Abstract

Start-up entrepreneurs in South Africa do not move from the stage of existence and survival to growth to maturity. In order for Start-up businesses to have a competitive advantage, they have to grow beyond the survival stage and keep on growing. Despite the availability of external finance, access to finance from banks has been identified as the main challenge to the establishment and growth of SME Start-ups in South Africa. The aim of this study is to investigate the determinants of start-up awareness to improve access to finance from banks by Start-up entrepreneurs in Pietermaritzburg, the capital city of KwaZulu-Natal province in South Africa. Data was collected through self-administrated questionnaires from a random sample of 253 respondents being members of the Chamber of Commerce in the capital city of one of the largest provinces in South Africa. The results from inferential statistical analysis revealed that start-up awareness factors such as conducting a feasibility study, finding a good location, knowing the amount of seed capital needed, developing a business strategy, a business plan, and business model as well as the source of seed capital, are significant determinants of access to bank financing by start-up entrepreneurs. Thus, entrepreneurs should understand the determinants of Start-up awareness in order to improve their ability to access bank finance.

Keywords: start-up entrepreneur; start-up awareness

1. Introduction

Mmako, Shambare, Radipere and Dhliwayo (2017:5) stated that any country’s economic development is attributed to the level of entrepreneurial activity in the country, and entrepreneurs are the primary source of the well-being of communities and nations (Mariotti&Glackin, 2014).

According to Scarborough, Wilson, and Zimmerer. (2009:21), an entrepreneur is an individual who creates a new business by taking a risk, considering that there are a number of uncertainties to consider through identifying and exploiting opportunities using the relevant
resources, to attain an economic profit. Start-up entrepreneurs are essential in pulling together the scarce resources that fuel the successful running of a business (Chell, 2013:10).

Although there are no clear definitions of Startups, various criteria, like the number of employees, annual sale or net profit, are some of the dimensions that could help differentiate between large and small Start-up firms (Tariq, 2013:3). There are mostly two types of Start-up, the first being an entrepreneur who converts ideas into commercial opportunities to create value (Leach & Melicher, 2012). The second type explains the Startup firms which are already operating however, they are yet to achieve the status of a small developed and operating firm (Hisrich et al, 2010:66).

Most of the South African Start-up businesses do not grow, and their failure rate of 75% is one of the highest in the world (Fatoki & Garwe, 2010; Bisseker, 2014; Wagner, 2015). The aforementioned authors highlight that Start-up entrepreneurs in South Africa do not move from the stage of existence and survival, to success, take-off and growth to maturity. In order for Start-up businesses to have a competitive advantage, they have to grow beyond the survival stage and keep on growing (Ayandibu & Houghton, 2017).

Despite the importance of Start-up businesses in national economies, Bongini, Ferrando, Rossi, and Rossolini(2017:2) indicated that Start-up entrepreneurs are financially more constrained than large firm entrepreneurs and are also less likely to have access to external finance. Mazanai and Fatoki’s (2012:58) indicated that compared to German, Italian and Spanish firms, South African Small and Medium Enterprises (SMEs) experience particular challenges in accessing external finance. This constraint appears to be severe in the case of Start-up businesses because of their limited choice of financing (Abor & Quartey, 2010:224).

It is against the above background that this study investigates the relationship between the determinants of Start-up awareness and access to bank finance by SMEs in South Africa. More specifically, the relationship between the entrepreneurs’ “start-up awareness” and their access to bankfinancing to start-ups will be empirically explored using descriptive and inferential statistical techniques to analyse survey data.

2. Determinants of Start-Up Awareness

Katwalo (2010:10) stated that “the inability of entrepreneurs to meet the bank’s requirements remains one of the principal challenges a Start-up entrepreneur experiences when accessing bank financing. Such requirements include business plans, management systems and other liability issues linked to business risks.” According to Chawla, Khanna and Chen (2010:2), the determinants of Start-up awareness, also called key success factors (KSFs) or key result areas (KRAs), that the entrepreneur must take into consideration in order to ensure the success of a business. The determinants characterise, condition and determine variables that have a direct and serious impact on the effectiveness, efficiency and viability of an organisation, program or project (Skrinjar & Trkman, 2013:50). The entrepreneur will consider the determinants of Start-up awareness with care to achieve their intended goal and overall objectives. If these determinants are identified in a general population of entrepreneurs and then applied to Start-up business, there is a high probability that business failure rate will be considerably reduced and high organisational performance will be achieved (Chawla, Khanna & Chen, 2010:2).

2.1. Awareness of the business opportunity
Awareness of the opportunity is the starting point, and it is defined by Short, Ketchen, Shook and Ireland (2010:40) as “a set of exploitable circumstances necessitating the involvement of commitment and resources with unknown risky result.” The business is likely to fail if there is lack of opportunity since a good idea is not enough to make profit within an existing market (Short, et al., 2010:40; Chell, 2013:11).

2.2 Market research

After defining the opportunity, the start-up entrepreneur would need to determine how the business can gain a competitive advantage in the market. Mariotti and Glackin (2014:144) claimed that market research is an effort that a new firm, which is not a market leader, would make to move up. Katz and Green (2014) further argued that a new business will gain market competitive advantage through three strategies: cost leadership, niche markets and differentiation. SMEs are however are unlikely to be market leaders by using cost leadership alone, they will gain market share through differentiation or targeting niche markets (Mariotti & Glackin, 2014:144; Short, et al., 2010:60).

2.3 Business strategy

According to Teece (2010:173) the assumption that “strategy is conceived as think out in advance, is valid only in some cases, in which the business model is a complex system that has been conceived in advance.” The fundamental question is how does a Start-up entrepreneur build a sustainable competitive advantage and make abnormal profit? Because of ease of imitation of products and services, developing a successful business model will not be enough. Louw and Venter (2010) suggested that the Start-up entrepreneur outperform his/her rivals by establishing a difference that it could preserve. Competitors will not be able to profit from imitation unless they match the whole activities system (Smorfit, 2010:173).

Philipson (2016:2) differentiates between a business model and business strategy as follows; a business model creates value for customers and develops a model around that value, and emphasis is placed on capturing the value created, and emphasis on the value captured and its sustainability is more on the realm of strategy. Therefore, a business strategy will require more analysis, calculations and choices that are reliable information available in the entrepreneur’s hands (Philipson, 2016:2). Additionally, Abraham (2013:31) opined that while the business model determines who the firm’s customers are, and how to make profit by providing value, the business strategy will look at how the firm would beat its competitors through differentiation.

2.4 Business plan

According to Jones and Penaluna (2013:805) a business plan is a tool that serves to identify and analyse uncertainty in the process of investment, and through which the Start-up entrepreneur identifies both internal and external benefits. Burke (2006) stated that from the external point of view, a business plan is a synopsis of the potential business and the blueprint to exploit it which is provided to potential investors, and from the internal point of view, it is a roadmap to be followed. These two perspectives (internal and external) when combined,
highlight why an Start-up entrepreneur should write and analyse a business plan before starting-up a business (Jones & Penaluna, 2013:805).

Schiraldi and Silva (2012:7) pointed out that a business plan is compulsory requirement for loan applications or co-investors; however, it still an important instrument for internal management. While writing a business plan, the Start-up entrepreneur must clearly indicate the mission, goals, objectives, strategies, core competencies, the action plan that links between resources and core competencies, and feedback and monitoring systems (Schiraldi & Silva, 2012:7).

2.5. Amount and source of seed capital

After establishing the plan and strategy of the Start-up business, the Start-up entrepreneur needs to solve the issue of the amount and source of seed capital, which are very important in starting a business. An incorrect source of seed capital will lead to inability to raise finance, and consequently business failure (Mmako et al., 2017).

2.6 Location

Fatoki and Odeyemi (2010:131) noted that market potential and growth opportunities are also influenced by the location of a new business. A new business that is geographically located in the proximity of its buyers or suppliers, creates an enabling environment that identifies and exploits growth opportunities in the market (Freeman & Style, 2014:182).

3. Access to Finance from Banks

Angela (2011:431) argued that for the establishment and growth of a business, access to finance is a very important factor, and a Start-up business’s access to finance is expanded to a variety of bank financial services, such as savings, insurance, credit, and payment facilities. The report presented by the International Finance Corporation (IFC) to the G20 Seoul 2010 summit stated that generally, finance from commercial banks remains as the most essential source of external finance for SME Start-ups (IFC, 2010:18).

Since the credit-risk profile of Start-ups may be too high, banks can risk only a relatively small percentage of their depositors’ money in Start-ups (Simpasa, 2013:793; Ringim, 2013:289). Banks do, however, provide many important debt products such as supplier credit, trade credit, overdraft, loans, factoring and invoice discounting, leasing, asset finance, and equity finance.

The 2010 FNB and Endeavor Report (2010:15) suggested that the issue is not so much a lack of access to capital but the stringent and lengthy process required to access external funding. This is exacerbated by the general lack of awareness about the procedures in gaining equity funding, which leaves entrepreneurs under-prepared. The application process tends to be bureaucratic and heavily laden with protocols and red tape as funders endeavour to gain confidence and assurance when granting funding to entrepreneurs (FNB & Endeavor, 2010:15).

Obtaining a business loan in South Africa is not easy and simple, and the application process is typically quite slow, as lenders require many documents and supporting information (LoansFind, 2017). Moreover, the banks and other companies providing business finance are traditionally risk averse, and they grant finance only to businesses which have an extremely low risk of not
repaying the loan. Since most SMEs do not fall into the low-risk category, this makes it impossible to obtain finance.

It is also difficult for many Start-up entrepreneurs to separate their personal finances from those of their businesses, thus appropriate non-financial support has remained a critical issue for these emerging entrepreneurs (FNB & Endeavour, 2010:14). Therefore, the bank has to pay particular attention when assessing a loan application in order to evaluate the risks involved and to seek methods to alleviate those risks (Benkraiem&Gurau, 2013:150).

A summary of the main requirements for accessing finance from major commercial banks of South Africa, namely, ABSA, Standard Bank, Nedbank and First National Bank (ABSA, 2017; Standard Bank, 2017; Nedbank, 2017; First National Bank, 2017) is presented in Table 1.

Table 1: Requirements for accessing business finance

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Black owned business</td>
<td>The applicant must be a previously disadvantaged individual (PDI) and the business must be 100% black owned. The applicant must be a South African citizen or a permanently residing in South Africa.</td>
</tr>
<tr>
<td>Start-up business</td>
<td>The business must be a small to medium-sized enterprise (SME) as defined by the Department of Trade and Industry (DTI).</td>
</tr>
<tr>
<td>Management skills</td>
<td>The owner-manager must have the skills and/or expertise relevant to the business and/or the industry or sector</td>
</tr>
<tr>
<td>Financial statements</td>
<td>The business must show profitability through historical financials or a realistic cash flow forecast.</td>
</tr>
<tr>
<td>Business plan</td>
<td>The business plan is an opportunity to lay out both financial goals, sales, profits, income, cash flow, etc., and qualitative business goals. A business plan to demonstrate the viability and sustainability of the business.</td>
</tr>
<tr>
<td>Credit history</td>
<td>The credit history reassures lenders that business’ owners are responsibly managing their personal finances. If the personal credit score shows that the business owner is a trustworthy borrower, the odds are he will be a trustworthy borrower as a business owner, too.</td>
</tr>
<tr>
<td>Statement of assets and liabilities</td>
<td>Statement of assets and liabilities of all members/directors/owners of the business.</td>
</tr>
<tr>
<td>Collateral information</td>
<td>Details of collateral held by existing bankers.</td>
</tr>
</tbody>
</table>

Source: Researchers’ compilation

4. Methodology

A quantitative research design using a specifically develop questionnaire was used to survey a sample of 253 owner-managers in Pietermaritzburg over a two month period. The targeted population is all SME owners and managers in Pietermaritzburg, South Africa. The population was 678 business members of the Pietermaritzburg Chamber of Business (PCB), which is a registered Non-Profit Organisation affiliated to the South African Chamber of Commerce and
Industry. The randomly selected respondents were provided with specifically designed questionnaires and the purposes of the research was explained. The questionnaires were to be returned after a week, and failure to do so by some owner-managers required the use of a fieldworker to personally collect the questionnaires and, also assist in its completion where these were not completed.

Secondary data collection involved a systematic review of the appropriate information from journal articles, textbooks, e-books, databases, policy documents, newspapers and magazine reports, government and non-governmental organisations publications and other relevant sources. Secondary data was helpful as it provided the necessary background and guidelines to the research.

The Statistical Package for the Social Sciences (SPSS) version 24 was used to analyse the data collected using a structured questionnaires, and the information is presented in the form of tables, as appropriate.

5. Research Findings

Only 28.1% of the respondents accessed finance from banks, either in their personal names or in the name of their Start-up businesses. The finding indicates that finance from banks is a major potential source of funds for Start-up entrepreneurs, however, access is a major challenge. The results are consistent with Smit and Watkin (2012) who stated that access to bank financing has been identified as hindrance to start-up entrepreneurs in South Africa.

Table 2 and Table 3 reveal that there is a significant difference in the level of agreement among the respondents that certain Start-up awareness factors influenced their ability to obtain funding from banks.

<table>
<thead>
<tr>
<th>Table 2: ANOVA output</th>
<th>Df</th>
<th>F</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feasibility study</td>
<td>2, 82</td>
<td>6.875</td>
<td>002</td>
</tr>
<tr>
<td>Location</td>
<td>2, 83</td>
<td>3.419</td>
<td>037</td>
</tr>
<tr>
<td>Amount of seed capital</td>
<td>2, 83</td>
<td>4.458</td>
<td>.014</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Table 3: Robust Test of equality of means</th>
<th>Df</th>
<th>Welch</th>
<th>P-Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business model</td>
<td>2, 29.046</td>
<td>8.943</td>
<td>.001</td>
</tr>
<tr>
<td>Business strategy</td>
<td>2, 30.303</td>
<td>15.516</td>
<td>.000</td>
</tr>
<tr>
<td>Business plan</td>
<td>2, 27.614</td>
<td>4.957</td>
<td>.014</td>
</tr>
<tr>
<td>Source of seed capital</td>
<td>2, 21.889</td>
<td>13.446</td>
<td>.000</td>
</tr>
</tbody>
</table>
In summary, the findings reported in Table 2 and 3 indicate that the following determinants of Start-up awareness, namely, feasibility study, good business location, knowing the amount of seed capital needed for business, business strategy, business plan, business model and source of seed capital, are significant determinants of access to finance from banks by Start-up entrepreneurs. The results are supported by previous studies (Fatoki & Odeyemi 2010), which found that prior market research and related factors significantly positively impact on the accessibility to different types of bank funding by Start-up entrepreneurs. The outcome of relationship between Start-up awareness (SUA) and Access to bank finance (BF) are shown in Table 4 below:
Table 4: Relationship between SUA and BF

<table>
<thead>
<tr>
<th>Proposed Relationship</th>
<th>Path Coefficients</th>
<th>T-Statistics</th>
<th>P-Values</th>
<th>Rejected/Supported</th>
</tr>
</thead>
<tbody>
<tr>
<td>SUA → BF</td>
<td>0.145</td>
<td>1.167</td>
<td>0.246</td>
<td>Supported but insignificant</td>
</tr>
</tbody>
</table>

Table 4 reveals that Start-up awareness has a relatively weak positive and insignificant effect on the entrepreneurs’ desire to choose the banks as a source of finance (β= 0.145; t=1.167; p-value = 0.246). This finding means that Start-up awareness in South Africa can possibly explain about 14.5% of the entrepreneurs’ considered choice of the banks as a source of finance. The results are supported by Olawale and Garwe, (2010), who found that prior market research and related factors significantly positively impact on the accessibility to different types of bank funding by SME start-ups.

6. Discussion, Conclusion and Recommendation

Small businesses in the Pietermaritzburg need to grow beyond their survival stage, to become competitive and gain a competitive advantage (Brand, Schutte & Du Preez, 2013:1). However, there is no contextualised growth model that a policy maker could rely on to know which steps to take in order to transform small-scale, informal enterprises, into dynamic firms operating in the formal economy, particularly those in rural areas, surrounding Pietermaritzburg (Wynne & Lyne, 2010:566). Furthermore, Wynne and Lyne (2010:566) indicated that for small businesses in Pietermaritzburg and surrounding areas, the transaction costs associated with accessing start-up finance are substantial, because the cost of information required to determine creditworthiness might exceed the benefits gained from a relatively small loan amount. Lenders therefore rarely have enough information to determine which businesses are productive and present a low risk (KZN Top Business Portfolio, 2017).

Against the above background, the purpose of this study was to assess, through a review of the literature and empirical investigation, the Start-up entrepreneurs’ access to bank financing in South Africa. The results indicated that feasibility study, good business location, knowing the amount of seed capital needed for business, business strategy, business plan, business model and source of seed capital are important start-up awareness determinants to improve access to bank financing by start-up entrepreneurs. Based on the findings of this study, it is recommended that entrepreneurs understand the determinants of Start-up awareness in order to improve their ability to access bank finance. Banks should be able to develop mature relationships with Start-up businesses and increase finance for Start-ups.

References


