FINANCIAL PLANNING AND CONTROL SYSTEMS: ESSENTIAL TOOLS TO INCREASE THE SURVIVAL RATE OF MICRO AND SMALL MANUFACTURING ENTERPRISES IN THE TSHWANE METROPOLITAN AREA

by

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submitted in accordance with the requirements for the degree of

MASTER OF COMMERCE

in the subject

ACCOUNTING

at the

UNIVERSITY OF SOUTH AFRICA

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CO-SUPERVISOR: PROF CC SHUTTLEWORTH

February 2011

ACKNOWLEDGEMENTS

Firstly, all honour and glory to my Lord and Saviour Jesus Christ for blessing me with the strength to complete the task.

I would also like to dedicate this research to my late father. His belief in me gave me the energy to complete the task.

I would also like to take this opportunity to thank the following individuals:

- My husband, Dudley, for his patience and understanding in the past few years
- My family, friends and colleagues for all their encouragement.
- Professors Piet du Plessis and Bienkie Shuttleworth, my supervisors, for their invaluable guidance, advice and moral support.
- Andries Masenge, who assisted me with the questionnaire and statistical matters.
- Professors Deon Tustin and Carel van Aardt, for their advice.
- Lynette Van den Heever for assisting me with the tables and graphs.
- All the respondents who participated in the study for their time and valuable contributions.
- Moya Joubert. for her professional and critical editing of the manuscript.

DECLARATION

Student number: 6910343

I declare that FINANCIAL PLANNING AND CONTROL SYSTEMS: ESSENTIAL TOOLS TO INCREASE THE SURVIVAL RATE OF MICRO AND SMALL MANUFACTURING ENTERPRISES IN THE TSHWANE METROPOLITAN AREA is my own work and all the sources I have used or quoted have been indicated and acknowledged by means of complete references.

Mrs P R Berry

February 2011

ABSTRACT

The use of financial planning and control systems is one of the factors that influence the survival of small businesses. The purpose of this study was to determine whether the use of financial planning and control systems contributes to the survival of manufacturing MSEs in the Tshwane metropolitan area.

The development and use of financial planning and control systems in MSEs was investigated. Manufacturing MSEs were asked to disclose the financial planning and control systems being utilised.

Respondents indicated that they use some form of financial planning and control, be it, on a formal or informal basis. Most of these firms had been operating for a number of years suggesting that the use of financial planning and control systems, inter alia, contributes to the survival of an entity. The more modern financial planning and control systems are not readily used by manufacturing MSEs, but could be beneficial to their survival.

Key terms

Financial planning and control systems; MSEs; budgeting; survival of MSEs; financial education

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CHAPTER 1

INTRODUCTION

If we knew what it was we were doing, it would not be called research, would it? Albert Einstein (1879–1955)

1.1 Background to the study

When the idea of budgeting began, accountants were there merely for their financial expertise, and seldom as part of the management team. Their only function was to compile the financial statements and produce other reports for management, which senior management used for decision making.

During 1950, a specialist team of accountants from the UK visited the USA and produced the Management Accounting Report, which defined management accounting as ”the presentation of accounting information in such a way as to assist management in the creation of policy and in the day-to-day operations of an undertaking” (Batty 1968:2). With this, the role of the accountant changed somewhat and management accountants came into being. Today, management accounting provides managers with vital information that helps them to manage the business (Seal, Garrison & Noreen 2009:4). Traditional budgeting and its variations, better budgeting and the more modern management accounting systems are just some of the techniques that can be used to improve planning and control in an organisation.

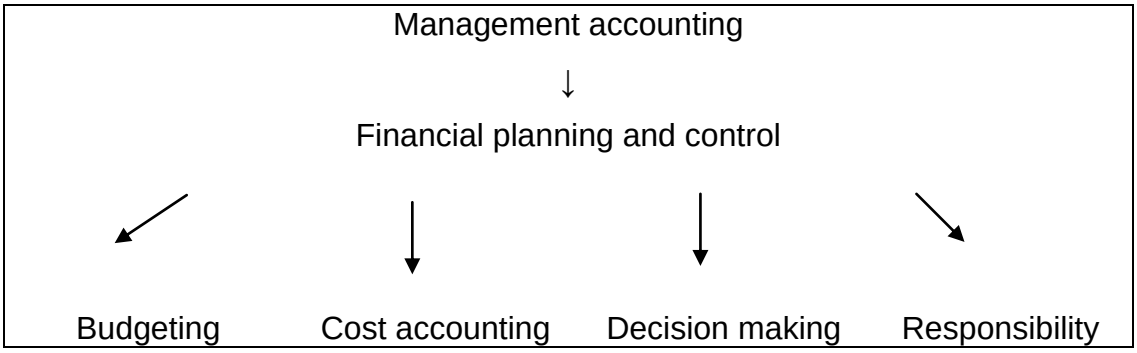
In the past, manufacturing enterprises were mostly concerned with manufacturing and selling their products. In the dynamic environment of today, organisations need to compete in a buyer’s market to be successful and the traditional systems of the past cannot always accommodate these changes. Many management accounting systems have evolved over the years, and these include financial planning and control systems. Financial planning is the

adaption of the broad objectives, strategies and other plans of an organisation into financial terms (Welsch, Hilton & Gordon 1988:72). Today, nonfinancial indicators such as competition, availability of resources, quality and customer satisfaction are also being used by management in their decision making. Management accounting systems help managers and staff members with decision making, and with planning and control by gathering and supplying them with the financial and nonfinancial information they need (Drury 2004:7); (Garrison, Noreen & Seal 2003:2).

Financial planning and control systems should be used by all enterprises including MSEs. Research indicates that there is a widely held view that many new businesses fail at a startling rate (Monk 2000:12; Perry 2001:205; Van Eeden, Viviers & Venter 2003:13; Radipere & Van Scheers 2005:402; Van Biesebroeck 2005:546; Carter & Van Auken 2006:493; Gruber 2007:784). Research on small firms in Vietnam revealed that enterprises with a formal planning system appeared to be more profitable than those without, and also that smaller firms were less likely to have formal plans (Masurel & Smit 2000:101). In this context, a formal plan means a written plan as opposed to an intuitive plan. These findings indicate that if any enterprise, which includes micro and small enterprises (MSEs), wishes to be successful in the current market, it needs to rethink the role it's planning and control systems play in the organisation.

Figure 1.1 gives an indication of the relationship between management systems, financial planning and budgeting systems.

Figure 1.1 Relationships in management accounting



Source: Compiled by researcher

The managerial ability to plan, lead, organise and control is a crucial function in any enterprise. Budgeting, as the process is commonly known, is there to aid in better management of the enterprise and to achieve higher profits or minimise losses. A budget is defined as a detailed plan indicating how resources are to be acquired and used (Hilton, Maher & Selto 2006:597); Garrison et al 2006:378). According to Garrison et al (2003:451), budgeting systems serve multiple purposes with **planning** and **control** being two of the more important functions. These authors state that it is up to management to decide which function should be more appropriate to the enterprise. For example, the authors argue that larger firms should focus on the control and coordination aspects of budgeting, whereas smaller companies should be more concerned with the planning aspects. Planning entails setting goals for the enterprise, whereas control implies the attainment of these goals. Longenecker and Moore (1991: 458) agree and suggest that small businesses that operate in uncertain and competitive environments need to plan and control their operations because this will help owners/managers to run their businesses successfully.

From the above-mentioned information it is apparent that because of the current economic environment and the fact that there are a large number of small firm failures, small entities need to plan and control their operations.

There is also a need to investigate whether the lack of planning and control operations is a reason for the high fatality rate of MSEs.

1.1.1 Micro and small enterprises (MSEs)

When the unemployment rate in a country is high, many people start their own small businesses just to survive. With unemployment levels being around 23% in South Africa (Statistics South Africa 2007:xvii) many people are starting their own private businesses, and according to Statistics South Africa, there are just under two million small businesses in South Africa, including informal businesses (Statistics South Africa 2007:26). In 2005, the South African government initiated the Accelerated and Shared Growth Initiative for South Africa (Asgi-SA) after it had been instructed to reduce unemployment to below 15% and halve the poverty rate to less than one-sixth of households (The Presidency 2006:13). There are a number of national support institutions that assist in the development of MSEs, for example, the Small Enterprise Development Agency (Seda), which was launched in December 2004, Khula Finance and the Industrial Development Corporation (IDC). These organisations assist with finance and capital as well as education and training in business skills. It is obvious that the South African government is encouraging the growth of small business to help alleviate unemployment and boost economic growth.

Those who start businesses because of unemployment and mere survival often do not register their businesses and, therefore, operate in the informal sector of the economy. According to the Labour Force Survey (Statistics South Africa 2007: x) conducted by Statistics South Africa, in September 2007, 16% of the South African labour force were employed in the informal sector. Valodia (2006:4) reports that “the informal sector is incorporated in South Africa’s national accounts and is estimated to contribute some 7% of GDP”. It is thus evident that there are many small enterprises in South Africa operating in the informal sector.

1.1.1.1 Classification of MSEs

There is no single definition of MSEs although there are a number of definitions for small businesses. In South Africa, they have been called small and medium enterprises (SMEs), small, medium and micro enterprises (SMMEs), micro and small enterprises (MSEs), very small enterprises (VSEs), very small and micro enterprises (VSMEs), entrepreneurial enterprises and survivalist enterprises. Businesses that fall into these categories are generally privately owned by individuals who, for various reasons, choose to establish a business. The focus of this study will be MSEs, which are obviously included in SMEs and SMMEs.

According to the Ntsika Enterprise Promotion Agency, which was a small development agency of South Africa's Department of Trade and Industry (DTI), small, medium and micro enterprises (SMMEs) form the backbone of the national economy and employ more than 50% of the workforce. Ntsika reveals that micro enterprises have about one to five employees, very small enterprises between five and 20 employees, small enterprises between 21 and 50 employees and medium enterprises between 51 and 250 employees (Malagas 2004:10). Petersson (1998:126) reports that one-man businesses and enterprises with 40 to 50 workers are included in the definition of MSEs. Of the MSEs studied in African countries, the enterprises with 10 to 50 employees consist of less than 2% of the total MSEs, while the majority consist of one person working alone (Mead & Liedholm 1996:620). Many family-owned firms fall within the definition of small and micro enterprises.

It is evident from the above that small enterprises, including those operating in the informal sector, play a vital role in the South African economy.

1.1.2 The informal economy

South Africa has many people operating in the informal economy. The informal sector consists of those enterprises that are not registered in any way. They are generally small and are seldom run from business premises. They are

usually run from homes, street pavements or other informal arrangements (Statistics South Africa 2005: xxiv). Most of the enterprises in the Third World fall within the informal economy, with few employees, very few assets and non-conformance with laws and regulations (Mead & Morrisson 1996:1617).

The education level of owners in enterprises in the informal sector is also a major factor to the survival of these enterprises. The DTI (2004:61) reports that small enterprises have a higher life expectancy if the owners have a better education. The Labour Force Survey indicates that between 18.0 and 39.5% of those with a grade 11 or lower qualification were unemployed (Statistics South Africa 2005:8). Also, many (51%) of the entrepreneurs in MSEs in South Africa do not even have a matric qualification (South Africa, DTI 2004:62). Many people who are employed in small and micro enterprises in either the formal or informal economies work in the manufacturing sector.

1.1.3 Manufacturing enterprises

Since most research on small business in South Africa has included all sectors of the economy, this study will focus on the manufacturing industry. Pedersen and McCormick (1999:109) report that by being employed in the industrial sector, there is a chance of higher wages and a better quality of life and that "industrialisation is seen as a key to development". For the purposes of this study, the definition of small and micro manufacturing enterprises was taken from Schedule 1 of the National Small Business Act of 1996, as revised by the National Small Business Amendment Bill of March 2003, which gives the following as the thresholds for classification as micro, very small, small or medium manufacturing enterprises:

Table 1.1 Classification of manufacturing SMMEs

Size	Total full-time equivalent of paid employees	Total annual turnover (Rm)	Total gross asset value(fixed property excluded) (Rm)
Medium	200	51.00	19.00
Small	50	13.00	5.00
Very small	20	5.00	2.00
Micro	5	0.20	0.10

Source: Adapted from the National Small Business Act 102 of 1996

The above table has been adapted by leaving out other sectors of the economy and only revealing information on manufacturing enterprises. For the purposes of the study, enterprises were selected on the basis of the number of full-time employees, that is, those manufacturing enterprises that employ 50 or fewer people.

The development of the manufacturing sector in a country is an opportunity for growth. The manufacturing sector in South Africa comprises 12% of the small enterprises in the formal sector (DTI 2004:12). Manufacturers represented 9% of small businesses in the informal sector in 2004 (DTI 2004:48). The South African government is eager to promote growth in the manufacturing sector because industry provides a stimulus for growth in other areas of the economy (South African Government 2005:27). Groups such as the National Manufacturing Advisory Centre (NAMAC) and its subsidiaries, a network of Manufacturing Advisory Centres (Macs) throughout South Africa assist small manufacturing enterprises in all spheres of operation. For small businesses to survive they should have distinct planning and control systems in place. This is especially so for manufacturing enterprises where the planning and control of raw materials and other resources is vital for the survival of the business.

1.1.4 Traditional financial planning and control systems

Traditional budgeting in the private sector became popular at the beginning of the 20th century, and the main function was that of cost control (Clarke 2001:3). Garrison et al (2003:450) define a budget as "a detailed plan for the acquisition and use of financial and other resources over a specified time period. It represents a plan for the future expressed in formal quantitative terms." In other words, a budget is a plan which, in detail, indicates how resources are to be acquired and used. Budgeting, however, is the whole process of developing and administering the budget (Keith & Keith 1985:168), while budgetary control is a system whereby budgets are used to control the activities of an organisation (Garrison et al 2003:450).

Traditionally, budgeting was a command and control design. The systems were designed by accountants mainly as a device for financial forecasting, managing cash flow and capital expenditure and controlling costs (Bunce & Fraser 1997:26). Top executives put the plan together and expected employees to adhere to it. This top-down approach caused negative behaviour in employees.

These days, employees desire empowerment and want to be part of the whole planning and budgeting process. The owners of a private enterprise will probably have profit as their main justification for the enterprise, but employees will not necessarily have the same goals. If employees are dissatisfied with the way the owner manages the enterprise, this could cause conflict and ultimately the failure of the enterprise. Stenzel and Stenzel (2003:62) suggest that management should be mindful of the human factor in budgeting and the budget system should be used positively.

Much research has been done worldwide on the effectiveness of traditional budgeting systems, and Clarke (2001:12) found in a survey in the UK that

budgeting was still the most important management system used. Ahmad, Sulaiman and Alwi (2003:723) found in their research of Malaysian companies that budgets are still useful today, and Sulaiman, Ahmad and Alwi (2004:495) discovered that traditional budgeting methods are still widely used in Asian countries.

The role of traditional budgeting has changed over the years, and many types of financial planning and control systems are used in practice. Stenzel and Stenzel (2003:81), highlight a number of important budget developments, referred to as "better budgeting", which include the following:

- continuous and flexible budgets
- zero-based budgets (ZBBs)
- activity-based budgets (ABBs)

According to Fanning (2000:60), by changing to better budgeting methods, organisations have experienced substantial changes for the better within three to six months. These better budgeting methods could also be useful for smaller entities.

It can be seen from the literature above that some sort of budgeting is valuable to an enterprise. This should also apply to small and micro enterprises, especially those in the manufacturing sector where the planning and control of the manufacturing process could help to reduce time, costs and waste.

However, the literature indicates that practitioners are concerned about the value of traditional budgeting (Fanning 2000:60; Stenzel & Stenzel 2003:82; Hope & Fraser 2003:14). According to Welch, the budget was the "bane of corporate America" and should never have existed (Loeb 1995:145). Some practitioners seem to feel that budgeting systems are outdated, **-** hence the development of more modern systems.

1.1.5 Modern financial planning and control systems

In traditional financial planning and control systems, the focus is on financial data which are used to measure performance. These days, with globalisation and more demanding customers, a number of new management systems have developed for managing operations, costs, time, quality and the environment. These more modern management systems include the following:

- activity-based management
- the balanced scorecard
- theory of constraints
- total quality management
- just-in-time production and inventory system

Many large companies are using the new or contemporary financial planning and control systems. Some small business managers are also looking for information on the latest management systems because they realise that they need to develop their skills and educate themselves (Hogsett 1981:128). Longenecker and Moore (1991: 458) agree that small businesses that operate in uncertain and competitive environments need to plan and control their operations because this will help owners/managers to run their businesses successfully.

Hope and Fraser formed the Beyond Budgeting Round Table (BBRT) with the Consortium for Advanced Manufacturing-International (CAM-I) in 1997 and over a period of years researched a number of companies that had abandoned the budgeting system. Some of the more important aspects of beyond budgeting are the fact that resources are available when they are required and that planning is an ongoing process. The literature indicates that there is no special recipe for beyond budgeting and that each organisation must use the appropriate management accounting methods available to effect the necessary change. Many enterprises in Europe have abandoned traditional budgeting but are still highly successful.

The general term “beyond budgeting” is used to indicate the use of an all-round management system employing a number of methods that are meant to replace budgeting (Hope & Fraser 1999:18; Scarlett 2007:54). In an interview by Oldman and Mills (1999:26), Jeremy Hope and Robin Fraser claimed that discarding budgeting does not mean discarding planning and they indicate that an enterprise needs to rely more on the accounting system when eliminating budget systems. This idea of “beyond budgeting” may well be the answer for smaller enterprises as it could save time and cost considerably less than other management systems.

1.1.6 Benefits and weaknesses for MSEs

The implementation and use of any financial planning and control system is bound to cost time and money. The literature (Brown 1981:44; Hansen, Otley & Van der Stede 2003:96; Garrison et al 2003:475) indicates that many of the management systems have some disadvantages. They are extremely time consuming, not always cost effective and can be highly restrictive and induce negativity towards management, to name but a few. According to Horngren and Foster (1987:6), accounting systems cost money and are economic goods. Financial planning and control systems can be highly effective in large enterprises, and the benefits of these systems seem to outweigh the cost of acquiring and implementing them in these larger corporations. However, the owner/manager of a smaller private enterprise often lacks the expertise required to effectively implement and run management accounting systems, and the cost/benefit of using these systems may not be worthwhile.

Over the past few years, many firms have entered the global market. The DTI reports that since the demise of apartheid in South Africa, small enterprises function in international, provincial and local environments which may deter their development and sustainability (DTI 2004:10). Macleod and Terblanche (2005:234) mention the lack of management skills and of budgeting and the failure to plan as some of the most common mistakes made by South African

small businesses. Operating in this dynamic global environment, where competition is fierce, small businesses need to have sound management systems in place.

1.1.7 Conclusion

From the literature mentioned above, it is clear that some form of financial planning and control system is a necessary part of the management process. According to Batty (1982:36), when budgetary control is introduced into a business, there is more hope of success, and with its emphasis on preplanning, feedback and control, it can be an extremely effective tool. Horngren and Foster (1987:140) concur and explain that although budgeting systems are used more commonly in larger companies, they are still useful to tiny concerns. They argue that there is uncertainty in all management decisions, whether or not budgeting is used, and that some form of budgeting and planning would be useful in any organisation. The above literature indicates that financial planning and control systems are necessary tools in any size enterprise.

1.2 Problem statement

A number of studies have been conducted abroad and in Southern Africa on the reasons for the failure of small businesses (Lussier & Pfeifer 2001:230; Headd 2003:59; Macleod & Terblanche 2005:234). It has also been indicated in some studies that the lack of proper planning is one of the major causes of firm failure (Shrader, Mulford & Blackburn 1989:58; Perry 2001:205). The researcher could not find evidence, however, of specific research on only manufacturing MSEs and the role of financial planning in the survival of these firms.

Micro and small private enterprises are rising in number in South Africa because of the difficulty in finding employment. In 2004, the number of entrepreneurs increased by around 40 000 in the formal sector and by 68 000

in the informal sector (DTI 2004:17). Many entrepreneurs start businesses with hardly any capital and in addition, often have little or no management training or skills. They do not know how to plan and control the activities of their businesses, and as a result they do not survive in this competitive market. Van Eeden et al (2003:13) note that the estimated failure rate of small firms is around 70 to 80%.

Businesses in the manufacturing sector have a greater need for planning and controlling their operations because they have the added task of the production process, which includes managing inventory, labour, procedures and time. Financial planning and control systems as essential tools to the economic survival of MSEs need to be addressed to determine whether these systems actually assist in the survival of these manufacturing enterprises. Whatever the size, it is essential for all manufacturing enterprises to use some form of budgeting or other financial planning and control system to effectively use resources to produce the required demand.

Using budgeting and/or other financial planning and control systems by more efficient planning and controlling of activities should give these small and micro manufacturing enterprises a better chance of survival in today's dynamic and competitive environment. This study aims to establish to what extent budgeting and/or other financial planning and control systems are used in manufacturing MSEs and whether use of these management techniques is more likely to improve their survival rate.

1.3 Research objectives

The main objective of the study is to determine whether financial planning and control systems are of value to the economic survival of manufacturing MSEs. An empirical study was conducted on manufacturing MSEs in the Tshwane metropolitan area to determine which budgeting and/or other financial planning

and control systems are used in practice, and their benefit to economic survival.

The secondary objectives are as follows:

- to explore related literature in order to present the background to the research problem

- to identify the profiles of the managers/owners of manufacturing MSEs

- to assess the profitability of manufacturing MSEs in the Tshwane metropolitan area

- to evaluate the link between other variables and those entities which do have formal financial planning and control processes in place

1.4 Importance of the study and potential benefits

According to the literature review conducted, many smaller private organisations seem to be emerging because of South Africa's high unemployment figures. Among these small businesses are a number of manufacturing enterprises on which little research has been done. Nieuwenhuizen and Groenewald (2006:70) indicate that a successful entrepreneurial business has been in business for at least four years, is profitable and has experienced growth over the past three years. The aim of this study is to indicate the value of using financial planning and control systems to the economic survival of manufacturing MSEs.

There are many textbooks on financial planning and control systems as well as a wealth of research on these topics. According to Rue and Ibrahim (1998:24), there are many research articles and publications in the literature that have recognised the significance of planning for profitability in small firms. Perry

(2001:201) agrees, and indicates that there is universal agreement that if enterprises wish to succeed, they must have a plan of action.

The use of effective financial planning and control systems is therefore of paramount importance to the smaller firm and the research findings would be of value to any new or existing small business.

1.5 Research methodology

The method of study that was used in this research was firstly, a literature review, and secondly, an empirical study.

1.5.1 Literature review

A literature study of applicable sources was undertaken to investigate the developments of financial planning and control systems as well as of other management planning and control systems which are used alone or in conjunction with budgeting. In addition, the character of MSEs was considered, with special reference to manufacturing firms. The informal sector and its role in South Africa were also explored.

The research objectives of the literature study can be formulated as follows:

- to identify the developments in financial planning and control systems in manufacturing MSEs
- to determine the value of financial planning and control systems in manufacturing MSEs
- to identify other management systems that can be used by manufacturing MSEs

- to determine to what degree these systems are of use to the economic survival of manufacturing MSEs

1.5.2 Empirical study

The empirical study was conducted by means of a questionnaire to evaluate whether financial planning and control systems assist in the economic survival of manufacturing MSEs in the Tshwane metropolitan area.

The research objectives of the empirical study can be formulated as follows:

- to identify which budgeting or other financial planning and control systems are used by manufacturing MSEs

- to determine whether financial planning and control and/or other management systems assist in the economic survival of manufacturing MSEs in the Tshwane metropolitan area

1.6 Layout of the dissertation

The following is a brief outline of the layout of the dissertation:

Chapter 1: Introduction

This chapter introduced the research topic and discussed the background to the study, the problem statement, the research objectives, the research methodology and the layout.

Chapter 2: Manufacturing MSEs

This chapter looks at the importance of MSEs and the role they play in the formal and informal economy of South Africa. The value of the manufacturing sector in South Africa is also highlighted. The use of budgeting, profit planning and control as well as other management systems in MSEs is also explored. A

few examples are cited of research conducted both globally and in South Africa.

Chapter 3: Financial planning and control systems for MSEs

This chapter deals with the developments of traditional budgeting and the alternatives to and modern approaches of traditional budgeting systems. The need for financial planning and control is considered. Other management systems which are either used alone or in conjunction with budgeting are also investigated. The basic principles and ideas behind a new concept referred to as “beyond budgeting” are examined. The benefits and weaknesses of each of these methods applicable to manufacturing MSEs are also highlighted.

Chapter 4: Research design and methodology

This chapter deals with the research design, methodology, research instruments, population, sample method of data collection and analysis as well as limitations of the study.

Chapter 5: Research results

This chapter provides an in-depth evaluation of the research results.

Chapter 6: Conclusions and recommendations

In this chapter, conclusions are drawn and recommendations made on the basis of the research results.

1.7 Summary

This chapter provided an introduction to the study by discussing the background to and rationale for the study. The research objectives, methodology and the chapter layout were also summarised. Chapter 2 investigates MSEs, with the focus on manufacturing enterprises in this category.

CHAPTER 2

MANUFACTURING MSEs

"Objectives are not fate; they are direction. They are not commands; they are commitments. They do not determine the future; they are means to mobilise the resources and energies of the business for the making of the future." Peter F Drucker (1909–2005)

2.1 Introduction

The value of small business to the growth of a country's economy, as indicated in chapter 1, is well known. It is also recognised that smaller firms generate employment and contribute to the wealth of a nation. There are many reports indicating that over the past number of years, the outputs of small business have played a major role in the economy of many countries and that a large number of employers in these countries are small enterprises (Kuratko, Goodale & Hornsby 2001:293; Morrison, Breen & Ali 2003:417). These reports indicate that smaller entities represent a vital segment of the world economy. However, a number of other authors reveal that there is a widely held view that new small businesses fail at an alarming rate (Monk 2000:12; Carter & Van Auken 2006:493). The reasons for the failure of small firms has been extensively researched, and various authors (Wright & Phillips 1990:48; Monk 2000:12; Macleod & Terblanche 2005:234) point out that there are many reasons for the failure of these firms, a lack of planning and bad management being two of them. Hence proper financial planning and sound management accounting systems are two factors that are needed to ensure the survival of more small enterprises.

A number of different gauges, such as employee numbers and turnover, are used to classify small businesses. This study concentrated on MSEs, which include micro, very small and small enterprises, and enterprises with fewer

than 50 employees are therefore included. As indicated in chapter 1, the definition of MSEs was taken from Schedule 1 of the National Small Business Act of 1996, as revised by the National Small Business Amendment Bill of March 2003. Hence SMMEs and SMEs include MSEs, and the terms will be used interchangeably in this study. The purpose of this chapter is to outline the situation of manufacturing MSEs.

This chapter provides a discussion of MSEs, emphasising their importance and value to the economy, especially in South Africa. The development of the manufacturing industry in South Africa will be examined and the role the informal sector plays in small manufacturing enterprises will be investigated and discussed. The value of financial planning and control as well as other management accounting systems in manufacturing MSEs will also be highlighted.

2.2 Manufacturing MSEs in South Africa

After the first democratic election in South Africa in 1994, one of the new government's objectives was to encourage the development of small enterprise to help alleviate unemployment. The high rate of unemployment in South Africa forces many people to start a small home-based business, which is normally not registered with any of the authorities and operates in the informal sector.

Prior to 1994, many people in South Africa had limited access to education, and the DTI (2005:11) reports that many people in the South African labour force, especially those in rural areas, are illiterate and have low levels of expertise. In another report, the DTI (2004:62) also reveals that almost 51% of entrepreneurs of MSEs in South Africa do not have a grade 12 (matric) qualification. Most of the decisions made in small firms are done by the owners or partners of the firm. It can therefore be assumed that many of the owners of

these small businesses lack tertiary education. With this in mind it is probable that many small business owners have never learnt any financial and management skills. This is all the more reason for small enterprises to have some sort of financial planning and control facility in order to succeed in the competitive market of today.

2.2.1 The importance of MSEs

As indicated in the introduction to this chapter, small businesses are crucial to the economy in most countries as they generate employment and enhance economic activity. Most of the firms in developing countries are tiny, and most of the labour force in most developing countries, including those in Africa, is employed by enterprises with fewer than ten workers (Little, Mazumdar and Page 1987:313; Petersson 1998:130).

Because of the role that small enterprises play in the economy of a country, for instance, by generating employment, they are included in the country's economic policy. The importance of the small business sector in South Africa was recognised in March 1995 when government adopted the DTI's White Paper for the National Strategy for the Development and Promotion of Small Business in South Africa. The document defines how the government plans to encourage the development of small, medium and micro enterprises by offering training, financial, marketing and management support. This is supported by Everett and Watson (1998:388) who assert that the government should assist both the individual firm and the economy to reduce the failure rate of small business. Döckel and Lighthelm (2005:61) also agree about the role of the government in creating favourable market conditions by ensuring a stable and growing economy. They suggest that policies need to be developed to stabilise the economic environment and they found that new businesses grow more quickly than their older counterparts, but that they are less likely to survive, which obviously influences employment growth.

The contribution of MSEs to counter unemployment levels and boost the economy is well known. McGrath (2005:1) reports that the South African government is encouraging the development of VSMEs with ten or fewer employees, as they help decrease poverty and can be a means to earn a living for those who cannot find employment in the formal sector after completing school.

2.2.1.1 Support for MSEs in South Africa

In 2005, the South African government initiated the Accelerated and Shared Growth Initiative for South Africa (Asgi-SA) in an effort to cut unemployment to below 15% and halve the poverty rate to less than one-sixth of households. As a result, the National Chamber of Commerce has promised to launch 100 000 new small and medium enterprises per annum. The DTI, Eskom, Umsobomvu and the Women's Development Bank are planning a fund especially for women entrepreneurs, while the government is supporting new venture funds which will assist those planning to start small businesses (The Presidency 2006:13).

Government, municipal, sectoral and labour regulations, for example, taxation laws and administration, labour laws and local government by-laws were found to be one of the major limitations to the growth of small business. The government has plans to review many of the regulations hindering the growth of small businesses (The Presidency 2006:13). Huge sums of money and time-consuming formalities are involved in starting a business. By reviewing the legislation and registration processes, the South African government is demonstrating its commitment to facilitating small business growth. These initiatives by the authorities do not, however, guarantee the survival of these firms, nor do they usually teach the owners of these small businesses financial and management skills.

2.2.2 Manufacturing enterprises in South Africa

When starting a manufacturing business, owners usually need more capital than for start-ups in other sectors because in most production processes there is a need for tools, machinery and/or equipment. This is an excellent reason for these enterprises to have systems in place which plan and control their resources and operations.

It is widely believed that manufacturing MSEs can assist in the growth of the economy and employment in developing countries. However, it is extremely difficult for the smaller enterprises to compete in South Africa with the large organisations which control many of the leading manufacturing sectors (Rogerson 2001:267). The authorities realise this and because the South African government is promoting small business development, they are encouraging the larger enterprises to make use of the products and services of smaller businesses (South African Government 2006:28). There is thus a need for the smaller manufacturing entities to have some proof of accounting and management systems in place with which they can obtain business transactions from the large firms.

2.2.2.1 Development of manufacturing in South Africa

Manufacturing in South Africa began in the late 19th century, and by the late 1960s, there were many different industries in the manufacturing sector. Because of political sanctions during the 1980s and early 1990s, the industrial sector began to suffer. Also, the concentration of industry to only certain areas in the country and the protection policies of government led to the deterioration of the sector. The previous government tried to implement reforms to avoid deindustrialisation, and since 1994, the current government has made many changes and undertaken to continue with and accelerate the growth of this crucial sector of the economy (DTI 2002:8). The growth in numbers of small manufacturing entities is therefore of utmost importance in the development of the industrial sector in South Africa.

a Pre-1994

Before 1994, South Africa was mainly a mineral and resource extraction economy and the government wanted to establish a sound internal industrial base by applying import-substituting industrialisation policies (Kraak 2002:663). In South Africa, capital-intensive resource-based activities in the basic chemicals and metals industries were the focus of investment before the 1980s. Constraints on black business during the apartheid regime had a negative impact on industrial growth and South Africa was separated from the global economy (Altman & Mayer 2003:68). The government of the day applied a traditional approach to regional industrial strategy which was a top-down activity, encouraging investors, by offering subsidisation, to set up manufacturing activities in regions with little economic potential.

b Post-1994

The new government has totally changed the industrial policy, and its focus on the manufacturing sector was to devise policies and ways to be more competitive in the international market (Altman & Mayer 2003:69). Since 1994, the focus has been on a contemporary regional policy which seeks to develop and improve both the weaker economic areas as well as the more successful regions (DTI 2006:16). In 2002, the government made changes to the microeconomic policies and the DTI made known its Integrated Manufacturing Strategy (Altman & Mayer 2003:77). In the same year, the National Advisory Council on Innovation (NACI) identified the need for a National Advanced Manufacturing Technology Strategy for South Africa in order to develop the competitiveness of this sector in South Africa (Department of Science and Technology 2002:2–6).

The National Manufacturing Advisory Centre (NAMAC) and its subsidiaries, a network of Manufacturing Advisory Centres (MACs) throughout South Africa and the International Manufacturing Strategy (IMS), are bodies that assist small manufacturing enterprises. The MAC programme was developed to assist small manufacturing enterprises with, inter alia, identifying new markets,

management skills and technology (Rogerson 2001:288). In July 2006, the DTI published a Draft Regional Industrial Development Strategy (RIDS) for South Africa in which it outlined ways and measures to ensure the development of all regions in the country, with its main focus on the manufacturing sector and highlighting the need for development of support and service industries (DTI 2006:11).

In developing countries like South Africa, industrialisation is readily encouraged as indicated above. Pedersen and McCormick (1999:109) report that employment in the industrial sector gives an individual a chance of higher wages and a better quality of life and that industrialisation will help to grow the economy. Rogerson (2001:287) believes that, because of globalisation, the manufacturing sector in South Africa needs to promote the operations and participation of the SMME economy. Altman and Mayer (2003:81) argue that SMMEs in the manufacturing sector are more labour intensive than their larger counterparts, and that by encouraging their growth they could help alleviate unemployment. These views indicate that with encouragement, smaller manufacturing enterprises could enter the business world in South Africa, but, as indicated above, many small firms fail. Therefore, these new firms entering the economy will need planning and control systems to help them survive in the vibrant economy.

2.2.3 The informal sector of the economy

Most economies consist of two sectors – the formal and the informal. The formal sector consists of those enterprises which are recognised officially and have recorded and measured indicators of gross domestic product (GDP), whereas the informal sector has no official recognition and is largely unregulated. The informal sector includes irregular and illegal activities and is also often referred to as the second economy. The International Labour Organisation (ILO) issued a report in 1972 on Kenya which popularised the idea of the informal economy (Tshabalala 2007:22). However, the term “informal” was first used by Keith Hart in a paper presented at the Conference

on Urban Unemployment in Africa which was held at the University of Sussex in September 1971(Hart 1973:61).

Many of the enterprises in the Third World, that is, those countries in Asia, Africa, Oceania and Latin America which are economically underdeveloped, fall into the informal sector, with few employees, few assets and non-conformance with laws and regulations (Mead & Morrisson 1996:1617). Freeman (2000:1), however, goes even further and asserts that Africa operates in three economic spheres, namely the formal sector, the informal sector and the global sector, and that over 50% of economic activity occurs outside the formal sector of the economy (ie in either the global or informal sectors). The result is that this economic activity is often not communicated in the nation's accounts or statistics, and Freeman (2000:1) therefore believes that common economic measures are not appropriate to the African continent. Arimah (2001:115) agrees and contends that in developing countries the informal sector has a critical impact on GDP. Interestingly, the DTI (2004:66) reports that MSEs contributed 39% to GDP in 2004.

It can therefore be concluded that the informal sector in most African countries is large, and many governments are encouraging this sector as it helps to alleviate unemployment in the labour force. Thus, in South Africa, as in many African countries, a large portion of the labour force operates in the informal sector of the economy.

2.2.3.1 Characteristics of businesses operating in the informal sector

The informal sector consists of those enterprises that are not registered in any way. They are generally small and seldom run from business premises. Instead they are run from homes or on street pavements or other informal arrangements apply (Statistics South Africa 2005: xxiv). Freeman (2000:3) believes that most African people do not identify with the first economy and that they prefer to operate in the informal or global economies as they do not trust the authorities. Hence many small firms operate in the informal sector

where there is no regulation or controls that they have to adhere to. However, Saunders and Loots (2005:100) have found evidence indicating that the informal sector has limited income-earning opportunities for the large increasing number of unemployed and poor in South Africa.

As indicated in section 2.2, many people in South Africa have limited basic education. This implies that there are many who are operating businesses in the informal sector who have limited financial management education and experience. It is also expected that there will be a greater need for more educated managers as the informal sector grows in South Africa. However, it is going to be difficult as these managers usually do not have access to universities, and other training facilites and little funding to do so (HSRC 2003a:620).

It is well known that there is a large influx of people entering South Africa from the rest of the continent. Many of these people are streaming into South Africa because of the poor economic conditions in their countries of origin and they are seeking a better life. According to Longenecker and Moore (1991:15), these people often start their own businesses because of discrimination in trying to obtain employment. With this entry of people who start their own small business, the number of MSEs will undoubtedly also increase.

2.2.3.2 Measurement of the informal sector

Interpretation of the informal sector is derived from its comparison with the formal economy (Arimah 2001:115). Many methods have been used to measure the informal sector worldwide. South Africa has many small and micro firms operating in the informal sector – hence the importance of information about the informal sector to this study.

There are three different views on how entities can be measured in the informal sector. These are as follows:

- those that are not regulated in any way (eg registered for taxation or with other authorities)
- the size of the firm
- the degree of capital intensity

Mead and Morrisson (1996:1611) found that these measures are related in many ways and no matter which one is used, the results will always reveal the same group of enterprises.

Saunders and Loots (2005:93) also mention a number of ways in which the informal sector can be measured in developing countries and proceed to estimate the size of the South African informal sector using the Currency Demand Approach. This method was employed because it is easy to use and it is also assumed that most of the individuals operating in the informal sector use cash to finance their transactions. Their findings expose that while the people operating in the informal sector of the economy have increased since the demise of apartheid, the influence of the informal sector on GDP has decreased. This suggests that when the number of people operating in the informal sector increases faster than the output, hardship and disparity may increase (Saunders & Loots 2005:100).

There are many opposing views on how to measure the informal economy, but no matter how it is measured, there are a large number of enterprises and people operating in the informal sector in South Africa. Information for this study will be collected from manufacturing SMEs, some of which may be operating in the informal sector of the economy.

2.2.3.3 The informal sector in South Africa

The South African government wishes to build a single economy that will benefit all by combining the first and second economies. Its intention is to use the influence of the formal economy to deal with the concerns of the second economy, which is one of the key issues of Asgi-SA (The Presidency 2006:11).

The first economy is modern, incorporated into the global economy and yields most of the country's wealth, whereas, the second economy is immature, detached and does not contribute much to the country's wealth. Another of the government's aims is to halve unemployment by the year 2014, and it is therefore encouraging small enterprise development, which often begins in the "informal" sector. However, according to Spring and McDade (1998:12), regardless of government policies or programmes, most of the growth in the informal sector is unplanned.

The survey of employers and self-employed (SESE) conducted by Statistics South Africa in February/March 2001 focuses on persons operating small and micro enterprises in South Africa that are not registered for value-added tax (VAT). Their findings were that 2.7 million people, of which 2.3 million were owners and 0.5 million employees, were working in non-VAT-registered small and micro business (Statistics South Africa 2002:21). Another finding was that around 93% of the non-VAT-registered businesses in South Africa had no licence or permit to operate their business, which shows the huge number of entities operating without being registered with any municipality or regional services council (Statistics South Africa 2002:29). This information indicates that there are many small businesses operating in the informal sector in South Africa.

2.2.4 Data on manufacturing MSEs in South Africa

The importance of small businesses is also shown by the DTI's Ntsika Enterprise Promotion Agency, which reports that small, medium and micro businesses employ more than 50% of the workforce and contribute 35% of GDP (Malagas 2004:6). However, Valodia (2006:4) reports that "the informal sector is incorporated in South Africa's national accounts and is estimated to contribute some 7% of GDP" but indicates that this figure may be a lot higher because there is no real observed confirmation.

Petersson (1998:130) reports that small business start-ups average around 20% in Southern African countries, and many of these businesses comprise a single person working alone. In agreement with this, it was reported at a planning meeting of the South African government and the International Labour Organisation (April 2003), that 40% of all enterprises in South Africa have between one and four employees, which implies that many of the small businesses fall into the micro and very small categories. The Labour Force Survey (Statistics South Africa 2007: x) indicated that 16% of the South African labour force were employed in the informal sector. According to Valodia (2006:1), this figure is not very reliable and could be even higher.

The manufacturing SMEs account for about 10% of the total SMEs in the country, and according to the Global Entrepreneurship Monitor, this sector has a high share of the new firms being created (Department of Science and Technology 2002:24). The manufacturing sector accounts for 20.5% of Gauteng's value added to the economy, and together with the trade and financial services sector, they account for 52% of the value added of South Africa (Gauteng Economic Development Agency 2007). In the formal sector, it was determined that small enterprises comprise 12% of the manufacturing sector in South Africa (DTI 2005:12).

There are a number of manufacturing enterprises operating in the informal economy, and according to Statistics South Africa, 9.2% of the small and micro businesses that were not registered for VAT purposes were manufacturing enterprises (Statistics South Africa 2002:24), and manufacturers represented 9% of small businesses in the informal sector in 2004 (DTI 2004:48). This was confirmed by Valodia (2006:5), who discloses that manufacturers represented more than 10% of small businesses in the informal sector in South Africa in 2005. This indicates that the number of small and micro manufacturing firms in the informal sector in South Africa has been on the increase. With this in mind, and the perception that many owners/managers, especially those operating in the informal sector, have

hardly any financial management education, it may be beneficial to establish whether financial planning and control systems contribute to the survival of the smaller manufacturing firms.

It can be concluded that there are many small manufacturing enterprises in South Africa, and that many of these businesses are tiny and operate in the informal sector.

2.2.5 Reasons for the failure of small business enterprises

An alarming number of small businesses fail, and research suggests that there is a widely held view that a large proportion of new small businesses fail within the first three years (Perry 2001:205; Van Biesebroeck 2005:546). Monk (2000:12) agrees and reveals that 68% of firms with fewer than five employees and 48% of firms with between five and 99 employees close down within five years of start-up. Brink, Lighthelm and Cant (2003:1) concur and indicate that the failure rate of small business in South Africa is above 70%.

Research reveals that there are various causes for the failure of small businesses and Marx, Van Rooyen, Bosch and Reynders (2001:732) list three major reasons for failure, namely financial factors, economic factors and lack of experience, especially in management. According to Monk (2000:12), the lack of a business plan is one of the main reasons for failure among SMMEs. Wright and Phillips (1990:48), Grosh and Somolekae (1996:1884), Radipere and Van Scheers (2005:409) and Macleod and Terblanche (2005:234) reveal that one of the most general mistakes made by small firms is failure to cultivate the required management abilities to effectively run an enterprise. According to the above-mentioned authors, the other mistakes made by SMMEs include the following:

- substandard planning and failure to review and update plans
- poor record-keeping and no use of financial statements
- allowing the accountant to run the business

- inferior management of money and mixing personal and business finances
- no attempt to reduce costs
- inaccurate costing and estimating and therefore pricing
- ignoring the client's needs
- inefficient human resource skills
- the owner's inability to change his or her role as the business expands and being too involved in operations

The DTI reports that since the demise of apartheid in South Africa, small enterprises function in international, provincial and local environments which may deter their development and sustainability (DTI 2004:10). Döckel and Lighthelm (2002:1) point out that there are three risk factors that influence a business's success, namely, economy-based, industry-based and firm-based risk. Economy-based and industry-based risk are external risk factors over which the individual owner has no influence, and are classified as exogenous, while in firm-based risk, the owner does have control and is classified as endogenous. Döckel and Lighthelm (2002:3) confirm that firm-based issues represent around 65% of all small business failures. As can be seen from the above, the authors have similar views on the errors that small business owners tend to make, and included in these mistakes are the lack of financial planning and the use of other management systems.

2.2.5.1 Training of owners/managers of small businessess

It is known that the skills base in South Africa is extremely inadequate and the International Institute for Management Development (IMD) Competitiveness yearbook, which reports the competitiveness of a number of countries, ranked South Africa as the lowest in this category for 2007 and 2008 (Institute for Management Development International 2008:246). In his survey of emerging black-owned manufacturing SMEs in the Western Cape, Sawaya (1995:118) found that there was a positive relationship between education and successful small businesses. Another survey was done on small enterprises in Soweto by

the Ntsika Enterprise Promotion Agency during 2000, and it was found that the respondents of these small businesses learnt their skills through on-the-job training, and that nearly 80% of these respondents indicated that they would like to have business management training (Van Heerden & Schoeman 2000:8–12). This seems to indicate that small business owners believe that they would have a better chance of success if they had some form of business management training. The DTI substantiates this and reports that small enterprises have a higher life expectancy if the owners have a better education.

Alongside the promotion of small business, the South African government is promoting the education of the owners/managers of these small entities. One of the key subjects of the Integrated Small Enterprise Strategy, a document issued by the DTI in 2005, which portrays how small enterprise development should progress in South Africa over the period 2005 to 2014, is the support and education of entrepreneurs in managing their enterprises effectively (DTI 2005:32). An important revelation by Devey, Skinner and Valodia (HRSC 2003d:149) is that over 25% of those working in the informal sector are working in craft-related work, which means that these people are, at the least, semiskilled. This was confirmed by Van Heerden and Schoeman (2000:22) who report that 64% of the respondents of small enterprises in Soweto did not have a grade 12 (matric) qualification. The above information emphasises the vital need for the training of owners/managers, especially for financial management education in the managing of a business.

Arimah (2001:140) indicates that entities that are registered with one of the authorities are more likely to have linkages with the formal sector and that these entities will improve productivity and learn many business skills from the enterprises operating in the formal economy. The HSRC (2003a:667) agrees and discloses that the South African government should devise plans to encourage SMME development in a more reliable informal sector which has firm connections with the formal sector and which will benefit the unemployed

and survivalists. Conversely, Martins & Van Wyk (2004:148) discovered in a survey that, the management skills of those working in SMMEs in the manufacturing sector were seen to be highly satisfactory. Of 438 small and micro manufacturing firms included in the survey, it was found that 31.5% were under four years of age and that 20.5% were between four and six years of age (Martins & Van Wyk 2004:45). This information is significant and leads to speculation on why there are so few manufacturing entities older than six years.

2.2.6 The use of financial planning and control and other management accounting systems in MSEs

By using financial information, managers/owners can achieve the objectives of the enterprise. Drury (2004:7) explains that management accounting differs from financial accounting in that information is supplied to people *within* the organisation who use it to assist them with their decision making. Financial planning and control and other management accounting systems are vital tools in any business wishing to succeed. The use of these management accounting systems is also vital in manufacturing entities. This is because the planning and control of raw materials, inventory and the production process are crucial for operations to run smoothly, because without proper systems and controls, the production process would be totally chaotic.

Management accounting systems are used extensively in larger organisations, but a lack of management skills and the time and cost of developing and maintaining management accounting systems may discourage the use of these systems in smaller entities. However, Galbraith and Nkwenti-Zamcho (2005:428) established that by planning and developing policies for

(1) the maintenance and up-grading of assets

(2) job specialisation

small manufacturing firms would be more productive. Manufacturing strategy, planning and financial performance were the focus of a study by Kazan, Özer and Çetin (2006:23), who found that financial performance increased in entities

that concentrated on lower costs and higher quality. The study was undertaken in Turkey, where the effects of, *inter alia,* the cost and quality of the product in organisations of all sizes were investigated. The increase in financial performance was higher in the larger firms, but was also found to have an influence in the smaller firms. This information indicates that by using management systems, smaller manufacturing entities also seem to perform better.

In the competitive business environment of today, customers are becoming extremely demanding, and enterprises have to keep their customers happy by providing quality products at reasonable prices and which are delivered on time (Drury 2004:13). With the many changes in the South African business environment over the past few years, and especially with the lifting of sanctions on the export and import markets resulting in greater competition, businesses have had to review their management accounting practices, forcing change (Luther & Longden 2001:313). This is not only applicable to large enterprises, because in South Africa, the government is also promoting small business trade with other countries (DTI 2005:38).

Nayager and Van Vuuren (2005:29) indicate that since the late 1980s, corporate managers have been using many of the management tools necessary to become more competitive in the ever-changing business environment. The number of small enterprises in South Africa is increasing, and by using financial planning and/or other management accounting systems, these firms could be more successful than their rivals. The above information reveals that a business, no matter what its size, cannot operate without a plan, and if used correctly, financial planning and control and/or other management accounting systems can be of value to any organisation, including small and micro enterprises.

Financial planning and other management accounting systems are discussed in more detail in chapter 3.

2.2.7 Previous research on the use of management accounting systems in MSEs

A number of studies have been conducted around the world and in Southern Africa, in which information about start-ups, growth, survival and closure of small and micro enterprises have been reported. Global research on these topics is vast, however, in South Africa limited research on manufacturing entities was found.

2.2.7.1 Global research on the use of management accounting systems in MSEs

As early as 1980, Cress (1980:111–114) found that small firms did not make official plans, but those that did, were much more open to adjusting the short-term plans, if necessary, than their larger counterparts. Matthews and Scott (1995:48) concurred, that when there was uncertainty in the environment, entrepreneurs' and small businesses' planning practices tended to decrease. There are many other research articles and publications in the literature that have recognised the significance of planning in small firms, and there is universal agreement that if enterprises wish to succeed, they must have a plan of action (Rue & Ibrahim 1998:24; Masurel & Smit 2000:101; Perry 2001:201). As indicated in chapter 1, Masurel and Smit (2000:101) also found that the smaller the enterprise, the less likely it was to have any formal plans. This was confirmed by Kuratko et al (2001:300), who conducted a survey in the USA and found that most small enterprises regarded strategic and operational planning as extremely important, but few of these entities actually had any formal documentation of planning. However, Upton, Teal and Felan (2001:67) undertook a survey on 65 fast-growing family firms in the USA and found that the majority of these firms did have a reasonably detailed formal written plan that could be used to assess performance and that most of the employees were aware of the plan details. In a study on the budgeting habits of 104 manufacturing and 58 retail enterprises in Malaysia it was found that budgets still formed an integral part of their planning and control systems (Ahmad et al

2003:723). Morrison et al (2003:420), however, found in their research on small businesses in Melbourne Australia, that less than 50% of the entities that were older than 10 years used very little, if any, form of planning. In contrast, the results of interviews with small business owners and managers in Charleston in the USA revealed that management are of the opinion that the firms would attain higher profits if they had sound planning and control practices (Hodges & Kent 2006/2007:84).

McKiernan and Morris (1994:S32) argue that formal planning restricts entrepreneurs from being individual and innovative and question whether it would increase their survival rate. This opinion is also voiced by Prater and Ghosh (2005:164) who note that when there is uncertainty in the business environment, small and micro organisations are inclined to depend on gut feelings rather than formalising plans. It is here that smaller entities could make use of the more modern management accounting systems, especially those that advocate quick changes to the environment.

Little et al (1987:207) did research for the World Bank on small manufacturing enterprises in India where it was noted that in some of the manufacturing sectors the new smaller enterprises grew at a faster rate that the old larger ones. Even today this finding is significant and should encourage smaller firms to have operational and strategic plans in place. About a decade later, Hu and Schive (1998:320) came up with evidence that the most competitive manufacturing entities in Taiwan were the small and medium enterprises. They (1998:322) suggest that smaller firms need not be innovative, but must be competent and capable of reading and responding quickly to market changes. Process innovation and new product development are also key factors in the growth and survival of small manufacturers in the changing environment of today. These small enterprises are close to the consumers and work in a flexible informal environment and it is essential to have a set of directions for the entity's long-term plans (Laforet & Tann 2006:364, 374).

Other global research on small manufacturing firms revealed that there was a noticeable correlation between planning sophistication and firm performance (De Zoysa, Fonseka & Perera 2004:212; Yusuf & Saffa 2005:493). Yusaf and Saffa (2005:493) reason that small firms that actually use planning will benefit in the same way as the large firms do.

There is an indication in the global research conducted that small firms tend to perform better if they have some form of planning and control systems in place.

2.2.7.2 Southern African research on the use of management accounting systems in MSEs

Over the past two decades, a number of studies have been undertaken in South Africa. With regard to the informal sector, Mead and Morrisson (1996:1612) confirm that most research is aimed at enterprises with up to five employees and sometimes up to as many as 20. This indicates that much of the research has been on very small, small and micro enterprises although limited research on manufacturing entities was found.

Kesper (2000:20) discovered that, in this highly dynamic economic environment, even profitable enterprises need to become more aggressive in their planning if they wanted to survive. To determine what skills were essential for micro enterprises to develop into highly profitable small enterprises, Perks and Struwig (2005:181) did a survey on small and micro enterprises in Port Elizabeth and found that management skills were critical for enterprise growth. They also found that if a business had debt, budgeting was a vital tool to use because it could assist the owner with decisions on how to make the entity profitable (Perks & Struwig 2005:183). Other researchers agree and conclude that the lack of managerial ability is one of the main reasons for failure (Radipere & Van Scheers 2005:410; Döckel & Lighthelm 2005:61). Unfortunately, it is extremely difficult to obtain information about a small business after it has closed down (Everett & Watson 1998:374), and in South

Africa data bases available that list most MSEs are limited. Another problem is that most of those businesses that are part of the informal sector are not recorded at all.

In their research, Nieuwenhuizen and Kroon (2003:133) found that there was an excellent relationship between, *inter alia*, planning of business, involvement in the business, knowledge of competitors and financial management and the success of small and medium manufacturing enterprises in South Africa.

The above literature indicates that small enterprises that use some form of financial planning or that have some sort of management system in place have a greater chance of survival than those that do not.

2.3 Summary

Micro and small enterprises make up a large percentage of the businesses in South Africa and the literature indicates that these entities fail at an alarming rate. Many of these businesses form part of the informal or second economy and the South African government have plans to assist these entities to help alleviate unemployment and boost the economy. In South Africa, there are many incentives and support structures for start-ups and assistance for small business owners because the government wishes to reduce unemployment and poverty.

Manufacturing enterprises are a crucial part of the South African economy and it is apparent that small manufacturing entities play a key role. Mead and Liedholm (1998:68) indicate that the manufacturing sector in South Africa is one of the most likely sectors to grow. Industrialisation is being encouraged by the government and policies have been put in place to assist this sector. The larger manufacturing firms have a definite advantage and it is imperative that their smaller counterparts have plans for the continuance of operations.

It is evident from the research that the survival of these smaller firms depends on having various management accounting systems in place. Whether the traditional approach or the more modern approach is used, is not the question, the principal issue is that in order to continue to exist, businesses must have some sort of planning and control mechanism in place.

CHAPTER 3

FINANCIAL PLANNING AND CONTROL AND OTHER MANAGEMENT SYSTEMS FOR MSEs

"Tell me and I'll forget; show me and I may remember; involve me and I'll understand." (Chinese proverb)

3.1 Introduction

In chapter 1 it was revealed that financial planning and control systems include budgeting as well as other management decision-making systems and techniques, while in chapter 2 the value of financial planning and control systems to MSEs was discussed. Management accounting information is used mainly by internal users to aid in decision making. This information deals with the future and therefore assists planning (Smith 2007:28). Various authors on financial planning and control indicate a large failure rate in small business, one of the reasons for failure being the lack of planning, especially formal planning (Monk 2000:12; Perry 2001:205; Macleod & Terblanche 2005:234; Carter & Van Auken 2006:493). Other authors (De Zoysa et al 2004:212; Yusuf & Saffa 2005:493; Mowen, Hansen & Heitger 2009:370) reported that by using financial planning and control and other management accounting systems, small manufacturing organisations have a better chance of survival.

The monetary implications of business plans are reflected in the firm's budget (Smith 2007:137) and this chapter therefore starts with a discussion of budgeting systems. The literature suggests that managers feel that traditional budgeting takes too long and is no longer effective in the modern environment, and as a result many variations of traditional budgeting have emerged (Fanning 2000:60; Prendergast 2000:14). Because of this dissatisfaction with traditional budgeting, researchers also started looking for new and different ways to budget. These developments were termed "better budgeting" and

include activity-based budgeting (ABB) and zero-based budgeting (ZBB). Since the 1980s, many new management accounting systems have evolved, for example, the balanced scorecard (BSC), just-in-time (JIT), theory of constraints (TOC) and total quality management (TQM). Garrison et al (2003:10) contend that when properly used, these newer management accounting systems can improve quality, decrease costs, increase output, reduce delays in reacting to customers and ultimately increase profits.

The purpose of this chapter is to discuss financial planning and control systems with the emphasis on budgeting. The principles of traditional budgeting and some of the variations of traditional budgeting as well as a few of the more modern management accounting systems which have developed over the years will be dealt with. The aim is to analyse these management techniques to establish if and how they could be used in MSEs, particularly manufacturing MSEs, for financial planning and control purposes.

This chapter commences with an explanation of traditional budgeting and its variations, followed by a discussion of better budgeting techniques, going "beyond budgeting" and other management accounting systems. In this chapter the importance of using these types of financial planning and control techniques in small manufacturing enterprises is further investigated.

3.2 Financial planning and control systems in MSEs

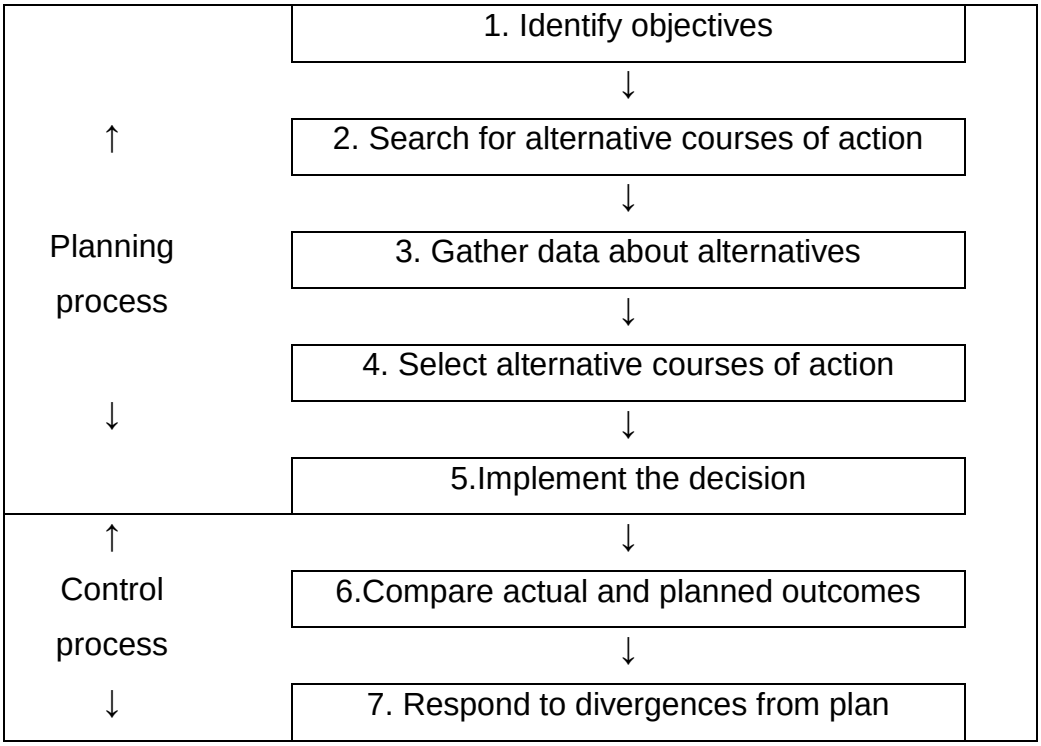
Information produced by small firms can be used for decision making, as well as planning and controlling activities in order to attain the firm's goals (Smith 2007:23).By planning a firm's activities, employees are given direction, and to ensure that plans are adhered to, management exercise control (Avis 2009:293–294).

Financial planning and control systems include budgeting systems and other management systems which aid in the planning and control of business operations.

3.2.1 The decision-making process in MSEs

Decisions about the effective operations of an enterprise need to be made by management in order to keep business procedures running smoothly. According to Drury (2004:8), the decision-making process comprises seven steps which include a planning and a control function. Planning entails five steps, namely identifying objectives, searching for different courses of action, gathering data about the different options, choosing an option and then applying it. The next part, which is no less important, is the control process in which actual data are compared with the plan and corrective action taken if there are any deviances from the plan. The following diagram illustrates the decision-making process:

Figure 3.1 The decision-making, planning and control process



Source: Drury (2004:9)

The above is typical of the steps large corporations follow in decision making. Even though smaller firms may not have the resources in the form of time and money to incorporate such a system, the owner/manager could, at the least, formulate a set of plans and then ensure that the plans are adhered to.

3.2.2 Traditional budgeting in MSEs

Making a profit is usually the main purpose of any business, and without a set plan of action, the entity will simply drift aimlessly with the wind. The use of planning and control is a sensible way to determine whether the business operations are adequate, and whether the strategic goals of the organisation are being met. According to Garrison et al (2006:378), an effective budgeting system includes both planning and control, where the former involves setting of objectives and preparing the budget, and the latter entails monitoring the progress of these plans and ensuring corrective action if they are not being met. Therefore, preparing a great plan is useless if there is no control. This applies to any organisation, regardless of its size, that wishes to succeed in today's competitive global market.

Owners of small enterprises are individuals, who bring their personality, skills and hopes to their businesses. These and other factors such as the state of the economy and the sector in which the entity operates will all have an influence on compiling a plan for the entity (Hogsett 1981:14). Interestingly, Matthews and Scott (1995:45) found that entrepreneurial firms used better strategic and operational planning techniques than small businesses, which could imply that entrepreneurs have a better financial management education and therefore use this knowledge to manage their businesses efficiently.

Each and every organisation should define a set of objectives and identify different courses of action that could be taken. In so doing, a strategic or long-term plan can be formulated for a number of years into the future. The annual budget is the execution of the strategic plan, for the year ahead (Drury

2004:590-593). However, small firms seem to prefer operational planning to long-term strategic planning (Smith 2007:23). This tendency could be the result of the lack of resources such as time, money and expertise.

The use of budgets, budgeting and budgetary control can assist entrepreneurs and managers of small entities in the daily operations of their businesses. The literature, however, indicates that although there are several advantages in using a budgeting system, many enterprises fail to do so because they are small (Smith 2007:37). According to Gibson & Cassar (2002:183) the management of these smaller firms have little or no understanding of the subject and those with lower educational levels are less likely to have plans. Research indicated that very few small and micro enterprises have any form of record keeping and that the lack of experience in business and management was a major contributor to small firm failure (Liedholm & Mead 1987:32; Longenecker & Moore 1991:51; Macleod & Terblanche 2005:234). In chapter 2 it was mentioned that many MSEs had very few or no employees and that a large number of the owners/managers of MSEs in South Africa did not have a grade 12 (matric) qualification. This indicates that numerous small business owners may have extremely limited knowledge about budgeting and financial planning and control systems.

3.2.2.1 Nature of traditional budgeting

Profit planning or budgeting is used to assist in the management of an organisation in order to achieve sustainability and higher profits.

Budgets fulfil many functions, including the following (Drury 2004:593; Correia, Langfield-Smith, Thorne & Hilton 2008:416):

- planning the annual operations
- coordinating the activities of all the segments of the organisation
- communicating the plans to all the managers
- motivating personnel to achieve the organisational goals
- controlling all activities

- evaluating each manager's performance

The above functions are vital in organisations of any size. MSEs may not need all the above functions because of their size and lack of personnel, but the basic steps in planning and control activities are crucial to a firm's success. The use of budgets and/or planning and control systems in very small manufacturing firms is vital because scarce resources, such as raw materials, labour, time and money, need to be managed effectively.

Manufacturing firms have to deal with raw materials and inventory, and if the control of these resources is not formalised in some way, the manufacturing process could grind to a halt. These findings were confirmed by Perry (2001:205) in his research on small businesses in the USA, where he found that there was a statistically significant relationship between formal planning and firm failure. Several small business owners in South Africa appear to run their operations without formal planning because of their limited management skills. The need for business management training in MSEs was discussed in chapter 2, where it was stated that business owners indicated that they believed their firms would be more successful if they had some form of management training.

The following are the most common steps taken in the development of the annual budget (Drury 2004:597; Smith 2007:140):

- reviewing and analysing the strategic plan
- determining what resources can be obtained
- estimating environmental impacts, and preparing the sales budget
- developing the other budget components, initiating negotiations between the different levels of management and obtaining top management's initial approval after they have reviewed the budget
- preparing the final budget

For subsequent years, the previous year's budget is regarded as given and then increased or decreased for the coming year. This means that attention is focused on the changes expected from the previous period to the next period. This is known as incremental budgeting. According to Correia et al (2008:419), the annual budget in smaller entities need not be as detailed as in the larger firms, but the same principles should be used. This indicates that even if MSEs do not go into detailed planning, they could still benefit from using an annual budget/plan.

The first budget to be compiled is the sales budget. Sales from the previous year as well as other factors such as the entity's pricing and marketing policies, economic conditions and industry trends should also be taken into account. (Garrison et al 2006:386). The importance of the sales forecast cannot be overemphasised because all the other budgets are based on the sales budget which determines the level of the businesses operations (Drury 2004:598). In a manufacturing enterprise, the sales budget is used to determine the number of units of each product that needs to be produced and the production budget can then be prepared. The direct materials budget, direct labour budget, manufacturing overheads budget, selling and administrative expense budget, a cash budget, and lastly, a budgeted income statement and budgeted balance sheet are compiled. These budgets collectively form the master budget or plan (Hilton et al 2006:601). These different budgets are compiled by the various line managers in larger entities, but in all probability, one person in very small firms would be responsible for preparing them. Ensuring that the sales budget is correct in manufacturing firms is critical because this could eliminate over- or underpurchasing of the resources required, which in turn would reduce costs and increase profits.

Because a firm's liquidity is crucial to its survival, one of the main budgets for MSEs is the cash budget. An entity can be profitable and still go out of business, but if there is enough cash to pay current expenses, a firm will still survive liquidation (Macleod & Terblanche 2005:106). Planning in a

manufacturing enterprise cannot be stressed enough because it reduces waste and costs. Research in small and medium-sized manufacturing enterprises reveals that the more formal and the better planning and control systems, the better the performance of the entity will be (Wijewardena, De Zoysa, Fonseka & Perera 2004:212). This finding reiterates the fact that small manufacturing businesses should have a formal system in place to plan and control their operations because this will increase their chances of survival and success.

3.2.2.2 Evolution of traditional budgeting

In the early days of traditional budgeting, a command and control approach was adopted, where top management set the plans and expected their subordinates to attain the given goals. There was little or no participation by line managers and other employees in the budget process. Regarding larger MSEs, Shrader et al (1989:59) found in their research that most small firms' planning was done only by top management as it was felt that the process of planning is both time consuming and extremely costly. Gibson and Cassar (2002:182) agree with these findings and report that time and the lack of the skilled staff required are major constraints in planning in smaller firms. In South Africa, many employees in the manufacturing sector are semiskilled (see ch 2), which indicates that the owner may be doing all the planning. Also, because such owners are often actively involved in the daily operations of the firm, they have hardly any time to spend on financial planning and control.

There have been many changes in budgeting since the early days and budgeting is now considered a complete management system. Some of those changes are discussed below.

a Responsibility accounting/budgeting

Nowadays, there is a bottom-up approach with the budget originating at the lowest level of management. This is often referred to as the self-imposed or participative budget. Responsibility accounting assumes that managers

influence costs and that the best way of controlling these costs is to hold these managers responsible for the costs they influence (Garrison, Noreen & Seal 2003:454; Correia et al 2008:434; Drury 2008:395). This means that bottom line or sectional managers are required to develop their own budgets and are then held responsible for meeting their targets. In MSEs, there are few or no sectional managers but this method of including employees in the budgeting process could still be used by these smaller firms because it could give employees a sense of ownership which would encourage them to perform better. In the larger MSEs that may have sectional managers, participation in the budgeting process could be beneficial where there are time constraints.

As the budgeting process evolved over the years, it became an all-inclusive profit planning and control system. As early as 1988, Welsch et al (1988:41) listed responsibility accounting as one of the major principles of a comprehensive profit planning and control system and they go on to describe a comprehensive profit planning and control system as "... a process designed to help management effectively perform significant phases of the planning and control functions". The responsibility-based budget is based on the chart of accounts and therefore focuses on departments, functions and cost categories (Stenzel & Stenzel 2003:83). Today, many organisations are decentralising and forming smaller units. These smaller business units must have a common goal in order to attain the objectives of the enterprise. A small enterprise could therefore be similar in size to a small business unit of a larger corporation and the basic principles of responsibility budgeting could be used for these smaller firms. According to Hilton, Maher and Selto (2006:744), because the goals of employees and the enterprise differ, evaluation and incentive methods are designed to motivate employees to act as if their goals were congruent with organisational goals. Responsibility budgeting is explained as the measures used to encourage employees to attain goals as well as behavioural congruence.

The smaller business units are known as responsibility centres and can be classified as either cost centres, profit centres or investment centres. The managers of these smaller units are held responsible for the items over which they have control (Garrison, Noreen & Brewer 2006:541; Mowen, Hansen & Heitger 2009:508). This implies that responsibility budgeting brings a personal touch to accounting information. The managers compile the budget for their specific units and therefore behave as if the goals were their own. Any deviations from the budget are their responsibility and they can take corrective action when necessary. In larger MSEs, where there are up to 50 employees, the use of responsibility budgeting could encourage personnel to align their goals with those of the organisation.

b Standard costing used in budgeting systems

Standard costing is used widely today by manufacturing, service and many other types of organisations. It is now often used in conjunction with a budgeting system because it provides a more reliable basis on which to compile the budgets. Standard costing, however, is not suitable in a business where the activities are not common or repetitive (Drury 2003:368). Standards are benchmarks for measuring performance and are predetermined or target costs which should be incurred if operating conditions are efficient (Drury 2004:726; Garrison et al 2006:429). These standards are set by top management and accountants using either historical data or determining what a unit should cost.

Quantity standards as well as cost standards are set and used to compile the annual budget. The actual results for a period are then compared with the standard or budget cost for control purposes. If there is a large variance between the standard and the actual values, the discrepancy is scrutinised by management. This is known as management by exception, which means that only material differences between the actual and standard values are examined and solved by management. These exceptional variances are analysed and corrected and this is the backbone of the budgetary control

process (Marginson & Ogden 2005:30; Shim & Siegel 2005:105; Garrison et al 2006:429). By concentrating only on those items that are way off budget, management have more time for their other duties in the organisation. It could be argued that investigating only material differences would not be suitable for small enterprises as these firms may have limited funds and all variances would thus need to be scrutinised. Regarding smaller entities, Upton, Teal and Felan (2001:68) reveal in their research of fast-growing family firms that these firms linked rewards to the attainment of firm goals, and that deviations between planned and actual outcomes were found to be communicated to all employees by many of these firms. These results indicate the value of communicating plans and actual performance in smaller organisations because the entities researched in their study were fast-growing entities.

Control is exercised by using the budget targets as a measure to check the actual results (Drury 2004:643; Niemand, Meyer, Botes & Van Vuuren 2006:530). By using standard costing in the setting of budgets as well as using variance analysis, the performance of departments and individuals can be assessed. Salary increases, bonuses and promotions are often determined by these assessments. Because of this pressure of reaching budget targets, employees often "manage the numbers" and "pad" the budget so as not to influence their chances of reward. In budget padding, employees underestimate revenue or overestimate costs in case they do not reach their budgeted target, and they therefore perceive that their performance will look better (Hilton et al 2006:619; Correia et al 2008:434). The importance placed on achieving budget targets was confirmed by Upton et al (2001:65) who conducted a survey on fast-growing family firms, which revealed that, whatever the size of the entity, about 77% of these family firms linked plans to actual performances and 71% rewarded management if they achieved their goals. In the larger MSEs, there could be line managers who are responsible for attaining their given budgets, but in very small organisations, the owner/manager would be responsible for setting targets, and budget padding would therefore probably not occur.

It has been indicated that standard costing is most relevant in a secure environment where high numbers of similar products are produced and also where labour costs are significant (Fry, Steele, & Saladin 1995:22; Drury 2008:418). The labour cost in the small manufacturing concerns is arguably higher than other costs, which implies that this traditional method could be a way of measuring success. In recent years, the relevance of standard costing has been questioned and activity-based costing (ABC) and the theory of constraints (TOC) are being considered as better options (Sheu, Chen & Kovar 2003:433).

c Flexible budgets

Budgets are usually compiled for a fixed volume of activity and are suitable for planning purposes. Flexible budgets, however, consider the variations in costs as the level of activity changes, and a budget is compiled for various levels of activity, which is more realistic. Flexible budgets are used when there is uncertainty about the level of activity as opposed to a static or fixed budget which is based on a specific level of activity. Fixed costs are assumed to remain constant within a certain range, and variable costs such as raw materials and labour will increase/decrease in direct proportion to the number of units produced (Hilton et al 2006:690). Budgets are compiled for various levels of activity within a certain range in which the business operates, and then at the end of the period, the actual level of activity is compared to the budget (Shim & Siegel 2005:100). When calculating variances for control purposes in flexible budgeting, there will only be cost variances and not volume variances – that is, the amount will be the result of either over- or underspending (Keith & Keith 1985:184). Flexible budgets are essentially a tool to control overhead costs, whereby actual costs can be compared with budget costs for the activity actually achieved.

Flexible budgets would probably be of benefit to manufacturing enterprises because there are often changes in the volume of production. By using flexible

budgets and computer programs it is much less complicated to plan for different circumstances, and although software packages are costly, they are worth purchasing in the long run (Faul, Du Plessis, Niemand & Koch 2001:458; Barr 2005:24). Using flexible budgets in manufacturing MSEs would be beneficial because it would be possible to calculate more accurate cost figures.

3.2.2.3 Benefits and weaknesses of using traditional budgeting in MSEs

One of the main advantages of using a budgeting system in MSEs is that the owner/manager is compelled to think and plan in advance, which encourages the reduction of costs. MSEs often have scarce resources, and by using budgets, the resources can be allocated more effectively and potential obstacles can be averted. Subordinates are managed more effectively and subsequent performances can be evaluated (Shim & Siegel 2005:18; Garrison et al 2006:379).

Research conducted in Malaysia, Asia, New Zealand and the UK revealed that traditional budgeting methods are still useful today (Ahmad et al 2003:723; Sulaiman et al 2004:495) The above researchers indicated that budgeting need not be abandoned but should rather be adapted to suit the ever-changing business environment, and that it can still be useful in the planning and control processes of the enterprise. Marginson and Ogden (2005:31) agree and contend that abandoning budgeting in the hope of solving some problems may in fact create many other problem areas.

Morrison et al (2003:421) did research on small business growth and indicated that above-average growth is experienced in firms that plan. Also, the budgeting process could be extremely useful to small business owners/managers in manufacturing firms as they need to organise and manage the purchase and distribution of raw materials, labour and other resources used in the manufacturing process.

The main disadvantages to small business owners of using a comprehensive budgeting system would be the time and cost spent on preparing the budget. When an unforeseen opportunity arises it may be detrimental for small businesses to ignore the opportunity and follow the budget because of the time and money spent on compiling it. It was found, however, that when there is uncertainty in the business environment, small and micro organisations are inclined to depend on their instinct instead of formalising plans (Prater & Ghosh 2005:164). This reliance on instinct is arguably the way in which activities are planned and controlled in most small and micro firms because of the many constraints previously mentioned.

Other weaknesses of using a budgeting system in MSEs include the fact that they are not compiled frequently enough and the main focus is on cost reduction instead of creating value. Traditional budgeting limits reaction to change and is therefore not suited to the vibrant business environment of today, especially for small business owners who need to make changes to suit the environment (Prendergast 2000:14; Hope & Fraser 2003:16; Hansen et al 2003:96; Stenzel & Stenzel 2003:82).

Budgets are often only compiled for the requirements of banks and other financiers and may not be reliable for use in small businesses unless they are continually updated (Correia et al 2008:418). According to Keith and Keith (1985:168), a budget is useless on its own and is only really a document containing a quantifiable plan, whereas budgeting involves the creation and administration of budgets. Budgets and budgeting are actually a waste of time and money without capable management. If use of a budget does not help to achieve organisational goals, or if the cost of compiling and using a budget outweighs its benefits, then the use of budgeting in any organisation, including MSEs, should be questioned.

3.2.3 Better budgeting in MSEs

Owing to the dissatisfaction with traditional budgeting, researchers started looking for new ways to budget. These developments were termed “better budgeting” because they were more modern versions of traditional budgeting. It has been shown that by changing to better budgeting methods, organisations have shown considerable changes for the better within a few months (Fanning 2000:60). The contemporary budgeting and financial planning techniques emerged as a result of the idea of managing instead of simply accepting costs (Hilton et al 2006:621). The following methods, inter alia, for “better budgeting” were found in research of the literature:

- activity-based budgeting
- rolling budgets and forecasts
- zero-based budgeting

3.2.3.1 Activity-based budgeting (ABB)

ABB evolved from the activity-based costing (ABC) and activity-based management (ABM) systems that were developed in the late 1980s (Stenzel & Stenzel 2003:85).

In traditional costing systems, manufacturing overheads are allocated to products using volume-based cost drivers. This was suitable in the past but there is now more product diversity, increased customer demand and more automation of processes (Correia et al 2008:352). The traditional approach can also be misleading, especially in firms with a wide range of products where the nonmanufacturing overheads are extremely significant (Niemand et al 2006:170). ABC is a costing system that was created to display the accumulation of financial data and it provides detailed information of all activities throughout the organisation as well as accurate information which assists managers in their decision making (Stenzel & Stenzel 2003:159). An activity is any work done in the operations of the business and is described by Hilton et al (2006:48) as “... any discrete task that an organisation undertakes to make or deliver a good or service”. ABC systems first assign overheads to

activity cost centres, and from there they are allocated to products or other cost objects (Drury 2004:372). Numerous international enterprises have adopted ABC methods. These include American Express, Carrier Corporation, Dana Corporation, Dialysis Clinic, Hallmark, Maxwell Appliance Controls, Pillsbury and the US Postal Services (Garrison et al 2006:314). In a survey of management accounting practices in a number of Asian countries, it was found that between 4 and 28% of manufacturing enterprises were using ABC (Sulaiman et al 2004:504). Kren and Tyson (2004:60) agree and point out that it has been found that ABC is extremely useful in manufacturing enterprises.

Implementing a new costing system can be costly, but Hicks (1992:304) reports that a small firm implemented ABC with minimal cost and that the model could be used in making many other decisions such as forecasting, budgeting and planning as well as make or buy decisions. In recent years, there has been a move to integrate ABC and another management accounting system known as the theory of constraints (TOC), which will be discussed later in this chapter. Sheu et al (2003:437) note that by using ABC in conjunction with TOC, costs will be lower and less effort than would be required in the original ABC. Because of these advantages, this method of costing is ideal for smaller enterprises.

ABM evolved from ABC when the users of the latter found that they could use the system to manage costs. The aim of ABM is to satisfy customers, at the same time making fewer demands on organisational resources. ABM assumes that activities cause costs and that the business has a number of interlinked activities which add value to the customer (Drury 2004: 951). According to Kren and Tyson (2004:60), ABM focuses on the control of activities and not on the amounts spent. Proponents of ABM argue that planning is the main focus of a budgeting system and that the traditional financial budget is not suitably affiliated to the operations of an entity (Hansen et al 2003:98). The above indicates that small firms would probably benefit by using ABM, which would enable them to better plan and calculate costs, which would ultimately benefit

their customers. Hilton et al (2006:603) indicate that an entity will not benefit fully by using ABC and ABM unless it incorporates these methods into the budgeting process.

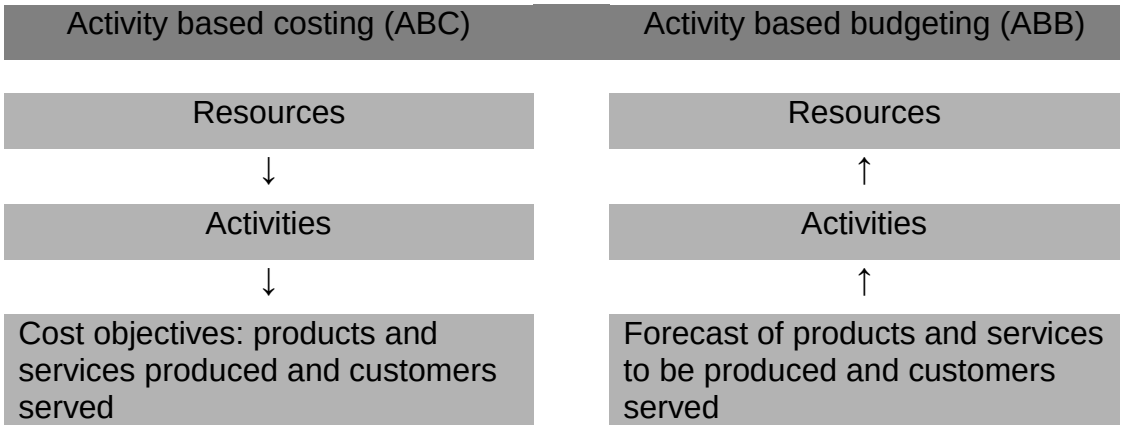
a Nature of ABB

ABB is ABC in reverse, whereby the latter assigns the use of resources to activities, determining cost drivers for these activities and using these cost drivers to cost objects such as products, services or customers. ABB focuses on the work to be accomplished and the fact that costs are allocated to the expected cost of activities and not to products, services or resources. This budgeting technique links the budget to the enterprise's planning with the focus on cost management. When implementing ABB there must be open communication between all employees and all problems must be dealt with along the way otherwise this could be detrimental to its success (Babbini 1999:54; Marcino 2000:31; Neumann 2001:46; Drury 2004:622).

The traditional budget is based on product-market relationships, responsibility centres or departments, whereas ABB generates a budget from activities within the organisation. The use of ABC information enables one to prepare a master budget. Firstly, the product/service to be produced and the customers to serve must be forecast for the budget period and then used to plan the activities. During the budget period, the actual results should regularly be compared to the budget which has been adjusted to actual output. This information will indicate to management the financial and nonfinancial variances (Drury, 2004:613; Hilton et al 2006:603).

As depicted in figure 3.2, in ABB, a forecast is done of the products and services required and the customers to be served, and this is then used to plan activities and the resources needed for these activities (Hilton et al 2006:603).

Figure 3.2 Activity-based costing versus activity-based budgeting



Source: Hilton *et al* (2006:603)

For the owner/manager of a small manufacturing firm, the use of ABB would be an effective method to plan for resources. Forecasting the products needed for a period will ensure that only the necessary activities and resources are planned for. By regularly reviewing the situation, the owner/manager could make adjustments where necessary.

b Benefits and weaknesses of using ABB in MSEs

The users of ABB maintain that more realistic budgets are set by using this method. In ABB, costs are identified and imbalances, inefficiencies and bottlenecks highlighted thereby preventing unnecessary calculations of their financial effects. ABB detects budgetary slack and also recognises the need for resources, which is beneficial for small businesses which can ill afford to waste the limited resources at their disposal (Hansen et al 2003:99; Drury 2004:614; Hilton et al 2006:609). There is evidence (Kren & Tyson 2004:60; Sulaiman, Ahmad & Alwi 2004:504) of the successful use of ABC in small manufacturing firms, which would suggest that a change to ABB may be beneficial to smaller manufacturing firms.

The main weaknesses of using ABB in MSEs are that the system is extremely costly to implement and operate and information on resources, activities and processes may not be easily obtainable (Hansen et al 2003:100).

3.2.3.2 Rolling or continuous budgets

In rolling or continuous budgeting, a budget is compiled for a period of say, a month or a quarter. A detailed budget is prepared for the following period and an outline forecast compiled in periods for the coming year, which compels management to continuously think about strategies and plans. At the end of one period, that forecast is removed from the budget, and a new budget added for a new period at the end of the other periods. Thus every month or quarter, a separate budget is prepared, which means that the budget tends to be more realistic and a legitimate measure for evaluating performance (Chan 1988:40; Garrison et al 2003:453; Lynn & Madison 2004:60; Hilton et al 2006:598). This system could be beneficial to the owners of small businesses, especially manufacturing entities, because they have to plan the purchase and use of raw materials and components. Owing to the size and the smaller customer base of MSEs, it would be more beneficial to plan only for a few months ahead on the basis of the orders received, which makes rolling budgets an option for these businesses.

a Nature of rolling budgets

In businesses that use rolling or continuous budgeting, the budget is often created for a range of volumes which means that flexible budgeting is also used (Stenzel & Stenzel 2003:83). These authors contend that by using rolling and flexible budgeting together it is easier to attain what has been planned because management are able to plan for different scenarios and can adjust the plan as changes occur. It is also a better method of controlling operations in different circumstances.

Randy Myers (2001:41), in his article “Budgets on a roll”, believes that rolling budgets ensure that financial forecasts are up to date and that the budgeting process is more appropriate. He indicates that this type of budget compels managers to respond faster to changing economic and business conditions. This is fundamental to the performance and survival of MSEs because they

need to keep abreast of changing circumstances. The opinion is that no major changes are required in the way a business does its budgets, and the use of rolling budgets can be implemented with ease. Information must be accessed and processed much faster if rolling budgets are to work, and using special software could resolve this problem (Myers 2001:41). Lynn and Madison (2004:63) do not totally agree with Myers and believe that changing to a rolling budget system is not easy and also that it is not simply annual budgeting on a more frequent basis.

b Benefits and weaknesses of using rolling budgets in MSEs

The main advantage of rolling budgets is that managers are required to continually evaluate their plans (Drury 2003:315; Lynn & Madison 2004:60). MSEs need to be competitive and by using rolling budgets they become more adaptable. There is less danger of becoming too focused on the short term when using rolling budgets and therefore more realistic targets are made which is advantageous for MSEs. Information is retrieved and dealt with much faster than with static budgets (Babbini 1999:61; Myers 2001:41; Drury 2003:315; Garrison et al 2006:380).

One of the major problems with rolling budgets is that strategic or long-term plans are often forgotten or neglected. Another problem for MSEs is that this type of budget is time consuming and costly and that the cost-benefit approach should be used when deciding whether to use rolling or continuous budgeting (Chan 1988:40).

Many firms appear to use a scaled down version of rolling budgets because of the difficulty of implementation. Summarised information is used in conjunction with software packages like Excel. This is less time consuming but still indicates to managers where the problem areas lie (Leone 2003:3). This finding is significant for smaller enterprises because it indicates that it could be beneficial for these smaller firms to implement a modified rolling budget system.

3.2.3.3 Zero-based budgeting (ZBB)

The modern idea of zero-based budgeting came to the fore in 1969, and by the early 1970s, many companies were using this kind of budgeting and many articles on the subject were published during that period. However, ZBB is used less frequently today, although some organisations utilise it every few years to assess the effect of incremental budgeting (Garrison et al 2006:384; Correia et al 2008:437).

a Nature of ZBB

In traditional budgeting, the previous year's budget is taken as given and then increased or decreased for the coming year. ZBB, however, is a method of budgeting whereby the annual budget is started from zero. All the firm's activities must be justified in terms of continued usefulness in order to receive money from the budget, and management can allocate resources accordingly (Pyhrr, 1973:5; Hilton et al 2006:620). It is possible that the smaller firm unknowingly uses a form of ZBB because the owner/manager may start planning from scratch each year and not according to the previous year's results.

In ZBB, decision packages are developed and then ranked according to quantitative and subjective techniques. A decision package is a document that identifies and describes all the aspects of the specific activity. After these two steps have been performed, top management can allocate resources to the highest ranked activities, sort them into their different budget units and with this information, compile a budget for each unit (Pyhrr 1973:5; Drury 2008:376).

This method of budgeting can be used in any organisation where a cost/benefit relationship can be identified for a particular activity. It is used mainly in nonprofit organisations, and in profit organisations, in the supporting activities and the allocation of discretionary costs (Drury 2004:622). However, Shim and

Siegel (2005:331) indicate that ZBB may be used by production departments in larger organisations, which leads to speculation that it could be beneficial to manufacturing MSEs. ZBB is also used widely in government departments in South Africa and has been found to work well in the provincial government of the North West (Correia et al 2008:437).

In a modified approach to ZBB, which is an easier and more effective method, all the decision packages can be approved, disapproved or partly approved. The approved and partly approved decision packages are not investigated any further, whereas the budget is reduced by the amount rejected in the disapproved and partly approved decision packages. These rejected decision packages can then be investigated further and units in the enterprise may be asked to develop new decision packages. In this way, top management are involved in all budget decisions, and it is not only the highest ranked decision packages that are approved. It is believed that this form of ZBB could be useful to smaller enterprises because it is takes less time, is more flexible and is much easier to operate (Brown 1981:47).

b Benefits and weaknesses of using ZBB in MSEs

ZBB avoids the weaknesses of incremental budgeting and directs attention to outputs in relation to value for money, which is vital to MSEs. It also forces the management to examine rather than assume that what is currently being done is best for the organisation (Hilton et al 2006:620; Correia et al 2008:437; Drury 2008:375). The modified ZBB model can be extremely useful in smaller organisations because it can be used when needed. There is less paperwork and better budgeting decisions are made which is vital for a small business (Brown 1981:50).

In contrast to the above advantages of ZBB, the literature indicates that the use of it is extremely costly and time consuming and requires a lot of documentation to be used on an annual basis and that it could result in little or no interaction between sections of the organisation. In addition, it is argued

that ZBB does not detect wastage, unnecessary activities, problems with communication in the organisation or prospects for better use of resources, all of which are detrimental to the survival of manufacturing MSEs (Brown 1981:44; Garrison et al 2003:475; Garrison et al 2006:384; Correia et al 2008:437). Many organisations use it as a once off, and then continue with their traditional budgeting system.

It appears that ZBB has many worthwhile benefits for larger organisations and that the modified version thereof could be useful to smaller entities. However, ZBB does not appear suitable for use in manufacturing concerns where the cost/benefit analysis is not as clear-cut as in service and nonprofit enterprises.

3.3 Going beyond budgeting in MSEs

In their search for a holistic general management system, Hope and Fraser (1999:18) found that many companies had actually stopped using a budgeting system. The findings revealed management accounting systems in total contrast to traditional methods where employees are empowered and held accountable for their decisions. These findings led the BBRT to design a framework for managing a business without budgets which they call “beyond budgeting” (Hope & Fraser 1999:18). They (2003:15) believed that a new management model should support enterprise goals. Six goals were identified which are common to most entities (including MSEs), namely to keep shareholders/owners happy by being constantly prosperous; to find and retain the best employees; to be innovative; to keep operation costs low in order to satisfy clients; and to provide efficient governance and promote ethical reporting.

When abandoning the budgeting system, the whole management structure needs to change, decentralisation must take place and responsibility must be transferred to the front line. This idea may benefit smaller entities as they are

somewhat “decentralised” because of their size, and if owners/managers had transferred more control to employees they would have more time to manage, resulting in improved success and thus survival.

3.3.1 Nature of going beyond budgeting

It should be emphasised that abandoning budgeting does not mean abandoning planning. It is believed that there is even more time for planning because traditional budgeting is time consuming and also that an enterprise needs to rely more on the accounting system when abandoning budget systems (Oldman & Mills 1999:26). By managing and controlling without budgets, enterprises eventually develop the flexibility of resource allocation which is at the heart of beyond budgeting (Daum 2002:1).

The beyond budgeting group believes that rolling forecasts, benchmarking, KPIs and exception-based monitoring should replace traditional and better budgeting systems (Hope & Fraser 2003:21; Player 2003:5; Drury 2008:377). A number of organisations that revolutionised their planning and control processes by abandoning budgets altogether applied two significant management methods, namely by radically decentralising and by making the performance management process more flexible (Player 2003:5). By decentralising, larger organisations are forming smaller groups within the organisations which have their own set of plans. The implication here is that smaller firms may also benefit by following the beyond budgeting approach.

Beyond budgeting is a set of principles to be followed and not a model or set of tools. Existing models or tools, for example, shareholder value, benchmarking, balanced scorecards, ABM, customer relationship management and enterprise-wide information systems can all be used “within the framework of an adaptive and decentralised organisation” to achieve the required results (Player 2003:8). Adopting the philosophy of beyond budgeting can improve an entity’s performance (De Waal 2005:66). Beyond budgeting offers much greater rewards if implemented properly, and enterprises in rapidly growing

markets with a diversified fast- growing product range will benefit from opting for this approach (Fanning 2000:61). Interestingly, William Cress (1980:114) discovered that the smaller firms were more apt to be flexible about revising the operational budget. This information suggests that small enterprises may, unknowingly, be using the principles of beyond budgeting.

If a small business wants to succeed, it has to invest in its most valuable resource, namely its employees. Employees require the correct tools and equipment and enough time to do the work properly. Also, they must have the approval necessary to be able to do their duties as well as clearly defined standards against which to evaluate their performance (Macleod & Terblanche 2005:230). When employees are empowered, they are more motivated and able to deal with difficulties and opportunities, but distinct boundaries must be set within which the employees can make their own decisions (Libby & Lindsay 2003:30).

3.3.2 Benefits and weaknesses of going beyond budgeting in MSEs

One of the major advantages of going beyond budgeting in MSEs is that the firm can react quickly to any changes in the plans and this enables firms to be much more flexible with their resources. Costs are reduced, which generates higher profitability, a positive factor for a small firm. There is greater alignment between plans and enterprise goals which help keep the business on track. Going beyond budgeting also creates new prospects for organisations in this highly competitive market which is crucial to the survival of small firms (Daum 2002:1; Player 2003:5; De Waal 2005:58). It was also found that about 20% of management time is freed when eliminating the budgeting process (Correia et al 2008:418), which means that for MSEs, the owners have more time to focus on the operations of their businesses.

The literature cites a number of disadvantages of in abandoning budgets. The researcher feels that the major disadvantages for MSEs are the need for the use of management accounting methods which the owner/manager may not

understand and the fact that the employees need to be reasonably well educated to be able to participate.

There has been great interest in the beyond budgeting movement because many businesses have benefited from adopting this approach to managing their enterprises (De Waal 2005:56). It is evident from the above discussion that those organisations that have gone beyond budgeting and abandoned the budgeting process have been highly successful. This is good news for small enterprises as it means that they need not follow the traditional management systems, which are costly and time consuming, in order to plan and control their operations effectively. However, Marginson and Ogden (2005:31) did a case study and their findings suggest that by abandoning budgets more problems could arise. They (Marginson & Ogden 2005:31) feel that by combining traditional budgeting and responsibility centres with other management control processes, communication between employees will increase, which could generate new ideas and innovation.

Fanning (2000:61) indicates that enterprises have to change to either the "better budgeting" or the "beyond budgeting" approach. He maintains that the "better budgeting" option can be implemented more quickly and easily than the "beyond budgeting" option. Fanning (2000:64) lists four courses of action which an enterprise should take when reviewing its budgeting system:

- The cost of the budgeting system must be determined.
- The IT systems in use must be assessed.
- The forecasting process must be improved.
- More performance management measures should be used.

Hsu and Sun (2005:422) believe that a firm's success or failure depends largely on the management systems a firm chooses. According to Gibson, Greenhalgh and Kerr (1995:294), manufacturing concerns stay in business by being competitive. This means that products and services must be better than

those of their competitors. By using some formal management system, better products and services are possible for any size manufacturing firm.

3.4 Other management accounting systems in MSEs

In today's competitive business environment, customers are becoming extremely demanding and enterprises have to keep their customers happy by providing quality products at reasonable prices which are delivered on time (Drury 2004:13). With the many changes in the South African business environment over the past few years, and especially with regard to the lifting of sanctions on the export and import markets resulting in greater competition, businesses have had to review their management accounting practices, thus forcing change (Luther & Longden 2001:313). This is not only applicable to large enterprises, because in South Africa, the government is also promoting small business trade with other countries (DTI 2005:38).

Because of globalisation and greater competition, customers are becoming more demanding – hence keeping the consumer happy must be the main concern if a business wants to survive (Drury 2004:13). Customer satisfaction is the main focus of the more modern management systems which would be suitable for smaller businesses because of their personal nature. The aim of the modern management systems is to be innovative in product development, reducing waste, keeping costs to a minimum while quality and time management are given constant attention. Employees are given more responsibility to sort out problems as they arise. The whole manufacturing process is analysed from the basic raw material to the finished product and the value created in each step results in improved activities and an advantage over competitors (Drury 2004:14). The movement away from traditional management accounting systems may be beneficial to the smaller enterprise, especially in the modern information era and global economy. Focusing on

customer satisfaction will enable smaller firms to be more competitive, which could boost growth and ensure survival.

A number of new management systems have evolved over the years because the traditional systems tended to focus on financial measures only. The importance of customers' needs and the challenge for quality products, for instance, are factors that were to some extent neglected in the past (Correia et al 2008:664). By using the newer management accounting systems and techniques, management in the larger corporations have found that inefficient products are being identified, the operational and strategic goals of the entity are being linked and a better understanding of the business is being provided (Prendergast 2000:14). It may be worthwhile for the owners/managers of smaller entities to learn from the larger businesses about what the best practices are and which management systems are successful.

The balanced scorecard, just-in-time, theory of constraints and total quality management are a few of these new management systems that could benefit manufacturing MSEs.

3.4.1 Balanced scorecard (BSC)

The problems with traditional management accounting systems and the need to improve the planning, control and performance measurements prompted the development of the balance scorecard (BSC) by Kaplan and Norton (Davis & Albright 2004:136; Correia et al 2008:669). The BSC was originally developed as a performance measurement system but has since evolved into a strategic management system which does what traditional systems have been unable to do, namely link a firm's long-term strategy to its short-term actions (Kaplan & Norton 1996:75). New and smaller firms may also use the BSC provided they align individual and business processes to the strategies of the organisation (Kaplan & Norton 2001:370).

3.4.1.1 Nature of BSC

Strategic planning is of vital importance to any firm because it focuses on the long-term objectives of the business. Strategies give management direction, and without this long-term vision, a firm is in danger of failure. If management only concentrate on the short-term and are not proactive in their approach to situations, the firm will underperform and possibly even fail. The BSC is a management system which brings together the strategies of the firm and the behaviour of its personnel (Davis & Albright 2004:135). Kaplan and Norton advocate the use of both financial and nonfinancial measures in determining business success, giving management a "balanced" view – hence the name. Management should plan and control the general development of the firm in a balanced way and not only concentrate on bottom-line profits or earnings per share. In so doing they can observe whether changes in one area are at the expense of another (Kippenberger 1996:8; Sanger 1998:198; Prendergast 2000:14). This is imperative in very small entities as wasted time and effort are costly. For instance, when an entity makes a decision to replace the current machinery or equipment, the BSC could indicate whether there are enough funds to purchase quality materials.

There are two types of measures used in the BSC, namely lag measures which are financial indicators, and lead measures such as timely delivery, product quality, etc. The lag measures are outcome measures, whereas the lead measures are those that drive the outcome measures (Sanger 1998:198; Drury 2004:1002; Correia et al 2008:670).

The view of the BSC is that a firm's success can be measured and attained when seen from the following four different perspectives:

a Financial

There should be a well-designed financial control system in place, including cash flow, sales growth, operating income by division, increased market share and/or return on equity (Kippenberger 1996:8). Performance is viewed from

the perspective of the owners of the entity (Correia et al 2008:669). MSEs that operate without a proper accounting system could find themselves in financial difficulty as actual costs and cash flow would be difficult to determine.

b Customer

Customer value is the key here and the following four areas affect customer relations: quality of products, on-time delivery, service and performance (Kaplan & Norton 1992:73). These are vital areas for small and micro businesses because they need to have an edge over their competitors to attract customers to purchase their products.

c Internal

To achieve customer and financial objectives, the business processes must be examined to establish where improvements can be made to achieve the purposes from this perspective (Garrison et al 2003:696). Time and quality of product are crucial to any organisation, especially the small business owner with few or no employees. Inspection of the business processes will address these considerations.

d Innovation and learning

This has to do with the growth and improvement of the organisation and the development and training of its employees (Mackay 2004:12). Continual improvement in the overall operations of MSEs could result in the firm keeping its current customers and possibly gaining new ones.

The above four perspectives are assumed to have a cause-and-effect relationship whereby the nonfinancial measures are used to forecast financial performance and continuous improvement from all four perspectives is encouraged (Hoque & James 2000:2; Garrison et al 2003:696; Drury 2004:1001). It was found that manufacturing firms that used BSC measures performed better than their counterparts who did not (Hoque & James 2000:12). This was confirmed by Davis and Albright (2004:150) who reported

that the financial performance of those firms that had implemented BSC improved and that this was because of the inclusion of the nonfinancial measures. However, Hoque and James (2000:11) found that larger organisations are more inclined to use BSC than their smaller counterparts. These authors (2000:3) believe that this is because the owner/manager is usually actively involved and also the smaller entities generally do not need sophisticated performance evaluation systems.

Gumbus and Lussier (2006:410) advocate the use of the BSC for SMEs because this can help these small firms to achieve their goals. They found (Gumbus & Lussier 2006:422) that the BSC used by the three SMEs they investigated was noticeably different, and they concluded that each entity must design its own BSC which can be used for continuous improvement, which is imperative in the progress of a small firm.

3.4.1.2 Benefits and weaknesses of using BSC in MSEs

Using BSC helps create strategy-focused firms which are necessary in the information age and of vital importance in MSEs to stay competitive. The link between long- and short-term planning is shown. A common language whereby staff can communicate is provided and it reveals whether an improvement in one area has been at the expense of another (Kippenberger 1996:8; Kaplan & Norton 2001:159; Drury 2004:1004). It has also been found that if employees have access to the firm's BSC, they are more eager and motivated to share their views (Kaplan & Norton 2001:328).

Critics of BSC question the assumption of the cause-and-effect relationship because it is vague and there is no theoretical foundation. Measures can be viewed from other perspectives, for example, employee or environmental angles (Nørreklit 2000:79; Drury 2004:1004). Prendergast (2000:15) reports that practitioners indicate that it is easier to distort nonfinancial measures than financial measures which suggest that budget padding is also possible with the BSC.

It could be argued that in this modern era, it would be more beneficial for firms, including MSEs, to use the BSC. Because each firm has its own BSC and the owner of an MSE is usually heavily involved in business operations, the BSC could be of value to these small enterprises.

3.4.2 Just-in-time (JIT)

Since the late 1970s, a number of Japanese firms have become internationally successful and it was found that the use of JIT production methods was one of the major contributors to their success (Drury 2004:967; Correia et al 2008:775).

3.4.2.1 Nature of JIT

JIT was established to remove all actions that do not add value to a product or process. These are called nonvalue-added activities and they are actions where expenses can be cut without affecting the customers' ideas about the said product or process. There are a number of steps in the manufacturing process, namely processing, inspecting, moving, queuing and storing. The only one of these which concerns the customer is processing which means the others are all nonvalue-added actions (Drury 2003:60; Correia et al 2008:775).

One of the main features of JIT is to have minimal quantities of all inventories (Mowen et al 2009:346). The following are the main aims of JIT:

- to eliminate nonvalue-added activities
- to have zero defects
- to have zero inventories
- to have batch sizes of one
- to have no breakdowns
- to have a 100% on-time delivery service

To achieve this, the firm must have an excellent relationship with its suppliers and enter into long-term agreements with them as well as organise with the

suppliers to deliver fewer goods on a more regular basis (Primrose 1992:18; Hilton et al 2006:247; Correia et al 2008:777). Having a long-term contract with suppliers may be detrimental for firms in the MSE category, especially in times when demand is low. In traditional systems, the products are pushed through the manufacturing process according to budgeted demand. JIT, however, advocates that products be pulled through the production process by customer demand (Garrison et al 2003:736; Mowen et al 2009:346).

3.4.2.2 Benefits and weaknesses of using JIT in MSEs

Many manufacturing MSEs are operated from homes and small locations which means there is little space for holding inventory. Also, many have financial constraints and by using JIT, MSEs can reduce inventory levels which would reduce ordering and holding costs. Productivity and manufacturing lead times are increased. Quality is improved which ensures customer satisfaction and there is less wastage in terms of obsolescence, spoilage and theft (Drury 2004:973; Correia et al 2008:778; Mowen et al 2009:347). It has also been established that JIT is successful in firms that want to lower expenditure, which would be important for small firms. This, however, only works in entities where the goods that are produced are static and do not constantly change (Gunasekaran, Korukonda & Yli-Olli 1994:181).

The major disadvantage of using JIT is the possibility of shortages of inventory (Correia et al 2008:778; Mowen et al 2009:347). This would be fatal for MSEs because they cannot afford to lose any sales which, in turn, would mean a loss of clients. Another important issue is the considerable cost of setting up the production facility to incorporate JIT (Primrose 1992:9; Correia et al 2008:778) and the cost/benefit relationship will have to be evaluated carefully, especially for the smaller entities which may not be able to undergo a large capital outlay. JIT is inflexible with regard to product and process changes as well as volume changes in the demand for products (Gunasekaran et al 1994:181). Keys (1991:24), however, warns that employees working in businesses using JIT need proper education in basic mathematics, verbal communication and

reading and writing which may not be the case for many employees in MSEs in South Africa.

3.4.3 Theory of constraints (TOC)

The philosophy of TOC was developed by Eliyahu M Goldratt in the 1980s. It has developed into a complete management accounting system which focuses on managing and removing bottlenecks, resulting in better performance and higher profits (Garrison et al 2003:787; Correia et al 2008:732).

3.4.3.1 Nature of TOC

Garrison et al (2006:17) define a constraint as "anything that prevents you from getting more of what you want." There are constraints or bottlenecks in every form of business, and often even in the production process of manufacturing entities. Any business, including small businesses, can use TOC because it is simple and logical and all that is needed is a comprehensive understanding of the current procedures of the business (Mabin, Forgeson & Green 2001:172; Holmes & Hendricks 2005:53).

Constraints can be caused by something physical or by policies and behaviours (Mabin et al 2001:189). The literature (Goldratt & Cox 1992:299; Womack & Flowers 1999:402; Hsu & Sun 2005:419) indicates the following five steps in identifying and improving constraints:

Step 1: Pinpoint the bottlenecks or constraints of the business processes.
Step 2: Decide how to make use of the constraints in the business processes.
Step 3: Subordinate everything else to the constraints.
Step 4: Improve the constraints.
Step 5: If a constraint has been overcome in the previous steps, return to step 1.

By using the above steps, obstacles can be eliminated which should lead to continuous improvement. TOC also reveals that traditional costing measures are outdated and that a new set of measurements should be used (Goldratt 1990:124). Applying TOC to accounting is known as throughput accounting in the USA (Dugdale & Jones 1998:204). Throughput is described as the units processed through the system and sold (Mohaghegh 2006:260). The three key performance measures underlying TOC are throughput, inventory and operational expenses. It therefore focuses on increasing throughput (sales) by eliminating constraints and decreasing both inventory and operating expenses (Ferrara 1995:33; Dugdale & Jones 1998:77; Goldratt 1990:91).

Mehra, Inman and Tuite (2005:338) conducted a study that found that TOC was more suited to manufacturing firms in the process industry, especially those with a continuous flow process. However, they indicated that their findings do not mean that TOC cannot be used in other firms. This was confirmed by Mohaghegh (2006:260), who reported in a survey of machine shops, that those scheduling their machines based on TOC were the most successful and profitable firms.

3.4.3.2 Benefits and weaknesses of using TOC in MSEs

TOC is a leadership model which promotes change. It is simple and logical to use, which is positive for the owner/manager of an MSE. By adopting TOC, the problems of having too much inventory can also be overcome quickly which could have a positive influence on the firm's cash flow (Mabin et al 2001:185; Holmes & Hendricks 2005:53; Hsu & Sun 2005:418). TOC is one of the leading new manufacturing systems to have emerged in the past few years because it aligns an entity's accounting procedure with its manufacturing strategy and is also used worldwide in businesses of all sizes (Mabin et al 2001:189; Mehra et al 2005:328).

According to Bushong and Talbott (1999:53), TOC has been successfully implemented and used in a very small business that produces hand-tied

fishing flies, which indicates that this management accounting system should be investigated by small manufacturers. TOC and JIT have a few similar features, whereby very low or zero levels of inventory are advocated (Jones & Dugdale 1998:81). By using TOC in conjunction with ABC in manufacturing entities, the benefits of both systems can be enjoyed, which in turn would promote better decision making (Ferrara 1995:33; Sheu et al 2003:441).

The main disadvantage mentioned is that TOC focuses on the short-term (Graves & Gurd 1998:38; Kee & Schmidt 2000: 2). When deciding to implement TOC, this could slow down the manufacturing process (Holmes & Hendricks 20005:53).

3.4.4 Total quality management (TQM)

In the past, quantity was more important than quality and it was felt that quality was merely an additional cost of manufacturing. During the 1980s, managers began to realise that quality products saved money and that quality is extremely important to the customer (Drury 2004:14). This resulted in enterprises continually trying to improve their products and services.

3.4.4.1 Nature of TQM

Modern customers purchase products which they ”perceive” to be quality products, which means that quality is crucial (Goetsch & Davis 1994:1). No business, even an MSE, is immune to global competition and in this worldwide market quality products are crucial if a firm wants to compete and survive (Goetsch & Davis 1994:33).

”Total quality” includes all facets of a firm, that is, products, services, people, processes and the environment (Goetsch & Davis 1994:5). TQM is a management system which uses many different tools to solve problems. These include Pareto charts, fishbone diagrams, check sheets, scatter diagrams, histograms, run and control charts and benchmarking (Goetsch & Davis 1995:361; Rao, Carr, Dambolena, Kopp, Martin, Rafii & Schlesinger 1996:232;

Garrison et al 2006:16). One of the mechanisms used in TQM is benchmarking. According to Zairi & Leonard 1994:26): “Benchmarking is the continuous process of measuring products, services and processes against the strongest competitors in their fields.” In TQM, the entity’s products and services are continuously evaluated against other entities to establish where improvements can be made (Drury 2003:12). Hence by assessing an MSE against its strongest competitors, the MSE is able to improve on total quality, which will satisfy customers, which in turn could increase the number of customers.

To achieve total quality, a firm must plan thoroughly (Huxtable 1995:21). Walter Shewhart developed the Plan-Do-Check-Act (PDCA) cycle or Shewhart cycle to provide a framework for the design of experiments. The steps are as follows: plan the experiment; do the experiment; check the results of the experiment; and act according to your observations. There are many variations of the steps used in the search for continuous improvement. These steps in TQM are even more important in small firms because if errors are made, it is often difficult for the firm to recover (Huxtable 1995:21). Therefore for MSEs to run smoothly, they should identify problem areas and follow the PDCA cycle, thereby averting wastage and losses.

The process encompasses planning and control as well as customer satisfaction. Employees are being given relevant information and the freedom to make decisions without authorisation from management. This results in improved employee morale, satisfied customers and reduced cycle times (Drury 2003:13). Research on manufacturing entities in the USA found that those businesses that used benchmarking had improved quality of product which caused lower costs, which in turn improved profitability (Maiga & Jacobs 2006: 117). A study of small and medium manufacturing enterprises and TQM revealed that in instances where training and compensation supported strategic goals, the firms tended to perform better (Chandler & McEvoy 2000:54).

3.4.4.2 Benefits and weaknesses of using TQM in MSEs

When using TQM, products are of a better quality, which leads to customer satisfaction, and cycle times are reduced, all of which are crucial to the continued existence of small firms (Drury 2003:13; Huxtable 1995:17; Goetsch & Davis 1994:562). The use of BSC in conjunction with TQM should boost employee morale, which should in turn improve performance (Hoque 2003:563).

TQM does not consider employees in its search for continuous improvement, which could lead to employee dissatisfaction, which is bad for any firm. TQM also suggests operating at full capacity, which, because of many constraints, for instance, lack of demand and raw materials, is not always possible in very small firms (Keys 1991:22; Rao et al 1996:18).

3.5 Summary

Over the years, there have been many new developments in the traditional budgeting process. Babbini (1999:54) contends that traditional budgeting is used for control purposes, and that with the many new developments in the budgeting process, the focus has changed to one of an ongoing strategic process. Hogsett (1981:139), however, warns that change for the sake of change is costly. He indicates that before an entity changes, any current ways of operation, the pros and cons and the cost should be thoroughly evaluated.

The use of budgets can determine the success of any size organisation, including small and micro enterprises. Research in many other countries indicates that there is a positive correlation between firm success and a formal planning and control system. Some literature seems to indicate that traditional budgeting is somewhat outdated and not conducive to the competitive

business environment, and that, although budgeting is still useful, the variations of traditional budgeting are more suited to modern times.

It is apparent that a business cannot operate successfully without a plan and if used correctly, budgeting can be of value to any organisation, including small and micro enterprises. However, a budgeting system is often used mainly for the control of employees. Reward systems are linked to the attainment of budgets, which can promote dishonesty among employees. Many researchers believe that the budgeting system is not being used properly, and that it could still prove to be a useful management tool in the 21st century.

The more modern budgeting techniques include, ABB, rolling budgets and forecasts and ZBB. These"better budgeting" techniques were developed in an attempt to improve on and eliminate the problems experienced with traditional budgeting methods. There are indications that these newer techniques could be used by manufacturing MSEs and that in doing so, the survival rate of these smaller firms could improve. ABB and ZBB require much more time and effort, and Neely, Bourne and Adams (2003:22) maintain that they should be used on a once-off basis. They seem to think that rolling budgets and forecasts have the most likely chance as a "better budgeting" approach (Neely et al 2003:22). ZBB began to be favoured in an era of recession and high inflation. It seems to be a management system which could be used especially by larger firms. It is extremely expensive and time consuming to implement, and therefore many firms are only using it on a once-off basis. The modified version of ZBB, however, may be of value to small and medium-sized enterprises because it can be used if and when needed.

Other management systems that help with financial planning include BSC, JIT, TOC and TQM. These systems are deemed to be better suited to the dynamic economic environment than traditional or better budgeting systems. Hope and Fraser coined the term "beyond budgeting", whereby the management system supports the enterprise's goals. Many firms have abandoned budgets and

gone ”beyond budgeting” and as a result been able to adapt to the ever-changing economic environment. Many managers think that “better budgeting” is still possible and focus their efforts on improving the planning process, but Hope and Fraser (1997:23) argue that better budgeting is not the answer because none of these improved methods are suitable in the information age. Entities which have abandoned budgets have shown positive results and are able to adapt quickly to market changes. This adaption to market changes is probably easier for the smaller firm than for the larger organisations.

There are many different planning tools for management, but one fact is certain and that is that the management of any enterprise should have a clear plan of what they wish to achieve and how this should be done. From this plan they can evaluate and control the activities of the enterprise. This will enhance the entity’s performance and promote the survival of the firm.

CHAPTER 4

RESEARCH DESIGN AND METHODOLOGY

After all, the ultimate goal of all research is not objectivity, but truth. Helene Deutsch (1884–1982).

4.1 Introduction

There is minimal literature on MSEs in South Africa and a study of the literature indicates that a large percentage of new firms fail within a few years (Gruber 2007:784; Radipere & Van Scheers 2005:402; Van Eeden et al 2003:13; Monk 2000:12). The purpose of the study is to establish to what extent budgeting and/or other financial planning and control systems are used in manufacturing MSEs in the Tshwane metropolitan area and whether by using these management techniques these enterprises are more likely to survive. The preceding chapters provided an overview of manufacturing MSEs in South Africa. Different types of financial planning and control systems, including traditional budgeting systems, the ”better budgeting” system and other management systems were also described and investigated and their value to MSEs questioned.

This chapter will outline the research methodology used in the empirical study. The planning of the research and the methods used will be highlighted. The research instruments used, the determination of the population and the selection of the sample will be explained. The collection and analysis of data will also be described.

4.2 Research design

According to Saunders, Lewis and Thornhill (2007:131), the research design is a general plan of how to answer a research question. Research design can be classified into three categories, namely, exploratory, descriptive and causal research.

- Exploratory research is used where there is little knowledge about the subject and insights into the problem are sought.

- Descriptive research is used to answer the "who", "what", "where", "when" and "how" questions.

- In causal research, experiments are used to determine whether one variable causes the value of another variable.

According to Tustin, Lighthelm, Martins & Van Wyk (2005:83–87), these research designs differ in terms of the purpose of the research, the research question, the accuracy of hypotheses formulated and the methods of data collection that are used.

Descriptive research was used for this study. Firstly, a literature review was conducted to investigate why small manufacturing firms fail and to explore the environment in South Africa in which these firms operate. Secondly, an empirical study was undertaken by means of a survey in which questionnaires were sent to manufacturing MSEs in the Tshwane metropolitan area to determine their financial planning and control activities. Mouton (2001:152) describes surveys as research that is mainly quantitative for the purpose of supplying an extensive outline of a representative sample of a large population.

Although it is essential for all entities to plan their operations, the study focuses on manufacturing enterprises because the researcher believes that without

proper planning, manufacturers will not be able to function. In order to stay in business they need to plan for the acquisition of the correct equipment, tools and raw materials. By using only manufacturing enterprises in the study, a large portion of the population was eliminated. For convenience and cost implications, it was decided to use a sample of manufacturing MSES in the area in which the researcher lives.

A questionnaire was designed to establish the financial planning and budgeting customs of these manufacturing entities. The questionnaire is the focal point of a research process because it helps to achieve the research objectives by translating them into specific questions, and also facilitates the processing and analysis of the data gathered (Tustin et al 2005:385). The choice of questionnaire used is also usually affected by the resources available to the researcher, and the following considerations are important (Saunders et al 2007:359):

- the time available to complete the data gathering
- the financial implications of data collection and entry
- the availability of interviewers and fieldworkers to assist
- the ease of automating data entry

Questionnaires can be either interview administrated, which entails the researcher or field worker interviewing the respondents, or self-administrated, where the respondents are required to complete the questionnaire (Saunders et al 2007:356). Self-administrated questionnaires were used in this study. The researcher initially chose the option of email questionnaires mainly because of the cost of employing fieldworkers as well as printing and postal costs. However, because of the low response rate the researcher and one

fieldworker also went to manufacturing entities and asked them to complete the questionnaire.

Questions can be open or closed. In closed (or closed-ended) questions, the respondents must choose between a number of alternatives, whereas in open (or open-ended) questions, the respondents answer in their own words (Hofstee 2009:132; Saunders et al 2007:593). Most of the questions used in the questionnaire were closed-ended questions.

One of the main advantages of using a questionnaire as a research instrument is that it promises anonymity to the respondents, which may encourage them to complete the questionnaire. According to Leedy and Ormrod (2010:189), the major disadvantages are as follows:

- low response rates
- misinterpretation of questions

4.3 Methodology

In this section, the measuring instruments of the empirical study, population and sample, data gathering and analysis will be discussed.

4.3.1 Research instruments

A research instrument can be defined as anything that is used to collect the data one needs to answer one's research question (Hofstee 2006:115). In this study, a questionnaire was the instrument used to gather data from the target population.

The questionnaire used in the study is provided in annexure A. The questions were based on the literature review and the purpose of the study. Discussions

were also held with the statistical analyst and the promoters of the study regarding the compilation of the questionnaire.

The following suggestions by Bedward (1999:65) on compiling a suitable questionnaire were followed in compiling the questionnaire for this study:

- *Write an introduction and directions to the respondents*. A covering letter was sent with the questionnaire, inviting the owners/managers of MSEs to participate in the study. They were assured of anonymity. The purpose of and reasons for the study were also explained.

- *Make the questions simple and clear*. The questionnaire (see annexure A) contained mainly closed-ended questions in order to eliminate possible misinterpretation of the questions.

- *Ask one question at a time*. Except for two questions, which were interrelated, all the questions were in stand-alone format.

- *Do not include too many options for multiple-choice questions*. Most of the questions were multiple choice, and where possible, the number of options was kept to a minimum.

- *Make sure that the questions are in the correct order*. The questions were sorted and resorted until the researcher felt they were in a logical order.

- *Always assume that some of the respondents will misread/ignore your directions or leave some questions unanswered*. The researcher tried to keep the questions simple and also included a number of questions to verify the answers to important questions.

- *Pilot the questionnaire*. A week before the bulk of questionnaires were sent, 24 questionnaires were randomly sent out asking for feedback.

- *If necessary revise and rewrite the questions*. Questions were added and changed on numerous occasions during the compilation of the questionnaire.

- *Thank your respondents*. The respondents were thanked in the covering letter as well as at the end of the questionnaire.

The questionnaire for this study contained 35 questions comprising mainly closed-ended and a few open-ended questions. The questionnaire took approximately 10 minutes to complete, and there was no time restriction. The questionnaire consisted of three parts and these are discussed below.

Part 1 consisted of questions about the profile of the business. The respondents were asked for information on the products manufactured, and the type and size of the entity. Close-ended questions were used in this section, where the respondents had to choose one of the given options. Only question 2 was open ended where information was gathered about the main product that the entity produced.

Part 2 focused on the financial status of the entity and here closed-ended and scale questions were used. Particulars about the profitability, growth and turnover of the firms were asked. These questions were incorporated into this part to indicate the success or failure of the firms.

Part 3(a) solicited information on the age, sex and education and training of the owner/manager of the firm. The reason for including these demographic questions was that they would highlight possible differences in the behaviour of the various demographic groups.

Part 3(b) consisted of questions that were most relevant to the study and enquired about the firm's financial planning and budgeting habits.

Most of the questionnaires were self-administered whereby the respondents completed the questionnaire themselves. In a few instances, for example, where the information was gathered from entities operating in the more informal business sector in the Tshwane metropolitan area, the researcher and one fieldworker hand-delivered the questionnaires and gave instructions on answering the questions. One fieldworker was used in order to include businesses in a previously disadvantaged area, namely Atteridgeville, where the fieldworker lived. The researcher felt that these businesses would probably not be registered and would therefore not appear on any lists of the manufacturers used. The researcher coached the fieldworker on what to expect and how the questionnaire should be completed.

4.3.2 Data

According to Leedy and Ormrod (2010:88), data are expressions of reality and not absolute facts of reality. The collection of the data and the sample from which they are gathered will be discussed below. Primary data are collected specifically to deal with the purpose of the research if there are insufficient sources of secondary data, whereas secondary data are readily obtainable from existing information (Tustin et al 2005:88 -89). In this study, the use of a questionnaire to collect primary data was deemed appropriate in that the aim of the study was to represent factual data about the budgeting and financial planning habits of MSEs.

Data can be qualitative or quantitative. Leedy and Ormrod (2010:94) describe quantitative research as investigating quantities or amounts of one or more variables, whereas qualitative research considers qualities or characteristics of various occurrences. In this study, quantitative data were gathered via a questionnaire for analysis.

4.3.2.1 Population

A population is the group from which the sample is drawn and consists of all the people or establishments whose opinions, behaviours, preferences and attitudes will produce information to answer the research question (Tustin et al 2005:96). For the purposes of this research, the target population consisted of small and micro manufacturing entities in the geographical location of the Tshwane metropolitan area. The total population was extremely difficult to determine because many people run small manufacturing businesses from their homes. These businesses usually do not have a license and are not registered for value-added tax (VAT).

According to the Bureau of Market Research at the University of South Africa's database, a total of 7 834 manufacturing entities operate in the Tshwane metropolitan area. A figure of 7 123 businesses was indicated as falling into the category of MSEs, based on employee numbers. This means that the MSEs on this list consisted of almost 91% of all manufacturing enterprises in the geographical area included in the study. A number of organisations, for example, the DTI, StatsSA, Seda and Finmark were contacted in an attempt to find a list of MSEs in the Tshwane metropolitan area, but these organisations were unable or unwilling to assist in this matter.

4.3.2.2 Sample

If the total population is studied, it is referred to as a census, whereas a sample is a subset of the population - in other words, it is drawn from the total population (Tustin et al 2005:337). There are two types of sampling methods:

- probability sampling, where all members of a population have a chance of being selected in the sample

- nonprobability sampling, in which the chances of selecting members of the population are unknown (Tustin et al 2005:344)

Nonprobability sampling methods were used in this study where purposive and convenience sampling was used. In convenience sampling, the sample is drawn from members of the population who are readily available, while purposive sampling involves chooses specific members or units of the population for a particular purpose (Leedy & Ormrod 2010:212). Convenience sampling was used when the first batch of questionnaires were sent via email. This method was chosen because of the lack of ‘”official” lists of the populations and that fact it was convenient to use. After sending reminders and few responses from only a handful of the manufacturing subcategories, purposive sampling was used. The researcher wished to include manufacturing entities from all the different categories within the Standard Industrial Classification (SIC). The SIC is a list which covers all economic activity and the manufacturing sector is major division 3. The manufacturing sector comprises the following ten subdivisions:

- food products, beverages and tobacco (SIC 30)
- textiles, clothing and leather goods (SIC 31)
- wood and products of wood and cork, except furniture; articles of straw and plaiting materials; paper and paper products; publishing, printing and reproduction of recorded media (SIC 32)
- coke, refined petroleum products and nuclear fuel; chemical and chemical products; rubber and plastic products (SIC 33)
- other nonmetallic mineral products (SIC 34)
- basic metals, fabricated metal products, machinery and equipment and of office, accounting and computing machinery (SIC 35)

- electrical machinery and apparatus not elsewhere classified (SIC 36)
- radio, television and communication equipment and apparatus and of medical, precision and optical instruments, watches and clocks (SIC 37)
- transport equipment (SIC 38)
- furniture; manufacturing not elsewhere classified; recycling (SIC 39)

The sample was drawn from data obtained from *The Yellow Pages*, on-line databases and the Manufacturing register of the Bureau of Market Research at the University of South Africa. The problem of unregistered entities not being included in the sample was addressed by visiting craft markets and sending a fieldworker into Atteridgeville in the hope of obtaining responses from unlicensed and unregistered firms.

4.3.2.3 Data gathering

Data were collected from the sample mentioned in the above section. Most of the questionnaires were emailed to the respondents, but the researcher and one fieldworker also personally handed out questionnaires. The data gathering took place over a period of about seven months. This was because of the low response to the original dispatch of questionnaires.

The questionnaire was sent out with a covering letter indicating the reason for and importance of the research as well as a promise of confidentiality of the information. Twenty-four (24) questionnaires were originally sent out to test the questionnaire, and the respondents requested to give overall feedback within a week. Only one response was received within the week, and three email notifications were received for failure to deliver to the given email address. The respondent completed the questionnaire and answered all the questions without any comments.

After a week, another 100 questionnaires were emailed. Only six responses were received within the first month of emailing the first set of questionnaires. The researcher then started sending out reminders. The researcher went to craft markets and personally handed out questionnaires there. Some owners completed the questionnaire immediately, but others indicated that they would email/fax their completed questionnaires. Only one respondent actually did email a completed questionnaire. A fieldworker tried to encourage owners in Atteridgeville to complete the questionnaire, but with minimal success. The fieldworker then went to Sunderland Ridge industrial area and managed to obtain 13 completed questionnaires. After another few weeks, the researcher contacted some of the businesses owners/managers to personally request that they complete the questionnaire. Eventually, random manufacturing entities were chosen and asked to complete the questionnaire in an effort to obtain a more representative sample. Two and half months later, another 60 questionnaires were sent via email and then after another three weeks 30 more emails were sent.

A total of 356 questionnaires and 81 reminders were sent out. Four (4) replied indicating that they did not fall into the population. There were 23 refusals which the researcher personally knew about. The fieldworker did not keep record of refusals but estimated the number at about 15. Thirty-nine (39) emails were returned address unknown. Of the questionnaires that were sent out, 67 were completed and returned, of which 65 were found to be usable. This represents 18.25% of the sample population.

All the questionnaires were coded using actual numbers so that the responses could be captured electronically. Coding involves assigning numerical values to the answers, which converts them into a computer-readable format (Ferreira 2007:180).The researcher coded the questionnaires when they were received back from the respondents. A data entry template was designed in a Microsoft Office Excel 2007 spreadsheet and the coded questionnaires were captured

on the spreadsheet. The electronic version was then checked back to the original questionnaires to eliminate any data capture errors.

4.3.3 Analysis

Mouton (2001:108) describes the aim of analysis as identifying the various pieces of data by examining the associations between concepts, constructs and variables as well as spotting any tendencies or determining any themes. This section deals with the way in which the data were analysed.

The statistical analysis was conducted with the assistance of the Bureau of Market Research. The data were cleaned by looking at the frequencies and observing unusual cases, whereafter, the data were statistically analysed using the Statistical Program for the Social Sciences (SPSS) version 18. Use was made of descriptive analysis, cross-tabulation and the chi-square test to analyse the data. Descriptive analysis is used to provide a synopsis of the sample in terms of the variables of interest (Tustin et al 2005:103). This was done using frequencies and percentages to review the responses to the questions. The information was then presented using tables, graphs and charts to discuss the findings. Cross-tabulations were also done to give a two-way frequency distribution to determine the link between the variables under discussion. The findings of the study are discussed in detail in chapter 5.

4.4 Limitations

The questionnaires were sent out during the global recession in 2009, which also affected South Africa (SouthAfrica.info 2009). Many businesses were closing down and people were losing their jobs. The study focused on manufacturing MSEs in the Tshwane Metropolitan area and it is possible that the owners/managers of such businesses were too busy trying to keep the business going. It was established that some of the owners/managers were too busy and did not have time to complete the questionnaire. Of the micro

businesses that were approached personally, many were hesitant to divulge information. This was especially so in the previously disadvantaged area of Atteridgeville where many refused to even speak to the fieldworker. The researcher believes that it was because these businesses were operating in the so-called “informal economy” and they did not want any repercussions from the authorities. Only 18.25% of the sample population took part in the study, and this low response rate implies that the validity of the results could be questioned.

Existing firms participated in the study and no information was gathered on firms that had already failed. It is extremely difficult to obtain information on businesses that have already closed down, which means there is no real conclusive evidence of why firms fail.

In addition, there are few available databases on small firms, especially manufacturing firms. Many small and micro businesses operate in the informal sector and are not registered anywhere, and these businesses would probably not be included in the databases available.

Despite these limitations, the researcher believes that the empirical study achieved the formulated objectives.

4.5 Summary

In this chapter the method used for the empirical study was explained. The selection and composition of the sample, the measuring instruments, data gathering and data processing, as well as the relevant statistical analysis were discussed. The information discussed here provided a basis for the interpretation of the data. Chapter 5 presents the findings of the analysed data obtained from the questionnaire.

CHAPTER 5

RESEARCH RESULTS

"Learning to learn is to know how to navigate in a forest of facts, ideas and theories, a proliferation of constantly changing items of knowledge. Learning to learn is to know what to ignore but at the same time not rejecting innovation and research." Raymond Queneau (1903–1976)

5.1 Introduction

This chapter will be devoted to the results of the empirical study. The literature study revealed that the use of financial planning and control systems are a factor to the survival of all enterprises including small businesses. The purpose of the empirical study was to determine, if any, which financial planning and control systems are used and their value to manufacturing MSEs in the Tshwane metropolitan area.

The results are reported and presented by means of tables, graphs and other descriptive statistics. Firstly, the profile of the businesses that took part in the study is studied and the financial status of the entities examined. The demographic profiles of the owners/managers are then examined, followed by an analysis of the financial planning and budgeting practices of the respondents.

Cross-tabulations were done to gain a better idea of the relationships between the different variables, which are then discussed. The chapter concludes with a summary of the findings of the study.

5.2 Profile of the respondents

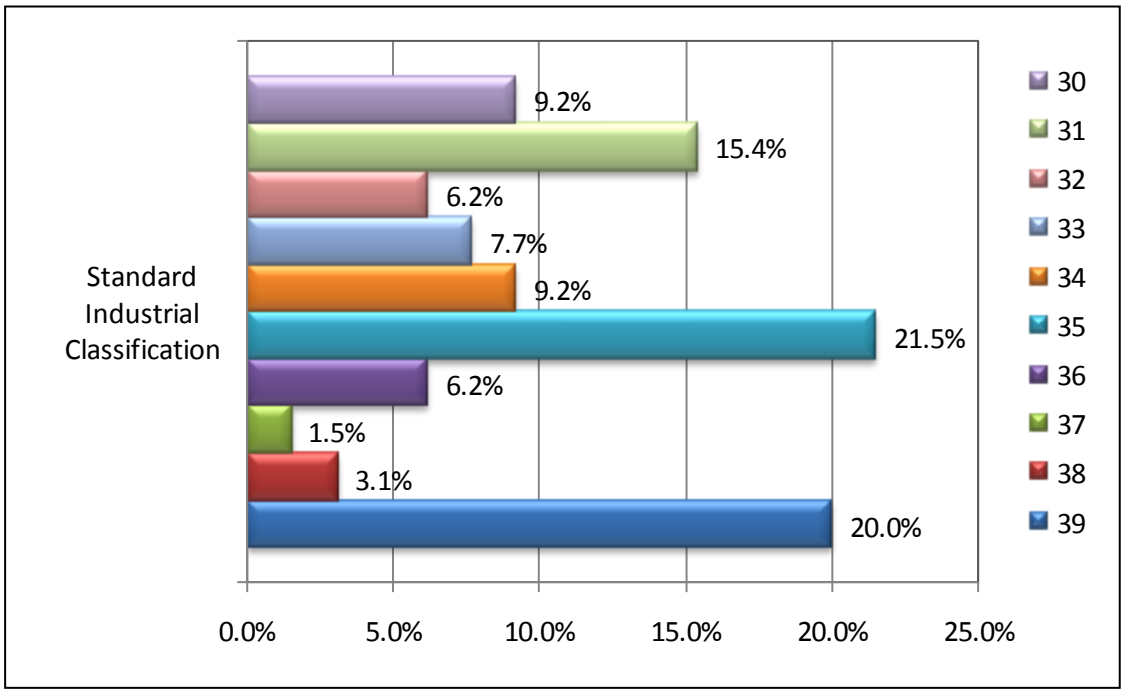
Questions 1 to 7 related to the profile of the businesses. The first question requested the respondents to indicate into which Standard Industrial Classification of manufacturing activity their entity belonged. The following 10 major manufacturing categories were given:

Table 5.1 Major SIC manufacturing activities

2-digit SIC category	Description
30	Food products, beverages and tobacco products
31	Textiles, clothing and leather goods
32	Wood and products of wood and cork, except furniture; articles of straw and plaiting materials; paper and paper products; publishing, printing and reproduction of recorded media
33	Coke, refined petroleum products and nuclear fuel; chemical products; rubber and plastic products
34	Other nonmetallic mineral products
35	Basic metals, fabricated metal products, machinery and equipment of office, accounting and computing machinery
36	Electrical machinery and apparatus not elsewhere classified
37	Radio, television and communication equipment and apparatus and of medical, precision and optical instruments, watches and clocks
38	Transport equipment
39	Furniture; manufacturing not elsewhere classified; recycling

The questionnaires were analysed to determine the frequency of the type of manufacturing activity of the firms and the results indicated in figure 5.1.

Figure 5.1 Frequency of the types of manufacturing activities of the respondents



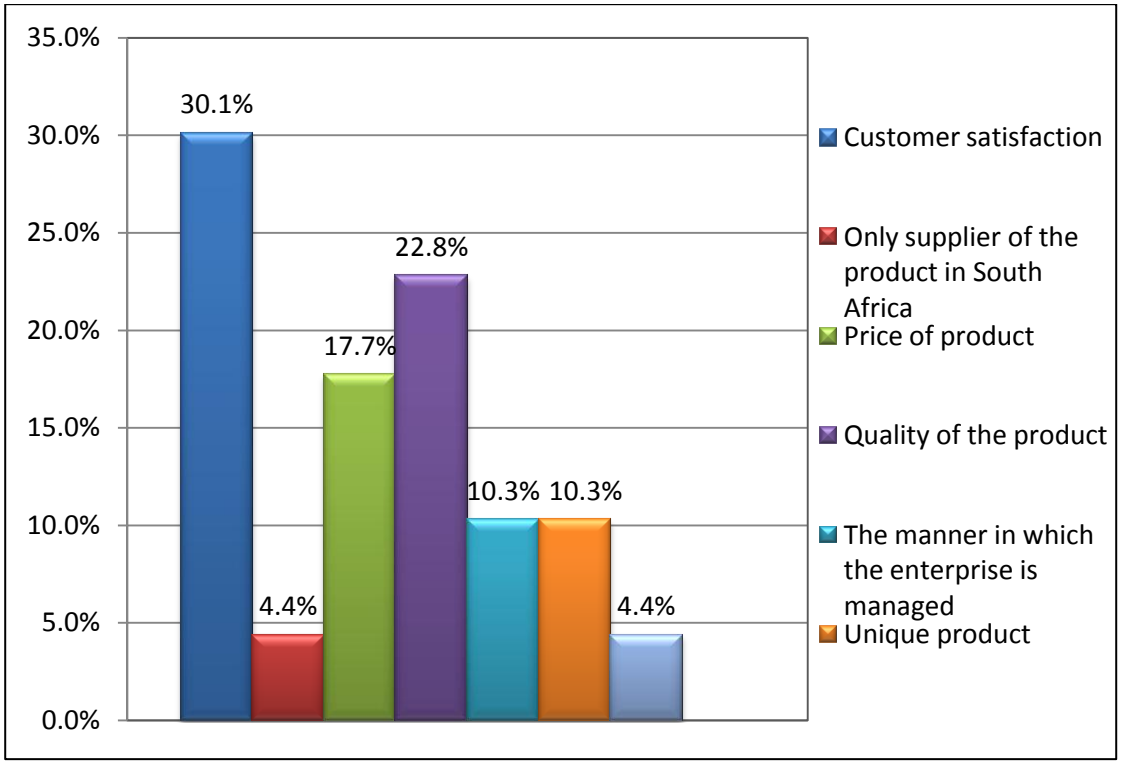
Most (57%) of the respondents are incorporated into three of the SIC classifications, namely:

- 35 - Basic metals, fabricated metal products, machinery and equipment of office, accounting and computing machinery, where 35.7% of this category manufactured metal (steel, wrought iron, aluminium) doors and gates and the rest did other forms of manufacturing from basic metals
- 39 - Furniture; manufacturing not elsewhere classified; recycling, where 38.5% of this category were furniture manufacturers, 15.4% costume jewellery manufacturers, 15.4% sign manufacturers; and 30.8 fell under other manufacturers
- 31 - Textiles, clothing and leather goods which consist mainly of the manufacture of clothing, curtains and textile handbags

Question 2 asked what main product(s) the entity produced. This question was also a verification of question 1.

In question 3, the owners/managers were asked what they thought was the main reason for the firm's continued operations. The results are depicted in the following figure:

Figure 5.2 Frequency of the main reason for the continued existence of the enterprise



A total of 30.1% believed that customer satisfaction was the reason for the business's continued operations, while 22.8% contended it was the quality of their products. A total of 17.7% said it was the price of their products, while 10.3% stated that it was the uniqueness of their products. Only 10.3% were of the opinion that the way in which the enterprise was managed was the reason for its continued survival, while 4.4% indicated that they were the only supplier of the goods in South Africa. Of the respondents, 4.4% cited other reasons such as quick turnaround time and customer service and after-care service.

Question 4 enquired about the number of years the entity had been in business and the results are shown in table 5.2.

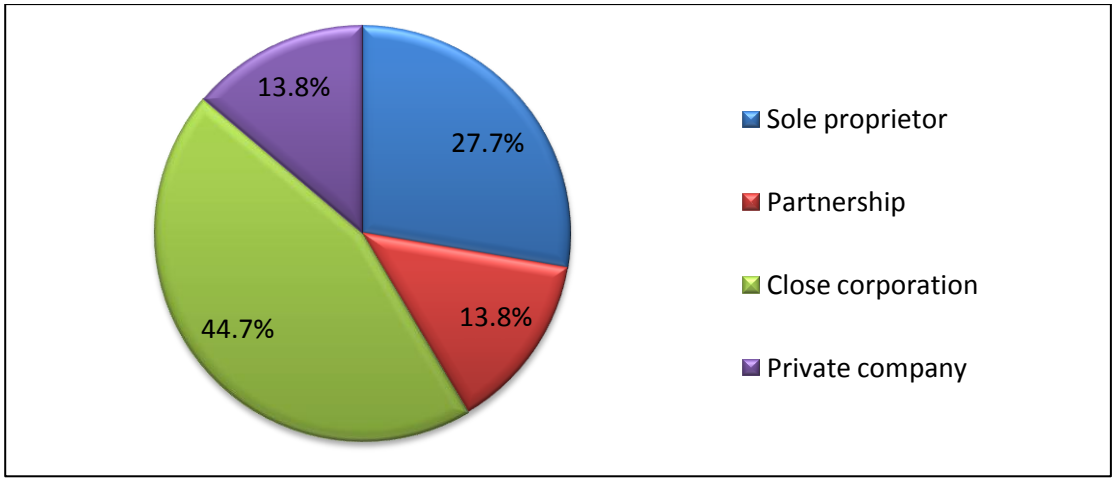
Table 5.2 Number of years in existence

	Frequency	Percentage
Less than a year	2	3.1
1–2 years	3	4.6
2–4 years	8	12.3
4–6 years	14	21.5
6–8 years	8	12.3
8–10 years	7	10.8
More than 10 years	23	35.4
Total	65	100.0

Surprisingly, the above table indicates that 35.4% of the firms had been in business for more than 10 years and 44.6% had been in existence for four to 10 years, while only 7.7% had been in business for less than two years. These statistics suggest that the responses were received from the more established firms.

Question 5 asked the respondents to indicate what type of entity they had, with the following options: sole proprietor, partnership, close corporation and private company. The results are depicted in figure 5.3.

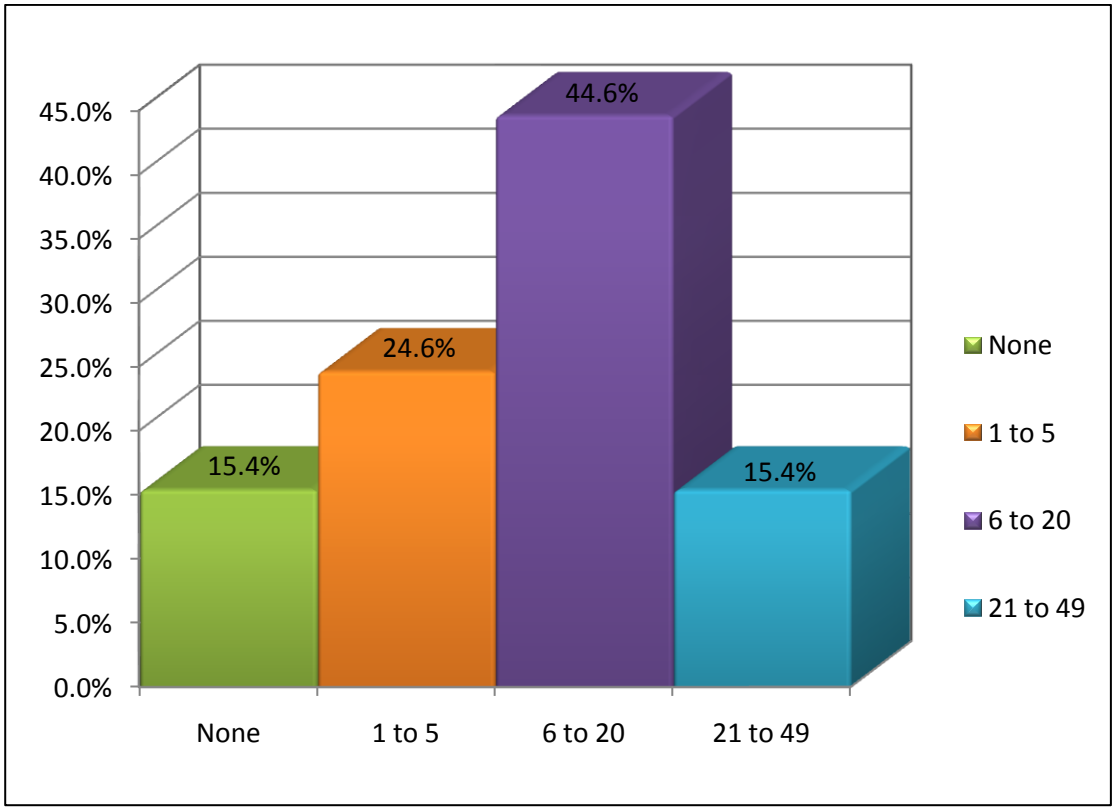
Figure 5.3 Type of entity



The majority (44.6%) were close corporations, 27.7% were sole proprietors, while partnerships and private companies each amounted to 13.8%.

Question 6 asked for information on the current number of employees and the results are depicted in figure 5.4 below.

Figure 5.4 Number of employees



The figure indicates that 44.6% of the businesses had between six and 20 employees; 24.4% between one and five employees, while 15.4% had between 21 and 49 employees and 15.4% were persons working alone. The above information reveals that the majority of the firms fall within the very small firm category of the National Small Business Act 1996.

On the basis of the information gathered in question 6, the responses were classified into size of business according to the definition used in the study (see ch 1). The results are indicated in table 5.3.

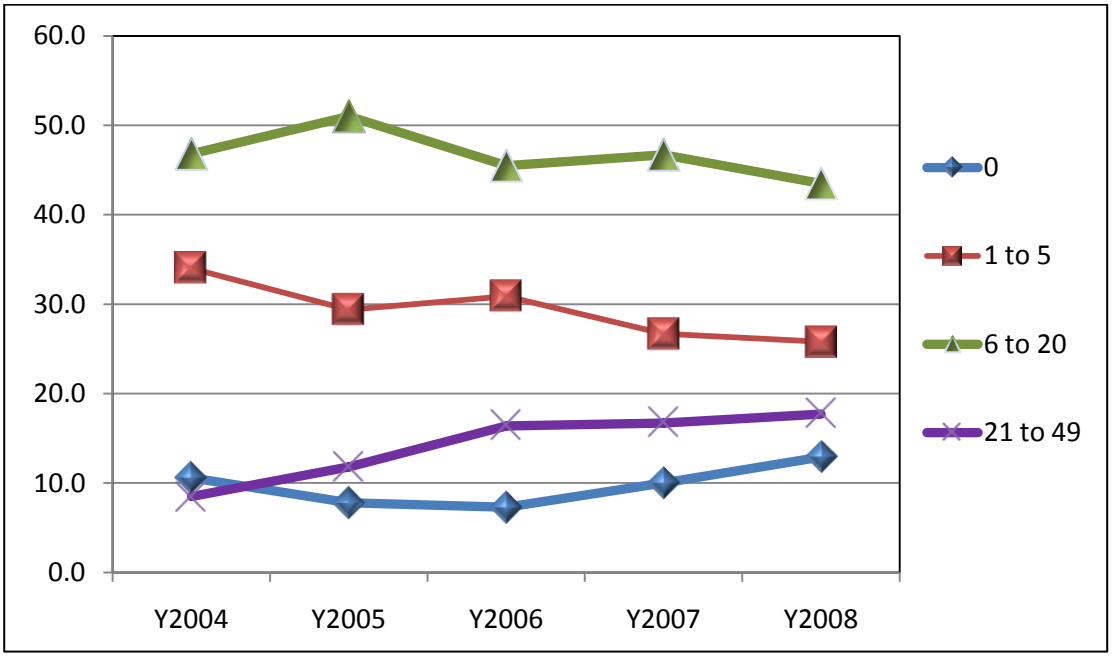
Table 5.3 Frequency of classification of businesses

Entity size	Responses	Percentage
Micro	26	40.0
Very small	29	44.6
Small	10	15.4
Total	65	100.0

It was established that 40% of the firms fell into the micro category and 44.6% into the very small category, while 15.4% were small businesses. This finding indicates that over 80% of the respondents had very small and micro enterprises.

Question 7 required information on the number of employees employed by the firm in the previous five years. Figure 5.5 depicts the results.

Figure 5.5 Number of employees in the previous five years



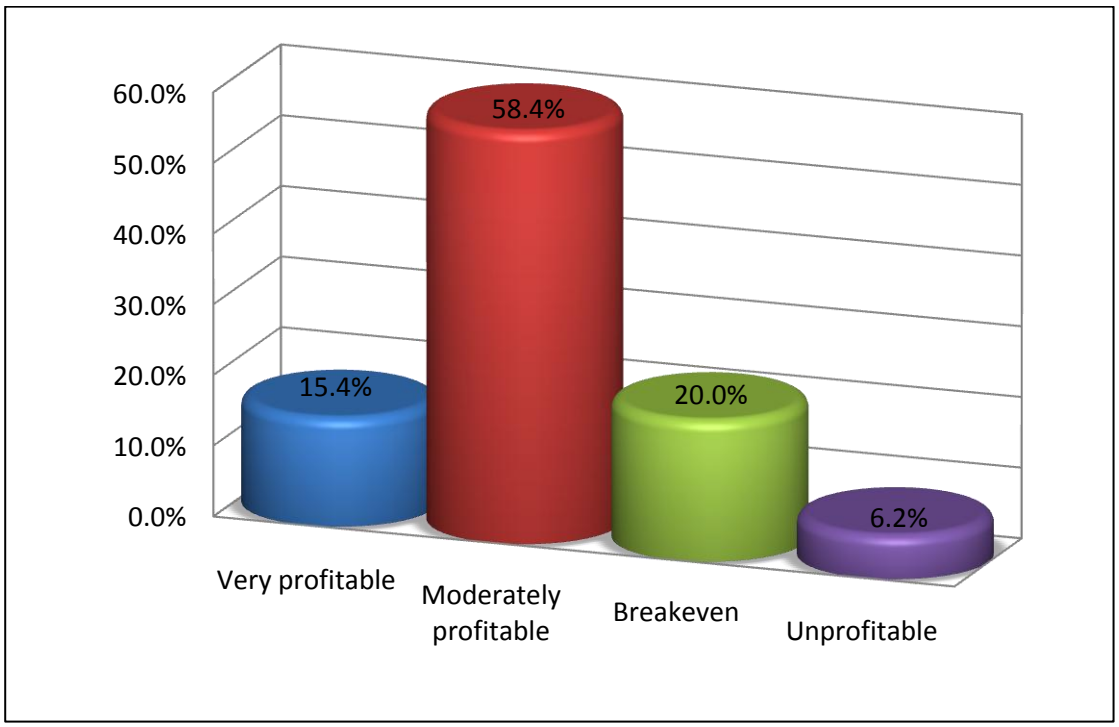
The above graph indicates that firms with one to five employees and six to 20 employees experienced a decline in numbers, whereas those with 21 to 49 employees and one-man businesses grew over the period 2004 to 2008. The graph also shows that more than 40% of the firms fell into the category of six to 20 employees, which means that most of the firms had belonged to the very small business category in the preceding five years. This also confirms the findings in table 5.3.

5.3 Financial status of the respondents

Part 2 of the questionnaire required information about the financial status of the firm in order to determine its profitability.

In question 8, the respondents were asked to assess their business's profitability over the past 12 months. The findings are depicted in figure 5.6 below.

Figure 5.6 Assessment of profitability over the past 12 months



Of the respondents, 15.4%) revealed that their business was very profitable; 58.4% were moderately profitable, 20% broke even and only 6.2% indicated that they were unprofitable.

Question 9 dealt with the growth of the enterprise over the past 12 months and the findings are indicated in table 5.4 below.

Table 5.4 Growth of enterprise over the past 12 months

	Frequency	Percentage
Growing	24	38.1
Stable	31	49.2
Declining	8	12.7
Total	63	100.0

According to the above table, of those who responded to the question, 38.1% indicated that the business was growing; 49.2% that the business was stable and only 12.7% that the business was declining. These findings are interesting because the empirical study was conducted during 2009, when the economy was experiencing a recession.

The next questions related to turnover for the past five years and the results are depicted in the following table:

Table 5.5 Approximate annual sales for 2004 to 2008

	Under R100 000	R100 001 – R200 000	R200 001 – R1 000 000	R1 000 000 – R5 000 000	Above R5 000 000
2004	33.2%	16.7%	16.7%	16.7%	16.7%
2005	23.5%	23.5%	17.6%	19.7%	15.7%
2006	27.2%	20.0%	16.4%	20.0%	16.4%
2007	23.8%	16.9%	18.6%	23.8%	16.9%
2008	28.1%	15.6%	14.1%	26.6%	15.6%

The table indicates that most of the businesses that participated in the survey had annual sales of either R1 000 000 to R5 000 000 or under R100 000. Also, the number of businesses in each annual sales category did not change materially over the five years.

Question 11 enquired whether any capital investments had been made by the business in the preceding two years. Table 5.6 indicates investment in property in the preceding two years.

Table 5.6 Investment in property

	Frequency	Percentage
Yes	13	20.3
No	51	79.7
Total	64	100.0

The table reveals that the majority of the businesses had not invested in property in the past two years.

Table 5.7 depicts the results for investments in plant, machinery and equipment.

Table 5.7 Investment in plant, machinery and equipment

	Frequency	Percentage
Yes	37	59.7
No	25	40.3
Total	62	100.0

Almost 60% of the respondents who answered the question had invested in plant, machinery or equipment. This is to be expected because the survey was conducted on manufacturing MSEs.

The last part of this question asked the respondents whether they had made any investments in vehicles. The results are indicated in table 5.8.

Table 5.8 Investment in vehicles

	Frequency	Percentage
Yes	32	50.8
No	31	49.2
Total	63	100.0

Just over half (50.8%) of the respondents indicated that they had invested in vehicles. These capital investments suggest that most of the businesses were stable.

Question 12 asked the respondents whether the entity was registered for VAT. The results are depicted in table 5.9.

Table 5.9 Value-added-tax (VAT) registration

	Frequency	Percentage
Yes	47	73.4
No	17	26.6
Total	64	100.0

Only one respondent did not answer this question, while 73.4% indicated that they were registered for VAT. This shows that the majority of the respondents were operating in the formal sector.

5.4 Demographic profile of the respondents

The next set of questions investigated the demographic profile of the respondents. Questions 13 to 17 made enquiries about the education and training of the owner/manager of the business.

Question 13 asked the respondents about the highest level of education of the owner/manager of the firm. The results are provided in table 5.10 below.

Table 5.10 Highest level of education of owner/manager

	Frequency	Percentage
University degree	24	37.5
Other post-matric qualification	23	35.9
Matric (Grade 12)	9	14.1
Grade 10	2	3.1
Grade 8	3	4.7
Grade 6 and lower	3	4.7
Total	62	100.0

The above table indicates that 37.5% had a university degree and 35.4% some other post-matric qualification. Only 14.1% had a Grade 12, while 12.5% had a Grade 10 and lower. Thus the majority of the owners/managers of the businesses that participated had a reasonably good education.

Question 14 asked about the highest technical qualification of the owner/manager. Table 5.11 below reports the findings.

Table 5.11 Highest technical qualification of owner/manager

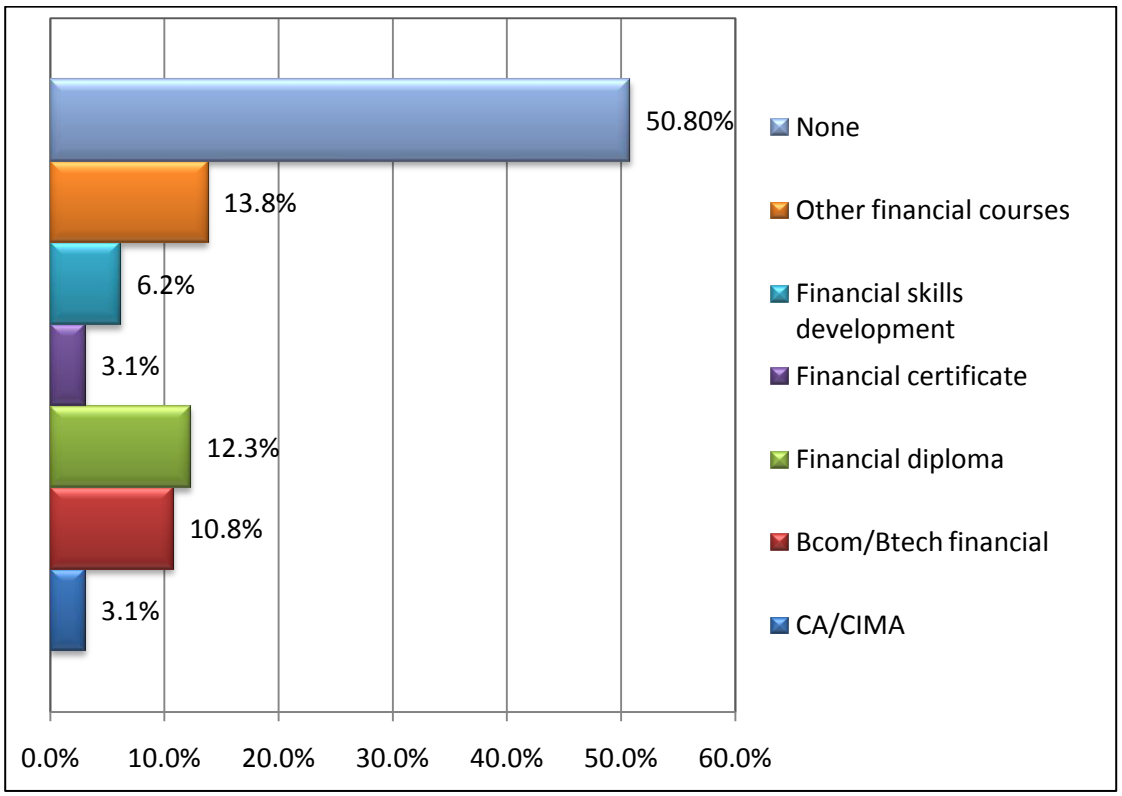
	Frequency	Percentage
BTech degree	5	7.7
Technical diploma	18	27.7
Technical certificate	5	7.7
Technical skills development	3	4.6
Other technical courses	5	7.7
None	29	44.6
Total	65	100.0

Regarding the technical qualifications of the owner/manager, 44.6% had no technical qualification, while 27.7% indicated that they had a technical diploma. Only 7.7% had a BTech degree; 7.7% had a technical certificate; 7.7% had done some other technical course; and 3.3% had technical skills development

training. The findings indicate that more than 50% of the owners/managers of the manufacturing firms had some technical knowledge.

Question 15 requested information on the financial education of the owner/manager of the business. The findings are provided in figure 5.7 below.

Figure 5.7 Frequency of highest financial qualification of the owner/manager



Half (50.8%) of the owners/managers indicated that they had no financial training, 13.8% had done some other financial courses, 12.3% had financial diplomas, 10.8% had a financial degree, 6,2% had done a financial skills development course, 3.1% had a professional financial qualification and 3.1% had a financial certificate. This was confirmed in question 17 where the owner/manager was asked whether he or she had any financial management training, and 53.1% indicated that they did not. These findings confirm the reality that many respondents probably do not know the meaning of formal financial planning and control.

In question 16 the owners/managers were asked to indicate their years' experience in related business. The results are shown in table 5.12.

Table 5.12 Years' experience in related business

	Frequency	Percentage
Less than 7 years	14	23.3
7–10 years	13	21.7
11–14 years	9	15.0
15–21 years	12	20.0
22 and more years	12	20.0
Total	60	100.0

Of those who answered the question, 55% had more than 10 years' experience, 21.7% had between seven and ten years' experience, while 23.3% had less than seven years' related experience. The above table indicates that more than half the respondents were highly experienced in their field of work.

Question 17 enquired whether the owner/manager had any financial management training. The results are shown in table 5.13 below.

Table 5.13 Financial management training

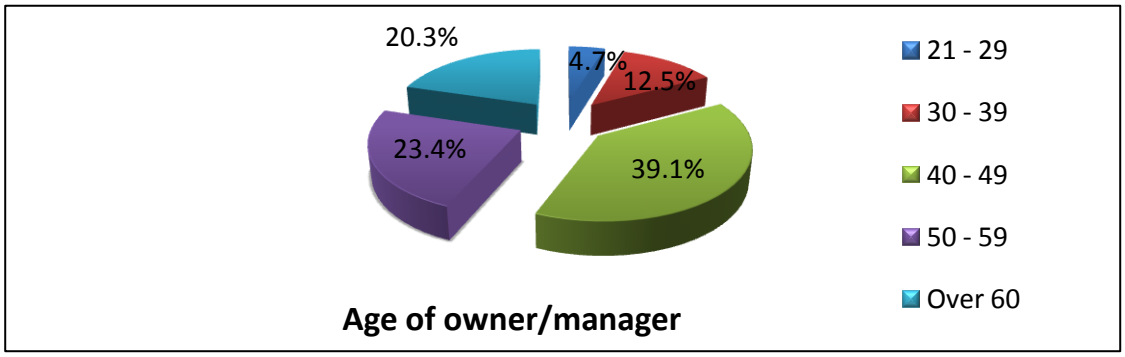
	Frequency	Percentage
Yes	30	46.9
No	34	53.1
Total	64	100.0

According to the above table, 53.1% of the owners/managers indicated that they did not have any financial management training, while 46.9% revealed that they did.

Questions 18 to 20 requested information on the age, race and sex of the owner/manager.

Question 18 asked for details of the owner/manager, and the findings are depicted in Figure 5.8 below.

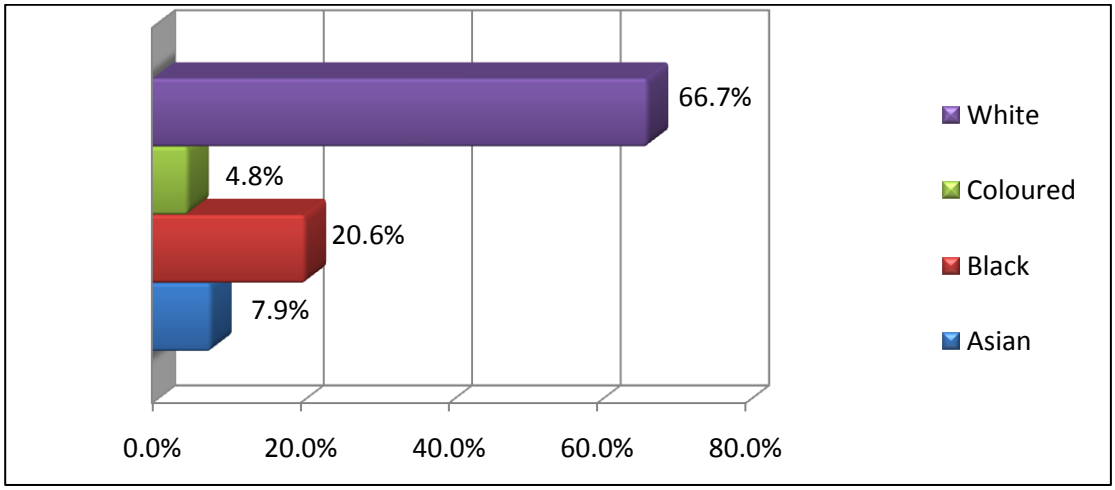
Figure 5.8 Age distribution of owners/managers



The above pie chart shows that most of the owners/managers were over 40 years of age, where 82.8% were in this age group. The statistics reveal that 39.1% were in the 40 to 49 age group, 23.4% in the category 50 to 59 years of age and 20.3% were over the age of 60. Only 17.2% were between the age of 21 and 39.

Question 19 asked for information on the race of the owner/manager. One respondent refused to answer the question. Figure 5.9 below indicates the results.

Figure 5.9 Frequency of race of owner/manager



The graph shows that 66.7% of the owners/managers were white, 20.6% were black, 7.9% were Asian and 4.8% were coloured.

Question 20 asked for information on the gender of the owner/manager. Table 5.14 depicts the results.

Table 5.14 Gender of owner/manager

	Frequency	Percentage
Male	46	71.9
Female	18	28.1
Total	64	100.0

Of the respondents, 71.9% were male and only 28.1% female.

5.5 Financial planning and budgeting habits of the respondents

Part 3(b) of the questionnaire asked the respondents about the financial planning and budgeting practices of the business.

In question 21(a) the respondents were first asked to indicate whether their firm kept formal financial records. Table 5.15 provides the results.

Table 5.15 Formal financial records

	Frequency	Percentage
Yes	55	85.9
No	9	14.1
Total	64	100.0

The results indicate that 85.9% of the respondents did have a formal bookkeeping system.

Question 21(b) then asked the respondents what system they used to keep financial records in the business. The results are shown in table 5.16.

Table 5.16 Type of financial records

	Frequency	Percentage
Computerised	35	62.5
Manual	18	32.1
Both	3	5.4
Total	56	100.0

Of those who did have formal financial records, 62.5% used a computerised system; 32.1% used a manual system; and 5.4% used a combination of the two. The above table indicates the sophistication of the respondents with regard to business processes.

The next question was crucial to the study because the main purpose was to investigate whether by using financial planning and control systems, the entities had a better chance of survival. In question 22(a) the owners/managers were asked whether they used any form of formal financial planning. Table 5.17 shows the results.

Table 5.17 Formal financial planning

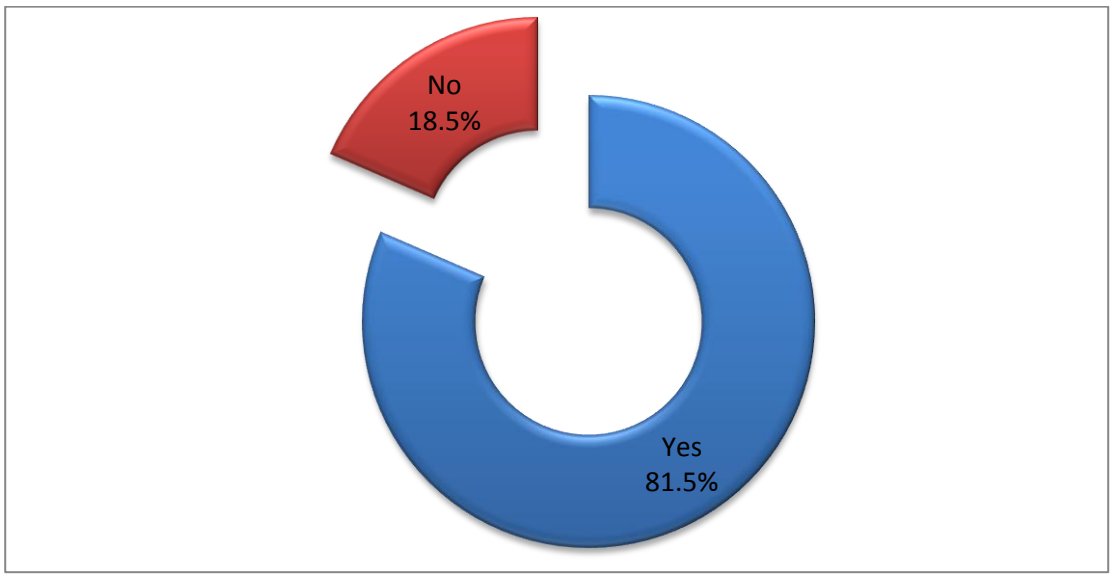
	Frequency	Percentage
Yes	33	52.4
No	30	47.6
Total	63	100.0

The above table shows that 52.4% did use some form of financial planning, whereas 46.6% said they did not. However, in question22 (b), where the respondents were asked to indicate what form of financial planning they used, it was evident that many did not understand the concept of financial planning because some of them indicated that they used financial statements, which is clearly not financial planning. When analysing other questions that specifically asked about the use of budgeting it was evident that more than the 52.4% of the sample indicated in this question that they were in fact using some form of

financial planning because budgeting is a form of financial planning and control.

Question 23 asked the respondents whether the business used standard costing to estimate the cost of products. The results are depicted in figure 5.10 below.

Figure 5.10 Frequency of use of standard costing



The majority of the respondents (81.5%) indicated that they did use standard costing. As mentioned in chapter 3, standard costing is often used in conjunction with traditional budgeting systems for planning and control purposes, and the above verifies the positive response to the use of a budgeting system.

Question 24 was asked to determine what form, if any, of budgeting the firm used. Five options were given, namely ordinary (traditional) budgeting (tab 5.18), activity-based budgeting (tab 5.19), flexible budgets (tab 5.20), rolling budgets (tab 5.21) and zero-based budgeting (tab 5.22). All the respondents were analysed in the following question because it was apparent from the responses received that many did not understand the concept of financial planning. Of those who said that they did not use formal financial planning,

however, did indicate that they used one of the budgeting systems given in this question. Some of the respondents indicated that they used more than one of the different types of budgeting systems.

Table 5.18 Ordinary (traditional) budgeting

	Frequency	Percentage
Yes	43	68.3
No	20	31.7
Total	63	100.0

Regarding the whole sample, 68.3% indicated that they used traditional budgeting systems, whereas 31.7% revealed that they did not.

Table 5.19 Activity-based budgeting

	Frequency	Percentage
Yes	12	19.4
No	50	80.6
Total	62	100.0

Regarding activity-based budgeting, 19.4% of the respondents indicated that they used this budgeting system, while 80.6% revealed that they did not.

Table 5.20 Flexible budgets

	Frequency	Percentage
Yes	13	21.3
No	48	78.7
Total	61	100.0

A total of 21.3% of the respondents indicated that they used flexible budgeting.

Table 5.21 Rolling budgets

	Frequency	Percentage
Yes	7	11.3
No	55	88.7
Total	62	100.0

A total of 11.3% indicated that they used rolling budgets.

Table 5.22 Zero-based budgeting

	Frequency	Percentage
Yes	4	6,5
No	58	93,5
Total	62	100,0

A mere 6.5% of the respondents indicated that they had used zero-based budgeting.

These findings reveal that the percentage of those who indicated that they used one or more of the above forms of budgeting was much higher than those who indicated that they used formal financial planning (question 22). Interestingly, 89.2% of all the respondents disclosed that they had used one or more of the above-mentioned budgeting systems. This could mean that they do not put their plans on paper, that is, formalise their plans, but tend to have more informal plans. Alternatively, because of the lack of financial education, this could imply that the respondents did not understand what financial planning involves.

In question 25, the respondents were asked to indicate on a three-point scale whether they thought the following were not important, important or very important:

- operational planning
- communication of goals

- performance evaluation
- strategy formation
- variance analysis

Table 5.23 indicates the results of the responses to this question.

Table 5.23 Frequency of importance of reasons for budgeting

Reason	Not important	%	Important	%	Very important	%
Operational planning	4	6.6	23	37.7	34	44.3
Communication of goals	4	7.0	26	45.6	27	47.4
Performance evaluation	4	7.0	25	43.9	28	49.1
Strategy formation	4	6.9	27	46.6	27	46.6
Variance analysis	12	21.4	24	42.9	20	35.7

Of those who completed question 25, 37.7% indicated that operational planning was important and 44.3% revealed that is was very important; 45.6% said that communication of goals was important and 47.4% indicated that it was very important; 43.9% indicated that performance evaluation was important while 49.1% believed it was very important; with strategy formation, 46.6% said it was important and 46.6% revealed it was very important; and 42.9% believed that variance analysis was important while 35.7% indicated that it was very important. These findings reveal that even though they may not have had formal financial planning systems in place, owners/managers were aware of the positive factors that planning and budgeting can produce.

Questions 26 to 29 asked the respondents whether the budget was used for reward and control purposes.

Question 26 enquired whether the budget was used to control business operations. Table 5.24 indicates the results.

Table 5.24 Budget used to control operations

	Frequency	Percentage
Yes	48	73.8
No	17	26.2
Total	65	100.0

The above table indicates that 73.8% of the respondents who used budgets said that they were used to control the business operations.

Question 27 asked whether incentives and rewards were linked to the budget process. The results are shown in table 5.25.

Table 5.25 Incentives and rewards linked to the budget process

	Frequency	Percentage
Yes	23	35.9
No	41	64.1
Total	64	100.0

The above table shows that 35.9% of the respondents linked incentives and rewards to the budget.

Question 28 asked whether the budget was used for comparing actual performance with budget figures. Table 5.26 shows the results.

Table 5.26 Budget used for comparing actual performance with budget figures

	Frequency	Percentage
Yes	39	60.9
No	25	39.1
Total	64	100.0

The results indicate that 60.9% of the firms used the budget to compare actual performance with budgeted figures, while 39.1% indicated that they did not.

The purpose of question 28 was to ascertain whether the budget contained procedures for evaluating differences between planned and actual performance. Table 5.27 provides the results.

Table 5.27 Budget has procedures for evaluating differences between planned and actual performance

	Frequency	Percentage
Yes	30	50.0
No	30	50.0
Total	60	100.0

When asked whether the budget contained procedures for evaluating differences between planned and actual performance, 50% indicated that it did.

The above results indicate that those who did use formal financial planning mainly relied on the traditional methods. This corroborates the findings in question 23, where most of the respondents indicated that they used a standard costing system, which goes hand in hand with traditional methods.

Table 5.28 reveals the results of question 30 which asked whether the respondents were satisfied with their enterprise's budgeting process.

Table 5.28 Satisfaction with budgeting process

	Frequency	Percentage
Yes	39	61.9
No	24	38.1
Total	63	100.0

A total of 61.9% respondents revealed that they were satisfied with their budgeting process.

Question 31 asked the respondents about the use of the following operational planning techniques:

- Clock card system

Table 5.29 indicates that only 32.2% of those who responded to this question used a clock card system.

Table 5.29 Clock card system

	Frequency	Percentage
Yes	19	32.2
No	40	67.8
Total	59	100.0

- Economic order quantity

Table 5.30 indicates that only 36.8% of the respondents used economic order quantity for purchasing raw materials.

Table 5.30 Economic order quantity

	Frequency	Percentage
Yes	21	36.8
No	36	63.2
Total	57	100.0

- First-in-first-out stock valuation

Regarding first-in-first-out stock valuations, table 5.31 indicates that 46.6% of the respondents used this method for evaluating inventory.

Table 5.31 First-in-first-out stock valuation

	Frequency	Percentage
Yes	26	46.4
No	30	53.6
Total	56	100.0

- Last-in-first-out

Table 5.32 indicates that 26.3% of the respondents used the last-in-first-out method of inventory valuation.

Table 5.32 Last-in-first-out stock valuation

	Frequency	Percentage
Yes	15	26.3
No	42	73.7
Total	57	100.0

- Weighted average method of stock valuation

Only 17.5% of the respondents used the weighted average method of stock valuation as depicted in table 5.33.

Table 5.33 Weighted average method of stock valuation

	Frequency	Percentage
Yes	10	17.5
No	47	82.5
Total	57	100.0

- Other operational planning

According to table 5.34, only 17.5% of the respondents indicated that they used other forms of operational planning.

Table 5.34 Other operational planning

	Frequency	Percentage
Yes	7	17.5
No	33	82.5
Total	40	100.0

Other operational planning as mentioned by the respondents referred mainly to inventory. The other operational planning included ordering inventory when needed, purchasing inventory in large amounts to reduce prices, conducting physical inventory counts and writing off inventory.

Question 32 asked those respondents who did not use any form of financial planning to indicate why, on the basis of the following reasons: do not know the benefits; lack of knowledge; lack of personnel; time constraints; too costly to implement; and other reasons. The results are provided in table 5.35.

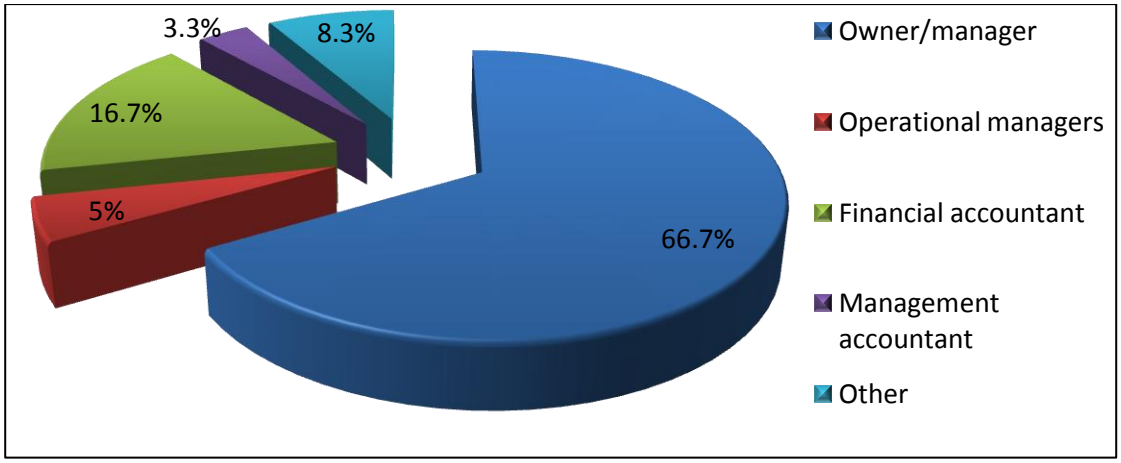
Table 5.35 Reasons for not using any formal financial planning

Reasons	Frequency	Percentage of respondents
Do not know the benefits	9	13.8
Lack of knowledge	7	10.8
Lack of personnel	13	20.0
Time constraints	14	21.5
Too costly to implement	9	13.8
Other reasons	6	9.2

Of the total number of respondents in the survey, 21.5% believed that time constraints were a major factor; 20.0% indicated they had a shortage of personnel; 13.8% stated that it was too costly to implement; 13.8% indicated that they did not know the benefits of using financial planning; 10.8% stated that they did not have the knowledge; and only 9.2% cited the following reasons: they had a casual attitude towards the business; operational levels did not warrant the use of financial planning; one wanted to keep costs as low as possible; and one respondent indicated that the firm was in a fast-growing phase and that financial planning would soon be implemented.

Question 33 asked the respondents who was responsible for preparing the budget for the enterprise. The results are indicated in figure 5.11 below.

Figure 5.11 Person who prepares the budget for the enterprise



The majority of the respondents (66.7%) indicated that it was the owner/manager; 16.7% the financial accountant, 8.3% other; 5% the operational manager; and 3.3% the management accountant.

Question 34 asked the respondents what techniques the enterprise used to classify fixed and variable costs. Five methods were mentioned, namely statistical regression techniques; subjective classification based on managerial experience; all overheads classified as fixed costs and material and labour costs as variable costs; fixed and variable overhead costs not separated; and other methods used. Three options were thus mentioned, namely, use it, do not use it and do not understand it. Tables 5.36 to 5.39 depict the results of the subquestions.

Table 5.36 Statistical regression techniques

	Frequency	Percentage
Use it	5	10.4
Do not use it	25	52.1
Do not understand it	18	37.5
Total	48	100

Regarding statistical regression techniques, 52.1% of the respondents indicated that they did not use them, while 37.5% stated that they did not understand them. Only 10.4% indicated that they did use this method. A total

of 44% indicated that they classified fixed and variable costs on a subjective basis whereas 34% said that they did not. A total of 22% mentioned that they did not understand this method.

Table 5.37 Subjective classification based on managerial experience

	Frequency	Percentage
Use it	22	44.0
Do not use it	17	34.0
Do not understand it	11	22.0
Total	50	100

Regarding all overheads being classified as fixed, with labour and material as variables, 60.45% of the respondents indicated that they did use this method. A total of 26.4% stated that they did not use it, while 13.2% did not understand it.

Table 5.38 All overheads classified as fixed costs and material and labour costs classified as variable costs

	Frequency	Percentage
Use it	32	60.4
Do not use it	14	26.4
Do not understand it	7	13.2
Total	53	100

Regarding fixed and variable costs not being separated, 35.5% indicated that they did not separate fixed and variable costs. A total of 46.7% stated that they did not use it, while 17.8% mentioned that they did not understand it.

Table 5.39 Nonseparation of fixed and variable costs

	Frequency	Percentage
Use it	16	35.5
Do not use it	21	46.7
Do not understand it	8	17.8
Total	45	100

Only 11.8% of the respondents indicated that they used other methods to classify fixed and variable costs.

Table 5.40 depicts the findings of the final question, namely question 35, the aim of which was to determine whether any of the enterprises used more modern management accounting methods. The four methods used in the study were given as options, namely the balanced scorecard, just-in-time, the theory of constraints and total quality management.

Table 5.40 Use of modern management accounting systems

	Yes	%	No	%	Total	%
Balanced scorecard	10	16.1	52	83.9	62	100.0
Just-in-time	17	27.4	45	72.6	62	100.0
Theory of constraints	3	4.8	59	95.2	62	100.0
Total quality management	23	37.1	39	62.9	62	100.0

Four methods were mentioned and the results were as follows: 16.1% used the balanced scorecard; 27.4% used just-in-time; only 4.8% used theory of constraints; and 37.1% used total quality management.

Cross-tabulations were done with question 22(a) and other questions more relevant to the study.

The purpose of the first cross-tabulation was to establish the connection between doing formal financial planning and keeping formal financial records. The findings are indicated in table 5.41.

Table 5.41 Connection between doing formal financial planning and keeping formal financial records

Formal financial records	Formal financial planning					
	Yes	%	No	%	Total	%
Yes	32	97.0	22	73.3	54	85.7
No	1	3.0	8	26.7	9	14.3
Total	33	100.0	30	100.0	63	100.0

Of the respondents who indicated that they kept formal financial records, 97% confirmed that they also did some form of financial planning. Of those who did not do any form of financial planning, 73.3% indicated that they did in fact keep financial records.

The link between doing formal financial planning and standard costing indicated in table 5.42.

Table 5.42 Link between doing formal financial planning and standard costing

Standard costing	Formal financial planning					
	Yes	%	No	%	Total	%
Yes	29	87.9	22	73.3	51	81.0
No	4	12.1	8	26.7	12	19.0
Total	33	100.0	30	100.0	63	100.0

Of those who indicated that they did not do any form of financial planning, 73,3% confirmed that they used standard costing to estimate the cost of products. Also, the 87.9% who mentioned they did do some form of financial planning, also used standard costing. This was to be expected because, as mentioned earlier, there is a strong link between traditional budgeting systems and standard costing.

Table 5.43 depicts the relationship between formal financial planning and number of years in operation.

Table 5.43 Relationship between doing formal financial planning and number of years in operation

Number of years in operation	Does your enterprise do any formal financial planning?			
	Yes	%	No	%
Less than 1 year	1	50.0	1	50.0
1–2 years	1	33.3	2	66.7
2–4 years	3	37.5	5	62.5
4–6 years	7	50.0	7	50.0
6–8 years	6	75.0	2	25.0
8–10 years	4	66.7	2	33.3
More than 10 years	11	50.0	11	50.0

Of the 33 businesses that indicated that they did do formal financial planning, the above table indicates that the longer the entity had been in business, the more likely it was to have formal financial planning procedures in place. However, of those who indicated that they did not do any formal financial planning, some form of financial planning must have been used because according to the results of question 24, many more indicated that they did have a budgeting system.

When examining which type of business used formal financial planning, the following results emerged:

Table 5.44 Association between doing formal financial planning and the type of entity

Type of entity	Does your enterprise do any formal financial planning?			
	Yes	%	No	%
Sole proprietor	6	33.3	12	66.7
Partnership	8	88.9	1	11.1
Close corporation	14	51.9	13	48.1
Private company	5	55.6	4	44.4

From the types of entities that indicated that they did do formal financial planning, it is evident that fewer sole proprietors (33.3%) used a formal financial planning process than the other types of entities. The results indicated that a majority of 88.9% of the partnerships in the study did do formal financial planning. Of the close corporations, 51.9% indicated that they did do formal financial planning, as did 55.6% of the private companies.

The connection between doing formal financial planning and the number of employees is depicted in table 5.45 below.

Table 5.45 Connection between doing formal financial planning and the number of employees in the enterprise

Number of employees	Does your enterprise do any formal financial planning?			
	Yes	%	No	%
None	4	40.0	6	60.0
1–5 employees	6	37.5	10	62.5
6–20 employees	18	66.7	9	33.3
21–49 employees	5	50.0	5	50.0

Regarding the size of the organisations in relation to employee numbers, it is evident that the larger the entity, the greater the probability that formal financial planning will be used. In very small enterprises (6–20 employees), it was found

that 66.7% did do formal financial planning, while 50,0% of the small enterprises (21–49 employees) also did.

The relationship between formal financial planning and the profitability of the enterprise is indicated in table 5.46.

Table 5.46 Association between doing formal financial planning and the profitability of the enterprise

Profitability of enterprise	Does your enterprise do any formal financial planning?			
	Yes	%	No	%
Very/moderately profitable	24	72.8	23	76.7
Breakeven	8	24.2	4	13.3
Unprofitable	1	3.0	3	10.0
Total	33	100.0	30	100.0

A total of 72.8% of the respondents who did do formal financial planning indicated that they were either very or moderately profitable, while 24.2% revealed that they broke even and only 3% showed that they were unprofitable. The above results imply that by using some form of financial planning the business would be less likely to be unprofitable.

Table 5.47 indicates the link between doing formal financial planning and the growth of the enterprise.

Table 5.47 Link between doing formal financial planning and the growth of the enterprise

Growth of enterprise	Does your enterprise do any formal financial planning?			
	Yes	%	No	%
Growing	11	34.4	13	39.3
Stable	18	56.2	12	49.2
Declining	3	9.4	4	11.5
Total	32	100.0	29	100.0

The majority (90.6%) of the firms that indicated that they did do some form of financial planning, were found to be either stable of growing. Only 9.4% believed that the growth of the entity was declining, whereas 11.5% of those who did not use formal financial planning systems felt their enterprises were declining in growth.

Table 5.48 indicates the relationship between formal financial planning and the financial education of the owner/manager:

Table 5.48 Relationship between doing formal financial planning and the highest qualification of the enterprise's owner/manager

Highest financial qualification of owner/ manager	Does your enterprise do any formal financial planning?			
	Yes	%	No	%
CA/CIMA	1	50.0	1	50.0
BCom degree or BTech Financial	2	28.6	5	71.4
Financial diploma	6	85.7	1	14.3
Financial certificate	1	100.0	0	0.0
Financial skills development courses	4	100.0	0	0.0
Other financial courses	7	77.8	2	22.2
None	12	36.4	21	63.6
TOTAL	33	52.4	30	47.6

The above table indicates that many (52.4%) of those who did do some form of financial planning also had some form of financial education. This finding is interesting as it implies that owners/managers who have had financial training would most likely do some form of financial planning.

The relationship between formal financial planning and the gender of the owner/manager is indicated in table 5.49.

Table 5.49 Relationship between doing formal financial planning and the gender of the owner/manager

Sex	Does your enterprise do any formal financial planning?			
	Yes	%	No	%
Male	22	48.9	23	51.1
Female	11	61.1	7	38.9

The above table shows that 61.1% of the females and 48.9% of the males in the study had formal financial planning processes in place. This finding indicates that the female respondents appeared to be more prone to doing formal financial planning

5.6 Summary

This chapter provided the detailed results of the empirical study. Frequency analyses and descriptive statistics were used to discuss the findings. Chapter 6 highlights the results and makes recommendations for possible further research.

CHAPTER 6

SUMMARY AND CONCLUSIONS

We are not certain, we are never certain. If we were we could reach some conclusions, and we could, at last, make others take us seriously. Albert Camus (1913–1960)

6.1 Introduction

This chapter summarises the study and draws conclusions on the basis of the findings of the empirical study. Recommendations are also made for possible further research.

6.2 Summary

Small businesses employ a large portion of the South African population. The South African government has plans, policies and support initiatives in place to grow small business in an effort to alleviate unemployment. Government also encourages industrialisation because the manufacturing sector is still largely labour intensive, and this is where growth efforts could be of value.

Unfortunately many businesses start in the informal sector of the economy, where the owners may have little or no education. As was indicated in chapter 2, the likelihood of these new businesses surviving and growing is dismal, but one factor that could help to ensure their survival is proper financial planning and control systems.

Financial planning and control systems are management systems that assist with the methodical management of the enterprise. For a number of years, traditional budgeting has been criticised as being outdated, but the system has now evolved into a complete management system. However, the traditional

methods are still widely used by all types and sizes of establishments including manufacturing MSEs.

A number of variations in the traditional methods, referred to as “better budgeting”, have also been developed in the past few decades. Various practitioners and academics developed these to alleviate the pitfalls of the traditional methods. Some of these better budgeting methods have proven useful to smaller entities and therefore may well be used in manufacturing MSEs.

Further developments in management systems are also evident, and these systems do not only focus on financial measures, but also include other factors such as quality, customer satisfaction, and timeliness. These nonfinancial measures are vital to the survival of small businesses as there is little room for error in the endeavour of keeping the customer happy.

According to Hope and Fraser (1999:18), a number of establishments discarded the budgeting process all together and moved over to what they called “beyond budgeting”. Beyond budgeting is not a model but a series of criteria that can be pursued using some of the existing tools available to management. This philosophy means that changes in the establishment are made according to the changes in the business environment, thereby eliminating wasted use of resources. By following this philosophy and eliminating waste of resources, MSEs could perhaps perform better.

In the empirical study in this research, most of the manufacturing firms belonged to only three of the ten types of manufacturing classifications, which may not be representative of all manufacturing MSEs. However, this should not affect the results of the study because it focused on financial planning and the control processes used and not the type of manufacturing activity.

The questionnaire was sent out during a period of economic crisis throughout the world and in South Africa, which explains the poor response rate. Hence the fact that predominantly established firms responded to the survey could mean that the other firms had closed down because they were unable to survive in the current economic climate. This is also underscored by the fact that the firms that were registered for VAT comprised 73.4% of the respondents. It was found that more than 70% of the owners/managers had a post-matric qualification and 55% had more than ten years of related business experience, which suggests that the level of education and experience of the respondents was high. Unfortunately, very few businesses operating in the informal sector responded, which could suggest that the owners/managers of these firms had lower levels of education and experience. The majority of the owners/managers were white males in the age category of 40 to 49. One interesting finding was that more women indicated that they had formal financial planning processes in place. The results also revealed that about half of the owners/managers had no financial training.

According to Masurel and Smit (2000:11), smaller firms are less likely to have formal plans. Only about half of the respondents specified that they did formal financial planning. However, 89.2% of the respondents revealed that they did use one of the given budgeting systems. This suggests that owners/managers do plan the operations of their businesses, but that these plans may be on an informal basis, with no actual written plan. The businesses participating in the empirical study were also mostly established firms. This was evident in the age of the entities, where 58.5% had been operating for six years and longer. Another finding was that the longer the entity had been in business, the more likely it was to have formal financial planning systems in place. In addition, very few of these owners/managers used the more modern management accounting systems. The only system that some of them perceived they were using was total quality management (TQM).

Regarding the profile of the businesses that did have formal financial processes, the larger firms, which were mainly private companies and close corporations, appeared to use more financial planning procedures, with very few sole proprietors having any formal financial plans. It was also evident from the cross-tabulations of some of the questions with those firms that indicated that they did have some form of formal financial planning, that they were more profitable, more than half of the owners/managers had some form of financial education and the enterprises were stable or growing.

The above findings seem to indicate that the use of financial planning may in fact help a firm to survive. However, management do not have any control over market changes, and survival often depends on the ability of the owner/manager to react to changing circumstances. This is in line with the basic idea of “beyond budgeting”, where the traditional methods of financial planning are ignored and the business adapts its planning to market forces.

Very few owners of manufacturing MSEs operating in the informal economy were willing to complete the questionnaire, chiefly, because they feared possible repercussions from the authorities. If more of these businesses had been included in the study, the results may have been totally different.

To conclude, many manufacturing MSEs in the Tshwane metropolitan area use financial planning, be it, formal, informal, traditional or modern methods, and there is evidence to suggest that by using any of these forms of financial planning, firms have a better chance of succeeding.

6.3 Conclusions

There is no doubt that many new businesses, including manufacturers, are developing in South Africa. A somewhat alarming fact, however, is that many of these new firms will not survive. One of the main reasons for this is the lack

of financial planning and control systems. The empirical study revealed that many manufacturing MSEs do some form of financial planning, although not necessarily on a formal basis. It is apparent that the very small and small firms are more likely to use formal financial planning than the micro firms. The more formal the planning process is the longer the firm has been operating, which would suggest that formal financial planning and control and other management accounting systems do have an influence on the survival of the firm. However, many other factors contribute to the survival and growth of an entity – hence the need to consider other factors.

The newer more modern financial planning and control systems have a lot to offer the small business owner/manager and many could benefit by adopting these new approaches.

6.4 Areas for possible further research

More research is needed on very small and micro enterprises, including those that operate in the informal sector. It is also essential to investigate only those entities that operate in the informal economy of South Africa in order to suggest and develop ways to assist these entities. Perhaps training programmes could be developed for use within the various Sector Education and Training Authorities (SETA) which will assist in educating the owners of small business in financial planning and control. Also, a financial planning model could be designed that is easily understood to assist these enterprises in continued operations and growth.

Lastly, it is recommended that a similar study be conducted in other metropolitan areas in South Africa to substantiate the findings.

ANNEXURE A

7 July 2009

Dear owner/manager

You, as the owner/manager of a micro/small manufacturing enterprise, are invited to participate in an academic research study conducted by Pam Berry, a Master's student in Accounting under the supervision of Professor Piet du Plessis and Dr Bienkie Shuttleworth from the Department of Management Accounting at the University of South Africa (Unisa).

The purpose of this study is to determine the extent to which small and micro manufacturing enterprises use formal planning techniques in their daily operations. Your participation in this study is extremely important as there is a large gap in the literature on the management accounting habits of small enterprises.

The information from the respondents will at all times be treated as confidential and will not be made available to any entity or third party. Neither your name nor your company will be linked to your contributions to this study. The data obtained from the questionnaires will be used for academic research purposes only.

If possible, please complete the questionnaire electronically, which should take you approximately 10 minutes, and return it via email as an attachment or fax or post the completed questionnaire before **15 November 2009** to the address below.

Should you require any further information, please do not hesitate to contact Pam Berry at:

Telephone:	083 772 6056/012 429 4415
Fax:	012 429 4894 (please mark for my attention)
Email:	berrypr@unisa.ac.za
Postal address:	AJH van der Walt Building Room 1-56 Unisa PO Box 392 Pretoria 0003

Your responses to the attached questionnaire would be greatly appreciated. Thanking you in anticipation for your kind cooperation and assistance with this research project.

Yours sincerely

Pam Berry

NB: ONLY TO BE COMPLETED BY MANUFACTURING FIRMS WITH FEWER THAN 50 (1–49) EMPLOYEES

PART 1

Question 1

In terms of the Standard Industrial Classification codes (SIC), under which manufacturing division does your enterprise fall?		X	Official use
Food products, beverages and tobacco products	30		
Textiles, clothing and leather goods	31		
Wood and products of wood and cork, except furniture; articles of straw and plaiting materials; paper and paper products; publishing, printing and reproduction of recorded media	32		
Coke, refined petroleum products and nuclear fuel; chemicals and chemical products; rubber and plastic products	33		
Other nonmetallic mineral products	34		
Basic metals, fabricated metal products, machinery and equipment and of office, accounting and computing machinery	35		
Electrical machinery and apparatus not elsewhere classified.	36		
Radio, television and communication equipment and apparatus and of medical, precision and optical instruments, watches and clocks	37		
Transport equipment	38		
Furniture; manufacturing not elsewhere classified.; recycling	39		

Question 2

What main product(s) does your enterprise manufacture?		
1.	3.	
2.	4.	

Question 3

What do you consider as the MAIN reason for your enterprise's continued operation?	X	
Customer satisfaction		
Only supplier of the product in South Africa		
Price of product		
Quality of product		
The manner in which the enterprise is managed		
Unique product		
Other		

Question 4

How many years has the enterprise been trading/been in business?	X	
Less than 1 year		
1–2 years		
2–4years		
4–6 years		
6–8 years		
8–10 years		
More than 10 years		

Question 5

How is your enterprise owned?

	X
Sole proprietor	
Partnership	
Close corporation	
Private company	

Question 6

How many people are currently employed?

	X
None	
1–5 employees	
6–20 employees	
21–49 employees	

Question 7

How many employees were there during previous years?
(Please provide ACTUAL numbers.)

	2004	2005	2006	2007	2008
Actual numbers					

PART 2
Question 8

Assessment of profitability of business over the past 12 months

Very profitable		Moderately profitable		Breakeven		Unprofitable	

Question 9

Assessment of growth of enterprise over the past 12 months?

Growing		Stable		Declining	

Question 10

What were the enterprise's approximate annual sales in rands? (Mark with an X)

	2004	2005	2006	2007	2008
Under R100 000					
R100 000–R200 000					
R200 001–R1 000 000					
R1 000 0001–R5 000 000					
Above R5 000 000					

Question 11

Has the enterprise made any capital investments in the following categories during the past two years? (Mark with an X.)	Yes	No	
Property			
Plant, machinery and equipment			
Vehicles			

Question 12

Is the business registered for VAT?	Yes	No	

PART 3(a)

Question 13

What is the highest education level of the owner/manager?	X	
University degree		
Other post-matric qualification		
Matric (Grade 12)		
Grade 10		
Grade 8		
Grade 6 and lower		

Question 14

What is the highest TECHNICAL qualification of the owner/manager?	X	
BTech degree		
Technical diploma		
Technical certificate		
Technical skills development courses		
Other technical courses		
None		

Question 15

What is the highest FINANCIAL qualification of the owner/manager?	X	
CA/CIMA		
BCom degree or BTech Financial		
Financial diploma		
Financial certificate		
Financial skills development courses		
Other financial courses		
None		

Question 16

How many years of experience does the owner/manager have in related business?		

Question 17

	Yes	No	
Does the owner/manager have any financial management training?			

Question 18

In which of the following ranges does the age of the owner/manager fall?

	X	
Under 20 years		
21–29 years		
30–39 years		
40–49 years		
50–59 years		
Over 60 years		

Question 19

To which population group does the owner belong?

	X	
Asian		
Black		
Coloured		
White		

Question 20

	Male	Female	
What is the gender of the owner/manager?			

PART 3(b)

Question 21(a)

Does the enterprise keep formal financial records or accounts, that is, do you have a bookkeeping system?	Yes	No	

Question 21(b)

If yes, which system does the enterprise use?

Computerised accounting system		
Manual accounting system		

Question 22(a)

Does the enterprise do any form of FORMAL financial planning?	Yes	No	

Question 22(b)

If yes, what form of formal financial planning does the enterprise use?	

Question 23

Does the enterprise use standard costing to estimate the cost of the product?	Yes	No	

Question 24

Does the enterprise use any of the following budgeting systems?

	Yes	No	
Ordinary (traditional) budgeting			
Activity-based budgeting			
Flexible budgets			
Rolling budgets			
Zero-based budgeting			

Question 25

Indicate what you consider to be the importance of the following reasons for budgeting for the enterprise:

	Not important	Important	Very important	
Operational planning				
Communication of goals				
Performance evaluation				
Strategy formation				
Variance analysis				

Question 26

	Yes	No	Do not use	
Does your enterprise use a budget to control the business operations?				

Question 27

	Yes	No	Do not use	
In your enterprise, are incentives and rewards linked to the budget process?				

Question 28

	Yes	No	Do not use	
In your enterprise, is the budget used for comparing the actual performance with the budgeted figures?				

Question 29

	Yes	No	Do not use	
Does the budget contain procedures for evaluating differences between the planned and actual performance?				

Question 30

	Yes	No	Do not use	
Are you satisfied with your enterprise's budgeting process?				

Question 31

Does your enterprise use any of the following techniques?

	Yes	No	
Clock card system			
Economic order quantity (EOQ)			
First-in-first-out stock valuation (FIFO)			
Last-in-first-out stock valuation (LIFO)			
Weighted average method of stock evaluation			
Any other operational planning? Please specify:			

Question 32

If your enterprise DOES NOT use any form of financial planning or budgeting, which of the statements below do you think best explains why not?

	X	
Do not know the benefits		
Lack of knowledge		
Lack of personnel		
Time constraints		
Too costly to implement		
Other reasons (state briefly):		

Question 33

Who prepares the budget for your enterprise?

	X	
Owner/manager		
Operational managers		
Financial accountant		
Management accountant		
Other		

Question 34

What techniques does your enterprise use to classify fixed and variable costs?

	Use them	Do not use them	Do not understand them	
Statistical regression techniques				
Subjective classification based on managerial experience				
All overheads are classified as fixed costs and material and labour costs as variable costs				
Fixed and variable costs are not separated				
Other				

Question 35

Does your enterprise use any of the following advanced management systems?

	Yes	No	
Balanced scorecard (BSC)			
Just-in-time (JIT)			
Theory of constraints (TOC)			
Total quality management (TQM)			

END OF QUESTIONAIRE

THANK YOU FOR YOUR TIME

Please return your completed questionnaire to Pam Berry at:

Email: **berrypr@unisa.ac.za**

Fax: **012 429 4894 (Please mark for my attention.)**

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