

**INTERNAL CONTROLS AND THE RISK PERFORMANCE OF SMALL AND  
MEDIUM MANUFACTURERS IN THE CAPE METROPOLE**

**By  
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**Lisa Nqala**

**September 2020**

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**Signed**

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**Date**

## **ABSTRACT**

In recent years, SMEs manufacturers seem to be refocusing and intensifying their keenness to know the nature of risks within their operational environments and their risk performance. Numerous external forces, including government regulators, credit-rating agencies, stock exchanges, occupational stakeholders, and institutional investors, are increasing their call for a significant focus on effective risk oversight and optimised risk performance. The manufacturing industry sector focuses on production, which makes them more exposed to risks of irregularities. This study investigates how small and medium manufacturers optimise their internal control systems and how the internal control systems are utilised to mitigate risks in the Cape Metropole. The study's objective is to explore how internal controls are utilised by manufacturing SMEs to (a) mitigate and (b) prevent risks by implementing standard practices from the onset. The research study was conducted on selected manufacturing SMEs in the Cape Metropole. The study follows a qualitative research paradigm, adopting an inductive approach to support the data collection, data analysis, and data presentation methods. The research study adds value to the body of knowledge. It gives a better understanding of the proper implementation and utilisation of internal control systems in small to medium manufacturers in the Cape Metropole. The managers were mainly the business owners and were largely responsible for implementing adequate internal control systems within their businesses. This would assist the managers to utilise the internal controls processes effectively to prevent and mitigate risks. To achieve the aim of the studies, interviews, observation and field notes were used to gather data from the relevant people in the businesses. The study showed that SMEs owners and managers were aware of the critical importance of the internal control systems; consequently, they effectively used the internal control systems. The owners and managers were aware of their challenges and limitations and were happy to learn better ways of efficiently implementing standard internal control systems.

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## DEDICATION

I dedicate this thesis to my Aunt Beatrice Mditshwa who raised me, my late mother Nokuvela Nqala, to my late father Petros Mzelemu, to my late two grandmothers Mambhele and Makhweshube, to my late cousin Ncumisa Nqala, to my late Uncle Bhekukuphiwa Nqala and my late Aunt Nomathamsanga Nqala.

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### Abbreviations

### Explanation

SMME	Small Micro and Medium Enterprises
SMEs	Small and Medium Enterprises
COSO	Committee of Sponsoring Organisations of the Trade Commission
SEDA	Small Enterprise Development Agency
ERM	Enterprise Risk Management
ISO	International Organisation for Standardisation
EFT	Electronic Funds Transfer
IIA	Institute of Internal Auditors
CBA	Cost-Benefit Products
GDP	Gross Domestic Analysis
4IR	The Fourth Industrial Revolution
MTS	Make To Stock
MTO	Make To Order
IT	Information Technology
DTL	Direct To Consumer
IP	Intellectual Property
JIT	Just In Time
HR	Human Resource
OED	Oxford English Dictionary
ROI	Return On Investment
PMBOK	Project Management Book Knowledge

SWOT	Strength Weakness Opportunities & Threat
RBS	Risk Breakdown Structure
WBS	Work Breakdown Structure
ICASA	Independent Communications Authority of South Africa
CEO	Chief Executive Office
IMF	International Monetary Fund

## CHAPTER ONE (1)

### INTRODUCTION AND PROBLEM ORIENTATION

#### 1.1 INTRODUCTION

Small and Medium Enterprises (SMEs) are known for their role in South Africa's socio-economic and sustainable development (Susman, 2017:1). Although SMEs contribute to the economy, the studies still reveal that their survival is still an issue as they are still faced with a high rate of failure over the years. These are subject to a high failure rate and this discourages many other entrepreneurial hopefuls. Friedrich (2016:1) posits that 80% of SMEs business start-ups close down within the first five years of starting the business. Small and Medium Enterprises (SMEs) are struggling to fulfil their potential, one critical element of effective business management is the accounting system (Kriel, 2020:1) which enables the business to measure its performance.

This necessitates the effective management of the internal controls as these are readily available to the internal stakeholder. It is hypothesised that if these can be measured, they can be managed or specific risk management strategies can be performed to avert possible failure. Internal controls in a business can be defined as a process used to assure that the organisation's objectives are met through operational effectiveness and efficiency (KPMG, 2020:1). This is measured from the financial perspective, which is a product of reliable financial reporting and the control of everything that assists in the controlling or managing of risks.

Risk is defined by COSO (2020:1) as the possibility or probability of an individual or organisation losing something or anything considered valuable for the organisation or individual. Small and Medium Enterprises (SMEs) operate on limited resources largely, and this increases the "risk" of them closing down or not operating at optimal levels (Delloite, 2020:1). Risk can be intentional (when individuals deliberately get involved in stealing the value) or may be unplanned, such as a change in the marketplace (COSO, 2020:1). Internal control systems will, therefore, enable the organisation, SMEs in this case, to direct, monitor, and measure the performance of the organisation. Furthermore, in this study risk performance refer to risk mitigation and prevention. This study seeks to evaluate the impact of internal controls as a determinant of the effectiveness and efficiency of an organisation. Internal control systems provide data and information needed to regularly monitor the "pulse" or the organisation's life.

## 1.2 BACKGROUND

Small and Medium Enterprises (SMEs) are critical to the South African economy as they create more jobs than both the government and existing large businesses (Friedrich (2016:1). On average, business start-ups contribute between 63% -76% to all new jobs created in a country (Susman, 2017:1), indicating the indispensable nature of SMEs in any economy. Together with this, these contribute to the innovation commonly needed in the market to advance the economies of countries generally. The high levels of unemployment in South Africa make it more critical for studying the survival of SMEs as a solution for the poverty levels in the economy. The employment generated by SMEs is essential for the reduction of poverty and the lowering of inequality through the increase of employed people in an economy (World Bank, 2020:1).

A study by the National Small Business Chamber (2016:1) concurred with the assertions above; this confirmed that SMEs are an essential part of the South African economy. Most graduates in the economy are not employed for many reasons, some of which are shrinking the South African economy. Any additional job in the market contributes to eradicating poverty and thus helps with both the economic development and growth of the country. Nimrod (2014:1) posits that the South African manufacturing SMEs are key drivers of the Growth of Domestic Product (GDP). It is evident that new manufacturing start-ups contribute positively to employment created, a lesson learned from the Asian Tigers (Friedrich, 2016:1). The bulk of the poverty eradication programmes in Asia comprise large SMEs and small family businesses or the cottage industry. Jiang and Li (2010:214), KPMG (2020:1) and World Bank (2020:1) explain that even though legislation has been passed in many countries to boost economic growth, there is still a very high start-up failure rate.

There is no scientifically correct definition of SMEs, and this is largely done per country as evidenced by the different definitions from different authors. Abor and Quartey (2010:219) postulate that some researchers try to define SMEs by size, some use legal status, type of production, capital assets, the skill of labour and revenue. These differ from country to country and therefore, there is no universal definition of what an SME is (Cacciolatti and Lee, 2016: 7). The definition used in this study is as it is understood and or called in South Africa. According to Ardjouman et al. (2015:157), SME definition depends on the organisation or country and can be looked at from different intuitive understandings. The National Small Business Act 102 of 1996 in South Africa, SMEs can be defined according to the size of the business, the number

of workers, annual sales and total assets excluding property. The definitions are classified systematic below in table 1.1

**Table 1.1 Definitions of SMMEs**

<b>Business Size</b>	<b>Number of Employees</b>	<b>Annual Turnover(Rand)</b>	<b>Total Assets, Excluding Fixed Property(Rand)</b>
<b>Medium</b>	Less than 100 to 200 based on the business	Minimum of R4million to R50 million, based on the business	Minimum of R2million to R18 million, based on the business
<b>Small</b>	Less than 50	Minimum of R2 million to 25million, based on the business	Minimum of R2million to R4.5 million, based on the business
<b>Very small</b>	Less than 10 to 20, based on the business	Minimum of R200000 to R500000, based on the business	Minimum of R150000 to R500000, based on the business
<b>Micro</b>	Fewer than 5	Minimum of R150000	Minimum of R100000

**Source: Falkena et al. (2001).**

The classification of SMEs in the South African context is somewhat complex since there is not one criterion used to classify these. Whichever way it may be classified, every manufacturing enterprise fits into one category or another of the guidelines tabulated above. The common factor about all these is that, regardless of the category in which one falls, all business operations of a necessity need internal control systems.

The government gazette (2019), the minister of Small Business Development, acting in terms of section 20 (2) of the National Small Enterprise Act, 1996 (Act No. 102 of 1996), has proclaimed the follows, in matters about the definition of Small Enterprise in South Africa Amend the Schedule of the Small Enterprise definition as contained in the National Small Enterprise Act, 1996 (Act No. 102 of 1996), read with the National Enterprise Amendment Act, 2003 (Act No. 26 of 2003) and the National Small Enterprises Act, 2004 (Act No. 29 of 2004) to:

- 1) New turnover threshold values to account for inflation, since the schedule was last revised in 2003;
- 2) Two proxies instead of three. The new schedule defines small enterprise using two proxies - `total full-time equivalent of paid employees and total annual turnover;
- 3) Removal of the third proxy of Total Gross Asset Value in the current definition as the proxy is often inappropriate and difficult to measure.
- 4) The size or class category very small enterprise' collapsed into the `micro enterprise' category. Many users found this size or class category unhelpful and inconsistent with international practice.

Friedrich (2016:1) mentions that SMEs are critical in achieving economic growth objective in developing countries. The World Bank (2020:1) agrees that the presence of active SMEs has a huge impact on economic growth and development across the board, but specifically in developing countries. The advantage of SMEs is that they are flexible to market conditions and changes compared to big companies (Abor and Quartey, 2010:223). Small and Medium Enterprises (SMEs) contribute more to the reduction of unemployment and poverty eradication than do large corporations. The future of developing countries, therefore, hinges mainly on the ability of the economy to nurture and sustain SMEs (Kriel, 2020:1). Small business start-ups, generally known as entrepreneurs, are defined as the part of the community that engages in conceptualising, organising, and innovative new ways of self-empowerment. The spin-offs are, as alluded to above, the creation of employment and poverty eradication (Cacciolatti and Lee, 2016: 7).

The unpredictable nature of the market terrain is another factor impacting negatively against the entrepreneur. Lack of adequate tools to combat the threat will simply weaken the chances of success for the business. Protiviti (2020:1) concurs that the exploitation of opportunities by these SMEs into manufacturing is a bold move that may be the only answer to the situation in Africa. The World Bank (2020:1) posits that SMEs contribute 70% to job creation in the economy, whereas large corporations only contribute 30%. Since job creation is largely dependent on new start-ups, many resources (financial, training and research) are imperatives that the governments should rally around.

Small and Medium Enterprises (SMEs) are credited with the most innovation in technology and approaches to other business techniques, whereas large corporations struggle to change from traditional business methods (IIA, 2020:38). The problem with large corporations is to do with the bureaucratic and tall structures which involve many levels before ideas can be accepted for implementation. South Africa Institute of Chartered Accountant (SAICA), (2020:2) postulates that despite the significant contribution of SMEs to the economy, they are numerous bottlenecks that have an impact on maximising their full potential. Furthermore, Kriel (2020:1) confirms that SMEs are not growing as expected, in line with the projection of 2023 in line with the projection on the economy's growth. The projections estimated that 80% of the new jobs (11 million) would come from SMEs.

### **1.2.1 Why SMEs / start-ups fail**

Though governments and non-governmental organisations have embarked on the start-up's development programs, the failure rate has not been reduced substantially. The causes of these unprecedented SMEs failure rates have been a subject of interest globally, admittedly different reasons have been identified, (SAICA, 2020:15) (Delloitte 2020:1) provide a comprehensive list



of the many different reasons /causes for the failure of these new operations. Below is the list of eighteen (18) possible causes for business failure emanating from different research findings in different places. Table 1.2 below is an illustration of the numerous reasons that may cause business failure.

**Table 1.2: Reasons why business start-ups fail**

<ul style="list-style-type: none"> <li>• under capitalisation,</li> </ul>	<ul style="list-style-type: none"> <li>• poor understanding of business,</li> </ul>	<ul style="list-style-type: none"> <li>• poor business planning</li> </ul>
<ul style="list-style-type: none"> <li>• a wrong type of business,</li> </ul>	<ul style="list-style-type: none"> <li>• lack of necessary / relevant skills,</li> </ul>	<ul style="list-style-type: none"> <li>• selling on credit terms,</li> </ul>
<ul style="list-style-type: none"> <li>• misuse of capital assets,</li> </ul>	<ul style="list-style-type: none"> <li>• regular stock shortages,</li> </ul>	<ul style="list-style-type: none"> <li>• wrong stock for customers,</li> </ul>
<ul style="list-style-type: none"> <li>• cultural practices,</li> </ul>	<ul style="list-style-type: none"> <li>• lack of hard work,</li> </ul>	<ul style="list-style-type: none"> <li>• unethical behaviour,</li> </ul>
<ul style="list-style-type: none"> <li>• poor control systems,</li> </ul>	<ul style="list-style-type: none"> <li>• activities by competition,</li> </ul>	<ul style="list-style-type: none"> <li>• lack of focus in the business, and</li> </ul>
<ul style="list-style-type: none"> <li>• cash flow management</li> </ul>	<ul style="list-style-type: none"> <li>• no clear objectives</li> </ul>	<ul style="list-style-type: none"> <li>• poor customer service</li> </ul>

**Source: Jowah (2020).**

It should be stated that the above risk factors would affect any business regardless of size or time in the market as long as they are allowed. The focus on SMEs is primarily because they are the subject of study and besides they are also characterised by a few factors, namely;

- the businesses are generally new and are not well established to withstand risk factors,
- the new businesses may not have adequate resources adding to the risk impact, and
- generally, business owners do not have much experience in running enterprises.

While the list is long and is a summation of the whole range of reasons, particular focus is put on those aspects that belong to the internal control systems. These are (extracted from the table above), namely, under capitalisation, misuse of capital assets, inadequate control systems, regular stock shortages, selling on credit terms, and wrong stock for the customers.

**Under capitalisation;** too often new businesses in the South African context are started and run by people with no adequate capital. This affects many issues including the ability to provide top of the range equipment, paying rent and electricity, paying salaries, and attracting experienced personnel to assist with the operations. This may make it difficult for the business to be sustained for long, ending up with the rounding up of the operations (Cardon, Stevens and Potter, 2010:79).

**Misuse of capital assets;** too often because of lack of experience the business hopefuls do not know what money (or other assets) belong to the business. The income is always treated as money available for personal use (Kriel, 2020:1), without distinguishing business money (capital) from net profit – income. The conversion of capital assets into personal money diminishes the capital reserves and weakens the capabilities of the business to expand.

**Regular stock shortages;** too often the stock is not available for customers to buy, and that will be money lost. Besides, customers get easily discouraged if they cannot get what they want. Conveniently, they can move to the competition (if there is one near) and may never come back to the business if they find joy in the competition's service.

**Selling on credit terms;** selling on credit is in a sense financing the buyer, and while this may attract traffic to one's business, getting them to pay may be difficult. Payment delays will affect the cash flow (Townsend, Busenitz, and Arthurs, 2010: 199), which works negatively against the business. Procurement of stock may be affected, rent has to be paid in time and salaries and other overheads need prompt payment (Li and Zheng, 2019:377-405).

**Wrong stock for the customers;** if there was no proper analysis of the market needs and trends, the business might manufacture products with dwindling purchases. Carrying the correct stock makes the customers trust the manufacturer and may attract more repeat buys. It is cheaper to maintain existing customers than it is to get new customers.

**Inadequate control systems;** the rest above can be picked easily if there are efficient internal control systems in place (Deloitte, 2020:1). This allows for early detection risks and possible future problems, “to be fore-warned is to be fore-armed.” Prevention will always be better than cure and the importance of management of risk is that the business anticipates a problem and takes decisions to avoid that (KPMG, 2020:1). Good, effective and efficient control systems will always help with the early identification and detection of problematic situations (Kriel, 2020:1).

If the system is applied expeditiously, these risk factors may be picked in time and failure can be averted if appropriate decisions and steps are taken and implemented. Samadi (2016:1) postulates that internal controls are necessary for both SMEs and large businesses alike, suggesting that they (internal controls) are part of the everyday activities of running a business. The failure of a business start-up means much in the form of spent costs that may never be recovered, thus “prevention is better than cure.” All aversive risk methods should be employed to maximise the chances of the success of the business start-up (SAICA, 2020:15). Apart from the sunk costs, there will be laying off employees, thereby reversing the campaign to eradicate poverty.

Jackson and Stent (2020:4) view that most research studies neglect the organic combination between internal systems and internal control in business which are the most effective tools used to measure the health of an organisation before the risk becomes threatening. Furthermore, Deloitte (2020:1) opines that there are numerous challenges in implementing and utilising internal control systems of manufacturing SMEs. The challenges are mainly due to either the absence of knowledge on the importance of the internal control systems by management or the improper use of the internal control systems. The Institute of Internal Auditors (IIA, 2020:38) states that SMEs' poor internal controls cause financial crises that lead to the failure of business start-ups.

The importance of risk management as a proactive way of pre-empting negative impacts on the business cannot be understated. If appropriate and effective control tools are implemented in the manufacturing and operations of a business, they will allow the measurability of the activities and help the sustenance of the business (Jackson and Stent, 2020:4). Suggestions for what constitutes a reasonable and appropriate internal control systems tool are identified below (Xiaofonga and Huili, 2011:680), these are believed to be critical for implementing the risk prevention tools and techniques necessary to perpetuate the firm's life. They are, namely;

- the awareness of risk management needs to be strengthened,
- managers need to be assisted with basic accounting knowledge,
- managers must have the ability to keep up with market changes,
- there must be disciplined controls on the finance of the firm, and
- managers should be exposed to basic knowledge on costing.

The business's financial activities need to be audited and controlled by a responsible body of the business (Aksay and Mohammed, 2020:196). To ensure that all necessary tools and techniques are made available, regular reviewing of the control systems should be reviewed to check for relevance. Since the internal control system of the business will be checked regularly, the process of measuring these activities becomes a priority managerial function (Karyawam and Low, 2014:26). The probability of averting risk through risk identification processes will assist the manager in understanding the business better and therefore make plans to meet any likely problems or risks. In achieving business goals, the top management seeks to increase risk awareness in the enterprise's operation and implement policies and procedures to provide a framework for risk prevention and mitigation (IIA, 2020:10). The use of internal control systems will therefore be the apparatus through which operational efficiency and effectiveness can be identified, measured and managed.

### **1.2.1.1 Other factors responsible for start-up failures**

Several research studies have been conducted to understand why SMEs do not survive despite all the established supporting programs. Jiang and Li (2010:214) explain that even though development programs have been established to assist SMEs, a significant number of SMEs are still failing, they are suffering from internal problems, especially in the financial crises: the implementation of ineffective internal controls. Jackson and Stent (2020:5) agree that although SMEs have many contributions, a large number of SMEs are failing. Njaramba and Ngugi (2014:44) mention that management skills are a critical factor in the growth of SMEs. Burger (2016:1) agrees that the lack of management skills of the business owner has affected the development of small businesses.

Aksay and Mohammed (2020:196) state that management neglects internal controls and risk awareness and they do not have enough knowledge on how the business is operated which is a common problem with SMEs. Blessley and Lewis (2016:1) mention the disproportionate impact of regulations compared to big companies as one of the main challenges faced by SMEs. According to the American Institute of Certified Public Accountants (2008:1), studies reveal that manufacturers have the highest number of fraud cases reported. Most of these cases are discovered or detected several years later due to a lack of adequate internal controls and implementation of anti-fraud controls. This is evidence that most small and medium manufacturing organisations have challenges implementing optimum internal risk controls (Siwangaza and Dubihlela, 2017:90).

Borrowing the views in the study by KPMG (2020:1), it could be said that SMEs do not put more effort into fraud prevention, as they tend to have a more relaxed attitude towards irregularities. Kakuru (2015:1) mentions that SMEs must implement adequate internal controls as they play a massive role in detecting and preventing risks. Jackson and Stent (2020:5) mention that the cost-benefit approach is the limitation of internal controls. This means that the managers and owners of the business try to compare the cost of implementing internal controls to get the benefits of internal controls (Sarens, Abdolmohammadi and Lenz 2012:191-204).

A watered-down version of these internal controls is often implemented as it is difficult for them to accurately calculate the Cost-Benefit Analysis. It is generally challenging to calculate beforehand the cost of risk, and sometimes management consoles themselves doing with the probability of the risk ever materialising. KPMG (2020:1) postulates that improper analysis and understanding of the impact of a risk factor ends up with weak and not-fit-for-use internal control systems. As a result that, the business entities become more exposed to risks or

irregularities. The researcher assumes that, since there is a high business start-up failure rate (Cope, 2011:608), these causes should be isolated and studied. Even though there are numerous reasons, internal controls are equally critical, if not the most vital, hence the decision to research this. Following the questions above, derived from and aligned to the objectives, some expansion is necessary for a deeper and broader analysis and understanding. A theoretical discussion around these questions is embarked on below.

**Types of internal controls measures may be possible:** because most of these start-ups come from people with a specific complex skill, who then venture into manufacturing (Bruwer, Coetzee and Meiring, 2019:1). It is known that 75% of the people/entrepreneurs who start businesses generally start businesses in an area related to or closely related to their skill (Friedrich, 2016:1). Most suffer from simple things like they may not be strong in marketing, bookkeeping, or simply human resource management. While they may have the hard skills about the discipline in which they apply their trade, too often admin work is cumbersome and boring to them. Whatever the internal control system is implemented, it would be better if it is done with the help of experts in that field (Burger, 2016:1). While there may be, and indeed, there is always a cost to the use of a specialist, a good CBA may assist in deciding on using an efficient and effective internal control tool.

**Limitations encountered by the SMEs;** numerous factors may affect the decision-making system, considering that most of them get experience in management at the point when they are managing their businesses (Simmons, Wiklund and Levie, 2014: 485). Their limitations may be compounded in a way that they may lack management experience, limited capital and the start of the business (World Bank 2020:22), poor understanding of the finance system in the business, and the absence of a plan ideal for the business kind of purpose. It should also be stated here that anyone venturing into manufacturing needs to assess the market dynamics (Delloite, 2020:1). Most of them have not had that experience and they leave everything to chance. Proper accounting systems assist them in understanding the movement of their finance, costing of the products, and understanding of their profitability (Bruwer, Coetzee and Meiring 2019:1). Internal control systems and the knowledge of the cash flow in the business will help the owner/manager to have a full grasp of the strengths and weaknesses of their business.

**Effectiveness of a system;** existing well researched and utilised internal controls methods are dependable tools for all practical processes. Numerous standards have been established by professional bodies in this discipline (Jackson and Stent ,2020:5). A good understanding of these professionals will help structure an effective internal control tool for the business. Thus, the internal control system itself becomes the watchdog (Donelson, Ege and McInnis, 2015:1),

assisting in identifying anomalies (early warning systems), enabling the owner/manager to put programs in place and avert the risks.

One element of the causes of failure of a business is the inability of SMEs to utilise knowledge, like internal controls, effectively. This is an assumption made from observations by a few people who have critically reported a need to interrogate and understand this phenomenon. It is critical to clearly understand the problems, opportunities, and whatever else in the business (Siwangaza and Dubihlela, 2017:90). The internal control systems bring about the importance of statistical data over these because if you cannot measure it, how will you manage it.

### **1.2.2 Internal controls**

COSO (2020:1) defines internal control as procedures established by leaders of an organisation with the primary objective to measure performance. The three goals mainly targeted during the use of internal controls are, namely;

- safeguarding of the assets of the organisation,
- compliance with legislation and regulations, and
- accuracy of the organisation's financial records.

Ejoh and Ejom (2014:133) define internal control systems as measures implemented by the management in the organisation to facilitate the achievement of the objectives. The internal control processes include a set of policies, standards, and procedures by management to give reasonable assurance to meet the organisation's goals. Bruwer, Coetzee and Meiring (2019:1) suggest that internal control systems should not be merely thrown to the organisation, but adequate planning is needed to design a fit-for-purpose tool. Throwing in any internal control system that might not be fit-for-purpose may negatively affect the results it will produce. Joseph, Albert and Byaruhanga (2015:49) believe that if businesses want to reduce risks in the companies, they must adopt accounting policies to meet business goals, safeguard assets and grow their businesses. In concurrence, Jackson and Stent (2020:5) identify the objectives of the internal control system as;

- a) adherence to management policies,
- b) deter and detection of fraud and error,
- c) timely preparation of financial reports, and
- d) complete and correct accounting records.

The internal control tool allows you to see where problems may be lying but does not on its own correct the error, and it is the management's responsibility to manage risks. Aksay and Mohammed (2020:196) view that internal control provides reasonable but not absolute assurance to the organisation and that the organisation will meet its objectives. Constant

evaluation of control tools to improve efficiency is a critical element of effective internal control systems. The use of manual and automated controls saves costs and improves the accuracy of the work performed (Joseph, Albert and Byaruhanga, 2015:49). It may not be a prudent idea to think of the internal control system merely as a tool to abide by the laws and regulations and prevent fraud (Jackson and Stent, 2020:6).

The primary benefit of internal controls is that, if properly utilised, supported by proactive management, it may be the one vital tool in the hands of leadership to help improve business operations. South Africa Institute of Chartered Accountants (SACIA) (2020:15) opines that continuous monitoring of control tools with the added advantage of technology will inevitably bring about much-desired effectiveness and efficiency.

### **1.2.3 Components of internal control systems**

Control results from the fact that there are parameters laid down against which the performance is measured, thereby providing internal control. In business operations, generally, plans are laid down, budgets are constructed, objectives are set, and operational and tactical issues are planned (Klamm and Watson, 2009:1-23). The control is meant to keep up or is measured against the expectations as laid down in the projections, this necessitates the need for internal control. Thus performance becomes a known standard against which the internal control systems operate to bring about much-needed efficiency control within the organisational strategy is supposed to be internal, even though advice on implementing it may come from professionals outside of the business (IIA, 2020:38). This takes place within or by way of interrelated components (Adam, Diale and Richard, 2019:8), these are, namely; the social environment impacting employee conduct, the information needed for the internal control processes, the policies and regulations within the organisation.

#### **1.2.3.1 Five components of internal controls**

**Control environment;** control activity is the most crucial aspect as it is established and managed by the management, it moulds the attitude towards internal controls in the organisation (Bruwer, Coetzee and Meiring ,2019:1). This is in agreement with the findings by Xiaofonga and Huili (2011:682), who considered the control environment to be critical for an effective internal control process as a whole.

**Risk assessment;** involves the processes and procedures that the organisation puts in place to identify and analyse any risks associated with the organisation's ability to achieve its objectives (Deloitte, 2021:2). Once the risk has been identified, it can then be categorised as high, medium or low based on the accuracy of assessment (Joseph, Albert and Byaruhanga, 2015:49). Therefore, risk tolerance can be estimated using the information given at the end and the objectives that the organisation has set for itself.

**Control activities;** control activities can be categorised into the directive and preventive control activities, they help in trying to foresee the most potential problems, this will allow for precautionary measures to avert these risks or reduce their impact should they occur (Ndenge et al. 2015:49). The preventive activities are implemented as a buffer to curb or eradicate the risk before it takes place.

**Information and communication;** information and communication refer to discovering, capturing, and exchanging information on a timely basis to accomplish financial report objectives (COSO: 2020:1). Communication with the other related parties outside and inside the business is vital for adequate internal controls (Deloitte, 2021:4).

**Monitoring;** Jackson and Stent (2020:4) posit that not every control tool will be effective in every case, thus there is a need to ensure that the internal control systems applied must be appropriate and effective. Therefore, it is prudent that there is a regular evaluation of the tool against the changing functions in the business terrain. According to Gakpo (2020:11-9) to achieve organisational goals, management needs to spend time monitoring the internal controls. Monitoring aims to ensure that internal controls are working as intended (Bruwer, Coetzee and Meiring ,2019:1).

Internal control systems are the most important tool that the management could use to ensure the achievement of the business goal (Donelson, Ege and McInnis, 2015:1).

These components could make a significant improvement to the manufacturing enterprise internal control systems. It is essential to point out that the tools are as effective as the people using them, it would be ideal for management to have some basic training on how these tools operate their benefit and their applicability in their manufacturing enterprises. Numerous researchers have come up with different “types” of internal control systems, and the most commonly spoken of in literature are directive, preventive, detective, and corrective.

**Directive controls;** directive controls refer to measures put in place by the leaders to encourage a desirable event to occur (Lemi, 2015:14). Directive control gives direction on what should happen to encourage and cause a desirable event to occur (Jackson and Stent, 2020:4).

**Preventive controls;** preventive controls are controls that leaders put in place aiming to deter undesirable events (KPMG, 2020:15). Lemi (2015:14) states that prevention controls involve employing more skilled staff, separation of duties, high moral standards and a sound control environment.

**Detective controls;** detective controls detect and report risks before they occur (Njeri, 2014:13). Detective controls are controls put in place by management aimed at deterring undesirable events, so corrective action can be taken (Gakpo, 2020:11-9).



**Corrective controls;** corrective controls are controls that leaders put in place to inform or address every problem that the system has encountered or is most likely to encounter (COSO, 2020:1).

#### **1.2.4 Risks performance**

South Africa Institute of Chartered Accountant (SAICA) (2020:15) urges that SMEs put in place risk management strategies to improve enterprise performance. Pre-empting the risk has tremendous benefits to the organisation in that the organisation does not react to a problem, but rather, proactively combats the likely happening. Cline (2015:43-45) defines risk as to the potential for losses of valuable things that have not been controlled or planned for as a result of some action or inaction. This comes because, too often there is, intentional interaction with uncertainty whether it was identified beforehand or not, planned or not planned - the impact may be the same. In concurrence COSO, (2020:1) postulates that just being uncertain on its own is potential for risk that may result in the unpredictable and most probably uncontrollable outcome. For this reason, therefore, it is crucial to identify potential risks and plan to avert the unwanted occurrence, controls of which may be significantly assisted by internal control systems. A few risks may be mentioned, and these are; strategic risk, compliance risk, operational risk, and financial risk.

**Strategic risk;** every successful business needs an all-encompassing plan with information covering both depth and breadth. On the other hand, the global environment is not static, thus, no matter how good a plan may be put up together, it has to be adjusted with the changing times. Failure to adapt to changes will render your organisation out of step more and more each time changes take place and you do not adjust. Some significant changes that cause business risk are customer demand shifts, technological changes, and competition activities, changes in the cost of raw materials (Jackson and Stent, 2020:4).

**Compliance risk;** complying with the laws and regulations may help reduce the risk the company may face, it is equally important to note that laws change all the time. The business expansion might mean that you may need to know other rules that apply to big businesses to avoid the risk. This specifically, if you get to a new product range, you may find it necessary sometimes to register the product or comply with other laws. It may even be employee safety, primary conditions of employment, labour relations, etc. (SAICA, 2020:3).

**Operational risk;** you may have operational problems, demotivated employees working below expected production capacity. The use of old machines may keep breaking or simply do not produce to meet your customers' demands. Some of these internal problems might use software that does not deliver as you want it to, or simply do not employ the right people for the right jobs. Then there can be payment of wrong amounts, pilferage, poor stock records, shortage of

stock, keeping wrong stock for the market – all these are expenses you do not want to sit with (COSO, 2020:1).

**Financial risk;** all risks have financial implications, whether it be losing money that you already have (say paying fines or overpayment of a creditor) or “leaving money on the table.” By not taking advantage of an opportunity to make money, unpaid debt, customers are given goods on credit (financing them) or supplying customers who pay after many days if not months thus affecting cash flow (cash is king). The absence of cash flow may affect wages and salaries, rentals, and other bills that need to be paid, including buying raw material cash from your suppliers (IIA, 2020:1).

The success of a business, therefore, hinges on many issues, it is critical to note that internal control systems depending on how they are structured can identify some of these risk factors. As already alluded to, the success of SMEs means a lot for many poor people and the country at large, and this is the simple most potent weapon in the hand of the government to eradicate poverty. However, this weakness, of a manager who does not have measurable and quantifiable information about his/her business does not help economic growth and development.

According to the statutory Annual Report (2016) risk appetite, vary on the risk type. Businesses are more exposed to different kinds of risks such as regulatory or compliance risk, operational risk, errors that could lead to financial loss or negative publicity (KPMG, 2020:1). Risk management practices involve insurance, recruitment, maintaining cash reserve, installing security systems, safety, training, monitoring, policy and procedures and effective communication with employees (Gakpo, 2020:9-11).

The absence of segregation of duties, putting so much trust on employees, lack of follow-up when something wrong happens, no control over cash and buying material, and lack of training regarding policies and procedures increase risk in the business. Effective implementation and proper use of internal controls are important to avoid failure as businesses fail due to staff misuse. Deloitte (2020:2) urges that basic internal control systems implementation in the finance department mitigate irregularities like theft. Bruwer, Coetzee and Meiring (2019:1) point out that in practice it has been proven that it is not possible to implement risk assurance that can provide absolute assurance, therefore; the risk can be mitigated depending on risk tolerance.

### 1.3 PROBLEM STATEMENT

Small and Medium Enterprises (SMEs) are known for their significant contribution to economic growth, economic development and job creation potential worldwide. Researchers has noted that approximately 80% of all new business start-ups close doors within the first five years of starting, most of which, as alluded to above, is because of inadequate internal control systems (Friedrich, 2016:1). The primary source of information in effective strategic planning for any business is sourced from the internal control systems which report on operational issues. Proper implementation and the utilisation of internal control systems can help improve the operation and performance of the organisation and reduce failure risks. The impact of ineffective implementation and improper utilisation of internal control systems leads to high rate failure of SMEs. Therefore, the research problem investigated within the scope of this dissertation reads as follows: **Internal control systems within small-medium enterprises in the Cape Metropole are not properly implemented and utilised, resulting in high-risk exposure.** The delineation of the study was the manufacturing SMEs in the Cape Metropole.

### 1.4 RESEARCH OBJECTIVES

Research objectives are the expectations that the researcher has and these are the anticipated deliverables from the research. Research objectives can be divided into two types, namely; primary objectives and secondary objectives.

#### 1.4.1 Primary objective

- Determine the framework/tools to be used to guide the implementation and utilisation of the internal control systems for reducing and preventing risks for manufacturing SMEs.

#### 1.4.2 Secondary objectives

- To determine the existence (implementation) of internal control systems
- To establish the limitation that SMEs encounter when making use of implemented internal control systems
- To identify factors that prevent SMEs leaders from implementing effective internal control systems.
- To determine the leakage on utilisation of implemented internal control systems on risk mitigation and prevention.

## **1.5 RESEARCH QUESTIONS**

Research questions are derived from the problem statement and the objectives, which are the expected deliverables for the research. Research questions also assist in delineation and or directing as to what literature is to be covered in the study, this makes the research question critical to the study. The research questions also become the guide for the research instrument to be used and the questions in this study will be divided into two, namely; main or primary questions and sub-questions or secondary questions.

### **1.5.1 Primary research question**

What internal controls system framework/tools can be utilised to guide the implementation of the internal control of risks for manufacturing SMEs?

### **1.5.2 Secondary research questions**

- What types of internal control systems are being used by SMEs in the manufacturing industry?
- What are the limitations that SMEs encounter based on the types of internal control systems implemented?
- What factors prevent SMEs to implement effective internal control systems?
- How effective are the implemented internal control systems in risk mitigation and risk prevention?

The research questions above guided the literature reviewed and assisted in the understanding in both breadth and depth of the problems with control systems by the manufacturing SMEs. These questions were derived from the problem statement and aligned to the research study's objectives to provide answers to the problem statement. The information-gathering instrument was derived or constructed from these research questions, in its entirety, including all three sections.

## **1.6 RESEARCH APPROACH**

The research study utilised a qualitative research approach. Qualitative research is a method that uses words to analyse data collected and is distinguished by its objectives (Quinn and Cochran, 2002:2). Yin (2017:129) states that qualitative research allows complications and dissimilarities of a world under investigation to be explored and represented. Inductive research begins with observation (O'reilly, 2009:4). The primary objective of inductive research is to allow research results to come out from the frequent, dominant or key themes acquired from raw data without the control force by structured methodology (O'reilly, 2009:4). The inductive format is appropriate for the study as the study's main objective was to develop a theory that

explains how SMEs owners and managers in manufacturing utilise and implement internal controls to mitigate and prevent risks and how phenomenon shapes their behaviour and attitude towards risk prevention and mitigation.

### **1.7 TARGETED POPULATION**

The targeted population of the study were the owners and managers of the SMEs in the Cape Metropolis.

### **1.8 DATA COLLECTION METHODS**

The data of this study was obtained through interviews, observation, field notes and was analysed in terms of words to help solve /or mitigate the research problem at hand using thematic analysis. The interview can be defined as a meeting between people, where the interviewer is asked questions to collect information and getting to know more about the interviewer (Merre, 2007:67).

### **1.9 SAMPLE AND SAMPLE SIZE**

The sample comprised of managers and owners in SME manufacturing companies within the Cape Metropolis. This area has been chosen for convenience as it would be challenging if not impossible to come to the whole province let alone the entire country. A purposive sample of thirteen (13) owners and managers were deemed adequate to give information on the risk control activities in the manufacturing SMEs' sector.

### **1.10 SAMPLING METHOD**

For this research, purposive sampling was used. In the case of purposive sampling, only the sample that provided the data needed to achieve the study's goal was selected. According to Merre (2007:178), purposive sampling is a sampling of the most likely population to provide the best information to satisfy the research study's goal. The population of the study was the owners and managers of SMEs in manufacturing industry.

### **1.11 DATA ANALYSIS**

A thematic analysis tool was used to analyse the data collected as it is effective and convenient to use. The collected data was captured on a word document where it was cleansed and later converted into themes for readability.

### **1.12 CONTRIBUTION OF RESEARCH**

At the end of the research study factors influencing risk performance and internal controls systems would be analysed. The research study would add value to the body of knowledge and give a better understanding of the proper implementation and utilisation of internal control systems in small to medium manufacturers in the Cape Metropole to mitigate risks. The study would establish the influence of internal controls on the operational efficiency and effectiveness of SMEs. The study would provide a general framework that can improve the implementation and utilisation of internal controls systems to mitigate risk. This study would be helpful to the manufacturer's managers, owners, and any other interested person, to a great extent. It would provide recommendations and conclusions on how manufacturing managers and leaders can implement and utilise internal controls to mitigate/prevent risks. Manufacturer's owner-managers who are in the process of implementing adequate internal control systems within their businesses would have a better understanding of its importance and how to utilise them effectively to prevent and mitigate risk.

### **1.13 DELINEATIONS OF THE RESEARCH**

The participants would have to adhere to a specific set of rules to justify a valid response:

- all manufacturing enterprises participants were in Cape Metropole,
- participants were limited to manufacturing leaders (i.e., be the owners and /managers),
- leaders (i.e., owners/or managers) should be actively involved in the daily operational activities of the manufacturing enterprise and should have been non-franchise, and
- all manufacturing participants were in existence for a minimum of 2 years.
- the manufacturing enterprise should not be in the privatisation process.

### **1.14 ETHICAL CONSIDERATION**

The ethical consideration of this study is more located in data collection. All information collected via interviews would be strictly confidential to ensure that it does not violate the organisation (s) privacy and does not reveal any information that could negatively affect the organisation (s) reputation or disclose private information to its competitors. Participants would be given an explanation of the aim of the study and that the data they provide would be for the purpose of the study. All participants were informed that they are voluntarily participating. Participant's statements during interviews would not be changed in any way to suit the study. Ethical Clearance certificate was obtained from the Cape Peninsula University of Technology Ethics Committee.

## 1.16 CHAPTER CLASSIFICATIONS

**Chapter one:** this chapter starts with an introduction to the background of the study. Then it discusses the objectives of the thesis, background to the research problem and the research questions. In addition, it presents the contribution of the research and provides a brief overview of the other chapters.

**Chapter two:** literature review: this chapter begins by introducing specific theories underpinning the study, manufacturing industry, characteristics and different manufacturing processes.

**Chapter three:** literature review: this chapter begins by introducing specific theories underpinning the study, business risk and the manufacturing sector.

**Chapter four:** literature review: this chapter begins by introducing specific theories underpinning the study, internal controls and risk management in business operations

**Chapter five:** this chapter provides the conceptual framework and conceptual model in this study.

**Chapter six:** research design and research methodology: this chapter provides the research design and method used in the study. The sampling techniques and sample size are discussed and explained. The data collection method is explained and discussed to give a clear picture of how the data was collected. The validity and reliability of the study was discussed. The data analysis is explaining as to how the findings were analysed. Lastly, the ethical consideration of the study is explained.

**Chapter seven:** data capturing, construction, analysis and interpretation. Analysis and findings: the chapter addressed the findings of the study to answer research questions related to research objectives. This chapter gives a clear picture to the readers as to how the findings were analysed for the purpose of the study.

**Chapter eight:** summary of the findings, interpretation and recommendations: the implications and value of the study is discussed in this chapter.

## CHAPTER TWO (2)

### MANUFACTURING INDUSTRY AND MANUFACTURING PROCESSES

#### 2.1 INTRODUCTION

Manufacturing is the conversion of goods from one form or state of unusable condition to another form or usable state through the use of hands or machines (Protivite, 2020:3). Therefore, the goods or finished products can be used or can be sold to a customer or consumer for use. The manufacturing process involves the conversion of raw materials (primary goods) or semi-processed goods (intermediate products) from one form to a finished form of goods (Brand South Africa, 2017:1). Manufacturing can be small or large scale conversion of materials or components for eventual use, this generally attracts or requires specific skilled labour of different forms, too often complementing each other in the process. Most manufacturing enterprises are not large and are classified as Small Medium Enterprises (SMEs).

Jennings (2015:1) indicates that 90% or more of manufacturing industries belong to this category. This was confirmed by Protiviti (2009:6), who states that 90% of South African manufacturing is classified as SMMEs in the South African business size classification system. Hatten (2014:12) concurs with this and alludes to the fact that these are the mainstay of any developed economy. Other researchers such as McIntyre, (2020:1) and World Bank,(2020:1) have confirmed, as alluded to above, that +- 80% of SMEs fail to survive beyond five years (5 years) after they have been inaugurated.

**Figure 2.1 South African manufacturing industry**



**Source: Brand South Africa (2017)**



## **2.2 TYPES OF MANUFACTURING FIRMS**

Some types of manufacturing firms common in SMEs are discussed below. The list below is limited in that it mentions only those types that were involved in the research, and there are many more different types of manufacturers that could not be reached.

### **2.2.1 Food manufacturing**

This is generally the transformation of primary farm products into an edible and packable format for the consumers. Typically, these will involve livestock packaging, processing of grains and or oilseeds, and these are generally sold to wholesalers.

### **2.2.2 Beverage product manufacturing**

These include alcoholic and non-alcoholic beverages including extraction of juices from fruits, fizzy drinks, and yoghurts which may also be made in liquid form.

### **2.2.3 Textile manufacturing**

Conversion of fibres from cotton or sheep wool into fabrics or fibre, yarn, thread, further used for making clothes, etc. from these towels, handkerchiefs, bed sheets, curtains etc., are made.

### **2.2.4 Apparel manufacturing**

The cutting and sewing of fabric into garments resulting in the clothes that we put on, such as trousers, dresses, jackets, suits, shirts, blouses, skirts, panties, etc.

### **2.2.5 Leather and allied product manufacturing**

Conversion of animal hide to the processed leather form. Therefore, this can be developed into purses, wallets, handbags, shoes, leather jackets, and leather sofas.

### **2.2.6 Wood product manufacturing**

The manufacture of plywood, veneers, flooring, wooden tiles, wooden walls, pre-fabrications, and any other wood forms is used to cover or model structures out of wood.

### **2.2.7 Paper manufacturing**

These manufacture paper, pulp, conversion to paper products, including printing material, textbooks, exercise books, notebooks, calendars and diaries, etc.

### **2.2.8 Petroleum and coal manufacturing**

Transformation of crude petroleum into a usable format like liquid paraffin, alcohol, turpentine and all organic solvents, and this together with coal as a fuel.

### **2.2.9 Chemical manufacturing**

Transformation of organic and inorganic material into consumables – soap, floor polish, paint, insecticides, pesticides, fertilisers, drugs for medicinal purposes, and hair products.

### **2.2.10 Plastics and rubbers manufacturing**

Conversion of malleable polymers into moulds irreversibly without breaking to form items like spoons, plates, syringes, desks, chairs, floors, Jerri cans, bottles etc.

### **2.2.11 Metal manufacturing**

Conversion of metals into usable items, like window frames, cups, tumblers, chairs, wheels, door frames, metal desks, metal chairs, plumbing pipes, water tapes, aluminium water bottles etc.

### **2.2.12 Machinery manufacturing**

This involves a lot of bending, stamping, forming, welding, hammers, crew-drivers, forging, saws, woodwork planes, welding rods, metal files, ploughs, cement mixers, compressors, and air-ventilation.

## **2.3 CHARACTERISTICS OF MANUFACTURING INDUSTRIES**

Manufacturing industries are comprised of numerous characteristics including among others that they are generally established far from the source of materials they use, far from the end-user of their finished product, are part of (the critical element of) distribution channel in the process of conversion, and are always the mainstay of the provision of the finished and usable products.

### **2.3.1 Distance from sources of material**

The general principle in manufacturing has always been determined by many factors, too often to do with convenience. Convenience in manufacturing and economic terms may have to do with the presence of production factors (Benchimol, 2015:152-184) among others would be land, finance and the political climate. Most of the minerals from the African continent were exported as raw material to Europe and America and eventually to Asia (World Bank, 2020:1). This helped develop the foreign countries and circulation of the wealth within those countries to the detriment of Africa (Zeng, Xie and Tam, 2010:183) which has remained largely poor.

Money or funding was not always available in Africa (even though it could have been transferred) and it was always convenient for the manufacturers with all other factors in their favour (Li, and Zheng, 2019:377-405). Most colonial companies and multinationals exported the raw materials from Africa to their home countries for many other reasons. Political factors and poor infrastructure on the African continent (Deloitte 2013: 3) even though that infrastructure could have been developed, the countries wished to develop the continent. Much of Africa has remained without the infrastructure to the advantage of Europe now referred to as the developed world (Masci, 2011:25-68).

The larger part of the market was always perceived to be in the developed world, allowing for the further development of that part of the world. Though 67% of the world's mineral resources are in Africa (Pawitan, 2012:131), the manufacturing GDP of African countries accounts for less than 7% of the world manufacturing GDP. Africa has not benefited its mineral wealth to manufacture and develop the continent to the levels of other continents if not better (Zeng, Xie and Tam, 2010: 184).

### **2.3.2 Distance from final consumer; in the modern structure**

Large multi-national corporations have moved their manufacturing enterprises to cheaper labour countries in Asia (Lloyds, 2017:1) using African raw materials. They manufacture at very low costs (cheap raw material from Africa and cheap labour from Asia) and ship to the developed countries where it is sold at high prices (Gelb et al, 2017:24) to enabling these countries to make large gross contribution margins in their investments.

Large corporations take advantage of economies of scale and manufacture large quantities and ship them across oceans and still trade at competitive advantages(Celli, 2013:255). The use of technology has also assisted in cutting down the costs of production and allowed large corporations added benefits on the global scene(Gelb, 2017:28).

### **2.3.3 Machinery and equipment**

All large-scale manufacturing requires machinery and equipment that will benefit from economies of scale (Zeng, Xie and Tam, 2010: 185). Most, if not all SMMEs may not acquire sophisticated large-scale production equipment and technology to give them competitive advantages. The arrival of the Fourth Industrial Revolution (4IR) may further weaken the position of the manufacturing SMEs, specifically on the African continent (Pawitan, 2012:131) illustrated in figure 2.2 below.

**Figure 2.2: Equipment for manufacturing**



**Source: Brand South Africa (2017)**

The use of hands and other less sophisticated equipment for manufacturing may only exacerbate the already dire condition under which the SMEs operate (Celli, 2013: 259) as shown in figure 2.2. The unavailability of infrastructure on the continent worsens the already uncomfortable situation on the continent as stated by the IMF global (Lloyds, 2017:1).

#### **2.3.4 Skilled labour requirements**

Since the industrial revolution in 1700, skilled labour has always been a requirement to manufacture goods (Deloitte, 2020:5). Africa has always lagged on this, hence the unprecedented low levels of manufacturing on the continent. McIntyre (2020:1) posits that 70-75% of entrepreneurs start businesses in areas with skills. The absence of technical skills based on the continent is a breeding ground for poor manufacturing enterprises.

The 4IR will worsen the situation of the manufacturing industry, specifically in the countries of Africa (Celli, 2013:259) that never actually got past the 2<sup>nd</sup> Industrial Revolution – Africa never has to manufacture but instead consumed what it never produced. Manufacturing in Africa is likely to be further affected and further diminishing the little capacity that sustains the economy. Gelb et al. (2017:14) indicate that the African manufacturing GDP is pathetic as it is, let alone with the arrival of the much talked about and dreaded 4IR.

These characteristics of the manufacturing industry, whilst they have a continental flavour are a reflection of the South African industry. The South African industry may not be understood well in isolation as globalisation has affected the structures and circumstances under which we

function (Li, and Zheng, 2019:377-405). Underlying all these should be the understanding that we are manufacturing in a highly globalised village and whatever the local SMEs do, is impacted on by the world we live in (Lloyd, 2017:1). As alluded to above, the basic structure and the wheels that propel the process of goods is the presence of a global supply chain on the basis on which goods are distributed worldwide (Celli, 2013:259). In all forms of manufacturing, there is a movement of materials from primary sources of supply to the final user of the finished product (Manuj, Esper and Stank, 2014:241-258), this process is referred to all critical distribution of the supply chain.

## 2.4 SUPPLY CHAIN PROCESSES

As indicated above, when products are eventually consumed, they are a result of many other activities and channels through which many processes take place. This takes place whether this involves food or other manufactured goods. For all purposes, the supply chain begins with the source up to the final consumer or customer of the goods concerned (Gelb et al, 2017:24). The manufacturing of any goods follows a particular supply chain, and are pre-determined by the product to be manufactured, considering that, there are different manufacturing processes. The different manufacturing types and or processes are discussed in detail below.

## 2.5 MANUFACTURING PROCESSES

The types or forms of manufacturing may be classified in different ways depending on what method is used for the categorisation. Manufacturing can be simplified by merely looking at it as a simple linear process;

**Table 2.1: Manufacturing process**

<b>BUY RAW MATERIAL</b>	<b>CONVERT TO DESIRED PRODUCT</b>	<b>SELL TO CUSTOMER</b>
<ul style="list-style-type: none"> <li>• Need money to buy raw materials, and money for rent, electricity, water and other materials for the business to operate.</li> </ul>	<ul style="list-style-type: none"> <li>• Need money to pay skills, maintain machinery and equipment, packaging material and telephone bills.</li> </ul>	<ul style="list-style-type: none"> <li>• Need money to pay personnel, storage, distribution of goods to the customer buying the goods</li> </ul>

**Source: Own construction**

From the onset, it shows that manufacturing involves many other activities, most of which have a cost element to them, without which production does not take place, as shown in figure 2.3. There are other requirements too that may be outside of the operations and yet they influence the activities of the manufacturer in the first place (Pawitan, 2012:137).

The manufacturer has to identify the final user – the presence of the market for the goods to be manufactured. The manufacturer must have the ability (skills, equipment and material) to manufacture the product in demand. The manufacturer must design a strategy dependent on the type of product and the costs required to produce. The manufacturer must determine the quantities to be manufactured dependent on market size and activities.

**Make-To-Stock (MTS)** – Some goods have a long shelf life and may be required any time and throughout – such products can be made and be stored (in warehouses/wholesalers) or in the retail outlets until the customer comes to buy – pencils, chalk, clothes, painkillers, cough syrups or cups etc.

**Make-To-Order (MTO)** – Project-type-manufacturing – manufacturer produces only because there is an order from a customer – printing of a magazine for the month, typesetting of a manuscript to be published, order for a graduation or wedding gown for a coming occasion.

**Figure 2.3: Manufacturing process**



**Source: Brand South Africa (2017)**

## **2.5 RISKS FOR MANUFACTURING COUNTRIES**

Industries and businesses in their different forms have different types of risks they encounter, and risk management is an important element of business success. Manufacturing specifically has numerous risks by the very nature of the industry considering the global nature of

manufacturing. Technological advances and the pace at which they take place are themselves a risk for SMEs (Protiviti, 2020:3) as shown in figure 2.3. Whilst advances in analytical tools used for internal control systems are improving on a global scale, the predictive modelling capabilities have produced large amounts of data that are overwhelming and sometimes confusing (Gakpo, 2020:11-9).

Cloud computing has made manufacturing benefit from the use of IT and data security, it is increasingly evidenced that there are imperatives for compliance. There are areas of compliance to be noted and used effectively to reduce the risk.

These compliance areas will assist in defining areas in which organisations need to be if they have to be set apart to be competitive. There are specific risk areas for which compliance promotes and improves the chances of competitiveness (Bird and Park, 2017: 285). The eight main areas of compliance are,

**Anti-corruption;** there are different forms of corruption that the organisation may fall victim to. The plans and programs of the organisation should be clearly stated and be subject to examination and or evaluation (auditing) to allow for internal controls of the business (Deloitte, 2020:1). The absence of systems and structures of internal control will become unmanageable risks that might affect business operations without the system allowing for predictively identifying causes of failure (SAICA, 2020:21).

**Product safety;** the production of the products should be according to specific standards, be they ISO or South African Bureau of Standards specifications and expectations (Knutson and Ribera, 2011:2). These specifications should be subject to internal evaluation against the product safety standards, failure to meet such specifications may only be identified during internal control systems execution (Knutson and Ribera, 2011:4).

**Health, safety and environment;** the government-industry safety departments have their stipulations on the levels of health and safety needed in every business operating in the country (Knutson and Ribera, 2011:2). These specifications should be measurable and be accessible to the company's internal control and evaluation systems market (Losiewicz-Dniestrzanska, 2015:804). These are critical in determining and sometimes pre-empting future health problems which may be used negatively against the organisation when there are accidents.

**Data protection;** acquisition and management has become increasingly critical for all business operations (Hordern, 2016:248) as this provides critical information needed for making decisions. On the other hand, the data needs to be protected against the competition as this may be used to develop competitive strategies by the rivals in the market (Adam, Diale and Richard, 2019:9). Data well-kept and utilised means the ability to predict and manage risks.

**Employment law;** the country (differs from country to country) has its labour laws within which the norms of business are conducted (Esser, 2009:188). The bulk of which are promulgated by the government, business and labour sitting and discussing the proper norms of doing business. Internal control systems may pre-empt many of these risk factors if the information is provided adequately and timeously.

**Export controls;** certain items (depending on the type of government) may be controlled by the government in terms of what should be exported, what quantities and in what form (Lloyds, 2017:1). In other countries (Botswana for example) no raw mineral (diamond) can be exported if it has not been cut, this protects the process of beneficiation by the government. In other countries, there may be limits of goods allowed into a country in a fully manufactured form (South Africa car importation) (Chapman, 2013:186).

**Fair competition;** the country has a “Competitions Act” which forbids certain unfair practices by the industry players (dominant advantage or price-fixing) are forbidden in South Africa (Schaper and Lee, 2016:49). All these are meant to protect small industries from the large industry practices, these practices can be identified both during internal control processes and in general competition activities in the market (Losiewicz-Dniestrzanska, 2015:805).

**IT Safety and Security;** the safety of an organisation’s systems should be paramount, measures should be available to enable internal control systems to identify suspect practices internally (Hordern, 2016:249). Too often some unscrupulous employees may connive with outsiders to provide technical expertise or features of a security nature to the detriment of the organisation (Adam, Diale and Richard, 2019:58). There should be methods that will allow internal controls mechanisms to detect any such practices.

The function of internal controls should be understood in the broader sense that it serves the purpose of guarding against any form of risk to the organisation, be it natural or deliberate.

Failure to detect these may impact negatively on the survival of the SMEs, which are already too few and failing at such a high rate. The failure of SMEs means the failure of the country to provide for its own and reduce poverty amongst the citizens (Vargas-Hernandez, Cardenoz and Campos, 2016:6). Because these (SMEs) are the mainstay of the economies, all necessary precautions should be taken to sustain the lives of these life-giving enterprises to the economy (Lloyds, 2017:1). The entry barriers are low and as such, they are easily attracted to those ambitious to start their enterprises, for different reasons of cause. People start businesses for many reasons (Protiviti, 2020:3) and as such their willingness and or preparedness to learn differs also. Some of the reasons why people start businesses are stated below are listed in table 2.2 below (Mask, 2014:1);( Urevig, 2014:1); (Xie, 2014:25).



**Table 2.2: Reasons why people start businesses**

1. <i>'to work the hours I want to work'</i> .	2. <i>'more spare time (eventually)'</i> ,
3. <i>'to be in charge of my own work-life'</i> ,	4. <i>'I want to determine my own life goals'</i> ,
5. <i>'do the type of job I want to do myself'</i> ,	6. <i>'I want to create my work environment'</i> ,
7. <i>'I want to do things I am passionate about'</i> ,	8. <i>'like innovation and making new products'</i> ,
9. <i>'like to develop my profession'</i> ,	10. <i>'like to build a team of my dream'</i> ,
11. <i>'I want to create jobs for the community'</i> ,	12. <i>'get into a new business and trade'</i> ,
13. <i>'invest in me for my children'</i> ,	14. <i>'make money and change the living standard'</i> ,
15. <i>'financial and social life independence'</i> ,	16. <i>'I want to be challenged by business life'</i> ,
17. <i>'give boring tasks to other people'</i> ,	18. <i>'stop being ordered around at work'</i> ,
19. <i>'it's my trade and I so I can do it myself'</i> ,	20. <i>'I am retrenched and have money available'</i>
21. <i>'there is government funding available'</i>	22. <i>'my friends always encouraged me to'</i>
23. <i>'I am a youth and there is funding for us'</i>	24. <i>'I am a woman and there is funding for us'</i> .

**Source: own construction from literature review**

There are as many reasons for starting a business as people are getting involved in the starting of the business. The critical part about the reason for starting the business is that it informs how people will perceive what it means to have and run a business. This impacts the preparation made in deciding on whether or not to start a business and what type of business (Protiviti, 2020:3). The process of preparing to start a business will inevitably require knowledge including the importance of accounting and the indispensable need for internal controls.

Those who take time to prepare for the business start-up may be funded or be able to attend training in courses to do with the running of business start-ups (Vargas-Hernandez, Cardenoz and Campos, 2016:6). Generally, during these training programmes, the business-start-up hopefuls are introduced to the basic principles of running a business, and bookkeeping is inevitably a requirement. Deloitte (2013:4) states that the government has put in place funds and skills to train those willing to start businesses at no cost of theirs. This is clearly because the government recognises that small businesses are the panacea for the much needed economic growth of the country. Training is therefore intended to assist the start-up hopefuls about the

problems in starting businesses, and the need for compliance with both legal and applications of business.

The level of compliance with expectations is determined by numerous factors, some of which are embedded in the reasons why people start businesses. People who start businesses because they “just had an opportunity” may not be in the business for the long time (Carsrud and Brännback, 2011:9). Such people may have a propensity to cut corners and make as much money as they can with little compliance. On the other hand, people who may resign from their jobs to start a business may be prepared to do everything they can to keep the business (Xie, 2014:25). Such people would generally take time to study what it takes to run a business efficiently and effectively. Such people would most likely carry out organised market and feasibility studies and intelligently get into business for the long time(Carsrud and Brännback, 2011:9). Such entrepreneurs would take time to study, understand, and try to implement whatever it takes them to be successful in their business.

Critical to the starting of a manufacturing business by a well organised, well-informed business starter would be a quest to understand the dynamics of the supply chain in an enterprise (Felin et al, 2019:1). The compliance factors become critical to such an entrepreneur is they mean the success and long life for the business?. Speier, et al (2011:721) posit that knowledge of and compliance with established supply chain has assisted tremendously in data analytics and the ultimate management of risk in businesses. The first source of this information that is needed by the entrepreneur from the start is the use of internal information control. Experienced business executives have attested to this as evidenced by the establishment of such units in large and prosperous organisations (Li, and Zheng, 2019:377-405). The ten generic manufacturing risks are listed in table 2.3 below.

**Table 2.3: The ten manufacturing risks**

1. Product recall,	2. IP protection,
3. Blockchain,	4. Supply chain ,
5. Direct-to-consumer models,	6. Smart facilities ,
7. Skills gap,	8. Co-bots,
9. Tariffs, and	10. Reputational risk

**Source: own construction**

The list in the table (2.5) above is many amongst many others, these included here are identified as generic (more common) in manufacturing and generally picked during internal control exercises. These have different effects and impacts on the survival of a business and as such need early detection allowing for the management of the risk in due time. These are discussed briefly below;

**Product recalls;** too often the manufacturer may be forced to recall a product if there are discoveries of faults or other issues that may impact the continued use of the product (Theron, 2019:1). This is likely to negatively impact the image of the organisation (risk on the business) which may result as a risk detrimental to the future of the business;

- with customers not trusting the company products in the future,
- company has lost money in the manufacturing of recalled products,
- run into problems with the law where certain standards are not met, and
- may be penalised financially by state or individuals - money they don't have.

These are risks that a manufacturer would want to avoid at all costs considering all the negative effects that go with this. The “sunk cost” may cause negative financial flows in the small business for much longer than desirable – loss of money is a critical risk for small manufacturers (Felin et al, 2019:2).

**Direct-to-consumer (DTC) models;** essentially manufacturers selling directly to the final consumer undercutting or bypassing the traditional distributor or middleman (retailer or wholesaler). Mostly sold as online products and may be ideal for large products and not small size commodities that are for mass consumption. Some manufacturers have opened factory shops (mostly in clothing) where they sell directly to the public and directly through or adjunct to their main e-commerce platform in a clicks-and-mortar business model Cockram (2019:1), The impact on the business, mixture of risk and benefits, is;

- new job opportunities will be created and the company has to keep pace,
- new highly technical skills are needed for the e-commerce processes to be effective,
- there will be a need for a warehouse in which to keep large stocks of the product,
- more people need to be trained for warehouse stock control and logistics,
- need for well-trained internal staff who can handle customer queries online,
- online lacks human interaction, an experience good for the customers generally,
- customers are concerned about the security of online shopping and prefer retailers, and
- the cost of returning rejected goods and safety inconvenience is a problem.

Skills gap; too often the manufacturer has the desired standard or the product range has certain expectations of the product to be manufactured. The skills gap is the difference between the expertise skills that the manufacturer has and what is needed to make the products the market needs. Too often it is important for manufacturers to regularly evaluate the skills they have against desired outcomes, internal control systems can assist in this process. The risks likely are that;

- the firm does not afford the skills required and fail to meet market needs and expectations,
- this will affect the competition levels of the firm in the market if other manufacturers meet the demands of the market,
- failure to regularly analyse the standing in productivity will not help the firm identify weak areas in their market standing, and
- if there is no fixed product plan, there may be no standard to measure against and internal control becomes impossible.

**IP Protection; Intellectual property (IP)** includes amongst other things are not tangible creations by an individual. Different countries have or recognise different types of intellectual property confusing as to what to follow and for how far that can be considered. The different types of intellectual properties would be, depending on the country, namely; copyrights, patents, trademarks, and trade secrets. The business may be fined large amounts for stealing property rights resulting in the financial loss (Felin et al, 2019:2):

- may be stopped from manufacturing a product by law and thus lose earnings or risk closing the operations Cockram (2019:1),
- your IP may also be stolen by some other manufacturers and you need to be on the watch for such activities (Theron, 2019:1), and
- some of the IP cases cannot be protected because different people can have similar products from their imaginations (Gonfalonieri, 2019:1).

Understand that nothing should stop an organisation (manufacturer) from being innovative, but vigilance is needed. The manufacturer may register their inventions for their protection knowing that some people can imitate their products (Lloyds, 2017:1). Some products seem not to have any patent rights, a nail or screw will always be as such, and these are manufactured worldwide.

**Supply chain risk;** supply chains are highly complex and continuously exposed to a variety of internal and external risks. Also, if not managed carefully, it can result in potential adverse impacts to manufacturers' sales and brand reputations. Manufacturers should build resiliency

into supply chains to address critical vulnerabilities proactively. Also, they should balance risk and costs to prevent or recover quickly from risk-related disruptions. Supply chain; this is a system comprised of structures which when put together allow for a flow of activities (materials) passing through stages from origin to the end which is the consumer or customer (Price Waterhouse Coopers, 2019:5).

The system involves different activities which may start with raw material processed through different stages until the final – end product. This is a link of value chains of materials and or resources as they have value added at every stage to the end of the process (Protiviti, 2020:3). In between many organisations, materials and human resources are involved in the organisation of these items. The length of the supply chain and the sources for the manufacturer may be the risky factors, namely;

- the dependability of the supply of the raw material needed for the processing,
- the distance between the manufacturing unit and the supplier of the raw material,
- the political climate of the country (ies) and how they can impact the supply,
- the number of firms involved between a primary source and the manufacturer,
- lead time on the purchase of the raw materials and adequate internal storage ,
- use of other supply methods like JITS (just in time supply) and their reliability,
- the economic climate and the stability of the prices at the source and transport ,
- labour activity, wage range and the disposable income for the final consumers, and
- cost benchmarking as a proactive strategy for both supply and selling purposes.

There are many supply chain-related risks for the business, and most of them may have more to do with the macro environment of the business (Felin et al, 2019:2). Yet the manufacturer needs to mitigate around these to allow continued functioning of the production plant and processes. Price Waterhouse Coopers (2019:5) proposes that the supply chain should be constantly reviewed and measured against market trends in both demand type and levels of demand with cognisance of the activities of the competition.

**Smart facilities;** smart facilities or the smart system; the coming in of the Fourth Industrial Revolution (4IR) seems to be preceded by technology that is fascinating to say the list. The smart facilities incorporate functions of sensing, actuation, control and sensing to evaluate and define a situation and make corrections in manufacturing (Felin et al, 2019:2). The smartness of these systems will be based on their ability to perform autonomous operations mainly based on energy efficiency and their ability to network effectively. The advent of such

technology will most probably take the small manufacturer by surprise and make it difficult to compete in the production of goods. The likely risks are,

- there might be much better productions from large corporations on large economies of scale,
- the prices are likely to make it difficult for manufacturers to compete with high technology productions,
- if the small manufacturers don't move with time they may fail to compete in the ever-growing global market, and
- failure to adjust may lead to failure to compete and eventual closedown of the manufacturing operations.

**Table 2.4: The three generations of smart systems**

**There are three generations of smart systems:**

**First-generation smart systems:** object recognition devices, driver status monitoring, and multifunctional devices for minimally invasive surgery.

**Second-generation smart systems:** active miniaturised artificial organs like cochlear implants or artificial pancreas, advanced energy management systems, and environmental sensor networks.

**Third-generation smart systems:** combine technical “intelligence” and cognitive functions so that they can provide an interface between the virtual and the physical world.

**SOURCE:** Meyer et al. (2018)

**Co-bots:** or collaborative robots are specially designed types of robots that interact with human beings in proximity and direct contact with men. Software is needed for safety and other related and this involves two types of robots, namely;

- industrial robots used in manufacturing, and
- service robots for domestic and professional use.

**Cobots:** can perform many other functions in the manufacturing industry, such as transportation of material, inspect other robots with cameras (Cockram, 2019:1). Logistics robots assist with the visual processing technologies which work with the patrolling of the perimeters of secure facilities. They assist in the automated repetition in what is ergonomic activities and tasks like fetching heavy parts and moving them into assembly units. Gonfalonieri (2019:1) posits traditionally industrial robots were used in the industry generally for pre-assembly such as cutting, welding, and putting up together the bodies of cars. This technology allows industrial

robots mostly in the high tech areas in automotive and electronics manufacturers to give finer finishing touches to the final product assembly (Meyer; et al. ,2018:15). Most if not all small manufacturing firms would not be involved in the manufacture of cars but may be involved in the manufacturing of car components. The most common car components are; starters, computer boxes, batteries, alternators, wiper motors that are supplied to the car assembly plants. The technology (IFR) provides a few types of collaborative manufacturing that might impact small parts or components manufacturers(Gonfalonieri, 2019:1), namely;

**Co-existence:** technicians and automation work side by side in the manufacturing of components,

**Sequential collaboration:** the human and automation do not work on the product at the same time and they do different complementary functions,

**Co-operation:** both human and automation work on the same product at the same time and both will be in motion, and

**Responsive collaboration:** the technician works and feeds information and gadgets to the automation that responds with the solution in real-time.

The human and machine occupy the same space and do the same functions complementing each other. This speeds up the manufacturing process, but because the machine has taken part in the human function, there is, therefore, an inevitable reduction of the human workforce and yet improved productivity (Deloitte, 2014:5). The occurring risks will generally be, namely;

- failure of small operations to acquire this high technology for their manufacturing purposes,
- inability to compete with the large mass-economy based manufacturers on the price in the market, and
- the resultant loss of customers may lead to the eventual closedown of the business if competition cannot be beaten.

### **Reputational risk;**

Quantifiable information is much easier to use for control purposes as measurements on progress or failure of progress can be computed(Li, and Zheng, 2019:377-405). This, therefore, allows the added advantage of data analytics as another important element in the effective management of risk in a business (Losiewicz-Dniestrzanska, 2015:803). Manufacturing is generally more complex than other operations like retail and wholesaling, and besides, there are generally fewer manufacturers than there are retailers. In most developed and or progressive countries, manufacturing is the mainstay of countries with healthy economies (IIA, 2014:12).

These enterprises tend to have a higher employee intake and are involved with fairly long supply chain structures from raw material to the final consumer.

### **Risk factors are integrated**

The different risk factors above should be understood as integrated with that one risk factor that might impact the functionality of the rest of the other factors (Adam, Diale and Richard, 2019:16). For instance, the implications of the skills gap in manufacturing can also pose a material impact on manufacturers' growth and profitability. Internal audit can play a key strategic role in assessing programs and identifying diversion of the planned from the actual (Hopkin, 2014:62). Programs like recruiting and retention initiatives, HR, IT systems, and deployment of data analytics capabilities to monitor trends are designed to mitigate the anticipated talent shortage and skills gap risk (Kovacova et al, 2020:54-60). Risk management is an ongoing, cyclical and continuous process, the failure to manage one risk factor may impact negatively on all other operations and survival of the business.

The risk identification process steps involve five critical steps that might be important to put into perspective. COSO (2020:1) Identify the five core steps within the risk identification and management process. These steps include risk identification, risk analysis, risk evaluation, risk treatment-response and risk monitoring. Beyond the specific legal framework associated with each of these areas of risk, the company should put in place board-level structures. These should inevitably be how the information required for the regular internal control systems are evaluated and actions implemented (Theron, 2019:1). Not forgetting that the reputation of a firm in the community may be directly connected to the volumes of sales (sales turnover) which impacts profitability. The manufacturing of products by small firms is a critical supplier to domestic economies for which both wealth and goods are provided.

Not every risk, of course, will be relevant to every company, and the significance of various risks will also vary from company to company (Tahir, 2020:99-115). Risk identification is an important starting point for the construction of comprehensive risk management and risk oversight system. Senior executives should devote time and attention to considering the most significant risks that face their company and educate the board or appropriate committee concerning these risks in the context of periodic reviews of the company's risk management structure (Cockram, 2019:1). Thus, the enhanced ability to recognise and effectively address strategic risks can give a manufacturer a competitive advantage, an advantage that enables it to not only survive but thrive amid change. It would therefore be necessary for managers to accept



that there is a need for, risk identification, risk analysis, risk evaluation, risk response, and risk monitoring.

**Risk identification:** is a process used to where the problem is likely to be, what kind of risk it would be when the risk is likely to take place, why it should be able to be a risk, and how we could avert the risk (Gakpo, 2020:11-9).

**Risk analysis:** is a process essentially in working out the likelihood that an event would take place, in the manner as we envisage it, and the probable impact on our business (Deloitte, 2021:4).

**Risk evaluation:** this is an assessment of the probable impact of the risk or the risks to priorities action on this risk, the more negative the impact, then that should be ranked highest and attended to with more caution to soften if not eradicate the effects of the perceived risk (Price Waterhouse Coopers, 2019:14).

**Risk treatment – risk response:** planning needs to be done to pre-empt or at the very least minimise the unwanted impact on the operations. Risk mitigation strategies are required with contingency plans (plan B and C) in the event the original plan may not be effective enough (Adam, Diale and Richard, 2019:16).

**Risk monitoring:** this is the continuous process of monitoring and evaluating the risks and factors that may be “drivers” of risk incubation. Throughout the life of the business planning for risks should be a continuous undertaking to enable the company to keep abreast of the situation (Rafik and Alain, 2011:32). There are generic responses to the risk and risk management problem for organisations, but it should be emphasised that managers decide to depend on the circumstances.

The management of risk is a critical element in the effective management of a business in that it is the only possible means of pre-empting probable problems (Protiviti, 2020:3), that may lead to business failure. COSO(2020:1) defines risk as “the likelihood of some unplanned for uncertainty taking place with the possibility of causing unwanted harm either on the human beings, objects, and any other victims. Risk involves uncertainty about the effects/implications of activity concerning something that humans value (such as health, well-being, wealth, property or the environment), often focusing on negative, undesirable consequences.

## **2.6 CHAPTER SUMMARY**

The manufacturing industry has remained the mainstay of any economy, and the reports and data in the organisation are used regularly to inform on decisions to be made (Cockram , 2019:1). In that case, this very vital element of the survival of the economy and welfare of the people in a country needs to be protected. The most convenient way to protect such operations is by having adequate information about the welfare of the operation (Bruwer, Coetzee and Meiring, 2019:1). The most an organisation can have is to understand that incremental improvements in risk management can lead to a significant impact on value enhancement. This is a result of a deliberate effort to collect information regularly to facilitate the construction of relevant and contextualised strategic risk management programs. Internal control systems play a critical role in the much needed continuous diagnosis of the state of the organisation (Protiviti, 2019:32) which will allow for improved risk management. There are risks in all forms of manufacturing, but the size of the enterprise and the type of risk will matter and determine the extent of the harm. Too many products in the market may mean too low prices that may not be economical to a small operator, too few goods may force customers to substitute the commodity, and bad quality may mean loss of customers, and so on. If mistakes happen, the long-term consequences may be serious. A small manufacturing business may need to focus on quality products, keeping production costs low with excellent efficient costing and sales management, this may reduce the risk in any type of manufacturing.

## **CHAPTER THREE (3)**

### **BUSINESS RISKS AND THE MANUFACTURING SECTOR**

#### **3.1 INTRODUCTION**

The failure rate of business start-ups is alarming at 80% within five (5) years of starting the operations (McIntyre, 2020:1), and this is a global phenomenon. People start businesses with intentions of succeeding, regardless of the factors that made them get started in those businesses in the first instance. Sad to say the closing down of business start-ups comes up with numerous casualties which may be too many to itemise. The major victims of the failure of the business would be the wounded investor or owner of the business who will lose much money when the business fails. The business-failure would be wounded and may never want to get into business again, reducing the number of people aspiring to be entrepreneurs in the society. Together with this will be the numerous employees that will have invested their future in the success of that business venture.

Most of which would have no other means of income and will have to join the long queue hunting for jobs again. The other aspirants (start-up hopefuls) who may have hoped to use the success of those that have entered into business as motivators and models, will equally be affected. The reasons why businesses fail is generical because the owners may not have managed the risks in their business when they planned from the beginning. A risk is negative uncertainty or uncertainties occurring on an individual either as a person or on anything of value to them (Masci, 2011:25-68). According to Manufacturing Indaba (2020:1) manufacturing is the second biggest sector in the Western Cape and contributes about 15% to the South African manufacturing sector output. Furthermore, the province's agro-processing sector has shown resilience during tough economic times, and its renewables and green tech industries have received significant investments in the past five years (Manufacturing Indaba, 2020:1).

#### **3.2 BUSINESS RISKS**

The world we live in is classifiable into two (2) environments relating to the existence of an organisation, namely macro and micro. The macro (external) environment refers to the outside part of the organisation, whereas the micro (internal) refers to the internal environment of a business (Bibi, 2014:2). The external environment of a business involves the market, the society and all other things that are not within the organisation. These are generally out of control for the organisation, and the organisation is impacted by happenings in this environment (Dutta, 2002: 34). Outside of the business is the external environment which is constructed by society and other factors around it which keep changing (Jankovie, Mihajlovic and Cvetkovic, 2016:

32). The business must confront this environment and adjust to the requirements and demands coming from this environment. Effective management is about the ability of the organisation to take advantage of the environment and identify opportunities that will enable the organisation to survive.

The firm has little control or influence over the general societal structure (Rafik and Alain, 2011:32) but the firm may make choices that will enable it to succeed in that environment. Strategic analysis of the environment is required before an organisation is established and before deciding on what products to manufacture (Protiviti, 2020:3). It would not make sense to start a beef canning business in an environment that is exclusively Hindu, because they are vegetarians, nor would it be prudent to start the manufacturing of beer in a place exclusively Seventh Day and Adventist, because they do not take alcohol. Scanning the environment is therefore the first step in the avoidance of risk for any business operation (Cortada, 2003:512). In all aspects of business operations, investors will always start by identifying risk factors as these will impact the prospects of their businesses (Rausand 2013:9).

### **3.2.1 Definitions of risk**

Risk has been defined in many different ways, and there seems to be no standard or universal definition, it is largely dependent on the items concerned (COSO: 2020:1). A few definitions are given below, the total of which covers all that the study will involve, but in principle, it would mean something is negative. Risk is the possibility that something unplanned and unintended will happen which will disrupt the intended objectives (Tahir, 2020:99-115). This suggests that the organisation has its objectives to be achieved, and as they work towards the achievement of their objectives, something negative happens. Risk involves uncertainty that may occur and affect negatively and impact in respect to something of value like health, well-being, wealth, property or the environment (COSO, 2020:1). The definition makes references to the destruction of value that the investor has built and wants to build the uncertainty interferes with the plan. Risk can also be defined as the possibility of an unexpected bad incident happening with unknown implications on the individual values. This generally refers to changes in an environment or situations for which no prior preparations were made because of the uncertainties (Masson, Lamoureux and de Guise, 2019: 121–130). This definition applies or can be considered as the possibility of injury, adverse conditions or unwelcome situations falling upon the individual, or, enterprise in this case. This focuses on the possibility of harm (physical or material) which is not desirable. What is of great concern is the fact that it is generally not expected under normal planning circumstances, and many organisations (especially start-ups) may not have suspected the occurrence.

Whichever way the word is defined, it has a few things in common, that was not expected and that causes injury or harm of one form or another. According to Rausand (2013:9), other definitions will include impressions such as deviation from the expected, potential events or consequences of an event. Whilst most definitions make direct reference to negative impact (downside risks) other definitions refer to deviations with positive impacts (upside risks) (Bibi, 2014:3). Other definitions, fairly recent have also referred to uncertainty about the harm or loss, measurable uncertainty or variance from the planned outcome. Tahir (2020:99-115) explains that there is no universal definition of what a risk is. Internal controls are critical for the supply of all data and information that will enable the management to have adequate information to make decisions on and avert unintended consequences for the manufacturing enterprise. The reasons for using internal assessment systems are illustrated in figure 3.1 below.

**Figure 3.1: Reasons for internal control systems**



**Source: COSO (2013)**

The society for risk analysis has concluded that “experience” shows that there is no unified and generic definition that realistically defines risk to fit in every -circumstance.

### 3.2.2 Other considerations of the definitions

**Risk and uncertainty:** other definitions differentiates between risk and uncertainty, suggesting that risk implies “a quantity susceptible of measurement,” meaning the risk is quantifiable. In economic terms, risk effects can be expressed in the form of loss of profit, assets, or any other such quantifiable deviations from the plan (Gakpo, 2020:11-9). The measurable risk is therefore considered different from an immeasurable risk, which may also mean uncertainty, non-quantitative type. COSO (2020:1) differentiate the two (risk and uncertainty) interchangeably used terms in most studies on risk, they are distinguished thus;

**Uncertainty:** the lack of complete certainty, is when there is no single or particular identifiable possibility; true outcome/state/ result/ value cannot be predicted or isolated from the other possibilities.

**Measurement of uncertainty:** an ability to identify sets of probabilities that can be assigned to certain outcomes/results/states. Can uncertainty be accurately measured in terms of the true percentage of possibilities ?

**Risk:** this would be a “state of uncertainty” where possibilities may involve an undesirable catastrophe, loss or outcome which can be expressed in the form of quantities or some form of unit.

**Measurement of risk:** a set of likely outcomes and possibilities quantifiable to the extent that predictions can be made to measure the impact of the intervention. The “measurability” of the risk enables effective management of the risk to the extent it can help rescue businesses from failure at least.

This would therefore mean that uncertainty can exist without it being a risk, and yet all risks would be uncertainties. Suggesting that uncertainty may be due to undesirable results even though there may be no personal stake in it. Risk, therefore, implies the presence of material, quantifiable and undesirable outcomes where the individual may have a personal stake. This would suggest that; we cannot be certain of who will win in a soccer tournament at the final match between the last two (2) competitors – if there is no personal stake in this, there is no risk. Unless if we bet (cash) for a team, one of the final competitors and the loss of the club you have betted for involves you losing the money, that constitutes a risk to our sacrifice.

In this research, the researcher is referring to risk as it pertains to quantifiable losses in a manufacturing business that may cause a closure. The different definitions of risk and uncertainty have their place, and the context in this study focuses on the internal risk and hence the study is internal control. Risk, therefore, involves the presence of uncertainty as it pertains to the realities in the SMEs manufacturing businesses. Jackson and Stent (2020:4) state that the framework for risk assessment may consider risk in the following categories:

**Strategic risk:** risk connected to adopting or changing entities strategy, i.e. expansion of the manufacturing facility, entering a new market in a foreign country, acquiring a new company (Carson, Elyasiani and Mansur, 2008: 873–891).

**Operation risk:** risk connected to health and safety, and the environment for the chemical manufacturer (Cline, 2015: 43–45).

**Financial risk:** the risk that impacts the cash flow usually when an entity change from cash flow like, when an entity changes from cash sale to credit sale(Deloite,2021:1).

**Information risk:** risk related to introducing electronic funds transfer for payment of creditors or trying to introduce online payment(COSO,2020:1).

**Compliance risk:** risk associated with the decision made by the business that could lead to breaches of legislation, related to polluting the environment, taxation, etc(SAICA:2019:11).

**Business risk:** risks that derive from the decisions that the board takes about the products or services that the organisation supplies (Masci, 2011:25-68).

### 3.2.3 Sources and causes of risks

The sources of risk on a business can be broadly categorised into two (2), these are the external environment and the internal environment.

**External sources of risks;** external environments risks may be generic in that they apply to all organisations, these are generally political, economic, social or technological. For these, the organisation simply has to comply and strategies to mitigate our way around these pressures (Deloitte, 2020:1). These are perceived to be the norm and they don't sound any alarm bells, as it is everyone else's problem. The second one, the internal sources are a management issue and the organisation can control, manage (Dittmeier and Casati, 2014:25). Once the assessment of the external risk is made and it is seen possible that the business can operate, it is this risk the study seeks to focus on. It is however critical that the external risk factors be included as they impact the decisions that management makes internally. It is important to classify the external risks in terms of, the frequency, duration of the occurrences of these risks and possible loss of assets from the external risks.

Frequency of the occurrence; what risks occur generally and how would this impact the organisation negatively. Special attention should be given to understanding what impact would be brought about by the risk and the probability of it being a pattern.

Duration of the risk when it occurs; this, mostly based on experience would be critical as it helps with the planning processes. Knowledge of this allows for a well-informed decision-making system to avoid or manage the risk impact and minimise the effects.

Loss of assets by the business; the extent to which the risk will impact the business operations and welfare and destroy the assets. These assets may be physical property, intellectual property or reputational property which may impact sales.

The source of the risk may have more to do with what type of risk it is, as such there may be no specificity in deciding on the source of the risk. Because there are different types of risks, the study is focusing on business risks and therefore would focus more on the internal sources of risk. It is important to identify the causal factors from the external environment; these are summarised below in Table 3.1

**Table 3.1: External sources of risks**

<b>Economic factors;</b>	The economic condition in the country affects the operation and profitability of an organisation – the disposable income in the society concerning the product to be manufactured. The demands of the product matter in the process of deciding on what the manufacturer would want to produce.
<b>Natural factors;</b>	Natural factors which cannot be controlled by human beings can affect the way the businesses will persevere. The floods, earthquakes, pestilences (pandemics), draught and other natural disasters may affect a business depending on what products are manufactured.
<b>Political factors;</b>	Politics in the country is a major concern in that change in governance may cause instability or promote business, where civil war occurs, depending on the product concerned, some may become closed, or they may thrive because of the war – gun and bullet manufacturers for instance.
<b>Legislation;</b>	Laws may be passed that may affect the marketing of products, introduce safety features that the manufacturers may not meet. Or this would fit in with the company’s capabilities which might impact the production of the products. Basic conditions of employment or other legal promulgations.

**Source: own construction**

The external (exogenous) risks factors generally apply to and affect all businesses, differently though. Continued market evaluation is a critical element of forwarding looking management, and this cannot be controlled but should be managed. Internal sources; internal sources of risks are inherently internal and therefore have to do with the way the business is run. To a large extent, after all, environmental scanning has been conducted efficiently, the survival of the organisation is measured on the basis on which internal risks are managed (Bibi, 2014:4). Here, the manager and the whole organisation indeed dictates the direction and takes decisions meant for its survival. Manufacturing businesses, which are the focus here, have a lot to do with providing products and the much-needed employment to the community.

The economic value of manufacturing businesses in both economic growth and economic development promotes the need for attention (Carsrud and Brännback, 2011:12). In the manufacturing business, it is surmised that the risks are fairly easier to identify as they will be specific to certain applications or misapplications. As alluded to, the internal environment is manageable by the manager even though the organisation is affected by exogenous factors. The causal factors are endogenous variables that are influenced by factors as stated in table 3.2 below.



**Table 3.2: Internal sources of risks**

<b>Human factors</b>	The recruitment, training, skilling and effective motivation and management of the personnel in the firm. The ability to have relevant contextually competent personnel at all levels of the organisation will reduce the risk of work with personnel that is not productive.
<b>Technological factors</b>	The changes in the technological space in the external environment may mean competitiveness needs to be adopted into manufacturing. The cost of production, the labour disgruntlement and such other factors will risk the company into working at a loss.
<b>Physical factors</b>	Constant repairs and maintenance of equipment or updating of machinery regularly may boost productivity and efficiency and reduce the risk of failing to compete. The equipment, ergonomics, and the structure as a whole should be such as to increase production efficiency and profitability.
<b>Operational factors</b>	Availability of funding to enable the firm to have up to date equipment, appropriate technical skills, enough marketing and advertising, procurement at economies of scale, regular research to monitor and evaluate changes in the market with state of the art good practice

**Source: own construction**

Companies will face different types of risks or will be impacted differently because of their structure, type of management, the products they manufacture etc. There are no two (2) firms that will be run in the same way even if they manufacturing the same product (Cockram, 2019:1). The difference comes from many aspects including the difference in managing and leading styles, the type of people working there. Price fluctuations, changing marketing tastes, changes in fashion trends or simply wrong selling methods may impact the productivity of the organisation (World Bank, 2020:1). Thus business risks may take place in different forms depending upon the nature of a company and its production.

**3.3 BUSINESS RISKS**

Business risk is generally associated with the possibility of the enterprise not making enough profits, to the extent that it may be making losses. Evidently as already discussed this is because of the uncertainties that may not have been identified (SAICA, 2019:1). It may also be pointed out that part of the failure to predict or identify likely risks might have much to do with the experience of the management team. Most small businesses are run by people who are starting

businesses for the first time, they are likely not to have previous knowledge on business failure. Other factors may be to do with changes in the market if the organisation does not continuously scan the market environment (Price water house Cooper, 2019:8). The changes in customer tastes will affect the demand for the product in the market resulting in the lowering of sales which impacts profitability. The competition in the market and their activities will equally impact severely on the survival of the organisation, these can be picked in the drop of sales (Protiviti, 2020:5). Some of the factors to be considered are, namely; bad decisions by the organisation, government regulations, technological changes in the market and within the firm. No business will operate outside of some form of pressure that may constitute directly or indirectly risks that have an impact on the welfare of the business.

### 3.3.1 Types of business risks

There are different types of risks experienced by a business, and these can be divided into five major types. Business risk is associated with threats to the existence of the business, mostly the quantification is done in financial terms. Organisations fail to achieve their goals and programmes for many reasons and as such the causes determine the classification used for identifying risk types (Hong and Lee, 2015:1289). Different methods may be used for the classification of the types of risks, with the consideration that different managers perceive these types differently. The generic classification is illustrated in figure 3.2 below.

**Figure 3.2: Different types of business risks**



Source: Druml (2011:1).

Businesses are established with specific intentions to make them work for the investors, who put in money into the enterprise. Not always though, most of these businesses are started by people who may have little experience in business, specifically manufacturing. Cockram (2019:1) indicates that 70%-75% of the people who start businesses are likely to be people with a particular skill or trade by training or experience. This venture is immediately exposed to different types of risks, considering that every aspect of the activities has a degree of risk in it (PwC, 2019:10). The types of risks have been identified and classified as indicated in figure 3. 2 above, strategic risk, compliance risk, financial risk, and operational risk.

**Strategic risk;** these are risks associated with the operations specific to the industry by its areas of specialisations and complexities. The risks, as indicated arise from, the business environment, transactions and investor relations which should have been assessed before the decision to start the business.

**Business environment;** the buyers and the sellers of both goods and services and the changes in the taste of customers affect supply and demand. The competitors equally spend their time working on best practices for them to be more competitive in the market.

**Transaction;** also referred to as reverse logistics, plays a very critical in corporate competitiveness which impacts the profitability of the enterprise. There is much at stake with the relocation processes involving packaging and transportation of the organisation's products and the supply chain. There is a lot needed to be considered including, best-in-class strategies and other challenges.

**Investor relations;** the stakeholders in the business need to be communicated to regularly and need to be satisfied with the way the business performs (Kantabutra, 2019:11). The day to day operations and the direction the business is taking, keeps them in or takes them outside of the business depending on the progress. A decline in sales for instance worries the investors hence the need for internal control to assist with information early to help the business (Severgnini, Galdamez and Moraes, 2017:120).

**Compliance risk;** from time to time promulgations, regulations, laws and other changes are introduced into the market. In the same way, such policy changes will possibly occur also within the organisation, compliance with these reduces the risks to the firm (Maxwell et al, 2012: 99–115). For instance, a new salary scale by the government and or an association published new operational risks, say safety guidelines for the manufacturing of specific products. Compliance reduces possible legal challenges, penalties, etc.

**Financial risk;** so goes the financial management saying – cash is king. When businesses are started, it is expected that much money is put into the start-up capital, operational costs, etc. The expectation is that there will be returns on this investment at one point, generally, the return

on investment (ROI) is in the form of money. The financial health of the business informs many things impacting the operations of the organisation (Losiewicz-Dniestrzanska, 2015:803), amongst these may be; selling on credit, expansion of operations, modification of equipment, advertising of products, attractive salaries, and so forth.

**Operational risk;** in manufacturing, whilst all other functions are operations, but there is a general emphasis on the use of operations as pertaining to the production section. But operational risks include everything, anything done in the business from production to administrative procedures in that particular business (Bowers and Alireza, 2014:20). The operational efficiency including production machinery, supply of materials, stocking of the materials, stocking of the finished products and the eventual sale of the products – all these may be sources of risks.

The presence of risks in every operation in life, specifically in the business suggests that some decision needs to be made to avert the impact of the risk. All operations in a business are and or must be recorded for future use in the organisation (Tahir, 2020:99-115). Information (data) is considered critical for all business operations, and data is essential in that it will allow for the comparison of information and data taken at different times. This will therefore allow the responsible people to identify the likelihood of trends that might inform on the possibility of deviations and possible risks (Aven, 2016:253). Financial accounting, as an example, focuses on reporting the organisation's financial information, which can be used for decision making by investors, potential investors and creditors. This is therefore critical in the provision of the needed decision-making tools, from this recording the emergence of risks may be identified in time. This underscores the critical importance of records, and as such should be practised throughout the organisation, records of which will periodically be inspected by you the internal control systems.

### **3.4 RISK IDENTIFICATION**

Risk identification is defined as the process of identifying possible risks to an organisation that may cause deviations to planned objectives (Price Waterhouse Coopers, 2019:8). It is a process of listing potential deviations from the intended course of action by an organisation. This is generally stated in the strategic and tactical plans of the business, and the objectives would be clearly stated. The list is documented and companies put this in a company risk register which will most probably state the type of risk, the sources of the risk, potential responses to the risk, according to their categories (Oehmen, 2020:657). The information is used for the classification and analysis of the risk and can be put in a hierarchical risk breakdown structure according to the importance of the risk. Risk identification is iterative in its nature and as such, it is a

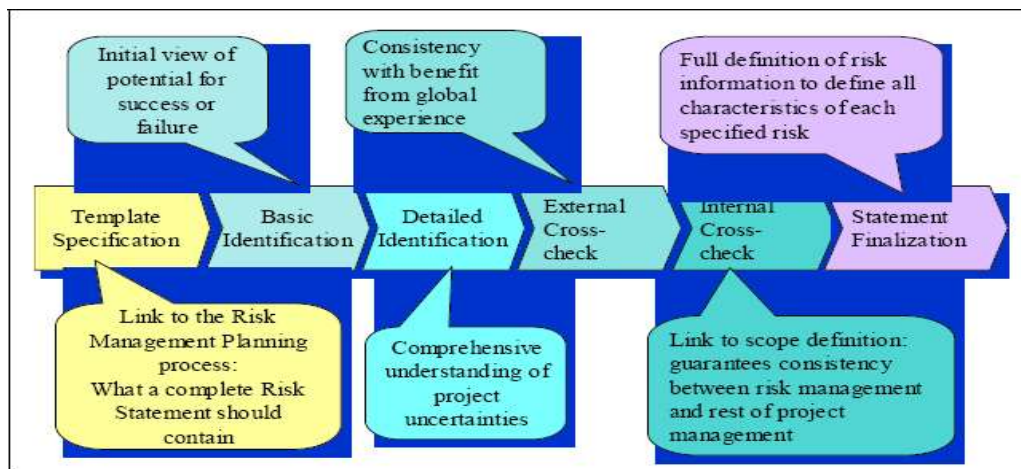
continuous process conducted by businesses as part of business management (Akram and Pilbeam, 2015:1205). The process of identification is continuous and the methods used to identify these risks may depend on numerous factors including, the presence of new activities in the firm.

The purpose and objective of the process of identifying the risk in a business are to ensure that all potential risks to the business are identified. Primarily the identification will enable the management to minimise the negative impact to the firm which may result in the failure of the business (Dittmeier and Casati, 2014, 26). If corrections can be affected to any deviations in time, this may help the organisation to maximise positive opportunities for survival. Identification, therefore, becomes the critical first step for efficient and effective business management. Oehmen (2020:657) posits that once the risks have been identified this will allow for the development of a structured response to avert the possible negative impacts on the business.

### 3.4.1 Steps in the identification of the risks

The identification of risk is the first necessary step needed in the process of planning to avert the risks or reduce the impact thereof. Different tools and levels of prior understanding and knowledge are necessary to deal with the complexities around the identification of risks in an operation. It will be important therefore for the practitioner to be able to understand what tool, why that tool and how it would help with the process. The Project Management Book of Knowledge (PMBOK) identifies six (6) steps to be followed in the process of identifying risks in a project. These steps are illustrated in figure 3.3 below.

**Figure 3.3: The six phases of the risk identification lifecycle**



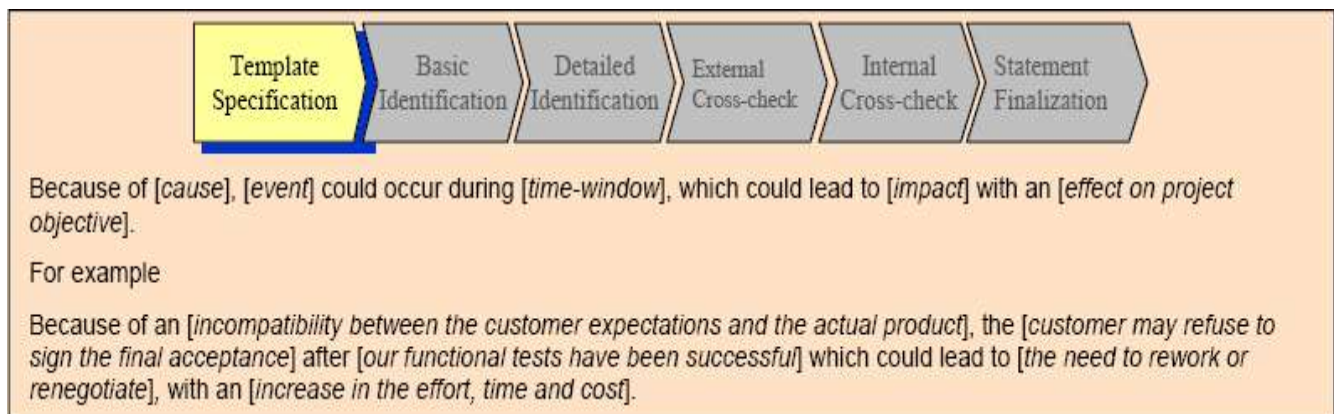
**Source: PMBOK [2003]**

This is a process and it will only be as effective as the competency of the people using it, it is always important that management spend time to understand risks and risk management. Some

of the known causes for failure of business are the inexperienced business owners (Losiewicz-Dniestrzanska, 2015:801), meaning they may not have prior knowledge of likely risks in a particular industry. The figure above is discussed briefly;

**Template specifications;** when a business plan is made there is a need to study the environmental concern to have a full understanding of the business. A good understanding of the business immediately points out the different operational templates – this can be from benchmarking. Table 3.3 below illustrates the temple specifications.

**Table 3.3: Template specification**

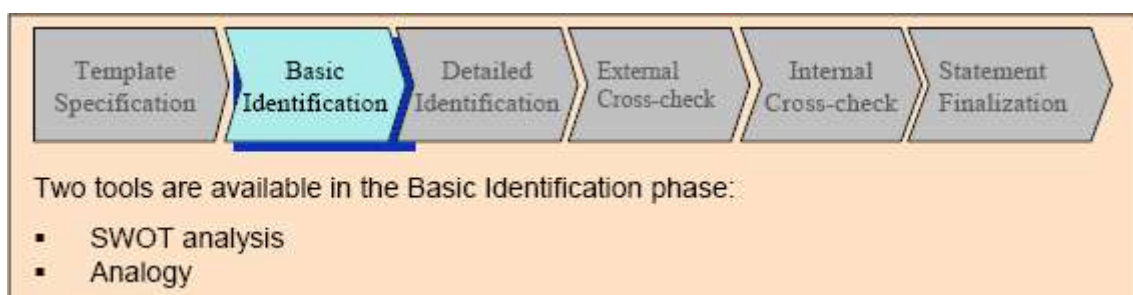


**Source: PMBOK (2003)**

Risks are generally not considered as full statements of the risks involved, and too often the risks are not quantified. The use of identification specific tools in the identification of these problems assists with the elaboration of the problems envisaged (Gonfalonieri, 2019:1). Cognisance should be made of the presence of two (2) types of risks, namely; negative risks (threats) and positive risks (opportunities). This distinction needs to be made between these different types in the identification process and report.

**Basic identification;** a feasibility study of the business allows for an extended understanding of both the product and the market. The product choice has to be ideal for the market and production systems ideal for the costing before it becomes a risk factor. This is detailed in figure 3.4 below.

**Figure 3.4: Basic identification**

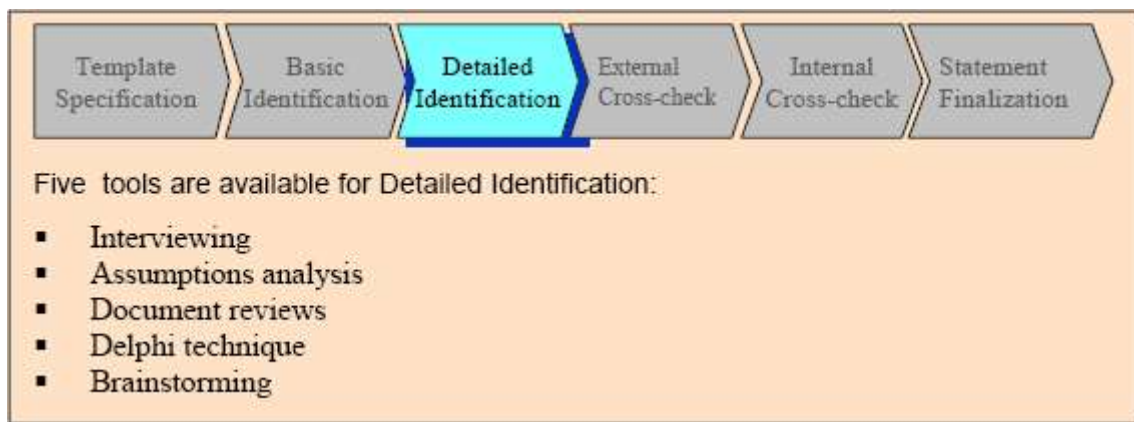


**Source: PMBOK (2003)**

A Strength, Weakness, Opportunities and Threat (SWOT) analysis would be the first most ideal thing to do in the basic identification process.

**Detailed identification;** there is a need for extensive investigation on product risks and the type of business. Again experience would be valuable, but consultation may be of tremendous assistance to the process if accurate information is needed (Protiviti, 2020:3). Accurate information with appropriate decisions will minimise if not eradicate the issues of unforeseen risk for the business. The risks that are identified in the first step become the trigger for thinking in depth about the risks. This is illustrated in figure 3.5 below.

**Figure 3.5: Detailed identification**



**Source: PMBOK (2003)**

According to PMBOK (2003), there are five tools and or techniques that are used for this purpose, and these are, namely; interviewing, assumption analysis, document reviews, Delphi technique and brainstorming.

**Interviewing;** a research project of sorts should be done for the interviewing of the relevant population. Like any project, it must have clearly defined objectives, measurable deliverables and must fit into the project success definition based on the triple triangle. Relevant questions should be developed (Almutairi, 2015: 144), appropriate target population with a defined research methodology, the research project should be as objective as can be.

**Assumptions analysis;** like in any project there must be reasonable assumptions based on some knowledge about the project at hand from lessons learnt (Tahir, 2020:99-115). It may be necessary to do some research and or consultation to equip oneself for this and avoid making errors – another risk. Each assumption is a potential risk and should therefore be tested against experience from other sources as stated above. All the assumptions should be analysed and tested against existing benchmarks, or else the assumption becomes a threat.

**Document reviews;** documents and reports in the business (assuming that they are accurately done) are a dependable source of information and data that should be used in the identification of risk (IIA, 2020:1). Risks may be a result of faulty processes, decisions that were not well thought, or some may be inherently systemic and within the nature of the type of operations. This brings in the importance of internal control systems as they will help identify possible errors and misinformation in the operations (Besant, 2016:4).

**Delphi technique;** first identified by PMBOK (2003; 1) and is especially useful a large number of people in different places have their views required. A form of remote interviewing with group feedback based on a document putting into context the subject and situation then sent to a participant with sets of questions to be answered. The responses are analysed and constructed into a standard format. The full list with constructed statements is returned to all the participants asking them to comment on the relative correctness of each statement. This goes with a request to suggest corrections or additions to the new list, the responses are collated and used to construct the final list to be approved.

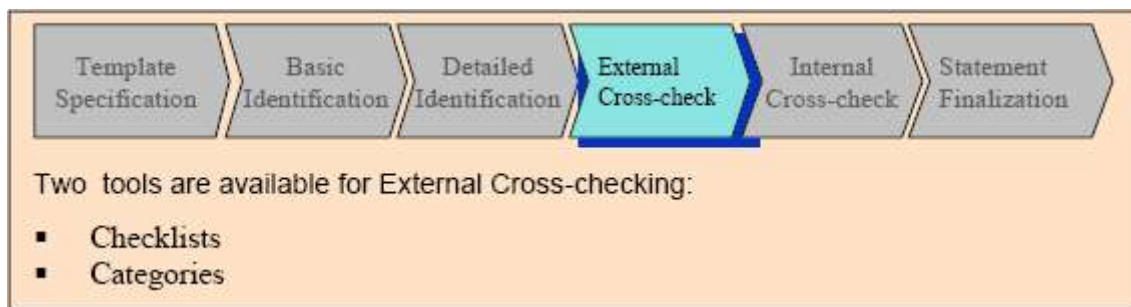
**Brainstorming;** all the participants are encouraged to think and contribute to the discussion on the proposition of new ideas. No criticism is allowed generally, so people say anything they consider to be creative thinking and helps to the discourse (Jankovie, Mihajlovic and Cvetkovic, 2016: 32). The process may be done purely verbal in which case it is referred to as the classic approach, partly written and then discussed which is called the nominal group technique (Besant, 2016:4). Brainstorming generally leads to large amounts of synergy amongst the participants and gives out the best of their thinking.

**External cross-check;** more often than not most products will be commodities and not necessarily specialised and unique to the firm. Consequently, it would be easier to look for information external including the hiring of employees who may have relevant experience for the industry. Cross-checking with competitors may be the panacea to the effective identification of potential problems. The firm can identify the potential risks generic to the industry and construct an informed risk management plan accordingly.

By so doing a long list of risks and uncertainties can be compiled and this will be based on knowledge and experience from external sources (Jankovie, Mihajlovic and Cvetkovic, 2016:32). This information needs to be collated with the internal circumstances of the firm. Figure 3.6 below seeks to provide further information in this regard.



**Figure 3.6: External cross-checking**



**Source; PMBOK (2003)**

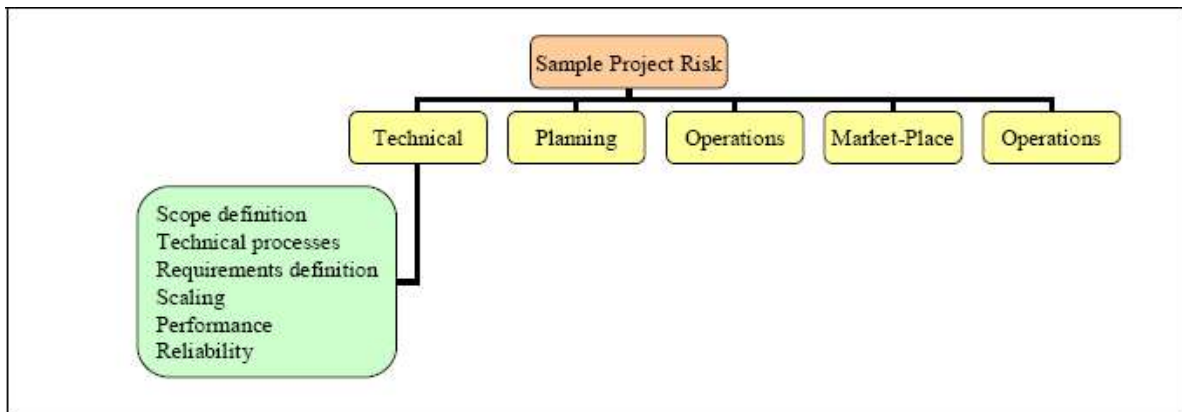
A few tools may be necessary for the preparation of the external cross-checking of risks, and these are, namely; checklist and categories.

**Checklists;** risk checklists for external cross-checking are aimed at specific markets, industries or technology types within a particular industry. The list of typical risks is drawn from different sources, literature, surveys including consultants and any other knowledgeable sources. It is best if the risk sources and the causal factors can also be identified as this assists in the drawing up of a risk plan (Rafik and Alain, 2011:32). The checklist should seek to state also the impact of the risk on the firm and lessons learnt from responses instituted by other organisations. The relevance of this list to the firm's situation needs to be analysed carefully to avoid focusing on risks that might have nothing to do with the industry or firm at hand.

**Categories;** many industries have lists of published work on the categorisation of industry risks, the firm needs to look for these. Kovacova et al (2020:54-60) suggest the construction of a hierarchical list based on the impact of the risks. The management has decided on each risk, the impact and how each should be averted or ignored depending on the cost-benefit analysis (CBA). It will be most ideal to develop a risk breakdown structure (RBS) for every risk to enable a good understanding of the risk (Hopkin, 2014:62) and thereby plan on an effective and efficient risk management program.

The sample of an RBS is illustrated in figure 3.7 below, as developed in clusters during Affinity Group stages. The risk is broken down into sub-categories in a well-studied and understood hierarchical format (Hillson, 2002:1), the sample below shows the RBS of a technical area.

**Figure 3.7: Sample of a Risk Breakdown Structure (RBS)**

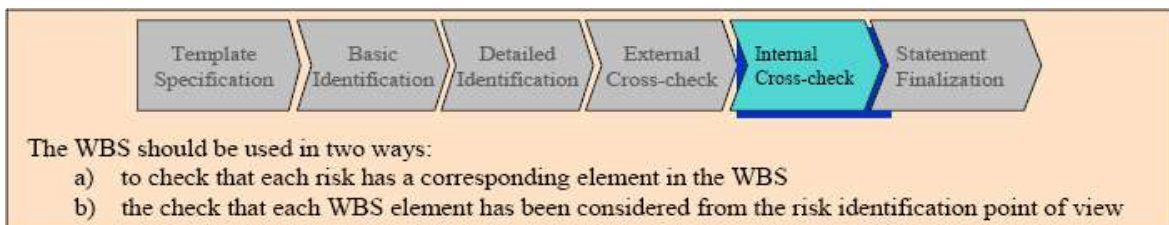


**Source: Hillson, 2002:1**

The scope definition of the risk is critical as it outlines the extent to which the risk may impact – how wide is the risk (COSO, 2020:1). The technical aspects if understood, would be most effective to identify would-be problems within the processes, thereby enabling the development of a relevant plan to manage the risk. This leads to the effective and informed identification of the requirements for the management of the risks and the rest falling into place accordingly – scaling, performance and reliability. Speier, et al, (2011:721) postulate that the Work Breakdown Structure (WBS) may be handy at this stage as that will assist in specifying what is to be done and to what extent. It is always important to confirm that the risk profile to be attended to is within the hierarchical breakdown of the planned risk management project (Protiviti, 2020:5).

**Internal cross-check;** internally for existing operations, it is important to carry out regular sessions with the practitioners. These are the same people who work to deliver on the set objectives, and working with them for good results is inevitable. Employees that are “engaged” in a firm are the custodians of the much-needed information, this is the role of internal control systems(Jowah, 2011: 1). Figure 3.8 below illustrates the relationship.

**Figure 3.8: Internal Cross-check**



**Source: PMBOK (Piney, 2003:1)**

The WBS is a critical management tool in the execution of multi-unit projects, so it is an indispensable tool in the planning of risk management. Every risk, therefore, needs to be aligned to the WBS to allow the ability to measure scope compliance and the other aspects of project

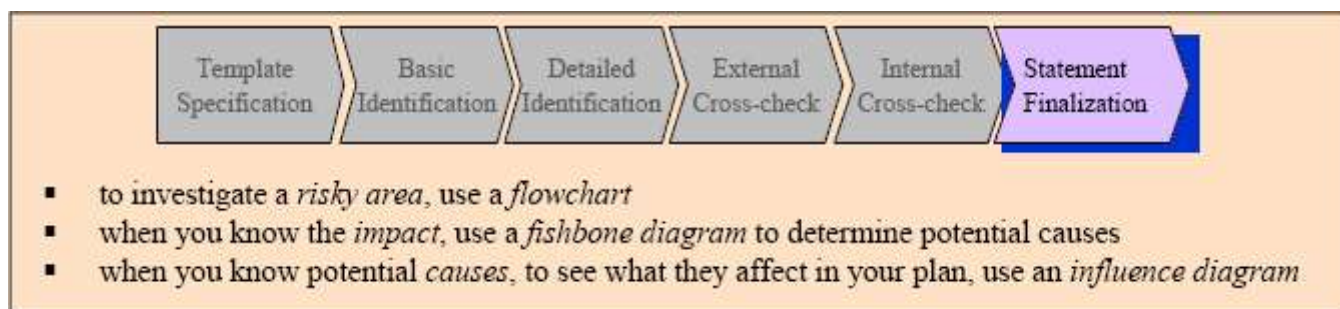
execution. The tools and techniques available would be, mapping the WBS and checking the WBS.

**Mapping to the WBS;** each identified risk should be traced to the WBS that corresponds to it with consideration of the hierarchy. A clearly defined and outlined risk will make it easy to align the risk to specific WBSs and will therefore allow management within the scope of the WBS (Rafik and Alain, 2011:32). The response becomes easier to plan and thereby clearly mapping the processes within the scope of the WBS, “A problem well defined is a problem half-solved.”

**Checking the WBS;** once mapping of the WBS is done, there is needed critical analysis of the relationship between the perceived or identified risk as specific aspects of the WBS. Whatever WBS elements or parts that have no alignment to the risk, should be flagged to indicate that the aspects or elements of the WBS are free of risks.

**Statement finalisation;** there must be a final statement for the risk – where the risk is identified and the most progressive methods come from depending on “lessons” learnt (Jankovic, Mihajlovic and Cvetkovic, 2016: 32). A detailed report on all the risks and their causal factors, sources, responses and any other aspects complementary to the management of the risk needs to be put together. This leads to the construction of a complete list of all the elements of the risk (risk profiling) to which reference can be made for decision making including future use. Any missing links need to be filled in, the other aspects are listed in figure 3.9 below.

**Figure 3.9: Statement finalisation**



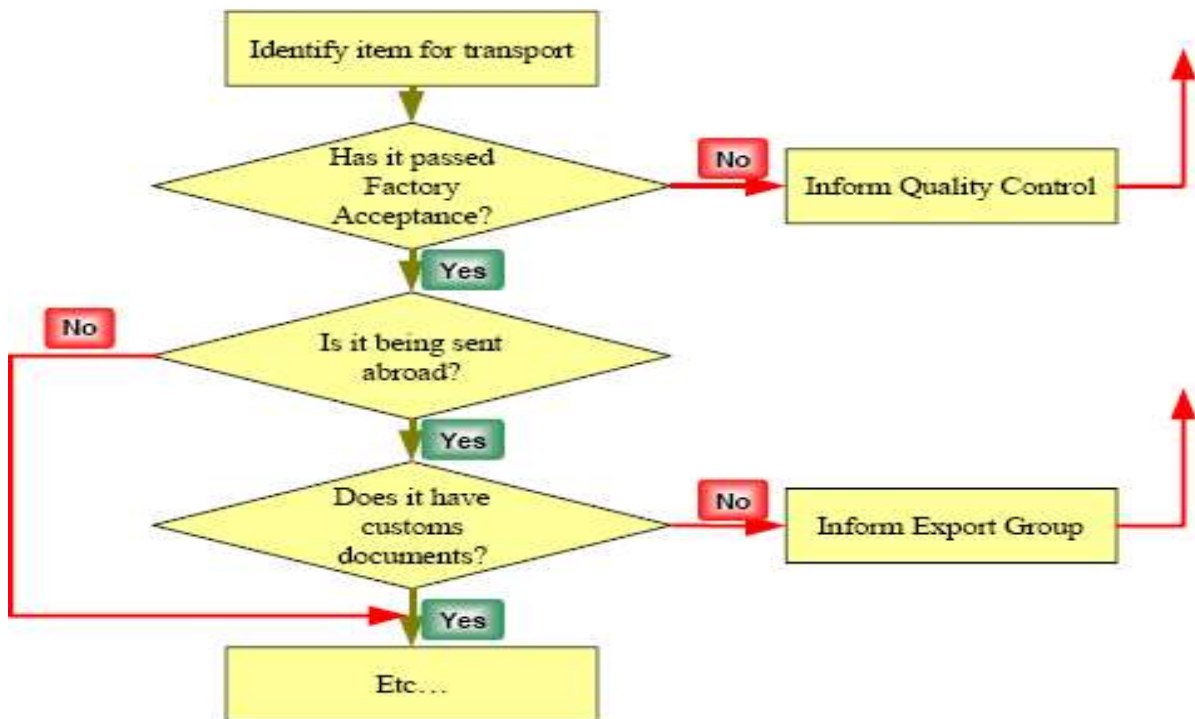
**Source: Piney (2003:1)**

The tools used to investigate a risky area would be by the use of a flowchart, and this can be complemented by the use of a fishbone to identify the potential causes (Hillson, 2000:49). Once a potential cause is identified, it may be a lot easier to plan with the use of a flowchart and an influence diagram.

**Flowcharting;** a flowchart displays the decisions made based on the activities determined for understanding the flow of control and data (Protiviti, 2020:3). If the activities are correctly and systematically lined up, it becomes easy therefore to identify areas of association with the risks.

The flowchart in figure 3. 10 below illustrates this using a delivery process in a manufacturing firm.

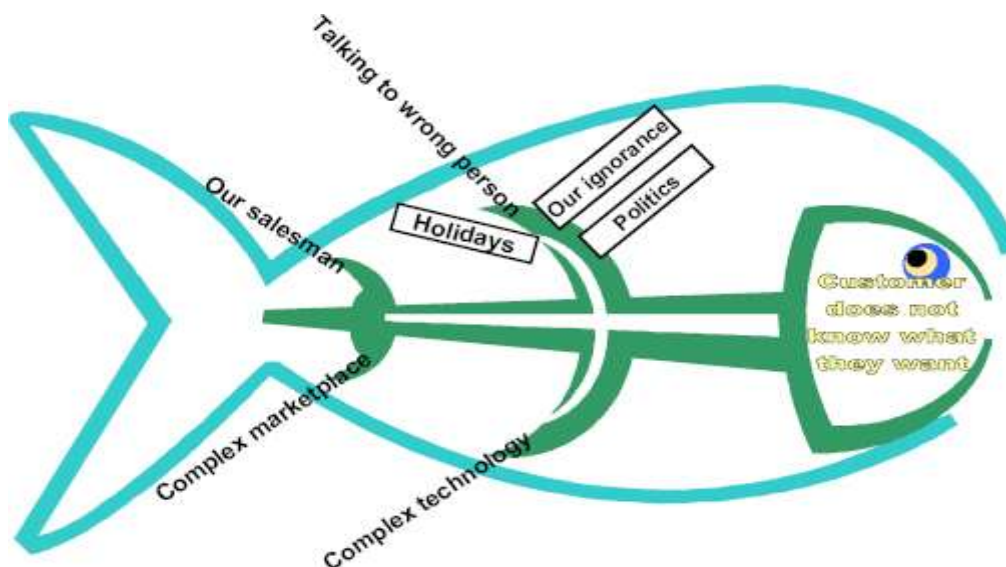
**Figure 3.10: Flowchart for sample delivery processes.**



**Source: Dale (1999:1)**

Fishbone diagram; commonly used in quality management, is referred to there as a “cause-and-effect diagram.” The diagram uses a “pictorial method” to show the breakdown of potential causes in a hierarchical form (Dale, 1999:1). The head of the fish represents the situation and the “backbone” of the fish is the link between all potential causes – skeletal fish bones. Each bone is a risk and an RBS and analysis are conducted to the lowest possible level. The structure is diagrammatically represented in figure 3. 11 below.

**Figure 3.11: Fishbone diagram for risk identification**

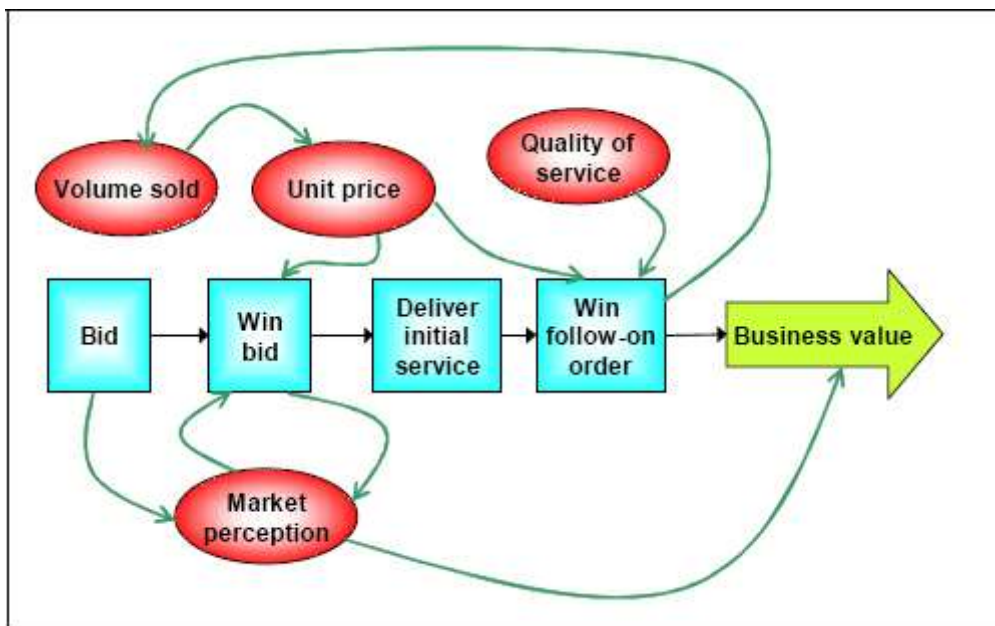


**Source: Piney (2003)**

The manufacturing environment is loaded with complexities that need to be understood, from both a quantitative and qualitative point of view. The fishbone diagram illustrates the interaction between the different aspects and activities in manufacturing and how they constitute risks. Protiviti (2020:3) opines that the risks surfacing at certain levels may merely be by-products or symptoms of other problems hidden in the structure somewhere e.g. – low sales may be a result of poor product-market-fit and not poor salesmanship.

**Influence diagram;** this is a way of showing how certain activities may be related to each other resulting in problems being identified elsewhere. It is important to try to understand the full set of activities and how they impact each other and surfacing at unexpected places – the fishbone effect above. The various scenarios need to be understood well by breaking them down to the smallest activities centres (Carsrud and Brännback, 2011:9) to build a better and clearer profile. By following the influence relationship, the causes may be easy to pick. An example of an influence diagram is demonstrated in figure 3. 12 below.

**Figure 3.12: An influence diagram for risk identification**



**Source: Piney (2003)**

Identifying the risk is a critical and too often complicated process (IIA, 2020:1) and the flow of activities and their likely impact on each other in the process needs to be thoroughly examined. The Project Management Institute (PMI) provides a project risk charter that contains clear guidelines.

### 3.5 PMI PROJECT RISK CHARTER

Much effort should be put into the preparation of an environment that limits or at best eradicates all chances of risks to the business. At every stage in the manufacturing process, including the administration, there may be factors that may deviate from best practices (Deloitte, 2019:1). So, the risk identification may be iterative in that it needs to be repeated regularly to encourage compliance and discourage deviations. The project management institute (PMI) (2009:1) suggests a more elaborate process to be followed for the identification of the risks. This is illustrated in figure 3.13 below.

**Figure 3.13: Risk identification**



**Source: PMI (2009) PMI Practice Standard for Project Management**

This method applies in all instances, including before the starting of the business, but critical to all risk identification is the presence of a business plan with operational details. To a large extent, this diagram combines all the different aspects of risk identification that have been discussed from different schools of thought. It is accepted in management studies that project execution has higher risks than most of the management disciplines (Price water house Coopers , 2019:9). The focus on risk management is therefore high considering the risks that occur in management by projects. The chart above integrates much if not all the other forms of project identification. Critical in the execution of projects is the need for data and information that informs project execution status step by step (Gonfalonieri ,2019:1). This directly speaks to the greater need for internal control systems that will assist in pre-empting by identifying the potential risks, their sources, and sometimes their causes (Losiewicz-Dniestrzanska, 2015:804).

### 3.6 ENTERPRISE RISK MANAGEMENT

Risk management is a process of defining, identifying and assessing risks for their effect on the entity and find the best control to prevent and mitigate that certain risk (COSO:2020:1). Furthermore, Pikett (2011:70) mentions that risk management response depends on the key controls which mitigate risk and if the internal controls work as they are intended, meaning they prevent and mitigate risks. Whittington and Penny (2012:252) mention that in 2004 the COSO issued enterprise risk management –an integrated framework which goes beyond internal controls as it put more emphases on effective management of risk and the like hood of risk, it encompasses:

- aligning the business risk appetite and its strategy,
- enhancing risk response decisions by focusing on the best techniques for managing risk, risk avoidance, reduction, sharing and acceptance,
- mitigating operational surprises or loss,
- identifying and managing multiple and –enterprise risk,
- seizing opportunities, and
- improving the deployment of capital.

Enterprise risk management framework is designed to achieve organisations objectives in the following four categories, namely (COSO, 2020):

- **Operational** - goals that are aligned with the effectiveness and efficient operation of the business or organisation,
- **Strategic** - goals that support the effectiveness and efficient operation of the business or organisations,
- **Regulatory or compliance** - goals that do require compliance with the laws, regulations, etc, and
- **Reporting objectives** – goals that encourage the reliability of financial statements.

### 3.7 COMPONENTS OF ENTERPRISE RISK MANAGEMENT.

The Committee of Sponsoring Organisation of Treadway Commission (COSO) ERM consist of eight components related or connected, they are obtained from the way management operates their business and are integrated with the management process( Reding et al,2016:4).

According to COSO 2020, ERM consist of eight interrelated components:

**Internal environment;** compasses the tone at the top by management on how risk is viewed and communicated by an entities people, including risk appetite, integrity and ethical values. The internal environment is influenced by an organisation's history and culture, it consists of many elements:

- **Risk management philosophy;** reflects the shared belief and attitude representing how the organisation consider risk and its effect.
- **Risk appetite;** is the amount of risk on the broad level, an entity is willing to accept in achieving its goals which take into consideration the amount of risk the management is willing to accept after balancing the cost and benefit of implementing controls.
- **Board of directors;** which give a detailed role played by the organisation primary governing body.
- **Integrity and ethical values;** represents the preferences, standard of behaviour and style.
- **Commitment to competence;** in addition to the knowledge and skill required to perform the assigned task.
- **Organisational structure;** as itself by the framework to plan, execute, control, and monitor activities.
- **Assignment of authority and responsibility;** represents the degree to which each person and team are authorised and motivated to use initiative to communicate problems and solve them, as well as limits to their authority.
- **Human resource standards;** consist of practices related to hiring orientation, training, and evaluation promotion, compensating and taking required actions.
- **Objective setting;** “the objective is set at the strategic level, establishing a basis for operation, reporting, and compliance objective, every entity faces a variety of risk from



external and internal sources, and precondition to effective event identification, risk assessment, and risk response is the establishment of objectives”. The objective is required to be aligned with the entities risk appetite, which drives risk tolerances must be aligned with entity risk appetite.

- **Event identification;** management identify the like hood of events that, if they happen, will they impact the entity and determine if these events reflect opportunity or whether they might impact the organisation’s ability to successfully implement strategy and achieve goals. COSO cite external factors and example related events.
- **Economic events;** such as price movement, capital availability or lower berries to the competitive entity.
- **Natural environment;** such as floods, fire, earthquakes or weather-related events.
- **Political events;** such as the election of a new government with new political agendas, or enactment of new laws and regulations.
- **Social events;** such as changing demographics, social mores, family structure, or work /life priorities.
- **Technological events;** such as new means of electronic commerce, storage or processing.

COSO cite internal factors and examples related to events:

- **Infrastructure factors;** such as increase capital allocation to preventive maintenance or call centre support.
- **Personal factor;** workplace accidents, fraudulent activities, or labour agreement expiration.
- **Process factors;** such as process modification, process execution errors, or outstanding decisions .
- **The technology factor;** such as increasing resources to handle volume volatility, security breaches, or systems downtime.
- **Risk assessment;** it permits the organisation to take into consideration the extent to which the like hood of an event affect achieving organisation’s goals, management assesses event from two perspective- like hood and impact – and usually make use

of quantitative and qualitative methods. The resulting whether they are positive or negative should be examined.

- **Risk response;** after the management has assessed the risk they determine how they will respond to risk, it includes risk acceptance management consider the cost and the benefit when responding to the risk.
- **Control activities;** policies and procedures that assist to ensure that management risk response is carried out. Control activities are classified differently and include different activities that may be preventative or detective, manual or automated and at the process level or the management level.

**Information and communication;** “pertinent information identified captured, and communicated in a form and time frame that enable people to carry out their responsibility information must be enough consistent with the entity need to identify, assess, and respond to risk, and remain with its different risk tolerance levels. COSO goes on to state “effective communication also occurs, flowing down, across, and up the organisation. All personnel receive a clear message from top management that [ERM] responsibilities must be taken seriously, they understand their role in [ERM] as well as how individual activities related to the work of others. They must have a means of communication with external parties, such as customers, supplies, regulators, and shareholders.

**Monitoring;** “enterprise risk management is monitoring – assessing the presence and functioning of its components over time”. It can be achieved by monitoring activities, separate evaluations, or a mixture of the two. Continuously monitoring normal occur in the daily management activities. The components of ERM provides a context for answering some common, daily questions that summarise risk management thinking:

1. What are we trying to achieve?
2. What could stop us from achieving those goals?
3. What are the options do we have to ensure that those things (risks) do not occur?
4. Do we have the ability to execute those options (designed and executed control activity to carry out the risk management strategies)? and,
5. How will we know that we have achieved what we wanted to achieve?

These five-questions apply to more than just risk management, answering these questions instils risk management-based type of thinking and discipline that aligns with COSO frameworks.

### **3.7 CHAPTER SUMMARY**

This chapter provided the review of literature on business risks within a manufacturing environment. Note that this study is not on the management of the risks by SMEs, but rather the internal control systems of manufacturing SMEs concerning risk control. This chapter, therefore, addressed the management of risk precisely focusing on the importance of internal controls systems. From this chapter, it is clear that the determination of what constitutes risk, and the identification of risk is centered on data and information. Internal control systems are precisely about regular checks of the data and information in the organisation. The data and information compiled in the process are critical as it serves as the thermometer gauging the temperature of the organisation. It can be concluded from this chapter that internal control systems are a critical component of the effective running of a manufacturing enterprise. Therefore, the following chapter will be dedicated to aspects of the literature on internal control systems and risk management within business operations.

## CHAPTER FOUR (4)

### INTERNAL CONTROLS AND RISK MANAGEMENT IN BUSINESS OPERATIONS

#### 4.1 INTRODUCTION

The management of a business enterprise as alluded to in preceding literature is more complex than meets the eye, specifically for business start-ups. The new business has to establish a system that works, have plans and programs that need to be achieved, monitoring and evaluation become critical. The first principle of business is to have a system through which the business needs to be managed, and these should be measurable (Hong and Lee, 2015:1289). The concept is, if you cannot measure the systems in the business, then it is not possible or at the very best difficult to manage the business. Records in a business are data and information that narrates the history and the status quo of an operation which helps to determine and or predict the direction the business may be taking (Gonfalonieri ,2019:1). The extent to which the set plans and programs are adhered to can only be measured if there is a system ideal for monitoring, evaluating and reporting on the status quo of the enterprise.

The presence of proper plans enables management to predict probable uncertainties that may become risks for the operation of the business (Hopkin, 2014:25). For this reason, risk management becomes a critical element in the management of small manufacturing enterprises considering the current failure rate and complexity of these businesses. The current operating systems are based on accounting records, production records, distribution records and all other data generated in the business (SAICA, 2019:1). Internal control systems are therefore critical for the effective collection, compilation and analysis of the data and information needed for decision making. It may be considered “suicidal” for a business operation to function without the use of an effective internal control system if risk management is to be considered an imperative for the success of a business.

**Figure 4.1 Internal control**



Source: Wall Street Mojo (2017)

## 4.2 INTERNAL CONTROLS

Internal control may be defined in different ways, but the general definition is based on accounting and auditing. The definitions of internal control should be understood more from the position of the stakeholder and their relationship to and in the organisation concerned. Price Waterhouse Coopers(PwC) (2019:8), defines internal control as a system put in place to assure the effective operation towards achieving the objectives of the organisation. The process is established by the board of directors and or senior management to provide the necessary operation data and information in the form of reports that will enable the management to measure compliance with objectives. The Committee of Sponsoring Organisation of Treadway Commission (COSO: 2020:1) defines internal control as a system that provides reasonable assurance concerning the achievement of the intended objectives relating to the operations of an enterprise. These are procedures established by organisational leaders primarily to afford the organisation a fair assurance on the achievement of three goals, namely; safeguarding of assets, compliance with law and regulations, and the completeness/accuracy of financial records. This is also supported by the definition by (Graham, 2015:2) which refers to internal control as compliance with the organisation’s objectives and expectations becomes the ultimate measure of the efficiency of the operational system. But because factors are going on internally and externally, that impact the status of the business at any given time, constant checks in the form of internal control systems become indispensable. The different organisations define internal control differently, the table 4.1 below illustrates the definitions from diverse associations and organisations.

**Table 4.1 Internal control defined by different establishments**

	<b>COSO</b>	<b>COCO</b>	<b>TURNBULL</b>
<b>Definition of internal control</b>	<ul style="list-style-type: none"> <li>Procedures established by leaders of an organisation with the primary objective to give a fair assurance on the achievement of three goals, which are: safeguard of assets, compliance with law and regulations and completeness and</li> </ul>	<ul style="list-style-type: none"> <li>Components of an entity that encourage people and give a fair assurance in the achievement of objectives in the following categories: effective and efficiency of</li> </ul>	<ul style="list-style-type: none"> <li>Consist of the policies, processes, task, behaviour, and other parts of a company that offer fair assurance in promoting effective and efficient operation, allowing it to respond effectively to</li> </ul>

	accuracy of financial records.	operations, reliability of reporting both internally and externally, compliance with the laws and regulations, and internal policies.	significant business, operation, financial, compliance, and another risk to achieve the company's objectives in the following categories: safeguarding of assets, identifying and managing liabilities, the quality of reporting, and compliance with the law and regulations.
<b>Components of internal control</b>	<ul style="list-style-type: none"> <li>Control environment, risk assessment, control activities, information and communication, and monitoring.</li> </ul>	<ul style="list-style-type: none"> <li>Purpose, commitment, capability, monitoring, and learning.</li> </ul>	<ul style="list-style-type: none"> <li>Control activities, information and communication process, monitoring, embeddedness in operation of company, response to risk and change, and reporting.</li> </ul>

**Source: Reding et al (2009:6)**

The function of managers in different units and indeed every individual in the organisation should be geared towards the attainment of the set objectives. The implementation thereof becomes the responsibility of management and auditors (COSO, 2020:1) even though it should be the responsibility of all involved. Reding et al (2009:6); (Aksay and Mohammed, 2020:198)

suggest three (3) generic internal control frameworks acceptable by management and the auditing fraternity at large.

**COSO**; Committee of Sponsoring Organisation of Treadway Commission, which was established in 1992 and was updated in 2020, which is internal control, integrated framework.

**COCO**; Canadian Institute of United Accountant established it in 1995, which guide controls.

**Turnbull report**; it was established by the financial reporting council in 1999 and was updated in 2005 which is internal control revised guide for directors on the combined code.

Reding et al (2009:6) confirm that there is no difference in these three frameworks as they all include the definition of internal controls, responsibilities of internal controls and components of internal controls.

Aksay and Mohammed, (2020:198) mention that different fragment is employed to assess the implementation of effective and efficient internal controls. Although there are many frameworks out there that are not different from the COSO framework and are accepted only in their countries, COSO is still the only framework that meets all the criteria's and is a world recognised (Graham,2015:2).

There is essentially no difference between the frameworks as they all define internal controls in the same way including components of internal controls(Reding et al 2009:6). There are different organisations in different countries, and some countries use the COSO whilst the other countries use their own. Concurr with (Vargas-Hernandez, Cardenoz and Campos, 2016:11) that there are striking similarities between the frameworks used in other countries and or regions. With all these variations, Graham (2015:2) posits that COSO is still the only framework with global acceptance as it meets all the necessary criteria for internal control.

#### **4.2.1 COSO framework**

According to Cruz (2016:1), the Committee of Sponsoring Organisations of the Treadway Commission (COSO) has put in place a model intended to be used for evaluating internal controls since 1992. To date that is generally accepted as the framework of internal controls globally, and this framework has five (5) components of internal controls and three (3) objectives of internal controls. This is illustrated in the COSO model figure 4.2 below.

**Figure 4.2 COSO Internal Control Systems Framework / Model**



**Source: COSO 2020**

Internal controls exist in all structures of life and activity and have been there since ancient times even before they were formalised into academic structures. To keep order in every environment, there has always been the need to have and adhere to some guiding principles and procedures. The running of a business enterprise is equally in need of internal controls, more so because of its complexities (Hopkin, 2014:62). The model in figure 4.2 above therefore shows and or has developed a simplified systematic classification (nomenclature) of the internal control system into five (5) components.

**Control environment**-sets the operations of any business and indeed individuals are impacted by the political, economic, socio-cultural and technological factors from outside (and inside also) of the organisation (Hong and Lee, 2015:1289).

These inevitably affect the firm, the policies and the general environment in the marketplace, something the firm is not able to control but should be able to manage. These together influence behaviour, consciousness and eventual policies and regulations in the firm and or environment (Tahir, 2020:99-115). Environment is the most important aspect as it is established and managed by management and it determines organisational culture and climate towards compliance with policies and procedures (Puttick and Van Esh, 2007:388). The organisational culture and practices concerning the business control environment consist of policies and procedures that reflect the behaviour and attitude of owners, directors, and top management (Eversonet al, 2013:1). That climate is initiated at the top and is made to cascade down to the different levels of the organisation as norm and practice. Deloitte (2020:1) postulates that the



control environment consists of integrity and ethical values of the entity, which themselves find their origin in the environment created by management. The control environment should put more emphasis on compliance to continuous process enhancement (COSO, 2020:1) as this allows for more efficient and effective ways of identifying weaknesses in the systems.

**Risk assessment;** risk is any uncertainty in the future that has not been prepared for and may bring about undesirable occurrences in a situation (Bibi, 2014:4).

Every individual's life and that of all organisations is impacted by some form of risk that needs mitigation. Identification and analysis of uncertainties is a proactive way of dealing with preparing for the eventualities not yet experienced but expected (KPMG, 2020:1). Assessing the impact of the risks is critical for effective planning ahead of the expected occurrence. Risk assessment is therefore the processes and procedures the organisation undertakes to identify and analyse the risk associated with the ability to achieve its objectives (IIA, 2020:1). The study by the Department of Energy in the United State of America (2016), concluded that risk assessment enables an organisation to understand better the possible impact of the undesirable occurrence. The knowledge of the impact thereof enables the organisation to make adequate preparation to combat the risk exposure and reduce or remove the "obstacle" to enable the organisation to reach its set objectives (Joseph, Albert and Byaruhanga, 2015:49). In concurrence with this, in a separate study by Bruwer, Coetzee and Meiring (2019:1) posit that risk assessment helps to identify possible problems and put in place controls to mitigate and prevent the risk assessment prevent and identify risk before it happens.

**Control activities;** when an organisation is established (business or not) there must be some guiding principles, policies and procedures that are provided for the effective operation of the firm (IIA, 2014:10). These are intended to bring about uniformity in the firm and allow the environment in which the objectives can be achieved. Control activities can be categorised into directive and prevention control activities, these involve responding to foreseen likely problems. Because these have been identified in advance, they can be pre-empted by implementing ways to prevent them (Ndenge et al. 2015:49). Control activity ensures that effective and appropriate controls are in place and are operating effectively to avert the foreseen danger ahead (Bragg, 2017:1). It is more prudent for an organisation to prevent rather than allow unwanted occurrences when they have been identified (Joseph, Albert and Byaruhanga, 2015:49). This is echoed by Deloitte (2020:1) in concurrence with this and opines that control activities are activities that the firm carries out to mitigate risk through policy and procedures to ensure that objectives of the organisation are achieved. In the same vein, the KPMG (2020:1) defines control activities as activities carried out at all levels of the organisation at different stages in the organisation processes.

**Information and communication-systems;** the internal control system is such a process that provides essential value to the decision-making system of an organisation. It is critical as it enables people to carry out their responsibilities from an informed source which may allow for effective management of the firm (COSO, 2020:1). Information and communication refer to procedures of discovering, capturing and the exchange of information on a timely basis to accomplish financial report objectives (Delloitte: 2020). The passing on of information - communication with the other related parties outside and inside the business is very important for effective internal controls (Ndenge et al. 2015:49).

**Monitoring;** this is a structured process of continuously reviewing the operations comparing the planned and the actual. The comparison against the planned and deciding on corrective measures where necessary is the primary purpose of monitoring (Tahir, 2020:99-115).

Monitoring enables the management to identify possible unwanted likelihoods in the operations, and thereby make appropriate decisions to pre-empt the effects. Monitoring according to KPMG (2020:1) to ensure the effectiveness of internal controls the internal controls system must be checked to assess the value of its overall performance. According to Ndege et al (2015:49) for the achievement of organisation goals, management should spend more time monitoring the internal controls. Monitoring aim to ensure that internal control is working as intended (Ejoh and Ejom, 2014:133).

Control is a basic principle of life, whether it be as individuals, organisations or society in general, there are accepted norms in each setting. There will be an aggregation of control systems emanating from many different individual control procedures. Fazel, (2012:1) Opines that controls will be found in the designated functions or aspects of an entity with activities and processes going on. The impact of the control system may be for the whole organisation or specific to certain components of the entity (Tahir, 2020:99-115). This, for instance, may occur specifically to the balance of an account, type and group of transactions, production figures, labour turnover, program failures, poor or increasing sales, etc. Hong and Lee (2015:1289) posit that controls are characterised by numerous methods, namely; manual, automated, authorisations, assets status, loopholes for fraud, duties and roles, etc. These different reports may be classified or summarised into control forms or types like, namely; financial reporting controls or operational controls (IIA, 2020:10). The primary objective of the COSO (2020:1) components is to ensure that the set purpose for the establishment of the organisation is realised, these are;

- operational effectiveness and efficiency to reduce the risk of closure or loss,
- reliable financial reporting to enable the organisation to ascertain achievement, and

- compliance with laws to avoid any conflict with the authorities which is risky.

Broadly speaking, any factor of risk that may be identified and pre-empted is the focus of internal controls in an organisation. Through this, the organisation's resources are monitored, measured, directed and protected from all uncertainties that may come up (Hong and Lee, 2015:1289). It assists in the prevention of fraud, protects the organisation's physical (machinery and property -tangible) and reputation (intangible – intellectual property, etc).

#### **4.2.2 Integrated functioning of the five components**

Of particular interest in the five (5) components is the control of activities which are intended to be the process of harnessing the resources towards the attainment of the objectives. The controlling system itself involves series of activities with specific objectives to be achieved through the implementation. Arguably the single most critical element of the five (5) components because this is to be supervised by the management directly (Tahir, 2020:99-115). This inevitably sets the tone for the environment for the whole organisation towards accepting the critical nature of the role of internal control. Gakpo, (2020:11-9) shares the same thoughts about the importance and role of internal control as an aid to organisation efficiency towards the attainment of the objectives of the enterprise. Inherent in the idea of setting up an organisation is the expectations of clear objectives, comprehensive budgets and alternative actions in the event. The control itself, therefore, tries to create a specific order or format within which, it is expected by management, and all drivers towards efficiency may be used to the maximum. Hong and Lee (2015: 1289) say control itself exists to keep performance as expected in the planning and maintain acceptable objective focused norms. It should be understood to exist in an interrelated format that combines other factors like the environment, employee behaviour, accuracy with information and the policies of the organisation (Adedeji and Olubodun, 2018:34). If this is to be effective, then there is a need for adequate and meticulous planning around the establishment of a context relevant internal control structure. This could assist in the manufacturing enterprise internal control system where the risks are high and the operations are generally complex. A variety of control structures have been identified, namely; directive controls, preventive controls, detective controls, corrective controls, key controls or primary controls, secondary controls, compensating controls, complementary controls, and entity level controls. These are illustrated in table 4.2 below.

**Table 4.2 Different types of internal controls systems**

Type of control	Definition and explanation
<b>Directive controls</b>	If in the planning, it is considered that certain actions will result in the attainment of the desired outcome, the management then gives directives intended to produce a specific intended and pre-determined outcome or result. These directives controls are measures put in place by the leaders to encourage a desirable event to occur (Aksay and Mohammed, 2020:196). Directive control gives direction on what should happen to encourage and cause a desirable event to occur (COSO, 2020:1).
<b>Preventive controls</b>	If management or operators know that taking a specific action may cause the occurrence of undesired results, they can decide to prevent the occurrence. Preventive controls are controls that leaders put in place aiming to deter undesirable events (Gakpo, 2020:11-9). Lemi (2015:14) states that prevention controls involve employing more skilled staff, separation of duties, high moral standards and a good control environment.
<b>Detective controls</b>	Sometimes the causal factors of certain outcomes are not known and or understood. Detective controls serve to work towards detecting and reporting risks before they occur (Njeri, 2014:13). Detective controls are controls put in place by management aim to deter (identify) an undesirable event so corrective action can be taken (Aksay and Mohammed, 2020:200). Prevention is better than cure- as such there is better management of risk than pre-empting it before it happens.
<b>Corrective controls</b>	When causal factors are identified that may result in unwanted outcomes, it is always prudent for management to be proactive and correct the situation before it turns to the undesirable. Corrective controls are controls that leaders put in place to inform or address every problem that the system has encountered or may encounter (COSO, 2020:1).
<b>Automated application controls</b>	Automated application controls apply to the process of individual control, they are designed to confirm the completeness, accuracy and validity of processed transactions with a financial impact (Adam, Diale and Richard 2019:54).

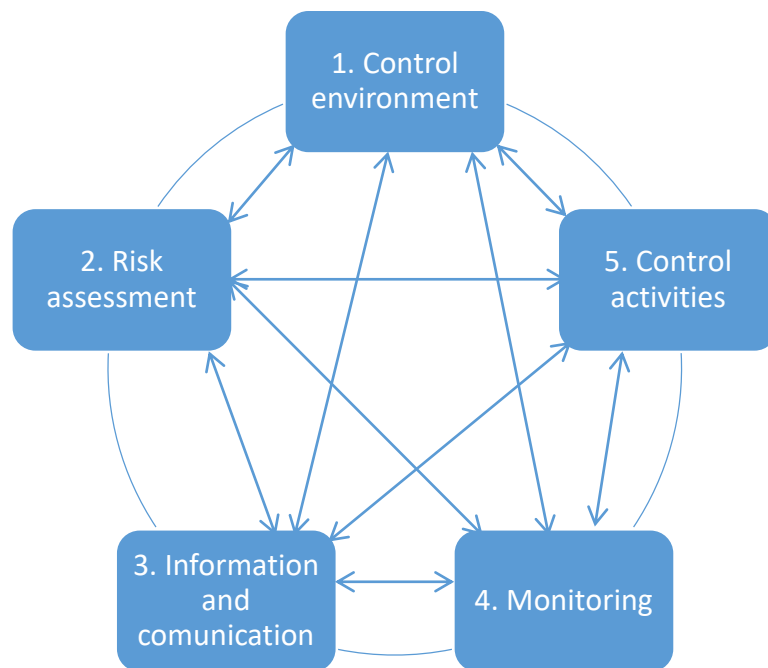
	If the IT general control environment have limited findings and the control environment is effective, the auditor may still rely on automated control but will need to test the access and change management around the automated application control embedded in the application.
<b>A key controls or primary controls</b>	Key or primary controls are designed to mitigate the key risks connected with the business objectives; a failure to implement effective and efficient key controls could lead to the failure of the business to achieve its objectives and to survive (Reding, 2009:6).
<b>Secondary controls</b>	Secondary controls are designed either to (1) mitigate risks that are primary (2) partially mitigate the level of risks when a key control does not work effectively. Secondary controls mitigate the level of residual risk when key control do not work effectively but they are not effectively by themselves to reduce a particularly key control to an acceptable level (Reding, 2009:6).
<b>Compensating controls</b>	They are designed to complete or enhance the key controls when they are not working effectively or efficient to mitigate or prevent risk alone to an acceptable level i.e. close supervision when effective segregation of duties cannot be achieved (Reding, 2009:6). Compensation controls exist where ineffectiveness of internal control may be compensated for by another control (Cascarion and Vane Esh, 2007:55)
<b>Complementary Controls</b>	They are necessary controls that are not adequate on their own to fully reduce risk, they must be combined with one or more other controls to operate effectively (Reding, 2009:6).
<b>Entity level controls</b>	Entity level controls in the Securities and Exchange Commission’s (SEC’s) Guidance for management, they are defined as “aspect of system of internal control that have a pervasive effect on the entity’s system of internal controls” Schemmann (2010:443), cited The U.S.Public Company Accounting Oversight Board (PCAOB).

**Source: own construction**

These directives, it may be stated categorically do not work or are not implemented without having been derived from one form or without leading to another form. A problem detected because directives were issued to identify possible causal factors, leads to corrective directives to correct what is considered risky. The complexity in manufacturing may mean also that identifying the shortage of supplies may result in closing a unit, or in proactively identify substitute suppliers (Adedeji and Olubodun, 2018:34).

The five COSO components in figure 4.3 are equally integrated and are not a smooth flow of activity, but involve going back and forth. Below is an illustration model of how these components operate in the real manufacturing space, which are explored and discussed in table 4.3.1

**Figure 4.3 Integrated operation of the COSO internal control components**



**Source: own construction**

When an organisation is started, initially the firm is influenced by environmental factors (PEST) be they political, economic, social and technological Kolios, and Read (2013:5035). A more modern structure proposed by Jowah (2015:67) is PESTLE is an acronym for; political, economic, social, technological, international and environmental. Needless to say that these factors mean a lot to what the firm becomes as these are outside factors (macro) beyond the firm’s controls. The effectiveness of managers is judged on their ability to manage the micro (internal) and make it work to produce the desired objectives (Nadezhda and Othman, 2017:25). Within the internal control, components are interdependency as illustrated by arrows showing back and forth movements. These are illustrated in tables 4.3.1, 4.3.2 and 4.3.3 below.

**Table 4.3.1. Control Environment and interactions**

<p><b>Risk assessment;</b> needs regular assessment by the management to understand and interpret correctly the likelihood of problems, types of problems and whether these will not impact the business. It may be likely that a product is getting out of the market, a manufacturer of fax machines may decide to move with the times and introduce computer scanning. There is direct interaction therefore between the control environment and the need for continuous risk assessment.</p>
<p><b>Information and communication;</b> the control environment provides information that is necessary for businesses to consider and to make decisions. The presence of correct, factual information allows for prospects for informed decision making to counter and act promptly. The control environment is dynamic, and all aspects of the business need to know what changes may be taking place. This will allow the operators to make necessary decisions and make appropriate moves whatever the best would be under the circumstances.</p>
<p><b>Monitoring;</b> there should be regular monitoring of the environment considering the constant changes in the macro and micro environment. Monitoring will provide information that needs to be disseminated to the correct and relevant structures for appropriate action in the circumstances. A constant evaluation of the status quo is a critical element of the monitoring process, with feedback (communication of the information) being critical in the end.</p>
<p><b>Control activities;</b> there needs to be put in place control activities including the external environment. The organisation has to design methods to control activities in and around them to maximise the benefits or minimise the impact. Monitoring will provide information that will determine the status quo, communication of the status quo (information) is provided, the impact of the risk impact is estimated and action is decided on.</p>

**Source: Own construction**

**Table 4.3.2. Risk assessment and interactions**

**Control environment;** the environment has its factors that impact the daily activities of individuals or organisations. To be able to understand the environment, an assessment has to be conducted, and it is this assessment that will inform other aspects of the components. Factors are identified and any would-be undesirable uncertainties can be isolated and special focus is put on these to avert possible negative impacts. Risk assessment therefore would thread through all the operations and all levels continuously

**Information and communication;** too often during operations data is accumulated on the operations, sometimes not even solicited data. Data does not say anything until it is interpreted to information which is what all operatives throughout the organisation will do well to know. Internal control compiles this from different aspects of the business and puts this together to show the relationship between the different components of the operation. Information and the communication thereof becomes the glue that puts all the different components together and unites the organisation into one “organism.”

**Monitoring;** every operation in an organisation should be according to the plan, starting from the strategic to tactical plans at the operation level. These plans are forms of budgets indicating what is needed, when it is needed, how much of it is needed, and the expected outcome. These “budgets” have to be reviewed to compare planned to the actual, this constitutes monitoring of the operations, and every component needs to be monitored for compliance. Monitoring therefore equally puts together the whole organisation and identifies areas that may be slowing down, allowing for the cycle of the components to start all over.

**Control activities;** apart from making plans to control the impact of the environment, there is a need for control activities around all the other aspects of the internal control system. The information and communication need to be designed in such a way that the right information is directed to the right activity centres in the correct format for those in that unit. Equally, monitoring needs to be controlled in that it should be coordinated and contextualised to enable efficiency in the monitoring and subsequent despatch of the information.

**Source: own construction**

In principle, the components of the COSO framework should be understood as one whole item with components or units that work together. If corporate governance is to be of any value to the organisation, then their greatest tool for measuring compliance is the internal control system (Losiewicz-Dniestrzanska, 2015:805). This indispensable tool will be the source of the information necessary for both evaluation of performance and the determination of what to do next. The key to the effective use of this tool for objective self-assessment also depends on the



right attitudes, culture in the firm, the integrity of the practitioners, and competence of the monitoring by managers. Aksay and Mohammed (2020:200) observe that the process of risk assessment is what an organisation must go through to identify and analyse risks associated with the ability to achieve the organisation's objectives. The identification of the risk and the use of effective risk assessment tools can assist in classifying the risks into low risk, medium risk or high risk (Joseph, Albert and Byaruhanga, 2015:49). Immediately this impacts the type of decisions to be made and the whole cycle of the internal control system kicks into place – integrating the organisation into one.

#### **4.2.3 The importance of internal controls**

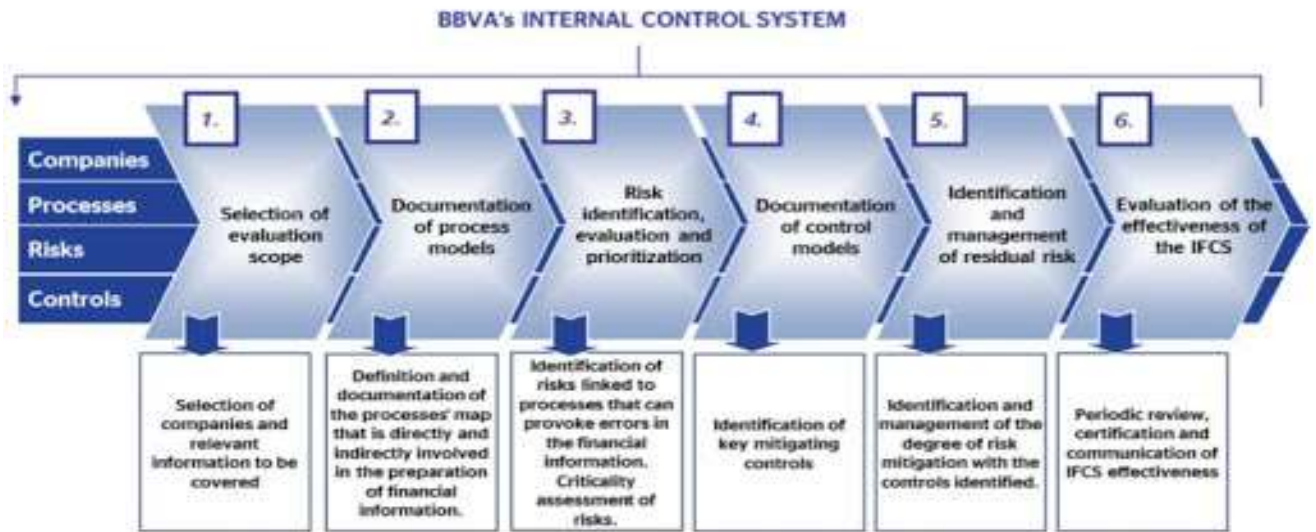
The use of internal control as a means of internally controlling the activities of the organisation is inbuilt like all human operations (Vargas-Hernandez, Cardenoz and Campos, 2016:11). When goals are set and objectives need to be met, it is a given that there should be a point at which an evaluation of compliance becomes necessary. Budgets are in the form of quantification of expectations of a firm in terms of finance, figures and performance (Lai et al, 2017:93). Internal control has therefore space in any of these operations, and the research has identified a working list based on which internal control can be evaluated. As alluded to in the preceding literature, internal controls have specific guidelines to which adherence is expected. The primary functions are, namely;

- check on the movement of organisational resources and reduce if not eradicate fraud from employees,
- regular check against the expected helps in the identification of significant errors or unforeseen risks to a business,
- regular checks enable the organisation to identify loopholes that may be used by employees to steal from the firm,
- regular checks enable the firm to create a standard by which the organisation operates towards meeting the objectives,
- using controls and checking on them regularly makes the staff know what they can and can't do within their duties,
- promote the use of quality checks before a product can be given or sold to the market by indicating trial runs,
- help identify errors that might have been innocently made by cross-checking reports and records by auditors,
- helps in the establishment of guidelines, policies and procedures that will assist in averting lawsuits and costly insurance,

- internal controls will most certainly identify failure to comply with legal standards to promote employee safety, etc.
- check the accuracy of your financial and other data systems and the impact on organisational performance,
- helps in the regulation of workers in terms of their roles, responsibilities and the accountability of their performance,
- knowledge of constant review motivates staff to keep to standards and this will promote operational efficiency
- to show the organisation's status quo in terms of all information with a view of reaching the set objectives,
- internal control helps identify risks by giving information that management uses to stop business failure or closure, and
- helps managers in the preparation and implementation of effective remedial plans and processes to reach objectives.

In summary, internal control properly structured and competently implemented will help in the identification of risks and prevention of negative impacts. A computerised system can improve segregation of duties by programming the computer to produce a log of who did what and when it was done especially in a complex industry such as manufacturing (Adam, Diale and Richards, 2019:42). This is critical to encourage reliable financial reporting which leads to the safeguarding of the assets for the organisation (Vargas-Hernandez, Cardenoz and Campos, and 2016:13). Compliance with the law in general and specifically internal operational guidelines will bring about positive performance in SMEs manufacturing. Furthermore, isolation of duties in a computerised environment is achieved by primary controlling access which employees have to the system itself, the application on it, and the module or function within the application (Adam, Diale and Richards, 2019:40). Effectiveness and efficiency in the operation of a business are critical as they will improve the profitability and sustenance of that business. Internal controls are the starting point and generally, the model follows a pattern of activities that constitute the internal control process. Figure 4.4 below illustrates BBVA's process.

**Figure 4.4 BBVA's internal control system**



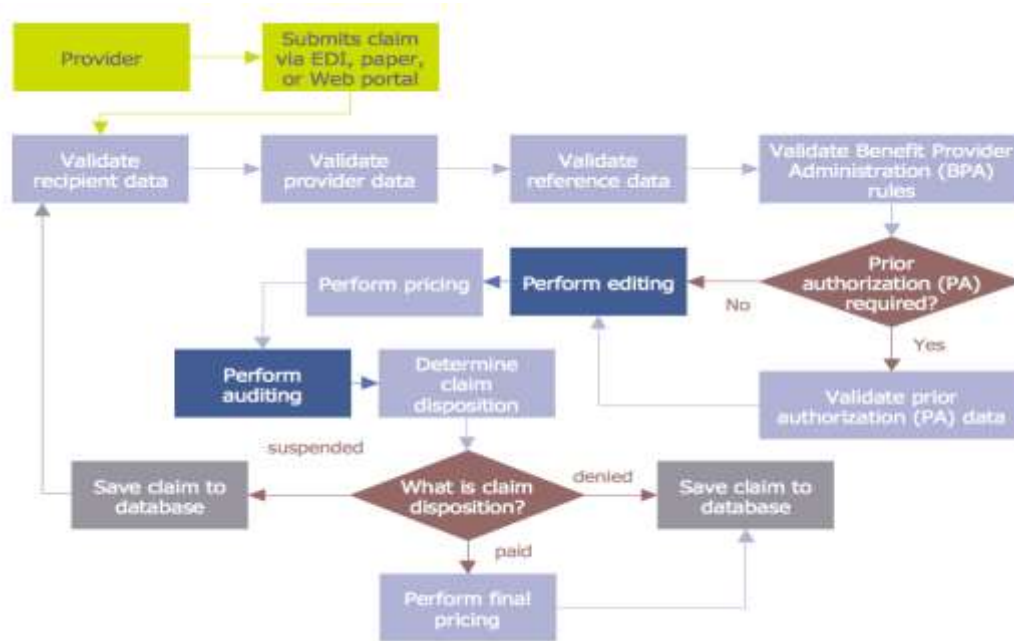
**Source: Hofvander (2014:3)**

Above (figure 4.4) is a simulation of how the internal control system is structured in linear form, together with this should be the understanding that the process integrates the company. The integration of the five (5) components is much more complicated when these are applied in the manufacturing systems as these have different divisions (Dubihlela and Nqala, 2017:87). The manufacturing organisation needs to outline and structure proper internal control systems if the internal control is to be effective. There is a need to have personnel that understand the principles and will efficiently document and communicate the management plan on internal controlling. The organisation needs to systematically implement the basic five (5) principles as illustrated in figure 4.3 above. These are;

- selection of the evaluation scope; what aspects of the business are to be targeted and what information is required,
- identification of the models to use for the collection of information and documenting the processes that will be used for the project,
- identification, evaluation and classification of risks to enable an appropriate and well-structured prioritisation list of the risks,
- identification of models to be used in the risk control with mitigating factors to avert or reduce the impact of the risk,
- identification of the residual risks and re-evaluation of the impact and how this can be managed going forward, and
- periodic review of these internal control systems and the effects of actions taken from the data and information collected.

The complexities of this in manufacturing create problems that may be the reason why few business start-ups seem to go for manufacturing. Not many people would have adequate funds to start a manufacturing business, but those who start need to have an adequate system of internal controls (Vargas-Hernandez, Cardenoz and Campos, 2016:11). A flow chart of the internal control system is demonstrated in the diagram (figure 4. 5) below.

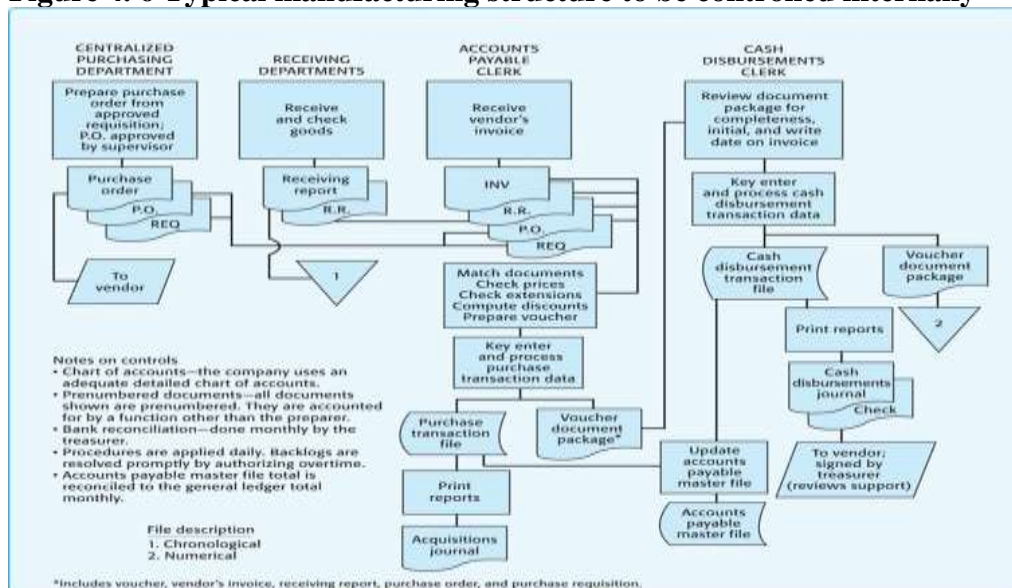
**Figure 4.5 Audit Process Flowchart. Audit Flowchart**



Source: Odessa (2014:1)

Above is a simplified version of what the audit process would go through, and below, Figure 4.6 illustrates a typical manufacturing structure. This system is therefore ideal to cater for all the cost centres and activity sites whose operations have a bearing on the final result.

**Figure 4. 6 Typical manufacturing structure to be controlled internally**



Chegg (2017:1)

Manufacturing business has to comply with many regulations about the industry, operational standards, safety for the employees, all of which are external (Cheggy, 2017:1). Internally the business has to contend with keeping external standards and being effective and efficient at the same time for them to remain competitive. Dubihlela and Nqala (2017: 100) postulate that there are many international standards that manufacturers need to abide by if they are to keep in business in this global village. The COSO framework becomes the guide for internal controlling by all organisations as an internal control is essential for the survival of businesses (Vargas-Hernandez, Cardenoz and Campos, 2016:8). Every one of the units or departments in the structure will need to produce data that should be compiled to build up a data bank that shows the direction the organisation is taking. This involves much more than what other types of businesses have to do for their internal controls, thus manufacturing becomes complex to manage. More than ever before manufacturing companies face changes that can affect the current system of internal control (Dubihlela and Nqala, 2017:200). There are three (3) such categories, and these are namely;

- PEST related changes involving the availability of raw materials, new laws and regulations,
- the world is constantly changing and technology may alter the current business models, and
- the future leadership of these organisations with the advent of the Fourth Industrial Revolution (4IR).

The technological space may change the way data and information are gathered thereby changing the role or the processes used in internal control. As a principal – the source of data and information for decision making is expected to remain as long as managers will still have to make decisions for their businesses (Hermanson, Smith, and Stephens, 2012:49). It is also envisaged that the advantages of internal control in the provision of critical decision making information will remain. This will consequently mean the continued existence of internal control as an indispensable tool, though it may be with little alteration, probably cosmetic at best if any.

#### **4.2.4 Advantages and disadvantages of Internal Controls**

The use of internal controls in a business operation is a “must-have” for organisations, specifically the manufacturing industry (Darrough, Huang and Zur, 2012:1). This is considered the mainstay of the economy of any country, and critically so for South Africa where there are high volumes of imported goods. Lai et al (2017:82) postulate that most African countries

depend on imported goods very much to the detriment of their economies and escalation of poverty. With the high levels of unemployment, the starting of a manufacturing enterprise is itself a sustainable method of wealth distribution. But it is evident that many business startups (80%) close down within the first five (5) years of their lives, and most do not have strong internal control systems.

**The advantages of internal controls;** the advantages of internal controls are essentially covered by the detail on the importance of internal control as stated above. A summary of the advantages is captured in figure 4.7

**Figure 4. 7 Advantages of internal controls**



**Source: Cheggy (2017:1)**

These together with the importance of the internal control system constitute what would be classified as the advantages. All these advantages are intended to boost the morale of the compliant employee as well as help apply moral pressure on the operating staff (COSO, 2020:1). It needs to be stated categorically that the internal control system function is only as good as the competence of the managers. This will provide the tools to work with, and the quality of decisions and implementing processes remains the function of the management (Hermanson, Smith and Stephens, 2012:48). As stated before, internal control is coordinated and integrated process methods and procedures to safeguard the assets of an organisation by providing the necessary information. The accuracy and reliability of the accounting data are expected to help with promoting of organisation's operational efficiency. Internal control extends beyond the traditional definition of auditing, it also includes units outside of the accounting and financial departments (Lai et al. 2017:82). Internal control systems incorporates

many other activities amongst which will be the inspection, internal auditing and many other factors of controls.

#### **4.2.4.1 Disadvantages of internal controls**

Internal control provides data and figures which at best may be reasonable but is not absolute (Aksay and Mohammed, 2020:198-200), the information is based on the data available. Beyond the regular visits by internal control operatives is the reality that the operational practitioners sit with. Too often the information provided is like the provision of quantitative research data without significance in terms of the how, why and when of the operation (qualitative research). Some of the internal factors may be a result of external occurrences like competition and technological innovation which may not reflect on reports. The researcher has identified disadvantages of the internal control systems listed below.

- it needs specially trained and knowledgeable personnel to execute the checks properly and objectively,
- badly planned internal control system increase frustration amongst the employees of an organisation,
- it is assumed and not necessarily verified that the information collected is valid and is accurate as per records,
- effective internal control is only about timely information at the moment of collecting the data but cannot state the status quo in a continuum,
- performance is measured against existing plans management assuming that their planning was correct in the first place,
- too rigidly designed internal control system may create adaptation problems with the employees,
- this may make the company's auditors depend largely on internal control reports instead of them doing their work,
- the best the system can do is to report and the decision making and the implementation remains a management issue,
- too often if it shows weaknesses in management very little of that information may be cascaded down to workers,
- it is not a guarantee in itself but the effectiveness and efficiency will depend on management decisions,
- there may be wrong or incorrect data supplied to the committee and there is no way of knowing and correcting,

- the internal control system is as good and as competent as the practitioners inside the system itself,
- this may be infiltrated by management and be used for political fights between authorities in the organisation,
- too many levels are involved in the screening of the information and the final decisions for implementation, and
- the directors and senior managers make decisions made out of data and not the operational context.

Many other factors may affect the efficiency of the internal control systems, like any system it is not infallible. However, this system has served well in many instances and helped many organisations stay profitable to avert risks that would otherwise result in them closing down. Computerisation is a danger to segregation of duties as it takes employees out of the application and enables the control procedures related to authorising executing, custody and recording to be performed by one employee and his computer (Adam, Diale and Richards, 2019:41). The manufacturing sector remains a critical element of the South African economy, and every one of these closing down means loss of jobs and an increase in poverty (Kovacova et al, 2020:54-60). There must be competent leadership in this regard, and this comes from clearly defined reporting structures, the roles and responsibilities in internal control.

#### **4.3 ROLES AND RESPONSIBILITIES FOR INTERNAL CONTROLS**

Everyone in an organisation has responsibilities regarding internal controls: management, board of directors, internal auditor, external auditor and other personnel (Jackson and Stent, 2020:4). Committee of Sponsoring Organisations of the Trade Commission (COSO), (2020:1) mentions that King 11 report indicated, “risk management and internal controls should be practised throughout the company by all staff and should be embedded in their day-to-day activities”. Table 4. 4 below demonstrates this.



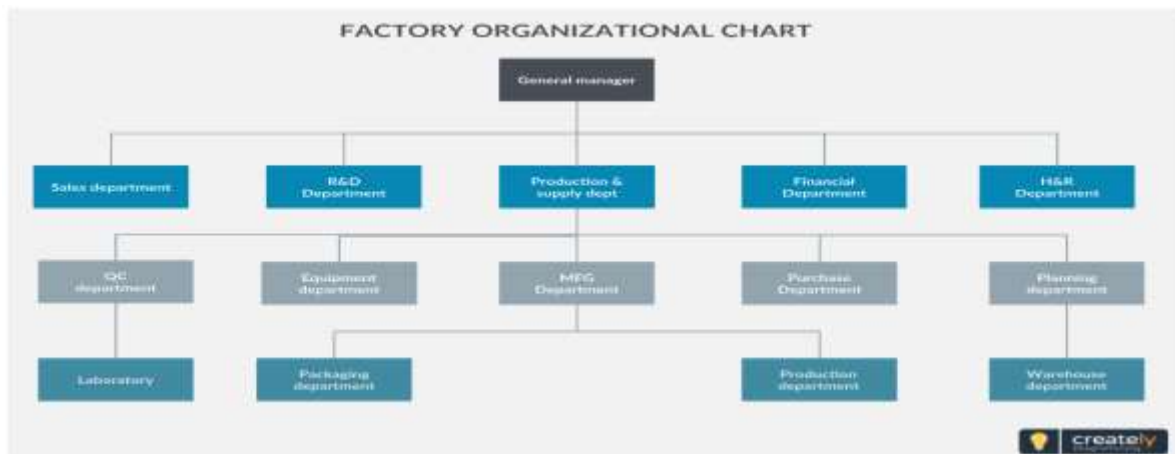
**Table 4.4 Roles and responsibilities in internal controls**

<b>Management</b>	<b>External Auditor</b>	<b>Internal Auditor</b>
<p>Management should</p> <p><i>Design</i> internal control structure and <i>implement</i> internal control activities:</p> <ul style="list-style-type: none"> <li>• To achieve management’s internal control objective, and</li> <li>• To meet organisational objectives.</li> </ul>	<p>External auditor should</p> <ul style="list-style-type: none"> <li>• <i>Evaluate</i> and <i>test</i> accounting structures, related internal control structure and financial control activities:</li> <li>• To achieve audit-related objectives, and</li> <li>• To express an opinion on financial statements.</li> </ul>	<p>Internal auditor should</p> <p><i>Evaluate</i> the adequacy and effectiveness of <i>all internal control activities</i>:</p> <ul style="list-style-type: none"> <li>• To achieve engagement objectives, and</li> <li>• To express an opinion on the adequacy and effectiveness of controls in mitigating risks.</li> </ul>

**Source; Coetzee et al 2014:114**

Accountability on the final performance resides with senior management in that they have to explain why an enterprise fails. But, it is the responsibility of all employees at all levels that the organisation should work to reach its objectives (Jackson and Stent, 2020:4). However, the direction and supervision of the operations of the whole organisation should be the responsibility of the chief executive officer. The structure of the application and functioning of the internal control system however starts with the chief executive officer – the top manager. A typical SME manufacturing organisational is illustrated in the chart in figure 4. 8 below.

**Figure 4.8 Organisational chart for manufacturing company**



**Source: Cheggy (2017:1)**

Depending on the size of the company and what the manufacturing enterprise is involved in, the firm can merge certain functions. But in this hierarchy, the general manager is the same here as the CEO, depending on the system adopted by the organisation. Of critical importance is to emphasised that each one of these offices (departments) generates information for internal control (Kovacova et al, 2020:54-60). The general manager oversees directly the functioning of those reporting directly to him/her and in most instances, these comprise an executive management team. This team is comprised of departments where there are sectional managers who also form a departmental management group with the divisional or departmental staff. This goes on to the lowest individual in an organisation (Lloyds, 2017:1). In smaller entities, the impact of the chief executive's leadership is more directly felt by those below. In a cascading format, the divisional, departmental, the sectional leader becomes the chief executive of that unit (Aksay and Mohammed, 2020:200). Of particular importance here may be financial officers because their control activities go right across the enterprise both vertically and horizontally.

#### **4.3.1 Senior Management**

Internal controls responsibility belongs to the board of directors of the entity and the board of directors assign the responsibilities to the management. The Chief Executive Officer (the top manager) has the primary responsibility to design and implement with effectiveness the internal control system (Coetzee et al. 2014:110). The tone in the organisation is set at the top, which, if properly structured will filter down to the whole organisation in the form of the culture. This tone sets the ethics, integrity, norms, and all other factors necessary for a positive work performance environment. Management is responsible for adequate control activities, seeing to it that the internal controls are working effectively to mitigate and prevent any negatives (Hermanson, Smith and Stephens, 2012: 34). It is given that the CEO will not implement these on his own, but it is he who decides on people that he works with to which these values must be disseminated (Jackson and Stent, 2020:4). There should be a clear understanding between the CEO and the managers who work with him towards the implementation and transference of this tone from the top. The cooperation of the other managers is essential, and the ability to get that cooperation is a clear indication of the ability of the CEO to lead (Tahir, 2020:99).

#### **4.3.2 Board of directors**

The Board of directors should ensure that management meets its responsibility for the design, implementation and monitoring of internal controls. In most instances, the audit committee is responsible for overseeing the compilation and the accuracy of the firm's financial statements (Jackson and Stent, 2020:4). The board of directors provides governance, guidance, and

oversight, an efficient board of directors can identify and correct management attempts to override controls (IIA, 2020:1). In South Africa, a board of directors consists of executive and non –executive directors. The chief executive director and the other directors are primarily responsible for the implementation of the internal control systems (Jackson and Stent, 2020:4).

#### **4.3.3 Audit committee**

Puttick and Van esh, (2003:236) reporting from the first King’s Report (1994) recognised the need for audit committees in giving assurance that an effective internal control system is implemented and monitored. This was based on the understanding that properly done and executed financial reports would give authentic information on the status of the organisation. The financial statements done by professionals would be properly done and fairly presented.

#### **4.3.4 Internal auditors**

Consider internal controls in terms of the role in the achievement of the goals of the entities. The internal auditors verify if the internal controls of the entities are properly designed and if they are working effectively to achieve management goals (Reding et al 2016:6).

The internal auditing unit or department should assist in maintaining effective controls by evaluating the effectiveness and efficiency. Internal auditors should take part in monitoring the implemented internal controls and the internal auditors’ roles are to promote the control environment in the organisation (Jackson and Stent, 2020:4). Internal auditors should also help the directors and management by developing recommendations for improving internal controls (Puttick and Van esh, 2003:237).

**External auditors;** these are responsible for identifying and assessing risks of a misstatement by understanding the entity and its environment (Jackson and Stent, 2020:4).

The external auditors have a statutory responsibility to report to the shareholders regarding financial statements and consider statutory requirements and accounting standards for financial reporting (Deloitte, 2019:1). The identify weaknesses of the audit report as indicated by the internal controls reports showing the likely risks to the organisation (Lauwer et al, 2006:149).

**Other personnel;** internal controls operation and application should be for the whole organisation and not be the preserve for the handful (IIA, 2020: 1).

A culture of control of the operations with intentions should be at all costs be inculcated into the minds of the workforce to meet the objectives of the organisation. The other person can participate actively in the provision of data and information, and where they are afforded an opportunity, they should explain some of their difficulties at the operation level. Responsible well-engaged employees may take the pain to report to top management any other irresponsible behaviour detrimental to the organisation (COSO, 2020:1).

#### **4.4 CHAPTER SUMMARY**

The primary purpose behind the use of internal controls is intended to help the organisation to reach its objectives. The welfare and success of the organisation should find favour in the hearts of all its employees at different levels. A well organised, properly managed and motivated staff will want to take ownership and participate actively in the development of the source of their income. Too often the management makes subordinates feel exactly like that subordinates, whereas they would want to share in the joy of the success of the enterprise. An organisation with a leadership that engages its employees and makes them feel like they belong, is most likely to have cooperation from all the participants in the operations. If internal control is to be the responsibility of all people employed in that organisation, then the organisation, from the top, should make all its employees “belong.” With this, it will be less more cumbersome to get cooperation and good performance in an environment where the employees are satisfied with their working conditions. The following chapter (chapter 5) provides the framework that guided this study.

## **CHAPTER FIVE (5)**

### **THE CONCEPTUAL FRAMEWORK**

#### **5.1 INTRODUCTION**

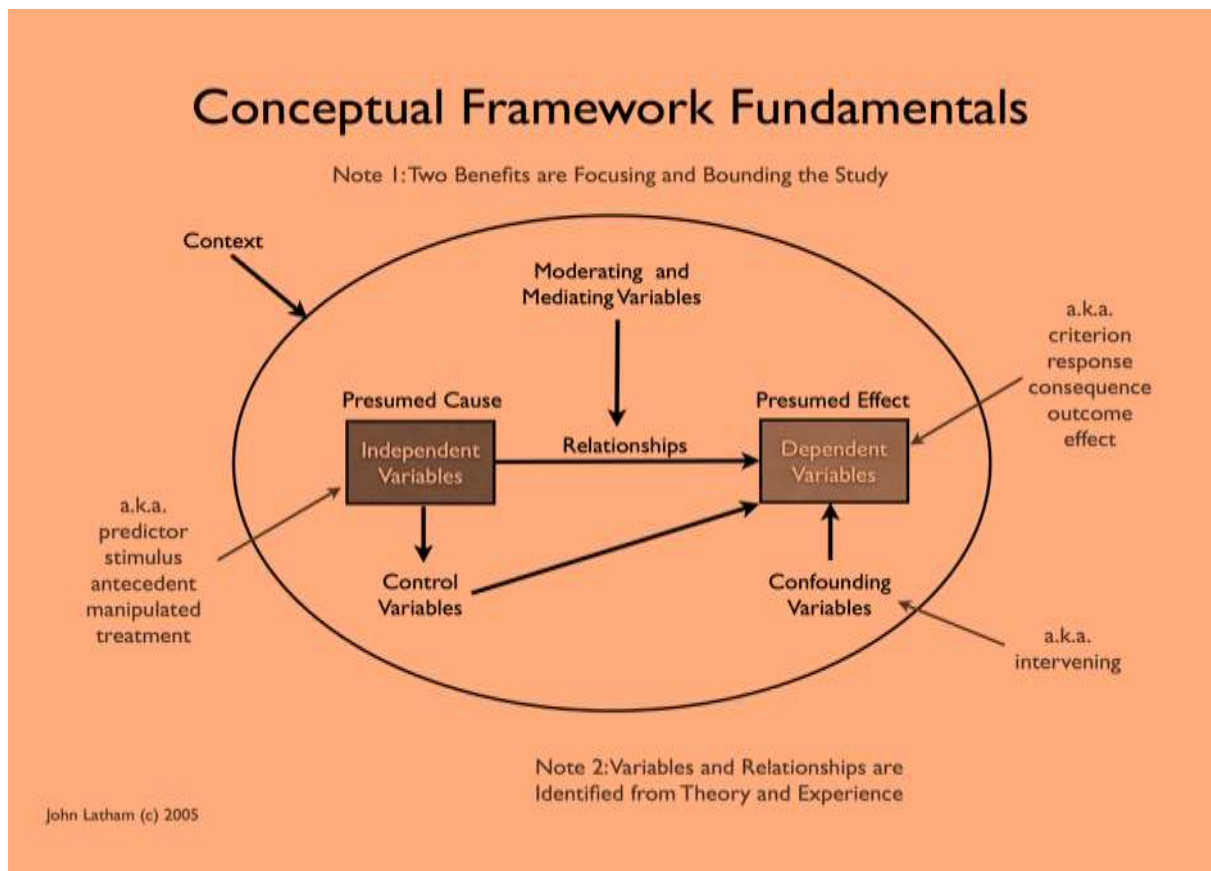
The conceptual frame is define by Maxwell (2013:25) as a structure showing assumptions, beliefs, concepts, expectations and theories that support the research. The researcher has the experience and has interacted with many of these systems and therefore has a view as to how these relate to each other. In another sense, this is a visual representation that explains graphically or in narrative form the main issues to be studied (Yin, 2017:146). This schematic graphical structure displays the variables to be studied or understudy (independent and dependent variables) and how if they were structured in a particular format, they would resemble a presumed solution or answer to questions. Osterman (2012:135) suggests that for a framework to be able to fulfil its purpose, it must of necessity identify certain issues that, if combined in a particular format will produce a certain result. These factors are generally scattered in literature by academics and in documents of files on experience by the practitioners (Yin, 2017:146). It is therefore deemed important that a conceptual framework be the result of extensive reading of academic work as well as experience and interaction with people with the necessary experience. The details of the different experiences, thoughts and views of people on this subject are therefore discussed in the section below.

#### **5.2 BACKGROUND**

A conceptual or theoretical framework is in its own right a tentative theory that is constructed to explain or predict phenomena. Other models have been drawn by different researchers based on their context to draw up context-relevant relationships which provided a form of behaviour (Brains et al, 2011). The models drawn will need to be consistent with generalisable similarities of their observations, ideas and elements of other models. It is anticipated therefore that the theoretical framework will support the theory of the research project (Osterman, 2012:135). By developing the concepts, which speak to the same subject and within the same context, the researcher's conceptual framework is then developed in a conceptual model based on the concepts developed (Riggan, 2015:12). The conceptual framework becomes the presumed reality which may impact the type of research design to be used for the research. This though should be understood to be the researcher's understanding and hence the reality of the problem to be researched (Maxwell, 2013:7). Literature is equally important in the process as it is the accumulation of studies by many researchers, but using literature alone will exclude the

experience of the practitioners. The practitioners have information on the operational problems, suggesting that any framework that will not include them will simply be devoid of the realities.

**Figure 5.1: Conceptual framework fundamentals**



**Source: Matten and Moon (2008:423)**

Matten and Moon (2008) propose that the exclusion of the practitioner’s experience makes the research a futile exercise, rather that there should be an interaction between operational realities and literature from other sources. The main sources thus suggested are, namely;

**Personal experience;** the researcher may have personal experience working in an environment where there was a need for internal control used to identify and avert risks in these small manufacturing enterprises.

**Personal research publications;** the researcher may have published about this subject suggesting wider knowledge from previous surveys on the subject and the different ramifications of this internal control systems.

**Empirical research;** there may be existing empirical research either by the researcher or work from previous work that may be known by the researcher. This adds to the level of understanding of the study at hand.

**Existing literature;** much work has been done by different academics over the years in different countries and regions. This work is recorded in different forms; journals, magazines, books, commission reports and other forms of literature.

A combination of the above put together may need to be streamlined and be put in a logical format to identify relationships and construct theories. The concept of the mind of the researcher is developed therefore as all this information is synchronised to make sense (Maxwell, 2013:94). This is intended to realistically represent the situation in internal control systems and the impact on risks likely to be encountered.

This will therefore be the tentative theory connecting the various components of the study on internal control and risk aversion where possible. Yin (2017:149) posits that the conceptual framework is used as an analytical tool with several variations and contexts to assist in the understanding of relationships between variables. This tool can be applied in different categories of tasks and work relationships where the different aspects feed into one finished (Brains et al, 2011). This provides a pictorial version of how the operations or relationships are in relation to or against each other (Matten and Moon, 2008).

Strong conceptual frameworks capture something real and do this in a way that is easy to remember and apply. Researchers use frameworks to explain the conflict theory come into resolution, within these conflict frameworks, visible and invisible variables function under concepts of relevance (Maxwell, 2013:46). For the purpose of this study, a conceptual framework or model is used to present the possible courses of action or preferred approach or idea (Ahmed, 2018:34).

### **5.3 CONCEPTUAL FRAMEWORK: A STEP BY STEP GUIDE**

By definition, the conceptual framework is a mind map by the researcher based on all the information available and interacted together (Maxwell, 2013:12). This represents the researcher's synthesis of all aspects and factors around the phenomenon that needs to be understood through the study. It outlines the steps and the actions (what is to be done and how it should be done) of the envisaged solution to the existing problem (Jowah, 2012:71). As alluded to above, this map is a result of a combination of numerous factors including the experience, the literature, the knowledge through education and even interaction with people knowledgeable in the subject (Moorstein, 2004:30). These became important sources on how the phenomenon was to be understood in its breadth and depth thereby allowing some serious consideration of how to solve the problem. Yin (2017:149) assert that the conceptual framework "sets the stage" that will enable the structuring of a context relevant research question for the study. The framework helps a better understanding of the problem statement and thus assists in identifying appropriate research objectives from which the research questions are derived

(Jowah, 2012:71). The research objectives are the researcher's expected outcomes from the research, but there is a need for questions that help with the understanding of the research objectives which helps answer the research problem. The process of constructing a conceptual framework, therefore, involves distinct steps to be taken – what is to be done of the mind map, following are the steps (in their chronological order) taken by the researcher in the construction of the mind map:

**Step 1;** the researcher has to decide on the study to be conducted by identifying a specific topic to be focused on. In this case, the study is on internal control systems and the mitigation (or prevention) of risks to small manufacturing start-ups.

**Step 2;** in this step, the problem is identified and defined and through the study of literature the researcher established a study gap – problem statement. This focused on the high failure of small manufacturing enterprises which was attributed largely to their inability to understand the movement of their assets in the business.

**Step 3;** adding to the literature reviewed the researcher interacted with people who were involved and knowledgeable about the practices in the industry. The practitioners simply narrated how they do their operations from which the researcher noted that there was no standardised system for internal controls of their activities.

**Step 4;** the researcher then identified the variables to be studied, classified them as independent and dependent variables whose relationship with each other would produce certain results. The preliminary definition and identification of the variables indicated that little knowledge (ignorance about) of the importance of internal control systems gave way to high risks of fraud and unchecked under-performance.

**Step 5;** the researcher referred to academic material and school work previously learnt and using that further interacted with the practitioners to compare the book education and the business owners' practices. From this, the researcher was convinced that there was a genuine problem to be studied and that a solution needed to be found to stop the high business failures.

**Step 6;** the researcher then put together all the information acquired from the different sources, including the education, literature reviewed, the interaction of the practitioners and models written by other researchers. This material was synthesised to help the researcher understand the situation in a holistic manner and then decide on what to research and how to research, with the objective therefore of helping to find a solution to the problem.

**Step 7;** from this, a mind map was designed which became the conceptual framework of this study on the impact or benefit of internal control systems on the reduction of business risks that result in business failure.



## 5.4 REASONS WHY BUSINESSES FAIL

McIntyre (2020:1) calculates after extensive research that 80% of all business start-ups close down every five (5) years. This has prompted an extensive study on why business start-ups fail since these start-ups generally create much-needed jobs in the market. It is equally a well-known fact that on average 60% - 70% of new jobs in the market come from these start-ups (McIntyre, 2020:1), this because a critical vehicle in the eradication of poverty, improvement of the standard of living of the people, and economic growth of a country in general. The failure rate figures are disturbing to say the least, specifically so for start-ups which are the most obvious solution to poverty and upliftment of the millions in poverty. Jowah (2012: 32) states why businesses fail and this is listed in table 5.1 below (listed in an earlier chapter as table 2.2).

**Table 5.1 Reasons why businesses fail**

<ul style="list-style-type: none"> <li>• Under capitalisation,</li> </ul>	<ul style="list-style-type: none"> <li>• Poor understanding of business,</li> </ul>	<ul style="list-style-type: none"> <li>• Poor business strategic planning,</li> </ul>
<ul style="list-style-type: none"> <li>• A wrong type of business,</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of necessary/relevant skills,</li> </ul>	<ul style="list-style-type: none"> <li>• Selling on credit terms,</li> </ul>
<ul style="list-style-type: none"> <li>• Misuse of capital assets,</li> </ul>	<ul style="list-style-type: none"> <li>• Regular stock shortages,</li> </ul>	<ul style="list-style-type: none"> <li>• Wrong stock for the customers,</li> </ul>
<ul style="list-style-type: none"> <li>• Cultural practices,</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of hard work,</li> </ul>	<ul style="list-style-type: none"> <li>• Unethical behaviour,</li> </ul>
<ul style="list-style-type: none"> <li>• Poor control systems,</li> </ul>	<ul style="list-style-type: none"> <li>• Activities by competition,</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of focus in the business,</li> </ul>
<ul style="list-style-type: none"> <li>• Cash flow management,</li> </ul>	<ul style="list-style-type: none"> <li>• No clear objectives and,</li> </ul>	<ul style="list-style-type: none"> <li>• Poor customer service.</li> </ul>

**Source: Jowah (2011:32)**

Most of the reasons given justify the need for internal control systems as a risk identifier in any business operation. These are listed and discussed briefly below;

**Under capitalisation;** internal control systems can identify where funds are needed and for what activities to assist the business to be productive. This may enable the management to look for funding in time or sell shares to boost their financial muscle (Cardon, Stevens and Potter, and 2010:79).

**A wrong type of business;** a wrong type of business can be identified by the poor sales figures and the high fixed costs relative to the earnings. Internal control systems can flash red lights to

indicate that the business is not productive and therefore management can either change products or close down before further losses (Samadi, 2016:1).

**Misuse of capital assets;** too often company assets are misused and abused – a record of activities and where the money is going to can be picked easily by an effective internal control systems. This will advise the management who have to put tighter controls, remove the factors responsible, or improve on the use of the firm's assets to make them do what they are there for – make a profit for the firm (Cope, 2011:607).

**Cash flow management;** they always say cash is king, and cash is one asset that can be easily misused, stolen and many other things. The internal control system demands that this be accounted for in (Burger, 2016:1), this will inevitably help stop the bleeding of the organisation if it is picked up in time thereby avoiding the traditional risks from misuse of cash.

**Regular stock shortages;** any business operation will involve some stock of some guide, be it goods, information or technical expertise, businesses are started because there is a customer somewhere (Kovacova et al, 2020:54-60). Customers pay the bills and the salaries for the business, and the absence of the stock regularly can be picked by internal controls if they see the number of orders (value of orders) and compare with the value available and sold (Cardon, Stevens and Potter, 2010:79).

**Selling on credit terms;** depending on the amount of money available to the business and too often the size and regularity of payment of debts – businesses can sink (Townsend, Busenitz and Arthurs, 2010: 199). Cash is king becomes the reality, internal control systems can pick this and alert management to change the selling policies (O'Brien, Folta and Johnson, 2003:530).

**Wrong stock for the customers;** the amount of stock staying on the shelves and the time it takes to get rid of it can be picked by internal control systems (Cardon, Stevens and Potter, 2010:79). This has the advantage of alerting the management (marketing and sales) of the imminent danger of running out of cash have to through away large amounts of stock that never moves and may expire (Burger, 2016:1).

The above simply helps to emphasise the critical nature of internal controls as a means of effectively running a business (Jowah, 2012: 32). Many factors influence the success or failure of a business, but one indispensable fact is the need for information and data for management to make decisions. These items are the function of the internal control systems, which, if properly executed will pre-empt all these risk factors and avoid business failure (Bruwer, Coetzee and Meiring, 2019:1). It should be noted that any business operation, regardless of the size of the enterprise, and indeed any organisation needs internal control systems (Samadi, 2016:1). Internal controls are part of the day to day activities of an efficiently and effectively

managed business enterprise or organisation in general. It is the source of all the information and data used to manage a business – so goes the saying; “if you cannot measure it, you can’t manage it. Internal control systems allow the management to measure the activities in the organisation so that they can manage the business operation.

## 5.5 OBJECTIVES OF INTERNAL CONTROLS

Much has been stated about the internal control systems and the argument and the decision to come up with a conceptual framework. The system has specific objectives against which it should be measured and monitored to align itself to prove and effective operational principles. Table 5. 2 below discusses the objectives for internal controls, this may not be exhaustive but it provides the main guidelines, and reasons why internal controls are indispensable.

**Table 5.2 detailed account of the internal control systems objectives**

Objectives	Input	Process	Output
<b>Authorization</b>	Is the source authorized?	Are the procedures approved?	What was approved?
<b>Recording</b>	Is it accurate and complete? Is it timely? Is it documented?	Who does it? When? Are procedures followed? Is it recoverable? Is management review adequate?	Is it accurate and complete? Is there an audit trail? Is management review adequate? Does it balance?
<b>Safeguarding/ Security</b>	Who should control? Are duties separated?	Who can access it? Are duties separated?	Is it confidential? Who should have it?
<b>Verification</b>	Are sources proper?	Are procedures followed complete? Are investigation and review of differences adequate?	Are differences properly resolved? Is management review adequate?
<b>Existence/ Placement</b>	Do policies and procedures define the adequate level of controls?	Are there procedures to create a control? Are controls adequate? Are controls placed in the most efficient part of the process?	Is the residual risk acceptable according to the company's risk tolerance?

13

**Source: Richard (2009:3)**

The internal control systems have a critical role as a source of information in any business large or small (Coetzee et al, 2014:110). The effective running of an enterprise requires information that would be useful to the management for effectively making informed decisions. The data emanating from the internal control reports enables the organisation leadership to predict the direction the organisation is taking (Hayes et al. 2005:232). Together with that would be the need for competent managing management that will make relevant decisions for the organisation. The system or tool is only as good as the hands that use it to facilitate processes

and tasks, thus a well organised internal control systems still needs visionary and competent management (Barlow, 2000:119). Figure 5.2 illustrate the purpose of the internal controls.

**Figure 5.2: Purpose of internal control systems**



**Source: Acree (2019)**

The primary pillars on which internal control systems are based, as stated in the table above are; authorisation, recording, security/safeguarding, verification, and existence/placement.

**Authorisation;** whatever activities including the use of the assets and or equipment of the organisation need to be authorised by the right person (Jackson and Stent, 2020:7). An organisation without authority structures is prone to misuse entities assests without accountability. This on its own is a recipe for risks that may impact the organisation’s future and objectives(Perry, 2016: 7).

**Recording;** no amount of intellect will be better than the recorded information or data (COSO, 2020:1). Correctly recorded it can be used to make decisions without mixing up on the figures, as long as the management values the importance of record-keeping (Uwaoma and Ordu, 2015:103). There should be a well-structured recording system that covers all the aspects as required by the company in all the units.

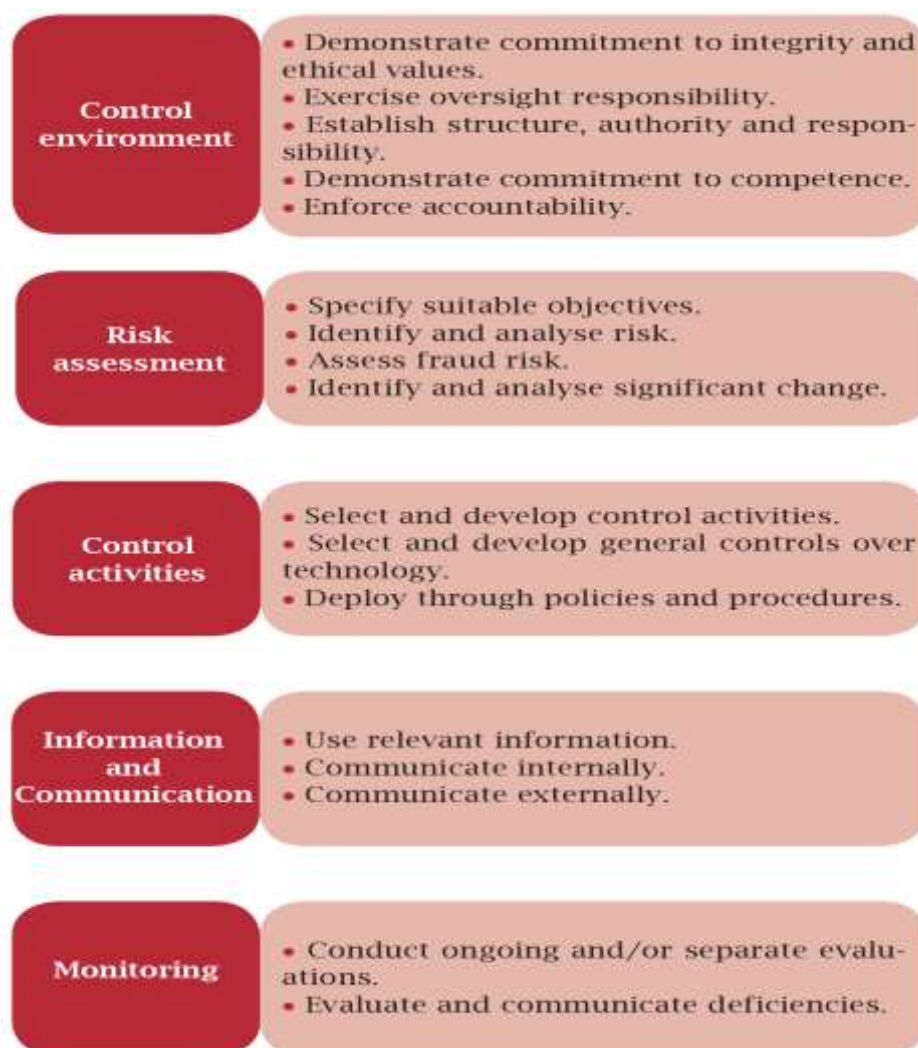
**Security/safeguarding;** both authorisation and recording serve the purpose of protecting the organisation from unscrupulous activities within and from outside (IIA, 2020:1). It should be clearly stated who is responsible to do what, and who is finally accountable for those activities, to avoid unregulated spending or misuse of company assets.

**Verification;** specific processes should be followed and there should constant checking on the validity of documents of information circulated (Akani and Oladutire, 2013:9). It should be monitored and evaluated as to who is responsible for what operations and how they have fared against the plan set by the organisation to reach those objectives.

**Existence/placement;** the internal controls established should be adequate for the purpose for which they are established and pitched at the correct levels (Uwaoma and Ordu, 2015:103). This should be measured against the organisation’s risk tolerance levels, with special care, monitoring and continuous evaluation of the controls.

The reality about internal control systems is that if they are properly executed, they pre-empt possible errors, fraud, and misuse of cash/goods, keep accurate records of all transactions, assure dependability of financial records and help identify the occurrence of any such practices (COSO, 2020:1). Thus for the effective operation of internal control systems, numerous other things need to be put in the mix. Campbell and Hatcher (2003:11) identify specific factors that need to be assessed in the development of an effective internal control system, as designed in figure 5.3 below.

**Figure 5.3 Factors in designing internal control systems framework**



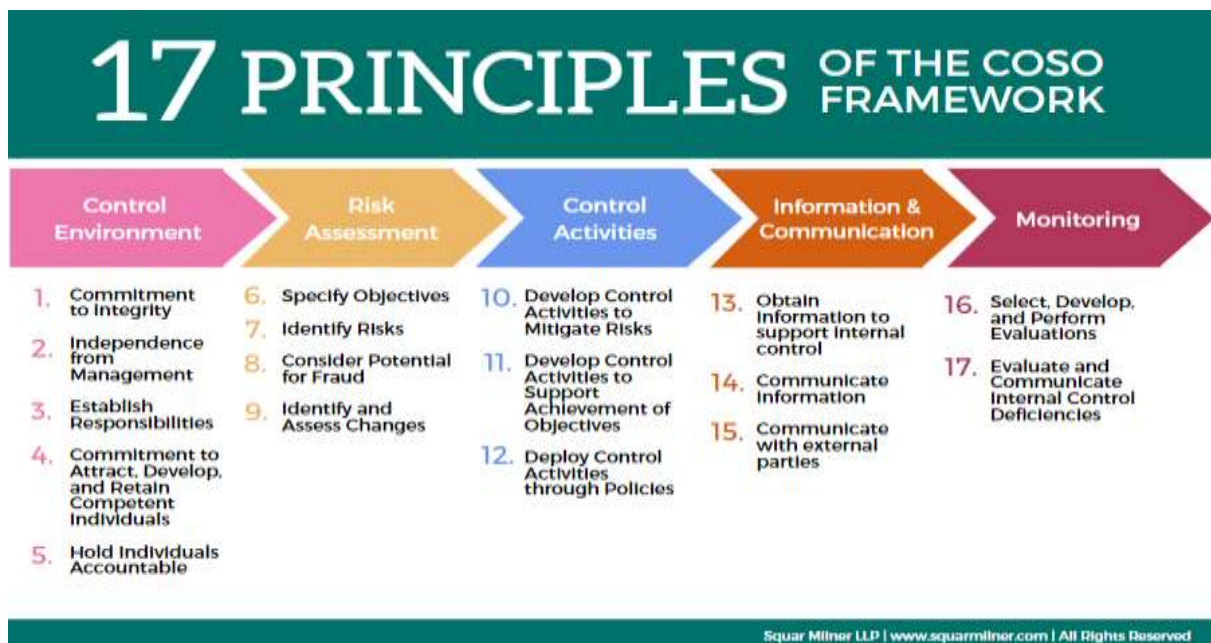
**Source: Myemane (2019)**

It is important for management to put in place certain parameters to support the internal controls systems concept such as the name; control environment, risk assessment, control activities, information and communication, and monitoring (Reding, 2016:6).

## 5.6 COMMITTEE OF SPONSORING ORGANISATIONS (COSO)

The existence of small manufacturing businesses boosts the economy of the country and creates between 60%-70% of all new jobs in the market (MacNally, 2013:6). The study of the survival of the businesses becomes a critical element of the government plans to eradicate poverty. The survival of these entities is pivotal to government stability and all stops should be put to help the manufacturing enterprises to survive. Internal control systems are one such way of helping businesses (both big and small) to survive the storm and continue to make informed decisions (Ndenge et al., 2015:49). COSO provides the standards and procedures required for the effective management of the internal control systems. Thus, all risk averse methods and tools should be employed to maximise the chances of the success of the business start-up (Bragg, 2017:1). Apart from the sunk costs, there is the laying off of employees thereby reversing the campaign to eradicate poverty. The COSO framework classifies the internal control objectives into three types (Cruz, 2016:1) namely; the business operations, the recording and reporting of activities and systems that comply with the set guidelines. COSO has developed 17 principles used as guides to allow both efficient and effective internal control systems operations (Graham, 2015: 2). The principles are illustrated in figure 5.4 below.

**Figure 5.4 The 17 principles of the COSO framework**  
**COMMISSION OF STANDARDS PRINCIPLES**

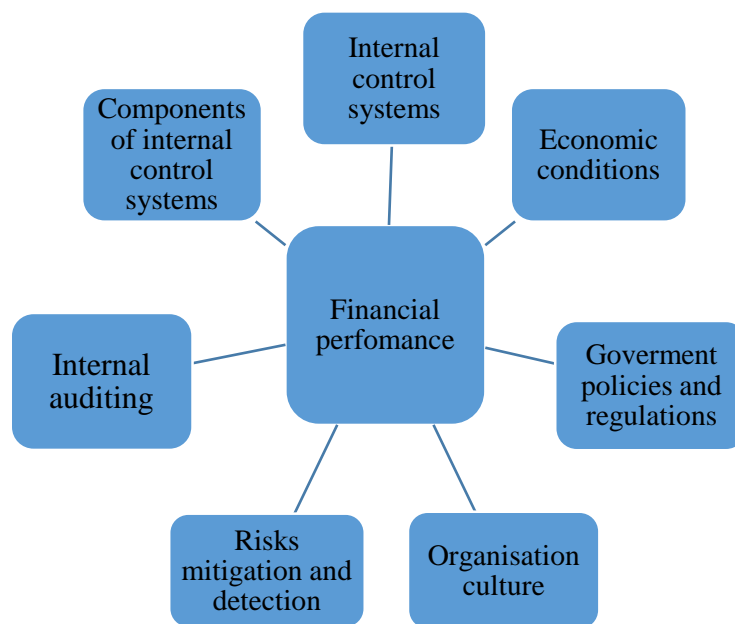


Source: COSO (2020)

These 17 principles are derived from the “pillars” of internal controlling, which are listed above as control environment, risk assessment, control activities, information and communication with monitoring as a tool used to determine compliance. All these if properly implemented would reduce if not eradicate the risk factors on the small business operations (Hartcher, Hodgson and Holmes, 2003:5). The failure of a business start-up means much in the form of wasted or spent costs, thus “prevention is better than cure.” All risk averse methods and tools should be employed to maximise the chances of the success of the business start-up (Pickett, 2011:87). Apart from the sunk costs, there is the laying off of employees thereby reversing the campaign to eradicate poverty. Several researchers have come up with different conceptual frameworks to help minimise the impact of risk by identifying the risk early through internal control systems (Solomon et al. 2017:1425).

The framework boundary as indicated serves as the context within which the mind map is drawn, the variables are stated. These constitute the independent and dependent variables of the research problem, and their relationship, therefore, helps to understand and establish a theory. Xiaofang and Huili (2011:680) state that most research studies neglect the organic combination between internal systems and internal control in the business. The internal control systems which are the most effective tools must be used to measure the health of an organisation before the risk becomes threatening. The researcher suggested some fundamentals required to be in place before putting a final conceptual framework in place. These are diagrammatically represented in figure 5.5 below.

**Figure 5.5 Fundamentals for effective business financial performance**



**Source: own construction**

The financial performance of an organisation is impacted by numerous variables which are interrelated and complement each other. Internal controls at the top are supported and or works interrelated with the other pillars. This is the first step towards the construction of the researcher's mind map of how these variables relate. There are different types of internal control systems, and these are classified and illustrated in figure 5.6 below.

**Figure 5.6 Types of internal control systems.**



**Source: Richard (2009)**

The control systems can be divided into three (arbitrary classification), namely; preventive, detective and corrective controls.

**Preventive controls;** are primarily intended to assist with identifying probable risks and thereby designing plans and programmes to mitigate the risks. The recording systems and the weaknesses/strengths may help in identifying likely deviations from the norm, which should be prevented.

**Detective controls;** specifically designed to identify deviations from the planned path, are meant to assist in identifying probable risks. The system is based on the formulation of formats that will enable easy identification of anything outside of the norm. Once deviations are detected the management is alerted to enable them, in time to adjust and or change programs.

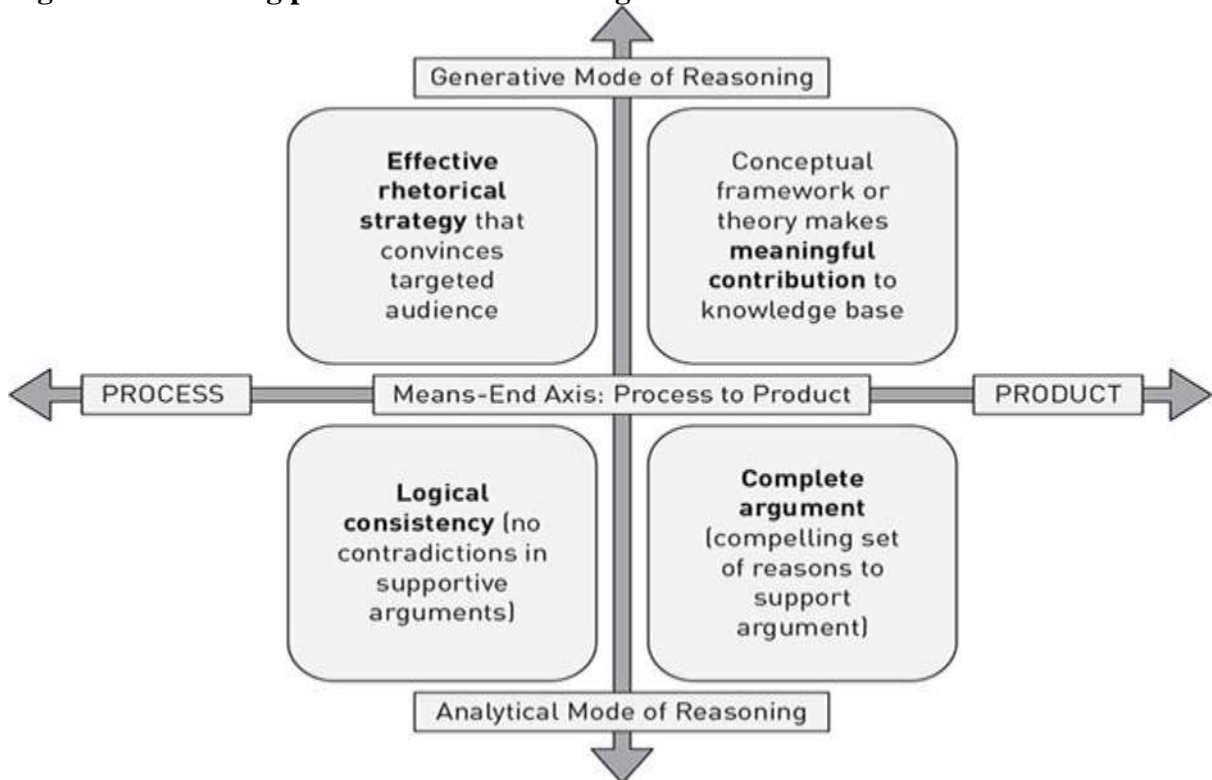
**Corrective controls;** once errors and deviations have been detected or identified the management puts measures in place and start monitoring and evaluating the situation. Corrective measures may be a difficult move because of the likely extent of the risk and the impact that it may have, no level of risk should ever be allowed if there is room to correct or pre-empt extended risk effects.



## 5.7 THE CONCEPTUAL FRAMEWORK

From the study, the researcher has developed the conceptual framework below to understand the relationship between internal control systems and financial performance. The researcher identified areas of critical importance, centred specifically on the issues and problems of training. It would be most ideal to acclimatise everyone with the knowledge and importance of training to enable had skilled technicians and engineers to accept the realities in the business operations. Internal control systems are a practitioner-driven process that needs people with training and understanding on how it should operate. Generic competencies in the field will ordinarily assist in the identification of the problem areas in the process of internal controls including both human and material (Kovacova et al, 2020:54-60). There should be a particular process of thinking and reasoning that need to be followed in a specific order to be able to establish a context relevant framework. Figure 5. 7 below illustrate the thinking to be followed in the development of the context-relevant model.

**Figure 5.7 Thinking processes in constructing a model.**



**Source: Hobbs and Norton (2006: 94)**

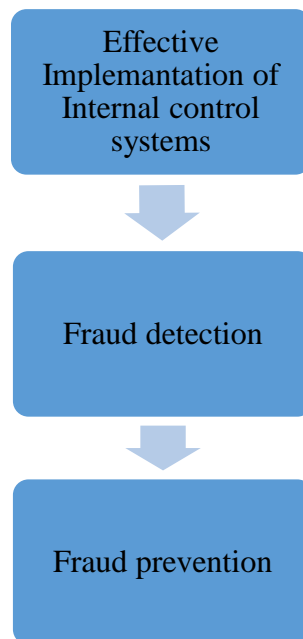
The success of any manufacturing enterprise is dependent on the thought processes and knowledge applied by the management and the failure of any manufacture. In the construction of conceptual framework according to (Hobbs and Norton, 2006:94) this process involves four stages. These are, namely; effective rhetorical strategy, meaning contribution, logical consistency and complete argument.

Record keeping is of the essence in all forms of internal control as it is an outsider (not working in that unit) who comes to evaluate processes within a particular unit or units. Suffice to say that in the framework it is critical to identify the variables that have relationships within the study. Considering that the framework is a culmination and summarisation of all the conditions and factors alluded to in the foregoing literature review and personal experience.

## 5.8 THE IMPACTS OF INTERNAL CONTROLS ON RISK MITIGATION AND PREVENTION

According to the study by Ndege, Albert and Byruhanga (2015) on the effect of internal controls on fraud detection and prevention in District Treasuries of Kakamega County. The study aimed to ascertain the effect of internal controls on fraud prevention and detection in district treasuries of Kakamega Country. The study was also guided by the following research hypothesis; **H01**: There is no statistically significant effect of internal control systems on fraud detection and prevention in internal auditing.

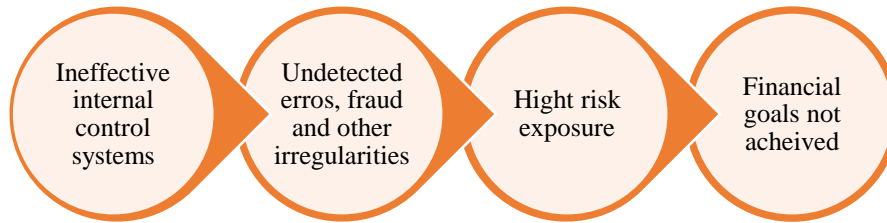
**Figure: 5.8. The relationship between internal control systems and fraud.**



**Source: Own construction**

The relationship between internal control systems and fraud as illustrated in Figure 5.8 shows that effective and ineffective implementation of internal control systems has both negative and positive results. Effective implementation of internal controls system has a positive result whereas the ineffective implementation of internal control systems has a negative impact. Figure 5.9 below show the results of ineffective and efficiency of internal control systems results in undetected risks, poor financial performance, exposure to risks of fraud and other irregularities.

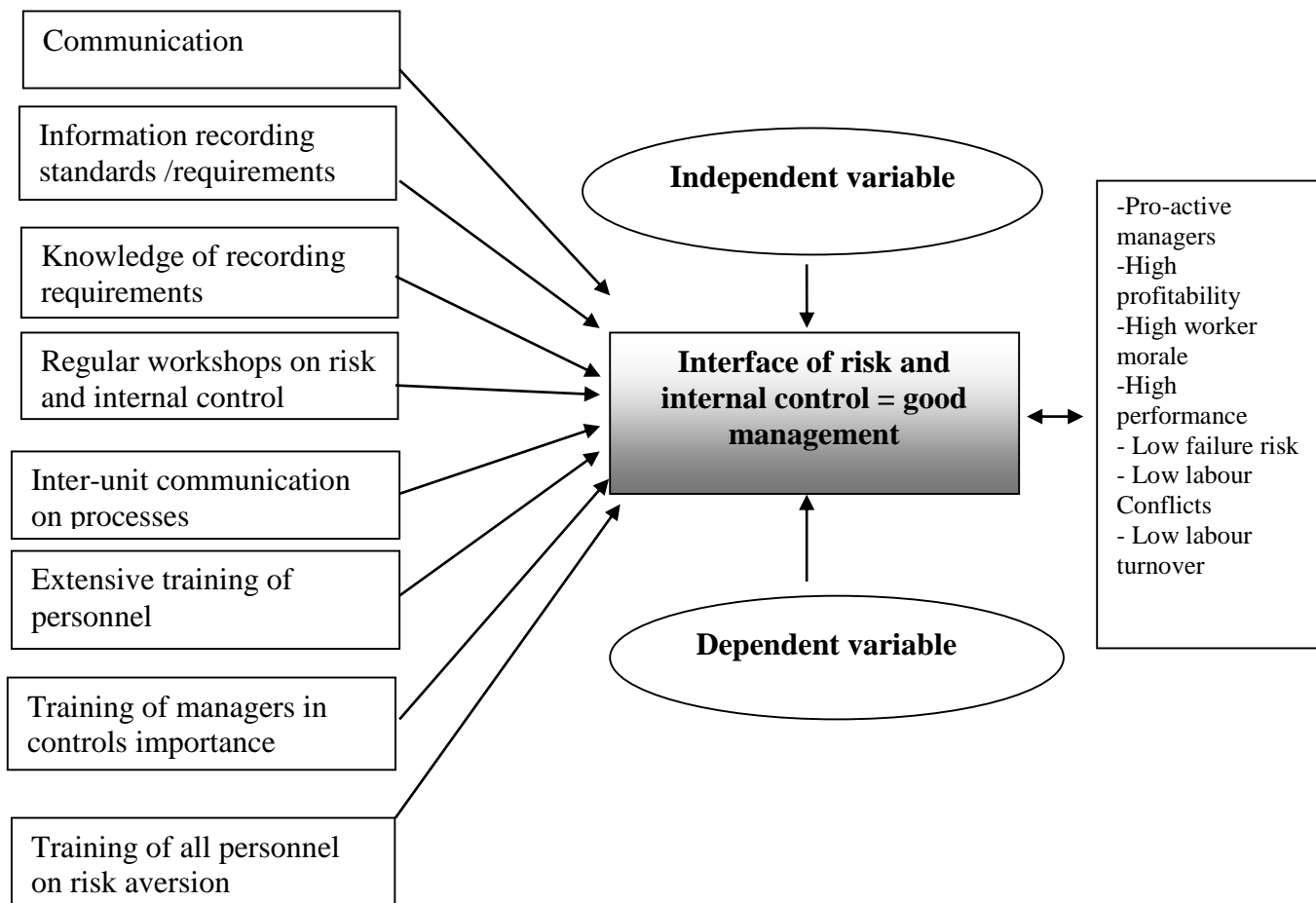
**Figure 5.9. Impact of ineffective internal controls in the organisation.**



**Source: Own construction**

When the internal control systems are not properly implemented and utilised, they have a huge impact on the entire operation of the organisation as illustrated by Figure 5.9. The business goals, mission and vision depend on the internal controls systems. With the effectiveness and efficiency of internal control systems, there more likely the business will achieve its goals vice-versa.

**Figure 5.10 Theoretical model for internal controls for the manufacturing SMEs**



**Source: Researcher's construction**

This conceptual framework is based on the understanding that the owners of most of these manufacturing enterprises have technical skills. They know exactly how to make a product, and possibly assume that once the product is there, all roads must lead to their factory. Too often keeping records and proper accounting methods are things they feel forced to do because that is not their passion. But people start businesses to make money, and the processes of protecting that money should be considered very important. All these projects were run by managers who were highly qualified and experienced engineering graduates, suggesting high product standards (Kovacova et al, 2020:54-60). De Grip and Simitis (2012:583-597) report the need for the introduction of soft skills to engineering students after the realisation that technical expertise is a small component of the project processes. The internal control system and its acceptability is a human element of the operations, it is necessary to accept therefore that training and close supervision should be implemented.

## **5.9 CHAPTER SUMMARY**

The purpose of this chapter is to provide a detailed theoretical understanding of SMEs, the manufacturing sector, internal controls and risks. This chapter identifies certain issues that if combined in a particular format they will resemble a presumed solution on internal control systems and risks in the SMEs in the manufacturing industry. This chapter provided detailed different experiences and views of other researchers on the connection of internal control systems, risks and SMEs. The concept in mind of the researcher regarding internal control systems and risk within SMEs is developed from this chapter. The failure rate of SMEs and the start-up rate indicate the willingness and the interest of entrepreneurs in starting the business and the issue of sustainability. The failure rate indicates the issue of sustainability due to a lack of proper internal control systems on risk mitigation and prevention. Once the business has started operating, it becomes more exposed to risks resulting in loss of profit, company assets, loss of motivation or interest in the business by the owners and managers. The impact of risk leads to the shutdown of the business and increase the rate of failure of SMEs. The detailed discussion and models of internal controls and risk in the chapter provide a better understanding of the problem at hand and revealed the possible solution to the matter at hand. Different types of frameworks for internal controls and risk are provided and explained and the study provided its own constructed framework.

## **CHAPTER SIX (6)**

### **RESEARCH METHODOLOGY**

#### **6.1 INTRODUCTION**

This chapter offers a bigger picture of the methodology of the qualitative research journey, by presenting the decisions and actions taken to ensure the quality of the research data sets. This chapter aims to describe how the study is designed for undertaking the research methodology adopted. The chapter will cover the following: the research paradigm, qualitative research approach, delineation of the study, sampling framework, sampling method and sampling size, validity and reliability issues in qualitative research, ethical consideration, data collection, the research questionnaires, instrumentation, data analysis and conclusion.

This research study follows a qualitative research paradigm. Qualitative research is set apart by its main aim, which is to understand some aspect of social life and its method, which make use of words as a way of data analysis (Patton and Conchron, 2002:1). This study is regarded as inductive research. Inductive research begins with observation (Yin, 2017:143). The primary objective of inductive research is to allow research results to come out from the frequent, dominant or key themes acquired from raw data without the control force by structured methodology (O'reilly, 2009:4). The inductive format is appropriate for the study as the main objective of the study is to develop a theory that explains how SMEs owners and managers in manufacturing utilise and implement internal controls to mitigate and prevent risks and how phenomena shape their behaviour and attitude towards risk prevention and mitigation. The inductive approach provides new knowledge and makes a broader generalisation from specific observations (Holidays, 2016:1). The population of the study will be owners and managers of SMEs. The question formulated and asked were relevant to participants involved in the implementation and utilisation of internal controls. Qualitative researchers believe that it is very important for a researcher to have the skills to interpret and make sense of what the researcher sees (Leedy and Ormrod, 2004:133).

#### **6.2 QUALITATIVE RESEARCH APPROACH**

Qualitative research is the method, which uses words to analyse data collected and is distinguished by the objectives of this type of research (Yin, 2019:142). Generally considered as subjective because it does not follow the traditional scientific processes of research which are considered to be objective. Thomas (2003:2) postulates that qualitative research seeks to get a better understanding of personal stories and the behaviour in those situations. Qualitative researchers usually articulate only general research problems and interview participants only

on general research questions about the phenomenon they are studying (Leedy and Ormrod, 2004:134). The main objective of the study is not to measure or quantify something but to get a broader understanding of the phenomena by obtaining participants experiences and attitudes or behaviour. According to Leedy and Ormrod (2004:133), qualitative research comprises different approaches to different qualitative studies. Furthermore, the qualitative research approach has two things in common which are phenomena that happen in the natural setting and studying those phenomena in all their complexity. Phenomenology is used to get a better understanding of how consciousness operates and enable the researcher to capture how individuals create an understanding of social life, and it uses different methods including in-depth interviewing or written experiences (Hesse-Biber, 2006:72) According to Leedy and Ormrod (2004:135) the followings are the purposes of qualitative research by Yin (2017:139):

**Description;** It can disclose the nature of a certain situation, setting, processes, relationship and systems or people,

**Interpretation;** It allows researchers to achieve a new understanding of particular phenomena and uncover the existing problems within the phenomenal,

**Verification;** It enables the researcher to test the validity of certain assumptions, claims, theories and generalisations within real-world contexts, and

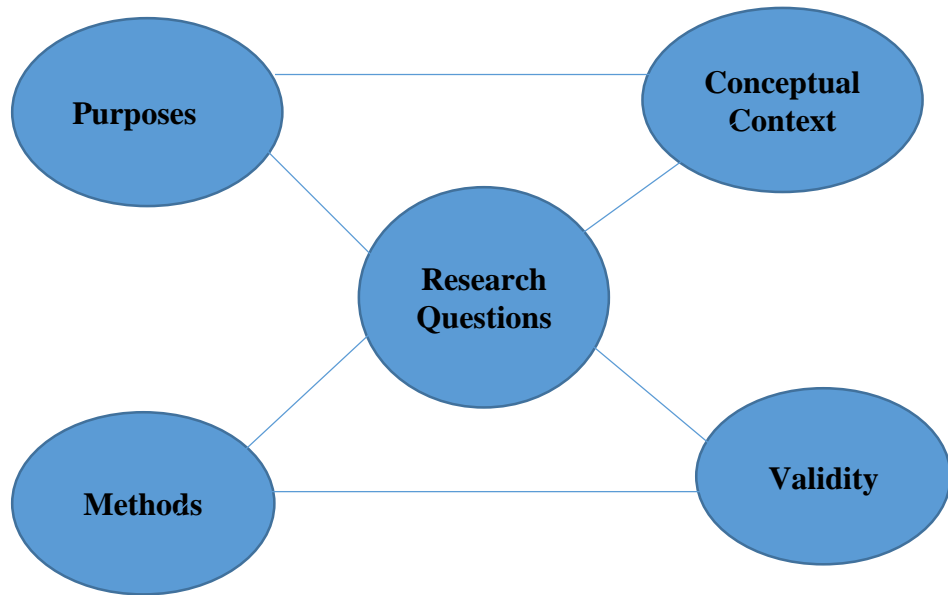
**Evaluation;** It contributes to the researcher's knowledge to enable the researcher to judge the effectiveness of certain policies, practices or innovations.

Maxwell (2013:6) mentions that qualitative research frequently asks how  $x$  play a role in causing  $y$  and what is the relationship between  $x$  and  $y$ . Furthermore, the research study's main question is how the proper implementation of internal controls are utilised to mitigate and prevent risk. Kielmann, Cataldo and Seeley (2012:8) posit that there is a direct relationship between proper structuring of the internal controls and the risks that may occur. The effectiveness of business is considered to be based primarily on the ability of the business to understand itself and how it operates.

### **6.3. ATTRIBUTES OF QUALITATIVE RESEARCH**

Maxwell (2013:4) presents the model, which represents five components of qualitative research; these are illustrated in figure 6.1 below.

**Figure 6.1. An Interactive Model of Research Design**



**Source: Maxwell (2013:5)**

According to the figure below, the purpose, refer to the purpose or goal of the research, the problem, aims and the importance of the study and findings. The conceptual context refers to the perception about the research on phenomena to be investigated. The theory and conceptual framework to be investigated, the preliminary findings, and previous studies on the phenomena if any.

The research questions refer to the questions or inquiries to be made to understand the phenomena under study as identified from the research gap or problem statement as explained in the research objectives. The methods refer to the systems and processes that will be used to collect the data and information required to answer the question as stipulated in the research objectives derived from the problem statement. Furthermore, validity is the measurement of the strength and extent to which a concept and conclusion of research are well and likely to stand any test put against it. This includes the ability of the tool (in this case qualitative research method) to measure correctly, what it claims to measure dependent on the evidence collected.

Furthermore, Leedy and Ormrod (2004:95-97) discuss the characteristics of qualitative research as follows:

**Purpose;** qualitative research purpose to describe and explain, explore and interpret, and build theory. Qualitative research seeks to get a better understanding of a complex situation and it uses observation to build theory from the start to finish. Qualitative research work is exploratory.

**Process;** qualitative research is usually holistic and “emergent” and have a specific focus, design, measurement instruments and interpretation that could change as the research progresses. The qualitative researchers begin the research with an open mind, flexibility along the way and interact with the participants in their environment and habitat.

**Data collection;** qualitative research is based on the understanding that reality is easily divided into discrete measurable variables. Qualitative data collection is dependent on personal involvement (of both the interviewer and the interviewee) in the setting such as interviews and observations. Qualitative research selects a few samples that can give better results in the phenomena being investigated. Verbal data such as interviews, comments, documents, field notes and non-verbal data such as drawings, photographs, a videotapes, and participants behaviour during the interview may be collected.

**Data analysis;** qualitative researchers make use of inductive reasoning, meanings, making observations, and then conclude larger and more general phenomena. Qualitative research identifies themes using an inductive process, and move to deductive mode to modify and verify with additional data.

**Reporting;** qualitative research creates stories from data and tries to express the complexity of the phenomenon being investigated.

## **6.4 SAMPLING FRAMEWORK**

A sample framework is a list of the items or material in your selected population (Turner, 2003:3). For the study, the position of the selected participants were owners and managers of SMEs in the manufacturing companies within Cape Metropole. The owners and managers of the selected SMEs in manufacturing companies are interviewed and audio recorded for the accuracy of the data.

## **6.5 POPULATION**

The targeted population of the study was owners and managers of the SMEs manufacturer’s in the Cape Metropole. The participants would have to adhere to a specific set of rules to justify a valid response:

- all manufacturing enterprise participants should be situated in the Cape Metropole,
- participants will be limited to manufacturing leaders (i.e. be the owners and /managers),
- leaders (i.e. owners/or managers) should be actively involved in the daily operational activities of manufacturing enterprises,
- all manufacturing respondents should be in existence for at least more than 2 years,
- the manufacturing enterprise should not be under the liquidation process, and



- the manufacturing enterprise should be classified under the classification of the National Small Business Amendment Act (26 of 2003) of South Africa.

## **6.6 SAMPLE METHOD AND SAMPLE SIZE**

Qualitative research in most cases studies a single setting or a small number of people or sites and the sampling method is a theoretical or purposeful instant of probability sampling (Maxwell, 2013:136-137): (Maree,2007:79). Furthermore, Hesse-Biber (2006:72) supports that qualitative researchers are often interested in purposive sampling. For this research, purposive sampling is used. Thirteen (13) participants were targeted, but only eight (8) were successfully interviewed for the study.

## **6.7 PURPOSIVELY SAMPLING**

The researcher purposively selected the owners and managers of the SMEs in the manufacturing who are in a position of implementation and guiding the utilisation of internal controls systems in the Cape Metropole. In this research (purposive sampling), only the sample that provided the data needed to achieve the goal of the study was selected. According to Palyse (2008:29), purposive sampling is a sampling of the population who are most likely to provide the best information to satisfy the research study's goal. In qualitative research, the focus or interest is more on the richness of data and thick in description rather than the extent to which the sample's data can be generalising the population (Struwing and Steady, 2001:125).

Purposive sampling was used, where only participants who were selected because of their definition and attributes that make them the holder of the information needed for the research study (Marrer, 2007:80). Qualitative research key aim is the depth or richness of the data and qualitative researchers prefer purposive rather than randomly selection (Struwing and Steady, 2001:121). Qualitative research sampling is adaptable and usually goes on until no new themes come out from the data collection process-called data saturation (Marre, 2007:79). Struwing and Steady (2001:121) emphasise that qualitative research must put into consideration the reason for selecting a specific sample not the other. Struwing and Stead (2001:122) outline the characteristics of purposeful sampling as follows: The sum of the sample is not selected in advance as in a quantitative research study. Characteristics such as gender, age, area of study are considered, as they may comprise the final sample. The sample size may be changed as the study progress and the sample size is only finalised once the study commerce. Each sample unit is drawn only after the data of the previous sample unit has been analysed, more units are needed only if the previous sample is giving less information or it differs from the information required. As additional data is needed, more specific, sampling units are sought and this could lead to new

insights or hypotheses being established as the research study progresses. The sample of the new unit progress until new information becomes unnecessary.

## **6.8 DATA COLLECTION**

The participant consisted of two groups: the owners and the managers of the SMEs in the manufacturing that are in the position of implementing and on the lookout for utilisation of internal controls systems. The owners and managers of small and medium manufacturers operating in Cape Metropole were approached for the purpose of the study. Walliman (2003:270) states that after the problem, the statement has been identified and formulated the kind of data needed for the problem statement and the kind of analysis that will be suitable for data analysis should be known. The letter of permission was given to the managers and the owners to sign. The letter stated the purpose of the study and the confidentiality, privacy of the data collection was explained. Data collection is very important to any research study regardless of the size of the project (Holiday, 2002:98). There are two types of data for the research study, primary and secondary data.

### **6.8.1 Primary data**

Primary data is data that does not exist unless it is produced through the research process and it is usually collected through interviews, experiments, observation and surveys (Crowther and Lancaster, 2009:74). Walliman (2004:184) mentions that primary data sampling must be used to collect only data the researcher is interested in and relevant to the research study and research problem. For the purpose of this study, data was collected through interview questionnaires from a sample of small and medium manufacturers in the Cape Metropole. The data collected was limited to the SMEs in manufacturers leaders and managers in the Cape Metropole.

### **6.8.2 Secondary data**

Secondary data is an analysis or presentation of data that was gathered by other individuals for the key objective, the use of this kind of data is more suitable for researchers who do not have enough time and resources (Johnston, 2014:619). Hax and Boeije (2005:596) mention that for the social research question, using data gathered by other researchers for another objective rather than for research. Walliman (2004:177) mentions that all research studies need secondary sources for the background of the study, researchers depend on secondary data as recorded existing data create subject to the study.

For the purpose of this study, data was collected from various publications such as previous studies on the subject, journals and textbooks. The advantage of secondary data is that it has been provided by a team of expert researchers and proved the opportunity to trace down the

development over time, and it is used to compare with the primary data (Walliman, 2004:177). Furthermore, Walliman (2004) outlines types and sources of secondary data as follows:

**Written material;** organisation records, such as reports, production records, personal data, committee reports and minutes of the meeting, business accounts, communication such as emails, letters, notes, publications such as a books, journals, newspapers, advertising copy's, government publications of all kinds.

**Non – written material;** television programmers, tape recordings, videotapes, films of all types, including documentaries, live reportings and interviews.

**Survey data;** government census of population, employment, household surveys, economic data, and organisation surveys of markets, sales, economic forecast, and employee's attitudes.

### **6.8.3 Authentication of the data source**

Sargeant (2012:2) mentions that when data is used for the research study it is important to be assured that the data is accurate, reliable and sufficient and this process is called authentication. Furthermore, Rasmussen (2007:2) states that concerning authentication of the source of data should be examined like government statistics and data gathered from the larger or well-known organisation are more likely to be authenticated, as the main aim is to maintain credibility. Records provided by the smaller organisation will be more difficult to check reliability unless its printed publication related to the research study may give more credibility (Walliman, 2004:179)

### **6.8.4. The data collection instrument**

The interview questionnaire guide was used for this research study. Sargeant (2012:2) states that research questions are developed from what the researcher wants to understand, and interview questions are what you use to get an understanding of what you want to understand by interviewing people to obtain knowledge.

The objective of the study was to explore and get a broader understanding of the implementation and utilisation of internal controls on risk mitigation and prevention from SMEs owners and managers in the manufacturing industry. The questions of the interview are formulated according to the model of the literature review.

The research study questionnaires consist of four sections, namely:

**Section A:** Business identification

**Section B:** Internal controls

**Section C:** Implementation of internal controls

**Section E:** Utilisation of internal controls

### **6.8.5 Interviews**

Qualitative interviews aim to get a better understanding and perception of the participant about a certain aspect, as they are a valuable source of information if they are used appropriately (Tuner, 2010:754). The data was obtained through interviews and analysed in terms of words to help solve and mitigate the research problem at hand. The interview can be defined as a meeting between two or more people, where the interviewer is asked questions to collect information and getting to know more about the interviewee (Edward and Holland, 2013:3). An interview acquires more data in such a short period (Marshall and Rossman, 2006:101). Rubin and Rubin (2001:3) mention that decision-makers use the findings of qualitative study interviewing to bring a solution to an old problem. The data was obtained through structured, semi-structured and unstructured interviews.

### **6.8.6 Structured interviews**

Structured interviews questions are comprehensive and developed in advance, they are usually used in multiple case studies or larger groups to ensure consistency (Adhabi and Anozie, 2017:88). Structured interviews mean that participants will be asked the same series of questions (Okeeffe et al, 2016). According to Alshenqeeti (2014:41) standardised interview consist of a set of formally structured question that is based on interviewer's theory and experience and there is a little room for elaborate.

### **6.8.7 Semi- Structured interviews**

Semi-structured interviews are designed in a format that allows a list of questions to be asked, but not in a fixed manner as more questions may be asked if there is a need for further questions (Smith, 2003:128). Semi-structured interview depends in the question that will be asked and they guide the interview to flow and it allows the participants to talk about what is important to them (Adhabi and Anozie, 2017:89). The semi-standardised interview is a combination of structured and unstructured interviews and it allows the interview to acquire multiple responses, as the participant response may be followed up by predetermined questions.

### **6.8.8 Unstructured interviews**

The unstructured interview allows an interviewee to tell his /her story without an interruption by the interviewer; it is also suitable for the study to learn from participants what matters or how procedures are understood (Yin, 2017:142). In unstructured interviews, the interviewee is only required to explain the topic investigated to the interviewer but is not allowed to provide leading questions (Alshenqeeti, 2014:40). Unstructured interviewing is used when you want to explore the situation and get answers that you will not be able to be assumed (Alshenqeete (2014:40).

The participants ask for an explanation when they did not understand the question. Struwing and Stead (2001:86-87) mention that personal interviews are more adaptable for the following reasons: Unstructured interviews of flexible time and long questionnaires may be used. Interviews can be flexible to any situation, if it is required, the interviewer and interviewee can give more clarity and explanation.

### **6.8.9 Personal in-depth interviews**

The personal interviews were conducted in the participant's workplace as it was comfortable for them, it allowed privacy, and it was suitable for the tape recording process. Alshenqeete (2014:40) mentions that many researchers have believed that personal interviews provide more accurate data rather than mail questionnaires and telephone interviews. Furthermore, Struwing and Stead (2003:87) state that more participants have pointed out that they prefer personal interviews to mail questionnaires, and mail questionnaires to telephone interviews.

#### **6.8.9.1 Advantage of personal interviews**

According to Alshenqeete (2014:40), the physical presence of the interviewer has a positive effect on the accuracy of data gathered and it usually gives a good response rate as the interviewer usually has the power to persuade the individual to participate in the research study. Face to face, interviews allow the interviewer to see and judge the quality of response or to notice if the question is not understood and to notice the visual signs (Tuner, 2010:756).

#### **6.8.9.2 Preparing for an interview**

For the preparation of the interview the researcher ensured that the recorder is working properly, the battery is full, there is enough space for recording and after the interview, the researcher would check it, the recorder recorded the whole interview. No recording issue was encountered during the process of interviews.

#### **6.8.9.3 Conducting the interview**

Firstly, I introduced myself, the purpose of the study, the ethical issue, and explain the reason why the participants were chosen. During the interview, interviewer have explained the aim of the study and that the data they provide will be for the study. All participants were informed that they are voluntary participating. Confidentiality and privacy were assured to the participants. After explaining the purpose of the study to the participant, they were informed that the data collected from them will only be used for the purpose of the study and will be destroyed after the study report is written. Participants were all informed before the commencing of the interview that the interview will be recorded and none of the participants interviewed had an issue with that. The interviews were audiotape and were conducted in

English. Each interview took about 20 to 35 minutes. The entire interviews were conducted in Cape Town, Western Cape.

#### **6.8.9.4 Role of the interviewer**

Yin (2017:139) discusses the role of the interviewer during the interview as follows: the interviewer should be calm and relaxe to create an environment for a thoughtful, rich interview. The level of concentration should be high and listing hardly and decide on the follow-up question and asking for explanations. The interviewer needs to balance personality with the interviewee. An aggressive personality scares the interviewee rather than ask a question in a less threatening manner. The interviewer should result in the urge to express his/her point of view during the interview as the researcher might have a strong feeling on particular topics and refrain from expressing sharp disapproval of certain subjects.

#### **6.8.9.5 Role of participants**

In this study, structured, semi-structured and unstructured interview questions were used. The participants were managers and owners of the SMEs in the manufacturing sector in the Cape Metropole who are exposed to the phenomenon, implementation and utilisation of internal controls, risk prevention and mitigation. The participants were able to answer without tension or force to answer the questions. The participants were allowed to ask if they did not understand the question. The participants were able to give relevant information to the phenomena being investigated. The participants were relaxed and comfortable during the interview and you could see their interest in the phenomena being investigated. It was easy for the participants to express and see their non verbal expressions when answering some questions. Some of the participants mentioned that they would love to get feedback on the research study when it has been completed.

#### **6.8.9.6 Translation**

All the interviews were conducted in English and all the participants were able to understand and respond in English. There was no need for a translator during the interviews.

#### **6.8.9.7 Observation**

Observation is the way of studying and recording the participant's behaviour without questioning and communicating with them (Marre, 2007:83). Yin (2017:145) states that observation helps gather behaviour events as interviews help acquire the perception of the participants. Leedy and Ormrod (2004:158) mention that observation is flexible as the researcher can be alert of new data, furthermore, the field note is inadequate to record the richness of what one is observing. Observation is very helpful in studying the participant's

behaviour between what they are presenting and what they are saying in a manner that the participant may not be aware of (Patton and Conchron, 2002:20).

#### **6.8.9.8 Field notes**

The field notes were taken during the observation. Field notes are documentation of observation in a field and they should indicate how participants behaved and reacted (Mack et al, 2005:21). Field notes are proposed in qualitative research as a tool for recording much-needed data (Phillippi and Lauderdale, 2017:1). Furthermore, Mack et al, (2005:21) mention that field notes are documentation of what the researcher has experienced and learned through the interaction with the participants and what the researcher observe.

#### **6.8.9.9 Transcribing**

After each interview, the interviews were transcribed as part of data analysis. This was time-consuming as hours were spent at the Cape Peninsula University of Technology Post Graduate library, as Stuckey (2014:2) mentions that transcribing is time-consuming. Transcription is required to be comprehensive to express an important part of talk such as speed, tone, of voice, timing and pauses, as this part of talk can be very important for data interpretation (Bailey, 2014:128). Rubin and Rubin (2003:204) agree that the transcript includes stalling words such as *uh* and *oh* and are spelt and pronounced the way they are, silence and pause of the participant during the interview and hesitation are shown in brackets. Stuckey (2014:2) mentions that the advantage of recoding allows the interviewer to give more attention to the participant without being distracted or having to write notes. The recording played repeated, and carefully listened to ensure the correctness of the data. Transcribing requires more attention on gathered data by repeatedly listening to the data collected such as interview recorded, as it is the crucial step in data analysis (Bailey, 2014:129). Furthermore (Siwangaza and Dubihlela, 2017) mention that transcription takes into consideration the interruption of the interview. For the purpose of confidentiality, the details of the participant were removed from the transcripts.

#### **6.8.9.10 Data storage**

Backing up the data was the most crucial step for data storage to avoid the frustration of losing the data. Data was backed up in safe online computer storage and was destroyed after transcription and data analysis.

### **6.9 VALIDITY AND RELIABILITY ISSUES**

#### **6.9.1. Validity**

The conception of validity in qualitative research has been a debate that leads many qualitative scholars to avoid the concept completely due to the perception that it is too closely connected to quantitative assumption that was not suitable for qualitative research (Maxwell, 2013:122).

According to Byrman and Bell (2011:24), validity is more focused on the integrity of the conclusions gathered for the research study. Jackson (2008:71) states, “*Validity refers to whether a measuring instrument measures what it claims to measure*”. Furthermore, Crowther and Lancaster (2009:80) state that validity is more focused on the extent to which data collection or research methods describe or measure what it is intended to describe or measure. Leedy and Ormrod (2004:100) outline and explain the following some additional strategies that should be used to support the validity of findings in qualitative research:

**Extensive time in the field;** the researcher may spend more time studying the particular phenomena formulating hypotheses and searching for evidence that supports or contradict those hypotheses.

**Negative case analysis;** the researcher will seek courses that disconfirm that hypothesis and revise theory and explanation in the study until all courses have been resolved.

**Thick description;** the data in the qualitative must be thick and rich that the readers can draw their conclusion from the data presented.

**Feedback from others;** the researcher looks for other people’s opinions in the field to examine and agree or disagree with the validity of the interpretation of data.

**Participant’s validation;** the researcher seeks confirmation from the participants regarding the conclusion of the study by asking if they agree or disagree with the conclusion based on their own experiences.

### **6.9.2 Validity issue in qualitative research**

According to Richards and Merse, (2007:80) validity in qualitative research is normally avoided due to the misconception that it reflects the attitude to analysis or to interpretation that meet the requirements of qualitative research methods. Maxwell (2013: 89-90) discusses the issue of validity in qualitative research below.

**Description;** the major threat to validity description is the ability to report or present what the researcher has seen and heard could be inaccuracy or incompleteness of the data. The audio or video recording of observation, interviews, transcription of these recordings, has resolved the issue.

**Interpretation;** the main threat of validity is researcher bias when interpreting the findings rather than trying to understand participant’s words and behaviour, the researcher may ask leading questions and not allow the participants to reveal their own perceptives.

**Theory;** the validity threat regarding theory is that the researcher may not want to pay more attention and consideration to the alternative explanation and knowledge of the phenomenon being studied.



### 6.9.3 Reliability

Reliability is more focused on the question of whether the findings of the research study are not repeated (Siwangaza and Dubihlela, 2017:89). Reliability relates to the extent to which the data collection approach will provide the same findings on different occasions. Jackson (2008:67) mentions, “*Reliability refers to consistency or stability of measuring instrument*”. Patton and Conchron (2002:11) outline and explain the techniques that an interview should aim to ensure validity and reliability:

**Reproductively;** it refers to the use of the same topic guide to generating the same data by someone else.

**Systematic;** It refers to the assurance that interviewees and information are not selected to agree with pre-existing ideas about the answer.

**Credible;** it refers to the questions that are asked and are asked in a way that should be reasonable to generate a valid account of phenomena.

**Transparent;** refers to the representation of the methods in a way that the reader will be able to get a broader understanding of how the data was collected and presented.

Furthermore, more (Patton and Conchron, 2002:11) emphasise that interviewer skill and training is very important to maximising validity and reliability. Participant’s statement during interviews was not changed in any way to suit the study. The participants would review the interviews to ensure that their responses were captured accurately to validate the result of the research study. The qualitative data provided by the instrument designed should truly reflect the influence of controlled variable-internal validity and should allow generalisation to be made beyond the immediate experimental situations-external validity.

### 6.9.4 Triangulation

Triangulation is a traditional approach for enhancing the validity and reliability of research or evaluating findings (Sargeant, 2012:2). According to Leedy and Ormrod (2004:100) validity in qualitative research, researcher’s uses triangulation comparing multiple data sources in search of common themes to ensure the validity of their findings. Forbes and Heale (2013:1) state that triangulation mitigates the risk of bias and being limited to one method, the researcher uses different methods of collecting data such as observation and in-depth interviews. The use of multiple methods for data collection such as interviews, observation, documentation analyses, is generally considered important and acceptable for the trustworthiness of the study (Fusch, Fusch and Ness, 2018:22).

### 6.9.5 Credibility and Trustworthy of the Study

Personal interviews were used, as they are known for having a positive effect on the accuracy of data (Strewing and Stead, 2001:87). The different types of the interviews such as structured,

semi-structured and unstructured interviews were used for this study. Participants were asked the same question in the same manner. The interviews were conducted in a language that the participants understand and can communicate in. Interviews were audio recorded and transcribed. Carefully listening and playing of the recorded audio was played over and over again to ensure correct wording of transcribed.

Yin (2017:139) states that using multiple methods of gathering data such as interviews, field notes and observation could aid the researcher to achieve the trustworthiness of the study. According to Leedy and Ormrod (2010:100), the risk for participating in the study must not be more than the normal day-to-day living risks. This awareness was made before the actual interview began. Except for the above, no participants were harmed, abused physically, or psychologically. The findings are presented in a way that the readers will be able to get a broader understanding of how the data is collected, analysed and the methods used (Patton and Conchron, 2002:11).

#### **6.9.6 Generalisation in Qualitative research**

Qualitative researchers purposively select the participants that provide the data they need rather than probability sampling and study the single setting and fewer individuals and rarely generalise their findings (Beck and Polit, 2010). Furthermore Maxwell (2013:94) mentions that it is different between internal and external generalisability, internal generalisation refers to the generalisation of conclusion within the group of individuals are being investigated and external generalisability refers to the generalisability beyond the group of individuals are being investigated.

#### **6.10 ETHICAL CONSIDERATION**

Flic (2007:72) advises that for informed consent it is best to prepare a mutual contract that outlines the purpose or objectives of the research study and expectations from the participants. Participants were informed by the nature of the study and that they are not forced to participate. The participant was informed that they have the right of withdrawal from the study any time they want. Five written consent letters were obtained from the small and medium manufacturers in the Cape Metropole and signed by the participants.

Confidentiality is more concerned with the handling of participant's information. Yin (2017:142) states that any research study that involves human beings is subjected to respect participants 'right to privacy. Confidentiality and privacy were assured to the participants after describing the study to them and they were informed that the data collected from them would only be used for the purpose of the study and will be destroyed after the study (Thesis) is written.

No image, name, credentials were presented in the study to avoid the issue of confidentiality and anonymity. The participants were identified for example as #participant one and #participant two. According to Leedy and Ormrod (2010:100), the risks for participating in the study must not be more than the normal day-to-day living risks. This awareness was made before the actual interview begun. Except for the above, no participants were harmed, abused physically, or psychological.

## 6.11 DATA ANALYSIS

Maxwell (2013:77) states that any qualitative research needs to have a decision on how the data will be analysed and those decisions should influence, and be influenced by, the rest of the research design. Holliday (2002:99) states that “*a data analysis is a process of making sense of sifting, organising, cataloguing, selecting, determining themes -processing the data*”.

Furthermore, (Maxwell, 2013:78) mentions that data analysis is a possible feature of qualitative research that certainly differentiates it from experimental and survey research. Mouton (2001:6) states that analyses consist of “breaking up” data into themes, patterns and relationship and the main purpose of the analysis is to understand the data collected and cauterised into themes.

## 6.12. THEMATIC ANALYSIS

For the purpose of this study, thematically analysis was used to analyse the data collected. Patton (2002:23) defines “*Thematically analysis looks across all the data to identify the common issue that recurs and identify the main themes that summarised all the views you have collected*”.

The interviews were recorded and save on Google drive for backup. For the analysis, the interview was played over and over again to get a better understanding of the participant’s answers and each meaning from the data was compared with other units and was placed in an appropriate category (themes) and were given different codes. Furthermore, Patton (2002:23) and Bengtsson (2016:8) provide the key stages in thematic analysis:

**Read and annotate transcript;** this is the basic stage where an overview of the data is not yet provided only made a preliminary observation. This is very helpful and is done when you just started with your transcript and still trying to analyse your data.

**Identifying themes;** the following step is to analyse the data by working in detail to identify themes, summarise the data and try to take note of what the participant referring to. After summarising the text, identify themes and make a list of these themes.

**Developing a coding scheme;** after the themes have been identified, they can be collected together to start developing a coding scheme. The broad code can each have a number of sub-

codes. The development of the coding scheme could be started at the beginning of data collection as the early data analysis help to structure the data collected at the later stage.

**Coding the data;** the following step after developing a coding scheme is to apply codes to a full set of data by writing codes on the margin of transcripts, note or margin the text on the line.

The coding scheme could be corrected as you go along with your data analysis in detail.

Yin(2017:135) states that any inductive coding that ends with more than eight major themes it's possible that is not completed as the categories might need to be combined and the research needs to decide on what is more important and less important.

### **6.13. CHAPTER SUMMARY**

This chapter provides an overview of qualitative research methodology which includes actions and decisions that were taken to provide the quality of the study. Qualitative methods are discussed and explained to get a broader understanding of the method used and the reason why it was used in the study. The chapter outlined and discussed the data collection methods used which are personal interviews, observation and field notes. The collection methods used in the study were selected according to the main aim of the study. The chapter furthermore discusses the validity issue in qualitative research and discussed the methods used to assure the validity and reliability of the study. The trustworthiness of the study is discussed. The use of a different method of collecting data in the study ensured the validity and reliability of the study. The sampling method and size are discussed in the chapter. The sample size of the study is different to the quantitative sample size as the main aim of the study was based on the quality and richness of the data, not the quantity. The population of the study are the owners and managers of the SMEs in the manufacturing industry within the Cape Metropole. The method of analysing findings is discussed and explained. The process of data presentation and analysis is explained clearly in the chapter. The method used to analyse the data is defined and explained in the chapter. The ethical consideration is discussed and assured how participants were treated and protected during the interviews. The study emphasises the participants did not experience any harm or abused physically or psychologically. The researcher was fully aware of the importance of the ethical implication during the data collection process.

## **CHAPTER SEVEN (7)**

### **DATA ANALYSIS, PRESENTATION AND FINDINGS**

#### **7.1 INTRODUCTION**

In this chapter, the qualitative analysis of interviews and observation is discussed. The data was analysed into themes. The direct quotations of the participants was used to support the researcher analysis of the findings. The main objective of the study was to determine the framework to guide internal controls and risk performance within the SMEs in the manufacturing industry in the Cape metropole. In this phase, the implementation and utilisation of internal controls to mitigate and prevent risk are explored and described. The need for internal control to avert business risks is realised in the literature reviewed and shows the indispensable nature of the process (internal control process). This should therefore be understood in the context of reducing the risk to allow the continued existence of the businesses amid the high failure rate of 80% of business start-ups within five (5) years of starting the business (Samadi, 2016:1). The research, therefore, sought to identify the practices from and by the small manufacturing business managers and owners. To get the data needed for the study it was necessary to guide participants by asking the following questions:

1. What type of internal controls systems the business is currently using?
2. What are the limitations that SMEs encounter in implementing internal controls systems?
3. What factors prevent SMEs from implementing effective internal control systems?and
4. How effective are the existing internal control systems on risk mitigation and prevention?

These questions were specifically intended to open up conversations with the participants on these issues which enable the researcher to understand the situation. Much of this questioning was done with the consideration that some of the participants may not have wanted to provide all the information about their operations. In the process of answering, a few questions arise because of areas that may not have been explained clearly or where the researcher needed clarity. A series of follow-up questions were therefore asked to help provide a full understanding of the phenomenon.

#### **7.2 PARTICIPANTS DEMOGRAPHICS**

Demographics is about particular characteristics of a population, this information provides the data about the individuals of this representative sample(Leedy and Ormrod, 2004:134). The

identification of the demographics of a population assists in the validation of the research process. For an objective and relevant and scientific approach to the research, the population targeted was especially identified to allow for adequate information about the internal control systems.

### **7.2.1 Participants demographics**

The participants would have to adhere to a specific set of rules to justify a valid response:

- all manufacturing enterprises participants should be situated in the Cape Metropole,
- participants had to be involved in manufacturing as owners or managers in the firm,
- the firm must have been in existence as a manufacturing entity for 2 years at the very least,
- the firm should not be under liquidation and in full operation in a manufacturing entity, and
- the firm should qualify under the National Small Business Amendment Act (26 of 2003) of South Africa.

There were certain expectations, the participants were required to provide biographic data on issues like namely; gender, position in the firm, how long the business had existed, the nature and or type of manufacturing, and the number of employees in the firm. The biographical detail is illustrated in table 7.1 below.

**TABLE 7.1 Biographical profiles of the participants**

Participant	Gender	Position of participants	Nature of the business	Number of workers	Year of existence (Years)
#1	Female	General Manager	Paper bag manufacturer	100-200	18
#2	Female	Owner	Shoe Manufacturer	7	15
#3	Male	Branch Manager	Bedspring manufacturer	50-99	+13
#4	Male	Owner	Leader bag manufacturer	10-20	5
#5	Female	Manager	Beam manufacturer	7	9
#6	Male	Director	Street Solar light	25-27	7-8
#7	Male	Manager	Rubber mat manufacturer	12	10
#8	Males	G M and Financial Manager	Plastic Bag manufacturer	30	300 odd Employee

**Source: Own construction**

Due to the busyness of the manufacturing industry, it was not easy the gain access, as qualitative research focuses on the richness of data, not the quantity that was not an issue for the study. The sampling method used which is purposively sampling made it better to get the richness of data as only participants who would provide the information needed to achieve the main aim of the study were selected. Different type of manufacturers were selected. The participants were both males and females. The participants also provided the number of total employees and the number of years of their businesses.

### **7.3 METHOD OF DATA ANALYSIS**

The data were analysed by performing an inductive approach, inductive approach begins with the gathering of data that is needed or related to the study. After collecting the data analysis of the situation was made to understand the phenomenon (It was considered that inductive research would be the most suitable for analysing qualitative research, informed by the guidance from the assertions (Thomas ,2003.1). The researcher tried to figure out the patterns in the data gathered to develop a theory that gives a better understanding of the patterns. For the findings to be usable or valid, the researcher conducted a data reduction focus only on what was considered critical important (Yin, 2017:140). The findings were therefore classified into themes and sub-themes, and these themes are discussed and illustrated in figure 7.1 below:

### **7.4 THEMES, SUB-THEMES**

The following themes emerged from the data:

**THEME 1:** SME's internal control systems,

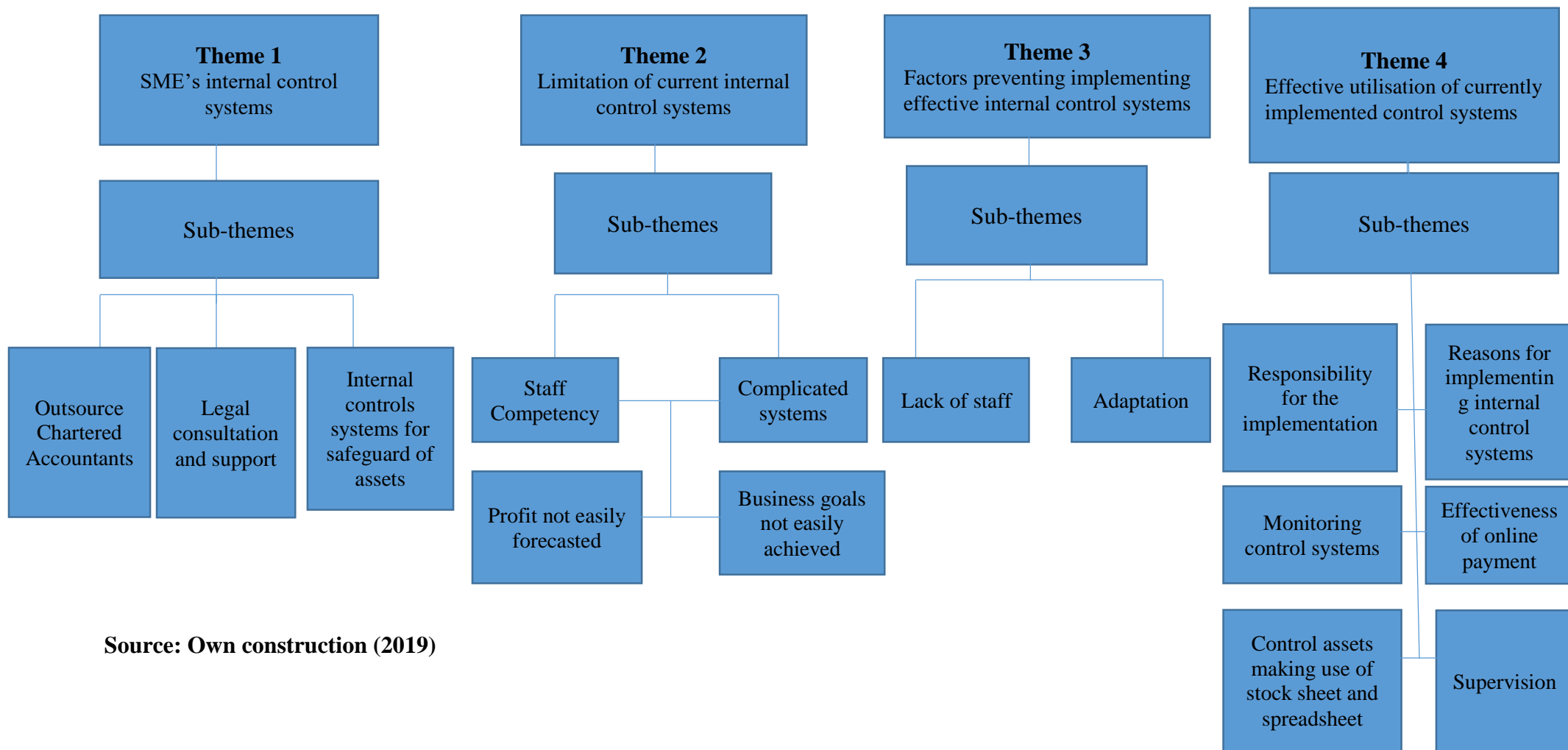
**THEME 2:** Limitation of current internal control systems,

**THEME 3:** Factors preventing implementing effective internal control systems,

**THEME 4:** Effective utilisation of implementation of current control systems.

**Figure 7.1 illustrates the themes and their sub-themes.**





Source: Own construction (2019)

#### **7.4.1 THEME 1: SME's internal control systems**

It is evident from the literature that internal control systems are designed by management to assist management to achieve their objectives by identifying and classifying the risks. Whitting and Penny (2012:252) posit that entities normally face different types of risks from external and internal sources. Risks by their definition are deviations from the planned path, these deviations threaten the ability to achieve the organisational goals for which they are established as alluded to in the literature. Thus the need for the internal controls to give accountability in terms of the operations, financial reporting and compliance with the law. In the research, the SMEs participation in the manufacturing industry identified their current internal control systems. The following sub-themes emerged when participants were asked about the internal controls they (the managers) implemented for the protection of assets, compliance with the law and accuracy of financial statements and other regularities. Sub-themes emanating from this are discussed below;

**Sub-theme 1.** Outsource Chartered Accountants

**Sub-theme 2.** Legal consultation and support

**Sub-theme 3.** Internal control systems for the safeguard of assets

##### **7.4.1.1 Sub-theme 1: Outsource accountants, external audits and internal audits**

Participants pointed out that they rely on outsourced qualified chartered accountants for the reliability of financial statements. Due to the size of the businesses, it is likely for some SMEs to afford full-time chartered accountants. Participants made it clear that the accountants that assist them are not employed full time by the manufacturing entities that participated in the research. Participants also explained that they do all the day to day accounting activities and send the work once a month to an accountant to check the accuracy and reliability of the work done by the company's accounts clerk or bookkeeper. The following statements from the participants relates to the findings:

*"We do all the work.... we sent it to an accountant who's not a full-time employer, we run the invoice the whole month, the director sends it to the accountant once a month"* **Participant #7**

*"We got a bookkeeper, she does all our books and double-checked by a qualified chartered accountant"* **Participant #3**

*"We have an accountant who looks after compliance with the law from an accounting point of view, we are consulting company for the accuracy of financial records".*

*Like I said we have the accountant, the accountant is not in the house it is an outsourced accounting firm ...* **Participant #6**

*“We’ve got accounting up in Johannesburg that has an access to our books”* **Participant #1**

#### **7.4.1.2 Sub-theme 2. Legal consultation and support**

The labour relation act (No 66 of 1995) deals with employment relationships and collective bargaining in South Africa, which compasses unions, workplace forum and employer organisation (Number et al, 2008:241). The main aim of the act is to advance the economic development, social justice, labour, peace, and democratisation of the workplace and the key objectives are to include the provision of a framework for collective bargaining and to promote collective bargaining at the sector level (Number et al, 2008:241). Participants mentioned that they are registered with labour law and they assist them with the law in terms of employees and they consult when they need advice. Furthermore, some participants mentioned that they comply with ISO 9001 standards. The following quotations relates to the findings:

*“.... we have ISO 9001 standard that we have to adhere to....”* **Participant#8**

*“We have ISO 9001 so we are a certified company.....”* **Participant #6**

One of the participants (Participant #7) mentioned that they use to be ISO compliant.

*“We have our own internal manufacturing standards. We are not ISO compliant I think the last time we were ISO compliant was in 2009 we used to be ISO compliant”* **Participant #7**

Furthermore, some participants indicated that they are registered with SEESA for legal law; they comply and consult SEESA concerning labour law. SEESA is legal support for the business provided by the government.

*“.... on the law side we are registered with SEESA which is the labour law we pay a fee every month, they handle our law staff like firing an employee”* **Participant #3**

*“We got labour employer s organisation called SEESA. So they basically help us with everything, they help us with our skill development with first aid, any labour issue that we have we just go to them”* **Participant #1**

#### **7.4.1.3 Sub-theme 3. The utilisation of currently implemented internal controls systems**

Participants identified their current implemented internal controls systems in their business; they all have different internal control systems. According to Samidi (2016:1) implementation of internal controls means that the internal control systems exist and the entity is using them Hayes (2005:232) ;(COSO, 2020:1) state that the reason behind the design and implementation of internal control by management is to achieve entities goals, prevent and mitigate risks that threaten the ability of entities to achieve those goals. Participants identified their implemented internal controls system for the safeguard of assets like inventories by having alarms, cameras,

spreadsheets supporting documents and stock controls sheets. The following quotations relates to the findings:

*“Ehmm internal alarms, access user, ehmm PET’s black large sender and receiver and electronic fencing ....as well as cameras”* **Participant #7**

*“We, we do, we have, our accounting system is not inventory management system, inventory management system is done strictly through excel spreadsheet that we recently moved with the integrations of the new company we move to electronic inventory system we hope it will be efficient than our excel, not that our excel management system is fraud it works but we are hoping for better results for the electronic system.*

*We got stock sheet, we got raw material in, we got processing day production, expense management all kind of staff but eh electronic system that we are working on is not accounting system which makes it both more efficient than extremely frustrating* **“Participant #7**

*“We got a camera system to check every person, we got a stock control sheet system that we do at the end of the month for what we buy, what we use, what we sold and we can also check that we got camera...”* **Participant #3**

*“Stocktaking, keeping book records for a quantity of order taken out for delivery, security control...”***Participant #5**

*“In-store Cameras, bookkeeping system”* **Participant #4**

*“We got electric fencing, and we got camera...”* **Participant #1**

*“We have a stock system in place ehmm, we have signed in and signing out (staff system), delivery notes, order sheet order plan... stock system material, stock system product, checklists”* **Participant #2**

*“We have a lot, its stock control, ehmm payment control so everything goes to the process of approval, in the month we reconcile everything to see that what is in the account is in the floor example stock count...there is also physical identification and there is also accounting packaging so that goes through the process. For a vehicle we have a tracking system, it gets traced if we see it if it gets misused or used without approval...you cannot take a vehicle without approval”* **Participant #8.**

It was evident that the majority of SMEs in the manufacturing industry relies more on cameras and stock sheet for the safeguard of their assets.

#### **7.4.2 THEME 2: The limitation on the utilisation of implemented control systems**

The main aim or goal of the SMEs leaders is to make a profit and generate income and that could be achieved through proper implementation and utilisation of internal control systems. Manufacturers that implement quality internal control systems experience a significant growth

compared to those manufacturers that implement ineffective internal controls and point out that effective internal controls should be considered as the most essential part of the manufacturing industry as they deter and detect risk in the business (Njeri 2014:17). According to Coetzee et al (2014:111) assessment of effective designed internal controls includes considering the capability of internal control in effectively preventing or detecting and correcting material misstatements, it is also recommended to assess the design of internal controls that address significant risk. The following sub-themes emerged when participants were asked about the limitations they encounter when making use of implemented internal control systems:

Sub-theme 1: Staff competency

Sub-theme 2: Complicated systems

Sub-theme 3: Profit not easily forecasted

Sub-theme 4: Business goals not easily achieved

#### **7.4.2.1 Sub-theme 1: Competency of staff**

Competency of staff relates to the staff's ability to do their work successfully and efficiently. Small businesses are usually dependent on humans and not machines that could make or break the business success (Nieman, 2006:62):(Deloitte, 2020:1). Participants expressed their concern about staff competency. Some participants mentioned that staff does not do their job properly and do things for the sake of doing. The result of staff not being able to utilise the implemented internal control systems is a like hood of risk, which could affect the operation and reputation of the business. The following statements from participants relate to the findings:

*"The only challenge is if someone does not do the job properly and does not count the stock properly, staff like that but then you can plus or minus and it cannot always be a minor mistake you can always go back to the previous month and see when the mistake corrected. When the new staffs come they make mistakes but it's quick to rectify"* **Participant #3**

*"People (laugh) its people"* **Participant #6**

*"Ammh heh people because we have quite discipline in terms of paperwork and procedures but its people filing the forms just for the sake of doing it, they do not do it for the purpose of what the system is designed for"* **Participant #6**

*"The challenges are internal controls not regular done, staff not reporting or staffs forgets to do something"* **Participant #2**

*" biggest challenges are employers....people not showing up to work  
Those people normally create the most wastage .basically employer yah*

*We buy our raw material from JHB and it comes from the truck nothing can go wrong there it's only when inventory it's here and need to be turned into a product and sold that's where the biggest wastage comes from as I can put it that way".* **Participant #3**

#### **7.4.2.2 Sub-theme 2: Complicated control systems**

Participants also explained that complicated control systems make it hard for the staff to utilise internal control systems and that open more room for errors. Furthermore, participants emphasise that the internal control systems must be easy to be understood. The following statements from participants relate to the findings:

*"Internal controls are the checklist system, it does not have to be complicated, it must be simple so people can easily read and understand it"* **Participant #2**

*"The more complicated your system is there more room for errors"* **Participant #5**

#### **7.4.2.3 Sub-theme 3: Profit not easily forecasted**

Every business owner goal or objective is to make or maximise profit and internal control are implemented to assist achieve management goals. Charofas (2001:159) (COSO,2020:1) (SAICA,2019:1) mention that forecasting other future events and trends is very easy but doing it more accurately is complicated especial when forecasting sales. Participants stressed out that profit cannot easily be forecasted on implementation and utilisation of current systems for the manufacturing industry that is the challenge as internal controls objectives is to assist management to achieve its goals. Some participants mentioned that there are mostly on the tender basis and are contract work not only regular customers which make it more difficult to forecast profit as they are not sure how many tender contracts are they going to get in a year or two years.

The following statement from participants supports the findings:

*"Our profit? (taking a deep breath) most of our work is tender basis okay eh some of them are municipalities, some are a large business which we quote with other people it's not quietly a tender... but we refer to as a tender process ..... so for us to forecast profit and loss more than three months in a row it's difficult because our installations are mostly small percentage..... the regular customers ahmm retail store which we supply for those we can forecast but the rest of them ehm is difficult to forecast. We can use historical data to do forecast it's difficult to forecast the majority of our business only the regular clients we supply mats to"* **Participant #7**

*"Profit cannot easily forecasted (pause, smiling the laughing)"* **Participant #6**

*“It’s difficult in the manufacturing industry you must also understand that they are different factors that contribute...”* **Participant #1**

Furthermore, some participants mentioned that they calculate overheads to forecast their profits. Manufacturing overhead refers to indirect factory cost that is incurred when a product is manufactured and such must be divided up and allocated to each unit produced. The following statement from participants supports the findings:

*“We take our overhead and we know our demand is plus or minus”* **Participant #3**

*“Based on the internal controls the business is currently using, cash can be easily forecasted by calculating what we could make from our overheads, what minimum profit we could make”*

**Participant #1**

#### **7.4.2.4 Sub-theme 4: Business goals not easily achieved**

Business goals refer to the management objectives such as the growth or survival of the business. The internal control system is carefully designed to promote the achievement of management goals (Pickett, 2011:102). Participants mention that business goals are not all easily achieved, some business goals are difficult to achieve even on implemented internal control systems. Furthermore, participants stressed out that their industry (manufacturing) make it more difficult to achieve some goals. The following statement from participants supports the findings:

*“It depends on what business goal not all of them are easily achievable as the rest.... business goals are not all easily achievable as others”* **Participant #7**

*“Business goals are not easily achieved Lisa(the researcher), business goals are the most, hardest thing to achieve putting it on paper and having it as yeah as ehh this is your goal for this week, this year or this financial year. It’s like a vision you need to have you do not know where you are going to if you do not have goals....but once you got a goal you aim towards it. Achieving that goal is procedures discipline, teamwork, cash flow, it is eh. Procedures definitely help .... but it is very difficult to say that based on the controls you gonna achieves it. If you do not have controls no business can survive”* **Participant #6**

#### **7.4.3 THEME 3: Challenges preventing the implementation and utilisation of internal control systems**

Management design and implement internal controls despite that no internal controls can give an absolute assurance that the entity will achieve its objective; internal controls can only provide reasonable assurance that the entity will achieve its goals (Reding et al, 2009:9). Furthermore, results from the literature indicate that SMEs faces different challenges that prevent them from implementing effective internal control systems. The following sub-themes

emerged when participants were asked about the challenges that prevent the effective implementation of internal control systems:

**Sub-theme 1:** Lack of staff

**Sub-theme 2:** Adaptation

#### **7.4.3.1 Sub-theme 1: Lack of staff**

Internal control is all about people, what show sound paper may be difficult to put in place (Pickett, 2011:102). Furthermore, Pickett (2011:102) states that internal control system such as authorisation, internal check segregation and supervision can suffer where they are not enough staff to make the agreed procedures. The following quotations from the participants relate to the findings:

*“The challenge is that we need more people to monitor controls”* **Participant #4**

*“It’s difficult in the manufacturing industry you must also understand that they are different factors that contribute for an example, we got machinery eh yah if that person who operates the machine cannot come to work for the day and our machine or our plant machine startup is 1800 in an hour so you can imagine with this different factor absence affect our production”*

**Participant #1**

*“We do not have the manpower to get somebody on we do not have a budget now to put some of internal controls”* **Participant #1**

#### **7.4.3.2 Sub-theme 2: Adaptation**

Adaptation refers to being flexible to the new condition or system. Flexibility is being able to adapt quickly throughout the changing business conditions (Nieman, 2006:74). Participants stressed out that they face the challenge of adaptation when they want to implement a new internal control system, getting staff to adapt to a new system is a huge challenge on implementation and utilisation of the new system. Participants stated that the reason for that is the staff might be too used to the old system or have been using the old system for a very long time. One of the participants mentions that they just implemented a new inventory system in their business and making the staff adapt to a new system has been a challenge even though the new system is more effective than the old system. The following statements from participants relate to the findings:

*“Eh that the company is not familiar of those systems when we integrated, Okay and the challenge is, I like the system it’s a very good system its very similar to the SAP system and SYSPRO that system have accounting and inventory management system which this company has never have before. The accounting system is basically done by administration side and now*



*we integrated inventory system, the challenge is that we never had something detailed as this one before here in the factory we used to excel which could be deleted and altered and deleted, rectified and deleted this new system won't allow that. This system is not flexible. But the challenge is getting everybody to accept the new system ...adaption is the greatest challenge, getting people to adopt”* **Participant #7**

*“If somebody or an employee has worked on a certain machine-like in our industry it depends from person to person but if someone has been working on a machine for ten years it's difficult to get him to change his ways that is the new system.... if we have some that cab driver and for me, the challenges are a person itself the operation “***Participant #1**

#### **7.4.4 THEME 4: Utilisation of internal control systems to mitigate risks**

Louwer et al (2006:174) mention that design effectiveness determines the effectiveness of the operation of internal control if would prevent or detect irregularities. The following sub-themes emerged when participants were asked about how the internal controls are utilised to deter and detect risks:

**Sub-theme 1:** Responsibility for the implementation

**Sub-theme 2:** Reasons for implementing internal control systems

**Sub-theme 3:** Monitoring internal control systems

**Sub-theme 4:** Effectiveness of online payment

**Sub-theme 5:** Control assets making use of stock sheet and spreadsheet

**Sub-theme 6:** Supervision

##### **7.4.4.1 Sub them 1: Responsibility for implementing internal controls systems**

Management is responsible for adequate control activities meaning that internal controls are working effectively that risk will be mitigated and prevented and entities goals will be met (Coetze et al, 2014:111). Furthermore, (Hopkin 2014:10): (COSO, 2020:1) support that managers are responsible for the proper implementation of internal control systems. All participants stated that managers implement internal controls systems. One of the participant mention that each department manager implements the internal control systems and the owner oversee the system. The following quotations from the participants relate to the findings

*“It could be the line managers”* **Participant #1**

*“The managers are responsible for implementing internal controls”* **Participant #2**

*“That could be me (manager) and the general manager”* **Participant #**

*“The manager”* **Participant #4**

*“Factory managers and the owners are responsible for the implementation of internal controls. The manager of the department implement the internal controls and the owner will double audit or oversee the internal control system”* **Participant #5**

*“It’s me (the manager)”* **Participant #7**

*“Finance and the production manager and will be, factory manager will implement his internal controls ...”* **Participant#8**

#### **7.4.4.2 Sub-theme 2: Sub-theme 2: Reasons for implementing internal control systems**

The best approach for risk is to have effective internal controls (SAICA, 2020:38) that will help with the identification of some of the risks before they impact negatively. Good designed and implementation of internal control systems will address the related risks that might affect the survival of the enterprise (IIA, 2020:1). It would be important for the management to realise the importance of internal control systems as early warning sign indicators for the business. This may lead to the identification of fraud, misuse of organisational assets and the eventual survival of the SME. Committee of Sponsoring Organisations of the Trade Commission (COSO), 2020:1 states that the reasons behind the design and implementation of internal control by management is to achieve entities goals, prevent and mitigate risks that threaten the ability of entities to achieve those risks. Risk management is a process of defining, identifying and assessing risks for their effect on the entity and find the best control to mitigate that certain risk (KPMG:2020:1). Risk management response depends on the key controls which mitigate risk and if the internal controls work as they are intended, meaning they mitigate risks. Participants explained that their reasons to implement internal controls is to identify risk, mitigate risk and prevent risks since they have disastrous effects. Many of the participants stated that they had programs they used monitoring and controlling the internal operations to reduce the likelihood of the risks. The following statements from the participants relate to the findings:

*“What we look at is the efficiency of the new system was the criteria for implementing that system. The current system is fraud so we recognise its fraud ehmm we ehmm firstly we needed to improve staff awareness and competency in eh operation of the system okay, the was more integrated ...more efficiency we were looking for more efficiency and the actual system. Understanding of the staff some of the criteria’s”* **Participant #7**

*“What goes out must be monitored and investigate the possibility of theft”* **Participant #5**

*“What we do, we do a risk analysis so say for an example we start up a different product we had to do a risk analysis and see what the possible risk on making the product are, receiving the order from the customers to delivering the order to the customers. So we do a flow diagram and identify the risk and put controls on those risks”* **Participant #6**

*“We can identify anything that is not in the system”* **Participant #4**

*“It can also be easily detected with cameras as it is not easy with a piece of paper”* **Participant #2**

#### **7.4.4.3 Sub-theme 3: Monitoring and control systems**

Internal controls are required to be monitored over time and monitoring includes regular management and supervision activities (Tamimi, 2021:115) (COSO,2020:1). Participants indicated that they monitor the internal control systems to evaluate their effectiveness on risk mitigation and prevention. Furthermore, participants indicated that they monitor and put control in place for the possibility of risk and monitor again to ensure it does not continue. The following statements from participants relate to the findings:

*“What our overheard must be monitored all of the payment we made stuff like that so we can monitor all of that financially. We basically have to find out what happened then we will repair what needs to be repaired ... and monitor again and make sure that its balancing”* **Participant #3**

*“Having tight controls in terms of ordering systems and keep it basic, What goes out must be monitored and investigate the possibility of theft”* **Participant #5**

*We do better manage our stock and assets we also have a stock monitor system as well. When the stock comes in we document it and when it goes out we document it and they do a stock take once a month or once a week to verify the stock.....and again I will say you can have all the systems in place its only good as long it's been used and implemented by the people”*

**Participant #6**

*What our overheard must be monitored all of the payment we made stuff like that so we can monitor all of that financially. We basically have to find out what happened then we will repair what needs to be repaired ... and monitor again and make sure that its balancing”* **Participant #3**

*“We have a camera system you know we keep an eye on night shift if we are not there”* **Participant #8**

#### **7.4.4.4 Sub-theme 4: effective and efficient online payment system to manage cash**

Online payment refers to the application control system (computer-based system) which is based on modern technology (use of computers) and this helps to minimise the risk of cash being stolen or keeping cash at their premises. The objective of the Application Controls System (ACS) is based on the use of IT to implement procedures in particular IT activities (Losiewicz-Dniestrzanska, 2015: 805). All participants mentioned that they use and prefer the online payment system to minimise the risk of cash being stolen, emphasis was put on the effective and efficient use of online payment system. Participants mentioned that they rely on an online

payment system to monitor their cash regular and protect it from being stolen. One of the participants mentions that they buy everything using a bank card.

Some of the statements relating to the findings:

*“There are only about 4 and 5 people that buy cash but as soon as they pay for by cash we receive the cash abs it’s all on the tax invoice and it gets banked immediately. Other people use electronic payment. We try to keep that to a minimum to protect ourselves against a loss like money goes missing. Like the money, that being counted is not right. But everyone else pays electronically it goes straight to our bank account that’s the easy way to control it”* **Participant #3**

*“As we do not have very much cash we have basically internet ordering and EFT and credit card payment. The invoice will be given for that, if there is a cash payment or received, for every transaction that takes place there is monetary transaction connected to that whether it is once in every six months, cash, EFT, credit card payment get linked to that specific invoice which is monitored very closely so that you cannot have an order that is there and no payment for it”* **Participant #5**

*“We prefer our payment to be EFT, credit card cash and petty cash book is recorded for expenses that are paid cash. We also try to make payments with the bank card.”* **Participant #2**

*“Everything is bought in card”* **Participant #6**

Keeping money in the organisation may not only be risky to the business because of possible pilferage, but it is also illegal and disallowed to keep large amounts of cash (Cope, 2011:607). Needless to say that the keeping of cash in the business premises will attract robbery and many other issues detrimental to the business's survival.

#### **7.4.4.5 Sub-theme 5: Control assets, making use of stock sheet and spreadsheet**

Participants indicated that they make use of spreadsheets to control their assets, like inventory or stock, motor vehicles, etc. Furthermore, participants explained that they use the spreadsheet to identify risks and irregularities that may occur according to the spreadsheet records. The following statements from participants relate to the findings:

*“Like I said the biggest deter and detect irregularity basically be a stock go missing and that we got our stock sheet.....Ahh (phone rang)*

*We got our stock sheet I can show you (checking on the computer)every first of the month we do it manually I got all my raw material, all the weight of everything so I know exactly how to get out of everything possible situation and then the end they count this is the finished product per sheet.....I can see there, what is left, what has been bought and what has been sold ...so I*

can see if anything went missing or not that's basically the only way I can control everything

**Participant #3**

*"When a company gets very big and you work around the country it's hard to manage people who manage the stock then I come back to discipline because you know like .it's all about controls....this is what she does, she controls all the fuel expenses (observed assets register) Ref no, description, quantity, model location (site).....and what we have we had a serial number, purchase date, the purchase price.*

*This is how we do control as soon as we buy something, we give a number and it goes to this asset register and then when there is asset movement what happens is she got another form here ehmm it's called eh basically if somebody takes assets away they sign for it and then she is like monitor it so they cannot take it away without her not knowing of it ..... (Long pause looking for the form in the computer) so to answer your question*

*Inventory can be managed through a spreadsheet when it comes in, we highlight it and when there is a sale, we also highlight it on the spreadsheet. We always know what is left so that because we monitor it regularly"* **Participant #4**

*"...inventory management system is done strictly through excel spreadsheet..."* **Participant #7**

#### **7.4.4.6 Sub-Theme 6: Supervision**

Supervision tends to have a double nature whereby employees are observed first-hand by their managers, at the same time supervision is available to assist junior staff. Kakuru (2015:1) posits that supervision is only effective when the double nature is allowed to work simultaneously. The participants emphasised that the practice of double-nature supervision is used predominantly in their control systems. Participants indicated that to ensure effective utilisation of internal control they make use of supervision. The following quotation from the participants relate to the findings:

*"inventory/assets can be managed by double eye checking, put two people to check each other"* **Participant #2**

## **7.5. OBSERVATIONS AND FIELD NOTES**

The observation was made on participants for verbal response and non-verbal body language during the interviews. The participants were so firm when asking to record the interview that they will not answer any questions that will require them to give out the company's private information. During the interviews participants were calm, confident and appeared to enjoy the interviews, they answered all the questions that were asked with confidence and willingness. No participant looked annoyed and irritated by the interviewer and the interview or the length of the interview. All participants did not struggle to identify their implemented internal controls systems. One of the participants was so enthusiastic when talking about the new system they just implemented in their business for inventory management.

The majority of participants were confident to answer the question about the challenges of implementing internal control as they all pointed out that it's people (employees). One of the participants look straight into my eyes and after a long pause, he smiled and say "*people*" and laughed. The participants showed concern about the challenge of not having enough competent staff for the effective utilisation and implementation of internal controls systems.

Participants struggle to answer a question about the forecast of profit, some of them tried to answer the question. Participants also looked stressed when were asked about achieving business goals with implemented internal control systems. They all made it clear that it is not easy to achieve business goals.

Some participant's phones rang during the interview and they asked the interviewer to pause the recording. One of the participants put his phone on ignoring and the interview continued. One of the participants seem so frustrated when mentioning that "*people (staff) fill in the forms for the sake of doing it, and they do not do it for the purpose of what the system is designed for*".

When the interviews were finished, the participant were interested in the feedback of the study as they ask if it can be sent to them when it's completed and they supply their email addresses.

## **7.6 CHAPTER SUMMARY**

The chapter has presented the qualitative data that was obtained from interviews, field notes and observations conducted in SMEs in the manufacturing industry in the Cape Metropole. This is in line with the aim of the study to determine the issues relating to internal control systems and risk performance within the SMEs in the Cape Metropole. Participant's demographics were presented in the chapter. The method of data analysis is briefly discussed. The themes and sub-themes that emerged were discussed in the chapter.

## **CHAPTER EIGHT (8)**

### **INTERPRETATION, RECOMMENDATIONS AND CONCLUSION**

#### **8.1 INTRODUCTION**

The main aim of the study was to determine the framework to guide internal control systems and risk performance within the small to the medium manufacturing industry in the Cape Metropole. To achieve the main objective of the study, the study explores the leaders of manufacturing SMEs in the Cape Metropole on types of internal control systems they are currently implemented, limitations they encounter based on the implemented internal control systems, factors that prevent implementation of effective internal control, effective of the existing internal control systems on risk mitigation and prevention. In the chapter, one of the concepts of research idea is explained. In chapter two-four the comprehensive literature was presented. In chapter five and six conceptual model, research methodology and design was discussed. Chapter seven data was analysed and presented. This chapter provides the interpretation of the findings, recommendations, and limitations of the study.

#### **8.2 LIMITATION OF THE STUDY**

The study was conducted on the SMEs in the manufacturing companies in the Cape metropole. Due to the type of industry, manufacturing, the study had a number of limitations. Gaining access was one of the limitations at the beginning of the study; getting permission letters that were needed by the University in order for the proposal to be accepted was also a struggle as it took so much time to get five letters from SMEs in the manufacturing industry. The managers or owners were adamant to give letters because they felt like they are committing to something they are not sure if they will be able to do when the time comes. They were concerned that when the time for data collection comes they will be busy or will not be able to participate due to the busy industry. Furthermore, during the data collection participants would agree to meet for the interview and would withdraw at the last minute due to their busy work schedules. As we know that manufacturing is a busy industry as they focus more on daily production and the managers and owners had to attend to all the factors related to effective production. Many participants agreed to participate and were sent emails but cancelled at the last minute and that took so much time for the researcher. Many participants made it clear that they were interested to participate in the study but unfortunately, due to their busy industry schedules, they could not participate. Many participants were concerned about time; how long it would take for the interviews.

### 8.3 THEMES RELATED TO SUB-QUESTIONS

In this chapter, the four sub-questions are answered by summarising the important themes extracted from participants' views on each of the questions.

#### 8.3.1 Themes related to sub-question 1

The research sub-question 1: *What types of internal control systems are being used by SMEs in the manufacturing industry?* The study found out that SMEs rely on sourced qualified accountants for the reliability of financial statements and other accounting related matters. Participants emphasised that the qualified accountants were not full-time employees, they would send the work done by a company's bookkeeper or account clerk once or twice a month to the qualified accountant. The outsourced work would therefore be checked by a qualified accountant for the correctness of the financial statements and reports. Participants also pointed out that qualified accountants assist them with the compliance related to financial or accounting aspects of their businesses. It was noted also that many of these organisations were registered with labour law SEESA for labour law compliance. Participants mentioned that they consult when they need advice related to labour law. It was found in the study that some of the participants are registered with ISO 9001 standards; they adhere to ISO 9001 standards. The study found out that all the participants have their systems in place for the safeguard of assets such as inventory.

#### 8.3.2 Themes related to sub-question 2

In this part of the discussion, the research findings are considered related to sub-question 2: *What are the limitations that SMEs encounter based on the types of internal control implemented?* **Firstly**, the study showed that the competency of staff or employees was one of the limitations that SMEs in manufacturing encountered. Consequently, the implementation of internal control systems was not given priority since there was ineffective personnel to operate in this space. There was seemingly a degree of low staff morale and it was believed that most employees did not work up to expectations.

**Secondly**, the participants in the study explained the effects of complicated internal controls systems and emphasised that internal control systems must be easy to understand. The study also revealed that business goals are not always easily achievable even on implemented internal control systems. The study also found out that profit is not easily forecasted on implemented internal control systems due to the nature of the industry. However, some participants in the study reveal that they use overheads calculations to forecast profit.



### **8.3.3 Themes related to sub-question 3**

The research sub-question 3: *What factors prevent SMEs to implement effective internal control systems?* It was found in the study that lack of staff and adaptation were factors that prevented effective internal control systems in the manufacturing industry.

**Firstly;** it was shown in the study that SMEs need more people to monitor internal control systems, which is generally missing or not adequate. Furthermore, it was also shown in the study that SMEs do not have enough staff to enable the firms to put some of the employees to be responsible for internal control systems.

**Secondly,** adaptation is the other factor that prevents the effective implementation of internal control systems. It was stressed out by participants in the study that getting staff to adjust or adapt to new internal control systems is the major problem in implementing the new internal control system as staff might be too used to the old systems.

### **8.3.4 Theme related to sub-question 4**

A number of points emerged from findings in answer to the research sub-question 4: *How effective are the internal control systems in risk mitigation and risk prevention?* Firstly, the study found out that internal controls are implemented by managers to identify risks, mitigate risks and prevent risks. It was also found in the study that the online payment system is the most effective system in managing cash from being stolen. The study found out SMEs in the manufacturing industry rely on online payment to monitor their cash. The study found that participants monitor internal control systems to evaluate their effectiveness on risk mitigation and prevention and put controls on identified risks. Furthermore, the study reveals that SMEs in the manufacturing industry make use of spreadsheets to control and monitor their assets such as vehicles and stock. The spreadsheets assist managers to identify risks and irregularities. The study found out that supervision is used to ensure the effective utilisation of internal control systems to mitigate and prevent risks.

## **8.4 CONCLUSION BASED ON RESEARCH OBJECTIVES**

### **8.4.1 To determine the existence (implementation) of internal control systems.**

Findings from the study showed that all SMEs have internal control systems put in place, even though the degree of usage and understanding differed. The findings revealed that SMEs in the manufacturing industry implemented different internal control systems, suggesting that there was no standard system used. Findings from the study showed that all SMEs in the manufacturing company relied largely on outsourced qualified accountants for the reliability and accuracy of financial statements. Findings from the study also revealed that SMEs consult

with regard to the law for compliance. Based on the results from the study one can conclude that SMEs in the manufacturing industry are aware of the importance of internal control systems. These firms have been doing this to protect the organisation from being sued, being penalised, theft from within, misuse of the company's assets and other irregularities.

#### **8.4.2. To establish the limitation that SMEs encounter when making use of implemented internal control systems.**

The study revealed that staff competence is the major limitation that SMEs in the manufacturing industry encounter when planning to implement internal control systems. Due to the inability of the staff to pay appropriate attention when performing their daily duties, implemented internal control systems may not work as they are intended. The managers can put in place the most effective internal control systems but if the staff do not use or utilise the internal control systems effectively. Consequently, when the internal control systems are not in place or not functioning, the organisation will be liable to serious risks that they are not prepared for (KPMG, 2020: 1). Among other limitations that SMEs encounter in the manufacturing industry, is to effectively work and provide appropriate information for the complicated manufacturing environment.

The findings from the study suggested that internal control systems should be easy to be understood. Furthermore, the study revealed that forecasting profit and achieving business goals is not easy when making use of implemented internal control systems. The research, therefore, concludes that SMEs are still facing major problems when making use of implemented internal control systems. The limitations revealed by the findings from the study could be some of the reasons why SMEs are still failing and struggling to survive.

#### **8.4.3 To identify factors that prevent SMEs leaders from implementing effective internal control systems.**

The finding from the study reveal that lack of staff and adaptation are the factors that prevent SMEs in the manufacturing industry from implementing effective internal control systems. Due to fewer staff, internal control systems such as segregation of duties is not easily achievable or cannot be implemented effectively compared to larger businesses. Furthermore, among the factors preventing the effective implementation of internal control systems adaptation is one of the factors identified from the findings of the study. Due to the challenges of getting staff to adapt to the new internal control system, it puts more strain on the manager when considering implementing a new internal control system. The challenge of adaptation could affect the operation of the business. The researcher can conclude that these mentioned above challenges of implementing effective internal control systems could also be some of the reasons why SMEs in the manufacturing industry are still failing and struggling to survive.

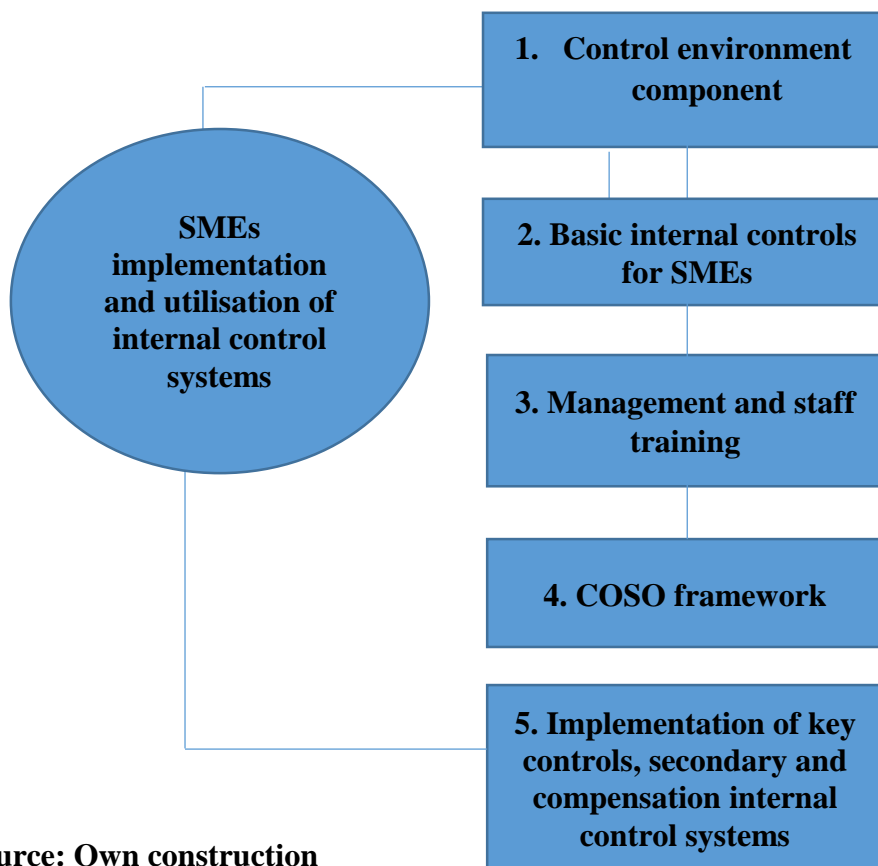
#### 8.4.4 To determine the leakage on utilisation of implemented internal control systems on risk mitigation and prevention.

The findings from the study reveal that managers implement internal control systems to identify, mitigate and prevent risks. The study found out that SMEs in the manufacturing systems rely on and prefer online payment systems to protect their cash from being stolen. It is also revealed from the study that SMEs make use of a spreadsheet to monitor and control assets and identify irregularities. The findings from the study showed that supervision ensures the effectiveness of the utilisation of internal control systems. The researcher can conclude that SME management makes an effort to ensure the effective utilisation of internal control systems to mitigate and prevent risks.

#### 8.5 RECOMMENDATIONS

Based on the findings of the study, the research proposed the following recommendation to improve the internal control systems implementation and utilisation to mitigate and prevent risks. Figure 8.1 illustrate the recommendation of SMEs effective implementation and utilisation of internal control systems.

**Figure 8.1: SMEs framework for implementation and utilisation of internal control systems.**



Source: Own construction

### **8.5.1 Control environment component**

Based on the findings of the study the majority of the participants (owners and managers) mentioned that employees prevent the effective implementation and utilisation of internal control systems. The researcher recommends that management should be aware that they set a tone at the top as they control the environment. According to Evenson, Goto and Furberg (2015:1) from the literature review chapter four, a controlled environment consists of policy and procedures that reflect the behaviour and attitude of the owner, director, and top management as they set the tone at the top. In SMEs, employees have better chances of being influenced by the top management as they work closely with the management (Jackson and Stent, 2020:4) from the literature chapter four. The management could use that as an advantage to have a positive influence on the effective implementation and utilisation of internal control systems in SMEs. Management should know that how the employees behave could be based on management behaviour and attitude towards internal control systems. If management does not behave in a way that he or she expects the employee to behave, the employee can not behave as expected by management. According to Kneche, Salterio and Ballou (2007) in chapter four literature review, explain that management behaviour and attitude is regarded as the most important role, if management has no clue on how policies and procedures which relate to risk mitigation, the control risk in the audit will likely be high, regardless how effective internal controls design appear to be. In conclusion, management should first practice what they preach.

### **8.5.2 Basic controls for SMEs**

Based on the findings that the participants outlined as the challenges of implementing and utilisation of internal control systems, which are complicated internal control systems, adaptation, profit not easily forecasted and business goals not easily achieved. Due to the small to medium industry that could be affected by fewer staff, uneducated and semi-educated staff, complicated internal control systems could put more strain on management and staff that could lead to difficulty of adaptation to new systems. Furthermore, from the literature chapter two (Whittington and Panny, 2012:279) outline the following basic controls for small business and mention that adherence to this basic controls will mitigate and prevent risk from going undetected:

- reconcile all cash receipts immediately,
- deposit all cash receipts daily,
- make all payments by serially numbered check, except for all disbursements from petty cash,
- reconcile bank account monthly and keep copies of reconciliation in the file,

- use serially number sale invoice, purchase order, and receiving reports,
- issue check to vendor only payment of approved invoices that have been matched with purchase order and receiving reports,
- balance subsidiary ledger with control account at regular intervals and prepare and mail customer's statement monthly, and
- prepare comparative financial statement matching in sufficient detail to disclose significant variation in any category at revenue or expense.

### **8.5.3 Staff training - implementation and utilisation of internal control systems**

Based on the findings on challenges of implementation and utilisation of internal control systems, the researcher recommends that management need to be trained on implementation and utilisation of internal control systems before they put more expectations on employees. When management knows what to do and what is expected of them, they are in a better position to train their employees on effective implementation and utilisation of internal control systems to mitigate and prevent risks.

### **8.5.4. Management to make use of COSO framework to enhance internal control systems and risk**

Committee of Sponsoring Organisation of Treadway Commission (COSO) provides a broader understanding and guidance on internal control systems and enterprise risk management. Management should make use of COSO framework documents for effective implementation of internal control systems and get a better understanding of the components of internal control systems. Furthermore, the COSO framework also guides SMEs internal control systems and enterprise risk management. Management can train themselves through COSO framework documents available online so that they could get a bigger picture on internal control systems and risks and they could be in a better position to train their staff.

### **8.5.5 Implementation of key controls and risk management**

Findings from the study reveal that profit and business goals are not easily achieved without implementing internal control systems. The researcher recommends that management should implement key controls, according to Reding (2009:6) key controls are design to mitigate the risk connected with the business objective, a failure to implement efficiency and effective key control could lead to the failure of business to achieve its objectives and survive.

### **8.5.6 Implementation of compensation and secondary controls**

The findings from the study reveal that there is a challenge of implementing segregation of duties due to fewer staff, the researcher recommends the implementation of compensation

control and secondary controls. According to Reding (2009:6), compensation controls are designed to complete or enhance controls when they are not working effectively to mitigate and prevent risks alone on an acceptable level (i.e. close supervision when effective segregation of duties cannot be achieved).

## **8.6 THEORETICAL IMPLICATIONS**

The current perception of previous researchers is that SMEs do not implement internal controls to protect their business and dismiss the challenges that SMEs experience. The researcher goes further by saying that SMEs neglect implementing internal controls and risk prevention. The previous researchers had made it clear that SMEs fail and struggle to survive due to a lack of management skills. Few studies investigate the real reasons and challenges SMEs experience when implementing and making use of implemented internal controls systems using qualitative research method in order to get a broader understanding of SMEs leader's perceptions.

The results from previous researchers do not have a better understanding of why SMEs leaders struggle to implement and utilise internal control systems to mitigate and prevent risks. Few studies cover the concept of SMEs in the manufacturing industry internal control systems implementation and utilisation to risk mitigation and prevention. The literature review has also come up with suggestions on the implementation and utilisation of the internal controls to help mitigate and prevent risk in SMEs. The study noted the limitation and factors preventing effective implementation and utilisation of internal control systems to mitigate and prevent risks in the SMEs in the manufacturing industry. Furthermore, with regard to these identified limitations and factors, there is a need to understand the industry and the perception of SMEs leaders.

## **8.7 MANAGERIAL IMPLICATIONS**

The managerial implications of the study are that SMEs leader can have effective internal control systems in place and utilise the systems effectively to mitigate and prevent risks. SMEs leaders should ensure that control environment is their priority for effective business operation. Management should also know that although they are faced with many challenges and limitations on implementation and utilisation of internal control systems to mitigate and prevent risks, it is possible to have effective control systems and effective utilisation of internal control systems to mitigate and prevent risks. From the study, it is noted that SMEs managers make an effort of implementing internal control systems and they make an effort to ensure that they are

utilised effectively to mitigate and prevent risks. Furthermore, SMEs leaders were aware of the limitations and challenges in their industry.

## **8.8. SUMMARY**

The study showed that SMEs managements are aware of internal control systems and they put an effort to implement internal control systems. The study reveals that SMEs put an effort to implement and utilise internal control systems effectively to mitigate and prevent risks. The study showed that SMEs leaders were aware of the challenges and limitations that they are faced with when making use of implemented internal control or when they are trying to implement new systems. The study showed that there are some effective internal control systems that the manager had put in place. The study showed that some are not effectively implemented or utilised due to challenges and limitations that SMEs management encounter. The sub-questions of the study were all answered. The objectives of the study were all met. Recommendations were provided to determine the framework to guide the internal control systems implementation and utilisation within SMEs in the manufacturing in the Cape Metropole.

## **8.9 The value of the study**

The research study contributed to the body of knowledge and gave a better understanding in terms of proper implementation and utilisation of internal control systems in small to medium manufacturers in Cape Metropole to mitigate and prevent risks. The factors influencing risk performance and internal controls systems were analysed in the research study. The influence of internal controls on the operational efficiency and effectiveness of SMEs management were established in the study. The framework that can improve the implementation and utilisation of internal controls systems to mitigate risk was provided as recommendations in the study. This study is useful to manufacturer's managers, owners and any other interested person to a great extent as it has provided recommendations and conclusion on how manufacturing managers and leaders can implement and utilise internal controls to mitigate and prevent risks. Manufacturer's owner-managers who are in process of implementing effective internal controls within their businesses would have a better understanding of it's importance, and how to utilise them effectively to prevent and mitigate risk. Auditors and government bodies will also get a better understanding and view of what is going on in the SMEs implementation and utilisation of internal controls systems process and will get the new perception of the SMEs leaders on internal control systems.

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# APPENDICES

## Appendix A: Consent letter from CPUT to partake in academic study.



20 July 2016

To whom it may concern

Dear Respondent

The importance of time in our days cannot be overemphasized. At the same time, sharing your time with someone can be very enriching, rewarding and fulfilling. I would like to introduce our Master's student Ms Lisa Nqala. Ms Nqala is currently working on a Masters research project for a degree in the field of Internal Auditing under the School of Accounting Sciences at the Cape Peninsula University of Technology. She is seeking your permission to share approximately 10-15 minutes of your valuable time to conduct her questionnaire-based interviews. Granted, such permission will enable the student to carry out surveys across the sector for the project entitled, 'internal controls systems and risk performance of Small and Medium Manufactures in the Cape Metro pole'.

The research project is intended to investigate the performance measures that are currently in place in Small and Medium Enterprises (SMEs), specifically manufacturing industry sector in terms of weighing its action on three independent scales: Economic Sustainability, Environmental Sustainability and Social Sustainability. The main objective of the research project is to determine the framework, to guide implementation and utilisation of internal control systems to mitigate/prevent risk SMEs in Cape Town.

The researcher and the supervisor pledge, that all the survey data will be aggregated and organisational information will be treated with the strictest confidence; and that you are under no obligation to participate. All the information obtained will be used for research thesis and research publication purposes only. The final report will not include any identifying information of your organisation. Please feel free to contact student and/or supervisor with regards to any queries you might have. Your participation in the research project will be most appreciated.

This information is given in good faith. Should you need any information, do not hesitate to contact our offices.

Yours sincerely

  
Professor J Dubihlela  
HOD: INTERNAL AUDITING & FINANCIAL INFORMATION SYSTEMS  
Tel: 021 650 3266/3477  
e-mail: DubihlelaJ@cput.ac.za



PO Box 1808 Belville 7535 South Africa  
086 123 2788



## Appendix B: Ethical clearance certificate



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P.O. Box 1906 • Bellville 7535 South Africa • Tel: +27 21 4603534 • Email: majamanin@cput.ac.za  
Symphony Road Bellville 7535

Office of the Chairperson Research Ethics Committee	Faculty: <b>BUSINESS AND MANAGEMENT SCIENCES</b>
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**At a meeting of the Research Ethics Committee on 02 May 2017, Ethics Approval**

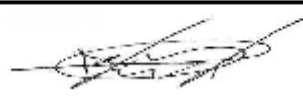
**was granted to Lisa Nqala (21004214) for research activities**

**Related to the MTech/DTech: Mtech Internal Auditing at the Cape Peninsula University of Technology**

Title of dissertation/thesis/project:	<b>INTERNAL CONTROLS SYSTEMS AND THE RISK PERFORMANCE OF SMALL AND MEDIUM MANUFACTURERS IN THE CAPE METRO-POLE</b>  Lead Researcher/Supervisor: Prof J. Dubihlela
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**Comments:**

**Decision: APPROVED**

	<b>02 May 2017</b>
<b>Signed: Chairperson: Research Ethics Committee</b>	<b>Date</b>

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Clearance Certificate No | 2017FBREC434

## Appendix D: Interview Questionnaire

Researchers Details	
Name	<u>Lisa</u>
Surname	<u>Nqala</u>
Email	<u>nqalalisa@gmail.com</u>
Contact Number	<u>0739279101</u>

SUPERVISOR DETAILS	
Name	Professor J Dubihlela
Surname	Dubihlela
Email	DulihlelaJ@cput.ac.za

RESEARCH TITLE
Internal controls and risk performance of Small and Medium Manufactures in the Cape Metropole.

ETHICAL CONSIDERATION
<p>The ethical consideration to this study is more located in data collection. All information collected via interviews will be strictly confidential to ensure that it does not violate the organisation (s) privacy and does not reveal any information that could negatively affect the reputation of the organisation(s) or reveal private information to its competitors. Participants will be given an explanation of the aim of the study and that the data they provide will be for the purpose of the study. All participants respondents will be informed that they are voluntary participating. The participants will review the interviews to ensure that their responses were captured accurately to validate the result of the research study. Participant statements during interviews will not be changed in any way to suit the study.</p>

## PRIMARY OBJECTIVES OF THE STUDY

The issue of implementation and utilisation of internal controls by SMEs leaders has a huge effect on the operation and survival of an enterprise, Yang et al (2011:1) agree that the quality of implemented internal controls ensures efficiency and effectiveness of the business and also recommend that manager should give more attention on the implementation of internal controls. The motive behind internal control is risk which is anything that could have undesired results on the business's ability to meet its objectives (Richard, 2009:3). Risk performance is how risks are performing on implemented internal controls which is risk mitigation and risk prevention.

The main objective, therefore, is to determine the framework to guide internal controls and risk performance within the small to the medium manufacturing industry in the Cape metropole. To address the main objective, the following sub-objectives are derived:

- To investigate the existence of internal control system within SMEs.
- To determine how the utilisation of internal controls can effectively enhance the overall risk performance of SMEs in the Cape Metropole
- To determine how proper implementation and utilisation of internal control systems can contribute to risk prevention and mitigation in SMEs.
- To recommend a framework that guides the effective use and implementation of internal controls to mitigate and prevent risk in SMEs.

## PART B: INTERVIEW CHECKLIST

### SECTION A- BUSINESS IDENTIFICATION

1. Name of the business?

2. What does your business manufacturer?

3. How long has your business been in existence? (years)

.....years

4. What is your position in the company?

4.1. Gender

Male  female

5. Is your business classified as

Small	<input type="checkbox"/>	Medium	<input type="checkbox"/>	Large	<input type="checkbox"/>
6. How many people do you employ?					
Fewer than 5 <input type="checkbox"/>					
10-20 <input type="checkbox"/>					
20-49 <input type="checkbox"/>					
50-99 <input type="checkbox"/>					
100-200 <input type="checkbox"/>					
Other .....					
<b>SECTION B – INTERNAL CONTROLS</b>					
2.1. What type of procedures /controls is your business currently using to <b>(1) protect your assets, (2) comply with the law and (3) for accuracy of financial records and other irregularities?</b>					
	<b>Answer</b>				
1.					
2.					
3.					
<b>2.2 EFFECTIVENESS OF INTERNAL CONTROLS</b>					
2.2.1. Based on the procedures or controls that your business is currently using can you briefly explain how profits can easily be forecasted?					
2.2.2. Based on procedures or controls that your business is currently using can you briefly explain how cash can be monitored regularly?					
2.2.3. Based on procedures or controls (name) that your business is currently using can you briefly explain how business goals can be easily achieved?					
2.2.4. Based on procedures or controls (name) that your business is currently using can you briefly explain how Inventory can be better managed (stock supplies)?					
<b>SECTION C: IMPLEMENTATION OF INTERNAL CONTROLS</b>					
3.1 Who is responsible for the implementation of procedures or control systems?					

3.2 What are the criteria's on the implementation of procedures or control systems in your organisation?

3.3 What is your view are the challenges that prevent effectively implementing the procedures or control systems?

3.4.How are the procedures or control systems designs to ensure that they deter and detect irregularities?

### SECTION E: UTILISATION OF INTERNAL CONTROLS

4.1 How do you use the current procedures or control systems in your organisation to ensure they prevent and mitigate risks?

4.2 What are the challenges you are currently experiencing while using the implemented procedures or control systems?

### SECTION D – THANK YOU

Thank you for your time and effort in answering the interview questions for the benefit of academic research in the field of Internal Auditing.

Details below refer to the respondent:

Name:

Surname:

E-mail:

Business name:

Suburb:

Would you like e-mail feedback on this study?

Yes

No

**Appendix E: Language editing Certificate**

9 Kingsbury Crescent Ave

Highbury Park

Kuilsriver 7580

22<sup>nd</sup> July 2020

## GRAMMARIAN CERTIFICATE

**TO WHOM IT MAY CONCERN**

This certificate serves to confirm that I edited the language/grammar for the student Lisa Nqala [**Student No; 210042214**] of the Cape Peninsula University of Technology, M. Tech; Business and Management Sciences. **The title of the dissertation is; “Internal controls and Risk Performance of Small and Medium Manufacturers in the Cape Metro-pole”**

Recommendations for corrections were made and the student duly corrected as per the language editor’s recommendations. I am satisfied with the corrections made and hereby award a language/grammar certificate.

Sincerely yours,



**P. Y. Mabhuro**

**M. A. Linguistics** [chimotov8@gmail.com](mailto:chimotov8@gmail.com); **0828155210**

## Appendix F: Informed consent



### **INFORMED CONSENT LETTER**

#### **TITLE OF THESIS/DISSERTATION**

*Internal Controls and the Risk Performance of Small and Medium Manufacturers in the Cape Metropole.*

#### **Principal Investigator:**

**Name:** Lisa

**Surname:** Nqala

**Department:** INTERNAL AUDITING & INFOSYSTEMS

**Phone:** 0739279101

**Email:** [nqalalisa@gmail.com](mailto:nqalalisa@gmail.com) /210042214@mycput.ac.za

#### **Identification of Investigator and purpose of this study**

You are being invited to participate in a research study conducted by **Lisa Nqala** from the Cape Peninsula University of Technology. Please note that it is important to read and understand why the research is being done and what it will involve.

#### **THE PURPOSE OF THE STUDY**

The manufacturing industry is known for creating much-needed jobs for uneducated and semi-educated people unlike other sectors (Jennings: 2015:1). The issue of implementation and utilisation of internal controls by SME's leaders has a huge effect on the operation and survival of an enterprise, Yang et al (2011:1) agree that the quality of implemented internal controls ensures efficiency and effectiveness of the business. The motive behind internal control is risk which is anything that could have undesired results on the business 's ability to meet its objectives (Richard,2009:3). Risk performance is how risks are performing on implemented internal controls which is risk mitigation and risk prevention. The main objective, therefore, is to determine the framework to guide internal controls and risk performance within the small to medium manufacturing industry in the Cape metropole.

## **STUDY PROCEDURES**

This study consists of interviews that will be conducted in the Cape Metropole. The interviews will be audio recorded during the interview to save time for taking notes. The confidentiality of the recorded audio during interviews is assured.

### **Time required**

Participation in the study will require 15 to 45 minutes of your time.

### **Risks**

The risk of this study are minimal (no risk beyond the risk associated with everyday life).

### **Benefits**

There will be no direct benefits to you for participating in this study however the information obtained from the study will contribute to the phenomenon being investigated.

### **Confidentiality**

The ethical consideration to this study is more located in data collection. All information collected via interviews will be strictly confidential to ensure that it does not violate the organisation (s) privacy and does not reveal any information that could negatively affect the reputation of the organisation(s) or reveal private information to its competitors. Participants will be given an explanation of the aim of the study and that the data they provide will be for the purpose of the study. All participants will be informed that they are voluntary participating. The participants will review the interviews to ensure that their responses were captured accurately to validate the result of the research study. Participant's statements during interviews will not be changed in any way to suit the study. For the purpose of confidentiality, the details of the participant will be removed from the transcripts.

### **Participation and withdrawal**

Your participation is voluntary. You are allowed to choose to participate or not to participate. Should you choose to participate; you are allowing to withdraw at any time without giving a reason. This will not affect the relationship you have with the researcher.



**Consent:**

I have read and understood the information above and have an opportunity to ask questions. I understand that my participation is voluntary and that I am free to withdraw at any time without giving a reason, I freely consent to participate.

Name of the participant

---

Signature

---

Date

---

Name of the researcher

---

Signature

---

Date

---