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### The Environmental Context for SMME Entrepreneurship in Kwazulu-Natal

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Employment Promotion Programme



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Entrepreneurship in Kwazulu-Natal**

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## **Abstract**

The development of SMME entrepreneurship is the focus of considerable policy interest in South Africa and many other countries of the world. This is particularly in recognition of its contribution to economic growth, poverty alleviation and employment. In South Africa, various new strategies and institutions have been created recently with a view to empower formerly disadvantaged members to enter the mainstream economy as entrepreneurs rather than job seekers. While considerable efforts are placed on advancing SMMEs by the government, there are also certain environmental factors that favour or hinder the optimal development of these firms.

According to the GEM reports, the level of entrepreneurial activity in South Africa is rather low in relation to other countries at similar level of development. This paper uses factor analysis to examine the internal and external environmental conditions influencing the development of small ventures on the basis of a survey done in Pietermaritzburg, the capital of the KZN province. The results indicate that 3 clusters constrain SMME development in Pietermaritzburg: Management, Finance and External environmental conditions. In the external set, rising crimes, laws and regulations, and taxation are found to be significant constraints to the development of business firms.

## **1. Introduction**

The promotion of SMMEs is the focus of considerable policy interest in South Africa and many other countries. In its 'White Paper on National Strategy for the Development and Promotion of Small Business in South Africa', the South African government has explicitly identified the promotion of SMMEs as a policy imperative for addressing the challenges of unemployment and poverty. SMMEs are an important source of jobs. They contribute significantly to the economic growth of countries and to advancing national and individual prosperity. The transition from poverty to wealth in most nations has mostly been through private actors, farmers, investors, small and larger businesses. If countries, particularly those in Africa, are to grow out of poverty, unemployment and create a more prosperous future, they will need more SMMEs and bigger businesses (Moss, 2007: 223). However, to achieve this, a better environment is required for entrepreneurs to start up businesses, operate and grow. The Business Confidence Index was at 85 for Pietermaritzburg in 2006 and nationally for South Africa it was (June 2008) 92.6, encouraging signs for business. Further, South Africa registered an average real growth rate of 2.6% over 1996-2000, and more recently the growth rate has been around 5% during the years 2004-2007 (SARB, 2008).

Committed to promoting SMMEs, the government in South Africa has put in place various measures and strategies, such as the Small Enterprise Development Agency (SEDA), Khula, Ntiska, National Empowerment Fund, and Umsombovu Youth Fund and the Accelerated and Shared Growth Initiative for South Africa (ASGISA) to fast track the empowerment of formerly disadvantaged individuals into business entrepreneurship. Apart from financial assistance and training through various SETAs, numerous fiscal incentives have been offered in the budgets over the past few years with a view to augment the supply of effective entrepreneurship at the SMME level. Despite all these commendable efforts, the total early stage entrepreneurial activity (TEA), as also reflected by recent Global Entrepreneurship Monitor (GEM) reports, is rather low in

South Africa relative to other countries at a similar level of development. South Africa's TEA decreased from 9.43 in 2001 to 5.29 in 2006. It thus seems that the level of entrepreneurial activity is not sufficient to sustain South Africa's growth expectations and provide employment to a rising annual number of school leavers (Herrington and Mass, 2007).

Even with the provision of capital and training, regarded as critical inputs to business start-ups and expansions, there is still a deficit in the stock of entrepreneurial firms. The question then arises whether environmental factors are having an influence on constraining the development of business ventures in the province. This paper, thus, examines whether environmental conditions are perceived to be favourable or detrimental to the growth of SMME entrepreneurship in Pietermaritzburg, the capital of South Africa's Kwazulu-Natal province. Environmental conditions refer to the broad range of conditions that affect the entrepreneurs and their businesses (Moss, 2007: 234).

The paper consists of 5 main sections. The first presents a review of the literature on internal and external constraints, the second describes the research methodology, the third presents the descriptive results, the fourth covers the factor analysis and the final section mentions some policy recommendations.

## **2. Literature Review**

### **Business Environmental Conditions**

Businesses are neither independent nor completely isolated from the internal and external environment within which they function. (Fry, Stoner and Hattwick, 2001: 13). The interaction of firms with their formal and informal institutions determines the environment in which the entrepreneurs operate at any point in time and in different places (North, 1994). The environment includes both 'rules of the game' and the social-economic setting that determines legitimate or acceptable behaviour. Put simply, the environment refers to a broad range of conditions that affect entrepreneurs (Moss, 2007: 235). The environmental conditions are related to both conditions internal to the firm and outside the firm. Changes in the environment can have positive or negative consequences

for business growth. The business environmental conditions are particularly unfriendly in much of Africa (World Bank, 2006).

## **Internal Environment**

### **Access to Finance**

Access to finance and the cost of financing are major obstacles to business starts-up and growth in South Africa as well as in developed and developing countries (Orford, Wood, Fisher, Herrington and Segal, 2003). According to the Investment Climate Survey (2004:12), finance ranked among the top five constraints to business development in Sub-Saharan Africa. This is partly because financial institutions view many small firms as high-risk ventures with poor collateral and lending to them entail high administrative costs in relation to the size of the loans. The majority of small entrepreneurial ventures raise finance through friends and family, or through informal lenders (Orford *et al*, 2003: 36). While increased financial support is necessary, what is more important is the ability to manage finance and keep proper records. Given the centrality of cash flow to the survival of a business, proficiency in financial administration can reduce business failure. Ability to handle finance therefore becomes a pre-requisite for business growth and expansion (Orford *et al*, 2003: 46).

The recently introduced National Credit Act (2007) may make it difficult for some firms to raise loans. However, as Marshall (1891) puts it, ability always finds the necessary capital. Firms, whose entrepreneurs are ‘dull’, are by this fact alone restricted in their growth and development (Penrose, 1995: 36).

### **Human resource and management skills**

A firm would not exist if it did not have productive human inputs. It is the entrepreneur’s responsibility to hire and manage labour within the firm. However, recruitment and retention of labour is affected by internal and external factors. Internally, if the firm is already operating near full capacity, expansion in demand for the firm’s products may necessitate additional labour. Although internal conditions necessitate the hiring of additional manpower, the intricacies of the labour laws, such as Labour Relations,

Employment Equity and Minimum Wage Regulations, may prevent employers from hiring additional labour. Such stringent legislation, that imposes labour market rigidities, robs the market of its flexibility, making hiring or firing too costly. When there is a shortage of skilled people, retention of labour is also a problem as skilled workers often hop from one firm to another in response to incentives. Skill shortages thus make the recruitment process for quality labour more difficult, time consuming and expensive.

In today's changing business environment, it is not enough to have just the technical understanding of how to start a venture. An entrepreneur who successfully starts a business may not necessarily be a good manager. According to the GEM report (2006), managerial and entrepreneurial skills necessary for SMME development are lacking in South Africa.

### **Innovation and Technology**

All businesses, regardless of their size, need to innovate and adopt new ideas and practices to satisfy the changing needs of the market in a global environment. Outcomes of innovation include: introducing new products or services in new and existing markets, developing new organisational structures competing in new ways; and using new production functions and technology in creative ways to service customer needs (Schumpeter, 1942; Casson, 2003). Although the utilisation of digital technology can be a source of competitive advantage, some conservative entrepreneurs often view information technology as extremely expensive and may still prefer the conventional way of doing business. Such a myopic view ultimately constrains the growth prospects, as the firm is likely to miss out opportunities in the changing environment. Indeed, according to a recent GEM study, 60% of the surveyed entrepreneurs reported making no use of new technologies. However, emerging entrepreneurs were found to be generally more optimistic about technologies than older businesses (GEM, 2006).

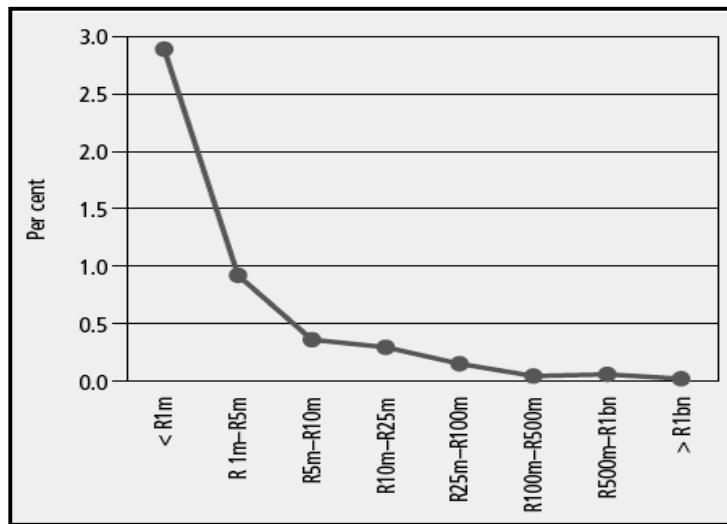
## **External Environment**

The external environment relates to factors over which the entrepreneur does not have much control. These include legal restrictions, such as requiring multiple licenses to start a business, lack of property protection (the state can seize the private entrepreneurs' assets and distribute them possibly to comrades or war veterans, making value-adding highly risky under conditions of low trust), excessive regulations and red tape, socio-economic conditions, such as high inflation and crime rates, availability or reliability of infrastructure services, including power, roads, transport services, information and communication technologies, and other exigencies. These environmental factors make running a business prohibitively onerous and raise the transaction costs. Investment climate surveys suggest that, compared with other developing country regions, Sub-Saharan Africa is a high-cost, high-risk place to do business. Overall, doing business in Africa costs about 20% to 40% more than in other developing country regions. The net effect of these 'obstructions' is scaring away foreign investors, squashing domestic entrepreneurs, forcing many small business entrepreneurs into the informal sector, and resulting in less investment, less growth and higher poverty (Gnyawali and Fogel (1994: 46; World Bank, 2005, 2006). Adverse economic conditions, such as high interest and unemployment rates can also affect business adversely (Fry *et al*, 2001: 165).

## **Taxation**

'Nothing is for certain except death and taxes' is a belief widely held by taxpayers and businesses. High tax rates and complex tax administration are constraints to enterprise development and can force firms to operate in the 'grey' economy, where the pay off from productive and non-productive activities can be high with possible tax evasion or avoidance.

Figure: 1: Annual Cost of Tax Compliance as a percentage of Turnover



Source: (Small Business Project, 2005: 46)

As indicated in figure 1, the cost of tax compliance is regressive; the annual cost of tax compliance for the small business (with an annual turnover of about R1m), is almost 3% of turnover, whereas for the larger firms, that have the resources to engage tax consultants, the cost is between 0.1 to 0.5 % of turnover. The SMME compliance cost in South Africa was R79b (about 6.5% of SA's GDP) in 2004, whereas in OECD it was less than 3%. It takes about 350 hours (almost 9 standard working week days) a year for a medium-sized firm to prepare, file and pay taxes in South Africa, a figure which is much higher compared to the U.K (105 hours), Botswana (140 hours) (World Bank, 2007).

### Regulation and Laws

International evidence suggests that the regulatory environment has a major influence on the survival and growth of small and new businesses. According to the World Bank, regulatory reforms in developing countries could add as much as 1.4% to average annual GDP growth in these countries (Orford, Wood, Fisher, Herrington and Hudson, 2004: 51). Excessive red tape compliance costs have the potential to make firms behave in ways that can damage South Africa's overall social and economic prospects (Small Business Project, 2005: 33). Although South Africa's regulatory environment compares

favourably with that in other developing countries, there is scope for further simplifying regulations and procedures.

Some African countries, like Rwanda, Mauritius, Botswana, Namibia and Nigeria, that have recently introduced reforms to their business environment, are registering high rates of economic expansion. Although the benefits of a less regulated environment are handsome, countries in Sub-Saharan Africa had the lowest business environment reform intensity compared with other groups of countries (World Bank, 2006).

### **Crime**

Crime is a costly burden to individuals and firms, worryingly more so in South Africa with 'official' unemployment close to 30%. Crime affects business directly through the theft of property and money, and indirectly through reduced business confidence, loss of investment, emigration and the steady erosion of the foundations upon which the economy is built (BAC, 2006: 1). About 29% of the respondents in the 2004 Investment Climate Survey rated crime as a major or very severe problem in South Africa (World Bank, 2006). Direct losses due to crime and the cost of security were equal to about 1.1% of sales, a figure that is much higher than in many middle-income countries (Investment Climate Survey, 2004: 12). Security costs account for about two-thirds of the cost of crime, while direct losses account for the remainder one third.

A Nedcor-sponsored study estimated that crime cost South Africa at least R31 billion in 1995; the figure is no doubt much higher now as most South Africans perceive that crime and corruption are still on the rise. Some 19,000 murder cases and 55,000 rapes were reported in 2004, making it one of the highest rates in the world (The Economist, 1/10/2005: 42).

The government's release of major crime statistics in June 2008, for the period April 2007 – March 2008, show that the number of reported murder cases in South Africa is still very high, at 18,487, (giving a rate of 38.6 per 100 000 of the population). This means that about 50 people are killed each day, which is 38 times the U.K rate and 9

times the U.S. rate. Nationally, the crime rate for business burglary over the same period was 131.7 (62,995 cases), 497.1 for house burglary (237,853 cases) and 247.3 for aggravated robbery (118,312 cases) (Natal Witness, 1/7/2008).

In the Kwazulu-Natal province, bank robberies increased from 11 to 22 (100%) over the period April 2007- March 2008. The most feared crime, home robbery, also increased from 2667 to 3480 cases (30%), and business robbery increased from 997 cases to 1923 (92%) over the same period (Natal Witness, 1/7/08). Crimes, together with corruption, constitute a serious obstacle to doing business. They retard entrepreneurial activity and add a transaction cost and slow down economic growth (Mauro, 1995).

### **3. Research Objectives**

- To evaluate the external environmental conditions that favour or constrain entrepreneurship and small business development in the Pietermaritzburg region.
- To evaluate the internal environmental conditions that favour or constrain entrepreneurship and small business development in the Pietermaritzburg region.

The external factors, as perceived by the entrepreneurs, in this study include the economy, regulations, crime, taxation, competition and technology. The internal factors include finance, labour, cash flows and managerial issues.

### **Research Design**

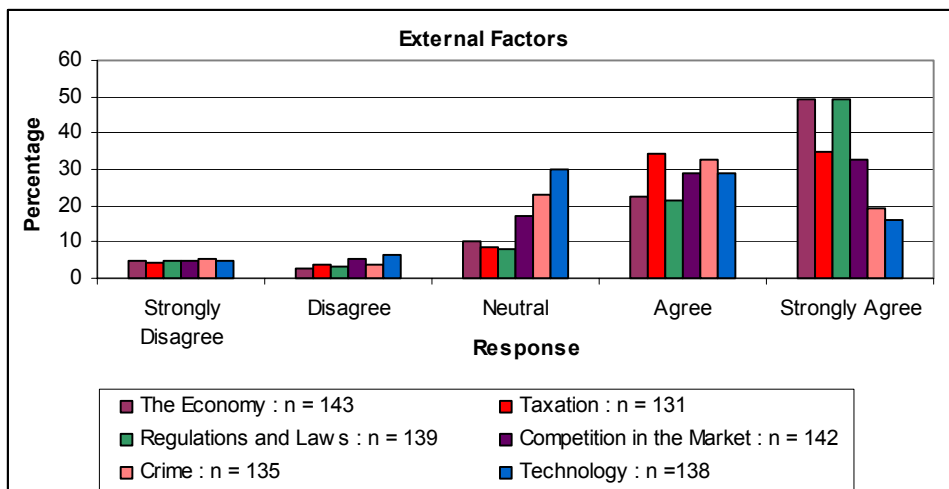
This cross-sectional study uses the survey method to establish a relationship between entrepreneurs' perception of the business environment (internal and external) and enterprise growth in Pietermaritzburg. The database of VAT registered SMMEs, obtained from the Pietermaritzburg Chamber of Commerce, was used to draw the sample. A sample of 160 firms was randomly chosen. They were engaged in diverse activities; 30% were in retailing, another 30% in service ventures, 10% in manufacturing and the remainder were in transport, food franchise, travel and tourism. Relevant data was gathered by means of a questionnaire. It was initially pre-tested on a sub-sample of 10 firms. Factor analyses and univariate analyses were used to determine whether the internal or external factors constraint the growth of the business. Reliability testing was

done on a set of the questions using the Cronbach alpha as they have the same scales. The alpha value obtained was 0.8687.

#### 4. Results

The perceived internal and external constraints to business are described below.

Figure: 2: External Environmental Factors



About 71% of the surveyed businesses (figure 2) felt that adverse conditions in the economy are an inhibitory growth factor. A majority of the respondents (69%) agreed or strongly agreed that taxation was a constraint to the growth of their business. Another 71% perceived that regulation and laws are a constraint to the growth of their business. According to Von Broembsen, Wood, Herrington, Shay and Sheppers (2005: 33), the growth potential of South African enterprises is enormous if they are able to apply the latest technologies to their products and services. However, many small ventures find new technology inaccessible owing to the cost involved or to a lack of knowledge and experience. Of the surveyed respondents (figure 2), 45% viewed technology as a constraint while 30% remained neutral.

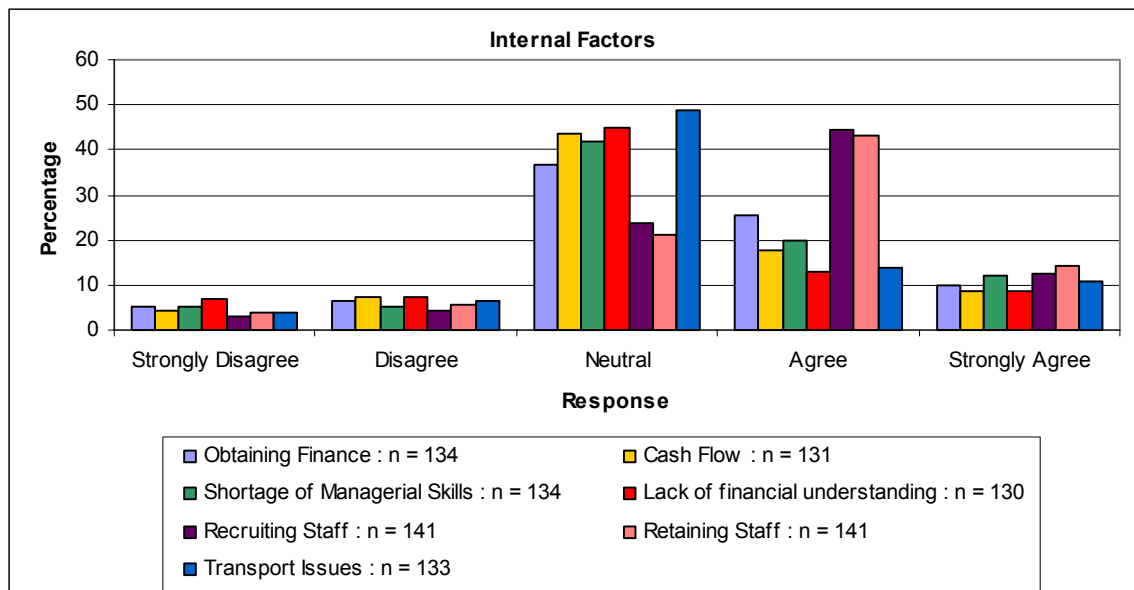
A business faces competition from different local and international sources. Competition can severely constrain the growth of a business. In Pietermaritzburg, 61% (figure 2) of

the respondents perceived competition, including cheap imports, as a constraint to business growth. Over half of respondents perceived crime in Pietermaritzburg (52%) as a constraint to business. On the positive side, high crime rates have led to the development of many security-related firms and have created jobs for many security personnel in recent times.

### Internal Factors

With regard to finance as an internal factor, about 11% of the respondents felt that obtaining finance is not a problem. About 37% were neutral in their response. However, about 35% (figure 3) of the respondents felt that obtaining finance to grow their businesses is a major constraint.

Figure 3: Internal Factors



Although the modal response to the question on cash flow (43.8%) was neutral, only 26% of respondents perceived cash flow to be an obstacle to their businesses.

Skills of planning, organising, leading and controlling are imperative for business development. In situations where these skills are lacking, entrepreneurs can hire the services of consultants to assist their firms. In this study, 41.9% of the respondents

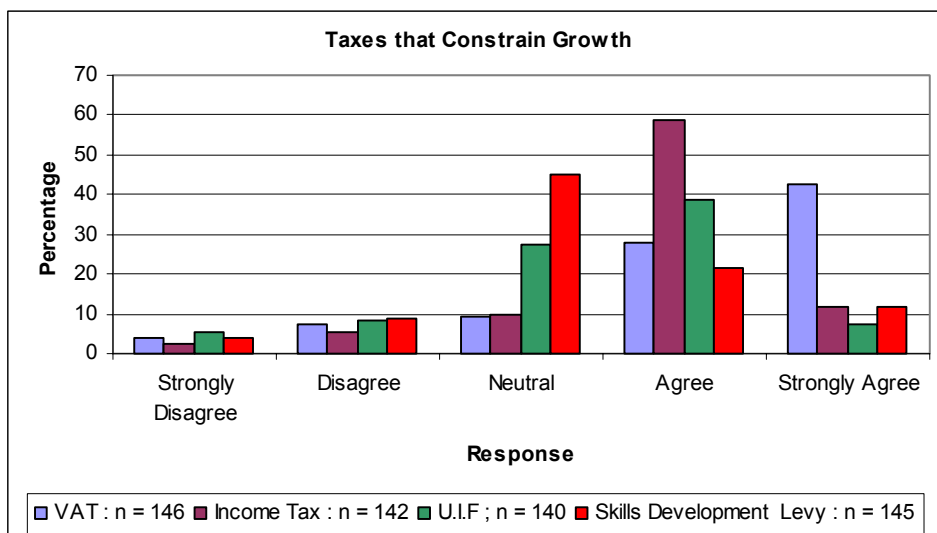
remained neutral whilst 31.9% agreed that shortage of managerial skills or business expertise is a constraint to business growth. At times, businesspersons do not understand the practice of good record keeping. With regard to the question of financial understanding, the modal response was neutral (45%), and about 22% agreed that a lack of financial understanding retards growth of the business (figure 3).

As the business grows, recruitment of staff requires more time and attention, as suitably qualified personnel needs to perform specific functions. Of the surveyed businesses, 57% felt that recruiting staff and another 58% indicated that retaining staff were constraints to business growth. Constantly rising fuel prices place a heavy cost burden on businesses and individuals. About half of the respondents (48.8%) gave a neutral response to the transport question. However, about a quarter (24%) perceived transport issues to constrain business in Pietermaritzburg.

### Taxes that Constrain Growth

The small business entrepreneur has to comply with numerous taxes and these impose a heavy burden on the owner in terms of finance, administration and paperwork and time. The taxes examined in this study were VAT, income tax, the Unemployment Insurance Fund (UIF) and the Skills Development Levy. The majority (71%) agreed that VAT and income tax are constraints to business growth (figure 4). The tax rate for companies was reduced from 29% to 28%, with effect from April 2008.

Figure: 4: Taxes that Constrain Growth



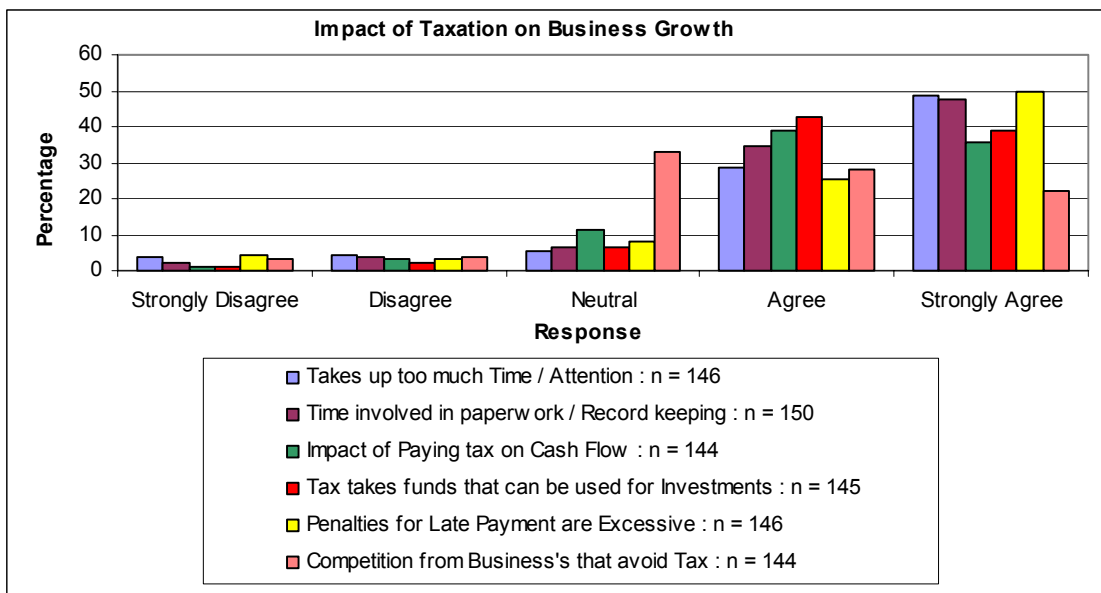
Small business corporations (namely corporations having an annual turnover of less than R10 million and which meet certain specified requirements), are taxed at the rate of 0% on the first R40,000 of taxable income, at 10% for income between R40,001 and R300,000, and at 29% for amounts above R300,000. A tax amnesty (expired June 2007) was granted to small businesses with an annual turnover of less than R10 million.

The Skills Development Levies Act (9 of 1999) imposes a 1% levy based on payroll, exceeding R500,000, for skills development. To the extent that there is appropriate training for the staff, a proportion of this levy may be claimed back. About a third of the respondents indicated that the skills development levy is a constraint on the growth of their business, though 45% of respondents remained neutral. However, about 40% of respondents agreed or strongly felt that UIF is a constraint to business growth.

### The Impact of Taxation on the Business

Taxes affect businesses in numerous ways, such as taking too much of the time and resources of the businesspersons and have cash flow implications.

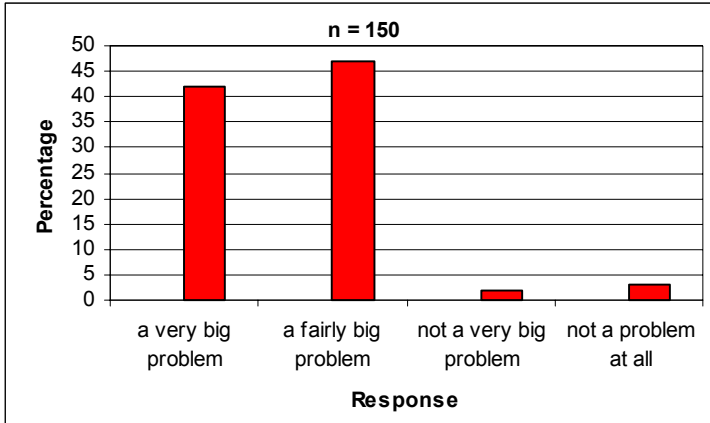
Figure: 5: The Impact of Taxation on Business Growth



- **Takes up to much Managerial attention:** About 80% felt that taxation takes too much of their managerial time.
- **Amount of time involved in keeping records, paperwork:** Over 80% agreed that the amount of time involved in keeping records and the paperwork involved in completing tax returns are excessive. There may be some relief as the tax form has been simplified since 2007.
- **Impact on cash flow of paying tax:** Over 55% of respondents stated that paying tax impacts adversely on the cash flow of the business.
- **Tax takes money out of the business that could be used for investment:** Almost 80% agreed.
- **Penalties for late payment are excessive:** About 75% perceived that penalties for late payments are excessive.
- **Competition from businesses that perhaps avoids tax:**  
Competition is healthy as it keeps firms on their 'toes'. However, some firms may operate informally and are not paying taxes. These firms then become a source of competition for tax-paying firms. A third of the respondents remained neutral, while 50% agreed that competition from firms that do not pay tax affect them.

## Crime and its Effects

Figure 6: Is Crime a Problem?

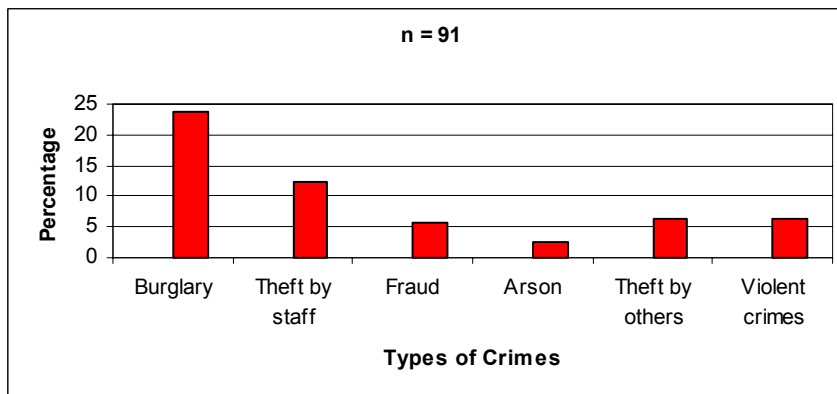


From figure 6, it is evident that crime is a serious problem. Almost 89% of respondents indicated that crime is a big or fairly big problem. Only 5% of respondents indicated that crime was not a problem.

## Types of Crime

Respondents were asked to indicate the types of crimes that they experienced recently. Burglaries (almost 25%) were most common followed by theft from staff (just over 10%). Arson was the least experienced type of crime (figure 7).

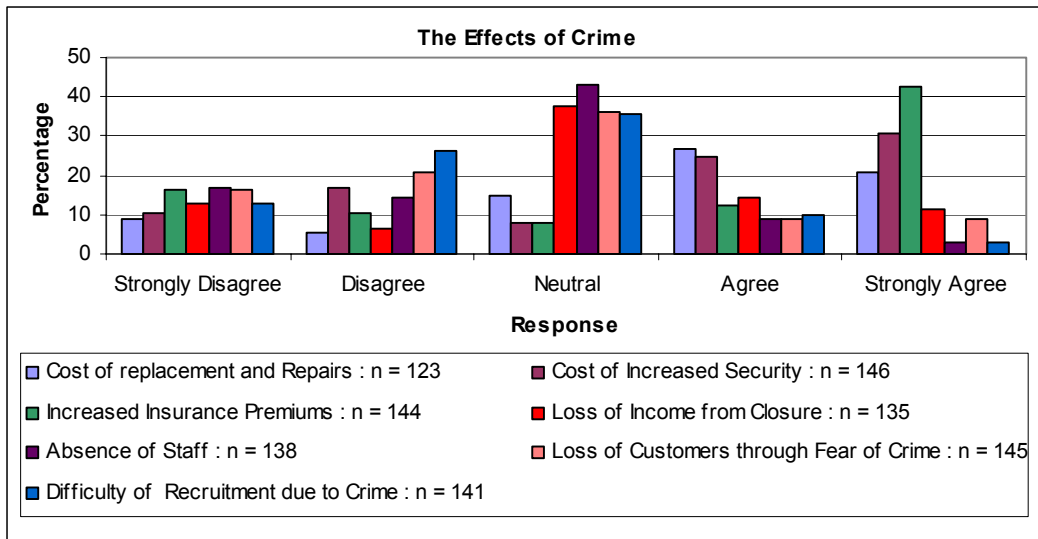
Figure 7: Types of Crime



## The Effects of Crime on the Business

Losses due to crime in South Africa amounted to R2,272 million (Investment Climate Survey, 2004). Crime is a constraint to business growth in a number of different ways. This is summarised below (figure 8).

Figure: 8: Effects of Crime on Business Growth



- **Costs of replacements of stolen stocks and repairs to damaged windows, doors and locks: (47%).**
- **Cost of Increased security: Over 50%.** Installing alarm systems and employing security guards are some of the costly measures taken by small firms to combat crime.
- **Increased Insurance Premiums: 55%**
- **Loss of Income from Closure: 25% agreed, 38% neutral.**
- **Absence of staff: 11%**

Violent crimes and armed robberies traumatise workers to such an extent that long periods of rest and counselling are needed to remedy the situation. This results in staff absenteeism and additional staff needs to be hired on a temporary basis. Such a situation affects productivity as well as cash flow. The modal response to the question was neutral (43%) while 31% disagreed. Only 11% of respondents

agreed. Therefore, absence of staff due to crime does not affect the business adversely.

- **Loss of customers through fear of crime:** Businesses that are located in areas that are constantly targeted by criminals can suffer from loss of customers and declining sales. Customers may avoid such firms for fear of being mugged or robbed. Over a third of respondents remained neutral, 36% disagreed and only 17% agreed that loss of customers through fear of crime constrains growth (figure 8).
- **Difficulty in Recruitment:** If the business is a high-risk, crime prone location, the recruitment of workers can become a problem because of their fear of being attacked. Of the respondents, only 13% agreed, 35% remained neutral and almost 40% of respondents disagreed.

## 5. Factor Analysis

Not all factors affect business growth uniformly. Some are more pronounced than others. If we are to secure the 'optimal' development of the SMME sector, it is important to have an understanding of whether the perceived internal factors are having a greater bearing on inhibiting growth than external factors. Accordingly, factor analysis was carried out in order to reduce the initial set of internal and external factors to a smaller manageable and interpretable cluster that adequately explains the growth constraints. The Principal Components method was used with varimax rotation.

Table 1: Total Variance Explained

| Component | Initial Eigenvalues |               |              | Extraction Sums of Squared Loadings |               |              | Rotation Sums of Squared Loadings |               |              |
|-----------|---------------------|---------------|--------------|-------------------------------------|---------------|--------------|-----------------------------------|---------------|--------------|
|           | Total               | % of Variance | Cumulative % | Total                               | % of Variance | Cumulative % | Total                             | % of Variance | Cumulative % |
| 1         | 4.701               | 36.159        | 36.159       | 4.701                               | 36.159        | 36.159       | 3.170                             | 24.382        | 24.382       |
| 2         | 1.663               | 12.794        | 48.953       | 1.663                               | 12.794        | 48.953       | 2.681                             | 20.623        | 45.005       |
| 3         | 1.333               | 10.257        | 59.210       | 1.333                               | 10.257        | 59.210       | 1.847                             | 14.205        | 59.210       |
| 4         | .996                | 7.659         | 66.869       |                                     |               |              |                                   |               |              |
| 5         | .911                | 7.005         | 73.874       |                                     |               |              |                                   |               |              |
| 6         | .724                | 5.565         | 79.439       |                                     |               |              |                                   |               |              |
| 7         | .605                | 4.657         | 84.096       |                                     |               |              |                                   |               |              |
| 8         | .514                | 3.953         | 88.049       |                                     |               |              |                                   |               |              |
| 9         | .480                | 3.692         | 91.741       |                                     |               |              |                                   |               |              |
| 10        | .393                | 3.022         | 94.763       |                                     |               |              |                                   |               |              |
| 11        | .301                | 2.316         | 97.079       |                                     |               |              |                                   |               |              |
| 12        | .215                | 1.654         | 98.733       |                                     |               |              |                                   |               |              |
| 13        | .165                | 1.267         | 100.000      |                                     |               |              |                                   |               |              |

Extraction Method: Principal Component Analysis

From the above table, the cumulative variance shows that 3 clusters are jointly explaining 59.210 % of the total variance in growth constraints. Furthermore, all of these 3 clusters have eigen values over 1. The variables (1 to 13) as constraints to growth under consideration range from retaining staff to competition and the formation of the clusters are presented in table 2.

Table: 2: Rotated Component Matrix

| Variables                       | Clusters |       |       |
|---------------------------------|----------|-------|-------|
|                                 | 1        | 2     | 3     |
| Retaining staff                 | .816     | .142  | .135  |
| Recruiting staff                | .810     | .011  | .047  |
| Shortage of managerial skills   | .653     | .510  | -.206 |
| Keeping up with new technology  | .626     | .209  | .169  |
| Transport issues                | .605     | .423  | .143  |
| Cash flow                       | .169     | .800  | -.160 |
| Obtaining finance               | .296     | .780  | .075  |
| Crime                           | -.005    | .658  | .257  |
| Lack of financial understanding | .354     | .574  | .144  |
| The economy                     | -.010    | -.042 | .813  |
| Taxation                        | .322     | .022  | .602  |
| Regulations and laws            | .561     | .158  | .597  |
| Competition in the market       | -.037    | .374  | .486  |

One looks at the rotated loadings table to find out which questions are not loading at all on the factors and could hence be eliminated from the data set and then re-run the factor analysis. All variables (13), ranging from retaining staff to competition in the market, are loaded in order to now look at the classification of the different sets of clusters.

The first set of factors is labelled as “management” and it consists of 5 items which had loadings ranging from 0.605 to 0.816 (table 2). These factors are: Retaining Staff, Recruiting Staff, Shortage of Managerial Skills, Keeping up with new Technology and Transport Issues. The management cluster, being largely internal factors to the business, accounts for 36.159% of the variance. Cronbach’s alpha calculated for this cluster yielded a value of 0.7278.

Table 3: Factor 1: **MANAGEMENT**

| FACTORS                        |          |
|--------------------------------|----------|
| Retaining staff                | Internal |
| Recruiting staff               | Internal |
| Shortage of managerial skills  | Internal |
| Keeping up with new technology | External |
| Transport issues               | Internal |

The second cluster, presented separately in (table 4), is labeled “Finance”. It consists of 4 factors, with loadings ranging from 0.574 to 0.800 (table 2). Group 2 consists of finance-related internal factors, with the exception of crime. Crime no doubt is an external factor. However, the negative effects of crime such as increased costs of security, replacement and repair costs impact internally on the finances of the business. The finance cluster accounts for 12.794% of the total variance (table 1). Cronbach’s alpha calculated for factor 2 equaled 0.8251, indicating the reliability of the second set.

Table 4: Factor 2: **FINANCE**

| FACTORS                         |          |
|---------------------------------|----------|
| Cash flow                       | Internal |
| Obtaining finance               | Internal |
| Crime                           | External |
| Lack of financial understanding | Internal |

The third cluster, consisting of 4 factors, has loadings ranging from 0.486 to 0.813 (table 2). This consists of the economy, taxation, regulation and laws, and competition in the market (table 3). Being largely external in nature, the third factor is classified as “economic” and this external set account for 10.257% of variation. Factor three is reliable as it has a Cronbach’s alpha of 0.8841.

Table 5: Factor 3: **EXTERNAL - ECONOMIC**

| FACTORS                   |          |
|---------------------------|----------|
| The economy               | External |
| Taxation                  | External |
| Regulations and laws      | External |
| Competition in the market | External |

From the above analysis, it is evident that the internal constraints (clusters 1 and 2) jointly account for almost 49% of variance in growth, and factor 3 accounts for 10.257% of the total variance. Collectively these three factors account for almost 60% of the variance in environmental growth constraints.

## **6. Discussion, Recommendation and Conclusion**

The results show that management and finance are major internal issues constraining the development of businesses. These internal constraints jointly account for almost half of the variance in growth impediments. The management cluster accounted for 36.159% of the variance while the finance-related cluster, again mainly internal factors with the exception of crime, accounted for 12.794% of the total variance.

The business entrepreneur has little control over external factors, of which crime, features prominently as a serious obstacle to business development. Constant environmental scanning can ensure alertness to both favourable and adverse external conditions. As the external environmental situation changes, SMMEs need to adapt to change in order to survive and develop. The external environment would identify opportunities and threats, while the internal environment would reflect resource strengths and weaknesses within the firm. To certain degrees, the internal factors are within the control of the entrepreneurs and these are areas over which improvements can be made with pro-active strategies. Therefore, they should enhance their managerial and entrepreneurial skills, in areas where these are sorely lacking, especially with regard to cash flow, keeping or understanding financial statements and use of technology as well as the recruitment and

retention of appropriate staff, with possible support for training. Provision of finance is certainly necessary but not a sufficient condition for advancing enterprise development. It makes no point to provide large amounts of finance if someone does not know how to use it to generate value-adding and wealth creation. What is also critical is the ability to manage finance effectively.

Taxation and regulations were also seen as major constraints to growth for various reasons, ranging from taking up too much managerial time in keeping records to the adverse impact on cash flow and increasing transaction costs. The third group factor to emerge from the factor analysis consisted of the Economy, Taxation, Regulation and Laws and Competition in the Market. Being external and economic in nature, this set accounts for about 10% of variation with growth. Firms are unlikely to develop in an environment where there are too many pressures from the government in the form of red tape or regulatory procedures, intrusive laws and administrative and fiscal burdens that affect the structure, conduct and profitability of business.

From the above results, it clearly emerges that the management factor has the greatest variance on growth, followed by finance and then the external cluster. Therefore, the internal factors constitute as great a burden as the external factors on the growth potentials of the business, though there can be a variation in their 'intensity'. This leads to suggest that policy on SMMEs should focus on both the internal conditions than external environmental factors.

On the external front, the problem of crime in its various manifestations and of perceived high levels of taxation and regulation should be urgently addressed if SMMEs in South Africa are to flourish. The role of the state is fundamental in making the broad environment a safer and better place for individuals to live, work and conduct businesses with attractive prospects of ethically earning adequate returns. The habitat for an optimal development of entrepreneurship is a safer and supportive environment with minimum legislation and regulation as well as visionary leadership.

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