Challenges of financing small, medium and micro-enterprises: The case of Botswana manufacturing sector

There is acute scarcity of detailed studies of the manufacturing sector in Botswana, especially the financing aspect, hence the need for the study. The study aims at exploring the financing challenges faced by manufacturing small, micro- and medium enterprises (SMMEs). It makes use of 100 questionnaires relevant to manufacturing SMMEs, and structured interviews were conducted with three commercial banks over a period of 8 months. Results show that SMMEs use more of internal financing than external financing because they cannot easily access external financing due to a lack of collateral security, high default rate, poor credit-rating, poor banking history, lack of honest reporting and lack of up-to-date records. It is recommended that commercial banks should offer financing on a case-by-case basis, consider financing SMMEs that have feasible ideas even when they have no collateral security and mentor and guide SMMEs rather than just financing them. SMMEs should keep up-to-date records. SMMEs need to save money for business’ future. SMMEs should keep clean banking track record and operate with integrity. SMMEs should separate personal transactions from business transactions to avoid misappropriation of funds. They should also seek help from Local Enterprise Authority, bank officials or competent consultants to ensure they have feasible business plans rather than carry unrealistic dreams. Furthermore, SMMEs need to benchmark with companies in other countries. Commercial banks should develop financing packages that suit firms according to their growth stage. They should consider applications individually. Government should develop policies and incentives to lure financial institutions to finance SMMEs.

Introduction

Globally, small, medium and micro-enterprises (SMMEs) boost Gross Domestic Product and contribute towards unemployment reduction, poverty alleviation and economic diversification and development. SMMEs are the stamina of the mainstream of the world’s economies (Rhodes 2012). However, Botswana manufacturing SMMEs are struggling to survive. In the past decade, there has been an enduring debate on SMME development and their contribution to Botswana. The contest has involved SMMEs significance towards employment creation, unemployment reduction, poverty eradication and economic diversification (Okurut, Olalekan & Mangadi 2011). Botswana is located in Southern Africa and has a small population of approximately 2 052 556 people. The country is strategically located at the centre of the southern African region and has potential to supply goods and services to over 200 million people within SADC (Republic of Botswana 2012; World Fact Book 2014). Although there is a big potential market, manufacturing SMMEs like other SMMEs face tremendous challenges that threaten their survival and growth (Jefferis 2014; Moore et al. 2010). The main challenges of SMMEs in Botswana include access to markets, financial issues and competitiveness.

In general, however, the main challenges of manufacturing SMMEs include lack of funding, misuse of business funds (Mannathoko 2011), lack of expertise, lack of innovation, no or poor planning, poor management, lack of business acumen, poor and/or no record-keeping on the performance of business, poor quality products, no or inadequate marketing and lack of market (Katz & Green 2011). Borrowing or external funding has not been easy for manufacturing SMMEs as lenders view them as risky (Okurut & Ama 2013). External finance is a paramount part of the market mechanism for the growth and development of any entity regardless of its size. However, access to credit finance by SMMEs in Botswana has been a daunting experience particularly with reference to accessing this credit from commercial banks (Kaplan & Warren 2010; Kapunda 2015; Nkwe 2012).

Access to finance has been reported to play a pivotal role on business start-ups (BIS 2012). Banks prefer financing individual employees with a guaranteed salary rather than SMME owners.
without undisputable earnings. So SMMEs struggle to finance their businesses and they end up borrowing at high interests from micro-lenders or do self-finance (Fotoku & Assah 2011). Although scholarly studies have been interested in exploring SMME financing, there are few studies on financing challenges of manufacturing SMMEs in Botswana. Thus, there is scarcity of literature. The study therefore fills in the gap by exploring challenges of financing manufacturing SMMEs in Botswana. The study starts with an abstract, followed by introduction, overview of SMMEs in Botswana: importance and financing perspective, literature review, methodology, results/analysis, conclusion and recommendations.

**Literature review**

**Introduction**

In this section the conceptual and theoretical literature review is provided first. The empirical literature review follows. The section ends with a conclusion, which gives a summary of the literature review and indicates how the study differs with others.

**Conceptual and theoretical literature review**

There are various definitions of SMMEs. The study adopts the Botswana national definition of SMMEs. A ‘micro’ business is one with six or less employees; they can have a turnover of up to P60 000 a year. A ‘small’ business is one with less than 25 employees and has an annual turnover of between P60 000 and P1 500 000. A ‘medium-sized enterprise’ is one with between 25 and 100 employees. They have between 25 and 100 employees and an annual turnover of between P1.5 million and P5 million (Republic of Botswana 1998). Some of the popular and relevant financing theories are The Internal Theory of Industrial Development and The External Theory of Industrial Development.

**The internal fund theory of industrial development**

The theory postulates that firms are financed internally through retained profits (Kapunda 2015). Neither gross profits nor net profits are used for investment, but rather retained profits and depreciation expense (funds set aside as plant, machinery, motor vehicles, equipment and other assets that lose value over time) (Stevens 1993). Internal financing is cheap (Almeida & Campello 2007) and easily available compared to external financing, which is usual costly in terms of interests and is not easily accessible, and in the event of failure to pay back, it can result in loss of security.

**External funds theory of investment**

Due to the limited sufficiency of internal funds, the external funds theory of investment suggests that external sources of finance are essential for investment (Kapunda 2015). These include grants, loans, shares, debentures, sales of bonds, strategic partnerships/joint-venturing, factoring, Angel funding and other forms of borrowing (Kaplan & Warren 2010). However, during tough times, firms struggle to repay loans, sometimes resulting in bankruptcy (Almeida & Campello 2007; Kapunda 2015). The challenges of SMMEs to acquire external finance as expounded by the external funds theory may cause firms to feel more secure using internal financing rather than external financing. Most SMMEs struggle to get external financing, so internal financing may be a better option. Nevertheless, some SMMEs apply both the external funds theory and the internal funds theory. In Botswana, for example, CEDA had to reduce funding during the recession in 2009 as many SMMEs were defaulting on repayments (CEDA 2012; Republic of Botswana 2012). By so doing, it meant that firms that had gotten external funds from CEDA to start and run business had to learn to implement internal funds theory henceforth, saving and ploughing back profits into the firm or else the business collapses. The situation is worsened by Botswana’s spiralling household debt, which is causing banks to further get more cautious with lending (African Economic Outlook 2014; International Monetary Fund 2014 Botswana [IMF] 2014).

**Empirical literature review**

A study was carried out by Acquah and Mosemanegape (2007:1–17) to determine factors influencing SMME performance in Botswana. They evaluated 200 SMMEs in Gaborone, Ramotswa, Tlokweng, Mochudi and Molepolole. It was found that start-up capital and total costs incurred in the business played a vital role in business performance. The researchers therefore recommended the following: entrepreneurs need to be assisted to have access to affordable loans (with reasonable interests) and start-up funds and fund utilization from government agencies needs monitoring and evaluation to improve Botswana SMMEs. In 2007, the Botswana Institute of Development Policy Analysis (BIDPA) carried out a survey on manufacturing SMEs in Botswana. The SME study, which covered a sample of 142 SME firms countrywide, indicates that the role and contribution of SMEs to the economy of Botswana is still very small. In particular, the study indicates that the contribution of SMEs to the economy is still hampered by many factors, such as lack of information on SME programmes due to inadequate publicity of available SME programmes and limited commercial bank financial support for SMEs, which makes SMEs solely dependent on the government for support (BIDPA 2007).

A survey by Okurut et al. (2011) on factors influencing credit rationing in Botswana states that that SMEs fail to get financing from financial institutions due to poor records, lack of profitability and performance of the SMEs’ bank accounts. The researchers recommended capacity building for SMEs. Another study by Okurut and Ama (2013) investigated environmental factors that affect performance of a nationally representative sample of 590 women and youth micro-enterprises in Botswana. Results suggest that lack of capital, poor management and lack of markets are the main challenges of micro-enterprises. However, the studies above are not specifically on manufacturing SMMEs and they major on SMEs and in most cases neglect micro-enterprises, which are covered in the current study. There is no recent available survey of financing challenges of manufacturing SMMEs, which is the essence of the current study by the writers of the paper.
Conclusion

All the studies available tend to focus on small and medium enterprises, thereby leaving out micro-enterprises or involve general SMEs, and none is specific to manufacturing SMMEs, in particular the financing aspect of the manufacturing SMMEs. The study attempts to fill the implied gap.

Methodology

The study was done using geographical cluster sampling on target of 329 manufacturing SMMEs from Local Enterprise Authority (LEA) list of clients and Botswana Exporters Manufacturers’ Association from all over Botswana. Geographical cluster sampling was chosen so that results could try to represent the whole country. Cluster sampling refers to a sampling technique where a cluster or group of population elements constitutes the sampling unit, instead of a single element of the population (Lewis, Saunders & Thornhill 2012). The main reason for cluster sampling was that SMMEs tend to locate in urban areas (John Hopkins Bloomberg School of Public Health, 2009). In the study, the population was divided into clusters as follows: Gaborone, Francistown, Maun, Kasane, Serowe and Ghanzi because these are the areas where SMMEs tend to operate. Due to the fact that some of the LEA members could not be reached owing to a lack of contact details, snowballing technique was used where an SMME that fills in a questionnaire is asked to refer the researcher to another SMME owner in the manufacturing industry. Snowballing technique was chosen as it is regarded as unbiased. One hundred SMMEs responded to the questionnaire. That made the final sample of SMMEs. A structured interview of three commercial banks was also administered. The three commercial banks were chosen out of a possible seven because the banks are SME focused. The banks include Capital Bank, Bank of Baroda and Stanbic Bank. All the banks reside in Gaborone, the capital city of Botswana, but have branches in other urban centres across the country. Before the banks were involved in the survey, permission to research was sought by the researcher from the Ministry of Finance and Development and from the three banks involved.

Analysis and discussion of findings

Analysis and discussion of findings for manufacturing SMMEs

Thus far, literature has been considered. In the section, manufacturing SMMEs’ responses to questionnaire are analysed and discussed to deduce meaning and suggestions for improvement. Participants were asked questions concerning their ability to keep accounting records, use of business money for personal use, ease of borrowing, preparation of cash flow projections and increase of and retention of profits. The options for participants ranged from strongly disagree (1) to strongly agree (5). The results of the survey are shown in Figure 1.

![Figure 1: SMMEs financing history](http://www.icbmd.org)
As shown in Figure 1, most of the participants \((n = 36)\) disagreed that funds raised for business are adequate, while only three of them strongly agreed that the funds raised were adequate. The result of the study showed that most of the participants \((n = 32)\) disagreed that securing a loan from either bank or CEDA was easy and nine of them agreed that securing a loan from either bank or CEDA was easy. The results demonstrate that SMMEs struggle with lack of capital. Furthermore, the findings show that 31 participants agree that manufacturing SMMEs are maintaining their accounting records up to date, while 18 of them disagreed that they were maintaining up-to-date accounting records. Majority of SMMEs show that they misuse business money by using it for personal expenses. This aggravates the already existing financing challenges. Majority of SMMEs plough back retained profits into the business. The participants’ sentiments on use of retained profits to finance business support the internal finance theory (Kaplan & Warren 2010). Figure 2 considers the financing challenges that affect business.

Figure 2 shows some of the financing challenges that affect manufacturing SMMEs in Botswana. Lack of working capital tops the list of financing challenges (13%). This is directly linked to the other challenge cited as a major challenge – lack of growth in the business (13%). Furthermore, ‘lack of funds for expansion’ (7%) is mentioned as a big financing challenge among others. Other challenges include ‘lack of customers’, ‘losing of tenders’ and failure ‘to meet targets’. However, a few of the participants mention that their reasons for not borrowing are ‘need to grow slowly, one step-at-a-time without risking borrowing’, ‘we don’t like borrowing’ and ‘the cost of borrowing is too high’. But overall, manufacturing SMMEs do not borrow because they cannot afford it. Furthermore, participants were requested to mention ways in which they solved their financing challenges. SMMEs try to solve their financing challenges as shown in Figure 3. Figure 3 shows that some SMMEs solve their financing challenges through external financing. Majority of the manufacturing SMMEs borrow money from friends/relatives, followed by those who use savings to finance business, that is, internal finance. These save part of the profits, which they later plough back into the business; then some SMMEs borrow money from financial institutions. Other measures include getting advice from experts, security reinforcement, diversifying, engage someone to follow-up payment. It can be concluded that manufacturing SMMEs tend to solve financing challenges the easier way, that is, borrowing from friends and family and falling back on their retained profits, while a few manage to get financing from financial institutions, particularly commercial banks. However, Kapunda (2015) argues that while external funding can be helpful, during tough financial times, businesses fail to pay back loans and they sink into more trouble. This usually leads to SMMEs remaining in financial turmoil, which threatens closure and/or failure.

### Challenges faced by commercial banks when trying to finance manufacturing SMMEs in Botswana

The bank interview participants were Head of Public Sector from Bank 1 (aged 35–40 years), the Senior Branch Manager (aged 45–55 years) from Bank 2 and the Head of SME Banking from Bank 3 (aged 35–40 years). According to the participants, some of the challenges that commercial banks face when trying to finance SMMEs in Botswana include the following.

### Lack of accounting records

SMMEs do not keep record of their daily financial transactions. This interview response from banks tallies with

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**FIGURE 2: Financing challenges that affect businesses.**

<table>
<thead>
<tr>
<th>Financing challenges</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not indicated</td>
<td>27</td>
</tr>
<tr>
<td>Failed to do the project at the expected cash flow and closing</td>
<td>1</td>
</tr>
<tr>
<td>Delay manufacturing process, cause loss of jobs and late deliveries</td>
<td>1</td>
</tr>
<tr>
<td>Delays in establishing a business</td>
<td>1</td>
</tr>
<tr>
<td>Failure to meet targets</td>
<td>2</td>
</tr>
<tr>
<td>Affect operations and difficulty in expansion</td>
<td>3</td>
</tr>
<tr>
<td>Lose some tenders</td>
<td>2</td>
</tr>
<tr>
<td>Delayed deliveries</td>
<td>2</td>
</tr>
<tr>
<td>Loose customers to competitors</td>
<td>2</td>
</tr>
<tr>
<td>Low production</td>
<td>4</td>
</tr>
<tr>
<td>Closing branches and retrenchments</td>
<td>3</td>
</tr>
<tr>
<td>Failure to pay workers</td>
<td>13</td>
</tr>
<tr>
<td>Lack of growth in the business</td>
<td>13</td>
</tr>
<tr>
<td>N/A</td>
<td>5</td>
</tr>
<tr>
<td>Robbery</td>
<td>1</td>
</tr>
<tr>
<td>Lack of customers</td>
<td>5</td>
</tr>
<tr>
<td>CEDA delayed proposal</td>
<td>3</td>
</tr>
<tr>
<td>Establish business workshop</td>
<td>4</td>
</tr>
<tr>
<td>Lack of funds for expansion</td>
<td>7</td>
</tr>
<tr>
<td>Lack of working capital</td>
<td>13</td>
</tr>
</tbody>
</table>

*Source: Research Findings, 2015*
the SMME questionnaire responses to the question ‘do you keep up-to-date records?’ In the questionnaire responses, about a third of manufacturing SMMEs stated that they did not keep records at all. The participant from Bank1 said:

We normally hold meetings with clients and tell them how to keep proper accounting records. But when they come for another meeting asking for financing, when you ask them for records, they either don’t have records or they have unacceptable records. For that reason, it becomes difficult to sponsor their projects.

Failure by manufacturing SMMEs to keep up-to-date accounting records agrees with the survey by Okurut et al. (2011), which revealed that in general SMEs in Botswana rarely keep records. As a result, manufacturing SMMEs find it hard to get bank financing as banks require up-to-date records to judge loan applicants’ potential for getting financing. Although Okurut et al. (2011) dwelt on general SMEs, the current study concentrating on manufacturing SMMEs affirms that SMMEs struggle to get financing, particularly for expansion.

**Mixing personal finances with business finance**

Respondents also mention that SMMEs do not separate their personal expenses from business expenses. Mannathoko (2011) asserts that SMEs tend to suffer financially because they misuse money. This point tallies with the current study’s rankings of challenges faced by manufacturing SMMEs from the questionnaire survey of SMMEs where SMMEs ranked misuse of money as a major financing challenge. One of the respondents (Bank3) puts it this way: ‘Many SMMEs just mix business and personal money, thereby misusing finances and hindering proper financial management. This in turn results in business failure or perpetual financial problems’. When SMMEs misuse business money, it affects records and causes the business to fail to attract financing from commercial banks.

**Heavy debts**

Findings reveal that one of the reasons why majority of manufacturing SMME loan applicants fail to get financing
is that SMMEs are overloaded with other debt before they approach the bank. This agrees with the findings made by Okurut et al. (2011) from a survey on general SME credit rationing. However, their survey differs from the current study in that the current study focuses on manufacturing SMMEs, while the earlier focuses on general SMEs that are not specific to any industry and it looks at small and medium enterprises, but excludes micro-enterprises. Bank 1 elaborates: ‘Most of the SMMEs have been black listed by Information Trust Company (ITC) because they have been reported for having unpaid debts for the next 7 years so they are rejected for any form of financial assistance. However, at our bank we are more tolerant such that even when a person has been blacklisted at ITC, if they show some commitment to a good working relationship with the bank, we can finance their business, but cautiously’. This assertion reveals one of the main reasons why some manufacturing SMMEs do not even try to get financing from banks. Even if they try, SMMEs rarely admit that banks are not lending money to them due to the SMME’s own indebtedness. This discovery helps the reader to understand that commercial banks do not just decide to refuse financing SMMEs. Rather, some SMMEs make things difficult for themselves by taking on too much credit, which hinders creditworthiness when financing is needed most.

**Failure to save money for the future**

Saving money is a general challenge for Botswana as a nation, and manufacturing SMMEs in particular. This notion is supported by IMF (2014) and African Economic Outlook (2014), which say that household debt in Botswana is one of the highest in the region and is a concern. Along these lines, Bank 1 explains:

> We normally teach our clients to avoid borrowing for every little need and want. For example, if we finance a client’s tender for BWP1 Million. Next time when the same client wins a tender for BWP20 000, we don’t expect the client ask for financing as we assume they saved some money from the previous big tender.

This statement proves that banks want SMMEs to grow financially and avoid being too dependent. Therefore, SMMEs need to learn to save money for future use, both for personal and business (Mutoko 2012). By saving money, it helps SMMEs to increase chances of bank financing and to self-finance some minor projects.

**Other worries by commercial banks towards SMMEs**

Other worries of the commercial banks when lending to SMMEs include, ‘risk factors’ that is poor financing management, small ‘market size, lack of collateral security, lack of honesty and SMMEs carrying unrealistic dreams and unattainable proposals. Bank 2 elaborates, ‘Some manufacturing SMMEs carry dreams that are too big and unattainable. So as a bank we have to sit with them and clarify to them the need to scale down their dreams and proposals to become realistic. Otherwise we cannot finance unrealistic ideas and projects’. This further clarifies why some SMMEs fail to get external financing.

**How banks deal with their worries**

The ways in which commercial banks dealt with their worries when lending money to SMMEs include:

**Blocking bank account temporarily:** The banks block the client’s account so that they cannot withdraw money from the account when the bank transfers the money into the account temporarily for records purpose. Some dishonest SMMEs had been rushing to withdraw the money before due time. As Bank 2 puts it, ‘Some SMME loan applicants are dishonest. When they apply for GPO; we are not supposed to give them cash to finance their tenders. Rather we should pay direct to their suppliers to avoid funds misuse. After funding approval, we transfer the money into the applicant’s bank account for record purpose before we transfer the money from his/her account to suppliers. But some dishonest SMMEs rush to withdraw the money from their account before we transfer to suppliers. They then quickly use the money for personal expenses. So we have learnt that as soon as the money enters applicant’s account, as a bank we lock the money’. By locking the money therefore, the bank secures the money away from applicants who want to dishonestly misuse the business money. Dishonest SMMEs clearly demonstrate that they are not serious with business. Rather they are concerned with personal gain at the expense of business growth.

**Obtaining financial history:** Banks gather information concerning SMMEs’ financial history, which includes past financing from elsewhere, records of cash flows over the years, SMME applicants’ other sources of income and dependence. However, ‘financial history is not easy to get because majority of manufacturing SMMEs do not keep up-to-date accounting records’ (Bank 1).

**Conclusions on challenges faced by banks in financing SMME manufacturing:** Negative tendencies by manufacturing SMMEs result in a blame game where SMMEs blame the bank for not supporting them and banks are also protecting themselves from indebted clients and protect funds which rightly belong to the public. In any case, as Bank 3 mentions, ‘banks are not in the business of losing money’. SMMEs therefore need to ‘clean their hands before blaming bankers’ (Bank 1). This means that SMMEs need to keep records, come out of debt, avoid using business money for personal reasons and learn to avoid borrowing for every little financial need.

**Conclusion**

The study concludes that manufacturing SMMEs have potential to help boost Gross Domestic Product, reduce poverty and unemployment and to diversify the economy. If all stakeholders put efforts together, this can be done, regardless of the current challenges besetting the industry. The findings have been very original, which will help increase the body of knowledge on challenges faced by manufacturing SMMEs. Implications of the study are that policy makers, manufacturing SMMEs, commercial banks and tertiary institutions are given homework to improve circumstances, thereby alleviating
financing challenges faced by manufacturing SMMEs and possibly all SMMEs in Botswana.

**Recommendations**

SMMEs should keep up-to-date records to meet commercial banks criteria for lending. SMMEs need to save money for business’ future and avoid borrowing always. SMMEs should avoid unnecessary debt, which reduces their credit score. SMMEs should keep clean banking track record and operate business with integrity. SMMEs should separate personal transactions from business transactions to avoid misappropriation of funds. They should also seek help from LEA, bank officials or from competent consultants to ensure they have feasible business plans rather than carry unrealistic dreams. Furthermore, SMMEs need to benchmark with companies in other countries. Government and policy makers should come up with policies and incentives that make it easier for banks to lend money to SMMEs. Commercial banks should offer financing on a case-by-case basis considering among other things a firm’s stage on the company life cycle, potential for success and not just refuse applications. They should consider financing SMMEs that have feasible ideas even when they have no collateral security and to mentor and guide SMMEs rather than just financing them. Symposiums should be held where SMMEs are taught on how to relate with financial institutions and how to keep up-to-date records.

**Limitations and scope for further research**

It was not easy to get enough willing participants because some questions were deemed sensitive such as questions on profitability of a firm. The study was also limited due to the fact that majority (63%) of study participants were based in Gaborone. In future, studies should concentrate on the whole country and possibly extend to other countries in the region to be more comprehensive.

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**Competing interests**

The author declares that they have no financial or personal relationship(s) that may have inappropriately influenced them in writing this article.

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