

# CONTRACTORS' PERCEPTIONS OF LATE PAYMENTS

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## ABSTRACT

The purpose of this article is to identify the effects of late payments on contractors, and to implement procedures which will ultimately eliminate payment delays in future. The article also highlights the importance of understanding the mechanisms and the workings of various contract agreements, in order for the contractor to be aware of their rights and responsibilities in terms of the contract, as well as what legal steps could be taken should a client be in default regarding payment. A quantitative research method was used. A structured questionnaire was administered to contractors who are members of the Master Builders Association (MBA), Eastern Cape Province. The findings revealed that contractors' cash flow is greatly affected as a result of late payments. Smaller contractors even face bankruptcy. Contractors are also forced to suspend work on-site due to late payments; this extends the contract period, and, as a result, the contractor's expenses increase. It is also suggested that payment legislation should be introduced in order to reduce the number of late payments made by clients to contractors. The research is limited to contractors who are registered members of the Master Builders Association (MBA), Eastern Cape Province. An understanding of the effects of late payments will assist contractors in the smooth running of a construction project financially. Contractors will also benefit from being knowledgeable in terms of contractual agreements in the event of a delay in payment from the client. Contractors will furthermore be able to identify the effects of late payments, and will be able to plan accordingly.

**Keywords:** cash flow, delays, effects, late payment, payment

## 1. INTRODUCTION

Payment has been a source of grief for contractors for generations, whether it is delays in payment or no payment whatsoever, and it is likely to be for generations to come if no adequate legislation is put in place (Gow, 2006). There are two parts to the problem. Firstly, the client fails to pay the contractor on time, or they do not pay at all. Secondly, the contractor is consequently not in a position to pay subcontractors, due to a lack of cash flow. The focus will be on clients failing to pay the contractor, and the implications as a result, as well as contractors' opinions of how to improve the current payment situation.

A common characteristic of construction projects is that they are dynamic and they have a high level of uncertainty (Al-Kharashi and Skitmore, 2009). When payments are

delayed, the contractor's cash flow suffers greatly, and it becomes difficult to remain competitive in the industry.

Payment problems arise from an imbalance of commercial power between the client and a contractor (Gow, 2006). The construction industry plays a vital role in any country's development process (Fikri Hasmori et al., 2012). Efficient and timely payment is a main factor in the success of a project. The problem at hand affects most countries and industries. Due to the long duration of construction projects, a large amount of money is required, and the need for prompt payment in construction industries is intensified. This research determines the effects of late payments on contractors registered at the Master Builders Association (MBA) in the Eastern Cape, especially the impact on the contractor's cash flow.

## **2. A REVIEW OF RELATED LITERATURE**

### **2.1 Causes and effects**

The main cause of late payment in South Africa is the client, according to Van der Merwe et al. (2011). According to Van der Merwe et al. (2011), the effects of late payments are that they create cash flow problems and financial hardships and put a lot of unnecessary stress on the contractor.

### **2.2 Forms of contract for construction work**

The issue of late payments has been seen as a major worldwide crisis, as the impact is negative in all construction sectors and related economies. To a certain extent, it is still currently a worldwide crisis, with the exception of a few countries that are implementing new legislation (cidb, 2010). The cidb has endorsed forms of contract for construction and building work, which provide legal remedies to enforce payment; forms of contract are the Joint Building Contracts Committee Principal Building Agreement (JBCC PBA), the General Conditions of Contract for Construction Works (GCC), the New Engineering Contract (NEC), and the Conditions of Contract for Construction for Building and Engineering Works Designed by the Employer (FIDIC Red). The most commonly used contracts in South Africa are the JBCC PBA and the GCC. South Africa does not have construction-specific legislation to address the need for prompt payment of building and civil engineering contractors and consultants (cidb, 2014).

The contractor is entitled to default interest on late payments, as all cidb-endorsed contract documents make provision for the payment of interest. The rate is dependent on the contract used. When work is partially complete, the contractor's claim for interim payment of the partially completed work could be met with a counterclaim from the client based on *exceptio non adimpleti contractus*, which is the exception of a non-performed contract; a contractor cannot abandon site if the client fails to pay for partially completed work (cidb, 2014). All four of the cidb-endorsed contracts contain provisions for suspension of work and/or cancellation of the contract when the client does not pay interim payment certificates. The contractor needs to take some aspects into consideration before leaving site or terminating the contract. In order to enforce the termination clause, the conditions for its implementation need to be stringently complied with. If the contractor is required to give the client notice of their intention to terminate the contract, the notice must be given as an express extrajudicial announcement, where such notice cannot be implied or given by notice of motion. If there is no contractual termination clause, a contractor will not be able to terminate a contract if a client does not make an interim payment (cidb, 2013).

Other remedies available in order to enforce payment are that the client provides evidence of the funds needed to pay for a specific project, a contractor's lien, a provisional sentence, a summary judgement, or to make an arbitration award an order of the court. The FIDIC Red provides for evidence to be provided by the client to the contractor, whereby, among other things, the client proves that there are sufficient funds available to pay the contract price. According to the Department of Public Works (2015), "[t]he Employer shall submit, within 28 days after receiving any request from the Contractor, reasonable evidence that financial arrangements have been made and are being maintained which will enable the client to pay the Contract Price (as estimated at that time). If the client intends to make any material change to his financial arrangements, the client shall give notice to the Contractor with detailed particulars". The mechanism for the provision of evidence is not a remedy, but it does help minimise the possible risks related to the capability of the client to pay for work. Similar provisions are not found in the JBCC PBA, the NEC3 ECC and the GCC documents.

### **2.3 Contractor's lien**

A contractor's lien entitles the holder to the right to retain possession of property until the defaulter has paid the money due. The lien is designed to support the contractor's claim for payment (cidb, 2014). A provisional sentence is an extraordinary procedure; it is available to a creditor who has liquid documentary proof of a claim against a debtor. This provides a quick provisional judgement without the expense and delay which an ordinary trial action would involve. A summary judgement enables a creditor with a clear case to obtain swift enforcement of his claim against a defendant who has no real defence to the claim (cidb, 2014). A common practice in South Africa is to make an arbitration award an order of the court. An award that has been made an order of the court can be enforced in the same way as any judgement or order to the same effect. After an award has been made an order of the court, the party enforcing its rights can issue a summons of execution, to be executed by the Sheriff of the Court. Restricted availability of funds occurs in not only the public sector, but the private sector as well; again, this is due to slack financial management and budgeting problems, which are the cause of late payments (Che Munaaim, 2006). The predicted outcome is to create a process which will ensure cash flow, establish payment provisions, and introduce adjudication as a compulsory first step for the resolution of disputes in both the public and private sectors. The proposed regulations avoid withholding of payments without going through a clear procedure. Contractors will have a statutory right to suspend work, charge interest on late payments and introduce a compulsory form of statutory adjudication to resolve disputes (Hattingh and Massey, 2015).

## **3. RESEARCH METHODOLOGY**

### **3.1 Methodology**

In this study, a quantitative approach was used for obtaining and analysing data. The aim of the research was to identify the effects that late payments have on contractors, the contractor's cash flow, and suspension of work on-site.

### **3.2 Questionnaire design**

A questionnaire was formulated, which was distributed to contractors in the province of the Eastern Cape. The questionnaire was designed to be brief, concise, and straightforward, so as to encourage a high response rate from potential respondents. The questionnaire was pre-tested by five contractors, to ensure that it was understandable to

the respondents. The results of the pre-tested questionnaires are included in the overall analysis of the survey. The questionnaire consisted of four main sections.

Section A consisted of questions related to the respondent's demographic background regarding organisational and personal data. Section B related to the contractor's knowledge and views based on past experience, section C solicited the contractor's opinions on cash flow problems caused by late payments, and section D pertained to the effects of late payment on suspension of work. A five-point Likert scale was used in the questionnaire to determine the extent to which the respondents agreed or disagreed with the questions posed.

### **3.3 Sample size and response rate**

The sample for the study consisted of 150 registered contractors, all members of the Master Builders Association (MBA) in the Eastern Cape. The online questionnaire was emailed to all the contractors. Forty-two completed questionnaires were returned, which represents a response rate of 28%.

## **4. FINDINGS**

### **4.1 Demographics**

It is notable that 80% of the respondents had more than 10 years of experience in the construction industry, while 60% of the respondents had more than 15 years' experience. These are positive indicators. All the respondents were males.

A further positive observation is that 92% of the respondents had a qualification higher than a matric certificate. This indicates that the respondents were all educated and knowledgeable.

### **4.2 Contractors' experiences related to late payments**

As is evident from Table 1, the respondents indicated that provision is needed for a mechanism that will ensure that a client cannot withhold payment from the contractor unless effective notice has been given by the client of their intention to withhold such payment. Litigation is seen negatively, as it is a time-consuming and costly exercise, where the outcome could also take some time to be reached. It should be compulsory for the client to place at least two months' turnover on deposit in a joint account or an account administered by the principal agent, as the contractor is exposed to approximately two months' further work on-site due to all the legal notice periods. The respondents furthermore indicated by means of an open-question response that consultants, such as the quantity surveyor, should play a more permanent role in the payment process, advising the client on the legal and contractual consequences of non-payment. Another open-question response indicated that contractors feel they have a right to the "pay-when-paid" clause, as the risk needs to be evenly distributed.

Table 1 indicates the contractors' opinions regarding various late payment or non-payment issues.

Table 1: Contractors' opinions

Aspect	Strongly Disagree	Neutral	Agree	Strongly agree	Unsure	Mean score (MS)	
	(%)						
	1	2	3	4	5		
Litigation takes a long time, and the results may often come too late to prevent financial harm to the company	0	8.3	0	16.7	75	0	4.58
Due to the high cost of litigation, a successful result may often be a 'paper victory' (a worthless judgement)	0	25	0	58.3	16.7	0	3.67
Once a company has instituted litigation against a party, chances are limited that the company will get further work from that party in future	0	0	8.3	75	16.7	0	4.08
Statutory prompt payment provisions will eliminate late payment practices in the South African construction industry	0	16.7	8.3	66.7	8.3	0	3.67
Provision of escrow accounts, or similar trust accounts, to the benefit of the contractor and for retention money retained from the contractor is needed	0	25	8.33	50	8.33	8.33	3.45
Provision is needed for a mechanism that will ensure that a client cannot withhold payment from the contractor unless they have given effective notice of their intention to withhold such payment	0	8.3	0	66.7	25	0	4.08

### 4.3 Contractors experience cash flow problems during the construction stage

Table 2 indicates that the respondents all agreed or strongly agreed (MS=4.83) that when interim payments are paid late, this affects the contractor's cash flow. Ninety-five percent of the respondents agreed or strongly agreed that cash flow problems are experienced during the construction stage of a project. Contractors are often unable to pay their subcontractors, labourers, and suppliers, due to their restricted cash flow. The delay in payment makes subcontractors reluctant to work with contractors known for paying late, which tends to inflate prices. Table 2 also shows that respondents are of the opinion that the ability to tender on future projects is consequently impacted.

Table 2: Contractors' opinions

Aspect	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Unsure	Mean score (MS)
	(% )						
	1	2	3	4	5		
Late payments are normally a result of a default caused by the client/employer	0	5	0	35	60	0	4.50
Cash flow is affected by late payments	0	0	8	0	92	0	4.83
Cash flow problems are experienced during the construction stage	0	5	0	25	70	0	4.60
When interim payments are paid late, this affects cash flow	0	0	0	17	83	0	4.83
Cash flow has a negative impact on the success of a company	0	0	8	8	84	0	4.75
Late payments by clients lead to bad working relationships	0	0	0	75	25	25	4.25
Late payments result in the contractor not being able to pay subcontractors, suppliers, and labourers	0	0	8	59	33	0	4.25
Cash flow problems lead to bankruptcy or liquidation	0	10	50	35	5	0	3.35
Subcontractors, suppliers, and labourers are reluctant to work with contractors known for paying late	0	8	0	75	17	0	4.00
Subcontractors, suppliers, and labourers inflate their prices in anticipation of late payments	0	0	25	67	8	0	3.83
The ability to tender on future projects is impacted by cash flow problems	0	0	0	75	17	8	4.18

#### 4.4 Suspension of work

Table 3 shows that the majority (83%) of contractors were of the opinion that late payments result in suspension of work on-site. Table 3 further indicates that 92% of the respondents agreed or strongly agreed that suspension of work forces the client to pay. All the respondents agreed or strongly agreed that the contractor's expenses and construction costs increase as a result of a delay in payment.

#### 5. CONCLUSION

The research investigates the effects of late payment or non-payment on the contractor. Procedures need to be implemented which reduce payment delays in South Africa. Contractors should be knowledgeable in terms of various contractual agreements, and they should be aware of their rights in the event of a delay in payment. The objective of the research was to find a solution, which will, in turn, create a better working environment, by eliminating late payments. Cash flow is affected due to late payment;

late payment also results in suspension of work on-site. The literature review stated the importance of various laws which could reduce the number of late or delayed payments within the construction industry. The results supported the literature regarding late payments to contractors being a re-occurring phenomenon and contractors failing to pay labourers, subcontractors, and suppliers due to the negative effect that late payments have on their cash flow. Suspension of work, in turn, results in a longer construction period, which increases the contractor's expenses. Other countries, such as Australia and the United Kingdom, have made progress regarding late payment and non-payment within the construction industry, which shows that it is possible for South Africa to do the same. The Department of Public Works Government Gazette released in May 2015 shows progress in the right direction for South Africa as a country.

Table 3: The effects of late payments on suspension of work

Aspect	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Unsure	Mean score (MS)
	(% )						
	1	2	3	4	5		
Late payments result in suspension of work on-site	0	17	0	83	0	0	3.67
Late payments which cause suspension of work are not always the fault of the client	0	17	8	8	67	0	3.67
Suspension of work forces the client to pay	0	0	8	84	8	0	4.00
Construction costs increase as a result of a delay in payment	0	0	0	83	17	0	4.17
The contractor's expenses increase	0	0	0	67	33	0	4.33

## 6. RECOMMENDATIONS AND FURTHER RESEARCH

The following are recommendations emanating from this study:

- A commission should be established to investigate errant payments; and
- Prompt payment legislation is required in South Africa.

Further research should be conducted on the reasons why clients are delaying payment, as well as the consultant's roles in the payment process. The payment systems used by government departments which also negatively affect the contractor should also be investigated.

## 7. ACKNOWLEDGEMENT

This article was language-edited by a freelance language editor, Anthony Sparg. He has edited several academic journal articles in the field of construction management. He has an MA *cum laude* in African Languages (isiXhosa), an MA *cum laude* in Linguistics, and a Higher Diploma in Education.

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