THEMATIC ANALYSIS OF CHALLENGES FACED BY SMALL AND MEDIUM CONSTRUCTION COMPANIES IN ACCESSING CREDIT IN SOUTH AFRICA

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Small- and medium-sized enterprises (SMEs) are considered the engines of growth in developing countries. In developed countries, SMEs have historically played a vital role in creating jobs, spurring innovations, and creating new products, and thus contributed to economic vitality and growth. However, it has been indicated that SMEs faces challenges in accessing credit. The purpose of the study was to provide an overview of the challenges small and medium contractors in South Africa construction industry are facing in accessing credit facilities. The method of the research is based on literature review. A thematic analysis was used to analyse both quantitative and qualitative research projects between 1995 and 2015. The literature revealed that lack of business management skills leads to difficulty in accessing credit, lack of collateral etc......The findings were based on literature review of relevant articles between 1995 and 2015, hence might be biased. The paper suggests that small and medium sized contractors in South Africa are subject to challenges in accessing credit making their growth and being innovative almost impossible.Conclusion: The study sought to explore the challenges and barriers in accessing credit by Construction SMEs in South Africa.

Keywords: small and medium construction company, South Africa, thematic analysis

INTRODUCTION

The objective of this paper is to thematically analyse and present the constraints of accessing credit by the construction small and medium construction enterprises (SMEs) in South Africa. A survey conducted by Financial Service Board (FSB 2012) reported, that 36.2 % of the construction SMEs in South Africa reported that their business closed down due to shortage of working capital. Despite the fact that some of the construction SMEs had operated for some years. Furthermore, the survey also established a meagre, i.e. 5.8 % of the construction SMEs applied for

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credit. This suggests that construction SMEs are stifled in accessing bank credit. This gap poses a problem and triggers the need to conduct a review on the challenges of construction SMEs in South Africa in accessing credit. A literature review was administered. The review established the challenges affecting the construction SME accessing credit to be; creditworthiness of the borrower, collateral requirement by the banks, risk default and lack of business plan.

The capacity for SMEs to fulfil their potential in an economy depends on the availability of finance or credit, Turner et.al., (2008). Finance in general and credit in particular is especially important for SMEs, since they are unable to finance themselves through retained earnings or equity financing. Despite the fact that credit or financing is a major factors for growth of construction SMEs, a number of studies and government enquiries have mentioned that construction SMEs face problems when accessing credit from financial institutions.

One of the significant characteristics of a flourishing and growing economy is a vibrant and blooming SME sector. Turner et al. (2008) propounds that most of the current multi-million dollar enterprises have their origin in SMEs. Despite the importance of construction SMEs, they are faced with different challenges. SMEs in developed and less developed countries (LDCs), as in other countries, are still facing a number of difficulties and obstacles that are impeding and complicating their operations and growth.. In South Africa access to credit by the construction SMEs is still one of the major challenges, despite the emphasis which is made to increase the availability of credits to the construction SMEs. A report by Fin-Mark (2010) found that up to 32.7% of the construction SMEs mentioned that they lack capital, which is the main problem, while only 10% of the contractors had ever received loans. The main credit source in South Africa is the informal credit market, which provides easier access to credit for construction SMEs, rather than in the formal credit market which have the lending terms and conditions, such as collateral, application procedures as well as the repayments periods (Fin-Mark 2010). The main objective of this paper is to determine the credit accessibility challenges of small and medium construction enterprises in South Africa.

PROBLEM STATEMENT

Small and medium scale enterprises in South Africa have been acknowledged to face many problems in their operations and this was often limited to the absence of a clear vision of the role they played in development of the economy of South Africa and the lack of credible policy framework and distinct interventions to promote the growth and expansion of construction SMEs (Aryeetey et al 1994). Coupled with the absence of clear vision for SMEs, they are further disadvantaged in accessing credit in formal financial institutions. This study seeks to answer three research questions, namely:

Research questions

- What are the sources of credit for the construction SMEs companies in South Africa?
- What are types of sources of credit available to construction SMEs from financial institution?
- What are the financial challenges of accessing credit facilities from the financial institution in South Africa?

Objectives of the study

The specific objectives of the study were;

- To identify the sources of funds/credit for the construction SMEs
- To identify the types of source of credit available to construction SMEs
- To identify the financial constraints faced by construction SMEs in accessing bank credit facilities.

RESEARCH METHODOLOGY

The literature review of scholarly work spanned the period September 1995 to 2015 and was based on a systematic Keyword combination search on the following debases: UJDigispace/Multidisciplinary, Sabinet /Multidisciplinary, ProQuest MTD, Emerald on Business studies and Entrepreneurship, Scopus /Economics Engineering and Technology, OECDilibray, Oxford journals online and Socio-logical Abstracts.

SEARCH METHOD

The search was conducted by deducing the main keywords and the keyword variables based on the aim of this paper and above stated background. From here the search was continuously expanded with new keyword variables as they appeared throughout the search in the specific databases. Following this, the search was conducted in every single database by searching the main keywords in combination with every single keyword variable. Where the results exceeded 30 hits yet another and keyword variable was added to the search. The review established the challenges affecting the construction SME accessing credit to be; creditworthiness of the borrower, collateral requirement by the banks, risk default and lack of business plan.

Criteria for inclusion

The article had to:

- Be peer reviewed;
- Be written in English

- State an aim, method, results and a conclusion;

Report, investigate or contain results relating to the aim of this literature relating to the aim of this literature review.

LITERATURE REVIEW

Definition of Small and Medium Construction Firm in South Africa

The definitions for the various enterprise categories are given as follows (Republic of South Africa - White paper on national strategy for the development and promotion of small business in South Africa, 1995) and the National Small Business Act (amended 2003).

According to Berry et al., (2009) when defining SMEs it is important to differentiate it from small, micro and medium- sized enterprises (SMME's). Although both terms are used to refer to small businesses, SMME's comprises of a wider range of firms, from "established businesses employing over one hundred employees to self- employed owners of informal micro- enterprises". SMEs form an upper end of the ranges contained by SMME's; these are larger in size compared to the micro and very small medium sized enterprises.

The definition of small and medium sized contractors can vary from one country to the other. However, the definition used for this research study will be largely based on turnover and the number of permanent employees. Dlungwana et.al. (2002) defines small construction companies in South Africa as those companies with an annual turnover of less than ten million rands (R10 million), while medium contractors have a turnover ranging between ten million rands (R10 million) up to fifty million rands (R50 million). The National Small Business Act No 102, 27 November 1996 (1996) defines small contractors as firms that employ between five (5) and fifty (50) permanent employees, while medium contractors employ between fifty (50) and two hundred (200) permanent employees.

SOURCES AND TYPES OF CREDIT FOR CONSTRUCTION SMES

The sources of finance available to SMEs could be from a variety of sources. These sources can be classified based on a number of factors which includes internal and external, formal and informal. It is also crucial for construction firms to choose the most appropriate source of finance for their several needs as different sources have their own benefits and costs.

There are many ways in which SMEs can be finance which include: Equity Financing method, family and friends, business angels, venture capital, capital markets. This is the act of raising money for company activities by selling common or preferred stock to individual or institutional investors. In return for the money paid, shareholders receive ownership interests in the corporation. (Schmid, 2001). Equity finance can sometimes be more appropriate than other sources of finance, for example bank loans. In this type of finance there is less cost which means interest is not paid on it. Raising finance through equity require much harder effort as investors need to be convinced of the market potential and of the business and good returns expectations. Equity financing can serve as a powerful tool for small-firm development when used for the true reasons. When a company does not hold a sufficient record of achievement or the collateral needed for a bank loan, and if the owners do not have adequate personal savings, equity financing may be an option when cash is required though a percentage of the ownership and profits is given up. Equity financing is used not only to secure cash, but as well to make key persons committed to the company's success.

Debt based finance method are those of microfinance banks, Commercial banks, non-bank Intermediaries, Non-Governmental Organizations (NGOs). Debt financing is a loan or direct obligation to pay back to a financial institution of what the firm borrowed. Debt finance exists in various forms and the tenure can be arranged in three principal terms thus, short term, medium term, and long-term debt.

Most traditional lenders prefer manufacturing or industrial operations where funds will be used to purchase fixed assets, like land, buildings or production equipment than construction sector. The benefit of debt financing is that it is finite and the debt is paid over time to a zero sum balance without any further obligation to the lender. The biggest advantage of debt financing is that it allows the firm owner to retain control of his or her company, also interest payments are tax deductible; there is no dilution to existing equity holders. Others are Quasi finance method includes guarantees, performance bonds, tax savings, trade credit finance, factoring and invoice discounting; business angels financing; venture capital funding; and leasing and hire purchase.

CHALLENGES FACED BY CONSTRUCTION SMES IN ACCESSING CREDIT FROM FINANCIAL INSTITUTIONS

The challenges that Small and Medium Construction SMEs encounter when trying to access credit can be due to an incomplete range of financial products and services, regulatory rigidities or gaps in the legal framework, lack of information on both the banks and the construction SMEs side, (Ackah and Sylvester 2011). Financial Institution may avoid providing finance to certain types of SMEs, in particular, new business entrants and very young firms that typically lack sufficient collateral, or firms whose activities offer the possibilities of high returns but at a substantial risk of loss. (Uriyo 2004). Kayanula and Quartey (2000) argued that factor like availability and cost of finance are the most common constraints faced.

Other are lack of collateral requirement, Informational barriers, Regulations and rules that impede construction firms access to credit, The legal framework and policies around investment and financial institutions lending are fundamental, lack of access to appropriate technology, weak institutional capacity, lack of management skills and training in the construction firms, lack of proper book keeping etc. The legal and regulatory frameworks that exist in South Africa also fail to provide the right support infrastructure to facilitate construction SMEs lending by the financial institutions. The lack of collateral, lack of proper financial management, lack of fiscal incentives for Construction SMEs, strict prudential regulations which restrict flexibility of financial institutions, unduly complex or onerous administrative procedures and even simply the lack of a consistent definition or enabling law for SMEs are some of the impediments to construction SMEs financing. A large majority of SMEs do not employ a qualified individual to manage their finances and that, compared to other aspects of running the firms, confidence in dealing with financial issues was not high. Lack of adequate management skills, strategic and operational factors further exacerbate the failure of SMEs in accessing credit. Even though construction SMEs tend to attract motivated managers, they can hardly compete with larger firms (Ofori, 2009).

According to studies done by Foxcroft et al. (2002), W, K, Herrington et al. (2008) reported that significantly large numbers of SMEs fail to gain access to credit from financial institution Wood kew, Herrington et al. further explained that bank credit are the most preferred source of external finance by entrepreneurs and a significant proportion of applicants to banks failed to get financed. Another study done by Angela and Motsa Associates (2004) reviewed that entrepreneurs face several problems in their efforts to access credit, particularly from banks. These are lack of collateral security, lack of owner contribution/ owner's equity, lack of good business plan, high interest rate, location of the business, lack of managerial ability, lack of cash flow statement, lack of information on the cost obtaining the credit, lack of good reference on the integrity, lack of experience and exposure on construction project also cited the firm characteristic was measured by looking at the risk profile of either the business or the individuals who borrowed loan. The loan characteristics was measured by the interest rate and collateral provided by the client.

The observable characteristics were measured by the age of the individual or the business and the credit history of the loan applicants, (Angela et.al 2004).

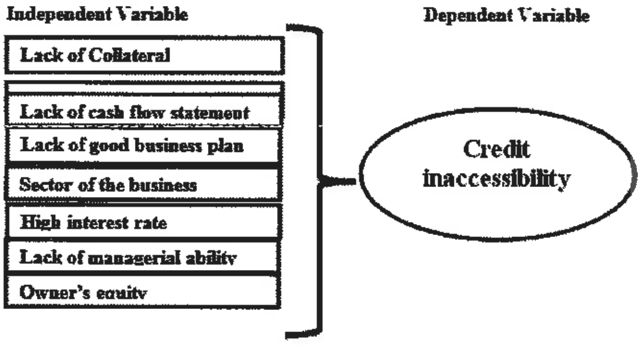

Figure 1: conceptual model inaccessibility to credit

Discussion on sources of credit for construction SMEs

Friends and Relatives

According Kuriloff et al. (1993) reported that contributions from friends and relatives are common source of credit, especially for new business since the financial institutions are reluctant to providing funding for start-up business because of the risk involve. This source of funds, however, bears a potentially dangerous price. Many friends' relatives find it very difficult to stay as passive creditors or investors. They usually try to interfere with policy and operational issues (Kuriloff et al.1993; Longenecker et al. 1994). As a remedy to this problem, Kuriloff et al. (1993) recommended the treatment of such credit like bank loans by putting in writing all the terms including interest rates and payment schedule.

Commercial Bank

According to Hisrich and Peters (1995) make an assertion that commercial banks constitute the most widely used source of debt financing for small companies. This assertion is also supported by longenecker et al. (1994). Again Longenecker et al. (1994) claim that commercial banks loans to small companies are mostly short-term loans, though some do offer long-term loans to small and medium size companies. According to Kuriloff et al. (1993), commercial banks usually provide loans for working capital or for the purchase of fixed assets. They demand evidence of a company's ability to pay the interest and principal as scheduled. This evidence is usually in the form of cash flows statements. They also demand some form of security. Collaterals are the most widely used form of security demanded by commercial banks. Longnecker et al. (1994) classify commercial bank loans as line of credit and term loans. Longnecker et al further reported that companies can enjoy some form of credit from their business suppliers. This is a very important source of credit, especially for construction SMEs. The suppliers allow the company some time to pay for the supplies. The credit periods varies from a few days to several years according to Broom et al. (1983). Credit from business suppliers may be trade credit or equipment loans and leases. Broom et.al. Further cited trade Credit, saying it basically involves the purchase of goods and services from a supplier on credit. The purchasing firm is given a few days, usually between 30 and 120 days, to settle the debt (Broom et al. 1983). This type of credit is very important to construction SMEs.

Types of credit for construction SMEs

Trade credit, however is not cost- free. The cost associated with trade credit may not be explicit as interest on bank loans, for instance. Suppliers incur costs by supplying goods on credit and they must recover cost. They usually pass the costs on implicitly as part of the purchase price of the merchandise.

Trade credit may come with an offer of cash discount. A cash discount may be quoted as 3/12 net 40. This means that SMEs has 40 days to pay the full amount but can enjoy a 3 percent discount if payment is done within 12 days. Failing to take cash discount may constitute an opportunity cost of trade. In the above quote, for example, failing to utilize such discount implies borrowing the amount for 28 days (i.e. 40-12) days at 3 percent. Therefore it is important to compare the cost of forgoing a trade discount and the cost of other available short-term credit facilities before decision is made (Moyer et al., 1992; Brealey et.al, 2001)

Personal Resources

According to Longenecker et al. (1994) observe that personal savings of the owners and partners of businesses constitutes an important source of funds, particularly in the formative stages of a firm. Personal contributions also help to raise additional funds from other sources.

Significant financial commitments made by owners of a company tend to build a lot of confidence among potential investors. Kuriloff et al. (1993) also note other personal resources apart from personal savings. These include borrowing using one's personal assets such as house and bonds as collateral.

There is a category of private individuals who invest in business ventures. These individuals are referred to as 'business angels'. Many of such individual investors tend to have some experience in business and/or are affluent professionals, who may have a lot of money to invest. Business angels constitute the informal capital source. They are said to represent the informal capital because there is no formal market place where their investment transactions are carried out. They are usually contacted through dealmakers such as business associates, accountants and lawyers (Longenecker et al. 1994).

Venture Capital

According to Stevenson et al., (1999), is a pool of equity capital contributed by wealthy individuals, as limited partners, and professionally managed by general partners for a fee and a percentage of the gain on investments. Thus venture capital firms are investment firms. Owing to the highly risky nature of the investments they undertake, venture capitalists demand very high returns on their investments, with target returns of about 50 percent or 60 percent being considered normal (Stevenson et al. 1999). Tuller (1994) notes that owing to their high expected returns, venture capital companies usually target companies that have prospects of rapid growth and above average profitability. The targeted companies must also have the prospect of going public in the foreseeable future – usually within five to seven years. Venture capital firms aim to capitalize on initial public offerings (IPOs) and cash in on their investments if prices are substantially above their initial investments in the respective companies. Apart from the provision of capital for very promising business ventures, venture capital firms also provide useful advice to these young enterprises, having acquired much more experience in business. They also provide additional financial assistance in the future if a firm they have invested in runs into financial difficulties. It will not be considered prudent to stand aside and watch their investments go to waste with a firm for lack of cash provided throwing in more cash will not amount to reckless investment (Tuller, 1994; Longenecker et al.1994). Tuller (1994) summarizes this as future availability of funds can be an enormous boost to achieving long-term strategic goals.

Discussion on factors affecting construction SMEs of credit inaccessibility

Project proposal: For the construction SMEs to qualify for a business loan, financial institutions require detailed information about the business including revenue, profit and expenses. Most of the construction SMEs, lack the ability to formulate a proper project proposal. The literature reviews showed that requirement of project proposal is considered by bank before they can have access to bank loan.

Collateral requirements: Securing borrowers' property rights to assets they can pledge as collateral particularly help small and medium company to access finance and obtain cheaper and longer-term loans. The use of appropriate collateral is the most common mechanism which is used by the financial institutions so as to reduce the informational problems in financing the construction SMEs. Lending to construction SMEs is backed by collateral so as to reduce moral hazard and adverse selection. Collateral requirements for construction SME loans are higher than for consumer loans, because construction SMEs' credit risk is usually more difficult to evaluate. The literature review showed that requirement of collateral is generally more stringent and therefore discourages them from borrowing. This is confirms the work by Beck et al. (2004) who found that better protection of property rights increases external financing of small companies significantly more than it does for large companies, particularly due to the differential impact it has on bank and supplier finance.

Bank charges: When banks lend to construction SMEs, they tend to charge them a commission for assuming risk and apply tougher screening measures which drive up cost on all sides. The literature review revealed that financial institutions charge higher interest rates to construction SMEs companies in order to compensate for the higher costs of information collection, the smaller volume of external financing and the greater risk of failure. Construction SMEs are more likely to pay higher interest rates to reflect their comparatively higher risk profile. The study also revealed that the high bank charges and fees discouraged the construction SMEs from borrowing.

Savings: Saving is important for households to weather difficult times, like drought, damage and fire and to plan for the future. The commercial banks are gradually moving away from the highly risky mass markets to individual account holders, whose balance could act as collateral in the event the borrower loses his or her job. Amount of savings usually determines how much is advanced as bank loan. it is important to note that financial lenders perceive that the higher the saving ability, the higher the ability of the customer to repay a bigger bank loan.

Risk default: It refers to the failure of the borrowers to repay the loans advanced to them by commercial banks. Commercial banks regard the construction SMEs as high risk borrowers due to perception of a high risk of business failure, their insufficient assets and low capitalizations and vulnerability to market fluctuations. Majority of commercial banks denied construction SMEs credits because of a higher defaulting rate. The banks therefore consider risk default as a major determinant.

Business plan: Based on the literature review showed that banks are much more likely to approve a loan when they can see a clear and defined plan for how a business intends to make profit. If an entrepreneur develops a comprehensive business plan at an early stage in the project, the risk perception is reduced and their likelihood of obtaining capital is increased. Plan which is not well thought out will likely be rejected. Based on the literature review at least 85% of the bank considered the factor as major challenges affecting construction SMEs.

Managerial skills: Quality of management determines the success or failure of any business. Better management enables businesses to command respect and trust from commercial banks because of their better chances of success and higher profitability for the banks. Studies by Shane and Stuart (2002) and Rudez and Mihalic (2007) positively associate managerial competencies with new venture performance. The higher the level of managerial competency exhibited by the owners of a new firm, the greater the viability and survival of the construction SMEs, the more successful they are in accessing credit. Commercial banks the literature review reported that they considered the quality of management of the construction SMEs before advancing bank loan. This is because constructions SMEs without quality management do not command their respect and trust as they are perceived to have limited chances of success.

CONCLUSION

The study sought to explore the challenges and barriers in accessing credit by CSMEs in South Africa. The challenges revealed by the study includes: Inability of CSMEs to provide collateral and other information needed by financial institutions such as audited financial statement couple with the high cost of credit in terms of high interest rates makes it extremely difficult to access finance. In the light of the key findings, policy actions should include better information provision regarding the various sources of finance. The results of this study revealed low awareness and usage levels of the various financing initiatives among CSMEs. Most of the schemes are perceived as difficult to access. The difficulties CSMEs often face in accessing these credit include: lack of securable assets, lack of knowledge by finance providers about the nature of respondents business, stringent eligibility criteria, lack of knowledge about lending criteria, difficulty in finding out about available finance, and bureaucracy. These really limit CSMEs' ability to access credit from these initiatives. Suggestions and recommendations for overcoming these challenges and barriers have been provided to management, government and other stakeholders in the built environment and financial sector.

DISCUSSION OF FINDINGS/RESULTS

Based on the findings of the present study, the following recommendations are made:

- To improve easy access to credit, construction SMEs (CSMEs) should endeavour to form strong associations to champion their course since financial institutions (FIs) believe that being in association can help them to get the right information about the firms towards gaining financial assistant, to reduce FIs inability to trace some CSMEs to recover their loans, thereby increasing the risk of defaulting by the firms. This might go a long way to reduce any bad image of CSMEs in credit default.
- The government through innovative initiatives should encourage specific training institutions and NGOs to provide training to CSMEs on entrepreneurial, management skills in areas like negotiation skills, writing good business plans and proposal, effective records keeping, having managerial ability, basic legal training in law of the country, among others.
- Government should institute some form of tax incentives to FIs involved in CSMEs lending. This will encourage other FIs to consider the option of lending to CSMEs.
- CSMEs should also reduce the reliance on banks and take advantage of institutions such as Venture Capital Trust Fund (VCTF) and Micro-Finance and Small Loans Centre (MASLOC) set up by the province to assist them in terms of finance.
- CSMEs are encouraged to adopt sound and rigorous financial management practices in order to reduce loan defaults, financial loss and mismanagement of financial resources that characterize small and medium scale enterprises in general.

- There should be dialogue between CSMEs and the FIs through trade fairs, open days, financial forums that are capable of bring to light the challenges of CSMEs and how they could be addressed effectively.
- Stakeholders in the construction industry should embark on strategic programmes to promote the development of skills in areas of management, technical, book-keeping, advisory to enable the CSMEs run their firms profitably to be able to repay loans.
- Financial Institutions in South Africa are encouraged to rethink and develop more innovative approaches to their requirement for granting financial facilities to CSMEs. Eligibility criteria and accessing credit should be made a bit more flexible to enable more CSMEs to qualify for these credits.
- Establishing of revolving credit by banks and non-bank financial services. Revolving credit is a lending product which enables a company to collect money on credit sales (Ackah at al., 2011).Revolving credit as it is well known will help CSMEs breathe in some air when it comes to the management of their account receivable because it has numerous benefits.

RECOMMENDATIONS

The study has important theoretical and managerial implications. Theoretically, the study provides preliminary evidence on the challenges faced by Construction SMEs in accessing credit from financial Institutions in developing country contexts. It is recommended that government should partner with some of the SMEs in forming public companies. Government could also take over some of these companies and develop them into a full fledge construction firm to boost the construction based of the economy. Also, since the study found that most construction SMEs use their personal savings in establishing their construction firms, which in some cases are inadequate to finance the start-up of the firm, it is recommended that government and other stakeholders should keep developing innovative ways of meeting the problem of inadequate sources of funds for SMEs start-ups.

LIMITATIONS OF THE RESEARCH AND FUTURE RESEARCH

One limitation of this paper is that it uses a relatively literature reviews of CSMEs. It is recommended that future studies should improve upon the literature and use a combination of qualitative and quantitative approach to provide more evidence to support the findings of this study. Future studies could attempt to measure the extent of the accessibility in obtaining credit by CSMEs in South Africa.

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