

Full Length Research Paper

Usefulness of business plans to small, micro and medium enterprises in East London, South Africa

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This study investigated the usefulness of business plans to small, micro and medium enterprises (SMMEs) in the Eastern Cape Province of South Africa. The objective of the study was to determine the usefulness of a business plan. A questionnaire was used to gather data from respondents. Simple random sampling technique was used. Data was also collected through interviewing representatives from financial banks. Data was analysed using descriptive statistics. Findings of this research showed that a business plan is important for all SMMEs. Recommendations are provided for SMMEs, banks, the government and government agencies.

Key words: Small, medium and micro enterprises (SMMEs), business plan, finance, bank, usefulness.

INTRODUCTION

The small, medium and micro enterprises (SMMEs) sector is globally regarded as the driving force in economic growth and job creation. These businesses play a major role in creating jobs and wealth in any economy. Central to the growth of an economy is the development of a vibrant SMME sector which is the key to resolving many societal challenges, including unemployment (Entrepreneur SA, 2005).

SMMEs form the backbone of South Africa's economy, not just in terms of their contribution to national Gross Domestic Product, but especially in terms of employment. According to 2009 estimates, a staggering 74% of South Africans active in the economy are employed by SMMEs (The Business Place, 2009). SMMEs are often the first to be offering new products in the market and they are more flexible than large organizations (Boone and Kurtz, 2006). This therefore, means that SMMEs can meet and satisfy customers' or the population's needs better than bigger businesses that lack flexibility.

According to Visagie (1997), in most areas in South Africa, where active population is too small to justify large enterprises, the only source of economic activity is that provided by SMMEs. This justifies why this sector has received much attention from the government in recent

years.

Despite support provided by the government in South Africa, SMMEs still face challenges. The main problem faced by owners and operators of SMMEs, is the inaccessibility of bank finances. The lack or inaccessibility of bank finances is a serious constraint during the formation of new ventures as well as at later stages as business requires additional inflows of capital to support expansion and growth (Nieuwenhuizen and Groenewald, 2004). Among the main causes of inaccessibility of finance is the unavailability or poor presentation of business plans by SMMEs. Below is the problem statement of the study.

PROBLEM STATEMENT

In South Africa, a disappointingly high number of SMMEs fail during the first few years of operation (Nieman and Nieuwenhuizen, 2009). Inaccessibility of bank finance is one of the major challenges that South African SMMEs face among others. In addition to this, most owners and operators of SMMEs do not make use of business plans, and therefore, lack direction causing most of them to fail.

According to Nieman and Nieuwenhuizen (2009), the largest percentage of SMMEs fails during the first two years of their existence due to cash flow problems that arise because they could not manage growth. Cash flow problems can occur as a result of lack of planning on how resources will be used. Unemployment in the Eastern Cape Province and South Africa at large is a challenge to the nation and SMMEs play a major role in curbing this problem. SMMEs need to be supported and they also need to be able to access resources they need to survive and grow. Most SMME owners and managers are unable to prepare business plans or even use them effectively. Unavailability of business plans or poor presentation is one of the common and main reasons for failure and inaccessibility of funds by SMMEs. Now that the problem statement has been formulated, the objectives of the study can be identified.

OBJECTIVE OF THE STUDY

Primary objective

The primary objective of the study is to investigate the usefulness of business plans to SMMEs in the Buffalo City Municipality, South Africa. The purpose of this study stems from the fact that SMMEs play an important role in the South African economy in terms of employment creation, sustainable output growth, the equitable distribution of income and the overall stimulation of the economy. The fact that SMMEs with or without business plans find it difficult to access bank finance raise a question on the importance of business plans.

Secondary objectives

- 1) To determine the importance of a business plan when applying for finance
- 2) Identify the uses and limitations of a business plan.
- 3) Investigate the perceptions of SMME owners and managers on the importance of business plans.

To find out the reasons why SMMEs in the Buffalo City Municipality find it difficult to access finance.

LITERATURE REVIEW

Defining a business plan

Business plan is a written document that spells out where the business is heading and explains in detail how it is going to reach that destination (Nieman and Nieuwenhuizen, 2009). According to Nieman and Nieuwenhuizen (2009), the business plan is a written

presentation that carefully explains the business, its management team, its products or services and its goals, together with strategies for reaching the goals. According to Bangs (2005) as cited in Van Aardt et al. (2008), a business plan will include a description of the business concept, the products or services of the business, the possible market, the operational and financial plans, a description of the of the management team, and a schedule for the implementation of the plan. According to Pretorius and Shaw (2004), throughout the business and academic world, a successful business plan is perceived as the most essential document to be prepared by the entrepreneur or small business venture owner when setting up a business.

Uses of a business plan

According to Van Aardt et al. (2008), before SMMEs (or prospective entrepreneurs) start a business it is vital that they should plan and such a plan should take the form of a business plan. Business plans are used for various purposes such as to determine the chances of business success, to raise capital, and as a schedule for business start up and growth (Van Aardt et al., 2008). Van Aardt et al. (2008) clearly states that financial institutions would generally not even consider providing financing for SMMEs (or would be entrepreneurs) who do not have a well reasoned business plan. An entrepreneur (SMME) without a business plan is comparable to an aeroplane without a flight plan, and that is lacking direction. No institution will be willing to fund a business that does not have a sound business plan. A business plan is not only important at start up or when sourcing funds. Even after the business has been started, the business plan plays an important role as a managerial tool (Van Aardt et al., 2008). According to Nieman and Nieuwenhuizen (2009), the reasons for compiling a business plan include to obtain funding, to serve an internal purpose and to be used as a tool for reducing risk.

Business plans and access to finance

In South Africa, lack of financial support is the second most reported contributor to start up failure after education and training (Oford et al., 2003). Pretorius and Shaw (2004) conclude that banks finance business ventures with poor potential for success if the applicant is credit worthy or has necessary security rather than assist those with good plans and ventures with potential, but lacking sufficient security. According to Fatoki and Odeyemi (2010), SMME owners are encouraged to prepare a business plan for presentation to banks, financial institutions and venture capitalists to stand a chance of obtaining financial support. New SMMEs that

are able to produce a business plan are significantly more likely to be successful in their credit applications (Fatoki and Odeyemi, 2010). According to Kitindi et al. (2007) as cited in Fatoki and Odeyemi (2010) trade creditors use business plans to evaluate the ability of SMMEs to meet repayment of credit obligations. Fatoki and Odeyemi (2010) results are consistent with the findings of Pretorius and Shaw (2004) which find that the availability of a business plan positively impacts the availability of debt.

Limitations of business plans

Bangs (2005) in Van Aardt et al. (2008) shows that there are certain things a business plan cannot do, and these include:

- 1) They cannot predict the future: A business plan can contain a best guess of what the future could possibly be like but they cannot predict the future.
- 2) They cannot guarantee funding: Although SMMEs may be convinced that they have a winning concept or idea, banks will not necessarily agree.
- 3) They cannot raise all the money required: Cost and sales estimates in business plans are often incorrect. Entrepreneurs often overestimate sales and underestimate costs, leading to a situation where there is a shortfall of cash required to run the business smoothly.
- 4) They cannot fool all the people all the time: As banks and other financiers see hundreds of business plans a year, they are able to spot fallacies and confidence tricks in business plans.

According to Van Aardt et al. (2008), business plans also have some important negative effects of which we need to take cognisance. Timmons (1994) in Van Aardt et al. (2008) indicate that the following problems are associated with business plans:

- 1) Business plans rapidly become dated of changing market conditions, new technologies and product innovations.
- 2) Rigidly sticking to a business plan may result in inflexibility in starting and managing a business.
- 3) Formulating a good business plan necessitates the use of various resources which may not be readily available or may be in short supply.

Different banks or financial institutions have different specifications when it comes to preparing business plan. It is not the aim of this paper to give a single and best outline of a business plan. A general outline of a business plan adopted from Nieman and Nieuwenhuizen (2009) that can be used as a preliminary planning guide is given in the Table 1.

RESEARCH QUESTIONS

- 1) Is a business plan useful to SMMEs?
- 2) Is a business plan a pre-requisite when applying for finance?
- 3) What are the uses of a business plan?
- 4) Does a business plan have any limitations?
- 5) What are the causes of inaccessibility to finance by SMMEs in the Buffalo City Municipality?

RESEARCH METHODOLOGY

Both primary data and secondary data were used to conduct this research. The research was conducted by the researcher moving from one business to another, distributing self administered questionnaires. The questionnaire was pre-tested before it was used to collect data. Data was collected from SMMEs in the Buffalo City Municipality, specifically East London in South Africa. The researcher used simple random sampling to collect data from SMMEs in East London, a probability sampling technique in which each element has a known and equal chance of selection. This method helps also to eliminate bias in selecting sample elements. According to Cooper and Schindler (2006), is the purest form of probability sampling. Executive interviews were also conducted with representatives from the four major banks, namely, First National Bank (FNB), ABSA, Standard Bank South Africa and Nedbank. Interviews were also conducted with representatives from Khula Enterprise Finance and Small Enterprise Development Agency.

Validity refers to whether an instrument actually measures what it is supposed to measure given the context in which it is applied. Babbie and Monton (2002) identify four major types of validity which are face validity, criterion related validity, content validity and construct validity. The researcher used the following steps to ensure the validity of the study as pointed out by Cooper and Schindler (2003); using a statistician and a panel of experts to evaluate the research instrument for conceptual clarity, pre-testing the research instrument in a pilot study, using self-administered questionnaires which generally have a high response rate and comprehensively reviewing the literature for theoretical constructs and empirical conclusions. Babbie and Monton (2002) point out that reliability is concerned with consistency of measures. Content analysis was used to analyse qualitative data.

The packages which were used to analyse data include the statistical analysis system (SAS) V8 for descriptive analysis. Statistica and SPSS are some of the packages that were used. The chi-square test for independence, was used to test for association, cross tabulation was also used to determine the distribution of respondents. According to Barreira (2004), chi-square allows for decisions about whether there is a relationship between two or more variables; if the null hypothesis is rejected, one can conclude that there is a statistically significant relationship between the variables.

RESULTS AND DISCUSSION

Population characteristics

A hundred and thirty two questionnaires were distributed and 109 of them were completed and returned. Of the respondents, 55% were owners and 45% were

Table 1. An outline of a business plan.

Cover sheet	- Include full name of business, full address, contact details and date of plan
Table of contents	- Lists main headings including graphs, charts and tables
Executive summary	- This highlights important aspects of the plan
Products or/and service plan	- Explain the business, the products and the industry
Marketing plan	- Outline the 4 Ps (Product, Price, Promotion and Place). - Competitive advantage - Customers, market size, competition and market evaluation
Operations plan	- Focus on facilities, manufacturing, capability and equipment - The time taken to bring the business up to full speed
Management plan	- The management team - List all directors, consultants, advisors and key professionals who will be involved in the business. - Attach detailed CVs as appendices
Financial plan	- Start up capital - Projected income - Projected balance sheet, cash flow statement and other financial statements
Appendices	- Attach all pieces of evidence, such as CVs, product brochures, testimonials and news articles.

Adapted from Nieman and Nieuwenhuizen, 2009.

managers. Sixty-two percent of respondents were male and 38% were female. Fifty one percent of respondents were owners or managers of small enterprises, 9% for medium enterprises and 40% owned or managed micro enterprises. Only 20% of these SMMEs managed to register in a period of less than one year of operation. It took one to two (1 - 2) years for 45% of them to register and more than two years for the remaining 35% to formally register their businesses. Only 28% of these SMMEs had business plans. Seventy nine out of 109 (73%) SMMEs once applied for bank finance but only 8 (10%) managed to access it. Thirty (30) out of 109 SMMEs (28%) never applied for bank finance.

Reasons for not applying for bank finance

SMMEs (28%) that never applied for bank finances gave four main reasons. The majority, 53% said they did not know the procedures. Another 23% said they lacked knowledge on the sources of finance available at banks. Only 7% said high interest charged by banks discouraged them from borrowing. The remaining 17% had enough capital to start and run their businesses.

Reasons why small, medium and micro enterprises (SMMEs) applications for finance were unsuccessful at banks

Twenty five percent (25%) of SMMEs that failed to access bank finance said they never got any response from banks clarifying why they could not offer them the much needed loans. Lack of financial deposit affected 17% of SMMEs that failed to access funds. It is lack of collateral security which proved to be the greatest obstacle in accessing finance by SMMEs, contributing 37%. Only 7% failed to access bank finance only because they had poor and the fact that there are no loans for foreigners since Khula does not guarantee loans given to non-South African citizens. The issue of business plan also affected even those who lacked collateral and financial deposit making it a very significant factor in accessing funds.

Answering research questions

The research questions were answered individually and the results are presented as follows.

Question 1: Is a business plan useful to SMMEs?

All SMMEs highlighted that there was a time that they were asked to produce a business plan. Most (52%) of them said they were asked to present it when they wanted finance. Others (48%) mentioned different reasons which include when they were considering selling the business, when they wanted to attract investors and also when registering the business. This shows that a business plan is very useful to any business. Although there are identified weaknesses of a business plan as a living document, the strengths outweighs the weaknesses. According to Van Aardt et al. (2008), a business plan remains useful since the effective use of human and financial resources depends on a good business plan and its successful implementation. Nieman and Nieuwenhuizen (2009) stress the need for a business plan to obtain funding, to serve an internal purpose and also to reduce risk.

Question 2: Is a business plan a pre-requisite when applying for finance?

All SMMEs (10% of the sample but 29% of those with business plans) that managed to access finance had business plans. This means without a business plan financial institutions will not grant SMMEs credit. This was confirmed by representatives of all banks and also of those of organisations that support SMMEs. To obtain bank finance, SMMEs will need to present a business plan which may need to be accompanied by collateral security and also a financial deposit. This is supported by Pretorius and Shaw (2004) who found that all banks require a business plan to accompany applications. When evaluating a business plan, the investor or banking institution will always consider risk as a prime factor, together with management skills and expertise relating to the type of business or venture before committing any funds (Shaw, 2002)

Question 3: What are the uses of a business plan?

Although SMMEs seem only to use business plans to source finance, a business plan is very important even if bank loans are not needed. In our sample, 28% (30 out of 109) that needed loans were the only businesses that confirmed that they were having business plans. It is a cause of concern that most (64% or 18 out of 28) of these businesses that had business plans were not using them at all and some had only submitted them at banks and could not even remember what was in that document. About 36% who were able to use their business plans mentioned that they were using them for control purposes and also to measure performance and growth.

Question 4: What are the perceptions of SMMEs on the importance of a business plan?

SMMEs that participated in the study indicated that banks are not just willing to offer loans to everyone. Some pointed out that bank officials may be using them to come up with ideas that they will steal. SMMEs also showed that they now think that banks always find a problem in a business plan if they do not want to fund it. Some said it is just a necessary evil when you need a loan but in actual fact you use a lot of resources and time to compile it.

Question 5: What are the causes of inaccessibility to finance by SMMEs in the Buffalo City Municipality?

Although business plans are a pre-requisite when applying for finance, they have not been identified as the only cause of inaccessibility to finance. Lack of collateral security, lack of financial deposit and poor business idea (viability) are some of the reasons that were mentioned together with poor presentation and unavailability of business plans by all banks.

MANAGERIAL IMPLICATIONS AND RECOMMENDATIONS

The following are key findings of this research:

- 1) Not all SMMEs in the Buffalo City municipality know the importance of business plans. Some do not even know how these documents are prepared, while others use experts to prepare them only when they need to apply for finance and will never refer to them.
- 2) SMMEs in Buffalo City Municipality find it difficult to access bank finance. Unavailability or poor presentation of business plans is one of the causes of failure to access finance.
- 3) Not all SMME operators trust bank officials with their business ideas contained in business plans. Some SMMEs fear that bank officials can implement their innovative ideas before them. This is mainly because many of these SMMEs cannot make use of intellectual property rights.
- 4) A business plan is useful to all SMMEs. A business plan is not only important when applying for finance. It is a very important document that businesses need to constantly refer to.
- 5) Not all SMMEs are aware of independent organisations and government agencies that can assist them with the proper preparation of business plans.
- 6) Based on the findings of this study, the following

recommendations are suggested.

Small, medium and micro enterprises (SMMEs)

SMMEs need to learn to write business plans for themselves not to only rely on experts or consultants. For a business plan to contain all details and facts, it needs to be prepared by the owners of the business, those who came up with the idea, not the consultants. In cases where owners are illiterate and cannot prepare this important document for themselves, they must at least be there when the document is prepared. SMMEs should also use their business plans effectively to monitor performance and growth of their ventures. This will help them attain success in business. SMMEs need to consider protecting their intellectual property legally. Intellectual property refers to all creations or products of the human mind that can be used for commercial gain (Nieman and Nieuwenhuizen, 2009). There are different ways of protecting property rights and these include copyrights, designs, patents and trademarks.

The government

There is need for the government to monitor activities of banks in as much as access to finance is concerned. Not all SMMEs are able to take advantage of intellectual property rights. The government should at least find a cost effective way to protect the ideas of SMMEs submitted to financial institutions or banks in business plans. The government should also improve the support they give to SMMEs.

Banks

Most SMMEs prepare business plans to present to the banks with hope to access bank finance. It is unfortunate that not all business plans will be considered successful. Banks should give timely responses to SMMEs that will have been unsuccessful in accessing finance. About 25% of SMMEs that applied for bank finance complained that they never got any response from the banks. It is understood that banks have different specifications and expectations in SMMEs' business plans. It is recommended that banks make these specifications and expectations known to SMMEs when applying for finance and also during the preparation of business plans. Banks or bank officials need to hold their clients' (SMMEs) ideas professionally and uphold ethical behaviour. They should ensure and guarantee SMMEs that their business plans will be used only for the purpose they were brought to the banks and nothing else. Banks need to be trustworthy when it comes to business ideas of SMMEs who in most cases lack intellectual property rights.

Small enterprise development agency (SEDA) and Khula enterprise finance

SEDA and Khula Enterprise Finance may be doing a great job in supporting SMMEs but most SMMEs do not know the role of these organisations, the support they can get or even where to find them. These government agencies need to be visible on the ground.

Limitations of the study

The study was limited to SMMEs in the Buffalo City Municipality. The study concentrated only on one municipality in the Eastern Cape Province of South Africa. Because of the limitations pointed out, care should be exercised in the interpretation and application of the results of this study and the generalisation of the findings to the whole province or country.

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