

# FINANCIAL BOOTSTRAPPING AND THE SMALL BUSINESS SECTOR IN A DEVELOPING ECONOMY

Bonginkosi Keith Zwane\*, Celani John Nyide\*\*

\*Department of Accounting, Mangosuthu University of Technology, South Africa

\*\*Department of Finance and Information Management, Durban University of Technology, South Africa

## Abstract

The assumption in academic literature and public debate is that lack of financial resources generally restrains small businesses' development and growth. With the constraints that small businesses face to access outside funding, there is a need to investigate bootstrapping as a means of obtaining resources which will lead to a reduction in the need for outside financing. The challenge facing small businesses in terms of obtaining finance from traditional sources has necessitated this study. A sample was chosen on a non-probability basis using convenience sampling of small business owners within the eThekweni Municipality, KwaZulu-Natal, South Africa. 83 participants completed the questionnaire. The data collected was analysed using descriptive and inferential statistics. The findings regarding awareness of financial bootstrapping as a source of funding remains unknown. The evidence in the study shows that a number of respondents unknowingly used some of the bootstrapping methods.

**Keywords:** Developing Economy, Financial Bootstrapping, Funding, Methods of Bootstrapping, Small Business Sector

## 1. INTRODUCTION

Research maintains that Small Medium and Micro Enterprises (SMMEs) have a key role to play in creating employment, fighting poverty and boosting economic growth and development (Cant and Wiid, 2013). South Africa, as a developing country, should not overlook the importance of promoting, nurturing and supporting small businesses (Cant, Erdis and Sephapo, 2014). The national and international literature and research on SMMEs has been developed very strongly in the last decade and there have been many successful attempts on the part of many researchers and scholars to unpack new and innovative dimensions of their operations, behaviour, attitudes, functions and other dynamics that boost, sustain or impede their growth and development (Lekhanya, 2015; Cant et al., 2014; Visser and Chiloane-Tsoka, 2014). After a thorough literature review on the problem, it has been established that there is a serious gap in the research, and hence general knowledge, regarding a very distinct practice within SMMEs internationally, that of bootstrapping. While there are general, particular and sectoral case studies on the issue internationally there is a serious paucity of studies associated with actual ideas, perceptions and attitudes of SMMEs and other stakeholders in South Africa. The present study is the first step in trying to fill this gap.

## 2. PROBLEM STATEMENT

South Africa has a large number of people who wish to become entrepreneurs and the demand for start-

up capital is very high (Marivate, 2014). A frequently cited challenge to new entrepreneurs in South Africa is a lack of start-up finance and development finance for new ventures (Cant et al., 2014; Marivate, 2014; Tustin, 2015). The major constraint is the access to the institutions in the economy that are established to provide such funds. Many businesses start up and as soon as they start too many close down (Cant and Wiid, 2013). With the advent of democracy in South Africa and globalisation, entrepreneurship, with its manifestation in the small business sector, has become a vehicle that could be used to promote economic liberation amongst ordinary South Africans (Lakhanya, 2015). It is important therefore to investigate alternatives of funding start-ups so that these economic realities may be realised. The success of the small business sector will contribute towards the social problems of South Africa that is the reduction of unemployment and increased productivity.

## 3. AIM AND OBJECTIVES

### 3.1. Aim

The main aim of this study is to investigate the use of financial bootstrapping by the small business sector in South Africa, as an alternative funding strategy.

### 3.2. Objectives

In order to address the aim of this study, the following objectives have been formulated:

- To investigate the awareness of financial bootstrapping as a means of financing the small business sector in South Africa.
- To identify financial bootstrapping methods used by the small business sector in South Africa.

#### 4. LITERATURE REVIEW

##### 4.1. Bootstrapping defined

As a point of departure it is important to identify and define financial bootstrapping, as a phenomenon. According to (Tomory, 2010) bootstrapping could be defined as highly creative ways of acquiring the use of resources without borrowing money or raising equity financing from traditional sources. According to Schofield (2015), bootstrapping allows small business owners to create new financial resources or stretch existing resources without using debt, a venture capitalist, or other external means to attain required capital. Van Auken and Neeley (2010) further refined the definition of bootstrap financing to include those sources of capital used after exhausting personal savings, but not personal capital or loans from banks. The definition of financial bootstrapping adopted for this study is “the use of highly creative ways for meeting the need for resources without relying on long-term external finance from debt holders and/or new owners” (Vanacker and Sels, 2009).

##### 4.2. Background to financial bootstrapping

Several studies have referred to the financial gap facing small businesses, in terms of problems in attracting long-term finance from market players such as banks, and venture capital companies (Fakoti, 2014; Lekhanya, 2015; Schofield, 2015). The underlying assumption in the research and the public debate is that financial problems generally restrain small businesses’ development and growth (Tomory, 2010; Afolabi, Odebumni and Ayo-Oyebiyi, 2014). With the constraints that small businesses face to access outside funding there is a compelling need to investigate bootstrapping or other methods for obtaining resources that collectively reduce the need for outside financing (Van Auken, 2004) cited in (Afolabi et al., 2014). It is often assumed that small business owners try to raise large sums of money from banks and venture capital companies (Daniel, Di Domenico and Sharma, 2015).

It has been stated that much research on small business finance has focused on constraints in the supply of institutional finance, whereas the handling of financial needs at the demand side (i.e., the small business manager’s perspective) has been given much less attention (Afolabi et al., 2014). There is general agreement in entrepreneurship studies to date that a number of small businesses utilize bootstrapping to some extent and that its use is not only prevalent to new businesses (Schofield, 2015). Despite the wide use of bootstrapping in practice there is a gap in the entrepreneurship literature on this particular practice, as the emphasis is still placed on other forms of business financing such as

venture capital and angel financing (Daniel et al., 2015). The scarcity of scholarly research on bootstrapping demonstrates that the finance and entrepreneurship academic community has not fully recognized the significance of the topic (Tomory, 2010). It is important to therefore formulate further research questions that must be addressed in the South African small business context, where not much literature exists on bootstrapping compared to the European and American context.

##### 4.3. Reasons for the use of bootstrapping

According to Herrington, Kew, and Kew (2009), starting and growing a business is fraught with difficulties - it is like trying to manoeuvre through quicksand or over a minefield. Raising funds for a new business or a start-up is a process riddled with challenges. There are various sources of finance that entrepreneurs may prefer, ranging from equity sources such as venture capital and angel capital and debt finance from banks or micro finance institutions (Marivate, 2014). Lack of funding or access to finance is regarded as a major inhibitor to business growth and development (Fatoki, 2014). New small business owners are often unable to access finance from outside sources of finance such as banks and venture capitalists. Therefore, bootstrapping is often characterized as a means to an end when other traditional sources do not exist.

It has long been known that outside debt and equity financing for small businesses is difficult to obtain, expensive, and often undesirable for personal reasons (Cassar, 2004). The financial gap for small businesses can be explained by the information asymmetry between external financiers and small business managers (Winborg and Landstrom 2001, Herrington et al., 2009). Small business owners have superior information and knowledge regarding the potential of their own ventures. In cases such as in new innovative businesses and start-ups, it can be a challenge for the business owners or managers to articulate and to give as detailed information about the business as outside funders or financiers may require. Small business owners or managers may be restrictive when it comes to providing external financiers with detailed information about the core of the business, since trade secrets, in one way or another, may leak through to competitors (Winborg and Landstrom, 2001). This places difficulties on the financiers in finding the information they require in order to make available funding, and as a consequence they experience great uncertainty.

According to Fakoti (2014) many small businesses are unlikely candidates for venture capital or angel investments given the amounts of capital needed and growth potential thus leaving them with fewer options for raising money. Even those small businesses that can be potential candidates for private equity such as venture and angel capital may be challenging as small business owners or managers are not experienced in raising finance externally (Lekhanya, 2015).

#### 4.4. Groups of financial bootstrapping methods

In order to overcome the lack of finance means, it is necessary and desirable that small business founders are made aware of other methods of financing that minimize the need for outside or debt financing. This can be achieved by securing resources at little or no cost, and by creatively acquiring resources without using debt financing and/or equity (Helleboogh, Laveren and Lybaert, 2010).

This section of the review will explore the different techniques or methods of financial

bootstrapping. The pioneering study by Winborg and Landstrom (2001) and Tommory (2010) identified 32 methods of bootstrapping as illustrated in Table 1. These methods were categorized into those that are used for capital minimization and those intended to meet the need for capital. The literature review shows that these individual methods can be grouped together. According to Helleboogh et al. (2010), where at least four types of methods were identified that can be used to bootstrap ventures, these were based on the pioneering study on financial bootstrapping in Sweden (Winborg and Landstrom, 2001).

**Table 1.** Methods of bootstrapping

<b>Owner financing methods</b>
Withholding manager's salary for shorter/longer periods
Use of managers private credit card for business expenses
Obtain capital via manager's assignments in other businesses
Obtain loans from relative/friends
Employ relative and/or friends at non-market salary
Run the business completely in the home
<b>Minimization of accounts receivables (customer related)</b>
Use interest on overdue payment from customers
Use routines in order to speed up invoicing
Offer same conditions to all customers
Offer customers discounts if paying cash
Cease business relations with customers frequently paying late
Deliberately choose customers who pay quickly
<b>Joint utilization</b>
Share equipment with other businesses
Share employees with other businesses
Share premises with others
Borrow equipment from other businesses for shorter periods
<b>Delaying payments</b>
Deliberately delay payment to supplier/s
Lease equipment instead of buying
Deliberately delay payment of value-added tax
Buy used equipment instead of new
Hire temporary personnel instead of employing permanent
<b>Minimization of capital invested in stock</b>
Seek out best conditions possible with supplier/s
Use routines in order to minimize capital invested in stock
Co-ordinate purchases with other businesses
Buy on consignment from supplier/s
Practice barter instead of buying/selling goods
<b>Subsidy finance</b>
Obtain Subsidy from County Labour Board
Obtain subsidy from Swedish National board for Industry and Technical Development
Obtain subsidy from County Administrative Board
Obtain subsidy from the Foundation Innovations centrum
Raise capital from a factoring business

Source: Tomory (2010)

The following categories were identified in the research:

- Customer-related methods,
- Owner-related financing and resources,
- Joint-utilization of resources with other ventures, and
- Delaying payments.
- Minimization of capital invested in stock
- Subsidy finance

##### 4.4.1. Customer-related methods

According to Helleboogh et al. (2010), "customer-related bootstrapping includes methods that improve cash flow from customers". These methods

would include ensuring that the business speeding-up invoicing to customers to allow for speedy payments. This allows the business to be funded using its own resources by improving their efficiencies or negotiating better with their customer so they will pay in advance for services and goods to be supplied. Winborg and Landstrom (2001) concede that obtaining advance payments improves the working capital of the business which in turn reduces the need for outside funding. The business may also explore granting cash discounts to customers in order to entice them to make cash payments instead of credit purchases. This would be favourable to the business as it improves the liquidity of the business and the cash position.

#### 4.4.2. Owner-related financing and resources

This group of methods regards the direct or indirect provision of resources from the owner or manager and relatives. According to Winborg and Landstrom (2001), these may include the manager or the owner working with assignments in other businesses, relatives of the manager or owner working for the business for no pay or at non-market rate. It may also include the use of the manager's or owner's private credit card or personal loans/debt for business expenses and purposes, and it may also include the withholding of the manager's or owner's salary and profits treating the business as an investment (Schofield, 2015). Fatoki (2014) asserts that more and more new businesses use the owners' personal credit card to finance operating expenses as it is easier for the owner to get a credit card from a bank than small business finance. A managers' or owner's salary from other operations may be used to finance the business. Another suggested approach to owner-related financing and resources is operating the business from the owners' home instead of separate premises (Daniel et al., 2015). The manager can also explore to use students or recent graduates for no cost in the business while they accumulate the know-how.

#### 4.4.3. Joint-utilization of resources with other ventures

According to Helleboogh et al. (2010) and Lam (2010), joint-utilisation of resources involves actions such as hiring temporary staff or outsourcing. The 'bootstrappers' using this method also make joint utilization of resources such as equipment, machinery and property. The study by Winborg and Landstrom (2001) revealed that business owners or managers initially had to share location, at a very low rental charge, with a friend who did not make full use of the space. Sharing of space rather than buying out or renting out own premises saves start up a lot of needed cash or funds. Winborg and Landstrom (2001) added that new businesses can use the equipment and machines of friends' businesses in the evenings at no or very little cost. New businesses can engage university students in projects related to their business idea. This allows businesses to obtain knowledge at no cost or minimal costs. Businesses can share employees too in order to minimize operational costs.

#### 4.4.4. Delaying payments

Delaying payments bootstrapping refers to methods that the managers or owners of business can negotiate with suppliers and lenders to make payments at later than usual dates (Lahm and Little 2005; Schofield, 2015). This method improves the cash flow position of the business by making payments at a later date, for example leasing

equipment where rentals can be paid on a quarterly or half yearly basis. Afolabi et al. (2015) add that delaying payments may also come in the form of postponing of payments such as value-added tax, where vendors or businesses can opt to pay value-added tax (VAT) on cash basis instead of an invoice basis. In terms of the Value Added Tax Act of 1991, cash basis means that the vendor will pay VAT once cash is received from customers or clients, whereas invoice basis means VAT is paid when an invoice is issued. The former would improve the cash flow position in that payment is deferred until cash is received compared to the latter.

#### 4.4.5. Minimization of capital invested in stock

This group includes methods regarding the minimization of own resources invested in stock. For example, by using formal routines, the amount of capital invested in stock can be minimized, and by seeking the best conditions possible with the supplier it can be argued that the supplier, to a greater or lesser extent, actually finances the resources invested in the stock (Winborg and Landstrom, 2001). This method in the main include businesses to seek out best conditions possible from suppliers, co-ordinate purchases with other businesses (for bulk discounts), buy on consignment from suppliers and practice barter when buying or selling goods (Tomory, 2010).

#### 4.4.6. Subsidy finance

This group includes methods concerned with obtaining subsidies from the state organisations (Winborg and Landstrom, 2001). Schinck and Sarkar (2012) assert that over the years, firms have used and benefited from government subsidies which are assigned to specific businesses, under particular conditions.

### 5. RESEARCH METHODOLOGY

The research is confined to small business owners whose businesses operate within the eThekweni municipality, in KwaZulu-Natal, a province in South Africa. For the purposes of this study, small businesses are defined as "an enterprise which has 50 or fewer employees and/or annual turnover of between R200 000 and R32 million" (Timm, 2011). The target population consisted of all small business owners with businesses registered with the eThekweni Municipality's SMME Database. The sample size of 83 subjects was chosen on non-probability snowball sampling from the population. The study, then employed an electronic questionnaire as a research instrument. Closed - ended questions were developed from literature review as source of information for the questionnaire. The questionnaires were administered on the web through QuestionPro.

**Table 2.** Demographic profile of respondents.

	<i>Demographics</i>	<i>Percentage</i>
<i>Race</i>	African	84
	Indian	11
	White	5
	Coloured	0
<i>Years in business</i>	Less than 1 year	5
	1-5 years	57
	6-10 years	24
	11 years and over	14
<i>Number of employees</i>	0-5 employees	68
	6-10 employees	19
	11-49 employees	9
	50-199 employees	4
<i>Annual turnover</i>	Less than R150 000	42
	R150 000 – R500 000	25
	R500 000 – R2 000 000	20
	R2 000 000 – R20 000 000	13

**Table 3.** Summary of key questions

<i>Research area</i>	<i>Question</i>
Awareness of bootstrapping.	<p><b>Do you know what financial bootstrapping is?</b> Alternative response: 1. <i>Yes</i> 2. <i>No</i></p>
Financial bootstrapping methods.	<p><b>What methods have you used to finance your business?</b> Alternative response: 1. <i>Bank loan</i> 2. <i>Finance from business partners</i> 3. <i>Angel finance</i> 4. <i>Venture capital</i> 5. <i>Government funded business support agencies</i> 6. <i>None of the above</i></p> <p><b>Which of the following alternate methods do you use to finance your business?</b> Alternative response: 1. <i>Personal credit card</i> 2. <i>Withhold own salary</i> 3. <i>Withhold profit earned from the business</i> 4. <i>Loans from friend/ and family members</i> 5. <i>Employ relatives and/or friends at non-market salaries</i> 6. <i>Run business completely from home</i></p> <p><b>Which of the following do you practice)?</b> Alternative response: 1. <i>Share business premises with other businesses or people</i> 2. <i>Share equipment, plant, machinery business premises with other businesses or people</i> 3. <i>None of the above</i></p> <p><b>How many days do you take to pay your suppliers and creditors?</b> Alternative response: 1. <i>30 days</i> 2. <i>60 days</i> 3. <i>90 days</i> 4. <i>Other</i></p> <p><b>How many days on average do customers or clients take to pay you?</b> Alternative response: 1. <i>30 days</i> 2. <i>60 days</i> 3. <i>90 days</i> 4. <i>Other</i></p> <p><b>Do you require an initial deposit or upfront payment from customers before order or work is done?</b> Alternative response: 1. <i>Yes</i> 2. <i>No</i></p> <p><b>How do you acquire plant, machinery and equipment?</b> Alternative response: 1. <i>Buy</i> 2. <i>Lease (rent)</i></p>

The reliability of the questionnaire was evaluated based on the Cronbach's Coefficient Alpha as this measure has the most utility for rating scales.

The Cronbach's Coefficient Alpha coefficient for the rating scales used in the questionnaire was 0.791 which is shown in Table 4.

**Table 4.** Reliability Statistics using Cronbach's Coefficient Alpha

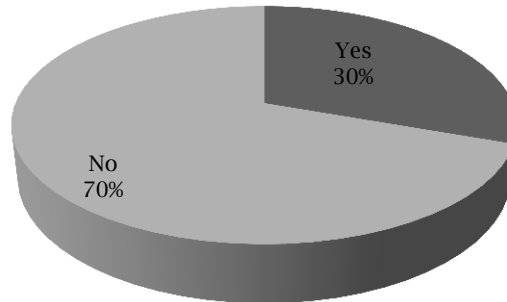
<i>Cronbach's Alpha</i>	<i>Cronbach's Alpha Based on Standardized Items</i>	<i>Number of Items</i>
0.791	0.721	8

A coefficient of 0.791 indicates that internal consistencies of the scale items have been satisfied and that the questionnaire was reliable. The data can therefore be used confidently for further analysis and interpretation.

**6. RESEARCH FINDINGS**

To investigate the respondents' awareness of financial bootstrapping as a means of financing small businesses, respondents were asked if they knew what financial bootstrapping was.

**Figure 1.** Awareness of financial bootstrapping



As illustrated in Figure 1, the majority of respondents did not know what financial bootstrapping was (69.6%) compared with those who indicated that they knew what it was (30.4%). The

findings of almost 70% of the respondents not being aware of financial bootstrapping is supported by other research (Afolabi et al., 2015; Fatoki, 2014).

**Figure 2.** Sources of business finance

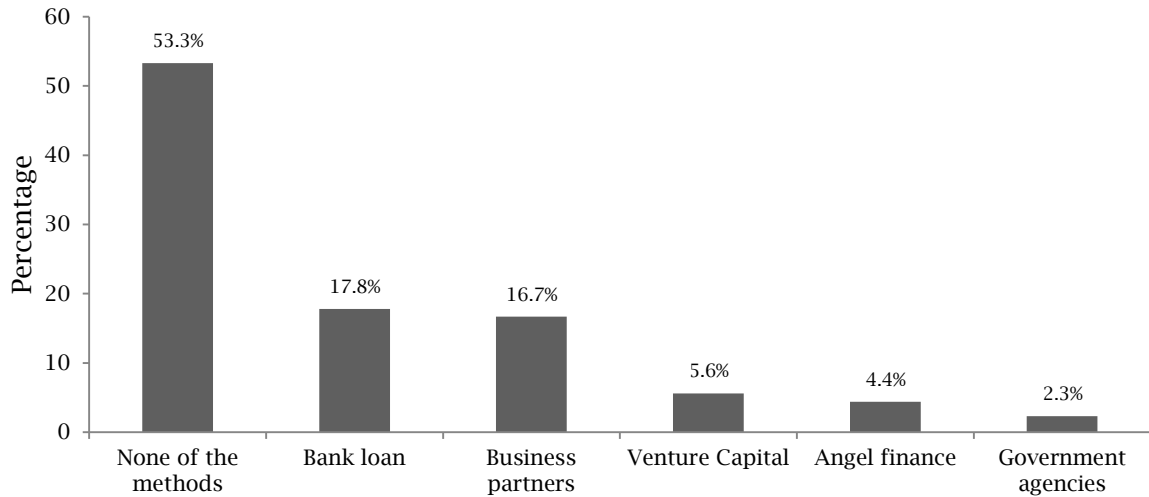


Figure 2 shows the responses from business owners when they were asked about their sources of financing start-up. The majority of respondents (53.3%) did not receive any outside finance to

support their introductory phase of the business. This illustrates that the businesses were financed by the owner's resources.

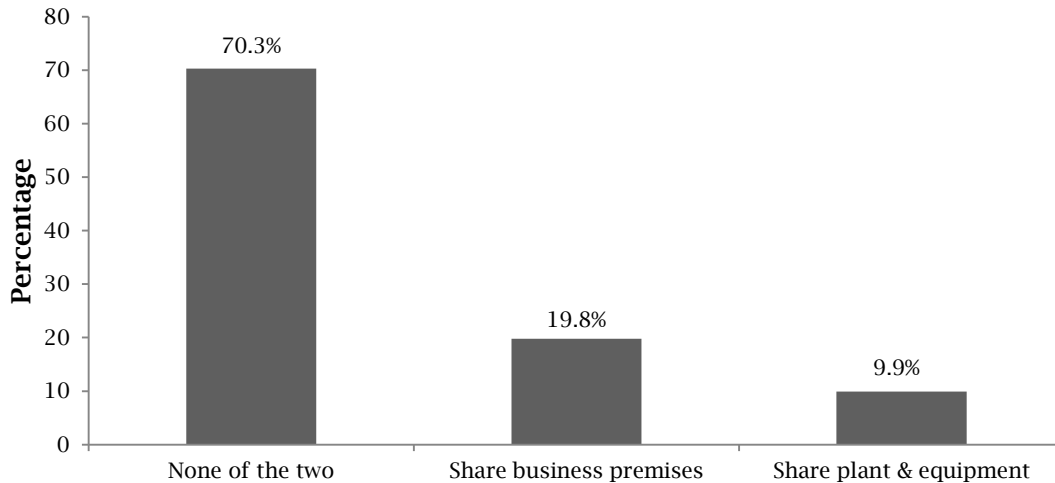
**Table 5.** Alternative methods used to finance business

<i>Alternate Financing Used</i>	<i>Percentage</i>
Withhold profit from business	24.0
Withhold own salary	20.9
Run business from home	16.6
Personal credit card	13.4
Loans from friends / family	12.8
Employ friends/relatives at below market rates	12.3

The respondents were given six methods to select from those methods that they practiced to finance their businesses. They had the option of selecting more than one or none if they did not use any of the listed choices. As shown in Table 4.4, it is evident that the respondents are using some of the bootstrapping methods. The majority of the

respondents (24.0%) withheld profits that they had earned from the business, 20.9% withheld their own salary, 16.6% ran their businesses completely from home, 13.4% used personal credit cards, 12.8% used loans from friends and family members and finally 12.3% of the respondents employed relatives and friends at below-market rates.

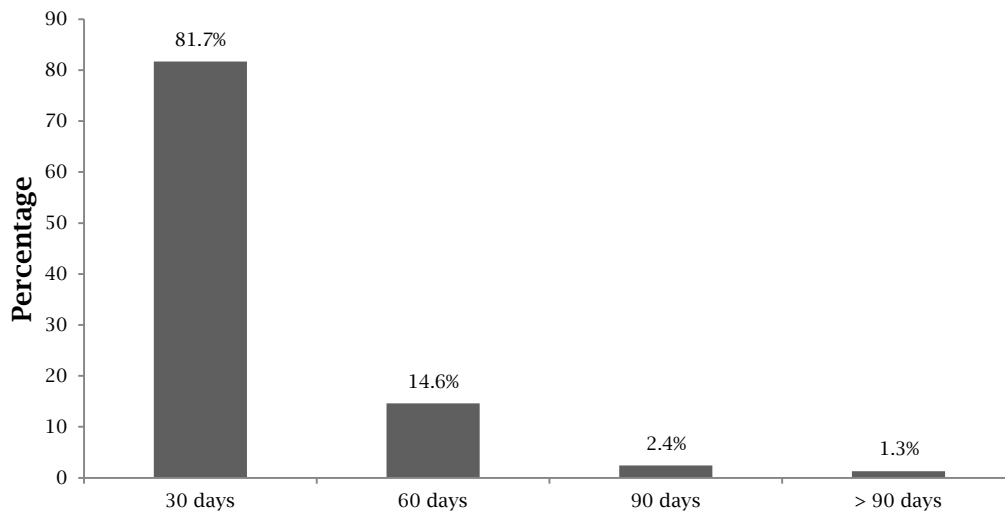
**Figure 3.** Practices with regards to business premises, plant, equipment and machinery



The majority of the respondents (70.3%) did not share their premises, equipment, plant and machinery, 19.8% of the respondents indicated that they shared business premises with other businesses while only (9.9%) of the respondents shared

equipment, plant and plant with other businesses. The results as illustrated in Figure 3 suggest that bootstrapping methods are not generally practiced in South Africa to finance business

**Figure 4.** Suppliers and creditors settlement period (days)



The results shown in Figure 4 indicate that the majority of the respondents (81.7%) settled their accounts within 30 days. The result shows that only 18.3% of the respondents took longer than 30 days

to pay suppliers and creditors. These results show that the respondents did not use payments to bootstrap their businesses.

**Figure 5. Days on average to receive payment from customers**

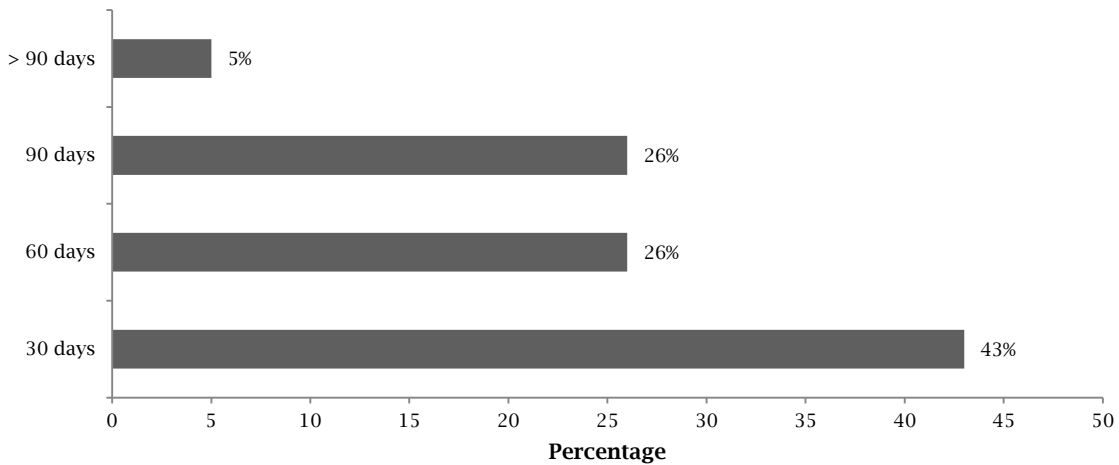
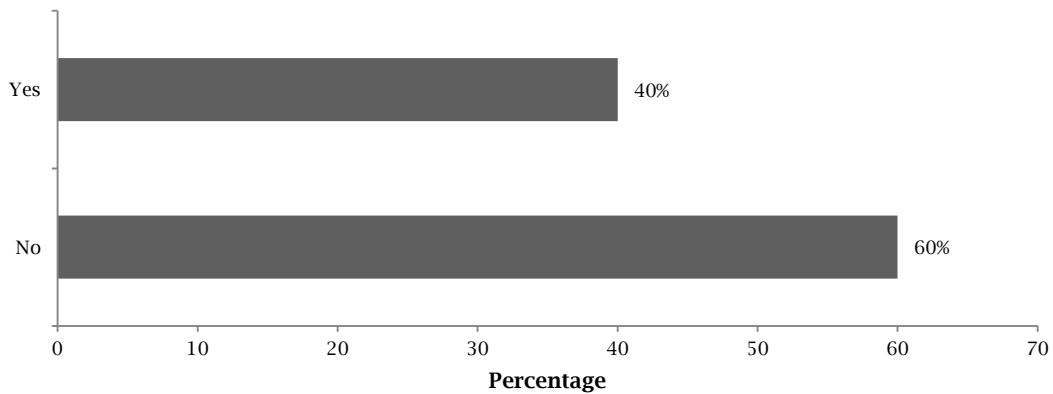


Figure 5 shows that the majority of the respondents (57%) did not receive payments from their customers within 30 days. Customer-related bootstrappers devise methods and means to entice

their customers to pay their accounts early (within 30 days) so as to improve cash flows and fund operations. The results suggest the respondents did not use their customers to finance their ventures.

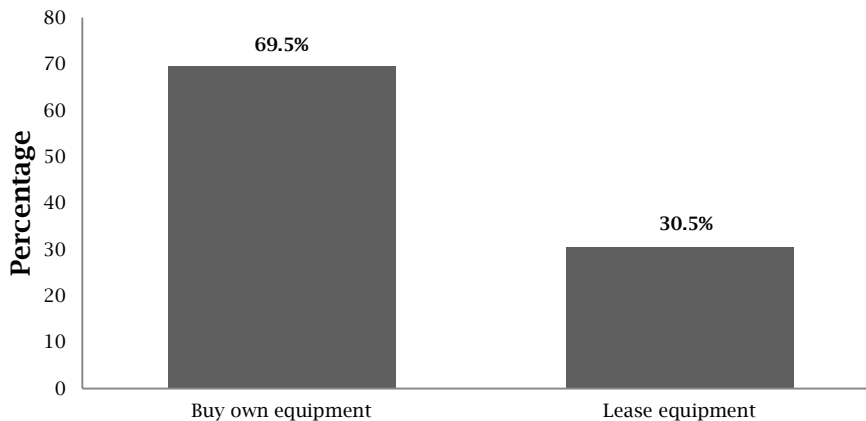
**Figure 6. Deposit or upfront payment from customers**



The responses shown in Figure 6 emanate from the question which sought to establish whether respondents required a deposit or upfront payment before an order was processed or service rendered. This method is very important to businesses who are struggling to finance operations by requiring an

upfront payment the customer will actually finance in part the order. The results showed that only the minority of the respondents (40%) required their customers to pay a deposit before orders or services were fulfilled, whilst 60% of respondents did not require upfront deposit from their customers.

**Figure 7. Buy or lease equipment, plant and machinery**





The respondents were asked if they bought or leased equipment, plant and machinery. The results depicted in Figure 7 indicate that the majority (69.5%) of the respondents bought equipment, plant and machinery and a minority (30.5%) leased the equipment, plant and machinery.

### 6.1. Summary of key findings

The results obtained from the analysis of data have revealed several interesting findings. Some of the most important findings are that the majority of small business owners were not aware of financial bootstrapping and only a few respondents knew what bootstrapping was. It was revealed that most of the respondents were financed by owner-related funds than those small businesses that received any funding from government funded agencies. Whilst many of the respondents did not know what financial bootstrapping was, all respondents were found to be practicing some level of bootstrapping. The commonly used group of bootstrapping method was the owner-related method. The respondents did not optimally practice joint utilization, delaying payments, and customer related bootstrapping methods.

## 7. LIMITATIONS

The following limitations were identified:

- Due to time and funding constraints, the data was collected from a small sample of small businesses within eThekweni Municipality with the hope of generalizing the results to all small businesses in South Africa.
- The findings of the study could not be generalized to all small businesses due to the sampling design and small sample size. Whilst the method of sampling used for this study was appropriate, non-probability purposive sampling is the least reliable in terms of generalization.
- There is limited literature of academic merit relating to financial bootstrapping in South Africa.

## 8. IMPLICATIONS

The use of financial bootstrapping by small businesses remains arguably unknown in South African. This is due to the fact that limited investigation has been done in this area. This study contributes to the identification and critical evaluation of the financial bootstrapping methods used by small businesses. South African researchers and entrepreneurship authors should research and write more about alternative business financing sources particularly financial bootstrapping to educate business owners in general and new and/or interested entrepreneurs in particular with regard to these concepts.

## 9. RECOMMENDATIONS

### 9.1. Recommendations for small businesses

The following recommendations are suggested to small businesses:

- A culture of sharing should be inculcated among business owners particularly those in the introductory phase. Small business owners need to be educated on the importance of sharing resources such as premises, machinery and equipment a lot of money can be saved and be reinvested in the business. Business owners must share equipment and employees with other businesses, share premises with others and borrow equipment for shorter periods.
- Small business owners should employ relatives, friends and students at below market rates and obtain loans from friends and/or relatives in order to save money to be invested in critical areas of the business. This will improve the efficiency of use of resources and results in improved profitability.
- Small businesses should use their customers more extensively as funders or partners. This can be achieved by requiring customers to make deposits for orders, settling their accounts early, use routines in order to speed up invoicing, offer customers discounts if paying cash, cease business relations with customers frequently paying late, and deliberately choose customers who pay quickly and levying interest for late payments resulting in improved cash flows to the business.
- Small businesses should negotiate with their suppliers for favourable settlement terms if they are to survive and perhaps grow. They should take longer to settle their accounts, lease equipment instead of buying equipment, and buy used instead of new equipment, and hire temporary personnel instead of permanent employees within, such measures will result in effective and efficient use of scarce resources and will ensure survival.

### 9.2. Recommendations for future research

Recommendations for further research include:

- Future studies should use probability sampling techniques so that the findings of such studies are more reliable and may be used with greater accuracy in generalising the findings to the entire population of entrepreneurs.
- The fact that most of the small business owners who participated in this study did not get any funding from the governmental funded agencies suggests a need for further research to explore the challenges faced by these entrepreneurs who have access to such funds.

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