

Development Finance Working Paper Series¹

Financing Structure and Performance of MSMEs in South Africa: “The Valley of Death”

Seroka Tau
Abdul Latif Alhassan

No. DEFWPS180012

July 2018

¹ **Note:** The findings from this working paper does not in any way reflect the views of the Development Finance Centre (DEFIC). The views are only representative of the authors.

©Development Finance Centre (DEFIC), GSB, UCT – 2018

Editorial Board

Dr Sean Gossel	–	Graduate School of Business, UCT
Dr Latif Alhassan	–	Graduate School of Business, UCT
Dr Mundia Kabinga	–	Graduate School of Business, UCT
Mr Lungelo Gumede	–	Graduate School of Business, UCT
Dr Grieve Chelwa	–	Graduate School of Business, UCT

Advisory Board

Professor Nicholas Biekpe	–	Graduate School of Business, UCT
Professor Danny Cassimon	–	University of Antwerp
Professor Charles Adjasi	–	University of Stellenbosch Business School,
Professor Joshua Abor	–	University of Ghana Business School
A/Prof Odongo Kodongo	–	Wits Business School, University of Witwatersrand

Published by:

The Development Finance Centre (DEFIC),
Graduation School of Business, University of Cape Town,
9 Portwood Rd, V & A Waterfront, Cape Town, 8002
Centre webpage: <http://www.gsb.uct.ac.za/s.asp?p=791>

Financing Structure and Performance of MSMEs in South Africa: “The Valley of Death”

Seroka Tau & Abdul Latif Alhassan

Abstract

Previous researchers, especially on large enterprises, have revealed that debt financing structure influences enterprise performance. Though the issue has been extensively researched, micro, small, and medium-sized enterprises (MSMEs) have traditionally been operating differently as compared to large enterprises in terms of their financial decisions, ownership and management style, and behaviour. Therefore, this study will explore the gaps encountered by all MSMEs to grow their businesses. These include forms and type of industry, firm size, asset tangibility, and a firm's current assets in relation to its current liabilities and profitability level. The study examines the influence of financing structures on performance of micro, small and medium-sized enterprises (MSMEs) in South Africa. The ordinary least squares (OLS) technique of measurement is applied to examine the effects of financing structure on performance across various industrial sectors in the years 2013, 2014 and 2015.

The findings in this study indicate an increase in the use of leverage to drive the influence of total debt on performance in all industrial sectors of MSMEs in South Africa. From the cross-sectional regression analysis, the results show that financing structure has a negative effect on the profitability of MSMEs, although not absolutely. The findings show that the size of the enterprise, asset tangibility, and the ratio of current assets to current liabilities are the most influential of borrowing decisions in total debt, short-term debt, and long-term debt. A significantly negative effect is observed for long-term debt, while short-term debt (STDR) exhibits a significantly positive effect. Thus, the influence on MSMEs' leverage on performance is driven by the usage of short-term debt. The variables of size of the firm, and ratio of current assets to current liabilities, do not have the same effect in all debt levels; the significance is substantially higher for long-term debt than for total debt and short-term debt. On the other hand, our empirical results suggested that transactional costs, and an asymmetric information problem in smaller firms, may lead to a mainly negative influence on size and total debt. The asset structure on profitability observed across the years showed mixed experiences. The ratio of current assets to current liabilities was found to be positive and significant on long-term debt and short-term debt leverage.

Keywords: Debt | Financing structure | MSME | South Africa |