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# SMME attitudes towards financial bootstrapping: A perspective from a developing economy

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## Abstract:

The national and international literature and research on SMMEs has been developed very strongly in the last decade. There have been many successful attempts on the part of many researchers and scholars to unpack new and innovative dimensions of SMMEs' operations, behaviour, attitudes, functions and other dynamics that boost, sustain or impede their growth and development. There is, however, a gap in research, regarding a very distinct practice within SMMEs in developing economies, that of bootstrapping. This study, therefore, used a sample chosen on a non-probability basis using convenience sampling of small business owners within the eThekweni Municipality, KwaZulu-Natal, South Africa. 83 participants completed the questionnaire. The study found that the practice of financial bootstrapping was very high amongst the investigated SMMEs. The use of financial bootstrapping within SMMEs is coincidental. The majority of the respondents indicated that they did not undergo any formal training on the use of financial bootstrapping methods.

**JEL Classifications:** G10, G11, G32, L26

**Keywords:** Developing economy, financial bootstrapping, SMMEs

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## 1. Introduction

In recent years, policy makers, commentators and researchers have become more interested in the importance of small businesses. It has been widely recognized that start-ups and more established small businesses play an important role in economic growth and job creation (Kruger, Chantal, & Saunders, 2015; Phillips, Moos, & Nieman, 2014). In order to improve the economic conditions and poverty issues in developing economies, small businesses can play a vital role because Small, Medium and Micro Enterprises (SMMEs) are generally regarded as the driving force of economic growth and poverty reduction (Okpara, 2011; Amra, Hlatshwayo, & McMillan, 2013; Cant, 2016). SMMEs have been described as the catalyst for economic growth that should be pursued by the South African government to address the scourge of unemployment and low gross domestic product (GDP) growth. While the contributions of small businesses to society development are generally acknowledged, entrepreneurs are faced with many social and economic hurdles that limit their growth and survival (Kruger et al., 2015). In this context the lack of access to capital, resources facing small businesses seems to be an ever-recurring theme (Bruwer & Van Den Berg, 2017). Given the constraints that small businesses face in acquiring financial capital, there is a need to investigate alternative

means of sourcing finance other than the traditional outside funding such as venture and angel capital (Phillips et al., 2014).

## **2. Problem statement**

Despite government's efforts to support and finance SMMEs in developing economies, the failure rate of these businesses is still high (Cant & Wüid, 2013). Within the South African context, SMMEs have ample support from the state through various initiatives, however, up to 75% of these businesses fail within their three years of operation (Bruwer & Van Den Berg, 2017). In spite of the arguments made by the afore-mentioned authors, several studies insist that the major constraint inhibiting SMMEs success is the access to the institutions in the economy that are established to provide funding (Lekhanya, 2015; Kruger et al., 2015; Worku, 2016). Even though it is important to investigate alternative funding mechanisms for SMMEs, of equally importance, is the investigation of their attitudes towards alternative means of sourcing finance other than the traditional funding methods.

## **3. Aim and objectives**

The main aim of this study is to investigate the SMMEs attitudes towards the use of financial bootstrapping as a funding model in the developing economy.

In order to address the aim of this study, the following objectives have been formulated:

- To investigate the awareness and the extent of the use of financial bootstrapping as a means of financing by SMMEs in the developing economy.
- To identify factors that affect the use of financial bootstrapping methods by SMMEs in the developing economy.

## **4. Literature review**

### **4.1. Financial bootstrapping defined**

This phenomenon is defined by (Tomory, 2010) as highly creative ways of acquiring the use of resources without borrowing money or raising equity financing from traditional sources. According to Schofield (2015), financial bootstrapping allows small business owners to create new financial resources or stretch existing resources without using debt, a venture capitalist, or other external means to attain required capital. Van Auken & Neeley (2010) further refined the definition of bootstrap financing to include those sources of capital used after exhausting personal savings, but not personal capital or loans from banks. The definition of financial bootstrapping adopted for this study is "the use of highly creative ways for meeting the need for resources without relying on long-term external finance from debt holders and/or new owners" (Vanacker & Sels, 2009).

### **4.2. The use of financial bootstrapping by SMMEs**

Several studies have referred to the financial gap facing small businesses, in terms of problems in attracting long-term finance from market players such as banks, and venture capital companies (Fakoti, 2014; Lekhanya, 2015; Schofield, 2015). The underlying assumption in the research and the public debate is that financial problems generally restrain small businesses' development and growth (Tomory, 2010; Amra et al., 2013;

Worku, 2016). It is often assumed that small business owners try to raise large sums of money from banks and venture capital companies (Daniel, Di Domenico and Sharma, 2015). It has been stated that much research on small business finance has focused on constraints in the supply of institutional finance, whereas the handling of financial needs at the demand side (i.e. the small business manager's perspective) has been given much less attention (Afolabi, Odebunmi, & Ayo-Oyebiyi, 2014).

The concept of financial bootstrapping for small businesses originated from Bhide (1992) and it has received increased academic attention, particularly in developed economies (Winborg, 2015). According to Löfqvist (2017), SMMEs engage in bootstrapping approaches to manage scarce resources such as capital and to promote product innovation. Löfqvist (2017) adds that resource scarcity in SMMEs hinders these entities from being innovative. Companies without access to formal debt or equity markets can creatively access resources through different means. Innovative financing methods are vital to the survival of new micro enterprises in the retail sector (Fatoki, 2014). According to the resource dependence theory (RDP) by Pfeffer & Salancik (1978) as cited by Drees & Heugens (2013), resources are a cornerstone for an entity's operation and survival. Thus, resources can help a new firm to gain and sustain competitive advantage. Therefore, Entrepreneurs who have trouble in attaining funds or who find external funding undesirable will need to think creatively to meet funding goals (Schofield, 2015).

Problems in securing finance from traditional sources such as angels, venture capitalists and banks for meeting the need for resources may imply that small business owners or managers handle the need for resources using other means. Simply put small business owners and managers must acquire resources without a financial transaction. Outside funders or financiers are generally skeptical of the success potential of small businesses due to information asymmetries, which in turn results in high costs in terms of interest rates, ownership, and control (Winborg, 2015). To manage their capital constraints and to preserve ownership and control of their businesses, small business owners devise methods to acquire essential resources that minimize the amount of outside debt and equity financing needed from banks, angels and venture capitalist (Fatoki, 2014). Afolabi et al. (2014) assert that businesses with higher leverage, lower liquidity, and lower profitability are more likely to bootstrap. However, the general consensus in SMME research, within the developing economy context, is that a very limited number of these organisations use financial bootstrapping (Fatoki, 2014; Afolabi et al., 2014; Schofield, 2015; Zwane & Nyide, 2016).

#### **4.3. Factors affecting the use of financial bootstrapping methods by SMMEs**

According to Grichnik, Brinckmann, Singh, & Manigart (2013), entrepreneurs with greater levels of human capital in different areas are likely to employ more bootstrapping activities. Entrepreneurs with managerial experience and those who have pursued higher levels of academic education or specific business training engage in bootstrapping to a greater extent (Grichnik et al., 2013). This shows that both specific direct experiences and education can affect bootstrapping. Winborg (2015) contends that the change in SMME life-cycle has a direct impact on the use of financial bootstrapping. The argument is that, at an infant stage, SMMEs struggle to negotiate for external funding. As such, financial bootstrapping becomes an innovative and a low cost approach that these entities can use to establish themselves. Surviving beyond the infancy stage, SMMEs are then able to acquire external funding using the traditional methods (Jonsson & Lindbergh, 2013; Schofield, 2015).

Another contributing factor affecting the use of financial bootstrapping is the lack of awareness by SMMEs. The majority of small business owners are not aware of financial bootstrapping and its use (Zwane & Nyide, 2016). This argument is in line with Munyanyi (2015) who contends that more needs to be done while awareness of the strategies for

financial bootstrapping is evident in literature. It is, therefore, recommended that government ministries, quasi-government institutions aligned to the development of small and medium enterprises, and non-governmental organizations mandated to rural development should intensify the awareness of these and other financial bootstrapping strategies as a way of promoting entrepreneurial activity. Cant, Erdis, & Sephapo (2014) assert that awareness regarding the financial bootstrapping resources, available to those who wish to establish their own entities, should be increased. Schofield (2015) adds that entrepreneurs can begin to mitigate the challenges associated with owning a small business through an increased awareness of alternative financing methods.

## 5. Research methodology

The focus of this research was SMMEs operating within the eThekweni municipality, in KwaZulu-Natal, the province in South Africa. The SMME definition used for the purposes of this study is "an enterprise which has 50 or fewer employees and/or annual turnover of between R200 000 and R32 million" (Timm, 2011). The target population consisted of all SMMEs registered with the eThekweni Municipality's SMME Database. The sample size of 83 subjects was chosen in non-probability snowball sampling from the population. The study then employed an electronic questionnaire as a research instrument. Closed-ended questions were developed from literature review as source of information for the questionnaire. The questionnaires were administered on the web through QuestionPro. To ensure reliability, the questionnaire was evaluated based on the Cronbach's Coefficient Alpha as this measure has the most utility for rating scales (Bonett & Wright, 2015). The Cronbach's Coefficient Alpha for the rating scales used in the questionnaire was 0.791 which is shown in Table 1. A coefficient of 0.791 indicates that internal consistencies of the scale items have been satisfied and that the questionnaire was reliable. The data can, therefore, be used confidently for further analysis and interpretation.

TABLE 1. THE CRONBACH'S COEFFICIENT ALPHA

Cronbach's Alpha	Cronbach's Alpha based on standardized items	Number of items
0.791	0.721	8

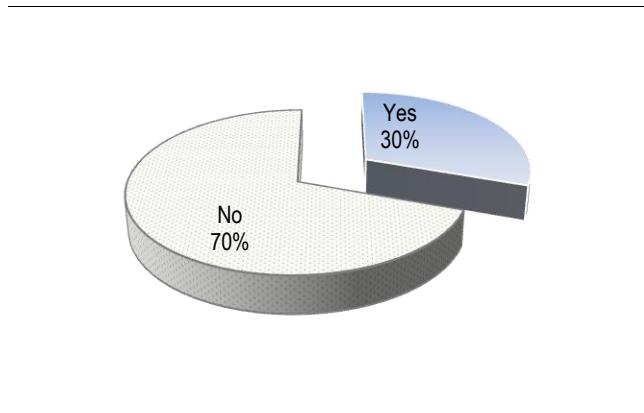
TABLE 2. SUMMARY OF KEY QUESTIONS

RESEARCH OBJECTIVE	QUESTION
To investigate the awareness and the extent of the use of financial bootstrapping as a means of financing by SMMEs in the developing economy.	<ol style="list-style-type: none"> <li>1. Do you know what financial bootstrapping is?</li> <li>2. How long have you been in business?</li> <li>3. What is the relationship between the business's number of years in existence and the financing method?</li> </ol>
To identify factors that affect the use of financial bootstrapping methods by SMMEs in the developing economy.	<ol style="list-style-type: none"> <li>4. Which of the bootstrapping methods work well for your business?</li> <li>5. Did you go under any training on how to use financial bootstrapping methods?</li> </ol>

## 6. Research findings

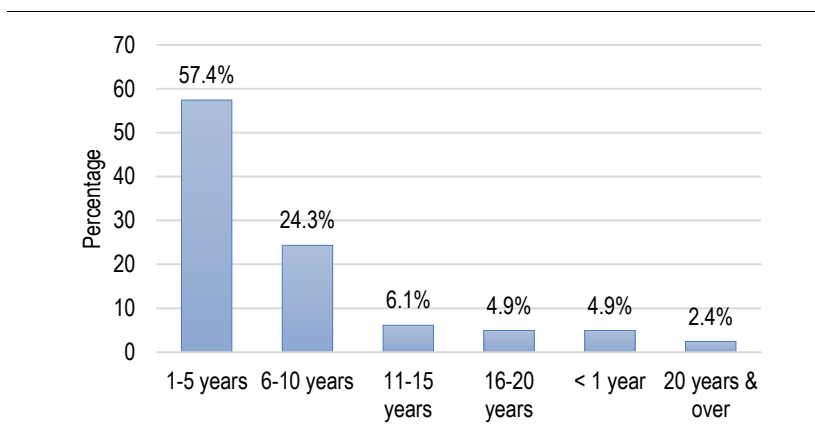
To investigate the respondents' awareness of financial bootstrapping as a means of financing small businesses, respondents were asked if they were aware about the financial bootstrapping.

FIGURE 1. AWARENESS OF FINANCIAL BOOTSTRAPPING



As illustrated in Figure 1, the majority of respondents did not know what financial bootstrapping was (70%) compared with those who indicated that they knew what it was (30%). This finding is supported by other research (Afolabi et al., 2015; Fatoki, 2014). Worku (2016) concurs by adding that one of the key obstacles to the growth and development of SMMEs operating in developing economies is the lack of awareness about support programmes such as financial bootstrapping.

FIGURE 2. EXPERIENCE IN BUSINESS



Respondents were asked about how long they have been in business. As it is illustrated in Figure 2, about 57% of the respondents indicated that they were in business for a period from one year to five years. These businesses are considered to be start-up SMMEs and have limited experience (Grichnik et al., 2014). About 5% of the informants responded that they have been in business for less than one year. The respondents that fall within the experienced cohort that is in range 6-10 years amounted to 24%, with 11-15 years of experience - 6.1%, with 16-20 years of experience - about 5%, and the ones that are 20 years and more in business made only a mere 2.4%. The majority of the studied SMMEs have been in business for less than five years. This implies that their experience with financial bootstrapping practices is very limited.

TABLE 3. RELATIONSHIP BETWEEN SMME EXPERIENCE AND THE FUNDING METHOD

Years in business	Bank loan	Business partners	Angel finance	Venture capital	Government funded business agencies	Bootstrapping method(s)	Total
<1year	1.1%	0%	1.1%	1.1%	0%	1.1%	4.4%
1-5 years	7.8%	8.9%	1.1%	1.1%	1.1%	36.7%	56.7%
6-10 years	6.7%	6.7%	0%	3.3%	2.2%	8.9%	27.8%
11-15 years	0%	1.1%	0%	0%	1.1%	3.4%	5.6%
16-20 years	2.2%	0%	0%	0%	0%	1.1%	3.3%
> 20 years	0%	0%	0%	0%	0%	2.2%	2.2%
Total	17.8%	16.7%	2.2%	5.5%	4.4%	53.4%	100%

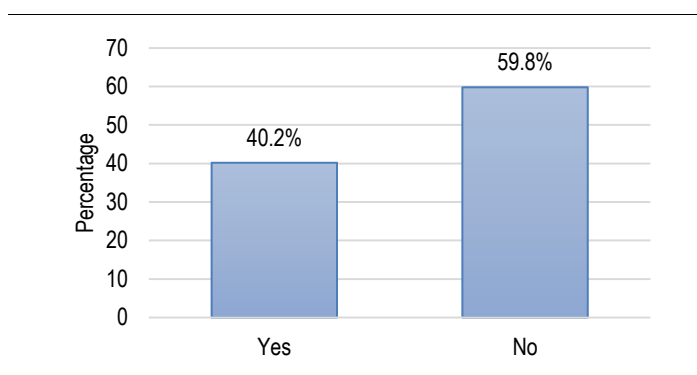
Table 3 depicts the age of the business and the sources of finance used by these businesses. Of all the methods of financing used by these businesses, 53.4% is attributed to the financial bootstrapping methods of finance. The balance being linked to the traditional financing methods such as bank loans, business partners, angel financing, venture capital, and government funded business agencies. The vast majority of the businesses, which were in existence for a period that did not exceed 5 years, did not receive any support from external financiers to fund their start-ups. Responses indicated that only 1.1% of businesses that existed for less than a year and 7.8% of those which existed more than a year but less than 5 years had received a loan from a bank to fund their start-up phase. Of particular interest was the fact that none of the businesses that were in existence for a period of less than a year had received any financial support from government-funded supporting agencies; and only 1.1% of respondents in business between 1 year and five years had received financial support from government-funded agencies.

TABLE 4. THE MOST USED FINANCIAL BOOTSTRAPPING METHOD

Years in business	Personal credit card	Withhold own salary	Withhold profit earned	Loans from friends/ family members	Employ relatives and friends at below-market rates	Run business completely from home	Total
<1year	1.1%	0.5%	0%	1.6%	0%	0%	3.2%
1-5 years	5.3%	12.8%	16.6%	6%	10.2%	15%	65.9%
6-10 years	4.3%	6%	4%	3.2%	1.6%	0.5%	19.6%
11-15 years	0.5%	0.5%	1.6%	1.1%	0.5%	0.5%	4.7%
16-20 years	1.6%	1.1%	1.1%	1.1%	0%	0.6%	5.5%
20 years and over	0%	0%	1.1%	0%	0%	0%	1.1%
Total	12.8%	20.9%	24.4%	13%	12.3%	16.6%	100%

Table 4 shows which of the selected financial bootstrapping methods were used by the respondents according to their years in business. The table shows that predominantly start-ups are funded by owner-related methods compared to outside funding. This finding is congruent with the literature (Jonsson & Lindbergh, 2013; Grichnik et al., 2014; Munyanyi, 2015). The respondents in the start-up phase indicated that they used personal credit cards (6.4%), withhold own salaries (13.3%), withhold profits earned from business (16.6%), loans from friends/family members (7.6%), employed relatives and friends at below market rates (10.2%) and run businesses completely from their homes (15%) to finance their businesses.

FIGURE 3. BOOTSTRAPPING TRAINING



Respondents were asked if there is a formal training they underwent on how to use financial bootstrapping. Figure 4 shows that the majority of respondents (59.8%) have not been trained on how to use financial bootstrapping methods. Only 40% responded that there is some sort of training done on how to use financial bootstrapping methods. (Zwane & Nyide, 2016) argue that most SMMEs use financial bootstrapping being unaware. Therefore, even if business owners have no formal training, they inevitably use bootstrapping methods. As it has been indicated in the previous section, accessing external funding is a challenge to SMMEs; hence financial bootstrapping approaches become their only option for survival.

### 6.1. Summary of key findings

The results obtained from the analysis of data have revealed several interesting findings. Some of the most important findings are that the majority of small business owners were not aware of financial bootstrapping; and only a few respondents knew what bootstrapping was. However, the study found that most of the respondents were financed by owner-related funds compared those small businesses that received any funding from government-funded agencies. Whilst many of the respondents did not know what financial bootstrapping was, all respondents were found to be practicing some level of bootstrapping. The use of financial bootstrapping was prevalent amongst SMMEs that are considered to be start-ups. The majority of SMMEs have not done any form of training on how to use financial bootstrapping methods.



## **7. Limitations**

Due to time and funding constraints, the data was collected from a small sample of small businesses within eThekweni Municipality with the hope of generalizing the results to all small businesses in South Africa. The findings of the study could not be generalized to all small businesses due to the sampling design and small sample size. Whilst the method of sampling used for this study was appropriate, non-probability purposive sampling is the least reliable in terms of generalization. There is limited literature of academic merit relating to financial bootstrapping in South Africa.

## **8. Implications**

It can be argued that the practice of financial bootstrapping in the developing economy is still limited. Even though this area of research has received academic interest in international literature, very little is available for academic and business consumption in developing economies. This paper contributes towards the establishment of the awareness of financial bootstrapping approaches by SMMEs in developing economies. Moreover, an attempt was made by this study to ascertain the extent at which financial bootstrapping is used by SMMEs in developing economies.

## **9. Recommendations**

Researchers and entrepreneurship authors should research and write more about alternative business financing sources, particularly financial bootstrapping, to educate business owners in general and new and/or interested entrepreneurs in particular with regard to these concepts.

Government-funded agencies must have better trained staff members who understand and have knowledge of all funding sources to better service the small business sector and thus encourage applicants to use internal methods for funding as they are both efficient and effective.

SMMEs need to be educated on the importance of various financial bootstrapping approaches including the sharing resources like premises, machinery and equipment. SMMEs need to be exposed to more financial bootstrapping methods such as employing relatives, friends and students at below market rates and obtaining loans from friends and/or relatives in order to save money to be invested in critical areas of the business.

In this study, the sampling frame used was limited as it basically included Black African respondents. A further study should include a considerable number of all social/racial groups.

Future studies should use probability sampling techniques so that the findings of such studies will be more reliable and may be used with greater accuracy in generalising the findings to the entire population of entrepreneurs.

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