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An Investigation into Credit Accessibility For Small and Medium Scale Enterprise In Construction Industry of Gauteng Province in South Africa. Literature Review

Olanrewaju Abdul Balogun, Nazeem Ansary, Justus Ngala Agumba, Aigbavboa Clinton and Willington Thwala.

Abstract- This paper focuses on determining the socio-economic and demographic factors that predict credit accessibility from financial institutions (banks) in South Africa. Data was obtained through, questionnaire survey from 179 small and medium enterprises (SMCEs) who were conveniently sampled. The questionnaire was developed from literature review. The socio-economic and demographic determinants predicting credit accessibility were identified. The data was analysed using statistical package for the social sciences (SPSS) version 22.The results indicate that credit was predicted by age group, current position in the organization, tax number and location. The gender of the respondent, type of business ownership and collateral (security). This study informs SMCEs owners and managers to provide, their age, current position in the organization when applying for credit. Furthermore, they should provide the tax number and the location of the business in order for them to obtain credit from banks.

Keywords—Credit accessibility, small and medium construction enterprise, South Africa.

Introduction

Small and Medium Construction Enterprises (SMCEs) contribute to economic growth through various mechanisms. Primarily, they create jobs to the semi-skilled and unskilled labour force that would otherwise remain jobless. Their importance is recognized in many countries across the globe. The [22] reports that SMCEs are key generators of employment and income, and drivers of innovation and growth. This is evidenced by the fact that they employ more than half the labour force in the private sector in OECD countries and account for 99% of private enterprises in the European Union. SMCEs have also notable contribution to Sub Saharan African economies. For instance, as reported by [26], SMCEs employ 78% of the Construction and manufacturing sector employees in the world. In South Africa, small businesses contributed to 27% of GDP in 2006 [13]. According to Fin Scope studies, small businesses are key players in the economies of Southern African countries.

However, SMCEs exhibit a slower growth than their larger counterparts. It has been observed that in South Africa, small firms 'contribution to employment creation is weak because most of them do not grow [24]. According to the [13], most of the small firms go out of business within a short period of time. For instance, it was observed that those registered between April 1, 2008 and March 31, 2010, only 1% survived for 1.5 to 2.5 years. In another a study by [14].it was reported that 75% of South African small firms fail. Although many factors that hinder their growth are cited in the literature, lack of access to credit is viewed a serious constraint [22]. This holds true for many economies in Sub-Saharan Africa for which the AfDB researchers [12] have reported that small firms are constrained by lack of access to credit. In South Africa, financial constraints is one of the most daunting challenge for small firms; [14] have reported that 75% of small firm loan applications are rejected. As a result of lack of access to credit, SMCEs heavily rely on internally generated funds that would not be sufficient to credit expansion and growth [8]. They experience either slow or stagnant growth. [6] observed, for instance, that firms that heavily depend on new share issues exhibit growth rates far above what can be supported by internal finance, thus further suggesting that small firms that are constrained by external finance are likely to exhibit slower growth.

Most studies on SME access to credit focus on macro level determinants, failing to account for important firm-level factors. While examining macro-level determinants of SME access to credit is important in identifying legal and institutional frameworks necessary to allow SMEs unfettered access to credit, understanding firm-level determinants to credit is important in understanding characteristics of SMEs that best suit the requirements of the formal credit market. This is critical because a workable SME support policy cannot be designed disregarding some important firm-level attributes. It is against this background that this study aims at examining the link between financial access and SME size in South Africa using firm-level data from the Fin-Scope South Africa Small Business Survey conducted by Fin Mark Trust in 2010.

The rest of the paper is structured as follows. This section presents review of empirical evidence on financial access and determinants of credit accessibility, why the next section discusses the empirical findings, and the last section presents conclusions and policy implications.

Olanrewaju Abdul Balogun
University of Johannesburg
South Africa
lbalogun@uj.ac.za
Nazeem Ansary
University of Johannesburg
South Africa
nasary@uj.ac.za
Aigbavboa Clinton
University of Johannesburg
South Africa
Caigbavboa@uj.ac.za
Willington Thwala
University of Johannesburg
South Africa
didbhukut@uj.ac.za

Determinants of credit accessibility for small and medium enterprise in the construction

This section discusses the determinants of credit accessibility as per the reviewed literature;

Gender

According to [1],[27] suggested that gender play a significant role on access to credit. A number of studies have shown that female SMEs are more constrained than male SMEs in term of difficulties when access credit from bank. [5] in his study suggested that female SMEs face more obstacles while accessing credit compared to male. [23] in there study based on Global Entrepreneurship Monitor (2004) Database of start-up businesses analysed gender differences in access to credit and explained that female are more financial constrained compared to their male counterparts in accessing credit.[26] indicated that access to credit is more oriented towards male than female. [18] in their study of SMEs with regards to the impact of gender on access to credit, established that female get credit easier compared to their male counterparts.

Age group

Age is one of the most commonly studied factors that affect access to bank loan. The effect that age has on access to bank loan can be viewed from both demand and supply side of loan. From the perspective of demand side, age is a factor that determines the owner/manager's preference or self-selection of either being user or non-user in the credit market [20]. This is based on the assumption that a particular age group tends to behave and prefer in a different way than other age groups. For instance, older owner/managers mostly appear to be at risk[20] and do not want to use bank loan. The motivation of entrepreneurs also varies with age. For instance old applicants' motivation to run a business often appears to be just a hobby or monopoly of power. Such individuals tend to fail to attract, apply or secure access to credit. Similarly, from supply side perspective, banks' perception of different age group also affects access to bank credit. For instance, applicants of old age group are generally perceived as non-innovative and non-dynamic. Young aged owner/managers are perceived as innovative and good performers, but risky portfolio. In addition, [1] observed that information asymmetry decreases as the age of owner/managers increases and lead to an improved access to credit. Therefore, there are some implicit and explicit implications which can affect the decision of both the lender and borrower. There are several studies that investigated the effect of age of applicant on access to credit, however there are mixed results, mainly on the significance of the variable. A study conducted by [21], [14] and [21] showed that age do not have significant effect on access to credit. [25] also found out that age and access to credit do not have significant relationship. However, contrary to the above findings,[21] demonstrated that age have significant effect on access to credit on the studied. [1] suggested that the positive of age group on access to credit prevails over the negative.

Current position

According to the report of Business Partners [4] stated that the level of the position of the directors, manager, or the owner of the company will determine the loan or credit the organization can be secure, this is because credit seekers with higher position in the company and high management level can access loan or credit easily.

Types of business ownership

According to [18] ownership structures in the company can influence the ability to have access to credit.[2], found that legal status influence the bank lending.[2] further stated that corporate status at start-up appears to be associated with a greater likelihood of bank lending. The effect of form of ownership on credit accessibility is related to the extent that it affects the availability of particular forms of credit.[25] argued that while some may consider the benefits of sole trader or partnership as the critical decision in the choice of legal form of the business, the limited liability gain is not real. On the other hand, choice of legal form involves weighing up credibility, taxation variation against statutory audit costs and public information. Given these, banks may perceive sole trader as good signal as it may portray credibility and formality of operations, or represent an indicator of future growth [7].The existing empirical evidence supports the existence of a positive relationship between form of business ownership and credit leverage. For example,[10] found evidence supporting a positive relationship between leverage and sole trader on access to credit. Similarly,[16] suggest that sole trader lead to a greater use of bank credit. Thus, the form of business ownership influences credit accessibility.

Tax Number

According to [4] pointed out that SMEs in the service sector reported a lower likelihood to register for tax (64 percent) than those in businesses (66 percent) construction, agriculture, and manufacturing sectors (80 percent). [11] indicated that SMEs employing worker were more likely to express a likelihood to register for tax (75 percent for those with six or more employees) than sole proprietors with no employees (61 percent). SMEs who kept complete financial records on paper and computer were more likely to report an intention to register for tax (78 percent) than those not keeping such records (63 percent). [11] again noted that those who rented separate premises for their business reported a much higher likelihood of registering for tax (74 percent) than others, perhaps because they were aware that their tax payments would be reported by their (property owner or landlords). Those who were within 30 minutes of the South Africa Revenue Services (SARS) office reported a higher likelihood to register (75 percent) than those farther away (67 percent) and much higher than those who said they did not know where the nearest South Africa Revenue Services office was located (57 percent).[11], [8] stated that SMEs who agreed that Government gives a good return on taxes paid in the form of government services reported a much higher likelihood of registration (80 percent) than those who disagreed (57 percent). The effect of the fear of getting caught was relatively less among the SMEs who believed that more than 10 percent of non-registered businesses were caught by the SARS in 2016 last year for tax. Those who believed that keeping books was relatively easy, or that tax compliance was relatively easy reported a higher likelihood of registering. [11].It can be suggested that when SMEs are registered for tax they eligible to have a tax number that will aid their access to credit application from the financial institutions.

Location of the business

The lenders who are geographically closer to their business owner are capable of utilising available qualitative information to establish the credibility of their customers for credit accessibility.[17] spotted that the location of the firm is dependent on access to the financial institution (Bank). According to [3] they indicated that the geographic nearness of the firm to the financial institution had an influence with the firm accessing credit.[15] articulated that SMEs located in the towns are successful in accessing credit compared to those found in the countryside. These studies therefore propose that the location of the business predicts credit accessibility.

Collateral security

In lending agreements, collateral is a borrower's pledge of specific property to a lender, to secure repayment of a loan [19]. The collateral serves as protection for a lender against a borrower's default - that is, any borrower failing to pay the principal and interest under the terms of a loan obligation. If a borrower does default on a loan (due to insolvency or other event), that borrower forfeits (gives up) the property pledged as collateral - and the lender then becomes the owner of the collateral. The study conducted by [19], established, that collateral is a major determinant of credit accessibility by SMEs.

Conclusions of findings

The study ascertains that SMEs are constrained from accessing credit because of lack of collateral/security, lack of cash flow statement and owners' equity. Despite these constraints majority of SMEs obtained the full credit they applied for compared to those who did not receive the full credit. It can be assumed 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 study established that when the predictors were modelled with, access to credit and did not access credit. The predicators did not predict the accessibility of credit. However, when the predictors were modelled with access to full credit and partial credit; age group, current position in the organization, tax number and location of the business in the Gauteng province of South Africa predicted full credit accessibility. However, the gender of the respondent, type of business ownership and collateral (security) did not predict full credit accessibility by SMEs.

Recommendations

Based on the conclusions, the study recommends the findings to different stakeholders, that is:

Recommendations to government

The government needs to encourage construction SMEs to approach commercial financial institutions to apply for credit as majority of SMEs obtained credit from them. The notion that commercial financial institutions reject or deny SMEs credit should be argued with caution as this study indicates that majority of SMEs acquired their credit from commercial financial institutions. The government agencies that are to offer financial assistance to SMEs need to be informed so that they can assist the SMEs. As per this research this was not evident. The government needs to inform financial institutions not to be too stringent with collateral (security), owners' equity and cash flow statement as these are the constraints impeding SMEs from credit accessibility.

Recommendation to financial institutions

The financial institutions should be aware of this constraints construction SMEs encounter in accessing credit. Collateral (security), owners' equity and cash flow statement should not be mandatory requirements in order for SMEs to acquire credit. Other requirements should be suggested which will make it easy for SMEs to access credit.

Recommendation to construction SMEs

SMEs should be informed that they 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 they apply for. However, 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.

Recommendations for further study

- Firstly, further research could determine if the findings of this research are consistent across different sectors. Since the study concentrated on SMEs in the construction sector only. A further research in other sectors will shed more light on the findings of this study;
- In addition, there is the need to replicate this research in other parts of South Africa to confirm if the results of this research can be generalized across the country;
- This study can also be carried out in other African countries for comparative purposes;
- Though the study establishes some predictors on access to full credit, not all the variables were good predicators. Therefore, a further study can be undertaken to justify this findings;
- The study proposes the use of stepwise logistic regression in future study; and
- A further research to test other independent variables not included in this study will be critical.

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Olanrewaju Abdul Balogun. (BSc, MTech, Dip, ASME) Holds a Bachelor's of Science in Building science from University of Lagos, Master Degree in Construction Management University of Johannesburg South Africa, Diploma in Project, Diploma in Blocking and Concreting and also a Member of American Society of Mechanical Engineers, Member Nigerian Institute of Building and has many years of working experience in the Construction Industry, Among orders are Telecommunication, Oil and Gas Industry. He is currently a lecturer and academic researcher at the Department of Construction Management and Quantity Surveying, University of Johannesburg. He has published extensively in various refereed conferences and has also presented papers in many international conferences all over the world. His main research interests are construction project management, construction management, financial management in construction

Justus N. Agumba (PhD, MTech, BTech, PrCM, MCIOB, MAQS) holds a Bachelor's Degree in Construction Management and Quantity Surveying and also obtained in 2006 his Master's Degree in Construction Management, from University of Johannesburg, South Africa. In 2013, he received his PhD in Engineering Management, from University of Johannesburg, South Africa. He is a Professional Construction Manager, and also a Member of the Association of South African Quantity Surveyors and has many years of working experience in the Construction Industry. He is currently a Senior lecturer and academic researcher at the Department of Construction Management and Quantity Surveying, University of Johannesburg. He has published extensively in various refereed journals and has also presented papers in many international conferences all over the world. His main research interests are construction project management, construction management, risk management and Health and Safety in construction.

Nazeem Ansary (NHD, BTech QS, MCPM, PrQS, PMAQS, MRICS, MCIOB) holds a National Higher Diploma in Building Surveying and Bachelor's Degree in Quantity Surveying from Cape Peninsula University of Technology, South Africa and Tshwane University of Technology respectively. He received in 2010 his Master's Degree, Master of Construction Project Management from University of New South Wales, Australia. He is a Professional Quantity Surveyor and has many years of working experience in the construction industry and currently working as a senior lecturer and Head of Department Construction Management and Quantity Surveying at the University of Johannesburg, South Africa. He has published several accredited articles in refereed journals and has presented papers in many international conferences all over the world. His main research interests are construction project management, construction management, dispute resolution, risk management in construction.