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## **IMPROVING THE BUSINESS TRAJECTORY AMONG SMALL AND MEDIUM SIZE CONSTRUCTION FIRMS IN SOUTH AFRICA**

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### **ABSTRACT**

The Construction Industry Development Board (cidb) register of contractors shows that small and medium sized enterprises (SMEs) outnumber established firms in South Africa. However, the failure rate of SME businesses, which has increased in recent years, constitutes a source of concern in the industry. This situation is reflected in the limited number of successful construction SMEs as a percentage of the total registered firms in the industry. The research design for the study reported on entailed semi-structured and unstructured interviews, which were conducted over an extensive period of time to gather sufficient information from the research participants. However, the preliminary findings that form the nexus of this paper are based on the reviewed literature, and a pilot study that was conducted among a purposive sample of construction SMEs - Grades 1 to 5 on the cidb register. It is notable that the initial findings suggest that construction SMEs often encounter difficulty in securing projects, fail to realise core organisational objectives and goals, and are unable to gain cost advantages over their immediate rivals, which affects their business performance. Thus it appears that more effort is required to improve the business performance of construction SMEs in South Africa.

**Keywords:** Construction Industry, Historically Disadvantaged Individuals (HDIs), Small and Medium Size Enterprises (SMEs), South Africa

### **1. INTRODUCTION**

It can be observed that the South African construction industry is in the process of transformation (Martin, 2010). The requirement for this transformation stems from the need to address the effects of apartheid (Martin, 2010). Since 1994, South Africa has been re-integrated into the international market, and has been positioning itself to realise the high expectations of its populace regarding a successful transition towards a more democratic society (Berry *et al.*,

2002). Berry *et al.* (2002) further posit that to achieve the objectives of economic growth and employment generation and income redistribution, SMEs must be actively promoted in South Africa.

SMEs encompass a broad range of firms, from established traditional family businesses that employ over a hundred people (medium-sized enterprises), to survivalist self-employed from the poorest layers of the population (Berry *et al.*, 2002). According to Shakantu (2012), there are several difficulties related to attempts to define a SME business enterprise. The yardstick for delineating enterprises by size is usually one or more of the following: total number of employees; value of fixed assets; paid-up capital; annual turnover, and annual volume of physical production. The nature of activity determines the viable and normal economic operating size. Therefore, there is no single definition.

Ofori, Ali Lin and Tjandra (2012) mention that the development and growth of construction businesses within the lower grades of the cidb is a fundamental element for all countries as a strong SME base has the capacity to produce quality infrastructure. However, in South African construction, SMEs are repeatedly experiencing certain difficulties that are not limited to lack of capital due to difficulty in accessing finance, and lack of experience; but more so the lack of general business and management training and exposure to achieve business sustainability in their market share (Murray and Appiah-Baiden, 2002). Many authors have stated the reasoning behind business failure among construction SMEs. With this failure, a number of proposed solutions have been identified. However, a gap and area which has not been adequately acknowledged is construction management. Construction Management can be viewed in two dimensions, the management of the business of construction, and of projects per se. Construction management lends itself as a mechanism to improve business performance and management among construction SMEs. Currently the concept of construction management is not clearly understood and therefore not well established amongst construction SMEs within the South African construction industry. Given the fact that the failure rate among construction SMEs is significant, there is a need to address this problem by providing a clear theoretical understanding of their competency levels with regards to the basic constructs and related concepts of construction management, as well as its application amongst construction SME businesses.

## **2. LITERATURE REVIEW**

### ***2.1 The importance of SMEs***

According to Fan (2003), SMEs are the engine of growth in every economy. They are deemed as essential for a competitive and efficient market and are critical in the reduction of poverty. In terms of economic growth, Fan (2003) posits that the SME sector is the largest provider of employment in most countries, especially in the creation of new jobs. They are recognised as a major source of technological innovation and new products. United Nations Centre for Human Settlements (UNCHS) (1996) cited by Shakantu (2012) reports that SMEs constitute 91-93% of industrial enterprises in the South East and East Asian countries of Malaysia, Singapore, Taiwan, and Thailand.

In addition, Fan (2003) mentions that in Russia and some parts of Europe, SMEs that employ up to 250 employees, account for approximately 90% of the total number of firms that provide 45% of the total employment and generate 40% of the total sales. Fan (2003) further states that SMEs tend to employ poor and low-income workers, which are located within poor regions and rural areas where self-employment is the only source of income for many. It is therefore suggested that SMEs are important role players to almost all economies in the world, but especially to developing countries where poverty is most severe (Fan, 2003).

## ***2.2 The importance of construction SMEs in South Africa***

The role of construction SMEs is considered to be equally important to the economy as that of SMEs in general. Shakantu (2012) mentions that construction SMEs form a crucial component of a government's strategies to create employment opportunities, and foster economic growth and national development. These SMEs provide a vehicle through which most of the under-privileged, who lack financial resources and skills, can typically gain access to economic opportunities. In addition, it is mentioned that construction SMEs are the potential engines of wealth creation, value reorientation, job creation, and poverty eradication (Shakantu, 2012). This is particularly crucial for South Africa that is characterised by the legacy of big business dominance and huge unequal distribution of wealth.

## ***2.3 The challenges facing construction SMEs in South Africa***

The existence of a vibrant small business sector often indicates the presence of an entrepreneurial spirit and an economically healthy society. Although facing many structural difficulties, the small business sector is a significant contributor to the South African economy. According to the Department of Trade and Industry (2003), small businesses represent 98% of the total number of firms in South Africa. They employ 55% of the country's labour force and contribute 35% towards the GDP of South Africa. They also contribute more than 40% of the GDP in four of the eight major economic sectors; construction being one of them. These are good figures in terms of SME involvement, but sadly, it was revealed that 40% of these SMEs who start new business ventures fail in the first year, 60% in their second year, and 90% in their first ten years of existence (Van Scheers, 2011). These figures speak not only to SMEs in general, but also to construction SMEs that form part of this business sector. However, the cidb and Construction Education Training Authority (CETA) estimate that 70% of construction SMEs fail in their first year of existence (Martin, 2010).

The challenges that contribute to the high business failure rate among construction SMEs are many and varied, and impact significantly on their development and sustainability. According to Barron (2000), one of the major challenges that most construction SMEs experience is that they generate good ideas and are generally competent in the physical work they deliver, but unfortunately "they do not have a clue on how to run a business and have no underlying appreciation of business fundamentals." Chilipunde (2010), in addition to Hormozi, Sutton, McMinn and Lucio (2002), observe that poor strategic leadership and insufficient control of essential aspects of financial management constitute the key issues behind their business decline and eventual failure. Ranjit, Mwanaumo and Nkado (2011), as well as Pansiri and Temtime (2006), also identify deficiencies in managerial skills and business knowledge among construction SMEs in South Africa. Brink and Cant (2003) further mention that business

problems experienced by construction SMEs can be categorised based on their origin in the external and internal environment. Within the external environment, construction SMEs are faced with problems such as the state of the economy, compliance with legislation, resource scarcity, HIV & AIDS, crime and corruption, and rapidly changing technology (Luo, 2003; Chen, 2006). As for the internal environment, construction SMEs' major cause of business failure revolves around management skills, financial knowledge, and lack of expertise in functional areas such as marketing and human resource management (Ligthelm and Cant, 2002).

Krajcovicova, Caganova and Cambal (2012), Ranjit, Mwanaumo and Nkado (2011), and Fatoki and Odeyemi (2010) are in agreement that some of the problems emanating from these factors include specific management issues such as lack of business management training and skills as well as a limited family business culture in South Africa (Ranjit, Mwanaumo and Nkado, 2011). Other reasons for failure include the inability to act as entrepreneurs, to control business growth and undue emphasis on financial rewards (Ndedi, 2013). In addition, management actions and behaviour that were found to be lacking in construction SMEs include: the inability to set strategic goals; plan forward actions; reluctance to seek advice; lack of management commitment, and unwillingness to adapt to change (Ligthelm and Cant, 2002). Proposed solutions have been identified to address the factors that contribute to the failure rate among construction SMEs in South Africa. These solutions include the need for entrepreneurship, for expertise, access to finance and a supportive regulatory environment (Shakantu, 2012). Other critical success factors for construction SME development include: the ability of contractors to market their services among the industry role players; the experience and management expertise of the owner; the ability to maintain a good relationship with clients, suppliers and other relevant role players, as well as to develop adequate project management capabilities (Shakantu, 2012).

As indicated in mainstream management literature, some of these difficulties can be surmounted. Hence, Hough *et al.* (2011) postulate that business strategy is management's action plan for running the business and conducting operations. Hough *et al.* (2011) add that core competencies and competitive capabilities are vital areas, which could assist construction SMEs in the execution of good business strategies. They are equally important areas that could be utilised in securing a competitive advantage over rivals in situations where it is relatively easy for rivals to copy smart strategies. Hough *et al.* (2011) further add that the best way to achieve a lasting competitive advantage is to out-execute competitors. For example, by performing certain value-chain activities in a superior fashion, SMEs could out smart their competitors. The core concept of this is that building competencies and capabilities that are very difficult or costly for rivals to emulate has a huge payoff for construction SMEs. This generally results in an improved execution strategy and the potential for competitive advantage. However, for most construction SMEs, the words 'business strategy' and 'competitive advantage' could be uncommon / or unknown as they tend to rather focus on survival, from project to project, instead of business growth.

Based on Porter's concepts (1980), a key fundamental in business growth, however, requires construction SMEs to understand trends within the industry, and to fully understand the market. Hough *et al.* (2011) opine that due to the emerging market being in its infancy, there is usually much speculation about how it will function, how it will grow and how big it will get. For

construction SMEs that are hampered by repeated shortcomings, it is very complicated in order to make profits due to limited historical information available to them (Hough *et al.*, 2011). Porter (1980) comments that a market signal is any action by a competitor that provides a direct or indirect indication of its intentions, moves, goals or internal situations. The behavioural pattern of competitors provides signals in a myriad of ways. Porter (1980) further mentions that some signals are bluffs, some are warnings and some are earnest commitments to a course of action. Therefore, if construction SMEs are able to recognise and accurately read these market signals, it would be of major significance for developing a competitive strategy and would be the key driver to competitor analysis (Porter, 1980).

In an attempt to assist construction SMEs to adapt to the abovementioned skills, a number of contractor development programmes were established. These programmes are managed by the National and Provincial Departments of Public Works (cidb, 2010a). These programmes have gained huge successes in relation to participation, but have not addressed the fundamental concern, which is the growth and development of construction SMEs into established contractors (Ranjit, Mwanaumo and Nkado, 2011). In addition, Ranjit *et al.* (2011) mention that the results of these contractor development programmes have been largely insignificant. This raises doubt surrounding the CDPs and their models for producing ‘serious industry players’ and developing sustainable construction SMEs. According to Ehlers and Lazenby (2004), research has revealed that firms who practice strategic management techniques usually outperform those that do not.

### 3. RESEARCH METHODOLOGY

An exploratory survey was used to obtain insights related to the issues impacting on the business failure rate among SMEs in South African construction. The survey was made up of three principal questions, two of which were 5 point likert scale type and the third question was open-ended. The first question required the respondents to rate certain statements that describe the characteristics of SMEs in South African construction, and the second question elicited responses relative to notable causes of business failure among such SMEs.

**Table 1. Research Participants.**

Respondent	Response	
	No.	%
Established owners	15	13.0
Construction managers	30	26.0
Quantity Surveyors	30	26.0
Academics	40	35.0
Total	115	100.0

The open-ended question then requested general comments pertaining to the subject area. A non-random sampling method was used to select respondents within the Western Cape Province. A purposive sampling method consists of identifying and selecting respondents that a researcher perceives to have prior knowledge in the subject area. Respondents were owners of established

construction firms, construction managers, and quantity surveyors involved in the South African construction industry and who are affiliated to professional bodies such as the SACPCMP, the ASAQS as well as the MBAWC. These respondents were chosen because of their active involvement in the development of construction SMEs in South Africa. Table 1 presents the research participants. In the context of this particular study, SME refers to firms that are graded between grades 3-6 on the cidb register.

#### 4. FINDINGS AND DISCUSSION

The first of the three questions required the respondents to rate certain statements that described the characteristics of SMEs in South African construction, and the second question elicited responses to notable causes of business failure among such SMEs. The open-ended question then requested general comments pertaining to the subject area.

**Table 2. Degree of concurrence relative to statements pertaining to SMEs within the South African construction industry.**

Statement	Response (%)					MS	Rank	
	Unsure	Strongly disagree.....Strongly agree						
		1	2	3	4			5
Construction SMEs encounter difficulty in terms of securing projects	4.0	0.0	0.0	27.0	33.0	36.0	3.91	1
Construction SMEs often fail to realise core organisational objectives and goals	1.0	4.0	2.0	20.0	50.0	23.0	3.83	2
Construction SMEs battle to gain cost advantages over their immediate competitors	4.0	5.0	1.0	14.0	51.0	25.0	3.77	3
Construction SMEs experience difficulty in terms of managing the business of construction	4.0	5.0	7.0	40.0	25.0	19.0	3.46	4
Construction SMEs do not expand their businesses	2.0	4.0	13.0	36.0	21.0	24.0	3.43	5
Construction SMEs are marginally profitable if at all	6.0	4.0	16.0	28.0	24.0	22.0	3.22	6
Procurement efforts of construction SMEs do not yield commensurate results	10.0	8.0	14.0	16.0	38.0	14.0	3.08	7

As indicated in Table 2, it is evident that construction SMEs within the South African construction industry are challenged in many areas, which need to be addressed in order to enhance their business performance. The mean score (MS) of 3.53 indicates that in general the respondents can be deemed to agree with the statements. The majority of the respondents were of the opinion that 'construction SMEs encounter difficulty in terms of securing projects', which is reflected in the highest MS of 3.91. In addition, respondents perceived that 'construction SMEs often fail to realise core organizational objectives and goals'. This statement achieved the second highest MS of 3.83. A MS of 3.77 was recorded relative to 'construction SMEs battle to gain cost advantages over their immediate competitors'. Respondents also concurred that 'construction SMEs experience difficulty in terms of managing the business of construction', 'construction SMEs do not expand their businesses' and 'construction SMEs are marginally profitable if at all'. However, the lowest MS of 3.08 was relative to 'procurement efforts of construction SMEs do not yield commensurate results'.

The findings in Table 3 indicate the respondents are of the opinion that the lack of management competencies (MS = 3.91), marketing competencies (MS = 3.62) and strategic planning (MS = 3.61) are the three key areas that construction SMEs need to develop before they can realise core organisational objectives and goals, which should enable them to expand their businesses. Lack of finance achieved a MS of 3.49. A likely reason for this is that finance is still a major concern in terms of start-up capital, which the majority of construction SMEs require. However, in terms of MSs it is followed closely by lack of skilled workers, estimating competencies, tendering competencies, and forecasting and trend monitoring that are needed for successful enterprise management. The poor prioritisation of value systems achieved the second lowest MS of 3.18. A likely reason for this score is that most SMEs are still early developers in terms of market position and would more than likely battle in terms of developing sufficient value systems. It is however notable that lack of entrepreneurial skills achieved a MS of 3.30, which is detrimental to the development of construction SMEs. The lowest MS of 2.79 relative to contractor development programmes do not adequately address the business of construction indicates disagreement as opposed to agreement, however marginally so. In essence, they hamper the development of new construction SMEs in terms of equipping them with the various competencies required to sustain and grow their businesses.

Many authors (Hodgetts and Kuratko, 2008; Van Scheers, 2011; Handfield and Nichols, 2002; Bikitsha and Root, 2011; Toor and Dhir, 2011; Hormozi, Sutton, McMinn and Lucio, 2002; Ranjit, Mwanaumo and Nkado, 2011) identify the various causes of business failure among SMEs in South African construction. However, it is evident from the findings of this explorative study that respondents generally agreed with the statements and notable causes. Conversely, managerial and marketing competencies as well as strategic planning served as the most reputable causes for business failure among these SMEs.

Beaver (2007) postulates that despite the contribution and significance of small firms, every year tens of thousands of small enterprises cease to trade. Many researchers and practitioners claim that one of the major causes of small business failure is poor management (Temtime and

Pansiri, 2006). However, Hodgetts and Kuratko (2008) concur that one of the major reasons behind small business failure is the lack of managerial competencies.

**Table 3. Causes of business failure among SMEs within the South African construction industry.**

Cause	Response (%)						MS	Rank
	Unsure	Strongly disagree...Strongly agree						
		1	2	3	4	5		
Lack of management competencies	6.0	0.0	4.0	13.0	39.0	38.0	3.91	1
Lack of marketing competencies	2.0	0.0	12.0	33.0	27.0	26.0	3.62	2
Lack of strategic planning	7.0	4.0	0.0	25.0	37.0	27.0	3.61	3
Lack of finance	13.0	4.0	1.0	19.0	28.0	35.0	3.49	4
Lack of estimating competencies	10.0	0.0	4.0	34.0	29.0	23.0	3.43	5
Lack of forecasting and trend monitoring	7.0	0.0	19.0	18.0	32.0	24.0	3.41	6
Lack of tendering competencies	10.0	4.0	8.0	30.0	14.0	34.0	3.37	7
Lack of skilled workers	2.0	4.0	23.0	18.0	36.0	17.0	3.33	8
Lack of entrepreneurial skills	10.0	0.0	13.0	23.0	37.0	17.0	3.30	9
Poor prioritisation of value systems	11.0	0.0	12.0	37.0	18.0	22.0	3.18	10
Contractor Development Programmes do not adequately address the business of construction	15.0	4.0	31.0	16.0	16.0	18.0	2.79	11

Van Scheers (2011) mentions that marketing is one of the most important tasks for SMEs in South Africa. It is a key determinant as to whether the construction SME businesses will succeed



or cease to trade. According to Fuller (1994) cited by Reijonen (2010), it is argued that through marketing, a firm aims to achieve competitive advantage by satisfying its customers more effectively and efficiently than its competitors, thus ensuring long-term profitability. In addition, it is stated that marketing places customers at the centre of the firm's activities. Marketing can therefore be regarded as a process that brings the firm in constant and direct contact with its customers.

Despite the importance of managerial and marketing competencies, Hormozi, Sutton, McMinn and Lucio (2002) suggest that, a key determinant of business success lies in the absence or presence of strategic planning. According to Beaver (2003), most SMEs do not engage in strategic planning. In addition SME owner-managers have been accused of being 'strategically myopic' and lacking the long-term vision as to where their firm is headed. The concern is that by neglecting strategic planning, SMEs may not achieve their full performance and growth potential, and their survival could be placed at risk (Wang, Walker and Redmond, 2011). Wang, Walker and Redmond (2011) further mention that in terms of business performance and growth, strategic planning is generally utilised most often in better performing SMEs. Wang, Walker and Redmond (2011) further confer that SMEs that engage in strategic planning are more likely to achieve higher sales growth, higher returns on assets, higher margins on profit, and higher employee growth, than those that do not.

## **5. CONCLUSION AND RECOMMENDATION**

The study was conducted to obtain proficient judgement on the various statements and possible causes which influence the business failure rate among SMEs in South African construction. The overall aim of this study is to improve the business performance of construction SMEs in South Africa. An exploratory survey was used as the method to collect data which would generate insights related to the issues impacting on the business failure rate among SMEs in South African construction. The survey entailed three principal questions, two of which were 5 point likert scale type, and the third was open-ended. The first question required the respondents to rate certain statements that describe the characteristics of SMEs in South African construction, and the second question elicited responses to notable causes of business failure among such SMEs. The open-ended question then requested general comments pertaining to the subject area. An empirical concern in terms of directing the overall research was that the findings confirmed the importance of managerial and marketing competencies as well as strategic planning which SMEs in South African construction should possess if they are to improve their business performance. The study was geographically limited to the Western Cape Province. In addition limitations also existed in terms of the choice of respondents, which did not include owners of construction SMEs. It is therefore acknowledged that the input of construction SMEs would have been more credible than professionals and that further empirical studies could be conducted. However, the findings indicate that the proposed study will contribute to the related body of knowledge.

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