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Full Length Research Paper

The impact of the business environment on the availability of trade credit to new SMEs in South Africa

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This study investigates the impact of the business environment on the availability of trade credit to new SMEs in South Africa. The literature identifies 78 questionnaire items. Exploratory factor analysis reduces the items to 44 items under nine factors that include both internal factors and external factors. The internal factors were labeled as managerial competencies, collateral, networking and business and financial information. The external factors were labeled macroeconomic, legal, ethics, crime and corruption. Empirical research was conducted to investigate the impact of the nine factors on the availability of trade credit to new SMEs. The instrument used was the self-administered questionnaire. The statistical analyses included factor analysis, item analysis and Pearson correlation. The results show that both the internal and external factors significantly impact on the availability of trade credit to new SMEs.

Key words: Business environment, new SMEs, trade credit.

INTRODUCTION

South Africa suffers from high unemployment with an official estimate of approximately 24.5% of the economically active population unemployed (Statistics South Africa, 2009). The country also suffers from high levels of poverty and income inequality. One of the best ways to address unemployment is to leverage the employment creation potential of small businesses and to promote small business development (FinMark Trust, 2006). Gree and Thurnik (2003:243) argue that the contribution of the SME sector cannot be sustained without the creation of new SMEs. A new SME can be described as an SME that has been in existence for less than forty two months. According to Maas and Herrington (2006) new SMEs are seen as a significant component of the solution to South Africa's development issues.

However, despite the noted contribution of new SMEs, the creation rate of new SMEs in South Africa is one of the lowest in the world. According to Herrington et al. (2009) South Africa's total entrepreneurship activity (TEA) at 7.8% is below the average rate (10.6%) of all the participating countries in the global entrepreneurship monitor (GEM) survey. In addition, 75% of new SMEs created in South Africa fail within the first two years of operation (Von Broembsen et al., 2005). Various challenges and impediments prevent the creation of new SMEs and as well cause the high failure rates of new SMEs in South Africa. One of these is the non availability of formal sector financing (Herrington et al., 2009).

Demirguc-Kunt et al. (2006:933) point out that the two primary sources of external finance for new SMEs are equity and debt. External equity in the form of venture capital or the stock exchange is usually not available for new SMEs. The lack of external equity makes many new SMEs dependent on bank loans and trade credit for early-stage financing. FinMark Trust (2006) provides evidence that only 2% of new SMEs in South Africa are able to access bank loans and that the use of suppliers credit by new SMEs is virtually non-existent. Balkenhol and Evans -Klock (2002) put the use of trade credit by new SMEs in South Africa at 0.2%.

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Previous studies on SMEs and access to finance in South Africa have completely ignored the impact of trade credit and have concentrated on bank loans. Wilson and Summers (2002:318) point out that studies of enterprise finance in Africa and elsewhere from the supply-side typically focus on bank credit, and more particularly on bank loans. Berger and Udell (2006:2949) note that although trade credit is extremely important to SMEs, it has received much less interest than commercial bank lending which provides only slightly more credit to SMEs. Since only a limited number of new SMEs have access to loans from financial institutions, trade credit may often be the best or only available source of external funding for working capital. New SMEs may prefer trade credit financing during the early years when the risk of default is high. Also, trade credit is a substitute to bank credit for firms that are credit-rationed by banks. This suggests that trade credit could be one of the solutions to the credit constraints faced by new SMEs in South Africa. The question is why is it that trade credit is not available to new SMEs in South Africa?

The argument of this study is that there are certain factors in the internal and external environment (business environment) of new SMEs that prevent trade creditors from granting credit new SMEs. A detailed literature review on the business environment and trade creditors was undertaken. This resulted in the development of a 78-item questionnaire. Exploratory factor analysis of the responses resulted in the reduction of the 78 items to 44 items and nine underlying factors which are collateral, business information, managerial competencies and networking (internal factors). External factors included ethics, the legal system, the macroeconomic environment, crime and corruption.

Trade credit theories

According to Huyghebeart et al. (2006:436). Trade credit arises when a firm purchases goods and services for which payment is delayed. It is a spontaneous source of financing, as it arises from ordinary business transactions. Trade credit is usually extended for an intermediate period of thirty to sixty days at which point payment is due. If payment is not made on the date, financing charges are applied and trade credit becomes an alternative method of financing business expenses. According to Selima (2007:17), trade credit theories can be broadly classified into four main groups. These are market imperfection asymmetric information, transaction costs, price discrimination and finance. The asymmetric information theory occurs when sellers face uncertainty about their customers' creditworthiness and financial health. Because of asymmetric information sellers cannot reliably make the best selling decisions. Frank and Maksimovic (2004) point out that another theory of trade credit is the transaction costs theory. The combination of the supply of both goods and finance from one source can lead to cost advantages and to a reduction in transaction costs. Furthermore, when the transactions take place on credit, the timing of the payment is less uncertain which enables firms to improve their cash-flow forecasts and simplify cash management.

Selima (2007:17) discusses the price discrimination theory of trade credit and points out that as demand for a product can vary, sellers can manipulate the product price through the variation of the credit terms offered to each separate customer. So varying the trade credit terms gives the seller a more flexible approach to pricing and to discriminate among customers, as it is much easier to adjust credit terms (based on the payment period) than product price in order to respond to fluctuating demand. Frank and Maksimovic (2004) point out that another theory of trade credit is the financing theory. When non-financial institutions offer credit, they play an intermediary role by obviating the need for buyers to obtain finance from their banks to pay for their purchases. Furthermore, customers that are rationed by financial institutions tend to turn to trade credit, considering it a cheap way of getting short- term funds. So suppliers that are financially sound and can relatively easily get access to external funds tend to play this intermediary role by financing their customers' stock through trade credit. Therefore, trade credit becomes an attractive way of obtaining required finance. The financing theory is the most applicable to the availability of trade credit to new SMEs.

Business environment

Smit et al. (2007:62) define a business environment as all those factors or variables, both inside and outside the organization that may influence the continued and successful existence of the organization.

Internal environment

The internal environment includes the factors that are largely controllable by the firm. In the capital structure context, the internal environment consists of factors largely controllable by the firm but which can influence its access to debt and or equity (Barbosa and Moraes, 2004). The internal environmental factors focused on by this study as identified by exploratory factor analysis are collateral, business information, managerial competencies and networking and collateral. Kitindi et al. (2007:55) find that trade creditors use business information provided by firms to analyse their present performance and predict future performance. Financial information reduces information asymmetry. If an entrepreneur has spent time developing a comprehensive and a priory business plan at an early stage in the project, risk perception should be reduced and the likelihood of obtaining capital should increase (Bollingtoft et al., 2003). This suggests that the availability of quality financial information and owners' capital contribution positively associate with the availability of trade credit.

Studies by Shane and Stuart (2002:156) and Rudez and Mihalic (2007:191) positively associate managerial competencies with new venture performance. The higher the level of managerial competency exhibited by the owners of a new firm, the greater the viability and survival of the new SME. This suggests that credit providers may be willing to extend facilities to new SMEs whose owners exhibit a high level of managerial competencies. Coulthard and Loos (2007) describe networking in a small firm context as an activity in which entrepreneurially oriented SME owners build and manage personal relationships with particular individuals in their surroundings. Okten and Osili (2004:1225) examine the impact of network formation on SME growth. The results indicated that the formation of networks helps new SMEs to tap resources in external environment successfully. This suggests that networking can improve the availability of trade credit to new SMEs.

According to Coco (2000:197) collateral helps reduce informational asymmetries and moral hazard problems that arise when between trade creditors and entrepreneurs. Trade creditors seldom take collateral. Willacy (2009) points out that if the customer fails to meet the trade creditor's credit criteria, the trade creditor will require the customer to provide security.

External environment

External factors are largely uncontrollable by SMEs and lenders. External factors are not only outside the reach of lenders' actions, but neither can they be changed in the short-run by policy makers (Beck, 2007) . External factors focused on by this study include the macroeconomic environment, the legal environment, ethics, crime and corruption. Economic variables can affect the availability of trade credit to SMEs. Weak economic conditions can affect sales, revenues, market and growth potential of new SMEs. Weak economic conditions make it difficult for firms to use debt positively and this may affect their ability to repay debt (Barbosa and Moraes, 2004). The Organisation of Economic Cooperation and Development (2006) shows that market imperfections such as those caused by inefficient legal systems can constrain the ability of firms to access external finance. Firms in countries with more efficient legal systems should therefore obtain more external financing than firms in countries with less developed financial institutions. The World Bank Country Report on South Africa (2003) reveals a relatively inefficient legal system compared to developed countries. There is a shortage of judges and magistrates, backlog of cases and lower creditor protection. This suggests that the inefficient legal system In South Africa could have an impact on the availability of trade credit to new SMEs in South Africa.

Lepoutre and Heene (2006:259) find that mew SMEs experience more difficulties than their larger counterparts when engaging in ethically responsible behaviour. The single most unethical practice by small firm professionals is dishonesty in making and keeping contracts. Creditors risk perception may be influenced by the extent to which they can assess that they can trust the entrepreneur or entrepreneurial team. Crime and corruption in South Africa are high and widely believed to restrain investment. The World Bank (2008) Investment Climate Survey finds that 30% of enterprises in South Africa rate crime as a major or very severe constraint on investment, putting crime amongst among the four most frequently mentioned constraints. The costs of crime to businesses in South Africa are substantial. Furthermore, the rate of corruption in South Africa is relatively high compared to developed countries (Transparency International, 2008). Crime and corruption may affect repayment of trade credit.

RESEARCH OBJECTIVES

The primary objective of the study is:

i. To investigate the impact of the business environment on the availability of trade credit to new SMEs.
ii. To primary objective will be achieved through the following secondary objectives.
iii. To investigate empirically the impact of internal environment on the availability of trade credit to new SMEs.
iv. To investigate empirically the impact on the external environment on the availability of trade credit to new SMEs.

METHOD

The study used the quantitative research design and survey research method. Data for the research study was gathered through self-administered questionnaires in 2009. Seven-point Likert scale questions were used except for demographic questions. The questions were asked negatively (e.g. lack of collateral causes non-availability of trade credit). The researcher focused on trade creditors in the wholesale, retail and manufac-turing sectors. According to Selima (2007:17) these three sectors account for most of the trade credits. The population frame of trade creditors was obtained from the Border-Kei Chamber of Commerce, the Port Elizabeth Regional Chamber of commerce and the Enterprise Black Business Directory 2008. The population of big firms and SMEs that are in the wholesale, retail and manufacturing was five hundred and forty one. Using the Raosoft sample size calculator at 5% margin of error and 95% confidence interval the sample size for trade creditors was 225. This is the minimum recommended sample size by the Raosoft sample size calculator. However, 315 questionnaires were distributed to trade creditors.

The empirical research for the study was conducted in two ways; a pilot study and the main survey. The measuring instrument was

Table 1. KMO and BTS.

Variables	Results
KMO	0.812
BTS	557.161
Sig.	0.02

designed to measure the internal and external environmental variables (the business environment) that impact on the availability of trade credit to new SMEs. For this purpose an initial 78-item questionnaire was designed. The questionnaire was administered to 101 respondents in a pilot study. Exploratory factor analysis of the responses allowed for content validity using the Cronbach's alpha and resulted in the reduction of the 78 items to 44 items and nine underlying factors for trade creditors.

Exploratory factor analysis (EFA) is used to uncover the underlying structure of a relatively large set of variables. Leech et al. (2005:82) point out that items with factor loading of less than 0.3000 can be removed. The conditions for factor analysis include: Factors with Eigen values greater than one are usually retained. Sampling adequacy: Bartlett's test of sphericity and the Kaiser-Meyer-Olkin (KMO) measure the sampling adequacy and can be used to determine the factorability of the matrix as a whole. (Leech et al., 2005:82).

DISCUSSION

Table 1 depicts the results of the BTS and KMO. The results (the BTS at 557.161 and the level of significance at *P*=0.000) indicated that the data were appropriate for the purpose of factor analysis. The result of the KMO measure of sampling adequacy was 0.812 which indicates that there are sufficient items for each factor. The two tests support the appropriateness of the factor analysis technique.

Table 2 shows that nine factors with Eigen values greater than one account for 75.3% of the total variance. According to the rules of factor analysis only factors that have Eigen values greater than one should be retained.

Table 3 depicts the rotated factor loading and Cronbach's alphas. Nine factors were identified.

Factor one was labeled as business information. The Eigen value for the factor is 10.225. This factor is internal to the firm. Factor two was labeled crime. The Eigen value for the factor is 6.441. The factor is largely external to the firm. Factor three was labeled networking. The Eigen value for the factor is 4.104. The factor is largely internal to the firm. Factor four was labeled as ethics. The Eigen value for the factor is 3.276. The factor is external to a firm. The factor is largely internal to the firm. Factor five was labeled as managerial competencies. The Eigen value for the factor is 3.015. The factor is internal to the firm. Factor 6 was legal system. The Eigen value for the factor is 2.284. The factor is external to a firm. Factor seven was labeled economic. The Eigen value for the factor 2.015. The factor is largely external to the firm. Factor eight was labeled collateral. The Eigen value for the factor is 1.846. The factor is internal to the firm. Factor nine was labeled *corruption*. The Eigen value for the factor is 1.424. The factor is external to a firm. All the factors have Cronbach's alphas greater than 0.7 indicating the reliability of the factors.

In the main survey, 315 questionnaires were distributed and 233 returned. The response rate was 74%. Most respondents are in the 31-40 age group. Males dominate. Most of the respondents were well educated with diplomas and degrees with about 6-10 years experience. In addition, the respondents' firms are predominantly independent, medium-size businesses in the manufacturing sector. Confirmatory factor analysis confirmed the nine factors.

Table 4 depicts the item analysis which included the means, standard deviation, skewness and kurtosis and the Cronbach's alphas. The Kolmogorov-Smirnov test was above 0.05 which indicated the normality of the data.

The results as indicated by the means show that the following variables have scale means above four out of seven (seven point Likert scale was used). Business information has the highest scale mean of 6.01, followed by crime 5.78, networking 5.75, ethics, 5.62, managerial competency 5.16, legal 5.02, macroeconomy 4.56, collateral 3.34 and corruption 2.90. The results indicate that three of the four internal factors and four of the five external factors positively impact on the availability of trade credit to new SMEs. The significance of the findings was confirmed by the Pearson correlation test.

The Pearson correlation (refer to Table 5) was used to test for the direction and strength of relationship between the business environmental factors and availability of trade credit. The results indicate that business information (r=.191, sig.0.26), low crime rate (r=.732, sig. 0.03), networking (r=.859, sig 0.01), ethics (r=.732; sig 0.03), managerial competency (r=.668; sig 0.01), legal (r=.657; sig 0.01) and macroeconomy (r=.592; sig 0.02) all have strong significant positive relationships with availability of trade credit. Collateral (r= .191, sig. 0.26) and corruption (r= .117, sig. 0.18) have weak insignificant relationships with the availability of trade credit.

CONCLUSIONS AND MANAGERIAL IMPLICATIONS

The results indicated that internal factors especially the availability of business information is the most important factors affecting the availability of trade credit to new SMEs. Other internal factors (managerial competency and networking) are very important. Out of the five external factors, four have positive and significant correlation with the availability of trade credit to new SMEs. The results suggest that variables in the internal environment and external environment are important with respect to the availability of trade credit.

To improve the availability of trade credit to new SMEs training and skill development need to be improved for

Table 2. Total variance explained.

Component	Initial eigen values			Extraction sums of squared loading			Rotation sums of squared loadings		
	Total	% of variance	%Cumulative	Total	% of variance	Cumulative	Total	% of variance	%Cumulative
1	10.225	22.228	22.228	10.225	22.228	22.228	11.302	24.569	24.569
2	6.441	14.002	36.230	6.441	14.002	36.230	7.464	16.227	40.796
3	4.104	8.921	45.151	4.104	8.921	45.151	3.270	7.108	47.904
4	3.276	7.122	52.273	3.276	7.122	52.273	2.906	6.317	54.221
5	3.015	6.554	58.827	3.015	6.554	58.827	2.479	5.839	60.060
6	2.284	4.965	63.792	2.284	4.965	63.792	2.395	5.206	65.266
7	2.015	4.380	68.172	2.015	4.380	68.172	1.972	4.287	69.553
8	1.846	4.013	72.185	1.846	4.013	72.185	1.680	3.654	73.207
9	1.424	3.096	75.281	1.424	3.096	75.281	1.110	2.074	75.281
10	.601	1.134	89.417						
11	.552	1.041	90.458						
12	.492	0.928	91.386						
13	.452	0.853	92.239						
14	.401	0.757	92.996						
15	.369	0.696	93.692						
16	.301	0.568	94.260						
17	.215	0.406	94.666						
18	.198	0.373	95.039						
19	.182	0.343	95.382						
20	.173	0.326	97.708						
21	.167	0.313	97.021						
22	.161	0.304	96.325						
23	.157	0.297	97.167						
24	.152	0.287	98.612						
25	9.452E.02	9.401E.02	98.715						
26	9.450E.02	9.399E.02	98.825						
27	8.436E.02	8.401E.02	98.865						
8	8.401E.02	7.990E.02	98.879						
29	7.399.E.02	7.200E.02	98.901						
30	7.100E.02	7.050E.02	98.957						
31	7.061E.02	6.980E.02	98.980						
32	6.778E.02	6.771E.02	98.987						
33	6.578E.02	6.501E.02	98.001						
34	5.998E.02	5.990E.02	98.126						

Table 2. Contd.

35	5.809E.02	5.678E.02	98.207
36	4.998E.02	4.880E.02	98.367
37	4.673E.02	4.086E.02	98.678
38	3.997E.02	3.990E.02	98.789
39	3.773E.02	3.156E.02	98.801
40	3.534E.02	3.026E.02	99.037
41	2.895E.02	2.601E.02	99.328
42	2.678E.02	2.501E.02	99.897
43	2.456E.02	2.301	99.997
44	1.398E.02	1.217E.02	100.00

Table 3. Rotated factor loading and Cronbach's alpha.

Variables	**Factor 1**	**Factor 2**	**Factor 3**	**Factor 4**	**Factor 5**	**Factor 6**	**Factor 7**	**Factor 8**	**Factor 9**
Cash flow does not show that the credit can be repaid	0.8841								
The business does not have a business plan	0.8420								
The business does not have a business plan	0.8100								
The business is not financially viable	0.7350								
The business does not have suitable business premises	0.5342								
The business plan is not thorough in its coverage of key issues	0.478								
The business plan does not do an excellent job in articulating opportunity	0.4500								
The business is located in high crime area		0.8100							
The business is not insured		0.7654							
No prior relationship			0.7352						
Short prior relationship			0.6975						

Table 3. Contd.

The business does not belong to a professional association	0.6530		
No distribution of output agreement	0.5986		
No social relationship	0.5373		
Business plan not produced with the aid of accountant/consultant	0.4500		
Perception of willingness to divert funds		0.7895	
Perception of payment default		0.6988	
Lack of good reference on integrity		0.6760	
Perception of dishonesty in keeping promises and commitments		0.6531	
Founder is not familiar with market		0.6356	
Lack of business skills		0.6013	
The business does not have necessary business documentation		0.5781	
False information and paddling of financial statements		0.4500	
Bad credit record			0.7880
Lack of experience relevant to the venture			0.7651
Founder lacks demonstrated managerial ability			0.6453
The entrepreneur does not have the resources to manage the business			0.5378
Founder has not received any training related to the business			0.4682

Table 3. Contd.

In the situation of legal action against the customer, it is costly to get judgment						0.8010			
In the situation of legal action against the customer, it takes a long time to get judgment						0.7632			
Court are not fair and impartial						0.6783			
Court decisions are not enforced									
In the situation that legal action is taken against customers to recover loan, the perception that corruption of court official may delay judgment						0.5984			
Weak confidence in the legal system to enforce contracts and property rights						0.4861			
Recession in the economy							0.6920		
High interest rate							0.6543		
The business does not have market potential							0.6401		
The business does not have growth potential							0.5352		
High inflation rate							0.4987		
Low equity contribution								0.6980	
No current assets as collateral								0.6500	
No guarantee								0.5987	
In the situation where the credit application is for government contract, the perception that the corruption of government official may delay payment									0.7543
In the situation where the credit application is for private contract, the perception that corruption may delay payment									0.6988
Cronbach's alpha	0.8210	0.7654	0.7865	0.8523	0.7119	0.7432	0.7608	0.8107	0.7112

Table 4. Item analysis.

	Collateral	Business information	Management Competencies	Economy	Crime	Network	Legal	Ethics	Corruption
Mean	3.34	6.01	5.16	4.56	5.78	5.75	5.02	5.62	2.90
Standard deviation	0.217	0.186	0.541	0.597	0.117	0.318	0.459	0.221	0.117
Cronbach's alpha	0.7257	0.8113	0.7210	0.7507	0.8002	0.7573	0.7103	0.7524	0.7290
Skewness	0.549	0.201	0.616	0.791	0.147	0.323	0.111	0.417	0.315
Kurtosis	0.318	0.125	0.497	0.316	0.593	0.216	0.149	0.114	0.347
Kolmogorov-Smirnov	0.71	0.62	0.75	0.49	0.17	0.26	0.58	0.41	0.57

P value significant at 0.05.

Table 5. Correlation results**.**

Factor	Results	
	R	P-value
Collateral	.191	0.26
Business information	.901	0.01
Managerial competency	.668	0.01
Crime	.883	0.03
Macroeconomy	.592	0.02
Networking	.859	0.01
Ethics	.732	0.03
Legal	.657	0.01
Corruption	.117	0.18

Significant 0.05 (2-tailed).

new SMEs. Government agencies such as small enterprise development agency (SEDA) can organize training for new SMEs. Awareness should be created for the training programmes through advertisements in local and national media. Furthermore, a mentorship approach can be instituted by government agencies to help new SMEs. Training can be costly for new SMEs. Subsidies, matching contributions to training, tax credits for training or reimbursements for completed training can be used to reduce the cost of training to new SMEs. There is the need to create a positive attitude toward entrepreneurship and training. Educational institutions should introduce and strengthen entrepreneurial education.

The study therefore strongly recommends that government, non-governmental organisations, and other local supporting agencies should organize network formation activities such as seminars, trade fairs. Reforming the legal framework for creditor rights and insolvency proceedings in general, and for secured lending in particular, would greatly enhance the ability of SMEs to access bank loans by pledging collateral. Specialized courts to act against SMEs that default on loan obligations could also facilitate SME finance. Government should work in partnership with organisations such as Business Against Crime South Africa and Business Unity South Africa. The literature review showed that poverty is one of the causes of crime. There is the need to create work opportunities for the vast number of the unemployed in South Africa. The legal system needs to be more efficient so that criminal cases against businesses can be dealt with quickly. More effective policing is needed, including better police visibility, area coverage and faster response times Business ethics should be introduced as a major module in the universities and colleges in South Africa to prepare likely entrepreneurs about the importance of ethics. SME owners should be trained on the importance of business ethics.

Limitations and areas for further study

The study focuses only on trade credit. Other providers of funds such as commercial banks and government agencies were not investigated. The study only focuses on the supply side of debt financing and the perception of providers of funds. A dyadic survey to examine the obstacles to credit as perceived by both trade creditors and SMEs could help to further confirm the findings of this study.

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