

THE IMPACT OF ACCESS TO CREDIT ON THE DEVELOPMENT OF SMMEs IN RURAL AREAS: SOBONAKHONA MAKHANYA TRIBAL AUTHORITY AREA, SOUTH AFRICA

Itumeleng Judith Maome
Durban University of Technology, South Africa

ABSTRACT

This study investigates the nature of credit available to SMMEs in rural areas, to determine the impact of access to credit on the development of these SMMEs. This study is quantitative and exploratory in nature; it explores the impact of access to credit on the development of SMMEs in Sobonakhona Makhanya Tribal Authority rural area. Research findings revealed that access to credit is a major concern for businesses in this area. SMMEs who obtained credit experienced positive changes in their businesses. Therefore, it is recommended that SMMEs be encouraged to apply for credit, as it is important for their development.

Keywords: SMMEs, Finance, Development, Credit Facilities, Rural Areas.

INTRODUCTION

SMMEs comprise the largest number of businesses in the private sector, however, owing to their small size and most academics and researchers often ignore informal structure, their importance. They are usually widely spread; which contributes to the economic stability of developing areas and the country as a whole, they constitute approximately 91% of formal businesses in South Africa (Gopaul & Manley 2015). They are in abundance in the poorer areas such as the outskirts of the cities and in the rural areas. Each one does a minimal amount of trading but the large number of traders makes this a substantial amount of trading/ money. Therefore their contribution towards employment creation, income generation and output growth cannot be disregarded (SEDA 2016). Nevertheless, in rural areas; poverty, inequality and unemployment have been identified as the three most serious constraints to the economic development of the country (Clover & Darroch, 2005). As a result, SMMEs in rural areas tend to be smaller, have lower growth rates and have a limited local market and skill base, and normally live from hand to mouth (Kroon 1998).

SMMEs face many challenges which impact their growth and development, and many of them fail within a year of establishment. The high failure rate has been attributed by many researchers to obstacles such as limited access to start-up and expansion finance, the inability to identify suitable markets, and the inaccessibility of appropriate technology (Nieman, et al 2003). As a result, a lot of creative business ideas are not developed into viable new ventures. Access to financial facilities assists businesses, especially those in rural areas, to grow, to meet their daily needs and to create more jobs for the community. In that way they are able to contribute to employment creation, economic growth and equal income distribution (Fatoki 2014). This research aims to i) identify the nature of businesses in rural areas, ii) establish the nature of credit available to SMMEs in rural areas and iii) determine the impact of credit facilities on the development of SMMEs in rural areas.

Nature of SMMEs in South Africa

The definition of what constitutes SMMEs varies from country to country. In South Africa, the National Small Business Act (Act 102 of 1996) amended in 2003 defines SMMEs according to the size of the enterprise - annual

turnover, the number of employees, gross asset value and its management (Fatoki & Garwe 2010). They employ fewer than 200 employees, have an annual turnover of less than R5 million, with capital assets of less than R2 million and are managed by owners. The term SMMEs covers a vast array of businesses, namely; micro enterprises which includes the survivalist enterprises, small enterprises and medium enterprises. This breakdown is formed on the basis of annual turnover and number of employees as indicated (DTI, 1998).

This research focusses on micro which includes the Survivalists enterprises; they operate in an informal sector and are not required to have a trading license to operate (DTI 1998 in SEDA 2016). They are undertaken by people who only start the business to survive, therefore employ a minimum of one and maximum of five employees who are usually family members and they have little capital is invested in these businesses as the main source of capital is from family and friends. Survivalists do not have any training and lack basic literacy, and therefore their opportunity for growth is very small (SEDA 2016).

Nature of Rural Areas

In South Africa the majority of the population that resides in rural areas are blacks. They do have access to resources such as water, learning facilities and employment opportunities. This is subsequent to discriminatory distribution of resources during the reign of the apartheid government (Molefe 1996). The rural areas of South Africa, with Kwa-Zulu Natal in particular, are dominated by micro and survivalists enterprises. As already mentioned, these enterprises are characterised by informal business practices and methods of delivery. They have small communities that are highly dispersed; villagers have to walk miles before reaching the next house. However, due to low population density which makes villagers to have a closely-knit and supportive of one another. Rural areas are further characterised by poor infrastructure with mostly untarred roads, lack of access to basic facilities, such as water, electricity and formal schooling. Most SMMEs established, especially in rural areas fail within one to four years of establishment (Gopaul and Manley 2015).

Nature of Trading for Rural SMMEs

Most SMME owners in rural areas live in shacks, and even if affluent enough, build mud houses with weed as roofing material (Nieman, et al, 2003). Their businesses are therefore constructed as such. The medium- sized component of SMMEs operates mainly in the formal manufacturing sector, whereas the small and micro enterprises are inclined to operate in the informal sector (Mears & Theron 2006). Due to poor infrastructure, high unemployment rates and lack of access to finances, SMMEs in South African rural areas tend to be smaller, have lower growth rates and have a limited local market and skill base. Subsequently, rural SMMEs contain a diverse and changing mix of enterprises. Across South Africa, the most common forms of rural SMMEs are in retail and service- related activities other than manufacturing enterprise, which are mostly found elsewhere (Ndabeni & Rogerson, 2005).

Financial Constraints of Rural SMMEs

One of the biggest challenges that any existing or emerging entrepreneur faces is how to gain finance, either through loans or equity, for their business. This has an impact on their growth and survival (Makhitha 2016). Many problems of rural SMMEs are inherent in the overall small size of the enterprise, rather than the individual enterprises themselves. SMMEs in rural areas are more likely to not have access to credit due to their nature of establishment because institutions prefer to offer them credit at a later stage of their development (SEDA 2016). The lack of access to credit has been attributed to inadequate collateral, unconvincing business plan and lack of access to vibrant markets (GEM 2014 in SEDA 2016). This is a major constraint on the development of SMMEs in South Africa Nieman et al (2003).

Access to Credit and SMME Development

In order for SMMEs to develop into big businesses and create employment, they should be able to access the credit they need from different sources and institutions. The nature of credit facilities required by SMMEs differs from business to business. This is because they need credit for different reasons and the amount required also varies, depending on their reasons for credit applications. The uses of finance are multitudinous and range from investments in fixed assets to the adoption of equipment. Furthermore, finances assist in the installation of a new and better technology for business enhancement (Abor, n.d). The capital of any business is contributed and used for two main purposes - to acquire fixed assets and to provide for necessary working capital (Langhout 1990). It is believed that an SMME that has had access to credit will flourish and thereby assist in the development of the community in which they operate, in this case, in rural areas. This is due to the belief that credit helps the business grow, meet its daily needs and create more jobs for the community. According to the Management Yearbook (2005), the identification of potential sources of growth or the lack thereof is a necessary step towards developing a more targeted small business development approach. The role of credit in the healthy evolution of the SMME sector has been controversial, both with respect to whether the lack of credit is typically one of the major impediments, and to whether financial liberalization is more likely to improve or weaken it (Berry 2002). When SMME owners are denied access to credit, they are unable to attract skilled labour, to purchase sufficient technology or afford business premises close to their suppliers (Clover & Darroch 2005).

RESEARCH METHODOLOGY

The nature of conducting research was quantitative and aimed at determining the nature of credit facilities accessible to SMMEs as well as the nature of development resulting from access to credit facilities. A survey was conducted in the Sobonakhona Makhanya Tribal Authority (SM/TA) area, investigating the dynamics of a sample of SMMEs where credit facilitation was studied. The theme of the questions asked was exploratory, where the behaviour and exposure of the SMMEs were questioned with pertinent enquiries regarding the nature of their trading and financing as well as their development consequent to financial opportunities made available to them.

The questionnaire was translated into isiZulu to meet the language requirements of most of the people in the SM/TA rural area. However, due to the difference in the isiZulu spoken in the city and rural areas, some complications were experienced by respondents when completing the questionnaire. Research assistants were therefore recruited to respond to the questions posed and to also assist owners or managers who could not read. The research assistants were familiar with the area and had to distribute the questionnaires, and conduct semi-structured interviews to the small businesses in Adams Mission, Madundube and Umbumbulu. Due to the geographical nature of this area, characterised by hills and mountains, shacks and mud houses, businesses were not easily visible. Therefore, a convenient sampling method was used, where the research assistants who were familiar with the area approached business owner/managers and gave the respondents the questionnaire to fill in, if the owner of the business was available. In instances where respondents could not read or write, the research assistants asked the questions orally and the owner/managers would respond accordingly. Where the owner was not available, the questionnaires were left with the shop assistants, for collection on the following day or whenever it was completed.

FINDINGS

According to the survey, the majority of the respondents were male, while most of them were evenly distributed between the ages of 20 and 40. In addition to this, most SMME respondents were found to be literate with at least a secondary education. This is consistent with the report by SEDA (2016), it highlights that majority of SMME owners hold secondary schooling with very few that have tertiary education.

Furthermore, the natures of businesses dominant in the research area are those of selling groceries. This is probably because this type of business is more in demand amongst the poorer rural areas than other businesses.

Groceries are a necessity without which people cannot live. Furthermore, this type of business requires little capital to build.

All the respondents indicated that they received only trade credit and bank loans. None of them obtained overdrafts, leasing or factoring. This would indicate that the loan requirements are much easier to obtain for the respondents to meet than those of overdraft or factoring. Migiros (2005) suggests that other sources of finance such as leasing could be more suited to meet the SMMEs financing needs. However, SMMEs need to be aware of their existence.

SMMEs' reasons for credit application are varied. Some of the reasons given by the respondents were that they wanted to buy equipment, improve their businesses, buy stock and start their businesses. This coincides with the findings of the research undertaken by Fatoki and Asah (2011) in Coetzee and Buys (2017), which argues that businesses need finances for working capital, to invest in fixed assets and for business purchases.

The most frequent reasons for lack of access to credit facilities, identified by SMME owners in the research area, were insufficient collateral, no business plan and lack of references from credit institutions.

In addition to this, all the respondents who had access to credit facilities experienced positive changes in their businesses; these included increases in the number of employees and in turnover. This indicates the importance of accessing credit to the development of SMMEs. The development of SMMEs is of great importance especially in the developing countries (Wang 2016).

CONCLUSIONS AND MANAGEMENT IMPLICATIONS

Very few respondents in the research area had access to credit facilities from banks. Those who were granted credit received it in the form of trade credit and bank loans. Most respondents were rejected access to credit while some business owners did not apply for the facilities because they assumed that their applications would be rejected. Those respondents that applied to wholesalers for trade credit were granted the credit. Following this, the rejections of some of the respondents' applications were based mainly on their inability to provide sufficient collateral as well as their business plans. Most importantly, the respondents that obtained credit were able to employ more people to work in the business and their turnover increased.

Therefore, workshops should be arranged for SMMEs to provide them with information that will heighten their opportunities to access credit. They should be made aware of the lending institutions that assist SMMEs in particular. Training should also be conducted in order to teach them how to apply for credit and draw business plans. Furthermore, big businesses should be encouraged to mentor SMMEs as they are the subcontractors of their businesses. Lastly, SMMEs should be encouraged to be responsible for their own learning, and further their educational training.

REFERENCES

- Abor, J. (n.d.) Female- Owned Businesses and Access to Finance: Evidence from Ghanaian Non-Traditional Export Sector. *Gender & Behaviour*. University of Ghana. Business Studies. Legon.
- Berry, A., von Blottnitz, M., Cassim, R., Kesper, A., Rajarathnam, B. & van Seventer, D.E. (2002). The economics of SMMEs in South Africa. Trade and Industrial Policy Strategies. Available from: <http://www.tips.org.za/files/506.pdf>.
- Clover, T.A. & Darroch, M.A.G. (2005). Owners' Perception of Factors that Constrain the Survival and Growth of Small, Medium & Micro Agribusiness in Kwa Zulu Natal, South Africa. *Agrekon* 44(2).
- Coetzee and Buys. (2017). The Impact of the Independent Review on SME Access to Bank finance: The Case of South Africa. *Banks and Bank Systems*, 12(1-1), 135-142. Available from: [http://dx.doi.org/10.21511/bbs.12\(1-1\).2017.06](http://dx.doi.org/10.21511/bbs.12(1-1).2017.06)
- Fatoki, O. (2014). The Causes of the Failure of New Small and Medium Enterprises in South Africa. *Mediterranean Journal of Social Sciences*, MCSER Publishing, Rome-Italy, 5(20), 922-926. Available from: Doi:10.5901/mjss.2014.v5n20p922
- Fatoki, O. and Garwe, D. (2010). Obstacles to the growth of new SMEs in South Africa: A principal component analysis approach. *African Journal of Business Management* 4(5), 729-738.
- Gopaul, M. and Manley, L.L. (2015). SME Perception of Government Assistance within South Africa. *Journal Governance and Regulation* 4(4), 306-314.
- Langhout, J. (1990.) *Aspects of Business Finance*. Cape Town. South African University Press.
- Mears, R & Theron, D.J. (2006). The Development and Management of SMMEs by NEPAD. *Acta Commercii* [online]. Available from: <https://doi.org/10.4102/ac.v6i1.84>
- Migiro, S.O. (2005). Small and Medium-Scale Manufacturing Enterprises in Kenya: A Perspective on Alternative Sources of Financing. Doctorate thesis. University of Zululand.
- Molefe, S.P. (1996). Rural Development in South Africa: Implications for Social Work Practice. *Journal of Social Development in Africa*. 11, 2, 21-31.
- National Small Business Act. (1996). (Act 102 of 1996). South Africa.
- Nieman, G., Hough, J. & Nieuwenhuizen, C. (2003). *Entrepreneurship: A South African Perspective*. 1st Ed. South Africa: Van Schaik Publishers.
- Small Enterprise Development Agency. (2016). The Small, Medium and Micro Enterprise sector of South Africa. University of Stellenbosch.
- Wang, Y. (2016). *What Are the Biggest Obstacles to Growth of SMEs in Developing Countries? An Empirical Evidence from an Enterprise Survey*. Charles University in Prague, IES FSV UK, Opletalova 1606/26, 110 00 Praha 1-Nove Mesto, Czech Republic.