

An Investigation into the Effectiveness of Detective Internal Control for Small Business Entrepreneurs in Mpumalanga, South Africa

Victoria Reneiloe Marule^{1,*} and Portia Pearl Siyanda Sifolo²

¹Milpark Business School, Johannesburg 2092, South Africa.

²Management Science, Tourism Management Department, Tshwane University of Technology, Pretoria 0183, South Africa.

Keywords

Conceptual Business Management Skills

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Abstract

Detective internal controls usually foster compliance among small businesses and are the second line of defence to identify errors, theft, or omission that the preventive controls failed to block. They provide a holistic technical view that safeguards and protects the assets of small businesses. However, failure to isolate small businesses' unique risks harms the detective internal controls as they are neglected. Use of qualitative method through semi-structured interviews among 12 small business entrepreneurs in Mpumalanga, South Africa. MAXQDA 2022 was used to analyse data. The results revealed that small businesses were reluctant to participate due to their concerns about the information being gathered. Moreover, small business entrepreneurs indicated a lack of technical and conceptual business management skills as prohibitors to implementing internal detective controls. Nevertheless, due to resource constraints and volatile employee dynamics, small business entrepreneurs must commit to competence.

*Corresponding Author

¹*victoria.marule@gmail.com

² SifoloPS@tut.ac.za

1. Introduction

Small businesses spur economic development, growth and efficiency in South Africa by enhancing competition, entrepreneurship, innovation, job creation and alleviating poverty (World Bank, 2022). Small businesses face several challenges, such as infrastructural inadequacy, high-interest rates, poor transportation networks, management problems, political instability, limited access to finance or capital, infrastructure, inconsistent implementation of government policies, multiple taxes and levies, limited access to modern technology, and unstable foreign exchange rates among the challenges facing these small businesses (Zondi, 2017; Oni, 2021, p. 229). This is an observed trend across South Africa.

1.2. Background

The Nkangala District Municipality is the smallest in Mpumalanga and comprises six local municipalities with historically diverse economic sectors such as mining, energy, tourism, and agriculture (Municipalities of South Africa – Overview, 2021). The South African Institute of Chartered Accountants (SAICA) concurs that internal controls are critical in a business, including the SMME. SAICA (2021), in the International Audit Standards (ISA) 315 (Revised 2019) (2021:9), define internal control as "...the process designed and maintained by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to financial reporting, effectiveness, and efficiency of operations and compliance with laws and regulations."

The definition indicates effective internal detective controls that provide a holistic technical safeguard that protects the assets and processes of small businesses. As a result, this suggests that exploring internal detective control activities among small businesses in South Africa is paramount. The three internal control activities in Table 1 provide accurate financial reporting, non-financial information, operational efficiency and compliance.

Table 1: Internal control activities

Preventative control activities	These are proactive policies and procedures to prevent errors or illegal events from occurring in the organisation (Adams <i>et al.</i> , 2019)
Detective control activities	These set policies and procedures mitigate internal control limitations, such as human error, collusion, or management overriding established internal controls. According to Adams <i>et al.</i> (2019:5/15), the detective control activities are called the "second line of defence" and are designed and implemented to identify errors, theft, or omissions that the preventative controls failed to block
Corrective control activities	These are set policies and procedures that rectify the errors, omissions, or unauthorised transactions identified by the detective controls activities.

Source: Own compilation

The paper layout includes the problem statement followed by the research objective. After that, the Literature Review will provide context on detective control activity by unpacking the System of Internal Control (SoIC) framework. Subsequently, the Research Methodology, including the research instrument used to collect data. From the data collected, the Findings are documented, generating the Managerial implications. Finally, the Conclusion, Limitations and Future Research will conclude this paper.

1.3. Problem Statement

The lack of basic business management skills, linked to an imbalance in technical and conceptual skills, contributes to small businesses' internal control challenges (Visser et al., 2016). Small businesses are regressing due to ineffective detective controls, which provide a holistic technical safeguard that protects their business assets and processes and fosters compliance, as reflected in their financial reporting.

Small businesses are not new in research; there is much literature available, post-democracy, in agreement that small businesses are a vehicle for poverty mitigation, job creation and increased contribution to South Africa's economy (Visser *et al.*, 2016). However, The Department of Small Business Development (DBSA) (2020:22) admit that educational support for small businesses is minimal and states that "...remain disconnected, with poor systems and procedures and little leadership on a national scale". However, there is a disjuncture between suitable policy formulation and dissemination of information to small businesses. Increased small business entrepreneurs do not possess the fundamental technical and conceptual business management skills critical for success. Herrington, Kew and Kew (2008:31) concur that the disjuncture imposes constraints such as a lack of financial support, inadequate training and skills intervention, and government policies affecting small businesses.

1.4. Research objective

To investigate the effect of internal detective controls on the small business entrepreneurs in the Nkangala District Municipality of Mpumalanga.

2. Literature Review

Business and financial management encompass fundamental technical and conceptual skills founded on vigorous internal control business activities, which are not sector-specific but are factors to grow the business and demonstrate good governance. Internal controls impact operational efficiency, progress and business endurance (Phornlaphatrachakorn & Na Kalasindhu, 2020). Putra (2019) states that small businesses perceive providing financial records as a waste of time. In the long run, small business entrepreneurs who lack the necessary financial skills will be unable to make critical financial decisions in the best interests of their business. Over-reliance on outsourcing makes small businesses not respond timeously and comprehensively to rapid changes, leading to inaccurate business decisions, non-compliance and many more issues (Massingham & Al Halaibi, 2017; Mthimkhulu & Aziakpono, 2015).

2.1 System of Internal Control

According to Fraser (2020), small businesses' System of Internal Control (SoIC) creates adequate control as this promotes accurate presentation and disclosure of management's objectives at an entity level. The System of Internal Control, including detective control activities, are not designed to detect human error, biases of human judgment, collusion, management overriding internal controls, fraud, and non-routine transactions (ISA 315 (Revised 2019), 2021). Below is an adaptive interpretation of the Five Components of the System of Internal Control alongside Understanding the Entity and its Environment component.

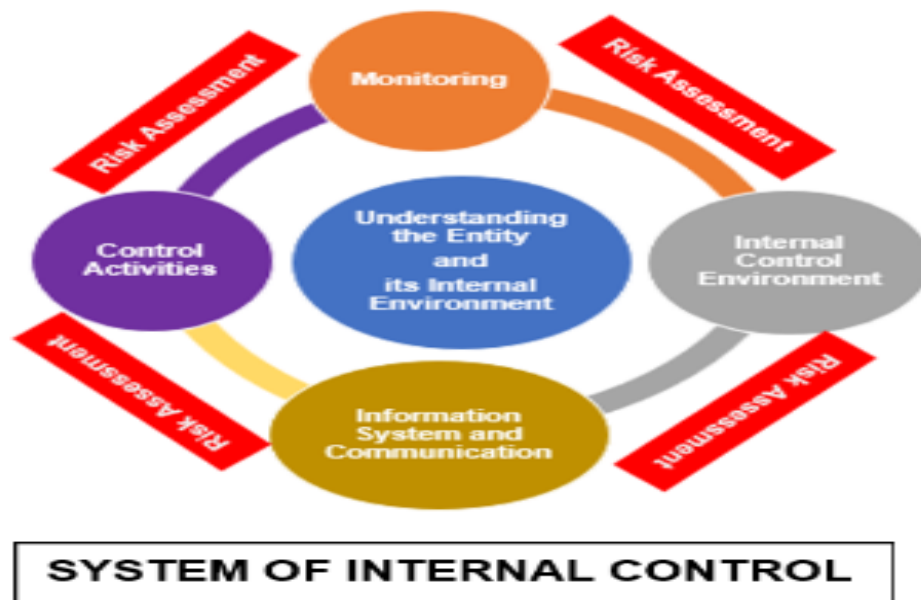


Figure 2.1: System of Internal Control

Source: Authors' own construction.

Presented below are Systems of Internal Control (SoIC) and its components, which are known for solving the problem of dealing with credible information for the decision-making process (Frazer, 2020, p. 28). Therefore, understanding each small business and its internal environment is the core starting point and contextualising the systems of internal control in the South African context is essential.

2.1.1. Understanding the business and its environment

The South African context is unique, with small businesses facing several challenges, such as unfavourable economic conditions, from unstable and expensive electricity to a record petrol price hike, the lingering aftermath of the Covid-19 pandemic and the July 2021 unrest in KwaZulu Natal and Gauteng (Makonye, 2022). The reality is the volatile external environment in which small businesses operate.

2.1.2. Internal control environment breakdown diagram

An adaptive interpretation of ISA315 internal control environment components organogram below, broken down to demonstrate the flow and interrelated nature of detective control.

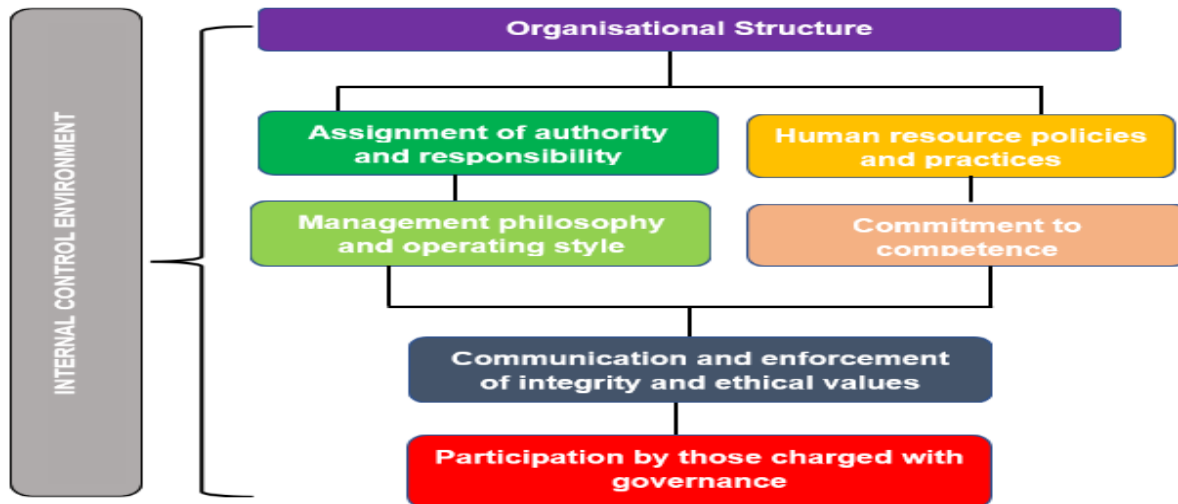


Figure 2.1: Internal control environment

Source: Authors' own construction.

- Organisational structure: Small business entrepreneurs are responsible for designing, planning, assigning, executing and revising the set business objectives. They accomplish that by implementing a minor distinction in duties between the employees as a form of delegation based on their job description (Sartipi, 2020; ISA 315 (Revised 2019), 2021).
- Assignment of authority and responsibility: Small businesses have limited skilled personnel and multiple duties executed by the same personnel, so senior management intervention is prevalent to ensure oversight or review of employees' work performed to maintain a robust control environment (Adams *et al.*, 2019).
- Small business entrepreneur's managing philosophy and operating style: Small business entrepreneurs and lower-level staff work closely, exposing employees to management's behaviour and conduct. The internal control environment can be eroded based on management's conduct. Conversely, a positive, direct influence on employees can result in a robust internal control environment culture (Barišić & Tušek, 2016)
- Human resource policies and practices: This element of the internal control environment ensures a business environment that hires competent, capable and suitable candidates according to human resources policies and procedures in alignment with the overall strategy

- Commitment to competence: For small businesses, a challenge may be implementing a commitment to competence due to resource constraints, which results in employees being responsible for multiple duties and duties they are underqualified to perform (Piskunov *et al.*, 2016; Doyle *et al.*, 2007).
- Communication and enforcement of integrity and ethical values: When small business entrepreneurs are perceived to have integrity, the employees are less likely to behave in an unethical manner (Kereri, 2019)
- Participation by those charged with governance: Small business entrepreneurs as directors must lead by example and not bypass or ignore the business' internal controls. The entrepreneur's attitude towards ethical awareness and actions will promote reliable financial reporting, accounting processes, function, and personnel (ISA315 (Revised), 2017).

2.1.3. Small Business Risk Assessment Process

Risks can be mitigated but often never terminated. Risk assessment is central in determining control activities to be implemented by the business (Boghean & Chihai, 2021). Risk assessment and control activities have an inverse relationship; therefore, risk exposure means the business does not achieve its objective (Pham, 2021). Therefore, risk assessment is continuously interacting with the five components.

2.1.4 Small Business monitoring processes and information systems

The monitoring control ensures that the input, processed data, and information output are accurate, valid and complete. Furthermore, it ensures timely communication for decision-making. Smaller businesses will likely have an information system represented by manual information systems with human intervention and automated information systems using a computer system (Adams *et al.*, 2019).

2.1.5. Small Business Control Activities

As risk is dynamic, risk assessment helps select relevant control activities for the business. Small business entrepreneurs at a strategic level need to break down their business into departments and isolate the unique departmental risk, which also affects their risk management function. Small business entrepreneurs cannot have unilateral control and access to a transaction from initialisation to completion (Edori & Ogaluzor, 2018).

The results reveal the absence and presence of internal detective controls and how these controls influence the challenges small businesses face. Below is a diagrammatic representation of detective control activities:

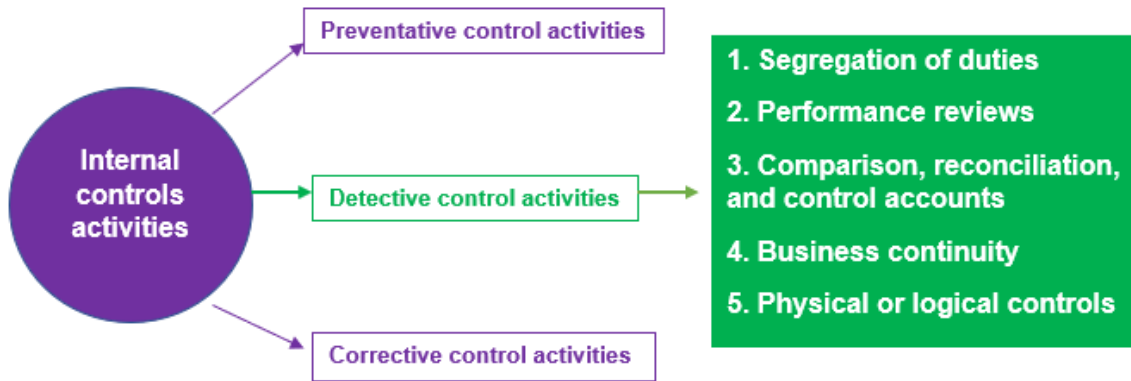


Figure 2.2. Categories of Control Activities.

Source: Authors' own construction.

Detective control's pertinent nature is that they are a process, which means they are action-based, involving human intervention. Detection control activities are not evident in tangible documents; instead, they are observable policies and procedures in the operational activities (Alarcon *et al.*, 2019). Detective control includes the following:

- Segregation of duties requires a clear reporting line and separating conflicting roles for the critical areas with significant risk. It is critical to delegate to mitigate operational risk by giving different people roles and responsibilities for authorising a transaction, recording a transaction, and maintaining custody of assets (Edori & Ogaluzor, 2018).
- Review Control Activity is for small businesses to design performance reviews for the small business entrepreneur, employees, operations and financials and compliance in line with objectives set for the business (ISA 315 (Revised 2019), 2021)
- Reconciliation Control Activity identifies gaps by comparing multiple data sets, records, documents and physical assets (Shiner & DuPriest, 2012). A separate employee must independently reconcile another employee's work. The interdependency on the segregation of duties strengthens the reconciliation, monitoring and performance review in alignment with the business objectives (Al-Mashhadi, 2021; Pham, 2021; Koutoupis & Malisiovas, 2021).
- Safeguard Physical and Logical Control Activity over tangible and intangible (logical) assets (Bruwer, 2016). The policies and procedures to safeguard business assets are called custody control, which involves segregating duties. A better form of segregation of duties, called isolation of responsibilities, means set duty has been delegated to separately and identifiable personnel. (ISA 315 (Revised 2019), 2021).

3. Research Methodology

A qualitative approach is adopted to obtain comprehensive information to evaluate participants' experiences, behaviours, interactions and social context (Fossey *et al.*, 2002). In addition, this study evaluated the social constructs to which the participants are exposed and the effects on their business' detective internal controls. The target population included a purposive sample of 12 small businesses in the Nkangala District from the SMME (expansion/scale-up) sub-category. The 12 Small businesses provide different goods and services to demonstrate diversity and balance sample selection.

Data was collected through semi-structured interviews with small business entrepreneurs in the Nkangala District. The interview exposes and interprets the participant's world: in essence, the interview will map out the individual's social construct. Denzin (2001) explained that the researcher becomes the co-producer by taking the participant's responses and merging them with the researcher's technical knowledge of the topic.

The qualitative research method hones in on the thematic nuances presented by the empirical data from the interviews. MAXQDA 2022 software was used to code and make connections to understand the inherent meanings of the raw data. The interviews have heightened the credibility of the findings and confidence in the conclusion and recommendations (Wester *et al.*, 2021). The transcripts were listened to and read several times to establish themes and categories (Jain & Ogden, 1999). The emerging themes and patterns created the code framework to provide meaning in this study (Marshall, 1999).

3.1. Ethics

Ethical clearance was approved by The Research Committee of Milpark Business School, Reference number MBA2021/07/004. In addition, ethical consent was obtained from The Nkangala District Municipality to conduct research and access the Small Business database. Pseudonyms were created for each participant to preserve identity and ensure anonymity in this study under the POPI Act. The data collected has three storage backup generations so data is not lost, compromised, or corrupted, namely the external hard drive, cloud storage and on the laptop. During this study, mutual respect and professional etiquette were consistently demonstrated when engaging participants and any other person involved in the research project. Compliance with COVID-19 regulations during the empirical research phase using WhatsApp as face-to-face contact had social distancing restrictions (Milpark, 2020).

4. Results and Findings

In this section, the ethnic demographic of the participants is homogeneous as all participants, both male and female, are Black African. Table 2 presents the classification and allocation of participants' businesses as

registered under the trading and accommodation industry according to the Department of Small Business Development (DSBD) Annual Performance Plan 2021 (2021:18).

Table 2: Classification of small business entrepreneurs in the study

Participant	Goods or services	Male	Female
A	Hospitality		X
B	Beauty and cosmetic product	X	
C	Mechanical engineering and construction	X	
D	Solar renewable energy	X	
E	Hair salon	X	
F	Beauty therapy		X
G	Internet cafe and I.T. consultant	X	
H	Electrical installation	X	
I	Estate agent		X
J	Student accommodation		X
K	Recruitment and corporate training		X
L	Civil construction and mechanical engineering		X

Source: Own compilation

As seen above, six participants were male, and six were female. Bowmaker-Falconer and Herrington (2020) argue that despite the inherent difficulties experienced by small businesses in South Africa, female small business entrepreneurs are narrowing the gap between the sexes, which historically favoured males.

The information in Table 3 below covers the age groups of participants ranging from 18 to 70 years.

Table 3: Age group of participants

Age group	Number of participants	Percentage	Male	Female
18-25	0	0%		
26-35	5	42%	2	3
36-45	3	25%	3	0
46-55	1	8,3%	1	0
56-65	1	8,3%	0	1
66-75	1	8,3%	0	1
Undisclosed	1	8,3%	0	1
Total	12	100%	6	6

Source: Own compilation

Liang *et al.* (2018) argue that senior employees are employed in high positions and close the door to younger employees' opportunities, experience and expertise; consequently, many have ventured into entrepreneurship. In this study, half of the participants, A, B, C, D, H and L, were permanently employed

and offered their goods and services to their employers. Of the small business entrepreneurs aged 26 to 35, four of five participants were full-time entrepreneurs, as young people are likelier to establish successful new businesses (Azoulay *et al.*, 2020). Of the small business entrepreneurs aged 26 to 55, seven participants explained that increasing business revenue was more urgent than incurring internal control costs, which can only be met after sufficient revenue. These results are similar to those from a study conducted by Chen, Hua and Sun (2018) on CEOs' ages and the persistence of Internal Control Deficiency: There was a negative relationship between "CEO age x number of material weakness in current period", which showed that age had a marginal impact on the determination to have adequate internal controls.

In this study, an observation of participants displaying a solid knowledge of strategic planning with feeble execution is directly linked with the years in operation in Table 4 below.

Table 4: Years in operation

Years in operation	Number of participants
0 > 1 year	1
1 > 5 years	3
5 > 10 years	5
10 years or older	3
Total	12

Source: Own compilation

In this study, for small businesses that had been operating for more than ten years, three participants displayed conceptual skills detailing industry competition and their experience. In addition, they articulated the internal controls present in their businesses. Participant I stated: "Yes, internal control is a measure a company will adopt to protect its asset and property. It will also mean the internal controls are there to assist in detecting and, preventing and correcting wrong things before they happen. So, it needs to be implemented in every company. If it was to minimise the risk." Conversely, nine participants had a vague concept of internal control for the ten-year-old small businesses or perceived it as not the internal responsibility of the small business but an outsourced function. Participant G confirmed this by saying, "These business terms – I am not good with them, but internal controls, the only thing I know was central budgeting, meaning you are the centre and you control the budget. But internal control, no."

4.1 State of detective internal controls for small business entrepreneurs in Mpumalanga

Quality of controls is affected in rapidly growing businesses as it outgrow its iterative internal controls, subsequently experiencing a lag before implementing new controls, which come at a higher cost (Eldridge & Kealey, 2005). For example, eight participants with a single-focus product and service offering were precise in their business descriptions and operating systems. The four small businesses offering multiple

goods and services suffered the same problem: they could not separate each operating system from the relevant departments in the operating system, indicative of weak controls.

4.1.1. Segregation of duties control challenges

Small businesses comprise family members participating in day-to-day business activities, and there may be no distinction between owners, those charged with governance or management and related party relationships (ISA 315 (Revised 2019), 2021; ISA 550, 2021). Participant H confirmed this by saying, "Because this is a family business, I am working with my brother, and I am relying much on him because he is the one who has this knowledge of electricity. I am the one doing the management, day-to-day running of the business, checking if their business is running, buying stock, advertising the business, seeing the customer, liaison clients and all this stuff." Eldridge and Kealey (2005) argue that the segregation of duty control functions in a small business must be cost-effective to implement, maintain and monitor. It is counterintuitive for a small business to hire multiple employees who do not form part of their product cost but add to the company's period cost because the benefit cannot be quantified, but the cost can be quantified (Platz & Temponi, 2007). This study shows an example of a small business that has scaled down its workforce and spread the current duties to its existing employees. Participant C elaborated, "We are four who are handling maybe the two or three positions. Like myself, sometimes I have to make sales at a higher level, and as I am the managing director."

Cost-benefit of outsourcing business functions

A prevailing theme was the challenge of small businesses preventing implementing detective controls as a result of volatile employee dynamics prompted their inability to afford competent people permanently without the relevant revenue stream (Coates & Srinivasan, 2014). Participant L elaborates: "We cannot say permanently employed because we do not have a contract. So we work in an order-to-order kind of business. So if there is no order, we do not have a business then. So, it cannot be permanent. Just keep them ready. On our side is to have their Information and Safety file ready for them to come in, but as they get better opportunities, obviously they will leave, so we do not have any permanent employees."

Participant C laments: "You get a suitable candidate from Durban, and they say: 'I cannot come for one month.' Those are the regrets we find in the business, so at the moment, they go to the well-established companies." With the lack of a skilled workforce, the odds continue to stack against small businesses as they try to maintain a competitive edge over well-established businesses by obtaining contracts with limited resources to increase revenue whilst maintaining adequate internal control.

4.1.2. Review control challenges

Musya and Aduda (2014), Origa (2015) and Salameh (2019) asserted that adequate controls include the review function over the integrity, transparency, accuracy and reliability of operating and financial

information. In addition, review promotes compliance with laws and regulations and employees' adherence to management directives to achieve the set objectives. The review control in small businesses is how frequently management monitor and review activities and evaluate if they respond timeously to detect misstatements (ISA315 (Revised 2019), 2021:A116).

Pakurár, Haddad, Nagy, Popp and Oláh (2019) stated that training, educating and sensitising their employees to the importance of control because controls are only functional if the people are skilled, competent and transparent. Small businesses in this study had mandatory operation review controls, which are essential to attract and keep clients and maintain a competitive edge. Participant C illustrates: "During service execution, we always engage the client to check if everything is still according to the specifications and the quality they want before we finish. After completion, we sit with the client to check all the work or the service and agree that everything went well. Then there will be the document of quality signed."

The financial performance review function frequently checks Financial Ratios, Forecasts and Budgeting, among many others. In this study, unfortunately, many participants like K, F, A, and C did not perform any forecast or budgetary functions. For the small businesses that did, it was an outsourced function. For the small businesses that did, it was an outsourced function. Participant C elaborates: "The accountant is handling them because they must be realistic when analysing performance, and with the last performance, we will be able to do our forecast.". There is a weak understanding of the importance of what is being reviewed and the interrelated nature of budgeting and financial reporting (Dabbicco & Mattei, 2021).

4.1.3. Reconciliation control challenges

Reconciliation helps to detect accounting errors and fraudulent reporting (Chang *et al.*, 2014). Financial reconciliation is a type of internal control where financial data is cross-checked with independent data to ensure that transactions recorded in the financial report are timeous, complete and accurate (Chew, 2020). Small businesses also perceived reconciliation control as the accountant's job and not an internal function done by small business entrepreneurs. As a result, there is an increased risk of exposure by small businesses to the inability to trace their expenses and revenues; therefore, fraud or inappropriate use of business assets by employees is prevalent. Moreover, those participants who did perform reconciliation could not pinpoint the financial challenges they faced as a small business. Participant H mentioned:

"Since it is a small business, some customers take advantage of it. So we start by installing the electricity. We have got payment methods in which our customers pay. Some of our customers do not comply with our payment methods, finding that some of the work done is not paid."

Inefficient management affects the business' working capital, which is the turnover of funds available in the business and disrupts internal controls. Furthermore, the risk profile of this small business increases because the sales transaction is on credit and the debtor does not pay; this adversely impacts the business's finances and internal control as the accounts receivable remain uncollectable (Rohendra & Saudi, 2020).

Lartey *et al.* (2020) state that reconciliation is the most common detective control activity to locate inconsistencies in accounting ledgers and bank accounts, as this addresses the review of financial and operating systems. Small businesses that use reconciliation are a step ahead in mitigating the risk.

4.1.4. Safeguard assets control challenges

Rapani and Malim (2020) state that the primary detective control objectives are designed to safeguard the business' assets and resources from misappropriation and fraud. In this study, Participant L explained, "We employ qualified fitters, so they come with their tools and equipment. . . .cannot afford to buy any assets and do not keep any assets." The pertinent issue is the confidentiality of the client's information used in the business according to the POPI Act. Participant A stated, "The files that keep all the information, the listed forms, are in a safe and lockable cabinet. No other person has access. I think it is something to look into." This study highlighted a challenge: small business entrepreneurs relied heavily on manual storage systems and hard copies. Participant H states, "They are written in a book and file those names with the customers' details in the customer book. I have a safe in my room and have put them there."

5. Managerial Implications

Effective detective internal controls determine the success of a business. Presented in this section are the internal detective controls for small business entrepreneurs.

5.1. Segregation of duties Detective control

Alawaqleh (2021) explains that small business entrepreneurs cognisant of leading by example adhere to setting controls and following the rules and regulations. To mitigate weak segregation of duties from fluctuations in employee numbers and inconsistent human intervention. Having a set organogram or a template mapped out shows the work processes and responsibilities so that there is a unified workflow to boost efficiency and control integrity (Massingham & Al Holaibi, 2017).

Traditionally, competency was the prerequisite, but in-house training empowers the business to improve strategic objectives, simplify the line of reporting and authority, increase efficiency, and alleviate conflict of interest. Thus, the business benefit from streamlining duties is the spare capacity to increase human capital.

5.2. Interrelated review and reconciliation detective control

Small business entrepreneurs need to be cognisant that the review and reconciliation control function is interrelated as they are a by-product of the segregation of duties. In this study, small businesses perform this function by reviewing employees for performance appraisal and their operation projects for client satisfaction and timely payment from trade receivables. The participants of this study answered the reconciliation functions poorly based on their assumption that it is an outsourced function. Al-Mashhadi

(2021) asserts that no single person should have the power to work and keep original documents and records from beginning to end without supervision or oversight.

5.3. Safeguarding of assets detective control

In this study, small businesses understood the importance of safeguarding control, demonstrated by various answers about restricting certain documents from easy accessibility. The recommendation is three-generation storage. Identifying the challenges around safeguarding assets and having mechanisms to mitigate associated risks maintains the accuracy, validity and quality of financial information, achieving efficient operation. In addition, it encourages the employees to follow the business's policies and procedures (Salameh, 2019).

6. Conclusion, Limitations and Future Research

There is an undeniable need for a balance of technical and conceptual business skill sets to successfully navigate the South African Economy. The results indicated that small business entrepreneurs understood, in hindsight, the importance of detective controls and the impact the absence and presence create. As these helped mitigate various risks associated with their finances and successfully achieve their business objectives. The pervasive nature of detective controls is depicted by relying heavily on human intervention and revolves around the segregation of duties. Moreover, the review and reconciliation detective controls overlapping links and monitoring detective control. Finally, small business entrepreneurs must commit to the skill competency of all personnel, even when the function is outsourced.

This study contributes to the detective control effects in small businesses in a developing context within a small town. The current study could be extended to include evaluations of detective control effectiveness for small businesses' growth and expansion based on broader demographic-driven research, including age, gender, race and qualifications in the Nkangala District Municipality as an extension of these results to reflect actual conditions and situations. Future studies might need to review the concepts introduced and add value by confirming and expanding these relationships.

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