

The Influence of Financial Constraints on SME Performance: A Survey of SMEs' Struggles in the Free State Province, South Africa

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ABSTRACT

This study investigates the impact of financial constraints on business performance of small and medium-sized enterprises (SMEs) in the Free State Province, South Africa. While SMEs, through their multiple functions in the national economy, are a vehicle for sustainable development, they continue to struggle with limited access to funds, low managerial skills, and problems resulting from the inefficiency of institutions. Besides, the present literature is often biased in suggesting that funds are either public or private, thereby, not recognizing the existence of hybrid models that can be used to promote the sustainability of SMEs. The study concentrates on those financial challenges which have a major influence on the performance of SMEs. These are the issues of access to credit that is limited, lack of security, insufficient financial literacy, and the personal or family sources of finance that are at times used without any limitations. The authors have associated these constraints with the common socio-economic problems of unemployment, poverty, and inequality. By means of a quantitative approach supplemented by semi-structured interviews, this research determines the effects of financial constraints on the performance of SMEs. Apart from that, the study also deals with the role of government policies, financial institutions, and digitalization in the problem. The findings reveal that the issue of financing methods is still prevalent among SMEs in the townships and villages and these enterprises require management training and integrated support systems. The study provides a series of recommendations such as the financial system reform, the increased engagement between public and private sectors, and strategies for making funds available to a larger number of people at a reasonable cost. These results, in fact, represent a major contribution to the argument that is still going on about the growth of small and medium enterprises, and they also indicate the potential solutions that could bring about the advancement of financial inclusion and the continuation of business in South Africa.

Keywords: SME performance, financial constraints, access to finance, inequality, government support, Free State Province

Introduction

Background to the Study

Small and medium-sized enterprises (SMEs) are globally, and in South Africa, very much acknowledged as the main contributors to economic growth, job creation, and the alleviation of poverty. However, these businesses still encounter continuous financial problems that block their expansion and general performance. Most of the literature done so far has represented the financing of SMEs as an "either/or" decision - either public or private financing - without considering the advantages of a hybrid source which combines the two funds [1-4]. Financial institutions can be seen as the main pillars of the SMEs through the provision of secure financial services, business advisory support, and credit

facilities which are the engines of growth (Demacon, 2010). The SMEs are the entities that contribute to the country's economy through different types of services. These services have become the basis of the creation of jobs, the development of skills, and the contribution to the national GDP. The SMEs' stagnation and failure have been identified as the major reasons for the high levels of unemployment, poverty, and inequality in the country. Access to finance is still counted among the most significant problems of SME survival. Studies have revealed that financial limitations can hamper business operations in almost all aspects - from administrative capacity and inventory management to long-term growth planning. Financial constraints are a constant issue for SMEs in emerging markets to innovate, expand and compete [5].

In the case of South Africa, Smit and Watkins are of the opinion that the absence of credit access is one of the most formidable

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obstacles to the growth of SMEs [6]. Research findings in the same vein have been recorded in other developing economies [7,8]. Moreover, SMEs have to battle managerial weaknesses, lack of planning skills, and inefficiencies in administration-which are factors that indirectly diminish their capacity to obtain funding from formal institutions. Point out that in most cases, SMEs do not have enough management skills, which further weakens their strategic planning and makes them seem as a risky venture to the lenders [9]. Therefore, financial institutions may be reluctant to allow SMEs a credit facility, thus deepening the problem of financial exclusion [5]. While many studies have been done to show the relationship between low financial capital and bad performance, the exact causal pathways are still largely unclear [10]. Furthermore, most of the SME owners in South Africa are dependent on the personal and family resources for the starting capital as a result of the limited access to bank financing [11]. The absence of collateral, lack of credit history, and perceived risks are some of the factors that limit their ability to get formal loans [12-4]. This study acknowledges these problems and intends to come up with ways of facilitating SME access to finance and their general performance in the Free State Province.

Problem Statement

In South Africa, SMEs are experiencing grave and prolonged difficulties in getting the financial resources that are critical for the growth, sustainability, and competitiveness of their businesses. Even after various public and private initiatives, financial constraints continue to be the stumbling block of SME performance. The inability to get funding not only impedes the widening of business but also restricts the possibilities of innovation, job creation, and contribution to the national economy. The difference between the availability of funding and how reachable it is for SMEs as well as the financial needs of SMEs is still wide although there are numerous institutions and policies to support the financing of SMEs. Traditional funding models tend to overlook the hybrid financing mechanisms and often impose strict requirements that are hard for SMEs, especially those located in townships and rural areas, to fulfill. Consequently, a large number of SMEs have resorted to informal sources of funding, which may not be sufficient or sustainable.. Moreover, the absence of research that links financial aid directly to the performance of SMEs is another factor that makes the issue difficult to comprehend. This research intends to identify the financial barriers experienced by SMEs in the Free State Province and to find out how these barriers affect business performance.

Research Objectives

Main Objective

To sightsee the extent to which financial constraints affected the performance of SMEs in the Free State Province of South Africa.

Specific Objectives

- To find out the financial challenges of SMEs when they are trying to get formal credit.
- To study the relationship between financial constraints and SME performance.
- To uncover the government and financial institutions' role in supporting the SMEs.

- To gauge the SME owners' level of financial literacy and management skills.
- To identify and recommend the best methods of facilitating access to finance and thus business growth.

Research Questions

- In what ways do these financial challenges impact the performance of SMEs?
- What financial barriers do small and medium enterprises (SMEs) encounter when seeking formal credit in the Free State Province?
- What role do government policies and financial institutions play in the funding of SMEs?
- How do management skills and financial literacy affect the availability of finance and business results?
- Which steps can be implemented to make it easier for SMEs to gain access to finance and to improve their performance?

Significance of the Study

The research has academic, economic, as well as policy importance. From an academic point of view, it is a part of the growing body of literature on SME financing in developing countries and draws the attention to the gaps in hybrid financing models. SMEs are the key players in the development of South Africa; hence, the understanding of their problems is a gateway to national productivity and employment improvement. The findings provide the evidence-based strategies of bridging the gap between the funding needs of SMEs and the available financing structures to the policymakers. The financial institutions and the SME support bodies can also utilize these insights to create more inclusive financing models that can better meet the needs of the disadvantaged and rural-based enterprises. Last but not least are the SME owners who may get the better grasp of financial management, funding strategies, and the requirements of credit institutions.

Scope and Delimitation

This study centers on small and medium-sized enterprises that are operating in the Free State Province. More specifically, the stipulations of this study pertained to SMEs located in Bloemfontein, Botshabelo, and Thaba 'Nchu. The investigation looks into financial restrictions as the major obstacle to SME growth while at the same time conceding that non-financial factors such as digitalization, entrepreneurial education, and regulatory environments also have an impact. The research only includes SMEs from the selected industries and excludes microenterprises that operate in the informal sector without registration. Gathering information was dependent on the completion of questionnaires and interviews by the participants, which may be subject to personal views.

Structure of the Dissertation

The dissertation is structured in the following way:

- **Chapter 1:** first gives an idea of the background, issue, aims, research questions, importance, and area.
- **Chapter 2:** goes deep into the review of the literature regarding SMEs, financial constraints, and government policy support.
- **Chapter 3:** lays out the research methodology which includes the design, sampling, data collection and ethical

considerations.

- **Chapter 4:** shows the research results along with the empirical findings.
- **Chapter 5:** offers a discussion and interpretation of the results in connection with the reference of the existing literature.
- **Chapter 6:** recalls the research, as well as, the next steps for government, practice, and further research.

Literature Review

Introduction

This chapter deliberates theoretical and empirical literature on small and medium enterprises (SMEs), their role in the evolution of the economy, and the financial challenges which limit their performance. The chapter continues with an outline of the contribution of SMEs to socio-economic development and financial constraints, followed by an account of access-to-finance determinants, government policy frameworks, and institutional support mechanisms. The chapter also reviews theoretical frameworks and empirical research to locate the voids that pave the way for the current study.

The Role of SMEs in Economic Development

SMEs are normally termed as the main factors that drive economic growth, create new jobs and lower poverty level, especially in third world countries like South Africa. Several studies have pointed out that SMEs are the major contributors to GDP, employment generation, and the development of entrepreneurial culture [15-17]. Fin Scope counted 5,579,767 small business proprietors and 5,979,510 small businesses in South Africa [18]. According to World Wide Worx, the SME sector is the ecosystem that maintains 7.8 million jobs [17]. Finweek also approximates that SMEs have a workforce of about 9 million South Africans and they contribute around 60% of the country's GDP [15]. Abor and Quartey explain that SMEs constitute about 91% of the formal businesses in South Africa, contribute 52-57% of the GDP, and are responsible for the employment of 61% of the total workforce [16]. Notwithstanding their significance, SMEs experience difficulties in obtaining bank loans. Agwa-Ejon and Mbohwa point out that only few SMEs have appropriate collateral to obtain bank loans [19]. The financing needs of SMEs change with time: internally, young firms are self-funded, while go-to commercial lenders are mature ones. In contrast, as age increases, information transparency decreases, thus affecting the decision of granting the loan [20]. The issue of the impact of SME age on financing opportunities is confirmed by the majority of researchers [21,22]. Barriers causing South African SMEs to be deprived of free access to funding are thus the focus of this research, which is geographically limited to the Free State Province with funding access as the main topic.

Financial Constraints and SME Performance

SMEs typically are heavily dependent on a few financial resources and therefore their finances limit their operations and their growth. The situation is so unfavorable that the pace at which SMEs get their money is both the reason for their failure and their way of growth in the market. The studies conducted in different countries reveal that the enterprises experience long-term problems in acquiring loans from banking sectors due to different collateral requirements and in some cases lack of necessary financial

documents and considered to be risky [5,6]. Besides money problems, the management side of the SMEs is influenced by the financial issues as well. As a rule, SMEs are caught in difficulties with taking records, planning for business and managing their money, which are the basics for the execution of successful credit applications. Thus financial organizations frequently view the condition of SMEs as a risky factor. According to Fafchamps and Schündeln, there is scarce research that provides data on the direct link between financial assistance and SME performance, most of the studies base on the presumptions rather than on the definite causal connections [10].

Financial inadequacy compels SMEs to self-fund or turn to informal sources of money, consequently, the scale of their operations is reduced, and the risk of those enterprises heightens [11]. Provision of collateral makes it difficult not only for those from cities but even more for SMEs of townships and rural areas that lack tangible assets to guarantee themselves with [12-14]. Hence, financial constraints are so deeply rooted and closely related to SME performance and survival, they need to be thoroughly studied.

Blended Finance and SME Performance in South Africa

Blended finance, facilitated through the strategic utilisation of concessional public or philanthropic resources alongside private investments, is increasingly being advocated as a key mechanism to address South Africa's on-going challenge of SME financing shortage and to generate firm-level effects like investment, job creation, and long-term sustainability [23]. Public or concessional funds take over the part of the perceived or real risk that scares private investors from exposure to SMEs, this way the cost of finance is reduced, the volume of the transaction is increased, and the length of the period allowed for SMEs is extended [24]. Both practical and policy evidence from South Africa support the idea that blended approaches open up both the quantity and quality of finance accessible to growth-oriented SMEs, but this happens only if these approaches are well-designed and are accompanied by non-financial interventions [11,23].

Among the mechanisms where blended finance plays a role in the improvement of the performance of SMEs are risk-sharing instruments (first-loss guarantees, junior tranches), catalytic equity and matched funding that lessen the investor's risk and at the same time provide a fair return for commercial players [23]. For SMEs this means that they will be able to get long-term loans for capital expenditure, have working capital facilities at lower effective interest rates, and gain equity that allows scaling instead of short-term survival [24]. If blended facilities are designed in such a way that early-stage and informal firms that have traditionally been neglected by banks are the main beneficiaries, then these firms can realize productive investments which otherwise would have been unattainable due to collateral constraints [11].

Nevertheless, the South African experience points out three limitations. Firstly, it is necessary that blended instruments be accompanied by reliable due diligence, suitable product design, and knowledge of the local market: deals that are not well thought out risk subsidizing the returns of private investors without bringing additionality to SMEs [25]. Secondly, volume is important: the majority of blended vehicles in the region are

relatively small compared to the total SMEs credit gap, as a result, the potential systemic impact on employment and GDP is minimal unless blended capital can either be scaled or duplicated [11,23]. Third, the provision of blended finance in itself is not enough. SMEs also need the provision of other services such as business development, market linkages and regulatory reforms in order to turn the newly obtained finance into productivity gains [26].

Recent South African policy documents reflect a deepening institutional interest in blended approaches, as evidenced by a number of these policies. The provincial frameworks and national MSME funding strategies openly talk about blended or alternative financing that can be used to attract institutional investors to public projects and small business finance. This is seen as a signal of a policy shift to use public funds more strategically in order to mobilize private capital [27,28]. However, the commitment shown in the policy needs to be supported by governance provisions such as transparency, a clear additionality test, monitoring, and sunset clauses to ensure that public funds are used to achieve developmental goals and are not simply used to transfer risk [27].

In reality, blended finance has recorded a number of positive but also some mixed results when it comes to SME South Africa outcomes. The various South African case studies and sectoral reviews point out that blended vehicles when they are supplemented with tailored lending products and advisory support, for instance, revenue-based financing or facility lines targeted at manufacturing clusters, SMEs reported higher capital expenditure and hiring intentions [24,26]. On the other hand, the instruments that focus solely on de-risking without giving attention to distributional targeting may risk deepening existing inequalities since the capital is directed towards the more well-connected firms. Hence, for blended finance to significantly enhance SME performance at a large scale, three design principles are necessary:

- detailed additionality and impact measurement;
- integrated product bundles (finance + non-financial support); and
- scale strategies that attract institutional investors through standardised, transparent instruments [11,23].

Blended public–private funding in South Africa has been escalated through two different but interrelated ways:

Big, infrastructure-scale blended vehicles (the Infrastructure Fund (IF) coordinated by DBSA/Infrastructure South Africa to attract institutional investors for public infrastructure) and SME-level blended products (grant + concessional/soft loan commercial co-finance, often accompanied by business development support) utilized by development finance institutions such as SEFA and the NEF. These hybrid models intend to solve market failures mainly risk perception, tenor mismatch and lack of project preparation by placing concessional public tranches (first loss, viability gap funding, or TA grants) to make projects or SME loans attractive to private capital.

Infrastructure Fund Case Study 1 Olifantspoort / Ebenezer Water-Supply Upgrade (Lepelle Northern Water) Overview & Structure

The Olifantspoort/Ebenezer upgrade is an instance where the Infrastructure Fund has evolved from providing early-stage

support to arranging a blended financing stack for a regional bulk water project. Lepelle Northern Water inked a memorandum with the Infrastructure Fund to back the R4.6 billion first-phase works that increase potable water availability (projected +55–65 Ml/day) to Polokwane and surrounding municipalities. The IF's intervention spans preparing blended funding combinations (fiscal contribution, concessional tranches and attracting DFI/private debt) and giving affordability and credit enhancement if needed to reach financial close. Mechanics & developmental intent. The undertaking merges:

- Fiscal contributions or BFI approvals to meet affordability gaps;
- IF/DBSA technical assistance and structuring to de-risk procurement and cash flow profiles; and
- Debt financing from DFIs and commercial financiers when project cash flows are sufficiently de-risked and contractually ring-fenced. The planned outcome is to facilitate housing and commercial development (estimated pipeline >US\$1.1bn in adjacent development) by lifting the water moratorium that hindered Polokwane's growth (Infrastructure South Africa, 2024). Strengths and challenges.

The strengths are among others strong developmental additionally (servicing an acute service backlog) and a bankable revenue base (bulk water charges), thus, the project becomes attractive to long-term investors after IF risk-mitigation. The problems, however, are timely procurement, coordinating multi-government sponsors, and ensuring the BFI/fiscal windows align with construction timetables (ISA/DBSA project notes). The Olifantspoort instance demonstrates the manner in which IF catalytic capital and project preparation propel the projects that would normally be left without funding.

Infrastructure Fund Case Study 2 uMkhomazi Water Project (uMWP-1 / TCTA involvement) Overview & Structure

The uMkhomazi Water Project (uMWP) is a huge inter-basin water transfer and dam scheme that was identified in national investment handbooks as a potential project for blended structuring due to its size and strategic importance to the Umgeni Water area. The IF / TCTA cooperation aims to provide a package of fiscal support, concessional DFI lines, and private debt/equity to cover the very large capital needs and to spread the construction risk among the stakeholders. Mechanics & developmental intent. The primary purpose of blended finances for uMWP is

- To finance the initial project preparations and environmental compliance through concessional / grant funds;
- To provision a viability gap fund where tariffs cannot fully recover the capital costs; and
- To invite long-term institutional capital where regulated cash flows or state-backed off take provide predictable revenue.

The IF's role in the project focuses on packaging the capital stack, coordinating BFI approvals, and standardizing documentation to lower the investor transaction costs. Strengths and challenges. The undertaking reveals that blended finance can be the enabler for mega-projects that are otherwise fiscally constrained; however, it also points out the necessity of having long lead times, robust procurement, and transparency on the public subsidy in order to keep the additionally intact (BFI and DBSA guidance).

SME Blended Case Study 1 SEFA Blended Grant + Loan (Early-Stage & Spaza Support Examples) Overview & Structure. SEFA's

Blended programme combines small grant portions (for business development, accreditation, or part of capital subsidy) with repayable loans to make small businesses bankable and mitigate first-loss/transaction costs for on-lenders. Several windows (spaza shop support, start-up packages, and Letlatsa/Letlhatsa-style blended deals usually structured at 80% loan / 20% grant or similar ratios), which combine finance with BDS, are documented in SEFA annual reporting and programme materials. These structures lower the effective cost and provide the necessary capacity that increases the chances of survival and scaling. Example & outcomes. Commonly SEFA's spaza / micro-enterprise packages comprise a small grant for stock or accreditation and a loan for working capital; monitoring reports indicate that such blends facilitate registration, compliance with tax/U I F, and formal distribution channels usage the factors that lead to higher revenues and increased loan repayment prospects. The blended model also facilitates on-lending partnerships with commercial banks and wholesalers (SEFA documentation).

SME Blended Case Study 2 NEF Financing & Women Empowerment / Example Beneficiaries (Emalangenji Lodge and Similar)

Overview & Structure. The National Empowerment Fund (NEF) uses a combination of direct equity, loans and targeted funds (for example Women Empowerment Fund, Tourism Transformation Fund) to provide co-investment and matched financing to black entrepreneurs. NEF annual/integrated reports depict actual beneficiary scenarios in which NEF funding (most of the time blended with private or commercial lines) led the way to the support of working capital, job retention, and growth (NEF Integrated Report; NEF FY25 Strategic Plan).

Example & Outcomes. The NEF disclosed the provision of support to business like Emalangenji Lodge CC (tourism) and stated that a "specific funding intervention (R14 million working capital support in the report) preserved existing jobs and empowered local employment" thus demonstrating how NEF structures merge public development objectives with commercial discipline to attain job-rich SMEs (NEF report). The comprehensive NEF program reporting (Women Empowerment Fund) records the portfolio results (numbers of funded firms, supported jobs, and leverage ratios) which also show private co-investors being attracted by NEF capital.

Synthesis: Lessons from the Four Cases:

- Project preparation matters most. Both large IF projects and SME blends can only be successful if the early-stage project preparation (feasibility, procurement, enviro/social work, and financial modelling) is financed upfront. The IF's application guidelines and PPDF templates prioritize TA grants for that reason (DBSA / PPDF guidance).
- Clear additional tests & transparency are essential. Public tranches should be explicitly linked to measurable crowd-in and developmental outcomes so as not to subsidize commercially viable projects. South African BFI policy and IF governance frameworks put the emphasis on additionally and reporting.
- Blends should be bundled with BDS for SMEs. The SEFA

and NEF cases demonstrate that finance alone does not have the power to transform firm productivity. When finance is combined with training, market linkages, and accreditation, loan performance and firm growth improve significantly.

- Scale and standardization open the door to institutional capital. The IF's desire to standardize instruments and aggregate pipelines (ISA handbooks) is a move towards attracting pension funds and insurers; without scale, blended pilots cannot significantly close the national SME/infrastructure gaps.

Access to Finance: Barriers and Determinants

Access to finance is changed by different firm-specific and external factors. International and local frameworks mark the below criteria as the base for SME financing [18,29,30].

Access to a Business Bank Account

Access to a formal business bank account is a base must for SME financial inclusion as it makes secure transactions, transparent record-keeping, and integration into formal value chains possible. Also, a bank account creates a concrete financial history that lenders use to assess creditworthiness, thus lowering the risk and allowing SMEs to seek formal funding [26]. Data reveal that SMEs that operate without bank accounts. Furthermore, business accounts enable compliance with tax regulations, which, in turn, boosts firm legitimacy. So, formal banking access is directly connected with the enhancement of financial visibility and the increase of the chances to get funding approved.

Availability of Diverse Financial Products

Firstly, the availability of a wide range of financial products such as microloans, term loans, asset finance, equity funding, and invoice discounting makes it possible for SMEs to adjust financial instruments to their specific operational needs [26]. The research indicates that a variety of funding options lowers the susceptibility of a firm by giving an entrepreneur the possibility to avoid the wrong matching of financing structures, for example, the use of short-term loans for long-term investments. Also, the diversity in products widens access to the most disadvantaged sectors, for example, townships and rural SMEs which depend on microfinance and blended-finance instruments. In addition, differentiated products assist SMEs at all stages of the business lifecycle, from start-up working capital to scale-up growth finance. Therefore, the financial product diversity is strongly linked with higher SME survival and competitiveness.

Use of Formal Financial Services

Formal financial services consumption, including electronic payments, insurance, savings products, and legitimate remittance platforms, enhances the financial soundness of SMEs and lowers their operating risk. Several empirical research works demonstrate that firms that use formal services keep more accurate records of their finances, have lesser volatility in their cash flows, and are in a better position to weather economic shocks. Apart from that, formalization also makes a business more transparent which lenders consider as an indication of better governance and lower credit risk (Fin find, 2025) [26]. Besides, access to digital financial services helps in speeding up the work through the use of automated invoicing, point-of-sale systems, and digital transaction trails. Thus those SMEs who are participants in formal financial systems are regularly reporting

that their revenues increase, and thus the possibility of getting funds also becomes stronger.

Access to Credit Lines

One of the ways in which SMEs can meet their financial needs in a flexible and on-demand manner is through access to revolving credit lines that can be used to bridge cash-flow gaps, manage seasonality and finance short-term operational needs. It is revealed through the evidence that business entities that have access to the use of credit lines are not much prone to cash-flow crises, and thus the cases of delayed supplier payments or lost contracts are rare [26]. Apart from that, credit lines contribute to making businesses more sturdy as they provide opportunities for SMEs to respond to market openings quickly without having to wait for the long process of loan approvals. Besides, the use of credit-line utilization paves the way for better financial track records which consequently results in SMEs being granted creditworthiness over the long term. Therefore, the availability of credit lines is one of the main factors that contribute to business stability and performance that is sustained over time.

Affordable, Reliable Financing from Reputable Institutions

Cheap and trustworthy financing obtained from creditworthy institutions like banks, SEFA, NEF, or regulated microfinance entities brings SMEs to a point where they have predictable capital at cost levels that are quite favourable for long-term growth, rather than the opposite. Empirical studies have found that high-cost and informal lenders are the major contributors to SMEs becoming stuck in debt cycles which in turn results in the weakening of their profitability and the increase of default risk [26]. On the contrary, well-established financial institutions deliver structured repayment terms, pricing that is transparent, and consumer protection that collectively works for the borrowing party to experience an uplift in confidence. Also, these institutions are the ones that offer non-financial support like training and advisory services that will help SMEs to convert finance into productive investment. Hence, the availability of affordable and creditworthy finance is one of the direct factors leading to SME sustainability and growth potential.

However, South African SMEs encounter substantial problems when trying to satisfy these criteria. The research shows that financing of SMEs is much lower in South Africa than in countries with similar economic profiles [13]. Thus, the SMEs are mostly dependent on personal savings, family financing, and informal networks [31,32]. Loan application rejections typically result from:

Insufficient Collateral

Insufficient collateral continues to be one of the main reasons most commonly cited for the failure of small and medium-sized enterprises (SMEs) to gain access to formal credit in South Africa. The majority of small firms do not have fixed assets such as machines, land, or vehicles that banks usually require as loan securities. Thus, lenders put such businesses into a high-risk category even when they show a good cash flow pattern. Limited asset ownership is particularly typical of township and rural businesses and thus the problem of financial exclusion becomes more serious in these areas. Therefore, the demand for collateral is at the same time a factor that is disadvantaging new and micro-enterprises in a systematic way.

Low Profitability

Low and irregular profitability lowers the perceived ability of an SME to repay a loan and this results in very high rejection rates of loan applications. According to the research, South African SMEs are reported to be running operations with very thin profit margins which are the result of high input costs, lack of economies of scale, and unstable market demand (Herrington & Kew, 2020). Based on these financial patterns, lenders see them as insufficient cash-flow buffers and thus they raise the risk associated with loans. Therefore, even SMEs that have strong growth potential may find it difficult to get a loan. The problem of continuous low profitability is thus the main reason for and, at the same time, the outcome of limited access to finance [26].

Inadequate Owner Equity

It is common for SMEs to present bank loan applications with very little owner equity contributions, and banks see this as a lack of financial commitment or the internal capacity to absorb losses at the early stage. Empirical evidence indicates that lenders are more willing to finance SMEs that show higher levels of self-investment as this is a sign of business confidence and therefore less risk is involved for the lender. Entrepreneurs' low personal savings, unemployment histories, and household financial pressure may all contribute to a situation where entrepreneurs will find it difficult to make a meaningful equity injection. This limitation is especially severe for young people and those who are engaged in the informal sector. Therefore, the problem of insufficient equity becomes the one that weakens the trust that investors have in funding proposals [26].

Poor Credit Records

Bad or incomplete credit histories are a major obstacle to the funding of SMEs, as lenders greatly depend on credit scores to make predictions about the repayment behavior. Many entrepreneurs have poor personal credit due to arrears in the past, borrowing within the informal sector, or being listed in the adverse credit registers, and this personal risk spills over into the business risk profile. Besides that, some SMEs do not keep formal financial records, thus lenders are prevented from verifying transactions or identifying repayment capacity. So, not having a clean and traceable credit history limits the access to bank loans as well as other types of financing instruments. This trend is causing long-term financial exclusion to become gradually more and more entrenched.

Insufficient Information

One of the most difficult challenges in the studies of SMEs is that there is a lack of enough and reliable information based on which lenders can make evaluations of business viability. There are many SMEs that find it hard to produce up-to-date financial statements, tax records, or any other operational data that is required for credit assessment. When lacking this information, the lenders experience high information asymmetry which in turn leads to increased costs of screening and perceived risk. Therefore, banks engage in credit rationing, and only well-documented applications are approved. The problem of insufficient information is thus a structural barrier that especially affects start-ups and informal enterprises [26].

Weak Business Plans

Poorly prepared or weak business plans have less chance

of convincing funding applications and thus they reflect the management's low capacity. It has been found that majority of SME owners lack the technical know-how required to provide market analysis, revenue projections, and operational strategies in a way that meets the expectations of lenders. A business plan without proper explanation or realistic assumptions is considered a sign of operational weaknesses even if the underlying business idea is feasible. It, therefore, results in a very high rejection rate of loan applications. Hence, the deficiency in planning skills is to a large extent linked with the problem of limited access to finance.

Unviable Business Ideas

Frequently, lenders turn down applications that are based on business ideas that seem to be unprofitable, oversaturated, or lacking a competitive advantage. Research evidence indicates that the majority of SMEs are found to be operating in sectors where the profit margins are low and are highly competitive without any clear differentiation thus making the generation of revenue uncertain [16]. Banks judge these ideas as financially nonviable regardless of the owner's enthusiasm or commitment. This problem becomes worse when entrepreneurs have done little market research or have misjudged the demand conditions. Consequently, unviable business ideas are among the main reasons for early-stage funding exclusion. The information gap between SMEs and lenders makes matters worse. Banks have a hard time evaluating the risk of SMEs due to the incompleteness and unreliability of financial information while SMEs are often not aware of the credit requirements. Determinants Affecting Access to Finance [32,33].

Empirical Research has Highlighted Various Main Factors:

- Age of the SME, Old SMEs usually have better credit access as they have an operational history and have shown stability [20,21].
- Size of the SME, Bigger SMEs have less financing constraints because they benefit from economies of scale, have assets at their disposal, and have stronger financial records [34,35].
- Life Cycle of the SME, SMEs that are startups have the most significant financing barriers; however, during the growth and expansion phases, access gets better [36].
- Owner Characteristics, Race, gender, education, and managerial experience all impact the financing of the SMEs [37].
- Collateral Availability, The availability of both movable and immovable assets drastically raises a person's chances of getting a loan [38].
- Location, Urban SMEs can easily access formal finance than those in rural areas or townships [39].
- Recordkeeping Practices, Proper financial records are a must for a loan application; however, many SMEs are without good accounting systems [40]. These determinants offer valuable benchmarks for comprehending the financial issues faced by SMEs in the Free State Province.

Government Policy and Institutional Support

The South African government has consistently viewed small and medium-sized enterprises (SMEs) as the most viable means of job creation, reducing poverty, and bringing about comprehensive economic development. The recognition of

this fact goes back to the era of early post-apartheid when decision-makers faced twofold difficulties; one, the economy was characterized by structural inequalities, and two, the entrepreneurial ecosystem was less evolved. In 1995, the White Paper on Small Business Development emerged as a landmark policy document that spelled out the need for a well-coordinated national approach to the promotion of SMEs. Small businesses, the paper said, were the most affected by apartheid spacial planning, financial systems discrimination, and market access limitation, and thus, required targeted state support in order to realize their developmental potential.

Based on this outline, the government enacted the National Small Business Act of 1996, which was the legal and institutional framework for the country to coordinate the support of SMEs at different levels. Mainly from this policy trajectory, we saw the emergence of two significant institutions. It was Khula Enterprise Finance Limited, whose main objective was to solve the issue of small firms' lack of finance through credit guarantees, wholesale lending, and micro-credit support, and the Ntsika Enterprise Promotion Agency, an entity mandated to provide non-financial support like training, mentorship, capacity building, and market access facilitation. It was a dual-intervention model together with these two entities that financial and non-financial were the means through which the multidimensional barriers faced by emerging enterprises had to be responded to. With the change of the policy setting, new institutions had been established to remove the gaps and extend the reach of state support there. Established in 2004 through the merger of Ntsika and other support programs, the Small Enterprise Development Agency (Seda) was the chief non-financial intervention provider institution in the national SME sector. Seda's role was enlarged through business advisory services, incubation support, and technology transfer as the focus on innovation and competitiveness had been increased.

The Umsobomvu Youth Fund (UYF) was established at the same time as Seda to encourage youth entrepreneurship through loans, grants, training programmes, and job creation initiatives. The UYF was incorporated into the National Youth Development Agency (NYDA), but it still had a major contribution in the building of a pipeline of young entrepreneurs, mainly in rural and township areas. In the Free State province, the Free State Development Corporation (FDC) had taken the lead role at the regional level in providing financial and property-based support such as industrial parks, businesses premises, and microfinance interventions to get the local enterprise development going.

Research, however, shows that despite the establishment of this wide institutional infrastructure, SMEs especially in the Free State province keep on coming across serious developmental challenges. Bank seta (2011) has pointed issues that impact Free State SMEs, among which are:

Limited Access to Funding

As a result of severe collateral requirements, incomplete financial records, high perceived risks from banks, and limited penetration of alternative financing models, Free State firms are often unable to secure working capital and growth finance. Even though institutions like Khula (now integrated into the Small Enterprise Finance Agency, SEFA) and the FDC are there to close this gap, the demand for SME funding is way beyond

the supply, especially for start-ups, informal enterprises, and township-based businesses.

Insufficient Technological Infrastructure

The majority of the SMEs do not have access to stable internet connectivity, modern machinery, digital tools, and production technologies. Such a technological deficiency causes the productivity, competitiveness, and the ability to be part of the current value chains to be low. The Free State with its vast rural areas and spots with poor connectivity has more infrastructural disparities than more urbanized provinces like Gauteng or the Western Cape. That is why SMEs in the region may have a hard time digitalizing their operations, accessing online markets, or adopting new innovations that could improve their efficiency.

Poor Pricing and Costing Skills

Many business owners do not use correct costing methods and usually underestimate production costs, overheads, or opportunity costs. This results in wrong pricing strategies which lead to reduced profitability and, therefore, businesses' long-term sustainability gets weakened. Besides that, inaccurate costing further affects cash flow management and may even scare off potential investors who depend on sound financial projections when they decide on the viability of small firms. The continuing financial illiteracy of business owners points out that non-financial support institutions should be giving priority to the targeted training of basic and advanced financial management.

Limited Understanding of Billing and Invoicing Procedures

Numerous enterprises especially micro and informal businesses are not using standard billing systems and as a result, their revenues are not tracked consistently and they are faced with administrative inefficiencies. Weak invoicing practices can also be the cause of delayed payments from clients; thus, businesses' cash flows get strained and their capacity to comply with formal supply chain requirements becomes limited. If SMEs want to have contracts with the government or private corporations, then following the proper invoicing standards is a must and at the same time, a lot of them do not have the systems, software, or administrative capacities needed to meet such requirements.

Though South Africa has put in place a good policy base and built a far-reaching institutional ecosystem for SME development, major obstacles are still present that hamper the performance of SMEs, especially in areas like the Free State. These barriers are of the kind: structural, financial, technological, and administrative. Their mere survival suggests that besides policy reforms, capacity development, and targeted interventions will be necessary for small and medium-sized enterprises (SMEs) to become engines of inclusive economic growth.

Theoretical Framework

The Financing Issues Faced by SME are Explained by Several Theoretical Models:

Information Asymmetry Theory
This theory discusses the situation where the bank does not have all the information compared to the customer. As a result, banks find it difficult to evaluate risks because SMEs hardly provide them with complete financial records. This leads to credit rationing [41,42].

Pecking Order Theory
Due to the expensive nature of an

external source of finance and the barriers which come with it, SMEs always look for an internal source of finance. When a company has already used up all its internal sources, it gets a loan, and it is only in a very desperate situation that it decides to issue equity [41,43].

Credit Rationing Theory Based on the explanation of the authors, even if some companies are creditworthy, banks still limit credit to small and medium-sized enterprises due to their high level of uncertainty, lack of sufficient collateral, and being considered risky [44].

Resource-Based View (RBV) Small and medium enterprises have to be equipped with financial, human, and technological resources to be able to get a competitive advantage. Unfortunately, the financial constraints have put them in a position where they cannot get these resources which in turn has caused their performance level to drop [45].

These theories, in sum, highlight the reasons that such financial barriers have been a continuous feature of the SME sector and how these barriers have affected business performance.

Empirical Studies Review

The constraints to finance have been empirically confirmed to be the primary cause of the growth of SMEs in the developing world. The studies in South Africa reveal that SMEs encounter problems in accessing external finance due to high-interest rates, strict collateral requirements, and the complexity of administration [46]. The pattern found in the local studies is also confirmed by the international ones, where SMEs are reported to have difficulties in meeting the documentation requirements set by financial institutions [47,48]. The main reasons for loan rejections continue to be unsteady income sources and the lack of business records. Furthermore, studies disclose that enterprises in rural or township areas have to overcome more difficult challenges that result from their location, which, combined with the unregistered nature of their operations, lack of infrastructure, and scarceness of financial education, create a difficult environment for them to survive and grow [39]. How financial literacy, digitalization and funding access interact for South African SMEs.

There is an increasing number of empirical pieces of literature, which show that financial literacy and digitalization are two separate factors that, jointly, they have a significant effect on the access of formal funding of SMEs in South Africa. Three interacting mechanisms that are discussed in studies and reports are present:

- Credit readiness and signalling,
- Alternative data and credit scoring,
- Administrative efficiency and financial management, all of which determine lender willingness and SME ability to obtain finance [26].

Financial literacy improves credit readiness and serves as a mediator in the link between finance and performance. One of the most important findings made by a number of empirical studies is that financial literacy of SME owners is strongly and positively related to the access to finance and firm performance when the finance is obtained. Quantitative surveys employing

hierarchical regression demonstrate that financial literacy has not only a direct positive impact on the performance of SMEs but also moderates the relationship between access to finance and firm outcomes, i.e., firms with higher financial literacy convert finance into productive investment and repayment capacity more effectively than their illiterate counterparts. The research conducted at the level of different municipalities and provinces (Ekurhuleni; Umgungundlovu) also finds that there is a strong positive correlation between the owners' skills in bookkeeping, budgeting and costing and the banks' readiness to provide loans. These results suggest that financial literacy enhances both the demand-side readiness (better applications, realistic projections) and supply-side confidence (lower perceived borrower risk), thus leading to better funding outcomes..

Digitalization Generates New Data that are up-to-date and can be Readily Used by Lenders to Underwrite Small Loans

Various reports at the macro-level and sector analyses reveal that digital payment flows, mobile transaction histories, telco and utility records, and supplier/buyer platform data are being increasingly referred to as alternative credit signaling sources for SME lending. The Fin find SA MSME Access to Finance Report uncovers that digital payment histories and telecommunication usage data are two significant instruments, which can warmly welcome the funding decision process by opening the door to scoring of businesses, which were formerly unbanked or informally banked [26]. Similarly, in sub-Saharan Africa as well as globally, research findings reveal that the adoption of digital tools (mobile money, digital invoicing, e-commerce receipts) greatly facilitate the overcoming of information asymmetry and thus the credit decision process takes less time, the however, the country specifics have an impact. In the case of South Africa, formal banking may be comparatively well-covered but many micro and township firms are still operating informally hence digital footprints offer a supplementary way for such marginalized SMEs to access formal credit.

Financial Literacy and Digitalization: Mutually Supportive Effects on Fundability

Research findings suggest that the use of digital means for business transactions can only go so far in facilitating the loan underwriting process if the businesses in question also carry out the accounting and data interpretation activities in the correct manner itself. An entrepreneur's financial literacy greatly enhances his/her ability to effectively utilize digital tools (such as e-invoicing, accounting apps), to keep good records and to be able to give a logical explanation of the inflow and outflow of his/her business to the lender - thereby making digital data a much better source for lenders when approaching a decision. On the other hand, digitalization intensifies the benefits of financial literacy as more literate business owners can use the software for better managerial tasks (improved forecasting, automated invoicing) and are thus able to provide stronger repayment profiles. The research from several South African case and survey studies reveals that the co- existence of digital bookkeeping and basic financial skills in an SME greatly increases the chance of getting working capital, and growth loans as compared to the SMEs that are only strong in one of the two aspects.

Evidence on alternative lenders and fintech: faster but mixed on affordability.
Evidence from the fintech experiments

and lender panels points to digital lenders and providers of alternative financing as rapid access expanders by employing non-traditional data (platform receipts, mobile money flows). Nevertheless, there is variation in pricing, transparency and sustainability; as some digital products have higher effective costs which can diminish the benefits of access if they are used for a long period. Specific South African reports put great emphasis on the point that while fintech can be a great tool for facilitating inclusion, it still needs to be regulated and coupled with literacy training in order to avoid the occurrence of over-indebtedness that will be harmful and also ensure that the funds are invested in the most productive way.

Quantitative Magnitudes and Patterns (What the Data Say)

Access to finance is regularly ranked by various national and sectoral diagnostic studies among the top five most severe constraints for SMEs in the respective countries. Based on survey-oriented research, it is found that Small and Medium-sized Enterprises (SMEs) with owners having basic financial literacy are by a significant statistical margin more likely to get bank loans and to use them for business growth; the effect sizes are different for various samples and measures but are consistent across several studies conducted in South Africa. According to the access to finance dataset of Fin find 2025, the time needed for underwriting approvals is greatly reduced if digital transaction data are available and at the same time, the risk scores get better, thus increasing the likelihood of funding especially for micro and small firms that are without the conventional collateral. Remaining empirical gaps and causality caveats.

Most South African research works are based on cross-sectional surveys, which point out relationships more definitely than cause-effect directions. A lesser number of panel or experimental interventions (financial literacy training and digital tools) would be able to show the causal magnitudes more clearly. However, the combination of results from surveys, lender datasets, and fintech pilots offers a consistent empirical argument for the interdependent roles of literacy and digital data in facilitating access to finance that is responsible and less risky.

Policy Implications Grounded in Evidence

Empirical evidence points to the necessity of implementing three priority actions:

- Promoting financial literacy programmes to a great number of SME owners with a follow-up linkage to simple digital accounting tools;
- Implementing open-finance and secure data-sharing frameworks that allow the use of alternative data in credit scoring while ensuring privacy and confidentiality;
- Implementing a literacy and consumer-protection programme together with the digital lending products so that workers can make good use of the loans and prevent the problem of over-indebtedness.

Summary of Literature Gaps

Regardless of numerous research works on the issue of the financing of small and medium enterprises, a couple of discrepancies have been found: Firstly, sharply only handful of papers were written that concentrates only on the Free State Province while it has different socio-economic conditions. The absence of such research spurs the need to study the financial

constraints of SMEs in the Free State province more thoroughly.

Research Methodology

Introduction

This chapter depicts the financial constraints methodological approach that was adopted to understand the impact of financial constraints on the performance of SMEs in the Free State Province. It features the research design, population, sampling techniques, sample size, data collection instruments, data analysis procedures, and ethical considerations, which served as the guiding framework for this study. The selected methodology shows how the research objectives and questions were addressed in a systematic and rigorous manner.

Research Design

The study used a quantitative design, and the qualitative information obtained from the semi-structured interviews was used as a supplement. The quantitative approach was suitable because it enabled the researcher to assess the relationships between the variables, verify the hypotheses, and perform the numerical data analysis on a large scale in a neutral way. Quantitative designs are appropriate when the aim is to find the patterns, establish correlations, and draw generalizable conclusions about the challenges and performance of SMEs. Moreover, semi-structured interviews were held with government agencies and SME support organizations.

The qualitative part of this research helped to get a deeper understanding of the policy effectiveness and the challenges of institutional support. These two ways combined research gave a comprehensive picture of financial constraints faced by SMEs in the Free State.

Population and Sampling Techniques

The population of the study was small and medium-sized enterprises that are operating in the three main areas of the Free State Province:

- Bloemfontein
- Botshabelo
- Thaba 'Nchu

The areas represented the Free State provincial urban, peri-urban, and semi-rural communities and were selected on the basis of their vibrant SME sectors. Sampling Techniques

Two methods for sampling were employed:

- **Stratified Random Sampling:** By means of this method, SMEs from different regions and ownership groups were represented. Stratification lowered the chance of sampling bias and guaranteed that representation was proportional.
- **Snowball Sampling:** It was utilized for contacting unregistered, foreign-owned, or informal SMEs that are usually neglected in the creation of official databases. These businesses make up a significant portion of the Free State SME sector and were therefore critical for representativeness. Through this dual strategy, the researchers achieved better inclusiveness and the findings' validity was strengthened.
- **Sample Size Determination:** Altogether, 500 SME owners and managers have contributed in the research. The sample size was determined by using formula for large populations,

which provides statistically reliable estimates for a population size of more than 10,000. Cochran's Formula:

$$n_0 = \frac{Z^2 p(1-p)}{e^2}$$

Where:

- ($Z = 1.96$) (95% confidence level)
- ($p = 0.5$) (maximum variability)
- ($e = 0.05$) (5% margin of error)

Calculation:

$$n_0 = \frac{(1.96)^2 (0.5) (0.5)}{(0.05)^2} = 384.16$$

At least 384 respondents were necessary. To be able to account for non-response, missing data, and incomplete questionnaires, the sample was increased by 25% thus: $384 + (0.25 \times 384) = 480$ So, there were 500 respondents after rounding, hence, the statistical power was sufficiently strong.

Sample Distribution

The 500 surveys were distributed as follows:

- Bloemfontein: 300 (60%)
- Botshabelo: 125 (25%)
- Thaba 'Nchu: 75 (15%)

This distribution reflects the relative SME concentration in each area.

Data Collection Instruments

Two Significant Instruments were Involved:

• Self-Administered Questionnaire

This survey comprised 25 structured items in two sections:
Section A: SME background and demographic information
Section B: Operational characteristics, financial constraints, performance indicators, and access-to-finance experiences
Surveys were handed out face to face and via the internet to SME owners and managers.

• Semi-Structured Interviews

Interviews were held with the representatives from:

- Government departments
- SME development agencies
- Financial support institutions

These conversations offered qualitative insight into policy implementation, funding challenges, and the institutional perspective.

Data Analysis Methods

Quantitative data from the surveys were examined using statistical software (SPSS/Excel) to:

- Produce descriptive statistics
- Recognize trends and patterns
- Determine relationships between variables

Investigate the Influence of Financial Constraints on SME Performance

The answers to the interviews were subjected to thematic analysis, a method that helped to find most talked- about subjects that concerned government support, policy implementation, and institutional challenges. The employment of both quantitative and qualitative analysis broadened the findings and gave support to triangulation.

Ethical Considerations

Moral principles in the research procedure were observed carefully in order to guarantee the safety of the participants and the honesty of the research.

Main Ethical Steps:

Voluntary participation: Participants’ received information about the purpose of the research and agreed to participate of their own free will.

Confidentiality and anonymity: No details that could identify individuals were given, and the confidentiality of the data was preserved.

Informed consent: Participants were given information about the research and they signed consent forms. There were no incentives or penalties: Participating in the study did not come with any material or social benefits.

Objective Analysis:

Information was analyzed without bias and the reports were honest.

Accountability in Data Management:

Data that could identify the participants were stored and used only for the purpose of this research.

Results

Introduction

This chapter illustrates the findings of the research conducted on the basis of 500 returned questionnaires from SMEs located in Bloemfontein, Botshabelo, and Thaba 'Nchu. The focus of the findings is on the demographic profiles of the respondents, the nature of their businesses, financial constraints experienced, and performance levels. The results section further points out to what extent the respondents had access to financial support and depicts the relationship between financial constraints and SME performance.

Data Presentation

Respondent Distribution by Area

Five Hundred owners and bosses of Small and Medium Enterprises (SMEs) have answered the surveys and contributed in the research:

- Bloemfontein: 300 (60%)
- Botshabelo: 125 (25%) • Thaba 'Nchu: 75 (15%)

This allocation mirrors the relative concentration of SMEs in Free State Province.

Respondent Distribution by Business Type

The sample of SMEs covered the diverse range of business sectors. Respondent claimed that they were involved in the following industries: retail, fashion, catering, construction, automotive services, technology, beauty services, and small-scale manufacturing.

Respondents operated the following number of business types:

Business Type	% of SMEs
Retail and General Trading	35%

Catering and Hospitality	20%
Fashion and Textile	15%
Beauty and Personal Care	10%
Construction and Maintenance	8%
ICT and Digital Services	6%
Other Mixed Sector)	6%

The diversity of business types shows that financial constraints affect SMEs across multiple sectors.

Years in Operation

Respondent’s also varied in the number of years their business had been in operation:

- Under 2 years: 30%
- 2–5 years: 40%
- 6–10 years: 20%
- More than 10 years: 10%

It appeared that a large number of SMEs were at the very beginning of their business journey, and this may have an impact on their capability of obtaining financing

Sources of Startup Capital

Respondents used the following sources to start their businesses:

Source of Capital	% of SMEs
Personal savings	70%
Family/friend contributions	15%
Bank loans	5%
Government funding	4%
Non-governmental organisations	3%
Other sources	3%

The figures illustrate that most people have turned to personal and informal sources for their needs, thus, the question of formal financing interventions remains open.

Key Findings

SME Satisfaction with Sales Growth (3-Year Period)

Respondents assessed their satisfaction level concerning the increase in sales that took place during the last 3 years.

Sales Growth Satisfaction	% of SMEs
Very satisfied	10%
Satisfied	20%
Neutral	30%
Dissatisfied	25%
Very dissatisfied	15%

Approximately 40% of SMEs testified dissatisfaction with their sales growth, signifying a declining revenue environment for many businesses.

SME Satisfaction with Profitability (3-Year Period)

Profitability Satisfaction	% of SMEs
Very satisfied	12%

Satisfied	18%
Neutral	28%
Dissatisfied	25%
Very dissatisfied	17%

A collective 42% expressed dissatisfaction with profitability, signifying strong financial pressures.

SME Overall Performance Satisfaction

Performance Rating	% of SMEs
Very good	8%
Good	22%
Average	35%
Poor	20%
Very poor	15%

The largest part of those surveyed judged their activities to be of an average level or even worse and thus SMEs are shown to have quite difficult situations in terms of keeping up stable growth.

Key Financial Constraints Identified

Respondents pointed to a number of money-related challenges that hinder the company's operations:

- No collateral
- Very high-interest rates
- Complicated procedures for submitting loan applications
- Lack of financial literacy
- Bad credit history
- Limited funding options
- Inadequate business records
- Long waiting periods for government funding
- Financial discrimination perception

Access to Financial Support

Respondents reported the following sources of financial assistance during operation:

Source of Support	% of SMEs
No support received	65%
Bank loans	10%
Government funding	8%
NGOs and development agencies	7%
Supplier credit	6%
Other sources	4%

The findings reveal that the majority of small and medium enterprises (SMEs) are without formal support, thereby pointing to the existence of a large accessibility gap.

Relationship Between Financial Constraints and SME Performance

The study established a negative correlation between financial constraints and the performance of small and medium enterprises (SMEs):

That were experiencing high financial constraints recorded low sales, low profitability, and slow growth. SMEs that were endowed with the financial support, business advisory services,

and credit facilities reported good performance.

Financial constraints were the main culprits that limited SMEs to:

Expanding operations investing in equipment and stock hiring additional employees innovating and competing participating in new markets. The interrelation highlighted here is that improving financial access for SMEs in the Free State Province is very crucial.

Discussion

Introduction

This chapter discusses the results outlined in Chapter 4, and it also links them with the previous works of other researchers. The discussion elucidates the financial problems that SMEs in the Free State Province encounter, the effects thereof on business performance, and the resulting impact on policy and economic development. The chapter further looks at whether the empirical findings confirm or contradict the previous studies and thus offer an understanding of the structural issues of SME finance.

Interpretation of Findings

Financial Constraints as a Major Barrier to SME Growth

The research reveals that most SMEs in the Free State depend on their personal savings and informal financing networks for funding. More than 70% of the respondents declared that they used their personal funds to start their businesses while only 5% were able to get bank loans. Hence, it is evident that formal financial institutions are still not accessible to SMEs. This corresponds with the views of Fatoki, Mutezo, and Herrington, who maintain that South African SMEs are confronted with obstacles that do not vanish over time, namely:

- Stringent collateral requirements
- High-interest rates
- Complicated loan application procedures
- Limited financial histories
- Being risky borrowers in the eyes of lenders

The barely noticeable utilization of government funds (4% for startups and 8% during operation) additionally points out that there are substantial gaps between policy intentions and real SME access.

Collateral and Risk Perception

Most of the respondents pointed to the collateral requirements as a significant source of their financial woes. This is in line with what Tale and Naumann found, i.e., the research that was done by these authors revealed that in most cases, the concerned SMEs do not have either movable or immovable assets demanded by lenders.

The Financial System in South Africa is Still Operating Under:

- Strict rules for collateral
- Credit-scoring models that are not suitable for SMEs
- Little if any flexibility for informal/township-based businesses

These limitations breathe life into the Information Asymmetry Theory, according to which financial institutions limit credit supply

when borrowers fail to provide adequate financial information or collateral. 1.2.3 Poor Financial Literacy and Recordkeeping

A considerable Proportion of the Surveyed SMEs Brought up Issues Related to:

- Insufficient business documentation
- Poorly developed administrative structures
- Lack of business skills and poor financial management

These points are corroborated by research works carried out by Maziriri and Mapuranga, Trust, and Shen et al., all of which argue that SMEs with poor financial recordkeeping are at a disadvantage when they try to secure loans because they are considered less creditworthy by financial institutions due to the lack of their financial records. This also agrees with the Resource-Based View (RBV), which is very specific about the importance of internal resources such as financial literacy in achieving a competitive advantage.

Business Performance Trends

The Research Findings Reveal that a Performance Level of the SMEs is from Moderate to Low:

- 40% were not satisfied with sales growth
- 42% were not satisfied with profitability
- 35% ranked their overall performance as mediocre

The financial constraints had been shown to negatively impact business performance indicators such as growth, profitability, and sustainability. This is in agreement with what Beck and have stated, that is to say, the lack of enough financial resources is the main factor that holds SMEs from making the following investments: buying new equipment, recruiting new staff, innovating, and expanding their markets.

Limited Government and Institutional Support

Even though there are support agencies in South Africa like Seda, NYDA, SEFA, and provincial development corporations the respondents reported that there was little financial support.

The research reveals that:

- 65% of SMEs did not get any kind of financial support
- Only 8% had access to government funding
- Application procedures were considered as being slow and difficult

These Revelations Raise Significant Questions About:

- Inefficiencies in bureaucracy
- Poor communication between agencies and SMEs
- Lack of sufficient support for enterprises in townships and rural areas
- Mismatch between policy objectives and practical results

This confirms the findings of who, in their reports, point to the steady gaps in the implementation of policies and in the engagement of SMEs. 1.2.6 Influence of Location, Age, and Size

The research findings point out that small and medium enterprises situated in urban areas (Bloemfontein) had somewhat better access to finance as compared to those located in Botshabelo and Thaba 'Nchu. The findings also corroborate those of, who found that the financial institutions and support services are more readily available to urban SMEs than to their rural counterparts.

Besides that: older SMEs had fewer financial constraints larger SMEs had a higher probability of getting finance than smaller ones. These results are in line with the views of who argue that credit histories of SMEs at advanced life-cycle stages are stronger and thus lenders have more confidence in them.

Policy and Practice Implications

The findings suggest a number of changes in policy and practice:

Strengthening SME Access to Finance

Policies Need to be Changed so as to Make it Possible for SMEs to:

- Use more flexible collateral models
- Be scored by alternative credit scoring systems
- Use lending platforms that are digital
- Have procedures for loans that are simplified

To broaden the support for SMEs, the hybrid funding models combining public and private financing should be considered.

Enhancing Financial Literacy and Managerial Skills

Training programs ought to be introduced so as to be able to uplift the capabilities of SME owners with respect to:

- Keeping accounts
- Financial planning
- Budgeting
- Knowledge of credit terms
- Compliance with lending requirements

This will lessen information asymmetry and raise the chances of success in loan applications.

Improving Government Support Systems the Government Institutions Should:

- Make funding application steps more user-friendly
- Lessen requirements for the paperwork
- Extend their activities to the businesses of townships
- Use digital platforms for loan management
- Regularly assess and analyze support programmes

Good coordination among government, banks, and SMEs plays a vital role in lessening the administrative obstacles.

Expanding Access Through Alternative Funding Models By Means of Such Alternatives as:

- Microfinance
- Fintech solutions
- Cooperative lending
- Peer-to-peer lending
- Supplier credit
- Venture capital

Situation will change for the better in terms of new opportunities for those SMEs that are not able to satisfy the bank criteria of the traditional type.

Comparative Analysis with Literature

This study confirms trends observed in local and international research:

Study Finding	Consistency with Literature
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Financial constraints are the main barrier	Matches Beck & Demirguc-Kunt (2006), Smit & Watkins (2012)
SMEs rely on personal savings	Matches Fin find (2018), Mutezo (2015)
Government funding is underutilised	Matches Bankseta (2011), Mail & Guardian (2013)
SME performance is negatively affected by financing gaps	Matches Fafchamps & Schündeln (2013), Rahman et al. (2016)
Urban SMEs access more support than rural ones	Matches Kira (2015), Mahloana (2019)

Thus, the study supports most of the previously conducted research while indicating the new aspects of hybrid funding and SME-specific barriers in the Free State Province.

Conclusion and Recommendations

Introduction

This chapter outlines the conclusions that the study results permit and provides feasible suggestions aimed at lessening financial constraints which, in turn, are the primary factors leading to the inefficient performance of SMEs in the Free State Province.. In addition, the chapter features the suggestions for further research. It is based on the major findings of the study in relation to the research objectives and provides valuable insights to the policy makers, financial institutions, support agencies, and SME practitioners.

Summary of Findings

This research was aimed at figuring out how the financial constraints influence the performance of SMEs that operate in Bloemfontein, Botshabelo, and Thaba 'Nchu. The results expose the multitude of the challenges which the SMEs face in obtaining finance, running the businesses, and making their growth sustainable.

The Key Findings are:

- Financial Constraints Are the Primary Barrier to SME Growth It has been found that most SMEs are funded mainly through personal savings (70%) and informal sources of funding. Merely 5% of them got bank loans for the initial capital, which, thus, reveals a considerable gap between formal financing and accessibility.
- Collateral Requirements and Risk Perception Limit Access to Credit. The people who answered the questions pointed out that the main obstacles to getting loans for them are the problems with collateral, the strict conditions for getting loans, and high-interest rates. Such obstacles have been in line with the problems addressed by the previous studies, which have long been known.
- Financial Literacy and Recordkeeping Are Weak. In numerous SMEs there is no proper documentation of business processes and the management of finances due to which businesses find it hard to apply for credit and sometimes such applications end in rejection. The reason for poor recordkeeping is still the major factor that limits the accessibility of finance.
- Government and Institutional Support Remains Limited

- while there are many institutions in South Africa that support SMEs, only 8% of them claimed that they had gotten government funds. As much as 65% affirmed that they had never received any financial support, thus, showing that there is a big gap between the policy and its implementation.
- SME Performance Is Negatively Affected The growth of sales, profitability, and, in general, performance have been found to be at moderate or low levels. SMEs that have limited access to finance have shown weaker performances.
 - Location, Age, and Size Influence Financial Access Urban SMEs, older enterprises, and larger SMEs were more likely to secure financing than rural/township SMEs, younger businesses, and micro-enterprises.

Recommendations as a result of the survey, the following suggestions have been made:

Recommendations for SMEs

Strengthen Financial Management Practices SMEs are Expected to:

- put in practice the fundamental accounting systems
- keep accurate financial records
- carry out budgeting and cash-flow monitoring
- enrol for a financial literacy course

Good financial management will make it easier for loan approval to be granted.

Improve Compliance and Documentation SMEs Should Make Sure that:

- They have updated business registration documents
- Tax clearance certificates are up to date
- Financial statements are current

Compliance lowers the risk that lenders perceive.

Explore Alternative Financing SMEs Should not Only Bank on Regular Bank Loans but also Consider-Financing from:

- Microfinance institutions
- Cooperatives
- Supplier credit
- Crowd funding
- Finch lending

These alternatives may provide more relaxed terms of loans.

Recommendations for Financial Institutions

Adjust Collateral Requirements Lenders Need to Look into:

- Movable asset registers
- Cash-flow-based lending models
- Risk-based pricing that is adjusted for SMEs

This would work to lessen the barriers that are unnecessary for SMEs that do not have physical collateral.

Simplify Application Processes Loan Applications Tought to be:

- simplified
- digitized
- Less document-intensive

The simplified processes would facilitate more accessibility and a decrease in the cases where loans are rejected.

Develop SME-Focused Credit Scoring Models what banks can do is to use credit-scoring tools that are made especially for small businesses. And one of the ways is, by introducing the use

of non-conventional data, like:

- Transaction history
- Mobile money usage
- Digital sales data

These new tools can be more accurate in approving the loans.

Recommendations for Government and SME Support Agencies

Increase Funding Access and Expand Support Programmes the government should:

- extend the facilities for grants and loans
- launch SME funding programs that are specific for provinces
- initiate the hybrid financing systems for the public and private sectors

Strengthen Capacity-Building Initiatives Training Should be Provided in:

- Financial literacy
- Business planning
- Recordkeeping
- Digital skills

Improve Policy Implementation The policies ought to be:

- checked regularly
- changed depending on effects
- being in line with the problems of the township/rural areas

Digitalise SME Support Services Government departments should:

- set up online application portals
- cut down on the paperwork

By integrating the databases of different support institutions. Digitalisation will be helpful in cutting down the waiting time as well as in promoting openness.

Recommendations for Future Research These Topics Deserve Further Research:

- Financing of SMEs in different provinces: a comparative study.
- Lengthy term studies on the influence of financial assistance on SME growth.
- The contribution of digital lending platforms and fintech resolutions in making finance more accessible.
- Hybrid funding models that combine the public and private support systems.
- Detailed qualitative research on the everyday life challenges of township-based SMEs.

Conclusion

The research at hand concludes that financial constraints have a significant impact on the performance of SMEs in the Free State Province. SMEs are still struggling to get formal financing because of reasons like the requirement for collateral, bureaucratic obstacles, financial illiteracy, and lack of institutional support. Their turnover has gone down, their net income has decreased, and their development has been stagnant due to the limitations they have imposed on themselves. Therefore, solving the problems of these enterprises would need a collaborative work of SMEs, banks, government agencies, and support organizations. The financial environment will be

strengthened to be able to support SME development, to bring about economic growth, and to make people's lives better in the Free State Province and beyond if the recommendations outlined above are put into practice [49-55].

Declaration

“The Influence of Financial Constraints on SME Performance: A Survey of SMEs’ Struggles in the Free State Province, South Africa” Is my own original work. It has not been submitted to any other institution for any degree or qualification further confirm that I have fully complied with the ethical standard of academic research, and that I have given due regard to the principles of confidentiality, voluntary participation, and impartial data collection.

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Dedication

This research is devoted to my family, whose unwavering support, love, and reinforcement were the core reasons of this accomplishment.

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