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THE INFLUENCE OF SEED FUNDING ON THE GROWTH OF INFORMAL SMALL BUSINESSES IN THE WINELANDS DISTRICT OF THE WESTERN CAPE

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ABSTRACT

Objective: The objective of this study was to explore seed funding as capital needed to start or expand a business. The study considered funding that was granted by local government to small businesses to address financial issues and how effective this intervention was. The main objective was on the impact of seed funding on the growth of informal small businesses in the Winelands District.

Research design and methodology: The quantitative research design was adopted, questionnaires were administered to 60 entrepreneurs who had received seed funding from Cape Winelands district Municipality. The Statistical Package for the Social Sciences (SPSS) transformed the data into usable statistics on the respondents' attitudes, opinions, and behaviours as well as certain variables, which could be generalised to a larger sample group of the population.

Findings: The findings indicate that the seed fund was helpful as it enabled a majority of the business owners to buy equipment and machinery. However, a much larger amount is needed to make their businesses stable and sustainable. In view of the contribution informal small businesses could make to job creation and poverty reduction, government should re-assess its current strategies and systems with regard to seed money.

Implications and recommendations: The main recommendation is that local governments should determine the financial support that is necessary on a case by case basis rather than granting a standard amount of money to small businesses. The start-up needs of informal businesses vary considerably and it is recommended that they be uniquely assisted.

Contribution and value added: The study makes a contribution to the literature on small business sustainability with particular reference to funding. It has implications on the survival of small enterprises and the promotion of entrepreneurship in the context of high unemployment facing South Africa.

Keywords: Entrepreneur, seed funding, growth and development, small businesses, start-ups.

INTRODUCTION

Globally, there is acceptance that economies are largely driven by informal small businesses. These small enterprises, however, experience a variety of challenges that endanger their existence (Agbenyegah, 2013:1). These challenges include, but are not limited to, lack of training and education, funding and lack of finance as well as negative attitudes (Chinomona & Mazirir,

2015:6). Seed funding is a concept that emerged as a solution to the financial challenges that start-ups face. Consequently, there is a need to look at the role played by the seed fund in the growth and development of informal small businesses. This study explored the role and impact of seed funding with particular focus on informal small businesses. The main research question explores the influence of seed funding on the growth and development of informal small businesses in the Winelands District.

The debate surrounding the role played by seed funding for small businesses has been looked at from different angles. One is that this is one of the few means of raising capital without which small businesses will find it difficult to grow (Fatoki & Garwe, 2010:731). In conducting this study, it was noted that though the vast majority of informal business owners have the appropriate registration documents, financial institutions are reluctant to assist these entrepreneurs (Khosa & Kalitanyi, 2014:213). A critical question then relate to whether seed funding fills the gap and makes it possible for informal small businesses to achieve the necessary growth and development.

LITERATURE REVIEW

Small business vulnerability

Small enterprises are often vulnerability in their start-up phases. Vulnerability means the state of being exposed to external pressures. This description is supported by the work of Anirudh and Abhishek (2017:5) who assert that vulnerability of start-ups mainly refers to the long-term prospects of start-ups and the likelihood that they will fail because of lack of planning, lack of execution, stiff competitions from pre-existing companies, lack of resources etc. If the entrepreneurs concerned do not have the necessary nurturing and mentorship, they inevitably succumb to the pressures of the outside world. Often young CEOs make the mistake of underestimating their competition because of their flawed analysis of the market and its demands. When they face the real world after gathering their initial capital, they cannot handle the pressure. Previous studies have also indicated that the failure rate of start-ups is on the rise, making them seem like bubbles that are about to burst. Nyamao, Patrick, Martin, Odondo and Simeyo (2012:5807) estimate that more than 40% of small businesses fail within the second year of their existence. Whereas Ligthelm (2013:57) and Ngorora and Mago's study (2013:9) assert that a reason why informal small businesses do not grow is that they are run by survivalist entrepreneurs who lack business acumen and mind-sets.

A study by Anirudh and Abhishek (2017:5) concluded that start-ups are exciting but risky. For many entrepreneurs, navigating the competitive landscape and securing the funding needed to survive are significant hurdles. The truth is that there is a limited amount of funding available for start-ups and innumerable new ventures that compete for it. Mukwarami (2017:5) points out that the investors and financial institutions require a well-articulated business plan, but there is considerable evidence that most informal business owners do not have such specialised knowledge. The ones that manage to secure funding are the ones that have been able to demonstrate how their good idea will actually come to fruition. Even though, Anirudh and Abhishek (2017:9) argue that obtaining a start-up as a mode of investment is no longer a worry, it seems that investors

are only interested in supporting start-ups that have properly explored the niche they will fill. In other words, investors are only prepared to invest in start-ups that will bring immediate returns.

Access to capital

According to Anurudh and Abhishek (2017:4), raising funding for start-ups is the most important step after the start-up plan has been drawn up. They mention several important and tried and tested methods to raise funds for start-up enterprises. Among those are crowd funding, angel investment, venture capital, raising money through bank loans, raising funds by winning contests, getting business loans from microfinance providers or NBFCs and applying for government programmes that offers funding of start-up.

Fatoki and Garwe (2010:731) contend that without capital, informal businesses find it hard to grow their businesses. However, the lack of capital, and acquiring it in the first place pose serious challenges to informal businesses. Even although a vast majority of informal business owners have the appropriate registration documents, financial institutions are reluctant to assist them (Khosa & Kalitanyi, 2014:213). In a different study, Tengeh and Nkem (cited in Tengeh & Murakwami, 2017:65) state that the problem is not necessarily because of a lack of finance, but rather because of limited access to formal finance. A number of factors, including limited information, no records of performance, and a lack of collateral to secure bank loans, inhibit reasonable access to formal finance. Unfortunately, as Rogerson (2010b:38) states, there is little support from government to assist these entrepreneurs to overcome these constraints. Anurudh and Abhishek (2017) argue that every time you get funding, you give up a piece of your business. The more funding you get, the more business you give up. That piece of company is 'equity'. Every person you share it with becomes a co-owner of the business.

The influence of seed funding on the growth and development of small businesses

Seed funding is often obtained in exchange for an equity stake in the enterprise concerned. In this case, however, the money was granted by local government. Basically seed funding can provide the fuel on which a business runs in the start-up phase. At this point, profits are likely to be low; hence the organisation needs financial aid to cover its expenses until its cash flow makes the business sustainable (Fakoti, 2010). As already noted, funding is needed to allow the profits to pick up to a point where the cash flow can meet the operational expenses. In the context of this study, seed funding is the money the Cape Winelands district municipality provided to the informal small businesses.

The reason that funding for small businesses is called seed funding is that the amounts range between R15 000 and R30 000. Investments termed seed funding usually range in the tens of thousands to hundreds of thousands, unlike venture capital investments, which can involve millions of Rands. It has to be acknowledged that local government aims to help small business enterprises address the challenges they face in the start-up phase. Abdulaziz and Worthington (2013:5) assert that government has acknowledged that the SME sector faces financial constraints, and cannot access financial aid in developed and emerging countries. At the same time, if the SME sector is unable to contribute to economic growth, it may negatively affect the at national goals.

The country's economy depends on the growth of SMEs'. As Fatoki and Odeyemi (2010:6) state, governments throughout the world acknowledge that the development of the SME sector promotes economic growth. Supporting small business development, for example, is an effective way to address unemployment, in that small businesses create jobs (FinMark Trust, 2006:1). For this reason, government schemes and programmes have been introduced to ensure that SMEs can access government financial schemes and programmes. Official government schemes have the potential to increase SMEs' access to additional credit. However, although it is acknowledged that the value of the government finance schemes, Jennings of Urban Ministry's article entitled, *Pros and Cons of Receiving Government Funding*, argues that when you bring investors into your business, you grant them a certain measure of control over the business. This means, in this case, that the SMEs are subject to restrictions in terms of fund usage. All government grants come with rules and regulations, and budget constraints are introduced each year, which affect the availability of funds to cover all businesses in need.

The financing of SMEs has been a major issue across the African continent. Gbandi and Amissah (2014:10) point out that the Nigerian government has introduced financing schemes and programmes for some years now to overcome these financial constraints. In their view, proper financing of SMEs is essential to promote and leverage small and medium enterprise development in Nigeria (Gibandi & Amissah, 2014). Fatai (2009:5) concurs, saying that one of the major challenges that SMEs face is lack of capital to finance their operations.

In South Africa, government seed funding for small businesses should help to grow the economy. Rogerson (2008:7) highlights the ability to access funding, skills and business management skills, training, and accommodative rules and regulations as key strategic elements that support the three pillars to promote entrepreneurship, strengthen the facilitating environment, and enrich enterprise level capacity and competitiveness. The investigation in this section is linked to the analysis provided above, in that it explores the challenges and disadvantages of receiving seed funding. An additional challenge that is not explored is that writing a good proposal is beyond the capacity of most small business owners. An indication of this is that some freelance writers specialise in writing grant proposals for others (Rogerson, 2008).

Methodology

Research traditions overallly recognise qualitative and quantitative paradigms as the dominant approaches to scientific enquiry (Creswell, 2018). This study relied on the quantitative approach which, as Brynard and Hanekom (2006:36) stated, is statistically orientated and assigns numbers to observation. While the qualitative approach is primarily concerned with understanding a particular incident or phenomenon and is used to uncover trends in thoughts and opinions, whilst delving deeper into the problem, the quantitative approach is objective and numerical. The quantitative approach enumerates the problem and generates data that can be transformed into usable statistics as opposed qualitative data which is non-numerical and often relies on small sample size. The quantitative approach was deemed appropriate as it makes it possible to generalise results from a large sample from a population by quantifying the respondents' attitudes, variables, opinions, and behaviours. The participants in this study were sixty (60) selected informal

business entrepreneurs. Following the belief that the quantitative tradition would effectively address the aim of this study, quantitative data collection techniques and analysis procedures were used in the research design. The primary collection of data was done using the survey method through a web-based questionnaire. In research, population is the sample selected randomly from a particular group which has similar characteristics (Brynard & Hanekom, 2006:55; Flick, 2007:85). This enables the researcher to obtain information that can be generalized. Probability random sampling, which can be used only for finite population (Alvi, 2016:16) seemed most suited to this research. Making it possible for every entrepreneur on the list to have an equal chance of selection helped the researchers to avoid any unconscious bias they may have had that would have affected the data they collected. The sampling frame for this study consisted of a list of 60 informal small businesses that had received seed funding from the Cape Winelands district municipality. According to Bryman (2004:87), a sample frame is a criterion that allows the researcher to select potential participants from the population, given that it would be time consuming and expensive to target the whole population of a study. The sample frame in this case was entrepreneurs who had received seed funding from Cape Winelands District municipality between the 2015 and 2018 financial years. Participants were drawn from the following local municipalities within the Cape Winelands district: Drakenstein Municipal Area (10), Stellenbosch Municipal Area (13), Witzenberg Municipal Area (13), Breedevalley Municipal Area (13) and Langeberg Municipal Area (11). Closed-ended questions were used in this questionnaire that offered the respondent a choice of two or more fixed alternatives. Closed-ended questions have the advantage of obtaining greater uniformity of measurement and, therefore, greater reliability since the respondent answer in agreement with the response category. The sample size of this research was 60 entrepreneurs and by analysing the data obtained, the researcher was able to calculate the number of businesses affected in order to explore the impact of a seed fund in their development.

RESULTS AND DISCUSSION

The web-based questionnaire automatically entered and saved the data to a computer file which was exported into an Excel spreadsheet so that a statistical analysis could be done. A descriptive as well as inferential statistical analysis was made of the data. The descriptive analysis was done to allow trends or patterns to emerge. The results, which were based on the survey and analysis of the questionnaire answered by the beneficiaries of seed fund granted by the Cape Winelands municipality, were categorized into: (1) the impact of seed funding policy, (2) the seed fund role, (3) the amount of seed fund, (4) Sufficiency of seed funding received as well as (5) Business management skills and mentoring offered to funded beneficiaries post seed fund release.

Profile of the entrepreneurs

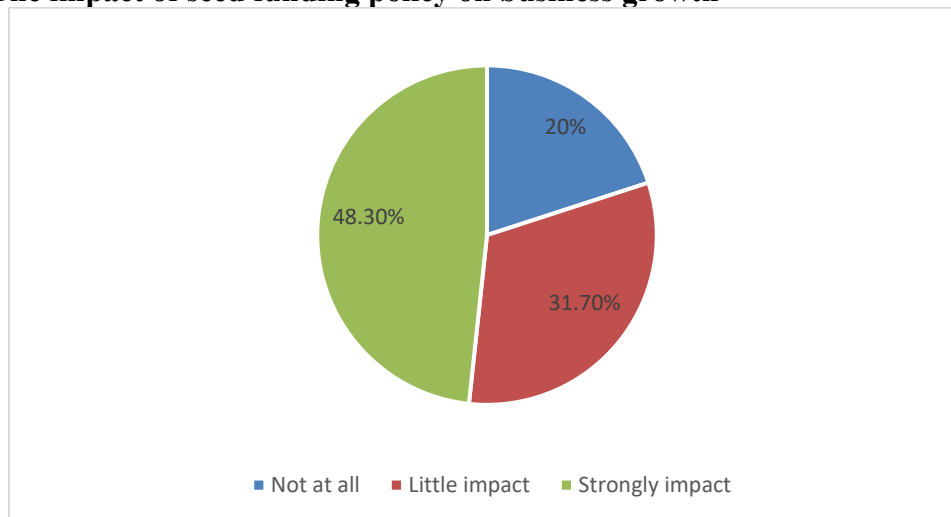
Fifty-two percent (52%) of the respondents were females, which is in line with the fact that they are in the majority of the population of this study. It shows that they are economically empowered and active in spite of few or no opportunities for employment. It was disappointing to learn that only seventeen percent (17%) were young people. The government should ensure that young people are aware of and have ready access to their support systems. Eighty-seven percent (87%) of respondents confirmed that their companies were in the service industry. The seed funding

amounts were minimal and it was difficult for them to obtain the required capital to engage in manufacturing or industrial businesses.

Restrictions on and blueprint for government financial assistance

Figure 1 below shows that the largest number, forty-eight percent (48%), of businesses that received seed funding in the Cape Winelands strongly believed that restrictions on accessing financial assistance affect business growth, while thirty-two per cent (32%) felt that the restrictions had little impact on their businesses' growth, twenty per cent (20%) considered that the restrictions had no negative effect on accessing financial assistance that prevented their businesses from growing. According to what the respondents in this study said, government should adjust some laws and regulations such as (but not limited to) licensing, permits and surety bonds that place serious restrictions on the ability of entrepreneurs to run their businesses. The study done by Ngorora and Mago (2013:9) supports this view. It shows that rural entrepreneurs can succeed when government regulatory systems provide flexible policies that can create better business growth chances. In addition, they also recommend that rural entrepreneurs should be given coaching in business management, access to knowledge and advice, and proper guidance. They should also be equipped with skills in financial management. In similar vein, the study done by Choto, Tengeh and Iwu (2014:96) found that South African government regulations have created a massive administrative burden which is costly to someone who is starting a business.

Figure1: The impact of seed funding policy on business growth

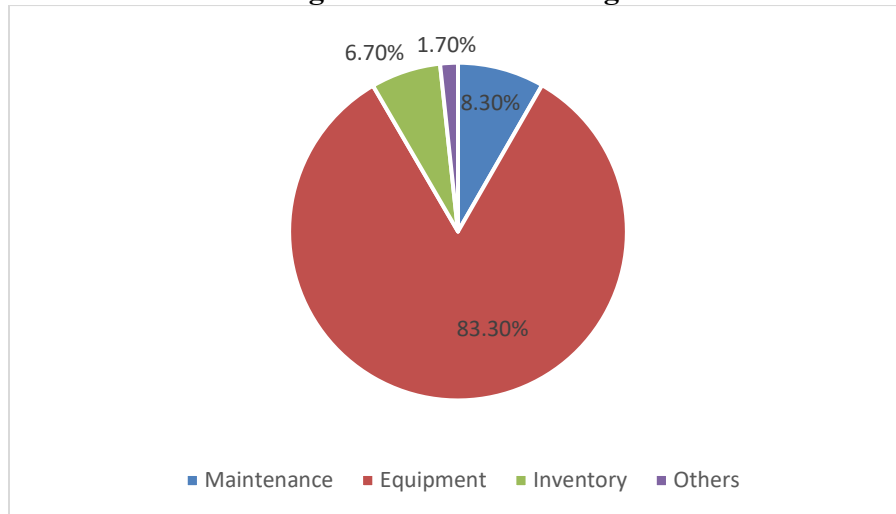


The role of seed fund to business functioning

Figure 2 shows that eighty-three percent (83%) of respondents spent their seed funding on business equipment, while eight percent (8%) spent it on maintenance of their business infrastructure, seven percent (7%) bought inventory, and two percent (2%) was spent on other business functions. In respect of this results, Ngorora & Mago (2013:4) recommended that the government should focus on providing equipment and developing infrastructure to support profitable businesses. If governments were to do what the literature recommends informal business growth would be

boosted. These businesses would be able to use the seed funding money to strengthen their profit making ability, and to have better infrastructure and business equipment.

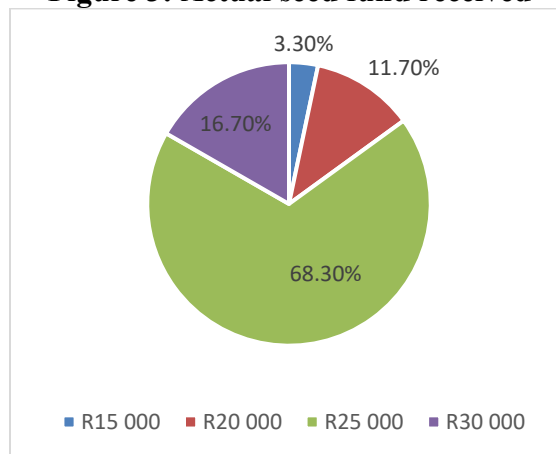
Figure 2: Seed fund usage



The amount of seed funding received

Figure 3 shows that sixty-eight percent (68%) of the respondents each received R25 000 seed fund, whereas seventeen percent (17%) R30 000, twelve percent (12%) R20 000 and three percent (3%) received R15 000 each. The amount of seed funding provided to these informal businesses between year 2015 and 2018 ranged from between R15 000 and R30 000 per entrepreneur.

Figure 3: Actual seed fund received

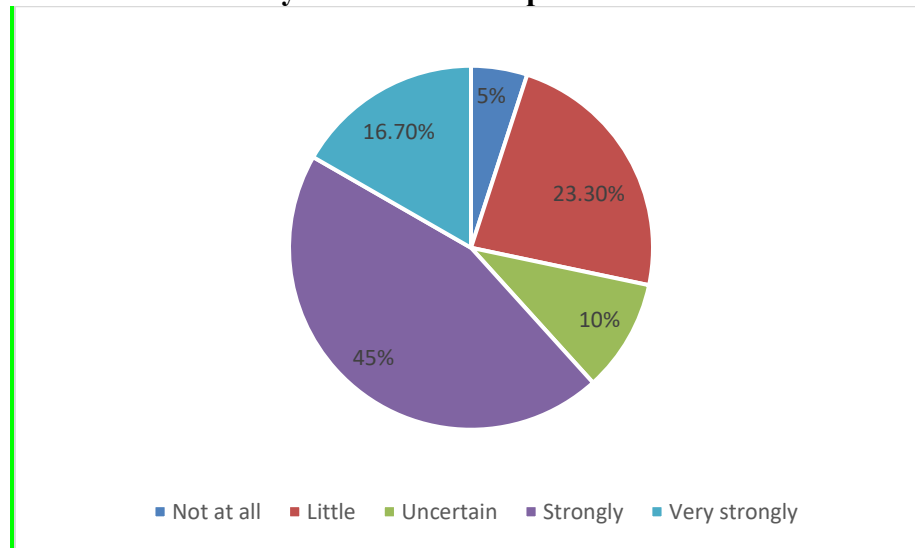


Sufficiency of seed funding

Based on respondents' feedback shown in Figure 4, sixty two percent (62%) strongly believed that seed funding covers only the basic needs of the business, (10%) are uncertain whether it is sufficient or not, twenty three percent (23%) believe that it covers basic needs, and five percent

(5%) believe that it is not sufficient at all. Based on the information shared by respondents, the seed fund helped them to buy start up equipment. Only a small percentage reported that they did not have enough money for business operations, to buy more stock and pay staff. Hence their businesses were not yet sustainable. According to Rath (2011:18), informal businesses with limited funds and resources end up failing. That is the case with the most seed funded informal businesses of the Cape Winelands.

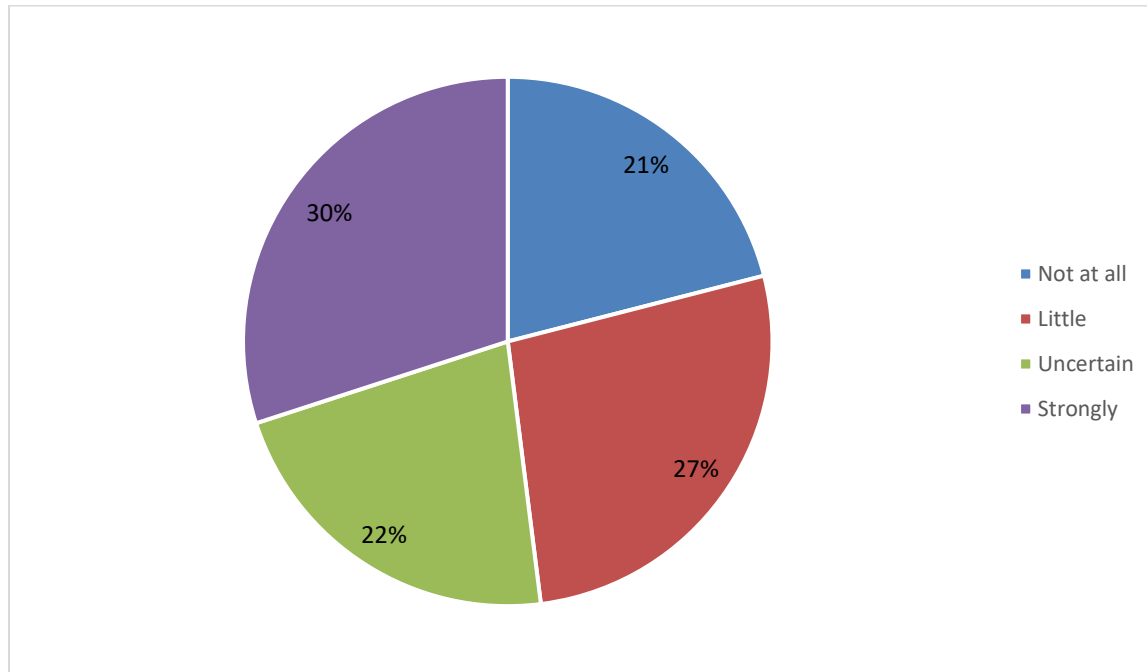
Figure 4: Seed fund covered only the basic start-up of business



Adequacy of seed funding strategy and system

Based on the feedback depicted in Figure 5, most owners were not happy about the support they received. Thirty percent (30%) of the respondents stated that government support is strongly available after seed funding is released, twenty-seven percent (27%) believed that a little support is given to seed fund beneficiaries, whereas twenty-two percent (22%) were uncertain about it, and twenty-one percent (21%) did not feel that any support was given to informal businesses at all. It is crucial for small informal business owners to have the benefit of mentoring so they can acquire the business and financial management skills which they need to be able to utilise seed funding efficiently. Without it they are unlikely to experience business growth and sustainability with the ability to create employment. Choto's (2015:68) study showed that there is a relationship between the number of employees hired by the entrepreneurs that have completed the incubation programme compared to those who did not do the programme. About seventy per cent (70%) of the respondents were not convinced that they had been provided with sufficient business management skills. This may explain stagnant business performance. Government should provide the informal businesses which received seed funding with incubation programmes to enable them to invest the seed fund effectively grow and sustain their businesses.

Figure 5: Skills and support received after seed funding



CONCLUSION

This study investigated how helpful seed funding is by exploring how the informal small business owners in the Cape Winelands district of the Western Cape had used it. The analysis of the impact of seed funding revealed a gap between the government business development strategies and systems of seed funding implementation and the needs of the informal businesses, particularly with regard to the insufficiency of the grant and the lack of mentoring and coaching. The findings suggest that the government should identify individual business needs rather than offering a standard amount of money. The research investigated how helpful seed funding is, and how informal small business owners used it. The findings indicate that the government granted between R15 000 and R30 000 to the small businesses, but this was not sufficient, as it only covered basic needs such as equipment and machinery. The respondents stated that there is a need for funds to assist them with business operations (inventory, materials, and human resources), and more effective infrastructure, storage facilities, internet technology, machinery and equipment and marketing strategies.

Recommendations

Based on the findings of this study, it can be recommended that governments should increase seed fund amounts to cover at least the infrastructural development necessary for the business to succeed. Additionally, the government also need to appoint officials or incubators to support the businesses until they become sustainable. At present, informal businesses cannot get loans from banks or other financial institutions because they lack the necessary security and business stability. Business incubators are, therefore, encouraged to assist survivalist entrepreneurs to build an

entrepreneurial mind-set. Choto et al. (2014: 40) identified lack of skills and expertise, funding challenges, technology and access to business networks as the reasons why entrepreneurs need business incubators. Business networks should enable entrepreneurs to be successful even if they have limited funding (Choto et al. 2014: 40). Vegitti & Adoscalitei (2017) agree that business incubators have established networks that they can connect entrepreneurs to, and they also run workshops where social interaction is encouraged: it is essential for entrepreneurs to join the incubation programmes. An outstanding finding was that the informal business owners used the seed funding to buy equipment, and said that they had expected the government to offer more assistance than just finance.

Future Research

This study took note that the informal small business owners had received seed funding from government. There is need for future research to explore the gap between the alignment of government business development policies and the informal businesses that constraints the growth of informal small businesses. In consideration of the findings of this study and those of the literature, Kabangele's (2019:136) in particular, future research should also consider existing government initiatives to support entrepreneurship, there is a need for those initiatives not only to be effective and efficient but also to be publicized. Many of the entrepreneurs who do not receive any support from government institutions, do not seem to be aware that they could. Therefore, organisations such as SEDA, Khula, NEF and IDC, amongst others, should extend their support campaigns and outreach programmes, especially those earmarked for the townships. Moreover, future research should focus on the extent to which government support structures and policies meet the needs of the informal small businesses. It should also be aim at exploring possible ways of supporting informal small businesses which are granted seed funding.

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