

# OVERCOMING SMES CHALLENGES THROUGH CRITICAL SUCCESS FACTORS: A CASE OF SMES IN THE WESTERN CAPE PROVINCE, SOUTH AFRICA

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Received: 28 October 2013

Accepted: 13 May 2014

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**ABSTRACT:** *SMEs comprise over 90% of African business operations and contribute to over 50% of African employment and Growth Domestic Product (GDP). SMEs sector has shown positive signs in South Africa, Mauritius and North Africa. In South Africa, SMEs constitute 55% of all jobs. Research of Bowler, Dawood and Page (2007) reveal that 40% of new business ventures fail in their first year, 60% in their second year, and 90% in their first 10 years of existence. It seems that a number of challenges have been identified as contributing to the failure of SMEs in South Africa and worldwide. The purpose of this paper is to identify some of the critical success factors for the SMEs to improve their performance in order to overcome the challenges they are faced within the competitive market environment. The research problem of this study emanates from the current high business failure rate. The research investigates what are the critical success factors that can help these SMEs to be sustainable and have positive growth so to limit the high business failure rate in South Africa. The research established that attracting repeat customers and the performance of the product are the critical success factors that can lead to the sustenance of these SMEs. The study concluded that the resource-constraint SMEs need to focus on critical success factors to build competitive advantage to stay competitive amidst the challenges from globalisation and liberalisation. This study will make further contribution on understanding these critical success factors as they are central to business success, especially in South Africa where it is estimated that the failure rate of small, medium and micro enterprises (SMEs) is between 70% and 80% (Brink and Cant, 2009).*

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**Keywords:** *SME, Critical Success Factors, South Africa*

**JEL Classification:** L26

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## 1. INTRODUCTION

Small and Medium Enterprises (SMEs) play a vital role in economic development as they have been the main source of employment generation and output growth, both

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in developing as well as in developed countries (Love and Roper, 2013). In developing countries, the roles of SMEs become more crucial as they have potential to improve income distribution, create new employment, reduce poverty and facilitate export growth. SME foster development of entrepreneurship, industry and the rural economy (Love and Roper, 2013). It is not only the fact that high rates of economic growth contribute to economic and social development and poverty reduction. Studies show that economic growth of any country is closely linked with SME development. For example, as noted by Mahmood (2008) there is a robust, positive relationship between the relative size of the SME sector and economic growth. Also as noted by Bouri et al (2011), the contribution of SMEs to the economy is high, contributing to almost 50 percent of Growth Domestic Product (GDP) on average. It is also important to note that majority of employment generation is through the growth of SME sector only (Ardic, Mylenko & Saltane, 2011). Though it is observed that the role of SMEs is increasing significantly in respective national economies, SMEs are generally underrepresented in world trade (OECD, 2007) and measures are required to be taken to make its share significant.

South Africa is facing an unemployment crisis; at least 25 percent of the population is jobless, with the number increasing to nearly 40 percent if one includes those that have given up the active search for work (Morgan, 2012). According to the Finscope 2010 study, the SME sector has an estimated 5.6 million small businesses operating in South Africa, creating 11.6 million total employment opportunities which equates to six million jobs excluding the small business owners themselves. Micro and small businesses in South Africa are not achieving the growth required for increased job creation, due to a number of challenges. To fully realise the potential of SMEs, the sector needs to be approached with a fresh perspective attuned to the challenges it faces. There is a need for the focus to shift from the available collateral in the business to the viability of the business and the ability of the entrepreneur. Each business needs finance tailored to their unique challenges. In addition to this, the business owner needs access to the expertise and market knowledge required to make their business a success.

## 2. AIMS AND OBJECTIVES OF THE STUDY

The purpose of this paper is to identify critical success factors for the SMEs to improve their performance in order to overcome the challenges they are faced with within the competitive market environment. Therefore, this paper develops a framework for explaining the challenges and success factors of SMEs in South Africa. The sample of the study was drawn from the SMEs who participated in the Swedish Trade Council (STC) and Small Enterprise Development Agency (SEDA) program of advanced small business development and management in the Western Cape Province, South Africa in 2012. The research questions aimed to identify factors that were considered critical for success by the selected SME owners/managers in the Western Cape Province of South Africa, namely:

- What factors are considered critical for SMEs success by those that attended the program?

- What are the challenges that these SMEs owners are faced with?
- What are the possible solutions to these challenges?

The overall value of this research is to further contribute to the existing literature around the understanding of drivers of SMEs growth.

A limitation of this study is the small sample size due to the criterion that was used to select the participants. It is important to note here that SMEs participation in the SME development and management program was based on the available budget which was able to cover only 16 SME owners/managers and the criterion that was set by the main sponsors of the program which are SEDA and STC. The criterion were that the SME must be registered on SEDA database, SME should have participated in the Export development orientation program and exported a product or service in the last five years. The SME's that were left out of the program were those who did not have a product that have a potential to be exported or exported a product or service in the past five years and those that have not participated in the export development orientation program even though they were registered on the SEDA database.

### 3. SMALL AND MICRO ENTERPRISES IN SOUTH AFRICA

An SME is described by the National Small Business Act of South Africa of 1996, as amended in 2003, as a separate distinct entity including cooperative enterprises and non-governmental organisations managed by one owner or more, including branches or subsidiaries if any is predominately carried out in any sector or subsector of the economy mentioned in the schedule of size standards and can be classified as SME by satisfying the criteria mentioned in the schedule of size standards (Government Gazette of the Republic of South Africa, 2008). The Department of Trade and Industry (DTI) (2012) of South Africa suggests that there are more than 800 000 SMEs and have estimated the total economic output of SMEs in South Africa to be 50% of GDP and it is also estimated that they provide employment to about 60% of the labour force. SMEs are therefore an important contributor to the economy and are considered a driver for reducing unemployment, given that the formal sector continues to shed jobs. South Africa is facing an unemployment crisis; at least 25% of the population is jobless, with the number increasing to nearly 40 percent if one includes those that have given up the search for work. At the same time, the level of entrepreneurial activity is low in South Africa when compared to other emerging markets. According to the Global Entrepreneurship Report (2006), the level of early-stage entrepreneurial activity is directly related to per capita income. In 2010, South Africa ranked 35<sup>th</sup> out of 54 profiled countries, ranging in income levels and regions, in terms of total entrepreneurial activity and was below the average for all participating countries. The report shows that the level of early-stage entrepreneurial activity is strongly related to per capita income. It was well behind countries such as Ghana, Zambia, Brazil and Chile in its ability to foster successful new businesses (Herrington, Kew, & Kew, 2010).

According to Finscope study (2010) the SME sector has an estimated 5.6 million small businesses operating in South Africa, creating 11.6 million total employment opportunities

– that is six million jobs excluding the small business owners themselves. However, the sector is heavily skewed towards micro-enterprises, with 82% of South African enterprises being micro or very small (as defined by the National Small Business Act). These businesses are often survivalist or lifestyle businesses. Two in three business owners operate their own businesses and do not have any employees. Only 300,000 of the country's businesses employ five or more employees. While medium-sized firms may not produce the bulk of output or production, they generally hire most people in an economy (National Planning Commission, 2011). Micro and small businesses in South Africa are not achieving the growth required for increased job creation, due to a number of challenges.

### **3.1. South Africa's policy and institutional framework for SMEs**

For the past fifteen years, the South African Government has invested in a plethora of initiatives aimed at supporting and growing the SME sector. South Africa's small business policy was principally informed by the 1995 "White Paper on National Strategy on the Development and Promotion of Small Business in South Africa (Timms, 2011). The 1995 White Paper outlined, among other things, the need for the Government to create an enabling legal framework, facilitate access to information and advice, boost procurement from small firms and to improve access to finance and affordable physical infrastructure. On the policy front, the NSB Act was passed in 1996, and stipulations pertaining to the sector were built into the Broad Based Black Economic Empowerment (BBBEE) Codes of Good Practice (SBP, 2009a). The objectives of the 1995 White Paper now finds practical expression in the Integrated Small Business Development Strategy for 2005 to 2014. The strategy is based on three pillars:

- Increasing the supply of financial and non-financial support;
- Creating demand for SMME products/services; and
- Reducing regulatory constraints.

### **3.2. SMEs are important for job creation in South Africa**

According to SBP Alert (2013) with good reason, SMEs are viewed as lynchpins of successful employment strategies. SMEs tend to be labour rather than capital intensive. In fact, in the South African context, the social impact of SME hiring is underappreciated. This is because small firms employ people whose labour market characteristics make them most likely to be unemployed and marginalised. The SME Growth index found a strong bias in SMEs' hiring patterns towards unskilled employees (SBP Alert, 2013). Unemployment is most severe among Africans, women and those with educational qualifications below a matric (in other words, the low-skilled). If employed, however, people from these groups are disproportionately likely to be employed in SMEs. In particular, those without matric qualifications are statistically far more likely – some 19 percentage points more likely – to be employed by SMEs than those holding higher qualifications (Wadhwa, Aggarwal, Holly and Salkever, 2009).

A final important feature concerns age. Chronic unemployment among the country's youth has come to the fore as one of the most serious problems facing South Africa; unaddressed, it could be a permanently destabilising factor. It is in this respect that SMEs might offer their most compelling attraction. SMEs are more likely to employ young (and older) work seekers than those in middle age. Relative to a 35 year old, a 20 year old is almost 4 percentage points more likely to be employed in a small firm (SBP Alert, 2013). There is, however, an important nuance. Whether or not firms are adding to employment seems to be related to the ratio of skilled to unskilled workers. Firms with a larger proportion of unskilled staff are less likely to be growing than those with smaller proportions. It seems that unskilled employment has an indirect link to the availability of skills, and by implication, the efficiencies and productivity gains that they bring. Seen from this perspective, the imperatives of competitiveness and employment are linked rather than incompatible. Unfortunately, this also means that there is a limited capacity for absorbing unskilled labour and that this is compounded by the shortage of skilled labour (Love and Roper, 2013).

Finally, SMEs are most likely to employ staff on a fixed term or temporary basis. According to SBP Alert (2013) data from Statistics South Africa shows a clear correlation between the size of firms and the use of such labour (as a proportion of overall employment in the various size categories). The smallest firms are most prone to using such labour, closely followed by SMEs of the Panel's size: 10 - 49 people. In each case, around one in five employees holds his or her position on a temporary or part time basis. This is substantially above the proportion employed in this way in larger firms (SBP Alert, 2013).

### **3.3. SMEs in the South African economy**

According to SBP Alert (2013) SMEs' potential to create jobs is accepted as axiomatic and unfortunately, this is not happening at present. Between 2011 and 2012, the Panel reported an aggregate 6% decline in permanent employment and this has a broader context. Over the past decade, a major change has taken place in the distribution of employment across the economy. Data from Statistics South Africa shows that firms employing fewer than 10 people provide the largest share of employment throughout this period – many of these being very small, in the informal sector, with little potential for growth. Perhaps more telling is the interplay between the group matching the SME Growth Index panel (in other words, those with 10-49 employees, those upon whom a special hope for growth and job creation rest) and their larger counterparts. They start off evenly proportioned, each at around 27% of the total (National Small Business Association, 2013). As the decade progresses, the 10-49 category accounts for an increasing share of the total, reaching a high of some 37% in 2007. At this point – more or less equivalent with the global economic crisis, the share of employment in these SMEs falls sharply, and it is superseded by that in the larger firms (Ayyagari, Demirguc-Kunt and Maksimovic, 2011).

#### 4. SMES SUCCESS FACTORS

Kuratko and Hodgetts (1995) believe that four factors help account for business success—firstly, the existence of a business opportunity. It is fair to believe that there is a target market in the marketplace who wants to buy the goods and services on offer. One of the main factors in the success of any small business is the existence of a real business opportunity. It is not enough that the business opportunity exist, but of more importance is the manner in which the opportunity is exploited or seized.

The second factor is the management ability. The ability of the owner/manager to allocate scarce resources effectively and efficiently is a question of management's abilities. Researchers such as Kuratko and Welsch (2004), Rwigema and Venter (2004), Megginson, Byrd and Megginson (2003) have all reported the lack of management ability as the most common reason for small business failure.

Another factor is adequate capital and credit. Kuratko and Hodgetts (1995) believe that the greater the amount of capital the owners invest in a business, the greater the chances of survival and vice versa. They go on to mention that banks are generally risk adverse when small business owners require loans. Ndwandwe (1998) reports that South African banks continue to display a crippling preoccupation with avoiding risk when dealing with loan applications from small businesses. Small businesses rely on their suppliers to provide them with credit for periods of up to 60 days. This arrangement ensures the survival of small businesses (Kuratko and Hodgetts, 1995). Under-capitalization is a problem synonymous to small businesses, in other words, lack of capital invested in a business on the part of the owner or owners. Those businesses which are under-capitalized and expanding too fast find themselves running into serious financial difficulties.

The final factor is the existence of modern business methods. According to Kuratko and Hodgetts (1995) firms must endeavour to use modern business methods, efficient equipment and procedures where available. Making use of modern business methods will ensure that small businesses remain competitive and efficient relative to its competitors.

#### 5. CHALLENGES FACING SMES SUCCESS IN SOUTH AFRICA

SMEs in South Africa face a number of challenges the most important of which have been reported by a number of organisations including Ntsika (2011) and the Department of Trade and Industry (2012) to be:

- a lack of management skills
- finance and obtaining credit
- access to markets and developing relationships with customers
- appropriate technology and low production capacity
- a quality product
- support for the role that they play in economic development

Other challenges faced by SMEs include access to finance, market access, skills and networks, and the enabling environment. Many businesses face financial constraints and cash flow uncertainty. Businesses often lack the collateral and financial records (e.g. audited financial statements) required for loans from commercial banks. Application processes tend to be bureaucratic. There are high transaction costs and a lack of awareness about the procedures involved in gaining financing. These challenges are evident in the fact that 75% of applications for credit by new businesses are rejected and only two percent of new SMEs are able to access loans (Finscope, 2010), whilst only 2% of businesses seeking private equity are successful. According to Fatoki and Garwe (2010), the lack of capital seems to be the primary reason for business failure and is considered to be the greatest problem facing agri-business, small and micro business owners. This was supported by Shafeek (2009) where he says: from a business viewpoint without adequate financing, the business will be unable to maintain and acquire facilities, attract and retain capable staff, produce and market a product, or do any of the other things necessary to run a successful operation. Stokes and Wilson (2006) also add on to say that financial difficulties of SMEs arise, either because of an inability to raise sufficient funds to properly capitalise the business, or a mismanagement of the funds that do exist or a combination of both. He further explains that, access to external funds may be difficult to achieve for new or young SMEs with no track record, especially for owners without personal assets to offer as security. Stokes and Wilson (2006) go on to stress that many new owner managers, having received funds, misuse them; small businesses are notorious for their lack of proper financial controls and information. While it is true that capital is essential and plays a key role in the ability of a business to progress, it is not the only necessary ingredient for success. There are non-financial barriers for SMMEs in South Africa which hinder growth.

The enabling environment is a key barrier to growth. Crime and theft ranked as the third highest obstacle to growth for business owners in the Finscope survey (2010). Other factors classified under “*red tape*” include labour regulations that are inflexible, imposing a high minimum wage for staff and often result in difficulties with unions and strikes. Poor infrastructure is often a constraint, with issues such as high energy costs and lack of consistent electricity supply, high cost and/or limited availability of transport.

Also, businesses often lack the necessary knowledge and networks required to be successful in a particular market or industry. They are unsure of what product or service should be sold in the market, and do not know how to attract and retain a sufficient customer base.

## 6. IMPORTANCE OF SMES TO THE ECONOMY

Small enterprises comprise between five and 100 formally employed persons. Employees are employed on a full-time basis. According to the Department of Trade and Industry, a small business is owner managed, registered with local authorities and business activities are conducted from fixed premises (Republic of South Africa, 2005). Medium enterprises constitute between 100 and 200 formal employees (Cronje et al., 2004: 5). Such businesses have vast potential of growing into large businesses, should capital injections be obtained.

Often they are characterised by a decentralisation of power to a new management layer (Falkena, 2000) between the SME operator and employees.

SMEs are considered the “lifeblood of modern economies” (Rao, Metts & Monge, 2003: 13), creating far more jobs than those created by large businesses and contributing 37% to employment in South Africa (Soontiens, 2002: 712; Barry & Milner, 2002: 316). SMEs provide a variety of goods and services for customers to choose from, some of which might otherwise not be provided by large businesses (Jackson, 2004: 6). SMEs act as catalysts for economic growth as well as for the development of the arts, human resources, manufacturing and sport sectors (Cronje et al., 2004: 6). Studies conducted by Moodley (2002: 37) from a development perspective reported that SMEs are important because of their potential for job creation and distribution of wealth which results in a multiplier effect on the socio-economic activities of a country which in turn creates developmental activities of a country.

SMEs are flexible and can also act as subcontractors to most large enterprises in the economy, ultimately leading to equitable distribution of income (Lloyd 2002). The Department of Trade and Industry report (2009) indicates that SMEs provide personalised services and also make a positive contribution to wealth creation in the South African economy. They are breeding incubators for entrepreneurial talent and a testing ground for new products (Chaston, 2000). They are agents of change, widely facilitating innovation and competition within various national economies (Barry & Milner, 2002).

The importance of small businesses is recognised in numerous African countries such as Togo, Uganda, Ghana, Cote d’Ivoire, Nigeria, Kenya, Malawi, Burkina Faso, as well as others (Brinders, Memela, and Mlosy, 2003). According to Rwigema and Karungu (1999), SMEs are dominant in numbers in most economies. In First World countries like the United States of America and the United Kingdom, SMEs play an important role in the economy, accounting for an estimated one third of industrial employment and a lower percentage of output. In Third World countries where SMEs dominate economically active enterprises, the SMEs’ prosperity is considered far more important than in First World countries (Rwigema and Karungu, 1999). The activities of SME enterprises in Africa (Rogerson, 2001a), is of vital importance for the promotion of economic growth, job creation and the mitigation of poverty. However, research conducted on SMEs in Africa by Mead and Liedholm (1998) confirmed that on average, there are more SMEs closures than expansions. It has long been debated that SMEs are pivotal to employment creation and economic growth, particularly in countries such as South Africa that has a high unemployment rate, estimated at up to 40% (Friedrich, 2004; Watson, 2004). Upgrading the roles of the SME sector in the South African economy to improve economic growth through increasing competitiveness, and by generating employment and redistributing income (Rogerson, 2004, 2006), has been the focus of new development policies since the democratic transition (Berry et al., 2002; GCIS, 2002). In order to aid in the facilitation of the SME environment, the South African government tabled the National Small Business Act of 1996 amended with Act 29 of 2004 to provide equal standing to SME enterprises (Rwigema and Venter, 2004; Ntsika, 2001) in South Africa’s economy. The vital role the



SME sector plays in the South African economy in addressing sustainable development, was highlighted by the 2003 Human Development Report (UNDP, 2003) for South Africa (Rogerson, 2004).

## 7. RESEARCH METHODOLOGY

According to Altinay & Paraskevas (2008) surveys are a commonly used for collecting data as far as the SMEs are concerned. For purposes of this research, a descriptive survey was conducted. According to Altinay & Paraskevas (2008), descriptive surveys are concerned with particular characteristics of a specific population and are predominantly used to gather information about what people do or think. In terms of this research this strategy proved the most useful to determine how the SME owners rate the importance of the critical success factors for the success of their business. The survey units extended across the SMEs owners who participated in the advanced training on SME management and development of 2012. These SME owners were selected through an interview process conducted by the Swedish Trade Council (STC) and the Small Enterprise Development Agency (SEDA) in the Western Cape Province, South Africa. The selection criterion was that these SMEs should be registered on the SEDA database and had to go through two stages of interview assessments. The reason for the client to be registered in the database was due to the fact that STC and SEDA wanted to deal with clients that had a working relationship with them and hence no SME that was not registered was considered for this training program. The first assessment was the evaluation of the business operation and its potential to export its products and the second being the face-to-face interview with the owner of the business who will participate in the program. The export potential of the SMEs was measured by two factors, first that the SME owner should have attended the Small Enterprise Development Export Orientation course offered by SEDA and the second being that the SME should have at least exported its products and services in the past five years. Two representatives from STC and one from SEDA conducted the face-to-face interviews. After the two assessments were conducted, only sixteen (16) SMEs met the criterion required. It is for this reason that the population sample of this study was very small. Another reason for the small sample was based on the cost for participating in the program. Each participant's overall cost was R50 000.00 and therefore the available budget could only cater for sixteen participants. This of course leads directly to a small sample size and unfortunately, the selected sample was dominated by the SMEs from the manufacturing sector. It is also important to emphasise at this stage that due to the small sample, the SMEs economic sectors were clustered into two to ensure reliable statistical analysis. A questionnaire was developed based on literature survey and was distributed amongst these SME owners during the training period. The first training took place in George, Western Cape for two weeks during June – July in 2012. The second training took place in Stockholm; Sweden for two weeks in September 2012. No requirements were set prior to completion of the questionnaire as all the SME owners participated in the survey. The questionnaire consisted of two sections, the first being the economic sector and the number of years in business and the second being the analysis of the critical success factors using the Likert scale. The processing of the data, ranging from checking to coding,

data capturing and analysis was undertaken using both the Microsoft Excel and Statistica software programme version 10. The results of the study are reported using frequency tables, descriptive statistics and Mann-Whitney U Test.

### 7.1. Survey results and discussion

In this section, the results of SME owners are discussed in terms of the SMEs types, the number of years of operation by the SMEs and importance of critical success factors for the success of these SMEs as evaluated by the participants in the program. The critical success factors used in this study were the following:

- The ability of the SME to generate enough cash;
- The ability of the SME to attract repeat customers;
- Competitive pricing;
- Advertising and promotion;
- Skilled workers; and
- Product performance

Table 1: *Frequency of industries*

	Count	Percent
Manufacturing	8	50
Agri-processing	1	6.25
Fashion design	3	18.75
Art and craft	1	6.25
Education resources	1	6.25
Sales services	1	6.25
Pharmaceutical products	1	6.25

Table 1 shows the frequency of the industries that were represented in the training programme by SME owners. The manufacturing industry accounted for half the industries while the remaining half was a distribution across various industries. The nature of the training programme and the selection process, as explained under the research methodology section, resulted in low numbers of representation of the industries and it is for this reason that the other industries were combined together to obtain a meaningful analysis. Therefore the industries will be categories as **Manufacturing and Other**. This therefore means that the sample for both (Manufacturing and Other) are not representative of all SMEs in the Western Cape Province but are representative of the sample in the SEDA database of only those SMEs that met the selection criterion set by SEDA and STC.

Table 2: *Number of years of business operations*

Numbers of years in operation								
	Valid N	Mean	Median	Mode	Frequency of mode	Minimum	Maximum	Std. Dev.
Number of years	16	2.94	2	2	6	1	7	2.11

The results of table 2 above infer that the shortest time that the SMEs have been in business is one year and the longest is seven years.

Table 3: *Observed frequencies on the critical success factors*

Industry	Very important	Important	Neutral	Not important	Not important at all
<b>The ability of the SME to generate enough cash</b>					
Manufacturing	4	4	0	0	0
Other	6	2	0	0	0
<b>The ability of the SME to attract repeat customers</b>					
Manufacturing	7	1	0	0	0
Other	8	0	0	0	0
<b>Competitive pricing</b>					
Manufacturing	2	3	3	0	0
Other	1	2	5	0	0
<b>Advertising and promotion</b>					
Manufacturing	4	1	3	0	0
Other	2	4	2	0	0
<b>Skilled workers</b>					
Manufacturing	3	4	1	0	0
Other	4	1	2	1	0
<b>Product performance</b>					
Manufacturing	8	0	0	0	0
Other	4	3	1	0	0

Table 3 shows the results of SMEs owner's views of the importance of critical success factors for their SMEs. The results infer that there were similar patterns of opinions as far as these factors were concerned. In all six critical factors, none of the SME owners viewed them as not important or not important at all with very few of them seen as neutral. The most prominent factor as far as its importance to the success of SMEs as inferred by the results was the ability of the SME to attract repeat customers amongst the two groups of SMEs. The results infer that 44% of those in manufacturing sectors see the ability of the SME to attract repeat customers as very important while 50% of the other economic sectors also see it as very important. The results also show that 6% from the manufacturing sector see this critical factor as important.

The second highest ranked critical success factor by both SMEs was product performance with 50% of those from the manufacturing SMEs viewing it as very important with 25% from other SMEs viewing it as very important as well. The results also infer that 19% from the other SMEs view this critical success factor as important.

The ability of the SMEs to generate enough cash was also seen as very important and important by both SME owners from the different sectors. The results infer that 25% of manufacturing SMEs view this critical success factor as very important while 38% of those other SMEs view it as very important as well.

The results show that competitive pricing was the lowest ranked factor as far as its importance is concerned. This was confirmed by a high number of SMEs who were neutral in viewing this critical success factor. The results infer that 19% of SMEs from Manufacturing and 31% from the other SMEs view it as a neutral factor.

Table 4: *Mann-Whitney U Test*

<b>Mann-Whitney U Test</b>				
	<b>Rank Sum</b>	<b>Rank Sum</b>	<b>U</b>	<b>2-sided</b>
	<b>Manufacturing</b>	<b>Other</b>		<b>exact p</b>
Generate enough cash	76	60	24	0.4418
Attract repeat customers	72	64	28	0.7209
Competitive pricing	59.5	76.5	23.5	0.3823
Advertising & promotion	65	71	29	0.7984
Skilled workers	66	70	30	0.8785
Product performance	52	84	16	0.1049

Table 4 shows results of the Mann-Whitney U Test, which is the non-parametric equivalent to the t-test to compare differences on an ordinal or interval/ratio scale variable between two groups. Since the test makes use of the ranks of the data, and not the actual data values, the results are interpreted in terms of median differences. The results as shown in Table 4 infer that since all the p-values are greater than 0.05, it means that in all cases, the data do not provide sufficient evidence to conclude that the medians of the two groups (Manufacturing and Other) are different. In other words the medians of the two groups do not differ statistically significantly. This pattern can be attributed to the low number of the SME owners who participated in this research as a direct result of the criterion set by the STC and SEDA.

The literature review has identified challenges facing SMEs in their growth and they included amongst others: a lack of management skills, finance and obtaining credit, access to markets and developing relationships with customers, appropriate technology and low production capacity, and support for the role that they play in economic development. In relation to the findings of this study, the results show a strong link between developing a literature review finding of relationships with customers with the finding of attracting repeat customers. The results of this study show that the SMEs involved in this research highlighted the importance of attracting repeat customers. Given the results of the study, it is quite clear that the SMEs involved in the study do agree that it is a challenge and hence the need to have more focus on attracting repeat customers to create stability of the business. Repeat customers are a solid base for customer loyalty and for customers to be loyal; they require a quality product that satisfies their need. Another identified challenge from literature review was quality products and the SMEs involved in this study identified

product performance as a key success factor for their businesses. Linking the performance of the product with repeat customers, it is quite clear that customers will only come back if they are satisfied with the quality of the product. The findings of the study in relation to product performance may be inferred as a direct result of the sample that participated in the study. Majority of the participants were from the manufacturing sector where they deal with products. Their views were that, for their SME's to grow, the product they offer should be of high quality with good performance. It also therefore means that the participants from the group called "Other" do not have products but deal with services. For them, it means that the quality of the service is what matters rather than the quality of the product. This finding is supported by (Reed, Lemak, & Mero, 2000) who states that around the world a growing number of organizations use quality management as a strategic foundation for generating a competitive advantage and improving firm's performance.

The results of the study also show that the SMEs involved in this research did not see competitive pricing, advertising and promotion and skilled workers as key compared to attracting repeat customers and product performance. This finding may infer that they believe that product performance and attracting repeat customers can overcome these other factors. Research has indicated that customers are willing to pay more for a quality performing product and therefore a quality performing product does not require aggressive advertising and promotion.

Finally the results of this study also confirm that skilled workers are not seen as a challenge in the SME sector as this sector is dominated by low-skilled work-force in South Africa. The dire skill shortage in South Africa makes it difficult to both attract and retain skilled talent and SMEs are generally labour-intensive and provide employment opportunities for low-skilled labour force.

## 8. FRAMEWORK FOR ADDRESSING SME'S CHALLENGES

In the introduction, it was mentioned that a framework for addressing challenges facing SMEs will be established. Below is the suggested framework to help minimise the challenges faced by SMEs in their growth:

**Developing country specific strategies** - The development of an effective SME finance strategy for an individual country should ideally be based on a comprehensive diagnostic of its SME finance gap and the quality of its SME finance architecture.

**Developing a supporting legal and regulatory framework** - An effective legal and regulatory framework promotes competition by avoiding overly restrictive licensing requirements and allows international and regional banks with better SME lending tools to enter the market. Competition among financial sector players can be promoted further by introducing technological platforms in key areas, facilitating a variety of financial products and services, driving down the costs of financial access, and reaching previously untapped markets.

**Strengthening the financial infrastructure** - Establishing a solid financial infrastructure (auditing and accounting standards, credit registries/bureaus, collateral, and insolvency regimes) should be a priority in financial development. The aim should be to develop a comprehensive credit reporting system that covers both personal and commercial credit information, and help lenders better manage credit risk and extend access to credit. Some countries, such as India, have introduced SME rating agencies as an additional institution designed to provide more information to prospective lenders. Moreover, a well-functioning collateral regime characterized by a wide range of allowable collaterals (immovable and movables), the establishment of clear priority rankings of claims over collateral, efficient collateral registries making priority interests publicly known, and effective enforcement of collateral in the case of default can further enhance risk acceptability of SME customers for financial institutions.

**Effective government support mechanisms** - In all cases, government interventions should be carefully designed and better evaluated with a view to accurately measure their achievements in terms of outreach and leverage. Partial credit guarantee schemes should remain an important form of intervention. Key guiding principles on such schemes should contain guidelines on eligibility criteria, coverage ratios, scalable credit approval mechanism, fees, payment rules, use of collateral/down-payment, and equity ratios, among other parameters.

**Building reliable data sources for SME finance** - An effective data collection framework at the national level should include efforts to standardize the definition of SMEs, centralize the collection of supply-side data by the central bank/banking supervisors and other financial supervisors, and survey SMEs in order to identify and quantify underserved SME segments. Demographic data on SMEs by number of employees, turnover, and asset size should be available and help normalize access to data. Computerized business registries would further facilitate the data gathering process and would serve as an important first step for firms joining the formal sector. Annual business and financial reports can provide important measures over time on the size and trends of the SME sector.

## 9. CONCLUSIONS AND RECOMMENDATIONS

As a contributor to a strategy for tackling South Africa's economic and social challenges, a thriving SME community has few equals. SMEs' general tendency towards labour intensity and the openings they offer to the lesser skilled highlight the priority that should be accorded to their growth and development. At present, the dominant narrative is about what is failing to happen: the SME economy is largely stagnant, and is a long way from the purposive, wealth-and-job-creating growth that the country desperately needs.

The findings of this study infer that the training program was dominated by the SMEs from the manufacturing sector as compared to other sectors. As indicated above, this was purely on the basis of the criterion set out by the selection panel. However the results of the SME growth index conducted by SBP business environmental specialist in February

2014 indicated that the manufacturing SME's in South Africa are the most dominant at 58% of the total SMEs in the country.

It is important to note that the success of these SMEs in the market place is crucial to the contribution to employment creation and poverty alleviation which are major challenges in South Africa. It is therefore recommended that SMEs should indeed focus more on their attracting repeat customers, product performance, and to generate enough cash as per the findings of this study. In this instance repeat customers will spend more with the SME while providing word-of-mouth recommendations to their friends and relatives because they will be satisfied with the quality of the products provided. It therefore also makes sense for the SMEs to focus on generating enough cash so they can have a good cash flow to meet their obligations and also to invest in new and improved products yielding a possible sustainable future for them. The implications of the challenges faced by SMEs in South Africa and the results of the study leads to the following recommendations aimed at minimising these challenges.

### 9.1. Government recommendations for policy considerations

- The government should establish a National Small Business Council which will serve as an information hub for all SMEs in the country;
- The country should develop a finance agency with the mandate to improve access to finance by the SMEs; primarily through the provision of 'wholesale finance' or guarantees to retail financial intermediaries, which, in turn, finance the provision of 'wholesale finance' or guarantees to retail financial intermediaries, which, in turn, finance the SME sector;
- Establishment of a skills programme through which SMEs are able to obtain assistance with two of the challenges that they face, i.e. "a lack of management skills" and "developing relationships with customers". Improving skills leads to improved productivity and affectivity - and therefore to a more stable organisation and increased profits;
- Government need to provide support services to SMEs through qualified service providers to allow for growth amongst SMEs.

It is further recommended that the key consideration should also be based on SMEs competitiveness. Most immediate among them is to rethink the regulatory environment, which is normally associated with "red tape" in South Africa. SMEs are contending with an environment ill-suited to their needs. They face numerous demands for compliance, and find that these are often indifferently managed by the officials responsible. Proper assessments of the costs and benefits of regulations are called for. Regulation is necessary, but it must take place with a clear eye on its implications for competitiveness. If the SMEs are to strengthen their areas of competitiveness around attracting repeat customers and product performance, as the two main critical factors as per the findings of the study, then the following is important: escalate the potential for firm productivity. Dealing with this encompasses a wide range of possible activities: investment in capital, innovation and up-skilling. South Africa's skills shortage is a prime problem. It is also one that cannot

be addressed solely within the workforce. The roots of the problem are in a problematic education and social system, and need to be addressed at that level. The other aspect is to appreciate that SMEs do not have the same capacities to focus on their non-core business as larger firms; they often operate with tighter margins, and many SMEs represent a first attempt at entrepreneurship. Assistance in the forms of training, finance or exposure to markets (local or foreign) can be greatly beneficial. According to Global Entrepreneurship, South African report (2006) perhaps most of all, South Africa needs to cherish its entrepreneurs, and its entrepreneurship. A past report from the Global Entrepreneurship Monitor (2006) commented: In an ideal entrepreneurial environment, the pull factors should outweigh the rest. Only then can one say that a true entrepreneurial culture exists in a country". This is equally applicable to the environment that attracts people to entrepreneurship and to the environment that makes it possible for them to thrive.

It is also recommended that government should assist with the formation of business development support (BDS) program. This is where government should play a leading role in mobilising a range of individuals and organisations to respond by providing a range of services broadly referred to as business development support (BDS). These organisations have the potential to address the barriers to SME growth. In South Africa, BDS providers have the potential to provide small businesses with much needed skills to address these challenges. They can help address management and strategic challenges through provision of training and on-going advice to business owners. However, on the demand side, the high cost of BDS services could discourage business owners from using them. It is therefore recommended that government should increase the amount of funding available for high-quality providers of BDS to ensure the continued support for growing South African enterprises.

## **9.2. Recommendations for SMEs' owners/managers**

The following recommendations are made for the SME owners/managers:

- SME owners/managers need to find the resources and take the time to build social and business networks;
- SME owners/managers need to develop an understanding of local markets;
- SME owners/managers need to maintain technological advantage;
- SME owners/managers need to seek bridging arrangements;
- Those owner-managers need to attend management development courses to enhance their knowledge and skills in terms of managing their businesses;
- That owner-manager needs to understand the significance of financial management and that this function is not outsourced to an accountant where the owner-manager is over-reliant on the accountant's role. Financial acumen is vital to the continued existence of the business and owner-managers need to address this. Cash flow can be hampered if credit terms are offered to customers who do not settle their debts within the specified period;
- That owner-manager needs to understand the significance of marketing management. The reliance on key customers requires owner-managers to develop strong customers



relationships, but also that they continually assess the state of their relationship by regularly conducting formal customer satisfaction surveys.

Finally the following is suggested as specific solutions to some of the challenges identified in the literature review so that SMEs can continue to grow:

- It is important for SME owners to understand cash management as a solution to lack of access to funding. This starts with a plan to see what your cash needs are and when your cash needs arise. Then one is in a position to manage it and focus on the cash management techniques most likely to be successful in your business.
- SME owners should strive to have access to skilled mentors and coaches. This will greatly enhance the ability of their businesses to be more successful in the competitive market environment. This requires the SME owners to commit an investment cost on the skilled mentors and coaches. Mentors and coaches in South Africa are mainly business consultants. It is therefore important that SME's needs to commit a certain cost to pay these coaches and business mentors. This is regarded a beneficial investment as the assistance gained from these business mentors and coaches will enhance the success of the SME's.

In conclusion, new development context requires change in both perception and practices in the promotion of SME development. Competitiveness is increasingly man-made; furthermore, it can be leveraged by factors other than location and natural resource endowments. One lever is through the maintenance of on-going access to the available store of global information and knowledge, including market standards, marketing opportunities and innovative technologies. Information in general is very scarce and always hinders market performance especially for the SMEs. Therefore an effort to provide critical information is necessary including technological advancement information.

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