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Full Length Research Paper

South African informal businesses sustainability in the Cape Town Central Business District: The power of internal financial controls

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Small medium and micro enterprises (SMMEs) are key players in the informal sector which contributes substantially to the development of the economy of South Africa. These firms also play an imperative role in promotion of entrepreneurial survival and entrepreneurial sustainability in a demanding and competitive informal sector. This paper provides insight, as to what extent SMMEs make use of internal financial controls to make ends meet in the informal sector. The key objective of this research was to determine the extent to which internal financial controls are utilised by informal businesses in the Cape Town Central Business District (CBD); and to ascertain the level of understanding owners and/or managers have regarding internal financial controls. To execute this research, empirical research was conducted through means of the positivistic research paradigm. This study was also regarded as a quantitative research study and a questionnaire-tool was used to glean data by means of purposive sampling from respondents with the main intention to obtain rich data. From the data analysed, it was found that though these businesses were in fact aware of the beneficial potential value internal financial controls could have on their business' well-being, however only a minority of these businesses actually had such implemented controls; those who implemented it had limited monitoring over these controls. From the data analysed, relevant recommendations and conclusions were also drawn upon.

Key words: Small medium and micro enterprises, informal business, internal financial controls, entrepreneur, sustainability.

INTRODUCTION

The development of SMMEs was identified by the South African Government as a priority with regards to creating jobs and reducing the unemployment rate in South Africa. SMMEs are essential in terms of promoting and achieving economic growth, development of the national economy and the widespread creation of wealth and employment (Nieman, 2001). Since 1994 however South Africa has had to face the challenge of re-entering the world markets as a global economy (post-Apartheid era).

To achieve the objectives of economic growth through competitiveness on the one hand, and employment on the other, South African SMMEs has been actively promoted by the South African Government since 1995 (Berry et al., 2002). The importance of SMMEs are further justified in the National Small Business Act No. 102 of 1996 which describes a small business as a separate and distinct business entity which is managed by its respective owners – being either a natural person, a sole proprietorship, partnership, close corporation or company (South Africa, 2004). Government also articulated a number of measures to foster an enabling environment for SMMEs by means of the National Development Strategy and the actual promotion of small business in South Africa (DTI, 2005).

It has been established that the total 'contribution' of SMMEs in South Africa could be as much as an estimation of 50% of the national Gross Domestic Product. Furthermore it is also estimated that SMMEs provide

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employment to over 60% of the entire South African workforce. With the above in mind Mutezo (2009) mentions that up to 78% of start-up SMMEs in South Africa fail within their first 3 years of existence. Brink et al. (2003) support the latter when stating that the overall failure rate of SMMEs can be estimated between 70 and 80% over a 5 year period. To aid SMMEs in their 'quest' to succeed, the South African Government established numerous support structures. These support structures (programmes) include that of the Small Enterprise Development Agency (SEDA), the Khula Enterprise, the National Youth Development Agency (NYDA) and the Ntsika Programme, just to mention but a few. Unfortunately these support structures have not experienced loads of success as SMMEs are still failing at a phenomenal rate; over 10,000 businesses failing on a monthly basis (Biyase, 2009).

The DTI (2005) expresses that view that the lack of funding does not contribute to the SMME failure rate alone; rather the combination of deficiency factors such as poor business planning, the lack of financial controls, weak general management and insufficient market access. Sha (2005) is of the opinion that a lack of internal financial controls in small businesses negatively influences the performance of such entities. Campbell and Hartcher (2006) raise the point that in order for any business to operate effectively, personnel in the business should ensure adequate internal financial controls are maintained. Despite the afore-mentioned, research has shown that there has been a limited implementation of financial controls by businesses at a holistic level. In essence the authors formulated the perception that SMMEs in the CBD district did not make effective use of internal financial controls, which had an adverse effect on their overall business sustainability.

LITERATURE REVIEW

An overview of South African SMMEs

For the past fifteen years the South African Government has invested in a plethora of initiatives aimed at supporting and growing the SMME sector (e.g. support programmes, customised SMME policies, etc.). According to South Africa (1996) SMMEs are classified in terms of micro-entities, very-small entities and medium-entities (Table 1) based on the number of employees they employ or on the annual turnover they make.

The concept of SMMEs was created and implemented by the South African Government in an attempt to improve the economy of South Africa, reducing the unemployment rate and eliminating poverty (Bruwer, 2010).

In fundamental nature the creation of new SMMEs introduces new products and develops new technologies. Because of a high failure rate of formal and public sector organisations to incorporate the vast growing number of job seekers, especially students that graduate 'fresh' out of varsity, the South African Government has increased its attention on entrepreneurship and new business creation, as these businesses have a potential to contribute towards economic growth and job creation (Olawale and Garwe, 2010). According to Krog (2008) majority of SMMEs go through a five step phase which pertains to the following:

1. Business start-up,
2. Existence,
3. Survival,
4. Resource maturity, and
5. Success.

Despite the economic contributions of small businesses, the failure rate of these entities in South Africa is one of the highest in the world (Olawale and Garwe, 2010). It is further noted that up to 70% of new South African businesses fail in their first two years of existence. The latter is supported by Nieman (2006) when stating that less than 33% of small businesses succeed after their first two years of existence. This failure statistic is relatively a 'large' figure as majority of formally employed citizens, in South Africa, are employed by some form of small business (Krog, 2008). There are numerous key reasons as to why SMMEs fail. These reasons generally relate to 'factors' which can be divided into two categories, namely that of internal factors (factors which can be controlled and managed to a large extent; taking place within a business organisation) and external factors (factors which can only be managed to some extent; taking place outside a business organisation, still affecting it). Examples of these factors, in turn, are economic factors (policies, procedures, inflation rates, interest rates etc.), social factors (crime, infrastructure, etc.) and managerial factors (planning, organising, leading, controlling, etc.)

The success rate of SMMEs

Prior research has shown that in order for a business to succeed, the business owner needs to collaboratively have the education and skills to 'make it happen' in their respective businesses. Krog (2008) explains that the survival of SMMEs is reliant on the abilities of the entrepreneur to succeed while Von Blottnitz (2009) make mention that educated business owners are more likely to survive. Principal literature reviews indicate that despite South Africa's favourable regulatory environment, a high failure rate among SMMEs is still evident (Naidoo, 2009).

Internal financial controls in SMMEs

Internal control can be defined as a system of helping a

Table 1. Classification of SMME sizes (**Source**, South Africa, 1996).

Measure	Micro	Very small	Small	Medium
Employees	0 – 5	10-Jun	11 - 50	51 – 100
Turnover	R150 k	R150k – R3m	R3m - R 15m	R15m – R30m

business to safeguard funds, providing efficient and effective management of assets, and to provide accurate financial accounting (Song, 2008). Internal control procedures are the policies and procedures that have been put in place to ensure that owners and managers can take the correct action, which will eventually ensure that a business achieves its objectives (Campbell and Hartcher, 2006). Internal controls cannot reduce all errors and irregularities that keep firms from growing however they can make management aware of potential problems adversely affecting its success. In fundamental nature, internal financial controls can therefore be defined as controls which are designed to help a business protect its 'financial interest'.

Song (2008) states that the Committee of Sponsoring Organisations (COSO) established a common internal control model for companies and organisations; containing 'standard' control systems. This model can benefit small businesses in South Africa once adopted and incorporated in business operations. The internal control process is designed to provide reasonable assurance regarding the achievement of objectives in effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. Majority of small businesses ignore the importance of internal controls and according to Song (2008) the cost of internal controls should never exceed the projected value of a business. Unfortunately, for small businesses, maintaining an effective system of internal controls presents quite a significant challenge.

Repercussions of inadequate internal financial controls

When any business, whether large or small has a deficiency of internal controls there is a possibility of collusion occurring. Collusion occurs when individuals of the business act together, especially employees who have an important control function, is able to commit and cover up the fraud they have committed (Noorvee, 2006). Noorvee (2006) further asserts that a lack of internal financial controls in small businesses can cause that management, whom has access to policies and procedures within the business, to override protocols for criminal purposes or even his and/or her personal benefit. The latter is supported by Campbell and Hartcher (2006) who express the view that majority of fraud in small businesses starts with the owner. Furthermore small businesses are susceptible to credit card fraud committed by their customers when inadequate internal financial controls are not implemented (Viviers and Venter, 2008). The consequence of control deficiencies on the financial statements of a business should therefore be evaluated both on an individual basis as well as in combination with other control deficiencies to determine the consequence they may have on the truthful presentation of the financial statements. As stated in a study conducted by PricewaterhouseCoopers (2010) businesses without sufficient entity-level controls are less to be effective.

RESEARCH DESIGN

The research was empirical in nature and was defined as descriptive research as the main intention of this research study was to describe a certain identified phenomena at hand. Furthermore this research fell within the positivistic research paradigm as this research was generally quantitative in nature. Moreover, data was collected by means of a questionnaire-tool.

The questionnaire distributed to respondents consisted of 17 close ended questions; mostly taking the form of Likert-scale questions. Data were collected from 30 owners and/or managers of informal small businesses which operated within the CBD in Cape Town. Apart from the above 'delineation criteria', valid responses also had to adhere to the following:

1. SMMEs should have been in existence for at least 3 years.
2. SMMEs owner and/or manager should have been actively involved in their business' operations.

The size of the population was unknown, and in an attempt to glean insight to the identified research problem (as identified above), a sample size of 30 SMMEs was chosen through means of non-probability sampling. Sampling specifically took place through means of purposive sampling, whereby the authors purposely came in contact with respondents who adhered to the afore-mentioned delineation criteria, with the main intention of gleaning rich data. All data were analysed accordingly through means descriptive statistics in MS Excel.

RESEARCH FINDINGS AND DISCUSSION

The average amount of employees employed by participating SMMEs was that of 3 with a minimum of 1 employee and a maximum of 10 employees. Furthermore participating SMMEs were also in existence, on average, for 9 years.

The authors are of the opinion that the main reason for the extensive business survival of the current researched case, when compared to other SMMEs as per the literature review conducted, is that these businesses operated on a weekly basis (every Wednesday) by setting-up

Table 2. Importance of internal financial controls.

Level of Importance	Importance (%)
Very little	3.33
Little	10.00
Quite	20.00
A lot	66.67
TOTAL	**100**

Table 3. Trustworthiness of internal financial controls.

Level of trust	Trustworthiness (%)
Rarely trustworthy	7
Trustworthy at times	13
Often trustworthy	27
Trustworthy most of the time	53
TOTAL	**100**

'informal stalls' on the Parade Grounds of the City of Cape Town for a limited time from early morning to late afternoon. Due to the high traffic (pedestrians and tourists) which visit the Parade Grounds on Wednesdays, these businesses have done fairly well in terms of surviving.

From the sample selected, the following percentage of respondents operated in the following industries:

1 Consumer goods: 20%.
2 Consumer service: 7%.
3 Food and beverage 10%.
4 Manufacturing: 3%.
5 Arts and crafts 40%
6 Clothing 20%

The main reason for the diverse response to the respective industry from respondents alluded to the fact that respondents were all operating informal business (as stated earlier).

Moreover, from the analysed data, it was evident that 50% of owners and/or managers perceived their businesses to have an 'average' level of success. In the same data-set, a mere 27% of owners and/or managers perceived their businesses to be quite successful while a total of 23% perceived their businesses to be very successful. The analogy can be drawn that most of the informal small businesses had a positive outlook on the future in terms of their business success.

When respondents were asked how valuable their current internal financial controls were, the following dispensation emerged in Table 2.

Respondents were also asked how trustworthy their internal financial controls were. It was found that 6.67% of owners and/ or managers perceived their internal financial controls as 'rarely trustworthy' while 53% of respondents believed that the trustworthiness of their internal financial controls were 'almost always trustworthy'. The remaining 13 and 27% of respondents respectively believed that their internal financial controls are 'sometimes trustworthy' and 'often trustworthy', respectively. The latter is collaborated below in Table 3.

To shed light on the above, respondents were asked to evaluate their current internal financial controls. In essence, internal financial controls should prevent, detect and correct any form of internal financial risks. From the findings the following dispensation emerged in Table 4.

In Table 4, respondents also indicated that, on average, internal controls are 83% necessary to achieve business objectives and 84% necessary to achieve business efficiency.

Also, 47% of respondents perceived internal financial controls to be useful, while 27% agreed that internal financial controls are quite useful. A total of 23% of respondents had an average perception of the usefulness of financial controls, while 3% of respondents believed that internal financial controls were of little and/or no use to their respective business.

When respondents were asked to indicate which internal financial controls they make use of, the following was evident (Table 5).

From Table 5, the analogy can be drawn that internal financial controls, according to the respondents, mostly serve the purpose of safeguarding assets (70% of the time), stock control (63% of the time), cash management (60% of the time), authorising payments (56% of the time) and to draft accurate financial statements (42% of the time).

RECOMMENDATIONS

Based on the above results it is fair to say that informal businesses do not utilise internal financial controls as effectively as they possibly can. Moreover, the authors are lead to believe that these entities also do not have adequate financial controls in place. It is clear that informal businesses do not regard internal controls as a major part of their business practices to attain overall business success (and business survival) but the limited utilisation thereof could impact on the succession, growth development and control over the overall business operations.

The authors are in recommendation that informal business should consider utilising internal financial controls more effectively to improve the effectiveness and efficiency of their business operations. By making use of internal financial controls it would help informal businesses have a better chance of accessing funding from financial institutions.

Furthermore owners and/or managers should look at areas that are high risk in their business or areas that

Table 4. Evaluation of current internal financial controls.

Evaluation yardstick	Preventive (%)	Detective (%)	Corrective (%)
Rarely	3	6	7
At times	20	17	20
Often	33	47	43
Most of the time	44	30	30
TOTAL	**100**	**100**	**100**

Table 5. Utilisation of internal financial controls

Type of control	Utilisation (%)
Safeguarding of assets	70
Regular stocktaking	63
Regular depositing of cash	60
Authorising of payments	56
Draft income statements	50
Budgets	43
Access level restrictions	43
Regular reconciliations	30
Draft balance sheets	30
Draft cash flow statements	23
Debtor age analyses	20
Creditor age analysis	20
Stock sheets	20
Pre-numbered receipts	17
Fixed asset registers	13
Budget variances	10

they think are of a concern and implement financial controls in these areas of the business. The management of informal businesses should also consider implementing financial controls in instances where they are non-existent. Informal businesses that have internal financial controls in place should use performance measures to monitor and evaluate the adequacy thereof.

Management and owners should establish business objectives and goals to achieve their entrepreneurial visions. Management and owners should implement performance measures to monitor and review the strength of financial internal controls within the business. Management and owners should be made aware of what internal financial controls are and how it would be effective to the business and how it can achieve reasonable assurance that the objectives of the business are met. Also, management of these entities should develop and gain the necessary skills, support and knowledge to implement adequate internal financial controls and performance measures. In gaining this knowledge and skills managers and owners should complete financial control courses that are available. The utilisation of unlimited internal financial controls could also improve the succession, development and growth of SMMEs in the informal sector.

Conclusion

Based on the findings the authors conclude that informal SMMEs existing for 3 years year or more within the Cape Town CBD have an average level of succession. During the research it was noted that business owners and/or management agreed that internal financial controls could add value to their business as it was perceived by them as:

1. Useful and effective towards business progress.
2. A preventive measures for fraud, losses and theft from occurring.

Respondents also believed that by having an established and strong internal control system in place, it would assist management in achieving their business' objectives and improve the efficiency of business operations. Albeit the above it is evident that informal businesses do not have adequate internal financial controls in place, as management lack the necessary knowledge and skills to implement internal financial controls and monitor the effectiveness of internal financial controls (those that do have the latter controls implemented in their businesses already). This could be one of the attributes as to the high failure rates of succession of SMMEs in South Africa. In conclusion by utilising internal financial controls any business would function in an effective and efficient manner and should be able to achieve reasonable assurance that the objectives of the business will be met.

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