# The Financing Preferences of Immigrant Small Business Owners in South Africa

**Olawale Fatoki**

*Department of Business Management, Turfloop campus,*
*University of Limpopo, Limpopo Province, South Africa*
*Email: Olawale.fatoki@ul.ac.za*

**Doi:10.5901/mjss.2014.v5n20p184**

***Abstract***

*Access to financial resources is very important to the survival and growth of immigrant-owned businesses. The objective of this study was to investigate the sources of finance used by immigrant entrepreneurs during the start-up and established phases of their businesses. The survey was conducted in the Johannesburg Central Business District in the Gauteng province of South Africa. The study used the qualitative research technique. In-depth interview method was used for data collection. The results indicated that the major sources of finance for immigrant entrepreneurs during the start-up phase are owners' contribution, family and friends. These sources of finance can be categorised as informal, ethnic sources of finance. The use of debt finance from commercial banks, suppliers and government agencies is very limited. During the established stage, immigrant entrepreneurs use a combination of internal equity and debt. Some immigrant entrepreneurs are able to obtain credit from suppliers and commercial banks during the established stage. The financial support from family and friends seems to decline as immigrant entrepreneurs become established.*

***Keywords:*** *immigrant small business owners, sources of finance, start-up phase, established phase, South Africa*

## 1. Introduction

Chrysostome and Arcand (2009) point out that one of the most important issues related to ethnic diversity in present day societies is the challenge of integrating immigrants into the labour markets of their host countries. Immigrants find it difficult to settle and integrate into the labour markets of host countries because of a variety of reasons such as discrimination, language and limited skills. This situation forces immigrants to start their own businesses. Entrepreneurship gives immigrants social dignity in the host country. Kushnirovich and Heilbrunn (2008) agree that immigrants usually face difficulties in entering the host country's labour market. The unemployment level of immigrants is very high. Self-employment is one of the solutions to unemployment by immigrants.

The unemployment rate in South Africa is 25.2% (Statistics South Africa 2014). Kalitanyi and Visser (2010) find that find that immigrant entrepreneurs employ South Africans in their businesses. In addition, entrepreneurial skills are transferred from immigrant entrepreneurs to their South African employees. Thus, immigrant entrepreneurs contribute to the growth and development of South Africa. Through the creation of jobs, immigrant entrepreneurship is one of the solutions to poverty and income inequality in South Africa. In addition, the general level of entrepreneurship is particularly low in South Africa. According to Turton and Herrington (2013), South Africa's Total Entrepreneurial Activity (TEA) rate decreased from 9.1% in 2011 to 7.3% in 2012. South Africa's TEA is significantly below the average of efficiency-driven countries (14.3%). This indicates the South Africa's consistently below-average trend in early-stage entrepreneurial activity relative to countries with a similar economic development level. In addition, South Africa's established business rate is 2.3%. This is the second lowest in the world. The established business rate is far lower than the average for efficiency-driven countries (8%). Immigrant entrepreneurship can be one of the solutions to the low level of firm creation in South Africa.

Hussain and Matlay (2007) and Fairlie (2012) assert that entrepreneurship is a very challenging initiative for immigrants given the various obstacles they face. Access to finance is one of the obstacles faced by immigrant entrepreneurs. Finance is critical to the survival and growth of small businesses. Adequate start-up capital is a critical factor in preventing the immigrant entrepreneur from failing. Immigrant entrepreneurs need financial resources to effectively face the operating expenses of their businesses. Altinay and Altinay (2008) explain that immigrant entrepreneurs may face discrimination in raising funds from formal resources such as banks and receiving credit from suppliers. It is significant to understand the financing preferences of immigrant entrepreneurs during the start-up and established phases of their businesses.

## 2. Research Objectives

Access to financial resources is critical to the survival and growth of immigrant-owned businesses. Successful immigrant entrepreneurs are important to job creation and poverty alleviation in South Africa. The objective of this study is to investigate the sources of finance used by immigrant entrepreneurs during the start-up and established phases of their businesses.

## 3. Literature Review

### *3.1 Entrepreneurship and Immigrant Entrepreneurship*

There is no single universally acceptable definition of the term entrepreneurship. Various definitions have emerged in an attempt to explain entrepreneurship. Gedeon (2010) points out that the term entrepreneurship (or who is an entrepreneur) lacks a single unified and accepted definition. The literature is replete with criteria ranging from creativity and innovation to personal traits such as appearance and style (Fernald et al. 2005). According to Gedeon (2010), Cantillon, Turgot, Say and Schumpeter laid the foundations for the meaning of entrepreneurship. Cantillon defines the entrepreneur as someone who assumes the risk and may legitimately appropriate any profits. Turgot and Say point out that the entrepreneur obtains and organizes production factors to create value. Schumpeter (1934) relates entrepreneurship to innovation. The innovative activity of entrepreneurs feeds a creative ''destruction process'' by causing constant disturbances to an economic system in equilibrium, creating opportunities for economic rent. In adjusting to equilibrium, other innovations are spun-off and more entrepreneurs enter the economic system. McCleland (1961) asserts that entrepreneurial activity involves risk-taking, energetic activity, individual responsibility, money as a measure of results, anticipation of future possibilities, and organizational skills. Drucker (1985) notes that the entrepreneur always searches for change, responds to it, and exploits it as an opportunity. Innovation is the tool of entrepreneurship

Immigrant entrepreneurship is described as the process by which an immigrant establishes a business in a host country (or country of settlement) which is not the immigrant's country of origin (Dalhammar 2004). According to Aaltonen and Akola (2014), an immigrant entrepreneur is a person who has immigrated to a new country and started a business there. Vinogradov (2008) describes an immigrant entrepreneur as a person who arrives in the country and starts a business for the purpose of economic survival Aaltonen and Akola (2014) point out that immigrant business owner is used as a synonym for an immigrant entrepreneur. The definition of an immigrant entrepreneur includes those individuals who employ themselves as well as those who employ also others.

### *3.2 The Resource Need of Immigrant Entrepreneurs*

Wernerfelt (1984) in a paper titled "a resource based view of the firm" points out that "a firm's resources at a given time could be defined as those (tangible and intangible) assets which are tied semi-permanently to the firm". Resources include brand names, technology, skilled personnel and capital. Akio (2005) and Kraaijenbrink et al. (2010) assert that resources can help a new firm to gain and sustain competitive advantage. According to Bolingtoft et al. (2003), to establish and sustain a firm, the entrepreneur needs to have access to different types of resources (i) human capital; (ii) physical capital; and (iii)financial capital, each playing different, but equally important roles during the life cycle of the firm. Winton and Yerramilli (2008) point out that once the core of the market opportunity and the strategy for seizing it are well defined, an entrepreneurial organization can then begin to examine the financial requirements in terms of (1) asset needs (facilities, equipment, research and development, and other one-time expenditures) and (2) operating needs (i.e. working capital for operations). Successful entrepreneurs anticipate the investment requirements of their firms so they can evaluate, select, negotiate, and craft business relationships with potential funding sources appropriately. This is consistent with the view of Timmons and Spinelli (2007) that the decision on what resources are needed, when they are needed and how to acquire them are strategic decisions that fit with other driving forces of entrepreneurship. According to Abor (2007), the financial resources of a firm include equity and debt.

Ou and Haynes (2006) divide equity into internal and external equity. Internal equity can be described primarily as owners' contributions and retained earnings. It is important for the firm owner to have some personal assets in the business, and this typically comes from personal savings. Padachi et al. (2012) note that finance literature documents that firms exhibit a clear preference for internal over external sources of financing, such as debt. Various explanations have been postulated for this preference for internal funding. First, using internal funds provides managers with greater flexibility. Second, firms avoid costs such as interest payments when raising funds externally. Bollingtoft et al. (2003)

agree that internal equity has several advantages over debt for a new firm. Internal equity can help a new owner to maintain control of the firm. Management of a small firm would prefer to finance the firm's needs from generated funds rather than external creditors or even new stockholders because they would like to have control of strategic decisions. Small firms also avoid venture capital because they fear losing control of the firm. Debt restricts managerial flexibility in decision making as creditors will stipulate terms of a debt agreement.

Gregory (2013) points out that small firms need external finance as internal equity is often limited and inadequate. Therefore, there is the need for new small firms to source external equity or debt finance. Furthermore, most new firms have little or no retained earnings because of their newness in the market. External equity implies equity contribution from external sources such as business angels, venture capitalists and the stock exchange**.** According to Berger and Udell (2006), venture capitalists are firms who make equity investments in firms with an opportunity for growth. Venture capitalists are formal business entities that maintain strong oversight over the firms they invest in, and that have clearly defined exit strategies. Business angels on the other hand, are a diverse group of high net worth individuals who invest part of their assets in high-risk/high-return entrepreneurial ventures.

Demirguc-Kunt et al. (2006) observe that external equity in the form of venture capital is usually not available for new small firms. Venture capitalists often enter the firm at the middle or later stages of its life cycle. Entrepreneurs often rely on debt when raising external funds. Blumberg and Letterie (2008) point out that the lack of venture capital funds makes many new small firms dependent on bank loans, overdrafts and suppliers credit for early-stage financing. Altinay and Altinay (2008) and Fairlie (2012) point out that the sources of debt for immigrant entrepreneurs include commercial banks, suppliers, family, friends, ethnic associations, and co-ethnic business associates. Chrysostome and Arcand (2009) assert that adequate start-up capital is a critical success factor for immigrant entrepreneurs

## 4. Research Methodology

The survey was conducted in the Johannesburg Central Business District in Gauteng province of South Africa. The area is suitable for research because of the high number of immigrant entrepreneurs. Because of the difficulty of obtaining the population of immigrant-owned businesses in the study area, purposive sampling and the snowball sampling methods were used. The study focused on immigrant entrepreneurs that are business owners in the retail sector. The study used the qualitative research technique. According to Bricki and Green (2007), qualitative research is characterised by its aims, which relate to understanding some aspect of social life, and its methods which generate words, rather than numbers, as data for analysis. In-depth interview method was used for data collection. Guion et al. (2011) point out that in-depth interviews are a qualitative data collection technique that can be used for a variety of purposes. In-depth interviews are very suitable for situations in which the researcher wants to use open-ended questions to obtain information in depth from relatively few people. Interviews were conducted with the participants and recorded. Each interview took about one hour and was done at the convenience of the participant. Opening questions focused on the biographical details of focused on the participants. The participants were then asked questions about their financing preferences. The participants were encouraged to expand their answers through additional probing questions. The interviews were recorded. It is noteworthy that the researchers shared the same language and ethnic background with some of the immigrant entrepreneurs that participated in the study and this helped to gain access to them. Furthermore, personal contacts who are also immigrant entrepreneurs assisted the researcher in gaining access to the participants of the study. The study classified businesses into the start-up and the established phases. In South Africa, according to Maas and Herrington (2006), a new small business is one that has existed for less than forty two months. After that period, the small business is considered an established firm. The classification of financing sources into formal and informal and ethnic and non-ethnic was adapted from previous studies on the financing of immigrant entrepreneurs such as Hussain and Matlay (2007), Kushnirovich and Heilbrunn (2008) and Fairlie (2012). The results of the interviews are summarised in tables 1 and 2.

## 5. Results and Discussions

Twenty nine immigrant entrepreneurs agreed to participate in the survey. Seven respondents can be considered as new entrepreneurs (i.e. the business is not less than 42 months) and twenty two can be considered as established entrepreneurs (the business is older than 42 months). All the respondents are in the retail sector. Out of the seven respondents that are new entrepreneurs, four have previous entrepreneurial experience having worked in the same sector with other immigrant entrepreneurs and three respondents have no previous entrepreneurial experience. Six respondents are female and twenty three respondents are male.

### *5.1 Sources of finance used by immigrant entrepreneurs during the start-up phase*

**Table 1:** Sources of finance used during the start-up phase

| Debt/equity | Source of debt or equity | Formal/informal | No of immigrant entrepreneurs | Ethnic/non-ethnic |
|---|---|---|---|---|
| Equity | Owners contribution | Informal | 7 | ethnic |
| Equity | Venture capitalist | formal | 0 | Non-ethnic |
| Debt | Capital from family | informal | 4 | ethnic |
| Debt | Capital from friends | informal | 6 | ethnic |
| Debt | Credit from co-ethnic business associates | informal | 4 | ethnic |
| debt | Ethnic credit association | Informal | 2 | ethnic |
| debt | Commercial bank (loan, overdraft, credit cards) | formal | 1 | Non-ethnic |
| debt | Trade credit from non-ethnic suppliers | formal | 1 | Non-ethnic |
| debt | Government agencies that provide financial assistance to SMEs | formal | 0 | Non-ethnic |

Table 1 depicts the financing options of immigrant entrepreneurs during the start-up phase. The results indicate that the most widely used financing option is owners' contribution. All the respondents used their own contributions to start business. This can be regarded as internal equity. No respondent was able to obtain capital from venture capitalists which can be regarded as a formal, non-ethnic source of external equity. The need for external (formal, non-ethnic) capital by immigrant entrepreneurs was also investigated. The results indicated that three immigrant entrepreneurs needed supplies from trade creditors and only one entrepreneur needed finance from the bank. The results suggest a low demand for external (formal, non-ethnic) capital during the start-up stage. Gregory (2013) points out that the external financing of small firms is about the demand and the supply. Many small firms do not demand for external debt and equity. The reasons for low demand for external finance by firms include lack of adequate equity, lack of collateral and unwillingness to provide information. New immigrant entrepreneurs with previous entrepreneurial experience seem to do better with respect to access to formal sources of finance than those without previous experience.

The supply of external formal, non-ethnics capital to small firms is limited during the start-up phase. Shane (2008) contends that venture capital provided only a small proportion of the equity funding for small firms. Venture capital funds are not interested in providing the small amounts of funding sought by many small firms. Blumberg and Letterie (2008) agree that the lack of venture capital funds makes many new small firms dependent on bank loans, overdrafts and suppliers credit for early-stage financing. Despite the dependence of new small firms on debt finance, paradoxically their access to debt finance is very limited. Commercial banks and trade creditors hesitate to grant credit to new small firms. The results indicate that the major sources of debt finance for immigrant entrepreneurs during the start-up phase are family and friends. The results are consistent with the pecking order theory (POT) of capital structure that the management of a firm has a preference to choose internal financing before external financing. When a firm is forced to use external financing sources, managers select the least risky and demanding source first. When it is necessary to use external sources, debt is preferred to external equity. Ou and Haynes (2006) emphasise that new small firms rely on internal sources of finance and external borrowing to finance operations and growth, and only a very small number of firms use external equity. The most important sources of funding for start-up and nascent firms are the personal funds of the firm owner, and debt funding. The results suggest that the awareness by immigrant entrepreneurs of government agencies that provide financial and non-financial assistance to small firms is limited.

The findings of the study are consistent with the results of similar empirical studies. According to Altinay and Altinay (2008), immigrant businesses may face discrimination in raising funds from formal resources such as banks and receiving credit from suppliers. Thus immigrant entrepreneurs often need to borrow from informal sources such as family members and co-ethnics during the start-up phase. The business model of immigrant entrepreneurs depends on access to cheap family labour and, close community networks, which may offer low-cost capital. Chrysostome and Arcand (2009) find that it is difficult for immigrant entrepreneurs to to get start-up capital from formal financial institutions because of their lack of a credit history in their host countries that would be convincing to financial institutions. Therefore, immigrant entrepreneurs rely on the support of family and friends for capital. Kushnirovich and Heilbrunn (2008), Piperopoulos (2010) and Fairlie (2012) find that the most common source of start-up capital for both immigrant entrepreneurs is from personal or family savings. The results of the interviews are summarised in tables 1 and 2.

### *5.2 Sources of finance used by immigrant entrepreneurs during the established phase*

Twenty two respondents that can be considered as established entrepreneurs. All of them have been in business for at least five years. All the respondents agree that their businesses have grown since inception. Sixteen respondents have established relationships with suppliers, fourteen respondents have overdraft or loan facilities and nineteen respondents make use of credit cards.

**Table 2:** Sources of finance used during the established phase

| Debt/equity | Source of debt or equity | Formal/informal | No of immigrant entrepreneurs | Ethnic/non-ethnic |
|---|---|---|---|---|
| Equity | Owners contribution | Informal | 22 | ethnic |
| Equity | Venture capitalist | formal | 0 | Non-ethnic |
| Debt | Capital from family | informal | 6 | ethnic |
| Debt | Capital from friends | informal | 8 | ethnic |
| Debt | credit from co-ethnic business associates | informal | 16 | ethnic |
| debt | Ethnic credit association | Informal | 8 | ethnic |
| debt | Commercial bank (loan, overdraft, credit cards) | formal | 19 | Non-ethnic |
| debt | Trade credit from non-ethnic suppliers | formal | 16 | Non-ethnic |
| debt | Government agencies that provide financial assistance to SMEs | formal | 0 | Non-ethnic |

The results as depicted by table 2 indicate that during the established stage, immigrant entrepreneurs use a combination of internal equity and debt. The owners' capital contribution is still significant during the established phase. This is internal equity. The use of external equity from venture capitalists is non-existent. The majority of the respondents use formal credit from commercial banks and trade creditors. No respondent in the sample used government agencies that assist small firms with finance. Twenty respondents in the sample need formal non-ethnic external capital to pursue growth. The results indicate that the use of formal, non-ethnic sources of finance increases as immigrant entrepreneurs become established. The results are consistent with the findings of Hussain and Matlay (2007) that the importance of financial support from family and friends tends to decline as immigrant entrepreneurs mature. Some immigrant entrepreneurs are able substitute the financial assistance of family and friends with bank and trade credit.

## 6. Conclusions

Immigrant entrepreneurs contribute to the growth and development of South Africa. By creating employment, immigrant entrepreneurship is one of the solutions to poverty and income inequality in South Africa. Access to financial resources is critical to the survival and growth of immigrant-owned businesses. The objective of this study is to investigate the sources of finance used by immigrant entrepreneurs during the start-up and established phases of their businesses. The results indicate that the major sources of finance for immigrant entrepreneurs during the start-up phase are owners, family and friends. These sources of finance can be categorised as informal, ethnic sources of finance. The use of debt finance from commercial banks, suppliers and government agencies is very limited. The results indicate that during the established stage, immigrant entrepreneurs use a combination of internal equity and debt. The owners' capital contribution is still significant during the established phase. Some immigrant entrepreneurs are able to obtain credit from suppliers and commercial banks at during the established stage. The use of formal, non-ethnic sources of finance increases as immigrant entrepreneurs mature. The financial support from family and friends tends to decline as immigrant entrepreneurs become established.

## References

Aaltonen Satu, Akola Elisa (2014), Lack of trust–the main obstacle for immigrant entrepreneurship? Available: http://pyk2.aalto.fi/ncsb2012/Aaltonen.pdf (March 15, 2014)

Abor, J (2007). Debt policy and performance of SMEs: Evidence from Ghanaian and South African firms. Journal of Risk Finance, 8(4):36 -379

Altinay, L., & Altinay, E. (2008). Factors influencing business growth: the rise of Turkish entrepreneurship in the UK. International Journal of Entrepreneurial Behaviour & Research, 14(1): 24–46

Berger, A., & Udell, G. (2006). A more conceptual framework for SME financing. Journal of Banking and Finance, 30(11): 2945-2966.
Blumberg, B.F., & Letterie, W.A. (2008). Business starters and credit rationing in small business. Small Business Economics, 3(1): 187-200.
Bollingtoft, A., Ulhoi, J.P., Madsen, A.H. & Neergaard, H. (2003). Effect of financial factors on the performance of new venture companies in high tech and knowledge-intensive industries: an empirical study in Denmark. International Journal of Management, 20(1): 535-547.
Bricki, Nouria, Green, Judith (2007), A Guide to Using Qualitative Research Methodology. Available:http://msf.openrepository.com/msf/handle/10144/84230 (March 19, 2014)
Chrysostome, E., & Arcand, S. (2009). Survival of Necessity Immigrant Entrepreneurs: An Exploratory Study. Journal of Comparative International Management, 12(2): 3-29.
Dalhammar, Tobias (2004), Voices of Entrepreneurship and Small Business- Immigrant enterprises in Kista, Available:http://www.diva-portal.org/smash/get/diva2:7559/FULLTEXT01.pdf (March 17, 2014)
Demirguc-Kunt, A., Maksimovic, V., Beck, T. & Laeven, L. (2006). The determinant of financing obstacles. International Journal of Money and Finance, 25(6): 932-952
Drucker, P.F (1985). Innovation and Entrepreneurship, London: Pan Books Ltd.
Fairlie, Robert (2012). Immigrant Entrepreneurs and Small Business Owners, and their Access to Financial Capital. Available: http://www.sba.gov/sites/default/files/rs396tot.pdf (March 9, 2014)
Gedeon, S. (2010). What is Entrepreneurship? Entrepreneurial Practice Review, 1(3):16-35
Gregory, Neil (2013), Financing Small and Medium Enterprises --- It's about Demand as well as Supply Available: http://www.gcbpp.org/files/EPV/EPV_Gregory_FinancingSMEs052013.pdf (March 5, 2014)
Guion, Lisa, Diehl, David, & McDonald, Debra (2014), Conducting an In-depth Interview. Available: https://edis.ifas.ufl.edu/pdffiles/FY/FY39300.pdf (April 9, 2014)
Hussain,, J., & Matlay, H. (2007). Financing preferences of ethnic minority owner/managers in the UK. Journal of Small Business and Enterprise Development, 14(3): 487-500.
Kalitanyi, V., & Visser, K. (2010). African immigrants in South Africa: Job takers or creators? South African Journal of Economic and Management Sciences, 13(4): 376-390.
Kraaijenbrink, J., Spender, J.C., & Groen, A. (2010). The resource-based view: a review and assessment of its critiques. Journal of Management, 36, 349-372
Kushnirovich, N., & Heilbrunn, S. (2008). Financial Funding of immigrant Businesses. Journal of Developmental Entrepreneurship. 13(2):167-184.
Maas, G. & Herrington, M. (2006), Global entrepreneurship monitor South Africa report. Available: http://www.gemconsortium.org/document.aspx?id756 (June 6, 2008).
McClelland, D.C (1961). The achieving society. Princeton, NJ: Van Nostrand
Ou, C., & Haynes, G.W. (2006). Acquisition of additional equity by small firms; finding from the national survey of small business finance. Journal of Small Business Economics, 27(1): 157-168.
Padachi, K., Howorth, C., Narasimhan, M.S, (2012). Working capital financing preferences: the case of Mauritian manufacturing Small and medium-sized enterprises. Asian Academy of Management Journal of Accounting and Finance, 8(1): 125–157
Piperopoulos, P. (2010). Ethnic minority businesses and immigrant entrepreneurship in Greece. Journal of Small Business and Enterprise Development, 17(1):139 –158
Shane, S. (2008), The importance of angel investing in financing the growth of entrepreneurial ventures. Available: http://www.sba.gov/adw/research/banking.html (April 15, 2009)
Statistics South Africa (2014), The Quarterly Labour Force Survey. Available: http://beta2.statssa.gov.za/?page_id=1854&PPN=P0211 (May 20, 2014)
Timmons, J.A., & Spinelli, S. (2007). New venture creation: entrepreneurship for the 21st century. Boston: McGraw Hill.
Turton, Natasha, & Herrington, Mike, (2013). Global Entrepreneurship Monitor South African 2012. Available:http://www.gemconsortium.org/docs/2801/gem-south-africa-2012-report (December 22, 2013)
Vinogradov, E (2008), Immigrant entrepreneurship in Norway. Available http://brage.bibsys.no/xmlui/bitstream/handle/11250/140348/Vinogradov.pdf?sequence=1 (May 5, 2014)
Wernerfelt, B. (1984). A Resource-based View of the Firm. Strategic Management Journal, 5(2):171–180,
Winton, A., & Yerramilli, V. (2008). Entrepreneurial Finance: Banks versus Venture Capital. Journal of Financial Economics, 5(3): 51-79