THE ROLE OF MANAGEMENT STYLE ON THE PROPENSITY FOR LOAN DEFAULT BY SMALL BUSINESSES

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ABSTRACT

The potential of small businesses to contribute to economic development has been reduced by a cocktail of problems of which inaccessibility to finance in the form of institutional loans is pre-eminent. This problem is linked to lenders’ perception that small businesses are high-risk investments; a perception which is based on an estimation of small businesses’ ability to repay loans. Such estimates are quite often, reliant on financial indicators, which small businesses are not adept at using to signal their performance ability. As a means to redress the situation, recourse to the use of non-financial indicators to complement loan decision techniques of lenders seems imperative.

This study investigated the existence of a relationship between management style, an important non-financial variable and a small business’s propensity to default on loans. Generally, the manner in which a business is managed impacts on organisational outcomes. With regard to the outcome of a small business’s propensity to default on loans, therefore, the role of management is expected to be pivotal. The study empirically analysed quantitative and cross-sectional primary data collected from small businesses in the Durban metropolis of South Africa. Results point to the existence of a strong relationship between management style and propensity to default. This identified relationship should complement lenders’ ability to estimate loan default propensity, which should, in turn, ease the problem of inaccessibility to finance.

INTRODUCTION

The importance of the small business sector to the development of the economies of most countries in the world has become widely acknowledged (Ladzani & Vuuren, 2000). This, according to Liedholm (2002), can be attributed to the general recognition of the potential contribution of small businesses to economies; the result of which has made them a significant feature of the economic landscape of the world. On this basis, it seems that the role that these businesses can play in the overall development of a nation would be even more critical in Africa, owing to its under-development. The case of South Africa is no different, as the obstacles of the past, slow growth of employment and restructuring of the economy lend further impetus to the development and sustenance of a virile small business sector (Department of Trade & Industry, 1998). In reality though, this much touted potential remains inert as contributions made by the small business sector continue to fail to reflect it. For instance, while the sector employs more than half of the working population, it accounts for less than only one-third of the GDP in South Africa (Diedrichs, in Nieman, Hough & Nieuwenhuizen, 2003). The reason why this kind of situation subsists can be attributed to a number of constraints that beleaguer the sector.

Research efforts in small business have, therefore, been mainly pre-occupied with the identification of the factors that constrain the growth of the sector. Academic researches point to managerial ineptitude, organisational ineffectiveness (Dodge, Fuller & Robbins, 1994), inaccessibility to finance, poor infrastructure, weak policy support, low demand for products and difficulties in procuring materials for production purposes (Mambula, 2002; Mead & Liedholm, 1998) as some of these constraints. Among these constraints, the issue of inaccessibility to finance remains pre-eminent (Eyiah 2001; Ojo, 1995; Rogerson, 1995).
In spite of this, the general tendency of small business research in a specifically South African context continues to be that most studies take a wide-angle focus of the problems that are associated with the sector. This, in itself, means that studies concentrating on single constraints are scarce. Research, for instance, directly focusing on the tendency for loan default that small businesses exhibit, and which exacerbates their problem of inaccessibility to finance, is lacking. In precise terms, this finance problem is essentially one of inaccessibility to institutional credit (Eyiah, 2001; Kotey, 1999; Mambula, 2002) and can be attributed to the perception that investments in the sector are of a high-risk nature (Bridge, O’Neill & Cromie, 1998; Hughes, 1997); meaning that such investments portend a high probability of default. In South Africa, the risk of default is central to the reluctance of formal financial institutions (like banks) to lend to the small business sector (Department of Trade & Industry, 1998).

From banks’ or lenders’ viewpoints, this high-risk notion emanates from a predictive estimation of the default risk that small businesses embody in the debt-financing relationship (Kolori, Berney & Ou, 1997; Levitsky, in Eyiah, 2001; Ovadje, 2003). Such estimates often depend on historical and projected financial information, which small businesses are not known to be good at using to signal their performance ability (Keasey & Watson, 1991; McConnel & Pettit, 1984). This, therefore, makes it pertinent to explore complementary non-financial ways by which default risk may be estimated in a bid to reduce the problem of inaccessibility to finance.

Central to the notion of risk associated with the sector is the manner in which the small business is managed. Management is critical to the success or failure of businesses because it is concerned with the achievement of goals, through the use of human and other resources. In other words, the manner or style by which a business is managed would be expected to impact upon its performance. Furthermore, the performance or non-performance of a small business enterprise that has obtained a loan is likely to impact upon the firm’s ability to repay or default on its loan repayment obligations. Along this line of argument, therefore, the thesis of this paper is that management style (by the contributory role it plays in the performance of a business), would impact upon the business’s loan repayment ability and, if so, can be relied upon to predict loan default propensity.

This study aims to identify the style of management in small business organisations and empirically investigates the relationship between style of management and the organisation’s propensity to default on financial loans that are obtained from a bank. This should help the study find an answer to the question: “What is the relationship between management style and propensity for bank financial loan default in a small business?” Towards this end, this research is driven by the following objectives:

1. To determine the management style employed in running the affairs of the business;
2. To investigate the nature of association, if any, that exists between management style and propensity to default; and
3. To relate the loan default propensity category to which a business belongs to records of actual loan default incident(s).

Generally, there is a dearth of studies that are aimed at identifying the management style applied in a small business with a view to establishing its relationship with the propensity of the small business to default on a loan and, particularly, to determine strategies for overcoming the incessant problem of inaccessibility to finance. This kind of study is especially important because the findings would have important practical implications for both parties in the debt-financing equation for two reasons. First, it would complement existing methods of estimating small business loan default risk potential and improve the ability of the bank (or lender) to separate the borrower with a high potential for default from that which would meet its loan obligations. Second, it would provide an indication to small business owners or managers as to what style of management may place them in a better position to meet loan repayment obligations.
This paper comprises four sections and is structured as follows: The extant literature that is relevant to the inaccessibility to finance problem, as well as management style, is reviewed. This section is succeeded by a presentation of the research methodology and includes a discussion of the data collection and analysis techniques that were utilised. The penultimate section focuses on the results of the enquiry and the paper concludes with a discussion of theoretical and practical implications of the findings of the study, while recommending probable strands of future research.

SMALL BUSINESSES: ACCESS TO FINANCE AND DEFAULT IN LOAN REPAYMENT

A prime objective of a bank’s screening of the loan application of a small business is the identification of problem borrowers (Sinkey, 1992) with a view to denying them access to the loan sought. From a lender’s perspective, therefore, the primary concern of lending, according to Coleman (2000), is capital recovery, ideally within the desired time frame. While this is desired, it is not, in practice, always the case. For the purpose of this study, therefore, a default refers to a situation where a borrower fails to make a repayment towards a loan when it is due. Quite often, such incidents pose a concern for lenders owing to the time value of money. Similarly, there are concerns that the criteria used by lenders to estimate the loan default risk of a small business might themselves constitute obstacles to accessibility to finance.

There appears to be a dearth of research focusing on issues of default in the repayment of institutional loans received by small businesses. The difficulty in studying this phenomenon may be owing to the statutory duty of non-disclosure placed upon institutional lenders such as banks and the difficulty of accessing information on loan default from defaulters. The consequence of this situation has been the shift of most research interest toward broadly examining small business performance failure and success factors.

Nevertheless, a number of contributory factors to loan default by small business have been noted. Writers (Baumback, 1983; Hempel & Simonson, 1990) agree that high interest rates can bring about an incidence of default in repayment by the borrower. This view rests upon the fact that the profit made from operations by a small business may not be sufficient to make repayments based on the high interest rates on loans secured. Consequently, small businesses are unable to promptly and sufficiently meet their loan repayment obligations when they are due.

High transaction costs also pose a problem (Bhatt & Tang, 1998) and may effectively limit the ability of the small business firm to repay its loan. This, as is the case with high interest rates, may increase the amount of money that should be repaid for a loan obtained, which the small business may be unable to accommodate within the low-profit environment that they operate in. Low profits, which characterise the small business sector, can be attributed to stiff competition arising from the large number of businesses that operate in the sector. Quite often, the extent of competition is not properly articulated by small business owner/managers. It is against this background that Baumback (1983) proffers that under-estimation or inability to compete successfully can constitute an impediment to loans repayment, given that it impacts negatively on business performance. This inability to compete within a chosen environment appears to be a consequence of organisational decisions, which are products of the way the business is managed.

Owualah (1999) identified the incidence of provision of insufficient capital as another problem in the small business loan-financing arrangement. This leads to a situation of under-capitalisation of the enterprise (Baumback, 1983; Ojo, 1992), which invariably does not augur well for the performance of the small business. Such a situation may arise in cases where the bank estimates that the small business requires a lower value of loan than has been applied for in order to meet particular needs. On these grounds, the bank approves a lower loan amount based upon its own evaluation of the need to which the loan would be directed. Due to the insufficiency of the approved or disbursed amounts to the small business applicant, the enterprise may be unable to
achieve planned levels of performance. This under-performance negatively impacts upon the firm’s financial projections and its ability to meet its loan repayment obligations.

Loan repayment difficulties may also be attributed to unexpected delays in disbursement of the loan. Obitayo (2001) opines that unanticipated time lags between loan-request and loan-disbursements can create repayment problems for the small business enterprise. The dynamic and competitive nature of the small business environment makes timing an important factor of success. The value of opportunities are time-dependent and so delayed disbursement of loans can possibly have far-reaching effects on the opportunity targeted for exploitation by the small business, the result of which may manifest as problems in loan repayment.

Sometimes, the small business is faced with a dilemma of choosing between opportunities to which approved loans can be applied. This dilemma may arise from a scenario where loans have been disbursed at a time when the opportunity targeted has been overtaken by events or other opportunities have become more attractive. Such situations can often lead the small business to divert loaned funds to these other “attractive” opportunities. The incidence of diversion of funds (Hempel & Simonson, 1990) is not uncommon amongst small businesses and potentially affects the ability for loans repayment. This problem leads to default in repayment of loans owing to the fact that, in most cases, by diversion, the loans are often misapplied (Ozigbo, 2000).

While the use of collaterals is common among lenders, worldwide, as a means of securing loans, it can effectively exclude a good number of small businesses from the loan market. For those who are able to provide some form of collateral, legal constraints that are associated with recovering loans by attaching collateral assets may provide impetus for loan default. Eyiah (2001) contends that collateral enforcement difficulties are a major concern of lenders. The legal bottlenecks in the framework for enforcement sometimes work in favour of the defaulting borrower rather than the lender. This is because the legal process is usually time-consuming and complex. Even though this appears inadvertent, it can contribute to loan default amongst borrowers.

THE ROLE OF MANAGEMENT IN LOAN REPAYMENT

Different as the causes of default may be among small businesses, the central role of management who request, obtain and control the loan funds is critical. The success or failure of small businesses is, in most cases, down to the manner in which the business is managed. Along this stream of thought, therefore, the style of management as a determinant of the performance of small businesses should make it a key consideration in the lenders’ effort to estimate the loan default propensity of a borrower. This consideration contributes to the decision as to whether or not to incur the risk of lending to a particular small business. It is, therefore, suggested that in the process of deciding to lend, indicators of business success can and often do serve as veritable proxies for the ability to repay the loan (Altman, 1983). This argument provides a major thrust of this study and influences the theoretical framework. The expected tendency is that a lender would opt to lend to a potential business success rather than a potential business failure. Why? One answer would be that, while success improves the ability of an organisation to meet its obligations to the lender, business failure inhibits it. Business prosperity is, therefore, expected to bear an inverse relationship with loan default propensity. Therefore, the paucity of literature specific to small business loan default is overcome by relying on studies that have investigated business performance.

The central and influential role that the owner/manager plays in the success or performance of the firm has been established (Roper, 1999). Herron and Robinson (1993) opine that he/she is the major determinant of the performance of a firm. On a similar note, Hambrick and Mason (1984) suggest by their “upper echelons” theory that organisational outcomes are dependent upon managerial characteristics of top management. Common to these viewpoints is the fact that the
performance of small businesses or their organisational outcomes are inextricably tied to management. Over and above the role or characteristics of the owner/manager, what may be of even more importance is how these eventually manifest in organisational outcomes. In other words, it is the manner in which business operations are guided and decisions made by management, which is key to such outcomes.

In identifying the central explanatory element for the performance of the small business, attention, therefore, deserves to be paid to the style of management employed in running the organisation. Scholars (Chandlier & Hanks, 1994; Child, 1973; Daft, 2005; Kallberg & Leicht, 1991) support the argument that management is central to performance and success/failure of a business organisation. This is even truer for small businesses where the role of management is often a domineering one. On the strength of the positions advanced by some of the scholars referred to, this study argues that the propensity of a small business to default, which, in itself, is an outcome of choices or decisions made by its management — much like organisational performance — can be estimated from knowledge of the style of management employed for running the business.

While there may be other organisational characteristics that contribute to the success of a business enterprise, of interest to this study is management style because of its pervasive nature especially in small businesses. This study is specifically focused on the extent to which management is participative and involves employees within the organisation as opposed to an autocratic management style. The belief is that the participatory approach should augur well for small businesses because of the notion that management is about getting things done through others in pursuit of the attainment of organisational objectives (Mullins, 1999). This may be because it creates a sense of importance in the employee by allowing him/her contribute to decision-making. Similarly, it avails management of a diverse range of ideas from different viewpoints. Generally, therefore, to secure a desirable level of commitment to the pursuit of organisational objectives, a participatory approach to management is thought to be more suitable.

Management theories are mostly concerned with the degree of focus and extent of concern that management has for tasks as opposed to employees. These task-centred and employee-centred dimensions of management also find a corollary in leadership literature (Bartolome & Laurent, 1989). The concepts of leadership and management seem closely related as it is increasingly difficult to separate them as distinct activities (Mullins, 1999) especially within a business organisation. Therefore, the managerial style dimensions which focus on task or people can be aligned with the behavioural leadership propositions of structure and consideration of the Ohio State studies, production-centred and employee-centred propositions of the University of Michigan studies, as well as McGregor’s theories X and Y whose basis is task-behaviour and relationship-behaviour among others. Along similar lines, Martin (2001) notes that Likert’s four-fold model of management systems designates different management styles by numbers:

- **System 1 Exploitative Autocratic**: where there is no confidence or trust in subordinates
- **System 2 Benevolent Autocratic**: where there is little confidence and trust in subordinates
- **System 3 Participative**: where there is significant confidence and trust in subordinates
- **System 4 Democratic**: where there is complete confidence and trust in subordinates

While systems 1 and 2 are closely related with a task-focus, systems 3 and 4 are relationship or employee-centred. Martin (2001) suggests that the trend from the results of the research, which was conducted by Likert, indicate that more success seemed to be attained by the application of systems 3 and 4 in comparison to systems 1 and 2. While acknowledging this opinion, research into the most effective styles of management in the work organisation is hardly conclusive as much depends upon contingent variables in each situation. Nevertheless, according to Mullins (1999), works of Likert and McGregor as well as Blake and Mouton suggest that an organisation is more likely to effectively harness its human resources by the application of a participative style of
management. This observation bears the connotation that such organisations stand a better chance to attain higher performance levels, which invariably lead to successful operations. This, in the reckoning of this study, would reduce the propensity for loan default that the business embodies. Relying on this perspective, therefore, it is this study’s proposition that small businesses with a participative style of management will exhibit a lower propensity for financial loan-default.

Going by Likert’s findings (see Martin, 2001), an environment that promotes participation of employees will have higher levels of commitment to the pursuit of the goals of the organisation (given that all parties were involved in formulating such goals/objectives). This is likely to result in improved chances of business success and, consequently, a lower propensity for financial loan default.

METHODOLOGY

The central aim of this study was to establish if a relationship exists between management style and a small business’s propensity to default. Furthermore, the study sought to determine the extent of this relationship between default categories and incidents of actual loan default experienced by the small business. In order to achieve these, the study adopted a cross-sectional approach in which the survey method of gathering data was utilised. Though the study was a primary research, it was one of an applied nature, since it is problem-oriented and directed towards solving particular intellectual puzzles with practical implications. The original data collected were empirically analysed in accordance with the requirements of primary research.

The study population comprised enterprises in the small business sector operating in the Durban area of South Africa. Even though the study focused on a single location, the number of small businesses was still quite large. The population was, however, delimited to exclude those operating in the informal sector, as these businesses were unlikely to have any meaningful banking relationships that would have qualified them for bank loans. Only registered small businesses that had bank accounts were, therefore, considered for the study. While it was desirable to reach all elements that met the study population criteria, it was impracticable and this made the utilisation of a sample imperative.

It is acknowledged that there is an inherent risk in utilising a sample for research purposes because it presents a problem for generalisation of results (Zikmund, 2000) and the drawing of inferences about population elements outside of the sample. Against this background, the choice of trading-off the generalisation benefits of an all-inclusive respondent base with those of a better and detailed focus on study elements contained in the sample was irresistible. Moreover, the absence of a comprehensive compendium of businesses in the Durban/South African small business sector gave impetus for the use of a sample in this instance. A sampling frame was constructed from information that was obtained from the Durban Chamber of Commerce, an organisation whose membership is drawn widely from businesses operating in the formal sector. From this sampling frame, a simple random sample of 120 businesses was drawn. All members of the 120-group sample were contacted for the purpose of the study. The valid response rate attained was 30.8% (37 out of 120 businesses), which was satisfactory given the normally low response rates that are typical of small business research (Curran & Blackburn, 2001).

Questionnaires were utilised as instruments of data collection. Two types of questionnaire were developed and personally administered. Questionnaire 1 was administered to the owner/manager primarily to elicit responses relating to demographics of the organisation, as well as bank loans. The other, Questionnaire 2, was an adaptation of Likert’s instrument for determining management style and was administered to a few randomly selected employees within the small business organisation, which is a sample element. Both questionnaires were largely structured in composition as most questions took the form of a Likert 5-point scale. The questionnaires showed good test-retest reliability after being administered to a pilot group of five businesses prior to being administered to members of the final sample.
Data collected was coded and quantitatively analysed using SPSS package. Given that the number of valid responses received was small and that an assumption of normality was not made about the distribution, the study relied upon the use of non-parametric statistical methods. A correlation analysis that seeks to estimate the strength of association between the dependent variable of propensity to default and the independent variable of management style was undertaken. Cross tabulation of propensity to default categories with records of actual loan default further enhances the value of the findings of the study.

RESULTS

The results of the study are presented in three parts. The results of the validity and reliability tests on the management style and propensity to default scales used in the survey instrument are presented, followed by descriptive statistics pertaining to members of the sample group and loan-related matters. The final part of the results section reports the analysis of the association between the dependent variable of propensity to default and the independent variable of management style.

The management style scale and the propensity to default scale used in the questionnaires were subjected to reliability and validity tests. In this particular case, the reliability tests undertaken were to determine internal consistency based on the average inter-item correlation. An acceptable level of reliability (Cronbach’s alpha value of 0.97) and validity (KMO = 0.888) was realised for the 18-item management style scale. Similar results were also obtained for the 10-item propensity to default scale (Cronbach alpha value of 0.957 and KMO value of 0.914). Both results suggest that the scales were of satisfactory reliability and validity.

The small business respondents represented the entire spectrum of micro, very small, small and medium enterprises. The current state of employment of these companies suggests that 16.2% were in the “micro business” band and had less than five employees, 24.3% had 6–10 employees and, therefore, belonged in the “very small business” category. 45.9% belong in the “small business” category with a workforce of 11–50 employees, while 13.5% were made up of “medium businesses”, which employed between 51–100 persons (Department of Trade & Industry, 1998; South African Institute of Race Relations, 2004).

Figure 1: Sample Demographics

All the respondents had applied for loans more than once in the past. Between them, the 37 respondents had made 321 applications for bank loans in the past (an indication of the level of bank loan demand among small businesses). However, these applications had been successful only 109 times. All respondents indicated that they had obtained loans at least once in the past.
Table 1 below shows that over 94% of the respondents had obtained bank loans 1–5 times in the past. This percentage is expectedly high because it was a precondition for belonging in the study population. The greatest percentage of respondents (40.5%) had obtained bank loans three times in the past. More important, while obtaining loans is of interest to the small business, the banks are more concerned about the other part, which is the timely repayment of the loan (avoidance of default).

**Table 1: Number of bank loans obtained by businesses**

<table>
<thead>
<tr>
<th>No. of times loans were sought</th>
<th>No. of businesses</th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Once only</td>
<td>6</td>
<td>16.2</td>
<td>16.2</td>
<td></td>
</tr>
<tr>
<td>Two times</td>
<td>6</td>
<td>16.2</td>
<td>32.4</td>
<td></td>
</tr>
<tr>
<td>Three times</td>
<td>15</td>
<td>40.5</td>
<td>73.0</td>
<td></td>
</tr>
<tr>
<td>Four times</td>
<td>6</td>
<td>16.2</td>
<td>89.2</td>
<td></td>
</tr>
<tr>
<td>Five times</td>
<td>2</td>
<td>5.4</td>
<td>94.6</td>
<td></td>
</tr>
<tr>
<td>More than five times</td>
<td>2</td>
<td>5.4</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>37</strong></td>
<td><strong>100</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In deference to this concern of banks, the study attempted to determine the number of times a business may have failed to meet loan repayment obligations when they were due. Going by the definition of loan default adopted by this study, a failure to make a repayment when it is due amounts to a default. Table 2 shows that 40.5% of the respondents had not defaulted on loans previously obtained from banks. Conversely, 59.5% of the small business respondents had defaulted on repayment at some point in time. However, the incidence of default on successive loans seemed to be much lower as the table suggests that only 8.1% of the respondents had a case of default occurring on three bank loans, while none of the respondents appear to have defaulted on more than three loans. The explanation for this may be the reluctance of banks to lend to borrowers with such a record of default on loans.

**Table 2: Incidences of default on loans actually obtained**

<table>
<thead>
<tr>
<th>No. of loans that led to default:</th>
<th>No. of businesses</th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>15</td>
<td>40.5</td>
<td>40.5</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>17</td>
<td>45.9</td>
<td>86.4</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>2</td>
<td>5.4</td>
<td>91.8</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>3</td>
<td>8.1</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>0</td>
<td>0.0</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>0</td>
<td>0.0</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>more than 5</td>
<td>0</td>
<td>0.0</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>37</strong></td>
<td><strong>100</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The gravity of the defaults indicated by the respondents was estimated from responses showing whether the business had ever been blacklisted by the credit bureau on the basis of delayed or non-repayment of loans obtained from banks. A total of 13 or 35.1% of the businesses that responded had defaulted seriously leading to them being blacklisted by the credit bureau at some time in the past. A total of 64.9% of the small business respondents, however, embodied lesser gravity of default on bank loans as evidenced by not having been previously blacklisted by the credit bureau because of a bank loan obtained.

Table 3 is a cross tabulation of the number of loans that led to a default incident and cases of a business being blacklisted by the credit bureau because of a previously obtained bank loan. The table suggests that all those that had maximum recurrent incidents of default (defaulted on three bank loans) were blacklisted by the credit bureau while none of those who met their repayment
obligations (no default) were blacklisted by the credit bureau. A total of 32.4% of the respondents defaulted to the extent of being blacklisted by the credit bureau and this figure represents 54.5% of all businesses that had previously defaulted on bank loans. The table suggests that all those businesses that may be described as “chronic defaulters” (defaulted on three bank loans) in the context of this study ended up being blacklisted by the credit bureau.

Table 3: Cross tabulation of number of loans that led to default and blacklisting of the business by the credit bureau

<table>
<thead>
<tr>
<th>No. of loans that led to default</th>
<th>Was the businesses listed by the credit bureau?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td>None</td>
<td>0</td>
</tr>
<tr>
<td>1</td>
<td>8</td>
</tr>
<tr>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>5 or more</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
</tr>
</tbody>
</table>

The propensity of a business to default was determined by scores obtained on the propensity to default scale. The sample means score of the respondents on this Likert-type 10-item scale was 30.57 and the standard deviation was 10.70. The minimum and maximum scores realised by respondents on this scale were 15 and 43, respectively. Of the 37 responding businesses, 20 (54%) displayed a low propensity to default given that their scores on the scale were below the mid-point score of 25 while 17 (46%) exhibited a high propensity for default.

The usefulness of this measure of propensity to default was evaluated by relating the propensity to default category to actual default in loan repayments by the business. A cross tabulation of propensity to default category with record of actual default is shown in Table 4. A total of 16 out of the 17 businesses that obtained high-propensity-to-default scores had actually defaulted on a loan, while only 6 of the 20 businesses that returned low propensity to default scores had failed, in the past, to meet loan-repayment obligations when they were due. Indeed, the result of Fisher’s exact test (p < 0.001) indicates that respondents in the high-propensity-to-default category actually did default significantly more than those in the low-propensity-to-default category.

Table 4: Cross tabulation of Propensity to default category and Record of actual default

<table>
<thead>
<tr>
<th>Propensity to default category</th>
<th>Actual Default Record</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Business has not defaulted</td>
</tr>
<tr>
<td>High</td>
<td>1 (5.9%)</td>
</tr>
<tr>
<td>Low</td>
<td>14 (70%)</td>
</tr>
<tr>
<td>Total</td>
<td>15 (40.5%)</td>
</tr>
</tbody>
</table>
The Role of Management Style on the Propensity for Loan Default by Small Businesses

Analysis of the management-style scale responses showed a sample mean of 47.31 and a standard deviation of 14.62. The minimum and maximum scores that were obtained by respondents on this 18-item scale were 25 and 66, respectively. An average of the scores obtained by the employees of a particular small business along this scale was utilised to establish whether they belonged to an organisation which is managed in accordance with participative or non-participative styles of management. Results suggest that, while 44.4% utilised the non-participative management style, 55.6% adopted the participative management style.

Correlation statistical analysis was undertaken to determine the nature and strength of relationship that exists between a business’s propensity to default and management style. The results obtained, as shown in Table 5, indicate the existence of a strong, significant relationship (Spearman’s rho = 0.836, p < 0.01) between both variables. This result implies that businesses that have a style of management which is non-participative portend a high propensity to default.

Table 5: Correlations between businesses’ propensity to default and management style

<table>
<thead>
<tr>
<th></th>
<th>Propensity to default score</th>
<th>Management style score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spearman’s rho</td>
<td>Correlation coefficient</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>N</td>
</tr>
<tr>
<td>Propensity to default</td>
<td>1.000</td>
<td>0.836**</td>
</tr>
<tr>
<td></td>
<td>37</td>
<td>0.000</td>
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<tr>
<td></td>
<td>0.000</td>
<td>37</td>
</tr>
<tr>
<td>Management style</td>
<td>Correlation coefficient</td>
<td></td>
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<tr>
<td>score</td>
<td>Sig. (2-tailed)</td>
<td>N</td>
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<td></td>
<td>0.836**</td>
<td>1.000</td>
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** Correlation is significant at the 0.01 level (2-tailed)

DISCUSSION OF FINDINGS

The issue of inaccessibility to loans faced by small businesses has long being identified as a major inhibiting factor of the potential that the sector has in making substantial contributions to economic development (Rogerson, 1995). Cook (2001) argues that, within developing economies, between 12–33% of small businesses have access to formal credit and that this inhibits the performance of small businesses. The state of unemployment in South Africa makes it even more pertinent to address some of the constraints of the small business sector, since the small business sector is known for its potential to provide employment (Diederichs, in Nieman, Hough & Nieuwenhuizen, 2003).

This study focused on one of the major constraints that small businesses face, which is a lack of financing from banks. This state of inaccessibility to finance has been attributed to the over-reliance of banks on financial indicators of performance, which small business are not adept at using (Keasey & Watson, 1991; McConnel & Pettit, 1984) to signal performance ability. There is, therefore, a case for consideration of non-financial factors especially as Storey, Keasey and Watson (1987) contend that non-financial predictors are as good as financial ones. This view is corroborated by Lussier and Pfeifer (2001), whose opinion is that non-financial variables pose profound relevance and higher reliability for evaluating small businesses.

It was against this background that the study concerned itself with a non-financial variable. It sought to estimate the propensity of a small business to default and then investigate the nature of association that this may have with the management style that is employed in the organisation. The investigation of this association was particularly instructive given the impact that style of management may have on organisational outcomes that could invariably lead to timely repayment or default on loans. It is believed that this is one of the first attempts to investigate the relationship that exists between management style and propensity for loan default. This study also contributes to the literature on small business by providing empirical support for the existence of such a
relationship. The knowledge gained is likely to complement loan default-potential estimation methods in a bid to improve accessibility to institutional loans for small businesses.

**Figure 2: Model of relationship between management style and propensity to default**

Results of the study indicate that a strong and significant relationship exists between management style and propensity to default of a small business. It was found that those businesses that operate according to the tenets of participative management displayed a low propensity to default on loans, while those that adopted the non-participative management approach exhibited higher propensities to default. This can be related to Likert’s findings that the participative management approach tended to bring about higher levels of organisational success, which by inference would put the small business in a position to meet loan obligations when they are due. However, based on the proposed model (Figure 2 above); this study determined that certain other factors, which did not form part of the present study, may have a moderating effect on the relationship. Such factors, which, among others, include the managers’ locus of control and the loan amount applied for, affect the business’s propensity to default. The value of the identified existence of a relationship between management style and propensity to default is further emphasised by study statistics that showed that businesses in the high-propensity-to-default category actually defaulted significantly in comparison to those in the low-propensity-to-default category.

**CONCLUDING REMARKS**

The results of this study bear managerial implications for both parties — small businesses and the banks — in a financial loan arrangement. On the side of the small businesses, it seems imperative that, in order to improve individual and organisational performance levels, employee participation in organisational processes is important. Generally, such a participatory approach to management results in: (a) higher levels of employee commitment to the pursuit of goals (Mullins, 1999), which engenders improved performance; and (b) leads to a consequent reduction in the business’s propensity to default on loan repayment. Over-concentration of authority, responsibility and decision-making in the hands of the owner/manager, which is a feature of non-participatory management, portends a higher propensity for loan default.

On the side of the lending institutions (banks), attention to the management style utilised in a small business widens the scope of consideration of the non-financial variables, which are important components of success and loan repayment ability of a small business. Knowledge of management style adds value to the small business default risk-estimation mechanism. Part of the reason for this is that management style (unlike other non-financial variables) is ascertained from the perspective of employees of the organisation and is not simply based upon characteristics of the owner/manager. Therefore, not only does the consideration of management style introduce an
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important non-financial determinant of business success, it also allows employees (important stakeholders in the business) to play a role in signalling the pattern of decision-making, as epitomised by management style. Such information would aid the quest of the bank to estimate the default risk potential that the business embodies with regard to loan repayments.

In conclusion, issues that border on research design present the main limitations of this study. The study was a cross-sectional one and, therefore, relied upon historical reports of actual defaults, as indicated by the respondents, to establish the propensity to default category of the businesses. Perhaps different results may have been obtained if the study was a longitudinal one, where management styles are determined prior to the obtaining of loans. Furthermore, with the small but acceptable sample size, it was unsuitable to make assumptions of normality, the implication of which was that more extensive statistical tools could not be used.

REFERENCES


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