

Small and Medium Size Contractors in South Africa: 15 Years of Learning

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Abstract

Purpose: The main purpose of this study is to examine the lessons learned through the management of Small and Medium Size Contractors over the past 15 years focusing on the North West Province as a case study. **Methodology:** A comprehensive literature study was conducted and it was supplemented by primary data gathering. A questionnaire was sent to over 100 contractors in the North West Province. **Problem investigated:** Since 1995 various contractor development programmes have been initiated in South Africa with little success. Various challenges and problems have been documented by various researchers. This study will document the lessons learned as to increase the success rate of Small and Medium Size contractors in South Africa. **Findings:** Small businesses have been advocated as an important means of generating employment in which the North West Province is not an exception. The main findings of the study highlighted that there are different critical success factors that makes small and medium sized contractors to be success. They range from experience in the construction sector, technical and management skills, mentoring, access to finance. The study also found that although there are different initiatives that are in place to assist small and medium sized contractors but the problems and challenges are still there. **Research limitations:** The scope of this study only focused on small and medium size contractors in North West Province. **Conclusion:** The aim of the study was to document the lessons learned in managing Small and Medium Size Contractors in South Africa. These will ensure that the programmes are relevant and effective.

Keywords: Contractors, Small and Medium Size, Emerging Contractor Development Programme, Enterprises.

1. Introduction

The South African government has committed to ensuring that black-owned companies have access to the construction sector. Under its black economic empowerment (BEE) programme, the South African government has set targets for the percentage of each industry to be controlled by black-owned businesses. Large, predominately white-owned corporations have sold assets to achieve this objective, with the first sale occurring in late 2000. From 1995 the democratic government through its various departments has initiated some contractors' development programmes by which it awards certain levels of its construction projects to the historically disadvantaged black contractors in order to enable develop competent skills, build viable construction companies, create jobs and redistribute wealth (Department of Public Works (DPW), 1996).

A construction company's decision to expand into international markets must be based on a good understanding of the opportunities and threats associated with international business, as well as the development of company strengths relative to international activities (Luger, 1997). The study was done by surveying the executives in charge of international construction of large United States based contractors. The findings indicate that track record, specialist expertise, project management capability are the most important company strengths; loss of key personnel, shortage of financial resources, and inflation and currency fluctuations are the most important threats relative to international markets; and increased long term profitability, the ability to maintain shareholders' returns, and the globalization and openness of the markets are the most important opportunities available in international works (Luger, 1997). The vast majority of construction firms are small enterprises that rely on outsourcing personnel as required. This has severely affected skills training and the retention of expertise in the industry as construction workers become highly mobile, walking in and out of the industry, depending on performance in other sectors of the economy. The impact can be seen in the rigid adherence to management techniques and construction practices handed down from colonial times which, as a result of inadequate skills and capacity. Delays with interim and final payments, as well as onerous contract conditions faced by construction firms, can also impose huge constraints on the industry. Many construction firms have suffered financial ruin and bankruptcy because of delays in payment, which are common with government contracts (Luger, 1997).

2. Research methodology

The sample consisted of purposively selected 100 small and medium sized contractors from the database of National Department of Public Works (NDPW), Mmabatho Regional Office: Emerging Contractors Development Programme; Local Municipalities: Contractors Development Programmes (CIP), and Construction Industry Development Board (CIDB) contractors register/database. The main instrument used in collecting data was questionnaire which was self-administered by the owners/managers of these companies. The number of questionnaire was distributed to companies that are categorized as SMEs based in North West Province. Also guided interviews were conducted on different contractor's

compulsory site inspections/briefings around the province with the owners/managers of the companies. The focus of the interview was to probe further on the nature of such innovation and source. The responses from the interview were used to supplement the data supplied in the questionnaire. A secondary source was used for data collection through articles, journals, construction magazines, books and periodicals to obtain historical data and other relevant information. Interviews were conducted on different contractor's compulsory site inspections/briefings around the province with the owners/managers of the companies to collect primary data on contractors.

3. Literature Review

(Dlungwana and Rwelamila, 2003) states that contractors can be distinguished from each other by variables such as the size of annual turnover, capacity and capability. The challenges facing small and medium-sized contractors can be distinguished between those that affect small-scale contractors and those that affect medium-sized contractors. Some key features of small-scale contractors are that they are largely unregistered, operate in the informal sector of the economy and have very little formal business systems. The small-scale sector comprises the largest percentage of total contractors, although they employ very few permanent staff, usually less than ten employees. The conditions in developing countries present additional challenges, which include, amongst others, the lack of resources for training contractors, such as funds, poor construction procurement systems and lack of management capacity and resources to equip managers to operate their business enterprises effectively and efficiently.

4. Challenges faced by emerging contractors in South Africa

The challenges faced by small and medium contractors can be distinguished between those that affect small-scale contractors and those that affect medium-sized contractors. Small and medium contractors are facing increased competition due to the long-term real decline in demand, and many contractors have responded by shedding labour. The larger contractors have also responded by moving into the international market. Small local contractors, in particular, are furthermore subject to volatilities due to the geographic distribution of construction and the peak workloads that characterize construction projects, which has further reduced their ability to build capacity. Emerging contractors are subject to the same market forces described above for small contractors. However, in addition, while emerging contractor development policies were intended for black economic empowerment, small government contracts have in fact been used as a job creation opportunities. This has resulted in an overcrowding of this market, and increased financial failures of emerging contractors.

Lack of effective management during their early stages is a major cause of business failure for small and medium sized contractors. Owners tend to manage their businesses themselves as a measure of reducing operational costs. Poor record keeping is also a cause for startup business failure. In most cases, this is not only due to the low priority attached by new and fresh entrepreneurs, but also a lack of the basic business management skills. Most business people, therefore, end up losing track of their daily transactions and

cannot account for their expenses and their profits at the end of the month. During the early stages of some business start ups, owners were unable to separate their business and family/domestic situations. Business funds were put to personal use and thus used in settling domestic issues. This has a negative impact on profitability and sustainability. Some owners/managers employ family members simply because of kinship relations. In some cases, these have turned out to be undisciplined and ineffectual, a factor that has led to eventual and sometimes rapid failure of businesses. This relative lack of success facing emerging contractors in South Africa was discussed by (Rwelamila, 2002; Miles, 1980; Croswell and McCutchen, 2001; Mphahlele, 2001 and Ofori, 1991); International Labour Organization –ILO- (1987); as follows: Inadequate finance and inability to get credit from suppliers; Inability to employ competent workers; Poor pricing, tendering, and contract documentation skills; Poor mentoring; and fronting for established contractors; Lack of entrepreneurial skills; Lack of proper training;

Lack of resources for either large or complex construction work; Lack of technical, financial, contractual, and managerial skills; and late payment for work done.

The Department of Public Works (DPW) has since 1995 has been actively involved in conceptualizing and implementing programmes to promote emerging contractors in the built environment. Through these programmes, the DPW has increased participation of previously disadvantaged individuals in the mainstream economy. Moreover, it increased economic activity in an economically depressed environment. Previous contractor development programmes have focused on the under R500 000 range, which has been found not to be a sustainable market given the number of new entrants to the market. This resulted in few of the contractors being sustainable and the cost of contractor development consequently being extremely high compared to the sustainable result.

The challenges faced by the emerging contractors include: the co-ordination and management of the many facets of the different programme; maintaining focus on sustainability against pressures to roll-out too rapidly; reaching target market with information about the opportunity; sourcing mentors with the requisite skills and experience; the large numbers of contractors targeted requires large numbers of trainers and mentors which are not readily available, and are costly; the available resources to effectively and efficiently monitor, evaluate and facilitate programmes are limited; An integrated development approach requires considerable support from senior management of public sector clients and considerable inputs from officials; programmes lack sustainability; while public sector clients have done a lot for contractor development, particularly in the area of policy, there are still many issues that must be addressed at operational level, such as late payment cycles; procurement policies should encourage longer contract periods and move away from frequent tendering which is both expensive and disruptive; more qualifications need to be developed that are targeted at the specific needs of small and emerging contractors; there is a lack of access to affordable finance; emerging contractors lack demonstrable credit and track records. The following are the major constraints faced by emerging contractors' development and growth:

5. Skills related barriers to construction emerging contractors' development and growth

South Africa is characterized by a systematic under-investment in human capital. This has resulted in a labour force with a skewed distribution of craft skills, career opportunities and work-place experience. While the promulgation of the Skills Development Act of 1997 is commendable, micro enterprises already express concern about the administration costs of recovering levies in the form of grants for training undertaken, the costs of designing a workplace training programme as an alternative to using external training institutions and the relatively high charges by private training institutions after the closure of the former industrial training boards which had been subsidized through levies from industry (Kesper, 2000).

6. Financial barriers to construction emerging contractors' development and growth

Efforts to promote SMME access to finance might have more impact on development and growth but access is limited and cost of capital is high. While government has made some efforts to increase accessibility to finances, the targeted programmes have had limited success because awareness and usage of existing promotional programmes is very low. In addition to insufficient access, high interest rates also pose a constraint to micro enterprise growth. Moreover, (Gounden, 2000) reports that there are core difficulties seen in terms of discrimination by financial institutions against micro enterprises with little collateral, difficulties in accessing information and lack of market exposure. The inadequacy of external finance at the critical growth/transformation stages of micro enterprises deters the enterprises with growth potential from expanding (Nissanke, 2001).

7. Legal barriers to construction emerging contractors' development and growth

With regard to legal barriers, a commonly perceived constraint of micro enterprises is the labour laws which are said to raise the cost of employment artificially prolong retrenchments or corrective action and do not allow for adequate flexibility especially in wage settings and the arrangement of working time (Bhorat et al., 2002). As a result enterprises feel a profit squeeze and impact on the willingness to create jobs.

8. Critical success factors for small and medium contractors

(Young and Hall, 1991; Abidali and Haris, 1995) suggest that contractor's project and financial management ability is a critical success factor. (Kotler, 2002; Cromie, 1991) state that the ability of a contractor to market himself among the industry role players is a critical success factor. (Yussof, 1995)

state that experience and management expertise of the owner is critical success factor. (Rotter, 1966; Barkham, 1994; and Jaafer et al, 2004) state that entrepreneurial characteristics in forms of creativity and need for achievement are critical success factor. (Yisa et al., 1996; Day, 1997; Kale, 1999; Winter and Preece, 2000) state that the ability of a contractor to maintain good relationship with clients, suppliers, and other role players is a critical success factor. (Upson, 1987) insists on the ability for financial gathering and management as critical success factor for small, medium and large contractors.

(Jaafer and Abdul- Aziz, 2005) surveyed 172 SME's contractors in Malaysia and concluded from what they call Resource-Based-View that contractor success lies in project and financial management capability, marketing and supply chain relationship; however, they state that educational background and owner-manager characteristics are not necessarily success factors because competent skill can be employed to run the firm. (Miller, 1962) from his 35 year construction experience examines the views of contractors who emphasized that their survival in this competitive industry depends on the understanding of requirements, progressive in estimating, scheduling, purchasing, organizing, controlling project activities, knowing what has been done and how, and being flexible enough to adjust to changing situations, are all important success factors. (Holroyd, 2003) says that success depends on competent skills, adequate resources, proper timing of activity planning and performance, teamwork, effective communication, fair dealing with people, honesty and integrity are essential.

9. Findings from the North West study

The graph below shows that the small and medium size industry in South Africa is still male dominated with 78% male and 22% female owned. The age of the people interviewed ranges from 20 to 59 years old. 98.3% of the people interviewed were Black and 1.7% percent Coloured people. The figure clearly shows that the small and medium size contractors in the North West Province are dominated by Black people. 71.2 % of the people interviewed were managing directors; 6.8% were managing partners; 8.5% were Construction Project Managers and 10.2% were Construction managers.

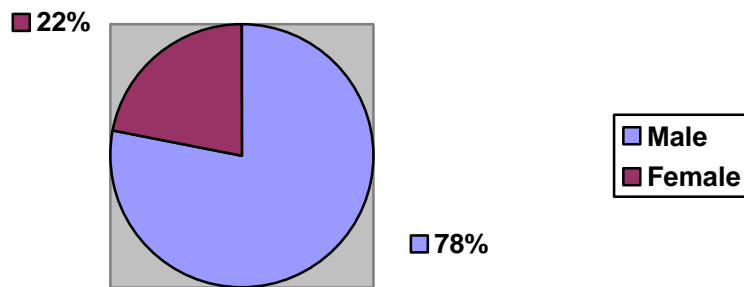


Figure 1: Gender in the North West Province

The results also shows that 16.9% of the owners of the contractors had a Grade 11 or lower qualification; 28.8% had Grade 12 qualification; 28.8% had Post-Matric Diploma or Certificate; 8.5% had a Bachelor’s degree and 11.9% had a post graduate degree. The results also shows that 45.7% of the owners had a qualification that is up to Grade 12. The results shows that 74.6% of the contractors manage between 0-2 projects; 18.6% of the contractors manage between 3-19 projects; 3.4% of the contractors manage between 11-15 projects and 1.7% of the contractors manage above 20 projects at a time. Most of the contractors at the lower grading lack the capacity to manage many projects at one time. The research also find that 27.1% of the owners of the contractors have less than three years experience; 33.9% of the owners have between 3 and 5 years experience; 18.6 % of the owners have between 11 and 15 years and 10.2% have above 15 years experience in the construction sector. The results show that 61% of the owners of contractors have less than 5 years experience in the construction industry. 81.4% of the contractors are based in the urban towns and 18.6% are based in rural towns. The number of people employed by the contractors ranges from 1 and 50. 47.5% of the contractors had participated in the contractor development programme in the past. More than 45.8% have never participated in the contractor development programme. The results shows that contractors lack basic construction skills with only 30.5% construction management; 47.5% business management; 30.5% project management; 30.5% health safety; 37.3% tendering and 27.8% site management. And it is clear that majority of the contractors in the North West Province lack important skills that will enable their contractors to be successful. The results shows that scarce skills in the construction industry it’s a main challenge, as most of small and medium sized contractors cannot afford to hire qualified artisans and construction professionals due to the high demand of built environment professionals. And it leaves small and medium sized contractors with no option but to outsource their work to the well established contractors.

10. Conclusions and recommendations

This paper has shown that after 13 years into new democratic South Africa, the state of small and medium sized contractors continues to be unsustainable and even with existence of supportive programmes (i.e contractor development programme and emerging contractor development programme). The South African construction industry will continue to provide jobs for Historically Disadvantaged Individuals (HDI) but without such intervention, small and medium sized contractors will remain unsustainable and their performance unsatisfactory. The study finds that lack of effective management during their early stages is a major cause of business failure for small and medium sized contractors. Owners tend to manage their businesses themselves as a measure of reducing operational costs. Poor record keeping is also a cause for startup business failure. And lack of financial management; lack of entrepreneurial skills; lack of proper training; lack of resources; lack of technical skills, lack of contractual and managerial skills; late payment for work done which are common with government contracts; inability to get credit from suppliers and fronting for established contractors are also contributing factors for the failure of small and medium sized contractors in the North West Province.

The author considers the following points as the main reason for the success of the small and medium sized contractors in the North West Province:

- **Business skills:** location of business premises is very important, set specific targets for your business, carrying out market research, employ qualified personnel and put them in position according to their skills, know and understand existing skills needed and attend refresher courses on business management skills.
- **Management skills:** financial management should be emphasized, networking with other people with similar businesses and keeping records of workers to help in evaluation of the performance.
- **Access to capital:** merge with others that have similar businesses, negotiate favourable credit purchases from the supplier, source affordable loans from financial institutions and negotiate advance payments from the clients.
- **Good record keeping:** financial record should be prioritized and establish a record of books of accounts on a daily basis, weekly, monthly and annual basis.
- **Well managed Cash flow:** prepare cash flow forecast and budgets, prepare a cost-benefit analysis, lease equipment and other financial assets to improve your cash flow, negotiate outstanding loans through payment procedures and scale down operational costs.
- **Family/domestic situation:** separate business activities and family obligations and look for alternatives sources of income to cater for family basic need.

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