

## Cash Flow Management: Assessing Its Impact on the Operational Performance of Small and Medium Size Enterprises at the Mafikeng Local Municipality in South Africa Prior to the Global Financial Crisis

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### Abstract

*Aims: This study propped up as a result of the repeated complaints from both electronic mails and customers' about the underperformance of Mafikeng Small and Medium-Size enterprises after the global financial crisis. The authors were on the view that, poor operational performance experienced by Mafikeng SMEs was as a result of the negative effects on the cash flow of these businesses due to volatilities in the business environment in general prior to the global crisis. Thus, the paper was mainly aimed at determining the shortcomings experienced by these SMEs with regards to cash flow management. It was also aimed at suggesting possible measures to improve cash flow management of these SMEs in this tough time. Methods: A case study was conducted on 3 beverage suppliers, 27 bottle stores, 3 largest fast consumer goods super markets and 7 automobiles enterprises in the Mafikeng local municipality. The study made use of a mixed method approach. A purposive sampling was used in selecting SMEs that participated. Views and experiences of participants of the paper were captured through in-depth interviews. Data from the empirical investigation were interpreted using open coding and a simple percentage formula. Results: Findings from the empirical research reflected that majority of Mafikeng SMEs suffer poor operational performance prior to the global financial crisis primarily as a result of poor cash flow management. However, the empirical outcome also indicted other secondary factors contributing to this poor operational performance. Conclusion: Finally, the authors proposed possible measures that could be used to improve cash flow management and to solve other factors affecting operational performance in Mafikeng bottle stores in other to achieve better business performance.*

## 1. Introduction

The global financial crisis has greatly affected the business environment globally. Ngowe (2012) states that the global financial crisis can also be termed as credit crunch, economic turmoil, economic downswings and global meltdown. The global meltdown emerged in 2008, mostly intense in Europe and the United States, made most business people to transfer their investment to stable economies whose currency are considered to be stable like the yen. In South Africa, the economy is also greatly affected. Julies (2009) asserted that the global economic meltdown had a negative impact on South Africa's Small and Medium- Size Enterprises (SMEs). Julies further indicated that, developments to improve their operations have been made through the introduction of the International Financial Reporting (IFR) to SMEs issued by International Accounting Standard Board (IASB). However, a question that can be raise here is how effective are such development programmes to make sure all SMEs effectively and fairly benefit. The problem of poor cash flow due to the current changes in the business environment poses a continuous threat on the operational performance of most businesses in general. Therefore, it was important to investigate this crisis at the Mafikeng local municipality.

## 2. Literature Review

### 2.1 SMEs development

The definition of what is considered as SMEs varies in different regions. According to Yusuff et al. (2011:5) there is no

single criterion for defining SMEs. The authors' further states that a study carried out by the International Labour Organisation (ILO) in 2005 shows that over 50 definitions were identified in 75 different countries. But in most definitions, reference was usually made to some quantifiable measures such as number of people employed by the enterprise, investment outlay, the annual turnover and the assets value of the enterprise. In South Africa, a SME is any business that has 13 million and 15 million of turnover maximum, 1- 49 and 51- 200 employees and a balance sheet maximum of 5 million and 19 million for small and medium businesses respectively (Olawale & Garwe 2009). SMEs in South Africa in general are facing a major problem with operational performance. Olawale & Garwe (2009) indicated that SMEs failure rate in South Africa is up to 75%. These failure rates are even moving up to 80% in some regions (Mboyane, 2006:1). The survival of new SME beyond 42 month is less likely in South Africa than any other Global Entrepreneurship Monitors (GEM) sample country (Broembsen et al. 2005). Sunday times March 12 (2006:2) indicated the view of one of South Africa's leading entrepreneurs associating most failures in South African businesses to cash issues.

Mafikeng is located in the North West Province (NWP) of the Republic of South Africa it is about 305 Km, 4 hours, 8 minutes drive from the capital city Pretoria (Google maps). The province has been struggling to develop its SMEs. Mavasa (2005:4) gives a clue on the actions instituted in 2005 by the Department of Economic Development in the NWP in developing its poorly performed SMEs. A major project in this program was the twenty million rands allocated to develop the Mafikeng industrial zone with another eight point three million allocated to help support its operational expenditures. Ssekoto (2007/2008:8-12) also gave the recent state of the performance of SMEs in Mafikeng as not encouraging. Ssekoto acknowledged a great degree of failure of business enterprises in the Mafikeng. A major failure the author indicated was the inability by the Mafikeng Bio-Diesel Company to achieve the Mafikeng Bio-Diesel project in first phase was highlighted. Despite all efforts to develop Mafikeng SMEs, they can still be seen to be poorly performing. Mafikeng bottle stores are among the most poorly performing SMEs in Mafikeng.

## 2.2 Cash flow management

Cash flow management can be seen from two different perspectives depending on how many responsibilities it includes, which are basic cash management and advanced cash management (Jose et al. 2008). Basic cash management is a technique conducive to optimising the level of disposable assets to be maintained by a business and to prevent breaks or gaps in the trading cycle due to lack of cash. Administrators must calculate the cash amount best suited to their level of activity and plan the timing of the relevant payments and collections. They should also draw up a policy of investment in assets with high liquidity that can be converted to cash at a low transactional cost, to serve as support for the funds maintained by the business (Jose et al. 2008).

Advanced cash flow management is a set of techniques that act on the short term liquidity of a business. At the same time, it affects those factors and processes that translate immediately into cash, with an ultimate aim of increasing the profitability of the business and improving working capital management (Jose et al. 2008). Cash flow is defined as the movement of money into and out of a business. The cycle of cash inflows and outflows determine the business solvency. Cash flow analysis helps to maintain adequate cash flow for the business and to provide the basis for cash flow management (Noor et al. 2012).

## 2.3 Cash Flow management and business performance

Business performance refers to the business success in the market, which may have different outcomes. Business performance is a focal phenomenon in business studies. However, it is also a complex and multi-dimensional phenomenon. Performance can be characterised as the firm's ability to create acceptable outcomes and actions (Chittithaworn et al. 2010). Cash from operations will determine the ability of a business to run its activities. As indicated from the various sources in the background, a business experiencing poor cash may not survive longer. As indicated by Luo (2007), the positivity of internal cash generation will determine a business financial power. Cash flow from operations is the best method to achieve a stable and positive business and ability to run business activities.

Proper cash flow management needs to be constantly done by businesses to be able to maintain a positive cash flow, by making sure it monitors the in and out movement of cash in the business. Reider & Heyler (2003:1&6) alluded that cash flow management is important in achieving operational aims because it plays a key effort in maintaining the business in the most efficient and effective manner possible. These authors noted that the most important agenda of all businesses should be that they make profits, that if a business does not generate a positive cash flow, it will not stay in business. Strong (2011:1) maintains most businesses base their minds on less important issues instead of managing cash flow, because no business can survive in today's business environment without sufficient cash.

Dropkin (2003:1) explained that it is difficult to pay for operating costs and expenditures for three to six months from current cash even though it can be possible. According to Dropkin if business cash balances are weak, the business will obviously be in serious trouble. The researcher noted that the main cause of such occurrence is the improper management of cash flow. If an organisation improves on how to manage its cash, it will lead to better performance.

#### 2.4 Cash flow elements

Cash flow is defined as the movement of money into and out of a business. The cycle of cash inflows and outflows determine the business solvency. Cash flow analysis helps to maintain adequate cash flow for the business and to provide the basis for cash flow management (Noor et al. 2012). Cash out flow is the total amount of outgoing cash from a business in a given period of time. Cash out flow includes expenses such as salaries, supplies and maintenances and servicing debts. Cash inflow refers to funds received by a business due to sales, financing or investments. Cash inflows are used to gauge the overall financial health of a business and a business with a large and stable cash flow can be considered to be in a good financial position. Cash inflow and outflow lead us to what is known as positive and negative cash flows. A positive cash flow is when the cash inflows outweigh cash out flows and a negative cash flow is when the cash out flows outweigh the cash inflows. It is advisable for every business to maintain a positive cash flow (O'berry, 2007:56-57).

Authors like Kew et al. (2006: 10) and Powers and Needles (2011:646-648), have indicated that cash flow involve three main elements or activities. These activities involve the operating, financing and investment activities. The operating activities give an idea of how much cash an organisation must have generated from its day-to-day delivery of its products and services. This number can and should be compared with the operating income on the income statement (Kew, et al. 2011:14). Cash inflows from operating activities include: Cash receipts for the sale of goods or services, cash receipts for the collection of sale of goods or services, cash interest received, cash dividends received and other cash receipts not directly identified with financing or investing activities. Operating activities is however also accompanied by cash out flow factors which include: Cash payments for trade goods purchased for resale or use in manufacturing, cash payments for notes to suppliers or trade goods, cash payments to other suppliers and to employees, cash paid for taxes, fees, and fines, and interest paid to creditors.

Financing activity shows whether and how much of the operating and investment activities have been financed by outside sources of finance through debt and equity. This can also mean obtaining resources from stockholders and providing them in return with dividends for their investments, and borrowing money from creditors and repaying the amount borrowed (Powers & Needles, 2011:648). Cash inflow from operating activities includes cash proceeds from the sale of stock, cash receipts from borrowing, and cash receipts from contributions and investment income that donors restricted for endowments or for buying, improving, or constructing long-term assets. Cash outflows from financing activities include the following, cash disbursed to repay principal on long and short-term debt, cash paid to reacquire common and preferred equity instruments, dividends paid to common and preferred stockholders.

The last category is investing activity. This category of the cash flow details how much cash the business made and used in making investments in other businesses, such as the purchase of stocks or bonds of another organisation. This category may also include the purchase and sale of productive assets, such as manufacturing equipment (Power & Needles 2011:647). Cash in flow from investing category include; collections of principal on debt instruments of other entities, cash proceeds from the sale of equity investments, and cash received from the sale of productive assets. Cash outflows from investing activities are as follows: Cash paid to acquire debt instruments of other entities, cash payments to buy equity interest in other entities, and disbursements made to purchase productive assets.

### 3. Research Methodology

The research design that was used in this study was mixed method research design. A mixed method research is referred to as a class of research studies in which a researcher mixes both qualitative and quantitative research approaches and techniques into a single research study (Johnson & Christensen, 2008:441&443). The findings from using both quantitative and qualitative approaches were adequate to best understand the empirical outcomes. A mixed method research can either be sequential, concurrent and transformative (Creswell 2009:121). For the purpose of this study, a concurrent triangulation approach of equal status was used. That is, both qualitative and quantitative studies were carried out at the same time and both given equal weights. Creswell (2007:36) gives a broader definition of a qualitative study as indicated by Denzin & Lincoln (2005) that qualitative research is a situated activity that locates the observer in the world. It consists of a set of interpretive, material practices that make the world visible. These practices

transform or turn the world into a series of representations through the use of field notes, interviews, conversations, photographs, recordings and memos. The qualitative study gave room to explore the true feelings and experiences of respondents through lengthy interviews. Quantitative research essentially refers to the application of systematic steps of scientific research, while utilising quantitative properties in the study (Edmonds & Kennedy, 2013:20). In this approach, the occurrences of behaviour are counted, correct answers or errors are also counted (Drew et al., 2008:20). Through structured questionnaires, the authors intended to take note of frequencies responses, therefore able to determine actual quantitative findings to the extent to which cash flow management influenced operational performance in Mahikeng SMEs.

### 3.1 *Population and sampling*

The population of this study constituted of owners and managers of SMEs in the Mafikeng local municipality of the North-West province of South Africa. A purposive sampling was used as the sampling technique of this study. Purposive sampling provides an in-depth knowledge or information which suits the specific need of a study (Tedllie & Yu, 2007). Purposive sampling was used because; the findings of the study were seen to be more accurate if a manageable size was used. Also SMEs and Participants from selected SMEs were purposively selected to enable the researcher to draw only information-rich participants who had reliable information and much experience on the relationship between cash flow management and operational performance in the Mafikeng municipality business environment. These were workers who were deeply involved in the management of sampled SMEs, which are the owners or managers. Therefore, purposive selection of participants for the study was on the basis of level of involvement in the management activities of the selected SMEs. Empirical research was conducted on 3 beverage suppliers, 27 bottle stores, 3 largest fast consumer goods super markets and 7 automobiles enterprises in the Mafikeng local municipality. This gave a total of 40 SMEs and 40 participants from all SMEs who participated in the study.

### 3.2 *Data collection method*

Interviews were used to collect qualitative data. The authors asked participants questions and collected information with respect to the conversations. Focus was on in-depth individual interviews. In-depth interviews were considered to be the most appropriate in collecting qualitative data because it gave room to first-hand information with regards the research problem. Participants were asked open-ended questions with the objective of giving room for participants to respond from their minds without been influenced by the researcher, creating a relaxed atmosphere and making interviews flexible for other important issues relevant to the study to come up. The researcher also recorded direct words of participants and journals were taken down during the interviews.

Referring to Gillham (2005:46) the in-depth individual interview used in this paper is sometimes called the informal conversation or unstructured interview (punch 2009:147). This is because participants were simply informed of the objectives of the study and asked what they thought about the research problem, without any pre-planned questions or themes identified before the interview took place. They were developed spontaneously in the course of the interactions with the interviewer. This made it possible to get detailed findings from participants' point of view since no prior categorisation which may have limit inquiry was imposed. When respondents deviated from the topic, the interviewer tactfully steered them back. Individual interview was conducted with a manager or director of each sampled 40 SMEs. This gave a total of 40 individual interviews that were conducted

Structured questionnaires with close-ended questions were used for collecting quantitative data. A questionnaire is a widely used and useful instrument for collecting survey information, providing structured, often numerical data (Cohen at al. 2011:337). Questionnaires were designed with respect to the experiences expressed by participants in the preliminary survey on how they felt about the research problem. Participants were required to say yes or no and to agree or disagree to certain elements with a tick on different options on the questionnaires. Through structured questionnaires, the authors intended to take note of frequencies responses, therefore able to determine actual quantitative findings to the extent to which cash flow management influenced operational performance in Mahikeng SMEs. Structured questionnaires were distributed to all the 40 managers or directors of the 40 SMEs who participated in the interview. This gave a total of 40 questionnaires that were distributed to participants to answer. All 40 questionnaires were all collected

## 4. **Data Analysis**

After data had been collected through interviews and questionnaires, there was need for it to be analysed. Qualitative

data was analysed using open coding. Open coding is a process of breaking down, examining, comparing, conceptualising and categorising data (White, 2002:82). Thomas (2003:4) procedures to analyse qualitative data through open coding was employed in this study. These procedures include: Preparation and organization of data, closing reading of text, creation of categories, continuing revision and refinement of category system. In analysing the data, the researcher started by transcribing the recorded interviews. The transcripts were read many times in other to understand and make sense out of the interview process before breaking them down into parts to determine emerging categories and themes.

The same topics were used in all the interviews and the data collected in the interviews were compared to establish themes. Themes that emerged were identified and written down. Emerging themes were cross checked if they were in line with the research questions to ensure that the investigation stayed on track. Identified themes were categorised into topics related and information belonging to each were grouped together. From the processes outlined above, it is evident that insight information the researcher was seeking was obtained. Thomas (2003:4) advises that researchers should look for subtopics within each category including contradictory views and new insights. In such a case, the researcher will select quotes that tie with the core theme or essence of a category. The categories identified in this study make up the essence of what respondents conveyed.

Simple percentage formula was used to analyse quantitative data. This method made it possible to come up with the responses of respondents in percentages. The formula is as follows

$$\text{Simple percentage formula} = \frac{\text{Observed frequency}}{\text{Expected frequency}} \times \frac{100}{1}$$

Quantitative Results are further elaborated for each question in graphs on excel. A descriptive statistics is further used to describe the features (data) in the figures in a simple summary.

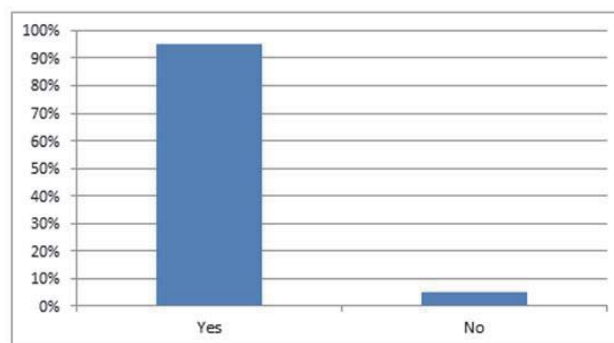
## 5. Results

Findings from the empirical investigation based on categories identified from interview data and quantitative findings are as follows:

### 5.1 Impact of global financial crisis on Mahikeng SMEs

Majority of interviewed managers and directors accepted that they have been experiencing negative effects on their cash flow especially recently due to the global financial crisis. And this element has greatly eroded on their profitability position, affecting their performance since it prevents them from carrying out their business operations perfectly.

**Figure 5.1** Impact of the global financial crisis on SMEs cash flow



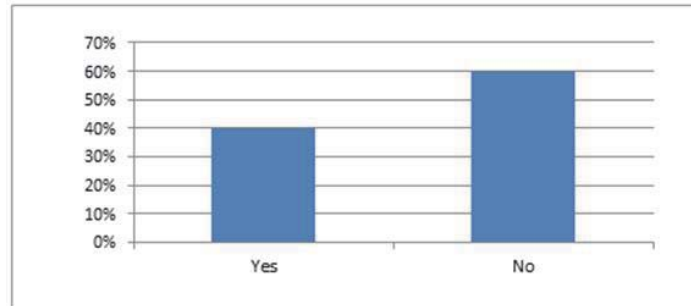
95% of the participants indicated that the changing environment have negatively affected their cash flow, while 5% of the participants see no negative effect on their cash flow as a result of changing business environment

### 5.2 Level of understanding about cash flow management

Responses from both owners and managers who participated in the study indicated most SMEs lacked an extensive understanding of what the concept of cash flow management is all about in details. However, there were some

participants, especially participants that were interviewed from the industrial zone who effectively showed that they had an effective understanding of the cash flow management concept. There is need for them to improve on their scope of cash flow management. There is also need for some decision makers like managers, to have a degree of understanding on the concept of cash flow management.

**Figure 5.2** level of understanding about cash flow management

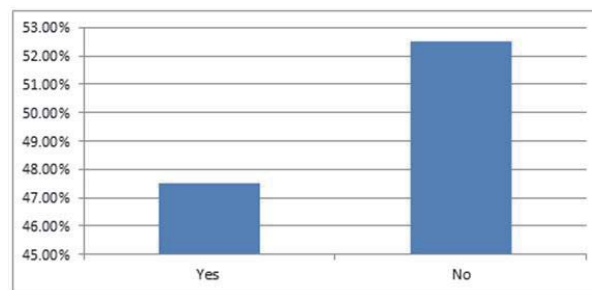


As indicated in the figure above, it can be seen that the larger population have no cash management idea or plan. A total of 16 participants representing 40% disclosed they had an idea in cash flow management and 24 participants representing 60% revealed they had have no idea in cash flow management. This is an indication that a greater majority of Mahikeng bottles are operating without measures to manage their cash movement

### 5.3 Involvement of cash management plan in the business strategy

Most SMEs indicated that they do not have a cash flow management plan to guide them manage their cash. Just few participants indicated that they had cash flow management plan. This was seen to be inappropriate for a SMEs to survive without it. Some SMEs that have been operating for lengthy years too, mentioned that cash flow management plan in their business was not necessary because they have been surviving for years without it. Further inquiries were made to see how cash control is therefore done on such SMEs with no cash flow management plan. The techniques indicated by such SMEs were all inappropriate method to effectively manage cash flow.

**Figure 5.3** Cash flow management strategy

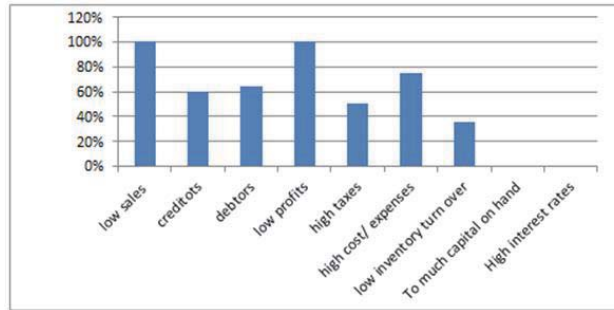


### 5.4 Cash flow challenges faced by SMEs

Cash flow challenges are one of the greatest problems most small and medium size businesses face. Participating SMEs gave indications to certain negative cash flow aspects challenging their operational performance. A low sale was commonly mentioned by most participants as an element affecting their profits. Some participants indicated that the taxes levied on them are too high for them to cope with. From the above indication, there is need for regulators to consider their decisions on SMEs before implementing them since they play a great role in the economy. SMEs also complained that the cost of running their business is going too high of recent, especially with the coming of the global crisis. Thus, increase in their expense figures. All bottle stores and super market participants indicated that they experience low inventory turnover in some products. Usually capital ties up in stock and eventually lead to losses especially for

supermarkets.

**Figure 5.4.** Cash flow problems challenging SMEs

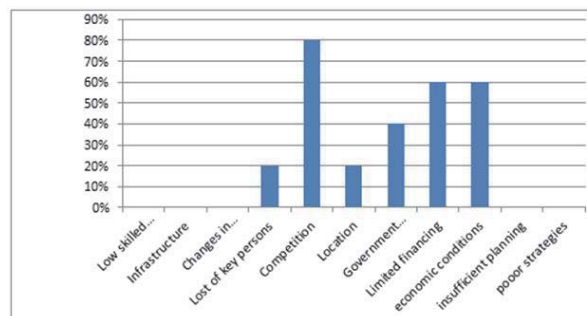


From the figure above, it is evident that 100% of participants indicted low sales and low profits as elements affecting their cash flow, 60% indicated creditors, 64% indicated debtors, 50% indicated high taxes, 75% mentioned high cost and expenses, 35% indicated low inventory and 100% of participants never indicated too much capital on hand or high interest rates.

### 5.5 Other factors that have been a challenge to SMES operational performance

Investigation was further made if they could be other non-cash flow issues that could possibly playing a role too, for the poor operational performance experienced Mafikeng SMEs. Competition was generally indicated by a large number of participants as a threat to their performance. Limited access to finance or loans was another factor raised by some SMEs as an element that affects their performance. Most small businesses mentioned that rejection for loans application is as a result of the fact they don't have efficient collaterals for banks to grant them loans. Another indication that was made is that, bank charges or interest rate is very high for them to manage. Most Automobiles highlight that lack and loss of key persons was a major factor that affects their performance. It was seen that most skilled workers migrate to larger provinces in search for better opportunities. The issue of lack or loss of key persons was also due to inefficient incentives that will prevent such employees from leaving. Government regulation and economic changes were also indicated

**Figure 5.5** secondary factors indicated to be affecting performance



As seen in the above figure, participants were again given a list of elements that could affect a business operational performance to indicate which possible elements could also be affecting their operational performance. Their responses are reflected on the figure.

## 6. Recommendations

There are effective measures that can be employed by Mafikeng SMEs to improve cash flow in their businesses. Increase in sales can be achieved by bringing in promotions that will enthuse or capture more customers. There is for fast consumer good businesses like beverage suppliers, bottle stores and supermarkets to be accurately stock because,

absence of stock will reduce sales. A lot of business organisations always face a problem of meeting up with tax burden. Business organisations need to use their skills to try and reduce the tax burden legally. The best way to reduce the impact of tax burden on a business cash flow is compliance. This is because tax frauds usually catch up with a business in the nearest future leading to more ugly effects. The cost of running business operations must be monitored to make sure it does not cut into the profits of the business. The greater the expenses, the higher the cost of running the business. Businesses need to cut out unnecessary products which lead to high cost but yield little or no profits when compared to the carrying cost of such products. Expenses should always be compared to the available budget to avoid over spending. Expense control like restructuring salaries and bonuses can be done to reduce cost. Preparing financial records is an important measure to monitor expenses.

Managing stock is an important issue for fast consumer goods businesses to focus on. The rate of capital tied up in stock can be reduced by buying less and instituting a just in time system (JIT). A JIT is the system of ordering stock just by the time it is needed. They should also conduct research on products that lead to low turnover rates and try to match the level of purchase to the demand. An agreement can also be reached with suppliers in which long overdue products are returned to suppliers. Tracking inventory on hand is also very important to keep accurate inventory levels. Lastly there is need for SMEs to improve or gain knowledge about cash flow management. This can be achieved by attending workshops or enrolling for programmes that offer knowledge in cash flow management.

Solving the lack or loss of key persons, employees should be given better incentives to enable them to stay. More persons should also be trained on carrying out key roles in the business. Employees' empowerment should be encouraged. First line employees should also be given an opportunity to have their fingers on the daily happenings in the business. It is therefore important to develop open communication that allows regular feedback about what is going on in the business to assist owners and managers make accurate decisions that will lead to a better performance. Competition is a factor that a business must be prepared for before going in to an industry. Businesses must offer better services and products compared to its competitors. Aggressive actions such as better prices of products to more customers should be implemented.

Mafikeng SMEs in general need to improve on their relationships with banks for mutual benefits. The more their transactions with banks, the higher their possibilities of gaining favours from banks. They also need to always prepare an update financial report for banks to determine their liquidity. Apart from banks, they can also look for funds from other micro-lenders who offer these services on a reasonable interest. Creating stronger unions or alliances that can better bargain for better treatment from the government is important. Pressure can be made on the government by a strong union to reduce certain regulations, reduce taxes and also boost their financial difficulties by introducing regulations on financial institutions that will force them to assist SMEs to improve their performance.

## 7. Conclusion

This paper successfully brought out the relationship between cash flow management and operational performance on Mafikeng SMEs. From the empirical findings results proved that, Mafikeng SMEs lacks skills to carry out effective cash flow management which in turn is affecting their operational performance. However effective measures are to be put in place to control this problem. This is because the more better a business can solve its shortcomings, the more competitive it becomes in the constantly changing business environments.

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