

**A needs analysis of financial management and accounting  
skills in the SME sector in KwaZulu-Natal**

**By**

**Rajendra Rajaram  
Student number: 892280779**

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**Supervisor: Professor R.C. O. Neill  
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**SUPERVISOR'S DECLARATION**

As the candidate's supervisor, I have approved this dissertation for submission.

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PROFESSOR C. O'NEILL

## DECLARATION

I, Rajendra Rajaram declare that:

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- ii) This thesis has not been submitted for any degree or examination at any other university.
- iii) This thesis does not contain other persons' data, pictures, graphs or other information, unless specifically acknowledged as being sourced from other persons.
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Rajendra Rajaram

## **ABSTRACT**

The Theory of the Firm consists of a number of economic theories that attempt to describe the nature and the behaviour of the firm. One of the important assumptions of the theory is that of profit maximisation. In order to maximise profits, there are four factors of production that are required by the firm, i.e. land, labour, capital and entrepreneurship. Although capital may relate to the acquisition of funds that are required by the business, it also relates to proper financial skills that are needed to manage these funds. Therefore, in order to successfully establish and manage a business, especially a small or medium sized enterprise, it is necessary to possess financial management and accounting skills.

The SME sector has been identified as having the potential to contribute to economic growth of the country. In order to achieve this objective, it is important that the sector is well managed and that there are sufficient accounting and financial management skills in the sector.

The research has been undertaken in order to determine and evaluate accounting and financial management skills that are needed by the SME sector in KwaZulu-Natal.

The literature review suggested that an absence of accounting and financial management and accounting skills contributes to the poor performance of the sector in South Africa and that the possession of some basic skills in these fields may enhance the growth and profitability of the sector.

The research design was of a quantitative nature. A questionnaire was completed by a group of thirty industry experts and these findings were statistically analysed. The questionnaire allowed for further comments and opinions from the experts on selected accounting and financial management aspects in the SME sector. The empirical research indicated that:

- there is a low level of accounting and financial management skills in the SME sector in KwaZulu-Natal; and,
- there is a need to improve the accounting and financial management skills in the SME sector in KwaZulu-Natal.

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## **CHAPTER ONE: INTRODUCTION AND CONTEXT OF THE STUDY**

### **1.1 THE NEED FOR THE STUDY**

#### **1.1.1 The Theory of the Firm**

The Theory of the Firm consists of a number of economic theories that describe the nature of the firm, including its existence, its behaviour and its relationships with the market (Williamson, 1964). Economists have examined a wide range of traditional and modern models in order to discover whether any of them can justly claim to be the Theory of the Firm. For example, Curwen sought a theory that is sufficiently general to explain the behaviour of all firms within the economy, irrespective of the size or the degree of competition that they face (Curwen, 1983, Introduction xiv). Whilst there have been limitations in trying to achieve such a general theory that is applicable to all aspects of the firm, many economic models have emphasised the assumption of profit maximisation.

For nearly a quarter of a century, the assumption that the firm maximises profits has been the focal point of neoclassical economic theory and perhaps the most important of the assumptions, that make up the Theory of the Firm, is the assumption that firms maximise profits by setting output where marginal costs equal marginal revenue (Anderson and Ross, 2005, p31).

In order to achieve the intended objective of profit maximisation, several factors of production are required by business entities. Economists have generally classified these factors of production into four specific areas, i.e. Land, Labour, Entrepreneurship and Capital. Each of these factors plays a critical role in determining the profitability of the firm.

Although capital may refer to the acquisition of funds that are required for a business, it also refers to the proper management and financial skills needed to manage the funds required to ensure that a business operates efficiently. Hence, there can be a strong correlation between the management of funds of a business and the maximisation of profits.

In order to successfully establish and grow any business entity, especially the small business entity, there are many crucial financial decisions that must be made. Many of these decisions relate to sourcing of capital and ensuring that such capital is utilised in a manner that results in the optimal growth and profitability of the entity. In order to achieve this objective, there is a necessity for the entity to possess financial management and accounting skills.

### **1.1.2 The Theory of Entrepreneurship**

Individuals or firms use the term ‘entrepreneurship’ in economic theory almost exclusively to refer to the innovative or market equilibrating activities that are performed in conditions of uncertainty. Although the concept of entrepreneurship is found throughout economic literature, many economic theories fail to give it a coherent place in their models (Adaman and Devine, 2000, p1).

During the twentieth century, many economists have attempted to clarify the process of entrepreneurship to aid our understanding of the market process. These economists have emphasised different aspects of entrepreneurship and contributed to an enhanced understanding of entrepreneurship (Wood, 2005, p1).

Kirzner, in *Competition and Entrepreneurship*, argued that entrepreneurs act as economic agents to rectify disequilibrium in the economy until the economy reaches equilibrium (Kirzner, 1973). Kirzner’s Theory of Entrepreneurship emphasises the equilibrating role of entrepreneurship by stating that profit opportunities exist when the market is not in equilibrium. These profit opportunities are discovered and acted upon by entrepreneurs, thereby causing the market to return to equilibrium. This theory has been used to emphasise the importance of entrepreneurship and could become a universally accepted model that is utilised by economists and industry experts. However, one of the weaknesses and difficulties of the theory is the assumption that all entrepreneurs have similar access to information and resources and that information and resources relating to entrepreneurial opportunities are readily available to all entrepreneurs (Holcombe, 2003, p25).

Holcombe argues that by seeking information and searching through promising ideas, it is possible to create an environment where entrepreneurial insights are more likely to be

developed, thereby creating a direct link between knowledge and entrepreneurship. Therefore, it might appear that the production and dissemination of knowledge and information will produce more entrepreneurs that will equilibrate the economy (Holcombe, 2003, p28).

This includes information relating to the financial management and accounting for resources needed by entrepreneurs. For example, it may be possible that a disequilibrium in the economy can be identified by the proper financial recordkeeping and that such financial records can be used in order to seize opportunities for profits, thereby allowing the economy to return to equilibrium. There is consensus amongst SME owners, bankers and development officials on four continents that SMEs lack the know-how to provide standardised, transparent, credible financial information to potential financial sources ([www.fmi-inc.net/sme/overview.html](http://www.fmi-inc.net/sme/overview.html)). An improvement in financial management and accounting skills may enhance the ability of SMEs to obtain funding so that they are better equipped to seize opportunities for profits.

The importance and need for financial management and accounting skills is widely recognised in large businesses. Most of these companies spend enormous resources to ensure that they have the necessary financial skills at a strategic and operational level. Larger institutions rely on these skills in order to achieve their operational goals and to achieve a return for their shareholders. They also rely on these skills to ensure that they comply with legislation and regulatory requirements, such as compliance with taxation laws.

Given the relative scarcity of financial resources in developing countries such as South Africa, a special focus on financial management and accounting skills can assist in establishing a culture of financial responsibility that will contribute to the establishment of an improved entrepreneurial culture. The analysis of financial skills can also be linked to the effort that has been made to improve the financial skills of business owners by the various SETAS and the information obtained from such an analysis can be used to enhance the service provided.

It is difficult to determine the financial management and accounting needs of the SME sector in KwaZulu-Natal due to the unavailability of information relating to their financial management and accounting skills. The objective of the research will therefore be to conduct a needs analysis of the financial management and accounting skills of

SMEs in KwaZulu-Natal so that the training needs can be ascertained and, if necessary, recommendations can be made for the formulation of an appropriate training programme.

## **1.2 BACKGROUND TO THE SME SECTOR IN SOUTH AFRICA**

“There is a growing interest in research in small firms among politicians and research workers. There are several reasons for this. The small firm sector is often looked upon as an economic seedbed where entrepreneurship is fostered and new ideas are tried out. Both of these are of crucial importance for the future development of any economy” (Andersson, 1987, p 12).

During the past decade government, business development organisations, financial institutions and large business have emphasised the importance of the SME (Small and Medium Sized Entity) sector to the South African economy. Although there was a general understanding and consensus of the commercial importance of the sector, SME development was also punted as a solution to many of the social problems that existed in the country, such as unemployment, crime and gender inequality. Addressing the President’s Conference on Small Business in Durban in 1995, Nelson Mandela said “...you are preparing, in consultation with representatives of a democratic government, to expand and develop the small business sector in a decisive manner. In this way, we will be able not only to make our rightful contribution towards a better life for all South Africans, but also open the way for others in this matter”.

Although the achievement of democracy in 1994 was accepted as a significant threshold in the country, there was wide recognition that the political success had to translate into economic liberation and freedom. “Political liberation is important, but you cannot eat politics. Economic liberation feeds people. Economic liberation allows everybody to create wealth; to earn their own living; to feed clothe and house their families; and buy better education for their children. Parliaments have their place but markets are more important” (Hetherington I, as quoted in Ladzani, 2001, p1).

The White Paper on Reconstruction and Development, tabled by the government in 1994, presented a strategy for the overall transformation and renewal of South African society. Embodied in the White Paper was a frank assessment of the need for changing the landscape in which small and medium sized businesses operate. “Our workers are poorly equipped for the rapid changes taking place in the world economy. Small and

medium sized enterprises are underdeveloped, while highly protected industries underinvested in research, development and training. The informal sector and the survival sector include many of South Africa's women workers, who are underpaid and exploited" (Department of Reconstruction and Development, 1994, p5).

However, there was also a determination to enhance government support to small and medium sized enterprises. "In line with the objectives of economic policy, growth in employment can be enhanced through government support to small and medium sized enterprises. The institutional framework of support for such enterprises will be fundamentally restructured" (Department of Reconstruction and Development, 1994, p33).

The government, in response to several economic and social challenges, accepted and realised the importance of small business development in South Africa. In March 1995, the White Paper on National Strategy for the Development and Promotion of Small Business was tabled in parliament by the Department of Trade and Industry. The White Paper stated that "Small, medium and micro-enterprises represent an important vehicle to address the challenges of job creation, economic growth, and equity in our country. Throughout the world, one finds that SMMEs (Small Micro and Medium Sized Entities) are playing a critical role in absorbing labour, penetrating new markets and generally expanding economies in creative and innovative ways. We are of the view that - with the appropriate enabling environment - SMMEs in this country can follow these examples and make an indelible mark on this economy" (Department of Trade and Industry, 1995, p2).

The White Paper contained a vision of economic development of the small business sector in South Africa. In order to achieve the vision of removing constraints relating to a lack of access to finance, markets, information and training, the White Paper proposed the following strategy on Small Business Development:

- The creation of a business-enabling environment for small businesses;
- Facilitation of greater education of income, wealth and earning opportunities;
- Addressing the legacy of apartheid based disempowerment of black businesses;
- Supporting the advancement of women in business;
- Creation of long term jobs in the sector;

- Stimulation of sector focused economic growth;
- Strengthening cohesion between small enterprises; and,
- Preparation of small businesses to comply with the challenges of an internationally competitive economy.

The White Paper also emphasised the government's role as "a facilitator and not an implementer" due to a realisation that "small business support programmes are best implemented by institutions that most closely reflect the entrepreneurs and risk characteristics of small business themselves".

As a result of the adoption of the White Paper, the government set about implementing its vision for the creation of a successful business-enabling environment for small business. Amongst others, the key initiatives implemented were:

- The creation of Ntsika Enterprise Promotion Agency – The role of Ntsika was to provide wholesale non-financial support, such as management support and business training, to small businesses. It operated by facilitating the use of management and training consultants by the small business sector (Van Bombsen, 2003, p6).

As a result of the National Small business Amendment Act in 2004, small enterprise agencies, such as Ntsika, were merged into a single small enterprise support agency called Seda. The mandate of Seda was to implement an integrated strategy for the growth and development of small business (Seda, 2007, online, introduction).

- The creation of Khula Enterprise Finance Limited – Khula served as a wholesaler of financial support to small business mainly by utilising the supply channel of commercial banks to grant loans to small businesses. Khula developed a mechanism whereby the commercial banks provided loans and credit guarantees to entrepreneurs. Khula (Van Bombsen, 2003, p6) guaranteed all funds loaned to entrepreneurs.

Khula is currently preparing a business case to transform its operations from a wholesaler to a retailer of funding for the small business sector, due to the current reliance that is placed on the supply channels of the commercial banks. However, the success of the changed approach will depend on its ability to

obtain the necessary level of capitalisation from the Government for its venture into retail finance (Ensor, 2007).

The effort to create a business-enabling environment for sustainable SMEs was not limited to government action and policy. Recognising the potential of the sector to contribute to addressing the social challenges that existed, multinationals, the NGO sector and commercial banks devised specific programmes to ensure that they contributed to the growth of the sector.

Many of the larger companies either formed business linkage programmes that promoted the development of small businesses or ensured that some of their corporate social initiatives focused on the development of the sector. For example:

- In 2003 BHP Billiton, a global resources company, created a Black Economic Empowerment Unit to promote supply initiatives. The aim of the programme is to promote the company's procurement from black-owned businesses by building the capacity of small and medium enterprises via the establishment of Business Development Centres and by ensuring that these businesses are aware of the opportunities and imperatives of the BHP Billiton Procurement Policy (BHP Billiton, 2004, p137).
- The Eskom Development Foundation, a wholly owned subsidiary of Eskom Holdings South Africa, was formed with the sole objective of promoting small and micro enterprises, especially in communities where Eskom implemented capital expansion projects. The Foundation has provided grants and training to assist small business owners to increase their managerial capacity and business skills. The Foundation has also been instrumental in providing preferential procurement opportunities to these small businesses for materials and services required by Eskom Holdings (Eskom, online, Corporate Social Investment, p1-3).
- South African Breweries Limited, one of the largest brewers in the world, has launched the KickStart programme. This programme focuses on the development of a culture of entrepreneurship awareness through training, awarding grants and mentorship for young people who intend setting up business. The programme involves the selection of youth who have developed

viable business ideas. These ideas are screened by a panel of businesspeople and selected participants are awarded grants to develop the business idea. The programme also provides technical mentorship when the business commences (SAB, online, sabkickstart, p1-2).

Several other linkage programmes have been implemented by multinationals and conglomerates, with the objective of promoting the development of the SME sector.

### **1.3 PERFORMANCE OF THE SME SECTOR**

Research into the small business sector has consistently demonstrated the positive correlation between the success of the sector and the overall economy of the country. “In most countries, SMEs account for more than one half of the total share on a number of measures, including the contribution of SMEs to employment, sales and value added, while constituting a predominant share of all enterprises in each economy. It is also worth recognising that the SMEs’ share of most developed economies is rising in terms of these magnitudes” (Fujita, 1998, p26).

Furthermore small and medium sized enterprises account for more than 90% of all enterprises in developing countries and in many countries they have become the largest contributor to the economy (Fujita, 1998, p29).

Business commentators have highlighted the ability of the small business sector to improve the economic landscape in South Africa by creating jobs, reducing crime and increasing the competitive environment of the local economy due to the advantages that exist in small business. Some of the advantages highlighted by Ntsika are:

- Small businesses are suited to the exploitation of small, isolated and niche markets;
- The average capital cost per job created is usually lower than in big business;
- The labour absorptive capacity of the small business sector is high; and,
- Subcontracting by large enterprises to small businesses adds flexibility to its production process.

(Ntsika, 2001, p38)

The focus and effort on the small business sector in South Africa has resulted in some growth and development. Many of the initiatives of government and other organisations

have sought to enhance the sector's contribution towards the economy. In South Africa, the small business sector accounts for almost 50% of employment and GDP. The sector has been increasingly targeted as a means of stimulating economic growth, the redistribution of wealth and the creation of employment (Ntsika, 2001, p38).

Any analysis of the performance of the sector is complicated by the fact that there is insufficient information that can be used to measure performance and provide key information and statistics on the small business sector. One of the basic problems encountered when trying to assist the small business sector is that, depending on the definition adopted of an SME, the number of enterprises involved may be anything from four hundred thousand to one million (SACOB, 1999, p3). The number of informal enterprises in rural areas compounds the problem of analysing the sector.

However, there is broad consensus that the small business sector in South Africa has not achieved the level of success required in order to make a positive contribution to removing the economic and social inequities that exist in South Africa. "According to comparative research, entrepreneurship in South Africa lags behind that in Chile, Thailand, Mexico and its other peers in emerging markets" (Centre for Development and Enterprise, 2004, p5).

The Global Entrepreneurship Monitor 2005, compiled by the University of Cape Town's Graduate School of Business, states that there has been a decline in the activity in the small business sector in South Africa, specifically relating to the level of new business creation. Some of the conclusions of the report are that:

- The entrepreneurial activity rate in South Africa ranks as one of the bottom four of the developing countries sampled;
- With the exception of Mexico, start-up businesses are less likely to mature to become large firms in South Africa than in any other sampled developing country; and,
- The probability of a firm surviving beyond forty-two months is less likely in South Africa than in any other country sampled in 2005.

(UCT, 2005, p21)

Although the sample that was used for the Global Entrepreneurship Monitor was small and therefore not representative, the findings are more of a qualitative and indicative

nature. The views contained in the report therefore provide a useful barometer of the environment in which small businesses in South Africa operate (UCT, 2005, p11).

There has been much concern over the failure rate of new businesses formed in the country. Although there has been insufficient research into the precise reasons for failure, it appears largely attributable to a lack of a coordinated approach towards the nurturing of these newly formed businesses.

The government has also recognised that there are many shortcomings in the regulatory framework and in their efforts to grow the sector. In 1998, the Minister of Trade and Industry, Alex Erwin, during a Trade and Industry Budget vote, said, “In the commentary from all quarters on the work of the Department of Trade and Industry, the three most frequent criticisms made are that we have no industrial strategy, we are not creating enough jobs, and we are failing to generate enough SMEs. As minister I would accept that that in each case the DTI would like to say that there is no cause for criticism, but I cannot” (Centre for Development and Enterprise, 2004, p41).

#### **1.4 DIFFICULTIES EXPERIENCED BY THE SME SECTOR**

There are many obstacles experienced by small business owners that are inherent to the size of the business. Some of the problems that are experienced by small businesses globally are:

- The “One-Man Band” problem - Due to a shortage of suitable management, the owner has to multitask and handle a range of functions. This normally occurs due to a lack of resources to employ an adequate and competent management team. The nature of the sector is such that entities and employees need to multitask and therefore, in order to achieve success, a broad range of skills are required ([www.yourbusinessmagazine.com/features/161-biz-mobile](http://www.yourbusinessmagazine.com/features/161-biz-mobile)).
- Lack of funding - Many surveys indicate that there is a lack of debt and equity funding to finance the business operation of the small business owner, especially in the start-up phase. Although there are many sources of commercial and development finance available, small business owners often either do not have the security to obtain the funding or the skills required to access the funding. This lack of skills results in the preparation of poor business plans and feasibility studies that are required by business funders. The SME Market Report, based on

email requests to 245 respondents, in 2007 confirmed that almost 30% of SMEs required more information on providing funding for the business. In addition, approximately 35% of respondents required better funding and banking services ([www.yourbusinessmagazine.com/features/161-biz-mobile](http://www.yourbusinessmagazine.com/features/161-biz-mobile)). The survey was conducted in Europe, North America, Asia and the Middle East.

- Poor market knowledge - Often the business owner fails to conduct research regarding the product or service that is being marketed. As a result of this the owner is uncertain of the effect that market forces, such as a competitors behaviour, will have on his business decisions (Baumback and Lawyer, 1979, p22-30).

In addition to the common difficulties that are experienced globally by the small business sector, there are specific problems experienced by this sector in South Africa. The White Paper on National Strategy for the Development and Promotion of Small Business lists some of the reasons for some of the specific problems encountered by the small business sector in this country:

- An absence of entrepreneurial education that prepares young people to enter the small business sector;
- Segregation increased the distance between residential areas and working areas, thereby increasing the cost and risk of doing business;
- Limitations on the property ownership rights of blacks made it difficult for them to acquire assets that could serve as collateral for loan financing;
- Bantu Education restricted opportunities for the acquisition of technical and professional skills needed to successfully manage small businesses; and,
- Apartheid confined the majority of blacks to homeland areas, which lacked proper business environments.

(Department of Trade and Industry, 1995, p11)

A combination of these and other factors has resulted in the poor performance of the sector locally. As a result, the following obstacles and difficulties have plagued the small business sector in South Africa:

- Macro environment - Many small business owners have difficulty in comprehending the effect that market influences and changes, such as interest rates and inflationary pressures, have on their businesses. They are also affected by high crime rates and the impact of HIV/Aids.
- Financial - Although an effort has been made to improve the access of the sector to funding, many entrepreneurs feel that this is the major problem experienced. "Historical imbalances created by the system of apartheid -

such as the lack of appropriate collateral to secure loan finance from the banking system - have added another dimension to this problem. Often these entrepreneurs are required to pay a premium to access the finance” (SACOB, 1999, p12). Most small business owners do not have the skills required to prepare the business and financial plans required by commercial and developmental financial institutions to access funds that are meant for entrepreneurs and are therefore required to spend scarce funds on consultants for these plans. If funding is approved, it is usually at premium lending rates.

- Operational - Small business owners usually lack the knowledge to implement production, quality management, financial and marketing systems that are required for the successful growth of the business. A failure to understand and implement these systems can result in losses to the enterprise. Due to cash flow constraints, it is difficult to acquire these operational skills needed to develop a sustainable business. In order for SMEs to thrive in the long term, their founders need operational and growth-enabling skills. Growth-enabling skills are defined as skills in acquisition, deal structuring, financing, risk management and capital management (Smith and Schallenkamp, 1998, p2). Although many operational skills are required for the success of the SME, there is an emphasis on financial growth-enabling skills for the long term success of the business.
- Regulatory Burden - The White Paper on National Strategy for the Development and Promotion of Small Business states that “Unduly strict regulations often harm small and, in particular, emergent enterprises and benefit the larger established ones” (Department of Trade and Industry, 1995, p28). Whilst the unfavourable regulatory framework was mentioned as an impediment to small business development growth, it seems that little progress has been made to remove the red tape and bureaucracy surrounding the sector.

Doing Business 2007, a report that is compiled by the World Bank and the IFC, shows that South Africa has fallen six places to 35th place in terms of its market regulation. The study measures the impact of regulation by looking at how it is applied to a small and medium sized enterprise (Joffe, 2007).

Small business owners are concerned by the cost of complying with labour, legal, taxation, environmental and other legislation that is applicable to the sector and there have been numerous calls for a simplified regulatory framework for small businesses.

### **1.5 MANAGEMENT PROBLEMS**

Many studies have shown that the greatest cause of failure in the small business sector is incompetent management (Pather, 2003, p11). Although other studies have indicated that many businesses fail due to a lack of access to funding, there is a growing realisation that poor management is probably the greatest cause of small business failure.

The following table, prepared from a summary of 570 small businesses that became bankrupt, summarises the perceived causes of business failure as expressed by the owners and the creditors of the business (Baumbach and Lawyer, 1979, p21).

**TABLE 1.1**  
**PERCEIVED CAUSES OF SMALL BUSINESS FAILURE**

<b><u>CAUSE OF FAILURE</u></b>	<b>PERCENTAGE OF ENTERPRISES AFFECTED</b>	
	<b><u>OWNERS</u></b> <b><u>OPINION</u></b>	<b><u>CREDITORS</u></b> <b><u>OPINION</u></b>
Business Depression	68	29
Ineffecient Management	28	59
Insufficient Capital	48	33
Bad Debt Losses	30	18
Competition	40	9
Decline in Value of Assets	32	6
Poor Business Location	15	3
Excessive interest charged on borrowed money	11	2
Unfavourable changes in trading area	11	2

Adapted from Baumbach and Lawyer, 1979, p21

Although details of the location and the sampling methods used are unavailable, the above table does indicate that business owners have a perception of their abilities and

problems that vary from the perception shared by others (in this case the suppliers). Whilst many business owners may feel that they have the necessary skills to manage the business, their perception is not shared by others.

The research conducted by Baumbach and Lawyer, although conducted approximately thirty years ago, appears to be supported by recent research conducted in the SME sector in South Africa. Radipere and Van Scheers (2007, p 85-91) confirm that there is a relationship between the success and viability of the SME sector and managerial skills. The research established that the lack of managerial skills in the small business sector has a negative impact on the success and viability of these businesses and that there is an urgent need to improve business skills in the sector.

In South Africa, there appears to be the misconception by small business owners that most businesses fail due to a lack of finance, whereas poor management seems to be the cause of business failures. “Many entrepreneurs and owners of emerging and start-up small businesses perceive the lack of access to finance as the major obstacle to the growth and development of their business. Often this belief is misplaced as it obscures the shortcomings of the entrepreneur, the business concept and the management structures of the enterprise concerned” (SACOB, 1999, p12).

Several research papers have focused on the issue of funding of the small business sector and have tried to link the success of the owner managed business and the availability of finance. Cronje Alberts, “Funding SMEs in the Natal Midlands Region”, has explored the effect of financing of the small business has on the success of the sector in the KwaZulu-Natal Midlands region (Alberts, 2004, p61).

However, management also plays a major role in the success and growth of small business. “Businesses fail because managers fail. The successful company is managed by the individual who makes a minimum of blunders” (Braverman, 1984, p5 quoting Carbone). Many successful management practices used in larger business may, when appropriately tailored, enhance the sustainability and viability of the small business.

## **1.6 SUMMARY OF CHAPTER**

In this chapter, a conceptual and theoretical argument has been provided of the importance of financial management and accounting skills in business entities and the

role that these skills have in the establishment and growth of a business in the SME sector.

The importance of the SME sector to the country has been highlighted, bearing in mind that its improved performance will have economic, political and social benefits. Although there are several factors that have contributed to the performance of the sector, a lack of management skills has been highlighted as an important reason for the failure of businesses in the sector. In undertaking a needs analysis of financial management and accounting skills of the sector, the research findings can contribute positively to the management and overall success, especially in view of the government's focus on this sector and the funds that have been earmarked for its growth.

In Chapter Two an attempt will be made to define an SME so that this definition can be used in the empirical study undertaken. As the needs analysis will be conducted in KwaZulu- Natal, consideration will be given to obtaining information on the economic and political environment of the province. This is important, as an analysis of the needs of the sector of the province has to be done against the background of the climate that exists for the growth of the sector. The chapter will also focus on determining the critical success factors of the small and medium sized businesses and the role of financial and management skills in these success factors.

In Chapters Three and Four, a literature review researching financial management and accounting skills needed in small and medium sized businesses will be presented. Due to the unique business environment in the province, such as the need to stimulate Black Economic Empowerment, research will also be undertaken into specific skills that are required in the province.

## **CHAPTER TWO: LITERATURE REVIEW OF SME DEVELOPMENT IN SOUTH AFRICA AND KWAZULU-NATAL**

### **2.1 INTRODUCTION**

Chapter One highlighted the conceptual reason for researching the accounting and financial management needs of the SME sector in KwaZulu-Natal, together with a synopsis of the performance of the sector in South Africa. In that chapter, it was mentioned that any analysis of the performance of the sector is complicated by the fact that there is insufficient information to measure performance and provide key information and statistics on the small business sector. One of the basic problems encountered when trying to assist the small business sector is that, depending on the definition adopted of an SME, the number of enterprises involved may be anything from four hundred thousand to one million (SACOB, 1999, p3).

In this chapter, an attempt will be made to reach consensus on the definition of an SME. Although there is no universally accepted definition, researchers, governments and business organisations have suggested various target ranges of enterprises that can be classified as SMEs. Several of these views will be considered in order to narrow the focus for the purposes of the empirical research.

Consideration will also be given to the political, economical and social conditions of KwaZulu-Natal province. An attempt will be made to assess the business environment in which the SME sector operates in the province. Factors used to assess the environment include:

- Government support for the sector;
- Linkage programmes;
- Access to funding; and,
- Business opportunities.

An understanding of these conditions is important in assessing the financial management and accounting needs of the SME sector in the province.

## **2.2 DEFINITION OF AN SME**

### **2.2.1 Introduction**

There is great difficulty in obtaining a universal definition of a small business that can be utilised in order to categorise those businesses belonging to the SME sector. Although there is little doubt of their relative importance to the country, the statistical base of small businesses in South Africa is poor (Department of Trade and Industry, 1995, p9). This has resulted in insufficient data to accurately categorise and identify businesses as belonging to the sector.

This difficulty in attempting to define and categorise businesses belonging to the small business sector is not unique to the South African economy. Many international economies have difficulties in determining an appropriate definition due to the diverse characteristics of small businesses.

“The term small firm is in such common use that the unwary reader might be forgiven for thinking that there was some uniformly accepted definition of what constitutes a small firm. Nothing could be further from the truth. The distinction between big and small is arbitrary and, in those industries where definitions are according to value of work done, they vary from year to year because of inflation” (Curran, Stanworth, Watkins, 1986, p12).

As far back as 1969, a committee of enquiry, known as the Bolton Committee, was established to research the small firm sector in England. The committee’s first responsibility was to define a small business. Unfortunately, this task could not be easily performed and there was an ultimate recognition that a single definition could not be used to cover divergent sectors and industries (Dewhurst and Burns, 1983, p3).

Due to the difficulties experienced in attempting to obtain a universal and constant definition for the sector, numerous definitions have been suggested by governments, financial institutions and researchers. These definitions vary between countries and ultimately depend on variables such as the country and industry sector of the business.

An analysis of most definitions utilised indicates that there are two sets of criteria that are incorporated into the definition of a small business, namely quantitative and

qualitative. Qualitative criteria contain economic variables whilst quantitative criteria contain statistical criteria (Du Plessis, 1996, p162). Examples of qualitative characteristics that may be used to categorise an enterprise as a small business are:

- Independence - ownership is normally vested in one person or a small group of people;
- Simple organisational structure - there is a simple and informal organisational structure and functions are carried out by a single person or a small team;
- Owner involvement - the business owner/s are directly involved in operating the business; and,
- Liability - the owner/s are jointly and individually responsible for loans and liabilities of the business.

Examples of quantitative characteristics that may be used to categorise an enterprise as an SME include:

- Annual turnover;
- Number of full time employees; and,
- Value of assets.

(Du Plessis, 1996, p162)

Most organisations that are involved in the development of the SME sector utilise a combination of the above characteristics to devise an appropriate definition so that a business may be categorised as an SME. For example, in South Africa the South African Revenue Services has embarked on a campaign to reduce the administrative and regulatory burden on small business. This has been achieved by establishing a specific definition of a small business corporation in the Income Tax Act. In order to be categorised as a small business corporation, an entity must comply with the following qualitative and quantitative requirements:

- the gross income of the entity must not exceed R14 million per annum;
- shareholders or members must be natural persons and must hold the entire shareholding during the entire year of assessment;
- not more than 20% of the gross income (receipts, accruals and all capital gains) of the company or close corporation must consist collectively of investment income and income from the rendering of a personal service;
- shareholders or members may not at any time during the year of assessment hold any shares or interest in any other company or close corporation (other than a

listed company, unit trust, share block company or sectional title body corporate); and,

- the company or close corporation must not be an employment company.

(Silke, 2008, p390)

By incorporating both quantitative and qualitative aspects in attempting to categorise a small business, due recognition is made of the nature and the role of the small business in the economy. Therefore the question “Is small business just a ‘small’ big business or is it something else?” (Dewhurst and Burns, 1983, p3), could be answered by the fact that unique qualitative aspects in the definition demonstrate that the operation and management of the business is different from a ‘small’ big business. For example, by utilising the above characteristics that have been suggested by Du Plessis, a listed company with a small turnover and/or a small staff compliment will not be classified as a small business.

In summary, it is probably impossible to achieve a universally consistent definition of an SME or a small business. However, depending on the objective of the organisation or geographical location, it is possible to set out quantitative and qualitative criteria that set out specific criteria for a business to be classified as an SME.

In the next section there will be a review of selected international and local definitions of SMEs. Thereafter, an appropriate definition or a combination of definitions will be used in order to devise a threshold for businesses that will be considered to be SMEs for the purpose of the empirical research.

### **2.2.2 Selected Definitions**

Although there is no universally accepted definition or fixed criteria for a small business or an SME, many countries have suggested definitions, based on the nature and scope of the small business sector. Such definitions are important as they enhance the effectiveness of specific measures to promote the growth of the small business sector (UN-ECE Operational Activities, 2008, p1).

For example, in order to ensure that specific finance related programmes in the European Union benefit the appropriate entity, the following definition is currently used by the European Commission:

“Small and Medium sized enterprises are defined as enterprises which:

- Employ fewer than two hundred and fifty persons;
- Have an annual turnover not exceeding EUR 50 million; and,
- Have an annual balance sheet total not exceeding EUR 43 million.”

(Definition of SMEs as per the Recommendation of the European Commission 2003/361/EC, 2003).

Many other countries have guidelines to classify enterprises as belonging to the SME sector. The following table, extracted from the website of the Confederation of Indian Industry, serves as a useful guide to analyse the different criteria adopted by countries that have tried to define an SME.

**TABLE 2.1**  
**SELECTED INTERNATIONAL DEFINITIONS OF AN SME**

<b><u>COUNTRY</u></b>	<b><u>BASIS USED</u></b>	<b><u>DEFINITION</u></b>
Australia	Number of employees	SMALL – fewer than twenty MEDIUM- 21 to 200 LARGE- greater than 200
France	Number of employees	Fewer than 250 employees
Malaysia	Employees, Turnover and other qualitative factors	<ul style="list-style-type: none"> <li>• Full time employees - fewer than 150</li> <li>• Annual sales not exceeding RM 25 million</li> <li>• Incorporated under the Companies Act</li> <li>• Must have at least 70% of shareholdings held by Malaysians</li> <li>• Involved in the manufacturing sector or</li> </ul>

		provision of manufacturing related services
United States	No official certification process	<ul style="list-style-type: none"> <li>• The definition varies from industry to industry</li> </ul>
United Kingdom	Turnover and number of employees	<ul style="list-style-type: none"> <li>• Small – Fewer than 50 employees, 5,6 million pounds turnover and 2,8 million pounds balance sheet total</li> <li>• Medium- Fewer than 250 employees, 22,8 million pounds turnover and 11,4 million pounds balance sheet total.</li> </ul>

Adapted from: Confederation of Indian Industry, [www.cii.in/menu\\_content.php](http://www.cii.in/menu_content.php)

It is evident from the above table, that the process of categorising a business as an SME is a practical one that is dependent on the regional or local circumstances. This has resulted in different definitions, not only between countries, but also within a country, such as the USA. These differences appear to be justified, as they seem to be borne out of the necessity of ensuring that measures that target their growth are directed towards the appropriate range of enterprises.

In South Africa, a similar difficulty exists in trying to determine an appropriate definition that can be used consistently. The difficulty that exists in other countries is compounded, given the diversity and the rural location of many small businesses in South Africa.

There has been a focus by the South African government in promoting legislation relating to small business development. Although some argue that much of the legislation has been ineffective in promoting the growth of the small business sector,

(Von Broembsen, 2003, p1), the legislation can be used in order to determine which businesses may be classified as SMEs.

The White Paper on a National Strategy for the Development and Promotion of Small Business, tabled by the government in 1995, presented a strategy for the overall transformation and renewal of South African society. The paper did recognise the diverse nature of the small business sector and attempted to classify four major categories of small business as follows:

- Survivalist enterprises: These activities are undertaken by people unable to find a job. The income received is minimal as these activities are undertaken with few skills or capital investment.
- Micro-enterprises: These are very small businesses, often involving only the owner and a few employees. These businesses usually do not have business licences, premises or the necessary permits. They possess very limited capital and do not have many business skills to adequately manage the business.
- Small enterprises: These enterprises make up the majority of established businesses. They have the following characteristics:
  - They employ between five and about fifty people;
  - They are owner-managed or directly controlled by the owner-community;
  - They are likely to operate from business or industrial premises, be tax-registered and meet other formal registration requirements; and,
  - Classification in terms of assets and turnover is difficult, given the wide differences in various business sectors like retailing, manufacturing, professional services and construction.
- Medium enterprises have the following characteristics:
  - They are owner/manager-controlled, though the shareholding or community control base could be more complex;
  - They employ fewer than two hundred people; and
  - They own capital assets (excluding property) not exceeding R5 million.

(Department of Trade and Industry, 1995, p8-9)

In 1996, the government promulgated the National Small Business Act, so that a coordinated approach could be adopted towards the development of the small business sector. Embodied in this Act was the following schedule that attempted to classify micro, small and medium sized businesses:

**TABLE 2.2****DEFINITION OF SMALL BUSINESS PER THE NATIONAL SMALL BUSINESS ACT**

<b>Column 1</b>	<b>Column 2</b>	<b>Column 3</b>	<b>Column 4</b>	<b>Column 5</b>
<b>Sector or accordance Standard Classification</b>	<b>sub-sector with Industrial</b>	<b>inSize the class</b>	<b>ofThe total full-time equivalent employees</b>	<b>Total turnover value (fixed gross asset property excluded)</b>
Agriculture	Medium	100	R 5 m	R 5 m
	Small	50	R 3 m	R 3 m
	Very small	10	R 0.50 m	R 0.50 m
	Micro	5	R 0.20 m	R 0.10 m
Mining and Quarrying	Medium	200	R 39 m	R 23 m
	Small	50	R 10 m	R 6 m
	Very small	20	R 4 m	R 2 m
	Micro	5	R 0.20 m	R 0.10 m
Manufacturing	Medium	200	R 51 m	R 19 m
	Small	50	R 13 m	R 5 m
	Very small	20	R 5 m	R 2 m
	Micro	5	R 0.20 m	R 0.10 m
Electricity, Gas and Water	Medium	200	R 51 m	R 19 m
	Small	50	R 13 m	R 5 m
	Very small	20	R 5.10 m	R 1.90 m
	Micro	5	R 0.20 m	R 0.10 m
Construction	Medium	200	R 26 m	R 5 m
	Small	50	R 6 m	R 1 m
	Very small	20	R 3 m	R 0.50 m
	Micro	5	R 0.20 m	R 0.10 m
Retail and Motor Trade and Repair Services	Medium	200	R 39 m	R 6 m
	Small	50	R 19 m	R 3 m
	Very small	20	R 4 m	R 0.60 m
	Micro	5	R 0.20 m	R 0.10 m
Wholesale Trade, Commercial Agents and Allied Services	Medium	200	R 64 m	R 10 m
	Small	50	R 32 m	R 5 m
	Very small	20	R 6 m	R 0.60 m
	Micro	5	R 0.20 m	R 0.10 m
Catering, Accommodation and	Medium	200	R 13 m	R 3 m
	Small	50	R 6 m	R 1 m

other Trade	Very	20	R 5.10 m	R 1.90 m
	small	5	R 0.20 m	R 0.10 m
	Micro			
Transport, Storage and Communications	Medium	200	R 26 m	R 6 m
	Small	50	R 13 m	R 3 m
	Very	20	R 3 m	R 0.60 m
	small	5	R 0.20 m	R 0.10 m
Finance and Business Services	Micro			
	Medium	200	R 26 m	R 5 m
	Small	50	R 13 m	R 3 m
	Very	20	R 3 m	R 0.50 m
Community, Social and Personal Services	small	5	R 0.20 m	R 0.10 m
	Micro			
	Medium	200	R 13 m	R 6 m
	Small	50	R 6 m	R 3 m
	Very	20	R 1 m	R 0.60 m
	small	5	R 0.20 m	R 0.10 m
	Micro			

(Department of Trade and Industry, 1996, p15-16)

The data contained in the above table appears to justify the earlier assertion that the definition of an SME will vary according to the sector of the market and the location.

In addition to the categories that have been recommended by the government, there are also various other organisations and interest groups that are responsible for improving the SME environment. For example, in 2007, the South African Institute of Chartered Accountants adopted International Accounting Standards relating to the reporting requirements of the SME sector. One of the benefits of adopting a common standard of reporting amongst SMEs is to facilitate easier access to finance by small businesses.

These standards define SMEs as entities that:

- (a) Are not publicly accountable; and
- (b) Publish financial statements for external users.

Examples of external users include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies.

An entity has public accountability if:

(a) It files, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or

(b) It holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, securities broker/dealer, pension fund, mutual fund or investment banking entity.

(International Accounting Standards Board, 2007, p14).

### **2.2.3 Conclusion**

Given the diversity of the small business sector and the objectives of the research being undertaken, both quantitative and qualitative characteristics will be used to define an SME. In addition, since the research is focusing on the accounting and financial management needs of SMEs, the criteria utilised by the International Accounting Standards Board will be incorporated.

Therefore, for the purposes of the empirical research, the following definitions will be used:

#### **A small business:**

- Does not have public accountability;
- Publishes general financial statements for external users;
- Employs between five and fifty people;
- Meets formal registration requirements; and,
- Is owner managed and controlled.

#### **A medium sized business:**

- Does not have public accountability;
- Publishes general financial statements for external users;
- Employs a maximum of two hundred people;
- Has an asset base of a maximum of R5 million; and,
- Meets formal registration requirements.

Having determined a suitable definition that can be used for an SME, an assessment will be made of the business environment for SMEs in KwaZulu-Natal. The assessment of

this environment is useful in determining the support mechanism available to the small business sector, the success of these mechanisms and the needs of the sector.

## **2.3 OVERVIEW OF THE SMALL BUSINESS SECTOR IN KWAZULU-NATAL**

### **2.3.1 Introduction**

In Chapter One, an assessment was conducted of the business and operational environment of the small business sector. It was established that the government has demonstrated the prioritisation of the growth of the small business sector in the country by introducing legislation such as the National Small Business Act and the National Strategy for the Development and Promotion of Small Business. This legislative framework has formed the foundation for the development a business support strategy for the SME sector in South Africa.

It has also been demonstrated that the success of government legislation in promoting the growth and development of the small business sector is low. The conclusions reached in Chapter One appear to be supported by recent comments by the Director General of the Department of Trade and Industry, Tshediso Matona, who stated that the governments small business development strategy has been “miniscule” and needed to be “massified” (Ensor, 2008). These comments by the director general indicate there is a large scope for improvement in promoting the growth and sustainability of the small business sector.

The initial national focus will be reduced to a regional one, in order to determine the business and operational environment of the small business sector in KwaZulu-Natal. The assessment is vital as it can be used to determine the needs of small business in the province.

### **2.3.2 Economic and social conditions in the province for the SME sector**

KwaZulu-Natal is South Africa’s third smallest province, with a total area of approximately ninety two thousand square kilometres. Although it occupies approximately 8% of the country’s total land area, it has the largest population, estimated at approximately ten million people in two thousand and six. The province

stretches from Port Edward in the south to the border of Swaziland and Mozambique in the north ([www.southafrica.info/ess\\_info/sa\\_glance/geography/Kwa-Zulu.htm](http://www.southafrica.info/ess_info/sa_glance/geography/Kwa-Zulu.htm)).

The following table presents a summary of social and economic conditions in KwaZulu-Natal:

**TABLE 2.3****DEMOGRAPHIC AND SOCIAL INDICATORS FOR KWAZULU-NATAL**

<u>Indicator</u>	<u>Unit</u>	<u>KwaZulu-Natal</u>	<u>South Africa</u>
Population	Number	9,665,875	48,568,607
Proportion of population resident in urban areas	Percent	46	57.5
Sex ratio	Males per 100 females	93	97
Total fertility rate (per women)	Number of children born	3.1	2.9
Age dependency (total)	Per 100 individuals of	6.3	59
Poor persons	Number	5,700,000	25,700,000
Poverty rate	Percent	61	57
Poverty gap	Rand billions (constant	18.3	81.3
Share of the poverty gap	Percent	22.5	-
Share of urban household expenditure allocated to expenditure on food items	Percent	21.9	16.1
Share of non-urban household expenditure allocated to expenditure on food	Percent	41.8	29.5
Proportion of individuals belonging to the least 20% income group	Percent	87.85	83.7
Proportion of households belonging ton the least 20% income group	Percent	54.9	49.4
HIV/AIDS prevalence rate (general)	Percent	11.7	11.4
HIV/AIDS prevalence rate (ante-natal)	Percent	36.5	26.5
Infant Mortality rate	Deaths per 1,000 live	67	59
Tuberculosis cure rate	Percent	49	64
Proportion of population without medical aid	Percent	88.9	84.9
Hospital admissions per 1,000 un-insured population	Number	127.7	104.9
Proportion of households with access to tap water in dwelling	Percent	35.2	39.5
Proportion of households with access to refuse removal at least once a week	Percent	49.3	55.4
Proportion of households with access to electricity for lighting	Percent	61.4	70.2
Proportion of households with access to telephone in dwelling and cell-phone	Percent	13.2	13.8
Proportion of households dwelling in a house or brick structure on a separate	Percent	41.6	53
Proportion of population 15-65 years that cannot read or write	Percent	10.8	10.8
Proportion of population 20 years and older that are without an education	Percent	12	11.1
Proportion of Senior Certificate candidates to have passed with an endorsement	Percent	16.8	15.1

Adapted from: Province of KwaZulu-Natal Provincial Treasury, 2004, p4

It is evident from the above table that there are higher levels of poverty in KwaZulu-Natal than in the rest of the country. The low literacy levels and the high proportion of the population without an education are indicative of the need for skills development in the province. A further cause for concern is the low level of access to electricity and telephone services, which can be considered as basic infrastructure for the survival of a small business.

These social problems appear to have resulted in the province experiencing low employment and a low entrepreneurial rate. Key statistics indicate that the unemployment rate, per the narrow definition, was approximately 33% in 2004. There has also been a declining trend in the registration of close corporations in KwaZulu-Natal as a proportion of the total registrations in South Africa. Statistics indicate that this ratio has decreased from approximately 15% in 1995 to approximately 10% in 2002 (Province of KwaZulu-Natal Provincial Treasury, 2004, p6).

The KwaZulu-Natal Provincial government has recognised these problems and has tried to create a platform to solve these social problems by using small business development as a vehicle to create employment and remove some of the social inequalities.

The strategy that has been followed in KwaZulu-Natal is consistent with the Integrated Small Business Strategy that was developed by the Department of Trade and Industry in 2005. The pillars of this strategy are:

- Strengthening the support for access to finance by the creation of state owned finance providers;
- Creating an enabling regulatory environment;
- Expanding market opportunities for specific categories of small enterprises;
- Localising small business support through a grid of Seda coordinated information and access points;
- Expanding education and training for small business; and,
- Co-funding business infrastructure facilities in local area authorities.

(Department of Trade and Industry, 2005, p5-6)

The responsibility for the development of the small business sector in the province is predominantly undertaken by the Department of Economic Affairs. As a result of this responsibility, it has set up several programmes to support the growth of the small

business sector in the province. The Department of Economic affairs has tried to implement the Small Business Strategy, outlined above, as follows:

- Allocating approximately two hundred million rands to Ithala Development Bank to fund small business development in 2006. This allocation from the provincial government was also matched with Ithala's own profits, resulting in a total funding of approximately four hundred and seventy million in loan funding for the small business sector. The funding for Ithala has resulted in the creation of approximately four thousand five hundred jobs in the small business sector in the province.
- The provision of business support to the small business sector by establishing the SMME Support Service Delivery Network. This network is aimed at providing an expert advice desk to assist small businesses in developing credible business plans and to access financial support from financial institutions.
- The development of the Industrial Development Strategy to identify sectors with economic potential to contribute to the growth of the small business sector. This has resulted in the Department of Economic Development establishing a Sector Development Division that has tried to stimulate the development of clusters for Arts and Crafts, Clothing and Textiles and Furniture. In the latter, a formal KwaZulu-Natal Furniture Cluster was established to manufacture and market timber products in the province.
- The creation of Local Economic Development initiatives within local municipalities, especially rural areas, to attract and implement local development opportunities. Due to the support received from the European Union funded Gijima KZN programme, it is envisaged that these initiatives may result in the creation of about seventeen thousand job opportunities.

(Mkhize, 2006, p1-7) and (Department of Economic Development, 2005, p7-9)

Changes to the National Small Business Amendment Act resulted in the establishment of the Small Enterprise Development Agency (Seda), which has a mandate to support the growth of small business in the country. The work that is carried out by Seda is consistent with the pillars of the Integrated Small Business Strategy that was developed by the Department of Trade and Industry that was outlined above. In KwaZulu-Natal, Seda was established in 2005 and has seven branches in major cities such as Durban, Pietermaritzburg and Richards Bay. Some of the work carried out by the branches comprises:

- Strengthening support for access to finance by the small business sector;

- Creating an enabling regulatory framework;
- Providing small business support through a grid of advice points; and,
- Providing education and training for small business.

([www.seda.org.za](http://www.seda.org.za))

It is evident that the provincial government has realised the importance of the creation and support of a small business sector and has responded to the challenge by developing and funding channels that will support the growth of the sector. In the next section, evidence from research into the small business sector will be reviewed to gauge the success of the interventions that have been undertaken by the provincial government.

### **2.3.3 SME needs in KwaZulu-Natal**

In order to continue to focus on the environment in which small business operates in KwaZulu-Natal, an analysis will be undertaken of previous research of the small business sector in the province. The results and conclusions from this research will provide an indication of the extent to which the provincial government initiatives that were outlined above, have contributed to the growth and development of the small business sector.

In 2007, Van Vuuren and Groenewald conducted research into the influence of start-up factors in small business and entrepreneurial ventures in South Africa. An ex-post facto formal research design was used as respondents were requested to indicate on a four-point scale the importance they attached to thirty-seven items. Data was collected by means of a personal interview and a random sample of three hundred and twelve people was selected.

One of the limitations of the research was that it was only conducted in Gauteng. However, the results of the research may be used as a useful indicator for other provinces due to the common business policy and development initiatives that have been adopted between provincial and national government. The recommendations may be utilised as a basis for national findings and recommendations due to the common problems of high levels of unemployment and poverty and the low entrepreneurial activity that exists. Another limitation of the research was that the sample was not representative of a sample frame of all start-ups in South Africa as such a database does not exist.

An important objective of the research was to make recommendations to policy makers and training and educational institutions regarding the start-up factors that influence small businesses in South Africa. The research was conducted by means of a personal interview using a sample size of three hundred and twelve businesses.

The key findings of the research were:

- Although small businesses operate in a similar business environment in South Africa, differences exist in the needs of male and female entrepreneurs, age of the entrepreneur, and the stage of the business life cycle. This is an important contribution as government policy does not take these differences into account in its promotion of the small business sector;
- Entrepreneurs need to be made aware of the role personal management, effective time management and support from partners and advisors will play;
- More attention must be given to role models and success stories of entrepreneurs and small business, as the focus is more on failures; and,
- The research indicated that small business owners do not regard support as important. Due to the level of support that is needed, such a perception by business owners has a major impact on the business.

(Van Vuuren and Groenewald, 2007, p269-280)

In KwaZulu-Natal, Clover and Darroch undertook research into forty-four agribusinesses that operated in the small business sector during October 2003 and January 2004. The intention of the research was to identify factors that small business owners, operating in the agricultural sector, perceive to constrain business survival and growth. The research was based on the premise that the sustained growth of the small business sector in KwaZulu-Natal will help reduce poverty, income inequality and unemployment problems in the province, which supports the information contained in Chapter One.

Data for the study was collected via personal interviews with forty-four Ithala agribusiness clients. These forty-four clients were selected by applying stratified random sampling to the population of two hundred and sixty-six agribusiness SMMEs financed by Ithala in KwaZulu-Natal at the time of the study. Although the sample selected was not representative of the small business sector, the results can be utilised to

obtain a useful indicator of some of the needs of the sector, especially if the findings are consistent with other research.

The following table summarises the results of the study:

**TABLE 2.4**

**MEAN SCORES FOR POTENTIAL CONSTRAINTS TO BUSINESS SURVIVAL AND GROWTH**

<b><u>Rank</u></b>	<b><u>Potential Constraint</u></b>	<b><u>Sample Mean Score</u></b>
1	Insufficient government support	3.86
2	Lack of access to start up capital	3.45
3	Cash flow stress	3.27
4	Lack of access to capital for expansion	3.14
5	Too many rules and regulations	3.05
6	Crime	3.00
7	Complex labour legislation	2.80
8	Paying and complying with VAT	2.68
9	Insufficient private sector support	2.64
10	Complying with minimum wage legislation	2.61
11	Competition	2.50
12	Lack of access to skills training	2.34
13	Bargaining power of suppliers	2.27
14	Lack of access to good roads	2.25
15	Bargaining power of buyers	2.18
16	Lack of access to telecommunications	2.05
17	Lack of management skills	1.98
18	Low labour quality	1.95

(Adapted from: Clover and Darroch, 2005, p247)

From the above table it is evident that:

- Notwithstanding the conclusions reached in 2.3.2, that the KwaZulu-Natal Provincial Government has recognised the importance of small business support and development, most respondents felt that there was a lack of business support for the agribusiness sector from the government;
- A lack of access to finance was deemed to be a major constraint; and,
- Of particular interest were observations that the following aspects were perceived as potential constraints:
  - Cash flow stress

- Lack of access to capital for cash flow expansion
- Lack of management skills
- Competition

(Clover and Darroch, 2005, p 238-263)

In 2007, Jinabhai and Kadwa undertook research into the small business textile sector in KwaZulu-Natal in order to determine the needs of the textile sector.

Initially a random sample, from target population that was extracted from the Industrial council List of Clothing Firms and the 2000 Clothing Federation Handbook, was selected to collect data in the form of a questionnaire. The selection criterion that was used to select the sample was based on:

- Small businesses located in KwaZulu-Natal; and,
- Businesses whose employee composition was fewer than two hundred or those businesses that owned fewer than two hundred sewing machines.

Due to the small size of the sample frame, that consisted of one hundred and nine members, it was decided to use the entire population as the sample.

The key findings of the research demonstrated that:

- There was a major difference in the perception towards skills training provided by the government. Approximately 61% of the respondents were negative in the belief that government had provided support with regard to skills training;
- Only 38% of the respondents had received skills training;
- There was a significant relationship between mentorship assistance and the productive growth of the small business; and,
- The overall research finding was that the government's growth plan was not working and that mentorship should be pursued as a strategy to improve productive growth, in addition to training.

(Jinabhai and Kadwa, 2007, p 15-24)

## **2.4 SUMMARY OF CHAPTER**

It is evident that in KwaZulu-Natal, similar to the national tendency, the provincial government has realised the importance of the small business sector as an important economic and social tool. The provincial government has also demonstrated its

commitment to funding programmes that may support the growth and viability of the sector.

Unfortunately, it is also evident that government policies for the small business sector have not been effective in stimulating the growth of the sector. The research that has been conducted into the sector indicates that small businesses perceive the government support and training programmes to be ineffective. These views seem to be supported by the continuous low entrepreneurial rate and the lack of reduction in the unemployment rate in the country.

The research that was highlighted in this section has demonstrated that the following constraints exist in the SME sector in KwaZulu-Natal:

- There is a need for business support and mentoring for the small business sector; and,
- The constraints relating to cash flow stress, lack of access to capital, lack of management skills and competition may be indicative of a need for financial management and accounting skills, as the presence of such skills may solve these problems.

It is important to emphasise that any action to improve the SME sector should be based on a holistic approach that considers all the difficulties and problems experienced by the sector, such as marketing, human resources, strategic management, accounting and financial management (Papulova, 2007, p3). The research is therefore based on the premise that accounting and financial management skills form a component of the overall solution to grow the SME sector.

Having considered the business and economic landscape for SMEs provincially and nationally, it has been established that there may be a need for greater accounting and financial management skills in the small business sector. In the following chapters a review will be conducted into the role of accounting and financial management skills that may contribute to the optimal performance of the sector.

## **CHAPTER THREE: LITERATURE REVIEW OF ACCOUNTING DEVELOPMENTS AND ACCOUNTING SKILLS NEEDED BY THE SME SECTOR**

### **3.1 INTRODUCTION**

In Chapter One, a review was conducted into the role of small business in the country and the province. Whilst there is consensus of the importance of the SME sector in improving the economic and political landscape of the country and province, results of research reviewed indicate that there is a low entrepreneurial success rate in the country. It was disappointing to note that, in addition to the common problems that are experienced by the small business sector globally, there are also many problems that are unique or more common to entrepreneurs in South Africa. For example the Bantu Education system has restricted opportunities for the acquisition of technical and professional skills needed to professionally manage a small business (Department of Trade and Industry, 1995, p11).

The review in Chapter One also indicated that a combination of these problems has resulted in the poor performance of the sector. The major problems that were experienced by the small business sector, as outlined in Chapter One, relate to:

- The macro environment - small business owners do not have the skills to comprehend the effect that market influences and changes have on the business;
- Lack of funding - a problem experienced by most entrepreneurs which may be attributable to a lack of skills to prepare business and financial plans needed to raise capital;
- Operational - a lack of knowledge needed in order to implement production, quality management, marketing and financial management systems needed to successfully grow the business; and,
- The regulatory burden - the great regulatory burden in the country is a major concern to entrepreneurs who lack the skills to comply with labour, legal and tax legislation.

The existence of the financial and operational obstacles may be indicative of a lack of accounting and financial management skills in the SME sector. In this regard, Mutezo (2005) has conducted research into obstacles in accessing small business finance, with

an objective to identify the obstacles encountered by entrepreneurs in accessing small business finance from financial institutions. The empirical research was undertaken by a questionnaire that was distributed to six hundred businesses that were selected from the Braby's Database, which comprised of approximately fifteen thousand businesses in South Africa. The sample was selected by using a probability sampling technique known as systematic sampling. A possible shortcoming of the sample frame is that it may have included more formalised businesses; however, this was complimented by the distribution of the questionnaires at business centres to less formalised businesses.

Some of the conclusions that relate to the research are:

- The research confirmed previous observations that a lack of start-up capital is the major problem among entrepreneurs as approximately 80% of the sample indicated that this is a problem. It is important to note that the researcher has concluded that further research be conducted into “certain skills that are a prerequisite for a successful application for finance such as bookkeeping, cash flow management and drafting of business plans. Further research could be conducted into how banks/government could impart these skills to the potential entrepreneur” (Mutezo, 2003, p93); and,
- There was a lack of business skills in 49% of the sample. This observation is also consistent with previous research reviewed in Chapter Two (Clover and Darroch, 2005 and Van Vuuren and Groenewald, 2007) and may also indicate that there is a need for accounting and financial management skills to complement and improve business skills.

Research conducted in KwaZulu-Natal by Clover and Darroch in 2005, highlighted in Chapter Two, also indicated that whilst there is a need for general mentorship and training in the small business sector, there are also specific constraints such as cash flow management, lack of access to capital and management skills. These specific constraints demonstrate that there may be a need for improved accounting and financial management skills in the province, in order to remove some of the business difficulties, threats and obstacles that the small business sector is facing.

It appears that there is a need for financial management and accounting skills as a mechanism to reduce some of the obstacles that are experienced by the sector, such as:

- A lack of access to finance;
- A lack of management skills; and,

- Specific problems such as cash flow management.

Due to the importance of accounting and financial management skills, Chapters Three and Four of the thesis will focus on formulating those basic accounting and financial management skills that may be required by small and medium sized businesses in order to optimise their performance.

There may be a tendency to confuse financial management and accounting skills due to the perceived overlap between these managerial functions. It is important to understand the distinction between these separate functions so that the skills that are needed to properly execute these functions can be assessed. Accounting is the maintenance of a systematic set of financial records and using these records as a basis for meaningful reporting (Haiden, 2006, p1). Financial management focuses primarily on decision making with regard to investment and financing decisions of a business enterprise and, although linked to accounting, the primary objective is to create wealth (Correia, 2007, 28).

In the SME sector the accounting function is concerned with collecting, analysing and communicating financial information, whereas the financial management focuses specifically on the financing and investing activities of the firm (Atrill and McLaney, 2006, p2 & 15). This distinction is important as Chapter Three will assess those skills needed to gather information in the form of financial statements, whereas Chapter Four will assess those skills needed to acquire and utilise funds in the business to meet the financial management goals, thereby enhancing the growth of the business.

In this chapter, an assessment will be made of those accounting skills that may be required by the SME sector as a mechanism to solve some of the financial and other management problems experienced. In performing the assessment of accounting skills needed, it is important to take cognisance of the fact that businesses operating in the SME sector may have different accounting needs due to their diversity in size, ownership structure and management capabilities. A key characteristic that distinguishes smaller companies from medium sized entities is the level of formalisation in terms of management and ownership structure (Van Bombsen, 2003, p2). Due to these differing characteristics, the accounting needs will be assessed by using the following categorisation:

### **a. Medium sized entities**

An assessment will be made of international and national developments in the field of accounting and the preparation of financial statements for **companies** operating in the SME sector. A focus on these developments is necessary in order to determine whether the accounting needs of companies in the SME sector have been considered in the development of accounting policy and statutes and also in assessing the corresponding accounting skills needed to meet the accounting regulatory environment.

### **b. Small entities**

There are many businesses that meet the definition of an SME, as outlined in Chapter Two, that are not classified as companies. Accordingly, there will be a focus on those basic skills, which, if implemented in these entities, will maximise the performance. Such skills include those required to prepare an income statement, balance sheet, cash flow statement and tax returns.

## **3.2 THE NEED FOR ACCOUNTING SKILLS**

In any organisation, accounting relates to the collecting, analysing and communicating of financial information. These objectives are usually achieved by the preparation of financial statements. Financial statements are prepared in order to provide information that is useful to a wide range of users and comprise of:

- The income statement;
- The statement of changes in equity;
- The balance sheet;
- The cash flow statement; and,
- The notes to the financial statements.

(Sowden-Service, 2007, p8)

One of the primary functions of accounting is to measure and communicate the financial results and position of a business (Haiden, 2006, p1). In South Africa, the requirement of companies to prepare financial statements is stipulated by the Companies Act, which requires that all companies, regardless of their form and size, must prepare annual financial statements in terms of Generally Accepted Accounting Standards, so that the needs of internal and external users are met (Stainbank and Wells, 2005, p51).

These financial statements are used by those parties who make decisions relating to the business and in maintaining control over the business. Apart from keeping a record of daily accounting activities, owners and managers of businesses may need accounting information to decide whether to:

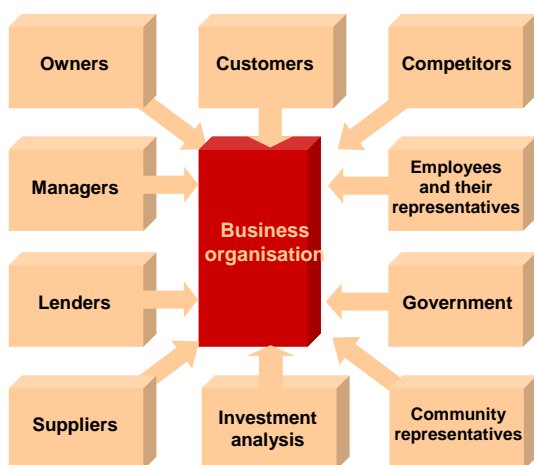
- Develop new products or services;
- Borrow money to help finance the business; and,
- Change the operating capacity of the business.

(Atrill and McLaney, 2006, p 2)

In addition to the owners and management of a company requiring information from financial statements, there are many other users of financial statements. The following table illustrates the various users of financial statements and their relationship with an entity:

**TABLE 3.1**

**USERS OF FINANCIAL INFORMATION RELATING TO A BUSINESS**



(Atrill and McLaney, 2006, p6)

It is evident from the above illustration that, in addition to the financial statements being used by the management of the company to make important decisions, they are also used by external stakeholders to make decisions. For example, they may be used by financiers, investors or creditors in order to evaluate the financial position of the entity prior to investing or providing a credit facility to the company.

### **3.3 ACCOUNTING NEEDS OF SME COMPANIES**

#### **3.3.1 The regulatory environment for the preparation of financial statements for companies in the SME sector**

Although most SMEs are not registered as companies, it is important to assess the regulatory environment relating to the preparation of annual financial statements for companies, as many businesses in the sector will aspire to grow to the level of formalisation found in these companies.

The requirement by the Companies Act that all companies must produce financial statements, results in companies that meet the definition of an SME as outlined in Chapter Two, having to comply with the requirement of producing financial statements in compliance with Generally Accepted Accounting Practice (GAAP).

In view of research observations relating to a lack of skills in the small business sector, this requirement places an onerous responsibility on entrepreneurs and the small business sector. One of the main concerns of owners of SMEs is the cost of producing these financial statements. The owners generally feel that the preparation of these financial statements are an inconvenience to them and that there is a large associated cost that is incurred in order to meet the statutory requirement (Coetzee, 2007, p2). According to the Economist publication “World in Figures”, the cost in doing business in South Africa is higher than in all but five other emerging markets in the world (Centre for Development and Enterprise, 2004, p66). The additional statutory requirement relating to the preparation of annual financial statements that comply with (GAAP) places an additional burden on the already scarce management and financial resources that the sector possesses.

Unfortunately, this burden appeared to be worsened by the adoption of International Financial Reporting Standards (IFRS) by GAAP.

The adoption and introduction of IFRS seemed inevitable due to a lack of a uniform and consistent international reporting standard. The start of the millennium was characterised by some of the largest accounting corporate scandals in America. These scandals were prevalent in conglomerates such as Enron, WorldCom and several other large corporations (Benston, 2003, p v). One of the solutions to these corporate scandals

was for the accounting profession to devise a common system of financial reporting. Accordingly, most of the developed countries and many developing countries, such as South Africa, adopted the IFRS standards of financial reporting for the preparation of financial statements. The advantages of the IFRS statements, which were adopted by South Africa in 2006, are that:

- They enhance the quality of financial reporting as these are common international reporting standards;
- They are a major step towards reducing fraud by means of accounting scandals; and,
- Since there is common alignment with international reporting systems, they help to attract foreign investment.

(De Beer, 2006)

Unfortunately, there are also many disadvantages to adopting these international reporting standards. For example concern has been voiced on the additional rules and policies that are required in terms of the new standards. Many in the accounting and auditing profession feel that the implementation of these standards will place additional cost and stress on auditing and accounting staff (Nyamakanga, 2007).

One of the major concerns that related to the adoption and implementation of the IFRS statements was the increased regulatory burden on the SME sector. Whilst the alignment of South African GAAP and IFRS was justified on the basis of a common reporting language, it resulted in almost three thousand disclosure requirements. This resulted in several calls for a modification of the IFRS standards to reduce the burden on small business owners and the SME sector. For example, the auditor general requested that the IFRS for small businesses be modified (Nyamakanga, R, 2007).

### **3.3.2 Preparation of financial statements for companies in the SME sector**

Much effort has made by the government to reduce the red tape that many small and medium sized business owners view as a threat to their growth. In the February 2009 budget the Minister of Finance outlined proposals to reduce the regulatory burden on small businesses by adopting a presumptive tax and also increased the threshold for the registration for value added tax (PKF Chartered Accountants, 2008, p3). Such measures will have the positive effect of reducing the burden and costs of compliance on the small business sector.

Similarly, after the adoption of IFRS, most member countries speedily recognised the need for a separate set of accounting standards for the SME sector. In a presentation entitled “Global Convergence and Suitability for SMEs: Current Challenges in Promoting high Quality Professional Standards”, the president of the International Federation of Accountants argued that the current IFRS accounting practices are designed mainly for entities that work in the global financial and capital markets. These standards require a degree of complexity that exceeds the needs of entities that are not subject to the same level of demand for accounting information (International Federation of Accountants, 2006, p2). Given the diversity in the needs between larger multinationals and the SME sector, there were calls for the development of a separate set of accounting standards for the SME sector. From a South African perspective, such calls appeared to be logical given the earlier assessment of the regulatory burden experienced by the SME sector.

The support for separate accounting standards for the SME sector appears to be supported by research undertaken in South Africa. Stainbank and Wells (2005) researched the appropriateness of differential reporting in South Africa, i.e. reporting that deviates from the requirements of the Companies Act to prepare financial statements in accordance with GAAP. The research highlighted the high cost of compliance by companies, frequently for very little benefit to the users of financial statements. Such a situation is common to many SME owners that spend large resources with little perceived benefits from the financial statements.

The research undertaken consisted of a questionnaire that was posted to a simple random sample of three hundred and fifty-three Registered Accountants and Auditors, taken from the total population of approximately four thousand practitioners that were listed in the Public Accountants and Auditors Board on 31 March 2002. Although the sample was selected on the basis of their expertise and familiarity with accounting standards, a limitation of the study appears to be a lack of feedback from business owners, many of whom may feel strongly about having a separate reporting framework for the small business sector. In addition, the Registered Accountants and Auditors views may differ substantially from those of the primary users of the financial statements.

The results of the survey indicate that:

- There is substantial support for limited formalised deviations from South African GAAP;
- A separate set of standards, adapted from GAAP for SMEs, enjoyed significant support; and,
- The cash basis and unlimited deviations from SA GAAP were rated as being unsuitable, irrespective of the extent of use by users of financial statements.

(Stainbank and Wells, 2005, p51-65)

The above appears to support the earlier views expressed that although SME companies should comply with accounting standards, there should be a modification to these standards that enables the sector to prepare financial statements at lower costs and so meet the needs of the sector. The research also supports the viewpoint that SMEs must comply with a set of accounting standards.

In South Africa, these needs and views have been accommodated by the proposed changes to the Companies Act of 1973 and the establishment and adoption of a statement of Generally Accepted Accounting Practice for companies that are SMEs.

### **3.3.3 Proposed changes to the Companies Act relating to SME Company financial statements**

In 2004, a policy paper, “Company Law for the 21<sup>st</sup> Century”, appeared in the Government Gazette. The paper proposed the development of a law that promotes growth, employment and enterprise opportunities. The key proposals in achieving this objective were:

- Encouraging entrepreneurship by simplifying the process of the formation of companies and reducing the costs of forming and maintaining a company;
- Recognising the broader social goal of companies; and
- Promoting the efficiency of companies and their management.

(Government Gazette, 2004, p 1-10).

As a result, the Government undertook to review and reform the laws relating to the operation of companies in South Africa and in 2007 the Department of Trade and Industry published a notice of intention to introduce the Companies Bill into parliament.

The Bill was introduced by a desire to develop a company law that promoted the competitiveness and development of the South African economy by encouraging entrepreneurship and enterprise development by:

- Simplifying the procedures for forming companies; and,
- Reducing the costs associated with the formalities of forming and operating a company.

(Government Gazette, 2007, p3)

These changes have resulted in a Corporate Laws Amendment Bill, which has already gone through parliament and is currently awaiting the president's signature. The bill introduces two new types of companies for the purposes of financial reporting and corporate governance, namely 'widely held' and 'limited interest' companies.

The bill stipulates that a company is a widely held company if:

- Its articles allow for unrestricted transfer of its shares;
- It is permitted by its articles to offer its shares to the public;
- It decides by a special resolution to be a widely held company; and,
- It is a subsidiary of the above company.

(SAICA, 2007, p1)

The bill also introduced the limited interest company, which is any company that cannot be classified as a widely held company. It is envisaged that many companies that belong to the SME sector will be classified as closely held companies, or limited interest companies, and the relief thus obtained is encouraging. For example, a company that is owner managed will be classified as a limited interest or a closely held company.

Whilst the bill makes provision for the financial statements of limited companies to be prepared, it is encouraging to note that these companies do not have to comply with statements of GAAP but to a simpler standard that will be developed by the Financial Reporting Standards Council, a body to be established to develop financial reporting standards. In addition, it is anticipated that in the next phase of the corporate reform process, the requirement for an audit of limited interest companies will be reconsidered.

The proposed changes to the Companies Act have relaxed the accounting requirements for limited interest companies, and because many SME companies are classified as limited interest companies, the new Act will have a positive effect on these companies.

It is important to note that whilst there is a relaxation of reporting standards for the SME sector, the proposed changes still require that closely held companies prepare financial statements that fairly present the financial position and results of operations of the entity so that disclosure and governance are still adhered to (SAICA, 2007, p1-6).

These changes support the observations of research conducted by Stainbank and Wells that it is suitable for SMEs to have a set of modified standards whilst also still ensuring that they adhere to the basic framework. The set of changes also appears to lend credibility to the government's commitment to reducing the regulatory burden on the small business sector.

### **3.3.4 Changes adopted by the International Accounting Standards Board**

In response to the difficulties experienced in adopting IFRS, such as the volume of changes and disclosures, many concerns were raised about the appropriateness of these standards for the SME sector. In recognition of these concerns, the International Accounting Standards Board developed a simplified, self-contained set of accounting principles that are appropriate for smaller, non-listed companies. The IFRS for SMEs incorporates five types of simplifications of full IFRS:

- Some topics in IFRS are not included because they are not relevant to a typical SME;
- Where IFRS allows an accounting policy choice, the SME statement includes only the simpler option;
- Simplification of many of the principles for recognising and measuring assets, liabilities, income and expenses that are in the full IFRS;
- Substantially fewer disclosures; and,
- Simplified redrafting.

(SAICA, 2007, Foreword)

The above IFRS statement was accepted by the South African Accounting Practices Board and in 2007, South Africa became the first country to adopt and implement this standard. There has been widespread local acceptance of this standard as it is estimated that the disclosure requirements for SMEs will be reduced from three thousand to four hundred (Carte, 2007). The adoption and implementation of the standard will particularly benefit the SME sector due to the cost savings.

In summary, financial statements are a necessary component in the decision-making process in the SME sector. However, they have traditionally been viewed as an unnecessary burden by the small business sector, due to the complexity of the preparation, audit requirements and the onerous framework.

The process and the costs involved in the preparation of financial statements for companies operating in the SME sector appear to be simplified by the proposed changes to the Companies Act and the adoption of the SME statement by IFRS. The effect is that useful financial statements that fairly represent the financial affairs of small businesses can be prepared with fewer skills and in a cheaper manner. Given the management skills gap that has been identified in earlier research, the simplification of the preparation of annual financial statements should contribute towards reducing some of the financial and management problems experienced by the sector.

Having acknowledged that companies form only a small portion of the SME sector, an assessment will be conducted of those accounting skills that are required by those small and medium sized businesses that do not meet the formal registration requirements of a company.

### **3.4 ACCOUNTING SKILLS REQUIRED BY OTHER ENTITIES IN THE SME SECTOR**

Some business commentators feel that the accounting responsibility is only a means to an end to have proper control over all activities of the business. The more control that a small business owner has over accounting issues, the better the control exerted on the business (Taylor, 2003, p11). In view of the overall advantage that accounting skills provide the small business owner, there is a strong case for small business owners to possess these skills.

It has been an observation that many small business owners fail to realise the importance of the accounting function and as a result cause the failure of the business (Stone, 2003, preface). This assertion supports the view that the implementation of an effective accounting system can contribute to the success and growth of a small business. In this section, an assessment will be made of those important accounting aspects and functions that are needed by the small business sector, specifically those smaller entities that are not classified as companies.

The task of an accountant in any organisation primarily relates to the preparation of financial statements and includes the following:

- Preparation of an income statement;
- Preparation of a balance sheet;
- Preparation of a cash flow statement and budgets; and,
- Calculating income tax (Haiden, 2006, p2).

Although these requirements seem very basic, most of the skills required to perform these functions may not be available in the SME sector. The acquisition of skills to assist in the preparation of the income statement, balance sheet, cash flow statements and income tax returns will enable SME business owners to:

- make important financial decisions;
- determine the business's financial position; and,
- understand and reduce their tax liabilities (Taylor, 2003, p13).

Ultimately, these skills will enable the owner to successfully grow the business into a sustainable and profitable one. Each of these areas will be reviewed to establish the skills required to prepare an income statement, balance sheet, cash flow statement and income tax return.

### **3.4.1 Preparation of an Income Statement**

Although there are a variety of reasons why any business is formed, one of the most important reasons and objectives of all business is to earn a profit so that it can sustain the owner. In the small business sector, success is frequently measured in terms of profits earned or profits earned in relation to funds invested (Meredith, 186, p3), implying that SMEs that continuously incur losses have little chance of survival in the long term.

It is important that SME owners have the necessary skills to determine if the business is achieving a profit or a loss and the impact that the business variables may have on the profitability of the entity. For example, if an owner has undertaken a business expansion he should be able to understand the impact that such an expansion has on the profitability of the entity. The SME sector can gain an insight into the measurement and analysis of profitability by preparing an income statement on a monthly basis.

An income statement provides information relating to the financial performance or profitability of the entity and includes all income and expenses (Sowden-Service, 2007, p34). The income statement usually comprises the following sections, which when combined reflect the profit of the business:

- A trading account, which provides the measurement of the gross profit by deducting the cost of goods sold from the revenue earned;
- A summary of expenses that have been incurred in the production of the revenue. These may include administration, establishment, financial costs and other business overheads; and,
- The final section deals with other or non-trading income that may have been received by the business, such as income on the sale of an asset or investment income (Taylor, 2003, p120).

Although an income statement is generally prepared in vertical format and must include the above elements, there is no prescribed format for an income statement, or any other financial statements for the non-company SME businesses. Whilst ensuring that the income statement should contain the above basic information, the format will differ according to the operations of the business. The appearance of the income statements of a manufacturer, retailer or a service business will differ to some extent (Baker and Hayes, 1980, p42). However, the basic concept of its use to determine and measure the profitability will remain the same for all entities.

The income that is earned by the business is always relevant to a specific time frame and it is important that the income statement relates to a specific period. For example, many listed companies prepare an income statement on a quarterly basis for their shareholders. It is recommended that small business owners prepare an income statement on a monthly basis so that it can be used as an effective tool to monitor and solve business problems in a timely manner.

Although the income statement is a useful tool in managing the business, it does have some limitations and therefore cannot be used as the sole accounting mechanism to control the business. Some of these limitations are:

- The income statement is usually prepared on the accrual basis. This means that income and expenses are recorded when the transaction occurs rather than when the cash is received or paid. Accordingly the small business owner will need to

understand that the profit reflected in the income statement does not necessarily correlate to the cash received and in most cases the cash may be tied up in debtors and stock. This shortcoming is overcome by the preparation of the cash flow statement; and,

- In an SME, the income statement cannot be used for the computation of income tax and there are many differences between the net profit and taxable income. This will necessitate the acquisition of skills that are necessary to compute and manage the taxation affairs of the business.

Notwithstanding the above shortcomings, the acquisition of skills that are required to prepare an income statement will hold the sector in good stead due to its ability to monitor the financial performance of the SME. The following table illustrates the format for a simple, yet effective, income statement that can be prepared by the SME sector.

**TABLE 3.2**  
**ILLUSTRATION OF AN INCOME STATEMENT FOR THE SME SECTOR**

**INCOME STATEMENT**  
**DATE**

Revenue		XXX
Less: Cost of Goods Sold:		XXX
Gross Profit (Loss)		<u>XXX</u>
Expenses:		
Total Expenses		<u>XXX</u>
Net Operating Income		XXX
Other Income:		
Gain (Loss) on Sale of Assets	XXX	
Interest Income	<u>XXX</u>	
Total Other Income		<u>XXX</u>
Net Income (Loss)		<u><u>XXX</u></u>

Adapted from IFC: SMETOOLKIT,  
www.smetoolkit.org/smetoolkit/en/category/915/Bookkeeping-Cash-Flow-  
Management)

### 3.4.2 Preparation of a Balance Sheet

One of the crucial elements of entrepreneurial success is to maintain a solvent business. A balance sheet is a document that provides a factual financial description of the value of a business (Stone, 2003, p22). It is a statement that lists the monetary measures of the resources used (assets) in the enterprise and the sources of funds (owner's equity or liabilities) used to finance those resources. Whilst the income statement is prepared by showing the cumulative revenue and expenses for a period, the balance sheet is prepared at a particular point in time and represents a snapshot of the financial position of the business (Meredith, 1986, p18).

A typical balance sheet consists of three main elements:

- Assets – comprised of items that are owned by the business, with a monetary value, that are usually employed earn a return. Examples of assets include fixed assets such as property, plant and equipment and current assets such as stock, debtors and cash. All assets are recorded at cost and their monetary value does not change to reflect any change in its market value.
- Liabilities – These are debts of a business. Certain liabilities in a business are short term, usually payable within a year, in nature such as payment for stock, salaries and other business expenditure. Other liabilities are long term and include mortgages, bonds and leases for equipment, payable in the medium to long term.
- Owners Equity – The owner's equity in a business is the total assets less the total liabilities and represents what the business is worth. The owner's equity generally emanates from an investment into the business by the owner and from the profits/losses of the business. A negative owner's equity implies that the liabilities exceed the assets and that the business is insolvent.

(Montgomery, 1998, p6-8)

Whilst the income statement is important in determining the profit or loss that is incurred, the balance sheet illustrates the level of solvency of the business, how the business is financed and the ability of the entity to convert assets into cash. (Seda, 2008, [www.seda.org.za/print\\_factsheets.asp?upd=1&factID=30](http://www.seda.org.za/print_factsheets.asp?upd=1&factID=30))

It is evident that the balance sheet is an important tool in determining the financial position of the small business and the information contained therein can be extremely

important to an SME. The following table contains a balance sheet that can be used by the SME sector.

**TABLE 3.3**

**ILLUSTRATION OF A BALANCE SHEET FOR THE SME SECTOR**

**BALANCE SHEET**

**DATE**

	Assets	
Current Assets:		
Cash	XXX	
Accounts Receivable	XXX	
Merchandise Inventory	XXX	
Prepaid Expenses	XXX	
Notes Receivable	XXX	
	XXX	XXX
Fixed Assets:		XXX
Total Assets		XXX
	Liabilities and Capital	
Current Liabilities:		
Accounts Payable	XXX	
Accrued Wages Payable	XXX	
Unearned Revenues	XXX	
Short-Term Bank Loan Payable	XXX	
	XXX	XXX
Long-Term Liabilities:		
Long term loans	XXX	
Mortgage Payable	XXX	
	XXX	XXX
Total Liabilities		XXX
Capital:		
Owner's Equity	XXX	
Net Profit	XXX	
Total Capital	XXX	XXX
Total Liabilities and Capital		XXX

Adapted from IFC: SME TOOLKIT,

[/www.smetoolkit.org/smetoolkit/en/category/915/Bookkeeping-Cash-Flow-Management](http://www.smetoolkit.org/smetoolkit/en/category/915/Bookkeeping-Cash-Flow-Management)

### 3.4.3 Preparation of a Cash Flow Statement

“Cash is like the flow of blood through your veins. If the flow stops, you will die. In the same way, if the flow of cash into your business ceases, your business will not survive” (Stone, 2003, p60). The assessment of poor business performance and threats to small business growth has consistently revealed that cash flow problems appear to be a major factor.

The preparation of an income statement and a balance sheet will assist the SME to determine the financial results of the operations and the financial position at a particular point in time. Whilst the preparation of these documents is of utmost importance to the small business, they do not necessarily indicate the cash position of the business to the owner.

One of the shortcomings of the income statement is the inability to reflect the cash position and the cash effects of the business transaction due to the accrual basis of accounting. In many businesses, and especially in the SME sector, there is often a lack of appreciation that profits do not necessarily mean cash in the bank. Often profits in a business can become locked into non-cash assets; more stock is held, debtors increase and profit may get tied up in capital equipment. Such common problems have led to the winding up of many small businesses (Taylor, 2003, p135). For example, although a sale, and the subsequent profit, may be reported in the income statement, the cash from the sale will only be realised when the debtor has settled this amount to the business.

This problem can be overcome by the preparation of a cash flow statement, which provides information regarding the entity’s cash flow, broken into three categories:

- Operating activities;
- Investing activities; and,
- Financing activities (Sowden-Service, 2007, p41).

The presentation of this information can be used to determine the manner in which the cash was utilised and the cash available to the business for growth and expansion. Using the cash flow statement, it is possible to ensure that the business will not over invest or overtrade, which can cause insolvency (Barrow, 1988, p39).

A cash flow statement allows profits to be converted into cash flow items by reversing non cash flow items and movements in working capital. The cash flow statement can be a useful guide in showing the cash inflows and outflows that occurred during the reporting period and the net effect that these have had on the cash resources (Bragg and Burton, 2006, p110-111). The obvious rule with inflows is to get customers to pay as promptly as possible and to minimise the outflows from the business.

**TABLE 3.4**  
**ILLUSTRATION OF A CASH FLOW STATEMENT FOR THE SME SECTOR**

**CASH FLOW STATEMENT**

**DATE**

Cash effects of operating activities	XXX
Cash receipts from customers	XXX
Cash paid to suppliers and employees	(XXX)
Cash generated from operations	XXX
Interest paid	(XXX)
Dividends paid	(XXX)
Normal tax paid	(XXX)
Cash effects of investing activities	(XXX)
Sale of plant	XXX
Purchase of plant - replacement	(XXX)
Cash effects of financing activities	XXX
Loans repaid	(XXX)
Proceeds from loans raised	XXX
Proceeds from share issue	XXX
Net cash (outflow) / inflow	XXX
Opening balance of cash and cash equivalents	XXX
Closing balance of cash and cash equivalents	XXX

(Sowden-Service, 2007, p718)

The above illustration provides a simple and easy way to determine the cash that was earned from operating activities and the cash that was utilised for investing activities and, finally, how required funds were obtained. Due to cash difficulties experienced by

the small business sector, it is essential that the above statement be produced on a monthly basis.

A logical extension of the cash flow statement is the preparation of a cash budget that can be used to determine the cash requirements of a business. However, the skills that are required to prepare the budget will be analysed in Chapter Four as they relate to the financial management of a business.

#### **3.4.4 Taxation requirements**

One of the problems that was identified during the review of problems experienced in the small business sector in Chapter One was the regulatory burden encountered by the small business sector. In the 2006 State of the Nation address, the State President recognised the scope of the problem. He also indicated that there will be an improvement of the regulatory environment so that the landscape for small business improves. There was also an acknowledgement of the importance of the sector in terms of the national strategy for accelerated and shared growth (Venter and De Clerq, 2007, p131).

A specific problem experienced in the small business sector has been the difficulty in complying with the tax regulations. A primary criticism by taxpayers and practitioners alike has been that, given the regulatory burden imposed by the Income Tax Act, the cost of compliance has been onerous (Kader, 2007, [www.taxtalk.co.za](http://www.taxtalk.co.za)). For example, a newly formed small business will have to register and complete regular returns for some or all of the following taxes:

- Income tax on profits;
- Employees tax;
- Value Added Tax;
- Skills Development Levy;
- Unemployment Insurance contributions; and,
- Depending on business transaction, other taxes such as secondary tax on companies, donations tax, estate duty, transfer duty, customs duty, exercise duty and stamp duty (Deloitte and Touche, 2004, p 127-128).

In 2007, Venter and Clercq undertook research to determine the impact that the regulatory burden of the tax laws of the country has on management's resources in the

SMME business services sector. The research was undertaken with due acknowledgement of the improvements in the tax regulations relating to the SMME sector. For example, in the 2005 and 2006 budget reviews, the Minister of Finance announced changes in the tax legislation to enhance tax compliance by the SME sector by reducing the administrative burden on SME owners.

The Bureau of Market Research's Register of Business Services Establishments was used as a sample frame. To ensure that only SMMEs were selected from the sample frame, all large businesses that employed in excess of two hundred employees were excluded from the database. A systematic, disproportionate, stratified sampling approach was used to select two hundred businesses from the small business sector that responded to an interviewer administered paper-based questionnaire. One of the limitations of the study was that it was only conducted in Gauteng and on services businesses in the small business sector, and that the conclusions reached may not be applicable to KwaZulu-Natal.

However, several important observations can be made from this research. Firstly, it was found that many respondents in the small business sector outsource their tax requirements, sometimes at great expense. The following table illustrates some of the reasons for the small business sector outsourcing their taxation requirements:

**TABLE 3.5**  
**REASONS FOR OUTSOURCING TAXATION REQUIREMENTS**

Reason	SMME category		
	Micro (percent)	Small (percent)	Medium (percent)
Unskilled tax staff	32.6	28.8	12.0
Cheaper to outsource	23.9	18.6	4.0
Time factor	43.5	30.5	24.0

(Venter and Clercq 2007, p 85)

It is evident that the main reason for outsourcing is a lack of tax skills and time by the small business owner. Although many small business owners agreed that it was not the cheaper option to outsource their tax requirements, a lack of skills and available time resulted in them having little option but to outsource.

It is also evident that most small businesses seldom use the tax inputs/advice/information for management planning purposes. A reason suggested for this is that they do not have the required skills to utilise the advice as a required management tool or that they do not see the potential advantages of tax information to support business planning. Recent changes to the tax legislation relating to the small business sector have resulted in generous tax rates and significant advantages to the sector and a failure by the owners of small businesses to understand and apply these rules can result in significant losses in the form of tax benefits.

**TABLE 3.6**

**VALUE OF TAX OUTPUTS/ADVICE/INFORMATION**

Statements	SMME category		
	Micro (percent)	Small (percent)	Medium (percent)
Tax functions are only performed because they are compulsory	39.1	30.5	24.0
Inputs from tax staff/division/consultants are used for short-term tactical business planning	10.9	1.7	20.0
Inputs from tax staff/division/consultants are used for long-term strategic planning	10.9	18.6	28.0
Tax knowledge support effective management of income/ expenses	17.4	8.5	12.0
Information provided by tax advisors is important for the survival of the establishment	26.1	20.3	28.0

(Venter and Clercq, 2007,p86)

It is evident from Table 3.6 that the knowledge and information supplied to the sector is seldom used in long term planning and current operational activities.

One of the overall conclusions of the study was that improving tax skills and knowledge among the small business sector would lead to a more effective management of taxation functions. This outcome will ultimately result in cost savings and help to ensure that the entity survives in the long term. The investment in taxation skills will also reduce the costs of outsourcing (Venter and Clercq 2007, p72-87).

Although there has been a recent relaxation in the income tax requirements relating to the small business sector announced in the 2008 Budget Speech by the Minister of Finance, it is clear that a simplification of the tax laws does not remove the need for the small business sector to improve their tax skills and knowledge. Some business commentators have said that accounting is the language of business (Baker and Hayes,

introduction, 1980). If this is so, then taxation is an important aspect of learning the language, due to the implications that it has for business profitability and management.

### **3.5 SUMMARY OF CHAPTER**

In this chapter a review was performed of the accounting requirements for financial statements for SMEs in South Africa. It was evident that the regulations relating to the preparation of financial statements have been reduced and the process has been simplified to ease the regulatory burden on the small business owner. This simplification does not remove the need for companies operating in the SME sector to possess the skills to produce simpler, but equally important, financial statements that comply with IFRS and the Companies Act.

A review was also conducted of selected accounting skills that may optimise profitability in the SME sector. Given the extreme shortage of skills that is possessed by the SME sector, the focus was on those important skills that will have a major impact on the business's sustainability and growth. Accordingly, those skills that are considered to be vital are those needed to prepare balance sheets, income statements, cash flow statements and tax returns. The possession of these skills may contribute towards the optimisation of profitability. It is important, once again, to emphasise that the accounting skills form part of several other management skills that are required for the successful growth of the business. For example, successful entrepreneurs have been identified as those that have successfully supplemented their technical ability with additional skills such as communication, legal, economic, or strategic knowledge (Smith and Schallenkamp, 1998, p4).

In the following chapter, a review of those financial management skills needed by SMEs, will be performed. There is a great overlap between accounting and financial management and it is sometimes difficult to distinguish between accounting and financial management skills. The next chapter will focus on these important skills that help to optimise the profitability, growth and sustainability of businesses in the SME sector.

## **CHAPTER FOUR: REVIEW OF RELATED LITERATURE IN THE FIELD OF FINANCIAL MANAGEMENT SKILLS**

### **4.1 INTRODUCTION**

In the previous chapter, the distinction between accounting and financial management was highlighted. Accounting is the maintenance of a systematic set of financial records which are used later as a basis for meaningful reporting (Haiden, 2006, p1), whereas financial management focuses primarily on decision making with regard to investment and financing decisions of a business enterprise and, although linked to accounting, the primary objective is to create wealth (Correia, 2007, p28).

In Chapter Three, a review was conducted of those accounting skills that, if acquired by the SME sector, may improve the performance of the sector. For example, the skills required to prepare an income statement, cash flow statement, balance sheet and complete tax returns may contribute to the growth and viability of an SME.

In this chapter there will be a focus on those financial management skills that are required by the SME sector to optimise profitability of the sector. As financial management focuses specifically on the financing and investing activities of the firm (Atrill and McLaney, 2006, p2&15), this chapter will assess those skills needed to acquire and utilise funds in the business to meet the financial management goals, thereby enhancing the growth of the business.

In attempting to analyse the financial skills required by the SME sector, appropriate consideration has to be taken of the existing issues and difficulties that are experienced by sector, such as a lack of funds and management capacity. Therefore, those skills that are assessed as being important should be simple and easy to implement whilst making a substantial contribution to the positive performance of the sector. These skills include the preparation of business plans, cash budgeting, an analysis of financial statements and scenario planning.

Financial management decisions cannot be made in isolation from other business decisions and therefore, instead of only focusing on financial management skills, an attempt will be made to explain and assess the financial management skills needed in the context of the difficulties that have been experienced by SMEs to access funds to

grow the business. Such an approach results in the preparation of a business plan assuming the focal point of the chapter. Although these management

## **4.2 THE NEED FOR FINANCIAL MANAGEMENT SKILLS IN THE SME SECTOR**

Financial management is one of several functional areas of management. Other than the general management function, specific areas in the management process include marketing, production, sales and financial management, which are central to the success of any small enterprise (Meredith, 1986, p9).

Establishing or successfully growing an SME is not a simple task. Barely 40% of small firms survive intact to see their fifth birthday. Most of these failures occur within the first few years, and poor or no financial management is the most cited reason for a small firm getting into difficulties. Owners and managers also need to know what finance is available and how to put themselves in the best possible position to raise the finance needed (Barrow, 2001, p6-7). The possession of adequate financial management skills may assist SMEs in achieving this objective.

Meredith (1986, p6) identifies business crises experienced and skills that are required by entrepreneurs during the business life cycle. The seven crises that have been identified in the life cycle of a growing enterprise are:

1. the start-up crisis;
2. cash crisis;
3. delegation crisis;
4. leadership crisis;
5. finance crisis;
6. prosperity crisis; and,
7. management succession crisis (Meredith, 1986, p6).

In addition, the following six skills were suggested as being extremely important to the owner-manager:

1. Financial management;
2. Advertising and promotion skills;
3. Ability to use professional accountants effectively;
4. Cost and inventory control;

5. Pricing of products and services; and,
6. Ability to obtain funds for the enterprise.

Both these findings demonstrate the importance of financial management in the small enterprise (Meredith, 1986, p6). It is evident that the presence of financial management skills will contribute to the superior performance of the SME.

In a recent study into small firm bankruptcy (Carter and Van Auken, 2006, p493-512), research was undertaken into the demographics and potential problem areas of fifty-seven bankrupt firms and fifty-five non-bankrupt firms, in an attempt to identify root causes of bankruptcy in small firms. The research was conducted in Iowa by means of a survey that was sent to firms. The sample frame that was used for bankrupt firms was a list of bankrupt firms per the court filings and the sample frame that was used for the non-bankrupt firms was the client list of the Iowa state office of the Small Business Development Centre.

Although it is unlikely that the samples were representative of small businesses in the state, the results of the research indicate that, amongst others, issues relating to cash flow and financing were amongst the most important for firms in general. In addition, bankrupt firms rated cash flow and financing as being more significant problems than non-bankrupt firms. Another important issue that surfaced was that non-bankrupt firms are at least one and a half times more likely to find information and knowledge more important than firms that go bankrupt. The authors suggest that those firms that go bankrupt do not put the effort into improving their knowledge and skills as these may solve the problems faced (Carter and Van Auken, 2006, p509).

Given the emphasis on the cash flow management and financing aspects, it may be possible that an improvement in the financial management skills of the SME sector may contribute towards the solvency and ongoing sustainability of the SME sector.

The Global Entrepreneurship Monitor 2005, compiled by the University of Cape Town's Graduate School of Business, states that there has been a decline in the activity in the small business sector in South Africa, specifically relating to the level of new business creation. Some of the conclusions of the report are that:

- The entrepreneurial activity rate in South Africa ranks as one of the bottom four of the developing countries sampled;

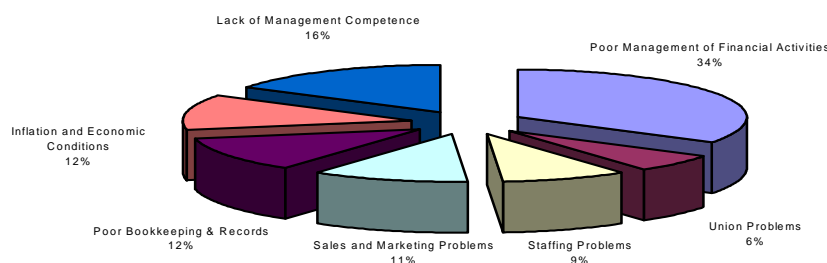
- With the exception of Mexico, start-up businesses are less likely to mature to become large firms in South Africa than in any other developing country sampled; and,
- The probability of a firm surviving beyond forty-two months is less likely in South Africa than in any other country sampled in 2005 (UCT, 2005, p21).

Although the sample that was used for the Global Entrepreneurship Monitor was small and therefore not representative, the findings are more of a qualitative and indicative nature. The views contained in the report therefore provide a useful barometer of the environment in which small businesses in South Africa operate (UCT, 2005, p11).

It has been established that the lack of knowledge of financial management contributes to the low prevalence of new venture creation and ultimately the high failure rate of South African SMEs (Kotze and Smith, 2008, p35) and limited access to finance has been cited as one of the main factors influencing the low level of entrepreneurship. One of the answers to this problem could be to provide financial management skills to empower individuals to effectively manage their finances in an attempt to increase entrepreneurship and decrease new business failures.

International research undertaken by Business Partners into reasons for the failure of SMEs indicates that poor management of financial activities contributes to 34% of SME failures.

**TABLE 4.1**  
**REASONS FOR SME FAILURE**



(Business Partners, 2007)

It is evident from the above illustration that any effort by the SME sector to improve their financial management skills will reduce the risk of business failure. It is also possible that an improvement of the financial management skills will contribute to the growth and sustainability of the sector.

In assessing those financial management skills that are required by the SME sector, consideration will be given to those basic skills that can be implemented in a cost effective manner and will have the maximum impact on the sector. The skills that have been assessed have therefore been limited to those that are required to raise finance (business planning) and to monitor the performance and utilisation of the funds of the entity (cash budgets and financial statement analysis).

### **4.3 BUSINESS PLANS**

#### **4.3.1 Business plans in the context of a strategic plan**

Many small businesses neglect the important aspect of strategic management because they may feel that the strategic management process is only applicable to large businesses. The failure to have a strategic plan may result in a failure to survive due to the importance of the strategic plan to assess realistically the businesses potential (Scarborough and Zimmer, 2003, p25).

Research undertaken in the United Kingdom (Peel and Bridge, 1998, p 848-856) in order to examine the relationship between strategic planning and business performance of the SME sector illustrates the importance of the strategic planning process.

The empirical research was undertaken by means of a survey of one hundred and fifty SMEs. The sample of companies used in the study was taken from the FAME CD-ROM UK corporate database in November 2007. A total of 1012 questionnaires were mailed to directors of firms that met the European Commission's definition of an SME. Of these firms 217 responded and only 150 were useable for the research. The questionnaire elicited information relating to business performance, environmental change, and the details of strategic practices adopted.

One of the primary policy implications that arose from the study was that a compelling case can be made for fostering a strategic planning methodology to improve the performance of the SME sector with the overall conclusion being that “ Strategic planning offers an integrating device in which the purpose of these initiatives can be more readily appreciated and in which the need to adopt technically sound principles of investment appraisals can be demonstrated as an aid to improving profitability and business performance in the long term” (Peel and Bridge, 1998, p 855).

Given the diverse challenges and obstacles that the SME is expected to encounter, it is vital that a strategic plan is developed in order to understand the challenges that are faced by the business and how it intends to address these challenges.

The strategic management process usually comprises the following steps:

1. Developing a clear vision and translating it into a meaningful mission statement;
2. Assessing the company’s strengths and weaknesses;
3. Scanning the environment for significant opportunities and threats facing the business;
4. Identification of the key factors for success in the business;
5. Analysing the competition;
6. Creating company goals and objectives;
7. Formulating strategic options and selecting the appropriate strategies;
8. Translating the strategic plan into an action plan; and,
9. Establishing accurate controls (Scarborough and Zimmer, 2003, p25).

There may be several important reasons for a business to prepare a business plan, such as the raising of finance. However, due to the importance of the business plan to the strategic planning process, SME owners may enjoy both strategic and operational benefits from the preparation of a business plan. The ability to secure funding from investors and banks constitutes a vital component of management skills and entrepreneurialism in an entity (Papulova, 2007, p6).

#### **4.3.2 Importance of business plans**

The following success story, extracted from the IFC’s SME Toolkit website, aptly illustrates the importance of a business plan for the SME sector:

*“Ms. Hasina Jahan is the CEO of a small business in Bangladesh that produces coir mattresses. She started off in a small way but her business grew quickly, and keeping up with the increasing demand for her product proved to be a challenge. In an experience-sharing session organized by the South Asia Enterprise Development Facility's Knowledge Centre at the Dhaka Chamber of Commerce and Industry, Hasina explained some of the challenges that her business was facing—chief among them was obtaining a bank loan.*

*Hasina had previously heard about a local bank that provides loans to SMEs without collateral. She went to the bank and spoke to a loan officer, who requested that she provide certain financial documents and a business plan. Fortunately, she already had the financial documents ready, and after soliciting suggestions from colleagues and friends, she quickly prepared an informal business plan. But after reviewing Hasina's documentation, the loan officer said he would be unable to give her the loan due to uncertainty that she would be able to repay it. Hasina left the bank feeling disheartened and unsure of what her next step should be.*

*It was at the Knowledge Center session that Hasina first heard about the SME Toolkit and its tools for assisting managers of small and medium enterprises in preparing a standard business plan. Hasina promptly returned to the Knowledge Center, where an associate guided her through the process of utilizing the SME Toolkit to create a formal business plan.*

*Shortly thereafter, Hasina's new business plan enabled her to obtain the loan of US\$2,000 that she needed. The loan provided a major boost to her business, and now Hasina is ready to apply for larger loans when she needs them”*

*(<http://www.smetoolkit.org/smetoolkit/en/content/en/136/Success-Story-A-Business-Planning-Success>)*

The above story aptly illustrates a common problem that is encountered by the small SME sector in South Africa. In Chapter One, it was noted that there are several financial institutions that have been established primarily to fund the small business sector in South Africa. However, many entrepreneurs have great difficulty in accessing these funds as they do not have the skills to provide the information that is required by the

financiers. Due to the lack of financial management skills, they are unable to demonstrate the funding need and the ability of the business to repay the funds.

The above scenario also appears to be consistent **with literature reviewed in this thesis**, which suggest that a lack of access to finance may be caused by the SMEs sector's inability to prepare business plans. Examples of this include:

- Many surveys indicate that there is a lack of debt and equity funding to finance the business operation of the small business owner, especially in the start-up phase. Although there are many sources of commercial and development finance available, small business owners often either do not have the security to obtain the funding or the skills required to access the funding. This lack of skills results in the preparation of poor business plans and feasibility studies that are required by business funders (Baumback and Lawyer, 1979, p22-p30);
- Many entrepreneurs and owners of emerging and start-up small businesses perceive the lack of access to finance as the major obstacle to the growth and development of their business. Often this belief is misplaced as it obscures the shortcomings of the entrepreneur, the business concept and the management structures of the enterprise concerned (SACOB, 1999, p12);
- Of particular interest were observations that the following aspects were perceived as potential constraints to the SME sector:
  - Cash flow stress
  - Lack of access to capital for cash flow expansion
  - Lack of management skills
  - Competition (Clover and Darroch, 2005, p 238-263); and,
- The research confirmed previous observations that a lack of start-up capital is the major problem among entrepreneurs as approximately 80% of the sample indicated that this is a problem. It is important to note that the researcher has concluded that further research be conducted into “certain skills that are a prerequisite for a successful application for finance such as bookkeeping, cash flow management and drafting of business plans. Further research could be conducted into how banks/government could impart these skills to the potential entrepreneur” (Mutezo, 2003, p93).

The above reviews demonstrate the usefulness of the business plan in improving access to finance and therefore the success of the SME sector.

The importance of skills required to prepare business plans also appears to be supported by recent research undertaken in order to assess the value of preparing business plans for new ventures (Liao and Gartner, 2007, p2-21) and specifically to determine whether business planning improves the chances of starting a new business. The key findings of the research were that:

- Entrepreneurs who complete a business plan are six times more likely to get into business than those entrepreneurs who don't complete a business plan; and,
- The overall recommendation is that when starting a new business, a business plan must be completed (Liao and Gartner, 2007, p18).

Other research undertaken in the United Kingdom (Wardle, Watts and Richbell, 2006, p496-514) to determine the extent of business planning amongst the owners/managers of small firms indicated that business planning was relatively underdeveloped in the SME sector.

Given the lack of proper business planning, it may be possible that an increase in the tendency to plan properly may result in a superior financial performance by the SME sector.

#### **4.3.3 Elements of business plans**

A well-researched business plan is the foundation upon which the financial success of a business depends and can be used as a business tool for the owner and other stakeholders. The construction of a business plan normally has the following benefits:

- It tests the validity of the business ideas; and,
- It provides the overview of the financial requirements (Barrow, 2001, p10).

In addition to these benefits, the preparation of a thorough business plan is a vital process to accessing funding for the SME sector. The prepared business plan should be able to convince an investor or a lender that the risk of investing or lending funds to the business is low and that reasonable returns will compensate them for taking the risk (Bragg and Burton, 2006, p175).

It is a primary requirement of most providers of funding to the SME sector that a detailed business plan accompanies the application for finance. For example, the websites of the Industrial Development Council, Ithala and ABSA specifically request

that a business plan is submitted when applying for funding. The acquisition of the financial management skills required to prepare a business plan may therefore contribute to the growth and viability of the SME sector.

Depending on the needs of the business and the reasons for which a business plan has been prepared, there are various formats that can be used in the preparation of a business plan. The following suggested format might be used when preparing a business plan for businesses in the SME sector:

- **Executive summary**

The executive summary is a brief overview of the plan and contains a synopsis of the entire plan. The summary should highlight the key advantages that are possessed by the business and briefly describe the business, management, market and the financial needs and the ability to repay the loan (Scarborough and Zimmer, 2003, p162).

The executive summary may be considered to be the most important aspect of the business plan and has to sell the business strategy to the potential investor. Although the executive summary is the first section of the business plan, it should be the last section written so that it summarises and highlights important aspects of the plan (Business Partners, 2008, p1).

From a financial management perspective, the preparation of a summary of the business can be useful in providing an overview to the owner of the financial resources and skills needed to fulfil the business strategy of the entity.

- **Business Overview**

It is important that the overall mission of the business is clearly defined so that the owner will understand the reason for establishing the business, the business deliverables and the overall business objectives (Wickham, 2004, p322).

It is important that the owner understands and has a clear vision of the entity's future and can demonstrate how the entity will be different from the competition in the marketplace (Adams, 2002, p77). This can be achieved by including a business profile relating to the background and history of the organisation and the company's long and short-term objectives in terms of business growth and development (Business Partners, 2008, p1-2).

The business overview may also contain very brief financial information relating to the historical business performance and a table may be included that provides annual figures of sales, gross profit, gross profit as a percentage of sales, operating costs by key areas, interest paid and net income before tax (Stutely, 2002, p60-61).

- **Company management**

The most important aspect of the success of a business venture is the management of the business. Therefore, the business plan must provide a brief description of the skills and experience of the entrepreneurs, covering the key areas of technology and product development, production, sales, marketing, finance and administration and the management structure of the business (Scarborough and Zimmer, 2003, p169).

This section should also include an organisational structure with brief CVs of key staff members. Details of consultants and advisors, such as accountants and attorneys, should be included (Business Partners, 2008, p2).

It is important that this section demonstrates that the skills that are needed to achieve the operational and strategic objectives of the entity are available to the business. Accordingly, a plan can be devised to address any skills that are required by the business in order to meet its strategic and operational objectives (Bird, 2004, p78).

- **The market**

An overall synopsis of the market provides context to the business and the business plan and facilitates an understanding of the market or the industry in which the SME operates (Adams, 2002, p85).

This section should summarise the industry in which the business will compete and should include aspects such as current trends and developments in the industry, industry segmentation, problems the industry might be experiencing and national or global events influencing the industry ([www.idc.co.za/brochoures/generic.pdf](http://www.idc.co.za/brochoures/generic.pdf)).

The business plan must also describe the existing market and its potential for growth, including a detailed analysis of the size and maturity of the market, trends and seasonality exhibited by the market, and the business's current and expected market

share, together with an analysis of the time, resources and actions required to achieve this desired market share (Wickham, 2004, p323).

It is important that any claims relating to the market are borne out of research and that vague and generalised claims are not included (Scarborough and Zimmer, 2003, p167).

- **Financial Projections**

To potential investors and lenders, **the financial projections represent the most important part of the business plan** and a decision to lend or invest is usually based on the financial projections (Scarborough and Zimmer, 2003, p170).

The section should include a summary of the financial statements and projections. It should include a summary of operating budgets, cash flow projections, income statements and balance sheets for at least three years, as well as a formulation of the capital needs of the business (Business Partners, 2008, p3). It is important that the financial projections clearly demonstrate and quantify the funding needs of the business and, more importantly, the ability of the business to repay these funds.

The significance of this section of the business plan highlights the importance of financial management skills, as financial management skills are required in order to prepare cash budgets and to determine the future financial needs of the business.

It is important that the entire business plan be concise and should range between 25-50 pages in length (Scarborough and Zimmer, 2003, p162).

As the business plan will be used by financiers, it is important that the plan is presented in a professional manner, by ensuring that:

- The layout of the business plan is in logical and sensible sequence, and that the potential financier will be able to obtain a sufficient understanding of the business for the purposes of funding the business;
- The plan is flexible to accommodate any changes in financial assumptions that are required as a result of changes to the business environment;
- The financial goals set in the business plan are specific and concrete, measurable, time-related, realistic and attainable;
- There is an appropriate focus on the financial viability, the market and the needs of the potential investor or creditor;

- There are sound projections with regard to sales, growth and profit expectations; and,
- The plan adequately explains the mechanisms for financial record keeping, cash control, purchasing records, inventory control and credit control.

(O Neill, 1999, p105-115)

In summary, the difficulties experienced by the SME sector to access funds can be reduced by the preparation of a sound business plan. The possession of skills that are required to prepare business plans may contribute to the optimal performance of the SME sector due to the assistance that the plan provides in terms of raising funds and the strategic benefits to the sector.

#### **4.4 CASH BUDGETING**

The review of the accounting skills that are required by the SME sector to improve their profitability and performance in Chapter Three, highlighted the importance of the preparation of a cash flow statement. The cash flow statement is prepared in order to account for the cash received and utilised by the entity. A shortcoming is that it is prepared for recordkeeping purposes and therefore cannot be used to anticipate the future cash requirements of the business. In keeping with the description of financial management skills, i.e. to ensure that the funds of the business are used properly, it is important that optimal usage is made of the cash resources of the business. An assessment will be made of the preparation of a cash budget to achieve this objective.

It is almost self evident that cash is critical to any small business and the proper management of cash resources ensures that there is adequate cash to meet the needs of the enterprise (Meredith, 1986, p236).

In addition to the operational emphasis, it has been found that a focus on cash management can create value to a business from a long-term perspective (Solano and Tereul, 2007, p176), thereby enhancing the value of the enterprise.

Research was conducted in South Africa of selected problems encountered by small business in the Nelson Mandela, Cape Town and Egoli Metropolises (Van Eden, Viviers and Venter,,2003, p13-23) to establish the extent that small businesses owners

experience selected problems as negatively influencing the success of their business. The research was conducted on one thousand and thirty eight small businesses in the Nelson Mandela, Cape Town and Egoli Metropolises in South Africa. Judgemental sampling was used as a basis to select a sample whereby the researchers used their discretion to select businesses that met the criteria that they stipulated to be a small business, which was to employ fewer than fifty people.

One of the findings, which support the earlier literature review, was that poor cash flow management was a threat to the small business sector (Eden, Viviers, Venter, 2003, p 17). This research is consistent with the views of many researchers and business commentators who feel that cash flow problems represent a major constraint to the growth of a small business. One reason for cash flow problems is that “one of the characteristics that most new or small businesses have in common is a tendency to change their size and shape very quickly” (Barrow, 1988. p39). Such changes in size and shape, for example an increase in turnover, stock or debtors require significant cash inflows into the business.

In an effort to maximise their profits and growth, it is important that small businesses have the required skills to anticipate future cash flow requirements and plan accordingly. Due to the lack of proper financial skills, there is often a lack of appreciation that profits do not result in cash in the bank. Many expanding businesses see profits tied up in stock, debtors and in capital equipment (Taylor, P. 2003, p135). This observation appears to be supported by earlier observations on conditions that are unique to small businesses, i.e:

- Increases in demand for the products of small businesses occur in discrete steps of considerable size relative to turnover. Hence turnover increases in sudden jumps rather than a continuous process; and,
- Increases in the supply of a firm’s product often require outlays which are large in relation to its capital base (Barber, Metcalf, Portteous, 1989, p41).

Whilst the preparation of financial statements, including the cash flow statement, is important to the business, they are prepared on a historical basis and the information contained therein is a recording of past events. These financial statements are therefore insufficient to forecast or predict a cash flow shortage. It is important that small business employ formalised practices in order to estimate their cash flow requirements

and plan accordingly, so that they have a clear understanding of the direction that the business is taking.

A common technique that is employed by many organisations to successfully manage their cash flows and anticipate their future needs is the use of a cash budget. A budget should be the most important tool for any owner or manager as it supplies information on the specifics of orders, sales, profits and cash and accordingly it gives a sense of reality to the company's objectives and strategies (Brown, 1995, p40). A budget is a summary of future inflows against anticipated outflows. The preparation of a budget is a simple, logical process and its benefits cannot be overestimated by the small business.

By considering the timing of all cash receipts and cash payments, the cash budget will reveal when there are cash shortages and surpluses and it will allow the firm to plan and know how it will acquire its resources (Correia, 2008, p422). Ultimately the cash budget can be used for the objective of financial management, which is to acquire and utilise its resources. The following table illustrates the format of a cash budget that can be used by the SME sector:

**TABLE 4.2**  
**FORMAT FOR A CASH BUDGET FOR THE SME SECTOR**

	<b>Expected Cash Flow</b>
Beginning Cash Balance	-
Cash Inflows (Income):	
Accts. Rec. Collections	-
Loan Proceeds	-
Sales & Receipts	-
Other:	
Total Cash Inflows	-
Available Cash Balance	-
Cash Outflows (Expenses):	
Subtotal	-
Other Cash Out Flows:	
Subtotal	-
Total Cash Outflows	-
Ending Cash Balance	-

(<http://www.smetoolkit.org/smetoolkit/en/content/en/751/Cash-Flow-Sensitivity-Analysis-Worksheet>)

Preparation of the above cash budget provides an effective tool for the SME sector to monitor and control its cash resources. Due to its importance and simplicity, management may even consider preparing a cash budget at least on a monthly basis.

In summary, given the severity of cash flow problems, and the number of businesses that have failed due to a lack of adequate cash flows, it is important that the small business sector obtain the necessary skills to prepare budgets so that future cash flows are anticipated and, if necessary, identify measures for corrective action.

#### **4.5 ANALYSIS OF FINANCIAL STATEMENTS**

Financial statements are prepared in a small business, as in any other business, in order to provide useful information to a variety of users. In Chapter Three, an assessment of accounting skills required by the SME sector highlighted the need for the preparation of an income statement and a balance sheet. In order for these financial statements to be useful to the SME, they need to be:

- Understandable;
- Relevant;
- Reliable; and
- Timely.

(SAICA, 2007, p5)

Although the preparation of financial statements is important and should meet the above characteristics, the entrepreneur needs skills to analyse the financial statements so that they can be used in the decision-making process. Therefore, in addition to preparing annual financial statements, small business should possess the necessary skills to review and analyse these financial statements as it is mainly during the review process that information can be obtained relating to the business operations.

The overall objective of financial statement analysis is to examine a firm's financial position and returns in relation to risk, with a view to forecasting the firm's future. (Correia, 2007, 5-5). The analysis can be used to determine various aspects of the financial position and performance and can be used for planning and control purposes by the small business owner (Atrill and McLaney, 2006, p167).

The link between financial statement analysis and the preparation of financial statements is important as the analysis depends on the quality of information that is obtained from the financial statements. Although the categorisation of the analysis is subjective, in most cases the analysis is undertaken in order to analyse the following main areas of the firm's performance:

- Profitability - the extent to which the business generates profits in order to provide a satisfactory return to its owner;
- Liquidity - the ability of the business to meet its financial obligations on a short term basis;
- Efficiency - the efficiency with which financial resources that are invested in the business are utilised; and
- Capital Structure - the extent to which the businesses' financial equity structure will provide it with a basis to grow and achieve profits.

(Mautz and Angell, 2006, p27)

The following table summarises the various financial ratios that can be produced by a small business:

**TABLE 4.3**  
**FINANCIAL RATIO DEFINITIONS**

<b>FINANCIAL RATIO</b>	<b>DEFINITION</b>
Current Ratio	Current Assets / Current Liabilities
Quick Ratio(Liquidity Ratio)	(Cash+Marketable Sec+ Acc. Rec.) / Current Liabilities
Absolute Liquidity	(Cash+Banks+Marketable Sec.+Acc. Rec.) / Current Liabilities
Inventories to Current Assets	Total Inventories / Current Assets
Debt Ratio	Total Debt / Total Assets
Current Liabilities to Total Liabilities	Current Liabilities to Total Liabilities
Long Term Liabilities to Total Liabilities	Long Term Liabilities to Total Liabilities
Equity to Assets Ratio	Total Equity / Total Assets
Current Assets Turnover Rate	Net Revenues / Current Assets
Fixed Assets Turnover Rate	Net Revenues / Fixed Assets
Total Assets Turnover Rate	Net Revenues / Total Assets
Days in Accounts Receivables	Net Accounts Receivable / (Net Revenues/365)
Inventories Turnover Rate	Net Revenues / Average Inventories
Equity Turnover Rate	Net Revenues / Equity
Profit Margin	Net Income / Total Margin
Return on Equity	Net Income / Total Equity
Return on Assets	Net Income / Total Assets

(Ozgulbas, 2006. p315)

Each of the ratios contained in the above table is useful in providing synopsis of the business. For example, profitability ratios, such as the net profit margin and the gross profit margin, can provide the owner of the business with information in relation to the adequacy of his mark-up and the extent to which expenses should be reduced. If there are difficulties that are experienced by competitors, as demonstrated by previous research in Chapter Two, the ratio can be used to analyse if margins are excessive and the necessary adjustments that need to be made.

Some of the more important ratios that can be used by management are:

- The current ratio - As demonstrated in table 4.3, this ratio provides information on the ability of the entity's current assets to meet the current liabilities;
- The quick ratio - this ratio is similar to the current ratio except that it provides information on the ability of current assets, excluding stock, to repay the current liabilities of the entity. The ratio is important as it is sometimes difficult to convert stock to cash;
- The debt ratio - This ratio provides information on the extent to which the assets have been financed by debt.

(Slater, 1981, p56-61)

Research has also indicated that small business view cash flow problems as a major threat (see page in Chapter Two). The utilisation of liquidity ratios could be of vital assistance to small business owners to determine the cash flow position and hence the ability of the business to settle its obligations. Research conducted in America, on the use of financial statement analysis in the small business sector, has also indicated that for many small businesses the users of financial statements are creditors and potential creditors, and that these users tend to focus more on the businesses' ability to meet its debt obligations rather than an analysis of profitability (Ivancevich, 1997, p25). The liquidity ratios appearing in Table 4.3 may therefore be used by the small business in order to assess the liquidity of the business and to take appropriate action if problems are highlighted by the analysis.

Research was undertaken in the SME sector in Turkey, on SME firms that were listed on the Istanbul Stock Exchange, in order to determine the performance of these SMEs based on a financial ratio analysis. The sample frame that was used for the survey was the listed firms that meet the definition of an SME (i.e. an annual turnover of less than

forty million Euros). Although there were two hundred and eighty-one firms that were listed on the Istanbul Stock Exchange, only one hundred and thirty-five met the selection criteria. The intention of the research was to perform a financial and ratio analysis on the financial statements, in order to measure the financial performance of the SME sector that was listed. One of the conclusions of the research was the importance of the return on equity (RoE) ratio to the SME sector in the sample. It was found that the RoE ratio may be used as a sole indicator to determine the financial performance of a business. Therefore, the small business sector should incorporate this ratio into their calculation and analysis (Ozgulbas, 2006, p319). Although there may appear to be a contradiction relating to the importance of the ratios, it does appear that both the liquidity ratios and the return on equity are important and that they may be used by the SME sector to analyse the profitability and liquidity of the business.

In summary, due to the importance of financial statements and their subsequent use, it is vital that business owners possess the necessary skills and expertise not only to prepare these financial statements, but also to use them as a tool to evaluate the performance of their business. Possession of financial analysis skills will enable business owners to undertake such an evaluation so that they have a broad understanding of the business variables that influence their entity.

#### **4.6 SCENARIO PLANNING**

It is a common objective of entities operating in the SME sector to grow and expand the business by improving their profitability. The possession of financial management skills, highlighted in this chapter, may enhance the ability of the sector to achieve this objective. These skills, when complemented with the accounting skills assessed in Chapter Three, have the potential to improve the financial performance of the SME sector and thereby contribute to the objective of growth and expansion.

Although the possession of these skills is considered important, the SME sector should also consider the impact of the changing business environment and the effect that these changes will have on small and medium sized businesses. Small and medium sized business owners should ensure they possess the necessary skills to become aware of new business trends and that they are involved in a continuous process to reconfigure and adapt to changing conditions (Burt and Van Der Heijden, 2003, p1012).

Given the fluid state of the economy and the volatility that is experienced in economic variables, such as inflation, interest and exchange rates, it is also important that the SME sector is able to anticipate the effect of the changes and to plan accordingly.

The SME sector cannot operate in isolation and the success of the sector will be dependent on businesses understanding and positively responding to social, economic and political change in the environment.

#### **4.7 SUMMARY OF CHAPTER**

In this chapter, an assessment was conducted of those financial management skills that may contribute to the superior performance of the SME sector. This included the skills that are needed to prepare business plans, cash budgets and analyse financial statements. Given the financial difficulties that are experienced by the SME sector, the possession of these skills may result in the improved managerial ability and capacity of the sector.

These financial management skills, when complemented by the accounting skills assessed as being important in Chapter Three, have the potential to improve the managerial capacity and performance of the SME sector. The availability of these skills will also have the effect of achieving other positive social and economic consequences, such as the reduction of unemployment.

Having concluded the literary review relating to the accounting and financial skills in the SME sector, the next chapter relates to the research methodology that will be required to analyse the needs of the sector in KwaZulu-Natal against those skills that were determined to be important.

The objective of Chapter Five will be to devise a research methodology to obtain information relating to the existence of accounting and financial management skills in the SME sector in KwaZulu-Natal.

## **CHAPTER FIVE: RESEARCH METHODOLOGY**

### **5.1 INTRODUCTION**

Due to the possibility that financial management and accounting skills can contribute to the improved performance and profitability of the SME sector, the literary review in Chapters Three and Four therefore focused on certain accounting and financial management skills that may contribute to these objectives. It was found that there are certain basic accounting skills, such as the preparation of an income statement, balance sheet, cash flow statement and income tax returns, that may contribute to this objective. In addition, it was also found that the possession of certain financial management skills, such as the skills required to prepare business plans, cash budgets and to analyse financial statements, can also contribute to this.

The preceding chapters have highlighted various accounting and financial management skills that can be utilised by the SME sector to improve the profitability of the sector and therefore overcome some of the problems and difficulties that were highlighted in the literary review.

In this chapter, a methodology will be designed to undertake a needs analysis of the accounting and financial management skills in the SME sector in KwaZulu-Natal in order to determine if this is an area that requires urgent attention.

The design of a research project refers to a broad plan that illustrates the main features of the study (Spatz and Kardas, 2008, p44). The chapter will therefore focus on designing a plan to empirically analyse the financial management and accounting skills needs in KwaZulu-Natal. The important aspects of the plan include:

- The research problem;
- Research objectives;
- Nature of the research;
- Sample frame;
- Data collection method; and,
- Data analysis.

## **5.2 RESEARCH PROBLEM**

To determine and evaluate accounting and financial management skills needed by the SME sector in KwaZulu-Natal.

## **5.3 RESEARCH OBJECTIVES**

The objective of this thesis is to perform a needs analysis of financial management and accounting skills in the SME sector in KwaZulu-Natal by:

1. Adequately defining an SME in the context of the business environment in South Africa (Chapter Two);
2. Analysing the local business environment in KwaZulu-Natal and to determine the performance of the sector, with a view to identifying some of the problems encountered by SMEs in the province (Chapter Two);
3. Research and consideration of the specific accounting and financial management skills needed by the small business sector in South Africa (Chapters Three and Four): and,
4. Analysing the availability of accounting and financial management skills in the SME sector in KwaZulu-Natal by empirical research and to evaluate whether there is a need to improve the financial management and accounting skills in the province (Chapter Six).

## **5.4 NATURE OF THE RESEARCH**

There are two main approaches to researching and obtaining data on the subject matter being analysed. The first method is a positivist approach and involves a scientific method to observe and objectively measure the subject matter. This approach is also known as a quantitative approach. The other main approach is the anti-positivist one whereby it is felt that it is inappropriate to follow strict natural-scientific methods when collecting and interpreting data. This approach is known as the qualitative approach (Welman, Kruger, Mitchell, 2005, p6-7).

A key distinction between the quantitative and qualitative approaches is that qualitative research tends to be associated with subject responses, narratives or observation data to identify themes, whereas quantitative analysis tends to be associated with numbers and variables (Kumar, 2005, p18).

Research designs may therefore be broadly classified as exploratory (qualitative) or conclusive (quantitative). The primary objective of exploratory research is to provide insights into and an understanding of the problem confronting the researcher. Exploratory research can be used in cases where a researcher may need to identify a relevant course of action or gain additional insights. The sample is selected to generate maximum insights and is small and non-representative, for example personal interviews with industry experts (Malhotra, 2004, p75).

Some of the prior research undertaken into the SME sector in KwaZulu-Natal indicates that most of the research has been of a quantitative nature. Examples of the research undertaken are:

**TABLE 5.1**  
**PREVIOUS RESEARCH INTO THE SME SECTOR IN SOUTH AFRICA**

<b><u>RESEARCHER</u></b>	<b><u>THESIS</u></b>	<b><u>RESEARCH METHODOLOGY, SAMPLING METHOD AND SAMPLE SIZE</u></b>	<b><u>LIMITATIONS</u></b>
Soni, S	M Com – An investigation into the key growth factors for small Indian retailers in some of the previous group areas of Pietermaritzburg: The role of marketing	Quantitative research utilising a sample size of one hundred judgmentally selected businesses from a sample frame of one hundred and fifty-five businesses that was constructed for the area being studied.	<ul style="list-style-type: none"> <li>• The study was unique to Indian retailers and therefore its findings may not be applicable to other businesses</li> <li>• Businesses did not want to provide financial information which they perceived to be confidential</li> </ul>
Cronje, A	M Com –Funding SMEs	Quantitative study, randomly selecting	<ul style="list-style-type: none"> <li>• Poor response rate, only sixty responses</li> </ul>

	in the KZN Midlands Region	two hundred small business owners from the Howick Chamber of Commerce's one thousand two hundred and forty-one members.	were received and the sample size was inadequate to make generalisations about the entire SME sector <ul style="list-style-type: none"> <li>• The survey was restricted to Pietermaritzburg and surrounding areas due to financial constraints</li> </ul>
Mutezo, A	M Com – Obstacles in the access to SMME finance: An empirical perspective in Tshwane	Quantitative research using the Braby's Database (2002) to extract a sample of six hundred businesses to obtain a 95% confidence level. A questionnaire was used and sent to each of the businesses	<ul style="list-style-type: none"> <li>• The use of an electronic questionnaire was problematic as many entrepreneurs did not have access to email facilities or were not computer literate in order to complete the questionnaire</li> </ul>
Ormond, K	M Com – Management development in small business with special reference to the South African formal manufacturing sector	Quantitative methodology using a sample frame of the manufacturing concerns in South Africa that have one hundred or fewer employees, extracted from the Bureau of Market Research (UNISA). A representative	<ul style="list-style-type: none"> <li>• The responses from small business managers were based on their perceptions and awareness of issues raised and therefore the answers were not necessarily objective</li> <li>• The accuracy of each response was</li> </ul>

		sample whereby every 30 <sup>th</sup> name from the list was selected resulting in a sample size of 324 firms.	dependant on each manager's willingness to discuss the business problems experienced.
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Although the above research reviewed is in no way representative of all research undertaken into the SME sector in KwaZulu-Natal, there is an indication that most of the local research relating to the SME sector is based on a quantitative methodology, and it is indicative of the researcher trying to record and measure the issues affecting the sector. However, considering some of the limitations of the above research, such as the ability of the business manager to answer questions and the issue of confidentiality of financial information, it may be more appropriate to consider a different approach from those used.

The use of a quantitative approach for research into the small business sector appears to be at odds with Hill and Wright who argue that existing research models for the SME sector need to be modified because their circumstances are different from existing companies. They argue that whilst quantitative research provides objective measures for the treatment of data, large sample and the statistical validation for a study, it has been criticized for ignoring the complex issue of attitudes and feelings. Therefore, the authors advocate a qualitative paradigm for research into the SME sector. An advantage of this approach is that it enables researchers to recognise the individuality, personality and attributes of the subject matter (Hill and Wright, 2001, p432-443).

This reasoning is consistent with observations in the literature review wherein it was stated that the question, "Is small business just a 'small' big business or is it something else?" (Dewhurst, J and Burns, P, 1983, p3) could be answered by the fact that unique qualitative aspects in the definition demonstrate that the operation and management of the business is different from a 'small' big business.

The use of a qualitative research methodology appears to be supported by an evaluation of current research into small business and entrepreneurship. Undertaking an analysis of 185 papers submitted for the 28<sup>th</sup> Annual Institute of Small Business and Entrepreneurship conference in November 2005, Ritchie and Lam (2005) found that 62

papers (34%) employed a qualitative research approach as opposed to 22 (11%) papers that employed a quantitative approach. The following table summarises the findings:

**TABLE 5.2**

**SME RESEARCH APPROACH/METHODOLOGY**

	<b><u>NUMBER</u></b>	
	<b><u>OF</u></b>	
	<b><u>PAPERS</u></b>	<b><u>%</u></b>
Conceptual Framework	9	5%
Literature Review	20	11%
Practitioner evaluation study	27	15%
Quantitative Study	22	12%
Qualitative Study	62	34%
Qualitative/quantitative mixed study	45	24%
	<b>185</b>	<b>100%</b>

(Lam and Ritchie, 2005, p324)

Based on the above findings, it is evident that, depending on the nature of the problem being researched, a qualitative methodology may be appropriate in research undertaken into the small and medium sized business sector. However, it is also important to note that, irrespective of the approach adopted, the authors have cautioned that the method utilised must be fully understood and that a thorough understanding must be obtained of the limitations and possible problems associated with using the chosen methodology (Lam and Ritchie, 2005, p324).

Due to the social, political and economic importance of the SME sector to the South African economy, there may be contrasting perspectives relating to the financial management and accounting needs of the sector. Conducting qualitative research will allow for these multiple perspectives to be highlighted. (Leedy and Ormod, 2005, p133).

In conducting exploratory research insights, ideas and opinions can be collected from individuals with knowledge and experience of the problem. The technique is becoming popular and is very important for business and management researchers. In addition, much masters and doctoral research work has been conducted using a qualitative method (Mkocha, 2005, p141).

Some of the characteristics of a qualitative research methodology are:

- The research implies an emphasis on processes and meanings that are not rigorously examined or measured in terms of quantity, amount or frequency;
- The aim of qualitative research is to establish the socially constructed nature of reality, to stress the relationship between researcher and the object of study, as well as to emphasise the value laden nature of the enquiry;
- Qualitative researchers try to achieve an insider's view and, by talking to subjects or observing their behaviour in a subjective way, they believe that first hand experience of the object under investigation produces the best data;
- Qualitative researchers work with the dynamic and changeable nature of reality; and,
- Qualitative research involves small samples of people, studied by means of in-depth methods.

(Welman, Kruger, Mitchell, 2005, p9)

One of the reasons for conducting qualitative research is that it is not always possible to obtain information from respondents, as people may be unwilling or unable to answer certain questions. In such situations, the desired information can be obtained through qualitative research (Malhotra, 2004, p138). The literature review indicated that there are indeed several accounting and financial management difficulties in the SME sector, such as a lack of knowledge relating to the accounting and financial management skills, and it may therefore not be prudent to devise a research strategy based on information obtained from business owners.

Given the complexities of managing an SME and the potential contribution that it can make to the economic, political and social landscape, it may be more appropriate to undertake quantitative based research design with an element of qualitative research to adequately explore and describe the accounting and financial management skills needs of the SME sector in KwaZulu-Natal.

This objective can be achieved by the design of a questionnaire that will be administered by an interview. The use of the Likert Scale in the questionnaire will enable responses to be analysed using quantitative statistical techniques and descriptive statistics.

Polit and Hungler (1995) define quantitative research as a systematic collection of numerical information and analysis of that information using statistical procedures. This means that the data are measured in numbers. According to Lee (1999), quantitative research is taken to mean deductive, theory testing, objective and positivist processes. The descriptive statistics, such as the mean, mode, median and standard deviation, just to name a few, will be used to describe and summarize the data obtained from the respondents. Inferential statistics, such as the correlation analysis, will be carried out to ascertain any relationships between two or more variables related to stress, amidst other tests, such as the one-way analysis of variance (ANOVA).

In order to ensure that the interviewees are able to contribute to the qualitative aspect of the research, the questionnaire will allow for comments and opinions to be made by interviewees.

## **5.5 SAMPLE FRAME**

One of the difficulties of identifying an appropriate sample frame relating to the SME sector is a lack of a comprehensive database of SMEs. Although there is little doubt of their relative importance to the country, the statistical base of small businesses in South Africa is poor (Department of Trade and Industry, 1995, p9). This has resulted in insufficient data to accurately categorise and identify businesses as belonging to the sector.

In KwaZulu-Natal, a similar problem exists in that a database of businesses belonging to the SME sector does not exist. Although there are several Business Chambers of Commerce in cities such as Pietermaritzburg and Durban, these lists are not comprehensive and therefore may not be representative of the SME sector.

Alberts (2004) explored the effect that financing of the small business has had on the success of the sector in the KwaZulu-Natal Midlands region by randomly selecting two hundred small business owners from the Howick Chamber of Commerce's membership list. However, it is extremely difficult to ascertain if the membership meet the criteria of an SME that was adopted in Chapter Two. In addition, there are many businesses that may have failed due to insufficient financial management, accounting or other skills that may not be on the membership list. There may also be several SME companies that are not members of the Chamber of Commerce.

Mutezo (2005) undertook quantitative research into obstacles in accessing finance in the SMME sector using the Braby's Database to extract a sample of six hundred businesses. Her thesis duly acknowledged the limitation of using the database as a sample frame due to the issues highlighted in the above paragraph.

The lack of an appropriate sample frame, combined with issues relating to:

- Client confidentiality - Many owners of SMEs are reluctant to provide financial information as they regard this as being strictly confidential (Soni, S, 1999, P7.21);
- A lack of skills by the SME sector to fully comprehend and understand accounting and financial management issues. The literature review highlighted the lack of financial skills and its contribution to business failure. It is possible that because of the lack of financial skills, owners of SMEs may not be able to answer research questions included in the questionnaire or may not have the necessary skills to determine their needs due to the high rate of business failure; and,
- Lack of appropriate infrastructure and resources - Many entrepreneurs do not have access to email facilities or are not computer literate to complete the questionnaire Mutezo (2005)

necessitates the use of industry experts in order to analyse the accounting and financial management needs of the SME sector in KwaZulu-Natal.

An example of the use of industry experts is research undertaken by Stainbank and Wells (2005, p51-65) who researched the appropriateness of differential reporting in South Africa, i.e. reporting that deviates from the requirements of the Companies Act to prepare financial statements in accordance with GAAP. The research highlighted the high cost of compliance by companies, frequently for very little benefit to the users of financial statements. Such a situation is common to many SME owners that spend large resources with little perceived benefits from the financial statements.

The research, undertaken in 2004, consisted of a questionnaire that was posted to a simple random sample of three hundred and fifty-three registered accountants and auditors, taken from the total population of approximately four thousand practitioners that were listed in the Public Accountant's Auditor's Board on 31 March 2002. Although a limitation of the study appears to be a lack of feedback from business

owners, the Registered Accountants and Auditors, considered to be industry experts, were utilised due to the fact that:

- They are exclusively qualified to perform the audit function on South African companies;
- They are familiar with South African accounting requirements; and,
- They have an understanding of their clients' accounting needs.

(Stainbank and Wells, 2005, p51-65)

In addition to industry experts being more knowledgeable about the accounting and financial management skills issues, they may also be able to be more open about issues faced by the SME sector. Many owners of SMEs are reluctant to provide financial information as they regard this as being strictly confidential (Soni, S, 1999, p7.21). It may therefore be difficult to engage with the owner in terms of entity profitability and turnover and may be impossible to obtain an indication of the impact that financial management and accounting skills have on the profitability and growth of the entity. Furthermore, the use of industry experts and people that are knowledgeable of the SME sector may be able to provide a broader perspective on the sector.

In summary, the research will focus on obtaining feedback from industry experts because:

- SME owners/managers may not have the necessary skills to analyse their needs;
- They may not want to provide financial information due to confidentiality; and,
- Industry experts may be more knowledgeable of the needs of the sector as a result of them having broader and more diverse views.

For the reasons stated above, the research will focus on obtaining data from individuals that are knowledgeable of SME matters in KwaZulu-Natal and who have the ability to provide information in order to undertake the analysis of accounting and financial management skills needed.

## 5.6 SAMPLE SIZE

Several difficulties were emphasised relating to the use of SME owners/managers as an appropriate sample frame. Although the use of industry experts addresses most of the issues highlighted, a difficulty associated with the use of industry experts is that there is no database of industry experts for the SME sector. Therefore, representative sampling methods could not be applied to determine an appropriate sample size.

A sample size of thirty industry experts was utilised for the research as this is considered an appropriate sample size to obtain diverse feedback from experts.

The sample size was chosen after consultation with a statistician from the Department of Statistics and Biometry, School of Statistics and Actuarial Science, UKZN. The justification provided by the statistician is that:

- The sample size of thirty ensures that distributions such as the t-distribution can be assigned to the data to be analysed; and,
- The Central Limit Theorem deems a sample size of thirty to be suitable in order for a statistical analysis to be undertaken. The theorem assumes that if the mean of the sample is taken, it will follow a normal distribution. This ensures that parametric techniques can be used to analyse the data from the sample size. In the analysis of data received from the interviewees, this objective was achieved by use of a one-sample t test to check if the mean equals different hypothesised values (Hogg and Craig, 1995, p247).

However, it must be emphasised that the sample size of thirty may be viewed as a limitation of the study and is an avenue for future research.

In order to ensure that the individuals selected do have the necessary knowledge to make a contribution to the research, they will need to meet at least one of the following criteria:

- A formal business qualification relating to the SME sector;
- At least five years experience with SME development;
- At least five years experience in management of an SME;
- Experience in the training of / Involvement with financial management in the SME sector; and,
- Experience in the training of / Involvement with accounting in the SME sector.

These experts, meeting the above criteria, were chosen on a random basis using professional judgement, and were then categorised into the following groups:

- **Group One: Entrepreneurs**

This group comprises entrepreneurs that have experience of successfully owning a business that conforms to the definition of an SME that was agreed upon in Chapter Two.

There may appear to be a contradiction between selecting entrepreneurs as interviewees, due to the motivation on pages 86-87 that highlighted their unsuitability to answer the questionnaire. However, the selected entrepreneurs possess a qualification or skill (as identified in the qualifying criteria for an expert) that enabled the entrepreneur to be classified as an expert. The possession of such a skill or qualification mitigates the risk of the entrepreneur not having the necessary skills to answer the questionnaire.

- **Group Two: Accountants**

This group consists of individuals that are involved in the provision of accounting and financial management services to SMEs in the province.

- **Group Three: Academics**

This group consists of academics that have exposure to the SME sector.

- **Group Four: Other Experts**

This group comprises financiers, other service providers, policy makers and any other experts that are involved in the SME sector.

It is anticipated that feedback from the above set of experts will provide a suitable response for the research

## **5.7 DATA COLLECTION METHOD**

Having identified that the individuals that meet the criteria to be considered experts, a method has to be devised to collect data from them to assist in the research findings.

The collection procedures in qualitative research involve four basic types, which are:

- Observations;
- Interviews;

- Documents; and,
- Audiovisual materials (Creswell, 2003, p185-186).

Each of these procedures has advantages and disadvantages. However, given the attempt to solicit information from the experts, interviews may be the most appropriate procedure.

Interviews are a particular kind of conversation and are an important source of qualitative data (Green and Torogood, 2004, p79). Some of the advantages of using interviews as a method of collecting data are:

- Depth of information - Interviews are good at producing data that deal with topics in depth and detail. Given the difficulties and challenges that have been experienced by the SME sector, this technique will assist in probing the sector;
- Insights - The researcher is likely to gain valuable insights based on the depth of the information gathered and the wisdom of experts; and,
- High Response rate - As interviews are usually prearranged, there is a high response rate.

(Denscombe, 2003, p189)

However, there are certain distinct disadvantages of using interviews , which are:

- The interview provides indirect information which is filtered through the views of the interviewees;
- The researcher's presence may result in a biased response; and,
- People are not equally articulate and perceptive.

(Creswell, 2003, p186)

Given the fact that the interviewees fit the criteria to be considered experts in the field of SME development, some of these risks are reduced.

In this study, questionnaire based personal interviews will be conducted in order to collect the maximum in-depth information from the identified experts and clarify possible problem areas.

## 5.8 QUESTIONNAIRE DESIGN

An interview study is defined as one where the data and findings are based on direct researcher to respondent conversations (in person or by phone) (Welch and Marscan-Piekkari, 2004, p185). The interview technique usually involves orally asking questions and recording answers. If the questions are prepared in advance and the same questions are asked of each participant, then the interviews are structured interviews. If the questions vary as a result of the interviewees' responses, then the interviews are unstructured interviews (Spatz and Kardas, 2008, p 319).

Due to the fact that the interview is being designed to explore and analyse the needs of the SME sector, a rating scale will be used in order to assess and categorise the responses, such as a Likert-type Scale (Leedy and Ormod, 2005, p185).

An important aspect that was considered in the design of the questionnaire, to be used during the interview, was the integration of the information relating to the SME sector that was highlighted in the literature review.

The questionnaire consists of four sections, namely personal details of the interviewee, business problems experienced by the SME sector in KwaZulu-Natal, accounting skills and financial management skills. The information that was highlighted in the literature review in Chapters Two-Four have been incorporated into the design of the questionnaire as follows:

- **Section A** - Relates to personal detail of the interviewee, such as occupation and age;
- **Section B - Business Problems Experienced by the SME sector** - Questions have been included to determine if SMEs are well managed, thereby testing the assertion of the literature review in Chapter One which found that the SME sector is not well managed (UCT, 2005, p21), (Pather, 2003, p11) and (SACOB, 1999, p12). The section also included a question relating to the adequacy of funds in the SME sector, thereby testing the research findings of (Clover and Darroch, 2005, p238-263) and (Mutezo, 2003, p93) that a lack of funds is considered to be an obstacle in the SME sector;

**Section C** - Accounting Skills - Questions were included to determine if accounting skills are important to the SME sector, the accounting needs of the SME sector, the current level of accounting skills in the sector and whether an improvement in accounting skills can enhance the profitability of the SME

sector. This information is relevant to the research problem and will allow for an evaluation of accounting skills that are needed by the SME sector in KwaZulu-Natal and in determining whether acquiring accounting skills will contribute to growth in the SME sector. This section of the questionnaire also included a question relating to the availability of the accounting skills that were suggested in the literature review in Chapter Three as having the potential to contribute to the growth and profitability of the sector. These accounting skills related to the preparation of income statements, balance sheets, cash flow statements and tax returns; and

**Section D - Financial Management Skills** - Questions were included to determine if financial management skills are important to the SME sector, the financial management needs of the SME sector, the current level of financial management skills in the sector and whether an improvement in financial management skills can enhance the profitability of the SME sector. This information is relevant to the research problem and will allow for an evaluation of financial management skills that are needed by the SME sector in KwaZulu-Natal and in determining whether acquiring financial management skills will contribute to growth in the SME sector. This section of the questionnaire also included a question relating to the availability of the financial management skills that were suggested in the literature review in Chapter Three as having the potential to contribute to the growth and profitability of the sector. These financial management skills related to the preparation of business plans and cash flow projections, analysing financial statements and performing scenario planning.

The definition that was suggested for an SME in Chapter Two was included in the questionnaire so that the interviewee understood the definition that related to the research. The distinction between accounting and financial management skills, that was highlighted in Chapters Three and Four, was also included in the questionnaire to avoid any confusion between these different sets of skills.

## **5.9 RELIABILITY AND VALIDITY**

The validity of an interview schedule is the extent to which the interview measures what it is supposed to measure, whereas the reliability is the consistency with which the interview schedule will yield a certain result if the entity being measured has not changed (Leedy and Ormod, 2005, p28-29). Validity relates to the extent to which the

research data and the methods for obtaining the data are accurate, honest and on target (Denscombe, 2003, p201).

The face validity criterion was achieved by considering the following issues:

- There is an avoidance of leading and loaded questions to maintain neutrality;
- Questions were not offensive and ambiguous;
- Questions were applicable to all respondents;
- Questions were structured to reduce fatigue effect with easy to answer questions at the end;
- The Likert Scale was used in the investigation whereby the respondents were required to pick a number from the scale to show how much they agreed or disagreed with the statement/question; and,
- Use was made of closed questions, as they are easier and quicker to respond to and allow for ease of comparison when analysing results.

It is important to “test out” the measurement instrument before it is administered and this can be done by means of a pilot study, which entails administering the interview to a limited number of subjects from the list of industry experts identified (Welman, Kruger, Mitchell, 2005, p148). In order to identify any problems or inconsistencies with the interview schedule, five industry experts will initially be interviewed to determine if any changes are required. These changes will be effected prior to the continuation of the remaining interviews.

A pilot study was carried out on a sample of five individuals. The purpose of the test was:

- To determine the clarity of instructions;
- To determine the time taken per questionnaire;
- To determine that questions were clear and not ambiguous; and,
- To ensure questions were not offensive and inappropriate.

The results of the pilot study showed that there were no problems with the questionnaire. Hence the survey could be carried out on a larger sample.

Coakes and Steed (2003, pg 140) state that there are a number of different reliability coefficients. A common coefficient is the Cronbach’s alpha, which is based on the average correlation of items within a test if the items are standardised. The Cronbach’s alpha can range from 0 to 1. The responses will be analyzed in SPSS using the

Cronbach's alpha and a value of 0.7 or higher will show that there is a reliability that was achieved from the respondents in the questionnaire. A value of 0.7 or higher is deemed to be suitable to conclude that if we increased the size of the sample, we would get similar results as we did with the original sample.

## **5.10 DATA ANALYSIS**

The results of the interview will be thoroughly analysed using the SPSS (version 15) and will also be used to test the following hypothesis:

### **Hypothesis**

The hypothesis is important to bring clarity to the research problem (Kumar, 2005, p74) and is derived from the objectives of the research. The research objective can be tested by the following hypothesis:

1. H1: According to the opinion of the experts interviewed, there is a need to improve accounting skills in the SME sector in KwaZulu-Natal; and,  
H0: According to the opinion of the experts interviewed, there is no need to improve accounting skills in the SME sector in KwaZulu-Natal.
2. H1: According to the opinion of the experts interviewed, there is a need to improve financial management skills in the SME sector in KwaZulu-Natal; and,  
H0: According to the opinion of the experts interviewed, there is no need to improve financial management skills in the SME sector in KwaZulu-Natal.

## **5.11 SUMMARY OF CHAPTER**

The focus of this chapter was to develop a rational and logical approach to empirically analyse the financial management and accounting skills needed in the SME sector in KwaZulu-Natal. In order to obtain a proper understanding, it was decided to adopt a combined approach that comprises a quantitative and qualitative approach that involves the interviewing of selected industry experts. An important consideration in designing a relevant methodology was the integration of some of the findings of the literature review.

The next chapter will involve a summary of the research findings and their implication for addressing the future training needs of the SME sector.

## **CHAPTER SIX: RESEARCH FINDINGS**

### **6.1 INTRODUCTION**

The objective of this chapter is to empirically analyse the feedback obtained from the interviewees according to methodology devised in Chapter Five. The methodology devised in Chapter Five was based on various practical considerations, one of which was the information and findings from the literature review. Therefore, in addition to performing an in-depth analysis on the findings, an attempt will be made to compare the research findings to certain aspects of the literature review.

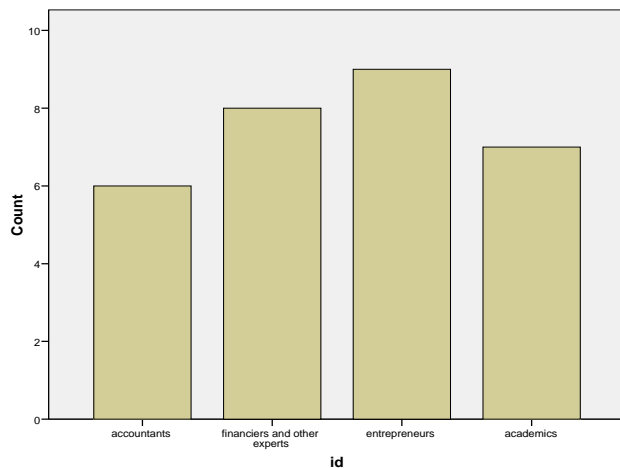
The chapter is structured as follows:

- There is a commentary on the characteristics and responses of the interviewees using graphical and descriptive statistics. Bar graphs and frequency tables will be calculated using SPSS (version 15) to gain an overview of the perceptions of accounting and financial management training for the commerce professionals. The descriptive statistics will also include the mean, mode, median and standard deviation for each of the questions contained in the questionnaire. These statistics will serve to confirm the results of the graphical statistics and frequency tables.
- A test will be conducted, using the Kolmogorov Smirnov technique, to determine if the data is derived from a normal distribution. The determination of the data distribution will establish the type of statistical tests that can be utilised to test the hypothesis that was devised in Chapter Five.
- In order for the research methodology to have integrity, there is a need for the data quality to be valid and reliable. The Cronbach's Alpha will be calculated for the questions that have the same scales. A value of 0.7 or higher is deemed to conclude a good internal consistency and reliability amongst the questions.
- The Chi-Square test and the one sample t-test will also be carried out to test the hypotheses as to whether there is a need or not for accounting and financial management training. The results of the hypothesis tests will also be confirmed by the descriptive and graphical statistics.
- The qualitative aspect of the questionnaire utilised for the interview allowed for comments from interviewees. These comments have been included in the analysis of the relevant section of the questionnaire.

## 6.2 ANALYSIS OF INTERVIEWEE RESPONSE

### 6.2.1 Personal details of interviewee

#### a) Identification

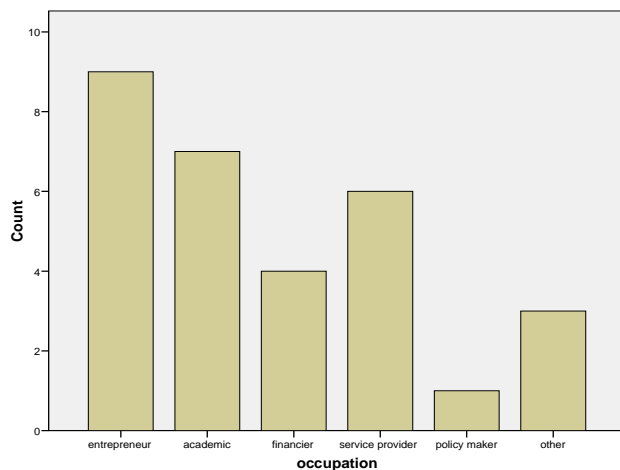


**Table 6.1: Results of the identification of respondents**

		Frequency	Percent	Cumulative Percent
	accountants	6	20.0	20.0
	financiers and other experts	8	26.7	46.7
	entrepreneurs	9	30.0	76.7
	academics	7	23.3	100.0
	Total	30	100.0	

The modal response was entrepreneurs (30%)

#### b) Occupation

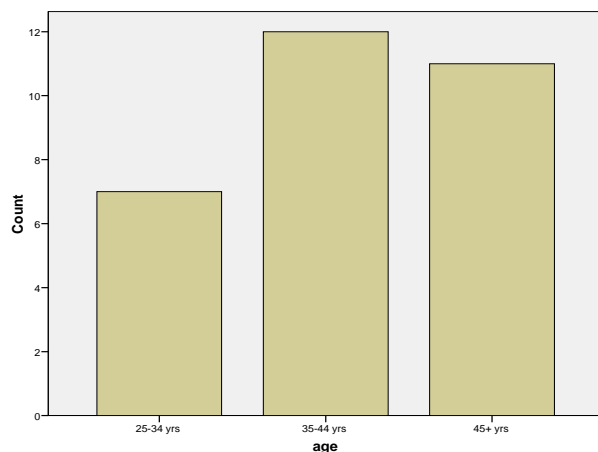


**Table 6.2: Results of the occupation of respondents**

		Frequency	Percent	Cumulative Percent
	entrepreneur	9	30.0	30.0
	academic	7	23.3	53.3
	financier	4	13.3	66.7
	service provider	6	20.0	86.7
	policy maker	1	3.3	90.0
	other	3	10.0	100.0
	Total	30	100.0	

The modal response was entrepreneur (30%)

**c) Age**

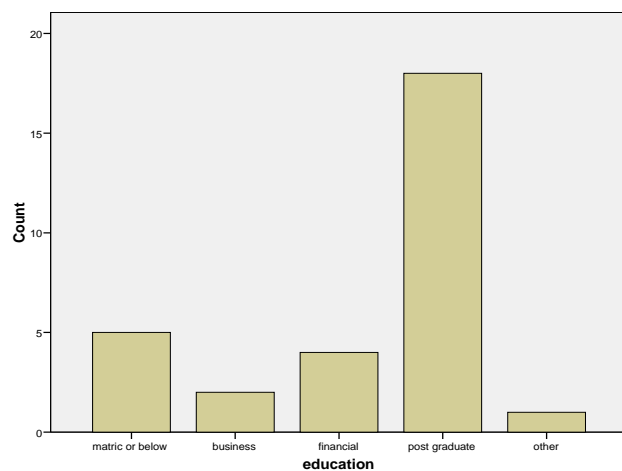


**Table 6.3: Results of the age of respondents**

		Frequency	Percent	Cumulative Percent
	25-34 yrs	7	23.3	23.3
	35-44 yrs	12	40.0	63.3
	45+ yrs	11	36.7	100.0
	Total	30	100.0	

The modal age group was 35-44yrs (40%)

**d) Educational Qualification**

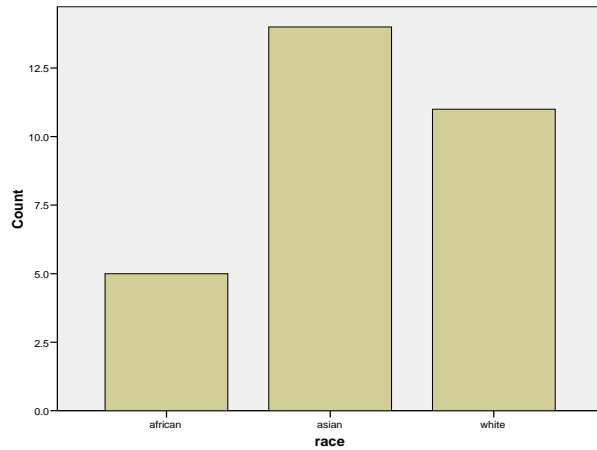


**Table 6.4 : Results of the educational qualification of respondents**

		Frequency	Percent	Cumulative Percent
	matriculation or below	5	16.7	16.7
	business	2	6.7	23.3
	financial	4	13.3	36.7
	post graduate	18	60.0	96.7
	other	1	3.3	100.0
	Total	30	100.0	

The modal educational group was postgraduate (60%)

**e) Race**

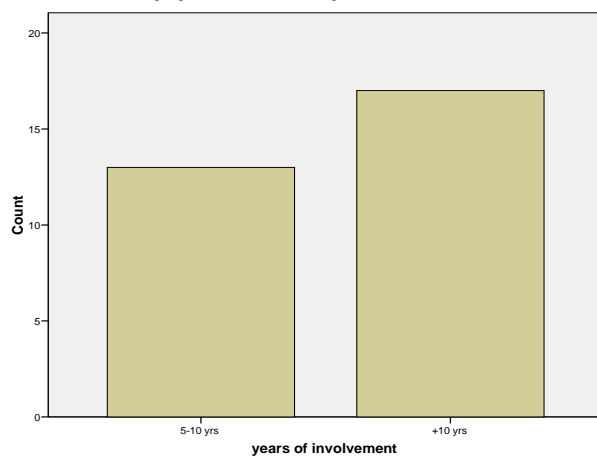


**Table 6.5: Results of the race of respondents**

		Frequency	Percent	Cumulative Percent
	african	5	16.7	16.7
	asian	14	46.7	63.3
	white	11	36.7	100.0
	Total	30	100.0	

The modal race group was Asian (46.7%)

**f) How many years have you been involved in the SME sector in KZN?**



**Table 6.6: Results of the years of involvement in the SME sector in KZN of respondents**

		Frequency	Percent	Cumulative Percent
	5-10 yrs	13	43.3	43.3
	+10 yrs	17	56.7	100.0
	Total	30	100.0	

The modal years of involvement was +10 years (56.7%)

The above analysis illustrates that there was an even distribution of respondents from the different fields relevant to accounting and financial management, i.e. entrepreneurs (30%), accountants (20%), financiers and other experts (26.7%) and academics (23.3%).

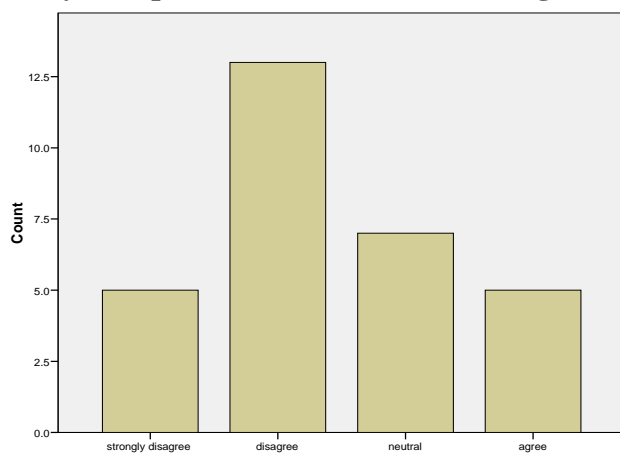
The different occupations were also evenly distributed with a majority of the respondents being entrepreneurs (30%), academics (23.3%) and service providers (20%).

The modal age group was the 35-44 years (40%), followed by 45+ years (36.7%). The majority of the respondents (60%) were postgraduates, followed by those respondents who had a matriculation or below (16.7%). The modal race group was Asian (46.7%), followed by the white race group (36.7%). There was a split in the number of years of involvement in the SME sector in KZN with 5-10 years (43.3%) and 10+ years (56.7%).

The decision to adopt a qualitative approach by interviewing industry experts appears to be justified by the qualifications and experience of the respondents. The experience and qualification of these respondents in the SME sector will hopefully provide this study with the relevant information in order to analyse the accounting and financial management skills needed by the SME sector.

### 6.2.2 Business problems experienced by the SME sector

#### a) In your opinion, are SMEs well managed?



**Table 6.7: Results of respondents' response to Section B, Question a**

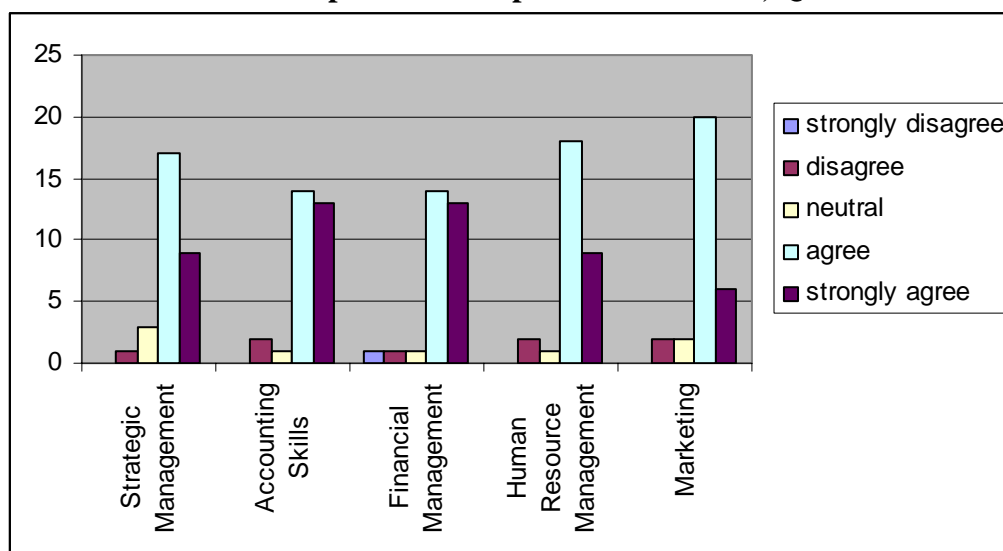
		Frequency	Percent	Cumulative Percent
	strongly disagree	5	16.7	16.7
	disagree	13	43.3	60.0
	neutral	7	23.3	83.3
	agree	5	16.7	100.0
	Total	30	100.0	

The modal response was disagree (43.3%)

**b) In your opinion, does the SME sector experience problems in the following areas?**

	Strategic Management	Accounting Skills	Financial Management	Human Resource Management	Marketing
strongly disagree			1		
disagree	1	2	1	2	2
neutral	3	1	1	1	2
agree	17	14	14	18	20
strongly agree	9	13	13	9	6

**Table 6.8: Results of respondents' response to Section B, Question b**



In each of the above five alternatives, 80%-95% of the respondents agree and strongly agree that there are definite areas of difficulty that the SME sector experiences.

The areas that have been identified as being areas of difficulty corroborate the literature review. For example, the review identified that some of the common business problems experienced relate to ineffective management planning, management information, poor controls, marketing and unsatisfactory financial management (Pather, 2003, p10-13). Clover and Darroch (2005, p238-263) highlighted that many SMEs view a lack of management skills as a major threat to their businesses. The above findings may also support the assertion (Jinabhai and Kadwa, 2007, p15-25) that mentorship and training may be used as a strategy to improve productive growth in the sector.

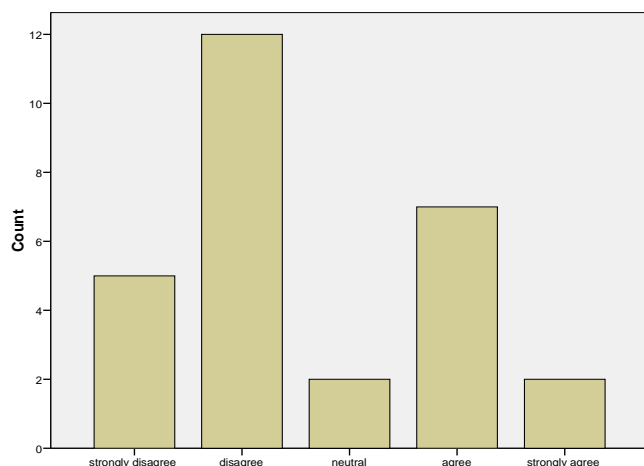
Approximately 17% of the respondents strongly disagree and 40% disagree that SMEs have sufficient funds to operate. Once again, these findings support the literature review of SACOB (1999, p12), Clover and Darroch (2005, p238-263) and Mutezo (2003, p93), which identified a lack of sufficient funds as a major obstacle to the growth of the SME.

It is evident that a lack of accounting and financial management skills represents a major problem area that is experienced by the SME sector in KwaZulu-Natal. The above findings are consistent with the literature reviewed. For example, Taylor (2003, p11) presented a strong case for the SME sector to possess accounting skills as a means to improve their control over the business. It is also important to note that there may even be a link between SME business failure and a lack of accounting skills (Stone, 2003, preface). Smith and Kotze (2008, p35) have established that a lack of knowledge of financial management contributes to a low prevalence of new venture creation and, ultimately, the high failure rate of South African SMEs.

**Interviewee comments:**

- ❖ SMEs have a problem adapting to change;
- ❖ Unable to strategise the business; and,
- ❖ HR legislation is a problem.

**c) In your opinion, do SMEs have sufficient funds to operate?**



**Table 6.9: Results of respondents’ response to Section B, Question c**

		Frequency	Percent	Cumulative Percent
	strongly disagree	5	16.7	17.9
	disagree	12	40.0	60.7
	neutral	2	6.7	67.9
	agree	7	23.3	92.9
	strongly agree	2	6.7	100.0
	Total	28	93.3	
Missing	System	2	6.7	
Total		30	100.0	

The modal response was disagree (40%)

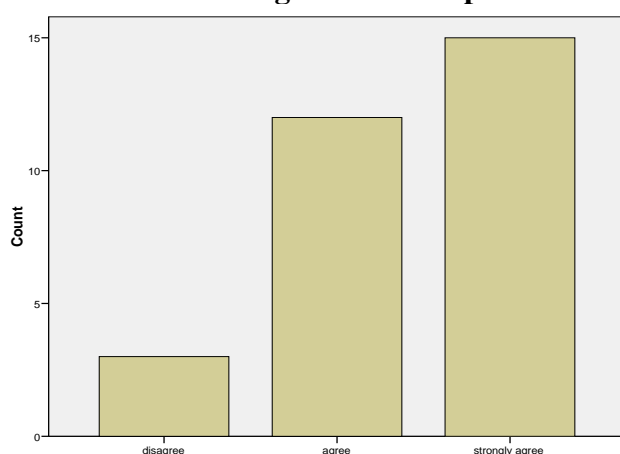
## Observation

In response to the assertion that SMEs are well managed, 16.7% of the respondents strongly disagreed, 43.3% of respondents disagreed and 23.3% remained neutral. The following summary gives the areas where respondents indicated the SME sector experience difficulties:

### 6.2.3 Accounting skills

#### a) Do you agree with the following statement?

- Accounting skills are important to the SME sector in KZN



**Table 6.10: Results of respondents' response to Section C, Question a**

		Frequency	Percent	Cumulative Percent
	disagree	3	10.0	10.0
	agree	12	40.0	50.0
	strongly agree	15	50.0	100.0
	Total	30	100.0	

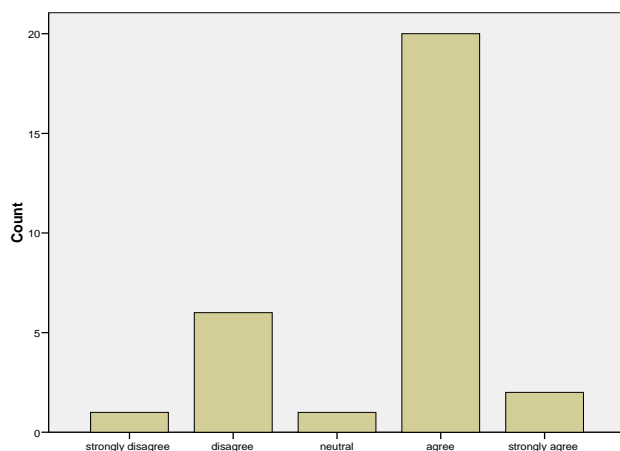
The modal response was agree (40%)

#### Interviewee comments:

- ❖ Poorly managed accounting systems impact on cash flow management, e.g. VAT may be overpaid;
- ❖ I believe what is important is the ability to identify people that can assist when it comes to financial matters and in the process learn the basics from such professionals;
- ❖ It will enable them to better understand their business;
- ❖ Focus should be the area of cash flow;
- ❖ SMEs don't understand the value of financial records and interpretation of financial information to make informed decisions;

- ❖ At the very outset, they will establish if the businesses are profitable or not; and,
- ❖ Proper accounting records ultimately lead to the generation of optimal decisions.

• **Accounting needs of the SME sector are different from larger businesses**



**Table 6.11: Results of respondents’ response to Section C, Question b**

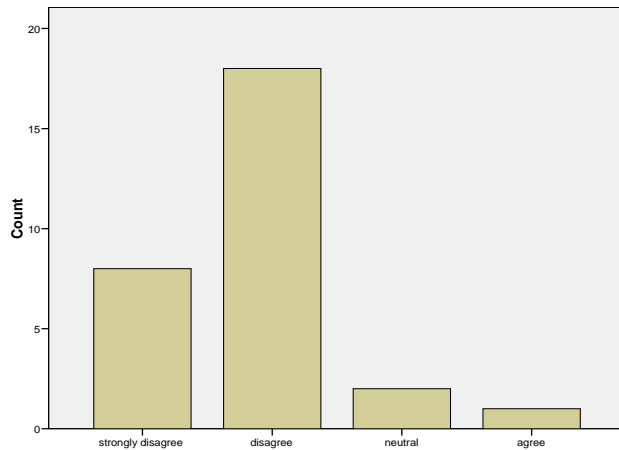
		Frequency	Percent	Cumulative Percent
	strongly disagree	1	3.3	3.3
	disagree	6	20.0	23.3
	neutral	1	3.3	26.7
	agree	20	66.7	93.3
	strongly agree	2	6.7	100.0
	Total	30	100.0	

The modal response was agree (66.7%)

**Interviewee comments:**

- ❖ They operate on a small scale so their needs are different but if they intend to grow big then they need to learn everything;
- ❖ The level of complexity will differ from large businesses;
- ❖ Accounting needs for any business is the same all;
- ❖ Larger businesses require CFO and below him/her an accounts department for which they have finance for;
- ❖ Too often small businesses have to use PASTEL products, which are expensive and complex. There are simpler cheaper packages, which are better for small businesses but not popular with the accounting profession; and,
- ❖ Cash flow and sustainability are more important than a technically correct set of financials.

- **There are sufficient levels of accounting skills in the SME sector in KZN**



**Table 6.12: Results of respondents’ response to Section C, Question c**

		Frequency	Percent	Cumulative Percent
	strongly disagree	8	26.7	27.6
	disagree	18	60.0	89.7
	neutral	2	6.7	96.6
	agree	1	3.3	100.0
	Total	29	96.7	
Missing	System	1	3.3	
Total		30	100.0	

The modal response was disagree (60%)

**Interviewee comments:**

- ❖ Too many of our qualified people have left the country;
- ❖ Big shortage;
- ❖ Very few individuals who are educated that operate in this sector;
- ❖ They don’t understand financial statements; not including management accounts into the business;
- ❖ Most of the accounting is outsourced; and,
- ❖ To my experience most SME sectors that closed over the past year had no or insufficient level of accounting skills.

**Observation**

50% of the respondents strongly agree and 40% of the respondents agree that accounting skills are important to the SME sector in KZN. A modal response of agree (66.7%) was given to the question that Accounting needs of the SME sector are different from larger businesses, whilst 26.7% and 60% strongly disagree and disagree

with the question that there are sufficient levels of accounting skills in the SME sector in KZN.

These observations highlight the importance of accounting skills in the SME sector and it does appear that these skills are largely unavailable to the sector. It is also important to note that the experts feel that the accounting needs of the SME sector are different to larger businesses. Therefore, the question that was analysed in the literature review, “Is small business just a ‘small’ big business or is it something else?” (Dewhurst, J and Burns, P, 1983, p3) has been answered by the respondents, from an accounting skills perspective, by agreeing that a different set of accounting skills are needed by the SME sector.

These findings support earlier assertions in the literature review relating to the accounting needs of the SME sector. In Chapter Three, the diversity in the accounting needs of the SME sector from larger businesses clearly highlighted the needs for a different set of accounting standards for the sector. For example, the president of the International Federation of Accountants argued for a separate set of accounting standards for the SME sector (International Federation of Accountants, 2006, p2). The literature review also indicated that the idea of a separate set of accounting standards for the SME sector enjoyed considerable support in South Africa (Stainbank and Wells, 2005, p51-65). It is encouraging to note that the changes to the Companies Act (Government Gazette, 2007, p3 and SAICA, 2007, p1) that were highlighted in the literature review, will assist in recognising the difference in needs and will thereby result in an improvement in the accounting skills.

Although the respondents agree that accounting skills are important, there is consensus that these skills are unavailable. This finding should be of concern to the provincial government as it may be an indication that much of the business training that is being provided, and mentioned in the literature review, is not producing the desired results. Examples of business training are those provided in terms of the Integrated Small Business Strategy (Department of Trade and Industry, 2005, p5-6), the SMME Support Service Delivery Network (Mkhize, 2006, p1-7) and Seda ([www.seda.org.za](http://www.seda.org.za)).

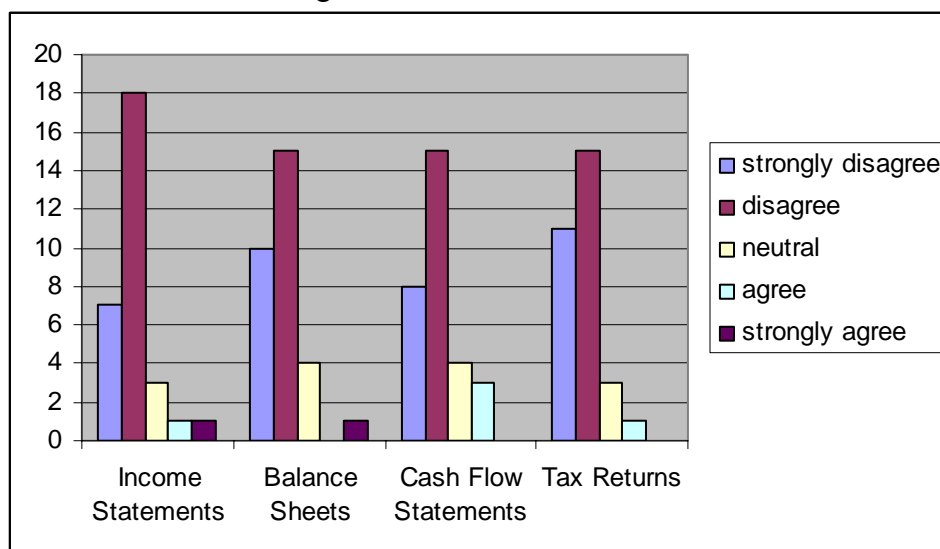
- **Management/Owners of SMEs in KZN have the necessary skills to prepare the following:**

The following table summarizes whether Management/Owners of SMEs in KZN have the necessary skills to prepare:

**Table 6.13: Results of respondents' response to Section C questions**

	Income Statements	Balance Sheets	Cash Flow Statements	Tax Returns
strongly disagree	7	10	8	11
disagree	18	15	15	15
neutral	3	4	4	3
agree	1		3	1
strongly agree	1	1		

Graphically, we see that the Management/Owners lack the necessary skills to provide these essential accounting functions.

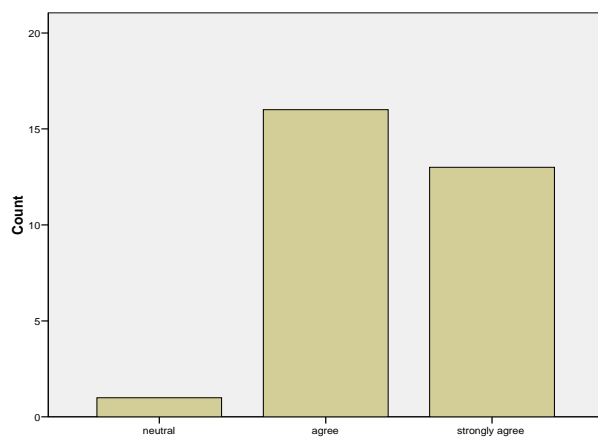


The information obtained from this section has serious implications for the SME sector, considering the importance of skills for the continued growth and profitability of the sector. The literature review did indicate that, although a basic level of accounting skills are needed to prepare an income statement, balance sheet, cash flow statement and income tax returns (Taylor, 2003, p13), such tools will assist the sector in undertaking important business decisions, determining the financial position and understanding and reducing tax liabilities. It is evident that the relevant authorities should consider a mechanism to impart these basic skills to the sector.

Given the importance of the financial statements to measure and communicate the financial position and results of the entity (Haiden, 2006, p1), and of tax skills and

knowledge in the long-term survival of the SME (Venter and Clecq, 2007, p72-78), absence of these skills will have a negative effect on the performance of the sector. It is vital that these accounting skills are considered when policy makers consider the training needs of SMEs.

- **The improvement of accounting skills can enhance the profitability of the SME sector in KZN**



**Table 6.14: Results of respondents' response to Section C, Question e**

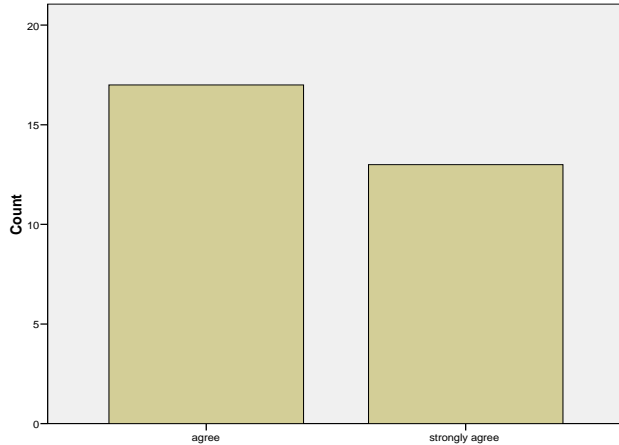
		Frequency	Percent	Cumulative Percent
	neutral	1	3.3	3.3
	agree	16	53.3	56.7
	strongly agree	13	43.3	100.0
	Total	30	100.0	

The modal response was agree (53.3%)

**Interviewee comments:**

- ❖ Especially scenario planning is important;
- ❖ Is also important for growth, CRM, quality, production and financial growth;
- ❖ Better control of working capital and control of expenses; and,
- ❖ People who have a business plan and work toward this in relation to understand the financials.

- **The SME sector in KZN will benefit from accounting training**



**Table 6.15: Results of respondents' response to Section C, Question f**

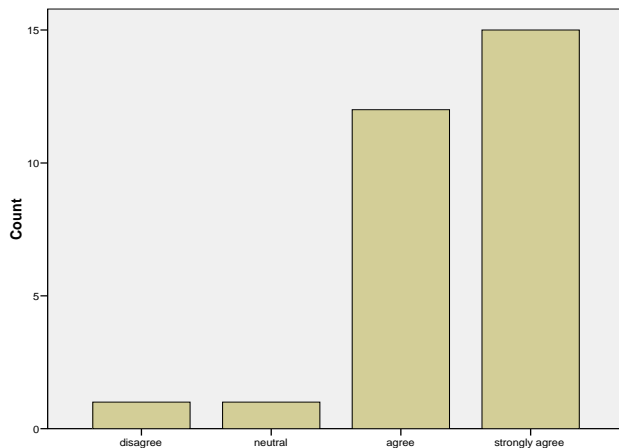
		Frequency	Percent	Cumulative Percent
	agree	17	56.7	56.7
	strongly agree	13	43.3	100.0
	Total	30	100.0	

The modal response was agree (56.7%)

**Interviewee comments:**

- ❖ More in terms of management accounting;
- ❖ This will enable them to do budgets to keep records for future;
- ❖ Accounting training with practical case studies, including the implication of marketing, production, management and networking; and,
- ❖ Better understanding of financial audits and profitability of businesses.

- **In your opinion is there a need for an improvement in accounting skills in the SME sector in KZN?**

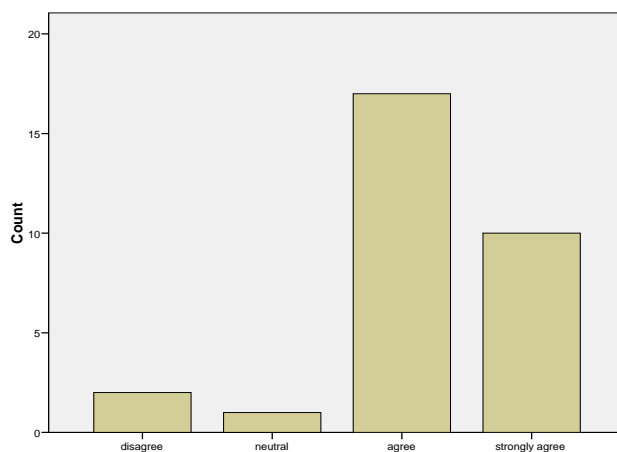


**Table 6.16: Results of respondents' response to Section C, Question g**

		Frequency	Percent	Cumulative Percent
	disagree	1	3.3	3.4
	neutral	1	3.3	6.9
	agree	12	40.0	48.3
	strongly agree	15	50.0	100.0
	Total	29	96.7	
Missing	System	1	3.3	
Total		30	100.0	

The modal response was strongly agree (50%)

- **A lack of accounting skills can result in a shortage of funds in the SME sector in KZN**



**Table 6.17: Results of respondents' response to Section C, Question h**

		Frequency	Percent	Cumulative Percent
	disagree	2	6.7	6.7
	neutral	1	3.3	10.0
	agree	17	56.7	66.7
	strongly agree	10	33.3	100.0
	Total	30	100.0	

The modal response was agree (56.7%)

**Interviewee comments:**

- ❖ Especially in the current difficult economic times;
- ❖ There are other factors such as marketing skill, overall business acumen, basic understanding of the environment; and,

- ❖ Past experience has shown that owners cannot manage their funds and as a result they experience shortages and their businesses fail.

### **Observation**

An overwhelming 53.3% and 43.3% agree and strongly agree that the improvement of accounting skills can enhance the profitability of the SME sector in KZN. This point is further solidified with a dominant response of agree (56.7%) and strongly agree (43.3%) that the SME sector in KZN will benefit from accounting training. There can be no doubt about this response since the total percentage of this affirmation (agree (43.3%) + strongly agree (56.7%)) adds up to 100%. A combined total response of 90%, made up of agree (40%) and strongly agree (50%) felt that there is a need for an improvement in accounting skills in the SME sector in KZN.

The literature review also confirmed that improving tax skills and knowledge among the SME sector will result in cost savings and ultimately ensure that an SME survives in the long term (Venter and Clercq, 2007, p72-87). In addition, it was also highlighted that the preparation of a cash flow statement enables one to better control and manage the business (Barrow, 1988, p39).

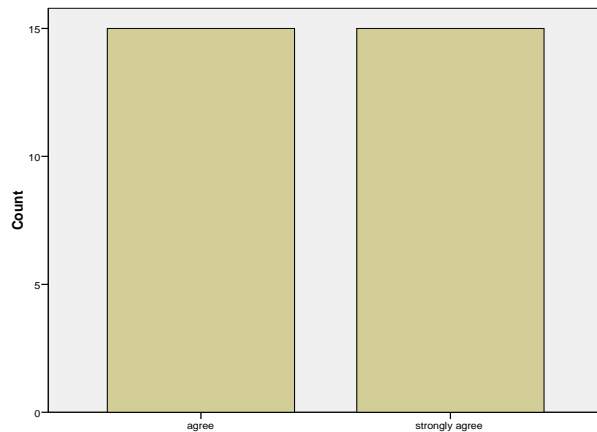
Finally, 56.7% and 33.3% of the respondents agree and strongly agree that a lack of accounting skills can result in a shortage of funds in the SME sector in KZN. This is an important observation as it answers a question relating to the research conducted by Mutezo (1993), who confirmed that, although a lack of access to funds is the largest obstacle faced by the SME sector, further research be conducted into “certain skills that are a prerequisite for a successful application for finance, such as bookkeeping, cash flow management and drafting of business plans” (Mutezo, 2003, p93). These observations seem to confirm that a lack of accounting skills is a contributory factor to the shortage of cash.

Considering the low entrepreneurial success rate in the country (UCT, 2005, p21), (Centre for Development and Enterprise, 2004, p5), it may be feasible to assume that an improvement in the accounting skills of the SME sector will have the potential to contribute to the growth and profitability of the sector.

## 6.2.4 Financial management skills

### a) Do you agree with the following statements?

- **Financial management skills are important to the SME sector in KZN**

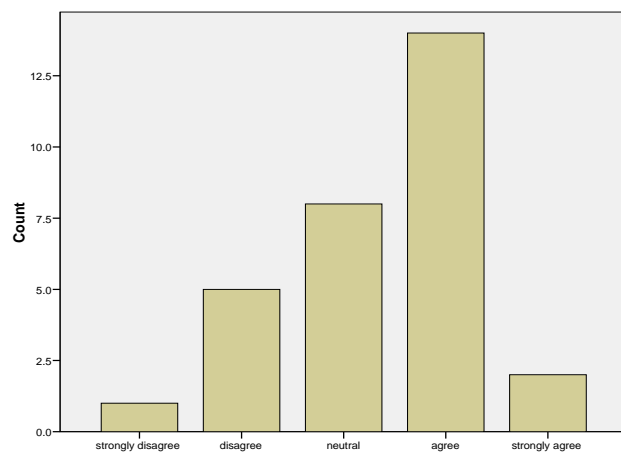


**Table 6.18: Results of respondents' response to Section D, Question a**

		Frequency	Percent	Cumulative Percent
	agree	15	50.0	50.0
	strongly agree	15	50.0	100.0
	Total	30	100.0	

The modal responses were agree (50%) and strongly agree (50%)

- **Financial management needs of the SME sector are different from larger businesses**



**Table 6.19: Results of respondents' response to Section D, Question b**

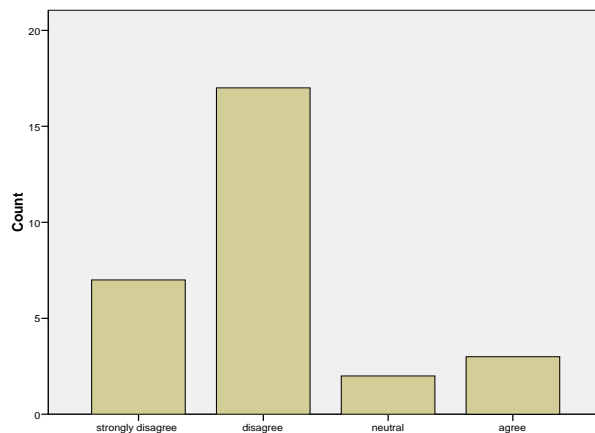
		Frequency	Percent	Cumulative Percent
	strongly disagree	1	3.3	3.3
	disagree	5	16.7	20.0
	neutral	8	26.7	46.7
	agree	14	46.7	93.3
	strongly agree	2	6.7	100.0
	Total	30	100.0	

The modal response was agree (46.7%)

**Interviewee comments:**

- ❖ Larger businesses would usually encounter more complex aspects of finance; and,
- ❖ Objective of any business to make a profit.

- **There are sufficient levels of financial management skills in the SME sector in KZN**



**Table 6.20: Results of respondents' response to Section D, Question c**

		Frequency	Percent	Cumulative Percent
	strongly disagree	7	23.3	24.1
	disagree	17	56.7	82.8
	neutral	2	6.7	89.7
	agree	3	10.0	100.0
	Total	29	96.7	
Missing	System	1	3.3	
Total		30	100.0	

The modal response was disagree (56.7%)

## Observation

50% of the respondents strongly agree and 50% of the respondents agree that financial management skills are important to the SME sector in KZN. These observations concur with the literature review that financial management skills are an important aspect of the general management function (Meredith, 1986, p9) and are central to the success of a small business. The importance of financial management skills was highlighted in the literature review by the observation that a lack of financial management skills contributes to the high failure rate of new business in South Africa (Business Partners, 2007).

A modal response of agree (46.7%) was given to the question that the financial management needs of the SME sector are different from larger businesses, whilst 23.3% and 56.7% strongly disagree and disagree to the question that there are sufficient levels of financial management skills in the SME sector in KZN. This finding is consistent with the literary review, which identified the lack of knowledge of financial management as a contributory factor to the low prevalence of new venture creation and ultimately the high failure rate of South African SMEs (Kotze and Smith, 2008, p35).

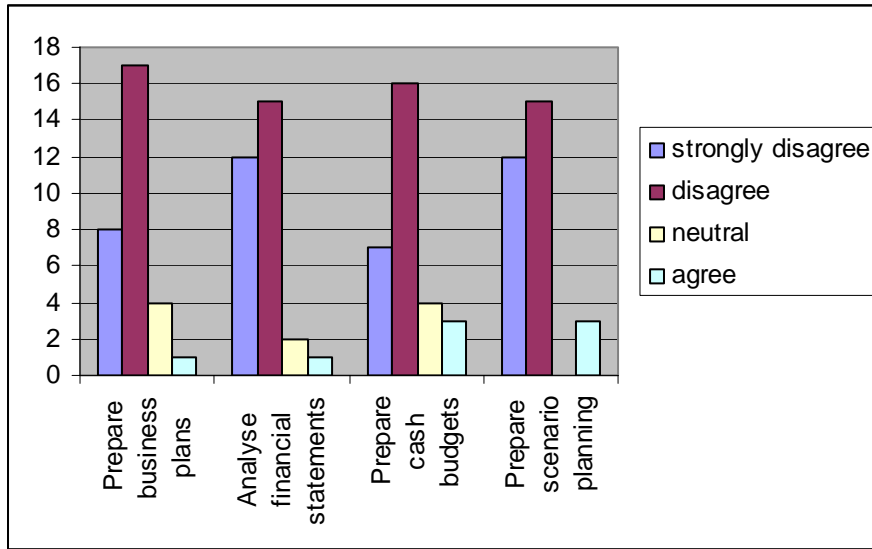
- **Management/Owners of SMEs in KZN have the necessary skills to prepare the following:**

The following table summarizes whether management/owners of SMEs in KZN have the necessary skills to:

**Table 6.21: Results of respondents' response to Section D, Question d**

	Prepare business plans	Analyse financial statements	Prepare cash budgets	Prepare scenario planning
strongly disagree	8	12	7	12
disagree	17	15	16	15
neutral	4	2	4	
agree	1	1	3	3

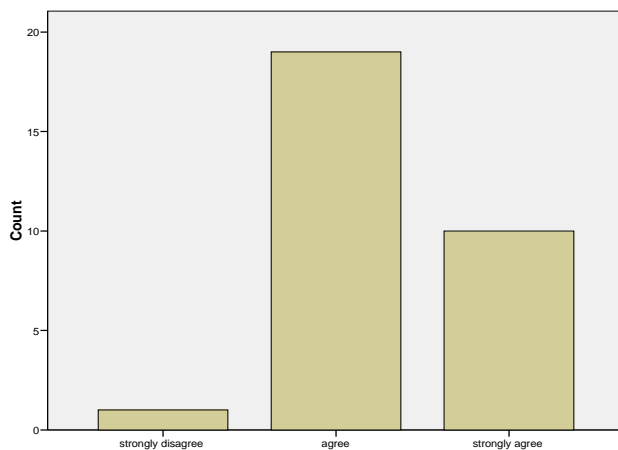
Graphically, it is evident that management/owners lack the necessary skills to provide these essential functions.



These observations are supported by the literature review that although funding is a problem, many SME owners lack the skills to prepare business plans and feasibility studies that are required by funders (Baumbach and Lawyer, 1979, p22-30). In addition, a SACOB report (1999, p12) stated that many entrepreneurs mistakenly believe that funding is a problem, when, in fact, it is really a lack of skills to access the funds.

The literature reviewed also indicated that many businesses fail to survive due to the failure to have a strategic plan (Scarborough and Zimmer, 2003, p25). The findings are also consistent with research undertaken in South Africa, which indicated that poor cash flow management was a threat to the small business sector (Eden, Viviers, Venter, 2003, p17).

- **The improvement of financial management skills can enhance the profitability of the SME sector in KZN**

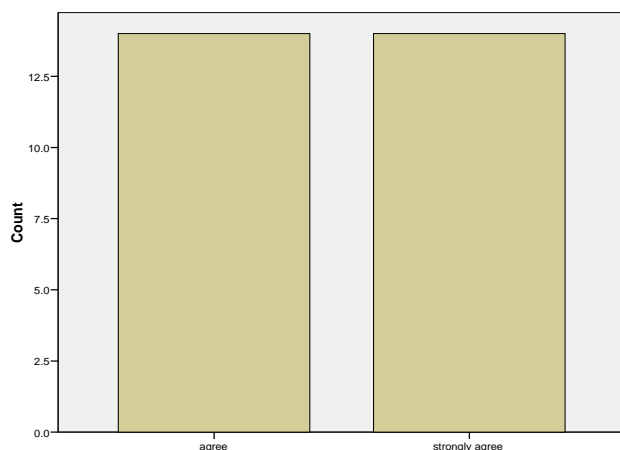


**Table 6.22: Results of respondents' response to Section D, Question e**

		Frequency	Percent	Cumulative Percent
	strongly disagree	1	3.3	3.3
	agree	19	63.3	66.7
	strongly agree	10	33.3	100.0
	Total	30	100.0	

The modal response was agree (63.3%)

- **The SME sector in KZN will benefit from financial management training**



**Table 6.23: Results of respondents' response to Section D, Question f**

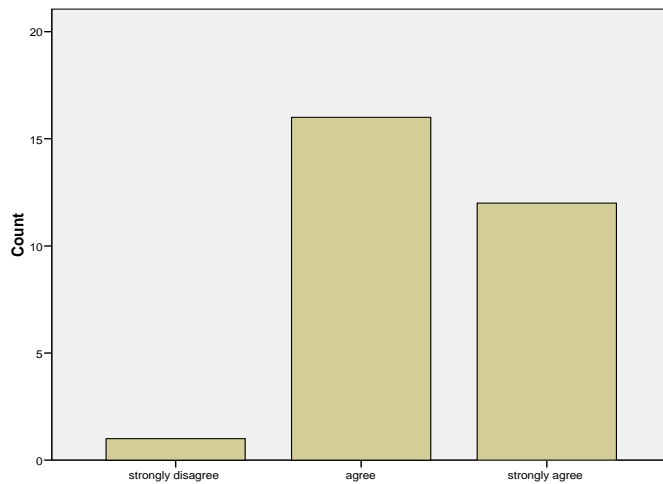
		Frequency	Percent	Cumulative Percent
	agree	14	46.7	50.0
	strongly agree	14	46.7	100.0
	Total	28	93.3	
Missing	System	2	6.7	
	Total	30	100.0	

The modal responses were agree (46.7%) and strongly agree (46.7%)

**Interviewee Comments:**

- ❖ Business schools etc. affordable subsidized courses; and
- ❖ Basic FM training will assist them in making the correct decisions.

- **There is a need for an improvement in financial management skills in the SME sector in KZN**

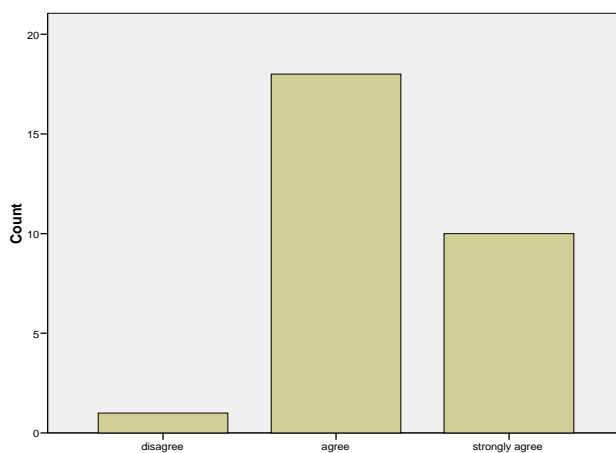


**Table 6.24: Results of respondents' response to Section D, Question g**

		Frequency	Percent	Cumulative Percent
	strongly disagree	1	3.3	3.4
	agree	16	53.3	58.6
	strongly agree	12	40.0	100.0
	Total	29	96.7	
Missing	System	1	3.3	
Total		30	100.0	

The modal response was agree (53.3%)

- **A lack of financial management skills can result in a shortage of funds in the SME sector in KZN**



**Table 6.25: Results of respondents' response to Section D, Question h**

		Frequency	Percent	Cumulative Percent
	disagree	1	3.3	3.4
	agree	18	60.0	65.5
	strongly agree	10	33.3	100.0
	Total	29	96.7	
Missing	System	1	3.3	
	Total	30	100.0	

The modal response was agree (60%)

### **Observation**

An overwhelming 63.3% and 33.3% agree and strongly agree that the improvement of financial management skills can enhance the profitability of the SME sector in KZN. This point is further solidified with a dominant response of agree (46.7%) and strongly agree (46.7%) that the SME sector in KZN will benefit from financial management training. The total percentage of this affirmation (agree (46.7%) +strongly agree (46.7%)) adds up to 93.4%. A combined total response of 93.3%, made up of agree (53.3%) and strongly agree (40%) felt that there is a need for an improvement in financial management skills in the SME sector in KZN.

60% and 33.3% of the respondents agree and strongly agree that a lack of financial management skills can result in a shortage of funds in the SME sector in KZN.

These findings are consistent with Meredith (1986, p6), which indicated that financial management skills were considered to be one of the most important skills that a business should possess. The findings could also explain the high failure rate in the SME sector in South Africa that was identified by the Global Entrepreneurship Monitor (UCT, 2005, p21). They also confirm previous observations that an improvement in financial management skills (such as businesses that are required to prepare business plans) may improve the profitability and the survival of the of the SME sector (Kotze and Smith, 2008, p35).

### 6.3 DESCRIPTIVE STATISTICS

**TABLE 6.26 :SUMMARY OF DESCRIPTIVE STATISTICS**

<b><u>QUESTION/ STATEMENT</u></b>	<b><u>Mean</u></b>	<b><u>Median</u></b>	<b><u>Mode</u></b>	<b><u>Std. Deviation</u></b>	<b><u>Variance</u></b>	<b><u>Range</u></b>
Are SMEs well managed?	2.4000	2.0000	2.00=disagree	.96847	.938	3.00
Do SMEs experience difficulties in strategic management?	4.1333	4.0000	4.00=agree	.73030	.533	3.00
Do SMEs experience difficulties in accounting skills?	4.2667	4.0000	4.00=agree	.82768	.685	3.00
Do SMEs experience difficulties in financial management?	4.2333	4.0000	4.00=agree	.93526	.875	4.00
Do SMEs experience difficulties in human resources management?	4.1333	4.0000	4.00=agree	.77608	.602	3.00
Do SMEs experience difficulties in marketing?	4.0000	4.0000	4.00=agree	.74278	.552	3.00
Do SMEs have sufficient funds to operate?	2.6071	2.0000	2.00=disagree	1.25725	1.581	4.00
Accounting skills are important to the SME sector	4.3000	4.5000	5.00=strongly agree	.91539	.838	3.00
Accounting needs of the SME sector are different form larger businesses	3.5333	4.0000	4.00=agree	1.00801	1.016	4.00
Sufficient level of accounting skills	1.8621	2.0000	2.00=disagree	.69303	.480	3.00
SMEs have the necessary skills to prepare income statements	2.0333	2.0000	2.00=disagree	.88992	.792	4.00
SMEs have the necessary skills to prepare balance sheets	1.9000	2.0000	2.00=disagree	.88474	.783	4.00
SMEs have the necessary skills to prepare cash flow statements	2.0667	2.0000	2.00=disagree	.90719	.823	3.00
SMEs have the necessary skills to prepare tax returns	1.8000	2.0000	2.00=disagree	.76112	.579	3.00
Improvement of accounting skills can enhance profitability	4.4000	4.0000	4.00=agree	.56324	.317	2.00
The SME sector can benefit from accounting training	4.4333	4.0000	4.00=agree	.50401	.254	1.00
There is a need for improvement in accounting skills	4.4138	5.0000	5.00=strongly agree	.73277	.537	3.00
Lack of accounting skills can result in shortages in the funds of SMEs	4.1667	4.0000	4.00=agree	.79148	.626	3.00
Financial management skills are important to the SME sector	4.5000	4.5000	4.00=agree	.50855	.259	1.00
Financial management needs of the SME sector are different from larger businesses	3.3667	4.0000	4.00=agree	.96431	.930	4.00
There are sufficient levels of financial management skills	2.0345	2.0000	2.00=disagree	.86531	.749	3.00
SMEs have the necessary skills to prepare income statements	1.9333	2.0000	2.00=disagree	.73968	.547	3.00
SMEs have the necessary skills to prepare balance sheets	1.7333	2.0000	2.00=disagree	.73968	.547	3.00
SMEs have the necessary skills to prepare cash flow statements	2.1000	2.0000	2.00=disagree	.88474	.783	3.00
SMEs have the necessary skills to prepare tax returns	1.8000	2.0000	2.00=disagree	.88668	.786	3.00
Improvement of financial management skills can enhance	4.2333	4.0000	4.00=agree	.77385	.599	4.00

profitability						
The SME sector can benefit from financial management training	4.5000	4.5000	4.00=agree	.50918	.259	1.00
There is a need for improvement in financial management skills	4.3103	4.0000	4.00=agree	.80638	.650	4.00
Lack of financial management skills can result in shortages in the funds of SMEs	4.2759	4.0000	4.00=agree	.64899	.421	3.00

The above table illustrates the mean, median, mode, standard deviation, variance and range for each question answered by the interviewee.

The mean or the arithmetic mean is the sum of all the values divided by the sample size, the mode is the most frequent response given by the respondents and the median is the middle most value when the data (per variable/question) is arranged from highest to lowest. The sample variance is the degree or quantity by which each observation varies one from another. The sample standard deviation is the square root of the sample variance. From the table above, the majority of the knowledge questions in Section C and D have modes of “4” and “2 ” which are “agree” and “disagree”. The standard deviations are consistently about ”1” and this indicates good consistency between the observations, due to the low variability. The mean and median values are consistent with modal values. The descriptive statistics serve to confirm the graphical statistics. It should also be stated that descriptive statistics for Section A are not tabulated since these are questions that reflect the demographics of the respondents. The codes of interpretation especially for the median and the mode are “1=strongly disagree, 2=disagree, 3=neutral, 4=agree, 5=strongly agree”.

#### **6.4 The Kolmogorv Smirnov test**

The Kolmogorv Smirnov test is used to determine if the data is derived from a normal distribution.

$H_0$ : the tested variables come from a Normal distribution

$H_1$ : the tested variables do not come from a Normal distribution

**TABLE 6.27**  
**ONE-SAMPLE KOLMOGOROV-SMIRNOV TEST**

<b>QUESTION/ STATEMENT</b>	Normal Parameters(a,b)		Kolmogorov -Smirnov Z	Asymp. Sig. (2- tailed)
Are SMEs well managed?	2.4000	.96847	1.425	.034
Do SMEs experience difficulties in strategic management?	4.1333	.73030	1.612	.011
Do SMEs experience difficulties in accounting skills?	4.2667	.82768	1.499	.022
Do SMEs experience difficulties in financial management?	4.2333	.93526	1.651	.009
Do SMEs experience difficulties in human resources management?	4.1333	.77608	1.817	.003
Do SMEs experience difficulties in marketing?	4.0000	.74278	2.008	.001
Do SMEs have sufficient funds to operate?	2.6071	1.25725	1.548	.017
Accounting skills are important to the SME sector	4.3000	.91539	1.521	.020
Accounting needs of the SME sector are different from larger businesses	3.5333	1.00801	2.255	.000
Sufficient level of accounting skills	1.8621	.69303	1.711	.006
SMEs have the necessary skills to prepare income statements	2.0333	.88992	1.908	.001
SMEs have the necessary skills to prepare balance sheets	1.9000	.88474	1.579	.014
SMEs have the necessary skills to prepare cash flow statements	2.0667	.90719	1.621	.010
SMEs have the necessary skills to prepare tax returns	1.8000	.76112	1.441	.031
Improvement of accounting skills can enhance profitability	4.4000	.56324	1.796	.003
The SME sector can benefit from accounting training	4.4333	.50401	2.036	.001
There is a need for improvement in accounting skills	4.4138	.73277	1.645	.009
Lack of accounting skills can result in shortages in the funds of SMEs	4.1667	.79148	1.734	.005
Financial management skills are important to the SME sector	4.5000	.50855	1.847	.002
Financial management needs of the SME sector are different from larger businesses	3.3667	.96431	1.521	.020
There are sufficient levels of financial management skills	2.0345	.86531	1.850	.002
SMEs have the necessary skills to prepare income statements	1.9333	.73968	1.629	.010
SMEs have the necessary skills to prepare balance sheets	1.7333	.73968	1.420	.035
SMEs have the necessary skills to prepare cash flow statements	2.1000	.88474	1.707	.006
SMEs have the necessary skills to prepare tax returns	1.8000	.88668	1.702	.006
Improvement of financial management skills can enhance profitability	4.2333	.77385	1.907	.001
The SME sector can benefit from financial management training	4.5000	.50918	1.783	.003
There is a need for improvement in financial management skills	4.3103	.80638	1.700	.006
Lack of financial management skills can result in shortages in the funds	4.2759	.64899	1.722	.005

of SMEs				
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- a Test distribution is Normal.
- b Calculated from data.

At the 5% significance level, H0 is rejected for all of the questions and consequently the conclusion is that the tested variables do not come from a Normal distribution, due to the p-values all being less than 0.05, resulting in non-parametric statistics being utilised.

## 6.5. HYPOTHESIS

In Chapter Five, the first hypothesis that was developed related to the need to improve accounting skills in the SME sector in KwaZulu-Natal as follows:

H1: According to the opinion of the experts interviewed, there is a need to improve accounting skills in the SME sector in KwaZulu-Natal;

H0: According to the opinion of the experts interviewed, there is no need to improve accounting skills in the SME sector in KwaZulu-Natal.

In order to test this hypothesis, the Chi-Square Goodness of Fit test will be utilised to hypothesize what responses should be based on the null hypothesis and test this against the actual responses. The results of the tests are summarized as follows:

**TABLE 6.28**  
**RESULTS OF CHI-SQUARE GOODNESS OF FIT TEST**

Question	Chi-Square Value	p-value
Accounting skills are important to the SME sector in KZN	42.250	.000
There are sufficient levels of accounting skills in the SME sector in KZN	18.660	.000
Income Statements	24.611	.000
Balance Sheets	10.036	.018
Cash Flow Statements	7.619	.045
Tax returns	11.057	.011
The improvement of accounting skills can enhance the profitability of the SME sector in KZN	55.050	.000
The SME sector in KZN will benefit from accounting training	21.350	.000
In your opinion is there a need for an improvement in accounting skills in the SME sector in KZN	47.552	.000
A lack of accounting skills can result in a shortage of funds in the SME sector in KZN	48.300	.000

At the 5% significance level, since the p-values are less than 0.05, the H1 is accepted. Therefore, according to the opinion of the experts interviewed, there is a need to

improve accounting skills in the SME sector in KwaZulu-Natal. Although the values for each of the variables are not reflected in the above table, it is important to note that we assumed an equal frequency/distribution of responses across the tested variables under the null hypothesis.

This hypothesis can also be tested using the one sample t-test to determine if the average score/response for Questions a, b, e, f, g and h is 1 (strongly disagree) or 2 (disagree) and if the average response score for Questions c and d is 4 (agree) or 5 (strongly agree).

The results are summarized below:

**TABLE 6.29**  
**ONE-SAMPLE TEST: TEST VALUE=1**

	Test value =1			
	t	Df	Sig. (2-tailed)	Mean Difference
Accounting skills are important to the SME sector in KZN	19.746	29	.000	3.30000
The improvement of accounting skills can enhance the profitability of the SME sector in KZN	33.063	29	.000	3.40000
The SME sector in KZN will benefit from accounting training	37.311	29	.000	3.43333
In your opinion, is there a need for an improvement in accounting skills in the SME sector in KZN?	25.088	28	.000	3.41379
A lack of accounting skills can result in a shortage of funds in the SME sector in KZN	21.914	29	.000	3.16667

**TABLE 6.30**  
**ONE-SAMPLE TEST: TEST VALUE=2**

	Test value =2			
	t	Df	Sig. (2-tailed)	Mean Difference
Accounting skills are important to the SME sector in KZN	13.762	29	.000	2.30000
The improvement of accounting skills can enhance the profitability of the SME sector in KZN	23.339	29	.000	2.40000
The SME sector in KZN will benefit from accounting training	26.444	29	.000	2.43333
In your opinion, is there a need for an improvement in	17.739	28	.000	2.41379

accounting skills in the SME sector in KZN?				
A lack of accounting skills can result in a shortage of funds in the SME sector in KZN	14.994	29	.000	2.16667

**TABLE 6.31**  
**ONE-SAMPLE TEST: TEST VALUE=4**

	Test value =4			
	t	df	Sig. (2-tailed)	Mean Difference
There are sufficient levels of accounting skills in the SME sector in KZN	-16.613	28	.000	-2.13793
Income Statements	-12.104	29	.000	-1.96667
Balance Sheets	-13.001	29	.000	-2.10000
Cash Flow Statements	-11.673	29	.000	-1.93333
Tax returns	-15.832	29	.000	-2.20000

**TABLE 6.32**  
**ONE-SAMPLE TEST: TEST VALUE=5**

	Test value =5			
	t	df	Sig. (2-tailed)	Mean Difference
There are sufficient levels of accounting skills in the SME sector in KZN	-24.383	28	.000	-3.13793
Income Statements	-18.259	29	.000	-2.96667
Balance Sheets	-19.191	29	.000	-3.10000
Cash Flow Statements	-17.710	29	.000	-2.93333
Tax returns	-23.028	29	.000	-3.20000

As the p-values are all less than 0.05, H1 is accepted. Therefore, according to the opinion of the experts interviewed, there is a need to improve accounting skills in the SME sector in KwaZulu-Natal.

The second hypothesis, developed in Chapter Five, was:

H1: According to the opinion of the experts interviewed, there is a need to improve financial management skills in the SME sector in KwaZulu-Natal.

H0: According to the opinion of the experts interviewed, there is no need to improve financial management skills in the SME sector in KwaZulu-Natal.

The results from the Chi-Square test are summarized as follows:

**TABLE 6.33**  
**RESULTS OF CHI-SQUARE GOODNESS OF FIT TEST**

	Chi-Square	p-value
Financial management skills are important to the SME sector in KZN	18.600	.000
Financial management needs of the SME sector are different from larger businesses	18.333	.001
There are sufficient levels of financial management skills in the SME sector in KZN	19.414	.000
Prepare business plans	19.333	.000
Analyse financial statements	19.867	.000
Prepare cash budgets	14.000	.003
Perform scenario planning	7.800	.020
The improvement of financial management skills can enhance the profitability of the SME sector in KZN	16.200	.000
The SME sector in KZN will benefit from financial management training	17.000	.000
In your opinion, is there a need for an improvement in financial management skills in the SME sector in KZN?	12.483	.002
Do you think that a lack of financial management skills can result in a shortage of funds in the SME sector in KZN?	14.966	.001

At the 5% significance level, since the p-values are all less than 0.05, H1 is accepted.

Therefore, according to the opinion of the experts interviewed, there is a need to improve financial management skills in the SME sector in KwaZulu-Natal.

The hypothesis can also be tested by using the one sample t-test and testing to see if the average score/response for Questions a, b, e, f, g and h is 1 (strongly disagree) or 2 (disagree) and if the average response score for Questions c and d is 4 (agree) or 5 (strongly agree).

The results are summarized below:

**TABLE 6.34**  
**ONE-SAMPLE TEST: TEST VALUE=1**

	Test value =1			
	T	df	Sig. (2-tailed)	Mean Difference
Financial management skills are important to the SME sector in KZN	37.696	29	.000	3.50000
Financial management needs of the SME sector are different from larger businesses	13.443	29	.000	2.36667
The improvement of financial management skills can enhance the profitability of the SME sector in KZN	22.885	29	.000	3.23333
The SME sector in KZN will benefit from financial management training	36.373	27	.000	3.50000
In your opinion, is there a need for an improvement in financial management skills in the SME sector in KZN?	22.107	28	.000	3.31034
Do you think that a lack of financial management skills can result in a shortage of funds in the SME sector in KZN?	27.183	28	.000	3.27586

**TABLE 6.35**  
**ONE-SAMPLE TEST: TEST VALUE=2**

	Test value =2			
	t	df	Sig. (2-tailed)	Mean Difference
Financial management skills are important to the SME sector in KZN	26.926	29	.000	2.50000
Financial management needs of the SME sector are different from larger businesses	7.763	29	.000	1.36667
The improvement of financial management skills can enhance the profitability of the SME sector in KZN	15.807	29	.000	2.23333
The SME sector in KZN will benefit from financial management training	25.981	27	.000	2.50000
In your opinion, is there a need for an improvement in financial management skills in the SME sector in KZN?	15.429	28	.000	2.31034
Do you think that a lack of financial management skills can result in a shortage of funds in the SME sector in KZN?	18.885	28	.000	2.27586

**TABLE 6.36**  
**ONE-SAMPLE TEST: TEST VALUE=1**

	Test value =4			
	t	Df	Sig. (2-tailed)	Mean Difference
There are sufficient levels of financial management skills in the SME sector in KZN	-12.232	28	.000	-1.96552
Prepare business plans	-15.303	29	.000	-2.06667
Analyse financial statements	-16.784	29	.000	-2.26667
Prepare cash budgets	-11.763	29	.000	-1.90000
Perform scenario planning	-13.590	29	.000	-2.20000

**TABLE 6.37**  
**ONE-SAMPLE TEST: TEST VALUE=5**

	Test value =5			
	t	Df	Sig. (2-tailed)	Mean Difference
There are sufficient levels of financial management skills in the SME sector in KZN	-18.455	28	.000	-2.96552
Prepare business plans	-22.708	29	.000	-3.06667
Analyse financial statements	-24.189	29	.000	-3.26667
Prepare cash budgets	-17.953	29	.000	-2.90000
Perform scenario planning	-19.767	29	.000	-3.20000

Since the p-values are all less than 0.05, H1 is accepted. Therefore, according to the opinion of the experts interviewed, there is a need to improve financial management skills in the SME sector in KwaZulu-Natal.

## 6.6 RELIABILITY ANALYSIS

Coakes and Steed (2003, pg 140) state that there are a number of different reliability coefficients. One of the most commonly used is the Cronbach's alpha, which is based on the average correlation of items within a test, if the items are standardised. If the items are not standardised, it is based on the average covariance among the items. The Cronbach's alpha can range from 0 to 1. Cronbach's alpha was also calculated as part of the reliability test to assess how consistent the results were, and whether we would get similar results to generalize if we increased the sample size. A value of 0.7 or higher is a very good value that indicates that we would get the same results if we carried out this survey with a larger sample of respondents. The Cronbach's alpha was calculated for all the questions, which have the same scales in each section, i.e. Section B, Section C and Section D and then overall. The results are as follows:

### **Section B: Business problems experienced by the SME sector** **Reliability Statistics**

Cronbach's Alpha	N of Items
.681	7

### **Section C: Accounting skills** **Reliability Statistics**

Cronbach's Alpha	N of Items
.776	11

### **Section D: Financial management skills** **Reliability Statistics**

Cronbach's Alpha	N of Items
.666	11

### **Overall** **Reliability Statistics**

Cronbach's Alpha	N of Items
.718	29

As indicated in Chapter Five, an overall score in excess of 0,7 indicates that the data is reliable

## **6.7 SUMMARY OF CHAPTER**

Based on the methodology devised in Chapter Five, interviews were conducted with thirty interviewees that were considered to have expert knowledge of the SME sector in KwaZulu-Natal. The feedback obtained indicates that, according to the respondents:

### **A) MANAGEMENT OF THE SME SECTOR IN KWAZULU-NATAL**

- The SME sector is not well managed;
- The sector is experiencing difficulties in accounting and financial management skills; and,
- The sector does not have sufficient funds to operate.

### **B) ACCOUNTING AND FINANCIAL MANAGEMENT SKILLS**

- Although the accounting and financial management skills needed by the SME sector are different from larger businesses, the sector does not have a sufficient level of these skills;
- The management/owners of SMEs do not have the necessary skills to prepare income statements, balance sheets, cash flow statements and tax returns;
- The management/owners of the SME sector do not have the necessary skills to prepare business plans, analyse financial statements, prepare cash budgets and perform scenario planning;
- An improvement of accounting and financial management skills will enhance the profitability of the SME sector in KwaZulu-Natal;
- There is a need for accounting and financial management training in the SME sector; and,
- A lack of accounting and financial management skills can result in a shortage of funds in the SME sector.

Most of the responses corroborate the literature review undertaken in Chapters Two to Four. Given the low success rate of the SME sector identified in earlier chapters and the low levels of financial management and accounting skills that were empirically identified during the research, there is definitely a need for a programme to impart these skills. The hypothesis, which indicated that, according to the opinion of the experts

interviewed, there is a need to improve accounting and financial management skills in the SME sector in KwaZulu-Natal, statistically supports this conclusion.

However, the need to improve accounting and financial management skills must be viewed in the overall context of the respondents feedback in Question Two, Section B, which indicated that problems are also experienced in the areas of strategic management, accounting, financial management, human resources and marketing.

Whilst the feedback does support the premise that accounting and financial management skills require an improvement, these areas cannot be viewed in isolation from the other important areas that are required to successfully manage and grow an SME. These other important areas include marketing, sales, planning, leadership and skills (Pretorius, 2008, p 412-413).

## **CHAPTER SEVEN: SUMMARY, RECOMMENDATIONS AND CAVEATS**

### **7.1 INTRODUCTION**

This chapter concludes the research by summarising the preceding chapters and highlighting the results of the empirical research from Chapter Six. It also includes a commentary on the contribution and limitations of the research and recommendations for future research.

### **7.2 RESEARCH PROBLEM AND OBJECTIVES**

**Research problem:** To determine and evaluate accounting and financial management skills that are needed by the SME sector in KwaZulu-Natal.

**Research objectives:** The objective of this thesis is to perform a needs analysis of financial management and accounting skills in the SME sector in KwaZulu-Natal by:

1. Adequately defining an SME in the context of the business environment in South Africa (Chapter Two);
2. Analysing the local business environment in KwaZulu-Natal and determining the performance of the sector, with a view to identifying some of the problems encountered by SMEs in the province (Chapter Two).
3. Research and consideration of the specific accounting and financial management skills needed by the small business sector in South Africa (Chapters Three and Four).
4. Analysing the availability of accounting and financial management skills in the SME sector in KwaZulu-Natal by empirical research and to evaluate whether there is a need to improve the financial management and accounting skills in the province (Chapter Six).

Due to the complexities of managing an SME and the potential contribution that it can make to the economic, political and social landscape, it was appropriate to undertake qualitative research to adequately explore and describe the accounting and financial management skills needs of the SME sector in KwaZulu-Natal.

Given the lack of business skills highlighted above, it may be more prudent to rely on the opinion of industry experts in order to analyse the accounting and financial management needs of the SME sector in KwaZulu-Natal.

In addition to industry experts being more knowledgeable about the accounting and financial management skills issues, they may also be more open to issues faced by the SME sector. Many owners of SMEs are reluctant to provide financial information as they regard this as being strictly confidential (Soni, S, 1999, P7.21).

A sample size of **thirty** industry experts was utilised for the qualitative research as this is considered an appropriate sample size to obtain diverse feedback from different sets of experts.

In order to ensure that the individuals selected do have the necessary knowledge to make a contribution to the research, they need to meet at least one of the following criteria:

- A formal business qualification relating to the SME sector;
- At least five years experience with SME development;
- At least five years experience in management of an SME;
- Experience in the training of / Involvement with financial management in the SME sector; and,
- Experience in the training of / Involvement with accounting in the SME sector.

The research objectives were tested by the following hypothesis:

1. H1: According to the opinion of the experts interviewed, there is a need to improve accounting skills in the SME sector in KwaZulu-Natal; and  
H0: According to the opinion of the experts interviewed, there is no need to improve accounting skills in the SME sector in KwaZulu-Natal.
2. H1: According to the opinion of the experts interviewed, there is a need to improve financial management skills in the SME sector in KwaZulu-Natal; and,  
H0: According to the opinion of the experts interviewed, there is no need to improve financial management skills in the SME sector in KwaZulu-Natal.

### **7.3 RESEARCH FINDINGS**

Based on the methodology devised in Chapter Five, interviews were conducted with thirty interviewees that were considered to have expert knowledge of the SME sector in KwaZulu-Natal. The feedback obtained from the respondents indicates that:

#### **A) BUSINESS PROBLEMS**

- The SME sector is not well managed – approximately 16% and 43% of the respondents strongly disagree and disagree respectively that the SME sector is well managed; and,
- The sector does not have sufficient funds to operate – approximately 17% and 40% of the respondents strongly disagree and disagree respectively that SMEs have sufficient funds to operate.

#### **B) ACCOUNTING SKILLS**

- Accounting skills are important to the SME sector in KwaZulu-Natal-approximately 40% and 50% of the respondents agree and strongly agree respectively that accounting skills are important to the SME sector in KwaZulu-Natal;
- Accounting needs of the SME sector are different from larger businesses-approximately 67% and 7% of the respondents agree and strongly agree respectively that the accounting needs of the SME sector are different from larger businesses;
- There is an insufficient level of accounting skills in KwaZulu-Natal-approximately 27% and 60% of the respondents strongly disagree and disagree respectively that there is a sufficient level of accounting skills in the SME sector in KwaZulu-Natal;
- Management/owners of the SME sector in KwaZulu-Natal do not have the necessary skills to prepare income statements, balance sheets, cash flow statements and tax returns - at least 75% of the respondents strongly disagreed or disagreed that owners/managers of the SME sector in KwaZulu-Natal have the necessary skills to prepare income statements, balance sheets, cash flow statements and tax returns;
- The improvement of accounting skills can enhance the profitability of the SME sector in KwaZulu-Natal – approximately 53% and 43% of the respondents

agree and strongly agree respectively that the improvement of accounting skills can enhance the profitability of the SME sector in KwaZulu-Natal;

- The SME sector in KwaZulu-Natal will benefit from accounting training - approximately 57% and 43% of the respondents agree and strongly agree respectively that the SME sector in KwaZulu-Natal will benefit from accounting training;
- There is a need for an improvement in accounting skills in the SME sector in KwaZulu-Natal - approximately 41% and 52% of the respondents agree and strongly agree respectively that there is a need for an improvement in accounting skills in the SME sector in KwaZulu-Natal; and,
- A lack of accounting skills can result in shortages of funds in the SME sector in KwaZulu-Natal - approximately 56% and 33% of the respondents agree and strongly agree respectively that a lack of accounting skills can result in a shortage of funds in the SME sector in KwaZulu-Natal.

### **C) FINANCIAL MANAGEMENT SKILLS**

- Financial management skills are important to the SME sector in KwaZulu-Natal – 50% and 50% of the respondents agree and strongly agree respectively that financial management skills are important to the SME sector in KwaZulu-Natal;
- Financial management needs of the SME sector are different from larger businesses- approximately 46% and 7% of the respondents agree and strongly agree respectively that the financial management needs of the SME sector are different from larger businesses;
- There is an insufficient level of financial management skills in KwaZulu-Natal - approximately 24% and 59% of the respondents strongly disagree and disagree respectively that there is a sufficient level of financial management skills in the SME sector in KwaZulu-Natal;
- Management/owners of the SME sector in KwaZulu-Natal do not have the necessary skills to prepare business plans, analyse financial statements, prepare cash budgets and perform scenario planning - at least 76% of the respondents strongly disagree or disagree that owners/managers of the SME sector in KwaZulu-Natal have the necessary skills to prepare business plans, analyse financial statements, prepare cash budgets and perform scenario planning;
- The improvement of financial management skills can enhance the profitability of the SME sector in KwaZulu-Natal – approximately 63% and 33% of the

respondents agree and strongly agree respectively that the improvement of financial management skills can enhance the profitability of the SME sector in KwaZulu-Natal;

- The SME sector in KwaZulu-Natal will benefit from financial management training - 50% and 50% of the respondents agree and strongly agree respectively that the SME sector in KwaZulu-Natal will benefit from financial management training;
- There is a need for an improvement in financial management skills in the SME sector in KwaZulu-Natal - approximately 55% and 41% of the respondents agree and strongly agree respectively that there is a need for an improvement in financial management skills in the SME sector in KwaZulu-Natal; and,
- A lack of financial management skills can result in shortages of funds in the SME sector in KwaZulu-Natal - approximately 62% and 34% of the respondents agree and strongly agree respectively that a lack of financial management skills can result in a shortage of funds in the SME sector in KwaZulu-Natal.

Most of the responses corroborate the literature review undertaken in Chapters Two to Four. Given the low success rate of the SME sector identified in earlier chapters and the low levels of financial management and accounting skills that were empirically identified during the research, there is definitely a need for a programme to impart these skills.

The hypothesis, which indicated that there is a need to improve the accounting and financial management skills in the SME sector in KwaZulu-Natal, statistically supports this conclusion.

#### **7.4 CONTRIBUTIONS OF THE FINDINGS**

Chapter Two highlighted the work undertaken by the provincial and national government to stimulate growth in the SME sector. It was demonstrated that there are several initiatives that are being undertaken to grow the SME sector by providing funding and non-financial support to grow the sector. For example, in 2006, an amount of R200 million was allocated to Ithala Financial Development Corporation to fund the SME sector in KwaZulu-Natal (Mkhize, 2006, p1-7). Such funding can be utilised more effectively if loans to the SME sector are complimented with basic levels of training in accounting and financial management, identified in Chapters Three and Four, such as

imparting the skills that are required to prepare income statements, balance sheets, cash flow statements and other financial management skills, as illustrated in Chapter Four.

The findings may be used by those entities that are outsourcing non-core services by the creation of smaller business owners. Although the non-core services that are being outsourced may not be a significant aspect of the entity's operations, the success or failure of these outsourced business units will impact on the overall profitability of the entity. The research findings can be used by the outsourcing entity to enhance the business skills of owners of the outsourced business. The suggestions that were made regarding the preparation of income statements, balance sheets and cash flow statements can be used to effectively control and monitor the outsourced business. In addition, the suggestions that were made relating to the preparation of business plans can be used in order to access finance that may be needed to grow the business.

Additionally, high schools and tertiary institutions that provide business training to potential entrepreneurs can use the research findings. There are many basic business and entrepreneurship courses offered at tertiary institutions and the findings relating to accounting and financial management skills can be incorporated into these courses. The advantage of using this channel is that these important skills can be imparted prior to the establishment of the business and in a formal manner.

Government departments and other organisations that have been established to improve the productivity of businesses can also use the findings. One such organisation, The National Productivity Institute, focuses on the improvement of internal business processes in order to improve profitability of businesses. These findings can be used by organisations such as the National Productivity Institute to improve the accounting and financial management skills of the business, thereby contributing to overall productivity.

## **7.5 LIMITATIONS**

There are some limitations to the research that was conducted:

- The methodology was designed to obtain feedback from experts in the SME sector in KwaZulu-Natal. Most of these experts are not involved in the operation of SMEs and it may be that if the research was only undertaken with business owners, the result may be different. However, this risk is reduced by the fact that

certain successful SME owners, that met the definition of an SME expert, were selected for the interview;

- Due to resource constraints, all of the experts selected were based in either Durban or Pietermaritzburg, and there exists a possibility that the research findings may only be applicable to Durban and Pietermaritzburg.
- It should also be noted that the sample size of thirty can be viewed as a limitation of the study and is an avenue for future research.

## **7.6 SUGGESTIONS FOR FUTURE RESEARCH**

The research findings clearly indicate that there is a need to improve the accounting and financial management skills in the SME sector in KwaZulu-Natal. An area for future research could relate to the development of an effective training programme to improve the financial management and accounting skills of the SME sector in the province. Such a programme can incorporate elements of the skills that were discussed in Chapters Three and Four. The programme can be modified to suite different entry levels into the SME sector, for example school training, informal training provided to businesses and modular training provided to business executives.

Future research may focus on the use of a larger sample size and undertaking a survey of SME owners, provided an appropriate sample frame can be utilised.

## **7.7 CONCLUSION**

This chapter highlighted the need for the study, the results of the literature review and the research findings. The literature review and the research findings support the assertions that, according to the experts interviewed, there is a need for an improvement in the accounting and financial management skills in the SME sector in KwaZulu-Natal.

The chapter also highlighted the limitations of the research and recommended further research. Considering the low levels of accounting and financial management skills that exist in the SME sector in KwaZulu-Natal, further research can be undertaken into the feasibility of a module that can be used to impart accounting and financial management skills to the sector.

**ANNEXURE ONE**

**ANNEXURE TWO**

**Informed Consent Document**

I, Rajendra Rajaram, am a student currently registered for the M Com Degree on the Pietermaritzburg campus of the University of KwaZulu-Natal (UKZN). A requirement for the degree is a dissertation and I have chosen the following topic:

*“A needs analysis of financial management and accounting skills in the SME sector in KwaZulu-Natal.”*

I can be reached on [rajaramr@ukzn.ac.za](mailto:rajaramr@ukzn.ac.za) or on 033 260 6267.

My academic supervisor is Professor Charles O’Neill, based in the School of Management on the Pietermaritzburg campus of the University of KwaZulu-Natal. He can be contacted on [oneillc@ukzn.ac.za](mailto:oneillc@ukzn.ac.za) or on 033 260 5223 during office hours.

The purpose of this research is to ascertain the availability of accounting and financial management needs in the SME sector in KwaZulu-Natal. Due to the in-depth knowledge required to make a meaningful contribution to this study, experts such as yourself have been selected as representatives of the regional business and academic community. Information gathered in this study will include data retrieved from the interview that I would require you to answer. Please note that your name or that of the institution or company you represent will not be included in the report. The questionnaire does not require any personal information. The information will be seen only by my supervisor, examiner and I. Your anonymity and confidentiality is of utmost importance and will be maintained throughout the study.

*The findings of this study will be utilized to make recommendations to the relevant parties to improve the accounting and financial management needs identified in the study.*

Your participation in completing the interview is completely voluntary and you are in no way forced to attend the interview. You have the right to withdraw at any time during the study.

I appreciate the time and effort it would take to participate in this study. I would be very grateful for your participation, as it would enable me to complete my dissertation.

**Please complete the section below:**

I ..... (full names of participant)  
hereby confirm that I understand the contents of this document and the nature of the research project, and I consent to participating in the research project.  
I understand that I am at liberty to withdraw from the project at any time, should I so desire.

Signature of Participant.....

Date.....

**ANNEXURE THREE**

**SECTION A: PERSONAL DETAILS OF INTERVIEWEE**

1. Name

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2. Occupation (Insert a tick (√) in the appropriate space)

<b><u>ENTREPRENEUR</u></b>	<b><u>ACADEMIC</u></b>	<b><u>FINANCIER</u></b>	<b><u>SERVICE PROVIDER</u></b>	<b><u>POLICY MAKER</u></b>	<b><u>OTHER (PLEASE SPECIFY)</u></b>

3. Age (Insert a tick (√) in the appropriate space)

<b><u>18-24</u></b>	<b><u>25-34</u></b>	<b><u>35-44</u></b>	<b><u>45+</u></b>

4. Educational Qualification (Insert a tick (√) in the appropriate space)

<b><u>MATRIC OR BELOW</u></b>	<b><u>BUSINESS</u></b>	<b><u>FINANCIAL</u></b>	<b><u>POST GRADUATE</u></b>	<b><u>OTHER (PLEASE SPECIFY)</u></b>

5. Race (Insert a tick (√) in the appropriate space)

<b><u>AFRICAN</u></b>	<b><u>ASIAN</u></b>	<b><u>COLOURED</u></b>	<b><u>WHITE</u></b>	<b><u>OTHER (PLEASE SPECIFY)</u></b>

6. How many years have you been involved in the SME sector in KZN? (Insert a tick (√) in the appropriate space)

<b><u>5-10</u></b>	<b><u>10+</u></b>

**SECTION B: BUSINESS PROBLEMS EXPERIENCED BY SME SECTOR**

**FOR THE PURPOSES OF RESPONDING TO THIS SECTION SMALL AND MEDIUM SIZED BUSINESSES ARE DEFINED AS:**

**SMALL BUSINESS:**

- Do not have public accountability
- Publish general financial statements for external users
- Employ between five and fifty people
- Meet formal registration requirements
- Are owner managed and controlled

**MEDIUM SIZED BUSINESSES:**

- Do not have public accountability
- Publish general financial statements for external users
- Employ a maximum of two hundred people
- Have an asset base of a maximum of R 5 million
- Meet formal registration requirements

1. In your opinion are SMEs well managed? (Insert a tick (√) in the appropriate space)

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

2. In your opinion does the SME sector experience difficulties in the following areas?

(Insert a tick (√) in the appropriate space)

	<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>
STRATEGIC MANAGEMENT					
ACCOUNTING SKILLS					
FINANCIAL MANAGEMENT					
HUMAN RESOURCES MANAGEMENT					
MARKETING					

3. In your opinion do SMEs have sufficient funds to operate? (Insert a tick (√) in the appropriate space)

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

**SECTION C - ACCOUNTING SKILLS**

**ACCOUNTING SKILLS ARE THOSE SKILLS REQUIRED TO MAINTAIN A SYSTEMATIC SET OF FINANCIAL RECORDS AND LATER USE THESE RECORDS AS A BASIS FOR MEANINGFUL REPORTING**

1) Do you agree with the following statements? (Insert a tick (√) in the appropriate space)

a) Accounting skills are important to the SME sector in KwaZulu-Natal

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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b) Accounting needs of the SME sector are different from larger businesses

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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c) There is sufficient level of accounting skills in the SME sector in KwaZulu-Natal

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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d) Management/owners of SMEs in KwaZulu-Natal have the necessary skills to prepare the following:

	<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>
Income Statements					
Balance Sheets					
Cash Flow Statements					
Tax returns					

e) The improvement of accounting skills can enhance the profitability of the SME sector in KwaZulu-Natal

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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f) The SME sector in KwaZulu-Natal will benefit from accounting training.

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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g) There is a need for an improvement in accounting skills in the SME sector in KwaZulu-Natal.

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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h) A lack of accounting skills can result in shortages of funds in the SME sector in KwaZulu-Natal.

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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**SECTION D – FINANCIAL MANAGEMENT SKILLS**

**FINANCIAL MANAGEMENT SKILLS ARE THOSE SKILLS REQUIRED TO FACILITATE THE INVESTMENT AND FINANCING DECISIONS OF A BUSINESS. ALTHOUGH LINKED TO ACCOUNTING, THE PRIMARY OBJECTIVE OF FINANCIAL MANAGEMENT IS TO CREATE WEALTH.**

1) Do you agree with the following statements? (Insert a tick (√) in the appropriate space)

a) Financial management skills are important to the SME sector in KwaZulu-Natal

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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b) Financial management needs of the SME sector are different from larger businesses

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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c) There is sufficient level of financial management skills in the SME sector in KwaZulu-Natal

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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d) Management/owners of SMEs in KwaZulu-Natal have the necessary skills to undertake the following:

	<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>
Prepare business plans					
Analyse financial statements					
Prepare cash budgets					
Perform scenario planning					

e) The improvement of financial management skills can enhance the profitability of the SME sector in KwaZulu-Natal

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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f) The SME sector in KwaZulu-Natal will benefit from financial management training.

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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g) There is a need for an improvement in financial management skills in the SME sector in KwaZulu-Natal.

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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h) A lack of financial management skills can result in shortages of funds in the SME sector in KwaZulu-Natal.

<b><u>STRONGLY DISAGREE</u></b>	<b><u>DISAGREE</u></b>	<b><u>NEUTRAL</u></b>	<b><u>AGREE</u></b>	<b><u>STRONGLY AGREE</u></b>

Comments (if any)

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