INVESTIGATING CHALLENGES AND BARRIERS FACING CONSTRUCTION OF SMALL, MEDIUM-SIZED ENTERPRISES IN CREDIT ACCESSIBILITY IN THE SOUTH AFRICAN CONSTRUCTION INDUSTRY

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Abstract

This study sought to investigate the challenges and the barriers facing Small and Medium –Sized Enterprises in South Africa construction industry in their quest to access credit from financial institutions for their business purposes. This study utilizes a combination of primary data emanating from structure survey questionnaires supplemented by secondary source of data from an extensive literature review, in order to present insightful commentary about credit accessibility with Construction SMEs in South Africa. The study was a cross-sectional survey that used semi-structured questionnaire to collect data from the sample. 50 questionnaires were distributed to Construction Company in Gauteng Province in in Johannesburg through a convenience sampling technique. The key barriers were identified include informational barriers, lack of managerial ability within construction SMEs. Limitation of the study have been note and recommendations for developing innovative approaches to making credit accessibility to construction SMEs in South African been discussed. The study contributes to the body of knowledge in the area of financing construction firm in developing countries in general, and in South Africa in particular.

Keywords: Credit Accessibility, Challenges, Construction SMEs, South Africa.

1. Introduction

This study reports on an in-depth study into demand and supply side issues relating to access to finance by construction firms in South Africa. There is evidence that some construction firms face difficulties in accessing bank finance from lenders National Strategy for Sustainable Development (NSSD, 2011). Finance is the set of activities dealing with the management of funds. More specifically, it involves the decision of collection and use of funds. Construction project finance is a unique funding and collections service that is specifically designed to support those in the construction industry offering informed funding and services specific to construction business needs. Access to finance includes issues such as the availability of financial services in the form of deposits, finance, payments, or insurance to individuals or firms. The availability of such services can be constrained for instance by physical access, affordability or eligibility.

Construction industry contributes significantly in terms of scale and share in the development process of South Africa. The construction industry provides the necessary public and private infrastructure for many industrious actions and services. The industry is not only important for its ended product, but it also employs a large number of groups (directly and indirectly) and therefore has an effect on the cost-cutting measure of a nation or state during the real construction process (ILO, 2001). It also contributes to the national socio-economic development by providing significant employment opportunities at non-skilled and skilled levels Beyond that, it provides the infrastructure and services that required for other sectors of the country to grow such as; schools for education and training, factories and shops for commercial etc. In a typical modern society, around half of all physical assets are created by the construction industry generating about 5- 10% of national wealth. (Ahadzie, 2010).

Small and Medium Enterprise (SMEs) have been noted to be the engine through which the growth objectives of developing countries can be achieved and are potential sources of income in many developing countries (Kayanula and Quartey, 2000). Over the years, SMEs have been supported through a number of means, from government assistance, financial institutions assistance, donor agencies, plough back profits, to family support and franchising arrangement, among others (Abor and Biekpe, 2006). One of the major forms of finance for SMEs is through the financial assistance (FA) from banks in the form of loans, etc. However, access to financial assistance from financial institution (FI's) has become a challenge to most SMEs in many developed and developing economies including South Africa. Most SMEs appear to be challenged in financing their business operations (Abor and Biekpe, 2006).

Though some studies have been conducted in the past in the area of financing SMEs in general (e.g. Abor and Biekpe, 2006; Biekpe, 2004; Kayanula and Quartey 2000), very little empirical evidence exists on the phenomenon in the developing countries in general and in the construction industry in particular. This study is an attempt to contribute to the literature on the critical challenges and barriers faced by SMEs in the construction industry in South Africa in accessing credit from financial institution's. The study will contribute to the understanding of the unique factors that pose a challenge to construction SMEs in accessing financial facilities from financial institutions in South Africa. This could provide useful avenues to the SMEs to develop strategies to overcome such challenges. It could also help financial institutions to understand the challenges and potential barriers impeding access to credit by SMEs and how new strategies could be developed to improve upon their financial assistance to construction SMEs.

1.2 Problem Statement

Despite the role of SMEs in the South Africa economy, the financial constraints they face in their operations are daunting and this has had a negative impact on their development and also limited their potential to drive the national economy as expected. This is worrying for a developing economy without the requisite infrastructure and technology to attract big businesses in large numbers. Most SMEs in the country lack the capacity in terms of qualified personnel to manage their activities. As a result, they are unable to publish the same quality of financial information as those big firms and as such are not able to provide audited financial statement, which is one of the essential requirements in accessing credit from the financial institution. This is buttressed by the statement that privately held firms do not publish the same quantity or quality of financial information that publicly held firms are required to produce. As a result, information on their financial condition, earnings, and earnings prospect may be incomplete or inaccurate. Faced with this type of uncertainty, a lender may deny credit, sometimes to the firms that are credit worthy but unable to report their results (Coleman, 2000).

Another issue has to do with the inadequate capital base of most SMEs in the country to meet the collateral requirement by the banks before credit is given out. In the situation where some SMEs are able to provide collateral, they often end up being inadequate for the amount they needed to embark on their projects as SMEs assets- backed collateral are usually rated at ‘carcass value’ to ensure that the loan is realistically covered in the case of default due to the uncertainty surrounding the survival and growth of SMEs (Binks et al., 1992). These are some of the factors already acknowledged by some researchers as blocking most SMEs in accessing credit from the financial institution in the country. But are these really the case in South Africa? SMEs in South Africa do not also have the luxury of picking a financing scheme that will be appropriate for their businesses. The major type of financing open to them is debt financing from the financial institutions, which most often comes with a long list of requirements that most SMEs find them difficult to meet. The other type that is Asset financing, aside the long list of criteria also requires operators of SMEs to provide 50% of the funds and the financing institution providing the other half to fund the purchases of the assets. This type of financing does not allow for growth of the SMEs sector since they are all short term in nature

To highlight the specific challenges inhibiting SMEs in accessing credit in South Africa with a view to proposing some recommendation to help mitigate these challenges.

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.

1.4 Motivation of the study

Studying why construction SMEs in South Africa have difficulty in accessing credit or funding from financial institutions from the perspective of the operators of these SMEs is crucial since it would present the problem from the perspective of the SMEs thereby making it a base line study for policy interventions by state agencies, development partners and non-governmental organisation with missions to develop the construction SME sector.

2. Literature Review

2.1 Introduction

This chapter on literature reviews discuss various theories that underpin source of credit and the challenges and barriers facing construction SMEs in accessing credit facilities. Specifically, sources of credit theory. This is followed by conceptual framework, empirical review of literature related to the topic under the study and critique of the literature.

2.2 Definition and Nature of Small and Medium- Sized Enterprises (SMEs)

The acronym SME stands for Small and Medium- Sized Enterprises. In most countries this has been extended to be SMME which stands for Small, Medium and Micro Enterprise. According to Berry *et.al.* (2002) 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 enterprises can vary from one country to the other. However, the definition used for this paper 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.

According to Megginson and Megginson (2006) explore the definition of SMEs and the distinction between small and medium enterprises further. They state that to meet the criteria of a small contractor the businesses usually have the manager as the owner of the business, the capital and ownership is usually held by an individual or a few individuals, the business mainly operates in its local area and the business is small in terms of number of employees as we all turnover as already discussed above. This definition is included in the National Small Business Act's definition, which prescribes that the business should be managed by the owner or owners to be considered an SME.

2.2 Global Definition of SMEs

It is important to compare the definition of SMEs in South Africa to the SMEs in the rest of the world. This is to ensure that South African standards and definitions are at par with the first world nations. It is common practice to define small and medium sized enterprises in terms of the number of employees and their turnover. According to Constrinnonet (2004) European Union defined SMEs according to turnover, degree of independence and the number of employees. The turnover for SMEs is not exceeding one hundred Euros (€ 100 million). It defines SMEs as having between zero (0) and two hundred and fifty (250) permanent employees.

2.3 Small and Medium- Sized Enterprises in the Construction Industry

Construction business encompasses a number of small and medium sized contractors which form a major part of the industry (Benjaoran, 2009). The need to develop Small and Medium Construction Enterprises has to be related back to the South African government's important policy of providing infrastructure in underdeveloped areas in order to improve the standard of living. According to the Department of Public Works (DPW, 1999) the development of SMEs is directly linked to the department's policy on job creation, innovation and long-term growth. Miles (1997), Gounden (1997) as well as Van Wyk (2003) support this statement by adding on to express that small and medium sized construction enterprises are vital for the economic growth of South Africa. Governments and policy makers have become aware of the social and economic benefits of SMEs.

Although there was a boom experienced in the construction industry during the preparations for the World Cup 2010 as well as a result of government's considerable infrastructural spending, unfortunately, the growth has not filtered down to the construction SMEs. This statement is supported by Venter *et.al* (2010) stating that a survey carried out in South Africa indicated that seventy to eighty percent (70 – 80%) of small and medium sized contractors fail within the first five years. The major reasons for SMEs failing is due to the lack of managerial development and more specifically, lack of long-term planning, strategic thinking and limited resources (Benjaoran, 2009).

Small and medium construction enterprises have unique characteristics that influence the manner in which they are structured and organised as well as the management of SMEs. This chapter explores the structure and operation of SMEs and highlights their importance both globally and locally. The chapter concludes by providing the importance of professional project management development and how this can be used and thus improve the development of SMEs. The SMEs improvement in infrastructure delivery is discussed in terms of managing time, cost and quality during the various phases of project management in the construction industry.

2.4 Global perspective on SMEs

It has been globally recognised that small and medium enterprises are important mechanisms for job creation, innovation and long- term growth and the development of economies as a whole (Storey, 2000). This statement is supported by Organization for Economic Co-operation and Development (OECD, 2000), which expresses that small and medium- sized enterprises play a major role in the economic growth of OECD member countries. This comprises of United States of America, France, United Kingdom, Australia, Canada, Turkey and Germany. OECD (2000) also states that ninety-five percent (95%) of overall businesses in these regions are classified under SMEs and they account for sixty percent (60%) to seventy percent (70%) of employment in most countries. The downsizing and outsourcing of larger enterprises gives rise to small and medium enterprises.

According to OECD (1996) the reasons for the significance of small and medium sized firms in any given country is that SME form a large portion of the businesses throughout and thus have a large impact on employment creation and creating work opportunities. They play an important socio-economic role in that they are the entry point into the business world and thus are more accessible to unskilled populations SMEs had a multiplying positive effect on the economy as a whole and as a result provide economic stability and improve the standard of living throughout the demographics of any country.

2.5 The role of SMEs in the South African construction industry

SME’s account for over ninety-five percent (95.3%) of all enterprises in South Africa, it is for this reason that the South African government has identified the importance of development of small and medium sized enterprises. The country’s White Paper on National Strategy for Development and Promotion of Small Businesses by the Department of Trade and Industry, has stated that SMEs are an important vehicle to address the challenges of job creation in the country (Department of Trade and Industry, 1995). This has led to the National Small Business Act of 1996 to address the challenges of unemployment and poverty in South Africa. The Small Enterprise Development Agency (SEDA) was set up from the National Small Business Act in December 2004 with the aim to promote small businesses within South Africa. In 2000 Ntsika and Statistics SA estimated that SMME’s accounted for about sixty-six percent (66%) of total employment in South Africa and those SMEs contributed over thirtyfour percent (34%) to the South African total GDP (Berry *et.al*, 2002).

South Africa still faces a challenge of a large number of low-skilled workers and so identifying the development of SMEs as an opportunity for South Africa to emerge from poverty. Small, medium and micro enterprises (SMME's) account for over 50% of employment and Gross Domestic Product (GDP) in South Africa (Van Wyk, 2003). In conclusion the small and medium enterprise sector has been identified and targeted as a means to stimulate economic growth.

2.6 Challenges and Barriers faced by Construction SMEs in Accessing Credit

The challenges that Small and Medium Construction Firms encounter when trying to access financing 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 SMEs side. Banks may avoid providing financing to certain types of SMEs, in particular, start-ups 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. There are many challenges to construction development and growth. These include policies regulations, inadequate financial infrastructure, firm regulations, trade regulations, tax regulations, changing government policies, tax rates, corruption, labour regulations, cost of capital, and keen competition for limited opportunities (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 finance, 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 SMEs lending by the financial institutions. The lack of collateral, lack of proper financial management, lack of financial institutions incentives for SMEs, strict prudential regulations which restrict flexibility of FI's, 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 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 finance. Even though SMEs tend to attract motivated managers, they can hardly compete with larger firms.

2.7 Sources of credit for construction small and medium enterprises.

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 its own benefits and costs. There are many known method (forms) of finance to finance a new venture include: Equity Financing method includes promoter's funds, 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, e.g. 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 convince 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 the only 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.

2.8. Equity financing

Due to moral hazard and problems with information opacity typically being more severe during the initial stages of SME development, internal equity financing, as best represented by owner–manager personal savings, is a critical source of funding for SMEs in these early stages (seed financing and start up). Subsequently, in later stages, in order to develop and grow SMEs tend to reduce their dependence on these sources and start seeking alternative channels for raising capital. Internally generated profits and venture capital exemplify just two of the other equity options SMEs seek to expand as they grow.

In general, "…equity capital is that capital invested in the firm without a specific repayment date, where the supplier of the equity capital is effectively investing in the business" (Ou &Haynes, 2006, p. 156). Equity capital can be raised either internally or externally. Internal equity is funds obtained from the current owner–manager(s), family, and friends or from the retained earnings within the firm. External equity, however, is capital acquired from external channels other than the existing partners and their relatives.As mentioned above, equity financing is preferred over debt as a mode of financing for new and young SMEs as they undergo a typical cash shortage and are generally unable to secure loans with collateral during the founding phase. The advantages of equity financing in this regard are twofold (Ou & Haynes, 2006). First, unlike debt, equity offers long-term financing with minimum cash outflow in the form of interest. Second, equity capital helps enhance the new/young firm's creditability by indicating that the firm has the approval of sophisticated financial professionals.

Ou and Haynes (2006) determined two situations when SMEs pursue financing from equity capital sources in order to meet expansion needs. The first case is when SMEs face financial distress coupled with a lack of alternative sources of finance. The second case is when cash outflows exceed the cash inflows generated from regular sources. Ou and Haynes (2006) attributed this attitude adapted by SMEs in these two particular cases to the reluctance of regular lenders to lend to the firm because of uncertainty about the firm's future growth opportunities. As a result, these firms are usually classified as high risk. Inconsistent with this, in their investigation of the determinants of financing mode chosen by young innovative SMEs in Germany, Schafer, Werwatz and Zimmermann (2004) found that risky SMEs are more likely to receive equity financing.

Other arguments suggest that some SMEs owner–managers may choose not to use equity as a source of financing in order to avoid any undesirable changes in the ownership of their firm (Reid, 1996). Other entrepreneurs, nevertheless, may choose to source funding from external equity in order to share the risk with less risk-averse investors. However, the valid judgement of the importance of the external equity for SMEs should be based on the eventual success of firms that receives it, not on the quantity that the firm utilises (Berger & Udell, 1998).

2.8.1 Venture capital

Venture capitalists are financial intermediaries. Venture capital is that form of financing in which funds are raised from investors and redeployed by investing in high-risk firms which for the most part are young or start-up firms (Potter & Porto, 2007). Further, venture capitalists decide the timing and type of investment in addition to their role in monitoring, screening and contracting (Gorman & Sahlman, 1989).

Moreover, by performing these functions, venture capitalists virtually participate in strategic planning and decision making in the firm. The venture capital market includes a variety of organisations, including public corporations, small business investment corporations and private limited partnerships.

Compared to other more conventional financing sources, venture capital displays some particular characteristics. To start with, investments employing venture capital often involve high levels of asymmetry information and uncertainty as well as higher intangible assets (Gompers, 1995). In addition, Hellmann (1998) explained that the situation in which a company has a sufficiently large incentive for active monitoring takes place only when the venture capitalist has a concentrated stake invested in that company. He added, monitoring in such cases may include spending more time in the company and regular meetings with the managers. Finally, venture capitalists can provide the firm with strategic access to new suppliers and clients as well as strategic partners (Bygrave & Timmons, 1992).

As discussed, venture capital investment is uniformly associated with high risk and uncertainty. For example, when providing external finance to firms, venture capitalists encounter a significant adverse selection problem and moral hazard (Smolarski & Kut, 2011). Another problem that may arise is the agency problem (Berger & Udell, 1998). This occurs in the relationship between the venture capitalist and the entrepreneur when the latter lacks sufficient information or skills to make optimal production decisions. This problem might also be combined as information about the project is imperfect and revealed over time (Bergemann & Hege, 1998). In order to alleviate these problems and reduce uncertainty, particular mechanisms can be implemented. In this context, Gompers (1995) emphasised three control strategies. These strategies are: (i) the use of convertible securities, (ii) the syndication of investment, and (iii) the staging of capital infusions. According to Cumming (2006), most venture capital transactions include convertible securities. Bascha and Walz (2001) asserted that unlike traditional debt and/or equity instruments, convertible securities have the ability to mitigate the agency problem effects by leaving the owner–manager with some control during the investment period. In addition, as the price of conversion is a function of performance, the venture capitalist has a better chance to recover the investment if the venture is not successful. Other studies show other motivations for employing convertible debt, with examples including reducing the risk-shifting incentives of the entrepreneur (Green, 1984), resolving problems arising with debt financing and gaining indirect equity financing when issuing traditional equity is unattractive (Stien, 1992).

Syndication is a common form of venture capital risk alleviation and refers to two or more venture capitalists sharing in a single financing round. The syndication mechanism is used in order to decrease problems associated with adverse selection through the participation of a co-investor sharing the investment risk (Smolarski & Kut, 2011). A study by Cumming (2006) reached a broadly similar conclusion stating that venture capital syndication significantly mitigates adverse selection problems. Additionally, Lerner (1994) suggested that adverse selection problem can be efficiently mitigated in the presence of high information asymmetry in venture capital financing by implementing the syndication strategy. It was also found that syndication reduces the entrepreneur's opportunistic behaviour (Wright & Lockett, 2003).

Another main characteristic of venture capital is staged financing. As the term suggests, venture capital staging refers to that mode of financing in which venture capitalists invest in stages in order to maintain the project under control (Organization for Economic Co-operation and Development (OECD), 2004). Gompers (1995) provided evidence indicating that staged investment enables venture capitalist to gather more information allowing him/her to monitor the firm prior to refinancing decisions to be made. As such, the venture capitalist has the option of abandoning the project if and when any unattractive information regarding the investment emerges. Wang and Zhou's (2004) results showed that the staging financing plays a crucial role in controlling moral hazard. Therefore, it is an effective mechanism in controlling agency problems.

Not only do venture capitalists provide an alternative source of funding for SMEs, they also help resolving many informational problems plaguing SMEs. Hence, by helping increasing the financial flexibility of SMEs, they offer them the chance of sourcing finance from other financial channels, such as banks and insurance companies. However, the supply of venture capital appears to be relatively inflexible, at least in the short-term, as it requires years of experience to develop the necessary skills (Kortum & Lerner, 2000).

2.8.2 Business angels

Unlike other external sources of financing, business angel finance is not intermediated. It is instead an informal market for direct finance (Berger & Udell, 1998). Angels are highly-selective wealthy individuals with long business experience who invest directly in high growth SMEs with which they have had no previous relationship (Madill, Haines, & Riding, 2005). This form of investment is usually based on an equity contract, typically common stock. Though angels by definition are individuals, they sometimes coordinate their investment in small investment groups. According to Harrison and Mason (1992), there are three features that make angel financing an appropriate option for SMEs. First, angels are more active in the early stages of enterprises (seed and start-up) closing the so-called 'equity gap' by forming a 'bridge' between internal financing sources and outside investors. Second, by having lower rates of rejection and being a more patient form of capital with longer exit horizons, angel financiers tend to be more obliging to the needs of SME owner– managers. For example, German entrepreneurs have ranked business angels as the most desirable funding providers (Brettel, 2003). Finally, unlike venture capitalists, angel investors prefer to invest in their local economies where the majority of SMEs operate. Angel investors are a crucial source of financing for many SMEs, especially start-ups. According to Morrissette (2007), the amount of capital that angels provide is estimated to be eleven times that provided by venture capitalists. Data collected by Shane (2012) from different surveys conducted between 2001 and 2003 showed that between 140 000 and more than 260 000 angels injected investments between $12.7 and $36 billion into between 50 000 to 57 000 ventures each year. In Germany, for example, a study by Stedler and Peters (2003) estimated the total capital assets for each business angel in the country at €2.5million to €5 million distributed across a portfolio of between 1 and 5 firms, all start-ups. The extent to which angels are involved in the firms in which they invest is debatable. Barry (1994) claimed that angels are not active investors. Yet, other empirical research show opposing results (e.g. Harding & Cowling, 2006; Landström, 1993). In terms of benefits, Mason and Harrison (1996) questioned a sample of 20 dyads regarding the role played by business angels apart from their financial stake. The respondents reported that nonfinancial contributions made by angels included assistance with management functions, finance and accounting functions, strategic advice, financial advice, general administration, networking and marketing. Further, 50% of the entrepreneurs rated these angel contributions as either helpful or extremely helpful. Worldwide, and based on quantitative analysis, angel financing dominates venture capital financing in terms of both the number of firms utilizing it and the financial value of investment (Fairchild, 2011). However, as a source of financing, business angels have two main limitations (Wall, 2007). First, few angels are prepared to inject additional money into a firm to enable it to grow and be a real competitor in its market. Second, most angel investors do not have neither the skills nor the interest in investing in a firm after it has access to other external sources of finance, including public equity markets.

2.8.3 Debt financing

It is well known that capital structure decisions, in SMEs as in large firms, relate to the use of either equity or debt or both. However, Berger and Udell (1998) believe that in the case of SMEs, this is partly incorrect because information opacity is more severe in SMEs. Issuing additional equity to satisfy the firm's financial needs would then lead to a dilution in ownership and control. Therefore, in order to keep full ownership and control of their businesses, SMEs owner–managers may prefer to seek debt financing rather than external equity.Three significant differences between debt financing for SMEs and that of large firms have been identified in the literature (Wu et al., 2008). First, unlike managers of large firms who usually have the choice of broader range of debt financing resources, SMEs tend to be more attached to commercial lenders, especially institutional lenders, as a source of short-term debt financing that can be renewed for long-term debt. Second, as information asymmetry problems are more acute in SMEs than in large firms, long-term lending relationships are important for SMEs in order to deal with the resultant agency problems along with the other three conventional mechanisms; signalling, monitoring and bonding (the provision of guarantee or collateral). Third, in concentrated owner–managed SMEs, and contrary to what the agency theory suggests, it is not clear whether debt can lower the agency costs that result from information asymmetry arising due to different motives of owners and managers.

2.8.4 Trade credit

One of the most important sources of external financing for SMEs is trade credit. For instance, Berger and Udell (2006) estimated that one-third of the total debt of SMEs in the US in 1998 was represented by trade credit. According to García-Teruel & Martínez-Solano (2010), trade credit is a delay in the payment for goods or services after they have been delivered or provided as a result of an agreement between the supplier and the firm. Therefore, for the firm this is a source of financing appears in the balance sheet under current liabilities, whereas for the supplier it is an investment in accounts receivable. The rationale behind the widespread use of trade credit among SMEs has been argued in the literature. Ellihausen and Wolken (1993) attributed this attitude to both transaction motive and financing motive. The transaction motive suggests the better ability for both parties (the seller and the buyer) to predict their cash needs in the short-term. As such, cash management transaction costs can be economized. The financing motive is that SMEs resort to trade credit when alternative sources of finance are unavailable or more expensive. In addition, (Fatoki & Odeyemi, 2010) argued that trade credit financing is preferred by new and young SMEs when the risk of default is high during the early years of operations. Moreover, in relation to financial motives, firms with easier access to credit market can act as a financial intermediaries and offer funding for firms that face difficulties in accessing external financing (Demirgüç-Kunt & Maksimovic, 2001).

2.8.5 Non-bank financial institution debt

As finance institutions tend to differ from banks in their lending policies possibly in part because of regulatory differences (Berger & Udell, 1998) and following Ayyagari, Demirgüç-Kunt and Maksimovic (2010) who separate bank finance from other non-bank financial institutions funding, the focus in this section is on nonbank financial institutions as the role of banks will be discussed in the later section.

Non-bank debt offers a channel for SMEs to raise funding in both developing and developed nations. In Zimbabwe, for example, loans granted by non-bank financial institutions account for nearly 30 % of total debt, and were ranked second in order of importance by domestic SMEs (Aryeetey, 1998). A more recent study conducted by the Federation of Small Businesses found that 15,000 financial institutions in the US competed to lend to SMEs, of which half were nonbank lenders in the form of credit unions (Goff & Nasiripour, 2012). Still in the US, an earlier study by Denis and Mihov (2003) using a sample of 1,560 new debt issuers firms during 1995–96 showed that of the total amount of debt of $350 billion raised by the firms in the sample, nonbank debt was responsible for almost $40 billion.

Johnson (1997) explained that while banks prefer short-term debt (as their liabilities are also short term), non-bank financial institutions such as insurance companies are generally in favour of long-term loans as they have long-term liabilities. However, Johnson (1997) believes that non-bank financial institutions can act as a financial intermediate between banks and public debt.

In general, the main advantage that encourages SMEs to use more debt than other external sources of finance in their capital structure is the tax shield benefit. In addition, when seeking external funding, SME owner–managers tend to limit the use of equity in order to meet control aversion and maintain control of their firms (Hutchinson, 1995). However, Abor (2008) found that SMEs with many shareholders (group-owned SMEs) may choose to utilize low debt levels to avoid bankruptcy and the agency costs accompanied with debt financing.

2.8.6. Policy framework for Small and Medium Construction Firms financing in South Africa

The regulatory and policy environment provided by the state and the range of financial support services provided by public agencies and private organizations, are just one set of factors that determine the competitiveness of construction firms. As far as institutional support is concerned, SMEs can benefit from two types of support. First, there is the government's role in creating an enabling regulatory and policy environment for SMEs access to FA. On the other hand, there is direct support through private and public agencies that provide FA and technical services to SMEs. It is generally accepted that the government's most important task is to provide an enabling regulatory and policy framework. Such a framework should contain stable financial institutional and monetary policy settings with reasonable interest rates, a system of financial markets that provides incentives to save, and mechanisms to channel savings into investments.

The problem does not appear to be a lack of funds but rather how to make them accessible to SMEs. Available funds are often diverted to the larger firms and only an insignificant number of SMEs seem able to attract bank financing.

3. Research Methodology

A cross-sectional survey was conducted to examine the challenges and barriers construction SMEs faced in accessing credit facilities in South Africa. The populations included some construction SMEs and financial institution in two major municipality Gauteng in South Africa, namely, City of Johannesburg Metropolitan Municipality and City of Tshwane Metropolitan Municipality. Construction SMEs are scattered across the length and breadth of the Province with most of them located in Tshwane and Greater Johannesburg area of the Province. These Province were identified to have high concentration of construction SMEs. Most of the SMEs are located in these areas, so are the financial institutions. Most of the financial institutions are located in the Greater Johannesburg areas of South Africa having branches across the various Provinces in South Africa. Due to the concentrated nature of SMEs in Johannesburg and Tshwane, coupled with the accessibility and available of information for the study, a convenience sample size of 179 SMEs firms in these Municipality were chosen for the survey.

3.1 Research Instrument

In order to achieve the aim and objectives of the study, a semi-structured questionnaire was designed to gather information from the 50 SMEs in South Africa. Since this study was one of the preliminary studies, the questionnaires was designed with question items requiring respondents to mention as many challenges as possible so it consisted of structured open ended questions to explore what challenges exist with accessing financial assistance from the respondents' banks and other financial institution towards the operations of their business. Respondents' consent was sought first using an informed consent cover letter and they were assured of anonymity and confidentiality of their responses. The survey generated a response of 32 out of 50 questionnaire\ sent constituting 62% response rate for analysis.

Table 1: Background data on construction SMEs

Item	Category	Frequency	Percentage
Business type	Limited liability company(LLC)	25	73.20
	Partnership	9	20.01
	Sole partnership	3	5.32
Monthly Turnover	Less than R130,000	9	26.01
	R130,000- 150,000	7	23.58
	R150,000- 250,000	9	22.03
	R250,000- 300,000	5	18.52
	R300,000 above	3	9.69
Sources of credit	Bank loan	21	41.23
	Business loan	16	36.44
	Personal saving	15	29.65
	Retained profit	10	19.94
	Friends and family/relative	4	9.45
Sources of credit for start-up	Personal savings	15	44
	Friends and family	10	30
	Bank credit	8	21
Requirement for obtaining credit	Collateral	17	24.01
	Statement of assets liabilities	13	21
	Cash flow statement	15	21
	Binding building contract agreement	2	1.78
	Detailed business plan	10	13.56
Interest on credit borrowed	Less than 20%	7	22.45
	21-30%	15	56.11
	31-40%	8	27

Accessibility of credit	Yes	11	34.2
	No	21	62.3
Affordability of credit	Yes	8	30.99
	No	23	69.34

Business, about 41% of them used bank loans, 29.79% of them relied on personal savings, 19.15% used retained profit, and about 11% of them used funds obtained from family and friends. In terms of sources of finance for start-up of these construction firms, 45% of them relied on personal savings, 32% depended on funds from family and friends and 19% obtained funds from banks to start-up their business activities. In terms of the requirement for accessing loans from banks, about 26% of the SMEs indicated that the banks demanded some collateral security from them, 20% of them were required to provide a cash flow statement of their firms' operations to the bank, 24% of them were required to provide some fixed asset for accessing the loan, 15% of them were required to submit an audited financial statement, about 13% had to produce a business plan of their present business for which they were going for the loans, and about 1.43% of them were to submit award letter from their business partners to access the loans. In terms of the interest paid by SMEs to the financial institutions, about 21% of the firms paid less than 20% interest rate on loans, 54.17% of them paid between 21% and 30% and 25% of them paid between 31% and 40% as interest rate on loans to the financial institutions. In terms of the availability of loans, 38.7% of them indicated that loans are available to them, while 61.3% indicated that loans were not readily available to them. Moreover, in terms of affordability of the loans, to 32.26% of the firms, the loans were affordable, while to 67.74% of the firms the loans were not affordable to them.

4. Challenges and Barriers faced by SMEs

The results of the survey for the challenges and barriers SMEs face in accessing finance in South Africa are presented in Table 2.

Table 2: Challenges and Barriers to Credit Accessibility for Construction SMEs in South-Africa

Category	No	%
Challenges in obtaining credit accessibility		
Lack of collateral requirement	7	20.34
Poor Institutional capacity	11	31.05
Inadequate financial infrastructure	7	20.01
Barriers in obtaining credit accessibility		
Lengthy and vigorous procedure for credit application	17	49.11
Lack of management ability	2	8.84
Weak institutional capacity	13	37.45
Lack of appropriate education and Training	3	7.01
Ranking of credit rates		
Extremely too high	7	20.02

High	25	76.01
Moderate	3	7.11
Low	1	0.99

According to the table 29% of the construction firms indicated that the policy regulation for the financing of firms by financial institutions, was not favourable to their business operations. 19.3% of SMEs mentioned that inadequate financial infrastructure is another challenge they face when it comes to accessing credit facilities from financial institutions, in South Africa. Moreover, according to 29% of the firms, they face the challenges of weak institutional capacity while 9.9% of them indicated that key challenge is that they lack the collateral requirements demanded by financial institution as a condition for accessing financial assistance.

On the barriers to accessing finance from financial institutions in South Africa, according to the data in Table 2, 48% of the SMEs indicated that there is information barrier which implies communication gap between SMEs and financial institutions, when it comes to managing the financial support to these firms. According to 9.09% of the firms, lack of managerial skills is a barrier to their access of credit facilities from financials. 36% indicated that lack of institutional capacity is a barrier. Regarding the perception of lending rate of financial institution, 19.35% of the firms perceived it to be extremely high, 74.19% perceived it to be high while 6.45% perceived it to be moderate. Thus a larger percentage perceived the lending rate to be high even though (Ayogyam, *et al*, 2012) indicated that interest rate in South Africa is generally low, this is not the case in the construction sector.

5. Summary of Findings and Discussion

The study has important theoretical and managerial implications. Theoretically, the study provides preliminary evidence on the challenges faced by construction SMEs in accessing credit facilities from financial institutions in developing country contexts. This has not been lacking in the construction management literature in South Africa. Since the study found that most construction SMEs are limited liability companies, and that this could be attributable to low trust and huge financial outlay needed to form public companies, it is fund that government should partner with some of the construction SMEs in forming 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 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.

6. Conclusion and Recommendations

The study sought to investigate the challenges and barriers in accessing Credit facilities by SMEs in South Africa. The challenges revealed by the study includes: Inability of construction SMEs to provide collateral and other information needed by financial institutions such as audited financial statement couple with the high cost of Credit facilities 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 SMEs. Most of the schemes are perceived as difficult to access. The difficulties construction SMEs often face in accessing these funds include: lack of securable assets, lack of knowledge by finance providers about the nature of respondent's business, stringent eligibility criteria, lack of knowledge about lending criteria, difficulty in finding out about available finance, and bureaucracy. These really limit SMEs ability to access Credit facilities 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.

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