THE MANAGEMENT OF TRADE CREDIT IN SMALL AND MEDIUM-SIZED ENTERPRISES

By

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LETTER FROM LANGUAGE EDITOR

TO WHOM IT MAY CONCERN

This is to confirm that I have edited Mr WH Otto's Masters dissertation, entitled:
The management of trade credit in small and medium-sized enterprises
for language use and technical aspects.

Marie-Therese Murray
Cellphone: 0828180114
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ABSTRACT

Of the economically active population in South Africa, approximately 24.5% are unemployed (Statistics South Africa, 2009). South Africa experiences severe income inequality and high levels of poverty. SMEs are expected to be an important vehicle to address the challenges of job creation and sustainable economic growth. The chance of survival for SMEs is less likely in South Africa than in any other GEM country sampled in 2005, according to Von Broembsen, Wood and Herrington (2005). The mismanagement of trade credit could be a cause of failure for SMEs in South Africa.

The primary objective of this study was to determine the trade credit-management practices of SMEs in order to establish whether trade credit is being mismanaged by SMEs in South Africa. To achieve this objective, it was necessary to determine and illustrate the trade credit-management practices of SMEs in order to establish whether SMEs find it difficult to manage trade credit successfully and fail to use trade credit effectively as a source of funding. Understanding and explaining possible reasons why SMEs find it difficult to manage trade credit successfully is important in explaining if SMEs' fail due to the mismanagement of trade credit within their own practices. For this purpose, this study made use of an e-mail survey and developed an online questionnaire as the primary data-collection instrument.

This online questionnaire, administered to 352 SME respondents, was developed following a thorough review of the literature on debtors and credit policy for SMEs along with the business environment and SMEs. Empirical research was conducted to determine the trade credit-management practices of SMEs in South Africa and, in doing so, establish the reasons why SMEs find it difficult to manage trade credit successfully and fail to use trade credit effectively as a source of funding. The statistical analyses included statistical techniques such as descriptive statistics, frequencies, cross-tabulations and mean scores. In addition, the matched samples t-test and the McNemar test were used in conducting comparison testing between two different classification values, namely debtors and creditors.

Recommendations were made to improve the management of trade credit among SMEs. The findings suggested that SMEs should make use of a sound and structured credit policy before granting trade credit to a customer, in order to strengthen and improve the management of trade credit among SMEs. Furthermore, credit policies must be structured and tightened up in order to increase the effectiveness of SMEs' credit policies, especially focusing on the relevant credit components as set out in the credit policy of the SME. The recommendations also included that SMEs should, as far as possible, try not to prolong the payment owed to other SMEs and/or clients. Training and communication can also help SME owners understand the concepts of effectively managing trade credit. In addition, owners of SMEs should network by attending seminars.

ABSTRAK

Ongeveer 24.5% van die ekonomies aktiewe bevolking in Suid-Afrika is werkloos (Statistiek Suid-Afrika 2009). Suid-Afrika ondervind geweldige inkomste-ongelykhede en hoë vlakke van armoede. Klein-en medium grootte ondernemings (KMOs) is veronderstel om 'n belangrike hulpmiddel te wees om die uitdagings van werkverskaffing en volhoubare ekonomiese groei aan te spreek. Volgens Von Broembsen, Wood en Herrington (2005) se opname is die kanse vir KMOs om te oorleef skraler in Suid-Afrika as in enige ander GEM land. Die wanbestuur van handelskrediet kan 'n moontlike oorsaak vir die KMOs se mislukkings in Suid-Afrika wees.

Die hoofdoel van hierdie studie is om die bestuur van handelskredietpraktyke van KMOs vas te stel en sodoende te bepaal of handelskrediet deur KMOs in Suid-Afrika wanbestuur word. Om hierdie doel te bereik, was dit nodig om die (huidige) bestuur van handelskredietpraktyke te bepaal en te illustreer om sodoende vas te stel of KMOs dit moeilik vind om handelskrediet doeltreffend te bestuur en onsuksesvol is om handelskrediet effektief as 'n bron van finansiering aan te wend.

Om te verduidelik hoekom KMOs as gevolg van wanbestuur van handelskrediet in hulle eie praktyke misluk, is dit belangrik om die moontlike redes vir die onsuksesvolle bestuur van handelskrediet te verstaan en te verduidelik. Ten einde hierdie doel te bereik, het hierdie studie van 'n e-pos opname gebruik gemaak en is 'n aanlynvraelys as die primêre data-insamelingsinstrument ontwerp.

Hierdie aanlyn-vraelys is aan 352 KMO respondente gegee en is ontwerp deur 'n deeglike oorsig van literatuur oor die debiet- en kredietbeleid vir KMOs saam met die besigheidsomgewing en KMOs te volg. Empiriese navorsing is uitgevoer om die bestuur van handelskredietpraktyke van KMOs in Suid-Afrika te bepaal. Die statistiese analises sluit statistiese tegnieke soos beskrywende statistiek, frekwensies, kruistabulering en gemiddeldes in. Daarmee saam is die ooreenstemmende t-toets en die McNemar-toets gebruik om vergelykings tussen die twee verskillende klassifikasiewaardes, naamlik debiteure en krediteure, te tref.

Aanbevelings is gemaak om die bestuur van handelskrediet onder KMOs te verbeter. Die bevindinge stel voor dat KMOs van ’n beproefde en gestruktureerde kredietbeleid gebruik maak alvorens handelskrediet aan ’n kliënt toegestaan word, sodat die bestuur van handelskrediet onder KMOs versterk en verbeter word. Verder moet kredietbeleid gestruktureer en opgeskerp word om die doeltreffendheid van KMOs se kredietbeleid te verhoog, veral deur op die relevante kredietkomponente, soos in die kredietbeleid van die KMO uiteengesit word, te fokus. Dit word ook aanbeveel dat KMOs, sover moontlik, moet probeer om nie die betalings uit te stel wat aan ander KMOs of kliënte gemaak moet word nie. Opleiding en kommunikasie kan ook KMO-eienaars help om die konsepte van doeltreffende bestuur van handelskrediet te verstaan. KMO-eienaars kan ook by netwerke inskakel deur seminare by te woon.

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GLOSSARY OF TERMS AND ABBREVIATIONS

SMEs: Small and medium-sized enterprises

GEM: Global Entrepreneurship Monitor

TEA: Total early-stage entrepreneurial activity

GDP: Gross domestic product

OECD: Organisation of Economic Cooperation and Development

CHAPTER 1

INTRODUCTION TO THE STUDY

1.1 INTRODUCTION

Trade credit arises when a buyer of goods or services makes a delayed payment to a supplier of goods or services (Fatoki & Smit, 2010: 1791). The buyer of goods or services delays the payment to the supplier while receiving goods or services immediately. Trade credit represents an investment for the seller of goods or services in current assets (debtors), while for the buyer of goods or services it is an important form of funding that is classed under current liabilities (creditors) (García-Teruel & Martínez-Solano, 2010: 216).

According to Peel, Wilson and Horworth (2000: 17), trade credit is an important source of financing for the majority of small and medium-sized enterprises (SMEs). Trade credit arises from the normal day-to-day business transactions between organisations, and can be classified as a spontaneous source of finance for such organisations (Fatoki, 2010: 104). Trade credit is usually extended for an intermediate period of thirty to sixty days, at which point payment is due. Penalties in the form of financing charges are applied on the outstanding balance owed by a customer if payment is not received on the date agreed upon between the provider of credit and the receiver of credit. Therefore, trade credit becomes an alternative method of financing business expenses (Fatoki, 2010: 105).

In their study, Berger and Udell (2006: 2949) observed that commercial bank lending, which supplies SMEs with slightly more credit compared to trade credit, received more attention than trade credit as a form of finance to SMEs. Trade credit is of particular importance to SMEs, due to the fact that small firms find it difficult to find funding through credit institutions (García-Teruel & Martínez-Solano, 2010: 216).

SMEs rely mostly on short-term debt finance (Peel *et al.,* 2000; García-Teruel & Martínez-Solano, 2007); use less external finance in the form of bank loans (Beck, Demirguc-Kunt & Peria, 2008), and their access to long-term capital markets is very limited (Petersen & Rajan, 1997). There are various theories that explain the reasoning behind the use of trade credit by SMEs, based on the advantages for both suppliers and customers in the SME sector.

Fatoki and Smit (2010: 1791) identify three main reasons why trade credit and the use thereof by SMEs are important. First, new SMEs should decide on trade credit as a form of finance, especially in their early years of business when the risk of default and financial loss for a firm is high. Secondly, trade credit is often the best or only available source of external finance for working capital for SMEs, due to limited access to bank loans. Thirdly, trade credit serves as a perfect substitute for bank loans in the case of firms that are credit-rationed by financial institutions. Other reasons why the use of trade credit is important for SMEs, according to García-Teruel and Martínez-Solano (2010: 216), include the following:

- Trade credit enables SMEs to separate the exchange of goods or services and their payment. This separation between the exchange and payment process provides more flexibility for the SMEs to respond to fluctuations in demand and will reduce cash uncertainty in making payment to other SMEs.
- Trade credit serves as a method for stimulating sales and is important in building and maintaining a long-term relationship with customers.
- Trade credit provides valuable information about the creditworthiness of the borrower to credit providers, and can help SMEs, when applying for external finance such as a bank loan, ultimately obtain the funding they require for investment in future projects.

Trade credit can be divided into two components, namely debtors that represent the assets or investment side of trade credit, and/or creditors that represent the liability or financing side of trade credit. Whited (1992) and Fazzari and Petersen (1993) explained that the majority of an SME's assets, mainly in the form of current assets, are financed through current liabilities, due to financial constraints faced by SMEs, thus emphasising the importance of effective trade credit management. It should be noted that many companies use trade credit as customers, but also provide it as suppliers. This is consistent with trade credit being identified as a "two-way transaction" (Peel *et al.,* 2000: 17). It is critical for SMEs to manage the *net* trade credit position effectively. With trade credit being a "two-way transaction" in nature, it is essential to differentiate between, and understand the importance of both receiving and granting trade credit (Wilson & Summers, 2002: 319).

By granting trade credit, when focusing on the importance of granting trade credit to other small firms, SMEs will be able to receive trade credit from a lender or supplier of trade credit, and thus be able to finance their own operations (Fatoki & Smit, 2010: 1791). Secondly, trade credit is a more cost-effective form of finance, especially when compared to the cost of commercial debt. Thirdly, for the majority of SMEs, trade credit provides a means of accessing certain markets when SMEs provide trade credit to buyers of goods or services. Finally, trade credit can be used as a mechanism to stop price discrimination and price competition and ultimately increase sales, thus increasing profit (García-Teruel & Martínez-Solano, 2010: 216).

Focusing on the importance of receiving trade credit for SMEs reduces the transaction cost associated with paying bills for the buyer of goods or services, because a receiver of trade credit can accumulate payment obligations and pay on a quarterly or monthly basis (Petersen & Rajan, 1997: 665). Secondly, when receiving trade credit, SMEs can improve their cash-flow forecasts and simplify their ever-important cash-management system (Fatoki & Smit, 2010: 1791). Thirdly, credit-rationed SMEs can receive trade credit and use it as a substitute for bank credit; furthermore, trade credit reduces the financial risk and risk of default for SMEs that are making use of bank loans in the early years of operation.

Padachi (2006: 46) adds that the management of working capital, and specifically the management of trade credit, is of particular importance to the small firm. The inability of financial managers to properly plan and control current assets and current liabilities is an important reason for the high failure rate of SMEs. SMEs rely more heavily on trade credit, owner equity (internal capital) and short-term bank loans to finance their needed investment in debtors, inventory and cash. However, the failure rate of SMEs compared to that of large firms is very high. Studies in the United

Kingdom and the United States have shown that poor short-term financial management, particularly poor management of trade credit and working capital, is a primary cause of failure among SMEs (Padachi, 2006: 46).

According to Zainudin and Regupathi (2011: 84), the recurring and widespread practice of late debtor collections can ultimately deteriorate the financial position of the provider of trade credit. Zainudin and Regupathi (2011: 84) further add that "[p]rudent trade credit management is a vital component of success and survival, particularly to the SMEs".

1.2 RESEARCH PROBLEM

South Africa has one of the lowest creation rates for SMEs in the world. The 2008 Global Entrepreneurship Monitor (GEM) survey confirmed the negative statements regarding the low creation rate of South African SMEs, by providing evidence that South Africa has a below average new firm creation rate. Of all new SMEs in South Africa, 75% fail within the first two years of business, and the creation rate of new SMEs in South Africa is one of the lowest in the world when compared to other developing countries (Fatoki, 2010: 3). The chance of SMEs surviving and ultimately growing into an established and/or highly successful business is less likely in South Africa than in any other GEM country sampled in 2005, according to Von Broembsen *et al.* (2005). According to Herrington, Kew and Kew (2009), the GEM survey provides useful data on both the extent and the nature of entrepreneurial activity in South Africa. South Africa has participated in the GEM survey since 2001.

FinMark Trust (2006) pointed out that only 2% of new SMEs in South Africa are able to access bank loans (long-term debt) to use as capital in order to finance operations and long-term projects. Evidence obtained in a study by Balkenhol and Evans-Klock (2002) shows that the use of trade credit by new SMEs in South Africa is as low as 0.2%. This can be attributed to poor management of trade credit along with the unavailability of credit in the SME sector, causing SMEs to neglect trade credit and ultimately forcing them to find other forms of short-term finance. In addition, as pointed out by Fatoki and Smit (2010: 1779), the South African business environment (internal and external environment), in which SMEs operate, contains/includes factors that can negatively affect the growth and development of SMEs in the country. As pointed out earlier, it should be noted that the probability of a new SME surviving for a period of 42 months and thereafter developing into an established business is less likely in South Africa than in any other country sampled by the GEM (Von Broembsen *et al.,* 2005).

A number of challenges prevent new and existing SMEs from growing into established enterprises, thus ultimately contributing to the high failure rate of new and existing SMEs in South Africa. According to Fatoki and Smit (2010), the following challenges prevent SMEs from growing into viable and sustainable organisations in the South African business environment, focusing on the internal business environment:

- Non-availability of quality financial or business information by SMEs.
- Lack of collateral by SMEs in order to offer security to the lender for the repayment of debt.
- Low level of managerial competencies and knowledge exhibited by SMEs.
- Lack of networking and the development of relationships between individuals.

The challenges in the external business environment are:

- Crime rate. The high crime rate in South Africa is widely believed to restrain investment. A total of 30% of enterprises in South Africa rate crime as a major or very severe constraint on investment, when compared to the four most frequently mentioned constraints (World Bank, 2008a).
- Ethics. Ethical issues for the small firm and SMEs' perception of dishonesty in keeping promises and commitments.
- Legal. A low confidence in the legal system; courts are not fair and impartial, and court decisions are not enforced.
- Macroeconomic conditions. As pointed out by Barbosa and Moraes (2004), weak economic conditions make it difficult for SMEs to use and manage trade credit positively and ultimately have a negative impact on the repayment ability of the small firm.

- Corruption. Corruption affects the repayment of credit by suppliers of credit to lenders.

According to Fatoki (2010: 70), a lack of planning and proper management for increasing working-capital needs can lead to serious cash-flow problems. Therefore, a large number of new and existing SMEs fail to grow into viable and sustainable businesses, due to poor working-capital management. Inadequate financial management and poor planning for cash requirements, in particular, are the main reasons why SMEs experience cash-flow problems. Furthermore, not only is management of trade credit and/or working capital important for the survival of new and existing SMEs, but the availability of working capital is also one of the critical success factors for new SMEs (García-Teruel & Martínez-Solano, 2007: 166).

Many SMEs find it difficult to manage their working capital effectively (Fatoki, 2010: 70). Due to poor management of trade credit, SMEs can be considered a credit risk to banks, suppliers and/or other financial institutions. According to Tagoe, Nyarko and Smurfit (2005: 33), the credit risk of new SMEs is the most important reason why banks and suppliers often reject credit applications. As providers of credit, SMEs often neglect their credit policy, while credit-management activities are also badly managed. In a study by Wilson (1996) that focused on the amount of time devoted to the management of credit within the SME business environment, it was observed that 33% of the time is spent on chasing overdue payments. Only 8% of total credit-management time was devoted to approving credit requests and negotiating and agreeing to credit terms. Invoicing and revenue collection represented 84% of the total time devoted to managing debtors. In addition, according to a more recent study by Poutziouris, Michaelas and Soufani (2005: 8), poor management of credit by SMEs ultimately contributes to poor management of trade credit within the small firm.

As receivers of trade credit, small firms exhibit volatile cash flow, but rely on trade credit as an important source of finance (Peel *et al.,* 2000: 18). Due to the volatility in cash flow for small firms and their dependence on trade credit as a form of finance, the importance of correctly managing trade credit should be emphasised. Ultimately, SMEs are categorised as a credit risk by banks and other providers of finance, due to volatile cash flow and poor management of credit.

Peel and Wilson (1996) argue that fewer firms will fail and that economic growth will ultimately increase substantially when all aspects of trade credit are managed more effectively in organisations. The literature suggests that SMEs find it difficult to manage their working capital and/or credit effectively, thus specifically contributing towards poor management of trade credit by the SME. Therefore, by determining the trade credit-management practices of SMEs, the problems resulting from ineffective trade credit management by SMEs can be identified. This could, therefore, decrease the failure rate as well as increase the creation rate of new SMEs. This is the focus of this study.

Drawing on the above, the aim of this research is to determine the trade credit-management practices of SMEs in order to establish whether SMEs find it difficult to manage trade credit successfully and fail to use trade credit effectively as a source of funding.

1.3 RESEARCH OBJECTIVES

The primary objective of this study is to determine the trade credit-management practices of SMEs in order to establish whether trade credit is being mismanaged by SMEs in South Africa.

The secondary objectives of this research undertaking are:

- To evaluate the importance of effective trade credit management (focusing on debtors and creditors).
- To identify the trade credit situation within SMEs (focusing on debtors and creditors).
- To identify the activities and measures that SMEs use to reduce late payment.
- To evaluate the importance of a sound and structured credit policy when granting trade credit.
- To identify aspects of SMEs' trade credit-management practices that represent major constraints in the SME sector (focusing on debtors and creditors).

- To determine the different trade credit terms being used/accepted and granted by SMEs (focusing on debtors and creditors).
- To determine the different credit policies used by SMEs when granting credit to a customer.
- To enable SMEs and small firms to use the results of this study in assessing the appropriateness and effectiveness of their own practices.

1.4 RESEARCH METHODOLOGY

The objectives of this study will be achieved by way of a literature study and an empirical study.

1.4.1 Literature study

Secondary data will be used in the literature study. The secondary data will be in the form of articles, academic journals, published and unpublished reports, newspaper articles and the Internet, as well as previous related research done in this field of study to provide a background to the research problem. In this study, all secondary data will be in the form of literature. The first literature chapter will cover debtors, the credit policy and the credit decision in SMEs, while the second chapter will focus on the South African business environment and SMEs. The overall aim of the literature study is to integrate theoretical material with the remainder of this study.

1.4.2 Empirical study

The empirical study will be of a quantitative and, to a lesser extent, of a qualitative nature, and will be based on the outcomes of the literature study. The empirical study will consist of quantitative and, to a lesser extent, qualitative questionnaires that were e-mailed to respondents that provide an indication of the trade credit practices of SMEs in the Free State Province of South Africa. The implication is that the concepts and principles identified in theory will be tested in the empirical research. Once the above is achieved, a conclusion will be drawn at the end of this study.

1.4.2.1 Research design

Zikmund (2003: 68) identifies three basic types of research design, namely quantitative, qualitative and a hybrid of the two. Quantitative research differs from qualitative research in that it generalises results from a sample of the population of interest. Qualitative research provides insight into the setting of a research problem (Cant, Gerber-Nel & Kotzé, 2003: 77). It is important to note that quantitative research entails a structured research approach whereby the end results can be quantified through methods such as computer programmes (Dillon, Madden & Firtle, 1993: 134; Wilson, 2003: 120). According to Cant *et al.* (2003: 77), qualitative data can also be collected by means of open-ended questions.

The underlying paradigm that informs this research project will be pivotal in choosing the type of research design along with the nature of the research, the setting and the possible limitations (Fatoki, 2010: 20). This study uses a quantitative research design with lesser input of qualitative data. When making use of quantitative questionnaires, considered to be an advantage to this study, the main aspect is the reliance of the researcher on data analysis in order to arrive at findings or conclusions.

1.4.2.2 Data collection

A structured questionnaire will be used to collect the data for the completion of this study. This is considered appropriate for this study, as it consists of a series of questions designed to elicit appropriate responses regarding trade credit-management practices of SMEs in South Africa. According to Gerber-Nel, Nel and Kotze (2005: 88), surveys, observations and experiments can be identified as the three most important data-collection methods. When conducting a survey, the researcher must choose a sample of respondents from a specific population and administer a standardised questionnaire to them. The survey method will be used by using an e-mailed questionnaire to gather the data obtained through the survey for the completion of this study. Questionnaires will either be given in hard-copy form or be sent electronically via e-mail. Ample time will be given for the completion of the questionnaires by the SMEs.

1.4.2.3 Study area and target population

The study area for this research will be the Free State Province of South Africa. Target populations for the research will be small and medium-sized enterprises (SMEs) in the Free State Province of South Africa. Databases of organisations such as the Centre for Development Studies will assist in accessing SMEs for the completion of this study.

1.4.2.4 Sample technique

This study will make use of a random sampling method.

1.4.2.5 Data analysis

The data gathered from the questionnaires will be statistically analysed and processed, using the Statistical Package of Social Sciences (SPSS) (version 21.0 for Windows) software program.

A set of data-analysis techniques will be used to analyse the data obtained in this study.

1.4.3 Referencing style

The referencing style for this study is the Harvard method.

1.5 LAYOUT OF THE STUDY

Chapter one includes the introduction, the research problem, the research objectives and the research methodology. In addition, the chapter discusses the definitions used in this study and provides a perspective on the contribution of this study.

Chapter two presents the literature review and focuses on debtors, the credit policy and the credit decision in SMEs.

Chapter three (literature review) focuses on the South African business environment and how it impacts on the availability and management of trade credit in SMEs.

Chapter four concentrates on the methodology used in conducting the empirical research. The chapter includes the research design; the type of research used in this study, the population, and the sample design as well as the data-collection and data-analysis methods.

Chapter five focuses on the analysis and interpretation of research results. The chapter explains the results from the analysis in an exploration of the data and discusses the findings by means of tables, figures and graphs.

Chapter six revisits the research problems and the objectives of the research, and discusses the conclusions and recommendations of the research. In addition, the limitations of the research are mentioned, the recommendations are highlighted and the areas for further research suggested.

1.6 DEFINITIONS

The following definitions are employed in this study.

1.6.1 Trade credit

Trade credit occurs when there is a delay between the delivery of goods or the provision of services by a supplier and their payment. For the seller, this represents an investment in current assets, namely debtors; for the buyer, it is a source of financing that is classed under current liabilities, namely creditors, on the balance sheet (García-Teruel & Martínez-Solano, 2010: 215).

1.6.2 Credit terms

A written policy provided to the customer regarding the payment method; ownership of goods prior to payment (e.g., retention of title of the goods or other types of security); penalties or interest charges, where applicable, on accumulated balances for late payment; timing of payment; discounts for early settlement, and the method of payment.

1.6.3 New SME

A new SME can be defined as an SME that has been in existence for a period of less than forty-two months (Fatoki & Smit, 2010: 1791).

1.6.4 Business environment

The business environment can be defined as a combination of factors and variables, both inside and outside the structure of the business, that play a critical role in the ongoing and successful existence of the organisation (Smit, Cronje, Brevis & Vrba, 2007: 62).

1.7 CONTRIBUTION OF THE STUDY

Previous studies on SMEs and access to finance and credit in the South African business environment have mostly ignored the impact of trade credit management and concentrated extensively on external finance such as long-term bank loans. Given the importance of trade credit, and its management, it is perhaps surprising that there is a relative paucity of research results published on this issue.

Study into this field is necessary because of the lack of available information regarding the trade credit-management practices of SMEs in South Africa. The study of the management of trade credit in SMEs in South Africa is crucial in order to broaden the understanding necessary to aid SMEs in managing their trade credit practices. This study can provide a basis for future research and theory development. In addition, by providing an overall picture of the trade credit-management practices of SMEs in South Africa, small firms could use the results of this study to assess the appropriateness and effectiveness of their own practices.

1.8 CONCLUSION

This chapter set out the research problem. In addition, the chapter examined the research objectives, the research methodology along with a layout of this study. The chapter also highlighted some definitions and the contribution of this study.

The next chapter will focus on debtors, credit policy and the credit decision for SMEs as well as on important aspects of trade credit through a review of the literature on debtors, credit policy and the credit decision for SMEs.

CHAPTER TWO

DEBTORS AND CREDIT POLICIES FOR SMEs

2.1 INTRODUCTION

The creation rate for new SMEs in South Africa, according to the Total Early-Stage Entrepreneurial Activity (TEA), is of the lowest in the world (Mass & Herrington, 2006). In the GEM report, Von Broembsen *et al.* (2005) highlighted that 75% of new SMEs created in South Africa fail within the first few years of operation. This is the highest failure rate of all developing countries in a survey conducted by Mass and Herrington (2006).

A problem for smaller firms, according to Wilson and Summers (2002: 320), is the late payment of commercial debt that leads to financial distress and ultimately constrains growth among smaller firms. Therefore, it could be argued that, due to poor management of trade credit, SMEs in South Africa fail to grow into viable and successful organisations. Ultimately, this negatively influences job creation and the overall productivity of the economy. Insufficient emphasis is placed on the importance of effectively managing trade credit for SMEs. Furthermore, SMEs do not sufficiently emphasise their credit policy, which influences the choice of whether or not to extend trade credit. In a study, Sunday (2011: 271) observes that the majority of SMEs neglect the management of working capital, causing them to often run out of cash and become insolvent.

There are various negative consequences for SMEs' poor management of trade credit. In a study by Wilson and Summers (2002), the following consequences were identified for the small firm when studying the trade credit terms offered: the existence of a strained and/or damaged relationship between debtor and creditor; the inability of the small firm to capture new business for its product offering, and a bad 'reputation' and poor financial health for the small firm. Another negative consequence resulting from poor management of trade credit is SMEs finding themselves in an inadequate cash situation, leading to their inability to repay their obligations as they become due and ultimately leading to their insolvency. The above consequences have a negative ‘spill-over’ effect in industries where SMEs are closely related to each other, thus negatively influencing the individual SME, the market and the overall economy. Wilson and Summers (2002: 319) discovered that the majority of SMEs and, in particular, those at intermediate points in the value chain use trade credit for two primary purposes, namely to receive credit as a customer and to provide credit as a supplier. SMEs operating in the same industry are closely related, because most SMEs extend and receive trade credit from each other on a continuous basis. This situation indicates the dependence between SMEs in the same industry and thus emphasises the possibility of a ‘spill-over’ effect.

Three main sections will be discussed in this chapter, namely debtors, the credit policy and the credit decision. The chapter begins by defining debtors and explaining the importance of debtors along with certain factors influencing the size of a firm’s debtors. The credit policy is discussed in detail along with the determinants and components of the credit policy. The last section of the chapter addresses the credit decision that identifies incentives for a firm in deciding to extend trade credit. In addition, the implications of trade credit extension are discussed along with important factors determining the credit decision.

2.2 DEBTORS

Debtors are one of the three primary components of working capital and a highly important marketing tool. According to Barad (2010: 166), debtors occupy a substantial portion of current assets in most firms and the capital invested in debtors is almost equal to the total sum of investment in cash and inventory. In the field of marketing, with granting credit being an important marketing tool, debtors act as a mechanism to distribute products or services from the manufacturing stage to distribution. Thus debtors can effectively minimise the time spent from manufacturing the product or service to distribution to a retailer, which will, in turn, increase profits. Granting credit can protect the sales of a firm by attracting potential customers to buy the product or service at conditions favourable to them but within the credit policy set out by the firm.

2.2.1 Definition and meaning of debtors

According to Barad (2010: 166), debtors can be defined as the amount due by the customer for products or services sold to the customer under an agreement permitting the customer to pay this amount at a date later than the time of purchase. Debtors can also be defined as liquid asset accounts representing amounts owed to the firm as a result of the credit sale of products or services in the ordinary course of business. The total value of these credit sales is carried on to the asset side of the balance sheet under different titles such as debtors, trade debtors, accounts receivables or customer receivables.

A firm is said to have granted trade credit when it does not receive cash payment immediately in respect of ordinary sale of its products or services (Barad, 2010:166). The firm extends credit in order to provide customers with a reasonable period of time to pay for the products or services they have received. Trade credit thus gives rise to certain debtors or outstanding customer accounts that are to be collected by the firm in the near future. It should be noted that cash from credit sales is only generated on maturity of debtors and that the sale of products or services on credit converts a firm’s finished goods into debtors.

According to Barad (2010: 167), debtors arising from credit sales have three dimensions:

- The cash payment for a credit sale remains outstanding; thus debtors carry an element of risk when extending credit to customers and should be carefully assessed.
- It implies futurity, as the payment for the product and service received by the customer is made by him/her to the firm on a date in the future.
- It is based on economic value. The economic value in products or services belongs to the customer immediately when the sale is made in return for an

equivalent economic value expected by the firm from the customer to be received on a date in the future.

Debtors or trade debtors can be defined as the set of customers that represent the firm's claim or assets, from whom debt is to be collected on a date in the future (Barad, 2010: 167). Funds generated as a result of credit sales can first be generated until the outstanding customer account is paid or with collection of debtors in the normal course of business. Debtors are a form of investment in any enterprise when selling products or services on credit; thus larger sums of funds are tied up in trade debtors. This emphasises the importance of effective and efficient management of trade credit to ensure a positive contribution for the firm towards an increase in turnover and profits. Although debtors are a form of investment, funds should not be tied up for long periods of time and should be liquid to provide the necessary cash for the firm to ensure the repayment of obligations (Barad, 2010: 169).

2.2.2 Factors influencing the size of debtors

According to García-Teruel and Martinez-Solano (2010: 215), debtors represent a substantial portion of current assets. Consequently, a number of factors influence the size of debtors. It should be noted that most of these factors differ from firm to firm and according to the type of industry in which the firm operates. The following factors influence the size of debtors (Barad, 2010: 172).

2.2.2.1 Stability of sales

For many firms, the continuity of sales is violated due to the seasonal nature of sales. Therefore, sale stability represents larger sales and/or larger debtor account size in certain periods of a firm's financial year or in specific seasons for the firm. Similarly, if a firm supplies products or services on an instalment basis, it will require a large investment in debtors.

2.2.2.2 Volume of credit sales to cash sales

The volume of credit sales to cash sales plays the most important role in determining the level of sales invested in debtors, relative to total sales in cash. A firm with a high ratio of credit to cash sale will have a high level of investment in debtors when dealing with a high level of sales.

2.2.2.3 Quality of debtors

In a situation where all customers of a firm are creditworthy and financially strong, the firm can comfortably operate with a lesser amount invested in debtors, because all payments will be received in due time.

2.2.2.4 Credit policy

A firm with a relatively more lenient credit policy will constitute a comparatively larger debtor account than a firm with a more rigid credit policy for the following two factors:

- A lenient credit policy leads to greater defaults in payments by financially weak or distraught customers, resulting in a bigger volume of debtors.
- A lenient credit policy encourages financially strong or sound customers to delay payments again, resulting in an increase in the volume of debtors.

2.2.2.5 Cash discount

Cash discounts reduce the level of management of outstanding debtor accounts, due to a decrease in working capital requirements. A cash discount can be considered an incentive to persuade a customer to make prompt payment within the stipulated period or before the lapse of the credit period. An offer of lesser payment is proposed to the customer, if the customer succeeds in paying within the period agreed upon. Thus, by offering this incentive to a customer, the level of management in debtors can be reduced.

2.2.2.6 Collection policy

It should be noted that the type of credit policy, the procedure of collecting outstanding debtor accounts and deciding on the credit amount greatly influence the level of investment in debtors for a firm. When a more lenient approach is used towards credit and especially collection procedures, more debtors are required for the purpose of investment, thus increasing the level of investment in debtors.

2.2.2.7 Terms of sale

The longer the credit period, the higher the amount invested in debtors, as long-term credit ties the funds for a long period of time and vice versa. Thus the time period for which a firm grants credit to a customer will lead to a decrease or increase in debtors.

2.2.2.8 Collection of debtor accounts

If a firm is able to effectively collect outstanding debtor accounts within the stipulated period granted to the customer, it will keep the level of investment in debtors low. This indicates a positive cash-flow situation for the firm. However, if firm experiences an undue delay in the collection of outstanding debtor accounts, it will always have to maintain a large level of investment in debtors.

2.2.3 Instruments indicating debtors

Several instruments in a firm can be identified in order to provide proof of a firm's debtor relationship (Barad, 2010: 169). These following instruments provide the reason for maintaining debtors in a SME (Gross, 1969).

2.2.3.1 Open book account

This represents an accounting entry into the ledger of a creditor, which indicates the sale of a product or service on credit. With an open book account, there is no evidence of the existence of debt under sale of goods.

2.2.3.2 Negotiable promissory note

This represents a written note of promise signed by the maker to pay a certain sum of money to the bearer or to order a product or service at a fixed period in time. Promissory notes are best used when a SME grants an extension of time for the collection of products or services on credit.

2.2.3.3 Increase in profits

Basically, an increase in debtors will lead to an increase in total sales of a SME that could ultimately lead to higher net profits. As debtors or higher credit sales will increase total sales, the increase in total sales should favourably increase the marginal contribution proportionally more than the additional costs associated with such an increase in total sales. Ultimately, this could lead to higher level of profits for the SME.

2.2.3.4 Protecting sales by meeting competition

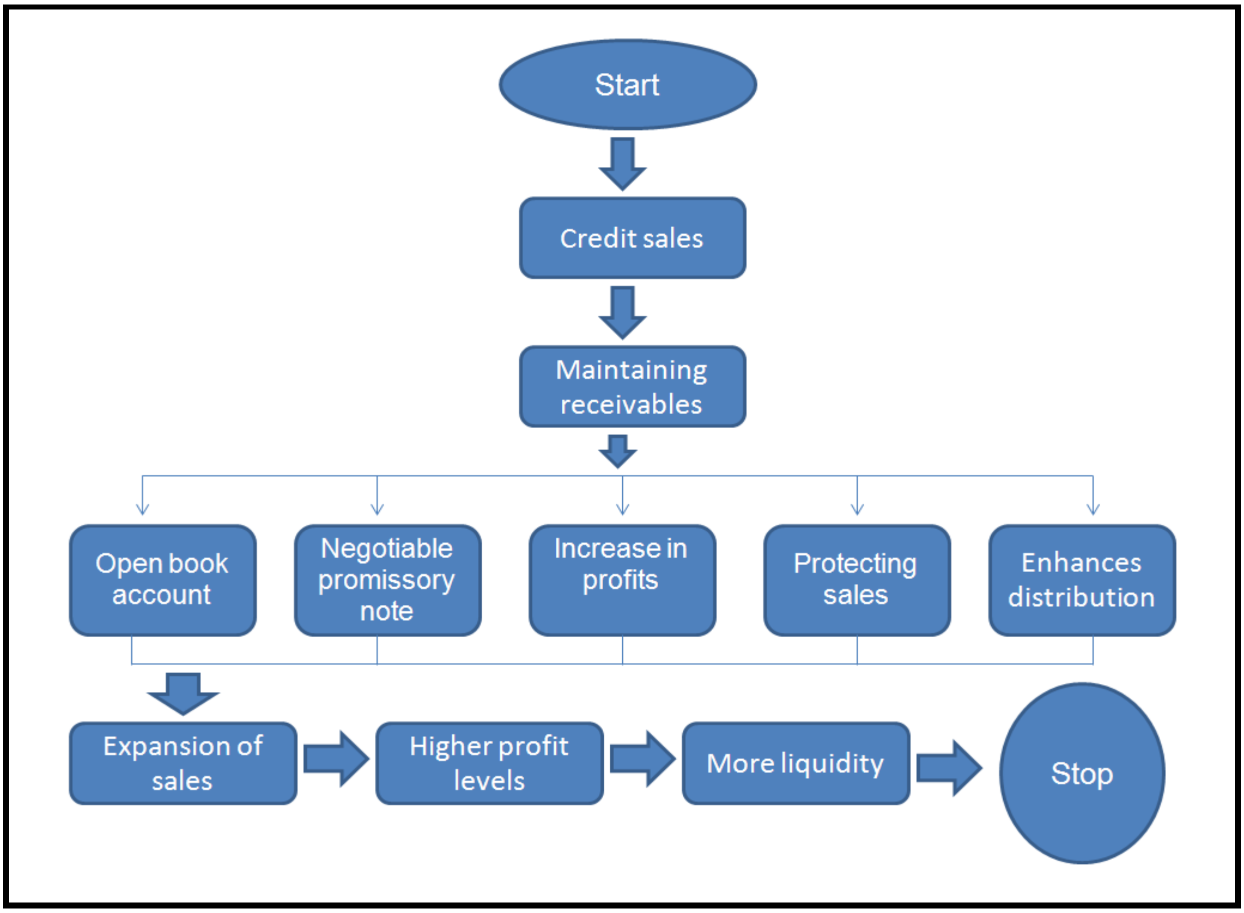
A SME may grant credit to its customers to prevent it from losing sales to its competitors. SMEs can also use this strategy in attracting potentially new customers and retaining present customers by weaning them away from competitor SMEs.

2.2.3.5 Enhances distribution

One important role of debtors is to enhance and accelerate the speed of distribution. A middleman can act quickly in distributing his/her products and/or services ordered from the place of production to distribution without any immediate cash payment being made. This holds true because s/he can pay the full outstanding amount after effecting his/her sales. Likewise, customers can conveniently purchase their needed products and services without paying cash instantly. Thus debtors are regarded as a bridge for the movement of products and services from production to distribution among customers. The above instruments provide proof and help maintain a SME’s debtor relationships. It should be noted that an increase in profits, protecting sales by meeting competition and enhanced distribution, can also serve as a consequence for maintaining debtors within a SME.

Figure 2.1 indicates the purpose of maintaining debtors in a firm.

Figure 2.1: The purpose of maintaining debtors in a firm.



Source: Barad (2010: 170)

Figure 2.1 identifies the instruments and the reasons for maintaining debtors in a firm. These instruments lead to an expansion of sales, which will result in higher profit levels and ultimately increase the liquidity of the firm.

This section of the chapter identified the definition and meaning of debtors along with the specific factors that influence the size of debtors for a firm. Furthermore, the instruments and reasons for maintaining debtors within a SME, in order to provide proof of a SME's debtor relationship, were also examined.

2.3 THE CREDIT POLICY

Credit is at the heart of business transactions (Peavler, 2012). SMEs extend credit to customers and make purchases on credit. However, sometimes customers fall behind on their payments and small firms find themselves with uncollected debt, which reduces cash flow. An up-to-date credit policy helps a SME proactively manage its outstanding invoices (Peavler, 2012).

A credit policy aims to reduce the outstanding invoice amounts as well as the bad debt expenses experienced by SMEs. SMEs should set different performance metrics, such as the total Rand value of outstanding invoices and the average number of days an account is overdue. Furthermore, the setting of responsibilities, within the small firm, is essential in establishing a chain of accountability and avoiding any possibility of duplication or confusion.

This section of the chapter will discuss the determinants of credit policy and identify two forms of trade credit, namely simple and complex forms of trade credit. Furthermore, the five theories of trade credit along with all eight components of the credit policy will also be examined.

2.3.1 Determinants of credit policy

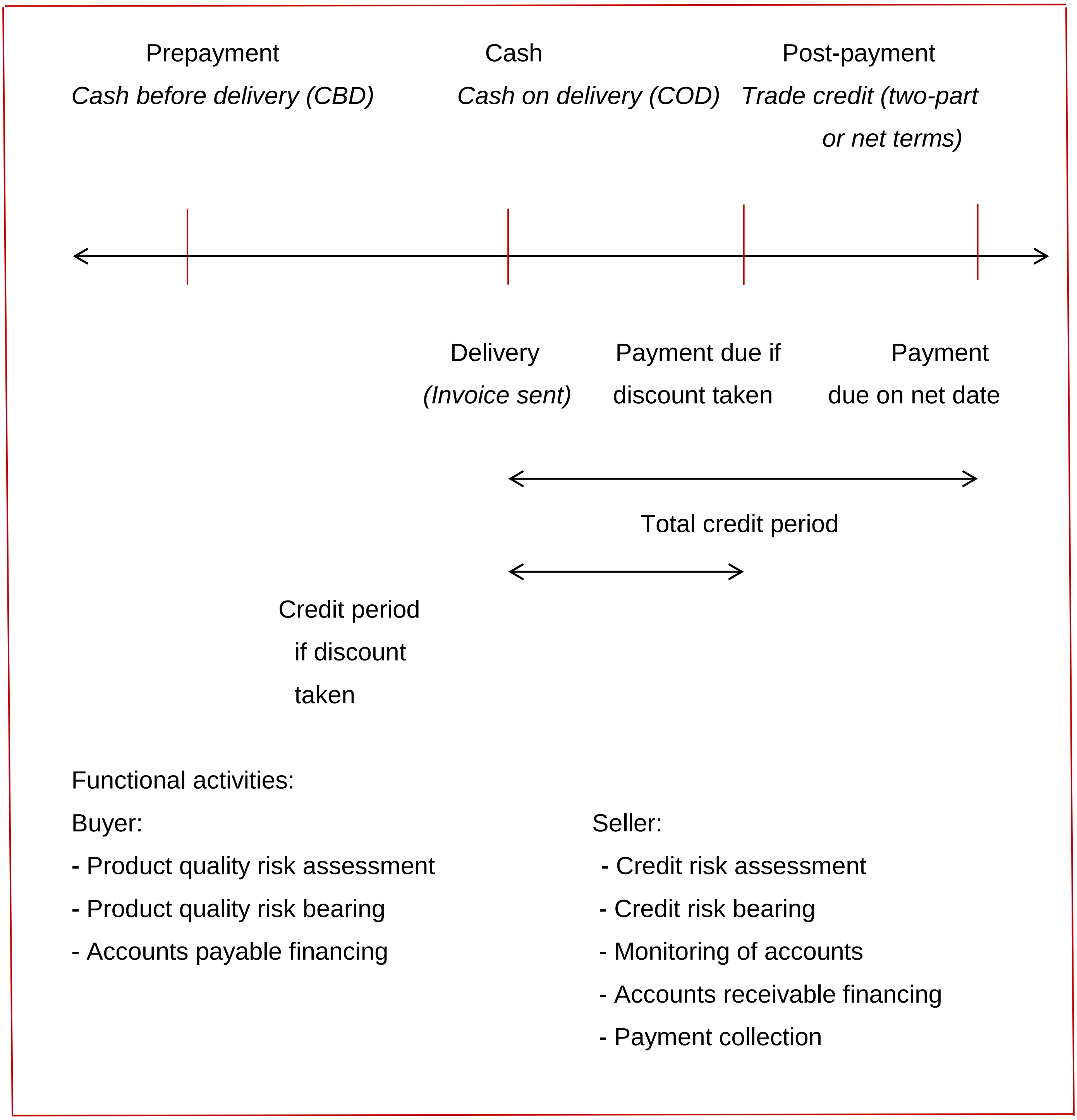
According to Ng, Smith and Smith (1999: 1110), the payment arrangement between firms is, in fact, based on credit terms, unless the transaction between the firms involved occurs immediately. Credit extension takes place between the seller and the buyer, if payment is made after delivery of a product or service. The opposite is true should payment be made by the buyer of the product or service before delivery.

Trade credit can be divided into two basic forms: the simpler form, net terms, and the more complex form, two-part terms. The simpler form of trade credit, net terms, specifies that full payment is due within a certain period after delivery of a product or service or after monthly statements. For example, “net 30” means that full payment is due 30 days after the date of invoice; the buyer is in default, if the account is not paid before that date. Invoicing of the product or service normally occurs at approximately the date of delivery for the product or service. The more complex form of trade credit, two-part terms, consists of three basic elements, namely the discount percentage; the discount period, and the final payment time. The most common two-part term used by firms is “2/10 net 30”. This represents a 2% discount for payment within the 10-day discount period; the net period ends on day 30. The “2/10 net 30” payment term defines an implicit interest rate of 43.53% to the buyer agreeing to this term of payment (Fatoki, 2010). If the buyer is unable to pay within the 10-day discount period, the 43.53% becomes the opportunity cost to the buyer in exchange for 20 additional days of financing. The buyer will be in default, should s/he not be able to repay the account by the end of the net period.

Figure 2.2 illustrates the basic choice between prepayment and post-payment. The figure describes the basic functions that must be performed by the seller or buyer when a particular policy is selected. The type of credit policy selected by the buyer will determine the type of functions used by the seller or lender of credit. For example, if prepayment is selected, the buyer assumes greater risk of product quality, since payment takes place immediately; thus the buyer cannot inspect the product before payment. The risk, therefore, falls upon the buyer of the product or service. Conversely, the seller assumes responsibility for assessing credit risk, collecting receivables or outstanding debtor accounts and financing, if the seller extends trade credit to the buyer. The risk now falls upon the seller of the product or service. Figure 2.2 shows the range of inter-firm credit arrangements. These arrangements include cash before delivery of products or services, where the buyer assumes product quality and must arrange for financing immediately, and payment after delivery, where the seller assumes credit risk and receivable financing responsibilities.

As illustrated in Figure 2.2, the credit policy is multifaceted.

Figure 2.2: The time profile of payment and functional activities implied by payment policy



Source: Ng *et al.* (1999: 1111)

Credit policy is an organisational design choice to internalise activities as opposed to relying on the market. As such, the following trade credit theories are expected to influence the choice of credit policy and can be classified into five main theories that serve as incentives for trade credit extension and policy choice. Generally, due to these theories, trade credit can and/or is extended to buyers (Fatoki & Smit, 2010: 1791; Huyghebaert, 2006: 308-313):

- Market imperfection asymmetric information or informational asymmetries that is present between supplier and buyer.
- Financial constraints and price discrimination.
- Transaction and monitoring costs.
- Financing advantage.
- Private benefits of control.

2.3.1.1 Market imperfection asymmetric information theory or informational asymmetries that are present between supplier and buyer

Market imperfection asymmetric information theory occurs when a situation of uncertainty arises concerning the financial health and creditworthiness of the customer (Fatoki & Smit, 2010: 1791). Due to asymmetric information, sellers are unable to make reliable selling decisions. Likewise, buyers cannot always make the most favourable purchasing decision and are faced with doubt regarding the quality of its supplier's products/services (Fatoki, 2010: 103). This is known as the asymmetric information problem, and can be reduced by means of trade credit. Thus both buyers and sellers have incentives to devise institutions that reduce transaction and monitoring costs due to asymmetric information (Ng *et al.,* 1999: 1110). Trade credit deals with this asymmetric information problem by providing a time period wherein sellers can access the necessary information concerning the customers' financial health. Sellers can access this information through their customers' ability to engage in early payment in order to take advantage of possible discounts when offered for prompt payment and by studying their customers' payment patterns.

A SME that extends trade credit can make use of buyer reputations and credit ratings in order to reduce concerns about non-payment or default of a buyer. Furthermore, trade credit deals with this asymmetric information problem by providing a time period to buyers for approving the quality of the product in satisfying their needs and for making payment to the seller after accessing the product/service (Fatoki, 2010: 103). This holds true, due to seller-provided guarantees that reduce the buyers’ concern about product quality. According to Ng *et al.* (1999: 1112), the choice of trade credit terms can be influenced by asymmetric information in two ways. First, by offering specific credit terms, a buyer can reveal the product quality through his/her payment practices. Because a buyer’s response to credit terms helps identify firms that experience difficulties in repayment of accounts, trade credit terms can be designed to provide information on creditworthiness. Secondly, in order to further reduce the concerns of non-payment or the potential risk thereof from buyers, due to a lack of sufficient buyer reputation, a seller can offer delayed payment. In offering delayed payment to the buyer, the seller provides an effective guarantee by allowing the buyer to verify product quality before payment (Fatoki, 2010: 103).

2.3.1.2 Financial constraints and price-discrimination theory

Financial constraints and price discrimination theory occur because SMEs and/or start-ups face significant financial constraints. Included is a high level of uncertainty leading to initial cash generation, most often negative, leading to a lack of internal sources of funding (Huyghebaert, 2006: 310). With price discrimination, firms can extend the net period of the payment term, thus essentially providing an interest-free short-term loan, ultimately reducing the present value of the product being sold (Huyghebaert, 2006: 308). Likewise, if customers make an early payment, a higher discount will decrease the price of the product being sold. According to Selima (2007: 17), a seller can manipulate the price of the product being sold through a variation of the credit terms offered to buyers. The above indicates that suppliers can make use of trade credit as a method of price discrimination, by giving longer credit than that agreed upon or increasing the discount rate offered to a customer.

2.3.1.3 Transaction and monitoring costs theory

Trade credit may reduce the transaction and monitoring cost of paying bills, due to all bills being paid simultaneously, while the supply of goods or services and finance from the seller can lead to cost advantages (Fatoki & Smit, 2010: 1791). Furthermore, the cash-flow forecasts and cash management of SMEs can improve, due to the timing of the payment being less uncertain (Fatoki & Odeyemi, 2010: 2764). It should be noted that, due to fluctuations in daily sales, a cash-based business carries the risk of unpredictable cash-receipt patterns. Fluctuations in sale patterns can decrease by providing trade credit. According to Fatoki (2010: 103), many suppliers are in a position to foresee when their customers will be able to settle their accounts, thus reducing the amount of cash held by a SME. This reduction in cash available subsequently decreases the holding cost of precautionary cash balances for a SME.

2.3.1.4 Financing advantage theory

This holds true, due to the fact that SMEs may be better able to control and evaluate the credit risk of their own customers than financial institutions such as commercial banks (Huyghebaert, 2006: 310). Furthermore, credit-rationed customers are likely to choose trade credit as a source of short-term finance, due to it being cheaper and/or lower in financing costs (Fatoki & Odeyemi, 2010: 2764). When focusing on the financing advantage theory, trade credit becomes a highly attractive method of finance for buyers. With the financing advantage theory, SMEs are in a position to extend credit to another SME and, in so doing, these SMEs provide a favourable environment to those that are unable to access external funds or to those that are not financially sound.

2.3.1.5 Private benefits of control

In a study by Huyghebaert, Van de Gucht and Van Hulle (2001: 44), it was observed that suppliers (firms that extend trade credit to other firms) adopt a more lenient liquidation policy towards distressed firms and are even willing to expand the amount of credit offered to these firms during periods of distress. It is important to note that, although suppliers adopt a more lenient liquidation policy, they charge a higher price for their credit than compared to the price of bank debt (Huyghebaert *et al.,* 2001: 44). According to Huyghebaert, Van de Gucht and Van Hulle (2007: 436), these private control benefits are typically lost in the case of liquidation where a firm chooses bank debt over supplier credit. As a result, firms that highly value their own private control benefits borrow more from suppliers in order to prevent defaulting on bank loans or long-term debt (Huyghebaert, 2006: 312). The liquidation policy of suppliers is far less strict than that of banks or financial institutions. Ultimately, firms that value their own private control benefits will choose suppliers as providers of credit over banks or financial institutions. Consequently, firms that value private control benefits will choose to accept the more lenient supplier liquidation policy against the lower cost of bank debt and thus choose suppliers in providing the needed funding for future operations Huyghebaert *et al.* (2007: 437).

2.3.2 Components of credit policy

According to Marx, De Swardt, Beaumont Smith and Erasmus (2009), the key components of a credit policy are credit period, cash discount, credit analysis, collection policy, evaluating credit policy, management of debtors, and age analysis of debtors. It is critical for an SME to address all components when developing and managing the credit policy.

2.3.2.1 Credit period

According to Wilson and Summers (2002: 330), the credit period represents the period of time in which the buyer needs to repay the outstanding account. For example, the “net 30” portion of the equation, if the lenders of credit offer a “2/10 net 30” credit term to the buyer, indicates that, should the buyer not decide on the 2% discount offered, the account must be paid within 30 days after statement. Credit period can also be expressed as the time period for which a firm extends trade credit to another firm or individual customer (Barad, 2010: 181). The overdue account must be paid by the customer in the time period of credit extension. Furthermore, credit period should be agreed upon explicitly and forms part of the conditions of sale. The following factors influence the credit period: customer demand, cost and profitability, credit risk, the size of the account, competition, and customer type.

2.3.2.2 Cash discount

Cash discount forms part of the credit term offered by a SME and represents a percentage deducted from the purchase price for which the buyer can receive a discount when paying within a specified time as set out in the terms agreed upon. For example, 2% discount if account is paid within 10 days, or 5% discount on cash sales (Wilson & Summers, 2002: 330). The period is normally much shorter than the credit extension period. The 'cash discount period' refers to the specified period during which the cash discount is offered (Marx *et al.,* 2009: 235).

2.3.2.3 Credit analysis

Credit analysis is the evaluation of applicants in order to distinguish between "good" customers that will pay and potential "bad" customers that will default. The purpose of credit analysis is to distinguish between the customers who pay on time and those who do not. The credit policy should specify the format of credit application forms and establish clear guidelines for reviewing these applications. Depending on the size of the credit limit request, credit officers and managers may need to review credit reports, financial statements, operating history and other information from the application form before granting credit approvals. Credit analysis should be a continuing process, because changes in the SME's business and economic conditions could affect the financial health of the small firm. Proactive credit management may require SMEs to turn down credit applications from other small firms and/or individual customers and reduce or cancel the credit limits of others. According to Marx *et al.* (2009: 230), the information regarding credit applicants is collected and organised by classifying the applicants according to the following dimensions, the so-called *Five C's of credit.* The Five C's of credit will be briefly discussed.

- Character. This refers to the willingness of the customer to pay and can be measured by the number of defaults to other traders and the payment history of the customer.
- Capacity. This refers to the ability of the customer to pay outstanding accounts from cash flows by a designated due date. A positive correlation exists between a high level of competence from management and the customer being more able to pay his/her accounts on the due dates.
- Capital. This includes the customer's financial reserves and position. The financial statements of the SME are analysed to obtain the necessary data using ratio analysis.
- Collateral. If a buyer is to be liquidated, the recovery of trade creditors will depend on the amount of debt of the customer; recoveries on assets sold, and the extent to which debts are secured. It is important to know that debt of secured creditors will be settled first. Trade creditors find it extremely difficult to obtain secured positions (Marx *et al*., 2009: 230). Thus, in circumstances where SMEs made use of secured borrowings, recoveries for trade creditors are much lower, emphasising the difficulties trade creditors face in obtaining secured positions over that of banks and larger financial institutions. It is important for SMEs to know that the creditworthiness of the small firm will decrease from a trade creditor's point of view when making use of extensive secured borrowings.
- Conditions. These refer to the general economic conditions and the political environment in which the decision to extend credit to other SMEs is made. SMEs need to focus on the current market conditions in which they operate before extending credit to a buyer. SMEs operating in an industry characterised by extensive competition should emphasise all aspects of the credit-selection process when conducting a credit analysis. They are more prone to failures and default buyers, since the income margin in such industries is likely to be lower.

2.3.2.4 Collection policy

The purpose of the collection policy is to reduce the bad debt exposure of the small firm (Marx *et al.,* 2009: 241). The probability of a collection drops rapidly as an account ages, as firms find it difficult to collect the outstanding account, especially when the buyer's account is in arrears. Thus, the SME should note that the longer an account is overdue, the more difficult it is to collect the outstanding balance. In the case of SMEs with a limited number of debtor accounts, personalised approaches in the form of telephone calls or personal visits can form part of the collection policy.

According to Marx *et al.* (2009: 241-247), methods and procedures that a SME can follow for the collection of accounts receivable include:

- An invoice is an important document to strengthen the collection policy by providing information on transactions to both managers and customers. An invoice includes valuable information regarding the amount and date on which the debt due must be paid by the customer. A collection policy starts with the correct and timeous mailing of invoices to the customer.
- Statements are needed in order to assist customers in reconciling their outstanding amounts.
- Standard or individual letters can be sent to customers. In order to strengthen the collection policy, a SME should study the timing, content, wording and presentation of letters to improve the response of customers upon receipt of a letter.
- Telephone calls are often one of the most effective ways of collecting outstanding debt.
- Personal visits to the customer or SME can also be used as a method of collection policy in order to work out disputes and/or any queries that may exist between buyer and seller.
- Collection agencies can assist the small firm in the collection of overdue customer accounts. A SME usually makes use of collection agencies after the customer has defaulted on his/her payments.
- To the firm, legal action is a costly method of collection in the form of time and money.

2.3.2.5 Evaluating credit policy

In evaluating the credit policy, the small firm needs to address the following five basic factors, according to Smit (2012):

- Revenue and cost effects. Strict or rigid credit standards within the credit policy can cause a decrease in the SME's credit sales; this will negatively affect the SME's revenue and ultimately be costly to the SME. In turn, more lenient credit standards within the credit policy can cause an increase in the SME's credit sales; this will have a positive effect on the SME's revenue.
- Cost of bad debt. Credit will be granted to customers with a lower credit ranking (Marx *et al.,* 2009: 233). This will lead to an increase in the possibility of bad debts. Credit sales and the risk of bad debt will increase when credit is granted more freely to customers. Bad debt negatively affects the net income of a SME (Marx *et al.,* 2009: 233).
- The probability of non-payment from debtors needs to be considered in evaluating the credit policy. Under such circumstances, a SME needs to specify the procedures at hand.
- Cash discount. In evaluating the credit policy, the SME needs to decide on the cash discount that will be offered to a customer who pays before a specified period.

2.3.2.6 Management of debtors

In evaluating the cost of bad debt to the small firm along with the payment patterns of debtors, a SME can determine the effectiveness of its credit and collection policy.

A SME can use the following methods in the management of debtors (Smit, 2012):

- Monitoring of payment patterns. Having a portfolio of payment patterns per customer can assist the SME in identifying possible late payments.
- Monitoring of bad debts. This involves the process of monitoring as an effort to manage existing bad debts and to prevent current debtor accounts from turning into bad debts.
- The percentage credit sales relative to total sales can provide a clear indication of the total portion of sales given on credit to customers. It is important to monitor the credit sales percentage throughout the SME's financial year.
- The percentage rejected credit applications can serve as an indication of the repayment ability of the customers willing to buy products and/or services from the SME.

2.3.2.7 Age analysis of debtors

The age analysis of debtors is important in determining the percentage of debtor days, from current to 120 days and older, outstanding relative to total sales, online: www.ehow.com (2013).

Table 2.1 gives an example of a debtor age analysis.

Table 2.1: Debtor age analysis

Period	Rand value	% Relative to total sales
Current	183 350.00	36.67%
30 days	133 350.00	26.67%
60 days	66 650.00	13.33%
90 days	50 000.00	10.00%
120 days and older	66 650.00	13.33%
TOTAL	**500 000.00**	**100.00%**

As shown in Table 2.1, a SME's percentage of outstanding debtor days relative to total sales can be presented by means of a debtor age analysis. It should be noted that a debtor age analysis can also be created in the form of a graph. The purpose of a debtor age analysis, also known as a debt analysis or accounts payable aging report, is to alert managers or owners to the status of money owed to the firm when it is due and when it is overdue (VanBaren, 2013). In addition, according to VanBaren (2013), a debtor age analysis enables managers or owners to pay accounts payable at the latest date possible. Managers and owners can, therefore, hold cash for a longer period within the firm by managing their finances more effectively.

This section of the chapter discussed credit policy determinants along with the two forms of trade credit, namely simple and complex. The more complex form of trade credit, two-part terms, consists of three basic elements, namely the discount percentage; the discount period, and the final payment time which was also explained in detail. According to Fatoki (2010), the most common two-part term used by SMEs is “2/10 net 30”. The five theories of trade credit that serve as reasons for the extension of trade credit to buyers was examined. Lastly, all eight components of the credit policy were discussed in full.

2.4 THE CREDIT DECISION

The final section of this chapter will identify the relevant incentives that exist for a firm in deciding on whether or not to extend trade credit to customers. Advantages versus disadvantages when extending trade credit will be discussed along with the five important factors to consider when developing a credit policy. Lastly, important factors affecting the credit decision for a SME will be examined.

2.4.1 Incentives to extend trade credit

According to Main and Smith (1992: 172), there are several incentives for a firm to extend trade credit to its customers, rather than requiring cash sales with the buyer obtaining credit from another firm willing to extend trade credit. These incentives are discussed below.

2.4.1.1 Cost advantage

Trade credit is likely to be extended to buyers, should the firm have a cost advantage relative to other firms in the same competing industry. In achieving such cost advantage, the specific firm will be able to supply the buyer with the product or service from a single source. In doing so, the firm achieves a cost advantage over competitors that can be a source of competitive advantage to the firm.

2.4.1.2 Market power

The return on market power influences the extent to which lenders are willing to supply borrowers with trade credit. Trade credit is more likely to be offered the greater the returns from exploiting market power through effective price discrimination (Main & Smith, 1992: 172).

2.4.2 Advantages versus disadvantages when extending trade credit

Extending trade credit has the following advantages and disadvantages.

2.4.2.1 Advantages of extending trade credit

One of the main advantages of extending trade credit is that a SME's customers are likely to spend even more money on products and services offered. This will have an increased effect on the sales of a SME, provided that a SME receives the payment on a regular basis. Furthermore, by providing a credit facility, a SME can increase its customer loyalty and goodwill among customers. Proper trade credit management is needed to ensure that customers are sufficiently reliable to enjoy such privileges and not damage the cash flow of the SME. Lastly, a SME extending trade credit can conveniently shift the customer focus from the price to the quality of the product or service being offered (www.hellotrade.com, 2012).

2.4.2.2 Disadvantages of extending trade credit

The main disadvantage of trade credit extension is the possibility of customers not paying their outstanding account. According to Peavler (2012), there is the possibility of bad debts, or debts that the business owner may never collect, if any percentage of a SME's sales is on credit. Ultimately, under these circumstances, the SME will go through a number of legal procedures, provided all necessary documents are available. The possibility of such a situation indicates the importance of verifying the financial status of customers in order to make an informed credit decision and to effectively manage the debtor account immediately after extension of trade credit.

2.4.3 Factors to take into consideration when developing a credit policy

According to Peavler (2012), all small and larger firms eventually have to develop a credit policy. The small firm owner or entrepreneur must basically decide whether or not s/he will extend credit to other SMEs and customers. Credit extension is a serious decision for SMEs, due to the nature of the decision. Credit extension has a direct impact on the cash flows and profits of a SME.

The following factors will influence a SME’s decision as to whether or not to extend trade credit to customers or other small firms (Peavler, 2012). It is also important, especially for the small firm, to consider each of these aspects when developing a credit policy.

2.4.3.1 The effect on sales revenue

In extending credit, a SME is providing a platform for customers to make a delayed payment to the supplier. The existence of such a platform is convenient to customers and could lead to an increase in monthly sales for the supplier of credit, but less convenient due to the possible negative impact it may have on cash flow. The sales revenue from the sales the SME made will be delayed for either the discount period or the credit period, and perhaps longer if the customer is late in making payment on the outstanding account. Due to the risk involved in extending credit, a SME can increase its prices for the convenience of extending credit to customers. Thus SMEs willing to extend credit to customers have a trade-off, the possibility of delayed and late payments in exchange for a bigger customer base and higher selling prices (Peavler, 2012).

2.4.3.2 The effect on cost of goods sold

Regardless of a SME selling a product or a service, the SME needs to have products and/or services available at all times and, when a sale is made, products and/or services need to be ready and in stock for immediate collection by the customer. When extending credit, a SME provides the customer with the relevant product or service immediately, while receiving the price value of that product after a certain period in time, due to payment being delayed by the customer. SMEs thus need to have sufficient cash reserves or cash flow available to compensate for the delayed payment. In addition, A SME will lose any interest income it might have earned on the money. Again, SMEs willing to extend credit to customers have a trade-off, namely lost interest income and temporarily lower cash flow in exchange for an increase in customers and higher sale prices.

2.4.3.3 The probability of bad debts

The probability of bad debts or debt that cannot be collected will be non-existent if a SME only accepts cash for sale. There is the possibility of bad debts if any percentages of the SME's sales are on credit. In such circumstances, there is the unfortunate possibility that a small firm owner or entrepreneur will never be able to collect the debt owed to him/her. In developing a credit policy, a SME should accept the possibility that a portion of its credit accounts will never be paid or paid in full by its customers. The trade-off exists that some percentage of a SME's credit sales will never be paid or paid in full. Ultimately, the SME needs to decide whether the probability of bad debts is worth obtaining more customers and higher profit margins, due to an increase in selling prices.

2.4.3.4 Offering a cash discount

A cash discount can be presented in the form of "2/10 net 30". This represents a 2% discount for payment within the 10-day discount period; the net period ends on day 30. Basically, all SMEs need to decide whether it is worth obtaining the outstanding debt within a certain time period (10 days) and, in exchange, extending the discount to the customer (2% of the invoice amount). This is the trade-off regarding cash discounts.

2.4.3.5 Taking on debt

In deciding on whether or not to take on debt, a SME must factor in the cost of short-term borrowing as part of the credit decision. The likelihood of a SME stretching payment to their suppliers in order to finance their accounts receivable is very good and common practice for the majority of South African SMEs (Peavler, 2012). A small firm owner or entrepreneur may not be able to afford to sell products or services without immediate payment, unless there is a strong working capital base for support (Peavler, 2012).

2.4.4 Important factors affecting credit decisions

A number of factors will influence the credit decision of a SME (Dennis, 2010). It should be noted that the relative importance of each of the following factors is different. These factors will influence the credit decision of a SME and it is, therefore, important that credit managers or those responsible for the credit decision do not fail to appreciate the needs of their employer. According to Dennis (2010), some of the more important factors affecting the credit decisions include:

- Competition. This will affect the choice of deciding on a more lenient or a more rigid credit policy. An increase in competition could influence the SME to change the credit policy towards a more lenient approach.
- Terms offered by competitors. If competitive SMEs increase their credit terms, it can be more beneficial to the customer to buy from these SMEs. Thus, in order for a SME to remain competitive, it will necessarily have to increase the dating of its own credit terms and avoid the possibility of customers switching to other competitors.
- The laws of supply and demand. When demand for a product or service exceeds its supply, the situation benefits the SME, due to the credit manager having a more conservative philosophy than when supply exceeds demand.
- General business conditions. In a recession, business operations can decrease, leading to a reduction in sales revenue. A relaxation in debtor-collection efforts and a more lenient credit-granting policy could increase a SME's sales revenue.
- Change in demand of the company's products. When demand for a SME's products and services declines, strategies must be put in place to retain current customers and attract new ones. This will lead to additional pressure to liberalise credit granting.
- The amount of bad debt losses experienced. Bad debt losses will have a severe impact on a SME's cash-flow situation. If bad debt losses are higher

than expected, the management of a SME may insist on a more restrictive credit policy.

- Profit margins. For SMEs selling on credit, a higher profit margin elicits a higher credit risk exposure for the SME (Dennis, 2010).
- Market share goals and strategies. When negotiating to increase market share, credit terms are an important element of the negotiation process.
- Experience of the credit department's staff. The higher the experience and education of credit managers, the more sophisticated the credit risk mitigation and management process tends to be.

This section of the chapter discussed the relevant incentives that exist for extending trade credit to customers. It examined the advantages versus the disadvantages when extending trade credit, as well as five important factors to consider when developing a credit policy. Lastly, some important factors affecting the credit decision of a SME were discussed.

2.5 CONCLUSION

This chapter reviewed the literature on debtors, the credit policy and the credit decision. It can be argued that poor management of trade credit by SMEs in South Africa is a problem that leads to the failure of SMEs of growing into viable and successful organisations. Of the consequences resulting from poor management of trade credit, according to Wilson and Summers (2002: 320), is the late payment of debt between SMEs that constraints growth among smaller firms. In addition, a number of consequences resulting from poor management of trade credit by SMEs were identified. Ultimately, these consequences contribute to the inability of SMEs to repay their monthly obligations as they become due, resulting in SMEs' negative cash-flow situation.

The literature reviewed theory regarding debtors, the credit policy, and the credit decision for SMEs. Factors influencing the size of a firm's debtors, along with instruments indicating a firm’s debtors, were provided in the literature. In the credit policy, the determinants of credit policy along with the time profile of payment and functional activities implied by payment policy were discussed. The literature on credit policy for this chapter was completed by identifying all eight components of the credit policy in detail. The last part of the literature chapter was the credit decision that identified the relevant incentives for firms in deciding to extend trade credit to other firms. The credit decision for SMEs also focused on the advantages and disadvantages of extending trade credit for SMEs. The chapter ended with a discussion of the relevant implications for SMEs when developing a credit policy, and factors that will affect the credit decision of the SME.

Chapter 3 will review the internal and external factors in the business environment that can lead to SMEs’ poor management of trade credit. The business environment is important to the survival and growth of SMEs (Beck, 2007: 402). Variables in the business environment may affect the management of trade credit by SMEs. The relevant variables in the business environment were introduced under the 5C’s of lending and will be discussed in detail in the next chapter. Improving the management of trade credit by SMEs is one of the key factors in addressing the weak TEA rate and reducing the high failure rate of SMEs in South Africa.

CHAPTER THREE

THE BUSINESS ENVIRONMENT AND SMEs

3.1 INTRODUCTION

For trade credit to be extended to SMEs, the risk associated with SMEs has to be reduced. The problem of SME financing and the management thereof cannot be separated from considerations about the environment in which these SMEs operate (Fatoki, 2010: 118). For credit to be extended to SMEs, the risk perception of lending to them must be reduced (Fatoki, 2010). The mismanagement of trade credit among SMEs can be a contributing factor towards the perception of high risk in respect of lending to SMEs. This chapter focuses on factors in SMEs' internal and external environments (business environment) that can contribute towards the mismanagement of trade credit among SMEs. This, in turn, can influence the risk perception of extending trade credit to SMEs.

This chapter reviews the literature on both the internal and external business environments and SMEs. The internal factors to be reviewed in this study include managerial competency, collateral, business information, and networking. The literature on external factors will concentrate on the macroeconomy, ethics, the legal system and corruption and how these factors impact on the management of trade credit for SMEs.

3.2 THE BUSINESS ENVIRONMENT

The South African economy has undergone major structural transformations and developments since the advent of democracy in 1994. The internal and external business environments should be strengthened in order for SMEs to prosper and grow into viable and successful organisations (Beck & Demirguc-Kunt, 2006: 2933).

The business environment can be defined as a combination of factors and variables, both inside and outside the structure of the firm, which play a critical role in the ongoing and successful existence of the organisation (Smith, Cronje, Brevis & Vrba, 2007: 62). The business environment affects a firm. According to the World Bank (2006), changes in the business environment have either a positive or a negative effect on the growth or failure of SMEs in much of Africa. Furthermore, the business environment in which a SME operates will affect its strategies and processes. It is important for successful SMEs to identify and respond to various opportunities and threats in the environment. Potential disturbances in the environment may hold threats and risks for the SME; successful SMEs should be able to foresee these disturbances before they occur (Fatoki, 2010: 118).

The remaining section of this chapter will discuss the internal and external business environments. Four factors will be examined in each business environment. The final section of the chapter will be a conclusion and summary of the literature.

3.2.1 The internal environment

The internal environment consists of factors within the SME's business environment and is, therefore, under the control of the SME itself. These factors can influence the management and accessibility of trade credit, debt and equity as methods of finance for the SME. These factors can also be viewed as challenges to SMEs (OECD, 2006). According to Fatoki (2010: 119), the internal business environment poses the following challenges:

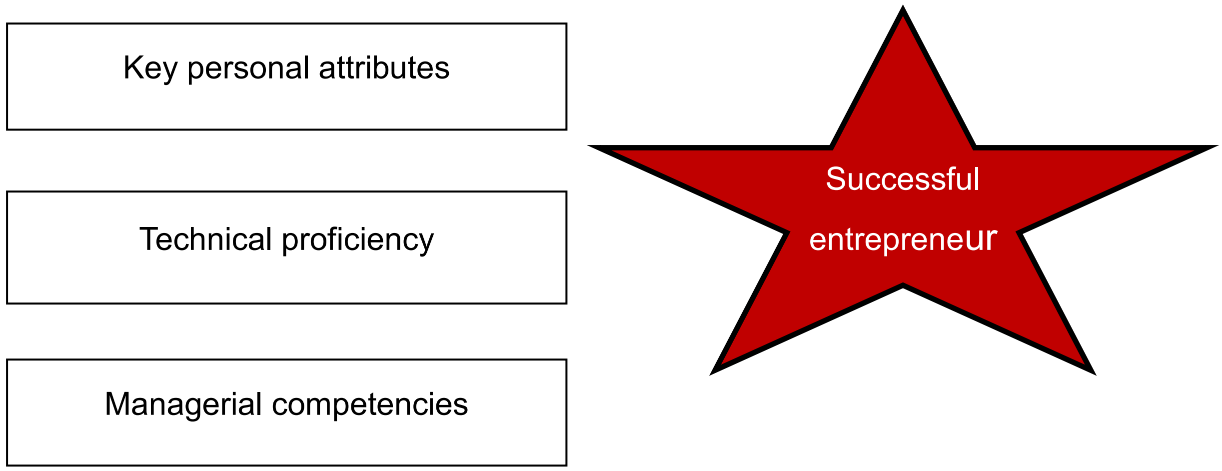
- Low level of managerial competencies and knowledge exhibited by SMEs.
- Lack of collateral by SMEs in order to offer security to the lender for repayment of debt.
- Non-availability of quality financial or business information by SMEs.
- Lack of networking and the development of relationships between individuals.

For the purposes of this study, these factors will be used as challenges in the internal business environment that SMEs face in managing trade credit.

3.2.1.1 Managerial competencies

Managerial competencies (also known as owner's characteristics) are measured by experience and education. Managerial competencies are a major measure of character, along with credit history. Managerial competencies can be defined as the existence of the following key variables: knowledge, skills, attitudes and behaviours within an individual that contribute to personal effectiveness (Hellriegel, Jackson, Slocum, Staude, Amos, Klopper, Louw & Oosthuizen, 2008: 5). According to Fatoki (2010: 119), competencies are a variety of things that people need to know, understand, achieve and be in order to achieve the desired outputs. Managerial competencies form part of a SME's assets and are capabilities that the owner of a SME possesses. These sets of skills, abilities and characteristics associated with high performance allow the SME to succeed and grow into a profitable and sustainable venture. Managerial competencies are a key success factor for entrepreneurs in developing the SME into a profitable and sustainable venture (see Figure 3.1).

Figure 3.1: Managerial competencies and successful entrepreneurs



Source: Hellriegel *et al.* (2008: 5)

As depicted in Figure 3.1, managerial competencies are the key for any entrepreneur to be successful. These competencies include key personal attributes, technical proficiency, and managerial competencies.

According to Lefebvre and Lefebvre (2002: 285), the innovative capabilities of the management team are associated with a SME's growth and performance. The managerial competencies identified in a study by Lefebvre and Lefebvre (2002: 285) include knowledge intensity, unique know-how, and the ability to undertake research and development. Martin and Staines (2008) conducted a study regarding the importance of management competence in small firm success. The study identified the following main reasons in order to determine why SMEs fail: a lack of managerial experience, skills and personal qualities. The study also identified other factors contributing to the failure of a SME, namely adverse economic conditions, resource starvation and poorly prepared business plans. The failure rate of business start-ups in the United Kingdom is very high, as pointed out by Martin and Staines (2008). There is a clear difference between high-growth and low-growth SMEs. This difference is a distinguishing feature when comparing high-growth small firms to low-growth small ones. Owners of a high-growth small firm will realise the importance of specialist or key management skills and organisational structure. Furthermore, these owners are more actively involved in their immediate market environment and understand the importance of human resource management along with the development and retention of managerial talent within the SME.

Managerial competencies impact on the availability of trade credit to SMEs. Lyles, Saxton and Watson (2004) observed that managerial competencies are measured by the founder's educational level as well as entrepreneurial, managerial, functional area, and start-up experience. All of these issues are both important and beneficial to new venture performance, survival and growth. In a South African study by Herrington and Wood (2003), a lack of education and training was found to contribute to the reduction in management capacity for SMEs in South Africa. In the same study, the lack of education and training was identified as one of the main reasons for the high failure rate for South African SMEs. This suggests that managerial competencies should have an impact on access to trade credit by SMEs.

Lyles *et al.* (2004: 352) used the following factors as measurement to evaluate managerial competencies versus the performance of new ventures: the founder's education as well as start-up, functional area, managerial and entrepreneurial experience. The factors that measured the new venture performance included: return on sales (ROS), return on assets (ROA), return on employees (ROE), growth rate of assets (GRAS), and growth rate of employees (GREP). The results show a positive relationship between relative high profits and entrepreneurs who possess more experience and education in the line of business. The study also showed that profitability levels are low when the entrepreneur lacks the necessary educational background and only possesses managerial and start-up experience.

It should also be noted that SME owners in South Africa often lack the expertise, training and experience related to the line of business they establish. In the GEM Report, Herrington and Wood (2003) observed that lack of training and education have undermined the management capacity in SMEs in South Africa. This lack of training and education contributes to the high failure rate of SMEs and other new ventures in South Africa. Until recently, the school curriculum did not recognise the importance of integrating entrepreneurship into the curriculum (Fatoki, 2010: 123). Entrepreneurship is crucial to the school curriculum to initiate confidence, innovation and creative thinking among scholars and prospective young entrepreneurs. This is an important reason why South Africa falls behind when comparing entrepreneurial development with that of other countries. The lack of education and training negatively influences the competency level of managers, contributing to a shortage of competent managers. Thus SMEs face constant difficulties in recruiting skilled employees to their businesses and SMEs.

According to Von Broembsen *et al.* (2005), 75% of all new SMEs in South Africa fail within the first two years of business, and the creation rate of new SMEs in South Africa is one of the lowest in the world compared to other developing countries. Managerially competent and highly educated SME owners are more likely to have a high post-failure earning capacity than less educated owners. The earning capacity of a business starter in a subsequent job, for example the job after the eventual failure of the SME, can serve as signal to the bank and other suppliers of credit and/or trade creditors (Blumberg & Letterie, 2008: 191). This signal indicates the creditworthiness of the SME, even if the SME fails. This suggests that the greater the level of managerial competency, the greater the possibility of survival and performance of SMEs. Consequently, managerially competent managers and SME owners will reduce the risk of extending trade credit to small firms.

3.2.1.2 Collateral

Collateral can be defined as a set of assets that are pledged by a borrower to a lender as security for the payment of debt (Gitman, 2003: 651). A security arrangement between the lender and the borrower specifies that the assets, as indicated in the arrangement, serve as collateral for the loan. Therefore, the lender obtains a security interest in the collateral. Assets held by collateral can be the fixed or the current assets of a firm or business owner. For short-term loans, a more liquid asset will be required for collateral in the form of current assets such as inventory or accounts receivable (Fatoki, 2010: 124). Liquid assets can be converted into cash far sooner than fixed assets. Therefore, current assets in the form of accounts receivable or inventory are most desirable. For long-term loans, fixed assets such as land and buildings are used to serve as collateral.

Table 3.1 depicts assets that can be used by a SME as collateral when applying for a loan.

Table 3.1: Assets that can be used by a SME as collateral

Security	Credit capacity
Land and buildings	More than 80% of value
Accounts receivable	70%-85% of those less than 90 days of accepted receivables
Inventory	20%-70%, depending on obsolescence risk and saleability
Equipment	70%-80% of equipment
Conditional sales contract	60%-70% or more of purchase price
Plant improvement loan	60%-80% of appraised value or cost

Source: Timmons and Spinelli (2007: 495)

As depicted in Figure 3.1, land and buildings constitute a credit capacity of 80% and higher. Thus, assets such as land and buildings will be favourable to any SME to serve as collateral when applying for a loan. It must be noted that, although inventory is a liquid form of asset, the credit capacity percentage can be as low as 20% of its value, depending on its obsolescence risk and saleability.

It should be noted that, unlike bank loans and overdraft facilities, trade credit is often not guaranteed by any formal collateral (Fatoki, 2010: 128). Therefore, the argument regarding credit being unavailable by banks and financial institutions, due to lack of collateral, may not be applicable to trade credit. In a study by Willacy (2009: 154), it was observed that, if SMEs fail to meet some of the criteria for lending, they will be required to provide security as collateral during credit evaluation by trade creditors. Therefore, it can be assumed that creditors feel better protected if there is collateral available with the extension of credit. This implies that creditors may only be willing to extend credit to SMEs that have the capacity to present adequate collateral.

3.2.1.3 Financial or business information

Financial and business information are the primary measures in any good business plan that creditors and lenders use in assessing the repayment ability of the borrower (Kwok, 2002: 353). When setting up a business, a well-prepared business plan is a necessity in planning and in applying for finance to fund future projects. In order to obtain the necessary funding from creditors, lenders, financial institutions and banks, entrepreneurs and SME owners need to be able to present a structured business plan. Banks, lenders and creditors analyse the financial information provided by firms in determining the future and present performance of the firm applying for finance (Kitindi, Magembe and Sethibe, 2007). This financial and business information consists of audit reports and annual financial reports and are usually contained in the business plan of the SME. Financial information refers to accounting information such as statement of cash flow, statement of comprehensive income, and statement of financial position. This financial information is provided by the firm's accountants and accounting system. Lenders and creditors need to have access to financial information that provides a clear indication of the ability to repay the loan, along with the future prospects of the borrower. Some lenders and/or creditors also acquire additional information that can be obtained through discussions with prospective borrowers (Kitindi *et al.*, 2007). Fatoki and Odeyemi (2010: 2766) point out that banks and creditors demand financial information from small firms in order to assess the repayment ability and performance of the SME applying for finance.

The business plan is a written document detailing the goals set out by the SME and how it plans to accomplish this set of goals (Fatoki, 2010: 129). The business plan is an important document for the SME and can be used both inside and outside the business (Fatoki, 2010: 129). Inside the SME, the plan serves as a blueprint in executing the set of goals and strategies for the SME. Outside the SME, the business plan introduces creditors (suppliers), stakeholders and/or potential investors to the business model and opportunity that the SME is pursuing. The business plan also identifies the planning that the SME sets out in order to achieve this set of goals along with the resource requirement in achieving these goals. Barringer and Ireland (2006: 205) identified two reasons why the business plan is important to SMEs. A business plan is an internal document that helps a SME consolidate its set of goals and incorporate the SME's business model. A business plan is also a selling document for the SME in that it provides a mechanism for the SME to present itself to potential suppliers and investors.

In order to obtain financial support from lenders of credit, banks, financial institutions and venture capitalists, SME owners are encouraged to prepare a business plan for presentation to the relevant parties. The business plan is essential for building a relationship between the parties and selling the business opportunity to potential investors. A business plan plays a fundamental role when setting up a business and is an essential document for the entrepreneur or small venture owner (Pretorius & Shaw, 2004: 225). However, the majority of SME owners in South Africa are not sufficiently competent and/or do not have the capabilities to articulate a business plan that meets the requirements set out by lenders of credit, banks or investors (Fatoki, 2010: 129).

In addition, the SME finance market is characterised by risk and uncertainty concerning the future conditions of the SME. Sadly, from the perspective of the creditor, the information regarding the underlying quality of the project and management of the SME does not suffice, giving rise to the issue of adverse selection (Fatoki, 2010: 130). Furthermore, credit managers of the SME may fail in their task of effectively managing trade credit, resulting in moral hazard that will lead to credit rationing. Moral hazard can be defined as the situation whereby individuals will alter their behaviour and take more risks (Pettinger, 2013). Individuals will choose to take more risks, because they do not have to bear any consequences in doing so. The effective use of financial information by SMEs is critical in order to receive credit from other small firms. It should be noted that, unlike large firms, SMEs face far greater constraints in acquiring the necessary working capital, due to the unavailability of adequate financial information (Fatoki, 2010: 130). Adequate financial information is essential to SMEs so that other small firms can assess their performance and repayment ability before extending trade credit.

This situation leads to information asymmetry where the credit provider does not have adequate or sufficient information on the financial circumstances of the credit receiver (Fatoki & Smit, 2010). Information asymmetry is the cause of financial problems for small businesses (Holmes & Cassar, 2003: 126). However, the development of a comprehensive business plan by an SME owner can reduce risk perception and increase the possibility of obtaining credit from other small firms.

The use of credit scoring has reduced the information asymmetry associated with lending long-term funds or extending trade credit to small businesses (Frame, Padhi & Woosley, 2001: 817). Initially, in an effort to reduce information asymmetry among small business lending, small firms focused on building long-term relationships. This included continuous interactions between the credit provider and the SME in order to generate the necessary adequate information about the credit receivers' financial statements (Frame *et al*., 2001: 817).

SMEs lack the necessary skills in preparing financial statements and business plans and do not disclose all-important information regarding their SME's business transactions (Fatoki, 2010: 133). SMEs not disclosing all-important information applicable to their SME's business transactions amplify the problem of information asymmetry.

3.2.1.4 Networking

In the case of inter-SME trade, Owualah (2002) observed that the existence of a long-term relationship between a trade creditor and a SME owner is beneficial to both parties involved. The problem of asymmetric information can be reduced if networking takes place in creditor/debtor relationships between SMEs in the same industry (Shane & Cable, 2002). Networking can be described as an activity whereby entrepreneur-oriented SME owners develop and maintain a personal relationship with other business owners within the same industry or surroundings (Coulthard & Loos, 2007). Overall networking will help the SME gain the much-needed support from key stakeholders; this will be of long-term benefit to the SME. Networking positively influences the SME's access to external financing, due to the fact that networking serves as a substitute for the lack of effective market institutions and can be beneficial to SMEs in accessing trade credit. SMEs have an advantage in accessing trade credit, due to networking that provides valuable information regarding the legitimacy of the SME to trade creditors (Ngoc, Le & Nguyen, 2009).

3.2.2 The external environment

The external environment consists of factors outside the SME's business environment and is, therefore, not under the full control of the SME. The external environment consists of variables that, directly or indirectly, influence the organisation (Ehlers & Lazenby, 2007: 106). The external environment can be characterised as a constantly changing environment. External environment factors influence the management and accessibility of trade credit, debt and equity as methods of finance for the SME. These factors can also be viewed as challenges to SMEs (OECD, 2006).

According to Fatoki (2010: 138), the external business environment poses the following challenges:

- The legal system. Low confidence in the legal system, courts are not fair and impartial, and court decisions are not enforced.

- Ethics. Ethical issues for the small firm and SMEs' perception of dishonesty in keeping promises and commitments.
- Macroeconomic conditions. Weak economic conditions make it difficult for SMEs to use and manage trade credit positively; this ultimately has a negative impact on the repayment ability of the small firm (Barbosa & Moraes, 2004).
- Corruption affects the repayment of credit by suppliers of credit to lenders.

For the purposes of this study, these factors will be used as challenges in the external business environment that SMEs face in managing trade credit.

3.2.2.1 The legal environment

For the purposes of this study, the legal environment is the first external business environment challenge that SMEs face when managing trade credit. This section of this study will examine the definition of law. It should be noted that Meiners, Ringleb and Edwards (2005: 115) point out that there is no general definition of law. Law is an abstract term that can be defined in many ways. This section will also include other relevant topics to the literature, such as insolvency law and creditor protection in South Africa.

- Definition of law

Law can be defined as "a principle or rule of conduct so established as to justify a prediction with reasonable certainty that the courts will enforce it if its authority is challenged" (Fatoki, 2010: 139). The members of a society must obey laws whereby all unlawful actions will be subjected to legal consequences and sanctions. Therefore, a law intends to direct human behaviour by means of a collection of rules.

- Insolvency law in South Africa

The function of the insolvency law is to provide a fair distribution of the proceeds of the debtor's property among the creditors in situations where the debtor's total liabilities exceed total assets (Nagel, 2005: 10). The insolvency law aims to be a collective debt-collecting procedure.

- Creditor protection in South Africa

The creditor right index ranges from 0 (indicating a weak creditor right) to 4 (indicating a strong creditor right). The creditor rights index serves as measurement for creditor protection (Djankov, Mcleish & Shleifer, 2007: 300). When laws and regulations define each of the following rights of secured lenders, a score of one is assigned:

- There are restrictions, such as creditor consent or minimum dividends, from a debtor to file for reorganisation.
- Secured creditors have the ability to seize their collateral after the reorganisation petition is approved. Thus there is no automatic asset freeze.
- First payment is to secured creditors through the proceeds of liquidating bankrupt firms, and thereafter to government and workers.
- Management does not retain administration of its property pending the resolution of reorganisation.

Table 3.2 illustrates the creditor rights index of South Africa and selected developing and developed countries.

Table 3.2: Creditor rights index in South Africa and selected developing and developed countries

Country	Creditor rights index
South Africa	3
Botswana	3
Nigeria	4
United Kingdom	4
United States of America	1
Cameroon	0
France	1
Sweden	1

Source: Djankov *et al.* (2007: 315)

Table 3.2 shows that South Arica and Botswana, with indices of 3, have relatively strong creditor protection. Nigeria and the United Kingdom, with maximum indices of

4, have very strong creditor protection. South Africa, Botswana, Nigeria and the United Kingdom belong to the English legal origin. The United States of America, France, Sweden and Cameroon all have indices ranging between 1 and 0, indicating very weak creditor protection. Table 3.2 implies that, in theory, creditors in South Africa enjoy high protection.

The World Bank (2003) identified a relatively inefficient and incapable legal system in South Africa compared to the legal systems of developed countries. Cronje (2003) identified that creditors often display a lack of interest in the administration of insolvent estates. The reasons for this lack of interest are that creditors, and specifically unsecured creditors, seldom receive any benefit of substance to their businesses from the insolvent estate. This study also identified that it takes a long time to finalise bankruptcy proceedings. Other problems within the legal system, when dealing with insolvent business estates, include the long duration, procedure and high cost involved in enforcing contracts, registering property and closing business upon bankruptcy. Thus, for the above reasons, the lack of interest displayed by creditors towards recovering part of their assets in an insolvent estate suggests a relatively inefficient legal system. This may negatively affect the management of trade credit by SMEs, leading to insolvent business estates and the inability of creditors to repossess collateral.

3.2.2.2 Ethics

Ethics can be defined as the way in which a firm integrates core values such as respect, trust, honesty and fairness into its policies, practices and decision-making (Hellriegel *et al*., 2008: 64). Ethics is a set of rules and values that encourage correct behaviour and discard wrong behaviour. Therefore, ethics will affect both individual and business organisations alike. Questions relating to ethics arise at an individual and business level. At an individual level, ethical questions arise when people are faced with issues such as honesty and individual responsibility. At business level, ethics relates to the principles of conduct within organisations that guide decision-making and behaviour. Business ethics “are the standards used to judge the rightness or wrongness of a business’ relations to others” Fatoki (2010: 149).

Smit *et al.* (2007: 412) described ethics as a summary of moral values and principles that will directly influence the behaviour of an individual or group of individuals in terms of what is right or wrong. Business ethics involves a SME's attitude and compliance towards legal standards and adherence to internal regulations and practices. Generally speaking, business ethics can be defined as the methods and principles a SME or organisation puts in place in order to adhere to legislation; company standards; regulatory and professional standards; keeping promises and commitments, and abiding to general principles or values such as honesty, fairness, respect and truth (Fatoki, 2010: 149).

In order to assist with the ethical conduct of business in South Africa, the King Reports on Corporate Governance were instituted in 1994 and 2002.

- King Report 1994

The King Committee's report, titled the King Report, was released in 1994. The King Committee on Corporate Governance was formed in 1992 to consider corporate governance in the South African context. It should be noted that the King Report of 1994 went beyond the financial and regulatory aspects of corporate governance in advocating an integrated approach to good governance, in the interest of a wide range of stakeholders with regard to the fundamental principles of good ethical, social, financial and environmental practices (King Report, 1994).

- King Report 2002

The King Report of 1994 was reviewed, leading to the King Report of 2002. This Report listed seven characteristics of good corporate governance:

- ➢ Corporate discipline. A commitment to adhere to behaviour that is universally recognised and accepted to be correct.
- ➢ Independence. The extent to which mechanisms have been in place to minimise and avoid potential conflicts of interest.
- ➢ Transparency. The ease with which an outsider is able to analyse a firm's actions in a meaningful manner.
- ➢ Responsibility. Behaviour that allows for penalising management and corrective action.

- Fairness. The system that exists within the firm must be balanced in taking into account all those that have an interest in the firm.
- Accountability. Individuals or groups in a firm, who make decisions and take actions on specific issues, need to be accountable for their decisions and actions.
- Social responsibility. A well-managed firm should place a high priority on ethical standards and respond to all social issues (King Report, 2002).

- Ethics and SMEs

Howorth and Moro (2006: 30) identified the vital role that ethics and trust play in any business environment in order to reduce agency problems such as adverse selection and moral hazard. Adverse selection occurs when the buyer chooses an inferior product based on unobservable private information regarding the product transferred through the seller (Berndt & Gupta, 2009: 744). Lending technologies such as the evaluation of a firm's financial statements, the provision of collateral and credit scoring are all based on hard facts and the availability of public information. The SME's decision to extend trade credit is often based on these three lending technologies (Fatoki, 2010: 153). Unlike lending technologies, private information collected between SMEs is often soft data and can be influenced by the context in which it is collected.

When focusing on ethics, it should be understood that the essence of successful lending is overcoming asymmetric information problems between the borrower and the lender. If a problem, such as asymmetric information, is not overcome between both SMEs entering into the credit agreement, the incentive for borrowers will be to default. In general, different sources of information will influence a SME's decision in extending trade credit to other SMEs.

The single most unethical practice by SMEs is dishonesty in making a credit agreement and not keeping to the policies set out in such agreement (Fatoki, 2010: 154). According to Fassin (2005: 268) and Lepoutre and Heene (2006: 260), SMEs experience more difficulties compared to their larger counterparts when engaging in socially responsible behaviour. Top management should be the first to express the ethical tone for the SME so that it may filter down to the other levels of management.

Top management has the most influence on ethical behaviour, especially for SMEs, due to the characteristic of the small firm. In brief, SMEs provide greater scope for individual beliefs, entrepreneurial ideas and moral decision-making to affect the practice of the business as a whole. In addition, social relationships, in which these owner-managed SMEs are entwined, cannot be separated from the business.

Ethical issues form part of the SME's life cycle from its start-up and maturity stage to its decline or rejuvenation. These ethical issues concern confidentiality of information, intellectual property, marketing, raising of funds and/or extension of trade credit. It should be noted that the majority of SMEs face significant resource pressures (Hannafey, 2003). Fatoki (2010: 154) points out that the "liability of newness may lead new firms towards more individualist ethical postures such as non-repayment of credit". Furthermore, regardless of specific positive attributes of collateral and credit history that the borrower may have, if the SME does not demonstrate trustworthiness and integrity, any credit proposal may be rejected. In deciding upon whether or not to extend credit to another SME, ethics (which includes character and personality) may well be the most important assessment that a lender of credit can make about the prospective borrower (Hannafey, 2003: 111).

Ethics includes character and personality traits that reveal the intent of a SME towards its own and other businesses. The borrower must reveal a character and personality that will influence the lender in such a way as to trust the borrower with the repayment of funds. If the lender senses a lack of commitment from the borrower towards fulfilling the responsibilities of the credit proposal, even towards the business, the lender will most certainly not grant credit to the borrower and ignore the proposal. In addition to the legal agreement, when being ethical in business, a borrower must win the trust of a lender by showing a certain moral obligation towards the repayment of funds (Fatoki, 2010: 155). Ethics plays an important role towards the credit decision, although it may also affect the way in which trade credit is managed after extending funds to a borrower.

3.2.2.3 Macroeconomic conditions

Economic forces ultimately result in prosperity or adversity and have specific implications for an organisation and/or the management of such an organisation (Ehlers & Lazenby, 2007: 108). Therefore, it is important for business organisations to study the economic environment in order to identify specific trends, changes and strategic implications. In the same study by Ehlers and Lazenby (2007: 108), the economic variables that affect organisations include the fiscal and monetary policies of the government, inflation, interest rates, and foreign exchange rates. It is important for SME owners to understand the specific economic situation in the country. They should develop the ability to scan and interpret environmental changes in order to grow into viable and successful organisations. SME owners should thoroughly understand the fiscal policies of the government and the monetary policies of the Reserve Bank and know that movements in the interest rate will influence consumer spending, thus the demand for their products. Understanding the economic environment can help managers predict how trends and events in those environments might affect their SMEs' future performance and can help SMEs manage the SME better.

In an economic downturn, it is difficult for firms to have a positive leverage (Fatoki, 2010: 147). According to Correia, Flynn, Uliana and Wormald (2007: 420), positive leverage occurs when a firm operates under favourable economic conditions where sales and profit margins are high. Therefore, the firm is able to generate a good return on assets. Such economic conditions are beneficial to the firm and may help manage the firm better. Negative leverage occurs when a firm faces difficult times along with a constant decrease in sales and profit margins. The current economic conditions suggest that there are still difficult times ahead for SMEs. This may influence the management of SMEs, especially that of trade credit. In a study by Coleman and Cohn (2000: 82), it was observed that an economic downturn usually has a negative impact on SMEs. In such negative economic conditions, SMEs are forced into situations where they do not have loyal customers and cannot reduce prices. Demand for their products and market issues are the most important factors that positively influence SME growth (Mollentz, 2002).

The Economist (2012) reports that consumption and confidence levels have fallen, due to the global economic crisis. Consequently, many firms are showing reduced sales, revenue and market potential for already established and new SMEs. A depressed or weak economic condition is a characteristic associated with the likelihood of a SME's failure to repay debt (Barbosa & Moraes, 2004). This suggests that weak economic conditions can negatively affect a SME's cash-flow cycle, especially one that makes use of trade creditors to finance its operations. Fatoki (2010: 149) states that "weak economic conditions make it difficult for firms to use debt positively and this may affect their ability to repay debt".

In summary, the inability of SMEs to repay debt may affect the way in which they manage trade credit. Weak economic conditions may force SMEs to postpone payment to certain creditors, due to a lack of cash available.

3.2.2.4 Corruption

Corruption can be described as the abuse of entrusted power for self- or private gain (Transparency International, 2008). There is nothing more important in the current work of the World Bank than fighting corruption (World Bank, 2005). Corruption is the main reason for social inequality and poverty in societies. Corruption damages societies that are dependent on the integrity of other people in a position of authority. It should be noted that, although corruption is at the core of the problems of social inequality and poverty, it is also a barrier to overcoming problems such as social inequality and poverty within societies. Corruption "undermines democracy and the rule of law, distorts national and international trade, jeopardises sound governance and ethics in the private sector and threatens democratic and international security and the sustainability of natural resources" (Fatoki, 2010: 161). Corruption is a global problem that hurts everyone.

- Corruption in South Africa

According to Transparency International (2008), corruption in South Africa is on the increase in both the public and the private sector. Transparency International has published the Corruption Perception Index (CPI) annually since 1995. This puts the issue of corruption on the international policy agenda. Through expert assessments and the use of opinion surveys, the CPI ranks 180 countries by their perceived level of corruption. A country can score a rank ranging between 0 (highly corrupt) and 10 (highly clean).

Tables 3.3 and 3.4 show the CPI in selected developed and developing countries. Corruption is much higher in developing countries than in developed countries.

Table 3.3: Corruption perception index of selected developed countries

Country	CPI	Rank
Denmark	9.4	1
New Zealand	9.4	1
Sweden	9.3	4
Canada	8.7	1
United Kingdom	8.4	12
United States of America	7.2	20

Source: Transparency International (2008)

Table 3.4: Corruption perception index of selected developing countries

Country	CPI	Rank
Botswana	5.4	38
South Africa	5.1	43
Uganda	2.8	111
Nigeria	2.2	147
Zimbabwe	2.1	150
Somalia	1.4	179

Source: Transparency International (2008)

- Corruption and SMEs

Corruption has the potential to affect both smaller and large firms. This is the reason why the OECD (2006) calls for more to be done in order to highlight the issue of corruption and bribery within the SME community. The majority of empirical studies on corruption have focused on how corruption affects large firms in developed countries. There is a paucity of research in the sphere of SMEs and, according to the World Bank (2005); studies on corruption have mainly focused on large firms. It should be noted that SMEs make up 90% of all established businesses worldwide (Fatoki, 2010: 164). Although corruption is detrimental to all types of businesses, from large or small to local and multinational, the smaller firms are the most affected (Fatoki, 2010: 164). Corruption totally undermines business ethics, weakens any possibility of economic investment that may exist and leads to a decrease in the quality of products and services sold. Fatoki (2010: 164) differentiates between corruption affecting SMEs as being public or private. Public corruption involves government officials seeking personal gain in order to grant licenses, tax incentives or permits. Private corrupt interactions include the extortion by employees of large firms and bribing in order to obtain a vital contract or for the approval of bank loans that do not meet basic financial criteria.

SMEs engage in corruption because of problems linked to bureaucracy and regulatory compliance (Gaviria, 2002: 249). The cost of dealing with bureaucratic requirements does not increase/decrease in proportion to firm size; therefore, the costs imposed on SMEs are very arduous (Fatoki, 2010: 165). This may encourage smaller business units to engage in corrupt behaviour. Unlike larger firms that have strong connections to higher bureaucrats and politicians, SMEs do not have the influence to oppose requests for unofficial payments and lack bargaining power.

The pain and consequences of corruption are greatly felt among SMEs, according to the United Nations Industrial Development Organisation (2007). Factors such as education, training, access to information, technology, financial support, infrastructure, property rights and export possibilities influence the ability of entrepreneurs to grow their business into viable and successful organisations. Corruption has been identified as the main obstacle to SME development (Fatoki, 2010: 165). According to Fatoki (2010: 165-166), SMEs are more liable to be affected by corruption than large enterprises for the following reasons:

- The structure of SMEs. The closer relationships between staff members in SMEs, along with the relatively greater degree of informality, can create a culture where corruption is more easily tolerated.

- The short-term vision and perspective of SMEs. A pronounced characteristic of the staff of many SMEs is only to focus on the present or short-term future of the business. Larger firms have the capacity to look ahead and consider the long-term drawbacks of corrupt practice. Therefore, there is a tendency for SMEs to view the short-term benefits of corruption.
- The limited financial resources of SMEs. In certain environments, SMEs do not always have the capacity to refuse to pay for bribes or other unofficial payments. This lack of capacity to accept bribes or other unofficial payments is caused by a shortage of capital available and smaller profit margins for SMEs.
- The inability of SMEs to exert a strong influence over officials and/or institutions. Compared to larger firms, SMEs lack the bargaining power and influence to oppose requests for unofficial payments and similar solicitations, as they usually do not have strong ties with, and connections to higher bureaucrats and politicians. Consequently, corrupt officials do not fear a great deal of resistance or counteractions from SMEs.
- The capital structure of SMEs. Large firms are generally publicly quoted and are, therefore, subject to even stricter stock-exchange regulations, compared to SMEs that are often tightly held, without a clear line of separation between shareholders, management and board of directors.

In many incidents, corrupt bank officials are targeted to approve loans that do not meet basic financial criteria. Although such incidents occur regularly, the question is whether private-to-private sector corruption poses a challenge to SMEs. In addition, corruption especially affects SMEs that take on government contracts (Fatoki, 2010: 166). Corruption, therefore, may affect the capacity of SMEs to repay credit granted to them (United Nations, 2008).

As corruption adds to uncertainty for banks and credit extenders to enforce their claims against defaulting debtors, it diminishes the willingness of banks and credit-extending businesses to grant loans or extend trade credit to debtors. Corruption within SMEs can have a negative influence on the management of trade credit, due to SMEs being uncertain about the repayment ability of their debtors. Corruption in South Africa is high, as shown by Transparency International Annual Reports.

Corruption is endemic in government institutions; the legal system, though strong on paper, is weak (Fatoki, 2010: 167). Corruption may affect the repayment of credit. This may, in turn, affect the management of trade credit by SMEs.
This section of the chapter discussed the internal and external business environments; four factors were examined within each business environment.

3.3 CONCLUSION

This chapter reviewed the literature of the business environment and SMEs in South Africa. The business environment comprises both the internal and the external environments. Internal environment factors include managerial competencies, collateral, business information, and networking. External environment factors include the legal system, ethics, macroeconomic conditions, and corruption. The literature showed that managerial competency has a positive impact on SME performance. Managerial competencies form part of a SME's assets and are capabilities that the entrepreneur should possess in order to grow the SME into a viable and successful organisation. Collateral serves as an important platform to reduce several types of problems that arise when there are informational asymmetries between banks and/or trade creditors and entrepreneurs. Collateral signals the confidence and commitment of entrepreneurs towards their future projects. A proper business plan is essential for accessing the necessary funds from external sources; failure in not providing a business plan leads to information asymmetry between creditor and debtor. Furthermore, networking is important for the survival of SMEs. This suggests that lack of managerial competencies, collateral, business information, and networking may lead to the poor management of trade credit by SMEs.

The literature reviewed showed that, although creditor protection in South Africa is relatively strong on paper, the lack of interest displayed by creditors towards recovering part of their assets in an insolvent estate suggests a relatively inefficient legal system. This can be an obstacle to the management of trade credit by SMEs. Although certainly the least quantifiable, ethics may well be the most important assessment that a lender can make about the prospective borrower (Hannafey, 2003: 101). In this respect, ethics implies the ethical perception of SMEs by trade creditors. Furthermore, the market and growth potential of a SME is a critical success factor that can be widely influenced by macroeconomic conditions within which the SME operates. Corruption may affect the capacity of SMEs to repay credit granted. The primary objective of this study is to investigate empirically the impact of the business environmental factors discussed in this chapter on the management of trade credit by SMEs.

The next chapter focuses on the research methodology used for this empirical study.

CHAPTER FOUR

RESEARCH METHODOLOGY

4.1 INTRODUCTION

Due to the social and economic importance of new SMEs, studies leading to improved understanding of the performance of new SMEs make a significant contribution to the literature (Chrisman, Bauerschmidt & Hofer, 2000: 6). According to Beck and Demirguc-Kunt (2006: 2935), “the failure rate of new SMEs in most developing countries is significantly high. Therefore, more fundamental reforms must be instituted to tackle the underlying reasons why new SMEs do not fulfil their growth potential”.

These statements indicate that, despite the importance of SMEs to the social and economic development of a country, their high failure rates prevent them from making their full potential contributions. This is true, specifically in developing countries such as South Africa (Fatoki, 2010: 169). The literature shows that the management of trade credit by SMEs is a major obstacle that confronts small firms in South Africa. As pointed out by Zainudin and Regupathi (2011: 84), the ongoing practice of late debtor collections can eventually deteriorate the financial position of a SME extending trade credit.

A review of literature revealed that no South African study has empirically explored the impact of the business environment on the management of trade credit by SMEs. This chapter aims to examine the research methodology followed in the empirical part of this study. Research methodology is the blueprint for the measurement, collection and analysis of data in order to achieve the objectives of a research project. Cooper and Schindler (2003: 633) define research methodology as the way in which data are gathered for a research project. Research and the research process will be defined and illustrated. This will be followed by a detailed discussion of the research process. The chapter will close with concluding remarks.

4.2 RESEARCH DEFINED

Research can be defined as any gathering or collection of data, information and facts for the advancement of knowledge (Zikmund, Babin, Carr & Griffin, 2010). It is a systematic process of collecting, analysing and interpreting data with the aim to increase the understanding of a point of interest (Wheather & Cook, 2000: 11). This study focuses on SMEs; therefore, the term business research will be used.

4.3 RESEARCH METHODOLOGY

Research methodology can be defined as the process that systematically solves the research problem (Kothari, 2004). It systematically identifies the steps of the research process. Research methods can be defined as the methods or techniques used for conducting research. The research methodology in this study will involve the collection of data from respondents (SMEs) by means of a structured questionnaire, with the aim of obtaining data on the trade credit-management practices of respondents, their perceptions, attitudes and behaviours concerning trade credit-management activities. Another aim is to determine whether SMEs find it difficult to manage trade credit successfully and fail to use trade credit as a source of funding effectively. Once the information has been gathered, the data will be analysed using statistical procedures to settle the research objectives.

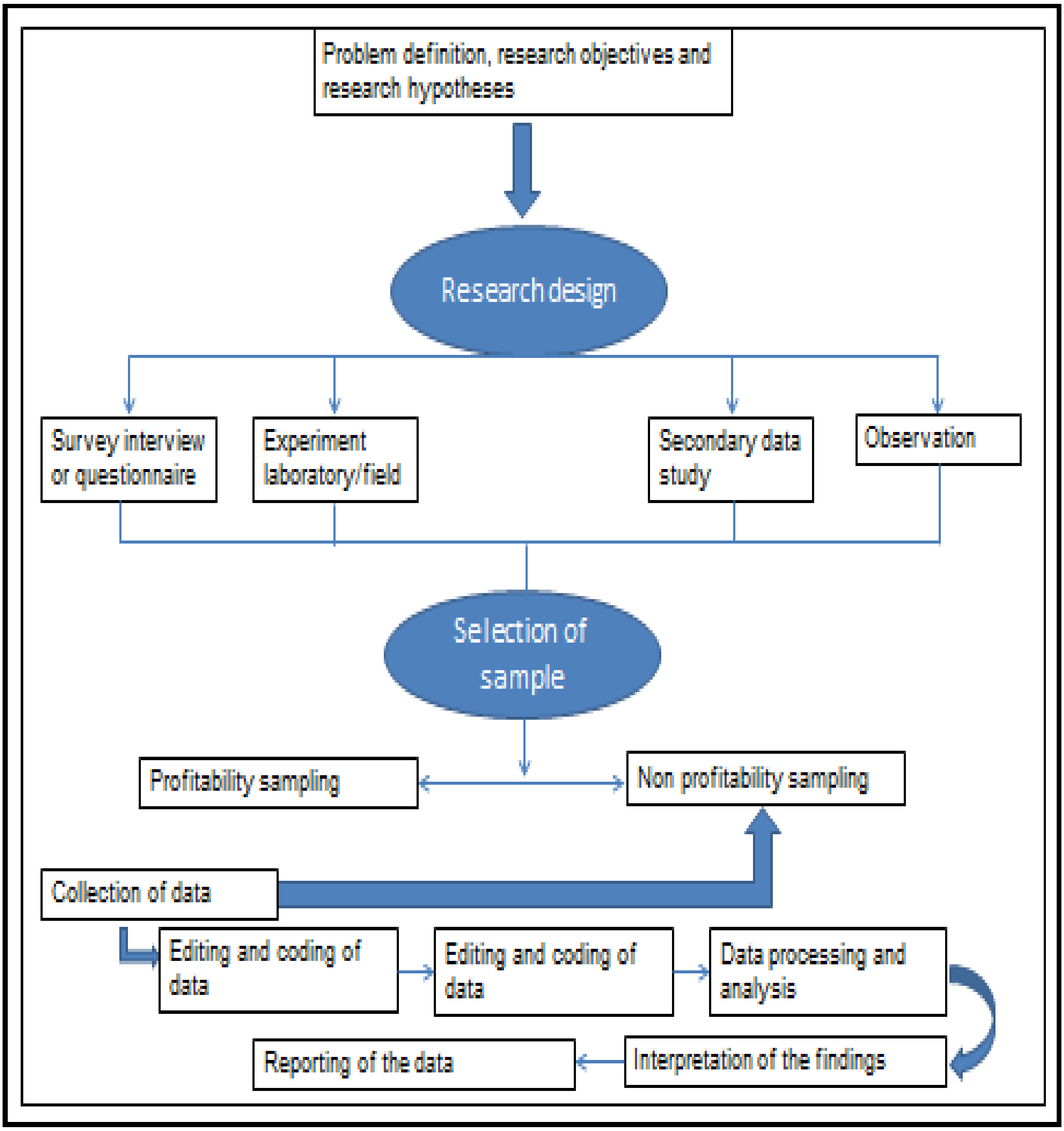
The research process is crucial to the researcher in identifying the steps to be followed throughout this study for gathering data. A discussion of the business research process follows.

4.4 THE BUSINESS RESEARCH PROCESS

The business research process can be defined as an ordered set of activities that focus on the systematic gathering of information, using accepted methods of analysis as a basis for drawing conclusions (Cooper & Schindler, 2003: 64). According to Bryman and Bell (2003: 57), the business research process is a sequential process consisting of several steps in the systematic collection and analysis of a firm's data. The business research process describes how research is designed and implemented.

Figure 4.1 depicts the phases of the business research process.

Figure 4.1: Steps in the business research process



Adapted from Zikmund (2003: 61)

4.4.1 Step 1: Problem statement and research objectives

4.4.1.1 Problem statement

As pointed out by Cooper and Schindler (2003: 64), “the formulation of the research problem is far more essential than its solution, which may be merely a matter of mathematical or experimental skill. To raise new questions and to regard old problems from a new angle requires creative imagination and marks real advance in science”. The business research process begins with the identification of the research problem (Gerber-Nel, Nel & Kotze, 2005: 37). In essence, a research problem serves as an indicator for the type of problem to be solved or of a specific managerial decision-making area. As pointed out by Cooper and Schindler (2003: 66), problem definition is essential before conducting a research project, especially for quantitative research. The research problem should be clearly defined and formulated in order to obtain the relevant results through research. Formal quantitative research should not begin until the research problem has been clearly defined. Defining a research problem is the fuel that drives the research process.

The motivation for this study originates from the fact that SMEs have a major role to play in the South African economy, especially in terms of sustainable economic growth, the equitable distribution of income, employment creation, and the overall stimulation of the country’s economy. Sadly, the rate of SME creation is very low; in 2008, South Africa was ranked 23 out of 43 countries, with a TEA rate of 7.8%, which was below 10.6% that represented the average rate of all countries surveyed by GEM. In addition, the failure rate of South African SMEs is one of the highest in the world, with a 75% failure rate for new SMEs (Herrington *et al.,* 2009).

The non-availability of finance for SMEs remains a major constraint (Fatoki, 2010: 172). The majority of new SMEs find it difficult to obtain debt financing from banks. External equity finance (stock exchange and venture capital) is universally unavailable to new SMEs. SMEs mainly rely on trade credit, owner equity (internal capital), and short-term bank loans to finance their investment in current assets. However, the failure rate of SMEs compared to that of large firms is very high. Poor short-term financial management, mainly focusing on the management of trade credit, is a primary cause of failure among SMEs (Padachi, 2006: 46). SMEs find it difficult to properly manage their trade credit activities, with this form of financing being the most widely accessible to SMEs, thus ultimately forcing SMEs to close.

By determining the trade credit-management practices of SMEs, the primary research problem of this study is to establish whether SMEs find it difficult to manage trade credit successfully and fail to use trade credit as a source of funding effectively. Improving the trade credit-management activities of SMEs will improve the high failure rate of SMEs in South Africa.

4.4.1.2 Research objectives

Objectives define certain standards of what the research should accomplish and explain the purpose of the research in quantitative and/or qualitative terms (Fatoki, 2010).

The primary objective of this study is to determine the trade credit-management practices of SMEs in order to establish whether trade credit is being mismanaged by SMEs in South Africa.

The primary research objective is achieved by pursuing the following secondary objectives:

- To evaluate the importance of effective trade credit management (focusing on debtors and creditors).
- To identify the trade credit situation within SMEs (focusing on debtors and creditors).
- To identify the activities and measures that SMEs use to reduce late payment.
- To evaluate the importance of a sound and structured credit policy when granting trade credit.
- To identify aspects of SMEs’ trade credit-management practices that represent major constraints in the SME sector (focusing on debtors and creditors).

- To determine the different trade credit terms being used/accepted and granted by SMEs (focusing on debtors and creditors).
- To determine the different credit policies used by SMEs when granting credit to a customer.
- To enable SMEs and small firms to use the results of this study in assessing the appropriateness and effectiveness of their own practices.

4.4.2 Step 2: Research design

Research design can be defined as a 'detailed plan' that serves as the blueprint for planning a course of action, so that the most valid research findings become evident (Hussey & Hussey, 1997: 114). Research design provides the glue that holds a research project together (Cooper & Schindler, 2003: 181). According to Chisnall (2005: 16), research design is the foundation of a good dissertation.

The research design is essential in answering questions about the nature of the study, along with identifying the techniques used in collecting and investigating the data retrieved from the study to best answer the research questions or problems (Cooper & Schindler, 2003). It is used to structure the research, by identifying all the parts of the research project such as sampling, data collection and data analysis and explaining how these different parts endeavour to address the central research question. The major parts of a research project consist of the research proposal, the literature, the research methodology, the research results, and the conclusions and recommendations (Cooper & Schindler, 2003). The research design provides answers to questions such as: What sampling techniques will be used? What techniques will be used to gather data?

Research design should also include the data-collection practices and sources used in this study. These sources can be either secondary (literature and past studies) or primary data in the form of new empirical information. According to Jankowicz (2000: 193), research design entails the classification of the particular population that will be examined, the selection of sample sizes, the methods used for collecting data, and the methods used to evaluate the data obtained from the sample.

4.4.2.1 Types of research design

The three basic types of research design are qualitative, quantitative and a hybrid of the two (Fatoki, 2010). The choice of research design depends on the nature of the research, possible research limitations, the setting, and the underlying paradigm that informs the research project (Zikmund, 2003: 68). In this section, both qualitative and quantitative research design as well as other types of research design, namely exploratory, descriptive, casual and explanatory research design will be discussed.

- Qualitative research

Qualitative research is the collection of a thorough understanding of human behaviour and the reasons that govern such behaviour (Chisnall, 2005: 18). The aim of qualitative research is to provide a perspective of a situation through research reports that show the ability of the researcher to describe the corresponding phenomenon. Qualitative research emphasises words in the collection and analysis of data (Bryman & Bell, 2011: 27).

- Quantitative research

Quantitative research addresses research objectives through empirical assessments that involve numerical measurements (Zikmund *et al.,* 2010). Quantitative research emphasises quantification in the collection and analysis of data (Bryman & Bell, 2011: 26). This study uses a quantitative research design, although qualitative data will, to a lesser extent, also be collected.

- Exploratory research

According to Gerber-Nel *et al.* (2005: 30), exploratory research aims to clarify and define the nature of the research problem by providing ideas and proposals as to how the research problem can be addressed. Briefly, exploratory research can be defined as research that is used to gather preliminary information in order to help better understand the research problem.

Gerber-Nel *et al.* (2005: 31) identified the following five types of exploratory research: secondary data analysis, experience surveys, pilot studies, case studies, and exploratory factor analysis.

Through exploratory research, the researcher can gather background information that will help define and formulate the research problem or opportunity (Fatoki, 2010: 184). The purpose of this type of research is to constantly narrow the scope of the research topic in order to better understand the research problem or opportunity (Gerber-Nel *et al.*, 2005: 30).

Exploratory research investigates previous studies on the research topic, examining the situation through secondary data (articles, unpublished reports, academic journals, the Internet, etc.), and talking with knowledgeable individuals. Exploratory studies are done to "better comprehend the nature of the phenomenon or research problem since very few studies might have been conducted regarding the phenomena needed to be understood" (Kotze, 2006: 71).

- Descriptive research

Gerber-Nel *et al.* (2005: 32) pointed out that this type of research answers questions such as who, what, when, where and how. Descriptive research can be conducted in two ways, namely longitudinal and cross-sectional. Longitudinal studies can be described as investigations involving a fixed sample of elements that are consistently measured over time (Cooper & Schindler, 2003: 45). Cross-sectional studies involve the gathering of data from any given sample population elements only once.

- Causal research

Causal research examines whether one variable can determine the value of another variable (Cooper & Schindler, 2003:46). Briefly, causal research aims to identify a cause-and-effect relationship between dependent and independent variables.

- Explanatory research

Explanatory research implies that the research in question is intended to explain and not merely describe the phenomena studied (Given, 2008). The purpose of explanatory research is to explain a type of behaviour in the market. This type of research design can be conducted by means of questionnaires, interviews, random sampling, and group discussions. This present study is explanatory in nature coupled with a quantitative and, to a lesser extent, qualitative research design.

4.4.2.2 Research design of this study

The management of trade credit in SMEs can be classified as explanatory quantitative research, although qualitative data will also be collected, to a lesser extent. The issue regarding trade credit management in SMEs has been examined in developed countries, but only to a certain extent, whereas the South African situation and context have not been examined in great detail.

4.4.2.3 Research technique

The research technique employed in this study will be of a quantitative nature, with a lesser input of qualitative data, by making use of surveys to ascertain the data required. This study aims to determine the extent of the trade credit-management practices of SMEs by means of a fully structured questionnaire. Articles, unpublished reports, academic journals, the Internet, newspapers and other publications will be used as secondary data. This study contains literature from South Africa, the United Kingdom and the United States of America, where more comprehensive research has been conducted, as well as from other countries.

4.4.3 Step 3: Selecting the primary data-collection method

The next step in the research process is data collection. This section will discuss the various methods of data gathering as well as the questionnaire design.

4.4.3.1 Basic primary collection methods

Three primary data-collection methods can be identified, namely observation, experiment, and survey (Gerber-Nel *et al.,* 2005: 88).

- Observation

According to Zikmund *et al.* (2010), observation is a process of obtaining primary data by recording the behavioural patterns of objects, people and occurrences.

- Experiment

Cooper and Schindler (2003: 115) pointed out that the experiment method can be defined as a carefully controlled study in which the researcher manipulates an independent variable and observes any corresponding change in the proposed effect through measurement.

- Survey

The survey method of data collection encompasses any measurement procedures that involve posing questions to respondents (Weather & Cook, 2000: 195). Basically, when conducting survey research, the researcher chooses a sample of respondents from a population and administers a standardised questionnaire to them. As pointed out by Cooper and Schindler (2003: 663), this study uses survey research for the following key reasons:

- Surveys are useful in describing the characteristics of a large population.
- Surveys can be administered from remote locations using methods such as mail, e-mail or telephone.
- Surveys are relatively inexpensive (especially e-mailed surveys).

This study follows the survey research approach, as pointed out by Gerber-Nel *et al.* (2005: 94):

- The population to be studied was defined.
- A representative sample was selected.
- Data was collected by means of an e-mailed questionnaire.
- SPSS (Statistical Package for Social Sciences) was used to tabulate and analyse the sample in order to produce various sample statistics.

- Methods of conducting survey research

Surveys can be divided into four major types: self-administered surveys, personal interviews, mail surveys, and telephone surveys (Gerber-Nel *et al.,* 2005: 94).

Personal interviews were not used during data collection, as they are an expensive technique for data collection. The researcher would have had to personally visit the respondents a few times to hold personal interviews. This would have resulted in a longer period for data collection. With telephone interviews, respondents are telephoned in order to gather primary data concerning a specific research problem (Gerber-Nel *et al.,* 2005: 94). The researcher did not make use of telephone interviews as the response rate is lower than that of self-administered questionnaires. According to Cooper and Schindler (2003: 326), self-administered questionnaires can be defined as research questions that are personally delivered to the respondent by the interviewer, but completed by the respondent with no involvement from the interviewer. The advantages of using self-administered questionnaires are:

- Self-administered questionnaires have proved to have a higher response rate when compared to other data-collection techniques such as mail surveys.
- Self-administered questionnaires are less expensive than other forms of data-collection techniques such as personal interviews.
- Self-administered questionnaires ensure the respondent's anonymity and privacy, thus encouraging more honest responses.

Zikmund *et al.* (2010) described a mail survey as a set of research questions or questionnaire sent to respondents via mail (or in the case of this study, e-mail). The researcher decided to make use of mail surveys for the simple reasons that it is a low-cost method of data collection and the ease and speed with which completed questionnaires could be received back.

4.4.3.2 Questionnaire design and content

- Questionnaire

A questionnaire was used as the primary research instrument. According to Wheather and Cook (2000: 195), a questionnaire is a formalised set of questions for the collection of information from respondents. A questionnaire can be regarded as an instrument that collects data and stipulates the questions to be asked in a formal manner in order to produce the desired information. The researcher used questionnaires for this research study for the following reasons:

- Questionnaires increase the speed and accuracy of recording.
- Questionnaires help with the processing of data.
- Questionnaires help provide comparable and reliable information from different respondents.
- Questionnaires provide the necessary platform for respondents to remain anonymous and to be honest in their response to all questions asked.

- Survey questions

There are two basic types of survey questions, namely open-ended and close-ended. Zikmund *et al.* (2010) described open-ended questions as response questions that pose some research problem and then ask respondents to answer in their own words. Open-ended questions are ideal when the researcher conducts exploratory research and does not know the possible outcome of questions or statements. Due to the elaborate nature in which respondents often answer questions, the use of open-ended questions must be limited for questionnaires (Gerber-Nel *et al.,* 2005: 150). The researcher used open-ended questions, to a lesser extent.

Close-ended (structured) questions specify the permitted responses and make information available to respondents (Wheather & Cook, 2000: 195). The majority of the questions asked should be structured in order to improve respondent cooperation. The researcher also used close-ended questions, as such questions are more easily analysed (Cooper & Schindler, 2003: 520). Close-ended questions are more specific in nature compared to open-ended questions and are more likely to communicate similar meanings. It is difficult to compare the meanings of respondents with open-ended questions, whereas close-ended questions are less time consuming for the researcher, interviewer and participant. The benefits of using close-ended questions rather than open-ended ones identify why the response rate for surveys that use close-ended questions is higher than for those using open-ended questions.

- Items included in the questionnaire.

The question items included in the questionnaire were divided into the following sections: biographical information of the respondent; debtor and creditor testing, and business environment testing.

- Section A: Biographical information of the respondent.

Questions in this section include the respondent's job description and age, gender, educational qualifications, and the number of years' experience in managing trade credit. Other questions in this section also include the type of industry in which the SME operates, the number of employees of the respondent's SME, if the respondent's SME operates independently, the description of the respondent's clients, and the average monetary value of a business transaction.

- Section B: Debtor and creditor testing.

The questions in this section determine the trade credit-management activities of SMEs. Questions concentrate on the debtor and creditor sections of SMEs. The questions in this section of the questionnaire aim to ensure that the secondary objectives of this study are achieved.

- Section C: Business environment testing.

The questions in this section determine the influence of the business environment (internal and external environment) on the management of trade credit within SMEs. The questions in this section of the questionnaire aim to examine the business environmental factors that cause the mismanagement of trade credit by SMEs.

4.4.4 Step 4: Sample design

According to Bryman and Bell (2003), sampling is the process of selecting a population segment for research purposes. The method of selection may be based on probability sampling or non-probability sampling. Selecting some of the elements in a population enables the researcher to draw conclusions for the entire population (Cooper & Schindler, 2003: 179). In generalising about the entire population, which is valid and allows for prediction, sampling enables the researcher to draw conclusions for the entire population (Cooper & Schindler, 2003). Compelling reasons for sampling for this study include: greater accuracy of results, greater speed of data collection, availability of population elements, and lower cost.

The following issues are discussed under sampling design, namely population, the sampling method and the sampling size.

4.4.4.1 Population

The universe or population can be defined as any complete group of entities that share some common characteristics between themselves (Zikmund *et al.*, 2010). It is critical in the sampling process to define the universe or population. Briefly, the population is the subject of this study.

The researcher focused on SMEs in the agricultural, construction, financial, food, health, manufacturing, retail, solar, transport and distribution, wholesale, and other sectors or industries. According to Selima (2007: 17), the wholesale, the retail and the manufacturing sectors account for the majority of trade credits. The population frame of SMEs was obtained from the Centre for Development Studies (CDS) that published a list of SMEs in the Mangaung district in 2012. This list of SMEs was generated from the Yellow and White Telephone Book for the city of Mangaung in the Free State Province. All SME names were crosschecked to eliminate double counting. The population of SMEs in this study totalled 352 respondents.

4.4.4.2 Types of sampling design

Bryman and Bell (2003: 100) identified two major types of sampling design, namely probability and non-probability sampling. As stated earlier, the method of selection may be based on non-probability sampling or probability sampling. Non-probability sampling refers to establishing a sample from a population where the respondents are identified and questioned because of certain variables such as their experience, role, position or background. Probability sampling differs from non-probability sampling in that the respondents are identified because they are part of a certain population.

This study used probability sampling. As pointed out by Bryman and Bell (2003: 101), probability sampling allows the researcher to make inferences from information about a random sample of the population from which it was selected. Cooper and Schindler (2003: 192) identified four major types of probability sampling, namely systematic sampling, stratified sampling, cluster sampling, and simple random sampling.

4.4.4.3 Sample size

Sample size constitutes the total number of elements included in this study. The Raosoft sample size calculator can be used in calculating the sample size (Fatoki, 2010). Raosoft is statistical software used in the calculation of sample size. It considers the following factors in the calculation of sample size (Raosoft, 2008):

- The margin of error. This is also known as the confidence interval and measures the precision with which an estimate from a single sample approximates the population value. In business research, the margin of error ranges from 3% to 7%, with 5% being the most commonly accepted (Raosoft, 2008).
- Confidence level. This is the estimated probability that a population estimate lies within a given margin of error. The confidence interval in business research varies from 90% to 100%, with 95% being the most commonly accepted.
- The population. This refers to the population to be used for this study (refer to 4.4.4.1).
- Response distribution. This answers the question, "For each question in the questionnaire, what does the researcher expect the answer to be?". It should be noted that, if the answer is highly skewed, the population is probably also skewed. Usually 50% is used as the response distribution, as it provides for the largest sample size (Raosoft, 2008).

Using the Raosoft sample size calculator at 5% margin of error and 95% confidence interval, the sample size for SMEs was 152. In total, 352 questionnaires were distributed to SMEs.

4.4.5 Step 5: Method of data collection

In this study, the data were collected by means of a structured questionnaire distributed to respondents. The questionnaire aimed to verify the trade credit-management activities of SMEs, as well as determine their attitudes and behaviours concerning trade credit management.

A questionnaire performs the following key functions in the research process:

- A questionnaire is an enduring record of the research.
- Research objectives are transformed into specific questions.
- Questionnaires facilitate data analysis.

- Standardised questions and response categories are identified (Burns & Bush 2000: 344).

The following steps were taken to reach respondents for this study:

- From the telephone directory, received from the CDS, only the list of SMEs within the Free State Province and the city of Mangaung were used in this study.
- This list of SMEs was filtered according to the specific industries that formed the focus of this study, namely agricultural, construction, financial, food, health, manufacturing, retail, solar, transport and distribution, wholesale, and others.
- SMEs were grouped according to the specific sector or industry in which they operate.
- Each SME was contacted separately in order to obtain a valid e-mail address of the credit or trade credit manager and/or persons managing the SME's debtors and creditors.
- This study made use of an online questionnaire to reaching the respondents through an electronic link sent to them via e-mail. The motivation for using an online questionnaire is that it is far more effective in reaching the number of respondents in time and it assists the respondent in answering all questions within a short period of time, thus not to the constraint of the respondent itself.
- After all necessary contact information was obtained from the sample of SMEs within this study, a letter was sent out to each SME, explaining the title of this study, a short introduction of the researcher, the time to completion of the questionnaire, and the assurance that the completion of the questionnaire is completely voluntary. The electronic link to the completion of the online questionnaire was also available on the letter sent via e-mail to respondents.
- A second letter was sent to the respondents to indicate that the data obtained from the questionnaire will be used to complete research for the University of the Free State. This letter was written on a formal letterhead of the University of the Free State and signed by Dr. J.H. van Zyl (Head: Department of Business Management in the Faculty of Economic and Management Sciences at the University of the Free State).

- The respondents opened the electronic link to the online questionnaire and thereafter completed the questionnaire. After completion, the data for each questionnaire was captured and saved for analysis.

4.4.6 Step 6: Data analysis

The objective of this section is to indicate how the researcher analysed the data collected. Data analysis "is the process of gathering, modelling and transforming data with the goal of highlighting useful information, suggesting conclusions, and supporting decision making" (Fatoki, 2010: 202).

A detailed discussion of the data obtained will follow in Chapter 5.

4.4.6.1 Statistical Package for Social Sciences (SPSS)

The SPSS (version 21.0 for Windows) software program was used in the statistical analysis of the data. This program, dedicated to processing statistics, is used by the University of the Free State in the analysis of information. SPSS is widely used by researchers to perform quantitative analysis and is renowned for being a complete statistical package.

4.4.7 Step 7: Reporting the results

The final stage in the business research process is the interpretation of the results and the drawing of conclusions. During this step, the researcher is responsible for reporting the research findings and conclusions, and for making recommendations (Gerber-Nel *et al.,* 2005: 234). The research results will be presented in the next chapter.

4.5 CONCLUSION

The aim of this chapter was to examine aspects related to the research methodology of this study. Research and research methodology were defined and the business research process was described. The steps throughout the business research process were identified and followed by the researcher. The formulation of the research problem is crucial in research, as pointed out by Cooper and Schindler (2003: 64). The two major types of research design, namely qualitative and quantitative research, were discussed. In addition, the four types of research, namely exploratory, descriptive, causal and explanatory research that can be used in either qualitative or quantitative research, were examined. This study made use of quantitative research design, along with a lesser input of qualitative data, and explanatory research. The three primary data-collection methods, namely observation, experiment and survey were identified (Gerber-Nel *et al.,* 2005: 88). The motivation for using the survey method was given.

The four major survey methods, namely personal interviews, telephone surveys, mail surveys and self-administered questionnaires were also discussed. The motivation for using the e-mailed survey was discussed and therefore an online questionnaire was used as the data-collection instrument (refer to sections 4.4.3.1 and 4.4.5). The questionnaire made use of close-ended questions, along with a lesser input of open-ended questions and Likert-scale questions. The questionnaire can be divided into the following six sections, namely demographic information of respondent, competency check 1, debtor, competency check 2, creditor, and the business environment. Both competency checks were introduced to assist with the accuracy of the data collected.

Data analysis can be defined as the application of reasoning in order to better understand the data collected throughout the study (Zikmund *et al.,* 2010). The data collected for this study was analysed using the SPSS (version 21.0 for Windows) software program.

The final step in the research process concerns the analysis of the results of the empirical study. This will be presented in the next chapter.

CHAPTER FIVE

RESEARCH RESULTS

5.1 INTRODUCTION

Chapter four presented important aspects of the research methodology, including the research design and the sampling methods, data-collection and data-analysis methods used in this study. The purpose of this chapter is to present and interpret the empirical findings of this research. The findings must be correlated with the research objectives. According to Proctor (2000: 273), both the data analysis and interpretation must be carried out properly in order to ensure the success of this study. This chapter aims to systematically present and interpret the findings of the research study.

This chapter focuses on the empirical findings that are structured into thirteen sections. Section 5.2 examines the response rate from SMEs. Section 5.3 focuses on the normality of the data obtained. The Kolmogorov-Smirnov test was used to test the normality of the data. Section 5.4 presents the findings of the demographic variables. In this section, data will be analysed using descriptive statistics. Three additional subsections are part of the demographic findings in further strengthening the research results of this study:

- The credit portion of the SMEs’ monthly sales and purchases, focusing on both debtors and creditors.
- The findings related to whether the management of trade credit is a problem for respondents, focusing on both debtors and creditors.
- The competency level of the respondent in answering the questionnaire.

Sections 5.5 to 5.11 answer the secondary objectives of this study. It is important to note that these sections form the main investigative part of this study. Tables, figures and graphs were used throughout this study to visually present the demographic and empirical findings. Data will be analysed using statistical techniques such as descriptive statistics, frequencies, cross-tabulations and mean scores. Data were also examined by comparing testing between two different classification values, namely debtors and creditors, using the matched samples t-test and the McNemar test.

The next section reports on the empirical findings of this study, starting with the response rate and normality of the data obtained. The empirical findings of the demographic variables will be examined. Thereafter, the findings related to the management of trade credit by SMEs focusing on the management of debtors and creditors will be examined in detail.

5.2 RESPONSE RATE

The response rate of SMEs for this specific study was 43.2%. Out of the 352 questionnaires that were sent out, 152 were returned. The population frame of SMEs was obtained from the Centre for Development Studies (CDS) that published a list of SMEs in the Mangaung district in 2012. Using the directory, received from the CDS, a list of SMEs within the Free State Province that operated within the city of Mangaung was used in this study.

5.3 THE NORMALITY OF THE DATA

According to Coakes (2005: 35), the normality of the data obtained from the empirical study can be determined by using the Kolmogorov-Smirnov test, if the sample size is above 100. If the sample size is below 100, the Shapiro-Wilks test can be used. If the significance level is greater than 0.05, using either the Kolmogorov-Smirnov or the Shapiro-Wilks test, normality is assumed. This study used the Kolmogorov-Smirnov test in determining the normality of the data, because the sample size was more than 100 respondents. The significance of the Kolmogorov-Smirnov test was greater than 0.05 in all the tests. This implies that the normality of the data can be assumed.

5.4 DEMOGRAPHICS

The demographic variables, for which information was obtained and data collected, included the respondents' job description, age, gender, educational qualifications and the number of years' experience in managing trade credit. The demographic variables also included the type of industry in which the SME operates, the number of employees, dependency of the SME or whether it belongs to a group, a description of the SME's clients, and the average monetary value of a transaction.

5.4.1 Job description of the respondents

Table 5.1 illustrates the job description of the respondents of the SMEs.

Table 5.1: Job description of the respondents

Job description	Frequency	Percentage
Clinical data analyst	1	0.7
Dentist	1	0.7
Banqueting coordinator	2	1.3
Office manager salaries	3	2
Building contractor	3	2
Human resources manager	4	2.6
OPS manager and practice manager	4	2.6
Administration manager	8	5.3
Financial director, financial accountant and financial manager	14	9.2
Business man, business owner and business partner	15	9.9
Credit control manager and national credit management	22	14.5
Other	23	15.2
Debtors and creditors clerk	52	34.2
TOTAL	**152**	**100**

The results indicate that the vast majority of the respondents are debtor and creditor clerks. The second largest group of respondents falls within the following jobs category, namely accountant, group accountant, bookkeeper and jack-of-all-trades on the financial side of this small company. The third largest group of respondents is currently employed as credit control managers. It is surprising to note that a vast majority of the respondents do not provide a job description that is in any way linked to the management of trade credit or finance, including a dentist, a building contractor and a human resources manager, to name a few.

5.4.2 The age of the respondents

Table 5.2 illustrates the age of the respondents of the SMEs.

Table 5.2: The age of the respondents

Age	Frequency	Percentage
21-30 years	70	46.1
31-40 years	51	33.6
41-50 years	8	5.3
51-60 years	14	9.2
61 years and older	9	5.9
TOTAL	**152**	**100.0**

The average age for SMEs is 35 years, with 21 years being the youngest and 67 years the oldest ages reported by the respondents. Furthermore, the results indicate that the age for the largest group of respondents is between 21 and 30 years. This is an indication that the majority of the respondents are young working individuals and could also be an indication of work experience.

5.4.3 The gender of the respondents

Table 5.3 illustrates the gender of the respondents of the SMEs.

Table 5.3: The gender of the respondents

Gender	Frequency	Percentage
Female	62	40.8
Male	88	57.9
TOTAL	**152**	**100**

The results show that more males (57.9%) than females (40.8%) completed the questionnaire. Two respondents did not answer this question.

5.4.4 The educational qualifications of the respondents

Table 5.4 illustrates the educational qualifications of the respondents of the SMEs.

Table 5.4: The educational qualifications of the respondents

Educational qualifications	Frequency	Percentage
Postgraduate degree	8	5.3
Postgraduate degree and higher	8	5.3
Did not complete secondary school	25	16.4
Matriculation	24	15.8
Diploma	31	20.4
Degree	56	36.8
TOTAL	**152**	**100**

The results indicate that the vast majority of the respondents have post-matriculation qualifications; approximately 16% did not complete their secondary school careers; just below 16% completed matriculation, and 68% have post-matriculation qualifications. This implies that the majority of the respondents are well educated and should be able to give informed responses to the questions.

5.4.5 The type of industry in which the SME operates

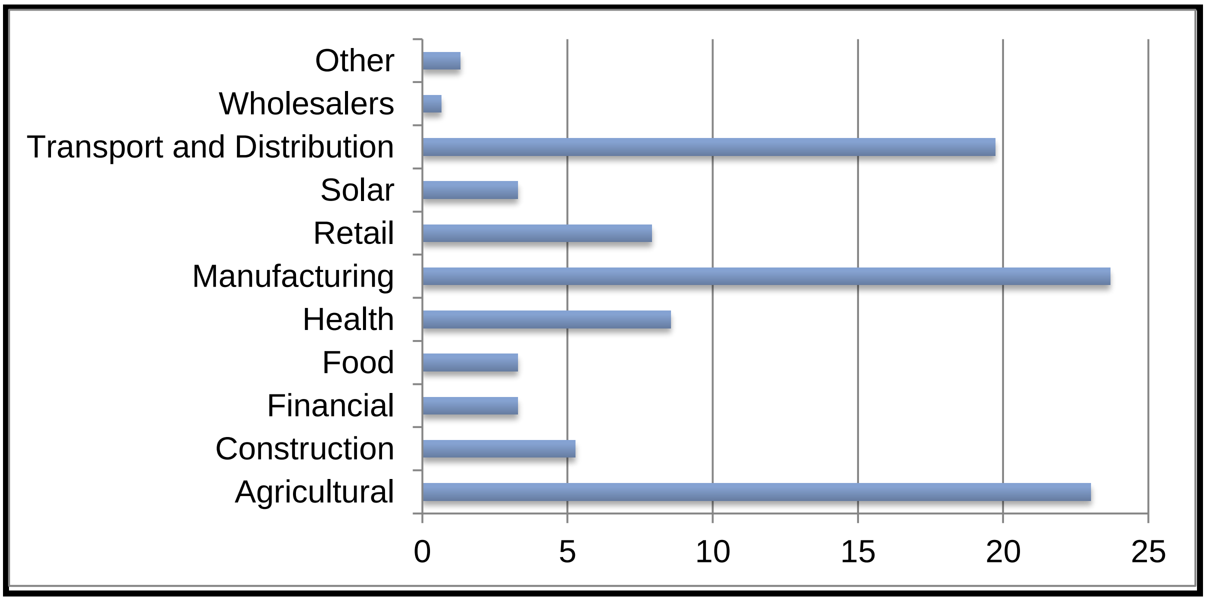
Table 5.5 illustrates the type of industry in which the SME operates.

Table 5.5: The type of industry of the respondents

Type of industry	Frequency	Percentage
Wholesale	1	0.7
Other	2	1.3
Financial	5	3.3
Food	5	3.3
Solar	5	3.3
Construction	8	5.3
Retail	12	7.9
Health	13	8.6
Transport and distribution	30	19.7
Agricultural	35	23
Manufacturing	36	23.7
TOTAL	**152**	**100**

Figure 5.1 illustrates the type of industry in which the respondents operate.

Figure 5.1: The type of industry in which the respondents operate



The results indicate that the largest group of SMEs (approximately 24%) operate within the manufacturing industry; 23% in the agricultural industry, and 20% in the transport and distribution industry.

5.4.6 The number of employees per SME

Table 5.6 illustrates the number of employees per SME.

Table 5.6: The number of employees per SME

Number of employees	Frequency	Percentage
0-50	68	44.7
51-100	49	32.2
101-150	23	15.1
151-200	1	0.7
201 and above	10	6.6
TOTAL	**152**	**100**

The results indicate that the largest group of SMEs (approximately 45%) has between 0 and 50 employees; 7% of SMEs have an employee count of between 201 and above, and only one SME has an employee count of between 151 and 200. A missing value of 1 indicates that one respondent did not answer this question.

5.4.7 SME dependence or independence

Table 5.7 illustrates whether the SME is independent or whether it belongs to a group of SMEs.

Table 5.7: Dependence of SMEs

Independent or group	Frequency	Percentage
Independent	48	31.6
Group	102	67.1
TOTAL	**152**	**100**

The findings indicate that 67.1% of SMEs questioned belong to a group of SMEs and that 31.6% of SMEs are independent. A missing value of 2 indicates that two respondents did not answer this question.

As indicated in Table 5.7, SMEs were categorised into two forms of dependence, namely those that operate independently or those that form part of a group of SMEs. It should be noted that SMEs, operating within a group structure, normally need to adhere to stringent rules and organisational structures, compared to individual SMEs operating independently.

5.4.8 Description of the SMEs' clients

Table 5.8 describes the clients that the SMEs serve. Respondents were given the option to choose between other businesses, the government, individuals (especially for SMEs serving in the retail and manufacturing industry), and if applicable, any other form of clients.

Table 5.8: Description of the SMEs' clients

Description of clients	Frequency	Percentage
Government	11	7.2
Other	13	8.6
Individuals	32	21.1
Businesses	95	62.5
TOTAL	**152**	**100**

As indicated above, almost 63% of all the respondents questioned have businesses as clients; 21% serve individual clients; 9% serve other types of clients, and 7% serve the government. A missing value of 1 indicates that one respondent did not answer this question.

5.4.9 Average monetary value of a transaction

Table 5.9 illustrates the average monetary value of a business transaction within the SME, with the minimum value of a business transaction starting at a category of R0-R1 000 and ending at R20 001 and above.

Table 5.9: The average monetary value of a transaction

Average monetary value per transaction	Frequency	Percentage
R0-R1 000	55	36.2
R1 001-R5 000	25	16.4
R5 001-10 000	28	18.4
R10 001-R15 000	11	7.2
R15 001-R20 000	5	3.3
R20 001 and above	28	18.4
TOTAL	**152**	**100.0**

The results indicate that, for the largest percentage of SMEs (approximately 36%), the average monetary value of a transaction is between R0 and R1 000; for 18.4%, it is between R5 001 and R10 000, and for 18.4%, it is between R20 001 and higher.

5.4.10 The credit position of the SME

5.4.10.1 Debtors

Table 5.10 illustrates the credit position of the SME’s monthly sales.

Table 5.10: The credit portion of the SMEs’ monthly sales

The credit portion of the SMEs’ monthly sales	Frequency	Percentage
0%-25% of monthly sales	51	33.6
26%-50% of monthly sales	1	0.7
51%-75% of monthly sales	23	15.1
76%-100% of monthly sales	77	50.7
TOTAL	**152**	**100**

Table 5.10 illustrates the credit portion of the SMEs' monthly sales. From the findings, approximately 34% of the respondents indicated that between 0% and 25% of their monthly sales are represented by credit; 0.7% sell between 26% and 50% of their monthly sales on credit; 15.1% sell between 51% and 75%, and 50.7% are between 76% and 100% on credit. It can be concluded that the largest percentage of respondent sales (approximately 51% of all the respondents) are on credit.

5.4.10.2 Creditors

Table 5.11 illustrates the credit portion of the SMEs' monthly purchases.

Table 5.11: The credit portion of the SMEs' monthly purchases

The credit portion of the SMEs' monthly purchases	Frequency	Percentage
0%-25% of monthly purchases	37	24.3
26%-50% of monthly purchases	15	9.9
51%-75% of monthly purchases	10	6.6
76%-100% of monthly purchases	90	59.2
TOTAL	**152**	**100**

From the findings in Table 5.11, it can be concluded that the largest percentage of respondent purchases (approximately 59% of all the respondents) are on credit.

In comparing the credit portion of the SMEs' monthly sales with the monthly purchases, the results indicate the following. A larger portion of the total population purchases are on credit (59.2% of all SMEs' purchases, 76%-100% of their monthly purchases on credit) compared to only 50.7% of all SMEs that indicated to sell 76%-100% of their monthly sales on credit to customers. For SMEs, this should suggest less strain being placed upon the never-ending cash-flow demands.

5.4.11 Findings related to whether the management of trade credit is a problem for SMEs (focusing on debtors and creditors)

Table 5.12 illustrates the findings related to whether the management of trade credit is a problem for SMEs.

Table 5.12: Is the management of trade credit a problem for SMEs?

Is the management of trade credit a problem for SMEs?	Frequency	Percentage
Yes	113	74.3
No	39	25.7
TOTAL	**152**	**100**

Respondents were asked to indicate whether the management of trade credit is a problem within the SME. It is important to note that this question (as with all other questions in the questionnaire) was asked directly to the relevant person working with the trade credit of the SME. The data for this section was collected by means of an open-ended question in the questionnaire. The largest percentage of the respondents (74.3%) indicated that the management of trade credit is a problem in their SMEs, which is substantial.

5.4.12 Competency check (focusing on debtors) and the number of years' experience in managing trade credit for SMEs

A competency check was asked at the end of the demographics section of the questionnaire. The competency check aimed to further strengthen the quality of the data obtained from respondents. The competency check consisted of two questions each that indicated the competency level of the respondents in answering the questionnaire, namely the number of years' work experience the respondents have with regard to managing debtors and their knowledge level concerning the credit policy of the SME.

Respondents had to indicate their level of work experience in managing debtors in years. Table 5.13 illustrates the years of work experience in managing debtors for the respondent.

Table 5.13: Work experience in managing debtors, expressed in years

Work experience in managing debtors, expressed in years	Frequency	Percentage
1-5 years	116	76.3
6-10 years	28	18.4
11-15 years	5	3.3
TOTAL	**152**	**100**

The results indicate that the largest group of respondents (approximately 76%) has between 1 and 5 years' work experience in managing debtors; approximately 18% has between 6 and 10 years' work experience, and approximately 3% has between 11 and 15 years' work experience. A missing value of 3 indicates that three respondents did not answer this question.

Table 5.14 illustrates the respondents' years of experience in managing trade credit.

Table 5.14: Number of years' experience in managing trade credit

Years' experience	Frequency	Percentage
1-10 years	107	70.4
11-20 years	33	21.7
21-30 years	11	7.2
TOTAL	**152**	**100**

The results indicate that the largest group of respondents (approximately 70%) managed trade credit for between 1 and 10 years. Thus, this result is conclusive of the previous results regarding the work experience of respondents in managing debtors (see Table 5.13), namely that the largest group of respondents (approximately 76%) has between 1 and 5 years' work experience in managing debtors. In addition, the second largest group of respondents (approximately 18%) has between 6 and 10 years' work experience in managing debtors (Table 5.13).

Therefore, the result is conclusive. Furthermore, 22% of the respondents managed trade credit between 11 and 20 years. A missing value of 1 indicates that one respondent did not answer this question. These results also correspond with the age of the respondents, as the majority of them are relatively young and have not been working for many years.

The knowledge level of the respondents concerning the credit policy of the SMEs was included in the questionnaire. Table 5.15 illustrates the respondents' knowledge level concerning the credit policy of their SME.

Table 5.15: Knowledge level of the respondents concerning the credit policy of the SME

Knowledge level of the respondents concerning the credit policy of the SME	Frequency	Percentage
Not knowledgeable	24	15.8
Moderately knowledgeable	54	35.5
Knowledgeable	74	48.7
TOTAL	**152**	**100**

The results indicate that approximately 49% of all the respondents perceive themselves as knowledgeable concerning the credit policy of their own SME; approximately 36% perceive themselves as moderately knowledgeable, and nearly 16% perceive themselves to be not knowledgeable concerning the credit policy of their own SME.

5.4.13 Competency check (focusing on creditors)

A second competency check was asked and, as indicated earlier, this competency check also aimed to further strengthen the quality of the data obtained from respondents. This competency check is identical to the previous one in that it also consists of two questions each that illustrate the competency level of the respondents in answering the questionnaire. As with the previous competency check, respondents were also asked to indicate the number of years' work experience with regard to managing creditors and their knowledge level concerning the credit policy of the SMEs and/or other suppliers/creditors from which they accept trade credit.

Respondents had to indicate their level of work experience in managing creditors in years. Table 5.16 illustrates the years of work experience in managing creditors for the respondent.

Table 5.16: Work experience in managing creditors, expressed in years

Work experience in managing creditors, expressed in years	Frequency	Percentage
1-5 years	64	42.1
6-10 years	58	38.2
11-15 years	27	17.8
TOTAL	**152**	**100**

The results indicate that the largest group of respondents (approximately 42%) has between 1 and 5 years' work experience in managing creditors, and that approximately 38% has between 6 and 10 years' work experience in managing creditors. Therefore, this result is conclusive of the result obtained earlier regarding the years' experience of respondents in managing trade credit (see Table 5.14 in section 5.4.12), namely that the largest group of respondents have managed trade credit between 1 and 10 years (approximately 70% of the total group of respondents). Approximately 18% has between 11 and 15 years' work experience in managing creditors. A missing value of 3 indicates that three respondents did not answer this question.

The respondents' knowledge level concerning the credit policy of their supplier/creditor was included in the questionnaire. Table 5.17 illustrates the knowledge level of each respondent concerning the credit policy of his/her suppliers/creditors.

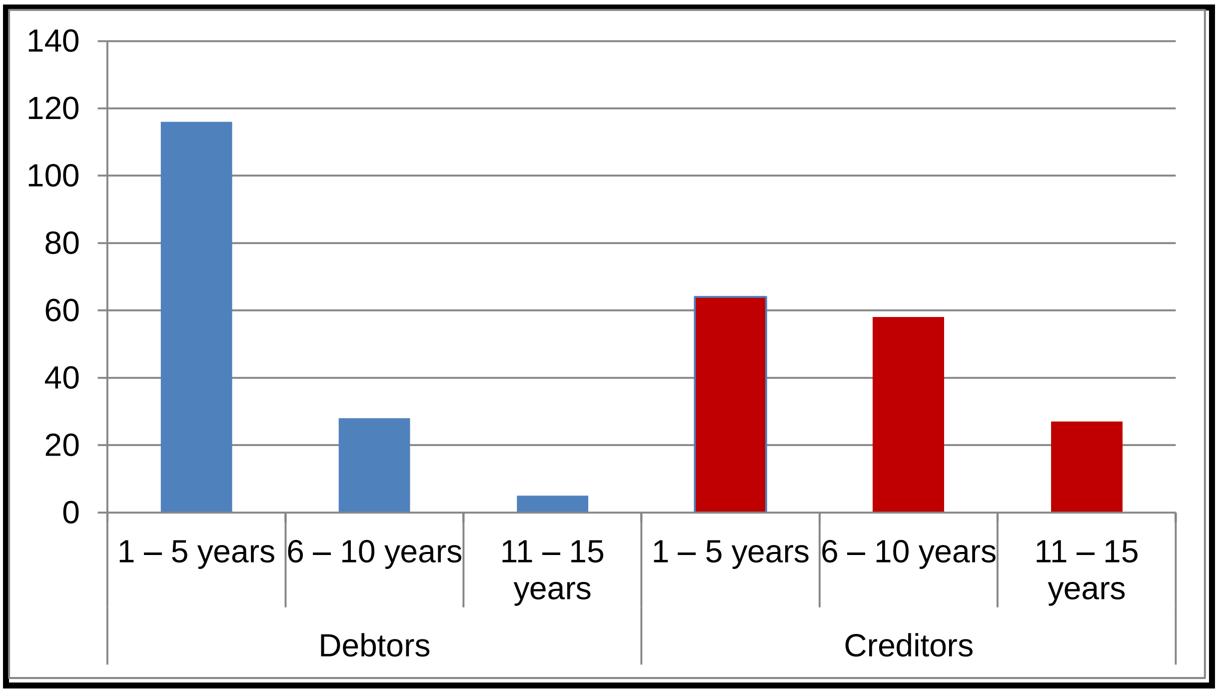
Table 5.17: Knowledge level of the respondents concerning the credit policy of their suppliers/creditors

Knowledge level of the respondents concerning the credit policy of their suppliers/creditors	Frequency	Percentage
Not knowledgeable	3	2
Moderately knowledgeable	78	51.3
Knowledgeable	71	46.7
TOTAL	**152**	**100**

The results indicate that approximately 51.3% of all the respondents perceive themselves as moderately knowledgeable concerning the credit policy of their suppliers/creditors; approximately 47% perceive themselves as knowledgeable, and 2% perceive themselves as not knowledgeable concerning the credit policy of their suppliers/creditors.

Figure 5.2 illustrates the work experience in managing debtors and creditors, expressed in years.

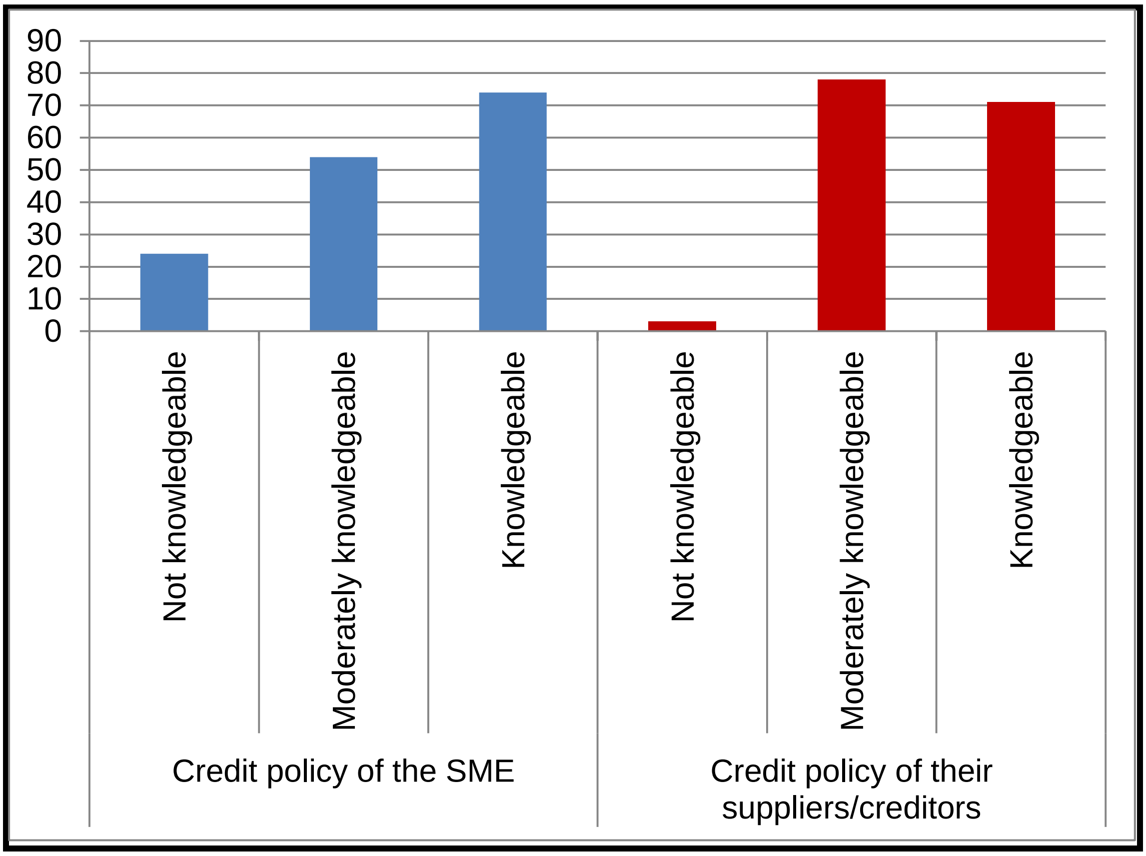
Figure 5.2: Work experience in managing debtors and creditors, expressed in years



As illustrated in Figure 5.2, a larger number of respondents indicated that they have more work experience (between 1 to 5 years) in managing the SME's debtors than compared to managing creditors. In addition, a larger number of respondents indicated that they possess more work experience in managing creditors than debtors between 6 to 10 years and 11 to 15 years.

Figure 5.3 illustrates the respondents' knowledge level concerning the credit policy of the SME and the credit policy of their suppliers/creditors.

Figure 5.3: Knowledge level of the respondents concerning the credit policy of the SME and the credit policy of their suppliers/creditors



As illustrated in Figure 5.3, the largest group of respondents perceive themselves as knowledgeable concerning the credit policy of their own SME, compared to moderately knowledgeable concerning the credit policy of their suppliers/creditors from which purchases are made.

This section discussed the demographic findings related to this study, and examined the findings related to the credit position of the SME, the findings related to whether the management of trade credit is a problem for SMEs, and the competency levels of the respondents who took part in this study.

The next section explains the empirical secondary findings related to the management of trade credit by SMEs.

5.5 Secondary objective 1: To evaluate the importance of effective trade credit management (focusing on both debtors and creditors)

Section 5.5 provides information relating to the identification of the management of trade credit by SMEs, focusing specifically on the management of debtors and creditors.

5.5.1 Debtors

This objective aims to use the relevant factors, as stated in the questionnaire, as an indication as to whether the respondents perceive it as important or not. Part of this objective is accomplished by focusing on the following factors, specifically related to debtors:

- Management of debtors.
- Having a credit policy in place.
- Conducting a credit analysis before granting credit to debtors/customers.
- Effective accounts or debtor-collection policy.
- Check customer creditworthiness before granting credit.
- Categorising customer accounts according to late-payment risk.
- Conducting a formal analysis into the reasons for late payment by debtor/customer.
- Offered discount for early payment.
- Having credit insurance for sales.

Table 5.18 and Figure 5.4 present the mean scores of the respondents' perceptions regarding the importance of trade credit management for SMEs. The mean scores are based on a 5-point Likert scale where 3 is the average value. Any score greater than 3 indicates a perception of importance towards trade credit management; any score lower than 3 indicates an overall perception of unimportance.

Table 5.18 illustrates the importance of effective trade credit management (focusing on debtors).

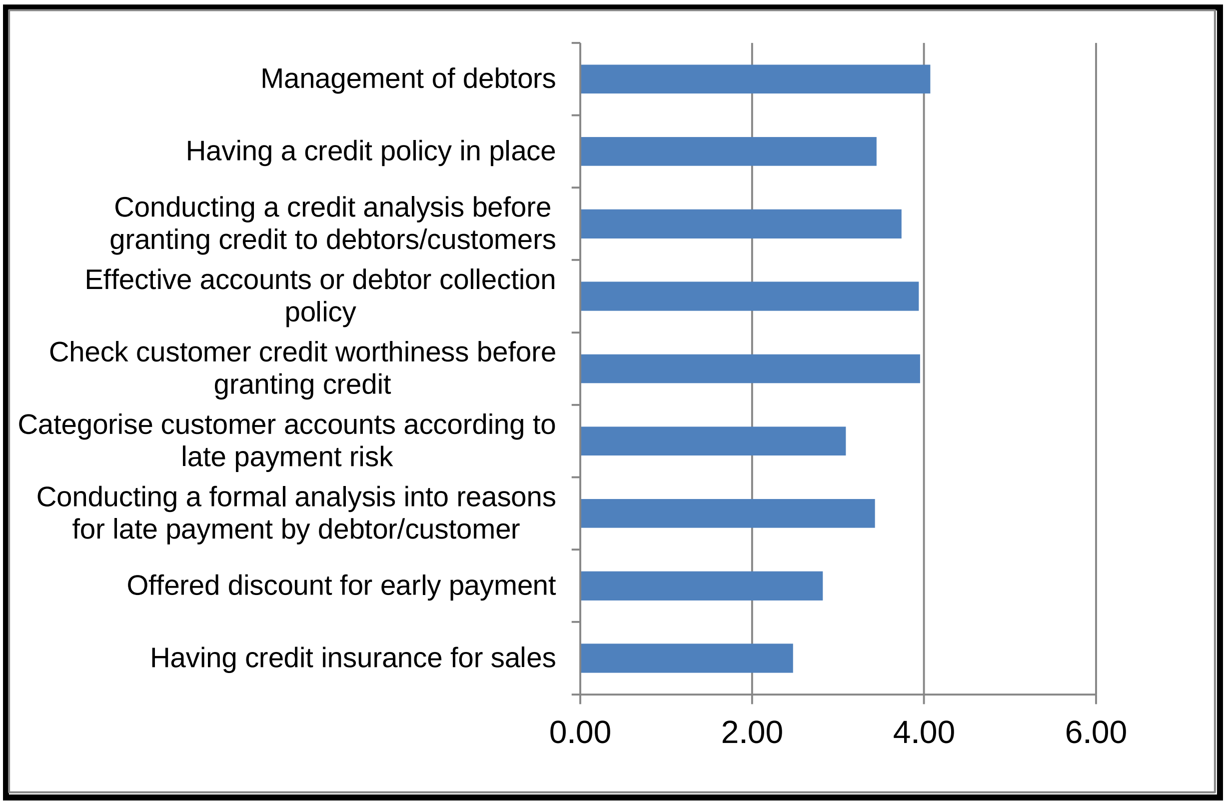
Table 5.18: The importance of effective trade credit management (focusing on debtors)

Factor	N	Totally unimportant / unimportant	Moderately important	Important / very important	Mean	Ranking
Management of debtors	152	14.5	2.6	82.9	4.07	1
Having a credit policy in place	143	30.9	3.9	59.2	3.45	5
Conducting a credit analysis before granting credit to debtors/customers	152	25.7	9.9	64.4	3.74	4
Effective accounts or debtor collection policy	152	19.1	7.2	73.6	3.94	3
Check customer creditworthiness before granting credit	152	25.7	5.9	68.4	3.95	2
Categorising customer accounts according to late-payment risk	152	33.6	21.1	45.4	3.09	7
Conducting a formal analysis into reasons for late-payment by debtor/customer	152	27.7	16.4	55.9	3.43	6
Offered discount for early payment	128	55.9	3.9	40.1	2.82	8
Having credit insurance for sales	128	53.3	15.8	15.1	2.48	9

The average mean of all factors is equal to 3.44, indicating that SMEs perceive effective trade credit management, focusing on debtors, as important.

Figure 5.4 illustrates the results of Table 5.18.

Figure 5.4: The importance of effective trade credit management (focusing on debtors)



In terms of importance, *the management of debtor's* factor has the highest mean for all the SMEs. The factor with the lowest mean for SMEs is *having credit insurance for sales*. Out of the nine importance factors, seven have means above 3, indicating that the management of debtors is perceived to be important in these SMEs.

The nine importance factors are discussed in more detail below in evaluating the importance of effective trade credit management (focusing on debtors).

Findings from the first factor in Table 5.18, *management of debtors*, indicate that half of the total population perceives the management of the SMEs debtors as very important in managing the SME's trade credit. In terms of *having a credit policy in place*, the vast majority of the total population perceives *the availability of a credit policy* as very important (28.3% of the total population) and important (30.9% of the total population) in managing the SME's trade credit. Note that nine of the SMEs did not answer this specific question. Furthermore, respondents were asked to indicate the importance of *conducting a credit analysis before granting credit to debtors/customers*. The results indicate that the vast majority of the total population (53.9%) perceives *the conducting of a credit analysis before granting credit to debtors/customers* as very important in managing the SME's trade credit.

Findings from the fourth factor, *effective accounts or debtor collection policy*, indicate yet again that 53.9% of the total population perceives an effective accounts or debtor-collection policy as very important in managing the SME's trade credit.

The results also indicate that 67.1% of the total population perceives the factor of *checking customer's creditworthiness before granting credit* as very important in managing the SME's trade credit. Compared to the results from the previous factor *(checking customer creditworthiness before granting credit)*, the results indicate that only 27% of the total population perceives the factor of *categorising customer accounts according to late payment risk* as important in managing the SME's trade credit. The largest group of the total population scored this factor between totally unimportant (21.1%), unimportant (12.5%) and moderately important (21.1%). The findings indicate that 28.9% of the total population perceives the factor of *conducting a formal analysis into reasons for late payment by debtor/customer* as very important in managing the SME's trade credit. Findings from the factor *offering discounts to customer for early payment of outstanding accounts* indicate that 28.9% the total population perceives this factor as unimportant in managing the SME's trade credit; 27.0% perceives this factor as totally unimportant, and 32.2% perceives *having credit insurance for sales* as unimportant in managing the SME's trade credit. Twenty-four SMEs did not answer the specific question.

The following section examines the importance of effective trade credit management (focusing on creditors) for SMEs.

5.5.2 Creditors

The second part of this objective is accomplished by focusing on the following factors, specifically related to creditors:

- Management of creditors.
- To build a sound and long-term relationship with creditors/suppliers.
- Selecting creditors/suppliers before purchasing from the business.
- Favourable credit terms as arranged with creditors/suppliers.
- Making payments on the due date as arranged with creditors/suppliers.
- Effective order and invoice control of all creditor records.

Table 5.19 and Figure 5.5 present the mean scores of the respondents' perceptions regarding the importance of trade credit management for SMEs. The mean scores are based on a 5-point Likert scale.

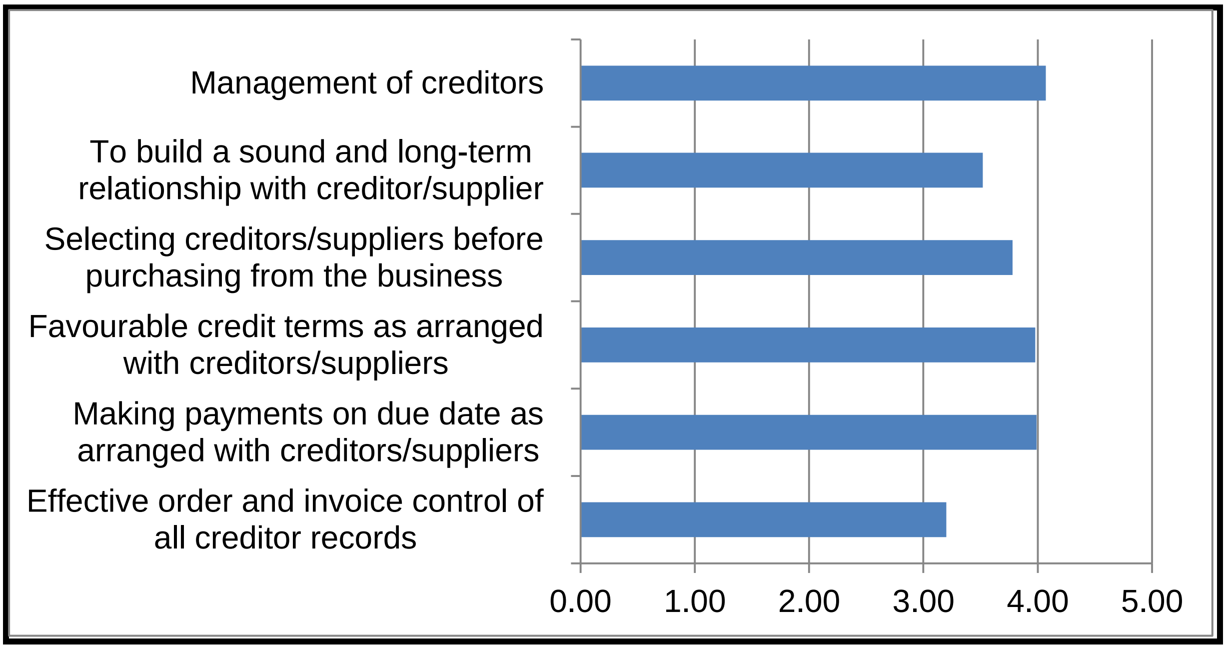
Table 5.19 illustrates the importance of effective trade credit management (focusing on creditors).

Table 5.19: The importance of effective trade credit management (focusing on creditors)

Factor	N	Totally unimportant / unimportant	Moderately important	Important / very important	Mean	Ranking
Management of creditors	152	16.4	2	81.6	4.07	1
To build a sound and long-term relationship with creditors/suppliers	145	30.3	3.3	61.9	3.52	6
Selecting creditors/suppliers before purchasing from the business	152	25	8.6	66.5	3.78	5
Favourable credit terms as arranged with creditors/suppliers	152	19.1	5.3	75.6	3.98	4
Making payments on the due date as arranged with creditors/suppliers	152	25	5.3	69.8	3.99	3
Effective order and invoice control of all creditor records	152	32.3	19.1	48.7	4.2	2

Figure 5.5 illustrates the results of Table 5.19.

Figure 5.5: The importance of effective trade credit management (focusing on creditors)



In terms of importance, the perceived *management of creditor's* factor has the highest mean for SMEs. The perception of importance factor with the lowest mean for SMEs is *effective order and invoice control of all creditor records*. All the six perception of importance factors have means above 3, indicating that SMEs perceive effective trade credit management, focusing on the management of creditors specifically, as important.

The six importance factors are discussed in more detail below in evaluating the importance of effective trade credit management (focusing on creditors).

Findings from the first factor in Table 5.19, *management of creditors*, indicate that the 53.3% of the total population perceives the management of creditors as very important in managing trade credit for the SME; 31.6% perceives *the building of a sound and long-term relationship with creditors/suppliers* as very important and 30.3% as important in managing the SME's trade credit. Note that seven of the SMEs did not answer this specific question. Of the total population, 53.3% perceives the factor of *selecting creditors/suppliers before purchasing from the business* as very important in managing the SME's trade credit. Furthermore, findings related to the factor, *favourable credit terms as arranged with creditors/suppliers*, indicate that 53.9% of the total population perceives the existence of favourable credit terms as arranged with creditors/suppliers as very important and 21.7% as important in managing the SME's trade credit. Findings relating to the factor, *making payments on the due date as arranged with creditors/suppliers*, indicate that 67.8% perceive this factor as important in managing the SME's trade credit.

Lastly, results related to the factor, *effective order and invoice control of all creditor records*, indicate that 13.2% of the total population perceives this factor as unimportant; 19.1% as totally unimportant; 26.3% as important, and 22.4% as very important.

The above section explained the importance of effective trade credit management (focusing on creditors) for SMEs.

In concluding section 5.5, secondary objective 1, the aim of this objective was to evaluate the importance of effective trade credit management (focusing on both debtors and creditors). Relevant factors were identified for both debtor and creditor sections. *The management of debtor's* factor had the highest mean of all factors in the debtors section, while for the creditors section the factor of *managing creditors* had the highest mean of all other factors.

The next section focuses on the second secondary objective, namely to identify the trade credit situation within the SME.

5.6 Secondary objective 2: To identify the trade credit situation in the SME (focusing on both debtors and creditors)

Section 5.6 presents the empirical findings on the trade credit situation in the SME, focusing on both debtors and creditors.

5.6.1 Debtors

The first step in reaching this objective was to provide an indication of the trade credit situation in the SME. The first step was formulated in order to understand the trade credit situation of the SME, with specific focus on debtors.

The following factors are expressed in more detail as frequencies and percentages of the respondents' monthly sales and total debtor accounts. Tables 5.20 to 5.26 illustrate the trade credit situation in the SME by focusing on debtors.

Table 5.20 illustrates the percentage of total sales written off as bad debts for the SMEs.

Table 5.20: Bad debts, relative to sales

Bad debts, relative to sales	Frequency	Percentage
0%-10% of sales	67	44.1
11%-20% of sales	12	7.9
21%-30% of sales	28	18.4
31%-40% of sales	29	19.1
51%-60% of sales	16	10.5
TOTAL	**152**	**100.0**

The above findings show the possible damaging bad debts situation in the SMEs. These bad debt figures are sales that the SMEs cannot recover or collect, due to debtors being unable to repay the amount owed to the SMEs. Therefore, the SMEs are forced to label such portions of their total sales as bad debts. The findings indicate that approximately 44% of SMEs regard 0%-10% of their total sales as bad debts, indicating that, for the majority of SMEs, bad debts seem to be relatively under control. Of all the respondents, 18.4% indicated that 21% to 30% of their total sales are bad debts; 19.1% indicated that between 31% and 40% of their total sales are bad debts and 10.5% indicated that 51% to 60% of their total sales are bad debts. A large percentage of SMEs do struggle with bad debt and regard a significant percentage of their total sales as bad debts. The above findings could serve as evidence that trade credit is being mismanaged by SMEs.

Table 5.21 illustrates the proportion of the SMEs debtors paying on the due date, relative to sales.

Table 5.21: Proportion of debtors paying on the due date, relative to sales

Proportion of debtors paying on the due date, relative to sales	Frequency	Percentage
0%-10% of sales	1	0.7
11%-20% of sales	0	0
21%-30% of sales	16	10.5
31%-40% of sales	25	16.4
41%-50% of sales	82	53.9
51%-60% of sales	28	18.4
TOTAL	**152**	**100**

The above findings illustrate that approximately 53% of debtors pay on the due date as agreed upon in the credit policy, as their debtors settle 41% to 50% of their total sales on the due date. Approximately 18% indicated that between 51% and 60% of their total sales are settled by their debtors on the due date; 16.4% indicated that only 31% to 40% of their total sales are settled by their debtors on the due date; 10.5% indicated that only 21% to 30% of their total sales are settled by their debtors on the due date. These findings are in line with the previous findings regarding the bad debt situation, relative to sales for SMEs. The above findings can serve as additional evidence that trade credit is being mismanaged by SMEs.

Table 5.22 illustrates the proportion of the SMEs debtors paying late, relative to sales, and therefore contributing towards the bad debts of the SME.

Table 5.22: Proportion of debtors paying late, relative to sales

Proportion of debtors paying late, relative to sales	Frequency	Percentage
0%-10% of sales	72	47.4
11%-20% of sales	44	28.9
21%-30% of sales	16	10.5
31%-40% of sales	13	8.6
41%-50% of sales	2	1.3
51%-60% of sales	5	3.3
TOTAL	**152**	**100.0**

The above findings illustrate that approximately 47% of the respondents indicated that 0% to 10% of their total sales are not settled by their debtors on the due date; approximately 29% indicated that between 11% and 20% of their total sales are not settled by their debtors on the due date; 10.5% indicated that 21% to 30% of their total sales are not settled by their debtors on the due date, and 10.5% that only 31% to 40% of their total sales are not settled by their debtors on the due date. Therefore, these findings are also in line with the previous findings with regard to the bad debt situation, relative to sales for SMEs. This can be regarded as evidence that trade credit is being mismanaged by SMEs.

Table 5.23 illustrates the number of debtor accounts for the SMEs.

Table 5.23: Number of debtor accounts

Number of debtor accounts	Frequency	Percentage
0	8	5.3
1-20	31	20.4
21-40	38	25
41-60	22	14.5
61-80	5	3.3
81-100	40	26.3
101 and above	8	5.3
TOTAL	**152**	**100**

The above findings indicate that approximately 26% of the respondents have between 81 and 100 active debtor accounts; 25% has between 21 and 40 debtor accounts, and approximately 20% have between 1 and 20 debtor accounts. The remaining four groups are also illustrated in Table 5.23, where the largest part of the total population does possess debtor accounts, with the largest group of respondents indicating that they do possess a high number of debtor accounts. The results indicate that a large part of the total population does extend trade credit to other SMEs and/or customers.

Table 5.24 illustrates the proportion of the SMEs' debtors paying on the due date, relative to total debtor accounts.

Table 5.24: Proportion of debtors paying on the due date, relative to total debtor accounts

Proportion of debtors paying on the due date, relative to total debtor accounts	Frequency	Percentage
0%-25% of total debtor accounts	60	39.5
26%-50% of total debtor accounts	29	19.1
51%-75% of total debtor accounts	40	26.3
76%-100% of total debtor accounts	23	15.1
TOTAL	**152**	**100.0**

The above findings are, to some extent, similar to the previous findings related to the proportion of the SMEs' debtors paying on the due date, relative to total sales, except that it compares the portion of debtors paying on the due date with the total debtor accounts for the SME and not the total sales. Approximately 40% of the respondents indicated that only 0% to 25% of total debtor accounts are settled on the due date as agreed upon. This suggests that SMEs do struggle with late payment from debtors and that only a small portion, for a large group of respondents (approximately 40%); of total debtor accounts are settled by the SMEs' debtors on the due date as agreed upon. In addition, 19.1% indicated that only between 26% and 50% of their total debtor accounts are settled on the due date. This further supports the finding that SMEs do struggle with late payment from debtors.

The above findings suggest that SMEs only receive a small percentage of their total debtor account owed to them on the due date as agreed upon between the SME and the debtor. Therefore, SMEs do struggle with late payment from debtors. This can be regarded as important evidence why trade credit is being mismanaged by SMEs.

Table 5.25 illustrates the proportion of the SMEs' debtors that do not pay on the due date, relative to total debtor accounts, thus contributing to the bad debts of the SME.

Table 5.25: Proportion of debtors that do not pay on the due date, relative to total debtor accounts

Proportion of debtors that do not pay on the due date, relative to total debtor accounts	Frequency	Percentage
0%-25% of total debtor accounts	75	49.3
26%-50% of total debtor accounts	46	30.3
51%-75% of total debtor accounts	8	5.3
76%-100% of total debtor accounts	23	15.1
TOTAL	**152**	**100.0**

The above findings are, to some extent, similar to the previous findings related to the proportion of the SMEs' debtors paying late (relative to sales), thus contributing towards the bad debts of the SME, except that it compares the portion of debtors that do not pay on the due date with the total debtor accounts for the SME and not the total sales. For approximately 49% of the respondents, 0% to 25% of total debtor accounts are not settled on the due date as agreed upon. This suggests that SMEs do struggle with late payment from debtors. For approximately 49%, a small portion of total debtor accounts is not settled by the SMEs' debtors on the due date as agreed upon. These findings suggest that SMEs do not receive a substantial percentage of their total debtor account owed to them on the due date as agreed upon between the SME and its debtor. Therefore, the findings further indicate that SMEs do struggle with late payment from debtors. This can be regarded as an indication that trade credit is being mismanaged by SMEs.

Table 5.26 illustrates the findings related to how often the SME receives payment from debtors later than the due date.

Table 5.26: How often do you receive payment from debtors later than the due date?

How often do you receive payment from debtors later than the due date?	Frequency	Percentage
Always	35	23
Often	40	26.3
Sometimes	51	33.6
Seldom	26	17.1
TOTAL	**152**	**100**

These findings illustrate that 23% of all the respondents indicated that they always receive payment from debtors later than the due date, thus on a date later than that agreed upon between both parties. Therefore, the findings indicate that SMEs do struggle with late payment from debtors as the largest percentage of respondents do receive payment from their debtors on a date later than that agreed upon between the SME and the debtor.

5.6.2 Creditors

This section aims to explain the trade credit situation of the SMEs, with specific focus on creditors.

The following factors are expressed in more detail as frequencies and percentages in providing an indication of the trade credit situation in the SME, with specific focus on creditors. Tables 5.27 to 5.29 illustrate the trade credit situation in the SME by focusing on creditors.

Table 5.27 illustrates the number of creditor accounts for the SME.

Table 5.27: Number of creditor accounts

Number of creditor accounts	Frequency	Percentage
0	26	17.1
1-20	72	47.4
21-40	21	13.8
41-60	8	5.3
61-80	3	2
81-100	10	6.6
101 and above	12	7.9
TOTAL	**152**	**100**

The above findings indicate that 47.4% of the respondents have between 1 and 20 active creditor accounts; 17.1% have 0 creditor accounts; 13.8% have between 21 and 40 creditor accounts. Table 5.27 also shows the remaining four groups, indicating that the largest part of the total population possesses either a small amount of creditor accounts or nothing at all. The results show that a large part of the total population does accept trade credit, but only to a limited extent, from other SMEs and that part of the total population does not accept any trade credit from other SMEs when purchasing from them.

Table 5.28 illustrates the proportion of the SMEs' creditors that are paid on the due date, relative to total creditor accounts.

Table 5.28: Proportion of creditors that the respondents pay on the due date, relative to total creditor accounts

Proportion of creditors that the respondents pay on the due date, relative to total creditor accounts	Frequency	Percentage
0%-25% of total creditor accounts	54	35.5
26%-50% of total creditor accounts	25	16.4
51%-75% of total creditor accounts	39	25.7
76%-100% of total creditor accounts	34	22.4
TOTAL	**152**	**100**

For 35.5% of the respondents, only 0% to 25% of total creditor accounts are settled on the due date as agreed upon. This suggests that SMEs do prolong the payment owed to other SMEs and/or suppliers and that for 35.5% of the respondents, a relative small portion of total creditor accounts are settled by the SMEs on the due date as agreed upon with the supplier. The findings indicate that a large part of the total population does settle between 51% and 100% of their total creditor accounts on the due date, but that the largest part of the total population only settles 0%-25% of their total creditor accounts on the due date as agreed upon with their suppliers. The findings suggest that SMEs do prolong the payment owed to other SMEs and/or suppliers. This could be regarded as important evidence why trade credit is being mismanaged by SMEs. In addition, the practice of paying late could also be the reason as to why the majority of SMEs have such a small number of creditor accounts.

Table 5.29 illustrates the proportion of the SMEs' creditors that are not paid on the due date, relative to total creditor accounts.

Table 5.29: Proportion of creditors that the respondents do not pay on the due date, relative to total creditor accounts

Proportion of creditors that the respondents do not pay on the due date, relative to total creditor accounts	Frequency	Percentage
0%-25% of total creditor accounts	84	55.3
26%-50% of total creditor accounts	37	24.3
51%-75% of total creditor accounts	9	5.9
76%-100% of total creditor accounts	22	14.5
TOTAL	**152**	**100**

For 55.3% of the respondents, 0% to 25% of total creditor accounts are not settled on the due date as agreed upon. The findings suggest that SMEs prolong the payment owed to other SMEs and/or suppliers and that, for 55.3% of the respondents, a relative small portion of total creditor accounts is not settled by the SMEs on the due date as agreed upon with the supplier. The above findings indicate that the largest part of the total population does not settle between 0% and 50% of

their total creditor accounts on the due date. Therefore, the findings suggest that SMEs prolong the payment owed to other SMEs and/or suppliers. This can also be regarded as further evidence and an important reason as to why trade credit is being mismanaged by SMEs.

5.6.3 Debtor and creditor comparisons

This section aims to provide an indication of the trade credit situation in the SME by comparison testing between the two different classification values, debtors and creditors. This section forms part of the second and final step in answering the second objective of this study.

First, findings related to the number of debtor accounts compared to the number of creditor accounts will be explained. Secondly, findings related to the proportion of the SMEs' debtors paying on the due date, relative to total debtor accounts, compared to the proportion of the SMEs' creditors that are paid on the due date, relative to total creditor accounts, will be discussed. Lastly, findings related to the proportion of the SMEs' debtors that do not pay on the due date, relative to total debtor accounts, and therefore contribute towards the bad debts of the SME, compared to the proportion of the SMEs' creditors that are not paid on the due date, relative to total creditor accounts, will be explained.

Table 5.30 illustrates the comparison between the number of debtor and creditor accounts. For this comparison, the matched samples t-test was used. This t-test is used in the case of two related observations (i.e., two observations per subject); in other words, the two groups of comparison (debtors and creditors) that are not independent. The t-test is specifically used to identify whether the means of the two interval variables differ from one another. A p-value approach is the preferred method of determining whether or not the null hypothesis can be rejected (Anderson, Sweeney, Williams, Freeman & Shoesmith, 2009: 293). A p-value is computed from the test statistic and is necessary in order to conclude whether the variables compared differ from each other. A small p-value leads to the rejection of the null hypothesis. According to Anderson *et al*. (2009), for a given level of significance α, we reject the null hypothesis if the p-value is less than α. For this analysis, the p-value is compared to the selected significance level of 0.1 (10%). Therefore, this means that, if the two groups of comparison differ from each other, the p-value will be less than 0.1 and vice versa.

Table 5.30: Number of debtor accounts compared to the number of creditor accounts

Debtors versus creditors	Mean differences (debtor to creditor)	p-value
Number of accounts	30.803	0

Table 5.30 indicates that there is a significant difference in the average number of accounts between debtors and creditors, as the p-value is equal to 0.000, which is less than 0.1. In addition, the significant difference in mean between debtor and creditor accounts indicates that the average number of debtor accounts is larger than the average number of creditor accounts. Thus, on average, SMEs possess more debtor accounts than creditor accounts.

Table 5.31 illustrates the findings related to the proportion of the SMEs' debtors paying on the due date, relative to total debtor accounts, compared to the proportion of the SMEs' creditors that are paid on the due date, relative to total creditor accounts. For this comparison, the McNemar test was used. It is important to note that in this test the variables together cannot contain more than two different classification values (Adedokun & Burgess, 2012). This section of the objective aims to compare the proportions of those that do not pay/are not paid on the due date for debtors and creditors. In so doing, the data was regrouped into two different categories. Again, the p-value was used in order to conclude whether the variables compared differ from each other.

Table 5.31: Proportion of the SMEs' debtors paying on the due date, relative to total debtor accounts, compared to the proportion of the SMEs' creditors that are paid on the due date, relative to total creditor accounts

Debtors versus creditors	p-value
Do pay/are paid on the due date	0.314

For the comparison of debtors paying on the due date and creditors receiving payment on the due date, the p-value is equal to 0.314, which is greater than 0.1. The findings indicate that there is no significant difference in the proportion of debtors who make payments on the due date and the proportion of creditors who receive payments on the due date. Therefore, the results indicate that the proportion of debtors paying on the due date, relative to total debtor accounts, is similar or equal to the proportion of creditors receiving payment on the due date, relative to total creditor accounts, for the SMEs. Thus, SMEs receiving payment on the due date from debtors will also make payment to creditors on the due date. There is no significant difference between the two variables.

Table 5.32 illustrates the findings related to the proportion of the SMEs' debtors not paying on the due date, relative to total debtor accounts, compared to the proportion of the SMEs' creditors that are not paid on the due date, relative to total creditor accounts. For this comparison, the McNemar test was used.

Table 5.32: Proportion of the SMEs' debtors that do not pay on the due date, relative to total debtor accounts, compared to the proportion of the SMEs' creditors that are not paid on the due date, relative to total creditor accounts

Debtors versus creditors	p-value
Do not pay/are not paid on the due date	0.899

For the comparison of debtors not paying on the due date and creditors not receiving payments on the due date, the p-value is equal to 0.899, which is greater than 0.1. The findings indicate that there is no significant difference in the proportion of debtors who do not make payments on the due date and the proportion of creditors who do not receive payments on the due date. Therefore, the results indicate that the proportion of debtors that do not pay on the due date, relative to total debtor accounts, is similar or equal to the proportion of creditors that are not paid on the due date, relative to total creditor accounts, for the SMEs. Thus, SMEs that do not receive payment on the due date from debtors will not necessarily make payment to creditors on the due date. There is no significant relationship between the two variables.

In concluding section 5.6, secondary objective 2, the aim of this objective was to identify the trade credit situation in the SME (focusing on both debtors and creditors). The findings related to section 5.6.1 (debtors) indicated that SMEs do struggle with late payment from debtors. A large percentage of SMEs do struggle with bad debts and regard a significant percentage of their total sales as bad debts. The results also indicated that a large part of the total population does extend trade credit to other SMEs and/or customers. The findings related to section 5.6.2 (creditors) suggested that SMEs do prolong the payment owed to other SMEs and/or suppliers. The results indicated that a large part of the total population does accept trade credit, but only to a limited extent, from other SMEs. The findings indicated that the majority of SMEs only have a small number of creditor accounts. Findings related to section 5.6.3 indicated a significant difference in the average number of accounts between debtors and creditors for SMEs. The second last comparison test for this section indicated that there is no significant difference in the proportions of debtors who make payments on the due date and the proportions of creditors who receive payments on the due date. This finding indicated that SMEs that receive payment on the due date from debtors will also make payment to creditors on the due date. The last comparison test for this section indicated that there is no significant difference in the proportions of debtors who do not make payments on the due date and the proportions of creditors who do not receive payments on the due date. Therefore, SMEs that do not receive payment on the due date from debtors will not necessarily make payment to creditors on the due date.

The next section focuses on the third secondary objective, namely to identify the activities and measures that SMEs use to reduce late payment.

5.7 Secondary objective 3: To identify the activities and measures that SMEs use to reduce late payment (debtors only)

Section 5.7 presents the empirical findings on the activities and measures that SMEs use to reduce late payment**,** focusing on debtors only.

5.7.1 Debtors

This objective aims to identify the importance of certain activities and measures that SMEs can use, on a daily basis, to reduce the possibility of receiving late payments from debtors.

Tables 5.33 and 5.34 present the mean scores in respect of the respondents' perception concerning the importance of these activities and measures. The mean scores are based on a 5-point Likert scale.

Table 5.33 illustrates the response with regard to activities to reduce the possibility of receiving late payments from debtors. These activities consisted of the Five Cs of credit, namely character, capacity, capital, collateral and conditions.

Table 5.33: Activities to reduce the possibility of receiving late payments from debtors

Activities to reduce the possibility of receiving late payments from debtors	N	Totally unimportant / unimportant	Moderately important	Important / very important	Mean	Ranking
Checking customers' ability to pay	152	27	13.2	59.8	3.64	11
Negotiating payment terms with customers	152	17.8	3.9	78.3	4.08	4
Checking orders against credit limits	148	16.5	17.8	63.1	3.8	9
Check customers' creditworthiness before granting credit	152	17.8	4.6	77.6	4.14	3
Conducting credit analysis. Focusing on character refers to the willingness of the customer to pay	152	27.6	5.9	66.4	3.77	10
Conducting credit analysis. Focusing on capacity refers to the ability of the customer to pay	152	19.1	15.8	65.1	3.87	8
Conducting credit analysis. Focusing on capital: the customer's financial reserves and position	152	15.8	30.3	54	3.63	12
Conducting credit analysis. Focusing on collateral: the extent to which the customer's debt is secured	152	18.4	32.9	48.7	3.55	13

Conducting credit analysis. Focusing on conditions refers to general economic conditions and the political environment	152	17.8	37.5	44.7	3.5	14
Collecting revenue in line with agreed terms, as set out in the credit policy	152	9.9	25.7	64.5	3.9	7
Administering sales ledger (monthly reconciliations of debtor accounts and all administration duties relating to debtor accounts)	152	15.2	14.5	70.4	3.95	5
Resolving dispute invoices with customer(s) that are overdue	152	13.8	9.9	76.4	4.2	2
Chasing overdue payments by making use of methods such as telephone calls, sending out statements via post, e-mailing statements, etc.	152	9.9	9.9	80.3	4.3	1
Categorising customer accounts according to late payment risk	152	12.5	23.7	63.9	3.92	6

In terms of importance, *chasing overdue payments by making use of methods such as telephone calls, sending out statements via post, e-mailing statements, etc.* (mean of 4.30 on a 5-point Likert scale) has the highest mean for the SMEs. The activity of *resolving dispute invoices with customer(s) that are overdue* (mean of 4.20 on a 5-point Likert scale) has the second highest mean, followed by the activity of *checking customers' creditworthiness before granting credit* (mean of 4.14 on a 5-point Likert scale). All fourteen perceptions of importance activities have means above 3, indicating that SMEs perceive all activities listed above as important to reduce the possibility of receiving late payments from debtors.

The three perceptions of importance activities with the lowest means for SMEs are:

- Conducting credit analysis. Focusing on conditions refers to general economic conditions and the political environment (mean of 3.50 on a 5-point Likert scale and is ranked 14th).
- Conducting credit analysis. Focusing on collateral refers to the extent to which the customer's debt is secured (mean of 3.55 on a 5-point Likert scale and is ranked 13th).
- Conducting credit analysis. Focusing on capital refers to the customer's financial reserves and position (mean of 3.63 on a 5-point Likert scale and is ranked 12th).

It is interesting to note that *credit analysis (focusing on conditions, collateral and capital only)* is the activity, out of all fourteen perceptions of importance activities, with the lowest means of all. It could be suggested that SMEs would not have struggled with late payment from debtors if the activity of conducting a credit analysis was properly conducted initially with the extension of trade credit.

The following section further explains the response of the total population to activities used to reduce the possibility of receiving late payments from debtors.

The first activity, *SMEs checking the customers' ability to pay outstanding accounts*, scored the eleventh highest mean score (3.64) of all fourteen activities. The mean score of 3.64 indicates that SMEs perceive this activity as important to reduce the possibility of receiving late payments from debtors. *Negotiating payment terms with customers* is the second activity that scored the fourth highest mean score (4.08) of all fourteen activities. Furthermore, the mean score of 4.08 indicates that respondents perceive this activity as important to reduce the possibility of receiving late payments from debtors. The vast majority of the total population (78.3%) perceives this activity as important or very important to reduce the possibility of receiving late payments from debtors. *Checking orders against credit limits* is the third activity and scored the ninth highest mean score (3.8) of all fourteen activities. Therefore, SMEs perceive this activity as important to reduce the possibility of receiving late payments from debtors. A missing value of 4 indicates that four respondents did not answer this question. The fourth activity is *the checking of customers' creditworthiness before granting credit to the relevant customer*. This activity scored the third highest mean score (4.14) of all fourteen activities. Of the total population, 77.6% perceives this activity as important or very important.

The activity of *conducting a credit analysis (focusing on character refers to the willingness of the customer to pay)* scored the tenth highest mean score (3.77) of all fourteen activities. To reduce the possibility of receiving late payments from debtors, the finding related to this activity indicates that respondents perceive this activity as important. The activity of *conducting a credit analysis (focusing on capacity refers to the ability of the customer to pay)* scored the eighth highest mean score (3.87) of all fourteen activities. The activity of *conducting a credit analysis (focusing on capital refers to the customer's financial reserves and position)* scored the twelfth highest mean score (3.63) of all fourteen activities. *Conducting a credit analysis (focusing on collateral refers to the extent to which the customer's debt is secured)* scored the thirteenth highest mean score (3.55) of all fourteen activities. *Conducting a credit analysis (focusing on conditions refers to general economic conditions and the political environment)* scored the lowest mean score (3.5) of all fourteen activities. Therefore, the total population perceives this activity as the least important to reduce the possibility of receiving late payments from debtors.

Collecting revenue in line with agreed terms as set out in the credit policy scored the seventh highest mean score (3.9) and the activity of *administering sales ledger (monthly reconciliations of debtor accounts and all administration duties relating to debtor accounts)* scored the fifth highest mean score (3.95) of all fourteen activities. To reduce the possibility of receiving late payments from debtors, the vast majority of the total population (70.4%) perceives this activity as important or very important. The activity of *resolving dispute invoices with customer(s) that are overdue* scored the second highest mean score (4.2) with 76.4% of the total population indicating that this activity is important or very important in reducing the possibility of receiving late payments from debtors.

Chasing overdue payments by making use of methods such as telephone calls, sending out statements via post, e-mailing statements, etc. scored the highest mean score (4.3) of all fourteen activities. Therefore, the findings indicate that the total population perceives this activity as the most important to reduce the possibility of receiving late payments from debtors. It is noted in Table 5.33 that 80.3% of the total population indicated that this activity is, in fact, important or very important in reducing the possibility of receiving late payments from debtors. Lastly, the activity of *categorising customer accounts according to late payment risk* scored the sixth highest mean score (3.92) of all fourteen activities.

The next section illustrates the measures taken to reduce the possibility of receiving late payments from debtors. Table 5.34 illustrates the measures provided by the respondents to reduce the possibility of receiving late payments from debtors**.**

Table 5.34: Measures taken to reduce the possibility of receiving late payments from debtors

Measures to reduce the possibility of receiving late payments from debtors	N	Not helpful / slightly helpful	Moderately helpful	Helpful / very helpful	Mean	Ranking
Statutory interests on late payment	152	41.5	25.7	32.9	2.92	5
Existence of cession of debtor contracts with customer(s)/debtors	145	29	29.6	36.8	3.06	4
Compulsory disclosure of payment practices	138	24.3	22.4	44.1	3.22	2
Better training/education in credit management	152	27	47.4	25.7	2.91	6
Collection policies by means of invoices, statements, letters, telephone calls, personal visits and collections agencies	152	10.5	17.8	71.7	4.08	1
Collection policies by means of legal action	152	38.2	14.5	47.4	3.12	3

In terms of importance, *collection policies by means of invoices, statements, letters, telephone calls, personal visits and collections agencies* (mean of 4.08 on a 5-point Likert scale) has the highest mean for SMEs. It is interesting to note that the perception of importance with the lowest mean for SMEs is *better training/education in credit management for employees* (mean of 2.91 on a 5-point Likert scale). Four out of the six perceptions of importance factors have means above 3, indicating that SMEs perceive the measures listed above as important to reduce the possibility of receiving late payments from debtors.

The first measure is *statutory interests on late payment*. This measure scored the fifth highest mean score (2.92) of all six measures. Note that the mean score of 2.92 indicates that respondents perceive this measure as not as important to reduce the possibility of receiving late payments from debtors. The second measure, *existence of cession of debtor contracts with customer(s)/debtors*, scored the fourth highest mean score (3.06). A missing value of 7 indicates that seven respondents did not answer this question. A cession of debtors is best described as a right that debtors agree to transfer to their creditors. With this right, creditors have the claim to money that is owed to the debtors by the debtor's debtors (www.agreementsonline.co.za) (2014). The measure, *compulsory disclosure of payment practices*, scored the second highest mean score (3.22) of all six measures tested. The findings indicate that the total population perceives this measure as the second most important to reduce the possibility of receiving late payments from debtors. The vast majority of the total population (44.1%) indicated that this measure is very helpful or helpful. A missing value of 14 indicates that fourteen respondents did not answer this question.

The fourth measure is *better training/education in credit management* and scored the lowest mean score (2.91) of all six measures. Therefore, the total population perceives this measure as the least important to reduce the possibility of receiving late payments from debtors, with only 25.7% of the total population perceiving this measure as very helpful or helpful to SMEs. *Collection policies (by means of invoices, statements, letters, telephone calls, personal visits and collections agencies)* scored the highest mean score (4.08) of all six measures tested. Therefore, the findings indicate that the total population perceives this measure as the most important to reduce the possibility of receiving late payments from debtors, as 71.7% of the total population perceives this measure as very helpful or helpful to SMEs. Lastly, the measure of *collection policies by means of legal action* scored the third highest mean score (3.12), with 47.4% of the total population indicating that this measure is very helpful or helpful to SMEs.

In concluding section 5.7, secondary objective 3, the aim of this objective was to identify the importance of certain activities and measures that SMEs can use, on a daily basis, to reduce the possibility of receiving late payments from debtors. First, findings related to the importance of certain activities indicated that *chasing overdue payments by using methods such as telephone calls, sending out statements via post, e-mailing statements, etc.* had the highest mean for SMEs. Secondly, findings related to the importance of certain measures indicated that *collection policies by means of invoices, statements, letters, telephone calls, personal visits and collections agencies* had the highest mean for SMEs.

The next section focuses on the fourth secondary objective, namely to evaluate the importance of a sound and structured credit policy when granting trade credit.

5.8 Secondary objective 4: To evaluate the importance of a sound and structured credit policy when granting trade credit (debtors only)

Section 5.8 presents the empirical findings on the importance of a sound and structured credit policy when granting trade credit, focusing on debtors only.

5.8.1 Debtors

This objective's primary aim is to determine the importance of a sound and structured credit policy for SMEs (according to the respondents) when granting trade credit to customers and/or other SMEs. In order to assist the respondent in evaluating the importance of a sound and structured credit policy when granting trade credit, the five C's of credit (along with other factors) formed the basis of the questions in the questionnaire. These factors assisted in evaluating whether the SME perceives a sound and structured credit policy as important or not. The respondent was asked to rate, on a scale, the importance of the credit policy components (as provided in the questionnaire) when granting credit to a customer.

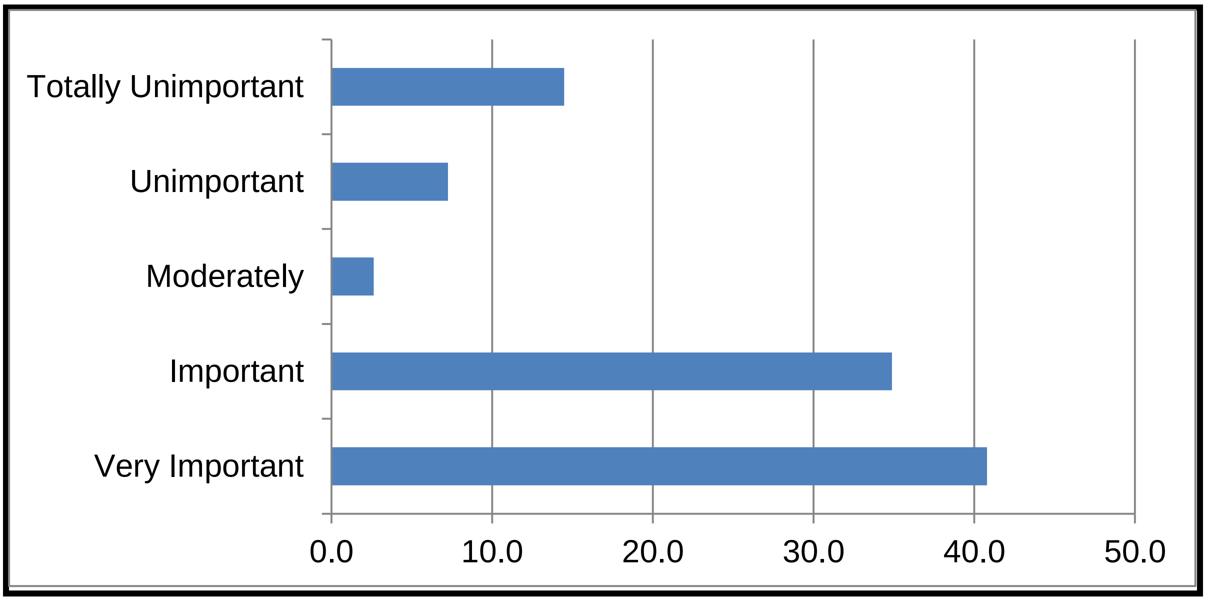
Table 5.35 illustrates the perception of respondents on the importance of a sound and structured credit policy, for SMEs, when granting trade credit to SMEs and/or other customers.

Table 5.35: The importance of the existence of a sound and structured credit policy when granting trade credit to customers

How important is the existence of a sound and structured credit policy when granting credit to customers?	Frequency	Percentage
Totally unimportant	22	14.5
Unimportant	11	7.2
Moderately important	4	2.6
Important	53	34.9
Very important	62	40.8
TOTAL	**152**	**100**

As illustrated in Table 5.35, the existence of a sound and structured credit policy when granting trade credit can be considered important to SMEs, with 34.9% of the respondents answering important and 40.8% answering very important. A total of approximately 22% of the respondents indicated that the factor is either unimportant (7.2%) or totally unimportant (14.5%). Figure 5.6 presents the above information graphically.

Figure 5.6: The importance of the existence of a sound and structured credit policy when granting trade credit to customers (focusing on debtors)



Of the respondents, 75.7% indicated that the factor is either important (34.9%) or very important (40.8%), indicating that the vast majority of the total population perceives the existence of a sound and structured credit policy as important and very important when granting trade credit to customers, and 14.5% of the respondents indicated that the existence of a sound and structured credit policy when granting trade credit is totally unimportant to them.

Table 5.36 presents the mean scores regarding the respondents' perception of the importance of a sound and structured credit policy when granting trade credit. The mean scores are based on a 5-point Likert scale.

Table 5.36 illustrates the perception of importance for SMEs of certain credit policy components when granting trade credit to a customer in evaluating the importance of a sound and structured credit policy.

Table 5.36: The perception of importance for SMEs related to certain credit policy components when granting trade credit to a customer in evaluating the importance of a sound and structured credit policy

Credit policy components	N	Totally unimportant / unimportant	Moderately important	Important / very important	Mean	Ranking
Credit period (the period of time in which the buyer needs to repay the outstanding account)	152	9.2	0	90.7	4.39	1
Cash discount (represents a percentage deducted from the purchase price for which the buyer can receive discount when paying within a specified time as set out in the terms agreed upon in the credit policy)	142	22.4	13.8	57.3	3.53	7
Credit analysis (evaluation of applicants in order to distinguish between "good" customers that will pay and potential "bad" customers that will default)	152	14.5	7.9	77.6	4.01	6
Collection policy (methods and procedures that a SME can follow for the collection of accounts receivable)	152	9.2	0	90.8	4.16	4
Evaluating credit policy	152	9.2	13.2	77.6	4.06	5
Management of debtors/customers	152	9.2	7.9	82.9	4.3	3
Age analysis of debtors (to determine the percentage of debtor days, from current to 120 days and older, outstanding relative to total sales)	152	9.2	0	90.8	4.36	2

In terms of importance, the *credit period component* (mean of 4.39 on a 5-point Likert scale) has the highest mean for SMEs. The credit policy component with the lowest mean for SMEs is *cash discount* (mean of 3.53 on a 5-point Likert scale). All seven credit policy (perception of importance) components have means above 3, indicating that SMEs perceive all relevant credit policy components listed above as important. Therefore, it can be argued that all respondents perceive the inclusion of these credit policy components, in a credit policy, as important.

In evaluating the importance of a sound and structured credit policy, the *credit period component* of the credit policy scored the highest mean score (4.39) of all seven credit policy components tested. Therefore, the findings indicate that the total population perceives the *credit period* as the most important component in evaluating the importance of a sound and structured credit policy. In addition, 90.7% of the total population indicated that the inclusion of a *credit period term*, as a component of the credit policy, is important or very important to SMEs when granting trade credit to a customer and is, therefore, necessary to form part of the credit policy. *Cash discount* scored the lowest mean score (3.53) of all seven credit policy components tested. A missing value of 10 indicates that ten respondents did not answer this question**.**

The findings in Table 5.36 indicate that *credit analysis* scored the sixth highest mean score (4.01) of all seven credit policy components tested; *collection policy* scored the fourth highest mean score (4.16), and *credit policy evaluation* scored the fifth highest mean score (4.06). This component consists of evaluating the credit policy and its effect on the SME. The SMEs need to consider five basic factors, namely revenue effects, cost effects, cost of debt, the probability of non-payment by debtors, and the cash discount within the credit terms as set out by the SME.

Of all the components listed in Table 5.36, the findings indicate that *managing the SME's debtors/customers* scored the third highest mean score (4.3) of all seven credit policy components tested. In addition, 82.9% of the total population indicated that *management of a SME's debtors/customers* is important or very important to SMEs when granting trade credit to a customer. Lastly, *the age analysis of debtors*, scored the second highest mean score (4.36) of all seven credit policy components tested.

In concluding section 5.8, secondary objective 4, the aim of this objective was to determine the importance of a sound and structured credit policy for SMEs, according to the respondents, when granting trade credit to customers and/or other SMEs. First, the vast majority of the total population perceives the existence of a sound and structured credit policy as very important when granting trade credit. Therefore, the vast majority of the total population believes that the existence and use of a sound and structured credit policy is very important to a SME in extending trade credit. Secondly, in terms of evaluating the importance of a sound and structured credit policy when granting trade credit, the perceived *credit period* component had the highest mean for SMEs.

The findings thus indicate that the respondents perceive the *credit period* as the most important component of a credit policy in extending trade credit. Of all seven credit policy components, *cash discount* scored the lowest mean score. Therefore, SMEs regard the proposition of offering a *cash discount*, for early settlement of debt by the SME’s debtors, as least important; this could have a negative impact on the growth and cash-flow requirements of a SME. The findings further indicate that SMEs are willing to wait and rather receive full remuneration than give a percentage discount on the amount owed by the debtor, if payment is made within a short period of time.

The next section focuses on the fifth secondary objective, namely to identify aspects of SMEs’ trade credit-management practices that represent major constraints in the small-firm sector.

5.9 Secondary objective 5: To identify aspects of SMEs' trade credit-management practices that represent major constraints in the small-firm sector (focusing on both debtors and creditors)

Section 5.9 presents the empirical findings on the aspects of SMEs' trade credit-management practices that represent major constraints in the small-firm sector, focusing on both debtors and creditors.

5.9.1 Debtors

The objective aims to identify aspects of the SMEs' trade credit-management practices that represent major constraints in managing trade credit. This section mentions the SMEs' constraints regarding the management of debtors. This objective also consists of an open-ended question in answering the above.

The following factors are expressed in more detail as frequencies and percentages in order to identify the aspects of the SMEs' trade credit-management practices that represent major constraints in managing trade credit. The data for this section was collected by means of an open-ended question in the questionnaire.

Tables 5.37 and 5.38 illustrate aspects of the SMEs' trade credit-management practices that represent major constraints in managing trade credit.

Table 5.37: The main problems respondents encounter when managing trade credit

The main problems respondents encounter when managing trade credit	Frequency	Percentage
The legal aspects regarding the natural or juristic person to whom credit is extended	1	0.7
Administration (invoices, POD's statements, queries, and credit notes must be 100% before payment is received)	1	0.7
Credit limits, payment of credit in terms, and collecting of credit	1	0.7
Special arrangements where clients are allowed to go over their originally approved credit terms	1	0.7
Cash-flow problems	15	9.9
Customers only paying a portion of the amount due	19	12.5
Clients cannot pay, because they have not yet been paid by their debtors or clients	22	14.5
Receiving a late payment from debtors and debtors exceeding credit terms	92	60.9
TOTAL	**152**	**100**

The above findings were retrieved from an open-ended question in the questionnaire where respondents were asked to identify the main problems they encounter when managing trade credit, as applicable to their SME's trade credit situation. The findings illustrate that 60.9% agreed that *receiving late payment form debtors* and *debtors are exceeding credit terms* are the main problems they encounter when managing trade credit; 14.5% claimed that *their clients cannot pay them, because they have not yet been paid by their debtors or clients*; 12.5% claimed that their main problem is that *customers only pay a portion of the amount due*, and 9.9% of all the respondents find *cash-flow problems* to be the main issue in managing trade credit.

Receiving late payments from debtors is the main problem experienced by the majority of the SMEs questioned, when managing trade credit.

Table 5.38 and the ensuing sections focus on the following factors: cash flow, bad debts, late payments received by debtors/customers, and the management of debtors, as the main problems respondents encounter when managing trade credit (focusing on debtors).

Table 5.38: Cash flow, bad debts, late payments received by debtors/customers, and the management of debtors as the main problems respondents encounter when managing trade credit

Factor	Not a problem / slight problem	Average problem	Somewhat of a problem / definite problem	Mean	Ranking
Cash flow	44.7	10.5	44.7	3.42	2
Bad debts	25	13.8	61.2	3.18	4
Late payments received by debtors/customers	20.4	1.3	78.2	3.92	1
Management of debtors	34.2	11.8	53.9	3.21	3

- Cash flow

As identified in Table 5.38, with respect to the management of trade credit, 44.7% of all the respondents encounter cash flow as a definite problem; 10.5% encounter cash flow as an average problem; 42.1% encounter cash flow as a slight problem, and 2.6% do not encounter cash flow as a problem.

From the above findings, it can be observed that cash flow is a definite problem to SMEs, although a number of SMEs indicated that cash flow is only a slight problem to them in managing trade credit.

Of the four factors, cash flow scored the second highest mean score (3.42), thus indicating that the respondents perceive the problem of cash flow as important.

- Bad debts

As identified in Table 5.38, with respect to the management of trade credit, 54.6% of all the respondents encounter bad debts as somewhat of a problem; 6.6% encounter cash flow as a definite problem; 13.8 % encounter bad debt as an average problem; 24.3% do not encounter bad debt as a problem, and 0.7% find bad debt to be a slight problem.

From the above findings, it can be observed that bad debt is a problem for SMEs, although a number of SMEs indicated that bad debt is not a problem to them in managing trade credit.

The mean score of 3.18 indicates that respondents perceive the problem of bad debts as the least important of the four factors listed in Table 5.38.

- Late payments received by debtors/customers

The findings indicate that, with respect to the management of trade credit, 36.8% of all the respondents encounter late payments received by debtors/customers as a definite problem; 41.4% encounter late payments as somewhat of a problem; 1.3% encounter late payments as an average problem; 2.6% do not encounter late payments as a problem, and 17.8% encounter late payments received by debtors/customers as a slight problem.

From the above findings, it can be observed that late payments received by debtors/customers are definitely a problem for SMEs.

Of the four factors, late payments scored the highest mean score (3.92). The problem of late payments received by debtors/customers is, therefore, a vital problem to address in effectively managing the SMEs' trade credit-management practices.

- Management of debtors

Table 5.38 illustrates that, with respect to the management of trade credit, 28.9% of all the respondents find management of debtors to be a definite problem; 25% find this as somewhat of a problem; 11.8% find this as an average problem; 27.6% do not find this to be a problem, and 6.6% find that the management of debtors is a slight problem.

From the above findings, it can be observed that the management of debtors is a definite problem for SMEs.

Of the four factors, the management of debtors scored the third highest mean score (3.21).

Therefore, the above findings suggest that cash flow, bad debts (although to a lesser extent), late payments received by debtors/customers, and the management of debtors are problems that the SMEs encounter in managing trade credit. In addition, of the four problems illustrated in Table 5.38, late payments received by debtors/customers are the most important problem to address.

5.9.2 Creditors

This section provides constraints that SMEs have with the management of creditors specifically.

In providing an identification of the aspects of the SMEs' trade credit-management practices that represent major constraints in their management of trade credit, the following factors are expressed in more detail as frequencies and percentages.

Table 5.39 illustrates the findings related to late payments made to creditors and the management of creditors as the main problems respondents encounter when managing trade credit (focusing on creditors).

Table 5.39: Late payment made to creditors and the management of creditors as the main problems respondents encounter when managing trade credit

Factor	Not a problem / slight problem	Average problem	Somewhat of a problem / definite problem	Mean	Ranking
Late payment made to creditors	48	11.2	40.8	3.26	1
Management of creditors	29.6	13.2	57.3	3.01	2

- Late payments made to creditors

As identified in Table 5.39, in respect of the management of trade credit, 48% of all the respondents encounter late payments made to creditors as not and/or a slight problem. Out of this percentage, a total of 41.4% of all the respondents encounter late payments made to creditors as a slight problem. A total of 40.8% of all the respondents encounter late payments made to creditors as somewhat of a problem and/or a definite problem when managing trade credit. Out of this percentage, a total of 39.5% of all the respondents encounter late payments made to creditors as a definite problem.

The above findings indicate that the largest group of the population encounter late payments made to creditors as a slight problem, with a smaller group that do not encounter late payment made to their creditors as a problem. A large number of the total population indicated that they definitely encounter problems regarding late payments made to creditors, with a smaller group of the population encountering somewhat of a problem.

Of the two factors, late payments made to creditors scored the highest mean score (3.26), indicating that the respondents perceive the problem of late payments made to creditors as the most important of the two factors listed in Table 5.39 and that it is a vital problem to address in effectively managing the SMEs' trade credit-management practices.

- Management of creditors

Table 5.39 illustrates that, in respect of the management of trade credit, 57.3% of all the respondents encounter management of creditors as somewhat of a problem and/or a definite problem. Out of this percentage, a total of 55.3% of all the respondents encounter the management of creditors as somewhat of a problem. Compared to that, a total of 29.6% of all the respondents encounter the management of creditors as not and/or a slight problem when managing trade credit. Out of this percentage, a total of 28.3% of all the respondents encounter the management of creditors as not a problem.

The above findings indicate that the management of creditors is a problem for SMEs.

This factor scored the second highest mean score (3.01) of the two factors. Therefore, the findings indicate that the respondents perceive the problem of managing creditors as the least important compared to that of late payments made to creditors. It should be noted that the respondents also perceive the problem of managing creditors as important, due to the mean score being higher than 3.

5.9.3 Debtor and creditor comparisons

This section aims to compare the following variables, late payments received by debtors/customers and the management of debtors to late payments made to creditors and the management of creditors, as SME s'constraints concerning the management of trade credit (with specific focus on debtors and creditors).

First, findings related to late payments received by debtors/customers compared to late payments made to creditors will be explained. Secondly, findings related to the level of constraint in the management of debtors compared to the level of constraint in the management of creditors will be explained.

Table 5.40 illustrates the comparison between the level of constraint for SMEs, by focusing on the two variables, late payments received by debtors/customers and late payments made to creditors. The McNemar test was used for comparing the two variables.

Table 5.40: Late payments received by debtors/customers compared to late payments made to creditors as constraints in managing trade credit

Debtors versus creditors	p-value
Late payments received by debtors compared to late payments made to creditors	0.000

The findings of the McNemar test presented in Table 5.40 indicate a significant difference in the extent of the constraint of late payments received by debtors and late payments made to creditors. This is illustrated by a p-value of 0.000, which is less than 0.1. The significant difference indicates that the extent of these constraints is not the same between debtor and creditor management for the SMEs. In other words, the effect is not the same between the two different classification values, namely debtors and creditors for SMEs**.** Therefore, the effect of the constraint (late payment received from debtors/customers) for SMEs is not the same as the effect of the constraint (late payments made to creditors) for SMEs. Therefore, SMEs that are struggling with late payments from debtors are not necessarily guilty of making late payments to creditors, and SMEs that pay creditors later than the due date are not necessarily also receiving payment from debtors later than the due date. Due to the late payments made by debtors, while payment to creditors is still paid on time, could lead to cash flow problems for the SMEs.

Table 5.41 illustrates findings related to the level of constraint in the management of debtors compared to the level of constraint in the management of creditors for SMEs.

Table 5.41: Management of debtors compared to management of creditors as constraints in managing trade credit

Debtors versus creditors	p-value
Management of debtors compared to management of creditors	0.691

The findings of the McNemar test presented in Table 5.41 indicate no significant difference in the extent of the constraint of the management of debtors and the management of creditors. This is illustrated by a p-value of 0.691, which is greater than 0.1. The non-significant difference indicates that the extent of these constraints is the same between debtor and creditor management for the SMEs. Therefore, the effect of the constraint (management of debtors) for SMEs is the same as the effect of the constraint (management of creditors) for SMEs. In other words, the effect is the same between the two different classification values, namely debtors and creditors for SMEs**.** Therefore, SMEs that are struggling with the management of debtors, as a primary constraint in managing the SME's trade credit, are also struggling with the management of the SME's creditors, and those SMEs that are struggling with the management of creditors, as a primary trade credit management constraint, are also struggling with the management of the SME's debtors.

In concluding section 5.9, secondary objective 5, the objective aimed to identify aspects of the SMEs' trade credit-management practices that represent major constraints to them in managing trade credit (focusing on both debtors and creditors). The findings related to section 5.9.1 (debtors) indicated that the largest group of respondents agreed that *receiving late payment form debtors* and *debtors are exceeding credit terms* are the main aspects of the SMEs' trade credit-management practices that represent major constraints to them in managing trade credit. In addition, as indicated earlier, the findings illustrated that cash flow, bad debts (although to a lesser extent), late payments received by debtors/customers, and the management of debtors are problems that the SMEs encounter in managing trade credit. The findings related to section 5.9.2 (creditors) indicated that a large number of the total population encounter slight and/or not any problems regarding late payments made to creditors. By comparison, the findings also indicated that the management of creditors is a problem for SMEs. The problem factor, in section 5.9.1

(debtors), with the highest mean score was that of late payments received by debtors/customers and, in section 5.9.2 (creditors), the highest mean score was that of late payments made to creditors. Findings related to section 5.9.3 indicated that there is a significant difference in the extent of the constraint of late payments received by debtors and late payments made to creditors. Thus, SMEs that are struggling with late payments from debtors are not necessarily also guilty of making late payments to creditors and vice versa. It is interesting to note that, when compared to the first comparison test for section 5.9.3, the findings indicated that there is no significant difference in the extent of the constraint for the management of debtors and creditors. Thus, SMEs that are struggling with the management of debtors, as a primary constraint in managing the SME's trade credit, are also struggling with the management of the SME's creditors and vice versa.

The next section focuses on the sixth secondary objective, namely to determine the different trade credit terms being granted and used and/or accepted by SMEs.

5.10 Secondary objective 6: To determine the different trade credit terms being granted and used and/or accepted by SMEs (focusing on both debtors and creditors)

Section 5.10 presents the empirical findings on the different trade credit terms being granted and used and/or accepted by SMEs, focusing on both debtors and creditors.

5.10.1 Debtors

This objective aims to determine the different trade credit terms being granted by SMEs. This question in the questionnaire, that is applicable to this objective, was also used in answering secondary objective 2.

The following factors are expressed in more detail as frequencies and percentages in order to identify the different trade credit terms granted by SMEs as well as the average debtor days as arranged with debtors of the respondent. The findings, illustrated in Tables 5.42 and 5.43, were collected by means of an open-ended question in the questionnaire.

Table 5.42 illustrates the different trade credit terms granted by SMEs.

Table 5.42: The different trade credit terms granted by SMEs

The different trade credit terms granted by SMEs	Frequency	Percentage	Ranking
A % discount for payment within 30 days	1	0.7	6
Company does not actually give discount. I do grant 1%, 1.5%, 2% or 2.5% on 30 days to some customers who pay me on 30 days	1	0.7	6
Bank codes and trade references	3	2	5
2.5% within 30 days from statement	22	14.5	4
2/10 net 30 days and 5/10 net 60 days	29	19.1	3
60 days net	38	25	2
30 days or net 30 days	58	38.2	1
TOTAL	**152**	**100**	

The findings show that 38.2% of the respondents grant trade credit on a 30 days or net 30 days basis; 25% grant trade credit on a 60 days net basis, and 19.1% grant trade credit on a basis of 2/10 net 30 days and 5/10 net 60 days.

Table 5.43 illustrates the average debtor days as arranged with debtors of the SME.

Table 5.43: The average debtor days as arranged with debtors of the SME

Average debtor days as arranged with debtors of the SME	Frequency	Percentage
45 days	1	0.7
60 days	1	0.7
Receive payment from debtors on average within 30 days	1	0.7
31 days	7	4.6
Local debtors on average 30 days and foreign debtors on average 60 days	10	6.6
30 days	22	14.5
30 to 45 days	48	31.6
55 days	62	40.8
TOTAL	**152**	**100**

Table 5.43 indicates that 40.8% of the respondents arrange an average debtor days of 55 with their customers to settle the debt owed to them; 31.6% arrange an average debtor days of 30 to 45 days, and 14.5% arrange an average debtor days of 30 with their customers to settle the debt owed. All the other debtor days, as arranged between the SME and the debtor, are listed in Table 5.43.

5.10.2 Creditors

This section aims to determine the different trade credit terms being used and/or accepted by SMEs. These trade credit terms are the terms within the credit policy of other SMEs that are willing to extend trade credit to the SME. The question in the questionnaire, that is applicable to this objective, will also serve to answer secondary objective 2. This objective also consists of an open-ended question in answering the above.

The following factors are expressed in more detail as frequencies and percentages in order to indicate the different trade credit terms being used and/or accepted by SMEs, as well as the average creditor days as arranged with the respondent's creditors.

Table 5.44 illustrates the different trade credit terms used and/or accepted by SMEs from other SMEs willing to extend trade credit to them.

Table 5.44: The different trade credit terms being used and/or accepted by SMEs

The different trade credit terms being used and/or accepted by SMEs	Frequency	Percentage
Some none and others 2.5% 30 days	1	0.7
Very little on % discount	1	0.7
2/10 net 30 days 5/10 net 60 days	6	3.9
30 days with 2.5% discount	8	5.3
60 day net	11	7.2
A % discount for payment within 30 days	11	7.2
Net 30 days	55	36.1
None	59	38.8
TOTAL	**152**	**100**

The above findings indicate that 38.8% of the respondents receive trade credit from their suppliers not on any specified or agreed upon terms; 36.1% receive trade credit on a net 30 days basis; 7.2% receive trade credit on a basis of a certain percentage discount for payment within 30 days from statement, and 7.2% of the total population receives trade credit on a net 60 days basis.

Table 5.45 illustrates the average creditor days as arranged with the SME's creditors.

Table 5.45: The average creditor days as arranged with the SME's creditors

The average creditor days as arranged with the SME's creditors	Frequency	Percentage
30 days, and some 60 days, our average for payments is 35 days	1	0.7
42 days	1	0.7
45 days	6	3.9
65 days	6	3.9
60 days	57	37.5
30 days after statement	80	52.6
TOTAL	**152**	**100**

Table 5.45 shows that 52.6% of the respondents arrange average creditor days of 30 days with their suppliers to settle the debt owed; 37.5% arrange average creditor days of 60 days; 3.9% arrange average creditor days of 65 days, and 3.9% of the total population arranges average creditor days of 45 days with their suppliers to settle the debt owed to them. All the other creditor days, as arranged between the SME and the creditor, are listed in Table 5.45. A missing value of 1 indicates that one respondent did not answer this question.

5.10.3 Debtor and creditor comparisons

This section aims to identify the comparison between the average debtor days as arranged with the SME's debtors and the average creditor days as arranged with the respondent's creditors. Data is examined by way of comparison testing between the two different classification values, debtors and creditors, using the matched samples t-test.

Table 5.46 presents the comparison between the average number of debtor and creditor days. The p-value was used in drawing the conclusion as to whether the variables compared differ from each other.

Table 5.46: Average number of debtor days compared to the number of creditor days

Debtors versus creditors	Mean differences (debtor to creditor)	p-value
Number of days	-2.566	0.094

For the comparison between the average debtor and creditor days, the p-value is equal to 0.094, which is less than 0.1. Therefore, the findings indicate that there is a significant difference between the average number of debtor days and the average number of creditor days for SMEs. In addition, the difference in mean between debtor days and creditor days indicates that the average number of debtor days is lower than the average number of creditor days. Thus, on average, the number of days within which a SME receives payment from a debtor is shorter than the number of days within which the SME ultimately makes payment to a creditor. For SMEs, this should suggest less strain on the never-ending cash-flow demands.

In concluding section 5.10, secondary objective 6, the aim of this objective was to determine the different trade credit terms being granted and used and/or accepted by SMEs (focusing on both debtors and creditors). The findings related to section 5.10.1 (debtors) indicated that the largest group of respondents grant trade credit on a 30 days or net 30-day basis. The largest group of respondents arrange an average debtor days of 55 with their customers to settle the debt owed to them. The findings related to section 5.10.2 (creditors) indicated that the largest group of respondents receive trade credit from their suppliers not on any specified or agreed upon terms, but arrange an average creditor days of 30 days with their suppliers to settle the debt owed to them. Based on this, this study justified the use of the matched samples t-test, as averages do not best represent the SMEs cash-flow situation. Findings related to section 5.10.3 indicated a significant difference between the average number of debtor days and the average number of creditor days for SMEs. The findings indicated that, on average, the number of days within which a SME receives payment from a debtor is shorter than the number of days within which the SME ultimately makes payment to a creditor. In addition, the number of days within which the SME ultimately makes payment to a creditor is longer than the number of days within which a SME receives payment from a debtor. Note that the negative difference in mean between debtor days and creditor days indicates that the average number of debtor days is shorter than the average number of creditor days, as the test aimed to compare the average number of debtor days with the average number of creditor days specifically. This finding, therefore, suggests that less strain should be placed on the cash-flow demands for SMEs.

The next section focuses on the seventh and final secondary objective, namely to determine the different credit policies used by SMEs when granting credit to a customer.

5.11 Secondary objective 7: To determine the different credit policies used by SMEs when granting credit to a customer (debtors only)

Section 5.11 presents the empirical findings on the different credit policies used by SMEs when granting trade credit to a customer, focusing on debtors only.

5.11.1 Debtors

The first aim of this objective is to identify whether the SMEs do make use of a credit policy; secondly, to explain the type of credit policy that the particular SME uses when granting trade credit and, thirdly, to determine the extent to which the respondent perceives its SME's credit policy to be effective.

Table 5.47 illustrates the findings related to whether the respondents do make use of a credit policy.

Table 5.47: Do the respondents make use of a credit policy?

Do the respondents make use of a credit policy?	**Frequency**	**Percentage**
Yes	63	41.4
No	89	58.6
TOTAL	**152**	**100**

The above findings show that approximately 59% of the respondents do not make use of a credit policy, compared to 41% that do make use of a credit policy in granting trade credit. Previous findings in this chapter illustrate that all the respondents in this study do grant trade credit to their debtors and that the trade credit terms and average debtor days differ between SMEs. Therefore, more than half of the total population does not make use of a credit policy when granting trade credit. This could be an indication as to why trade credit is being mismanaged by SMEs.

Table 5.48 illustrates the type of credit policy that the respondent uses.

Table 5.48: The type of credit policy the respondents use

Type of credit policy the respondents use	Frequency	Percentage
Bank codes on bank accounts of clients for the terms they request and trade references	1	0.7
In-house credit policy	5	3.3
All customers must be checked with credit bureau before being accepted	6	3.9
Gut feel	7	4.6
Making use of a software program to evaluate credit history of client	8	5.3
Credit management experience in evaluating new applicants	17	11.2
Implementing a new credit application form for each new debtor	24	15.8
Arrangement with debtors to receive full payment within 30 days from statement	27	17.9
No specific credit policy in place; make use of statements, invoices and telephone calls	57	37.5
TOTAL	**152**	**100**

These findings indicate that 37.5% of the respondents do not make use of a credit policy when granting trade credit to a customer. It must be noted that, of this 37.5%, 3.3% of the total population indicated that they use statements, invoices and telephone calls when granting trade credit to a customer, although they do not have any specific credit policy in place. In addition, 17.9% of the total population has an arrangement with their debtors to receive full payment within 30 days from statement. Of the total population, 15.8% only makes use of an application form and/or the implementation of a new credit application form for each new debtor when granting trade credit. Of the total population, 11.2% makes use of credit management experience in evaluating new applicants and/or experience when granting trade credit to a customer.

Table 5.49 illustrates the extent to which the respondents perceive their SME's credit policy to be effective.

Table 5.49: The extent to which the respondents perceive their SME's credit policy to be effective

The extent to which the respondents perceive their SME's credit policy to be effective	Frequency	Percentage
Not effective at all	0	0
Slightly ineffective	53	34.9
Moderately effective	39	25.7
Slightly effective	27	17.8
Very effective	33	21.7
TOTAL	**152**	**100**

According to Table 5.49, approximately 35% of the respondents perceive their credit policy to be slightly ineffective and thus not fully able to eliminate the possibility of late payments from debtors. Zero respondents perceive their SME's credit policy as not effective at all. Approximately 26% of the respondents perceive their SME's credit policy to be moderately effective; approximately 18% perceive their SME's credit policy to be slightly effective, and approximately 22% perceive their SME's credit policy to be very effective. Therefore, the findings indicate that the largest group of the population perceives its SME's credit policy as slightly ineffective and moderately effective. Thus, for the most part, the respondents perceive their current credit policies as not sufficiently effective. This could indicate why trade credit is being mismanaged by SMEs.

In concluding section 5.11, secondary objective 7, the first aim of this objective was to identify whether SMEs do make use of a credit policy and, secondly, to explain the type of credit policy that the particular SME does make use of when granting trade credit. First, the findings indicated that more than half of the total population does not make use of a credit policy when granting trade credit. Secondly, and with regard to the type of credit policy, the findings illustrated that the largest group of respondents do not make use of any credit policy when granting trade credit to a customer. Section 5.11 also illustrated the extent to which the respondents perceive their own SME's credit policy to be effective. The findings indicated that the largest group of the population perceives their SME's credit policy as not effective.

In addition to the empirical findings, sections 5.12 and 5.13 serve to further strengthen the research results of this study.

The next section focuses on the findings related to the extension of trade credit by the SME between certain time periods. Therefore, the ensuing section will focus on the findings related to the most recent credit position of the respondent. The last empirical section focuses on the findings related to the perception of the management of trade credit for the SME. It should be noted that sections 5.12 and 5.13 are additional to the empirical findings and serve to further strengthen the research results of this study.

5.12 Findings related to the extension of trade credit by the SME between certain time periods (focusing on debtors and creditors)

Section 5.12 presents the empirical findings related to the extension of trade credit by the respondents between certain time periods.

5.12.1 Debtors

This section aims to provide additional information about the SMEs' trade credit behaviour, with specific focus on the extension of trade credit between certain time periods for debtors. The aim is to identify whether the respondents extended more or less trade credit to borrowers between different time periods ranging from 0 to 2 years.

Table 5.50: Extension of trade credit by SMEs between the following time periods: 0-6 months, 7-12 months and 13 months-2 years

	Time periods	Frequency: yes	Percentage	Frequency: no	Percentage
Extension of trade credit by the respondents	0-6 months	66	43.4	86	56.6
	7-12 months	24	15.8	128	84.2
	13 months-2 years	34	22.4	118	77.6

From the above findings, it can be observed that SMEs extend more trade credit within the recent six months of operation than later. It can also be observed that SMEs extend more trade credit in the most recent six months (0-6 months) of operation than in the first six months (7-12 months) within that specific financial year. The results indicate an increase in the extension of trade credit by SMEs, specifically within the most recent six months of operation, as a total of approximately 43% of all respondents did extend trade credit between 0 and 6 months within the recent year of operation.

5.12.2 Creditors

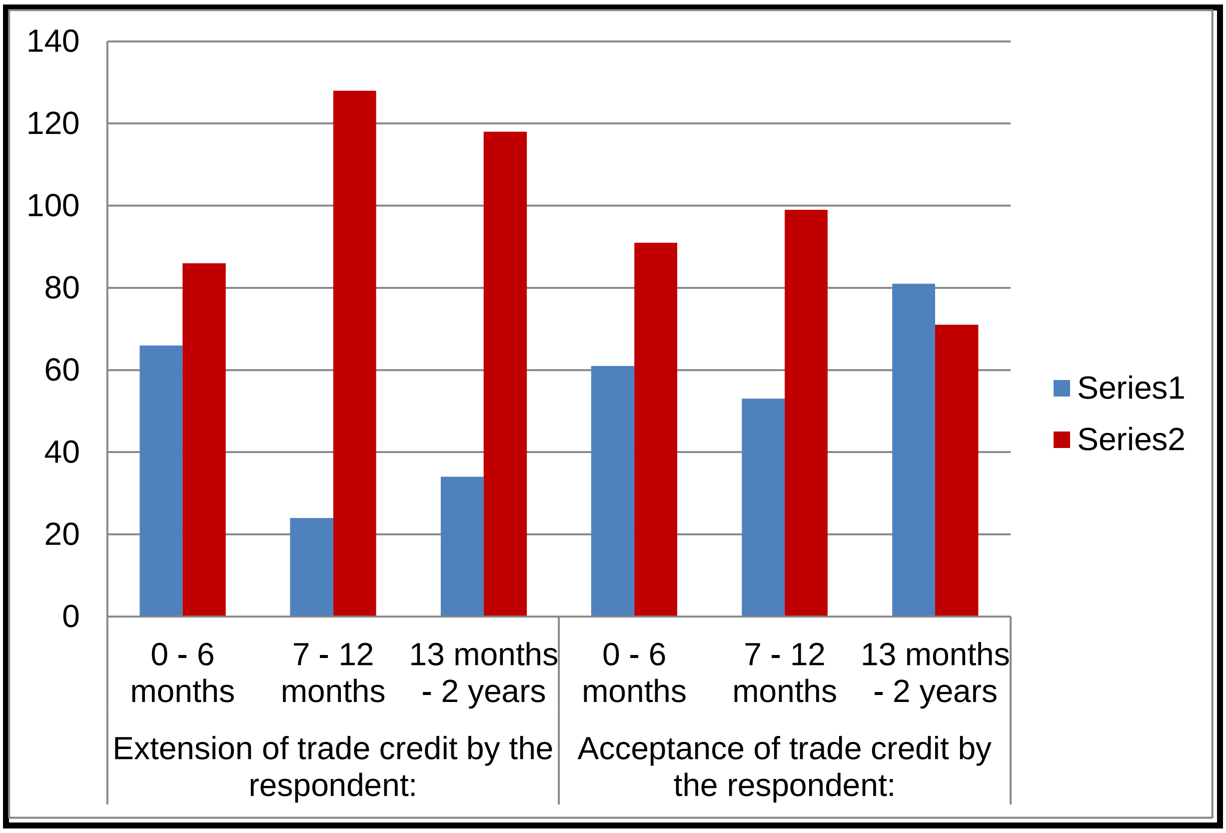
This section aims to provide additional information about the trade credit behaviour of the SMEs, with specific focus on the acceptance of trade credit between certain time periods for creditors. The aim is to identify whether the respondents accepted more or less trade credit from other lenders between different time periods ranging from 0 to 2 years.

Table 5.51: Acceptance of trade credit by SMEs between the following time periods: 0-6 months, 7-12 months and 13 months-2 years

	Time periods	Frequency: yes	Percentage	Frequency: no	Percentage
Acceptance of trade credit by the respondents	0-6 months	61	40.1	91	59.9
	7-12 months	53	34.9	99	65.1
	13 months-2 years	81	53.3	71	46.7

From the above findings, it can be observed that SMEs accept more trade credit within the previous 13 months to 2 years than recently within the current year of operation. It can also be observed that SMEs accept more trade credit in the last six months (0-6 months) of recent operation than in the later six months (7-12 months) within that specific financial year. The results indicate a decrease in the acceptance of trade credit by SMEs, specifically within the most recent year of operation, as a total of only approximately 35% of all the respondents did accept trade credit between 7 and 12 months within the recent year of operation.

Graph 5.1: The extension and acceptance of trade credit by SMEs between the following time periods: 0-6 months, 7-12 months and 13 months-2 years



Note that series 1 represent the decision to extend or accept trade credit and series 2 represent the decision to not extend or accept trade credit as expressed by the SMEs within the particular time periods. The findings related to sections 5.12.1 and 5.12.2 indicate an increase in the extension of trade credit by SMEs, specifically within the most recent six months of operation, compared to a decrease in the acceptance of trade credit by SMEs for the first six months (7-12 months) within that specific financial year of operation, followed by an increase in the last six months (0-6 months) of recent operation. Therefore, this situation could further lead to cash-flow constraints for the SMEs, as more credit is being extended to debtors and less credit granted by the creditors of the SMEs for the financing of purchases.

The next section focuses on the findings related to the perception of the management of trade credit for the respondent.

5.13 The perception of the management of trade credit (focusing on debtors and creditors)

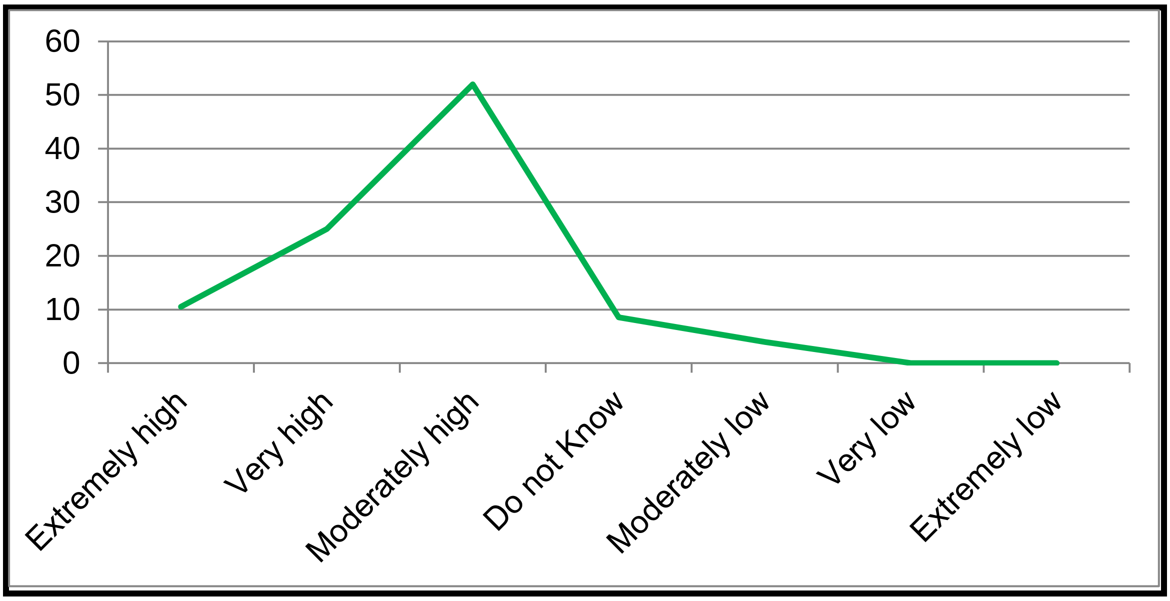
Section 5.13 presents the empirical findings related to the perception of the respondents regarding the management of trade credit within the SME, focusing on both debtors and creditors.

Table 5.52 illustrates the respondents' perception related to the SMEs' management of trade credit.

Table 5.52: How would you rate the possibility of SMEs failing due to the mismanagement of trade credit by managers in the SME?

How would you rate the possibility of SMEs failing due to the mismanagement of trade credit by managers in the SME?	Frequency	Percentage	Mean
Extremely high	16	10.5	
Very high	38	25	
Moderately high	79	52	
Do not know	13	8.6	
Moderately low	6	3.9	
Very low	0	0	
Extremely low	0	0	
TOTAL	**152**	**100**	**2.70**

Graph 5.2: The possibility of SMEs failing due to the mismanagement of trade credit by managers within the SME (presented in percentages)



Respondents were asked to rate, on a scale question provided in the questionnaire, the possibility of SMEs failing due to the mismanagement of trade credit by managers within the SME. The above findings illustrate that approximately 11% of all the respondents rate the possibility of SMEs failing due to the mismanagement of trade credit by managers within the SME as extremely high; 25% rate the possibility of SMEs failing due to the mismanagement of trade credit by managers within the SME as very high, and 52% rate the possibility of SMEs failing due to the mismanagement of trade credit by managers within the SME as moderately high. A total of 87.5% of all the respondents rate the possibility of SMEs failing due to the mismanagement of trade credit by managers within the SME as either moderately high (biggest significance), very high (second to moderately high) and extremely high (third to very high). Only 8.6% of the respondents rate the possibility as do not know, followed by 3.9% of all the respondents rating the possibility of SMEs failing due to mismanagement of trade credit by managers within the SME as moderately low.

Table 5.52 also indicates a mean score of 2.70, indicating that respondents rate the possibility of SMEs failing due to the mismanagement of trade credit between very high and moderately high, leaning towards moderately high. Therefore, the above findings indicate that SMEs rate the possibility of SMEs failing due to the mismanagement of trade credit by managers within the SME as high.

The previous section explained the empirical findings related to the management of trade credit by SMEs, with the focus on the management of debtors and creditors.

5.14 CONCLUSION

This chapter presented the empirical findings of this study. The main objective of this chapter was to present, assess and examine the research results of the empirical study. The use of the Kolmogorov-Smirnov test ensured the normality of the data. The response rate for SMEs was 43.2%. Thus, the mean response rate for all the respondents was 43.2%.

The empirical data were presented in sections 5.4 to 5.13. Section 5.4 examined the empirical findings on demographic variables by means of tables, figures and graphs. Sections 5.5 to 5.13 presented the empirical findings on the management of trade credit by SMEs, focusing on the management of debtors and creditors, by means of tables, figures and graphs.

The next section explains the final conclusion related to the empirical findings on the management of trade credit by SMEs, focusing on the management of debtors and creditors.

5.14.1 Final conclusion related to the empirical findings on the management of trade credit by SMEs (focusing on the management of debtors and creditors)

In conclusion, the aim of this research was to determine the trade credit-management practices of SMEs in order to establish whether SMEs find it difficult and therefore struggle to manage trade credit successfully and fail to use trade credit effectively as a source of funding. The trade credit-management practices of SMEs were comprehensively explained in sections 5.5 to 5.13.

In sections 5.5 to 5.13, this study identified the following as reasons why SMEs struggle to manage trade credit successfully and fail to use trade credit effectively as a source of funding:

1. The existence of bad debt within the SME. A large percentage of the total population do struggle with bad debt and regard a significant percentage of their total sales as bad debt. The findings also indicated that 50.7% of the population sales are on credit.
2. SMEs are constantly receiving late payment from debtors. The findings indicated that, for 60.9% of the total population, receiving late payment from debtors and debtors that are exceeding their credit terms, are the main problems when managing trade credit.
3. SMEs also struggle with cash-flow problems, the management of debtors, and the problem of receiving late payment form debtors/customers. The findings indicated that cash flow, the management of debtors, and late payments received by debtors/customers are definite problems and major constraints to the SME when managing trade credit.
4. SMEs are not making use of a credit policy when granting trade credit. As stated earlier, the findings indicated that 58.6% of the total population does not make use of a credit policy when granting trade credit. In addition, when respondents were asked to identify the type of credit policy they use when granting trade credit, the finding indicated yet again that approximately 37.5% of the total population do not make use of a credit policy when granting trade credit to a customer.
5. SMEs perceive their current credit policies as slightly ineffective. Respondents were asked to identify the extent to which they perceive their SME's credit policy as effective. The findings indicated that 35% of the total population perceive their current credit policies as slightly ineffective.
6. SMEs prolong the payment owed to other SMEs and/or suppliers. The findings indicated that SMEs do struggle with late payment from debtors and, for that reason, SMEs prolong payments owed to their creditors and/or suppliers. The findings indicated that a relative small portion (0%-25% of total creditor accounts), for a large group of the total population (55.3%), is not settled by the SME on the due date, as agreed upon with the supplier.

Furthermore, 24.3% of the total population indicated that between 26% and 50% of their total creditor accounts are not settled on the due date.

7. Late payments made by SMEs to their creditors and/or suppliers. Of the total population, 39.5% indicated that they definitely encounter problems regarding late payments made to creditors and/or suppliers, 59.2% of the total population makes purchases on credit.
8. SMEs that are struggling with the management of debtors, as a primary constraint in managing the SME's trade credit, are also struggling with the management of the SME's creditors and vice versa. Of the total population, 74.3% indicated that the management of trade credit is a problem in their SMEs.
9. The proportion of debtors that do not pay on the due date, relative to total debtor accounts, is equal to the proportion of creditors that are not paid on the due date, relative to total creditor accounts. Therefore, due to SMEs prolonging payments owed to other suppliers, SMEs indicated that they are, in fact, responsible for late payments made to suppliers. Due to the large percentage of the total population purchasing on credit, the situation is even more problematic. Ultimately, SMEs indicated that, due to the large proportion of debtors that do not pay on the due date, they are forced to prolong the outstanding payments owed to suppliers. This can have a devastating and negative impact on SMEs and the trade credit-management practices of SMEs operating within the same industry.

The next chapter examines the conclusions and recommendations of this study. In addition, the achievement of this study's objectives is also presented. Limitations of this study and areas for future study are also discussed.

CHAPTER SIX

CONCLUSIONS AND RECOMMENDATIONS

6.1 INTRODUCTION

This chapter concludes a study that was undertaken to determine the trade credit-management practices of SMEs in the Free State Province of South Africa in order to determine whether SMEs struggle to manage trade credit successfully and fail to use trade credit effectively as a source of funding. This chapter proceeds as follows. It presents a brief summary of each chapter of this study, including the empirical findings. The ensuing sections highlight the achievement of objectives, followed by some additional findings to this study. The next section identifies the limitations of this study. The last sections present the recommendations and examine areas for further study. The final section concludes this study.

6.2 SUMMARY OF CHAPTERS

This study comprises six chapters. Each chapter will now be summarised.

6.2.1 Introduction to this study (Chapter one)

The primary focus of this dissertation was to determine the trade credit-management practices of SMEs in order to establish whether SMEs struggle to manage trade credit successfully and fail to use trade credit effectively as a source of funding. In 2009, the unemployment rate was 24.5%, according to Statistics South Africa (2009). The three major challenges that South Africa faces in its development process are high unemployment, income inequality, and high levels of poverty. The development of SMEs is viewed as one of the most important vehicles in addressing these development challenges. Economic stagnation will be the final result for a country that does not possess a high new firm start-up rate. The development of new firms results in a country’s higher economic growth and has a positive impact on income inequality and, even more importantly, job creation (Mass & Herrington, 2006). Based on the introduction and the background to this study, the aim of this research was: *To determine the trade credit-management practices of SMEs in order to establish whether SMEs find it difficult to manage trade credit successfully and fail to use trade credit effectively as a source of funding.*

6.2.2 Debtors and credit policies for SMEs (Chapter two)

Chapter two focused on debtors, credit policy and the credit decision for SMEs. It emphasised that poor management of trade credit by SMEs in South Africa is a problem that leads to the failure of SMEs in growing into viable and successful organisations. Peel *et al.* (2000: 18) pointed out that SMEs are major receivers of trade credit and they, therefore, rely on trade credit as a highly important source of finance. Subsequently, SMEs exhibit volatile cash flows. The late payment of debt between SMEs restrains growth among smaller enterprises; this is a serious consequence of poor management of trade credit (Wilson & Summers, 2002: 320). The conclusion to this chapter, as pointed out by Peel and Wilson (1996) is that “fewer firms will fail and that economic growth will ultimately increase substantially when important aspects of trade credit are managed more effectively in organisations”.

6.2.3 The business environment and SMEs (Chapter three)

Chapter three examined the literature in respect of the business environment and SMEs. It specifically reviewed the literature on how the business environment can impact on the management of trade credit for SMEs. The focal point is that there are certain factors in the internal and external business environments of SMEs that contribute to trade credit being poorly managed by credit managers in the SME. This mismanagement of trade credit has a negative impact on the cash flow of the SME, ultimately forcing the SME into insolvency. The internal environment includes factors such as managerial competencies, collateral, financial and business information, and networking. In addition, literature on the impact of external environment factors such as the legal system, ethics, macroeconomic conditions and corruption was explained. The conclusion of this chapter, as pointed out by Beck (2007: 404), was that "there is the need to investigate empirically the impact of the business environment on the management of trade credit among SMEs in South Africa".

6.2.4 Research methodology (Chapter four)

Chapter four of this study addressed the research methodology. It examined aspects of this study such as the business research process that was followed. A number of steps in the business research that focus on the systematic gathering of information using accepted methods of analysis as a basis for drawing conclusions (Cooper & Schindler, 2003: 64) were discussed in detail to form part of the methodology for this study. These steps included:

- Problem statement and research objectives.
- Research design.
- Selecting the primary data-collection method.
- Sample design.
- Method of data collection.
- Date analysis.
- Reporting the results.

The population frame of SMEs was obtained from the CDS that published a list of SMEs in the Mangaung district in 2012. The researcher focused on SMEs in the agricultural, construction, financial, food, health, manufacturing, retail, solar, transport and distribution, wholesale and other sectors or industries. SMEs were grouped according to the specific sector or industry of operation. This study made use of an online questionnaire to reach the respondents through an electronic link sent to respondents via e-mail. Data collected was transformed into a more suitable format of analysis by using Excel software. After data processing, the Statistics Package for Social Sciences (SPSS) was used for data analysis. Data was analysed using the following statistical techniques: descriptive statistics, frequencies, cross-tabulations and mean scores. In addition, by means of comparison testing between two different classification values, namely debtors and creditors, corresponding data was analysed using the matched samples t-test and the McNemar test.

6.2.5 Research findings (Chapter five)

The research findings were explained according to the format of the questionnaire presented to the respondents.

- Response rate

The response rate for the SMEs was 43.2%, which is also the mean response rate for this study. A total of 352 questionnaires were sent out, of which 152 were completed and returned.

- Demographics of the respondents and the SMEs

The demographic variables included the respondents' job description, age, gender, educational qualifications, and number of years' experience in managing trade credit. Furthermore, the demographic variables for the SMEs also included the type of industry in which the SME operates, the number of SME employees, dependency of the SME or whether it belongs to a group, a description of the SME's clients, and the average monetary value of a transaction. The results indicated that the largest percentage of respondents were debtor and creditor clerks. The average age of the respondents is 35 years, with 21 years being the youngest and 67 years the oldest age for a respondent. For the total population, males were the dominant gender. In addition, the results indicated that the largest percentage of the total population have post-matriculation qualifications. Of the total population questioned, 47% have degrees and postgraduate degrees or higher.

In identifying the type of industry in which the SMEs operate, the results indicated that 23.7% of the total population operates in the manufacturing industry and 23% in the agricultural industry. In indicating the number of employees per SME, the results revealed that the largest percentage of the total population has between 0 and 50 employees in their SME. In addition, 67% of the total population questioned belongs to a group of SMEs and 32% are independent. In identifying the type of client for

SMEs, the results proved that 63% of the total population questioned has businesses as clients. In identifying the average monetary value per transaction, the majority of the total population specified that the average monetary value of a transaction was between R0 and R1 000.

To further strengthen the research results of this study, three additional sections, as part of the demographic findings, were identified and formed part of the demographics of this study (refer to 5.4 in chapter 5).

The credit portion of the SMEs' monthly sales indicates that the majority of the SMEs (50.7% of the total population) sell between 76% and 100% on credit. Therefore, it can be concluded that the largest percentage of respondents sells a significant percentage of their products and/or services on credit. Of the total population, 59.2% of the SMEs purchase between 76% and 100% on credit. Therefore, it can be concluded that the majority of purchases for SMEs is on credit.

The aim of the second additional section, within the demographic findings in chapter five, was to indicate whether the management of trade credit is a problem in the SME. It must be noted that this question (as with all other questions in the questionnaire) was asked directly to the relevant person working with the trade credit of the particular SME. Of the respondents, 73% indicated that the management of trade credit is a problem in their SMEs, which is substantial.

In addition, the results specified that 70.4% of the respondents have managed trade credit for between 1 and 10 years. With regard to the separate management of debtors and creditors, the results indicated that the largest group of respondents (76.3%) has between 1 and 5 years' work experience in managing debtors; 42.1% has between 1 and 5 years' work experience in the management of creditors, and 48.7% perceive themselves as knowledgeable concerning the credit policy of their own SME compared to 51.3% of all the respondents that perceive themselves as moderately knowledgeable concerning the credit policy of their suppliers/creditors from which they accept trade credit.

- The management of trade credit by SMEs focusing on the management of debtors

The aim of this section of the questionnaire was to answer the secondary objective applicable to the debtor section of the SME. The remaining section of this chapter explains the conclusions to these secondary objectives as applicable to the debtor section of the SME (refer to 6.4). In addition, the last section of this chapter concludes the empirical findings on the management of trade credit by SMEs, focusing on the management of debtors (refer to 6.8).

- The management of trade credit by SMEs focusing on the management of creditors

The aim of this section of the questionnaire was to answer the secondary objective applicable to the creditor section of the SME. Section 6.4 explains the conclusions to these secondary objectives as applicable to the creditor section of the SME. The last section of this chapter concludes the empirical findings on the management of trade credit by SMEs, focusing on the management of creditors (refer to 6.8). Debtors and creditors formed the two classification values for comparison testing.

6.3 ACHIEVEMENT OF OBJECTIVES

This section measures the achievement of the research objectives formulated in chapter one of this study.

The primary objective of this study was to determine the trade credit-management practices of SMEs in order to establish whether trade credit is being mismanaged by SMEs in South Africa.

The achievement of the primary objective was dependent upon realising the following secondary objectives:

- To evaluate the importance of effective trade credit management (focusing on debtors and creditors).
- To identify the trade credit situation within SMEs (focusing on debtors and creditors).

- To identify the activities and measures used by SMEs to reduce late payment.
- To evaluate the importance of a sound and structured credit policy when granting trade credit.
- To identify aspects of SMEs' trade credit-management practices that represent major constraints in the SME sector (focusing on debtors and creditors).
- To determine the different trade credit terms being used and/or accepted and granted by SMEs (focusing on debtors and creditors).
- To determine the different credit policies used by SMEs when granting credit to a customer.
- To enable SMEs and small firms to use the results of this study in assessing the appropriateness and effectiveness of their own practices.

The first objective was to evaluate the importance of effective trade credit management (focusing on creditors and debtors). This was achieved in chapter five of this study and focused on the SMEs' debtors and creditors. The empirical study revealed that SMEs perceive effective trade credit management, focusing on the management of debtors and creditors, as important.

The second objective was to identify the trade credit situation within SMEs. This was achieved in chapter five of this study.

Focusing on debtors in identifying the trade credit situation in SMEs, the results proved that a large percentage of the total population (29.6%) regard a significant percentage of their total sales (31%-60%) as bad debt. In terms of the portion of debtors paying on the due date, compared to the total number of debtors accounts, the findings proved that SMEs only receive a small percentage of their total debtor accounts owed to them on the due date and that, therefore, a substantial percentage of their total debtor accounts are not settled by the debtor on the due date for the majority of the population. Findings from chapter five indicated that, for 39.5% of the respondents, debtors do pay on the due date as agreed upon in the credit policy, but these debtors only settle 0%-25% of the SMEs' total number of debtor's accounts on the due date. By comparison, 15.1% of the population indicated that they receive between 76% and 100% of their total number of debtor's accounts on the due date. The findings are in line with the previous findings regarding the bad debt situation, relative to sales for SMEs, due to 39.5% of the population indicating that they do not receive 75% of their total debtor accounts on the due date from debtors. SMEs are, therefore, struggling to effectively manage debtors and are definitely struggling to effectively prevent debtors from paying later than the due date. The findings also proved that SMEs do not receive a substantial percentage of their total debtor account owed to them on the due date, as agreed upon between the SME and its debtors. Findings from chapter five indicated that, for 49.3% of the respondents, debtors do not pay on the due date, as agreed upon in the credit policy, as 0%-25% of their total debtor accounts are not settled by their debtors on the due date. This finding suggests that SMEs do not receive a substantial percentage of their total debtor account owed to them on the due date, as agreed upon between the SME and its debtor. The problem of receiving late payment from debtors is evident and a major cause for concern to SMEs. The finding also questions the ability of SMEs to prevent the devastating impact of late payments from debtors in their own enterprises. The results proved that 26.3% of the total population possess debtor accounts (81-100 active debtor accounts). The results indicated that a large part of the total population does extend trade credit to other SMEs and/or customers. Only a small part of the total population does not extend any trade credit to debtors/customers (5.3% of the total population possess 0 debtor accounts). In indicating how often the SMEs receive payment from debtors later than the due date, the results proved the following. Of the total population, 33.6% indicated that they sometimes receive payment from debtors later than the due date, compared to 23% of the population that always receive payment from debtors later than the due date, thus on a date later than what was agreed upon between both parties. The finding is also an indication that debtors of the SMEs do prolong the payment owed to them.

Focusing on creditors in identifying the trade credit situation in SMEs, the findings indicated that 47.4% of the respondents have between 1 and 20 active creditor accounts. Part of the total population does not accept any trade credit from other SMEs when purchasing from them (17.1% of the total population possess 0 creditor accounts). In addition, a relatively small percentage of the total population does accept trade credit, to a large extent, in financing their purchases on a short-term basis (14.5% of the total population possess 81-101 and above active creditor accounts). The findings also proved that SMEs do prolong the payment owed to other SMEs and/or suppliers. In terms of the portion of creditors being reimbursed on the due date by the SME, compared to the total number of creditor accounts, the findings proved the following. For 35.5% of the respondents, only 0%-25% of total creditor accounts are settled on the due date as agreed upon between the SME and its creditor/supplier. Therefore, as stated earlier, this finding suggests that SMEs do prolong the payment owed to other SMEs and/or suppliers, because a relative small portion, for a relative large group of respondents (35.5%), of total creditor accounts are settled by the SMEs on the due date, as agreed upon with the creditor/supplier. For 55.3% of the respondents, 0%-25% of total creditor accounts are not settled on the due date, as agreed upon between the SME and its creditor/supplier. The findings suggest that SMEs do prolong the payment owed to other SMEs and/or suppliers and that a relative small but substantial portion, for a large group of respondents (55.3%), of total creditor accounts are not settled by the SME on the due date, as agreed upon with the creditor/supplier.

The three comparison tests in this objective identified that there is a significant difference in the average number of accounts between debtors and creditors for SMEs as the p-value is 0.000, which is less than 0.1, and therefore a significant difference in the average number of accounts between debtors and creditors. Thus, on average, SMEs possess more debtor accounts than creditor accounts. In addition, the findings indicated that there is no significant difference in the proportions of debtors who make payments on the due date and the proportions of creditors who receive payments on the due date. The findings indicated that SMEs receiving payment on the due date from debtors will also make payment to creditors on the due date. Lastly, the findings indicated that there is no significant difference in the proportions of debtors who do not make payments on the due date and the proportions of creditors who do not receive payments on the due date. Therefore, SMEs that do not receive payment on the due date from debtors will also not make payment to creditors on the due date.

The third objective was to identify the activities and measures used by SMEs to reduce late payment. This was achieved in chapter five of this study and only focused on the debtor section of the SME. First, and focussing on activities for SMEs, the results proved that all fourteen activities have means above 3. This indicates that SMEs perceive all activities (refer to 5.7.1 in chapter five) as important to reduce the possibility or reality of receiving late payment from a debtor. Secondly, and focusing on measures for SMEs, results proved that four out of the six measures (refer to 5.7.1 in chapter five) have means above 3, indicating that SMEs perceive most of the measures as important to reduce the possibility or reality of receiving late payment from a debtor.

The fourth objective was to evaluate the importance of a sound and structured credit policy when granting trade credit. This was achieved in chapter five of this study and only focused on the debtor section of the SME. The results proved that the existence of a sound and structured credit policy, when granting trade credit, is viewed as important to SMEs. The results also proved that the credit period component has the highest mean of all other components in evaluating the importance of a sound and structured credit policy when granting trade credit by SMEs. All seven credit policy components had means above 3, indicating that SMEs perceive all seven credit policy components as important.

The fifth objective was to identify aspects of the SMEs' trade credit-management practices that represent major constraints in the SME sector (focusing on creditors and debtors). This was achieved in chapter five of this study and focused on both the debtor and creditor sections of the SME.

Focussing on debtors, the findings proved that the main problem for SMEs, when managing trade credit, is receiving late payment form debtors and that debtors are exceeding their credit terms, with 60.9% of the respondents agreeing to that. In addition, cash flow, bad debts (although to a lesser extent), late payments received by debtors/customers, and the management of debtors are definite problems, as indicated by the total population, when managing trade credit. Of these four problems (refer to 5.9.1 in chapter five), that of late payments received by debtors/customers, according to the findings, is the most important problem to be addressed by SMEs, with 78.2% of the respondents agreeing to that. Of the total population, 53.9% also indicated that the management of trade credit is a definite problem in their SMEs (refer to 5.4.11 in chapter five). Of the total population, 52% rated the possibility of SMEs failing due to mismanagement of trade credit by managers in the SME as moderately high (refer to 5.13 in chapter five).

Focusing on creditors, the findings proved that 48% of the total population encountered not any and/or slight problems regarding late payments made to creditors; 40.8% regarded late payments made to creditors as somewhat of a problem and/or a definite problem when managing trade credit. The findings also proved that 57.3% of the total population perceived the management of creditors as somewhat of a problem and/or a definite problem when managing trade credit; 29.6% perceived it as not any and/or a slight problem when managing trade credit. Of these two problems, the problem of late payments made to creditors, according to the findings, is the most important problem to be addressed by SMEs.

The two comparison tests within this objective identified the following. First, there is a significant difference in the extent of the constraint of late payments received by debtors and late payments made to creditors. Thus, SMEs that are struggling with late payments from debtors are not necessarily also guilty of making late payments to creditors. Those SMEs that pay creditors later than the due date are not necessarily also receiving payment from debtors later than the due date. Secondly, the findings indicated that there is no significant difference in the extent of the constraint for the management of debtors and creditors. Therefore, SMEs that are struggling with the management of debtors, as a primary constraint in managing the SME's trade credit, are also struggling with the management of the SME's creditors. Those SMEs that are struggling with the management of creditors, as a primary trade credit-management constraint, are also struggling with the management of the SME's debtors.

The sixth objective was to determine the different trade credit terms being granted and used and/or accepted by SMEs. This was achieved in chapter five of this study and focused on the SMEs' debtors and creditors.

Focusing on debtors, the results proved that 38.2% of the population grants trade credit on a 30 days or net 30 day basis and that 40.8% also arranges an average debtor days of 55 days with their customers.

Focusing on creditors, the findings showed that 38.8% of the total population receives trade credit from its suppliers not on any specified or agreed upon terms. Furthermore, the findings indicated that 52.6% of the total population arranges an average creditor days of 30 with their suppliers when identifying the trade credit situation in the SME.

The comparison test within this objective identified that there is a significant difference between the average number of debtor days and the average number of creditor days as the p-value is equal to 0.094, which is less than 0.1. The finding indicates a significant difference in the average number of debtor days and the average number of creditor days for SMEs. This finding indicates that, on average, the number of days within which a SME receives payment from a debtor is shorter than the number of days within which the SME ultimately makes payment to a creditor. This suggests that less strain should be placed on the cash-flow demands of SMEs.

The seventh objective was to determine the different credit policies used by SMEs when granting credit to a customer. This was achieved in chapter five of this study and focused only on the SMEs' debtor. The findings proved that 58.6% of the total population does not make use of a credit policy when granting trade credit. In the second section of this objective in the questionnaire, respondents were asked to identify the type of credit policy they use when granting trade credit. The finding proved that 37.5% of the total population does not use a credit policy. This could also be regarded as an important reason why trade credit is being mismanaged by SMEs. Lastly, in the third section of this objective in the questionnaire, the findings proved that 34.9% of the total population perceive, to a large extent, their current credit policies as slightly ineffective.

The eighth objective was to enable SMEs and small firms to use the results of this study in assessing the appropriateness and effectiveness of their own practices.

6.4 ADDITIONAL FINDINGS

Two additional sections, to further strengthen the research results of this study, were identified and formed part of the empirical secondary findings of this study (refer to sections 5.12 and 5.13 in chapter 5).

Findings on the trade credit behaviour of the SMEs, with specific focus on the extension of trade credit between certain time periods to debtors, indicated the following. SMEs extended more trade credit within the recent six months of operation when compared to the last six months of the current year of operation and the previous year. Findings on the trade credit behaviour of the SMEs, with specific focus on the acceptance of trade credit between certain time periods from creditors, indicated the following. SMEs accepted more trade credit within the previous 13 months to 2 years of operation than recently within the current year of operation. It is clear from the above findings that more credit is being extended to debtors and less credit is being granted by the creditors for the financing of SMEs' purchases. Therefore, the situation could lead to cash-flow constraints for SMEs, especially when creditors are less willing to extend trade credit and are forcing the SMEs to pay cash for future purchases.

Respondents were also asked to rate the possibility of SMEs failing due to mismanagement of trade credit by managers in the SME. The findings indicated that 52% of the total population rates the possibility of SMEs failing due to mismanagement of trade credit by managers in the SME as moderately high. This finding also questions the managerial competencies of managers in these SMEs in managing the SMEs trade credit effectively. More specifically, the finding questions whether these managers possess the necessary skills to manage their SMEs' trade credit effectively.

6.5 LIMITATIONS OF THIS STUDY

This section intends to highlight certain problems that were not adequately covered in this study. This study was a regional study and focused only on SMEs in the Mangaung district in the Free State Province of South Africa. There is a definite need to initiate this study on a national basis. A limitation can exist in the generalised uniqueness of the geographical region. SMEs situated in other geographical regions of South Africa could have different opinions and particulars.

Another limitation of this study is that only the literature, the business environment and SMEs (refer to chapter three) investigated the internal and external business environment variables that impact on the management of trade credit for SMEs. There is the need to empirically investigate the internal and external business environment variables that could impact on the management of trade credit for SMEs.

Lastly, not all the factors in the business environment were considered in the literature study. Factors such as the international environment were not included.

6.6 RECOMMENDATIONS

The following recommendations with regard to this research study are made. SMEs have a major role to play in the South African economy. They are a vital source of poverty alleviation, reduction of income inequality, and economic growth. Furthermore, the creation and development of SMEs contribute towards employment, improved living standards and help diversify economic activity. The mismanagement of trade credit is a key obstacle to their survival and growth. The use of a sound and structured credit policy is essential in minimising the effect of late payments from debtors and, therefore, recommended. All vital credit policy components must form part of the SMEs' credit policy before providing customers with the relevant policy. These credit policy components must enforce a reduction in the amount of outstanding invoice still owed to the SME as well as a reduction in bad debt expenses for the SME. SMEs must begin to adopt a more rigid credit policy approach. Due to the large number of SMEs selling on credit and perceiving their own credit policies to be slightly ineffective, this study recommends that SMEs tighten up their credit policies, especially with regard to the credit components within the credit policy.

SMEs should try not to prolong the payment owed to other SMEs and/or suppliers. In doing so, SMEs will create a more secure climate for themselves and their creditors/suppliers in managing trade credit. Due to the large number of SMEs purchasing on credit and accepting, to a large extent, trade credit from their creditors/suppliers not on any agreed upon terms, this study recommends that SMEs agree to accept trade credit from creditors/suppliers on specific terms and conditions as set out in a credit policy between both parties before purchase.

It is also recommended that the government put certain measures and regulations in place to control the bad debt situation in the small-firm. Therefore, measures and regulations need to be put in place to control late payments made by the SMEs' debtors as well as measures and regulations to control the SMEs' actions to prolong outstanding payments to creditors/suppliers. Lastly, training and better communication can also help SME owners understand the concepts of effectively managing trade credit. Therefore, it is suggested that SME owners attend seminars based upon practical trade credit- and working capital-management techniques in enabling them to apply these practices to their own enterprise success. This will, in turn, provide SME owners with the necessary managerial competencies, skills and abilities to effectively manage their SME's trade credit practices.

6.7 AREAS FOR FURTHER RESEARCH

This research study endeavoured to obtain an indication of the trade credit-management practices of SMEs. This subject or research topic has not been covered extensively and not many enquiries were made in this field of study. Areas for future research in this field of study are:

- To empirically investigate the role of the business environmental factors (internal and external) that contributes to the mismanagement of trade credit among SMEs.
- To further empirically investigate the role of the business environmental factors (with specific focus on the international environment) that contributes to the mismanagement of trade credit among SMEs.
- Investigations into the various demographic variables, with specific focus on the dependency of the SME and the industry of operation, on the trade credit-management practices of these SMEs that fall within the parameters.

6.8 CONCLUSION

This chapter examined the conclusions, recommendations, achievement of objectives, limitations and areas for further research in respect of a study titled "*The management of trade credit in small and medium-sized enterprises*". Economic development challenges are common in developing countries. According to the World Bank (2008b), in a developing country such as South Africa, the three main development challenges are unemployment, income inequality and poverty. The creation and specifically the survival of SMEs hold the key to solving these development challenges for South Africa. A number of challenges cause the very high failure rate of SMEs in South Africa (Mass & Herrington, 2006). One of these challenges is the mismanagement of trade credit by SMEs. The purpose of this study was to determine the trade credit-management practices, specifically of SMEs, in South Africa, in order to establish whether SMEs struggle to manage trade credit successfully and fail to use trade credit effectively as a source of funding.

This study revealed a number of negative trade credit-management practices exercised by the SMEs themselves. These negative trade credit-management practices have a devastating impact on the SME as, in most instances; SMEs are also victims of negative trade credit-management practices. Ultimately, the consequences of these negative trade credit-management practices by SMEs have a devastating 'spill-over' effect on other SMEs and stakeholders operating in a similar industry and, therefore, negatively influence the individual SME, the market and the economy, in general.

Throughout this study, the necessity for SMEs to successfully manage trade credit constantly emerged, especially due to the lack of external funding for SMEs. Therefore, trade credit becomes the only available source of funding for the majority of SMEs. This study provided the unique opportunity to reveal and understand the trade credit-management practices of SMEs in the Free State Province of South Africa. It also provided a unique opportunity to explain why SMEs find it difficult and therefore struggle to successfully manage trade credit and, ultimately, fail in effectively using trade credit as a source of funding.

SMEs depend on trade credit as a vital source of funding. The importance of effective trade credit management by SMEs is evident throughout this study and, therefore, necessitates the application of effective trade credit-management practices in growing into viable and sustainable businesses.

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APPENDIX 1: QUESTIONNAIRE (SMEs)

2013

Dear participant

My name is Werner Otto and I am a Junior Lecturer in the Department of Business Management at the University of the Free State's Faculty of Economic and Management Sciences. I am currently completing my Masters degree under the supervision of Dr. Liezel Alsemgeest. I am inviting you to participate in my research by completing a questionnaire.

My Masters study is entitled "The management of trade credit in small and medium-sized enterprises".

Through the questionnaire, I hope to be able to identify the trade credit-management practices of SMEs and make the necessary recommendations to appropriate authorities in order to enhance the trade credit-management practices.

The questionnaire should take approximately 15 minutes to complete. The information supplied by participants will be treated as strictly confidential. Completion of the questionnaire is voluntary. Should you wish to obtain a summary of the results of this research, I would be happy to send you a copy.

Please feel free to contact me at ottowh@qwa.ufs.ac.za with regard to any queries you may have, or my supervisor, Liezel Alsemgeest, on 0514017614 or at alsemgeestl@ufs.ac.za. Herewith the link to the online survey: <http://whotto.masters.questionpro.com>

Thank you very much for your time and support.

Regards
Werner Otto