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

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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. Resource 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 been 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 organisation'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 Kraaijenbrink 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 expoused 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 information and moral hazards can impact on the availability of credit to small firms. Myers (1984) pecking order theory (POT) argues that management has a preference to choose internal financing before external financing. When a firm is forced to use external financing sources, managers select the least risky and demanding source first. When it is necessary to issue external sources, debt issuance is preferred to new equity. 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 information and moral hazards can impact on the availability 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 Ebben 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 management strategy. Consistent with the RDT framework, firm owners take actions to reduce financial uncertainty and dependence of their business by actively deploying bootstrapping techniques. Bootstrapping can be used as a creative financing strategy. In addition, bootstrapping can be used for the acquisition and control of resources (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; Ebben 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, bootstrapping business development, bootstrapping to minimize the need for (outside) capital financing, and bootstrapping to minimize the need for capital). Lahm and Little (2005) add that bootstrapping strategies include (1) the acquisition and control of resources (both tangible and intangible) 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 analysis identified six bootstrapping strategies. (1) delaying bootstrapping (2) relationship-oriented bootstrapping (3) subsidy-oriented bootstrapping (4) minimizing bootstrapping (5) non-bootstrapping and (6) private owner-financed bootstrapping A similar study by Schinck and Sarkar (2012) also identified four bootstrapping strategies. (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 Johannesburg Central Business District in Gauteng province, South Africa. The empirical approach consists 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 accessibility 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 to 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) financial 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. 19 Likert scale questions where the respondents could answer 1-5 representing "1 never use", "2 rarely use", "3occassionally", "4 a moderate amount" "5 a great deal" The questionnaire also includes 10 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 proprietorship. Males dominate and most of the respondents have 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 on the average between two and three employees.

Table 1: Biographical information

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

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 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 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 Tangeh 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 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.

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 secur-

Table 2: Financial bootstrapping methods used by immigrant entrepreneurs

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

Table 3: Rotated component matrix

	1	*2*	*3*	*4*	*5*
Withhold all or part of owner's payment	0.827				
Obtain loans from family and friends	0.795				
Use owners credit card for business expense	0.741				
Employ relatives and friends at non-market rate	0.703				
Contribute capital via other projects the owners get paid for	0.655				
Seek out best conditions with suppliers		0.892			
Buy on consignment from suppliers		0.827			
Deliberately choose customers who pay quickly		0.779			
Get payment in advance from customers		0.636			
Offer customer discount to pay early		0.601			
On occasion liquidated a business relationship with a customer for frequently paying late		0.527			
Give same terms of payments to all customers		0.501			
Use routine to speed up invoicing		0.467			
Share premises with other			0.877		
Share equipment with other businesses			0.729		
Deliberately delay payment to suppliers				0.811	
Use different routines for minimising capital invested in stock				0.745	
Occasionally hires personnel for a shorter period instead of employing permanently				0.692	
Borrow equipment or machinery from other businesses					0.724
Buy used equipment instead of new					0.682
Eigen value	21.004	8.507	3.244	2.538	1.729
% of variance explained	47.024	20.271	6.234	5.801	4.230
Cronbach's alpha	0.702	0.797	0.817	0.742	0.803

Item loading of less than 0.300 removed

ing capital (Hayer and Ibeh 2006; Robb and Fairlie 2008). 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.

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