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Analysis of Determinants of Revolving Credit for Small and Medium Construction Enterprises: A Case of Gauteng Province.

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Abstract

Small and medium construction enterprises (SMEs) are an important vehicle to drive the economic growth globally. However, this enterprise sector has been constrained by different factors that stifle their full participation in the main stream economy specially credit accessibility. There is paucity of research to verify the determinants that predict revolving credit accessibility from financial institutions in South Africa. The data was obtained using questionnaire survey. 179 small and medium contractors responded from conveniently sampled respondents in Gauteng province in South Africa. The data was analysed using Statistical Package for the Social Sciences (SPSS) version 22. The study found that the dependant variable i.e. revolving credit was not predicted by the independent variables suggested i.e. gender, age group, current position, organization ownership, tax number, location and collateral. The finding informs bank managers they should not force clients to submit collateral before awarding credit to the SMEs. The suggested model that was tested attained the Hosmer and Lemeshow Test goodness of fit hence the results were credible. However, a further study is proposed for the entire country as the researchers acknowledge limitation on the chosen location of study.

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1. Introduction

The loan recovery rate among small businesses reveal a worrying trend as observed by the South African Trade and Industry minister Rob Davies in a May 2010 Parliamentary Question and Answer session. Studies by the South African Micro-Finance Apex Fund (SAMAF) and the National Empowerment Fund (NEF) attest to a similar trend where default rates of as high as 35% have been recorded [42].

Nomenclature

A	radius of
B	position of
C	further nomenclature continues down the page inside the text box

The management of revolving credit in SMEs is a primary concern for the policy makers, development finance institutions, banks, non-bank credit providers, managers and owners of those SMEs because it has a direct impact on the success, creditworthiness and growth of entrepreneurial ventures. Efficient debt management determines the cash flow and the success of the day-to-day operations of the business. Poor credit management leads to late payment to creditors and other stakeholders in the supply chain. Thus credit management needs to ensure ample monitoring of cash flow as well as collection strategies from debtors. Crucial to this practice are measures to assess with due caution the customer's ability to meet the business's credit payment terms. Consequently, a study that examines both measures of credit management and the determination of key factors that trigger these measures establishes the fundamentals for this research. This presentation is devoted to revolving credit management of small businesses. Prior to the 1950s, small businesses were known as small-scale industries and in the 1980s they were termed small and medium enterprises (SMEs), while currently they are referred to as small, micro and medium enterprises (SMMEs)[1]. In this study the terms "small business", "SME" and "SMME" are used interchangeably. In South Africa, the post-apartheid government is faced with a litany of social problems, primarily unemployment and abject poverty. The government of South Africa has tried several ways to address these problems but a lot more still needs to be done. The Reconstruction and Development Programme (RDP) initiated in 1994, the Growth, Employment and Redistribution (GEAR) strategy of 1996, the Small Business Development policy of 1996, the Financial Services Charter (FSC) of 2007 and the Accelerated and Shared Growth Initiative for South Africa (AsgiSA) of 2007 are some of the strategies designed and implemented by the post-apartheid government. Despite all these attempts, the unemployment rate of approximately 25 per cent[41] is still unacceptably high, resulting in the proportion of people living below the poverty datum line being about 50 per cent (MDG, 2010).

Research and statistics have shown that the failure rate of small businesses in South Africa is very high. According to the Global Entrepreneurship Monitor (GEM)[16], South Africa's established business rate, meaning those that have survived for at least three-and-a-half years, stands at a low 2.1 per cent compared to countries such as Angola at 8.6 per cent, Zambia 9.6 per cent, China 13.6 per cent, Brazil 15.3 per cent, Uganda 27.7 per cent and Ghana 35.5 per cent. South Africa's low survival percentage is an indication of the high failure rate among start-up businesses. According to[30]and[30], it has been observed that despite all the initiatives implemented, both by the government and the private sector, small businesses continue to fail. The vast majority of SMMEs fail during their first two years of take-off as a result of insufficient working capital, owners' lack of financial and operation management capabilities, and mother factors (ibid). This observation is also noted by [22] and [22], [30] and [30],[30]and[24]. This study was therefore motivated by the high default rates among small businesses in general. Many studies single out lack of access to finance, mostly from banks, as the biggest contributing factor to the high failure rate of small businesses worldwide[31]&[31]; [31]; and[30]&[31].

1.1 Problem Statement

From as early as the 1960s, there have been a large number of studies aimed at assessing the application of revolving credit models to corporation data with a view to predicting business failure and credit default [2]. This issue has become increasingly important in recent years, in the mist of the current economic crisis popularly referred to as the credit crunch. Continuous default by borrowers affects the economic growth of the country and is therefore a major concern for the government and the financial institutions. As a result, these —revolving credit are depleting in nominal as well as real terms, even without counting the substantial costs to the Government of operating them, with a negligible outreach. Another study by[5] Stated that lack of credit is the most critical reason for the lack of growth affecting construction SMEs in their operation. This study analysed revolving credit advancements to construction SMEs by a (South African bank)

This study's main aim was to analyse the determinants of revolving credit among the construction enterprises relationship and the significance level of factors predicting revolving credit by SMEs in Gauteng Province in South Africa. Based on this discussion this study is guided by two specific research questions and objectives: viz;

- What factors prevent construction SMEs from accessing revolving credit from financial institutions? And
- What are the socio-economic and demographic predictors of revolving credit accessibility from financial institutions?

Therefore, the objectives of the study are:

- To determine the factors that prevent construction SMEs from accessing revolving credit; and
- To determine the socio-economic and demographic determinants predicting revolving credit accessibility from financial institutions.

2 Literature Review

2.1 Small, Micro and Medium Enterprises (SMMES) In South Africa

Although the concept of SME is widely used globally, defining SMEs and their size criteria can be controversial as different countries use different definitions and guidelines for small businesses. Annual turnover, assets and number of people employed are the main criteria commonly used both in developing and developed countries. The World Bank defines small businesses in three categories, namely micro-scale (less than 50 employees), small-scale (50 employees) and medium scale (50-200 employees) (Hauser, 2005). The European Union defines SMEs as "firms with 10 to 250 employees, with less than Euro50 million in turnover or less than Euro43 million in balance sheet total". This definition is currently used by approximately 27 countries [5]. In South Africa, the small business is defined in the National Small Business Act as amended [3] as a "separate and distinct business entity, including co-operative enterprises and nongovernmental organisations, managed by one owner or more which, including its branches or subsidiaries, if any, is predominantly carried on in any sector or sub-sector of the economy mentioned in column I of the Schedule and which can be classified as a micro-, a very small, a small or a medium enterprise". In contrast, South African banks do not use the number of employees when defining SMEs. As is the case in Brazil, they use annual turnover. The big four South African banks, namely Absa, Standard Bank, FNB and Nedbank, use annual turnover to define small businesses as shown in Table 2.1.

Table 2.1: Definition of SMEs by South African Banks

Banks	Turnover (SMEs)
Absa	R10 million
Fnb	R10 million
Standard Bank	R10 million
Nedbank	R7.5million

Source: Absa, 2015; Standard Bank, 2015; FNB, 2015; Nedbank, 2015.

There is a growing body of literature attesting that the success or failure of small businesses is dependent on managerial competencies. It is widely accepted that lack of appropriate management skills is the primary cause for small business failure ([10]&[4];[25],[23];[26]&[26]; [22]&[22];[37]&[37].[19],[18], [19],[13 and[15] discussed managerial capabilities as personal effectiveness demonstrated by different skills, attitude, behaviour and understanding. A research study by[40]and[40] and [3] endorsed managerial competencies, measured by experience, training and knowledge of the industry, as having a positive impact on the performance of new SMEs in South Africa.[20]suggested that the reason for the high failure rate of SMMES in South Africa is a result of lack of education and training.[33] and [33] scrutinised the implication of management competence on SMME performance and their findings indicated lack of managerial skills, poor economic conditions, resource starvation and poorly thought-out business plans, among other things, as crucial to SME success. The distinctive feature of growth and failure is equated to education, training and experience of owners or managers (ibid).[27] reasoned that four functional areas of business management, namely finance, operation, general management and marketing, have an impact on small business growth. Adding to this, the size and start-up conditions of a small enterprise may play a big role. This implies that the enterprise-level barriers should be considered when analysing constraints to SME success and economic development. In the opinion of[17], the key limiting factor of small businesses is the control exerted by the owner and business independence. Small business owners struggle to separate business finances from personal finances. This independence and control eventually leaves the owner misusing the finance of the business and in the process crippling the business by starving it of resources. From such an insight, one can understand why small business owners end up failing to employ skilled, experienced and educated personnel to lead the organisation into the phase of growth and

sustainability.

Other studies, however, challenged the view that entrepreneurial competence and access to funding are barriers to small business growth. Some researchers have a different school of thought regarding the success of SMEs, for example [35] rejected the idea that entrepreneurial competence is equated to the growth of SMEs. The behaviour or characteristics of the founder have nothing to do with the success of the venture. The business concept and the capacity to accumulate capital are factors said to be of value in starting up a business. When buying and starting a business, hospitable environment, unsaturated markets, an understanding of economics and cash flow dynamics of the given industry together with understanding customer preferences are key to the success of the business. According to [4], “71 per cent of respondents in the research sample did not perceive that accessing finance was a barrier to small business survival or growth”. These findings are consistent with current research [21] and [21] showing that “less than 1 per cent of respondents reported that access to finance was or could become a strategic issue”. [8] and [8] also noted that finance is not a major barrier to SME development in the United Kingdom. Such studies, however, need to be treated with caution, as they may not apply to developing countries of Asia and Africa, specifically sub-Saharan Africa where this study is centred.

2.2 Obstacles Facing SMEs in South Africa

Having discussed common obstacles faced by small businesses in general, the focus of this study was primarily on the South African small business environment. According to [29] and [10], “In South Africa, a disappointingly high number of SMMEs fail during the first few years of operation”. This failure rate is blamed on a number of factors as discussed by different authors. According to [15], [15], 75 per cent of applications for bank credit by new SMEs in South Africa are rejected which puts the survival and growth of these businesses in jeopardy. This claim was confirmed by [18] and [18] who indicated that most entrepreneurs, most importantly small businesses, struggle with accessing finances from banks due to extreme red tape and administrative load. They argued that banks hardly ever finance start-up businesses owing to the fact that they are bureaucratic and lack understanding of the owners or operators of SMMEs (entrepreneurs). In addition, banks are not willing to assist or are distrustful in providing finance to people who do not have any business history. [14] made it clear that lack of access to finance can be a limitation on SME growth. [13] found that only two per cent of new SMMEs in South Africa are able to access bank loans and that this lack of access to bank finance is one of the major challenges that South African SMMEs face. [20] concluded that access to finance is the major problem for South African SMMEs. According to [12] and [12], lack of access to finance in South Africa is the second most reported contributor to low firm creation and failure, after education and training. However, failure of SMEs cannot be limited to lack of credit. [30] and [30] pointed out that the largest percentage of SMEs fail during the first two years of their existence due to cash flow problems. Cash flow problems can ensue as a result of lack of access to bank finance or lack of financial management knowledge. The same authors further endorsed the belief that SME owners must themselves be able to interpret and understand financial statements. In addition to this, most owners and operators of SMEs are financially illiterate, which leads to mismanagement of business finances causing most enterprises to fail (ibid). [11] asserted that lack of education and training has reduced management capacity in new firms. Lack of education and skills can as well mean, or lead to lack of, financial management knowledge. In support of this notion, [12] and [12] argued that lack of knowledge and training are some of the reasons for the low level of entrepreneurial creation and the high failure rate of small businesses in South Africa.

3 Research Methodology

A structured questionnaire survey was used to collect data. [7] describes a survey as a quantitative or numeric description of some fraction of the population – the sample. Which enables researchers to generalize their findings from a sample of respondents to a population within the limitations of the sampling method. Convenience sampling was used which consisted of contractors registered with the CIDB. A total of 179 SMEs completed the questionnaire survey. Content validity was conducted on the questionnaire using pilot study administered to 30 construction SMEs. SPSS version 22 was used to perform the binary logistic regression analysis. A binary logistic regression model with a dichotomous dependent variable of Yes or No was modelled. Yes, response was defined as having accessed full credit and No accessed part of the credit. The dependent variable was coded as 1 and 0, for “Yes” and “No” respectively. The independent variables of the logistic regression model were also coded. They were the demographic and socio-economic characteristics of the SMEs: gender if male 1 and female 2; age group, 30 years and below 1, 31 years to 39 years 2, 40 years to 49 years 3 and 50 years and above 4; current position, director 1, owner 2, manager 3 and manager/owner 4; ownership, sole proprietorship 1, partnership 2, limited partnership 3, limited Liability company 4, corporation (for-profit) 5; tax number No, 0 and Yes, 1; location of business, city of Johannesburg Metropolitan Municipality 1, city of Tshwane Metropolitan Municipality 2, Ekurhuleni Metropolitan Municipality 4, West Rand District Municipality 4; collateral No, 0 and Yes, 1. Logistic regression is recommended over linear regression when modeling dichotomous responses and allows the researcher to estimate probabilities of the response occurring (Hosmer and Lemeshow, 2004). The logistic regression equation takes the following form

$$\ln(p/1-p) = \beta_0 + \beta_1x_1 + \beta_2x_2 + \dots + \beta_kx_k \dots \dots \dots (1.1)$$

Where p is the estimated probability of passing, and x_1, x_2, \dots, x_k are independent variables. The estimated probability of the response occurring or passing (p) divided by the probability of it not occurring or not passing ($1-p$) is called the odds ratio. Maximum likelihood method is used to estimate the odds ratios of the model. Values of odds ratios higher than 1 indicate positive association between the variables, odds ratios equal to 1 indicate no association, while odds ratios lower than 1 indicate negative association between each independent variable and the dependent variable of the model. Furthermore, in order for an independent variable to be a predictor of the dependent variable the p -value should be less than 0.05 at 95% confidence, which connotes its significance in the model. In achieving a fitting model, the Hosmer-Lemeshow goodness of fit test should be significant i.e. the value should be greater than 0.05 (Pallant, 2013). The factors preventing SMEs from accessing revolving credit were measured using Likert scale of 1 to 5. 1= Strongly disagree (SD), 2= Disagree (D), 3= Neutral (N), 4 = Agree (A), 5= Strongly agree (SA). The Likert-scale questions are discussed based on their mean score in the interval scale. The difference between the upper and lower ends of the used scale is 4.0 since there are five points. Each range can be equated to 0.80 because the extent of the range is determined by a division between 4.0 and 5.0 (4/5). However, in the current study the intervals are as stated: $> 4.21 \leq 5.00$ Strongly agree; $> 3.41 \leq 4.20$ Agree; $> 2.61 \leq 3.40$ Neutral; $> 1.81 \leq 2.60$ Disagree; $> 1.00 \leq 1.80$ Strongly disagree.

Findings and Discussion

Table 4.1 indicates that male respondents were the majority than female respondents, at 63% to 37% respectively. Majority i.e. 51% of the respondents were in the age group between 40-49 years old. Furthermore, 82% of the respondents were owners of the organizations surveyed. Majority i.e. 72% of the respondents had business experience of between 6 to 10 years. 98% of the SMEs are sole. Furthermore, majority i.e. 41% of the SMEs were located in the city of Johannesburg metropolitan

Table 4.1: Profile of respondents and organization

<i>Gender</i>	<i>Frequency</i>	<i>Percentage</i>
Male	112	63%
Female	67	37%
<i>Age group</i>	<i>Frequency</i>	<i>Percentage</i>
30 years and below	2	1%
31-39 years	49	27%
40-49 years	92	51%
50 years and above	36	20%
<i>Current position</i>	<i>Frequency</i>	<i>Percentage</i>
Director	29	16%
Owner	146	82%
Manager	3	2%
Manager/owner	1	1%
<i>Experience of respondent</i>	<i>Frequency</i>	<i>Percentage</i>
1-5 years	15	8%
6-10 years	130	72%
11-15 years	33	18%
16-20 years	1	1%
<i>Ownership</i>	<i>Frequency</i>	<i>Percentage</i>
Sole proprietorship	175	98%
Partnership	2	1%
Limited partnership	1	1%
Limited liability company (LLC)	1	1%
<i>Location of company</i>	<i>Frequency</i>	<i>Percentage</i>
City of Johannesburg metropolitan	74	41%
City of Tshwane metropolitan	42	24%
Ekurhuleni metropolitan	34	19%
West Rand district municipality	29	16%

Source: Researcher

Table 4.3 indicates that the SMEs respondents strongly agreed that lack of collateral, lack of cashflow statement and owners equity were hindering SMEs from accessing credit from financial institutions. The means were in the band of 4.21 to 5.00. The sector of the business, lengthy and vigorous procedure for credit application, high interest rates, location of the business were in the band of 3.61 to 4.20 suggesting that the respondents agreed that they contributed to their difficulty of obtaining credit. Furthermore, the SMEs respondents disagreed that lack of appropriate education and training, and lack of managerial ability were hindering them from accessing credit. These two constraints were in the band of 1.81 to 2.60.

Table 4.3: Constraints in revolving credit

<i>Constraints of revolving credit accessibility</i>	<i>Mean</i>	<i>Stdev.</i>	<i>Rank</i>
Lack of collateral	4.69	0.58	1
Lack of cash flow statement	4.51	0.98	2
Owner's equity	4.39	1.01	3
Sector of the business	4.14	1.21	4
Lengthy & Vigorous procedure for credit application	4.13	1.37	5
High Interest rates	3.81	1.51	6
Location of the business	3.76	1.27	7
Lack of good reference on integrity	3.03	1.66	8
Lack of awareness of existing credit schemes	2.97	1.71	9
A general lack of experience and exposure on construction project	2.75	1.73	10
Lack of information on the cost obtaining such service	2.72	1.74	11
Lack of appropriate education & Training	2.21	1.68	12
Lack of managerial ability	2.09	1.59	13

Source: Researcher

The result in Table 4.4 suggest that of the 179 respondents one respondent did not get credit at all. Therefore, 21.91% i.e. 39 of the respondents received part of the revolving credit they applied for and 78.09% i.e. 139 of the respondents obtained the full revolving credit. It can be indicated that some of the SMEs did not receive the full revolving credit they applied from the financial institutions. This is imperative to this study as there is lack of studies that have determined the predictors that influence full revolving credit accessibility and partial revolving credit accessibility globally.

Table 4.4: Full or partial revolving credit accessed

Revolving Credit accessed	Respondents	Percentage
Accessed partial revolving credit	39	21.91%
Accessed full revolving credit	139	78.09%
Total	178	100.00%

Source: Researcher

The results in Table 4.5 indicates that of the seven demographic and socio-economic independent variables modelled to predict full credit accessibility. Age group 40-49 years were likely to receive full credit than applicants who were in the age group 30 years and below. This finding suggests that financial institutions might deem applicants who are 30 years and young as being risky clients.

Table 4.5 Predictors of accessing revolving credit

Variable	Exp. (B) Odds ratio	95% C.I. for EXP (B) Lower	95% C.I. for EXP (B) Upper	P-value
Gender (1)	2.102	0.929	4.757	0.075
Age group				0.133
31-40 years (1)	135383335.572	0.000	.	0.999
40- 49 years (2)	0.269	0.079	0.916	0.036
50 years and over (3)	0.668	0.215	2.074	0.485
Current position				0.040
Owner (1)	0.000	0.000	.	1.000
Manager (2)	0.000	0.000	.	1.000
Manager/owner (3)	2.191	0.000	.	1.000
Ownership				1.000
Partnership (1)	0.000	0.000	.	1.000
Limited partnership (2)	1.357	0.000	.	1.000
Limited Liability company (LLC) (3)	1.274	0.000	.	1.000
Tax number (1)	0.050	0.004	0.564	0.015
Location (municipality)				0.085
City of Tshwane Metropolitan Municipality (1)	0.785	0.218	2.828	0.711
Ekurhuleni Metropolitan Municipality (2)	0.246	0.063	0.958	0.043
West Rand District Municipality (3)	0.707	0.175	2.863	0.627
	3470747228046773200.000			0.999

Source: Researcher

Dependent variable: full credit accessibility (0=partial credit; 1=full credit) sig. at 5%

The results in Table 4.5 further indicate that the current position of the applicant predicted full revolving credit accessibility. However, no category of current position in the organization stated indicated prediction of full revolving credit accessibility. The results indicated the level of significance (p-value) were greater than 0.05 for all categories of current position in the organization. It was found that when the SMEs provided their tax number they had a greater chance of accessing full revolving credit at 0.05, compared to those who do not provide their tax number. The level of significance was less than 0.05 at 0.015 hence a strong predictor. Furthermore, the SMEs whose premise were in Location, Ekurhuleni metropolitan municipality in Gauteng province had a higher probability of getting full revolving credit, compared to SMEs in the city of Johannesburg metropolitan municipality. This predictor was significant at 0.043 which was less than 0.05. The odds of getting the full revolving credit was 0.247 more those in city of Johannesburg. The gender of the respondent, and type of ownership did not predict full revolving credit accessibility. Furthermore, it is imperative to mention that collateral was not statistically interpreted in the output result of SPSS despite being included in the analysis as a predictor. However, prior to testing this model, the goodness of fit of the model was tested which indicated a good fit. This result was justified by the Hosmer and Lemeshow test. The significance of the model was greater than 0.05 at 0.271. The result suggests that the independent variables were fitting in the proposed theoretical model.

5 Conclusions and Recommendations.

The study found that SMEs are stifled from accessing credit because of lack of collateral/security, lack of cash flow statement and owners' equity despite the results suggesting that majority of SMEs received the full credit they applied for compared to those who did not receive the full credit. However, this is still alarming as partial credit can hinder the progress of these organizations economically. It can be indicated that when SMEs receive part of the credit they might apply for credit in other financial institutions or request financial assistance from friends in order to cover for the deficit. The researchers established that for SMEs to access full credit from the financial institutions age group, current position in the organization of the respondent applying for credit predicated full accessibility. Furthermore, tax number and location of the business in the Gauteng province were also predictors of full credit accessibility. However, the gender of the respondent, type of business ownership and collateral (security) did not predict full credit accessibility by SMEs. These findings should be interpreted with caution as SMEs from Gauteng were the only respondents who participated. It is opined that the results might have been different if a country wide survey was undertaken within construction SMEs. Based on these findings, the researchers recommend that: SMEs should provide, the age, and current position in the organization of the person applying for the credit. Furthermore, they should provide the tax number and the location of the business in order for them to obtain full credit from banks. It is worth indicating that SMEs should also be aware of the requirements that the financial institutions will request them to submit as they apply for credit. In relation to these findings the researchers propose the need to use other socio-economic and demographic factors that were not used in this study as the current factors are not exhaustive in relation to the full characteristic of SMEs. The factors recommended for testing are marital status of the applicant, bank account statement and managerial ability of the respondent

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