreneurs.

5.7 Conclusion

This chapter observed the achievement of objectives, recommendations, conclusions, limitations, as well as the areas for further studies in connection with a study titled: The reasons for failure of SMEs in the Free State Province of South Africa. Herrington et al. (2009) point out the fact that one of the country's greatest limitations to economic growth and development can be attributed to the lack of potential managers and entrepreneurs.

According to these authors, the ratio of potential entrepreneurs or managers to South African employees is approximately 1:52; meanwhile, in most developed countries, the ratio is approximately 1:10. Potential managers and entrepreneurs are the key challenge to deal with. Various reasons are faced by these managers and it influences their business performance. The purpose of this study was to find ways of decreasing

the SMEs' high failure rate in South Africa by ascertaining the perceived values, motivations, knowledge and managerial skills of SMEs.

The six most important values of SMEs, as revealed by the study, include honesty, loyalty, hard work, trust, achievement and work ethics. While the six least important values, include challenge, reputation, pride, risk taking, authority and autonomy. Managerial skill was found to be the most contributing factor to affect the performance of SMEs.

To improve the performance of SMEs, the study recommends that SMEs should improve on their educational level in order to be able to analyse the market for better business opportunities, as well as different strategies of marketing their products. The study also recommends that SMEs should attend training and seminars to improve on their managerial skills as well as their financial knowledge.

In addition, the study recommends that the Government should invest more in SEDA and the Development Corporation, so that these agencies can arrange seminars and training for SMEs on a regular basis. A corporate value standard is also recommended by the study as an organisational behaviour's good guide, as the success and effectiveness of every organisation is based on the close link between organisational and personal values.

The study further recommends that the Government should look at ways and strategies of ensuring that SMEs are paid on time, once the delivery of goods and services have been made. The study also recommends that SMEs do proper research on the business industry that they wish to be involved in, so that they can establish whether the market is not concentrated, in other words, there should not be too many SMEs providing the same goods and services.

The study finally recommends that there should be clear guidelines on the conduct of all the partners involved in the business so as to avoid infighting that can have a detrimental effect and cause the business to fail.

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ANNEXURE A

QUESTIONNAIRE

Dear participant

My name is Lefa Kalane and I am a Master student in Business Administration at the University of Free State under the supervision of Dr. J. van Zyl. I am writing to invite you to participate in my research in the form of a questionnaire. My Masters Degree project is entitled "Reasons for failure of SMEs in the Free State Province". Specifically, the reasons on why there is a high failure rate of SMEs in the Province.

The failure rate of SMEs in South Africa is as high as 63%. This is one of the highest levels in the world. Literature suggests that the values, motivations and skills possess by SMEs are responsible for how good or bad their businesses perform. Consequently, the success or failure of SMEs is largely influenced by the skills, values and motivations of the managers.

Through the questionnaire, I hope to be able to determine the skills, motivations and values of owner/managers of SMEs that affects firm performance and make necessary recommendations to appropriate authorities. The questionnaire should take about 20 minutes to complete. The information supplied by participants will be treated as strictly confidential. Completion of the questionnaire is voluntary. If you would like to obtain a summary of the results of this research, I would be happy to send you a copy.

Please feel free to contact me on 079 496 2777 or lefa.kalane@webmail.co.za with regards to any queries you may have, or my supervisor, Dr. J van Zyl (email: vanzyljh@ufs.ac.za) (phone no: 051-401 2286).

Section A: Biographical questions

Question 1: The age of the respondent (in years);

20-30	31-40	41-50	51-60	Above 61

Question 2: Gender of the respondent;

Male	Female

Question 3: Educational qualification of the respondent;

No formal education	Grade 1 - 7	Grade 8 - 11	Matric	Diploma	Bachelor's Degree	Post. Grad Degree

Question 4: Current business

1-5 years	6-10 years	11-15 years	Above 16 years

Business sector:

Sector	Mark with (X)
Agriculture	
Mining and Quarrying	
Manufacturing	
Electricity, Gas and Water	
Construction	
Retail, Motor Trade and Repair Services	

Sector	Mark with (X)
Wholesale Trade, Commercial Agents & Allied Services	
Catering, accommodation & other Trade	
Transport, Storage and Communications	
Finance and Business Services	
Community, Social & Personal Services	

Question 5: Previous business experience

No business experience	1-5 years	6-10 years	11-15 years	Above 16 years

Business sector:

Sector	Mark with (X)
Agriculture	
Mining and Quarrying	
Manufacturing	
Electricity, Gas and Water	
Construction	
Retail, Motor Trade and Repair Services	
Wholesale Trade, Commercial Agents & Allied Services	
Catering, accommodation & other Trade	
Transport, Storage and Communications	

Sector	Mark with (X)
Finance and Business Services	
Community, Social & Personal Services	

Question 6: What is the legal status of your business?

Sole proprietor	Partnership	Close Corporation	Company

Question 7: For how long has your business been in operation (in years)?

1-3	4-9	10-14	Above 15

Question 8: How many full time employees do you have?

Number

Section B: Questions on Motivations

Indicate your level of agreement or disagreement with the following questions on the motivations of managers.

Question 9: (Don't answer the first question if your response to question 4 is "no business experience")

Motivations of managers	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
Your past business experience motivated you to start your own business.					

Motivations of managers	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
Your educational qualification also motivated you in starting your own business.					
The reasons why you started your business was out of necessity.					
You started your business because you saw an opportunity in the market.					
One should not start a business if there is a risk it might fail.					

Section C: Questions on managerial Skills

Question 10: Circle the number that corresponds to the extent to which each of the following managerial skills was used in your business during the past three years.

Managerial skills	Not used at all	Used moderately	Used quite extensive	Used very extensive
Advertised your products	1	3	4	5
Extended credits to customers	1	3	4	5
Emphasized product quality	1	3	4	5
Priced your products lower than competitors.	1	3	4	5
Involved employees in decision-making	1	3	4	5
Assessed employees" job satisfaction	1	3	4	5

Managerial skills	Not used at all	Used moderately	Used quite extensive	Used very extensive
Assessed employees" performance	1	3	4	5
Emphasized a clearly laid down reward and punishment system for all employees.	1	3	4	5
Prepares financial plans and measures performance	1	3	4	5
Re-invest profit earned	1	3	4	5
Maintain large cash balances	1	3	4	5
Emphasis cost reduction in all areas of your business	1	3	4	5
Produced formal statements of business objectives	1	3	4	5
Set performance goals of the business	1	3	4	5
Developed plans	1	3	4	5
Prepare budget/forecasts	1	3	4	5
Belongs to a professional association (e.g. chamber of commerce)	1	3	4	5
Attends trade exhibitions	1	3	4	5
Maintains relationship with suppliers	1	3	4	5
Maintains relationship with customers	1	3	4	5
Documented all detailed aspects of your business	1	3	4	5
Administered provision of employee amenities and facilities	1	3	4	5

Managerial skills	Not used at all	Used moderately	Used quite extensive	Used very extensive
Consulted/employed professionals in management	1	3	4	5
Reviewed progress of activities to determine their consistency with plans.	1	3	4	5

Section D: Personal Values of Managers

Question 11: Circle the number that corresponds to the level of importance of each value to you, show the extent to which you consider each of the VALUES listed to be important

Values	Not important	Slightly important	Moderately important	Very important	Extremely important
Achievement - values achievement within the business and personally.	1	2	3	4	5
Trust - trusts customers, employees, suppliers and receive trust in return	1	2	3	4	5
Reputation - pleasure from building a good reputation.	1	2	3	4	5

Values	Not important	Slightly important	Moderately important	Very important	Extremely important
Reputation is seen as fundamental to the business					
Autonomy (independence) - free from rules and regulations imposed by others	1	2	3	4	5
Pride - in the business he/she has created and the offer he/she put to customers	1	2	3	4	5
Loyalty - devotion towards the business and to customers.	1	2	3	4	5
Pleasure - from doing what he/she does and being with people	1	2	3	4	5
Challenge - liking the challenge of creating something, the challenge of the business	1	2	3	4	5
Equality - love and treat all employees and customers	1	2	3	4	5

Values	Not important	Slightly important	Moderately important	Very important	Extremely important
without discriminating					
Honesty - relates to honesty in dealing with employees, customers and suppliers	1	2	3	4	5
Security - provides security for him/herself and others	1	2	3	4	5
Development - satisfied with the growth and progress of the business	1	2	3	4	5
Affection - communicates warmth and care towards employees and customers	1	2	3	4	5
Optimism - has a positive outlook towards , and view of, the business in the future	1	2	3	4	5
Innovation - doing what he/she is	1	2	3	4	5

Values	Not important	Slightly important	Moderately important	Very important	Extremely important
doing better than his/her competitors					
Authority (power) - the pleasure of being the boss and delegating tasks to others	1	2	3	4	5
Creativity - bringing novel ways and strategies in doing business	1	2	3	4	5
Hard work - belief in complete commitment (hands-on) to the business	1	2	3	4	5
Risk taking - use profit from business to invest in other businesses	1	2	3	4	5
Work ethics - relates to dressing code and conduct within the business	1	2	3	4	5

Section E: Performance of SMEs

Question 12: Indicate your level of agreement or disagreement with the following questions on the performance of your business.

Question	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
You are satisfied with the sales growth of your business for the last three years.					
You are satisfied with the profitability growth of your business for the last three years.					
You are satisfied with the performance of your business compared to the performance of your competitors					
You are satisfied with the overall performance of your business					

Question 13: Do you know the reasons why small businesses closed in such a high number over the last five years in South Africa.

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_____
_____
_____
_____
_____

Question 14: Why do you think that the number of new business start-ups is at an all-time low?

_____
_____

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Thank you for taking your time to complete this survey. I appreciate that your time is valuable. So has been your contribution!