Investigating Challenges Faced by Investment Firms in Financing Small Businesses

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ABSTRACT

Purpose: This study seeks to examine the impact of internal control, accountability, and transparency on the quality of financial statements.

Methodology: Data for this study was primarily collected through questionnaires distributed to respondents. The questionnaires covered aspects of internal control, accountability, transparency, and financial statement quality. The study focused on the Amil Zakat Institute of the Indonesian Zakat Initiative as the population, and a purposive sampling method was used to select 35 samples. The research methodology involved descriptive statistical analysis, testing of classical assumptions, and multiple linear regression with subsequent hypothesis testing.

Findings: The findings indicate that transparency has a positive and significant influence on the quality of financial statements. However, accountability and internal control factors do not demonstrate a significant impact on financial statement quality. Nevertheless, when considered together, the variables of internal control, accountability, and transparency do significantly affect the quality of financial statements.

Implications: Financial statements will be useful to users if the information presented in these financial reports is understandable, relevant, reliable and comparable.

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Introduction

Investment firms express their interest in investing in small businesses due to their crucial role as drivers of the economy and major employers in the country. However, some investment firms have faced difficulties in doing so, citing issues like a lack of collateral, formal registration, and
longstanding plans as obstacles. Consequently, it is essential to understand the difficulties faced by investment firms when financing small and medium enterprises in Gauteng, with a focus on a financial institution as a case study.

In South Africa, Small, Medium, and Micro Enterprises (SMMEs) make significant contributions, accounting for over sixty percent (60%) of the Gross Domestic Product (GDP) of the nation and employing more than fifty percent (50%) of the labor force (Cameron, 2021). Despite the potential, investment firms, as stated by Mhlanga (2020), encounter challenges while attempting to invest in small businesses through investment deals, leading some to withdraw from such ventures. Cameron (2021) also highlights another concern, where investment firms complains about the lack of clear strategic plans spanning over ten years among small businesses seeking funding, making it difficult to invest in them.

Within the Gauteng Region, a financial institution represents one an investment firm that is facing difficulties or challenges in financing small and medium enterprises. According to Lukhele and Soumonni (2021) small and medium enterprises or businesses are crucial drivers of the economy and should qualify for investment opportunities. However, Kumar (2021) points out the hurdles faced by investment firms, including a lack of registration, collateral, and long-term plans, which pose significant setbacks despite their desire to contribute to the growth of small businesses through investments. Nevertheless, these challenges remain largely unexamined, prompting the need for this research study to conduct an assessment on the obstacles that investment firms are facing in financing Small, Medium and Micro Enterprises (SMMEs) in the province of Gauteng and suggest some recommendations to improve small business financing.

In summary, the research study aims to evaluate the difficulties investment firms encounter when financing small enterprises in the Gauteng province, with a particular emphasis on a financial institution as a case study. Understanding and addressing these challenges can enhance the prospects for small businesses and promote their growth and development. This study addressed objectives specified as follows:

To identify requirements in financing small enterprises from a viewpoint of investment firms with specific reference to the financial institution.

To establish the difficulties investment firms face in financing small enterprises in the Gauteng province with specific reference to the financial institution.

To make recommendations to investment firms on measures for investing and financing SMMEs in Gauteng.

This study holds significant value for both investment firms and small businesses, offering numerous benefits to the parties involved. It contributes to the existing body of knowledge on difficulties faced by investment firms in funding small enterprises, providing valuable knowledge or literature for future academics in the field. For this financial institution under research, this study entirely assists in overcoming lending challenges, paving the way for the development of effective strategies. The study's recommendations also provide valuable insights to the organization's management on financing activities.

Moreover, from a theoretical standpoint, the study enriches the discussion surrounding small businesses in emerging economies, offering insights into potential remedies for the challenges they encounter. This research can serve as a valuable reference for academia, providing a reliable source for future investigations into the challenges of investment firms financing small businesses.

In summary, this study’s significance lies in its potential to enhance the interpretation of difficulties and challenges investment firms face by in financing small and medium enterprises, benefiting both the financial institution involved and the broader academic and business communities. The
next section illustrates the literature review of this study.

**Literature Review**

The various authorities were consulted for an all-inclusive understanding of the subjects under study.

**Investment Firms**

Sheen (2020) discusses how investment companies, as financial entities, specialize in investing in securities. Their primary focus is on acquiring and managing assets for investment purposes. In addition to asset management, these firms offer a diverse range of services to investors, including portfolio management, recordkeeping, custodial services, and assistance with legal, accounting, and tax matters. This comprehensive suite of services ensures that investors receive professional guidance and support throughout their investment journey.

Moreover, Han and Kim (2019) explore the performance of investment firms and underscore the importance of choosing the right investment company. Their study highlights the significance of evaluating factors such as investment strategies, risk management practices, and track record when selecting an investment firm. By carefully considering these aspects, investors can make informed decisions and maximize the potential returns on their investments.

Overall, investment firms play a crucial role in the financial sector, providing a variety of investment services to both individuals and institutions. Recent research sheds light on the nature and functions of these firms, emphasizing their significance in managing assets and offering diverse investment opportunities.

**Small Businesses**

Small businesses hold a critical position in the global economy, driving innovation, generating employment, and benefiting local communities. Recent scholars have emphasized their importance, shedding light on their definition, characteristics, and significance. According to Jones and Temple (2019), small businesses are independent enterprises with relatively few employees, usually ranging from under 20 to 500 employees, depending on the industry and country. These businesses often operate with limited financial resources, targeting local or niche markets, and are typically managed by entrepreneurs or family owners. Their agility, adaptability, and capacity to foster creativity and innovation are well-known traits.

Marlow et al. (2020) underscore the role of small businesses in driving economic growth and job creation, particularly in developing economies. They are crucial in offering employment opportunities and fostering entrepreneurship, allowing individuals to pursue their business ideas and contribute to economic development.

Furthermore, Ramalho et al. (2021) highlights the resilience of small businesses, particularly during times of economic uncertainty and crises. Their research indicates that small businesses often exhibit higher resilience compared to larger enterprises, attributed to their flexibility, close customer relationships, and local market focus, which ultimately contributes to the overall stability and sustainability of the economy.

In the context of South Africa, Small and Medium Enterprises (SMEs) or SMMEs are defined as organizations meeting specific criteria, including having less than two hundred (200) employees, an annual income less than sixty-four million rands (R64 million), and capital assets below ten million rands (R10 million), managed by owners directly (Kalidas et al., 2020). Additionally, small enterprises have varying maximum turnovers depending on the sector, ranging from one million rand (R1 million) in agricultural activities to thirty-two million rands (R32 million) in wholesale
trade, including catering, accommodation, manufacturing and other trade sectors, (World Bank, 2015).

**Investment Firms Requirements to Finance Small and Medium Enterprises**

To be eligible for business loans from investment financing firms, small enterprises are required to provide assets as collateral. Collateral refers to assets like property, equipment, real estate, or inventory that the lender can seize and sell if the debtor fails to repay the loan. Traditional loans typically demand adequate collateral as a security for the loan, along with a personal agreement to repay from each owner, director, or shareholder of the company (Ramsay & Renda-Tanali, 2018; Block et al., 2018).

Alternatively, small firms can use outstanding receivable invoices as a second option to secure a company loan when they lack tangible assets for collateral, which is common for many SMEs. This approach also helps in dodging high interest rates associated with company loans that are unsecured (Staškeviča, 2019; Leitch et al., 2019).

Furthermore, investment financing firms require a comprehensive business plan that outlines the purpose of the loan, demonstrates how the business projects cashflows and expects to enhance profitability. The detailed business plan should show clearly that the company will have sufficient cash inflow to cover existing business expenses and additional loan payments (Staškeviča, 2019; Lee and Shin, 2018).

**Challenges in Financing Small Enterprises**

Investment financing firms often face several challenges in financing the small businesses.

**Limited Operating History**

Banks tend to favor companies with a long and established track record, which poses a challenge for small and medium enterprises that have only been in operation for a few years. This could result in small firms being denied loans due to their lack of an established operational history (Zahorskyi et al., 2019; Eggers, 2020).

**Customer Concentrations**

Banks may view enterprises heavily reliant on a small number of clients for the majority of their revenue with caution. Small businesses relying primarily on regular customers for consistent income could face difficulties in obtaining loans from investment firms (Eggers, 2020).

**Insufficient Collateral**

Investment firms encounter challenges in offering loans to small firms due to the lack of sufficient collateral as security. Without collateral, there is no guarantee for the recovery of the loan if the firm defaults on payment (Zahorskyi et al., 2019; Cantele & Zardini, 2018).

**Influence of Monetary and Fiscal Policy**

Government fiscal and monetary policies and priorities influence banks' lending decisions. In inflationary times, restrictive monetary policies may be adopted, leading to higher interest rates, affecting the ability of commercial banks to lend to small enterprises and making borrowing challenging for SMMEs (Cantele & Zardini, 2018; Muriithi, 2017).

**High Inherent Risks**

The inherent risks associated with SMMEs serve as a factor limiting their access to funding or debt financing. Poor management, inadequate accounting practices, and the lack of separation in SMEs between interest of owners and the business pose significant risks to their survival (Ezeagba, 2017; Storey, 2017; Muriithi, 2017).
High Periodic Payments
SMEs may be reluctant to borrow due to the need for high-term repayments within a short timeframe, typically around 16 weeks. Owners must assess the business’s ability to repay the loan with generated profits before applying for a specific loan amount (Ezeagba, 2017; Storey, 2017; Muriithi, 2017).

Low Profitability and Liquidity
The profitability and liquidity levels of SMEs are crucial factors that banks consider when deciding whether to lend to them. Low profit levels and liquidity conditions can make it challenging for SMEs to obtain financing (Eggers, 2020; Ezeagba, 2017; Storey, 2017).

Market Imperfections
Limited access to SMME funding can be attributed to imbalances between loan demand and supply. The financing gap between capital needs of small enterprises and the supply of funds from investment financial institutions restricts the amount of funding they can obtain (Cantele and Zardini, 2018; Storey, 2017).

The Effect of Funding Difficulties on the Performance of SMEs
Limited access to funding not only hampers the growth and development of Small and Medium Enterprises but also poses a threat to their survival. When SMEs fail to secure timely financing, it adversely affects their operations, thereby underscoring the urgency of SME financing. The absence of adequate funding can lead to the demise of SMEs, thus highlighting the crucial role financing plays in the sustainability of the SME sector (Tuffour, Amoako & Amartey, 2022; Fitriasari, 2020; Agyapong & Attram, 2019).

High Mortality Rate of SMEs
The poor financial performance and profitability of small enterprises demonstrates that limitations to the accessibility of capital contributes to a high mortality rate among SMEs. When SMEs fail to obtain the necessary funding, they become vulnerable to failure, and this contributes to the high mortality rate as observed in the industry (Fitriasari, 2020; Tuffour, Amoako & Amartey, 2022).

Inability of SMEs to Create Sustainable Job Opportunities
SMEs' inability to create sustainable job opportunities is closely linked to their struggle in obtaining sufficient funding. The closure of SMEs and subsequent job losses indicate that many SMEs fail to progress beyond the survival stage, hindering the creation of meaningful employment opportunities. Limited access to finance negatively impacts SMEs' ability to generate sustainable jobs (Tuffour, Amoako and Amartey, 2022; Fitriasari, 2020).

Weakens the Competitive Position of SMEs
The restricted availability of capital for SMEs, coupled with the impact of globalization, has significantly weakened the competitive position of these enterprises. The failure to secure adequate funding can undermine the competitive edge of SMEs, as small-scale operations lead to higher average operating costs (Muriithi, 2017; Fitriasari, 2020).

Delay in Paying Operating Costs
The limited access to financing for SMEs results in several challenges, including delays in paying operating costs, inadequate machine maintenance or replacement, inability to attain much needed services, purchase necessary equipment or materials, limited opportunities for expansion, and failure to achieve the main objectives of the SMEs (Muriithi, 2017; Fitriasari, 2020; Storey, 2017).

Recommendations on funding small enterprises
Several strategies can be employed by investment financial institutions to ensure sustained
financing for small enterprises.

**Enhance Coverage by Leveraging Non-Traditional Data**
To better cater to the needs of Small and Medium Enterprises (SMEs), investment firms must develop a deeper understanding of their specific financing requirements. Employing advanced analytics and digital credit assessments, investment firms can better evaluate risk even in areas where traditional credit data is unavailable. By leveraging non-traditional data, investment firms can price their financing solutions accordingly, making them more accessible and tailored to the needs of SMEs (Eggers, 2020; Muriithi, 2017).

**Strengthen Digital Products and Channels**
Digitizing key client interactions and processes for SMEs offers a significant advantage for investment firms. By streamlining the application-to-loan-disbursement process through digital channels, investment firms can enhance customer satisfaction and efficiency. Embracing digital solutions allows investment firms to offer SME financing in a more convenient and streamlined manner (Lee et al., 2018; Storey, 2017).

**Innovate Products and Propositions**
To accommodate the unique nature of SME businesses, investment firms should reevaluate their traditional lending strategies. They can achieve this by repackaging their lending products as tailored funding solutions for SMEs. Additionally, investment firms can explore innovative business models to better align with the needs and preferences of SMEs (Lee et al., 2018; Eggers, 2020).

**Research Methodology**
The research methodology employed in this study encompasses various aspects, including research design and approach, data sampling, pilot studying, data gathering, analysis, and ethical considerations.

**Research Philosophy**
The study adopted an interpretivism paradigm, which proved suitable for investigating employees' experiences and opinions on change management. This paradigm emphasizes the use of individuals with genuine and direct experiences to gather knowledge. According to this philosophy, human behaviors are influenced by how individuals interpret the situations they encounter. By adopting an interpretive stance, the study aimed to gain insight into the unique circumstances that arise during the research investigation. Interpretivism suggests that knowledge is socially constructed as individuals interact with the world around them (Saunders et al., 2016).

**Research Design**
An exploratory research design was employed for this study. This approach allows for the exploration of new problems and fresh perspectives related to the difficulties investment firms face in financing small enterprises in the Gauteng province. By focusing on small businesses in the region and examining the difficulties encountered by investment firms in providing financing, the study aimed to generate new insights and a deeper understanding of the dynamics involved. The exploratory research design facilitated the investigation of unexplored aspects, leading to valuable insights for future research and decision-making in the field.

**Research Approach**
A qualitative research technique was utilized for this study. The qualitative approach allowed for a detailed exploration of participants' feelings, views, and experiences, enabling researchers to provide comprehensive descriptions and explanations. This approach offers flexibility and openness in exploring various issues within the research focus area. Qualitative research involves the interpretation of observations in a non-numerical manner, aiming to uncover underlying
meanings and patterns. Researchers can gather information by attentively observing and listening to the interviewees' speech patterns, tone, facial expressions, and attitudes. The use of qualitative research methods provided depth and detail in the exploration of specific topics, as researchers were not constrained by preexisting analytical categories during the fieldwork (Patton, 2018; D'Alimonte et al., 2020).

**Research Strategy**

Aligned with the qualitative research approach, the research strategy employed the interpretivists' paradigm through interviews to gain a profound understanding of the difficulties faced by the financial institution in funding small enterprises in the Gauteng province. The interviews provided the opportunity for in-depth exploration and clarification of specific areas of interest. As stated by Bryman (2015), the research strategy defines the method or framework utilized to conduct a study with the aim of achieving defined objectives and addressing research questions. Furthermore, in keeping with the qualitative research approach, the phenomenological research strategy was applied through interviews. This strategy incorporates an explanatory element that employs theories to shed light on, support, or challenge actions and concepts. Interviews played a crucial role in this strategy, enabling comprehensive data collection and facilitating an in-depth exploration of responses. By adopting the interpretivists' paradigm, the interviews contributed to a thorough comprehension of the challenges faced by one investment financial firm in funding small enterprises in the Gauteng province. Moreover, structured interview used in data gathering provided an opportunity for further exploration and clarification of specific areas of interest.

**Target Population and Sampling**

The research focused on 15 individuals comprising both managerial and non-managerial personnel at a financial institution. These participants were chosen due to their expertise and knowledge regarding the difficulties investment firm encounter in financing small enterprises in the Gauteng province.

To select the participants, a non-probability sampling method, specifically the purposive sampling technique, was utilized. This approach offers the advantage of judgmental sampling, which involves several phases, each building on the preceding step.

**Data Collection**

The study conducted a primary study where interviews were used to collect data. A pilot study was conducted first before commencing. Interview sessions were recorded on a digital tape recorder and interviews took between 20-30 minutes per session. Before the interview were conducted permission to record was sought. Semi-structured interview questions were used which gave room for deeper understanding of the responses as the interviewer was guided and confined to the scope of the research study, questions, and objectives. The use of semi-structured interview questions were necessary because it allowed the interviewer to conduct personality test extensively beneficial to data interpretation.

**Data Analysis**

The findings underwent thematic analysis, a method that offers the advantage of being unsupervised. In this approach, the researcher sets the categories in advance, without requiring algorithm training, making it easier to capture elements that are unknown. The thematic approach of analyzing themes to categorize responses enabled the identification of codes linked to themes that emerged from the challenges or difficulties faced by investment financial firms in funding small enterprises in the province of Gauteng.

According to Creswell (2014), thematic analysis is generally used as a fundamental approach for examining and analysing data that is qualitative in nature. Maree (2017) emphasized its flexibility
and utility as a research tool, enabling detailed descriptions of complex data. Through this method, researchers can identify, report, and analyze the themes present in the collected data.

The process of thematic analysis involves the initial examination of the data and the generation of preliminary codes based on observed patterns during interviews (Creswell, 2014). These coded themes are then carefully reviewed, defined, and given appropriate names. The unsupervised nature of thematic analysis means that researchers predefine the categories without requiring algorithm training, making it easier to identify unknown factors. In this study, thematic analysis played a crucial role in coding the themes related to the difficulties investment firms face in funding small enterprises in the Gauteng province.

Research Rigor
The study's trustworthiness was secured by upholding four essential aspects: credibility, transferability, dependability, and conformability. For credibility, the researcher ensured that each study participant understood the significance of their contributions during the interviews, aiming to establish accuracy in the explanations provided. To enhance the reliability of the qualitative data, the interviews were recorded and transcribed. The study's findings genuinely represent the perspectives of the participants and the research context, free from any biases, objectives, or opinions of the researchers. Moreover, the researchers were mindful of the level of detail and its relevance, avoiding unnecessary redundancy and distractions from the research's main purpose.

Ethical Considerations
The ethics of this study refers to good practices, regulations, ideas, ideals, or codes of behavior that should be adopted systematically during a research process. The ethics followed include: Informed consent is obtained from the respondents before commencement of the research. Protecting respondent from any form of harm. Enforcing confidentiality and anonymity of participant’s details and responses. Obtaining permission from the institution and all other stakeholders involved.

Research Results
The main purpose of the study was to evaluate the challenges and difficulties investment firms face in funding small enterprises in the province of Gauteng in South Africa.

Imperative Requirements Considered when Financing Small Businesses by Investment Firms
According to the study findings, investment firms have specific criteria that they consider when financing small businesses. It was revealed that one crucial requirement is for the small business seeking financial support to be formally registered, ensuring compliance with legal obligations. This is because loans are considered credit arrangements, and both the lender and recipient must be formally registered entities if the provision of finance is intended for the purposes of conducting business. Additionally, to access funding, an enterprise must present a comprehensive business plan, which includes cash projections flow, information about debtors outstanding, management accounts that are up-to-date, and recent annual financial statements. These documents play a vital role in the evaluation process conducted by investment companies when considering potential funding opportunities for businesses.

Difficulties in Financing Small Enterprises
The study indicated various challenges which investment firms face in the context of providing finance to small enterprises. The study found that the investment financial firms are really facing difficulties in providing finance or funding to small enterprises. The main challenges identified include small enterprises do not have credit scores and there is a huge maturity gap. Investment firms fail to establish the credit level of the small enterprises due to lack of credit scores or being
unable to calculate these credit scores. The financial institutions are skeptical to invest or finance small enterprises due to the aspect of maturity gap, as it becomes difficult to obtain medium-term loans due to asset-liability maturity mismatches and the surrounding uncertainty that may prompt losses.

These findings indicated that investment firms face significant challenges when it comes to financing small businesses. These challenges primarily revolve around the absence of credit scoring mechanisms and the maturity gap observed in small enterprises. The absence of credit scoring systems hinders investment financial firms from accurately assessing the creditworthiness of small enterprises. Additionally, the maturity gap poses difficulties in obtaining medium-term loans due to mismatches between the maturity of assets and liabilities. Consequently, financial institutions exhibit caution when it comes to investing or providing financing for small businesses due to the uncertainties surrounding their financial stability, which could potentially lead to losses.

**Interventions**
The study found that there is need for recommendations on how investment financing institutions or lenders can finance small enterprises. These enterprises need to have adequate credit reporting systems and consider investing or participating in high income generating projects. The existence of credit reporting systems helps bridge the knowledge gap that exists between lenders and borrowers as well as help funders to consider new borrowers and to correctly price loans. Also, the investment in high-income generating projects needs to be limited and regulated using high income margin and be based on an established framework of cost-benefit-analysis indicating which business ventures may produce high investment returns.

To address the identified challenges, the study suggests several recommendations for investment financial institutions in finding small enterprises. Firstly, it emphasizes the importance of implementing credit reporting systems, which can bridge the information gap between borrowers and lenders. These systems would enable investment firms to make informed decisions, attract new borrowers, and appropriately price loans. Secondly, the study proposes that investment firms should focus on investing in projects with high return potentials. However, it highlights the need for these investments to be regulated and limited, taking into account a high returns margin and relying on an established cost-benefit analysis framework. Such an approach would help identify business ventures that offer the potential for significant profit returns.

**Conclusion**
In conclusion, the study sheds light on the challenges investment firms encounters while financing small businesses in Gauteng, South Africa. These challenges include credit scoring limitations and the maturity gap prevalent in small businesses. To address these issues, investment firms should consider financing registered small businesses with well-structured business plans, encompassing cash inflow projections, outstanding borrowers, up-to-date finance or management accounts, and recent annual financial reports. Moreover, investment firms should adopt a cost-benefit-analysis framework to invest in high return projects while managing risk effectively.

The study recommends the implementation of credit reporting systems to bridge the information gap between borrowers and lenders, attracting new borrowers and facilitating accurate loan pricing. To enhance success rates, investment firms are encouraged to adopt a centralized financing strategy that aligns with both business and social goals, reducing the likelihood of failed investments and potential losses.

Another recommendation is for the organization under research to engage in Corporate Social Responsibility (CSR) activities, benefiting the community and building a loyal customer base. Furthermore, investment firms should identify and support small businesses contributing
significantly to entire value chains, providing capacity building programs to increase their chances of success.

Policy supports specifically targeting high growth or knowledge-intensive small businesses is also recommended, creating an enabling environment for their growth and development. Local and central governments should promote entrepreneurship through streamlined registration processes and facilitate networking and workshops.

Microfinance banks should play a role in providing finance to entrepreneurs, enhancing their productive capacities and market competitiveness, with utmost transparency and compliance in fund disbursement.

The study's focus on investment firms and small businesses in Gauteng leaves room for further exploration in other contexts, such as different regions in South Africa or broader entrepreneurship studies. Future research could assess the impact of investment in small enterprises on economic growth or GDP, job creation, and societal standards of living. To complement the qualitative approach, quantitative research techniques or a combination of both methods could be used for triangulation and to fill any gaps in understanding.
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