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Period in trading and sources of funding in South African micro enterprises

Abstract

The aim of the study is to find out the relationship between micro enterprises' period in trading and methods of funding operations as well as the effect period in trading has on the choice of the form of funding. This is necessitated by the problems small businesses face in accessing finance despite the critical roles they play in many economies. A structured questionnaire is used to collect data from a randomly selected sample of 150 street traders in the Johannesburg central business district (CBD). A Pearson's correlation test is used to measure the relationship between period in trading and the use of informal financial sources while a chi-square test is used to establish the effect period in trading has on the adoption of different informal forms of funding; savings, borrowing from friends and relatives and rotating credit schemes. Results show that there is a positive and significant correlation between period in trading and use of savings to finance business operations. There is also a significant but negative correlation between period in trading and membership of an informal rotating credit scheme. Results also show that there is no significant difference between new and old firms in terms of the use of the three methods of informal business funding. The study recommends the development of microfinance to improve SMMEs access to finance. The important contribution the small business sector makes to economies of different countries should be recognized and better strategies adopted to improve the sector's access to formal financing.

Keywords: micro enterprises, street traders, period in trading, savings, family and friends, rotating credit scheme, micro finance, SMMEs, South Africa.
JEL Classification: G23, E26.

Introduction

Small, medium and micro enterprises (SMMEs) are universally considered the engines of economic growth in most economies (Chen, Ding & Wu, 2014; Lighthelm, 2010; Mahembe, 2011; Okechukwu and Emeti, 2014; Chittithaworn, Islam, Keawachana and Yusuf, 2011). It is for this reason that policy makers all over the world continue to find ways of supporting SMMEs to enhance their success (Abor & Quartey, 2010). However the focus for many studies seems to be on small and medium enterprises and little focus is placed on the lower end of the scale, the micro enterprises. Micro enterprises such as street traders (Liedholm and Mead, 2013) are part of the much lauded small, medium enterprises (SMEs) that contribute enormously to GDP (gross domestic product) and employment in different economies all over the world. Studies on micro enterprises tend to be limited to sociologists (Egbert, 2006) and non-governmental international organizations such as the World Bank and the International Labour Organization (ILO). The focus of these organizations' studies tends to be poverty alleviation, gender, and empowerment. Enterprise dynamics such as business strategies are largely ignored. There seems to be limited interest from economists (Bernard, Jonathan, Jensen and Kortum, 2003) and business scholars to explore business issues within the micro enterprise space. This study contributes in its small way to this void by investigating the financial strategies micro enterprises use to finance business operations.

Micro enterprises face a number of problems due to their size and survivalist nature. One such problem is their inability to access formal credit (Chimucheka & Rungani, 2011). As pointed out by Mazanani and Fatoki (2012), Herrington, Kew and Kew (2009), Nkuah, Tanyeh and Gaeten (2013) and Addotei (2012), access to credit is a challenge to small business start-up and growth especially in developing economies. For example in South Africa, only 2% of SMMEs can access bank loans (Goodwin-Groen and Kelly-Louw, 2006).

This study argues that, due to the difficulties of accessing formal finance, small businesses adopt different informal methods to finance business operations. It further argues that irrespective of the period in trading businesses resort to informal forms of financing operations due to inaccessibility of formal funding. The study's focus is on the period the business would have been operating. The IFC (2010), Kauffman (2005) point out that young or start-up traders are likely to face stiffer challenges to access finance due to liability of newness, higher risks and lack of collateral or credibility. Chimucheka and Rungani (2011) are of the opinion that the problem applies even to older enterprises. Older enterprises however are expected to have

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grown bigger in size, having acquired more experience (knowledge and capacity) to build more credibility and probably to have more resources or collateral. However these expectations can not be assumed with certainty due to the risky nature of any business operation. The question is, do young and old enterprises respond with the same strategies to counter inaccessibility to formal external funding? Does the period in trading have an effect on the financial strategies adopted to finance operations?

A literature review will be presented first. The methodology used in the study is presented next, then the findings and lastly the conclusion.

1. Literature review

The literature review highlights the economic importance of the micro enterprise sector first then reviews the relationship between period in trading and funding strategies. Micro finance as a possible external source for financing micro enterprises concludes the review.

1.1. Importance of micro enterprises. Micro enterprises contribute to the economies of both developed and developing economies and the goods and services they supply respond to consumer demands hence the enterprise's continued existence. Traders, for example are able to eke a living and provide for their families especially in difficult spatial and economic environments (Manganga, 2007; Tissington, 2009; Asiedu & Agyei-Mensah, 2008). However as stated by Kebbed (2004) it is not correct to assume that all micro scale trading such as street hawking consist of survivalist economic activities. Saha (2011) points out that the profit margin of the hawker is quite impressive compared to other businesses and adds that some street hawker's income is higher than the legal minimum wage in some countries. Street trading produces incomes, feeds, clothes and educates millions of people throughout the world.

Cant and Wiid (2013) point out that many SMMEs do not develop despite government assistance. The reason according to Mazanai and Fatoki (2012), Ahiawodzi and Adade (2012) may lie in their failure to invest in restructuring and innovation and in coming up with financial strategies that develop and sustain business operations. We therefore would like to find out if traders who have been operating for different periods adopt the same informal financing strategies. The period in trading is discussed in the next section.

1.2. Period of trading and access to credit. The life cycle of the average business spans approximately 10 to 15 years and the risk of closure is highest during the first five years of operations. And in ten years' time half the start-ups would have closed shops (Dunn & Bradstreet, 2011). According to the U.S. Small Business Administration, 50 percent of new businesses survive in the first five years, and 33 percent in ten years, with just 25 percent lasting 15 years or more (Hirsh, 2014). It can rightly be assumed that if a micro enterprise has operated for more than five years it has been a success. Since risk is highest during the first five to ten years, it would be important to find out if the funding strategy used by micro enterprises is dependent on the period the entity has been operating. Why do most businesses fail to survive the first ten years? It is because they would have not managed to overcome certain problems of newness such as raising adequate financial resources?

The study assumes therefore that there would be a difference in the financing strategies adopted by enterprises with different operating periods. Access to finance adversely affect the growth of the SMME sector more than that of large companies (IFC, 2010; Beck, Thorsten, Demirguc-Kunt and Asli, 2006) and it has been established that enterprise financial requirements as well as sources change over time. For example newly established firms (start-ups) use informal financing sources such as personal savings or funds borrowed from family and friends (Bbenkele, 2007; Fatoki, 2014). As they become more established and possibly grow external sources of funding such as banks are more likely to be utilized. This is because with time the enterprise establishes a better business track record, develops better accounting systems and may become a registered legal entity. At these later stages of trading, additional capital to support expansion may be required. It is therefore assumed that the more the trading period the less internal (informal) funding is used to finance operations. The opposite is also assumed to be true, that is, the less the trading period the more the use of informal sources of funding. The formal finance sector is made up of formal finance institutions such as commercial banks, microfinance institutions and development agencies (Gbandi & Amissah, 2014).

The study therefore hypothesizes that there is a negative and statistically significant correlation between a micro enterprise's period in trading and the use of savings to fund business operations (Hypothesis 1). The study also hypothesizes that there is a negative and statistically significant correlation between a micro enterprise's period in trading and use of informal rotating credit schemes to fund business operations (Hypothesis 2).

1.3. Financial constraints and the strategies used by micro enterprises. The inability to access finance is among the major challenges of micro enterprises, especially in the Sub-Saharan region, (ILO, 2013; IFC, 2010). This negatively affects and stifles the desire by many unemployed individuals to start or grow businesses (Osotimehin, Jegede, Akinlabi, & Olajide, 2012; Green, Kirkpatrick & Murinde, 2006). Their main sources of capital thus, become either savings or rotating credit associations (EU, 2005). Micro enterprises can not access external funding due to their failure to provide collateral security or guarantees which traditional lenders require (Gbandi & Amissah, 2014). Credit information is also costly to retrieve for banks and not easy to access by micro enterprises (Padilla-Perez & Ontanon, 2013). According to Bakhas (2009), Padilla-Perez and Ontanon (2013), reasons for inaccessibility include the stringent lending criteria of financial institutions, excessive transactional costs, discrimination and lack of management and business skills on the side of micro enterprises. From the lender's point of view, micro enterprises are a high risk.

There seems to be consensus amongst researchers, Richard and Mori (2012), Mazanai and Fatoki (2012), Tshuma and Jari (2013), Bbenkele (2007) on the fact that SMEs always face problems accessing debt and equity finance. As a result of failure to get finance from formal sources, micro enterprise resort to own funding. Sources of own funding include savings, borrowing from friends and relatives and joining informal rotating credit schemes. Lapah and Tengeh (2013) agree that micro enterprises are usually started with personal savings and according to Schindler (2009) with informal loans from friends and relatives.

It is therefore assumed that younger micro enterprises (those with less than 10 years in operation) will depend more on savings and borrowings from relatives and friends than those which have been operational for longer periods (older than 10 years) mainly due to liability of newness. The study therefore hypothesizes that, there is not a statistically significant difference between the two periods in trading and the use of own savings in financing business operations (Hypothesis 3), and that, there is not a statistically significant difference between the two periods in trading and borrowing from relatives and friends to finance business operations (Hypothesis 4).

1.4. Informal rotating credit schemes. Brafu-Insaidoo and Ahiakpor (2011) state that susu is an informal microfinance initiative that is practiced by friends and relatives among the poor in Ghana and has its origins in Nigeria. Dupas and Robinson (2013) note that the difficulties of obtaining formal financial services for micro enterprise owners has led to the utilization of rotating savings and credit associations (also known as merry-go-rounds). Dupas & Robinson (2013) further explain rotating savings associations as informal savings clubs where participants contribute and share from the saving pool. This activity is commonly referred to as stokvel in South Africa. A nationwide survey by research company African Response found that there are 811 830 stokvels in South Africa with an estimated value of R44bn (about US$ 4.4 Billion) and a membership of about 11.4 million people, about a fifth of the total population (Massmart stores, 2014; BSK Marketing, 2014). Though there are stockvels for different purposes, such as burials, holidays, savings, investments, grocery purchases and so on stockvel receipts find their way to financing business start-ups, provide working capital finance as well as expansion capital. Due to difficulties of accessing external funding it is therefore assumed that there will be no differences in the use of informal credit schemes by enterprises of different trading periods. It is assumed that there is no statistically significant difference between the period in trading (new and old traders) and the use of informal rotating credit schemes (Hypothesis 5).

Micro finance could provide tailor made financial assistance to SMMEs especially micro enterprises. However literature indicates this facility is also not readily accessible by small businesses. Micro financing is briefly discussed next.

1.5. Microfinance and SMMEs. Micro finance is a tool that has been used in several developing countries to alleviate poverty and to assist the informal sector with access to credit (Wckramanayake, 2004; Senanayake & Premaratne, 2006). Dev (2006) believes that for the poor to access the formal financial sector, banking services costs should be low. Brau and Woller (2004) view microfinance as a significant financial platform for the poor to become bankable and access credit. However Green, Kirkpatrick and Murinde (2006) argue that microfinance cannot be viewed as a remedy for poverty alleviation or as a means to enter the formal economy. This is supported by Kanayo, Jumare and Nancy (2013) who also believe that a large amount of small businesses do not receive loans from microfinance institutions to support their businesses. This is because the poor people cannot afford high interest rates, coupled by mismanagement in the microlending institutions themselves. Credit therefore becomes an extra burden for these enterprises (Ghosh, 2013; Yerramilli, 2012).

Microfinance is a scheme which if properly developed can be a panacea to non-accessibility to formal finance by micro enterprises. The Grameen ***Banking*** system is a typical success story of microfinancing.

2. Methodology

Data were collected from the Johannesburg central business district (CBD) of the Johannesburg metropolitan area. Respondents were street traders (hawkers) operating from municipality allocated trading stalls. Their merchandise varied from vegetables, clothing, prepared food stuffs to hair dressers. The traders operate at three bus terminus located at three separate places in the centre of Johannesburg, South Africa. The termini were chosen due to their high concentration of traders and the variety of products and services traded.

The SMME population in South Africa is not accurately known (Strydom & Tustin, 2003; Dockel & Legthelm, 2005). Brabys.com. (2011) and the DTI (2011) estimates the population of SMMEs in retail and services, in Johannesburg to be approximately 10 000. The number of micro enterprises is also unknown. At the three centres 40 traders were selected randomly, resulting in a sample of 120. The number 40 was considered to be half the total population of the total number of traders at each of the three termini. A total number of 120 were considered big enough to represent the data sought. A total of 120 questionnaires were distributed amongst the hawkers at the three locations, 40 from each terminus. Face to face interviews were conducted to collect data and all 120 questionnaires were retained for analysis.

The questionnaire was divided into four sections. The first section asked demographics questions of the respondents, age, gender, education and period operating. In all cases the period in trading was confirmed as the trading experience of the trader. The second part of the questionnaire asked the financial methods that the traders use to conduct their businesses. The respondents were asked, (1) whether they borrowed from friends and relatives to sustain business operations (2) used savings to sustain operations or (3) they were a member of an informal rotating credit scheme. Respondents were asked to answer yes or no to each of these three questions. Financing business operations includes start-up capital, operational as well as expansion capital.

3. Findings

Data were analyzed using SPSS. Results show that of the 120 respondents, 47% were male and 53% female. This is a fair representation of the sample. The sample comprised of the following age categories: 18-25 age group (22%); 26-35 age group (27%); 36-45 age group (21%); 46-55 age group (17%); and 56 plus age group (17%). Education; 17% have no formal education, 73% have primary school education while the remainder, 10% have tertiary education. Results show that the majority of the respondents, 90% have no high school education and that all age groups are fairly represented in the sample.

The periods of operating were divided into two groups, below 10 years of operations and above 10 years of operations. The results show that 38% of the businesses have been operating for less than 10 years and 62% have been operating for more than 10 years. In terms of operating experience, those that have been operating for less than 10 years will be termed young micro enterprises (Esteve-Pe´, Requena-Silvente & Pallardo´-Lopez, 2013) while those that have been operating for more than 10 years are referred to as older micro enterprises.

The study's aim was to find out the relationship between period of trading (trading experience) of the micro enterprise, and the method used to finance its operations. Literature shows that due to inaccessibility of formal funding, micro enterprises resort to informal funding methods, namely, (1) own savings; (2) borrowings from relatives and friends and (3) informal credit schemes (stokvels) to finance business operations.

Hypothesis 1 stated that there was a negative and statistically significant correlation between period in trading (experience) and use of savings to finance business operations; and,

Hypothesis 2 stated that there was a negative and statistically significant correlation between period of trading and membership to an informal savings credit scheme.

Results, (Table 1), indicate that there is a statistically significant and positive correlation between period in trading and use of savings to finance business operations as shown by a correlations coefficient of 0.449 and a p-value of $0.00 < 0.01$. Hypothesis 1 is therefore rejected.

Table1. Spearman's correlation: period, savings and informal credit club funding

	Use own savings to finance business operations	Membership to an informal credit scheme
Period in trading	.449**	-.379**
Sig. (2-tailed test)	.00	.00
N	120	120

Note: ** Correlation is significant at the 0.01 level (2-tailed).

The result for hypothesis 2 shows a statistically significant but negative correlation between period in trading and membership to an informal rotating credit scheme as shown by a correlations coefficient of - 0.379 and a p-value 0.00 < 0.01. Hypothesis 2 is therefore accepted.

Hypothesis 1 result implies that when micro enterprises are still young (less than ten years) they would rely less on the owner's personal savings. The more the trading period, the more the owners' savings would be utilized in the business. This could be because the owner has no savings at all. The owner's is likely therefore to start operations with borrowed money. The result implies that the more the business operates the more it is able to save funds which are then ploughed back into the business to continue sustaining it. The term saving implies a surplus. This means that micro enterprises do well to the extent of building surpluses (retained earnings) bearing in mind that no records are usually kept. This deduction is supported by literature which point out that micro enterprises are at times very profitable and have in some cases, higher profits. Savings are only realized over time when operations have stabilized and possibly grown.

The inverse relationship in hypothesis 2 is in line with hypothesis 1 result. It implies that start-ups enterprises utilize the informal credit schemes to finance business operations but this declines significantly as the business becomes older. This may be explained by the fact that, in the absence of savings during the start-up phase rotating credit schemes becomes the source of start-up capital. With time dependence on rotating credit schemes declines as the business resort more to own savings. The result confirms Schindler's (2009) assertion that small businesses are normally started with informal loans, be they from rotating credit schemes or from friends and relatives. It is also in line with literature findings which show that personal savings (and not formal external funding) play a role in funding operations.

Hypothesis 3 stated that there was no statistically significant difference between the two trading periods (less than 10 years and over 10 years) and the use of own savings in business operations. Results as shown in Table 2, indicate that there is no significant difference between period in trading and the use of own saving as shown by a Pearson chi-square value of 2.938 and p value of 0.121 > 0.05. Hypothesis 3 is therefore accepted, because there is no significant difference as hypothesized.

Hypothesis 4 stated that there is no statistically significant difference between period in trading and borrowings from friends and relatives to finance business operations. Hypothesis 4 is also accepted, because there is no significant difference between the two periods and the use of funds borrowed from friends and relatives as shown by a Pearson chi-square value of 0.603 and p-value of 0.437 < 0.05 (Table 3).

The result for both hypotheses 3 and 4 show that irrespective of the time the micro enterprise has been trading, it will still depend on informal sources of funding (own savings or loans from relatives and friends). This confirms the literature position that it is very difficult for SMMEs to access formal funding in South Africa. Funding is continuously needed in the life span of the micro enterprise, from start-up, working capital to expansion capital. Unfortunately micro enterprises will depend on informal funding to run their businesses for most if not their whole life span, unless they change their legal and structural status.

Table 2. Pearson's chi-square tests: period in trading and use of own savings

	Value	df	Asymp. sig. (2-sided)	Exact sig. (2-sided)	Exact sig. (1-sided)
Pearson chi-square	2.398	1	.121		
Continuity correction	1.367	1	.242		
Likelihood ratio	2.296	1	.130		
Fisher's exact test	2.378	1	.123	.144	.122
Linear-by-linear association					
N of valid cases	119				

Table 3. Pearson's chi-square tests: period in trading and borrowing from friends and relatives

	Value	df	Asymp. sig. (2-sided)	Exact sig. (2-sided)	Exact sig. (1-sided)
Pearson chi-square	.603[a]	1	.437		
Continuity correction	.338	1	.561		
Likelihood ratio	.600	1	.438		
Fisher's exact test	.598	1	.439	.444	.280
Linear-by-linear association					
N of valid cases	119				

Hypothesis 5 stated that, there was no significant difference between period intrading and membership to an informal credit scheme.

Results as shown in Table 4, show that there is no significant difference between period in trading and membership to an informal credit scheme as shown by a Pearson chi-square value of 0.158 and p-value of 0.691 > 0.05. Hypothesis 5 is therefore accepted.

The period in trading does not have a statistically significant effect on the micro enterprise's decision to join informal credit schemes to finance business operations. This is in line with literature which emphasizes that micro enterprises do not access external funding in the form of loans from micro finance institutions or the formal banking sectors. The result implies that micro enterprises would join stokvels irrespective of the time they have been operating. Inaccessibility to finance is the most reported contributor to low firm creation and failure in South Africa (Fatoki and Garwe, 2012) and this is confirmed by Herrington, Kew and Kew (2009). SMMEs face challenges in accessing external funding and this seems to be the case in a number of many developing economies (Padilla-Perez & Ontanon, 2013; Bakhas, 2009; and Richard & Mori, 2012).

Table 4. Pearson's chi-square tests: trading experience and informal rotating savings scheme

	Value	df	Asymp. sig. (2-sided)	Exact sig. (2-sided)	Exact sig. (1-sided)
Pearson chi-square	.158	1	.691		
Continuity correction	.032	1	.859		
Likelihood ratio	.156	1	.692		
Fisher's exact test				.827	.426
Linear-by-linear association	.156	1	.693		
N of valid cases	119				

4. Discussion

The study's findings support the wide use of informal forms of business funding, personal savings, borrowing from close relatives and friends and informal rotating credit saving schemes. The small business owner has to resort to own funding which according to Rungani and Chimucheka (2011) is not an adequate form of funding. The implication of this status is that a potential entrepreneur who cannot access external funding and can not borrow from informal sources will not be able to start a business. Expansion can only be organic through retained earnings. Though there is evidence which supports that micro enterprises save, it is not clear if they can save enough for expansion. If friends and relatives do not have much to lend (a common situation in many poor communities) then business start-up or enterprise development suffers. This situation is quite dire in developing economies which usually have high unemployment rates and have no or little government social support systems.

Microfinance however is a potential solution which governments, non-governmental agencies and other stakeholders have used to try addressing the problem. Microfinance should be a formal instrument that offers financial services to small businesses enabling them to access formal financing (Brau & Woller, 2014; Wickramanayake, 2004; Senanayake & Premaratne, 2006). The Grameen bank has been a major success in terms of effect and how it is run. The study therefore recommends the maximum utilization of microfinance schemes especially if they are run along the successful Gremeen principles. This should enable enterprise creation, sustainability and growth. This facilitation of small businesses to access formal funding should not be left to government and developmental organizations like the ILO alone but the private sector should play its part as well. For example the private sector can do so through supplier funding.

The payment cycle by some governments departments is not favorable for SMMEs. They take between 30 days to 90 days to pay supplies which negatively impacts a business' cash-flow. If this can be reduced to cash and a maximum of 15 days for the SMME sector, this would go a long way to assist the cash flow position of these enterprises. Cash payments is possible since the amounts involved are relatively small compared to transactions involving big businesses. It is not all micro enterprises that are informal. As long as an enterprise is on the records of the authorities then it is formal and should be treated as such. The attitude of treating micro enterprises as informal should change so that these businesses can claim their rightful place in the economic space of many countries. Governments should formalize as many of these entities as possible so that interventions become easier, less costly and more beneficial to the enterprises in particular and the economies in general. This would make it easier for SMMEs to access external funding, since formalization improves interaction between funders and borrowers.

Conclusion

The study found out that micro enterprises use informal sources to finance operations irrespective of the period they would have been operating. The SMMEs sector plays an important role in the development of many economies (developing and developed) and this contribution should be appreciated and the necessary support extended to enhance continued progress.

The sample consisted of only street traders and the results may therefore not apply to other micro enterprises that are in other sectors such as manufacturing. Future research could encompass other types of businesses to widen representation. The study's sample is the lower end (in terms of size) of SMMEs, the micro enterprises. Though the study discusses SMMEs, findings pertain more to micro enterprises and may not be generalized to include the medium sized businesses in particular, which may have better access to formal (external) funding. The study was conducted in the CBD of a major city, Johannesburg and though the findings may apply to other major metropolitans in other countries, different cultural settings, such as rural-urban divide, developing and developed economic setting may also limit the generalization of results.

It is therefore recommended that future research be conducted to compare this study's finding with other social, economic and geographic settings as well as enterprises of different sizes. A more detailed analysis which compares demographic aspects such as gender and age also needs to be done because of the existence of age and gender biased funding programs by governments and non-governmental organizations.

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