ISSN 2039-2117 (online)
ISSN 2039-9340 (print)
Mediterranean Journal of Social Sciences
MCSER Publishing, Rome-Italy
Vol 5 No 23
November 2014

Micro Enterprises' Start-Up Constraints in South Africa

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Doi:10.5901/mjss.2014.v5n23p30

Abstract

The creation of micro enterprises is important to the reduction of high levels of poverty, income inequality and unemployment in South Africa. The objective of the study is to investigate the constraints faced by the owners of micro enterprises during the start-up stage. Understanding these factors can help to improve the low total early stage entrepreneurial activity rate of South Africa. The study used the qualitative research technique. In-depth interview method was used for primary data collection from twenty two owners of micro enterprises. The results indicate that inadequate owners' capital, difficulty in raising external finance and lack of physical resources such as equipment are some of the major constraints to new business creation. Other important barriers are lack of experience and start-up skills, high level of competition and difficulty in getting a proper location. Recommendations to reduce the constraints faced by the owners of new micro enterprises during the start-up phase are suggested.

Keywords: *micro enterprises, start-up, constraints, South Africa*

1. Introduction

Small, medium and micro enterprises (SMMEs) are vital to the development of many countries. SMMEs help in alleviating poverty and income inequality and also provide employment. SMMEs and entrepreneurship are now recognised worldwide to be a key source of dynamism, innovation and flexibility. SMMEs are responsible for most net job creation and they make an important contribution to productivity and economic growth (Organisation for Economic Cooperation and Development, 2014). South Africa suffers from high unemployment with an official unemployment rate of estimate of 25.2% (Statistics South Africa, 2014). One of the best ways to address unemployment is to leverage the employment creation potential of SMMEs (FinScope, 2010).

Munoz (2010) points out that micro enterprises comprise the smallest end (by size) of the small business sector and constitute the vast majority of the small business sector in both developed and developing countries. Micro-enterprises add value to a country's economy by creating jobs and enhancing income. Rolfe et al. (2010) observe that micro enterprise activity (especially in retail trade) is the most pervasive entrepreneurial activity in South Africa. Thus, the creation of new micro enterprises is critical to the economic development of South Africa. Klapper et al. (2006) remark that new business creation is a critical part of the process of creative destruction. New business creation is very important for the continued dynamism of the modern economy. Aidis et al. (2012) note that entrepreneurship and new business creation promote innovation and development, boost employment creation and leads to more equitable income distribution. Herrington et al. (2009) point out that new firm creation contributes to economic growth and job creation in South Africa.

According to Herrington and Kew (2014), the total early stage entrepreneurial activity (TEA) measures the level of early-stage entrepreneurs who are in the process of starting or who have just started a business. The TEA rate of South Africa at 10.6% remains significantly below that of other sub-Saharan African countries included in the Global Entrepreneurship Monitor survey. However, there has been some improvement in South Africa's TEA from a low 4.3% in 2003 to 10.6% in 2013. South Africa's position in TEA ranking in 2003 was 35^{th} out of 68 countries with one position above the median position. This indicated a low but improving level of new business creation in South Africa. Wright and Marlow (2012) assert that the start-up stage is a crucial period in the development cycle of small businesses. Entrepreneurial activities and challenges are different across the various stages of small business development. The failure to recognize the complex and dynamic process of entrepreneurship may hamper subsequent development of the small business. This can lead to the failure of the small business. Herrington and Kew (2014) ascertain that there is a high rate of new business discontinuance in South Africa. According to Van Gelderen et al. (2006), it is important to study businesses at the nascent stage. People that are considering starting a business should know the factors that contribute to success or failure in the pre-start-up stage. With this knowledge, nascent entrepreneurs can evaluate their own prospects and likely problems. One of the ways to promote entrepreneurship in a country is to understand the factors that contribute to success or failure in the pre-start-up stage. Thus, the knowledge of the predictors of pre-start-up performance has significant benefits for entrepreneurship practice and policy.

2. Objective of the Study

The creation and survival of micro enterprises are critical to the reduction of high levels of poverty, income inequality and unemployment in South Africa. New business creation can also help to improve economic growth. The objective of the study is to identify the factors that hinder micro enterprises during the start-up stage. Understanding these factors can help to improve the low TEA rate of South Africa.

3. Literature Review

3.1 New business creation

Gartner (1985) describes new venture creation as "the organising of new organisations. To organise is to assemble ongoing independent actions into sensible sequences that generate sensible outcomes". Gartner presents a framework to describe the creation of new ventures based on four dimensions. (1) The individual(s): This is the person that is involved in starting a new organisation. That is, the entrepreneur. The entrepreneur is different from a non-entrepreneur in a variety of ways. These include the background and the personality of the entrepreneur. Factors related to the entrepreneur's personality include the need for achievement, the locus of control and risk-taking propensity. Factors related to the entrepreneur's background include previous work experience, education and entrepreneurial parents. (2) The new venture process: Entrepreneurship is an activity or function. Common behaviour of the entrepreneur include the location of business opportunity, the accumulation of resources, production and marketing of goods, services, building of an organisation, response to government and society (3) Organisation: the type of firm, the presence of partners, strategic choice variables such as cost leadership, differentiation and focus and a competitive organisation. (4) The environment|: The entrepreneur does not operate in a vacuum and needs to respond to the environment. Environmental factors that stimulate entrepreneurship include the availability of financial resources, presence of experienced entrepreneurs, skilled labour, availability of suppliers, accessibility to markets and customers, availability of land and other facilities, accessibility to transportation, attitude of the area population, availability of supporting services and barriers to entry.

Griener (1972) provides one of the earliest theoretical foundations for a firm's life cycle. Griener identifies five phases for the organisation: Creativity, direction, delegation, coordination and collaboration. Adizes (1979) categorises ten life cycle stages for a firm: courtship, infancy, go-go, adolescence, prime, stability, aristocracy, recrimination, bureaucracy and death. Churchill and Lewis (1983) analyse five stages of enterprise growth: start-up stage, survival stage, successful stage, take-off stage and mature stage. A venture is considered a start-up if it has not yet reached a phase in its development where it could be considered a mature business. In South Africa, according to Herrington and Kew (2014), a start-up can be described as a business that has existed for less than three months and a new business can be described as a business that has been in existence for more than three but less than forty two months.

3.2 Constraints to business creation

Martins (2004) points out that the barriers to entrepreneurship and business creation include (1) Regulatory barriers: the creation of a business requires supportive policies such as a stable macroeconomic environment. In addition, factors such as barriers to entry and exit, the registration procedures, labour market and bankruptcy laws can impose burdens that impact adversely on entrepreneurial activity. (2) Cultural and social barriers: The lack of information on the available institutions that can help small businesses is a barrier to business creation. This includes limited access to social and business networks and institutions. A culture that does not promote entrepreneurship and lack of support of family and friends can also create barriers to entrepreneurship during the start-up stage. A lack of role models, the real cost of business creation (physical or financial) and fear of failure are barriers to business creation. (3) Economic and financial barriers: Inadequate owners' funds and inaccessibility to external finance are important barriers during the start-up stage of a business. Small start-ups because of their size and their liability of newness find it difficult to access external equity and debt finance.

Van Gelderen et al. (2006) ask the question "Why does one person actually succeed in starting a business, while a second person gives up?" The first success of a firm is its birth. Inability to write a business plan and lack of experience can impact on the success of start-ups. Setting up a business part-time may be a barrier because the entrepreneur is not completely focused on the business. Lack of capital can be a barrier. The amount of intended start-up capital should be related to intended size. Smaller capital may be easily obtainable without having to go through the financial lending system.

Klapper et al. (2006) study the effect of market entry regulations on new business creation. The researchers find that costly regulations hamper new business creation especially in industries that should naturally have high entry. Mickiewicz (2009) and Aidis et al. (2012) find that in the context of a developing economy, weaknesses in property rights increase transaction costs and the riskiness of entrepreneurial activity. Also, the welfare and tax system influence both the opportunity cost and the net financial return to entrepreneurial activity. Lack of well-defined and efficient system of registering and protecting of property rights can be an obstacle that prevents the entrepreneurs from utilising and combining the potentially productive assets and turning them into real capital. Crime and corruption are also barriers to business entry. In addition, small business creation can be hampered by competition especially from large firms. Weeks and Benade (2008) and Phillip (2010) point out that small businesses in South Africa are faced with many difficulties. Amongst these is the dual nature of the economy, where small businesses, often, have to compete with large firms in the same sector. Consequently, small businesses face the constraints of entering and staying in a highly competitive market. The South Africa's economy is highly centralised, with high levels of concentration of capital and limited levels of competition in key sectors.

Gorji et al. (2012) divide the barriers to business creation into three. (1) Individual barriers: These include lack of family support and lack of education and experience. (2) Organisational barriers: these include financial resources, physical resources and lack of customers. (3) Environmental barriers: these types of barriers include socio-cultural factors, especially the beliefs, attitudes and values that a society places on entrepreneurship. Rules and regulations such as labour laws and registration procedures can also create environmental barriers to new business creation. Kanniainen and Poutvaara (2007) agree that distortions in the labour market especially where rent-seeking unions protect the interests of special groups with their bargaining power on wages. Such behaviour can raise the opportunity cost of entry for a potential entrepreneur. Johnson (2013) notes that the barriers to business creation include corruption and unsupportive business environment, employee related difficulties, severe market entry regulations, shortage of funds and resources, lack of entrepreneurship opportunities, lack of entrepreneurial capacity, lack of adequate entrepreneurship training, lack of technical and practical skills, lack of market experience, fear of failure and risk aversion. The is consistent with the findings of Islam (2009) that shortage of start-up capital, difficulties in finding suitable premises or location, lack of previous business knowledge and ideas of present business, non-cooperation of family members and others, lack of skilled employees, lack of start-up training are the major constraints to formation of new business formation during the start-up phase.

4. Research Methodology

The study focused on new micro enterprises that have been formed in the past forty two months, with formal trading places in the retail and service sectors in Polokwane, Limpopo Province, South Africa. According to the Parliament of the Republic of South Africa (1995), a micro enterprise is a business with (1) total full-time equivalent of paid employee of less than 5 (2) total annual turnover of less than R150,000 and (3) total gross asset value (fixed property excluded) of less than R100,000. The number of employees was used to determine a micro enterprise. Because of the difficulty of obtaining the population of micro enterprises in the study area, purposive and snowball sampling methods were used. 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 owners of micro enterprise. 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 the constraints that they faced when establishing their businesses. The participants were encouraged to expand their answers through additional probing questions. The interviews were recorded. Descriptive statistics was used for data analysis.

5. Results and Discussion

Twenty two owners of micro enterprises participated in the study. There were seventeen male participants and five female participants. Thirteen participants had post matric qualification and eleven participants had Matric qualification. Fourteen participants had previous work experience in similar business area and eight did not have previous business experience in the same field. Table 1 depicts the summary of the constraints experienced by the owners of micro enterprises during start-up phase.

Table 1: Start-up constraints

Constraint	Number of participants
Not enough owners' capital	19
Difficulty in raising external finance	6
Lack of physical resources	7
Lack of previous similar business experience	8
Difficulty in getting a proper location for the business	8
Lack start-up skills	12
Difficulty in getting skilled labour in the business line	7
Too many competitors	7
Difficulty getting customers	9
No problem	2

The results as presented in table 1 indicate that inadequate owners' capital, difficulty in raising external finance and lack of physical resources such as equipment are some of the major constraints to new business creation. Herrington et al. (2009) point out that access to finance is a major problem for the South African entrepreneur in South Africa. Many entrepreneurs raise the start-up capital from their own or family savings, which is often inadequate, rather than approaching formal institutions or agencies for external finance. Ou and Haynes (2006) note that internal equity which can be described primarily as owners' contributions, contributions from family and friends and retained earnings, is used more widely by small firms. It is important for the firm owner to have some personal assets in the business, and this typically comes from personal savings. Also a banker or any credit provider may not grant credit to a small firm if the owner does not have his or her own money at risk. In addition, contribution from friends and family is another important source of finance for small firms. This kind of contribution often comes in the form of delayed compensation or reduced or free rent. Internal equity capital provides long-term funding with minimal cash flow drains typically associated with debt financing. 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. However, some new entrepreneurs do not need external finance. Many small firms have limited growth prospects because of market limitations or because the owners is not interested in expanding the business.

Lack of previous business experience is another barrier to new business creation. Lack of experience and start-up skills are constraints to new business creation. Laguna et al. (2012) find that managerial competencies as measured by education, managerial experience, start-up experience and knowledge of the industry positively impact on the performance of new firms. High level of competition is another barrier to new business creation. The extent of competition impacts on the market potential and growth opportunities of small firms. Potential entrants are entrants that enter an industry for the first time and offer a substitute product or service to a particular sector. The potential competitor is very important in competitive industry analysis. To survive and achieve success, new firms need to understand the dynamics of competition in their industry and develop skills and competencies that give them a competitive advantage. In ability to get consumers affect the prospect of a small firm. Demand and supply characteristics associated with products determine their market prospects (Razzaque, 2003), Zhou and Chen (2008). According to Weeks and Benade (2008) and Phillip (2010), small businesses face the constraints of entering and staying in a highly competitive market. The South Africa's economy is highly centralised, with high levels of concentration of capital and limited levels of competition in key sectors.

Difficulty in getting a proper location for the business is another constraint to business creation. Entrepreneurs like locations that are close to the markets for their products. Dahl and Sorenson (2007) note that location also impacts on the market potential and growth opportunities of new firms. Geographical proximity to either critical buyers or suppliers produces a form of enhanced environmental scanning that enables new firms to more easily identify and exploit growth opportunities in the market. Geographical location has implications for access to markets and other resources such as finance, skilled labour and infrastructure. New firms in geographic clusters benefit tremendously by having access to abundant supply of funds and other sources of information. In addition, proximity to participants in the supply chain (customers and suppliers) reduces the search cost new ventures would otherwise encounter in gathering the needed resources and overall operation. . Gilbert (2008) points out that the geographical area where the firm is launched has implications for its access to markets and resources. Stable access to markets is crucial for enhancing entrepreneurship while inadequate access to profitable markets inhibit entrepreneurship.

6. Conclusions and Recommendations

Micro enterprise activity (especially in retail trade) is the most pervasive entrepreneurial activity in South Africa. Thus, the creation of new micro enterprises is critical to the economic development of South Africa. One of the solutions to the high levels of poverty, income inequality and unemployment in South Africa is the creation of more micro enterprises. The objective of the study is to identify the factors that hinder micro enterprises at the start-up stage. Understanding these factors can help to improve the low TEA rate of South Africa. The results indicate that inadequate owners' capital, difficulty in raising external finance and lack of physical resources such as equipment are some of the major constraints to new business creation. Other important constraints are lack of experience and start-up skills, high level of competition and difficulty in getting a proper location.

To reduce the effect of these constraints on new business creation, government agencies such as Small Enterprise Development Agency (SEDA) and the Small Enterprise Finance Agency (SEFA) can organise training for new entrepreneurs about the critical skills needed to start a business and how to obtain finance. Awareness should be created for the training programmes through advertisements in local and national media. Furthermore, a "learning from peers" or mentorship approach can be instituted by government agencies to help the owners of new micro enterprises. New micro enterprises should look at the option of using non-executives at an early stage to bring external expertise and guide investment decisions. There is the need for personal development by the owners of micro enterprises especially in the area of business and financial management skills through training.

It is important to improve access to finance by micro enterprises. The websites of the big four commercial banks have addressed business plan preparation However, it is important to provide awareness that such facilities exist. Commercial banks can create awareness of their funding requirements especially the importance of collateral through advertisements and communication with trade associations. Government agencies such as SEDA can also assist in making the owners of micro enterprises to be investment ready through training. In addition, government and its agencies have, over the years, expended significant resources creating and implementing market interventions. It is vital that these interventions are effective and meet the needs of those they declare to support. It is therefore incumbent on Government and other stakeholders to ensure that these schemes, such as the Small Firm Loan Guarantee, are well publicised and available to owners of micro enterprises.

A major limitation of the study is the small number of participants in the study. Thus, caution must be taken in interpreting the findings and in making generalisations. Data collection could be expanded to include a larger sample of micro entrepreneurs in South Africa.

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