Exploring Transformation Challenges: Limits to the Growth of Building Contractors in South Africa

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Abstract
Although there are many avenues for transformation, economic empowerment and growth is its cornerstone in the construction industry. The current structure and performance of the construction industry in South Africa is evident of the needed transformation in the sector. While a number of research projects have examined this issue through an objective lens, this paper is based on a phenomenology study. This approach shows that without basic skills, knowledge and capacity, there can be no growth that could change the industry to a high gross domestic product (GDP) contributor to the South African economy. The results of the study shows that although the firms are keen on business expansion, barriers related to capital, skilled labour, late payments, low profit margins, empowerment requirements, competition with larger firms and economic restraints, should be surmounted. It can therefore be concluded that until each firm is open to a new approach to skills acquisition, use of finance and business judgement / decisions, business expansion will be unattainable. Training, education and mentoring that would engender needed construction business skills among SME building contractors is recommended.

Keywords: Bankruptcy, building contractors, transformation, South Africa.

Research Background

Although there are many challenges in South African construction, one of the major issues is the transformation challenge and the limitations that contractors face when they are keen on putting their firms on the growth trajectory. It is well known that the construction industry is a very challenging industry as it is very competitive and at times unstable during economic down turn (De Valence and Runeson, 2011). However, the management dilemma that is the focus of this paper is the inability of emerging or small and medium sized (SME) building contractors to expand their organisational footprint and portfolio without an exposure to business bankruptcy in South Africa. One of the major problems in South African construction is that building contractors do not expand and develop into larger and more prosperous firms with ease (Martin and Root, 2009). The importance of researching this problem lies in the fact that there are many SME construction firms that are owned and managed by Historically Disadvantaged Individuals (HDIs) in South Africa. These HDI owned entities often lack resources that are vital for prosperity in the sector (Martin, 2012). As a result of this, few large firms tend to dominate the landscape and often secure major contracts in the industry. As evident in the construction industry development board (CIDB) register of active contractors, there are so many lower grade contractors

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in comparison to higher grades (Emuze and Smallwood, 2011). This gives a clear indication that the contractual capacity required for high value jobs is dominated by larger firms.

Research Rationale

The problem background is rooted in the idea that SME building contractors struggle to transform into larger contracting firms in South Africa. Thwala and Phaladi (2009) acknowledge the poor understanding of broad business issues among emerging contractors. All actors in the construction industry face the same market forces that have implications for different firms. What this means to a small contractor is that they are unable to always respond appropriately to changes in the industry in a fluid situation (Thwala and Phaladi, 2009). According to Martin and Root (2009), main issues that contribute to the pitfalls of contractors that attempt expansion in South African construction include:

- Tendering too low to make a sufficient profit because of the highly competitive nature of the business.
- Lack of managerial skills as well knowledge, in areas of general law, estimation and tender pricing.
- Fronting that tends to act as antithesis of government empowerment initiatives in the sector.

The "fronting idea in South African terms is where the company claims to be managed by HDI, yet it is managed by white South Africans" (Emuze and Adlam, 2013: 139). In a nutshell, it has been observed that SME building contractors often struggle to transform into larger contracting firms in South Africa (Martin & Root, 2009; Martin, 2012). The inability of such contractors to transform limits the available contracting capacity in the industry and then exposes a project to increased numbers of stakeholders that are involved in its delivery.

This in turn has a concomitant cost implications for projects (Emuze & Smallwood, 2011). Thus, the main research problem for this particular study can be said to be "*small and medium sized firms willing to expand in South Africa fail to do so timely due to management related challenges*. Based on these arguments, it is vital to assist SME building contractors to have a clear understanding of how and when to expand their organisational footprint and minimise the risk of bankruptcy; by so doing, the number of failed contractors should be limited in South Africa since economic sustainability and competitiveness in the market should be discernable (Martin & Root, 2009). The study could also potentially assist firms to note when to embark upon business expansion in the sector as emerging firms are battling to overcome social responsibility, business processes, planning and strategy related challenges (ladzani, Smith and Pretorius, 2010).

SME Building Contractors: Challenges

Flooding of the construction market with many contracting entities has been flagged as a major problem. According to Thwala and Mvubu (2008), the construction industry is flooded with empowerment based firms that overcrowd the market in South Africa. The word 'flooding' is used in that there are thousands of firms that are on the CIDB register without having appropriate jobs to show for their involvement in the sector. For instance, these firms lack the skills that are vital to the success of contracting firms (Martin, 2012). It is therefore necessary that these firms acquire the necessary skill for the industry to expand and accommodate them, if economic growth in South Arica is to be obtained (Thwala & Mvubu, 2008).

The study by Thwala and Mvubu (2008) further shows that due to market overcrowding, competition is steep and the tender margins are tough and profit is at a minimal, thus making it difficult for emerging contractors to make it in the industry. In such a situation, SME building contractors would tender for projects even when they are not capable of handling them in areas of finance and experience in order to survive. As a result of the lack of the required antecedents, banks are reluctant to give these building contractors money and if they do, it is at very high interest rates. So many emerging contractors either liquidate or abandon projects due to lack of finance or are disqualified due to the fact that they could not provide construction guarantee. A further hindrance for the contractors is that of late payment by the client, which causes a downward spiral of events (Thwala & Mvubu, 2008; Maritz and Robertson, 2012). To support this perspective, the study by Tokuori (2010) shows that delay of payment from government departments creates a cash flow problem, due to the fact that SME contractors are already low on capital and they cannot start work without advanced payments and due to this issue – the project and business performance of building contractors suffers. The effects of delayed payment is equally made worse by poor cost and accounting practices found among SME contractors (Thwala and Mofokeng, 2012). The situation is made worse as such contractors often use simple estimation techniques that do not stand a competitive chance (Seeletse and Ladzani, 2012).

In addition, Seeletse and Ladzani (2012) note that SME contractors lack essential resources and skills for competitive tendering because of inexperience. Larger experienced contractors do not experience this difficulty. Apart from estimation and pricing, the management of projects in the early stages is critical to success. Many small enterprise owners tend to manage all aspect of their business alone. This is often because of financial constraints. Because of this pressure and a lack of understanding of the importance of record keeping, bookkeeping is often poor. Inability to access adequate finance and credit, lack of contractual skills and documentation, inability to employ competent workers and lack of skills in the managerial, financial, and technical aspects are also causes of failure to properly manage businesses (Thwala & Phaladi, 2009). Thwala and Mvubu (2008) also found that the relations between emerging contractors and suppliers are not very healthy because most suppliers are reluctant to advance credit towards the emerging contractors because of their project completion related failures and mismanagement of materials.

Research Method

Within the qualitative method cluster, the phenomenology approach was adopted. The method was chosen for its ability to effectively obtain information through experiences, and individuals' perspectives. The primary data stems from face-to-face interviews that were conducted between June and August, 2013. The interviews were conducted in specific locations in order to meet individual representative of the firms that took part in the study. The interviewees were thirteen construction professionals (Table 1). The sample included two classes: seven established contractors and six emerging contractors. The purposively selected interviewees were from different income and geographic areas (Springer, 2010). The interviewees include those who had formal education in the form of diplomas and degrees, while other participants had no tertiary education (Table 1). All the interviewees however had formal education of at least a matric certificate. There were participants who worked on multimillion rand projects and others who worked on projects amounting to thousands of rand. Some interviewees were based in a single province, and some, the large firms, work in various locations around South Africa - covering a large spectrum of geographical areas in South Africa.

Table 1: Background Information of Interviewees

No.	Highest Level of Education	Job Title	Years in Industry
1	Grade 12	Construction Manager	12 years
2	National higher diploma	Project Director	38 years
3	National diploma	Construction Manager	6 years
4	Bachelor's degree	Construction Manager	14 years
5	Bachelor's (Honours) degree	Construction Manager	4 years
6	Bachelor's degree	Company Owner	40 years
7	National diploma	Company Owner	12 years
8	Bachelor's degree	Company Owner	7 years
9	National diploma	Company owner	5 years
10	Matric	Contract Director	32 years
11	Plummer's certificate	Company owner	11 years
12	Matric	Company owner	13 Years
13	National diploma	Company owner	5 years

The information gathered during the interviews was analysed thematically. The data were examined and repetitive information excluded, and the relevant data were grouped into themes and the views on the themes were taken into account (Bryman and Bell, 2003). Experiences were documented as well as the personal and general information. The interview protocol was broken down into themes that reflect the research questions of the study. Barriers prohibiting expansion, bankruptcy in the industry and possible interventions form the major themes that emerged from the transcribed interviews.

Research Findings

Theme 1: barriers prohibiting expansion

Desire to expand

The firms, established and emerging, that were interviewed desire to expand their businesses. However, there were different views about what expansion entails. The smaller firms would like to expand, but they were afraid of the risk of stretching valuable and reliable resources over larger areas. Such resources that were mentioned include management, supervision and finance. Another hindrance to expansion is time and effort, which they require at work. In their mind, additional work time would lead to a loss in family time. The larger firms appeared very keen on the idea of expansion and to quote from one respondent, "*there comes a time when expansion becomes inevitable*."

Barriers to expansion

It seems that similar barriers affect both emerging and established contractors. With the expansion of a firm, it appeared that capital, skilled labour, late payments, low profit margins, empowerment requirements, competition with larger firms and economic restraints all played a role in preventing expansion. Capital and cash flow was clearly a restraint to a firm that is keen on expansion. The increase in competition further lowered profit margins and inevitably the cash flow and future capital for possible expansion. Without the cash flow and capital, it is impossible to maintain heavy equipment and pay wages.

It appeared that the large and small firms both struggled with labour issues: lack of skilled labour, foremen and managers who could manage project teams, labour relations and wage uncertainties. An interviewee state that quality of rural education has not prepare labourers for the labour market as they were unable to solve simple problems even after years of training. One of the contracting directors made the statement about employees when he says, "very few employees want to start at the bottom and work their way through middle management, where they can acquire valuable experience, to reach top management." He further explains that middle management was lacking and this has affected supervision and the quality of the end product. The interviewees further say that the work culture of the modern school graduate is, "*I want to be here to earn a salary, but I do not really want to work too hard*".

The data analysis also shows that late payments affect established and emerging firms. This had a greater impact on the smaller firms as their cash flow and capital are limited. The large firms had the capital and cash flow to hold out longer when clients were late with payments. Economic restraint clearly affected emerging contractors as well as established contractors, as most of the interviewees stated it as a reason to be reluctant to expand.

According to the interviewees, the Broad Based Black Economic Empowerment (BBBEE) requirements are difficult to conform to. One of the interviewees explain that the BBBEE partners often lacked the skills to contribute meaningfully within the business and this placed unrealistic demands on the firm. The same respondent said that there were political interventions in the award of tenders, and that sums of money needed to be paid on the side in order to be awarded the tender.

Overcoming barriers

The more established firms definitely had a better understanding than the smaller contractors of how to overcome business obstacles. As an example, the smaller contractors would say that they needed to find better and more skilled labour force when asked how to overcome expansion barriers. The more established firms had a plan and said that they needed to appoint subcontractors and that this would avoid cost increases in areas such as vehicles, tools and salaries. The established contractors said that the turnaround time, after having committed capital and to get a return, was relatively short and thus reduced the risks of expensive financing cost. The more established firms had a way of generating sound management; they recruited students who had academic training and knowledge. The established firms also say that they strive to make the potential middle management employee proud of the firm. Employees were used for their specific strengths, and interest, which motivate the workers to create healthy competition between project sites.

In the area of late payment, the more established contractors tried to negotiate with clients and resolve the issue. However, this was not always successful and cancellation of the contract could occur. The smaller contractors claim that the cost in trying to win the disputes and get the delayed payment was not worth the high expense and effort. There appeared to be a “success secret” in the fact that the more successful and established firms sought to subdivide their organisation and hire subcontractors.

Theme 2: bankruptcy in the industry

Link between bankruptcy and expansion

Both emerging and established contractors believed that there is a link between bankruptcy and expansion in the industry. The reasons appeared to be of the same nature.

One respondent went as far as to say that emerging contractors appear to be set up for bankruptcy as they were a times allowed to take out large loans, which gives room for spending money unwisely by purchasing luxury items. He further stated that some people are willing to work for such items, while others are not. Some of the key areas linking bankruptcy to expansion include: taking on projects that they could not handle or ‘grew too fast’ and they found themselves with insufficient capital and cash flow for future overhead payments and expenses related to operations. Another follow up was that jobs took longer than planned for which caused extra unforeseen costs.

The interviewees even noted that management tend to be stretched as the firm expand. People became overloaded and could not manage the work load properly. Expansion required new foremen and workers. Many were unproductive as they still needed training for required skills and this had a negative effect on the cash flow of an organisation at the worst possible time “in the expansion process”.

Instances of bankruptcy in the Industry

Every individual interviewee had either heard of or encountered bankruptcy in the construction industry. This gave an indication that this is a real problem in South African construction, especially with emerging contractors.

Why are contractors struggling in the construction industry?

Once again, the established contractors had a broader understanding of the issues regarding why contractors fail in the industry. Many had first-hand experience as they had numerous emerging contractors who work with them. Emerging contractors had a tendency to stick to a very narrow field of skills. The industry is very competitive and there was not always work available. Therefore, the contractors were undercutting one another in order to get a tender. The bigger firms were tendering for smaller jobs for the sake of survival, while emerging contractors were struggling to compete with the larger firms.

In another response to the question, “too many projects were awarded to unskilled BBBEE companies because; ‘no sufficient barriers of entry’ exist, was recorded”. The interviewees further say that corruption, poor management and BBBEE transformation issues impacted on the bottom line. One respondent stated that with, “BBBEEE you have to share your company”. Poor site and office management meant that there was an overall lack of proper management and financial skills. This leads to poor use of resources. A particular difficulty is that of poor record keeping, which means SME building contractors, would have limited evidence to prove allegations when things go wrong. Other issues that were raised include:

- “Labour was unwilling to work hard for little money”.

- “Late payments”.
- “Strikes”.
- “Theft on sites”.
- “Corruption in the award of tenders”.
- “Non-compliance with health and safety (H&S) regulations.

Implications of the Findings

The findings of the interviews identified the contributing factors to SME building contractors’ business failure as most of the data confirmed what has been said in the literature, apart from new insights that should be contextualised as indicated below:

Expansion hindrance amelioration: The study was able to identify barriers that tend to stop contractors from expanding as well as the means to overcome these barriers. In this respect, the aim and objective was only partially fulfilled as obstacles and current challenges were continuously changing among the firms and varied from one respondent to another.

Right time to expand: The research was able to give insights into the advice of when it is the correct time to expand a business portfolio within the sector. Although, there appears to be no absolute strategy that works for all, correct situational analysis in the business environment should provide the right timing for aspiring firms.

Generally**,** the issues that were examined show that the transformation challenges among SME building contractors in the sector could be reduced by addressing:

- Lack of managerial skills and knowledge.
- Lack of appropriate credit ratings in relation to banking and material supplier services.
- Imprudent use of business funds.
- Non-separation of domestic finance from business finance.
- Poor preparation of tenders due to lack of knowledge and experience.
- Owners trying to manage business unassisted due to cost implications.
- Poor bookkeeping and accounting systems.
- Employment of family members who do not necessarily have the required skills.
- Disparity between capacity and project commitments.
- Tendering for projects with low profit margin projections.
- Usurpation of small jobs by large established contractors.
- Improper award of contracts, especially to unskilled empowerment firms solely on preferential grounds.
- Late payments by client, especially in relation to small contractors that do not have sufficient capital to maintain themselves without clients’ payments.

Concluding Remarks

The literature has shown that the growth outlook for SME building contractors is not promising as their construction related education background is deemed to be either inadequate or non-existent, a situation that is evident in their poor estimation and book keeping competencies. As a result, clients and established businesses are not very keen to take on unreliable SME building contractors due to the possibility of poor performance. Some of the common feature of the SME building contracting business tends to be counterproductive to the long term interest of the owners. Such feature includes the general perception that the business money is usually used for domestic purposes and the business simultaneously. All these negate the intentions of transformation initiatives in the sector and as such, they limit the growth of non-established building contractors that are still '*finding their feet*' in the business.

To sum up, as previously noted in past studies, most SME building contractors in South Africa are still '*living a hand to mouth existence*' and cannot take advantage of tenders as they lack capacity and managerial skills. Suppliers are also unwilling to give credit to them due to '*performance related stereo type*'. This category of firms equally think of survival when making financial decisions so much so that they often employ close associates without required competencies to undertake assigned roles. The common causes of SME Business failure thus pertain to:

- Finance: lack of capital, poor cash flow, poor credit facilities, and spending business money on domestic issues.
- Skills and know-how: lack of managerial skills, especially in relation to accounting systems, labour skills, and tender practices.
- Poor judgment: buying unnecessary items for the firm, undertaking projects that exceed their capabilities, and growing too fast.

The clear trend in terms of challenges has necessitated the use of entry barriers to curtail the flooding of the market by ill-conceived firms that can barely survive for more than a couple of years. The usefulness of mentoring, training and education that would engender necessary construction business skills cannot be overstated. It is good business practice when SME building contractors with the correct 'ethos' engage in project execution in partnership with established firm. Their 'tutelage' under the established firm should be seen as a precursor to competitiveness and expansion in the industry. When this is done, SME building contractors may be less exposed to the penalties of delayed payments from clients and also, they should be able to upgrade their project capacity.

As this study was based on a small sample of contractors, it has marginally explored the issues. However, the findings should serve as a starting point for future studies that would tackle the dynamics of each challenge and disseminate how to completely eradicate it in the system. The persistence of some of the problems that were identified in the study suggests that '*the challenges that limit the growth of SME building contractors*' can be considered to be systemic in nature. Future research directions should endeavour to tackle why contractors are unaware of the organisations that could assist them in terms of business expansion; what are the necessary steps to ensure contractors are not involved in projects that could lead to insolvency due to cash flow problems; and most importantly, how can managerial skills and knowledge be leveraged to stem off bankruptcy, and then, encourage growth in the sector.

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