IDENTIFYING RISK IN SMALL AND MEDIUM ENTERPRISES:
THE CASE OF BLACK-OWNED SMEs IN SOUTH AFRICA

Submitted by

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DECLARATION

I, Ghislaine Jessica Lokolo Lothin, declare that the research work contained in this dissertation is my own work except where otherwise indicated and acknowledged. This dissertation is submitted in partial completion of the Master degree of Management in Finance and Investment at the University of the Witwatersrand, Johannesburg. This dissertation has not, either in whole or in part, been submitted for a degree or a diploma at any other university.

Signature ......................................................

At ..............................................................

Date ............................................................
DEDICATION

This research is dedicated to my parents, Michel Claude Lokolo and Elisabeth Chantal and Stean Mpolo for their unconditional love and support. No words could adequately express my gratitude. I love you dearly.

To my younger siblings, may this be a testimony that with hard work we could conquer new lands over and over. This achievement is only the beginning of many more to come. I love you.
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I would like to thank God Almighty, whose Grace has guided me and given me the necessary strength and courage through my studies but also the energy to keep pushing.

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To my friends and classmates, thank you for standing by me. Your tireless help and encouragement have been vital to me in completing this degree.
ABSTRACT

The increasing number of BB-BEE policies and strategies aimed at supporting SMEs in South Africa is evidence that Black-owned SMEs are important for development of the country. Between 2007 and 2010, the number of SMEs grew by almost 60%, contributing approximately 61% of the country's GDP.

In spite of the widespread financial support put in place by government agencies to support them, findings reported that SMEs in South Africa score a relatively high failure rate. Moreover, little is known about the causes of these high failure rates. This thesis aimed at filling the gap in the literature by identifying the risks that South African Black-owned SMEs face.

In doing so, Black-owned SME owners/managers were interviewed across various industry sectors. This revealed that although these owners/managers were well educated and skilled, they did not believe that their staff were trained enough.

The findings revealed financial risks were still the most prominent risks these SMEs face, which seemingly gave rise to other risk factors such as the lack of access to technological improvements or skilled labour, and their inability to set up or run effective marketing strategic plans. The gap between the supply of and the demand for financial support for Black-owned SMEs could be attributed to a number of factors, including red tape, bureaucracy, corruption, politics and an unstable economy.

A number of implications followed from this. For the financial support to reach its target effectively, independent and transparent micro-finance institutions have to be in place. This needs to be coupled with the establishment of a platform for Black-owned SMEs that could be used to market Black-owned SME products and services. Another solution could be the design of SME-aligned skills transfer incubation programmes.

Applying the results from this research, one should be careful to consider its limitations because of the small sample size and selection criteria, which imply that these results cannot be generalised beyond the scope of this study.
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Chapter 1

1. Introduction and Background

There was consensus among policymakers, financial and business specialists that small and medium enterprises (SMEs) were drivers of economic growth (OECD, 2004; The World Bank, 2011; The Banking Association South Africa, 2015). They argued that a healthy SME sector played a pivotal role in the development of a nation, creating employment opportunities, introducing innovation and entrepreneurship skills.

The National Credit Regulator report (2011) stated that most of the current multi-million dollar enterprises had their origin in SMEs. Nevertheless, SMEs in developed and less developed countries (LDCs) were facing a number of difficulties and obstacles that kept on impeding and complicating their operations and growth.

Every business decision and entrepreneurial act is connected with risk (Napp, 2011). This also applies to SMEs. Every SME faces risks of the same or higher magnitude than those risks faced by bigger companies; yet, risk management is a challenge for most SMEs. In contrast to larger companies, they often lacked the necessary resources with regard to manpower, databases and expert knowledge how to perform standardised and structured risk management. The result was that many smaller companies did not perform any or sufficient in-depth analysis to identify their risk and thus knew very little about the risks they faced. This was highlighted by the lack of literature about methods for SMEs’ risk management methods, as stated by Henschel (2008).

1.1. Importance of SMEs in the economy

The value of the small business sector had been recognised in economies across the world, irrespective of the economies’ developmental stage.
According to the National Credit Regulator (2011) and the Small Enterprise Development Agency (2012), the growing number of SMEs in South Africa was strongly contributing towards the creation of wealth in the economy and job creation.

Gatt (2012) and Khan (2014) reported that small and medium-sized enterprises (SMEs) were increasingly being recognised as productive drivers of economic growth and development for African countries.

The number of South Africa's SMEs grew from 2.4 million (StatsSA Labour Force Survey, 2007) to 6 million in 2010 (FinScope Survey, 2010). Abor and Quartey (2010) estimated that 91% of the formal business entities in South Africa were SMEs and that these SMEs contributed between 52 and 57% to GDP and accounted for approximately 61% of employment. This growth was mostly attributed to the South African government’s effort to create a fertile environment for SMEs to bloom, focusing on Black-owned SMEs.

1.2. High Failure rate of SMEs in South Africa

Despite this acknowledged importance of SMEs and their contribution to economic growth, SMEs across the globe, and in South Africa in particular, were still faced with numerous challenges that inhibited entrepreneurial growth. Watson (2004) and Van Niekerk (2005) reported that SMEs in South Africa had a high failure rate of 70 to 80%, mostly reported in their first year.

This failure was caused by different problem areas that could be grouped into three broad factors: economically-based problems; enterprise-based problems; and industry sector-based problems (Naicker, 2006). Smit and Watkins' (2012) research showed that SME failure could further partly be ascribed to the lack of management skills. It was also reported that South African SMEs did not aspire to corporate governance best practices such as the voluntary, non-compulsory implementation of King III (King, 2009). Risk management, a component of King III, was somehow
regarded as an optional organisational activity, and not as a vital component to organisational success.

2. Problem Statement

Managing SMEs' risk had become crucial, considering the role they play in the economy. Some risk-taking was inevitable if an organisation was to achieve its objectives. Those organisations that were more risk aware appreciated that actively managing not only potential problems (threats), but also potential opportunities, provided them with a competitive advantage. Taking and managing risk was the very essence of business survival and growth. SMEs were becoming increasingly aware of the importance of risk and its management, but it still remained a challenge for them as the literature on SMEs in South Africa and the challenges they faced - challenges that constituted risks - was limited.

Khan (2014) argued that economic boom in many countries resulted from the growth and performance of their SMEs’ markets. South Africa’s government launched different initiatives to provide a ground for SMEs to be created and grow, focusing more on Black-owned companies. These initiatives were, however, for the most, of a financial nature, including preferential procurement and Broad Based Black Economic Empowerment codes, tax incentives for entrepreneurs as well as provisions for grant funding and soft loans.

The Broad Based Black Economic Empowerment (BB-BEE) Act also provided opportunity for private companies to provide soft funding for Black-owned companies in order to attain their Enterprise Development points (Kruger, 2011).

It was also evident that it had been assumed that SMEs' financial constraints were believed to be the more important, if not the principal reason for the high rate of SME failure in South Africa. This was more evident when analysing the research studies that had been published on SMEs: the majority of these studies focused on the
financing challenges that South African SMEs faced (Falkena et al., 2004; Kruger, 2011; National Credit Regulator, 2011; Khan, 2014).

This over-concentration on financial constraints may have been to the detriment of other equally important factors that had been neglected when developing laws and regulations to assist the development of SMEs. These other factors may in reality have been more important or have had more impact on SMEs’ performance than their financial constraints.

A report published by Schüssler (2012) showed that 32% of SMEs were concentrated in Gauteng, followed by 19% in KwaZulu-Natal and 11% in Limpopo. This report furthered revealed the ownership classification by race: 70% of SMEs were owned by Black, followed by 21% White, 5% by Coloured and 3% by Indian/Asian business people. An update on this report (ABSA, 2014) stated that the new numbers were only marginally higher compared to the 2012 numbers. The one noticeable change was the number of employers. Through this research, it was evident that Black-owned SMEs and more so Black-owned SMEs in Gauteng, were at the centre of SMEs’ contribution to the economy of South Africa.

This research sought to fill the gap in literature on the different risks – other than financial risks – that were hampering the success of SMEs in South Africa and in particular Black-owned SMEs. In the light of the stated problem, the following questions arose: Were financial risks the only risks that Black-owned SMEs faced? Were there other risks that contributed to the high failure rate of South African SMEs in general and Black-owned SMEs in particular? Where and how – other than providing financial support – could investors and government assist Black-owned SMEs to reduce their high failure rate?

3. Objectives

The research objectives, therefore, can be formulated as follows:
• Identify the different challenges that Black-owned South African SMEs face;
• Identify the causes of the high rate of failure in Black-owned South African SMEs;
• Deduce solutions for investors and government support of Black-owned South African SMEs' to achieve sustainable growth.

4. Significance of the Research

As reported by Henschel (2008), “The literature on risk management being available mainly concerned the implementation in very large joint stock companies.” In other words, the theory about risk and risk management was not sufficiently applied to SMEs in general, and in particular within the South African context.

This research, therefore, will assist in reducing the gap in literature by providing theory on risk and risk management that is applicable to SMEs in general and South Africa in particular.

This is also relevant for investors who wish to invest in SMEs, but who are not aware of all the risks faced by these SMEs, other than financial risks.

This research will also assist policymakers concerned with enterprise development, to understand where the risks lie in SMEs, which will further assist them in developing suitable policies to support Black-owned SMEs in South Africa.

This research will also assist risk managers in developing adequate risk management models for SMEs in South Africa in general, but mostly Black-owned SMEs in South Africa.
5. **Outline of the Report**

This report will be presented as follow:

Chapter 2: Literature Review

Chapter 3: Research Design and Methodology

Chapter 4: Research Findings

Chapter 5: Conclusion and Recommendations
Chapter 2: Literature Review

The literature review described aspects connected to the study. First, some definition relating to SMEs were given, which was then followed by a description of South African SMEs. This paved the way for the discussion of their importance to economic development and growth. Attention was then focused on the risks faced by SMEs, which commenced with the definition and contextualisation of risk.

1. SME Definition

According to Ward (2005), there was no universal definition for SMEs since the definition depended on who was defining it and where it was being defined. Definitions differed mostly because of the vast number of elements to consider. According to the South African National Small Business Amendment Act of 1996, SMEs can be grouped into five categories.

Category 1 was made up of survivalist enterprises, which were small businesses generally run and undertaken by unemployed persons with little or no business training. They invested little capital in the business and therefore generated below poverty level incomes, with limited opportunities for growing the business. These businesses operated in the informal sector of the economy, meaning they did not have any bricks-and-mortar infrastructure, did not pay taxes and did not adhere to labour laws.

Category 2 consisted of micro enterprises, which were small businesses run by persons with basic business skills and training. The businesses were most often informal, with no license or formal business premises. They usually employed between one to five employees, usually the owner and his family. These businesses had a high potential for transiting into formal small businesses.
Category 3 was comprised of small “official” enterprises, which formed part of formal businesses in the economy and included self-employed artisans and professionals. They usually had fewer than 10 employees.

Category 4 was made up of small enterprises that were formal and registered, with fixed business premises, had fewer than 100 employees and although they were owner-managed, the management structure was much more developed and complex.

Category 5 consisted of medium-sized enterprises that employ up to 200 people and operated from fixed premises with formal requirements. Although they were owner-managed, the management structure was decentralised with clear division of labour.

For the purpose of this research, we will focus SMEs of from categories 2, 3 and 4; respectively micro enterprises, small official enterprises and small enterprises.

2. What is a Risk?

Risk was commonly defined as the probability that an unforeseen event occurs (Campbell, 2005). In this research study, the author will not be limited to this definition. We will consider risk also as any risk that arises from constraints. A constraint exposes a company to certain disadvantages. SMEs in general were constrained by limited access to finance, limited education and lacking skills in production, the challenging regulatory environment, and lack of marketing know-how (Carlton, 1999; St-Pierre & Bahri, 2006; Rogerson, 2010). These constraints all carried certain risks that affected the company’s growth performance and sustainability.

According to Ganbold (2008), the lack of or limited access to finance restrained SMEs' capability and capacity or potential to grow and extend the business or
deepen their production process through restructuring, innovation and enhanced owner/staff qualifications. Being constrained by low education levels meant that they lacked certain skills that would have enabled them to research and identify profitable business opportunities for their business. This carried a risk that could be illustrated and measured through lost opportunity cost (Department of State and Regional Development, 2005). Lacking the right level of education may also limit the entrepreneurs' ability to relate to the clients' target market. The Department of State and Regional Development (2005) classified this as operational risk as it may result in unsuccessful development and delivery of a product or service.

3. Risks faced by SMEs

The traditional approach to SME risk management focused on and was biased towards the finance-based risks. This approach was reflected by the great number of publications around the financial risks faced by SMEs.

3.1. Financial Risks

Many authors such as Allen (2013), Murphy (2008), Saunders and Cornett (2007) talked about financial risk management as key to every company. Like these authors, the literature used the term financial risk, an umbrella term, to refer to multiple risks associated with financing activities. It encompassed diverse risks including interest rate risk, market risk, credit risk, off-balance-sheet risk, foreign exchange risk, sovereign risk, technology risk, operational risk and liquidity risk, among others (Horcher, 2005).

Access to finance, which pertained to financing activities, featured prominently in a number of studies as a constraint to SME development and more so in SME development in Africa. According to Rogerson (2001) and Skinner (2005), a lack of access to credit was a major constraint experienced by most emerging African and Black entrepreneurs; who were dependent on personal savings or loans from relatives and friends, as the primary source of their limited startup capital. This limited
access to finance had long been identified by financiers as resulting from SMEs’ information asymmetry issues (Fidrmuc, Hainz & Malesich; 2006), but this cannot be the only reason. Ackah and Vuvor’s (2011) research justified this suspicion. In their study, about 60% of the respondents attributed their lack of access to bank loans or credit to their inability to provide the required security or collateral for the requested loans or credit and in situations where they were able to provide some security, it was found inadequate. This supports the opinion of Binks, Ennew and Reed (1992), who attributed the high default risk of SMEs to the inability to provide asset-backed collateral to support loans.

On the other hand, it was because of their very nature that SMEs’ access to finance was usually limited: high level of risk and insufficient forecast level of return (Pretorius, Shaw & Van Vuuren, 2003). These financial risks were analysed in more detail below.

3.1.1. Interest rate risk

Saunders and Cornett (2008) defined interest rate risk as the risk incurred when the maturities of assets and liabilities did not match. As the name indicated, this risk occurred as a result of interest rate fluctuations, which was reported to be one of the most prominent causes for the challenges faced by SMEs in South Africa (ABSA, 2014).

As reported by Cosh and Hughes (2003), banks were and remained the main financial supplier of external finance to SMEs. Access to external finance provided by these institutions was subject to their funding preferences, resulting from the pecking order theory and their risk aversion (Hamilton & Fox, 2004; Howorth, 2001). In practice, this meant that in the midst of an economic downturn, banks will be inclined to lend money at a higher interest rate to risky borrowers as the market’s appetite for risk is then lower. Falling equity markets, and rate sensitive liabilities increases were
then also obvious in the market (MacMorran, 2009). This represented a great risk to SMEs, which further limited their capacity and ability to expand and grow.

In their research on challenges faced by SMEs in obtaining credit, Ackah and Vuvor (2011) found that 71% of the respondents in Ghana believed that level of interest rate charges on loans from the banks and non-banking financial institutions were extremely high. According to their research, these extremely high interest rates cost small businesses their competitive edge and made them unprofitable.

Likewise, interest rates had been reported by 51% to be a factor impeding the growth of SMEs in South Africa (Herrington, Kew & Kew, 2009). Of the respondents in Cant and Wiid's (2013) study, 76% reported that interest rates were a very important factor impeding on SMEs' development.

3.1.2. Liquidity risk, insolvency risk and credit risk

Saunders and Cornett (2008) defined liquidity risk as the risk that a sudden surge in liability withdrawals may require that a firm liquidate its assets in a very short period of time and usually at prices far lower than their fair market prices. According to Acharya (2006) and the OECD (2009), liquidity risk arises from a number of areas including unplanned reduction in revenue, unplanned capital expenditure, business disruption, sustained reduction in profitability, increase in operational costs, inadequate cash flow management or breach of loan covenants.

Insolvency risk is the risk that occurs when the market value of a firm's assets is lower than its debts (Davydenko, 2013). According to Ceptuneano (2015), SMEs – especially young SMEs – are generally financially more overstretched, leveraged and reliant on bank financing compared to large firms. As a result, they tend to have significantly higher chances to experience insolvency.
Credit risk, also called *default risk*, is defined as the risk that promised cash flows from loans and securities held by a firm may not be paid in full (Saunders & Cornett, 2008). Illiquidity, insolvency and default risks are related to the potential default risk. Davydenko (2013) explained that default was triggered both by the firm's illiquidity and insolvency, but to a different extent. Black and Cox (1976), Leland (1994), Longstaff and Schwartz (1995) argued that default occurred as soon as the market value of assets fell below the face value of debt, so that the firm became economically insolvent. Anderson and Sundaresan (1996) and Ross (2005) argued that default was triggered by financial distress or the firm's inability to meet its short-term financial obligations.

In strong contrast to the risk faced by SMEs, Kolari and Shin (2006), Berger and Udell (2004) concluded in their research studies that small business lending had a strong positive effect on banks' profitability. This implied, as reported by Dietsch and Petey (2004), Altman and Sabato (2007), that SMEs bore relatively more financial risk than the banks, the prime suppliers of external finance to SMEs. However, at the same time, SMEs credit/default risk was 30% higher than that of generic corporations.

Fidrmuc, Hainz, and Malesich (2006) believed that the core of the suspected and reported high credit risk of SMEs was the information asymmetry problem. Their study revealed that default risk rates were surprisingly low, even in an international context, as loans to SMEs were only a very small fraction of the bank's total loan portfolio. Although their study justified the anticipated high credit risk by the lack or limited credit history that banks had on SMEs (usually no information was found about SMEs before and after the credit window); it also revealed cases of no default by SMEs. This research can be criticised on the argument that it examined the risk of lending to SMEs and hypothesised that it was comparable to that in developed Western markets rather than the South African market in particular, but African markets in general.
Research conducted in Ghana (Ackah & Vvor, 2011) revealed a different risk focus compared to the previously mentioned arguments. According to 85% of their respondents, the high default rate of SMEs was mainly caused by the delay in receiving payments for their goods and services rendered. Ackah and Vvor (2011) argued that these delays affected their cash flow considerably, making it even more difficult for SMEs to comply with their financial obligations such as loan repayments. This resulted in extra financing cost being contracted and heightened their liquidity risk.

3.1.3. Foreign exchange risk

Internationalised and innovative businesses are growing faster, more profitable and better able to create wealth and jobs than their domestically focused peers. In working with overseas suppliers, customers, creditors and other partners, these businesses often need to deal in foreign currencies, thus exposing themselves to some measure of risk in the process. This is what Saunders and Cornett (2008) defined as foreign exchange risk. For these companies, swings in currencies can make or break profits.

A recent report (ACCA, 2013) demonstrated that small SMEs with international activities were significantly exposed to foreign exchange risk. The report further revealed that this foreign exchange risk was typically around 19% of the SMEs' revenue; of which only a part was hedged and even less was managed in an active manner.

3.1.4. Operational and technology risks

Operational risk is the risk that existing technology, auditing, monitoring, and other support systems may malfunction or break down, while technology risk was defined as the risk incurred when the technological investments did not produce the anticipated cost savings (Saunders & Cornett, 2008).
Because of their size, small and medium-sized enterprises ended up using cheaper and less efficient/capable technology, often below the acceptable market threshold. This mostly resulted into higher costs of production and rendered SMEs less competitive as compared to other enterprises in the market (Carmichael, 2015).

Technology risks included risks associated with lacking research and development (R&D) activities and consequently, less frequent use of relevant and up-to-date technology. In a globally competitive environment, it was important for any firm to keep up with technology advancement, improved efficiencies and globally accepted standards. Olawale and Garwe (2010) stated that technology played a crucial role in the development of new SMEs and helped in evolving strategies. With restricted financial resources and limited ability for leveraging the necessary financial structure, SMEs can often not acquire the advanced technology, which would help them optimise their available resources (Phillips & Wade, 2008).

3.2. Gap between supply and demand for external finance

A report published by the World Bank (2011) stated that SMEs’ access to finance became tighter as over 70% of surveyed banks changed their credit management practices after the 2008 economic downturn. This report estimated the financing gap affecting around 45-48% of all SMEs in South Africa.

Despite the relatively large SME financing gap reported in South Africa, there was ample proof that money was available and was also made available to SMEs through different vehicles, mostly government financing vehicles focusing on Black-owned businesses. An analysis of the supply side of the SME credit market revealed that South Africa had a variety of financing schemes established by the public and private sector funding agencies (NCR, 2011).
Assuming that funding could be accessed by SMEs, the question remained: What was the underlying problem for the gap between demand and supply of external finance to Black-owned SMEs in South Africa?

Maas and Herrington (2006) argued that although there were financing vehicles available to the SME market, their awareness was very low as to what was available and how to access such funding. This was supported by the SME credit market analysis report published by the National Credit Regulation in 2011.

Other authors focused on the structure and the way financial intermediaries functioned as potential reasons for lack of SME funding. Ojah and Mokoteli (2010) argued that other factors linked to the limited access of finance to SMEs were the wrong channels being used. They reported that inappropriate financing vehicles had been used to provide finances to SMEs, especially those that were located in rural areas. They concluded their arguments by providing a number of alternatives that could be more effective in providing financing to SMEs in South Africa such as venture capital and angel finance.

3.3. Non-Financial Risks

The traditional approach to the assessment of SME risk was biased in favour of the finance-based risk analysis. The modern approach, however, recognised the multifaceted nature of the SMEs’ total risk. Various authors (Carlton, 1999; Cotner & Fletcher, 2000; St-Pierre, 2004; St-Pierre & Bahri, 2006) recognised that total risk constituted not only of financial risk, but also business risk; technological risk; economic risk and legal risk. These risks are discussed further below.

3.3.1. Business risk

According to St-Pierre and Bahri (2006), business risk included management risk, which comprised of lack of knowledge about management, lack of skilled human
resources, and insufficiency of resources devoted to management and skills. It also included strategy risk, which consisted of a lacking or poor marketing strategy and no clear strategic business planning (Carlton, 1999).

3.3.1.1. Education level

According to a study conducted on African enterprises by Rogerson (2010), human capital was a critical success factor. This study revealed that successful entrepreneurs were more likely to have education and training beyond primary levels; in other words, entrepreneurs with a greater level of education and training were more likely to adapt to a rapidly changing business environment and subsequently managed to succeed.

According to the 2014 StatsSA report, 60% of the Black unemployed population had achieved less than Matric, compared to than 30% for Indian/Asian unemployed populations and 39% of the White unemployed population. Similarly, during the last quarter of 2014, it was found that 53.5% of the Black employed population of South Africa had education levels below Matric, 29% had completed their Matric and 16% had a tertiary education (StatsSA, 2014). During the same quarter, 60% of Black unemployed South Africans had education levels below Matric, 32% had Matric and 7% achieved a tertiary education level (StatsSA, 2014).

3.3.1.2. Inadequate management skills

Research showed the lack and/or inadequacy of business managerial skills amongst entrepreneurs as severe shortcomings, which mapped to the requirement of education and training within SMEs, and a factor that inhibited SME growth (Von Blottnitz, Cassim, Kesper, Rajaratnam & Van Seventer, 2002, as cited in Smit & Watkins, 2012). The lack of general business and managerial skills also impacted on SME sustainability.
Rogerson (2010), supported by Brink, Cant, and Ligthelmon (2003) and Rogerson (2008), reported that it was the lack of technical and managerial skills that primarily impeded on business development capacity of SMEs in South Africa. The latter study reported that 90% of a sample of 100 entrepreneurs believed that SME failure was due to a lack of managerial skills.

According to StatsSA (2014), South Africa’s population of 57.7 million inhabitants, of which 3.8 million were skilled, 7 million semi-skilled and 4.3 million low-skilled. The categorisation of 'skilled' included managers, professional and technical occupations; 'semi-skilled' included clerks, sales and services, skilled agriculture, crafts and related trade, and plant and machine operator occupations; 'low-skilled' included elementary and domestic worker occupations. According to this report, only 18% of the skilled population was Black against 61% of Whites, while only 3% of the low-skilled population was White against 34% among the Black population.

3.3.1.3. Marketing or commercial risk

Among the challenges that small business faced were lack of efficient marketing (IRMSA, 2015). It was crucial to the success of a business to be able to identify correctly the needs of the market, to package its product and/or service offerings, to promote and sell its products and/or service offerings. Marketing challenges were not only encountered when formulating marketing strategies, but also when estimating the costs that went with promoting and advertising the business (IRMSA, 2015).

Doherty (1985) and Valsamakis, Vivian, and Du Toit (2000), as cited by Smit and Watkins (2012), supported this view when they reported that lack of effective marketing as part of all business risks, was another important risk that SMEs face. They argued that poor market screening and poor analysis of consumers and their behaviour were detrimental to the success of businesses in general, but more so the success of small business.
3.3.2. Legal risk

Based on Cotner and Fletcher’s (2000) definition, legal risks were those risks, which comprised compliance with all regulations and government policies affecting their businesses.

Absa’s SME Growth Index repeatedly identified the regulatory burden as a critical challenge facing small businesses (Absa, 2014). Frequent changes in the regulatory environment, the need to keep track of overlapping and sometimes conflicting regulatory requirements across multiple departments and levels of government, poor communication and access to information, and administrative inefficiencies in government departments and municipalities, meant that the SME owner spent a disproportionate amount of time dealing with regulatory compliance.

3.3.3. Economic risk

Economic risks included, among a whole host of other factors, labour, labour laws and regulations around labour; competition, currency devaluation, and particularly in South Africa, reliable electricity and water supply (Smit & Watkins, 2012; Herrington, Kew & Kew, 2009).

3.3.3.1. Labour

FinScope South Africa (2014) reported a 25% official unemployed rate against 35% expanded unemployment rate. StatsSA (2014) published that 27% of the unemployed labour force (aged between 15 and 64 years old) was Black against 23% Coloured, 12% Indian/Asian and 8% White.

3.3.3.2. Cost of labour

Mahadea (2008) reported that in the midst of relatively high unemployment rates in South Africa, it was rather expensive for SMEs to hire skilled people. She further
argued that this impacted negatively on SMEs and was caused by SMEs having limited capital and access to capital and thus not being able to hire at costs as stipulated by the Employment and Minimum Wage Regulations.

### 3.3.3.3. Cost of production

South Africa’s stringent policy framework and legislation was proving it more difficult for SMEs to grow, assuming that SME business owners were aware of these rules and regulations in the first place and were compliant. The rising cost of inputs in South Africa, especially the cost of electricity and oil were proving to constrain growth. The introduction of national load shedding by Eskom from mid-June 2014 had a significant impact on the economy in general, but more so on the SME sector (Edwards, 2014). This resulted in decreased productivity and financial losses across all firms in South Africa. The power crisis had been referred to as one of the most critical structural impediments to economic growth in the country, and continued to have far reaching effects on SMEs across all industries (Edwards, 2014).

According to Wakeford (2006), oil shocks generated increased uncertainty about inflation, interest rates, exports and the exchange rate, and therefore had a general dampening effect on consumption and investment. As a result of these factors as well as rising production costs, labour demand is likely to fall and unemployment to rise.

### 3.3.3.4. Competition

Knowing and understanding one’s competition was vital for every business, but particularly so for SMEs that did not have the international connections or the financial muscle to combat competition. The level of such competition was very important for SMEs to consider as it may impede on their ability to be sustainable or grow. Because of their size, SMEs were limited when it came to broader market access. In most cases, SMEs were not big enough to achieve a sizeable market share. Added to this, a highly competitive market will impede the activities of SMEs
that clearly cannot compete with large multinationals in the South African environment (Zahra, 2002).
Chapter 3: Research Methodology

This chapter discusses the research design and the data collection methods that had been used throughout this research. It presents aspects such as research design, study population, sample and sampling techniques.

1. Research Method

Although exploratory qualitative research methods were time consuming, expensive and did not allow to study larger sample groups, the author decided to use them for this study because qualitative research methods are known to provide deeper insights into the matters under study (Saunders, Lewis & Thornhill, 2009). According to the authors, an exploratory study was a valuable means of finding out "what was happening, to seek new insights, ask questions and assess phenomena in a new light". The authors argued that explorative research was useful in understanding the precise nature of a problem.

The research was designed based on case studies because they were used to explore situations in which the interventions being evaluated had no clear, single set of outcomes (Yin, 1994). According to the same author, case study research was applicable to the social sciences as well as professional fields such as the management sciences.

Research studies mentioned in literature review such as Cant and Wiid (2013), Smits and Watkins (2012), Olawale and Garwe (2010) and Herrington et al. (2009), among others; used primary data sources. More so, the published literature on risks faced by Black-owned South African SMEs was so limited that it made more sense to seek primary data for a deeper understanding of the different risks faced by South African Black-owned SMEs.
2. Population

The population was made up of owners and managers of Black-owned SMEs in South Africa. These SMEs had been drawn from a database of companies across all industries and sectors in order to avoid biases related to specific industries and sectors.

3. Sample and Sampling Methods

A sampling strategy was selected as opposed to a census strategy. According to Saunders et al. (2009), sampling was needed when it was impossible to collect data from an entire population, but also when the research was constrained by budget and time limitations. The authors further argued that a sampling strategy was preferred when the availability of the population elements was an issue.

After reviewing the different sampling methods, the self-selection non-probability sampling method was selected. According to Saunders et al. (2009), this sampling method was suitable for exploratory research studies with very limited budget. The primary detrimental aspect of this sampling method was the fact that the likelihood of the sample being representative of the population was very low.

The research unit of analysis was an owner-manager of a Black-owned SME. A sample size of 100 participants was targeted for responses. Two hundred questionnaires were distributed to these SMEs, out of which 53 were completed, 96 were not completed at all, 28 were incomplete as respondents felt it was taking too long to complete or they were not comfortable with the questions or did not want to answer and their data could not be used. The remaining 23 questionnaires were filled, but were not admissible for further analysis as the screening question was answered "No", meaning they were not Black-owned SMEs.
4. Data Collection Methods

The data for this research was gathered using primary data sources. It was collected using questionnaires; which can be categorised according to the distribution method, each presenting its own set of strengths and weaknesses.

4.1. Computer-administered questionnaires

These self-administered questionnaires were distributed electronically by e-mail or the internet, affording the respondents the opportunity to complete them in their own time, without any interview bias. A disadvantage of this collection method was the restriction of the sample to users of the internet/e-mail, and complexities pertaining to programming and design.

4.2. Telephone interview questionnaires

The interview-administered questionnaire was a relative low-cost technique with reduced interview bias. However, due to the inaccessibility of unlisted numbers, response bias errors may occur.

4.3. Personal interview questionnaires

These interview-administered questionnaires required face-to-face conversation where open-ended and/or closed questions were asked, with approaches ranging from informal to highly structured. Disadvantages pertaining to personal interview questionnaires related mainly to cost and time taken. Advantages of this collection method included the opportunity to probe complex issues, a relaxed interview environment, possibility to record additional information and high response rates.
4.4. Mailed questionnaires

This self-administered questionnaire allowed the respondents to complete the questionnaire in their own time, without possible interviewer influence. A major drawback of the use of mailed questionnaires was the low response rate.

In selecting the type of research questionnaire to be used, a certain number of elements should be looked at, namely the time available to collect data, the financial implications associated with the collection and capture of the data as well as the availability of the interviewers (Saunders et al., 2000). By taking the former into account, computer-based, personal and telephone interview questionnaires were used.

5. Survey Design

Survey designs can be classified in terms of their purpose: analytical surveys seek to identify the independent, dependent and extraneous variables, whereas descriptive surveys seek to identify the phenomena that the researchers wish to describe.

As this research was concerned with identifying the phenomenon of risks faced by Black-owned SMEs in South Africa, the descriptive survey was conducted. Interviews were conducted in a non-standardised one-to-one manner, following a semi-structured pattern. Semi-structured interviews are a qualitative method of inquiry that combines a pre-determined set of open-ended questions, which prompt the discussion, with the opportunity for the interviewer to explore particular themes or responses further (Gillman, 2000). The semi-structured interviewing method was selected because it assisted in providing a deeper insight into a problem as it did not limit respondents to a set of pre-determined answers; as argued by Gomm (2004).

The questionnaire was designed using both closed and open-ended questions. According to Saunders et al. (2009), the use of open-ended questions allowed
participants to define and describe a situation or event and encouraged them to provide an extensive and developmental answer as opposed to closed questions. These questions were organised in five sections.

The first part had as its objective to ensure that the right people took part in the survey. It consisted of a screening question to which the respondent could either answer "Yes" or "No".

The second part sought to establish the demographic profile of respondents. It comprised multiple choice questions around the respondents' level of education, gender, age and race.

The third part sought to establish the profile of the companies the respondents owned, managed or worked for. This part focused on the type of industry, number of employees, type of company and whether it was registered or not. It comprised a mix of open-ended and multiple choice questions.

The fourth part sought to identify the risks that Black-owned SMEs face. This part was designed to reflect the perception of the respondents and for this reason, it only comprised open-ended questions.

The fifth part sought to establish the extent to which the literature applied to the group under study. In other words, this part sought to investigate how the Black-owned SME owner/manager perceived the risks they faced. The main constructs of this section were management, education, legal, marketing, technological advancement, compliance with regulations and access to finance. These constructs were measured through a seven-point Likert-type scale ranging from strongly disagree to strongly agree.
6. Credibility of Research Findings

In order to reduce the possibility of getting the answer wrong, attention had to be paid to two particular focus areas of research design: reliability and validity.

6.1. Reliability

Reliability refers to the extent to which data collection techniques or analysis procedures will yield consistent findings (Saunders et al., 2009).

6.1.1. The threats to reliability

Robson (2002) asserted that there may be four potential threats to reliability.

**Subject or participant error**: Questionnaires completed at different times of the week may generate different results. The time of the week could have an impact on the response rate as well as the extent to which the respondents were committed to provide in-depth answers. This had a huge impact on the research.

**Subject or participant bias**: Interviewees may have been stating what they expected or thought the interviewer wanted them to say. The respondents found the interview questionnaires long and for some reasons they thought they could finish faster (avoiding more questions) by saying what they thought the interviewer wanted to hear.

**Observer error**: This happens when the presence of many observers gives way to different ways of conducting the interview and/or asking questions to elicit answers. This was dealt with by limiting the number of interviewers to two.
**Observer bias**: This happens when the presence of many observers gives way to different interpretations of the same replies. This was dealt with by limiting the number of data analysts to one.

### 6.2. Validity

Validity is concerned with whether the findings are really about what they appear to be about. To ensure that the data really reflected the situation, interviewers presented the research as one that sought to understand the Black-owned SMEs in order to assist them. Care was taken to avoid presenting the research just as seeking to identify the risks Black-owned South African SMEs faced, as risk had different meanings to different people.

This is sometimes referred to as external validity. It is concerned with the extent to which the findings of the research can be generalised or are equally applicable to other research settings.

### 6.3. Ethics of research

The objective of research ethics is to ensure that no adverse consequences or harm follow from the research activities. According to Saunders et al. (2009), cognisance should be taken of the following ethical issues:

The privacy of participants concerns the right of the participant to refuse to take part in the research. It also concerns the time spent in approaching the participant as well as convincing them to take part in the research and actually interviewing them. Many respondents refused to take part in the research and complained about their lack of time and their concern that they were going to be exposed in some way.
Participation was on a voluntary basis and participants were allowed to exercise their right to withdraw from the research at any stage. Because of the exploratory nature of the research, a contractual agreement could not be obtained.

SME owner-managers were informed that no survey data was going to be used that could identify the specific business entity and completed questionnaires were not going to be made public to any person or institution.

Owner-managers of Black-owned SMEs were informed of the purpose and expected benefits of the research study. SME owner-managers were offered the option to receive follow-up information about the research results. If this choice was selected by the participants, contact details were provided by the research participant.
Chapter 4: Data Analysis

This chapter discusses the results of the survey conducted on Black-owned SMEs in South Africa. Because of the nature of the questionnaire and the topic of the research, only the questionnaires to which the screening question was answered "Yes" were analysed as those answering "No" did not qualify for inclusion according to the population requirements.

1. Demographics of Respondents

This section aimed at presenting the demographics of the respondents.

1.1. Gender

The majority of the Black-owned SMEs owner/managers were male (63%) against the minority of 37% female (refer to Figure 1).

![Figure 1: Gender](image)

1.2. Race

All SMEs were Black-Owned. A total of 91% of these Black-owned SMEs owners/managers were Black Africans (refer to Figure 2). Only 5% of these Black-owned SMEs were managed by Coloured respondents and even fewer than that managed by Indian and White – both represent 2%.
1.3. Age

Nearly 50% of the Black-owned SMEs owners/managers of this study were aged between 20 and 29 years (refer to Figure 3), while 30% were aged between 30 and 39 years. Only 12% were aged between 40 and 49 years, followed by 7% aged between 50 and 59 and 2% of Black-owned SMEs owners/managers were older than 60. This meant that close on 80% of respondents were under the age of 40. By implication, this would indicate that SME entrepreneurship is an ideal method for youth employment creation.

1.4. Marital status

More than 55% of Black-owned SMEs owners/managers were single (refer to Figure 4), which maps to the relative high percentage (almost half) of respondents aged between 20 and 29 years. About 42% of the respondents were married, while only 2% were divorced.
1.5. Education

The study revealed that 74% of the respondents had an education level equal to a National Diploma/Bachelor Degree and above (refer to Figure 5), while the other 26% had at most some tertiary education without a tertiary degree. From the above, the obvious analogy could be drawn: SMEs owners/managers in this survey were all well educated individuals. However, it also raised some flags as to whether the sample was truly representative of all SMEs in South Africa. If this would be found to be true, then the hypothesis that lack of education could be the biggest risk to SME sustainability, would not be proven in this sample.

![Figure 4: Marital status](image)

1.6. Skills level

The study revealed that about 70% of the Black-owned SMEs owners/managers were managers and professionals with 33% and 37% respectively represented (refer to Figure 6). Only 2% were employed as craft traders, followed by 7% as technician and 14% in a clerical or sales position. Further analysis allowed the author to classify managers and professionals according to their age (refer to Figure 8) and gender.

![Figure 5: Education](image)
(refer to Figure 7). About 60% of the respondents with skills level of a manager and/or professional were aged between 20 and 29 years old.

1.7. After-tax monthly household income

The study revealed that more than 40% of the respondents earned above R20 000 per month, followed by 30% and 18% respectively earning between R15 000 to R19 999, or R 5 000 to R 9 999 per month (refer to Figure 9). Only 5% of the respondents earned between R 1 000 to R 4 999 and R 10 000 to R 14 999 per month. In line with their education and qualification, the majority of these young respondents earned well above R15 000 per month (70%). It also indicated that they were paying those who were employed by them significantly less.
2. Business Profile

2.1. Age of the company

Nearly 65% of the SMEs were relatively new and had been in business for between 1 and 3 years (refer to Figure 10). Just less than 20% were in business between 4 to 6 years, while just above 10% were in business for less than a year. Only 2% of these SMEs had 10 years and more and 5% had 7 to 9 years in business. If one remembers that most businesses fail in their first year, the highest risk of business failure within this sample would then have been faced by only 10%.

2.2. Registered companies

About 72% of the survey respondents owned, managed or worked for a registered Black-owned SME (refer to Figure 11) against 28% which were not registered. This spoke in favour for the effort of Black-owned SMEs to operate inside the legal parameters set by the Department of Trade and Industry.
Further analysis of the registered companies revealed that about 70% of respondents’ companies had been in business for less than 3 years (refer to Figure 12), followed by 23%, which had been in business between 4 to 6 years. The remainder had been in business for 7 years and more.

![Figure 11: Registered companies by age](image1)

![Figure 12: Registered companies](image2)

2.3. Type of companies

More than 35% of the companies that the respondents owned, managed or worked for operated as private companies (refer to Figure 13), against 26% operating as partnerships. They were followed by sole proprietorships (16%) and public companies (7%). The remaining 14% of respondents reported that they owned, managed or worked for a close corporation.

![Figure 13: Type of companies](image3)
2.4. Type of industry

About 23% of the respondents interviewed worked for an ICT type company (refer to Figure 14) against 21% working for Management Consulting companies. The remaining companies fell into Marketing/Media (14%), Food (9%) and Investments industries (5%). Others fell into Electronics, Logistics, Mining, Retail industries at 7% each.

![Figure 14: Type of industry](image)

2.5. Type of business activities

The survey revealed that more than 65% of Black-owned SMEs provided pure services to their clients (refer to Figure 15) against 16% whose business activities revolved around retailing. Only 2% of the respondents for this survey conducted export activities and 14% were involved in manufacturing activities.

![Figure 15: Business activities](image)
2.6. Number of employees

Over 70% of the respondents interviewed stated that their companies had fewer than 10 permanent employees (refer to Figure 16). Just under 15% said their companies had between 10 and 19 permanent employees, 7% between 20 and 49 and 5% between 50 and 99 permanent employees. Only 2% said to have over 100 employees.

![Figure 16: N° of permanent Employees](image)

2.7. Business aggregate monthly turnover

Over 35% of the Black-owned SMEs interviewed for this survey had a monthly turnover exceeding R100 000, while just under 30% had less than R20 000 (refer to Figure 17). About 19% of these SMEs turned over between R20 000 and R39 999 and 16% between R40 000 and R59 999 per month. Further analysis revealed that 65% of the businesses had a turnover of under R1 million per year, indicating that the majority of the enterprises fell within the boundary of micro-, or very small enterprises as per Category 2 and 3 of the adopted SME definition (refer to Chapter 2 Section 1). The remaining 35% represented small enterprises from Category 4, which were formal and registered with over than R1 million turnover per year.

![Figure 17: Aggregate monthly turnover](image)
2.8. Business total assets

About 45% of respondents declared that their company had assets that exceeded R100 000 (refer to Figure18) against over 30% that declared that they had less than R20 000 of total assets on their balance sheet. Only 9% of the respondents’ companies had between R40 000 and R59 999 of total assets. Companies that declared to have between R20 000 and R39 999, those between R60 000 and R79 999 and between R80 000 and R99 999 represented 5% each.

![Figure 18: Total assets](image)

2.9. Business total liabilities

About 40% of respondents declared that their company had liabilities below R20 000 (refer to Figure 19) against 29% that declared that they had business liabilities exceeding R100 000 on their balance sheet. Only 7% of the respondents’ companies had liabilities in the range between R80 000 and R99 999 of total assets, followed by 12% between R60 000 and R79 999 and 14% with liabilities between R20 000 and R39 999.
2.10. Board of Directors

It was found that 65% of the Black-owned SMEs interviewed for this research had a Board of Directors against 35% that did not have a board (refer to Figure 20). Further analysis revealed that nearly 50% of those SMEs that had a Board of Directors had only one BOD meeting per year, 35% met twice-annually, 12% met over 5 times and 6% met quarterly (refer to Figure 21).

3. Risk Identification

This section aimed to identify the risks Black-owned SMEs of this survey faced.

3.1. Concerns of the respondents

The respondents identified the following as being of concern to them in the completion of their business activities. Nearly 30% were concerned about funding being available to finance their activities (refer to Figure 22). They were also concerned about their capacity to manage costs and be profitable (23%), the market competition from big companies and the regulations, 19% respectively. This was
followed by their inability to find skilled employees, being faced with bureaucracy and concerns about customer relationship management, 16% respectively. The state of the country’s economy and its politics were mentioned by 14% of the respondents and corruption by 12%. Thus, financial concerns amounted to 51%, labour 16%, bureaucracy and regulations 35%, the market, competition and customers 35% and other external challenges 26%.

3.2. Changes in regulations

Nearly 40% of respondents reported they had been affected by the changes in regulations (refer to Figure 23). These changes related to BB-BEE, consumer protection, health and safety standards, labour and transport laws. They stated that these changes slowed down their business activities, affected their cash flows and negatively impacted their profitability. They also mentioned that these changes in regulations restrained their ability to expand their activities and therefore grow.
3.3. Changes in key personnel

Only 9% of the respondents said their companies made changes in key personnel in the past year (refer to Figure 24). They all stated this was a strategic decision and they needed better skilled directors.

![Figure 24: Changes in key personnel](image)

3.6. Work on contract based

About 47% of respondents declared to work on contract basis (refer to Figure 25) and 10% of them declared that the terms of their contracts had changed over the past years (refer to Figure 26). They all worked in the logistics sector and stated that these changes concerned the costs of services.

![Figure 25: Contract](image)

![Figure 26: Changes in terms of contracts](image)
3.7. Company's turnover

About 47% of these SMEs' turnovers were reported to be constant, while 44% reported their turnover to be slowly decreasing (refer to Figure 27). They explained that this was mainly due to the state of the economy, which had been unstable for the past year. Only 9% of the respondents declared that their turnover was increasing. They specified that this increase was at a small or decreasing rate. They also explained that this increase was the result of increased marketing and advertising expenses.

![Figure 27: Company's turnover](image)

3.8. Employees

Almost 40% of the respondents believed that the staff of their SMEs were not well trained, against just above 60% who believed they were (refer to Figure 28). About 25% of these SMEs had a BOD (refer to Figure 29), while 20% of the companies who reported that their staff was not well trained operated on contract basis (refer to Figure 30).

![Figure 28: BOD by companies with untrained staff](image)
About 75% were employing between 10 employees and 50 employees (refer to Figure 31). About 19% of them work in the retail environment, while 31% worked in manufacturing and 50% provided services (refer to Figure 32).

These companies stated that not having well-trained employees resulted in wastage of resources, loss of time and money, development of a limited range of product/service offerings and inefficiency.

About 45% of the SMEs that said to have well-trained staff declared that their turnover had been constant over the past years (refer to Figure 33). Only 37% of them worked on contract (refer to Figure 34) and had a BOD in place (refer to Figure 35). They mostly offered services (80%) (refer to Figure 36) and 70% of them employed fewer than 10 permanent employees (refer to Figure 37).
Companies that reported to have well-trained employees said that it assisted and served them to better serve customers, achieve better performance, retaining customers and increased efficiency, which potentially resulted in increased profitability.
3.9. Processes

Companies that reported to have some sort of processes in place represented about 74% of respondents (refer to Figure 38). The remaining 26% declared not having any processes in place.

Among those that did not have processes in place, nearly 65% did not have trained employees (refer to Figure 39) and nearly 20% worked on contract basis (refer to Figure 40). Nearly 45% of the companies that had processes in place declared that their turnover was increasing, though at a slow or decreasing rate, 31% of them declared their turnover was constant and 25% declared it was decreasing (refer to Figure 41). They said that having a set of processes assisted them in delivering services according to standards, which were kept consistent, it helped boost performance and efficiency, assisted in tracking errors in the production line, avoided loss of time and cost.
Amongst those that had a set of processes in place, about 75% of their employees were well trained (refer to Figure 43) and only 44% worked on contract (refer to Figure 42). Nearly 45% of the companies that had processes in place declared that their turnover was increasing, though at a slow or decreasing rate, 31% of them declared their turnover to be constant and 25% declared it to be decreasing (refer to Figure 44).

Those that did not have processes in place said that not having processes in place affected their performance in terms of the quality of their products, the management of time and tracking of production.

![Figure 43: Contract by companies with processes](image1)
![Figure 42: Trained employees by companies with processes](image2)

![Figure 44: Turnover by companies with processes](image3)
![Figure 45: Technology Improvements](image4)

3.10. Technology and equipment improvements

SMEs that reported to have made changes in technology and equipment represented about 67% of the respondents for this research (refer to Figure 45).
These companies reported that their staff was well trained at 76% (refer to Figure 47). About 66% of them worked on contract (refer to Figure 46) and only 14% did not have processes in place (refer to Figure 48). 41% of these companies declared that their turnover was increasing, 35% of them declared their turnover was constant and 24% declared it to be decreasing (refer to Figure 49).

The remaining 33% declared not having made any changes in technology nor equipment over the past years (refer to Figure 45). SMEs where respondents worked on contract (7%)(refer to Figure 50) reported that their staff was well trained (57%) (refer to Figure 51). About 21% of these companies declared that their turnover was increasing, 29% of them declared it to be constant and 50% declared it to be decreasing (refer to Figure 52). Only half of them had a set of processes in place (refer to Figure 53).
3.11. Risks perceived

Only 37% of respondents stated that risks faced by their company had significantly increased in the past years (refer to Figure 54). The most frequently mentioned risk perceived by the respondents was the state of the economy and the politics at 44%, which was followed by finance at 28% and social issues and corruption at 19% each. They also mentioned regulations 16%, working capital 14% and technology 12% as risks their companies face (refer to Figure 55).
Amongst those who stated that the risks their company faced had increased, nearly 70% mentioned that this was a result of the economy not being stable and by restraining exchanges with international audience and constraining growth. 50% of them mentioned social unrest such as crimes and xenophobia, while 25% reported corruption and lacking skills as being at the root of the increased risks (refer to Figure 56).

**Figure 55: Risks perceived**

![Graph of Risks percieved](image)

Amongst those who stated that the risks their company faced had increased, nearly 70% mentioned that this was a result of the economy not being stable and by restraining exchanges with international audience and constraining growth. 50% of them mentioned social unrest such as crimes and xenophobia, while 25% reported corruption and lacking skills as being at the root of the increased risks (refer to Figure 56).

**Figure 56: Risks by companies perceiving an increased in risks**

![Graph of Risks by companies perceiving an increased in risks](image)

### 3.12. Key success factors

The following factors were named as key success factors by the respondents of this research: customer service at 51%, skills at 47%, sales and marketing at 37%, finance at 28% and management and technology both at 19%. Only 7% mentioned that improved regulations were a key success factor, while 12% voted in favour of an improved economy (refer to Figure 57).
3.13. Sources of funds

Nearly 90% of the respondents stated that most of their funding came from personal savings (refer to Figure 58) and 35% from equity. Only 5% used public schemes, 7% venture capital and 12% used bank loans. Twenty three percent mentioned that they were funded through family and friends as well as private investors. This confirms other studies that had shown that most funding stemmed from private or family sources.

3.14. Marketing

Over half of the respondents reported that they used online marketing tools to promote their companies, their products and services (refer to Figure 59). Most companies made use of referrals from customers, family and friends at 33% and direct marketing tools at 37%. Only 5% of the respondents reported that they made
use of network marketing, although access to such network was restrained. Only 12% of respondents did not have any marketing plan in place. These respondents mentioned that this was a result of limited working capital and efforts to save costs.

![Figure 59: Marketing](image)

### 3.15. Frequency of payments received

Over half of the respondents stated that there was no regular frequency in the payments of the services rendered (refer to Figure 60). They stated that they received payments upon delivery, depending on the terms of the contract or the project. About 30% of respondents received payments either as cash on sale or within 30 days after the sale, while 16% had to wait between 30 and 60 days for their payments. Over 90% of those that did not receive payments regularly were service providers and they declared that this made it difficult for them as their supplies had to be replenished constantly (refer to Figure 61).

![Figure 60: Frequency of payments received](image)

![Figure 61: Business activities by low payment frequency](image)
4. Literature Review Analysis

4.1. Summary of Factors

This section presents the different statements that the respondents had to weight according to the seven-point Likert scale. Table 1 shows the results of the respondents in a frequency form. It also presents the weighted averages for each statement – and indirectly refers to the factor that statement sought to analyse.

In order to calculate the weighted average for each statement on the Likert scale, the author applied the following formula:

\[
W_{\text{Average}} = \frac{\sum_{k=1}^{n} (\text{Number of votes} \times \text{Weighting of the column})}{\text{Total number of votes}}
\]

Where: \( n \) = Maximum Weight of a column (the number of point scale)
Table 1: Summary of statements and corresponding weighted average
4.2. Descriptive statistics of factors

Descriptive statistics were calculated for the statements of Section 4 of the questionnaire of the study. This allowed the author to identify, which factor was more important in the view of the respondents concerning the risk their companies faced and their relative impact on their success.

Table 2: Descriptive Statistics of Statements

<table>
<thead>
<tr>
<th>Statistics</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>5.528333333</td>
</tr>
<tr>
<td>Max</td>
<td>6.21</td>
</tr>
<tr>
<td>Min</td>
<td>5.02</td>
</tr>
<tr>
<td>Median</td>
<td>5.59</td>
</tr>
<tr>
<td>Mode</td>
<td>5.6</td>
</tr>
<tr>
<td>Standard Deviation</td>
<td>0.26703712</td>
</tr>
</tbody>
</table>

The most important statement was “Small businesses have limited access to finance” and the one with the least importance was “Government regulations are not favourable to small businesses”.
Chapter 5: Conclusion and Recommendations

This chapter presents the summary of the findings of the study, the recommendations for policy implementations, the limitations and avenues for future research studies.

5.1. Summary of Findings

With no existing evidence in South Africa, this study sought to identify the risks that Black-owned South African SMEs face. The study made use of a sample of 53 Black-owned South African SMEs across various industries within the boundary of micro-, very small enterprises and small enterprises.

As explained in Chapter 1, this study aimed to identify the challenges faced by Black-owned South African SMEs as well as the causes for their high rate of failure. The findings of this study revealed that although respondents were well educated and skilled (refer to Figures 5 and 6), they did not believe their staff were trained enough – and obviously did not feel it was their job to train them (refer to Figure 63). Very few of these SMEs employed more than 10 permanent employees (refer to Figure 16). This in turn created inefficiencies in resources management and resulted in financial losses.

Having a set of simple processes in place was reported to be of value to Black-owned SMEs as their turnover was said to be constant or increasing at nearly 75% (refer to Figure 44). Processes affected performance as it helped track errors in the production line, enable management to manage cost and time more efficiently and ensure a certain level of quality in product and service delivery.

Over 65% of the respondents reported that their companies had to improve their technology and equipment to stay relevant to their clients. Those that were not able to do so stated that they did not have the financial means to do so. The SMEs that
enhanced their technology or systems regularly reported that by doing so they were able to keep turnover constant or increasing at just above 75% against 50% for companies without technology improvements (refer to Figures 49 and 50).

Most Black-owned SMEs reported to have been heavily affected by the state of the economy and politics, but also by issues such as social unrest (xenophobia and crime), limited access to skilled labour, corruption and competition from big and well established companies (refer to Figures 55 and 56). These factors were particularly important when considering the key success factors for Black-owned South African SMEs that emerged from this study, which included customer service (reliability, satisfaction), skilled labour, enhanced sales and marketing efforts, network access and finance (refer to Figure 57). Respondents linked their ability to score high on ROI based on additional marketing expenditure and their ability to access networks and technologies.

Only 7% of the respondents were confident enough to seek funding through public sources (refer to Figures 56 and 58). Public subsidies and public funds were associated with bureaucracy, red tape and corruption. Poor cost management was also another underlying issue that caused some South African Black-owned SMEs to fail.

This research revealed that many Black-owned SMEs were not well equipped to grow to their full potential, despite having excellent educational bases and theoretical access to funding: access to finance is still a huge problem for them despite it being widely available. Respondents stated that this gap between the demand and the supply of financial support to Black-owned SMEs had not been breached yet as a result of corruption, bureaucracy and red tape, restricted access to facilitating networks and burdensome regulations, all which impacted on their firms’ financial performances (refer to Figure 22).
5.2. Contributions to Literature

In order to identify the most important factors, the statements, which recorded a weighted average above the median of 5.59 were chosen. The following statements ranked above the median:

- I consider education as important to the success of the business.
- I consider marketing as important to the success of the business.
- Poor market analysis is detrimental to the success of small businesses.
- Small businesses cannot afford skilled labour.
- I believe that the fact that small businesses cannot afford skilled labour contributes to their failure.
- Small businesses have limited access to finance.
- High lending rates are obstacles to small business success.
- Small businesses' limited access to finance contributes to their failure.
- Technological advancement is incremental for small business success.

This feeds into the results of the research mentioned in the previous section. Although access to finance is still the most prominent factor, other factors weight as much: access to skilled labour, access to technology, ability to markets, products and services.

5.3. Recommendations

There were several implications of these research findings. First, the findings suggested that finance was the most prominent challenge facing Black-owned South African SMEs, but will probably also face any other SME. The gap between the supply and the demand for finance seemed to be caused mainly by the distrust towards the very institutions that were put in place to assist Black-owned SMEs. Such distrust was probably caused because of perceived bureaucracy, red tape, lengthy processes, demanded paperwork and also by corruption. Some of these
challenges could be addressed by creating simpler access through tailored-down processes, by transparent and independent institutions that will manage the public funds made available to Black-owned SMEs in South Africa. This should help reduce time in treating applications and reduce bureaucracy and red tape. With more finances available, Black-owned SMEs could afford to spend more on marketing and staff training or even hire skilled employees.

Another challenge and potential cause for the high rate of failure is the issue with efficient and effective marketing. Most SMEs did not have the means to compete with big companies and therefore had to rely on basic digital marketing and traditional marketing through flyers or word of mouth and personal referrals/recommendations. Organisations such as the Black Business Council or the Ministry of Small Enterprises had put in place network groups, where Black-owned SMEs can register. This platform needs to be promoted to Black-owned SMEs to make use of all the avenues open to them. SMEs often state that they do not have time to take out of their business life to attend functions, training courses or other offered avenues. However, by ignoring these available routes for improving their performance, they actually fall behind the more active competitors. Internal measures have to be taken by these SMEs to improve their marketing and sales plans, their business strategies and developed processes. If they do not have the current skills needed to handle such tasks within their companies, and do not have the resources to hire fully skilled staff that are able to conduct such business planning and execution, then they will be forced – by market forces – to acquire the extra skills in order to survive and hopefully grow and expand.

The findings revealed that among the reasons for high failure of SMEs within the first year was the fact that although managers/owners were highly educated and well trained, their employees did not receive such training. This fuelled the inefficiency in resources management, which was internal to each company. Besides essential in-house training, this could also be managed by incentivising big companies to take small companies in for incubation for a specific period with the emphasis on skills
transfer. This could help companies that are very small (categories 1 and 2 mostly) that might not have the sufficient background to access a certain level of funding to grow and become sustainable. However, such skills transfer would have to happen at the SME premises, as the SME could not afford to ‘close shop’ for the period of absence.

Another potential reason for the high failure rate of SMEs was the inability to access technology. To ensure that SMEs are competitive, government could provide them with subsidies for technology development or SMEs could form ‘cooperatives’ to form a technology pool, whereby they put funds together to buy certain technologies in order to share the costs and the benefits.

5.4. Limitations of the Research

While the study findings are important as in any other empirical study, there may be several limitations, which need to be acknowledged.

First, there may be criticism relating to the sample selection procedure and size. The sample of 53 selected at the convenience of the researcher was not representative enough of the total population of Black-owned South African SMEs across all nine provinces and might not be considered sufficiently large enough a sample to generalise the results of this study.

Second, the timeframe for the research might be too short to appreciate the validity of certain constructs, which may be more prominent at this stage because of the current state of the economy. For this reason, the stochastic effects have to be dealt with accordingly.
For these reasons, the findings from this study need to be interpreted according to these contextual limitations; which represent also avenues for future research studies as detailed in the next section.

5.5. Avenues for Future Research Studies

There are several relevant topics for future research studies. First, this study has primarily examined risks faced by Black-owned SMEs across industry sectors. Future studies could investigate the risks faced by Black-owned SMEs according to sector and industry. For example, does a Black-owned SME in the tourism sector face the same challenges as one in the ICT sector, or in manufacturing? What are the challenges particularly in the sectors identified by government as the most supported and growth sectors over the next few decades? Also, which of these sectors shows the best resilience over time, provides most growth and ‘permanent’ job creation?

Furthermore, future studies can examine the relationships between the critical factors identified (labour, technology, marketing, network and finance) with the actual performance of these SMEs. Quantitative studies should examine which SMEs do actually make use of further training initiatives, mentorships, incubation efforts or network facilities. It has to be established whether such initiatives fit into the time available/made available for them by these SMEs.

Another area of future study could be to compare the impact of these factors between Black-owned SMEs and other SMEs and also with big companies and truly assess the impact and the weight of each factor to each segment.
 References


27 October 2015


