An Investigation into the Financial Bootstrapping Methods Used by Immigrant Entrepreneurs in South Africa

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KEYWORDS

ABSTRACT
This study investigates the financial bootstrapping methods used by immigrant entrepreneurs in South Africa. Access to formal debt and equity markets is limited for immigrant entrepreneurs. Data was collected through the use of self-administered questionnaire in a survey. Factor analysis identified five bootstrapping methods used by immigrant entrepreneurs. The methods are owners’ resources, management of accounts receivable, sharing resources, delaying payment and minimising investment. Recommendations on how immigrants can improve the use of financial bootstrapping are suggested.

INTRODUCTION
South Africa suffers from high rate of unemployment, poverty, crime, income inequality and weak economic growth. The country’s official unemployment rate is 24.7% according to Statistics South Africa, Quarterly Labour Force Survey (2013). Aguero et al. (2007) find that approximately 57% of individuals in South Africa live below the poverty income line of two United States Dollars per day. Given the failure of the private and public sectors to absorb the growing number of job seekers in South Africa, increasing attention has focused on entrepreneurship and small and medium enterprises (SMEs) and their potential for contributing to economic growth, job creation and poverty alleviation (Herrington et al. 2009). The terms entrepreneurship and small and medium enterprises (SME) are often used interchangeably in many studies conducted in the field of entrepreneurship (Acs 2006).

Pendleton et al. (2006) point out that South Africa is a rainbow nation composed of various racial groups from all facets of the earth. Following independence in 1994, an increasing number of immigrants migrated to South Africa from other African countries and from other continents. Rath and Kloosterman (2000) point out that entrepreneurship can provide immigrants with work and income as immigrants find it difficult to enter into the labour markets. Gibson et al. (2011) note that entrepreneurship can help to limit the persistently high unemployment rate generally associate with immigrants. Thus, immigrants can become a significant driving force in the creation of new businesses. Gebre et al. (2011) note that immigrant entrepreneurship can positively impact the South African economy. Kalitanyi and Visser (2010) find that immigrant entrepreneurship is one of the ways to reduce unemployment in South Africa. Dana (2007) immigrant entrepreneurs have emerged as key engines of growth in their host countries and with better planning and support, immigrant entrepreneurship can provide an even bigger economic boost in the future.

According to Herrington et al. (2011) in the Global Entrepreneurship Monitor, South African Report, total early-stage entrepreneurial activity (TEA) shows that South Africa’s rate in 2011 (9.1%) has remained constant (8.9% in 2010). South Africa’s TEA rate however, far below the average of comparable economies around the world. In addition, South Africa’s established business ownership rate of 2.3% is substantially lower than the average of 7.2% for all participating efficiency-driven countries. Immigrant entrepreneurship can be one of the ways to improve South Africa’s relatively low TEA rate.

Kalitanyi and Visser (2010) and Tengeh et al. (2011) point out that access to formal external finance is limited for most immigrant entrepreneurs. Vargas (2005) and Dana and Morris (2007) summarise the barriers to the performance of immigrant entrepreneurs to include lack of capital, lack of skills, lack of support, excessive compliance costs, excessive regulations, excessive tax, discrimination, language and crime. Re-
source acquisition is one of the more important activities for successful entrepreneurs and small business owner-managers (Shane and Venkataraman 2000). Inaccessibility to capital can impact negatively on the survival of immigrant-owned businesses.

According to Bhide (1992) and Spinelli and Adams (2012), bootstrap financing has become especially important for entrepreneurs that experience high start-up costs and low revenues. Winborg (2008) points out that financial bootstrapping is used when internal or external finance is not available. Lahm and Little (2005) and Van Auken (2005) note that existing scholarly research on bootstrapping is limited, despite the widespread use of bootstrapping strategies in actual practice among start-up entrepreneurs. Traditional finance theory does not recognize the use or potential importance of bootstrap financing among small firms. A review of the literature on immigrant entrepreneurship (Kalitanyi and Visser 2010; Tengeh et al. 2011) revealed that no study has investigated empirically the financial bootstrapping methods used by immigrant entrepreneurs in South Africa.

Objective of the Study

Access to debt and equity markets is limited for immigrant entrepreneurs. Therefore, the objective of this study is to investigate empirically the bootstrapping strategies employed by immigrant entrepreneurs in South Africa. The results of this study can yield some interesting insights on immigrant entrepreneurs’ strategies for non-conventional methods of financing.

Literature Review

Resource Dependency Theory

According to Pfeffer and Salancik (1978), the Resource Dependency Theory (RBT) argues that resources are a critical or important part of an organization’s operation. RDT focuses on how the external resources of organizations affect the behavior of the organization. The resources one organization needs are thus often in the hand of other organizations. Thus, organizations are not autonomous, but rather are constrained by a network of interdependencies with other organizations. Barney (2001) points out that resources include all assets, capabilities, organisational process firm attributes and firm information knowledge used by a firm to conceive and implement strategies. According to Kraijjenbrink et al. (2010), resources can help a firm gain and sustain competitive advantage. Elsenhardt and Martin (2000) use the RBT to demonstrate the financing needs of small firms. These firms need resources such as fixed assets and working capital to be able to achieve a competitive advantage in the market. Resources in an expanded form include assets such as plant and machinery, financial resources and good management.

Bolingtoft et al. (2003) points out that to establish and sustain a small firm, the entrepreneur needs to have access to different types of resources (i) human capital; (ii) physical capital; and (iii) financial capital, each playing different, but equally important roles during the life cycle of a new SME. This is consistent with the view of Timmons and Spinelli (2007) that the decision on what resources are needed, when they are needed and how to acquire them are strategic decisions that fit with other driving forces of entrepreneurship. According to Ebben and Johnson (2006), the traditional view of bootstrapping coincides with the RBT as exposed by Pfeffer and Salancik in 1978. RBT assumes that firms do not possess all of the resources they need and must therefore obtain resources from external parties.

Capital Structure

Capital structure is described as the mix of debt and equity that a firm uses to finance its operations. Regardless of size or age of a firm, access to capital is a matter of paramount importance (Van Praag 2003). According to Demirguc-Kunt et al. (2006), the two primary sources of external finance for small firms are equity and debt. External equity in the form of venture capital or the stock exchange is usually not available to small firms. Blumberg and Letterie (2008) agree that the lack of venture capital funds makes small firms dependent on bank loans, overdrafts and suppliers credit for financing. Despite the dependence of small firms on debt finance, paradoxically access to debt finance is very limited for small firms. Commercial banks often hesitate to lend to small firms leading to inaccessibility to debt finance. Theories on inaccessibility to external finance by small firms (of which most immigrant-owned businesses are) include
the agency theory by Jensen and Meckling 1976
and the pecking order theory by Myers (1984).
According to Jensen and Meckling (1976),
agency problems such as asymmetric informa-
tion and moral hazards can impact on the avail-
ability of credit to small firms. Myers (1984)
pecking order theory (POT)
argues that manage-
ment has a preference to choose internal financ-
ing before external financing. When a firm is
forced to use external financing sources, manag-
ers select the least risky and demanding source
first. When it is necessary to issue external
sources, debt issuance is preferred to new eq-
uity. POT postulates that the cost of financing
increases with asymmetric information. This can
negatively impact on the ability of small firms to
raise external finance.

Stiglitz and Weiss (1981:394) agree that
agency problems such as asymmetric informa-
tion and moral hazards can impact on the avail-
ability of credit and hence the capital structure
of small firms. Stiglitz and Weiss termed this
phenomenon credit rationing. The Stiglitz and
Weiss’ theory therefore suggests that there are
significant numbers of small firms that could use
funds productively if they were available, but
cannot obtain finance from the formal financial
system. Thus, owners of small firms tend to seek
funding through various non-traditional financial
bootstrapping methods.

Bootstrapping

Winborg and Landström (2001) and Ebbon and
Johnson (2006) define bootstrapping as the
use of resourceful and innovative methods, which
(i) minimize the amount of finance firms need to
raise through financial market transactions with
traditional outside financiers and (ii) allow firms
to secure resources owned by others at little or
no cost. According to Vanacker et al. (2011),
bootstrapping is a resource dependence manage-
ment strategy. Consistent with the RDT frame-
work, firm owners take actions to reduce finan-
cial uncertainty and dependence of their busi-
ness by actively deploying bootstrapping tech-
niques. Bootstrapping can be used as a creative
financing strategy. In addition, bootstrapping can
be used for the acquisition and control of re-
sources (both tangible and intangible), and the
efficient uses of those resources to finance the
enterprise for growth. Bootstrap financing refers
to a range of highly creative ways of acquiring
resources without borrowing money or raising
equity from traditional sources (Winborg and
Landström 2001; Ebbon and Johnson 2006;
Yilmazer and Schrank 2006).

Vanacker et al. (2011) point out that there are
four types of bootstrapping options (that is,
bootstrapping product development, bootstrap-
ing business development, bootstrapping to
minimize the need for (outside) capital financ-
ing, and bootstrapping to minimize the need for
capital). Lahm and Little (2005) add that boot-
strapping strategies include (1) the acquisition
and control of resources (both tangible and in-
tangible) and (2) the efficient (minimising) uses
of those resources to finance the enterprise for
growth. Winborg and Landstrom (2001) identify
thirty two bootstrapping strategies. Cluster analy-
is identified six bootstrapping strategies. (1)
delaying bootstrapping (2) relationship-oriented
bootstrapping (3) subsidy-oriented bootstrapping
(4) minimizing bootstrapping (5) non-bootstrap-
ing and (6) private owner-financed bootstrap-
ing A similar study by Schinck and Sarkar
(2012) also identified four bootstrapping strate-
gies. (1) acquisition of subsidies and investors
(2) internal management process (3) delaying
cost, and (4) minimising investment.

RESEARCH METHODOLOGY

The survey was conducted in the Johannes-
burg Central Business District in Gauteng prov-
ince, South Africa. The empirical approach con-
sists of data collection through the use of self-
administered questionnaire in as survey. Because
of the difficulty of obtaining the population of
immigrant-owned businesses in the study area,
convenience sampling and the snowball sampling
methods were used. According to Cooper and
Schindler (2003), convenience sampling is a non-
probability sampling technique where subjects
are selected because of their convenient accessi-
bility and proximity to the researcher. Snowball
sampling method is a non-probability sampling
technique where existing study subjects recruit
future subjects from among their acquaintances.
As the sample builds up enough data is gathered
be useful for research. The questionnaires were
given to the owners of the business to complete.
The questionnaire was divided into four parts (1)
biographical information (2) need for external
finance (3) access to external finance (4) finan-
cial bootstrapping methods employed. Question
items included dichotomous questions and Likert scale questions. The part of the questionnaire on financial bootstrapping was adapted from Winborg and Landstrom (2001) and Schinck and Sarkar (2012). The questionnaire contained twenty-nine question items. Nineteen Likert scale questions where the respondents could answer 1-5 representing “1 never use”, “2 rarely use”, “3 occasionally”, “4 a moderate amount” “5 a great deal”. The questionnaire also includes ten non-metric dummy variable questions where the respondents could answer yes or no. The aim is to discover financial bootstrapping methods used at least once and those that have never been used by immigrant entrepreneurs. A pilot study was conducted on the survey instrument used in this research with thirty immigrant entrepreneurs in order to ensure face and content validity. The pilot study led to some modifications to the questionnaire. The Cronbach’s alpha was used to measure reliability. Owners were assured of confidentiality with regard to the data collected. Data analysis included univariate analysis and the principal component analysis. The study focused only on immigrant entrepreneurs in the retail sector. Studies by Kilitanyi and Visser (2010) and Tengeh et al. (2012) find that most immigrant entrepreneurs are in the retail sector.

RESULTS AND DISCUSSION

Out of 380 questionnaires distributed, 148 were returned. This gives a response rate of 39%. Table 1 depicts the biographical information of the respondents. For the status of the business, most of the respondents are sole proprietors. Males dominate and most of the respondents have a post Matric qualification and are in the retail (trading) sector. Most of the respondents have businesses that have been operating for between six and ten years and employ an average between two and three employees.

Need for External Capital

Out of 148 respondents, 111 respondents are in need of external capital and 37 respondents do not need external capital. It can be concluded that most of the respondents are in need of external capital. Pretorius and Shaw (2004) observe that access to external finance is needed to reduce the impact of cash flow problems for small firms. Carpenter and Petersen (2002) find that the growth of small firms is constrained by dependence on internal finance. In contrast, firms that make use of external funds exhibit growth rates far above what can be supported by internal finance.

Application to Bank for External Finance

43 respondents have applied for credit from commercial banks and 68 have never applied despite the need for credit.

Approval of Credit

Out of the 43 respondents that applied for credit, only 14 confirmed that their credit applications were successful.

According to Demirgüç-Kunt et al. (2006), the two primary sources of external finance for small firms are equity and debt. External equity in the form of venture capital or the stock exchange is usually not available for small firms. Shane (2008) contends that venture capital provided only a small proportion of the equity funding for small firms. Kilitanyi and Visser (2010) and Tengeh et al. (2012) find that immigrant entrepreneurs in South Africa have limited access to debt finance from commercial banks as they have problems in opening bank accounts, and acquiring visas and permits. In addition, most of

Table 1: Biographical information

<table>
<thead>
<tr>
<th>Biographical question</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Status of the Business</td>
<td></td>
</tr>
<tr>
<td>Sole proprietorship</td>
<td>126</td>
</tr>
<tr>
<td>partnership</td>
<td>15</td>
</tr>
<tr>
<td>Close corporation</td>
<td>2</td>
</tr>
<tr>
<td>Company</td>
<td>5</td>
</tr>
<tr>
<td>Gender</td>
<td></td>
</tr>
<tr>
<td>Male</td>
<td>113</td>
</tr>
<tr>
<td>Female</td>
<td>35</td>
</tr>
<tr>
<td>Level of Education</td>
<td></td>
</tr>
<tr>
<td>Below matric</td>
<td>14</td>
</tr>
<tr>
<td>Matric or equivalent</td>
<td>37</td>
</tr>
<tr>
<td>Post matric</td>
<td>97</td>
</tr>
<tr>
<td>Age of the Business</td>
<td></td>
</tr>
<tr>
<td>1-5</td>
<td>44</td>
</tr>
<tr>
<td>6-10</td>
<td>86</td>
</tr>
<tr>
<td>11-15 years</td>
<td>18</td>
</tr>
<tr>
<td>Above 15</td>
<td>0</td>
</tr>
<tr>
<td>No. of Employees</td>
<td></td>
</tr>
<tr>
<td>No employee</td>
<td>5</td>
</tr>
<tr>
<td>1 employee</td>
<td>11</td>
</tr>
<tr>
<td>2 employees</td>
<td>24</td>
</tr>
<tr>
<td>3 employees</td>
<td>47</td>
</tr>
<tr>
<td>4 employees</td>
<td>39</td>
</tr>
<tr>
<td>More than four but less than 10</td>
<td>22</td>
</tr>
</tbody>
</table>

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the respondents have never applied for credit, despite the need for credit and may thus be classified as discouraged borrowers.

Financial Bootstrapping Methods Used by Immigrant Entrepreneurs

Table 2 depicts the responses from the highest application to the lowest application of the different variety of financial bootstrapping techniques. Table 2 shows that the six most widely used bootstrapping methods are (1) share premises with others (2) withhold owners salaries (3) obtain loans from family and friends (4) Employ relatives and or friends at non-market salary (5) Seek out the best conditions possible with suppliers and (6) buy on consignment from suppliers. The six least used methods are (1) share employees with other businesses (2) Lease equipment from leasing businesses (3) use interest on overdue payment as a way to speed up payments from customers (4) Deliberately delays payments of value added (5) Raises capital from a factoring company and (6) Has obtained some kind of subsidy.

### Table 2: Financial bootstrapping methods used by immigrant entrepreneurs

<table>
<thead>
<tr>
<th>Method</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share premises with others</td>
<td>141</td>
<td>95</td>
</tr>
<tr>
<td>Withhold owners/manager’s salary for shorter/longer periods</td>
<td>136</td>
<td>92</td>
</tr>
<tr>
<td>Obtain loans from family and friends</td>
<td>123</td>
<td>83</td>
</tr>
<tr>
<td>Employ relatives and or friends at non-market salary</td>
<td>115</td>
<td>78</td>
</tr>
<tr>
<td>Seek out the best conditions possible with suppliers</td>
<td>113</td>
<td>76</td>
</tr>
<tr>
<td>Buys on consignment from suppliers</td>
<td>108</td>
<td>73</td>
</tr>
<tr>
<td>Contributes capital via other projects the owner gets paid in</td>
<td>101</td>
<td>68</td>
</tr>
<tr>
<td>Offers customers discounts if paying in cash, in order to get paid earlier</td>
<td>86</td>
<td>58</td>
</tr>
<tr>
<td>Get payments in advance from customers</td>
<td>80</td>
<td>54</td>
</tr>
<tr>
<td>Use managers private credit card for business expense</td>
<td>77</td>
<td>52</td>
</tr>
<tr>
<td>Buy used equipment instead of new</td>
<td>77</td>
<td>52</td>
</tr>
<tr>
<td>Deliberately delay payments to suppliers</td>
<td>76</td>
<td>51</td>
</tr>
<tr>
<td>Deliberately choose customers who pay quickly</td>
<td>73</td>
<td>49</td>
</tr>
<tr>
<td>On any occasion liquidated a business relation with a customer for frequently paying late</td>
<td>72</td>
<td>48</td>
</tr>
<tr>
<td>Use different routines for minimizing capital invested in stock</td>
<td>65</td>
<td>44</td>
</tr>
<tr>
<td>Use routines in order to speed up invoicing</td>
<td>62</td>
<td>42</td>
</tr>
<tr>
<td>Coordinate purchases together with other businesses (for better agreements)</td>
<td>61</td>
<td>41</td>
</tr>
<tr>
<td>Borrows equipment or machinery from other businesses</td>
<td>56</td>
<td>38</td>
</tr>
<tr>
<td>Occasionally hires personnel for a shorter period instead of employing permanently</td>
<td>56</td>
<td>38</td>
</tr>
<tr>
<td>Share equipment with other businesses</td>
<td>37</td>
<td>25</td>
</tr>
<tr>
<td>Give the same terms of payment to all customers</td>
<td>16</td>
<td>11</td>
</tr>
<tr>
<td>Carries out barter instead of buying products/services</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Run the business completely in the home</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>share employees with other businesses</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Leases equipment from leasing businesses</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Uses interest on overdue payment as a way to speed up payments from customers?</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Deliberately delays payments of value added</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Raises capital from a factoring company</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Has obtained some kind of subsidy</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Principal Component Analysis

According to Leech et al. (2005), the principal components analysis is a data reduction technique used to reduce a large number of variables to a smaller set of underlying factors that summarize the essential information contained in the variables. In addition as pointed out by Winborg and Landstrom (2001), although variables for factor analysis are generally assumed, to be metric variables, dummy variables (coded 0 or 1) can be used along with metric variables. The departures from the assumption of normality involved in the use of non-metric variables, apply only to the extent that the observed correlations between variables can diminish.

Table 3 shows that five components with Eigen values greater than one account for 83.56% of the total variance. Factor one is titled owners resources. These resources include those from the owner of the business directly and those that are close to the owners such as family and friends. Access to formal finance is limited for immigrant entrepreneurs and networking with family and friends is often one of the major ways of secure-
Factor 2 is titled management of accounts receivable. The factor consists of seven items. The items include to seek out best conditions with suppliers and to buy on consignment from suppliers. This factor shows the importance of trade credit to immigrant entrepreneurs. Wilson and Summers (2002) and Berger and Udell (2006) point out that banks are not the only principal source of external finance for small firms. Trade credit is a substitute to bank credit for firms that are credit-rationed by banks. Factor 3 is titled sharing resources. By sharing resources, immigrant entrepreneurs can save on cost. Miller et al. (2008) point out that for a business owner, linked to the concept of social networking is the concept of business strategy. This means collaborative conduct driven by the need to achieve firm success. Factor 4 is titled delaying payment. This can help to improve the cash flow of immigrant entrepreneurs. However, delaying payment can impact negatively on the reputation of an immigrant entrepreneur. Factor 5 is titled minimising investment. By borrowing equipment and buying old equipment, a firm can minimise the level of investment. According to Spinelli and Adams (2012), an entrepreneur with this approach can reduce some of the risk in pursuing opportunities. Minimising investment leads to lower cost, more flexibility and reduced risk.

CONCLUSION

This study investigates the financial bootstrapping methods used by immigrant entrepreneurs in South Africa. Access to formal debt and equity markets is limited for immigrant entrepreneurs. Bootstrapping is the use of resourceful and innovative methods, which (i) minimize the amount of finance firms need to raise through financial market transactions with traditional outside financiers and (ii) allow firms to secure resources owned by others at little or no cost. Factor analysis identified five bootstrapping methods used by immigrant entrepreneurs. The methods are owners’ resources, management of accounts receivable, sharing resources, delaying payment and minimising investments.

RECOMMENDATIONS

Government agencies such as the Small Enterprise Development Agency (SEDA), the Small Enterprise Finance Agency (SEFA) should strive to create awareness of bootstrapping strategies that immigrant entrepreneurs can use. Training...
on improving access to finance should not only focus on how entrepreneurs can obtain external debt and equity but on how immigrant entrepreneurs can develop an entrepreneurial approach to resources through an understanding of bootstrapping strategies. Thus education and training of immigrant entrepreneurs on the various bootstrapping techniques can be critical to the development of immigrant owned businesses. In addition, the use of guarantees and subsidies by government agencies should be extended to immigrant entrepreneurs. Universities should make it part of their community engagement to visit immigrant entrepreneurs and train the owners on bootstrapping strategies. It is also important for immigrant entrepreneurs to be proactive and understand the various types of bootstrapping strategies that can be employed. Entrepreneurs could benefit from pursuing resources through appropriate bootstrap techniques.

AREAS FOR FURTHER STUDY
Further studies can investigate the impact of firm, entrepreneur and industry characteristics on the use of financial bootstrapping by immigrant and local SME owners in South Africa.

REFERENCES


