Compliance Risks and Business Performance of Selected South African Retail Stores, Case of Emerging Markets

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Abstract: In South Africa, it is commonly acknowledged that objectionably high numbers of borrowers are over-indebtedness. However, it is also true that some retailers still need to uphold ethical standard and be risk compliant in line with the statutory and governance requirements. Research has revealed irresponsible credit provision, and inconsistent training, education and sensitisation programs aimed at alerting borrowers about the intricacies of borrowing. This research study sought to evaluate compliance risk and ethical standards within selected departmental stores located in Cape Town, South Africa, whose main operations is based on credit granting. Because these stores do not sufficiently evaluate the compliance risks and ethical standards in the process of granting credit, they ultimately lose potential profits which possibly impact on the long term viability and sustainability of their business operations. The research evaluates the processes surrounding the credit environment vis-à-vis the processes involved in granting credits to customers within department stores and how compliance risk affects their performance. A quantitative research approach was conducted by way of a structured questionnaire. The convenient sampling method was used from selected retail departmental stores in Cape Town. The findings indicate that although departmental stores have written policies and incorporate some level of training on personal lending and credit policies, poor ethical standards are still prevalent within their credit granting environments. Credit granting departmental stores are still exposed to substantial amount of compliance risks, deterring overall business performance. Paper adds value to the domain of credit risk management, and also proposes possible future studies.

Keywords: Ethical behavior; credit risks; retail credit environment; credit granting; department stores

JEL Classification: M4; M41; M42

1. Introduction

Retail industry is one of the major industries in the world. It is also regarded as one of the largest sectors in many emerging economies such as South Africa (Luce, 2013), contributing immensely to socio-economic growth and employment creation. In the year 2014 alone, sales generation was over $22 trillion, making it responsible for roughly 28.4% of the world's gross domestic product (GDP) (Ross, 2015). The South African Retail sector is a major contributor to the African economy by being

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the largest on the African continent and classified 24th on A.T. Kearney's 2010 Global Retail Development Catalog (GRDI) (Thomas White International, 2011). Retail, albeit combined with wholesale, motor trade, catering and accommodation accounts for 15% of the South African GDP (South Africa.info, 2016; Corporation, 2014) and trading economy (2016a) claims that this contribution has been static since 1994. This makes it a major contributor to the economic growth through employment creation for both semi-skilled and skilled labours in the country. However, this has not been the case in recent times with a decrease in employment in retail trade in the first quarter of 2016 compared to December 2015 (Stats SA, 016). It is therefore not far-fetched that this industry in South Africa has been growing from strength to strength over the years. Due to the many business opportunities in this industry, entrepreneurs and the Government have invested substantial amount of resources towards the construction of several shopping centres for different retail stores all across the world and in South Africa (Economic Analysis Unit of SRM, 2012). In South Africa, the biggest department store is Edcon (PTY) LTD, with 31% of the market share of the clothing, footwear and textiles retailing group (Economic Analysis Unit of SRM, 2012). Other big shots in the industry are the Foschini Group, Massmart Holding Ltd, Woolworths Holding Ltd and Truworths. For the purpose of this research, attention was paid on those departmental stores that are renowned to offer credit facilities to their customers.

The growth of these stores has brought about a more intensity in the competition in the industry in South Africa to win over the consumers. On the other hand, these departmental stores also make additional income through the credit they grant to their customers by way of interests charged.

The main type of credit offered by the department stores is in form of instalments agreement. The debtor takes the goods home in exchange for a possibility to pay later. Clothing, furniture, and major appliances are main examples of goods often purchased this way. The customer is usually provided with a contract, has to make a down payment, and then agrees to pay the balance with a specified number of equal payments called instalments. The finance charges are included in the payments. The item purchased may be used as security for the loan. Another type of credit granting is that of a credit card, often issued by individual retail stores. Using a credit card can be the equivalent of an interest-free loan--if you pay for the use of it in full at the end of each month.

The use of credit and poor management skills often leads people into a situation of over-indebtedness where they are unable to meet the credit agreements. These credits enable consumers to use money they do not have, use more money than they earn, use credit for normal buying, using credit even when they are in possession of cash and using debt to pay off debt.

The remainder of this paper is divided as follows: Section 2 provides a literature review on investigation based on compliance risks and ethical Standards of the selected stores, section 3 covers the methodology and approach used for this study and why it was used, section 4 gives the findings and discussions, while Section 5 concludes and makes some recommendations.

2. Literature Review

2.1. Role of Compliance in Credit Granting

Compliance can be defined as conforming to rules such as a specification, policy, standards or Law (ISO 19600, 2014). Compliance can be defined as an enterprise-wide commitment to acting within pre-determined norms that enables business owners to act legally and ethically (Murphy, 2010 cited in Adams & Bernstein, 2016, p. 5). Compliance also refers to an organization acting upon certain laws that are relevant to the industry's standards and policies e.g. code of conduct. These laws, policies and standards of the organization has a great impact on the business, staff and treatment of consumers in the company. Again, compliance is achieved through defined management processes which identifies the applicable requirements such as laws, regulations, and code of conduct, and policies (ISO 19600, 2014). However, compliance management is very important for all businessmen as it gives them benchmark in maintaining the standard and objectives of their business. The major objective of a compliance management is to make sure that business owners fulfil all their responsibilities and effectively manage the risk of potential non-conformance by themselves or by their customers/consumers (ISO 19600, 2014).

2.2. Role of Credit in Retailing

A credit is defined as a deferral or delay of payment of a sum of money to another person, or a promise to pay money". Again, a credit is a legal relationship that results in or may result in a claim on a second party (TFSA, 2005). While an agreement is a contract binding two or more persons. According to August 2004 policy framework of the Department of Trade and Industry; the role of credit is as follows:

- Credit enables people to have use of a product or service, at a cost represented by an interest rate, prior to their having paid for that product or service or, where an item cannot be afforded from a single month's salary, to spread payments over a number of months;

- Credit is also a double-edged sword as described by "NCA". This is because of the "considerable imbalance of power between consumers and credit providers" due to poor consumer education levels and knowledge of consumer rights, and inability to enforce such rights through negotiation or legal actions. There is a greater need to balance access to credit with protection for consumers, especially the vulnerable.

Generally, there are different types of credit facilities used in both organizations and in the business environment. These include: credit facility, credit transaction, instalment agreements, unsecured money loans, pawn transactions, mortgage agreements, secured loans, leases of movable goods, credit guarantees and Incidental credit agreements. Both in this research, the author will be concentrating on "instalment agreements" which is found in business environment or amongst business owners. Instalment agreements is explained as when moveable goods such as furniture, clothing or a car is sold, then the price of the goods is paid on instalments, and the item is delivered to the consumer. The consumer becomes owner only when all the instalments have been paid off (NCA, 2005, No. 34).

2.3. Credit Risk Compliance

Risk is an age long concept in the business world. Dickerson (2012) outlines that a risk can be a possibility that an event may lead to a different results. Compliance risks are legal penalties, financial loss and material loss that a business faces when it fails to comply with industrial laws and regulations, policies or prescribed best practices (Rouse, 2016).

Credit risk can be defined as the probability of loss due to borrower's failure to make payments on any type of debt". It is also referred to "a deferral of payment of money owed to a person, or a promise to defer such a payment". Also, it is "a promise to advance or pay money to or at the direction of another person (SA Government Gazette, 2006).

According to Brown and Moles (2012), a Credit risk is the possibility that a contractual party will fail to meet its obligations in compliance with the agreed terms. It is also referred to as default risk, performance risk or counterparty risk. Credit risk management is the practice of mitigating losses by understanding the adequacy of both the business capital and the losses incurred through the lenders at any given time.

2.4. Retail Credit Environment

The retail industry in South Africa has evolved from a small familiar industry to an immense, strong and controlled industry today (Economic Analysis Unit of SRM, 2012). The industry is characterized by a big number of retailers that try to push their merchandises and services to uphold their market share or to support new business. The most common products that these entities sell include clothing, shoes, accessories, furniture, household equipment etc.

A great deal of stiff competition exists among retail firms in South Africa with the capturing of and winning over the consumers (Dickerson, 2012). However, in this kind of competitive environment retail firms need much more than a ready market to succeed. To have the right characteristic marketing capabilities for selecting a suitable strategy allows a business to successfully create an appropriate good benefit

(Abubakar & Ibrahim, 2015). PriceWaterhouseCoopers (2008) argued that one of the three key barriers consumers are restricted by is high price, little wonder Carrigan & de Pelsmacker (2009) acknowledges that the retailers who offer some kind of discounts are thriving.

Credit policies differ from company to company. They help to retain old customers and create new ones by winning away from competitors (Omino, 2014). Credit policy documents can be one-page statements of intent or major volumes in a bound set of corporate guidelines. Whatever the format, it is issued by top management (Bullivant, 2011). When it comes to credit granting, at these department stores' disposal is the so called credit scoring technologies. According to Crook et al (2007), a credit scoring can be a process that forms estimation for a client's payment capability when it comes for a credit decision. The estimation on the credit score is based on a client's credit record.

The business uses the credit scoring and behavioural scoring as common techniques that help to decide whether or not to give credit to consumers who apply to them. At this point of view, Thomas (2000) outlines that these techniques are very important and useful methods used in retail and consumer finance capacities. These techniques are also applied in other areas such as consumer lending (Marron, 2007). An actual credit scoring has to reduce the cost in terms of cost effective decision making and less bad debts process (Crook et al, 2007).

2.5. Ethics in Retail Credit Environment

Good ethics is also good business. Di Florio (2011, p. 4) identified the following ethical behaviours as observable by credit granting organizations:

- Customers receiving the credit should be treated fairly and honestly. This helps in building the business reputation and brand name. This also help in attracting best employees and business partners;
- Business owners should have a culture that reinforces ethical behavior as a key component of effectively managing risk across the enterprise;
- In establishing standards of internal control of the business based on credit granting, there is a need to establish strategies and objectives that will be implemented based on preferences, value judgments, and management styles;
- Integrity and commitment of the business owner is paramount in credit granting as well as transparency;
- Business owners need to have adequate resources and authority to enable them implement and monitor credit granting;

- They should also do their internal audit as when due, as this provides independent verification and assurance in controlling the consumers credit and helps the business owner operate effectively.

2.6. Compliance in Retail Credit Granting

Compliance policies and procedures are the means to ensure consistent operating guidelines that support businesses in complying with applicable federal consumer protection laws and regulations. These measures will provide standards by which business owners may review business operations (Audit Function Review Team, 1997).

Compliance policies of any business or organization should be documented, reviewed and updated. Policies established in any business are meant to include the goals, objectives and the procedures that should be followed in credit granting. The business policies and procedures should provide information needed to perform business transactions such as customer credit granting. The information may include applicable regulation cites, definitions and sample forms with instructions, business policy, and directions for reviewing, retaining and destroying of transaction documents. For instance, loan application forms and procedures should be made available so that business owners will treat their customers equitably and fairly.

Consumers are shifting expenditure from a future period of their lives to the present (Ssebagala, 2017). Though this situation cannot overstate the positive welfare effects of this innovation, there is always an immense risk involved. Normally, consumers make every effort to repay their debts, the possibility of default will always remain inevitable even for tightly regulated credit market due to some factors that are beyond the control of both the consumer and the lender (Niemi-Kiesilainen & Henrikson, 2005). At times, consumers may go wrong or default, lenders will have no choice but to go for their repayment either through litigation process or seizure collateral while some usually engagement heavy handed debt collection approaches or they will decide to write it off as bad debt. These options listed are unwelcomed costs to the credit system. Modern credit societies have recognized this and have devised legal means that these debts can be processed for easy repayment known as the credit granting process (Niemi-Kiesilainen & Henrikson, 2005). In South Africa, Consumer credit regulatory regime was introduced and this emphasizes on prevention of consumer over-indebtedness. Such tools allow individuals or debtors to get relief from their over-indebtedness through a formal re-negotiation of the credit terms, thereby compelling creditors to compromise on repayment demands that will enable them discharge their over-indebtedness (Van Apeldoom, 2008; Dickerson, 2012; Niemi-kiesilainen & Henrikson, 2005). The need for this regulatory interventions is to prevent the debtors and their family welfare from devastation with the hope of achieving financial rehabilitation so as to be productive in their individual homes and in the economy as a whole (Van Apeldoom, 2008).

According to Tabb (2005) and Viimsalu (2010), political pressures to restrain growing power imbalances between creditors and consumers have increased in countries like South Africa over the years, this has led to them recognizing the accumulation of debts and the inability to repay it which is now calling for a liberal consumer debt relief system.

Again, the South African National Credit Act 34 of 2005 introduced a legal mechanism to relieve debt problems. This brings solutions that will alleviate debt already incurred, settlement of the credit agreements, early payments and surrender of goods if not able to pay.

2.7. Retail Business Performance and Credit Risk

The granting of trade credit is a powerful selling aid, and is a fundamental foundation upon which all trading relationships are built. Both seller and buyer gain advantage from credit facilities, but the risk of slow or non-payment is borne by the seller – risk in the form of non-payment, and cost in the form of the interest expense incurred from the date of the sale to receipt of the funds Omino (2014) carried out a study within retail stores in Migori County in Kenya and found out that indeed there exists a relationship between working capital management (of which receivables constitute a substantial portion of current assets in several firms) and profitability of these stores. There is t-he risk that the consumer can fail to meet its requirements in agreement with arranged terms, thereby leaving the business with bad debts. Another possible risk is that of bad cash flow leading to a loss in forgone income. Businesses also face a risk of reduced cash flow because it may wait for customer payments which reduce the ability to purchase replacement products from suppliers. Beresford-Smith and Thompson (2007) supports this stance by stating that if this risk is not well calculated, it will affect the cash flow and the profitability of the business

A number of researches exist on how both credit risk and its management affect business's financial performance and profitability. Although majority of these researchers are with the two variables have a positive relationship, a few of them however believe that the relationship is negative. Alshatti AS (2015) claims that the credit risk management does affect the financial performance of businesses. Poudel RPS (2012) went on to find that credit risk has an inverse impact on the financial performance of businesses. Aruwa & Musa (2012) and Boahene et al (2012) have both found a positive relationship between risk components and the financial performance

3. Research Design

This research was carried out in the form of a descriptive research particularly exploring an existing problem. The selected departmental stores operating in the Cape Metropole do not sufficiently evaluate the compliance risks and ethical standards in the process of granting credit, and as a result lose potential profits which possibly impact their performance. A descriptive research describes phenomena as it exists by identifying and obtaining information of characteristics of a particular problem. In essence, this type of research is about describing a specific situation (Collis & Hussey, 2013). Within this study, the author described to what extent the department stores comply with the required standards when it comes to granting credits to their customers. Secondly the research described the possible compliance risks they are exposed to due to inefficiency. The aim is to provide a precise and valid illustration of the factors or variables that relate or applicable.

Quantitative research (positivism as part of the research paradigm) was used to obtain data to solve and mitigate the identified research problem. This was done by means of disseminating questionnaires (mainly structured as 5-point likert). A total of 55 valid questionnaires were collected and analysed by means of statistics. Primary data was obtained directly from the retail departmental stores in Cape Town. A convenience sampling method was used based on the availability and willingness of the respondents. Measurement validation was employed, as well as reliability tests with SPSS 22.0 to validate the data. Preliminary analysis included frequencies, sample profiling, mean scores and correlations significant at $p>0.05$

4. Results and Discussions

Table 1 reports the age groups of the sample used in this study. Just over a quarter *(27.3;n=15)* of the respondents were under the age of 30, majority *(61.8%; n=34)* of the respondents were aged between 30 and 39 years, a paltry 3.6 percent *(n=2)* reported their age to be between 40-49 years, and only 5.5 percent (*n=3*) of the respondents reported that they were 50 years and above. The table also shows the organisational position of the sample. Most *(67.3%; n=37)* of the respondents are managers of the stores, while a few others are dominated by both the credit clerks and the finance managers. From the data illustrated in Table 1, it can be said that the management within the department stores in Cape Town are mainly the store managers within the age brackets of 30-39 years. This consequence is logical since operating a business is a challenging endeavour which requires experienced individuals who can make well-grounded marketing decisions (Parker and Castleman, 2009), especially strategic marketing decisions.

Table 1. Sample Characteristics

Respondent's Age	Frequency	Percentage	Respondent's Position	Frequency	Percentage
Under 30 years	15	27.3	Board member	0	0.0
30-39 years	34	61.8	Chief Executive Officer	0	0.0
40-49 years	2	3.6	Finance manager	4	7.3
50 and over	3	5.5	Manager/Credit manager	37	67.3
			Risk officer	1	1.8
			Credit clerk	4	7.3
			Head of dept	1	1.8
			Other	8	14.5
Total	**55**	**100**		**55**	**100**

4.1. Descriptive Measurements

A measurement model of the conceptual model was estimated. The reliability of the constructs was assessed using composite reliability (CR) and Cronbach's alpha (CA) values. Table 2 indicates that the CR and the CA values were all above the recommended 0.6 in line with Hulland (1999). With values ranging from 0.747 to 0.781 for composite reliability, and from 0.613 to 0.791 for all Cronbach alphas, these indicators show that the scales are reliable. The internal consistency for constructs was assessed using the average variance extracted (AVE) measures following Fornell and Larker (1981) who suggested benchmarks of 0.5 in their studies. As reported in Table 2, all the AVE values reached the recommended benchmark; suggesting that all scale-items converged well on the constructs that they were measuring, and hence confirmed the existence of convergent validity

Also the correlations of variables are statistically significant at $p<0.05$ level, suggesting the correlations between ComRi, EthSt, CredEn and MeaRi are statistically significant non-zero correlations at the 95 percent confidence level. Root squares of AVE indicators for the constructs are greater than their correlations, suggesting discriminant validity

Table 2. Descriptive statistics for accuracy analysis

CONSTRUCTS	Mean	Standard Deviation	ComRi	EthSt	CredEn	MeaRi	Composite Reliability	AVE	Cronbach Alpha
Compliance Risks (ComRi)	4.876	0.521	0.452				0.759	0.672	0.693
Ethical Standards (EthSt)	3.103	0.573	0.397*	0.517			0.781	0.723	0.791
Credit Risk Environment (CredEn)	2.713	0.519	0.189	0.147	0.486		0.769	0.697	0.613
Measures to mitigate Risks (MeaRi)	4.211	0.503	0.371*	0.193*	0.183	0.491	0.747	0.701	0.718

Notes: *Diagonal elements are square roots of AVE; off-diagonal elements are correlations. * shows correlations are significant at $p<0.05$ (two-tailed); otherwise correlations are significant at $p<0.001$ (two-tailed)*

Previous studies (FECMA, 2015; Moorad, 2013) have demonstrated that organisations do not evaluate the compliance risks and ethical standards in terms of credit granting. For this study, descriptive data suggest availability of written policies, rules and regulations that they set that guides credit granting processes. This is in line with Omino's (2014) view. However, the question is the credit environment is not conducive for them to implement these standards, which is indicated by the illustrated results. The purpose of this study was to explore the evaluation of the compliance risks and ethical standards within the selected department stores in the Cape Metropole in terms of credit granting. The result from the survey clearly shows a high level of compliance risks that still exist in these stores, probably due to proper diligence in applying the set standards stipulated by the organizations, which in contrast is lower than the risks. Results also show the possibility of a negative tone at the top, owing from the low responses by more senior personnel members. This is even more important, with the top management being the custodians and issuers of the credit policy documents (Bullivant, 2011).

5. Conclusion

This study found compelling evidence to suggest that even though there exist certain guidelines and rules within these stores' credit granting environments, poor ethical standards are still prevalent. The mere existence of these credit rules might be just not to incur the penalties of the Government regulations, hence they are only forced to do so, and not because of understanding and awareness of the ethical standards (FECMA, 2015). This could also be due to lack of trainings on personal lending and credit policies or low education exposure by the managers. Credit granting departmental stores are still exposed to substantial amount of compliance risks deterring overall business performance. Retailer must put in place to minimise the risk of damage to an all stakeholders and practitioners within the credit environment, and to keep credit providers up to date with regulatory requirements.

While this study has shed some light on various significant issues, there are some limitations that reveal opportunities for future research enquiries. Future research could examine these among retail shops in different location/province. There are more existing variables that were not investigated in the current study, but could be important in explaining fundamental relationships and their consequences. Also, triangulation research approach to this study could potentially yield different insights.

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