International Research Science and Development Center

International Research Science and Development Journal

www.IRSDJournal.com

International Research Science and Development Journal
Vol. 2, No. 3, 2021, pp. 22-35.
ISSN 2348-3008

FINANCING SMALL AND MEDIUM ENTERPRISES AND ROLE OF THE BANKING SECTOR

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Abstract
SMEs are universally recognized as a key force in driving forward the economic development. Hence, the role of SMEs in the development process continues to be high on the agenda of policy makers and researchers. However, Namibia is struggling with access to formal financial services for its citizens especially the SMEs and the informal sector. Family and friends remain the main source for business loan in the informal and / or micro business sector. Many challenges and weaknesses have been identified by policy makers in Namibia within the financial sector Small and medium enterprises (SMEs) are universally recognized as a key force in driving forward the economic development; however, SME entrepreneurs face a variety of challenges including lack of access or limited access to formal financial services. Using mixed method research, the study attempted to analyses the SME ease of access to finance from banks and the impact of bank finance on their performance measured as return on assets (ROA). Contrary to many other studies, the results show that sample SMEs in Namibia had good access to finance from banks. The study further establishes that availability of bank loan is positively related to the performance of SMEs, while the age of enterprise was found to have negative relationship with performance.

Keywords: SMEs, finance, banks.

1. Introduction:

Governments across the world have realised the important role of the SME sector in the overall economic development process and thus have devised policies and programmes to support SMEs. The Namibian government is no exception in this regards (Arnold, Grossmann, Mwatotele, Stork & Tobias, 2005). Angula (2011) and Arnold et al. (2005) found that financial support to small businesses in Namibia is primarily driven by the government development budget and government financial institutions or donor funded initiatives with only few private providers in the microfinance field.The Namibia Financial Sector Strategy (NFSS) points out that although Namibia’s financial system is sound and functioning well , weaknesses such as limited access to financial services for individuals and SMEs have also been identified (Republic of Namibia, 2012).

1.1 Research problem

SMEs are universally recognized as a key force in driving forward the economic development (Migiro, 2005; Ramsden, 2010). Hence, the role of SMEs in the development process continues to be high on the agenda of policy makers and researchers. However, Namibia is struggling with access to formal financial services for its citizens especially the SMEs and the informal sector. Family and friends remain the main source for business loan in the informal and / or micro business sector (Stork, 2010). Many challenges and weaknesses have been identified by policy makers in Namibia within the financial sector (Republic of Namibia, 2012). SMEs in Namibia lack access to finance especially during start-up phase (Ramsden, 2010).

Previous studies on SMEs in Namibia have focused mainly on the whole financial system; therefore this study focused on the investment policy and the role of the banking sector in financing SMEs because the Namibian financial system is dominated by the banking sector. The primary purpose of this study was to investigate the relationship between bank finance and SMEs success.

1.2 Research objectives

While attempting to explore and describe the role of the banking sector in financing SMEs, the following specific objective guided the study:

To determine the extent to which bank finance contributes to the success of SMEs.

1.3 Challenges faced by SMEs

Although the contribution of small businesses to development is generally acknowledged, entrepreneurs are faced with many obstacles that limit growth and survival of SMEs. Orser et al. (as cited in Gill & Biger (2012) found that the severity of the problems varied by firm attributes, including firm size. They further concluded that micro operations were more likely to encounter problems of demand, the availability of alternative sources of finance, a lack of information about financing options, and a lack of financial expertise. Smith and Beasley (2011) identified lack of business acumen, contradictory and poor advisory support from external agencies, lack of sector-specific mentors and advisory support, lack of finance and experience of familial entrepreneurship as constraining factors.

Chu, Kara, Zhu and Gok (2011) found that problems encountered by Chinese entrepreneurs are, undependable/ unreliable employees, competition, lack of management training, lack of marketing knowledge and inability to maintain accounting records.

Migiro (2005) concluded that the majority of SMEs are not aware of the existence of certain sources of finance, thus, SMEs are credit-constrained. Iarossi (2009) points out that more than 80% of informal microenterprises rank access to finance to be a major constraint, compared with 55% of formal micro enterprises. According to Okpara (2011) there are several factors responsible for hindering small business growth and survival in Nigeria. Among these are financial constraints, management problems, corruption and lack of infrastructure.

According to Mbonyane and Ladzani (2011) identified lack of government support for business registrations, poor communication between the government and small business owners, lack of financial management as constraints facing South African SMEs.

Access to and cost of capital remains the biggest obstacles to business performance and further investment. Family and friends remain the main source for business loans in the informal and/or micro business sector in Namibia (Paliwal & Kandjaba, 2009; Nuyoma, 2010). Due to the risk-averse bankers, unsuitable financial products and high bank charges informal businesses often have no choice but to make use of informal financial services, which are much expensive (Stork, 2010). The lack of collateral, as well as difficulties in dealing with banking procedures and regulations, are the main factors impeding the access of SMEs to formal credit (Paliwal & Kandjaba, 2009; Kakwambi, 2012).

Other challenges faced by the SME sector in Namibia include the supply constraints, fierce competition from Chinese traders and South African retail chains, demand-side constraints whereby locals are said to prefer buying foreign supplied goods and services, lack of appropriate institutions and legal instruments to protect patents, and lack of transparency in procurement, amongst others. The symposium notes that the lack of local SMEs protection from unfair foreign competition compromises the growth and development of the sector (Bank of Namibia, 2010).

Stork (2010) explains that a critical issue to overcome is that of asymmetrical information. SMEs do not keep receipts or do bookkeeping. There is no information also on the business performance which makes it so difficult for lenders to consider lending to them.

2. Literature review

In Namibia, as in any other country, a small business may be an informal unregistered enterprise or a formally licensed firm. Ramsden (2010) points out that in Namibia SMEs account for 20% of employment, and contribute 12% to GDP. In addition, the government's 'Vision 2030' clearly states that SMEs should act as the locomotive that drives the economy forward to achieve '….human development, equitable and balanced growth, with a growing industrial sector and modernized agriculture….'). According to Kakwambi (2012) SME sector contributes notably towards poverty reduction and allows the majority of poor people

to become self-employed and to start meaningful production activities on a small scale, thus serving as important avenues to generate incomes and generally as a way of reducing poverty.
Stork (2010) points out that the informal sector is different from the formal sector in that the laws and regulations that govern SMEs are only partly followed if at all adhered to. Employees usually do not have an employment contract; they have no leave, no social security and medical aid benefits and are usually family members or friends. Informal businesses usually do not pay taxes, keep receipts or conduct bookkeeping. Mostly the informal sector is for those who cannot thrive in the formal sector and are struggling to make a living.
The current and potential contributions that SMEs can make to the Namibian economy namely, employment and income opportunities, alleviating poverty, reducing gender based income gaps, driving technological innovation and diversification of production processes call for greater government support and a more conducive environment in which they can operate (Republic of Namibia, 2012).

3. OVERVIEW OF THE FINANCIAL SYSTEM IN NAMIBIA

Similar to most other developing economies, Namibia inherited a dual financial system comprising of the formal and the informal sector upon the country's independence in 1990. The formal sector comprises the Bank of Namibia as the central bank, five commercial banks, a number of other banking institutions, a range of non-banking financial institutions such as insurance companies and pension funds, smaller financial intermediaries in the form of stockbrokers and money market funds, and the Namibian Stock Exchange. The informal sector comprises cash loan operators, money lenders, pawn brokers and others. In addition, there are a number of development finance institutions in Namibia e.g. Namibia Development Bank etc. (Mushendami, 2007; Republic of Namibia, 2012).
Before Namibia's political independence (1990), Namibia had no central bank of its own. The central banking functions were performed by the South African Reserve Bank (SARB). This was as a result of South Africa's occupation of the then South West Africa (Namibia) after the First World War which culminated in Namibia's integration into the South African monetary system. From 1961, SARB operated a branch in Windhoek, whose functions were very restricted and concentrated on: the distribution of SARB issued currency; administering of exchange control; clearing facilities to commercial banks, and serving as a banker to commercial banks. The Bank of Namibia was only established in 1990, by section 2 of the Bank of Namibia Act, 1990 (Act No.8 of 1990) (Sindano, 2009). The financial system in Namibia is dominated by the commercial banking sector and plays a clear intermediary role than any other type of financial institution. Before independence there were seven banks operating in Namibia, namely SWABank, Trust Bank, Bank Windhoek, Boland Bank, Ned Bank, Standard Bank and Barclays Bank, Ikhide and Fitchat (as cited in Sindano, 2009). Currently there are five commercial banks (Bank Windhoek, Standard Bank, Ned Bank, First National Bank and FIDES Bank (Ltd.) in the country with total assets valued at N$ 52,501,025.00, total deposits amounting to N$ 44,583,831.00, total loans N$ 38,725,170.00

as at 31 December 2010 (Republic of Namibia, 2012). The commercial banking system has strong links to the South African system and this is reflected by the strong South African shareholding in the Namibian commercial banks. Namibia's financial sector structure is presented in

3.1 The role of banks in SME financing

Small and medium-sized enterprises (SMEs) are highly bank dependable firms worldwide for their external funding needs (Gama & Geraldes, 2012; Kundid & Ercegovac, 2011). However, credit availability to SMEs and affordability varies due to variety of factors. According to Kundid and Ercegovac (2011) banks consider SMEs as being an information opaque sector and subject them to more frequent credit rationing than large enterprises. The provision of financial education to SMEs is important since many small business owners lack educational qualifications and operate in the informal sector. Binks et al. (as cited in Lindstrand & Lindbergh, 2011) argues that, banks have a critical role to play – not only as partners that can provide capital but also as partners that can increase the financial knowledge of firms by providing advice pertaining to investments and continued growth.

Mäenpää and Voutilainen (2011) found that there is a shift in how banks offer financial services, from independent provision of non-related products towards consideration of hybrid products in the SME customer segment. According to Abor and Biekpe (2007) SMEs that have long-term business relationships with banks, and SMEs with adequate collateral, tend to access bank sources of finance more easily.

3.2 SME access to Bank Finance

Generally, access to finance refers to the availability of quality financial services at reasonable costs. Figure1 illustrates the difference between access to and the use of financial services. On the one hand are those who do not use financial services for cultural or religious reasons or because they do not see any need. These non-users include enterprises without any promising investment projects. These non-users have access, but they choose not to use financial services. From a policy maker's view point, non-users do not really constitute a problem because their lack of demand drives their non-use of financial services. On the other hand are the involuntarily excluded who, despite demanding financial services, do not have access to them. There are several different groups among the involuntarily excluded. First, there is a group of firms that are considered "un-bankable" by commercial financial institutions and markets because they do not have enough income/collateral or present too high lending risks. Second, there might be discrimination against certain groups based on social, religious, or ethnic grounds. Third, the contractual and information framework might prevent financial institutions from reaching out to certain groups of firms because the outreach is costly to be commercially viable. Finally, the price of financial services may be too high or the product features might not be appropriate for certain firms. While the first group of the involuntarily excluded cannot be a target of financial sector policy, the other three groups demand different responses from policy makers (Ganbold, 2008).

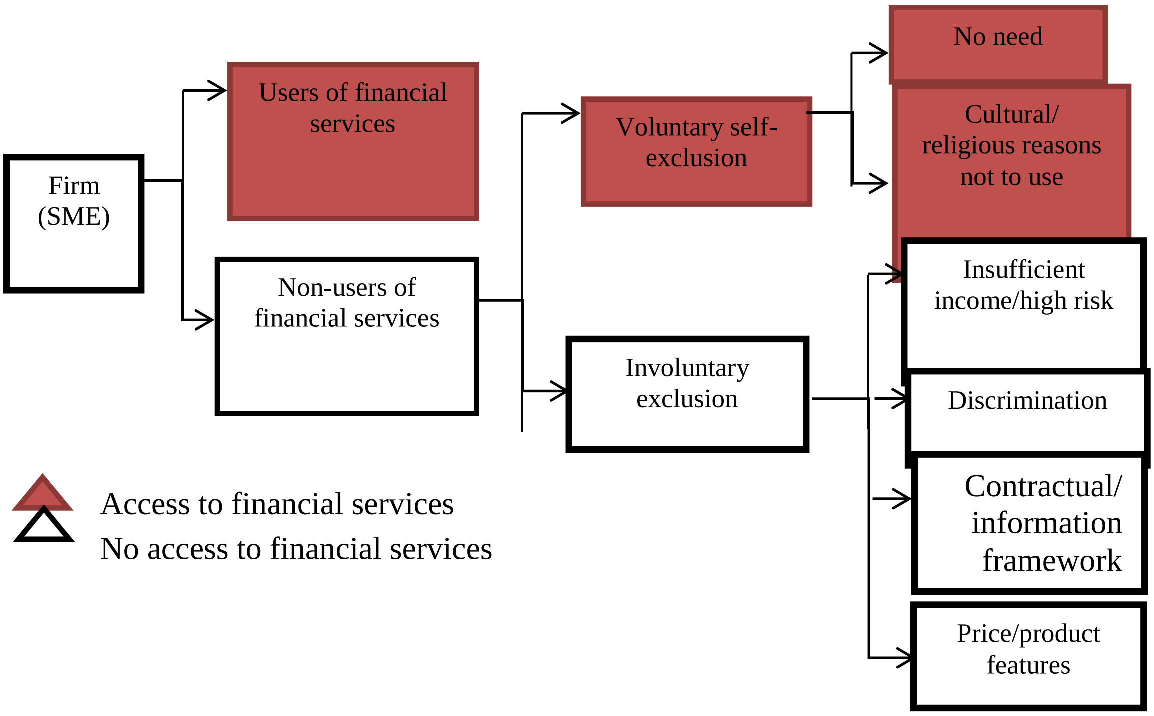


Figure1: Access to finance and use of financial services

Access to financial services, especially by SMEs, has become critical in many developing countries. SMEs make up a large part of the emerging private sector in most countries, but are also more constrained in their access to financial services than large firms, Ayyagari, Beck and Demiurgic-Kunt; Beck, Demiurgic-Kunt and Maksimovic (as cited in Beck, Demiurgic-Kunt & Singer, 2013). Firms often depend on informal sources of funding in the very early stages of their development. External sources, however, become more important as firms start expanding, and their availability can determine decisively the growth trajectory of SMEs. Bank financing remains by and large the most important source of external finance to SMEs (Berggren & Silver, 2010; IFC, 2010). Banks finance a significant proportion of companies' investment finance needs and are also the major providers of financing for working capital. SMEs typically need a variety of additional financial services that only commercial banks are well-positioned to provide. These include cash management, insurance, transfers, and other transactional products (IFC, 2010).

3.3 Bank finance contribution to SME success

Gama and Geraldes (2012) argue that to achieve growth, SMEs usually need external funding. Because small firms depend so heavily on bank loans for their external finance, a lack of efficient bank lending can materially hinder the development of SMEs. In addition, this lack of credit has been identified as one of the major factors inhibiting the success of small businesses (Pansiri & Temtime, 2010). Lack of access to financial services has potential to retard growth and development if not addressed and corrected, particularly in respect of SMEs in Namibia (Republic of Namibia, 2012). Mac an Bhaird and Lucey (2011) point that as successful firms survive nascent and start-up phases, and matures through growth stages, personal funding becomes relatively less important as investment finance is increasingly sourced from retained profits. Furthermore, accumulation of a trading history facilitates access to increased sources and amounts of external financing, particularly bank finance and trade credit.

Contrary to these studies, Smorfitt (2010), when analyzing critical success factors for start-up and growth phases of SMEs, does not mention finance as a critical factor. Simpson, Padmore and Newman, (2012) also disagrees that finance is a critical success factor but pointed out that growth or development of SMEs can depend on both financial and non-financial factors.

4. Methodology

This study used a mixed method design to determine the extent to which bank finance contributes to the success of SMEs. Ordinary Least Square (OLS) regression method in simple linear form was used to analyze cross-sectional data. This study adopted the model used by Su and Sun (2011) to test the relationship between bank finance and SME success as measured by Return on Assets (ROA). The log-linear regression model took the following form:

$$\ln ROA = \beta_0 + \beta_1 bankl + \beta_2 over + \beta_3 (control) + \varepsilon$$

Where: ln*ROA* represent the natural logarithm of return on assets (DV); *bankl* is amount of bank loan in (N$'00 000); *over* is the bank overdraft which is a dummy variable which is equal to 1 if a firm takes bank overdraft and 0, otherwise; *control* represents the control variables used in this research which are leverage and company age in years; ε is the random error term which is introduced to accommodate the effect of other factors that affect SMEs performance that are not included in the model. The ROA used is the ROA measure at the end of 2012.

The target population of this study consisted of 7114 SMEs registered with the Ministry of Trade and Industry (MTI) in Namibia by the end of December 2012, seven banks (both commercial banks and other banks) and the Ministry of Trade and Industry (MTI).

The sample was drawn using stratified random sampling technique. SMEs were classified according to year of registration and regions in which they operate. Out of the 13 regions of Namibia three regions were selected at random Due to the relative small size of the banking sector population, data was collected from all banks and the MTI. The sample size was set at 120 consisting of 60 from Khomas region and 30 each from Omaheke and Otjozondjupa regions. The distribution of the sample was out of convenience and given the fact that most businesses are operating in Khomas region, Windhoek, a big sample was chosen from it.

The questionnaires were tested through a pilot study. The major aim of piloting was to improve the validity of the questionnaires by administering the instrument to a small group of respondents. Based on findings of the pilot testing no significant changes were made to the original questionnaires, therefore, no post-test questionnaire was compiled. A structured interview schedule was used to solicit information from the banks and Ministry of Trade &

Industry on the investment policy and the role of the banking sector in support of Small and Medium-sized Enterprises.

The data collection process for this study consisted of four stages, using the following four methods: piloting the questionnaire, face-to-face interviews, a questionnaires and documentary/secondary data. The data collected from the primary sources as well as from secondary sources were checked for completeness. Qualitative data were coded to enable interpretation and discussion using thematic analysis. Quantitative data was analyzed using STATA statistical package. Ordinary Least Squares (OLS) regression method was utilized to test the relationship and the influence of bank finance on SME success measured as Return on Assets (ROA).

5. Finding

Of the 120 questionnaires sent out, 72 were returned which represents a response rate of 60%. Of those 72 questionnaires returned, 42 were from the Khomas region, 15 were from the Otjozondjupa region and 15 from the Omaheke region.

5.1. Profile of the respondents

Table 1 below summarizes the profile of respondents. The result showed that 77.78% of the respondents held the position of owner and manager, while 22.22% of the respondents held the position of employed manager. The educational background of the respondents was predominantly those with undergraduate degree (n=24; 33.33%), twenty respondents (27.78%) were having only high school education, twenty respondents (27.78%) had obtained a certificate or diploma, eight respondents (11.11%) had obtained a Honors or Master's degree. The question on education was asked to find out whether SME owners were well educated, especially in respect of reading information concerning contracts, SME promotion and development.

Table1: Profile of SME respondents

Category	**Number**	**Percentage**
Male	40	56
Female	32	44
Total	**72**	**100**
Nationality		
Namibian	64	88.89
Other	8	11.11
Total	**72**	**100**
Position held		
Owner and Manager	56	77.78
Employed Manager	16	22.22
Total	**72**	**100**
Education		
high school	20	27.78

Certificate or Diploma	20	27.78
Undergraduate degree	24	33.33
Honors/ Master's degree	8	11.11
Total	**72**	**100**

Source: Data collected through survey, November 2013

5.2 Access to Trade Credit

The study revealed that 72% of the respondents purchased goods on credit during 2012, while only 28% indicated that they did not purchase the goods on credit. This is an indication that most of the SMEs are not financially stable to purchase goods on a cash basis which might be cost effective. The researcher asked this question in order to find out other sources of finance available to small businesses, as revealed in the literature review.

5.3 SME Financing, Challenges and Constraints

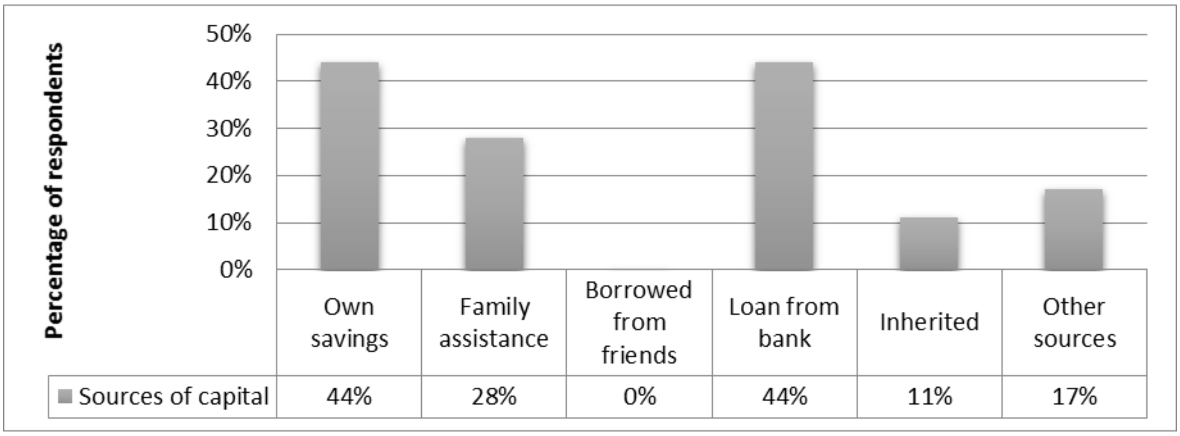
Start-up business capital

The amount of capital employed by most startup businesses (39%) is less than N$100 000. 40% of them had start – up capital of more than N$ 100000 but less than N$ 500000, while remaining started their business with more than N$500 000 of capital.

Sources of Capital

The following Figure 2 shows the sources of capital used by sample SMEs. As some of them used more than one source of capital the percentage total adds to more than 100%

Figure2: Sources of capital to start-up the business



Source: Data collected through survey, November 2013

Ownership of assets

In terms of ownership of assets, the researcher wanted to find out if the SME owners have assets which can be pledged as collateral, when applying for external sources of financing. In response, most of the respondents (89%) indicated that they own furniture followed by machinery/equipment/tools (83%); vehicles (67%), premises (50%) and 11% responded that they own other assets such as clothes, shoes and handbags.

Loan application and approval of loans

Exactly half of the respondents said that they applied for load from banks. Of those who applied for bank loans, most of the respondents (n=32; 89%) acknowledged that their loans were approved. Based on this finding, this suggests that financial service providers (banks in particular) have initiated efforts in order to address the lack of access to finance for SMEs

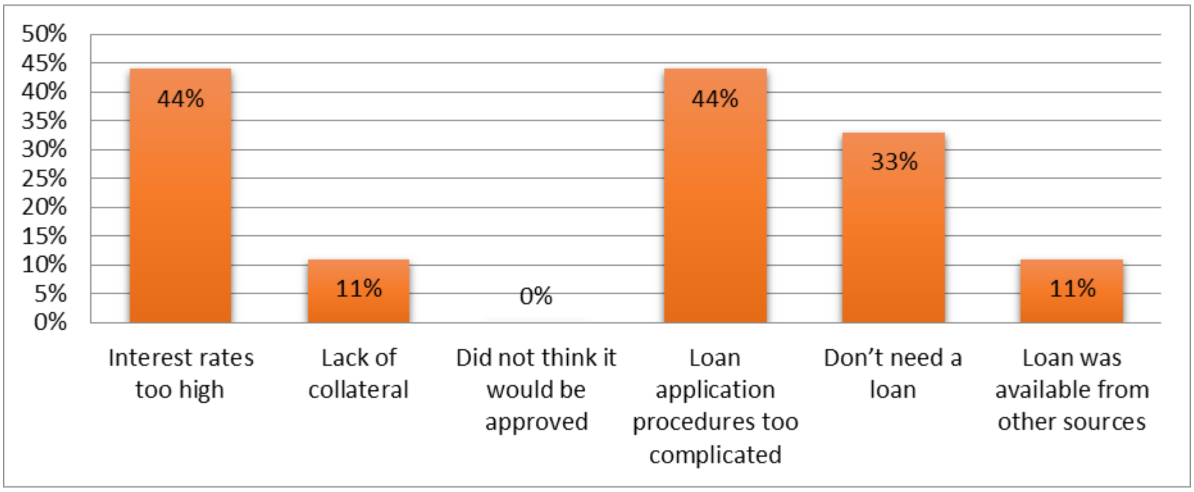
Reasons for disapproval of loans

Of the 36 respondents who noted that their loans were not approved, most respondents (n=27; 75%) mentioned that lack of collateral was the major reason behind their loan disapproval while the remaining (n=9; 25%) cited the failure of drawing an appropriate business plan as the reason to get their loan applications approved.

Reasons for not applying for bank loans

A large number (44%) of the respondents indicated that the reason they did not apply for a loan is because the interest rates are too high, as well as loan application procedures are too complicated.

Figure3: Reasons for not applying for a loan



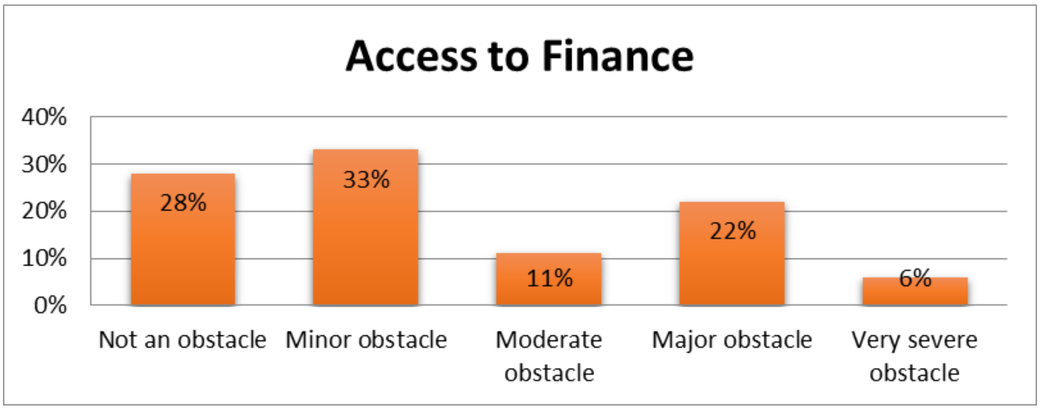
Source: Data collected through survey, November 2013

In response to a question whether the SMEs utilize bank overdraft facilities or not, approximately 61% of the respondents acknowledged having an overdraft facility while the remaining 39% acknowledged that they did not use bank overdraft facilities. Large number of SMEs having access to overdraft is an indication that sample SMEs had good relationship with banks.

Extent to which access to finance is an obstacle to the current operations of SMEs

As depicted in Figure 4 below, 33% of the respondents opined that not having access to finance is a minor obstacle while only 6% agreed that lack of access to finance is a very severe obstacle.

Figure 4: The degree of access to finance as an obstacle



Source: Data collected through survey, November 2013

Bank Finance and Performance of SMEs:

Table 2 below shows the descriptive statistics of the variables used in this research

Table 2: The descriptive statistics of the variables

Variables	Number of observations	Mean	Std. deviation	Minimum	Maximum
Roa	57	1.48517	4.044455	0.004	16
Bankl	57	5.71053	9.74906	0	32
Over	57	0.54386	0.5025	0	1
Age	57	10.0702	0.5025	0	23
leverage	57	0.1274	0.180095	0	0.5

Source: Author's computation based on survey findings

AS can be noted from Table 2 above, the mean of ROA of the sample is 1.5%. It can also be noted that about 54% of the firms used bank overdraft as source of finance. The average age of the firms in the sample is 10 years while the mean leverage is relatively low at 13%.

6. Contemporaneous correlations of the variables

Table 3 below shows the contemporaneous correlations of the variables used in this research. From Table 3, ROA, which measures firm's performance is positively correlated to overdraft but negatively correlated to the variables *bankl*, *age* and *leverage*. Furthermore, Table 3 indicates that multicollinearity is not an issue in the regression model as the variables have no approximate linear relationship.

Table 3: Contemporaneous correlations matrix

	Roa	*Bankl*	*Over*	*Age*	*Leverage*
Roa	1				
Bankl	-0.19	1			
Over	0.1218	-0.1058	1		
Age	-0.3151	0.4842	-0.124	1	
Leverage	-0.2064	0.6685	-0.1421	0.1413	1

Source: Author's own computation

7. Interpretation of the regression results

Table 4 lists the regression results using the equation specified in the research methodology section. Regression (1) tests the influence of bank loan on the ROA of SMEs. From Table 4 the results of regression (1) prove that performance of SMEs is significantly positively related to the amount of bank loan. This is so because variable *bankl* is significant at 1% level of significance with a positive coefficient of 0.0430246. This indicates that if SMEs increase their bank loans, they also increase their performance as measured by ROA. This finding is also consistent with theory and findings by Su and Sun (2011). Regression (2) in Table 4 tests the influence of bank overdraft on the performance of SMEs and determines if the SMEs which use bank overdraft perform better than those SMEs which do not use bank overdraft. Results in Table 4 show that variable *over* is not significant in explaining changes in *ROA*, although this variable has the expected sign (positive) to indicate that firms which take bank overdraft perform better than those which do not take bank overdraft holding other variables in the model constant.

Table 4: Regression results

Variables	(1)	(2)	(3)
Bankl	0.0430246* (0.0119462)		0.0425152* (0.0122088)
Over		0.1548529 (0.4292755)	0.128852 (0.4289222)
Age	-0.1858599* (0.0236551)	-0.1615929* (0.0204648)	-0.1846341* (0.0239253)
Leverage	0.2386761 (0.9639731)	0.089729 (0.6807201)	-1.328704 (0.9784136)
Constant	0.2732755 (0.4678682)	0.001699 (0.4956307)	0.1857886 (0.5294648)
Number of observations	57	57	57
R-squared	0.3682	0.3518	0.3692
Prob > F	0.0000	0.0000	0.0000

*Note: Numbers in the parentheses are the robust standard errors. *Significant at 1% level.*
Source: Author's computation based on survey findings

Regression (3) in Table 4 above, tests the influence of both bank loans and overdraft facilities on the ROA of SMEs. The results show that those only SMEs with bank loans are significantly positive in explaining the performance of SMEs as given by the positive coefficient of 0.0425152 which is significant at 1% level of significance. Variable *over* remain insignificant in explaining the performance of SMEs. It is imperative to note that in all the three regressions results (1-3), variable *age* is significant in explaining the performance of SMEs at 1% level of significance with a negative coefficient. This indicates that as SMEs grows old, the ROA decline. This is also consistent with findings by Su and Sun (2011) who found a negative relationship between age and performance of firms. Variable *leverage* is insignificant in explaining the performance of SMEs in all the three regression results.

8. Conclusion

This study reveals that only 40% of the SMEs are aware of the government SME policy. Based on the findings from the SMEs, the most important source of money to start-up a small business is from own savings and loans borrowed from the bank, which is in line with the findings of IFC (2010) and Berggren and Silver (2010). Contrary to the studies by (Migiro, 2005; De la Torre, Martinez, Pería & Schmukler, 2010; Ramsdem, 2010; Su & Sun, 2011) the evidence in this study indicates that access to finance is a minor obstacle in financing SMEs. However, SMEs unable to obtain access to finance cited a lack of collateral, high interest rates and loan application procedures being complicated as the main reasons of them not applying for finance.

The study empirically tested the influence of bank finance on SME success measured by ROA and found that the amount of bank loans approved has a positive effect on the performance of SMEs as measured by the ROA. This indicates that the more the amount of a loan taken by SMEs, the greater the chance of success and vice versa. This finding is consistent with theory and findings by Su and Sun (2011).

Based on the study findings, the following recommendations made:

- It is recommended that SME entrepreneurs and managers should develop and improve their information management practice by keeping proper and accurate records of firm operations, which could reduce the bank's perception of risk and facilitate easier access to financing to SMEs on favourable terms of credit.
- In order to induce growth of the SME sector, banks should still develop more products designed to serve the needs of SMEs.
- The Ministry of Trade & Industry should collect and disseminate information's of SMEs developments;
- Government should come up with a policy for commercial banks to compulsory submit data on SME access to bank finance.

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