

*Full Length Research Paper*

# **An exploratory study on corporate governance practices in small and micro fast moving consumer goods enterprises in the Cape Metropole, Western Cape, South Africa**

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Small, medium and micro enterprises (SMMEs) play a crucial role in the growth and development of a country's economy. With this in mind, the small business sector is seen as an important force to generate employment and more equitable income distribution. SMMEs strive towards sustainability and growth, however a substantial number of SMMEs fail due to, amongst other, the lack of corporate governance compliance. One of the major factors that may hinder the implementation of corporate governance practices in SMMEs is insufficient access to SMME funding and lack of skills and information. The main outcome of this study is to provide insight into governance practices of small and micro enterprises in the fast moving consumer goods sector. The descriptive quantitative research design was used in this study. In this research, an exploratory design was used to help develop areas for future research. Furthermore, this study can be regarded as a statistical study and are classified as basic research with the intention of increasing our understanding of corporate governance influence on small and micro enterprises without seeking to solve or treat problems. The units of analyses for this research study were fast moving consumer goods small and micro enterprises operating in the Cape Metropole, while the target population comprised of the owners and/or managers of these enterprises. Judgemental sampling technique was used to select the sample of 36 small and micro enterprises. The data collection consisted of questionnaires, done within the ambit of a survey, which were completed by owners/managers of small and micro enterprises.

**Key words:** Small and micro enterprises, sustainability, growth, corporate governance.

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## **INTRODUCTION**

Small, medium and micro enterprises (SMMEs) play a crucial role in the growth and development of a country's economy. In South Africa, SMMEs contribute 57.3% towards employment and 36.1% to the GDP (Solomon, 2004). Small businesses are often started as a means of survival in order to combat unemployment. These kinds of enterprises are often termed survivalist enterprises

(Solomon, 2004).

Small and micro enterprises however fail due to, amongst other, a lack of managerial and planning skills, ineffective working capital management, an inability to manage the competitive environment, and growth over-expansion (Solomon, 2004). The success of the business therefore depends crucially on how the business

manages and organises its resources. Banerjee (2005), states that competence of a firm or of an industry sector is directly related to issues of corporate governance.

Poor corporate governance in small and micro enterprises, strained further with insufficient access to key factors such as funding, lack of skills and information have made businesses susceptible to closure (Banerjee, 2005). However, with the introduction of corporate governance in small and micro enterprises the possibility of obtaining funding from banks will improve (Banerjee, 2005). In addition, the foundation of transparency and accountability will be entrenched in their corporate behaviour should corporate governance be applied early.

This behaviour of transparency and accountability would also indicate competence and first-class corporate governance, which is a basic foundation for flourishing and well structured businesses (Tan and Tan, 2004). Accessible research reveals that better corporate governance in small and micro enterprises are positively linked to their growth and long term sustainability. Better governance is not a solution to all problems faced by small and micro enterprises, but it is an unquestionably essential element to success.

The objective of the research study is to provide insight into governance practices of small and micro enterprises in the fast moving consumer goods sector.

## LITERATURE REVIEW

### Small and micro enterprise overview

Small and micro enterprises are separate and distinct business entities managed by one or more persons and are predominately carried on in any sector or sub-sector of the economy (South Africa, 2004).

Small and micro enterprises play a pivotal role in the economy of many countries. Naidoo (2007), states that approximately 80% of all businesses in South Africa are described as small businesses. In essence, small and micro enterprises add value to their communities and can be seen as an important ally in the fight against unemployment, ultimately providing a road out of poverty which leads to sustainable development and greater economic stability (Kloppers and Kloppers, 2006). Olawale and Garwe (2010), mentions that small, micro and medium enterprises in South Africa contribute 56% to private sector employment and 36% to the gross domestic product.

### Failures of small businesses

According to Naidoo (2007), up to 50% of new small businesses eventually fail, some in their infancy stage and some within a few years after start-up. Bruwer and Watkins (2010) mentions that 80% of all small

businesses tend to fail within the first five years of operation hence, entrepreneurs feel discouraged to start new businesses.

### Corporate governance within small businesses

A lack of good corporate governance may be the reason for the high levels of failure in small and micro enterprises. Corporate governance in South Africa was institutionalised in November 1994 by the publication of the King Report. According to the King III Report, corporate governance is essentially about leadership. It is a guideline system that structures the operating and controlling of a business to achieve good business management, good consideration for staff and good relations with trading partners (Smit, 2011).

King III state that all entities regardless of the manner and form of incorporation or establishment should embrace corporate governance practices. Although small and micro enterprises are not obligated to implement corporate governance practices, they will reap the benefits thereof by doing so. The concept of corporate governance has in the past decade become increasingly significant and in this regard South Africa is no exception (Kloppers and Kloppers, 2006).

According to Muller (2009) good corporate governance is vital for the development of a healthy and competitive corporate sector. Muller (2009) further states that one of the key benefits of corporate governance to small business includes a better and stronger system of internal controls, accountability, transparency, and an enhanced strategic vision. Through the participation of outside experts the owner is able to focus more on the strategic directions and expansion of the business, than day-to-day operations thus creating the ability to attract better managers and investors. Abor and Adjasi (2007), agrees that the benefit that accrue from corporate governance practices further assist small businesses to grow rapidly. This view is confirmed by Johnson (2008), stating that corporate governance is a significant factor in improving economic efficiency and growth. Empirical evidence indicate that good corporate governance practises in small business gives a positive signal to investors, and encourages small businesses and those who own and managed them to achieve their corporate objectives though the more efficient use of resources. Furthermore, applying good corporate governance principles reduces the problems associated with information asymmetry and makes small businesses less risky to invest in (Abor and Adjasi, 2007).

The rationale for small and micro enterprises to implement corporate governance practices are (Davies, 2010; Le Roux, 2010):

- Good corporate governance pave the way for companies to grow and attract additional investors as

alternative to raising capital through borrowing from banks and other financial institution at high cost.

- Sound governance practises lead to improved internal control systems which results in more accountability and higher profitability. The latter is attributed to enhanced controls which minimise the likelihood for fraud losses.
- A corporate governance framework ensures that owners are freed from administrative duties. Conflict among business owners who assume management roles in the organisation would be reduced to a greater extent.

If small and micro enterprises infuse corporate governance structures at an early stage, they will gain experience and instil discipline in the management of the business (Juul, 2006). Embedding corporate governance practices facilitates small and micro enterprise growth and improved decision making processes (Solomon, 2007).

### **Obstacles to corporate governance in small businesses**

Small and micro enterprises are highly diverse with structures, problems, growth potential and access to support differing widely between segments. Furthermore, small businesses are faced with obstacles such as financial constraints and access to financial services, control and flexibility, lack of skills and lack of information. As small and micro enterprise owners do not possess the necessary skills and knowledge regarding corporate governance they are unable to implement these principles in their businesses. The lack of skills can contribute to the failure of the enterprise and thus may have a direct effect on poverty alleviation and ultimately sustainable development (Kloppers and Kloppers, 2006). This is reiterated by Johnson (2008) who is of the view that small and micro enterprises are not embracing corporate governance due to the following reasons:

- There is generally a lack of awareness among small business regarding corporate governance and its relationship with corporate performance.
- The cost of implementing corporate governance is too high as compared to the perceived benefits.

According to Kloppers and Kloppers (2006), one of the principles of corporate governance is a clear distinction between ownership and management. This is problematic for small and micro enterprises as the owner may be required to employ a manager/director which could result in loss of control over the business.

### **Growth**

Corporate governance plays a significant role in improving the economic efficiency and growth within small businesses. It has been empirically proven that that good

governance practices of a company gives a positive signal to investors and where it is lacking, as in most small and micro enterprises, investors tend to raise a lot of questions (Mponji, 2009). However, access to equity and finance is a major constraint to small and micro enterprise growth in many developing countries (Mponji, 2009). Small and micro enterprise growth can also be hampered due to the lack of education and training. According to Naidoo (2007), the upgrading of the skills level is an important priority in addressing economic growth within small business as it is vital for the owner/manager of small businesses to possess entrepreneurial skills in order for the business to be successful. Naidoo (2007), also states that entrepreneurship is the emergence and growth process of new businesses during which changes occur in the economic system through innovation of individuals who respond to opportunities in the market.

### **Sustainability**

At present, small and micro enterprises in South Africa are facing many sustainability problems. According to Bruwer and Watkins (2010), the factors that primarily affect sustainability, are broken down into macro-economic factors, micro-economic factors and psychological factors. It is important for small and micro enterprises to be sustainable, the development to be efficient and essential for enterprises to be based on sound business principles which is entrenched through embedding corporate governance principles. The weakened South African currency, volatility of the market and the global recession are factors which impacts negatively on small and micro enterprise sustainability. Financial difficulties, inadequate start-up financing, lack of management knowledge, lack of accounting knowledge, the underestimation of financial performance measures are also factors affecting small and micro enterprise sustainability (Bruwer and Watkins, 2010).

The weak corporate governance of small enterprises burdened further with the poor availability of important resources has made the sustainability of these enterprises extremely vulnerable. To remain competitive in a changing world small enterprise's must innovate and adopt corporate governance practices so that new demands can be met and new opportunities grasped (Le Roux, 2010).

### **RESEARCH DESIGN AND METHODOLOGY**

Descriptive quantitative research design was used to explore the possible correlation among two or more phenomena (Leedy and Ormrod, 2001). Data collection was done by way of questionnaires (Saunders et al., 2000). Quantitative research studies provide a solid platform for describing and analysing what was, and some insight into why it was the way it was. In this research study an exploratory type of design, specifically a descriptive study, was adopted (Patton, 1990). The purpose of the exploratory research

was to gain insight into corporate governance practices by small and micro enterprises (Bless and Higson-Smith, 1995).

This research study is a statistical study, capturing a population's characteristics by making inferences from a sample's characteristic (Cooper and Schindler, 2006). The results of this research will be used to gain more insight into corporate governance behaviour of micro and small enterprises. It is classified as basic research, which has the intention of increasing our understanding of certain phenomena without seeking to solve the problem (Cherry, 2012).

The units of analyses for this research study was fast moving consumer good small and micro enterprises in the Cape Metropole, Western Cape, South Africa while the target population comprised of the owners and/or managers of these firms. A purposive sampling technique (Malhotra, 1999) was used to select the sample of 36 small and micro enterprises to be analysed with data collected by means of a questionnaire. Secondary data was gathered by way of literature review studies.

The following ethical considerations (Cooper and Emory, 1995; Cooper and Schindler, 2006), was applied during the research study:

- Inform participants of the benefit of the research: Owner-managers of small and micro enterprises were informed of the purpose and expected benefits of the research study.
- Maintaining confidentiality and anonymity of participants: Small and micro enterprise owner-managers were informed that no data will be made available that may identify the specific business entity, and completed questionnaires will not be made public to any person or institution.
- Informed consent: Small and micro enterprise owner-managers were informed of the nature of the questionnaire. They were made aware that their participation in the research is of a voluntary nature and that they are under no obligation to answer any questions they are uncomfortable with.
- Debriefing: Small and micro enterprise owner-managers were offered the option to receive follow-up information about the research results. If this choice was selected by the participants, contact details were provided by the research participant.

The positivistic measuring criteria of validity, reliability and practicality were used for the research as these measurement indicators provide valid quality checks (Remenyi et al., 2002). The interactive threats of external validity were eliminated in this study by not conducting any pre-tests on the subjects, and the sample frame in this study was selected using purposive sampling. Internal validity was achieved by ensuring that the research instrument adequately covered the research topic (Cooper and Emory, 1995).

In assessing the reliability of the measurement instrument, the following questions were posed (Easterby-Smith et al., 1991:41 cited by Saunders et al., 2000):

- Will the measurement indicator produce the same result on different occasions?
- Will similar observations be reached if the researcher and the occasion differ?

The measurement process selected should, in addition to complying with the requirements of validity and reliability, comply with the operational requirement of practicality, where practicality encompasses economy, convenience and interpretability. However, in line with the nature of non-positivistic research, focus was not solely be directed at validity, reliability and practicality, but also at achieving consistency and integrity of the research design (Remenyi et al., 2002).

### **Delineation**

The target population for this empirical study was small and micro

enterprises in the non-franchise based fast moving consumer goods sector within the Cape Metropole, Western Cape, South Africa. This study did not cover medium enterprises. For the small and micro enterprises to have been included in our sample size, the enterprise should have been in existence for one year or longer and should have met the definition of a small and micro enterprise as per the Small Business Act No.29 of 2004 (South Africa, 2004).

## **RESEARCH FINDINGS AND DISCUSSION**

From the 36 questionnaires distributed, a 100% response rate was achieved. The following results pertain to the analysis of the research findings.

### **Classification of enterprises and enterprise age**

From the 36 questionnaires distributed, 22% of the businesses were classified into micro enterprises, 36% were classified as very small enterprises and 42% were classified into small enterprises. On average, the SMMEs have been trading for 12 years which contradicts literature sources (Bruwer and Watkins, 2010) indicating that on average 80% of small businesses fail within the first five years. However, these enterprises in the study can be a second (or more) attempt of the enterprise owners in their entrepreneurial activities.

### **Positions of respondents in the business**

After carefully analysing the 36 questionnaires, it was found that 39% of the respondents comprised of owners, 47% comprised of managers and 14% of the respondents held the position of owner and manager. As owners and managers of enterprises are in a position to holistically observe business processes, these individuals are in the best position to answer questions on governance activities.

### **Corporate governance**

Only 36% of the respondents actually understood the term corporate governance whereas the remaining 64% of the respondents were unaware as to what corporate governance entailed. Taking regard of this lack of knowledge about good business practices that are embedded in governance activities, a substantial number of enterprises succeeded if success is measured in terms of years trading.

### **Organisational processes**

In the questionnaire the respondents were asked to rate the importance of organisational policies and procedures within the enterprise. 58% of the respondents rated their

**Table 1.** Factors influencing organisational survival.

Factors	High (%)	Medium (%)	Low (%)
Internal controls	50	44	1
Access to finance	42	56	2
Satisfied employees	72	22	6
Educated employees	17	47	36
Training provided to employees	36	44	20
Customer Satisfaction	92	3	5
Organisational policies and procedures	44	47	9
Sound IT system	17	39	44
Geographical placement	58	28	14
Effect of competitors	44	42	14
Other	0	0	3

policies and procedures to be very important, 33% rated policies and procedures to be fairly important and 8% rated the policies and procedures to be slightly important. Thus, although the owner/managers understanding of corporate governance principles are lacking, they intuitively realise the importance of some of the fundamental principles within 'governance'.

### Importance of growth, success and survivability

The respondents were asked to rate growth, success and survival (however they perceived it) in order of importance. Growth was rated as the most important (55%), followed by in equal rating, success and survival. However, each of these terms can encompass a different understanding for respondents, therefore this indicator provide an opportunity for future studies to elaborate upon.

### Owner/mangers perspective on enterprise survivability, sustainability, growth and success

The respondents were asked to rate the survivability, sustainability, growth and success (success as perceived by the owner-manager) of their businesses. Based on the information gathered it was found that 25% rated their businesses to be growing, 39% rated their business as succeeding and 36% rated their businesses as successful and a sustainable enterprise. Although the average enterprise age is 12 years, and thus a relative degree of success and sustainability is implied (in terms of the years trading), a significant margin of improvement are still aspired to by owner/managers of small and micro enterprises.

### Importance of organisational survival

The respondents were asked to rate the factors

influencing organisational survival in order of importance. Customer satisfaction was rated as the most important followed by employee satisfaction as the second most important factor. A sound information technology system and employee education was rated as the least important factors influencing organisational survival. It is of interest to note that when the importance of organisational processes are evaluated on a stand alone basis, respondents awarded it a significant higher rating of importance (58%), than when its importance is evaluated along with other options (44%). It is of concern that the importance of the factor 'A sound IT system' that is integral to good governance processes, are rated only at a 17% importance level compared to a factor such as geographical placement that is rated at a 58% importance level. Table 1 shows a comprehensive list of factors influencing organisational survival as rated by the respondents.

### Level of internal controls

The respondents were asked to rate the level of internal controls within their businesses. Based on the information gathered, 14% rated their internal controls as excellent, 56% rated their internal controls as good and 30% rated their internal controls to be fair. This results maps to the results obtained when respondents rated the importance of factors influencing their survival where the factor 'internal controls' where rated at a 50% importance.

### Obstacles encountered in following good business practices that is governance components

Respondents where asked what obstacles they encounter in following good business practices were good business practices encompasses: **A** employee well-being, **B** community involvement, **C** implementing and adhering to internal controls, **D** financial accountability

**Table 2.** Obstacles encountered in following good business practices.

Good business practices	Obstacles (%)				
	Cost	Lack of knowledge	Not important	Not enough staff	Other
<b>A</b> Employee	44	44	6	3	3
<b>B</b> Community	17	19	44	17	3
<b>C</b> Controls	25	42	19	14	0
<b>D</b> Financial	39	28	6	25	2
<b>E</b> Customer	31	8	17	39	5

**Table 3.** Respondents rating of the importance of organisational values.

	Adhering to values %				
	1=None	2=Limited importance	3=Influence	4=Important	5=Very important
Honesty	0	0	0	8	92
Fairness	0	0	14	19	67
Responsibility	0	6	11	44	39
Social responsibility	8	8	28	39	17
Accountability	0	0	25	25	50
Discipline	0	6	8	25	61

and **E** meeting customer expectations. The majority of respondents rated 'cost' and 'lack of knowledge' as an obstacle to 'employee well-being' with 'employee well-being' rated at a 72% importance level for 'organisational survival'. However, the impact of 'training' on employees' well-being is clearly not recognised by owner/managers as they rate it only at a 36% importance level for survival. 'Community involvement' is not seen as important by small and micro enterprises, and 'meeting customer expectations are hindered by 'not enough staff' although meeting 'customer expectations' are rated at a 92 % importance level. 'Community involvement', which forms an importance part of governance, is clearly not recognised by small and micro enterprises. Table 2 depicts the obstacles which SMME owners/managers encounter in following good business practices.

### Adhering to values

Respondents were asked to rate the importance of adhering to values (honesty, fairness, responsibility, social responsibility, accountability and discipline – all paramount to good governance practices), within their business using a scale from 1 (none) – 5 (very important). Honesty was rated by most respondents as very important, followed by fairness as the second most important value and discipline as the third most important organisational value. Not surprisingly, social responsibility was rated by only 17% of respondents as important which maps to the 'not important' rating given to

'community involvement' as part of good business practices. The respondents' responses are depicted in Table 3.

### Conclusion

Based on the findings of the research, it is concluded that the fast moving consumer goods sector within the Cape Metropole, Western Cape, South Africa, have some policies and procedures (that forms part of good governance practices) in place to manage their enterprise. Most of the respondents rated their policies and procedures within their businesses as good.

Small and micro enterprise owners and managers are however not familiar with corporate governance; hence a majority of small and micro enterprises do not comply with corporate governance principles which are described as 'good business practices' within the study. As indicated, a limited degree of intuitive governance is applied by owners' and managers whereby the importance of some elements of good governance are recognised, i.e. policies and procedures. Based on the data collected; it is further evident that small and micro enterprise owners and managers do not understand the importance of corporate governance practices which to a limited degree maps to these enterprises not complying with governance practices. By and large this can also be mapped to enterprise owners and managers limited knowledge of the meaning of governance. Only a small number of respondents actually understood what corporate governance

entailed. From those enterprise owners managers that do have the knowledge, there is little belief that corporate governance can contribute to an improvement in the organisation's performance were performance encompasses sustainability and growth as evident from the literature study.

Cost and a lack of knowledge were found to be the main obstacles encountered in following good business practices. Although the average age of small and micro enterprises in this study was 12 years, no indication was given whether this was the first (or more) attempt of entrepreneurs in operating an enterprise. This factor alone can have a significant influence on results as entrepreneurs that undertake a second or more attempts at operating a business will embed important experiences learned from their first trading experience, which can aid in enterprise survival. This exploratory study therefore confirms that small and micro enterprises are largely ignorant about all the important components of governance and do not realise the importance of full adherence to governance within their enterprise. Future research opportunities exist to research the effect of governance compliance on enterprise success, as claimed by the various literature sources discussed in this study, if success is measured in terms of financial growth and/or enterprise expansion.

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