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The Impact of Networking on Access to Debt Finance and Performance of Small and Medium Enterprises in South Africa

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ABSTRACT The study investigates the impact of networking on access to debt finance and on performance of SMEs in South Africa. Data was collected using self-administered questionnaires in a survey. Data analysis included univariate and bivariate analysis. Results indicate there is a significant positive relationship between networking and access to debt finance and performance of SMEs. Recommendations to improve networking by SMEs are suggested.

INTRODUCTION

According to the World Bank (2008) and Ploch (2011), South Africa is characterised by high levels of poverty (57% of South Africans live in absolute poverty) and income inequality (Gini co-efficient 0.67). In addition, South Africa suffers from high levels of unemployment with the official unemployment rate of 24.7% (Statistics South Africa 2013). The Department of Trade and Industry (2008) suggests that small and medium enterprises (SMEs) are an important vehicle in addressing development challenges faced by South Africa. SMEs incorporate approximately 66% of private sector employment signifying the high labour absorption capacity of the SME sector in South Africa (Fatoki et al. 2010). SMEs represent one of the fundamental tools in income redistribution (Graaf 2007).

However, despite the significant contributions of SMEs alluded to in literature, SMEs in South Africa suffer from weak performance and a high failure rate (Sha 2006). The weak performance and high failure rate of SMEs negatively impacts on their ability to achieve the objectives of poverty alleviation, employment creation, income redistribution and economic growth. Bowen et al. (2009) note that given the importance of SMEs to development, and their high failure rate, it becomes essential to research into factors that will enable SMEs to grow.

According to the World Bank (2010) access to finance is a significant business environment issue for the SME sector in South Africa. Agnew (2003) notes that finance is the life-blood of any firm and no firm, no matter how well managed, can survive without enough funds for working capital, fixed assets investment and employment of skilled workers. Consequently, access to finance is essential to the survival and performance of any firm. However, Fatoki and Odeyemi (2010) observe that in South Africa, 75% of all applications by SMEs for bank credit are rejected. Additionally, FinMark Trust (2006) provides evidence that only 2% of all start-up SMEs in South Africa are able to access bank loans. This lack of access to external finance will inhibit the performance of SMEs. The Small Business Project (2009) finds that one prominent factor that can enhance the probability of an SME accessing debt finance, and thus lead to high performance, is networking.

Ngoc et al. (2009) suggest that the literature is inconclusive about the impact of networking on access to debt finance. Atieno (2009) and Pandula (2011) find a positive relationship between networking and access to debt finance. On the other hand, Chua et al. (2011) argue that most SMEs are too small and lack resources to make use of networking (social capital) to gain access to debt finance. In addition, empirical literature on the impact of networking on firm performance has also produced mixed results. Research by Hakansson and Ford (2002) and Thrikawala (2011) establishes that networking positively impacts on performance. However, Watson (2007) and Yu and Chiu (2010) find that networking, beyond some level, starts having negative impacts on firm performance.

A thorough review of literature revealed that no empirical study has investigated the impact of networking on access to finance and performance of SMEs in South Africa. Sefoko (2003) analyses the role of networks in the commercialisation of rural weavers in South Africa. Zaaiman (2006) investigates the existence and form of social networks in large organisations in South Africa. Zenzo (2011) evaluates business angels as a business start-up financing option in South Africa.

Objective of the Study

The objective of the study is to investigate the impact of networking on access to debt finance and performance of SMEs in South Africa.

Literature Review

Theoretical Framework of Networking

According to Watson (2007) a lot of terminologies are used to denote the concept of networking. However, the definition of networking suggests that networking involves information and resources sharing, reduction of costs and social interactions that exist between individuals and organisations. Claro (2004) points out that the roots of the networking theory can be traced from organisational behaviour, management and sociology. However, networking theory relevant to SMEs can be described through the transaction cost theory by Coase (1937) and extended by Williamson (1985), the resource dependency theory by Pfeffer and Salancik (1978) and social network theory by Moreno (1937) and Coleman (1988). The Transaction Cost Theory was formulated by Commons (1934) and reinforced by Coase (1937), Arrow (1969, 1974) and Williamson (1985, 1991). According to Arrow (1969), transaction costs are the costs involved in running the economic system. Coase (1988) suggests that there are always costs for carrying out market transactions. Therefore, a firm would prefer transactions to be organised within the firm if the cost would be less than the cost of carrying out the transaction in the market. However, as the additional costs of transactions within the firm exceed the cost of carrying out the transaction through the market, firms attempt to reduce transaction costs by vertical integration (Williamson 1991). Therefore, the rationale behind the transaction cost theory is that market costs are usually too high for firms to overcome individually. This leads to the creation of linkages for small firms (Thorelli 1986).

The central premise of the resource dependency theory by Pfeffer and Salancik (1978) is the interdependency of firms. Specifically, Pfeffer and Salancik (1978) argue that the effectiveness and performance of firms is highly dependent on the firm's external environment. Interdependence is necessary because no one actor (firm) entirely controls all the conditions necessary for the achievement of desired outcomes. All firm actions and outcomes are thus based on interdependent causes in the external environment. However, the dependency of a firm on its external environment leads to uncertainty. This uncertainty derives from the lack of coordination among social units of the firm and the external environment. With the need to improve performance and increase coordination between the firm and its external environment, there is formation of linkages (Pfeffer and Salancik 1978). These linkages will lead to information exchange and resource sharing to gain strategic options and improve their performance (Sengenberger and Pyke 1992).

The social network theory introduced by Moreno (1937) argues that individuals in any society are involved in a number of social relationships with each other. Coleman (1988) argues that within a society/group marked by a high degree of social disintegration, trustworthiness among members will be low and the value derived from such connections is not great. Therefore, members will seek to form linkages and networks. This will result in mutual bonds among members creating trustworthiness which leads to beneficial information and resource exchanges. Burt (1992) proposes the structural holes theory which suggests that an individual is in an advantageous position to acquire information if he/she is connected to others who are not directly connected to each other. This forms the basis for individuals forming linkages or networks with other individuals or firms. Therefore, a manager who spans the structural holes by having non-redundant contacts on both sides of the structural hole will have access to different beneficial information flows (Burt 1997).

Networking and Access to Finance

Several authors have researched on the impact of networking on access to finance. However, debt financing for SMEs in developing countries is mainly limited to bank loans and trade credit and thus studies have focused on the impact of networking on access to bank loans and credit (Organisation for Economic Cooperation and Development 2006). Talavera et al. (2010) investigate the impact of social capital on access to bank financing. The results indicate that entrepreneurs who spend more time on social activities are more likely to obtain loans from commercial banks. In addition, membership of business associations positively impacts on loan access. Pandula (2011) finds that SMEs who are members of representative organisations such as Chamber of Commerce have a high probability of accessing bank finance because these societies have close relationships with SME owners and are aware of the problems and needs of their members. Similarly, Biggs and Sha (2006) and Atieno (2009) find a positive relationship between networking and access to debt finance. However, Du et al. (2010) find that social capital is negatively associated with access to long-term debt financing for SMEs in China. Chua et al. (2011) argue that most SMEs, given their small size and lack of resources, are not able to make use of social capital to gain debt finance. Ngoc et al. (2009) suggest that most studies relating to networking and access to debt have been inconclusive as to the types of networks that influence access to debt finance or whether networking significantly impacts on access to debt. Ngoc et al. (2009) point out that networking positively impacts on the legitimacy of SMEs. An organization's legitimacy refers to the extent that key stakeholders, the general public, key opinion leaders, and/or government officials know about and accept the organization and its practices. Thus, an organization can increase its legitimacy by spreading the knowledge of its existence among key stakeholders and the general public. Thus it is hypothesised that there is a positive relationship between networking and access to debt finance by SMEs.

Networking and Firm Performance

Research conducted by Zhang and Fung (2006) finds a positive relationship between networking and firm performance. Chen et al. (2007) provide evidence that firms with individuals that accumulate their social capital gain benefits as it promotes their business size, market share and performance. Atieno (2009) finds that membership in trade associations as well as linkages with financial institutions are positively associated with SME performance. Thrikawala (2011) points out that linkages with government improve firm performance by providing resources and information. Eisingerich and Bell (2008) conclude that the capacity of a firm to manage the balance between strong and open network linkages is a key source of sustainable firm performance. Weerawardena and Mort (2006) argue that much of the existing literature on networking and performance has only focused on the positive effects. Research by Watson (2007) find that networking, beyond some level, starts having a negative impact on firm performance. Similarly, Yu and Chiu (2010) disclose that when the social network of a firm's owner or manager becomes too high, the performance of the firm will decrease. Kenny (2009) posits that weak ties in networks are negatively associated with the performance of firms. Okten and Osili (2004) point out that the formation of networks helps SMEs to tap resources in external environment successfully. At the same time, such networks pave the way to new markets. This suggests that networking can positively impact on firm performance. It is hypothesised that networking has a positive impact on SME performance.

RESEARCH METHODOLOGY

The study used the quantitative research methodology approach. The target population was identified as all SMEs in the Buffalo City Municipality (Eastern Cape, South Africa) which comprises the towns of King Williams Town, Bhisho and East London. The population frame of 612 SMEs was identified using the Yellow Pages Telephone Directory. A sample size of 237 SMEs was identified using the Raosoft sample size calculator (Raosoft 2010). The number of employees was used as the proxy to measure SMEs. Probability sampling technique was used to select respondents using simple random sampling as the method of choosing respondents. The self-administered questionnaire was the survey research method used to collect data from respondents. The questionnaire included close-ended questions, dichotomous questions and Likert-scale questions.

Lechner (2006) suggests that no concrete measure of networking exists. However, approaches by Premaratne (2002), Lechner (2006) and Watson (2011) provide insights as to how networking may be comprehensively measured. Networking was measured using a series of close-ended dichotomous questions based on the networks respondents could be engaged in. Specifically, general networks refer (membership in professional associations; attendance of trade fairs; use of accountants, relationships with government agencies and external consultants). Managerial networks included relationships with suppliers, competitors and customers while social networks included relationships with friends and family/relatives and membership in social clubs or associations. Following research by Ngoc et al. (2009) and Talavera (2010), access to finance was measured through dichotomous questions relating to access to bank loans and access to trade credit. Performance was measured through both financial (objective) and non-financial (subjective) methods. Following studies by Fatoki (2011) and Thrikawala (2011) financial measures included satisfaction with sales growth and profitability growth while non-financial measures related performance relative to competitors and satisfaction with overall business performance. Pair-wise deletion was used to treat missing values. Data Analysis was done using the Statistical Analysis Software. Statistical analysis included descriptive statistics (distribution, mean and standard deviation) and bivariate analysis (regression models). To ensure validity, the study used a panel of experts to evaluate the research instrument. In addition, the research instrument was pre-tested in a pilot study.

RESULTS AND DISCUSSION

Two hundred and thirty- seven questionnaires were distributed and sent out to respondents. However, forty-nine respondents were unavailable for the survey and twenty-seven of the respondents did not respond or discarded the questionnaires. The response rate for the study was 68%. The majority of the respondents were males (66%) while 44% were female. The results indicate that most SME owners (41%) were between the ages of 31 to 40. Most SMEs (45%) were small firms with the most common form of ownership (43%) being sole proprietorship. Table 1 presents the full survey results of entrepreneurs' and firm characteristics. The results also indicate that the most commonly used networks were managerial (74%) and social (74%) networks while on average, the mean score for the overall networking of SMEs was 67%. Table 2 presents the full survey results on the different networks of SMEs.

The results of the study indicate that, generally, SMEs network. The scores of the different network types were appropriated and the mean/average score calculated for individual networking as well as overall networking of SMEs. As depicted in Table 2, SMEs utilise managerial

Table 1: Demographics: Firm and entrepreneurs' characteristics

Variable	*Frequency*	*Variable*	*Frequency*
Owners' Age		*Legal Status*	
20-30 years	42	Sole proprietorship	72
31-40 years	68	Partnership	40
41-50 years	32	Close corporations	15
Over 50 years	19	Company	29
Gender		*Industry Type*	
Male	106	Service	19
Female	55	Manufacturing	32
Education		Retail	55
Less than Matric	5	Construction	18
Matric	26	Wholesale	26
Diploma	29	*Size of SME (measured by no of employees)*	
Degree	66	0-49	72
Post graduate	25	50-99	47
Age of SME		100-149	26
1-4 years	58	159-200	16
5-9 years	53		
10-14 years	29		
15 years and above	21		

(74%) and social (74%) networks more than general networks (54%). On average, the mean score for overall SME networking was 67%. 69% of the respondents indicated that they did not have access to bank loans while 57% indicated they had access to trade credit. The mean of the three performance measures was used to evaluate the performance of SMEs. The mean result (3.27) of performance shows that SME owners are satisfied with the performance of their firms.

Table 2: Summation of SME network participation

Range of networks	*Yes*	*No*
General Networks		
Professional associations	48%	52%
Trade fairs and business seminars	69%	31%
Government agencies	58%	42%
Accountant	45%	55%
External consultant	49%	51%
Average for General Networks	54%	46%
Managerial Networks		
Competitors	73%	27%
Suppliers	78%	22%
Customers	71%	29%
Average for Managerial Networks	74%	26%
Social Networks		
Social associations/clubs	63%	37%
Friends	77%	23%
Family and relatives	81%	19%
Average for Social Networks	74%	26%
Average/Overall Networking	67%	33%

Regression analysis was used to determine the extent of the relationship between networking, access to finance and performance of SMEs. The results of the linear regression models (Table 3) (t value = 3.565; beta = .330) indicate that there is a significant positive relationship between overall networking and access to bank loans for SMEs. However, individually, (Table 4) the logistic regressions indicate that only general networks (p=0.0003) are positively associated with access to bank loans. The linear regression model (Table 5) testing networking and access to trade credit indicates that the relationship is significant and positive (beta =.512). Individually, general, managerial and social networks (Table 6) all positively impact on access to trade credit. The results of the linear regression model (Table 7) testing the relationship between networking and performance is positive and shows that there is a significant positive relationship between networking and performance. The parameter estimate (beta = .493) is positive indicating that as the level of networking increases by one unit, performance will increase by .493. Similarly, results of logistic regression models (Table 8) indicate that there is a significant positive relationship between general, managerial and social networks and performance of SMEs. The findings of the study are consistent with similar empirical studies such as Atieno (2009) and Pandula (2011) on the impact of networking on access to debt finance. In addition, Zhang and Fung (2006) and Thrikawala (2011) also find a positive relationship between networking and firm performance.

Table 3: Linear regression - relationship between overall networking and access to bank loans

Model	*Beta*	*t*	*Sig.*
Constant		1.421	.158
Networking	.330	3.565	.001

Table 5: Linear regression - relationship between overall networking and access to trade credit

Model	*Beta*	*t*	*Sig.*
Constant		-7.41	.461
Networking	.512	6.086	.000

Table 4: Logistic regression - Relationship between individual networking and access to trade credit

Variable	*DF*	*Parameter estimate*	*Standard error*	*Wald Chi-square*	*Pr> Chi-square*
General network	1	-3.6653	0.8384	19.1117	.0001
Managerial network	1	-2.0396	0.7378	7.6416	0.0057
Social network	1	-2.8783	0.9846	8.546	0.0035

Table 6: Logistic regression - Relationship between individual networking and access to trade credit

Variable	*DF*	*Parameter estimate*	*Standard error*	*Wald Chi-square*	*Pr> Chi-square*
General network	1	-3.6653	0.8384	19.1117	.0001
Managerial network	1	-2.0396	0.7378	7.6416	0.0057
Social network	1	-2.8783	0.9846	8.546	0.0035

Table 8: Logistic regression-relationship between individual networks and performance

Variable	*DF*	*Parameter estimate*	*Standard error*	*Wald Chi-square*	*Pr> Chi-square*
General network	1	2.8829	0.6491	19.7266	.0001
Managerial network	1	1.3479	0.6077	4.9195	0.0266
Social network	1	2.2969	0.9846	15.1317	0.0035

Table 7: Linear regression-relationship between overall networking and performance

Model	*Beta*	*t*	*Sig.*
Constant		10.352	.000
Networking	.493	5.781	.000

CONCLUSION

The literature discussed has proved that SMEs face difficulties in accessing debt finance. However, as presented by the results of this study, SME with superior access to information and resources through business networking and shares contacts with individuals through social networking will have better access to finance and will also perform better. The findings of this research indicate that networking significantly and positively impacts of access to debt finance and performance of SMEs. In addition, the results of the study also show that different types of networking impact differently on access to debt finance and performance of SMEs.

RECOMMENDATIONS

SMEs are encouraged to build and enhance their networks. By maintaining relationships with government agencies, using accountants and consultants as well as attending seminars, SMEs will gain legitimacy and advice which may improve their access to debt finance. SMEs that gain access to bank loans are most likely to perform better than those firms that do not access debt finance. On the other hand, managerial and social networks will improve SME's access to superior information, contact and resource sharing which will lead to superior performance. SMEs should form joint ventures to counteract their small sizes. This would enable them to access wider markets and compete with larger firms. Government agencies such as the Small Enterprise Development Agency should organise training and mentorship programmes to improve networking by SMEs.

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