

# INVESTIGATING ALTERNATIVE ACCESS TO START-UP CAPITAL FOR TSHWANE BUILT ENVIRONMENT SMMEs

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## Abstract

The aim of this study was to investigate alternative access to start-up capital for Built Environment SMMEs from established support and developmental institutions in South Africa. The aim and objectives of the study have been met. The study has shown that Built Environment SMMEs accessing start-up capital from alternative funding institutions and the perceived challenges associated with accessing the finance includes the following: 1) More than half of the sample population did not apply to commercial institution for start-up capital, which may indicate that the SMMEs did not meet the financial requirements of the commercial institution; 2) More than 80% of respondents did not apply to any alternative funding institution to access start-up capital; 3) Approximately 80% of respondents made use of savings and other sources of funding for start-up capital; 4) Most SMMEs are not aware of alternative funding institutions, and that alternative funding institutions are not easily accessible.

**Keywords:** Alternative Access to Start-up Capital, Built Environment, SMMEs, SEFA, Commercial Institution

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## 1 Introduction

Increased attention has been paid to the role of the Small, Medium and Micro Enterprises (SMME) sector in economic development. Berry, von Blottnitz, Cassim, Kesper, Rajaratnam, van Seventer (2002) and Kesper (2002) maintain that in order to attain the objectives of economic growth through competitiveness on the one hand, and employment generation and income redistribution on the other, increased policy attention had to focus on the promotion of SMMEs in the country. The development of SMMEs contributes significantly to job creation, social stability and economic welfare across the globe (Ladzani and Van Vuuren, 2002).

In South Africa, SMME development was identified by government as a priority in creating jobs in an attempt to reduce the high unemployment. With unemployment at an estimated 25% (Stats SA, 2012), the SMME sector cannot be ignored. While unemployment and job creation is an important priority, much has been documented about the lack of start-up capital or access to finance for SMMEs, not just in South Africa (Herrington *et al.*, 2010), but in many other parts of the world as well (Turner *et al.*, 2008; OECD, 2006; Kauffmann, 2005). In the construction sector, Martin (2010, citing Shakantu, Kajimo-Shakantu, Saidi and Mainga, 2006) indicated that “lack of access to finance and cost of capital is a barrier that is being caused by lack of collateral, lack of financial information available on emerging

companies, a lack of market exposure, as well as issues around performance bonds. Due to the challenges and obstacles faced by many SMMEs to access start-up capital, this study will focus on accessing alternative start-up capital for SMMEs.

The FinScope Survey of 2010 focus on establishing the levels of access to finance for the small business sector and identify and describe the drivers of, and the barriers to the usage of financial services and products for the small business sector in South Africa. As a result of the many barriers, it would therefore seem that SMMEs could benefit from accessing start-up capital from alternative funding institutions.

In most countries construction contributes more than half of the total capital investment, and this contribution can amount to as much as 10% of the Gross Domestic Product (GDP) (Van Wyk, 2003:13). The World Bank (2003:8) also emphasises the importance of the building construction industry and its continued growth. Nearly half of the world's population (47.2%) is currently urbanised and it is estimated that by 2050 the urbanised world population will be approximately 66%. SMMEs face a large number of challenges which affect them on a daily basis. Rogerson (2004) contended that when these challenges are not met with responsive solutions at an early stage, it often leads to the demise of the SMME in its first year of operation. For the building construction industry to cope with the growth in urbanisation there is a dire need for improved access

to start-up capital from either commercial institutions or alternative funding institutions to ensure sustainable small business enterprises.

GEM 2011 reports that lack of profitability and problems securing financing account for more than half the business discontinuances in the factor-driven and efficiency driven economies. The data obtained from South African participants echo this pattern, with 32.6% of respondents who have exited businesses in the past year citing lack of profitability as the reason for exiting, and a further 24% noting problems with access to finance. Kelley *et al* (2012) observe that the rate of business discontinuance generally declines as economic development level increases. Business discontinuation is more pronounced during the early stages of economic development as more businesses are started during these stages. Given the risks associated with starting businesses, it is not surprising that many fail during the initial start-up period. Taking cognisance of the above, why are SMMEs not making use of alternative funding institutions to access alternative start-up capital? Visser (2011) further notes that the economy needs commercial banks as well as financial institutions in order to function properly. SMMEs capital needs can be satisfied by either debt or employing internal funds or equity. With the high failure rate of SMMEs during the SMME start-up phase, this demonstrates the importance of the problem and the need to investigate access to alternative start-up capital. Limited research has been conducted on accessing start-up capital. The aim of this research is therefore to investigate alternative access to start-up capital for SMMEs in the Built Environment sector in the Tshwane region, and to establish the perceived challenges associated with accessing start-up capital from alternative financial institutions.

## 2 Research methodology

A quantitative research method was employed, using a self-administered questionnaire as the instrument to collect the data. The results indicated that Built Environment SMMEs do not apply to alternative funding institutions to access alternative start-up capital. The results further confirm that Built Environment SMMEs are not aware of alternative funding institutions for accessing start-up capital and that these intuitions are inaccessible. The Built Environment SMMEs also perceive the challenges to be similar to the challenges experienced when applying for funding from commercial institutions. The population for this study is from the construction industry and include SMMEs registered on the Construction Industry Development Board (CIDB) database for the Tshwane region. The sampling method to be used in the population is simple random sample and includes 120 SMME contractors

registered with the Construction Industry Development Board (CIDB) in the Built Environment.

## 3 Literature review

An emerging contractor is defined as any contractor within the Construction Industry Development Board (CIDB) level 1 to level 5, to be registered in recognition of their cidb grading for appropriate development support and progression within the cidb programmes, (CIDB, 2011). Start-up capital refers to the money that is required to start a new business, whether for office space, permits, licenses, inventory, product development and manufacturing, marketing or any other expense. Start-up capital is also referred to as "seed money" (<http://www.investopedia.com>, 23 October 2012). The Construction Registers Service comprises the Register of Contractors and the Register of Projects which have been established in terms of the CIDB Act (Act 38 of 2000). The Register of Contractors grades and categorises contractors according to financial and works capability. It is mandatory for public sector clients to apply the Register of Contractors when considering construction works tenders. The Register of Contractors facilitates public sector procurement and serves as a framework for contractor development.

In South Africa during 2010, the construction industry delivered an output in excess of R220 billion per annum, of which approximately 58% came from public sector orders and tenders, 13% from public corporations and 30% from the private sector. According to the CIDB 2010, contractors registered in the following categories are as follows:

▪ Civil Engineering	25 575
▪ Electrical Engineering (Building)	1 680
▪ Electrical Engineering (Infrastructure)	3 052
▪ General Building	61 861
▪ Mechanical Engineering	3 465
▪ Specialist Works	12 770
<b>Total</b>	<b>108 393</b>

As at December 2010, a total of 108 393 contractors had been registered on the CIDB register of contractors. The scope of the research will be limited to understanding whether SMMEs of the Built Environment are aware of alternative funding institutions as well as whether the challenges when accessing start-up capital from commercial funding institutions are also experienced in accessing alternative start-up capital. Although, the study will focus on SMMEs in Built Environment, Tshwane, South Africa, research results can be generalize to other parts of South Africa because SMMEs all over South Africa tend to have the same characteristics.

## 4 Research findings

The challenge that South Africa faces is the low ranking in terms of global competitiveness (Naidoo, 2004; Shezi, 2004; South African Excellence

Foundation [SAEF], 2005). Among this low ranking, South African SMMEs are also characterised by poor management, lack of access to finance (Badenhorst, Cant, de Cronje, Du Toit, Erasmus, Grobler, Kruger, Machado, de Marais, Marx, Strydom & Mpofu, 2006).

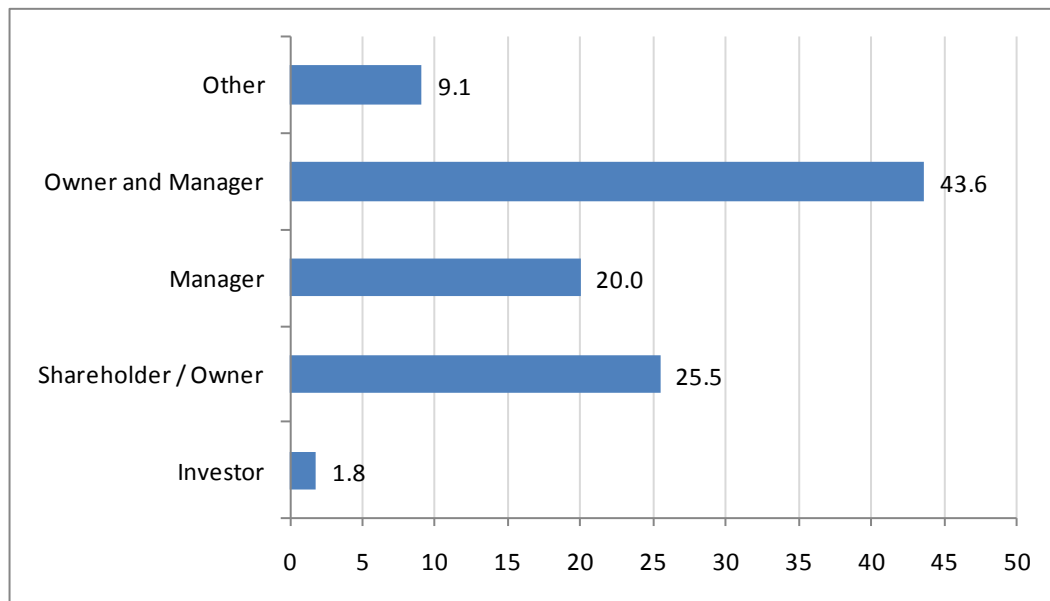
#### 4.1 Demographics

An overview of the demographics of the respondents was necessary to determine the profile of the SMMEs in the sample as indicated in Figure 1.

##### 4.1.1 Question A1: What are your responsibility / role in the business?

The aim of this question was to understand the role and or level of responsibility respondents have in terms of the operations of the business, as indicated in Figure 1.

**Figure 1.** Role or responsibility of respondents in the business



The figure shows that from the sample population, the owner and manager were the most at 43,6%. Thereafter were the shareholder and owner at 25,5%. The responses from the respondents clearly indicate that the owner managers are actively involved in the operations of the businesses. Respondents who are not shareholders or managers account for 20% and

9,1% are responsible for the business in some supervisory capacity.

##### 4.1.2 Question A2: For how many years has your business been in operation?

This question was to establish the average business age of the SMMEs, as indicated in Figure 2.

**Figure 2.** How long has the respondents business been operating

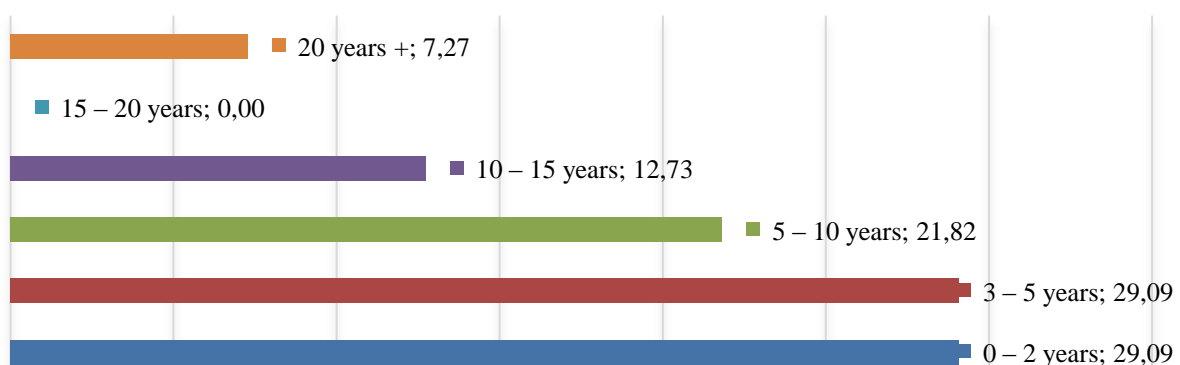


Figure 2 indicated that approximately 60% of the respondents were in business between 0 and 5 years as per fig. 4.2. Start-up SMMEs between 0 – 2 years account for 29,1% and for businesses between 3 – 5 years also account for 29,1% of the sample populations. Thereafter businesses between 5 – 10 years account for 21,8% and between 10-15 years account for 12,7%. This decline is consistent with other studies highlighted by Visser (2010). Businesses in the 15 – 20 years range accounted for 0% and business beyond the 20 years accounted for 7,3%. It is

clear from the respondents that most businesses do not survive after 3-5 years which could be due to a myriad of reasons.

#### 4.1.3 Question 3: What is the annual turnover of your business?

This question was to establish what the annual turnovers of the SMMEs are, as indicated in Figure 3.

**Figure 3.** Annual turnover of the business

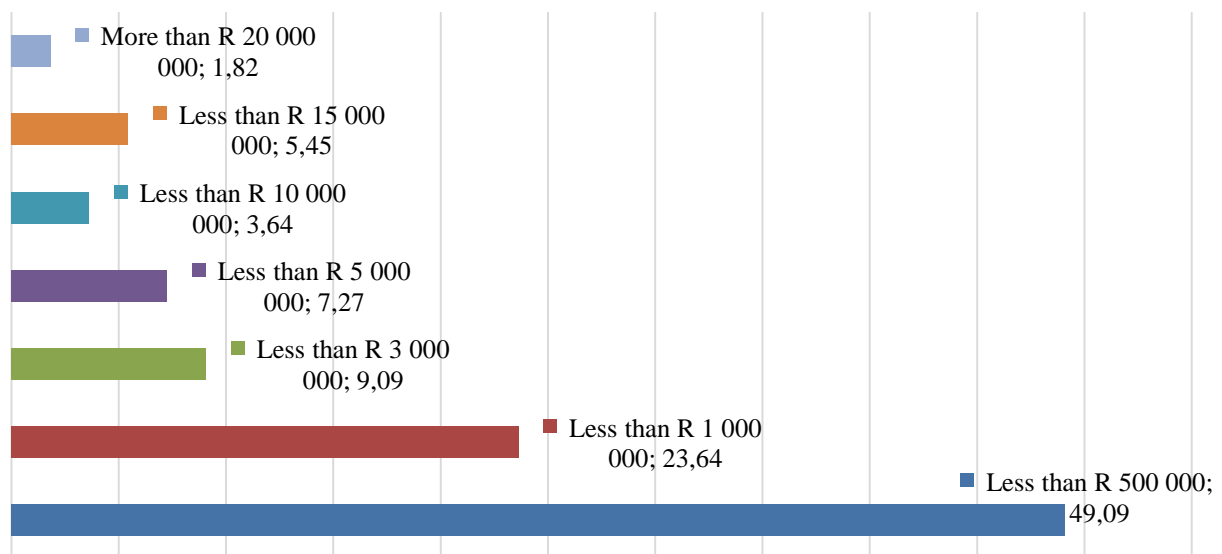


Figure 3 shows that 72.7% of the respondents had a turnover of less than R 1 000 000,00. 49,1% of the respondents indicated that their turnover was less than R 500 000,00. Thereafter, businesses who had a turnover of less than R 1 000 000,00 accounted for 23,6%. Businesses with a turnover of less than R 3 000 000,00 accounted for 9,1% and businesses with a turnover of less than R 5 000 000,00 accounted for 7,3%. Businesses with an annual turnover of less than R10 000 000,00 accounted for 3,6% and less than R15 000 000,00 for 5,5%. A very small number of businesses had an annual turnover of more than R 20 000 000,00 which accounted for a very low 1,8%. The

turnover figures from the respondents clearly suggests that the majority of SMMEs do not grow beyond the R 1 000 000,00 threshold.

#### 4.2 Perception of SMME owners

##### 4.2.1 Question B1: Did you apply to any commercial institution for start-up funding when starting with your business, if yes which bank?

The purpose of this question was to establish how or where SMMEs obtained start-up capital for the business, as indicated in Figure 4.

**Figure 4.** Application to commercial institution for start-up funding

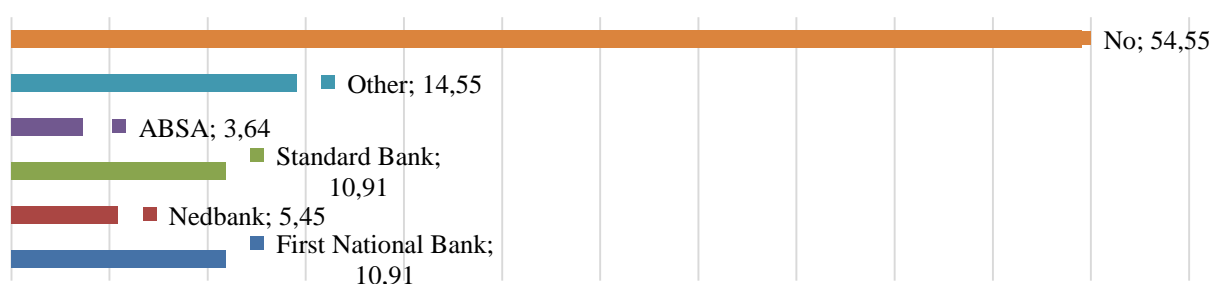
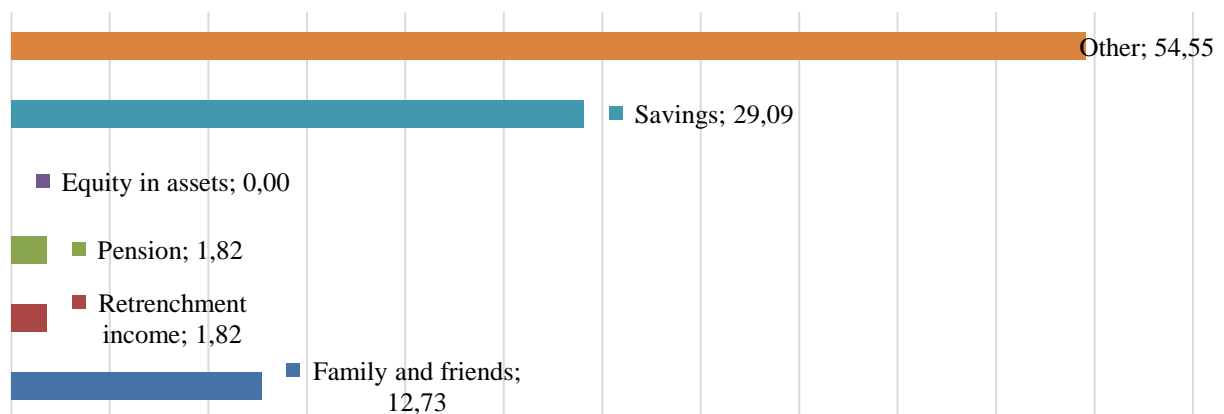


Figure 4 refers. Most of the business entities did not apply to any commercial institution for start-up funding which accounted for 54,5% of the responses. Further, a total of 30,9% of the respondents did apply to a commercial institution for assistance with start-up capital for their business. First National Bank accounted for 10,9% while Nedbank accounted for 5,5%. Standard Bank accounted for 10,9% and ABSA accounted for a low 3,6%. A total of 14,5% of the respondents indicated that they applied for start-up finance from other sources.

#### 4.2.2 Question B2: If your answer in 1. above is No, how did you fund your start-up capital?

The purpose of this question was to establish that if SMMEs did not make use of any commercial lending intuitions for start-up capital, how they raised start-up capital for their business ventures, as indicated in Figure 5.

**Figure 5.** Alternative start-up capital funding



A huge percentage of respondents as indicated in Figure 5, 54,5% indicated their sources of start-up capital came from other sources which may include amongst others but not limited to, micro lenders and stokvels ect. Then most businesses obtained their start-up capital from own savings, which accounted for 29,1%. Thereafter, family and friends accounted for 12,7%, retrenchment income 1,8% and pension funds accounted for 1,8%. Equity in assets accounted for 0%. This clearly indicates that SMMEs are willing to make use of own funds to start-up their business due to the challenges experienced by SMMEs highlighted in the literature review.

#### 4.2.3 Question B3: Did you apply to alternative funding institutions e.g. Khula?, if yes, which enterprise?

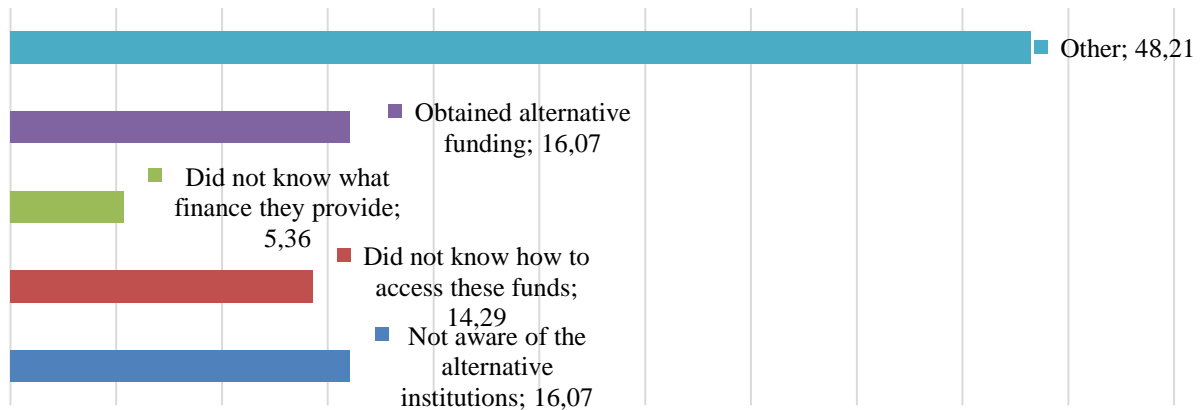
The purpose of this question was to establish if sources of funding were obtained from any alternative institutions, as indicated below. A staggering 81,8% of respondents indicated that they did not apply to any alternative institutions for any start-up capital for their business. Respondents who did apply for start-up capital from alternative institutions listed Umsombovo Youth Fund at 9,1% and the National Development Youth Agency at 5,5%. Khula Enterprise Finance accounted for 1,8% as well the South African Micro

Finance Apex Fund (SAMAF) also accounting for 1,8%. The National Empowerment Fund, Small Enterprise Development Agency, Industrial Development Corporation as well as the Youth and Graduate Entrepreneurship all accounted for 0%. These responses clearly confirm that SMMEs are not aware of alternative funding institutions to access alternative start-up capital.

#### 4.2.4 Question B4: If your answer in 3. above is No, what were the reasons for not applying?

The purpose of this question was to establish, if respondents did not apply to alternative funding institutions, what was the reason for not applying, as indicated in Figure 6.

A huge number of respondents (see Figure 6) cited other reasons for not applying to alternative funding institutions which accounted for 48,2%. SMMEs who obtained alternative funding accounted for 16,1%. A total of 16,1% of respondents indicated that they were not aware of any alternative funding institutions. A further 14,3% of respondents indicated that they were not aware of how to access funds from alternative funding institutions. A total of 5,4% of respondents indicated that they did not know what financial products were being offered by alternative funding institutions.

**Figure 6.** Reasons for not applying to alternative funding institutions

**4.2.5 Question B5: Do you believe that commercial banks advertise their financing packages better than alternative funding institutions?**

could be a contributing factor to the low awareness of alternative funding institutions among SMMs, as indicated in Figure 7.

The purpose of this question was to try and understand whether advertising of financial products

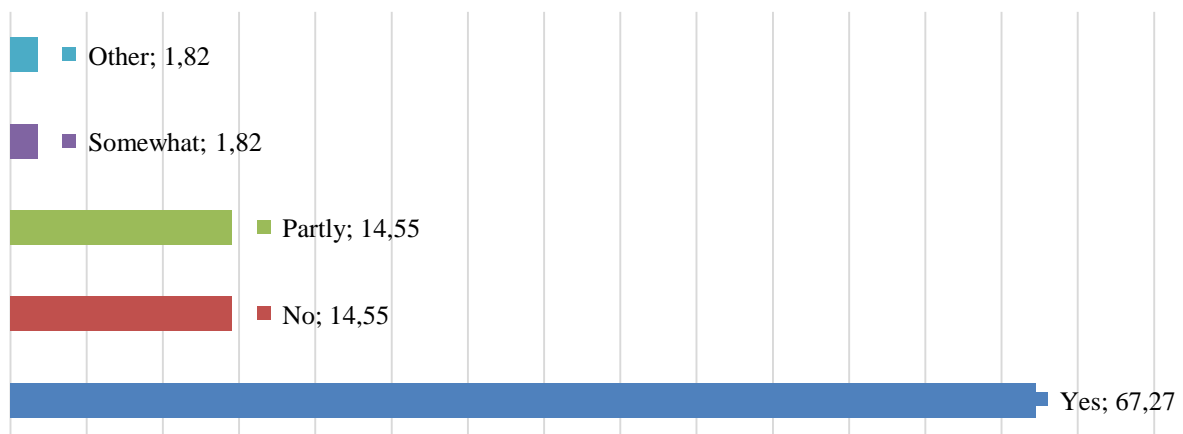
**Figure 7.** Advertisement of financial products

Figure 7 shows that a phenomenal 67,3% of the respondents indicated yes, which implies that alternative funding institutions do not advertise their product well, and therefore resulting in the low application rate, because SMMs are not aware the institutions nor are they aware of the financial products they offer. A total of 14,5% of respondents indicated that they do not believe that commercial banks advertise their financing packages better than alternative funding institutions, while a further 14,5% believes that it is partly the case. A small amount of respondents of 1,8% indicated somewhat, and another 1,8% indicated other reasons. It is clear for the responses indicated in figure 4.10, that the advertisements of the financial products play a

significant role in the awareness of products offered as well as access to alternative start-up capital from alternative funding institutions.

**4.2.6 Question B6: What is your perception of accessing finance from alternative funding institutions?**

The purpose of this question was to try and understand what perceptions SMMs help in relation to alternative funding institutions, as indicated in Figure 8

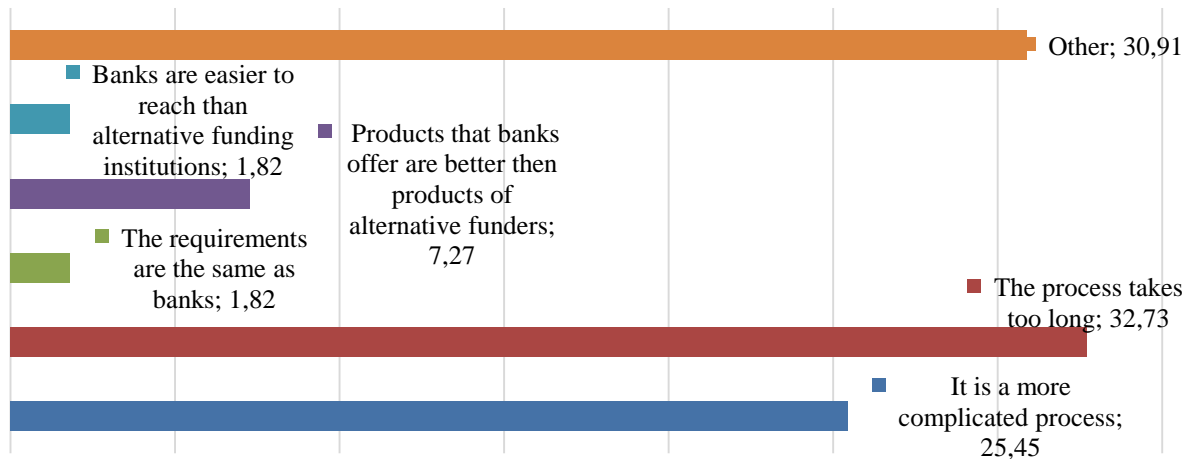
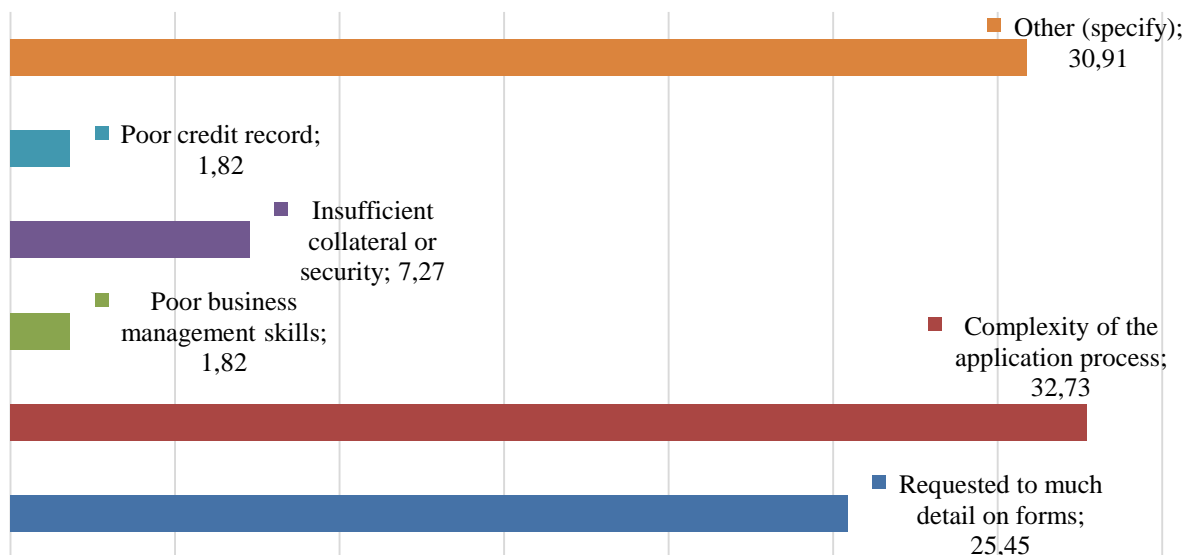
**Figure 8.** Perceptions of accessing finance from alternative funding institutions

Figure 8 refers. A total of 32,7% believes that the process takes too long, while another 30,9% of respondents cited other reasons. A total of 25,5% believes that the processes to secure start-up capital from alternative funding institutions is a more complicated process. A further 7,3% of respondents believe that products that banks offer are better than the products of alternative funding institutions. Another 1,8% of respondents believe that the requirements are the same as those of banks, and another 1,8% of respondents believe that banks are much easier to reach than alternative funding institutions.

#### **4.3 Challenges experienced accessing start-up capital from alternative funding institutions**

##### **4.3.1 Question C1: When applying for funding, which of the challenges did you experience?**

The aim this question was to understand the challenges experienced from the respondents who have attempted to apply for funding from alternative institutions, as indicated in Figure 9.

**Figure 9.** Challenges experienced when applying for funding

A total of 32,7% of respondents cited as indicated in Figure 9 that the complexity of the application process, while another 30,9% of respondents indicated other reasons for challenges experienced in the application process. A further 25,5% of respondents indicated that alternative

funding institutions requested too much details or information on the application forms. A total of 7,3% of respondents indicated that insufficient collateral or security posed a challenge for SMMEs obtaining funding, while another 1,8% of respondents accredited their challenges to poor business

management skills. Poor credit records accounted for 1,8%.

#### 4.3.2 Question C2: If your application has been declined, what was the reason?

The purpose of this question was to understand the reasons for applications being declined. A huge percentage of respondents, 73,2% indicated other reasons, which could imply that they did not apply for start-up funding from alternative funding institutions. Poor or insufficient collateral or security at 10,7% and Insufficient equity at 7,1% were the reasons why applications were declined. Inadequate business plan

at 3,6% and poor business management at 1,8%. Poor credit records accounted for 1,8% as well as over indebtedness or blacklisted which accounted for 1,8%. Inappropriate market or business accounted for 0%.

#### 4.3.3 Question C3: If your application was declined, what support or assistance did you receive from the alternative finance institution to become compliant?

The purpose of this question was to understand whether SMMEs obtained any support during and or after the application process in an attempt to assist the SMMEs in becoming compliant with the institutions requirements, as indicated in Figure 10.

**Figure 10.** Support from alternative finance institutions in becoming compliant

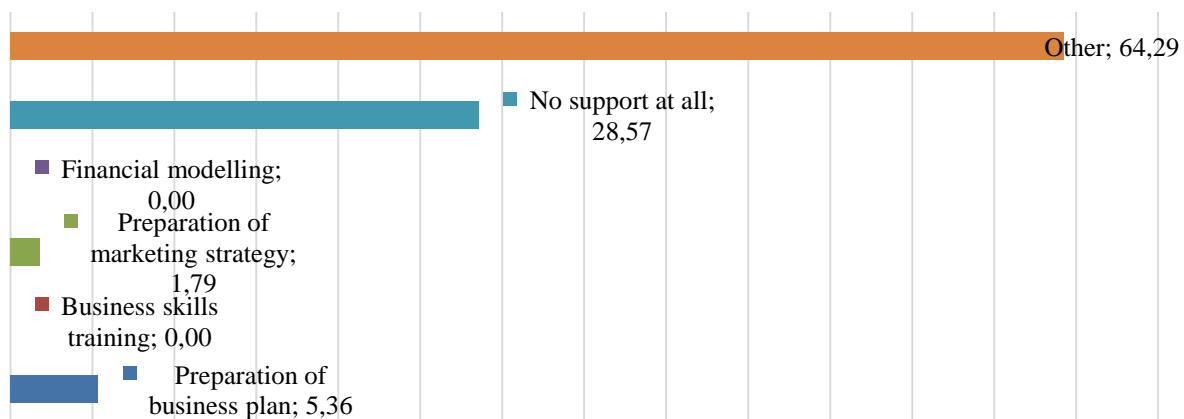
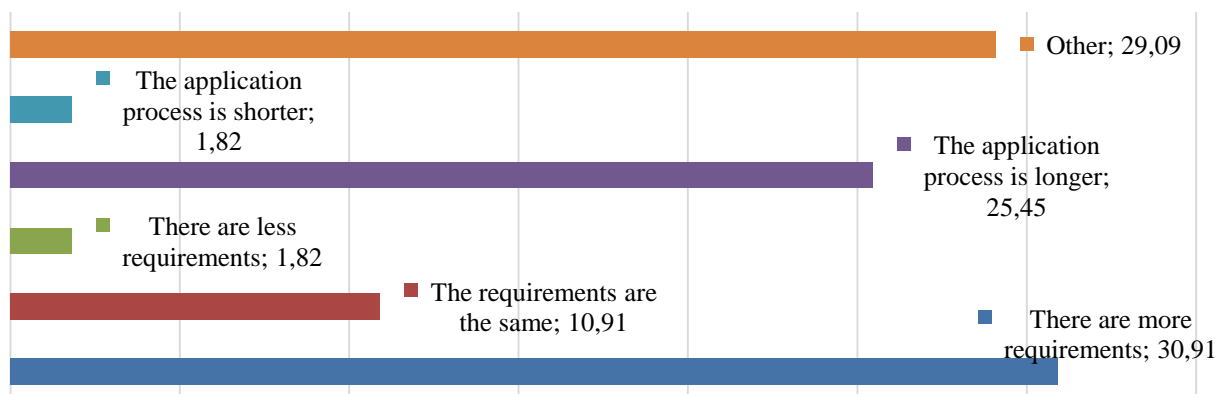


Figure 10 refers. A huge percentage of respondents indicated other (not specifying support) at 64,3% while a further 28,6% of respondents indicated that they received no support at all. A total of 1,8% of respondents received assistance with the preparation of business plans, and another 1,8% received assistance with the preparation of a marketing strategy. Business skills training accounted for 0% and financial modelling also accounted for 0%. It is clear from the information identified in figure 10 that very little support is granted to the SMME to assist their businesses in becoming compliant.

#### 4.3.4 Question C4: In your opinion, how does the process of applying for finance from alternative funding institution compare to commercial banks?

In this question, the researcher tried to understand whether there are differences or similarities in applying for funding at commercial and alternative funding intuitions, as indicated in Figure 11.

**Figure 11.** Application comparison between alternative funding institution and commercial banks



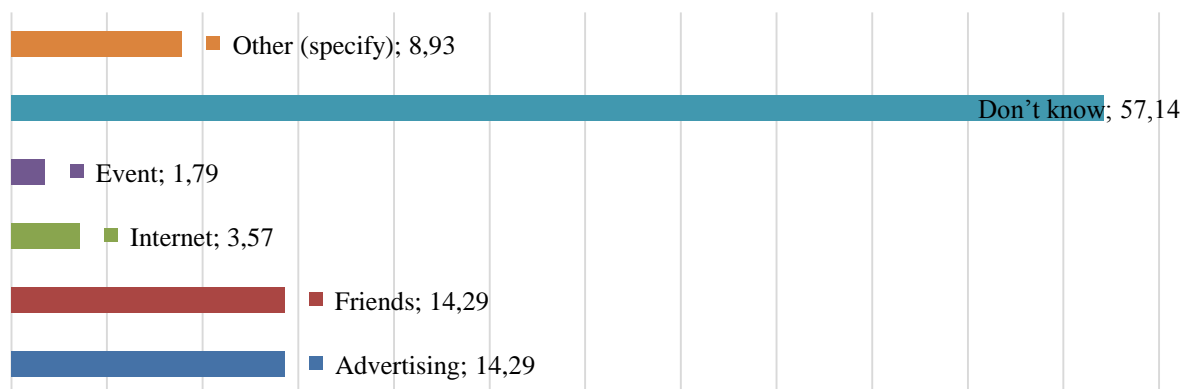


A total of 30,9% of respondents indicated in Figure 11 that alternative funding institutions have more requirements than commercial banks, while another 29,1% of respondents cited other reasons. 25,5% of respondents indicated that the process is longer than that of commercial banks and another 10,9% of respondents indicated that the requirements are the same. A total of 1,8% indicated that there are less requirements, while a further 1,8% indicated that the process is shorter.

#### 4.3.5 Question C5: How did you learn about alternative funding institutions such as Khula?

In this question, the researcher wanted to establish how SMMEs get to learn about alternative funding institutions, as indicated in Figure 12.

**Figure 12.** How SMMEs learn about alternative funding institutions



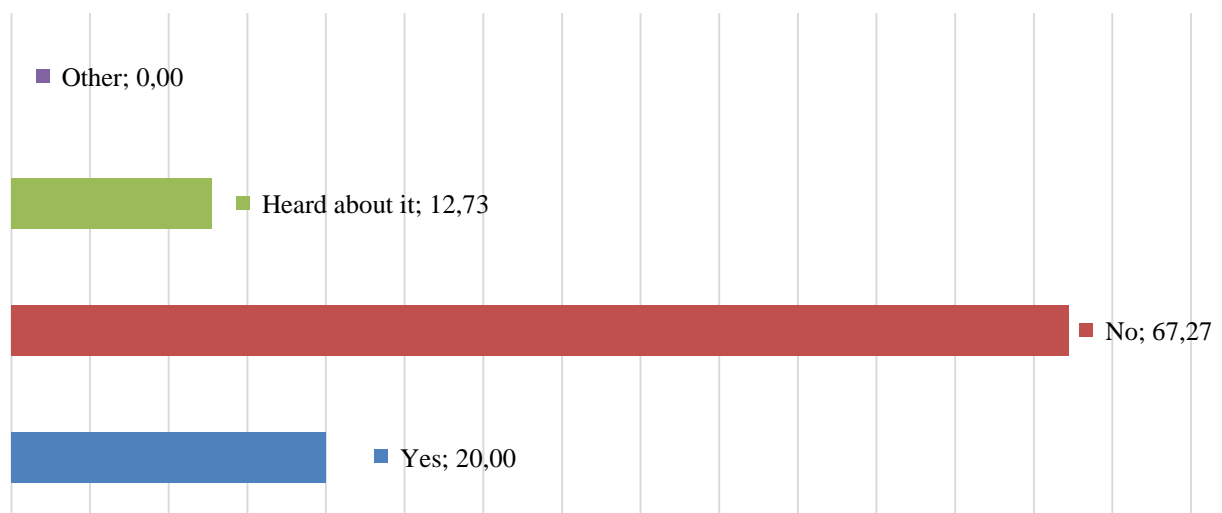
An astounding 57,1% of respondents indicated in Figure 12 that they did not know about alternative funding institutions. A further 14,3% of respondents indicated that they learnt about alternative funding institutions through advertising, and another 14,3% learnt through friends. A total of 8,9% of respondents indicated other, while a further 3,6% indicated that they had learnt through the internet. 1,8% of the respondents indicated that they had learnt through events where these alternative funding institutions were being marketed.

#### 4.4 Small Enterprise Finance Agency (SEFA)

##### 4.4.1 Question D1: Are you aware of the establishment of SEFA?

The aim of this question was to establish whether SMMEs were aware of the establishment of SEFA, as indicated in Figure 13.

**Figure 13.** Are you aware of the establishment of SEFA?

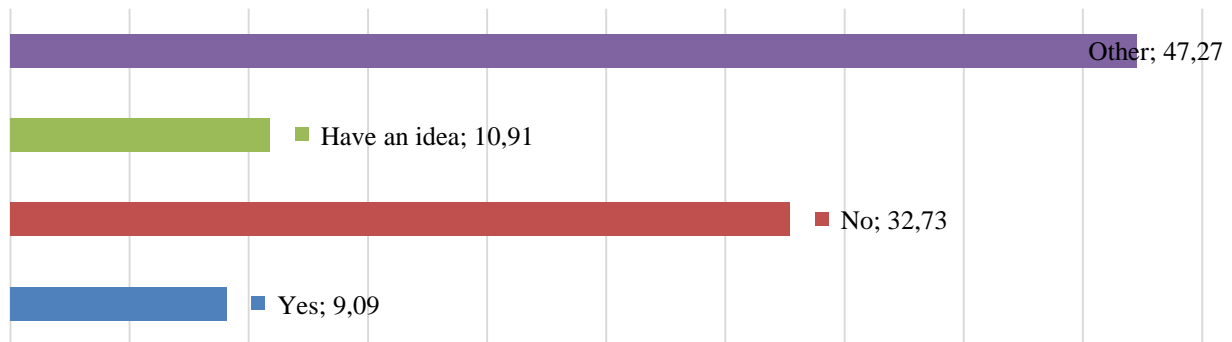


A staggering 67,3% of the respondents indicated in figure 13 that they do not know about SEFA, while another 20% of respondents indicated that they are aware of the establishment of SEFA. A further 12,7% of respondents indicated that they have heard about the establishment of SEFA, and do not really know about SEFA. The information in Figure 17 further confirms again that the establishment of alternative funding institutions is not known to SMMEs

#### 4.4.2 Question D2: If your answer in 1 above is Yes, do you know why SEFA has been established?

The researchers tried to understand, if SMMEs knew about the establishment of SEFA, do they know why it has been established, as indicated in Figure 14.

**Figure 14.** Do you know why SEFA has been established?



A huge percentage of respondents, 47,3% indicated in figure 14 other (do not know SEFA), a total of 32,7% of respondents indicated that they do not know why SEFA has been established. A further 9,1% of respondents indicated that they do know why SEFA has been established, and a further 10,9% of respondents has an idea why SEFA was established.

#### 4.4.3 Question D3: In your opinion, do you think that SEFA will deliver better services than Khula ect. ?

The purpose of this question was to get an idea from the respondents on whether they perceive the newly established entity to be a more effective entity the previously established support entities, as indicated in Figure 15.

**Figure 15.** Perception on effectiveness of SEFA

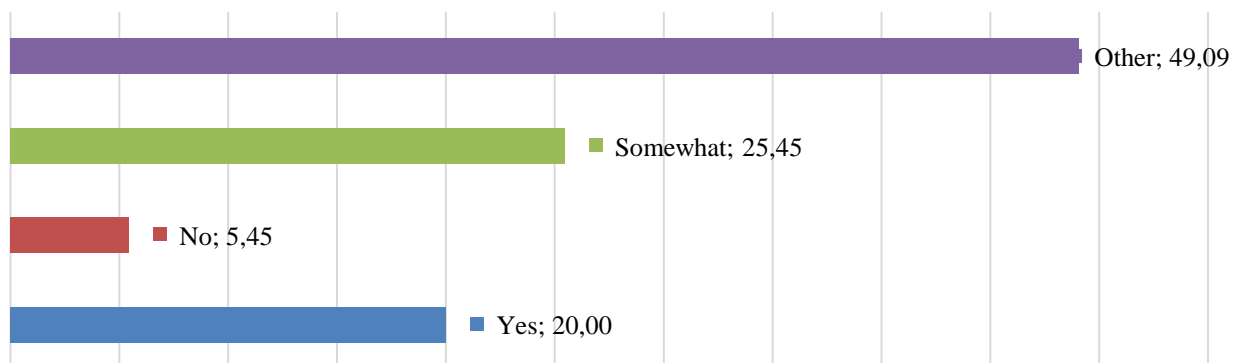


Figure 15 refers. A huge percentage of respondents indicated other, at 49,1% indicating that they were not sure whether the newly established SEFA will provide a better and or more effective service than other established alternative finance institutions. A total of 25,5% of respondents believes somewhat that better services will be delivered, while another 20% is absolutely sure that SEFA will deliver better services. 5,5% of the respondents do not believe that SEFA will deliver better services.

It can be concluded from the results that most of the challenges in accessing alternative start-up funding relates to unawareness and challenges in accessing these established alternative funding institutions. The next section summarizes the findings of the research study.

## 5 Summary of findings

The aim of this study was to investigate alternative access to start-up capital for Built Environment SMMEs from established support and developmental institutions in South Africa. The aim and objectives of the study have been met. The study has shown that Built Environment SMMEs accessing start-up capital from alternative funding institutions and the perceived challenges associated with accessing the finance includes the following:

- More than half of the sample population did not apply to commercial institution for start-up capital, which may indicate that the SMMEs did not meet the financial requirements of the commercial institution;
- More than 80% of respondents did not apply to any alternative funding institution to access start-up capital;
- Approximately 80% of respondents made use of savings and other sources of funding for start-up capital;
- Most SMMEs are not aware of alternative funding institutions, and that alternative funding institutions are not easily accessible;
- SMMEs are not aware of the financial products that are available from the alternative funding institutions;
- Approximately 70% of SMMEs believe that commercial institutions advertised their financial products better than the alternative funding institutions;
- The overall perception from SMMEs is that accessing finance from alternative funding institutions is a more complex process and that the process takes very long;
- SMMEs also perceive alternative funding institutions to have more complex processes and that generally more detail is required in comparison to commercial institutions;
- A small number of SMMEs who did attempt to access funding from alternative funding institutions highlighted that they received not support when their application were declined;
- Approximately 70% of SMMEs are also not aware of the newly established Small Enterprise Finance Agency (SEFA);
- A further 80% of SMMEs did not know why SEFA had been established, and
- Approximately 55% of SMMEs did not believe that SEFA will be more effective in delivering services to SMMEs.

## 6 Conclusion

The aim of this study was to investigate alternative access to start-up capital for Built Environment SMMEs from established support and developmental institutions in South Africa. Conducted research indicates that the majority of the Built Environment

SMMEs do not apply to alternative funding institutions to access start-up capital. Further, access to the alternative funding institution has proven to be inaccessible, and that Built Environment SMMEs are not aware of the available products and services offered by the established alternative funding institutions and programmes.

The greatest potential for creating employment in South Africa comes from the formation of new SMMEs. For this employment to be sustainable requires these SMMEs to succeed over a long term. An influx of newly formed SMMEs which succeed in the long term will develop the economy, stimulate a more competitive environment, and thus achieve the national goals proposed by legislation. The focus of small business development in South Africa should therefore be on new business formations and entrepreneurship.

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