

**INVESTIGATING OBSTACLES OF ACCESSING FORMAL FINANCIAL  
SERVICES BY SMALL MEDIUM ENTERPRISES IN KHOMAS REGION**

**A THESIS SUBMITTED IN PARTIAL FULFILMENT  
OF THE REQUIREMENTS FOR THE DEGREE OF  
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**BY**

**PENEYAMBEKO LIHONGENI KAMATI**

**200117467**

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Supervisor: Dr. R. Kamati - Bank of Namibia

## **ABSTRACT**

This study investigates the obstacles to accessing formal financial services by small and medium enterprises in the Khomas region. It further identified obstacles that hinder the SMEs' access to formal financial services in Namibia. Primary data was collected through the use of structured questionnaires which were issued out to a sample of forty firms selected from a population of fifty-five SMEs which are presently operational at Soweto and Dr. Libertina Amadhila center. Additionally, secondary data was extracted from annual reports and documents from the relevant banking and nonbanking institutions in Namibia.

Analysis of survey result by descriptive statistics in tables, graphs and charts indicates that most SMEs owners use own savings or borrow money from friends and relatives as an initial source to start-up and run their businesses. The result of this study indicates that, there is a substantial difficulty by SMEs to access finance from formal financial service providers. Moreover, SMEs unable to obtain access from formal financial providers cited the major obstacles to their financial access as; lack of information and advice from financial institutions, complexity and cumbersome processes in loan applications, as well as inadequate collateral.

It is therefore recommended to introduce a participatory program where the borrower and the bank discuss the credit scheme and the loan disbursement decision making process. Moreover, SMEs are encouraged to use government services assistance of SME incubation program as well as equipment finance and credit guarantee schemes.

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## **DECLARATION**

“By submitting this thesis I, Peneyambeko Lihongeni Kamati, declare that this is my own original work and has not been submitted elsewhere in fulfillment of the requirements of this or any other award”

I, Peneyambeko Lihongeni Kamati, declare that this thesis entitled ‘**Investigating obstacles of accessing formal financial services by small medium enterprises in Khomas region**’ is a true reflection of my own research, and that this work, or part thereof has not been submitted for a degree in any other institution of higher education. No part of this thesis may be reproduced, stored in any retrieval system, or transmitted in any form, or by means (e.g. electronic, mechanical, photocopying, recording or otherwise) without the prior permission of the author, or The University of Namibia in that behalf.

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## LIST OF ABBREVIATIONS

BON	: Bank of Namibia
DBN	: Development Bank of Namibia
GDP	: Gross Domestic Product
GTZ	: Gesellschaft für Technische Zusammenarbeit
IMLT	: Institute of Management and Leadership Training
JCC	: Joint Consultative Council
MSMEs	: Micro, Small and Medium Enterprises
MTI	: Ministry of Trade and Industry
NEPRU	: Namibia Economic Policy Research Unit
NTB	: Namibia Tourism Board
SBCGF	: Small Business Credit Guarantee Fund/Scheme
ROI	: Return on Investment
SME	: Small and Medium Enterprises

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Orientation of the proposed study**

Small Medium Enterprises (SMEs) play a significant role in the economy in terms of sustainable growth, employment creation, development of entrepreneurial skills and contribution to export earnings (Mass & Herington, 2006; Kadhikwa, Nakesera & Mushendami, 2008).

According to Ogbokor & Ngeendepi (2011), Namibia has witnessed a phenomenal growth in the number of business start-ups during the past two decades, especially when it comes to the operations of small and medium enterprises (SMEs). Indeed, almost 40,000 SMEs are currently registered in Namibia. The SMEs sector, through its labour , contributes to Namibia's economy in various ways. These include adding value to the gross domestic product of the country, and helping towards the realisation of the government's vision 2030.

The SMEs sector forms the backbone of Namibia's economy, not just in terms of its contribution to national Gross Domestic Product (GDP), but also because of employment creation. Arnold, Grossman, Mwatotele, Stork and Tobias (2007) revealed

that about 20 percent of the Namibians active in the economy were employed by the SMEs, and this contributes about 12 percent to the GDP.

SMEs are often the first to offer new products in the market and they are more flexible than large organisations (Ramsden, 2010). The immediate implication is that SMEs can meet, and satisfy, the population's needs better than bigger businesses that are inflexible. As such, this justifies why this sector has received much attention from the government in recent years. However, the SMEs sector faces challenges in Namibia. These challenges include startup capital acquisition, their survival and growth, as well as challenges of inaccessibility to finance from formal financial institutions. It is, thus, imperative to draw lessons from both the developed and the developing countries in order to identify the best practices in helping to set up successful SMEs (Kadhikwa, Nakusera & Mushendami, 2008).

In recognition of the important role that the SME sector plays in growth and employment creation, the Government of Namibia, created numerous Development Finance Institutions, which were responsible for enabling SMEs to access financial services (Bank of Namibia, 2010). However, due to the operational inefficiencies which characterize most of the Development Finance Institutions, some of these entities collapsed or merged to form new companies (Jauch, 2010). The financial institutions that were still operational as of 2014 include Development Bank of Namibia, Agricultural Bank of Namibia, National Housing Enterprise and the Small Business Credit Guarantee Trust (Bank of Namibia, 2010). Despite the efforts made by

Government to create institutions that make funds available to SMEs, it is still clearly visible that a large number of SMEs still face challenges of accessing financial assistance such as start-up and working capital from formal financial institutions (Shoopala, 2015).

Ogbokor & Ngeendepi, (2011) conducted a study on the 100 SMEs in Namibia and noted that 87% used their own savings, 11% borrowed money from friends, and only 2% managed to get a bank overdraft. None of the participants in that research received assistance in the start-up phase of the business. Similarly Ipinge (2010) investigated the SMEs' development in Namibia, focusing on areas such as access to finance, sound management, business processes, marketing and strategic alliances. The research found out that most SMEs do not have sufficient funds to venture into capital intensive programmes like manufacturing activities. As a result, general dealing becomes a better option for them since it does not require large sums of money to start operating or to expand current operations.

Nuyoma (2010) argues that more than 40 per cent of Micro, Small and Medium Enterprises (MSMEs) in the country identified access to finance as the most serious obstacle to growth. Meanwhile, Paliwal and Kandjaba (2009) believes that access to finance, and the cost of credit, both featured prominently as some of the challenges faced by the SMEs sector.

Besides, the study conducted by Baye (2004) indicates that, (162 of 300) of the SMEs owners' that applied for financial assistance from formal financial institutions, 54 percent of the applicants were rejected; only 36 percent were approved. Likewise, a study by Kapepiso (2014) indicated that only (234 of 500) or 47 percent of those that applied for financial assistance was successful, while the remaining (266 of 500) or 53 percent was disapproved. Moreover, a study by Ogbokor and Ngeendepi (2011) indicated that 26 percent of the small businesses received assistance from formal financial institutions. However, majority of the respondents in that study indicated that source of capital to start up and grow their business is a major obstacle to obtain from formal financial provider. From the statistics provided, the result implies that a challenge of accessing formal financial service exist and there is a need to investigate on why SMEs fail to access finance from formal financial institutions.

Despite support provided by the Namibian government, Arnold et al (2007) argues that SMEs still face challenges such as the lack of access to bank finance both during the formation stage of new SMEs as well as in the later stages. This is so, because businesses require additional inflow of capital to support expansion and growth. Furthermore, Stork (2010) indicates that there are funds available for the government to support SMEs; however SMEs do not have access to these funds due to information asymmetry that exist between SMEs and formal financial institutions. This intrinsically means that a feasible solution that can address this gap needs to be investigated.

Therefore, the aim of this study is to investigate obstacles that hinder SMEs' access to finance from formal financial institutions at Soweto and Dr. Libertine Amadhila in the Khomas region. The investigation will also examine the reasons why SMEs lack access to finances when there seems to be enough capacity for the sector to grow.

## **1.2 Statement of the problem**

SMEs are struggling to access formal financial services in Namibia. They lack access to finance, especially during the start-up phase, and consequently fail to thrive during the first two years due to cash flow problems (Ministry of Finance, 2012). In Namibia, a significant number of SMEs reported that, although having sufficient funds is important to their success, it remains difficult to access funds from formal financial institutions, especially during start-up (Nieman, Hough, and Nieuwenhuizen, 2004). It, therefore, implies that family members and friends remain the main source of business loans for SMEs sector (Stork, 2010). Similarly, Iiping (2010) also alluded to lack of finance as being one of the major impediments to the growth and operations of SMEs' in Namibia.

Despite that SMEs are globally regarded as an integral force in driving forward the economic development, they still face many challenges on multiple fronts. The crux of the argument is that, efforts such as the Small Business Credit Guarantee Fund (SBCGF) that was set up by government to a tune of N\$16 million to serve as a collateral or security for local commercial banks to lend to the SME entrepreneurs seems to have

failed, and many SMEs still face financial assistance challenges (Stork, 2010). Furthermore, the weakness of SBCGF is that the funds are only available through Bank Windhoek which lends mostly to already well established SMEs. As such, both the potential reach for all SMEs to access this fund are severely limited.

Echoing similar sentiments, Ogbokor & Ngeendepi, (2011) noted that of the 100 participants in their study none of the participants had received any funding during the starting up phase. 35% of the respondents indicated that they had received financial help from the government after their company had been operating for many years.

Ipinge (2010) and Stork (2010) both pointed out lack of finance is one of the major impediments and challenges to the growth of SMEs in Namibia. However, these studies did not go further to explore the obstacles that hinder SMEs to access formal financial services.

Departing from previous studies, this research extends the research focus on SMEs by probing and identifying why SMEs in Namibia struggle to access formal financial aid. Specifically, the research aims to identify obstacles that constrain the SMEs in Soweto and Dr. Libertine Amadhila in the Khomas region to access bank financial aid. In examining this problem, the research hopes to fill the gap by providing empirical evidence related obstacles to formal finances in the SMEs sector.

### **1.3 Objectives of the study**

Given the above background, the objectives of the study are:

- To identify obstacles that hinders the SMEs' access to formal financial services in Namibia.
- To investigate why SMEs in Namibia lack access to finance while there seems to be enough space for this sector to grow

### **1.4 Significance of the study**

The study conducted by Ogbokor & Ngeendepi, (2011) clearly demonstrated the challenges faced by SMEs in accessing formal financial services. Most of the individuals struggled to secure finance for start-up or expansion of their business. The government of the Republic of Namibia, in accordance with vision 2030, is dedicated to the development of SMEs in Namibia as part of its plan for poverty alleviation and employment creation. This research intends to fill the gap in knowledge about what can be done to help SMEs secure funding for their businesses. This is necessary to ensure sustainable SMEs development and their subsequent progression into larger organizations.

Given the SME sector and its challenges to access the formal financial services in Namibia, the outcome of this study is to augment the existing store of knowledge on the subject, and serve as a catalyst for further research on innovative ways of financing

SMEs. This study will be a useful source of reference to researchers, academics, students, policy makers, marketing professionals and other stakeholders interested in the financing challenges currently faced by SMEs. The findings of the study will provide a more reliable guide for, and new insights into, monitoring the financing challenges of SMEs to policy makers like government agencies which include the Ministry of Industrialisation, Trade and SME Development, Venture Capital Fund and financial institutions.

In addition, the study attempts to provide suggestions to government and financial institutions on how to facilitate owners and managers of SMEs to take advantage of financial support programs that are available for them. From a theoretical perspective, this study also seeks to make a contribution to the existing academic literature by providing insights into the principal challenges experienced by SMEs in accessing finance and their impact on SME performance in a context of a developing country.

Furthermore, the study results will serve as a tool for financial institutions to facilitate the availability of the needed finances to SME consumers. Moreover, the study results will serve as an awareness raising tool for formal financial institutions to achieve the highest level of efficiency in the provision of funds to SMEs. It will also probe the financial institutions to be responsive to SMEs. Lastly, this study will serve as a benchmark for measuring and achieving the intended national objectives and goals of vision 2030.

## **1.5 Limitation of the study**

This study only focused on the two informal markets of Soweto and Dr. Libentina Amadhila due to the limited time that was available to conduct this research. Moreover, this study was limited to a sample forty (40) SMEs' that were randomly selected from a population of fifty-five SMEs which are presently operational at these centers.

This location is chosen due to cost and time considerations, and also because most SMEs are concentrated in this area of the regional capital. Other limitations include the reluctance of some of the SMEs management to release information that would have strengthened the study by enhancing its validity and reliability.

## **1.6. Definitions of key terms**

The following terms can have different definitions depending on the context in which they are used. Therefore for the purpose of this study, the following terms are defined according to their context in this study.

**Access to finance** - access to financial services and products, as well as to financial service infrastructure which enables consumers to gain access to financial services and products (Kadhikwa, Nakusera & Mushendami, 2008). It is therefore, the availability of supply of quality financial services at reasonable costs.

**Formal financial services** -defined by Meng and Liang (2007) as the formal financial market groups of intermediaries that are recognised by the government. These intermediaries act under the monetary supervision or at least are connected with some public function. Some of them are commercial banks, savings banks, development banks and other non-bank financial intermediaries such as insurance or leasing companies.

**SME finance** – financing or funding of small and medium enterprises possibly in the form of loans, bank overdrafts and provision of working capital credits, in order to support and promote the development of the SME sector (Ramsdem, 2010).

### **1.7. Ethical considerations**

Ethics are standards of behaviour that guide moral choices about our actions and relationships with others. The aim of ethics in research is to ensure that no one suffers adverse significances from the research activities. The maintenance of ethical guidelines refers to whether a researcher displays competency and sustains honesty in the management of the resources. It is also concerned with acknowledgement of the sources and the inputs of supporters during the study as well as presenting an accurate report of the findings.

The researcher maintained the key ethical protocols as stated in this paragraph; Consent was obtained from all the participants and they were informed of the objectives and benefits of the study before administering the questionnaire. The response to questionnaires was on a voluntary basis and respondents were guaranteed confidentiality as only the researcher would have access to the collected data. Furthermore, the respondents were informed that data will be locked in a safe cabinet, and will be destroyed after five (5) years, thereby enabling the researcher to observe research ethics.

### **1.8 Organisation of the Study**

The remainder of the thesis is as follows: Chapter two is the literature review. Literature is reviewed according to the objectives of the study. The conceptual framework for the study is also outlined. Chapter three presents the research methodology. Chapter four is the data presentation, results and discussion. Finally, chapter five presents the conclusions and recommendations of the study.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This literature review examines the work of other scholars and critics on the main issues surrounding obstacles to access formal financial services by Small and Medium-sized Enterprises (SMEs). The chapter commences with the definition of SMEs, and focuses on literature that relates to objective 1 and 2 of the study as outlined in sub-section 1.3 of the introductory chapter.

- To identify obstacles that hinders the SMEs' access to formal financial services in Namibia.
- To investigate why SMEs in Namibia lack access to finance when there seems to be enough space for this sector to grow.

According to Biggam (2011) a good literature review presents the work of others in a clear, remarkable and liberal manner. It also provides evidence of in-depth critical evaluation (i.e. to show that you can give an opinion and support it with arguments/evidence). In addition, it sets out what has been done by others, relevant to your research aims or objectives, as well as it citing the relevant sources.

At the end of this section it is expected that the reader will emerge with a clear focus and justification of the study in the field of challenges that constrain SMEs from accessing formal financial services in Namibia. In the first instance, it is important to start by understanding what is meant by the term SME.

## **2. 2 The Definition of the concept of SMEs world wide**

Abor and Biekpe (2007) argued that the issue of what institutes a small or medium enterprise is a major concern amongst scholars and critiques. In fact, it seems that there is no singular definition for SMEs, in the academia arena. Many authors, countries and international organisations set their own guidelines for defining SMEs, which are often based on the number of employees, sales, or assets concerned. SMEs have indeed not been spared with the definition problem that is usually associated with concepts which have many components.

The definition of firms by size varies among researchers. Some researchers such as United Nation (UN) and The Bolton Committee attempt to use capital assets while , others use skill of labour and turnover level in their definitions. Others such as United Nations Industrial Development Organisation (UNIDO) define SMEs in terms of their legal status and method of production. Storey (1994) tries to sum up the danger of using size to define the status of a firm by stating that in some sectors all firms may be regarded as small, whilst in other sectors there are possibly no firms which are small.

The Bolton Committee (1971) first formulated an “economic” and “statistical” definition of a small firm. Under the “economic” definition, a firm is said to be small if it meets the following three criteria; namely,

- It has a relatively small share of their market place.
- It is managed by owners or part owners in a personalised way, and not through the medium of a formalised management structure.
- It is independent, in the sense of not forming part of a large enterprise.

The UN uses a different criterion to define small and medium-sized enterprises. It defines SMEs as enterprises which have fewer than 250 employees, and have either an annual turnover not exceeding ECU 40 million, or an annual balance-sheet total not exceeding ECU 27 million. However, the UN definition now needs to be adapted in order to take into account the economic developments and reduce the likelihood of the definition being circumvented.

In addition, the United Nations Industrial Development Organisation defines SMEs in terms of the number of employees by giving different classifications for industrialised and developing countries (Elaiian, 1996). The definition for industrialised countries is given as follows: large - firms with 500 or more workers; Medium - firms with 100-499 workers; and Small - firms with 99 or less workers.

While firms in manufacturing, construction and mining were defined in terms of the number of employees, (Bolton Committee, 1971) (in which case, 200 or less qualified

the firm to be a small firm), those in the retail, services, wholesale, etc. were defined in terms of monetary turnover (in which case the range of 50,000-200,000 British Pounds is considered to be classified as a small firm). Firms in the road transport industry are classified as small if they have 5 or fewer vehicles. However, the Bolton definitions have been criticised. The criticisms center mainly on the apparent inconsistencies in defining characteristics of firms based on the number of employees and on the managerial approach. For instance, the inconsistencies of the SMEs definition of each country, depending on its economic and industry model as well as on its strategic and risk management approach.

Weston and Copeland (1998) hold that definitions based on the size of enterprises suffer from a lack of universal applicability. In their view, this is because SMEs may be defined in various terms. Also, significant to note is the fact that size has been defined in different contexts, such as, the number of employees, annual turnover, industry of enterprise, ownership of enterprise, and the value of fixed assets.

It is clear from the various definitions that there is no general consensus over what constitutes an SME. Its definitions vary across industries and countries; hence it is difficult to compare the results from one author to another or from one country to another. This means that the results on the studies on SMEs should be interpreted with caution because of definition differences. On that note, it is important to now examine definitions of SMEs in the context of Namibia.

### **2.3 SME definition in the Namibian context**

The definition of this sector was last officially enunciated in the 1997 SME Policy. This definition has remained constant over the years, despite various regional and global dynamics leading to economic changes and the nature of firms undergoing structural changes (Ministry of Industrialisation, Trade and SME development, 2015). Moreover, the 1997 definition doesn't include the micro enterprises and only differentiated between MSMEs engaged in manufacturing activities and all other businesses. No provision was made for timely modifications of the definition as and when local, regional and global dynamics would dictate.

It is for the above mentioned reasons that the revised MSME Policy proposes a revised version of the Namibian MSME definition. The definition complies with internationally acknowledged standards and defines MSMEs according to two criteria, namely number of employees and annual turnover. It can be noted that the search for an SME definition is not just a vain academic pursuit, but it's a meaningful effort that is meant to guide investment policy and direction in any country Labour Resource and Research Institute (LaRRi ) (2002).

The following definition of SMEs' in the Table 1 below has been crafted by the Ministry of Industrialisation: Trade and SME Development under the National Policy on Micro,

Small and medium enterprises and adopted to suit the Namibian context (Ministry of Industrialisation, Trade and SME development, 2015).

**Table 1: Definition of SMEs in Namibia**

<b>Category</b>	<b>No of Employees</b>	<b>Annual Turnover (NAD)</b>
Micro	Up to 10	Up to N\$300,000
Small	11-30	Up to N\$3,000,000
Medium	31-100	Up to N\$10,000,000

*Source: Ministry of Industrialisation, Trade and SME development, 2015*

It is important to note that this definition is to be seen as a guideline only. In the event of an enterprise falling under two categories, the final categorisation will be of the appreciation of the appraiser, and additional information might be required to determine the category of the given enterprise.

According to the table above, SMEs within the Micro category should have employment of up to 10 persons and an Annual Turnover of up to N\$ 300 000, while SMEs in the Small enterprise category should have employment of between eleven to thirty people

and an Annual Turnover of up to N\$3,000,000. The last category of Medium enterprises should have an employment of between thirty one to one hundred people as well as an Annual Turnover of up to N\$10,000,000. Informal and survivalist enterprises are not included in this definition, as these enterprises will be tackled in another, dedicated policy.

Moreover, this MSME definition is to be adopted by stakeholders from both the Namibian public and private sectors. A one (1) year time frame is to be allowed for all stakeholders to align their current MSME definition with the national definition as outlined in the Policy.

The Government of the Republic of Namibia may from time to time modify the MSME definition adopted in the Policy in order to ensure it is continuously aligned with the national economic aspirations. Moreover, modifications of the MSME definition may be needed to reflect structural economic changes affecting the Namibian economy. Any modifications to the MSME definition will be informed by the Monitoring and Evaluation system in place and will be officially announced through publication in a Government Gazette.

## **2.4 SMEs role in the economic development in Namibia context**

SMEs are key contributors to employment creation, income generation and poverty reduction among the inhabitants of Namibia, both in rural and urban areas. Indeed, strong, independent and growing SMEs are the drivers of growth, innovation, development and job creation in an emerging economy where the scale and diversity of large businesses are insufficient to meet the demand for new investment and employment. SMEs are by nature flexible enterprises and thus are at the forefront of technological innovation. SMEs can evolve into growth-oriented businesses that provide much needed jobs. Furthermore, a deeper integration of SMEs into the national economy and the participation of SMEs in key value and supply chains of major national industries will have a knock-on effect on many larger and more formal businesses, and hence benefit the Namibian economy as a whole (Ministry of Industrialisation, Trade and SME development, (2015).

In Namibia, the latest figures show that an estimated 33,700 (of which around 15,000 are formally registered) SMEs provide some form of employment and income to 160,000, accounting for approximately one third of the nation's workforce and contribute approximately 12% to the Namibian GDP (Bank of Namibia, 2010). However, these figures are outdated, which speaks for the need to conduct continuous quantitative research on Namibian MSMEs.

According to a study conducted by the Institute of Public Policy Research (IPPR) (2005), there is a higher job destruction among SMEs than among large firms, but the number of jobs created tends to outweigh the number of jobs destroyed, resulting in a higher net job creation for SMEs than larger firms. Namibian SMEs operate in a variety of economic sectors, with the majority of them being retail traders, one quarter in food processing and other manufacturing or craft, and the others involved in services. However, this study posits that, in spite of the important role of SMEs on employment creation as well as contributing to GDP of many countries, this sector still faces many challenges such as lack of access to finance, even though there seems to be enough space for this sector to grow.

Another major challenge is highlighted in a study by Mass and Herrington (2006). They observed that the working conditions in the SMEs sector were noticeable poor, characterised by long working hours, low salaries, lack of formal employment contracts, lack of benefits such as pension and no reward for overtime as prescribed by the Namibian Labour Act of 2007. Jauch (2010) also noted that the majority of people employed in the SMEs sector in Namibia can be categorized as the working poor. The potential of SMEs to contribute to economic growth is therefore limited by numerous challenges.

## **2.5 Theoretical literature**

### **2.5.1 Agency Theory**

This section sets out to review literature on SMEs in Namibia so as to identify factors that hinder their access to formal financial institutions. The discussion is premised on the two types of agency conflict theories, namely the moral hazard (agency theory) and static trade -off theory.

The moral agency focuses on the conflict between shareholders and managers whereas, static trade off theory focuses on the conflict between equity holders and debt holders. The agency theory has important implications to the relationship between stockholders and debt-holders. Stockholders are interested in the return over and above that amount which is required to repay debt. Debt-holders are only interested in the debt payment specified in the contract (Stiglitz and Weiss, 1981).

The agency theory further suggests that there are significant numbers of SMEs that could use funds productively if they were available. However, because of the inability of most SMEs to meet the stringent requirements of these financial institutions, they are unable to access funds from the formal financial system. Firms that are expected to make profitable investments should have less need for the discipline that debt provides.

Shoopala (2015), notes that the agency theory gives vital insights into the problems of ownership and credit rationing. Issues around information asymmetry, moral hazard and adverse selection are likely to arise in contractual arrangements between firms and external providers of finance. These problems may well be more severe, and the associated costs much higher for SMEs than for large businesses. SMEs are also subject to the risk of asset substitution which, in practice, means a change in the firm's asset structure (Cofie, 2012).

Furthermore, Berger & Udell (2006) indicated that lack of access to bank loans by SMEs is attributed to the information asymmetry theory. This theory proposes that there is an imbalance of information between buyers and sellers and this leads to inefficient outcomes in certain markets. As such; in a particular transactions one party has more or better information than the other and thus this creates an imbalance of power in transactions, which can sometimes cause the transactions to go awry.

Notably, lending in developing economies, specifically to micro and small enterprises is particularly affected by information asymmetries between borrowers and lenders. Thus, startups and expansions' potentials experience difficulties in obtaining intermediate external financing, which depend mainly on internal financing or informal external financing such as friends and family.

It can be concluded that due to the agency problem, asymmetric information problems and credit rationing behaviours of financial institutions, SMEs are significantly denied

access to external financing. Therefore, the capital structure decisions for SMEs are greatly influenced by factors beyond their control.

### **2.5.2 Static Trade-off Theory**

The static theory stresses the risk that SMEs face in trying to access finance from formal financial institutions. In terms of SMEs cases the risks of bankruptcy are quite high. While the agency theory analyses the way in which the challenges of ownership of SMEs and other factors increase the element of risk when giving credit to SMEs, the Static trade theory analyses the risk of SMEs' financial independence and growth.

Kim and Gallent (2000) explain that the static trade-off theory claims that a firm's optimal debt ratio is determined by a trade-off between the losses and gains of borrowing. As such; it holds the firm's assets and investment plans constant. The gain of debt is primarily the tax-shield effect, which arises when paid interest on debt is deductible on the profit and loss account. The costs of debt are mainly direct and indirect bankruptcy costs. Therefore, the static trade theory has implications for SMEs credibility on the repayment of loans that they have acquired from formal financial providers.

In addition, Lepolesa (2008) points out that for SMEs, the expected costs of bankruptcy are quite high and the expected costs of financial distress may outweigh any potential benefits from the tax shield. SMEs rarely generate profit in their early stages of

operations, and the potential benefit of tax shields of interest payments remains doubtful. Also, Kim and Gallent (2000) point out that SMEs have limited access to external equity. In addition, internal equity is often inadequate for growing SMEs. Therefore, SMEs have to depend on external debts to survive and grow. In conclusion the static trade of theory emphasises that the repayment of the borrowed loan cannot be guaranteed from the SMEs.

## **2.6 Empirical Perspective**

Empirical evidence provided by Fatoki and Garwe (2010) suggests that inaccessibility to finance is the second most reported contributor to low firm creation and failure, after education and training. Migro, (2005) succinctly captures this in his observation that inaccessibility to finance can incapacitate the SMEs' growth and success. The same limitations are evident in a research conducted by Cassar (2004) who proves that most entrepreneurs, specifically SMEs struggle with accessing finances from banks due to excessive red tape and administrative burden.

Both Migro (2005) and Cassar (2004) have raised a valid reason to explain why SMEs faces challenges of access to finance. They argued that financial institutions rarely finance startup SMEs. This is because SMEs are believed to be rigid and inflexible, and have lack of knowledge or understanding of the operation of their business as well as lack of entrepreneur's strategies. They further contend that financial institutions are not willing to assist SMEs because they believe they are unable to repay the borrowed loan

on time as agreed. Furthermore, financial providers are wary in providing finance to people who do not have sound business plans and records, non-performing loan history, lack of business experience as well as inadequate collateral.

However, access to finance is not the only challenge faced by SMEs. Rogerson (2006), identifies other factors in addition to access to finance and these are; inadequate premises, lack of equipment and tools, inadequate markets and market information, theft, registering and transport challenges as attributes to the failure rate in that particular area. Despite a host of these factors, the impact of most of these challenges can be reduced if the challenge of inaccessibility to finance is addressed. Rogerson (2006) concurs by noting that inaccessibility to finance is the primary challenge and all other challenges can be said to emanate from it.

Next, Arnold et al. (2007) contends that it is widely believed that of all the many constraints to the stability and growth of small businesses in Namibia, lack of finance is the most crucial. The lack of collateral, as well as difficulties in dealing with banking procedures and regulations are the main factors impeding the access of small entrepreneurs to formal credit. However, the degree of stringency attached to each set of criteria varies for each institution and scheme.

The problems and reasons why SMEs do not have access to finance from the bank have been highlighted by Kapepiso (2014). These include required equity contributions to

certain percentage of the loan amount, collateral, high administrative cost on the low value of loans required as well as poor record keeping by SMEs. As such, NEPRU (2002) through their study concluded that most businesses use only a few banking financial services and the majority rely on their own financial contribution and on those from family or friends.

## **2.7 Obstacles and challenges that hinder the SMEs' access to formal financial services**

Lack of finance is one of the major issues deterring the survival and growth of SMEs. SMEs encounter great difficulties in raising fixed and working capital because of the hesitancy of formal financial services to provide loans. There is restricted knowledge on the role that can be played by financial institutions in helping to address the challenges faced by SMEs. This study intends to fill that gap.

According to a study by Ipinge (2010), 90 per cent of the SMEs conducted in that survey did not know of any sources of finance. Above all, they have also expressed reservations about the way they are treated by commercial banks, merchant banks and finance houses. Ipinge study's observation is in line with what was observed by Nieman et al. (2004) where they argued that SMEs cannot attract equity capital. The availability of outside capital is limited by poor creditworthiness of many SMEs. Thus, SMEs view banks and financiers as not friendly to SMEs or small businesses. This is perhaps one of

the many reasons SMEs do not even bother to find out what financial platforms and vehicles are available to them through the financial institutions.

Also, Maas and Herrington (2006) highlight that a substantial number of SMEs are of the opinion that, although there seems to be satisfactory funds available, access to these funds remains difficult, especially for SMEs. Similarly, Bank of Namibia (2010) noted that Namibia is struggling with financial services for its citizens specifically the SMEs sector. They further ascertain that access to financial resources is observed to be a major stumbling block to business expansion in Namibia for both the large businesses and SMEs sector.

Despite the capital structure theories' emphasis on the importance and relevance of debt financing or external financing in general, the literature review from South African studies claims that access to debt financing is limited for SMEs (Foxcroft, Wood, Kew, Herrington, & Segal, 2002; Angela Motsa and Associates, 2004; Herrington, 2009). These studies divulge that approximately 75% of credit applications by SMEs to banks are rejected. Therefore, there is need for policy reforms to ensure improved accessibility of external finance for SMEs in South Africa.

The challenges for SMEs are complex and they range from business regulations, lack of infrastructure, challenges in terms of access to finance as well as lack of technical or management skills. In the majority of cases in Namibia, SMEs may start with a person's

savings, but in the long term more financial investment will be required in order to expand and grow the business.

Research conducted by the Namibian Research and Labour Institute (2002), show that only 15% of SMEs had accessed loans in the previous year. The research also established that the people in SMEs had negative perceptions of loans. This gloomy state of affairs has been ascribed to a number of factors such as risk averse bankers, inappropriate financial products, and astronomical bank charges. The Ministry of Trade and Industry (MTI) (1997) asserted that SMEs' businesses often lack required accounting skills needed to be generated in order to convince a formal financial institutions to give financial assistance to SMEs.

Also, the Namibian banking sector faces challenges of SMEs' irregular clients. These are individual SMEs owners that do not have bank accounts and when they approach a bank for credit they are likely to be rejected, if they do not have collateral. Banks generally maintain that these people do not have a credit history and it is problematic to ascertain their ability to repay the loan (Institute of Public Policy Research (IPPR), 2005).

Finally, Musara (2010) indicated that there are four main reasons why formal financial institutions are reluctant to finance SMEs. These include; high administrative costs of small-scale lending, asymmetric information, high risk perception, and lack of collateral.

Although the reasons apply to both developed as well as developing economies, they tend to be more significant in developing countries.

### **2.7.1 Asymmetric information**

The problem of asymmetric information is more acute for SMEs than for larger businesses because of lower information standards and the greater variability of risk. SMEs and small privately owned firms face no legal reporting requirements and are more vulnerable than large firms (Cofie, 2012). Furthermore, asymmetric information makes it impossible to distinguish accurately between “good” and “bad” borrowers. The two main problems associated with asymmetric information are adverse selection and moral hazard, both of which may affect the quality of the loan.

Adverse selection refers to the fact that the probability of default increases with the interest rate, the quality of the borrower pool worsens as the cost of borrowing rises. SMEs are more likely to be rationed because they are seen as particularly risky. Although they might be willing to pay more to compensate for this additional risk, the banks refuse to raise the interest rate sufficiently to equate supply with demand (April, 2005)

Formal financial institutions can resort to two methods to reduce moral hazard which are: making it profitable to tell the truth, for example through the promise of renewed credit in the future and/or including penalties for low effort levels, for example, collateral which is lost if the firm becomes insolvent. Due to information imperfections and costly control mechanisms, the superior selection criteria based on cash-flow projections is thus often abandoned in favour of loan selection according to firm-size and collateral (Green, 2003).

### **2.7.2 Collateral Requirements**

Collateral refers to the extent to which assets are committed by borrowers to a lender as security for debt payment (Gitman, 2003). The security assets should be used to recover the principal in case of default. SMEs in particular provide security in form of properties (houses, the businesses, the car, and anything that could actually bring back the principal) in case of default on loans (Garrett, 2009). Security for loans must actually be capable of being sold under the normal conditions of the market, at a fair market value and also with reasonable promptness. However, in most banks, in order to finance SMEs and to accept loan proposals, the collateral must be 100 % or more, equal to the amount of credit extension or finance product (Mullei and Bokea, 2000).

April (2005) emphasises that financial institutions are more likely to approve loans to businesses that are able to provide collateral and to those firms that have established long term relationships with lenders as well as to those who have very well established business. Due to the existence of asymmetric information, banks base their lending

decisions on the amount of collateral available. Collateral acts as a screening device and reduces the risk of lending for formal financial institutions. By pledging assets, a borrower signals the quality of the project and the intention to repay. In the case of a default, the collateral serves to put the lender in a privileged position with regard to other creditors (Ackah & Vuvor, 2011).

SMEs are disadvantaged in this regard, because they lack collateral security and also a proved credit track record. Therefore, firms with innovative products may be constrained by the lack of access to finance because they may not have collateral security. Furthermore, information asymmetries may prevent financial institutions from seeing the profitability of the proposals (April, 2005).

Cressy and Toivanen (2001) indicate that, large firms with collateral provision get larger loans and lower interest rates. Also, formal financial institutions use qualitative and quantitative information in structuring loan contracts to small businesses. Besides, banks approach the lending process in a risk-averse way (in order to protect the funds of savers), and thus turn down a number of SMEs applicant that are perceived to be riskier.

However, moral hazard issues can be reduced by collateral requirements by increasing and adding a potential cost to borrowers when those are not making their best effort. Sometimes the borrowers extract the funds provided by the lenders for their own personal and private use. Therefore, the collateral requirements when in place can reduce negative consequences that can rise due to an improper utilization of the funds by SMEs. It is evident that most SMEs are denied and discriminated by the lenders in

providing financing. This is because of high risk and for not having adequate resources to provide as collateral (Kihimbo, 2012).

### **2.7.3 High credit facilities processing fee**

The cost of access to finance (credit) refers to the amount of money the entrepreneurs (SMEs owner) pay in the process of borrowing money from financial institutions. The key indicators of cost in this respect are handling fees, negotiation fees, interest rates, personal insurance, legal fees and travelling expenses that the entrepreneurs have to satisfy in the process of acquiring credit.

The high transaction cost does not only increase the cost of borrowing, but can also restrict access to external finance for some borrower groups. While the transaction costs restrain most borrowers, there are arguments that they are even more constraining for small and micro enterprises.

According to Marr, Chiwara and Munyuki (2011), SMEs typically require relatively small loans as compared to large firms. The transaction costs associated with processing and administering loans are however fixed and banks often find that processing small SME loans is inefficient. Ackah and Vuvor (2011) suggested that administrative costs should also include information gathering costs such as visiting borrowers, analysing their applications and monitoring their loans. For a number of reasons, these costs tend to be higher for SMEs than for large firms. Small enterprises are often located away

from the main urban centers, their accounting skills and standards are usually lower, and banks lack experience in servicing them (Cofie,2012).

A study carried out by Kakwambi (2012) on enhancing the contribution of small and medium-sized enterprises to local economic development in Oshakati Town, Namibia, found out that most SMEs faced challenges in accessing credit due to the high cost of credit, specifically in loan processing fees, legal fee, interest rate, insurance as well as expenses incurred in travelling in the process of accessing credit. The research recommends that the financial institutions should look for ways of developing credit products that would attract SMEs owner. The financial institutions and other stakeholders should explore lowering rates of interest for credit products meant for the SMEs.

#### **2.7.4 Risk**

Lepolesa (2008) observes that formal financial institutions tend to impute a high risk to SMEs and are therefore reluctant to extend credit to them. Due to their small size and inherent vulnerability to market fluctuations, the mortality rates of small enterprises are relatively high. These firms, by their very nature, often relatively young and consequently lack a financial history and a track-record of profitable projects. In addition, organisational and administrative deficiencies lower the quality of management, and a lack of appropriate accounting systems may compromise the accessibility and reliability of information from small firms on their repayment capacity (Nashidengo, 2007).

In South Africa the risk perception of SMEs is attributed to the high failure rates. Therefore, it is reasonable for financial institutions not to grant finance to SMEs, particularly SMEs who have little or even no credit history (Musara, 2010). Tightening collateral security requirements is one of the ways through which financial institutions attempt to protect themselves against such risks. The need for collateral militates against potentially viable small, emerging enterprises getting finance from formal financial institutions (Maas & Herrington, 2006).

### **2.7.5 Challenges faced by SMEs in Developed Countries**

While the contribution of SMEs to development economy is commonly recognised worldwide as well as in Namibia (Stork, 2010), entrepreneurs are still faced with many obstacles that limit the growth and survival of SMEs. SMEs in developed countries face similar challenges as in other parts of the world (Gill & Biger, 2012). The two authors' results showed that micro-operations were more likely to encounter problems of demand, availability of alternative sources of finance, a lack of information about financing options, and a lack of financial expertise. In addition, the result further pointed out that the intensity of several problems faced by small firms differed by sector, gender of owner, size of the business, legal structure, and age of the SMEs.

Smith and Beasley (2011) investigated factors that influenced seven graduates in the creative and digital industries to start their own small businesses in Barnsley, South Yorkshire, UK. The research identified constraining factors to graduate business start-up

to be the slow growth of the economy, lack of business acumen, lack of sector-specific mentors and advisory support, lack of finance and experience of familial entrepreneurship.

On the other hand, Chu, Kara, Zhu and Gok (2011) found that the most critical problems encountered by Chinese entrepreneurs include undependable/ unreliable employees, competition, lack of management training, lack of marketing knowledge and inability to maintain accounting records.

#### **2.7.6 Challenges faced by SMEs in other African countries**

It is important to understand the problems faced by SMEs in Africa as they may differ from those faced in developed countries. Problems facing the growth and survival of SMEs in Africa can be generally classified as: administrative, operating and strategic problems (Okpara, 2011). This background information is not meant to cover in-depth all challenges faced by SMEs in Africa but partially highlight the challenges faced from an African perspective. The focus will be on three randomly chosen African countries, namely, South Africa, Nigeria and Kenya.

### **2.7.6.1 Challenges faced by SMEs in South Africa**

South Africa SMEs has various factors that limit them from accessing finance from formal financial institutions as well as contributing to the poor growth of small businesses as in other African countries.

According to Mbonwane and Ladzani (2011) the government does not give enough support to the small business sector in terms of legal issues for business registration to ensure the success of SME's. There is also poor communication between the government and small business owners. Small businesses also face lack of financial management to run their businesses; hence they are not trusted by financial institutions. They do not have a reliable track record and they fail to grasp the importance of business registration with relevant authority. Lack of training is also another factor; the government does not have enough support mechanisms available to ensure that small business owners and their employees receive the training that would enable them to run the business successfully.

Crime is another factor hindering small business growth, as crime is more often committed because of the large size of the building structure that needs to be secured. Crimes are committed by employees because they do not earn enough money too.

#### **2.7.6.2 Challenges faced by SMEs in Nigeria**

According to Okpara (2011) there are several factors responsible for hindering small business growth and survival in Nigeria. Among these are financial constraints, management problems, corruption and lack of infrastructure. Lack of capital and complexities of obtaining loans from formal financial institutions are the major hindrances to small business development. Lack of management skills is another hindrance to small business development as many business owners have little or no management skills or experience before starting their business.

Corruption is also a major constraint to business development and survival in Nigeria because of bribery and political connections. In addition, lack of essential infrastructure is another notable obstacle to business development. Thus, key infrastructure and services such as roads and bridges, water, electricity, a reliable telephone and other telecommunication system that could facilitate business success are not readily available.

#### **2.7.6.3 Challenges faced by SMEs in Kenya**

A study conducted by Migiro (2005) in Kenya, concluded that SMEs face financial challenges since the majority of SMEs are not aware of the existence of certain sources of finance. Thus, SMEs are credit-constrained as a result of a number of factors. Iarossi (2009) points out that unlike firms in the formal sector, microenterprise, both formal and

informal, rely significantly on internal funds and retained earnings to finance their working capital and investment.

Furthermore, the investment climate survey showed that, unlike with formal microenterprises, access to land is also ranked as a major problem by informal firms. Most micro firms, both informal and formal, do not own land. Besides access to finance and land, other problems for both the informal and the formal micro firms include transport, electricity and formal registration. On the other hand, micro firms, find tax administration and regulatory requirements to be major constraints. In Kenya, tax obstacles could determine whether an enterprise is formal or informal; one of the main benefits of informality is the ability to avoid taxation.

### **2.7.7 Challenges faced by SMEs in Namibia**

The economic importance and the contribution of SMEs in Namibia, as discussed earlier is positive, however the sector still faces many challenges that hamper it despite the factors that there seems to be enough space for this sector to grow. In general, the main challenge facing SME development in Namibia has been singled out as lack of access to finance to start up a business and for expansion (Bank of Namibia, 2010).

**Access to finance:** SME financing is unattractive to formal financial institutions as they are perceived to be high risk investments that do not yield commensurate returns. Even if they offer promising, commercially viable investment opportunities, SMEs are often

not backed by adequate collateral. Only few businesses use financial services, the majority relies on their own financial contributions and contributions from family members or friends (Stork, 2010). Further, Arnold et al (2007) indicated that limited access to finance is also strongly correlated with poor financial literacy (the majority of SMEs make use of private saving accounts or private cheque accounts to run the business for instance). As a result, 97% of Namibian SMEs are considered non-bankable. According to the World Bank Enterprise Survey, 40.9% of small and 28.6% of medium enterprises identify access to finance as a major constraint, whereas only 1% of large enterprises see access to finance as a challenge for their development. The lack of access to such capital is a reflection of the inflexibility of the financial institutions concerned.

**Cumbersome administrative processes:** According to the Doing Business Survey by the World Bank as quoted by (Ministry of Industrialisation, Trade and SME development, (2015), Namibia remains a country with lengthy and costly administrative procedure. Applying for a loan requires going through 10 different steps and can take up to 66 days. Moreover, it comes with a cost. MSMEs do not always have the technical and financial capacities to comply with these procedures.

**Information asymmetry:** Shoopala (2015) explains that a critical issue to overcome is that of asymmetrical information. A person without a bank account approaching a bank for a loan is likely to be rejected unless collateral is at hand. This is because the bank has no transaction history for this individual or SMEs' business and hence does not know anything about the applicant's creditworthiness. As a result, SMEs are faced with lack of information keeping about the business; they do not keep receipts or do bookkeeping. There is no information also on the business performance which makes it very difficult for lenders to consider rendering assistance to them.

**Lack of a structured and regulated Business Development Services (BDS) market:**

The Bank of Namibia (2010) symposium noted that there is still a shortage of skills and capacity in the SME sector; hence Government was called upon to ensure the provision of skills and capacity. April (2005) noted that Business consultants have identified this gap, by offering costly trainings and consultancy services targeting SMEs. Therefore there is a need to regulate this market, in order to ensure quality and value for money to the SMEs making use of such services.

**2.8 Formal financial services' contribution to SMEs success**

According to Shoopala (2015) SMEs are considerable contributors to the economic growth and job formation for nations, and therefore the success of these businesses are important. Gama and Geraldes (2012) contend that to achieve growth, SMEs generally need external financing because small businesses depend heavily on formal financial

institutions loans for their external finance. Hence, a lack of efficient bank lending can materially hinder the development of SMEs.

In addition, this lack of credit has been identified as one of the major factors impeding the success of small businesses, (Pansiri & Temtime, 2010). Access to finance challenges obliges the development and growth of SMEs, because many SMEs are unable to access the same kind of growth funding which is often available to large businesses.

In their paper, (Migiro & Wallis, 2006; Ramsden, 2010; Stork, 2010) concluded that because SMEs business owners make significant contributions to the economy and employment creation, formal financial institution, Non-Governmental institutions (NGOs) and government should aid SMEs especially in the areas of finance, marketing and human resource areas in order for the SMEs to succeed, grow and become independent entities. Thus, lack of access to formal financial services is likely to hinder the growth and development of SMEs in Namibia if not prudently addressed (Ministry of finance, 2012).

However, all the literature reviewed in this study shows that even though there is no consensus among researchers on the factors contributing to business success, a few variables are discussed more often such as understanding customers' needs, availability of capital, and possession of business skills and support of family. According to Chu,

Kara, Zhu and Gok (2011) Chinese entrepreneurs regarded reputation for honesty as the crucial factor contributing to their success. They also perceived good customer service, good general management skills, and friendliness to customers and access to capital as the leading factors to a higher level of business achievement.

Building onto these studies, Naidu & Chand (2012) who conducted a survey of 100 SMEs in Indonesia disclosed that some of the critical success factors of SMEs in Indonesia are marketing, technology and access to capital. Out of these, the most significant factor that determines the success of small businesses in Indonesia is access to capital.

Bhaird and Lucey (2011) point out that as successful firms survive budding and startup phases, and mature through growth stages, personal funding becomes relatively less important as investment finance is increasingly sourced from retained profits. Furthermore, the accumulation of a trading history facilitates access to increased sources and amounts of external financing, particularly bank finance and trade credit.

Contrary to these studies, Smorfitt (2010) indicates that when analysing critical success factors for start-up and growth phases of SMEs, the study does not mention access to credit from formal financial institutions as a critical factor. Simpson, Padmore & Newman, (2012) also disagree that access to credit is a critical success factor but point

out that growth or development of SMEs can depend on both financial and non-financial factors.

## **2.9 The role of SME sector in Namibia**

The private segment is the engine for sustainable economic growth. The role of the public sector is to create an enabling environment in which entrepreneurs can explore opportunities and thus increase productivity, contribute to economic growth and create jobs. Small businesses fall under the wider category of SMEs, which are believed to provide employment and income for approximately one third of the Namibian workforce (Stork, 2010).

According to Kakwambi (2012), the SME sector contributes notably towards poverty reduction and allows the majority of poor people to become self-employed and to start meaningful production activities on a small scale. Thus, they serve as important avenues to generate income and generally, as a way of reducing poverty. Namibia's principal sectorial sources of growth and sustained income are industry and services.

Large and medium-sized industries are mainly foreign in terms of ownership and investment and enjoy good access to financial services from the formal banking sector. Small enterprises, including the micro businesses, are locally owned and, as of now, hardly have access to bank credit, nor to other support services, such as training, business counseling, adequate purchasing facilities, etc. (Zehender, 2000).

According to White (as cited in April, 2005) the roles and the significance of the SME sector were neglected in Namibia prior to independence. Priority was only given to the large businesses, which were regarded as the stimulus for economic growth. Although potential small businesses operated successfully, they were not provided with the necessary support. Small businesses operated mostly in the retail, trade and service sectors. Today, the SME sector has been identified as the priority sector for reducing unemployment and poverty.

### **2.9.1 Involvement of formal financial institutions in financing SMEs**

Lack of finance is widely believed to be the most crucial constraint to the stability and growth of small businesses in Namibia. The lack of collateral, as well as difficulties in dealing with banking procedures and regulations are the main factors impeding the access of small entrepreneurs to formal credit (Kapepiso, 2014).

The predicaments of access to finance faced by the SMEs in Namibia are twofold: firstly, they are considered too small for lending by the commercial banks. As a result, their ability to repay the money borrowed is questionable. Secondly, they are considered too large for lending by micro-lenders because the amount required often exceeds the available credit limits. Financial service providers (banks in particular) have initiated efforts in order to address the lack of access to finance. For instance, the Development Bank of Namibia (DBN) has been channeling funds for SME development through commercial banks. Moreover, commercial banks have established specialised branches

dedicated to SME lending and have also initiated mentoring programs in order to assist SMEs (Ministry of Finance, 2012).

Stork (2010) further indicates that formal financial institutions are hesitant to offer financial services to SMEs due to many lending obstacles such as, inadequate collateral, lack of business experience, and lack of sound business plans, non-performing loan history, and high transaction per loan application. In addition, the study revealed that formal financial institutions, especially banks, have traditionally had collateral-based lending practices and lack the know-how to differentiate SMEs' risk. These exacerbate the financial gaps and hinder access for SMEs.

### **2.9.2 The Role of Government in SME development**

The small and micro businesses sector in Namibia has failed to produce an acceptable standard of living for entrepreneurs, their dependents or their employees. Therefore, the Namibian government realised the need to continuously reviewing policies in order to develop measures, and to overcome this shortcoming. The cabinet of the Republic of Namibia in 1997 adopted the "Policy and Programme on Small Business Development" which distinguishes the vibrant role played by the small business sector in the country's economic development. Despite such recognition, little has been done so far in this direction; hence the sector is still faced with on-going challenges (Zehender, (2000)

Furthermore, the Programme on Small Business Development Policy, in its framework, stresses its determination to achieve sectorial development, which is, to facilitate the creation of a favourable and an enabling environment for the sector. This can be enabled by embarking on initiatives such as; deregulation and the offering of incentives, development of proactive programmes, as well as provision of a strong institutional support.

Under incentives and de-regulation, a number of policy and legislative measures have been taken towards the creation of a more favourable regulatory environment for small businesses. The policy framework is determined in its approach to direct the government to undertake and to create a favourable environment in which small businesses are able to flourish. It regulates the regime so as to minimise bureaucratic obstacles to the establishment and expansion of the SME sector. Under, the pro-active programmes, the policy needs to address the following areas: finance, marketing, technology transfer, purchasing, sites and premises as well as training (Zehender, 2000).

#### **2.10 Effects of failure on SMEs to access finance from formal financial institutions**

Bank financing remains by and large the most important source of external finance to SMEs (Berggren & Silver, 2010; IFC, 2010). Access to finance by SMEs from formal financial institutions constrains the development and growth of SMEs. Moreover, Gama and Geraldes (2012) confirmed that to achieve growth, SMEs usually need external

funding from formal financial institutions. In addition, lack of access to finance has been identified as one of the major factors inhibiting the success of small businesses, Abdullah and Baker (as cited in Pansiri & Temtime, 2010). This implies that lack of access to finance can materially hinder the success of SMEs.

Stork (2010) indicates that SMEs contributes to approximately 28% of the employment in the Namibian market; hence, lack of financing SMEs from formal financial institutions can impede the employment opportunities in the market. Moreover, Bank of Namibia (2010) indicates that SMEs contributes about 12% to the GDP of the country, hence access to finance by SMEs is very crucial to the growth of economy.

## **2.11 Research Gaps**

A lot of research has been carried out locally and internationally reviewing challenges facing micro and small enterprises in accessing credit facilities. The majority of these studies concentrated on objectives different from those of this study.

Departing from previous studies, this research is strikingly unique in the sense that it focuses on uncharted territory of identifying obstacles that hinder SMEs access to finance in Soweto and Dr. Libertine Amadhila market in the Khomas region. It also endeavours to explain why SMEs lack access to finance even though there seems to be enough space for this sector to grow. It is this knowledge gap that this study hopes to address by exploring such obstacles.

## **2.12 Solutions to Challenges of Access of Finance**

According to, Teece, Pisano and Shuen (1997), experience from the microfinance industry shows that some ways to successfully bridge the gap between the demand and supply of credit is through innovative lending methodologies. Such methodologies as emphasised by Freiling (2007) include a loan analysis that focuses on the prospective client's ability to pay (cash flow).

Less emphasis should also be placed on collateral. The analysis should be highly standardised, and loan processing times kept to the minimum. The recurrence debtors should be entitled to increasingly larger loans. The borrower should also bear full responsibility for the loan throughout its entire life and should be paid performance based salaries. If payment problems occur, there should be a powerful incentive structure in place for immediate follow-up and appropriate decision-making. Control mechanisms should also be in place and supported by a strong management information system (MIS) and information technology (IT) to assist in the management and administration of the loan portfolio.

In another study, Chiwara (2008) argues that many formal financial institutions have developed tools, such as credit scoring models and other sophisticated techniques, to discriminate between high-risk and low-risk borrowers, thus reducing the risk of lending to SMEs. Despite the potential for the above mentioned methodologies to be effective in

addressing challenges of access to finance by SMEs applying these approaches has failed to provide a clear path to closing the information asymmetry gap, between the SMEs and the financial institutions (Teece, Pisano and Shuen (1997). Therefore, there is a need to find more effective ways to ensure that the information gap between financial institutions and SMEs is closed.

In South Africa, policy debates have failed to close the financial gap between SMEs and providers of financial resources. Various authors have revealed that access to finance challenges is the main reasons for low entrepreneurial growth and SME survival in the country (Mass and Herrington, 2006). Policy reforms to improve access to finance to SMEs should be in line with different requirements at each stage of growth in the SME sector.

Marr, Chiwara and Munyuki (2011) imply that, at each stage, SMEs have different financial requirements and will source their financial needs from different sources. Therefore, both theoretically and practically, problems of access to finance occur due to the gaps that exist between the suppliers of external financing and the demand for financial resources.

### **2.13 Summary**

The chapter looked at the global challenge of defining SMEs. Furthermore, the chapter looked at the two theories that underpin the study. The theories are the Agency theory

and Static Trade off theory. From the above discussion, the literature review stressed the important role of banks in SMEs financing and the importance of SMEs economic growth if access to finance is granted to them at a reasonable lending rate. Moreover, the reasons that make banks reluctant to loan money to SMEs were discussed. Parts of the reasons are lack of collateral, lack of business plan and poor book keeping by the SMEs owner.

Furthermore, the chapter has discussed the approach that can be used by financial institutions to reduce the risk of lending money to SMEs. In addition, the government policy intervention program to stimulate SME development has been enlightened. The issue of whether financial institutions can contribute to SMEs success and growth has been liberated. Finally, the review discussed in detail the SME sector in Namibia, and it emerged that this sector plays an important role in economic growth.

## **CHAPTER THREE**

### **METHODOLOGY**

#### **3.1 Introduction**

This chapter describes the research methodology that was adopted in the research process, analysis and interpretation of the results. It describes the research design, the research population, the sample, the techniques that were used for sampling, the research instruments, the process of data collection; and the method of data analysis.

A quantitative approach was adopted for achieving the set objectives. These objectives were: to examine whether formal financial services contribute to the success of SMEs, as well as to examine why SMEs in Namibia lack access to finance although there seems to be enough space for this sector to grow.

#### **3.2 Research Design**

The study used a descriptive research design method to identify the obstacles that hinder SMEs' access to formal financial services in Namibia. The use of descriptive research design enables a clear presentation of variables under investigation. In addition, this method provides simple summaries about the sample and measures. Moreover, descriptive statistics describes what the data shows.

The independent variables of the study comprised of gender, age, education, duration of business in operation, businesses registration, SMEs characteristics, startup capital, as well as source of capital. These were evaluated in relation to how they affect the dependent variable which is access to finance. Data was collected, summarized and reduced to basic representative values and presented the findings in tables and graphs.

The researcher used both primary and secondary data. Primary data was obtained through questionnaires, while secondary data was obtained from journals, books and other online resources.

### **3.3 Population**

The target population of this study consisted of all SMEs in Soweto and Dr. Libertina Amadhila informal markets. These SMEs were selected based on the variety composition in terms of SME activity and business nature. This enabled the survey to explore across fields as to why SMEs fail to acquire financial aid for setup, growth and expansion. The SMEs in operation are mainly in manufacturing (shoes and clothes), ICT SMEs (printing and scanning), hardware SMEs (locks and keys), Electronic repair SMEs (cellphone, television and radio), Salons and barber shops, Food SMEs (restaurant, dried food and groceries), Retail SMEs (ice-cream and DVD selling).

The business owners responded to the questionnaires since most of these SMEs are run by the owners. The nature of the business and population where the primary data were collected is shown in Table 2 below.

**Table 2: Nature of the business**

<b>Nature of the business</b>	<b>Population</b>
Manufacturing (shoes and clothes)	2
ICT SMEs (printing, faxes, email and scanning)	4
Hardware SMEs (locks and keys)	5
Salon and barber shop	15
Electronic repair SMEs (cellphone, television and radio)	5
Food SMEs (restaurant, dried food and groceries)	4
Retail SMEs (ice-cream and DVD).	5
<b>Total</b>	<b>40</b>

*Source: field survey May 2016*

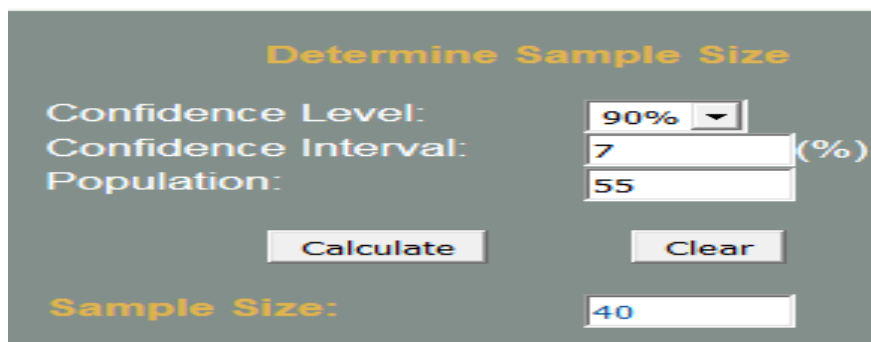
As can be seen on table 2 above, the majority of the respondents (15 out of 40) were in the salon and barber shop dealing, (5 out of 40) were in hardware, electronic repairs well as retail businesses. 4 respondents out of 40 were in ICT businesses and food dealing. The least category was by manufacturing which consisted of 2 respondents.

### 3.4 Sample

There are 55 registered SMEs which are presently operational at Soweto and Dr. Libertina Amadhila center. For the purpose of this study, a sample of forty SMEs was systematically randomly selected from a population of fifty-five. In probability sampling, the chance, or probability of each case being selected from the population is equal in all cases. The sample was 80% of the target population, and was obtained as highlighted below.

The sample size was calculated using a system developed and used by Creative Research Systems and MaCorr Research experts using MaCorr sample size calculator. In calculating the estimated sample size the researcher used a confidence level of 90 percent and confidence interval of 7 percent. Using a 90% confidence level and a confidence interval of 7%, with a population of fifty-five twenty one (55) resulted in the estimated sample size of forty twenty (40) SMEs for both market where the questionnaires were distributed for data collection.

**Figure 1: Sample size calculator (MaCorr)**



The image shows a screenshot of a web-based sample size calculator. The title is "Determine Sample Size" in yellow text. Below the title, there are three input fields: "Confidence Level:" with a dropdown menu set to "90%", "Confidence Interval:" with a text box containing "7" and a "(%)" label to its right, and "Population:" with a text box containing "55". Below these fields are two buttons: "Calculate" and "Clear". At the bottom, there is a label "Sample Size:" in yellow text, followed by a text box containing the result "40".

Source: <http://www.macorr.com/sample-size-calculator.htm>

### **3.5 Pilot study**

The questionnaires were tested through a pilot study done by the researcher at both Soweto and Dr. Libertina Amadhila in the Khomas region in Windhoek. The aim of piloting was to improve the validity of the questionnaires and to administer the instrument to a small group of respondents. These respondents had a similar profile as the respondents of this particular study in order to clarify the instructions. Based on the findings of the pilot testing no changes were made to the original questionnaires, therefore, no post-test questionnaire was compiled.

### **3.6 Research Instruments**

In view of the nature of the topic, it was realised that questionnaires would be the main and the most appropriate instrument to use. Questionnaires are an inexpensive way to gather data from a potentially large number of respondents.

The questionnaires are attached on (Appendix A) were in the open and closed ended choice-formats. In the open ended questionnaire, the respondents formulated their own answers freely. In the closed format, respondents are given options to select from. It minimised discrimination against the less literate (in self-administered questionnaires). It was easy to code, record, and analyse results quantitatively, and to report results (Leung, 2001).

The open ended format allowed exploration of the range of possible themes arising from an issue. It was used where a comprehensive range of alternative choices could not be compiled. The questionnaires are attached on Appendix A.

The questionnaire covered headings such as; profile of business owner, background information on the business and finance. Questions were designed in such a way that the questions were short and precise so as to ensure accurate interpretation of the questions by the respondents.

Some questions sought data on the profile of the business owner such as gender, age and educational qualifications. Other questions sought information on the finances of the SMEs such as, startup capital and source of startup. Open ended questionnaires were analysed using Likert scale such as strongly agree, agree, neutral (no opinion), disagree and strongly disagree. The questionnaires had structured questions relating to the objectives.

### **3.6.1 Administration of Questionnaire**

The questionnaires sent out to respondents had a personalised cover letter explaining briefly the purpose of the survey, the importance of the respondents' participation, the name of the researcher, and a statement guaranteeing confidentiality. This cover letter also expressed thanks to the respondents at the end.

These questionnaires were self-administered because no interviewer was present to inject bias in the way questions are asked. It is one of the economical and reliable methods of surveying large samples. Confidentiality was preserved as none of the respondents had written their business name or their personal name on the questionnaire; rather, they just specified the nature of the business on the questionnaire that helped the research to identify which category does the business belongs to. The questionnaires were administered in a standard manner and completed at the respondent's convenience.

The respondents were given one month to complete the questionnaires before their collection. This was done to give them ample time to respond. Repeated visits and phone calls, though costly, were made to the respondents to ensure a high return rate of questionnaires.

### **3.6.2 SME questionnaire**

Questions were formulated by the researcher in collaboration with the research supervisor. The questionnaire consisted of a total of 17 questions which were divided into two parts in order to solicit information on the obstacles of accessing credit from formal financial institutions by Small and Medium-sized Enterprises financing (see appendix A). Questions were short and precise so as to ensure accurate interpretation by the respondents. They were then analysed in relation to the research objectives.

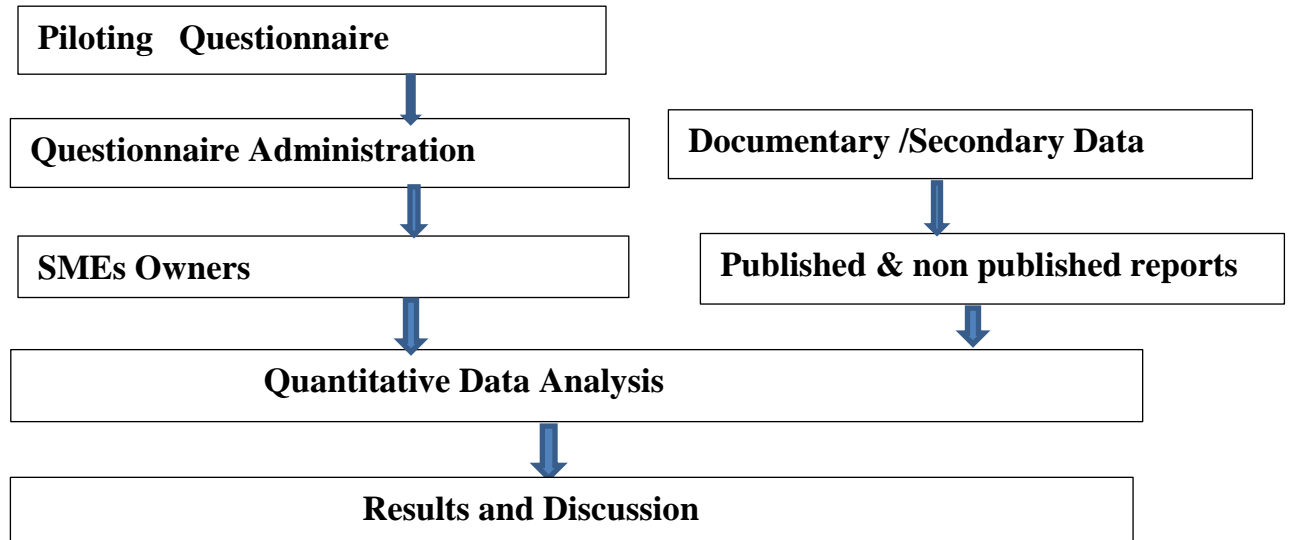
### **3.7 Procedure**

Data collection means gathering information to address the critical questions that had been identified earlier in the study (Cooper and Emory, 1995). Many methods to gather information, and a wide variety of information sources were identified. The most important issue related to data collection is selecting the most appropriate information or evidence to answer questions raised in the study (Brinkerhoff 1983; Archer, 1988; Leeds, 1992).

Primary data is data observed or collected directly from first-hand experience. This type of data is more accommodating as it shows the latest information. Secondary data is data published and collected in the past. This type of data is available effortlessly, rapidly and is inexpensive.

Data was collected from, both primary and secondary sources. Primary data were captured by administering the questionnaires. Secondary data, specifically for the literature review, was collected from journals, handbooks and manuals as well as reviewed articles and editorials, in order to complement the primary data. Primary data were collected from 01 - 30 May 2016.

**Figure 2: Data collection process and methodological approach**



*Source: Author's own computations*

Figure 2 above highlights the approach that was used to collect data. The results were interpreted and discussed in line with the objective of the study.

### **3.8 Data Analysis**

The data collected was checked for completeness because, the raw data obtained from a study is useless unless it is transformed into information for the purpose of decision making (Cooper and Emory, 1995). The data analysis involved extracting raw data into a manageable size, developing summaries and applying statistical inferences. The data collected was grouped into two categories which were lack of access to finance by SMEs and business support services. It was then analysed using Likert scale score in order to measure the interval level of opinion of the respondents as well as to test the relationship and the influence of bank finance on SME success and growth.

Quantitative data was analysed using the Microsoft Excel application software in order to achieve the objectives of the study. The results of these tests are presented in Chapter four. To make the presentation more comprehensive for the readers, and to assist them with conceptualising the findings of the research, data was presented in tabular, graphical and narrative forms. In analyzing the data, descriptive statistical tools such as bar graphs complemented with mean and standard deviations were used.

### **3.9. Summary**

This chapter explained the research methodology used in this study. The study adopted descriptive research designs. Primary data was collected through the administration of closed and open ended questionnaires; while secondary data was collected from journals, textbooks, handbooks and manuals, review articles, editorial and literature review, as well as published guides. The data collected from primary and secondary sources was analysed using quantitative methods. The next chapter presents the findings and discussions of the study.

## **CHAPTER FOUR**

### **PRESENTATION AND ANALYSIS OF DATA**

#### **4.1 Introduction**

Using graphs, charts and tables, this chapter presents the data gathered during the study. A comparison of this study's data and that which was found in various reviewed literature is also made.

#### **4.2 Demographic Coverage of Respondents**

The researcher used systematic random sampling to select twenty (20) SMEs from the population of current operating 55 SMEs from both Soweto and Dr. Libertina Amadhila center. These SMEs were selected so as to add diversity to the study as there are various informal SMEs specialising in different trades. With various SMEs specialising in different trades, this diversity will give the researcher a holistic opportunity to fulfill the objectives of the study from various angles of specialization and trades on to why accessing formal financial services by SMEs is a challenge. In addition, this method ensured that all the known elements of the population were represented in the sample. The sample was calculated using MaCorr calculator as indicated in figure 1. The selected sample of forty (40) SMEs consisted of twenty-four (24) female and sixteen (16) male SMEs owners of the targeted population that responded to the administered questionnaire. Details are shown in table 3 below.

#### 4.2.1 Response Rate

**Table 3: Response Rate**

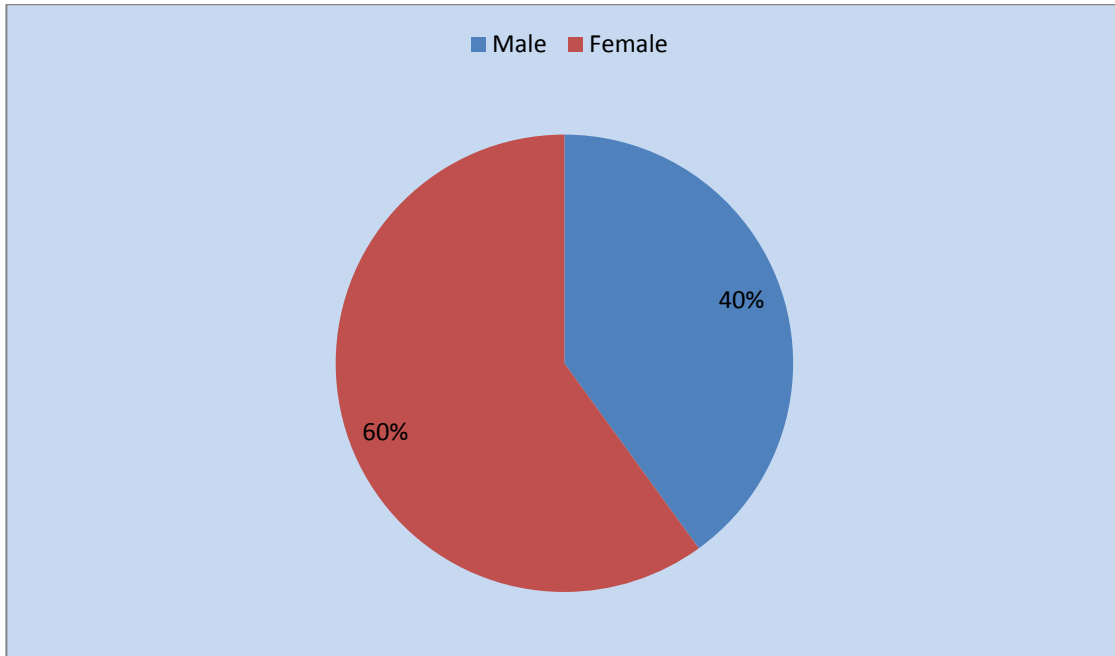
Details	Male		Female		Total	
	Frequency	Percentage	Frequency	Percentage	Count	Percentage
SMEs owner	16	40	24	60	40	100

*Source: Field Survey, May 2016*

The researcher administered a total of 40 questionnaires and achieved an overall response of 100 percent of the targeted sample. However, some selected SMEs owners had to be replaced (also using systematic random sampling) as they were hesitant to respond to the questionnaire. The researcher replaced the hesitant participants with those who were willing to respond to the questionnaires in order to ensure that the research objective was achieved. The response rate was adequate to allow the researcher to continue with the analysis. The study sought to establish the obstacles of accessing formal financial services by SMEs at two informal markets of Soweto and Dr. Libertina Amadhila in Khomas Region.

#### 4.2.2 Gender Ratio of the respondents

**Figure 3: Gender Ratio**



*Source: Field Survey, May 2016*

This question was meant to capture the relationship between the gender respondent ratio, and its access to formal financial services funding. This independent variable of gender had been identified in literature review as one of the determinants of SMEs characteristics that influence access to finance by LaRRi, (2002), who argued that financial institutions are less inclined to extend credit to SMEs run by males than females due to the perception that men take on high risk ventures beyond their capability. Of the 40 respondents 60% were female, and 40% were male. The ratio is an indication that female dominated the response rate than male.

The higher response of females can be accredited to most formal financial institutions preferring to give credit to women entrepreneurs. This is because women are said to honour credit repayment better than men LaRRi,( 2002).

Although females are said to honor credit repayments better than men, practical understanding of gender advocacy groups in Namibia, and the operation of SMEs show that some of these groups exaggerate this claim in order to campaign for more credit towards women than men. There are biased factors such as women offered small credit amounts (loan) with longer duration repayment periods; of course this translates into manageable monthly installments compared to large instalments and shorter repayments for males counter-part which results in high defaults among men than women in SMEs business.

On the other hand, it could be that men are offered a large amount of financial assistance (loan) towards their businesses and short duration repayment period because of high risk adventure among. As such, men are unable honor their credit repayments on time, as it might take time for risk ventures to reach break-even point due to large capital start-up. Hence, this does not mean gender is main determinant whether to access finance but the risk appetite of the financial institutions, and of course the probability of credit defaults in relation to gender needs further investigation. Hence, this outcome of women said to honor credit repayment better than male should be read with the above factors in mind.

Moreover, this claim can only be confirmed if factors such as allocating equal amount of financial assistance as well as same duration repayment period to both parties have been examined and evaluated accordingly. However, due to time and need to limit this study the issue of whether both men and women were given an equal opportunities on the factors mentioned was not examined in this study and therefore this can be future extension to this study.

#### 4.2.3 Age categories of the SME owners/managers

**Table 4: Age Categories**

<b>Demographic Characteristics</b>	<b>Description</b>	<b>Number of respondents</b>	<b>Percentage</b>
<b>Age</b>	<25 years	0	0%
	25–29 years	0	0%
	30 – 34 years	4	10%
	35 –39 years	10	25%
	40 - 44 years	17	42.5%
	45 - 49 years	6	15%
	50+ years	3	7.5%

*Source: Field Survey, May 2016*

This question was meant to capture the relation between the SMEs owner's age categories ratio and access to formal financial services funding. The study revealed that most respondents (42.5 percent) are between the ages 40 and 45. Twenty five percent of the respondents were between 35 and 39 years, and 15 percent were aged between 45 and 49. The least number of respondents (7.5 percent) were aged over 50.

The high response from participants aged 40 to 45 may be because most of them have been in business for a long period of time and have established businesses. Therefore access to funds from financial institutions has become moderate due to reliable track records such as available financial statements, bank accounts, as well as that they have acquired assets that can be regarded as collateral.

The result of this study concur with the literature on the study conducted by Bhaird and Lucey (2011) who point out that all successful firms survive the budding and start-up phases, and mature through growth stages. Therefore when the business passes all those stages personal funding becomes relatively less important as investment finance is increasingly sourced from retained profits. As such formal financial institutions do not hesitate to offer credit to those SMEs owner whose businesses are well established and are able to provide trading history transactions, as they are more likely to settle their debt in full.

#### 4.2.4 Educational Level of SMEs owners/managers

**Table 5: Educational level**

Details	Frequency	Percentage
Primary Education	4	10
Secondary School	29	72.5
Post-Secondary School	5	12.5
University	2	5
Others	0	0
Total	40	100

*Source: Field Survey, May 2016*

This question was asked to determine whether there is a relationship between SMEs owners' level of education and their access to formal financial services. The study revealed that all the respondents have some form of formal education. The participants with post-secondary education were 12.5 percent of the entire sample, while those that hold a primary school education were 10 percent. The least number of respondents (5 percent) were those with university degrees as shown in the table above. None of them held any other educational qualifications.

In the literature review, education is deemed to be one of the important deterministic variables of access to finance by SMEs from formal financial institution as indicated by the study of Meng and Liang (2007) that involved entrepreneurs in Singapore. The study disclosed that successful entrepreneurs have higher education levels compared to that of unsuccessful entrepreneurs. Meng and Liang (2007) indicated that seventy seven percent of successful entrepreneurs were university graduates, while twenty-three percent were not. Similarly , Lussier and Pfeifer (2007) state that after entering the entrepreneurial world, those with higher levels of education are more successful because university education provides them with knowledge and modern managerial skills. They say it makes them more conscious of the reality of the business world, and, thus, puts them in a position to use their learning capabilities to manage the business. Hence, with this understanding and knowledge from the educated SMEs owner, it makes it easier for them to access finance from formal financial institution as compared to the lowly educated SMEs owners. This trend shows that there is a positive correlation between owner's education levels and SMEs success (Thapa 2007).

In relation to this study, the literature review is in concurs with the SMEs scenario at Soweto and Dr. Libertina Amadhila in the Khomas region. The SMEs owners have indicated that education is very important in conducting their businesses. They indicated that if the SME owners or managers have not obtained at least a tertiary education it is very difficult to keep up with all the infinite changes in the business environment.

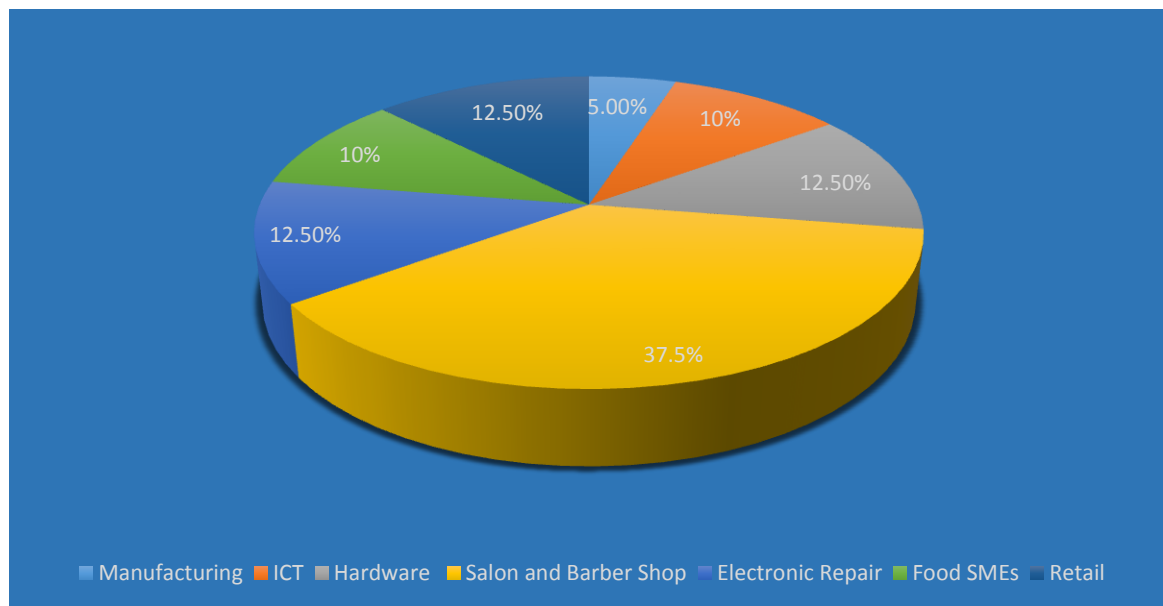
Moreover, the SME owners and managers with relatively lower levels of education find it difficult to draw up business plan, conduct efficient bookkeeping as well as to maintain proper financial statements that will enable them to apply for financial assistance from formal financial institutions. Due to this limited knowledge on how to run their business effectively, in most cases their applications end up being rejected. However, Wanjohi and Mugure (2008) have stated that people with higher education are not necessarily more entrepreneurial there are other factors too, such as risk taking and building relationship with financial institutions. These two contradicting findings make it more even necessary to conduct further research on the subject.

While 42 percent of the respondents indicated that education is one of the detriment factor for a prospective SMEs to access finance and is considered as a major obstacles, practical understanding of how SMEs works in Namibia indicate that higher education level are not necessarily a prerequisite for successful entrepreneurship. There are other factors too, such as risk taking, commitment to the business and ability to build sound relationship will financial institutions. Furthermore this claim can only be confirmed if two SMEs owner for instance one with low education and the other with higher education level were for instance given the same opportunity such as an equal amount of financial assistance were offered to them to start up their businesses and after a given period of time say, after one year an evaluation will be done on their performance to determine who performed better than the others on their businesses, only then with empirical evidence education level can be categorized a major hindrance to access

formal finance. Thus, in the absence of such empirical evidence the lack higher education can only be listed as one of the obstacles for SMEs to access finance.

#### 4.2.5 Nature of the business

**Figure 4: Nature of business**



*Source: Field Survey, May 2016*

This question was meant to capture the relation between the type of business conducted by SMEs and its growth as well as its success rate. The majority of SMEs at Soweto and Dr. Libertina Amadhila are involved in general dealing, like footstalls, salon and barber shop and service industry. In response to this question, it was found that the majority of the respondents own salons and barber shops (37.5%), the second highest categories were that of Hardware, Electronic repair and Retail business with 12.5%. The next category of 10% was that of ICT and food SMEs. The least represented category of 5

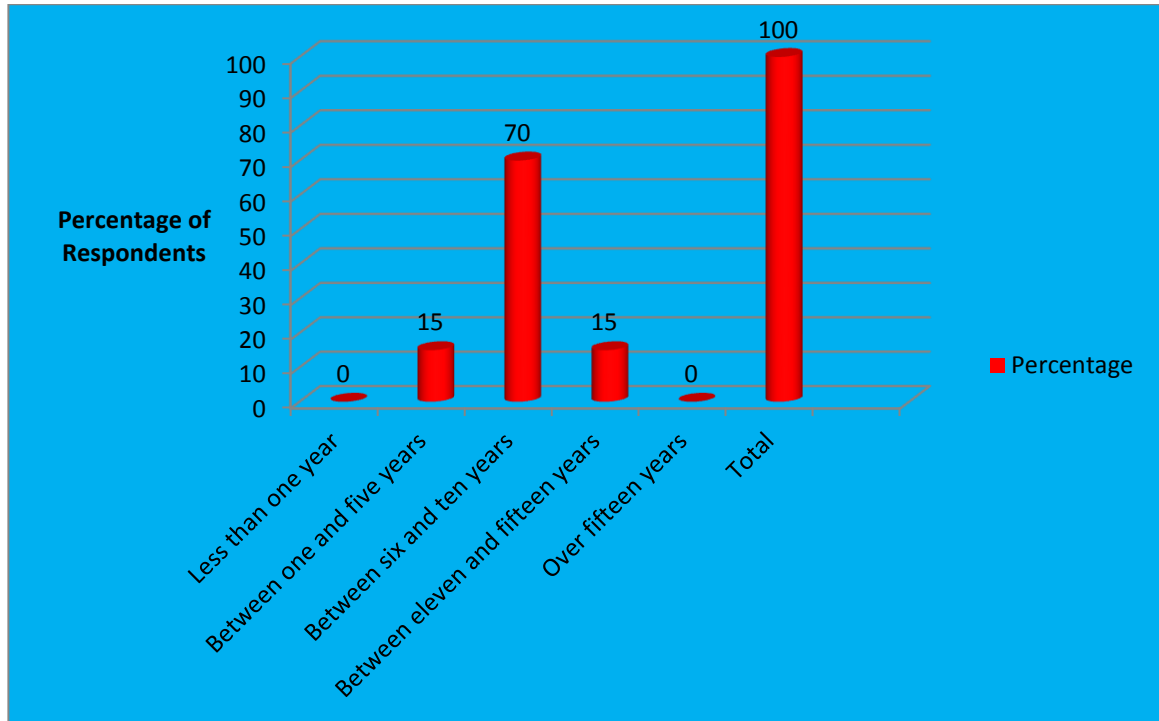
percent was that of the manufacturing SMEs. However, none of the respondents indicated any other sector. The challenges that are involved with accessing finance were discussed in the literature, especially with regards to start-up capital, this has made the majority of the SMEs in this study to opt for being in the salon and barber shop sector which requires less investment, succeed and grows faster than other business sectors

Also, according to the MTI (1997: 29), lack of finance is widely regarded as one of the major obstacles to the development of more advanced small businesses. Most of the SMEs do not have sufficient funds to venture into capital intensive programmes like manufacturing activities. As a result, some of the SMEs at Soweto and Dr. Libertina Amadhila opted for general dealing which does not need large sums of money to start operating or to expand current operations. About 12.5 per cent indicated that their businesses are of providing service. Only five per cent showed that they are in the manufacturing industry.

NEPRU (2005) also concluded that most small businesses rely on their own savings or support from family or friends for funding their business activities, because they cannot afford high interest charges by commercial banks, neither do they have the required collateral security to access bank loans.

#### 4.2.6 Duration of the business in operation

Figure 5: Duration of the business in operation



Source: Field Survey, May 2016

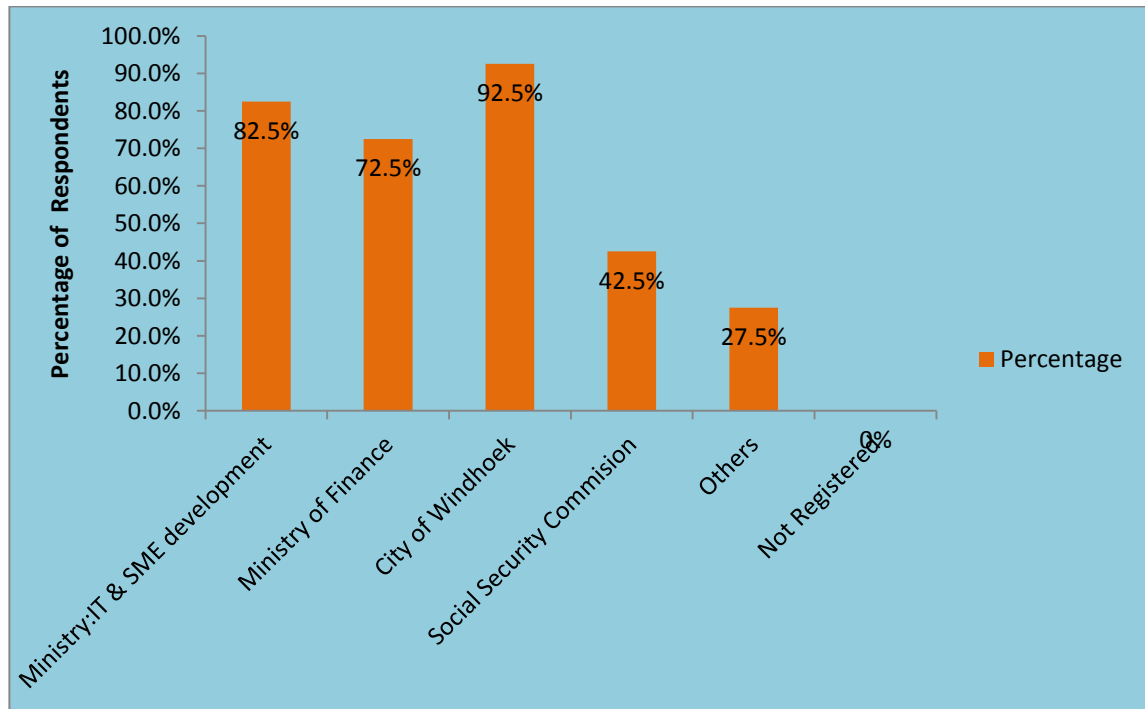
This question sought to reveal whether there is an influence between the duration of business in existence and access to finance by SMEs from formal financial institutions. The study found out that SMEs owners, who participated, have been operating for at least a year to fifteen years, with the six to ten-year duration category attaining the highest response rate of seventy percent. Nevertheless, the category of between one to five years, as well as that of eleven to fifteen years both attained a response rate of 15 percent. This implies that the researcher sought opinions from respondents who had been in business long enough to understand the challenges faced when trying to access credit facilities from formal financial institutions.

This indicates that there is a relationship between the business existence in operation and access to finance. SMEs that were considered very young one to five years considered themselves disadvantaged while trying to access finance from formal financial institutions, this was true especially for startup businesses as most of the respondents in that category indicated that they started their businesses with their own savings, as financial institutions were reluctant to offer financial assistance to them.

It seemed as though SMEs that have been in operation for a longer period of time have easier to access finance. This is so because different stages of growth require different level of financing. SMEs that have been in business for a long time no longer require start-up capital but rather require working capital for expansion. The working capital amount is usually not as large as that required to start-up. With SMEs that have been in existence for a longer period, the issue of collateral, market information as well as financial statements are properly managed. This usually makes it easier for formal financial institutions to grant financial assistance to these SMEs.

#### 4.2.7 Business Registration

Figure 6: SMEs Business Registration



Source: Field Survey, May 2016

This question was asked to determine whether a relationship exists between business registration and access to finance by SMEs from formal financial institutions. In response to this question the respondents were required to indicate all the authorities with whom they are registered. More than 90 percent (37 of 40 respondents) of the SMEs owners that participated stated that they had officially registered their business with the City of Windhoek SME department. About 82.5 percent of the businesses were also registered with the Ministry of Industrialisation: Trade and SME Development (MIT&SMED), while 72.5% were registered with Ministry of Finance. About 42.5% percent and 27.5 percent were registered with Social Security commission and other

authorities such as Shack Dwells association and Namibia Tourism Board (NTB), respectively.

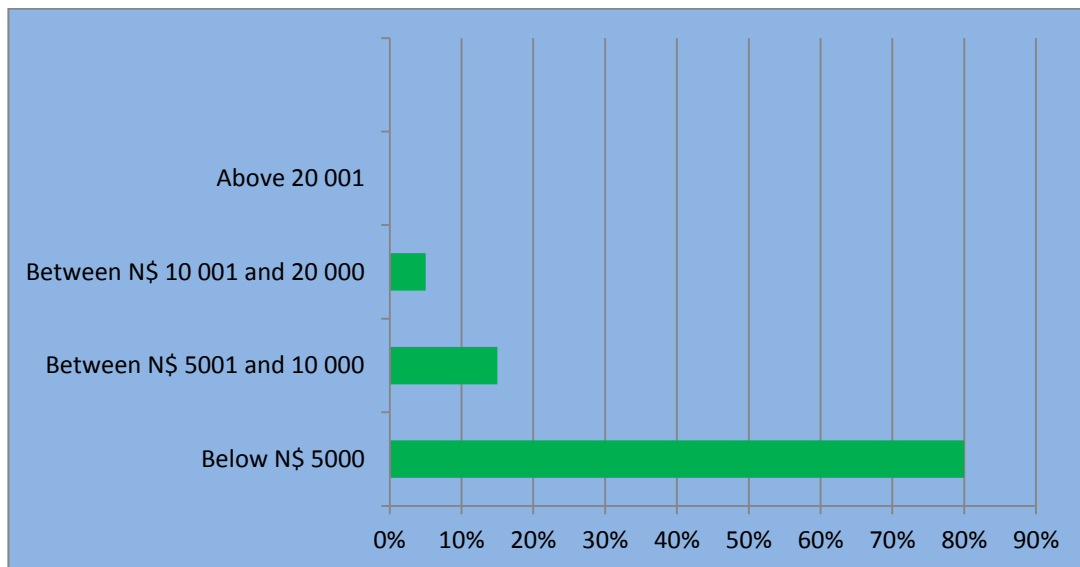
The issue of business registration has been highlighted in the literature review as one of the variables that determine access to finance by SMEs. According to Mboniyane and Ladzani (2011) the government does not give enough support to the small business sector in terms of legal issues for business registration to ensure the success of SME's. Hence, this hinders their chances of getting financial assistance from formal financial institutions. If the SME is not registered with the relevant authority such as Social Security Commission (SSC), MITSMED and Ministry of Finance, there is no proof that it really does exist, thus is considered as high risk to be financed.

Similarly, this study found that the majority of SMEs have been registered with most relevant authorities as shown in the table above. However, the majority does not complete their tax return every year, and some have not registered their businesses for tax purposes due to limited knowledge. There are some SMEs owners that do not renew their social security certificates yearly. All these reasons make it difficult for financial providers to evaluate the status of SMEs for financial assistance considerations. This also makes it difficult for SMEs to participate in other business such as tenders.

#### 4.2.8: Start-up business capital

Figure 9, below, indicates that the level of capital employed by most businesses (80%) is below N\$5 000. Fifteen percent of SMEs had invested between N\$5 001 and N\$10 000 in their business operations. An additional five per cent of the SMEs have started their business with capital between N\$ 10 001 and 20 000.

**Figure 7: Start-up business capital**



*Source: Field Survey, May 2016*

From the above figure, the majority of SMEs (80%) indicated that the amount of capital employed was below N\$ 5 000. Start-up capital is one of the major hindrances for SMEs to kick start their businesses, as highlighted in the literature review. According to Beck, 2008 formal financial institutions avoid providing financial assistance to certain

types of SMEs, in particular, start-ups and very young firms that typically lack sufficient collateral, or firms whose activities offer the possibilities of high returns but at a substantial risk of loss. The literature review concurs with this study. Most SMEs owners at Soweto and Dr. Libertina Amadhila indicated that they struggled to get start-up capital from formal financial providers, as they are regarded as high risk borrowers. Those SMEs that were granted financial assistance received very low amounts. Most, if not all, of them had no choice but to accept it and seek for other alternatives, such as starting with their own savings or borrowing from family or friends.

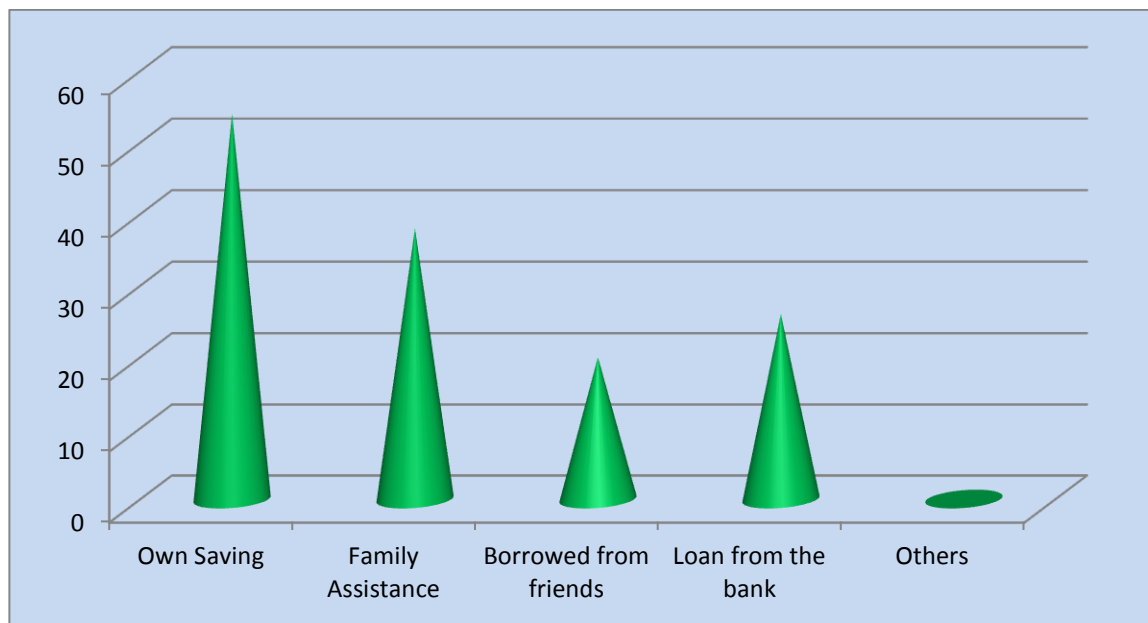
Similarly, as argued by the Institute of Management and Leadership Training (IMLT 2003), it is difficult for SMEs to get start-up capital from formal financial institutions. Financial institutions insist that SMEs must keep proper accounting records for the banks to be able to monitor and evaluate their profitability and viability before their loans are granted. Hence, this is a challenge for start-up SMEs as they have not yet established any records that they can present to financial institutions in order for them to be granted loans.

#### **4.2.9 Sources of Capital**

Furthermore, the researcher wanted to find out about the sources of finance when SMEs commenced their businesses. The results are shown in figure 10, below. This study found that 54 percent used their own savings, 38 and 20 percent were assisted by family

and borrowed from friends, respectively. About twenty six percent had bank loans to start-up their business.

**Figure 8: Sources of capital to start-up the business**



*Source: Field Survey, May 2016*

These findings concur with Nieman (2004) who stated that gaining financial support is one of the most challenging experiences faced by SMEs. This explains why most of the SMEs at Soweto and Dr. Libertina Amadhila used their savings to kick-start their operations. However, in this study, 26 percent of the small businesses received assistance from formal financial institutions. The moderate efforts being made by some formal financial institutions should be emulated, in order to promote wealth and employment creation. Furthermore, these results suggest that bank loan remain the most

important source of external finance for SMEs, which is also consistent with the findings by Berggren and Silver, (2010) and IFC, (2010).

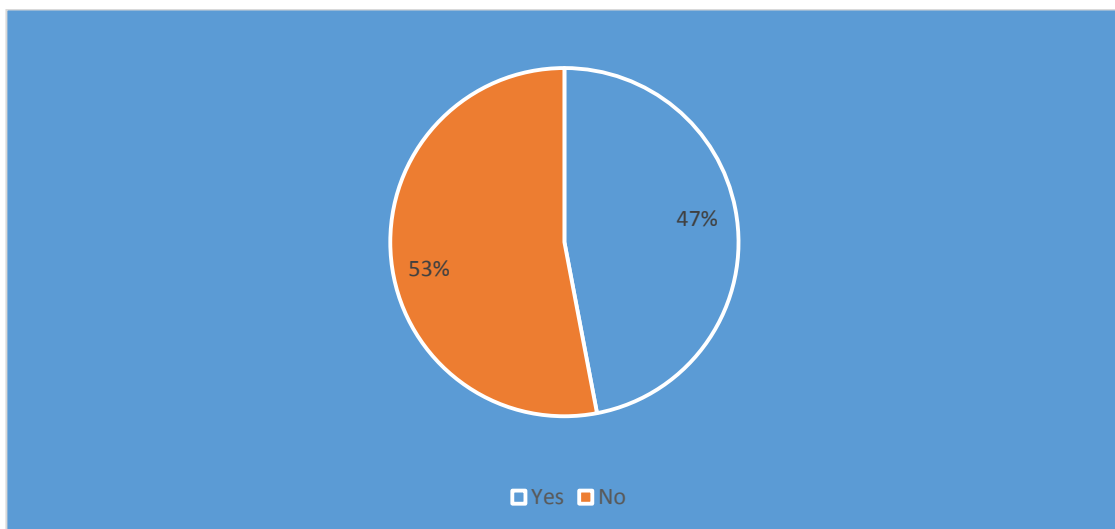
Majority of the respondents indicated that source of capital to start up business is a major obstacles to obtain from formal financial provider. The real-world understanding of SMEs operation in Namibia indicate that the state has considerable made different funding available to mitigate the problem of startup capital. However, government effort for start-up capitals towards the SMEs funding is not well marketed. Nevertheless, this results show that, 57 percent of the SMEs owner did not know of any other sources of financial aid, apart from commercial bank. It seems the real problem is lack of information sharing form government rather than availability of start-up capital toward SMEs. Most SMEs owner are not aware of Non-banking institutions, Government and some Non –Governmental Organistaions (NGOs) that also finance SMEs and support them in terms of SME incubation program, equipment finance and credit guarantee schemes, hence this results in SMEs owner not taking advantage of the available benefits at hand.

Further, inability of SMEs owners to access funds for start-up can only substantiated if truly all options of obtaining assistance from government were proved not working. For instance, if the SMEs owners are unable to get finance from formal financial provider due to lack of collateral they can approach government for guarantees schemes which could then act as their collateral. Other option is to apply for equipment finance

program, instead of being offered money, and then they can be offered equipment to start up their businesses depending on the type of business they are embarking upon. Hence, the outcome above must be read with this understanding government offers are there but it seem that there short coming due to less publicity. This study did not examined how effectives are current government funds and credit guarantee schemes in assisting SMEs start-up, this can be explored in the future.

#### 4.2.10 Applied for a loan

**Figure 9: SMEs applied for a loan**



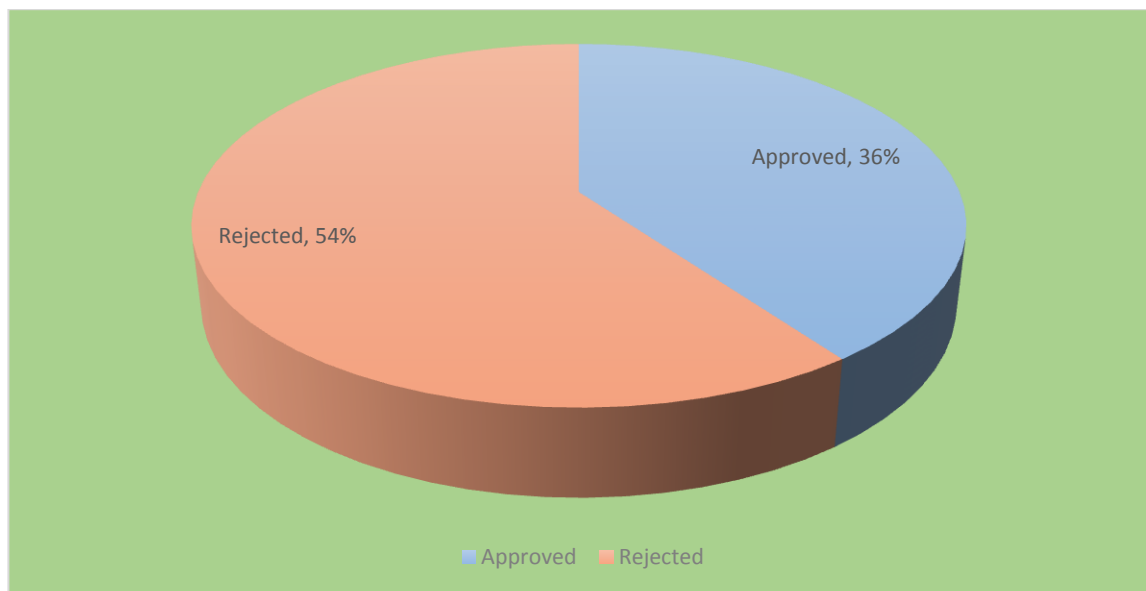
*Source: Field Survey, May 2016*

In response to this question the respondents were required to state whether they had applied for a loan for startup or expansion of their businesses or not. The study revealed that 53% (n=21) of the respondents did not apply for a loan and the other 47% (n=19) applied for one. As discussed in the literature review, Baye (2004) asserts that many SMEs are poorly managed and thus, are categorised as high-risk borrowers.

This makes it more difficult for SMEs to access finance because formal financial institutions charge high rates of interest where the risk is high. This could be the reason why 53% of the SMEs in this study did not apply for financial assistance. Other reasons could be lack of collateral to back up their loan equivalent as well as rigid loan application procedures. The 47% that applied for loans have done so because small businesses depend heavily on bank loans, Kapepiso (2014). The result shows that external finance is important in the growth of SMEs.

#### 4.2.11 Loan approved or disapproved

**Figure 10: SMEs loan approved or disapproved**



*Source: Field Survey, May 2016*

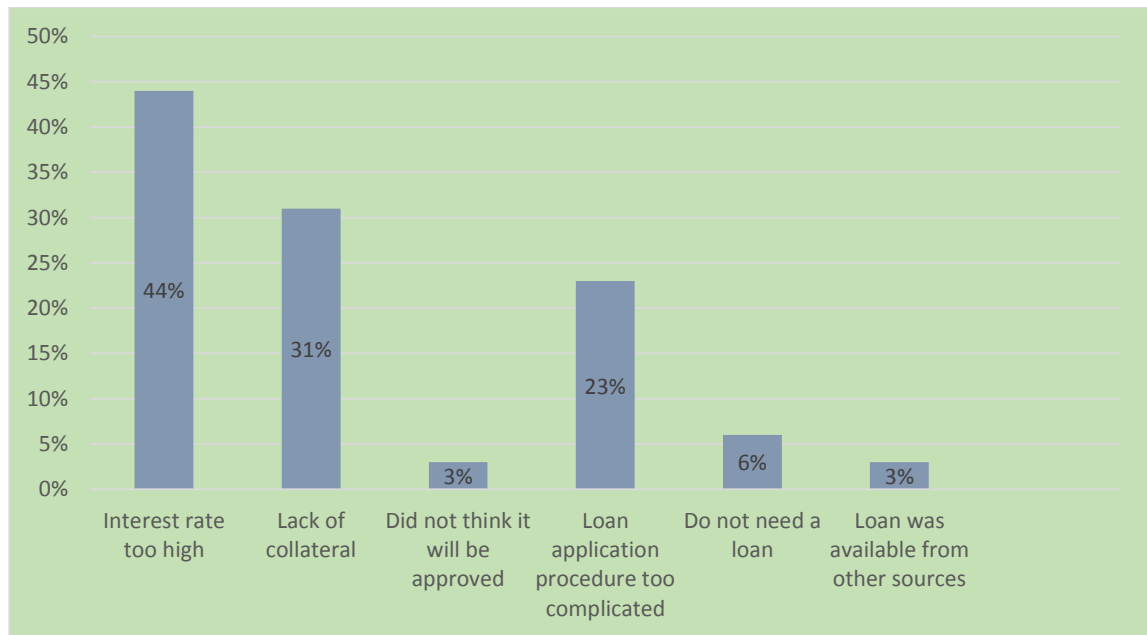
Of those who have applied for formal financial assistance, 36% acknowledged that their loans were approved. The remaining 54% had their application disapproved as indicated in Figure 11 above. The respondents whose loans were approved indicated that there are

many factors that formal financial institutions use in approving loans. Some of the criteria used are; viability of the business, the possibility of the business creating jobs for the unemployed, the existence of a functional business bank account, valid collateral, records of the business financial statements; and prepared business plan amongst others.

While 54% of the respondents had their loan application disapproved due to factors such as lack of collateral to back up their loan equivalent as well as loan application rigid procedures, practical understanding of how SMEs works in Namibia indicate that the SMEs owner tend to exaggerate this. Most SMEs owner are not aware of two method of external financing that are mostly important for financing their businesses, which are equity and debt financing. The majority are only aware of debt financing part. The equity financing method refers to the extent to which the company issues a certain portion of shares of its stock and in return receives money, whereas debt financing refers to the case where companies get finance products in a form of loan from lending institutions and give their promise to repay back at a given period of time and interest rate, hence, this outcome must be read with this understanding in mind.

#### 4.2.13 Reasons for not applying for a loan

**Figure 11: Reasons for SMEs owner not applied for loan**



*Source: Field Survey, May 2016*

The study aimed to find out the reasons why some SMEs owner did not apply for financial assistance. The result is shown on the figure below. Summary statistics show that 44 percent of the respondents indicated that they did not apply for a loan because the interest rates were too high. About 23 percent of the respondents indicated that the loan application procedures are too complicated, lengthy, costly and cumbersome. For instance applying for a loan requires going through 10 different steps and can take up to 66 days. Moreover, it comes with a cost. SMEs do not always have the technical and financial capacities to comply with these procedures. About 6 percent of the respondents revealed that they were not in need of a bank loan. The other 31 percent revealed that

they did not apply for a bank loan because of lack of collateral. 3 percent indicated that they did not think their application would be approved

Interest rates charged by formal financial institutions are one of the independent variables that have been discussed in the literature review that hinders access to finance by SMEs. Indeed, formal financial institutions categorises SMEs as high-risk borrowers, with a very poor rating on their creditworthiness, such that the majority of SMEs find it very difficult, if not impossible, to access bank loans for capitalisation. Due to this scenario , the formal financial institutions discriminates the SMEs by charging them high interest rates and unfavourable service fees on most of their transactions (The Business Analyst Newspaper, 2005). Hence, the reasons why most, SMEs at Soweto and Dr. Libertina Amhadhila were hesitant to apply for financial assistance.

Availability of collateral was identified in the literature as one of the important factors that influence access to finance by SMEs from formal financial provider. This is mainly because banks and lending institutions require collateral or asset tangibility especially while dealing with the SME sector whose information availability is scarce and hence higher information asymmetry Nieman (2004). This could be the reason why some respondents on this study could not apply for a loan due to non-availability of collateral.

Of the six percent that specified they do not need loan, they further indicated that even though they have accumulated some asset during their years of operation they had the

fear of the burden that is associated with formal financial institutions loan and therefore would rather continue in their current financial constraints rather than risk the few assets they had.

Furthermore, Ipinge (2010), indicated that most SMEs owner had no information about the lending market and hence lacks adequate information about the operations of the lending institutions and the various financial services available for them. This literature is in agreement with those SMEs owner at Soweto and Dr. Libertina Amadhila who did not considered borrowing because they fought the application will not be approved. This group category of SMEs owner revealed that in fact they do not have much information about the lending procedure from formal financial institutions.

#### 4.2.14 Challenges faced by SMEs

**Table 6: Challenges faced by SMEs**

Type of challenge faced	Not a Problem	Slight Problem	Moderate Problem	Problem	Major Problem
Lack of management training	30	19	7	9	13
Lack of technical skills	26	32	5	7	7
Lack of marketing information	33	24	8	6	6
Lack of finance for working capital	18	14	9	25	17
Lack of credit for investment	17	11	21	19	19
Lack of labor with skills	17	17	28	19	15
Poor employee retention strategies	20	17	13	18	12

*Source: Field Survey, May 2016*

As depicted in Table 5 above, thirty six respondents representing 33% thought that lack of marketing information is not a problem while 24% agreed to it being a slight problem. About 25% indicated that lack of finance for working capital is a problem; while 14% opined that it is a slight problem. Similarly 17% of the respondents are of the opinion that lack of finance for investment is a slight problem. Finally about 36% of the respondents face other problems such as higher tax and lack of credit purchases. This is an indication that formal financial institutions are providing moderate financial services to small businesses as some are still faced with the problem such as; lack of working

capital and credit for investment. As such, a balance needs to be established between SMEs and financial providers to offer assistance to SMEs at a reasonable cost.

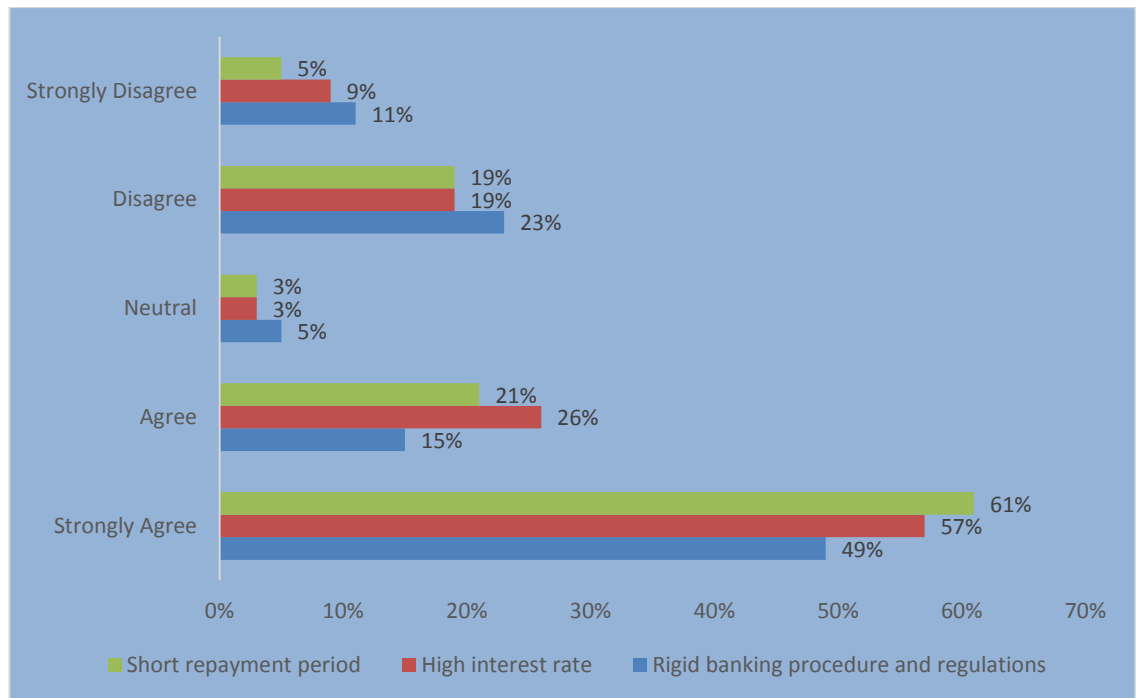
While, most SMEs indicated that finance for working capital, lack of management training as well as lack of marketing information amongst others are the challenges faced by SMEs, it is practical important to understand how financial institutions and SMEs operates in Namibia. Actually, there exist information asymmetry between the SMEs and the financial institutions and this is consistent with the results discussed under section 4.2.9. Information asymmetry theory postulates that when two parties are making decisions or transactions, there exists a situation where when one party has more or better information than the other. Thus, information asymmetry may cause an imbalance of power between parties. In this instance, borrowers (SMEs) know more about financial institution business cases and the financial institutions (banks) know very little about the SMEs cases. Therefore, due to limited information on the SMEs side from the lender side, this information should be interpreted with cautious, taking into consideration the existence of information symmetry and possibilities of eliminating it.

Thus, availability of information is essential to both the banks and the SMEs. This flow of information will enhance the better understanding of the pros and cons associated with the SMEs from the lender side. It is also further suggested that financial institution should visit, assess and access the location where the SMEs will be operating and its market segments in order for them to make conclusive judgment. However, due to time

and need to limit this study this option was not examined and this can be future extension to this study.

#### 4.2.15 Factors that limit access to finance by SMEs

**Figure 12: Factors limits SMEs access to finance**



*Source: Field Survey, May 2016*

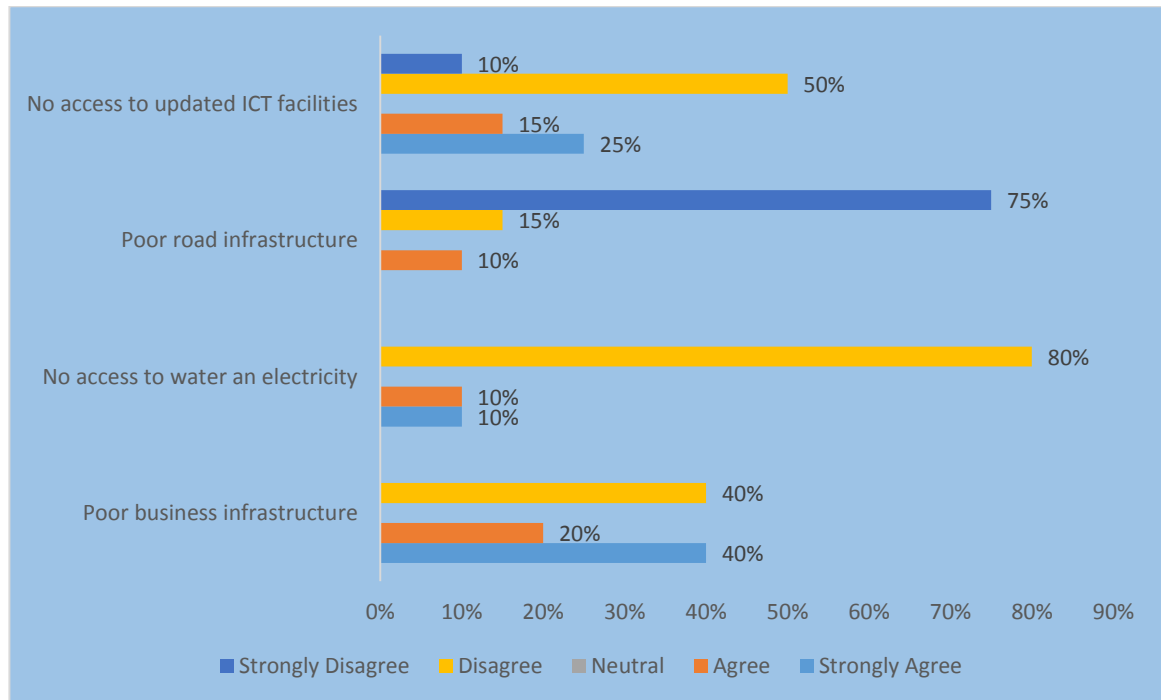
The researcher used rickets scale to measure the factors that limit access to finance. The results are indicated in Figure 12 above. 49 percent of the respondents strongly agree that rigid banking procedures and regulations, while 57 percent strongly agree that high interest rates severely limit the SMEs to access finance from formal financial institutions. Similarly, about 61 percent strongly agrees that short repayment periods also limit the SMEs access to finance. Between 3 and 5 percent of respondents were

neutral on short repayment period, high interest rate and rigid banking procedure being limitations to SMEs' to access to finance. 5 to 11 percent strongly disagrees that rigid banking procedure as well as short repayment period limit SMEs' access to finance.

The results on the graphical display above are in agreement with the literature review of the study done by Cronje et al. (2001) that indicated that SMEs are not happy with the services they received from financial institutions. Most SMEs owners complained that financial institutions maximize their return by setting high interest rates and this renders the potential borrowers unable to use the facility. In addition, the repayment period is always set to a minimal time, which makes it even more difficult for the SMEs owners to meet the repayment rate and time. Moreover, most financial institutions have a cumbersome procedure in evaluating application for SMEs, which is often coupled with payments such as administrative fee and, legal claims, making it more difficult for the SMEs to afford this process. Therefore this makes many small firms struggle with access to finances from financial institutions.

#### 4.2.16 Drawback towards the success of SMEs

Figure 13: Drawbacks towards the success of SMEs



Source: Field Survey, May 2016

To measure the severity of the drawbacks in the SMEs, the researcher used the rickets scale as indicated in figure 15 above. 50 percent disagrees that updated ICT facilities are a drawback towards the success of SMEs; while 15 percent of the respondents agrees that updated ICT facilities can positively impact the success of the SMEs, and 25 percent strongly disagree that updated ICT facilities can affect the success of SMEs.

In relation to, poor road infrastructure 75 percent of the respondents strongly disagree that it can have any effect on the success of SMEs because the roads are fully tarred at

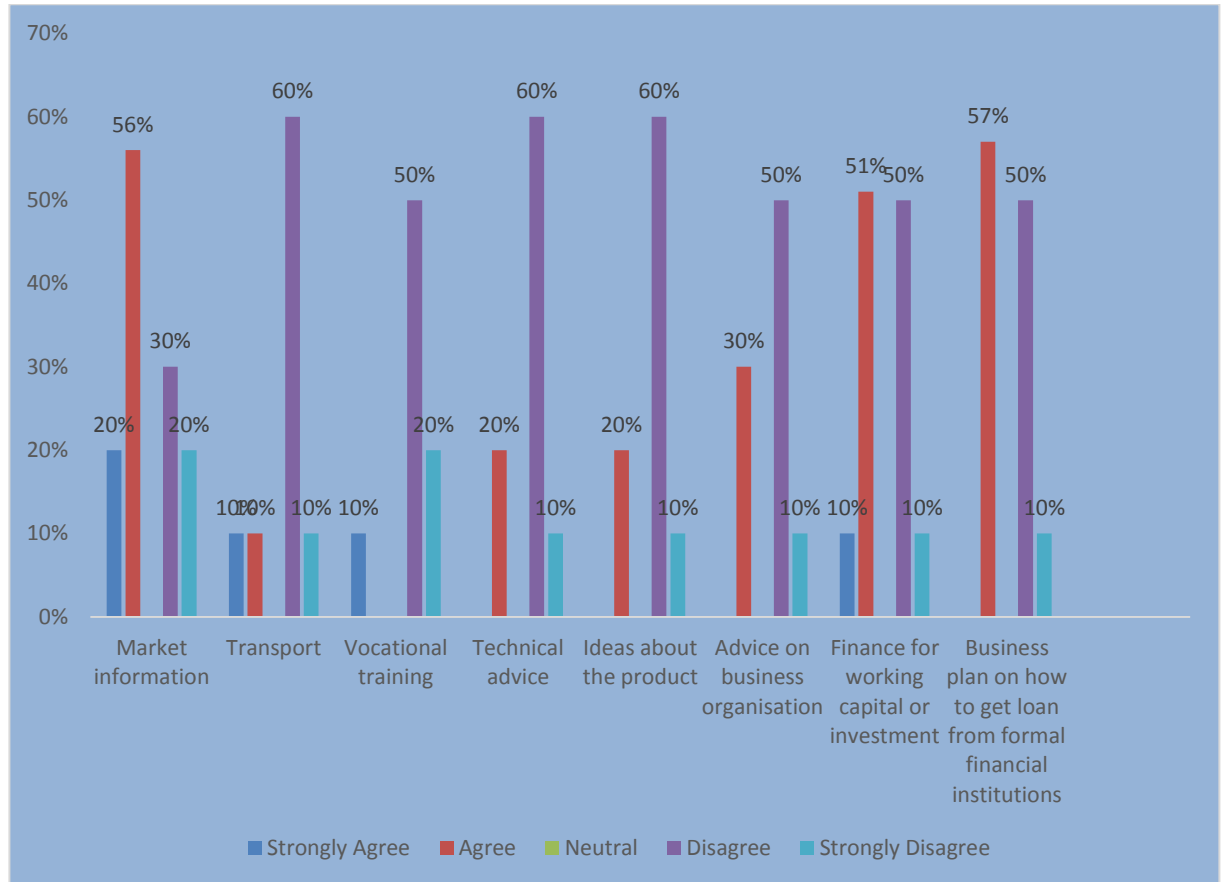
Soweto and Dr. Libertina Amadhila SMEs center, while 15 and 10 percent disagree and agree, respectively, that poor road infrastructure is a drawback to the success of SMEs.

The respondents further mentioned that apart from poor road infrastructure, there are limited ICT facilities such as fax and internet facilities to be utilized when needed. As a result, the SMEs owners have to travel to different places offering these facilities, and this hinders the production of their business, as time and money is utilized to go look for this resource elsewhere and leaving the business unattended. About 80 percent disagrees that access to water and electricity is an obstacle toward the success of SMEs as there is a water point at each stand (stall), while 10 percent agrees that electricity is an obstacle concerning the success of SMEs because it is very costly.

Lastly , 16 out of 40 respondents (40 percent) strongly disagree and disagree that, poor business infrastructure is one of the drawbacks of SMEs as they felt that the available infrastructure is sufficient for the type of businesses they are in , while the remaining 20 percent agrees that, poor business infrastructure contribute to the drawback of SMEs success.

#### 4.2.17 Support required for SMEs to succeed

**Figure 14: Support required for SMEs to succeed**



Source: Field Survey, May 2016

As indicated in figure 16 above, in terms of the support required for SMEs business to succeed and sustain themselves, about 25 of 40 respondents, or 60 percent, indicated that they are very well equipped with technical advice and ideas about the type of job they are doing, as well as the type of products they are selling and manufacturing. Hence, they disagree that they need technical advice or support to help SMEs grow. However, 56 percent of the respondents strongly agree that market information is

required for their businesses to succeed. The respondents further indicated that most people outside their market do not really understand the type of services and products that they are offering, hence awareness about, and marketing of their product is required. This could be done in the form of a trade fair organized by the City of Windhoek whereby, the SME owners can showcase their products and services.

The majority of the SMEs indicated that they do not advertise at all. This concept is in agreement with the literature on the study conducted by Kotler and Keller (2006).It indicated that most SMEs have neither marketing personnel nor a marketing department. The ability to generate good publicity, contacts in the media and marketing skills which are important for SMEs growth and development has not been experienced. As such SMEs, miss out on important opportunities such as sales promotion techniques, special pricing and attractive competitions for clients which are essential for SMEs success. This indicates why 56% of SMEs in this study agreed that marketing support is required for them to succeed.

Ten percent (4 of 40) of the participants strongly agrees that for SMEs to grow and succeed, they need vocational training, transport and working capital financing. From the responses given by most participants, lack of working capital is a major hindrance as they are sometimes unable to buy stock in the middle of the month. This is detrimental to the businesses as they are unable to make any profit in such cases. Twenty (20) percent of the respondents agree that, they need assistance in drawing up business plans

that will enable them to successfully apply for a loan from formal financial institutions. 30 percent of the participants agree that they require guidance in business organization in order for their SMEs to succeed.

Most of the SMEs indicated that they need the most support with finance for working capital as well with how to draw up business plan for the purpose of applying for a loan. This revelation is supported by Cronje et al. (2001) who pointed out that, SMEs poor creditworthiness, coupled with lack of collateral and the non-availability of bankable business plans, critically hinder SMEs from various forms of financial assistance. As such, financial institutions find it difficult to assess SMEs worthiness credibility to repay the loan hence this makes it difficult for financial institutions to make conclusive decision on the SMEs application. This then indicates why 51% and 57% of the SMEs at Soweto and Dr. Libertina Amadhila agrees that they require assistance on working capital and drawing up of business plan in order for their businesses to grow and succeed, respectively.

#### **4.4. Summary**

This chapter presented the findings of the study, which include the demographic information, the business characteristics of the SMEs, as well as the challenges and factors influencing the access for finance in SMEs in Soweto and Dr. Libertina Amadhila, in Khomas Region. The researcher used quantitative methods to interpret the result.

The findings of the study, revealed that, majority of the respondents indicated that, the source of capital to start-up a business is a major obstacle to obtain from formal financial providers. However, it seems the real problem is lack of information sharing from government rather than availability of start-up capital toward SMEs. Almost 57 percent of the SMEs owner indicated that they are not aware of any other sources of finance apart from the commercial bank. However, government has designed programmes that assist SMEs, by providing a bank guarantee in order for them to meet stipulated requirements to access finance from formal financial institutions. But due to lack of information sharing SMEs miss to grab-up and utilise these opportunities.

Also, lack of entrepreneurial skills such as management skills and training, marketing, accounting as well as creativity personal commitment, has been regarded as obstacles to access finance by SMEs from formal financial providers. However, this study, revealed that there exists, information asymmetry between SMEs and financial provider. As a result, SMEs submits poor business proposal and project that lack viability for financial assistance. Thus their application ends up being rejected. Therefore, availability of information is essential to both the banks and the SMEs. This flow of information will enhance the better understanding of the pros and cons associated with the SMEs from the lender side in order for the banks to make conclusive judgment.

Moreover, some respondents indicated that even though, they had applied for, a loan, their application were not approved. This is so because, majority of the respondents are

not aware of both methods of external financing, which are, equity and debt financing. The majority are only aware of debt financing part. Since equity financing can be mostly offered to SMEs with a proven track record experience, as a result most SMEs do not really qualify for this type of financing. However, government is encouraged to support the expansion and establishment of venture capital funds, to ensure that most SMEs are able to be financed from both equity and debt financing methods.

Lastly, 42 percent of the respondents indicated that education is a major obstacle for SMEs to access finance from formal financial provider. However the study finds that education is not a prerequisite for successful entrepreneurship. Factors such as risk taking, commitment to the business and ability to build sound relationship with financial institutions amongst others, can determine the success and growth of SMEs. Thus, in the absence of such empirical evidence the lack of higher education can only be listed as one of the obstacles for SMEs to access finance. In chapter five are the conclusions and recommendations of the study.

## **CHAPTER FIVE**

### **CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1. Introduction**

The previous chapter focused on the interpretation and discussion of the results of this study. This chapter presents the summary of the conclusions and recommendations based on the findings in Chapter Four.

#### **5.2. Summary of Findings and Conclusions**

Despite the SMEs' critical role as the drivers of economic growth as argued by Migiro (2005) and Ramsdem (2010), they still face an overabundance of problems, with lack of access to finance to start-up and expand their business as one of the most common. Although Ipinge (2010) and Stork (2010), among other authors, have conducted studies to determine the challenges that SMEs are facing in Namibia, and how to mitigate them, the obstacles hindering SMEs from accessing formal financial services have not been addressed. The main theme of this study focused on uncharted territory of exploring and identifying obstacles that constrain SMEs' access to formal financial services, at Soweto and Dr. Libertina Amadhila in Khomas region. This was in order to fill the gap in SME literature with regard to their challenges and problem solving methods. The researcher used questionnaires to gather information from the SMEs, in order to meet the objectives of the study.

### **5.2.1 Conclusion on Research objective 1**

**To identify the obstacles which hinder the SMEs' access to formal financial services in Namibia.**

Based on the findings from the SMEs, the most important source of money to start-up a small business is from one's own savings, or borrowing from friends and relatives. This correlates with the results of the study by (Migiro, 2005; Stork, 2010; Su & Sun, 2011) that indicates that access to finance from the formal financial service providers is a major obstacle for SMEs. The results also indicated that despite the N\$ 16 million Small Business Credit Guarantee Fund (SBCGF) that was set up by the government to serve as collateral or security for local commercial banks to lend to the SME entrepreneurs, they still face financial assistance challenges due to lack of information sharing from government to SMEs. Hence, the real problem here is lack of information sharing rather than availability of start-up capital toward SMEs (Stork, 2010). Most SMEs cited lack of collateral, high interest rates, unreliable SMEs accounting system, lack of SMEs business planning, and complicated loan application procedures as the main reasons they have not been able to secure a loan. Contrary to the study conducted by Berggren and Silver (2010) which found that bank financing remains the most important source of external finance to SMEs, this study found that SMEs are very well established without the assistance of formal financial loans. However, most SMEs owners pointed out that if loans were readily available, or there were less complex

application procedures, their businesses were going to succeed and grow into bigger businesses as they would always have working capital available to buy stock.

### **5.2.2 Conclusion on Research objective 2**

**To investigate why SMEs in Namibia lack access to finance even though there seems to be enough space for this sector to grow and succeed.**

The results from the SMEs indicate that among the ways through which SMEs could access finance, succeed and grow are: low interest rates for SMEs from financial institutions, finance for working capital, and support with how to draw up business plans to enable SMEs to apply for financial assistance from financial institutions, marketing ideas as well as technical advice. This concurs with the study by Ferreira, Strydom and Nieuwenhuizen (2010) which established that business owners should be assisted especially in finance, marketing, technical and human resource areas. Equally, the evidence from the respondents whose loans were approved by formal financial services reveals that formal financial services contribute to the success and growth of their businesses by substantiating them with mentoring services, providing letters of credit guarantee as well as provision of specialized training. The study further indicated that the SMEs that were financed by formal financial services have a greater chance of success, and vice versa, as they always have available working capital. This is consistent with theory and findings by Su and Sun (2011) that finds a negative relationship between financed and non-financed SMEs.

### **5.3 CONTRIBUTION TO KNOWLEDGE**

Below is a summary of some of the contributions to knowledge made during this research study with regard to SMEs access to finance:

- The study revealed that the majority of the SMEs in Soweto and Dr. Libertina Amadhila had limited access to financial assistance due to SMEs owner lack of knowledge and information on the available financial assistance schemes for small and medium enterprises.
- Also, SMEs in Soweto and Dr. Libertina Amadhila find it difficult to borrow money from formal financial institutions for start-up or for additional stock due to reasons such as lack of collateral, poor credit rating as well as lack of proper business planning and financial management records.
- Furthermore the study revealed that the majority of the SMEs conducted for this study in the Soweto and Dr. Libertina Amadhila were registered with the City of Windhoek and Ministry of Industrialisation: Trade and SME Development.
- However, most SMEs are not aware of other services such as, government assistance of supporting SME incubation program as well as equipment finance and credit guarantee schemes and thus resulting in them not taking advantage of the benefit at hand.

- The study also found that there exist information asymmetry between formal financial institution and SMEs. Formal financial institutions dealing with SMEs do not effectively engage the surveyed SMEs in Soweto and Dr. Libertina Amadhila due to weak sensitization communication strategies.
- The study further revealed that financial institutions classify SMEs as high risk borrowers. Thus, they are charged high interest rates when borrowing because the organizational and administrative deficiencies lower the quality of management, and a lack of appropriate accounting systems compromise the accessibility and reliability of information from SMEs on their repayment capacity.
- Formal financial institutions dealing with SMEs do not effectively engage SMEs in Soweto and Dr. Libertina Amadhila, and possibly elsewhere in the country, to develop and support their business management and financial accounting skills in order to effectively and efficiently run their business.
- The Institutions dealing with SMEs are not disseminating and communicating relevant information to SMEs on time to influence their growth.

## 5.4 Recommendations

The recommendations resulting from this thesis are based on the conclusions that were found and are specified below.

- It is recommended that SMEs owners and managers seek to improve their information administrative practice by keeping proper and accurate records of firm operations. This could reduce the bank's perception of risk, and facilitate easier access to financing for SMEs on complimentary terms of credit.
- Regardless of the mentioned challenges, formal financial services remain a good source for most SMEs as this increases their chances of growth and success, compared to the non-financed SMEs.
- In order to prompt growth of the SME sector, formal financial providers should develop products suited to serve the needs of SMEs.
- The Ministry of Industrialisation: Trade and SME Development should release information regarding SMEs developments. Similarly, the government should come up with a compulsory policy for formal financial providers to submit data on SME access to finances.

#### **5.4.1. Recommendations for future research**

In view of the findings and conclusion of this study, the following recommendations were made:

The research recommends a stakeholder's dialogue which can explore ways in which the formal institutions can work effectively with SMEs regarding funding. In addition, financial institutions must be active and find innovative ways to accommodate SMEs. This can be done by assisting with preparation of business plans, training in financial management, record keeping and ensuring that information of loans facilities are made available to SMEs.

NGOs and parastatals can also help SMEs by offering training, mentoring, monitoring and evaluations, and mobilizations of savings, while credit is offered by formal institutions. It is also important for formal credit institutions to experiment with innovative approaches to offering credit to SMEs.

One such approach is to introduce a participatory program where the borrower and the bank discuss the credit scheme and the loan disbursement decision making process. It is recommended that specialized microcredit institutions be set up to help small enterprises. Additionally, since the government provides security through the credit guarantee facilities, the interest rate of prime plus must be lowered.

Due to time restrictions and limited data, further studies in this area should examine factors such as whether the SMEs owner with higher levels of education are more entrepreneurial than the lower educated ones. Further, the study can explore on encouraging the SMEs to approach government for guarantees schemes which could then act as their collateral or they could apply for equipment finance program, instead of being offered money to start up their businesses.

Other variables that can be considered are to use both financial and non-financial measures in order to come up with different results than those obtained in this study. Financial performance measure variables include profits, revenues, returns on sales, returns on investment (ROI), as well as returns on equity. Non-financial performance variables include contribution to industrial employment, number of employees, contribution to industrial production and market share. Moreover, future research may also increase the sample size of other studies to see if the results will remain robust.

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## APPENDIX A

### QUESTIONNAIRE

#### Section A: Credentials (The respondent must be the owner of the business)

1. Is the respondent male or female (please tick):

Sex	Tick
Female	
Male	

2. What is your age? (Please tick)

Age	Tick
< 25	
25-29	
30-34	
35-39	
40-44	
45-49	
50+	

3. What is your highest level of education? (Please tick)

<b>Education</b>	<b>Tick</b>
Primary School	
Secondary School	
Post-Secondary School Education	
University	
Others (Specify)	

4. Please tick to indicate the nature of your business.

<b>Nature of the business</b>	<b>Tick</b>
Manufacturing (shoes and clothes)	
ICT SMEs (printing, faxes, email and scanning)	
Hardware SMEs (locks and keys)	
Salon and barber shop	
Electronic repair SMEs (cellphone, television and radio)	
Food SMEs (restaurant, dried food and groceries)	
Retail SMEs (ice-cream and DVD).	

5. For how long has your business been in operation? (Please tick)

<b>Years</b>	<b>Tick</b>
Less than one (1) year	
Between 1 and 5 years	
Between 6 and 10 years	
Between 11 and 15 years	
Over 15 years	

6. Business registration

a) Is your business registered?

Yes	
No	

b) If yes with whom is your business registered? Please tick option(s).

<b>Registering Authority</b>	<b>Tick</b>
Ministry of Trade & Industry	
Ministry of Finance	
Not Registered	
Others (Specify)	

**Section B: Finance**

7. What was the start-up cost (fixed and working capital) of this business?

<b>Amount</b>	<b>Tick</b>
Below N\$ 5 000	
Between N\$ 5 001 and 10 000	
Between N\$ 10 001 and 20 000	
Above 20 001	

8. What was your main source of funds to start this business? (Please tick one source only)

<b>Source of Money</b>	<b>Tick</b>
Own Saving	
Family assistance	
Borrowed from Friends	
Loan from the bank	
Inherited	
Others (Specify)	

9. Have you ever applied for a loan from a formal finance institution? (Please Tick)

<b>Applied for a loan</b>	<b>Tick</b>
Yes	
No	

10. Was the loan approved or disapproved? (Please Tick)

<b>Received a loan</b>	<b>Tick</b>
Approved	
Disapproved	

11. If not applied for loan, what are the reasons? (Please Tick)

<b>Amount</b>	<b>Tick</b>
Interest rate too high	
Lack of collateral	
Did not think it will be approved	
Loan application procedure too complicated	
Loan was available from other source	

12. What are the major problems (challenge) faced by your business? (Please tick)

Type of problem faced	Strongly agree	Agree	Neutral	Disagree	Strongly Disagree
Lack of management training					
Lack of technical skills					
Lack of marketing information					
Lack of finance for working capital					
Lack of credits for investment					
Lack of labor with skills					
Poor employee retention strategies employee					

13. Which of the following factors limit the SMEs from accessing finance from the formal financial institutions? Please indicate your answer by ticking your choice.

Factors that limit access to finance	Strongly agree	Agree	Neutral	Disagree	Strongly Disagree
Rigid banking procedures and Regulations					
High interest rate					
Short repayment period					

14. Which of the following factors are the drawbacks toward the success of SMEs?

Please indicate your answer by ticking your choice.

Type of problem faced	Strongly agree	Agree	Neutral	Disagree	Strongly Disagree
Poor business infrastructure					
No access to Electricity and Water					
Poor road infrastructure					
No access to updated ICT facilities					

15. What type of support do you need for the success of your business? Please indicate your answer by ticking the number of your choice for each of the following.

Support	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Market information					
Transport					
Vocational training					
Technical advice					
Ideas about products					
Advice on business organisation					
Finance for working capital or investment					
Business plan on how to get loan from formal financial institution(s)					

16. In your opinion, do formal financial services contribute to the success of SMEs?

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17. In your opinion, what can be done to minimise the obstacles of accessing formal financial services?

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